7

Provincial and local government allocations

In the 2005 MTEF, R48,8 billion is added to the baseline allocations of provincial and local governments. This will see national transfers to provinces growing by 10,2 per cent a year over the MTEF period while local government allocations increase by 13,3 per cent.

In the provincial sphere, the 2005 MTEF consolidates social services spending on school education, health, social security grants, infrastructure and housing. Increased local government allocations will improve and support delivery of free basic services, especially to poor households, and includes the phased eradication of the bucket sanitation system.

Intergovernmental finances – an overview

Provinces and municipalities receive a bigger share of nationally raised revenue

The 2005 division of revenue between the three spheres of government set out in this Budget is informed by Government's spending priorities, the revenue raising capacity and functional responsibilities of each sphere, and takes into account the recommendations of the Financial and Fiscal Commission. Excluding debt services cost, the Budget allocates about 62 per cent of nationally raised revenue to the 9 provinces and 284 municipalities. Provinces and municipalities are in turn empowered to determine their own resource allocation decisions within the context of Government's broad medium term strategic objectives.

Review of provincial fiscal framework

The 2005 Budget further reflects the outcome of the comprehensive review of the provincial and local government fiscal frameworks completed in 2004. The review of the provincial fiscal framework mainly focused on the equitable share formula and the social security conditional grant, taking into account the shift in funding of the social security function. The structure of the provincial formula has been revised. The social security grant function will be administered as a conditional grant from 1 April 2005 until the new social security agency is fully operational. A review of the health conditional grants is under way and will inform the conditional grant framework for the 2006 Budget.

Review of local government fiscal framework

The review of the local government fiscal framework centred on the redesign of the equitable share formula to improve the components for basic services and institutional arrangements and better reflect the revenue-raising capacity of municipalities. Greater account is also taken of the level of services provided by municipalities. Further changes to the local government fiscal framework are planned over the MTEF to address the phasing out of the regional services council levies from 1 July 2006.

Further changes to the functions of provinces and municipalities

Two further policy shifts will also impact on provincial and local government. The first relates to housing, where Government's new housing policy provides for the accreditation of municipalities as delivery centres, particularly metropolitan and other urban municipalities, resulting in provinces transferring housing funds to municipalities. The second relates to the shifting of all primary health functions away from municipalities to provinces, and enabling district municipalities to fund municipal health services.

Improving the quality of spending continues to be priority

At the same time as resource allocations are increased for key social and economic programmes targeted at supporting the poor and vulnerable, Government will continue to prioritise micro-reforms aimed at improving the quality of spending, especially in the areas of housing, health services, education and social security.

Improvements in the governance arrangements for conditional grants are also reinforced, with a stronger differentiation between general grants with softer conditions and other specific conditional grants – enabling greater oversight of spending and outcomes. Both the provincial and municipal infrastructure grants are of the former type, as are the national tertiary services and health professions training grants.

Additional allocations to provinces for service delivery

The additional R43,4 billion of nationally raised revenue added to provincial budgets further reinforces social services, improves the service conditions of educators and social workers, expands the outreach of social security grants and protects their real value, speeds up housing delivery, and addresses social and economic infrastructure needs.

Infrastructure delivery is key driver in achieving developmental goals

The delivery of social and economic infrastructure in provinces is central to achieving Government's developmental goals. While infrastructure investment in generally labour-intensive, provinces will also continue to channel more resources towards the Expanded Public Works Programme. By providing technical support to selected provincial departments, Government is building institutional capacity to speed up infrastructure delivery and ensure effective spending of the R40,7 billion provincial capital budget over the next three years.

R5,4 billion more for free basic services and infrastructure

Additional allocations of R5,4 billion over the MTEF to the local government sphere are aimed at supporting municipalities to provide free basic services to those who cannot afford them, improve service delivery capacity, and maintain and extend municipal infrastructure. The 2005 Budget provides R1,2 billion in the municipal infrastructure grant to eliminate the bucket system. The Budget also provides funds to implement financial management reforms as envisaged in the Municipal Finance Management Act (No. 56 of 2003).

To achieve their development priorities, municipalities will need to alter the composition and improve the quality of their spending. Increasing the proportion of spending on infrastructure and basic services relative to personnel and administration remains a key challenge.

Redirecting funds to infrastructure and basic services

In 2004, Government introduced an urban development zone tax incentive to stimulate investment in rejuvenating inner city areas. To date, the Minister of Finance has approved zones in nine municipalities with a further seven zones pending approval or applications still to be submitted.

The rest of this chapter sets out the provincial and local government priorities that informed revisions to national transfers to sub-national government. It outlines the composition and trends in national transfers to provinces and local government. It also explains criteria used for dividing the allocations within each sphere, which are discussed in more detail in *Annexure E*.

***Transfers to provinces and municipalities detailed in* Annexure E**

Funding for provincial governments

Provincial priorities for the 2005 MTEF

Of the R43,4 billion added to the provincial budget framework over the 2005 MTEF:

- R22,3 billion is added over baseline for social security grants, resulting in spending of R181,6 billion over the next three years. This is mainly to extend social assistance through enhanced income support to the poor (including completion of the take up of 11, 12 and 13 year old children), to protect the real value of social security grants and improve the social grant payment system.

R22,3 billion for social security grants

- R6,9 billion is set aside over the next three years to implement pay progression in education in line with Government's strategy to improve remuneration packages of educators, attract and retain management skills in schools and accelerate the delivery of quality mathematics and science education.

R6,9 billion set aside for educator pay progression

- R2 billion is added to the housing subsidy programme over the next three years to support the implementation of the new housing strategy, which is aimed at upgrading informal settlements, encouraging densification, expanding rental housing stock and drawing the private sector into investing in low cost housing.

R2 billion to speed up sustainable housing delivery

- R1 billion is invested in the recapitalisation of further education and training colleges, specifically targeting the rehabilitation of infrastructure, improved governance and administration, and greater curriculum flexibility. This investment is central to the development of skills critical for sustained economic growth.

R1 billion for further education and training

- R1 billion is added to the provincial infrastructure grant over the MTEF to speed up delivery of social infrastructure (particularly classrooms, health facilities, water and sanitation in schools and welfare services) and economic infrastructure (roads, tourism and agriculture).

R1 billion to increase the pace of social infrastructure delivery

Provincial revenue

97 per cent of provincial revenue from national transfers

Provincial revenue consists of transfers (equitable share and conditional grants) from revenue raised nationally and own revenue from motor vehicle license fees, hospital fees and gambling taxes. National transfers to provinces constitute 97 per cent of their total resource envelope. The remainder is from own revenue sources, which are limited due to the nature of provincial functions.

Shift in the composition of national transfers

A major change in the provincial fiscal framework for the 2005 MTEF is the shift in the financing mechanism for social security transfers and their administration from the equitable share into two conditional grants. This takes effect from 1 April 2005, and reduces the equitable share component of national transfers from 88,5 per cent in 2004/05 to 64,4 per cent in 2005/06. The share of conditional grants increases from 11,5 per cent to 35,6 per cent.

Increased net resources to provinces

Considering the full liability associated with the social security grant function and the crowding-out effect this had on provincial budgets, Government opted to reduce the provincial equitable share by an amount that was less than what provinces had initially budgeted for social security grants. This provides additional resources to provinces to increase budgets for education, health and other priorities.

Strong growth in national transfers to provinces

After taking account of the revision over baseline, national transfers to provinces are budgeted to rise by 12,9 per cent in nominal terms from a revised R185,4 billion in 2004/05 to R209,3 billion in 2005/06, and will grow at an average annual rate of 10,2 per cent to R248,2 billion by 2007/08 as shown in table 7.1. In table 7.1 and in subsequent tables, the historic baseline numbers for the equitable share and conditional grants are adjusted to reflect the new financing arrangements for social grants.

Provincial equitable share increases by R16,6 billion over the MTEF

Of the R43,4 billion added to the provincial share over the MTEF, R16,6 billion is allocated to the equitable share. Over R26,8 billion of additional allocations to provinces is in the form of conditional grants. Table 7.2 sets out total national transfers (equitable shares and conditional grants) by province.

Table 7.1 Provincial revenue, 2004/05 – 2007/08

R million	2004/05 Budget	2004/05 Revised estimate	2005/06	2006/07	2007/08
			Medium-term estimates		
Transfers from national	**181 089**	**185 354**	**209 273**	**229 282**	**248 236**
Equitable share	121 578	122 426	134 706	146 757	157 678
Conditional grants	59 511	62 928	74 567	82 525	90 558
Own revenue	**5 363**	**5 920**	**5 772**	**6 033**	**6 308**
Total	**186 452**	**191 274**	**215 045**	**235 315**	**254 543**
Percentage growth					
Transfers from national			12,9%	9,6%	8,3%
Equitable share			*10,0%*	*8,9%*	*7,4%*
Conditional grants			*18,5%*	*10,7%*	*9,7%*
Own revenue			-2,5%	4,5%	4,6%
Total			**12,4%**	**9,4%**	**8,2%**

Table 7.2 Total transfers to provinces, 2003/04 – 2007/08

R million	2003/04 Outcome	2004/05 Budget	2004/05 Revised	2005/06	2006/07	2007/08
				Medium-term estimates		
Eastern Cape	26 815	30 119	30 850	35 288	38 266	41 084
Free State	10 872	12 160	12 455	14 152	15 317	16 505
Gauteng	26 183	29 002	29 636	32 045	35 469	38 491
KwaZulu-Natal	32 689	36 897	37 764	44 453	48 819	53 226
Limpopo	21 405	23 949	24 518	27 580	29 924	32 321
Mpumalanga	11 324	12 811	13 111	14 778	16 269	17 761
Northern Cape	3 903	4 403	4 527	5 023	5 572	6 006
North West	13 088	14 866	15 229	17 033	18 711	20 269
Western Cape	15 215	16 880	17 264	18 922	20 436	22 072
Unallocated	–	–	–	–	500	500
Total	**161 494**	**181 089**	**185 354**	**209 273**	**229 282**	**248 236**

Table 7.3 sets out total transfers to provinces in 2005/06 and shows that at R55,9 billion, Social Development conditional grants now make up the largest share of conditional grants. Further details on transfers to provinces are discussed in *Annexure E*.

Table 7.3 Transfers to provinces, 2005/06

R million	Equitable share	Conditional grants: Health	Provincial Infrastructure Grant	Housing	Social Develop-ment	Other[1]	Total
Eastern Cape	22,202	848	675	581	10,705	276	35,288
Free State	8,660	759	221	408	4,015	88	14,152
Gauteng	20,810	2,547	370	1,345	6,852	120	32,045
KwaZulu-Natal	28,399	1,315	788	800	12,865	287	44,453
Limpopo	18,376	522	661	399	7,385	238	27,580
Mpumalanga	9,976	257	286	321	3,826	112	14,778
Northern Cape	3,124	249	181	80	1,345	45	5,023
North West	11,086	353	321	468	4,674	131	17,033
Western Cape	12,072	1,815	229	466	4,265	74	18,922
Total	**134,706**	**8,666**	**3,731**	**4,868**	**55,932**	**1,370**	**209,273**

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

The equitable share

Provincial budget processes set the allocation of the equitable share

The provincial equitable share allocation is an unconditional grant. Provinces have discretion over how they allocate it among the functions they perform, taking into account Government priorities as agreed through intergovernmental consultation processes. The revised provincial equitable shares shown in table 7.4 are divided among provinces through an objective redistributive formula.

Table 7.4 Provincial equitable shares, 2003/04 – 2007/08

	2003/04	2004/05		2005/06	2006/07	2007/08
R million	Outcome	Budget	Revised	Medium-term estimates		
Eastern Cape	18 716	20 513	20 649	22 202	23 839	25 239
Free State	7 312	8 019	8 080	8 660	9 262	9 765
Gauteng	16 900	18 656	18 782	20 810	22 865	24 775
KwaZulu-Natal	22 620	25 125	25 295	28 399	31 388	34 205
Limpopo	14 952	16 560	16 680	18 376	20 018	21 506
Mpumalanga	7 895	8 821	8 879	9 976	10 970	11 895
Northern Cape	2 669	2 917	2 936	3 124	3 327	3 492
North West	9 133	10 086	10 158	11 086	11 990	12 787
Western Cape	9 807	10 883	10 965	12 072	13 099	14 015
Total	**110 004**	**121 578**	**122 426**	**134 706**	**146 757**	**157 678**

The forward estimates for the provincial equitable share published in last year's budget are revised up by R2,6 billion in 2005/06, R5,1 billion in 2006/07 and R8,9 billion in 2007/08, resulting in growth of 10,0 per cent between 2004/05 and 2005/06 and 8,8 per cent a year over the MTEF period.

The provincial equitable share formula

A broad-ranging review of the formula was undertaken for the 2005 MTEF. The review covered the structure of the formula, weights of components and other economic development and poverty related policy considerations. The review also took into account the change in the financing and administrative arrangements relating to the delivery of social security grants.

The formula consists of four main components and two relatively small elements, which capture the relative demand for services between provinces and takes into account particular provincial circumstances. The current structure of the formula is summarised below (weights of each component are included in brackets):

- An education share (51 per cent) based on the size of the school-age population (ages 5-17) and the average number of learners (Grade R to 12) enrolled in public ordinary schools for the past three years
- A health share (26 per cent) based on the proportion of the population with and without access to medical aid
- A basic share (14 per cent) derived from each province's share of the total population of the country
- An institutional component (5 per cent) divided equally among the provinces
- A poverty component (3 per cent) which reinforces redistribution in the formula
- An economic output component (1 per cent) or proxy for revenue raising capacity based on Gross Domestic Product by Region (GDP-R) data.

The revised formula results in shifts in individual provincial equitable shares. To avoid disruptive adjustments in provincial allocations, the impact of the new formula will be phased in over three years, from 2005/06 to 2007/08.

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

Three new grants introduced

The new *Social Assistance Administration* and *Social Assistance Transfer Payment Grants* to administer the social security grant function, increases in grants for housing and the introduction of a conditional grant for the recapitalisation of further education and training colleges represent the most significant changes in conditional grants for the 2005 MTEF. After all adjustments are taken into account, total conditional grant allocations will be R74,6 billion in 2005/06 rising to R90,6 billion in 2007/08. Table 7.5 lists conditional grants to the provinces over the 2005 MTEF. Conditional grant frameworks are revised to define their outputs more sharply.

Agriculture grants

More funds are earmarked for support to emerging farmers …

The *Comprehensive Agriculture Support Programme (CASP)*, which was introduced in 2004, is allocated R965 million over the MTEF. This programme provides management, capacity building and business development support to emerging farmers who receive land through the land reform programme. It aims to further expand farming infrastructure for dipping, fencing, and the rehabilitation of irrigation schemes.

…and to promote sustainable resource use

Over R131 million is allocated to the *Land Care Programme* over the next three years to promote sustainable use and management of land, support food security and job creation.

Education

R1 billion to recapitalise FET institutions

The *FET Recapitalisation Grant* is introduced in 2006/07 to fund the overhaul of further education and training institutions. The grant will target the rehabilitation of infrastructure, modernisation of equipment and facilities, improved governance and administration, and greater curriculum flexibility. The grant is allocated R500 million in each of the two outer years of the MTEF.

The National School Nutrition programme is allocated R3,2 billion over the next three years

The *National School Nutrition Programme* seeks to improve the nutrition of poor school children, to counter malnutrition, enhance active learning capacity and improve attendance in schools. The programme targets about 15 000 schools in poor communities, at which about 5 million learners will be provided with meals for approximately 156 school days. To further expand its coverage, the programme is allocated R912 million in 2005/06, R1,1 billion in 2006/07 and R1,2 billion in 2007/08.

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

The *HIV and Aids (Life Skills Education) Grant* receives R136 million, R144 million and R152 million over the three-year period to fund school-based life skills training. The programme is now fully integrated into the schooling system with learner and teacher support material provided for grades 1 to 9 learners. Since the inception of the programme in 1999/00, provinces have trained 12 989 learners as peer educators and 34 470 educators in life skills. In addition, over 300 district officials were trained as master trainers to train educators in life skills.

Table 7.5 Conditional grants to provinces, 2004/05 – 2007/08

R million	2004/05	2005/06	2006/07	2007/08
Agriculture	**344**	**290**	**345**	**462**
Comprehensive Agricultural Support Programme Grant	200	250	300	415
Land Care Programme Grant: Poverty Relief and Infrastructure Development	44	40	45	47
Agricultural Disaster Management Grant	100	–	–	–
Education	**991**	**1 048**	**1 743**	**1 805**
Further Education and Training College Sector Recapitalisation Grant	–	–	500	500
HIV and Aids (Life Skills Education) Grant	134	136	144	152
National School Nutrition Programme Grant	832	912	1 098	1 153
Early Childhood Development Grant	2	–	–	–
Financial Management and Quality Enhancement Grant	22	–	–	–
Health	**7 655**	**8 666**	**9 408**	**9 870**
Comprehensive HIV and Aids Grant	782	1 135	1 567	1 646
Health Professions Training and Development Grant	1 434	1 520	1 520	1 596
Hospital Management and Quality Improvement Grant	142	150	159	167
Hospital Revitalisation Grant	912	1 027	1 180	1 239
Integrated Nutrition Programme Grant	112	123	–	–
National Tertiary Services Grant	4 273	4 709	4 981	5 221
Housing	**4 589**	**4 868**	**5 660**	**6 918**
Integrated Housing and Human Settlement Development Grant	4 474	4 843	5 660	6 918
Human Settlement Grant and Redevelopment Grant	116	24	–	–
Land Affairs	**6**	**8**	**8**	**–**
Land Distribution: Alexandra Urban Renewal Project Grant	6	8	8	–
National Treasury	**3 348**	**3 731**	**4 118**	**5 324**
Provincial Infrastructure Grant	3 348	3 731	4 118	5 324
Provincial and Local Government	**220**	**–**	**–**	**–**
Local Government Capacity Building Fund Grant	220	–	–	–
Social Development	**45 766**	**55 932**	**61 205**	**66 139**
Integrated Social Development Services Grant	388	388	411	432
HIV and Aids (Community-Based Care) Grant	70	138	139	143
Social Assistance Administration Grants	–	3 382	3 584	3 734
Social Assistance Transfers Grants	45 308	52 023	57 070	61 830
Sport and Recreation South Africa	**9**	**24**	**39**	**41**
Mass Sport and Recreation Participation Programme Grant	9	24	39	41
Total	**62 928**	**74 567**	**82 525**	**90 558**

Health

Health grants total R27,9 billion over the next three years

The national Department of Health administers 6 conditional grants that comprise 11,6 per cent of total provincial conditional grants and 4,1 per cent of national transfers to provinces. Health grants are R8,7 billion in 2005/06 and are budgeted to increase to R9,9 billion by 2007/08.

R4,3 billion for HIV/Aids treatment and care

The *Comprehensive HIV and Aids Grant* is allocated R4,3 billion over the next three years to enable provinces to, in addition to other interventions, implement Government's Comprehensive HIV and Aids Treatment and Care plan. The grant supports also specific interventions including voluntary counselling and testing, prevention of mother to child transmission, post exposure prophylaxis and home based care.

R3,4 billion for hospital upgrading

The *Hospital Revitalisation Grant* assists provinces to transform and modernise infrastructure and equipment in hospitals. Since the start of the grant in 1999/00, 210 hospitals have been fully revitalized. In 2002/03 the grant focused on large upgrading and replacement projects. The first 27 of these are under way of which 10 will be completed in 2005/06. The grant is allocated R3,4 billion to rehabilitate and upgrade 59 hospitals over the next three years.

Tertiary services and training grants will be streamlined to achieve more equity across provinces

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 improve 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 2006 Budget. The NTS Grant baseline is increased by R180 million a year over the MTEF, raising the total allocation for the NTS Grant to R14,9 billion. The HPTD Grant is allocated R4,6 billion over the next three years.

Management development initiatives in health

The *Hospital Management and Quality Improvement Grant* is allocated R150 million in 2005/06, increasing to R167 million in 2007/08. This grant facilitates a range of management development initiatives, including personnel and procurement delegations and financial management capacity.

Housing

R2 billion is added to support the comprehensive housing strategy

Government approved a comprehensive housing strategy in September 2004 to speed up housing delivery and at the same time develop sustainable human settlements. An additional R2 billion is allocated to finance the new housing strategy, resulting in total allocations of R17,4 billion for housing development over the next three years. The policy will also step up the pace of accrediting capable municipalities to perform the housing function.

Housing grants reorganised into a single grant to aid flexibility

The Housing Subsidy Grant, which provides subsidies for low-income housing, and the Human Settlement Redevelopment Grant, which funds projects that aim to address dysfunctional human settlements, have been subsumed into a single grant (the *Integrated Housing and Human Settlements Grant*). The new approach streamlines funding to allow for greater flexibility in housing finance. The new grant takes effect from 1 April 2005. However, part of the Human Settlement Grant (R24 million) is retained for 2005/06 to fund outstanding commitments on some of the projects not finalised in 2004/05. The *Integrated Housing and Human Settlement Grant* increases from R4,5 billion in 2004/05 to R6,9 billion in 2007/08, a growth of 15,6 per cent a year over the period.

National Treasury

Provincial infrastructure increases by R1 billion over the next three years

The *Provincial Infrastructure Grant* is increased by R1 billion over baseline for the next three years. The grant grows from R3,3 billion in 2004/05 to R5,3 billion in 2007/08 or 16,7 per cent per year. The grant enables Government to direct funds towards provinces with large backlogs, without neglecting provinces that have inherited higher levels of infrastructure. Provinces are expected to use these funds mainly for rehabilitation and construction of roads, schools, and health facilities and to address infrastructure needs for rural development.

Social Development

Social Development manages 75 per cent of total conditional grants

The Department of Social Development manages the largest share (75 per cent) of conditional grant allocations to provinces constituting 26,7 per cent of total national transfers to provinces. Total conditional grants administered by the Department of Social Development are R55,9 billion in 2005/06 growing to R66,1 billion by 2007/08.

R181,6 billion to be spent on social security grants over the MTEF

Over R22,3 billion of additional allocations over the MTEF is allocated to social security grants. The *Social Assistance Transfer Grant* is allocated R52,0 billion in 2005/06, R57,1 billion in 2006/07 and R61,9 billion in 2007/08 to fund grant payments in terms of the Social Assistance Act. These allocations incorporate the Child Support Extension Grant that was funding the phased extension of the means-tested child support grant to children until they reach the age of 14 years. The *Social Assistance Administration Grant* is allocated R3,4 billion in 2005/06, R3,6 billion in 2006/07 and R3,7 billion in 2007/08. This grant will fund the overall administration of the function, which includes personnel costs, payment contractor commitments and other administrative aspects that are involved in the payment of grants to beneficiaries.

Further support for social welfare services

The *Food Emergency Relief Grant* has been reconfigured into a general-purpose grant to enable provinces to support and provide appropriate social welfare services, development interventions, and short term relief to vulnerable individuals and households who are not receiving any form of assistance in terms of the Social Assistance Act. The new *Integrated Social Development Services Grant* is allocated R388 million in 2005/06, R411 million in 2006/07 and R432 million in 2007/08.

Support for home-based care for people with Aids

Social Development also administers the *HIV and Aids (Community-Based Care) Grant* to provide support to households caring for people with Aids. The grant is allocated an additional R60 million a year resulting in total allocations of R420 million over the MTEF.

Sport and Recreation

Promoting developmental sports

The Department of Sport and Recreation has been allocated R24 million in 2005/06, R39 million in 2006/07 and R41 million in 2007/08 to promote mass participation within historically disadvantaged communities in a selected number of development sporting activities.

Provincial expenditure and budget estimates

Provincial budgets reflect strong alignment to Government priorities

Provinces will table their budgets in the fortnight following the tabling of the national budget, highlighting how each individual provincial budget gives expression to national and provincial priorities. Thereafter, provincial departments will table their strategic and performance plans detailing specific measurable objectives and showing how Government priorities are to be achieved. Preliminary provincial MTEF Budgets reflect strong alignment to priorities articulated in the *2004 Medium Term Budget Policy Statement*.

Details of provincial finances in the 2005 Intergovernmental Fiscal Review

Table 7.6 sets out actual consolidated expenditure trends for the past three years, projecting outcomes for 2004/05 and preliminary provincial MTEF budgets for the next three years. It must be emphasised that the projections for provincial MTEF budgets can only be accurately determined after all nine provinces table their budgets. The *2005 Intergovernmental Fiscal Review* will update these projections when it publishes the actual consolidated figures for each provincial function.

Table 7.6 Consolidated provincial expenditure according to function, 2001/02 – 2007/08

R million	2001/02	2002/03 Outcome	2003/04	2004/05 Revised estimate	2005/06	2006/07 Medium-term estimates	2007/08
Education	47 214	53 044	60 205	65 702	70 014	76 470	82 070
Health	29 181	32 611	36 719	40 636	45 799	49 918	53 496
Welfare	23 761	32 368	42 182	51 598	59 762	66 119	71 907
Housing and community development	6 098	7 452	8 398	9 492	9 055	10 223	11 599
Public works, roads and transport	8 650	10 878	12 281	14 094	15 493	17 178	19 406
Other functions	7 572	9 398	10 876	12 193	13 301	14 336	15 807
Total expenditure	**122 476**	**145 752**	**170 661**	**193 714**	**213 425**	**234 243**	**254 285**
Total revenue	**126 136**	**142 729**	**168 116**	**191 274**	**215 045**	**235 315**	**254 543**
Surplus (+) / Deficit (-)	**3 659**	**-3 023**	**-2 545**	**-2 441**	**1 620**	**1 071**	**258**
Economic classification							
Current payments	85 489	95 696	107 018	118 993	130 699	142 315	153 451
Of which compensation	*67 690*	*73 890*	*80 955*	*88 659*	*95 811*	*102 796*	*109 584*
Transfers and subsidies	30 950	42 323	54 035	63 518	71 137	78 112	85 494
Payments for capital assets	6 037	7 733	9 608	11 203	11 588	13 816	15 340
Percentage shares of total expenditure							
Social services	*81,8%*	*81,0%*	*81,5%*	*81,5%*	*82,3%*	*82,2%*	*81,6%*
Other functions (incl. housing)	*11,2%*	*11,6%*	*11,3%*	*11,2%*	*10,5%*	*10,5%*	*10,8%*

Provincial budgeted expenditure set to grow 9,5 per cent in real terms over the MTEF

Budgeted provincial expenditure is set to grow by 10,2 per cent in 2005/06 and 9,5 per cent annually over the MTEF. The strong growth reflects Government's commitment to shift resources towards areas critical for sustainable human and community development. Spending on social services is central to achieving Government's developmental goals and constitutes 82 per cent of total provincial spending.

Social service spending

82 per cent of provincial spending allocated to social services

The 2005 allocations to provinces build on provincial budgets in previous years to further strengthen the delivery of school education, health and social development. While the share of social services spending in total spending remains stable around 82 per cent, it grows 8,3 per cent a year over the MTEF. The strong growth in pro-poor social services is mainly to expand the key inputs needed to improve the quality of these services, extend their outreach and at the same time build sustainable communities.

Infrastructure spending

Capital expenditure of R40,7 billion to be made in education, health and economic functions

Provincial investment in social and economic infrastructure sustains its upward growth trajectory over the MTEF. Provinces are planning to spend R40,7 billion on education, health and road capital over the next three years. Excluding housing, provincial budgets for capital grow from R11,2 billion in 2004/05 to R15,3 billion in 2007/08. This type of investment will significantly support Government's efforts to reduce backlogs in social and economic infrastructure and at the same time address unemployment through the labour-intensive Expanded Public Works Programme.

Improving infrastructure delivery

Investment in social and economic infrastructure has grown considerably over the past few years with emphasis on the construction of new infrastructure and the regular maintenance of existing facilities. National transfers (through the provincial infrastructure and the hospital revitalisation grants) augment provincial infrastructure budgets. Over the past four years, provinces invested R37 billion on infrastructure and have budgeted to spend a further estimated R47 billion over the next three years.

Government undertook a review of provincial infrastructure delivery, which indicated that while spending on infrastructure budgets is continuously improving, its efficacy and quality remain a concern. Poor planning and deficient infrastructure delivery systems continue to retard delivery. Through partnerships with the Construction Industry Development Board and Development Bank of Southern Africa, Government introduced an Infrastructure Delivery Improvement Programme (IDIP) to reform infrastructure delivery in departments like education, health, roads and public works. The IDIP will enable infrastructure departments in provinces to develop institutional capacity and delivery systems that will address deficiencies in planning, management and the delivery of infrastructure projects.

The IDIP is being implemented in phases. Phase 1 covers all 9 provincial education departments as well as pilot projects in 2 health and 2 roads departments. Phase 2 of the programme will cover all health and public works departments and is planned to start in May 2005. The key strategy of the rollout programme is to facilitate the development of appropriate capacity, including skills and systems for efficient infrastructure planning and delivery management.

Local government finance

Local government budget priorities

Local government priorities are free basic services and municipal infrastructure

Unlike provinces, municipalities vary significantly in their revenue raising capacity, raising from 97 per cent in some metropolitan municipalities to 3 per cent in the most rural municipalities. National transfers to municipalities take account of fiscal capacity, complement own revenue and position them to fulfil their developmental role. The key Government priorities for the local sphere include:

- Provision of free basic services - water, sanitation, electricity and refuse removal to households that cannot afford to pay for them
- Progressive redressing of backlogs in municipal infrastructure, including elimination of the bucket sanitation system
- Job creation through the Expanded Public Works Programme
- Enhancement of service delivery and financial management capacity.

R5,4 billion over baseline

To fund the spending commitments arising from local government priorities over the next three years, municipalities will receive an additional R5,4 billion. This will see total national transfers to local government over the next three years totalling R58,3 billion.

The bulk of extra funding is for the equitable share

The local government equitable share, which funds operational expenditure, is increased by R3,7 billion, to speed up the rollout of free basic services. With these additional allocation, the local government equitable share rises by 25,6 per cent in 2005/06 and 14 per cent a year over the next three years.

R1,7 billion is added to the MIG

The Municipal Infrastructure Grant is increased by an additional R1,7 billion over the MTEF. This includes R1,2 billion earmarked for the eradication of the bucket sanitation system.

Capacity building grants to be reviewed

Municipal capacity building initiatives focus primarily on planning, project and financial management and budget reforms envisaged in the Municipal Finance Management and Municipal Systems Acts. The capacity building and restructuring grants are currently being reviewed; hence no changes are made to these grants.

Policy and budget reforms

Lack of infrastructure hampers the rollout of services

Since 1994, Government has increased access to social and economic infrastructure and services in historically underserved areas. Despite these successes, Census 2001 reported substantial backlogs in water, sanitation and electricity infrastructure. Addressing these backlogs remains one of the top priorities for Government as it seeks to rollout essential basic services. The increases in transfers to local government aim to accelerate the extension of services to historically disadvantages communities.

The review of the local government fiscal framework

The local government fiscal framework is under review

A two-part review of the local government fiscal framework was initiated in 2004. The first part focused on the local government equitable share formula taking into account the recommendations of the Financial and Fiscal Commission. The second part, which is still underway looks at broader taxation and financing arrangements pertaining to local government, particularly with respect to the possible effects of the regional electricity distributors, the new property tax legislation and the phasing out of regional services council levies.

A new local government formula is introduced

The review prompted the development of a new equitable share formula for local government to be phased in over the 2005 MTEF. The new formula introduces a revenue raising capacity measure, while at the same time rationalises the previous S-grant, free basic services and free basic electricity 'windows'. The new formula is more redistributive as it directs more resources to poorer municipalities with limited revenue raising capacity.

RSC levies to be abolished from 1 July 2006

On the broader review, the first phase investigated the suitability of the two Regional Services Council levies as local government taxes. The investigation found that although these levies are an important source of revenue for metropolitan and district municipalities, they do not meet a number of criteria of a good tax. Consequently, they will be phased out and replaced by a mixture of grants and alternative taxation instruments from 1 July 2006.

National transfers to local government

National transfers to local government are channelled through three funding streams, namely the equitable share (including the water operating subsidy), infrastructure grants and capacity building and restructuring grants.

Rationalisation of local government grants

The number of grants to local government has been reduced making the system of transfers simpler, ensuring certainty and providing greater flexibility for municipalities. The establishment of the Municipal Infrastructure Grant is a major step forward in this process.

A shift to greater discretion at the local level

Table 7.7 shows that national transfers to local government rise to R17,2 billion in 2005/06, R19,7 billion in 2006/07 and R21,5 billion in 2007/08. The unconditional equitable share component makes up 56 per cent of national transfers to local government in 2005/06, up from 48,8 per cent in 2001/02, reflecting a shift to greater discretion at the local level as capacity is developed and fiscal reforms take hold.

Equitable share

About 86 per cent of local government revenue is own revenue

The equitable share supplements municipal own revenue to deliver free basic services such as water, sanitation, electricity and refuse removal to poor households. Despite large variations among municipalities, 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 R7,7 billion in 2004/05 to R11,4 billion in 2007/08 – providing a major boost to the delivery of free basic services to the poor.

The formula directs more resources to poorer municipalities

The horisontal division of the local government equitable share between municipalities is based on a redistributive formula that favours poor municipalities with less revenue raising capacity. The new formula will be phased in over the 2005 MTEF with full implementation by 2007/08.

Table 7.7 National transfers to local government, 2001/02 – 2007/08

R million	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Equitable share and related	**3 876**	**4 887**	**7 437**	**8 626**	**10 578**	**11 505**	**12 411**
Equitable share	3 184	4 187	6 350	7 678	9 643	10 515	11 371
Water and sanitation operating	692	700	1 087	949	934	991	1 040
Infrastructure	**2 307**	**3 472**	**4 102**	**5 363**	**5 833**	**7 454**	**8 301**
Consolidated Municipal Infrastructure Programme	999	1 723	2 285	–	–	–	–
Water Services Project	757	999	1 022	217	139	–	–
Community Based Public Works Programme	357	260	262	–	–	–	–
Local Economic Development Fund	120	143	117	–	–	–	–
Sport and recreation facilities	36	84	122	134	–	–	–
National Electrification Programme	–	225	245	251	258	–	–
Urban Transport Fund	38	40	9	–	–	–	–
Municipal Infrastructure Grant	–	–	41	4 481	5 436	7 454	8 301
Disaster relief	–	–	–	280	–	–	–
Current transfers	**337**	**400**	**856**	**768**	**749**	**749**	**749**
Restructuring grant	230	151	494	388	350	350	350
Financial management grant	60	155	211	198	199	199	199
Municipal Systems Improvement	46	94	151	182	200	200	200
Total	**6 520**	**8 759**	**12 396**	**14 757**	**17 159**	**19 708**	**21 461**

Key features of the new local government equitable share formula

The new local government equitable share formula retains some of the elements of the old formula originally introduced in 1998. The provision of services to poor households and the importance of core institutional capacity are still recognised. The basic structure of the new formula takes the following form:

Grant = Basic Services (BS) + Development (D) + Institutional Support (I) – Revenue Raising Capacity (RRC) +/- Stabilisation Constraint (C)

The key innovation of the new formula is the introduction of the Revenue Raising Capacity Correction (RRC). The RRC of each municipality is imputed in the absence of comparable data. The imputation is similar to the method used to measure poverty on the Census data. In 2005/06, an additional R1,2 billion is reallocated through this mechanism for the provision of basic services and administrative support.

The cost of the basic services package to poor households is being updated for the first time since 1998 and includes a distinction between serviced households (receiving R130 a month) and unserviced households (receiving R45 a month).

The Institutional Support Component determines the subsidy to municipalities to fund basic institutional and governance arrangements.

The development component is set at zero for the time being. However, the developmental focus of the nodal allocations will be maintained for at least 2005/06 and 2006/07 as the indicative allocations published in 2004 are guaranteed at 100 per cent for those two years.

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

Infrastructure transfers

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 enable municipalities to address backlogs and provide appropriate infrastructure for the delivery of essential services to the poor.

Infrastructure grant contribute about 34 per cent of capital expenditure

The Municipal Infrastructure Grant will assist municipalities to provide basic municipal infrastructure and community services to low income households. It further aims to provide greater certainty in allocations, improve capital planning and facilitate higher infrastructure spending.

Infrastructure transfers increase by 15,7 per cent a year

Table 7.7 shows that grants for infrastructure increase to R8,3 billion in 2007/08 from R4,5 billion in 2004/05. On average, infrastructure transfers to municipalities increase by 15,7 per cent a year over the MTEF.

This process of consolidating infrastructure grants will be completed by the end of 2005/06 with the incorporation of the National Electrification Programme and Water Services Capital Grant into the MIG. Details of this formula are available in *Annexure E*.

Capacity building and restructuring

Capacity building approach under review

Two types of support are being funded through this component: capacity building and restructuring. Over the past four years more than R2,4 billion has been committed for capacity building and restructuring initiatives but without a measurable impact on capacity. These grants will be reviewed in 2005/06 and in the interim, are capped at R750 million a year from 2005/06.