7

Provincial and local government allocations

The evolution of a stable and well-functioning intergovernmental fiscal system has been a notable success of South Africa's first decade of democracy. In 1994 South Africa had fragmented administrations designed to spend public resources and deliver services along racial lines. Ten years on, there is a unitary state, nine sound provincial governments and 284 municipalities, whose consolidation and institutional capacity-building are well under way.

Ten years ago, budget decisions were highly centralised and provinces, homelands and black local authorities only existed as administrations. This year, R195,4 billion of nationally raised revenue will be transferred to democratically elected provincial and local governments for the delivery of improved public services to all South Africans.

In the 2004 MTEF, R30,2 billion is added to the baseline allocations of provincial and local governments. This will see national transfers to provinces growing by 4,8 per cent in real terms over the MTEF while local government allocations will grow by 5,8 per cent in real terms.

In the provincial sphere, the increases will reinforce pro-poor social services spending on school education, health and social security grants. Increased local government allocations are intended to accelerate the delivery of municipal services, especially basic services to poor households.

Over the medium term, provinces and municipalities will prioritise labour-based infrastructure projects as part of Government's Expanded Public Works Programme.

Intergovernmental finances – an overview

South Africa has made remarkable strides in developing its intergovernmental system in the last ten years. Before 1994, the country had a highly centralised budget process, which sought to allocate resources along racial lines, spending disproportionately less on black South Africans per capita. Ten years later, South Africa has a non-racial, decentralised budgeting system, with substantial resources allocated to the poor regardless of their race.

Intergovernmental system decentralises budget responsibilities

The Budget allocates about 61,8 per cent of nationally raised revenue (after debt-servicing) to the 9 provinces and 284 municipalities who are empowered to take resource allocation decisions within the context of broad medium-term priorities of government that are agreed through consultative processes in intergovernmental forums such as the Budget Council, Budget Forum, sectoral MinMECs, joint MinMECs and extended Cabinet meetings in which provinces are represented by Premiers and local government by the chairperson of the South African Local Government Association.

Division of revenue is informed by social and development priorities

For the 2004 MTEF, the intergovernmental consultative processes and the recommendations of the independent Financial and Fiscal Commission (FFC) have culminated in the division of revenue set out in table 6.2 of Chapter 6, which is informed by spending commitments, revenue capacity, government priorities and the functional responsibilities of each sphere.

Census results will affect grant allocations

The publication of 2001 Census data presents an opportunity for a review of all grant formulae. A review is also necessary to take account of the shift of social security payments to the national sphere, and the restructuring of the electricity distribution industry. Hence this process will be undertaken in two parts.

Comprehensive Review of all formulae for 2005 MTEF

For the 2004 Budget, selected components have been updated where new data could readily be applied. For 2005, a more comprehensive review will be undertaken covering aspects pertaining to the structure of all formulae, weights of components, type of data and other economic development and poverty related policy considerations. This will also consider revisions to the fiscal framework as it applies to provinces and municipalities, to assess their taxation and borrowing powers.

Provincial priorities include improving school education and comprehensive HIV and Aids programme

Provinces receive R26,3 billion more of nationally raised revenue to fund increases in social services expenditure: implementation of a scarce skills strategy and scaling up of HIV and Aids treatment in health; further extension of social assistance through enhanced income support to the poor and procurement of complementary inputs such as textbooks and other materials in school education.

Additions to provincial baseline allocations are also intended for spending on Expanded Public Works and Comprehensive Farmer Support programmes which are among the top priorities for the next decade. Provinces will continue to channel increasing resources towards provincial economic development programmes with high potential for creating employment opportunities.

Social services need to be balanced with investment in infrastructure

Provinces face a number of challenges over the next decade. Foremost is the need to balance the expansion of social services with reinforcement of investment in infrastructure and economic development. More work needs to be done to improve the quality of spending, especially in the areas of housing, health services and school education. Though improving, financial management capacity need to be deepened further to reduce the number of provincial departments still receiving qualified audit reports.

Local government priorities include improved accountability

National transfers to local government for the next three years go up by a further R3,9 billion to accelerate the roll out of free basic services to poor households and the provision of municipal infrastructure. Key financial reforms over the next three years will be driven by implementation of the Municipal Finance Management Act. Local government challenges include improving service delivery capacity, maintaining and extending infrastructure, collecting revenue, reducing the share of personnel expenditure, and improving accountability through the timely submission of financial statements for audit.

Transfers to provinces and municipalities are dealt with in detail in Annexure E

This chapter sets out the provincial and local government priorities that informed revisions to the national transfers to the two spheres. It outlines the composition, criteria and trends in national transfers to provinces and local government, which are discussed in detail in *Annexure E*.

The chapter also summarises the projected provincial expenditure outcome for the 2003/04 financial year and makes preliminary observations on trends in 2004 provincial MTEF budgets, which will be tabled during the two weeks after the national Budget. The coming *2004 Intergovernmental Fiscal Review,* to be published in May, will cover the budgets of each province and municipality.

Funding provincial governments

Provincial priorities for the 2004 MTEF

The 2004 MTEF builds on the sound policy framework that evolved over the first decade of democracy and provides for further deepening and consolidation of social services, which make up the bulk of provincial expenditure.

Budget framework provides for implementation of Aids treatment programme

The provincial budget framework aims to strengthen the health sector to implement Government's comprehensive response to HIV and Aids. In addition to amounts allocated through the equitable share in previous years, the framework allocates an additional R1,9 billion to the Health HIV and Aids conditional grant over the next three years for the rollout of antiretroviral drugs in designated facilities across the nine provinces.

Additional allocations provide for the completions of the extension of CSG

The allocations to provinces provide for the completion of the phasing of the extension of the Child Support grant and increases in grant values. The 2004 MTEF provides for the cost of extending this benefit to children in the age cohorts 9 to 13. Accordingly, R2,5 billion is added to the conditional grant in 2006/07 to provide for the additional beneficiaries. The equitable share is also adjusted to take account of higher take-up of other social security grants and increases in grant values with the view of protecting their purchasing power.

Focus on further improving education outcomes

Revisions to provincial allocations make provision for stepping up spending on school education and other education programmes such as Early Childhood Development and Adult Basic Education. The aim is to raise the level of spending on non-personnel components of education expenditure in order to improve educational outcomes.

Increased infrastructure expenditure will also create jobs

With regard to non-social service functions delivered by provinces, the priority is to ensure that infrastructure delivery facilitates the creation of employment opportunities. Additional allocations to the Provincial Infrastructure grant are expected to create room for increased spending on labour intensive projects such as rural roads and agricultural infrastructure. Over the next five years, about R15 billion of provincial infrastructure expenditure will be directed at such programmes, contributing towards the programme's overall target of providing 1 million job opportunities. A further priority is to provide on- and off-farm support to developing farmers, including those benefiting from the Land Redistribution for Agricultural Development (LRAD) programme.

Provincial revenue

The design of South Africa's intergovernmental fiscal system is such that provinces rely on national transfers for funding public services such as school education, health, social security grants and housing. This is largely due to the fact that most of these services are targeted at the poor and do not lend themselves to cost recovery.

National transfers to provinces continue to show strong growth in real terms

National transfers to provinces make up 97 per cent of total provincial revenue in 2004/05 and are budgeted to rise from a revised R161,5 billion in 2003/04 to R181,1 billion in 2004/05, and to R216,3 billion by 2006/07. This translates into a nominal growth in national transfers of 12,2 per cent in 2004/05, and an average annual growth of 10,2 per cent over the MTEF period. Provincial revenue from own sources makes up 3 per cent of total provincial revenue and is projected to grow from R5,4 billion in 2004/05 to R6,2 billion in 2006/07.

Table 7.1 Provincial revenue, 2003/04 – 2006/07

	2003/04		2004/05	2005/06	2006/07
	Budget	Revised	Medium-term estimates		
R million		estimate			
Transfers from national	158 995	161 476	181 130	199 704	216 344
Equitable share	*142 386*	*144 743*	*159 971*	*173 852*	*186 392*
Conditional grants	*16 609*	*16 733*	*21 158*	*25 853*	*29 953*
Own revenue	*5 683*	*5 985*	*5 363*	*5 833*	*6 219*
Total	**164 678**	**167 461**	**186 493**	**205 537**	**222 563**
Percentage growth					
Transfers from national			*12,2%*	*10,3%*	*8,3%*
Equitable share			*10,5%*	*8,7%*	*7,2%*
Conditional grants			*26,4%*	*22,2%*	*15,9%*
Own revenue			*-10,4%*	*8,8%*	*6,6%*
Total			***11,4%***	***10,2%***	***8,3%***

The 2004 MTEF provides R26,3 billion more for provinces over 2003 baselines

The 2004 MTEF allocations provide for a further R26,3 billion additional spending in the provincial sphere. With these adjustments to baseline allocations, the provincial share of nationally raised revenue rises from 56,8 per cent in 2003/04 to 58,0 per cent in 2006/07.

Provincial equitable share increases by R19,7 billion over the MTEF

Of the R26,3 billion added to the provincial share over the MTEF, R19,7 billion goes into the equitable share, while R6,6 billion is added to conditional grants. This will see the equitable share rising from R144,7 billion in 2003/04 to R186,4 billion in 2006/07. Conditional grants grow from R16,7 billion to R29,9 billion over the same period, with the CSG extension grant accounting for R9,3 billion of the total conditional grant amount by 2006/07. Table 7.2 sets out total national transfers to provinces, including equitable shares and conditional grants.

Table 7.2 Total transfers to provinces, 2002/03 – 2006/07

	2002/03	2003/04		2004/05	2005/06	2006/07
	Outcome	Budget	Revised	Medium-term estimates		
R million			estimate			
Eastern Cape	22 714	26 447	26 826	30 129	33 248	35 911
Free State	9 270	10 709	10 873	12 164	13 294	14 321
Gauteng	22 413	25 794	26 188	29 008	31 697	34 005
KwaZulu-Natal	27 516	32 196	32 681	36 906	40 921	44 555
Limpopo	17 981	21 043	21 403	23 953	26 580	28 926
Mpumalanga	9 414	11 131	11 311	12 814	14 273	15 623
Northern Cape	3 270	3 841	3 899	4 412	4 784	5 150
North West	11 032	12 869	13 077	14 862	16 493	17 927
Western Cape	13 314	14 964	15 218	16 884	18 415	19 927
Total	**136 925**	**158 995**	**161 476**	**181 130**	**199 704**	**216 344**

Equitable share comprises the largest transfer to provinces

Table 7.3 shows that the equitable share, which amounts to R159,9 billion, is the most significant transfer to provinces in 2004/05, while conditional grants amount to R21,2 billion. The two components of national transfers to provinces are discussed in detail below, and further details are provided in *Annexure E.*

Table 7.3 Transfers to provinces, 2004/05

	Equitable	Conditional grants					
	share	Health	Provincial Infrastructure Grant	Housing	Social Develop-ment	Other[1]	Total
R million							
Eastern Cape	26 990	628	609	611	1 004	286	30 129
Free State	10 551	620	199	395	288	111	12 164
Gauteng	24 547	2 609	332	1 140	259	121	29 008
KwaZulu-Natal	33 059	1 209	706	776	861	294	36 906
Limpopo	21 789	318	593	381	640	231	23 953
Mpumalanga	11 606	227	255	304	298	124	12 814
Northern Cape	3 839	179	159	93	79	63	4 412
North West	13 270	268	288	430	466	139	14 862
Western Cape	14 320	1 596	205	460	213	89	16 884
Total	**159 971**	**7 655**	**3 348**	**4 589**	**4 108**	**1 458**	**181 130**

1. Includes grants in the national departments of Agriculture, Education, Provincial and Local Government and Sport and Recreation South Africa.

The equitable share

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

The equitable share comprises 88,3 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 R4,7 billion in 2004/05 and R6,3 billion in 2005/06. With the new baseline allocation for 2006/07, the provincial equitable share allocation rises by 8,8 per cent a year over the MTEF period.

Allocation of equitable share is determined through provincial budget processes

The provincial equitable share allocation is an unconditional grant and provinces have discretion over how they allocate it among the functions they perform taking into account Government priorities.

The revised provincial equitable shares in table 7.4 are divided among provinces by means of a redistributive formula. The formula is reviewed and updated every year for new data, taking into account recommendations of the FFC. The publication of 2001 Census data presents an opportunity for a comprehensive review of the formula, for the 2005 MTEF.

Table 7.4 Provincial equitable shares, 2002/03 – 2006/07

R million	2002/03 Outcome	2003/04 Budget	2003/04 Revised estimate	2004/05	2005/06	2006/07
				Medium-term estimates		
Eastern Cape	21 166	24 228	24 627	26 990	29 083	30 914
Free State	8 270	9 463	9 621	10 551	11 378	12 104
Gauteng	18 844	21 876	22 237	24 547	26 644	28 530
KwaZulu-Natal	25 157	29 279	29 763	33 059	36 105	38 901
Limpopo	16 692	19 352	19 674	21 789	23 730	25 497
Mpumalanga	8 705	10 220	10 388	11 606	12 748	13 813
Northern Cape	3 000	3 455	3 512	3 839	4 125	4 372
North West	10 328	11 822	12 018	13 270	14 410	15 436
Western Cape	11 294	12 692	12 904	14 320	15 628	16 825
Total	**123 457**	**142 386**	**144 743**	**159 971**	**173 852**	**186 392**

Selected components of the formula are updated for the 2004 Budget

For the 2004 Budget, only selected components are updated with new data. These are the education, basic and economic components. The current structure of the formula is summarised below (weights of each components are included in brackets):

- An *education component* (41 per cent) based on the size of the school-age population (ages 5-17) and the average for three years' enrolment (2000-2002)
- A *health component* (19 per cent) based on the proportion of the population without medical aid or health insurance
- A *welfare 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 component* (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 infrastructure needs as captured in the schools register of needs, the audit of hospital facilities and the share of the rural population
- An *economic 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.

Further details on the equitable share formula and Government's response to the recommendations of the FFC are discussed in detail in *Annexure E.*

Conditional grants to provinces

Baseline allocations of grants central to Government's priorities are revised upwards. Table 7.5 lists conditional grants to the provinces over the 2004 MTEF. Conditional grant frameworks have been revised with the view of defining more sharply their outputs. However, much still remains to be done to improve the administration and monitoring of conditional grants, as noted by the report of the Auditor-General for the 2002/03 financial year.

Changes to conditional grants reflect national priorities

Changes to baseline allocations for conditional grants are made to the HIV and Aids, Provincial Infrastructure and Child Support Extension grants. Two new grants are also introduced to provide support to developing farmers and to encourage mass sport participation in previously disadvantaged communities. The school-based portion of the Integrated Nutrition Programme Grant previously administered by Health now shifts to Education. The Financial Management and Quality Enhancement Grant in Education is phased into the provincial equitable share. After all adjustments are taken into account, total conditional grant allocations will be R21,2 billion in 2004/05 rising to R29,9 billion in 2006/07. This reflects an upward adjustment of R802 million, R1,6 billion and R4,2 billion in conditional grants over the MTEF period.

Health

About 36 per cent of conditional grants to provinces are in the health sector, comprising six of the nineteen grants. Health conditional grants total R7,7 billion in 2004/05 rising to R8,5 billion and R9,2 billion in the two outer years of the MTEF.

The health HIV and Aids grant receives the largest increase

An amount of R1,9 billion over the next three years is added to the baseline allocation of the Health HIV and Aids grant bringing budgeted spending for this purpose to R3,5 billion over the next three years. This level of growth is in preparation for the rollout of antiretroviral treatment programmes and augments other treatment and prevention strategies currently under way. The main elements of the ARV programme are the costs of coordinating the programme, drugs, treatment, training and nutrition.

Enhanced performance of Hospital Revitalisation programme

After a 17 per cent increase to R718 million in 2003/04 the Hospital Revitalisation grant is allocated R912 million in 2004/05 and R1 billion in 2005/06. A further R91 million is added to the grant in 2006/07 increasing it to R1,2 billion. The grant funds major rehabilitation and replacement of equipment in central hospitals in line with the strategic transformation of the hospital sector.

Table 7.5 Conditional grants to provinces, 2003/04 – 2006/07

R million	2003/04	2004/05	2005/06	2006/07
Provincial and Local Government	**298**	**261**	**44**	**46**
Local Government Capacity Building Fund	232	220	–	–
Project Management Capacity for MIG	38	41	44	46
Disaster Management	27	–	–	–
National Treasury	**2 534**	**3 348**	**3 731**	**4 118**
Provincial Infrastructure	2 334	3 348	3 731	4 118
Provincial Infrastructure - Flood Rehabilitation	200	–	–	–
Education	**1 144**	**961**	**1 048**	**1 243**
Financial Management and Quality Enhancement	213	–	–	–
HIV and Aids	132	129	136	144
Early Childhood Development	88	–	–	–
Primary School Nutrition Programme	712	832	912	1 098
Health	**6 711**	**7 655**	**8 486**	**9 228**
National Tertiary Services	3 995	4 273	4 529	4 801
Health Professions Training and Development	1 333	1 434	1 520	1 520
Hospital Revitalisation	718	912	1 027	1 180
Hospital Construction - Academic Hospitals	92	–	–	–
Comprehensive HIV and Aids Grant	334	782	1 135	1 567
Integrated Nutrition Programme	97	112	123	–
Hospital Management and Quality Improvement	133	142	150	159
Medico-legal	9	–	–	–
Social Development	**1 654**	**4 108**	**7 362**	**9 774**
HIV and Aids (Community-Based Care)	66	70	74	79
Child Support Extension	1 200	3 650	6 900	9 284
Food Emergency Relief	388	388	388	411
Agriculture	**36**	**227**	**290**	**345**
Land Care: Poverty Relief and Infrastructure Development	36	27	40	45
Comprehensive Agriculture Support Programme	–	200	250	300
Housing	**4 355**	**4 589**	**4 868**	**5 160**
Housing Subsidy	4 246	4 474	4 745	5 030
Human Resettlement and Redevelopment	109	116	122	130
Sport and Recreation South Africa	**–**	**9**	**24**	**39**
Mass Sport and Recreation Participation Programme	–	9	24	39
Total	**16 733**	**21 158**	**25 853**	**29 953**

Tertiary services and training grants streamlined to achieve equity in the funding and distribution of health services

The National Tertiary Services grant (NTS) and Health Professions Training and Development grant (HPTD) are the main tertiary services and training grants administered by the national Department of Health. These grants are reconfigured progressively to achieve equity in the funding and distribution of health services. A further review of the NTS grant and funding arrangements for academic hospitals is currently under way and its recommendations will be considered for the 2005 Budget. The NTS grant is allocated R4,3 billion in 2004/05, R4,5 billion in 2005/06 and R4,8 billion in 2006/07. The HPTD grant is allocated R1,4 billion in 2004/05 and R1,5 billion for each of the outer years of the MTEF.

Education

Relocation of PSNP to education will improve planning, coordination and delivery

The Primary School Nutrition Programme grant, which makes up the largest part of the Integrated Nutrition Programme previously administered by Health shifts to Education from April 2004. In view of the fact that the beneficiaries of the programme are school pupils, it is envisaged that the relocation of the programme will further improve planning, enhance co-ordination and contribute to more efficient feeding in schools. Amounts of R832 million, R912 million and R1,1 billion over the three-year period will now be part of the education budget for this programme. Health retains R112 million in 2004/05 and R123 million in 2005/06 to continue with Integrated Nutrition outside of the school system for another two years. Thereafter this part of the programme will be integrated into the health budgets of provinces through the equitable share.

HIV and Aids grant to fund school-based life skills training

The R129 million in 2004/05, R136 million in 2005/06 and R144 million in 2006/07 allocated to the HIV and Aids grant administered by the Department of Education is to fund school-based life skills training.

The education Financial Management and Quality Enhancement grant is phased into the provincial equitable share from 2004/05.

Social Development

R19,8 billion earmarked for the Child Support Extension Grant

The grants administered by the Department of Social Development grow sharply over the next three years, reaching R9,8 billion by 2006/07. The Child Support Extension grant is the reason for the growth as it rises from R1,2 billion in 2003/04 to R3,7 billion in 2004/05 and to R9,3 billion by 2006/07 bringing total spending on this grant to R19,8 billion over the next three years. In addition, R1,2 billion is set aside for emergency food relief over the next three years. The level of growth in these grants is in line with Government's aim of addressing poverty and vulnerability by widening income support.

Phasing of the CSG will be completed in 2006/07

Since its introduction in 2003/04, the Child Support Extension grant provides income support to 756 000 seven and eight year old children a month bringing the total amount of children benefiting from CSG to over 4 million. The grant is extended to nine and ten year-olds in 2004/05, and will cover 11, 12 and 13 year-olds in 2005/06. It is envisaged that by 2006/07 when the CSG Extension grant phasing is complete, a total of over 6 million children will be accessing the Child Support Grant at a monthly cost of around R1,4 billion.

A National Social Security Agency will take over social security payments in future

While social assistance is currently a provincial responsibility, legislation is currently being processed to consolidate 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 it is expected that the Social Security Agency will be implemented over several years.

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

Social Development also administers the component of the HIV and Aids grant which provide support to households caring for people with Aids. Over the MTEF, R223 million has been allocated to this grant.

Housing

R14,2 billion allocated for housing, but pace of spending is sluggish

The Housing Subsidy grant is allocated R14,2 billion over the next three years. Past and present spending trends on this programme reflect some sluggishness. For 2002/03, underspending of approximately R1,2 billion was recorded, while this year's third quarter report shows that spending continues to be slow at 56,3 per cent of the adjusted budget.

Pace of housing delivery likely to improve in future

However, following the National Housing Summit held during November 2003, and with the review of the programme to be undertaken by the Department of Housing and National Treasury, it is expected that some of the impediments to speedy and efficient delivery will be reduced or eradicated paving the way to faster housing delivery.

Provincial Infrastructure

Provincial infrastructure increases by R2 billion over the next three years

The Provincial Infrastructure grant is increased by R1,5 billion over baseline for the next three years and rises from R2,3 billion in 2003/04 to R4,1 billion in 2006/07 resulting in budgeted transfers of R11,2 billion over the next three years. Provincial capital spending capacity has improved over the past three years. In addition to increasing infrastructure spending and addressing backlogs in social and economic infrastructure, the rising infrastructure allocations lay the basis for the expansion of labour-intensive projects under the auspices of the Expanded Public Works Programme. From 2004/05 the scope of the grant is expanded to also provide for agricultural infrastructure development to support farmers who acquire land through the LRAD programme.

Sport and Recreation

Promote developmental sports within communities

The Department of Sport and Recreation has been allocated funds to promote mass participation among historically disadvantaged communities in a selected number of development sport activities. A grant called 'Mass Participation in Sport' is introduced, allocating a total of R72 million to provinces over the next three years.

Agriculture

Promotion of sustainable use and management of natural resources

The Department of Agriculture has allocated R112 million to provinces to implement the Land Care Programme. The goal of the Land Care Programme is to promote sustainable use and management of natural resources. This is to encourage and empower communities to take responsibility for the management of resources in order to support food security and job creation through increased productivity. Some of the themes within the programme include: water care, soil care, veld care and Junior Land Care Programme.

A new grant is introduced in agriculture to support the implementation of the Comprehensive Agricultural Support Programme (CASP). This will provide on- and off-farm support and effective extension services to developing farmers. Increasing provision of agricultural support services is critical for the success of of land redistribution initiatives, such as the Land Reform and Agricultural Development programme. R750 million is allocated over the MTEF years for this programme.

A new conditional will provide for comprehensive support to developing farmers

Local Government

Consistent with the process of streamlining fiscal flows between spheres, the local government capacity building grant, which currently flows through provinces is allocated R220 million in 2004/05 and is to be phased into the local government equitable share thereafter.

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

Provinces are, however, allocated R41 million in 2004/05, increasing to R46 million in 2006/07 to provide managerial, technical and administrative support to municipalities to implement infrastructure projects.

Provincial expenditure and budget estimates

Table 7.6 sets out actual consolidated expenditure trends for the past three years, a projected outcome for 2003/04 and preliminary provincial MTEF budgets for the next three years.

Table 7.6 Consolidated provincial expenditure according to function, 2000/01 – 2006/07

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
		Outcome		Revised		Medium-term estimates	
R million				estimate			
Education	43 442	47 088	52 838	59 770	64 776	69 289	73 545
Health	27 177	30 145	33 709	38 208	40 494	44 215	47 034
Welfare	20 930	23 889	32 473	41 769	47 813	55 690	62 436
Housing and community development	5 663	5 784	7 370	8 674	8 905	9 126	9 421
Other functions	12 870	15 462	19 348	22 914	24 126	26 669	28 701
Total expenditure	**110 083**	**122 369**	**145 738**	**171 336**	**186 113**	**204 989**	**221 137**
Total revenue	**113 430**	**126 041**	**142 670**	**167 461**	**186 493**	**205 537**	**222 563**
Surplus (+) / Deficit (-)	**3 347**	**3 672**	**-3 068**	**-3 874**	**380**	**548**	**1 426**
Economic classification							
Current payments	79 210	85 453	95 558	107 812	117 273	126 481	134 480
Of which compensation	*63 990*	*67 816*	*73 913*	*81 267*	*87 868*	*92 928*	*98 022*
Transfers and subsidies	26 854	30 476	41 834	53 059	57 200	65 520	72 819
Payments for capital assets	4 019	6 439	8 346	10 464	11 640	12 987	13 839
Percentage shares of total expenditure							
Social services	*83,2%*	*82,6%*	*81,7%*	*81,6%*	*82,3%*	*82,5%*	*82,8%*
Other functions (Incl. Housing)	*16,8%*	*17,4%*	*18,3%*	*18,4%*	*17,7%*	*17,5%*	*17,2%*

2003/04 projected outcome

Provincial finances are stable, but pressures are evident

The 2003/04 projected outcome set out in table 7.6 is based on actual expenditure for the first nine months, as at 31 December 2003. The figures show that provincial finances are broadly stable. In 2000/01 and 2001/02 provinces posted successive surpluses of about R3 billion in each year followed by a deficit of the same magnitude in 2002/03. This deficit was fully funded from previous years' surpluses and rollovers.

Allocative efficiency remains a challenge

One of the challenges facing provinces is to improve alignment between budgets and spending capacity, after taking account of rollovers. Underspending in housing and capital budgets, for example, will be addressed over time through improved planning and project management.

Provinces project a combined deficit of R3,9 billion for 2003/04

Provincial 2003/04 third-quarter reports also indicate that budgets have come under pressure as a result of unanticipated growth in social security grants expenditure. After taking account of adjustment budget estimates, provinces are projecting a combined deficit of R3,9 billion, of which about R1,5 billion is due to over-expenditure on social security grants, mainly attributable to rapid growth in take up of the disability grant, which has grown at an annualised rate of over 40 per cent.

2004 budget estimates

Consolidated preliminary provincial MTEF Budgets reflect strong alignment to priorities articulated in the *2003 Medium Term Budget Policy Statement*. Provinces will table their budgets in the two weeks following the tabling of the national budget, highlighting how each individual provincial budget gives expression to Government's priorities. Thereafter, provincial departments will table their strategic and performance plans detailing specific measurable objectives and showing how Government priorities are to be achieved. The following analysis is based on initial projections, and the *2004 Intergovernmental Review* will report on provincial budgets in May.

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

Supported by strong growth in transfers of nationally raised revenue, total provincial expenditure is budgeted to grow by 8,6 per cent in nominal terms in 2004/05, and at an average annual rate of 8,9 per cent over the MTEF. On the back of low inflation, this sets a base for strong real growth in key provincial functions.

Social services

This year's Budget sees a further consolidation of social service delivery – school education, health and social development. Social service spending grows by 9,4 per cent a year over the MTEF, facilitating further strengthening of pro-poor social services programmes, with emphasis on improving quality, while at the same time extending their reach to historically underserved areas.

Social services stable, but social security payments are rising rapidly

While the figures in table 7.6 reflect some stability in the share of social service spending around 82 per cent; the share of social development expenditure rises significantly from about 22 per cent in 2002/03 to about 26,0 per cent in 2004/05 and will exceed 28,0 per cent by 2006/07.

Non-personnel inputs in school education will receive a strong boost over the MTEF

Budgeted provincial education spending growth of 8,4 per cent in 2004/05 is aimed at sustaining the delivery of inputs like learner support materials and school infrastructure (new buildings, maintenance and furniture) needed to improve the quality of school education and also provide for the school nutrition programme. In addition, this growth funds the expansion of the Early Childhood Development Programme and the steady scaling up of adult basic education. 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.

ECD becomes part of mainstream education budgets

A phased expansion of the Early Childhood Development Programme within the core provincial education function is now funded from the equitable share and the conditional grant is phased out.

Health policy to focus on staffing and equipping of health facilities

In the health sector, personnel expenditure is expected to increase in line with the strategic aim of attracting and retaining professional personnel with scarce skills into the public health service, especially into rural areas. An agreement with the unions in the sector has now been concluded. Priority will also be given to equipping the sector with human resources, drugs and equipment, in order to implement HIV and Aids prevention and treatment regimes. Total health spending is budgeted to grow from R38,2 billion in 2003/04 to R47,0 billion in 2006/07.

Beneficiary trends support Government's commitment to widen the social safety net

Policies on welfare and social assistance are proving to be an effective and well-targeted mechanism in the effort to alleviate poverty. For the past decade of democracy, great strides have been made to widen the social safety net. There are currently over 7,4 million social grant beneficiaries accessing grants at a monthly cost of over R3 billion. There are presently 4 million children up to the age of 8 years accessing the Child Support Grant in addition to 179 000 benefiting through foster care grants. Projections are that, in total, just over 10 million beneficiaries will be receiving income support through social security grants by 2006/07. In addition to the growth in beneficiary numbers, grant values are adjusted each year to protect their purchasing power.

Strengthening administrative systems is key to efficient social grant delivery

The sharp growth of beneficiaries over the past years is supported mainly by policy changes directed at expanded coverage and improving the efficiency and effectiveness of the social security grant system. Particular attention is devoted to enhancing systems and administrative capacity in social development departments, supporting the implementation of norms and standards for social security delivery, and strengthening other welfare services delivered by non-governmental organisations.

Social development expected to be about 28,2 per cent of provincial spending and 3,9 per cent of GDP by 2006/07

Increases in social security spending demonstrate Government's commitment to providing direct income support to vulnerable individuals and households. In aggregate, it is anticipated that about R8 billion more will be spent on social security grants in 2004/05, raising the level of spending on social development to R41,7 billion. The increase includes R3,7 billion earmarked for spending on the phased extension of child support grants to the 9 and 10 year old cohorts. Social Development budgets are expected to grow to R62,4 billion by 2006/07 and include R9,3 billion to fund the extension of the child support grant to 11, 12 and 13 year olds. In addition, provincial budgets provide for increases in pension and disability grant values to a maximum of R740 and child support grant values to R170 a month. As a percentage of GDP provincial social development spending (which excludes social security fund spending) increased from 2,3 per cent in 2000 to 3,4 per cent by 2003/04 and is expected to reach 3,9 per cent by 2006/07.

Other provincial functions

Provinces provide for increased allocations towards non-social sector functions like housing, roads, agriculture, economic affairs, environment and tourism and other administrative functions. The 2004 provincial budgets provide for continued acceleration in the turnaround in spending that started in 2001/02 on these functions. Provincial budgets for the 'other functions' provide for sustainable rural development, investment in economic and social infrastructure and employment opportunities across provinces.

Increased spending on non-social service functions is sustained over the MTEF

The growing share in social spending, driven by the growth in social grants results in a slight decrease in the share of spending on other functions. However, in absolute terms spending on these functions continues to show a strong upward trend. Spending on other provincial functions, including housing, rises from R27,7 billion in 2002/03 to a projected R31,6 billion in 2003/04, and is set to reach R38,0 billion by 2006/07.

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

Strong growth in non-social services expenditure of 8 per cent over the next three years, largely driven by growth in infrastructure expenditure, will provide a significant boost to Government's efforts to address unemployment through the labour-based Expanded Public Works Programme and create economic opportunities across provinces. Provincial infrastructure allocations also provide for increased provision for Government's Comprehensive Agricultural Support Programme, which in addition to rural development, is important in providing food security, especially to the rural poor, and supporting the Land Redistribution for Agricultural Development Programme.

Provincial infrastructure investment continues to rise rapidly

Provincial investment in public infrastructure sustains an upward trajectory over the next three years. Provinces budget to make payments of R38,4 billion to capital assets over the MTEF. Payments for capital assets are budgeted to grow from R10,5 billion in 2003/04 to R11,6 billion in 2004/05 and to R13,8 billion by 2006/07. 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 challenge to provinces, which if met, will further accelerate infrastructure delivery over the medium term.

Local government finance

Local government budget priorities

Three phases of transformation since 1993

In the first decade of democracy, the local government sphere underwent significant changes as municipalities moved through a three-phase transition beginning in 1993, followed by interim local authorities in 1995 and the establishment of new municipalities in 2000. Among the major milestones has been the adoption of the Local Government White Paper in 1998, which has served as the basis for a series of new legislation such as the Municipal Structures Act (No. 33 of 2000), Municipal Systems Act (No. 44 of 2003), Municipal Finance Management Act (No. 56 of 2003) and the Property Rates Bill. In sum, the local government system has successfully amalgamated previously racially segregated municipalities, repealed archaic local government legislation and rationalised the number of municipalities from 843 in 1995 to the present 284 as part of the broader processes of addressing the challenges of poverty and inequality.

The year 2000 marked the start of the final phase of transformation

The 2000 local government elections ushered in the current phase of transformation of local government. Over the next decade, the challenges facing local government include institution-building, administrative reform, integrated planning, improvement in financial management and governance, expanding services and the delivery of free basic services, removing backlogs in infrastructure, enhancing revenue collection and management, and containing administrative and personnel costs within acceptable limits.

Local Government priorities: poverty relief, free basic services, job creation and capacity building

National transfers to municipalities supplement own revenue to enable them to fulfill their developmental roles. The key local government priorities are the expansion and provision of free basic services; acceleration of delivery of water, electricity and sanitation infrastructure to poor households; extension of services to areas not presently serviced; the creation of jobs through the Expanded Public Works Programme and enhancing capacity in the local sphere through administrative and financial management reforms.

Over the next three years, municipalities will receive an additional R3,9 billion, taking total transfers to local government over the next three years to R47,3 billion.

Consolidation of infrastructure grants gains momentum

The 2004 MTEF takes a further major step in streamlining funding through the consolidation of infrastructure grants into the Municipal Infrastructure Grant (MIG). Approximately R1,7 billion of the additional allocation of R3,9 billion for local government goes directly into the Municipal Infrastructure Grant, enabling municipalities to address backlogs in basic municipal infrastructure in sustainable manner.

The remaining R2,2 billion goes into the local government equitable share, the unconditional transfer to municipalities, to subsidise the delivery of services to poor households. The local government equitable share rises by 12,1 per cent a year with a total budget of R28,5 billion over the next three years.

Capacity building allocations are aimed at in-house skills development

Allocations for capacity building and restructuring increase up to R750 million a year over the MTEF period. This is to encourage municipalities to prioritise focused in-house capacity building and to access funds in the local government sector education and training authority to assist in broad-based skills development. Over the 2004 MTEF period this will primarily focus on planning, project and financial management and budget reforms envisaged in the Municipal Finance Management and Municipal Systems Acts.

Guideline growth in municipal budgets set at 7 per cent in 2004/05

Taking into account increase in transfers, anticipated changes in service charges, tariffs for electricity and water and medium-term salary agreements within the local government sphere, the guideline growth rates for municipalities in compiling budgets are 7 per cent; 6,5 per cent; and 6 per cent for 2004/05, 2005/06 and 2006/07.

Policy and budget reforms

Despite increased access to services, backlogs still remain

The past ten years has seen increased access to social and economic infrastructure and services in historically underserved areas. However, Census 2001 indicates that substantial backlogs still exist in water, sanitation facilities and electricity infrastructure. Addressing backlogs remains one of the top priorities for Government.

Lack of adequate infrastructure hampers rollout of services

While significant successes have been recorded in ensuring that the poor have access to a package of free basic services, a large number of citizens still do not have access to essential basic services. A major factor in this regard is the absence of adequate infrastructure to facilitate access of the poor to basic services. This highlights the relationship between infrastructure investment and provision of basic services. The increases in both the local government equitable share and infrastructure grants are intended to speed up the redressing of backlogs.

Municipal Infrastructure grant aims to remove backlogs over a ten-year period

The consolidation of infrastructure grants into the Municipal Infrastructure Grant is a major achievement in reforming the grant system in relation to local government. The aim is to improve coordination and integration in infrastructure development at municipal level. The Municipal Infrastructure Grant further aims to remove the backlogs in basic municipal infrastructure over a ten-year period. Strong growth in the grant will facilitate expansion of labour-based projects in the construction and maintenance of municipal infrastructure.

Local government faces a number of fiscal challenges

Notwithstanding progress made, local government continues to face a number of fiscal challenges, which impact on the sphere's revenue base. These include the restructuring of the electricity industry, the future of the Regional Services Council levies, the review of the formula for the equitable share and infrastructure grants and local government taxation powers. The review of the Local Government Fiscal Framework was originally planned for 2004 but could not commence because of the need to verify disaggregated local government information from the 2001 Census. The review will be completed in time for possible implementation in 2005.

Three-year municipal allocations are published with this Budget

In 2003, for the first time, national transfers to local government by municipality were published on Budget Day, four months ahead of the municipal financial year. This practice is being institutionalised and continues in the present Budget. Early publication of municipal allocations from national government enables municipalities to align their integrated developments plans (IDPs) and budgets for the timely implementation of programmes.

Alignment of functions between category B and C municipalities

Revisions to the powers and functions of municipalities in 2003 resulted in major shifts in allocations among municipalities. The update of the formula with the 2001 Census information has led to further shifts in allocations for the 2004 MTEF. The impact of the new data will be phased in over time to ensure that municipalities are not adversely affected by the shifts. These issues are discussed in more detail in the section on the equitable share below and in *Annexure E.*

MFMA takes effect in 2004

The Municipal Finance Management Act will take effect on 1 July 2004. A programme for the phased implementation of the Act will be issued shortly. It will take due regard of the uneven capacities of municipalities to implement financial reforms.

Implementation of the MFMA

The Municipal Finance Management Act (No. 56 of 2003) will be implemented on a phased basis over the medium term. In order to assist municipalities with implementation, the National Treasury in collaboration with the South African Local Government Association will develop uniform standards and conduct workshops. Initially, emphasis will be placed on the rollout of budgetary and financial reforms. Key objectives of the Act are to strengthen financial management through publication of quality and timely information, in-year monitoring, and improved accountability, and to facilitate greater transparency in managing financial matters.

Strong synergies have been developed with relevant local government legislation by providing for budget and other consultation processes in line with the Municipal Systems Act, linking IDPs with budgets and aligning the financial management requirements for alternate service delivery mechanisms.

National transfers to local government

National transfers to local government occur through an unconditional equitable share and conditional grants for infrastructure, capacity building and restructuring.

Rationalisation of local government grants to ensure simplicity, flexibility and certainty

The number of grants to local government has been reduced to make the system of transfers simpler, ensure certainty and introduce greater flexibility for municipalities. In 1998/99, the number of grants was reduced drastically through the merger of programmes associated with the introduction of the equitable share and the Consolidated Municipal Infrastructure Programme. The phasing out of individual local infrastructure grants and their consolidation into the MIG will be completed over the next two years.

Table 7.7 National transfers to local government, 1998/99 – 2006/07

R million	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
Equitable share	1 975	2 163	2 415	3 184	4 187	6 350	7 678	8 643	9 365
Water and sanitation operating	599	727	786	692	700	1 001	858	934	991
Equitable share and related	**2 574**	**2 890**	**3 201**	**3 876**	**4 887**	**7 352**	**8 536**	**9 578**	**10 355**
Consolidated Municipal Infrastructure Programme	703	696	851	996	1 671	2 246	–	–	–
Water Services Project	520	626	725	757	999	1 102	160	139	–
Community Based Public Works Programme	152	356	374	357	260	262	–	–	–
Local Economic Development Fund	–	10	78	87	111	117	–	–	–
Sport and Recreation Facilities	–	–	–	36	84	123	132	–	–
National Electrification Programme	–	–	–	–	225	230	248	258	–
Urban Transport Fund	–	30	22	38	40	9	–	–	–
Municipal Infrastructure Grant	–	–	–	–	–	47	4 446	5 193	5 987
Other	–	–	6	33	32	–	–	–	–
Infrastructure	**1 375**	**1 718**	**2 057**	**2 305**	**3 421**	**4 137**	**4 986**	**5 589**	**5 987**
Restructuring grant	–	–	225	230	151	539	343	350	350
Financial management grant	–	–	50	60	154	211	198	199	199
Municipal Systems Improvement	205	–	–	41	94	151	182	200	200
Other	34	19	4	5	–	–	–	–	–
Current transfers	**239**	**19**	**279**	**337**	**399**	**901**	**723**	**749**	**749**
Total transfers to local government	**4 188**	**4 627**	**5 536**	**6 517**	**8 706**	**12 390**	**14 245**	**15 916**	**17 091**

National transfers to municipalities make up approximately 14,4 per cent of total local government revenue. Local government receives an additional allocation of R3,9 billion above baseline over the 2004 MTEF period, of which R2,2 billion is equitable share and R1,7 billion is allocated to infrastructure.

Local share increases to 4,6 per cent of the national budget

Table 7.7 shows that national transfers to local government rise to R14,2 billion in 2004/05, R15,9 billion in 2005/06 and R17,1 billion in 2006/07, representing 4,6 per cent of national spending by 2006/07, up from 3,6 per cent in 2002/03. The unconditional equitable share component makes up 55 per cent of national transfers to local government in 2006/07, up from 47 per cent in 1998/99, reflecting a shift to greater discretion at the local level as capacity is developed and fiscal reforms take hold.

Equitable share

No major changes to the equitable share formula

The division of the local government equitable share among municipalities is based on a redistributive formula that favours poor municipalities. Unlike in previous years, the 2004 Budget contains no major changes to the equitable share formula, as information was not available in time to complete a review of the formula. For further explanation of the formula refer to *Annexure E.*

About 86 per cent of local government revenue is own revenue

The equitable share is intended to supplement municipal own revenue to deliver free basic services such as water, sanitation, electricity and refuse removal to poor households. On average, up to 86 per cent of local government revenue is own revenue, from property taxes, regional service council levies, user charges and borrowing.

Equitable share continues to increase

The local government equitable share rises from R7,4 billion in 2003/04 to R10,4 billion in 2006/07.

Census 2001 results

Population, access to services and poverty statistics are central in determining both the equitable share and municipal infrastructure grant allocations. According to the Census 2001 results released in 2003, the number of households has increased by 29 per cent since 1996 or at an annual growth rate of 5, 2 per cent. Absolute growth in the six metropolitan municipalities has been slightly higher, at 33 per cent. Of the total number of households estimated in South Africa in 2001, 36 per cent can be found in these six metropolitan municipalities. A significant part of this growth can be attributed to urban migration, over and above the natural population growth rate.

Although the definitions of basic levels of service differ slightly between 1996 and 2001 censuses, as does the measurement error, the overall picture suggests that there is still a substantial backlog in access to basic services that need to be addressed. However, significant progress has been made in providing water and electricity. The number of people without access to water and electricity has fallen since 1996 by 12 per cent and 9 per cent, respectively over the five-year period.

Nevertheless, access to services, such as sanitation and refuse removal, needs to be extended considerably to provide every household with a full package of basic services. Population movement, growth and poverty play a key role in influencing these backlog statistics, as do funding to address the backlogs, and effective and efficient implementation of infrastructure.

Infrastructure transfers

Infrastructure transfers contribute about 34 per cent of capital expenditure

National and provincial infrastructure transfers to local government are an important source of municipal capital revenues, contributing approximately 34 per cent to local government capital expenditure. Infrastructure transfers complement the equitable share allocations and enable municipalities to address backlogs and provide appropriate infrastructure for the delivery of essential services to the poor.

Infrastructure transfers contribute to poverty relief and job creation

Infrastructure transfers are conditional and municipalities are expected to utilise them to benefit poor households. Municipalities are required to actively contribute to the goals of the Expanded Public Works Programme by promoting projects that lend themselves to increased labour intensity.

Priority will be on labour-intensive construction methods

More specifically, municipalities will be required to apply labour-intensive methods for specified maintenance, upgrading and construction projects. The types of projects targeted are rural roads, low volume municipal roads (less than 500 users per day), pipelines, trenches and sidewalks. Details and further guidance will be provided by the Department of Public Works.

Infrastructure allocations increase at an annual average of 13,1 per cent in nominal terms

Table 7.7 shows that grants for infrastructure increase to R5,0 billion in 2004/05 from R4,1 billion in 2003/04. Total infrastructure transfers rise further to R5,6 billion and R6,0 billion in 2005/06 and 2006/07. On average, infrastructure transfers to municipalities increase by 13 per cent a year over the MTEF.

Accelerated transition to full implementation of MIG

The phased transition to a poverty-weighted formula for the Municipal Infrastructure Grant provides greater certainty in allocations, facilitating higher infrastructure spending. The Municipal Infrastructure Grant is intended to assist municipalities in providing basic municipal infrastructure and community services to low income households. The following programmes will be merged into the Municipal Infrastructure Grant:

- Consolidated Municipal Infrastructure Programme
- Water Service Capital Fund
- Community Based Public Works Programme
- Local Economic Development Fund
- Building for Sport and Recreation programme
- Electrification funding (in two years time).

Consolidation of municipal infrastructure grants

In the 2004 Budget, local government infrastructure transfers have been shifted onto the Vote of the Department of Provincial and Local Government. This arrangement will not apply to commitments where the Department of Water Affairs and Forestry is the implementing agent. As a result the Municipal Infrastructure Grant allocation is R4,4 billion in 2004/05, R5,2 billion in 2005/06 and rises to R6,0 billion in 2006/07, when the consolidation process is completed. Details of this formula are available in *Annexure E.*

Capacity building and restructuring

Capacity building approach being reviewed

Two types of support are being funded through this component: capacity building and restructuring. Capacity building and restructuring grants have been capped at R750 million a year from 2005/06. In the two outer years of the MTEF, R550 million is shifted from the capacity building programme to the local government equitable share.

Capacity building grants

Focus on building planning, budgeting, financial management and technical skills

Capacity building grants were introduced to assist municipalities in building organisational, institutional, planning, budgeting, financial management and technical skills. These grants also give effect to section 154(1) of the Constitution. There are two types of capacity building grants: the Municipal Systems Improvement Programme and the Financial Management grant. Although substantial resources have been committed over recent years towards local capacity building efforts, concern has been expressed that these have not had a measurable impact on capacity.

To build in-house capacity of district and selected local municipalities

The Municipal Systems Improvement Programme receives an average of R194 million over the three years and aims to assist municipalities in building in-house capacity of district and selected local municipalities to ensure that the new system of local government is fully implemented. Key aims of this programme are to develop planning capacity, build governance systems, and establish Planning Implementation and Management Support Centres as part of the implementation of the Municipal Structures and Municipal Systems Acts.

Financial Management Grant supports budgeting and financial management reforms

The Financial Management grant aims to improve financial management practices, including the modernisation of budgeting, improved reporting, accounting, and monitoring in municipalities as part of the implementation of the Municipal Financial Management Act. Key priorities include assisting municipalities to produce credible multi-year budgets and quality annual reports, linking budgets to integrated development plans, and improving financial management practices.

Number of municipalities receiving technical assistance set to rise

In 2000, a pilot programme commenced in selected municipalities. The programme provides for bringing in international support and provides direct allocations to municipalities at a cost of R50 million in 2000/01, R60 million in 2001/02, R154 million in 2002/03 and R212 million 2003/04. The number of participating municipalities grew from the initial seven in 2000 to 63 in 2003. A full national roll out commenced in 2003 and by the end of 2004 all municipalities will be participating in the programme. The Financial Management Grant is set at R200 million per annum over the MTEF period. During 2003 sixteen financial advisors were placed in selected municipalities to support the implementation of the reforms. This initiative is to be expanded over the medium term. Furthermore, to facilitate skills development in financial management, municipalities have utilised the grant to appoint over one hundred municipal finance management interns.

Restructuring grants

Restructuring grants aims to improve service delivery and ensure sustainability

The restructuring grant assists municipalities with large budgets with the reorganisation, restructuring of their finances and administrative processes to improve performance. The grant follows a demand driven approach with municipalities providing benchmarks and conditions against which they will be measured. Disbursements are based on achieving outputs and outcomes. The medium term outcome of the restructuring grant is to ensure that funding is disbursed to the larger cities in order to enhance management, local development, effective and efficient service delivery and long-term sustainability. It is anticipated that such improvements will have positive spin offs for the national economy.

Municipal budgets and trends

Municipalities have the capacity to generate their own revenue from user charges for the consumption of services such as water, electricity, sanitation and refuse removal and municipal rates and taxes.

Local government reforms also targeted at improving quality of financial information

Municipal budgets should be seen in the context of legislative, structural and institutional transformation, which local government has undergone since 1993. As such, the budgets are not strictly comparable year-on-year and trend analysis is not possible. The budget and financial management reforms have been initiated to address the challenges in quality, content and usability of financial information.

Sharp increases in budgeted local government spending since 1996/97

Table 7.8 shows that in aggregate, municipal budgeted expenditure[1] increased from R45,8 billion in 1996/97 to R85,7 billion in 2003/04 over an eight-year period, representing a 9,4 per cent annual increase. Operating expenditure experienced the biggest increase, rising from R34,0 billion in 1996/97 to R68,9 billion in 2003/04, an increase of 10,6 per cent a year whereas capital expenditure increased by 5,2 per cent a year over the period under review. The increases in operating expenditure was largely driven by significant increases in personnel expenditure. The *2004 Intergovernmental Review* will provide more detailed information on municipal budgets when it is published in May.

Table 7.8 Budgeted municipal expenditure, 1996/97 – 2003/04

R billion	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
Capital	**11,8**	**10,8**	**13,7**	**13,7**	**13,7**	**11,7**	**13,1**	**16,8**
% Change		*-8,1%*	*26,9%*	*0,0%*	*0,0%*	*-14,6%*	*12,1%*	*28,0%*
Operating	**34,0**	**38,2**	**41,1**	**44,4**	**48,1**	**52,7**	**61,5**	**68,9**
% Change		*12,4%*	*7,6%*	*8,0%*	*8,3%*	*9,6%*	*16,7%*	*12,0%*
Total	**45,8**	**49,0**	**54,8**	**58,1**	**61,8**	**64,4**	**74,6**	**85,7**
% Change		*7,0%*	*11,8%*	*6,0%*	*6,4%*	*4,2%*	*15,8%*	*14,9%*

Capital spending trends reflect institutional and financing bottlenecks

The low increase in budgeted capital spending is a reflection of institutional and financing bottlenecks within local government and among the spheres of government. The bottlenecks result from a combination of factors including uncertainty in the timing and flow of funds, insufficient capacity and skills in planning and implementation of programmes, weaknesses in budgeting and project management, focusing on the annual short term measures, a cautious investor outlook as well as emphasis on inputs rather than outputs and outcomes. The initiatives taken in the regulatory environment over the past few years and implementation of key policies in the medium-term will assist in addressing these impediments.

Capital budgets

National and provincial transfers increasingly finance capital spending projects

Table 7.9 indicates consolidated budgeted capital expenditure and income for the eight years from 1996/97 to 2003/04 municipal financial years. The table shows that since 2001/02, budgeted capital spending is increasingly financed from national and provincial infrastructure grants and subsidies. Previously, capital spending was financed largely by external loans, own sources and

[1] Consolidated actual expenditure trends were not available at the time of drafting this *Review*.

other sources such as donations and public contributions. The development of a municipal bond market should facilitate greater private investment in municipal infrastructure.

Table 7.9 Municipal capital budgets, 1996/97 – 2003/04

R billion	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
Infrastructure	**6,8**	**7,0**	**10,3**	**10,2**	**9,9**	**7,6**	**8,9**	**13,6**
% Change		*2,9%*	*47,1%*	*-1,0%*	*-2,9%*	*-23,2%*	*17,1%*	*52,8%*
Other capital	**5,0**	**3,8**	**3,4**	**3,5**	**3,8**	**4,1**	**4,2**	**3,2**
% Change		*-24,0%*	*-10,5%*	*2,9%*	*8,6%*	*7,9%*	*2,4%*	*-23,8%*
Total	**11,8**	**10,8**	**13,7**	**13,7**	**13,7**	**11,7**	**13,1**	**16,8**
% Change		*-8,5%*	*26,9%*	*0,0%*	*0,0%*	*-14,6%*	*12,0%*	*28,2%*
Sources of finance								
Loans	1,0	0,1	1,1	1,3	1,2	1,7	1,7	1,7
Own sources	3,1	3,4	4,6	4,4	4,7	4,8	4,9	4,8
Grants and subsidies	2,0	0,8	2,7	2,7	2,5	3,9	5,2	7,6
Other	5,7	6,5	5,3	5,3	5,3	1,3	1,3	2,7
Total	**11,8**	**10,8**	**13,7**	**13,7**	**13,7**	**11,7**	**13,1**	**16,8**
% Change		*-8,2%*	*26,9%*	*0,0%*	*0,0%*	*-14,6%*	*12,1%*	*28,1%*

Operating budgets

Operating budgets show significant increases in personnel spending

Table 7.10 shows the local government budgeted operating expenditure and income trends over an eight-year period. Operating expenditure increased from R34 billion in 1996/97 to R68,9 billion in 2003/04, an average annual increase of 10,6 per cent. The significant increase was in personnel expenditure (10,9 per cent). If the cost of water and electricity purchases and intra-municipal transfers are excluded, personnel expenditure becomes as high as 40 per cent of total operating expenditure over the eight-year period. This leaves fewer resources available for direct service delivery. Government has instituted initiatives and strategies to optimise this expenditure and also improve the capacity and skill levels in local government.

Table 7.10 Municipal operating budgets, 1996/97 – 2003/04

R billion	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04
Expenditure								
Personnel	11,0	8,4	10,9	13,5	15,9	17,9	19,9	22,7
Water	1,8	1,8	2,1	2,5	2,7	3,7	4,3	4,3
Electricity	7,4	4,5	5,7	6,0	6,6	9,9	11,1	12,4
Other	13,8	23,5	22,4	22,4	22,9	21,2	26,2	29,5
Total	**34,0**	**38,2**	**41,1**	**44,4**	**48,1**	**52,7**	**61,5**	**68,9**
% Change		*12,4%*	*7,6%*	*8,0%*	*8,3%*	*9,6%*	*16,7%*	*12,0%*
Income								
Regional levies	2,6	2,9	3,3	3,5	3,6	3,9	4,4	5,2
Property rates	6,5	5,1	8,0	8,9	9,7	11,6	12,5	14,6
Water	3,6	3,8	4,2	4,7	5,1	6,3	9,0	9,6
Electricity	12,8	10,0	10,0	11,1	11,8	15,0	19,1	21,4
Grants and subsidies	2,0	1,9	2,0	1,7	1,9	3,2	6,7	8,3
Other	6,5	14,5	14,4	14,5	16,0	14,3	9,9	10,3
Total	**34,0**	**38,2**	**41,9**	**44,4**	**48,1**	**54,3**	**61,6**	**69,4**
% Change		*12,4%*	*9,7%*	*6,0%*	*8,3%*	*12,9%*	*13,4%*	*12,7%*

On average, water and electricity constitute around 45 per cent to 53 per cent of municipal revenue annually. Property rates constitute on average 20 per cent of revenue. The remaining revenue comes from a variety of sources such as Regional Services Council levies, refuse removal, grants and subsidies, donations and fines.

Conclusion

Provinces and municipalities are central to Government's social and development objectives

Within the context of an expansionary fiscal stance, provinces and municipalities are getting substantial resources over baseline. In addition to ensuring that they sustain pro-poor programmes that have proved very effective in redressing imbalances of the past, this places the two spheres in a firm position to play a central role in delivering on Government's priority programmes, including the rollout out of free basic services to households, a comprehensive response to HIV and Aids and implementation of the Expanded Public Works Programme, thus contributing to job creation.

Whilst the system of intergovernmental grants has matured over the last ten years, with the foundations now in place, Government will be embarking on a comprehensive review of the intergovernmental fiscal framework for the 2005 MTEF, with a view to ensuring that the intergovernmental system can meet the challenges of the next ten years.