6

Division of revenue and spending by provinces and municipalities

In brief

- Provinces and municipalities provide a range of critical social and economic services. Over the next three years, they will focus on improving service delivery.
- Over the medium-term expenditure framework (MTEF) period, after providing for debt-service costs, the contingency reserve and provisional allocations, 48.8 per cent of nationally raised funds are allocated to national government, 41.4 per cent to provincial government and 9.8 per cent to local government.
- Since the 2021 *Medium Term Budget Policy Statement* (MTBPS), direct transfers to provinces and municipalities over the medium term have been increased by R58.4 billion and R30.7 billion respectively. These funds help address various spending pressures.

Overview

The 2022 Budget increases allocations for both provincial and local government to assist with urgent spending pressures. Relative to the 2021 Budget, direct provincial allocations will increase by R74.1 billion over the medium term. The majority of this amount consists of R53 billion added to the provincial equitable share and R5.4 billion added to direct conditional grants following the 2021 MTBPS. Local government allocations will be increased by a total of R30.7 billion over the same period: R28.9 billion in the local government equitable share and R1.8 billion in direct conditional grants.

These allocations alleviate some of the pressures in subnational government. Nonetheless, provinces and municipalities will need to improve efficiency and spend more effectively to fulfil their mandates – including through the implementation of findings from spending reviews. This requires political will, good governance and better financial controls.

Over the past several years, provincial budgets have been stretched by unaffordable wage agreements agreed at the national level, and because demand for medical goods and services is growing faster than total budgets. The COVID-19 pandemic put further pressure on provincial health budgets, particularly given the need to hire new medical staff. In municipalities, pandemic-related restrictions appear to have had no significant impact on revenue collection. Many municipalities, however, are in financial distress. In line with the findings of a recent review, government is reforming the way it builds capacity in municipalities.

Division of revenue

Over the MTEF period, after budgeting for debt-service costs, the contingency reserve and provisional allocations, 48.8 per cent of nationally raised funds are allocated to national government, 41.4 per cent to provinces and 9.8 per cent to local government.

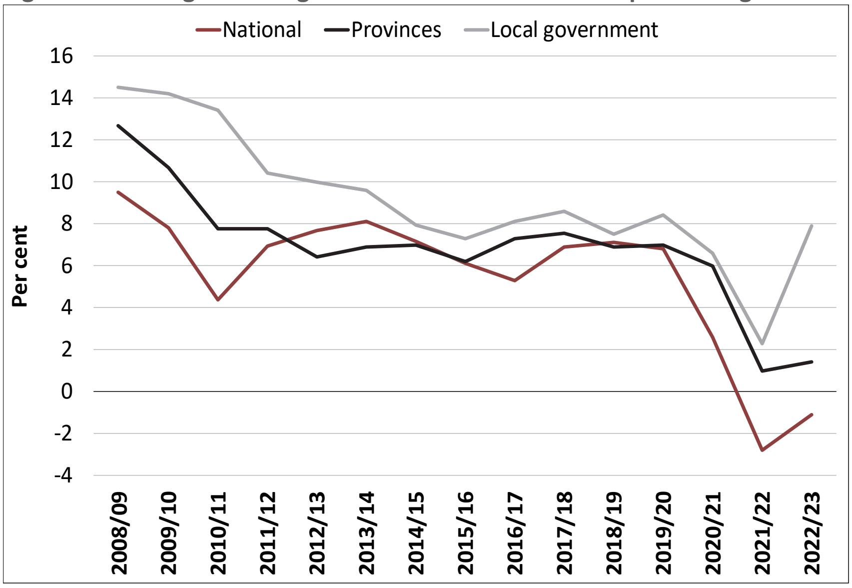
Table 6.1 Division of nationally raised revenue

R billion	2018/19	2019/20 Outcome	2020/21	2021/22 Revised estimate	2022/23	2023/24 Medium-term estimates	2024/25	Average annual MTEF growth
Division of available funds								
National departments	**634.3**	**749.8**	**790.5**	**831.1**	**824.7**	**770.9**	**805.7**	**-1.0%**
of which:								
Indirect transfers to provinces	*3.9*	*2.9*	*3.1*	*4.0*	*4.6*	*4.5*	*4.0*	*0.5%*
Indirect transfers to local government	*6.3*	*5.6*	*4.1*	*4.9*	*8.1*	*8.5*	*8.9*	*21.8%*
Provinces	**572.0**	**613.4**	**628.8**	**661.2**	**682.5**	**667.3**	**690.2**	**1.4%**
Equitable share	470.3	505.6	520.7	544.8	560.8	543.1	562.0	1.0%
Conditional grants	101.7	107.9	108.1	116.4	121.8	124.2	128.1	3.3%
Local government	**118.5**	**123.0**	**137.1**	**135.3**	**150.6**	**160.5**	**170.1**	**7.9%**
Equitable share	60.8	65.6	83.1	75.7	87.3	94.1	101.5	10.3%
Conditional grants	45.3	44.2	40.0	45.0	48.0	51.0	52.5	5.3%
General fuel levy sharing with metros	12.5	13.2	14.0	14.6	15.3	15.4	16.1	3.3%
Provisional allocation not assigned to votes[1]	–	–	–	–	5.6	28.3	32.1	
Non-interest allocations	**1 324.8**	**1 486.2**	**1 556.4**	**1 627.6**	**1 663.5**	**1 627.0**	**1 698.0**	**1.4%**
Percentage increase	*6.6%*	*12.2%*	*4.7%*	*4.6%*	*2.2%*	*-2.2%*	*4.4%*	
Debt-service costs	181.8	204.8	232.6	268.3	301.8	335.0	363.5	10.7%
Contingency reserve	–	–	–	–	10.0	5.0	5.0	
Unallocated reserve	–	–	–	–	–	25.0	30.0	
Main budget expenditure	**1 506.6**	**1 691.0**	**1 789.0**	**1 896.0**	**1 975.3**	**1 992.0**	**2 096.6**	**3.4%**
Percentage increase	*7.2%*	*12.2%*	*5.8%*	*6.0%*	*4.2%*	*0.8%*	*5.2%*	
Percentage shares								
National departments	*47.9%*	*50.4%*	*50.8%*	*51.1%*	*49.7%*	*48.2%*	*48.4%*	
Provinces	*43.2%*	*41.3%*	*40.4%*	*40.6%*	*41.2%*	*41.7%*	*41.4%*	
Local government	*8.9%*	*8.3%*	*8.8%*	*8.3%*	*9.1%*	*10.0%*	*10.2%*	

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

The provincial share of nationally raised revenue grows by an annual average of 1.4 per cent over the medium term, including growth in equitable share transfers of 1 per cent and in conditional grants of 3.3 per cent. The municipal share grows by an annual average of 7.9 per cent, including equitable share growth of 10.3 per cent and conditional grants growth of 5.3 per cent. In contrast, the national share contracts by an annual average of 1 per cent.

Figure 6.1 Average annual growth rate of allocations to spheres of government

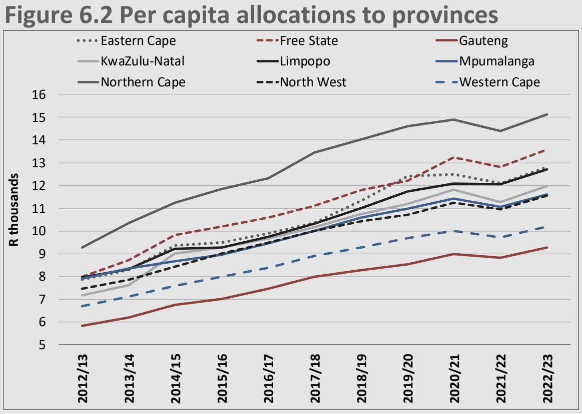


Source: National Treasury

Redistributive nature of allocation through division of revenue

Rural and lower-income provinces and municipalities are less able to raise their own revenue – and have higher per capita costs for delivering most services due to lower population density – than their urban counterparts. To adjust for this imbalance, national government allocates revenue in a redistributive manner. Although urban provinces receive a higher proportion of funding, rural provinces receive more funding per capita. Unlike local governments, which can raise their own revenue, provinces are heavily dependent on national government for their funding.

Figure 6.2 Per capita allocations to provinces



Source: National Treasury

Over the past 10 years, per capita allocations have consistently been higher for more rural provinces. For example, the Northern Cape received about R3 400 more per person in 2012/13 than Gauteng – and this difference increased to about R6 100 in 2019/20. On average, the per capita allocation in the Northern Cape is about 1.7 times higher than Gauteng.

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.

Provincial revenue and spending

About 95 per cent of provincial budgets are funded through transfers from national government. The provincial equitable share, which is used to provide education, health and other services, makes up most of these transfers. Most services are provided at no or low cost to recipients. Over the next three years, additional provincial allocations aim to alleviate some of the pressure on health and education services in particular.

The equitable share is made up of six components: education, health, basic, institutional, poverty and economic activity. It is calculated using a formula based on demand for services and demographic factors that affect this demand, such as the school-age population. Government is reviewing the formula and its components. Changes based on the health component review will be phased in progressively over the next three years.

The next review will focus on education. It will develop options for how to manage the different funding needs of various types of schools and learners. Provincial treasuries, the National Treasury and the Department of Basic Education will work together on the review. More detail is included in the *Explanatory Memorandum to the Division of Revenue*.

Table 6.2 Provincial equitable share

	2021/22	2022/23	2023/24	2024/25	Average annual
R million			Medium-term estimates		MTEF growth
Eastern Cape	70 950	72 231	69 779	71 842	0.4%
Free State	30 342	31 107	30 109	31 109	0.8%
Gauteng	115 621	120 042	116 264	120 760	1.5%
KwaZulu-Natal	111 592	114 509	110 786	114 373	0.8%
Limpopo	62 556	64 056	62 073	64 127	0.8%
Mpumalanga	44 543	45 962	44 595	46 220	1.2%
Northern Cape	14 469	14 942	14 434	14 895	1.0%
North West	38 294	39 540	38 298	39 702	1.2%
Western Cape	56 467	58 367	56 810	58 991	1.5%
Total	**544 835**	**560 757**	**543 149**	**562 018**	**1.0%**

Source: National Treasury

Changes to provincial allocations

Since the 2021 MTBPS, R58.4 billion in additional allocations has been added to provincial transfers. Of this, R53 billion is added to the provincial equitable share and the remainder is through conditional grants.

Over the medium term, provincial equitable share allocations include:

- R24.6 billion to address shortages of teachers and materials
- R15.6 billion to fund COVID-19 responses and reduce the effect of budget reductions on essential medical goods and services

- R12.7 billion to hire education and other assistants in schools as part of the presidential employment initiative
- R988 million to ensure that social welfare budgets grow by inflation.

In the 2021 MTBPS, R13.9 billion was added in 2022/23 to help fund the costs of the non-pensionable cash gratuity for employees from the 2021 wage agreement.

Medium-term allocations to conditional grants include:

- R3.3 billion to fund medical interns and community services doctors requiring placement through the *human resources and training grant*
- R1 billion added to the *district health programmes grant* in 2022/23 to help provinces continue rolling out COVID-19 vaccines
- R809 million in 2022/23 to assist in funding the cash gratuity for employees flowing from the 2021 wage agreement
- R873 million added to the *human settlements development grant* to rehabilitate houses, R471 million to the *education infrastructure grant* to repair schools and R784 million to the *provincial roads maintenance grant* to repair flood-damaged roads in KwaZulu-Natal.

Analysis of provincial employee compensation

Compensation of employees accounts for the majority of provincial expenditure. Over the MTEF period, approximately 62 per cent of health budgets and 77 per cent of education budgets will be spent on compensation.

In 2021, the National Treasury analysed trends in provincial compensation. Key findings from the analysis show that:

- Compensation accounts for about 55 per cent of spending in the Western Cape and Gauteng and up to 69 per cent in poorer, more rural provinces. Education and health account for about 85 per cent of compensation spending.
- In line with overall public-service compensation trends, salary growth has accounted for 75 per cent of the increase in compensation spending since 2006/07, while increased headcounts account for only 25 per cent.
- Growth in average provincial remuneration is determined through national government, with provinces having little control over remuneration levels.

In this context, policies that define staffing norms need to be reviewed on the basis of affordability. There is a need to review the approaches provinces have taken to managing different employees – such as community health workers, early childhood development practitioners and Expanded Public Works Programme workers – to identify differences in practices, and the associated costs and benefits.

Changes in conditional grants

In 2022, the National Treasury will work with several national departments to address shortcomings in the policy framework and effectiveness of conditional grants. This includes:

- Working with the Department of Transport to ensure that the incentive component within the *provincial roads maintenance grant* is allocated equitably using the most recent road data.
- Working with the Department of Basic Education to determine how to incorporate the *school infrastructure backlogs grant* into the *education infrastructure grant*. The change will be implemented from 2023/24.
- Reviewing the human settlements grants, following the establishment of the standalone informal settlements upgrading grants.

The *HIV, TB malaria and community outreach grant* has been reconfigured from eight to two components, and its name has been changed to *district* *health programmes grant*. Mental health services and oncology services components previously included in this grant have been moved to the direct *national health insurance grant*. The *early childhood development grant* has been moved from the Department of Social Development to the Department of Basic Education.

Table 6.3 Conditional grants to provinces

R million	2021/22 Revised estimate	2022/23	2023/24	2024/25	MTEF total
			Medium-term estimates		
Direct conditional grants					
Comprehensive agricultural support programme	1 558	1 599	1 618	1 691	4 908
Ilima/Letsema projects	597	610	620	648	1 879
Education infrastructure	11 689	12 384	13 094	13 342	38 820
National school nutrition programme	8 115	8 508	8 879	9 278	26 665
District health programmes grant	27 753	29 023	26 866	28 072	83 961
Health facility revitalisation	6 435	6 780	7 120	7 361	21 261
Human resources and training grant	4 298	5 449	5 479	5 367	16 295
National tertiary services	13 708	14 306	14 024	14 654	42 984
Human settlements development	13 403	14 256	14 944	15 118	44 318
Informal settlements upgrading partnership	3 890	4 121	4 303	4 496	12 920
Community library services	1 496	1 573	1 571	1 641	4 785
Provincial roads maintenance	11 937	11 256	13 330	13 613	38 200
Public transport operations	7 121	7 090	7 403	7 735	22 229
Other direct grants	4 363	4 826	4 910	5 121	14 858
Total direct conditional grants	**116 361**	**121 782**	**124 161**	**128 138**	**374 081**
Indirect transfers	**3 954**	**4 612**	**4 550**	**4 015**	**13 177**
School infrastructure backlogs	2 397	2 403	2 079	2 172	6 653
National health insurance indirect	1 557	2 209	2 471	1 843	6 523

Source: National Treasury

Municipal revenue and spending

Local government has the capacity to finance a large portion of its budget from own revenue collected from services provided to households. The legislative framework empowers municipalities to bill for and collect revenue for services provided, and to enforce credit control measures where revenue is not paid.

Although revenue-raising capacity varies across municipalities, tariffs are intended to reflect the costs of providing services. Many municipalities currently charge less than the cost of services, creating a revenue gap. In practice, municipalities frequently use transfers from national government – designed to subsidise services provided to poor households – to compensate for low revenue collection rates among households that can afford to pay for services. This reflects insufficient collection measures and a lack of political will to address non-payment. Table 6.4 sets out direct allocations to local government, which grow more quickly than inflation over the medium term.

Table 6.4 Transfers to local government

R million	2021/22 Adjusted Budget	2022/23	2023/24 Medium-term estimates	2024/25	MTEF total
Equitable share and related	**77 999**	**87 311**	**94 087**	**101 486**	**282 885**
General fuel levy sharing with metros	**14 617**	**15 335**	**15 433**	**16 127**	**46 895**
Direct conditional grants	**44 969**	**47 983**	**50 994**	**52 534**	**151 511**
Municipal infrastructure	15 593	16 842	17 595	18 385	52 822
Integrated urban development	1 009	1 085	1 123	1 173	3 381
Urban settlements development	7 405	7 352	7 676	8 021	23 050
Informal settlements upgrading partnership	3 945	4 181	4 365	4 561	13 106
Integrated national electrification programme (municipal)	2 003	2 119	2 212	2 311	6 642
Public transport network	5 175	6 013	6 689	7 720	20 422
Water services infrastructure	3 620	3 701	3 864	4 038	11 603
Regional bulk infrastructure	2 237	2 521	2 892	2 763	8 176
Other direct grants	3 982	4 169	4 578	3 562	12 309
Total direct transfers	**137 585**	**150 630**	**160 514**	**170 147**	**481 291**
Indirect transfers	**7 727**	**8 055**	**8 481**	**8 862**	**25 399**
Integrated national electrification programme (Eskom)	2 824	3 588	3 821	3 993	11 402
Regional bulk infrastructure	3 857	3 455	3 607	3 769	10 832
Other indirect grants	1 046	1 012	1 053	1 100	3 165

Source: National Treasury

Changes to local government allocations

Since the 2021 MTBPS, local government allocations have been increased by a total of R30.7 billion – R28.9 billion in the local government equitable share and R1.8 billion in direct conditional grants – as follows:

- The *local government equitable share* has been increased by R4.2 billion in 2022/23, R10.5 billion in 2023/24 and R14.2 billion in 2024/25 to expand the provision of free basic services to poor households.
- The *neighbourhood development partnership grant* is allocated R800 million in 2022/23 and R856 million in 2023/24 to continue with city-led employment programmes forming part of the presidential employment initiative.
- The *municipal disaster recovery grant* is allocated R26 million in 2022/23 and R321 million in 2023/24 to reconstruct and rehabilitate municipal infrastructure damaged by the floods and storms in KwaZulu-Natal in 2019 and 2020.
- The *public transport network grant* allocations are reduced by R754 million in 2022/23 and R105 million in 2023/24, and increased by R621 million in 2024/25. These changes are made to align with the revised implementation plan of phase 2 of the MyCiTi project for the City of Cape Town.
- To fund a sport project in Polokwane Local Municipality, R10 million in 2022/23 is shifted from the sport component of the *municipal infrastructure grant* to the *integrated urban development grant*.

Municipal capacity building

A number of municipalities fail to deliver services effectively because of poor governance, financial mismanagement and insufficient capacity. The number of municipalities in financial distress – according to the 13 indicators used by the National Treasury – has risen from 86 in 2013/14 to 175 in 2019/20, and 123 municipalities passed unfunded budgets. Revenue collected has been increasing over time. This implies that other factors, most likely the high costs of key inputs or poor spending management, are the reasons behind financial distress. Municipalities are accountable for these results. Nonetheless, national and provincial government, and supporting institutions, play a role in supporting municipalities to achieve their mandates effectively.

National government provides a range of resources and support to help municipalities build capacity and function efficiently. During 2021, the National Treasury reviewed the system of capacity building for local government to inform a multi-year programme aimed at improving its outcomes and cost-effectiveness.

The review identified deficiencies in capacity, especially among senior municipal executives and technical managers responsible for advising political office-bearers, as a major contributor to poor performance. Weak strategic leadership also contributed to poor corporate governance, insufficient financial management skills and inappropriate personnel appointments. These deficiencies were exacerbated by gaps in data and duplication in programmes.

The findings indicate the need for radical changes to the current capacity-building system, which will require coordinated efforts and consistent leadership from within municipalities and from supporting institutions across government. The review recommends a differentiated system of capacity building. The four guiding principles are:

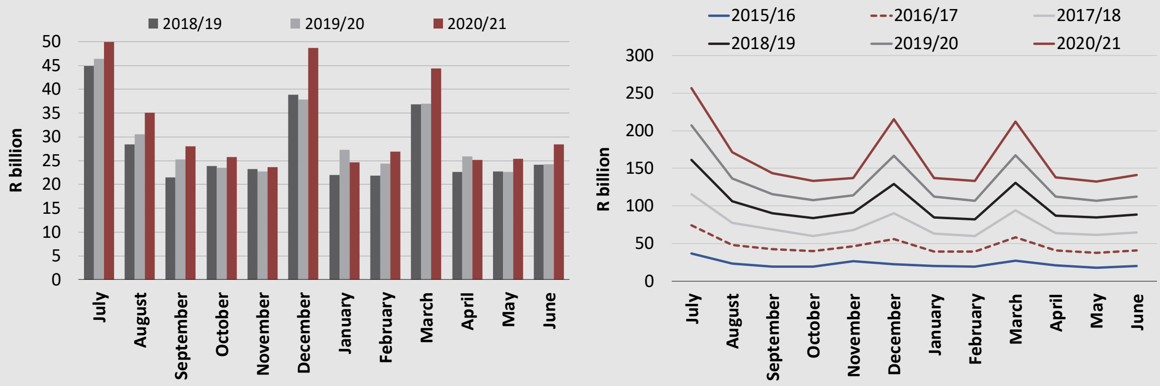
- A clear focus on developing capabilities, including skills and the broader environment in which employees work and the processes that they use.
- A problem-led approach, implying that solutions are tailored to the specific municipality, rather than generic recommendations.
- The inclusion of municipalities in designing and implementing the system.
- An integrated approach, rather than separating capacity-building responsibilities across different supporting institutions.

This work will be managed by a committee comprising representatives of the National Treasury and other national departments, provincial treasuries and departments of cooperative governance and traditional affairs, the Financial and Fiscal Commission, the South African Local Government Association and the Development Bank of Southern Africa.

Impact of COVID-19 on municipal revenues

Municipalities expected a substantial decline in revenue in the 2020/21 municipal fiscal year (July 2020 to June 2021) as a result of pandemic-related restrictions, business closures and job losses. However, revenue collection remained similar to the previous year, with no apparent impact from restrictions.

Figure 6.3 Municipal revenue collection and trend, 2015/16–2020/21*



** The line graph shows cumulative revenue collection*
Source: National Treasury

Revenue collection has been increasing gradually from 2015/16 and this trend continued in 2020/21. Furthermore, there were no significant changes in the collection pattern corresponding to periods of higher restrictions (April to August 2020 and July to September 2021). It is important to note, however, that low-income and poor households that receive free basic services – whose contribution to revenues are covered by national transfers – are likely to have experienced a much higher financial impact from the pandemic. In addition, revenue collection remains relatively low as a proportion of total billed revenue in a number of municipalities.

Long-term borrowing for municipalities

The National Treasury has updated the municipal borrowing policy framework and submitted changes to Cabinet for approval. The proposed changes aim to increase the permissible term-to-maturity of borrowing, strengthen the secondary market for municipal debt instruments, and better define the role of development finance institutions to avoid their crowding out the private sector.

Outstanding municipal long-term debt has grown at an annual average of 6 per cent over the past 21 years, from R20.3 billion in 1999/2000 to R70.9 billion at the end of 2020/21. Inflation accounts for much of the change: in real terms, this debt grew at an annual average of 0.8 per cent. Municipalities mainly borrow through loans and securities (bonds). Municipal debt held in loans has grown faster than that held in bonds, from R10.4 billion in 1999/2000 to R53.9 billion at the end of 2020/21. Municipal bonds grew from R9.8 billion to just R16.5 billion over the same period.

In many respects, South Africa’s municipal debt market is comparable to that of developed countries, with a sophisticated investor base. Development finance institutions such as the Development Bank of Southern Africa, Agence française de développement and KfW Development Bank are the main public-sector investors. Commercial banks, pension funds and insurers are the main private-sector lenders. Public-sector investors accounted for most lending to municipalities over the past 21 years. As of June 2021, municipalities owe R37.2 billion to public-sector investors and R33.2 billion to private-sector investors.

Conclusion

National government has used some of the higher-than-anticipated revenue to provide additional funding to provinces and municipalities. Greater spending efficiency and fiscal discipline are required in provinces and municipalities to ensure that they are able to deliver services effectively, in line with their mandates.