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Explanatory memorandum on the division of revenue

Introduction

The division of revenue between the spheres of government is one of the most crucial decisions made in the budget process. It determines the allocation of resources to the broad functions performed by each sphere, and thus to the types of services delivered. The division of resources reflects the priority of the respective services provided by each sphere and its ability to fund these services.

The issues that must be considered in determining the division of revenue are listed in Section 214(2) of the Constitution. This memorandum, in terms of Section 10(5) of the Intergovernmental Fiscal Relations Act, explains how the constitutional requirements have been met, how recommendations of the Financial and Fiscal Commission have been considered, and any assumptions and formulae underlying the division of revenue. Although the Division of Revenue Bill considers only allocations for 2000/01, the division of revenue is made in the context of the medium-term expenditure framework (MTEF). This memorandum, therefore, refers to the MTEF and to deviations from the projections of last year's Budget where appropriate.

The *Budget Review* presents the revised fiscal framework that was made possible by sound policies during last year's Asian crisis and the subsequent recovery in emerging markets. Stronger growth and a more positive economic outlook resulted in increases in available funds of R8,3 billion and R12,1 billion for 2000/01 and 2001/02, respectively, compared with estimates in the 1999 Budget.

Meeting constitutional requirements

The division of revenue must support the nation's priorities and take into account the spending pressures associated with its policy choices. As presented in Section 214(2), the Constitution requires that the division of resources must be consistent with the functions of each sphere and that, among other things, it must:

- reflect the national interest and Government's priorities
- allocate resources to providing basic services and meeting developmental needs
- take account of the fiscal capacity and efficiency of each sphere
- enable the reduction of economic disparities.

National interest and the division of resources

The national interest encapsulates policies and programmes that benefit the nation as a whole. For example, a stable macroeconomic environment, stronger economic growth, lower unemployment, reduced crime and a more efficient public service all contribute to a higher standard of living for all South Africans. Since programmes to meet these goals cut across all three spheres of government and often across departments, they are most appropriately coordinated and funded by national government. Broad-based programmes in the national interest introduced by Government since 1994 include the campaign against HIV/Aids, the working for water programme, initiatives to promote empowerment and job creation, and an integrated nutrition programme.

Government is committed to sound public administration, improved governance and transformation. To this end, funds are allocated to the national sphere to cover the costs of anti-corruption initiatives, investments in information technology, public service restructuring and financial management upgrading. Conditional grants for implementation of the Public Finance Management Act and information systems are provided to support these commitments in provinces.

Government recognises that South Africa has a growing role in maintaining peace and security in the region. In the 2000 Budget, therefore, a substantial upward adjustment is made in the national share to accommodate a strategic defence procurement programme. After an extended period of cuts in defence spending, higher economic growth and an increase in available resources enabled government to modernise the defence force while still improving access to social services.

Provision for debt costs

Interest on government debt, estimated to be R46,5 billion in 2000/01, is a first charge on Government revenues. Lower interest rates and the retiring of debt with the proceeds of privatisation resulted in a R3,3 billion saving in debt costs in 2000/01. These savings release funds for expenditure on other priorities. In addition, the commitment to fiscal discipline will contribute to lower future debt service costs through the continued reduction of the annual budget deficit.

Natural needs and interests

The national government is exclusively responsible for those functions that transcend provincial boundaries, including protection services, economic services and foreign affairs. These responsibilities are financed from national government's equitable share of revenues. Of the increase in non-defence spending in 2000/01, 41 per cent is awarded to national departments. This includes strengthening the crime prevention strategy, restructuring public enterprises, and funding programmes to alleviate poverty and enhance job creation. The national sphere is also responsible for meeting the contractual commitments of the state and for providing transversal systems of governance, including tax administration and financial information systems.

National government is responsible for policy development and monitoring in functions shared with provincial government. National government allocates 13 per cent of its share to conditional grants to ensure adequate financial provision for national interests in provincial budgets. A further 1 percent is transferred as grants to local government. Agency payments are made to both provincial and local government for functions performed on behalf of the national sphere.

Provincial and local basic services

Subnational governments have significant autonomy over allocating resources to meet basic needs and to respond to provincial and local priorities. The division of revenue, however, continues the emphasis of previous years on supporting provincial and local basic services – extending health services, broadening the social security net and creating a culture of learning in schools are central elements of Government's social policy. Of the increase in non-defence spending, 52 per cent is allocated to the provincial sphere and 7 per cent to local government.

Within the equitable share formula, the weighting of the social services components is increased to reflect the increasing spending pressures of broader access to services, better quality services and the impact of HIV/Aids and unemployment. Increased expenditure, however, must be accompanied by the development of service delivery indicators to enable future budget decisions to take account of effectiveness in spending. The Department of Education has set aside R202 million in 2000/01 as a conditional grant to provinces to improve the quality of learning in schools. Grants are also provided by the national Departments of Health and Welfare and

Population Development to strengthen expenditure control, hospital management and financial administration in these sectors.

Another spending pressure is the need for an effective rural development strategy, which requires expanded agriculture budgets at the provincial level, increased investment in rural infrastructure and sustained land reform. In addition to specific grants that support these initiatives, provinces and municipalities use funds from their equitable shares and own revenues.

Fiscal capacity and efficiency

The Constitution assigns the primary sources of government revenue to national government. Local governments finance the bulk of their expenditure from property rates, user charges and fees. This means that national government receives more revenue than it requires to meet its obligations, local government is largely self-financing, but provincial expenditure responsibilities exceed provincial sources of own revenue. This imbalance is addressed by sharing nationally collected revenues between the spheres, with provinces receiving the largest equitable share.

Options for increasing provincial fiscal capacity through own revenue sources continues to be explored. However, expanding the ability of provinces to levy taxes is neither a prerequisite for nor a guarantee of greater accountability or fiscal capacity. A review of provincial own revenues showed that improvements in collecting revenues already owed to provinces can increase fiscal capacity without encroaching on existing tax bases.

Budget reform and the MTEF emphasise the importance of efficiency in spending – increased expenditure is not a guarantee of better services. Improved information on service delivery is needed to inform future budget decisions so that funds are directed to where they best enhance the delivery of services. The use of performance contracts for senior departmental managers and the introduction of the Public Finance Management Act strengthen the incentives for sound financial management and good budget practice.

The responsibilities of provincial and local government in accelerating service delivery have grown over the past four years. Implementing budget reforms, improving the effectiveness of public spending and enhancing service delivery are dependent on the building of capacity. Conditional grants for training and capacity building are provided by several national Departments, including Health, Housing, Welfare, Education, Finance, Provincial and Local Government and State Expenditure. Two new grants, totalling R350 million, are introduced this year to assist municipalities in restructuring and building financial management capacity, particularly in view of the municipal demarcation process.

All three spheres are strengthening financial management capacity. The programme funded by the Department of State Expenditure focuses on appointing qualified personnel, training financial managers and improving reporting and oversight procedures. Several provinces are establishing or expanding internal audit units to improve control over expenditure. At local government level, the financial management grant will assist municipalities in upgrading financial management capacity.

Developmental needs

Development needs are considered in both the equitable share formulae for provincial and local government and in specific conditional grants. The health component of the provincial equitable share formula distributes resources towards poorer provinces in that persons without access to medical aid are weighted more heavily. The welfare component includes a poverty adjustment that captures poor people’s increased reliance on grants. The backlog component reflects the need for basic infrastructure in rural areas, as well as maintenance backlogs within the health and education sectors.

Funds for initiatives to enhance job creation and alleviate poverty are increased to R1,2 billion in 2000/01. In particular, the needs of the rural poor receive priority, in recognition that they have fewer economic opportunities than other South Africans. For example, in 2000/01 R609 million is set aside to fund water and sanitation programmes in rural and small communities. Following the Presidential Job Summit, funds are provided for projects that focus on job creation. These include a community-based public works programme, a local tourism infrastructure programme and the flagship programme to promote employment for women with young children. The Umsobomvu Fund, in addition to other Government-funded finance institutions, channels funds to stimulate employment creation and skills development among South African youth.

Government demonstrates its commitment to hospital rehabilitation by providing a conditional grant from the national department to complement provincial maintenance of hospital infrastructure. Grants are also provided for the construction of hospitals in Umtata and Durban, and to upgrade facilities in the five provinces without academic hospital complexes. The Consolidated Municipal Infrastructure Programme funds infrastructure for low-income urban households and will be extended this year to pilot projects in rural communities.

Government adopted a further education and training policy aimed at broadening the skills base. The introduction of the skills development levy this year, of which 20 per cent will be allocated to the National Skills Fund, mobilises substantial funds for human resource development. The National Skills Fund provides training initiatives for the unemployed and supports provincial training schemes and centres.

Investment, increased domestic savings and job creation are clear objectives of Government's social and economic policies. This year's allocations enable Government to take advantage of opportunities created by the EU trade agreement and stronger trade ties with the rest of Africa. As part of the defence procurement package, various industrial participation commitments were negotiated that will promote investment, trade and job creation in the local economy. Over time, these projects should contribute to stronger economic growth and increased revenue to finance further development. Local development will benefit from the recapitalisation of the taxi industry and targeted industrial programmes to support small, medium and microenterprises.

Agricultural development initiatives have been pressured by constraints on provincial budgets and the priority given to social service expenditure. Greater stability in provincial social service budgets and significant progress in reducing provincial debt will release resources for these and other initiatives.

Economic disparities

The equitable share formula recognises that the provinces have different demographic and economic profiles, markedly different levels of economic development and significant variations in socio-economic circumstances. The equitable share formula is therefore redistributive, to assist provinces in providing a basic level of services for all South Africans. Table E.6 shows the progress made towards a more equitable distribution of resources.

The formulae or criteria used by national departments to distribute grants among provinces are also redistributive. For example, the allocation of the education quality enhancement grant redistributes resources to poorer provinces with a higher proportion of under-resourced schools. The health rehabilitation and redistribution grants recognise the varying capacity of provinces to maintain and upgrade public health facilities.

Within provinces, access to economic opportunities and public services vary significantly between regions and between urban and rural areas. Provincial governments have to redistribute resources within their budgets to promote the development of poor areas. The slower growth in allocations to health, welfare and education departments will also require these departments to reprioritise their budgets towards poor communities.

Obligations in terms of national legislation

While the Constitution confers significant autonomy on provincial governments to determine provincial priorities and allocate provincial budgets, national government retains responsibility for policy development and for monitoring implementation within shared functions. Therefore, although the equitable share allocations and other transfers are intended to allow provinces and local government some discretion, national policies create mandates that must be accommodated. For example, improvements in conditions of service are negotiated centrally but the ongoing costs must be provided for on provincial budgets. National policy also obliges provinces to provide for national entitlements such as welfare grants and free primary health care.

Individual components of the equitable share formula are designed to allocate resources in line with national obligations. For example, the education component reflects national policy aimed at reducing out-of-age enrolment and compulsory education for all children between Grades 1 and 9. The health component relies on the number of individuals without health insurance, the group that makes the most use of public health services. Similarly, the welfare component tries to capture demand for social security grants. The take up of the child support grant is being analysed to assess whether the weighting of the child and poverty subcomponents adequately capture the demand for the grant.

Conditional grants and agency payments provide funding for national priorities that are implemented by provincial or local government. The national Department of Health allocates R582 million in 2000/01 to fund integrated nutrition programmes in the provinces. The Department of Housing will transfer more than R3 billion to provinces to subsidise low-cost housing. The Department of Welfare made R50 million available in 2000/01 to assist provinces with reregistration of beneficiaries and upgrading of information systems to manage the grants system. A further R17 million is allocated to activities to promote the take-up of the child support grant. The Department of Provincial and Local Government has allocated R883 million to the consolidated municipal infrastructure programme.

Predictability and stability

Government has resolved that the equitable shares for a given year will be based on estimates of nationally collected revenues, as announced in the Budget. Allocations will not be adjusted if actual revenue collected is different from these targets. Furthermore, the Division of Revenue Bill specifies that all allocations must be transferred according to a payment schedule. Thus, at the beginning of the financial year provinces and local governments are assured of the resources they will receive and know the dates on which the allocations will be transferred.

Stable and predictable revenue flows are essential for departments to undertake sound planning and to encourage better financial management. The 3-year MTEF projections give departments a baseline allocation against which to plan. Although the estimates are a statement of intent and are revised annually, changes must be justified in terms of a revised macroeconomic framework or specific policy changes.

In addition to 3-year projections of the equitable share, national departments must also provide projections of ongoing conditional grants. While departments may still adjust these amounts should circumstances change, such adjustments will have to be justified and incorporated into the budget process. Greater certainty of revenues improves the quality of provincial budget planning and expenditure projections.

The incidence analysis of social service expenditure and an evaluation of allocations from 1995/96 show that significant reprioritisation has taken place in favour of the social services. This foundation and the revised fiscal framework allow for more moderate reprioritisation between sectors over the next three years, introducing greater stability in allocations. Provincial finances have undergone considerable realignment over the past two years as expenditures were brought more in line with revenues and accumulated debts reduced. Slower growth in provincial expenditures thus reflects stabilisation of provincial budgets putting them on a sound footing for future years.

Need for flexibility

The contingency reserve provides a cushion against the uncertainties inherent in medium-term planning and gives Government the flexibility to shift expenditures in response to changing priorities without compromising existing programmes. Some provinces have created contingency reserves to increase flexibility in provincial budget planning and to enable them to repay accumulated debt.

Financial and Fiscal Commission recommendations

The Financial and Fiscal Commission did not make specific recommendations for the 2000 Budget, as its previous recommendations were in terms of a multi-year framework that covered the 2000 Budget. The Commission is currently undertaking a comprehensive review of the intergovernmental fiscal system, referred to as Project 2001. In keeping with the 3-year MTEF planning cycle, it focused its attention on 2001 and beyond. The research phase has been completed and consultations with stakeholders are expected to culminate in substantive recommendations in April 2000.

Economic assumptions underlying the division of revenue

The growth and performance of the economy must be taken into account in determining the resources available for allocation. As explained in the *Medium Term Budget Policy Statement*, a turnaround in emerging markets and the soundness of South Africa's policies facilitated stronger growth than anticipated in the 1999 Budget. The more positive outlook for the MTEF period is reflected in the revised medium-term macroeconomic framework set out in Table E1.

Table E1 Medium-term macroeconomic assumptions

	1999/00		2000/01		2001/02		2002/03
	1999 Budget	2000 Budget	1999 Budget	2000 Budget	1999 Budget	2000 Budget	2000 Budget
Gross domestic product (R billion)	813,9	809,7	881,1	885,2	952,1	958,2	1 036,7
Real GDP growth	*1,8%*	*1,7%*	*3,2%*	*3,6%*	*3,8%*	*3,2%*	*3,3%*
GDP inflation	*6,4%*	*5,5%*	*4,9%*	*5,5%*	*4,1%*	*4,9%*	*4,8%*
National Budget Framework							
Revenue (R billion)	190,9	196,3	206,6	210,4	221,5	227,4	243,6
Percentage of GDP	*23,5%*	*24,2%*	*23,5%*	*23,8%*	*23,3%*	*23,7%*	*23,5%*
Expenditure (R billion)	213,9	216,0	229,9	233,5	251,5	251,5	266,7
Percentage of GDP	*26,3%*	*26,7%*	*26,2%*	*26,4%*	*26,0%*	*26,2%*	*25,7%*
Budget deficit (R billion)	23,0	19,7	23,3	23,1	25,0	24,1	23,1
Percentage of GDP	*2,8%*	*2,4%*	*2,6%*	*2,6%*	*3,0%*	*2,5%*	*2,2%*

Note: 1999 Budget figures exclude RDP grants from revenue and expenditure.

Division of revenue between spheres of government

The primary sources of nationally collected revenue are taxes and borrowing, although limited non-tax revenues are also collected. Before the resources can be divided, however, provision must be made for national commitments such as debt service costs and a contingency reserve. The remaining pool of revenue is available for sharing between national, provincial and local government.

The determination of the equitable shares is the result of an extensive process in which the functions of each sphere, the delivery implications of various options and the outputs of technical teams are discussed by a number of forums before recommendations are presented to Cabinet. Although technical analysis of the options informs the division of revenue, it is fundamentally a political choice between competing priorities.

Over the past four years, expenditure on defence and economic services were curtailed and social services and integrated justice reprioritised. In particular, the 1999/00 division of revenue protected the social services and basic service delivery despite the unanticipated slowdown in economic activity. The division of revenue for 2000/01 continues to support the social services but the revised economic projections allow Government to also give attention to other national functions.

Revised economic projections, fiscal policy considerations and adjustments to the calculation of GDP are discussed in the main chapters of the Budget Review. The revised budget framework provides for additional spending of R4,0 billion in 1999/00, R8,3 billion in 2000/01 and R12,1 billion in 2001/02 compared with the estimates projected for these years in the 1999 Budget. As shown in Table E2, these additional funds were distributed across the three spheres in differing proportions. The national government received the largest share, primarily reflecting the decision to modernise the defence force. The national portion also includes expenditure on programmes funded by the skills levy, which is an earmarked revenue.

Table E2 Revised allocations to spheres

R billion	1999/00	2000/01	2001/02
Change in available resources	4,0	8,3	12,1
Allocation to:			
National government	1,9	5,4	8,1
Defence	–	2,8	3,9
Skills development programmes	–	0,5	1,2
Other non-defence	1,9	2,0	3,0
Provincial government[1]	2,1	2,6	3,6
Local government[1]	*	0,4	0,5
Percentage share of available resources			
National government	*47,6*	*64,5*	*66,8*
Provincial government	*52,1*	*31,3*	*29,5*
Local government	*0,3*	*4,2*	*3,7*
Percentage share of non-defence funds, excluding skills development programmes			
National government	*47,6*	*40,8*	*42,5*
Provincial government	*52,1*	*52,2*	*51,0*
Local government	*0,3*	*7,0*	*6,5*

1 Provincial and local government allocations include conditional grants from national government

** Less than R50 million*

Of the remaining funds allocated to non-defence spending, over half were allocated to the provinces, recognising the challenges they face delivering social services, building economic infrastructure and promoting rural development. In addition, a portion was allocated to local government, which is undergoing significant transformation and restructuring. Although the additional amount for local government is small, it is significant relative to the overall level of resources transferred to that sphere.

The impact of these policy decisions on the division of revenue is shown in Table E3, which presents the resources allocated to the three spheres. The additional funds for defence and the new skills development programmes increase the share of funds going to national government. Its share rises from 40,4 per cent in 1999/00 to 42,1 per cent in 2002/03. The share dedicated to local government also rises modestly, reaching 1,6 per cent in 2002/03. The provincial share declines correspondingly, from 58,2 per cent in 1999/00 to 56,4 per cent in 2002/03. Although the provincial share declines relative to the other spheres, its allocation nonetheless continues to grow faster than the rate of inflation over the medium term.

Table E3 Division of revenue between the spheres of government

	1999/00	2000/01		2001/02	2002/03
R million	Revised estimates[1]	1999 Budget[1]	2000 Budget	Medium-term estimate	
National allocation[2]	68 999	70 739	76 095	83 107	87 834
Provincial allocation	99 376	103 433	106 037	111 810	117 057
Equitable share	86 595	92 071	94 408	100 167	105 158
Conditional grants	12 781	11 362	11 629	11 643	11 899
Local government allocation	2 327	2 480	2 830	3 030	3 233
Equitable share	1673	2 480	1 867	1 997	2 130
Conditional grants	654		963	1 033	1 103
Total to be shared	**170 702**	**176 652**	**184 963**	**197 947**	**207 674**
Plus:					
Debt service	44 483	49 754	46 490	49 531	50 997
Contingency reserve		3 500	2 000	4 000	8 000
Umsobomvu fund	855				
Total expenditure	**216 030**	**229 906**	**233 453**	**251 478**	**266 671**
Percentage of shared total					
National allocation	*40,4*	*40,0*	*41,1*	*42,0*	*42,1*
Provincial allocation	*58,2*	*58,6*	*57,3*	*56,5*	*56,4*
Local government allocation	*1,4*	*1,4*	*1,5*	*1,5*	*1,6*

1. Adjusted to include housing subsidies in the provincial allocation and remove them from the national allocation; national allocation in the 1999 Budget adjusted to include transfers to skills funds

2. The national allocation excludes conditional grants as these are spent at the provincial and local levels.

National government share

National departments deliver a range of services that provide benefits across provincial boundaries. The increased allocation to the national equitable share provides for:

- costs associated with South Africa's international responsibilities, including regional peacekeeping and other international commitments
- modernisation and strengthening of the justice system to combat crime
- provision of a comprehensive strategy to deal with HIV/Aids
- increased pressure on the transport system, including commuter transport and the roads network
- initiatives to root out corruption and improve financial management

- restructuring of state assets and the transformation of the public service.

National departments provide conditional grants and agency payments to other spheres to promote spending on national priorities. These transfers contribute to Government's redistribution and development goals by providing funds to subsidise transport, low-income housing, basic infrastructure, nutrition programmes and maintenance of health facilities.

Provincial allocations

Provinces have three sources of revenue. Transfers from national government comprise more than 96 per cent of provincial revenues on average, of which 88 per cent is the discretionary equitable share (see Table E4). The remaining 12 per cent flows through conditional grants. Provinces raise less than 4 per cent of their revenues from own sources.

Table E4 Total transfers to provinces, 2000/01

R million	Equitable share	Conditional grants	Total transfers
Eastern Cape	16 452	1 332	17 784
Free State	6 408	857	7 265
Gauteng	14 235	2 971	17 206
KwaZulu-Natal	18 894	2 234	21 128
Mpumalanga	6 423	570	6 993
Northern Cape	2 302	180	2 482
Northern Province	12 626	1 068	13 694
North West	8 009	658	8 667
Western Cape	9 059	1 782	10 841
Unallocated		590	590
Total	**94 408**	**12 242**	**106 650**

Provincial equitable share

The provincial equitable share is distributed among the provinces on the basis of a redistributive formula reflecting their demographic and economic profiles. Table E5 shows the current structure and distribution of the shares by component and the target shares to be reached by 2003/04. The elements of the formula are neither indicative budgets nor guidelines as to how much should be spent on those functions. Rather, the components are weighted broadly in line with expenditure patterns to provide an indication of relative need.

Last year, the baseline allocations to provinces had to be adjusted to incorporate the results of the census. This year, less new data were available for updating the formula components, contributing to smaller deviations from the baseline allocations. In particular, the Statistics SA mid-year estimates of population did not include a breakdown by age. Even in terms of the totals, the percentage distribution across provinces did not change. As a result, the 1996 census data have been retained throughout.

Two revisions have been made to the formula. First, the economic activity component has been adjusted on the basis of updated data. Second, expenditure trends in the social services resulted in shifts in the weightings of the various components. The most significant change to the provincial allocations, however, arises from revisions to the fiscal framework. The baseline allocations to be distributed through the equitable share increased, resulting in larger provincial allocations across the board.

Table E5 Distributing the equitable share, percentages by province

	Education	Health	Social welfare	Basic share	Economic activity	Institutional	Backlog	Target shares
Weighting	*41,0*	*19,0*	*17,0*	*7,0*	*8,0*	*5,0*	*3,0*	*100,0*
Eastern Cape	18,5	17,0	19,6	15,5	6,5	11,1	20,6	16,9
Free State	6,3	6,5	7,1	6,5	5,3	11,1	5,7	6,6
Gauteng	12,3	14,7	13,9	18,1	41,6	11,1	5,1	15,5
KwaZulu-Natal	22,1	21,7	19,6	20,7	17,0	11,1	22,9	20,6
Mpumalanga	7,3	7,2	6,5	6,9	4,9	11,1	8,5	7,2
Northern Cape	1,9	2,0	2,2	2,1	1,7	11,1	1,3	2,4
Northern Province	15,7	13,3	13,7	12,1	3,0	11,1	22,9	13,6
North West	8,0	8,6	8,7	8,3	5,7	11,1	9,4	8,3
Western Cape	7,9	8,9	8,8	9,7	14,4	11,1	3,7	8,9
Total	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**

Since its introduction, the equitable share formula has been phased in to avoid disruptions in provincial allocations where the target shares differ substantially from the current allocation of resources. Taking into account the significant impact of the final census data on the allocation of funds for 1999/00, a 5-year phase-in period was employed last year, using the 1998/99 equitable share allocations (including improvements in conditions of service) as the base. The target date of 2003/04 has been retained, so that four years remain in the phasing process. The higher than anticipated improvements in conditions of service in 1999/00 have been incorporated into the revised equitable shares.

Table E6 Phasing in the equitable share, 2000 Budget

Percentage	1999/00 base	2000/01	20001/02	2002/03	2003/04 target
Phasing		*Year 1*	*Year 2*	*Year 3*	*Year 4*
Eastern Cape	17,6	17,4	17,3	17,1	16,9
Free State	6,8	6,8	6,7	6,7	6,6
Gauteng	14,9	15,1	15,2	15,4	15,5
KwaZulu-Natal	19,8	20,0	20,2	20,4	20,6
Mpumalanga	6,7	6,8	6,9	7,0	7,2
Northern Cape	2,4	2,4	2,4	2,4	2,4
Northern Province	13,3	13,4	13,5	13,5	13,6
North West	8,6	8,5	8,4	8,3	8,3
Western Cape	9,8	9,6	9,4	9,2	8,9
Total	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**

Overall, the changes to the formula have a relatively small impact on the distribution of funds among provinces. The table below shows the 2003/04 target shares from last year (1999 Budget) and this year, after the formula has been updated. In general, most provincial shares change by less than 0,05 percentage points.

Table E7 2003/04 target shares, 1999 and 2000 Budget

Percentage	1999 Budget	2000 Budget	Difference
Eastern Cape	16,8	16,9	0,1
Free State	6,6	6,6	*
Gauteng	15,7	15,5	-0,2
KwaZulu-Natal	20,7	20,6	-0,1
Mpumalanga	7,1	7,2	*
Northern Cape	2,4	2,4	*
Northern Province	13,5	13,6	0,1
North West	8,2	8,3	*
Western Cape	8,9	8,9	*
Total	**100,0**	**100,0**	**0,0**

** Less than 0,05 per cent.*

The weightings applied to the social services components reflect a 3-year average of expenditure on these services. Based on the most recent 3-year period, 1997/98 to 1999/00, weights of 41,0 per cent for education, 19,0 per cent for health and 17,0 per cent for welfare have been applied. Compared with last year, this reflects a 1 percentage point increase for the education and health components, but no change for welfare. These increases are offset by a 2 percentage point reduction in the weighting of the basic share, from 9,0 to 7,0 per cent.

The education component targets primary and secondary schooling, which accounts for roughly 90 per cent of provincial education spending. Both the population of school-going age and enrolment numbers are used to reflect the demand for education services. The school-age cohort is double weighted, accentuating the role of this measure of educational need. The Department of Education has not yet prepared adjusted 1999 enrolment numbers and the 1998 enrolment figures have been retained.

Table E8 Calculation of education component

Thousands	Enrolment	School-age (6–17)	Weighted share (%)
Weighting	*1*	*2*	
Eastern Cape	2 295	2 010	18,5
Free State	808	680	6,3
Gauteng	1 400	1 394	12,3
KwaZulu-Natal	2 812	2 377	22,1
Mpumalanga	924	789	7,3
Northern Cape	202	223	1,9
Northern Province	2 043	1 665	15,7
North West	946	896	8,0
Western Cape	905	895	7,9
Total	**12 335**	**10 930**	**100,0**

The health component addresses the need for provinces to deliver primary and secondary health services. As all citizens are eligible for health services, the provincial shares of the total population form the basis for the health share. It recognises that people without medical aid support are more likely to use public health facilities and these people are therefore weighted four times higher than those with medical aid. This implies that the uninsured account for 95 per cent of the usage of public health facilities. The proportions of the population with and without access to medical aid are taken from the 1995 October Household Survey and applied to the census figures.

Updated information on the number of people without medical aid was unavailable as this was not reported in the 1996 October Household Survey. The Department of Health agreed to leave the health component unchanged for 2000/01.

Table E9 Calculation of health component

Thousands	With medical aid	Without medical aid	Weighted share (%)
Weighting	*1*	*4*	
Eastern Cape	510	5 793	17,0
Free State	467	2 166	6,5
Gauteng	2 958	4 390	14,7
KwaZulu-Natal	1 103	7 314	21,7
Mpumalanga	392	2 409	7,2
Northern Cape	175	665	2,0
Northern Province	376	4 554	13,3
North West	457	2 897	8,6
Western Cape	1 127	2 830	8,9
Total	**7 566**	**33 018**	**100,0**

The welfare component captures provinces' responsibility for providing social security grants. The constituent parts reflect the target populations of social security payments, weighted by the distribution of expenditure for each type of grant. For example, the bulk of social security payments are old-age pensions. Means-testing of grants is reflected through an income adjustment based on the provincial share of the population in the lowest two quintiles of the income distribution. This information was drawn from the 1995 Income and Expenditure Survey, which has not been updated. Data from the Department of Welfare on actual expenditure by grant type indicate that the current weightings are still appropriate. However, in future, the weightings of the grant types will be adjusted to reflect the growing importance of the child support grant.

Table E.10 Calculation of the welfare component

Percentage	Old age	Disability	Child care	All grants	Income adjustment	Weighted share
Weighting	*65,0*	*25,0*	*10,0*	*75,0*	*25,0*	*100,0*
Eastern Cape	19,1	15,5	17,4	18,0	24,3	19,6
Free State	6,2	6,5	5,7	6,2	9,6	7,1
Gauteng	15,7	18,1	14,3	16,2	7,2	13,9
KwaZulu-Natal	19,8	20,7	21,7	20,2	17,6	19,6
Mpumalanga	5,9	6,9	7,3	6,3	7,1	6,5
Northern Cape	2,1	2,1	2,0	2,1	2,6	2,2
Northern Province	13,0	12,1	14,8	13,0	15,8	13,7
North West	7,8	8,3	8,4	8,0	10,7	8,7
Western Cape	10,4	9,7	8,4	10,0	5,2	8,8
Total	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**

The economic activity component is a proxy for provincial tax revenue, directing a proportion of nationally collected revenue back to its source. It also reflects costs associated with economic activity, such as maintenance of provincial roads. Last year, provincial GGP figures were replaced by the distribution of employee remuneration, since remuneration comprises roughly 60 per cent of provincial GGP and the GGP figures had not been updated since 1994.

Remuneration data are released by Statistics SA on a quarterly basis, and the economic activity component relies on the most recent six quarters of data. The updated information reflects a modest change in distribution, with Gauteng's share declining by 1,5 percentage points and KwaZulu-Natal's by 2 percentage points. Other provinces had offsetting increases, with Northern Province showing the largest increase. The continuing absence of GGP data raises concerns about the appropriateness of data in the economic shares component; alternative data sources are being investigated.

Table E11 Economic activity shares, 1999 and 2000 Budgets

Percentage	1999 Budget	2000 Budget	Difference
Eastern Cape	5.9	6,5	0,6
Free State	5.1	5,3	0,1
Gauteng	43.2	41,6	-1,5
KwaZulu-Natal	18.9	17,0	-2,0
Mpumalanga	4,7	4,9	0,2
Northern Cape	1,6	1,7	0,1
Northern Province	1,7	3,0	1,2
North West	5,1	5,7	0,6
Western Cape	13,7	14,4	0,7
Total	**100,0**	**100,0**	**0,0**

Last year, the basic component was split into a basic share distributed by population and a backlog component. The backlog component incorporates estimates of capital needs as drawn from the Schools Survey of Needs and the 1998 MTEF health sectoral report on hospital rehabilitation. The backlog component also incorporates a rural factor, in keeping with Government's focus on rural development. As no new information was available regarding its subcomponents, the backlog component remained unchanged.

Table E12 Calculation of backlog component

Percentage	Health	Education	Rural	Weighted share
Weighting	*19,0*	*41,0*	*40,0*	*100,0*
Eastern Cape	16,3	22,0	21,3	20,6
Free State	3,8	7,8	4,4	5,7
Gauteng	10,8	6,3	1,2	5,1
KwaZulu-Natal	16,0	23,5	25,5	22,9
Mpumalanga	9,2	7,5	9,1	8,5
Northern Cape	1,2	1,2	1,3	1,3
Northern Province	27,5	20,4	23,3	22,9
North West	9,1	7,5	11,6	9,4
Western Cape	6,1	3,9	2,3	3,7
Total	**100,0**	**100,0**	**100,0**	**100,0**

The basic share is unchanged and reflects the distribution of total population according to the 1996 census. The institutional component recognises that some costs associated with running a government and providing services are not directly related to the size of a province's population. It is therefore evenly distributed between provinces, as it was last year.

Conditional grants to provinces

Conditional grants support compliance with national norms and standards, compensate provinces for providing services that extend beyond provincial boundaries and enable national priorities to be adequately provided for in subnational budgets. The conditional grants proposed over the medium term are summarised in Table E13.

Table E13 Conditional grants to provinces

	2000/01	2001/02	2002/03
R million		**Medium-term estimate**	
Eastern Cape	1 332	1 210	1 246
Free State	857	782	808
Gauteng	2 971	3 089	3 209
KwaZulu-Natal	2 234	1 938	1 891
Mpumalanga	570	496	512
Northern Cape	180	164	170
Northern Province	1 068	939	961
North West	658	584	591
Western Cape	1 782	1 8009	1 873
Unallocated	590	1 255	1 272
Total	**12 242**	**12 266**	**12 532**
Allocation by grant category			
Health	5 717	5 803	5 905
Finance	2 512	2 300	2 300
Housing	3 031	3 187	3 330
Local Govt	613	623	633
Other	369	353	364
Total	**12 242**	**12 266**	**12 532**

The health grants constitute the largest conditional transfer to provinces. They include funding to support research and the training of health professionals across the provinces and to support the construction and rehabilitation of public facilities. Further support is channelled to the five provinces that provide specialised health services to citizens of all provinces.

Three separate grants support improvements in financial management at the provincial level. These are allocated through the Departments of Education, State Expenditure and Welfare and Population Development. The Department of Education uses the grant to encourage improvements in the quality of learning and not just to improve financial management practices in provincial education departments. The Department uses a redistributive formula to facilitate a re-allocation of resources to poor schools. The Welfare financial management grant is used to improve social security grants systems to make the administration of these grants more efficient and cost-effective.

The second largest grant, after health, is the supplementary grant managed by the Department of Finance. This grant is intended to support improvements in financial management and budget practice at the provincial level.

In the past, funds for improvements in conditions of service were transferred to provinces as a conditional grant. As part of the revised policy on public service remuneration, funds for improvements will be incorporated in the provincial equitable share. This will allow provinces greater flexibility in managing their personnel budgets within the national framework.

In previous years, funds to subsidise low-income housing flowed through the National Housing Fund to provincial Housing Boards. The housing subsidies have been converted into a conditional grant in 2000/01 to improve transparency and accountability. These funds will now flow to provincial revenue funds and transfers to Housing Boards will be reflected in the provincial accounts.

Local government allocations

Local government is expected to receive R6,7 billion in grants, agency payments and services-in-kind. Direct allocations amounts to R2,8 billion, an increase of R350 million over the previous year. Of this allocation, the local government equitable share which is the primary source of funding for poor and rural local governments is R1,8 billion.

The formula for distributing the equitable share between municipalities comprises a municipal basic services transfer and a municipal institutional transfer. The basic services component enables poor municipalities to deliver basic municipal services to households, while the institutional component provides support to those municipalities that lack administrative capacity and basic infrastructure.

In addition to the equitable share, local government will receive conditional grants for providing infrastructure, water and commuter transport subsidies. The baseline allocations for these grants are reflected in Table E14. The grants have been restructured to better serve the needs of municipalities. In particular, two new grants have been introduced.

The financial management grant assists the metropolitan, district, and large category B municipalities to build capacity for financial planning and budgeting. The grant will grow from R50 million in 2000/01 to R70 million in 2002/03. It will aid municipalities in developing financial reporting systems and budgeting procedures to link delivery of services to resource allocations. The salary increase for R293 staff are excluded from the totals, and will be allocated by provinces directly.

Table E14 Grants to local government

R million	1999/00	2000/01	2001/02	2002/03
	Revised estimate	Medium-term estimate		
Equitable share	1 673	1 867	1997	2130
Conditional grants	654	963	1 033	1 103
Agency payments and grants-in-kind	3 505	3 879	4 265	4 510
Total allocation	**5 832**	**6 709**	**7 295**	**7 743**