The capabilities of ministries of finance and planning to coordinate capital and recurrent expenditure

Country case study
South Africa

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This case study was put together by Joan Stott from the Collaborative Africa Budget Reform Initiative (CABRI). Ms Stott conducted interviews with representatives and officials from South Africa's National Treasury, Department of Education, Department of Planning, Monitoring and Evaluation, and civil society.

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For information on the Collaborative Africa Budget Reform Initiative, or to obtain copies of this publication, please contact:
CABRI Secretariat, Cnr John Vorster & Nellmapius Drive, Centurion, 0062, South Africa
+27 (0)12 492 0022
Email: info@cabri-sbo.org
www.cabri-sbo.org

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Context setting

Question one

How integrated or separate is the management of capital expenditure and recurrent expenditure in the legal, institutional and presentational dimensions (the capital expenditure context frame)? To what degree are expenditure management responsibilities decentralised?

Institutional separation

Discussion

In the South African system, the Ministry of Finance (MoF), or the National Treasury, is responsible for the recurrent or operational budget and the infrastructure and capital budget. The National Planning Commission is the custodian of the National Development Plan, which was adopted as the overarching strategy of government recently. However, the National Planning Commission is no longer a ministry on its own. All capital expenditure – as defined for this paper – is included within the fiscal framework prepared by National Treasury. Once the budget is passed, national, provincial and local departments are responsible for managing and spending those funds. According to the Standard Chart of Accounts (SCOA) and the economic reporting format adopted by the National Treasury, payments on standalone items or inventory are classified as recurrent if the cost of each item falls below the capital threshold (not the cost of total number of items). If the cost of an item is above the threshold, it is classified as a capital payment. Also, the SCOA and economic reporting format stipulate that payments made on projects should be capitalised. Any sort of inventory (such as bricks, cement or fencing) or payments in wages to individuals directly involved in the building of a classroom or school, for example, who are not directly employed by government, should be capitalised as part of the "cost of production". Basically, compensation for individuals employed by government, such as teachers, forms part of current payments. It does not include construction workers, architects or engineers who are employed for the duration of a project.

In this study, education is a concurrent function – it is the responsibility of both national and provincial departments. Funds are transferred to provincial departments of basic education, either as part of their allocation from the provincial equitable share (PES) or in the form of a conditional grant. The PES is the portion of revenue that is raised nationally but allocated to each province. This is informed by Section 227 of the Constitution. Each province's portion is calculated using a formula based on six components that capture the relative demand for services among provinces. Four out of six components rely on population figures. Money allocated as part of the PES is unconditional and does not need to be spent according to the components used in the formula. Provinces have the flexibility to budget their resources as they see fit in order to provide services. The education component of the formula makes up 48 percent of the overall PES and is calculated according to the number of children in school and the number who should be in school. However, this does not imply that provinces should allocate 48 percent of the PES to education.

The National Treasury's powers are laid down in law, in Section 16 of the Constitution. The Public Financial Management Act (PFMA) (1999) gives effect to Sections 213, 215, 216, 217, 218 and 219 of the Constitution. Chapter two of the PFMA establishes the National Treasury.

From an institutional perspective, current and capital budgets are integrated within one national department (the National Treasury) when planning the budget. Submissions from the Department of Basic Education are expected to include both capital and current spending needs for the medium-term expenditure framework (MTEF). This is stipulated in Treasury guidelines. The National Treasury issues MTEF guidelines and capital planning guidelines in May or June each year, which inform department submissions to the Medium-term Expenditure Committee (MTEC). The 2017 guidelines include a section specifically on maintenance and ongoing project costs:

"Direct maintenance costs will include the costs over the full project cycle of maintaining the assets in the condition required to deliver the specified outputs, and may include the costs of raw materials, tools and equipment, and labour associated with maintenance. The level of maintenance assumed must be consistent with the capital costs and the operating cost forecasts. It is important to ensure that maintenance costs are budgeted for and not diverted to other funding pressures during the year, to ensure that there is no depletion to the current stock of assets."

The PFMA, which governs national and provincial expenditure, permits departments to shift funds within current payments (from maintenance to wages, for example) and within capital payments. But departments are not permitted to exceed budgeted allocations and cannot shift funds from capital to current. Both the capital and recurrent budgets are published in one document. Functional and economic classifications are made available for expenditure, whether at an aggregate level or by vote/department.

Municipalities are governed by the Municipal Finance Management Act (MFMA) (2003). The PFMA and MFMA limit provinces and municipalities respectively in terms of the type of borrowing they can undertake in relation to capital expenditure. Capital transfers are made to municipalities in the form of grants, and they have legislative independence; legislation prohibits control on maintenance.

What are the responsibilities of the MoF and the National Planning Commission then throughout the budget cycle for recurrent versus capital expenditure?

Budget preparation

The National Treasury makes macroeconomic projections on a quarterly basis, which it uses to update the fiscal framework. This framework includes aggregate-level data for consolidated government (including national and provincial departments, social security funds and some public entities) for revenue, expenditure and debt service costs. The fiscal framework database is linked to several other databases in the National Treasury. Public Finance, Intergovernmental Relations (IGR) and the Budget Office (collectively known as the budget group) are the three divisions that coordinate expenditure and revenue information for national, provincial and local government for the MTEF.

At the beginning of the budget process in July, the fiscal framework for the latest budget (tabled in February) is updated with the macroeconomic outcomes and revised forecasts over the MTEF period made in June. The budget office then meets with the Revenue Analysis Working Committee to determine the revised revenue forecasts for the MTEF, after which the budget group discusses the required cuts to expenditure or expected real growth in expenditure per year or over the MTEF period – given revenue, macroeconomic and debt service cost projections. The budget group must also make allowance for the contingency reserve in each year. Year one is a contingency for unavoidable and unexpected expenditure; in year two and three, the reserve is used to provide for unavoidable expenditure as well as additional or new expenditure for departments. Once the "envelope" or expenditure ceiling is determined, the National Treasury hears budget submissions and presentations from departments as part of the MTEC process. Departments are grouped together according to strategic functions and must report on spending to date, proposals for additional spending or changes to spending over the MTEF, and proposed savings. Departments then determine the share of additional spending or savings among the function group. Capital and recurrent expenditures are both discussed and integrated throughout this process. A similar MTEC process takes place between provincial departments to determine expectations.

Public Finance and IGR work closely during the preparation phase to determine any changes to conditional grants to provinces and municipalities.

Once or twice during the MTEC process, the minister and the Minister's Committee on the Budget[1] are presented with the fiscal framework and division of revenue (split among national, provincial and local government). Once the MTEC and the budget council[2] is finalised, the proposed fiscal framework is approved by the minister and the Minister's Committee on the Budget. A copy of the fiscal framework is included in the Medium-term Budget Policy Statement and submitted to Cabinet.

The Minister of Finance tables the Medium-term Budget Policy Statement in Parliament at the end of October. Parliamentary committees discuss and debate the framework, and are able to dispute forecasts under the Money Bills Amendment Procedure and Related Matters Act (2009).

The MTEF is also tabled in October and forms the basis of the budget to be tabled in February the following year. Between November and February, the fiscal framework is updated with the December macroeconomic outcomes and revised forecasts. The Revenue

1 The Minister's Committee on the Budget is constituted as a Committee of Cabinet, chaired by the Minister of Finance. Its members are appointed by the President on the MoF's recommendation. The committee includes members from the MoF (including the Deputy Minister of Finance); Department of Planning, Monitoring and Evaluation (DPME); Department of Public Service and Administration; Department of Cooperative Government and Traditional Affairs; Department of Public Enterprises; Chair of the Economic Cluster; Chair of the Social Cluster; Department of Trade and Industry; Department of Health; Department of Science and Technology; and the Department of Water and Sanitation. The committee may invite other Cabinet members or senior officials to attend and/or present on issues of relevance to its mandate. In addition to political office bearers, committee meetings are attended by the director general of the National Treasury, the Presidency, and the DPME. Senior National Treasury officials may attend as determined by the director general.

2 The budget council and budget forum are structures within the budget process that consider whether the constitutional requirement for an equitable division of revenue between the three spheres of government has been met and that shared priorities are agreed upon. These two structures consider all the decisions made in the course of the budget process that have intergovernmental implications.

Analysis Working Committee meets again to revise revenue forecasts if necessary. Changes in taxes and tax expenditures are the sole discretion of the Minister of Finance and are not included in the committee discussions. Finally, the framework is updated to include any adjustments in expenditure estimates and debt service cost projections. This is discussed twice during the process with the minister and the Minister's Committee on the Budget. Once finalised, it is shared with Cabinet before the minister tables the budget in Parliament in February. Between February and April, parliamentary committees hold sessions on the budget and can make adjustments in line with the stipulations of the Money Bills Amendment Procedure and Related Matters Act. The budget is passed and implemented in April.

Line ministry processes: At line ministry level, the budget for capital and recurrent expenditures are dealt with together. In the Department of Basic Education (DBE), the Directorate of Physical Planning and Rural Schooling prepares and manages development budget submissions for school infrastructure, including required maintenance costs. According to the Government Immovable Asset Management Act (2007), the Department of Public Works is responsible for maintaining public infrastructure, including schools. Not all nine provinces have to use the department to maintain buildings – where this is optional, provinces have contracted organisations outside of government to do the job partly because of the department's "sloppy" work and poor delivery. Money is allocated according to where responsibility lies. The National Treasury has included a mandatory portion for maintenance (20 percent) in the education infrastructure grant from 2017/18 on a trial basis to support and, in some instances, force provinces to spend money on school maintenance. According to the DBE, the recurrent costs of maintenance are the weakest link in the provincial capital budgeting process.

Provinces submit capital project plans to the DBE, which it collates as part of its budget submission to the National Treasury. The DBE checks and updates the recurrent portion of costs in submissions. The National Treasury public finance teams and the Directorate of Physical Planning and Rural Schooling in the DBE jointly determine the total budget allocation and changes to the baseline of the MTEF. The IGR division liaises with departments at provincial level and incorporates this discussion within budget group decisions. This takes place as part of the MTEC discussions. Cabinet makes the final recommendations to Parliament.

The provincial member of the executive council (MEC) and national department are statutorily responsible for providing education to children (as a concurrent function). The DBE developed norms and standards for the buildings of schools in 2013. This is being rolled out.

Central ministry allocation processes: The National Treasury developed the Infrastructure Delivery Improvement Programme (IDIP) to build capacity at provincial and local government level, and rolled it out in 2004. This eliminated the ad-hoc approach to delivering projects and implemented a standardised system. Where there was willingness to build capacity, spending improved by up to 90 percent. But the Eastern Cape and Limpopo provinces lagged behind, affected mostly by backlogs, and a lack of systems, consolidated information and skills. This meant that in education, for example, teachers were responsible for delivering infrastructure. There were also political issues (government is the largest contributor to GDP in these provinces, so rent-seeking behaviour was high).[3] The IDIP is expected to end in 2018.

In 2011/12, the National Treasury introduced the school infrastructure backlogs grant, an indirect grant that aimed to eradicate and replace inappropriate school infrastructure, and ensure access to basic services. Funding for the education sector comes from a province's revenue, equitable share, and infrastructure grants (the backlogs grant and the education infrastructure grant).[4] Due to delivery failure in provinces, some money was allocated at national level. Once assets were complete they were transferred to the asset register of provinces. The backlogs grant was intended to be a short-term, high-impact project. Although national government believed it was improving its delivery, it took two years to develop the requisite capacity to deliver. Also, mixed policy priorities, such as creating employment and engaging with communities, slowed the pace of delivery. There was also a lack of capacity in the DBE to deliver and manage contracts. The National Treasury officially established the backlogs grant by the end of the second year. In year one, R624 million was underspent (from an allocation of R700 million) and in year two R860 million (from an allocation of R2.3 billion).

Due to its lack of success, the backlogs grant was incorporated into the education infrastructure grant from 2017/18. The DBE is responsible for delivery, while the National Treasury's Public Finance team is responsible for commenting on overall policy priorities via the provincial benchmark exercises, with IGR helping provincial treasuries to ensure correct allocations are made to provincial education departments in terms of the number of teachers, schools, and textbooks, among other things. Recently, the IGR infrastructure support team and infrastructure planning team in the Budget Office requested departments to submit more representative information for capital projects. With this, appropriations for capital projects are now made in total (not annually) to projects to cover their lifecycle costs, and cash flow is determined by the pace of a project's rollout. This makes allowances for project delays and reduces the level of underspending each year.

The main problem with the backlogs grant was that it was an annual appropriation and, in some instances, caused projects to get off to a slow start. With no rollover of funds, the department lost the year's unspent funds. The grant was thus extended from three years to six years. However, there were still challenges, with too many intermediaries between national government and delivery at provincial level. There was also a coordination issue in terms of planning for the inclusion of municipal services and transport to support a school, as well as decisions around whether small schools should be rehabilitated or replaced by a new, bigger school. Such decisions were

3 Because government provides the main portion of consumption and investment within the provinces' GDP, there have been some issues with government agencies tendering for and procuring the same services – through affiliated agencies. In some instances, rent-seeking also refers to using teachers for education and engineering skills to "save" funding for other line items.

4 Schedule 5/4 of the Division of Revenue Act.

made difficult with national government being so removed from the realities in provinces. Maintenance was also excluded from the grant, so there was less chance of provinces taking the initiative to account for this. The indirect backlogs grant will form part of the education infrastructure grant from 2017/18 and include conditions on planning for teacher distribution and maintenance. The DBE will then be involved only in supervising. From 2017/18, 20 percent of the education infrastructure grant will be ring-fenced for maintenance.

There are several units in the National Treasury that work on capital projects. In the Budget Office, the infrastructure planning team maintains a database of all government projects, which includes the lifecycle costs and stage of delivery. The Public Finance team considers projects as part of the overall sector policy priorities and budget submissions from departments. The IGR team has a unit dedicated to infrastructure planning and delivery. It works closely with another IGR team on the IDIP and manages the infrastructure reporting model, a web-based database that is updated with budget submissions and stages of delivery. There are some issues with capturing data because provinces often table different projects to what was approved as part of the budget process, and implement yet another set of projects. The infrastructure reporting model has helped to identify these red flags for provincial MECs and the MoF, but it has not helped to maintain an accurate reflection of what is being delivered on the ground. The capital projects division appraises large or mega projects. Education projects are often of too little value to be considered by this team, but in instances where they are involved, their role is to make recommendations to Public Finance and the Budget Office on the costing, planning and risks associated with the project. The SCOA team oversees the financial accounting side of expenditure on capital.

Despite these capable teams working towards a single-budget process, none of these databases speak to one another – they are each independently maintained and often contain different information.

The International Development Cooperation team is responsible for donor funding in different sectors and acts as the main liaison between donors and the relevant Public Finance sector teams.

Project and budget cycle integration: Departments are expected to have completed feasibility studies and the associated environmental impact assessments prior to their budget submission. The National Treasury's capital planning guidelines indicate that the following should be concluded and included in the budget submission (the detail of each depends on the size and scope of the project):

- Preparatory work
- Needs-and-demand analysis with specified project outputs
- Options analysis
- Demand analysis
- Technical engineering analysis
- Environmental analysis
- Socio-economic analysis
- Legal and regulatory due diligence
- Viability evaluation
- Financial analysis
- Economic analysis
- Risk assessment and sensitivity analysis
- The preferred option
- Implementation readiness
- Institutional capacity
- Procurement plan
- Project concept note.

Implementation

Parliamentary submission and approval processes have been discussed in some detail. There is a separate process for the tabling and approval of the national budget (including the division of revenue) and the tabling of the B5 schedule by provinces. The national budget is tabled in February and the provincial budgets, including the B5 schedule of capital projects, is tabled in February/March. IGR noted that this does not give the National Treasury a lot of time to assess whether there are differences between what was submitted for the division of revenue and as part of the B5.

Once parliamentary working committees have discussed submissions, they are approved and money can flow. Both national and provinces have a fiscal year beginning 1 April.

As indicated, provincial funding is made up of a province's own revenue, equitable share and conditional grants. Section 227 of the Constitution stipulates that provinces must use their own sources of revenue to provide for their needs and Section 230 allows them to borrow for both capital and recurrent expenditures. The Constitution indicates that borrowing may occur only as bridging finance to cover a fiscal gap, and must be repaid within 12 months. The provincial MEC can borrow over a longer term in the case of capital expenditure, as indicated in the Borrowing Powers of Provincial Government Act (1996). Provinces may borrow only within the local market and may not undertake foreign commitments.

National government funds its capital expenditure through the national revenue fund and borrowing in both local and foreign markets. Borrowing is undertaken to fill the gap between revenue and expenditure, and is not done on a project-by-project basis. Any funding from development partners or development banks is usually done on a concessional basis. The National Treasury Liabilities Management Unit oversees government's cash flow requirements, doing daily checks of all accounts.

Accounting

Provinces and national government both submit information on a monthly basis through the basic accounting system, which has been in use for 40 years in South Africa and has been adapted to address changes in the SCOA (which now has eight segments). For the past 12 years, National Treasury has been working on implementing an adapted integrated financial management information system, which is expected to be implemented within the next two years. Provincial and national departments are expected to submit information into the system on a monthly basis and to report to the National Treasury on a quarterly basis. This is part of the in-year monitoring system. The SCOA team indicated some discomfort with the use of so many different reporting models on capital expenditure between divisions. They would prefer a unified system that can meet all user requirements.

Accounting systems include both recurrent and capital expenditures, and can be structured as an economic or functional classification.

National and provincial government use a hybrid Government Finance Statistics classification, which is updated on a cash basis. The Reserve Bank of South Africa also collects and publishes provincial and national government data as part of a full Government Finance Statistics classification and the System of National Accounts. In terms of capital expenditure, it is particularly difficult to compare the budget to data in the Reserve Bank quarterly bulletin. This has to do with different sources of information (the National Treasury uses the basic accounting system; the Reserve Bank uses Statistics SA) and differences in definitions of capital expenditure among the SCOA, Government Finance Statistics and the System of National Accounts.

Reporting, reviewing and evaluating

Financial reports are submitted to the National Treasury (Accountant General) and reviewed by several entities including the IGR division, Public Finance division, the Accountant General, and Public Finance Statistics (SCOA). Performance information is also gathered and used within provincial departments, then by the Department of Planning, Monitoring and Evaluation (DPME).

In the IGR, the Provincial Budget Analysis Unit established a standardised reporting format on quarterly performance, which was agreed upon across provinces and with national departments.

The annual performance plans include annual targets and quarterly targets (in-year monitoring quarterly performance measurement). This function has been moved to the DPME, which shares information with IGR and the National Treasury. A monitoring function exists within each treasury in provinces, but this was moved to the MEC's office.

As data has improved, IGR and the DPME have started comparing financial and non-financial indicators to measure things like value for money. There is some concern that there may now be too much data and whether it is in the right format. The SCOA is standardised up to facility level five.

The IGR infrastructure team has been trying to get a sense of trends in maintenance, but this has been challenging due to different classifications of maintenance, rehabilitation and renovation between provinces.

Parliament reviews the adjustments budget, which is tabled by the National Treasury in October each year, as well as the Auditor General's reports on provincial and national department expenditure. The parliamentary committee on finance or education may request special reports on the progress of projects or programmes from time to time.

The accountability report, which is submitted to Parliament at the end of the fiscal year, outlines both recurrent and development expenditures, end-of-year information for the previous year and a mid-year review for the current year.

Presentational and legal separation

Discussion

As is set out above:

Budget presentation: The National Treasury submits two documents to Parliament with details of the distribution of expenditure in the budget preparation cycle:

- The Medium-term Budget Policy Statement, which is submitted as a pre-budget statement, in October. This document is set out by National Treasury and provides an overview of the proposed MTEF projections, and main policy and strategic priorities for the upcoming budget. It reflects expected capital and recurrent expenditures as well as a draft division of revenue.
- The National Treasury tables a budget statement (Budget Review) and Estimates of National Expenditure (a detailed book of estimates by vote) in February. These include both recurrent and capital expenditures over the MTEF period. As part of the process, the National Treasury also tables the Division of Revenue Bill, indicating the separation of national, provincial and local government. The Estimates of National Expenditure include the strategic and policy priorities of each vote, with a breakdown of expenditure and information by programme. Each programme's expenditure is detailed by economic classification for capital and recurrent expenditures.

Provinces table the Estimates of Provincial Revenue and Expenditure in February/March each year. This includes the estimates as scheduled in the Division of Revenue Act, as well as estimates of each province's revenue expenditure by vote and programme. A draft appropriation bill is also tabled with this document.

The Estimates of Expenditure underpins the Appropriation Act in accordance with the PFMA. The Appropriation Act approves amounts per vote and by main division.

Budget reporting: The Budget Review and Estimates of National Expenditure provide brief overviews of expenditure performance to date. But the main document contains reports by the Auditor General and the DPME (non-financial). The Auditor General usually submits reports to Parliament in November each year.

The National Treasury publishes a monthly expenditure and revenue performance report on its website.

Degree of public finance management decentralisation

Discussion

The section on institutional separation above addresses this issue.

Research findings

Question two

What do the results of public financial management suggest about the integration of capital and recurrent expenditure?

Part A: Under-integration

Key evidence	Discussion
Capital expenditure is not under-integrated Capital and recurrent expenditures are not separated between ministries and are therefore integrated within the same budget process.	Budget submissions are considered in total, including both capital and recurrent expenditures. Funds are allocated to national and provincial departments for capital and recurrent expenditures as part of the Appropriation Act. Departments are also responsible for managing and reporting on capital and recurrent expenditures. The National Treasury and the DPME evaluate and monitor financial and non-financial performance for both areas of spending.
Recurrent and capital expenditure is under-integrated The finding of the study is that current and capital expenditure is under-integrated. This is despite efforts by the National Treasury and the DBE to integrate processes. The following issues were identified: • Maintenance expenditure is not legislated within conditional grants for capital expenditure. • The PFMA allows provinces to apportion and appropriate the equitable share as they think best. • The PFMA allows the movement of funds within "current payments" from maintenance to goods and services or wages. • The lack of concern for "lifecycle costs" of infrastructure in past budget submissions. • The separation of functions between provincial education departments (responsible for capital projects) and the Department of Public Works (responsible for maintenance of government assets). • Tight fiscal constraints since 2008/09. • Lifecycle costs continue beyond the MTEF.	• **Maintenance expenditure is not legislated within conditional grants for capital expenditure.** Up until the 2017/18 budget, recurrent costs associated with school buildings and other projects have not been included in conditional grant allocations. This has meant that provinces have had to budget for maintenance out of the PES or own revenue, despite being expected to submit capital project budgets including all lifecycle costs. From 2017/18, 20 percent of the education infrastructure grant will be allocated for maintenance. This will be on a trial basis and may be increased in future if successful. • **The PFMA allows provinces to apportion and appropriate the equitable share as they think best.** Legislation provides that money transferred from the national revenue fund as the PES is unconditional and therefore allows provinces the flexibility to budget their resources in the best way possible to provide services. In theory, maintenance of capital assets would be part of this mandate. But there is no penalty for not doing so. • **The PFMA allows the movement of funds within "current payments" from maintenance to other goods and services or wages.** Section 43 of the PFMA indicates that accounting officers may not use a saving in capital expenditure to cover current expenditure. "Savings" may, however, be transferred within a main division or programme. Evidence from past budgets indicates that wage settlements in public service have been consistently higher than budgeted for. So provinces and national departments have often had to find additional money within existing allocations, meaning there is less money available for maintenance. Provinces may have also become too reliant on the conditional grant in sectors such as education, making no capital contribution from the equitable share or their own revenue. There is no maintenance allowance within current equitable share payments.

Key evidence	Discussion
	• **The lack of concern for "lifecycle costs" of infrastructure in past budget submissions.** The capital planning guidelines and the MTEF guidelines are recent reforms to the budget process. The insistence on including maintenance and lifecycle costs in budget submissions has also been a recent development in the past two to three years. Understandably, there is still a way to go to institutionalise these practices within the budget process. Historically, South Africa has also funded some capital projects that are of high strategic priority, regardless of the quality of budget submissions into the MTEC process. The biggest challenge facing education in particular is backlogs in maintenance. Maintenance projects are often reclassified as capital due to the cost, size or magnitude. The DBE is grappling with the issue of lifecycle maintenance costs – for example, when a new school is built it quickly deteriorates due to lack of planning. • **The separation of functions between provincial education departments (responsible for capital projects) and the Department of Public Works (responsible for maintenance of government assets).** The Department of Public Works is responsible for maintaining public infrastructure, including schools. But not all provinces have to use the department for building maintenance – some have contracted outside parties because of the department's poor delivery. Most of the backlogs in school infrastructure are in the Eastern Cape, while the Western Cape is able to carry out projects, can access the indirect grant and self-implement. While the Western Cape still has the most inappropriate infrastructure in the school system, second to the Eastern Cape, the province still has a good relationship with the Department of Public Works. In most cases, the DBE has taken ownership of assets because the Department of Public Works lacks capacity. • **Tight fiscal constraints since 2008/09.** In 2007/08, South Africa had a budget surplus of 1.7 percent of GDP at consolidated government level. Due to its exposure to global economic events and a resulting recession, the budget balance widened to a deficit of 1.1 percent in 2008/09 and 6.5 percent in 2009/10. Since then the deficit has remained between 3 percent and 5 percent of GDP and government has been focused on reducing growth in government expenditure. This means a significant portion of budget expenditure has been reallocated between votes and functions. The National Treasury has been clear in its aim to maintain capital expenditure to support economic growth. However, there is now less money available for maintenance, with rising pressures on wages and other government priorities. Between 2005/06 and 2008/09, real growth in consolidated government expenditure averaged 8.2 percent. This was based on large additions to expenditure following high tax collections and lower debt service costs. The Budget Office intimated that during this time of plenty, maintenance was not considered a risk to government expenditure because there was additional funding available to supplement budgets to address maintenance backlogs, regardless of the size and need. • **Lifecycle costs continue beyond the MTEF period.** In line with South Africa's fiscal constraints, the Budget Office indicated that challenges exist for government to "set aside" funds for maintenance beyond the MTEF period. This is a challenge even in year two and three of the MTEF, given the focus on reducing the fiscal and primary deficit, rising debt service costs (currently growing faster than expenditure in real terms), the threat of a sovereign rating downgrade, poor economic growth and poor performance in revenue.

Part B: Integration

Key evidence	Discussion
Capital expenditure is integrated; specific procedures allow projects to be managed appropriately Capital expenditure is integrated within the baseline and additional allocations to ministries, departments and agencies. The Public Finance team recently requested departments to submit more representative information for capital projects. With this, appropriations for capital projects are now made in total (not annually) to cover their lifecycle costs; cash flow is determined by the pace of project rollout. This makes allowances for project delays and reduces underspending each year. The capital planning guidelines also require extensive information as part of the budget submission on capital. The guidelines are largely adhered to, so approved projects are underfunded. However, delays may occur, but this is on account of the lack of capacity of provinces and national departments to implement projects.	Evidence from interviews on performance of capital expenditure The IGR division believes that the National Treasury's supervision and incentives encourage better quality in capital projects – essentially, what the National Treasury pays attention to, departments pay attention to. Many IGR reforms deal with their supervisory function. IGR believes it has done well on a macro level but more needs to be done in terms of proactive supervision at the sectoral level. The infrastructure reporting model, introduced in 2015/16, is a web-based database where provincial project and budget managers can update the progress of projects and spending. The National Treasury uses this as a check against budget submissions and provincial B5 schedules, which are related to the Appropriation Act for a particular year. This allows IGR to alert the MoF and MEC to areas of expected underspending or delay. The idea is that an alignment between B5 schedules and the infrastructure reporting model would capture cash flows to determine where spending is happening (this would inform reports to Parliament on budgeted projects and non-tabled projects). National departments appear to be reluctant to withhold payments due to non-delivery, and the National Treasury is relying on supervisory institutions to correct behaviour. GR faces many challenges in terms of the final stages of projects, which remain unfinished because the "snag lists" of provinces often are not signed off. But there is still incentive, because departments continue to receive funds as long as the project remains uncompleted. IGR is looking to the chief procurement officer to provide guidance on how best to solve this problem. According to the Budget Office, most of the underperformance on spending and cost escalation is in relation to mega projects, such as those involving power utility Eskom. Standard processes in national departments ensure that underfunding rarely occurs. The planning and rollout of projects cause delays, which leads to underspending within a year but generally not over the lifecycle of the project. In the past 10 to 15 years, there has been greater real growth in capital spending, especially at local government level. Spending capacity usually trails the budget allocation, but over the past decade, South Africa has moved from spending levels of 60 percent to 90 percent. This has been a process of "learning by doing". The infrastructure reporting model includes the three-year MTEF period plus five years, but IGR analysts have found that data is poorly estimated or non-existent for the outer years – data is captured up to the delivery of an asset rather than throughout its lifespan. Implementation is also siloed in provinces. Capital teams rarely consult budget teams on available equitable share for projects. IGR and Public Finance are working on reviewing the PES formula.

Question three

What evidence is there of the Ministry of Finance's coordinative capabilities, and what contribution can be made to the integration outcomes observed?

Assessment dimensions

Discussion

Step 1: Identify the need for coordination to integrate capital and recurrent expenditures

Determine the need for coordination

While the capital and recurrent budgets are well integrated within the budgeting and planning processes, the lack of coordination and integration of these aspects is apparent in the execution of the budget and at the decentralisation stage.

The Budget Office requests capital and maintenance expenditure as part of the budget submissions for the MTEC, which is detailed in the capital planning guidelines. However, the office is concerned that the recurrent costs of construction are not fully or properly accounted for. Overall, maintenance budgets are often very low. The team suspects this is an analytical capability issue and has to do with correct calculation of maintenance costing. Even when the costing of a project's lifecycle has been included in the guidelines, there is no system to check that the submitted information is correct, and evidence shows that spending on this is low or non-existent. The Budget Office believes its team can do a lot more to assess the quality of budget submissions, particularly maintenance costs over the lifecycle of a project. Assessment of maintenance trends is challenging for National Treasury staff because each province has a different definition of maintenance, rehabilitation and renovation. The Public Finance Statistics and SCOA teams are working on this.

There is close coordination within the National Treasury across its units. School buildings are covered by the education infrastructure grant, so this sector is less of a concern than others. However, to date, maintenance expenditure has been taken from the PES and provincial own revenue. From 2017/18, 20 percent of the education infrastructure grant will be dedicated to maintenance, on a trial basis. According to the budget team, the aim is to increase this portion to 25 percent. Over the past two years, there has been more consideration of the performance of maintenance expenditure when departments apply for disaster relief funding. The standards for assets are set by the Department of Cooperative Government and Traditional Affairs, and if it is determined that assets were destroyed due to poor maintenance, funds are not paid out.

The National Treasury (Budget Office, Government Technical Advisory Centre and provinces [IGR]) provides considerable capacity-building, technical and budget support to those involved in capital and infrastructure spending analysis and planning. Infrastructure is a political priority, which often implies there is little consideration for broader issues such as maintenance or the recurrent costs of managing buildings such as hospitals or schools. This is a problem for sustainability and returns on investment. Maintenance costs also escalate with higher enrolment in schools. The inability of the Department of Public Works to maintain assets is a concern. There is also a lack of coordination between the DBE and the Department of Public Works to maintain buildings, and within provincial departments, between the project manager and budget manager.

The constrained fiscal environment limits the number of extraordinary capital projects by public entities or development partners outside of the budget process. This is because there is insufficient capacity to plan for the integrated recurrent costs of sustaining these investments and for departmental budgets to do so. It is also challenging for the National Treasury to budget beyond the MTEF in the current fiscal environment. According to the deputy director general of the Budget Office, the fiscus needs to be flexible so that it can evolve as problems occur. Following the financial crisis, it has become necessary to apply more scrutiny to maintenance.

The level of detail required in provincial budget submissions is less rigorous than National Treasury guidelines usually dictate. The DBE works closely with provinces to update its submissions for the public finance team and MTEC process.

Step 2: Gather evidence of the MoF's capability to coordinate

Has the MoF set a common goal of integration that is achievable?

The legal framework gives the Minister of Finance the power to determine the budget process, and agree on budget allocations and the format of the budget submissions. The minister is mandated to propose the allocations to Parliament after agreement by Cabinet. The Constitution provides for the allocation of provincial and local equitable shares from the national revenue fund. Provinces and municipalities can decide on how this funding is spent. The National Treasury therefore only has the ability to integrate information on maintenance and capital as part of the budget planning and allocation processes. It can dictate on implementation at provincial and local levels if funds have been appropriated as part of a conditional grant.

The evidence points to good coordination within the National Treasury between divisions and units. Public Finance and IGR have also spent a lot of time developing good relationships with their counterparts in provincial and national departments. But it is apparent that

this may not be the case in every sector. The Public Finance team in education has remained relatively unchanged for more than 10 years and has a lot of institutional memory. Also, the ego and personality of individuals seem to have a significant influence on how well coordinated interdepartmental work is.

The goals to include lifecycle costs and provide for maintenance as part of the conditional grant are both recent developments. This may be the result of the tight fiscal environment and the growing need to sustain existing investments where possible and consolidate new infrastructure projects. This was not discussed in detail during interviews. It is certainly an important issue for the National Treasury and national departments, but it unclear if this view of maintenance is shared at all levels of government. This could be a result of poor capacity and skills at decentralised government level, corruption, or that the list of priorities outweighs the amount of money on hand, which is also an issue at national level.

What mechanisms has the MoF put in place to manage the dependencies between activities

This is addressed in the section on reporting, reviewing and evaluating under question 1. Also, refer to the information on disaster relief funds under question 3.

Step 3: Argue contribution

0Can evidence of successful or unsuccessful integration be partly attributed to MoF's attempts at coordination?

Initiatives by the National Treasury such as the IDIP and the infrastructure reporting model both point to successful attempts to coordinate the integration of recurrent and capital spending. However, the efficacy of these initiatives comes into question when provinces have to input information and identify needs. This may not be an issue for all provinces, just those where there is reduced capacity, legacy development issues, and strong political influence.

Reforms by the SCOA team also indicate that a lot of work has been done to capture the right kind of information to inform evaluation and monitoring activities, and future budget processes. But the fact that each "system" (infrastructure reporting model, SCOA, Budget Office, or capital budgets) is unique and they do not necessarily talk to one another still poses a challenge to the National Treasury.

Question four

Which factors – internal or external, technical, or political/institutional incentive factors – determine the Finance Ministry's ability to coordinate the integration of capital and recurrent expenditure?

What coordinative contribution – the ability to resolve dependencies in integrating capital and recurrent expenditures – has the Ministry of Finance made in terms of regulatory, analytical and delivery capacities?

Discussion

The National Treasury's regulatory capability to set the budget process is well recognised. This formal capability means the rules it lays down are abided by. The PFMA has also increased its regulatory capability by imposing penalties on lack of compliance and financial mismanagement. Players across the system recognise the ministry's authority and quote the legal basis for it.

The ministry is effective in its ability to engineer a budget process and put in place a set of rules that will allow integration. The single budgeting system and high level of consultation and transparency throughout the process means the incentives for compliance are built into the system, explicitly or implicitly. Recent developments in South Africa's political environment have also forced the National Treasury to follow the "rules" more conscientiously. Therefore, the ministry does not allocate funds outside of the process because it is aware that a slip-up could mean a loss of power in the system that could negatively affect budget credibility.

The National Treasury guidelines provide information on the form in which estimates should be prepared.

In terms of the structure of programmes within education, Public Finance indicated that it would prefer them to represent spending areas more closely. The existing programme structure reflects the original services of the department and has remained in place, despite several changes to the structure of the department over many years.

The National Treasury and the DBE have published standards and norms to inform infrastructure and school buildings. The IGR and Public Finance divisions have more analysts per sector than most provincial departments. In some provinces there may be only one budget analyst working on all social sectors, while the Public Finance team working in the education sector has at least three people. This is in addition to IGR functions in infrastructure, IGR analysts in each province, Budget Office teams in capital and expenditure planning, and the DPME working in monitoring and evaluation. The National Treasury therefore has strong analytical capability in each sector and aspect of the budget.

In terms of delivery, the National Treasury also measures well when it comes to budget allocations and appropriations. The ministry is not measured on implementation and execution as these do not fall within its mandate. The improvement in spending capacity by provincial and national departments over recent years also points to the success of the National Treasury's capacity-building initiatives. This has also improved delivery capability.

How does the MoF's capacity (inputs over which it has control) contribute to or detract from its coordinative capability?

Discussion

The budget group in National Treasury coordinates budget planning and proposals. The group is made up of the Budget Office (infrastructure budgets in fiscal policy and the capital projects, public-private partnerships, and international development cooperation), IGR (provincial and local government analysis and provincial infrastructure) and Public Finance (divided by sector or function). Each unit is staffed with highly skilled professionals who engage in substantial analysis and relationship-building with relevant sectors.

The National Treasury has also done a lot of work to improve capacity within sectors. This has included extensive training in changes made to the SCOA, IDIP and the infrastructure reporting model. It has also intervened in instances where skills or funding are inadequate. Through its conditional grant programmes or IDIP, it works with provinces to build capacity and improve service delivery.

As part of the budget process, the National Treasury provides comprehensive guidelines at the start of the calendar year and continues to engage with local, provincial and national departments in the run-up to the budget policy statement and budget. It also discusses the fiscal policy stance, economic outlook, and budget proposals with the Ministers' Committee on the Budget and Cabinet on more than one occasion, and engages with supervisory institutions such as the National Assembly and parliamentary committees, as well as the National Council of Provinces and civil society.

Part of the budget process involves presentations of both the policy statement and budget, following tabling in Parliament, to the National Economic Development and Labour Council secretariat. This council is a social dialogue platform that brings together government, business, trade unions and civil society to discuss policy and legislation before these are presented to Parliament. Over the past three or so years, Parliament has been setting up a parliamentary budget office, which will act as another supervisory institution once it is fully capacitated.

Internal political/institutional factors

Discussion

The National Treasury's support for integration has been weakened in practice by significant and frequent changes in staff since the departure of Minister Trevor Manuel and the major political challenges that the National Treasury has faced over the past two or so years.

Changes in staff have involved senior officials with substantial institutional memory moving units (outside of the budget process) and transferring to other institutions such as the Reserve Bank or the private sector. While there have been competent junior staff available to pick up the slack, they often lack the institutional memory and reputation to negotiate on hard policy and allocative issues. However, it is apparent that National Treasury staff members are aware of the importance of working towards one credible budget outcome, despite internal disputes or shortfalls. Respondents did not cite cases of individuals trying to undermine the budget process or the National Treasury's mandate internally. All employees appear to support the Minister of Finance and the director general.

External technical factors

Discussion

Issues of capacity in national and provincial departments to plan for and spend on maintenance and capital in an integrated manner have been discussed in detail. A summary of key factors are:

- Lack of capacity to accurately assess the lifecycle cost of capital projects, including all relevant recurrent items.
- The separation of sector analysts and budget managers at provincial level. The National Treasury also has far more analysts than any provincial department, with several provincial sector analysts responsible for more than one sector.
- Different definitions of maintenance, refurbishment and renovation in different provinces. This is also related to SCOA training that may not be passed on to the relevant data managers.
- Fiscal constraints result in trade-off pressures in current payments at national and provincial level. Departments often shift funds from maintenance to cover wages (particularly when wage settlements are higher than expected).

External political factors

Discussion

While the National Treasury's formal mandate fully supports integration, its mandate is weakened when announcements are made outside of the budget process. There have been instances when announcements have been made by other ministers or by the President in his state of the nation address that then need to be added to the budget. The National Treasury will not necessarily include every announcement that occurs outside of the formal process. The decision depends on how the addition relates to the medium-term strategic framework and national priorities for inclusive growth and development.

Over the past few years, the National Treasury has faced increasing political pressure on several fronts. This is said to be related to personal vendettas within the ruling party as well as a lack of spending on "priority" areas. The pressures are seen to be an attempt to undermine the National Treasury's mandate, and reduce its power within the allocation process and policy environment. This has filtered through to officials to some degree. The Public Finance team has noticed changes in the representation of departments at MTEC meetings. In the past, departments sent sector analysts and experts or the director general to negotiate budget allocations. According to the Public Finance team, departments are increasingly sending their chief financial officers to negotiate. This means discussions have become much more about financial matters rather than the strategic priorities of programmes because chief financial officers are not always well versed in the service-delivery outcomes of their departments.

Teams also intimated that there was a growing lack of respect for treasury officials at certain levels among sectoral ministries, departments and agencies. In the past, the director general of education, for example, would have been comfortable with meeting the chief director from Public Finance or IGR dealing with its sector's matters. As political pressure has grown, these meetings rarely take place. If they do, they are undermined by follow-up meetings between the director general of education, for example, and the National Treasury's director general (or in some instances at ministerial level). National Treasury employees see this as an attempt to bypass the budget process in order to receive allocation requests through networking or high-level official negotiation.

While this may seem concerning, it is well-established that the Minister of Finance is still a senior minister in the Cabinet and has significant political power. To a large degree, the minister is able to reject unaffordable policies or expenditure outside the strategic priorities of government. This power is supported by the National Treasury's regulatory and delivery capability. Respondents on the margin reported that there will always be some politically driven projects. These, however, would be the exception rather than the rule.

South Africa is also fortunate that it still has some of the strongest and well-developed institutions on the continent. The Constitution, PFMA and related legislation are adhered to despite attempts to bypass them. Supervisory institutions such as the Office of the Auditor General and Parliament are also well established and respected.

Therefore, the integration of recurrent and capital expenditures is usually undermined at a technical and execution level, not necessarily through the political process.

Conclusion and lessons learnt

Question five

How has the Ministry of Finance adjusted factors within its control to boost its ability to coordinate capital and recurrent expenditures under different circumstances? What are the lessons? What policy advice can be derived from the study?

Discussion

Details are provided in previous sections on the adjusted factors to boost coordinative capability and better spending performance on recurrent and capital items, as well as the incorporation of lessons learnt over several years in developing capacity and better monitoring and evaluation of spending.

Some of the key findings from the study in South Africa includes the following:

- Very few procedures around the management of databases and interaction with departments throughout the budget process have been documented. This means much of the process is reliant on institutional memory, egos, personalities and relationships to ascertain the best possible outcome.
- There is a plethora of legislation, databases and forums that have been developed to ensure that integration takes place at the budget planning and allocation stages. The system lacks incentives on the implementation and execution side. This may be a problem in terms of the capacity of government or the ability of various institutions to hold departments to account on spending behaviour.
- While the National Treasury has undertaken several training initiatives, there are still large gaps. This indicates that training is not reaching the appropriate people in departments, there is a lack of incentives, or the challenges facing implementing agents go beyond a lack of skills. It may be worthwhile for the National Treasury and a subsection of provincial officials to work together to identify causes of problems around the integrated implementation of recurrent and capital expenditures.
- The effective implementation of recurrent and capital expenditures may also benefit from the National Treasury engaging more at the departmental and sectoral level of provinces. These engagements should be more informal than presentational. Sectoral officials should be given the opportunity to voice their thoughts and ideas, and the National Treasury should try to communicate its reasons for allocations and intended outcomes of spending areas. All stakeholders would then be on the same page in terms of service delivery goals.
- Staff retention was cited as an issue, with “good” people being poached between departments at provincial level. The policy response to this kind of practice is unclear. It could be counteracted by a targeted programme to employ a skilled official in each sector, thereby diminishing the need to rotate skills among units and departments.