ISS INSTITUTE FOR SECURITY STUDIES

Budget Guide

for Members of Parliament

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ISS GUIDE

Contents

1. About this guide

1.1 Parliament's role in the budget

Parliament is required to represent the people and to ensure government by the people under the Constitution. It does so by choosing the president, by providing a national forum for public consideration of issues, by passing legislation and by scrutinising and overseeing executive action.

Parliament's oversight of the executive is strengthened by its ability to analyse budgets before and after they are implemented.
To perform this oversight function effectively and participate in public debates, Parliamentarians must have a good understanding of budgeting and public finance.

Parliament's role in the budget has been formally reinforced by the Money Bills Amendment Procedure and Related Matters Act ('Money Bills Amendment Act'), which was passed in 2009. The establishment of the Parliamentary Budget Office is an example of institutional support for the implementation of the Act.

1.2 Who should read this guide – and why

This guide aims to:

- Give a foundation in budgeting for members of Parliament (MPs)
- Demystify public budgets
- Help committee members become more effective in their oversight role

Having a better understanding of the laws, processes and issues relating to the budget will help MPs to fulfil their oversight responsibilities and develop a fiscally assertive legislature.

The guide is especially for MPs who do not sit on finance or appropriation committees, but who deal with departmental budgets as part of their oversight work. Better oversight will ultimately mean better budgetary accountability, and will improve the developmental and transformational impact of the budget on citizens.

2. The budget and the role of government in the economy

2.1 What is the budget?

The budget is a plan for a certain time, often a year. It sets out how resources will be generated and allocated to achieve the government's objectives. The government's expenditure proposals and revenue-raising intentions are set out in a collection of documents for the budget period. The info box lists the key budget documents in South Africa.

Key budget documents in South Africa
Budget speech
Appropriations Bill/Act
Division of Revenue Bill/Act
Estimates of National Expenditure
Budget Review
Medium-Term Budget Policy Statement

As a key planning tool for allocating scarce resources, the budget is the vital link between policy and delivery. It is therefore an important part of effective financial control, Parliamentary oversight and accountability to society.

There are two types of accountability relating to the budget:

- ***Ex ante*** (a Latin term meaning 'before the fact')
This means scrutinising budget planning and resource allocations to determine if these are adequate for achieving policy objectives.

- ***Ex post*** ('after the fact')
This means scrutinising what actually happened to see whether resources were used as intended and the policy objectives were met.

Budget analysis plays an important role in both dimensions of analysis.

2.2 What is the government's role in the economy?

Most modern economies are mixed economies. That means the government is an important player alongside the private sector. What governments spend money on and how they raise that money affects everybody.

In modern mainstream economic thinking, the general view is that the role of government in the economy is to enhance welfare by dealing with situations where market failures exist or are likely to exist.

Market failures could be actual harm imposed on society, for example from pollution or the social consequences of high inequality. Governments are also called on to intervene when goods and services that make a positive contribution to society aren't provided at all, or not enough, through market mechanisms.

So, the way economists see the role of government in the economy comes from an understanding of how markets, when left to themselves, would not provide the best possible welfare from a set of resources.

Government may enhance the following aspects of the economy:

- Stability
- Efficiency
- Equity

Stability

It's unlikely that markets, left to themselves, will ensure stability in the macro-economy (the total flow of what is produced, consumed and saved). Instead, there will probably be boom and bust periods, which is not good for longer-term growth and development.

How do governments intervene?

Governments can enhance the stability of the total economy by using fiscal and monetary policy, and the regulatory framework, to:

- Smooth out these fluctuations ('ups and downs'), smoothing the **volatility** of the business cycle and the impact this has on growth and job-creation
- Keep general price increases moderate and stable
- Discourage excessive risk-taking in the financial sector

Efficiency

Efficiency is getting the greatest social welfare possible with a certain set of resources. This means that the right things are produced and consumed in the right amount. Changes in things like technology, customer preferences, and the availability of resources lead to adjustments in what is made, how it's made, and who benefits from it. They also affect prices. Price plays a crucial role in these adjustments – in free, competitive markets, it's assumed that price shows all the available information about the market, and that it changes as other things change.

When can governments intervene?

Government can step in when:

- Prices do not exist at all (even though a product or service is seen as being socially valuable)
- Prices do not accurately reflect available information about preferences and scarcities

Examples of these situations:

- Pure public goods, such as **parks, national defence**
- Goods with externalities (spill-over effects). These can be costs, **like pollution from cars**, or benefits, **for example from education**, that are not shown in the price
- Natural monopolies, for example **utilities like water and electricity**
- Markets where there is little or no competition, such as **oligopolies**, where just a few companies control the market
- Markets where information asymmetries are likely. **This happens when either one of the parties – the buyer or seller – knows more than the other**, for example in health care

How do governments intervene?

Some of the ways governments can bring efficiency to the economy are:

- Through government provision, providing services such as public health and education, and economic infrastructure
- Through regulation

- By establishing a regulatory framework for private interactions, in that way ‘making markets’ – for example, ‘cap and trade’ emissions schemes where total emissions permits are capped, but these permits can be traded between polluters
- By creating conditions that enable private production – this is known as ‘dynamic efficiency’, allocating resources to new growth areas where a future advantage might exist

Equity

An efficient economy is not necessarily an equitable one – that is, a society where the level of inequality conforms to the preferences of the majority of its members or to conceptions of social justice.

How do governments intervene?

Governments can help to redistribute resources, using the two sides of the budget: taxation and expenditure to achieve greater equality in post-budget incomes than in pre-budget incomes. Typically, most governments use progressive taxation and targeted expenditure to contribute to greater equity, though estimating budget incidence (who benefits from and who finances public spending) remains a complex exercise with some speculative components.

2.3 The budget, efficiency and accountability

At the core of modern budget reform efforts is the desire to get greater results from public funding by:

- Enhancing both allocative and operational efficiency
- Addressing the social, political and institutional challenges that stand in the way of greater efficiency

Allocative efficiency refers to what is provided through the budget. Governance in the form of participation is a key dimension of achieving allocative efficiency

Operational efficiency refers to minimum waste in providing and allocating resources. Governance in the form of robust oversight and accountability is a key dimension of operational efficiency.

2.4 The programme approach to budgeting: where finance and function meet

South Africa's budget process takes a **programme** and sub-programme approach. This is one way of organising the budget to try to achieve performance accountability. With this approach, the focus is on what is to be achieved and how, rather than on simply checking that money is spent on what it was authorised for (the line-item budgeting approach).

> A programme is a coherent set of activities and associated financing aimed at achieving a clearly stated objective

With the programme approach, the aim is to show the link between finance and function link in such a way that one can assess two things:

i. Whether the programme has managed to do what it set out to do

ii. Whether this was done at the agreed cost

> **Based on the above, a basic programme budget should include:**
>
> - Clear and measurable objectives
> - The outputs and inputs required to achieve these objectives

3. The four stages of the budget cycle

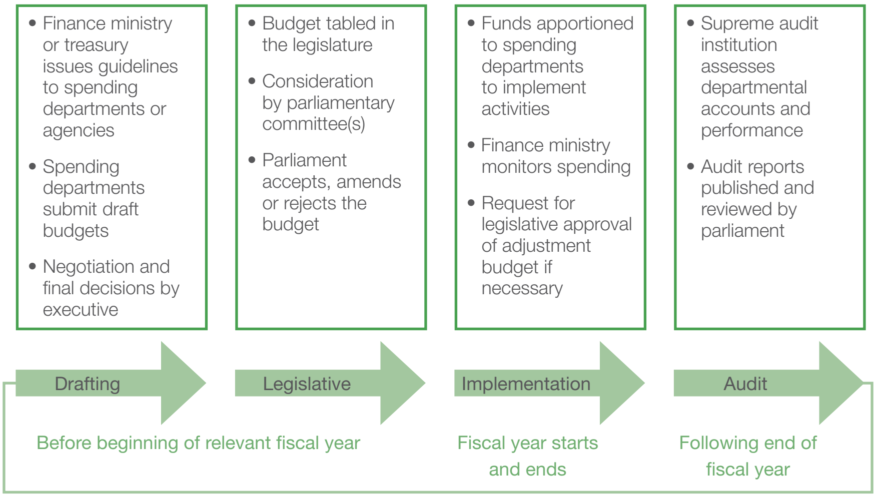
The **budget cycle** has four stages:

1. Drafting
2. Legislative (generally where the role of Parliament and Parliamentary committees begins)
3. Implementation
4. Audit

Each stage falls under the authority of different parts of government, but the stages overlap in time. At any point in the fiscal year, a future budget is being drafted, the current budget is being implemented, and a past budget is probably being audited.

The diagram below shows what happens in each stage. We discuss these four stages in more detail in the sections that follow.

Stages of the annual budget process



4. Multi-year budgets and medium-term (three-year) planning

4.1 Why have a multi-year budget?

A budget is usually a plan for generating and allocating resources for a given year. Over the last ten years, however, many countries, including South Africa, have introduced multi-year budgets to try to make budgeting more transparent, stable and predictable.

For multi-year budgeting, economic forecasts, fiscal policy parameters and spending proposals are conceptualised over a longer period. Often this means using a three-year planning horizon, or outlook. The idea behind this is that a three-year planning framework will:

- Deal better with ad hoc policy changes
- Send clear signals to other stakeholders about the direction of economic policy
- Get government departments and other spending entities to think about their aims and resource requirements over the longer term

4.2 The Medium Term Expenditure Framework

In South Africa, a Medium Term Expenditure Framework (MTEF) was introduced in 1997/1998. The framework aligns budget allocations with the priorities set out in the Medium Term Strategic Framework (MTSF), and should guide departmental strategic plans.

Parliament votes only on the immediate year's budget. However, the values in the medium-term plans, or 'outer year allocations', as well as in the three-year projections of economic growth and tax revenue, are a reliable base for policy debates.

One of the advantages of an MTEF is its potential for stronger budgetary participation. In the past, Parliament would see the budget only when it was tabled, and would have limited time and capacity to engage with it. The MTEF means that Parliamentary committees have a much better idea of medium-term allocations, in addition to the five-year strategic plans and the annual performance plans that departments must present.

4.3 The Medium Term Budget Policy Statement

The Medium Term Budget Policy Statement (MTBPS) is a document that communicates the MTEF. It is presented to Parliament in October each year. Usually, the MTBPS document begins with a summary of the medium-term economic outlook. It then outlines fiscal policy proposals, which are followed by sectoral allocations.

The MTBPS also includes information on:

- Spending estimates for the first half of that particular year
- Any adjustments to the proposed revenue and spending estimates for the second half of the current year
- Outcomes for the previous year

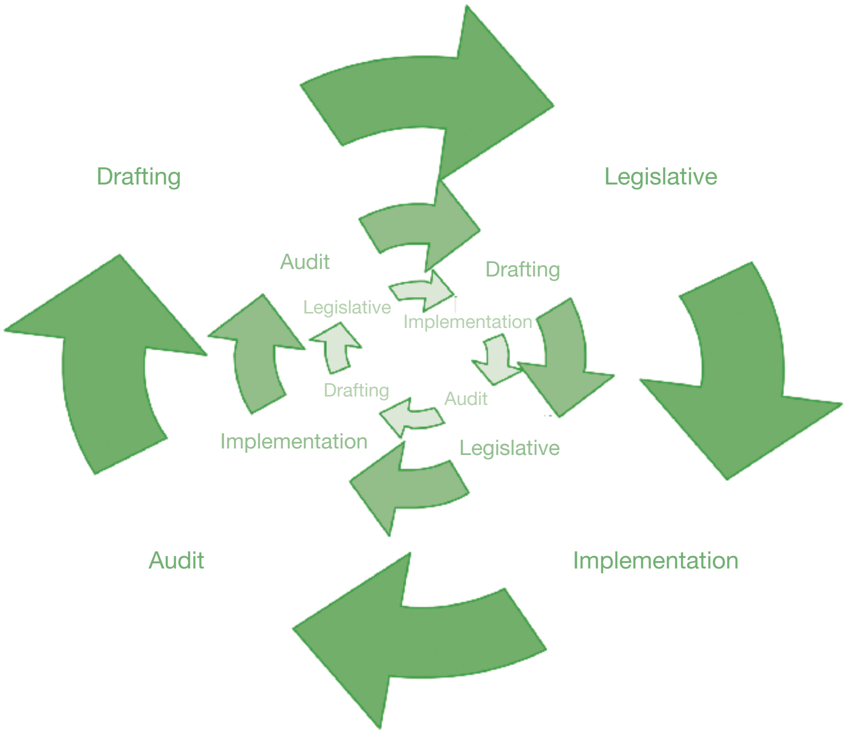
> For example, the 2013 MTBPS presented in October 2013 would include outcomes for 2012/13 as well as half-year (April to September) spending estimates for 2013/14 for all the national votes and for education, health, social development and other functions for each province.

This information is now included because the Money Bills Amendment Procedure and Related Matters Act (2009) states that the MTBPS must include more in-year departmental spending information than before. The reason for this is to enhance Parliament's formal oversight role.

4.4 The budget cycle and three-year planning framework

Having a three-year planning framework means that the stages of the budget cycle overlap in an even more complex way, as Figure 1 shows.

Figure 1: Overlapping stages of the budget cycle



5. The fiscal framework

The **fiscal framework** refers to the broad budgetary aggregates of total revenue, expenditure and borrowing for a given year. The interaction of these variables, and their impact on the broader economy, make up fiscal policy.

5.1 Government's contribution to gross domestic product

The scope of a government's regulatory influence is difficult to measure, and so is the extent of incentives like tax breaks. It's easier to determine the scope of government's narrower role as a provider of goods and services. This is usually given as a share of the total output in the economy, that is, as a share of gross domestic product (GDP). Table 1 shows South Africa's fiscal framework from 2010 to 2017.

GDP is the total value of goods produced and services provided in a country during one year.

Table 1: Consolidated fiscal framework: revenue, expenditure and budget balance as percentage share of GDP, 2010/11-2016/17

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
Revenue	27.7	28.2	28.4	29.2	29.0	28.9	29.1
Expenditure	32.0	32.0	32.7	33.2	33.0	32.6	31.9
Budget balance	- 4.3	- 3.7	- 4.3	- 4.0	- 4.0	-3.6	- 2.8

Source: Adapted from 2014 Budget Review, Table 3.1 Page 33.

5.2 Budget deficits and surpluses

Government spending tends to be in line the total amount of income that comes from tax and other, non-tax revenue sources. This because, in the longer run, government can only spend what it raises through tax. Over the short and medium terms, however, deficits (shortfalls) may be financed through borrowing, and budget surpluses may even occur.

A negative budget balance (**deficit**) means that, for a given year, planned expenditure is higher than anticipated revenue, and borrowing will be required. A positive budget balance (**surplus**) means that planned expenditure is less than anticipated revenue, and government is contributing to total savings in the economy.

Governments may run deficits for many reasons, but there are two main economic reasons for doing this:

1. *Macroeconomic stabilisation*

Governments can spend more or less at different times to help moderate fluctuations and stabilise aggregate demand in the economy. For example, a government may spend less when income and the demand for labour in the private market are high.

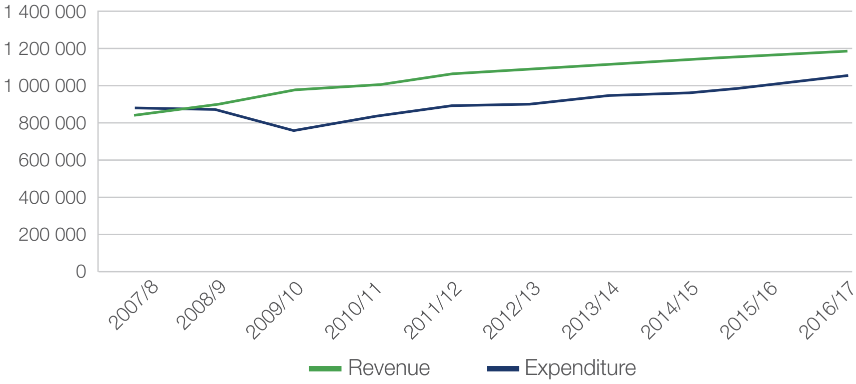
When demand for labour and income in the private market are low, the government could spend more. However, it would be increasing its own spending just when its tax revenues are decreasing (because income is less). This mean higher deficits in recessionary periods and lower deficits, or even surpluses, in expansionary periods.

A budget deficit increases debt and the costs of servicing that debt, which may change because of interest rate changes. This will need to be taken into account in future budgets.

2. *Inter-generational equity (fairness)*

Government spending tends to generate benefits for many generations of people. An obvious example would be infrastructure such as roads, power stations, and dams. Since the benefits are over a longer period, it is fair to finance those benefits over the same period. Debt-financed infrastructure, repaid through taxes, is one way of doing this, especially if there is a significant drive for infrastructure.

Figure 2: Main budget revenue and expenditure 2007/08 – 2016/17, real R million 2014/15



Sources: 2014 Budget Review, Appendices, author's calculations

5.3 The budget balance

There are different ways of looking at the budget balance, depending on what is and what is not included:

- The **conventional budget balance** is the difference between total expenditure and total revenue
- The **current budget balance** is the difference between current, non-capital expenditure and current revenue

If the government is borrowing funds mainly for capital spending, the current budget balance may be in surplus even though there is a deficit in the conventional budget.

The budget is a plan, and plans are not always realised. We therefore refer to **budget outcomes** when we talk about what actually happened. In the case of the budget balance, the outcome may be different from what was proposed because expenditure and revenue are larger or smaller than anticipated.

Expenditure differences may happen because of challenges with budgetary control or poor implementation capacity. Revenue differences may result from under- or overestimating key variables such as economic growth.

6. A closer look at South African tax revenue

6.1 Sources of government revenue

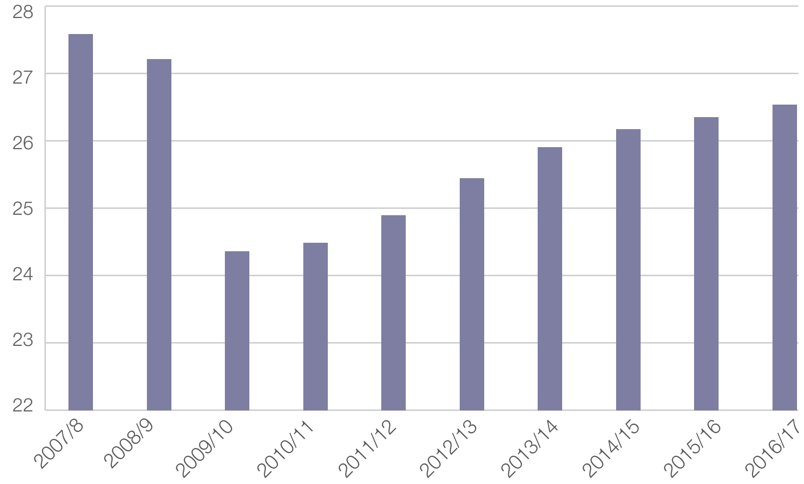
There are four main sources of government revenue:

- Taxes
- Service charges
- Grants
- Loans (borrowing)

In South Africa, taxes are by far the largest part of total government revenue. Service charges are paid mainly to local governments for utilities such as water and electricity.

All taxes collected by the national government, through the South African Revenue Service (SARS), are paid into the National Revenue Fund. Figure 3 shows the total tax revenue as a share of GDP over the last 10 years. The impact of the global economic crisis can be seen in the drop and slow recovery of this share.

Figure 3: Gross tax revenue as share of GDP, 2007/08 – 2016/17



Sources: 2014 Budget Review, Appendices, author's calculations

6.2 Sources of tax revenue

A tax is generally defined by:

- Its rate, in percentage terms
- Its base (what is actually being taxed)

So, direct taxes are taxes on income and wealth, and indirect taxes are typically taxes on activities, such as consumption.

In South Africa the three main sources of national tax revenue are:

- Personal income tax (PIT)
- Corporate income tax (CIT)
- Value added tax (VAT)

In the 2013/14 fiscal year these taxes made up 80.7% of total gross tax revenue – Table 2 shows the breakdown.

Table 2: Rand amount and shares of total tax revenue from three main taxes, 2013/14

	R million	Share of total gross tax revenue
Personal income tax (PIT)	308 930	34.4%
Corporate income tax (CIT)	176 965	20.0%
Value-added tax (VAT)	239 286	26.6%
Total	725 181	80.7%

Sources: 2014 Budget Review, Appendices, author's calculations

Personal income tax (PIT)

PIT has a progressive rate structure to contribute to greater equity. This means that taxable income is taxed at different rates. Higher income is taxed at higher rates. The highest rate is currently 40% for annual income over R638 601. In 2013/14 PIT contributed 34.4 % of total tax revenue.

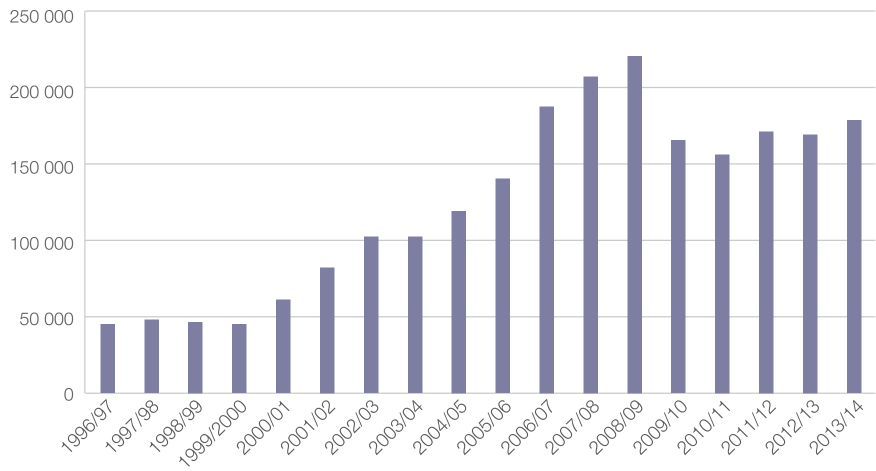
The difference between marginal and average personal income tax rates: To balance the need for revenue with people's ability to pay taxes, governments may choose not to tax some parts of a person's income. Or, it may tax them at different rates – this is known as marginal income taxation. As a result, the average tax rate will differ from the marginal tax rates in the PIT schedule.

Corporate income tax (CIT)

CIT is a tax on profit (that is, revenue less expenditure). It is currently set at 28%; however, the actual tax rate paid by companies in South Africa varies by sector. This is because there are tax incentives aimed at enabling corporate investment, profitability and labour demand.

In South Africa, the CIT over the ten years has proven to be particularly elastic with respect to growth. In other words, high economic growth generated even higher profits that could be taxed, while CIT declined significantly after the global economic crisis, as Figure 4 shows.

Figure 4: Real CIT revenue (constant 2013 rands), 1996/97-2013/14



Source: 2014 Budget Review

Value added tax (VAT)

South Africa's VAT is imposed at a rate of 14%: the tax is imposed on consumption and is collected and handed over by VAT vendors. Some VAT goods and services qualify for zero ratings and exemptions. Basic food and related items are zero rated in order to reduce the inequitability of the VAT: since poorer households tend to spend a larger share of their income on consumption, a VAT without zero ratings would in effect be imposed at a higher rate on poor households when compared to rich households.

7. Key budget and public finance legislation

7.1 The budget and the constitutional mandate

The constitution of South Africa states that 'National, provincial and municipal budgets and budgetary processes must promote transparency, accountability and the effective financial management of the economy, debt and the public sector' (Section 215).

Fulfilling this constitutional mandate has required a comprehensive and phased reform of the country's budget system. This section looks at some key pieces of budget legislation.

7.2 The Public Finance Management Act of 1999 (PFMA) and the Municipal Finance Management Act of 2003 (MFMA)

The PFMA was passed to regulate the financial management of both the national and provincial levels of government. The act seeks to promote the efficient and effective management of public funds. It also establishes the responsibilities of the people entrusted with financial management within government.

An important objective of the PFMA is to **put in place more effective financial accountability systems** so that budgets and actual spending are aligned.

The act gives effect to Sections 213 and 215 – 219 of the constitution. These require:

- the establishment of national and provincial treasuries, treasury norms and standards; and
- the procedural framework for guarantees, borrowing, procurement, and oversight of national and provincial revenue funds.

The PFMA legally establishes the National Treasury, headed by the minister of finance. The minister is responsible for coordinating macro-economic policy and promoting the national fiscal framework. The act coordinates intergovernmental financial relations, manages the budget preparation process, and exercises control over the implementation of the annual national budget, including adjustment budgets.

The PFMA legally establishes provincial treasuries headed by the Finance Members of the Executive Council (MECs). MECs are responsible for preparing and managing the provincial budgets, and enforcing norms and standards set out by both the PFMA and the National Treasury. The Finance MEC is also responsible for seeking legislative approval and the adoption of the provincial budget.

Important points from the PFMA

- Annual, audited actual **spending information must be presented to Parliament within six months** of the financial year's closing date. This shortens the evaluation stage of the budget cycle

- Performance indicators, such as measurable objectives, are an essential part of the planning process. The act's introduction of **performance measurement indicators** is aligned with global trends towards performance budgeting
- All government department heads and chief executives of constitutional institutions are **accounting officers**. They must ensure the operation of basic financial management systems, regulate budget spending, and produce financial and performance reports in line with written performance agreements between them and the executive authority

Accounting officers must explain and **justify their allocations and any decisions about allocations,** at any time. All transfers must be planned. Only those specifically **allowed by an act are seen as authorised.** The accounting officer is responsible for all unauthorised expenditure.

- **Parliament must approve departmental allocations** (votes) at a functional programme level. This limits accounting officers' ability to move funds from one account to another during the financial year without being authorised to do so. The authorised shifting of funds between programmes within a vote (**virement**) is limited to 8%

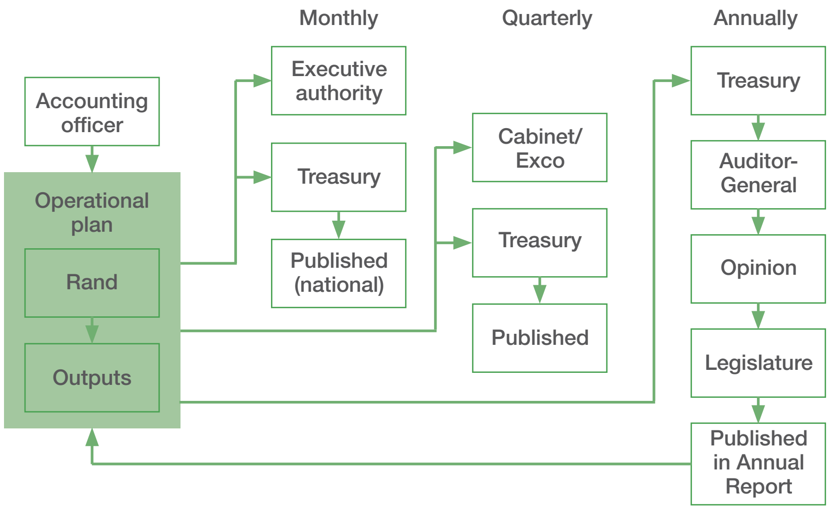
Virement is the process of transferring items from one financial account to another

- Provinces and municipalities **may not take out loans for current expenditures** such as salaries, unless this is necessary to bridge temporary gaps in funding. In these situations, loans must be repaid within the same year they were borrowed. This is also stated in the Municipal Finance Management Act (MFMA)
- Provincial borrowing on foreign financial markets, or in a foreign currency, is not allowed

8. Budget reports

The PFMA is specific about who must submit reports, on what, to whom, and when.

Figure 5: In-year reporting requirements



Source: Guide for Accounting Officers Public Finance Management Act, National Treasury (2000: 20)

8.1 Monthly reports

Accounting offers must send monthly reports within 15 days of the end of every month to the relevant treasury. These reports should include:

- All actual revenue and expenditure transfers
- The expenditure of conditional grants
- Anticipated revenue and expenditure for the remainder of the financial year
- All variances
- A summary of actions to be taken to ensure expenditure and revenue remain within the approved budget

Provincial Treasuries must send a statement to National Treasury before the 22nd of every month. The statement shows transactions affecting their revenue funds and should include:

- Detailed information on state finances

- Any corrective measures taken, such as disciplinary actions
- Progress on PFMA implementation
- Non-financial information needed to determine measurable objective progress, such as service delivery

8.2 Quarterly Reports

Quarterly reports must be sent within 15 days of the end of the quarter. They should include:

- The same information in the monthly reports, only with figures and information for that quarter
- Additional information on grants as received from the Division of Revenue

Treasuries have a **strategic, active monitoring role** in the progress and reporting of performance weaknesses. They **must send regular reports** to cabinet or the executive on the extent to which accounting officers **resolve audit queries.**

The **National Treasury** must publish the following in the Government Gazette:

- Financial statements regarding revenue and expenditure for each of the provinces and the national sphere
- A progress report of actual performance against the national budget and objectives

This information must be made available for scrutiny by government, non-government organisations and civil society, and must be on the website of the National Treasury.

8.3 Annual Reports

Annual reports should have the following information:

- Reviews on performance against plans and budget, as agreed with legislature at the start of the financial year
- All losses, misuse of funds and non-performance

- Efficiency, economy and effectiveness in determining outputs per operational plan
- Relevant non-financial indicators
- Reports on public entities, where applicable

Section 32 reports

To comply with Section 32 of the PFMA, reports are combined and published in the Government Gazette monthly (national reports) or quarterly (provincial reports). These 'Section 32 reports' must have the following information:

- Revenue – budgeted versus actual tax revenue and departmental receipts
- Expenditure – budgeted versus actual spending
- Deficit and net borrowing requirement
- How the deficit is financed, for example whether from a domestic or foreign market, bonds, loans, etc.

The **Standing Appropriations Committee** plays an important role in monitoring an in-year budget. It must analyse the monthly and quarterly expenditure statements in terms of Section 32 of the PFMA.

Each quarter, the Standing Appropriations Committee compiles reports for Parliament on actual revenue, and progress in relation to budget implementation and service delivery. These reports focus on:

- The efficiency of spending
- The quality and speed of service delivery
- Assessing value for money
- Activity timelines of a department
- Planning within a department

To comply with the PFMA, **Treasury** must continually monitor and enforce norms and standards as the budget is implemented. This is in addition to its financial oversight role over the other organs of state across government.

9. South Africa's system of intergovernmental fiscal relations

9.1 Responsibilities of national, provincial and local government

Chapter 3 of the South African constitution defines national, provincial and local spheres (areas) of government. These spheres are distinctive, interdependent and interrelated. They must uphold principles of cooperative governance in their engagement with each other. Each government sphere is responsible for providing a particular set of government services.

Schedules 4 and 5 of the constitution explain how responsibilities are shared among the three spheres.

National government

As a general principle, the national government is responsible for functions and issues of national interest that bridge provincial boundaries, such as:

- National defence and police
- Prisons
- Trade and industry
- Labour regulation
- International relations

National government is also concerned with developing policy, defining minimum norms and standards for programmes, and coordinating government policy between spheres.

Provincial governments

Provincial governments are tasked mainly with social service delivery, as well as roads and regional economic planning and development. A key issue in the design of any Inter-Governmental Fiscal Relations (IGFR) system is the way functions, revenue instruments, and fiscal transfers are distributed among the levels of government. South Africa has chosen to:

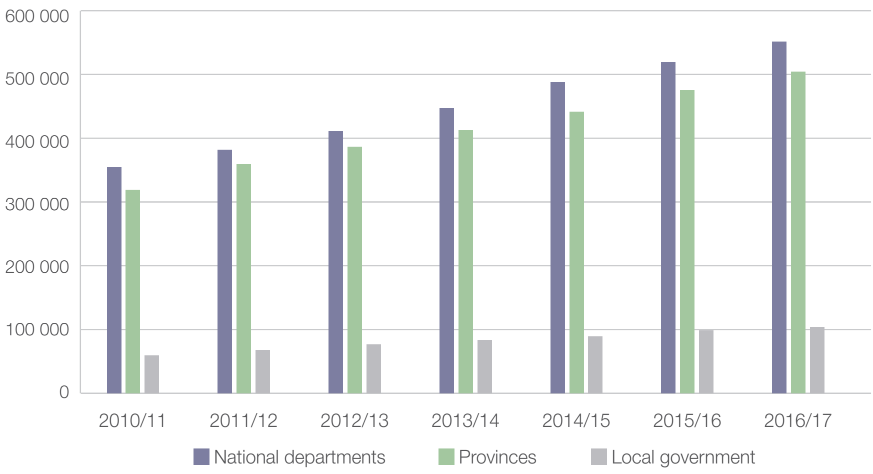
- Keep most major revenue sources at the national level
- Give the bulk of social spending to the provincial level
- Allow fiscal equalisation transfers between provinces and local governments to address any expenditure-revenue mismatch (or 'vertical imbalance') (this is explained in more detail below)

9.2 How revenue is allocated among spheres of government

Cabinet, advised by Treasury, decides on the vertical division of **nationally raised revenue** – that is, how much each sphere of government will get. This division is formally approved by Parliament, which passes the **Division of Revenue Act**.[1] **The Intergovernmental Fiscal Relations Act (1997)** states how the equitable (fair and reasonable) allocation of revenue is to take place. Sections 9 and 10(4) outline the consultation process to be followed in conjunction with the **Financial and Fiscal Commission (FFC)**, as well as how to consider recommendations about the equitable division of revenue.

Figure 6 shows this division from 2010 to 2017.

Figure 6: Division of nationally raised revenue (2010/11-2016/17)



Sources: 2014 Budget Review, Appendices, author's calculations

1. As required by Section 214(1) of the constitution

Fiscal equalisation transfers are required by the constitution. There are two types:

- Provincial equitable share (PES)
- Local equitable share (LES)

Provincial equitable share

The provincial equitable share (PES) formula takes the total provincial sphere allocation and divides it into shares for each province, according to the needs, and economic and demographic profiles of each province. The formula is redistributive. This means that poorer provinces get more than richer ones, relative to their share of the population. The provincial equitable formula has six components, shown below.

Provincial government equitable share components

Component	Percentage	Calculated based on
Education	48%	• Number of learners enrolled in public ordinary schools • The size of school-age population (5-17 years)
Health	27%	• Combination of a population risk-adjusted capitation index • Health risks of the demographic profile (75% weighting) and relative case load share in hospitals (25% weighting)
Basic	16%	• Province's national population share
Institutional	5%	• Divided equally among provinces
Poverty	3%	• Reinforces the formula's redistributive impact
Economic output	1%	• Based on GDP-R data

Source: Budget Review Annexure W1, National Treasury (2014)

Apart from the institutional and economic output components, 94% of the allocations are influenced by population movements and characteristics within a province.

Conditional grants

In addition to the equitable share, conditional grants are given to provincial and local governments. Conditional grants are transfers from national departments to provinces and municipalities for spending on national priorities.

While a province can (in line with the requirements of the constitution) allocate PES revenue to the priorities it has identified, conditional grants are for specific purposes. They can be paid in lump sums up front, or at certain times, according to an agreed schedule. Grants come with strict provincial reporting requirements.

The administration of these grants works as follows:

- The national department is responsible for monitoring, compliance and assessing if the goals were achieved
- The government (provincial or local) receiving the grant takes care of spending the grant

Both the equitable shares and conditional grant allocations are set out in the annually passed **Division of Revenue Act**. Table 4 shows an overall trend of equitable and consolidated grants over time: total allocations decrease for national government, remain fairly stable for provincial governments and increase for local governments.

Table 4: 2014 /15 Provincial equitable share and conditional grants

Province	R million	
	Provincial equitable share	Conditional grants
Eastern Cape	52 154	9 846
Free State	20 883	6 158
Gauteng	68 673	16 935
Kwa-Zulu Natal	78 138	15 941
Limpopo	43 274	7 580
Mpumalanga	29 355	6 352
North Cape	9 652	3 406
North West	24 707	5 621
Western Cape	35 631	9 917

Source: Budget Review Annexure W1, National Treasury (2014)

Local equitable share

Although transfers to local governments have increased over time, most of their revenue comes locally, from, for example:

- Property rates and taxes
- Service charges
- Various fines

Municipalities differ in their abilities to generate revenue because of issues like poverty, the size of their tax base size, and backlogs in providing basic services. Generally, smaller, rural municipalities and districts will depend more on equitable transfers and grants. This means they need a bigger equitable share than urban municipalities and metros do. The reformed local equitable share (LES) formula gives these aspects more consideration. It is intended to ensure basic services and to help clear backlogs, predominantly in rural and poorer municipalities.

To minimise **perverse incentives**, the constitution states that equitable shares or national government transfers such as conditional grants may not be seen as 'normal' revenue by a provincial or local government. Also, national government does not have to compensate provincial and local governments which fail to raise revenue in proportion to their fiscal capacity and tax base.

> A perverse incentive is one that produces an adverse (bad) consequence because of the actions taken to receive it

10. Budget approval and the Money Bills Amendment Act

10.1 Going beyond 'rubber stamping'

Legislature has the 'power of the purse'. As the citizens' representative, it authorises the executive to spend and tax. However, legislatures in modern democracies tend to play a subordinate role in budgeting. They are likely to 'rubber stamp' executive budgets without close scrutiny. Often, their in-year oversight is weak. There is limited evaluation of results and impact which could then feed into policy design and resource allocation decisions.

Mostly, the ideal of an assertive legislature in public finances has not been met. Some reasons for this are understandable, such as the growing complexity of government which places the legislative branch at a disadvantage to the executive branch. Others, however, are more about political will and having the right legislative framework to guide engagement with the budget.

Section 77 of the constitution states that an act of Parliament must provide for a procedure to amend money bills (the budget). Without this procedure, Parliament could – and did – consider and debate the budget; but ultimately had to pass or reject the entire budget. As rejecting it in this way is clearly not practical, Parliament was, formally, largely a 'rubber stamping' institution.

10.2 Procedures for amending the fiscal framework

The Money Bills Amendment Procedure and Related Matters Act of 2009 met the constitutional requirement and gave Parliament a formalised procedure for amending the budget.

The act gives Parliament unrestricted power to change the fiscal framework, the Division of Revenue (Division of Revenue Bill) allocations, and tax policy. However, these changes must be madeby following a set order of engagements with different parts of the budget. This is to ensure that:

- Changes to allocations are in line with the fiscal framework
- A large number of changes does not result in an unsustainable fiscal policy stance
- The overall sustainability of the budget is not put at risk

Factors to be considered when amending the fiscal framework

1. The total amount of revenue raised is in line with the approved fiscal framework and the Division of Revenue Bill
2. Principles of equity, efficiency, certainty and ease of collection
3. The impact of the proposed change on the structure of tax revenue, both indirect and direct taxes
4. Regional and international tax trends
5. The impact on development, investment, employment and economic growth

The order of engagements is as follows:

1. A tabled or amended fiscal framework is adopted
2. The tabled or amended Division of Revenue Bill is adopted
3. The Appropriation Bill is considered

Revenue bills, such as tax policy proposals, must also be consistent with the fiscal framework and the Division of Revenue

10.3 Summary of the contents of the act

- **Section 4** states that each legislature must set up a finance committee and an appropriations committee, and establish their respective powers and functions.

> The finance committees are mandated to focus on macro-economic and fiscal policy, changes to the fiscal framework, and revenue allocations.
>
> The appropriations committees focus on actual expenditure and changes to the Division of Revenue and Appropriations Bills.

- **Section 5** sets out the procedure to be followed before the introduction of the national budget. It explains how committees must conduct their debates on budget approval and amendment, based on having enough information about the performance of departments.
- **Section 5(1)** states that the National Assembly, through its committees, must assess departmental financial regularity, as well as the extent to which actual spending is aligned with strategic plans and the resources allocated to these plans.
- **Section 5(2)** states that portfolio committees must send budgetary review and recommendation reports (BRRRs) to the finance committees. The finance committees assess departments for how efficiently and effectively they have used their resources, in effect, the impact of their spending. The act also states that these BRRRs ‘may include recommendations on the forward use of resources’. Committees will have access to the BRRRs for the previous fiscal year, which would have ended at the end of March, as well as a review of spending during the nine months of the current year. In other words, spending performance is explicitly linked to possible amendment via the formal requirements of committees to assess performance, both in terms of management and impact.

- **Section 6** states that the minister of finance must give Parliament a medium term budget policy statement (MTBPS) at least three months before the budget is introduced. This section gives details on the PFMA requirement for an annual tabling of multi-year budget and macro-economic projections.
- **Sections 7-11** outline the procedures for introducing and adopting or amending the budget. This includes the Appropriations and Division of Revenue Bills.

Public hearings

Throughout the act there are requirements for holding public hearings during the approval or amendment process. The finance committee has to conduct joint public hearings on the fiscal framework, revenue proposals and the revenue bills. The appropriations committee must hold public hearings on the Appropriation Bill and the Division of Revenue Bill.

The role of other committees

Once the fiscal framework and Division of Revenue Bill have been adopted, the act allows (although does not require) advice from other portfolio committees about passing or amending the Appropriation Bill in relation to their vote allocations. They may advise the appropriations committee to make a particular allocation conditionally in order to ensure efficiency, effectiveness and economy. In addition, the standing rules allow portfolio committees to consult with the appropriations committee about proposed changes.

The appropriations committee is the mediator and final authority in reporting to the National Assembly. So, while committees may give input on their relevant proposed appropriations, the act gives primary authority to the appropriations committee. The appropriations committee is responsible for assessing proposed changes. It will recommend to Parliament that changes that conflict with the fiscal framework and the adopted Division of Revenue be rejected.

Ministerial response

The act also seeks to set up a clear and functionally effective relationship between the executive, in the person of the minister of finance, and Parliament – not only during budget tabling and during approval, but also through the MTBPS, which is an opportunity for discussion and consensus-building.

The minister of finance must explain how the recommendations included in those Parliamentary reports are shown in the budget and the Division of Revenue, or why they have not been included. This is a crucial part of tabling the budget.

During the adopting or amendment process, the minister of finance must respond to committee reports and amendment recommendations within specific periods of time (see Table 5), before they are sent to Parliament. The minister's responses must be included in the reports sent to the house.

Table 5: Number of days given to the minister to respond

Document	Time
Fiscal framework and revenue proposal	At least two days
Division of Revenue Bill	At least three days
Conditional appropriation	Two days
Appropriation amendment	At least 10 days
Revenue bills	At least 14 days

Parliamentary Budget Office

- **Section 15** states that a Parliamentary budget office must be set up to 'provide independent, objective and professional advice and analysis to Parliament on matters related to the budget and other money bills'. An independent and impartial director must report to Parliament any inappropriate political or executive interference which could get in the way of the budget office's mandate. The finance and appropriations committees see to the appointment and removal of the director, confirmed by an adopted resolution by both Houses.

Parliament's capacity to analyse the budget is an important aspect of effectively using the amendment authority which Parliament now has. Without this capacity, it's unlikely that committees will be able to use amendment power in a way which makes a positive contribution. They risk producing an amended budget which is inferior with respect to, for example:

- trade-offs between competing priorities, and the optimisation problems this represents;
- trade-offs between the present and the future (the question of sustainability); or

- If committees don't engage strongly and effectively with the executive through the amendment process, they also risk trivialising the authority they have been given.

11. Timeline of Parliamentary budgetary engagement

11.1 Before national budget

Annually

The National Assembly, through its committees, must assess the performance of each national department.

Three months before:

1. The Minister must send an MTBPS to Parliament an MTBPS
2. Each finance committee must give a report on the MTBPS to the National Assembly or NCOP, within **30 days**
3. The finance committee reports must be sent to the minister within **seven days** of being adopted by the National Assembly
4. Each appropriations committee must send a report on the MTBPS to the National Assembly or National Council of Provinces (NCOP), within **30 days**
5. The appropriations committee reports must be sent to the minister within **seven days** of being adopted by the Assembly

11.2 Budget day

The minister of finance must give Parliament the national budget documents that accompany the national budget speech. These documents must include information about the year at hand as well as the following two years.

11.3 After budget day

Adopting the fiscal framework and Revenue Proposals

The finance committees must:

- Hold public hearings
- Send a report to the National Assembly and NCOP on the fiscal framework and revenue proposals within sixteen days of budget tabling

- Allow for a minimum of two days for the minister to respond to any proposed changes before the submission of reports to Parliament

The National Assembly and NCOP must consider all proposals and changes sent by the committees for the adoption of resolution within 16 days of budget tabling.

11.4 Passing the Division of Revenue Bill

Once the fiscal framework has been passed, the Division of Revenue Bill must be referred to the appropriations committees. The Division of Revenue Bill is not strictly a money bill, as it does not collect money, impose taxes, abolish or reduce grants, or authorise charges (Section 77 of the constitution). It is tabled before Parliament at the same time as the money bills as it is directly related to them.

The Division of Revenue Bill must be passed no later than **35 days** after the adoption of the fiscal framework by Parliament.

The appropriations committees must:

- Allow for the participation of other committee chairpersons
- Hold public hearings
- Give the minister at least three days to respond to proposed changes before the report can be sent to Parliament

11.5 Passing the Appropriations Bill

After the fiscal framework is approved, the Appropriations Bill must be referred to the appropriations committees of the National Assembly.

Any Parliament committee may ask for a subdivision of a main division within a vote to be appropriated (funds to be moved from or to), as long as:

- The minister of finance or the affected cabinet minister is given two days to respond to the proposed conditional appropriations
- The minister and any other cabinet member has least ten days to respond to proposed changes on the original Appropriations Bill, before the Bill is sent to the National Assembly

- The National Assembly considers all recommendations from the appropriations committee within seven days of the report being admitted

Parliament must pass the Appropriations Bill, with or without changes, or reject it, within four months of the start of the financial year it relates to (i.e. by the end of June).

11.6 The revenue bills

The minister of finance must be given 14 days to respond to proposed changes to the revenue bills.

11.7 National adjustments budgets

Finance adjusted budgets overseen by the finance committee

- Committees must send a report on the revised framework within nine days after the adjusted budget is tabled
- If there are any changes, the minister must be given two days to respond to these before the framework is sent to Parliament

Division of Revenue Bill overseen by the appropriations committee

- Committees must send a report on the Division of Revenue Bill within nine days after the adjusted budget is tabled
- If there are any changes, the minister must be given four days to respond to these before the framework is sent to Parliament

11.8 The Adjusted Appropriations Bill

Once the adjusted Division of Revenue Bill has been passed, the appropriations committees can review the Adjusted Appropriations Bill, which has proposed changes to the Appropriations Bill. Then:

- If there are any changes, the minister must be given four days to respond to these before the report is sent to Parliament
- The appropriations committees must send a report within 30 days of the tabling of an adjusted budget

11.9 Additional money bills

All other money bills must be sent to the appropriations committees. If there are any changes, the minister must have at least 14 days to respond before the committee reports to Parliament.

12. Budgetary review and recommendation reports: some additional considerations

As we've noted, Section 5(1) of the Money Bills Amendment Act states that 'The National Assembly, through its committees, must annually assess the performance of each national department' and, in Section 5(2), that committees must 'annually submit budgetary review and recommendation reports for tabling in the National Assembly for each department'.

12.1 BRRRs are key to oversight

The BRRRs are a key oversight mechanism. They help ensure that amendment debates are based on a reliable analysis of departmental performance. They are the starting point of the adoption or amendment process.

> **The BRRR should show departmental performance for the previous, completed fiscal year.** For example, the 2011 BRRR should show performance for the 2010/2011 fiscal year.

After the BRRR is adopted, Parliament and its committees will then consider the MTBPS.

> **The MTBPS must include a review of actual departmental spending for the first six months of the current fiscal year.** For example, the 2011 MTBPS will include actual departmental spending for April to September 2011.

The BRRR, together with the MTBPS, allows committees to base their February/March amendment debates on a clear sense of departmental spending trends and performance.

The extent to which amendment debates are based on accurate departmental performance depends on the quality of the information and analysis in the BRRRs.

12.2 Content of the BRRRs

Section 5(1) of the Money Bills Amendment Act lists the aspects of performance that must be considered each year. It outlines budgetary performance for oversight and accountability by Parliament, so should be carefully considered and thoroughly understood. These aspects are:

- The medium-term estimates of expenditure, strategic plans and measurable objectives as tabled in the Assembly
- Prevailing strategic plans
- Expenditure reports as published by the National Treasury in terms of Section 32 of the Public Finance Management Act (PFMA)
- Financial statements and annual reports of departments
- Reports of the Committee on Public Accounts relating to the relevant department
- Any other information requested by or presented to Parliament

This information relates to accountability for the alignment of planning, financial management and implementation. It is accountability for *internal coherence*. **Here, committees must consider whether, and to what extent, a department has done what it was authorised to do.**

The BRRRs must also include:

- An assessment of the department's service delivery performance, given available resources
- An assessment on the effectiveness and efficiency of the department's use and planned allocation of available resources

The BRRR may include recommendations on the future use of resources, that is, it may recommend changes.

This information relates to accountability for *external results*. **Here, committees must consider and report on the impact of what departments have done, that is, the services they have or have not delivered.**

12.3 Timeframes in the BRRR process

Section 4 of the Money Bills Amendment Act states that committees must send their BRRRs to the National Assembly after Appropriation Bill is adopted and before the reports on the medium-term budget policy statement are adopted. This is usually between June and November.

However, since the BRRRs must consider a range of performance documents, it is important that committees take an ongoing approach to assessment, rather than leaving everything to be completed in September or October.

Other sources of information about a department's performance are useful in assessing service delivery performance and departmental efficiency and effectiveness. Committees should take the opportunity to hear the views of external stakeholders about a department.

Public hearings

Committees should set up both a public hearing and a committee discussion session focused on the service delivery dimension of the BRRR. The public hearing should invite civil society and expert commentary on departmental performance, and should take place in September or October. If time allows, fact-finding visits by a committee would be useful.

Additional sources of information on service delivery

- Performance audits by the Auditor-General
- Performance reports by the Public Accounts Committee
- National Treasury reports, such as the Budget and Expenditure Review
- Performance monitoring and evaluation reports from the presidency
- Reports by the Financial and Fiscal Commission

Evaluating efficiency and effectiveness

The assessment of service delivery quality requires expert views. It is more open to interpretation than, for example, assessing whether the department's annual report is consistent with its strategic plan. A committee should strive to assess, and should report on, whether a department has been both efficient and effective in its operations. **The BRRR should clearly state whether or not the committee is satisfied with these dimensions of performance.**

Efficiency refers to what a department has produced (outputs) with the resources it has. Waste of all kinds must be avoided. Efficiency can be assessed for an entire vote, as well as for a programme or sub-programme.

Effectiveness refers to the relationship between what is produced and the attainment of objectives. It assesses whether the right things have been produced, given the challenges a department is trying to address.

For this reason, it's essential to get the input of many different stakeholders and provide opportunities for discussions. Of course, this does not mean that a committee should not strive for evidence-based agreement on departmental performance.

The BRRR should clearly spell out whether or not the committee, after considering all the evidence, is satisfied with a department's service delivery performance. The BRRR can then also make recommendations on future allocations, as noted in Section 5(3)(c) of the Money Bills Amendment Act.

12.4 Guideline points and questions for BRRRs

1. **Is there internal coherence in the department? Does the annual report give a clear account of the measurable objectives of the strategic plan?**
   Focus on the extent to which planning, financial management and implementation are aligned. If there seems to be an absence of internal coherence, the committee should question the department to find out the reasons for this.
2. **What is the department's audit opinion?**
   This should be included in the BRRR together with a discussion of measures taken, or to be taken, to deal with adverse or disclaimer audit opinions.
3. **Has significant over- or under-spending occurred?**
   If so, get explanations from the department. If necessary, the department should also discuss the steps taken to improve matters.
4. **Does the BRRR assess and report on the efficiency and effectiveness of service delivery?**
   That is, it should assess whether a department was producing or doing the right things and doing so with a minimum of waste.

A template showing the typical structure of a BRRR is given below.

12.5 BRRR Template

Introduction

- The role of the committee
- The department's mandate
- Summary of department's five-year strategic plan

Assessment of annual report, financial statements and related documents

This assessment looks at the alignment of the annual report and the strategic plan. The department would probably need to answer questions in a session with the committee.

Assessment of service delivery

This assessment looks at the efficiency and effectiveness of what the department has done. The department would probably need to answer questions in a session with the committee. In addition, this assessment would probably require the views of experts, civil society organisations and similar non-government stakeholders.

Findings

This section should clearly indicate whether the committee was or was not satisfied with the different dimensions of performance, as listed in the act.

Recommendations

The act authorises committees to make recommendations on the future use of resources. This section should also include recommendations, based on discussions with departments, on improving performance. Recommendations should be:

- Clear (who they are directed to, what action is expected)
- Realistically achievable
- Linked to specific timeframes
- Open to monitoring and future evaluation

13. The audit stage

Chapter 9 of the constitution states that an independent Auditor General must be appointed and 'must audit and report on the accounts, financial statements and financial management' (Section 188). The Auditor General must report to the National Assembly on audits of national departments and public entities, as well as any institution which the national legislature requires to be audited.

> The South African Auditor General is a member of the International Organisation of Supreme Audit Institutions (http://www.intosai.org), which sets an international standard benchmark for the auditing of public and private entities through auditing frameworks (http://www.issai.org).

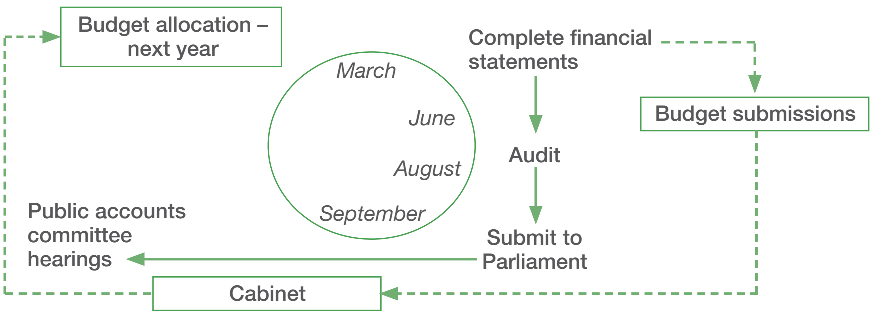
Internal department audits are required for all non-exempt departments. These audits aim to help management carry out their responsibilities effectively by highlighting potential problems and encouraging immediate action to solve these. An internal audit committee should (ideally) meet once a quarter. The committee should have three to five members, none of whom are office bearers.

During the auditing and evaluating of the budget, all actual expenditures are accounted for and assessed for effectiveness.

There are two main types of audits:

- **Regularity audits:** financial and compliance audits and the auditing of performance information
- **Specialised audits:** performance audits and special investigations

Figure 11: Cycle of auditing the budget



Source: Guide for Accounting Officers Public Finance Management Act, National Treasury (2000: 10)

An audit report will have one of four rankings:

1. Unqualified opinion ('clean audit')

The auditor states that the financial statements:

- Have been prepared using generally accepted accounting principles (GAAP)
- Comply with relevant legislation and statutory requirements and regulations
- Adequately disclose all material relevant for an accurate financial report

All changes regarding required principles and their application methods have been fully disclosed and explained.

2. Qualified opinion

One of two types of situations have been found but they do not affect the overall fair presentation of the rest of the financial statements:

- Single deviation from GAAP: one or more areas of the financial statements deviate from GAAP
- Limitation of scope: the auditor could not verify one or more areas, for example the counting of a department's inventory

3. Adverse opinion (opposite of a clean or unqualified audit)

Financial statements extensively differ from GAAP.

4. Disclaimer of opinion ('disclaimer')

The auditor couldn't form an opinion on the financial statements as auditing could not be completed, for various reasons.

Two institutions focus on auditing a budget:

- The Auditor General
- The Standing Committee on Public Accounts (SCOPA)

13.1 Role of the Auditor General

The Auditor General tables two general reports as well as a number of special and performance audit reports before Parliament. The two general reports are based on in-depth analysis of departmental performance. Here, the Auditor General:

- Establishes whether polices and directives were followed
- Verifies the findings
- Checks for compliance using an evidence-based approach
- Evaluates the performance and impact of programmes

13.2 Role of the Standing Committee on Public Accounts

The Standing Committee on Public Accounts (SCOPA) was established in accordance with Rule 204 of the National Assembly, and has functions and powers accorded through Rule 206. SCOPA is focuses on assessing if a budget has been implemented as planned, and if public funds have been spent in way that is efficient, effective and economic.

SCOPA assesses:

- The financial statements and audit reports of all executive organs of state sent to Parliament
- The financial statements and audit reports of all constitutional institutions sent to Parliament
- Any reports submitted by the Auditor General
- Any financial statements and reports referred to SCOPA

Reports are put into one of three categories:

1. **A – material findings, disclaimer and advise opinions**
   This requires a hearing.
2. **B – qualified opinion**
   Queries are sent to the department, which must give a written response.
3. **C – unqualified opinion, clean reports, immaterial findings**
   There is no further inquiry.

SCOPA may then start investigating issues of competency, which are followed by hearings. During these hearings, the responsible accounting officer and/or minister must:

- Explain how problems highlighted by the Auditor General are going to be responded to and solved
- Give reasons for why ongoing problems have not yet been resolved

SCOPA resolutions include both audit findings, and evidence from hearings and investigations. These resolutions are sent to Parliament and, once adopted, are sent to the relevant department minister. The Auditor General follows up with relevant departments on resolution implementation.

SCOPA's oversight cycle is as follows:

- September to October: analyse and prioritise annual reports
- January to April: schedule hearings
- April to May: produce and adopt resolutions
- June to August: attend to other reports

14. Budget analysis toolkit: looking at the numbers

Budget analysis is a key component of **assessing poverty alleviation** and **redistribution measures**. It looks at the extent to which a budget is 'developmental', and how likely it is to adequately **address socio-economic rights**.

Understanding a budget is the first step in evaluating it. Although budget analysis can be complex, you can use some simple techniques to demystify the numbers, see the fundamental trends and priorities in resource allocation, and come up with different ways of meeting specific objectives within a given resource envelope.

A key aim of quantitative (numerical) budget analysis is to **identify** trends so you can **ask informed questions** which require responses from decision makers. This fosters **accountability and debate** when resources with competing claims need to be allocated efficiently to maximise the social return of public spending.

Table 6: Budget analysis tools and questions

Focus	Key question	Outcome of analysis
1. Priority	How does the budget for this purpose compare to resources spent in other areas?	Assess whether these budget priorities are in line with government's policy promises and commitments
2. Progress	Is government's budgeting on this issue improving over time?	Monitor whether government is shifting its priorities over time
3. Equity	Are resources being allocated or spent fairly?	Evaluate whether government budgets discriminate unfairly
4. Adequacy	How much is being allocated to this issue?	See whether government's allocation is sufficient. Consider whether government allocations are keeping up with inflation

14.1 Priority

The **analysis of priority** does not tell us anything about **how many resources** have been allocated to a particular function. It only **compares functions to each other**.

Calculation

One way to find out priority is to work out the share of a department or programme's allocation in the total allocation. The percentage share is calculated as:

$$\frac{\textit{Amount allocated}}{\textit{Total budget amount}} \; x\ 100 \qquad \frac{\textit{Amount allocated}}{\textit{Total budget amount}} \; x\ 100$$

Example

A typical set of allocations in a budget document might look like something like this:

Table: 7: Programme allocations (R million)

Year	Education	Health	Economic Affairs	TOTAL
2011/12	131.4	84.6	130.2	800
2012/13	165.1	104.6	161.1	934
2013/14	189.5	112.6	136.6	979.4

Applying this technique to the numbers, we get the following:

Table 8: Programme allocations as percentage share of total budget

Year	Education	Health	Economic Affairs
2011/12	16.4%	10.6%	16.3%
2012/13	17.7%	11.2%	17.2%
2013/14	19.3%	11.5%	13.9%

It is much easier to get a sense of the priorities in the budget from the percentages than from the numbers themselves, and to identify changing relative priorities over time.

From Table 8, we see that, from 2011/12-2013/14, education was a growing priority of government. Health increased slightly, while economic affairs first increased, and then decreased significantly. This kind of analysis can generate further questions, such as what policy shifts, if any, explain these changes to resource allocation.

14.2 Progress

The **progress analysis looks at trends in resources** allocated to **programmes, departments** or **functions** over time.

Change in allocation from year to year

Calculation

This formula works out the percentage change, from one year to the next, in an allocation for a particular use:

(Allocation Year 2 – Allocation Year 1/Allocation Year 1)*100

Table 9: Allocations to widgets

	Year 1	Year 2	Year 3	Year 4
Widgets	R20 000	R27 000	R31 000	R30 000
Percentage change calculation	((27 000 – 20 000)/20 000)*100		Etc.	Etc.
Percentage Change	35%		15%	- 3%

Working out progress in the medium term

To assess progress of a department or programme's budgets in the medium term, calculate the average annual growth over a period of more than a year (usually over three years).

$$\textit{Average annual growth rate over the medium term} = \frac{year\ 1 + year\ 2 + year\ 3}{3}$$

Calculation

$$\textit{Average annual growth rate over the medium term} = \frac{year\ 1 + year\ 2 + year\ 3}{3}$$

Limitations of these calculations

These two calculations don't show changes in the buying power of money, because of **inflation**, over time. You can buy less with R50 today than 10 years ago.

Inflation is a general increase in prices and a fall in the buying power of money

A positive real increase can be seen as the minimum condition for progress in particular allocations. So, if a particular function, say spending to enable free primary education, is important to a country's development and poverty alleviation efforts, then you should see real growth (progress) in these allocations.

However, it also important to compare real trends in these allocations with real trends in other allocations, and the real growth of the economy (GDP) as well as of the budget as a whole.

Example

For example, if the government:

- Forecasts a real GDP growth rate of 4% for the coming fiscal year
- Estimates that tax revenue will increase in real terms by 5.5%

but

- Only increases allocations towards free primary education by 2%, you need to ask questions. Of course, a 2% increase may be enough to provide free primary education to all citizens

Accounting for inflation/deflation when assessing progress

Real allocations are allocations that have been adjusted for inflation.

Nominal allocations are allocations expressed simply at face value.

Note that though deflation (a general decrease in the price level) is fairly rare in modern economies, you would use exactly the same calculations to convert the nominal into the real amounts

If you compare budget allocations over time (longitudinally) you will get a skewed sense of progress if you haven't adjusted the numbers for the effects of inflation.

To do this, you will need to use a price index. You can get this from Statistics South Africa (http://www.statssa.gov.za/). Using a **price index**, you get a series of values, for example from 2000 to 2014, expressed in the rand value of a particular year, say 2014. This is called the base year.

Price indexes measure, for different purposes, changes in the price of particular baskets of goods and services. In South Africa, the Consumer Price Index (CPI) measures changes in the cost of a 'representative' basket of goods and services consumed by a household.

Calculation

The formula for this conversion is:

$$\textit{Real Allocation} = \textit{Nominal Allocation} \times \frac{\textit{Base Year Index Value}}{\textit{Current Year Index Value}}$$

Table 10: Nominal values of widgets converted to real values using (hypothetical) price indexes

	Year 1	Year 2	Year 3	Year 4
Widgets (nominal)	R20 000	R27 000	R31 000	R30 000
Price Index	86	89	95	100
Conversion calculation	20 000 *(86/100)	27 000 * (89/100)	31 000 * (95/100)	30 000 * (100/100)
Widgets (real)	R17 200	R24 030	R29 450	R30 000

When analysing real resource allocation trends, look at whether the allocation:

- Shows a positive real increase
- Shows a positive real increase similar to that of the economic growth rate and the growth rate of the budget in its entirety

Example

For example, if you wanted to evaluate the actual percentage growth rate of allocations to the National Health Vote over 10 years, you would need to use

Table 11: Annual budget allocations to the national health vote

Year (R Millions)	1999-2000	2000-2001	2001-2002	2002-2003
Nominal allocations	69 000	74 400	87 300	98 900
Total nominal allocations	170 700	188 900	215 100	244 600
Real allocations (2010 rands)	126 631	128 819	142 112	147 888
Total real allocations	313 275	327 068	350 152	365 758

Table 12: Annual percentage growth to national health vote allocations

Year (Percentage %)	2000-2001	2001-2002	2002-2003	2003-2004
Nominal allocations	8	17	13	12
Real allocations (2010 rands)	2	10	4	7
Difference in percentage growth	6	7	9	5

all those budget reviews. As the allocations in each budget review are nominal amounts for that year, you would need to convert them to real amounts to get an accurate view of growth rates and comparisons.

Table 12 shows the percentage increase in nominal allocations, and allocations adjusted for inflation (real allocations in 2010 rands). So, while it looks like the annual budget allocations for health increased by an average of 18% over the 10-year period, once you account for inflation you see that the real growth rate is 7% lower, at 11%.

This difference between **nominal and real allocations** can substantially **skew budget analysis and conclusions.** For example, if **the purchasing power of the rand has decreased,** what you were able to buy for R1 last year is not what you could buy with R1 today.

The higher and/or more volatile the inflation rate, the more difference there will be between real and nominal allocations, and the more essential it is to do the conversions before you start analysing the numbers.

2003-2004	2004-2005	2005-2006	2006-2007	2007-2008	2008-2009	2009-2010
110 500	121 100	196 400	213 500	246 900	288 300	346 100
284 400	321 200	367 800	418 400	489 300	579 600	691 200
158 255	170 664	267 546	277 792	295 278	306 831	346 100
407 311	452 662	501 035	544 394	585 174	616 855	691 200

2004-2005	2005-2006	2006-2007	2007-2008	2008-2009	2009-2010	Average
10	62	9	16	17	20	18
8	57	4	6	4	13	11
2	5	5	9	13	7	7

14.3 Equity

Budgetary incidence is the analysis of **who benefits from the budget expenditure** and **who contributes towards budgetary revenue** (resources).

Equity generally refers to a sense of justice and fairness. The budget can play a key role in promoting a fairer society. A redistributionary budget is a budget that favours the poor over the wealthy, making overall personal income more equal once the effects of the budget are taken into account.

Calculation

Budgetary incidence is fairly easy to describe, but its calculation is very difficult. For this reason, equity aspects are probably the most complex dimension of budget analysis.

Example

Budgetary redistribution can take place through both the expenditure and the revenue sides of the budget. For example, subsidised or free public services can be targeted at poorer individuals and households, as can allocations of direct income transfers. However, it can be difficult to determine whether the rich or the poor really benefit more from them, and to quantify (put a number to) this benefit.

A **progressive income tax system** taxes higher-income earners at a steadily increasing rate. As a result, wealthier individuals make a relatively larger contribution to the country's revenue pool. Taxes on consumption, such as South Africa's Value-Added Tax (VAT) tend to be moderately regressive, meaning poorer households contribute more as a share of their income than richer households. This is because a tax on consumption excludes savings, which are higher for the rich than the poor. Zero rating of basic household items means some items are excluded from the VAT. However, the extent to whether this benefits the poor depends on whether producers are able to keep the benefits of zero rating in the form of higher profits.

It is often more helpful to focus budget analysis on allocations to specific programmes or categories. Look at what budget allocations do for a specific group or issue, for example, women, children or rural households.

In some cases, equity must be balanced against efficiency. Setting tax rates too high may prevent investment in the economy and even lead to capital flight (**money leaving the country**), which would reduce economic growth and future tax revenue. High levels of poverty and inequality can increase the demand for and dependency on social welfare expenditure. They also contribute negatively to a country's economic potential as they tend to generate social ills like crime, illness and an absence of trust.

> It has been suggested that **the tax limit of a country is less than a government would hope** and **more than the private sector would like**.

14.4 Adequacy

> An adequacy analysis looks at whether the **inputs are enough to achieve intended goals.** To determine this, you will need to know **how much is needed for success.** This makes assessing adequacy **more difficult than assessing progress, priority and equity.** However, effective costing methods can help solve this problem.

Costing means working out the expenditure required to achieve an activity or strategy. When doing a costing, all inputs and outputs are identified and measured. The costs related to the outcomes they produce are calculated. Costing should be done for both the intermediate and final outputs. Sometimes it helps to relate costings to a specific activity. For example, how much does it cost to supply water to x number of houses?

There are three main types of costing.

1. **Total cost:** the cost of all inputs used to achieve a given level or number of outputs.

2. **Average cost:** the total cost divided by the total output. The formula for this is:

$$\textit{Average Cost} = \frac{\textit{Total Cost}}{\textit{Total Quantity Produced (Units of Output)}}$$

$$AC = \frac{TC}{Q}$$

3. **Marginal cost:** the extra cost of producing one more unit after other units have already been produced. The formula for this is:

$$\textit{The Marginal Cost} = \frac{\textit{Change in Total Cost of Production}}{\textit{Change in Quantity Produced}}$$

$$MC = \frac{\Delta\, TC}{\Delta\; Q}$$

Often the costs of producing one more unit decreases after the initial units have been produced. This is known as **economies of scale**.

Three types of costs must be considered

- **Direct costs** – all the expenses, including shared expenses
- **Indirect costs** – additional costs
- **Intangible costs** – expenses which may not be easy to assign a cost to. For example, the cost of time spent implementing a project using a manager instead of a researcher, or of not having implemented a project compared to implementing it. Often these are not firm values but need to be estimated with regard to their impact and consequences

Once a costing is done it can be compared to the resources allocated to the project. If the cost is higher than the resources available, then the allocation is inadequate. However, if the costing is equal to or less than the resources available, then the allocation is adequate or more than adequate. Adequacy is best assessed at the end of a financial year, when you know the outcomes and the costs for that year. However, to budget correctly, estimates of costings and questions of adequacy need to be assessed.

14.5 Useful budget analysis equations

Table 13: Useful budget analysis equations (quick reference sheet)

Calculation	Equation
To work out budget share	Budget Section ÷ Total Budget = Budget Share
To adjust for inflation by inflating an earlier year's data to a later year's values	Nominal Value x Current Year Inflation Index ÷ Later Year Inflation Index = Adjusted value
To adjust for inflation by deflating a later year's data to an earlier year's values	Nominal Value x Prior Year Inflation Index ÷ Later Year Inflation Index = Adjusted Value
To work out the inflation rate over several years	(Later Year Price Index - Prior Year Price Index) ÷ Prior Year Price Index = Inflation Rate
To work out an inflation index using a base year	Base Year Index + Later Year Inflation Rate = Inflation Index for Later Year
To calculate a growth rate	(Later Year % - Prior Year %) ÷ Prior Year Percentage = Percentage Increase in Budget Share
To work out the rate of growth required to reach a desired level of spending	(Desired Amount - Current Year Amount) ÷ Current Year Amount = Required Rate of Increase
To calculate increase in budget share over time	(Later Year Percentage - Prior Year Percentage) ÷ Prior Year Percentage = Percentage Increase in Budget Share
To work out an annual average growth rate in Excel	Rate (Number of Years, 0, - Prior Year Amount, Current Amount)
To calculate per capita spending	Spending ÷ Population Number = Per Capita Spending
To calculate spending as abshare of the economy	Spending ÷ GDP = Spending as a Share of the Economy

Notes

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The Institute for Security Studies is an African organisation that aims to enhance human security on the continent. It does independent and authoritative research, provides expert policy analysis and advice, and delivers practical training and technical assistance.

Acknowledgements

This guide was made possible with support from the governments of Finland and Sweden. The ISS is also grateful for support from the other members of the ISS Partnership Forum: the governments of Australia, Canada, Denmark, Japan, Netherlands, Norway and the USA.

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ISS Guide

ISBN 978-1-920678-05-0