W1

Website annexure to the 2008 Budget Review

Explanatory memorandum to the division of revenue

Background

The allocation of resources to the three spheres of government is a critical step in the budget process, required before national government, nine provinces and 283 municipalities can determine their own budgets. The allocation process needs to take into account the powers and functions assigned to the three spheres of government. The process for making this decision is at the heart of cooperative governance as envisaged in the Constitution.

To foster transparency and ensure smooth intergovernmental relations, section 214(1) of the Constitution of South Africa requires that every year a Division of Revenue Act determine the equitable division of nationally raised revenue between the three spheres of government. The Intergovernmental Fiscal Relations Act (1997) prescribes the process for determining the equitable sharing and allocation of revenue raised nationally. Sections 9 and 10(4) of the act set out the consultation process to be followed with the Financial and Fiscal Commission (FFC), including the process of considering recommendations made with regard to the equitable division of nationally raised revenue.

This explanatory memorandum to the 2008 Division of Revenue Bill fulfils the requirement set out in section 10(5) of the Intergovernmental Fiscal Relations Act that requires the Division of Revenue Bill to be accompanied by an explanatory memorandum detailing how the bill takes account of the matters listed in section 214(2) (a) to (j) of the Constitution, government's response to the recommendations of the FFC, and any assumptions and formulas used in arriving at the respective divisions among provinces and municipalities. This explanatory memorandum contains five parts:

- Part 1 describes the division of resources between the three spheres of government.
- Part 2 sets out how the FFC's recommendations on the 2008 division of revenue have been taken into account.
- Part 3 explains the formula and criteria for the division of the provincial equitable share and for conditional grants to provinces.

- Part 4 sets out the formula and criteria for the division of the local government equitable share and conditional grants between municipalities.
- Part 5 summarises issues that will form part of subsequent reviews of provincial and local government fiscal frameworks.

This memorandum should be read with the Division of Revenue Bill. The Division of Revenue Bill and its underlying allocations are the culmination of extensive consultation processes between the three spheres of government. The Budget Council deliberated on the matters discussed in this memorandum at its August 2007 lekgotla and at several other meetings held during the year. The approach to local government allocations was discussed with organised local government at several technical meetings with the South African Local Government Association (SALGA), culminating in a meeting of the Budget Forum (Budget Council plus SALGA) on 11 October 2007. An extended Cabinet meeting, involving cabinet ministers, premiers of provinces and the chairperson of SALGA was held on 24 October 2007, and agreed on the final budget priorities and the division of revenue for the next three years.

Part 1: The 2008 division of revenue

The 2008 medium-term expenditure framework (MTEF) recognises the important developmental role played by provincial and local government and continues to strengthen their ability to provide social and municipal basic services and perform the functions allocated to them in line with section 214(2)(a to j) of the Constitution. Excluding debt service costs and the contingency reserve, allocated expenditure to be shared between the three spheres amounts to R553.9 billion, R618.5 billion and R673.5 billion over each of the MTEF years. These allocations take into account government's spending priorities, the revenue-raising capacity and functional responsibilities of each sphere, and inputs from various intergovernmental forums and the recommendations of the FFC. Further, the design of the equitable share formulas for both provincial and local governments are such that these spheres have desirable, stable and predictable revenue shares, and economic and fiscal disparities are addressed.

Government's policy priorities for the 2008 MTEF

The progressive realisation of basic social rights, economic growth and people-centred development through strategic economic investment remain the key pillars of government's overall development strategy. Access to services such as housing, electricity, water and sanitation, education and health, of which the largest beneficiaries are the poor, has improved considerably. Continued strategies are explored to improve the efficiency of the state to ensure that the quality of services is enhanced. While progress has been made, a number of social and developmental challenges remain to be addressed. In line with section 214(2)(a to j) of the Constitution, the period ahead will see further investments in infrastructure, with emphasis on broadening access to basic household services, public transport, education, health, labour-intensive employment initiatives, industrial policy initiatives that raise productivity and employment, fighting crime and improving service delivery. The 2008 Budget focuses on the following in order to achieve its national objectives:

- *Infrastructure investment:* Investing in both economic and social infrastructure so that the economy can grow faster, and access to basic social and household services can be assured. General government investment is mainly focused on areas that contribute to social cohesion, and sustainable communities. This includes housing, water, electrification, sanitation, schools, health facilities, police stations, roads and public transport investment.
- *Improved quality of public services:* Improving the quality of education, health and other social services, and stepping up targeted anti-poverty initiatives. These include improved early learning opportunities to increase success rates in the later years; alleviating pressures

on health and emergency services; better agricultural extension services and post-settlement support to new farmers to ensure that the objectives of the land reform programme are achieved.

- *Supporting employment growth and poverty reduction:* Enhancing job creation associated with growth by supporting labour-absorbing industries and active labour market initiatives, and expanding employment intensive government programmes. These include direct job creation through the expanded public works programme (EPWP).
- *A more efficient criminal justice sector:* Improving efficacy of police services and the justice system to make further progress in reducing crime. Over the MTEF period the budget for the police will prioritise improved IT and communications infrastructure, and forensic laboratories. Provisions will also be made to secure both citizens and visitors during the 2010 FIFA World Cup. Improving court efficiency and sharply reducing longstanding cases are key priorities for the criminal justice system.
- *Raising the productive capacity of the economy:* Enhancing the effectiveness of economic and sectoral interventions through appropriate regulation of and support for business to expand the productive side of the economy, and through regional and international partnerships

Table W1.1 shows how the additional allocations are apportioned to the different priority areas across the three spheres of government.

Table W1.1 2008 Budget priorities – additional MTEF allocations, 2008/09 – 2010/11

R million	2008/09	2009/10	2010/11	Total
Provincial equitable share	5 903	9 682	17 574	**33 159**
includes school education, health care, welfare services, provincial infrastructure and economic development				
Local government equitable share	1 114	711	4 649	**6 474**
Economic infrastructure and investment				
Public transport, roads and rail infrastructure	883	911	2 132	**3 926**
Public transport infrastructure and systems grant	–	–	2 000	**2 000**
Communications infrastructure	409	285	290	**984**
2010 World Cup stadiums and infrastructure	1 200	788	296	**2 284**
Housing and built environment				
Housing grants	–	200	2 000	**2 200**
Municipal infrastructure, and related services	604	1 200	2 000	**3 804**
Infrastructure grant to provinces	400	800	1 500	**2 700**
Productive capacity of the economy				
Industrial development, international trade and SMMEs	460	780	1 300	**2 540**
Research and development and knowledge production	1 790	1 980	630	**4 400**
Land and agrarian reform	730	900	930	**2 560**
Expanded public works programmes - DEAT	200	250	300	**750**
Education, health and welfare				
Higher education	150	150	800	**1 100**
National school nutrition programme	345	493	918	**1 756**
Hospitals and tertiary services	750	770	1 590	**3 110**
HIV and Aids	350	600	1 150	**2 100**
Social grants	2 705	4 510	4 800	**12 015**
Public administration and service delivery				
Home Affairs reforms	298	427	592	**1 317**
SARS administration and capacity building	150	250	600	**1 000**
Expanded public works programmes - Public Works	30	50	80	**160**
Justice, crime prevention and policing				
Policing personnel, forensic and IT equipment	300	450	1 920	**2 670**
Appointment of judges, magistrates and public defenders	50	100	150	**300**
Correctional facilities and personnel	50	60	1 843	**1 953**
International relations and defence				
Defence modernisation and military skills development	100	200	1 100	**1 400**
Foreign Affairs capacity and African Renaissance Fund	229	264	230	**723**
Pan African Parliament	145	388	198	**731**
Other allocations	4 652	5 531	7 326	**17 509**
Total policy adjustments	**23 997**	**32 730**	**58 898**	**115 625**

The fiscal framework

Table W1.2 presents medium-term macroeconomic forecasts for the 2008 Budget. It sets out the growth assumptions and fiscal policy targets on which the fiscal framework is based.

Table W1.2 Medium-term macroeconomic assumptions, 2007/08 – 2010/11

	2007/08		2008/09		2009/10		2010/11
R billion	**2007 Budget**	**2008 Budget**	**2007 Budget**	**2008 Budget**	**2007 Budget**	**2008 Budget**	**2008 Budget**
Gross domestic product	1 938.9	2 045.5	2 141.7	2 286.9	2 379.3	2 506.9	2 758.6
Real GDP growth	*4.8%*	*4.7%*	5.2%	*4.0%*	5.3%	*4.2%*	*4.7%*
GDP inflation	*5.4%*	*8.1%*	5.0%	*7.5%*	5.5%	*5.2%*	*5.1%*
National budget framework							
Revenue	544.6	558.0	591.2	625.4	641.5	692.9	759.0
Percentage of GDP	*28.1%*	*27.3%*	*27.6%*	*27.3%*	*27.0%*	*27.6%*	*27.5%*
Expenditure	533.9	542.1	594.2	611.1	650.3	681.6	744.7
Percentage of GDP	*27.5%*	*26.5%*	*27.7%*	*26.7%*	*27.3%*	*27.2%*	*27.0%*
Main budget balance[1]	10.7	15.8	-3.0	14.3	-8.8	11.3	14.3
Percentage of GDP	*0.6%*	*0.8%*	*-0.1%*	*0.6%*	*-0.4%*	*0.5%*	*0.5%*

1. A positive number reflects a surplus and a negative number a deficit.

Table W1.3 sets out the division of revenue for the 2008 MTEF after taking into account of new policy priorities.

Table W1.3 Division of revenue between spheres of government, 2004/05 – 2010/11

	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
R million		**Outcome**		**Revised estimate**		**Medium-term estimates**	
National departments	167 289	194 723	212 629	246 937	273 929	302 672	324 142
Provinces	138 511	154 368	178 871	205 224	238 076	268 158	293 640
Equitable share	*120 885*	*135 292*	*150 753*	*172 862*	*199 377*	*225 466*	*246 306*
Conditional grants	*17 627*	*19 076*	*28 118*	*32 362*	*38 699*	*42 692*	*47 334*
Local government	13 808	16 682	26 501	37 127	41 855	47 651	55 732
Equitable share[1]	*7 678*	*9 643*	*18 058*	*20 676*	*24 889*	*30 156*	*36 196*
Conditional grants	*6 130*	*7 038*	*8 443*	*16 451*	*16 966*	*17 495*	*19 536*
Non-interest allocations	**319 608**	**365 772**	**418 000**	**489 288**	**553 860**	**618 481**	**673 514**
Percentage increase	*13.2%*	*14.4%*	*14.3%*	*17.1%*	*13.2%*	*11.7%*	*8.9%*
State debt cost	48 851	50 912	52 192	52 829	51 236	51 125	51 156
Contingency reserve	–	–	–	–	6 000	12 000	20 000
Main budget expenditure	**368 459**	**416 684**	**470 192**	**542 117**	**611 096**	**681 606**	**744 670**
Percentage increase	*12.1%*	*13.1%*	*12.8%*	*15.3%*	*12.7%*	*11.5%*	*9.3%*
Percentage shares							
National departments	*52.3%*	*53.2%*	*50.9%*	*50.5%*	*49.5%*	*48.9%*	*48.1%*
Provinces	*43.3%*	*42.2%*	*42.8%*	*41.9%*	*43.0%*	*43.4%*	*43.6%*
Local government	*4.3%*	*4.6%*	*6.3%*	*7.6%*	*7.6%*	*7.7%*	*8.3%*

1. With effect from 2006/07, the local government equitable share includes compensation for the termination of RSC/JSB levies.

Table W1.4 shows how additional resources are divided among the three spheres of government. The new priorities and additional allocations are accommodated through reprioritisation and growth in the resource envelope.

Table W1.4 Changes over baseline, 2008/09 – 2010/11

R million	**2008/09**	**2009/10**	**2010/11**
National departments	13 358	17 388	24 760
Provinces	7 891	12 743	25 043
Local government	2 748	2 599	9 095
Allocated expenditure	**23 997**	**32 731**	**58 898**

Table W1.5 sets out Schedule 1 of the Division of Revenue Bill, which reflects the legal division of revenue between the three spheres. In this division, the national share includes all conditional grants to the other two spheres in line with section 214(1) of the Constitution, and the provincial and local government allocations reflect their equitable shares only.

Table W1.5 Schedule 1 of the Division of Revenue Bill, 2008/09 – 2010/11

R million	2008/09 Column A Allocation	2009/10 Column B Forward estimates	2010/11
National[1, 2]	386 830	425 984	462 168
Provincial	199 377	225 466	246 306
Local	24 889	30 156	36 196
Total	**611 096**	**681 606**	**744 670**

1. National share includes conditional grants to provinces and local government, debt service cost and the contingency reserve.

2. The direct charges for the provincial equitable share are netted out.

The 2008 *Budget Review* sets out in detail how the constitutional issues and government's priorities are taken into account in the 2008 division of revenue. It focuses on the economic and fiscal policy considerations, revenue issues, debt and financing considerations, and expenditure plans of government. Aspects of national, provincial and local government financing are discussed in some detail in Chapters 7 and 8. For this reason, this memorandum should be read with the 2008 *Budget Review*.

Part 2: Response to the recommendations of the FFC

Section 214 of the Constitution and section 9 of the Intergovernmental Fiscal Relations Act (Act 97 of 1997) require the FFC to make recommendations in April every year, or soon thereafter, on the division of revenue for the coming budget. The FFC complied with this obligation by tabling its submission entitled *Submission for the Division of Revenue 2008/09* to Parliament in May 2007. This part of the explanatory memorandum complies with the Constitution and section 10 of the Intergovernmental Fiscal Relations Act by setting out how government has taken into account the FFC's recommendations when determining the division of revenue for the 2008 MTEF.

Like the 2007 MTEF proposals, the current recommendations are divided into three main parts. Part A deals with the 2008 division of revenue, mainly focusing on the economic impact of the 2010 FIFA World Cup, the financing of learner support material and review of some of the conditional grants. Part B deals with supplementary submissions made during the 2006/07 period, while Part C covers the FFC's analyses of spending performance and capacity of provincial government departments (2003-2009), comments on the vertical and horizontal division of revenue, and provides a framework for assessing function shifts within the Intergovernmental Fiscal System.

Part A: Recommendations and advisories on the 2008/09 division of revenue

FFC comments on the economic impacts of the 2010 FIFA World Cup

The FFC did not make direct proposals regarding the financing of the 2010 FIFA World Cup. It cautioned that care should be taken to ensure that the financing of 2010 FIFA World Cup by the government should not negatively impact on considerations in section 214 (a-j) of the Constitution. The FFC further highlighted the importance of managing the risks associated with inflation, the current account deficit, government dissaving (through a higher budget deficit), poor project management and cost overruns.

The FFC believes that the legacy effects of hosting the 2010 FIFA World Cup should be properly addressed, costed and financed. In its research the FFC identified specific legacy effects, namely: increased economic investments, football and sport development, human capital development, social and political development, infrastructure and technology development. These can be location-specific or countrywide. The FFC proposes two approaches for sustaining the positive legacy effects of the 2010 FIFA World Cup:

- Appoint a national agency to oversee the legacy effects of a national character. In keeping with prudent macroeconomic behaviour that has characterised government policy thus far, it recommends that household savings be stimulated and be seen as the main source of funds to finance such projects; and
- Make the hosting cities responsible for sustaining location-specific legacy effects. As legacy benefits accrue to the city it is recommended that the city fund these from their own revenue sources.

Government response

Government agrees that the financing of the 2010 FIFA World Cup should be done in a manner that does not adversely impact on the considerations in section 214 (a-j) of the Constitution. Government is taking steps to ensure that the costs of hosting the World Cup remain reasonable. Despite the large investments made for the 2010 FIFA World Cup, social spending, particularly spending targeted towards the poor, grows sharply over the 2008 MTEF. In this regard, for the 2008 MTEF, R45.7 billion additional allocations are made for key pro-poor functions like education, health, social welfare and housing, while about R3 billion is allocated to the 2010 FIFA World Cup. The secondary effects of the event are positive as jobs are created, greater interest and confidence is shown in the country, and the public transport systems of the country's major centres are transformed. Government agrees with the FFC's observation that the macroeconomic and fiscal risks be closely monitored and minimised.

With respect to the legacy effects, government also agrees that these be properly addressed, costed and financed and that these be managed and financed by the host cities. Government does not support the establishment of a national agency to oversee the legacy effects of a national nature. It is of the view that existing institutions can manage this, and if needs be such institutions can be strengthened.

FFC proposal on the national school nutrition program (NSNP) grant

As a step towards extending the programme to secondary schools the FFC recommends that: budget allocations for the NSNP in primary schools should be increased to cover learners that are presently not covered, and to increase the number of days beyond the prescribed minimum; the requisite capacity (human resource and infrastructure) be put in place to improve the implementation of the programme; the programme be implemented in all "no-fee" schools; national norms and standards to guide the implementation of programme be developed; the quality of performance information be improved to support planning and budgeting; and where necessary, provinces supplement the conditional grant with funds from their equitable share.

Government's response

While government supports some of the observations put forward by the FFC, it wishes to caution that decision to extend the programme to secondary schools has not yet been taken.

Government agrees that steps should be taken to improve the overall performance of the programme. While there may be implementation challenges, generally the programme is successful, covering 6 million learners in 18 000 schools. The programme receives an additional R1.8 billion over the next three years to improve the quality of the meals; to extend coverage of all eligible learners (including learners in all “no fee” schools) in primary schools; and to provide meals on more school days. A baseline study on the programme has been completed and informs its present functioning. Government’s approach seeks to improve the effectiveness and efficiency of the programme before looking at the possibility of extending it to secondary schools.

FFC proposal on financing school infrastructure and education outcomes

FFC proposes that the conditions of the *infrastructure grant to provinces* targeted at educational infrastructure should specify the requirement that provinces should use such funds to exclusively support development of education infrastructure in areas of most need and where they are most likely to improve school outcomes. Further, that effective coordination of planning for the various provincial and municipal infrastructure grants should be instituted as a matter of urgency to ensure optimal outcomes from school infrastructure investment.

Government response

Government agrees that greater investment in school infrastructure (classrooms, science and computer laboratories, and libraries) is key to improving the quality of schooling. To foster social cohesion within a school setting, government extends infrastructure needs to the development of sports and recreational facilities within schools.

The recently published national education infrastructure management system shows that while further infrastructure investments needs to be made, great strides have been made in addressing education infrastructure needs. Past budgets, through the provincial equitable share, have provided for greater investment in laboratories (science and maths) and libraries. These are to be extended in the years ahead. Over the next three years R2.7 billion is added to the infrastructure grant to provinces to address school infrastructure needs including replacing unsafe and inappropriate school structures. The rules of the grant have been revised in line with objectives of addressing education infrastructure needs, with strong emphasis on channelling funds towards maintenance of school infrastructure.

Government agrees that coordination between provincial and municipal infrastructure grants be improved to ensure optimal outcomes from infrastructure investments. In general municipal infrastructure development supports school infrastructure. To address misalignment where this exists, government introduced the electricity and water and sanitation grants to ensure that municipal infrastructure supports the school infrastructure programme.

FFC proposal on the learner support material

The FFC recommends that learner support material be clearly defined and its meaning restricted to stationery, textbooks, learner and teacher aids. The FFC further recommends that there should be a separate budget line item for learner support material as this would ensure that budgets and spending is properly monitored.

With respect to maintenance, repairs and equipment, the FFC recommends that this also be reflected in a separate line item to monitor spending.

Government response

Government’s definition of learner support materials is in line with the FFCs recommendation. Government agrees that there should be separate line items for learner support materials and maintenance, repairs and equipment. The 2008 Provincial Budget Format Guide which informs the 2008 Provincial Budget Statements requires provincial education departments to clearly show spending and budgets for learner support materials and maintenance, repairs and equipment separately. This practice is extended to all other provincial sectors.

FFC proposal on no-fee school policy

The FFC believes that the application of the no-fee school policy is sound. However, challenges that hinder the implementation process need to be addressed. The FFC proposes that funding should be adequate to cover all the operations of the schools.

Government response

Government agrees with the proposal that the no-fee schools policy should adequately cover all the operations of the schools. However this needs to be viewed within the minimum and maximum funding levels as prescribed by the norms and standards policy. Excluding the Eastern Cape, most provinces are already funding at a maximum level.

FFC proposal on roads and transport infrastructure

The FFC proposes that all provinces should put in place a more effective road management system that will ensure that they are able to gather accurate data on road conditions and use this information in their road spending priorities.

The FFC is of the opinion that unless the ongoing needs of provinces towards road maintenance are explicitly considered in the comprehensive review of the provincial equitable share, the condition of provincial roads will continue to worsen, and the cost thereof rises exponentially. The FFC recommends that the impending review of the provincial equitable share formula should consider provincial road expenditure needs and should be reconfigured in a manner that enables provinces to fund their maintenance needs.

Government's response

Government agrees with the proposal that provinces should put in place more effective road management systems and that such systems should guide resource allocation.

With respect to funding roads infrastructure maintenance, large funding is channelled to provinces via the *infrastructure grant to provinces*. Provinces augment this allocation from their equitable shares. However one needs to be cautious in linking targeting through an allocation formula with providing adequate resources for roads infrastructure development. Targeting through a formula does not necessarily result in increased spending. The FFC is spearheading the review of the provincial equitable share formula. The financing of roads infrastructure will be dealt with within the context of that review.

FFC's proposal on housing delivery

The FFC recommends that a process for the collection of data on homelessness be initiated and that such data should be included in the housing formula as part of the indicators of housing need.

Government response

Government agrees that homelessness should be quantified. The current housing allocation formula takes into account homelessness when determining the housing need across provinces.

Part B: Supplementary submissions made during the 2006/07 financial year

Part B of the FFC's recommendations deal with the supplementary submissions made during 2006/07. The supplementary submissions covered the fiscal implications of the re-demarcation of provincial boundaries; the Municipal Fiscal Powers and Functions Bill; initial comments on the draft policy paper on the framework for considering market-based instruments to support environmental fiscal reform in South Africa; and the fiscal regime for windfall profits in the liquid sector. These proposals were addressed in 2006 and 2007.

Part C: FFC analyses and methods

This part of the FFCs submission analyses the fiscal and financial performance of provincial government departments with the view of making proposals on how capacity to improve performance can be further developed. It also looks at a model for reviewing the equitable share and provides a framework for assessing function shifts within the intergovernmental fiscal system. These proposals are work-in-progress and just for noting by government.

Part 3: Provincial allocations

Sections 214 and 227 of the Constitution require that an equitable share of nationally raised revenue be allocated to the provincial sphere of government to enable it to provide basic services and perform the other functions allocated to the sphere.

The provincial equitable share baselines are revised upwards by R33.2 billion and conditional grants are increased by R12.5 billion over the next three years. National transfers to provinces increase from R205.2 billion in 2007/08 to R238.1 billion in 2008/09. Over the three-year period provincial transfers are projected to grow at an average annual rate of 12.7 per cent to R293.6 billion in 2010/11.

Table W1.6 below sets out the total transfers to provinces for the 2008/09 financial year, which amounts to R238.1 billion, with R199.4 billion allocated to the provincial equitable share and R38.7 billion to conditional grants.

Table W1.6 Total transfers to provinces, 2008/09

R million	Equitable share	Conditional grants	Total transfers
Eastern Cape	31 383	4 607	**35 990**
Free State	12 413	2 786	**15 199**
Gauteng	33 064	11 214	**44 278**
KwaZulu-Natal	43 246	6 264	**49 509**
Limpopo	25 935	3 168	**29 103**
Mpumalanga	16 436	2 114	**18 550**
Northern Cape	5 341	1 297	**6 638**
North West	13 821	2 579	**16 399**
Western Cape	17 739	4 672	**22 410**
Total	**199 377**	**38 699**	**238 076**

Provincial equitable share

A sizeable amount of nationally raised revenue is allocated to provinces through the equitable share. At 81.5 per cent of total provincial revenue and 84.5 per cent of national transfers, the equitable share constitutes the main source of revenue for meeting provincial expenditure responsibilities. The proposed revisions of R4.2 billion, R6.8 billion, and R13.4 billion bring the equitable share allocations to R199.4 billion in 2008/09, R225.5 billion in 2009/10, and R246.3 billion in 2010/11. These revisions result in the provincial equitable shares increasing 15.3 per cent between 2007/08 and 2008/09, and 12.5 per cent over the MTEF in nominal terms. In real terms, the provincial equitable shares are budgeted to grow 7 per cent per year over the next three years.

Policy priorities underpinning equitable share revisions

The additions to the baseline equitable shares are intended to strengthen provincial social services programmes that have a high impact on human development and the quality of life. The focus continues to be on public schooling, health and programmes contributing to social development. Greater emphasis is placed on improving the service conditions of social service sector professionals. The public sector wage agreement and the occupation-specific dispensations for educators, social workers and nurses sustain the pattern of civil service salary improvements with the aim of attracting and retaining personnel in these sectors.

In education the focus is on scaling up Grade R, including training more practitioners and ensuring that public schools are more inclusive. Facilities are to be modified and/or built to cater for disabled learners. To help provinces implement the new curriculum, government has set aside funding for the procurement of textbooks for Grades 10, 11 and 12 learners.

A general adjustment of health budgets is proposed to reinforce the entire public health system and to ensure that it can meet the needs of those who depend on it. Allocations are set aside to mitigate the impact of extreme- and multi-drug resistant TB, supporting extended hospitalisation and associated treatment. The funds will cover redesign of existing facilities and construction of new units and additional costs of hospitalisation, medicines and lab tests.

Social welfare services will be scaled up to support the development of sustainable communities. Allocations support early childhood development centres and practitioner salaries. Services to children in conflict with the law are expanded, with the construction of secure care centres and strengthened home- and community-based care.

The equitable share also provides for investment in economic growth-stimulating activities in the areas of roads, agriculture, economic affairs and tourism. Targeted interventions in rural economic development will be prioritised. These include agricultural support and investment in rural access roads. Further resources will be channelled to the expanded public works programme with the view of providing employment opportunities in the short term, while affording participants opportunities to acquire skills that will boost their chances of obtaining permanent employment in the long term. Additional allocations support agriculture, roads and transport, small business development, and other interventions targeted at growing the economy and creating employment.

The equitable share formula

An objective redistributive formula is used to divide the equitable share among provinces. The formula is reviewed and updated with new data annually. For the 2008 MTEF, the formula has been updated with the data from the 2007 Community Survey, 2007 education Snap Survey, 2006 General Household Survey, and the 2005 GDP-R. The 2007 Community Survey data were used to update the basic and poverty components. The 2006 General Household Survey was used to update the health component, the 2007 Snap Survey to update the education component and the 2005 GDP-R data to update the economic activity component. The impact of these updates on the provincial equitable shares is phased in over the next three years.

Table W1.7 Comparing 2006 mid-year estimates and 2007 Community Survey

	2006 Mid-year estimates	2007 Community Survey	Population Change	Current	New	Change
Eastern Cape	6 894	6 528	-366	14.5%	13.5%	-1.1%
Free State	2 959	2 773	-186	6.2%	5.7%	-0.5%
Gauteng	9 526	10 450	924	20.1%	21.5%	1.4%
KwaZulu-Natal	9 924	10 261	337	20.9%	21.2%	0.2%
Limpopo	5 365	5 239	-127	11.3%	10.8%	-0.5%
Mpumalanga	3 508	3 643	135	7.4%	7.5%	0.1%
Northern Cape	1 095	1 058	-36	2.3%	2.2%	-0.1%
North West	3 374	3 272	-102	7.1%	6.7%	-0.4%
Western Cape	4 746	5 279	533	10.0%	10.9%	0.9%
Total	**47 391**	**48 503**	**1 112**	**100.0%**	**100.0%**	–

Because the formula is largely population driven, the allocations it generates are sensitive to and capture shifts in population across provinces. Shifts in population in turn lead to changes in the relative demand for public services across the provinces. When the revised population figures are included, the weighted equitable shares of provinces are revised over the MTEF as per table W1.8.

Table W1.8 Changes in weighted shares due to data updates

	2008 MTEF weighted shares 3-year phasing		
	2008/09	2009/10	2010/11
Eastern Cape	-0.07%	-0.13%	-0.20%
Free State	-0.05%	-0.09%	-0.14%
Gauteng	0.11%	0.22%	0.32%
KwaZulu-Natal	0.05%	0.10%	0.15%
Limpopo	-0.04%	-0.07%	-0.11%
Mpumalanga	-0.01%	-0.02%	-0.03%
Northern Cape	-0.01%	-0.01%	-0.02%
North West	-0.06%	-0.12%	-0.17%
Western Cape	0.07%	0.13%	0.20%

Summary of the structure of the formula

The formula (Table W1.9) consists of six components which capture the relative demand for services between provinces and take into account specific provincial circumstances. The components of the formula are neither indicative budgets nor guidelines as to how much should be spent on those functions in each province or by provinces collectively. Rather, the education and health components are weighted broadly in line with historical expenditure patterns to provide an indication of relative need. Provincial executive councils have discretion regarding the determination of departmental allocations for each function, taking into account the priorities that underpin the division of revenue. For the 2008 Budget, the distribution of the weights by component remains unchanged as set out below:

- An *education share* (51 per cent) based on the size of the school-age population (ages 5-17) and the number of learners (Grade R to 12) enrolled in public ordinary schools
- A *health share* (26 per cent) based on the proportion of the population with and without access to medical aid
- A *basic share* (14 per cent) derived from each province's share of the national population

- An *institutional component* (5 per cent) divided equally between the provinces
- A *poverty component* (3 per cent) reinforcing the redistributive bias of the formula
- An *economic output component* (1 per cent) based on GDP by region (GDP-R) data.

Table W1.9 Distributing the equitable shares by province

	Education	Health	Basic share	Poverty	Economic activity	Institu-tional	Weighted average
	51%	**26%**	**14%**	**3%**	**1%**	**5%**	**100%**
Eastern Cape	16.9%	14.9%	13.5%	20.0%	7.9%	11.1%	15.6%
Free State	5.7%	6.2%	5.7%	6.9%	5.5%	11.1%	6.1%
Gauteng	14.9%	19.0%	21.5%	12.4%	33.7%	11.1%	16.8%
KwaZulu-Natal	23.1%	21.5%	21.2%	23.9%	16.3%	11.1%	21.8%
Limpopo	14.1%	12.0%	10.8%	16.0%	6.7%	11.1%	13.0%
Mpumalanga	8.5%	7.6%	7.5%	7.3%	6.7%	11.1%	8.2%
Northern Cape	2.2%	2.4%	2.2%	2.5%	2.2%	11.1%	2.7%
North West	6.4%	6.9%	6.7%	6.7%	6.3%	11.1%	6.8%
Western Cape	8.1%	9.6%	10.9%	4.2%	14.7%	11.1%	9.0%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

The weights assigned to the education (51 per cent) and health components (26 per cent) are derived from average provincial spending on education and health in total provincial spending for the past three years, excluding conditional grants.

Phasing-in of the formula

Government agreed not to phase in the impact of the last redemarcation on the allocations published in the 2007 Budget. This was mainly due to the fact that there was an immediate shift in the relative demand for services and therefore in the expenditure of affected provinces. For the 2008 Budget, to mitigate the impact of new data updates on provincial equitable shares, the new weighted shares are phased in over the MTEF. Table W1.10 shows the revised weighted provincial equitable shares for the period 2007/08 to 2010/11.

Table W1.10 Implementation of the equitable share weights, 2007/08 – 2010/11

	2007 MTEF	2008/09	2009/10	2010/11
	Weighted shares	2008 MTEF weighted shares 3-year phasing		
Percentage				
Eastern Cape	15.8%	15.8%	15.7%	15.6%
Free State	6.3%	6.2%	6.2%	6.1%
Gauteng	16.5%	16.6%	16.7%	16.8%
KwaZulu-Natal	21.6%	21.7%	21.7%	21.8%
Limpopo	13.1%	13.0%	13.0%	13.0%
Mpumalanga	8.2%	8.2%	8.2%	8.2%
Northern Cape	2.7%	2.7%	2.7%	2.7%
North West	7.0%	6.9%	6.9%	6.8%
Western Cape	8.8%	8.9%	8.9%	9.0%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Education component

The component is intended to enable provinces to fund school education, which amounts to approximately 80 per cent of provincial education spending. The formula uses school-age population (5 to 17 years) based on Census 2001 and actual enrolment drawn from the 2007 Snap Survey to reflect relative demand for education, with each element assigned a weight of 50 per cent. Table W.11 shows the weighted target shares for the 2008 MTEF after updating the education component for new data.

Table W1.11 Comparison of new and old education component weighted shares

	Revised education component				New weighted average	Old weighted average	Difference in weighted average
	2007 School enrolment	Age cohort 5 - 17	% share school enrolment	% share age cohort 5 - 17			
Eastern Cape	2 140	2 152	17.2%	16.6%	16.9%	16.9%	0.1%
Free State	681	760	5.5%	5.9%	5.7%	5.7%	0.0%
Gauteng	1 884	1 893	15.2%	14.6%	14.9%	14.8%	0.1%
KwaZulu-Natal	2 849	3 013	23.0%	23.3%	23.1%	22.9%	0.2%
Limpopo	1 783	1 799	14.4%	13.9%	14.1%	14.1%	0.0%
Mpumalanga	1 088	1 075	8.8%	8.3%	8.5%	8.6%	-0.1%
Northern Cape	265	281	2.1%	2.2%	2.2%	2.2%	0.0%
North West	753	865	6.1%	6.7%	6.4%	6.5%	-0.2%
Western Cape	969	1 095	7.8%	8.5%	8.1%	8.2%	-0.1%
Total	**12 411**	**12 933**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**–**

Health component

The health component addresses the need for provinces to deliver health care. As all citizens are eligible for health services, the provincial shares of the total population form the basis for the health share. Within the health component, people without medical aid are assigned a weight four times that of those with medical aid, on the grounds that the former group is likely to use public health care more. The proportions of the population with and without medical aid are taken from the 2006 GHS. Table W1.12 shows the impact of the revised weighted shares of the health component.

Table W1.12 Comparison of new and old health component weighted shares

	Old			New			Difference in weighted shares
	Population with medical aid	Population without medical aid	Weighted shares	Population with medical aid	Population without medical aid	Weighted shares	
Eastern Cape	684	24 628	15.1%	713	24 536	14.9%	-0.2%
Free State	410	10 172	6.3%	439	10 072	6.2%	-0.1%
Gauteng	2 061	29 528	18.8%	2 058	30 200	19.0%	0.2%
KwaZulu-Natal	1 111	34 968	21.5%	1 062	35 420	21.5%	0.0%
Limpopo	372	20 032	12.1%	374	20 052	12.0%	-0.1%
Mpumalanga	339	12 404	7.6%	367	12 488	7.6%	0.0%
Northern Cape	150	3 804	2.4%	131	3 884	2.4%	0.0%
North West	393	11 428	7.0%	468	11 240	6.9%	-0.1%
Western Cape	1 041	14 444	9.2%	893	15 400	9.6%	0.4%
Total	**6 561**	**161 408**	**100.0%**	**6 505**	**163 292**	**100.0%**	–

Poverty component

The poverty component introduces a redistributive element within the formula and is assigned a weight of 3 per cent. The poor population comprises persons who fall in quintiles 1 and 2 based on the 2000 Income and Expenditure Survey (IES). Each province's share is then expressed as the percentage of the "poor" population residing in that province, where the population figure is drawn from the 2007 Community Survey. Table W1.13 shows the impact of the revised weighted shares of the poverty component.

Table W1.13 Comparison of new and old poverty component weighted shares

	Old				New				Difference in weighted shares
	IES Survey 2000 (Q1+Q2)	Basic component value	Poor population	Weighted shares	IES Survey 2000 (Q1+Q2)	Basic component value	Poor population	Weighted shares	
Eastern Cape	56.4%	6 894	3 890	21.2%	56.4%	6 528	3 684	20.0%	-1.2%
Free State	45.7%	2 959	1 353	7.4%	45.7%	2 773	1 268	6.9%	-0.5%
Gauteng	21.9%	9 526	2 086	11.4%	21.9%	10 450	2 288	12.4%	1.1%
KwaZulu-Natal	43.0%	9 924	4 263	23.2%	43.0%	10 261	4 408	23.9%	0.7%
Limpopo	56.3%	5 365	3 021	16.5%	56.3%	5 239	2 949	16.0%	-0.4%
Mpumalanga	36.9%	3 508	1 293	7.0%	36.9%	3 643	1 343	7.3%	0.2%
Northern Cape	44.0%	1 095	481	2.6%	44.0%	1 058	465	2.5%	-0.1%
North West	37.9%	3 374	1 280	7.0%	37.9%	3 272	1 241	6.7%	-0.2%
Western Cape	14.6%	4 746	691	3.8%	14.6%	5 279	769	4.2%	0.4%
Total		**47 391**	**18 358**	**100.0%**		**48 503**	**18 415**	**100.0%**	–

Economic activity component

The economic activity component is a proxy for provincial tax capacity and is assigned a weight of 1 per cent. For the 2007 MTEF, 2005 GDP-R data is used. The component is not aligned to the revised provincial boundaries as Stats SA indicated that it would be difficult to adjust GDP-R data with high levels of confidence. Table W1.14 shows the impact of the revised weighted shares of the economic activity component.

Table W1.14 Comparison of new and old economic activity component weighted shares

	Old		New		Difference in weighted shares
	GDP-R, 2004 (R million)	Weighted shares	GDP-R, 2005 (R million)	Weighted shares	
Eastern Cape	112 908	8.1%	122 021	7.9%	-0.2%
Free State	75 827	5.5%	84 068	5.5%	0.0%
Gauteng	462 044	33.3%	519 017	33.7%	0.4%
KwaZulu-Natal	231 616	16.7%	251 286	16.3%	-0.4%
Limpopo	93 188	6.7%	103 697	6.7%	0.0%
Mpumalanga	94 450	6.8%	102 378	6.7%	-0.2%
Northern Cape	30 087	2.2%	33 380	2.2%	0.0%
North West	87 127	6.3%	97 627	6.3%	0.1%
Western Cape	199 412	14.4%	225 779	14.7%	0.3%
Total	**1 386 659**	**100.0%**	**1 539 253**	**100.0%**	–

Institutional component

The institutional component recognises that some costs associated with running a provincial government, and providing services, are not directly related to the size of a province's population. It is therefore distributed equally between provinces. It constitutes 5 per cent of the total equitable share, of which each province receives 11.1 per cent.

Basic component

The basic component (Table W.15) is derived from the proportion of each province's share of the total population of the country and is assigned a weight of 14 per cent. For the 2008 MTEF, population data are drawn from the 2007 Community Survey. Table W1.15 shows the impact of the revised weighted shares of the basic component.

Table W1.15 Comparison of new and old basic component weighted shares

	Old		New		Difference in weighted shares
	2006 Mid-year estimates	Weighted shares	2007 Community Survey	Weighted shares	
Eastern Cape	6 894	14.5%	6 528	13.5%	-1.1%
Free State	2 959	6.2%	2 773	5.7%	-0.5%
Gauteng	9 526	20.1%	10 450	21.5%	1.4%
KwaZulu-Natal	9 924	20.9%	10 261	21.2%	0.2%
Limpopo	5 365	11.3%	5 239	10.8%	-0.5%
Mpumalanga	3 508	7.4%	3 643	7.5%	0.1%
Northern Cape	1 095	2.3%	1 058	2.2%	-0.1%
North West	3 374	7.1%	3 272	6.7%	-0.4%
Western Cape	4 746	10.0%	5 279	10.9%	0.9%
Total	**47 391**	**100.0%**	**48 503**	**100.0%**	–

Conditional grants to provinces

There are two types of provincial conditional grants: Schedule 4 and 5 grants, each with their own governance arrangements. Schedule 4 sets out general grants that supplement various programmes partly funded by provinces, such as infrastructure and central hospitals. Transfer and spending accountability arrangements differ, as more than one national or provincial department may be responsible for different outputs expected from the grant, so accountability is broader and more comprehensive, and related to entire programmes. Schedule 5 grants are specific conditional grants, with specific responsibilities for both the transferring and receiving provincial accounting officers.

Changes to conditional grant framework

Minor changes are effected to the provincial fiscal framework for the 2008 MTEF. The *FET college sector recapitalisation grant* is phased into the provincial equitable share from 1 April 2009. The programmes funded through this conditional grant continue as part of the provincial departments of education's normal responsibilities and funding thereof continues in provincial budgets.

The shifting of provincial properties administered by the national Department of Public Works on behalf of provinces will take effect on 1 April 2008. A new transitional conditional grant is introduced (*devolution of property rate funds grant*) to ensure that provinces take over the responsibility of paying the property rates and municipal charges of properties that were administered by national government on their behalf.

Table W1.16 Revisions to conditional grant baseline allocations, 2008/09 – 2010/11

R million	2008/09	2009/10	2010/11	2008 MTEF Total revisions
Agriculture				
Comprehensive agricultural support programme grant	100	150	250	**500**
Education				
National school nutrition programme grant	345	493	918	**1 756**
Health	**1 143**	**1 418**	**2 800**	**5 360**
Comprehensive HIV and Aids grant	350	600	1 150	**2 100**
Forensic pathology services grant	–	70	110	**180**
Hospital revitalisation grant	600	500	900	**2 000**
National tertiary services grant	193	248	640	**1 080**
Housing				
Integrated housing and human settlement development grant	–	200	2 000	**2 200**
National Treasury				
Infrastructure grant to provinces	400	800	1 500	**2 700**
Total	**1 988**	**3 061**	**7 468**	**12 516**

Table W1.16 shows the proposed revisions to conditional grants. Revisions to conditional grant baseline allocations totalling R2 billion, R3.1 billion and R7.5 billion or R12.5 billion over the MTEF bring the new conditional grant baselines to R38.7 billion in 2008/09, R42.7 billion in 2009/10 and R47.3 billion in 2010/11.

Table W1.17 provides a summary of conditional grants by sector and province for 2008 MTEF. More detailed information, including the framework and formula for each grant, is provided in Appendix W1 of the 2008 Division of Revenue Bill. The frameworks provide the conditions for each grant, the outputs expected, the allocation criteria used for dividing each grant between provinces, a summary of the audit outcome in 2006/07 and any other material issues to be addressed. Table W1.19 presents a summary of all the conditional grants listed in Schedules 4 and 5 of the bill for the 2008 MTEF.

Table W1.17 Conditional grants to provinces, 2007/08 – 2010/11

R million	2007/08	2008/09	2009/10	2010/11
Agriculture	**552**	**584**	**680**	**812**
Agricultural disaster management grant	155	–	–	–
Comprehensive agricultural support programme grant	350	535	628	757
Land care programme grant: poverty relief and infrastructure development	47	49	51	55
Arts and Culture	**163**	**338**	**441**	**494**
Community library services grant	163	338	441	494
Education	**2 017**	**2 546**	**1 995**	**2 536**
Further education and training college sector recapitalisation grant	631	795	–	–
HIV and Aids (life skills education) grant	166	168	177	188
National school nutrition programme grant	1 219	1 583	1 817	2 348
Health	**11 507**	**13 687**	**15 143**	**17 349**
Comprehensive HIV and Aids grant	2 006	2 585	3 276	3 987
Forensic pathology services grant	592	467	492	557
Health professions training and development grant	1 596	1 676	1 760	1 865
Hospital revitalisation grant	1 991	2 883	3 082	3 637
National tertiary services grant	5 321	6 076	6 534	7 303
Housing	**7 650**	**9 853**	**11 731**	**14 223**
Integrated housing and human settlement development grant	7 650	9 853	11 731	14 223
National Treasury	**6 414**	**7 247**	**8 797**	**10 080**
Infrastructure grant to provinces	6 164	7 247	8 797	10 080
Transitional grant: North West	250	–	–	–
Public Works	**837**	**889**	**997**	**1 096**
Devolution of property rate funds grant	837	889	997	1 096
Sport and Recreation South Africa	**194**	**290**	**402**	**426**
Mass sport and recreation participation programme grant	194	290	402	426
Transport	**3 029**	**3 266**	**2 507**	**318**
Gautrain rapid rail link grant	3 029	3 266	2 507	318
Total	**32 362**	**38 699**	**42 692**	**47 334**

Agriculture grants

The *comprehensive agricultural support programme* is revised upwards by R500 million for the next three years to promote and facilitate agricultural development of farmers benefiting from the land reform programme. This increase brings the allocations to R535 million in 2008/09, R628 million in 2009/10, and R757 million in 2010/11. The programme seeks to provide management, capacity building and business development support to emerging farmers. In addition, the programme aims to further expand farm infrastructure for dipping, fencing, and the rehabilitation of irrigation schemes where these could be viable.

The *land care programme* is allocated R155 million over the next three years. This programme promotes sustainable use and management of natural resources by encouraging and empowering communities to take responsibility for the management of resources to support food security and job creation through increased productivity. Other objectives of this grant relate to taking care of resources such as water, soil and land.

Education grants

The Department of Education administers the *national school nutrition programme, HIV and Aids (life skills) programme* and *FET recapitalisation grants,* which make up 6.1 per cent of total conditional grant spending.

The *national school nutrition programme* seeks to improve nutrition of targeted school children, enhance active learning capacity and improve attendance in schools. An amount of R1.7 billion is added to the national school nutrition programme over the MTEF to extend coverage to include more learners, improve the quality of meals, provide meals for all school days and cushion the programme from food inflation. Currently, the programme provides meals to 6 million learners in 18 000 schools over 156 school days. The programme is allocated R1.6 billion in 2008/09, R1.8 billion in 2009/10, and R2.3 billion in 2010/11.

The *HIV and Aids (life skills) programme grant* provides for life skills training, sexuality and HIV and Aids education in primary and secondary schools. The grant is allocated R168 million in 2008/09, R177 million in 2009/10, and R188 million in 2010/11. The programme is now fully integrated into the school system, with learner and teacher support material provided for Grades 1 to 9.

The *FET recapitalisation grant* funds the recapitalisation of 50 FET colleges to improve their capacity in contributing to skills development and training. In addition to skills development, the grant also contributes to upgrading of physical infrastructure for the colleges and acquisition of equipment. The grant is allocated R795 million in 2008/09 and is phased into the equitable share by 2009/10.

Health grants

The health sector accounts for the largest share (36 per cent) of total provincial conditional grants. The sector accounts for at least five conditional grants with a total allocation of over R13.7 billion annually.

The *national tertiary services grant* aims to provide strategic funding to enable provinces to plan, modernise, and transform the tertiary hospital service delivery platform in line with national policy objectives. The grant operates in 27 hospitals across the nine provinces, largely concentrated in Gauteng and Western Cape. Consequently, the Western Cape and Gauteng receive 61.9 per cent in 2007/08 of the grant as they provide the largest proportion of these high-level, sophisticated services for the benefit of the health sector countrywide.

The baselines for the *national tertiary services grant* are revised upwards by R193 million in 2008/09, R248 million in 2009/10, and R640 million in 2010/11 to fund radiology and oncology equipment. The additional funds will strengthen cancer services and medical and radiology equipment. The grant grows to R6.1 billion in 2008/09, R6.5 billion in 2009/10 and R7.3 billion in 2010/11.

The *health professions training and development grant* funds the costs associated with the training of health professionals, development and recruitment of medical specialists. It enables the shifting of teaching activities from central to regional and district hospitals. It is allocated R1.7 billion in 2008/09, R1.8 billion in 2009/10 and R1.9 billion in 2010/11.

The *comprehensive HIV and Aids grant* enables the health sector to develop a specific response to HIV and Aids. The grant supports, in addition to HIV and Aids prevention programmes, specific interventions that include voluntary counselling and testing, prevention of mother-to-child transmission, post-exposure prophylaxis and home-based care. The grant is revised upwards by R350 million in 2008/09, R600 million in 2009/10 and R1.2 billion in 2009/10 to extend coverage of the programme. The grant is allocated R2.6 billion, R3.3 billion and R4.0 billion over the MTEF.

The *hospital revitalisation grant* plays a key role in transforming and modernising infrastructure and equipment in hospitals. It funds the upgrading and replacement of hospital infrastructure and focuses primarily on projects in which an entire hospital is upgraded. The grant also supports management development initiatives, including personnel, procurement delegations and financial management capacity. The grant is allocated an additional R2 billion over the next three years. The additional allocations in the first two years will address anticipated shortfalls and faster progress on hospitals currently under construction, whereas the additions in the outer year will allow additional hospitals to enter the programme. The grant grows to R2.9 billion in 2008/09, R3.1 billion in 2009/10 and R3.6 billion in 2010/11.

The transitional *forensic pathology services grant* assists with the transfer of medico-legal mortuaries from the South African Police Service to the health sector and to provide comprehensive forensic pathology services for the criminal justice system. The allocation amounts to R467 million in 2008/09, R492 million in 2009/10, and R557 million in 2010/11.

Housing grants

The *integrated housing and human settlement development grant* facilitates the establishment of habitable, stable and sustainable human settlements in which all citizens have access to social and economic amenities. The programme targets eradication or formalisation of informal settlements on a phased basis by 2014. The baselines for this grant are revised upwards by R2.2 billion over the next three years. Taking into account these revisions, government plans to spend R35.8 billion over the medium term on low-cost housing. Spending on the *housing subsidy programme* is set to reach R14.2 billion by 2010/11.

National Treasury grants

The *infrastructure grant to provinces* augments provincial funding to accelerate construction, maintenance and rehabilitation of new and existing infrastructure in education, roads, health and agriculture, and also contributes to rural development. The grant also focuses on the application of labour-intensive methods in delivery in order to maximise job creation and skill development.

Findings released by the Department of Education in September 2007 show major progress in alleviating South Africa’s school infrastructure backlog. The number of overcrowded schools and schools without electricity and water has declined markedly. To accelerate school infrastructure delivery, including replacing unsafe and inappropriate school structures, R2.7 billion is added to the infrastructure grant to provinces. This brings the allocation for the *infrastructure grant to provinces* to R26 billion over the next three years. The grant is allocated R7.2 billion in 2008/09, R8.8 billion in 2009/10 and R10.1 billion in 2010/11.

Arts and culture grants

Community library services are important for building well-informed communities as they give direct access to information and knowledge that contribute to education and self-empowerment. The *community library services grant* is allocated R338 million in 2008/09, R441 million in 2009/10 and R494 million in 2010/11 to transform community library infrastructure facilities and services.

Sports and recreation grants

The *mass sport and recreation participation programme grant* is allocated R290 million in 2008/09, R402 million in 2009/10 and R426 million in 2010/11 to promote mass participation by historically disadvantaged communities in a number of developmental sporting activities.

Transport grant

The Department of Transport is allocated R3.3 billion in 2008/09, R2.5 billion in 2009/10 and R318 million in 2010/11 as national government’s contribution to the construction of the Gautrain Rapid Rail Link.

Public works grant

This year also sees the introduction of a public works grant, the *devolution of property rate funds grant*, to ensure that provinces take over the responsibility of paying property rates and municipal charges of properties that were administered by national government on their behalf. The grant is introduced with baselines of R889 million in 2008/09, R997 million in 2009/10 and R1.1 billion in 2010/11. The grant is expected to be phased into the provincial equitable share in about five years.

Part 4: Local government fiscal framework and allocations

Municipalities have a constitutional mandate to deliver crucial services that meet the public service needs of all and at the same time facilitate local economic development within their jurisdiction. Significant progress has been made in ensuring that municipalities are efficiently funded to continue to roll out infrastructure and services on a sustainable basis. Following the revision and implementation of a new equitable share formula during 2005/06, there is a continuing rise in local government's share of nationally raised revenue.

As part of the ongoing review of the local government fiscal framework, a few options are currently being explored that will introduce a new dispensation in the funding of weaker municipalities with limited resources. A number of these municipalities will already start to receive more focused attention in areas such as the implementation of budget reforms and improved financial management over the MTEF.

National transfers to municipalities are published to enable them to plan fully for their coming 2008 budgets, and to promote better accountability by ensuring that all national allocations are included in municipal budgets. Allocations are published for both the national and municipal financial years.

Table W1.18 Transfers to local government: revisions to baseline, 2008/09 – 2010/11

	2008/09	2009/10	2010/11
R million	Medium-term estimates		
Equitable share	**1 114**	**711**	**4 649**
Infrastructure transfers	**1 604**	**1 300**	**4 100**
Municipal infrastructure grant	604	1 200	2 000
Public transport infrastructure and systems grant	–	–	2 000
2010 FIFA World Cup stadiums development grant	1 000	100	100
Current transfers	**30**	**588**	**346**
Financial management grant	30	100	150
2010 World Cup host city operating grant	–	488	196
Total	**2 748**	**2 599**	**9 095**

National allocations to local government (Table W1.19) grow from a revised allocation of R39.2 billion in 2007/08 to R44.2 billion in 2008/09, R50.4 billion in 2009/10 and R58.1 billion by 2010/11. The share of nationally raised revenue for local government rises from 7.6 per cent in 2007/08, to 8.3 per cent in 2010/11.

Table W1.19 National transfers to local government, 2004/05 – 2010/11

R million	2004/05	2005/06 Outcome	2006/07	2007/08 Revised estimate	2008/09	2009/10 Medium-term estimates	2010/11
Equitable share	7 678	9 643	18 058	20 676	24 889	30 156	36 196
of which							
RSC/JSB replacement grant	–	–	*7 000*	*8 045*	*9 045*	*10 107*	*11 035*
Water and sanitation operating subsidy: direct transfer	133	165	384	622	861	855	570
Equitable share and related	7 811	9 808	18 442	21 297	25 750	31 011	36 766
Infrastructure transfers	6 936	8 053	8 831	16 928	18 018	18 393	20 580
Capacity building transfers	768	654	664	929	430	500	577
Other current transfers[1]	–	–	–	–	–	488	196
Total	**15 515**	**18 515**	**27 936**	**39 154**	**44 198**	**50 392**	**58 119**
Growth rates							
Equitable share and related		*25.6%*	*87.3%*	*14.5%*	*20.4%*	*21.2%*	*20.0%*
Infrastructure transfers		*16.1%*	*9.6%*	*91.7%*	*6.4%*	*2.1%*	*11.9%*
Capacity building transfers		*-14.9%*	*1.5%*	*39.9%*	*-53.7%*	*16.3%*	*15.4%*

1. 2010 World Cup host city operating grant

The local government equitable share

The equitable share allocation to the local sphere of government is an important supplement to existing municipal revenue and takes account of the fiscal capacity, fiscal efficiency, developmental needs, extent of poverty and backlogs in municipalities, to the extent that such information is available. Table W1.19 shows that the equitable share increases from R20.7 billion in 2007/8, to R24.9 billion in 2008/9 and is budgeted to grow to R36.2 billion in 2010/11.

Equitable share formula

The structure and components of the formula are summarised in the text box below:

Structure of the local government equitable share formula

Grant = BS + D + I – R ± C

where

BS is the basic services component

D is the development component

I is the institutional support component

R is the revenue-raising capacity correction and

C is a correction and stabilisation factor.

The basic services component

The purpose of the *basic services component* is to assist municipalities in providing basic services and free basic services to poor households. For each of the subsidised basic services there are two levels of support: a full subsidy for those households that are connected to services from the municipality, and a partial subsidy for households that are not yet connected to the municipal networks, currently set at a third of the cost of the subsidy to serviced households.

The characteristics of the basic services component are:

- Supporting only poor households earning less than R800 per month.
- Distinguishing between poor households connected to services and those that are not connected to services and may be provided with alternatives.
- Recognising water reticulation, sanitation, refuse removal and electricity reticulation as the core services.
- Providing for municipal health services to all households, not only defined as poor.

The basic services component

*BS=[Water Subsidy 1*Poor with Water + Water Subsidy 2*Poor without Water] +*

*[Sanitation Subsidy 1*Poor with Sanitation + Sanitation Subsidy 2*Poor without Sanitation] +*

*[Refuse Subsidy 1*Poor with Refuse + Refuse Subsidy 2*Poor without Refuse] +*

*[Electricity Subsidy 1*Poor with Electricity + Electricity Subsidy 2*Poor without Electricity] +*

*[Municipal Health Services*Total number of households]*

The institutional support component

The *institutional support component* is particularly important for poor municipalities, which are often unable to raise sufficient revenue to fund the basic costs of administration and governance. Such funding gaps make it impossible for poor municipalities to provide basic services to all their residents, clients and businesses. The component supplements the funding of a municipality for administrative and governance costs, but is not intended to fully fund the entire administration and governance cost of a municipality; this remains the primary responsibility of each municipality.

The institutional component

There are two elements to the institutional component: administrative capacity and local electoral accountability – the grant therefore is as follows:

I = Base allocation + [Admin support * Population] + [Council support * Number of Seats]

Where the values used in the formula are:

I = R350 000 + [R1*population] + [R36 000* councillors]

The “base allocation” is an amount that will go to every municipal structure (except for a district management area). The second term of this formula recognises that costs go up with population. The third term is a contribution to the cost of maintaining councillors for the legislative and oversight role. The number of “seats” that will be recognised for purposes of the formula is the one determined by the Minister of Provincial and Local Government for purposes of elections and composition.

The revenue-raising capacity correction

This mechanism is a means of redistributing resources with the formula to fund the cost of basic services and administrative infrastructure. The basic approach is to use the relationship between demonstrated revenue-raising capacity among municipalities that report information and objective municipal information from Statistics South Africa to proxy revenue-raising capacity for all municipalities. The revenue that should be available to a municipality then is converted to a "correction" by imposing a "tax" rate of 5 per cent. In the case of the *RSC levy replacement grant* the correction is based on the actual grant to each municipality.

Stabilising constraint

With the publication of three-year budget allocations, a guarantee mechanism is applied to the indicative outer-year baseline amounts with the aim of ensuring that municipalities are given what they were "promised" in the previous MTEF round of allocations, as far as this is possible. An additional constraint is to ensure that allocations are not negative due to the revenue-raising correction. The 2008 MTEF provides guarantees of 100 per cent and 90 per cent on the allocations for the first two years of the MTEF cycle, respectively.

Other considerations in applying the formula

The formula as outlined above has to be rescaled to make allowance for intricacies in the allocation process. In particular, powers and functions must be taken into account, and the overall budget must balance.

a) Powers and functions

The local government system has a number of asymmetries, not only between different categories of municipalities, but also within the same category of municipalities. Firstly, there is the broad division of the sphere into Category A, B and C municipalities. Secondly, the division of powers and functions between Category B and C municipalities differs – and this is also true between the different Category B municipalities within the same Category C district. In order to deal with these differences the model has to ensure that the allocations made in terms of the "basic services" component have to go to the municipality that actually performs the function.

b) Balancing allocations

The "horizontal division" of allocations made between municipalities depends on the size of the overall allocation that is made to the local government sphere, normally determined through a separate consultative process to determine the equitable share of nationally raised revenue for each of the three spheres of government (i.e. the "vertical division"). Since there is no guarantee that allocations made in terms of the vertical division add up precisely to the amount allocated to the local government equitable share, such allocations need to be adjusted to fit within the constraints outlined above.

Rescaling of the BS, D and I components

The simplest way of making the system balance is to rescale the BS, D and I components to the available budget, hence the formula actually becomes:

Grant = Adjustment Factor*(BS + D + I) – R ± C

This adjustment factor is calculated so as to ensure that the system balances.

To deal with the constraints, municipalities are divided into two groups: those municipalities that require a "top-up" in order to meet the stabilising constraints and those that do not. The total size of the top-up is calculated and this is deducted from those that do not require a top–up amount in proportion to the "surplus".

Measurement issues

The integrity of the data is as important as the set of equations in determining whether the allocations meet the constitutional requirement of equity. It is important to acknowledge that the data used is, in some cases, fairly old (e.g. Census 2001 data). However, the principle of equity is generally maintained in the model, and there is a very specific focus on uniformity in the data version, and making use of the latest information that meets this and other criteria for all municipalities, as soon as it is reliably available. Measurement itself is a dynamic issue – new data sets become available, while existing data series might be discontinued. Thus, the allocation process is subject to regular changes and innovation.

a) Poverty

The baseline information for the measurement of poverty comes from Census 2001. The "income" method is used to estimate poverty at a municipal level as it allows for a cross-tabulation of poverty against servicing levels.

b) Servicing levels

A key ingredient in the current formula is the subsidy received by poor households for various services delivered to them. The subsidy amounts in the current formula use a study by the Department of Provincial and Local Government. The service costs are R130 per month for a serviced household and R45 per month for an unserviced household (see Table W1.20 below). In addition, all households receive approximately R18 a year each towards the provision of municipal health services.

Table W1.20 Service costs

Service costs per month Rand	1998 Estimates	Serviced households	Households not connected to services[1]
Electricity	36.0	40.0	15.0
Water	20.0	30.0	10.0
Refuse	20.0	30.0	10.0
Sanitation	10.0	30.0	10.0
Total	**86.0**	**130.0**	**45.0**

1. One third of serviced households (2004 DPLG study).

c) Revenue-raising capacity

The lack of comparable information between different municipalities requires the use of an imputation process in the formula, using municipal revenue data and census information. This process has the advantage that it leads to measures of revenue-raising capacity that are highly correlated with actual revenues raised; and municipalities cannot manipulate it in order to influence their equitable share allocations.

Funding poorer municipalities through the equitable share model

For the 2008 Budget, considerable effort has been invested in targeting municipalities with low financial capacity for additional allocations within the equitable share formula. Numerous options were explored including substantial increases in the base allocation (see above) of the institutional component of the formula, as well as adjustments to the basic services component. This was done across the entire three-year cycle of the MTEF. After scrutinising a substantial array of options and simulations, the redistributive capacity of the model proved to be limited, due to the fact that the model is not designed for this purpose.

The local government equitable share fulfils an important objective of ensuring stable and equitable allocations to all the municipalities. However, in recognition of the large differences in the circumstances that exist at local government level, a concerted reform process is necessary to prevent poorer municipal areas from being underfunded. This process is already under way, with the hope that a solution can be implemented during the earliest subsequent budget cycle.

The water service operating subsidy

The *water service operating subsidy* is a transitional operational grant closely related to the local government equitable share and will be phased into the *equitable share grant* between 2009/10 and 2011/12. It is a grant in-kind, used to fund 318 water schemes in municipalities through the water trading account on the vote of the Department of Water Affairs and Forestry. The department administered a number of these schemes in poor areas prior to 1994. The operating grant (direct and indirect) amounts to R1.1 billion in 2008/09, R855 million in 2009/10 and R570 million in 2010/11.

As an update to the transfer process, the department has progressed substantially in finalising the transfer of the schemes. At the end of October 2007, 85 per cent of schemes had been transferred to local authorities. This included the handover of 6 916 staff members and assets valued at over R5.9 billion. The transfer process is expected to end in 2011/12, after which all the funding will be folded into the local government equitable share.

The operating subsidy covers staff-related costs and direct operating and maintenance costs, while provision is also made for the refurbishment of infrastructure. The allocation per municipality is according to the operational budget for each scheme and the funding requirements identified and agreed in the transfer agreement.

Conditional grants to local government

National government provides conditional grant funding to municipalities on the basis of their varying fiscal capacities to deliver on their responsibilities to eradicate backlogs in crucial infrastructure and essential basic services, and to support municipal capacity-building initiatives. The total of conditional grants directly transferred to local government, including the water operating subsidy, increase from R17 billion in 2008/09, R17.5 billion in 2009/10 and R19.5 billion in 2010/11.

Infrastructure conditional grants to local government

National transfers for infrastructure, including indirect or in-kind allocations to entities executing specific projects, amount to R18 billion, R18.4 billion and R20.6 billion for each of the 2008 MTEF years.

In addition to funding for municipal infrastructure, public transport infrastructure and the national electrification programme, there is continuing funding for water services regional bulk infrastructure, 2010 FIFA World Cup stadium development, water and sanitation services to schools and clinics, and the electrification of schools and clinics.

Table W1.21 Infrastructure transfers to local government, 2004/05 – 2010/11

R million	2004/05	2005/06 Outcome	2006/07	2007/08 Revised estimate	2008/09	2009/10 Medium-term estimates	2010/11
Direct transfers[1]	**5 298**	**6 286**	**7 447**	**14 954**	**15 725**	**15 652**	**18 193**
Municipal infrastructure grant	4 481	5 436	5 938	8 691	8 657	10 330	11 678
National electrification	196	297	391	468	596	897	951
Implementation of water service projects	208	–	–	–	–	–	–
Disaster relief	280	311	–	–	–	–	–
Poverty relief funds	134	–	–	–	–	–	–
Public transport infrastructure and systems grant	–	242	518	974	3 170	2 325	4 465
Neighbourhood development partnership grant	–	–	–	116	407	700	1 000
2010 FIFA World Cup stadiums development grant	–	–	600	4 605	2 895	1 400	100
Municipal drought relief fund	–	–	–	100	–	–	–
Indirect transfers[2]	**1 638**	**1 767**	**1 383**	**1 974**	**2 293**	**2 741**	**2 387**
Water and sanitation operating subsidy	819	904	440	490	269	–	–
National electrification	819	863	893	973	1 151	1 421	1 649
Regional bulk infrastructure	–	–	–	300	450	650	689
Backlogs in water and sanitation at clinics and schools	–	–	–	105	210	350	–
Backlogs in the electrification of clinics and schools	–	–	–	45	90	150	–
Neighbourhood development partnership grant	–	–	50	61	123	170	49
Total	**6 936**	**8 053**	**8 831**	**16 928**	**18 018**	**18 393**	**20 580**

1. Transfers made directly to municipalities
2. In-kind transfers to municipalities

Municipal infrastructure grant

The largest infrastructure transfers are through the *municipal infrastructure grant* (MIG), which supports government's objective of expanding the delivery of services, as well as alleviating poverty. The grant also seeks to stimulate local economic development and job creation over the medium term. Municipalities are required to dedicate a portion of their capital budgets to labour-based infrastructure methods to meet the objectives of the expanded public works programme. This grant is listed on Schedule 4 of the Division of Revenue Bill, as it supplements municipal allocations for infrastructure. The role of national departments in relation to this grant is limited to enforcing compliance with conditions, and monitoring performance by the receiving municipalities.

The role of national and provincial government is to support and monitor policy outcomes of municipal infrastructure investments. A great deal of policy reform has been undertaken to ensure an improved approach in the utilisation of this grant. The aim is to ensure sufficient resources for successful implementation of integrated development plans (IDPs), and effective intergovernmental coordination. Consequently, there is greater potential to further expand municipal infrastructure, and a more differentiated approach which will include a reasonable minimum allocation for every municipality. Municipalities with limited own resources, will therefore benefit from the renewed focus.

A constant component is phased in over the next three years to ensure that a reasonable minimum allocation is made to poor municipalities. This constant is R2,2 million in 2008/09, R4,4 million in 2009/10 and R5 million in 2010/11. By 2010/11 all municipalities would receive a minimum allocation of R5 million. The MIG formula comprises of a vertical and horizontal division. The vertical division allocates resources to sectors or other priority areas; the horizontal division is determined based on a formula that takes account of poverty, backlogs, and municipal powers and functions. There are five main components of the formula, as demonstrated in the box below.

$$MIG_{(F)} = C + B + P + E + N + M$$

C Constant to ensure increased minimum allocation for poor municipalities (This allocation is made to all municipalities)

B Basic residential infrastructure (new and rehabilitation of existing ones)

Proportional allocations for water supply and sanitation, electricity, roads and 'other' (Street lighting and solid waste removal)

P Public municipal service infrastructure (new and rehabilitation of existing ones)

E Allocation for social institutions and micro-enterprises infrastructure

N Allocation to all nodal municipalities

M Negative or positive allocation related to past performance of each municipality relative to grant conditions

The MIG allocations grow to R8.7 billion, R10.3 billion and R11.7 billion over the MTEF years. This represents real growth of 4.6 per cent during the period.

The full incorporation of the electricity programme (which includes both municipal and Eskom programmes) into the MIG is, however, deferred until the completion of the restructuring of the electricity distribution industry. Table W1.22 shows the weighted share per sector and the respective amounts that flow through the vertical division of the MIG funds.

Table W1.22 Municipal infrastructure grant allocations per sector, 2007/08 – 2010/11

	2007/08	2008/09	2009/10	2010/11
Weights			**Adjusted weights**	
Municipal infrastructure grant (a)				
Special municipal infrastructure fund and management (b)				
Ring-fenced allocation: Eradication of bucket sanitation System (c)				
Bulk infrastructure (d)				
Municipal infrastructure grant (formula)	*(a)-(b)*	*(a)-(b)-(c)-(d)*	*(a)-(b)-(c)-(d)*	*(a)-(b)-(c)-(d)*
of which: Municipal infrastructure grant (formula)				
B Component	**75.0%**	**75.0%**	**75.0%**	**75.0%**
Water and sanitation	72.0%	72.0%	72.0%	72.0%
Electricity	0.0%	0.0%	0.0%	0.0%
Roads	23.0%	23.0%	23.0%	23.0%
Other	5.0%	5.0%	5.0%	5.0%
P Component	**15.0%**	**15.0%**	**15.0%**	**15.0%**
E Component	**5.0%**	**5.0%**	**5.0%**	**5.0%**
N Component	**5.0%**	**5.0%**	**5.0%**	**5.0%**

The public transport infrastructure and systems grant

The *public transport infrastructure and systems grant* is administered by the Department of Transport. The grant provides for the establishment, construction and improvement of new and existing public transport infrastructure and systems. It is allocated R3.2 billion in 2008/09, R2.3 billion in 2009/10 and R4.5 billion in 2010/11. This will particularly assist 2010 FIFA World Cup host cities to meet the massive transportation requirements of hosting the events.

The neighbourhood development partnership grant

The *neighbourhood development partnership* grant, which seeks to develop community infrastructure and create the platform for private sector investment that improves the quality of life in targeted areas, receives R2.4 billion over the next three years. The grant is administered by the National Treasury and is allocated R530 million in 2008/09, R870 million in 2009/10 and R1 billion in 2010/11. By the end of 2008 the targeted number of projects under management associated with this grant is expected to reach 100. The project values range between R50 million to very large projects worth R500 million, and the total estimated project value over the next 10 years is R9.2 billion.

The national electrification programme

To sustain the current progress, particularly for poor households, government plans to spend R6.7 billion over the next three years on its national electrification programme. Of this, R2.4 billion will be spent by municipalities directly and R4.2 billion by Eskom on behalf of municipalities. This programme was instrumental in the connection of 80 per cent of all households in the country to the national electricity grid as reported in the 2007 Community Survey.

The regional bulk infrastructure grant

This grant supplements the financing of the social component of regional bulk water and sanitation infrastructure and is allocated R450 million in 2008/09, R650 million in 2009/10 and R689 million in 2010/11.

The backlogs in water and sanitation at clinics and schools grant

This grant has been created to eliminate the backlog in access to water and sanitation services at schools and clinics. An amount of R560 million is available for ensuring access for all identified clinics and schools by 2008/09 and 2009/10 respectively.

The backlogs in the electrification of clinics and schools grant

The grant provides funding to the amount of R240 million for connecting schools and clinics across the country with electricity by the end of the 2009/10 fiscal year. During 2007, 704 schools and 104 clinics were identified and the project has thus far completed 400 connections, with the remainder due for completion in the first half of 2008.

The 2010 FIFA World Cup stadiums development grant

The purpose of the grant is to provide funding for the design and construction of new stadiums and the upgrading of existing ones in 2010 FIFA World Cup host cities. Funds of R2.9 billion in 2008/09, R1.4 billion in 2009/10 and R100 million in 2010/11 are allocated for this grant.

Capacity-building and other operating grants

The *capacity-building grants* were set up to assist municipalities in building management, planning, technical, budgeting and financial management skills. The current MTEF includes an expansion to the capacity support programme in order to assist weaker or poorer municipalities to progressively implement financial management reforms in particular. Total allocations for capacity-building grants amounts to R430 million in 2008/09, R500 million in 2009/10 and R577 million in 2010/11.

The *financial management grant* under the National Treasury vote funds the modernisation of financial management, including building in-house municipal capacity to implement multi-year budgeting, linking integrated development plans to budgets, producing quality and timely in-year and annual reports, and generally supporting municipalities in the implementation of the MFMA. Total allocations amount to R845 million over the three year cycle.

Table W1.23 Capacity-building transfers to local government, 2004/05 – 2010/11

R million	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
		Outcome		Revised estimate		Medium-term estimates	
Direct transfers[1]	**699**	**588**	**610**	**875**	**380**	**500**	**577**
Municipal systems improvement grant	182	200	200	200	200	200	212
Restructuring grant	388	255	265	530	–	–	–
Financial management grant: Municipalities	129	133	145	145	180	300	365
Indirect transfers[2]	**69**	**66**	**53**	**53**	**50**	**–**	**–**
Financial management grant: DBSA	69	66	53	53	50	–	–
Total	**768**	**654**	**664**	**929**	**430**	**500**	**577**

1. Transfers made directly to municipalities
2. In-kind transfers to municipalities

The *municipal systems improvement grant* under the vote of the Department of Provincial and Local Government focuses on stabilising municipal and governance systems, planning and implementation management support centres, reviewing integrated development plans and implementing the Municipal Systems Act (2000). The grant is allocated R612 million over the next three years.

The *2010 FIFA World Cup host city operating grant* is a new grant that will be administered by Sport and Recreation South Africa and R684 million is made available between 2009/10 and 2010/11 for operational expenses associated with the hosting of the Confederations Cup and the 2010 FIFA World Cup competitions.

Part 5: Future work on provincial and municipal fiscal frameworks

Refinement of the local government fiscal framework

Various reforms have been made to the local government fiscal system, such as the reforms to the local government equitable share and infrastructure grant formulas. Further refinements will be made to the local government fiscal framework to enhance the ability of municipalities to perform their developmental and service delivery responsibilities. Some of the key issues that will form part of the additional reform and refinement of the framework are discussed in more detail below.

Interim and longer-term arrangements to replace funding from RSC/JSB levies

The Regional Services Council (RSC) levies (referred to as Joint Services Board levies in KwaZulu-Natal) were introduced in 1985 and 1990 respectively to fund the provision of basic services and accrued to metropolitan (Category A) and district (Category C) municipalities.

The Minister of Finance announced in the 2005 Budget speech the phasing out of RSC and JSB levies with effect from 1 July 2006. The Small Business Tax Amnesty and Amendment of Taxation Laws Act, 2006 revoked the power of district and metropolitan municipalities to impose RSC and JSB levies from 1 July 2006. Nevertheless, the importance of maintaining existing levels of revenue in order for municipalities to meet their expenditure obligations was acknowledged.

National government will continue to compensate local government until a permanent replacement for these levies is introduced Government is proposing that part of the fuel levy be devolved to municipalities as full replacement for RSC/JSB levies. For the 2008 Budget, R30.2 billion (R9 billion in 2008/09, R10.1 billion in 2009/10 and R11 billion in 2010/11) will be allocated as an interim funding measure. Similar to RSC levies, the replacement grant should be prioritised towards basic services and infrastructure development in under-serviced communities.

As part of a package of reforms, the VAT zero-rating of municipal property rates and other VAT reforms, were introduced as part of the permanent replacement for RSC/JSB levies from 1 July 2006. This resulted in an estimated R1.4 billion in additional VAT refunds accruing to the relevant municipalities. As the reforms progress, it is important that, similar to RSC levies, a substantial replacement grant should be channelled towards basic services and infrastructure development in under-serviced communities.

Also refer to discussion under the Implementation of the Municipal Fiscal Powers and Functions Act for a more detailed discussion on the long-term options to replace RSC and JSB levies.

Restructuring of the water and electricity distribution industries

Reform of the water and electricity distribution industries has been driven by the need to address their fragmentation, which could have led to a number of problems – including the inability of small municipalities to achieve economies of scale, skills and specialisation.

In October 2006, government agreed that six wall-to-wall regional electricity distributors (REDs) should be established as public entities. Eskom will become a shareholder in the respective REDs for a transitional period and will reduce its shareholding over time.

Government is developing a road map for the purposes of the new electricity distribution industry (EDI) structure. Various pieces of legislation will underpin the restructuring.

The Electricity Regulation Act (Act no. 4 of 2006), provides a national electricity regulatory framework for the generation, transmission and distribution of electricity. Additional provisions will be enacted shortly which will clarify the roles of local government in electricity reticulation services.

Government is developing the EDI restructuring legislation that will put in place the legislative and policy framework for the establishment of REDs. As part of this process, work is under way to resolve various outstanding policy issues related to the restructuring, including the allocation of shares to national government, Eskom and local government in each RED; the valuation methodology to be used for the valuation of assets; the compensation of Eskom and each municipality for assets contributed to the REDs; and the capital structure of the REDs.

Municipalities will retain surcharges on electricity reticulation services after the establishment of REDs. National legislation may regulate how this may be done and the limits of such charges. The Municipal Fiscal Powers and Functions Act (Act No. 12 of 2007) makes provision for the Minister of Finance to prescribe compulsory national norms and standards for imposing municipal surcharges, including on electricity reticulation services.

The Department of Water Affairs and Forestry is repositioning itself as a sector leader responsible for policy, development, regulation and support functions. As part of this process, the department is ending its role as an implementing agent and the process of transferring the water schemes it operated to local government is almost complete. Institutional reforms to the water services sector are still in the early stages and are likely to take several years to complete.

Implementation of the Municipal Fiscal Powers and Functions Act

The recently enacted Municipal Fiscal Powers and Functions Act (Act No. 12 of 2007) gives effect to sections 229(1)(b) and 229(2) of the Constitution and is one of the last building blocks in the process of creating a regulatory framework that will facilitate proper coordination of macro-economic policy objectives across all spheres of government, especially aspects of taxation. In 2003, the Provincial Tax Regulation Process Act was enacted. It sets out the regulatory framework for provincial taxes. The Municipal Fiscal Powers and Functions Act sets out a similar framework for municipal taxes (including surcharges).

The Act provides for the process and procedure necessary for the authorisation of taxes, levies and duties that municipalities may impose under section 229(1)(b) of the Constitution and regulates the exercise by municipalities of their power to impose surcharges on fees for services under section 229(1)(a) by empowering the Minister to prescribe norms and standards.

The Act focuses on municipal surcharges and taxes other than property rates and user charges (tariffs). Municipal property valuation and rating are dealt with through the Municipal Property Rates Act and municipal user charges (tariffs) are dealt through the Municipal Finance Management Act, Municipal Systems Act and sector legislation.

Implementation of the Local Government Municipal Property Rates Act

Municipalities have until 1 July 2009 to introduce new valuation rolls (based on market value) as required in terms of the Municipal Property Rates Act (Act No. 6 of 2004). Properties that were previously not liable for property rates, such as many rural and agricultural properties, as well as public service infrastructure, will now become liable under the new system. The Act also requires that a rate levied on newly rateable property must be phased in over a period of three financial years.

Only four municipalities targeted 1 July 2006 to implement their first valuation in terms of the Act, while 24 municipalities started implementation on 1 July 2007, including the City of Cape Town. The majority of municipalities (approximately 90 per cent of municipalities, including the remaining five metros) are targeting either 1 July 2008 or 1 July 2009 as the implementation date.

The process of publishing regulations in terms of the Municipal Property Rates Act for public comment began with the first set of regulations focusing on administrative issues being gazetted in 2006. The draft regulations dealing with financial matters, prescribing ratios between residential and non-residential properties (section 19 of the Act) and upper limits on the percentage by which rates on properties or a rate on a specific category of properties may be increased (section 20), were gazetted for public comment on the 19 December 2007.

Policy review of provincial and local government

Government conducted a review of the provincial and local government system in July 2007. The review will culminate in a White Paper on Provincial Government and a review of the White Paper on Local Government.

The first phase of the review has been completed. The Department of Provincial and Local Government received 135 submissions on the questions posed with respect to provincial and local government systems.

The next phase of the review will be undertaken under five thematic areas, namely (1) the roles of provincial government and two-tier local government, (2) deepening local democracy, accountability and participation, (3) strengthening capacity to meet basic needs and enable sustainable development, (4) refining the intergovernmental roles, functions and fiscal frameworks of spheres, and (5) making cooperative governance work more effectively and improving oversight, performance management, and the monitoring and evaluation system. This will culminate in the release of a draft white paper in mid-2008 for further public consultation. The overall process will be completed in early 2009 with the submission of a white paper to Cabinet.

It is accordingly important to ensure that there is proper alignment between the outcomes of the Department of Provincial and Local Government review process and the evolution of the intergovernmental fiscal system in the period ahead.

Updates to formulae

The 2007 Community Survey by Statistics South Africa provides updates to the 2001 Census information. Although released only up to provincial level, an undertaking is in progress to update the data at municipal level as well, for availability in 2008. This presents an opportunity to revise the information on which formula calculations are based, and the National Treasury will act accordingly as soon as relevant data is available.

The exact timing of the release is critical, as it determines the time available for analysing the impact of the new data on allocations, and the necessary policy decisions that need to be taken to allow for a smooth transition in the municipal finance system.