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**Website annexure to the 2017 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 257 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 2017 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 2017 division of revenue.
- Part 3 sets out how the FFC's recommendations on the 2017 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 (the Budget Council and SALGA). An extended Cabinet meeting involving ministers, provincial premiers and the SALGA chairperson was held in October 2016. 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 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, flexibility in responding to emergencies, resource allocation for basic services and developmental needs, the fiscal capacity and efficiency of provincial and local government, the reduction of economic disparities, and the 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 governance goals that benefit the nation as a whole. The National Development Plan 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 14 priority outcomes adopted by Cabinet in 2014 for the 2014–2019 medium-term strategic framework. In the 2016 *Medium Term Budget Policy Statement*, the Minister of Finance outlined how the resources available to government over the 2017 medium-term expenditure framework (MTEF) would be allocated to help achieve these goals. Chapter 4 of the 2016 *Medium Term Budget Policy Statement* and Chapters 5 and 6 of the 2017 *Budget Review* discuss how funds have been allocated across the three spheres of government 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 14 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 7 of the 2017 *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. Functions may shift between spheres of government to better meet the country's needs. The division of revenue responds to this by modifying the funding arrangements. Changes continue to be 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 responsible for providing education, health, social development, housing, roads, electricity and water, and municipal infrastructure services. 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, together with conditional grants for basic service delivery.

Robust growth in allocations to provincial and local government reflects the priority placed on health, education and basic services, as well as the rising costs of these services as a result of higher wages, and bulk electricity and water costs. 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.

The 2017 division of revenue prioritises the rollout of water and sanitation infrastructure in municipalities. A new provincial grant for early childhood development, which aims to improve education outcomes, especially among poor children, will come into effect on 1 April 2017.

## 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. 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. Municipalities finance most of their expenditure through property rates, user charges and fees. However, rural municipalities raise significantly less revenue than large urban and metropolitan municipalities.

Local government's share of nationally raised revenue has increased from 3 per cent in 2000/01 to 9.1 per cent over the 2017 MTEF period. Following a review of the local government equitable share in 2012, a new formula has been phased in from 2013/14 to 2017/18. The formula incorporates a revenue adjustment factor that considers the fiscal capacity of the recipient municipality (full details of the formula are provided in part 5 of this annexure). The mechanisms for allocating funds to provinces and municipalities are continuously reviewed to improve their efficiency. 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. To maximise the effect of allocations, many provincial and local government conditional grants use criteria that consider the efficiency with which the recipient has used previous allocations.

## Developmental needs

Developmental needs are accounted for at two levels. First, in the determination of the division of revenue, which continues to grow the provincial and local government shares of nationally raised revenue, and second, in the formulas used to divide 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, such as the *municipal infrastructure grant*, which allocates funds according to the number of households in a municipality without access to basic services. 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. Through the division of revenue, government continues to invest 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 of concurrent functions. It also ensures that baseline reductions do not affect important obligations that are already funded through existing provincial and local government allocations. The 2017 MTEF, through the division of revenue, continues to fund the delivery of provincial, municipal and concurrent functions through a combination of conditional and unconditional grants.

### 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 themselves are phased in to ensure minimal disruption.

### Flexibility in responding to emergencies

Government has a contingency reserve 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 2017 division of revenue

The central fiscal objectives over the MTEF period are to stabilise the growth of debt as a share of GDP and to strictly adhere to the planned expenditure ceiling (see Chapters 1, 3 and 5 of the 2017 *Budget Review*). However, the most important public spending programmes that help poor South Africans, contribute to growth and generate employment have been protected from major reductions. The 2017 division of revenue reprioritises existing funds to ensure these objectives are met despite a lower expenditure ceiling. Parts 4 and 5 of this annexure set out in more detail how the baseline reductions have affected provincial and local government transfers.

Excluding debt-service costs and the contingency reserve, allocated expenditure shared between the three spheres amounts to R1.2 trillion, R1.3 trillion and R1.4 trillion over each of the MTEF years. These allocations take into account government's spending priorities, each sphere's revenue-raising capacity and responsibilities, 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 2017 MTEF period

Following the reductions to the baseline, existing budgets need to be reprioritised to meet government's policy priorities outlined in the medium-term strategic framework. Priorities over the 2017 MTEF period that are funded through reprioritisations in the division of revenue include:

- Strengthening specialised tertiary health services for children through a new paediatric hospital.
- Preserving the school nutrition initiative by countering the effects of rapid food price inflation and increasing the number of children receiving meals.

- Providing free basic services to poor households.
- Promoting access to social housing through increased subsidies.
- Introducing a new grant to promote equitable, countrywide access to social services.
- Introducing a new grant to educate learners with profound intellectual disabilities.

## The fiscal framework

Table W1.1 presents the medium-term macroeconomic forecasts for the 2017 Budget. It sets out the growth assumptions and fiscal policy targets on which the fiscal framework is based.

**Table W1.1 Medium-term macroeconomic assumptions**

| | 2016/17 | | 2017/18 | | 2018/19 | | 2019/20 |
|---|---|---|---|---|---|---|---|
| **R billion/percentage of GDP** | **2016 Budget** | **2017 Budget** | **2016 Budget** | **2017 Budget** | **2016 Budget** | **2017 Budget** | **2017 Budget** |
| Gross domestic product | 4 388.4 | 4 409.8 | 4 750.7 | 4 741.2 | 5 161.3 | 5 129.2 | 5 545.5 |
| *Real GDP growth* | *1.2%* | *1.0%* | *1.9%* | *1.3%* | *2.5%* | *2.1%* | *2.3%* |
| *GDP inflation* | *6.4%* | *6.9%* | *6.3%* | *6.1%* | *6.0%* | *6.0%* | *5.7%* |
| **National budget framework** | | | | | | | |
| **Revenue** | **1 162.0** | **1 136.9** | **1 264.3** | **1 242.4** | **1 388.7** | **1 351.0** | **1 471.5** |
| *Percentage of GDP* | *26.5%* | *25.8%* | *26.6%* | *26.2%* | *26.9%* | *26.3%* | *26.5%* |
| **Expenditure** | **1 318.3** | **1 307.4** | **1 421.7** | **1 409.2** | **1 540.0** | **1 522.2** | **1 652.2** |
| *Percentage of GDP* | *30.0%* | *29.6%* | *29.9%* | *29.7%* | *29.8%* | *29.7%* | *29.8%* |
| **Main budget balance**[1] | **-156.3** | **-170.5** | **-157.4** | **-166.8** | **-151.3** | **-171.2** | **-180.7** |
| *Percentage of GDP* | *-3.6%* | *-3.9%* | *-3.3%* | *-3.5%* | *-2.9%* | *-3.3%* | *-3.3%* |

*1. A positive number reflects a surplus and a negative number a deficit*
*Source: National Treasury*

Table W1.2 sets out the division of revenue for the 2017 MTEF period after accounting for new policy priorities.

**Table W1.2 Division of nationally raised revenue**

| R million | 2013/14 | 2014/15 Outcome | 2015/16 | 2016/17 Revised estimate | 2017/18 | 2018/19 Medium-term estimates | 2019/20 |
|---|---|---|---|---|---|---|---|
| **Division of available funds** | | | | | | | |
| **National departments** | **453 406** | **489 987** | **546 065** | **557 495** | **590 178** | **631 447** | **681 600** |
| *of which:* | | | | | | | |
| *Indirect transfers to provinces* | 2 693 | 5 808 | 3 458 | 3 654 | 4 258 | 1 765 | 1 864 |
| *Indirect transfers to local government* | 5 945 | 8 250 | 10 370 | 7 824 | 7 338 | 7 596 | 8 015 |
| **Provinces** | **410 572** | **439 544** | **471 424** | **500 391** | **538 160** | **578 614** | **620 995** |
| Equitable share | 336 495 | 359 922 | 386 500 | 410 699 | 441 331 | 471 522 | 506 104 |
| Conditional grants | 74 077 | 79 623 | 84 924 | 89 692 | 96 829 | 107 092 | 114 892 |
| **Local government** | **82 595** | **87 570** | **98 338** | **103 255** | **112 524** | **121 470** | **132 277** |
| Equitable share | 38 964 | 41 592 | 49 367 | 51 169 | 57 012 | 62 732 | 69 273 |
| Conditional grants | 34 018 | 35 788 | 38 313 | 40 863 | 43 727 | 46 270 | 49 836 |
| General fuel levy sharing with metros | 9 613 | 10 190 | 10 659 | 11 224 | 11 785 | 12 469 | 13 167 |
| **Non-interest allocations** | **946 574** | **1 017 102** | **1 115 827** | **1 161 141** | **1 240 862** | **1 331 532** | **1 434 872** |
| *Percentage increase* | *7.9%* | *7.5%* | *9.7%* | *4.1%* | *6.9%* | *7.3%* | *7.8%* |
| Debt-service costs | 101 185 | 114 798 | 128 796 | 146 281 | 162 353 | 180 652 | 197 320 |
| Contingency reserves | – | – | – | – | 6 000 | 10 000 | 20 000 |
| **Main budget expenditure** | **1 047 759** | **1 131 900** | **1 244 623** | **1 307 423** | **1 409 215** | **1 522 183** | **1 652 192** |
| *Percentage increase* | *8.5%* | *8.0%* | *10.0%* | *5.0%* | *7.8%* | *8.0%* | *8.5%* |
| *Percentage shares* | | | | | | | |
| *National departments* | *47.9%* | *48.2%* | *48.9%* | *48.0%* | *47.6%* | *47.4%* | *47.5%* |
| *Provinces* | *43.4%* | *43.2%* | *42.2%* | *43.1%* | *43.4%* | *43.5%* | *43.3%* |
| *Local government* | *8.7%* | *8.6%* | *8.8%* | *8.9%* | *9.1%* | *9.1%* | *9.2%* |

*Source: National Treasury*

Table W1.3 shows how changes to the baseline are spread across government. The new focus areas and baseline reductions are accommodated by shifting savings towards priorities.

**Table W1.3 Changes over baseline**

| R million | 2017/18 | 2018/19 |
|---|---|---|
| National departments | -3 372 | 1 181 |
| Provinces [1] | -4 234 | 1 502 |
| Local government | -816 | 159 |
| **Allocated expenditure** | **-8 422** | **2 842** |

*1. This reduction includes a R2.6 billion conversion from education infrastructure grant to the school infrastructure backlogs grant*

*Source: National Treasury*

Table W1.4 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 W1.4 Schedule 1 of the Division of Revenue Bill**

| R million | 2017/18 Allocation | 2018/19 Forward estimates | 2019/20 |
|---|---|---|---|
| National[1] | 910 872 | 987 929 | 1 076 815 |
| Provincial | 441 331 | 471 522 | 506 104 |
| Local | 57 012 | 62 732 | 69 273 |
| **Total** | **1 409 215** | **1 522 183** | **1 652 192** |

*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*

*Source: National Treasury*

The 2017 *Budget Review* sets out in detail how constitutional issues and government's priorities are taken into account in the 2017 division of revenue. It describes economic and fiscal policy considerations, revenue issues, debt and financing considerations, and expenditure plans. Chapter 6 focuses on provincial and local government financing.

## Part 3: Response to the FFC's recommendations

Section 9 of the Intergovernmental Fiscal Relations Act 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 2017/18* to Parliament in May 2016. These recommendations are divided into 11 chapters, with a primary focus on rural development, under four main areas: the macro and fiscal context of rural development, national government and rural development, provincial government and rural development, and municipalities and rural development.

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

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

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

Government responses to the first and second categories are provided below. The relevant national departments are considering the recommendations that do not relate to the division of revenue, and they will respond directly to the FFC.

## Recommendations that apply directly and indirectly to the division of revenue

### *Chapter 1: Rural development and intergovernmental fiscal relations*

#### Dealing with disparities between and within regions

The FFC recommends that government "deals with disparities between and within regions by harnessing the growth potential of rural areas.

- "Inter-regional and inter-provincial migration is already underway following freedom of movement brought about by democracy. Government should further strengthen the equity focus of intergovernmental transfers, in particular in the health and education sectors targeted at rural areas, as this facilitates efficient reallocations;
- "Policy efforts should complement these reallocation-enhancing processes in order to sustain productivity growth within rural areas. Government should actively and specifically include conditions in rural grants aimed at increasing productivity and employment whenever significant capital investment in rural public infrastructure occurs."

#### Government response

Government shares the FFC's concerns regarding disparities in the quality of public services and the desire to stimulate greater economic growth in rural economies. The Integrated Urban Development Framework highlights the linkages between our urban and rural economies, with people, goods and money flowing between rural and urban areas. Efforts to develop both urban and rural economies will therefore stimulate development across the country as a whole.

Government agrees that transfers need to be equitable. Allocations through the intergovernmental fiscal system provide higher per capita allocations to rural provinces and municipalities. Government is also exploring the possibility of adding rural-focused indicators to the provincial equitable share formula to further strengthen the equity of intergovernmental transfers.

Government agrees that provinces and municipalities need to structure their infrastructure investments in ways that promote economic growth where possible. However, it should be noted that most of the conditional grant transfers to provinces and municipalities are to fund infrastructure that provides access to basic human rights such as water, sanitation, schooling and healthcare. It may not be appropriate to make these social investments conditional on economic outputs. Where grants have a clear economic link, government agrees that conditional grants should require that the economic impact of the spending is maximised. In the roads sector, for example, grant funding for provinces and municipalities is conditional on the use of data on road conditions and road traffic patterns to ensure that maintenance funds are invested in the roads that have the greatest economic impact. All major infrastructure grants include requirements to adhere to the Expanded Public Works Programme's guidelines for maximising labour intensiveness. The Expanded Public Works Programme also awards incentive grants to provinces and municipalities for labour-intensive projects. As a result, infrastructure projects, including those in rural areas, are designed to maximise their employment-creating impact.

### *Chapter 3: The role of targeted intergovernmental transfers in rural poverty reduction*

#### Evaluating and monitoring key agricultural grants

The FFC recommends that, "The Department of Agriculture, Forestry and Fisheries enhances agricultural productivity by establishing a framework for implementing, evaluating and monitoring key agricultural grants targeted at subsistence and small-scale farmers."

#### Government response

Government agrees with this recommendation. The Department of Agriculture, Forestry and Fisheries is engaging with the recommendations from the Department of Planning, Monitoring and Evaluation's expenditure reviews on its key grants. Given that agriculture is a concurrent function with a range of agricultural stakeholders, a task team consisting of the Department of Rural Development and Land Reform, the Department of Agriculture, Forestry and Fisheries and the National Treasury is looking at ways to enhance existing processes for agricultural productivity, particularly for subsistence and small-scale farmers. The Department of Agriculture, Forestry and Fisheries also recognises that monitoring and evaluation can enhance the sector's productivity. It is working to increase its in-house capacity for monitoring and evaluation and to improve its coordination with its provincial counterparts and national stakeholders in the agricultural sector.

### Promote equity in transfers

The FFC recommends that, "Agriculture-related intergovernmental transfers are distributed across recipient provinces in a manner that promotes equity and ensures access for targeted groups, especially emerging and subsistence farmers located within rural provinces and municipalities. This can be achieved through expanding the current disbursement criteria to incorporate weights for a province's share of national rural population, the proportion of a province's rural population with incomes below official poverty levels/measures, and the extent to which the rural population in a province participates in subsistence and smallholder farming."

### Government response

Government agrees with this recommendation. The current allocation criteria are meant to achieve equity across provinces. These criteria need continuous monitoring to ensure they uphold the principle of equity. Given that there is little consensus on the definition of "rural", it is not possible to implement the FFC's recommendation to use indicators of a rural population. It remains unclear who within government is ultimately responsible for a South Africa definition of this concept. Moreover, the concept of rural will affect services in various sectors differently. The FFC, through its efforts to guide dialogue on defining the concept, may recommend a starting point for government to consider. However, the process will require government-wide stakeholder engagement, including with the Department of Agriculture, Forestry and Fisheries, the National Treasury, the Department of Planning, Monitoring and Evaluation, the Department of Cooperative Governance, Statistics South Africa, and the Department of Rural Development and Land Reform.

## *Chapter 4: National land reform programme and rural development*

### Consolidating programmes

The FFC recommends that, "The Comprehensive Agricultural Support Programme and the Recapitalisation and Development Programme are consolidated into one funding programme for post-settlement support to emerging and land reform farmers under the Department of Agriculture, Forestry and Fisheries, which has more expertise in the area of agriculture. The consolidated fund should provide timeous support to land reform beneficiaries and be complemented by affordable loan funding. Development finance institutions should explore possible funding models, so that the funding framework can reach more land reform beneficiaries. For individual farm transfers, the Land Redistribution for Agriculture and Development model should be emulated, as it provides the necessary incentives to access credit, own an asset and enter into productive activity on the land. For group-owned projects, models should be explored in partnership with commodity organisations and land reform specialists."

### Government response

Government agrees that post-settlement support that ensures arable land remains in production is important. Moreover, government acknowledges the need to improve coordination in the agricultural sector given its multifaceted nature and its intersecting mandates across several departments, including the Department of Agriculture, Forestry and Fisheries and the Department of Rural Development and Land Reform. However, given the overlapping roles between the Department of Agriculture, Forestry and Fisheries and the Department of Rural Development and Land Reform, the first task is to clarify the roles of these two departments, which both include aspects of post-settlement support. This first step was recently completed. Given the ongoing nature of this process, it would be premature to start shifting programme funding or conditional grants between departments, in isolation of an assessment of the funding flows to the entire agriculture sector. As such, the next step is to assess the current funding model, for realignment to the delineated roles and to promote better outcomes. The funding model should support increased land-reform outputs and ensure that both departments are able to deliver on their responsibilities. While conditional grants make up part of the funding of these functions, the funding landscape should be assessed in its entirety to ensure it supports productivity and land reform across the country. Government agrees that improved post-settlement support can be provided within existing resources as a result of this process.

### *Chapter 6: Fiscal transfers and own revenue in funding provincial rural development mandates*

#### Criteria for allocating infrastructure conditional grants

The FFC recommends that, "The National Treasury, in collaboration with the departments of basic education, health and those responsible for provincial roads, ensures that the criteria for allocating infrastructure conditional grants take into account spending efficiency, delivery targets and performance, as well as the applicable national norms and standards. This should assist with monitoring of provinces in meeting their developmental goals and facilitate targeted intervention where a province consistently fails to meet delivery targets."

#### Government response

Government agrees with this recommendation. To some extent, this is current government practice. The criteria proposed in the recommendation are – to varying degrees in different sectors – already incorporated in the allocation criteria of the conditional grants.

In the education and health sectors, the major infrastructure conditional grants include an incentive component that rewards both planning and performance. When these incentive components were first introduced they were based only on assessments of planning, but, since 2016/17, they now also explicitly include performance measures as part of their allocation criteria – in line with this recommendation. In addition, the Department of Basic Education has issued its norms and standards, and is ensuring that grants are spent in line with these standards.

In the roads sector, a range of indicators to improve road conditions are included in a performance component, which is introduced into the *provincial roads maintenance grant* in the 2017 MTEF period.

If a provincial department encounters problems during implementation, the Division of Revenue Act allows funds to be reallocated to another province during the year if it will prevent under-expenditure. This provides an additional measure through which the amounts transferred to a province can be affected by performance, although funds are usually only reallocated as a last resort.

While government agrees with the recommendation that it should take account of performance when allocating funds, it is also cognisant of the need to balance this with ensuring equity in allocations. The inclusion of delivery targets, although good in principle, can unduly penalise some provinces if the reasons for delays are outside of the control of implementing agents (for example, strikes and litigation). Government tries to maintain this balance by including performance as one of the factors in determining allocations, but not determining allocations solely on this criterion.

#### Review the framework for allocating agriculture conditional grants

The FFC recommends that, "The Department of Agriculture, Forestry and Fisheries and the National Treasury review the framework for allocating agriculture conditional grants to reduce the weighting of agriculture land size and poverty relief and to incorporate factors that are closely aligned to the objectives of the grant, in particular the promotion of emerging farmers or agriculture production in the rural areas, as stipulated in the Agriculture Policy Action Plan."

### Government response

Government agrees with this recommendation. The frameworks that guide conditional grants are assessed every year to make improvements and ensure they continue to deliver on the policies they are meant to be supporting. These assessments generally culminate in individual conditional grant framework meetings for all conditional grants in the system. In the case of the agricultural sector, the most recent conditional grants have been adjusted to give expression to the Agriculture Policy Action Plan, albeit in an incremental manner to prevent the sector's destabilisation. For example, 55 per cent of grant allocations under the *comprehensive agriculture support programme* is earmarked for projects that give effect to the Agriculture Policy Action Plan, of which 35 per cent is specifically for projects that work to achieve the commercialisation of smallholder farmers. Previously, 70 per cent of allocations were for the Fetsa Tlala programme, which is now a focus of the *Ilima/Letsema projects grant*.

### Efficacy in infrastructure conditional grant spending

The FFC recommends that, "The Department of Planning, Monitoring and Evaluation conducts a comprehensive review of expenditure outcomes associated with infrastructure conditional grants targeted at the rural provinces, to ascertain the extent to which infrastructure backlogs have been reduced and the efficacy of the spend. The outcome of the review should be used to form the basis of any adjustments to infrastructure grants earmarked for rural development."

### Government response

Government appreciates the recommendation and agrees on the importance of eradicating rural infrastructure backlogs. The Department of Planning, Monitoring and Evaluation considered the inclusion of the proposed review in its programme of reviews to be conducted in 2017/18. The reviews are always co-funded by the department itself and the department whose programme is being reviewed. This ensures the review is done as a partnership, increasing the likelihood that any recommendations will be implemented. In this case it was not possible to secure a co-funder for this review. As a result, this review will not be undertaken in 2017/18, but may be considered in future if co-funding can be secured.

## *Chapter 7: Assessing government's fiscal instrument to fund public programmes employment in rural areas*

### Training for Expanded Public Works Programme beneficiaries

The FFC recommends that, "The Department of Public Works and the National Treasury ensure that Expanded Public Works Programme grant frameworks in the Division of Revenue Act include an explicit condition that appropriate training of recipients (especially in skills that promote self-employment) is mandatory, given that only a small portion of programme beneficiaries transition into formal sector jobs. An assessment of microenterprises in rural areas that are viable self-employment options should be conducted and inform the roll-out of training programmes to Expanded Public Works Programme beneficiaries."

### Government response

Government recognises the importance of equipping Expanded Public Works Programme participants with the skills to achieve sustainable livelihoods. However, it does not agree that imposing a condition for mandatory training for every programme participant is an appropriate or practical way to achieve this objective. The first phase of the Expanded Public Works Programme aimed to train every participant, but it lacked the funding. In addition, many participants who were trained did not gain meaningful skills because training was done mainly for compliance reasons. Training remains important in the third phase of the programme, but it is now more focused on accredited training and meaningful skills development that makes a difference to the work being done through the programme's projects or significantly improves the participants' opportunities to achieve sustainable livelihoods.

Government agrees that self-employment provides a viable potential exit strategy for many Expanded Public Works Programme participants, which is why the programme provides entrepreneurship courses.

The third phase of the programme promotes the principle of sustainable livelihoods, providing training to participants to enable them to run their own small businesses. Training and enterprise development is carried out at sub-programme level across all sectors of the Expanded Public Works Programme.

### *Chapter 8: Financing rural local municipalities for rural development*

#### Consolidation of grants

The FFC recommends that, "The National Treasury continues to consolidate grants (as previously recommended by the Commission) because viewing grants in isolation gives the impression that some services are underfunded, whereas services may be fully or overfunded when viewing the grants holistically."

#### Government response

Government agrees on the importance of consolidating conditional grants. This is one of the main recommendations of the review of local government infrastructure grants. The review has already led to the consolidation of several conditional grants, including the merger of the *public transport network operations grant* and the *public transport infrastructure grant* in 2015/16 to form the *public transport network grant*. Three separate water and sanitation grants with overlapping objectives and activities were merged to form the *water services infrastructure grant* in 2016/17. Further grant consolidation is expected in future, especially in urban areas. The National Treasury is engaging with other stakeholders on the possible incorporation of *integrated national electrification programme (municipal) grant* allocations for metropolitan municipalities into the *urban settlements development grant* in 2018/19. This would reduce the number of separate grants transferred to metropolitan municipalities.

#### Objective cost estimates to inform local government allocations

The FFC recommends that, "The National Treasury ensures that the local government equitable share and conditional grants are informed by objectively derived cost estimates, without which the viability of rural municipalities will always be under threat."

#### Government response

Government recognises the importance of using realistic cost estimates to inform allocations to municipalities and analyse their performance. Government welcomes the study on the costing of municipal services that the FFC and SALGA have recently released as a valuable addition to the data available to inform policy discussions in this area. The study found that the cost of building and operating infrastructure for basic services was higher in urban areas than rural areas as a result of the different assumptions made regarding the levels of service provided in urban and rural areas. Findings such as these need to be carefully interrogated before they are considered for use in informing allocations. The current local government equitable share formula allocates higher allocations to rural municipalities in recognition of their limited ability to raise their own revenue to fund administration and community services costs.

### *Chapter 9: Effectiveness of transfers to local and district municipalities for rural development*

#### Evaluate the effectiveness of existing grant supervision methods

The FFC recommends that, "The National Treasury includes, as part of the principles underlying grants to rural municipalities, more stringent expenditure supervision, in order to minimise wastage and improve efficiency. The national and provincial governments should evaluate the effectiveness of existing supervision methods with a view to strengthening them."

#### Government response

Government agrees on the importance of monitoring the financial and non-financial performance of conditional grants to minimise wastage and improve efficiency. The review of local government infrastructure grants includes improving the management of the grant system as one of its key areas of reform, which involves ongoing work to improve performance monitoring.

### *Chapter 10: Farm evictions and increasing rural local municipalities' responsibilities*

#### Municipal disaster grant is allowed to cater for eviction-related emergencies

The FFC recommends that, "The current *municipal disaster grant* be allowed to cater for eviction-related emergencies. The same approach of accessing the portion of the disaster grant should be applicable to farm eviction incidences. This approach is aligned with the findings from previous research by the Commission that provinces and municipalities, rather than national government, appear better at ensuring grant funding is spent."

#### Government response

Government appreciates and agrees with the concerns raised regarding evictions. Government does not, however, agree that evictions meet the definition of disasters prescribed in the Disaster Management Act (2002), which means that the *municipal disaster grant* is not the appropriate instrument for alleviating the effect of evictions.

The National Housing Programme for Housing Assistance in Emergency Circumstances specifically provides funding for housing assistance for evicted households. Provinces are required to set aside funds from the *human settlements development grant* for this programme. It should also be noted that eviction orders from farms are only granted by the courts if alternative accommodation has been identified.

### *Chapter 11: Reviewing effectiveness of sanitation fiscal instruments and governance in enhancing rural development*

#### Evaluation of the impact of sanitation grants

The FFC recommends that, "The Department of Planning, Monitoring and Evaluation, the National Treasury and the Department of Water and Sanitation undertake a comprehensive evaluation of the impact of sanitation grants on rural municipalities before discontinuing the grants."

#### Government response

Government agrees on the need to review the performance of conditional grants before they are phased out. When a grant ends, a report on the reasons for its discontinuation is submitted to Parliament. This report sets out the grant's objectives, the extent to which these have been achieved and how these objectives will be achieved in future. It is important to note that there are relatively few cases where the end of a particular grant means that government stops implementing a programme or performing a function entirely. In most cases, the work continues to be funded through other programmes and grants. Some grants are merged, or shifted between direct and indirect allocations, in which case the grant is not truly ending and so there is no need for a closeout report. In line with the FFC's other recommendations on the desirability of reducing the number of grants through the consolidation of existing grants, it is important that grants that are introduced to achieve a particular set of outcomes in a defined period of time do not remain in the system indefinitely.

#### Submission of compliant business plans

The FFC recommends that, "The district and rural municipalities that are water services authorities submit compliant business plans timeously to the national Department of Water and Sanitation. Should they fail, executives should be held accountable. In cases where water services authorities lack capacity, the national and provincial departments of water and sanitation should intervene and provide requisite capacity."

#### Government response

Government agrees with the recommendation. The Division of Revenue Act and its conditional grant frameworks require that business plans be signed off and submitted to the transferring officer. This is an important mechanism to ensure that proper planning has taken place before funds are transferred, and municipalities can be held accountable for adhering to their approved business plans. Where appropriate, municipalities could include the completion and submission of business plans that meet grant requirements in the performance agreements of senior managers. This would provide a mechanism through which municipal executives can be held accountable for the preparation and submission of business plans.

Where municipalities do not have the capacity to draw up their own business plans for grant spending, funds would usually be allocated through an indirect grant instead. This allows the Department of Water and Sanitation to plan and implement the projects on behalf of the municipality. At the same time, government provides extensive support to improve the capacity of municipalities over the medium to long term, so that in future they will be able to implement these projects themselves.

## 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.

National transfers to provinces increase from R500.4 billion in 2016/17 to R538.2 billion in 2017/18. Over the MTEF period, provincial transfers will grow at an average annual rate of 7.5 per cent to R621 billion in 2019/20. Table W1.5 sets out the total transfers to provinces for 2017/18. A total of R441.3 billion is allocated to the provincial equitable share and R96.8 billion to conditional grants, which includes an unallocated R123.4 million for the provincial disaster grant.

**Table W1.5 Total transfers to provinces, 2017/18**

| R million | Equitable share | Conditional grants | Total transfers |
|---|---|---|---|
| Eastern Cape | 61 848 | 11 297 | **73 145** |
| Free State | 24 522 | 7 267 | **31 789** |
| Gauteng | 86 643 | 20 828 | **107 471** |
| KwaZulu-Natal | 93 757 | 18 824 | **112 580** |
| Limpopo | 51 960 | 7 885 | **59 845** |
| Mpumalanga | 36 082 | 7 183 | **43 264** |
| Northern Cape | 11 720 | 4 289 | **16 009** |
| North West | 30 330 | 7 552 | **37 882** |
| Western Cape | 44 470 | 11 580 | **56 050** |
| Unallocated | – | 123 | **123** |
| **Total** | **441 331** | **96 829** | **538 160** |

*Source: National Treasury*

### Changes to provincial allocations

The baseline reductions discussed in Chapter 5 of the *Budget Review* were shared across the three spheres of government in proportion to the division of revenue. A weaker than expected economic and fiscal environment has meant that the budget had to be reprioritised to fund new and changing government priorities. In 2017/18, provincial baselines remain unchanged since the figures published in the 2016 *Medium Term Budget Policy Statement*. Of the R6.8 billion reduction to the provincial fiscal framework published in 2016, only 23.5 per cent (R1.6 billion) was applied to the equitable share, despite its accounting for more than 80 per cent of transfers to provinces. This ensures that the basic services funded by the provincial equitable share, such as health and education, are protected. The remaining R5.2 billion of the reduction comes from provincial conditional grants. Notwithstanding the need for fiscal consolidation announced in the 2016 *Medium Term Budget Policy Statement*, several grants funding essential services such as the *national school nutrition programme grant*, the *early childhood development grant* and the *public transport operations grant* were not reduced. The provincial equitable share grows at an average annual rate of 7.2 per cent over the MTEF period, while conditional grant allocations grow by

8.4 per cent per year. Where possible, the baseline reductions announced in 2016 have been weighted towards grants with a history of underspending or infrastructure grants that can defer implementation.

Three new grants come into effect over the MTEF period. The first, the *social worker employment grant*, is to improve social welfare through increased deployment of social workers, and the second, the *learners with profound intellectual disabilities grant*, improves educational access for learners with intellectual disabilities. The *early childhood development grant* becomes active in 2017/18 to expand access to early childhood services across the country. Both the provinces and the national Department of Social Development have carried out extensive preparatory work to ensure a successful first year of spending under this grant. A total of R1.3 billion is allocated to the grant over the 2017 MTEF period. The *school infrastructure backlogs grant*, which was meant to conclude in 2016/17, is extended for an additional year to ensure that projects under this government priority are completed. The grant is allocated R2.6 billion for 2017/18.

Over the 2017 MTEF period, the provincial equitable share increases by R64.8 billion. The *national school nutrition programme grant* increases by R390 million which is added specifically to feed more children and alleviate the negative effects of food price inflation as a result of persistent drought. After accounting for all reprioritisations, fiscal consolidation and additions, the net revisions to the provincial direct and indirect allocations amount to a reduction of R1.4 billion per year in 2017/18 and 2018/19.

## The provincial equitable share

The equitable share is the main source of revenue for meeting provincial expenditure responsibilities. To ensure that allocations are fair, the equitable share is allocated through a formula using objective data on the context and demand for services in each of the nine provinces. For each year of the 2017 MTEF, the following amounts are allocated to the provincial equitable share respectively: R441.3 billion, R471.5 billion and R506.1 billion. These revisions result in the provincial equitable share increasing by 23.2 per cent between 2016/17 and 2019/20, and growing at an average annual rate of 7.2 per cent over the medium term.

### *Allocations calculated outside the equitable share formula*

The equitable share includes an amount of R2 billion in 2017/18, which previously funded adult basic education and training. This function shifted from national to provincial government from the start of the 2015 MTEF period, and is still allocated to provinces in the same proportions prior to the function shift. However, from 2018/19 onwards, funds will be allocated using the provincial equitable share formula.

## The equitable share formula

The provincial equitable share formula is reviewed and updated with new data annually. For the 2017 MTEF, the formula has been updated with data from the 2016 mid-year population estimates published by Statistics South Africa, the 2016 preliminary data published by the Department of Basic Education on school enrolment, data from the 2015 General Household Survey for medical aid coverage, and data from the health sector and the Risk Equalisation Fund for the risk-adjusted capitation index. Allocation changes tend to mirror shifts in population across provinces, which results in changes in the relative demand for public services across these areas. The effect of these updates on the provincial equitable share is phased in over three years (2017/18 to 2019/20).

### *Full impact of data updates on the provincial equitable share*

Table W1.6 shows the full impact of the data updates on the provincial equitable share per province. It compares the target shares for the 2016 and 2017 MTEF periods. The details of how the data updates affect each component of the formula are described in detail in the sub-sections below.

**Table W1.6 Full impact of data updates on the equitable share**

| | 2016 MTEF weighted average | 2017 MTEF weighted average | Difference |
|---|---|---|---|
| Eastern Cape | 14.0% | 14.0% | -0.02% |
| Free State | 5.6% | 5.6% | -0.01% |
| Gauteng | 19.7% | 19.8% | 0.15% |
| KwaZulu-Natal | 21.2% | 21.1% | -0.09% |
| Limpopo | 11.8% | 11.7% | -0.03% |
| Mpumalanga | 8.2% | 8.1% | -0.07% |
| Northern Cape | 2.6% | 2.7% | 0.00% |
| North West | 6.9% | 6.9% | -0.00% |
| Western Cape | 10.0% | 10.1% | 0.06% |
| **Total** | **100.0%** | **100.0%** | **0.00%** |

*Source: National Treasury*

### *Phasing in the formula*

Official data used annually to update the provincial equitable share formula invariably affects each province's share of the available funds. However, it is important that provinces have some stability in their revenue stream to allow for sound planning. As such, calculated new shares, informed by recent data, are phased in over the three-year MTEF period.

The equitable share formula data is updated every year and a new target share for each province is calculated, as shown in Table W1.7. The phase-in mechanism provides a smooth path to achieving these new weighted shares by the third year of the MTEF period. It takes the difference between the target weighted share for each province at the end of the MTEF period and the indicative allocation for 2017/18 published in the 2016 MTEF, and closes the gap between these shares by a third in each year of the 2017 MTEF period. As a result, one-third of the impact of the data updates is implemented in 2017/18, two-thirds in the indicative allocations for 2018/19, and the updates are fully implemented in the indicative allocations for 2019/20.

**Table W1.7 Implementation of the equitable share weights**

| | 2017/18 | 2017/18 | 2018/19 | 2019/20 |
|---|---|---|---|---|
| **Percentage** | **Indicative weighted shares from 2016 MTEF** | **2017 MTEF weighted shares 3-year phasing** | | |
| Eastern Cape | 14.1% | 14.0% | 14.0% | 14.0% |
| Free State | 5.6% | 5.6% | 5.6% | 5.6% |
| Gauteng | 19.6% | 19.6% | 19.7% | 19.8% |
| KwaZulu-Natal | 21.2% | 21.2% | 21.2% | 21.1% |
| Limpopo | 11.8% | 11.8% | 11.7% | 11.7% |
| Mpumalanga | 8.2% | 8.2% | 8.2% | 8.1% |
| Northern Cape | 2.7% | 2.7% | 2.7% | 2.7% |
| North West | 6.9% | 6.9% | 6.9% | 6.9% |
| Western Cape | 10.0% | 10.1% | 10.1% | 10.1% |
| **Total** | **100.0%** | **100.0%** | **100.0%** | **100.0%** |

*Source: National Treasury*

### *Provincial equitable share allocations*

The final equitable share allocations per province for the 2017 MTEF are detailed in Table W1.8. These allocations include the full impact of the data updates, phased in over three years.

**Table W1.8 Provincial equitable share**

| R million | 2017/18 | 2018/19 | 2019/20 |
|---|---|---|---|
| Eastern Cape | 61 848 | 66 167 | 70 961 |
| Free State | 24 522 | 26 285 | 28 165 |
| Gauteng | 86 643 | 93 030 | 100 227 |
| KwaZulu-Natal | 93 757 | 99 741 | 106 841 |
| Limpopo | 51 960 | 55 386 | 59 371 |
| Mpumalanga | 36 082 | 38 489 | 41 214 |
| Northern Cape | 11 720 | 12 501 | 13 418 |
| North West | 30 330 | 32 473 | 34 857 |
| Western Cape | 44 470 | 47 452 | 51 049 |
| **Total** | **441 331** | **471 522** | **506 104** |

*Source: National Treasury*

### *Summary of the formula's structure*

The formula, shown in Table W1.9, 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.

For the 2017 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 (Grades R to 12) enrolled in public ordinary schools.
- A *health component* (27 per cent), based on each province's risk profile and health system caseload.
- 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 regional gross domestic product (GDP-R, measured by Statistics South Africa).

**Table W1.9 Distributing the equitable shares by province, 2017 MTEF**

| | Education | Health | Basic share | Poverty | Economic activity | Institu-tional | Weighted average |
|---|---|---|---|---|---|---|---|
| | **48.0%** | **27.0%** | **16.0%** | **3.0%** | **1.0%** | **5.0%** | **100.0%** |
| Eastern Cape | 15.1% | 13.5% | 12.6% | 16.3% | 7.6% | 11.1% | 14.0% |
| Free State | 5.3% | 5.3% | 5.1% | 5.2% | 5.0% | 11.1% | 5.6% |
| Gauteng | 18.0% | 21.8% | 24.1% | 17.3% | 34.3% | 11.1% | 19.8% |
| KwaZulu-Natal | 22.3% | 21.7% | 19.8% | 22.2% | 16.1% | 11.1% | 21.1% |
| Limpopo | 13.0% | 10.3% | 10.4% | 13.6% | 7.1% | 11.1% | 11.7% |
| Mpumalanga | 8.4% | 7.3% | 7.7% | 9.1% | 7.5% | 11.1% | 8.1% |
| Northern Cape | 2.3% | 2.1% | 2.1% | 2.2% | 2.1% | 11.1% | 2.7% |
| North West | 6.5% | 6.7% | 6.8% | 8.0% | 6.5% | 11.1% | 6.9% |
| Western Cape | 9.1% | 11.3% | 11.3% | 6.1% | 13.6% | 11.1% | 10.1% |
| **Total** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **100.0%** |

*Source: National Treasury*

### *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 Department of Basic Education's 2016 School Realities Survey. Each of these elements is assigned a weight of 50 per cent.

Table W1.10 shows the effect of updating the education component with new enrolment data on the education component shares.

**Table W1.10 Impact of changes in school enrolment on the education component share**

| | Age cohort 5 – 17 | School enrolment 2015 | School enrolment 2016 | Changes in enrolment | Weighted average 2016 MTEF | Weighted average 2017 MTEF | Difference in weighted average |
|---|---|---|---|---|---|---|---|
| Eastern Cape | 1 856 317 | 1 948 855 | 1 957 187 | 8 332 | 15.1% | 15.1% | -0.04% |
| Free State | 657 489 | 681 310 | 687 072 | 5 762 | 5.3% | 5.3% | -0.00% |
| Gauteng | 2 231 793 | 2 247 389 | 2 310 810 | 63 421 | 17.8% | 18.0% | 0.17% |
| KwaZulu-Natal | 2 758 594 | 2 875 074 | 2 873 339 | -1 735 | 22.4% | 22.3% | -0.11% |
| Limpopo | 1 536 294 | 1 752 451 | 1 764 551 | 12 100 | 13.1% | 13.0% | -0.03% |
| Mpumalanga | 1 053 846 | 1 077 372 | 1 072 151 | -5 221 | 8.5% | 8.4% | -0.06% |
| Northern Cape | 288 839 | 289 233 | 291 650 | 2 417 | 2.3% | 2.3% | -0.00% |
| North West | 824 724 | 813 161 | 828 674 | 15 513 | 6.5% | 6.5% | 0.03% |
| Western Cape | 1 174 625 | 1 094 752 | 1 113 563 | 18 811 | 9.0% | 9.1% | 0.04% |
| **Total** | **12 382 521** | **12 779 597** | **12 898 997** | **119 400** | **100.0%** | **100.0%** | **–** |

*Source: National Treasury*

### *Health component (27 per cent)*

The health component uses a risk-adjusted capitation index 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 W1.11 shows the shares of the risk-adjusted component, which accounts for 75 per cent of the health component.

**Table W1.11 Risk-adjusted sub-component shares**

| R million | Mid-year population estimates 2016 | Insured population 2015 | Risk-adjusted index | Weighted population | Risk-adjusted shares 2016 | Risk-adjusted shares 2017 | Change |
|---|---|---|---|---|---|---|---|
| Eastern Cape | 7 062 | 10.7% | 96.9% | 6 108 | 13.5% | 13.2% | -0.27% |
| Free State | 2 862 | 16.2% | 103.3% | 2 476 | 5.3% | 5.4% | 0.06% |
| Gauteng | 13 498 | 27.7% | 105.4% | 10 288 | 21.7% | 22.3% | 0.60% |
| KwaZulu-Natal | 11 080 | 11.9% | 98.9% | 9 654 | 21.8% | 20.9% | -0.90% |
| Limpopo | 5 804 | 8.5% | 91.6% | 4 867 | 10.3% | 10.5% | 0.21% |
| Mpumalanga | 4 328 | 15.5% | 95.7% | 3 500 | 7.4% | 7.6% | 0.21% |
| Northern Cape | 1 192 | 17.6% | 100.7% | 989 | 2.1% | 2.1% | 0.07% |
| North West | 3 791 | 15.0% | 102.2% | 3 294 | 6.7% | 7.1% | 0.40% |
| Western Cape | 6 293 | 24.2% | 104.0% | 4 963 | 11.1% | 10.8% | -0.37% |
| **Total** | **55 909** | | | **46 138** | **100.0%** | **100.0%** | **–** |

*Source: National Treasury*

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 insurance, based on the 2015 General Household Survey, is deducted from the 2016 mid-year population estimates to estimate the uninsured population per province. The risk-adjusted index, which is an index of each province's health risk profile, is applied to the 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 W1.11 shows the change in this sub-component between 2016 and 2017.

The output sub-component is shown in Table W1.12 below.

**Table W1.12 Output sub-component shares**[1]

| | Primary healthcare visits | | | | Hospital workload patient-day equivalents | | | |
|---|---|---|---|---|---|---|---|---|
| R thousand | 2014/15 | 2015/16 | Average | Share | 2014/15 | 2015/16 | Average | Share |
| Eastern Cape | 17 904 | 18 208 | 18 056 | 14.1% | 4 637 | 4 567 | 4 602 | 14.3% |
| Free State | 6 779 | 6 537 | 6 658 | 5.2% | 1 706 | 1 571 | 1 639 | 5.1% |
| Gauteng | 23 831 | 22 099 | 22 965 | 17.9% | 6 714 | 6 934 | 6 824 | 21.1% |
| KwaZulu-Natal | 31 235 | 30 872 | 31 053 | 24.2% | 7 912 | 7 613 | 7 762 | 24.0% |
| Limpopo | 14 343 | 14 356 | 14 350 | 11.2% | 2 882 | 2 949 | 2 915 | 9.0% |
| Mpumalanga | 9 485 | 9 309 | 9 397 | 7.3% | 1 963 | 1 979 | 1 971 | 6.1% |
| Northern Cape | 3 305 | 2 992 | 3 148 | 2.5% | 592 | 599 | 595 | 1.8% |
| North West | 8 363 | 8 154 | 8 258 | 6.4% | 1 553 | 1 642 | 1 597 | 4.9% |
| Western Cape | 14 257 | 14 151 | 14 204 | 11.1% | 4 341 | 4 409 | 4 375 | 13.6% |
| **Total** | **129 501** | **126 676** | **128 089** | **100.0%** | **32 300** | **32 263** | **32 282** | **100.0%** |

*1. Some provincial numbers for patient-days and healthcare visits for 2014/15 have been restated, resulting in small variances from numbers published in 2016*

*Source: National Treasury*

The output sub-component uses patient load data from the District Health Information Services. The average number of visits at primary healthcare clinics in 2014/15 and 2015/16 is calculated to estimate each province's share of this part of the output component, which makes up 5 per cent of the health component. For hospitals, each province's share of the total patient-day equivalents from public hospitals in 2014/15 and 2015/16 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 W1.13 shows the updated health component shares for the 2017 MTEF period.

**Table W1.13 Health component weighted shares**

| | Risk-adjusted | Primary healthcare | Hospital component | Weighted shares | | Change |
|---|---|---|---|---|---|---|
| Weight | 75.0% | 5.0% | 20.0% | 2016 | 2017 | |
| Eastern Cape | 13.2% | 14.1% | 14.3% | 13.5% | 13.5% | -0.02% |
| Free State | 5.4% | 5.2% | 5.1% | 5.3% | 5.3% | -0.01% |
| Gauteng | 22.3% | 17.9% | 21.1% | 21.7% | 21.8% | 0.14% |
| KwaZulu-Natal | 20.9% | 24.2% | 24.0% | 21.8% | 21.7% | -0.11% |
| Limpopo | 10.5% | 11.2% | 9.0% | 10.3% | 10.3% | -0.06% |
| Mpumalanga | 7.6% | 7.3% | 6.1% | 7.4% | 7.3% | -0.09% |
| Northern Cape | 2.1% | 2.5% | 1.8% | 2.1% | 2.1% | 0.03% |
| North West | 7.1% | 6.4% | 4.9% | 6.7% | 6.7% | -0.08% |
| Western Cape | 10.8% | 11.1% | 13.6% | 11.1% | 11.3% | 0.20% |
| **Total** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **100.0%** | **–** |

*Source: National Treasury*

### *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 2017 MTEF, population data is drawn from the 2016 mid-year population estimates produced by Statistics South Africa. Table W1.14 shows the impact on the basic component's revised weighted shares.

**Table W1.14 Impact of the changes in population on the basic component shares**

| R million | Mid-year population estimates 2015 | Mid-year population estimates 2016 | Population change | % population change | Basic component shares 2016 MTEF | Basic component shares 2017 MTEF | Change |
|---|---|---|---|---|---|---|---|
| Eastern Cape | 6 916 | 7 062 | 146 | 2.1% | 12.6% | 12.6% | 0.05% |
| Free State | 2 818 | 2 862 | 44 | 1.6% | 5.1% | 5.1% | -0.01% |
| Gauteng | 13 200 | 13 498 | 298 | 2.3% | 24.0% | 24.1% | 0.12% |
| KwaZulu-Natal | 10 919 | 11 080 | 161 | 1.5% | 19.9% | 19.8% | -0.05% |
| Limpopo | 5 727 | 5 804 | 77 | 1.3% | 10.4% | 10.4% | -0.04% |
| Mpumalanga | 4 284 | 4 328 | 44 | 1.0% | 7.8% | 7.7% | -0.05% |
| Northern Cape | 1 186 | 1 192 | 6 | 0.5% | 2.2% | 2.1% | -0.03% |
| North West | 3 707 | 3 791 | 84 | 2.3% | 6.7% | 6.8% | 0.03% |
| Western Cape | 6 200 | 6 293 | 93 | 1.5% | 11.3% | 11.3% | -0.03% |
| **Total** | **54 957** | **55 909** | **952** | **1.7%** | **100.0%** | **100.0%** | **–** |

*Source: National Treasury*

### *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, constituting 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, the Free State 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 of people in that province that fall into the poorest 40 per cent of South African households by the province’s population figure from the 2016 mid-year population estimates. Table W1.15 shows the proportion of the poor in each province from the Income and Expenditure Survey, the 2016 mid-year population estimates and the weighted share of the poverty component per province.

**Table W1.15 Comparison of current and new poverty component weighted shares**

| R million | Income and Expendi-ture Survey 2010/11 | Current (2016 MTEF) | | | New (2017 MTEF) | | | Difference in weighted shares |
|---|---|---|---|---|---|---|---|---|
| | | Mid-year population estimates 2015 | Poor popula-tion | Weighted shares | Mid-year population estimates 2016 | Poor popula-tion | Weighted shares | |
| Eastern Cape | 52.0% | 6 916 | 3 599 | 16.2% | 7 062 | 3 674 | 16.3% | 0.1% |
| Free State | 41.4% | 2 818 | 1 167 | 5.3% | 2 862 | 1 185 | 5.2% | -0.0% |
| Gauteng | 28.9% | 13 200 | 3 811 | 17.2% | 13 498 | 3 897 | 17.3% | 0.1% |
| KwaZulu-Natal | 45.3% | 10 919 | 4 947 | 22.3% | 11 080 | 5 020 | 22.2% | -0.1% |
| Limpopo | 52.9% | 5 727 | 3 027 | 13.6% | 5 804 | 3 068 | 13.6% | -0.0% |
| Mpumalanga | 47.3% | 4 284 | 2 024 | 9.1% | 4 328 | 2 045 | 9.1% | -0.1% |
| Northern Cape | 40.8% | 1 186 | 483 | 2.2% | 1 192 | 486 | 2.2% | -0.0% |
| North West | 47.9% | 3 707 | 1 775 | 8.0% | 3 791 | 1 815 | 8.0% | 0.0% |
| Western Cape | 21.9% | 6 200 | 1 356 | 6.1% | 6 293 | 1 376 | 6.1% | -0.0% |
| **Total** | | **54 957** | **22 189** | **100%** | **55 909** | **22 566** | **100.0%** | **–** |

*Source: National Treasury*

### *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 2017 MTEF, 2015 GDP-R data is used. Table W1.16 shows the weighted shares of the economic activity component.

**Table W1.16 Current and new economic activity component weighted shares**

| | Current (2016 MTEF) | | New (2017 MTEF) | | Difference in weighted shares |
|---|---|---|---|---|---|
| | GDP-R, 2014 (R million) | Weighted shares | GDP-R, 2015 (R million) | Weighted shares | |
| Eastern Cape | 272 714 | 7.7% | 290 581 | 7.6% | -0.09% |
| Free State | 179 776 | 5.1% | 189 183 | 5.0% | -0.12% |
| Gauteng | 1 194 144 | 33.8% | 1 309 552 | 34.3% | 0.56% |
| KwaZulu-Natal | 565 226 | 16.0% | 615 607 | 16.1% | 0.15% |
| Limpopo | 256 896 | 7.3% | 271 725 | 7.1% | -0.14% |
| Mpumalanga | 269 863 | 7.6% | 286 295 | 7.5% | -0.13% |
| Northern Cape | 71 142 | 2.0% | 80 149 | 2.1% | 0.09% |
| North West | 239 020 | 6.8% | 249 724 | 6.5% | -0.21% |
| Western Cape | 485 545 | 13.7% | 519 790 | 13.6% | -0.10% |
| **Total** | **3 534 326** | **100.0%** | **3 812 607** | **100.0%** | **–** |

*Source: National Treasury*

## Conditional grants to provinces

There are four types of provincial conditional grants:

- Schedule 4A grants supplement various programmes partly funded by provinces.
- Schedule 5A grants fund specific responsibilities and programmes implemented by provinces.
- Schedule 6A grants provide in-kind allocations through which a national department implements projects in provinces.
- Schedule 7A grants provide for the swift allocation and transfer of funds to a province to help it deal with a disaster.

### *Changes to conditional grants*

The overall growth in direct conditional transfers to provinces is buoyant, averaging 8.4 per cent over the MTEF period. Direct conditional grant baselines total R96.8 billion in 2017/18, R107.1 billion in 2018/19 and R114.3 billion in 2019/20. Indirect conditional grants amount to R4.3 billion, R1.8 billion and R1.9 billion respectively for each year of the same period.

Table W1.17 provides a summary of conditional grants by sector for the 2017 MTEF period. More detailed information, including the framework and allocation criteria for each grant, is provided in the 2017 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 grants' audited outcomes for 2015/16.

**Table W1.17 Conditional grants to provinces**

| R million | 2016/17 | 2017/18 | 2018/19 | 2019/20 | MTEF total |
|---|---|---|---|---|---|
| **Agriculture, Forestry and Fisheries** | **2 202** | **2 242** | **2 381** | **2 542** | **7 164** |
| Comprehensive agricultural support programme | 1 642 | 1 646 | 1 751 | 1 876 | 5 273 |
| Ilima/Letsema projects | 491 | 522 | 552 | 583 | 1 658 |
| Land care programme: poverty relief and infrastructure development | 69 | 74 | 78 | 82 | 234 |
| **Arts and Culture** | **1 357** | **1 420** | **1 499** | **1 580** | **4 499** |
| Community library services | 1 357 | 1 420 | 1 499 | 1 580 | 4 499 |
| **Basic Education** | **16 586** | **17 154** | **21 023** | **22 230** | **60 408** |
| Education infrastructure | 9 933 | 10 046 | 13 390 | 14 141 | 37 576 |
| HIV and Aids (life skills education) | 231 | 245 | 260 | 274 | 779 |
| Learners with profound intellectual disabilities | – | 72 | 185 | 221 | 478 |
| Maths, science and technology | 362 | 365 | 386 | 408 | 1 160 |
| National school nutrition programme | 6 060 | 6 426 | 6 802 | 7 186 | 20 414 |
| **Cooperative Governance and Traditional Affairs** | **–** | **123** | **131** | **138** | **392** |
| Provincial disaster | – | 123 | 131 | 138 | 392 |
| **Health** | **33 981** | **37 520** | **41 217** | **44 615** | **123 352** |
| Comprehensive HIV, Aids and TB | 15 291 | 17 558 | 19 922 | 22 039 | 59 519 |
| Health facility revitalisation | 5 273 | 5 654 | 5 916 | 6 247 | 17 817 |
| Health professions training and development | 2 477 | 2 632 | 2 784 | 2 940 | 8 357 |
| Human papillomavirus vaccine | – | – | 200 | 211 | 411 |
| National tertiary services | 10 847 | 11 676 | 12 395 | 13 178 | 37 248 |
| National health insurance | 94 | – | – | – | – |
| **Human Settlements** | **18 284** | **19 969** | **21 115** | **22 338** | **63 423** |
| Human settlements development | 18 284 | 19 969 | 21 115 | 22 338 | 63 423 |
| **Public Works** | **762** | **781** | **824** | **882** | **2 487** |
| Expanded public works programme integrated grant for provinces | 402 | 396 | 416 | 452 | 1 263 |
| Social sector expanded public works programme incentive for provinces | 360 | 386 | 408 | 431 | 1 224 |
| **Social Development** | **86** | **556** | **758** | **806** | **2 120** |
| Substance abuse treatment | 86 | 57 | 71 | 75 | 203 |
| Early childhood development | – | 318 | 491 | 518 | 1 327 |
| Social worker employment grant | – | 182 | 197 | 213 | 591 |
| **Sport and Recreation South Africa** | **556** | **586** | **618** | **653** | **1 857** |
| Mass participation and sport development | 556 | 586 | 618 | 653 | 1 857 |
| **Transport** | **15 878** | **16 477** | **17 526** | **18 507** | **52 510** |
| Provincial roads maintenance | 10 478 | 10 754 | 11 536 | 12 182 | 34 471 |
| Public transport operations | 5 400 | 5 723 | 5 990 | 6 326 | 18 039 |
| **Total direct conditional allocations[1]** | **89 692** | **96 829** | **107 092** | **114 292** | **318 213** |
| **Indirect transfers** | **3 654** | **4 258** | **1 765** | **1 864** | **7 886** |
| **Agriculture, Forestry and Fisheries** | **212** | **–** | **–** | **–** | – |
| Comprehensive agricultural support programme indirect | 212 | **–** | **–** | **–** | – |
| **Basic Education** | **2 181** | **2 595** | **–** | **–** | **2 595** |
| School infrastructure backlogs | 2 181 | 2 595 | – | – | 2 595 |
| **Health** | **1 261** | **1 663** | **1 765** | **1 864** | **5 292** |
| National health insurance indirect | 1 261 | 1 663 | 1 765 | 1 864 | 5 292 |

*1. Excludes provisional allocations*

*Source: National Treasury*

## *Agriculture grants*

The *comprehensive agricultural support programme* aims to support newly established and emerging farmers, particularly subsistence, smallholder and previously disadvantaged farmers. The grant is reduced by R235.9 million over the 2017 MTEF period, of which R135.5 million is kept within the sector as an allocation to the national Department of Agriculture, Forestry and Fisheries for an agricultural census to assess the farming landscape in South Africa. The allocations for 2017/18 include R131.8 million for the repair of flood damage to agricultural infrastructure. The grant is allocated R5.3 billion over the medium term.

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, R233.7 million is allocated to this grant.

The *Ilima/Letsema projects grant* aims to boost food production by helping previously disadvantaged farming communities. The grant's baseline is protected, with R522.1 million allocated for 2017/18, and a total of R1.7 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 information to improve their socioeconomic situation. The grant is allocated to the relevant provincial department and administered by that department or through a service-level agreement with municipalities. In collaboration with provincial departments of basic education, the grant also funds libraries that serve both schools and the general public. Funds from this grant may also be used to shift the libraries function between provinces and municipalities. The baseline reduction on this grant in 2017/18 is R20.8 million. The grant is allocated R4.5 billion over the next three years.

### *Basic education grants*

Provinces use the *education infrastructure grant* to construct, maintain and refurbish education infrastructure and schools. 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 *school infrastructure backlogs grant* was to merge with the *education infrastructure grant* in 2017/18, but it has been extended for another year to allow time for projects to be completed and for the thorough assessment of the grant transition process.

The *education infrastructure grant*'s baseline has been protected over the medium term and the total allocation for this period is R37.6 billion. This includes the *school infrastructure backlogs grant* component, which will remain unallocated in 2018/19 and 2019/20. As such, the baseline of the *education infrastructure grant* is R9.6 billion in 2017/18, R12.8 billion in 2018/19 and R13.5 billion in 2019/20. This leaves unallocated funds of R3.8 billion in 2018/19 and R4.1 billion in 2019/20.

Infrastructure grant reforms to improve planning were introduced in 2013 after a decade of provincial capacity building through the Infrastructure Delivery Improvement Programme. Under the requirements introduced in the 2013 Division of Revenue Act, provincial education departments had to go through a two-year planning process to be eligible to receive incentive allocations from 2016/17 onwards. To receive the 2017/18 incentive, the departments had to meet certain prerequisites in 2015/16 and have their infrastructure plans approved in 2016/17. The national Department of Basic Education and the National Treasury assessed the provinces' infrastructure plans. A moderation process was undertaken between the national departments, provincial treasuries and provincial departments of basic education to agree on the final scores. Provinces needed to obtain a minimum score of 60 per cent to qualify for the incentive. Table W1.18 shows the final score and incentive allocation for each province.

**Table W1.18 Education infrastructure grant allocations**

| R thousand | Planning assessment results from 2016 | 2017/18 | | | Final allocation for 2017/18 |
|---|---|---|---|---|---|
| | | Basic component | Incentive component | Disaster recovery funds | |
| Eastern Cape | 81% | 1 413 416 | 168 334 | – | 1 581 750 |
| Free State | 53% | 661 635 | – | – | 661 635 |
| Gauteng | 71% | 1 299 812 | 168 334 | – | 1 468 146 |
| KwaZulu-Natal | 76% | 1 824 812 | 168 334 | – | 1 993 146 |
| Limpopo | 56% | 810 523 | – | – | 810 523 |
| Mpumalanga | 58% | 750 184 | – | – | 750 184 |
| Northern Cape | 76% | 443 933 | 168 334 | – | 612 267 |
| North West | 61% | 905 997 | 168 334 | – | 1 074 331 |
| Western Cape | 89% | 925 246 | 168 334 | – | 1 093 580 |
| **Total** | | **9 035 560** | **1 010 002** | **–** | **10 045 562** |

*Source: National Treasury*

The *national school nutrition programme grant* seeks to improve the nutrition of poor school children, enhance active learning capacity and increase school attendance. It provides a free daily meal to pupils in the poorest 60 per cent of schools (quintile 1 to 3). To account for the rapid inflation in food prices over the past year, the baseline for this grant is increased by R390 million over the MTEF period to preserve the quality of the food provided and to expand access to deserving learners.

The *maths, science and technology grant* resulted from the merging of the *Dinaledi schools grant* and the *technical secondary schools recapitalisation grant*. This grant, in its second year, appears to be gaining some traction, but is still underspending. As a result, R63 million is cut from the grant's baseline over the 2017 MTEF period, allowing these funds to be reprioritised to other priority areas. The grant's total allocation is R1.2 billion over the medium term.

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 Grades 1 to 9. The grant's baseline is preserved over the MTEF period, with allocations of R245.3 million in 2017/18, R259.5 million in 2018/19 and R274.1 million in 2019/20.

The new *learners with profound intellectual disabilities grant* will be introduced over the 2017 MTEF period. The grant aims to expand access to education for learners with profound intellectual disabilities. The grant is allocated R72 million in 2017/18, R185.5 million in 2018/19 and R220.8 million in 2019/20.

### *Cooperative governance grant*

The *provincial disaster grant* is administered by the National Disaster Management Centre in the Department of Cooperative Governance. It is unallocated at the start of the financial year. The grant allows for an immediate (in-year) release of funds to be disbursed by the National Disaster Management Centre after a disaster is declared, without the need for the transfers to be gazetted first. The reconstruction of infrastructure damaged by disasters is funded separately through ring-fenced allocations in sector grants. Mitigation strategies against the ongoing drought have, in part, been funded by this grant.

To ensure that sufficient funds are available in the event of a disaster, section 26 of the 2017 Division of Revenue Bill allows for funds allocated to the *municipal disaster grant* to be transferred to provinces if funds in the *provincial disaster grant* have already been exhausted, and vice versa. The bill also allows for more than one transfer to be made to areas affected by disasters so that an initial payment for emergency aid can be made before a full assessment of damages and costs has been completed. Over the 2017 MTEF period, a total of R391.9 million has been allocated to the *provincial disaster 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 33 hospitals across the nine provinces. The urban areas of Gauteng and the Western Cape receive the largest shares of the grant because they provide the largest proportion of high-level, sophisticated services for the benefit of the country's health sector. In light of previous baselines reductions, coupled with the pressures that tertiary services face, this grant's baseline is preserved over the 2017 MTEF period. The grant is allocated R37.2 billion over the medium term.

The *health facility revitalisation grant* funds the construction and maintenance of health infrastructure. It was created in 2013/14 through the merger of three previous grants. 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. This grant's baseline is reduced by R115.4 million in 2017/18 and by R248.2 million over the remainder of the 2017 MTEF period. In spite of the reduction, R17.8 billion is allocated to this grant over the medium term, with ring-fenced funds for disasters.

Similar to the reforms to the *education infrastructure grant* discussed previously, a two-year planning process is now required for provinces to access this grant. The national Department of Health and the National Treasury conducted an assessment of the provinces' infrastructure plans, followed by a moderation process between the national departments, provincial treasuries and provincial departments of health to agree on the final scores. Provinces had to obtain a minimum score of 60 per cent to qualify for the incentive. Funds for the incentive component in the outer years are shown as unallocated. Table W1.19 sets out the final score and the incentive allocation per province.

**Table W1.19 Health facility revitalisation grant allocations**

| R thousand | Planning assessment results from 2016 | 2017/18 | | | Final allocation for 2017/18 |
|---|---|---|---|---|---|
| | | Basic component | Incentive component | Disaster recovery funds | |
| Eastern Cape | 77% | 542 939 | 77 818 | - | 620 757 |
| Free State | 66% | 474 339 | 77 818 | - | 552 157 |
| Gauteng | 69% | 812 847 | 77 818 | - | 890 665 |
| KwaZulu-Natal | 73% | 1 071 537 | 77 818 | - | 1 149 355 |
| Limpopo | 66% | 430 326 | 77 818 | - | 508 144 |
| Mpumalanga | 55% | 325 617 | - | - | 325 617 |
| Northern Cape | 64% | 365 935 | 77 818 | - | 443 753 |
| North West | 72% | 480 443 | 77 818 | - | 558 261 |
| Western Cape | 78% | 569 471 | 36 315 | - | 605 786 |
| **Total** | | **5 073 452** | **581 043** | **–** | **5 654 495** |

*Source: National Treasury*

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 baseline for this grant is protected over the 2017 MTEF period, with an allocation of R8.4 billion over the medium term.

The *comprehensive HIV, Aids and TB grant* supports HIV/AIDS 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 the 2016 MTEF, the grant's scope was extended to include Tuberculosis. To support fiscal consolidation efforts, the grant's baseline is reduced by R327.3 million over the 2017 MTEF period, but still grows at an average of 12.9 per cent over the medium term. To make provision for the continued expansion of antiretroviral treatment in response to the universal test-and-treat policy, R1 billion has been added to the grant in 2019/20.

The *national health insurance grant* was introduced in 2013/14 to fund the national health insurance pilot sites. Ten pilot districts were selected to test interventions that aim to strengthen the health system in preparation for national health insurance, including primary healthcare reengineering. However, this grant has performed poorly, with little evidence of improved outcomes and impact. The grant is now closed – 2016/17 was its final year – and the Department of Health has compiled a close-out report. The grant highlighted several challenges that will need to be addressed as the country transitions to universal health coverage, including poor supply chain management systems, weak human resource capacity and lack of delegation powers at district level. In future, the national Department of Health will fund all preparatory work under the *national health insurance indirect grant*, which has five targeted components:

- Support infrastructure projects
- Support the national health insurance scheme pilot sites
- Support the rollout of the human papillomavirus vaccine
- Implement the ideal clinic initiative
- Roll out the patient information system, which starts in 2017/18.

The infrastructure component will be used to accelerate construction, maintenance, upgrades and rehabilitation for new and existing health infrastructure. The second component will be used to contract general practitioners from the private sector for national health insurance sites. The last component will support 10 central hospitals to strengthen their patient information systems, and develop and pilot alternative hospital reimbursement tools, which will allow for appropriate reimbursement of hospitals when the health sector transitions to universal health coverage.

From 2018/19, the human papillomavirus vaccine component will become a direct grant to provinces. The national Department of Health will ensure that provincial departments are ready to take over the provision of this service and preserve the coverage ratio.

### *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. This grant is allocated using a formula with three components:

- The first component shares 70 per cent of the total allocation between provinces in proportion to their share of the total number of households living in inadequate housing. Data from the 2011 Census is used for the number of households in each province living in informal settlements, shacks in backyards and traditional dwellings. Not all traditional dwellings are inadequate, which is why information on the proportion of traditional dwellings per province with damaged roofs and walls from the 2010 General Household Survey is used to adjust these totals so that only traditional dwellings that provide inadequate shelter are counted in the formula.
- The second component determines 20 per cent of the total allocation based on the share of poor households in each province. The number of households with an income of less than R1 500 per month is used to determine 80 per cent of the component and the share of households with an income of between R1 500 and R3 500 per month is used to determine the remaining 20 per cent. Data used in this component comes from the 2011 Census.
- The third component, which determines 10 per cent of the total allocation, is shared in proportion to the number of people in each province, as measured in the 2011 Census.

In addition to the allocations determined through the formula, a total of R3.6 billion is ring-fenced over the 2017 MTEF period to upgrade human settlements in mining towns in six provinces. These allocations respond to areas with significant informal settlement challenges, with a high proportion of economic activity based on the natural resources sector. A total of R134.3 million is also ring-fenced over the medium term to repair infrastructure damaged by natural disasters.

The baseline reduction on this grant in 2017/18 is R871 million. The grant's allocation totals R63.4 billion over the medium term, with a yearly growth rate of 6.9 per cent, outpacing projected inflation.

### *Public works grants*

The *expanded public works programme integrated grant for provinces* incentivises provincial departments to use labour-intensive methods in infrastructure, environmental and other projects. Grant allocations are determined upfront based on the performance of provincial departments in meeting job targets in the preceding financial year. The grant is allocated R1.3 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 incentivises provincial departments to participate in the Expanded Public Works Programme and measures the performance of each province relative to its peers, providing additional incentives to those that perform well. The grant is allocated R1.2 billion over the MTEF period.

### *Social development grants*

The *substance abuse treatment grant* aims to build public substance abuse treatment facilities in the four provinces that did not already have such facilities: the Eastern Cape, the Free State, the Northern Cape and the North West. Starting in 2017/18, the purpose of this grant, which was exclusively for the construction of treatment centres, has changed to one that supplements the operationalisation of the newly constructed treatments centres. No baseline reduction has been effected on this grant. It has been allocated R202.5 million over the 2017 MTEF period.

The *early childhood development grant* was introduced last year, with disbursements starting in 2017/18. The grant plays a part in government's prioritisation of early childhood development, as envisioned in the National Development Plan. The grant has two distinct objectives: improve poor children's access to early childhood programmes, and ensure that the early childhood centres have adequate infrastructure. Over the MTEF period, the grant baseline totals R1.3 billion.

The new s*ocial worker employment grant*, which also comes into effect this year, aims to reduce the backlog in the number of social worker graduates that remain unemployed while the need for social work across the country continues to increase. The grant uses reprioritised funds that the Department of Social Development previously used to subsidise the education of social workers. A total of R591.3 million is reprioritised and allocated towards this new grant over the 2017 MTEF period.

### *Sport and recreation grant*

The *mass participation and sport development grant* aims to increase and sustain mass participation in sport and recreational activities in the provinces, with greater emphasis on provincial and district academies. The baseline of this grant is preserved, with an allocation of R1.9 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 2017/18. If this takes place, funds for this grant will be transferred directly to the assigned municipality. Given the pressure this sector faces, R700 million was added to the grant's baseline over the 2016 MTEF period. For the 2017 period, this baseline has been preserved. The grant is allocated R5.7 billion in 2017/18, R6 billion in 2018/19 and R6.3 billion in 2019/20.

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 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.

The performance indicators for the incentive portion of the grant, based on traffic loads, safety engineering and visual condition indicators, come into effect in 2017/18. The total allocation for the MTEF period is R34.5 billion, including ring-fenced allocations of R480 million for the repair of infrastructure damaged by floods.

## 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 – including all transfers and own revenues – is structured to support the achievement of the National Development Plan's goals.

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. However, the proportion of revenue 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.

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 2017/18 budgets, and to promote better accountability and transparency by ensuring that all national allocations are included in municipal budgets.

### Transfers to local government

Over the 2017 MTEF period, R366.3 billion will be transferred directly to local government and a further R23 billion has been allocated to indirect grants. Direct transfers to local government over the medium term account for 9.1 per cent of national government's non-interest expenditure. When indirect transfers are added to this, total spending on local government increases to 9.7 per cent of national non-interest expenditure.

**Table W1.20 Transfers to local government**

| R million | 2013/14 | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 |
|---|---|---|---|---|---|---|---|
| | | Outcome | | Revised estimate | | Medium-term estimates | |
| **Direct transfers** | **82 595** | **87 570** | **98 338** | **103 255** | **112 524** | **121 470** | **130 477** |
| **Equitable share and related**[1] | **38 964** | **41 592** | **49 367** | **51 169** | **57 012** | **62 732** | **67 473** |
| Equitable share formula[2] | 34 268 | 36 512 | 44 211 | 45 719 | 51 326 | 56 723 | 61 136 |
| RSC levy replacement | 3 930 | 4 146 | 4 337 | 4 567 | 4 795 | 5 073 | 5 357 |
| Support for councillor remuneration and ward committees | 766 | 935 | 819 | 883 | 891 | 936 | 981 |
| **General fuel levy sharing with metros** | **9 613** | **10 190** | **10 659** | **11 224** | **11 785** | **12 469** | **13 167** |
| **Conditional grants** | **34 018** | **35 788** | **38 313** | **40 863** | **43 727** | **46 270** | **49 836** |
| Infrastructure | 32 412 | 34 167 | 36 866 | 39 120 | 41 777 | 44 274 | 47 775 |
| Capacity building and other | 1 606 | 1 621 | 1 446 | 1 743 | 1 950 | 1 995 | 2 062 |
| **Indirect transfers** | **5 945** | **8 250** | **10 370** | **7 824** | **7 338** | **7 596** | **8 015** |
| Infrastructure | 5 705 | 7 998 | 10 119 | 7 740 | 7 235 | 7 480 | 7 893 |
| Capacity building and other | 240 | 252 | 251 | 84 | 103 | 115 | 122 |
| **Total** | **88 541** | **95 820** | **108 708** | **111 079** | **119 862** | **129 066** | **138 491** |

*1. Excludes provisional allocations*

*2. Outcome and revised estimate figures for the equitable share reflect amounts transferred after funds have been withheld to offset underspending by municipalities on conditional grants. Roll-over funds are reflected in the year in which they were transferred*

*Source: National Treasury*

## Changes to local government allocations

Direct transfers to local government grow at an annual average rate of 8 per cent over the 2017 MTEF period. This strong growth in transfers reflects the importance of local government functions, while recognising the rising costs of delivering municipal services to a growing number of households. At the same time, small reductions to some large conditional grants have been made to reprioritise funds to other government priorities. Grant administrators and municipalities will need to maximise efficient spending to minimise the effect of these reductions on service delivery. These changes are summarised in Table W1.21.

**Table W1.21 Revisions to direct and indirect transfers to local government**

| R million | 2017/18 | 2018/19 | 2019/20 | 2017 MTEF Total revisions |
|---|---|---|---|---|
| **Additions to baselines** | **–** | **1 000** | **3 285** | **4 285** |
| **Direct transfers** | **–** | **1 000** | **3 285** | **4 285** |
| Local government equitable share | – | 1 000 | 2 285 | 3 285 |
| Integrated national electrification programme | – | – | 1 000 | 1 000 |
| **Reductions to baseline** | **-878** | **-925** | **-951** | **-2 754** |
| **Direct transfers** | **-816** | **-841** | **-857** | **-2 514** |
| Municipal infrastructure grant | -100 | -106 | -106 | -312 |
| Water services infrastructure | -400 | -400 | -423 | -1 224 |
| Urban settlements development | -90 | -96 | -96 | -282 |
| Public transport network | -200 | -211 | -211 | -622 |
| Expanded public works programme | -25 | -29 | -19 | -73 |
| **Indirect transfers** | **-63** | **-84** | **-95** | **-241** |
| Regional bulk infrastructure | -33 | -51 | -58 | **-142** |
| Integrated national electrification programme | -30 | -33 | -36 | -99 |
| **Total change to local government allocations** | | | | |
| Change to direct transfers | -816 | 159 | 2 428 | 1 771 |
| Change to indirect transfers | -63 | -84 | -95 | -241 |
| **Net change to local government allocations** | **-878** | **75** | **2 333** | **1 530** |

*Source: National Treasury*

A total of R4.3 billion is added to local government allocations over the MTEF period. Of this, R3.3 billion is added to the local government equitable share to assist municipalities with the rising costs of providing free basic services to their residents. A further R1 billion is added to the *integrated national electrification programme (municipal) grant* in 2019/20.

The 2016 *Medium Term Budget Policy Statement* announced significant growth in the local government equitable share allocations between 2018/19 and 2019/20. This is in part due to the indicative allocation of R1.8 billion in 2019/20, which will only be confirmed in the 2018 budget process. These funds are therefore not included in tables W1.20 and W1.21, but they are included in tables W1.2 and W1.4. They are also not included in the allocations per municipality published for the 2017 MTEF period.

Over the MTEF period, transfers are reduced by R2.8 billion in total, including R2.5 billion from direct grants and R189.3 million from indirect grants. To make resources available for other government priorities, small reductions are made to a mix of urban and rural grants, including the *public transport network grant*, the *water services infrastructure grant*, the *municipal infrastructure grant,* and the *urban settlements development grant*. Despite the proposed reductions, all of these grants continue to grow by at least 5 per cent per year over the 2017 MTEF period. In addition, transfers to three grants have been reduced to reprioritise funds for other government priorities. Funds are reprioritised from the *expanded public works programme integrated grant to municipalities* for the expanded mandate of the Commission for Conciliation, Mediation and Arbitration. Funds have been reprioritised from the indirect *integrated national electrification programme (Eskom) grant* to fund the management of nuclear waste. Small amounts from the indirect *regional bulk infrastructure grant* will be reprioritised to augment funding for water catchment management agencies.

After accounting for all reductions and additions, direct transfers to local government increase by R1.5 billion over the MTEF period (not including the preliminary allocations discussed below). This increase is primarily due to the additions to the local government equitable share. Indirect transfers to local government (allocations spent by national departments on behalf of municipalities) decrease by R240.9 million over the medium term. Total allocations to local government (including direct and indirect transfers) decrease by R878.5 million in 2017/18, followed by increases of R75 million in 2018/19 and R2.3 billion in 2019/20.

## 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 revenue raised through 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 2017 MTEF period, the local government equitable share, including the *RSC/JSB levies replacement grant* and *special support for councillor remuneration and ward committees,* amounts to R187.2 billion – R57 billion in 2017/18, R62.7 billion in 2018/19 and R67.5 billion in 2019/20.

To help compensate for the rising costs of providing free basic services in municipalities, R1 billion will be added to the local government equitable share in 2018/19 and R2.3 billion will be added in 2019/20. This is in addition to the R1.5 billion in 2017/18 and R3 billion in 2018/19 that were added in the 2016 division of revenue.

### *Formula for allocating the local government equitable share*

The portion 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 257 municipalities, using a formula (the horizontal division) to ensure objectivity.

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 current formula for the local government equitable share was introduced in 2013/14. The formula's principles and objectives were set out in detail in the Explanatory Memorandum to the 2013 Division of Revenue.

### *Updating the formula with 2016 Community Survey data*

The formula, which is based on data from the 2011 Census, will be updated with data from the 2016 Community Survey over the 2017 MTEF period. To smooth the impact of this update on the allocations to municipalities, the data will be phased in over the three years of the MTEF. In 2017/18, allocations will still be based primarily on 2011 Census data (although the 2016 Community Survey data will begin to be introduced). In 2018/19, allocations will be based on data from the 2016 Community Survey, but the impact will be cushioned through a phase-in mechanism described in more detail below). By 2019/20, the formula will be fully based on 2016 Community Survey data.

### *Structure of the local government equitable share formula*

The formula uses demographic and other data to determine each municipality's portion 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 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 other 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 the *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 sub-sections that follow. The formula's structure is summarised in the box.

**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. Following municipal consultation, the formula's affordability measure (used to determine how many households need free basic services) is 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. However, the proportion in each municipality varies widely. The 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 the budget process.

The number of households per municipality, and the number below the poverty threshold, is updated annually based on the growth experienced between the 2001 and 2011 Censuses. Provincial growth rates are then rebalanced to match the average annual provincial growth reported between 2002 and 2015 in the annual General Household Survey. Statistics South Africa has advised the National Treasury that, in the absence of official municipal household estimates, this is a credible method of estimating the household numbers per municipality needed for the formula. The same methodology will be used to update the number of households used to calculate allocations for 2017/18. In 2018/19, the number of households will be taken from the 2016 Community Survey. From 2019/20 onwards, the annual updates will use the rate of growth in household numbers between the 2001 Census and the 2016 Community Survey. Statistics South Africa is researching methods for producing municipal-level data estimates, which may be used to inform equitable share allocations in future.

The proportion of households below the affordability threshold in each municipality will continue to be based on 2011 Census data. This is because the 2016 Community Survey data on income has not been released. Although the total number of households in each municipality is adjusted every year to account for growth, the share of those households that are subsidised for free basic services through the formula remains constant (but the number of households subsidised increases annually in line with estimated household growth). In 2017/18, a total of 9.5 million households are funded through the basic services subsidy.

The basic services component provides a subsidy of R359.04 per month in 2017/18 for the cost of providing basic services to each of these households. The subsidy includes funding for the provision of free basic water (six 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, 2017/18**

| | Allocation per household below affordability threshold (R per month) | | | Total allocation per service (R million) |
|---|---|---|---|---|
| | Operations | Maintenance | Total | |
| Energy | 68.52 | 7.61 | 76.13 | 8 725 |
| Water | 104.99 | 11.67 | 116.66 | 13 369 |
| Sanitation | 81.39 | 9.04 | 90.43 | 10 364 |
| Refuse | 68.23 | 7.58 | 75.81 | 8 688 |
| **Total basic services** | **323.13** | **35.90** | **359.04** | **41 147** |

*Source: National Treasury*

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 on the National Treasury website. 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. The approved bulk electricity tariff for the multi-year price determination period from 2014/15 to 2018/19 allows for increases of 8 per cent per year. If any variations to this increase are approved for 2017/18, funding will be considered during the budget adjustments process. Other electricity costs are updated based on the National Treasury's inflation projections in the 2016 *Medium Term Budget Policy Statement*.
- The water cost estimate is also made up of bulk and other costs. Bulk costs are updated based on the 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). The approved average tariff increase for bulk water from water boards in 2016/17 was 10.8 per cent. Other costs are updated based on the National Treasury's inflation projections in the 2016 *Medium Term Budget Policy Statement*.
- The costs for sanitation and refuse removal are updated based on the National Treasury's inflation projections in the 2016 *Medium Term Budget Policy Statement*.

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 must transfer funds to the provider in terms of section 29 of the Division of Revenue Act. The basic services component is worth R41 billion in 2017/18 and accounts for 80.2 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 with their own revenue. But, because poor households are not able to contribute in full, the equitable share includes an institutional support component to help meet some of these costs. To ensure that this component supports municipalities with limited 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.

This component consists of a base allocation of R6.3 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). 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 7.9 per cent of the equitable share formula and is worth R4.1 billion in 2017/18. This component is also complemented by special support for councillor remuneration in poor municipalities, which is not part of the equitable share formula.

### *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 revenue-raising abilities, a revenue adjustment factor is applied so that these municipalities receive a larger proportion of the allocation.

The allocation for this component is split between district and local municipalities, which both provide community services. In 2017/18, the allocation to district and metropolitan municipalities for municipal health and related services is R8.79 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 11.9 per cent of the equitable share formula and is worth R6.1 billion in 2017/18.

### *The revenue adjustment factor*

The Constitution gives local government substantial 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 revenue.

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 do not receive an 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, which ensures that this component does not create a 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 and 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, while those with lower allocations receive a higher revenue adjustment factor.

### *Correction and stabilisation factor*

Providing municipalities with predictable and stable equitable share allocations is one of the principles of the equitable share formula. 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 period.

A new equitable share formula was introduced in 2013/14 using 2011 Census data. As a result, some municipalities experienced 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 were phased in over five years, from 2013/14 to 2017/18. This process is complete. In the 2017 MTEF period, the formula will be updated with data from the 2016 Community Survey and the effect of those updates will be phased in over three years from 2017/18 to 2019/20.

Updating the formula with 2016 Community Survey data results in some significant changes to municipal allocations. This is because the number of households in some municipalities in the survey results differs from the projected numbers used in the local government equitable share formula (based on 2011 Census numbers, updated annually using past growth rates). Although the projected number of households in the formula for the country as a whole differed from the 2016 Community Survey results by only about 1 000 households, or a difference of only 0.006 per cent, in some individual municipalities the differences were as high as 24 per cent. In 44 per cent of municipalities, the difference between the formula's projections and the 2016 Community Survey results was less than 5 per cent, but to preserve the stability of allocations to those municipalities with larger differences it is necessary to phase in the updates over a three-year period.

The phasing in of the 2016 Community Survey data is structured so that the municipality with the highest percentage decrease as a result of the data update will receive 95 per cent of its indicative allocation for 2017/18, as set out in the 2016 Division of Revenue Act. The rest of the municipalities receive amounts above their 95 per cent guaranteed amount that are proportional to the size of their total allocation, adjusted to account for the percentage increase or decrease they will experience as a result of the data updates. The same methodology is applied in 2018/19, with the municipality with the highest percentage decrease receiving 90 per cent of its indicative allocation. By 2019/20, municipalities will be receiving allocations as determined by the updated formula.

### *Ensuring the formula balances*

The formula is structured so that all of the available funds are allocated. 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 balancing the formula to the available resources must take place in the second part of the formula, which includes the institutional and community services components. The formula automatically determines the value of the allocation per council seat in the institutional component and the allocation per household for other services in the community services component to ensure that it balances. Increases in the cost of providing basic services can result in lower institutional and community services allocations.

### *Potential future refinements to the formula*

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

- Exploring the use of differentiated cost variables to take account of the cost of services in various circumstances, including costs related to the size of the land area served and settlement types in municipalities. SALGA and the FFC have completed a research project that provides some estimates of these different cost factors and demonstrates how complex it would be to incorporate such details into the formula.
- Refining the methodology used to update household growth estimates, taking account of updated data from Statistics South Africa, and possibly using district-level data.
- Improving the responsiveness of the formula to the different functions assigned to district and local municipalities.

### *Details of new allocations*

In addition to the three-year formula allocations published in the Division of Revenue Bill, a copy of the formula, including the data used for each municipality and each component, is published online (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 a Regional Services Council (RSC) or Joint Services Board (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 *RSC/JSB levies replacement grant*'s value increases every year. In 2017/18, adjustments are made to the grant to redistribute funds to the 13 district municipalities currently receiving less than R40 million per year from this grant. To fund increased allocations to these district municipalities, the growth rates of the 10 district municipalities with the largest allocations are reduced so that they receive two-thirds of their original growth rate in 2017/18 and one-third of their original growth rate in 2018/19. In the outer year of the MTEF period, the grant increases by 8.8 per cent a year for district municipalities authorised for water and sanitation and 2.9 per cent for unauthorised district municipalities. The different rates recognise the various service-delivery responsibilities of these district municipalities and the fact that the allocations to unauthorised municipalities have an average growth rate below inflation.

### *Special support for councillor remuneration and ward committees*

Councillors' salaries are subsidised in poor municipalities. The total value of the support provided in 2017/18 is R910 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 allocated based on a system gazetted by the Minister of Cooperative Governance and Traditional Affairs, which 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).

A subsidy of 90 per cent of the gazetted maximum remuneration for a part-time councillor is provided for every councillor in grade 1 municipalities, 80 per cent for grade 2 municipalities and 70 per cent for grade 3 municipalities. In addition to this support for councillor remuneration, each local 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 Division of Revenue Bill appendices.

## 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 R43.7 billion in 2017/18 to R46.3 billion in 2018/19 and R49.8 billion in 2019/20.

There are four types of local government conditional grants:

- Schedule 4B sets out general grants that supplement various programmes partly funded by municipalities.
- Schedule 5B grants fund specific responsibilities and programmes implemented by municipalities.
- Schedule 6B grants provide in-kind allocations through which a national department implements projects in municipalities.
- Schedule 7B grants provide for the swift allocation and transfer of funds to a municipality to help it deal with a disaster.

### 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 R156.4 billion over the 2017 MTEF period.

**Table W1.23 Infrastructure grants to local government**

| R million | 2013/14 | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 |
|---|---|---|---|---|---|---|---|
| | | Outcome | | Revised estimate | | Medium-term estimates | |
| **Direct transfers** | **32 412** | **34 167** | **36 866** | **39 120** | **41 777** | **44 274** | **47 775** |
| Municipal infrastructure | 14 224 | 14 745 | 14 956 | 14 914 | 15 891 | 16 788 | 17 734 |
| Water services infrastructure | 1 129 | 1 051 | 2 305 | 2 845 | 3 329 | 3 559 | 3 757 |
| Urban settlements development | 9 077 | 10 285 | 10 554 | 10 839 | 11 382 | 11 956 | 12 631 |
| Integrated national electrification programme | 1 635 | 1 105 | 1 980 | 1 946 | 2 087 | 2 204 | 3 328 |
| Public transport network | 5 550 | 5 871 | 5 953 | 5 593 | 6 160 | 6 583 | 6 962 |
| Neighbourhood development partnership | 586 | 590 | 584 | 624 | 663 | 702 | 741 |
| Integrated city development | 40 | 255 | 251 | 267 | 292 | 309 | 326 |
| Regional bulk infrastructure | – | – | – | 1 850 | 1 865 | 2 060 | 2 175 |
| Rural roads asset management systems | 52 | 75 | 97 | 102 | 107 | 114 | 120 |
| Municipal disaster recovery | 118 | 190 | 186 | 140 | – | – | – |
| **Indirect transfers** | **5 705** | **7 998** | **10 119** | **7 740** | **7 235** | **7 480** | **7 893** |
| Integrated national electrification programme | 2 141 | 2 948 | 3 613 | 3 526 | 3 846 | 3 962 | 4 182 |
| Neighbourhood development partnership | 55 | 30 | 13 | 22 | 28 | 29 | 31 |
| Regional bulk infrastructure | 3 261 | 4 005 | 4 858 | 3 479 | 2 774 | 2 881 | 3 037 |
| Water services infrastructure | 247 | 732 | 659 | 362 | 587 | 608 | 642 |
| Bucket eradication programme | – | 282 | 975 | 350 | – | – | – |
| **Total** | **38 117** | **42 165** | **46 985** | **46 859** | **49 012** | **51 755** | **55 668** |

*Source: National Treasury*

#### *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. Although the grant's baseline is reduced by R100 million in 2017/18, R106 million in 2018/19 and R106 million in 2019/20, total allocations still amount to R50.4 billion over the 2017 MTEF period and grow at an average annual rate of 5.9 per cent.

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.

**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 (including sport infrastructure)

**E** Allocation for social institutions and micro-enterprise infrastructure

**N** Allocation to the 27 priority districts identified by government

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 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 | Value of component 2017/18 (R millions) | Proportion of municipal infrastructure grant per sector |
|---|---|---|---|
| **B-component** | **75.0%** | **10 846** | **68.3%** |
| Water and sanitation | 72.0% | 7 809 | 49.1% |
| Roads | 23.0% | 2 495 | 15.7% |
| Other | 5.0% | 542 | 3.4% |
| **P-component** | **15.0%** | **2 169** | **13.7%** |
| Sports | 33.3% | 722 | 4.5% |
| **E-component** | **5.0%** | **723** | **4.6%** |
| **N-component** | **5.0%** | **723** | **4.6%** |
| **Constant** | | **1 130** | **7.1%** |
| **Ring-fenced funding for sport infrastructure** | | **300** | **1.9%** |
| **Total** | | **15 891** | **100.0%** |

*Source: National Treasury*

The *municipal infrastructure grant* includes an amount of R300 million, which is allocated outside of the grant formula and earmarked for specific sport infrastructure projects identified by Sport and Recreation South Africa. In addition, municipalities are required to spend a third of the P-component (equivalent to 4.5 per cent of the grant) on sport and recreation infrastructure identified in their own integrated development plans. Municipalities are also encouraged to increase their investment in other community infrastructure, including cemeteries, community centres, taxi ranks and marketplaces.

The Department of Cooperative Governance, which administers the *municipal infrastructure grant*, continues to implement measures to strengthen the management and implementation of the grant in line with the ongoing review of local government infrastructure grants. Changes due to be introduced in 2017/18 include:

- The circulation of a guideline on how refurbishment projects funded by the grant should be planned, assessed and implemented. The rules of the grant were changed in 2015/16 to allow funds to be spent on refurbishment but relatively few projects of this nature have been implemented since then. The new guideline should clarify the requirements around refurbishment funding and enable more municipalities to refurbish ageing infrastructure.
- The circulation of a revised guideline on the use of project management unit funds. Municipalities are allowed to use up to 5 per cent of their allocations from this grant for a project management unit. The

guideline will help municipalities achieve greater impact from these units. Grant conditions that require municipalities to submit business plans for their project management units will also allow the Department of Cooperative Governance to ensure municipalities adhere to the guideline's best practices over time.

- The Department of Cooperative Governance will provide training to municipalities on the use of the management information system for the *municipal infrastructure grant*. This is a project management system that provides useful tools for municipalities to track and manage their own projects. If used correctly, the system can reduce the reporting burden by easily generating reports itself.

### *Urban settlements development grant*

The *urban settlements development grant* is an integrated source of funding to provide infrastructure for municipal services and upgrade urban informal settlements in the eight metropolitan municipalities. The grant is allocated as a supplementary grant to cities (schedule 4B of the Division of Revenue Act), which means that municipalities are expected to use a combination of grant funds and their own revenue to develop urban infrastructure and integrated human settlements. Cities report their progress on these projects against the targets set in their service-delivery and budget implementation plans. This grant helps cities respond to the challenge of providing services to the large number of urban households living in informal settlements. The grant's rules require that at least 50 per cent of the grant is used to fund the upgrading of informal settlements. Up to 3 per cent of the *urban settlements development grant* may be used to fund municipal capacity in the built environment in line with the capacity-building guideline to be published by the Department of Human Settlements.

Although the grant's baseline is reduced by R90 million in 2017/18, R96 million in 2018/19 and R96.3 million in 2019/20, total allocations still amount to R36 billion over the 2017 MTEF period and grow at an average annual rate of 5.2 per cent.

### *Integrated city development grant*

The grant provides a financial incentive for metropolitan municipalities to focus their use of infrastructure investment and regulatory instruments to achieve more compact and efficient urban spaces. The grant's incentive allocations were previously based on performance measures of good governance and administration. However, in 2017/18 an additional indicator is introduced, based on the assessment of a city's built environment performance plan. Cities are required to adopt built environment performance plans that provide a strategic overview of its plans for the built environment, and how its infrastructure investments will transform the city's spatial development patterns over time. Including a peer-reviewed assessment score in the allocation criteria for this grant provides a tangible reward to cities for improving the quality of these plans. This is in line with the reforms emerging from the ongoing review of local government infrastructure grants, which calls for increased use of incentives in urban grants and the use of grants to support urban spatial transformation. The grant is allocated R927.6 million over the 2017 MTEF period.

### *Public transport network grant*

The *public transport network grant*, administered by the Department of Transport, helps cities create or improve public transport systems in line with the National Land Transport Act (2009) and the Public Transport Strategy. This includes all integrated public transport network infrastructure, such as bus rapid transit systems, conventional bus services, and pedestrian and cycling infrastructure. The grant also subsidises the operation of these services.

A formula determines 80 per cent of the grant's allocations. The use of a formula aims to increase certainty about the extent of national funding that municipalities can expect when planning their public transport networks, and encourage cities to shift towards more sustainable transport investments. Cities need to plan within a realistic envelope of support from national government, without expecting additional subsidies. Strict eligibility conditions are also being introduced, including requirements that cities demonstrate that their planned public transport systems will be financially sustainable. Several cities have already revised their planned public transport networks as a result of these new planning requirements. The formula is made up of three components, which account for the number of people in a city, the number of public transport users in a city (the weighting of train commuters is reduced as trains are subsidised separately through the Passenger Rail Authority of South Africa) and the size of a city's economy.

**Table W1.25 Formula for the public transport network grant**

| | Population component shares | Regional gross value added component shares | Public transport users component shares | Grant formula shares |
|---|---|---|---|---|
| **Non-formula-based allocations account for 20% of the grant** | | | | |
| **Formula-based allocations account for 80% of the grant** | | | | |
| **Formula shares for each city:** | | | | |
| Buffalo City | 3.3% | 2.8% | 3.1% | **3.1%** |
| Nelson Mandela Bay | 5.0% | 4.7% | 3.6% | **4.5%** |
| Mangaung | 3.3% | 2.4% | 3.2% | **3.0%** |
| Ekurhuleni | 13.8% | 9.5% | 14.9% | **12.8%** |
| City of Johannesburg | 19.3% | 25.2% | 20.5% | **21.7%** |
| Tshwane | 12.7% | 15.0% | 14.0% | **13.9%** |
| eThekwini | 15.0% | 15.8% | 18.0% | **16.3%** |
| Msunduzi | 2.7% | 1.5% | 2.4% | **2.2%** |
| Mbombela | 2.6% | 1.9% | 2.4% | **2.3%** |
| Polokwane | 2.7% | 1.5% | 1.3% | **1.9%** |
| Rustenburg | 2.4% | 3.5% | 2.3% | **2.7%** |
| George | 0.8% | 0.5% | 0.2% | **0.5%** |
| Cape Town | 16.3% | 15.8% | 13.9% | **15.3%** |
| **Total** | **100.0%** | **100.0%** | **100.0%** | **100.0%** |

*Source: National Treasury*

Although the grant's baseline is reduced by R200.3 million in 2017/18, R210.6 million in 2018/19 and R211.4 million in 2019/20, total allocations still amount to R19.7 billion over the 2017 MTEF period and grow at an average annual rate of 7.6 per cent.

### *Neighbourhood development partnership grant*

The *neighbourhood development partnership grant* supports cities in developing and implementing urban network plans. The aim is to create a platform for third-party public and private investment, which will improve the quality of life in township urban hubs. Projects in towns and rural areas are implemented in conjunction with the Department of Rural Development and Land Reform. The grant is allocated R2.2 billion over the 2017 MTEF period, which consists of R2.1 billion for the direct capital component and R88.1 million for the indirect technical assistance component.

### *Water services infrastructure grant*

This grant aims to accelerate the delivery of clean water and sanitation facilities to communities that do not have access to basic water services. The grant, administered by the Department of Water and Sanitation, provides funding for various projects, including the construction of new infrastructure and the refurbishment and extension of existing water schemes. It has both direct and indirect components. In areas where municipalities have the capacity to implement projects themselves, funds are transferred through a direct grant. In other areas, the Department of Water and Sanitation implements projects on behalf of municipalities through an indirect grant. As with other indirect grants, the national department is required to transfer skills to the municipalities benefiting from the indirect grant so that they will be able to implement projects themselves in future. A maximum of 3 per cent of a municipality's allocation from this grant can be used for capacity building to ensure municipalities can operate and maintain projects in future.

This grant will also be used to support the completion of the bucket eradication programme in formal residential areas, as the *bucket eradication programme grant* came to an end in 2016/17. The *water services infrastructure grant* can also be used to fund projects responding to water supply problems caused by drought. To ensure efficiency, these projects and their plans must be shared with the National Disaster Management Centre.

Over the 2017 MTEF period, the total allocation for the indirect portion of the grant is R1.8 billion. The direct component of this grant is reduced by R400.4 million in 2017/18, R400 million in 2018/19 and R423.4 million in 2019/20, however total allocations for the direct component still amount to R10.6 billion over the 2017 MTEF period and grow at an average annual rate of 9.7 per cent.

### *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 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. It has both direct and indirect components. In areas where municipalities have the capacity to implement projects themselves, funds are transferred through a direct grant. In other areas, the Department of Water and Sanitation implements projects on behalf of municipalities through an indirect grant. A parallel programme, funded by the Department of Water and Sanitation, also funds water boards for the construction of bulk infrastructure. Though not part of the division of revenue, these projects still form part of the Department of Water and Sanitation's larger programme of subsidising the construction of regional bulk infrastructure for water and sanitation. For the 2017 MTEF period, this grant will also fund the cost of developing and implementing transfer plans for how assets built through the indirect grant will be handed over to municipalities, including skills transfer, training and planning for tariff alignment. This grant will also be used to fund the bulk infrastructure needed for the completion of the bucket eradication programme in formal residential areas.

The grant has a total allocation of R14.8 billion over the 2017 MTEF period, consisting of R6.1 billion and R8.7 billion for the direct and indirect components respectively. The indirect component is reduced by R32.7 million in 2017/18, R50.5 million in 2018/19 and R58.3 million in 2019/20.

### *Integrated national electrification programme grants*

The aim of this grant is to provide capital subsidies to municipalities to electrify poor households and fund bulk infrastructure to ensure the constant supply of electricity. Allocations to this grant are made based on the backlog of un-electrified households and administered by the Department of Energy. The grant only funds bulk infrastructure that serves poor households. The national electrification programme has helped provide 91 per cent of all poor households with access to electricity, as reported in the 2016 Community Survey, an increase from the 85 per cent reported in the 2011 Census. To sustain this progress, government will spend R19.6 billion on the programme over the next three years. Of this, municipalities are allocated R7.6 billion and Eskom is allocated R12 billion to spend on behalf of municipalities through an indirect grant. The *integrated national electrification programme (Eskom) grant* allocation includes reductions of R30 million in 2017/18, R33 million in 2018/19 and R36.3 million in 2019/20. The *integrated national electrification programme (municipal) grant* receives an additional allocation of R1 billion in 2019/20 to further accelerate the rollout of electricity connections to all households.

The Select Committee on Appropriations and the review of local government infrastructure grants have recommended that allocations to metropolitan municipalities from the *integrated national electrification programme (municipal) grant* should be incorporated into the *urban settlements development grant*. This will allow better planning and alignment between electrification projects and the delivery of other basic services funded through the *urban settlements development grant.* Discussions on the alignment of electrification and human settlements projects will continue in 2017, with the aim of shifting allocations for electrification from 2018/19.

### *Rural roads asset management systems grant*

The Department of Transport administers the *rural roads asset management systems grant* 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 information guides investments to maintain and improve these roads. District municipalities collect this data on all the municipal roads in their area, ensuring that infrastructure spending (from the *municipal infrastructure grant* and elsewhere) can be properly planned to maximise impact. As data becomes available, incentives will be introduced to ensure that municipalities use this information to plan road maintenance appropriately. The *municipal infrastructure grant* stipulates that municipalities must use data from roads asset management systems to prioritise investment in roads projects.

The Department of Transport will work with the *municipal infrastructure grant* administrators to ensure that municipal roads projects are chosen, prioritised and approved using roads asset management systems data wherever possible. A total of R340.7 million is allocated to this grant over the 2017 MTEF period.

## Capacity-building grants and other current transfers

Capacity-building grants help to develop municipalities' management, planning, technical, budgeting and financial management skills. Other current transfers include the *expanded public works programme integrated grant for municipalities*, which promotes increased labour intensity in municipalities, and the *municipal demarcation transition grant*, which assists municipalities with the additional costs associated with significant boundary changes. A total of R6.3 billion is allocated to capacity-building grants and other current transfers to local government over the 2017 MTEF period.

**Table W1.26 Capacity-building and other current grants to local government**

| | 2013/14 | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 |
|---|---|---|---|---|---|---|---|
| R million | | Outcome | | Revised | | Medium-term estimates | |
| **Direct transfers** | **1 606** | **1 621** | **1 446** | **1 743** | **1 950** | **1 995** | **2 062** |
| Local government financial management | 425 | 449 | 452 | 465 | 502 | 531 | 561 |
| Municipal human settlements capacity | – | 300 | 100 | – | – | – | – |
| 2014 African Nations Championship host city operating | 120 | – | – | – | – | – | – |
| Expanded public works programme integrated grant for municipalities | 611 | 595 | 588 | 664 | 691 | 729 | 781 |
| Infrastructure skills development | 99 | 104 | 124 | 130 | 141 | 149 | 157 |
| Energy efficiency and demand-side management | 181 | 137 | 178 | 186 | 203 | 215 | 227 |
| Municipal demarcation transition | – | – | 4 | 297 | 112 | – | – |
| Municipal disaster | 171 | 36 | – | – | 300 | 371 | 335 |
| **Indirect transfers** | **240** | **252** | **251** | **84** | **103** | **115** | **122** |
| Municipal systems improvement | 240 | 252 | 251 | 84 | 103 | 115 | 122 |
| **Total** | **1 846** | **1 873** | **1 698** | **1 827** | **2 053** | **2 110** | **2 183** |

*Source: National Treasury*

### *Municipal demarcation transition grant*

The *municipal demarcation transition grant*, administered by the Department of Cooperative Governance, assists municipalities with additional costs that may arise during the transition to the new municipal boundaries. This grant was introduced in 2015/16 to subsidise the costs involved in implementing major boundary re-determinations announced by the Municipal Demarcation Board. In line with the FFC's recommendations, the grant will conclude at the end of 2017/18 because it is only intended to fund transitional costs and it will not form a permanent part of the intergovernmental transfer system. The grant is allocated R111.9 million in 2017/18.

### Local government financial management grant

The *local government financial management grant*, managed by the National Treasury, funds the placement of financial management interns in municipalities 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 and provides funds for the implementation of the municipal standard chart of accounts. Total allocations amount to R1.6 billion over the 2017 MTEF period.

### Infrastructure skills development grant

The *infrastructure skills development grant* 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 within their respective built environment fields. The interns can be hired by any municipality at the end of their internship. The grant is allocated R447 million over the 2017 MTEF period.

### Municipal systems improvement grant

The *municipal systems improvement grant* will be implemented as an indirect grant in the 2017 MTEF period. It funds a range of projects in municipalities in support of the Back to Basics strategy, including helping municipalities set up adequate record management systems, drawing up organograms for municipalities and reviewing their appropriateness relative to their assigned functions, and assisting municipalities with revenue collection plans. The indirect grant will be complemented by the Department of Cooperative Governance's work to develop an integrated consumer database that municipalities can draw data from, as well as a performance management system to track municipal performance. Over the 2017 MTEF period, R340 million is allocated to this grant.

### Expanded public works programme integrated grant for municipalities

This grant promotes the use of labour-intensive methods in delivering municipal infrastructure and services. It is allocated through a formula based on past performance, which creates an incentive for municipalities. The formula is weighted to give larger allocations to poor, rural municipalities. The grant is allocated R691 million in 2017/18, and R2.2 billion over the 2017 MTEF period.

### Energy efficiency and demand-side management grant

The *energy efficiency and demand-side management grant* funds selected municipalities to implement energy-efficiency projects, with a focus on public lighting and energy-efficient municipal infrastructure. In the 2017 MTEF period, the Department of Energy will monitor and verify grant-funded projects to ensure greater consistency in the procurement of accredited verification services. The grant is allocated R645.3 million over the 2017 MTEF period.

### Municipal disaster grant

The *municipal disaster grant* is administered by the National Disaster Management Centre in the Department of Cooperative Governance as an unallocated grant to local government. The centre is able to disburse disaster-response funds immediately, without the need for the transfers to be gazetted first. To ensure that sufficient funds are available in the event of disasters, section 21 of the Division of Revenue Bill allows for funds allocated to the *provincial disaster grant* to be transferred to municipalities if funds in the *municipal disaster grant* have already been exhausted, and vice versa. The bill also allows for more than one transfer to be made to areas affected by disasters, so that initial emergency aid can be provided before a full assessment of damages and costs is conducted. Over the MTEF period, R1 billion is available for disbursement through this grant. To ensure that sufficient funds are available for disaster relief, section

20 of the Division of Revenue Bill allows funds from other conditional grants to be reallocated for this purpose, subject to the National Treasury's approval.

## Part 6: Future work on provincial and municipal fiscal frameworks

The fiscal frameworks for provincial and local government encompass all their revenue sources and expenditure responsibilities. As underlying social and economic trends evolve and the assignment of intergovernmental functions change, so must the fiscal frameworks. The National Treasury, together with relevant stakeholders, conducts continuous reviews to ensure that provinces and municipalities have an appropriate balance of available revenues and expenditure responsibilities, while taking account of the resources available and the principles of predictability and stability.

This part of the annexure describes the main areas of work to be undertaken during 2017/18 as part of the ongoing review and refinement of the intergovernmental fiscal framework. Provinces and municipalities will be consulted on all proposed changes to the fiscal frameworks.

### Review of the provincial equitable share formula

The Constitution stipulates that provinces are entitled to a share of nationally raised revenue to deliver on their mandates. The current process of dividing up provincial funds uses a formula that considers the spread of the burden of service delivery across provinces. The provincial equitable share formula contains weighted elements that reflect government priorities and incorporates elements to redress inequality and poverty across provinces. Over time, the formula, like any budgetary allocation tool, may no longer mirror the realities provinces face. As such, there is a need for periodic review of the formula to assess its continued appropriateness and equity. In 2016, the National Treasury started a detailed review of the equitable share formula. The Technical Committee on Finance and the Budget Council is consulted as part of this work. To date, the National Treasury has assessed the credibility and reliability of the datasets.

### The role of provinces in promoting economic development

Provinces and municipalities play a crucial role in advancing the economic development of their respective precincts. Fully functional, well-equipped schools produce a vibrant and employable workforce. Smarter health systems develop and maintain the health of the workforce. Provincial agriculture departments' support to farmers can stimulate rural development. The provision of provincial and municipal roads and public transport services ensures mobility for goods and workers, while basic municipal services such as water, electricity and refuse removal, as well as business licencing and environmental health functions, enable businesses to operate and grow. Well-managed procurement can maximise developmental impact without compromising efficiencies.

Government must work with businesses and other relevant stakeholders to provide an enabling environment for the faster and more inclusive economic growth called for in the National Development Plan. Since 2015, national and provincial treasuries have been working together through a task team of the Technical Committee on Finance to better define the role provinces should play in promoting economic development. The potential for provinces to make cost-effective progress is also being explored.

### National health insurance policy work

The National Health Insurance White Paper was released for comment on 11 December 2015. The Department of Health, in collaboration with the National Treasury and other stakeholders, is refining the policy in response to the comments received. This work will continue identify practical pathways to implementation of universal health coverage in South Africa.

### Improving intergovernmental coordination on infrastructure investment

Public infrastructure investments can play a major role in transforming South Africa's spatial development patterns. This requires a significant improvement in intergovernmental coordination in planning and budgeting for infrastructure. In particular, provinces need to ensure that their investments in schools, roads, health facilities and housing are made in locations that align with the spatial development plans of municipalities.

To facilitate improved planning alignment with municipalities, the guidelines for provincial infrastructure will require that municipalities be consulted on and agree to the location and bulk services requirements of all provincial infrastructure projects from 2017/18. Provincial treasuries will also be expected to include municipalities in their infrastructure medium-term expenditure committee meetings where projects to be included in the next budget are selected.

### Local government transfers

The system of transfers to local government is continuously being reviewed and refined to improve spending efficiency and the impact achieved through these transfers. Over the period ahead, the National Treasury will examine the funding and efficiency of rural municipalities and how the transfers they rely on can be structured to improve their sustainability and performance. At the same time, urban municipalities will be encouraged to increase their reliance on own-revenue sources to fund their budgets (including borrowing to fund infrastructure investments).

Government will also review the amounts allocated to different sectors across the local government infrastructure grant system and how these compare to the extent of backlogs revealed in the 2016 Community Survey. This may result in recommendations for a rebalancing of the resources allocated to each sector and in the way projects are selected under the different grants.

### Reforming municipal borrowing

Long-term borrowing can be an effective way for municipalities to finance infrastructure development. However, responsible borrowing requires an appropriate institutional framework and financial controls. The Policy Framework for Municipal Borrowing and Financial Emergencies (1999) and the Municipal Finance Management Act set a range of measures to facilitate responsible municipal borrowing and financial controls. These measures deal with issues such as sovereign risk, credit enhancements, maturities, avoidance of direct government assistance, and liquidity through the development of secondary markets.

Despite these measures and improvements in municipal borrowing, there are still some bottlenecks that need to be addressed to promote the development of municipal debt markets. Currently, the municipal debt market is skewed, with a predominance of commercial bank loans. As a result, municipalities find it difficult to issue debt instruments with maturities that match the life span of their infrastructure assets. One solution is to promote the participation of more actors, including institutional investors, in the municipal debt market. Institutional investors (such as pension funds) hold long-term assets on their balance sheets that can be matched with the life spans of municipal infrastructure assets. The National Treasury has established an Urban Finance Working Group, comprising commercial banks, institutional investors, international development finance institutions, metropolitan municipalities and the Development Bank of Southern Africa, to identify and recommend practical and innovative urban infrastructure financing solutions.

The working group is reviewing the policy framework for municipal borrowing and financial emergencies, with a focus on analysing the existing policy and regulatory framework, strengthening partnerships with financial institutions, improving monitoring and evaluation, and designing municipal capacity-building programmes and strategies for responsible municipal borrowing.

### Reviewing own-revenue sources for metropolitan municipalities

Government is reviewing metropolitan municipalities' own-revenue sources to assess whether they are adequate to meet municipal service-delivery and development mandates. A task team consisting of the National Treasury, the Department of Cooperative Governance, SALGA, the FFC, the South African Cities Network and metropolitan municipalities is conducting the review. The project consists of three phases.

During the first phase, competed in May 2015, the task team developed socio-economic profiles of the eight metropolitan municipalities. The findings highlight that there are both similarities and disparities across the municipalities. For example, the number of households is growing more rapidly in Gauteng metropolitan municipalities than in the other metros in South Africa. During phase two of the review, the task team analysed whether the own revenues for metropolitan municipalities match their expenditure responsibilities. It also assessed if metropolitan municipalities are optimising the collection of their own revenues and if their sources are sustainable. The outcomes of the analysis highlight that there is a funding gap in infrastructure finance in metropolitan municipalities and that the existing funding sources cannot close this gap. The third phase, already under way, explores various funding options to ensure that metropolitan municipalities are adequately funded.