7

Provincial and local government

The financial management reforms instituted over the last four years have laid a strong foundation for consolidating public service delivery across all spheres of government.

In order to improve service delivery, provinces are now targeting spending on infrastructure rehabilitation, construction and maintenance. Challenges include enhancing the efficiency and effectiveness of spending in education and health, accelerating the take-up rate of the child support grant, and addressing backlogs in infrastructure and housing. Transfers to provinces grow by 7,5 per cent between 2000/01 and 2003/04.

Municipalities still face significant consolidation challenges, following the demarcation of new boundaries and resulting mergers. Their immediate task is to ensure the effective amalgamation of staff, assets and budgets, and the integration of systems, while maintaining and improving service delivery and expanding infrastructure. Local government transfers grow by 11,2 per cent over the MTEF period.

Introduction

The Constitution establishes three distinct spheres of Government. It identifies the responsibilities of each sphere and requires an intergovernmental fiscal system that meets these requirements. Local and provincial governments are responsible for delivering social and municipal services as well as a range of services that contribute to the economic and social well-being of South Africans.

Alignment of priorities with national objectives

Local and provincial government are instrumental in implementing Government's broad objectives. Local government, with support from the provincial and national spheres, will need to meet the additional challenge of giving effect to Government's commitment to providing free basic services

This chapter explains the division of revenue between the three spheres of government, highlighting changes to the forward estimates published in the 2000 Budget. It covers transfers and spending trends in provincial government, and deals with major financial trends in local government. It also provides budgetary information for selected municipalities.

Response to FFC proposals

Annexure E provides a detailed account of the formula used to divide resources between provinces, an explanation of the recommendations of the Financial and Fiscal Commission (FFC) on the division of revenue and the equitable share formula, and Government's response to those recommendations. The annexure also indicates how the local government equitable share formula will be adjusted, and provides detailed information on all conditional grants.

Policy framework

Development of the intergovernmental policy framework continues. Most of the legislative frameworks will be completed over the MTEF cycle.

New reforms set out in this budget include the extension of taxation powers to provinces, the phasing in of provincial borrowing for capital projects, the enhancement of municipal revenue raising powers, the phasing in of three year municipal budgets and ongoing reform of the conditional grant system.

Provincial taxation powers

Provinces have limited fiscal capacity at present. In order to enhance the taxation powers of provinces, Government will be tabling a Provincial Tax Regulation Bill. Taxation powers will be conferred in terms of a nationally determined framework, and a prescribed set of taxes. Although provinces will still require significant transfers of nationally raised revenue, the shifting of revenue-raising powers on a number of smaller taxes should help improve accountability.

Provincial borrowing powers for capital projects

Provincial borrowing powers for capital projects will also be phased in over the MTEF. The Budget Council is expected to approve a framework later in the year. The dependence of cost of borrowing on a strong credit-rating should provide a further incentive to improve the management of resources by provinces.

Municipal borrowing supported by tax and legislation reform

Although municipalities have the power to raise their own revenue and borrow capital, reforms in the design of current taxes and borrowing legislation should enable them to raise more resources for service delivery. These include pending legislation to reform property taxes and financial management, including obligations of lenders and borrowers. Such legislation should lead to the establishment of a municipal bond market in the long-term and, in the short-term, enable municipalities to secure longer-term project loans.

Phasing of three year municipal budgets

The municipal budgeting system is to be modernised, with the phasing in of three-year budgets. In the coming financial year, the local government equitable share and other conditional grants will be allocated to municipalities on a three-year basis, in order to facilitate the implementation of three-year budgets

Reform of the conditional grant system is ongoing, and is set out in the annual Division of Revenue Bill. These reforms are aimed at enhancing accountability and responsibility for the administration and reporting of conditional grants, and extending the best practice principles and reporting requirements of the PFMA to all transfers to the provincial and local sphere.

Reforms to conditional grants

New reforms to the conditional grant system to be introduced this year include measures to:

- Clarify objectives and improve design.
- Further clarify accountability arrangements.
- Reduce the administrative burden of grants.
- Regularise the updating of data on which the allocation process is based.

Further details are provided in the appendix attached to Annexure E.

Conditional grants replace agency payments

Agency payments are transfers from national departments that do not appear on provincial and municipal budgets. All agency payments are being phased out or converted into conditional grants to provinces. This year, only poverty-relief programmes are treated as agency payments.

Co-operation with the Auditor-General to ensure that accounting officers are held accountable for conditional grants will complement measures set out in the schedules to the 2001 Division of Revenue Bill.

In-year monitoring and financial management

Implementation of section 32 reports

In December, national departments and provinces submitted their third quarterly reports in terms of section 32 of the PFMA. Section 32 requires departments across government to report actual expenditure on a monthly and quarterly basis.

The section 32 reports serve a number of functions, among the most important of which are:

- To keep the Executive, Parliament and the public informed of developments and trends in spending across Government.
- To provide the basis for an assessment of the efficacy of cash flow management in spending agencies.
- To provides advance warning to Government on programmes that are disfunctional or underspending.

Section 32 reports require improvement

While the implementation of section 32 reports has been generally successful - with provinces and departments broadly complying with reporting requirements - there remains room for improvement in the quality of data and definitions.

Trends emerging from the section 32 report

The section 32 reports for December 2000 show that some provinces may underspend on their budgets by significant amounts in the current financial year. A large proportion of the underspending could occur in infrastructure programmes funded through conditional grants or provincial reserves. This is partly due to long lead-time for capital projects and delays in the preparation and finalisation of plans and allocation of funds to projects. A policy review of conditional grants has been undertaken by the Treasury and will inform policy changes in this regard.

Division of revenue

The division of revenue between spheres is determined by Cabinet, and follows a process of extensive consultation. This process involves the Budget Council and Budget Forum, which includes the Minister of Finance, MECs responsible for Finance and organised local government, the Ministers' Committee on the Budget, and the constitutionally independent FFC. This year, for the first time, an intergovernmental Division of Revenue workshop also helped shape the recommendations.

Table 7.1 sets out the division of revenue between spheres, and the revisions to the forward estimates published in the 2000 Budget.

It reflects the following considerations:

- The importance of investing in the construction, rehabilitation and maintenance of infrastructure.
- The need to support the social services sector in coping with the impact of HIV/Aids, and in managing the increased take-up of the child support grant.
- The cost implications of consolidating newly demarcated municipalities
- The need to reinforce the provision of basic services and programmes aimed at overcoming poverty.

Table 7.1 The division of revenue between the spheres of government

	1999/00	2000/01		2001/02	2002/03	2003/04
R million	**Actual**	**Budget[1]**	**Revised estimate**	**Budget**	**Medium-term estimate**	
National allocation[2]	66 154	75 212	74 414	84 286	89 954	95 432
Provincial allocation	99 032	106 037	108 736	117 387	126 564	135 221
Equitable share	*86 595*	*94 408*	*96 186*	*104 136*	*112 560*	*120 215*
Conditional grants	*12 437*	*11 629*	*12 551*	*13 251*	*14 004*	*15 006*
Local government allocation	4 419	3 713	5 712	6 506	7 155	7 849
Equitable share	*2 136*	*2 330*	*2 330*	*2 618*	*3 002*	*3 551*
Conditional grants	*2 243*	*1 383*	*3 382*	*3 888*	*4 153*	*4 298*
Allocated expenditure[3]	**169 605**	**184 962**	**188 863**	**208 180**	**223 672**	**238 502**
Percentage shares						
National	*39,0%*	*40,7%*	*39,4%*	*40,5%*	*40,2%*	*40,0%*
Provinces	*58,4%*	*57,3%*	*57,6%*	*56,4%*	*56,6%*	*56,7%*
Local government	*2,6%*	*2,0%*	*3,0%*	*3,1%*	*3,2%*	*3,3%*

1. *For comparative purposes, local government transfers have been shifted from provincial share to the local government share*
2. *Excludes transfer to Umsobomvu Fund of R855 million*
3. *Excludes the contingency reserve for the period 2001/02 to 2003/04, which remain unallocated at this stage*

Revised framework

Revisions to the 2000 budget framework

Revisions to the 2000/01 expenditure envelope were approved by Parliament in the 2000 Adjustments Estimates, and provide for R3,9 billion additional expenditure. Of this additional expenditure, R1,5 billion was allocated to national departments, R2,3 billion to the provinces and R100 million to local government.

The revised national budget framework provides for total additional spending of R10,2 billion in 2001/02 and R16,0 billion in 2002/03, over the forward estimates published in the 2000 Budget Review.

Significant real growth in spending

With the revisions to the forward estimates, set out above, total government spending, after providing for debt service costs and the contingency reserve, increases by 10,2 per cent between 2000/01 and 2001/02, from R188,9 billion to R208,2 billion. Over the period of the MTEF it is projected to grow at an annual average rate of 8,1 per cent.

Slight shift in allocation of resources

Consistent with the expanded role of local government, the local government share increases from 2,6 per cent in 1999/00 to 3,1 per cent in 2001/02, as shown in Table 7.1.

Provincial government finance

Provincial government finance comprises transfers from national government to the provincial sphere, and provincial own revenue.

Table 7.2 sets out the components of provincial revenue from 2000/01 to 2003/04.

Table 7.2 Provincial revenue

	2000/01		2001/02	2002/03	2003/04
R million	**Budget**	**Revised estimate**	**Budget**	**Medium-term estimate**	
Transfer from national	106 037	108 736	117 387	126 564	135 221
Equitable share	*94 408*	*96 186*	*104 136*	*112 560*	*120 215*
Conditional grants	*11 629*	*12 551*	*13 251*	*14 004*	*15 006*
Own revenue	3 630	3 742	3 957	4 262	4 600
Total	**109 667**	**112 478**	**121 344**	**130 826**	**139 821**
Percentage growth					
Transfers from national	-	-	*8.0%*	*7.8%*	*6.8%*
Equitable share	-	-	*8.3%*	*8.1%*	*6.8%*
Conditional grants	-	-	*5.6%*	*5.7%*	*7.2%*
Own revenue	-	-	*5.8%*	*7.7%*	*7.9%*
Total	**-**	**-**	***7.9%***	***7.8%***	***6.9%***

Transfers to the provincial sphere

Table 7.3 shows the total transfers to each province over the 2001 MTEF.

Growth in provincial allocations

Provinces' share of nationally raised revenue grows from a revised level of R108,7 billion in 2000/01 to R117,4 billion in 2001/02, and R135,2 billion in 2003/04. This represents an annual average growth rate of 7,5 per cent over the period of the MTEF.

Provincial transfers fall as a proportion of the national budget from 58,4 per cent in 1999/00 to 56,4 per cent in 2001/02. However, the provincial share rises again to 56,7 per cent by 2003/04, as a result of strong growth in the provincial equitable share and provincial bias in the distribution of infrastructure grants.

Strong growth in equitable share

Transfers to the provincial sphere take two forms: the equitable share, which accounts for 88,7 per cent of transfers to provinces, and conditional grants, which account for the remaining 11,3 per cent. The revised budget framework provides R5,1 billion in 2001/02 and R9,0 billion in 2002/03 over the forward estimates published in the 2000 Budget.

Table 7.3 Total transfers to provinces

R million	1999/00 Outcome	2000/01 Budget	2000/01 Revised estimate	2001/02 Budget	2002/03 Medium-term estimate	2003/04 Medium-term estimate
Eastern Cape	16 598	17 699	18 179	19 385	20 796	22 075
Free State	6 810	7 174	7 364	7 908	8 467	8 996
Gauteng	16 394	17 193	17 724	19 321	20 999	22 574
KwaZulu-Natal	19 398	20 967	21 583	23 280	25 282	27 298
Mpumalanga	6 284	6 945	7 305	7 805	8 582	9 340
Northern Cape	2 418	2 466	2 545	2 757	2 982	3 184
Northern Province	12 482	13 571	14 110	15 111	16 481	17 782
North West	8 084	8 601	8 788	9 460	10 155	10 797
Western Cape	10 563	10 831	11 138	11 760	12 420	12 975
Unallocated[1]		590		600	400	200
Total	99 032	106 037	108 736	117 387	126 564	135 221

1 Reflects funds earmarked for flood disaster which are unallocated at this stage.

Table 7.4 provides a breakdown of total transfers to provinces for 2001/02.

Table 7.4 Transfers to provinces 2001/02

R million	Equitable share	Conditional grants: Health	Conditional grants: Finance	Conditional grants: Housing	Conditional grants: Other[1]	Total
Eastern Cape	17 965	323	534	507	56	19 385
Free State	7 018	397	226	246	21	7 908
Gauteng	15 848	2 308	419	708	38	19 321
KwaZulu-Natal	21 034	910	625	643	68	23 280
Mpumalanga	7 205	148	214	213	25	7 805
Northern Cape	2 533	65	85	66	8	2 757
Northern Province	14 010	267	436	345	53	15 111
North West	8 761	158	252	264	25	9 460
Western Cape	9 762	1 381	257	334	26	11 760
Unallocated			600			600
Total	**104 136**	**5 957**	**3 648**	**3 326**	**320**	**117 387**

1. Includes small grants mainly in education and welfare.

The equitable share

Provincial equitable shares

The equitable share is allocated "horizontally" between provinces according to the equitable share formula. The formula is based on 1996 recommendations of the FFC. It takes into account the demographic and economic profiles of the provinces, and has components for education, health and welfare, as well as for backlogs in infrastructure.

The share allocations are merely broad indication of relative need, and each province allocates its equitable share according to its own priorities.

Components of the equitable share formula

The equitable share formula comprises seven components, explained in detail in Annexure E. The components are summarised below, with the share of each component given in brackets:

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

Equitable share allocations to provinces between 1999/2000 and 2003/04 are set out in Table 7.5.

Table 7.5 Provincial equitable shares

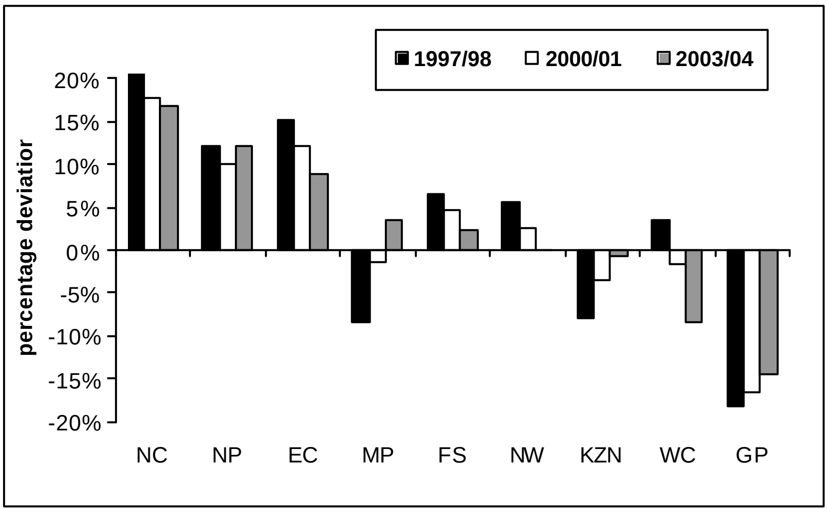
	1999/00	2000/01		2001/02	2002/03	2003/04
R million	**Outcome**	**Budget**	**Revised estimate**	**Budget**	**Forward estimate**	
Eastern Cape	15 238	16 452	16 750	17 965	19 221	20 317
Free State	5 918	6 408	6 536	7 018	7 531	7 985
Gauteng	12 932	14 235	14 517	15 848	17 289	18 634
KwaZulu-Natal	17 169	18 894	19 241	21 034	22 944	24 728
Mpumalanga	5 790	6 423	6 540	7 205	7 919	8 597
Northern Cape	2 131	2 302	2 342	2 533	2 730	2 908
Northern Province	11 506	12 626	12 866	14 010	15 233	16 365
North West	7 412	8 009	8 158	8 761	9 391	9 945
Western Cape	8 499	9 059	9 235	9 762	10 302	10 736
Total	**86 595**	**94 408**	**96 186**	**104 136**	**112 560**	**120 215**

The equitable share formula is redistributive, allocating more funds per capita to the poorer, rural provinces. Northern Cape, for instance, receives a higher per capita allocation to reflect the costs associated with its large land area, sparse population and higher take-up of social security grants.

Figure 7.1 shows per capita allocations to each province, expressed as a percentage above or below the national average.

It shows that although some provinces' per capita equitable shares are above/below the national average, over time all shares are moving closer to the average.

Figure 7.1 Deviation from the national average of the per capita equitable shares



Phased introduction of formula

The 2001 Budget marks the third year of the phased approach to the incorporation of the equitable share formula. The phased approach was developed as a response to differences between the data on which the formula was originally based, and the data contained in the subsequent Census of 1996, and on the need to avoid disruption to provincial government finances while adjusting for the new data.

FFC recommendations on the equitable share formula

For the 2001 Budget, the FFC undertook a review of the provincial transfer system. It proposed a new approach to allocating funds to the provinces, which entails dispensing with the present formula, and adopting a "costed norms" approach. The costed norms approach entails estimating the cost of providing basic services in education, health and welfare based on nationally determined norms and standards in each sector.

The Budget Council recommended against adopting the FFC proposals and expressed a preference to remain with the current formula. This, follows a thorough examination of their practicability and their likely impact on the stability of the intergovernmental system. The basis for this decision is set out in detail in Annexure E.

Conditional grants

Conditional grants

In addition to the equitable share, provinces also receive transfers in the form of conditional grants. Conditional grants are transfers from the national budget to sub-national governments. They are determined by national government and are earmarked for specific priority programmes. They are reflected in the Division of Revenue Bill, which spells out the monitoring and reporting requirements for all conditional grants.

Rationale for conditional grants

Conditional grants were introduced into the intergovernmental system in 1998 in order to:

- Provide for national priorities in provincial budgets.
- Promote national norms and standards.
- Compensate provinces for cross-boundary flows and provision of specialised services that have important cross-province externalities.
- Effect transition by supporting capacity building and structural adjustment within recipient administrations.

The departments of Health, Housing and the National Treasury administer the largest proportion of conditional grants to provinces.

Rationalisation of conditional grants

In 2000 the National Treasury conducted a review of the conditional grant framework. The review identified the need to reduce the number of conditional grants in order to improve administrative efficiency.

As a first step towards rationalising conditional grants, four small grants have been merged into the supplementary grant administered by National Treasury. These grants are the Financial Management Grant on the Treasury budget, a capacity building grant on the Department of Housing vote, the National Land Transport Transition Act Grant on the Department of Transport vote and the R293 Grant on the Department of Provincial and Local Government vote.

The R293 Grant forms part of the Supplementary Grant in 2001/02, after which it will go into the provincial equitable share. The Supplementary Grant also includes R243 million over the MTEF period for pilot projects to improve financial management in health departments and hospital management.

Table 7.6 sets out conditional grants for the 2001 MTEF.

Stable funding for conditional grants

The overall level of spending on programmes funded through conditional grants grows by 6,1 per cent a year, with fastest growth in spending on infrastructure grants.

Most grants have been adjusted upwards to ensure that their value is not eroded by inflation. Others have been kept constant pending policy reviews, on the basis of which future funding levels will be determined.

The Provincial Infrastructure Grant

In 2000, Government introduced grant funding for provincial infrastructure, in the form of the Provincial Infrastructure Grant, in response to significant backlogs in infrastructure maintenance, the need to expand the public infrastructure base and low infrastructure spending in provinces. The baseline allocation for the grant was R300 million over the MTEF.

Table 7.6 Conditional grants to provinces

R million	2000/01[1] Revised	2001/02 Budget	2002/03 Medium term estimate	2003/04
Health				
Central hospitals	3 112	3 271	3 419	3 580
Training and research	1 174	1 234	1 291	1 351
Redistribution of specialised services	286	182	189	198
Hospital rehabilitation	423	500	520	543
Nkosi Luthuli Nelson Mandela and Academic Hospitals	443	104	-	-
Pretoria Academic Hospital	-	50	70	90
Integrated Nutrition Programme	582	582	582	582
HIV/Aids	17	34	-	-
Finance				
Supplementary grant	2 212	2 248	2 152	2 158
Provincial Infrastructure	300	800	1 550	2 314
Provincial Financial Management	75	-	-	-
Infrastructure rehabilitation	595	600	400	200
Education				
Financial management and quality enhancement	202	213	224	234
Early Childhood Development	-	21	52	88
HIV/Aids	27	64	-	-
Housing				
Housing Fund	3 001	3 226	3 440	3 559
Capacity building	10	0	-	-
Human Settlement	39	100	104	109
Social Development				
Social security	30	10	11	-
Child support	17	-	-	-
HIV/Aids	6	13	-	-
Total	**12 551**	**13 251**	**14 004**	**15 006**

1. *Compared with the 2000 Budget Review, the revised amounts reflect the infrastructure rehabilitation grant.*

Increased funding for the infrastructure grant

In recognition of the catalytic role of infrastructure in promoting sustained economic growth, job creation and accelerated service delivery, the Infrastructure Grant is massively expanded and now includes a specific component for rehabilitating infrastructure damaged during the floods.

Through the expanded grant, Government has set aside an additional R7,8 billion for infrastructure expenditure over the next three years. Provinces will receive R5,3 billion to repair flood damage, supplement infrastructure expenditure in the social services sector and for growth-enhancing infrastructure projects in the economic sector. Roads, schools, health facilities and rural infrastructure projects will receive priority from these funds.

Two new grants are introduced in the 2001 Budget. These are the Pretoria Academic Hospital Grant and the Early Childhood Development Grant.

The Pretoria Academic Hospital

The Pretoria Academic Hospital Grant will support the construction of new buildings, as was the case with funding for the Nkosi Luthuli and

Mandela Academic Hospitals. The allocation for this grant amounts to R210 million over the MTEF.

The Early Childhood Development Grant

The Department of Education has operated a number of donor-funded early-childhood and pre-primary schooling pilot projects. From 2001 these pilot projects will be funded on budget, through a conditional grant of R21 million. This will increase to R52 million in 2002/03 and R88 million in 2003/04.

These new allocations compliment a number of conditional grants across a range of departments.

Supporting quality enhancement in education

In addition to the Early Childhood Development Grant, the Department of Education will provide R213 million in grant funding in 2001/02, R224 million in 2002/03, and R234 million in 2003/04, towards the support of quality enhancement in the education system. The major aims of these grants are improvements to school performance and to financial management in provincial education departments. The allocations of these grants to provinces are redistributive, with more funds going to poorer provinces.

Health grants

The cluster of health grants comprises over 42 per cent of the total conditional grants to provinces over the medium-term. The two largest health grants fund specialist tertiary services in central hospitals, research activities and the training of health professionals.

At present, the Central Hospitals Grant, which flows to five provinces, constitutes more than half of the total health grants. The Rehabilitation and Redistribution Grants total R682 million in 2001/02 and support the development and maintenance of provincial hospitals. The Redistribution Grant is intended to fund the development of tertiary service capacity in provinces without tertiary facilities. The Integrated Nutrition Grant (previously known as the Primary School Nutrition Programme) continues to fund projects providing assistance for children.

Reprioritisation of the Housing grant

The Department of Housing makes over R3 billion available through the South African Housing Fund to provide subsidies for low-cost housing. The current mechanism for allocating the grant is being reviewed in light of underspending in some provinces. The Grootboom Constitutional Court judgement is also implemented by ensuring that provincial housing departments reserve a percentage of their allocation for extremely urgent housing needs.

Review of conditional grants underway

Although the implementation of conditional grants has improved since their introduction three years ago, there is scope for further improvement. In particular measures are needed to address underspending on a number of the larger grants. The National Treasury is in the process of finalising a review of conditional grants, which – together with a separate review of grants made by the Department of Health - will help improve the alignment of policies and funding mechanisms.

Provincial own revenue

Provincial own revenue makes up about 3,5 per cent of total provincial revenue. The main sources of provincial own revenues are fees collected in terms of the Road Traffic Act (about 45 per cent), hospital services (11 per cent) and gambling (13 per cent).

Turnaround in provincial revenue collections

Since 1996/97, provincial revenues declined from R4,1 billion or 4,6 per cent of total provincial revenue to a projected level of R3,7 billion or 3,3 per cent in 2000/01.

Between 2000/01 and 2001/02, provincial own revenue collections are projected to grow by 5,7 per cent, and at an annual average rate of 7,1 per cent over the MTEF. However, owing to substantial growth in total provincial transfers, which represent 96 per cent of total provincial revenue, own revenue remains at 3,4 per cent of total provincial revenue over this period.

In order to improve efficiency of the tax system, Government is taking steps to optimise the collection of provincial own revenue. These include amending relevant legislation, reviewing billing systems and introducing appropriate incentive systems for provincial departments.

Provincial budget estimates

Table 7.7 sets out consolidated provincial expenditure from 1997/98 to 2003/04.

Provinces table their budgets in the two weeks following the publication of the national budget. So that complete data can be presented in the Budget Review, Treasury requires provinces to provide preliminary expenditure estimates prior to the formal approval of their adjustment estimates for the current financial year, and before finalising their MTEF budgets.

Table 7.7 presents actual provincial revenue and expenditure for 1997/98 to 1999/00, revised estimates for 2000/01, and projected estimates from 2001/02 to 2003/04. Where necessary, and to facilitate inter-provincial comparisons, the figures are adapted.

Trends in provincial expenditure

Table 7.7 shows that the turnaround in provincial finances achieved over the last two years has been sustained. Provinces that experienced budget overruns in the past have reduced their debts and are budgeting for surpluses to eliminate outstanding liabilities. As debts are repaid, resources are being released for infrastructure spending and complementary inputs into the delivery of social services. Provinces will also be in a better position to manage the increase in the take-up of the child support grant.

The 2000 Intergovernmental Fiscal Review provides a more detailed historical review of provincial expenditure.

Social services still dominate budgets

Government aims to consolidate social services delivery while simultaneously accelerating non-social services spending. Infrastructure expenditure is a particular priority. Social services constitute the largest proportion of total provincial budgets. Actual expenditure on social services rose from 81,8 per cent in 1995/96 to a peak level of 83,4 per cent in 1999/00. The estimated outcome is 83,0 per cent in 2000/01. However, although social services expenditure still grows fast on a year on year basis, its share of total spending declines somewhat to 81,8 per cent in 2001/02 and levels off over the MTEF.

Provincial spending recovers

Table 7.7 also shows that budgeted total provincial expenditure grows by 9,2 per cent between 2000/01 and 2001/02. It increases from a revised R110,6 billion in 2001/02 to a budgeted R120,7 billion. This is mainly attributable to strong growth in non-social services expenditure, in particular capital expenditure. Social services expenditure also grows markedly over this period. This is due to significant projected growth in welfare spending, partly in response to the impact of HIV/Aids.

The recovery in provincial expenditure is coupled with shifts in the composition of expenditure, as reflected in figure 7.2.

Increases in social services spending over the past three years were partially accommodated by a reduction in planned capital spending. However, trends in provincial budgets reflect a reversal of the downward trend in non-social services expenditure, and a sharp upward trend in infrastructure investment. The provincial infrastructure grant will help sustain this trend over the medium term, as will the provinces' prudent financial management.

Social services expenditure

Social services expenditure shows a moderate upward trend, while the growth rate of the wage bill of provincial governments slows down. These trends indicate that some of the measures initiated three years ago to contain wage bill growth, and to reprioritise spending aimed at improving the quality of service delivery, are beginning to yield desired results. Over the medium-term, however, improvements in social services should derive more from efficiency gains – improvements in the quality of spending – than from large injections of funds into the sector.

Strong growth in capital expenditure

Capital expenditure grows by 19,7 per cent between 2000/01 and 2001/02, from a revised level of R7,2 billion to R8,6 billion, and increases at an annual average rate of 18,8 per cent over the next three years.

Provinces budget for moderate surpluses

Provinces are budgeting for a combined surplus of R642 million in 2001/02, which rises moderately to just over a billion in 2003/04. The surpluses will be used to pay off outstanding debts. The need to provide for surpluses will deminish as liabilities decline.

Table 7.7 Consolidated provincial expenditure[1]

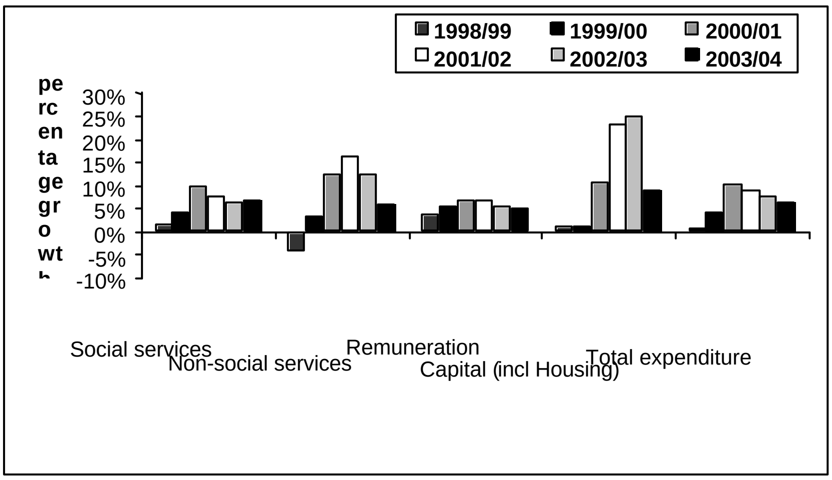
R million	1997/98 Outcome	1998/99 Outcome	1999/00 Outcome	2000/01 Revised estimate	2001/02	2002/03 Medium term estimates	2003/04
Education	38 502	38 678	39 929	43 688	47 141	50 054	53 564
Health	22 491	22 953	24 238	26 479	28 756	30 463	32 497
Welfare	17 566	18 365	19 259	21 595	22 879	24 782	26 307
Housing and Community Development	4 884	4 614	3 940	4 475	4 537	5 621	5 970
Other functions	12 012	11 538	12 621	14 345	16 865	18 674	19 367
Unallocated reserve					523	378	766
Total expenditure	**95 454**	**96 148**	**99 987**	**110 582**	**120 701**	**129 972**	**138 471**
Total revenue	**89 996**	**96 697**	**103 026**	**112 479**	**121 343**	**130 825**	**139 821**
Surplus/(deficit)	**-5 458**	**549**	**3 039**	**1 897**	**642**	**853**	**1 350**
Economic classification							
Current expenditure	89 150	89 759	93 751	103 427	112 136	118 968	126 472
Of which remuneration	*54 419*	*56 476*	*59 702*	*63 836*	*68 110*	*71 880*	*75 586*
Capital expenditure (incl. Housing)	6 304	6 389	6 236	7 155	8 564	11 003	11 999
Percentage shares of total expenditure							
Social services	*82,3%*	*83,2%*	*83,4%*	*83,0%*	*81,9%*	*81,0%*	*81,1%*
Other functions(Incl. Housing)	*17,7%*	*16,8%*	*16,6%*	*17,0%*	*17,7%*	*18,7%*	*18,3%*
Contingency reserve					*0,4%*	*0,3%*	*0,6%*

1. Inherited debt, local government transfers and unallocated reserves have been deducted from total provincial spending.

Possible under-expenditure on capital projects

The long lead-time of infrastructure projects may lead to underspending. At the time of tabling the 2000 Budget, provinces projected growth in capital expenditure of 21,5 per cent. However, latest projections indicate that actual expenditure on some projects may not take place by the end of the financial year. This underscores the need to build capacity to manage and implement infrastructure projects in the public sector. The revised growth rate in capital expenditure between 1999/00 and the revised 2000/01 estimated outcome is 10,6 per cent.

Figure 7.2:Growth in categories of spending



Local government finance

Overview

Local government priorities

With local government in transition, financial management and greater public accountability continue to be major priorities. The objectives of such reforms are to improve multi-year budgeting, ensure more accurate and timely reporting, improve the quality and reliability of budget information, and enable municipalities to improve their revenue flows.

These reforms occur against the backdrop of municipal restructuring and the demarcation of new municipal boundaries. While service delivery must continue, municipalities also face the challenge of integrating budgets, staff and systems.

Minister sets 6 per cent growth limit for municipal budgets

In the interest of macro-economic and fiscal prudence, the Minister of Finance may set growth limits for municipal budgets. This limit will be set at 6 per cent for the forthcoming 2001-02 financial year, calculated on the amalgamated budgets of newly demarcated municipalities. As in previous years, exemptions to this limit will be considered taking into account financial viability and the sustainability of the budgetary proposals.

Objectives of transfers to local government

Transfers to local government are targeted at supporting the capital and operating budgets of local governments, and at promoting restructuring and institutional change in municipalities.

New legislative framework

New legislation has reshaped the local government environment. The Municipal Structures Act and the Municipal Systems Act have established a new regulatory environment for local government. The finances of local government will be reformed through the Municipal Finance Management Bill, the Property Rating Bill and the introduction of Generally Accepted Municipal Accounting Practices.

Fiscal reforms have been carefully sequenced to track changes to municipal structures and systems. Government will hence rationalise the system of intergovernmental transfers to support municipal reform.

The fiscal framework

The primary mechanism to support the expenditure programmes of municipalities is the equitable share allocated to the local sphere from nationally raised revenues. In addition there are transfers for infrastructure investment, capacity-building, restructuring and transition funding. Municipalities also raise their own revenue, accounting for over 90 per cent of total local government income

Challenges of Local Government Transition

The 1998 White Paper on Local Government initiated an extensive process of change to enhance municipal accountability, improve developmental impact, streamline systems and improve the delivery of services.

In 2000 the number of municipalities was reduced from 843 to 284; the categories and types of local governments have changed; powers and functions are under review; and new systems, resource allocations and functional orientations will be introduced. After demarcation, five municipalities have operating budgets in excess of R5 billion, one other in excess of R1.5 billion, four others in excess of R700 million and thirteen others in excess of R200 million. In total, together these municipalities account for over 80% of operating expenditure in the local sphere of government.

New local governments face considerable challenges. Many councils experience financial problems, management practices are inadequate, and institutional systems are often dysfunctional. Service delivery is often inefficient and operating costs - especially wage bills - are disproportionately large.

The new demarcations pose particular transitional challenges. Municipalities will incur moving costs related to consolidation, integration, staff rationalisation and redeployment, asset and liability alignment, and the alignment of agreements, contracts, bank accounts, investments, insurance, and IT systems integration. Furthermore, restructuring exercises typically impose significant costs on a municipality in the short-term, while delivering benefits in the medium- to long-terms.

Government has introduced a number of local government grants to meet these challenges. These include the Local Government Restructuring Grant, the Local Government Support Grant, the Municipal Finance Management Grant, the Municipal Systems Improvement Grant, and the Transition Grant. These grants are discussed in detail in this chapter and in Annexure E.

Increased local government transfers

The revised fiscal framework approved by Cabinet provides for significant increases in the allocation to local government. These increases amount to R795 million in 2001/02 and R649 million in 2002/03. This brings the totals for these years to R6,5 billion in 2001/02, R7,2 billion in 2002/03 and R7,8 billion in 2003/04. These figures exclude some agency payments and some in-kind services provided by national departments.

The equitable share

The equitable share is an unconditional transfer to assist municipalities to perform their basic functions. It focuses on poverty alleviation.

Reforms to the equitable share allocation in this budget include:

- The introduction of three-year allocations to improve the predictability of transfers.
- Improved targeting through further refining of the data on which poor households are identified.
- The inclusion of the former R293 grants into the equitable share allocation.

Local government equitable share expanded

R1,9 billion was allocated to the equitable share in the current fiscal year. Including R293 funds, the allocation now rises from R2,6 billion in 2001/02 to R3,6 billion in 2003/04. This substantial increase in the equitable share will continue to facilitate a more equitable distribution of resources among local governments, improve the provision of basic services to the poor, and assist municipalities with meeting Government's goals relating to the provision of free basic services.

Table 7.8: National transfers to local government

R millions	2000/01	2001/02	2002/03	2003/04
Equitable share	1 867	2 618	3 002	3 551
R293 personnel[1]	463	--	--	--
Transition grant	100	250	200	--
Water & sanitation operating	746	692	644	662
Subtotal equitable share & related	**3 176**	**3 560**	**3 846**	**4 213**
Restructuring grant	300	350	450	465
Local government support grant	150	160	220	230
Financial management grant	50	60	120	125
Urban transport fund[2]	22	81	40	42
Land development objectives[3]	44	--	--	--
Municipal systems improvement prog.		30	30	30
Subtotal capacity building & restructuring	**566**	**681**	**860**	**892**
CMIP	883	994	1 159	1 407
Water Service projects	609	822	818	835
Community based public works	374	374	374	374
Local economic development[4]	104	76	99	127
Subtotal capital	**1 970**	**2 266**	**2 450**	**2 743**
Total transfers to local government	**5 712**	**6 507**	**7 156**	**7 849**

1. *R293 municipal portion (R358 m) incorporated into equitable share from 2001/02.*
2. *2001/02 allocation is R38 m plus rollovers from previous years.*
3. *Incorporated into equitable share and municipal systems improvement programme*
4. *Includes allocation for Social Plan Measures.*

Free basic services

National government already makes a significant contribution to ensuring universal access to municipal services. This occurs through both the provision of capital grants for municipal infrastructure (via CMIP, the rural water programme and some poverty relief allocations), and the formula-driven S Grant portion of the local government equitable share. The significant increase to the equitable share will enhance the ability of municipalities to extend basic levels of service to all citizens. The equitable share's allocation formula continues to facilitate a more equitable distribution of resources among municipalities. This helps poorer municipalities, which have either small revenue bases or a limited potential to effect local cross-subsidisation, to meet the free basic services challenge.

Transition grant

A Transition Grant has been established to assist municipalities to meet the once-off costs associated with municipal amalgamations. The Transition Grant will exist for two more years as a separate grant (R100 million has already been allocated for 2000/01). It will provide R250 million in 2001/02 and R200 million in 2002/03. The transition grant will then be incorporated into the equitable share and distributed by formula.

Water services operating subsidy

Further expansion of the equitable share is anticipated via the inclusion of the Water Services Operating Subsidy into the equitable share. This allocation, which is made as an augmentation to the Water Trading Account on the Department of Water Affairs and Forestry's budget, provides an untargeted subsidy to users of water schemes that are directly operated by that Department.

The Department is currently preparing for the transfer of these schemes to municipalities. The subsidy will facilitate this transfer process. Thereafter, the funds will be transferred into the equitable share.

Using resources efficiently

The onus will be on municipalities to use these funds appropriately alongside available own revenue and local tariffs to lower the cost of services to poor consumers. The free basic services commitment necessitates balancing equity objectives and efficiency concerns, and is not solely a fiscal issue. The National Treasury, in conjunction with other departments, is implementing support strategies and an appropriate regulatory framework to support and sustain the policy of free basic services

Transfers for municipal infrastructure

Improved planning framework

The framework for planning and financing infrastructure investment provides for municipalities to use their own revenues, grant funding and loans from the capital market. The primary objective of allocations for municipal infrastructure is to expand delivery of basic infrastructure services to poor households.

Grants being rationalised

Measures being introduced will further rationalise existing capital grant programmes and reform disbursement procedures. This will improve the equity of allocations, the efficiency of spending and the sustainability of infrastructure services.

Infrastructure allocations

The total budgetary allocations for local government infrastructure transfers are R2,3 billion in 2001/02, R2,5 billion in 2002/3 and R2,7 billion in 2003/04. This total includes CMIP, water services capital projects, local economic development, and community based public works transfers. This represents an average annual increase in national transfers for municipal infrastructure of 11,7 per cent between 2000/01 and 2003/04.

Capacity grants

A total of R681 million in 2001/02, R860 million in 2002/03 and R892 million in 2003/04 will be made available for capacity building grants to local government.

Building sustainable capacity

The challenge is to manage these programmes in such a way that sustainable capacity is created within municipalities, with a concomitant reduction of their dependence on other spheres or external consultants.

Capacity building transfers to local government remain fragmented. Government aims to consolidate these grants through a phased programme. In particular, attempts will be made to more effectively link access to decentralised capital grant allocations with proven progress in building financial and strategic management capacity.

Local government financial management grant

The introduction of the Local Government Financial Management Grant in 2000/01 marks the first phase of this consolidation. This grant assists municipalities to reform their financial management and budgeting practices that, in turn, will lead to improved service delivery. The allocations for this grant are R60 million in 2001/02, R120 million in 2002/03 and R125 million in 2003/04, and may be supplemented through partnerships with donor agencies.

Municipal systems modernisation programme

The second phase of consolidation starts with the introduction of the Municipal Systems Improvement Programme. This grant will have a five year life span and will be allocated in terms of a framework determined by an interdepartmental committee. If successful, it will provide a framework for consolidating transfers for municipal capacity-building. It is intended to affect this consolidation by the 2002 Budget.

Restructuring and support grants

Local government policy reforms require a fundamental shift in the structures, systems and approaches of municipalities to the performance of their functions. The Restructuring and Support Grants are provided to assist and encourage municipalities to restructure their organisations, functions and fiscal positions, and to improve the equity and efficiency of service delivery. Care is taken to avoid providing perverse incentives to municipalities, such as rewards for past poor performance. The approach adopted differentiates between large and small municipalities, on the basis of their significantly different capacities and requirements.

Support to larger urban centres

The Local Government Restructuring Grant assists large municipalities to undertake complex institutional and budgetary restructuring exercises. These exercises typically impose significant short-term costs on a municipality, while only delivering benefits in the medium- to long-terms. Specific support to these larger municipalities with budgets of over R300 million is required because of the significant impact they have on the national economy, and their distinctive restructuring requirements.

The grant will also assist municipalities to expand their access to the municipal debt market. This should facilitate more rapid expansion of services to poor households. The Greater Johannesburg Metropolitan Council is already receiving support and a number of other municipalities are currently finalising applications.

The Local Government Support Grant assists smaller municipalities. The approach taken in the disbursement of these two restructuring grants will converge over the MTEF period.

Municipal borrowing

Stimulating the debt market

Government will take steps to stimulate the municipal debt market through measures aimed at reducing lending risks and encouraging greater responsibility in decision-making by municipal borrowers. An active debt market will allow municipalities to overcome the challenges imposed by the limited amount of public funds available for infrastructure development. To this end, national government has terminated any implicit guarantees on municipal debt. A framework to regulate municipal borrowing will be introduced shortly after the Municipal Finance Management Bill is enacted. This will provide clear procedures for raising loans, while clarifying the rights and responsibilities of borrowers and lenders.

Municipal own revenue

A number of measures will be introduced to enhance the revenue raising powers of local government. These include legislative measures to improve the administration of property taxes, clarify municipal tax powers, as well as reform of the levying and collecting of RSC levies.

Municipal budgets

Although consolidated budget information is not yet sufficiently accurate and comprehensive, the National Treasury received information on the budgets of 605 municipalities for the 2000-01 financial year[1].

Table 7.9 sets out consolidated expenditure budgets for municipalities for the years 1998-99, 1999-00 and 2000-01. Although some smaller municipalities report occasionally, they account for a very small percentage of total expenditure, and thus do not impact significantly on the trends outlined below.

Table 7.9 Consolidated municipal expenditure budgets

R billion	1998-99	1999-00	2000-01
Salaries	12,8	13,8	15,9
Bulk services	12,8	13,8	14,9
Other[1]	15,6	16,9	17,3
Operating budget	**41,1**	**44,4**	**48,1**
Capital	13,7	13,7	13,7
Total	**54,8**	**58,1**	**61,8**

1 This category includes repairs and maintenance, interest charges, contributions to special funds, the provision for working capital, etc.

Audited figures for expenditure outputs for these years are not yet available, and will differ from the budgeted figures in Table 7.9.

Municipal budgets total R62 billion

Municipalities budgeted to spend nearly R62 billion, including R13,7 billion on capital infrastructure in 2000-01. Municipalities budgeted for balanced operating budgets. The R48,1 billion operating costs in 2000-01 are to be covered by R23,6 billion in charges for bulk services, R10,1 billion in property taxes, R3,9 billion in RSC levy income and R10,6 billion in other income including user charges, tariffs and fines.

Projected operating revenues are set out in Table 7.10.

1. The local government financial year is from 1 July to 30 June - denoted here as 2001-02 - as opposed to the national and provincial 2001/02 fiscal year, which covers the period from April to March. These budget figures differ from the estimates published by the South African Reserve Bank. The Reserve Bank estimates do not apply to the same fiscal year as those of the Treasury. Treasury also includes purchases and sales of electricity and certain other goods and services that are excluded from the Reserve Bank figures.

Table 7.10 Consolidated municipal operating revenue budgets

R billion	1998-99	1999-00	2000-01
Property tax	7,8	8,4	10,1
Bulk services	19,7	23,1	23,6
RSC levies	3,3	3,1	3,9
Other[1]	10,3	9,8	10,6
Total	**41,1**	**44,4**	**48,1**

[1] *This category includes user charges, tariffs and fines, etc.*

Operating budgets grow by 8,2 per cent a year

Operating budgets for both revenues and expenditure grew by 8,2 per cent a year between 1998-99 and 2000-01. On the expenditure side, the fastest growth has been in the category of salaries, which grew by 11,6 per cent a year. Bulk services expenditure grew by 8,2 per cent a year and the remaining expenditure by 5,3 per cent. The slow growth in the last category of expenditure reflects stagnation in expenditure on repairs and maintenance – a trend which needs to be addressed in the medium-term.

On the revenue side, property taxes grew fastest at 13,7 per cent a year, with bulk services income growing at 9,4 percent, RSC levies growing at 8,2 per cent and other income by 1,4 per cent annually.

The share of salaries in total expenditure grows

The net effect of these trends is an increase in salary expenditure from 31 per cent of total expenditure to 33 per cent between 1998-99 and 2000-01, while the other categories decline. Property taxes and bulk service charges now make up 70,1 per cent of income compared to 67 per cent in 1998-99.

The RSC levies, shown on the income side, comprise payroll and turnover taxes that accrue to metropolitan and district councils. These levies are largely for capital programmes. Capital expenditure at a municipal level is financed through:

- Drawing on own reserves created through operating surpluses.
- Loans.
- Contributions from District Councils.
- The Consolidated Municipal Infrastructure Programme and other transfers.

Tables 7.11, 7.12 and 7.13 show operating income budgets, operating expenditure budgets and capital budgets respectively for selected municipalities for 2000-01.

Bulk services take up 55% of budgets in largest municipalities

The 14 municipal budgets reflected in the tables below constitute approximately 65 per cent of total municipal budgeted expenditure for 2000-01. Within these municipalities, bulk services income constitutes 55,3 per cent, property taxes 22,0 per cent, while payments for bulk services and salaries each consume 32 per cent of their budgets on average. Interest payments, at about 15,6 per cent, make up the next largest expenditure item.

Table 7.11 Operating income budgets of selected municipalities, 2000-01

R million	Property tax	RSC levies[1]	Bulk services	Grants and subsidies	Other (e.g. fees, fines)	Total
Johannesburg	1 799	720	3 708	119	948	7 294
Cape Town	1 663	354	3 134	212	1 226	6 589
Durban	1 198	285	3 226	200	1 086	5 995
Pretoria	984	293	3 569	403	398	5 647
Pietermaritzburg	191		485	61	121	858
Nelspruit	44		93	9	18	164
Potchefstroom	32		147	8	10	197
East London	120		376	67	89	652
Pietersburg	70		233	15	19	337
Kimberley	57		183	7	70	317
Bloemfontein	136		485	18	59	698
Port Elizabeth	263		934	29	155	1 381
Germiston	294		662	31	44	1 031
Total	**6 851**	**1 652**	**17 235**	**1 179**	**4 243**	**31 160**

1. Only Category A (Metropolitan) and Category C (District) municipalities have the authority to collect RSC levies.

Table 7.12 Operating expenditure budgets of selected municipalities, 2000-01

R million	Salaries	Bulk services	General expenses	Repairs and maintenance	Interest	Contribution to funds	Total
Johannesburg	2 053	2 888	249	359	1 100	645	7 294
Cape Town	2 434	1 662	859	364	1 026	244	6 589
Durban	1 951	1 740	299	686	1 111	208	5 995
Pretoria	1 726	1 916	207	733	828	278	5 688
Pietermaritzburg	277	309	19	67	118	67	857
Nelspruit	62	40	13	13	28	8	164
Potchefstroom	74	70	17	14	18	3	196
East London	241	154	41	59	122	34	651
Pietersburg	115	97	18	38	57	13	338
Kimberley	92	69	76	29	34	17	317
Bloemfontein	204	243	51	70	87	31	686
Port Elizabeth	504	373	87	150	198	69	1 381
Germiston	326	397	43	87	123	53	1 029
Total	10 059	9 958	1,979	2,669	4 850	1 670	31 185

Of the R6,8 billion in capital investment which these 14 municipalities will spend in 2000-01, approximately 49 per cent will be financed from loans, 27 per cent from grants and 16 per cent from own reserves. The rest will come from development grants and district councils.

Table 7.13 Capital budgets of selected municipalities, 2000-01

R million	Loans	Contribution from funds	District Council funds[1]	Development projects funds	Grants and subsidies	Total
Johannesburg	331	15	0	0	498	844
Cape Town	929	802	136	86	483	2 436
Durban	1 038	39	6	19	341	1 443
Pretoria	370	133	42	0	130	675
Pietermaritzburg	105	4	23	36	21	189
Nelspruit	48	10	8	5	11	82
Potchefstroom	26	1	22	0	40	89
East London	101	6	35	81	54	277
Pietersburg	57	5	15	3	16	96
Kimberley	30	3	8	0	20	61
Bloemfontein	100	45	0	0	8	153
Port Elizabeth	99	5	2	10	68	184
Germiston	74	3	33	10	114	234
Total	**3 308**	**1 071**	**330**	**250**	**1 804**	**6 763**

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

Conclusion

The intergovernmental system hinges on co-operative governance. That such co-operative governance is working is evident from a number of developments and trends that demonstrate how the intergovernmental system is maturing and consolidating.

Policy-making and fiscal and financial management across all spheres ensures coherence in implementation. Through co-operative governance, a foundation has been laid for improved co-ordination of government programmes and accelerating service delivery. A range of public finance and budget reforms have strengthened the link between policy and budgets in the provincial sphere. The system of intergovernmental transfers has been overhauled to support service delivery at a provincial and local level through increased predictability, transparency and co-ordination amongst Government departments.

While provinces enter a phase in which healthier fiscal positions will underlie approved service delivery and infrastructure expenditure, local government still has to manage significant transition challenges over the next few years.