Chapter 14
Financial Framework for Comprehensive Social Protection

14.1 Introduction

There is no single approach to financing or delivering social security. A range of approaches including user charges, earmarked taxation of one form or another, Government regulation or general tax financing exists. In some instances, non-contributory social assistance is combined with contributory social insurance to achieve greater institutional integration.

Mixed financing options for public and semi-public goods and services are not the exclusive domain of social security. Establishing these principles generically for Government is, however, essential quite aside from its applicability to social security. In this chapter of the Report consideration is given to:

- The Constitution, particularly where it refers to aspects of Government finance
- An overview of South Africa's social security system and the key issues in social security financing
- The principles underlying the use or selection of particular forms of taxation, levy or user fee for the social security system as a whole, or individual programmes
- Accounting for alternative revenue sources in the national accounts, and their relationship to the National Revenue Fund
- Financial management issues where mixed financing options are considered.

14.2 Constitutional provisions affecting social security financing

An important issue for the Committee to consider was whether any "prohibition" to the use of earmarked taxes or contributory financing existed in terms of the Constitution. These forms of funding social security are well established internationally and will need to be introduced more extensively in South Africa over the medium-to long-term.

Section 185 of the Constitution prescribes that a National Revenue Fund be established, "into which shall be paid all revenues, as may be defined by an Act of parliament, raised or received by the national Government, and from which appropriations shall be made by an Act of parliament, raised or received by the national Government, and from which appropriations shall be made by parliament …"

Section 186 stipulates that an annual budget reflecting the estimates of revenue and expenditure shall be laid before the National Assembly for each financial year. Provision is similarly made in section 159 as amended, for provincial revenue funds in each province:

> *… into which shall be paid all revenue accruing to the provincial government, and all financial allocations … made by the national government to such a provincial government and to local governments within the province of such a provincial government.*

The Constitution stipulates, in effect, that the national Government and provincial Governments should receive revenue into, and make appropriations from, single general purpose funds. The Constitution lays the basis for consolidated national and provincial revenue and expenditure accounts, thereby contributing to the transparency and the effective accountability to the legislative authorities of the public finances.

According to the Katz Commission, although the notion of "revenues" in section 185 is not defined and the sections of the Constitution dealing with financial matters are open to various possible interpretations, these provisions appear to bar the extra-budgetary assignment of national or provincial Government revenues to special purpose funds.

The Katz Commission also notes that although the constitutional provisions:

> *… do not altogether preclude the earmarking of nationally collected taxes for the (conditional) financing of specific schedule 6 services within the budgetary process, it is clear that such arrangements could only be considered as an integral part of the broader inter-governmental financial framework. (Katz Commission, par.3.5.4).*

The Constitution also provides for the imposition by provincial legislatures of user charges, taxes, levies and duties other than income tax, value added tax or other sales taxes, and surcharges on taxes. These may not discriminate against citizens who are not residents of the provinces concerned.

The Committee finds that the Constitution in no way prohibits the creation of dedicated taxes, earmarked funding or for tax and non-tax forms of revenue for public or quasi-public institutions. Choices about revenue or spending mechanisms fall into the realm of policy determination and their merits have to be evaluated on a case-by-case basis.

14.3 An overview of South African social security financing

This section provides a review of specific issues and concerns brought to the attention of the Committee. These came by way of written and oral submissions, and reports made available.

14.3.1 Determination of the allocation to the social sector functions

The determination of the social sector allocation is said to be based largely on available funds rather than an objective relationship between priorities and available resources. The issue in question is not whether or not financial constraints actually exists, but rather whether the constraint is related to objective criteria that takes into account social impact and relative priorities.

The constitutional obligations imply that a proper budgetary assessment must be carried out which takes into consideration *all* the available resources of the state, not simply those in the relevant department's budget. If resource constraints prevent the state from discharging all of its obligations then it must give priority to the most vulnerable sections of the community. Further, it must demonstrate that every effort has been made to use all of the resources that are its disposition.

14.3.2 Budget prioritisation

The process of prioritising the allocation of the Government's budget is a complex political and institutional exercise. From 1994 a substantial change in the process and the policy direction of Government occurred. These changes included a number of attempts to improve budget prioritisation and planning. Substantial improvements have occurred in areas such as transparency and explicit links between intentions and fiscal resources.

However, residual problems appear to remain. A key concern relates to the fact that three social policy areas of major national significance, social security, health and education, are budgeted for at a provincial level. The link between national policy determination and provincial decision-making is consequently weak. This affects the degree to which provinces adhere to national policy, and the extent to which financial resources are allocated according to national priorities.

The process by which the largest and most important social allocations are determined is both indirect and fragmented. As a consequence, changes in global and inter-provincial allocations are not explicitly determined.

The loss of explicit budgeting control over national priorities appears to result in particular problems in the following areas:

- Poverty alleviation
- Social transfers
- Inter-provincial co-ordination and planning of healthcare services
- The achievement of equity in the physical allocation of health resources.

14.3.3 Mixed financing principles

No clear framework, consistent with generally accepted public finance principles, exists in relation to non-general tax revenue sources of finance. Alternative financing will always exist for goods and services that are quasi public or quasi private in nature. Sources will derive from levies, user charges and earmarked taxes of one form or another. The approach used to price and operate public entities that are fully or partially funded on such a basis needs to be consistent and uniformly applied.

14.3.4 Allocation of the horizontal division

The formula used to divide up the allocation between provinces was cited as a problem. Mismatches can occur between the funds made available through the formula and actual needs resulting from mandates established at the national level. A key example is the social assistance system, whereby national legislation establishes the entitlement but the provincial allocation system does not guarantee that funds will be available.

14.3.5 Medium-term Expenditure Framework

The Medium-term Expenditure Framework (MTEF) is intended to improve budget planning. The MTEF process is clearly in its infancy in terms of achieving more advanced and complex budget planning and prioritisation objectives. To date it has assisted in collating budgets within fiscal envelopes. These were largely devoid of relative prioritisation.

14.3.6 Conditional grants and special projects

Conditional grants are allocations voted for transfer to a lower level of Government subject to certain conditions being met. South Africa has used this fiscal mechanism since the introduction of the fiscal federal system in 1997 for a number of special programmes and spillover problems. The largest system of conditional grants occurs within the health sector, with around R6 billion voted to the national Department of Health for allocation to provinces with supra-regional services and teaching and research activities.

A number of the smaller grants linked to poverty alleviation, HIV/AIDS, hospital rehabilitation, primary school nutrition, all faced difficulties at various stages in fully utilising the available funds. Problems appear to have been related to the following:

- Onerous application requirements are placed on accessing the funds.
- Treasury, in advance of adequate planning in departments, often determines the availability of funds. This results in significant delays in complying with planning and tendering requirements and has an impact on the utilisation and disbursement of the allocations.

14.3.7 Allocation of the vertical division

According to the 2001 Budget Review the national provincial and local spheres of Government provide different services, so that the allocation of resources between the spheres also reflect the prioritisation of different services.

The Budget Review explains that the Constitution establishes three distinct spheres of Government. It identifies the responsibilities of each sphere and requires an inter-Governmental fiscal system that meets these requirements. According to Treasury, local and provincial Governments are responsible for delivering social and municipal services as well as a range of services that contribute to the economic and social well-being of South Africans:

A system of concurrent or joint responsibilities applies between national and provincial governments for functions like school education, health, welfare, housing, agriculture and urban and rural development. This in practice means that national government determines policy and regulates compliance,