6

Provincial and local government finances

National transfers to provinces and local government will grow by 4,0 per cent and 4,3 per cent a year in real terms over the 2005 MTEF period. Together, the two spheres receive additional allocations amounting to R36,3 billion over the baseline to further reinforce spending on social services, infrastructure and basic municipal services.

Provinces receive R33,5 billion more over baseline. This will see total national transfers to provinces rising from R185,4 billion in 2004/05 to R242,4 billion by 2007/08. The composition of national transfers to provinces changes significantly in 2005/06 as social security expenditure will be funded through a conditional grant as a transitional step towards the establishment of a social security agency.

Local government receives additional allocations of R2,8 billion to reinforce operational and infrastructure expenditure relating to free basic water, electricity and other municipal services in line with Government's social development commitments.

Introduction

Allocations to provinces and local government give expression to the social contract

Provincial and municipal functions are central to the attainment of Government's social and development objectives. The proposed 2005 budget framework further reinforces the shift in the vertical division of revenue in favour of these spheres.

Additional resources mainly reinforce existing priorities

With the expanded resource envelope, provinces are now in a position to:

- Step up spending on education, including remuneration of educators, key curricular support material and improved maintenance of infrastructure.
- Further raise spending on health, including improved remuneration of professional staff, and comprehensive HIV and Aids prevention and treatment programmes.

- Complete the phasing in of the child support grant to children until they turn 14.
- Implement key programmes that contribute to economic growth and job creation such as the Expanded Public Works Programme and the Comprehensive Agricultural Support Programme.

An additional R1,5 billion is allocated to housing

Adjustments to the provincial total allocation include R1,5 billion earmarked for the implementation of the new Housing Strategy that will support a broader range of accommodation options and contribute to more integrated urban development. In addition, R500 million is added to the provincial infrastructure grant.

Shifting of social security creates space for consolidation of remaining services

Coupled with the shift of the social security grants function, the expanded resource envelope puts provinces in a firm position to consolidate service delivery in education and health, and to prioritise welfare services. The shift of responsibility for social security grants will allow provinces to devote more resources – financial, human and otherwise – to the remaining welfare services, thereby facilitating their consolidation.

A further R2,3 billion for basic services

About R2,3 billion of the additions to the local government share flow through the equitable share over the 2005 MTEF. It is anticipated that municipalities will reinforce delivery of basic services by accelerating the roll out of basic electricity, water, refuse removal and sanitation to poor households. An additional R500 million is allocated to the Municipal Infrastructure Grant to reduce infrastructure backlogs.

Funding provincial government

Provincial priorities for the 2005 MTEF

Consistent with Government's commitment to accelerate implementation of existing policies, the provincial budget framework seeks to consolidate ongoing programmes.

Both personnel and non-personnel spending in education will be stepped up

For education, the 2005 MTEF provides for salary adjustments agreed in the recent wage settlement. At the same time, strong growth in spending on school infrastructure will be accommodated in order to eliminate backlogs and improve the maintenance of school buildings. The current trajectory of spending on school-based education inputs such as textbooks and equipment, important in improving the quality of learning, will also be sustained.

Implementation of scarce skills strategy remains priority

Because highly skilled professional personnel are key to the delivery of good health care, implementation of the scarce skills strategy continues to be priority in health. As the roll out of treatment programmes under the umbrella of the Comprehensive

Treatment Programme for HIV and Aids gathers momentum, spending on this programme is likely to increase.

About R900 million added to provincial primary health care spending over the next three years

The newly promulgated National Health Act assigns primary health care, which now excludes environmental health, to the provincial sphere. Primary health care services currently residing in local government amount to about R1,0 billion. Of this amount, approximately R700 million is spent in metropolitan areas, and R300 million in non-metropolitan municipalities. To facilitate a phased shifting of the funding responsibility for primary health care, provinces will take over the funding of services mainly delivered by non-metropolitan municipalities from 2005.

26 more hospitals to have their infrastructure revamped

Following the completion of ten projects funded through the Hospital Revitalisation Grant, 26 new projects amounting to R3,4 billion will commence next year. Funding for these projects is part of the baseline allocations.

The biggest increases go to social security grants

The main additions to the provincial share go to the new conditional grant for social security payments. Excluding the technical adjustment, due to the change in the financing mechanism from equitable share to conditional grant, an additional R20,8 billion over baseline is set aside for social security. This provides for completion of the phasing in of the child support grant, increases in grant values, and growth in numbers of disability and foster care grant beneficiaries.

Changes in social security financing will have positive spin offs for welfare services

Over the period ahead, provinces will prioritise strengthening of developmental welfare services by building and expanding welfare service capacity. The change in the funding mechanism relating to social security creates more scope for provinces to focus on welfare services.

Spending on labour based infrastructure projects will still be prioritised

Alongside social services, several other provincial functions will continue to enjoy priority. The housing programme is allocated an additional R1,5 billion over the MTEF period, which together with resources released through reprioritisation, will fund implementation of the new housing strategy. Increased support for emerging farmers through the Comprehensive Agricultural Support Programme will continue, alongside implementation of labour-based projects in the area of roads and other provincial infrastructure.

National transfers to provinces

Additional resources for education, health and social development

The provincial fiscal framework for the 2005 MTEF provides additional resources to consolidate school education, health (particularly primary health care), developmental welfare services, and to expand the coverage of social security grants. These programmes are funded mainly from nationally raised revenue.

Table 6.1 Provincial fiscal framework (adjusted for social security grant function shift)

R million	2004/05	2005/06	2006/07	2007/08
Provincial equitable share adjustments				
Current equitable share baselines	159 971	173 852	186 392	195 711
Less: Social security[1]	-38 393	-41 724	-44 734	-46 971
New equitable share baseline	**121 578**	**132 127**	**141 658**	**148 741**
Conditional grants				
Current conditional grant baselines	21 181	25 853	29 953	31 450
Social security[1]	38 393	41 724	44 734	46 971
Municipal infrastructure grant function shift[1]	-41	-44	-46	-48
New conditional grant baselines	**59 534**	**67 534**	**74 640**	**78 372**
Total transfers to provinces baseline	**181 112**	**199 661**	**216 298**	**227 113**
Shares in national transfers				
Equitable share	*67,1%*	*66,2%*	*65,5%*	*65,5%*
Conditional grants	*32,9%*	*33,8%*	*34,5%*	*34,5%*

1. The social security grants shift from the provincial equitable share to conditional grants and the municipal infrastructure grant shifts from provinces to local government, as from 1 April 2005. The 2004/05 number is reflected for comparative purposes.

The shift of social security grants to the national sphere has implications for the provincial fiscal framework

A major change in the provincial fiscal framework for the 2005 MTEF is the shift of the social security grant function from the provincial to the national sphere of government. Table 6.1 shows the new provincial fiscal framework after adjusting for the social security grant function shift and before the 2005 MTEF revisions. This results in the equitable share decreasing from 88 per cent of total transfers to provinces to around 66 per cent, while the share of conditional grant transfers increases from 12 per cent to 34 per cent. The conditional grant for social security is a first step towards the shift of this function to the national sphere when the National Social Security Agency is fully operational.

Though the funding mechanism for social security grant funding will only change from 2005/06, these adjustments are made to the 2004/05 financial year in the tables above and below, to facilitate comparisons between the 2005 MTEF and the current year budget.

National transfers comprise the bulk of provincial funding

Transfers to provinces from nationally raised revenue will grow by 4,0 per cent in real terms over the MTEF, from a revised R185,4 billion in 2004/05 to R242,4 billion in 2007/08.

Table 6.2 Revision to provincial budget framework, 2004/05 – 2007/08

R million	2004/05 Revised	2005/06	2006/07	2007/08
		Medium term estimates		
Total provincial allocation	**185 354**	**207 782**	**226 380**	**242 428**
Equitable share	122 425	133 647	144 792	154 756
Conditional grants	62 928	74 135	81 588	87 672
Changes to baseline				
Equitable share	847	1 520	3 134	6 015
Conditional grants	3 395	6 601	6 948	9 300
Total changes to baseline	**4 242**	**8 121**	**10 082**	**15 315**

Table 6.2 shows the revisions to the technically adjusted provincial fiscal framework and the new equitable share and conditional grant baselines for the 2005 MTEF. Of the R33,5 billion added to the provincial share over the MTEF, R10,7 billion goes to the equitable share, while R22,8 billion is added to conditional grants. This will see the equitable share rising from R122,4 billion in 2004/05 to R154,8 billion in 2007/08. Conditional grants grow from R62,9 billion to R87,7 billion over the same period.

National transfers to provinces increased by R33,5 billion over the next three years

The provincial equitable share and the horizontal division of revenue

The growth in the provincial equitable share primarily caters for the three-year wage agreement for public servants and further adjustments to the remuneration of educators. The additional allocations also provide for funding of the primary health function in non-metropolitan municipalities, strengthening of school-based education, and the expansion of developmental welfare services.

Equitable share provides for further improvements to the remuneration packages of educators

The division of the equitable share allocation among provinces is done through an objective redistributive formula. The formula is reviewed and updated every year for new data, taking account the recommendations of the Financial and Fiscal Commission (FFC). More detail on Government's response to the FFC's proposals, which informed this year's review, will be published with the Division of Revenue Bill next year.

Objective formula used to divide the equitable share amongst provinces

A broad-ranging review of the formula has been undertaken for the 2005 MTEF. It covered the structure of the formula, weights of components and other economic development and poverty related policy considerations. The review also takes into account the change in the financing and administrative arrangements relating to the delivery of social security grants. The formula consists of four main components and two minor elements, as outlined below:

The structure of the provincial equitable share formula

- The education component uses census data for the school-age cohort and official estimates of school enrolment, weighted equally (whereas in the previous formula school-age population was double weighted). The weight of the education component is 51 per cent, based on average education expenditure (excluding conditional grants) in total provincial spending.
- The health component is based on estimated numbers of people with and without medical aid coverage weighted at a 1:4 ratio. The weight of the health component is 26 per cent,

based on average health expenditure (excluding conditional grants) in total provincial spending.

- An institutional component is allocated equally across provinces, to take account of core provincial administration costs. It has a weight of 5 per cent.
- The basic component, with a weight of 14 per cent, is calculated on the basis of the population share of each province.
- A poverty component, with a weight of 3 per cent, reinforces the redistributive bias of the formula
- An economic component, weighted at 1 per cent, takes care of the fact that provincial revenue raising powers have not changed, notwithstanding the Provincial Tax Regulation Process Act.

The impact of the formula will be phased over three years

The revised formula results in shifts in individual provincial equitable shares. To avoid disruptive adjustments in provincial allocations, the new share will be phased-in over three years as reflected in table 6.3.

Table 6.3 Equitable share phase-in percentages, 2005/06 – 2007/08

	Current weighted shares	2005 MTEF New weighted shares (target)	2005/06 New weighted shares 3-year phasing	2006/07	2007/08
Eastern Cape	16,7%	16,0%	16,5%	16,3%	16,0%
Free State	6,5%	6,2%	6,4%	6,3%	6,2%
Gauteng	15,3%	15,7%	15,5%	15,6%	15,7%
KwaZulu-Natal	20,8%	21,7%	21,1%	21,4%	21,7%
Limpopo	13,6%	13,7%	13,7%	13,7%	13,7%
Mpumalanga	7,3%	7,5%	7,4%	7,5%	7,5%
Northern Cape	2,4%	2,2%	2,3%	2,3%	2,2%
North West	8,3%	8,1%	8,2%	8,2%	8,1%
Western Cape	9,0%	8,9%	8,9%	8,9%	8,9%
Total	**100,0%**	**100,0%**	**100,0%**	**100,0%**	**100,0%**

Provincial equitable share grows by 2,8 per cent a year in real terms

Table 6.4 sets out the revised equitable share allocations for 2004/05 and the 2005 MTEF period. Although the new data and the structure of the formula result in lower target shares for some provinces, all provinces still receive increases in absolute terms over the MTEF (as total allocations to provinces increases over baseline). On average, the provincial equitable share grows by 2,8 per cent in real terms over the next three years.

Table 6.4 Provincial equitable share allocations, 2004/05 – 2007/08

R million	2004/05 Revised	2005/06	2006/07	2007/08
		Medium term estimates		
Eastern Cape	20 655	22 044	23 543	24 800
Free State	8 075	8 586	9 129	9 573
Gauteng	18 786	20 670	22 596	24 368
KwaZulu-Natal	25 300	28 159	30 944	33 539
Limpopo	16 675	18 247	19 773	21 139
Mpumalanga	8 882	9 890	10 811	11 658
Northern Cape	2 938	3 100	3 282	3 425
North West	10 156	10 996	11 825	12 544
Western Cape	10 959	11 956	12 889	13 709
Total	**122 425**	**133 647**	**144 792**	**154 756**

Conditional grants to provinces

Main changes to conditional grants occur in Social Development

The addition of the conditional grant for social security is the major change to the conditional grant framework for the 2005 Budget. In addition, some grants are phased out while others are subsumed into new grants. Table 6.5 sets out the conditional grants to provinces over the 2005 MTEF period.

Social security grants will be funded through a conditional grant from 1 April 2005

Social security spending (grants and administration) will be funded through a nationally administered conditional grant from 1 April 2005. This is an interim measure in preparation for the shifting of the administration of this function to the Social Security Agency that is being established. The current Child Support Extension Grant is incorporated into this grant. The conditional grant for social security is allocated R55,2 billion in 2005/06, R60,9 billion in 2006/07 and R64,1 billion in 2007/08. This includes upward revisions of R6,6 billion, R6,8 billion and R7,4 billion in each of the MTEF years.

Conditional grants rationalised

The Local Government Capacity Building Fund administered by the Department of Provincial and Local Government is phased out, in line with previous budget announcements. The Project Management Capacity for the Municipal Infrastructure Grant is added to the Municipal Infrastructure Grant, which is transferred directly to municipalities. Accordingly, amounts of R43,6 million in 2005/06, R46,2 million in 2006/07 and R48,5 million in 2007/08 are deducted from the share of conditional grants to provinces and added to local government.

INP phased into the provincial equitable share in 2006/07

The Integrated Nutrition Programme administered by the Department of Health will be incorporated into the provincial equitable share from 2006/07. The nutrition programme will continue, directly funded by provinces.

The housing programme is allocated R16,6 billion over the next three years

The housing subsidy programme is allocated an additional R1,5 billion over baseline. In total, the housing programme is allocated R16,6 billion over the next three years. A further R500 million is allocated to the Provincial Infrastructure Grant.

Table 6.5 Conditional grants to provinces, 2004/05 – 2007/08

R million	2004/05 Revised	2005/06	2006/07	2007/08
		Medium term estimates		
Agriculture	**344**	**290**	**345**	**362**
Comprehensive Agriculture Support Programme Grant	200	250	300	315
Land Care Programme Grant	44	40	45	47
Agricultural Disaster Management (Drought Relief) Grant	100	–	–	–
Education	**991**	**1 048**	**1 243**	**1 305**
HIV and Aids (Lifeskills Education) Grant	134	136	144	152
Primary School Nutrition Programme Grant	832	912	1 098	1 153
Early Childhood Development Grant	2	–	–	–
Financial Management and Quality Enhancement Grant	22	–	–	–
Health	**7 655**	**8 486**	**9 228**	**9 690**
Comprehensive HIV and Aids Grant	782	1 135	1 567	1 646
Health Professions Training and Development Grant	1 434	1 520	1 520	1 596
Hospital Management and Quality Improvement Grant	142	150	159	167
Hospital Revitalisation Grant	912	1 027	1 180	1 239
Integrated Nutrition Programme Grant	112	123	–	–
National Tertiary Services Grant	4 273	4 529	4 801	5 041
Housing	**4 589**	**4 868**	**5 260**	**6 818**
Housing Subsidy Grant	4 474	4 745	5 130	6 682
Human Settlement and Redevelopment Grant	116	122	130	136
Land Affairs	**6**	**–**	**–**	**–**
Alexandra Urban Renewal Project Grant	6	–	–	–
National Treasury	**3 348**	**3 731**	**4 118**	**4 824**
Provincial Infrastructure Grant	3 348	3 731	4 118	4 824
Provincial and Local Government	**220**	**–**	**–**	**–**
Local Government Capacity Building Grant	220	–	–	–
Social Development	**45 766**	**55 688**	**61 356**	**64 634**
Food Relief Grant	388	388	411	432
HIV and Aids Community-Based Care (CBC) Grant	70	74	79	83
Social Security Grants	45 308	55 225	60 866	64 119
Sport and Recreation South Africa	**9**	**24**	**39**	**41**
Mass Sport and Recreation Participation Programme Grant	9	24	39	41
Total	**62 928**	**74 135**	**81 588**	**87 672**

Funding local government

Policy priorities and fiscal framework

The vertical division of revenue takes account of the fiscal capacity of municipalities

Additional allocations to local government are intended to boost spending on free basic services such as water and sanitation, electricity and refuse removal, and to contribute to accelerating infrastructure investment in under-serviced areas. The vertical division of nationally raised revenue takes into account the fiscal capacity and functions of local government, as municipalities have the power to impose taxes and user charges. The key priorities over the medium term relate to the expansion and provision of free basic services and the phased expansion of basic infrastructure to poor households.

Although substantial progress has been made in the reform of local government, many municipalities are finding it difficult to meet their developmental mandate.

An additional R2,8 billion is added to the local government share

Of the additional R2,8 billion allocated over the MTEF period to local government, R2,3 billion is added to the equitable share and R500 million is added to the Municipal Infrastructure Grant. Additional resources flowing through the equitable share are intended to reinforce accelerated implementation of free basic services to poor households.

Implementation of MIG to be staggered

The implementation of the Municipal Infrastructure Grant (MIG) commenced in 2004/05. The MIG, which consolidates all infrastructure grants from national to the local sphere, received a substantial boost of R1, 7 billion above baseline in the 2004 Budget and will be increased in the outer years as spending capacity improves. The grant contributes towards increasing the capital budgets of municipalities, thereby laying the basis for the elimination of backlogs in infrastructure and ensuring that all South Africans enjoy access to a basic level of service.

A review of the local government fiscal framework is under way

Government commenced the process of reviewing the local government fiscal framework in 2003. The review is intended to lead to reforms that will improve the performance of the local government sphere. The review will focus on the reform of regional services council levies, introduction of a new property rating and valuation system as contained in the Municipal Property Rating Act and assessing the impact of the restructuring of the electricity distribution industry on municipal finances.

Local Government equitable share formula is also under review

The formula for allocating the local government equitable share allocations is also under review. The aim of the review is to develop a simpler formula that balances demand for basic services and takes more explicit account of variations in the revenue raising capacity of municipalities. Taking account of the constitutional role of local government, the design of the new formula will seek to reinforce the following objectives:

- Provision of basic services
- Development
- Efficiency and good governance
- Redistribution
- Stability and predictability of allocations.

The review will be completed in time for the 2005 Budget, though many of the new proposals emerging will be phased in over three years. The review also takes into account the recommendations of the FFC. The 2005 Division of Revenue Bill published on the day of the 2005 Budget will provide further details on the outcome of the review, as well as Government's response to the FFC.

Transfers to local government

Local government receives an additional R2,8 billion

Allocations to municipalities from the national sphere occur through an unconditional equitable share and through conditional grants. Conditional grants are allocated for infrastructure and for capacity building and restructuring. The total allocations to local government grow from R14,8 billion in 2004/05 to R19,4 billion in 2007/08. In addition to the R2,8 billion increase over baseline for the 2005 MTEF a further R138,2 million shifts from the provincial share to the local share as the Project Management Capacity Building Grant for MIG is incorporated into the main Municipal Infrastructure Grant. Table 6.6 sets out the allocations to local government.

The equitable share receives the bulk of the resources

With the additional allocations, the equitable share component grows at a real rate of 6,8 per cent a year from R8,5 billion in 2004/05 to R11,9 billion in 2007/08 boosting the ability of municipalities to fund the provision of basic services to poor households. The equitable share portion rises to 61 per cent of total transfers to local government, reflecting a shift towards greater discretion at the local level.

R500 million is added to MIG over the MTEF period

An additional R500 million is added to the MIG taking total allocations for infrastructure over the three-year period to R18,4 billion. The capacity building and restructuring grants were set up to assist municipalities in developing their planning, budgeting, financial management and technical skills. Three grants fall into this category: the Financial Management Grant, the Municipal Systems Improvement Grant and the Restructuring Grant. Given that municipalities can also access funds from the local government SETA, no additional allocation is made to capacity building and restructuring grants.

Table 6.6 Revision to local government allocations, 2004/05 – 2007/08

	2004/05	2005/06	2006/07	2007/08
R million		Medium term estimates		
Local government baseline allocation	**14 280**	**15 959**	**17 137**	**17 994**
Equitable share and related [1]	8 536	9 578	10 355	10 873
Infrastructure	4 980	5 589	5 987	6 323
Capacity building and restructuring	723	749	749	749
Municipal infrastructure grant function shift[2]	41	44	46	48
Changes to baseline	**477**	**600**	**800**	**1 400**
Equitable share and related	–	600	700	1 000
Infrastructure	477	–	100	400
Total revised allocations	**14 757**	**16 559**	**17 937**	**19 394**
Equitable share and related [1]	8 536	10 178	11 055	11 873
Infrastructure	5 498	5 633	6 133	6 772
Capacity building and restructuring	723	749	749	749

1. Includes water operating subsidy.

2. The municipal infrastructure grant shifts from provinces to local government from 1 April 2005. The 2004/05 number is reflected for comparative purposes.