6

Provincial and local government finance

The Medium Term Expenditure Framework outlined in Chapter 5 indicates a continuing shift in the division of revenue towards local and provincial government. This reflects Government's policy commitment to strengthen the social security grant system, improve municipal services in under-served communities and enable the health system to tackle the HIV/Aids epidemic. Significant developments in provincial and local government finances include:

- *A change in the provincial equitable share formula to take account of the increased spending commitments in social security grants*
- *A continuation of strong growth in infrastructure grants*
- *Changes in the local government grant system to take account of the new municipal boundaries and fiscal capacities of new municipalities.*

Funding of provincial government

Provincial government revenue includes transfers from the National Revenue Fund and provincial own revenue. Transfers take two forms - the provincial equitable share, which is a direct charge on the National Revenue Fund, and conditional grants administered by national departments. Conditional grants are used to support compliance with national norms and standards, to compensate provinces for providing services that may extend beyond provincial boundaries, and to ensure that national priorities are adequately provided for in provincial and local government budgets.

Social and municipal services are essential to the alleviation of poverty, improving the quality of life and for economic development

Financial and Fiscal Commission recommendations of Provincial Government

In line with the Constitution and the Intergovernmental Fiscal Relations Act, the Financial and Fiscal Commission (FFC) makes recommendations to Parliament and the executive on the sharing of nationally-raised revenue between the three spheres of government. The FFC's submission: Division of Revenue 2002-2003, in which the recommendations for the 2002 Budget are made, was published in June 2001.

Of the 22 specific proposals made by the FFC, nine relate to provinces. The recommendations fall under three broad areas: equitable share, provincial own revenue, contingency reserve and capital grants.

The recommendations relating to the equitable share are underpinned by the principle of allocating each sphere sufficient resources to enable it progressively to provide "constitutionally mandated obligations in general and provision of basic services in particular", including:

- An institutional element for each sphere of government
- Other constitutional functions for which norms and standards should also be specified
- Obligations other than constitutional functions, that may be funded through conditional grants, own revenue and borrowing
- The need for infrastructure funding, which should vary according to policy priorities.

With respect to provincial own revenue, in addition to identifying the specific taxes that provinces might impose, the FFC proposes creation of tax room to maintain the tax burden within nationally determined targets. On capital grants it advocates earmarked allocations distributed through a model that seeks to address backlogs and attain a predetermined optimum level of capital stock. It also proposes that objective criteria be developed for allocating contingency reserve. The general thrust of the FFC's proposals is consistent with government's approach to the division of revenue with respect to provinces, barring a few differences in emphasis and matters of detail.

The current approach seeks precisely to enable each sphere to fulfil its constitutional mandate. On one hand, division among spheres is an outcome of a political process informed by objective technical analyses, policy priorities and takes account of functional responsibilities of spheres. On the other hand, division among provinces is based on an objective redistributive formula.

Without pre-empting the final outcome of the process of exploring practical implications of the FFC proposals, Government has reservations about the implicit suggestion in the FFC proposals regarding translating the constitutional provisions relating to basic services into a formula for dividing resources among the three spheres. It prefers, instead, to leave this to political judgement informed by rigorous technical analyses and to provisions of legislation approved by parliament.

Taking this into account and recognising the information requirements and other difficulties inherent in the proposed approach to budget preparation, Budget Council has advised against changes to the equitable share formula for the 2002 Budget. However, further work will be undertaken in collaboration with the FFC.

Government will respond to the FFC recommendations in greater detail when it tables the 2002 Division of Revenue Bill.

Equitable share of revenue

The equitable share is the largest of the provincial allocations. Table 6.1 sets out the provincial equitable shares for the 2002 Budget. Over the course of the MTEF, the equitable share allocation will rise from R105,3 billion in 2001/02 to R133,1 billion in 2004/05, an average annual growth rate of 8,1 per cent.

The provincial equitable share formula distributes resources on the basis of relative need, taking into account the different profiles of each province.

The equitable share portion of national transfers to provinces is divided 'horizontally' between provinces in accordance with a formula based on the 1996 recommendations of the Financial and Fiscal Commission. This formula allocates resources on the basis of relative need between provinces, taking into account the demographic and economic profiles of the provinces.

Table 6.1: Provincial equitable share division

	2001/02	2002/03	2003/04	2004/05
R million		Medium term estimates		
Eastern Cape	18 171	19 932	21 245	22 644
Free State	7 103	7 774	8 298	8 844
Gauteng	16 028	17 720	19 183	20 446
KwaZulu-Natal	21 274	23 669	25 674	27 365
Mpumalanga	7 289	8 194	8 961	9 551
Northern Cape	2 560	2 824	3 030	3 229
Northern Province	14 179	15 699	16 970	18 087
North West	8 863	9 716	10 366	11 049
Western Cape	9 870	10 615	11 129	11 862
Total to be shared	**105 336**	**116 142**	**124 856**	**133 078**

The equitable share formula recognises that the provinces have different demographic and economic profiles, markedly different levels of economic development and significant variations in socio-economic circumstances. The levels of wealth or income within a province are important determinants of demand for social services, particularly primary health care, education and income support. The redistributive nature of the equitable share formula assists all provinces to provide a basic level of service for all South Africans.

Provincial and local governments are responsible for their own budget processes, accountable to their own electorate within a framework of co-operative

Revisions to the formula

The structure of the present equitable share formula has been retained for the 2002 Budget. The formula, however, has been adjusted to reflect shifts in spending on social services in provinces and new data. Firstly, the weighting of the social services components reflects expenditure on these services in recent years. Based on expenditure data reported in the Intergovernmental Fiscal Review 2001, the weight for the welfare component has been increased by one percentage point with a balancing reduction in the weight of the economic component. The formula has also been updated to take account of average provincial educational enrolment over the past three years.

Provincial equitable share changes to reflect increased priority for social security grants

Although the formula has components for education, health and welfare, these elements are not earmarked funding allocations, but broad indications of relative need. Provincial Executive Committees have discretion regarding the provincial allocations for each function.

The provincial equitable share formula (with latest updates) comprises the following components, with the weights of each component shown in brackets:

The equitable shares formula takes into account the main services provided by provinces

- An education share (41 per cent) based on the size of the school-age population (ages 6-17) and the average number of learners enrolled in public ordinary schools for the past three years
- A health share (19 per cent) based on the proportion of the population without medical aid or health insurance
- A social security component (18 per cent) based on the estimated number of people entitled to social security grants - the elderly, disabled and children - weighted using a poverty index derived from the Income and Expenditure Survey
- A basic share (7 per cent) derived from each province's share of the total population of the country
- A backlog component (3 per cent) based on the distribution of capital needs as captured in the schools register of needs, the audit of hospital facilities and the share of the rural population
- An economic output component (7 per cent) based on the distribution of total remuneration in the country and
- An institutional component (5 per cent) divided equally among the provinces.

The current formula will be phased in by 2003/04

The target date of 2003/04 for phasing-in the impact of updating demographic data with the final results of the 1996 Census is retained. The 2002 Budget will mark the fourth year of the phased approach to the application of the equitable share formula. The phased approach was developed as a response to differences between the data on which the formula was originally based and the data contained in the 1996 Census. The phasing avoided unmanageable disruptions in provinces where the target shares differ substantially from the initial allocation of resources.

Conditional grants

Conditional grants are an important part of the intergovernmental system, reinforcing the inter-relatedness of all three spheres of Government

Conditional grants are transfers to provinces to implement specific national priorities in provincial budgets, and constitute about 11 per cent of total transfers to provinces. The 2002 Budget marks the fourth year since conditional grants were introduced in the intergovernmental fiscal framework. The 2001 Division of Revenue Act built on the foundation laid in the first two acts and introduced measures aimed at strengthening the conditional grant system and clarifying lines of reporting and accountability, thus, enhancing transparency while contributing to better planning and budgeting for conditional grants. These measures include:

- Publication of three-year allocations for grants, including all grants to municipalities, though Parliament is requested to appropriate allocations for the first year only.
- Publication of statements of purpose, outputs, conditions and criteria for allocating each grant.
- Alignment of reporting requirements for conditional grants with the requirements of the Public Finance Management Act.

Total conditional grants amount to R14 672 million in 2002/03, R16 072 million in 2003/04 and R17 013 million in 2004/05, with strong growth in health grants, housing allocations and infrastructure allocations.

Further improvements to conditional grant system

For the 2002 Budget, the Division of Revenue Bill will seek to deepen reforms introduced in the previous acts. This year, a draft Division of Revenue Bill will be published in November 2001 with to view of providing a complete picture of fiscal transfers to provincial and local governments. This will also assist provinces in finalising their budgets and planning ahead for implementation.

This year, a draft Division of Revenue Bill will be published in November to further strengthen the intergovernmental budgeting system

With the exception of the housing subsidy and HIV/Aids grants no significant changes are made to the conditional grant allocations in the 2002 MTEF. However, significant changes occur in the policy framework underlying some of the grants, particularly in health and housing. These have informed the restructuring and rationalisation of these grants planned for the 2002 Budget.

The health grants are by far the biggest, and probably the most complex. Apart from the integrated nutrition programme, all grants administered by the Department of Health are predominantly aimed at hospitals, particularly the funding of tertiary health services and training.

Significant shift in structure of health conditional grants to develop capacity in hospital services in poorer provinces

The health sector has completed a review of the funding of tertiary services and training (central hospitals, redistribution of specialised health services and training and research grants). The review's findings, which are summarised in the Intergovernmental Fiscal Review 2001, indicate that improvements in the equity and targeting of current funding mechanisms for tertiary services are possible. The review highlights the need to redress inequities in the distribution of health specialists between provinces

Health conditional grants will attempt to shift 25 per cent of post-graduate training capacity to poorer provinces

Table 6.2: Conditional grants to provinces

R million	2001/02	2002/03	2003/04	2004/05
		Medium term estimates		
Health				
Central hospitals	3 271	3 419	3 579	3 794
Training and research	1 234	1 338	1 415	1 541
Redistribution of specialised services	182	189	198	209
Hospital rehabilitation	500	520	543	576
Nkosi Albert Luthuli academic hospital	104	-	-	-
Pretorial Academic	50	70	90	-
Integrated Nutrition Programme	582	582	582	617
HIV/AIDS	34	132	240	353
Sub-Total Health	**5 957**	**6 251**	**6 649**	**7 091**
National Treasury				
Supplementary allocation	2 248	2 152	2 158	2 166
Provincial infrastructure	800	1 550	2 314	2 853
Flood infrastructure rehabilitation	600	400	200	-
Section 100 Grant	300			
Sub-total Treasury	**3 948**	**4 102**	**4 672**	**5 019**
Education				
Financial management and quality enhancement	213	224	234	248
HIV/AIDS	64	142	117	125
ECD	21	52	88	-
Sub-total Education	**298**	**418**	**440**	**373**
Housing				
Housing Fund	3 226	3 740	4 138	4 346
Human Settlement (Urban Development)	100	104	109	116
Sub-total housing	**3 326**	**3 844**	**4 247**	**4 462**
Welfare and Labour				
Financial management	10	11	-	-
HIV/AIDS	13	47	64	68
Sub-Total Welfare	**23**	**57**	**64**	**68**
Total	**13 551**	**14 672**	**16 072**	**17 013**

through the development of postgraduate training capacity in provinces where this is limited or non-existent.

The health sector has developed a new framework for the tertiary services and training grants which aims to support a more equitable distribution of these services over time. The new framework provides for a rationalisation of the three grants into two: a national tertiary service grant (NTS grant) and a health professional and development grant (HPD grant).

The NTS grant amounts to R3 666 million in 2002/03, increasing to R4 151 million in 2004/05. It will fund tertiary units in 27 hospitals, whereas the current central hospitals grant took into account costs of services provided by ten hospitals only. This will lead to a redistribution of funds from Western Cape and Gauteng to other provinces. In order to give these provinces time to adjust to lower levels of funding from the grant, the shift between provinces will be phased in over five years. Since the cost methodology underlying the new grant includes certain training costs, part of the health professionals training and research grant has been incorporated into NTS Grant.

New NTS grant will fund tertiary services in 27 hospitals

The HPD grant consists of several components. The largest of these is distributed to provinces according to a formula based on the number of current medical students. It provides for a phased increase in the number of medical specialists and registrars in under-served provinces. The aim is that 25 per cent of post-graduate training capacity should be developed in provinces that presently do not have such capacity. The allocation for the HPD grant is R1 393 million in 2002/03.

Government started implementing an integrated strategy for HIV/Aids through the social service departments (education, health and welfare) in the 2001 Budget. The strategy focuses on care and support for children and youth affected and infected by HIV/Aids. Provinces were allocated R110 million 2001/02, 58 per cent of which is allocated to education departments to implement lifeskills programmes at schools, with the remaining amount going to health and social development departments for HIV testing and counselling and for home based care. Mindful of the need to further step up HIV/Aids programmes, government is setting aside increased allocations for special programme of the Health, Education and Social Development departments, amounting to R320 million in 2002/03, R422 million in 2003/04 and R546 million in 2004/05.

Increases in grants to tackle HIV/Aids through community based care, life skills programmes in schools, counseling and voluntary testing

These grants aim to strengthen home and community-based care, support voluntary counselling and testing, provide for the roll-out of the mother-to-child transmission prevention programme and strengthen life-skills programmes in schools.

Housing grant

Additional allocations for the housing programme allow for an increase in the maximum subsidy level and for a prioritisation of urban and medium density housing. This programme increases by R300 million in 2002/03,

Significant increase in housing allocations

R579 million in 2003/04 and R574 million in 2004/05 above the baseline forward estimates.

Education grant for early childhood development

Early childhood education programme to be rolled out over ten years, to enhance quality in the foundation phase of education

The grant for the piloting of sites for early childhood development (ECD) was introduced in the vote of the National Department of Education in 2001/02. Conditional grant funding for the pilot programme is phased out by 2003/04. The roll out of the programme, which is expected to be phased in over ten years, will principally be funded from the provincial equitable share.

Infrastructure grants

The 2001 Budget announced a large increase in infrastructure allocations, predominantly going to provinces. The 2002 Budget will continue this trend. A number of institutional and legislative reforms are being put into place to improve the capacity of provincial government to accelerate the pace at which these projects are rolled out. The 2001 Intergovernmental Fiscal Review signalled a marked increase in actual expenditure in 2000/01. Actual spending in 2001/02 is likely to be even more robust. Taking into account the lead times prevalent in infrastructure projects, additional resources for this programme are only provided in the third year, taking total infrastructure grants to provinces up to R2,8 billion by 2004/05.

Strong growth in infrastructure spending will expand service delivery and contribute to economic growth and job creation

In addition to increased direct expenditure on infrastructure, provinces have begun negotiations on various public-private partnership arrangements that will enhance infrastructure investment and service delivery over the longer term.

Funding of local government

Large shift in resources to local government strengthens Government's commitment to expand the delivery of basic municipal infrastructure and to fund free basic services

Local government faces significant financial pressures during the final phase of its transformation. Municipalities are expected to provide basic services to all residents, with the poorest receiving a minimum level of free services.

The creation of the new (and larger) municipalities will result in significant transition costs, as various administrations are merged. In particular, municipalities face both the challenge of containing personnel expenditure - which has risen rapidly to an average in the order of 31 per cent in the last few years - and the pressure of equalising salaries across amalgamated municipalities. In addition, some newly created municipalities have limited effective tax capacity at present.

Public-Private Partnerships

Public-Private Partnerships (PPPs) are taking root as government departments, extra-budgetary agencies and municipalities seek assistance to enhance their own capacity, and private investors explore new opportunities. These partnerships enable private financing, efficiencies and skills to be harnessed to improve and propel public infrastructure and service delivery.

The benefits of PPPs are achieved through shifting technical, operational and financial project risk to the private party in exchange for a fee or assigned revenue flow, in terms of a detailed long-term contract. In a PPP, government is not procuring an asset, rather it is procuring a specific level of service.

The National Treasury's PPP Unit provides support to departments or provinces contemplating a PPP project. Treasury Regulations require that a PPP:

- is affordable to the department over the life of the contract
- is good value-for-money to the public
- transfers risk appropriately to the private party.

The Intergovernmental Fiscal Review 2001 details a number of PPP initiatives currently in progress or under review in provinces. Some of the larger projects nearing transaction closure are listed below.

Provincial Dept	PPP project	Project status	Approx project value
Free State Dept Health	Universitas and Pelonomi Hospitals – co-location	Preferred bidder announced, financial closure expected October 2001	build value R80 million
Gauteng Blue IQ	Hi-speed train	Feasibility Study under review by National Treasury.	not yet determined
KwaZulu-Natal Dept Health	Inkosi Albert Luthuli Hospital equipment and maintenance	Negotiations in final stages with preferred bidder. Financial closure due September 2001	R500 million investment in equipment and
KwaZulu-Natal Ezemvelo KZN Wildlife.	Eco-tourism – Vivane resort/ Pongolapoortdam	Bidders' proposals due for Vivane; RFP issued for Pongolapoort	not yet determined
Mpumalanga Dept Finance/Econ	Eco-tourism – Zithabiseni Resort	Bids from investors due September 2001	not yet determined
Northern Cape Dept Transport	Fleet Management	Negotiations underway with preferred bidder. Financial closure due September 2001	R150 million
Northern Province Dept Finance/Econ	Eco-tourism – Manyelethi Reserve and Letaba Ranch	Preferred bidders selected. Financial closure due Sept 2001 for Pungwe, Khoko Moya, Honey Badger, North	not final
Western Cape Dept Transport	Chapman's Peak Toll Road Concession	Four bidders pre-qualified. Tender documents issued end-July 2001	build value R160 million

These challenges must be met if municipalities are to deliver municipal services at affordable prices, provide free basic services to poor households and promote social and economic development in accordance with their developmental mandate.

Allocations to local government

The 2002 Budget will reinforce the momentum of the 2001 Budget, with strong real growth in transfers to local government. Local government allocations are projected to grow faster than the other two spheres. This is in recognition of the role that municipal services play in addressing the basic needs of all South Africans and in consideration of the

Local government faces significant challenges in amalgamating various local authorities into the new councils with new boundaries

immense restructuring challenges faced by this sphere after the 2000 local government elections.

The local government share comprises of the equitable share and various conditional grants.

The allocations reflect the work undertaken by a Ministerial task team instituted by Cabinet and chaired by the Minister of Provincial and Local Government.

Equitable share formula is adjusted to take account of free basic services and poor fiscal capacity in some municipalities

The significant increases in allocations to the equitable share, and the allocations for municipal infrastructure reflect the multiple pressures facing local government. These include the implementation of the free basic services commitment, expanding access to infrastructure by poor households, providing support to municipalities with limited effective tax capacity in the short to medium term, promoting social and economic development of communities and supporting the restructuring and transformation within municipalities as they become more developmentally focussed. National government's commitment to these objectives is reflected in the growth in equitable share and infrastructure allocations.

Equitable share for local government

Equitable share formula funds a basic package of services for poor households including water, refuse removal and electricity

The local government equitable share is projected to increase by an average of 13,9 per cent a year over this period, rising to R5,7 billion by 2004/05.

The equitable share is distributed to municipalities relative to the number of households in poverty within their jurisdictions. The formula is targeted at households earning less than R1 100 a month, and aims to support the delivery of a basic package of services, including water, sanitation, energy and solid waste. A portion of the equitable share also targets both local and district municipalities without the fiscal capacity to cover the governance costs associated with a basic level of municipal administration.

Improved monitoring and reporting on municipal finances planned

Although the equitable share is an unconditional allocation, municipalities are encouraged to prioritise the allocation of funds towards this basic package of services. To this end, national government is expanding its monitoring of developmental outcomes at local level through the introduction of new budget formats and improved reporting requirements that will ensure that municipalities report regularly on income and expenditure as well as on the outputs of their programmes. National and provincial

Table 6.3: Local government allocations in the 2002 MTEF

	2001Budget				2001 MTBPS			
R millions	**2001/02**	**2002/03**	**2003/04**	**2004/05**	**2001/02**	**2002/03**	**2003/04**	**2004/05**
Equitable Share & Related								
Equitable share	2 618	3 002	3 551	3 764	2 618	3 429	4 598	5 037
Transition grant	250	200			578	200	0	0
CWSS (operating)	692	644	662	702	692	644	662	702
Subtotal: Equitable share & Related	**3 560**	**3 846**	**4 213**	**4 466**	**3 888**	**4 273**	**5 260**	**5 739**
% increase						*9,9%*	*23,1%*	*9,1%*
Restructuring & capacity building[1]	600	820	850	901	600	818	838	869
Infrastructure[2]	2487	2680	3095	2983	2487	3080	3694	3784
Electrification	0	0	0	0	0	210	210	210
Total LG Allocation[3]	**6 647**	**7 346**	**8 158**	**8 350**	**6 975**	**8 381**	**10 002**	**10 602**
% increase						*20,2%*	*19,3%*	*6,0%*

1 Includes recurrent transfers scheduled for consolidation such as the Municipal Systems Improvement Programme, the Financial Management Grant, the Local Government Support Grant and the Restructuring Grant.

2 Includes infrastructure transfers scheduled for consolidation such as CMIP, the Rural Water Programme, the LED Fund and the Community Based Public Works Programme.

3 Excludes Allocations to SALGA of R22 million, R20 million and R17 million reflecting an increase of R7 million, R5 million and R2 million over the 2002 MTEF funded from the Local Share.

governments will also continue to provide assistance in building municipal service delivery and governance capacity.

Government remains committed to the progressive expansion of the formula-driven equitable share mechanism. This will occur primarily through the restructuring and incorporation of existing national departmental grants, such as existing allocations within the water services trading account.

Over time, the formula-based equitable share will incorporate the present grant programmes

Conditional grants to local government

In additional to the equitable share, municipalities also receive conditional grants for infrastructure, capacity building and restructuring. The 2002 Budget will continue the process that began in 2001 of consolidating local government grants. Reforms to the disbursement mechanisms for infrastructure transfers are currently being explored, with a view to consolidating several existing programmes into a formula-driven municipal infrastructure grant by 2004/05.

Municipal infrastructure grants grow by 17 per cent a year, allowing for an expansion of basic services.

Allocations for municipal infrastructure are projected to increase by an average of 17 per cent a year over the MTEF

Anticipated reforms to the local government equitable share

The reforms to the equitable share for the local government sphere that are currently under consideration include:

- The introduction of three-year allocations to improve the predictability of transfers. This was initially achieved during the 2001 Budget and is anticipated to improve over the medium term.
- Improved targeting of the allocations by municipality, through further refinement of the data on which poor households are identified.
- The proposed inclusion of the water and sanitation operating support grant into the equitable share allocation over the medium term.
- The adjustment of the formula in 2002/03 to incorporate costs of governance, funding district municipalities that provide services and to support the delivery of free basic services.

period, rising to R4,0 billion by 2004/05.

Demarcation, together with the evolving developmental role of local government, requires an overhaul of the structures, systems, and financial resources available to municipalities. The restructuring of local government poses financial challenges to municipalities and national government will offer transitional support in this respect through the Local Government Transition Grant.

Strong growth in local and provincial transfers give effect to Government's commitment to enhance municipal and social service delivery

Transfers to support municipal capacity building are projected to increase by 36 per cent in 2002/03, with funding increasingly focussed on improvements to the strategic management systems of municipalities, in particular financial management reforms and development planning practices.

The division of conditional grants between individual municipalities will be announced in February 2002, in conjunction with the 2002 Budget. These allocations will include targeted support for those nodal municipalities identified in the urban renewal and integrated sustainable rural development programmes.

The projected increases and restructuring of municipal transfers alone will not overcome the significant challenges and cost pressures that face municipalities after demarcation. Policy measures and institutional reforms need to be pursued that enhance municipalities' own revenue performance, contribute to effective management of expenditure pressures and support reprioritisation towards social and developmental priorities, including free basic services for poor households.

Financial and Fiscal Commission recommendations on Local Government

In line with the Constitution and the Intergovernmental Fiscal Relations Act, the Financial and Fiscal Commission (FFC) makes recommendations to Parliament on the sharing of nationally-raised revenue between the three spheres of government. The FFC's Submission: Division of Revenue 2002-2003 in which the recommendations for the 2002 Budget are contained was published in June 2001. The (FFC) submitted a comprehensive set of 13 proposals on local government allocations for the 2002/03 fiscal year. In addition, the FFC also submitted recommendations on councillor allowances and the shifting of functions between category B and C municipalities.

Government welcomes the scope and detail of the FFC's recommendations on local government. In some instances, these can be considered for immediate implementation, and in others further work is required to develop implementable proposals. A task team comprising the key national government departments, the FFC and SALGA will be established to take the recommendations forward.

There is agreement on the significance the FFC attaches to the equitable share mechanism within the fiscal framework for local government. Changes to the local government equitable share will be effected through an adjustment in the institutional component ("I" grant) of the formula that takes into account the weak fiscal capacity of category B and C municipalities. This change will accommodate recommendations incorporating institutional, systemic and functional realignment after demarcation. Critical to any fiscal policy stance towards local government is a coherent and comprehensive fiscal policy framework. Such a framework must resolve tensions and contradictions between constitutional and legal parameters, principles of public finance and the goals of local government policy. The reconciliation of these factors is necessary to drive the development of a coherent and stable system of local government finance.

The recommendations regarding consolidated infrastructure funding for municipalities, local government borrowing and non-metropolitan powers and functions are also broadly supported and are currently being implemented. National government is phasing in a consolidated, formula-driven and decentralised infrastructure grant to municipalities, as evidenced in the Division of Revenue Act, 2001 and accepts the need for clarity on the funding of district and local municipalities through this mechanism. Such clarity will only be possible once the division of powers and functions between these categories of municipalities have been finalised. The national government is committed to addressing the FFC's recommendations.

National government shares the FFC's concerns regarding recent trends in municipal borrowing and welcomes the FFC's support for the borrowing framework as a basis for restoring capital market access by providing certainty and clarifying the rights of borrowers and lenders.

The recommendation that funding be directed to service authorities is also accepted, although the complexity of the resulting framework will require consideration prior to its implementation. As noted by the FFC, further policy clarity is required before fiscal reforms are possible in this respect. A subsequent submission by the FFC on the allocation of non-metropolitan powers and functions has been made. This submission makes a substantive contribution to this debate, and is currently being considered by national government as part of broader policy developments following the amendment to sections 84 and 85 of the Municipal Structures Act. The finalisation of a policy framework is expected soon.

Government will respond to the FFC recommendations in greater detail when it tables the 2002 Division of Revenue Bill.

Conclusion

The division of revenue set out in this *MTBPS* reinforces the strong growth in national transfers to the provincial and local government spheres, which started in the 2001 Budget. In addition to consolidating social services delivery, increased funding to provinces allows for a sustained accelerated infrastructure development programme. In the case of local government, increased allocations will give expression to the provision of free basic services to households, while at the same time facilitating a smooth transition following the demarcation process.

The changes effected in both the provincial and local government equitable share formulae and conditional grant allocation mechanisms are aimed at speeding up attainment of equity within each sphere. Combined with increased funding levels, ongoing budget and financial management reforms will place provinces and local government in a better position to face the new challenges of delivering more and better quality services to all South Africans on a sustained basis.