Optimization of Limpopo Provincial Budget- a micro economic analysis

Dr JW Mostert[1]

Limpopo Provincial Treasury

Abstract

South Africa has been known to implement sound fiscal policy since the early days of the new democracy.

Minister Manual managed to reduce the debt burden to quite acceptable levels, which in turn reduced the interest payments in government debt. The percentage of revenue to GDP was also to close to the implicit target of 25%.

In the recent financial years rating agencies and other participants in the economy started to raise their concern regarding the increase of debt to GDP and the corresponding increase in debt repayments. To address these fears the Minister of Finance indicated that National Treasury will ensure that the budget on a macro level improves to more acceptable norms and standards.

The recent downgrade just added to the problem. his will lead to further budget cuts on provincial level.

These budget cuts on provincial level leads to difficult policy choices because the needs and demands on the provincial budget keeps expanding. The solution to the

[1] The views expressed in this paper is that of the author and not necessarily those of the Limpopo Provincial Treasury.

problem is to optimize the expenditure to ensure maximum efficiency and effectiveness.

In the first part of the paper a brief overview will be provided about the fiscal developments in South Africa since 1994. It will be indicated that the budget allocation on macro level is sound but the concern is on the micro economic efficiency.

A questionnaire was administered at the 10 departments in the Limpopo province to determine the percentage premium that Provincial government is paid for goods and services. The results are that provincial government can save at least 10% on its procurement budget. This will free an additional R6 billion rand of budget to reprioritize for other priorities than health, education and social development.

The conclusion is that considerable scope exists to optimize expenditure on a provincial level.

Introduction

South Africa has been known to implement sound fiscal policy since the early days of the new democracy. Minister Manual managed to reduce the debt burden to quite acceptable levels, which in turn reduced the interest payments in government debt. The percentage of revenue to GDP was also to close to the implicit target of 25%. In the recent financial years rating agencies and other participants in the economy started to raise their concern regarding the increase of debt to GDP ratio and the corresponding increase in debt repayments. To address these fears the Minister of Finance indicated that National Treasury will ensure that the budget on a macro level improves to more acceptable norms and standards. The recent downgrade just added to the problem. This will lead to further budget cuts on provincial level.

These budget cuts on provincial level leads to difficult policy choices because the needs and demands on the provincial budget keeps expanding. The solution to the problem is to optimize the expenditure to ensure maximum efficiency and effectiveness. In the first part of the paper a brief overview will be provided about the fiscal developments in South Africa since 1994. It will be indicated that the budget allocation on macro level is sound but the concern is on the micro economic efficiency.

A questionnaire was administered at the 10 departments in the Limpopo province to determine the percentage premium that Provincial government is paid for goods and services. The results of this study will be reported in the second part of the paper. The paper will conclude with some recommendations on the impact of the research for the provincial budget allocation in the Limpopo province and South Africa in general.

The Developments in fiscal policy since 1994

In this part of the paper an overview will be provided on the developments in fiscal policy on a national and provincial level. The development in fiscal policy must be evaluated against the economic situations at that stage as well as the policy prescriptions then.

After the slow growth of the 1980's the most important policy issue was that of fiscal sustainability. It was also important that South Africa showed that the fiscal policy will be sustainable after the high budget deficits of the early 1990's

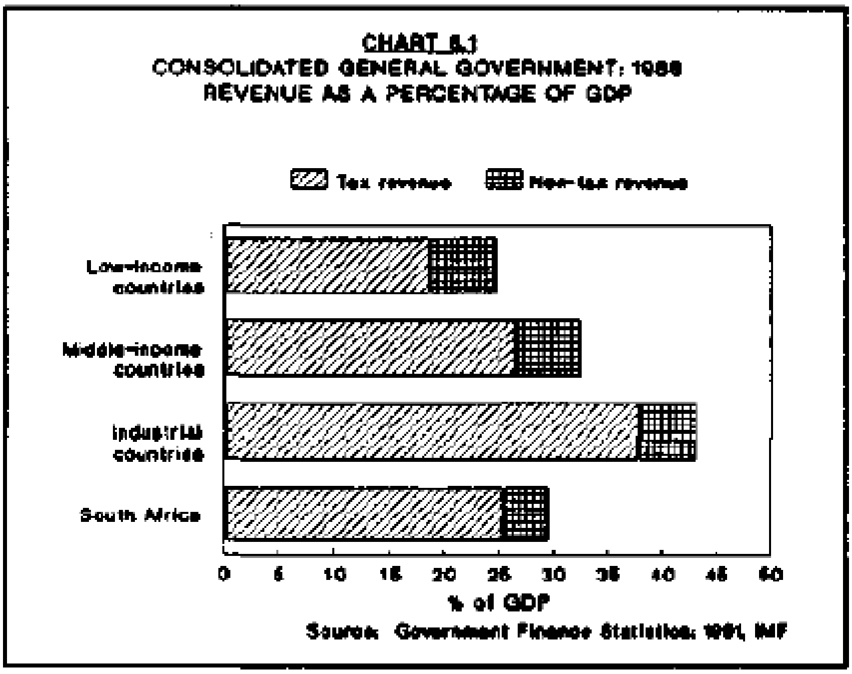
During the early 1990's research was conducted into the issues that needs to be addressed by National Treasury in terms of fiscal sustainability. According to the Budget Review (1993) it was agreed that the level of consumption expenditure by Government will have to decline. It was also agreed that the deficit will be limited to smaller than the level of capital investment. Other issues that was highlighted was the focus on increase expenditure on high priority infrastructure in specific fields and to pay attention to the nature of the service is terms of socio economic development.

In reality it was much more difficult to implement the recommendations. Because of the recession during 1992 revenue collected was much lower than anticipated with the budget deficit ending at 8,6% of GDP. During the 1992/93 budget debt servicing cost was 14.8% of total expenditure and it increased in the 1993/1994 budget to 17,4%.

During the 1993/94 fiscal year the total debt of government, as published by the Reserve Bank, increased by R37.5 billion, which was an increase of 24,2% (Budget Review,1994).

The concerns regarding the budget deficit and the total government revenue caused the National Treasury to compare South Africa with other middle income countries in terms of revenue levels. The total revenue to GDP ratio for different countries in 1988 is indicated in Fig 1

Fig 1 Consolidated general Government revenue as a percentage of GDP



Source Budget Review, 1993

From the graph it is clear that South Africa total revenue to GDP in 1988 was 29,6% which is lower than the average for other middle income countries. The average revenue to GDP ratio was 32,5% 1993/1994 budget deficit 6,8% of GDP. The conclusion was that government is not making an unnecessary demand on the local economy in terms of utilizing resources.

Due to the decline in real GNP per capita of over 10 per cent during the 1989 to 1993 recession, the key policy focus, in the 1995/96 budget, was to ensure sustainable growth.

The following has been identified as key issues to be addressed to reach higher levels of economic growth (Budget Review,1995):

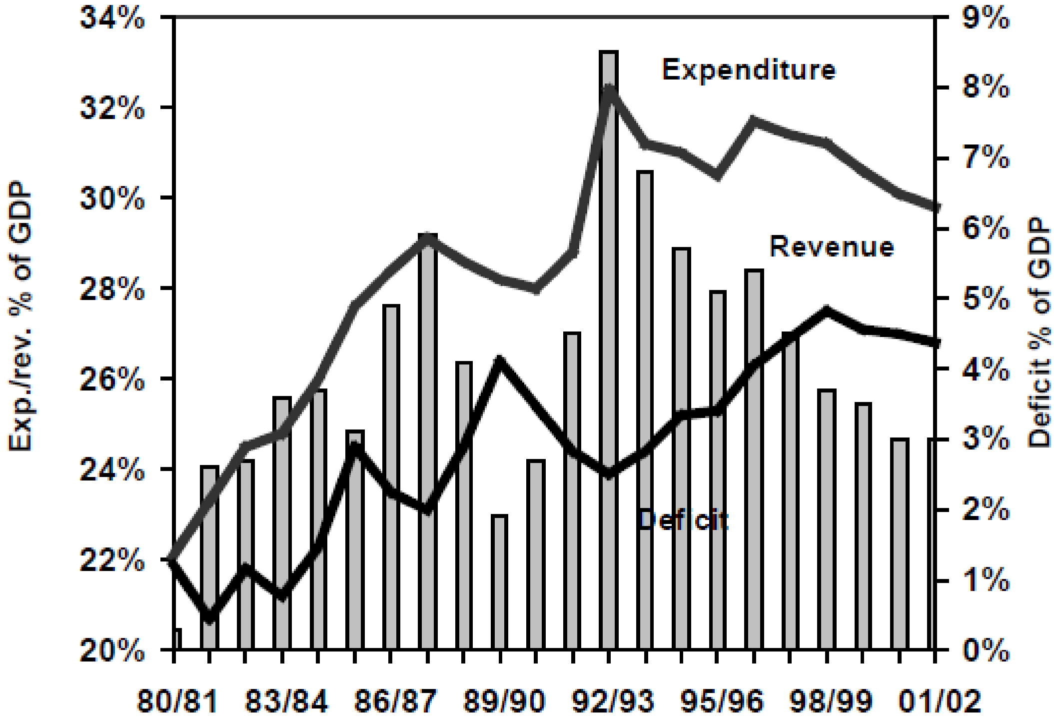
- An increase in investment spending in the economy with a focus on housing development and the expansion of the manufacturing capacity of the economy;
- The savings performance of the economy should be improved. This includes the contribution of the general government to the savings performance in the South African Economy
- The trade and industrial policy should focus on the enhancement of exports
- Foreign capital inflows will be important to help to finance the deficit on the current account. The deficit on the current account is a result of the domestic expansion that was expected then.
- Careful domestic demand management was needed to avoid too much inflationary pressure and pressure on the balance of payments.

Based on these broad policy objectives the new government stated in 1995 that the intention is to reduce the budget deficit. The target that was agreed to was that the deficit should be reduced to less than 4% in the 1998/99 fiscal year (Budget Review,1995). This reduction in the deficit was based on the assumption that GDP growth will be an average of 3% per annum. The government highlighted the importance of keeping inflation under control to assist to reach this target.

In terms of revenue, the total revenue from the provincial and national government as percentage of GDP was 24,6% in the 1993/1994 financial year. The target of government revenue not exceeding the implicit target of 25% of GDP was then accepted in the 1995/96 budget.

It was decided that the adjustment to reach the revenue target should be on recurring government expenditure. It was decided that the additional revenue that was expected will not be used to increase government expenditure. Government also planned to reduce it level of consumption expenditure over time from 21% to 17% of GDP. Government also planned to increase its contribution to social and economic infrastructure from the 2% of GDP in 1995 (Budget Review, 1995)

Fig 2 Fiscal developments since 1992



Source: (Budget Review, 1995)

Fig 2 shows the development in the fiscal situation since the 1980's. Due to the recession in 1992 the deficit reached an all time high of 9.2% of GDP. The level of expenditure to GDP also reached a high in 1992/1993 of 34% of GDP but the situation both in terms of expenditure and revenue improved over time.

During 1999/2000 it was also expected that the expenditure and revenue position will improve in the outer years. This expectation of an improvement in the fiscal situation in South Africa actually realized as indicated in table 1

Table 3.1 Key fiscal indicators – 1995–2004

Percentage of GDP	1995	1999	2000	2001[1]	2004
Government consumption expenditure	18,3	18,4	18,0	18,1	18,3
General government saving	-4,2	-2,3	-2,3	-0,8	0,0
Interest on public debt[2]	5,9	6,2	5,8	5,5	5,0
General government tax revenue	24,1	27,0	26,1	26,8	26,0
	1995/96	**1999/00**	**2000/01**	**2001/02**	**2004/05**
Public sector borrowing requirement	5,0	0,6	0,9	0,5	1,7
Main budget deficit	4,5	2,0	2,0	1,4	1,7
	1990-1994		**1995-1999**		**2000-2004**
Gross fixed capital formation by general government (average annual real growth)	-8,6		4,2		5,1

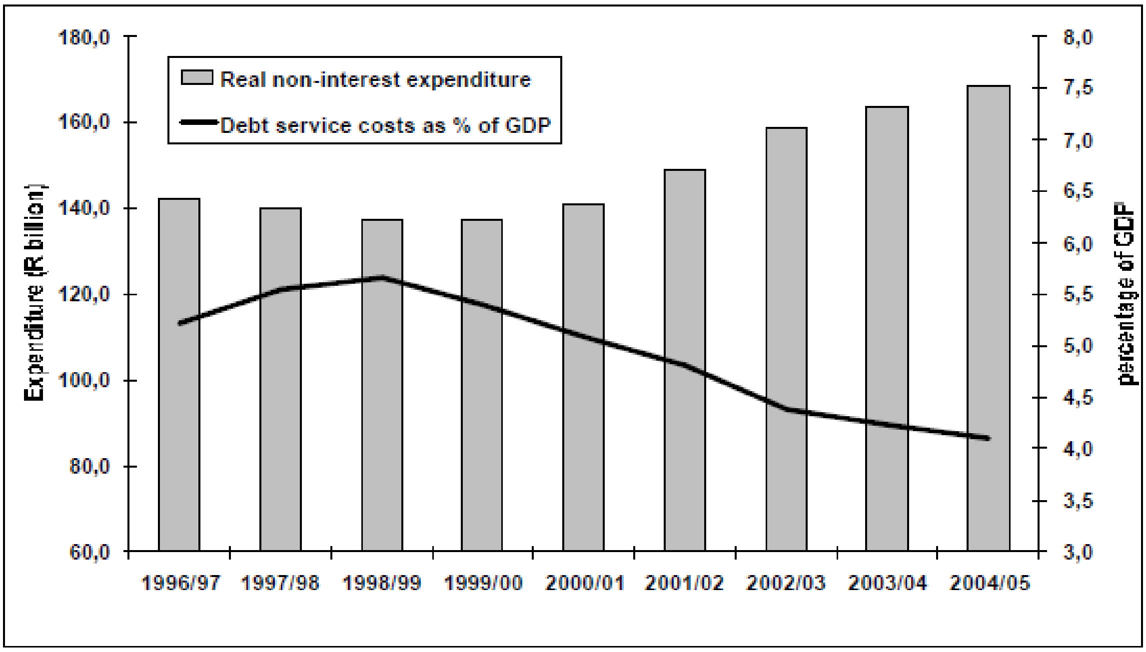
1 2001 figures are based on three quarters of data.

2 Including amortisation of discount.

Source Budget review (2005:47)

From Table 1 it is clear that the Treasury managed to reduce the dissaving from 4.2% to an expected 0% in 2004. The public sector borrowing requirement also reduced from 5% of GDP in 1995/1996 to only 1,7% in 2004. Government also managed to turn around the situation in terms of gross fixed capital formation.

The positive trend in debt service cost is also clear from fig 3

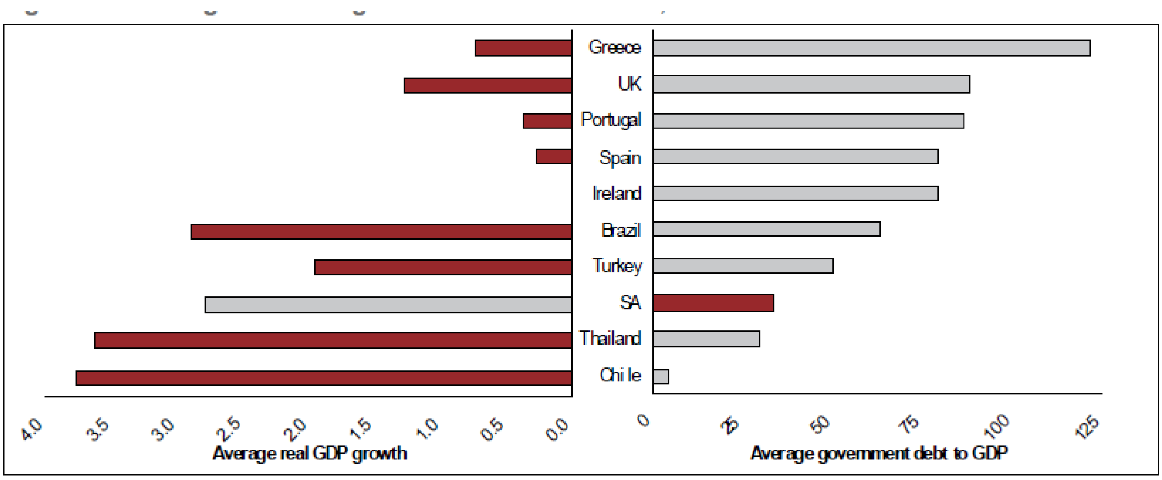


Source: Budget Review, 2005:52.

The fiscal situation during the growth years of 2004 to 2007 consolidated at the same levels. The first major challenge for fiscal policy was the global crisis of 2009.

The low debt level enabled the South African government to respond to the global downturn by increasing borrowing. Because of the relative low basis, the level of debt was still acceptable, even after the contra cyclical stimulation of the economy. This is indicated in Fig 4

Fig 4 Average GDP Growth and average government debt to GDP

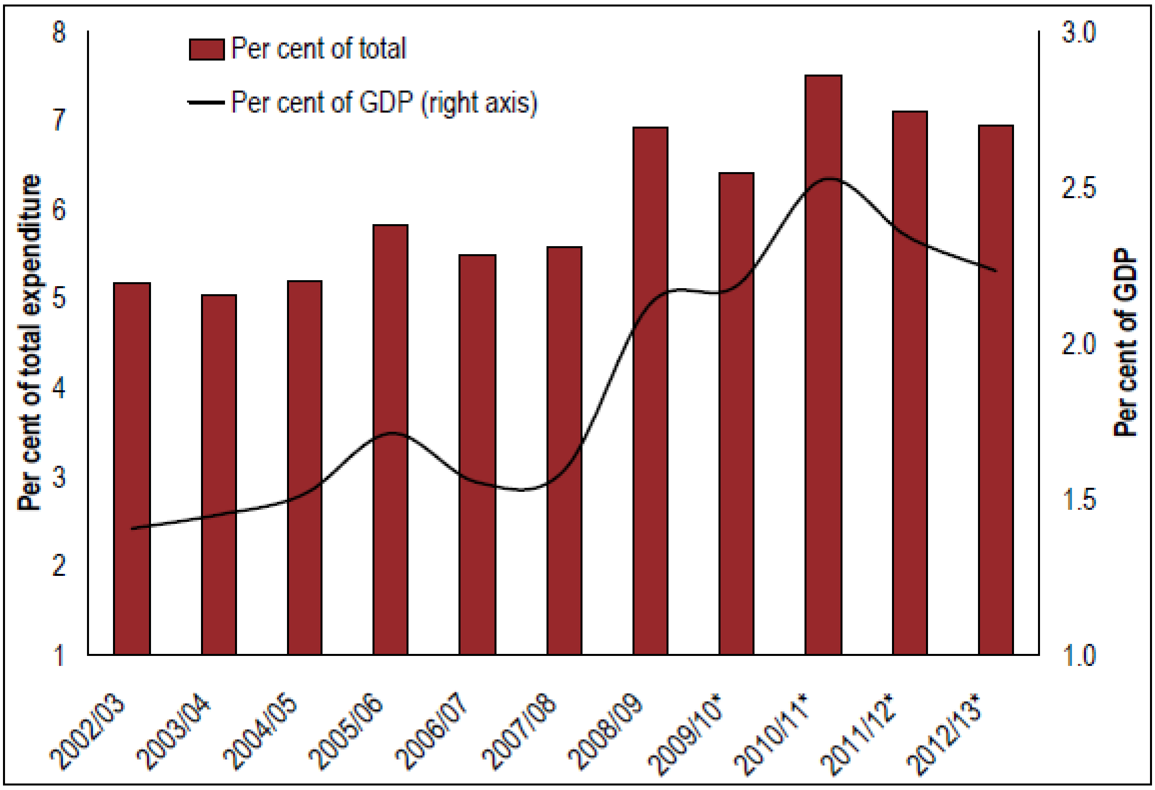


- Consolidated government spending grows to 34.1 per cent of GDP in 2009/10, before declining to 32.1 per cent by 2012/13, with additional allocations to the main budget of R86.7 billion.
- Consolidated government budget revenue increases to 27.3 per cent of GDP in 2010/11, compared with 26.8 per cent in 2009/10.
- The consolidated government budget deficit improves over the medium term, from 7.3 per cent of GDP in 2009/10 to 4.1 per cent by 2012/13.
- Consolidated government debt-service costs increase from 2.4 per cent of GDP in 2009/10 to 3.2 per cent in 2012/13.
- The public sector borrowing requirement rises to 11.1 per cent of GDP in 2010/11 before moderating to 7.1 per cent by 2012/13.

Table 4.1 Consolidated government fiscal framework, 2006/07 – 2012/13

R million	2006/07	2007/08 Outcome	2008/09	2009/10 Revised estimate	2010/11	2011/12 Medium-term estimates	2012/13
Revenue	**541 224**	**627 669**	**689 672**	**657 552**	**738 404**	**827 742**	**922 278**
Percentage of GDP	*29.5%*	*30.2%*	*29.7%*	*26.8%*	*27.3%*	*27.9%*	*28.0%*
Expenditure	**518 447**	**593 269**	**713 890**	**835 324**	**906 964**	**977 361**	**1 058 622**
Percentage of GDP	*28.3%*	*28.5%*	*30.8%*	*34.1%*	*33.6%*	*32.9%*	*32.1%*
Budget balance	**22 777**	**34 400**	**-24 218**	**-177 773**	**-168 560**	**-149 619**	**-136 344**
Percentage of GDP	*1.2%*	*1.7%*	*-1.0%*	*-7.3%*	*-6.2%*	*-5.0%*	*-4.1%*
Gross domestic product	*1 833 191*	*2 081 626*	*2 320 117*	*2 449 858*	*2 699 888*	*2 967 560*	*3 295 749*

Fig 5 Debt to expenditure and GDP



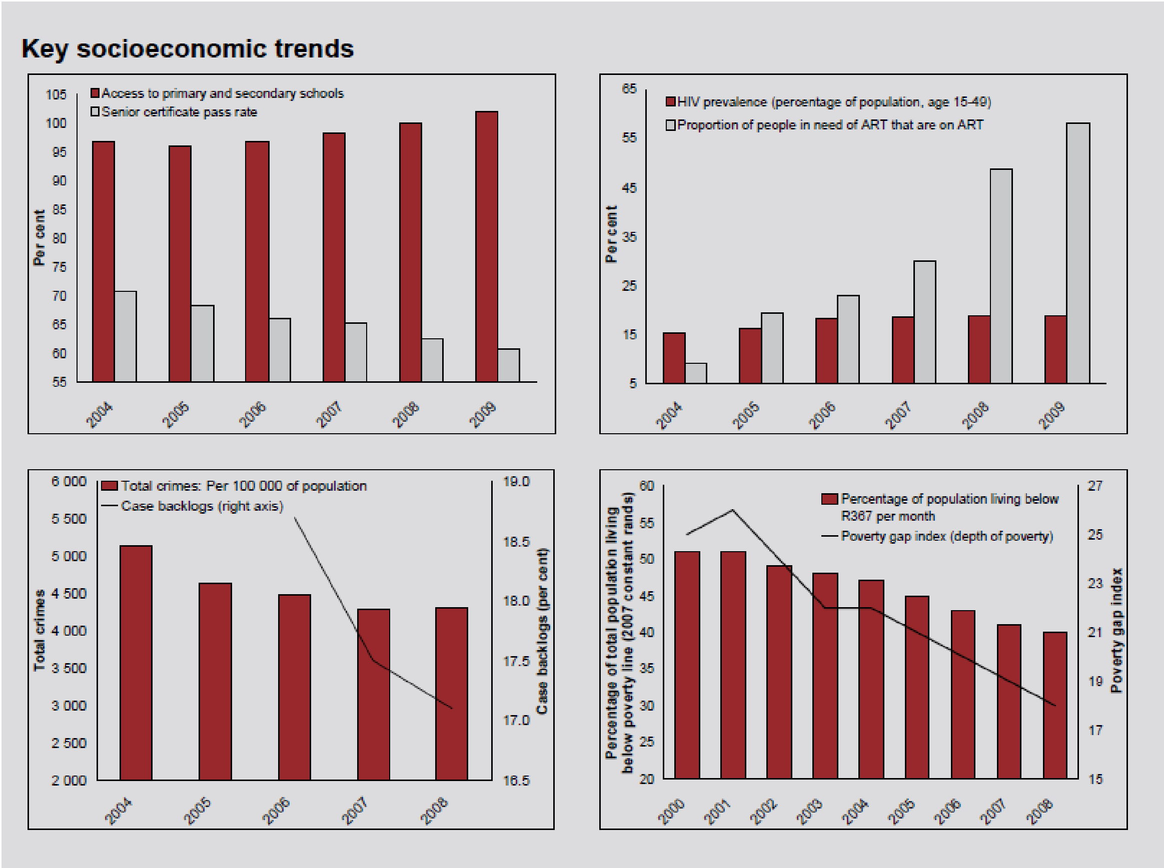
** 2009/10 – 2012/13 are based on forecasts.*

The government however realized that the expenditure does not achieve the required outcomes as expected during 2012. They have decided to adopt the outcomes based approach to planning in government. This will now be discussed

.

The outcomes based approach to planning in government.

Fig 6 Key socio economic trends



Source Budget Review 2010:116

It was therefor decided to re-allocate the budget to achieve the following 12 outcomes:

Outcome targets: 2010-2014

1. Improve the quality of basic education
2. Create decent employment through inclusive economic growth
3. Develop a skilled and capable workforce
4. Improve health care and life expectancy among all South Africans
5. Build a safer country
6. Support an efficient, competitive and responsive economic infrastructure network
7. Develop vibrant, equitable and sustainable rural communities that contribute to adequate food supply
8. Protect our environment and natural resources
9. Create sustainable human settlements and improved quality of household life
10. Build a responsive, accountable, effective and efficient local government system
11. Create a better South Africa, a better Africa and a better world
12. Generate an efficient, effective and development-oriented public service and an empowered, fair and inclusive citizenship.

The fiscus managed to obtain savings of R112,2 billion over the MTEF from the different departments to refocus their expenditure to the 12 outcomes away from non core items like overseas travel etc.

Fiscal policy 2012-2017

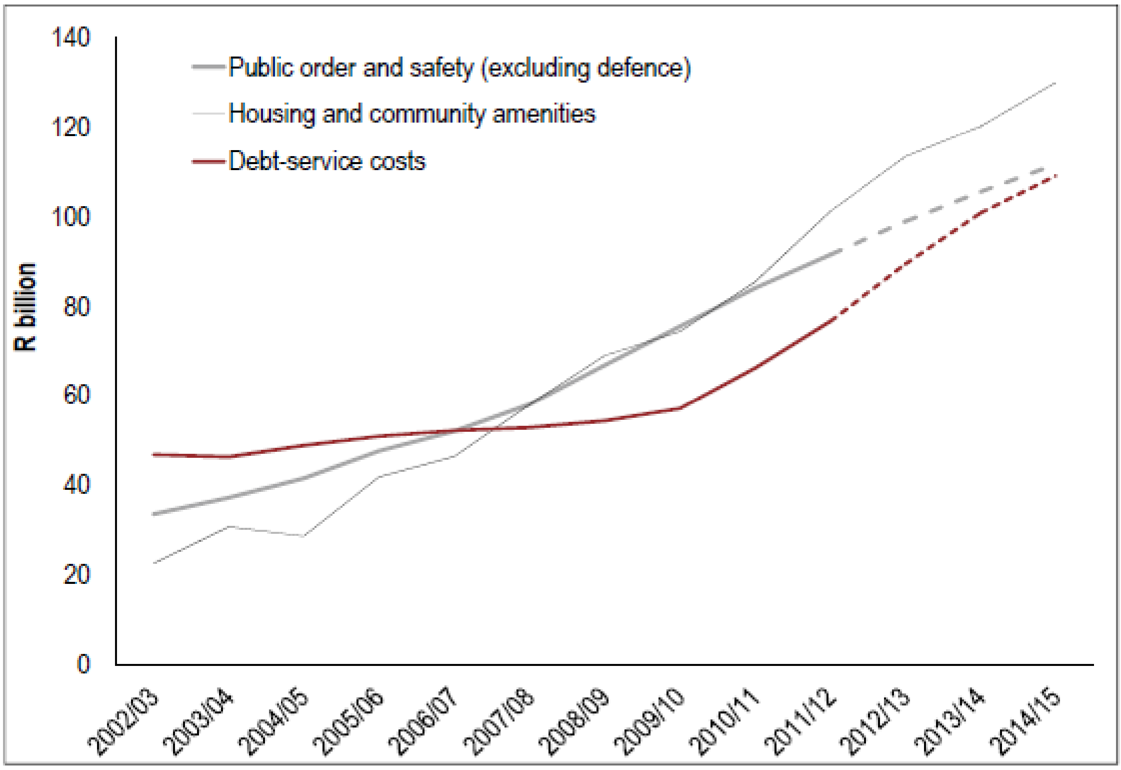
The budget proposals in the 2012 budget is based on the fiscal principles that was highlighted in the 2011 budget. These include the counter cyclicality, long term debt sustainability and inter-generational equity (Budget review 2012: 34).

The rise in the primary deficit since 2009 has led to an increase of R1 trillion rand in the stock of debt of South Africa by 2014/15 (Budget review 2012:35)

By 2014/15 government is expected to narrow the primary deficit to 0.3 per cent of GDP, allowing debt to stabilise at about 38.5 per cent of GDP. Debt-service costs are expected to peak at 2.8 per cent of GDP in 2013/14, declining moderately to 2.7 per cent in 2014/15. If these targets can be achieved it will release budget to be re allocated to produce investment and social expenditure, in line with the 12 outcomes that have been identified by the Presidency.

Fig 7 shows the relative expenditure on debt service cost versus other spending priorities.

Fig 7 Debt service cost vs other priorities

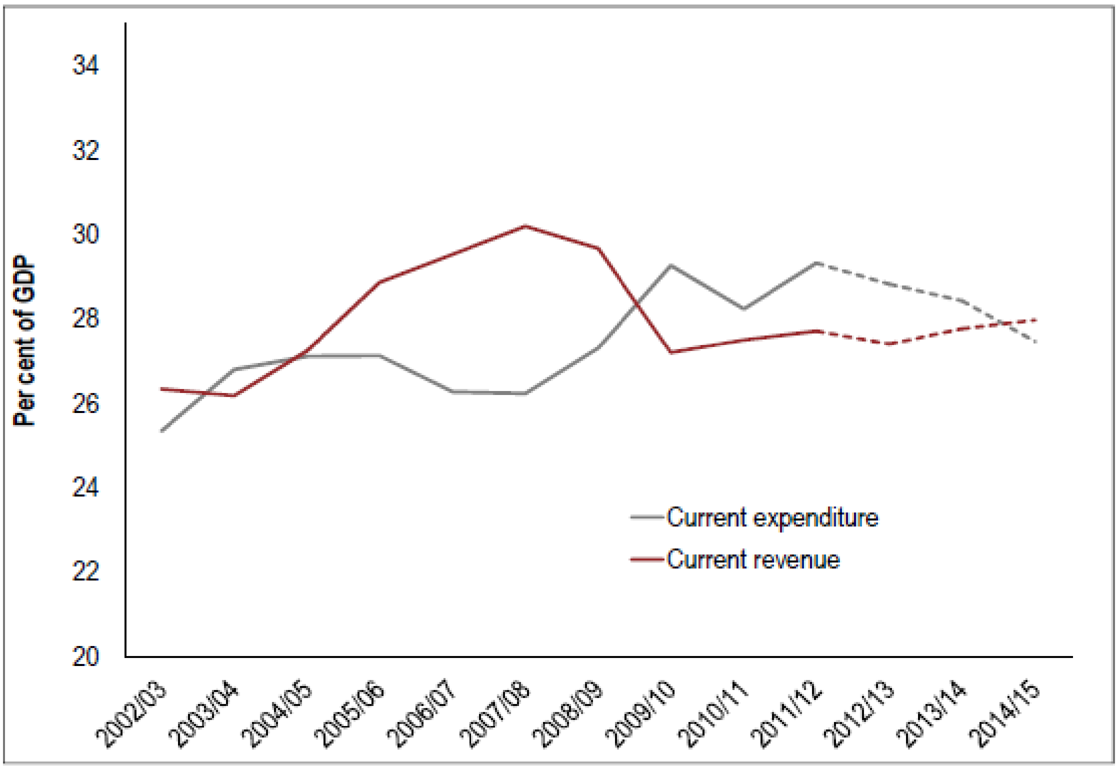


Source Budget Review (2012: 35)

Fig 7 shows the increase and expected increase of debt services cost as compared to other priorities. Another challenge is the fact that the increase in debt was used to pay for consumption items on the budget and not for longer term projects like investment expenditure. According to the budget review the fiscus will close this gap between expenditure and revenue by 2014/2015.

Fig 8 Current balance of consolidated government, 2002/3 -2014/2015

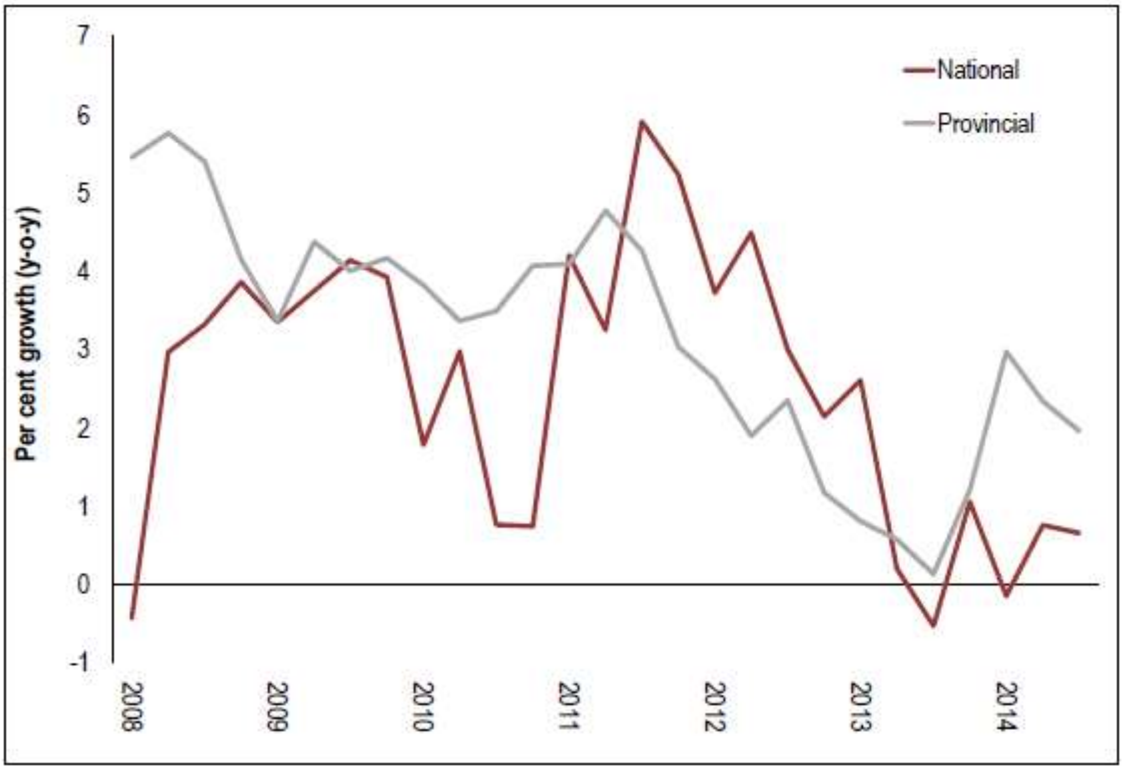
Figure 3.3 Current balance of consolidated government, 2002/03 – 2014/15



Source: Budget Review (2012:36)

A huge part of the saving was planned to come from the moderation of the public sector wage bill that increased from 2002 at an index value of 100 to an index value of nearly 200 in 2012/13.

Fig 9 Growth in public sector employment



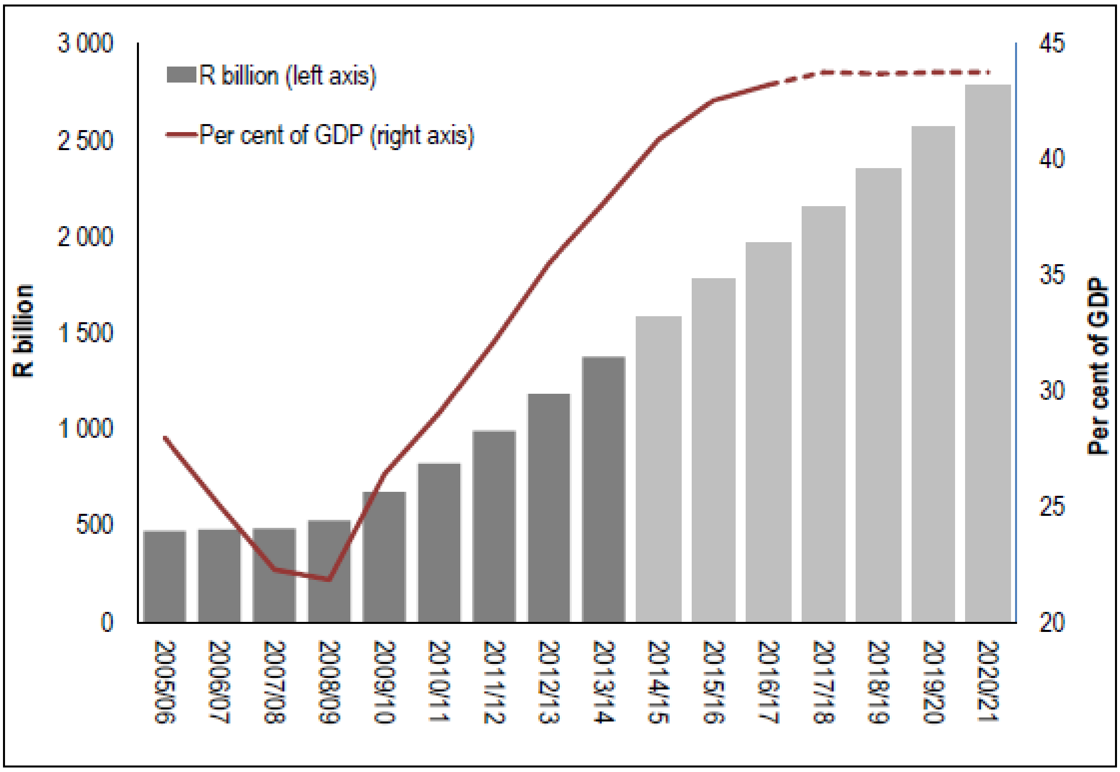
Source Budget Review (2015:33)

The aim of the savings of salaries will be to curb the growth in the employment in the public service on national and provincial level.

In the 2015 budget it was expected that the level of debt /GDP will stabilize at 43,5%, much higher than the 38% expected earlier.

Fig 10 national government net debt outlook, 2005/06-2020/21

Figure 3.3 National government net debt outlook, 2005/06 – 2020/21



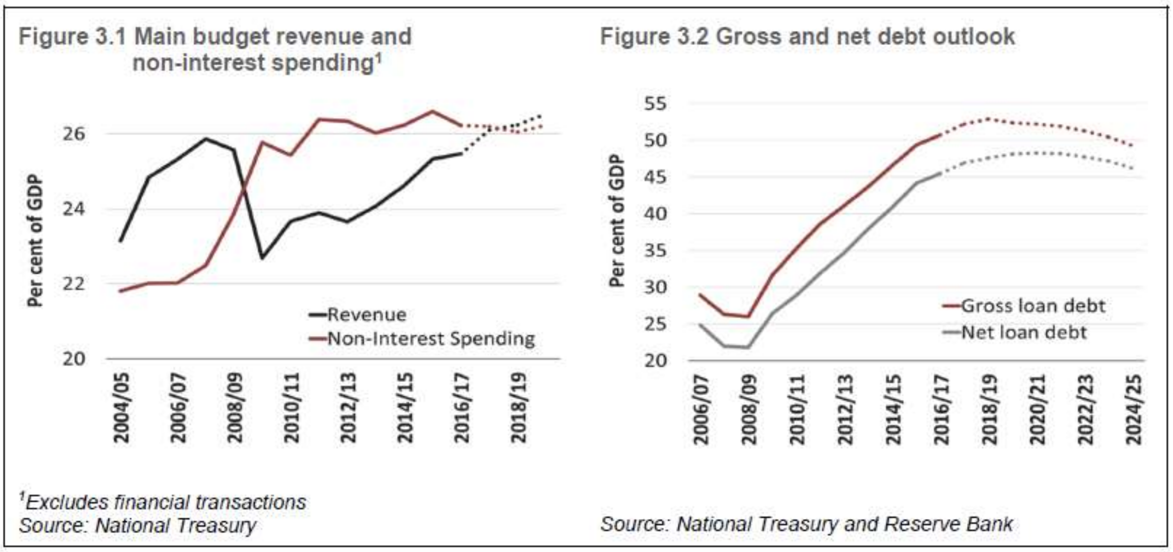
Source: National Treasury

Source 2015 budget review :38

The 2016/17 budget expected the debt to GDP ceiling would be at 2017/2018 at 46,2% but in the 2017 budget the ceiling increased to 48,2% in 2020/2021

This is indicated in fig 11

Fig 11 Gross and nett debt outlook



Source Budget Review 2017:30.

From fig 11 it is clear that the closing out of gap between revenue and expenditure that was expected in 2015/2016 never materialized due to slower levels of growth than was anticipated at that stage.

The conclusion is that the national budget is currently in a situation where fiscal consolidation is the only option. Despite the relative poor economic growth outcomes in the last few years and the resultant negative impact on government revenue, no room for expanding government expenditure at a faster rate that government revenue exists. The only option is to look at intensifying the micro economic efficiency of the expenditure as has been indicated in the last few years' budget review statements.

Intensifying of the micro economic efficiency of public expenditure.

It was decided to administer a questionnaire at the 10 provincial government departments in Limpopo to determine the average premium that government is paying on goods and services.

Based on prior experience the premium on goods expected in the survey is between 10% and 40% depending on the nature of the product and the relevant services provider.

Results of the survey.

From own experience of the author government is paying a premium of between 10 and 100% on goods and services. This depends mainly on the price awareness of the supply chain staff and should not be interpreted as corruption or mismanagement.

Implications of the results.

In the process the interpret the results it should be remembered that price is not the only consideration when evaluating the efficiency of government expenditure. The provincial government is also trying to address other economic issues by means of procurement. The provincial cabinet took a decision to allocate 10% of its procurement to cooperative and SMME's. The aim of the decision is to promote SMME in the local economy with the resultant job creation. This will in turn address the triple challenge of inequality, poverty and unemployment.

Based on these more social goals it is advisable to allow for a specific pre-determined premium to local entrepreneurs that are being classified as a start-up business. A start-up business is any SMME that is operating for less than 5 years or with a turnover of less than R1 million per annum. A premium of 10-15% is suggested for these enterprises.

The second challenge is how to improve the supply chain procedures in government without neglecting the principle that suppliers will compete in an open bid system for the right to provide goods and services to government. The proposal is that for smaller routine procurement items that is eventually contributing a significant part of expenditure like air tickets, hotel booking, car booking, stationary, photo copying the first option is to enter into transversal contracts with suppliers to ensure that all department procure at a preferential rate. The only disadvantage of transversal contracts is that they are negotiated on national level. This leads to the procurement for the country taking place in Gauteng.

Another proposal is that a reference price range must be provided to supply chain staff. This will solve the problem of these staff members often not aware about the market price for an item. Possible suppliers will then be invited to tender within this specified range.

It is also possible to establish a central supply chain unit on provincial level that will be able to handle the supply chain issues more efficiently. Some national departments have also appointed their own in house travel agencies to make the flight and accommodation bookings more cost effectively.

The impact on the budget allocation in the Limpopo province.

A 10% saving due to these proposals will release close to R6 billion rand that can be re allocated to specific outcomes that cannot be achieved in the current situation. This includes additional expenditure on infrastructure and roads and the economic development of the province.

Conclusion

The South Africa fiscus is facing severe challenges in terms of sustainable fiscal policy. Due to a valid effort the overall debt to GDP ratio in South Africa is still expected to below 50%. The relative poor economic situation puts additional pressure on the achieving this target.

This research propose that the focus should be on increasing the micro economic efficiency of the expenditure on the provincial budget. Two proposals are to increase the use of transversal contracts and to provide reference price guidelines to supply chain staff in provincial government departments.

Bibliography

Budget Review. 1993. *Budget Review-1993*. National Treasury: Pretoria

Budget Review. 1994. *Budget Review-1994*. National Treasury: Pretoria

Budget Review. 1995. *Budget Review-1995*. National Treasury: Pretoria

Budget Review. 2010. *Budget Review-2010*. National Treasury: Pretoria

Budget Review. 2012. *Budget Review-2012*. National Treasury: Pretoria

Budget Review. 2015. *Budget Review-2015.* National Treasury: Pretoria

Budget Review. 2017. *Budget Review-2017*. National Treasury: Pretoria