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Website annexure to the 2014 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 2014 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 2014 division of revenue.
- Part 3 sets out how the FFC's recommendations on the 2014 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 among provinces.

- Part 5 sets out the formula and criteria for the division of the local government equitable share and conditional grants among 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 4 October 2013. 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, the needs of national government and emergencies, resource allocation for basic services and developmental needs, fiscal capacity and efficiency of provincial and local government, 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 overseen by the Presidential Infrastructure Coordinating Council and the 12 priority outcomes adopted by Cabinet in 2010. In the 2013 *Medium Term Budget Policy Statement*, the Minister of Finance outlined how the resources available to government over the 2014 medium-term expenditure framework (MTEF) would be allocated to help achieve these goals. Chapter 4 of the 2013 *Medium Term Budget Policy Statement* and Chapter 7 of the 2014 *Budget Review* provide a detailed analysis of how funds have been allocated based on these priorities. 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 public spending. 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 2014 *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 various 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 objectives. 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 carry-through effects of public-sector wage increases due to higher-than-anticipated inflation. Funds are also added to the provincial fiscal framework to construct facilities for the treatment of substance abuse, roll out a new vaccine for the human papillomavirus, accelerate housing programmes in mining towns and repair infrastructure damaged by floods. Transfers to local government have grown significantly in recent years, providing municipalities with greater resources to deliver basic services. This is in addition to local government's substantial own-revenue-raising powers. In the 2014 division of revenue, additional resources have been made available to accelerate the rollout of bulk water and sanitation infrastructure, build capacity for cities to manage the development of human settlements, and to incentivise the planning and development of more integrated and efficient urban spaces.

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 mechanisms for allocating funds to provinces and municipalities are continuously reviewed to improve their efficiency. The provincial equitable share formula was reviewed in 2010 and the recommendations were implemented in 2011. In 2013, the formula was updated with 2011 Census data, reflecting significant changes in the distribution of demand for services between provinces. A new approach to the funding of provincial infrastructure is being implemented to promote better planning and implementation, and to improve efficiency in the delivery of health and education infrastructure. A review of the local government equitable share was completed during 2012 and a new formula is being phased in from 2013/14 to 2017/18 (details of the formula are provided in part 5 of this annexure).

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 the 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

The equitable share and infrastructure grant formulas are redistributive towards poorer provinces and municipalities. Government is investing in economic infrastructure (such as roads) and social infrastructure (such as schools, hospitals and clinics) to stimulate economic development, create jobs, 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 2014 MTEF and division of revenue provide additional funding for higher-than-anticipated wage costs, increases in the cost of provincial bus services, and to accelerate the provision of housing, water and sanitation. 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 this 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 in the immediate aftermath of a declared disaster. 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 2014 division of revenue

Expenditure in the 2014 MTEF will remain within the bounds set out in the 2013 Budget. National and provincial departments implemented savings measures and reprioritised spending to make additional resources available to fund government priorities in the 2014 Budget.

Excluding debt-service costs and the contingency reserve, allocated expenditure shared between the three spheres amounts to R1.1 trillion, R1.2 trillion and R1.3 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 fair, stable and predictable revenue shares, and to address economic and fiscal disparities.

Government’s policy priorities for the 2014 MTEF

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

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

- Subsidise the carry-through costs of higher-than-projected inflation on wage agreements
- Construct facilities for the treatment of substance abuse
- Roll out a new vaccine for the human papillomavirus
- Accelerate housing programmes in mining towns
- Repair infrastructure damaged by floods

- Cover the increased costs of provincial bus services.

Local government allocations receive additional funds to:

- Accelerate the provision of bulk water and sanitation
- Promote more integrated and efficient cities
- Build capacity for the development of human settlements.

Funding for the eradication of bucket sanitation has been prioritised within existing allocations to municipalities and a new indirect component of the *human settlements development grant* to provinces will also fund this priority.

Table W1.1 shows how additional allocations are distributed to priority areas across national, provincial and local government over the MTEF period.

Table W1.1 2014 Budget priorities – additional MTEF allocations, 2014/15 – 2016/17

R million	2014/15	2015/16	2016/17	Total
Provincial departments: Compensation of employees cost pressures	2 738	4 347	4 964	12 049
National departments: Compensation of employees cost pressures	1 317	1 798	2 199	5 314
Defence and Military Veterans: Improving operational capability of South African Air Force	342	387	555	1 284
Transport: Procurement of railway rolling stock	348	338	410	1 096
Cooperative Governance and Traditional Affairs: Community Work Programme	–	–	1 072	1 072
Human Settlements: Municipal human settlements capacity grant	300	300	300	900
Water Affairs: Regional bulk infrastructure grant, to accelerate the delivery of bulk water and sanitation	–	350	500	850
Justice and Constitutional Development: Increased accommodation costs	200	210	310	720
Communications: Provision of set-top boxes, antennae and installation in 5 million households	–	300	400	700
Water Affairs: Construction of Umzimvubu Dam and bulk water scheme	–	264	430	694
Statistics SA: New head office accommodation	282	135	–	417
Transport: Rehabilitation of road infrastructure destroyed by natural disasters	235	178	–	414
Health: Introduction of new vaccine for cervical cancer	200	200	–	400
National Treasury: Integrated city development grant	105	116	135	356
Human Settlements: Repair of housing infrastructure damaged by disasters	185	141	–	326
Defence: Military Health Services: medical equipment and supplies	100	100	100	300
Environmental Affairs: Green Fund, to support the transition to a green economy	250	–	–	250
Agriculture, Forestry and Fisheries: Repair of farm infrastructure damaged by natural disasters	196	14	–	209
Home Affairs: Rescheduling of information technology system modernisation projects	–	–	200	200
Provincial Health: Provision of the cervical cancer vaccine by provincial governments	–	–	200	200
Energy: South African Nuclear Energy Corporation, upgrading of the Safari-1 nuclear reactor, research and development	190	–	–	190
Human Settlements: Informal settlement upgrading in mining towns	180	–	–	180
Total	**7 168**	**9 178**	**11 775**	**28 120**

The fiscal framework

Table W1.2 presents the medium-term macroeconomic forecasts for the 2014 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, 2013/14 – 2016/17

	2013/14		2014/15		2015/16		2016/17
R billion	2013 Budget	2014 Budget	2013 Budget	2014 Budget	2013 Budget	2014 Budget	2014 Budget
Gross domestic product	3 520.3	3 464.9	3 880.4	3 789.6	4 270.8	4 150.5	4 552.9
Real GDP growth	*3.0%*	*2.0%*	*3.6%*	*2.9%*	*3.8%*	*3.3%*	*3.5%*
GDP inflation	*6.5%*	*6.2%*	*6.4%*	*6.3%*	*6.0%*	*6.0%*	*5.9%*
National budget framework							
Revenue	**873.0**	**886.2**	**967.9**	**962.8**	**1 070.7**	**1 058.1**	**1 172.6**
Percentage of GDP	*24.8%*	*25.6%*	*24.9%*	*25.4%*	*25.1%*	*25.5%*	*25.8%*
Expenditure	**1 055.1**	**1 049.1**	**1 138.0**	**1 142.6**	**1 225.7**	**1 232.6**	**1 323.6**
Percentage of GDP	*30.0%*	*30.3%*	*29.3%*	*30.1%*	*28.7%*	*29.7%*	*29.1%*
Main budget balance[1]	**-182.1**	**-162.9**	**-170.1**	**-179.8**	**-155.0**	**-174.5**	**-151.0**
Percentage of GDP	*-5.2%*	*-4.7%*	*-4.4%*	*-4.7%*	*-3.6%*	*-4.2%*	*-3.3%*

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

Table W1.3 sets out the division of revenue for the 2014 MTEF period after accounting for new policy priorities.

Table W1.3 Division of nationally raised revenue, 2010/11 – 2016/17

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
R million		Outcome		Revised estimate		Medium-term estimates	
Division of available funds							
National departments	**356 027**	**382 712**	**412 706**	**449 251**	**489 424**	**522 257**	**552 983**
of which:							
Indirect transfers to provinces	*–*	*76*	*860*	*2 693*	*5 413*	*5 044*	*4 127*
Indirect transfers to local government	*2 939*	*2 770*	*4 956*	*5 697*	*7 726*	*9 467*	*10 221*
Provinces	**322 822**	**362 488**	**388 238**	**414 932**	**444 423**	**477 639**	**508 254**
Equitable share	265 139	291 736	313 016	338 937	362 468	387 967	412 039
Conditional grants	57 682	70 753	75 222	75 995	81 955	89 672	96 215
Local government	**60 904**	**68 251**	**76 430**	**83 670**	**90 815**	**100 047**	**105 187**
Equitable share	30 541	33 173	37 139	39 789	44 490	50 208	52 869
Conditional grants	22 821	26 505	30 251	34 268	36 135	39 181	41 094
General fuel levy sharing with metropolitan municipalities	7 542	8 573	9 040	9 613	10 190	10 659	11 224
Non-interest allocations	**739 752**	**813 451**	**877 374**	**947 853**	**1 024 662**	**1 099 943**	**1 166 424**
Percentage increase	*7.2%*	*10.0%*	*7.9%*	*8.0%*	*8.1%*	*7.3%*	*6.0%*
Debt-service costs	66 227	76 460	88 121	101 256	114 901	126 647	139 201
Contingency reserve	–	–	–	–	3 000	6 000	18 000
Main budget expenditure	**805 979**	**889 911**	**965 496**	**1 049 109**	**1 142 562**	**1 232 590**	**1 323 624**
Percentage increase	*7.9%*	*10.4%*	*8.5%*	*8.7%*	*8.9%*	*7.9%*	*7.4%*
Percentage shares							
National departments	*48.1%*	*47.0%*	*47.0%*	*47.4%*	*47.8%*	*47.5%*	*47.4%*
Provinces	*43.6%*	*44.6%*	*44.2%*	*43.8%*	*43.4%*	*43.4%*	*43.6%*
Local government	*8.2%*	*8.4%*	*8.7%*	*8.8%*	*8.9%*	*9.1%*	*9.0%*

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

Table W1.4 Changes over baseline,[1] 2014/15 – 2016/17

R million	2014/15	2015/16	2016/17
National departments	-32	551	5 113
Provinces	2 696	3 250	4 861
Local government	-764	-1 422	-1 660
Allocated expenditure	**1 900**	**2 379**	**8 314**

1. Excludes shifting of savings towards priorities over the MTEF

Table W1.5 sets out schedule 1 of the Division of Revenue Bill, which reflects the legal division of revenue between national, provincial and local 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 the allocations for each sphere reflect equitable shares only.

Table W1.5 Schedule 1 of the Division of Revenue Bill, 2014/15 – 2016/17

R million	2014/15 Column A Allocation	2015/16 Column B Forward estimates	2016/17
National[1, 2]	735 604	794 415	858 717
Provincial	362 468	387 967	412 039
Local	44 490	50 208	52 869
Total	**1 142 562**	**1 232 590**	**1 323 624**

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 2014 *Budget Review* sets out in detail how constitutional issues and government's priorities are taken into account in the 2014 division of revenue. It describes economic and fiscal policy considerations, revenue issues, debt and financing considerations, and expenditure plans. Chapter 7 focuses on provincial and local government financing.

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 2014/15* to Parliament in May 2013. These recommendations are divided into 13 chapters, which cover three main areas: national levers for inclusive growth in a post-crisis fiscal response; provincial fiscal levers – state capability and performance; and local government levers – collaborative governance for effective and sustainable municipalities.

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 the 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: Budget consolidation in South Africa: balancing growth and socioeconomic rights

Moderate the growth in public-sector wage expenditure

The FFC recommends that, "Government continues its efforts to moderate the growth in expenditure components such as the public-sector wage bill (which constitutes some 60 per cent of government expenditure), as decreases in government expenditure increase the probability of a successful fiscal consolidation in South Africa. More effort must be made to improve the effectiveness of public finances, through greater and more rigorous oversight to ensure the elimination of fruitless, wasteful and unauthorised expenditure, and corrupt practices in managing public finances."

Government response

This recommendation deals with two different issues. The moderation of the wage bill is about the broad public-sector remuneration policy, whereas improving the effectiveness of public finances (in respect of fruitless, wasteful, unauthorised expenditure and corrupt practices) is an issue of accountability, governance and legal compliance.

Moderating the public-sector wage bill requires the management of employee remuneration policies (wage increases, allowances and so on) and staff numbers. The former is governed by the Department of Public Service and Administration. Government recognises that there is dualism in this area and has raised the issue in the FFC's presence both in Parliament and in other executive forums (the Technical Committee on Finance and the Budget Council). Government is working to address this issue. In terms of staff numbers, accounting officers and the executive authority are responsible for ensuring that people are not recruited where there is no pre-authorised budget to pay their salaries, and that budgets are not increased to cater for staff growth at the expense of other service delivery areas. Government has proposed the development of a management framework for this aspect of personnel management, and has initiated a project for personnel costing and modelling to help departments plan for personnel requirements and reduce the financial impact.

Government is committed to improving the effectiveness of public spending. The cost containment measures announced in the 2013 *Medium Term Budget Policy Statement* are being implemented through new guidelines issued by the National Treasury. Financial monitoring systems are being continuously improved across government, including through the design of a standard chart of accounts for local government. These improvements provide managers, oversight bodies and the public with the information they need to hold government accountable for the way public funds are spent.

Chapter 3: Funding of the South African further education and training sector

Funding further education and training colleges

The FFC recommends that, "The funding model for the further education and training sector after the function shift ensures that: baseline funding does not perpetuate past underfunding of the function in certain provinces; additional allocations are used to achieve a more equitable funding regime across the provinces; and ongoing infrastructure development and maintenance are provided for."

Government response

In 2012, the Department of Higher Education and Training developed a comprehensive turnaround strategy for all 50 further education and training colleges. The strategy, which is being implemented, aims to systematically address the colleges' key challenges to achieve sustainable improvements in the quality of teaching and learning. The strategy uses individual assessments and tailored interventions to respond to the specific strengths and weaknesses of each college. The Department of Higher Education and Training is solving immediate problems while laying out a developmental agenda that will be sustained beyond 2030. The coordination and implementation of the strategy is important and will drive annual operational plans, budgets and priorities. A portion of the cost per course will cover ongoing maintenance and infrastructure development. Large-scale infrastructure development will require additional funding, if available.

Chapter 5: Evolution of conditional grants

Consulting the FFC when planning for conditional grants

The FFC recommends that, "The section in the Division of Revenue Act dealing with preparation for the next financial year is reviewed to make consultation with the commission mandatory when planning for conditional grants for the forthcoming year. This would assist departments with grant design, especially in the case of new grants, phased-out grants, and material redesign of existing grants."

Government response

The consultation processes between the FFC and national government on the annual budget is prescribed in the Intergovernmental Fiscal Relations Act and not the annual Division of Revenue Act. Government, however, welcomes the commission's offer to provide assistance to national departments. Given the tight timeframes involved in planning for the annual Division of Revenue Bill, government recommends that the FFC focus on assisting departments with the design of new grants, redesigning grants and grants that need to be phased out, as these are the areas where the commission's advice can be of most value. The National Treasury will refer individual departments considering major changes to conditional grants to the FFC for consultations and advice.

This initiative will complement the well-established practice of extensive consultation between government and the FFC on matters relating to the division of revenue. These consultations include the National Treasury consulting the commission on proposed changes to the division of revenue before announcements are made in the Medium Term Budget Policy Statement and the Budget Speech; the FFC's participation in the Budget Forum, Budget Council and Technical Committee on Finance meetings; sharing draft conditional grant frameworks with the FFC for comments; and the commission's inclusion in review initiatives, such as the review of the local government equitable share undertaken in 2012 and the review of local government infrastructure grants currently under way.

Reviewing the efficacy of conditional grants

The FFC recommends that, "The efficacy of conditional grants is reviewed, specifically in relation to the necessity and purpose of some of the grants, criteria for allocations, targeting, reporting on non-financial data, performance, and value for money."

Government response

Government agrees on the importance of assessing the effectiveness of conditional grants. Government assesses grant performance and effectiveness on an ongoing basis and makes changes where necessary in the annual Division of Revenue Act and the grant frameworks gazetted in terms of that act.

In addition, government also conducts periodic reviews of the conditional grant system. In the explanatory memorandum to the 2013 Division of Revenue, government announced a review of the local government infrastructure grant system. This review is under way and includes a number of stakeholders in its working group and steering committee, including the FFC. The review will also involve extensive consultation with affected sectors and municipalities. Consultative reviews of systems as complex as the local government infrastructure grant system take time to complete and are therefore done periodically rather than continuously.

New measures have also been introduced to improve the effectiveness of conditional grants. For example, years of experience with the Infrastructure Delivery Improvement Programme have demonstrated that one of the biggest obstacles to the successful implementation of infrastructure projects in provinces is weak planning. As a result, a new infrastructure grant allocation mechanism has been introduced that requires provinces to begin submitting draft plans two years before project implementation. More details on progress in implementing these reforms can be found in part 6 of this annexure.

Recommendations that indirectly apply to the division of revenue

Chapter 5: Evolution of conditional grants

Capacity building in transferring national departments

The FFC recommends that, "National Treasury builds the capacity of transferring national departments for the effective grant design, monitoring and evaluation to ensure that guidelines are adhered to."

Government response

Government agrees on the importance of appropriate capacity to manage conditional grants. The National Treasury provides technical guidance to national departments on how to design, manage and monitor conditional grants. Departments considering establishing a new grant are able to consult with National Treasury officials and are provided with guidance and templates for the grant application process. Annual workshops on the Division of Revenue Act are held with all national transferring officers to discuss changes to the act, how the different provisions in the act work, and what levers are available to grant managers to carry out their mandates. The National Treasury also conducts annual training sessions with provinces and national departments on how to compile a business plan using a generic template. The National Treasury meets with national departments each quarter to review performance and assist departments with Division of Revenue Act compliance issues. Although the National Treasury offers guidance and training, national departments are responsible for devising their own capacity-building strategies and ensuring that suitably qualified staff are assigned to tasks relating to conditional grants.

Chapter 6: Assessing and improving the fiscal performance of provinces

Establishing a provincial fiscal performance framework

The FFC proposes that, "National and provincial treasuries put in place an agreed-upon measurement and assessment framework for fiscal performance against which provinces are evaluated. The assessment framework must: a) take into account various factors that capture fiscal performance holistically, including services burden, expenditure efficiency, and funding and delivery norms; b) incorporate information from internal audit reports and serve as an early warning system to complement section 32 reports and National Treasury benchmarking exercises; c) provide for monitoring and disclosure of key fiscal performance indicators of provincial departments, particularly when deviation (as defined by the Public Finance Management Act) from a healthy fiscal trajectory is prolonged; and d) provide for monitoring of expenditure benchmarks against which key provincial expenditure items are regularly evaluated and reported by provincial accounting officers."

Government response

Government agrees that frameworks for fiscal performance are critical. In this regard, expenditure reviews are being conducted (short term within the National Treasury and long term in a joint project with the Department of Performance Monitoring and Evaluation), as well as the public expenditure and financial accountability assessments in provinces. A planning and performance management framework is in place, with annual guidelines that are produced by the National Treasury and used by departments. A quarterly performance reporting system has been implemented to complete the financial reporting system for all departments. Each sector develops norms for its specific delivery requirements (for example, school funding and feeding norms), which feed into the department's budgeting and planning. The section 32 report is a summary output of the early warning system and does not necessarily contain all the details available in that system. The report's high-level content presents information in a way that can be accessed and used by a broad audience. Internal audit reports cannot serve as an early warning system because they only become available after the event in question has occurred. In addition, even though they are available earlier than the Auditor-General's report, they are still available much later than the information from the existing monthly warning system. The FFC has previously been invited to assess the National Treasury's early warning system and this invitation is still open.

Mandatory expenditure reviews by provincial treasuries

The FFC recommends that, "Provincial treasuries must carry out mandatory expenditure reviews (overseen by National Treasury and the Department of Performance Monitoring and Evaluation in the Presidency) after every MTEF cycle, specifically focusing on composition, efficiency, economy and effectiveness of expenditure, as well as access to services and realignment of spending with programme objectives and delivery targets."

Government response

The largest and most significant provincial programmes are concurrent functions driven by national policies. As a result, reviews of the composition of expenditure should be a nationally driven process, working in conjunction with provinces. The National Treasury and the Department of Performance Monitoring and Evaluation are conducting expenditure reviews during 2013/14 and 2014/15. Provincial treasuries have instituted expenditure reviews in their respective provinces. The framework for strategic planning and annual performance planning has aligned spending with service delivery, programme objectives and delivery targets in both provincial and national government. Government acknowledges that sector indicators, definitions, plans and reports need to be improved, which is an ongoing process. The relevant service delivery sectors must take direct ownership and responsibility for managing and improving their programme performance.

Chapter 7: Managing the provincial wage bill to contain fiscal stress

An appropriate balance between wage and non-wage components of provincial budgets for social spending

The FFC recommends that, "A transition over the medium to long term is required, towards a more appropriate balance between the wage and non-wage components of provincial budgets for social spending (starting with education and health). This should be in the form of national sector departments setting a norm or ratio of frontline versus administrative staff to total expenditure per sector and/or by specific occupational categories, and developing accurate and up-to-date management information systems to monitor employee compensation expenditure against those norms."

Government response

Government supports the recommendations relating to the transition towards a more appropriate balance between the wage and non-wage components of provincial budgets for social spending. This transition must be systematic – the estimates should be informed by the staffing norms and not the other way around. For example, the health sector itself should recommend the scenarios to determine the ratio of administration staff in head offices or facilities to the number of doctors and nurses. This work is under way. After this, a collaborative effort between treasuries and health departments must take place to determine what is affordable.

Chapter 9: Effective intergovernmental planning and budgeting for better outcomes

Budget process reforms for collective responsibility for delivery agreement outcomes

The FFC recommends that, “National Treasury and the Department of Performance Monitoring and Evaluation introduce budget process reforms necessary for reconciling the collective responsibility for delivery agreement outcomes and the individual department-focused budget-bidding process by: a) realigning the budget process along service delivery agreements such that Medium-Term Expenditure Committee hearings are conducted at an outcome level, where applicable, rather than the current sectoral, individual institutional approach; and b) directly linking resource allocation to realistic, measurable and limited performance targets per outcome. Programme expenditure reviews must be undertaken at the end of each targeting period.”

Government response

The budget process explicitly incorporates the outcomes approach. This is evident in the introduction of a functional approach to budgeting from the 2011 Budget onwards, which shifted the focus from administrative units and clusters to government’s objectives, irrespective of which unit or department the related function falls under. The budget process, including Medium-Term Expenditure Committee deliberations, allows for efficient budget allocations and for specific focus on achieving identified national outcomes. National and provincial departments, and in some cases specific individual departmental programmes, and public entities are grouped according to their functions. The function groups that institutions and programmes are classified under support the outcomes approach because allocations are based on government objectives or functions, rather than individual departments.

In the annual estimates of national expenditure and provincial estimates, departments provide information on the outcomes to which all the programme performance indicators contribute. In their annual performance plans, national and provincial departments report on both financial and non-financial performance, and how budgets contribute to the achievement of targets. Conditional grant frameworks also identify which outcomes the grant contributes towards. Outputs and other indicators and the targets of the national outcomes are also incorporated into departmental planning documents.

Reorienting conditional grant incentives to reward successful delivery

The FFC recommends that, “In order to incentivise collaboration, government consolidates and reorients existing conditional grant incentives to reward successful achievement of delivery targets/outcomes rather than specific, individual, department-specific programme objectives.”

Government response

The conditional grant system includes a wide range of grants for a variety of objectives. As such, it encompasses several different approaches and cannot adopt a “one-size-fits-all” system. However, government is committed to improving the incentives where appropriate. In the 2013 division of revenue, changes to the way health and education infrastructure grants are allocated to provinces created strong incentives for provinces to improve their planning. A new *integrated city development grant* introduces incentives for developing more integrated and efficient cities. The review of local government infrastructure grants that is under way may also deliver changes to grants in line with the FFC’s recommendation (though the outcomes of the review cannot be known at this stage).

Chapter 10: Improving the performance of municipalities through incentive-based grants

Performance-based grants

The FFC recommends that, “Performance-based grants are based on principles and guidelines. The following principles should guide the design of performance-based grants: a) incentives should have sufficient monetary value to motivate desired behaviours by municipalities; b) incentive and performance indicators should be periodically revised and renegotiated between national government and municipalities; c) performance measures should capture performance unambiguously and be within the control and influence of the municipalities; d) performance incentives and associated performance measures should be evaluated at regular and scheduled intervals, and allow time for learning from each cycle; e) incentives should be achievable and evaluated within the specified timeframe; f) the transferring officials and the municipality should be sufficiently capacitated to understand the purpose and impact of incentives; and g) incentives should be tailor-made to suit specific situations."

Government response

Government appreciates the FFC's work in proposing these principles and guidelines, and will consider them in the design of future incentive grants. Grants will be designed on a case-by-case basis and the appropriateness of each of these proposed principles will be considered for each grant.

An incentive-based transfer system could improve service delivery in municipalities with adequate institutional and fiscal capacity. This is premised on the fact that socioeconomic circumstances and institutional capacities of various municipalities in South Africa differ greatly. It is therefore highly likely that the best-performing municipalities would consistently benefit from this initiative. A number of municipalities find it difficult to use the *municipal infrastructure grant* allocations for basic services, which indicates that there are underlying challenges that need urgent attention. To redress this situation, government has implemented capacity building and support programmes to accelerate infrastructure delivery in local government.

With regard to revision of the grant framework, existing mechanisms are in place to ensure that allocations are incremental or demand-driven, and tailor-made to suit the objectives of all sectors in South Africa. Government agrees with the FFC that transferring officers need to be capacitated to address the skills gap in a number of sectors.

Although government agrees with most of the recommendations on monitoring and evaluation, it should be noted that government is currently crafting guidelines for outlining performance indicators. These guidelines are for metropolitan municipalities, and will be rolled out to secondary and local municipalities at a later stage. The indicators take cognisance of the fact that municipalities differ in institutional, social, economic and political context. Indicators can perform a valuable role in clarifying long-term goals, guiding municipal actions to achieve them, measuring their progress over time and rewarding good performance. Indicators are also important for national government to account for the effective use of taxpayer funding.

Sufficient awareness of the nature of performance-based grants

The FFC recommends that, "The National Treasury and Department of Cooperative Governance ensure that there is sufficient awareness of the nature of performance-based grants, the value of incentives, relevant indicators, assessment criteria and potential benefits thereof, and how potential implementation risks could be managed."

Government response

Government agrees that if any new incentive or performance-based grants are introduced, national government must ensure that municipalities understand how the grants are allocated and what performance is expected of them to earn more from the grant. The National Treasury will ensure that the allocation criteria are set out clearly in the grant framework gazetted in terms of the Division of Revenue Act, but it is the responsibility of the department managing and transferring the grant to distribute guidelines on the grant and if necessary to hold workshops with receiving officers on how a grant works.

Chapter 13: A collaborative effort to enhance revenue generation in rural municipalities

Linking grant funding for municipalities in rural areas to capacity-building initiatives

The FFC recommends that, "National and provincial governments ensure that grant funding to rural municipalities is linked to capacity-building initiatives and structured assistance, so that systems are built to improve the municipality's ability to collect revenues due and increase the quality of spending."

Government response

Government provides extensive capacity support to rural municipalities through a range of programmes, including the *financial management grant*, the *municipal systems improvement grant*, the Municipal Finance Improvement Programme, the *infrastructure skills development grant* and the Municipal Infrastructure Support Agency. These programmes target various aspects of local capacity, including revenue management and infrastructure spending. In some cases, capacity is built through resource allocations, while in others capacity is built through technical, hands-on transfer of skills or through formal competency training programmes. This differentiated approach to capacity building cannot always be linked to specific grant transfers. However, government strives to ensure that every municipality with capacity problems receives appropriate support. As part of this effort, the Municipal Infrastructure Support Agency is working to ensure that municipalities with high levels of underspending on capital grants receive support to improve their planning and capital spending.

The Municipal Finance Improvement Programme is designed to ensure that all disciplines related to the Municipal Finance Management Act are addressed through technical assistance placed at the municipality. Support is directed towards revenue management and collections, and budgeting. The programme transfers skills and experience to municipal officials. Although municipalities receive support to address gaps in their budget and treasury offices by identifying critical posts, filling these is a matter that municipal councils must prioritise. Rural municipalities need to develop new strategies to attract and retain skills, for example, by recruiting retired individuals and using shared services models more extensively.

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.

A total of R10.8 billion is added to the provincial baseline over the next three years. The provincial equitable share baselines are revised upwards by R12 billion, while direct conditional grant allocations are reduced by R1.2 billion over the MTEF period due to reprioritisations. National transfers to provinces increase from R414.9 billion in 2013/14 to R444.4 billion in 2014/15. Over the MTEF period, provincial transfers will grow at an average annual rate of 7 per cent to R508.3 billion in 2016/17.

Table W1.6 sets out the total transfers to provinces for 2014/15, which amount to R444.4 billion. A total of R362.5 billion is allocated to the provincial equitable share and R82 billion to conditional grants, which includes an unallocated R197.4 million for the *provincial disaster grant*, but excludes indirect transfers of R5.4 billion.

Table W1.6 Total transfers to provinces, 2014/15

R million	Equitable share	Conditional grants	Total transfers
Eastern Cape	52 154	9 846	**62 000**
Free State	20 883	6 158	**27 041**
Gauteng	68 673	16 935	**85 608**
KwaZulu-Natal	78 138	15 941	**94 080**
Limpopo	43 274	7 580	**50 854**
Mpumalanga	29 355	6 352	**35 707**
Northern Cape	9 652	3 406	**13 057**
North West	24 707	5 621	**30 328**
Western Cape	35 631	9 917	**45 549**
Unallocated	–	197	**197**
Total	**362 468**	**81 955**	**444 423**

The provincial equitable share

The equitable share is the main source of revenue for meeting provincial expenditure responsibilities. The proposed revisions of R2.5 billion in 2014/15, R4.3 billion in 2015/16 and R5.1 billion in 2016/17 bring the equitable share allocations to R362.5 billion, R388 billion and R412 billion respectively for each year of the MTEF. These revisions result in the provincial equitable share increasing by 6.9 per cent between 2013/14 and 2014/15, and growing at an average annual rate of 6.7 per cent over the MTEF period. These equitable share amounts include 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 will be fully phased into the provincial equitable share from 2016/17.

Policy priorities underpinning equitable share revisions

The revisions to baseline equitable share allocations provide for personnel and policy adjustments to fund urgent government priorities identified in health and social development. The personnel adjustments provide for the carry-through costs of higher-than-anticipated inflation on personnel budgets, the upgrade of clerical positions in all sectors and the costs of occupation-specific dispensation agreements for therapists in the education sector. A total of R11.6 billion is added to the provincial equitable share over the 2014 MTEF for these personnel-related costs. Policy-related adjustments to the provincial equitable share amount to R350 million over the MTEF period. A total of R50 million is added per year to provide shelters for victims of gender-based violence and R200 million is added in 2016/17 for the rollout of the human papillomavirus vaccine (the Department of Health will roll out the vaccine through an indirect grant in 2014/15 and 2015/16).

The equitable share formula

The provincial equitable share formula is reviewed and updated with new data annually. For the 2014 MTEF, the formula has been updated with data from the 2013 mid-year population estimates published by Statistics South Africa; the 2013 preliminary data published by the Department of Basic Education on school enrolment; data from the 2012 General Household Survey for medical aid coverage; and data from the health sector and the Risk Equalisation Fund for the risk-adjusted capitation index. 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. The impact of these updates on the provincial equitable share is phased in over three years (2014/15 to 2016/17).

Provision for 2011 Census impact

The provincial equitable share formula was updated with 2011 Census data in 2013/14. The incorporation of new Census data for the first time in a decade resulted in significant changes. To give provinces time to adjust to their new allocations, the Census updates were phased in over three years and R4.2 billion was added as a “top-up” for provinces with declining shares over the 2013 MTEF period. As Table W1.7 shows, R1.5 billion in 2014/15 and R2.1 billion in 2015/16 of these “top-up” funds will be transferred during the 2014 MTEF.

Table W1.7 Cushioning for 2011 Census impact on provinces with declining shares in the 2014 MTEF

	2014/15	2015/16	2016/17
R thousand	**Medium-term estimates**		
Eastern Cape	421 166	685 628	–
Free State	78 350	171 261	–
Gauteng	–	–	–
KwaZulu-Natal	656 600	773 075	–
Limpopo	297 127	487 036	–
Mpumalanga	–	–	–
Northern Cape	–	–	–
North West	–	–	–
Western Cape	–	–	–
Total	**1 453 243**	**2 117 000**	**–**

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 “top-up” support provided between 2013/14 and 2015/16 to adjust to their new baselines. Provinces may choose to retain some of the “top-up” funds allocated in 2015/16 to cover the costs of adjusting to their new baselines that will be incurred in 2016/17.

Phasing in the formula

To mitigate the impact of annual data updates on provincial equitable shares, the new shares are phased in over the three-year MTEF. An amended phase-in mechanism is being introduced in the 2014 MTEF to ensure that the weighted share of the provincial equitable share allocated to each province over the MTEF period closely follows the indicative shares for each year published in the previous MTEF.

The equitable share formula data is updated every year and a new target share for each province is calculated, which is shown in Table W1.8. The phase-in mechanism provides a smooth path towards achieving these weighted shares by the third year of the MTEF. It takes the difference between the target weighted share for each province at the end of the MTEF and the indicative allocation for 2014/15 that was published in the 2013 MTEF and closes the gap between these shares by a third in each year of the 2014 MTEF. As a result, one-third of the impact of the data updates is implemented in 2014/15, two-thirds in the indicative allocations for 2015/16 and the updates are fully implemented in the indicative allocations for 2016/17.

Table W1.8 Implementation of the equitable share weights, 2014/15 – 2016/17

Percentage	2014/15 Indicative weighted shares from 2013 MTEF	2014/15	2015/16	2016/17
		2014 MTEF weighted shares 3-year phasing		
Eastern Cape	14.5%	14.4%	14.2%	14.0%
Free State	5.8%	5.7%	5.7%	5.6%
Gauteng	18.8%	19.1%	19.3%	19.5%
KwaZulu-Natal	21.5%	21.5%	21.4%	21.3%
Limpopo	12.0%	12.0%	11.9%	11.8%
Mpumalanga	8.1%	8.1%	8.2%	8.2%
Northern Cape	2.7%	2.7%	2.7%	2.7%
North West	6.8%	6.8%	6.9%	6.9%
Western Cape	9.7%	9.8%	9.9%	10.0%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**

In previous MTEF periods, the previous year's weighted shares (for example, 2013/14 shares for the 2014 MTEF) were used as the starting point for the phase-in mechanism. By using the indicative allocations for the first year of the new MTEF (2014/15) instead, the revised phase-in mechanism follows the indicative shares set out in the previous MTEF more closely and reduces the likelihood of any temporary anomalies in a province's phase-in path (such as a decrease in its share in one year despite a consistently upward trend over the MTEF period).

Summary of the formula's structure

The formula, shown in Table W1.9 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 W1.9 Distributing the equitable shares by province, 2014 MTEF

	Education	Health	Basic share	Poverty	Economic activity	Institu-tional	Weighted average
	48%	**27%**	**16%**	**3%**	**1%**	**5%**	**100%**
Eastern Cape	15.2%	13.4%	12.5%	16.1%	7.5%	11.1%	14.0%
Free State	5.3%	5.4%	5.2%	5.3%	5.3%	11.1%	5.6%
Gauteng	17.5%	21.5%	24.0%	17.2%	34.5%	11.1%	19.5%
KwaZulu-Natal	22.6%	22.0%	19.7%	22.2%	15.7%	11.1%	21.3%
Limpopo	13.1%	10.4%	10.4%	13.6%	7.1%	11.1%	11.8%
Mpumalanga	8.5%	7.3%	7.8%	9.1%	7.0%	11.1%	8.2%
Northern Cape	2.3%	2.1%	2.2%	2.2%	2.2%	11.1%	2.7%
North West	6.5%	6.8%	6.8%	8.1%	6.5%	11.1%	6.9%
Western Cape	9.0%	11.1%	11.4%	6.2%	14.2%	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 W1.10 shows the full impact of the data updates on the provincial equitable share per province. It compares the target shares for the 2013 and 2014 MTEF periods.

Table W1.10 Full impact of data updates on the equitable share

	2013 MTEF	2014 MTEF	Difference
Eastern Cape	14.2%	14.0%	-0.11%
Free State	5.6%	5.6%	-0.02%
Gauteng	19.4%	19.5%	0.04%
KwaZulu-Natal	21.3%	21.3%	0.02%
Limpopo	11.8%	11.8%	0.01%
Mpumalanga	8.2%	8.2%	0.02%
Northern Cape	2.7%	2.7%	-0.04%
North West	6.9%	6.9%	0.04%
Western Cape	10.0%	10.0%	0.05%
Total	**100.0%**	**100.0%**	**–**

For the 2014 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 the risk profile of each province and its health system case load.
- 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) based on income data. This component reinforces the redistributive bias of the formula.
- An *economic output component* (1 per cent) based on GDP-R data. GDP-R is a measure of regional gross domestic product produced by Statistics South Africa.

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 2013 School Realities Survey conducted by the Department of Basic Education. Each of these elements is assigned a weight of 50 per cent.

Table W1.11 shows the impact of updating the education component with new enrolment data on the education component shares.

Table W1.11 Impact of changes in school enrolment on the education component share

	Age cohort 5 – 17	School enrolment 2012	2013	Changes in enrolment	Weighted average 2013 MTEF	2014 MTEF	Difference in weighted average
Eastern Cape	1 856 317	1 938 837	1 927 081	-11 756	15.3%	15.2%	-0.09%
Free State	657 489	660 966	663 312	2 346	5.3%	5.3%	-0.00%
Gauteng	2 231 793	2 062 526	2 116 391	53 865	17.3%	17.5%	0.17%
KwaZulu-Natal	2 758 594	2 866 369	2 857 959	-8 410	22.7%	22.6%	-0.10%
Limpopo	1 536 294	1 714 518	1 713 696	-822	13.1%	13.1%	-0.04%
Mpumalanga	1 053 846	1 051 356	1 049 995	-1 361	8.5%	8.5%	-0.03%
Northern Cape	288 839	276 420	281 500	5 080	2.3%	2.3%	0.01%
North West	824 724	774 615	787 470	12 855	6.5%	6.5%	0.03%
Western Cape	1 174 625	1 034 392	1 048 883	14 491	8.9%	9.0%	0.04%
Total	**12 382 521**	**12 379 999**	**12 446 287**	**66 288**	**100.0%**	**100.0%**	**–**

Health component (27 per cent)

The health 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 methods work together to balance needs (risk-adjusted capitation) and demands (output component).

The health component is presented in three parts below. Table W1.12 shows the shares of the risk-adjusted component, which accounts for 75 per cent of the health component.

Table W1.12 Risk-adjusted sub-component shares

Thousand	Mid-year population estimates 2013	Insured population 2012	Risk-adjusted index 2013	Weighted population	Risk-adjusted shares 2013	2014	Change
Eastern Cape	6 620	10.9%	96.9%	5 713	13.0%	13.1%	0.10%
Free State	2 753	18.1%	103.3%	2 328	5.4%	5.4%	-0.08%
Gauteng	12 728	29.0%	105.4%	9 527	22.7%	21.9%	-0.82%
KwaZulu-Natal	10 457	12.3%	98.9%	9 070	20.6%	20.9%	0.30%
Limpopo	5 518	8.0%	91.6%	4 652	10.6%	10.7%	0.09%
Mpumalanga	4 128	14.5%	95.7%	3 378	7.6%	7.8%	0.13%
Northern Cape	1 163	18.9%	100.7%	949	2.3%	2.2%	-0.13%
North West	3 598	14.1%	102.2%	3 159	7.2%	7.3%	0.11%
Western Cape	6 017	25.2%	104.0%	4 682	10.5%	10.8%	0.30%
Total	**52 982**			**43 459**	**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 Schemes’ Risk Equalisation Fund. The percentage of the population with medical aid insurance, based on the 2012 General Household Survey, is deducted from the 2013 mid-year population estimates 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 W1.12 shows the change in this sub-component between 2013 and 2014.

The output sub-component, which is updated with 2011/12 and 2012/13 data obtained from the District Health Information Services, is shown in Table W1.13 below.

Table W1.13 Output sub-component shares

	Primary healthcare visits				Hospital workload patient-day equivalents			
	2011/12	2012/13	Average	Share	2011/12	2012/13	Average	Share
Eastern Cape	18 255	17 716	17 986	14.1%	4 550	4 373	4 461	14.2%
Free State	7 175	7 473	7 324	5.7%	1 741	1 810	1 776	5.7%
Gauteng	22 309	23 053	22 681	17.7%	6 556	6 578	6 567	20.9%
KwaZulu-Natal	29 139	31 013	30 076	23.5%	8 133	8 061	8 097	25.8%
Limpopo	14 696	14 330	14 513	11.4%	2 868	2 888	2 878	9.2%
Mpumalanga	8 760	9 046	8 903	7.0%	1 724	1 812	1 768	5.6%
Northern Cape	3 338	3 409	3 373	2.6%	449	471	460	1.5%
North West	7 867	7 872	7 870	6.2%	1 551	1 570	1 560	5.0%
Western Cape	15 431	14 728	15 079	11.8%	3 759	3 869	3 814	12.2%
Total	**126 970**	**128 639**	**127 804**	**100.0%**	**31 331**	**31 431**	**31 381**	**100.0%**

The output sub-component uses patient load data from the District Health Information Services. The average number of visits at primary healthcare clinics in 2011/12 and 2012/13 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 2011/12 and 2012/13 is 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.

Table W1.14 shows the updated health component shares for the 2014 MTEF.

Table W1.14 Health component weighted shares

	Risk-adjusted	Primary health care	Hospital component	Weighted shares		Change
Weight	**75.0%**	**5.0%**	**20.0%**	**2013**	**2014**	
Eastern Cape	13.1%	14.1%	14.2%	13.5%	13.4%	-0.11%
Free State	5.4%	5.7%	5.7%	5.4%	5.4%	-0.00%
Gauteng	21.9%	17.7%	20.9%	21.9%	21.5%	-0.41%
KwaZulu-Natal	20.9%	23.5%	25.8%	21.7%	22.0%	0.32%
Limpopo	10.7%	11.4%	9.2%	10.3%	10.4%	0.11%
Mpumalanga	7.8%	7.0%	5.6%	7.2%	7.3%	0.13%
Northern Cape	2.2%	2.6%	1.5%	2.2%	2.1%	-0.15%
North West	7.3%	6.2%	5.0%	6.7%	6.8%	0.07%
Western Cape	10.8%	11.8%	12.2%	11.1%	11.1%	0.03%
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 2014 MTEF, population data is drawn from the 2013 Mid-Year Population Estimates produced by Statistics South Africa. Table W1.15 shows the impact on the basic component's revised weighted shares.

Table W1.15 Impact of the changes in population on the basic component shares

	2011 Census Population	Mid-year population estimates 2013	Population change	% population change	Basic component shares 2013 MTEF	2014 MTEF	Change
Eastern Cape	6 562 053	6 620 100	58 047	0.9%	12.7%	12.5%	-0.18%
Free State	2 745 590	2 753 200	7 610	0.3%	5.3%	5.2%	-0.11%
Gauteng	12 272 263	12 728 400	456 137	3.7%	23.7%	24.0%	0.32%
KwaZulu-Natal	10 267 300	10 456 900	189 600	1.8%	19.8%	19.7%	-0.10%
Limpopo	5 404 868	5 518 000	113 132	2.1%	10.4%	10.4%	-0.03%
Mpumalanga	4 039 939	4 128 000	88 061	2.2%	7.8%	7.8%	-0.01%
Northern Cape	1 145 861	1 162 900	17 039	1.5%	2.2%	2.2%	-0.02%
North West	3 509 953	3 597 600	87 647	2.5%	6.8%	6.8%	0.01%
Western Cape	5 822 734	6 016 900	194 166	3.3%	11.2%	11.4%	0.11%
Total	**51 770 561**	**52 982 000**	**1 211 439**	**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, because 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 lowest 40 per cent of household incomes in the 2010/11 Income and Expenditure Survey. The estimated size of the poor population in each province is calculated by multiplying the proportion in that province that fall into the poorest 40 per cent of South African households by the population figure for the province from the 2013 Mid-Year Population Estimates. Table W1.16 shows the proportion of poor in each province from the Income and Expenditure Survey, the 2013 Mid-Year Population Estimates and the weighted share of the poverty component per province.

Table W1.16 Comparison of current and new poverty component weighted shares

Thousand	Income and Expenditure Survey 2010/11	Current (2013 MTEF) 2011 Census population	Poor population	Weighted shares	New (2014 MTEF) Mid-year population estimates 2013	Poor population	Weighted shares	Difference in weighted shares
Eastern Cape	52.0%	6 562	3 414	16.3%	6 620	3 445	16.1%	-0.20%
Free State	41.4%	2 746	1 137	5.4%	2 753	1 140	5.3%	-0.10%
Gauteng	28.9%	12 272	3 543	16.9%	12 728	3 675	17.2%	0.26%
KwaZulu-Natal	45.3%	10 267	4 652	22.2%	10 457	4 738	22.2%	-0.06%
Limpopo	52.9%	5 405	2 857	13.6%	5 518	2 917	13.6%	-0.00%
Mpumalanga	47.3%	4 040	1 909	9.1%	4 128	1 951	9.1%	0.01%
Northern Cape	40.8%	1 146	467	2.2%	1 163	474	2.2%	-0.01%
North West	47.9%	3 510	1 681	8.0%	3 598	1 723	8.1%	0.03%
Western Cape	21.9%	5 823	1 273	6.1%	6 017	1 316	6.2%	0.07%
Total		**51 771**	**20 933**	**100.0%**	**52 982**	**21 377**	**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 2014 MTEF, 2011 GDP-R data is used. Table W1.17 shows the weighted shares of the economic activity component.

Table W1.17 Current and new economic activity component weighted shares

	Current (2013 MTEF) GDP-R, 2010 (R million)	Weighted shares	New (2014 MTEF) GDP-R, 2011 (R million)	Weighted shares	Difference in weighted shares
Eastern Cape	203 993	7.7%	219 170	7.5%	-0.15%
Free State	145 405	5.5%	153 284	5.3%	-0.21%
Gauteng	897 553	33.7%	1 005 795	34.5%	0.75%
KwaZulu-Natal	420 647	15.8%	458 841	15.7%	-0.08%
Limpopo	191 934	7.2%	207 308	7.1%	-0.11%
Mpumalanga	187 367	7.0%	205 600	7.0%	0.01%
Northern Cape	61 175	2.3%	65 259	2.2%	-0.06%
North West	177 075	6.7%	189 047	6.5%	-0.17%
Western Cape	376 284	14.1%	413 235	14.2%	0.03%
Total	**2 661 433**	**100.0%**	**2 917 539**	**100.0%**	**–**

Phasing of conditional grant into the provincial equitable share

The *devolution of property rate funds grant* will be fully phased into the provincial equitable share by 2016/17. The grant was introduced to enable provinces to take over the responsibility of paying rates and municipal charges on properties that were administered by national government on their behalf. Progress in ensuring that all provinces have records of their properties and liabilities for municipal rates means that there is no longer a need for a separate conditional grant. A grant phase-out report detailing this progress was submitted to Parliament in February 2013. From 2013/14 to 2015/16, provinces 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 and programmes implemented by provinces. Schedule 6A grants provide 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 reduce some underspending grants to fund key priorities. As a result, the baselines of certain conditional grants have been revised downward. However, because most of the reduced grants have a history of underspending, the impact of these reductions on service delivery should be minimised. Table W1.18 shows the revisions made to provincial conditional grants to make resources available for government priorities, and to provide for technical, policy and inflation adjustments.

Table W1.18 Revisions to conditional grant baseline allocations, 2014/15 – 2016/17

R million	2014/15	2015/16	2016/17	2014 MTEF
Technical revisions	**–**	**–**	**–**	**–**
Direct transfers	**-399**	**-575**	**400**	**-575**
Health facility revitalisation	500	400	400	1 300
Human settlements development	-899	-975	–	-1 875
Indirect transfers	**399**	**575**	**-400**	**575**
National health	-500	-400	-400	-1 300
Human settlements development	899	975	–	1 875
Additions to baseline	**1 373**	**798**	**1 251**	**3 421**
Direct transfers	**1 173**	**598**	**1 251**	**3 021**
Comprehensive agricultural support programme	196	14	–	209
Education infrastructure	53	40	–	92
Health facility revitalisation	1	1	–	2
Comprehensive HIV and Aids	–	–	1 000	1 000
Further education and training colleges	31	60	69	160
Human settlements development	365	141	–	506
Expanded public works programme integrated grant for provinces	–	–	10	10
Social sector expanded public works programme incentive for provinces	–	–	74	74
Provincial roads maintenance	235	178	–	414
Occupational-specific dispensation therapists	213	67	–	280
Substance abuse treatment	29	48	48	124
Public transport operations	50	50	50	150
Indirect transfers	**200**	**200**	**–**	**400**
National health grant	200	200	–	400
Reductions to baseline	**-1 077**	**-1 807**	**-1 675**	**-4 559**
Direct transfers	**-621**	**-1 043**	**-935**	**-2 599**
Comprehensive agricultural support programme	–	-67	-77	-144
Land care programme: poverty relief and infrastructure development	–	-3	-3	-6
Expanded public works programme integrated grant for provinces	-22	-25	–	-47
Social sector expanded public works programme incentive for provinces	-15	-18	–	-33
Human settlements development	-300	-300	-300	-900
Education infrastructure	-284	-630	-555	-1 469
Indirect transfers	**-456**	**-764**	**-741**	**-1 960**
National health	-225	-285	-285	-794
School infrastructure backlogs	-231	-479	-456	-1 166
Net change to provincial allocations	**295**	**-1 009**	**-425**	**-1 138**

After accounting for the reductions and shifts from provincial direct conditional grants, net revisions to direct conditional grant baseline allocations consist of an addition of R152.3 million in 2014/15, a reduction of R1 billion in 2015/16 and an addition of R716 million in 2016/17, or a net decrease of R152 million over the MTEF period. This brings the new direct conditional grant baselines to R82 billion in 2014/15, R89.7 billion in 2015/16 and R96.2 billion in 2016/17.

Table W1.19 provides a summary of conditional grants by sector for the 2014 MTEF. More detailed information, including the framework and allocation criteria for each grant, is provided in Annexure W2 of the 2014 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 and a summary of the grant's audited outcomes for 2012/13.

Table W1.19 Conditional grants to provinces, 2013/14 – 2016/17

R million	2013/14	2014/15	2015/16	2016/17	MTEF total
Agriculture, Forestry and Fisheries	**2 152**	**2 389**	**2 238**	**2 336**	**6 963**
Comprehensive agricultural support programme	1 604	1 861	1 688	1 757	5 306
Ilima/Letsema projects	438	461	482	507	1 450
Land care programme: poverty relief and infrastructure development	109	68	68	72	208
Arts and Culture	**598**	**1 016**	**1 341**	**1 412**	**3 768**
Community library services	598	1 016	1 341	1 412	3 768
Basic Education	**11 836**	**13 170**	**15 827**	**16 662**	**45 659**
Dinaledi schools	109	111	116	122	350
Education infrastructure	6 160	6 929	9 469	10 038	26 436
HIV and Aids (life skills education)	204	221	226	238	686
National school nutrition programme	5 173	5 462	5 704	6 006	17 172
Technical secondary schools recapitalisation	190	233	244	257	735
Occupational-specific dispensation for education sector therapists	–	213	67	–	280
Cooperative Governance and Traditional Affairs	**38**	**197**	**204**	**215**	**617**
Provincial disaster	38	197	204	215	617
Health	**27 686**	**30 111**	**32 484**	**35 184**	**97 780**
Comprehensive HIV and Aids	10 534	12 311	13 957	15 697	41 965
Health facility revitalisation	5 291	5 240	5 389	5 652	16 281
Health professions training and development	2 190	2 322	2 429	2 557	7 308
National tertiary services	9 620	10 168	10 636	11 200	32 004
National health insurance	51	70	74	78	222
Higher Education and Training	**2 454**	**2 631**	**2 819**	**2 974**	**8 424**
Further education and training colleges	2 454	2 631	2 819	2 974	8 424
Human Settlements	**17 028**	**17 084**	**18 533**	**20 410**	**56 027**
Human settlements development	17 028	17 084	18 533	20 410	56 027
Public Works	**614**	**607**	**624**	**786**	**2 017**
Expanded public works programme integrated grant for provinces	357	349	357	412	1 117
Social sector expanded public works programme incentive for provinces	258	258	268	375	900
Social Development	–	**29**	**48**	**48**	**124**
Substance abuse treatment	–	29	48	48	124
Sport and Recreation South Africa	**498**	**526**	**550**	**579**	**1 654**
Mass participation and sport development	498	526	550	579	1 654
Transport	**13 090**	**14 194**	**15 005**	**15 610**	**44 809**
Provincial roads maintenance	8 538	9 361	9 952	10 292	29 606
Public transport operations	4 553	4 833	5 053	5 318	15 203
Total direct conditional grants	**75 995**	**81 955**	**89 672**	**96 215**	**267 842**
Indirect transfers	**2 693**	**5 413**	**5 044**	**4 127**	**14 583**
Basic Education	**1 956**	**2 939**	**2 433**	**2 611**	**7 982**
School infrastructure backlogs	1 956	2 939	2 433	2 611	7 982
Health	**737**	**1 575**	**1 635**	**1 516**	**4 726**
National health	731	1 575	1 635	1 516	4 726
2014 African Nations Championship: health and medical services	6	–	–	–	–
Human Settlements	**–**	**899**	**975**	**–**	**1 875**
Human settlements development	–	899	975	–	1 875

Agriculture grants

The *comprehensive agricultural support programme* aims to support newly established and emerging farmers, in particular subsistence, smallholder and previously disadvantaged farmers. From 2014/15, 70 per cent of the grant will be allocated to the production of livestock and crops. The grant also aims to expand farm infrastructure and provide support for dipping, fencing and rehabilitating viable irrigation schemes. Allocations in 2014/15 and 2015/16 include R507.4 million for the repair of flood damage to agricultural infrastructure. The grant amounts to R5.3 billion over the 2014 MTEF period.

The *land care programme grant: poverty relief and infrastructure development* aims to improve productivity and the sustainable use of natural resources. Provinces are also encouraged to use this grant to create jobs through the Expanded Public Works Programme. Over the medium term, R207.5 million is allocated to this grant.

The *Ilima/Letsema projects grant* aims to boost food production by helping 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 period.

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 administered by that department or through a service-level agreement with municipalities. At least 20 per cent of the funds added to this grant in the 2013 MTEF must be used to set up dual service points in collaboration with provincial departments of basic education. Dual service points are libraries for both schools and the general public. The rest of the additional funding must be used to shift the libraries function between provinces and municipalities. The total grant amounts to R3.8 billion over the next three years.

Basic education grants

The *education infrastructure grant* is used by provinces to construct, maintain and refurbish education infrastructure and schools. The grant totals R26.4 billion over the MTEF period, which includes R92.4 million previously allocated for the 2014 MTEF to repair school infrastructure damaged by floods. 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. The reforms require provinces to meet certain prerequisites and have their infrastructure plans approved before they can receive allocations. The full amounts available for this grant in 2015/16 and 2016/17 have not been indicatively allocated per province because not all provinces have met these requirements. The remaining funds for the outer years of the MTEF are reflected as unallocated. Further details on these reforms are discussed 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. It provides a free daily meal to pupils in the poorest 60 per cent of schools (quintile 1 to 3). This grant is allocated R17.2 billion over the MTEF period.

The *technical secondary schools recapitalisation grant* provides for equipment and facilities in technical high schools. This grant has been extended to 2016/17 to address the growing need to recapitalise technical schools identified in provincial needs assessments. This grant is allocated R734.9 million over the 2014 MTEF period.

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 English as a first additional language. Dinaledi schools are schools in disadvantaged communities that perform well in mathematics and physical science. The grant is allocated R349.9 million over the MTEF period.

The *HIV and Aids (life skills education) programme grant* provides for life skills training, and sexuality and HIV/AIDS education in primary and secondary schools. It is fully integrated into the school system, with learner and teacher support materials provided for Grade 1 to 9. This grant is allocated R685.8 million over the MTEF period.

The *school infrastructure backlogs grant* is an indirect grant to provinces that was introduced in 2011 as a temporary, high-impact grant. The national Department of Basic Education uses this grant to build and upgrade schools on behalf of provinces to address inappropriate structures and access to basic services. The grant is allocated R8 billion over the 2014 MTEF period.

The occupational-specific dispensation for education sector therapists grant provides funds for provinces to implement the occupation-specific dispensation agreement for therapists, counsellors and psychologists in the education sector. The grant is allocated for two years (2014/15 and 2015/16) while back-pay is being funded and new remuneration levels are normalised. From 2016/17, the funds will be allocated as part of the provincial equitable share. The grant has been allocated R280 million over the MTEF period.

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 centre after a disaster is declared, without the need for the transfers to first be gazetted. Over the MTEF period, R616.9 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 the urban areas of Gauteng and the Western Cape. These provinces receive the largest shares of the grant as they provide the largest proportion of high-level, sophisticated services for the benefit of the country’s health sector. This grant is allocated R32 billion over the MTEF period.

The *health facility revitalisation grant* funds the construction and maintenance of health infrastructure. This grant was created in 2013/14 through the merger of three previous grants: the *health infrastructure grant*, the *hospital revitalisation grant* and the *nursing colleges and schools grant*. In 2013/14, the grant had separate ring-fenced components corresponding to the previous grants that it replaced. From 2014/15, these components fall away, giving even greater flexibility to provinces to shift funds between projects during the year so that delays in one project do not result in underspending on the grant as a whole. The grant funds a wide range of health infrastructure projects, including large projects to modernise hospital infrastructure and equipment, general maintenance and infrastructure projects at smaller hospitals and the refurbishment and upgrading of nursing colleges and schools.

In the 2014 MTEF, R1.3 billion is added to this grant from the *national health grant* (an indirect grant) to enable provinces to accelerate and complete infrastructure projects under way. This grant also forms part of the reforms to provincial infrastructure grants that affect the *education infrastructure grant*. As detailed above, the reforms require provinces to meet certain prerequisites and have their infrastructure plans approved before they can receive allocations. The full amounts available for this grant in 2015/16 and 2016/17 have not been indicatively allocated per province because not all provinces have met these requirements. The remaining funds for the outer years of the MTEF are reflected as unallocated. The grant is allocated R16.3 billion over the MTEF period.

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. The grant is allocated R7.3 billion over the medium term.

The *comprehensive HIV and Aids grant* enables the health sector respond to HIV/AIDS. It 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 four MTEF periods, R1 billion is added to the grant in 2016/17 to cover the increased antiretroviral treatment take-up rate. This brings the baseline over the MTEF period to R42 billion.

The *national health insurance grant* funds the national health insurance pilots introduced in 2012/13, which aim to strengthen primary healthcare 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 2014 MTEF period, the grant has been allocated R221.9 million. This grant is complemented by the national health insurance window within the *national health grant*.

The *national health grant* is an indirect grant introduced in 2013/14, which is spent by the Department of Health on behalf of provinces. The grant has three components, one to support infrastructure projects, a second to support the national health insurance scheme pilot sites and a third to support the rollout of the human papillomavirus vaccine. 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 human papillomavirus vaccine component is allocated for two years (2014/15 and 2015/16), and will be used to support provincial health departments with the rollout of this vaccine. Funds for the vaccine have been added to the provincial equitable share in 2016/17. The grant is allocated R4.7 billion over the MTEF period.

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 was transferred directly to colleges as a subsidy from the Department of Higher Education and Training. An amount of R159.9 million has been added for the carry-through cost of increased employee compensation over the MTEF period. The total allocations are R2.6 billion in 2014/15, R2.8 billion in 2015/16 and R3 billion in 2016/17, bringing the total value of this grant to R8.4 billion over the MTEF period.

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 formula used to allocate the grant was reviewed during 2013 and a revised formula will be introduced from 2014/15 to ensure closer alignment between provincial allocations and the number of households with inadequate housing in each province. The new formula will be phased in over two years (2014/15 and 2015/16) to give provinces time to adjust to their new allocations.

Funds have also been added to the *human settlements development grant* to accelerate the upgrading of informal settlements in mining towns. A total of R2.4 billion is allocated over the 2014 MTEF period to 21 such towns in six provinces with significant informal settlement challenges and where a high proportion of their economic activity is based on the natural resources sector. A total of R325 million is also allocated over the MTEF period to repair infrastructure damaged by floods.

Government has prioritised the eradication of bucket sanitation systems. Amounts of R899.2 million in 2014/15 and R975.4 million in 2015/16 have been shifted into a new indirect version of the *human settlements development grant* so that the Department of Human Settlements can complete infrastructure on behalf of provinces. This indirect grant will focus on improving sanitation in areas where housing projects did not adequately provide for decent sanitation systems.

The human settlements function is due to be assigned to six metropolitan municipalities in 2014, in line with government’s Outcome 8 target. When a municipality is assigned the function, all further *human settlements development grant* allocations for that city will be transferred directly to the municipality instead of the province. The grant’s allocation totals R56 billion over the 2014 MTEF period.

Public works grants

The *expanded public works programme integrated grant for provinces* was revised in 2012 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 period.

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, early childhood development, adult literacy and numeracy, community safety and security, and sports programmes. The grant’s allocation model has been amended to provide greater incentives for provincial departments to participate in the Expanded Public Works Programme and to measure the performance of each province relative to its peers and provide additional incentives to those that perform well. The revised model will be implemented from the 2014 MTEF onwards. This grant is allocated R900.2 million over the MTEF period.

Social development grant

The *substance abuse treatment grant* is a new grant administered by the Department of Social Development. It will run for three years before it is incorporated into the provincial equitable share. This grant aims to strengthen the harm-reduction programme by building public substance abuse treatment facilities in the four provinces that do not already have such facilities: Eastern Cape, Free State, Northern Cape and North West. The grant has been allocated R124 million over the 2014 MTEF period.

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, with greater emphasis on provincial and district academies. This grant is allocated R1.7 billion over the MTEF period.

Transport grants

The *public transport operations grant* subsidises commuter bus services. It supports provinces 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 2014/15. If this takes place, funds for this grant will be transferred directly to the assigned municipality. The grant is allocated R15.2 billion over the MTEF period.

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 rehabilitate roads that are heavily used in support of electricity production. Grant allocations are determined using 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. 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. The model’s indicators – vehicle operating costs and remaining asset lifespan – have been finalised and the performance component will inform future grant allocations. The total allocation for the MTEF is R29.6 billion. This includes allocations of R602.3 million and R178.4 million in the first two years of the 2014 MTEF for the repair of infrastructure damaged by floods. In addition, R803 million in 2014/15 and R840 million in 2015/16 has been allocated to repair roads that are heavily used in support of electricity production.

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.

The 2013 division of revenue saw several major changes to the local government fiscal framework, including the introduction of a new formula for the local government equitable share, several new conditional grants and the use of updated data from the 2011 Census in allocating the *municipal infrastructure grant*. As several of these changes are still being phased in over the next few years, fewer changes are proposed in the 2014 MTEF. A review of local government conditional grants for infrastructure (discussed in part 6 of this annexure) is also likely to result in further changes in future years.

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 2014/15 budgets, and to promote better accountability and transparency by ensuring that all national allocations are included in municipal budgets.

Changes to local government allocations

After accounting for all reductions and additions, direct transfers to local government decrease by a net amount of R3.8 billion in the 2014 MTEF. Indirect transfers to local government (allocations spent by national departments on behalf of municipalities) increase by R2.3 billion over the MTEF period, bringing the total decrease in local government allocations to R1.6 billion.

Changes to individual conditional grants are discussed in more detail below, including a new conditional grant to fund capacity in cities to manage the development of human settlements. The human settlements and public transport functions may be assigned to selected metropolitan municipalities during 2014/15. 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 affected municipalities.

Government’s commitment to the expenditure limits set out in the 2013 Budget means that some items have to be reduced to make funding available for national priorities. As a result, the baselines of several conditional grants have been revised downward. Because these revisions are made to grants with a history of underspending, the impact on service delivery is minimised. Table W1.20 shows the reductions made to local government conditional grants to make resources available, as well as the technical revisions and additions to local government allocations over the 2014 MTEF period. No reductions were made to the local government equitable share.

Table W1.20 Revisions to direct and indirect transfers to local government, 2014/15 – 2016/17

R million	2014/15	2015/16	2016/17	2014 MTEF Total revisions
Technical adjustments	**-580**	**-1 000**	**-1 000**	**-2 580**
Direct transfers	**-1 050**	**-1 359**	**-1 512**	**-3 921**
Municipal water infrastructure	-525	-1 292	-1 512	-3 328
Integrated national electrification programme	-460	–	–	-460
Public transport infrastructure	-158	-181	-455	-794
Public transport network operations	158	181	455	794
Rural households infrastructure	-66	-67	–	-133
Indirect transfers	**470**	**359**	**512**	**1 341**
Municipal water infrastructure	525	1 292	1 512	3 328
Integrated national electrification programme	460	–	–	460
Rural households infrastructure	66	67	–	133
Regional bulk infrastructure	-580	-1 000	-1 000	-2 580
Additions to baselines	**526**	**788**	**945**	**2 259**
Direct transfers	**442**	**438**	**445**	**1 325**
Integrated city development	105	116	135	356
Municipal disaster recovery	37	22	–	59
Municipal human settlements capacity	300	300	300	900
Expanded public works programme integrated grant for municipalities	–	–	10	10
Indirect transfers	**84**	**350**	**500**	**934**
Regional bulk infrastructure	84	350	500	934
Reductions to baseline	**-156**	**-501**	**-594**	**-1 251**
Direct transfers	**-156**	**-501**	**-594**	**-1 251**
Municipal infrastructure	–	-350	-500	-850
Urban settlements development	-50	-45	-35	-130
Expanded public works programme integrated grant for municipalities	-38	-42	–	-80
Infrastructure skills development	-50	-50	-50	-150
Energy efficiency and demand-side management	-19	-14	-9	-41
Net change to local government allocations	**-210**	**-713**	**-649**	**-1 572**

Transfers to local government

Over the 2014 MTEF period, R296 billion will be transferred directly to local government and a further R27.4 billion has been allocated to indirect grants. Direct transfers to local government in 2014/15 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 7.9 per cent over the MTEF period, which is above projected inflation.

Table W1.21 Transfers to local government, 2010/11 – 2016/17

R million	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
		Outcome		Revised estimate		Medium-term estimates	
Direct transfers	**60 905**	**68 251**	**76 430**	**83 670**	**90 815**	**100 047**	**105 187**
Equitable share and related	**30 541**	**33 173**	**37 139**	**39 789**	**44 490**	**50 208**	**52 869**
Equitable share formula[1]	26 761	29 289	32 747	35 093	39 410	44 895	47 282
RSC levy replacement	3 492	3 544	3 733	3 930	4 146	4 337	4 567
Support for councillor remuneration and ward committees	288	340	659	766	935	976	1 020
General fuel levy sharing with metros	**7 542**	**8 573**	**9 040**	**9 613**	**10 190**	**10 659**	**11 224**
Conditional grants	**22 822**	**26 505**	**30 251**	**34 268**	**36 135**	**39 181**	**41 094**
Infrastructure	20 871	24 643	27 923	31 053	32 582	35 324	36 722
Capacity building and other	1 951	1 862	2 329	3 214	3 553	3 857	4 372
Indirect transfers	**2 939**	**2 770**	**4 956**	**5 697**	**7 726**	**9 467**	**10 221**
Infrastructure	2 682	2 553	4 823	5 558	7 584	9 316	10 062
Capacity building and other	257	217	133	139	142	151	159
Total	**63 844**	**71 021**	**81 386**	**89 367**	**98 541**	**109 514**	**115 408**

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 revenue that municipalities can raise themselves (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 2014 MTEF period, the local government equitable share, including the *RSC/JSB levies replacement grant* and *special support for councillor remuneration and ward committees,* is worth R147.6 billion – R44.5 billion in 2014/15, R50.2 billion in 2015/16 and R52.9 billion in 2016/17.

Formula for allocating the local government equitable share

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) to ensure objectivity.

A new formula for the local government equitable share was introduced in 2013/14, following a review of the previous formula by the National Treasury, the Department of Cooperative Governance and SALGA, in partnership with the FFC and Statistics South Africa. The new formula is based on data from the 2011 Census, which resulted in major changes to some allocations. As a result, new allocations are being phased in over a five year period, ending in 2017/18.

The principles and objectives of the local government equitable share formula were set out in detail in the Explanatory Memorandum to the 2013 Division of Revenue.

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 for 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 their own revenue. Municipalities that are 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. The formula's structure 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. Municipalities 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, which means that two old age pensions were worth R2 280 per month. A monthly household income of R2 300 per month (in 2011) has therefore been used to define the formula's affordability threshold. Statistics South Africa has calculated that 59 per cent of all households in South Africa fall below this income threshold. This threshold is not an official poverty line or a required level to be used by municipalities in their own indigence policies – 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 they have consulted with their community during their budget process.

To account for the growth in households each year, the number of households per municipality is updated annually based on the growth in households reflected in each province in the General Household Survey conducted by Statistics South Africa. To account for the likelihood that municipalities within a province will grow at different rates, the growth rate of each municipality is based on the rate it experienced in the period between the 2001 and 2011 Censuses. However, the total number of households per province is rebalanced to match the provincial total in the General Household Survey. Statistics South Africa has advised the National Treasury that in the absence of official municipal level household estimates, this is a credible method of estimating the household numbers per municipality needed for the formula. Statistics South Africa is researching possible methods for producing municipal-level data estimates. These estimates may be used to inform equitable share allocations in future.

The basic services component provides a subsidy of R293 per month in 2014/15 for the cost of providing basic services to each of these households. The 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 W1.22 and includes an allocation of 10 per cent for service maintenance costs.

Table W1.22 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	54.20	6.02	60.22	6 289
Water	83.78	9.31	93.09	9 722
Sanitation	68.40	7.60	76.00	7 937
Refuse	57.34	6.37	63.71	6 654
Total basic services	**263.72**	**29.30**	**293.03**	**30 603**

The formula uses the fairest estimates of the average costs of providing each service that could be derived from available information. More details of how the costs were estimated can be found in the discussion paper on the proposed structure of the new local government equitable share formula (available at: http://mfma.treasury.gov.za/Media_Releases/LGESDiscussions/Pages/default.aspx).

The per household allocation for each of the basic services in Table W1.22 is updated annually based on the following:

- The electricity cost estimate is made up of bulk and other costs. Bulk costs are updated based on the multi-year price determination approved by the National Energy Regulator of South Africa and other costs are updated based on the National Treasury's inflation projections.
- The water cost estimate is also made up of bulk and other costs. Bulk costs are 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 for all municipalities). Other costs are updated based on the National Treasury's inflation projections.
- The costs for sanitation and refuse are updated based on the National Treasury's inflation projections.

The allocations for each service for 2015/16 and 2016/17 are based on forward projections of the cost factors described above.

The basic services component allocation to each municipality is calculated by multiplying the monthly subsidy per household by the updated number of households below the affordability threshold in each municipal area.

The basic services component

BS = basic services subsidy x number of 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 basic services component is worth R30.6 billion in 2014/15 and accounts for 77.7 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. Because this component should support 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 their own revenue. The revenue adjustment factor is described in more detail later in this annexure.

This component consists of a base allocation of R5.3 million, which 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 8.9 per cent of the equitable share formula and is worth R3.5 billion in 2014/15. This component is also complemented by special support for councillor remuneration in poor municipalities, which is not part of the equitable share formula (described in more detail later).

The community services component

This component funds services that benefit communities rather than individual 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 management, street lighting and parks. To ensure this component assists municipalities with limited own-revenue-raising abilities, a revenue adjustment factor is applied so that a larger proportion of the allocation is received by municipalities with less potential to raise their 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, because both provide community services. In 2014/15, the allocation to district and metropolitan municipalities for municipal health and related services is R7.39 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 13.4 per cent of the equitable share formula and is worth R5.3 billion in 2014/15.

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 most of their own administrative costs and cross-subsidise some services for indigent residents. Given the varied 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 community 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 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 a percentage of the total number of households in the municipality.

Based on this index, municipalities were ranked according to their per capita revenue-raising potential. The top 10 per cent of municipalities have a revenue adjustment factor of zero, which means that they receive no allocation from the institutional and community services components. The 25 per cent of municipalities with the lowest scores have a revenue adjustment factor of 100 per cent, which means that they receive their full allocation from the institutional and community 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.

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

The new equitable share formula and the updated 2011 Census data used in the formula mean that some municipalities 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 are being phased in over five years, from 2013/14 to 2017/18. For municipalities with smaller allocations under the new formula, the phase-in mechanism measures the difference between the municipality's old and new allocations and closes this gap by 20 per cent each year. This means that in the first year, a municipality only experienced a change equivalent to 20 per cent of the gap between their allocations under the old and new formulas, in the second year (2014/15) 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 approach, while staying within the limits of the equitable share, municipalities with larger allocations will also have their increases phased in over five years. The total top-up amount needed to fund the phasing 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. It 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 it cannot be manipulated. This means that the balancing of the formula to the available resources must take place in the second part of the formula, which includes the institutional and community services components.

Potential future refinements to the formula

Although the local government equitable share formula has been through extensive consultations and technical work, national government is still working with stakeholders to improve the formula. Areas of work include:

- Exploring the introduction of factors to account for costs related to the size of the land area served and settlement types in municipalities.
- Developing differentiated costing variables to take account of the different costs of services in different circumstances. Both SALGA and the FFC are conducting research projects that could provide the basis for calculating such variables in future.
- Exploring the creation of separate sub-components for fire services and municipal health services within the community services component. This would enhance transparency in allocations, although funds for the fire services function would need to be allocated to the municipality (district or local) authorised for this function within a specific area. This component therefore depends on the compilation and maintenance of a credible and comprehensive database on the assignment of the fire services function. The National Disaster Management Centre under the Department of Cooperative Governance is compiling this database.

Government is committed to considering all proposed refinements to the formula, but another full review is not envisaged until the current formula has been fully phased in.

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 remaining four years of the phase-in period will be provided on the National Treasury’s website. This will enable municipalities to see the full impact of the new formula once it is phased in. To promote transparency, 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 2014/15, 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. The total value of the support provided in 2014/15 is R934.6 million, calculated separately to the local government equitable share and 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). All subsidy levels are based on the gazetted upper maximum levels for part-time councillors. The gazette issued on 29 January 2014 includes a shift to the use of 2011 Census data in determining the grades of municipal councils. Because it takes time for municipalities to calculate their grades and confirm these with provincial Members of the Executive Council for local government, the municipal grades used for allocations in 2014/15 do not account for these updates. The National Treasury, together with the Department of Cooperative Governance, will examine the impact of the use of Census 2011 data on municipal grades before determining the 2015/16 allocations for councillor remuneration. 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.

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 R36.1 billion in 2014/15 to R39.2 billion in 2015/16 and R41.1 billion in 2016/17.

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 R131.6 billion over the 2014 MTEF period.

Table W1.23 Infrastructure transfers to local government, 2010/11 – 2016/17

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
R million		Outcome		Revised estimate		Medium-term estimates	
Direct transfers	**20 871**	**24 643**	**27 923**	**31 053**	**32 582**	**35 324**	**36 722**
Municipal infrastructure	9 704	11 443	13 879	14 355	14 684	15 098	15 767
Municipal water infrastructure	–	–	–	403	534	1 380	1 302
Urban settlements development	4 968	6 267	7 392	9 077	10 285	10 655	11 232
Integrated national electrification programme	1 033	1 097	1 151	1 635	1 105	2 056	2 165
Public transport infrastructure	3 700	4 612	4 884	4 669	4 968	5 098	5 104
Neighbourhood development partnership	832	738	578	598	591	600	632
Integrated city development	–	–	–	40	255	266	293
2010 FIFA World Cup stadiums development	302	–	–	–	–	–	–
Rural roads asset management systems	10	35	37	52	75	98	103
Rural households infrastructure	–	–	–	107	48	51	125
Municipal disaster recovery	320	450	–	118	37	22	–
Indirect transfers	**2 682**	**2 553**	**4 823**	**5 558**	**7 584**	**9 316**	**10 062**
Integrated national electrification programme	1 720	1 165	1 879	2 141	2 948	3 680	3 875
Neighbourhood development partnership	50	50	80	55	58	55	52
Regional bulk infrastructure	851	1 260	2 523	3 261	3 987	4 222	4 624
Municipal water infrastructure	–	–	–	–	525	1 292	1 512
Rural households infrastructure	62	78	341	101	66	67	–
Total	**23 553**	**27 196**	**32 746**	**36 611**	**40 165**	**44 639**	**46 784**

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 increase to R14.7 billion in 2014/15, R15.1 billion in 2015/16 and R15.8 billion in 2016/17.

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 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 (proportional allocations for water supply and sanitation, roads and other services such as 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 2014 MTEF, the *municipal infrastructure grant* allocation formula uses data from the 2011 Census. Allocations for basic services sub-components are based on the proportion of the national backlog for that service in each municipality. Other components are based on the proportion of the country's poor households located in each municipality. Table W1.24 sets out the proportion of the grant accounted for by each component of the grant formula. The C-component provides a R5 million base to all municipalities receiving *municipal infrastructure grant* allocations.

Table W1.24 Municipal infrastructure grant allocations per sector

Municipal infrastructure grant (formula)	Component weights	Proportion of municipal infrastructure grant per sector	Value of component 2014/15 (R millions)
B-component	**75.0%**		**10 086**
Water and sanitation	72.0%	54.0%	7 262
Roads	23.0%	17.3%	2 320
Other	5.0%	3.8%	504
P-component	**15.0%**		**2 017**
Sports	100.0%	15.0%	2 017
E-component	**5.0%**	**5.0%**	**672**
N-component	**5.0%**	**5.0%**	**672**
Constant			**1 235**
Total			**14 684**

Since 2011/12, the P-component (15 per cent of the grant) has been ring-fenced for municipal sport and recreation infrastructure. This continues in the 2014 MTEF.

The *municipal infrastructure grant* has been reduced by R350 million in 2015/16 and R500 million in 2016/17, less than 2.3 per cent and 3.1 per cent of the value of the grant in each respective year. These funds are added to the *regional bulk infrastructure grant*, allowing more resources to be invested in the bulk water and sanitation infrastructure needed for future household connections funded through the *municipal infrastructure grant*.

Government has prioritised the eradication of bucket sanitation systems. Although substantial funds are already available for the upgrading of sanitation infrastructure through the *municipal infrastructure grant*, these funds have not always been prioritised towards bucket eradication at a local level. To ensure this national priority is also prioritised in municipalities, conditions will be added to the grant to require municipalities with many households served by bucket systems to prioritise sanitation upgrades. If municipalities fail to make this a priority or are unable to implement projects, funds may be converted to an indirect grant for national government to provide infrastructure on behalf of the municipality.

Urban settlements development grant

The *urban settlements development grant* is an integrated source of funding to upgrade urban informal settlements in the eight metropolitan municipalities. The grant is allocated as a supplementary grant to cities (schedule 4 of the Division of Revenue Act), which means that municipalities are expected to use a combination of grant funds and their own revenue to upgrade informal settlements. Cities report their progress on these projects against the targets set in their service delivery and budget implementation plans. The grant has been reduced by R50 million in 2014/15, R45 million in 2015/16 and R35 million in 2016/17. These reductions – of less than 0.5 per cent of the total grant allocation in any year – will be used to fund other priorities in urban development. The *urban settlements development grant* is allocated a total of R32.2 billion over the 2014 MTEF period.

To accelerate the eradication of bucket sanitation backlogs, conditions will be added to the *urban settlements development grant* to require metropolitan municipalities to prioritise this commitment in metropolitan municipalities that still use bucket systems. If municipalities fail to make this a priority or are unable to implement projects, funds may be converted to an indirect grant for national government to provide infrastructure on behalf of the municipality.

Municipal water infrastructure grant

This grant was introduced in 2013/14 to accelerate the delivery of clean water to communities that do not have access to basic water services. The grant, administered by the Department of Water Affairs, provides funding for various projects, including the construction of new infrastructure and the refurbishment and extension of existing water schemes. Although this grant was implemented in 2013/14 as a direct grant (schedule 5B to the Division of Revenue Act), in the 2014 MTEF it will have both a direct and indirect grant component (schedule 6B to the Division of Revenue Act). In areas where municipalities have the capacity to implement projects themselves, funds will be transferred through a direct grant. In other areas, the Department of Water Affairs will implement projects on behalf of municipalities through an indirect grant. The direct and indirect grants have a total allocation of R6.5 billion over the 2014 MTEF period.

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* since 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 R15.2 billion over the 2014 MTEF period.

The rural roads asset management systems grant

The *rural roads asset management systems grant* is administered by the Department of Transport to improve rural road infrastructure. The grant funds the collection of 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 2014 MTEF period, this grant will be extended to all district municipalities. The grant has an allocation of R275.9 million over this period.

The rural households infrastructure grant

The *rural households infrastructure grant* funds the provision of on-site solutions for sanitation services for rural households where piped infrastructure is not feasible. This grant was implemented as a direct grant in 2013/14, but from 2014/15 the grant will have both direct and indirect components. In areas where municipalities have the capacity to implement projects themselves, funds will be transferred through the direct grant. In other areas, the national Department of Human Settlements will implement projects on behalf of municipalities through an indirect grant. The grant has an allocation of R356.1 million over the 2014 MTEF period.

The neighbourhood development partnership grant

The *neighbourhood development partnership grant* is administered by the National Treasury and has two components in the 2014 MTEF. One focuses on urban areas and the other focuses on towns and rural areas. The urban component supports and facilitates the development of urban network plans to create a platform for third-party public and private investment to improve the quality of life in township urban hubs. Projects in towns and rural areas will be implemented in conjunction with the Department of Rural Development to support catalytic projects in these areas. The grant has an allocation of R2 billion over the MTEF period, which consists of R1.8 billion for the capital (direct) grant and R165.3 million for the technical assistance (indirect) grant.

Integrated cities development grant

In its second year, this grant 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 and efficient urban spatial form. Cities are required to submit built environment performance plans for this grant. The plan provides a brief strategic overview of a city's plans for the built environment, with a focus on the infrastructure grants that form part of the capital budget. The plan should show how the municipality will ensure alignment between its different grant-funded programmes and how it will address related policy and regulatory matters. From 2014/15, all projects funded by sector-specific infrastructure grants, including the *urban settlements development grant*, the *public transport infrastructure grant,* the *neighbourhood development partnership grant* and the *integrated national electrification programme grant*, must form part of a metropolitan municipality's built environment performance plan. This grant receives additional funding of R356 million over the 2014 MTEF period, bringing the total value of the grant to R814 million.

The integrated national electrification programme

To sustain progress in connecting poor households to electricity, government will spend R15.8 billion over the next three years on the national electrification programme. Of this, municipalities will spend R5.3 billion and Eskom will spend R10.5 billion on behalf of municipalities through an indirect grant. This programme has been instrumental in providing 85 per cent of all households with 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 infrastructure. It targets projects that cut across several municipalities or are large bulk projects within one municipality. The grant funds the bulk infrastructure needed to provide reticulated water and sanitation services to individual households. It may also be used to appoint service providers to carry out feasibility studies, related planning or management studies for infrastructure projects. The grant is allocated additional funding of R934 million over the 2014 MTEF period to accelerate the implementation of projects. An amount of R2.6 billion is shifted out of this grant over the 2014 MTEF period to fund water boards' construction of bulk infrastructure. These projects still form part of the Department of Water Affairs' larger programme of subsidising the construction of regional bulk infrastructure for water and sanitation, so the funds are used to achieve the same objective. However, because the infrastructure will be owned and operated by water boards, it cannot be classified as an indirect transfer to municipalities. This brings the total value of the grant to R12.8 billion over the 2014 MTEF period.

Municipal disaster recovery grant

The *municipal disaster recovery grant* was introduced in the 2013 Division of Revenue Amendment Bill. This grant, administered by the National Disaster Management Centre in the Department of Cooperative Governance, is used to rehabilitate and reconstruct municipal infrastructure damaged by disasters. Over the 2014 MTEF period, R59.1 million is made available to repair infrastructure damaged by floods that took place in 2012 and 2013.

Capacity-building grants and other current transfers

Capacity-building grants help to develop municipalities' 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 national water schemes that are being transferred to municipalities. A total of R12.2 billion is allocated to direct and indirect capacity-building grants and other current transfers to local government over the 2014 MTEF period.

Table W1.25 Capacity building and other current transfers to local government, 2010/11 – 2016/17

R million	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
		Outcome		Revised estimate	Medium-term estimates		
Direct transfers	**1 951**	**1 862**	**2 329**	**3 214**	**3 553**	**3 857**	**4 372**
Municipal systems improvement	212	220	230	240	252	261	275
Local government financial management	365	385	403	425	449	470	495
Municipal human settlements capacity	–	–	–	–	300	300	300
Public transport network operations	–	–	–	881	903	1 043	1 362
2010 FIFA World Cup host city operating	210	–	–	–	–	–	–
2013 African Cup of Nations host city operating	–	–	123	–	–	–	–
2014 African Nations Championship host city operating	–	–	–	120	–	–	–
Water services operating subsidy	664	542	562	411	450	470	495
Expanded public works programme integrated grant for municipalities	280	364	662	611	595	619	706
Infrastructure skills development	–	39	75	99	104	129	139
Energy efficiency and demand-side management	220	280	200	181	137	188	204
Municipal disaster	–	32	73	247	364	376	396
Indirect transfers	**257**	**217**	**133**	**139**	**142**	**151**	**159**
Energy efficiency and demand-side management	109	119	–	–	–	–	–
Water services operating subsidy	148	98	133	139	142	151	159
Total	**2 208**	**2 079**	**2 461**	**3 353**	**3 695**	**4 008**	**4 531**

Municipal human settlements capacity grant

This new grant, administered by the Department of Human Settlements, funds capacity for the development of human settlements in the six metropolitan municipalities targeted for assignment of the housing function in 2014. This grant has been allocated R300 million in 2014/15, R300 million in 2015/16 and R300 million in 2016/17.

Financial management grant

The *financial management grant*, managed by the National Treasury, funds the placement of financial management interns and the modernisation of financial management systems. This includes building in-house municipal capacity to implement multi-year budgeting, linking integrated development plans to budgets and producing quality and timely in-year and annual reports. The grant supports municipalities in the implementation of the Municipal Finance Management Act. Total allocations for the *financial management grant* amount to R1.4 billion over the 2014 MTEF period.

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 cities with greater certainty about the levels of operational funding they will receive to support their new public transport networks. The *public transport network operations grant* is allocated R3.3 billion over the 2014 MTEF period.

Infrastructure skills development grant

The *infrastructure skills development grant*, now in its third year, develops capacity within municipalities by creating a sustainable pool of young professionals with technical skills related to municipal services, such as water, electricity and town planning. The grant places interns in municipalities, so they can complete the requirements of the relevant statutory council/professional body within their respective built environment fields. The interns can be hired by any municipality at the end of their internship. The grant has an allocation of R372.4 million over the 2014 MTEF period.

Municipal systems improvement grant

The *municipal systems improvement grant* helps municipalities perform their functions and stabilise institutional and governance systems, as required in the Municipal Systems Act (2000) and related legislation. The grant is administered by the Department of Cooperative Governance and is allocated R788.1 million over the MTEF period.

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, which creates an incentive for municipalities. The formula has an extra weighting to give bigger allocations to poor, rural municipalities. The grant has an allocation of R1.9 billion over the 2014 MTEF period.

The energy efficiency and demand-side management grant

The *energy efficiency and demand-side management grant* was introduced to address load shedding in 2008. It funds selected municipalities to implement energy-efficiency projects, with a focus on public lighting and energy-efficient municipal infrastructure. In the 2014 MTEF, the Department of Energy will monitor and verify grant-funded projects to ensure greater consistency in in the procurement of accredited verification services. The grant is allocated R529 million over the MTEF period.

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 direct grant funds the refurbishment and upgrading of schemes, while the indirect grant funds the costs of staff that have not been transferred to municipalities. In the 2014 MTEF, R1.9 billion is allocated for the *water services operating subsidy* (direct and indirect transfers). It is a transitional grant that is expected to continue until 2016/17, subject to review by the National Treasury and the Department of Water Affairs.

Municipal disaster grant

The *municipal disaster grant*, introduced in the 2011 MTEF, 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 2014 MTEF period, this grant is allocated R1.1 billion.

Part 6: Future work on provincial and municipal fiscal frameworks

Provincial infrastructure transfers

Reforms to the health and education infrastructure transfers to provinces began to be implemented in 2013/14. These reforms aim to address planning and procurement failures in infrastructure delivery by introducing incentives, which will promote good infrastructure delivery management system practices and complement existing capacity support programmes.

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 are now required to bid for their infrastructure grant allocations two years in advance (during 2013/14, provinces submitted bids for their 2015/16 allocations). A set of bidding prerequisites and criteria are used to evaluate bids. Unsuccessful bids are not funded and those allocations are pooled in an unallocated fund, for which provinces with successful bids can apply. The 2013 Division of Revenue Act required provinces to complete and submit plans and bids during 2013/14 as part of the first approval process. The 2014 Division of Revenue Bill outlines the requirements for the second approval process, which will determine the final allocations in 2015/16.

Approval processes

There are two approval processes before a final allocation is made. First, provinces are required to submit an asset management plan, an infrastructure programme management plan and a supporting construction procurement strategy. In the second approval process, conducted for the first time during 2014/15, successful departments will prepare project proposals and longer-term asset management plans. These will be assessed to confirm each province’s allocation (confirmed by an allocation letter from the National Treasury). The province will then be instructed to proceed with tender procedures.

After the second approval, the application process for the year is complete. Allocations may still 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, would 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, it will not receive further transfers until it has spent the funds already transferred. Options will also be explored to shift unspent funds to projects where they can be spent during the year.

Progress to date

This process is being implemented for the first time to determine allocations for the *health facility revitalisation grant* and the *education infrastructure grant* for 2015/16. Departments that have not complied with the submission requirements of the 2013 Division of Revenue Act will only be allocated funds for existing projects in 2015/16, and not for any new projects. This reflects the principle of using performance-based allocations that these reforms promote. The baseline allocations per province will be reflected in the 2014 Division of Revenue Bill as partially unallocated for 2015/16 and fully unallocated for 2016/17. These allocations will be finalised after the second approval process during 2014.

During 2014/15, provinces will also submit applications for the first part of the approval process to determine their grant allocations for 2016/17.

Local government infrastructure transfers

Infrastructure grants account for 40 per cent of transfers to local government and amount to over R40 billion in 2014/15 alone, following substantial real growth in recent years. Many of these grants are the government’s primary mechanisms for funding infrastructure and essential services such as water, sanitation, electricity and roads. The consistent growth in allocations reflects government's prioritisation of these services. However, the 2011 Census revealed that despite improvements in access to services, the pace of these improvements does not always reflect the large increases in allocations over the past decade.

The local government infrastructure grant system is being reviewed to investigate the efficiency and effectiveness of these grants. The review stems from the 2011 Census data and calls for reform across government and by other stakeholders. For example, the FFC has raised concerns about the proliferation of grants, parliamentary committees have issued caution over the frequent underspending on infrastructure grants, and sector departments and municipalities have raised the issue of funding gaps in the grant system.

This review of local government infrastructure grants was announced in the 2013 Budget and the Budget Forum endorsed its terms of reference in October 2013. The National Treasury is leading the review in collaboration with the Department of Cooperative Governance, the Department of Performance, Monitoring and Evaluation, the FFC and SALGA through a working group and steering committee. In addition, extensive plans are in place for municipal consultation through workshops and online questionnaires in early 2014. National sector departments will also be consulted. Using these inputs from national and municipal stakeholders, in addition to extensive data analysis and research into domestic and international literature, an evidence base is being built to inform policy decisions regarding changes to the grant system. The current structure's development was ad hoc in its approach, resulting in many different grants with various overlapping responsibilities. It is envisaged that this collaborative and research-based process will introduce a clear grant system structure.

By October 2014, the review's working group and steering committee will condense the analysis and evidence into a set of recommendations to be presented to the Budget Forum. These proposals should set out how to improve the efficiency and effectiveness of the infrastructure grant system, but no conclusions can be pre-empted or ruled out before the necessary objective analysis is conducted. Recommendations could involve, for example, the merging of current grants, changes in the administration of grants, or reforms to the Division of Revenue Act. After the Budget Forum and Cabinet have made changes and given approval, the review's recommendations will be communicated clearly to all stakeholders before they are implemented, starting in the 2015 Budget.

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.

Municipal Property Rates Act

The Municipal Property Rates Act regulates the power of municipalities to impose rates on properties. The Department of Cooperative Governance administers the act, monitoring municipalities' compliance with the act and its regulatory framework periodically, and guiding non-compliant municipalities to comply with the provisions of the act and its regulations. The department introduced the Municipal Property Rates Amendment Bill to Parliament in September 2013 to strengthen the regulatory, monitoring and reporting provisions of the act, which in turn will improve its implementation and minimise legal ambiguities. As at February 2014, Parliament has already received public submissions on the bill, held public hearings and considered the bill.

Development charges

A development charge is a once-off infrastructure access fee imposed on a land owner as a condition of approval of a land development that will substantially increase the use of or need for municipal infrastructure engineering services. There is currently no legislation that adequately defines development charges and recognises their unique character as a multi-sector and upfront infrastructure charge.

The National Treasury is amending the Municipal Fiscal Powers and Functions Act to incorporate the regulation of development charges. A national draft policy framework that will give expression to the implementation of development charges has been developed and consultations with various stakeholders are under way.

Sharing of the general fuel levy

The sharing of the general fuel levy is a direct charge that is formalised annually through the Government Gazette under schedule 1 of the Taxation Laws Amendment Act (2009). It was introduced in 2009/10 as a permanent replacement to the former RSC and JSB levies for metropolitan municipalities, in addition to the VAT reforms introduced in 2006. District municipalities still receive the *RSC/JSB levies replacement grant*.

The allocation to each city for 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 to account for overlapping magisterial district boundaries using population statistics from the 2011 Census.

Several concerns have been raised by metropolitan municipalities since the introduction of the sharing of the general fuel levy. First, changes in the volume of fuel sales from one year to another can result in significant changes to municipal allocations, making it difficult for cities to budget for revenue from this source over the medium term. From 2014/15, a new phase-in approach will be introduced for the levy's outer year allocations. This will enhance stability, allowing metropolitan municipalities to budget for revenue from the sharing of the general fuel levy over the medium term.

Second, cities have raised concerns about the long-term incentive effects of sharing a revenue source based on fuel consumption, when cities are mandated to encourage the use of public transport. The National Treasury is reviewing its own sources of revenue for metropolitan municipalities to explore options that complement and/or replace some existing own sources of revenue, including the sharing of the general fuel levy.