W1

Website annexure to the 2011 Budget Review

Explanatory memorandum to the division of revenue

Background

The allocation of resources to the three spheres of government is a critical step in the budget process, required before national government, nine provinces and 278 municipalities (after the 2011 municipal elections) can determine their own budgets. The allocation process takes into account the powers and functions assigned to the three spheres of government. The process for making this decision is at the heart of cooperative governance as envisaged in the Constitution.

To foster transparency and ensure smooth intergovernmental relations, section 214(1) of the Constitution requires that every year a Division of Revenue Act determine the equitable division of nationally raised revenue between the three spheres of government. The Intergovernmental Fiscal Relations Act (1997) prescribes the process for determining the equitable sharing and allocation of revenue raised nationally. Sections 9 and 10(4) of the act set out the consultation process to be followed with the Financial and Fiscal Commission (FFC), including the process of considering recommendations made with regard to the equitable division of nationally raised revenue.

This explanatory memorandum to the 2011 Division of Revenue Bill fulfils the requirement set out in section 10(5) of the Intergovernmental Fiscal Relations Act that requires the Division of Revenue Bill to be accompanied by an explanatory memorandum detailing how the bill takes account of the matters listed in sections 214(2)(a) to (j) of the Constitution, government's response to the recommendations of the FFC, and any assumptions and formulas used in arriving at the respective divisions among provinces and municipalities. This explanatory memorandum contains six parts:

- Part 1 lists the factors that inform the division of resources between the three spheres of government.
- Part 2 describes the 2011 division of revenue between the three spheres of government.
- Part 3 sets out how the FFC's recommendations on the 2011 division of revenue have been taken into account.
- Part 4 explains the formula and criteria for the division of the provincial equitable share and for conditional grants to provinces.
- Part 5 sets out the formula and criteria for the division of the local government equitable share and conditional grants between municipalities.
- Part 6 summarises issues that will form part of subsequent reviews of provincial and local government fiscal frameworks.

The Division of Revenue Bill and its underlying allocations are the culmination of extensive consultation between national, provincial and local government. The Budget Council deliberated on the matters discussed in this memorandum at several meetings during the year. The approach to local government

allocations was discussed with organised local government at technical meetings with the South African Local Government Association (SALGA), culminating in a meeting of the Budget Forum (Budget Council plus SALGA) on 5 October 2010. An extended Cabinet meeting involving ministers, provincial premiers and the chairperson of SALGA was held on 13 October 2010, and the division of revenue was agreed for the next three years.

Part 1: Constitutional considerations

Section 214 of the Constitution requires that the annual Division of Revenue Act be enacted only after account is taken of factors in sub-sections (2)(a) to (j) of the Constitution. These include national interest, provision for debt, needs of national government and emergencies, the allocation of resources to provide basic services and meet developmental needs, fiscal capacity and efficiency of the provincial and local spheres, reduction of economic disparities, and promotion of stability and predictability. The constitutional principles taken into account in deciding on the division of revenue are briefly noted below.

National interest and the division of resources

The national interest is encapsulated by those governance goals that benefit the nation as a whole. The spending priorities for the medium-term expenditure framework (MTEF) are informed by the 12 priorities adopted at the Cabinet lekgotla held from 20 to 22 January 2010, which are derived from the medium-term strategic framework (MTSF). A detailed analysis of how these have been allocated in government budgets can be found in Chapter 4 of the 2010 Medium Term Budget Policy Statement and Chapter 8 of the 2011 *Budget Review*.

Provision for debt costs

The resources shared among the three spheres of government include proceeds from national government borrowing used to fund spending by all spheres. National government provides for the resulting debt costs to protect the integrity and credit reputation of the country.

National government’s needs and interests

The Constitution assigns exclusive and concurrent powers and functions to each sphere of government. National government is exclusively responsible for functions that serve the national interest and are best centralised. National and provincial government have concurrent responsibility for a range of functions. Changes have been made to a number of national transfers to provincial and local government to improve their efficiency, effectiveness and alignment with national strategic objectives.

Provincial and local government basic services

Provinces and municipalities are assigned key service delivery functions such as school education, health, social development, housing, roads, and provision of electricity, water and municipal infrastructure. They have significant autonomy to allocate resources to meet basic needs and respond to provincial and local priorities, while giving effect to nationally agreed priorities. The division of revenue provides equitable shares to provinces and local government. This year’s division of revenue provides additional resources to provinces for the public-sector wage agreements of 2010, to address the occupation-specific dispensation (OSD) agreements in the health and education sectors, and to fund policies on HIV and Aids treatment, agricultural support programmes and infrastructure provision for education and roads. These additions, especially in the case of HIV and Aids treatment and prevention and education infrastructure, build on significant additions to baselines in previous budgets. In the 2010 division of revenue, government reinforced its commitment to free basic services at the municipal level through a substantial increase to the local government equitable share. The 2011 division of revenue

protects these baselines, ensuring that municipalities are able to deal with the cost pressures of providing free basic services due to increased electricity charges.

Fiscal capacity and efficiency

The Constitution assigns the primary government revenue-raising power to the national sphere. Provinces have limited revenue-raising capacity relative to the resources required to deliver provincial functions that do not lend themselves to self-funding or cost recovery. Local governments finance most of their expenditure through property rates, user charges and fees. It is recognised, however, that rural municipalities raise significantly less revenue than larger urban and metropolitan municipalities. To compensate for this, provinces receive the largest share of nationally raised revenue, and local government a portion that is substantial and will continue to grow over the medium term. The provincial equitable share formula was reviewed in 2010 and the recommendations will be implemented in 2011. A new health component will be introduced and constantly improved to ensure that its objectives are achieved. A review of the local government equitable share is under way. Both reviews should lead to significant changes that result in more efficient and effective funding arrangements.

Developmental needs

Developmental needs are encapsulated in the equitable share formulas for provincial and local government and in specific conditional grants. In particular, the various infrastructure grants and growing capital budgets aim to boost the economic and social development of provinces and municipalities. Developmental needs are accounted for at two levels: first, in the determination of the division between the three spheres, which explains the continued commitment to grow provincial and local government shares of nationally raised revenue, and second, in the determination of the division within each sphere, through the formulas used for dividing national transfers among municipalities and provinces.

Economic disparities

Both the equitable share and infrastructure grant formulas are redistributive towards poorer provinces and municipalities. Government remains committed to investing in economic infrastructure (roads) and social infrastructure (schools, hospitals and clinics) to stimulate economic development and job creation, and address economic and social disparities.

Obligations in terms of national legislation

While the Constitution confers autonomy on provincial governments and municipalities to determine priorities and allocate budgets, national government retains responsibility for policy development, national mandates and the monitoring of implementation for concurrent functions. New national mandates and priorities result in increased allocations to provincial and local government, in addition to their existing baseline allocations. The 2011 MTEF and division of revenue provides additional funding for OSD agreements in health and education and HIV and Aids prevention and treatment programmes. Resources have also been made available to address backlogs in education infrastructure.

Predictability and stability

Provincial and local government equitable share allocations are based on estimates of nationally raised revenues. These allocations are protected. In the event that nationally raised revenue falls short of the estimates, the equitable share will not be adjusted downwards. Allocations are assured (voted, legislated and guaranteed) for the first year and are transferred according to a payment schedule. To contribute to longer-term predictability and stability, forward estimates for a further two years are published alongside the annual proposal for appropriations. Changes in the forward estimates or revisions to the equitable share formulas are phased in to ensure minimal disruption.

Need for flexibility in responding to emergencies

Government has flexibility to respond to emergencies through a contingency reserve that provides a cushion for emergencies and unforeseeable events. The 2011 division of revenue introduces two new conditional grants to allow for the swift allocation and transfer of funds to provinces and municipalities affected by emergencies that could not be provided for through the budget or adjustment budget processes. Sections 16 and 25 of the Public Finance Management Act (PFMA) (1999) make specific provision in relation to allocation of funds to deal with emergency situations while section 30(2) deals with adjustment allocations in respect of unforeseeable and unavoidable expenditure. Section 29 of the Municipal Finance Management Act (MFMA) (2003) allows a municipal mayor to authorise unforeseeable and unavoidable expenditure in an emergency or extraordinary circumstances. The 2011 Division of Revenue Bill introduces special provisions for funding immediate responses to disasters through new disaster conditional grants to provinces and municipalities.

Part 2: The 2011 division of revenue

In preparation for the 2011 MTEF, all spheres of government have identified cost savings, eliminated non-essential expenditure and are focusing on high-priority programmes. While the economic outlook has improved in the past year, government had to raise debt significantly to ensure budget baselines were protected following the economic downturn of 2008/09. Increases to government expenditure are aimed at specific priorities; however these increases are moderate to ensure that debt costs remain within sustainable levels.

Excluding debt service costs, allocated expenditure to be shared between the three spheres amounts to R812.3 billion, R877.3 billion and R949 billion over each of the MTEF years. These allocations take into account government's spending priorities, the revenue-raising capacity and functional responsibilities of each sphere, and inputs from various intergovernmental forums and the recommendations of the FFC. The local and provincial equitable share formulas are designed and implemented in a manner that ensures desirable, stable and predictable revenue shares, and that economic and fiscal disparities are addressed.

Government's policy priorities for the 2011 MTEF

Government's major budget priorities over the medium term include:

- Enhancing the quality of basic education and skills development.
- Improving the quality of health care and infrastructure.
- Investing in new infrastructure and proper maintenance of social and economic infrastructure networks.
- Acceleration of job creation.

Government has responded to the recession by maintaining social expenditure and continuing to invest in infrastructure, leading to improved access to basic services, expanded public transport and more schools and hospitals. These investments form part of a long-term commitment to the economy's growth.

Substantial additional resources are allocated to provinces to cover the 2010 wage agreements, the OSD agreements, the carry-through effect of previous agreements in education and health, infrastructure in education and roads, and HIV and Aids treatment.

Given the continuous large-scale rural-urban migration to South Africa's cities, infrastructure grants have been reorganised to develop the urban built environment and upgrade informal settlements.

Table W1.1 shows how the additional allocations are apportioned to the priority areas across the three spheres of government.

Table W1.1 2011 Budget priorities – additional MTEF allocations, 2011/12 – 2013/14

R million	2011/12	2012/13	2013/14	Total
Job creation				
Job creation, small enterprise development, youth employment	2 301	3 352	4 415	10 067
Economic affairs and infrastructure development				
Public transport	2 107	3 607	4 701	10 415
Rural development and emerging farmer support	622	919	1 303	2 844
Consolidation of economic regulatory capacity	353	177	205	735
Enterprise investment programme	150	200	250	600
Infrastructure projects	–	265	297	562
Green economy	200	300	500	1 000
Broadband ICT: universal access and cost reduction	100	150	200	450
Housing and community amenities				
Human settlements upgrading and municipal services	794	1 618	2 452	4 865
Water infrastructure and services; acid mine drainage response	840	944	666	2 450
Education				
FET college expansion and skills development	2 022	3 337	4 158	9 517
School infrastructure and facilities, improved learner support materials	780	2 315	5 189	8 284
Funza Lushaka teacher bursaries and bursaries for scientific post graduate students	5	272	677	954
Health				
Hospital revitalisation and primary health family care teams	858	1 931	2 730	5 519
HIV and Aids and ARVs	60	560	1 860	2 480
Social protection				
Other (including social grants)	1 164	2 644	5 102	8 910
Public order and safety				
Police personnel expansion and training	100	400	1 283	1 783
General public services				
Municipal disaster grant	470	330	350	1 150
Provincial disaster grant	305	180	190	675
Post-recovery and reconstruction for current floods	600	–	–	600
Municipal charges	683	964	1 149	2 796
Compensation of employees adjustments				
Wages (including additional personnel)	11 413	13 164	14 806	39 382
Other adjustments	-5 185	-8 057	-8 685	-21 927
Total	**20 742**	**29 573**	**43 797**	**94 112**

The fiscal framework

Table W1.2 presents medium-term macroeconomic forecasts for the 2011 Budget. It sets out the growth assumptions and fiscal policy targets on which the fiscal framework is based.

Table W1.2 Medium-term macroeconomic assumptions, 2010/11– 2013/14

	2010/11		2011/12		2012/13		2013/14
R billion	**2010 Budget**	**2011 Budget**	**2010 Budget**	**2011 Budget**	**2010 Budget**	**2011 Budget**	**2011 Budget**
Gross domestic product	2 699.9	2 666.9	2 967.6	2 914.9	3 295.7	3 201.3	3 536.0
Real GDP growth	*2.9%*	*3.1%*	*3.4%*	*3.6%*	*3.6%*	*4.2%*	*4.4%*
GDP inflation	*7.1%*	*5.9%*	*6.3%*	*5.5%*	*7.2%*	*5.4%*	*5.8%*
National budget framework							
Revenue	643.2	666.6	721.7	729.9	807.9	806.4	904.3
Percentage of GDP	*23.8%*	*25.0%*	*24.3%*	*25.0%*	*24.5%*	*25.2%*	*25.6%*
Expenditure	818.1	809.9	888.3	888.9	964.3	968.1	1 053.0
Percentage of GDP	*30.3%*	*30.4%*	*29.9%*	*30.5%*	*29.3%*	*30.2%*	*29.8%*
Main budget balance[1]	-174.9	-143.4	-166.6	-159.1	-156.4	-161.7	-148.7
Percentage of GDP	*-6.5%*	*-5.4%*	*-5.6%*	*-5.5%*	*-4.7%*	*-5.1%*	*-4.2%*

1. A positive number reflects a surplus and a negative number a deficit.

Table W1.3 sets out the division of revenue for the 2011 MTEF, taking new policy priorities into account.

Table W1.3 Division of nationally raised revenue, 2007/08 – 2013/14

R million	2007/08	2008/09 Outcome	2009/10	2010/11 Revised estimate	2011/12	2012/13 Medium-term estimates	2013/14
Debt-service cost	52 877	54 394	57 129	66 570	76 579	90 808	104 036
Non-interest expenditure	488 566	581 560	690 068	743 353	812 345	877 324	948 992
Percentage increase	*16.9%*	*19.0%*	*18.7%*	*7.7%*	*9.3%*	*8.0%*	*8.2%*
Total expenditure	**541 443**	**635 953**	**747 197**	**809 923**	**888 923**	**968 132**	**1 053 029**
Percentage increase	*15.2%*	*17.5%*	*17.5%*	*8.4%*	*9.8%*	*8.9%*	*8.8%*
Unallocated					40	330	530
Contingency reserve	–	–	–	–	4 090	11 405	23 375
Division of available funds							
National departments	**242 580**	**289 236**	**345 366**	**359 120**	**380 154**	**408 439**	**439 049**
Provinces	**207 504**	**246 836**	**293 164**	**323 080**	**357 929**	**380 450**	**404 251**
Equitable share	171 054	201 796	236 891	265 139	288 493	305 725	323 604
Conditional grants	36 451	45 040	52 073	57 941	69 436	74 724	80 647
Gautrain loan	–	–	4 200	–	–	–	–
Local government	**38 482**	**45 487**	**51 537**	**61 152**	**70 171**	**77 029**	**82 317**
Equitable share[1]	20 676	25 560	23 845	30 559	34 108	37 573	39 960
General fuel levy sharing	–	–	6 800	7 542	8 573	9 040	9 613
Conditional grants	17 806	19 928	20 892	23 051	27 490	30 416	32 743
Total	**488 566**	**581 560**	**690 068**	**743 353**	**808 254**	**865 919**	**925 617**
Percentage shares							
National departments	49.7%	49.7%	50.0%	48.3%	47.0%	47.2%	47.4%
Provinces	42.5%	42.4%	42.5%	43.5%	44.3%	43.9%	43.7%
Local government	7.9%	7.8%	7.5%	8.2%	8.7%	8.9%	8.9%

1. With effect from 2006/07, the local government equitable share includes compensation for the termination of Regional Services Council (RSC) and Joint Services Board (JSB) levies for metros and district municipalities. From 2009/10 the RSC levies replacement grant will only be allocated to district municipalities.

Table W1.4 shows how additional resources are divided among the three spheres of government. The new priorities and additional allocations are accommodated through shifting of savings towards priorities.

Table W1.4 Changes over baseline, 2011/12 – 2013/141

R million	2011/12	2012/13	2013/14
National departments	9 947	14 682	24 188
Provinces	9 507	13 385	17 280
Local government	1 288	1 506	2 329
Allocated expenditure	**20 741**	**29 573**	**43 796**

1. *Excludes shifting of savings towards priorities over the MTEF.*

Table W1.5 sets out schedule 1 of the Division of Revenue Bill, which reflects the legal division of revenue between the three spheres. In this division, the national share includes all conditional grants to the other two spheres in line with section 214(1) of the Constitution, and the provincial and local government allocations reflect their equitable shares only.

Table W1.5 Schedule 1 of the Division of Revenue Bill, 2011/12 – 2013/14

	2011/12	2012/13	2013/14
	Column A	Column B	
R million	Allocation	Forward estimates	
National[1, 2]	566 323	624 833	689 464
Provincial	288 493	305 725	323 604
Local	34 108	37 573	39 960
Total	**888 923**	**968 132**	**1 053 029**

1. *National share includes conditional grants to provinces and local government, general fuel levy sharing with metropolitan municipalities, debt service cost and the contingency reserve.*
2. *The direct charges for the provincial equitable share are netted out.*

The 2011 *Budget Review* sets out in detail how constitutional issues and government's priorities are taken into account in the 2011 division of revenue. It focuses on the economic and fiscal policy considerations, revenue issues, debt and financing considerations, and expenditure plans of government. This memorandum should be read with the 2011 *Budget Review*, as aspects of national, provincial and local government financing are discussed in some detail in Chapter 8 of the review.

Part 3: Response to the recommendations of the FFC

Section 214 of the Constitution and section 9 of the Intergovernmental Fiscal Relations Act (1997) require the FFC to make recommendations in April every year, or soon thereafter, on the division of revenue for the coming budget. The FFC complied with this obligation by tabling its *Submission for the Division of Revenue 2011/12* to Parliament in May 2010. This part of the explanatory memorandum complies with the Constitution and section 10 of the Intergovernmental Fiscal Relations Act by setting out how government has taken the FFC's recommendations into account when determining the division of revenue for the 2011 MTEF.

The 2011/12 recommendations cover four interrelated areas. The first chapter deals with the global economic crisis, fiscal frameworks and coping with vulnerabilities; the second chapter discusses options for social assistance reform during a period of fiscal stress; the third chapter focuses on an effective, efficient and transparent intergovernmental fiscal system and the fourth chapter discusses the intergovernmental fiscal issues in urban public transport.

Chapter 1: The global economic crisis, fiscal frameworks and coping with vulnerabilities

The FFC recommends that in the short term, government should continue to strive for fiscal consolidation by limiting the growth in entitlement spending to successful programmes, and refocus expenditure on improved service quality. In particular, child support and old-age pension grants should be expanded, and the high access levels to education and health services achieved despite the global

economic crisis must be maintained. Government should also reprioritise expenditure towards repair and maintenance by emphasising existing projects and initiating new ones.

Government response

Government agrees that the implications of the global economic crisis and reduced fiscal space necessitate fiscal consolidation. Government has refocused existing budgets towards government priorities and more efficient spending. The number of social grant beneficiaries has more than tripled between 2002/03 and 2010/11 and a committee of inquiry is in place to investigate more cost-effective beneficiary payment options for the South African Social Security Agency.

The majority of additions to baseline over the 2011 MTEF target health, education, roads and the eradication of informal settlements. These additions are on top of substantial increases in previous budgets and will enable provinces to increase the quality of health and education services through improved infrastructure, conditions of employment, and provision of medicines. Government is finalising asset registers as it implements the Government Immovable Asset Management Act (2007) to ensure that infrastructure assets are properly maintained.

Block grant for health, education and social development

The FFC recommends that government should introduce a block grant for education, health and social development over the medium to long term, to fund clearly defined and costed outcomes.

Government response

As part of the review of the provincial equitable share formula, government considered proposals made by the FFC in 2009, which were included in their recommendations on the 2010/11 division of revenue. These proposals dealt with challenges created by the design of the intergovernmental fiscal system and a number of issues related to the provincial equitable share formula. Government has not fully considered decentralising further fiscal powers to provinces. Thus, government agreed to separate the review of the provincial equitable share formula from the devolution of fiscal powers.

Government considered the proposal on block grants as part of the provincial equitable share review, and it has concluded that block grants are potentially unconstitutional.

Independent cost effectiveness and quality reviews

Undertake independent cost effectiveness and quality reviews of education, health and the social wage in both the public and private sectors.

Government response

Government agrees that independent cost effectiveness and quality reviews should be undertaken. The Ministry of Performance Monitoring and Evaluation would perform such reviews in the period ahead.

Chapter 2: Options for social assistance reform during a period of fiscal stress

The FFC recommends that during a period of fiscal stress, government should protect social assistance expenditure as far as possible during fiscal consolidation. Government should protect the relative simplicity of the social assistance system, especially when contemplating reform options. The FFC also recommends that government pilot conditional cash transfer and workfare programmes on a small scale and evaluate them to expand successful pilots, strengthen non-cash complementary social developmental services by emphasising quality improvements within defined resource limits, and avoid universal income grants.

Government response

Government supports these recommendations with the exception of the piloting of a workfare programme. Although exploring potential policy initiatives through pilot programmes has many benefits, giving cash benefits to individuals can be problematic. It will be extremely difficult for government to exclude people from the pilot and if it fails it will be complicated to withdraw support.

Chapter 3: Towards an effective, efficient and transparent intergovernmental fiscal system

The FFC recommends that when introducing and terminating conditional grants, national departments must introduce a mandatory, systematic process for designing and planning individual conditional grants that covers incentive effects, administrative accountability arrangements and stipulates regular review periods and exit strategies of the grant. Government should also ensure there is an independent evaluation of the grant performance at entry, midterm and end of the grant.

Government response

Guidelines on how to introduce and terminate conditional grants are available and the recommendation that criteria for disbanding the grant should be identified upon introduction is welcomed. It will be beneficial in the long term to develop capacity within national and provincial departments, provincial treasuries and municipalities to perform independent evaluations of grant performance. However, the fiscal system should continue to be responsive to the needs of government. Government should have the flexibility of introducing and terminating conditional grants where there is a clear rationale to do so.

Allocation criteria of conditional grants

The FFC recommends that government should make the criteria for dividing grant allocations transparent.

Government response

The allocation criteria for grants are explained in the relevant conditional grant frameworks.

Emphasise non-financial data reporting

The FFC recommends that government continue to emphasise the importance of non-financial data reporting, linking outer-year allocations to independently evaluated performance information and gazette expected deliverables.

Government response

Government agrees and will continue to emphasise the importance of non-financial performance reporting. Performance audits at provincial level should bring about substantial improvements to the quality of performance information. Reforms are in place to develop proper reporting systems for financial reporting in municipalities, and once these are in place the focus will shift to non-financial reporting. Government seeks to improve alignment of budgets and measurable objectives through its budget reforms.

Results-based accountability

The FFC recommends that through incentive grants, national departments must make accounting for delivery a prerequisite for most conditional grants. They should encourage designing grants that

explicitly promote innovation in sub-national governments and strengthen incentives for optimal service delivery.

Government response

Government supports this recommendation. However, the administrative ability in provincial and local government must be strengthened before incentives for innovation are likely to have the desired effect.

Budget allocation process

The budget allocation process must specifically follow the conditional grant frameworks and this should be monitored periodically through section 32 of the PFMA and section 71 of the MFMA.

Government response

Government agrees with the proposal and monitoring is taking place through section 32 of the PFMA and section 71 of the MFMA.

Improve general performance of municipalities in revenue improvement and collection

The FFC recommends that government adopt standard indicators or early warning systems to measure and detect fiscal stress in municipalities. In addition to those already prescribed, these indicators should be pre-conditions for instigating mandatory provincial interventions. Monthly budget statements should report on actual revenue per source and on the percentage of collected revenue to the total value of billed revenue.

Government should legislate ratios for revenue collection as one of the key performance areas against which to assess overall municipal performance. Collection and coverage ratios must be used as standard indicators to revenue collection performance assessment across municipalities.

Excessive levels of municipal debt must be reduced through constant taxpayer education and incentives to improve the quality of services in general. Local government should be able to issue garnishee orders and the judicial system should have dedicated courts to deal with outstanding municipal accounts until the debt is reduced to acceptable levels.

The FFC recommends that government should make a concerted effort to estimate the fiscal capacity and fiscal effort of municipalities to dispel the perception that certain municipalities will never be financially viable.

Municipalities should have broad revenue improvement programmes that focus on administrative streamlining as well as revenue and expenditure interventions, and efficiency-based interventions. These interventions should be specific to local economic circumstances so that the emphasis is appropriate.

Effective revenue management processes, good financial management and the provision of good quality services should underpin revenue improvement programmes. These should only be conducted when municipalities have maximised the collection of local and outstanding revenue sources and should be subject to empirical tests.

Government response

National government agrees that improving municipalities' management of their own revenue sources is an essential part of placing local government finances on a more sustainable base, while strengthening local accountability and service delivery. National government's estimates indicate that improving municipalities' management of their revenues has the potential to yield substantially greater returns than

the additional funds local government is budgeted to receive through the local government equitable share and conditional grants over the 2011 MTEF.

National government supports the recommendation that each municipality should have a broad revenue improvement programme in place. It is for this reason that national government has emphasised the importance of fostering a culture of payment for local government services through various initiatives, and why National Treasury and the Department of Cooperative Governance and Traditional Affairs are working together to provide practical support to municipalities on initiatives to strengthen their own revenue policies, procedures and processes.

Regarding the FFC's specific proposals for revenue improvement and collection:

National government has an early warning system that monitors municipal finances. This system is anchored by the budget formats prescribed in terms of the municipal budget and reporting regulations, the associated funding compliance assessment (see MFMA Circular 42) and monthly financial reports required in terms of section 71 of the MFMA. This system has proved to be very effective at identifying fiscal stress in municipalities. The real challenge is finding people with the necessary skills and integrity to tackle the identified problems.

The new budget and reporting formats emphasise cash-flow budgeting and reporting, which lays the foundation for closely monitoring actual revenue collections against billed revenues. However, it is not practical to insist on one-to-one reporting of revenue collected against revenue billed – because of the way systems are set up, the manner in which payments are allocated to settle bills, and the impact that debt repayments have on current revenue numbers.

The relevant acts that govern revenue collection by municipalities place positive obligations on municipal councils and municipal managers to put policies, processes and systems in place to ensure sound management of the various own revenue sources. National government is progressively strengthening its ability to monitor compliance with this legislation. The primary challenge is to get municipalities to make it a priority and manage it effectively.

Legally, municipalities may apply to a court for a garnishee order to recover outstanding debts from a customer. However, this is a costly approach and is therefore not widely used. National government believes that at this stage there is far more to be gained from improving the accuracy and completeness of municipal billing systems, and putting in place proper customer relations capacity. Experience has shown that these yield far better results for debt collection, but the idea of creating municipal debt courts can be considered in the medium term.

The notion that certain municipalities will never be financially viable is a misrepresentation of both the design of the local government fiscal framework and the practical reality of local economies. The fiscal framework is intended to ensure an equitable distribution of resources between the rich and poor areas of the country – but it does not absolve municipalities of the responsibility to raise property rates and services charges for the non-poor living within their municipal boundaries. Information on municipal own revenues indicates that many smaller municipalities are failing to do so. National government is investigating the issue of developing measures of fiscal capacity – it is by no means a straightforward task given the impact that traditional land and different modes of service delivery have on many municipalities' rates bases and service revenues.

Local government equitable share

The FFC recommends that the institutional component and revenue-raising correction component are reformed, so that the institutional component assists poor municipalities and the step structure of the differentiated tax mechanism of the revenue-raising correction component is removed. The current method of using actual property rates and own revenues collected to calculate the correction is problematic as poor fiscal effort and reporting is used as a measure for additional funding, which could

be seen as a contradiction of section 227(2) of the Constitution. The FFC recommends that this practice is replaced with alternative methods of revenue prediction.

Government response

Government agrees that changes are required to improve the way the local government equitable share is allocated between municipalities. To assess whether the local government equitable share formula results in an equitable division among individual municipalities (horizontal division) as stipulated in sections 214 and 227 of the Constitution, the formula should be analysed as a whole – rather than subcomponents in isolation. Several adjustments are made to the local government equitable share formula this year and further changes will be made after a full review of the formula in 2011 (discussed in part six of this annexure).

The institutional component has been changed in 2011, adjusting the amount allocated to municipalities in terms of their poverty rate. This means that poorer municipalities will receive increased allocations. Details of this change are set out in part five of this annexure.

The revenue-raising correction component was introduced in 2005 following the FFC's recommendation that equitable share allocations should be adjusted to take account of the ability of municipalities to raise their own revenues. The original model used to predict municipal revenue-raising capacity became distorted over time and was replaced in 2008 with a simple model that uses reported revenue raised in previous years to predict future revenue-raising capacity. Although the Municipal Property Rates Act (2004) has been amended to take effect by not later than 1 July 2011, stipulating that municipalities must implement valuation rolls, the system is not yet at a stage where property rates revenue estimates can inform municipal equitable share allocations. In the absence of accurate property valuation rolls for all municipalities and with no official data on economic activity at municipal level, it is very difficult to construct a model that would provide fair estimates of municipalities' capacity to raise their own revenues.

During 2010, National Treasury has worked together with officials from the FFC, SALGA and the Department of Cooperative Governance and Traditional Affairs to try to develop an alternative model. Due to the lack of adequate data, these attempts did not succeed in producing a model that could provide plausible predictions of the revenue-raising capacity of all municipalities. Using these models in the formula would have produced large distortions in allocations to municipalities and would risk contravening section 214(2)(i) of the Constitution that requires that allocations "take into account the desirability of stable and predictable allocations of revenue shares." The current method used for predicting municipalities' capacity to raise own revenues is therefore the fairest and most accurate method available at present and cannot be changed this year.

Government agrees to the recommendation to remove the stepped structure from the revenue-raising correction and a smooth curve has been used instead to calculate the differentiated "revenue correction" rate applied to each municipality. As outlined in part five of this annexure, the value of the revenue-raising correction has also been reduced in this MTEF to compensate for demographic changes not reflected in the formula, due to the use of 2001 Census data. The total value of the revenue-raising correction component of the formula will be reduced, giving it less of an impact on the allocations to individual municipalities.

Regionalising municipal services: the electricity distribution industry in South Africa

The FFC does not support the blanket regionalisation approach proposed in the 17th amendment to the Constitution. The electricity distribution industry (EDI) restructuring process should consider an approach that allows for differences in performance.

The FFC made a number of recommendations with respect to the EDI restructuring and establishment of regional electricity distributors.

Government response

The FFC recommendations were proposed before government resolved not to continue with the restructuring and establishment of the regional electricity distributors. The FFC's recommendations are therefore moot.

Chapter 4: Intergovernmental fiscal issues in urban public transport

Urban public transport

The FFC recommends that the Passenger Rail Agency of South Africa (PRASA) and cities should ensure that investment projects on rail and roads infrastructure are aligned and coordinated for optimal use of resources.

Government response

The regulation function for public transport is being developed in municipalities to support the alignment and coordination of investment and planning for public transport services. Changes to funding flows to improve coordination include the transfer of the *public transport operations grant* in the 2011 Division of Revenue Act. Talks are also under way with the national Department of Transport to discuss the transfer of rail operational subsidies to cities, rather than directly to PRASA, to ensure integrated network design and management.

Municipal Land Transport Fund

The FFC recommends that government make an immediate decision on the funding for the Municipal Land Transport Fund, as delays could negatively affect the financial position of affected municipalities.

Government response

The National Land Transport Act (NLTA) (2009) requires the creation of a municipal land transport fund in each municipality. Municipalities can deposit grants from national and provincial governments into the Municipal Land Transport Fund, as well as user charges from transport services and revenue from local taxes. If municipalities need to raise additional local taxes for the fund, they can apply to the Minister of Finance to authorise such a tax. To date no such request has been received.

Funding for commuter rail sector

The FFC recommends that PRASA should ensure that funding for investment on the commuter rail sector prioritises corridors already identified as A and B in the National Rail Plan.

Government response

Government supports the proposal.

Comprehensive review of the urban form

The FFC recommends a comprehensive review conducted by relevant stakeholders into the costs associated with current urban form in a selection of major South African cities. This review will improve the efficiency of land-use patterns. The current mechanisms and basis for distributing transport subsidies should be reviewed by the Department of Transport, National Treasury and other key stakeholders to promote the efficiency of urban transport and land-use systems, taking equity and distributional effects on households into account.

Government response

Government recognises the need to review fiscal and financing arrangements for large cities, particularly in light of recent policy development resulting in the transfer of public transport, human settlements and land management functions to cities. This requires the development of new fiscal instruments, monitoring and capacity-support arrangements. The introduction of the new *urban settlements development grant* to address informal settlements and accelerate urban land release should help to improve the efficiency of land-use patterns. The current system of transport subsidies is not linked to ridership levels in cities, nor does it cover the full cost of ridership, thus placing ridership risks with the cities. Government will consider possible further changes to the financing of urban housing and public transport. A key challenge is to improve service delivery while breaking down the apartheid settlement patterns that continue to marginalise the poor in cities.

Cities will require capacity support to take on these new roles. Government looks forward to FFC analysis and recommendations on key fiscal issues, options and risks regarding this issue.

National Land Transport Act

The FFC recommends that government examines the potential financial implications of the NLTA on municipalities, and identifies dedicated funding streams for public transport.

Government response

Funding has been allocated to the Department of Transport for the implementation of the NLTA over the MTEF. National Treasury will review funding options to support the creation of regulatory capacity at local level. Funding also needs to be shifted from provinces to local government, as the act transfers the function from provinces to municipalities.

National Household Travel Survey

The FFC recommends that the Department of Transport should regularly update the South African National Household Travel Survey.

Government response

Government supports the recommendation. Funding has been allocated to the Department of Transport to begin updating the National Household Travel Survey in 2011/12.

Part 4: Provincial allocations

Sections 214 and 227 of the Constitution require that an equitable share of nationally raised revenue be allocated to provincial government to enable it to provide basic services and perform the other functions allocated to this sphere.

An amount of R40.2 billion is added to the provincial baseline over the next three years. The provincial equitable share baselines are revised upwards by R30.1 billion and conditional grants are increased by R10.1 billion. National transfers to provinces increase from R323.1 billion in 2010/11 to R357.9 billion in 2011/12. Over the three-year period, provincial transfers will grow at an average annual rate of 7.8 per cent to R404.3 billion in 2013/14.

Table W1.6 below sets out the total transfers to provinces for the 2011/12 financial year, which amounts to R357.9 billion, with R288.5 billion allocated to the provincial equitable share and R69.4 billion to conditional grants, which includes an unallocated R305 million for the *provincial disaster grant,* but

does not include an indirect transfer to provinces of R700 million for the *school infrastructure backlogs grant*.

Table W1.6 Total transfers to provinces, 2011/12

R million	Equitable share	Conditional grants	Total transfers
Eastern Cape	44 120	8 896	**53 016**
Free State	17 521	4 976	**22 497**
Gauteng	50 428	14 665	**65 094**
KwaZulu-Natal	62 928	13 314	**76 241**
Limpopo	36 349	6 912	**43 261**
Mpumalanga	23 379	5 197	**28 576**
Northern Cape	7 743	2 473	**10 216**
North West	19 271	4 541	**23 813**
Western Cape	26 754	8 156	**34 910**
Unallocated	–	305	**305**
Total	**288 493**	**69 436**	**357 929**

Provincial equitable share

At 80.6 per cent of national transfers to provinces in 2011/12, the equitable share constitutes the main source of revenue for meeting provincial expenditure responsibilities. The proposed revisions of R7.8 billion, R10.3 billion, and R12 billion bring the equitable share allocations to R288.5 billion in 2011/12, R305.7 billion in 2012/13, and R323.6 billion in 2013/14. These revisions result in the provincial equitable shares increasing 8.8 per cent between 2010/11 and 2011/12, and 6.9 per cent over the MTEF in nominal terms.

Policy priorities underpinning equitable share revisions

The revisions to baseline equitable share allocations provide for personnel and policy adjustments. The personnel adjustments provide for the 2010 wage agreements and additional resources to provinces to deal with outstanding OSD costs in education and new and outstanding OSD costs in health. Policy adjustments seek to improve access to health services and to help provinces stabilise their health systems and prepare for the introduction of national health insurance.

Review of the provincial equitable share formula

Background

Section 227 of the Constitution entitles provinces to an equitable share of nationally raised revenue to enable them to provide basic services and perform their functions. Section 214 of the Constitution requires that before providing for the equitable division of revenue through the Division of Revenue Act, government must consider a number of factors listed in Section 214(2)(a) to (j), which provide a framework to guide revisions to the provincial equitable share formula.

In 2004 it was decided that national government should take responsibility for social assistance. These funds were taken out of the provincial equitable share and the formula was reviewed and some minor changes were made.

An objective redistributive formula is used to divide the equitable share among provinces. In 2006 the Budget Council called for a comprehensive review of the provincial equitable share formula to address concerns that it was not flexible enough to deal with expenditure responsibilities driving provincial budgets. The review was conducted in two phases; the first phase was concluded by the FFC in 2009. The FFC identified the policy imperatives that should underpin the review and proposed options for

reform of the provincial fiscal powers and the provincial fiscal framework. National Treasury lead the second phase of the review and the recommendations were presented to Budget Council on 4 October 2010. Government responds to the FFC's recommendations relating to the formula and the provincial division of revenue, but has not considered FFC's proposed changes to the fiscal powers of provinces.

Based on the review, a number of reforms will be introduced to the provincial equitable share formula for the 2011 Budget. The structure of the provincial equitable share (six components) remains unchanged. A new health component will be introduced and the weights of the education, health and basic components will be revised. The unconditional nature of the equitable share formula, the oversight and support responsibilities of national departments in charge of concurrent functions and the discretion of provincial governments have not been affected by these changes.

Formula incentives

The formula consists of six components. The components' respective weights should be considered together, along with the interrelated functions that provinces perform, taking into account the autonomy provinces have regarding the way in which they address government priorities.

Of the six components, only the institutional component and the economic activity component, which account for 6 per cent of the provincial equitable share, are not informed by demographic data. Therefore 94 per cent of the equitable share is influenced by population movements and the characteristics of provincial populations.

The education component encourages enrolment at schools, but due to the weighting of the subcomponents, penalises provinces that allow retention and repetition. The value of any province's health component, even in its new form, will not change significantly if the demand for health services in the province falls. This creates an incentive for provinces to manage their overall health care and social programmes well and improve the health of their population, reducing the burden on the health system and freeing up resources for other purposes.

The poverty component ensures the formula is redistributive and the economic component creates an incentive for provinces to create favourable economic conditions. The economic component is weighted according to the limited economic functions provinces are required to perform. The fixed institutional component ensures all provinces receive administrative funding, and due to the fixed value of this component, provinces that are administratively efficient are able to free up resources for service delivery.

Improving the formula's ability to deal with provincial expenditure responsibilities

The provincial equitable share is agreed to during the vertical division of revenue and the amount allocated to it is an indication of the value placed on the functions performed by provinces relative to the responsibilities of the two other spheres of government. The role of the formula is to ensure that each province receives its share of the provincial equitable share.

The provincial equitable share formula, as a blunt instrument, facilitates robust democratic engagement and provincial priority setting, which is consistent with the principles of the intergovernmental fiscal system. Resource allocation and budgeting decisions are made at the provincial level. Thus, poor resource and budgeting decisions cannot be attributed to the formula.

The intergovernmental fiscal system and implementation of concurrent functions can be improved through the strengthening of two key institutions. First, national departments responsible for concurrent functions must ensure that the policy standards for their sector are in place and legislated, so that provinces can align their activities with these standards. By requiring compliance with norms and standards, national departments allow provinces to choose how to achieve compliance, which encourages efficiency and innovation. Second, the capacity of provincial treasuries needs to be strengthened so that the cost implications of policies can be fully understood and monitored. A capacitated provincial treasury

enables the provincial executive to prepare and defend a balanced budget that addresses government priorities.

Changes to the provincial equitable share formula

A number of new components to the formula were considered, but all options were constrained by the availability of regularly updated official demographic data sets.

A new social development component was considered, but as the key dependent variable was poverty, it was agreed that it would be more efficient to simply use Statistics South Africa (StatsSA) poverty estimates, used in the existing poverty component. As the poverty component already exists it was decided that a social development component was unnecessary. A number of possibilities were considered for the education formula, particularly the costed norms approach often promoted by the FFC. However, this approach is too subjective, and as the incentives created by the existing component are supported it was left unchanged.

Since the last review of the provincial equitable share formula, the expenditure shares of education and health have changed. Health and education are still the two largest expenditure items on provincial budgets. Total enrolment has stabilised and is starting to fall off, however the pressure on health budgets continues and the relative share of these sectors has changed. The average expenditure on health and education as a proportion of total provincial expenditure for the period 2007/08 to 2009/10 was used to estimate new weights for these components.

The health sector proposed a new formula for the health component and it is discussed in detail below.

The equitable share formula

The formula is reviewed and updated with new data annually. For the 2011 MTEF, the equitable share formula has been updated with data from the 2010 mid-year population estimates, 2010 Education School Realities and output data from the health sectors. The risk-adjusted capitation index is based on data from the Risk Equalisation Fund, the 2008 gross domestic product by region (GDP-R) and the 2005 Income and Expenditure Survey. The impact of these updates on the provincial equitable shares is to be phased-in over three years (2011/12 to 2013/14).

Because the formula is largely population driven, the allocations it generates capture shifts in population across provinces, leading to changes in the relative demand for public services.

Phasing-in of the formula

To mitigate the impact of the new data updates on provincial equitable shares, and the new health component, the new shares are phased in over the MTEF. Table W1.7 shows the revised weighted provincial equitable shares for the period 2010/11 to 2013/14.

Table W1.7 Implementation of the equitable share weights, 2011/12 – 2013/14

Percentage	2010/11 Weighted shares	2011/12	2012/13	2013/14
		2011 MTEF weighted shares 3-year phasing		
Eastern Cape	15.5%	15.3%	15.2%	15.1%
Free State	6.1%	6.1%	6.0%	6.0%
Gauteng	17.3%	17.5%	17.6%	17.8%
KwaZulu-Natal	21.7%	21.8%	21.9%	21.9%
Limpopo	12.8%	12.7%	12.5%	12.3%
Mpumalanga	8.2%	8.1%	8.0%	8.0%
Northern Cape	2.7%	2.7%	2.7%	2.7%
North West	6.6%	6.7%	6.7%	6.8%
Western Cape	9.1%	9.2%	9.3%	9.4%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Summary of the structure of the formula

The formula, shown in Table W1.8 below, consists of six components that capture the relative demand for services between provinces and take into account specific provincial circumstances. The components of the formula are neither indicative budgets nor guidelines as to how much should be spent on those functions in each province or by provinces collectively. Rather, the education and health components are weighted broadly in line with historical expenditure patterns to provide an indication of relative need. Provincial executive councils have discretion regarding the determination of departmental allocations for each function, taking into account the priorities that underpin the division of revenue.

Table W1.8 Distributing the equitable shares by province, 2011 MTEF

	Education	Health	Basic share	Poverty	Economic activity	Institu-tional	Weighted average
	48%	27%	16%	3%	1%	5%	100%
Eastern Cape	16.7%	14.1%	13.5%	16.7%	7.5%	11.1%	15.1%
Free State	5.6%	5.9%	5.7%	5.9%	5.2%	11.1%	6.0%
Gauteng	15.5%	20.2%	22.4%	15.7%	33.1%	11.1%	17.8%
KwaZulu-Natal	23.1%	22.4%	21.3%	22.9%	16.4%	11.1%	21.9%
Limpopo	13.9%	10.6%	10.9%	14.3%	7.2%	11.1%	12.3%
Mpumalanga	8.4%	7.0%	7.2%	8.6%	7.6%	11.1%	8.0%
Northern Cape	2.2%	2.3%	2.2%	2.5%	2.3%	11.1%	2.7%
North West	6.3%	7.0%	6.4%	7.5%	6.5%	11.1%	6.8%
Western Cape	8.3%	10.5%	10.4%	6.0%	14.3%	11.1%	9.4%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

For the 2011 Budget, the weight of the education component changes from 51 per cent to 48 per cent, the weight of the health component changes from 26 per cent to 27 per cent and the basic component changes from 14 per cent to 16 per cent. The new weights for the education and health components are aligned with their expenditure shares, excluding expenditure on conditional grants over the past three years. The basic share is a residual component, changing to capture the balance in the changes mentioned above. The formula components are set out as follows:

- An *education share* (48 per cent) based on the size of the school-age population (ages 5-17) and the number of learners (Grade R to 12) enrolled in public ordinary schools.
- A *health share* (27 per cent) based on a combination of risk-adjusted capitation index for the population, which takes into account the health risks associated with the demographic profile of the population and the relative share of case loads in hospitals. The risk-adjusted capitation is given a 25 per cent weighting and the case load (output component) is given a 75 per cent weighting.

- A *basic share* (16 per cent) derived from each province's share of the national population.
- An *institutional component* (5 per cent) divided equally between the provinces.
- A *poverty component* (3 per cent) reinforcing the redistributive bias of the formula.
- An *economic output component* (1 per cent) based on GDP-R data.

Education component

The education component is intended to enable provinces to fund school education, which amounts to about 90 per cent of provincial education spending. The formula uses school-age population (ages 5-17), based on Census 2001, and actual enrolment data drawn from the 2010 Education School Realities to reflect relative demand for education, with each element assigned a weight of 50 per cent. Table W1.9 shows the impact data updates on the education component shares.

Table W1.9 Impact of changes in school enrolment on the education component shares

Learner numbers	Age cohort 5 - 17	2009 School enrolment	2010 School enrolment	Changes in enrolment	Weighted average		Difference in weighted average
					2010 MTEF	2011 MTEF	
Eastern Cape	2 151 992	2 076 400	2 052 386	-24 014	16.8%	16.7%	-0.13%
Free State	760 486	656 754	654 704	-2 050	5.6%	5.6%	-0.02%
Gauteng	1 931 719	1 939 231	1 974 066	34 835	15.4%	15.5%	0.11%
KwaZulu-Natal	3 013 243	2 816 974	2 806 988	-9 986	23.2%	23.1%	-0.08%
Limpopo	1 798 862	1 707 280	1 706 401	-879	13.9%	13.9%	-0.03%
Mpumalanga	1 074 972	1 035 469	1 036 432	963	8.4%	8.4%	-0.01%
Northern Cape	280 975	267 709	269 392	1 683	2.2%	2.2%	0.00%
North West	826 218	741 892	759 114	17 222	6.2%	6.3%	0.06%
Western Cape	1 094 565	973 136	1 000 616	27 480	8.2%	8.3%	0.10%
Total	**12 933 032**	**12 214 845**	**12 260 099**	**45 254**	**100.0%**	**100.0%**	**–**

Health component

The previous health component was based on population with medical aid, using the 2009 General Household Survey. Mid-year population estimates are used to update the subcomponent "people without medical aid." People without medical aid were weighted four times as much as people with medical aid.

Government has adopted a new health component that will be used in the 2011 division of revenue. This component combines a risk-adjusted capitation index based on the Risk Equalisation Fund (REF) and output data from public hospitals to estimate each province's share of the health component. These two methods work together to balance needs (risk-adjusted capitation) and demands (output component).

Cost curves have been developed from the REF using data on consumption of health services in the private sector. These curves are based on health services used by people on medical aid and disaggregated by age and gender. For the purposes of the health formula, these curves have been weighted for HIV and Aids and pregnancy. The resulting curves are used to estimate an age- and gender-adjusted weighted population for each district and province. The risk-adjusted capitation is estimated using demographic data of the non-insured population in each district and province drawn from the basic population estimates in the General Household Survey (2009). In the absence of data on health consumption patterns in the public sector, the health formula has had to rely on REF data.

Output data or workload data (patient-day equivalent) has been provided by the District Health Information System (DHIS) for 2007/08 to 2009/10. Hospitals are divided by level of care, based on classifications used in the DHIS. A normative estimate of the care mix per hospital level has been developed, and average unit costs for this mix of care have been formulated, so that the relative cost of

services provided at the different levels can be estimated. The estimated level of care is based on a modified version of the National Planning Framework's bed mix by hospital and standard bed-to-population ratios. This approach is normative to deal with the various types of hospitals in provinces.

The unit costs used are derived from a combination of actual data (BAS and DHIS) and previous information comparing normative costs for different hospital types. Each patient-day equivalent is multiplied by a normative costing to estimate a normative health budget per district and aggregated to the provincial level. This is used to estimate a total health budget and each province's share of the output component is based on their share of the total normative budget.

Table W1.10 compares the weighted shares for the health component using the old formula with the new formula. The first column shows the weighted shares in 2010 and what they would be in 2011 using the updated General Household Survey population estimates. The first two columns on the left show the weighted share for 2010 and what the shares would be in 2011 with data updates if the health formula was not changed. The weighted share 2011 column is estimated by weighting the risk-adjusted component (75 per cent) and the output component (25 per cent). These weights will be reviewed as more data becomes available.

Table W1.10 New health component weighted shares

	Weighted shares updated with GHS and mid-year population estimates		Weighted shares 2011 MTEF	Difference in weighted shares
Percentage	2010 MTEF	2011 MTEF	25% output, 75% risk adjusted	
Eastern Cape	14.0%	14.1%	14.1%	0.03%
Free State	5.9%	5.6%	5.9%	0.38%
Gauteng	19.9%	20.8%	20.2%	-0.62%
KwaZulu-Natal	22.2%	22.1%	22.4%	0.27%
Limpopo	11.3%	11.7%	10.6%	-1.10%
Mpumalanga	7.5%	7.4%	7.0%	-0.41%
Northern Cape	2.4%	2.2%	2.3%	0.11%
North West	6.7%	6.5%	7.0%	0.47%
Western Cape	10.1%	9.6%	10.5%	0.88%
Total	**100.0%**	**100.0%**	**100.0%**	**–**

Poverty component

The poverty component introduces a redistributive element within the formula and is assigned a weight of 3 per cent. The poor population consists of persons who fall in quintiles 1 and 2 based on the 2005 Income and Expenditure Survey. Each province's share is then expressed as the percentage of the poor population residing in that province, where the population figure is drawn from the 2010 mid-year population estimates. Table W1.11 shows the poverty quintiles of the Income and Expenditure Survey, basic component value and the weighted share of the poverty component per province.

Table W1.11 Comparison of current and new poverty component weighted shares

	IES Survey 2005 (Q1+Q2)	Current (2010 MTEF)			New (2011 MTEF)			Difference in weighted shares
		Basic compo-nent value	Poor population	Weighted shares	Basic compo-nent value	Poor population	Weighted shares	
Eastern Cape	49.8%	6 649	3 314	16.7%	6 744	3 361	16.7%	0.00%
Free State	41.7%	2 902	1 211	6.1%	2 825	1 178	5.9%	-0.25%
Gauteng	28.1%	10 757	3 025	15.3%	11 192	3 147	15.7%	0.40%
KwaZulu-Natal	43.2%	10 449	4 511	22.8%	10 646	4 596	22.9%	0.11%
Limpopo	52.9%	5 227	2 763	13.9%	5 440	2 875	14.3%	0.37%
Mpumalanga	47.7%	3 607	1 720	8.7%	3 618	1 725	8.6%	-0.09%
Northern Cape	44.9%	1 148	515	2.6%	1 104	496	2.5%	-0.13%
North West	46.9%	3 224	1 513	7.6%	3 201	1 502	7.5%	-0.16%
Western Cape	23.1%	5 357	1 237	6.2%	5 224	1 206	6.0%	-0.24%
Total		**49 321**	**19 809**	**100.0%**	**49 991**	**20 087**	**100.0%**	–

Economic activity component

The economic activity component is a proxy for provincial tax capacity and is assigned a weight of 1 per cent. For the 2011 MTEF, 2008 GDP-R data is used. Table W1.12 shows the impact of the revised weighted shares of the economic activity component. The right-hand column shows changes as a result of relative growth of provincial contributions to GDP.

Table W1.12 Current and new economic activity component weighted shares

	Current (2010 MTEF)		New (2011 MTEF)		Difference in weighted shares
	GDP-R, 2007 (R million)	Weighted shares	GDP-R, 2008 (R million)	Weighted shares	
Eastern Cape	155 520	7.8%	170 502	7.5%	-0.31%
Free State	108 892	5.4%	119 317	5.2%	-0.22%
Gauteng	668 926	33.5%	755 391	33.1%	-0.39%
KwaZulu-Natal	324 216	16.2%	373 662	16.4%	0.14%
Limpopo	138 163	6.9%	164 150	7.2%	0.28%
Mpumalanga	138 732	6.9%	172 587	7.6%	0.62%
Northern Cape	44 159	2.2%	52 681	2.3%	0.10%
North West	129 872	6.5%	148 219	6.5%	-0.01%
Western Cape	290 607	14.5%	327 314	14.3%	-0.21%
Total	**1 999 087**	**100.0%**	**2 283 822**	**100.0%**	–

Institutional component

The institutional component recognises that some costs associated with running a provincial government and providing services are not directly related to the size of a province's population. It is therefore distributed equally between provinces. It constitutes 5 per cent of the total equitable share, of which each province receives 11.1 per cent.

Basic component

The basic component is derived from the proportion of each province's share of the national population. Following the review of the provincial equitable share formula, the weight of this component increases from 14 per cent to 16 per cent to balance the total change in weights for the education and health components. For the 2011 MTEF, population data are drawn from the 2010 mid-year population estimates. Table W1.13 shows the impact of the revised weighted shares of the basic component.

Table W1.13 Impact of the changes in population on the basic component shares

Population (thousand)	2009 Mid-year population estimates	2010 Mid-year population estimates	Population change	% population change	Current (2010 MTEF)	New (2011 MTEF)	Difference in weighted shares
Eastern Cape	6 649	6 744	95	1.4%	13.5%	13.5%	0.01%
Free State	2 902	2 825	-78	-2.7%	5.9%	5.7%	-0.23%
Gauteng	10 757	11 192	435	4.0%	21.8%	22.4%	0.58%
KwaZulu-Natal	10 449	10 646	196	1.9%	21.2%	21.3%	0.11%
Limpopo	5 227	5 440	212	4.1%	10.6%	10.9%	0.28%
Mpumalanga	3 607	3 618	11	0.3%	7.3%	7.2%	-0.08%
Northern Cape	1 148	1 104	-44	-3.8%	2.3%	2.2%	-0.12%
North West	3 224	3 201	-24	-0.7%	6.5%	6.4%	-0.14%
Western Cape	5 357	5 224	-133	-2.5%	10.9%	10.4%	-0.41%
Total	**49 321**	**49 991**	**671**	**1.4%**	**100.0%**	**100.0%**	**–**

Conditional grants to provinces

There are four types of provincial conditional grants. Schedule 4 sets out general grants that supplement various programmes partly funded by provinces, such as infrastructure and central hospitals. Transfer and spending accountability arrangements differ, as more than one national or provincial department may be responsible for different outputs expected from the grant. Schedule 5 grants fund-specific responsibilities for both the transferring and receiving of provincial accounting officers. A schedule 8 grant, introduced in 2009/10, is intended to provide provinces (and municipalities) with an incentive to meet or exceed prescribed targets. A schedule 9 grant, introduced in 2011/12, provides for the swift allocation and transfer of funds to a province to assist it in dealing with a disaster.

Changes to conditional grant framework

The 2011 MTEF introduces two new conditional grants: the *school infrastructure backlogs grant* and the *provincial disaster grant*. The *school infrastructure backlogs grant* is a short-term grant introduced to deal with the backlog in inappropriate structures and access to basic services in education. To improve alignment of provincial infrastructure transfers with sector needs, the *infrastructure grant to provinces* has been restructured. The portion of the grant that was earmarked for health is now allocated to the new *health infrastructure grant.* The portion that was earmarked for roads is now put into the *provincial roads maintenance grant,* which will be administered by the Department of Transport. The portion of the grant earmarked for education is now in the new *education infrastructure grant.*

Table W1.14 shows the revisions to provincial conditional grants, which provide for technical, policy and inflation adjustments. Including additions funded from savings and after accounting for shifts from provincial conditional grants to municipal grants, revisions to conditional grant baseline allocations total R2.2 billion, R3.4 billion and R5.9 billion over the MTEF, and bring the new conditional grant baselines to R69.4 billion in 2011/12, R74.7 billion in 2012/13 and R80.6 billion in 2013/14. This excludes the *school infrastructure backlogs grant*, which is an indirect transfer.

Table W1.14 Revisions to provincial conditional grant baseline allocations, 2011/12 – 2013/14[1]

R million	2011/12	2012/13	2013/14	2011 MTEF
Technical adjustments	**-2 578**	**-3 232**	**-3 821**	**-9 631**
Health	**–**	**-620**	**-1 154**	**-1 774**
Forensic pathology services	–	-620	-654	-1 274
Hospital revitalisation	–	–	-500	-500
National Treasury	**-13 091**	**-14 008**	**-14 778**	**-41 877**
Infrastructure grant to provinces	-13 091	-14 008	-14 778	-41 877
Revised to:	**13 091**	**14 008**	**14 778**	41 877
Education infrastructure	5 498	5 883	6 207	17 588
Health infrastructure	1 702	1 821	1 921	5 444
Provincial roads maintenance	5 891	6 303	6 650	18 845
Human Settlements	**-2 246**	**-2 339**	**-2 468**	**-7 053**
Human settlements development	-2 246	-2 339	-2 468	-7 053
Public Works	**-332**	**-273**	**-199**	**-804**
Expanded public works programme incentive for provinces	-533	-515	-485	-1 532
Social sector expanded public works programme incentive for provinces	200	242	286	728
Savings effected on conditional grants	**-71**	**-45**	**-54**	**-170**
Human Settlements	**-35**	**–**	**–**	**-35**
Human settlements development	-35	–	–	-35
Health	**-36**	**-45**	**-54**	**-135**
Hospital revitalisation	-36	-45	-54	-135
Additions to baselines	**2 227**	**3 433**	**5 852**	**11 512**
Agriculture, Forestry and Fisheries	**50**	**175**	**275**	**500**
Comprehensive agricultural support programme	50	120	230	400
Land care programme: Poverty relief and infrastructure development	–	55	45	100
Cooperative Governance and Traditional Affairs	**305**	**180**	**190**	**675**
Provincial disaster grant	305	180	190	675
Higher Education and Training	**354**	**536**	**864**	**1 754**
Further education and training colleges	354	536	864	1 754
Health	**310**	**560**	**2 110**	**2 980**
Comprehensive HIV and Aids	60	60	1 360	1 480
National tertiary services	250	500	750	1 500
Public Works	**641**	**718**	**804**	**2 163**
Devolution of property rate funds	641	718	804	2 163
Transport	**566**	**1 264**	**1 609**	**3 440**
Provincial roads maintenance	566	1 264	1 609	3 440
Indirect transfers	**700**	**2 315**	**5 189**	**8 204**
Basic Education	**700**	**2 315**	**5 189**	**8 204**
School infrastructure backlogs	700	2 315	5 189	8 204

1. Some national shifts and savings are not recorded in provincial conditional grant baselines.

Table W1.15 provides a summary of conditional grants by sector for the 2011 MTEF. More detailed information, including the framework and formula for each grant, is provided in Annexure W2 of the 2011 Division of Revenue Bill. The frameworks provide the conditions for each grant, the outputs expected, the allocation criteria used for dividing each grant between provinces, a summary of the audit outcome in 2009/10 and any other material issues to be addressed.

Table W1.15 Conditional grants to provinces, 2010/11 – 2013/14

R million	2010/11	2011/12	2012/13	2013/14
Agriculture, Forestry and Fisheries	**1 167**	**1 487**	**1 684**	**1 867**
Agricultural disaster management	50	–	–	–
Comprehensive agricultural support programme	862	1 029	1 148	1 315
Ilima/Letsema projects	200	400	420	443
Land care programme: Poverty relief and infrastructure development	55	58	116	109
Arts and Culture	**513**	**543**	**571**	**602**
Community library services	513	543	571	602
Basic Education	**7 107**	**10 546**	**11 331**	**11 954**
Dinaledi schools	–	70	100	106
Education infrastructure	3 206	5 498	5 883	6 207
HIV and Aids (life skills education)	188	199	209	221
National school nutrition programme	3 663	4 579	4 928	5 199
Technical secondary schools recapitalisation	50	200	210	222
Cooperative Governance and Traditional Affairs	**214**	**305**	**180**	**190**
Provincial disaster	–	305	180	190
Provincial infrastructure disaster relief	214	–	–	–
Health	**20 483**	**23 948**	**25 746**	**28 175**
Comprehensive HIV and Aids	6 052	7 493	8 825	10 607
Forensic pathology services	557	590	–	–
Health infrastructure	840	1 702	1 821	1 921
Health professions training and development	1 865	1 977	2 076	2 190
Hospital revitalisation	3 771	4 136	4 336	4 068
National tertiary services	7 398	8 049	8 689	9 389
Higher Education and Training	**3 804**	**4 326**	**4 705**	**5 262**
Further education and training colleges	3 804	4 326	4 705	5 262
Human Settlements	**13 033**	**14 942**	**15 599**	**16 457**
Housing disaster relief	134	–	–	–
Human settlements development	12 899	14 942	15 599	16 457
Public Works	**2 181**	**2 271**	**2 505**	**2 778**
Devolution of property rate funds	1 865	1 803	1 938	2 091
Expanded public works programme incentive for provinces	259	267	325	402
Social sector expanded public works programme incentive for provinces	57	200	242	286
Sport and Recreation South Africa	**426**	**452**	**475**	**501**
Mass sport and recreation participation programme	426	452	475	501
Transport	**9 013**	**10 616**	**11 929**	**12 860**
Gautrain rapid rail link	438	5	–	–
Overload control	11	–	–	–
Provincial roads maintenance	4 700	6 457	7 568	8 259
Public transport operations	3 863	4 153	4 361	4 601
Total	**57 941**	**69 436**	**74 724**	**80 647**
Indirect transfers	**–**	**700**	**2 315**	**5 189**
School infrastructure backlogs	–	700	2 315	5 189

Agriculture grants

The *comprehensive agricultural support programme* aims to provide support for newly established and emerging farmers. Included in this grant is the extension recovery programme, which focuses on improving extension services through training programmes and providing equipment for extension officers. The grant also targets farm infrastructure and provides support for dipping, fencing and

rehabilitation of viable irrigation schemes. An amount of R400 million is added to this grant over the MTEF.

The *land care programme grant: poverty relief and infrastructure development* aims to increase productivity and the sustainable use of natural resources. Provinces are encouraged to use this grant to create jobs through the expanded public works programme. An amount of R282 million is allocated over the medium term.

The *Ilima/Letsema projects grant* is intended to boost food production. The grant is aimed at assisting previously disadvantaged South African farming communities to achieve an increase in agricultural production and receives R1.3 billion over the MTEF.

Arts and culture grant

The c*ommunity library services grant* is administered by the Department of Arts and Culture. The purpose of the grant is to enable South Africans to gain access to knowledge and information that will improve their socioeconomic situation. The grant is allocated to the relevant provincial department and either administered by that department or through a service-level agreement with municipalities. This grant is allocated R1.7 billion over the MTEF.

Basic education grants

The Department of Basic Education administers the *national school nutrition programme grant, the Dinaledi schools grant,* the *technical secondary schools recapitalisation grant* and the *HIV and AIDS (life skills education) grant.* The new s*chool infrastructure backlogs grant* and the e*ducation infrastructure grant* will be administered by the department over the 2011 MTEF.

The national department will administer the s*chool infrastructure backlogs grant* – a grant-in-kind for provinces to ensure a national, coordinated and high-impact approach to eradicating backlogs in inappropriate structures and access to basic services at schools. The grant has been allocated R8.2 billion over the MTEF during which all backlogs will be eradicated and the grant will cease to exist at the end of this period.

The new *education infrastructure grant* is the portion of the *infrastructure grant to provinces* that was earmarked for education, and has been allocated R17.6 billion over the MTEF. The best-practice planning principles established through the *infrastructure grant to provinces* will continue to be implemented through this grant.

The Department of Basic Education will coordinate the implementation of these infrastructure grants to ensure provinces manage their entire education asset stock efficiently and effectively. Key to the success of these grants is the institutionalisation of best-practice infrastructure procurement practices that lead to the packaging of many small- and medium-sized infrastructure projects into single projects, which are delivered through a single contracting process.

The *national school nutrition programme* seeks to improve nutrition of poor school children, enhance active learning capacity and improve attendance in schools. An amount of R14.7 billion is allocated to this grant over the MTEF.

The technical secondary schools recapitalisation grant provides for equipment and facilities in technical high schools. This grant came into effect in 2010/11 and R632 million is allocated to it over the MTEF.

The *Dinaledi schools grant* starts in 2011/12. The grant will support Dinaledi schools to improve teaching in mathematics and sciences. The grant is allocated R276 million over the MTEF.

The *HIV and Aids (life skills education) grant* provides for life skills training, sexuality and HIV and Aids education in primary and secondary schools and is fully integrated into the school system, with

learner and teacher support material provided for grades 1 to 9. This grant is allocated R629 million over the MTEF.

Cooperative governance grants

The new conditional *provincial disaster grant* is introduced in the 2011 MTEF. This grant will be administered by the National Disaster Management Centre in the Department of Cooperative Governance and Traditional Affairs as an unallocated grant to provincial government. A new schedule and clauses have been inserted into the Division of Revenue Act to create special provisions for this grant, enabling the National Disaster Management Centre to disburse disaster response funds immediately after a disaster is declared, without the need for the transfers to first be gazetted. Over the MTEF, R675 million is available for disbursement through this grant.

Health grants

The *national tertiary services grant* aims to provide strategic funding to enable provinces to plan, modernise, and transform tertiary hospital service delivery, in line with national policy objectives. The grant operates in 26 hospitals across the nine provinces, concentrated in urban Gauteng and the Western Cape. Consequently, the Western Cape and Gauteng receive the largest shares of the grant as they provide the largest proportion of these high-level, sophisticated services for the benefit of the health sector countrywide. The grant has been increased by R1.5 billion over the MTEF to provide for OSD agreements for doctors and implementation of norms and standards in hospitals.

The health portion of the *infrastructure grant to provinces* will be transferred through the new *health infrastructure conditional grant*. The capacity-building programmes that supported the *infrastructure grant to provinces* will continue and the national department will support provinces to implement best-practice planning and project implementation processes through this grant, which has been allocated R5.4 billion over the MTEF.

The *hospital revitalisation grant* plays a key role in the large-scale transformation and modernisation of infrastructure and equipment in hospitals. This grant remains separate to the *health infrastructure grant* to enable the national Department of Health to manage projects funded through this grant closely. Taking into account revisions to the baseline of this grant, R12.5 billion is allocated over the MTEF. During 2011/12, work will begin on merging the *health infrastructure grant* and the *hospital revitalisation grant* into a single consolidated source of infrastructure funding for health.

The *health professions training and development grant* funds the training of health professionals, and the development and recruitment of medical specialists. It enables the shifting of teaching activities from central to regional and district hospitals. This grant is allocated R6.2 billion over the medium term.

The *comprehensive HIV and Aids grant* enables the health sector to develop a specific response to HIV and Aids. In addition to prevention programmes, the grant supports specific interventions that include voluntary counselling and testing, prevention of mother-to-child transmission, post-exposure prophylaxis and home-based care. In addition to substantial increases to this grant over the 2010 MTEF and additions to the provincial equitable share over the 2011 MTEF for HIV and Aids programmes, R1.5 billion is added to this grant over the 2011 MTEF to fund the higher-than-expected demand for treatment and prevention programmes. The grant is allocated R26.9 billion over the MTEF.

The *forensic pathology services grant* assists with the transfer of medico-legal mortuaries from the South African Police Service to the health sector and supports the provision of comprehensive forensic pathology services for the criminal justice system. This grant will be phased into the provincial equitable share from 2012/13 and is allocated R590 million in 2011/12.

Higher education and training grants

The *further education and training colleges grant* was introduced in 2010/11 to protect spending on these colleges by provinces while the legislative processes required to shift this function to national government are completed. An amount of R1.8 billion is added to this grant over the MTEF to cover the cost of wage agreements, carry-through effects of OSD agreements and to provide for increased enrolment.

Human settlements grants

The *human settlements development grant* facilitates the establishment of habitable, stable and sustainable human settlements in which all citizens have access to social and economic amenities. From 2011/12 the portion of this grant that should go to cities for internal infrastructure to houses will be taken out of the grant and added to the *urban settlements development grant,* formerly the *municipal infrastructure cities grant*. The baseline of the *human settlements development grant* has accordingly been revised to R47 billion over the MTEF. As more municipalities with large urban centres are able to take on these responsibilities, they will join the *urban settlements development grant* and their portion of the *human settlements development grant* will be transferred. This should accelerate the eradication and formalisation of informal settlements. In cases where municipalities are accredited in terms of the Housing Act (1997), the municipalities will receive the grant directly from national government.

Public works grants

The *devolution of property rate funds grant* ensures that provinces take over the responsibility of paying property rates and municipal charges on properties that were administered by national government on their behalf. An amount of R2.2 billion is added to this grant over the MTEF, as more information about property ownerships and municipal rates has become available.

The *expanded public works programme incentive grant for provinces* provides incentives to provinces to increase spending on labour-intensive programmes. It is awarded to provinces based on the number of work opportunities they create through specific programmes. The baseline of this grant has been revised to provide for the *social sector expanded public works programme incentive grant for provinces* and is in line with provincial department's capacity to perform. Over the MTEF, R994 million is allocated to this grant. In the 2010 Budget, the Department of Public Works introduced a subsidy grant: the *expanded public works programme for the social sector*. That grant has been restructured into an incentive grant for the social sector to increase employment in non-profit organisations working in this sector and to improve the reach and quality of their services. The grant has been allocated R728 million over the MTEF.

Transport grants

The Department of Transport is allocated R5.3 million in 2011/12, through the *gautrain rapid rail link grant*, as a final contribution to the construction of the Gautrain Rapid Rail Link to cover the cost of any foreign exchange losses. This is the last year of this grant.

The *public transport operations grant* subsidises commuter bus services. The payment of bus subsidies to operators was previously funded on an agency arrangement between national and provincial government, and this grant enables government to take greater responsibility in ensuring contractual obligations are met. This grant will amount to R13.1 billion over the MTEF.

The portion of the i*nfrastructure grant to provinces* earmarked for provincial roads has been allocated to the *provincial roads maintenance grant*, which comes into effect in 2011/12. An amount of R3.4 billion is added to the earmarked portions from the *infrastructure grant to provinces* over the MTEF to enable provinces to expand their maintenance activities and to cover the cost of rehabilitation work created by coal haulage in Mpumalanga and Gauteng. The *provincial roads maintenance grant* will require

provinces to follow best-planning practices according to road asset management systems and to keep these systems updated regularly. The grant has been allocated R22.3 billion over the MTEF.

Sports and Recreation grants

The Department of Sports and Recreation administers the *mass sport and recreation participation programme grant* to encourage mass sports participation within communities and schools through selected activities. This grant is allocated R1.4 billion over the MTEF.

Part 5: Local government fiscal framework and allocations

A number of changes are made to the fiscal framework and allocations to local government this year. Revisions have been made to conditional grants to differentiate between and better respond to the needs of rural and urban municipalities. The formula used to allocate the equitable share to municipalities has also been adjusted to direct more funds towards poorer municipalities. These changes will be built on after a review of the local government fiscal framework to be conducted during 2011.

This section outlines what transfers are made to local government and how these funds are distributed between municipalities. Funds raised by national government are transferred to municipalities through conditional and unconditional grants. These funds help municipalities to meet their constitutional mandate to deliver basic services and meet the public service needs of all their residents, while promoting local economic development. National transfers to municipalities are published to enable them to plan fully for their coming 2011 budgets, and to promote better accountability and transparency by ensuring that all national allocations are included in municipal budgets.

Table W1.16 Revisions to direct and indirect transfers to local government, 2011/12 – 2013/14

R million	2011/12	2012/13	2013/14	2011 MTEF Total revisions
Technical adjustments	**1 463**	**953**	**1 050**	**3 465**
Direct transfers	**1 552**	**1 453**	**1 566**	**4 572**
Municipal infrastructure grant	-493	-600	-633	-1 725
Urban settlements development grant	2 739	2 939	3 101	8 778
Neighbourhood development patnership grant	-440	-382	-447	-1 270
Municipal systems improvement grant	-5	-6	-6	-17
Expanded public works programme incentive grant to provinces for the infrastructure sector	-428	-498	-448	-1 374
Water services operating subsidy grant	181	–	–	181
Indirect transfers	**-90**	**-500**	**-517**	**-1 107**
Rural households infrastructure grant	-119	-271	-274	-663
Water services operating subsidy grant	100	–	–	100
Regional bulk infrastructure grant	-71	-230	-243	-544
Additions to baselines	**2 037**	**2 691**	**3 843**	**8 571**
Direct transfers	**1 937**	**2 307**	**3 375**	**7 619**
Equitable share	168	339	678	1 185
Urban settlements development grant	396	662	1 008	2 067
Public transport infrastructure and systems grant	378	875	1 212	2 465
Rural transport services and infrastructure grant	24	26	27	77
Municipal drought relief grant	450	–	–	450
Municipal disaster grant	470	330	350	1 150
Financial management grant	50	75	100	225
Indirect transfers	**100**	**384**	**468**	**952**
Regional bulk infrastructure grant	100	384	468	952

The 2011 MTEF provides for an additional R1.2 billion for the local government equitable share over the MTEF, which results in a growth for unconditional allocations to municipalities over the period, from R30.6 billion in 2010/11 to R40 billion in 2013/14, at an average annual rate of 9.4 per cent. This growth follows several years of significant increases that saw the local government equitable share grow 971 per cent in the decade between 2001/02 and 2011/12 and more than double the proportion of the total national budget it accounts for – growing by an annual average rate of 30.1 per cent. This growth rate could not be sustained indefinitely and will level off over the MTEF. Changes to the local government equitable share in this budget are focused on adjustments to improve the allocative efficiency of the formula. Including additions funded from savings, an amount of R7.6 billion is added to direct transfers and R952 million is added to indirect transfers over the MTEF.

Table W1.17 Transfers to local government, 2007/08 – 2013/14

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
		Outcome		Revised		Medium-term estimates	
R million				estimate			
Direct transfers	**38 483**	**45 487**	**51 538**	**61 152**	**70 171**	**77 029**	**82 317**
Equitable share	**20 676**	**25 560**	**23 845**	**30 559**	**34 108**	**37 573**	**39 960**
General fuel levy sharing with metros	**–**	**–**	**6 800**	**7 542**	**8 573**	**9 040**	**9 613**
Conditional grants	**17 807**	**19 927**	**20 893**	**23 052**	**27 490**	**30 416**	**32 743**
Infrastructure	16 290	18 562	18 812	20 972	25 596	28 642	30 774
Capacity building and other	1 517	1 365	2 081	2 080	1 894	1 774	1 969
Indirect transfers	**1 884**	**2 307**	**2 997**	**3 095**	**3 992**	**4 445**	**4 734**
Infrastructure	1 334	1 928	2 754	2 947	3 892	4 445	4 734
Capacity building and other	550	379	243	148	100	–	–
Total	**40 367**	**47 794**	**54 535**	**64 247**	**74 164**	**81 474**	**87 051**

The local government equitable share

The primary role of the local government equitable share is to distribute local government's share of nationally raised revenue, supplementing municipal own revenues, to assist municipalities in providing basic services to poor households.

Equitable share formula

Local government's share of nationally raised revenue is allocated between municipalities using a formula that takes account of the different demographics and service levels in municipalities. The equitable share formula ensures that each municipality receives a share that allows it to meet its basic service obligations, taking account of both the operational costs of providing those services and administrative and governance costs incurred in running a municipality. Allocations are corrected to account for the varying ability of municipalities to raise their own revenues.

Changes to the formula

Government recognises that the current equitable share formula could be improved on and intends to introduce a new equitable share formula for local government after a thorough review of the local government fiscal framework over the medium term (more details on this review are provided in part six of this annexure). However, it is likely that this new formula will only be introduced after the data from the 2011 Census is made available, and it may only affect allocations in 2014/15. Several adjustments have been made to the current formula to ensure that some of the flaws are addressed over the MTEF. In particular, adjustments to the formula are made to ensure that a greater proportion of funds are allocated to municipalities in the poorest areas of the country to improve service delivery, and changes are made to the basic services, institutional and revenue-raising capacity correction components of the formula.

To ensure stability in municipal allocations, municipalities are guaranteed to receive at least 90 per cent of the indicative allocation for 2011/12 published in the 2010 Division of Revenue Act and 100 per cent of their 2010/11 allocation. The majority of municipalities (and all local municipalities), poor municipalities in particular, will receive more than their guaranteed amounts.

The adjustments to the formula are described in detail in the subsections that follow. Their net effect is to increase the equitable share allocations to the 70 poorest municipalities by an average of 6.7 per cent and to the 21 district municipalities that provide water and sanitation services by an average of 5 per cent. These increases are in addition to the increases in funds added to the local government equitable share, which benefits all municipalities.

The structure and components of the formula are summarised in the box below:

Structure of the local government equitable share formula

Grant = BS + D + I – R ± C

where

BS is the basic services component

D is the development component

I is the institutional support component

R is the revenue-raising capacity correction and

C is a correction and stabilisation factor

The basic services component

The purpose of this component is to assist municipalities in providing basic services to poor households and with meeting municipal health service needs for all. For each subsidised basic service there are two levels of support: a full subsidy for poor households that are connected to municipal services, and a partial subsidy for poor households that are not yet connected to municipal networks. In the past, the allocation for un-serviced households was set at a third of the cost of the subsidy to serviced households. In the 2011 MTEF this has been increased to 45 per cent of the value of subsidy to serviced households. This increase acknowledges that progress has been made in connecting more poor households to services, increasing the service costs to municipalities. It is not possible to adjust the number of serviced households accurately until the next census results are released, so a general increase to the value of allocations against un-serviced households has been made to help cover these additional costs. This has a significant impact on municipalities in the poorest parts of the country, as they tend to have the highest service backlogs.

The characteristics of the basic services component are:

- Supporting poor households earning less than R800 per month in 2001 prices.
- Distinguishing between poor households connected to services and those that are not connected to services and may be provided with alternatives.
- Recognising water reticulation, sanitation, refuse removal and electricity reticulation as core municipal services.
- Providing for municipal health services to all households (through funding allocated to district and metropolitan municipalities).

The basic services component

BS=[water subsidy 1*poor with water + water subsidy 2*poor without water] +

[sanitation subsidy 1*poor with sanitation + sanitation subsidy 2*poor without sanitation] +

[refuse subsidy 1*poor with refuse + refuse subsidy 2*poor without refuse] +

[electricity subsidy 1*poor with electricity + electricity subsidy 2*poor without electricity] +

[municipal health services*total number of households]

The development component

This component is currently inactive. The review of the local government fiscal framework which will commence in 2011 will consider how best the formula can respond to the development needs of the different types and categories of municipalities.

The institutional support component

The average low- or medium-capacity municipality (typically in rural areas or small towns), spends more than half of its own revenue on administrative and governance costs, leaving a reduced portion available for the provision of basic services to residents. Given the existing capacity challenges in these municipalities, the institutional support component of the equitable share formula offers assistance in meeting some of these requirements, providing a supplement to augment, but not fully cover, institutional costs.

The institutional support component has been adjusted in the 2011 formula to take account of the level of poverty in a municipality and its relative ability to fund administrative and governance costs from own revenue. Previously, this component was largely determined by the population size of a municipality. The adjusted formula still reflects the relative sizes of different municipalities, but this is now adjusted by their poverty rate.

The institutional support component

I = Base allocation + [allocation per councillor * number of seats] * [poverty factor]

Where the values used in the formula are:

I = R550 000 + [R54 000* councillors] * [% of households in poverty + 17%]

The base allocation is an amount that will go to every municipality. The second term of this formula recognises that administrative costs go up with the size of a municipality and the ability of a municipality to fund these costs from their own revenue is lower the greater the proportion of its residents that are poor. This second term incorporates two elements; an allocation per councillor that reflects the relative size of a municipality (councillor numbers are determined by the population of a municipality) and a poverty factor calculated as the proportion of poor households in a municipality (poor households divided by total households). The municipality with the highest proportion of poor households receives a poverty factor of 100 per cent (the poorest municipality has 83 per cent of its households below the R800-a-month poverty line according to 2001 prices), so 17 per cent is added to the proportion of poor households in each municipality to calculate the poverty factor.

This component (together with the special support for councillor remuneration to poor municipalities provided outside of the equitable share formula) provides sufficient resources for municipalities to pay their councillors' salaries and a significant portion of their administrative costs without having to use the funds allocated through the basic services component.

The number of seats that will be recognised for purposes of the formula is determined by the Minister of Cooperative Governance and Traditional Affairs for elections and composition.

The revenue-raising capacity correction

To account for the varying fiscal capacities of municipalities, the formula must account for each municipality's ability to raise revenue for the purposes of fulfilling its constitutional mandate. This component therefore takes into account income from property rates and the fuel levy sharing with metropolitan municipalities. In the absence of proper information on property valuation rolls across the spectrum of municipalities and as an interim measure, previous property rate collections between 2004/05 and 2006/07 have been used as a basis for determining future capacity to collect income from this source.

The formula does not look at changes in the levels of revenue collection after 2006/07, to avoid penalising municipalities that have improved their revenue collection efforts. The projected capacity of a municipality to raise revenue from property rates is assumed to be the average of past revenue collection grown to reflect the impact of inflation. In the case of fuel levy sharing with metropolitan municipalities, the revenue-raising capacity correction is calculated using the allocations published for the MTEF.

In order to achieve greater horizontal equity in the allocation system and to acknowledge the revenue-raising constraints faced by smaller municipalities, a differentiated "revenue correction" rate on property rates income is applied. The applicable revenue correction rate for a municipality is based on the level of per capita own operating revenue (based on 2004/05 to 2006/07 figures), and own operating revenue is the difference between past actual total operating revenue and income from grants and subsidies.

The revenue correction rates range from 1 per cent for municipalities with the lowest operating revenue per capita to 7 per cent for those municipalities with the highest operating revenue per capita. The correction rate applied to each municipality's predicted revenue from property rates is calculated using the following formula (with a 7 per cent maximum cut-off for municipalities with operating revenue per capita above R2 500):

"Revenue correction rate" = 1 + 6/2500 * [Operating revenue per capita]

The application of revenue-raising capacity correction in the local government equitable share formula means that municipalities are expected to use between 1 per cent and 7 per cent of the revenue they raise from property rates to top-up the funds provided through the equitable share.

District municipalities do not collect property rates, so the revenue-raising capacity correction component of the formula is applied as a flat "tax" of 6 per cent of the value of the *regional services council RSC / Joint Services Board (JSB) levy replacement grant,* allocated to each district. This grant is an unconditional allocation that replaces the major source of own revenue for district municipalities prior to 2006.

There have been two changes in this component of the formula for the 2011 MTEF. The previous stepped taxation structure for property rates (in which municipalities were placed into eight bands with one revenue correction rate applying to all municipalities in each band) has been replaced with the smoothed curve structure described above. This is fairer to municipalities that were on the outer edges of the bands in the previous formula, as they will now have their own revenue correction rate. In addition, the rate of revenue correction has been reduced for all municipalities. Previously, this rate ranged from 1.5 per cent to 9.5 per cent, now it ranges from 1 per cent to 7 per cent.

These changes reduce the impact of this component on the final allocations to municipalities by 12 per cent. The revised component takes account of the substantial migration to more prosperous municipalities since 2001. These municipalities are funding the provision of services to larger numbers of poor residents through cross-subsidisation from their own revenue. Reducing the revenue correction rate in this component will free up more funds within these municipalities for cross-subsidisation.

Stabilising constraint

With the publication of three-year budget allocations, a guarantee mechanism is applied to the indicative outer-year baseline amounts with the aim of ensuring that municipalities are given what was indicated in the previous MTEF, as far as this is possible, given overall budget constraints and the need to amend the formula to increase allocations to poorer municipalities. In the 2010 MTEF, the applicable guarantees on the allocations are 100 per cent for 2010/11 and 90 per cent for 2011/12. In the schedules of the 2011 Division of Revenue Act, the applicable guarantees are 100 per cent for the 2011/12 allocations, 90 per cent for the 2012/13 allocations, with no guarantee on the indicative 2013/14 allocations published.

To deal with these constraints, municipalities are divided into two groups: municipalities that require a "top-up" in order to meet the stabilising constraints and those that do not. The total size of the top-up is calculated and deducted from those that do not require a top–up amount in proportion to the "surplus."

All district management areas (DMAs) have been incorporated into local municipalities as part of the redemarcation of municipal boundaries that comes into effect with the 2011 local government elections. Previously, district municipalities received the equitable share funds allocated on the basis of households in the DMAs. As these district municipalities are no longer responsible for providing services in the DMAs, the guarantees on their equitable share allocations (described above) were applied after subtracting the amounts previously allocated to them for the DMAs.

Other considerations in applying the formula

The formula outlined above has to be rescaled to make allowance for intricacies in the allocation process. In particular, powers and functions must be taken into account, and the overall budget must balance.

Powers and functions

Local government is divided into categories A, B and C.[1] The division of powers and functions between local and district municipalities differs – and this is also true between the different local municipalities within the same district. In order to deal with these differences, the formula has to ensure that the allocations made in terms of the basic services component go to the municipality that is authorised to perform that function. To enhance transparency in the budget process, local government equitable share and *municipal infrastructure grant (MIG)* allocations to district municipalities are published per unauthorised local municipality in the relevant district municipality.

Balancing allocations

The horizontal division of allocations made between municipalities depends on the size of the overall allocation made to the local government sphere, usually decided through a separate consultative process to determine the equitable share of nationally raised revenue for each of the three spheres of government (the vertical division). As there is no guarantee that allocations made in terms of the horizontal division add up precisely to the amount allocated to the local government equitable share, such allocations need to be adjusted to fit within the constraints outlined above.

[1] Category A are metropolitan municipalities, category B are local municipalities and category C are district municipalities.

Rescaling of the BS, D and I components

The simplest way of making the system balance is to rescale the BS, D and I components to the available budget, and the formula actually becomes:

Grant = adjustment factor*(BS + D + I) – R ± C

This adjustment factor is calculated to ensure that the system balances.

Measurement issues

The integrity of the data is as important as the set of equations in determining whether the allocations meet the constitutional requirement of equity. Although extensive work has been undertaken to try update the data used in the formula, Census 2001 remains the only source of data that is reliable down to municipal level for population, income and service access data. Data for the number of councillors per municipality is provided by the Independent Electoral Commission and the Municipal Demarcation Board, and data on property rates collected between 2004/05 and 2006/07 is sourced from the reports that municipalities submit to National Treasury in terms of section 71 of the MFMA.

a) Poverty

Household income is used to estimate poverty at a municipal level, as it allows for a cross-tabulation of poverty against servicing levels. The majority (over 90 per cent) of funds allocated through the formula are based on the service delivery needs of poor households.

b) Changes to municipal boundaries

The Municipal Demarcation Board announced in September 2010 that a series of municipal boundary changes would come into effect with the local government elections in 2011. Buffalo City and Mangaung will shift from local municipalities to metropolitan municipalities, and Metsweding district municipality and its local municipalities will be incorporated into the Tshwane metropolitan municipality. Several local municipalities will shift into different district municipalities, some municipalities will merge, and certain wards will move from one municipality to another. All district management areas will be eliminated. These sparsely populated areas were previously serviced by district municipalities, but will now be incorporated into local municipalities. To reflect these changes in the allocations for the 2011 MTEF, the 2001 Census data used to calculate the equitable share has been updated by StatsSA.

c) Servicing levels

The basic services subsidy for poor households is a key determinant in the current formula. There is no accurate data on these service costs across all municipalities, and so these allocations are based on estimates on the relative costs of services and the amount of funds available. As outlined in the basic services section, it is now assumed that providing alternative services to households that did not have services when Census 2001 was conducted is 45 per cent of the cost of providing full services. After the adjustment factor and other components are applied, the actual subsidies per basic service made available through the equitable share are set out in table W1.19.

Table W1.18 Number of poor households

Service	Serviced households	Unserviced households
Electricity	3 079 340	2 456 443
Water	3 322 295	2 213 488
Sanitation	3 260 814	3 274 969
Refuse	2 176 923	3 358 860

Source: 2001 Census

Table W1.19 Actual average monthly basic services subsidies per poor household

Monthly	Serviced households			Households not connected to services		
Rand	2011/12	2012/13	2013/14	2011/12	2012/13	2013/14
Electricity	188.04	208.31	222.05	84.62	93.76	99.92
Water	125.36	138.84	148.03	56.41	62.53	66.61
Sanitation	125.36	138.82	148.03	56.41	62.52	66.61
Refuse	125.36	138.82	148.03	56.41	62.52	66.61
Total	**564.12**	**624.79**	**666.15**	**253.85**	**281.32**	**299.77**

Other unconditional allocations

RSC/JSB levies replacement grant

Prior to 2006, district municipalities raised levies on local businesses within their districts through either an RSC levy or a JSB levy. This source of revenue was replaced in 2006/07 with the *RSC/JSB levies replacement grant,* which was allocated to all district and metropolitan municipalities, based on the amounts they had previously collected through the levies. In the 2011 MTEF, the *RSC/JSB levies replacement grant* is grown by 9 per cent a year for municipalities authorised for water and sanitation functions and 3 per cent for unauthorised municipalities, acknowledging the very different service responsibilities of these district municipalities.

The redemarcation that will come into effect with the 2011 local government elections will see two district municipalities disestablished and the boundaries of a further five district municipalities changed substantially. Alfred Nzo, Xhariep and Thabo Mofutsanayana district municipalities will expand to include additional local municipalities. The *RSC levy replacement grant* to these district municipalities will be increased. The value of this increase will be calculated as a portion of the *RSC levy replacement grant* of the district municipality that each local municipality used to form part of, in proportion to their share of that district's population. OR Tambo and Amatole districts will both reduce in size but their *RSC levy replacement grant* will not be changed. Motheo and Metsweding districts will both be disestablished; their *RSC levy replacement grant* will be returned to the local government equitable share and allocated to all municipalities through the formula. Both new metropolitan municipalities (Mangaung and Buffalo City) will receive funds from the *fuel levy sharing with metropolitan municipalities* and Tshwane metropolitan municipality's allocation will be increased to account for its incorporation of Metsweding district (details in part six of this annexure).

Special support for councillor remuneration

Councillors' salaries are subsidised in poor municipalities. This support is calculated separately to the local government equitable share and is additional to the governance costs allocation provided in the institutional support component. The level of support provided to each municipality is published in the government gazette issued by the Minister of Cooperative Governance and Traditional Affairs, determining the upper limits of salaries, allowances and benefits of members of municipal councils. The gazette classifies municipal councils into six grades based on their total income and population size. Special support is provided to the lowest three grades of municipal councils (the smallest and poorest municipalities).

Conditional grants to local government

Conditional grants to local government aim to eradicate backlogs and build institutional financial capacity in local government. The total value of conditional grants directly transferred to local government, including the water operating subsidy, increase from R27.5 billion in 2011/12, to R30.4 billion in 2012/13 and R32.7 billion in 2013/14.

Conditional grant allocations to local government are being reconfigured to increase differentiation between the funding of urban and rural municipalities. The most significant change to be introduced in 2011 is the creation of a new *urban settlements development grant* for metropolitan municipalities to fund the upgrading of informal settlements. This means that metropolitan municipalities no longer receive allocations through the *MIG*. Several other grants also provide for specific rural and urban challenges, including the *rural transport infrastructure grant* and *rural households infrastructure grant,* which fund rural municipalities while the *public transport infrastructure and systems grant* funds public transport projects in large cities. A new *municipal disaster grant* has also been introduced to enable the speedy allocation and transfer of funds to municipalities affected by disasters.

Infrastructure conditional grants to local government

National transfers for infrastructure, including indirect or in-kind allocations to entities executing specific projects in municipalities, amount to R29.5 billion, R33.1 billion and R35.5 billion for each of the 2011 MTEF years.

Table W1.20 Infrastructure transfers to local government, 2007/08 – 2013/14

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
R million		Outcome		Revised estimate		Medium-term estimates	
Direct transfers	**16 290**	**18 562**	**18 812**	**20 972**	**25 596**	**28 642**	**30 774**
Municipal infrastructure grant	6 967	6 968	8 788	9 515	11 444	13 914	14 679
Urban settlements development grant	2 950	3 590	4 285	4 855	6 267	7 410	8 127
National electrification programme	462	589	914	1 020	1 097	1 151	1 215
Public transport infrastructure and systems grant	1 174	2 920	2 418	3 699	4 803	5 000	5 564
Neighbourhood development partnership grant	41	182	506	1 030	750	800	800
2010 FIFA World Cup stadiums development grant	4 605	4 295	1 661	302	–	–	–
Rural transport services and infrastructure grant	–	9	10	10	35	37	39
Electricity demand side management	–	–	175	220	280	–	–
Municipal disaster grant	–	–	–	–	470	330	350
Municipal drought relief grant	90	9	54	320	450	–	–
Indirect transfers	**1 334**	**1 928**	**2 754**	**2 947**	**3 892**	**4 445**	**4 734**
National electrification programme	973	1 148	1 478	1 720	1 738	1 882	1 986
Neighbourhood development partnership grant	61	54	90	125	100	80	55
Regional bulk infrastructure grant	300	450	612	893	1 704	2 003	2 176
Backlogs in water and sanitation at clinics and schools	–	186	350	–	–	–	–
Backlogs in the electrification of clinics and schools	–	90	149	–	–	–	–
Electricity demand-side management	–	–	75	109	119	–	–
Rural households infrastructure grant	–	–	–	100	232	480	517
Total	**17 624**	**20 490**	**21 566**	**23 919**	**29 488**	**33 087**	**35 508**

Municipal infrastructure grant

The largest infrastructure transfers are through the *MIG*, which supports government's objective of expanding service delivery and alleviating poverty. The *MIG* funds the provision of infrastructure to provide basic services, roads and social infrastructure for poor households in all non-metropolitan municipalities. *MIG* previously also included the *MIG cities grant* – a schedule 4 allocation to

metropolitan municipalities, but from 2011/12 *MIG cities* forms part of the baseline of the new *urban settlements development grant.*

The *MIG* allocations are based on a formula with a vertical and horizontal division. The vertical division allocates resources to sectors or other priority areas, and the horizontal division is based on a formula that takes account of poverty, backlogs, and municipal powers and functions. There are five main components of the formula, as demonstrated in the box below. A constant component of R5 million ensures that a reasonable minimum allocation is made to poor municipalities.

$$MIG_{(F)} = C + B + P + E + N + M$$

C Constant to ensure increased minimum allocation for poor municipalities (This allocation is made to all municipalities)

B Basic residential infrastructure (new and rehabilitation of existing ones)

Proportional allocations for water supply and sanitation, electricity, roads and "other" (street lighting and solid waste removal)

P Public municipal service infrastructure (new and rehabilitation of existing ones)

E Allocation for social institutions and micro-enterprises infrastructure

N Allocation to all nodal municipalities

M Negative or positive allocation related to past performance of each municipality relative to grant conditions

The total *MIG* allocations grow to R11.4 billion, R13.9 billion and R14.7 billion over the 2011 MTEF. This represents real growth of 28 per cent during the period. Amounts of R493 million, R600 million and R633 million have been removed from the *MIG* baseline and added to the previous *MIG cities* baseline to create the *urban settlements development grant*. Table W1.21 shows the weighted share per sector and the respective amounts that flow through the vertical division of the *MIG* funds.

Table W1.21 Municipal infrastructure grant allocations per sector, 2010/11 – 2013/14

	2010/11	2011/12	2012/13	2013/14
Weights			**Adjusted weights**	
Municipal infrastructure grant (a)				
Special municipal infrastructure fund and management (b)				
Ring-fenced allocation: Eradication of the bucket sanitation system (c)				
Bulk infrastructure (d)				
Municipal infrastructure grant (formula)	*(a)-(b)*	*(a)-(b)-(c)-(d)*	*(a)-(b)-(c)-(d)*	*(a)-(b)-(c)-(d)*
B Component	**75.0%**	**75.0%**	**75.0%**	**75.0%**
Water and sanitation	72.0%	72.0%	72.0%	72.0%
Electricity	0.0%	0.0%	0.0%	0.0%
Roads	23.0%	23.0%	23.0%	23.0%
Other	5.0%	5.0%	5.0%	5.0%
P Component	**15.0%**	**15.0%**	**15.0%**	**15.0%**
E Component	**5.0%**	**5.0%**	**5.0%**	**5.0%**
N Component	**5.0%**	**5.0%**	**5.0%**	**5.0%**

Urban settlements development grant

This is a new grant introduced in the 2011 division of revenue. It is allocated to metropolitan municipalities to supplement their capital budgets, enabling them to better leverage their resources to

develop sustainable human settlements. The grant funds the provision of basic municipal services to new housing projects and will allow municipalities to plan and budget for both services and the construction of housing as they attain authorisation for the human settlements function. The grant is created with funds previously allocated to these cities through the *MIG cities grant* and the internal infrastructure portion of the provincial *human settlements development grant,* as well as additional allocations of R2.1 billion over the MTEF. The total *urban settlements development grant* is allocated R6.2 billion in 2011/12, R7.4 billion in 2012/13 and R8.1 billion in 2013/14.

The public transport infrastructure and systems grant

This grant is administered by the Department of Transport, and aims to provide passenger transport networks in cities, particularly public transport and non-motorised transport infrastructure. This includes the provision of bus rapid transit systems. The grant has an allocation of R4.8 billion in 2011/12, to R5 billion in 2012/13 and R5.6 billion in 2013/14.

Rural transport services and infrastructure grant

This grant aims to improve rural transport infrastructure, and will fund the collection of accurate data on the condition of rural roads in 2011/12, in line with the Road Infrastructure Strategic Framework for South Africa. The grant will support rural district municipalities in establishing databases on the condition and usage of all the municipal roads in their area, so that the spending of infrastructure funds (from the *MIG* and elsewhere) can be properly planned. The grant has an allocation of R35 million in 2011/12, R37 million in 2012/13 and R39 million in 2013/14.

Neighbourhood development partnership grant

The grant supports the development of community infrastructure and aims to attract private-sector investment that improves the quality of life in townships. The grant is administered by National Treasury and is allocated R850 million in 2011/12, to R880 million in 2012/13 and R855 million in 2013/14 for both the technical assistance (indirect) and capital (direct) grant.

Integrated national electrification programme

Government plans to spend R9.1 billion over the next three years on its national electrification programme, to sustain the progress made in supplying electricity to poor households. Of this amount, R3.5 billion will be spent by municipalities directly and R5.6 billion by Eskom on behalf of municipalities. This programme was instrumental in the connection of 80 per cent of all households in the country to the national electricity grid, as reported in the 2007 Community Survey.

Electricity demand-side management grant

The grant aims to improve energy efficiency demand-side management in residential dwellings and commercial buildings, reducing energy consumption. The grant has been allocated R399 million in 2011/12, and it is scheduled to end after the 2011/12 financial year. A review of the grant’s performance will be conducted during 2011 and will inform any decision on whether to extend the life of the grant.

Regional bulk infrastructure grant

This grant aims to provide regional bulk water and sanitation across several municipal boundaries. In the case of sanitation, it supplements regional bulk collection and regional wastewater treatment works. The grant has an allocation of R1.7 billion in 2011/12, to R2.0 billion in 2012/13 and R2.2 billion in 2013/14.

Municipal disaster grant

A new conditional grant for disasters is introduced in the 2011 MTEF. This grant will be allocated to the National Disaster Management Centre in the Department of Cooperative Governance and Traditional Affairs as an unallocated grant to local government. A new schedule and clauses have been inserted into the Division of Revenue Act to create special provisions for this grant that enable the immediate disbursement of disaster response funds after a disaster is declared, without the need to gazette the transfers. Over the MTEF, R1.2 billion is available for disbursement through this grant.

Drought relief grant

R450 million is allocated in the 2011/12 financial year to provide assistance to the Nelson Mandela Metropolitan Municipality for drought relief.

Capacity-building and other current transfers

The *capacity-building grants* aim to assist municipalities in building management, planning, technical, budgeting and financial management skills. The current MTEF expands the capacity-support programme to assist weaker or poorer municipalities, particularly with the implementation of financial management reforms. Total allocations for *capacity-building grants* amount to R2 billion in 2011/12, R1.8 billion in 2012/13 and R2 billion in 2013/14.

Table W1.22 Capacity building and other current transfers to local government, 2007/08 – 2013/14

R million	2007/08	2008/09	2009/10	2010/11 Revised estimate	2011/12	2012/13	2013/14
Direct transfers	**1 517**	**1 365**	**2 081**	**2 080**	**1 894**	**1 774**	**1 969**
Municipal systems improvement grant	200	200	200	212	219	230	243
Restructuring grant	530	–	–	–	–	–	–
Financial management grant	145	180	300	365	435	479	526
2010 FIFA World Cup host city operating grant	–	–	508	210	–	–	–
Water services operating subsidy grant	642	985	871	670	561	399	421
Expanded public works programme municipal incentive grant	–	–	202	623	680	666	779
Indirect transfers	**550**	**379**	**243**	**148**	**100**	**–**	**–**
Financial management grant: DBSA	53	50	–	–	–	–	–
Water services operating subsidy grant	497	329	243	148	100	–	–
Total	**2 067**	**1 744**	**2 324**	**2 228**	**1 994**	**1 774**	**1 969**

The *financial management grant* under the National Treasury vote, funds the modernisation of financial management, including building in-house municipal capacity to implement multi-year budgeting, linking integrated development plans to budgets, producing quality and timely in-year and annual reports, and generally supporting municipalities in the implementation of the MFMA. Total allocations for the *financial management grant* amount to R1.4 billion over the three year cycle.

Expanded public works programme incentive grant for municipalities

This grant encourages municipalities to hire more people in public works projects. The grant is allocated R680 million in 2011/12, to R666 million in 2012/13 and R779 million in 2013/14.

Water services operating subsidy

The *water services operating subsidy* is a grant with schedule 6 (direct) and schedule 7 (in-kind) components used to fund water schemes. The grant covers staff-related costs and direct operating and maintenance costs, while provision is also made for the refurbishment of infrastructure. The allocation per municipality is based on the operational budget for each scheme and the funding requirements identified and agreed on in the transfer agreement. These schemes were administered by the Department of Water Affairs prior to 1994 and are now being transferred to municipalities. At the end of 2009/10, 59 agreements had been signed, 4 903 staff transferred and 1 643 schemes (including rudimentary schemes) with a total asset value of about R6.4 billion transferred to municipalities. In the 2011 MTEF, R1.5 billion is allocated for the *water services operating grant* (direct and indirect transfers), to enable the transfer of staff to water schemes. It is a transitional grant and is expected to be phased out over time.

Part 6: Future work on provincial and municipal fiscal frameworks

Refinement of the provincial fiscal framework

The new formula for the health component of the provincial equitable share formula is one of the first steps towards the introduction of national health insurance. The health formula will be improved as more information on the provincial consumption of health services becomes available. These improvements will complement the implementation of the national health insurance system.

Review of the local government fiscal framework

Local government is South Africa's youngest sphere of democratic government, the system of wall-to-wall, democratically elected local municipalities is only just over a decade old. This is an appropriate time to evaluate the fiscal framework's performance in supporting local government. Government has already achieved significant success in creating a system of intergovernmental transfers that is stable, predictable and transparent. Building on this foundation in the second decade of democratic local government, the fiscal framework can do more to promote the efficient and equitable delivery of services. Towards this end, an extensive review process will be undertaken in 2011 that may lead to significant changes in the future shape of the local government fiscal framework.

Although municipalities have made significant strides in building their institutions and delivering services, they have failed to achieve their full potential, and finances are a contributing factor. Government will review the fiscal system and identify reforms to create the right incentives for more effective local government in the future.

For reforms to be successful, a differentiated approach to local government needs to be adopted and conditional grants (separate grants for rural and urban municipalities) are likely to play a major role in future. National Treasury will conduct a full review of the equitable share formula during 2011/12, with the aim of introducing a new formula in time for the release of the Census 2011 data. The formula review will include an examination of municipal services and their costs, different municipal functions, and how the data used in the formula could be updated between censuses. The changes that follow the review processes in 2011 have the potential to substantially alter the nature and effectiveness of the local government fiscal framework.

Municipal Property Rates Act

The Municipal Property Rates Act regulates the power of municipalities to impose rates on properties in accordance with section 229(1)(a) of the Constitution. Income derived from municipal property rates is an important own revenue source.

The original four-year transitional period given to municipalities to implement the Municipal Property Rates Act (up to 1 July 2009) was extended by two years (up to 1 July 2011) through a legislative amendment to the act in 2009 to allow those municipalities that had failed to implement new valuation rolls to continue to use existing valuation rolls and supplementary valuation rolls until 30 June 2011. There are eight municipalities that are expected to implement valuation rolls in terms of the act for the first time on 1 July 2011.

The Department of Cooperative Governance and Traditional Affairs intends to introduce further amendments to the act in 2011/12 to improve its implementation and minimise legal ambiguities. In addition, a number of the proposed amendments make provision that property rating by municipalities is undertaken in the national interest.

Municipal Fiscal Powers and Functions Act

The Municipal Fiscal Powers and Functions Act (MFPFA) of 2007 provides for the authorisation of taxes, levies and duties that municipalities may impose under section 229 of the Constitution. The MFPFA does not deal with property rates or municipal tariff charges and fees.

Authorisation of taxes that existed prior to the act in terms of section 12

In terms of section 12 of the act, a municipality had to apply to the Minister of Finance by 9 September 2009 for the authorisation of an existing tax. All municipalities submitted applications to the Minister of Finance by the deadline stipulated. These applications were analysed and municipalities, SALGA, FFC and appropriate national departments were advised of the preliminary rulings by the Minister of Finance. Out of 155 applications received from 55 municipalities, only 19 in 17 municipalities potentially complied with the criteria of a municipal tax. The affected municipalities gave extensive feedback, and this will result in some adjustments to the preliminary determinations. To conclude this process, draft regulations need to be published for public comment and submitted to Parliament. Based on feedback received from these processes, the Minister of Finance will gazette the final determinations.

Application for a new municipal tax in terms of section 5 of the act

Section 5 of the MFPFA requires that a municipality, group of municipalities or organised local government apply to the Minister of Finance for the authorisation of a municipal tax, levy or duty, other than property rates, before imposing such a tax. An application for a municipal tax must set out the reasons for the proposed tax and how the revenue from the tax will be used. An application for a new municipal tax is more likely to succeed if it is proven that the municipality’s own revenue is insufficient to meet service delivery needs.

To date, National Treasury has received one application that complies with the requirements stipulated in section 5 of the MFPFA. The application is for the introduction of a rural-based development levy in areas where the municipality faces difficulties in implementing valuation rolls. Similar applications were identified during the verification process of taxes that existed prior to the act. Authorisation of this tax needs to be informed by the criteria of good municipal tax, and whether it can run alongside the property rates system and be applicable to other municipalities.

Regulation of surcharges in terms of section 8 of the act

In terms of section 8 of the MFPFA, the Minister of Finance may prescribe compulsory national norms and standards for imposing municipal surcharges, including maximum municipal surcharges that may be imposed by municipalities. Surcharges currently form part of a tariff (when regulations are introduced in terms of section 8 of the act, these will be split). Due to the interrelationship between tariffs and surcharges, it is important that National Treasury’s regulatory processes regarding surcharges be aligned

to the regulatory processes of sector departments regarding municipal tariffs. The National Electricity Regulator of South Africa is currently in the process of introducing an economic regulation framework in metropolitan municipalities, which will be subsequently rolled out in other smaller municipalities. The regulation of municipal tariff practices regarding water and waste are moving at a much slower pace, therefore the introduction of norms and standards for municipal surcharges will only be over the medium to long term.

Sharing of the general fuel levy

The sharing of the general fuel levy with metropolitan municipalities was introduced in the 2009 Budget as the primary replacement to the former RSC and JSB levies, in addition to the VAT reforms introduced in 2006. The sharing of the general fuel levy is a direct charge and is formalised annually through a government gazette under schedule 1 of the 2009 Taxation Laws Amendment Act.

To facilitate the smooth transition from the RSC levy replacement grant system to the sharing of the general fuel levy system, implementation has been phased-in over three years. In 2011/12, metropolitan municipalities receive 25 per cent of the former RSC levy replacement grant and 75 per cent of the sharing of the general fuel levy. Allocations in 2012/13 will be based on fuel sales only. The 2011/12 allocations will include two additional metropolitan municipalities that will be introduced after the 2011 local government elections. The fuel levy data has also been updated for those existing metropolitan municipalities whose boundaries change after the 2011 local government elections.