South African Budget Guide

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Foreword

INTRODUCTION

The national *budget* is the term commonly used for the process of how revenue raised by the national government will be allocated to national, provincial and local government, as well as government departments. The budget process also determines how much each province and local authority will receive from national government in the upcoming year. Through the *budgeting process,* national, provincial and local governments plan, collaborate, negotiate, and decide together on a comprehensive plan for spending governments' funds in the upcoming **fiscal year**. The budget takes the form of a package of bills considered and passed by Parliament before being signed by the President into law.

The budgeting process is not a purely mechanical or bureaucratic decision on numbers. Showing where government plans to use its resources, the budget reflects policy priorities. The budgeting process therefore becomes an important conversation between national departments and between national, provincial and local government about where money and resources are most urgently needed and, more largely, what role government ought to be playing in meeting the needs of South Africa's people.

This guide has two aims. First, it provides an overview of the budget process itself, describing how revenue is raised by the national government and then allocated between national, provincial and local government. Second, it outlines how government arrives at the annual budget, focusing on the early drafting period, as well as what happens after the budget is tabled in Parliament.

Many thanks to Tania Ajam at the University of Cape Town, and Laura Walker and Joel Friedman with the Department of Finance for their help with this project. Warren Krafchik and Albert van Zyl at IDASA's Budget Information Service also offered invaluable input.

OVERVIEW OF GOVERNMENT BUDGETING:

How is the budget organised?

One of the basic principles in the Constitution is the cooperative relationship between the three spheres of government: national, provincial, and local. This principle of cooperative government is also intended to shape the financial relationship between the three spheres. Each sphere is responsible for delivery of a unique set of government services, and revenue raised nationally is distributed to provinces and local governments to assist in delivering the services for which they are responsible.

The vast majority of the revenue raised by government overall is collected by the national government through the company tax, personal income tax, and Value-Added Tax, or **VAT**.[1] In contrast, the provinces levy minimal taxes and fees. Only 4 percent of the provinces' budgets come from revenue they have collected themselves. The provinces receive nearly 96 percent of their budgets from central government, in the form of equitable share grants. In an inverse relationship, local governments raise nearly 90 percent of their budgets themselves—largely through taxes, levies and **user charges**—and rely very little on revenue from the national government.[2]

The bulk of social service delivery is located at the provincial level. Social spending generally makes up 78 to 90 percent of a province's overall budget, with the majority of those funds going to education. Personnel costs are significant—ranging from 50 to 65 percent of total spending (see Figure 1). **Capital expenditure** is typically low, accounting for only 4 to 6 percent of provincial spending.[3]

[1] 1999 Budget Review, Annex E—An Explanatory Memorandum of the Division of Revenue, pg. 3.
[2] 1999 Budget Review, Annex E, pg. 3.
[3] O'Grady, Kevin. "Provinces are starting to make headway on debt," *Business Day*, 25 February 1999.

Figure 1.

Consolidated Provincial EXPENDITURE 1999/2000		
	R billion	
Education	40.3	41%
Health	23.7	24%
Welfare	18.7	19%
Other	15.4	16%
Total Expenditure	98.1	
Social Spending as a percent of total expenditure		84%
Personnel spending as percent of total expenditure		59%
Consolidated Provincial REVENUE 1999/2000		
Transfers from National Revenue	94.3	96%
Own Revenue	3.7	4%
Total Revenue	98.1	
1999 Budget Review, Provincial and Local Government Finances.		

Figure 2 gives an overall picture of how money raised by the national government is spent.[4] The national revenue fund refers to the total resources the national government has to spend in the upcoming year. However before dividing that pie between national, provincial and local government, a certain amount is taken out to go towards **debt service** and **contingency reserves**.

After this top slice is set aside, the remaining funds are divided vertically. The **vertical division** allocates funds between national, provincial, and local government. About 47 percent of these funds (excluding the top slice) are retained by the national government.[5] Another 52 percent is earmarked for the provinces, and the small remaining portion is divided between local governments (see Figures 2 and 3). A **horizontal division** divides the money for the provinces between the nine provinces.[6]

The following sections explain the composition of the budgets in more detail. They describe the vertical division between spheres of government, the horizontal division between provinces, and the process for giving funds to local government.

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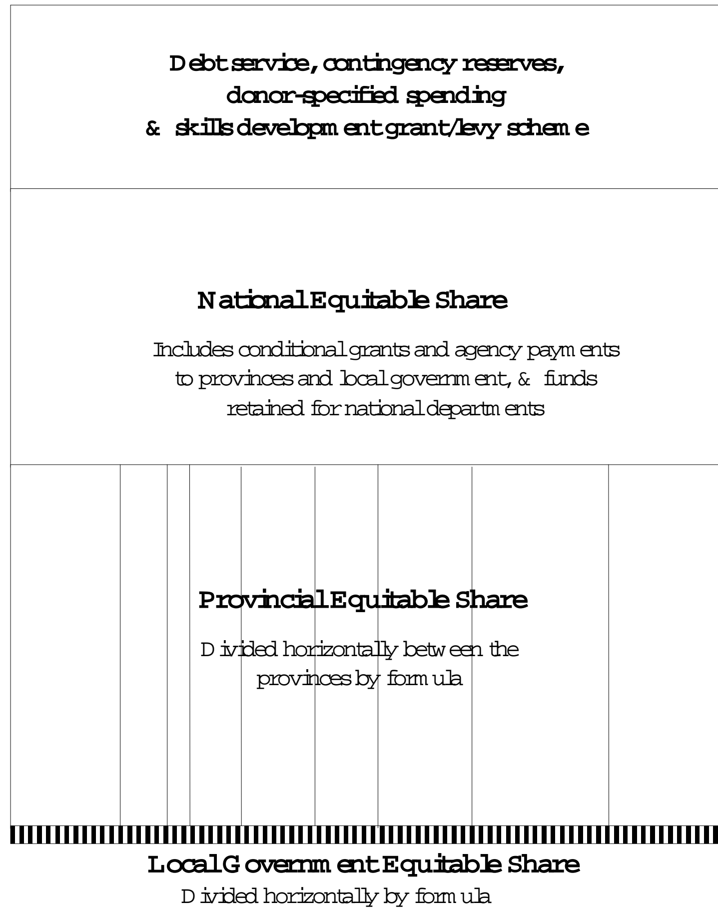
[4] Presentation by Mr. Ismail Momoniat of Department of Finance to the Western Cape Provincial Legislature at a workshop organized by the NDI on behalf of the NCOP, 25 November 1997.

[5] This 47 percent *includes conditional grants,* which will go to the provinces. See page 11.

[6] Department of Finance Presentation by Mr. Brian Molefe, Director: Provincial Budget Analysis, 1 April 1998, National Council of Provinces Budget Workshop.

Figure 2.

Division of All Revenue Raised Nationally



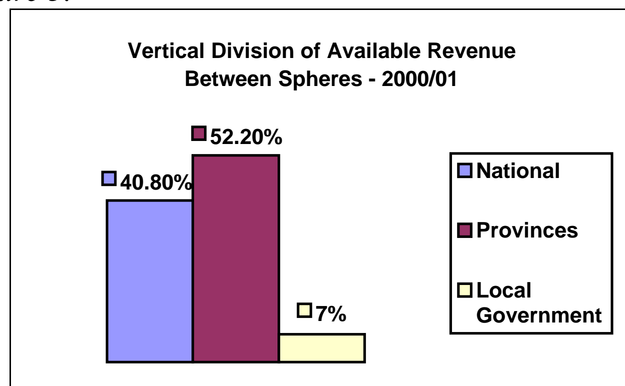
I. Vertical Division Between Spheres of Government: *How is the budget distributed between national, provincial, and local government?*

Before the national government even begins allocating funds between national, provincial and local government, a portion of the national budget is set aside. This amount is "*sliced*" off the top so that it remains available to all three spheres of government. The top slice goes to pay for four items:

- *Debt service costs*—The interest the government pays on its loans.
- *Contingency reserves*—The pot of money government sets aside for unanticipated needs or national emergencies.
- *Skills development*—The levy collected from private sector employers for a fund for training and skills development for personnel.[7]
- *Donor-financed spending*—Money from foreign donors dedicated to specific projects and thus not part of the revenue available to be shared.

Notably, skills development and donor-financed spending are new additions to the national revenue fund but do not create an increase in the total amount taken off the top for debt servicing. The skills development scheme is entirely funded by the private sector, and the donor-financed spending category was created to provide greater information and transparency. (This money was previously spent, but not reflected in the budget.) Thus these two new designations provide more detailed information, but do not indicate a shift in how resources are allocated.

Figure 3.



Source: 2000 Budget Review, Department of Finance, pg. 7.

The remaining funds are divided between the three spheres of government based on the division of responsibilities between the spheres and their alternative sources of revenue (outside of transfers from central government). The following sections describe the factors affecting the vertical division and the how it is determined.

[7] 1999 Budget Review, Overview, Department of Finance, pg. 7.

A. What are the different responsibilities of each sphere of government?

Schedules 4 and 5 of the Constitution explain the sharing and division of responsibilities between the three spheres. As a general rule, national government retains responsibility for those functions and issues of national interest that bridge provincial boundaries. The national government *shares* responsibility with the provincial governments for many other services, such as education, health, housing, and public transport.

National government priorities include national defence and police, prisons, justice, finance, trade and industry, labour, and international relations.[8] The central authority is also concerned with public administration and infrastructure in the sense of establishing norms and standards for programmes and coordinating government policy between spheres.

Provincial governments are primarily tasked with social services as well as roads and regional economic planning and development. Notably education, health and welfare services—the three most expensive items in the country's whole budget—are functions shared by the national and provincial government, but their delivery rests with the province. *Local* governments deliver basic services including water, electricity, and refuse collection.[9] The responsibilities of each sphere of government are important because, in the budgeting process, funding is allocated to each level to fulfill its unique functions.

B. Besides transfers from national government, what are the additional sources of revenue for provincial and local government?

As mentioned earlier, provinces rely heavily on national government transfers and grants. Revenue raised by provinces themselves makes up only 4 percent of total provincial revenue. In contrast, local governments raise nearly 90 percent of their budgets themselves.[10] Besides these transfers from national government, provinces and local government have limited taxing and borrowing powers, which they utilise to different degrees. The additional sources of revenue for provinces and local government are important because they impact the vertical division.

Taxing

The Constitution carefully specifies which taxes may be levied by which sphere of government. According to Section 228, only the national government can collect a VAT tax, personal and corporate income tax, and customs duties. The provinces are free to collect surcharges on taxes levied by the national government subject to national legislation, but are constitutionally forbidden to impose a tax that interferes with another sphere. For example, the provinces cannot collect a property tax. That is a local government tax. But the provinces can impose a **flat-rate surcharge** on some national tax schemes.

Both provinces and local government collect **user charges**, which are classified as non-tax revenue. For instance, the Northern Cape's sources of revenue include motor vehicle licenses,

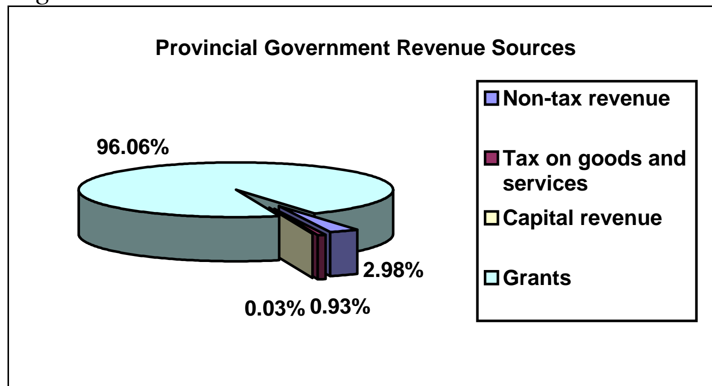
[8] 1998 Medium Term Budget Policy Statement, Division of Revenue, pg. 2.
[9] 1999 Budget Review, Provincial and Local Government Finances, pg. 5.
[10] 1999 Budget Review, Provincial and Local Government Finances, pg. 3.

hospital fees, gambling and racing revenues. However, these levies and taxes generally do not exceed 5 percent of the total budget of the province. (Figures 4 and 5 show the sources of revenue for the provinces and local government.)

The vertical division takes into account how much money the provinces and local government raise themselves through taxes.[11] According to the Constitution, Parliament may consider "the **fiscal capacity** and efficiency of the provinces and municipalities" when deciding how much national government should give them.[12]

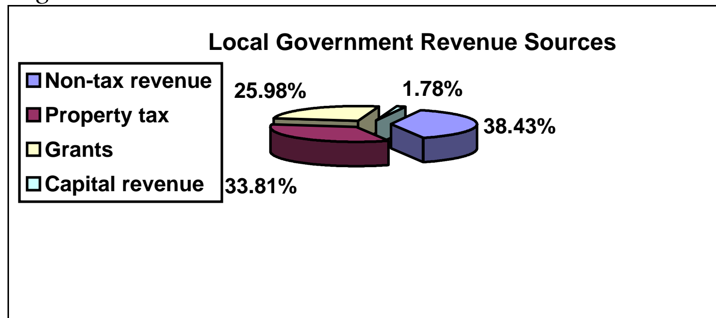
Under the Constitution, the provinces' and municipalities' revenue may not be deducted from their **equitable share** or other allocations from the national government (e.g. **conditional grants**). Further, the national government is under no obligation to compensate provinces or municipalities that "do not raise revenue commensurate with their fiscal capacity and **tax base**."[13]

Figure 4.



1999 Budget Review, Public Finance, pg. 9.

Figure 5.



1999 Budget Review, Provincial and Local Government Finances, pg. 15.

[11] 1999 Budget Review, Provincial and Local Government Finances, pg. 5.
[12] South Africa Constitution, Chapter 13, Section 214, (2)e.
[13] South Africa Constitution, Chapter 13, Section 227 (2).

Borrowing

The Constitution states that provinces and municipalities may borrow funds, but only for capital expenditures. Provinces and municipalities are barred from taking out loans for **current expenditures** such as wages, except where necessary to bridge temporary gaps in funding. In these situations, the loan must be repaid within the same year.[14] Provinces cannot guarantee loans made by local governments, and the national government does not guarantee provincial loans, unless they are to foreign creditors.[15]

In practice, provinces do very little borrowing on the capital market. Instead they have relied on overdrafts from banks made on a short-term basis.[16] In contrast, local governments rely much more on borrowing.

C. How is the vertical division determined?

The **division of revenue** between spheres of government is not based on a technical formula. Essentially, it is a political judgment based on the programmatic responsibilities of each sphere, the capacity of each sphere to raise its own revenue, and national policy priorities as determined by the government.

Two points must be noted. First, because certain functions are assigned to particular spheres of government, the decision of where the money goes is not simply a structural decision between spheres of government. Instead it represents a *political* choice between national, provincial, and local programme priorities.

The second important point pertains to the apparent stability of the vertical division of revenue for the next three years. Figure 6 gives the vertical division for fiscal years 1999-2001. The Medium Term Expenditure Framework (MTEF) system has allowed for more stability in the allocations to each sphere, as can be seen by the relatively constant ratio of the vertical split. Yet, functions have been shifted to the provinces from national government. These added demands for services from the provincial governments are not easily apparent from these numbers.

[14] South Africa Constitution, Chapter 13, Section 230 (1).
[15] Iraj Abedian, Tania Ajam, and Laura Walker. Promises, Plans, and Priorities: South Africa's Emerging Fiscal Structure. Cape Town: IDASA, 1997. pg. 65.
[16] 1998 Medium Term Budget Policy Statement, Division of Revenue, pg. 2.

Figure 6.

Vertical Division of National Revenue			
R million			
	1999/00	**2000/01**	**2001/02**
Total revenue raised nationally	**216,780**	**230,722**	**247,250**
Top slice	**50,072**	**55,070**	**55,359**
Debt service	48,222	49,820	52,609
Contingency reserves	1,100	3,500	8,000
Skills development		1,000	2,000
Donor-financed spending	750	750	750
National equitable share	**78,733**	**81,100**	**84,489**
Conditional grants to provinces and local government	8,761	8,361	8,257
As percent of national equitable share	*11.1%*	*10.3%*	*9.8%*
Retained for national departments	69,972	72,739	76,232
As percent of national equitable share	*88.9%*	*89.7%*	*90.2%*
Provincial equitable share	**86,302**	**92,071**	**96,822**
Local government equitable share	**1,673**	**2,480**	**2,580**
Total revenue available to be shared[17]	**166,708**	**175,652**	**183,891**
National equitable share as percent	*47.2%*	*46.2%*	*45.9%*
Provincial equitable share as percent	*51.8%*	*52.4%*	*52.7%*
Local equitable government share as percent	*1.0%*	*1.4%*	*1.4%*
Addendum[18]	**96,736**	**102,912**	**107,659**
Provincial allocations including conditional grants	94,420	100,432	105,079
Local government share including conditional grants	2,316	2,480	2,580

Source: 1999 Budget Review, Provincial and Local Government Finances, pg. 6. Also Annex E, pg. 8.

[17] Total revenue minus the top slice.

[18] The Addendum refers to appropriations made in the Supplementary Estimate of Expenditures. See page 23.

II. Horizontal Division Between Provinces: How is the budget divided between the provinces?

The equitable share for the provinces is another key budgeting principle in the Constitution. According to Sections 214 and 227, each province is entitled to an equitable share of the revenue raised nationally.[19] The purpose of the equitable share is to provide provinces with resources to uphold national standards in providing those services that are the concurrent responsibility of national and provincial governments. Provinces still retain some independence in setting their own budgets and determining how their equitable share is spent.

However in practice, much of the provinces' funds are tied up in fulfilling National Executive mandates or upholding contractual obligations.[20] For example, large salary bills negotiated at a national level immediately consume a portion of the provincial budget—more than one half—and thus limit the flexibility the provincial governments have in their spending.

The total funds transferred to the provinces from the national government take three forms: the equitable share block grant, conditional grants and agency payments. These are described below.

A. How is the **Equitable Share** for each province determined?

The equitable share is an unconditional allocation delivered as a block grant. This means that provinces are free to distribute this money to particular departments and programmes as they see fit. They are directly accountable for how the money is spent. However, this money is generally spent on services, which are guided by national standards.

The amount of each province's equitable share is computed using an objective, technical formula that aims to take into account the size and demographics of its population, the relative size of its rural communities, and the poverty level of the province. The formula is explained in the Budget Review, a document tabled by the Minister of Finance in Parliament. Annexure E is the section of the Budget Review with an explanatory memorandum on the division of revenue. (See page 26.)

An equitable shares formula was introduced in the Medium Term Budget Policy Statement for fiscal year 19997/98.[21] It relies on the official statistics of Statistics South Africa (formerly CSS), but also utilises data from the Departments of Health and Education. Changes to the fundamental structure of the formula are avoided, but as new demographic data becomes available, the numbers are updated. Currently the formula has seven components with the following weightings given to each factor:[22]

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[19] Wehner, Joachim. "Resolving the uneven distribution of wealth among provinces," *Budget Watch,* Vol. 3, Issue 3; September 1997. (IDASA Budget Information Service).
[20] Tania Ajam, Deputy Director, Applied Fiscal Research Centre, University of Cape Town. Interview. 4 August 1999.
[21] See section below on the Medium Term Expenditure Framework, page 15.
[22] 2000 Budget Review, Annex E, pg. 11.

1. **41 Percent Education Share**: This is determined based on both the size of the school-age population (ages 6-17) in the province *and* the total number of students enrolled in public schools. School-age children receive twice the weighting as the number simply enrolled. It also avoids distorted incentives that would be created if only enrollment rates were considered.

2. **19 Percent Health Share**: Since all citizens are eligible for public health service, this share is based on the population of the province. However, people without private medical insurance are clearly more likely to take advantage of public health services. Therefore the number of people *without* medical aid is given four times as much weight as the number of people who have private medical aid.

3. **17 Percent Welfare Share**: This share covers social security payments to the elderly, disabled, and children. It is determined by calculating the number of people in each province who are eligible for each type of social security grant. For example, the number of children under age six in the province would determine the childcare component of the welfare share. This number is then adjusted by an income factor for that province. This is done because the income level of recipients of old age pensions and child support grants are taken into account in determining eligibility.

4. **7 Percent Basic Population Weighting**: This is determined by the percent share of the total population in the country.

5. **3 Percent Backlog Share**: In the 1999/00 budget, a **backlog** share was added because of criticism that the previous formula did not recognise the backlogs some provinces confront. The backlog share is divided between provinces based on the relative demand for services in each. It is calculated based on the capital needs of the province, as measured by looking at the schools register of needs, the audit of hospital facilities, and the share of rural population in each province.[23]

6. **8 Percent Economic Output Share**: This part of the formula recognises that some expenditures are due to the province's economic activity, and not just the size of the population, such as the maintenance of roads. Provinces currently have very limited taxing power. This part of the formula attempts to compensate wealthier provinces that are disproportionately affected by this limitation. In 1999, this economic output share was determined using the total remuneration of employees country-wide as a proxy for the province's tax capacity.[24]

7. **5 Percent Institutional Component**: This amount is the same for each province, regardless of the size of the population. This is because government operations entail overhead costs regardless of the size of the population served.

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[23] 1999 Budget Review, Annex E, pg. 15.

[24] Laura Walker, Deputy Director: Provincial Policy, Intergovernmental Relations, Department of Finance. Correspondence. 21 September 1999.

As with the vertical division between spheres of government, it is constitutionally forbidden to deduct the revenue that provinces raise themselves from their equitable share. But at the same time, the national government is not required to compensate provinces that do not collect fully on their tax base.

A second point to note is that the weighting given to these components in the formula does not indicate the amount of money those functions are assigned in the provinces' budgets. For example, the 18 percent weighting for the health share does not necessarily mean that 18 percent of the provinces' budgets go towards health services. As noted earlier, the equitable shares transfer to the provinces is an unconditional grant, and provinces then independently determine the priority given to education, health, and welfare, depending upon their particular constraints and needs.

B. How do the **Conditional Grants** to the provinces work?

Provinces also receive grants from the national government, which come with conditions on how they are spent. In contrast to the equitable share block grant, which provinces may allocate as they see fit, the conditional grants are earmarked to be spent for specific functions. Typically, these are areas where national government functions are shared by provincial governments, or require the cooperation and empowerment of provincial authorities for their delivery. Conditional grants make up roughly 10 percent of the funds provinces receive from the national government and are primarily for improvements in conditions of service and hospitals.[25]

Conditional grants are a relatively new feature of the budget and only introduced in 1998/99. They are included as part of the national equitable share, and are listed in Schedule 3A of the Division of Revenue Bill.[26] For instance, improvements in conditions of service for public employees are listed as part of national share in the Division of Revenue Act, and then given to provinces as a conditional grant in adjusted estimates. The administration of these grants works in the following manner:

- The national department retains responsibility for monitoring compliance;
- The provincial government takes care of actual expenditure of funds, and;
- Funds are usually paid in lump sums up front, or on a previously-agreed schedule.[27]

C. How do **Agency Payments** differ from conditional grants?

Agency payments are best described as fee-for-service arrangements between departments or between spheres of government. The government body with responsibility for a function may contract with another department or another sphere of government to deliver that service.

[25] Tania Ajam, Deputy Director, Applied Fiscal Research Centre, University of Cape Town. Interview. 4 August 1999.
[26] 1999 Budget Review, Annex E, pg. 9.
[27] Ibid.

Agency payments therefore provide another way for funds to flow from the national departments to provincial departments. In the case of agency payments, the national government retains accountability for the funds and their expenditure. The relationship is similar to a contractual agreement: provinces or local government agree to perform a function or administer a program on behalf of the central government. Usually provinces are reimbursed for expenses in the case of agency payments. They also do not current flow through the budgets. They are not voted upon in provincial budgets as in the case of conditional grants.

III. Determination of Local Government Share: *How are resources divided between local governments?*

Local governments, in a financial sense, are expected to be mostly self-sufficient. Local governments raise all but about 10 percent of their budgets. This is done through property taxes, user fees for water and electricity, and other local taxes and levies.[28]

As with provinces, the Constitution states that the revenue local governments raise on their own cannot be deducted from their share of nationally-raised revenue.[29] However when determining the local government equitable share, the finance ministry *does* consider what other funds local government is also receiving from the national government—including conditional grants for capital or operating expenditures.[30]

In 1998/99, a new local government funding system was established on the recommendation of the Financial and Fiscal Commission (FFC). The new system of fiscal transfers to municipalities was announced in an April 1998 document entitled "Introduction of an Equitable Share of Nationally Raised Revenue For Local Government." The system will be phased in gradually over four to seven years.

The new system includes two significant changes. First, transfers will no longer pass through the provinces as conditional grants earmarked for local government. Instead they will go directly to the local authorities from the central government.[31]

A second important change is the adoption of a formula-based system that accounts for the poverty levels. This will mean that after an initial transition phase, poor rural areas will be receiving considerably more than their urban counterparts.

Transfers from the national government to local governments include:

A. Equitable share grants—Similar to the provinces, the Constitution entitles local governments to an equitable share of nationally-raised revenue. An equitable share formula divides funds

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[28] 1999 Budget Review, Provincial and Local Government Finances, pg. 14.
[29] South Africa Constitution, Chapter 13, Section 227 (2).
[30] Section 4.4.6. "The Introduction of an Equitable Share of Nationally Raised Revenue for Local Government," Ministry of Finance, 21 April 1998.
[31] Van Zyl, Albert. "Poorer local authorities biggest winners," *Budget Briefs*, No. 1; June 1998. (IDASA Budget Information Service).

between the local authorities, including tiny rural villages and larger metropolitan areas.[32] According to the new system of intergovernmental transfers for local government, the equitable share grant includes four components:

- *Municipal basic services transfer*: This is intended to ensure that all South African residents have access to basic municipal services. The amount of the transfer is computed by multiplying the number of people in poverty by the cost per person of providing services. (This sum is then multiplied by the fraction of that need which will be covered by the municipal basic services transfer. For example, if the national government decides the basic services transfer should cover 50 percent of the need of the poor in the municipalities, the sum would be multiplied by one half.)[33]

- *Municipal institution transfers*: This provides funds for operating and maintaining basic facilities for local government, so that local authorities lacking infrastructure or administrative capacity to raise taxes can at least operate at a minimum level (e.g. community centres and an office for elected officials.) The intention of these transfers is to promote democratic local government. The amount of the transfer is defined as the difference between the normative income generated by the local authority from user charges, and the minimum level of funds necessary to support municipal government institutions.[34]

- *Spillover transfers.* Some services create important benefits for residents outside of the local authority in which they are undertaken. When programmes benefit people other than those incurring costs for them, they are said to create **spillover**. These transfer payments by the central government support the essential infrastructure for those programmes with positive economic spillover.

- *Equalisation transfers.*[35] These are transfers between substructures within the same metropolitan council jurisdiction in order to equalise the tax base. Their purpose is to rectify the uneven development in metropolitan areas where households, capital investment, and labour are not spread smoothly throughout an area, leaving some local authorities with a weaker tax base than others. The transfers are computed using a formula.[36]

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[32] 1999 Budget Review, Provincial and Local Government Finance, pg. 14.

[33] In this formula, poverty is defined as a household income of less than R800 per month for a family size of 4.5. The annual cost of providing basic services is set at R230 per person. Notably, both figures are the same nation-wide. Section 4.2.1. "Introduction of an Equitable Share of Nationally Raised Revenue for Local Government," Ministry of Finance, 21 April 1998.

[34] "Normative" refers to the income the local authority ought to be able to raise from its tax base. It is determined by looking at the average personal income in the area. The reason for tying this formula to the amount the local authority *could* raise—as opposed to actual revenue from rates—is so that local authorities do not have perverse incentives to make little effort to raise taxes.

[35] Van Zyl, Albert. "Poorer local authorities biggest winners," *Budget Briefs*, No. 1; June 1998. (IDASA Budget Information Service).

[36] Section 4.2.2. "Introduction of an Equitable Share of Nationally Raised Revenue for Local Government," Ministry of Finance, 21 April 1998.

B. R293 towns staff and functions grants—This is a transitional measure to be phased out by 2002/03. These are conditional grants and funds going directly to particular municipalities to cover personnel and services in the R293 towns of the former homelands.[37]

C. Other transitional allocations—Besides the R293 grants, other allocations will be phased out as the formula-based system is phased in over the next four to seven years. These include a fund for local governments to help with transitional and emergency costs, water services in rural areas, and subsidies from the Department of Land Affairs.

[37] 1999 Budget Review, Provincial and Local Government Finance, pg. 19.

WHAT IS THE MEDIUM TERM EXPENDITURE FRAMEWORK?

The Medium Term Expenditure Framework (MTEF) was adopted in 1998 as part of a wide package of budget reforms that included the Intergovernmental Fiscal Relations Act of 1997 (IGFRA). That year, for the first time, the annual budget included three-year spending plans. Although Parliament only votes on the upcoming fiscal year, the government presents numbers for the following two years as well.

The MTEF is a tool to encourage cooperation across ministries and planning over a longer horizon than the upcoming fiscal year. This approach is preferable to reactive, piecemeal, short-term decisions that ordinarily characterise budgeting because it:

Enhances stability, by letting provinces and national ministries know what resources will likely be available to them in future years. This allows government planning to be more credible and accurate.

Encourages investment, by making taxation, interest rates, and government spending more predictable.

Improves transparency, by making government's long-term policy goals and overall strategy available to the public. Outlining future spending provides a signal to civil society and public at large of government's priorities and how it intends to them.

Eases program evaluation, by providing a baseline for assessing the effectiveness of the past year's programs.

How does it work?

Timing

The Medium Term Budget Policy Statement, (MTBPS), is published by the Ministry of Finance in October, five months before the following year's budget is tabled in Parliament. For example, the government's policy framework for the 1999 Budget was published in the Medium Term Budget Policy Statement of 2 November 1998.[38] This document does three things:

- Delineates the equitable division of revenue between the three spheres of government,
- Gives the rationale for that division in terms of macro economic context and assumptions, and
- Provides spending estimates for the next three years.

These spending projections serve as a starting point for the next year's detailed budget. For example, the forward estimates for the 1999/00 fiscal year included in the MTBPS will be the baseline for determining the fiscal year 2000/01 budget. Appropriate adjustments are made to

[38] 1999 Budget Review, Overview, pg. 1.

these baseline numbers if policies are altered, government priorities shift, or the macro-economic environment changes unexpectedly.

The final budget numbers and projections for the next three years are then announced in February when the budget is tabled in Parliament.[39]

Contents of the Medium Term Budget Policy Statement (MTBPS)

The Medium Term Budget Policy Statement includes the following sections:

- *Macro-economic context*—The MTBPS summarises the assumptions and predictions underpinning the government's fiscal policy. It provides the key numbers for the government's three-year estimates specifically on: the projected real Gross Domestic Product (GDP) growth, real private consumption growth, real gross domestic fixed investment growth, and GDP inflation. The MTBPS also describes current trends in employment, consumption and investment.

- *Overall Fiscal Policy*—The MTBPS lays out the principles behind the fiscal policy, its overall aims, and the subsequent objectives for the next three years. Following this, the MTBPS describes what adjustments have been made to the numbers in the previously published projections. A detailed rationale is given for each revision.

- *Division of Revenue*—The decision on how funds are to be allocated vertically is not determined by formula but by policy. This section spells out the policy priorities and values that guide that decision, along with the factors laid out in Section 214 (2) of the Constitution. It also provides information on the equitable share and conditional grant transfers to provinces.

- *Medium Term Expenditure Projections*—Lastly, the MTBPS projects expenditures over the next three years.

National Expenditure Survey

As part of the Medium Term Expenditure Framework, the government published a National Expenditure Survey (NES), for the first time in 1999. This is a separate document intended to complement the Estimate of Expenditure (see page 23).[40] It is an account of money spent and outcomes achieved by national government departments and agencies. Each national department submits a report to the Ministry of Finance, which shows what programmes or services were successfully delivered with the expenditures of the previous year.

In this way, the NES directly links spending to service delivery and outputs. Instead of focusing strictly on accounting and asking whether actual expenditure exceeded the previous

[39] 1998 Medium Term Budget Policy Statement, pg. 1.
[40] 1999 Budget Review, Chapter 1, pg. 2.

year's budget, the NES looks at what national departments delivered for that money. In other words, it evaluates the budget by the tangible outcomes produced on the ground.[41]

The NES can be a critical instrument for evaluating programmes and understanding the value of spending in certain areas. Currently the NES is only produced for national ministries and agencies. Similar reporting for provincial departments and standardisation of the reporting format across departments would make it a more useful and accessible tool.

[41] Tania Ajam, Deputy Director, Applied Fiscal Research Centre, University of Cape Town. Interview. 4 August 1999.

THE BUDGET PROCESS:

How does government arrive at the annual budget?

The following sections first explain the bodies that coordinate decision-making in the budget process and then describe the budgeting chronology in detail. Essentially there are two stages: the drafting stage and the legislative process.

I. Who are the main actors in the budgeting process?

The IGFRA empowered three intergovernmental bodies to strengthen cooperation on budgeting between the executive and parliament, and between spheres of government. The Act helped to clarify the roles of the FFC, Budget Council and Budget Forum in the budget cycle. The MTEF teams, also explained below, are intergovernmental teams that take a unique sectoral perspective on budgeting and planning.

A. Financial and Fiscal Commission

The FFC is an independent, impartial body constitutionally established in 1994. It is intended to serve as an expert resource for Parliament, the provincial legislatures and the Budget Council.

The FFC has 22 members, serving terms of five years. They include:

- Nine persons, each nominated by the provincial Executive Councils;
- Two persons nominated by SALGA, and;
- Eleven members appointed by the President.

The FFC plays the greatest role in the earliest stages of the budget process by recommending the formula for determining the equitable share allotted to each sphere of government, and also the share going to each province. It makes its recommendations in May, ten months prior to the tabling of the budget.

B. Budget Council

The Budget Council consists of the Minister of Finance and provincial Members of Executive Committees for Finance, along with a few others. They make recommendations to the Cabinet on the budget. In practice, it has become the principal forum for consultation and debate at the executive level in the ten months leading up to the official tabling of the budget in Parliament.

Chaired by the Minister of Finance, the Budget Council also includes:

- The Deputy National Minister of Finance and Ministry advisors,
- Director General of Finance and Heads of Treasury, and
- The FFC (as observers).

The Budget Council was formalised and given specific functions by the IGFRA. The Act also requires the Ministry of Finance to convene the Council at least twice a year. The Budget Council met seven times during the 1999 budget process.[42]

C. Local Government Budget Forum

The Local Government Budget Forum examines the allocations to local government in particular. It consists of:

- The Budget Council,
- The Chairperson of the FFC, and;
- Fourteen representatives from local government appointed by SALGA.

Legislation requires the Minister of Finance to convene the Local Government Budget Forum at least once a year. The 1999 budget process included two meetings of the Budget Forum.[43]

D. MTEF Sectoral Teams or "4x4s"

In 1998, Medium Term Expenditure Framework Sectoral Teams were created as task forces for budget planning in a particular sector. The MTEF teams assigned to carry out these sectoral reviews included Ministry of Finance officials, treasury officials from all provinces, and national and provincial department members for that sector. They closely evaluated expenditures over the previous years, measured the effectiveness of those policies, and produced policy options.[44]

However the MTEF teams were found to be cumbersome, and recently were transformed into leaner "4x4s." The teams still discuss policy options for the sector, problems with service delivery and budget difficulties, yet the composition of the groups may vary. The new 4x4s are designed to include four national and four provincial representatives, with both treasuries and the line departments present. [45] Only a few provinces are represented on a particular 4x4 but each province is involved in at least one. However, the important element of the 4x4s is that they bring together Finance and line departments, at both the national and provincial levels.

The 4x4s are more permanent than the MTEF teams, meeting throughout the year and picking up on other sector-wide policy issues beyond budgeting. Where the original MTEF teams

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[42] 1999 Budget Review, Provincial and Local Government Finances, pg. 4.
[43] Ibid.
[44] Ibid.
[45] Joel Friedman, Senior Manager: Provincial Budget Policy, Department of Finance. Interview. 24 August 1999.

were formed for health, education, welfare, personnel and justice, 4x4s have now been convened to tackle infrastructure and transport.

The 4x4s have a standing slot on the agenda of Budget Council meetings to report on progress. In this way, the 4x4s feed their work into the decisions of the Budget Council. The 4x4s also have significant impact on the Medium Term Budget Policy Statement released in November. Besides their role in the budgeting process, the 4x4s inform Joint MinMEC meetings (meetings between Ministers and MECs of Finance and line departments where political dimensions are addressed).[46]

The purpose of the 4x4s is to enhance inter-governmental relations and the exchange of information, while taking a long-term perspective on spending and policy. The important point to note is that while the rest of the budgeting planning is done along provincial lines, the sectoral teams are taking a *global* look at a particular government function. However ultimately the 4x4s are advisory bodies of officials and do not have particular decision-making power.

II. Stage One: Drafting the Budget

The budget process begins approximately ten months prior to the April start of the fiscal year. For example, the FY2000/01 budget process would be initiated in April 1999, stretch through that year, and only finish when the fiscal year begins in April 2000. (Figures 7 and 8 provide a timeline and flow chart of the budget process.)[47]

A. Cabinet and Ministry of Finance set preliminary allocations

Between November and February of the year prior to the particular fiscal year, the Department of Finance determines the basic fiscal, policy and spending parameters for the budget. The Ministry uses the MTEF projections of the previous year as a starting point to ascertain the total expected revenue for that fiscal year, anticipated expenditure, and resulting shortfall or **deficit**. The Finance Department also makes a preliminary recommendation on the division between national departments and between the nine provinces. The result of this top-down process is an overall set of parameters for the departments and provinces to work within—these are referred to as the **indicative allocations**, or resource envelopes.

In January, the Cabinet meets to set priorities and review and approve these preliminary allocations.

B. Budget Council meets to determine vertical division of revenue

By requirement of the IGFRA, the FFC is required to submit its recommendations on the revenue split between spheres of government and among the nine provinces at least ten months before the start of the fiscal year. In practice, this means May of the prior year. At this time, the

[46] Laura Walker, Deputy Director: Provincial Policy, Intergovernmental Relations, Department of Finance. Correspondence. 17 September 1999.

[47] Thanks go to Tania Ajam and Laura Walker for their help in clarifying this timeline.

FFC is supposed to send its recommendations to the Budget Council, Parliament, and the provincial legislatures.

In May or June, the Budget Council meets for the first time to consider the recommendations of the FFC. A preliminary decision on the vertical division of revenue between the spheres of government is made at this point. At the same meeting, the Council makes a tentative decision on the horizontal division of revenue between the nine provinces. These are soft allocations that may change.[48]

C. Detailed departmental budgets drafted

The budgeting process now becomes a more bottom-up procedure. From approximately May through August of the prior year, detailed departmental planning and budgeting takes place. Each provincial treasury takes the preliminary allocation assigned to their province in the May Budget Council meeting and makes rough allocations between their provincial departments. The provincial departments then draw up proposals of how that money will be spent, making decisions between programmes and line items. (The provincial departments' detailed plans or proposals will later be brought to the second meeting of the Budget Council in October.)

Also during this period, the national ministries compile their budgets, determining allocations between programmes and line items. At the end of this process, the national departments submit their budgets to the Department of State Expenditure, and provincial departments submit their detailed draft budgets to their treasuries.

D. Briefings held

In August the Department of Finance reports to the Finance Committee in the National Assembly. Its presentation covers the basic macro view of the budget and the medium-term expenditure framework. In essence, this briefing is the first time Parliament receives word on the developing budget.[49]

Also in August, the Minister's Committee on the Budget meets to discuss government priorities and the fiscal framework for the budget. The Minister's Committee on the Budget (or MINCOMBUD) is a technical subcommittee of the Cabinet, most closely involved in the oversight of the developing budget and its compliance with government goals.

In September and October, the Medium Term Expenditure Committees or MTECs[51] meet to evaluate whether the spending plans submitted by departments are economical, efficient and equitable. National government and all provincial governments have MTECs led by the Treasury. During these meetings, the State Expenditure and Finance departments meet with the separate departments. The meetings shed light on various spending pressures, which help to

[48] Laura Walker, Deputy Director: Provincial Policy, Intergovernmental Relations, Department of Finance. Interview. 31 August 1999.
[49] Laura Walker, 31 August 1999.
[50] Laura Walker, Deputy Director: Provincial Policy, Intergovernmental Relations, Department of Finance. Correspondence. 21 September 1999.
[51] "Spend and Deliver: A Guide to the Medium-Term Expenditure Framework" by Laura Walker and Berhanu Mengistu, Idasa 1999

inform decisions on priorities. Those priorities are laid out in the Medium Term Budget Policy Statement published the next month. (Parallel MTEC hearings at the provincial level are held in October.)[52]

E. Budget Council meeting on horizontal division of revenue

In October the Budget Council meets again. At this meeting, the final decision is made on the horizontal division of revenue between the provinces.

Following the Budget Council meeting, the MINCOMBUD meets. An extended Cabinet meeting on the budget follows, and is attended by the provincial premiers. The purpose of this meeting is to discuss and finalise the vertical and horizontal divisions of revenue. Parliament is then provided with updated briefings, and the outcomes of the parliamentary briefings are fed back into the process.

F. Medium Term Budget Policy Statement published

In November, the Ministry of Finance publishes the MTEF Budget Policy Statement, drawing on the work of the 4x4s, the revised macro projections, the MTEC process and preliminary Cabinet decisions on priorities.[53] The MTBPS contains preliminary spending projections for the next immediate fiscal year, as well as the two years following. It includes the numbers from the October Budget Council meeting which produced the formula for the revenue division between the provinces. The MTBPS is also discussed by the Cabinet.[54]

G. Negotiation and reconciliation of requests

With the final allocation for the provinces determined at the October Budget Council meeting, the months between November and January are used by the provincial treasuries to move money between departments and programmes. Adjustments to original budget proposals developed might require adjustment once the provinces know the actual amount they will be receiving from the national government.

The Minister of Finance then presents the outcome of these meetings and negotiations to the Budget Council, to be accepted or sent back for changes. At the provincial level, a parallel process occurs: each provincial department meets with the provincial treasuries or executive committees.

H. Budget Council approval and ratification by Cabinet

Once the Budget Council approves, the Minister of Finance presents the budget to the Cabinet, seeking its ratification of the proposal. This normally occurs in November or December.

[52] Laura Walker. Interview. 31 August 1999.
[53] Laura Walker. Correspondence. 21 September 1999.
[54] Laura Walker. Interview. 31 August 1999.

In the provinces, the provincial MEC for Finance submits the budget to the provincial cabinet for ratification. This usually happens in December.[55]

I. Final changes and printing

The two months prior to the tabling of the national budget in Parliament is characterised by final, often secret, negotiations and small changes. It concludes with the printing of the budget. (The provinces table their budgets approximately one week after the tabling of the national budget.)[56]

III. Stage Two: The Legislative Process

A. How is the national budget legislation structured and classified?

On Budget Day, the Minister of Finance delivers his Budget Speech in the National Assembly and formally tables the national budget in Parliament. The national budget is presented as two pieces of legislation, introduced at the same time.

- *Division Of Revenue Bill.* In addition to providing for the distribution of revenue between spheres and provinces, the Division of Revenue Bill must be accompanied by a memorandum that explains the rationale for the divisions proposed between spheres of government and among provinces.[57] The Minister also has a legal obligation to respond in this memo to the FFC recommendations, explaining why those recommendations were adopted or rejected.[58]

- *Appropriations Bill.* This legislation gives departments the legal authority to spend the money allotted to them. The budget is divided into "votes" which refer to the sub-budgets of each department.

Section 77 of the Constitution defines a money bill as one, which "appropriates money or imposes taxes, levies or duties." Thus the **Appropriations Bill** is a money bill treated as Section 75 legislation (ordinary bills not affecting the provinces). As with all other Section 75 bills, the NCOP has very limited powers. A section 75 bill passed by the National Assembly and voted down by the NCOP can still be passed through an override vote in the Assembly.

However, the **Division of Revenue bill** is tagged as Section 76 legislation affecting the provinces. This allows the NCOP to have greater impact: Section 76 bills rejected by the NCOP must be referred to a mediation committee, and should consensus still not be reached, must earn a two-thirds majority vote by the National Assembly to be passed on for Presidential approval.

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[55] "The Budget—A Tool for Change, Drafting Training Manual", IDASA Budget Information Service, April 1998, pg. 14.

[56] Joel Friedman, Senior Manager, Provincial Budget Policy, Department of Finance. Interview. 24 August 1999.

[57] This memorandum is mandated under the Intergovernmental Fiscal Relations Act, and commonly referred to as "Annexure E".

[58] Murray, Christina. "Revenue Bill Makes Sense," *NCOP News*, April 1998, pg. 4.

B. Does Parliament have powers to amend the budget?

Currently Parliament's power to amend the taxation and appropriations bills of the national budget is ambiguous and weak. However, Parliament can amend the Division of Revenue bill. The difference is a result of the variant classifications of the three bills.

As previously stated, the taxation and appropriations bills of the national budget package are money bills, which are classified as Section 75 legislation. Theoretically, both the NCOP and NA have the power to propose amendments to Section 75 legislation. Sections 77 and 120 of the Constitution call for Parliament to enact special legislation to set up procedures for Parliament and provincial legislatures to amend money bills. However, as yet, this legislation has not been passed, and the location and extent of the proposed powers are still under debate.

What this means is that the NA and NCOP committees currently have the power to hold hearings on the taxation and appropriations bills, and recommend a vote in favour or against the bills, but cannot recommend specific changes. And although the committees and both houses theoretically have the authority to vote down these bills, this could only be done by rejecting the bills in total, an action that would cause severe upheaval in the process and essentially amount to a no-confidence vote in the executive. This is highly unlikely.

The Division of Revenue is a different matter. It is not a money bill, and therefore is covered by Section 76.[59] As a result, technically the bill *can* be amended by the NCOP without any special legislation being enacted beforehand. However, it is again unlikely this would occur.

C. What are the roles of the National Assembly and NCOP?

Budget Day marks the start of a three to four month review process in national and provincial legislatures.[60] The bill is first sent to the NA Finance Committee, and then passed along to the finance committees in each province. The NA Finance Committee then has seven days to hold public hearings on the budget and compile a report for the Assembly. Portfolio standing committees for particular sectors might also hold hearings on individual votes.[61]

The Finance Committee then presents its report to the whole Assembly, and the budget is debated for approximately one week on the floor of the Assembly.[62] The majority of time Parliament spends on the budget is thus consumed with floor debate, rather than scrutiny in committee.[63]

[59] Thanks to Christina Murray for pointing out this distinction.
[60] Ajam, Tania. "NCOP challenged to make bigger impact on budget" *Budget Watch*, Volume 4, Issue 2; June 1998. (IDASA Budget Information Service).
[61] Warren Krafchik and Joachim Wehner, "The Role of Parliament in the Budget Process", 3 June 1998.
[62] IDASA, "The Budget—A Tool for Change" Draft Training Manual, Idasa Budget Information Service, April 1998
[63] Warren Krafchik and Joachim Wehner. "The Role of Parliament in the Budget Process," Discussion Paper. 3 June 1998. (IDASA Budget Information Service).

A number of key documents are released with the budget on National Budget Day to explain the policies and numbers.

Key Documents
White Book, known officially as the Estimate of Expenditure, is the comprehensive and details list of departmental votes. It provides information on the spending plans for government departments as well as their individual departmental programmes at both the national and provincial level.
Budget Review, is a more readable and accessible version of the White Book. Annexure E of the Budget Review is of particular importance to provincial and local spheres of government as it includes explanatory memoranda on the division of revenue as well as an overview of economic policy under which the budget was drafted.
Minister's Speech, provides an easily understandable "popular" version of the Budget that indicates major policy shifts or funding changes.
National Expenditure Review, is a survey of the actual expenditure during the past financial year, and provides an overview of service delivery at a national level.

Once the National Assembly has voted its approval, the budget passes to the National Council of Provinces. Following a positive vote in the NCOP, it is passed along to the President for signing.

Glossary of Terms

Appropriation	Amount of money authorised to be spent by a department, province, or local government.
Backlog	Situation where the level of resources or services in a locality are significantly below national standards (see page 10).
Bridging finance	When provinces or local governments borrow money on a short-term basis to cover an immediate need, in anticipation of income in the near future.
Capital expenditure	Money spent on an item that lasts for longer than one year—typically infrastructure, such as buildings or equipment.
Conditional grants	Money given to provinces or local government from the national government that has certain legal requirements that limit or direct how the money can be spent. (For example: requirements to deliver a particular programme, distribute goods or payments to residents, or maintain a certain standard in services).
Contingency reserves	Money set aside by the national government (before the vertical and horizontal divisions of revenue are made) to cover unanticipated expenses in the upcoming fiscal year.
Current expenditure	Money spent by government departments for routine services or goods regularly used during the fiscal year. These would include rent, wages, office supplies, etc. but does *not* include welfare payments.

Debt service	Interest that government pays on the money it has borrowed.
Deficit	Difference between government spending and government revenue.
Division of Revenue	How money taken in by the government through taxes is distributed vertically (between national, provincial, and local government), and horizontally between the nine provinces.
Equitable share	The term used in the Constitution (Section 214) to refer to the funds legally owed by the national government to the provinces and local governments.
Expenditure	Money paid out or spent by government.
Fiscal capacity	Taxing capacity or the ability of government to raise taxes in an area.
Fiscal policy	The entire collection of government taxing and spending policies.
Fiscal year	The fiscal year typically does not coincide with the calendar year. The South African fiscal year is 1 April to 31 March.
Flat-rate surcharges	A surcharge is an additional tax levied by a province or local government that is attached to a tax already collected by the national government. A flat-rate surcharge means there is a set rate (For example, the percentage cannot be graduated for different income levels).

Horizontal division	The decision on how the total funds given by national government to the provinces will be allocated among the nine provinces. The total amount of funds for local government is also distributed between municipalities according to a horizontal division.
Indaba	Meeting. In the context of the budget process, the word is used to refer to the main Budget Council meetings in May and October. *Lekgotla* is also frequently used.
Indicative allocations	The initial amounts allocated for each national department and, in turn, to each provincial department. The indicative allocations are set by Cabinet and the Budget Council in the early stages of the budget drafting process.
Lekgotla	Meeting. In the context of the budget process, the term is often used to refer to the main Budget Council meetings in May and October. *Indaba* is also frequently used.
Medium Term Expenditure Framework	The system introduced in 1998 whereby government would not simply decide the budget on a year to year basis, but plan revenue and expenditures three years ahead. The MTEF is a planning tool as opposed to a legal obligation.
R293 towns	Areas of the former homelands—largely poor—which receive special transitional grants under the local government funding scheme (see page 14).
Revenue	Money government takes in, either through taxation or by borrowing.

Spillover	When the benefits (or costs) of a program or project extend beyond the residents of the immediate area, to residents of other municipalities who do not incur costs for those positive effects. For example, a polluting factory or medical research facilities.
Tax base	What a tax is levied on (e.g. personal income, or cigarettes). More largely, the term refers to the potential funds to be raised in an area through taxes.
Transfer payments	Funds given from one body to another, with no conditions. This term is used for cash payments made by government to welfare recipients (such as the pension program), and also can refer to grants given from one sphere of government to another.
User charges	Fees for services delivered to residents. Beneficiaries are charged according to their use. Examples of user charges include licenses and utility charges.
Unfunded mandates	Legislation from national government directing provinces or local authorities to provide certain services or uphold national standards without providing the necessary funds to carry out the program or comply.
VAT—Value Added Tax	Tax levied by the national government. The VAT is an indirect tax, meaning it is paid to a second party (stores or vendors) and passed on to the national government.
Vertical Division	The decision on how the total revenue raised by the national government will be distributed between national government, provincial government, and local government.

Figure 7.

Budget Process Timeline

	2000		2001										2002			
	Nov	**Dec**	**Jan**	**Feb**	**May**	**June**	**July**	**Aug**	**Sept**	**Oct**	**Nov**	**Dec**	**Jan**	**Feb**	**Mar**	**Apr**
National	Department of Finance determines total anticipated revenue, expenditure and deficit, and makes preliminary recommendation on division between national departments and nine provinces		National Cabinet meeting held to set priorities and approve indicative allocations.		FFC submits its recommendations to Budget Council, Parliament and provincial legislatures.			Finance Ministry makes presentations to NA committees and cabinet	MTEC hearings held	**Second Budget Council Meeting** held to make final decision on horizontal split between the provinces.	National Minister of Finance presents plan to Budget Council for approval	National Cabinet meets to ratify budget.	Final negotiations and changes. Budget is printed		Committee hearings and floor debate take place in NA and NCOP.	***Fiscal Year begins***
					Budget Council considers FFC recommendations.			4x4s meet to review and examine provincial and departmental budgets for their sector			**Medium Term Budget Policy Statement** is published			**Budget Day**: Finance Minister tables budget in Parliament		
					Budget Lekgotla held to determine vertical split between national, provincial & local governments, and make preliminary horizontal split between provinces.											
Provincial						Provincial treasuries take preliminary figures for their province and allocate between provincial departments	Provincial departments draw up detailed budget proposals within parameters given by provincial treasuries.				Provinces revise department budgets and programmes, given their final allocation determined at the October Budget Council meeting.					
											Provincial Cabinets meet to ratify provincial budgets					