7

Provincial and local government

Introduction

Transfers made from the national budget

Transfers from the national Budget to provincial and local government are made in line with constitutional requirements. Both spheres receive an equitable share of nationally collected revenues to meet their expenditure responsibilities. The equitable shares are supplemented by conditional grants to fund specific functions in support of national priorities. Transfers to other spheres represent 60 per cent of non-interest expenditure on the national Budget.

Provinces are highly dependent on transfers from the national Budget since they raise less than 4 per cent of their revenues from own sources. Provinces spend some 85 per cent of their budgets on delivering social services. Local government, on the other hand, is largely self-funded and provides basic services, such as water and electricity, and infrastructure to households.

This chapter lays out the division of resources between and within the spheres of government and summarises projected spending trends over the next three years. In addition, it highlights developments in the intergovernmental system and, in particular, the implementation of budget reforms to enhance good governance. The reforms being implemented by provincial and local government support the broader path of public sector and budget reform laid out in other chapters of this *Budget Review.*

Transfers from national government

Dividing revenue between the spheres

The revised national budget framework for 2000/01 to 2002/03 is set out in Chapter 3. After provision for debt service costs and a contingency reserve to cater for unforeseen circumstances, the remaining revenues are shared between the three spheres as shown in Table 7.1. The division between the spheres is a political judgement that takes into account the relative priority of the functions of each sphere and its ability to raise revenue. The division of revenue is discussed in more detail in Annexure E. The provincial and local equitable shares for 2000/01 are higher than the baseline indicated in the 1999 Budget, as a result of a stronger fiscal position.

Provincial equitable share

The Constitution entitles provinces to an equitable share of nationally raised revenues, since their revenue sources are insufficient to fund the expenditure responsibilities allocated to them. The provincial equitable share is further subdivided among the nine provinces, using an objective formula that, in conjunction with 3-year allocations, introduces greater certainty in provincial revenue flows. This in turn facilitates better planning for expenditure. The equitable shares by province are shown in Table 7.2.

Table 7.1 The division of revenue between the spheres of government

	1998/99	1999/00	2000/01		2001/02	2002/03
R million	**Actual**	**Revised estimate**	**1999 Budget[1]**	**2000 Budget**	**Medium-term estimate**	
National allocation[2,3]	64 115	68 999	70 739	76 095	83 107	87 384
Provincial allocation[2]	92 594	99 376	103 433	106 037	111 810	117 057
Equitable share[4]	80 802	86 595	92 071	94 408	100 167	105 158
Conditional grants	11 792	12 781	11 362	11 629	11 643	11 899
Local government allocation	2 156	2 327	2 480	2 830	3 030	3 233
Equitable share	1 024	1 673	2 480	1 867	1 997	2 130
Conditional grants	1 132	654		963	1 033	1 103
Total to be shared	**158 865**	**170 702**	**176 652**	**184 963**	**197 947**	**207 674**

1. Includes transfer to skills funds in the national allocation consistent with its treatment in the 2000 Budget.
2. Adjusted to include housing subsidies in the provincial allocation and remove them from the national allocation.
3. The national allocation excludes conditional grants that have been allocated to provincial and local government.
4. The equitable share includes provincial improvements in conditions of service.

Components of the formula

The equitable share formula comprises six components, the calculations of which are explained in detail in Annexure E. The specific components attempt to capture the relative demand for services between provinces and to adjust for particular provincial circumstances, such as infrastructure backlogs and poverty levels. The components are summarised below, with the share of each component given in brackets:

- an education share (41 per cent) based on the average school-age population (ages 6–17) and the number of learners in schools
- a health share (19 per cent) based on the proportion of the population without access to medical aid funding
- a social security component (17 per cent) based on the estimated number of people entitled to social security grants – the elderly, disabled and children – weighted using a poverty index derived from the 1995 Income and Expenditure Survey
- a basic share (7 per cent) derived from each province's share of the total population of the country
- a backlog component (3 per cent) based on the distribution of capital needs as captured in the schools register of needs, the audit of hospital facilities and the share of the rural population
- an economic output share (8 per cent) based on the distribution of total remuneration in the country
- an institutional component (5 per cent) divided equally among the provinces to reflect the costs of running a provincial government.

Updating the formula

Compared with last year, when the equitable shares formula was updated to reflect new demographic data from the census, only minor adjustments were made this year. Revised data on a comparable basis were available only for the economic shares component, which was updated accordingly. In addition, based on expenditure trends for the past three years, the weightings of the education and health components were increased by one percentage point, with a balancing reduction in the weight of the basic share. These changes and their impact on the provincial distributions are discussed in more detail in Annexure E.

Table 7.2 Provincial equitable shares

	1998/99	1999/00	2000/01		2001/02	2002/03
R million	**Outcome[1,2]**	**Revised estimate[2]**	**1999 Budget**	**2000 Budget**	**Medium-term estimate**	
Eastern Cape	14 492	15 238	16 015	16 452	17 280	17 956
Free State	5 610	5 918	6 243	6 408	6 750	7 036
Gauteng	12 077	12 932	13 943	14 235	15 244	16 152
KwaZulu-Natal	15 979	17 169	18 461	18 894	20 233	21 435
Mpumalanga	5 367	5 790	6 265	6 423	6 931	7 398
Northern Cape	2 012	2 131	2 257	2 302	2 436	2 551
Northern Province	10 773	11 506	12 257	12 626	13 476	14 231
North West	7 033	7 412	7 801	8 009	8 427	8 773
Western Cape	8 199	8 499	8 830	9 059	9 390	9 625
Total	**81 542**	**86 595**	**92 071**	**94 408**	**100 167**	**105 158**

1. Excludes R741 million recovered from pension funds in 1998/99.

2. The estimates for 1998/99 and 1999/00 include actual expenditure on improvements in conditions of service.

Moving towards equity

Provinces have differing demographic profiles, markedly different levels of economic development and significant variations in socio-economic circumstances. Although the equitable share formula is highly redistributive, its implementation has been phased in to minimise disruptions in services where the target provincial shares differ markedly from current resource allocations. Figure 7.1 shows the per capita allocations for each province compared with the national average for 1997/98, 2000/01 and 2003/04 when the formula will be fully phased in.

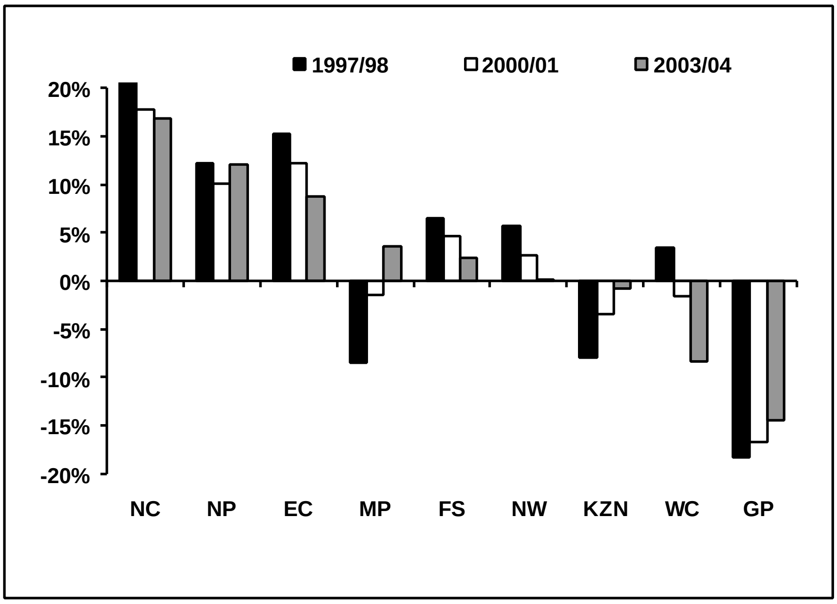
Conditional grants

The Constitution provides for allocations from the national equitable share to provincial and local government with, or without, conditions. These allocations may be either conditional grants or agency payments, depending on the nature of the project to be funded.

Differentiating between conditional grants and agency payments

A conditional grant is voted as expenditure in the national budget and is recorded as revenue in the provincial or local government accounts. The national department is responsible for monitoring compliance with the conditions of the grant, while the province is accountable for the actual expenditure of the funds. Agency payments are grants made to provinces and municipalities to reimburse them for services provided on behalf of national government.

Figure 7.1 Equitable share per capita, per cent above or below national average



Grants to fund national priorities

The primary purposes of conditional grants are to support compliance with national norms and standards, to compensate provinces for providing services that may extend beyond provincial boundaries and to enable national priorities to be adequately provided for in subnational budgets. Changes to conditional grants in 1999/00 and projected grants for the next three years are summarised in Table 7.3.

Revisions to 1999/00

Table 7.3 shows estimated conditional grant transfers of R13,4 billion in 1999/00, compared with a budgeted figure of R11,6 billion. The difference results from the net effect of three factors: new grants identified in the Adjustments Estimate, rollovers of 1998/99 grants and projected underspending of grants. A total of R544 million was rolled over from 1998/99, of which R393 million was in health conditional grants. In particular, R241 million was rolled over to reimburse provinces for spending in 1998/99 on the integrated nutrition programme. The Adjustments Estimate also included R1,7 billion in new conditional grants. Finally, departments estimate that about R485 million of available grant funds will not be transferred in 1999/00, with the largest portion in the area of health capital investment.

Health grants

The cluster of health grants comprises 48 per cent by value of the total grants to provinces over the medium-term expenditure framework. The two largest health grants fund specialist tertiary services in central hospitals, research activities and the training of health professionals. At present the central health grant, which flows to five provinces, constitutes more than half of the total health grants. The rehabilitation and redistribution grants, totalling R576 million in 2000/01, support the development and maintenance of provincial hospitals. In particular, the redistribution grant is intended to fund the development of tertiary service capacity in five provinces to reduce the burden on the existing academic hospitals. The integrated nutrition grant (previously known as the primary school nutrition programme) continues to fund projects providing assistance for undernourished children.

Supporting quality enhancement in education

The Department of Education provides R202 million in 2000/01 to support quality enhancement and to improve the performance of the school system. The allocation of the grant among provinces is redistributive, channelling more funds to those provinces with large backlogs.

Strengthening provincial budget practice

The Department of Finance manages the finance supplementary grant, set at R2,2 billion in 2000/01. The conditions attached to it support best practice in provincial budgeting. These include that adequate provision must be made for social service spending and that budgets must reflect efforts to improve own revenue collections. Treasuries must also comply with generally recognised financial management practices and all norms and standards set by the national treasury. The supplementary grant is budgeted to decline to R2,0 billion over the next three years.

Grants to fund the construction of a legislature building in Northern Cape (R69 million) and to support the reduction of outstanding provincial debts (R1,4 billion) were provided in the 1999/00 Adjustments Estimates. These allocations are not recurrent grants. A new grant for the provision of infrastructure has been introduced in 2000/01, and will provide R300 million to supplement provincial infrastructure commitments.

Funding low-income housing

The national Department of Housing makes R3 billion available through the South African Housing Fund to provide subsidies for low-cost housing. The conversion of the housing subsidies from an agency payment to a conditional grant in 2000/01 accounts for a large proportion of the increase in conditional grants over the baseline reported in the 1999 *Medium Term Budget Policy Statement.*

Provinces receive some grants that are channelled to local government, the most significant of which is the allocation to fund the salary costs of personnel from R293 towns. As part of the process to make transfers directly to municipalities from national government, some of these grants will be redirected over the next three years. All allocations to local government are discussed in more detail in the last section of this chapter.

Transfers to provinces

Transfers to provinces in the 2000 Budget

Table 7.4 shows the total transfers, including equitable share and conditional grants, to each province over the period 1999/00 to 2002/03. Table 7.5 provides a breakdown of the transfers for 2000/01, which shows the impact of the large conditional grants on the distribution of total transfers. In health, for example, the central hospitals grant favours Gauteng, KwaZulu-Natal, Free state and Western Cape. In 2000/01 the equitable share, which includes funds to cover the cost of improvements in conditions of service, represents about 86 per cent of provincial revenue, while conditional grants equal 10 per cent and own revenue contributes about 4 per cent.

Table 7.3 Conditional grants to provinces

R million	1999/00 Budget[1]	1999/00 Revised estimate[2]	2000/01 Budget	2001/02 Medium-term estimate	2002/03 Medium-term estimate
Health					
Central hospitals	3 075	3 075	3 112	3 221	3 350
Training and research	1 118	1 118	1 174	1 215	1 264
Redistribution of specialised services	112	78	176	182	189
Hospital rehabilitation	200	160	400	500	520
Durban and Umtata hospitals	311	336	273	103	
Integrated Nutrition Programme	555	708	582	582	582
Finance					
Contingency grant for debt relief	–	1 420	–	–	–
Supplementary grant	2 500	2 500	2 212	2 000	2000
Northern Cape Legislature	–	69	–	–	–
Infrastructure grant	–	–	300	300	300
Education					
Financial management and quality enhancement	111	192	202	213	224
Housing					
Housing Fund[3]	2 876	2 876	3 001	3 177	3 320
Capacity building	10	10	10	10	10
Urban development	–	–	20	–	–
Hostels development	–	15	–	–	–
State Expenditure: Financial management	20	31	100	140	140
Welfare and Population Development					
Financial management	50	37	50	–	–
Victim empowerment	–	3	–	–	–
Child support	–	17	17	–	–
KwaZulu-Natal Peace Initiative	–	80	–	–	–
Labour: Training centres	56	56	–	–	–
Subtotal	**10 994**	**12 781**	**11 629**	**11 643**	**11 899**
Grants to provinces for local government					
R293 staff	463	463	463	463	463
R293 transfer costs	40	40	–	–	–
Local government support	140	137	150	160	170
Land development support objectives[4]	–	14	–	–	–
Subtotal	**643**	**654**	**613**	**623**	**633**
Total conditional grants	**11 637**	**13 435**	**12 242**	**12 266**	**12 532**

1. *For some grants, amounts were either retained at the national level or the distribution between national government and provinces had not been determined at the time of the Budget. The total amount of the grants is reflected here.*
2. *Compared with the 1999 Budget estimates, the revised amounts reflect new grants and rollovers of 1998/99 grants allocated in the Adjustments Estimate, reduced by the amounts projected not to be transferred in 1999/00.*
3. *Housing subsidies were an agency payment in 1999/00, but are shown as a conditional grant in the table to be consistent with their treatment in the 2000 Budget.*
4. *Although funds have been allocated on the Land Affairs vote for land development objectives over the MTEF period, the appropriate transfer mechanism for the funds is still under discussion. Therefore, they have been excluded from the table.*

Implementation of conditional grants

Conditional grants were introduced in 1998/99 to meet particular needs, but without a comprehensive framework for planning and managing the grants in the budget cycle. As a result several teething problems have emerged, both practical and policy-related, with the administration of conditional grants.

Over the past two years, significant underspending of certain conditional grants resulted in rollovers. These rollovers reflect not only a lack of experience with administering such grants but also insufficient capacity at both the national and provincial levels to monitor and implement these programmes. Within national departments, conditional grants have been insufficiently integrated with strategic planning and budget processes. The roles and responsibilities of national departments and grant recipients have often been unclear, further complicating grant management.

Provincial cash flows, and ultimately service delivery, have been disrupted by delays in the allocation and transfer of some grants. In particular, recurrent grants that are paid only on proof of expenditure have proved problematic. With grants for capital projects, delays in provincial tender processes have held up the disbursement of funds. A failure to make provincial allocations of some grants sufficiently in advance has further compromised the ability of provinces to plan and budget for grants and their associated services.

To address these problems a policy framework is being developed for conditional grants in accordance with the long-term view of intergovernmental fiscal arrangements. Once the framework is agreed by stakeholders, guidelines for future processes will be developed for national departments and provincial treasuries.

Table 7.4 Total transfers to provinces

	1998/99	1999/00	2000/01	2001/02	2002/03
R million	Outcome	Revised estimate	Budget	Medium-term estimate	
Eastern Cape	15 923	16 820	17 784	18 490	19 202
Free State	6 630	6 895	7 265	7 532	7 844
Gauteng	15 297	16 344	17 206	18 333	19 361
KwaZulu-Natal	18 739	19 831	21 128	22 171	23 326
Mpumalanga	5 876	6 383	6 993	7 428	7 910
Northern Cape	2 189	2 425	2 482	2 601	2 721
Northern Province	11 732	12 629	13 694	14 415	15 192
North West	7 721	8 204	8 667	9 011	9 364
Western Cape	10 115	10 548	10 841	11 199	11 497
Unallocated[1]	204	-49	590	1 255	1 272
Total	**94 467**	**100 030**	**106 650**	**112 433**	**117 690**

1. Reflects amounts that have not been allocated by province. The amounts in 1998/99 and 1999/00 are adjustments related to the housing subsidies, which have been included in the provincial totals.

Trends in provincial transfers

As shown in Table 7.6, between 1999/00 and 2002/03 transfers to provinces grow at an average annual rate of 5,6 per cent. However, the equitable share grows faster than the conditional grants. The 8,9 per cent decline in conditional grants in 2000/01 is primarily attributable to the non-recurrent grants provided in the 1999/00 Adjustments Estimate, such as the R1,4 billion to reduce provincial liabilities. Slow growth in the outer years reflects the discontinuation of some grants and the levelling off of others. In contrast, the equitable share grows by 9,0 per cent in 2000/01 and is projected to increase faster than inflation in the following two years. Growth in provincial own revenue, discussed in more detail below, improves over the medium term.

Table 7.5 Transfers to provinces, 2000/01

R million	Equitable share	Conditional grants: Health	Finance	Housing	Local Govt	Other[1]	Total
Eastern Cape	16 452	260	390	522	60	47	17 784
Free State	6 408	385	148	234	68	14	7 265
Gauteng	14 235	2 120	322	516	0	27	17 206
KwaZulu-Natal	18 894	1 028	451	558	143	53	21 128
Mpumalanga	6 423	98	153	223	36	15	6 993
Northern Cape	2 302	42	52	66	0	5	2 482
Northern Province	12 626	200	305	390	106	40	13 694
North West	8 009	103	186	265	50	18	8 667
Western Cape	9 059	1 306	206	247	0	20	10 841
Unallocated		176	300	10	150	130	590
Total	**94 408**	**5 717**	**2 512**	**3 031**	**613**	**369**	**106 650**

1. Includes education, welfare and state expenditure grants.

Table 7.6 Provincial revenue

	1999/00	2000/01	2001/02	2002/03
R million	**Revised estimate**		**Medium-term estimate**	
Transfers from national	100 030	106 650	112 433	117 690
Equitable share	86 595	94 408	100 167	105 158
Conditional grants	13 435	12 242	12 266	12 532
Own revenue	3 640	3 630	3 896	4 164
Total	**103 670**	**110 280**	**116 329**	**121 854**
Percentage growth				
Transfers from national	–	*6,6*	*5,4*	*4,7*
Equitable share	–	*9,0*	*6,1*	*5,0*
Conditional grants	–	*-8,9*	*0,2*	*2,2*
Own revenue	–	*-0,3*	*7,3*	*6,9*
Total	**–**	***6,4***	***5,5***	***4,7***

Provincial own revenue

Growth in own revenues

Own revenues represent between 2 and 6 per cent of provincial revenues. Although own revenues are projected to grow by about 7 per cent a year in 2001/02 and 2002/03, collections will nonetheless only reach 1996/97 levels, representing a significant real decline. The main sources of provincial own revenues are fees arising from the Road Traffic Act, hospital services and gambling. Part of the decline in own revenues results from structural shifts in the underlying sources, which are unlikely to be reversed. For example, hospital revenues dropped as patients with medical insurance moved to the private sector, and interest income declined as overdrafts were used to finance deficit spending in 1997/98.

Steps to improve collections

The Budget Council emphasised the need to boost current own revenue sources as a first step in increasing provincial revenues. Although provincial line departments, such as transport, health and the gambling boards, rather than provincial treasuries are responsible for the collection of major own revenue sources, provincial treasuries will coordinate the reform process. Current initiatives include the creation of dedicated revenue directorates within provincial treasuries, investments in information technology, recruitment of financial managers and the appointment of accountants-general in several provinces. Some provinces also introduced legislation to enhance the powers of treasuries to manage revenue collections.

Provincial budget estimates

Trends in provincial expenditure

The 1999 *Intergovernmental Fiscal Review* provides a historical review of provincial expenditure. Table 7.7 shows that total provincial expenditure is stabilised at more sustainable levels over the medium term and that expenditure has been brought in line with revenue.

Preliminary provincial estimates

Table 7.7 presents actual provincial revenue and expenditure for 1996/97 and 1997/98, revised estimates for 1998/99 and 1999/00, and projected estimates from 2000/01 to 2002/03. The figures for 1999/00 to 2002/03 are based on preliminary estimates provided by provincial treasuries as part of their budget preparation processes. The estimates are adapted for analytical and comparative purposes and to be consistent with the national budget estimates provided in other chapters of the 2000 *Budget Review.*

For instance, although housing subsidies will be voted in provincial budgets for the first time in 2000/01, the subsidy amounts for previous years are included in the provincial totals in Table 7.7 to facilitate year-on-year comparisons. Similarly, some shifting of the non-social services' functions occurred over the period. These are shown as separate items under "other functions". Other adjustments distribute funds that, at this stage, remain unallocated either to provinces by national departments or to provincial line departments by provincial treasuries. The surpluses reflected in the table indicate the financing of accumulated provincial debt, which often forms part of the contingency reserve in individual provincial budgets.

Restoring a balance in social services

Provincial budgets are dominated by social service expenditure; this limits provinces' ability to address their other functions. These include the maintenance of roads and other infrastructure, rural and provincial industrial development and tourism. Within the social services, personnel spending has tended to crowd out other expenditures, such as maintenance of public facilities and the provision of textbooks, medicines and development programmes. Overall, about three quarters of provincial budgets are consumed by personnel expenditure and social grants, both of which are centrally determined.

As detailed in the 1999 *Intergovernmental Fiscal Review,* spending on the social services grew faster than the rate of inflation and than total provincial expenditure between 1996/97 and 1998/99. After adjusting for function shifts, the share of social service spending is projected to fall from a peak of 83,3 per cent of provincial expenditure in 1999/00 to 82,4 per cent by 2002/03. This reflects more moderate growth in these sectors and a greater emphasis on other provincial functions. This stability in the social services is reflected in Figure 7.2.

Investing in infrastructure

The increase in social service spending over the past three years was partially accommodated by a reduction in planned capital spending. However, estimates of capital expenditure in the provincial medium term budgets suggest that provinces plan to increase investment in capital projects. Budgeted capital expenditure, which includes housing subsidies, increases by 21,8 per cent in 2000/01, with 6 per cent growth thereafter. This trend is also captured in Figure 7.2. The 8,6 per cent increase in non-social service spending for 1997/98 reflects a large rollover of housing funds from the previous year. The growth in non-social services excluding housing is around 2,0 per cent in 1997/98.

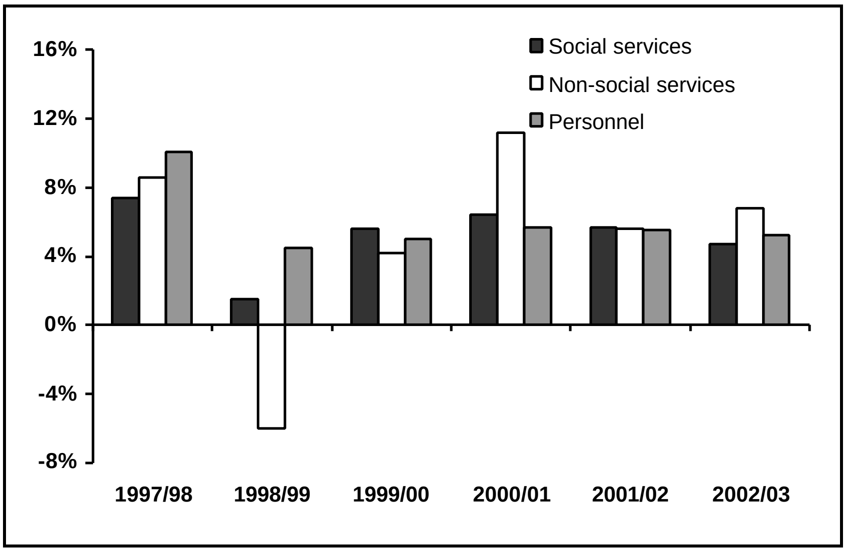
Table 7.7 Consolidated provincial expenditure

R million	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03
	Outcome	Outcome	Revised estimate	Revised estimate	Medium-term estimate		
Education	36 606	38 570	38 649	40 548	43 043	45 531	47 978
Health	20 640	22 376	22 877	24 465	26 223	27 909	29 221
Welfare	15 938	17 669	18 274	19 239	20 398	21 293	21 942
Other functions							
Inherited debt[1]	1 998	–	–	–	–	–	–
Local govt transfers	2 238	1 999	1 132	654	613	623	633
Contingency reserve	–	–	–	–	269	349	417
All other	15 844	17 200	16 168	16 844	18 729	19 769	21 106
Total expenditure	**93 264**	**97 815**	**97 100**	**101 750**	**109 275**	**115 474**	**121 296**
Total revenue	**89 774**	**91 999**	**97 841**	**103 670**	**110 280**	**116 329**	**121 854**
Surplus/(deficit)	**(3 490)**	**(5 815)**	**740**	**1 919**	**1 004**	**855**	**558**
Addendum:							
Total adjusted expenditure[2]	89 028	95 816	95 968	101 0096	108 393	114 502	120 246
Current	82 886	88 232	88 974	94 119	99 917	105 093	110 408
Personnel	49 464	54 462	56 914	59 762	63 159	66 617	70 107
Capital	6 162	7 584	6 994	6 977	8 476	9 409	9 838
Percentage growth in adjusted expenditure							
Personnel	–	*10,1*	*4,5*	*5,0*	*5,7*	*5,5*	*5,2*
Other current	–	*1,1*	*-5,1*	*7,2*	*7,0*	*4,7*	*4,7*
Capital	–	*23,1*	*-7,8*	*-0,2*	*21,5*	*11,0*	*4,6*

1. Payment of interest on debts inherited by provinces that were later assumed by national government.

2. Inherited debt, local government transfers and the contingency reserves have been deducted from total provincial spending.

Figure 7.2 Growth in categories of adjusted spending

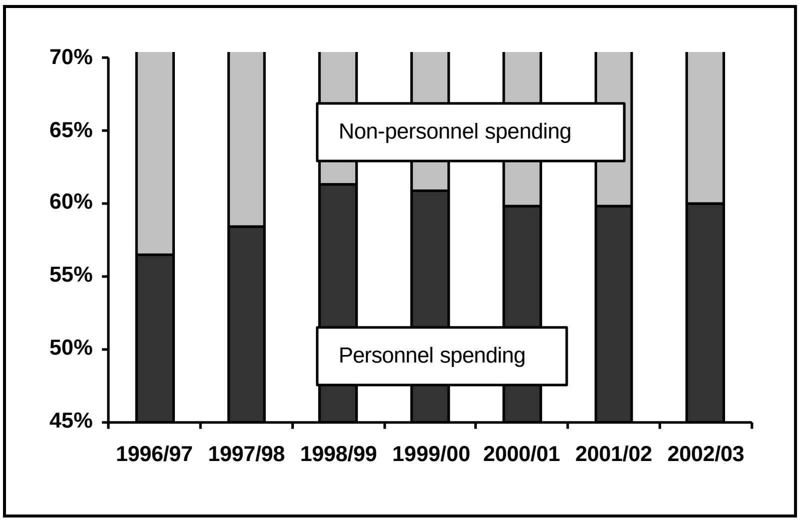


The moderate growth in social service budgets partly reflects slower growth in personnel expenditure. Personnel costs are projected to grow by approximately 5,5 per cent per year over the medium term, and these estimates assume salary increases in line with inflation. As a result, personnel spending is projected to decline slightly to around 58 per cent of adjusted expenditure over the medium term, as shown in Figure 7.3. Despite this improvement in personnel budgets, anticipated growth in the child support and other social security grants could put the provincial social services budgets under pressure.

Budgeting for personnel

In the past, Government budgeted for public service salaries in the Improvements in Conditions of Service vote. Salary negotiations took place in July and the provincial shares of the vote were distributed in the Adjustments Estimate. From the 2000 Budget, provincial equitable share allocations include estimates of expenditure on salaries and benefits. Changing the way in which provinces budget for personnel does not reflect a shift away from collective bargaining in the public sector.

Figure 7.3 Trends in personnel spending



Managing provincial liabilities

In the 1998/99 and 1999/00 Adjustments Estimates, provinces received an additional R1,0 billion and R1,4 billion, respectively, to address outstanding liabilities accumulated after 1995/96. These additional funds are largely reflected in the budget surpluses of R0,7 billion and R1,9 billion in those two years, as these surpluses were used to eliminate debts and build reserves. As a condition for receiving these funds, provinces agreed to budget for the further reduction of remaining liabilities over the medium term. In line with this agreement, Table 7.7 shows combined provincial surpluses totalling R2,4 billion over the 3-year budget period. In addition, provinces made provision for other outstanding liabilities, largely payments in arrears. This raises the total debt reduction in provincial budgets to about R3 billion over the medium term.

Reforms to the intergovernmental system

Adopting a gradual managed approach

The evolution of the intergovernmental fiscal system is shaped by political, historical and demographic influences, the interdependence of the three spheres, constitutional parameters and South Africa's social and developmental challenges. Although some of these factors will become less influential in time, others are structural and likely to endure. The future development of the intergovernmental fiscal system must be managed, with the consideration of these factors, to maintain the integrity of the system as a whole. This approach was endorsed by the Select Committee on Finance in the National Council of Provinces (NCOP) in its report on the *1999 Intergovernmental Fiscal Review.* It noted that "South Africa is both a unitary and a developing country" and that "the question of fiscal federalism must be viewed within these paradigms".

Lessons from international experience

International experience, particularly in other developing countries, supports Government's managed approach. Fiscal decentralisation can offer significant gains under the right conditions, but it can also accentuate inequalities and compromise macroeconomic stability. Responsibilities must be devolved in the correct sequence and at an appropriate pace to maximise the gains from a multi-sphered system of governance.

Provincial taxation issues

Introducing new sources of revenue

The Constitution provides for independent provincial taxes, surcharges on national taxes and user charges and fees. Under the right conditions, expanding provincial taxing powers could give provinces more flexibility to adjust the mix of services in response to the needs of citizens. Assigning new taxes to the provinces is, however, neither a prerequisite nor a guarantee of responsiveness to needs or of accountability and efficiency in spending. Any further expansion of tax powers must be supported by effective processes for administration, collection and monitoring. It must occur within the boundaries of the national tax reform process, and economic and administrative constraints.

Constraints on provincial taxes

While the equitable share formula is strongly redistributive, tax revenues would flow to those provinces where economic activity is concentrated. The uneven distribution of income across the provinces, capacity constraints within SARS and national policy considerations require that revenue assignment must be an evolutionary process that adapts as the intergovernmental system evolves.

Wide-ranging support for a gradual approach

Cabinet and the Budget Council endorsed a gradual approach to extending the taxation powers of provinces, as recommended by the Katz Commission. A provincial surcharge on personal income tax was rejected as a viable option in the medium term.

National regulation of provincial taxes

National regulation of provincial taxes, in terms of the Constitution, will require proposed provincial taxes to be reviewed for consistency with national economic and tax policy, including the tax-GDP ratio. If an appropriate tax option is approved by the Minister of Finance, it would be available for individual provinces to implement. The list of allowed taxes would be expanded gradually, as appropriate. More technical work is necessary to identify possible candidates for the initial list and to determine the appropriate legislative and regulatory processes. The Department of Finance is undertaking this research and a draft national framework on provincial taxation should be in place for 2001/02.

Strengthening institutional arrangements

Expanding political involvement

Inadequate political participation in the budget process weakens a government's ability to set priorities and pursue policy goals through its budget. Securing wider involvement by political office bearers remains one of the key challenges facing provincial budgeting. Some provinces have mirrored the national government by establishing a subcommittee of the executive council to deal with budget issues and oversee the budget process.

Commitment to cooperative governance

The success of the constitutional principle of cooperative governance is reflected in the stronger fiscal position of the provinces and closer alignment between fiscal flows and strategic objectives. A primary role of intergovernmental institutions, such as sectoral forums, is to align national policy goals with provincial budgets and planning.

Establishing intergovernmental institutions

A MinMEC is a forum where national ministers and provincial MECs discuss policy issues. The finance MinMEC, known as the Budget Council, was established in terms of the Intergovernmental Fiscal Relations Act of 1997. Joint MinMECs, where the Budget Council meets with other sectoral MinMECs, address both budget and policy issues. The MinMECs play a crucial role in increasing political oversight over both the policy planning and budgeting processes.

Extending sectoral co-ordination

Technical committees (known as 4x4s, as explained in Chapter 6) were established in 1998 to support the policy coordination process in the social services and provide inputs into the Budget Council and the Joint MinMECs. These deal with issues such as managing transformation, developing coherent policy within sectors and norms and standards for service delivery. They analyse the impact of policy choices on budget decisions, identify cost pressures and investigate alternative service delivery methods without compromising affordability. Each committee includes representation from national and provincial treasuries, and the relevant line departments. Transport and public works committees were introduced last year and others are planned for infrastructure and personnel.

Emphasising service delivery

Focus on innovation and delivery

Government is held accountable both for the level of resources it manages and for the mix and quality of public services provided with these resources. The Budget Council resolved to emphasise innovation in the delivery of services and improved financial management over the medium term. This will ensure value for money and improve the collection of current sources of own revenue.

Service delivery indicators

The introduction of service delivery indicators in the social service sectors should highlight the effectiveness of spending and provide a benchmark against which to assess future budgets. To this end, the *National Expenditure Survey* provides information on the desired policy goals and expected outcomes for national departments. The technical committees for social services are developing delivery indicators for provinces. By emphasising performance and the achievement of policy outcomes as the standard for success, budgeting will promote efficient and effective use of public funds.

Local government finance

Supporting municipal transition

The costs of local government transition

Local government is in the final stage of the transition outlined during the constitutional negotiations in 1993. It is being reshaped to fulfil new mandates, improve its performance and serve more effectively as an instrument of democracy. In terms of the 1998 White Paper on Local Government, this transition entails the redemarcation of municipal boundaries, the implementation of the Municipal Structures Act and the reorientation of local governments' focus. The Local Government Finance Management Bill, the Property Rating Bill and more stringent accounting and reporting standards will reform the finances of local government. Pilot projects to modernise municipal budget systems and formats are being introduced in 2000.

This transition process will be challenging for many municipalities. In particular, many municipalities face financial problems due to poor management and cumbersome administrative and budget systems, inefficient service delivery, disproportionate wage bills and high levels of poverty among residents. The allocations for local government in the Budget take these trends into account and reflect a concerted attempt by national Government to support the transformation of the local sphere

Grants to local government

Local government has significant capacity to raise its own revenue. Grants from national government, including the equitable share and conditional grants, comprise about 7 per cent of the projected R58 billion local government budget in the municipal financial year 1999-00. The local government financial year is from 1 July 1999 to 30 June 2000 – denoted here as 1999-00 – as opposed to the national and provincial 1999/00 year, which covers the period from April to March.

MTEF allocation and growth limits

The national medium-term estimates provide for an increase in the allocation to local government from R5,8 billion in 1999/00 to R6,7 billion in 2001/02, rising to R 7,7 billion in 2002/03.

In the interests of macroeconomic stability and fiscal prudence, municipalities are required to ensure that their budgets fall within guideline growth limits set by the Minister of Finance. For 1999-00 this limit was set at 5,5 per cent for both capital and operating expenditure, excluding capital expenditure funded by grants and subsidies from other spheres of government. For 2000-01 the limit is 5 per cent growth. These limits should promote more realistic revenue and expenditure projections and maintain fiscal discipline during the transition and transformation process.

Table 7.8 National transfers to local government[1]

R million	1999/00	2000/01	2001/02	2002/03
Equitable share formula	1 673	1 867	1 997	2 130
Conditional grants				
R293 personnel[2]	463	463	463	463
R293 transfer	40	0	0	0
LG support grant	137	150	160	170
Land development objectives[3]	14			
Restructuring grant	0	300	350	400
Financial management	0	50	60	70
Subtotal conditional grants	**654**	**963**	**1 033**	**1 103**
CMIP	696	883	994	1 059
Community-based public works	274	274	274	274
Community water & sanitation (capital)	429	609	744	807
Community water & sanitation (operating)	710	704	731	741
Spatial development initiatives	103	0	0	0
Bus subsidies	1 293	1 409	1 522	1 629
Subtotal agency payments	**3 505**	**3 879**	**4 265**	**4 510**
Total	**5 832**	**6 709[2]**	**7 295**	**7 743**

1. Excludes other grants-in-kind such as R702 million for operating subsidies from Water Affairs.

2. Excludes salary increases for R293 personnel.

3. Although funds are allocated on the Land Affairs vote for land development objectives over the MTEF period, the appropriate transfer mechanism for the funds is still under discussion.

Equitable share

For 2000/01, the local government equitable share allocation will be R1 867 million; in 2001/02 it will be R1 997 million and in 2002/03 R2 130 million. Distributed by formula, it will continue to facilitate a more equitable distribution of resources among local governments.

The current fiscal framework is being reviewed in light of the major impact of municipal demarcation. The equitable share must enable local government to provide basic services to poor households. Any changes to the equitable share formula will be phased in to avoid destabilising municipal finances.

New conditional grants

The 2000 Budget provides for two new conditional grants. A restructuring grant will assist eligible municipalities whose financial difficulties pose a significant threat to national economic development. The grant will be funded from the additional local government allocation in the 2000 Budget. The total envelope for the restructuring grant will be R300 million in 2000/01, R350 million in 2001/02 and R400 million in 2002/03.

The second new grant is to build financial management capacity. The first stage of this programme will focus on the financial management capacity of the metropolitan authorities, district councils and large primary municipalities, as well as the implementation of impending budget reforms. The second stage will focus on planning and performance management capabilities. The proposed allocation is R50 million for 2000/01, R60 million for 2001/02 and R70 million for 2002/03. Discussions are underway to incorporate the Land Development Objectives (LDO) allocations into this grant.

R293 grants

R293 towns are those towns that were serviced by former bantustan governments in terms of Proclamation No. R293 of 1962. In 1994, these functions and personnel were transferred to the appropriate province. The Transfer of Staff to Municipalities Act was passed in 1998 with the intention of transferring the municipal functions of these towns, as well as the corresponding personnel, to the relevant new municipalities. The aim was to consolidate the integration of these towns into the mainstream system of governance in post-apartheid South Africa.

R951 million was allocated in 1998/99 to fund the personnel – approximately 14 000 employees – and other service commitments of these towns. Initially in provincial budgets, the understanding was that these funds would be transferred to the relevant municipalities as the personnel and functions were shifted. They were eventually to be included in the local government equitable share.

In 1999/00 the funds were split into three separate grants:

- A R293 personnel grant to provinces to pay for the salaries of staff that render municipal services (R463 million)
- A R293 functions grant to local governments to fund services such as electricity and water for these towns (R447 million)
- A R293 transfer incentive grant (R40 million) to encourage the transfer of staff to local governments.

In view of the slow progress to date, Government has set 31 August 2000 as the cut-off date for transferring personnel. Local governments that have accepted R293 personnel before then will receive a commensurate share of the R293 personnel grant for the next three years and a once-off share of the R293 transfer incentive grant. It is expected that about 8 400 of the 14 000 staff will be transferred by the cut-off date.

Personnel not transferred will be included in the permanent establishment of the relevant province. A corresponding portion of the R293 personnel grant of R463 million will be allocated to them as a separate conditional grant. Thereafter the R293 personnel grant will be incorporated into the provincial and local equitable shares in proportion to the personnel distribution as at 31 August 2000.

The transfer incentive grant of R40 million and the R293 function component of R447 million will be incorporated into the local government equitable share after 31 March 2000.

Other conditional grants

The local government support grant will be increased to R150 million in 2000/01, R160 million in 2001/02 and R170 million in 2002/03. It will fund a range of management support and capacity-building initiatives aimed at smaller municipalities and is administered by the Department of Provincial and Local Government.

Important ongoing programmes include the Consolidated Municipal Infrastructure Programme for basic infrastructure, the community based public works programme for job creation, and the land development objectives grant. These grants are determined through the normal national budget process.

Grant-in-kind-payments

The grant-in-kind payments include funds for the community water supply and sanitation programme (capital and operation) for rural areas and bus subsidies to assist low-income commuters.

Local government budgets

The Department of Finance collected information on the budgets of approximately 750 municipalities for the local government financial year, 1999-00. These budgets represent close to 99 per cent of all local government expenditure. They include both the general governing functions of municipalities and their role as water and electricity distributors.

Sources of revenue

Municipal operating budgets for 1999-00 total R44,4 billion, while R13,7 billion is budgeted for capital expenditure. Nearly R5,0 billion of capital expenditure will be financed through loans, and the remainder from other sources, including grants and subsidies from other spheres of government.

Municipalities are budgeting for income of R23,2 billion from electricity, water and sewerage charges in 1999-00. The bulk purchase of these services is expected to amount to R13,7 billion, yielding net revenues of R9,5 billion.

Operating income and expenditure

Bulk services comprise 52 per cent of total operating income budgets in 1999-00, property rates 19 per cent, regional levies 7 per cent, grants 4 per cent and other income (including fees and fines) 18 per cent.

Bulk services and salaries each comprise 31 per cent of total operating expenditure budgets in 1999-00, capital charges 13 per cent, general expenses (less reallocations) 12 per cent, repairs and maintenance 8 per cent and contributions to funds 5 per cent.

Selected local government budgets

The following is a list of the 1999-00 budgets for the major municipalities in the country. The regional services council levies, shown on the income side, comprise payroll and turnover taxes that accrue to metropolitan and district councils. Metropolitan and district councils receive these levies, which are then distributed to primary municipalities, largely for capital programmes.

Table 7.9 Operating income budgets of selected municipalities, 1999-00[1]

R million	Property tax	RSC levies	Bulk services	Grants and subsidies	Other (e.g. fees, fines)	Total
Johannesburg	1 661	696	1 683	91	2 830	6 961
Cape Town	1 462	500	3 411	163	1 317	6 853
Durban	1 083	270	2 610	213	1 409	5 585
Pretoria	921	264	1 538	225	1 851	4 799
Pietermaritzburg	176	–	436	64	120	796
Nelspruit	38	–	86	5	18	147
Potchefstroom	28	–	135	7	11	181
East London	109	–	339	77	83	608
Pietersburg	63	–	214	10	20	307
Kimberley	52	–	171	7	64	294
Bloemfontein	113	–	428	19	65	625
Port Elizabeth	236	–	867	36	160	1 299
Germiston	276	–	617	30	57	980
Total	**6 218**	**1 730**	**12 535**	**947**	**8 005**	**29 435**

Table 7.10 Operating expenditure budgets of selected municipalities, 1999-00[1]

R million	Salaries	Bulk services	General expenses	Repairs and main-tenance	Interest	Contri-bution to funds	Total
Johannesburg	1 959	2 681	210	310	1 008	652	6 820
Cape Town	2 272	1 376	1 653	406	936	211	6 854
Durban	1 825	1 638	241	681	1 098	96	5 579
Pretoria	1 637	1 515	35	679	851	175	4 892
Pietermaritzburg	267	270	14	61	109	62	783
Nelspruit	54	41	8	12	26	7	148
Potchefstroom	67	68	11	13	19	3	181
East London	232	158	37	48	106	27	608
Pietersburg	102	91	14	34	54	12	307
Kimberley	84	65	69	27	33	17	295
Bloemfontein	193	219	39	60	81	28	620
Port Elizabeth	476	347	76	145	191	66	1 301
Germiston	320	381	30	82	119	46	978
Total	**9 488**	**8 850**	**2 437**	**2 558**	**4 631**	**1 402**	**29 366**

1. In current budgeting practice, municipalities use different classifications for revenue and expenditures. In 2001 a uniform classification system will be introduced

Table 7.11 Capital budgets of selected municipalities, 1999-00

R million	Loans	Contribution from funds	District Council funds[1]	Funds for development projects	Grants and subsidies	Total
Johannesburg	95	7	0	16	188	306
Cape Town	1 338	60	143	80	440	2 061
Durban	902	14	12	34	470	1 432
Pretoria	440	107	62	0	0	609
Pietermaritzburg	100	3	20	41	20	184
Nelspruit	36	14	7	0	18	75
Potchefstroom	20	2	19	0	27	68
East London	120	3	25	30	54	232
Pietersburg	50	5	22	4	14	94
Kimberley	21	3	8	7	24	63
Bloemfontein	97	43	0	0	13	153
Port Elizabeth	116	1	16	14	109	256
Germiston	70	3	82	4	113	272
Total	**3 405**	**265**	**416**	**230**	**1 490**	**5 801**

1. District councils receive funds from RSC levies and distribute them to local councils for capital projects.

Conclusion

Dealing with transition

Post 1994, provincial and local government faced the challenge of accelerating service delivery while contending with large inherited backlogs, outdated systems and limited information bases. They have instituted significant reforms to address these challenges and put their finances on a firmer footing.

Provincial and local government play a pivotal role in realizing a better life for all. Transfers from the national budget promote redistribution, transformation and development within an affordable budget framework.