6

Division of revenue and spending by provinces and municipalities

In brief

- Over the next three years, after providing for debt-service costs, the contingency reserve and provisional allocations, 48.7 per cent of nationally raised funds are allocated to national government, 41.9 per cent to provincial government and 9.4 per cent to local government.
- Provinces and municipalities play a critical role in the public health response to the COVID-19 pandemic in line with their spending capacity. As of January 2021, provinces had spent R12.8 billion, or 60.2 per cent, of additional COVID-19 funds provided by government. Between March 2020 and February 2021, municipalities spent R4.2 billion of a budgeted R11 billion added to the local government equitable share.
- The National Treasury continues to expand the tools available for provinces and local government to improve spending, with funds provided through the 2021 Budget. Where they fail to meet basic standards, national government is prepared to impose consequences, including intervening and withholding transfers.

Overview

Over the next three years, provinces and municipalities will have to adjust to significant changes in expenditure plans, while improving accountability. The 2021 Budget protects transfers that focus on infrastructure, service delivery and COVID-19 spending, while reducing those spent less effectively.

Provincial governments receive an additional R8 billion in 2021/22 to continue the public health response to the pandemic, and the potential for additional waves of infection. Provinces can mitigate the negative impact of COVID-19 and the associated lockdowns on their revenues by improving efficiency, particularly in the procurement of health equipment. Local governments, many of which have experienced a severe deterioration in basic services in recent years, need to institute financial management reforms where there is significant underspending.

National government continues to expand programmes and tools to build capacity in provincial and local government. Where provinces and municipalities fail to meet basic standards, national government will intervene. For example, this chapter reports on the progress of government's continuing intervention in North West province.

In March 2020, the National Treasury halted grants to 47 municipalities where significant problems were evident. These funds are being reallocated to municipalities that have fast-tracked projects and shown an ability to spend their allocations. The 2021 Budget includes funding for initiatives to improve municipal revenue collection and support financially distressed municipalities.

Division of revenue

Over the medium-term expenditure framework (MTEF) period, after budgeting for debt-service costs, the contingency reserve and provisional allocations, 48.7 per cent of nationally raised funds are allocated to national government, 41.9 per cent to provinces and 9.4 per cent to local government. Because reductions to the public-service wage bill affect only national and provincial government, local government's share of revenue has risen in relative terms.

Transfers to provinces grow by an annual average of 1 per cent over the medium term, with equitable share transfers growing by 0.3 per cent and conditional grants by 4.1 per cent. Local government transfers grow by an annual average of 2.3 per cent; the equitable share declines by 0.4 per cent and conditional grants grow by 7.3 per cent.

The division of revenue is redistributive. Allocations through the intergovernmental fiscal system provide higher per capita allocations to rural provinces and municipalities. Government is developing indicators focused specifically on rural areas for the provincial equitable share formula to strengthen the equity of intergovernmental transfers.

The Explanatory Memorandum to the Division of Revenue, published on the National Treasury website as Annexure W1 to the *Budget Review*, sets out the provincial and municipal allocations, details the equitable share formulas, and explains how the division incorporates the recommendations of the Financial and Fiscal Commission.

Reductions to transfers

Last year, government announced that it would not implement the final increase of the three-year public-service wage agreement. Because most government employees are employed in provinces, the impact of this decision is most noticeable in provincial transfers. The provincial equitable share is reduced by R58.3 billion in 2021/22, R83.5 billion in 2022/23 and R64.1 billion in 2023/24. Downward adjustments to compensation account for about 85 per cent of these amounts. In addition, conditional grants are reduced by a net R10.9 billion over the MTEF period.

As part of government's fiscal consolidation policies over the medium term, transfers to local government are reduced by R20.2 billion, including R15.5 billion from the local government equitable share, R2.7 billion from the general fuel levy and R2 billion in direct conditional grants.

Table 6.1 Division of nationally raised revenue

R billion	2017/18	2018/19 Outcome	2019/20	2020/21 Revised estimate	2021/22	2022/23 Medium-term estimates	2023/24	Average annual MTEF growth
Division of available funds								
National departments	**592.6**	**634.3**	**749.7**	**804.5**	**763.3**	**736.3**	**739.0**	**-2.8%**
of which:								
Indirect transfers to provinces	*3.8*	*3.9*	*3.9*	*4.2*	*4.4*	*4.9*	*4.9*	*5.5%*
Indirect transfers to local government	*7.8*	*7.9*	*7.0*	*6.9*	*7.1*	*8.2*	*8.5*	*7.3%*
Provinces	**538.6**	**572.0**	**613.4**	**628.3**	**639.5**	**643.3**	**646.8**	**1.0%**
Equitable share	441.3	470.3	505.6	520.7	523.7	524.1	525.3	0.3%
Conditional grants	97.2	101.7	107.9	107.6	115.8	119.3	121.5	4.1%
Local government	**111.1**	**118.5**	**123.0**	**138.5**	**138.1**	**146.1**	**148.4**	**2.3%**
Equitable share	55.6	60.8	65.6	84.5	78.0	83.1	83.6	-0.4%
Conditional grants	43.7	45.3	44.2	40.0	45.5	47.7	49.4	7.3%
General fuel levy sharing with metros	11.8	12.5	13.2	14.0	14.6	15.3	15.4	3.2%
Provisional allocation not assigned to votes[1]	–	–	–	–	11.6	32.1	33.2	
Non-interest allocations	**1 242.3**	**1 324.8**	**1 486.2**	**1 571.3**	**1 552.5**	**1 557.8**	**1 567.5**	**-0.1%**
Percentage increase	*7.2%*	*6.6%*	*12.2%*	*5.7%*	*-1.2%*	*0.3%*	*0.6%*	
Debt-service costs	162.6	181.8	204.8	232.9	269.7	308.0	338.6	13.3%
Contingency reserve	–	–	–	–	12.0	5.0	5.0	
Main budget expenditure	**1 404.9**	**1 506.6**	**1 690.9**	**1 804.2**	**1 834.3**	**1 870.8**	**1 911.0**	**1.9%**
Percentage increase	*7.6%*	*7.2%*	*12.2%*	*6.7%*	*1.7%*	*2.0%*	*2.1%*	
Percentage shares								
National departments	*47.7%*	*47.9%*	*50.4%*	*51.2%*	*49.5%*	*48.3%*	*48.2%*	
Provinces	*43.4%*	*43.2%*	*41.3%*	*40.0%*	*41.5%*	*42.2%*	*42.2%*	
Local government	*8.9%*	*8.9%*	*8.3%*	*8.8%*	*9.0%*	*9.6%*	*9.7%*	

1. Includes support to Eskom, amounts for Budget Facility for Infrastructure projects and other provisional allocations
Source: National Treasury

The reduction to direct conditional grants includes R329 million from the *municipal infrastructure grant* and R21 million from the *integrated urban development grant*. These amounts have been reprioritised from underspending grants to fund a once-off councillor gratuity for non-returning councillors. The largest proportional reduction of R1.3 billion to local government grants has been made in the *public transport network grant*, because only six of the 13 cities receiving the grant have successfully launched public transport systems. Indirect conditional grants are reduced by R286 million over the period.

Building capability for service delivery

The National Treasury continues to expand the tools available for provinces and municipalities to improve spending and build operational and technical capacity.

In 2020, the National Treasury and the Government Technical Advisory Centre helped train provincial officials to conduct spending reviews to address inefficiency and poor financial management. In 2021, the Government Technical Advisory Centre and provincial treasuries will assess programme relevance, effectiveness and efficiency to improve value for money in selected provincial departments.

National government provides a range of capacity-building grants and programmes for local government. These are under review, with reforms likely to be implemented in 2022/23.

The Infrastructure Delivery Management System has helped provinces to build infrastructure units with qualified staff and institutionalise best practices. This system will be rolled out to municipalities to build capacity, reduce the reporting burden and standardise the system across spheres.

The poor financial position of many municipalities – a consequence of weak financial management – has been exacerbated by COVID-19. According to the Auditor-General's 2018/19 report on local government finances, about 47 per cent of municipalities incurred a deficit, and total deficits grew from R669 million in 2017/18 to R2.3 billion in 2018/19. The audit deadline has been extended for 2019/20 and that report will only be available in March 2021. In the year to June 2020, uncollected municipal revenues grew by 16.3 per cent to R171.9 billion.

Above-inflation wage increases in local government will add to the financial pressure on local government. In July 2020, most municipalities implemented the first year of a three-year wage agreement, negotiated separately from the national agreement, that raises wages by 6.25 per cent per year. Not all municipalities have budgeted for these increases. Unless municipalities rapidly improve efficiency, this agreement will compromise the local government fiscal framework and service delivery.

Past performance

Underspending has stabilised across national and provincial government. In 2019/20, national expenditure, excluding direct charges to the National Revenue Fund, amounted to R945 billion out of a total adjusted appropriation of R941 billion. This amounted to overspending of 0.4 per cent. Provincial government underspent its adjusted budget of R638.6 billion for 2019/20 by R9.8 billion (1.5 per cent), compared with R7.7 billion (1.3 per cent) in the prior year. Spending on provincial conditional grants improved, from 96.6 per cent in 2018/19 to 99.1 per cent in 2019/20.

Because the local government financial year ends in June, strict restrictions on activity to contain COVID-19 affected 2019/20 outcomes. Spending outcomes varied across the 257 municipalities, which spent 79.9 per cent of the adjusted expenditure budget of R481.2 billion. Most of the underspending was concentrated in capital expenditure, where municipalities spent only R41.2 billion or 59.9 per cent of the adjusted budget of R68.8 billion.

Of the R32.2 billion in specific purpose conditional grants transferred to municipalities in 2019/20, R22.5 billion (68.2 per cent) was spent – down from the 80.1 per cent spent in 2018/19. This was mainly a result of restrictions on activity that prevented construction and maintenance work. For example, the *municipal infrastructure grant* only spent 73.5 per cent of transferred funds, compared with an average of over 90 per cent for the past five financial years.

Provincial revenue and spending

Provinces are responsible for providing social services, including public basic education for 13.2 million learners and healthcare for 49.8 million South Africans who do not have private insurance. Most recipients access these services free of charge or at very low cost. Provinces do not have significant taxation powers, so the division of revenue compensates them for the cost of the services they provide through transfers, which account for about 95 per cent of provincial revenues.

The equitable share accounts for 81.6 per cent of transfers to provinces. It is calculated using a formula based on demographic factors that affect demand for services, such as the school-age population. The underlying data is updated each year. Provinces are responsible for drawing up their own budgets and prioritising the use of these funds to meet their mandates.

Table 6.2 Provincial equitable share

R million	2020/21	2021/22	2022/23	2023/24	Average annual MTEF growth
		Medium-term estimates			
Eastern Cape	69 195	68 060	67 428	66 899	-1.1%
Free State	28 934	29 055	29 008	29 005	0.1%
Gauteng	108 310	111 429	112 561	113 870	1.7%
KwaZulu-Natal	107 608	107 126	106 928	106 895	-0.2%
Limpopo	60 299	60 028	59 621	59 306	-0.6%
Mpumalanga	42 637	42 828	42 798	42 835	0.2%
Northern Cape	13 749	13 919	13 928	13 959	0.5%
North West	36 307	36 793	36 939	37 144	0.8%
Western Cape	53 677	54 448	54 876	55 390	1.1%
Total	**520 717**	**523 686**	**524 088**	**525 304**	**0.3%**

Source: National Treasury

Although wages account for a growing share of provincial budgets, provinces generally manage to remain within their planned spending for compensation. Over the past three financial years, provinces have on aggregate spent less than they budgeted on wages, and in 2019/20 only the Eastern Cape exceeded its compensation budget.

The proposed wage bill adjustment will reverse the four-year trend of compensation growing as a share of provincial budgets. Over the MTEF period, spending on compensation of employees is likely to decrease from 61.1 per cent of provincial budgets to 60.8 per cent. Reducing the proportion of budgets spent on salaries will allow provinces to expand the healthcare system, build more schools and improve service delivery. Provinces will continue to reduce their costs by merging entities, improving integrated planning and exploring new revenue sources.

Progress in improving financial management in North West province

The 2020 Budget reported on government's intervention in the North West province, in which five national departments took responsibility for delivering the mandates of their provincial counterparts. The intervention contained three phases: the first phase aimed to stabilise the province's finances, the second aimed to strengthen supply chain management and the third will monitor ongoing implementation.

Following successful completion of the first and second phases, the audit results for 2019/20 show a turnaround after five years of decline and stagnation. The province reported a decrease in annual irregular expenditure from R4.7 billion in 2018/19 to R3.5 billion in 2019/20. Departments that were placed under intervention as reported in the 2020 Budget show lower irregular and wasteful spending.

The National Treasury has conducted training and built capacity across departments to strengthen supply chain management. Irregular project management units and outsourcing arrangements have been terminated. Investigating authorities, including the National Prosecuting Authority, are looking into over 50 criminal cases and attempting to recover funds related to financial mismanagement.

Provincial departments have been reconfigured in line with their mandates. Several senior personnel, including the director-general, and the heads of the health, social development, and agriculture and rural development departments have left their posts. New leadership is expected to be in place by the start of 2021/22. The national departments involved will recommend to the National Council of Provinces that the intervention ends by March 2021. The National Treasury and relevant national departments will continue to monitor developments in their provincial counterparts and provide support where needed.

In 2021, the National Treasury will review provincial infrastructure sector funding policies and propose how grants, incentives and other funding can best be structured to coordinate planning and budgeting. This is in line with the Cabinet-approved district development model, which is intended to improve coordination between national, provincial and local government – including state entities – to strengthen accountability and service delivery. The model focuses on 52 district and metropolitan spaces as convergence points for public- and private-sector investment, supported by joint planning, budgeting and implementation processes.

Update on provincial and municipal COVID-19 spending

In 2020, government supplemented funding reprioritised by provincial and local governments to mitigate the effects of the COVID-19 pandemic.

Government provided R21.2 billion for provinces, with the largest allocation going to KwaZulu-Natal (R5.3 billion) and the smallest allocation going to the Northern Cape (R490.2 million). At the beginning of the final quarter of 2020/21, provinces had spent R12.8 billion, or 60.2 per cent, of the additional funding, signalling that the allocations were adequate. Provinces spent most of this on compensating employees, increasing hospital bed capacity in existing facilities, building field hospitals, purchasing and distributing personal protective equipment and medical supplies, and paying for laboratory services. Between April and December 2020, provinces employed almost 17 000 additional health professionals to manage the pandemic. Over 3 million, or 42 per cent, of the country's COVID-19 tests were conducted in public health facilities. According to the National Institute for Communicable Diseases, public health facilities admitted about 115 000 patients with COVID-19-related illnesses by mid-February 2021, representing 52 per cent of the country's total admissions.

Municipalities also seem to have sufficient financial support in line with their spending capacity during the pandemic. COVID-19 reports from March 2020 to February 2021 show that municipalities spent R4.2 billion of a budgeted R11 billion that was added to the local government equitable share. In 2021/22, several conditional grants to municipalities will retain provisions for COVID-19-related programmes to continue supporting these municipal services.

Government continues to increase direct conditional grant funding to provinces. An additional R430 million is reprioritised to the *national school nutrition programme grant* in 2023/24 to maintain meals for about 9 million learners at 19 950 schools.

Provinces have had to prioritise COVID-19-related programmes in their budgets, particularly in 2021/22. Government's COVID-19 response has shifted the focus of healthcare services towards pandemic-related interventions, including protecting health workers from infection, ensuring the availability of personal protective equipment, and prevention and contact tracing.

Changes in conditional grants

If a province or municipality is not spending its allocated funds or does not comply with grant conditions, then further transfers can be withheld or reallocated to another recipient. In 2019/20, the National Treasury withheld six conditional grants from four provinces, pending the resolution of outstanding problems, and stopped one conditional grant from one province, which was then reallocated to another province.

In March 2020, the National Treasury stopped grants to 47 municipalities for the same reasons. These funds are being reallocated to municipalities that have fast-tracked projects and shown an ability to spend their allocations. In February 2020, the National Treasury placed Nelson Mandela Bay Municipality under intervention, as authorised by the Constitution, due to persistent non-compliance and mismanagement of funds. The National Treasury will stop all transfers to the municipality until its finances have been stabilised. The provincial treasury and department of cooperative governance are managing this intervention.

Proposed changes to the structure of conditional grants are designed to align them with evolving policy objectives. From 2021/22, a standalone *informal settlement upgrading grant* for provinces and municipalities will be introduced. This grant is made up of components previously within the *human settlements development grant* and the *urban settlements development grant* for provinces and municipalities. Lessons learnt from the components will inform the implementation of the standalone grants.

The *title deeds restoration grant* was introduced for a specific period to eradicate the backlogs in the title deeds registrations for projects completed before 31 March 2014. In 2021/22, this grant is reincorporated into the *human settlements development grant*. The COVID-19 component within the *HIV, tuberculosis, malaria and community outreach grant* will continue in 2021/22.

Other changes aim to improve the effectiveness of conditional grant spending. The 2021 Division of Revenue Bill will enhance responsiveness by allowing for disaster grant funding to flow more rapidly following a disaster declaration.

Table 6.3 Conditional grants to provinces

R million	2020/21 Revised estimate	2021/22	2022/23	2023/24	MTEF total
		Medium-term estimates			
Direct conditional grants					
Comprehensive agricultural support programme	1 191	1 558	1 592	1 618	4 768
Ilima/Letsema projects	423	597	610	620	1 828
Community library services	1 153	1 496	1 554	1 571	4 620
Education infrastructure	8 787	11 689	12 229	12 768	36 687
National school nutrition programme	7 666	8 115	8 504	8 879	25 498
HIV, TB, malaria and community outreach	27 222	27 585	27 910	27 090	82 585
Health facility revitalisation	6 315	6 445	6 886	7 235	20 566
Human resources and training grant	4 309	4 054	3 999	3 997	12 050
National tertiary services	14 013	13 708	14 000	14 024	41 732
Human settlements development	14 892	13 403	13 858	14 469	41 730
Informal settlements upgrading partnership	–	3 890	4 121	4 303	12 314
Provincial roads maintenance	10 467	11 937	12 506	13 057	37 499
Public transport operations	6 750	7 121	7 090	7 403	21 614
Other direct grants	4 405	4 185	4 395	4 487	13 067
Total direct conditional grants	**107 594**	**115 783**	**119 255**	**121 520**	**356 558**
Indirect transfers	**4 160**	**4 401**	**4 944**	**4 882**	**14 227**
School infrastructure backlogs	2 415	2 284	2 403	2 079	6 765
National health insurance indirect	1 710	2 118	2 541	2 803	7 462
Ilima/Letsema projects	36	–	–	–	–

Source: National Treasury

Municipal revenue and spending

Local government budgets are dominated by electricity, water and sanitation, and refuse collection, which are trading services to be funded primarily by revenue collection. National transfers to local government supplement municipal revenue, primarily subsidising the operational and capital costs of providing services to the poor. The provision of services to all other consumers should be funded through cost-reflective tariffs.

South Africa's municipalities range from large cities that can raise substantial revenue and poor rural municipalities where budgets are primarily funded from transfers. The largest transfer is the local government equitable share, which is allocated through a progressive formula that incorporates the number of poor households in each municipality and the cost of free basic services. The equitable share decreases by 1 per cent over the next three years to support fiscal consolidation.

Municipalities also earn revenue from levying charges on developers to connect new developments to municipal services. The National Treasury is addressing comments received on the draft Municipal Fiscal Powers and Functions Amendment Bill, which is designed to strengthen the revenue-raising framework for municipalities. The bill will be submitted to Cabinet and Parliament for consideration in 2021.

Initiatives to improve municipal revenue collection and support financially distressed municipalities are funded through the 2021 Budget. In addition, revenue advisors appointed by the National Treasury will train provincial treasuries on municipal revenue enhancement initiatives, and help municipalities set cost-reflective tariffs and improve revenue collection.

Government continues to reform the system of conditional grant transfers to local government based on the principles set out in the 2019 *Budget Review*. In 2021, government will expand the scope of the *municipal infrastructure grant* to allow municipalities to use up to 5 per cent of their allocation to develop infrastructure asset management plans. This change addresses poor asset management in municipalities.

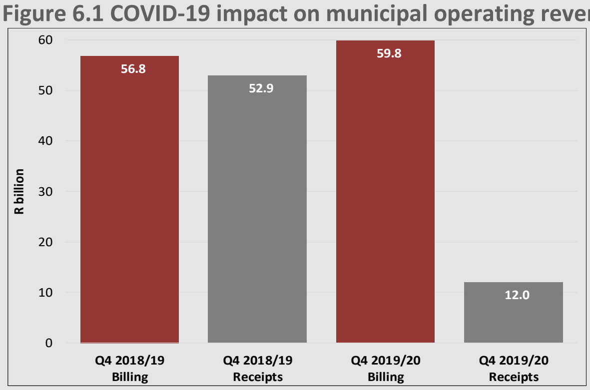
In December 2020, the Minister of Finance hosted a special lekgotla of the Budget Forum – the intergovernmental structure established to facilitate formal consultation on local government finances – to review the municipal funding model. The meeting resolved that the National Treasury, the Department of Cooperative Governance and the South African Local Government Association should collaborate on all matters related to the local government fiscal framework. This will help to resolve contentious issues and build consensus.

Impact of COVID-19 on municipal revenues

The full effect of the COVID-19 lockdowns on municipal revenues will only become clear in March 2021, when reporting for the municipal financial year is complete. Restrictions on activity are likely to have shifted some business expenses to households and the contraction in GDP growth may have longer-term effects on revenue items such as property rates.

Early indications are that the effect will be significant. Figure 6.1 shows a sharp drop in revenue collection in the fourth quarter of the 2019/20 municipal fiscal year (April to June 2020), implying that many municipal customers were unable to pay for services. Only 20 per cent of billed revenue was collected in the quarter, compared with 93 per cent of billed revenue collected in the same period of the previous year.

Figure 6.1 COVID-19 impact on municipal operating revenue



Source: National Treasury

Table 6.4 Transfers to local government

R million	2020/21 Revised estimate	2021/22	2022/23	2023/24	MTEF total
		Medium-term estimates			
Equitable share and related	**84 483**	**77 999**	**83 085**	**83 570**	**244 654**
General fuel levy sharing with metros	**14 027**	**14 617**	**15 335**	**15 433**	**45 386**
Direct conditional grants	**40 018**	**45 477**	**47 679**	**49 419**	**142 575**
Municipal infrastructure	14 491	15 593	16 852	17 595	50 039
Integrated urban development	936	1 009	1 075	1 123	3 207
Urban settlements development	10 572	7 405	7 352	7 676	22 433
Informal settlements upgrading partnership	–	3 945	4 181	4 365	12 491
Integrated national electrification programme (municipal)	1 359	2 003	2 119	2 212	6 334
Public transport network	4 389	6 515	6 767	6 794	20 075
Water services infrastructure	3 368	3 620	3 701	3 864	11 185
Regional bulk infrastructure	2 006	2 156	2 281	2 381	6 818
Other direct grants	2 897	3 231	3 351	3 409	9 991
Total direct transfers	**138 528**	**138 093**	**146 098**	**148 423**	**432 614**
Indirect transfers	**6 865**	**7 055**	**8 200**	**8 481**	**23 737**
Integrated national electrification programme (Eskom)	1 983	2 824	3 638	3 821	10 284
Regional bulk infrastructure	4 108	3 275	3 550	3 607	10 432
Other indirect grants	774	956	1 012	1 053	3 021

Source: National Treasury

Investing in building resilient, productive and inclusive cities

The National Treasury's Cities Support Programme helps metropolitan municipalities coordinate public investment in infrastructure, housing and transport to build more inclusive, productive and sustainable cities.

Since December 2019, six metros have launched pilot initiatives to develop the economic potential of underperforming and degraded industrial parks, townships, inner cities and regional economic spaces through integrated planning, investment and management. Developing these spaces requires coordination by metros, government departments and other stakeholders.

In 2020, the *integrated city development grant* was repurposed to assist cities to build internal capacity or obtain technical support to prepare and package key infrastructure projects. This will continue in 2021 and private-sector participation will be encouraged in these projects. In addition, the eThekwini metropolitan municipality is piloting a programmatic city-wide informal settlement upgrading project.

Conclusion

Provinces and municipalities are responsible for providing social and economic services and infrastructure, which requires a balance of revenue and expenditure responsibilities. National government continues to support them to deliver their mandates and impose consequences where there is evidence that public finance laws have been violated.