7

Provincial and local government allocations

The provincial and local government spheres are at the forefront of delivering on the social and economic rights envisioned in the Constitution.

This year's division of revenue provides for strong real growth in national transfers to provinces and local government of 6,1 per cent and 12,2 per cent respectively over the MTEF period.

National transfers to provinces and local government reaffirm Government's commitment to accelerating the delivery of social services, extension of free basic services to households that cannot afford them and the creation of employment opportunities through expansion of labour-intensive infrastructure development.

Introduction

Approximately 60 per cent of expenditure on the main budget takes the form of transfers to the provincial and local spheres. This chapter outlines the structure of these transfers, and the manner in which they address the priorities outlined in chapter 6. The *2003 Division of Revenue Bill* and the explanatory memorandum contained in *Annexure E* provide further detail.

A full account of the revenue and expenditure plans of provincial and local governments will be set out in the *Intergovernmental Fiscal Review*, to be published April.

Shift in division of revenue toward provinces and local authorities

The 2003 division of revenue, set out in Table 6.2 of chapter 6, reinforces the shift in the division of nationally raised revenue towards provinces and local government. It signals Government's continued commitment to the progressive realisation of basic needs, which are largely the functional responsibility of provinces and local government. It prioritises selected components of spending in social services within provincial budgets and supports provision of free basic services in the local government sphere.

Conditional grants to provinces prioritise extension of the child support grant and infrastructure development

Conditional grants to provinces over the MTEF include:

- An allocation of R10,9 billion for funding the extension of the child support grant to children until they turn 14
- R8,0 billion earmarked for infrastructure development in social and economic services sectors
- R2,8 billion for the Integrated Nutrition Programme
- R2,7 billion for hospital revitalisation, covering both infrastructure improvements and replacement of equipment
- R1,2 billion for emergency food relief.

Adjustments to the provincial equitable share

The equitable share is also adjusted upwards to provide for substantial increases in the following components of provincial expenditure:

- Equipment, medicines and drugs, to equip the health sector sufficiently to bolster its efforts to prevent the spread of HIV/Aids and to expand treatment
- Non-personnel non-capital spending in education, specifically to boost expenditure on textbooks, stationary and maintenance to support effective teaching and learning
- Social security transfers, to provide for increases in grants in order to protect their purchasing power and provide for further growth in the take up of the child support grant for children up to 7 years
- Construction, upgrading and maintenance of roads and other public infrastructure
- Support for economic services such as agriculture, economic affairs, environment and tourism.

Revisions to the equitable share include R2,3 billion to be spent over the next three years in order to support initiatives aimed at attracting and retaining doctors, pharmacists and other health professionals with scarce skills in the health sector. An additional R3,3 billion has been added to the equitable share and conditional grants over the MTEF to support the further expansion of the enhanced response to HIV/Aids.

Transfers to local government

National transfers to local government include additional allocations over baseline over the next three years:

- R1,8 billion for infrastructure, including R1 billion for labour-intensive infrastructure programmes
- R4,1 billion for free basic services, with R1,4 billion allocated for rolling out free electricity
- R300 million extra to support the implementation of financial and other management reforms at municipal level.

Provincial revenue

Alignment between national priorities and the division of revenue is vital to the intergovernmental system. The 2003 vertical division of revenue reflects further strengthening of the link between policy priorities and budgets, resulting in an increasing share of national revenue flowing towards provinces. National transfers to provinces make up 96,5 per cent of total provincial revenue in 2003/04.

National transfers to provinces grow by 9,5 per cent in real terms

National transfers to provinces rise from R136,9 billion in 2002/03 to R158,9 billion in 2003/04, and are projected to grow to R191,6 billion by 2005/06. This translates into a real growth in national transfers of 9,5 per cent in 2003/04, and average annual real growth of 6,1 per cent over the MTEF period.

The 2003 MTEF provides for R69,3 billion more to provinces over 2002 baseline

The 2003 MTEF allocations provide for R69,3 billion more spending in the provincial sphere, over the 2002 Budget baseline. This includes an inflation adjustment of R19,1 billion, which represents 27,5 per cent of the total adjustment to the provincial share over baseline. Inflation adjustments also take account of higher adjustments to values of social security grants – an important component of provincial spending.

Table 7.1 Provincial revenue

R million	2002/03 Budget	2002/03 Revised estimate	2003/04	2004/05	2005/06
			Medium-term estimates		
Transfer from national	132 420	136 919	158 995	175 468	191 590
Equitable share	*119 452*	*123 457*	*142 386*	*155 313*	*167 556*
Conditional grants	*12 967*	*13 462*	*16 609*	*20 155*	*24 033*
Own revenue	4 103	5 458	5 683	5 971	6 278
Total	**136 523**	**142 377**	**164 678**	**181 438**	**197 868**
Percentage growth					
Transfers from national	–	–	*16,1%*	*10,4%*	*9,2%*
Equitable share	–	–	*15,3%*	*9,1%*	*7,9%*
Conditional grants	–	–	*23,4%*	*21,3%*	*19,2%*
Own revenue	–	–	*4,1%*	*5,1%*	*5,1%*
Total	**–**	**–**	***15,7%***	***10,2%***	***9,1%***

Provincial share rises from 56,0 per cent to 57,6 per cent over the MTEF

With the substantial adjustment to baseline allocations to provinces, the provincial share of nationally raised revenue rises from 56,0 per cent in 2002/03 to 57,6 per cent in 2005/06. Table 7.2 sets out total transfers to provinces, including equitable shares and conditional grants.

Table 7.2 Total transfers to provinces

R million	2001/02 Outcome	2002/03 Budget	2002/03 Revised estimate	2003/04	2004/05	2005/06
				Medium-term estimates		
Eastern Cape	20 217	22 020	22 714	26 447	29 431	32 512
Free State	8 322	8 966	9 270	10 709	11 868	12 973
Gauteng	19 790	21 712	22 413	25 794	28 237	30 476
KwaZulu-Natal	24 012	26 477	27 516	32 196	35 593	38 917
Limpopo	15 924	17 401	17 975	21 043	23 132	25 354
Mpumalanga	8 492	9 122	9 414	11 131	12 271	13 405
Northern Cape	2 858	3 153	3 270	3 841	4 233	4 603
North West	9 699	10 680	11 032	12 869	14 360	15 720
Western Cape	12 086	12 889	13 314	14 964	16 343	17 630
Total	**121 400**	**132 420**	**136 919**	**158 995**	**175 468**	**191 590**

Equitable share comprise the largest transfer to provinces

Table 7.3 summarises intergovernmental transfers from national to provinces for 2003/04. The most significant transfer is the equitable share, which amounts to R142,4 billion in 2003/04, while conditional grants amount to R16,6 billion. These components are discussed in detail below.

Table 7.3 Transfers to provinces 2003/04

R million	Equitable share	Conditional grants				Total
		Health	Treasury	Housing	Other[1]	
Eastern Cape	24 228	592	457	653	518	26 447
Free State	9 463	568	163	334	182	10 709
Gauteng	21 876	2 552	236	945	186	25 794
KwaZulu-Natal	29 279	1 128	500	822	466	32 196
Limpopo	19 352	372	541	437	342	21 043
Mpumalanga	10 220	243	216	282	170	11 131
Northern Cape	3 455	162	72	89	63	3 841
North West	11 822	250	204	356	238	12 869
Western Cape	12 692	1 549	145	437	141	14 964
Total	**142 386**	**7 414**	**2 534**	**4 355**	**2 306**	**158 995**

1. Includes grants in agriculture, education, provincial and local government and social development.

The equitable share

Strong growth in equitable share gives provinces flexibility in aligning budgets and priorities

The equitable share comprises 89,5 per cent of national transfers to provinces, and grows strongly over the MTEF period. The forward estimates for the provincial equitable share published in last year's budget are revised up by R13,9 billion in 2003/04 and R18,2 billion in 2004/05. With the new baseline allocation for 2005/06, the provincial equitable share allocation rises by 10,7 per cent a year over the MTEF period, or 5,0 per cent in real terms. This accounts for the strong real growth in total transfers to provinces.

Allocation of equitable share is determined through provincial budget processes

Unlike the case for conditional grants – in which spending is determined by national government and prescribed through the Division of Revenue Act – provinces have discretion over how they allocate the equitable share among the functions they perform. Increased equitable share allocations will give provinces more flexibility in determining budgets, and in giving effect to national priorities in their 2003 budgets, to be tabled shortly after the national Budget.

The equitable share is divided among provinces by means of a redistributive formula, comprising seven components (weights of each component are included in brackets):

- An education share (41 per cent) based on the size of the school-age population (ages 6-17) and the average for three years' enrolment (1998-2000)
- A health share (19 per cent) based on the proportion of the population without medical aid or health insurance

Table 7.4 Provincial equitable shares

	2001/02	2002/03		2003/04	2004/05	2005/06
	Outcome	Budget	Revised	Medium-term estimates		
R million			estimate			
Eastern Cape	18 550	20 498	21 166	24 228	26 427	28 510
Free State	7 269	7 996	8 270	9 463	10 322	11 135
Gauteng	16 329	18 224	18 844	21 876	23 862	25 743
KwaZulu-Natal	21 708	24 343	25 157	29 279	31 938	34 455
Limpopo	14 464	16 145	16 692	19 352	21 109	22 773
Mpumalanga	7 435	8 428	8 705	10 220	11 147	12 026
Northern Cape	2 609	2 907	3 000	3 455	3 769	4 066
North West	9 038	9 993	10 328	11 822	12 895	13 911
Western Cape	10 056	10 919	11 294	12 692	13 844	14 936
Total	**107 460**	**119 452**	**123 457**	**142 386**	**155 313**	**167 556**

- A social security component (18 per cent) based on the estimated number of people entitled to social security grants – the elderly, disabled and children – weighted using a poverty index derived from the Income and Expenditure Survey
- A basic share (7 per cent) derived from each province's share of the total population of the country
- A backlog component (3 per cent) based on the distribution of capital needs as captured in the schools register of needs, the audit of hospital facilities and the share of the rural population
- An economic output component (7 per cent) based on the distribution of total remuneration in the country
- An institutional component (5 per cent) divided equally among the provinces.

Provincial equitable share formula to undergo a comprehensive review for the 2004 Budget

The data and weights of the equitable share formula are reviewed annually, taking account of recommendations of the Financial and Fiscal Commission (FFC). The present structure of the formula, a product of collaboration between National Treasury and the FFC, was adopted in 1998/99, and modified to add a backlog component in 1999/00. For demographic data, the formula currently uses the 1996 Census data. The publication this year of the 2001 Census results presents the opportunity for a comprehensive review of the formula structure, component weights and replacement of demographic data for the 2004 Budget.

A detailed exposition on the equitable share formula and Government's response to the recommendations of the FFC is contained in Annexure E.

Conditional grants to provinces

Conditional grants fund national priorities

In addition to the equitable share, conditional grants remain an important part of the intergovernmental transfer system, providing for national priorities in provincial budgets, compensating provinces for cross-boundary flows and specialised services, and supporting transition and capacity building.

Conditional grants make up 10 per cent of total national transfers to provinces. The current conditional grant system has been shaped by reforms introduced through Division of Revenue Acts since 2000. The reforms have contributed to clarifying accountability between spheres, as conditional grants are budgeted on the vote of the national department, but spent by a provincial department. The reforms have also helped strengthen parliamentary oversight and sharpened the description of policy objectives and grant outputs, resulting in the improved use of grants to enhance service delivery.

Social Development grants account for the revisions to baseline allocations for conditional grants

Table 7.5 sets out conditional grants to provinces over the 2003 MTEF. The figures indicate upward adjustments of R1,8 billion and R4,4 billion to 2002 baseline allocations. The adjustments accommodate two new conditional grants, to be administered by the Department of Social Development, for extension of child support and for food relief, and which together receive R1,5 billion in 2003/04 and R3,8 billion in 2004/05.

Phased extension of child support will be funded through a conditional grant

In this year's Budget, the most significant change to the conditional grant allocations to provinces is the child support extension grant, which provides funding to extend the child support grant, currently accessible to children until they are 7 years old, to children until they are 14 years old. Allocations for the grant are R1,1 billion in 2003/04, R3,4 billion in 2004/05 and R6,4 billion in 2005/06. The Department of Social Development will administer the grant.

While social assistance currently is a provincial responsibility, Cabinet has agreed to a consolidation of this function into a new agency, to be overseen by the national Department of Social Development. Detailed planning and preparation for this change is in progress and will be implemented over a number of years.

Emergency food relief will receive R1,2 billion

Social Development will also administer the food relief grant, which is designed to minimise the negative impact of high food prices on poverty-stricken individuals, households and communities. Government introduced this support in the *2002 Adjusted Estimates* in the face of rising food prices and the threat of starvation among vulnerable communities. Funding for domestic food relief efforts amounts to R230 million in 2002/03.

Government increases support for home-based care for people with HIV/Aids

Social Development also administers the component of the HIV/Aids grant, which funds home-based care. This grant has been allocated R210 million over the next three years. The funds will support households caring for people living with HIV/Aids.

Increases in health grants signal prioritisation of health services

The bulk of conditional grants to provinces are in the health sector. Health conditional grants total R7,4 billion in 2003/04 rising to R8,2 billion and R8,8 billion in the two outer years of the MTEF.

Health conditional grants have been increased significantly over the 2002 forward estimates. The most significant changes are in the HIV/Aids, hospital revitalisation and Integrated Nutrition Programme grants. Overall, the baseline allocations for health grants published in the *2002 Budget Review* are increased by R608 million in 2003/04 and R935 million in 2004/05. With these adjustments, health grants grow by 8,7 per cent in 2003/04, and at an average annual rate of 8,9 per cent over the MTEF.

Table 7.5 Conditional grants to provinces

R million	2002/03	2003/04	2004/05	2005/06
PROVINCIAL AND LOCAL GOVERNMENT	**293**	**271**	**261**	**44**
Local Government Capacity Building Fund	241	232	220	–
Consolidated Municipal Infrastructure Programme	52	38	41	44
NATIONAL TREASURY	**1 950**	**2 534**	**2 876**	**3 056**
Provincial Infrastructure	1 550	2 334	2 876	3 056
Flood Rehabilitation	400	200	–	–
EDUCATION	**409**	**443**	**377**	**400**
Financial Management and Quality Enhancement	228	234	248	263
HIV/Aids	127	120	129	136
Early Childhood Development	53	88	–	–
HEALTH	**6 821**	**7 414**	**8 193**	**8 804**
National Tertiary Services	3 727	3 995	4 273	4 529
Health Professions Training and Development	1 299	1 333	1 434	1 520
Hospital Revitalisation	649	718	912	1 027
Cholera Epidemic - KwaZulu-Natal	147	–	–	–
Pretoria Academic Hospital	70	92	–	–
HIV/Aids	210	334	482	535
Integrated Nutrition Programme	592	809	950	1 042
Hospital Management and Quality Improvement	126	133	142	150
SOCIAL DEVELOPMENT	**58**	**1 554**	**3 858**	**6 862**
HIV/Aids	48	66	70	74
Child Support Extension Grant	–	1 100	3 400	6 400
Food Relief	–	388	388	388
Financial Management	11	–	–	–
AGRICULTURE	**24**	**38**	**–**	**–**
Land Care and Special Food Security Projects	24	38	–	–
HOUSING	**3 907**	**4 355**	**4 589**	**4 868**
Housing Subsidy	3 801	4 246	4 474	4 745
Human Resettlement and Redevelopment	106	109	116	122
TOTAL	**13 462**	**16 609**	**20 155**	**24 033**

Reconfiguration of health grants aims at equity in tertiary health services

Apart from the Integrated Nutrition Programme, health grants are mainly aimed at hospitals, particularly for tertiary health services and training. Following comprehensive research, a new framework for funding tertiary services and health professions training was introduced in 2002/03. It entails reconfiguring the previous Central Hospitals, Redistribution of Specialised Services and Health Professions Training grants into two grants – the National Tertiary Services Grant and Health Professions Training and Development

Grant. The reconfiguration is aimed at improving equity in the funding and distribution of health services.

The tertiary services grant amounts to R4,0 billion in 2003/04, increasing to R4,5 billion in 2005/06. The training and development grant now has a new component for employing more registrars and medical specialist trainers in those provinces with the most severe shortage of medical specialists. The Health Professions Training grant amounts to R1,3 billion in 2003/04, increasing to R1,5 billion in 2005/06.

Eighteen hospitals are earmarked for major upgrading of infrastructure

After a redefinition of the focus of the Hospital Rehabilitation Grant, the grant was renamed the Hospital Revitalisation Grant in the 2002 Budget. Over the MTEF, the grant will fund major rehabilitation and replacement of equipment in an additional 18 hospitals, as part of the strategic transformation of the hospital sector. Funding for the hospital revitalisation grant increases to R718 million in 2003/04 rising to R1,0 billion in 2005/06.

A new component introduced into the revitalisation grant in this year's Budget is aimed at improving systems for the upgrading and management of medical equipment.

INP is increased substantially to extend reach of the programme

Funding for the integrated nutrition programme grows by 37 per cent in 2003/04, and almost doubles over the next three years. In addition to extending the coverage of the programme to Grade R pupils, this increase will also ensure provision of standard menus across a larger number of schools. The grant increases to R809 million in 2003/04, R950 million in 2004/05, and R1 042 million in 2005/06, offsetting the impact of food inflation on the programme.

The health sector receives R1,4 billion for special HIV/Aids interventions

Further increases in the budget for HIV/Aids programmes is made to implement national government decisions and other programme priorities, including post-exposure prophylaxis for victims of sexual abuse, rollout of mother-to-child transmission prevention, strengthening sexually transmitted infection prevention programmes, targeted interventions for commercial sex workers, voluntary counselling and testing. The health sector is allocated R1,4 billion for this purpose, over and above the general strengthening of the sector, which is funded through an increased equitable share allocation.

Housing grant increases by R373 million

The housing subsidy grant receives substantial adjustments aimed at ensuring that price increases do not hamper housing delivery. About R373 million is added to the programme over the next three years. This grant increases by 7,7 per cent a year over the period, contributing to the acceleration of the housing programme and development of sustainable communities.

Provincial infrastructure grant rises to R3,1 billion in 2005/06

The provincial infrastructure grant was introduced in the 2000 Budget to assist provinces to step up their spending on infrastructure. The grant rises from R1,6 billion in 2002/03 to R3,1 billion in 2005/06. After a period of sluggish performance, provinces are now increasing their capital spending rapidly. In the first nine months of 2002/03, provinces spent R2,7 billion more on infrastructure than during the first nine months of 2001/02.

Consistent with the process of streamlining fiscal flows between spheres, the local government capacity building grant, which currently flows through provinces, will flow directly to local government from 2005/06.

Local government capacity building grant will flow directly to local government in 2005/06

2003 provincial budget allocation estimates

Aggregate trends in provincial MTEF budgets reflect strong alignment to the priorities articulated in the *2002 Medium Term Budget Policy Statement*. Priorities in the provincial sphere focus on improvements to public services in school education and health services, enhancing the delivery and reach of government's social security grants, and investment in public infrastructure, especially roads upgrading and maintenance. The trends discussed here are based on preliminary budgets of provinces, and will differ slightly from the final budgets to be tabled over the next two weeks. The *2003 Intergovernmental Fiscal Review,* to be published in April, will be based on final budgets of provinces.

Total provincial expenditure is budgeted to grow by 6,7 per cent in 2003/04 in real terms, and at an average annual rate of 5,0 per cent over the MTEF. Components growing fastest in real terms over the MTEF include capital (11,2 per cent), social development (10,3 per cent) and education non-personnel expenditure (8,0 per cent). Consistent with the objective of attracting and retaining professional personnel with scarce skills, health personnel expenditure is set to grow by over 9 per cent, in nominal terms.

Provincial expenditure will grow in line with strong growth in national transfers

Social services

Government continues to prioritise social services – school education, health and social development. Social services spending grows by 4,8 per cent a year in real terms, over the MTEF. Growth of this magnitude will facilitate further consolidation of pro-poor social services programmes, with emphasis on improving quality, while at the same time extending their reach to underserved areas.

Budgeted education spending in provinces grows by 2,9 per cent in real terms in 2003/04. This is driven by increases in non-personnel spending, which grows by 10,2 per cent. In this sector, priority is given to funding for learner support materials, expansion of early childhood development programmes, steady scaling up of adult basic education, and school building and maintenance. The bulk of the increase in non-personnel, non-capital expenditure is expected to go to learner support materials.

Non-personnel non-capital spending in education will receive a strong boost over the MTEF

After running the Early Childhood Development Programme on a pilot basis, Government has now decided to incorporate the programme into the core provincial education function funded within the normal budgets. The equitable share has been adjusted to accommodate phased expansion of the programme, while conditional grant funding is phased out from next year.

Early childhood development becomes part of mainstream education programmes

Government affords adults a chance to improve their literacy and numeracy

Continued support for adult basic education and training reflects the importance of increasing basic literacy and numeracy among those denied educational opportunities in the past. Expenditure for this purpose is anticipated to grow steadily over the MTEF period.

Table 7.6 Consolidated provincial expenditure according to function

R million	1999/00 Outcome	2000/01 Outcome	2001/02 Outcome	2002/03 Revised estimate	2003/04 Medium-term estimates	2004/05	2005/06
Education	39 828	43 235	46 903	53 591	58 462	62 908	66 909
Health	24 110	26 385	29 759	33 159	36 569	39 881	42 946
Welfare	19 374	20 896	23 833	32 217	37 358	43 532	50 605
Housing and Community Development	3 341	4 086	4 509	5 191	6 087	6 600	7 298
Other functions	13 435	15 785	17 612	21 536	26 424	27 737	30 122
Total expenditure	**100 088**	**110 387**	**122 616**	**145 694**	**164 901**	**180 658**	**197 880**
Total revenue	**103 615**	**113 727**	**126 380**	**142 377**	**164 678**	**181 438**	**197 868**
Surplus/(deficit)	**3 527**	**3 341**	**3 764**	**-3 317**	**- 222**	**780**	**- 13**
Economic classification							
Current expenditure	94 154	102 596	110 957	132 538	146 899	161 857	176 699
Of which remuneration	*59 160*	*63 549*	*67 731*	*74 468*	*81 585*	*87 262*	*92 633*
Capital expenditure (incl. Housing)	5 934	7 791	11 659	13 156	18 002	18 802	21 182
Percentage shares of total expenditure							
Social services	*83,2%*	*82,0%*	*82,0%*	*81,7%*	*80,3%*	*81,0%*	*81,1%*
Other functions(Incl. Housing)	*13,4%*	*14,3%*	*14,4%*	*14,8%*	*16,0%*	*15,4%*	*15,2%*

Health policy to focus on staffing and equipping of health facilities

In the health sector, personnel expenditure is expected to see substantial funding. This is in line with the strategic aim of attracting and retaining professional personnel with scarce skills within the public health service. Priority will also be given to equipping the sector with human resources, drugs and equipment, in order to implement HIV/Aids prevention and treatment regimes within the current policy framework.

Attracting and retaining health professions in the public service

Additional allocations of R500 million, rising to R1 billion over the MTEF, have been made to address two key health professional interventions. Shortages of skilled health professionals in some provinces and hospitals have been identified as a major obstacle to improving health care. In certain areas of the profession, shortages in medical specialists, physiotherapists, psychologists, and pharmacists are particularly acute. A range of interventions has been designed to make serving in rural areas more attractive, as part of a broader rural health strategy. In 2003/04, the rural allowance for doctors, specialists and dentists will be increased significantly. Furthermore, the allowance will, for the first time, be extended to a wider range of categories of skilled professional personnel where inequities exist.

The 2003 Budget marks the launch of scarce skills strategy, which will see a significant upward adjustment in salaries for a range of health professionals, who are currently difficult to attract and retain in the public sector. Criteria have been developed to identify appropriate categories of professions.

These policies are in the process of finalisation by the Departments of Health and Public Service and Administration in consultation with the Bargaining Council. Once implemented, these incentives should help to impact positively on the ability of the public service to retain skilled professionals.

Provincial allocations to social development reflect commitment to accelerate implementation

Social development policy will continue to seek to enhance the effectiveness of South Africa's system of social security grants, which is proving to be an effective and well-targeted weapon in the effort to alleviate poverty. Both the personnel and non-personnel components of provincial social development budgets reflect strong growth rates, of 20 per cent and 16 per cent respectively.

Share of social development expenditure grows to 25 per cent by 2005/06

Combined with increased take up for the child support grant, especially the phased extension to children up to 14 years, the share of social development spending in total provincial expenditure rises from 22 per cent this year to 25 per cent by 2005/06, demonstrating Government's commitment to providing direct income support to vulnerable individuals and households.

R4,7 billion more expected for social security in 2003 Budget

Extending the social security net has substantial implications for provincial finances. As beneficiary numbers and grant values have increased, social development expenditure is set to grow sharply in this year's provincial budgets. In aggregate, it is anticipated that about R4,7 billion more will be spent on social security grants in 2003/04, raising the level of spending on social development to R37,4 billion. The increase includes R1,1 billion earmarked for spending on the phased extension of child support grant to eligible children until they turn 14.

Grant administration is key to effective and efficient delivery of social security

As the types of grants and the range of social development services increase, institutional capacity within the sector needs to be strengthened. In addition to providing for increases in grant values and take-up, provincial budgets will make provision for enhancing systems and administrative capacity in the social development departments, reinforcing support for the implementation of norms and standards for social security delivery, for the Child Justice Bill, and support for other welfare services delivered by non-governmental organisations.

From 1 April 2003, pension and disability grants will go up to a maximum of R700 and child support grants to R160 a month.

Child support grant extended to children until they turn 14

The means-tested child support grant has proven to be an effective weapon in alleviating poverty, and has contributed towards keeping households from total destitution. The child support grant was introduced in 1998 in order to improve the standard of living of the poorest children. In particular, the grant aims to reduce infant mortality, improve child nutrition and support general care of children.

The grant is presently available to children up to their seventh birthday. It is estimated that approximately 3,6 million children up to the age of six are eligible for the child support grant. Presently, 2,5 million children are receiving the grant, with one million still to gain access. The grant will be extended in a phased manner to children from the ages of seven and 14. The phased extension to children until they turn 14 will add another estimated 3,2 million eligible beneficiaries over the next three years.

In order to make sure that the capacity exists to add these large numbers of beneficiaries, and that extension can properly be targeted to the most vulnerable, seven- and eight-year olds will be able to apply for grants in 2003/04, nine- and ten-year olds in 2004/05 and 11 to 14 year olds in 2005/06. In order to fund this rollout, R1,1 billion, R3,4 billion and R6,4 billion are allocated as a conditional grant to provinces in each of the next three financial years. These amounts include a component for administration.

Other provincial functions

In addition to school education, health and social development, provinces are also responsible for housing, roads, agriculture, economic affairs, environment and tourism and other administrative functions. After being squeezed out by social services functions in the late 1990s, provincial spending on other functions recovered in 2000/01. The 2003 provincial budgets reinforce the turnaround in spending on these functions.

Spending on non-social service functions rises sharply over the MTEF

Spending on other provincial functions, including housing, rises from R22,0 billion in 2001/02 to a projected R26,0 billion in 2002/03, and is set to rise to R37,4 billion by 2005/06. The share of spending on other functions will exceed 20 per cent in 2003/04 before levelling off over the MTEF.

Changes in expenditure mix will contribute to growth prospects and job creation

Strong real growth in non-social services expenditure of 6,1 per cent over the next three years, largely driven by growth in capital expenditure, will provide a significant boost to economic opportunities and employment creation across provinces, and will open more opportunities for public private partnerships.

Provincial infrastructure investment continues to rise rapidly

Provincial investment in public infrastructure has grown strongly over the last three years, rising from R7,8 billion in 2000/01 to R10,7 billion in 2001/02, or approximately 10 per cent of total provincial expenditure. Although growth in capital expenditure was initially slow, reflecting weak institutional capacity, levels of expenditure are now catching up with allocations, rising by 33 per cent in 2001/02.

Provincial Public Private Partnership (PPP) initiatives

Several provincial departments engage in, or are exploring the use of PPP arrangements in the delivery of services. In fact, all but one of the six PPPs concluded in 2002 in accordance with the Treasury Regulations were provincial projects. Of these, two were hospital projects, based at the Albert Luthuli Central Hospital in KwaZulu-Natal and the Universitas and Pelonomi Hospitals in Bloemfontein.

The Albert Luthuli Hospital PPP covers facilities management, medical equipment, and IT systems and maintenance, as well as equipment and IT refurbishment. The project is a milestone in South Africa's PPP experience. As the first provincial PPP in the country, it demonstrated a remarkable degree of co-operation between the different spheres, highlighting the state's ability to design and procure through PPP-type arrangements.

In the Bloemfontein project, the private sector will invest some R206 million (in nominal terms over 15 years) in Universitas and Pelonomi hospitals, in return for concession rights to operate hospital facilities within the public hospitals over the period. The project presents a good example of alternatives to competition for revenue between private and public health services. Both projects have very strong black economic empowerment components.

There are currently 22 other PPP projects that fall within the ambit of the PPP Unit. These include provincial toll roads, eco-tourism projects, a number of government fleet outsourcings and a wide range of health projects. In each project, the Treasury PPP Unit works closely with the relevant provincial treasury, with a view to delegating regulatory control to the provinces. This is particularly important, as PPPs cannot be procured outside of the budgetary framework. Provincial treasuries are now linking their PPPs to their budget framework.

The Treasury Regulations clearly envisage the exercise of the regulatory function over PPPs being delegated by the Minister of Finance to the provincial treasuries.

Notwithstanding indications of improvement in spending capacity on capital allocations, more remains to be done to further enhance infrastructure delivery. The increased allocations to capital expenditure present a major challenge to provinces, which if met, will help reinforce further acceleration of infrastructure delivery over the medium term.

Local government finance

Local government budget priorities

Average annual growth of 18,4 per cent to local sphere

Substantial resources are being made available to the local government sphere in the 2003 Budget, to provide for poverty relief, extend infrastructure delivery and further strengthen the local government system through skills development and capacity building. National transfers to local government increase at an annual average growth rate of 18,4 per cent, from R8,8 billion in 2002/03 to R14,6 billion in 2005/06.

This increase is particularly significant when compared to the forward estimates of the 2002 Budget. The local government share rises by R1,8 billion in 2003/04, R2,4 billion in 2004/05 and R3,1 billion in 2005/06 above the forward estimates published in the 2002 Budget, taking the local share of nationally raised revenue from 3,6 per cent in 2002/03 to 4,4 per cent by 2005/06..

Government prioritises free basic services

The bulk of the additional resources will be targeted towards the provision of free basic services, the extension of services to areas not presently serviced and further infrastructure investment. In total, R4,1 billion over the 2003 MTEF will be made available for water, electricity, refuse removal and sanitation as part of Government's commitment to provide free basic services to households that cannot afford them.

Support for urban and rural development

Infrastructure grants to municipalities remain a key instrument in urban renewal and rural development:

- The municipal infrastructure programme has benefited 2,5 million people since 1997
- The local economic development fund has contributed to 4 550 permanent and 9 050 temporary jobs to date
- Between 1994 and 2001 a total of 1,2 million new electricity connections were made
- Some 8,5 million people have gained access to improved water services, 105 000 toilets have been constructed and 670 000 have benefited from water-related health and hygiene programmes
- Sports facilities have been constructed or improved in 55 communities, providing about 2 200 job opportunities.

Table 7.7 Transfers to local government

R million	2002/03	2003/04	2004/05	2005/06
Equitable share	3 964	6 343	7 078	7 698
Transition grant	223	–	–	–
Water & sanitation operating	700	836	858	934
Subtotal equitable share & related	**4 887**	**7 180**	**7 936**	**8 633**
Consolidated Municipal Infrastructure Programme	1 671	2 246	2 724	3 016
Water Services Project	999	1 102	948	1 037
Community Based Public Works Programme	260	260	–	–
Local Ecomomic Development Fund	111	117	–	–
Sport & Recreation facilities	76	123	–	–
National Electrification Programme	228	240	245	258
Urban Transport Fund	40	9	–	–
Integrated Sustainable Rural Development	32	–	–	–
Municipal Infrastructure Grant	–	47	117	97
Unallocated[1]	–	–	555	588
Subtotal capital	**3 416**	**4 144**	**4 588**	**4 996**
Restructuring grant	250	315	343	363
Financial management grant	154	212	199	208
Municipal Systems Improvement	94	150	182	423
Subtotal capacity building & restructuring	**498**	**677**	**724**	**995**
Total transfers to local government	**8 801**	**12 001**	**13 249**	**14 624**

1. Poverty relief allocations in 2004/05 & 2005/06 are subject to a Cabinet review and therefore unallocated

R1 billion for labour-based infrastructure and services

An additional R1,8 billion over the next three years is allocated for infrastructure delivery of which R1 billion will be earmarked for labour-based infrastructure investments, to boost employment creation at a local level.

Consolidation of grants sharpen their strategic focus

An additional R300 million over this MTEF is set aside for capacity building. An interim framework has been adopted for aligning the capacity building allocations into a single grant by 2005/06. Capacity building grants to municipalities that flow through provinces will be incorporated into the Municipal Systems Improvement Grant in 2005/06. This translates into an additional R233 million to the local sphere, and accounts for the sharp increase in the value of the grant in 2005/06. Increases will be focused on financial management and reform, and on improving strategic management and service delivery skills.

Guideline growth limit in municipal operational budgets set at 9 per cent

In terms of current legislation, the Minister of Finance is required to determine the maximum growth limits for municipal budgets. There is strong link between the rate of growth in municipal budgets and increases in service charges. The guideline growth rates for municipal budgets for the next three years are set at 9, 8 and 7 per cent, respectively. The guideline rates also take into account anticipated changes in service charges and tariffs for electricity and water, and medium term salary agreements between the South African Local Government Association (SALGA) and relevant employee representatives.

Policy and Budget reforms

Unlike provinces, local governments have significant revenue raising powers. However, the high proportion of poor household in some municipalities presents serious challenges to the efforts of local government to realize their revenue-raising potential.

Transfers from national constitute 17 per cent of local revenue

While transfers from national government comprise 17 per cent of total local government revenue (the remainder raised through own revenue)[1], this percentage is much higher for the smaller and predominantly rural municipalities, which typically receive 60 per cent of their income in transfers.

Local government fiscal framework under review

Broadening the revenue base of local government remains an important objective. A number of policy developments are being considered to enhance the revenue raising capacity of local authorities. These include:

- The alignment of municipal fiscal powers and functions
- A review of the Regional Services Council levies to overcome administrative, compliance and other inefficiencies
- A review of the equitable share formula, primarily in light of new census data, and the need to give effect to government policy on addressing basic services
- Changes to powers and functions between category B and C municipalities as gazetted in January 2003
- Tabling of the Property Rates Bill, to regulate the levying of property rates by municipalities
- Restructuring of the electricity distribution industry and other service sectors
- Implementation of the Municipal Finance Management Act and other legislative reforms to financial management, such as the borrowing powers of municipalities.

Early publication of municipal allocations to facilitate multi-year budgeting

For the first time this year, a breakdown of national transfers to local government by municipality is published in the *Division of Revenue Bill* on Budget Day, four months ahead of the municipal financial year. Early publication of municipal allocations from national government will enable municipalities to incorporate these allocations into their budgets, to improving planning and budgeting, and thus facilitating the timely execution of capital projects. This should also enhance transparency in the intergovernmental fiscal system.

Transfers to local government are made through three types of funding streams – the equitable share, infrastructure transfers and recurrent transfers for capacity building and restructuring purposes. These are outlined below.

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[1] The National Treasury estimates actual budgets to be in the region of R68 billion. This estimate is lower than budgeted figures, since municipalities do not collect all revenue budgeted.

Equitable share

Provision of free basic services continues to be one of key priorities

The equitable share is an unconditional transfer, intended to assist municipalities to deliver basic services such as water, sanitation, electricity and refuse removal. The equitable share formula, outlined in detail in Annexure E, favours poorer municipalities.

The local government equitable share nearly doubles

The equitable share grows in significance from 45 percent of transfers to local government in 2002/03, to 53 per cent in 2005/06. In principle, the unconditional portion is set to grow relative to conditional grants in future as the intergovernmental system matures. The equitable share rises from R3,9 billion in 2002/03 to R6,3 billion in 2003/04, R7,1 billion in 2004/05 and R7,7 billion in 2005/06.

Over the 2003 MTEF, the equitable share has been supplemented with a R1,4 billion allocation for free electricity, and R2,7 billion for free basic water, sanitation and refuse removal services. These funds will flow to municipalities, either directly or through national department programmes and other agencies. Where other agencies provide these services, service level agreements will be negotiated. In 2002/03, 20 per cent of the equitable share went to category A municipalities (metropolitan councils), 67 per cent went to B municipalities (primary local councils) and 13 per cent to C municipalities (district councils).

Shifts in powers and functions changed distribution of resources

Figure 7.1 sets out the distribution of the equitable share between different categories of municipalities for 2003/04. Due to the reconfiguration of powers and functions between category B and C municipalities, the portion of the equitable share going to category C municipalities increases to about 17 per cent in 2003/04, with a corresponding decline in category B municipalities' share. Since category A municipalities are not affected by the shift in municipal powers and functions, their share of the total equitable share remains at approximately 20 per cent. Approximately 38 per cent of the equitable share is distributed to the 30 largest municipalities (measured in terms of budget), which house approximately 49 per cent of the poor.

Infrastructure transfers

Infrastructure transfers to local government receive a strong boost in this year's Budget, geared principally towards expanding basic infrastructure services to poor households, infrastructure rehabilitation, and to promoting job creation through labour-intensive delivery mechanisms. Increased allocations within municipalities will prioritise urban and rural development nodes.

Figure 7.2 provides a breakdown of infrastructure grants by category A, category B and category C municipality.

Figure 7.1 Distribution of the equitable share for 2003/04

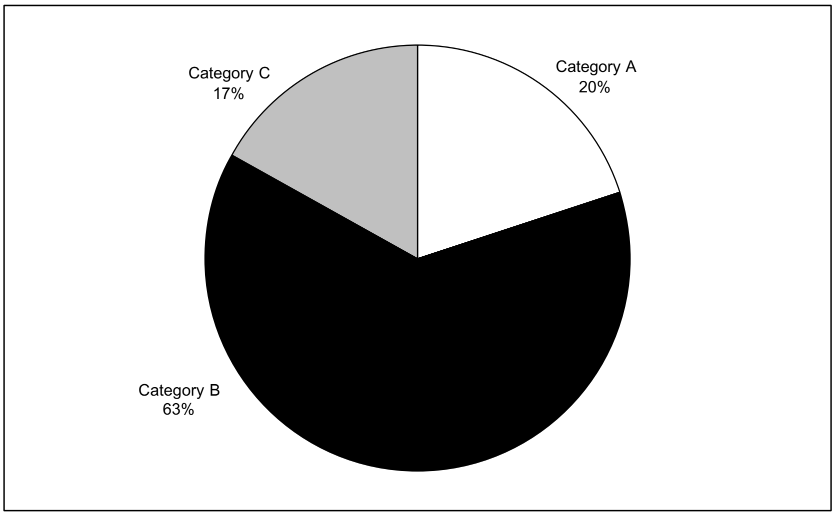


Table 7.7 shows grants for infrastructure increasing at a real annual average of 8,7 per cent over the MTEF, from R4,1 billion in 2003/04 from R3,4 billion in 2002/03. For the outer years of the MTEF, total infrastructure transfers rise further to R4,6 billion and R4,9 billion. The largest rise is in the Consolidated Municipal Infrastructure Programme (CMIP) Grant, accounted for by R1 billion of additional expenditure spread over the MTEF, for labour-based infrastructure investment and services.

Infrastructure allocations increase by 8,7 per cent in real terms with priority given development nodes

The rise in infrastructure grants is likely to have a positive impact on expanding municipal infrastructure and accelerating basic service delivery to areas most in need. In aggregate, infrastructure grants to local government increase at an annual average of 7,8 per cent in real terms.

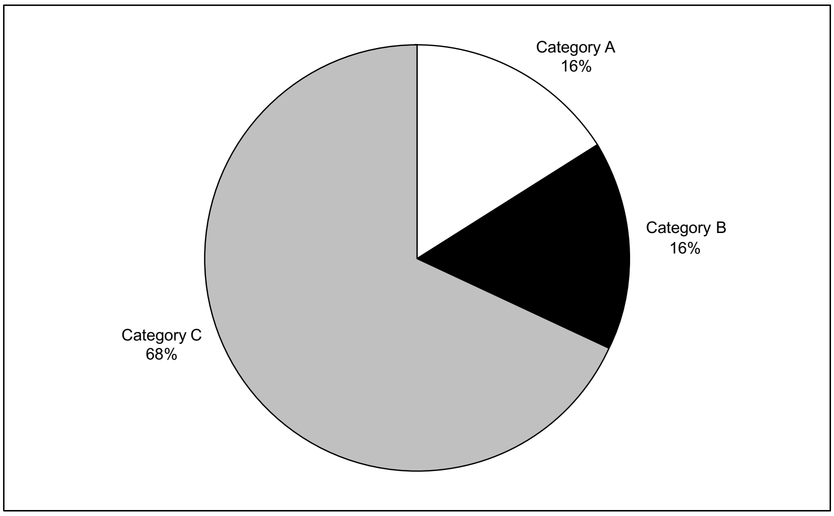
For the medium term, work is under way to rationalise infrastructure transfers to local government and to make the system of transfers simpler, predictable, more policy-sensitive and fair. The phased transition to a formula-driven infrastructure grant, referred to as the Municipal Infrastructure Grant, is under consideration. This grant will be created through the merger of the existing municipal infrastructure transfers listed in table 7.7. The consolidation will be phased in over a three-year period, beginning with a R47 million allocation in 2003/04, which will be used to pilot the new municipal infrastructure grant in select municipalities.

Consolidation of infrastructure grant is under consideration

The grant is intended to assist municipalities to provide basic municipal infrastructure and community services to low income households, and to promote economic development. It is also intended to resolve current problems of inequity in grant distributions, as well as flaws in financial accountability arrangements as identified during the implementation of past Division of Revenue Acts and by the Auditor-General.

Focus will be on basic municipal infrastructure

Figure 7.2 National infrastructure transfers 2003/04



The Restructuring Grant

The restructuring grant targets larger municipalities

Larger cities have a significant impact on the regional and national economy. It is important that cities operate in an effective and efficient manner, and are able to generate sufficient revenues to deliver and extend services in their areas. The Restructuring Grant assists municipalities with large budgets with their restructuring process. Funding will be targeted towards the larger cities, in order to enhance macroeconomic growth, revenue management, local economic development, effective and efficient service delivery and long-term sustainability.

Current recipients, including the City of Johannesburg, have used the grant to improve their organisation, financial, administrative and operational processes, translating into effective service delivery. Negotiations with Mangaung and Msunduzi municipalities are at an advanced stage. A number of applications for this grant are currently being evaluated. Moreover, seed funding was made available to a number of municipalities in 2002 to assist in the preparation of applications to access the grant.

Capacity building and support

39 pilot municipalities currently benefit from the Financial Management Grant

Experience from financial management reforms in selected municipalities indicates that proper preparation of budgets is critical for reforming operational systems and improving service delivery. The Municipal Financial Management Grant supports reforms presently being implemented in 39 pilot municipalities. In 2003/04, the allocation for the grant increases to R212 million. This will enable a further 31 municipalities to be added to the programme, offering opportunity for over 200 internships.

Government collaborates in international programme to support capacity building

Government has also entered into an agreement with the International Bank for Reconstruction and Development (IBRD) to provide technical assistance in implementing municipal financial management reforms. The programme is modeled on the spirit of municipal finance management reforms. The first phase has commenced with the placement of international advisors in nine municipalities. Rollout of the programme will be fast-tracked over the MTEF.

Promulgation of Municipal Finance Management Act expected shortly

A framework for the implementation of the Municipal Finance Management Act will be issued shortly after the formal adoption process. The implementation of the act, to be completed by mid-2007, will take cognisance of the uneven capacities of municipalities to implement financial reforms.

An interim framework has been adopted for aligning capacity building initiatives into a consolidated grant by 2005/06. The framework prioritises planning, strategic management, service delivery skills and financial management reforms. Capacity Building grants to municipalities that flow through provinces will be incorporated into the Municipal Systems Improvement grant in 2005/06.

Conclusion

The financial and fiscal reforms of the last five years substantially enhanced the capacity of provinces and local authorities. Significant increases in fiscal transfers to provinces and local government set out in this chapter will contribute to the consolidation of social services delivery and provision of free basic services to households that cannot afford them.

The imminent promulgation of the Municipal Financial Management Act will facilitate extension and deepening of financial management and budget reforms at the level of local government, similar to those implemented at national and provincial level under the Public Finance Management Act. This will be accompanied by a review of the fiscal framework for local government to commence in 2003, entailing a range of reforms to accommodate shifts in powers, functions and fiscal capacity.

With Census 2001 results due to be published this year, the equitable share formula will the reviewed. If changes are deemed necessary, they are likely to be introduced in the 2004 Budget.