4

Expenditure priorities and the division of revenue

In brief

- Government proposes expenditure growth of 7.6 per cent a year over the next three years, reaching R1.55 trillion by 2017/18.
- The proposed fiscal package reduces previously announced indicative budgets for 2015/16 and 2016/17 by R10 billion and R15 billion respectively.
- In line with the medium-term strategic framework, the largest allocations over the three-year spending period ahead are to basic education (15 per cent), health (11 per cent) and social protection (11 per cent).
- Spending by function will grow most rapidly in post-school education and training, and employment, labour affairs and social security funds.
- Debt-service costs will grow at 9.3 per cent per year – faster than the budget as a whole – reaching about R150 billion in 2017/18.

Spending plans for the next three years

In line with the economic outlook discussed in Chapter 2, and the fiscal policy considerations set out in Chapter 3, government has adjusted its plans for the three-year spending period ahead. Moderate real growth in spending will enable government to finance most of the key priorities of the National Development Plan as expressed in the medium-term strategic framework (MTSF).

Moderate real growth in spending will enable government to finance most MTSF priorities

Expenditure will remain focused on social services (education and skills development, health and social protection), which will account for about 42 per cent of allocated spending over the medium-term expenditure framework (MTEF) period. About 18 per cent of spending will be directed towards the provision, management and regulation of social and economic infrastructure. Government will continue to pursue greater efficiency and value for money in achieving its goals.

Lowering the previously announced expenditure ceiling necessitates some downward adjustment to spending plans over the next two years, and a comprehensive assessment of baselines may result in the reconfiguration

Spending ceilings have been lowered for 2015/16 and 2016/17 of the composition of spending in 2017/18. Cost-containment measures announced in the 2014 Budget are being reinforced.

This chapter discusses the policy considerations that will inform the division of revenue over the medium term and outlines government's approach to funding the first three years of the MTSF.

Medium-term expenditure framework

Policy goals

The 2014-2019 MTSF guides the coordination of policy and resource distribution through 14 *outcomes* that shape allocations to government's functions.

Outcomes targeted in the medium-term strategic framework

1. Quality basic education
2. A long and healthy life for all South Africans
3. All people in South Africa are and feel safe
4. Decent employment through inclusive growth
5. A skilled and capable workforce to support an inclusive growth path
6. An efficient, competitive and responsive economic infrastructure network
7. Vibrant, equitable, sustainable rural communities contributing to food security for all
8. Sustainable human settlements and improved quality of household life
9. Responsive, accountable, effective and efficient local government
10. Protect and enhance our environmental assets and natural resources
11. Create a better South Africa, and contribute to a better Africa and a better world
12. An efficient, effective and development-oriented public service
13. A comprehensive, responsive and sustainable social protection system
14. A diverse, socially cohesive society with a common national identity

Public spending trends

Public spending grew faster than economy as a whole over past decade

Long-term trends in public spending reflect the expansion of service delivery to poor households and the development of a social wage. They also show how fiscal space has closed as growth has weakened and debt costs have risen:

- Public spending has increased faster than inflation, with nominal annual spending growth averaging 11.7 per cent between 2005/06 (when the main budget was R421 billion) and 2014/15 (R1.14 trillion).
- Between 2005/06 and 2014/15, public spending grew faster than the economy as a whole. Public spending on the main budget now accounts for 31 per cent of GDP, up from 26 per cent in 2005/06.
- Expenditure growth has concentrated on social and economic infrastructure, as well as programmes that contribute to the social wage, such as education and health care. Together, spending on these functions has risen from 51 per cent of the main budget in 2005/06 to 59 per cent in 2014/15. Much of this growth is accounted for by the doubling of the proportion of spending allocated to housing and municipal infrastructure and services, from about 6 per cent in 2005/06 to 12 per cent in 2014/15.
- Growth in spending on capital goods has outpaced growth in current spending.

- Compensation of employees has grown relatively quickly. As a result, growth in spending on goods and services, and transfers to households, now accounts for a smaller share of spending.
- Although expenditure on state debt costs grew more slowly than total spending over the past decade, interest payments have grown rapidly in the past few years, and now absorb more than 10 per cent of the budget, up from about 8 per cent in 2008/09 and 2009/10.

Laying the foundations for growth

To achieve the principal goals of the National Development Plan, including the creation of 11 million new jobs by 2030, the economy must grow rapidly over an extended period. Public spending can help lay the necessary foundations for growth both directly and by encouraging greater private-sector investment. In this regard, government is focusing on several policy goals.

To create 11 million jobs by 2030, economy must grow more rapidly

Dynamic cities

Well-planned and well-managed urbanisation can accelerate economic growth. Proposed reforms to the structure and conditions of infrastructure grants to local government will scale up provision of well-located and affordable social housing, and strengthen the upgrading of informal settlements. Public investments in housing and infrastructure should also be designed to crowd-in additional private-sector and household investment. Government will work with development finance institutions to expand the municipal debt market.

Proposed reforms to local government infrastructure grants aim to help reconfigure cities

Government is providing support to enable cities to promote growth and urban spatial transformation:

- A project preparation facility helps municipalities prepare plans that are ready for implementation.
- The infrastructure delivery management system is being expanded from provinces to large cities.
- Technical assistance will support the review of borrowing strategies.

Including the local government equitable share, about R560 billion has been made available for service delivery, municipal infrastructure development and housing over the next three years, with annual allocations growing at 8.1 per cent a year. In addition, nearly R230 billion has been allocated for economic infrastructure and network regulation.

Increasing competitiveness and employment

South Africa needs to boost exports to help finance development. To this end, government has increased support for the function group responsible for industrial development, trade and innovation at a rate considerably faster than that of overall spending in recent years. Key incentive programmes run by the Department of Trade and Industry, for example, have grown by nearly 18 per cent a year over the past three years. Over the MTEF period, proposed allocations in excess of R18 billion support the competitiveness of the manufacturing sector, and government is looking to improve the design of the support offered.

Support for industrial policy has increased more rapidly than overall spending in recent years

Expanded public works, employment tax incentive, Jobs Fund contribute directly to job creation

Government supports employment growth directly in a variety of ways:

- Improved management of the Expanded Public Works Programme, combined with rapid growth in allocations, means that government is on track to achieve its target of 6 million short- to medium-term jobs between 2014 and 2019.
- The employment tax incentive, which provides firms with incentives to hire young workers, is already supporting at least 209 000 young workers in about 23 500 firms.
- The Jobs Fund, which will spend about R3.9 billion over the next three years, will partner with the private sector and non-governmental organisations on projects expected to create more than 167 000 jobs.
- To create platforms for the growth of export-oriented firms, a number of special economic zones are to be established, complementing existing incentives for industrialisation.

Education and skills

Over the next three years, government proposes to allocate R833 billion to basic education and skills development. New tools for monitoring educational outcomes – such as the annual national assessments – are establishing platforms to address longstanding challenges. In combination with greater attention to teacher training and human resource management, these approaches will help to improve teaching and learning. Post-school education and training, which had the fastest-growing budget over the past three years, continues to expand.

Medium-term spending proposals

Spending is projected to grow at 7.6 per cent a year over the MTEF period

Over the next three years, a more constrained fiscal environment means that proposed spending growth, at 7.6 per cent a year, will slow relative to the period between 2011/12 and 2014/15, when annual growth averaged 9.4 per cent.

Government proposes to place significant resources for 2017/18 into an unallocated reserve to serve as a buffer against economic and fiscal shocks. This amounts to R45 billion, a portion of which can also be used to fund high-impact programmes. Because these funds are not yet allocated to functions, average annual growth rates for spending programmes are generally lower than the growth rate proposed for total spending.

Considering only allocated funds, the fastest-growing programmes are post-school education and training; employment, labour affairs and social security funds; and housing development and social infrastructure. Below-average growth is proposed for general public services. Lower-than-average growth is also proposed for economic infrastructure and network regulation, where spending grew rapidly between 2011/12 and 2014/15 and is now levelling off.

Table 4.1 Consolidated government expenditure,[1] 2013/14 – 2017/18

R billion	2013/14 Outcome	2014/15 Revised	2015/16 Medium-term estimates	2016/17	2017/18	Average annual growth 2014/15 – 2017/18
FUNCTION GROUPS						
Basic education	**176.8**	**188.0**	**201.5**	**212.8**	**226.1**	**6.3%**
Health	**134.2**	**145.5**	**154.6**	**163.8**	**175.1**	**6.4%**
Defence, public order and safety	**153.9**	**163.9**	**171.6**	**181.7**	**193.1**	**5.6%**
Defence and state security	45.0	47.9	50.0	52.9	56.0	5.4%
Police services	74.2	78.5	82.4	87.0	93.0	5.8%
Law courts and prisons	34.7	37.6	39.1	41.7	44.1	5.5%
Post-school education and training	**51.2**	**53.3**	**59.5**	**64.7**	**68.1**	**8.5%**
Economic affairs	**176.4**	**195.0**	**202.4**	**217.7**	**227.2**	**5.2%**
Industrial development, trade and innovation	59.5	63.3	67.8	72.4	74.1	5.4%
Employment, labour affairs and social security funds	48.4	57.6	64.1	68.9	72.8	8.1%
Economic infrastructure and network regulation	68.5	74.1	70.5	76.4	80.2	2.7%
Local development and social infrastructure	**159.1**	**176.4**	**199.6**	**208.8**	**221.5**	**7.9%**
Housing development and social infrastructure	141.4	156.9	179.6	187.0	198.3	8.1%
Rural development and land reform	10.1	10.4	10.7	11.6	12.3	5.7%
Arts, sport, recreation and culture	7.6	9.1	9.3	10.2	10.9	6.2%
General public services	**63.4**	**67.1**	**68.3**	**67.8**	**71.4**	**2.1%**
Social protection	**131.2**	**143.4**	**154.9**	**165.4**	**176.3**	**7.1%**
Allocated by function	**1 046.2**	**1 132.6**	**1 212.4**	**1 282.6**	**1 358.7**	**6.3%**
Debt-service costs	101.2	114.5	126.5	139.4	149.7	9.3%
Unallocated reserves	–	–	5.0	15.0	45.0	
Consolidated expenditure	**1 147.4**	**1 247.1**	**1 344.0**	**1 437.1**	**1 553.4**	**7.6%**
ECONOMIC CLASSIFICATION						
Current payments	**692.9**	**750.9**	**797.7**	**847.4**	**902.3**	**6.3%**
Compensation of employees	407.6	440.7	470.6	501.8	533.5	6.6%
Goods and services	177.8	189.5	193.8	200.2	213.0	4.0%
Interest and rent on land	107.5	120.8	133.3	145.3	155.9	8.9%
of which: Debt-service costs	*101.2*	*114.5*	*126.5*	*139.4*	*149.7*	*9.3%*
Transfers and subsidies	**370.3**	**402.0**	**440.2**	**470.8**	**495.1**	**7.2%**
Provinces and municipalities	91.1	96.2	107.3	113.2	119.4	7.5%
Departmental agencies and accounts	20.7	25.3	27.7	29.0	29.1	4.9%
Higher education institutions	23.8	25.3	27.1	29.2	30.6	6.5%
Foreign governments and international	2.7	2.2	2.3	2.4	2.4	3.2%
Public corporations and private	27.3	27.9	30.9	33.1	32.9	5.6%
Non-profit institutions	27.0	28.9	29.4	31.4	33.1	4.7%
Households	177.7	196.2	215.4	232.7	247.4	8.0%
Payments for capital assets	**80.3**	**90.2**	**97.7**	**103.6**	**110.6**	**7.0%**
Buildings and other capital assets	63.8	73.1	80.0	84.9	89.5	7.0%
Machinery and equipment	16.5	17.2	17.8	18.6	21.1	7.1%
Payments for financial assets	**3.8**	**4.0**	**3.4**	**0.3**	**0.3**	
Total	**1 147.4**	**1 247.1**	**1 339.0**	**1 422.1**	**1 508.4**	**6.5%**
Unallocated reserves	–	–	5.0	15.0	45.0	
Consolidated expenditure	**1 147.4**	**1 247.1**	**1 344.0**	**1 437.1**	**1 553.4**	**7.6%**

1. Consisting of national, provincial, social security funds and public entities

Total expenditure by economic classification indicates relatively rapid growth in spending on state debt costs, transfers to households, transfers to provinces and municipalities, and the acquisition or construction of capital assets.

Wage settlement that outpaces inflation would require corresponding adjustments in other spending areas

Compensation spending is budgeted to grow at 6.6 per cent a year over the medium term, but depends on the outcome of public-sector salary negotiations. Should the outcome of wage negotiations result in faster growth in compensation for employees, corresponding adjustments will be required in other spending areas. Below-average spending growth is proposed for the goods and services budget.

Spending priorities, by function group, are discussed below.

Basic education

This function group is responsible for MTSF *outcome 1: quality basic education*. Spending is driven largely by provincial allocations, a high proportion of which is for compensation of employees. Provincial personnel budgets are being reviewed to ensure they reflect medium-term spending estimates.

Basic education accounts for nearly 15 per cent of all spending

Over the 2015 MTEF period, proposed allocations to basic education exceed R640 billion, accounting for nearly 15 per cent of all spending. The rate of spending growth over the medium term is projected at an average of 6.3 per cent a year.

Allocations proposed over the MTEF period for school infrastructure will ensure that gazetted norms and standards are met by 2016.

Post-school education and training

Skills development allocation amounts to R200 billion

This function group has significant responsibility for the attainment of MTSF *outcome 5: a skilled and capable workforce to support inclusive growth*. Allocations cover universities and colleges, sector education and training authorities, and the National Skills Fund. The latter two are funded by ring-fenced payroll taxes. Underscoring government's commitment to addressing skills constraints, medium-term spending on post-school education and training, which grows more strongly than other spending programmes, will amount to nearly R200 billion. Of this, 55 per cent will consist of subsidies to universities and contributions to the National Students Financial Aid Scheme, allowing for an additional 116 000 university enrolments by 2016/17.

The MTSF projects a large expansion of access to technical, vocational and adult education centres, as well as universities. Given the scale of needs identified, an interdepartmental team will develop financing proposals. Expanded access should be matched by improvements in the quality of training provided.

Achieving a reduction in baseline allocations

Government proposes to lower previously announced spending ceilings for 2015/16 and 2016/17 by R10 billion and R15 billion respectively, with reductions proportionate to the division of nationally raised revenue (47 per cent from national government, 44 per cent from provincial government and 9 per cent from local government). For national departments, savings will be achieved by:

- Extending cost-containment measures announced earlier this year by freezing the budgets of certain non-essential goods and services at 2014/15 levels, and allowing others to increase at the rate of inflation.
- Withdrawing allocated personnel budgets where posts have been vacant over an extended period.
- Reducing the rate of growth of transfers to public entities, particularly those with cash reserves.

Of the reduction in the national government spending ceiling over the next two years, about two-fifths will come from curtailing spending growth on non-essential goods and services. A further 40 per cent of savings will be achieved by reducing the rate of growth of transfers to public entities. The remaining savings will come from the withdrawal of funding for non-essential vacant posts.

Provincial governments retain considerable authority to allocate their own resources, but it is anticipated that they will follow a similar approach in adjusting their budgets to accommodate the reduction in the equitable share. National government will work with provinces to ensure that pro-poor social services are fully protected. Adjustments to local government spending will take place mainly through reducing allocations to conditional grants that do not finance operations, some of which have recorded significant underspending.

Health

Almost R500 billion, or nearly 11 per cent of total spending, will be allocated to health over the MTEF period. This will help achieve *outcome 2: a long and healthy life for all South Africans*.

HIV treatment programme now reaches 2.7 million people

A large share of spending growth covers the expanding provision of antiretroviral drugs, which now reach 2.7 million people. The *comprehensive HIV and AIDS conditional grant* will grow by about 13 per cent a year over the medium term. Expenditure growth in provinces is driven largely by compensation of employees, which has grown by about 10 per cent a year over the past three years. This must be managed to ensure continued funding for other essential inputs.

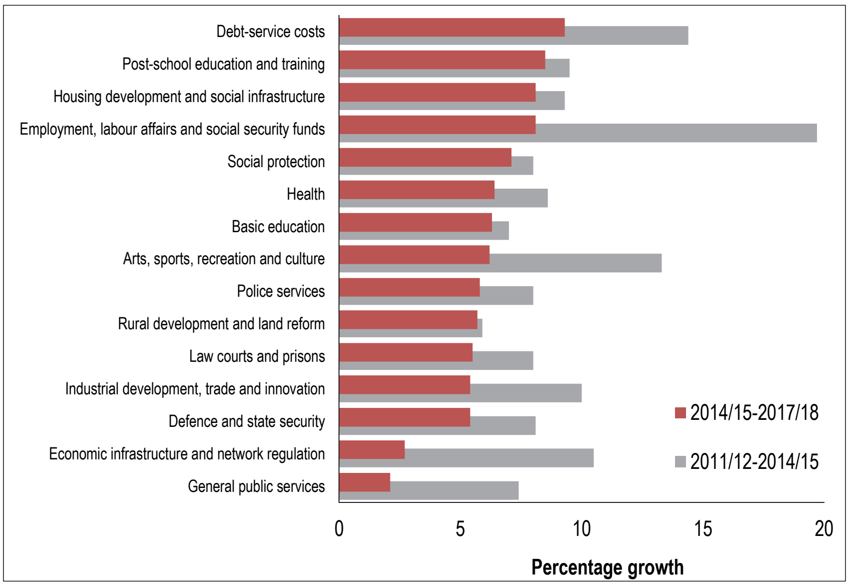
The future introduction of national health insurance could imply a significant restructuring of intergovernmental fiscal relations in the health sector. These considerations will be examined by a high-level working group that will make recommendations to the Ministers' Committee on the Budget.

Social protection

Social grants will soon reach about 17.3 million South Africans

Government proposes to allocate just under R500 billion to social protection over the medium term. Social grants, which are expected to reach 17.3 million people by 2017/18, will account for nearly 85 per cent of this spending. This will help achieve MTSF *outcome 13: a comprehensive, responsive and sustainable social protection system*. The MTSF focuses on enhancing the legislative and policy framework to improve service delivery and access to social assistance. The national department will also improve regulation and oversight of the sector. Removal of the means test for access to the old-age grant has been deferred and will form part of comprehensive social security reforms.

Figure 4.1 Average annual growth by function, 2011/12 – 2017/18



Source: National Treasury

Defence, public order and safety

In line with MTSF *outcome 3: all people in South Africa are and feel safe*, the priorities for defence, public order and safety remain fighting crime and corruption. The budget for the cluster, which accounts for 13 per cent of total spending, will grow at an annual average of 5.6 per cent, reaching over R190 billion in 2017/18. About 67 per cent of proposed spending is to be allocated to compensation.

Resources shifted to Public Protector and Financial Intelligence Centre

Within the function group, resources will be shifted to priority programmes and institutions, including the Public Protector, the Financial Intelligence Centre, family advocates, public defenders, and the prosecution service. Funds have also been reallocated to expand the Office of the Chief Justice, as envisaged in the Superior Courts Act (2013). The departments of Defence and Police have shifted funds in response to a shortfall in employee compensation owing to higher-than-expected inflation-linked salary adjustments.

Economic infrastructure and network regulation

Economic infrastructure will account for 5 per cent of spending over the MTEF

This function group is primarily responsible for MTSF *outcome 6: an efficient, competitive and responsive economic infrastructure network*. In line with the National Development Plan, the expansion of South Africa's energy, transport, water and communications infrastructure is under way. Economic infrastructure will account for 5 per cent of spending over the next three years, amounting to about R230 billion.

Apart from growing budget allocations, increased attention is needed to improve efficiency in the provision of infrastructure and, crucially, to plan and conduct regular maintenance. Complementary investments by the private sector will also be encouraged.

Government proposes to shift funds from existing road allocations at provincial and national level to the Moloto Road project. In addition, funds will be shifted from the solar water heater programme, where capacity constraints have led to underspending, to support the rollout of broadband infrastructure. To respond to critical service delivery pressures in bulk water and reticulation, surpluses in the Water Trading Account will shift to these priorities.

Housing development and social infrastructure

Funding for municipal services and infrastructure includes focus on sanitation

Funding for housing and social infrastructure such as electricity, potable water, sanitation and public transport supports MTSF *outcome 8: sustainable human settlements and improved quality of household life*. Medium-term priorities include balancing support for urban growth and delivering rural services. Government aims to transform South Africa's urban spaces, encouraging greater integration of residential areas, employment and trade. Over the three-year spending period, more than R560 billion is expected to be allocated to this function, with most of the funds supporting municipal services and infrastructure. Average annual spending growth of 8.1 per cent in this function is driven mainly by investments in commuter rail transport.

Funds shifted to manage disasters and effects of acid mine drainage

Government proposes to shift funds within this function group to support high-priority infrastructure projects, including the repair and restoration of infrastructure damaged in natural disasters and floods, and to manage the effects of acid mine drainage.

Addressing apartheid's spatial legacy requires considerably more coordination and alignment in planning and delivering infrastructure and services. The current approach to housing is also being reviewed to develop an approach that is more effective and affordable, and which will help to densify cities.

Industrial development, trade and innovation

This function group promotes industrialisation, economic transformation and sustainable resource management, and is partly responsible for achieving MTSF *outcome 4: decent employment through inclusive growth*. About R215 billion, or 5 per cent of total spending, will be allocated to these activities over the next three years. Relatively slow growth in projected allocations is largely the result of moderating spending on the economic competitiveness support package, which was designed to support the economy temporarily in the wake of the global financial crisis.

Tax rebates supporting industrial development amount to about R20 billion per year

Expenditure on incentives accounts for about one-third of overall spending in this function group. Although not reflected on the expenditure side of the budget, a range of tax rebates amount to about R20 billion a year. The bulk of these rebates support the automotive industry, as well as clothing manufacture and textiles.

Allocations are also proposed to develop the regulatory architecture for shale gas exploration and policies to develop the oceans economy.

Employment, labour affairs and social security funds

Employment growth also falls under MTSF *outcome 4*. Expenditure by this function group, totalling just over R205 billion over the MTEF, will grow by 8.1 per cent annually. Spending by the statutory social security agencies, which are financed by levies rather than directly through the National Revenue Fund, accounts for 80 per cent of this amount, and grows by 8 per cent a year. A further 15 per cent is allocated to state employment programmes, which grow by 10 per cent a year over the spending period ahead.

Over the next three years, the budget group will focus on two MTSF targets to be achieved by 2019: creating 6 million short- to medium-term jobs through the Expanded Public Works Programme and a 30 per cent increase in statutory workplace inspections by the Department of Labour.

By 2017, Community Work Programme will be rolled out to every municipality

Strong spending growth is proposed in the Community Work Programme, which will be rolled out to every municipality by 2017. The Expanded Public Works Programme is expected to achieve its targets without additional resources because municipalities and provinces are incorporating expanded public works jobs into their infrastructure projects.

Table 4.3 shows funding for employment programmes up to 2017/18.

Table 4.2 Funding for employment programmes, 2011/12 – 2017/18

R million	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	Average annual growth 2014/15 – 2017/18
		Outcome		Estimate		Medium-term estimates		
National								
Community Work Programme	624	1 290	1 731	2 258	2 385	3 254	4 016	21.2%
Expanded Public Works Programme management unit	210	237	262	262	266	284	298	4.4%
Non-state sector	154	283	438	477	485	600	630	9.7%
Tourism programmes	301	314	291	320	493	631	633	25.5%
Environmental programmes	1 977	2 705	2 835	3 286	3 399	3 950	4 039	7.1%
Jobs Fund	272	590	953	1 339	1 318	1 387	1 318	-0.5%
National Rural Youth Service Corps	289	536	862	678	343	473	437	-13.6%
Provincial								
Incentive grant for provincial infrastructure	225	293	354	349	357	412	432	7.4%
Incentive grant for social sector	200	217	256	258	268	375	393	15.1%
Local government								
Incentive grant for municipal infrastructure	364	662	611	595	619	706	741	7.6%
Total	**4 617**	**7 126**	**8 593**	**9 822**	**9 931**	**12 071**	**12 939**	**9.6%**

Source: National Treasury

Rural development and land reform

Funds reprioritised to manage and investigate new land claims

This function group – responsible for *outcome 7: vibrant, equitable, sustainable rural communities contributing to food security for all* – has a proposed medium-term allocation of about R35 billion, largely to support agricultural development, land restitution and reform. The reopening of the land reform process has resulted in the lodging of new land claims. Reprioritising funds already on its budget, the Department of Rural Development and Land Reform is expected to allocate R1.1 billion over the spending period to manage and investigate these claims. Where appropriate, government will also address duplication of activities by departments and agencies working on rural development.

Arts, sport, recreation and culture

Government to spend about R30 billion to support arts, sport and culture

Government will spend about R30 billion over the medium term to promote the arts, sport, recreation and culture. This is in pursuit of *outcome 14: a diverse, socially cohesive society with a common national identity*. Priorities include repositioning arts and culture to contribute to economic growth and job creation, and developing new heritage projects. Sport and Recreation will focus on implementing the national sport and recreation plan.

General public services

Outcome 12: an efficient, effective and development-oriented public service, is a core goal of government generally, with specific responsibilities distributed among several national departments. The baseline allocation to this function group amounts to about R210 billion over the next three years, with budgets expected to grow relatively slowly. The most rapid spending growth is associated with government's international commitments, the costs of which have risen with the depreciation of the exchange rate. Within the overall budget, funds have been made available for the Community Survey 2016, data from which will inform policy planning and resource allocation.

New entity to manage state property portfolio, resulting in greater efficiency

The launch of the Property Management Trading Entity will redefine institutional arrangements in the state's immovable property portfolio, and should support greater efficiency in national infrastructure investments.

Division of revenue

Over the MTEF period ahead, national departments are allocated 48 per cent of available non-interest expenditure, provinces are allocated 43 per cent, and local governments are allocated 9 per cent. Medium-term allocations to national departments will increase by an average annual rate of 5.7 per cent, provincial resources grow by 6.2 per cent and local government allocations grow by 6.5 per cent (7.2 per cent including all indirect grants).

Table 4.3 Division of revenue, 2014/15 – 2017/18

R billion	2014/15	2015/16	2016/17	2017/18	Average annual growth 2014/15 – 2017/18
National allocations	494.7	523.1	553.2	585.0	5.7%
Provincial allocations	440.2	468.5	496.8	527.0	6.2%
Local government allocations	91.1	99.2	103.9	110.0	6.5%
Total allocations	**1 026.0**	**1 090.8**	**1 153.9**	**1 222.0**	**6.0%**
Percentage shares					
National departments	48.2%	48.0%	47.9%	47.9%	
Provincial	42.9%	42.9%	43.1%	43.1%	
Local government allocations	8.9%	9.1%	9.0%	9.0%	

Source: National Treasury

Funding provincial government

Over the MTEF period, provinces are allocated R1.49 trillion. Of this amount, 81.6 per cent will take the form of unconditional transfers through the provincial equitable share, and 18.4 per cent through conditional grants transferred by national departments.

Spending adjustments will not be allowed to disrupt front-line services

The focus of provincial financing will be on improving efficiency in core areas of responsibility: basic education, health, roads, and social development. The lower expenditure ceiling means that baseline allocations for the provincial equitable share will be reduced by R2.6 billion in 2015/16 and R4 billion in 2016/17, with baseline allocations for direct and indirect conditional grants reduced by R1.8 billion and R2.6 billion in those years. National government will work with provinces to ensure that spending adjustments do not disrupt front-line services.

Savings can be achieved by reducing non-core staff, and ensuring recruitment and retention of skills

As personnel-related expenditure is the largest category of spending in provinces (62 per cent in 2014/15), tight management of compensation spending will be essential to improve efficiency. Savings can be achieved by reducing non-core staff, and by ensuring the recruitment and retention of appropriate skills. The National Treasury has been working with provincial treasuries to improve management of personnel spending. As a result, provincial staff numbers declined from 931 471 in December 2012 to 917 061 in August 2014. Although staff costs have risen as average wages have increased, slower growth in headcount saw compensation spending remain within budget in 2012/13 for the first time since 2007/08.

Over the next three years, greater emphasis will be placed on achieving efficiencies in goods and services budgets. Provinces should be able to identify areas where efficiency can be improved from expenditure reviews undertaken by the National Treasury and provincial treasuries, as well as reforms driven by the Office of the Chief Procurement Officer.

Modernising public procurement

Modernising procurement systems will lead to more cost-effective operations in the public sector. Design of a national price-referencing mechanism is complete. Piloting with selected provinces and large national departments will begin in the next few months, and the system should be fully operational by 1 April 2015.

Over the next three years, the Office of the Chief Procurement Officer will roll out a new national approach to procurement. Its main features will include:

- Publishing national norms and standards for procurement.
- Creating a national database to enable public monitoring of procurement plans and tenders.
- Creating a database of suppliers, service providers and contractors to streamline compliance requirements and reduce costs for small businesses.
- Establishing a formal process to consider complaints and refer cases to appropriate legal authorities.

The number of nationally negotiated contracts will be significantly expanded. Centralised contracting will be considered for a range of common goods and services, including air travel and hotel accommodation; standard equipment used in schools and clinics; information and communications technology infrastructure; professional services; and leasing and accommodation.

To promote more efficient delivery of infrastructure for schools and health facilities, government is phasing in an incentive-based funding approach. The first such allocations will be awarded in 2015/16, based on provinces' performance in meeting planning requirements. Support is being provided to those provinces that are not yet meeting the required standards.

Funding local government

A call for municipalities to get back to basics in delivering services and funding infrastructure

The division of revenue promotes the goal of MTSF *outcome 9: responsive, accountable, effective and efficient local government*. The Minister of Cooperative Governance and Traditional Affairs has called for municipalities to get back to basics. Medium-term allocations to local government support this call by funding the infrastructure needed to deliver basic services and to subsidise the provision of free basic services.

Transfers to local government total R313 billion over the MTEF period, with 61.4 per cent transferred as unconditional allocations such as the equitable share and sharing of the general fuel levy. The remainder is allocated through conditional grants. The lower expenditure ceiling means that baseline allocations for local government conditional grants will be reduced by R920.6 million in 2015/16 and R1.4 billion in 2016/17.

Local government financing takes account of varied obligations of urban and rural municipalities

The structure of local government financing continues to emphasise a differentiated approach in responding to the different capacities and obligations of urban and rural municipalities. Cities, which raise up to 80 per cent of their own revenues from property rates and service charges, are treated differently than rural municipalities, some of which rely on transfers to fund up to 80 per cent of their budgets.

Following years of rapid growth in the value of local government transfers, the rate of growth will moderate over the period ahead. A review of infrastructure grants is intended to maximise the impact of these transfers, while several reforms are aimed at enabling cities to achieve more with their own revenues.

Improving the performance of local government infrastructure grants

The National Treasury is leading a collaborative review of the local government infrastructure grant system. It aims to make evidence-based reforms that maximise value for money from existing resources, while improving the sustainability of the system and the assets created.

Work on the review will continue in 2015 but has already produced proposals for reform in three areas:

- Rationalising the number of grants that each municipality receives, while introducing greater differentiation in the types of grants and accompanying levels of oversight for different types of municipalities.
- Life-cycle asset management to sustain the functionality of existing infrastructure.
- Strengthening administrative oversight to avoid ad-hoc proliferation of grants, standardising reporting to increase accountability, and improving monitoring and benchmarking of performance.

The details of how these reforms will affect each grant and the system as a whole will be refined in 2015, and implemented over the course of the 2016 MTEF period.

The local government equitable share continues to fund the cost of providing free basic amounts of electricity, water, sanitation and refuse removal to the approximately 59 per cent of households that have incomes below the value of two old-age grants. In many municipalities, greater emphasis will be placed on ensuring that free basic services are extended to reach all poor households.

Further details of provincial and local government allocations and changes to conditional grants are set out in the technical annexure.

Conclusion

While reduced spending envelopes will require difficult choices, pro-poor spending will be protected

Over the next three years, expenditure will continue to grow in real terms, but at a slower rate than in the recent past. Reduced spending ceilings over the next two years will affect national, provincial and local government. While this will involve difficult choices, pro-poor expenditure in areas such as education, health and social services will be protected. The reductions, while substantial, are small relative to total government spending. Improvements in service delivery will come through efficiency gains and reducing waste.