W1

Website annexure to the 2013 Budget Review

Explanatory memorandum to the division of revenue

Background

Section 214(1) of the Constitution requires that every year a Division of Revenue Act determine the equitable division of nationally raised revenue between national government, the nine provinces and 278 municipalities. This process takes into account the powers and functions assigned to each sphere of government. The division of revenue process fosters transparency and is at the heart of constitutional cooperative governance.

The Intergovernmental Fiscal Relations Act (1997) prescribes the process for determining the equitable sharing and allocation of nationally raised revenue. Sections 9 and 10(4) of the act set out the consultation process to be followed with the Financial and Fiscal Commission (FFC), including considering recommendations made regarding the division of revenue.

This explanatory memorandum to the 2013 Division of Revenue Bill fulfils the requirement set out in section 10(5) of the Intergovernmental Fiscal Relations Act that the bill be accompanied by an explanatory memorandum detailing how it takes account of the matters listed in sections 214(2)(a) to (j) of the Constitution, government's response to the FFC's recommendations, and any assumptions and formulas used in arriving at the respective divisions among provinces and municipalities. This explanatory memorandum has six sections:

- Part 1 lists the factors that inform the division of resources between national, provincial and local government.
- Part 2 describes the 2013 division of revenue.
- Part 3 sets out how the FFC's recommendations on the 2013 division of revenue have been taken into account.
- Part 4 explains the formula and criteria for the division of the provincial equitable share and conditional grants between 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 result 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 meetings of the Budget Forum (Budget Council plus SALGA). An extended Cabinet meeting involving ministers, provincial premiers and the SALGA chairperson was held on 10 October 2012. The division of revenue – and the government priorities that underpin it – 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 factors in sub-sections (2)(a) to (j) of the Constitution are taken into account. These include national interest, debt provision, needs of national government and emergencies, the resource allocation for basic services and 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 National Development Plan, endorsed by Cabinet in November 2012, sets out a long-term vision for the country's development. This is complemented by the strategic integrated projects (SIPs) overseen by the Presidential Infrastructure Coordinating Council and the 12 priority outcomes adopted by Cabinet in 2010. In the 2012 *Medium Term Budget Policy Statement*, the Minister of Finance outlined how the resources available to government over the 2013 medium-term expenditure framework (MTEF) would be allocated to help achieve these goals. A detailed analysis of how funds have been allocated based on these priorities can be found in Chapter 4 of the 2012 *Medium Term Budget Policy Statement* and Chapter 8 of the 2013 *Budget Review*. The frameworks for each conditional grant allocated as part of the division of revenue also note how the grant is linked to the 12 priority outcomes.

Provision for debt costs

The resources shared between national, provincial and local 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 country's integrity and credit reputation. A more detailed discussion can be found in Chapter 5 of the 2013 *Budget Review*.

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. Provincial and local government receive equitable shares and conditional grants to enable them to provide basic services and perform their 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 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 national priorities. The division of revenue provides equitable shares to provinces and local government. This year's division of revenue allocates additional resources to provinces to provide for the effects of the 2012 public-sector wage agreements, repair infrastructure damaged by floods, extend and improve school facilities, expand library services, improve health services and increase social welfare services. Transfers to local government have grown significantly in recent years, providing municipalities with greater resources to deliver basic services. This is in addition to the substantial own-revenue-raising powers available to local government. In the 2013 division of revenue, additional resources have been made available to compensate for the rising costs of providing free basic water and electricity, accelerate access to these services and ensure their sustainability.

Fiscal capacity and efficiency

National government has primary revenue-raising powers. Provinces have limited revenue-raising capacity and the resources required to deliver provincial functions do not lend themselves to self-funding or cost recovery. Municipalities finance most of their expenditure through property rates, user charges and fees. However, rural municipalities raise significantly less revenue than larger urban and metropolitan municipalities. Due to their limited revenue-raising potential and their responsibility to implement government priorities, provinces receive a larger share of nationally raised revenue than local government. Local government's portion has significantly increased over the last few years and will continue to grow over the medium term. The provincial equitable share formula was reviewed in 2010 and the recommendations were implemented in 2011. In the 2013 MTEF, the formula is updated with 2011 Census data. Over this period, a new approach to the funding of provincial infrastructure will be implemented to promote better planning and implementation (details of this new approach are provided in part 6 of this annexure). A review of the local government equitable share was completed during 2012 and a new formula will be phased in from 2013/14 (details of the formula review and the new formulas are provided in part 5 of this annexure). These reviews are part of wider, ongoing reviews of provincial and local government functions and the funding thereof to ensure efficient and effective resource allocations.

Developmental needs

Developmental needs are accounted for at two levels: first, in the determination of the division of revenue, 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. Developmental needs are encapsulated in the equitable share formulas for provincial and local government and in specific conditional grants. In particular, various infrastructure grants and growing capital budgets aim to boost the economic and social development of provinces and municipalities.

Economic disparities

Both the equitable share and infrastructure grant formulas are redistributive towards poorer provinces and municipalities. Government is 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

The Constitution confers autonomy on provincial governments and municipalities to determine priorities and allocate budgets. National government is responsible for policy development, national mandates, setting national norms and standards for provincial and municipal functions and monitoring implementation for concurrent functions. The 2013 MTEF and division of revenue provide additional funding for the 2012 wage agreements, which were higher than expected. Additions to conditional grants address the demand for HIV and Aids prevention and treatment programmes, and access to housing and basic services. The local government equitable share has been increased to address the rising costs of providing free basic services to poor households. These allocations are in addition to obligations funded through existing provincial and local government baseline allocations.

Predictability and stability

Provincial and local government equitable share allocations are based on estimates of nationally raised revenue. If nationally raised revenue falls short of the estimates within a given year, the equitable shares of provinces and local government 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, estimates for a further two years are published with the annual proposal for appropriations. Adjusted estimates as a result of changes to data underpinning the equitable share formulas and revisions to the formulas are phased in to ensure minimal disruption.

Flexibility in responding to emergencies

Government has a contingency reserve that provides a cushion for emergencies and unforeseeable events. In addition, two conditional grants for disasters allow for the swift allocation and transfer of funds to affected provinces and municipalities. Sections 16 and 25 of the Public Finance Management Act (1999) make specific provision for the allocation of funds to deal with emergency situations. Section 30(2) deals with adjustment allocations for unforeseeable and unavoidable expenditure. Section 29 of the Municipal Finance Management Act (2003) allows a municipal mayor to authorise unforeseeable and unavoidable expenditure in an emergency.

Part 2: The 2013 division of revenue

Expenditure in the 2013 MTEF will remain within the bounds set out in the 2012 Budget. National and provincial departments implemented savings measures and reprioritised spending to make additional resources available to fund government priorities in the 2013 Budget.

Excluding debt-service costs and the contingency reserve, allocated expenditure shared between the three spheres amounts to R951.3 billion, R1 trillion and R1.1 trillion over each of the MTEF years. These allocations take into account government's spending priorities, the revenue-raising capacity and responsibilities of each sphere, and input from various intergovernmental forums and the FFC. The provincial and local equitable share formulas are designed to ensure desirable, stable and predictable revenue shares, and to address economic and fiscal disparities.

Government's policy priorities for the 2013 MTEF

Government has adopted a policy of changing the composition of spending to focus on promoting economic support and development, investing in infrastructure, creating jobs and enhancing local government capacity.

Following the saving exercise mentioned above, additional resources are allocated to provinces to cover the following:

- The 2012 wage agreements
- Cushioning the impact of the phasing in of the 2011 Census data in the provincial equitable share formula
- Increased numbers of teachers for poor schools and Grade R
- Improved diagnostics for tuberculosis

- Increased assistance to non-governmental organisations providing social development services
- Absorption of social work graduates
- Continued expansion of HIV and Aids prevention and treatment programmes
- Investment in provincial roads
- Upgrade of informal settlements in mining towns
- Improvements in community library services
- School infrastructure.

Local government allocations receive additional funds to:

- Compensate for the rising costs of providing free basic water and electricity to poor households
- Accelerate provision of access to clean water through bulk and reticulation projects
- Accelerate provision of access to electricity and improving the sustainability of access through the refurbishment of key infrastructure
- Expand the collection and use of data on the condition of municipal roads
- Increasing the number of interns with infrastructure-related skills working in municipalities
- Host the 2014 African Nations Championship
- Promote more integrated and efficient cities.

Table W1.1 shows additional allocations for major infrastructure projects.

Table W1.1 Infrastructure project proposals

R million	2013/14	2014/15	2015/16	Total
Local government, housing and community amenities	**1 321**	**2 134**	**5 652**	**9 108**
Interim bulk water supply	311	585	1 400	**2 296**
Indirect grant: Regional bulk water infrastructure	269	954	1 953	**3 176**
Pilanesberg (Magalies water)	200	–	–	**200**
Human settlements development (informal settlements upgrading)	–	110	830	**940**
Social housing	160	90	435	**686**
Municipal infrastructure supports agency	60	60	60	**180**
De Hoop dam	171	335	974	**1 480**
Acid mine drainage	150	–	–	**150**
Transport, energy and communication	**1 193**	**1 596**	**3 284**	**6 073**
Sentech	277	–	–	**277**
SANEDI:[1] Research and development	71	111	35	**217**
Integrated national electrification programme	320	77	500	**897**
South African National Roads Agency (SANRAL)	275	–	1 126	**1 401**
Passenger Rail Agency of South Africa (PRASA)	250	1 408	1 623	**3 281**
Education and related functions	**150**	**500**	**1 000**	**1 650**
New universities in Northern Cape and Mpumalanga	150	500	1 000	**1 650**
Health	**30**	**30**	**30**	**90**
Infrastructure unit systems support programme	30	30	30	**90**
Transport, energy and communication	**191**	**195**	**1 922**	**2 309**
Indirect grant: Integrated national electrification programme: Eskom	191	195	1 522	**1 909**
Provincial roads maintenance	–	–	400	**400**
Total	**2 886**	**4 455**	**11 888**	**19 229**

1. South African National Energy Development Institute

The fiscal framework

Table W1.2 presents medium-term macroeconomic forecasts for the 2013 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, 2012/13 – 2015/16

	2012/13		2013/14		2014/15		2015/16
R billion	**2012 Budget**	**2013 Budget**	**2012 Budget**	**2013 Budget**	**2012 Budget**	**2013 Budget**	**2013 Budget**
Gross domestic product	3 301.4	3 209.1	3 622.2	3 520.3	3 997.0	3 880.4	4 270.8
Real GDP growth	*3.0%*	*2.5%*	*3.8%*	*3.0%*	*4.3%*	*3.6%*	*3.8%*
GDP inflation	*7.0%*	*5.4%*	*5.7%*	*5.3%*	*5.8%*	*6.5%*	*6.4%*
National budget framework							
Revenue	799.3	782.5	894.3	873.0	997.2	967.9	1 070.7
Percentage of GDP	*24.2%*	*24.4%*	*24.7%*	*24.8%*	*24.9%*	*24.9%*	*25.1%*
Expenditure	969.4	967.0	1 053.8	1 055.1	1 139.6	1 138.0	1 225.7
Percentage of GDP	*29.4%*	*30.1%*	*29.1%*	*30.0%*	*28.5%*	*29.3%*	*28.7%*
Main budget balance[1]	-170.0	-184.5	-159.5	-182.1	-142.4	-170.1	-155.0
Percentage of GDP	*-5.2%*	*-5.7%*	*-4.4%*	*-5.2%*	*-3.6%*	*-4.4%*	*-3.6%*

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

Table W1.3 sets out the division of revenue for the 2013 MTEF after accounting for new policy priorities.

Table W1.3 Division of nationally raised revenue, 2009/10 – 2015/16

R million	**2009/10**	**2010/11**	**2011/12**	**2012/13**	**2013/14**	**2014/15**	**2015/16**
		Outcome		**Revised estimate**		**Medium-term estimates**	
Debt-service costs	57 129	66 227	76 460	88 325	99 741	108 718	118 163
Non-interest expenditure	690 068	738 914	812 063	878 642	955 333	1 029 262	1 107 564
Percentage increase	*18.7%*	*7.1%*	*9.9%*	*8.2%*	*8.7%*	*7.7%*	*7.6%*
Total expenditure	**747 197**	**805 141**	**888 523**	**966 967**	**1 055 075**	**1 137 981**	**1 225 727**
Percentage increase	*17.5%*	*7.8%*	*10.4%*	*8.8%*	*9.1%*	*7.9%*	*7.7%*
Contingency reserve	–	–	–	–	4 000	6 500	10 000
Division of available funds							
National departments	**345 366**	**355 188**	**381 324**	**413 098**	**452 530**	**489 456**	**521 706**
Provinces	**293 164**	**322 822**	**362 488**	**388 516**	**414 152**	**441 727**	**474 389**
Equitable share	236 891	265 139	291 736	313 016	337 572	359 924	383 697
Conditional grants	56 273	57 682	70 753	75 500	76 580	81 803	90 692
Local government	**51 537**	**60 904**	**68 251**	**77 028**	**84 651**	**91 579**	**101 469**
Equitable share[1]	23 845	30 541	33 173	37 373	40 582	44 490	50 208
General fuel levy sharing with metropolitan municipalities	6 800	7 542	8 573	9 040	9 613	10 190	10 659
Conditional grants	20 892	22 821	26 505	30 615	34 456	36 899	40 603
Total	**690 068**	**738 914**	**812 063**	**878 642**	**951 333**	**1 022 762**	**1 097 564**
Percentage shares							
National departments	50.0%	48.1%	47.0%	47.0%	47.6%	47.9%	47.5%
Provinces	42.5%	43.7%	44.6%	44.2%	43.5%	43.2%	43.2%
Local government	7.5%	8.2%	8.4%	8.8%	8.9%	9.0%	9.2%

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 levies for metros and district municipalities
From 2009/10 the RSC levies replacement grant is only allocated to district municipalities

Table W1.4 shows how additional resources are divided. The new focus areas and additional allocations are accommodated through shifting savings towards priorities.

Table W1.4 Changes over baseline, 2013/14 – 2015/16

R million	2013/14	2014/15	2015/16
National departments	6 310	10 628	24 752
Provinces	3 060	4 723	17 283
Local government	793	873	6 608
Allocated expenditure	**10 164**	**16 223**	**48 643**

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

Table W1.5 Schedule 1 of the Division of Revenue Bill, 2013/14 – 2015/16

	2013/14	2014/15	2015/16
	Column A	Column B	
R million	Allocation	Forward estimates	
National[1, 2]	676 920	733 566	791 822
Provincial	337 572	359 924	383 697
Local	40 582	44 490	50 208
Total	**1 055 075**	**1 137 981**	**1 225 727**

1. National share includes conditional grants to provinces and local government, general fuel levy sharing with metropolitan municipalities, debt-service costs and the contingency reserve

2. Direct charges for the provincial equitable share are netted out

The 2013 *Budget Review* sets out in detail how constitutional issues and government's priorities are taken into account in the 2013 division of revenue. It focuses on the economic and fiscal policy considerations, revenue issues, debt and financing considerations, and expenditure plans. Aspects of national, provincial and local government financing are discussed in detail in Chapter 8 of the 2013 *Budget Review*.

Part 3: Response to the recommendations of the FFC

Section 9 of the Intergovernmental Fiscal Relations Act (1997) requires the FFC to make recommendations regarding:

a) "An equitable division of revenue raised nationally, among the national, provincial and local spheres of government;

b) the determination of each province's equitable share in the provincial share of that revenue; and

c) any other allocations to provinces, local government or municipalities from the national government's share of that revenue, and any conditions on which those allocations should be made."

The act requires that the FFC table these recommendations at least 10 months before the start of each financial year. The FFC tabled its *Submission for the Division of Revenue 2013/14* to Parliament in May 2012. These recommendations are divided into 10 chapters, which cover three main areas: supporting inclusive growth (jobs, knowledge and regional development); climate change and environmental sustainability (opportunities and risks for inclusive growth and innovation); and institutional development for inclusive growth and innovation.

Section 214 of the Constitution requires that the FFC's recommendations be considered before tabling the division of revenue. Section 10 of the Intergovernmental Fiscal Relations Act requires that the Minister of Finance table a Division of Revenue Bill with the annual budget in the National Assembly. The bill must be accompanied by an explanatory memorandum setting out how government has taken into account the

FFC's recommendations when determining the division of revenue. This part of the explanatory memorandum complies with this requirement.

The FFC's recommendations can be divided into three categories:

- Recommendations that apply directly to the division of revenue
- Recommendations that indirectly apply to issues related to the division of revenue
- Recommendations that do not relate to the division of revenue.

Government responses to the first and second categories are provided below. Recommendations that do not apply to the division of revenue are being considered and dealt with through alternative processes.

Recommendations that apply directly to the division of revenue

Chapter 1: Perspectives and prospects for job creation and the intergovernmental fiscal relations system

Impact of government spending on unemployment

The FFC recommends that, "Government should re-direct government spending towards those activities that directly or indirectly create jobs through enhancing productivity performance. Activities such as health care, durable goods manufacturing, agriculture, community services, and hospitality and food service should also form the basis of much of the expanded infrastructure expenditure plan which traditionally have gone chiefly to construction activities (e.g. building highways and bridges, dams and flood control structures)."

Government response

Job creation is a key priority of government. The 2011 *Budget Review* discussed proposals to stimulate job creation based on government's position that job creation is an outcome of business investment and a thriving economy, as well as government's activities and the regulatory environment. These strategies include promoting education and skills development, the manufacturing competitiveness enhancement programme, the Jobs Fund, a youth wage subsidy, the community work and expanded public works programmes, and government's infrastructure investment programmes. The 2012 *Budget Review* highlighted that productivity gains are essential to improved growth and rising incomes. Wage settlements that increase real wages at a pace higher than labour productivity gains threaten the labour market's recovery and are a key impediment to growth throughout the economy.

Chapter 2: Financing e-education and achieving policy goals in public ordinary schools

Finance e-education and achieve policy goals in public ordinary schools

The FFC recommends that, "E-education policy should be funded as a part of government's operating budget for the programme, just like teacher salaries, school buildings and other teaching aids."

Government response

Government supports the FFC's recommendation that an e-education policy should be funded and implemented, and that provinces should report on the implementation of and spending on e-education policy initiatives. This can be achieved by amending provincial performance indicators so that they include e-education in their annual performance plans and report against it in their annual reports.

Chapter 4: The impact of climate change on South Africa's rural areas

Adjust the objectives, terms and conditions and procedures of the municipal infrastructure grant

The FFC recommends that, "The Department of Cooperative Governance should adjust the objectives, terms and conditions, and procedures of the *municipal infrastructure grant* to: (a) permit municipalities to use grant funds for climate adaptation and mitigation investments that involve creating, rehabilitating or modifying municipal infrastructure; and (b) ensure that these investments prioritise and directly address the vulnerabilities faced by poor households."

Government response

Government, through the Department of Cooperative Governance and the National Treasury, is reviewing the local government functional and fiscal framework, including local government conditional grants. The FFC's concerns will be taken into account during this review. Possible reforms to the grants could include ensuring that infrastructure development (energy, water and transport sectors) is aligned with South Africa's broader sustainable development and climate-change objectives.

Special municipal infrastructure grant component

The FFC recommends that, "The Department of Cooperative Governance should restructure the special municipal infrastructure grant component of the *municipal infrastructure grant* in order to (a) allow municipalities to acquire or rehabilitate ecological infrastructure, provided that the return on investment is greater than a comparable engineering solution; and (b) provide a funding window for rural municipalities to receive resources from the Green Fund and similar global resources in accordance with their terms and conditions."

Government response

This issue will be addressed as part of the local government functional and fiscal framework review process discussed above.

Chapter 5: Alternative financing mechanisms for disaster management in South Africa

The design of existing key municipal conditional grant programmes

The FFC recommends that, "National Treasury should require that environmental management and vulnerability objectives are explicitly incorporated into the design of existing key municipal grant programmes. These objectives should promote disaster risk-reduction methods (ex ante approach) and enhance municipal resilience to climate change through mitigation and adaptation methods. They should: (a) include the *integrated housing and human settlement development grant*, the *urban settlements development grant*, the *municipal infrastructure grant*, the *national electrification grant*, the *public transport infrastructure and systems grant* and the *regional bulk infrastructure grant*; (b) incorporate a statement of environmental and climate-change resilience objectives in each grant programme, together with measurable indicators; (c) prioritise the most vulnerable municipalities when determining the horizontal division of available resources in each programme; (d) provide for beneficiary municipalities to conduct appropriate climate-resilience evaluations on existing infrastructure over the medium term, subject to disaster risk-reduction methods being incorporated in respective integrated development plans; and (e) be accompanied by capacity support to and engagement with the most vulnerable municipalities to ensure that they are able to identify and address disaster risk comprehensively."

Government response

Government has developed a planning toolkit for climate-change response to help municipalities incorporate mitigation, adaptation and response strategies into their integrated development plans and other planning processes. In the horizontal division of available resources, several factors are considered to promote equity, including the fiscal capacity and efficiency of municipalities. Vulnerability to climate-change impacts does not necessarily translate into a lack of fiscal capacity. As a result, using climate-change vulnerability as a key indicator of determining the municipalities' equitable share or other grant allocations may compromise the principle of equity.

Chapter 6: Financing of waste management in South Africa

Job creation in the waste management sector

The FFC recommends that, “Government should take greater advantage of the opportunities for job creation in the solid waste sector, by incentivising municipalities to create ‘green’ jobs through labour-intensive service delivery. In particular: (a) the Department of Public Works should review the expanded public works programme, which may negatively impact on the ability of municipalities to support job creation in the sector due to the comparatively higher capital costs associated with solid waste collection and recycling activities; (b) the Department of Cooperative Governance should review the funding conditions of the *municipal infrastructure grant* to ensure that local-level municipal waste management assets are eligible for financing; (c) a portion of resources from the recently established Green Fund should provide transitional financial support to municipalities that introduce innovative, labour-intensive waste collection, reduction and recycling mechanisms to areas where services are currently inadequate. These might include developing small waste collection and recycling contractors or community cooperatives to manage waste buy-back centres and materials recovery facilities; and (d) the Department of Environmental Affairs should develop municipal guidelines and regulations that support community involvement in waste management activities through community-based trusts and partnerships.”

Government response

Government, being conscious of the potential economic and social returns, is committed to investing in a green economy. The green economy is one of the New Growth Path’s ten “job drivers”. These interventions will accelerate and sustain economic growth in a more labour-absorbing, value-adding and environmentally sustainable manner.

Government will review the local government infrastructure conditional grants (including the *municipal infrastructure grant* and other infrastructure grants) during 2013/14. The FFC’s proposals will be considered as part of this review.

Expand access to solid waste services to poor households

The FFC recommends that, “Government should emphasise the expansion of access to solid waste services to poor communities, while strengthening the policy framework for the provision of refuse removal free basic services. In particular: (a) the Department of Cooperative Governance should review the *municipal infrastructure grant* guidelines to ensure that (i) adequate funding for solid waste assets is available to municipalities with weaker fiscal capacity; and (ii) expenditures on specialised vehicles and equipment required for solid waste management services are eligible for financing; (b) the Department of Environmental Affairs should prioritise support to municipalities seeking to expand services to poor communities using labour-intensive service delivery, including investigating potential fiscal instruments that might be incorporated with the expanded public works programme or Green Fund; and (c) the Department of Environmental Affairs should commission a review of the refuse removal free basic services policy, with a specific focus on its impacts on (i) expanding and sustaining services to poor households; (ii) the affordability and quality of service to poor households; and (iii) environmental impacts, such as the extent of reduction in illegal dumping.”

Government response

Government acknowledges the importance of promoting sustainable access to solid waste services. Conditional grants and the local government equitable share already provide funding for access to services for poor households. The primary capital grants available for municipal solid waste facilities are the *municipal infrastructure grant* and the *urban settlements development grant*. The *municipal infrastructure grant* provides basic residential infrastructure for poor households. The grant can be used for new infrastructure, upgrading bulk and connector infrastructure, or the rehabilitation of existing infrastructure. The *urban settlements development grant* replaced the *municipal infrastructure grant* in metropolitan municipalities. The local government equitable share includes funds for the operational costs of providing solid waste services. The equitable share formula was reviewed during 2012 (in partnership with the FFC) and the infrastructure grants will be reviewed during 2013/14. The FFC's proposals will be taken into account as part of this process.

The National Policy for the Provision of Basic Refuse Removal Services to Indigent Households was gazetted in June 2011 and should be given time to be implemented before it is reviewed. The Department of Environmental Affairs provides support to municipalities through a range of measures that are being continually strengthened.

Chapter 7: The impact of aggregate revenue and expenditure assignments on economic growth – the case of provinces and municipalities in South African intergovernmental relations

The role of non-metropolitan municipalities in economic growth

The FFC proposes that, "Municipalities, and particularly non-metropolitan municipalities, should be encouraged to play a more direct role in economic growth. This can be achieved by (a) national government assigning greater revenue and tax handles to the municipalities than is presently the case; and (b) reassessing all elements to support the growth-enhancing role of municipalities, when reviewing the fiscal framework. These elements would include local government equitable share, local own-revenue sources (e.g. local business taxes) and conditional grants. Such reassessment should ensure a better balance between equity and growth objectives in the local government fiscal framework."

Government response

Government agrees that municipalities have an important role to play in supporting economic growth and that their ability to raise their own revenue creates both a source of funding for this objective and a positive incentive to promote economic activity in their municipal area. Government also agrees that potential impacts on economic growth should be considered in any review of local government funding. However, the fiscal framework also has to balance the need to ensure that government is able to meet its social and other objectives with the need to promote economic growth. Municipalities must ensure that they are making full use of their existing revenue-raising powers and that they spend their budgets efficiently.

Chapter 9: Understanding the dynamics of the capacity challenge at local government level

Environmental constraints

The FFC is of the view that, "Environmental constraints, specifically with respect to the allocation of powers and functions and the formulation of conditional grants, may need to be simultaneously adjusted."

Government response

Government agrees that funding and capacity should be based on the assignment of powers and functions. Any change in these responsibilities should be accompanied by an assessment of whether changes are needed in the conditional grant and capacity-support systems.

Capacity-related conditional grants

The FFC recommends that, "The grants' conditionality must commit municipalities to specific, independently verifiable capacity and performance improvements. Grants should be redesigned to consider the quality of capacity-building interventions, instead of having a narrow quantitative focus; and an external, objective evaluation dimension should also be included in capacity grant requirements."

Government response

National government took steps in 2010/11 to streamline and focus capacity-building support efforts. The *financial management grant* and *municipal systems improvement grant* frameworks have been improved to remove overlaps and include conditionalities. Commitments and their deliverables are being audited in line with the accountability arrangements in the Division of Revenue Act.

Recommendations that indirectly apply to the division of revenue

Chapter 2: Financing e-education and achieving policy goals in public ordinary schools

Finance e-education and achieve policy goals in public ordinary schools in South Africa

The FFC recommends that, "A well-structured, inter-governmental financing mechanism should be established with explicit guidelines to provincial departments of education regarding the budget line items that must be prioritised in their annual budget allocations, as well as those budget line items that will be contained in the national budget allocation. Decisions on the particular line items can be informed by a review of policy documents and various studies conducted on e-education over several years and by a broader review of the available knowledge of e-education financing across the globe.

"The impact of e-education policy and financing should be continuously assessed, taking into account cross-departmental issues and supporting measures from a range of government departments and relevant public-sector bodies (Department of Basic Education, Department of Higher Education and Training, Department of Labour, Department of Science and Technology, Department of Communications, metropolitan municipalities, the Independent Communications Authority of South Africa and others). Such assessment would consider both school-level and economy-wide impacts. From an analytical perspective, the requirements would be twofold: (a) to understand how e-education affects students' decisions about acquiring ongoing skills in the education system (econometric analysis coupled with case studies, repeated over time); and (b) to consider interactions between e-education and the rest of the economy. Quantifying these interactions allows the value of various policy and financing options to be compared."

Government response

Government agrees that successful e-education requires both content and technology. Education departments will need to allocate resources for infrastructure, hard and software, and training for the implementation of e-education policies. These must be integrated with and support the delivery of the curriculum. E-education should be factored into existing norms and standards and be included in routine budgeting, monitoring and evaluation.

Chapter 6: Financing of waste management in South Africa

Full cost accounting

The FFC proposes that, "By the end of the 2015/16 financial year, government should phase in full cost accounting for solid waste management within municipalities. To achieve this goal, (a) government should develop specific (full cost accounting) guidelines for integrated municipal solid waste management that addresses the specific and interrelated environmental and service delivery needs of the sector, within the framework of activity-based costing that the National Treasury is introducing; and (b) government should develop a capacity-support programme to implement the guidelines that allows a phased introduction of full cost accounting starting with high-capacity municipalities that face major solid waste management."

Government response

Government agrees that full cost accounting for solid waste should be phased in within municipalities. This will help determine the full costs of solid waste management as well as its component costs, which will allow municipalities to identify the service's key cost drivers. Government has introduced many initiatives to support municipalities, such as the successful training of waste officers on waste-related issues. The Department of Environmental Affairs has also produced a costing tool to help municipalities cost their waste management service and set appropriate tariffs. Government will continue to encourage municipalities to use these tools.

Chapter 7: The impact of aggregate revenue and expenditure assignments on economic growth – the case of provinces and municipalities in South African intergovernmental relations

Alternative aggregate revenue and expenditure assignment for provinces and municipalities

The FFC recommends that, "The key principles of national strategies such as the New Growth Path document and the National Planning Commission's Vision for 2030 need to permeate provincial and local strategies. This can be achieved by translating these principles into complete sub-national strategies with full details on sustained implementation, followed by provincial and local governments' commitment to achieve the goals identified in the strategies. Key components for sub-national government to consider are capital and labour inputs, and multifactor productivity. Provincial and municipal governments should continue to invest in physical and human capital, focusing specifically on issues such as lack of adequate skills and physical infrastructure needs (maintenance, better location, etc). In addition, effective management and accountability mechanisms should be aimed at increasing multifactor productivity."

Government response

Government agrees that provinces and municipalities should continue to invest in physical and human capital. These investments should be consistent with the policy direction set out in the New Growth Path, the National Development Plan and other policies adopted by Cabinet.

Municipal revenue-collection efforts

The FFC is of the view that, "Municipalities are not necessarily doing a good job of collecting revenue from the public. Hence, municipalities need to improve their revenue-collection efforts, as these can positively contribute towards economic growth. It is well known that in South Africa some municipalities (for example, metropolitan municipalities) are raising substantial revenues, while other municipalities are still very dependent on transfers from national government. Issues that need to be addressed include weak capacity within local administrations, small tax bases, delivery of free basic services requiring high municipal expenditures (that can only be financed through national transfers), and a lack of 'payment culture' for services."

Government response

Government acknowledges that revenue-collecting performance varies widely among municipalities. Not all municipalities have the potential to collect the same proportion of income from own revenue, but they all need to make the necessary effort to collect what they can. Failure to do so leaves municipalities with fewer resources to invest in service delivery, including services that support economic growth. While national government agrees that weak capacity within municipalities and a "lack of payment culture" are important issues to address, the costs of free basic services for poor households are already funded by transfers through the local government equitable share. Municipalities with small tax bases are still responsible for collecting revenue due to them and should be able to fund their operations with a combination of transfers and own revenues if they spend efficiently.

Government is addressing the quality of municipalities' revenue-management capabilities through an in-depth analysis of the revenue value chain, considering all variables that constitute effective and efficient revenue management. Government agrees that the municipal administrative capabilities should be enhanced by building institutional knowledge and improving their ability to enforce by-laws.

Chapter 9: Understanding the dynamics of the capacity challenge at local government level

Capacity-building interventions

The FFC recommends that, "Capacity-building interventions should holistically coordinate individual, organisational and institutional level dimensions of capacity building in a particular municipality over the medium term. Instead of focusing disproportionately on training, support programmes should include technical support for new systems, business process redesign and change management, based on an assessment of the relevant municipality. The level dimensions have been summarised as follows:

"Individual: officials must have the necessary technical skills, knowledge, experience and competencies to fulfil their particular functions. This means appointing the correct person to the correct post (adherence to recruitment, selection and any minimum competency requirements) and ensuring that officials then receive training (both accredited and non-accredited) relevant to their areas of responsibilities, to ensure continued workplace effectiveness.

"Organisational: municipalities should be supported in compiling realistic integrated development plans, implementing functional and effective performance management systems and knowledge management policies, to enhance organisational memory and data management, and to ensure accurate and relevant reporting. Critical vacancies must also be filled and workable staff-retention strategies implemented. Skilled individuals must be appointed to vacant positions for which affirmative action candidates cannot be found, and audits should be conducted of municipal positions that fall outside the approved organisational structures.

"Institutional: greater differentiation and flexibility is required in the design of the local government fiscal framework. A differentiated approach is needed for the assignment of functions to municipalities, based on their capacity to effectively manage them. Once a municipality has proved its ability to provide a specific basket of services, decisions can be made regarding expanding the range of services provided by such a municipality. Where service delivery failures persist, such services should be removed from municipalities. Furthermore, the establishment of a coordinated capacity-building function across all local government departments is recommended. These actions must be complemented by simplified, streamlined and coordinated reporting requirements for local government and clearly defined roles and responsibilities for national and provincial departments. To assist rural municipalities, the value and practicality of an assistance programme should be explored, aimed at attracting and retaining scarce skills in these areas (similar to the scarce skills payments made to doctors in rural areas)."

Government response

Government supports the recommendations relating to the different dimensions of capacity building. The National Treasury has developed a strategy for capacity building that incorporates these dimensions to deal with financial management disciplines in national, provincial and local government. Government also agrees that minimum standards should be set for the sectors identified in the recommendations. The sector departments, with legislated responsibilities in their respective areas, have also been encouraged to address capacity building in a holistic manner. For the recommendation to be effective, all sectors and spheres of government need to implement systems that ensure the appointment of suitably skilled and qualified officials.

Minimum competencies entrenched in the Municipal Finance Management Act

The FFC recommends that, "Minimum competencies as entrenched in the Municipal Finance Management Act should be enforced so as to ensure that appropriate technical skills are in place. Based on field work conducted by the Commission, the following functions require particular attention: revenue management, supply chain management, sewerage and water treatment plant operators, road maintenance supervisors, health inspectors and planning and project managers."

Government response

Government agrees with the recommendations. The National Treasury set out the compliance process for minimum competency requirements in regulations promulgated in 2007, which came into effect on 1 January 2013. The regulations cover a wide range of financial management disciplines, including revenue management, supply chain management and project management. To facilitate the process and improve communication and compliance, the National Treasury has issued Municipal Finance Management Act circulars, most recently in April 2012. This circular addressed the support measures in place, recognition of prior learning, non-compliance and consideration of special merit cases, reporting requirements, accountability arrangements for municipal managers, and requirements to include these arrangements in performance agreements of senior managers.

Chapter 10: Assessing gender-responsive budgeting in local government

Assess gender-responsive budgeting in local government

The FFC recommends that, "National and provincial governments should (a) run gender budgeting pilots in a few municipalities first and evaluate results before wider application. These pilots could be linked to ensuring gender disaggregated data for key conditional grants as part of the grant framework in the Division of Revenue Act; (b) ensure municipal integrated development plans institutionalise gender planning by sector (e.g. water and sanitation, local economic development etc.) and include gender disaggregated performance indicators and targets; (c) provide gender budgeting good practice guides and toolkits; and (d) provide guidelines for collecting sex-disaggregated data for budgeting processes and ensure that municipalities have the capacity to analyse budgets from a gender perspective."

The FFC also proposes that, "Local government should (a) institutionalise gender-responsive budgeting process linked to integrated development plans; (b) build capacity for gender mainstreaming and gender-responsive budgeting at local level; (c) ensure gender-responsive appropriations and budget allocations; and (d) ensure gender-sensitive public participation and consultations at local level."

Government response

Government supports the proposals, which will help ensure that the collection and allocation of public resources is effectively carried out and contributes to advancing gender equality and women's empowerment. It will provide tools to assess the different needs and contributions of men, women, boys and girls within existing revenues, expenditures and allocations, and will call for adjusted budget policies to benefit all groups.

Gender-responsive budget analysis, along with legislation and other practical policy measures, can address gender bias and discrimination. It is a step towards increased accountability and public transparency, and it can shift economic policies leading to gains across society. However, the proposals' implementation may be hindered by capacity constraints in municipalities.

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 its allocated functions.

Of the R44.3 billion added to the provincial baseline over the next three years, the provincial equitable share baselines are revised upwards by R36.1 billion and conditional grants are increased by R8.2 billion. National transfers to provinces increase from R388.7 billion in 2012/13 to R414.2 billion in 2013/14. Over the MTEF period, provincial transfers will grow at an average annual rate of 6.9 per cent to R474.4 billion in 2015/16.

Table W1.6 sets out the total transfers to provinces for 2013/14, which amount to R414.2 billion, with R337.6 billion allocated to the provincial equitable share and R76.6 billion to conditional grants, which includes an unallocated R188 million for the *provincial disaster grant*, but excludes indirect transfers of R13.4 billion.

Table W1.6 Total transfers to provinces, 2013/14

R million	Equitable share	Conditional grants	Total transfers
Eastern Cape	50 165	9 466	**59 631**
Free State	20 000	6 021	**26 021**
Gauteng	61 375	15 510	**76 885**
KwaZulu-Natal	73 510	14 575	**88 085**
Limpopo	41 362	7 179	**48 541**
Mpumalanga	27 211	5 788	**32 998**
Northern Cape	9 022	3 274	**12 295**
North West	22 754	4 990	**27 744**
Western Cape	32 175	9 589	**41 764**
Unallocated	–	188	**188**
Total	**337 572**	**76 580**	**414 152**

Provincial equitable share

The equitable share constitutes the main source of revenue for meeting provincial expenditure responsibilities. The proposed revisions of R7.4 billion, R10.1 billion and R18.6 billion bring the equitable share allocations to R337.6 billion in 2013/14, R359.9 billion in 2014/15 and R383.7 billion in 2015/16. These revisions result in the provincial equitable share increasing by 7.2 per cent between 2012/13 and 2013/14, and growing at an average annual rate of 6.8 per cent over the MTEF. These equitable share amounts include R2 billion in 2013/14, R2.2 billion in 2014/15 and R2.3 billion in 2015/16, which were previously part of the *devolution of property rate funds grant*. This grant is being phased into the provincial equitable share in the 2013 MTEF. The phase-in process is discussed in more detail later.

Policy priorities underpinning equitable share revisions

The revisions to baseline equitable share allocations provide for personnel and policy adjustments for funding of urgent government priorities identified in education, health and social development. The personnel adjustments provide for the impact of the 2012 wage agreements on personnel budgets in all sectors. Policy-related adjustments to the provincial equitable share provide for an increased number of teachers in Quintile 1 schools and in Grade R, improved diagnostic tests for tuberculosis, absorption of social work graduates, and support to non-governmental organisations for the provision of social welfare services.

The equitable share formula

The provincial equitable share formula is reviewed and updated with new data annually. For the 2013 MTEF, the formula has been updated with data from the 2011 Census on the population and the school-age cohort (5 to 17 year olds); data from the 2012 School Realities Survey conducted by the Department of Basic Education on school enrolment; data from the 2011 General Household Survey for medical aid coverage; data from the health sector and the Risk Equalisation Fund for the risk-adjusted capitation index; and data from the 2010 gross domestic product by region (GDP-R) survey and the 2010 Income and Expenditure Survey for poverty. The impact of these updates on the provincial equitable share is phased in over three years (2013/14 to 2015/16).

Because the formula is largely population-driven, the allocations capture shifts in population across provinces, which leads to changes in the relative demand for public services across these areas. This can be seen in the changes in the equitable shares of different provinces after updating the formula with population data from the 2011 Census.

Population shifts in 2011 Census data

Over 60 per cent of the formula uses population data and the new census reveals larger changes in the population of some provinces than anticipated in the mid-year population estimates (used to update the formula in previous years). Table W1.7 below shows population changes between the 2011 mid-year estimates used in the 2012 formula and the 2011 Census data. Some provinces recorded significantly smaller populations in the 2011 Census than had been estimated, including KwaZulu-Natal, the Eastern Cape, Limpopo and the Free State. Gauteng has the highest population increase of close to 1 million people.

Table W1.7 2011 mid-year estimates vs 2011 Census

	2011 mid-year estimates	2011 Census	Population shifts	Percentage shares (mid-year 2011)	Percentage shares (2011 Census)	Population shifts
Eastern Cape	6 829 958	6 562 053	-267 905	13.5%	12.7%	-0.83%
Free State	2 759 644	2 745 590	-14 054	5.5%	5.3%	-0.15%
Gauteng	11 328 203	12 272 263	944 060	22.4%	23.7%	1.31%
KwaZulu-Natal	10 819 130	10 267 300	-551 830	21.4%	19.8%	-1.55%
Limpopo	5 554 657	5 404 868	-149 789	11.0%	10.4%	-0.54%
Mpumalanga	3 657 181	4 039 939	382 758	7.2%	7.8%	0.57%
Northern Cape	1 096 731	1 145 861	49 130	2.2%	2.2%	0.05%
North West	3 253 390	3 509 953	256 563	6.4%	6.8%	0.35%
Western Cape	5 287 863	5 822 734	534 871	10.5%	11.2%	0.79%
Total	**50 586 757**	**51 770 561**	**1 183 804**	**100.0%**	**100.0%**	**–**

Provision for 2011 Census impact

The formula has been updated to reflect these shifts in provincial populations. As a result, provinces with increased populations received additional resources for their growing service-delivery responsibilities, while those with decreasing populations receive reduced allocations. Sufficient time will be given to provinces with reduced populations to adjust to smaller budgets. An addition of R6.3 billion is made available over the MTEF to cushion the impact of the new census data. An amount of R4.2 billion is added as a “top-up” for provinces with declining shares over the MTEF, and R2.1 billion is extended to all nine provinces and allocated through the formula in 2015/16. The R4.2 billion top-up for the four provinces with declining shares is shown in Table W1.8.

Table W1.8 Provincial equitable share: Cushioning for 2011 Census impact on provinces with declining shares

	2013/14	2014/15	2015/16
R thousand	**Medium-term estimates**		
Eastern Cape	185 962	421 166	685 628
Free State	34 594	78 350	171 261
Gauteng	–	–	–
KwaZulu-Natal	289 915	656 600	773 075
Limpopo	131 193	297 127	487 036
Mpumalanga	–	–	–
Northern Cape	–	–	–
North West	–	–	–
Western Cape	–	–	–
Total	**641 664**	**1 453 243**	**2 117 000**

This allocation will only provide relief in the 2013 MTEF. From 2016/17, the provincial equitable share will be allocated solely through the formula with no additions to support provinces with declining shares. Provinces must use the three years of support provided to adjust to their new baselines.

Phasing in the formula

To mitigate the impact of data updates on provincial equitable shares, the new shares are phased in over the MTEF. The data is updated each year and a new target share is calculated, which is shown in Table W1.9. The table shows the revised weighted provincial equitable shares for the period 2013/14 to 2015/16.

Table W1.9 Implementation of the equitable share weights, 2013/14 – 2015/16

Percentage	2012/13 Weighted shares	2013/14	2014/15	2015/16
		2013 MTEF weighted shares 3-year phasing		
Eastern Cape	15.2%	14.9%	14.5%	14.2%
Free State	6.0%	5.9%	5.8%	5.6%
Gauteng	17.6%	18.2%	18.8%	19.4%
KwaZulu-Natal	21.9%	21.7%	21.5%	21.3%
Limpopo	12.6%	12.3%	12.0%	11.8%
Mpumalanga	8.1%	8.1%	8.1%	8.2%
Northern Cape	2.7%	2.7%	2.7%	2.7%
North West	6.7%	6.7%	6.8%	6.9%
Western Cape	9.3%	9.5%	9.7%	10.0%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Summary of the formula's structure

The formula, shown in Table W1.10 below, consists of six components that capture the relative demand for services between provinces and take into account specific provincial circumstances. The formula's components are neither indicative budgets nor guidelines as to how much should be spent on functions in each province or by provinces collectively. Rather, the education and health components are weighted broadly in line with historical expenditure patterns to indicate 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 W1.10 Distributing the equitable shares by province, 2013 MTEF

	Education	Health	Basic share	Poverty	Economic activity	Institu-tional	Weighted average
	48%	**27%**	**16%**	**3%**	**1%**	**5%**	**100%**
Eastern Cape	15.3%	13.5%	12.7%	16.3%	7.7%	11.1%	14.2%
Free State	5.3%	5.4%	5.3%	5.4%	5.5%	11.1%	5.6%
Gauteng	17.3%	21.9%	23.7%	16.9%	33.7%	11.1%	19.4%
KwaZulu-Natal	22.7%	21.7%	19.8%	22.2%	15.8%	11.1%	21.3%
Limpopo	13.1%	10.3%	10.4%	13.6%	7.2%	11.1%	11.8%
Mpumalanga	8.5%	7.2%	7.8%	9.1%	7.0%	11.1%	8.2%
Northern Cape	2.3%	2.2%	2.2%	2.2%	2.3%	11.1%	2.7%
North West	6.5%	6.7%	6.8%	8.0%	6.7%	11.1%	6.9%
Western Cape	8.9%	11.1%	11.2%	6.1%	14.1%	11.1%	10.0%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Full impact of data updates on the provincial equitable share

Table W1.11 shows the full impact of the data updates on the provincial equitable share per province. The provinces with negative shifts in population according to the 2011 Census experienced a declining trend in their equitable shares, with significant upward revisions in the shares of provinces with increased population numbers. This table compares the target shares for the 2012 and 2013 MTEF.

Table W1.11 Full impact on data updates on the equitable share

	2012 MTEF	2013 MTEF	Difference
Eastern Cape	14.9%	14.2%	-0.79%
Free State	5.8%	5.6%	-0.20%
Gauteng	18.0%	19.4%	1.44%
KwaZulu-Natal	22.2%	21.3%	-0.89%
Limpopo	12.4%	11.8%	-0.56%
Mpumalanga	7.9%	8.2%	0.24%
Northern Cape	2.6%	2.7%	0.05%
North West	6.6%	6.9%	0.21%
Western Cape	9.4%	10.0%	0.51%
Total	**100.0%**	**100.0%**	**–**

For the 2013 Budget, the formula components are set out as follows:

- An *education component* (48 per cent) based on the size of the school-age population (ages 5 to 17) and the number of learners (Grade R to 12) enrolled in public ordinary schools.
- A *health component* (27 per cent) based on a combination of a 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 index is given a 75 per cent weighting and the case-load (output component) has a 25 per cent weighting.
- A *basic component* (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 (48 per cent)

The education component uses the school-age population (5 to 17 years), based on the 2011 Census, and enrolment data drawn from the 2012 School Realities Survey conducted by the Department of Basic Education. Each of these elements is assigned a weight of 50 per cent.

Table W1.12 shows the changes in the school-going age population between the census of 2001 and 2011.

Table W1.12 Impact of changes in school enrolment on the education component share

	Age cohort 5 – 17	School enrolment 2011	2012	Changes in enrolment	Weighted average 2012 MTEF	2013 MTEF	Difference in weighted average
Eastern Cape	1 856 317	1 963 578	1 938 837	-24 741	16.3%	15.3%	-0.99%
Free State	657 489	658 010	660 966	2 956	5.6%	5.3%	-0.29%
Gauteng	2 231 793	2 017 931	2 062 526	44 595	15.7%	17.3%	1.66%
KwaZulu-Natal	2 758 594	2 847 378	2 866 369	18 991	23.2%	22.7%	-0.52%
Limpopo	1 536 294	1 695 524	1 714 518	18 994	13.9%	13.1%	-0.73%
Mpumalanga	1 053 846	1 046 551	1 051 356	4 805	8.4%	8.5%	0.09%
Northern Cape	288 839	274 745	276 420	1 675	2.2%	2.3%	0.08%
North West	824 724	765 120	774 615	9 495	6.3%	6.5%	0.15%
Western Cape	1 174 625	1 015 038	1 034 392	19 354	8.4%	8.9%	0.56%
Total	**12 382 521**	**12 283 875**	**12 379 999**	**96 124**	**100.0%**	**100.0%**	**–**

Table W1.13 shows the impact of the changes in school-age cohort (5 to 17 years) and new enrolment data on the education component shares.

Table W1.13 School-age cohort, 5 – 17 years (2001 Census versus 2011 Census)

Province	Person age 5 – 17 (Census 2001)	Person age 5 – 17 (Census 2011)	Population shifts	Percentage shares (2001)	Percentage shares (2011)	Population shifts
Eastern Cape	2 151 992	1 856 317	-295 675	16.6%	15.0%	-1.65%
Free State	760 486	657 489	-102 997	5.9%	5.3%	-0.57%
Gauteng	1 931 719	2 231 793	300 074	14.9%	18.0%	3.09%
KwaZulu-Natal	3 013 243	2 758 594	-254 649	23.3%	22.3%	-1.02%
Limpopo	1 798 862	1 536 294	-262 568	13.9%	12.4%	-1.50%
Mpumalanga	1 074 972	1 053 846	-21 126	8.3%	8.5%	0.20%
Northern Cape	280 975	288 839	7 864	2.2%	2.3%	0.16%
North West	826 218	824 724	-1 494	6.4%	6.7%	0.27%
Western Cape	1 094 565	1 174 625	80 060	8.5%	9.5%	1.02%
Total	**12 933 032**	**12 382 521**	**-550 511**	**100.0%**	**100.0%**	**–**

Health component (27 per cent)

A new health component for the provincial equitable share formula was adopted in 2010 and implemented in the 2011 Budget. The 2011 Annexure W1 explained how the new health component is calculated and the rationale behind it. The component uses a risk-adjusted capitation index based on the Risk Equalisation Fund 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).

The health component is presented in three parts below. Table W1.14 shows the shares of the risk-adjusted component, which accounts for 75 per cent of the health component.

Table W1.14 Risk-adjusted sub-component shares

	Population Census	Insured population	Risk-adjusted index	Weighted population	Risk-adjusted shares		Change
Thousand	**2011**	**2011**	**2012**		**2012**	**2013**	
Eastern Cape	6 562	11.1%	96.9%	5 650	14.0%	13.0%	-0.94%
Free State	2 746	17.0%	103.3%	2 353	5.6%	5.4%	-0.20%
Gauteng	12 272	23.9%	105.4%	9 845	21.0%	22.7%	1.72%
KwaZulu-Natal	10 267	12.3%	98.9%	8 906	22.0%	20.6%	-1.45%
Limpopo	5 405	7.2%	91.6%	4 596	11.1%	10.6%	-0.52%
Mpumalanga	4 040	14.4%	95.7%	3 310	7.2%	7.6%	0.43%
Northern Cape	1 146	13.0%	100.7%	1 004	2.3%	2.3%	0.06%
North West	3 510	13.6%	102.2%	3 100	6.8%	7.2%	0.32%
Western Cape	5 823	25.1%	104.0%	4 537	9.9%	10.5%	0.59%
Total	**51 771**			**43 301**	**100.0%**	**100.0%**	**–**

The risk-adjusted sub-component estimates a weighted population in each province using the risk-adjusted capitation index, which is calculated using data from the Council for Medical Aids Scheme's Risk Equalisation Fund. The percentage of the population with medical aid insurance, based on the 2011 General Household Survey, is deducted from the 2011 Census population data to estimate the uninsured population per province. The risk-adjusted index, which is an index of the health risk profile of each province, is applied to this uninsured population to estimate the weighted population. Each province's share of this weighted population is used to estimate their share of the risk-adjusted sub-component. Table W1.14 shows the change in this sub-component between 2012 and 2013. In total, the risk-adjusted component is weighted at 75 per cent of the health component.

The output sub-component, which is updated with 2010/11 and 2011/12 data obtained from the District Health Information Services, is shown in Table W1.15 below.

Table W1.15 Output sub-component shares

	Primary health care visits				Hospital workload patient-day equivalents			
	2010/11	**2011/12**	**Average**	**Share**	**2010/11**	**2011/12**	**Average**	**Share**
Eastern Cape	17 667	18 269	17 968	14.6%	4 666	4 747	4 707	15.0%
Free State	6 596	7 194	6 895	5.6%	1 644	1 751	1 698	5.4%
Gauteng	20 011	22 318	21 164	17.1%	6 007	6 572	6 289	20.1%
KwaZulu-Natal	26 191	29 197	27 694	22.4%	7 886	8 167	8 026	25.6%
Limpopo	13 941	14 696	14 319	11.6%	2 710	2 869	2 789	8.9%
Mpumalanga	8 031	8 769	8 400	6.8%	1 726	1 715	1 720	5.5%
Northern Cape	3 473	3 340	3 407	2.8%	532	520	526	1.7%
North West	8 043	7 889	7 966	6.5%	1 545	1 563	1 554	5.0%
Western Cape	15 671	15 537	15 604	12.6%	3 980	4 112	4 046	12.9%
Total	**119 626**	**127 209**	**123 417**	**100.0%**	**30 695**	**32 017**	**31 356**	**100.0%**

In the 2011 division of revenue, normative costings derived from government's Basic Accounting System and the District Health Information Services were used to weight primary health care visits and patient-day equivalents. The weighted visits were combined to estimate the output component. For the 2013 division of revenue, the output sub-component still uses patient load data from the District Health Information Services. The average number of clinic visits at primary health care clinics in 2010/11 and 2011/12 is calculated. Each province's average is used to estimate their share of this part of the output component, making up 5 per cent of the health component. For hospitals, each province's share of the total patient-day equivalents from public hospitals in 2010/11 and 2011/12 are used to estimate their share of this part of the output sub-component, making up 20 per cent of the health component. In total, the output component is

25 per cent of the health component. This new approach still applies a ratio to weight primary health care visits to patient-day equivalents, but it is simpler and more transparent than the method used in 2011.

Table W1.16 shows the updated health component shares for 2013.

Table W1.16 Health component weighted shares

	Risk-adjusted	Primary health care	Hospital component	Weighted shares		Change
Weight	**75%**	**5%**	**20%**	**2012**	**2013**	
Eastern Cape	13.0%	14.6%	15.0%	14.2%	13.5%	-0.64%
Free State	5.4%	5.6%	5.4%	5.5%	5.4%	-0.09%
Gauteng	22.7%	17.1%	20.1%	20.5%	21.9%	1.46%
KwaZulu-Natal	20.6%	22.4%	25.6%	23.0%	21.7%	-1.36%
Limpopo	10.6%	11.6%	8.9%	10.7%	10.3%	-0.39%
Mpumalanga	7.6%	6.8%	5.5%	6.8%	7.2%	0.32%
Northern Cape	2.3%	2.8%	1.7%	2.2%	2.2%	0.04%
North West	7.2%	6.5%	5.0%	6.5%	6.7%	0.23%
Western Cape	10.5%	12.6%	12.9%	10.6%	11.1%	0.43%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**–**

Basic component (16 per cent)

The basic component is derived from the proportion of each province's share of the national population. This component constitutes 16 per cent of the total equitable share. For the 2013 MTEF, population data is drawn from the 2011 Census. Table W1.17 shows the impact on the basic component's revised weighted shares.

Table W1.17 Impact of the changes in population on the basic component shares

	Mid-year population estimates	Population Census	Population change	% population change	Basic component shares		Change
	2011	**2011**			**2012 MTEF**	**2013 MTEF**	
Eastern Cape	6 829 958	6 562 053	-267 905	-3.9%	13.5%	12.7%	-0.83%
Free State	2 759 644	2 745 590	-14 054	-0.5%	5.5%	5.3%	-0.15%
Gauteng	11 328 203	12 272 263	944 060	8.3%	22.4%	23.7%	1.31%
KwaZulu-Natal	10 819 130	10 267 300	-551 830	-5.1%	21.4%	19.8%	-1.55%
Limpopo	5 554 657	5 404 868	-149 789	-2.7%	11.0%	10.4%	-0.54%
Mpumalanga	3 657 181	4 039 939	382 758	10.5%	7.2%	7.8%	0.57%
Northern Cape	1 096 731	1 145 861	49 130	4.5%	2.2%	2.2%	0.05%
North West	3 253 390	3 509 953	256 563	7.9%	6.4%	6.8%	0.35%
Western Cape	5 287 863	5 822 734	534 871	10.1%	10.5%	11.2%	0.79%
Total	**50 586 757**	**51 770 561**	**1 183 804**	**2.3%**	**100.0%**	**100.0%**	**–**

Institutional component (5 per cent)

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 or the other factors included in other components. 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. This component benefits provinces with smaller populations, especially the Northern Cape and the North West, as the allocation per person for these provinces is much higher in this component.

Poverty component (3 per cent)

The poverty component introduces a redistributive element to the formula and is assigned a weight of 3 per cent. The poor population includes people who fall in the first two quintiles of household incomes in the 2010 Income and Expenditure Survey. The estimated size of the poor population in each province is calculated by multiplying the proportion in that province from the survey by the population figure from the 2011 Census. Table W1.18 shows the poverty quintiles of the Income and Expenditure Survey, the 2011 Census data and the weighted share of the poverty component per province.

Table W1.18 Comparison of current and new poverty component weighted shares

	Income and Expendi-ture Survey 2010/11	Current (2012 MTEF)			New (2013 MTEF)			Difference in weighted shares
		Basic compo-nent value	Poor popula-tion	Weighted shares	Basic compo-nent value	Poor popula-tion	Weighted shares	
Eastern Cape	52.0%	6 830	3 404	16.7%	6 562	3 414	16.3%	-0.43%
Free State	41.4%	2 760	1 151	5.7%	2 746	1 137	5.4%	-0.23%
Gauteng	28.9%	11 328	3 186	15.7%	12 272	3 543	16.9%	1.26%
KwaZulu-Natal	45.3%	10 819	4 671	23.0%	10 267	4 652	22.2%	-0.75%
Limpopo	52.9%	5 555	2 936	14.4%	5 405	2 857	13.6%	-0.79%
Mpumalanga	47.3%	3 657	1 744	8.6%	4 040	1 909	9.1%	0.54%
Northern Cape	40.8%	1 097	493	2.4%	1 146	467	2.2%	-0.19%
North West	47.9%	3 253	1 527	7.5%	3 510	1 681	8.0%	0.52%
Western Cape	21.9%	5 288	1 221	6.0%	5 823	1 273	6.1%	0.08%
Total		**50 587**	**20 332**	**100.0%**	**51 771**	**20 933**	**100.0%**	**–**

Economic activity component (1 per cent)

The economic activity component is a proxy for provincial tax capacity and expenditure assignments. Given that these assignments are a relatively small proportion of provincial budgets, the component is assigned a weight of 1 per cent. For the 2013 MTEF, 2010 GDP-R data is used. Table W1.19 shows the impact of the revised weighted shares of the economic activity component. The right-hand column shows changes as a result of the relative growth of provincial contributions to GDP.

Table W1.19 Current and new economic activity component weighted shares

	Current (2012 MTEF)		New (2013 MTEF)		Difference in weighted shares
	GDP-R, 2009 (R million)	Weighted shares	GDP-R, 2010 (R million)	Weighted shares	
Eastern Cape	182 147	7.6%	203 993	7.7%	0.06%
Free State	130 973	5.5%	145 405	5.5%	-0.00%
Gauteng	811 907	33.9%	897 553	33.7%	-0.16%
KwaZulu-Natal	384 937	16.1%	420 647	15.8%	-0.26%
Limpopo	168 506	7.0%	191 934	7.2%	0.18%
Mpumalanga	169 973	7.1%	187 367	7.0%	-0.05%
Northern Cape	54 917	2.3%	61 175	2.3%	0.01%
North West	156 374	6.5%	177 075	6.7%	0.13%
Western Cape	336 234	14.0%	376 284	14.1%	0.11%
Total	**2 395 967**	**100.0%**	**2 661 433**	**100.0%**	**–**

Phasing of conditional grant into the provincial equitable share

The *devolution of property rate funds grant* will be phased into the provincial equitable share over the 2013 MTEF. The grant enables provinces to take over the responsibility of paying rates and municipal charges on properties that were administered by national government on their behalf. Progress has been made in ensuring that all provinces have records of their properties and liabilities for municipal rates. Over the 2013 MTEF period, provinces will continue to receive the same amounts they would have received from the grant, but these will be transferred as part of the equitable share and not as a separate conditional grant. From 2016/17, these funds will be allocated through the provincial equitable share formula.

Conditional grants to provinces

There are four types of provincial conditional grants. Schedule 4A 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. Schedule 5A grants fund-specific responsibilities for both the transferring and receiving of provincial accounting officers. A schedule 6A grant provides allocations-in-kind through which a national department implements projects in provinces. A schedule 7A grant provides for the swift allocation and transfer of funds to a province to help it deal with a disaster.

Changes to conditional grants

Given the challenging economic environment and fiscal constraints, government decided to find savings from existing baselines to fund key priorities. As a result, the baselines of some conditional grants have been revised downward. Table W1.20 shows the savings made on provincial conditional grants to make resources available for government priorities.

Table W1.20 Savings effected on provincial conditional grants

R million	2013/14	2014/15	2015/16	MTEF total
Basic Education	**-113**	**-324**	**-639**	**-1 075**
Education infrastructure	-100	-300	-600	-1 000
HIV and Aids (life skills education)	-7	-12	-17	-35
National school nutrition programme	-6	-12	-22	-40
Cooperative Governance and Traditional Affairs	**-2**	**-4**	**-6**	**-12**
Provincial disaster	-2	-4	-6	-12
Health	**-135**	**-184**	**-237**	**-556**
Health facility revitalisation	-125	-174	-232	-531
National health insurance	-11	-10	-5	-26
Public Works	**-6**	**-12**	**-19**	**-37**
Expanded public works programme integrated grant for provinces	-6	-12	-19	-37
Transport	**-13**	**-14**	**-14**	**-41**
Provincial roads maintenance	-13	-14	-14	-41
Total	**-268**	**-538**	**-916**	**-1 722**

Table W1.21 shows the revisions to provincial conditional grants, which provide for technical, policy and inflation adjustments. After accounting for the savings shown in Table W1.20 and shifts from provincial conditional grants, net revisions to conditional grant baseline allocations (a reduction of R8.6 million in 2013/14 and increases of R1.5 billion in 2014/15 and R6.6 billion in 2015/16, or a net increase of R8.2 billion over the MTEF) bring the new conditional grant baselines to R76.6 billion in 2013/14, R81.8 billion in 2014/15 and R90.7 billion in 2015/16.

Table W1.21 Revisions to conditional grant baseline allocations, 2013/14 – 2015/16

R million	2013/14	2014/15	2015/16	2013 MTEF
Technical revisions	**-5 583**	**-7 396**	**-7 635**	**-20 614**
Basic Education	**533**	**–**	**–**	**533**
Education infrastructure[1]	533	–	–	533
Health	**-1 098**	**-2 100**	**-2 120**	**-5 318**
Health infrastructure	-1 296	-1 219	-1 326	-3 841
Hospital revitalisation	-3 752	-3 424	-3 564	-10 740
Nursing colleges and schools	-76	-95	-98	-269
Rescheduled to:				
Health facility revitalisation	5 124	4 739	4 988	14 850
Health infrastructure[2]	-401	-563	-563	-1 527
Hospital revitalisation[2]	-332	-1 012	-1 002	-2 346
National health insurance[2]	-291	-420	-444	-1 155
Nursing colleges and schools[2]	-74	-105	-111	-290
Higher Education and Training	**-2 966**	**-3 128**	**-3 248**	**-9 342**
Further education and training colleges[3]	-2 966	-3 128	-3 248	-9 342
Public Works	**-2 052**	**-2 168**	**-2 267**	**-6 487**
Devolution of property rate funds[4]	-2 052	-2 168	-2 267	-6 487
Additions to baseline[5]	**260**	**2 083**	**7 558**	**9 901**
Arts and Culture	**–**	**385**	**680**	**1 064**
Community library services	–	385	680	1 064
Basic Education	**–**	**1 191**	**4 101**	**5 292**
Education infrastructure	–	1 191	4 101	5 292
Health	**–**	**100**	**1 184**	**1 284**
Comprehensive HIV and Aids	–	100	1 184	1 284
Higher Education and Training	**91**	**110**	**130**	**331**
Further education and training colleges	91	110	130	331
Human Settlements	**–**	**110**	**1 040**	**1 150**
Human settlements development	–	110	1 040	1 150
Transport	**169**	**187**	**424**	**780**
Provincial roads maintenance	169	187	424	780
Total additions to baseline	**260**	**2 083**	**7 558**	**9 901**
Less: Savings effected on conditional grants	-268	-538	-916	-1 722
Net additions to baselines	**-9**	**1 545**	**6 642**	**8 178**

1. Conversion from school backlogs grant
2. Rescheduled to national health grant (indirect grant)
3. Subsidy portion transferred to national department
4. Rescheduled to provincial equitable share
5. Additions come from reprioritisation and policy reserve

Table W1.22 provides a summary of conditional grants by sector for the 2013 MTEF. More detailed information, including the framework and allocation criteria for each grant, is provided in Annexure W2 of the 2013 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 grant's audited outcomes for 2011/12 and any other material issues to be addressed.

Table W1.22 Conditional grants to provinces, 2012/13 – 2015/16

R million	2012/13	2013/14	2014/15	2015/16	MTEF total
Agriculture, Forestry and Fisheries	**1 925**	**2 147**	**2 194**	**2 294**	**6 635**
Comprehensive agricultural support programme	1 393	1 600	1 665	1 742	5 007
Ilima/Letsema projects	416	438	461	482	1 381
Land care programme: poverty relief and infrastructure development	116	109	68	71	248
Arts and Culture	**565**	**598**	**1 016**	**1 341**	**2 955**
Community library services	565	598	1 016	1 341	2 955
Basic Education	**10 990**	**12 343**	**13 188**	**16 350**	**41 882**
Dinaledi schools	100	105	111	116	333
Education infrastructure	5 587	6 631	7 161	10 059	23 851
HIV and Aids (life skills education)	203	214	221	226	661
National school nutrition programme	4 906	5 173	5 462	5 704	16 339
Technical secondary schools recapitalisation	194	221	233	244	699
Cooperative Governance and Traditional Affairs	**180**	**188**	**197**	**204**	**590**
Provincial disaster	180	188	197	204	590
Health	**26 073**	**27 517**	**29 610**	**32 083**	**89 210**
Africa Cup of Nations 2013: medical services	15	–	–	–	**–**
Comprehensive HIV and Aids	8 763	10 534	12 311	13 957	36 802
Health facility revitalisation	6 191	5 124	4 739	4 988	14 850
Health professions training and development	2 076	2 190	2 322	2 429	6 941
National tertiary services	8 878	9 620	10 168	10 636	30 425
National health insurance	150	49	70	74	192
Higher Education and Training	**4 845**	**2 443**	**2 600**	**2 759**	**7 802**
Further education and training colleges	4 845	2 443	2 600	2 759	7 802
Human Settlements	**15 726**	**16 984**	**17 918**	**19 667**	**54 569**
Human settlements development	15 726	16 984	17 918	19 667	54 569
Public Works	**2 429**	**613**	**644**	**667**	**1 925**
Devolution of property rate funds	1 919	–	–	–	–
Expanded public works programme integrated grant for provinces	293	356	371	382	1 108
Social sector expanded public works programme incentive for provinces	217	258	273	286	816
Sport and Recreation South Africa	**470**	**498**	**526**	**550**	**1 573**
Mass participation and sport development	470	498	526	550	1 573
Transport	**12 299**	**13 249**	**13 909**	**14 777**	**41 934**
Provincial roads maintenance	7 982	8 696	9 126	9 774	27 596
Public transport operations	4 317	4 553	4 783	5 003	14 338
Total	**75 500**	**76 580**	**81 803**	**90 692**	**249 075**
Indirect transfers	**1 277**	**3 060**	**5 269**	**5 032**	**13 361**
Basic Education	**1 277**	**1 956**	**3 170**	**2 912**	**8 038**
School infrastructure backlogs	1 277	1 956	3 170	2 912	8 038
Health	**–**	**1 104**	**2 100**	**2 120**	**5 324**
2014 African Nations Championship health and medical services	–	6	–	–	6
National health	–	1 098	2 100	2 120	5 318

Agriculture grants

The *comprehensive agricultural support programme* aims to support newly established and emerging farmers. This grant includes the extension recovery programme, which focuses on improving extension services through training programmes and providing equipment for extension officers. The grant also aims to expand farm infrastructure and provide support for dipping, fencing and rehabilitation of viable irrigation schemes. The 2012 Budget allocated a total of R995 million to this conditional grant over the MTEF to repair flood damage to agricultural infrastructure in January and February 2011. The remaining allocations of R299 million and R298 million are already within the baselines for 2013/14 and 2014/15 and provinces are expected to continue allocating the funds towards these disaster recovery projects. The grant amounts to R5 billion over the 2013 MTEF.

The *land care programme grant: poverty relief and infrastructure development* aims to improve productivity and sustainable use of natural resources. Provinces are encouraged to use this grant to create jobs through the expanded public works programme. Over the medium term, R248 million is allocated to this grant.

The *Ilima/Letsema projects grant* is intended to boost food production by assisting previously disadvantaged farming communities. After the Department of Agriculture, Forestry and Fisheries has tested the new approach, it will make this grant subject to the standard operating procedure for farmer support. This grant is allocated R1.4 billion over the MTEF.

Arts and culture grant

The *community library services grant*, administered by the Department of Arts and Culture, aims to help South Africans access knowledge and information, so that their socioeconomic situation can be improved. 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 will receive additions of R385 million in 2014/15 and R680 million in 2015/16 to enhance capacity in the sector, address issues arising from the function shift and provide for dual-purpose libraries where needed. The total grant amounts to R3 billion over the next three years.

Basic education grants

The *education infrastructure grant* is used by provinces for maintenance, refurbishment and the construction of new education infrastructure and schools. This grant will receive additions of R1.2 billion in 2014/15 and R4.1 billion in 2015/16 to improve the delivery of school infrastructure in provinces. This brings the grant total to R23.9 billion over the MTEF, which includes R159 million previously allocated for 2013/14 to repair school infrastructure damaged by floods in 2011. The infrastructure conditional grants are being reformed and incentives will be introduced to promote improved performance. This grant, together with the *health facility revitalisation grant*, will be the first grants to form part of this new approach. These reforms are discussed in more detail in part 6 of this annexure.

The *national school nutrition programme* seeks to improve the nutrition of poor school children, enhance active learning capacity and improve attendance in schools. This grant is allocated R16.3 billion over the MTEF.

The *technical secondary schools recapitalisation grant* provides for equipment and facilities in technical high schools. Provision is made for this grant to extend to 2015/16 in response to the growing need to recapitalise technical schools identified in provincial needs assessments. This grant is allocated R699 million over the MTEF.

The *Dinaledi schools grant*, started in 2011/12, supports Dinaledi schools to improve the quality of learner performance in mathematics, physical science, life sciences and first additional language English, in line with the Action Plan to 2014. Dinaledi schools are schools in disadvantaged communities that perform well in mathematics and physical science. The grant is allocated R333 million over the MTEF.

The *HIV and Aids (life skills) programme grant* provides for life skills training, sexuality and HIV and Aids education in primary and secondary schools. It is fully integrated into the school system, with learner and teacher support material provided for Grade 1 to 9. This grant is allocated R661 million over the MTEF.

The s*chools infrastructure backlogs grant* is an indirect grant to provinces introduced in 2011 as a short-term, high-impact grant to address backlogs in inappropriate structures and access to basic services. The grant's funds have been rescheduled to align the baseline with capacity to spend. An amount of R2.5 billion is shifted from 2013/14 to 2015/16. A reprioritisation of R1.7 billion over the MTEF is also effected to make resources available for the construction of new universities in Mpumalanga and the Northern Cape as part of the SIPs identified by the Presidential Infrastructure Coordinating Committee; the *community library services grant,* which provides a complementary service to education; and the *education infrastructure grant*. The grant now amounts to R8 billion over the 2013 MTEF.

Cooperative governance grant

The *provincial disaster grant* is administered by the National Disaster Management Centre in the Department of Cooperative Governance as an unallocated grant to provincial government at the start of the financial year. The grant allows for an immediate (in-year) release of funds to be disbursed by the National Disaster Management Centre after a disaster is declared, without the need for the transfers to first be gazetted. Over the MTEF, R590 million is available for disbursement through this grant.

Health grants

The *national tertiary services grant* provides 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. These provinces 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. This grant is allocated R30.4 billion over the MTEF.

The *health facility revitalisation grant* funds the construction and maintenance of health infrastructure. This grant has been created through the merger of three previous grants: the *health infrastructure grant*, the *hospital revitalisation grant* and the *nursing colleges and schools grant*, which are now three components within the merged grant. The combination gives greater flexibility to the Department of Health to shift funds between the three grant components, with the approval of the National Treasury, so that they can avoid under- or overspending in any one area of health infrastructure. This grant is supported by the *national health grant*. The three components of the grant are:

- Health infrastructure – Funds general maintenance and infrastructure needs at smaller hospitals and clinics. The National Treasury and the Department of Health have joint capacity-building programmes funded through this grant to support provinces' best-practice planning and project implementation. The grant will be part of the first phase of infrastructure reforms (discussed in part 6 of this annexure), which will introduce incentives in the funding and delivery of infrastructure to improve planning and procurement practices in line with the infrastructure delivery management system and best practices by the Construction Industry Development Board. This component is allocated R3.8 billion over the MTEF.
- Hospital revitalisation – Supports large projects that modernise hospital infrastructure and equipment. It is allocated R10.7 billion over the MTEF.
- Nursing colleges and schools – Funds the refurbishment and upgrading of nursing colleges and schools. The Department of Health will play a more active role in the planning, packaging and procurement of projects funded through this window than it does in other infrastructure grants. It is allocated R269 million over the next three years.

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. It is allocated R6.9 billion over the medium term.

The *comprehensive HIV and Aids grant* enables the health sector to develop a response to HIV and Aids. The grant supports prevention programmes and specific interventions, including voluntary counselling and testing, prevention of mother-to-child transmission, post-exposure prophylaxis, antiretroviral treatment and home-based care. In addition to substantial increases to this grant and the provincial equitable share over the previous three MTEF periods for HIV and Aids programmes, the grant is allocated an additional R100 million in 2014/15 and R1.2 billion in 2015/16 to cover the increased antiretroviral treatment take-up rate and the impact of the withdrawal of the Presidential Emergency Plan for Aids Relief donor funding used for HIV and Aids prevention, care and treatment programmes within this grant. This brings the baseline over the MTEF to R36.8 billion.

The *national health insurance grant* funds national health insurance pilots introduced in 2012/13. These projects aim to strengthen primary health care for the implementation of national health insurance. Ten districts have been selected as pilot sites to test interventions that aim to strengthen health systems and improve performance. Over the 2013 MTEF, the grant has been allocated R192 million. This grant is complemented by the national health insurance window within the *national health grant*.

The *national health grant* is a new indirect grant introduced in 2013/14 that will be spent by the Department of Health on behalf of provinces. The grant has two components, one to support infrastructure projects and the second to support the national health insurance scheme pilot sites. The infrastructure component will be used to accelerate construction, maintenance, upgrading and rehabilitation of new and existing health infrastructure and to supplement expenditure on infrastructure delivered through public-private partnerships. The second component will be used to contract general practitioners from the private sector for national health insurance sites. It will also support 10 central hospitals to strengthen their patient information systems and develop and pilot alternative hospital reimbursement tools. The grant is allocated R5.3 billion over the MTEF.

The *2014 African Nations Championship health and medical services grant* will be introduced as an indirect grant for 2013/14 only, to support provinces hosting the 2014 African Nations Championship. This grant will be spent by the Department of Health in support of provinces providing medical services for the tournament. The grant has a value of R6 million in 2013/14.

Higher education and training grant

The *further education and training colleges grant* was introduced in 2010/11 to protect provincial spending on these colleges while the legislative processes required to shift this function to national government are completed. From 2013/14, a portion of the grant will be transferred directly to colleges as a subsidy, which will now flow from the Department of Higher Education and Training. The grant baselines over the MTEF have also been revised to accommodate this decision. In addition, an amount of R138 million in 2013/14, R178 million in 2014/15 and R243 million in 2015/16 is added to the grant to cover the cost of wage agreements, bringing the total value of this grant to R7.8 billion.

Human settlements grant

The *human settlements development grant* seeks to establish habitable, stable and sustainable human settlements in which all citizens have access to social and economic amenities. The human settlements function will be assigned to six metropolitan municipalities, with the assignment target date being the start of the municipal financial year (1 July 2013). From the date of assignment, funds for the *human settlement development grant* for these municipalities will be transferred directly to them. As the function has not yet been assigned, the funds for these cities are still reflected in the allocations to provinces. However, provisions in the 2013 Division of Revenue Bill will allow these funds to be transferred directly to cities once assignment takes place. Additional funding of R110 million in 2014/15 and R1 billion in 2015/16 is allocated to upgrade informal settlements in rapidly urbanising mining towns, in support of the SIPs. An amount of R299 million is included in the existing baseline, added in the previous MTEF for the repair of infrastructure damaged by floods. The grant amounts to R54.6 billion over the MTEF.

The formula used to allocate the *human settlements development grant* will be reviewed during 2013, resulting in new allocations. To provide scope for this change, while still providing some degree of planning certainty over the MTEF, only half of the funds for 2014/15 and 2015/16 have been indicatively allocated among provinces in the schedules of the Division of Revenue Bill. The remaining funds will be allocated once the revised formula is in place.

Public works grants

The *expanded public works programme integrated grant for provinces* was revised last year to be a schedule 5A grant. Allocations are now made available upfront based on meeting job targets in the preceding financial year rather than the in-year performance measures used previously. Transfers depend on provincial departments reporting on jobs created through the expanded public works programme and implementing labour-intensive projects. This grant is allocated R1.1 billion over the MTEF.

The *social sector expanded public works programme incentive grant for provinces* rewards provinces for creating jobs in the preceding financial year in the areas of home-based care and early childhood development, adult literacy and numeracy, community safety and security, and sports programme services. This grant is allocated R816 million over the MTEF.

Sport and recreation South Africa grant

The *mass participation and sport development grant* aims to increase and sustain mass participation in sport and recreational activities in provinces. This grant is allocated R1.6 billion over the MTEF.

Transport grants

The *public transport operations grant* subsidises commuter bus services. It allows national government to ensure that contractual obligations are met and services are efficiently provided. The public transport contracting and regulatory functions may be assigned to certain metropolitan municipalities during 2013/14. If this takes place, funds for this grant will be transferred directly to the assigned municipality. The grant is allocated R14.3 billion over the MTEF.

The *provincial roads maintenance grant* consists of three components. The largest component enables provinces to expand their maintenance activities. The other components allow provinces to repair roads damaged by floods and cover the cost of rehabilitation work created by coal haulage activities in Mpumalanga and Gauteng. Allocations for this grant are determined through a new formula based on provincial road networks, road traffic and weather conditions. These factors reflect the different costs of maintaining road networks in each province. Allocations will also depend on satisfactory use of the road asset management systems from 2013/14. The grant requires provinces to follow best practices for planning and to use and regularly update road asset management systems. From 2015/16, the grant will be based on performance. During 2013/14, the Department of Transport will finalise the indicators – probably vehicle operating costs and remaining asset lifespan – and the performance component to inform grant allocations. Additional allocations of R169 million in 2013/14, R187 million in 2014/15 and R424 million in 2015/16 are added to the grant for road maintenance, bringing the total allocation to R27.6 billion over the MTEF. This includes amounts of R368 million and R367 million in the first two years of the 2013 MTEF allocated in the 2012 Budget for the repair of infrastructure damaged by floods in January and February 2011. Amounts of R809 million in 2013/14, R803 million in 2014/15 and R840 million in 2015/16 are allocated to repair roads damaged by coal haulage.

In addition to these grants, R450 million was allocated in the 2012 Adjustment Appropriation Act to provide for the upgrading of the Mthatha airport. The Department of Transport paid for the upgrade, but as the airport is an asset of the Eastern Cape provincial government, the province will benefit from this expenditure once the work is completed in 2013/14.

Part 5: Local government fiscal framework and allocations

The local government fiscal framework responds to the constitutional assignment of powers and functions to this sphere of government. The framework refers to all resources available to municipalities to meet their expenditure responsibilities. National transfers account for a relatively small proportion of the local government fiscal framework, with the majority of local government revenues being raised by municipalities themselves through their substantial revenue-raising powers, including property rates and service charges. However, the proportion of revenue coming from transfers and own revenues varies dramatically across municipalities, with poor rural municipalities receiving most of their revenue from transfers, while urban municipalities raise the majority of their own revenues. This differentiation in the way municipalities are funded will continue in the period ahead.

In the 2013 MTEF, a number of significant changes are being introduced to the way funds are allocated among municipalities. The two largest transfers to municipalities, the equitable share and the *municipal infrastructure grant*, are allocated among municipalities based on census data. The release of the 2011 Census results means that the formulas used for both these allocations have been updated. In addition, the formula used to allocate the local government equitable share has been reviewed and redesigned. Four new conditional grants are also being introduced to:

- Increase access to clean water
- Help cities develop more integrated and efficient patterns of urban development
- Subsidise the operating costs of cities running new public transport networks
- Support the host cities of the 2014 African Nations Championship (this is a once-off grant).

It is also likely that human settlements and public transport functions will be assigned to selected metropolitan municipalities during 2013/14. This will result in the funds for these functions – currently allocated to provinces and described in part 4 of this annexure – being transferred directly to municipalities.

This section outlines the transfers 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. National transfers to municipalities are published to enable them to plan fully for their 2013/14 budgets, and to promote better accountability and transparency by ensuring that all national allocations are included in municipal budgets.

Changes to local government allocations

Given the constrained and uncertain economic outlook, government will use savings from existing baselines to fund government priorities. As a result, the baselines of most conditional grants have been revised downward. Table W1.23 shows the savings made on local government conditional grants to make resources available. No savings were made on the local government equitable share.

Table W1.23 Savings effected on direct and indirect transfers to local government, 2013/14 – 2015/16

R million	2013/14	2014/15	2015/16	2013 MTEF Total revisions
Direct conditional grants	**-36**	**-292**	**-414**	**-742**
Infrastructure transfers	**–**	**-211**	**-349**	**-560**
Urban settlements development grant	–	-211	-331	-542
Neighbourhood development partnership grant	–	–	-18	-18
Recurrent transfers	**-36**	**-81**	**-64**	**-182**
Energy efficiency and demand-side management grant	-19	-45	-7	-71
Municipal disaster grant	-4	-7	-12	-23
Municipal systems improvement grant	-2	-5	-8	-16
Expanded public works programme integrated grant for municipalities	-11	-24	-37	-72
Indirect conditional grants	**-489**	**-221**	**-229**	**-939**
Integrated national electrification programme	-33	-36	-38	-106
Rural households infrastructure grant	-282	–	–	-282
Water services operating subsidy	-174	-186	-192	-551
Total	**-525**	**-513**	**-643**	**-1 681**

Table W1.24 outlines all of the technical revisions and additions to local government allocations for the 2013 MTEF.

Table W1.24 Revisions to direct and indirect transfers to local government, 2013/14 – 2015/16

R million	2013/14	2014/15	2015/16	2013 MTEF Total revisions
Technical adjustments	**-82**	**-289**	**37**	**-334**
Direct transfers	**25**	**-289**	**37**	**-227**
Municipal infrastructure grant	-291	-1 259	-1 273	-2 823
Municipal water infrastructure grant	291	946	1 273	2 510
Public transport infrastructure grant	-881	-745	-862	-2 488
Public transport network operations grant	881	745	862	2 488
Infrastructure skills development grant	-2	-2	-2	-5
Expanded public works programme integrated grant for municipalities	-80	-88	-80	-248
Rural households infrastructure grant	107	113	118	338
Indirect transfers	**-107**	**–**	**–**	**-107**
Rural households infrastructure grant	-107	–	–	-107
Additions to baselines	**1 278**	**3 010**	**9 859**	**14 147**
Direct transfers	**805**	**1 454**	**6 966**	**9 225**
Equitable share	–	851	4 561	5 413
Municipal water infrastructure grant	312	113	1 399	1 824
Municipal infrastructure grant	–	179	231	410
Integrated national electrification programme	320	77	500	897
Infrastructure skills development grant	–	50	70	120
Integrated city development grant	40	150	150	340
2014 African Nations Championship host city operating grant	120	–	–	120
Rural roads asset management systems grant	13	34	54	101
Indirect transfers	**473**	**1 556**	**2 892**	**4 922**
Neighbourhood development partnership grant	–	–	4	4
Integrated national electrification programme	191	425	1 522	2 139
Regional bulk infrastructure grant	282	1 131	1 366	2 779

Due to the cumulative effect of the savings to fund national priorities, technical revisions and additions to baselines, the value of transfers to local government increases by R12.1 billion over the MTEF. Of this, R8.2 billion is added to direct transfers and R3.9 billion will be spent by national departments as indirect transfers.

Table W1.25 Net changes to direct and indirect transfers to local government, 2013/14 – 2015/16

R million	2013/14	2014/15	2015/16	2013 MTEF total revisions
Total of revisions to baselines	**1 196**	**2 721**	**9 896**	**13 813**
Direct transfers	830	1 165	7 003	8 998
Indirect transfers	366	1 556	2 892	4 815
Less				
Total savings to fund government priorities	**-525**	**-513**	**-643**	**-1 681**
Direct transfers	-36	-292	-414	-742
Indirect transfers	-489	-221	-229	-939
Net additions to baselines	**671**	**2 208**	**9 253**	**12 131**
Direct transfers	793	873	6 590	8 256
Indirect transfers	-123	1 335	2 663	3 875

Transfers to local government

Over the 2013 MTEF, R277.7 billion will be transferred directly to local government and a further R21.5 billion has been allocated to indirect grants. Direct transfers to local government in 2013/14 account for 8.9 per cent of national government's non-interest expenditure. When indirect transfers are added to this, total spending on local government rises to 9.5 per cent of national non-interest expenditure. The value of direct transfers to local government grows at an average annual rate of 9.9 per cent over the MTEF. This is significantly above projected inflation, but lower than the rapid growth in transfers between 2001/02 and 2011/12 – when the value of direct transfers to local government grew from R6.5 billion to R68.3 billion, with an average annual growth rate of 27.2 per cent.

Table W1.26 Transfers to local government, 2009/10 – 2015/16

R million	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
		Outcome		Revised estimate		Medium-term estimates	
Direct transfers	**51 537**	**60 904**	**68 251**	**77 028**	**84 651**	**91 579**	**101 469**
Equitable share and related	**23 845**	**30 541**	**33 173**	**37 373**	**40 582**	**44 490**	**50 208**
Equitable share formula[1]	20 281	26 761	29 289	32 981	35 886	39 409	44 900
RSC levy replacement	3 306	3 492	3 544	3 733	3 930	4 146	4 337
Support for councillor remuneration and ward committees	258	288	340	659	766	935	971
General fuel levy sharing with metros	**6 800**	**7 542**	**8 573**	**9 040**	**9 613**	**10 190**	**10 659**
Conditional grants	**20 893**	**22 822**	**26 505**	**30 615**	**34 456**	**36 899**	**40 603**
Infrastructure	18 699	20 871	24 643	28 029	31 092	33 548	36 971
Capacity building and other	2 194	1 951	1 862	2 586	3 364	3 351	3 632
Indirect transfers	**3 081**	**2 939**	**2 770**	**4 956**	**5 538**	**7 171**	**8 768**
Infrastructure	2 763	2 682	2 553	4 823	5 399	7 029	8 617
Capacity building and other	318	257	217	133	139	142	151
Total	**54 618**	**63 843**	**71 021**	**81 984**	**90 190**	**98 751**	**110 237**

1. Outcome figures for the equitable share reflect amounts transferred after funds have been withheld to offset underspending by municipalities on conditional grants

The local government equitable share

In terms of section 227 of the Constitution, local government is entitled to an equitable share of nationally raised revenue to enable it to provide basic services and perform its allocated functions. The local government equitable share is an unconditional transfer that supplements the income that municipalities can raise from the sources of own revenues available to them (including property rates and service charges). The equitable share provides funding for municipalities to deliver free basic services to poor households and subsidises the cost of administration and other core services for those municipalities that have the least potential to cover these costs from their own revenues.

Over the 2013 MTEF, the local government equitable share, including the *RSC/JSB levies replacement grant* and *special support for councillor remuneration and ward committees,* is worth R135.3 billion – R40.6 billion in 2013/14, R44.5 billion in 2014/15 and R50.2 billion in 2015/16.

Review of the equitable share formula

The share of national revenue allocated to local government through the equitable share is determined in the national budget process and endorsed by Cabinet (the vertical division). Local government's equitable share is divided among the country's 278 municipalities using a formula (the horizontal division).

During 2012, the National Treasury, the Department of Cooperative Governance and SALGA, in partnership with the FFC and Statistics South Africa, reviewed the local government equitable share formula. The review did not include a review of the *RSC/JSB levies replacement grant* or the *special support for councillor remuneration and ward committees*, both of which are transferred with the equitable share, but calculated separately. The review proposed an improved structure for the formula, but did not make recommendations about the vertical division of revenue (total transfers to local government), as this is a decision made separately as part of the budget process.

The review was conducted in three phases. In the first phase, the formula's principles and objectives were reviewed and proposed revisions were presented to, and broadly welcomed by, municipalities during a series of consultations in May and June 2012. In the second phase, these revised principles and objectives (following the consultations) were used to formulate a proposal for a new structure for the formula. This was presented to municipalities in a discussion paper and at a workshop held in September 2012. The proposed structure was generally accepted by municipalities and was endorsed by the Budget Forum in October 2012. In the third phase, the review team constructed the new formula using data from the 2011 Census results, taking into account comments and proposals from municipalities where possible. The new formula and allocations were endorsed by the Budget Forum on 7 February 2013 and by Cabinet on 13 February 2013.

Principles of the local government equitable share formula

Following the first round of consultations with municipalities, it was agreed that the following principles should underpin the new local government equitable share formula. These principles were endorsed at a meeting of the Budget Forum on 8 October 2012.

The local government equitable share formula must:

1. *Be objective and fair* – Municipalities with similar characteristics must be treated in the same way by the formula and the formula design must be immune to subjective adjustments to favour a particular municipality.
2. *Be dynamic and able to respond to changes* – The formula must be capable of taking account of significant changes in the objective circumstances of municipalities, enable the smooth updating of data and be able to respond to policy changes.
3. *Recognise diversity among municipalities* – The formula should take account of the different characteristics of municipalities and funds allocated for a particular function must go to the municipality officially authorised to perform that function (the local government equitable share will not fund municipalities for services that are the competency of other spheres).
4. *Only use high-quality, verifiable and credible data* – Official, up-to-date data should be used wherever possible. Data must not be manipulated (this does not preclude the use of credible estimates and projections) and fair average cost estimates for basic services should be used (including maintenance costs).
5. *Be transparent and simple* – The formula and information about how allocations are derived must be transparent and available to municipalities and the general public. The simpler the formula is, the more people will be able to engage with it. Local municipalities must remain accountable to their residents for resources they use, including transfers received.
6. *Provide for predictability and stability* – Municipalities should be provided with a degree of certainty about their future allocations to enable them to plan and budget effectively.

Objectives of the local government equitable share formula

The following objectives of the new local government equitable share formula were agreed upon following the first round of consultations with municipalities. These objectives were also endorsed at a meeting of the Budget Forum on 8 October 2012:

1. *Enable municipalities to provide basic services to poor households*

   The local government equitable share should:

   - Supplement municipal budgets so that an efficient municipality will be able to progressively provide free basic services to its poor households in line with national policy norms and standards.
   - Assist with the operational costs (including maintenance costs) of basic services for poor households. Capital costs should be funded through conditional grants, own revenues and borrowing.
   - Support municipalities to create the foundation for economic growth through the sustainable provision of municipal functions.
   - Reflect that maintenance should be budgeted for as part of the operational costs of service delivery.
   - Promote the efficient delivery of services and not penalise efficient alternative modes of service delivery.
   - Create positive incentives for municipalities that roll out services to reach more households.

2. *Enable municipalities with limited own resources to afford basic administrative and governance capacity and perform core municipal functions*

   The local government equitable share should:

   - Provide funding to enable resource-poor municipalities to afford a basic level of administrative and governance capacity.
   - Provide funding towards the cost of performing essential functions in municipalities with limited own-revenue bases.
   - Recognise the ability of certain municipalities to cross-subsidise the delivery of administrative and other essential municipal services from their own revenue.
   - Take account of the different levels of fiscal capacity in municipalities, without rewarding inefficiency.
   - Ensure that allocations do not crowd out municipal own-revenue-raising efforts and the revenue-accountability link that the collection of these revenues creates.

Structure of the local government equitable share formula

The formula uses demographics and other data to determine each municipality's share of the local government equitable share. It has three parts, made up of five components:

- The first part of the formula consists of the *basic services component*, which provides for the cost of free basic services for poor households.
- The second part enables municipalities with limited own resources to afford basic administrative and governance capacity and perform core municipal functions. It does this through three components:
  - The *institutional component* provides a subsidy for basic municipal administrative costs.
  - The *community services component* provides funds towards the provision of core municipal services not included under basic services.
  - The *revenue adjustment factor* ensures that funds from this part of the formula are only provided to municipalities with limited potential to raise own revenues. Municipalities the least able to fund these costs from their own revenues should receive the most funding.
- The third part of the formula provides predictability and stability through a *correction and stabilisation factor*, which ensures that all of the formula's guarantees can be met.

Each of these components is described in detail in the subsections that follow, while the structure of the formula is summarised in the box below.

Structure of the local government equitable share formula

LGES = BS + (I + CS)xRA ± C

where

LGES is the local government equitable share

BS is the basic services component

I is the institutional component

CS is the community services component

RA is the revenue adjustment factor

C is the correction and stabilisation factor

The basic services component

This component helps municipalities provide free basic water, sanitation, electricity and refuse removal services to households that fall below an affordability threshold. During the consultation process it emerged that municipalities would prefer the formula's affordability measure (used to determine how many households should be targeted for free basic services) to be based on the level of two state old age pensions. When the 2011 Census was conducted, the state old age pension was worth R1 140 per month, two old age pensions were therefore worth R2 280 per month. A monthly household income of R2 300 per month has therefore been used to define the formula's affordability threshold. Statistics South Africa has calculated the number of households in each municipality that fall below this income level in the 2011 Census. The basic services component provides a subsidy of R278 per month in 2013/14 for the cost of providing basic services to each of these households. The allocation to each municipality is calculated by multiplying this monthly subsidy by the number of households below the affordability threshold in each municipal area.

The free basic services subsidy includes funding for the provision of free basic water (6 kilolitres per poor household per month), energy (50 kilowatt-hours per month) and sanitation and refuse (based on service levels defined by national policy). The monthly amount provided for each service is detailed in Table W1.27 and includes an allocation of 10 per cent towards the maintenance costs of providing the service.

Table W1.27 Amounts per basic service allocated through the local government equitable share

	Allocation per household below affordability threshold (Rands)			Total allocation per service (R millions)
	Operations	Maintenance	Total	
Energy	50.66	5.63	56.29	5 719
Water	77.80	8.64	86.45	8 783
Sanitation	64.84	7.20	72.04	7 319
Refuse	54.35	6.04	60.39	6 136
Total basic services	**247.65**	**27.52**	**275.17**	**27 957**

The formula uses the fairest estimates of the average costs of providing each service that could be derived from available information. These cost estimates do not account for municipalities' different circumstances as there are no credible ways of estimating the cost pressures in each municipality. By using generous estimates for each of the four services, municipalities should receive sufficient funds to provide the full basket of free basic services to their poor households. More details of how the cost estimates were arrived at can be found in the discussion paper on the proposed structure of the new local government equitable share formula (available at the following address: http://mfma.treasury.gov.za/Media_Releases/LGESDiscussions/Pages/default.aspx).

Unlike the previous formula, which provided a lower subsidy for households without access to services, this formula provides the same basic services subsidy for all poor households. Funding for each basic service is allocated to the municipality (metro, district or local) that is authorised to provide that service. If another municipality provides a service on behalf of the authorised municipality, it should transfer funds to the provider in terms of section 28 of the Division of Revenue Act.

The previous local government equitable share formula used a household income level of R800 per month in terms of the 2001 Census to define the affordability threshold for funding free basic services. About 47 per cent of all households were below this threshold in 2001. Adjusting for the effects of inflation between 2001 and 2011, an income of R800 per month in 2001 would be worth about R1 500 in 2011. The new affordability threshold of R2 300 per month is substantially higher in real terms. As a result, more households (59 per cent) fall below this threshold in the new formula. This threshold is based on inputs from municipalities and should not be taken as an official poverty line or as a required level to be used by municipalities in their own indigence policies. However, if municipalities choose to provide fewer households with free basic services than they are funded for through the local government equitable share, then their budget documentation should clearly set out why they have made this choice and how it has been consulted on with their community during their budget process.

The basic services component

BS = basic services subsidy x number of poor households

The basic services component is worth R28 billion in 2013/14 and accounts for 77.9 per cent of the value of the local government equitable share.

The institutional component

To provide basic services to households, municipalities need to be able to run a basic administration. Most municipalities should be able to fund the majority of their administration costs through own revenues, but because poor households will not be able to contribute, the equitable share includes an institutional support component to help meet some of these costs. As this component is intended to assist municipalities with limited own-revenue-raising abilities, a revenue adjustment factor is applied to ensure that a larger proportion of the allocation is received by municipalities with less potential to raise own revenue. The revenue adjustment factor is described in more detail later in this annexure.

This component consists of a base allocation of R5 million that goes to every municipality and an additional amount that is based on the number of council seats in each municipality. This reflects the relative size of a municipality’s administration and is not intended to fund the costs of councillors only (the number of seats recognised for the formula is determined by the Minister of Cooperative Governance and Traditional Affairs for elections and composition). The base component acknowledges that there are some fixed costs that all municipalities face.

The institutional component

*I = base allocation + [allocation per councillor * number of council seats]*

The institutional component accounts for 8.8 per cent of the equitable share formula and is worth R3.2 billion in 2013/14. This component is also complemented by the special support for councillor remuneration to poor municipalities provided outside of the equitable share formula (described in more detail later).

The community services component

This new component funds services for communities rather than households (which are provided for in the basic services component). It includes funding for municipal health services, fire services, municipal roads, cemeteries, planning, storm water, street lighting, parks and so on. As this component is intended to assist municipalities with limited own-revenue-raising abilities, a revenue adjustment factor is applied to ensure that a larger proportion of the allocation is received by municipalities with less potential to raise own revenue. The revenue adjustment factor is described in more detail later in this annexure.

The allocation for this component is split between district and local municipalities, as both provide community services. In 2013/14, the allocation to district and metropolitan municipalities for municipal health and related services is R7 per household per month. The component's remaining funds are allocated to local and metropolitan municipalities based on the number of households in each municipality.

The community services component

CS = [municipal health and related services allocation x number of households] + [other services allocation x number of households]

The community services component accounts for 13.3 per cent of the equitable share formula and is worth R4.8 billion in 2013/14.

The revenue adjustment factor

The Constitution gives local government substantial own-revenue-raising powers (particularly through property rates and surcharges on services). Municipalities are expected to fund much of their own administrative costs and cross-subsidise some services for indigent residents. Given the different levels of poverty across South Africa, the formula does not expect all municipalities to be able to generate similar amounts of own revenue. A revenue adjustment factor is applied to the institutional and non-trading services components of the formula to ensure that these funds assist municipalities that are least likely to be able to fund these functions from their own revenues.

To account for the varying fiscal capacities of municipalities, this component is based on a per capita index using the following factors from the 2011 Census:

- Total income of all individuals/households residing in a municipality (as a measure of economic activity and earning)
- Reported property values
- Number of households on traditional land
- Unemployment rate
- Proportion of poor households as percentage of total number of households in the municipality.

To create an index from these factors, a regression was run to determine to what extent each of these factors correlated with the ability of municipalities to collect own revenue from property rates in 2009/10 and 2010/11 (recorded in their audited budget figures). Based on this analysis, each factor was given a weighting and an index was calculated based on what these factors predict about the potential for municipalities to collect own revenue in future. Based on this index, municipalities were ranked from highest per capita revenue-raising potential to the lowest. The top 10 per cent of municipalities on this list have a revenue adjustment factor of zero, meaning that they will receive no allocation from the institutional and non-trading services components when the factor is applied to them. The 25 per cent of municipalities with the lowest scores have a revenue adjustment factor of 100 per cent, which means that they will receive their full allocation from the institutional and non-trading services components. Municipalities between the bottom 25 per cent and top 10 per cent have a revenue adjustment factor applied on a sliding scale so that those with higher per capita revenue-raising potential receive a lower revenue adjustment factor and those with less potential receive a larger revenue adjustment factor.

The revenue adjustment factor is not based on the actual revenues municipalities collect. This component therefore does not create any perverse incentive for municipalities to under-collect potential own revenues to receive a higher equitable share.

As district municipalities do not collect own revenues from property rates, the revenue adjustment factor applied to these municipalities is based on the *RSC/JSB levies replacement grant* allocations. This grant replaces a source of own revenues previously collected by district municipalities. It is still treated as an own-revenue source in many respects. Similar to the revenue adjustment factor for local and metropolitan municipalities, the factor applied to district municipalities is based on their per capita *RSC/JSB levies replacement grant* allocations. The 10 per cent of municipalities with the highest per capita scores receive a revenue adjustment factor of zero, while those with the lowest 10 per cent receive a factor of 100 per cent. District municipalities in between are given revenue adjustment factors on a sliding scale – those with a higher per capita *RSC/JSB levies replacement grant* allocation receive a lower revenue adjustment factor and those with lower allocations receive a larger revenue adjustment factor.

Correction and stabilisation factor

Providing municipalities with predictable and stable equitable share allocations is one of the principles of the equitable share formula. To ensure predictability, indicative allocations are published for the second and third years of the MTEF period. To provide stability for municipal planning, while giving national government flexibility to account for overall budget constraints and the need to amend the formula, municipalities are guaranteed to receive at least 90 per cent of the indicative allocation for the middle year of the MTEF.

With the introduction of the new equitable share formula and the updated 2011 Census data used in the formula, some municipalities will experience large changes in their equitable share allocations. To smooth the impact of these changes and give municipalities time to adjust (both for municipalities with increasing and decreasing allocations), the new allocations will be phased in over five years. For municipalities with smaller allocations under the new formula, the phase-in mechanism will measure the difference between the municipality’s old and new allocations and will close this gap by 20 per cent each year. This means that in the first year, a municipality will only experience a change equivalent to 20 per cent of the gap between their allocations under the old and the new formulas, in the second year they will experience a 40 per cent change, and so on until in the fifth year their allocation is determined entirely through the new formula.

To provide for this phase-in, while staying within the limits of the equitable share envelope, municipalities with larger allocations will also have their increases phased in over five years. The total top-up amount needed to fund the phase-in for municipalities with declining allocations is calculated and deducted from those that do not require a top-up in proportion to their “surplus.” This means that municipalities with larger allocations will have some of those gains delayed over the phase-in period.

Ensuring the formula balances

The formula is structured to ensure that all of the available funds are allocated. The formula automatically determines the value of the allocation per council seat in the institutional component and the allocation per household for other services in the community services component to ensure that it balances. The basic services component is determined by the number of poor households per municipality and the estimated cost of free basic services, so this component cannot be manipulated. This means that the balancing of the formula to the available envelope of resources must take place in the second part of the formula, which includes the institutional and community services components.

Structure of the previous local government equitable share formula

The previous local government equitable share formula is shown below. Like the new formula described above, it has basic services and institutional and correction components. But while the previous formula subtracts a revenue-raising capacity correction from the whole formula, the proposed new formula applies a revenue adjustment factor to the institutional and community services components only. The community services component is a new addition to the formula. The development component in the previous formula has never been activated.

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

C is a correction and stabilisation factor

Updating the formula for future years

One of the major changes introduced in the new formula is that the data underpinning each of the components will be updated annually to reflect changes or estimated changes. The previous formula's demographic information was still based on the 2001 Census and cost of services was based on estimates from the mid-1990s.

In future, the following factors will be updated in the formula:

- The electricity cost estimate is made up of bulk and other costs. Bulk costs will be updated based on the multi-year price determination approved by the National Energy Regulator of South Africa and other costs will be updated based on the National Treasury's inflation projections.
- The water cost estimate is also made up of bulk and other costs. Bulk costs will be updated based on the weighted average increase in bulk tariffs charged by water boards (although not all municipalities purchase bulk water from water boards, their price increases serve as a proxy for the cost increases faced by all municipalities). Other components will be updated based on the National Treasury's inflation projections.
- The cost estimates for other services will be updated based on the National Treasury's inflation projections.
- The base amount for municipal health and related services and the base allocation in the institutional component will also be updated based on the National Treasury's inflation projections.
- The number of households and those falling below the affordability threshold per municipality will be updated each year using average annual household growth in each municipality between the 2001 and 2011 Census. This data will be used to estimate future growth. The estimated total number of households reflected in the formula will be adjusted each year to balance with Statistics South Africa's mid-year population estimate (for the purposes of calculating these estimates, it will be assumed that average household size remains constant in future years). It is assumed that municipalities that experienced negative household growth between 2001 and 2011 will have zero growth in future. The credibility of estimates will be constantly reviewed and this methodology will be updated to reflect any municipal-level population estimates endorsed by Statistics South Africa or any municipal-level survey or census.

For the 2013 MTEF, the indicative allocations for 2014/15 and 2015/16 have been calculated assuming electricity bulk price increases of 16 per cent, water bulk increases of 7.2 per cent, inflation of 5.1 per cent in 2014/15 and 4.9 per cent in 2015/16 and household growth in line with the period between 2001 and 2011. These variables will be updated in future budgets to reflect any changes in the growth in prices or estimates of population growth. Such updates will result in changes to the allocations to municipalities, and indicative allocations for future years will change to reflect adjustments in these variables.

The need to introduce the new formula over a five-year period means that the full impact of the annual updates will be moderated by the phasing-in effect, which will slow the pace of both increases and decreases in the allocations to individual municipalities. This is necessary to avoid any sudden and potentially destabilising changes in allocations.

Potential refinements to the formula

Although the new local government equitable share formula has been through extensive consultations and much technical work, national government is still open to improving the formula's functioning in terms of the agreed principles and objectives. Areas for possible refinement include the introduction of factors to account for the land area and settlement types of municipalities within the community services component (this was an option many municipalities were strongly in favour of during the consultations, but it was not technically feasible for the 2013 formula). The proposal for the new local government equitable share formula included a specific sub-component for fire services within the community services component. These funds were to be allocated to the municipality (district, local or metropolitan) authorised to perform the function. Unfortunately, implementation will have to be delayed as there is no credible and comprehensive database available on this function's assignment.

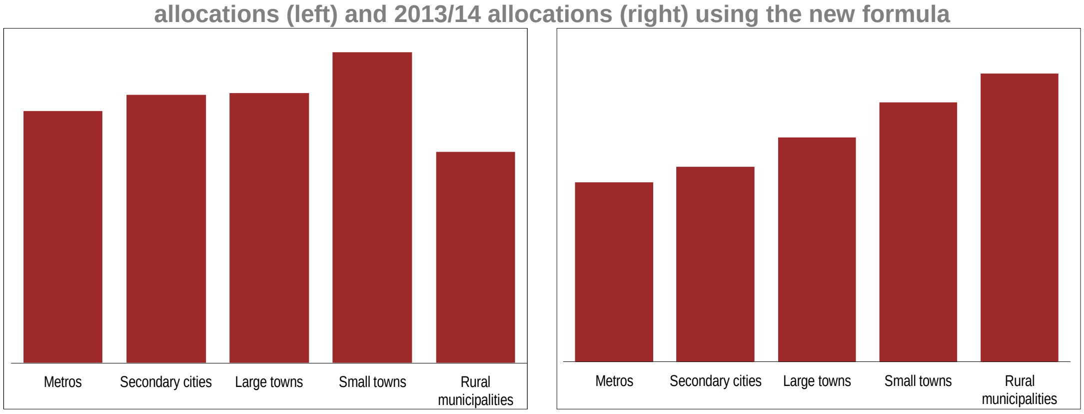
While national government is committed to considering all proposed refinements to the formula, another full review is not envisaged until it has been fully phased in.

Impact of the new formula

The new local government equitable share formula has many advantages. The structure responds directly to the formula's objectives; cost estimates for basic services are more realistic; the broadly accepted poverty measure covers nearly 60 per cent of households in South Africa; institutional funding for poor municipalities is better targeted; there is funding for community services; and the data used to calculate allocations is updated annually.

The new formula also changes the allocations to municipalities. As Figure W1.1 below demonstrates, under the previous equitable share formula the allocations for rural municipalities were the lowest when considered per poor household (comparison is made after adding all funds allocated to district and local municipalities to serve the same area). In the new formula, rural municipalities receive the largest allocations on a per-poor-household basis. As rural municipalities generally struggle to fund their costs from own revenues it is appropriate that they receive stronger support from transfers.

Figure W1.1 Equitable share allocations per poor household for different types of municipalities, 2012/13 allocations (left) and 2013/14 allocations (right) using the new formula



Note: Allocations reflect all funds allocated for services in the area of a municipality, whether those funds are transferred to a district or local municipality. Allocations for 2013/14 are determined through the new formula before the correction and stabilisation component is applied.

The full impact of these changes will not be felt in 2013/14 as the guarantees and phase-in process will keep the new formula's allocations to some municipalities above the determined amount, and funds will be subtracted from allocations to other municipalities to fund these guarantees. The full impact of the new formula will therefore not be felt until 2017/18 when it is fully phased in.

The addition of R5.4 billion to the equitable share over the 2013 MTEF (R851 million in 2014/15 and R4.6 billion in 2015/16) will cover the expected increases in the costs of basic services and provide for additional funds to flow through the institutional and community services components in 2015/16. These additions will further increase the allocations to municipalities with low own-revenue-raising potential.

Details of new allocations

In addition to the three-year formula allocations published in the Division of Revenue Bill, estimates of municipal allocations over the full five years of the phase-in period will be provided on the National Treasury's website. This will enable municipalities to see what the full impact of the new formula will be once it is fully phased in. To promote transparency (in line with principle 5 of the formula), details of each component's allocation and a summary version of the formula will also be published (available at: http://mfma.treasury.gov.za/Media_Releases/LGESDiscussions/Pages/default.aspx).

Other unconditional allocations

RSC/JSB levies replacement grant

Before 2006, district municipalities raised levies on local businesses through an RSC or 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 (the *RSC/JSB levies replacement grant* for metropolitan municipalities has since been replaced by the sharing of the general fuel levy). The value of the grant increases every year. In 2013/14, the grant increases by 9 per cent a year for district municipalities authorised for water and sanitation and 3 per cent for unauthorised district municipalities. The different rates recognise the various service-delivery responsibilities of these district municipalities.

Special support for councillor remuneration and ward committees

Councillors' salaries are subsidised in poor municipalities. This support is calculated separately to the local government equitable share and is in addition to the funding for governance costs provided in the institutional component. The level of support for each municipality is determined by the classification system used in the Government Gazette, which determines the upper limits of salaries, allowances and benefits of different members of municipal councils. The gazette, published annually by the Minister of Cooperative Governance and Traditional Affairs, 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). Funds were added in the 2012 MTEF to increase the support for councillor remuneration. These additions are still being phased in during 2013/14 and 2014/15. The proportion of councillors' salaries subsidised through this allocation for different grades of municipalities is shown in Table W1.28. All subsidy levels are based on the gazetted upper maximum levels for part-time councillors. In addition, each municipality in grades 1 to 3 receives an allocation to provide stipends of R500 per month to 10 members of each ward committee in their municipality. Each municipality's allocation for this special support is published in the appendices to the Division of Revenue Bill.

Table W1.28 Subsidy levels provided for councillor remuneration

Municipal grade	2013/14	2014/15	2015/16
1	90.0%	90.0%	90.0%
2	70.0%	80.0%	80.0%
3	55.0%	70.0%	70.0%

Conditional grants to local government

National government allocates funds to local government through a variety of conditional grants. These grants fall into two main groups: infrastructure and capacity building. The total value of conditional grants directly transferred to local government increases from R34.5 billion in 2013/14 to R36.9 billion in 2014/15 and R40.6 billion in 2015/16.

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 R122.7 billion over the 2013 MTEF.

Table W1.29 Infrastructure transfers to local government, 2009/10 – 2015/16

R million	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
		Outcome		Revised estimate		Medium-term estimates	
Direct transfers	**18 699**	**20 871**	**24 643**	**28 029**	**31 092**	**33 548**	**36 971**
Municipal infrastructure grant	8 728	9 704	11 443	13 882	14 352	14 684	15 448
Municipal water infrastructure grant	–	–	–	–	603	1 059	2 672
Urban settlements development grant	4 418	4 968	6 267	7 392	9 077	10 335	10 700
Integrated national electrification programme	900	1 033	1 097	1 151	1 635	1 565	2 056
Public transport infrastructure grant	2 421	3 700	4 612	4 988	4 669	5 126	5 279
Neighbourhood development partnership grant	508	832	738	578	598	591	600
2010 FIFA World Cup stadiums development grant	1 661	302	–	–	–	–	–
Rural roads asset management systems grant	10	10	35	37	52	75	98
Rural households infrastructure grant	–	–	–	–	107	113	118
Municipal drought relief grant	54	320	450	–	–	–	–
Indirect transfers	**2 763**	**2 682**	**2 553**	**4 823**	**5 399**	**7 029**	**8 617**
Integrated national electrification programme	1 616	1 720	1 165	1 879	2 141	2 488	3 680
Neighbourhood development partnership grant	70	50	50	80	55	58	65
Regional bulk infrastructure grant	577	851	1 260	2 523	3 203	4 483	4 872
Backlogs in water and sanitation at clinics and schools	350	–	–	–	–	–	–
Backlogs in the electrification of clinics and schools	149	–	–	–	–	–	–
Rural households infrastructure grant	–	62	78	341	–	–	–
Total	**21 462**	**23 553**	**27 196**	**32 852**	**36 492**	**40 577**	**45 588**

Municipal infrastructure grant

The largest infrastructure transfer is made through the *municipal infrastructure grant*, which supports government's aim to expand service delivery and alleviate poverty. The grant funds the provision of infrastructure for basic services, roads and social infrastructure for poor households in all non-metropolitan municipalities. The total allocations for this grant grow to R14.4 billion, R14.7 billion and R15.5 billion over the 2013 MTEF.

The *municipal infrastructure grant* is allocated through a formula with a vertical and horizontal division. The vertical division allocates resources between sectors and the horizontal division takes account of poverty, backlogs, and municipal powers and functions in allocating funds to municipalities. The five main components of the formula are described in the box below. A minimum allocation of R5 million ensures that a reasonable minimum allocation is made to small municipalities.

Municipal infrastructure grant = C + B + P + E + N

C Constant to ensure increased minimum allocation for small municipalities (this allocation is made to all municipalities)

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

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

P Public municipal service infrastructure (ring-fenced for municipal sport infrastructure)

E Allocation for social institutions and micro-enterprises infrastructure

N Allocation to the 23 priority districts identified by government

For the 2013 MTEF, the *municipal infrastructure grant* allocation formula has been updated with data from the 2011 Census. Allocations for basic services sub-components are based on the proportion of the national backlog for that basic service in each municipality. Other components are based on the proportion of the country’s poor households located in each municipality. Table W1.30 sets out the proportion of the grant accounted for by each component of the *municipal infrastructure grant* formula. The C-component provides a R5 million base to all municipalities.

In the 2011 division of revenue, the P-component (15 per cent of the grant) was ring-fenced for municipal sport and recreation infrastructure. This ring-fencing continues in the 2013 MTEF.

Amounts of R291.4 million in 2013/14, R946 million in 2014/15 and R1.2 billion in 2015/16 have been shifted from the *municipal infrastructure grant* to the new *municipal water infrastructure grant* described below. In the 2012 Division of Revenue Bill, the *rural households infrastructure grant* was to be phased into the *municipal infrastructure grant*. This decision has been reversed and amounts of R113.1 million in 2014/15 and R118.3 million in 2015/16 have been shifted from the *municipal infrastructure grant* to restore the *rural households infrastructure grant.*

Table W1.30 Municipal infrastructure grant allocations per sector

Municipal infrastructure grant (formula)	Component weights	Proportion of MIG per sector	Value of component 2013/14 (R millions)
B-component	**75.0%**		**9 838**
Water and sanitation	72.0%	54.00%	7 083
Roads	23.0%	17.25%	2 263
Other	5.0%	3.75%	492
P-component	**15.0%**		**1 968**
Sports	100.0%	15.00%	1 968
E-component	**5.0%**	**5.00%**	**656**
N-component	**5.0%**	**5.00%**	**656**
Constant			**1 235**
Total			**14 352**

Urban settlements development grant

In 2011/12, the *urban settlements development grant* was introduced for the eight metropolitan municipalities as an integrated source of infrastructure funding to upgrade urban informal settlements. The grant combines basic services funding (previously allocated through the *municipal infrastructure grant*) with part of the basic services portion of the *human settlements development grant* (previously allocated to provinces). This shift reflects the importance of upgrading informal settlements and coordinating housing and basic services projects, and perhaps most significantly, government's policy to devolve more housing authority to cities. The *urban settlements development grant* is allocated a total of R30.1 billion in the 2013 MTEF.

Municipal water infrastructure grant

This is a new grant, administered by the Department of Water Affairs, to accelerate the delivery of clean water to communities that do not have access to basic water services. The grant provides funding for municipalities to plan and implement various projects, including the construction of new infrastructure and the refurbishment and extension of existing water schemes. The grant has an allocation of R4.3 billion over the 2013 MTEF.

The public transport infrastructure grant

The *public transport infrastructure grant* is administered by the Department of Transport. This grant was previously the *public transport infrastructure and systems grant.* The operational portion of the previous grant has been separated as the *public transport network operations grant* from 2013/14, meaning that the infrastructure grant will only fund capital expenditure. The grant aims to help cities create new and improve existing public transport and non-motorised transport infrastructure. This includes the provision of infrastructure for bus rapid transit systems. The grant has an allocation of R15.1 billion over the 2013 MTEF.

The rural roads asset management systems grant

The *rural roads asset management systems grant* is administered by the Department of Transport to improve rural roads infrastructure. The grant funds the collection of accurate data on the condition and usage of rural roads in line with the Road Infrastructure Strategic Framework for South Africa. This data will guide investments to maintain and improve these roads. Rural district municipalities are funded to collect data on the condition and usage of all the municipal roads in their area so that the spending of infrastructure funds (from the *municipal infrastructure grant* and elsewhere) can be properly planned to maximise their impact. Over the 2013 MTEF, this grant will be extended to more municipalities. The grant has an allocation of R225.2 million over the MTEF.

The rural households infrastructure grant

The *rural households infrastructure grant* funds the provision of on-site solutions for water and sanitation services for rural households where piped infrastructure is not feasible. The grant will become a direct grant to municipalities in 2013/14. It was previously an indirect grant through which the Department of Human Settlements provided on-site infrastructure for water and sanitation in rural areas. From 2013/14, funds will be transferred directly to municipalities for these projects. This will allow municipalities to manage community consultation processes. The municipality will also be responsible for ensuring the infrastructure is maintained, providing a much greater incentive for maintenance planning to be included in projects from the beginning. The grant has an allocation of R338.2 million over the MTEF.

The neighbourhood development partnership grant

The *neighbourhood development partnership grant* seeks to develop community infrastructure and create a platform for private investment to improve the quality of life in townships. The grant is administered by the National Treasury and has an allocation of R2 billion over the MTEF for both the technical assistance (indirect) and capital (direct) grant.

The integrated national electrification programme

To sustain progress in connecting poor households to electricity, government will spend about R13.6 billion over the next three years on the national electrification programme. Of this, municipalities will spend R5.3 billion and Eskom will spend R8.3 billion on behalf of municipalities. This includes an additional R2.9 billion over the 2013 MTEF. This programme was instrumental in ensuring 85 per cent of all households have access to electricity, as reported in the 2011 Census.

The regional bulk infrastructure grant

This grant supplements the financing of the social component of regional bulk water and sanitation. It targets projects that cut across several municipalities or are large bulk projects within one municipality. The grant supplements regional bulk collection and wastewater treatment works. It may also be used to appoint service providers to carry out feasibility studies, related planning or management studies for infrastructure projects. The grant has additional funding of R2.8 billion over the 2013 MTEF, bringing the total value of the grant to R12.6 billion over the MTEF.

Capacity-building grants and other current transfers

Capacity-building grants boost municipalities' building management, planning, technical, budgeting and financial management skills. The *expanded public works programme integrated grant for municipalities* promotes increased labour intensity in municipalities and the *water services operating subsidy grant* supports particular national water schemes that are being transferred to municipalities.

Table W1.31 Capacity building and other current transfers to local government, 2009/10 – 2015/16

R million	2009/10	2010/11	2011/12	2012/13 Revised estimate	2013/14	2014/15	2015/16
Direct transfers	**2 194**	**1 951**	**1 862**	**2 586**	**3 364**	**3 351**	**3 632**
Municipal systems improvement grant	200	212	220	230	240	252	261
Local government financial management grant	300	365	385	403	425	449	470
Public transport network operations grant	–	–	–	–	881	745	862
Integrated city development grant	–	–	–	–	40	150	150
2010 FIFA World Cup host city operating grant	508	210	–	–	–	–	–
2013 African Cup of Nations host city operating grant	–	–	–	123	–	–	–
2014 African Nations Championship host city operating grant	–	–	–	–	120	–	–
Water services operating subsidy grant	849	664	542	562	421	450	470
Expanded public works programme integrated grant for municipalities	101	280	364	662	611	632	661
Infrastructure skills development grant	–	–	39	75	99	154	179
Energy efficiency and demand-side	175	220	280	200	181	155	202
Municipal disaster grant	61	–	32	330	347	364	376
Indirect transfers	**318**	**257**	**217**	**133**	**139**	**142**	**151**
Energy efficiency and demand-side	75	109	119	–	–	–	–
Water services operating subsidy	243	148	98	133	139	142	151
Total	**2 512**	**2 208**	**2 079**	**2 719**	**3 503**	**3 493**	**3 783**

Local government financial management grant

The *local government 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 Municipal Finance Management Act. Total allocations for the *local government financial management grant* amount to R1.3 billion over the 2013 MTEF.

The public transport network operations grant

The *public transport network operations grant* subsidises the operational costs of public transport systems built through the *public transport infrastructure grant*. Previously, both grants formed part of the *public transport infrastructure and systems grant*. This grant has been split into separate infrastructure and operational grants to provide more transparency on what is being funded and to provide cites with greater certainty about the levels of operational funding they can expect to receive to support the new public transport networks they are running. The public transport network operations grant is allocated R2.5 billion over the 2013 MTEF.

Integrated city development grant

This is a new grant that provides a financial incentive for metropolitan municipalities to integrate and focus their use of all available infrastructure investment and regulatory instruments to achieve a more compact urban spatial form. The grant has an allocation of R340 million over the MTEF.

Infrastructure skills development grant

This grant, introduced in 2012, places interns with technical skills in municipalities. These interns spend two years in a well-capacitated municipality or entity gaining skills and experience, and are then transferred to a rural municipality with poor capacity to complete their internship. This programme will increase the pool of qualified engineers and scientists working in municipalities and will give rural municipalities the opportunity to hire these skilled personnel when they have completed their internships. The first cohort of interns in this programme began working in 2012. The grant has an allocation of R432.2 million over the MTEF.

Municipal systems improvement grant

The *municipal systems improvement grant* provides funding to non-metropolitan municipalities to help them implement their local government turnaround strategies. The grant is administered by the Department of Cooperative Governance and is allocated R753.5 million over the MTEF.

Expanded public works programme integrated grant for municipalities

This grant promotes the use of labour-intensive methods in delivering municipal infrastructure and services. The grant is allocated through a formula based on past performance – creating an incentive effect – with a bonus to give bigger allocations to poor, rural municipalities. The grant has an allocation of R1.9 billion over the MTEF.

The energy efficiency and demand-side management grant

The *energy efficiency and demand-side management grant* was introduced following load shedding in 2008. It funds selected municipalities to implement demand-side management projects, with a focus on public lighting and energy-efficient municipal infrastructure. The grant has an allocation of R538.1 million over the MTEF.

The water services operating subsidy

The *water services operating subsidy* is a grant with schedule 5B (direct) and schedule 6B (in-kind) components to fund water schemes. The grant covers staff-related costs, direct operating and maintenance costs, and infrastructure refurbishment. Allocations per municipality are based on the operational budget for each scheme and the funding requirements identified in the transfer agreement. Before 1994, the Department of Water Affairs administered these schemes, which are now being transferred to municipalities. At the end of 2011/12, 59 agreements had been signed, 5 524 staff transferred and 1 655 schemes (including rudimentary schemes) with a total asset value of about R6.6 billion transferred to municipalities. In the 2013 MTEF, R1.8 billion is allocated for the *water services operating subsidy* (direct and indirect transfers). This grant enables the transfer of staff operating water schemes from national government to municipalities. It is a transitional grant that is expected to be phased out over time.

2014 African Nations Championship host city operating grant

Following the successful hosting of the African Cup of Nations in January/February 2013, South Africa will host the African Nations Championship tournament in January 2014. An allocation of R120 million in 2013/14 is provided to support the cities hosting the tournament.

Municipal disaster grant

The *municipal disaster grant* was introduced in the 2011 MTEF. This grant is administered by the National Disaster Management Centre in the Department of Cooperative Governance as an unallocated grant to local government. The centre is able to disburse disaster-response funds immediately – without the need for the transfers to be gazetted first. Over the 2013 MTEF, R1.1 billion is available through this grant.

Part 6: Future work on provincial and municipal fiscal frameworks

Provincial infrastructure transfers

Infrastructure conditional grants to provinces will be reformed during the 2013 MTEF to introduce incentives in existing grant structures, which will promote good infrastructure delivery management system practices and complement existing capacity support programmes. These incentives will aim to address infrastructure planning and procurement failures in infrastructure delivery.

From 2015/16, provinces will only be eligible to receive allocations for the *health facility revitalisation grant* and the *education infrastructure grant* if they meet certain planning criteria. Provinces will be required to bid for their infrastructure grant allocations two years in advance (during 2013/14, provinces will bid for their 2015/16 allocations). A set of bidding prerequisites and criteria will be used to evaluate bids. Unsuccessful bids will not be funded and those allocations will be pooled in an unallocated fund, which provinces with successful bids can apply for. The 2013 Division of Revenue Bill requires provinces to complete and submit plans and bids for these grants during 2013/14.

Prerequisites

Provinces will only be entitled to bid for funds if they have the following in place:

- An agreed framework outlining the roles and responsibilities within a provincial infrastructure delivery management system, which has been adopted and signed off by the Provincial Cabinet. This framework must also be supported by the appropriate capacity.
- Long-term infrastructure plans (a user asset management plan) for each sector, aligning a department’s strategic objectives and infrastructure needs.
- Appropriate monitoring systems and contract management systems that enable filing, record-keeping and tracking project expenditure.

Approval processes

After the prerequisites have been met, there will be two approval processes. First, provinces will be required to bid for their allocations using a signed-off infrastructure programme management plan and supporting construction procurement strategy. In the second process, successful departments will have to prepare and define the project/programme packages that are to be implemented. These will be assessed to confirm each province’s allocation (confirmed by an allocation letter from the National Treasury). The province will be instructed to proceed with tender procedures. These two approval processes will be finalised during the two years before projects/packages are implemented.

After the second approval, the process is closed and the application process for the year is complete. But there will still be a possibility that allocations will be withdrawn if there is non-compliance, irregularities or material deviation from original submissions. Funds that remain unallocated at the end of this approval process can be allocated to provinces that are ready to implement additional projects. These projects, which would already be in the approval process but proposed for subsequent years, will be brought forward.

During the year in which funds are spent, measures will be put in place to ensure that if a province is not spending at the planned rate, they do not receive further transfers until they have spent the funds already transferred. Options will also be explored to shift unspent funds to projects where they can be spent during the year.

Local government infrastructure transfers

In the 14 years since the first Division of Revenue Act was first introduced in 1998, more than R165 billion in infrastructure grants have been made available to municipalities or to national departments to spend on their behalf. Of this amount, just over R134 billion was allocated in the last six years (2007/08 to 2012/13). The impact of this massive amount of funding on levels of access to service is revealed in the results of the 2011 Census. A preliminary analysis of these results reveals a mixed picture in which some municipalities have managed to make impressive inroads in providing access to basic services while in other areas progress has been very limited.

The 2011 Census results reveal where infrastructure spending has achieved results, and where it has been less effective. This will allow government to draw lessons from these successes and failures and examine how the grant system can be most effective in delivering infrastructure. The Budget Forum has recommended that the 2011 Census data should form the basis of a thorough review of the local government conditional grant system in the period leading up to the 2014 Budget. This review will be coordinated by the National Treasury, using a collaborative process that will include national departments, SALGA and the FFC, and extensive consultation with municipalities. Obtaining input from as many stakeholders as possible will enhance the analysis in the review and help to build consensus about the system's challenges and potential solutions.

Municipal taxation

The national framework for municipal taxation powers is determined by section 229 of the Constitution, which empowers municipalities to impose a property tax and surcharges on fees for municipal services, subject to national regulation. However, in exercising their revenue-raising powers, it is important that municipalities do not materially or unreasonably prejudice national economic policies and economic activities across municipal boundaries.

The Municipal Property Rates Act (2004) and the Municipal Fiscal Powers and Functions Act (2007) regulate municipal fiscal powers and functions as provided for in section 229 of the Constitution.

Municipal Property Rates Act

The Municipal Property Rates Act regulates the power of municipalities to impose rates on properties. The act is administered by the Department of Cooperative Governance. The department proposed amendments to the act in 2011/12 to improve its implementation and minimise legal ambiguities. The Municipal Property Rates Amendment Bill was published on 9 June 2011 for public comment. The department has considered all inputs from the public and intends to resubmit the bill to Cabinet during 2013, following which the bill will be introduced to Parliament.

Municipal Fiscal Powers and Functions Act

The Municipal Fiscal Powers and Functions Act, which came into effect on 7 September 2007, deals with the regulation of all municipal taxes other than property rates. The act aims to promote predictability, certainty and transparency of municipal fiscal powers and functions, and to ensure that these powers and functions are exercised in line with the provisions of section 229 of the Constitution. The National Treasury intends to amend the act to improve its implementation.

Application for a new municipal tax

Section 5 of the Municipal Fiscal Powers and Functions Act provides for a municipality, a group of municipalities or organised local government to apply to the Minister of Finance for the authorisation of a new municipal tax. A new municipal tax may not be imposed without prior approval by the minister. Any application for a new tax must set out the reasons for the proposed tax and the manner in which the revenue from the tax will be used.

To date, two applications that comply with the requirements of section 5 of the Municipal Fiscal Powers and Functions Act have been received by the National Treasury: (a) an application for the introduction of a rural-based development levy in areas where municipalities struggle to implement valuation rolls for the purposes of imposing property rates; and (b) an application for the introduction of a local business tax for businesses operating within the jurisdiction of metropolitan municipalities. The Minister of Finance did not approve the proposal for a local business tax. His ruling was informed by the following:

- New taxes or increases in existing taxes during periods of slow growth would be unwise, as it could bankrupt businesses that are already struggling.
- Although metropolitan municipalities are relatively well equipped to exploit their existing own-revenue base, such as property rates, service charges and other own-revenue sources, there is still room to further improve own-revenue collections.

Municipalities are encouraged to further improve their debt management and eliminate non-priority expenditure. This could raise significant additional funds for municipal priorities.

Sharing of the general fuel levy

The sharing of the general fuel levy was introduced in 2009/10 as a permanent replacement to the former RSC and JSB levies for metropolitan municipalities. This was done in addition to the VAT reforms introduced in 2006. District municipalities still receive the *RSC/JSB levies replacement grant*.

The transition from the *RSC/JSB levies replacement grant* system to the sharing of the general fuel levy has been phased in over three years to ensure a smooth transition. The final year of this phase-in process was 2011/12. From 2012/13, the sharing of the general fuel levy is based on fuel sales.

To determine the actual fuel sales in a metropolitan municipality, the fuel sales figures from the Department of Energy have been adjusted using population statistics to account for overlapping magisterial district boundaries, based on the 2011 Census.

The sharing of the general fuel levy is a direct charge and is formalised annually through the Government Gazette under schedule 1 of the Taxation Laws Amendment Act (2009).