W1

Website annexure to the 2012 Budget Review

Explanatory memorandum to the division of revenue

Background

Section 214(1) of the Constitution requires that every year a Division of Revenue Act determine the equitable division of nationally raised revenue between national government, the nine provinces and 278 municipalities. This budget 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 revenue raised nationally. Sections 9 and 10(4) of the act set out the consultation process to be followed with the Financial and Fiscal Commission (FFC), including considering recommendations made regarding the equitable division of nationally raised revenue.

This explanatory memorandum to the 2012 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 2012 division of revenue.
- Part 3 sets out how the FFC's recommendations on the 2012 division of revenue have been taken into account.
- Part 4 explains the formula and criteria for the division of the provincial equitable share and conditional grants between provinces.

- Part 5 sets out the formula and criteria for the division of the local government equitable share and conditional grants between municipalities.
- Part 6 summarises issues that will form part of subsequent reviews of provincial and local government fiscal frameworks.

The Division of Revenue Bill and its underlying allocations are the culmination of extensive consultation between national, provincial and local government. The Budget Council deliberated on the matters discussed in this memorandum at several meetings during the year. The approach to local government allocations was discussed with organised local government at technical meetings with the South African Local Government Association (SALGA), culminating in a meeting of the Budget Forum (Budget Council plus SALGA) on 6 October 2011. An extended Cabinet meeting involving ministers, provincial premiers and the chairperson of SALGA was held on 12 October 2011. The division of revenue – and the government priorities that underpin it – was agreed for the next three years.

Part 1: Constitutional considerations

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

National interest and the division of resources

The national interest is encapsulated by those governance goals that benefit the nation as a whole. The spending priorities for the medium-term expenditure framework (MTEF) are informed by the 12 priority outcomes adopted at the Cabinet Lekgotla held from 20 to 22 January 2010, which reflect the mandate of government and are derived from the medium-term strategic framework (MTSF). The Minister of Finance also announced in the 2011 *Medium Term Budget Policy Statement* that over the 2012 MTEF, government aims to increase spending on infrastructure and job creation. A detailed analysis of how funds have been allocated based on these priorities can be found in Chapter 4 of the 2011 *Medium Term Budget Policy Statement* and Chapter 8 of the 2012 *Budget Review*.

Provision for debt costs

The resources shared between national, provincial and local government include proceeds from national government borrowing used to fund spending by all spheres. National government provides for the resulting debt costs to protect the integrity and credit reputation of the country. A more detailed discussion can be found in Chapter 5 of the 2012 *Budget Review*.

National government's needs and interests

The Constitution assigns exclusive and concurrent powers and functions to each sphere of government. National government is exclusively responsible for functions that serve the national interest and are best centralised. National and provincial government have concurrent responsibility for a range of functions. Provincial and local government receive equitable shares and conditional grants to enable them to provide basic services and perform their functions. Changes have been made to a number of national transfers to provincial and local government to improve their efficiency, effectiveness and alignment with national strategic objectives.

Provincial and local government basic services

Provinces and municipalities are assigned key service-delivery functions such as school education, health, social development, housing, roads, and provision of electricity, water and municipal infrastructure. They have significant autonomy to allocate resources to meet basic needs and respond to provincial and local priorities, while giving effect to national priorities. The division of revenue provides equitable shares to provinces and local government. This year’s division of revenue allocates additional resources to provinces to provide for the carry-through effects of the 2011 public-sector wage agreements, repair infrastructure damaged by the floods in January and February 2011, extend coverage of HIV and Aids treatment, fund major health infrastructure projects, pilot interventions in district health care services and central hospitals that will inform the roll out of national health insurance, increase access to grade R and no-fee schools, standardise subsidies for early childhood development centres and accelerate the upgrading of informal settlements. Transfers to local government have grown significantly in recent years, providing municipalities with greater resources to deliver basic services. This is in addition to the substantial own-revenue raising powers available to local government. The 2012 division of revenue protects the value of transfers to local government, providing a buffer against the effect the slow economic recovery has had on the growth in municipal own revenues. Additional resources have been made available to help poor municipalities with the institutional costs of running efficient municipal operations and with further increases to the cost of basic services for poor households, particularly electricity and to accelerate the upgrading of informal settlements.

Fiscal capacity and efficiency

National government has primary government revenue-raising powers. Provinces have limited revenue-raising capacity and the resources required to deliver provincial functions do not lend themselves to self-funding or cost recovery. Municipalities finance most of their expenditure through property rates, user charges and fees. It is recognised, however, that rural municipalities raise significantly less revenue than larger urban and metropolitan municipalities. Due to their limited revenue-raising potential and their responsibility to implement government priorities, provinces receive the largest share of nationally raised revenue. Local government’s portion has significantly increased over the last few years and will continue to grow over the medium term. Following a review of the provincial equitable share formula in 2010, the recommendations were implemented in 2011 and minor refinements will be implemented in 2012. A review of the local government equitable share is under way. These reviews are part of wider, ongoing reviews of provincial and local government functions and the funding thereof, and should lead to significant changes in current funding arrangements that improve efficiency and effectiveness, especially in the built environment.

Developmental needs

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

Economic disparities

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

Obligations in terms of national legislation

While the Constitution confers autonomy on provincial governments and municipalities to determine priorities and allocate budgets, national government is responsible for policy development, national mandates and the monitoring of implementation for concurrent functions. The 2012 MTEF and division of revenue provide additional funding for the 2011 wage agreements, which were higher than expected. Additions to conditional grants address the demand for HIV and Aids prevention and treatment programmes. The provincial equitable share has been increased to help provinces provide no-fee schooling, universal access to grade R and to standardise subsidies for early childhood care services. These allocations are in addition to obligations funded through existing provincial and local government baseline allocations.

Predictability and stability

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

Need for flexibility in responding to emergencies

Government has a contingency reserve that provides a cushion for emergencies and unforeseeable events. In addition, two conditional grants for disasters allow for the swift allocation and transfer of funds to affected provinces and municipalities. Sections 16 and 25 of the Public Finance Management Act (1999) make specific provision for allocation of funds to deal with emergency situations, while 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 2012 division of revenue

Following the economic downturn of 2008/09, government protected budget baselines by raising debt. These baselines continue to be protected by increasing government's net loan debt, discussed in Chapter 3 of the 2011 *Medium Term Budget Policy Statement*.

To ensure the debt burden is kept within sustainable levels, government has called for all departments and provinces to rigorously review their budget baselines and identify areas of inefficient and non-priority expenditure when preparing for the 2012 MTEF. In addition, the composition of expenditure will shift away from consumption towards investment expenditure.

Excluding debt service costs and the contingency reserve, allocated expenditure to be shared between the three spheres amounts to R874.2 billion, R941.2 billion and R1 trillion over each of the MTEF years. These allocations take into account government's spending priorities, the revenue-raising capacity and functional responsibilities of each sphere, and inputs from various intergovernmental forums and the recommendations of the FFC. The provincial and local equitable share formulas are designed to ensure desirable, stable and predictable revenue shares, and to address economic and fiscal disparities.

Government's policy priorities for the 2012 MTEF

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

The 2012 MTEF encourages government to continue to find savings and reprioritise existing baselines towards the priorities discussed above. The overarching goal is to expand the economy, create more jobs and spread the benefits of growth more widely.

In preparing the 2012 Budget, existing baselines were thoroughly interrogated to ensure wasteful expenditure is eliminated. Budgets for non-essential items were reprioritised and projects were rescheduled to ensure key priorities were funded.

Additional resources are allocated to provinces to cover the following:

- The 2011 wage agreements
- Expansion of no-fee schools and universalisation of grade R
- Equalisation of subsidies paid to early childhood development centres
- Expansion of informal settlement upgrading in certain municipalities
- The repair of infrastructure damaged by floods in January and February 2011
- National health insurance pilots
- Major health infrastructure projects
- Provision of HIV and Aids treatment to meet increased demand due to lower CD4 count threshold.

Government introduced the *urban settlements development grant* in the 2011 division of revenue to enable large urban municipalities to respond to pressures created by continued urbanisation and growing urban poverty. Additional resources are made available for this purpose over the 2012 MTEF. Municipalities will also receive additional funds through the local government equitable share to strengthen their administration and governance – an important foundation for improving the effectiveness of municipalities.

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

Table W1.1 2012 Budget priorities – additional MTEF allocations, 2012/13 – 2014/15

R million	2012/13	2013/14	2014/15	Total
Job creation				
Community work programme	590	1 089	1 780	**3 459**
Working for water	150	200	400	**750**
Working on fire	80	100	200	**380**
Mzansi Golden Economy	50	100	150	**300**
National rural youth service corps	200	–	–	**200**
Other job related items	145	429	524	**1 098**
Education and related functions				
Equalisation of no fee schools and expansion of access to Grade R	–	1 116	1 899	**3 015**
Annual national assessments	–	75	160	**235**
University infrastructure	150	300	400	**850**
Health and social protection				
National health insurance pilot project	150	350	500	**1 000**
HIV and Aids and ARVs	–	–	968	**968**
Revitalisation of hospital infrastructure	–	132	294	**426**
Early childhood development	–	650	700	**1 350**
Economic infrastructure				
Passenger Rail Agency of South Africa (rolling stock)	–	–	4 000	**4 000**
Sentech: Digital terrestrial television (DTT) infrastructure	–	141	–	**141**
SABC: Digital library and Playout centre	–	76	62	**138**
Integrated national electrification programme (municipal) grant	–	100	200	**300**
Electricity demand-side management grant: Eskom (solar water geysers)	1 000	1 700	2 000	**4 700**
Electricity demand-side management grant: (municipalities)	200	200	200	**600**
Repair of flood damaged infrastructure	1 302	1 125	665	**3 092**
Signalling and depot infrastructure	279	350	400	**1 029**
Human settlements and community amenities				
Regional bulk infrastructure grant	382	606	896	**1 884**
Informal settlement upgrading: Local conditional grant	–	950	1 931	**2 881**
Informal settlement upgrading: Provincial conditional grant	139	526	363	**1 028**
Social housing	220	200	200	**620**
Economic support and environmental affairs				
Upgrading of tourism facilities: SANPARKS	–	150	200	**350**
Special economic zones	500	750	1 000	**2 250**
Manufacturing competitiveness enhancement programme	1 250	2 000	2 500	**5 750**
Green fund	300	500	–	**800**
General public services				
Who Am I project	–	349	425	**774**
Border post infrastructure upgrading	110	130	160	**400**
Defence, public order and safety				
Court infrastructure	100	100	100	**300**
Strategic defense procurement programme	150	200	250	**600**
Compensation of employees adjustment	5 688	6 249	6 757	**18 694**
Other priorities	5 862	5 212	7 534	**18 608**
Total	**18 997**	**26 155**	**37 818**	**82 970**

The fiscal framework

Table W1.2 presents medium-term macroeconomic forecasts for the 2012 Budget. It sets out the growth assumptions and fiscal policy targets on which the fiscal framework is based.

Table W1.2 Medium-term macroeconomic assumptions, 2011/12 – 2014/15

	2011/12		2012/13		2013/14		2014/15
R billion	2011 Budget	2012 Budget	2011 Budget	2012 Budget	2011 Budget	2012 Budget	2012 Budget
Gross domestic product	2 914.9	2 995.5	3 201.3	3 301.4	3 536.0	3 622.2	3 997.0
Real GDP growth	*3.6%*	*2.7%*	*4.2%*	*3.0%*	*4.4%*	*3.8%*	*4.3%*
GDP inflation	*5.5%*	*5.9%*	*5.4%*	*7.0%*	*5.8%*	*5.7%*	*5.8%*
National budget framework							
Revenue	729.9	734.6	806.4	799.3	904.3	894.3	997.2
Percentage of GDP	*25.0%*	*24.5%*	*25.2%*	*24.2%*	*25.6%*	*24.7%*	*24.9%*
Expenditure	888.9	891.2	968.1	969.4	1 053.0	1 053.8	1 139.6
Percentage of GDP	*30.5%*	*29.8%*	*30.2%*	*29.4%*	*29.8%*	*29.1%*	*28.5%*
Main budget balance[1]	-159.1	-156.6	-161.7	-170.0	-148.7	-159.5	-142.4
Percentage of GDP	*-5.5%*	*-5.2%*	*-5.1%*	*-5.2%*	*-4.2%*	*-4.4%*	*-3.6%*

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

Table W1.3 sets out the division of revenue for the 2012 MTEF after taking into account new policy priorities.

Table W1.3 Division of nationally raised revenue, 2008/09 – 2014/15

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
R million		Outcome		Revised estimate		Medium-term estimates	
Debt-service cost	54 394	57 129	66 227	76 645	89 388	100 806	109 039
Non-interest expenditure	581 560	690 068	738 914	814 554	879 977	953 024	1 030 539
Percentage increase	*19.0%*	*18.7%*	*7.1%*	*10.2%*	*8.0%*	*8.3%*	*8.1%*
Total expenditure	**635 953**	**747 197**	**805 141**	**891 199**	**969 365**	**1 053 830**	**1 139 579**
Percentage increase	*17.5%*	*17.5%*	*7.8%*	*10.7%*	*8.8%*	*8.7%*	*8.1%*
Contingency reserve	–	–	–	–	5 780	11 854	24 000
Division of available funds							
National departments	**289 236**	**345 366**	**355 189**	**383 747**	**412 368**	**446 220**	**478 828**
Provinces	**246 836**	**293 164**	**322 822**	**362 626**	**384 487**	**411 092**	**437 004**
Equitable share	201 796	236 891	265 139	291 736	309 057	328 921	349 351
Conditional grants	45 040	56 273	57 682	70 891	75 430	82 171	87 653
Local government	**45 487**	**51 537**	**60 904**	**68 180**	**77 342**	**83 858**	**90 707**
Equitable share[1]	25 560	23 845	30 541	32 876	37 873	40 582	43 639
General fuel levy sharing	–	6 800	7 542	8 573	9 040	9 613	10 190
Conditional grants	19 928	20 892	22 821	26 732	30 429	33 663	36 878
Total	**581 560**	**690 068**	**738 914**	**814 554**	**874 197**	**941 170**	**1 006 539**
Percentage shares							
National departments	49.7%	50.0%	48.1%	47.1%	47.2%	47.4%	47.6%
Provinces	42.4%	42.5%	43.7%	44.5%	44.0%	43.7%	43.4%
Local government	7.8%	7.5%	8.2%	8.4%	8.8%	8.9%	9.0%

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

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

Table W1.4 Changes over baseline[1], 2012/13 – 2014/15

R million	2012/13	2013/14	2014/15
National departments	4 229	7 742	19 244
Provinces	4 038	6 840	8 546
Local government	312	1 541	3 451
Allocated expenditure	**8 579**	**16 123**	**31 241**

1. Excludes shifting of savings towards priorities over the MTEF

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

Table W1.5 Schedule 1 of the Division of Revenue Bill, 2012/13 – 2014/15

	2012/13	2013/14	2014/15
	Column A	Column B	
R million	Allocation	Forward estimates	
National[1, 2]	622 435	684 327	746 589
Provincial	309 057	328 921	349 351
Local	37 873	40 582	43 639
Total	**969 365**	**1 053 830**	**1 139 579**

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

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

The 2012 *Budget Review* sets out in detail how constitutional issues and government's priorities are taken into account in the 2012 division of revenue. It focuses on the economic and fiscal policy considerations, revenue issues, debt and financing considerations, and expenditure plans. Aspects of national, provincial and local government financing are discussed in detail in Chapter 8 of the 2012 *Budget Review*.

Part 3: Response to the recommendations of the FFC

Section 9 of the Intergovernmental Fiscal Relations Act, which gives effect to section 214 of the Constitution, prescribes that the FFC must submit recommendations on the division of revenue for the coming budget at least 10 months before the start of each financial year. The FFC tabled its *Submission for the Division of Revenue 2012/13* to Parliament in May 2011.

Section 10 of the Intergovernmental Fiscal Relations Act requires the Minister of Finance to table a Division of Revenue Bill with the annual budget in the National Assembly. The bill must be accompanied by an explanatory memorandum explaining how the bill has taken into account the recommendations made by the FFC. This part of the memorandum outlines how government has considered the FFC's recommendations.

The 2012/13 FFC recommendations are divided into six chapters, which cover three areas: macroeconomic and fiscal outlook, vibrant urban economies and improving development outcomes of the intergovernmental fiscal relations system.

Chapter 1: South Africa's transition to a consolidated budget and fiscal guidelines

Fiscal guidelines in the short to medium-term

The FFC recommends that, "Over the medium term, government should continue with a gradual programme of fiscal consolidation that entails reducing moderately but consistently the budget deficit. Such efforts to preserve fiscal sustainability must be sustained in the future, even with the addition of longer-term programmes such as the New Growth Path and proposals for National Health Insurance.

"Recent government proposals on fiscal guidelines in South Africa should be supported. The Commission is of the view that proper implementation of fiscal rules (guidelines) can contribute to and complement existing fiscal policies in South Africa. However, even though international experience with fiscal guidelines has shown that such measures can further strengthen the current countercyclical policy and contribute towards fiscal sustainability, there is no 'one size fits all' formula when it comes to the institutional arrangements, design and the implementation of such guidelines. The Commission recommends that government should thus focus on these aspects of fiscal guidelines in the short to medium term. The Commission will continue to investigate the implementation implications of introducing fiscal rules in South Africa."

Government response

Government welcomes the recommendation as it broadly supports current policy. Fiscal policy will continue to be developed based on the guidelines published in the 2011 *Budget Review*. As part of developing these guidelines, National Treasury will prepare a long-term fiscal report. The report, to be published during 2012, will aim to encourage public discussion and greater parliamentary oversight of revenue and expenditure trends over the long term, and consider how to improve the institutional basis of the fiscal guidelines.

Chapter 2: Inclusive growth, development and fiscal policy

Reprioritise funding towards attaining the Millennium Development Goals

The FFC recommends that, "National, provincial and local government should further reprioritise expenditures in respect of the Equitable Share and Conditional Grants for 2012/13 to move towards attaining the Millennium Development Goals. In this respect:

- Government should prioritise MDG2 (universal education) and MDG6 (HIV indicators) in the interim as their attainment will have positive impacts on the other MDGs (positive spillovers); and
- The time frame for attaining all outstanding MDGs simultaneously should be extended beyond 2015 to make the task feasible."

Government response

Government acknowledges that for South Africa to achieve a more inclusive and equitable economic future, rapid progress is needed. The priorities are education, health care, fighting crime, rural development and creating jobs. These priorities are reflected in the 12 outcomes and associated outputs adopted by government. The 2012 Budget process is underpinned by these 12 outcomes, their associated output targets and service-delivery agreements. Health, including HIV and Aids, is a key government priority. The emerging policy framework of the New Growth Path and the urgent need to create more jobs are central to government's medium-term strategic outlook. Government is pursuing significant capital investments in public infrastructure and exploring mechanisms to accelerate roll out of social and economic infrastructure.

Strengthen equity of intergovernmental transfers system

FFC recommends that, "Government should continue strengthening the equity focus of the current system of intergovernmental transfers, in particular in the health and education sectors. The existing transfer system is not the most effective instrument to support government's growth objectives, and this aspect should continue to be strengthened so that it plays a supportive role in this respect."

Government response

Transfers to provinces are agreed to during the annual national budget process. The size of the transfers indicates the value placed on the functions performed by provinces relative to the responsibilities of the two other spheres of government. The provincial equitable share formula is an objective instrument to ensure that the available provincial envelope is equitably divided among the nine provinces. The transfer system is intentionally redistributive so that fiscal imbalances are addressed. While it is important, the intergovernmental transfer system on its own cannot ensure government achieves its growth objectives. It needs to be accompanied by a capable public service that can deliver on its mandates.

Invest in public infrastructure

FFC recommends that, "Government should actively and specifically continue pursuing the implementation of significant capital investment in public infrastructure that has a positive impact on total factor productivity and employment in the context of the New Growth Path."

Government response

Public-sector infrastructure investment remains central to government's economic development plans. Infrastructure projects in education, health, energy, roads, rail, telecommunications and water are priorities over the next three years. This will contribute significantly to job creation over time. Government has also instituted complementary reforms to improve the quality of regulation and encourage increased private-sector participation to improve efficiency and lower costs.

Chapter 3: Analysis of local government revenue and expenditure

Benchmarking exercises

The FFC recommends that, "National and provincial treasuries' efforts to improve the credibility of municipal budgets through annual benchmarking exercises should continue to be supported, the results of these evaluations be reported to Parliament and provincial legislatures, and placed in the public domain. This may incentivise effective financial management among municipalities."

Government response

The benchmark processes enable robust and in-depth technical discussions on municipal budgets among national, provincial and municipal officials. The benchmarking documents are shared with institutions that form part of the benchmarking exercise, including the FFC, SALGA and the Department of Cooperative Governance and Traditional Affairs. Broader circulation of these documents is not advisable, as benchmarking is intended to provide technical support to municipalities, but does not replace the formal budget processes of municipalities. The formal budget process, which includes public consultation and adopted municipal budgets approved by individual municipal councils, is made available to the public.

Enforce section 74(2) of the Municipal Systems Act

The FFC recommends that, "National government should specifically enforce the provisions set out in section 74(2) of the Municipal Systems Act, such that the basis of municipal tariffs accurately reflects the cost of providing the specific service, as well as conforms to the National Treasury expenditure guidelines for repairing and maintaining municipal infrastructure. This will improve planning and funding of repairs and maintenance."

Government response

Government supports the proposal. Mechanisms are in place to guide municipalities in setting tariffs, in particular, the Municipal Finance Management Act Budget Circulars 51, 54 and 55 highlight the need for cost-reflective tariffs. However, it may take time to develop appropriate systems that can provide reliable data to determine accurate cost-reflective tariff structures for various municipal services. The information foundation required for cost-reflective tariffs is being laid. For example, National Treasury is exploring appropriate cost accounting and tariff-setting methodologies, and financial management reforms are being undertaken, including updating asset registers and developing a standard chart of accounts for municipalities.

Identify the primary cause of municipalities' poor performance

The FFC recommends that, "National and provincial government should require and assist municipalities to identify the primary cause of poor performance in their billing and revenue collection functions and use the information to design appropriate remedial strategies. Subsequently, municipalities should establish municipal service districts to facilitate improved performance."

Government response

Government agrees that municipalities should be assisted. National Treasury is conducting training in municipalities on revenue management and sending teams to help municipalities identify gaps and weaknesses in their revenue management value chain.

However, there are a range of issues along the revenue management value chain that need to be addressed. Shortcomings in the transaction processing environment result in poor billing performance and lack of integrity in billing data. This is largely caused by poorly designed organisational structures that blur the lines of accountability. Municipalities can only overcome these problems by developing skilled and competent workforces that operate in appropriately designed organisational structures. This requires a long-term view and response.

Guidelines on municipal consumer debt

The FFC recommends that, "As an interim measure, government should establish and publish guidelines for municipalities on the management of municipal consumer debt in terms of, but not exclusive to, interest charges, debt impairment and the writing off of bad debts."

Government response

A legislative framework and related policies already exist, including guidelines and circulars to assist municipalities with the budgeting process, including the writing off of bad debts. There are also complementary efforts to enhance the capacity of municipalities.

Update indigent policies

The FFC recommends that, "Section 64 of the Municipal Finance Management Act (No. 56 of 2003) should be amended to require the regular collation and updating of information on the indigent residents of a municipal area, as an integral component of municipal revenue management practices."

Government response

The updating of indigent registers is a policy matter governed by the Municipal Systems Act, which adequately provides for the integration of municipalities' indigent policies into municipal credit control and debt management policies. Guidelines have been issued to help municipalities implement their indigent policies as defined within the national indigent framework. Government supports the proposal for regular updating of indigent registers.

Peer learning and support programmes

The FFC recommends that, "National and provincial government should develop and support peer learning and support programmes that assist poorly performing municipalities to leverage the experience and best practices of well-performing municipalities, particularly in relation to spending performance, efficiency in using resources, proper debt management and the achievement of desired developmental outcomes."

Government response

Government agrees with the recommendation for peer learning. The Municipal Finance Management Act requires a range of policies and information to be published on municipal websites, which enables peer learning. In addition, there are a range of forums, such as Chief Financial Officers Forums, the Cities Budget Forum, the Municipal Finance Management Act Implementation Forum and various district and provincial level forums, which all promote peer learning.

Review of local government data

The FFC recommends that, "The available data at local government level should be reviewed so as to ensure appropriate surveys or alternatives are available to account accurately for changes in demographics and other factors at municipal level. This recommendation is a reiteration of previous recommendations on data requirements for the local government fiscal framework made by the Commission."

Government response

The Local Government Data Collection Forum was established in response to the need to rationalise data collection from local government. The forum will be a national coordinator – setting standards, collecting and capturing data, assuring quality and disseminating data.

Chapter 4: Sustainable development of South Africa's built environment

Develop spatially compact urban form

The FFC recommends that, "Government should actively and specifically pursue the development of a more spatially compact urban form for South African cities, by developing and adopting appropriate policies and financing instruments. Specific fiscal instruments that can support these objectives include wider use of development charges in financing infrastructure associated with the land development process, public transport subsidies that specifically target high density low-income areas, and fiscal incentives for urban land development projects located within the existing urban form."

Government response

Government agrees with the objective of promoting a more spatially compact urban form. Government has initiated a new cities support programme involving several departments to assist cities manage the built environment in a way that promotes economic growth, job creation, access to basic services and environmental sustainability. It draws on global best practice by linking direct capacity support to fiscal and organisational incentives for improved performance, particularly through restructuring the system of fiscal transfers to reward achievement, encourage self-financing and support environmental sustainability.

Review of housing financing

The FFC recommends that, "Government should conduct a broad-based review of the efficacy of current housing finance arrangements in meeting housing needs within the context of creating sustainable and more compact human settlements. The Commission acknowledges recent developments in the funding framework, including the introduction of the *urban settlements development grant*. It believes that this creates an important opportunity for the realignment of other funding instruments in the built environment, particularly the *integrated housing and human settlements grant*. The Commission intends to review the design of the *urban settlements development grant* once further details about this programme are made known."

Government response

Government is considering the efficacy of all housing financing instruments within the wider context of improving delivery of infrastructure and services to enhance built environments. This will lead to further reforms of the *human settlements development grant* and the *urban settlements development grant*.

Fiscal and economic costs analysis

The FFC recommends that, "Government should review the Commission's analytical work on the fiscal and economic costs of the current urban form of South African cities and guide the Commission as to the further development of these analytical methods."

Government response

Government welcomes the opportunity to help the FFC develop their analytical methods.

Chapter 5: Environmental sustainability and climate change in the local government sector

Climate change mitigation and adaption strategies

The FFC recommends that, "Government should ensure that municipalities develop their own climate change mitigation and adaptation strategies and plans for climate change as part of the Integrated Development Planning process. Government should provide support in this respect to municipalities over the next three years, distinguishing between different types of municipalities by both location and capacity in terms of the mandatory requirements placed on them."

Government response

Government agrees that municipalities should develop their own climate change mitigation and adaptation strategies and plans so that adequate contingency plans for risks associated with climate change are developed.

Government is undertaking a number of initiatives that will assist municipalities in planning for the impacts of climate change. For example, the Department of Cooperative Governance and Traditional Affairs, in partnership with the Department of Environmental Affairs and SALGA, is developing an integrated planning toolkit for climate change. The toolkit will guide municipalities through the process of integrating climate responses into all phases of planning, from problem analysis to operations and review.

Performance-based conditional grant

The FFC recommends that, "Government should consider providing municipalities with a performance-based conditional grant, which rewards or incentivises actions that are environmentally efficient and responsive to the adaptation and mitigation challenges of climate change. The design of the proposed grant should pay attention to municipality specific factors, such as the area, topography, coastal/or otherwise, and vulnerability to climate change. Specific focus areas for this grant should include:

- Efficient water management practices, including the minimisation of water losses, effective asset management or rehabilitation programmes, and demand management;
- Efficient energy management practices, including the minimisation of electricity losses (unaccounted for electricity), the elimination of illegal connections and energy savings by both households and industry; and
- The implementation of green procurement principles."

Government response

The poor uptake of existing incentive grants shows that such grants are not the most efficient way to influence the behaviour of municipalities. There may be merit in a specific conditional grant to address major infrastructure requirements related to climate change, for example, coastal breakwaters or storm water management systems. However, more research is needed to determine the structure of such a grant.

Chapter 6: Budget analysis and exploration of issues to increase performance in basic education and health

Basic education and health

The FFC recommends that, "Government should finalise the implementation of occupation specific dispensation and formalise the performance evaluation system. In dealing with the expansion and implementation for occupational specific dispensation, government should:

- Be mindful of the rising public sector wage bill relative to other priorities;
- Rethink funding of personnel costs, which are centrally determined but funded by provinces through the equitable share. A full costing of the occupational specific dispensation implementation must be undertaken, and national government must take the responsibility for funding, preferably through a specific purpose conditional grant; and
- Formalise performance evaluation with the aim of boosting performance by emphasising high competence for education and health personnel."

Government response

Government is mindful of the rising public-sector wage bill and works with the labour unions on the matters raised above. It does not support the recommendation that national government take full responsibility for funding personnel costs, especially through a conditional grant, as this will create perverse incentives that will undermine government's efforts to address the issues raised by the FFC.

Spending in education

The FFC recommends that, "Increases in education spending should be directed towards investments that will have the biggest impact on quality, including learner and teacher support materials. In this regard, government should improve quality and prioritise epistemological access to education by:

- Developing capacity to evaluate the academic performance of learners throughout their academic careers.
- Ensuring that the required amount of time is spent on teaching by relieving teachers of administrative duties through the hiring of administrative assistants;
- Supporting the training and development of teachers and making explicit the amount spent for this purpose through the Division of Revenue; and
- Improving the accountability of schools for learner performance."

Government response

The introduction of literacy and numeracy annual national assessments for grades 3 and 6 is an important step towards enabling government to evaluate the performance of learners throughout their schooling. Government intends to extend these assessments to grade 9, which will ensure that learner performance will be measured in each educational phase. Assessing learner performance will only lead to improved performance if the system is able to use the results effectively.

Government does not support the proposal to explicitly specify upfront the amounts to be spent for training and development of teachers. Training and development in provinces is funded from their equitable share and provinces decide the allocations for this purpose in line with their specific requirements.

Coordinating, financing and providing scholar transport

The FFC recommends that, "Coordination financing and provisioning of scholar transport should be improved. The Commission is aware that agreement has been reached between the Departments of Basic Education and Transport that the scholar transport function be transferred from the Department of Basic Education to the Department of Transport. In so doing, the FFC recommends that:

- All resources associated with delivering a service associated with scholar transport must be transferred to the Department of Transport, including current assets and budget and all future resources; and
- A thorough assessment of the financial and fiscal implications of this shift must be conducted before the shift happens."

Government response

The Department of Basic Education and the Department of Transport are working on ways to improve the provision of scholar transport in provinces. However, no agreement has been reached on the full transfer of the service to the Department of Transport. At this stage, provincial executives can locate the service with either provincial department based on their requirements.

Inclusive education of intellectually disabled children

The FFC recommends that, "Government must, through input and output norms and standards, take reasonable measures to give effect to the inclusive education of intellectually disabled children. These norms should indicate human, physical, administrative and regulatory resources provided by the government dedicated to achieving targets for inclusive education."

Government response

The Department of Basic Education is developing norms and standards for inclusive education, which should include all learners with special education needs.

Health fiscal frameworks

The FFC recommends that, "Government should extend its ongoing efforts to reform the health fiscal frameworks by taking into account the burden of disease giving rise to budget pressures, to cover:

- Review of the funding for HIV/Aids, opportunistic and other infectious diseases through a regular review of usage costs for chronic disease services in HIV/Aids, TB, maternal and child health to inform resource allocations in the public sector health care system;

- Institutionalisation of a budget process that forces provincial health budgets to be based on estimations of the needs of health care service users and holds provincial governments accountable for underfunding of hospitals and clinics; and
- Re-examination of the distribution of resources between the different levels of care without weakening the role played by tertiary hospitals, but also strengthening the role played by primary health care in the health system of the country.

Certain functions, such as procurement, human resources and financial management, should be devolved to hospital management to boost efficiencies and better performance."

Government response

Government released the green paper on national health insurance after the FFC tabled its recommendations for the 2012/13 division of revenue. As a result, the FFC did not take into account the contents of the green paper when these recommendations were prepared. Health policy pronouncements and reforms to the health sector will be conducted as part of the review of the green paper and other policy documents and legislation that may emerge during these discussions.

Part 4: Provincial allocations

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

Of the R19.4 billion added to the provincial baseline over the next three years, the provincial equitable share baselines are revised upwards by R14.9 billion and conditional grants are increased by R4.4 billion. National transfers to provinces increase from R362.6 billion in 2011/12 to R384.5 billion in 2012/13. Over the three-year period, provincial transfers will grow at an average annual rate of 6.4 per cent to R437 billion in 2014/15.

Table W1.6 sets out the total transfers to provinces for 2012/13, which amount to R384.5 billion, with R309.1 billion allocated to the provincial equitable share and R75.4 billion to conditional grants, which includes an unallocated R180 million for the *provincial disaster grant,* but excludes an indirect transfer of R2.3 billion for the *school infrastructure backlogs grant*.

Table W1.6 Total transfers to provinces, 2012/13

R million	Equitable share	Conditional grants	Total transfers
Eastern Cape	46 940	9 683	**56 624**
Free State	18 531	5 520	**24 051**
Gauteng	54 545	15 623	**70 168**
KwaZulu-Natal	67 803	14 427	**82 230**
Limpopo	38 721	7 546	**46 267**
Mpumalanga	24 874	5 621	**30 495**
Northern Cape	8 255	3 082	**11 337**
North West	20 615	4 939	**25 554**
Western Cape	28 772	8 809	**37 581**
Unallocated	–	180	**180**
Total	**309 057**	**75 430**	**384 487**

Provincial equitable share

At 97.1 per cent of total provincial revenue and 80.4 per cent of national transfers to provinces in 2012/13, the equitable share constitutes the main source of revenue for meeting provincial expenditure responsibilities. The proposed revisions of R3.3 billion, R5.3 billion and R6.3 billion bring the equitable share allocations to R309.1 billion in 2012/13, R328.9 billion in 2013/14, and R349.4 billion in 2014/15. These revisions result in the provincial equitable share increasing by 5.9 per cent between 2011/12 and 2012/13, and 6.2 per cent over the MTEF in nominal terms.

Policy priorities underpinning equitable share revisions

The revisions to baseline equitable share allocations provide for personnel and policy adjustments. The personnel adjustments provide mainly for the impact of the 2011 wage agreements on personnel budgets in health and education. Policy-related adjustments to the provincial equitable share provide for child and youth care services, equalisation of subsidies provided to early childhood development centres, victim empowerment, expansion of no-fee schools and the universalisation of grade R.

The equitable share formula

The formula is reviewed and updated with new data annually. In 2010, government concluded a review of the provincial equitable share formula, the results of which were detailed in the 2011 Annexure W1. As a result of that review, a new health component was introduced and the weights of the health and education components were revised to align with the expenditure shares of the sectors in provincial budgets. The weight of the basic component was also revised to balance out these changes.

During 2011, revisions to the education component were considered but not implemented. The Department of Basic Education is implementing the learner unit record tracking system, which should produce more reliable enrolment data. The need to revise the education component will be considered after the formula has been updated with the 2011 Census data.

For the 2012 MTEF, the equitable share formula has been updated with data from the 2011 Mid-year Estimates, the 2010 General Household Survey, 2011 Education School Realities, output data from the health sector and a risk-adjusted capitation index based on data from the Risk Equalisation Fund, the 2009 gross domestic product by region (GDP-R) and the 2005 Income and Expenditure Survey. The impact of these updates on the provincial equitable share is phased-in over three years (2012/13 to 2014/15).

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

Phasing-in of the formula

To mitigate the impact of data updates on provincial equitable shares, the new shares are phased in over the MTEF. The weighted share per province for 2011/12 is used to calculate the weighted provincial equitable share for the 2012 MTEF. The data is updated each year and a new target share is calculated, which is shown in Table W1.8. To ensure funding is certain and there are no shocks to individual provincial budgets, the impact of the data updates is phased in over three years. Table W1.7 shows the revised weighted provincial equitable shares for the period 2012/13 to 2014/15.

Table W1.7 Implementation of the equitable share weights, 2012/13 – 2014/15

	2011/12	2012/13	2013/14	2014/15
	Weighted shares	2012 MTEF weighted shares 3-year phasing		
Eastern Cape	15.3%	15.2%	15.1%	14.9%
Free State	6.1%	6.0%	5.9%	5.8%
Gauteng	17.5%	17.6%	17.8%	18.0%
KwaZulu-Natal	21.8%	21.9%	22.1%	22.2%
Limpopo	12.7%	12.6%	12.5%	12.4%
Mpumalanga	8.1%	8.1%	8.0%	7.9%
Northern Cape	2.7%	2.7%	2.7%	2.6%
North West	6.7%	6.7%	6.7%	6.6%
Western Cape	9.2%	9.3%	9.3%	9.4%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Summary of the structure of the formula

The formula, shown in Table W1.8 below, consists of six components that capture the relative demand for services between provinces and take into account specific provincial circumstances. The 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 provide an indication of relative need. Provincial executive councils have discretion regarding the determination of departmental allocations for each function, taking into account the priorities that underpin the division of revenue.

Table W1.8 Distributing the equitable shares by province, 2012 MTEF

	Education	Health	Basic share	Poverty	Economic activity	Institu-tional	Weighted average
	48%	**27%**	**16%**	**3%**	**1%**	**5%**	**100%**
Eastern Cape	16.3%	14.2%	13.5%	16.7%	7.6%	11.1%	14.9%
Free State	5.6%	5.5%	5.5%	5.7%	5.5%	11.1%	5.8%
Gauteng	15.7%	20.5%	22.4%	15.7%	33.9%	11.1%	18.0%
KwaZulu-Natal	23.2%	23.0%	21.4%	23.0%	16.1%	11.1%	22.2%
Limpopo	13.9%	10.7%	11.0%	14.4%	7.0%	11.1%	12.4%
Mpumalanga	8.4%	6.8%	7.2%	8.6%	7.1%	11.1%	7.9%
Northern Cape	2.2%	2.2%	2.2%	2.4%	2.3%	11.1%	2.6%
North West	6.3%	6.5%	6.4%	7.5%	6.5%	11.1%	6.6%
Western Cape	8.4%	10.6%	10.5%	6.0%	14.0%	11.1%	9.4%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Full impact of data updates on the provincial equitable share

Table W1.9 shows the full impact of the data updates on the provincial equitable share per province. This table compares the target shares for the 2011 and 2012 MTEF.

Table W1.9 Full impact on data updates on the equitable share

	2011 MTEF weighted average	2012 MTEF weighted average	Difference in weighted average
Eastern Cape	15.1%	14.9%	-0.17%
Free State	6.0%	5.8%	-0.14%
Gauteng	17.8%	18.0%	0.17%
KwaZulu-Natal	21.9%	22.2%	0.26%
Limpopo	12.3%	12.4%	0.03%
Mpumalanga	8.0%	7.9%	-0.04%
Northern Cape	2.7%	2.6%	-0.04%
North West	6.8%	6.6%	-0.13%
Western Cape	9.4%	9.4%	0.06%
Total	**100.0%**	**100.0%**	**–**

For the 2011 Budget, the weight of the education component changed from 51 per cent to 48 per cent, the weight of the health component changed from 26 per cent to 27 per cent and the weight of the basic component changed from 14 per cent to 16 per cent. The weights for the education and health components were aligned with their expenditure shares, excluding expenditure on conditional grants over the past three years. An analysis of expenditure over the past three years shows that the weights of the education and health components do not require further revision. The formula components are set out as follows:

- An *education share* (48 per cent) based on the size of the school-age population (ages 5-17) and the number of learners (grade R to 12) enrolled in public ordinary schools.
- A *health share* (27 per cent) based on a combination of a risk-adjusted capitation index for the population, which takes into account the health risks associated with the demographic profile of the population and the relative share of case loads in hospitals. The risk-adjusted capitation index is given a 75 per cent weighting and the case load (output component) is given a 25 per cent weighting.
- A *basic share* (16 per cent) derived from each province's share of the national population.
- An *institutional component* (5 per cent) divided equally between the provinces.
- A *poverty component* (3 per cent) reinforcing the redistributive bias of the formula.
- An *economic output component* (1 per cent) based on GDP-R data.

Education component

The education component is intended to enable provinces to fund school education, which amounts to about 90 per cent of provincial education spending. The formula uses school-age population (5-17), based on Census 2001, and actual enrolment data drawn from the 2011 Education School Realities to reflect relative demand for education, with each element assigned a weight of 50 per cent. Table W1.10 shows the impact of data updates on the education component shares.

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

Learner numbers	Age cohort 5 - 17	School enrolment 2010	School enrolment 2011	Changes in enrolment	Weighted average 2011 MTEF	Weighted average 2012 MTEF	Difference in weighted average
Eastern Cape	2 151 992	2 052 386	1 963 578	-88 808	16.7%	16.3%	-0.38%
Free State	760 486	654 704	658 010	3 306	5.6%	5.6%	0.01%
Gauteng	1 931 719	1 974 066	2 017 931	43 865	15.5%	15.7%	0.16%
KwaZulu-Natal	3 013 243	2 806 988	2 847 378	40 390	23.1%	23.2%	0.14%
Limpopo	1 798 862	1 706 401	1 695 524	-10 877	13.9%	13.9%	-0.06%
Mpumalanga	1 074 972	1 036 432	1 046 551	10 119	8.4%	8.4%	0.03%
Northern Cape	280 975	269 392	274 745	5 353	2.2%	2.2%	0.02%
North West	826 218	759 114	765 120	6 006	6.3%	6.3%	0.02%
Western Cape	1 094 565	1 000 616	1 015 038	14 422	8.3%	8.4%	0.05%
Total	**12 933 032**	**12 260 099**	**12 283 875**	**23 776**	**100.0%**	**100.0%**	**–**

Health component

A new health component for the provincial equitable share formula was adopted in 2010 and implemented in the 2011 division of revenue. The 2011 Annexure W1 explained how the new health component is calculated and the rationale for introducing it. The new health component will be refined as more data on the public health sector becomes available and data quality improves.

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 (Health component)

Thousand	Mid-year population estimates 2011	Insured population 2010	Risk-adjusted index 2011	Weighted population	Risk-adjusted weighted shares 2011 MTEF	Risk-adjusted weighted shares 2012 MTEF	Difference in weighted shares
Eastern Cape	6 830	11.8%	96.9%	5 838	13.9%	14.0%	0.06%
Free State	2 760	17.4%	103.3%	2 354	6.1%	5.6%	-0.44%
Gauteng	11 328	26.6%	105.4%	8 772	20.1%	21.0%	0.91%
KwaZulu-Natal	10 819	14.1%	98.9%	9 192	21.9%	22.0%	0.14%
Limpopo	5 555	8.7%	91.6%	4 650	10.7%	11.1%	0.49%
Mpumalanga	3 657	14.0%	95.7%	3 012	7.4%	7.2%	-0.15%
Northern Cape	1 097	14.5%	100.7%	944	2.4%	2.3%	-0.19%
North West	3 253	14.2%	102.2%	2 854	7.4%	6.8%	-0.51%
Western Cape	5 288	25.0%	104.0%	4 129	10.2%	9.9%	-0.31%
Total	**50 587**			**41 743**	**100.0%**	**100.0%**	**–**

The risk-adjusted sub-component estimates a weighted population in each province using the risk-adjusted capitation index, which is calculated using data from the Council for Medical Aid Scheme's Risk Equalisation Fund. The percentage of the population with medical aid insurance, as per the 2010 General Household Survey, is deducted from the 2011 mid-year population estimates to estimate the uninsured population per province. The risk-adjusted index, which is an index of the health risk profile of each province, is applied to this uninsured population to estimate the weighted population. Each province's share of this weighted population is used to estimate their share of the risk-adjusted sub-component. Table W1.11 shows the change in this sub-component between 2011 and 2012. In total, the risk-adjusted component is weighted at 75 per cent of the health component.

Table W1.12 shows the output sub-component using data from the District Health Information Services (DHIS).

Table W1.12 Output sub-component shares (Health component)

	Primary health care visits				Hospital workload patient-day equivalents			
	2009/10	2010/11	Average	Share	2009/10	2010/11	Average	Share
Eastern Cape	18 604	17 556	18 080	15.0%	4 571	4 525	4 548	14.6%
Free State	6 538	6 598	6 568	5.4%	1 591	1 617	1 604	5.2%
Gauteng	19 623	20 216	19 920	16.5%	6 106	5 968	6 037	19.4%
KwaZulu-Natal	26 332	26 151	26 242	21.7%	8 906	7 982	8 444	27.1%
Limpopo	15 132	13 972	14 552	12.1%	2 765	2 681	2 723	8.7%
Mpumalanga	7 961	8 029	7 995	6.6%	1 714	1 724	1 719	5.5%
Northern Cape	3 451	3 472	3 461	2.9%	523	507	515	1.7%
North West	8 335	8 025	8 180	6.8%	1 518	1 550	1 534	4.9%
Western Cape	15 791	15 643	15 717	13.0%	4 076	3 941	4 008	12.9%
Total	**121 768**	**119 663**	**120 715**	**100.0%**	**31 770**	**30 494**	**31 132**	**100.0%**

In the 2011 division of revenue, normative costings derived from government's Basic Accounting System and the DHIS were used to weight primary health care visits and patient-day equivalents. The weighted visits were combined to estimate the output component. For the 2012 division of revenue, the output sub-component still uses patient load data from the DHIS. The average number of clinic visits at primary health care clinics in 2009/10 and 2010/11 is calculated. Each province's average is used to estimate their share of this part of the output component, making up 5 per cent of the health component. For hospitals, each province's share of the total patient-day equivalents from public hospitals in 2009/10 and 2010/11 are used to estimate their share of this part of the output sub-component, making up 20 per cent of the health component. In total, the output component is 25 per cent of the health component. This new approach still applies a ratio to weight primary health care visits to patient-day equivalents, but it is simpler and more transparent than the method used in 2011.

Table W1.13 shows the updated health component shares for 2012.

Table W1.13 Health component weighted shares

	Risk-adjusted	Primary health care	Hospital component	2011 MTEF weighted shares	2012 MTEF weighted shares	Difference in weighted shares
Weight	**75%**	**5%**	**20%**			
Eastern Cape	14.0%	15.0%	14.6%	14.1%	14.2%	0.01%
Free State	5.6%	5.4%	5.2%	5.9%	5.5%	-0.41%
Gauteng	21.0%	16.5%	19.4%	20.2%	20.5%	0.30%
KwaZulu-Natal	22.0%	21.7%	27.1%	22.4%	23.0%	0.66%
Limpopo	11.1%	12.1%	8.7%	10.6%	10.7%	0.15%
Mpumalanga	7.2%	6.6%	5.5%	7.0%	6.8%	-0.18%
Northern Cape	2.3%	2.9%	1.7%	2.3%	2.2%	-0.16%
North West	6.8%	6.8%	4.9%	7.0%	6.5%	-0.52%
Western Cape	9.9%	13.0%	12.9%	10.5%	10.6%	0.15%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**–**

Poverty component

The poverty component introduces a redistributive element within the formula and is assigned a weight of 3 per cent. The poor population includes people who fall in the first two quintiles of household incomes in the 2005 Income and Expenditure Survey (IES). The estimated size of the poor population in each province is calculated by multiplying the proportion in that province from the IES by the population figure from the 2011 mid-year population estimates. Table W1.14 shows the poverty quintiles of the IES, the mid-year population estimates and the weighted share of the poverty component per province.

Table W1.14 Comparison of current and new poverty component weighted shares

	IES Survey 2005 (Q1+Q2)	Current (2011 MTEF) Basic compo-nent value	Current (2011 MTEF) Poor population (000)	Current (2011 MTEF) Weighted shares	New (2012 MTEF) Basic compo-nent value	New (2012 MTEF) Poor population (000)	New (2012 MTEF) Weighted shares	Difference in weighted shares
Eastern Cape	49.8%	6 744	3 361	16.7%	6 830	3 404	16.7%	0.01%
Free State	41.7%	2 825	1 178	5.9%	2 760	1 151	5.7%	-0.20%
Gauteng	28.1%	11 192	3 147	15.7%	11 328	3 186	15.7%	-0.00%
KwaZulu-Natal	43.2%	10 646	4 596	22.9%	10 819	4 671	23.0%	0.09%
Limpopo	52.9%	5 440	2 875	14.3%	5 555	2 936	14.4%	0.13%
Mpumalanga	47.7%	3 618	1 725	8.6%	3 657	1 744	8.6%	-0.01%
Northern Cape	44.9%	1 104	496	2.5%	1 097	493	2.4%	-0.05%
North West	46.9%	3 201	1 502	7.5%	3 253	1 527	7.5%	0.03%
Western Cape	23.1%	5 224	1 206	6.0%	5 288	1 221	6.0%	0.00%
Total		**49 991**	**20 087**	**100.0%**	**50 587**	**20 332**	**100.0%**	**–**

Economic activity component

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 2012 MTEF, 2009 GDP-R data is used. Table W1.15 shows the impact of the revised weighted shares of the economic activity component. The right-hand column shows changes as a result of relative growth of provincial contributions to GDP.

Table W1.15 Current and new economic activity component weighted shares

	Current (2011 MTEF) GDP-R, 2008 (R million)	Current (2011 MTEF) Weighted shares	New (2012 MTEF) GDP-R, 2009 (R million)	New (2012 MTEF) Weighted shares	Difference in weighted shares
Eastern Cape	170 502	7.5%	182 147	7.6%	0.14%
Free State	119 317	5.2%	130 973	5.5%	0.24%
Gauteng	755 391	33.1%	811 907	33.9%	0.81%
KwaZulu-Natal	373 662	16.4%	384 937	16.1%	-0.30%
Limpopo	164 150	7.2%	168 506	7.0%	-0.15%
Mpumalanga	172 587	7.6%	169 973	7.1%	-0.46%
Northern Cape	52 681	2.3%	54 917	2.3%	-0.01%
North West	148 219	6.5%	156 374	6.5%	0.04%
Western Cape	327 314	14.3%	336 234	14.0%	-0.30%
Total	**2 283 822**	**100.0%**	**2 395 967**	**100.0%**	**–**

Institutional component

The institutional component recognises that some costs associated with running a provincial government and providing services are not directly related to the size of a province’s population or the other factors included in other components. It is therefore distributed equally between provinces. It constitutes 5 per cent of the total equitable share, of which each province receives 11.1 per cent. This component benefits provinces with smaller populations, especially the Northern Cape and the North West, as the allocation per person is much higher in this component.

Basic component

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 2012 MTEF, population data is drawn from the 2011 mid-year population estimates. Table W1.16 shows the impact of the revised weighted shares of the basic component.

Table W1.16 Impact of the changes in population on the basic component shares

Population (thousand)	Mid-year population estimates 2010	2011	Population change	% population change	Basic component shares 2011 MTEF	2012 MTEF	Difference in shares
Eastern Cape	6 744	6 830	86	1.3%	13.5%	13.5%	0.01%
Free State	2 825	2 760	-65	-2.3%	5.7%	5.5%	-0.19%
Gauteng	11 192	11 328	136	1.2%	22.4%	22.4%	0.01%
KwaZulu-Natal	10 646	10 819	174	1.6%	21.3%	21.4%	0.09%
Limpopo	5 440	5 555	115	2.1%	10.9%	11.0%	0.10%
Mpumalanga	3 618	3 657	40	1.1%	7.2%	7.2%	-0.01%
Northern Cape	1 104	1 097	-7	-0.7%	2.2%	2.2%	-0.04%
North West	3 201	3 253	53	1.6%	6.4%	6.4%	0.03%
Western Cape	5 224	5 288	64	1.2%	10.4%	10.5%	0.00%
Total	**49 991**	**50 587**	**595**	**1.2%**	**100.0%**	**100.0%**	**–**

Conditional grants to provinces

There are four types of provincial conditional grants. Schedule 4 sets out general grants that supplement various programmes partly funded by provinces, such as infrastructure and central hospitals. Transfer and spending accountability arrangements differ, as more than one national or provincial department may be responsible for different outputs. Schedule 5 grants fund-specific responsibilities for both the transferring and receiving of provincial accounting officers. A schedule 7 grant provides allocations-in-kind through which a national department implements projects directly in provinces. A schedule 8 grant, introduced in 2011/12, provides for the swift allocation and transfer of funds to a province to help it deal with a disaster.

Changes to conditional grants

Given the constrained and uncertain economic outlook, government decided to find savings from existing baselines to fund key government priorities. As a result, the baselines of most conditional grants have been revised downward. Table W1.17 shows the savings made on provincial conditional grants to make resources available for government priorities.

Table W1.17 Savings effected on provincial conditional grants

R million	2012/13	2013/14	2014/15	Total for MTEF
Agriculture, Forestry and Fisheries	**-15.7**	**-18.4**	**-35.9**	**-70.1**
Comprehensive agricultural support programme	-11.5	-13.8	-26.9	-52.2
Ilima/Letsema projects	-4.2	-4.6	-9.1	-17.9
Arts and Culture	**-6.2**	**-4.4**	**-6.7**	**-17.3**
Community library services	-6.2	-4.4	-6.7	-17.3
Basic Education	**-203.4**	**-189.7**	**-349.8**	**-743.0**
Dinaledi schools	-0.3	-0.3	-0.6	-1.3
Education infrastructure	-180.2	-168.0	-309.3	-657.5
HIV and Aids (life skills education)	-0.6	-0.7	-1.4	-2.7
National school nutrition programme	-21.6	-20.1	-37.2	-78.8
Technical secondary schools recapitalisation	-0.6	-0.7	-1.4	-2.7
Health	**-504.9**	**-375.6**	**-389.7**	**-1 270.1**
Comprehensive HIV and Aids	-61.8	-72.8	-131.7	-266.3
Health infrastructure	-100.0	-50.0	–	-150.0
Hospital revitalisation	-282.3	-183.9	-123.6	-589.9
National tertiary services	-60.8	-68.9	-134.3	-264.0
Higher Education and Training	**–**	**–**	**-18.3**	**-18.3**
Further education and training colleges	–	–	-18.3	-18.3
Human Settlements	**-168.2**	**-172.5**	**-336.5**	**-677.3**
Human settlements development	-168.2	-172.5	-336.5	-677.3
Public Works	**-19.4**	**-38.9**	**-48.6**	**-106.8**
Devolution of property rate funds	-19.4	-38.9	-48.6	-106.8
Sport and Recreation South Africa	**-4.9**	**-3.1**	**-5.1**	**-13.1**
Mass participation and sport development	-4.9	-3.1	-5.1	-13.1
Transport	**-119.3**	**-134.8**	**-263.0**	**-517.1**
Provincial roads maintenance	-75.7	-86.6	-168.9	-331.2
Public transport operations	-43.6	-48.2	-94.1	-185.9
Total savings created	**-1 042.1**	**-937.3**	**-1 453.6**	**-3 433.0**

Table W1.18 shows the revisions to provincial conditional grants, which provide for technical, policy and inflation adjustments. After accounting for the savings shown in Table W1.17 and shifts from provincial conditional grants, net revisions to conditional grant baseline allocations (R706 million in 2012/13, R1.5 billion in 2013/14 and R2.2 billion in 2014/15, or R4.4 billion over the MTEF) bring the new conditional grant baselines to R75.4 billion in 2012/13, R82.2 billion in 2013/14 and R87.7 billion in 2014/15.

Table W1.18 Revisions to provincial conditional grant baseline allocations, 2012/13 – 2014/15[1]

R million	2012/13	2013/14	2014/15	2012 MTEF
Technical revisions	**-57**	**-68**	**-73**	**-198**
Health	**–**	**–**	**–**	**–**
Health infrastructure	-100	-150	-200	-450
Revised to:				
Nursing colleges and schools	100	150	200	450
Public Works	**-57**	**-68**	**-73**	**-198**
Expanded public works programme integrated grant for provinces	-32	-40	-42	-115
Social sector expanded public works programme incentive grant for province	-24	-28	-30	-83
Additions to baseline	**1 805**	**2 530**	**3 742**	**8 076**
Agriculture, Forestry and Fisheries	**398**	**299**	**298**	**995**
Comprehensive agricultural support programme	398	299	298	995
Basic Education	**119**	**159**	**–**	**278**
Education infrastructure	119	159	–	278
Health	**450**	**950**	**2 318**	**3 718**
Comprehensive HIV and Aids	–	–	1 100	1 100
Hospital revitalisation	50	300	368	718
National health insurance	150	350	500	1 000
National tertiary services	250	300	350	900
Higher Education and Training	**52**	**55**	**58**	**166**
Further education and training colleges	52	55	58	166
Human Settlements	**295**	**699**	**700**	**1 694**
Human settlements development	295	699	700	1 694
Transport	**490**	**368**	**367**	**1 225**
Provincial roads maintenance	490	368	367	1 225
Net technical additions to baseline	**1 748**	**2 461**	**3 669**	**7 878**
Less savings effected on conditional grants	-1 042	-937	-1 454	-3 433
Net additions to baselines	**706**	**1 524**	**2 215**	**4 445**

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

Table W1.19 provides a summary of conditional grants by sector for the 2012 MTEF. More detailed information, including the framework and allocation criteria for each grant, is provided in Annexure W2 of the 2012 Division of Revenue Bill. The frameworks provide the conditions for each grant, the outputs expected, the allocation criteria used for dividing each grant between provinces, a summary of the audit outcome for 2010/11 and any other material issues to be addressed.

Table W1.19 Conditional grants to provinces, 2011/12 – 2014/15

R million	2011/12 Revised estimate	2012/13	2013/14	2014/15	Total for MTEF
Agriculture, Forestry and Fisheries	**1 652**	**2 066**	**2 147**	**2 194**	**6 407**
Comprehensive agricultural support programme[1]	1 189	1 535	1 600	1 665	4 800
Ilima/Letsema projects	405	416	438	461	1 315
Land care programme: Poverty relief and infrastructure development	58	116	109	68	292
Arts and Culture	**570**	**565**	**598**	**632**	**1 794**
Community library services	570	565	598	632	1 794
Basic Education	**10 737**	**11 247**	**11 923**	**12 321**	**35 491**
Dinaledi schools	70	100	105	111	316
Education infrastructure[1]	5 678	5 822	6 198	6 270	18 290
HIV and Aids (life skills education)	199	209	220	233	661
National school nutrition programme	4 579	4 906	5 179	5 474	15 559
Technical secondary schools recapitalisation	211	209	221	233	664
Cooperative Governance and Traditional Affairs	**–**	**180**	**190**	**201**	**571**
Provincial disaster	–	180	190	201	571
Health	**23 877**	**25 692**	**28 750**	**31 794**	**86 235**
Comprehensive HIV and Aids	7 398	8 763	10 534	12 211	31 508
Forensic pathology services	590	–	–	–	–
Health infrastructure	1 690	1 621	1 721	1 836	5 179
Health professions training and development	1 977	2 076	2 190	2 322	6 588
Hospital revitalisation	4 172	4 104	4 184	4 556	12 844
National health insurance	–	150	350	500	1 000
National tertiary services	8 049	8 878	9 620	10 168	28 667
Nursing colleges and schools	–	100	150	200	450
Higher Education and Training	**4 375**	**4 757**	**5 318**	**5 618**	**15 693**
Further education and training colleges	4 375	4 757	5 318	5 618	15 693
Human Settlements	**15 122**	**15 726**	**16 984**	**17 808**	**50 518**
Human settlements development[1]	15 122	15 726	16 984	17 808	50 518
National Treasury	**1 090**	**–**	**–**	**–**	**–**
Infrastructure grant to provinces	1 090	–	–	–	–
Public Works	**2 161**	**2 429**	**2 671**	**2 824**	**7 924**
Devolution of property rate funds	1 803	1 919	2 052	2 168	6 138
Expanded public works programme integrated grant for provinces	157	293	362	383	1 038
Social sector expanded public works programme incentive grant for provinces	200	217	258	273	748
Sport and Recreation South Africa	**452**	**470**	**498**	**526**	**1 493**
Mass participation and sport development	452	470	498	526	1 493
Transport	**10 856**	**12 299**	**13 093**	**13 736**	**39 128**
Gautrain rapid rail link	5	–	–	–	–
Provincial roads maintenance[1]	6 697	7 982	8 540	8 953	25 475
Public transport operations	4 153	4 317	4 553	4 783	13 652
Total conditional grants	**70 891**	**75 430**	**82 171**	**87 653**	**245 255**
Indirect transfers	**700**	**2 315**	**5 189**	**5 500**	**13 004**
School infrastructure backlogs	700	2 315	5 189	5 500	13 004

1. Includes funding for disasters

Agriculture grants

The *comprehensive agricultural support programme* aims to provide support for newly established and emerging farmers. Included in this grant is the extension recovery programme, which focuses on improving extension services through training programmes and providing equipment for extension officers. The grant also aims to expand farm infrastructure and provide support for dipping, fencing and rehabilitation of viable irrigation schemes. From 2012/13, provinces will be required to use this grant to support government's Zero Hunger programme and ensure supported farmers sell their produce to government institutions, such as schools and hospitals. Provinces will be required to implement a standard operating procedure for farmer support to improve responsiveness to the needs of emerging farmers. Provincial departments will interact with commodity groups and other private-sector role-players, as well as the non-profit sector, when finalising terms of support for farmers. The Department of Agriculture, Forestry and Fisheries will work with the Department of Rural Development and Land Reform to ensure this new approach improves alignment between the products offered by the two departments. A total of R995 million is added to this conditional grant to repair flood damage to agricultural infrastructure in January and February 2011.

The *land care programme grant: poverty relief and infrastructure development* aims to improve productivity and sustainable use of natural resources. Provinces are encouraged to use this grant to create jobs through the expanded public works programme. Over the medium term, R292 million is allocated to this grant.

The *Ilima/Letsema projects grant* is intended to boost food production. The grant aims to assist previously disadvantaged farming communities to increase agricultural production. After the Department of Agriculture, Forestry and Fisheries has tested the new approach, it will make this grant subject to the standard operating procedure for farmer support. This grant is allocated R1.3 billion over the MTEF.

Arts and culture grant

The c*ommunity library services grant* is administered by the Department of Arts and Culture. The grant aims to help South Africans' access knowledge and information, so that their socioeconomic situation can be improved. The grant is allocated to the relevant provincial department and either administered by that department or through a service-level agreement with municipalities. This grant is allocated R1.8 billion over the MTEF.

Basic education grants

The s*chool infrastructure backlogs grant* was introduced in 2011 as a short-term, high-impact grant to address backlogs in inappropriate structures and access to basic services during the 2011 MTEF. Over the 2012 MTEF, the grant is allocated R13 billion.

The *education infrastructure grant* is earmarked for infrastructure expenditure needs in provinces. This grant is used by provinces for maintenance, refurbishment and the construction of new education infrastructure and schools. Best-practice planning principles required by the Construction Industry Development Board will be implemented through this grant. The grant is allocated R18.3 billion over the MTEF, which includes R278 million in the first two years for repair of school infrastructure damaged by floods in 2011. The Department of Basic Education will coordinate the implementation of the above two infrastructure grants to ensure provinces manage their entire education asset stock efficiently and effectively. The success of these grants lies in procurement practices that facilitate the packaging of many small projects into single large projects to accelerate delivery.

The *national school nutrition programme* seeks to improve the nutrition of poor school children, enhance active learning capacity and improve attendance in schools. This grant is allocated R15.6 billion over the MTEF.

The *technical secondary schools recapitalisation grant* provides for equipment and facilities in technical high schools. Provision is made for this grant to extend to 2014/15 in response to the growing need to recapitalise technical schools identified in provincial needs assessments. This grant is allocated R664 million over the MTEF.

The *Dinaledi schools grant* started in 2011/12 and supports Dinaledi schools to improve teaching in mathematics and physical science. Dinaledi schools are schools in disadvantaged communities that perform well in mathematics and science. The grant is allocated R316 million over the MTEF.

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

Cooperative governance grants

The *provincial disaster grant* was introduced in the 2011 MTEF and is allocated to the National Disaster Management Centre in the Department of Cooperative Governance as an unallocated grant to provincial government. Special provisions were introduced in the 2011 Division of Revenue Act for this grant that enable the National Disaster Management Centre to disburse disaster response funds immediately after a disaster is declared, without the need for the transfers to first be gazetted. Over the MTEF, R571 million is available for disbursement through this grant.

Health grants

The *national tertiary services grant* provides strategic funding to enable provinces to plan, modernise and transform tertiary hospital service delivery in line with national policy objectives. The grant operates in 22 hospitals across the nine provinces, concentrated in urban Gauteng and the Western Cape. As a result, these provinces receive the largest shares of the grant as they provide the largest proportion of these high-level, sophisticated services for the benefit of the health sector countrywide. Over the MTEF, R900 million is added to the *national tertiary services grant* in recognition that provinces with large tertiary services bear a larger proportion of the wage agreements for health-sector employees. This grant is allocated R28.7 billion over the MTEF.

The *health infrastructure grant* funds general maintenance and infrastructure needs at smaller hospitals and clinics. National Treasury and the Department of Health have joint capacity-building programmes funded through this grant to support provinces' implementation of best-practice planning and project implementation processes. The baseline of this grant has been reduced to make resources available for the *nursing colleges and schools grant*. The *health infrastructure grant* is allocated R5.2 billion over the MTEF.

The *hospital revitalisation grant* supports large projects that modernise infrastructure and equipment in hospitals. It remains separate to the *health infrastructure grant* to enable the Department of Health to manage projects funded through this grant closely. An amount of R718 million has been added over the 2012 MTEF for major infrastructure projects involving public-private partnerships. This grant is allocated R12.8 billion over the MTEF.

The *health professions training and development grant* funds the training of health professionals, and the development and recruitment of medical specialists. It enables the shifting of teaching activities from central to regional and district hospitals. This grant is allocated R6.6 billion over the medium term.

The *comprehensive HIV and Aids grant* enables the health sector to develop a response to HIV and Aids. In addition to prevention programmes, the grant supports specific interventions, including voluntary counselling and testing, prevention of mother-to-child transmission, post-exposure prophylaxis, antiretroviral treatment and home-based care. In addition to substantial increases to this grant and the provincial equitable share over the 2010 and 2011 MTEF for HIV and Aids programmes, a further R1.1 billion is added to this grant over the 2012 MTEF to fund the higher-than-expected demand for antiretroviral treatment due to the lowering of the CD4 count threshold. This brings the baseline over the MTEF to R31.5 billion.

The *nursing colleges and schools grant* is a new grant that will fund the refurbishment and upgrading of nursing colleges and schools. The Department of Health will play a more active role in the planning, packaging and procurement of projects funded through this grant than it does in other infrastructure grants. This grant is allocated R450 million over the 2012 MTEF.

The *national health insurance grant* will fund national health insurance pilots. These pilot projects aim to strengthen primary health care for the implementation of national health insurance, and improve revenue collection and management in selected central hospitals. The pilots will test the feasibility of policy proposals and delivery models, such as district-based clinical specialist support teams, school-based primary health care services, municipal ward-based primary health care agents, general practitioner services and primary care clinic and allied health professional services. Ten district health authorities have been selected as pilot sites to test interventions that aim to strengthen health systems and improve performance, develop models to set up district health authorities as contracting agents, enhance primary health care service packages and improve referral systems and innovative models for districts to work with private providers. Seven central hospitals have been selected as intervention sites. Over the 2012 MTEF, R1 billion has been allocated to this grant.

Higher education and training grants

The *further education and training colleges grant* was introduced in 2010/11 to protect spending on these colleges by provinces while the legislative processes required to shift this function to national government are completed. Although progress has been made, this process is not yet complete. Over the MTEF, R166 million is added to this grant to cover the cost of wage agreements, bringing the total value of this grant to R15.7 billion.

Human settlements grants

The *human settlements development grant* facilitates the establishment of habitable, stable and sustainable human settlements in which all citizens have access to social and economic amenities. Over the 2011 MTEF, a portion of this grant was added to the new *urban settlements development grant,* which goes to the eight metros for internal infrastructure. As more municipalities with large urban centres are able to take on these responsibilities, they will join the *urban settlements development grant* and their portion of the *human settlements development grant* will be transferred. This should accelerate the eradication and formalisation of informal settlements. In cases where municipalities are accredited in terms of the Housing Act (1997), the municipalities will receive their *human settlements development grant* funds directly from national government. A total of R1.1 billion has been added to the *human settlements development grant* over the MTEF to address the eradication of informal settlements and R594 million has been added to repair infrastructure damaged by floods.

Public works grants

The *devolution of property rate funds grant* enables provinces to take over the responsibility of paying property rates and municipal charges on properties that were administered by national government on their behalf. When all provinces have full records of their properties and liabilities for municipal rates, consideration will be given to phasing the grant into the provincial equitable share. This grant is allocated R6.1 billion over the 2012 MTEF.

The *expanded public works programme integrated grant for provinces* has been revised – the incentive will now be based on meeting job targets in the preceding financial year rather than in-year performance. Transfers will depend on provincial departments reporting on jobs created on the expanded public works programme system and implementing labour-intensive projects. This grant is allocated R1 billion over the MTEF.

The *social sector expanded public works programme incentive grant* is also an incentive grant based on meeting job creation targets in the preceding financial year. This grant rewards provinces for creating jobs in the provision of home-based care and early childhood development. This grant is allocated R748 million over the MTEF.

Sports and Recreation South Africa grants

The *mass participation and sport development grant* aims to increase and sustain mass participation in sport and recreational activities in provinces. This grant is allocated R1.5 billion over the MTEF.

Transport grants

The *public transport operations grant* subsidises commuter bus services. The payment of bus subsidies to operators was previously funded through an agency arrangement between national and provincial government. This grant enables government to take greater responsibility in ensuring contractual obligations are met. This grant will amount to R13.7 billion over the MTEF.

The *provincial roads maintenance grant* enables provinces to expand their maintenance activities and to cover the cost of rehabilitation work created by coal haulage activities in Mpumalanga and Gauteng. The grant requires provinces to follow best-planning practices according to road asset management systems and to keep these systems updated regularly. A total of R1.2 billion has been added to this grant for the repair of infrastructure damaged by floods in January and February 2011. This grant is allocated R25.5 billion over the MTEF.

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 local government fiscal framework refers to all resources available to municipalities to meet their expenditure responsibilities. National transfers account for only a relatively small proportion of the local government fiscal framework, with the majority of local government revenues being raised by municipalities themselves through their substantial revenue-raising powers, including property rates and service charges. However, the proportion of revenue coming from transfers and own revenues varies dramatically across municipalities, with poor rural municipalities receiving most of their revenue from transfers, while urban municipalities raise the majority of their own revenues. Although transfers from national government have helped fund significant improvements in overcoming the service disparities of the past, large backlogs remain.

The transfers outlined here are distributed among municipalities to best respond to their different needs. In recent years, adjustments have been made to increase allocations to poor rural municipalities and to restructure funding to upgrade informal settlements in growing metropolitan municipalities. 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 2012 budgets, and to promote better accountability and transparency by ensuring that all national allocations are included in municipal budgets.

Changes to local government allocations

Given the constrained and uncertain economic outlook, government will use savings from existing baselines to fund key government priorities. As a result, the baselines of most conditional grants have been revised downward. Table W1.20 shows the savings made on local government conditional grants to make resources available. No savings were made on the local government equitable share.

Table W1.20 Savings effected on direct and indirect transfers to local government, 2012/13 – 2014/15

R million	2012/13	2013/14	2014/15	2012 MTEF Total revisions
Direct conditional grants	**-64.6**	**-72.8**	**-142.0**	**-279.4**
Infrastructure transfers	**-63.4**	**-71.5**	**-139.5**	**-274.4**
Municipal infrastructure grant	-32.5	-35.9	-70.1	-138.5
Urban settlements development grant	-17.3	-19.9	-38.8	-76.0
Public transport infrastructure and systems grant	-11.7	-13.6	-26.6	-51.9
Neighbourhood development partnership grant	-1.9	-2.0	-3.8	-7.6
Rural transport services and infrastructure grant	-0.1	-0.1	-0.2	-0.4
Recurrent transfers	**-1.1**	**-1.3**	**-2.5**	**-4.9**
Financial management grant	-1.1	-1.3	-2.5	-4.9
Indirect conditional grants	**-2.7**	**-3.0**	**-5.8**	**-11.5**
Integrated national electrification programme	-2.7	-3.0	-5.8	-11.5
Total	**-67.2**	**-75.8**	**-147.8**	**-290.8**

Table W1.21 outlines all of the technical revisions and additions to local government allocations for the 2012 MTEF.

Table W1.21 Revisions to direct and indirect transfers to local government, 2012/13 – 2014/15

R million	2012/13	2013/14	2014/15	2012 MTEF Total revisions
Technical adjustments	**141**	**46**	**-130**	**57**
Direct transfers	**-123**	**-278**	**-58**	**-458**
Municipal infrastructure grant	–	–	274	274
Neighbourhood development partnership grant	-220	-200	-253	-673
Expanded public works programme incentive grant	-66	-78	-82	-226
Financial management grant	-75	-100	-106	-281
Infrastructure skills development grant	75	100	106	281
Water services operating subsidy grant	163	–	3	167
Indirect transfers	**264**	**323**	**-72**	**516**
Regional bulk infrastructure grant	132	139	149	420
Rural households infrastructure grant	–	-128	-548	-677
Water services operating subsidy grant	133	313	328	773
Additions to baselines	**882**	**2 498**	**4 547**	**7 926**
Direct transfers	**500**	**1 891**	**3 651**	**6 042**
Equitable share	300	621	1 281	2 202
Urban settlements development grant	–	970	1 970	2 940
Integrated national electrification programme	–	100	200	300
Electricity demand side management grant	200	200	200	600
Indirect transfers	**382**	**606**	**896**	**1 884**
Regional bulk infrastructure grant	382	606	896	1 884

When the cumulative effect of the savings to fund national priorities, technical revisions and additions to baselines are taken together, the value of transfers to local government increases by R7.7 billion over the MTEF. Of this, R5.3 billion is added to direct transfers and R2.4 billion will be administered by national departments as indirect transfers.

Table W1.22 Net changes to direct and indirect transfers to local government, 2012/13– 2014/15

R million	2012/13	2013/14	2014/15	2012 MTEF Total revisions
Total of revisions to baselines	**1 023**	**2 544**	**4 417**	**7 984**
Direct transfers	377	1 614	3 593	5 584
Indirect transfers	646	930	824	2 400
Less				
Total savings to fund government priorities	**-66**	**-74**	**-144**	**-284**
Direct transfers	-65	-73	-142	-279
Indirect transfers	-1	-1	-3	-5
Net additions to baselines	**957**	**2 470**	**4 273**	**7 700**
Direct transfers	312	1 541	3 451	5 305
Indirect transfers	645	928	821	2 395

Transfers to local government

Over the 2012 MTEF, R251.9 billion will be transferred directly to local government and a further R16.6 billion has been allocated to indirect grants. Direct transfers to local government in 2012/13 account for 8.8 per cent of national government's non-interest expenditure. When indirect transfers are added to this, total spending on local government rises to 9.4 per cent of national non-interest expenditure. The value of direct transfers to local government grows at an average annual rate of 10 per cent over the MTEF, slightly above projected inflation, but significantly lower than the rapid growth in transfers between 2001/02 and 2011/12 – when the value of direct transfers to local government grew from R6.5 billion to R68.2 billion, with an average annual growth rate of 27.2 per cent.

Table W1.23 Transfers to local government, 2008/09 – 2014/15

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
R million		Outcome		Revised estimate		Medium-term estimates	
Direct transfers	**45 487**	**51 537**	**60 904**	**68 180**	**77 342**	**83 858**	**90 707**
Equitable share and related	**25 560**	**23 847**	**30 541**	**32 876**	**37 873**	**40 582**	**43 639**
Equitable share formula[1]	16 300	20 283	26 761	28 991	33 483	35 879	38 538
RSC levy replacement[2]	9 045	3 306	3 492	3 544	3 733	3 930	4 146
Support for councillor remuneration and ward committees	215	258	288	340	658	772	955
General fuel levy sharing with metros	**–**	**6 800**	**7 542**	**8 573**	**9 040**	**9 613**	**10 190**
Conditional grants	**19 928**	**20 891**	**22 821**	**26 732**	**30 429**	**33 663**	**36 878**
Infrastructure	18 562	18 759	20 870	24 846	28 029	31 222	34 301
Capacity building and other	1 366	2 132	1 951	1 886	2 400	2 440	2 577
Indirect transfers	**2 418**	**3 088**	**2 996**	**4 029**	**5 088**	**5 661**	**5 836**
Infrastructure	2 038	2 763	2 682	3 781	4 956	5 348	5 509
Capacity building and other	380	326	314	247	133	313	328
Total	**47 906**	**54 626**	**63 899**	**72 209**	**82 430**	**89 519**	**96 543**

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

2. The RSC levy replacement grant for 2008/09 includes allocations for metros, from 2009/10 metros received the general fuel levy sharing instead. In 2011/12 two new metros were added to the general fuel levy sharing

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. The local government equitable share is an unconditional transfer that enables municipalities to provide free basic services to poor households and covers basic municipal administration costs. The equitable share supplements municipal own revenues.

Over the 2012 MTEF, the local government equitable share, including the *RSC/JSB levies replacement grant* and *special support for councillor remuneration and ward committees,* is worth R122.1 billion – R37.9 billion in 2012/13, R40.6 billion in 2013/14 and R43.6 billion in 2014/15.

Equitable share formula

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

Over the last three years, several adjustments have been made to the equitable share formula to increase the allocations to poor rural municipalities. Details of these changes are described in previous explanatory memoranda (Annexure W1) to the Division of Revenue. A review of the equitable share formula is under way and is discussed in part six of this annexure.

The formula uses demographic and other data to determine each municipality's share of the local government equitable share. The equitable share is an unconditional transfer that is intended to provide municipalities with sufficient funds to be able to provide free basic services to their poor households. It consists of five components:

- The *basic services component* is worth 99.1 per cent of the value of the equitable share and provides for the cost of free basic services for poor households as well as municipal health services.
- The *development component* is dormant.
- The *institutional support component* is worth 7.9 per cent of the value of the equitable share and provides a subsidy for basic municipal administrative costs.
- The *revenue-raising capacity correction* accounts for the fact that some municipalities have a much greater ability to raise own revenues than other municipalities. It subtracts 7 per cent of the value of the equitable share, primarily from the wealthiest municipalities, to make those funds available for poorer municipalities.
- The *correction and stabilisation factor* makes sure all of the guarantees in the formula can be met and accounts for a negligible proportion of the final equitable share allocations.

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

Structure of the local government equitable share formula

$$Grant = BS + D + I - R \pm C$$

where

BS is the basic services component

D is the development component

I is the institutional support component

R is the revenue-raising capacity correction

C is a correction and stabilisation factor

The basic services component

This component helps municipalities provide basic services to poor households and municipal health services. For each of the subsidised basic services, there are two levels of support: a full subsidy for poor households that are connected to municipal services and a partial subsidy for poor households that are not yet connected to the municipal networks. The allocation for un-serviced households is 45 per cent of the value of the subsidy to serviced households.

The basic services component aims to:

- Support poor households earning less than R800 per month in 2001 prices
- Distinguish between poor households receiving connector services and those that do not and need to be targeted through alternative service-delivery mechanisms
- Recognise water reticulation, sanitation, refuse removal and electricity reticulation as core municipal services
- Provide municipal health services to all households (through funding allocated to district and metropolitan municipalities).

The basic services component

*BS=[water subsidy 1*poor with water + water subsidy 2*poor without water] +*
*[sanitation subsidy 1*poor with sanitation + sanitation subsidy 2*poor without sanitation] +*
*[refuse subsidy 1*poor with refuse + refuse subsidy 2*poor without refuse] +*
*[electricity subsidy 1*poor with electricity + electricity subsidy 2*poor without electricity] +*
*[municipal health services*total number of households]*

Table W1.24 shows the total amount of funding provided for each of the four basic services through the local government equitable share (amounts reflect the final allocations per basic service after rescaling).

Table W1.24 Amounts per basic service allocated through the local government equitable share

R millions	2012/13	2013/14	2014/15
Electricity	10 538	11 294	12 144
Water	7 201	7 717	8 297
Sanitation	6 204	6 648	7 149
Refuse	6 116	6 556	7 051
Municipal health	896	958	1 001
Total basic services	**30 954**	**33 173**	**35 641**

The development component

This component is currently inactive. The 2012 review of the local government fiscal framework will consider how best the equitable share formula can respond to the development needs of the different types and categories of municipalities.

The institutional support component

To provide basic services to households, municipalities need to be able to run a basic administration. Municipalities should be able to fund most of their administration costs through own revenues, but because poor households will not be able to contribute to these costs, the equitable share includes an institutional support component to help meet some of these costs. This component was changed in the 2011 formula to take account of the level of poverty in a municipality and its relative ability to fund administrative and governance costs from own revenue. Previously, this component was largely determined by the population size of a municipality. The adjusted formula still reflects the relative sizes of different municipalities, but this is now adjusted by their poverty rate.

The institutional support component

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

where the values used in the formula are:

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

The formula for this component has two sub-components. The base allocation is an amount that will go to every municipality. The formula recognises that larger municipalities have larger administration costs, and municipalities with proportionally large poor populations will struggle to cover these costs. In response, the second term incorporates two elements: an allocation per councillor that reflects the relative size of a municipality and a poverty factor based on the proportion of poor households in a municipality. The proportion of poor households is adjusted to arrive at a relative scale for all municipalities – the municipality with the highest proportion of poor households receives a poverty factor of 100 per cent. The poorest municipality has 83 per cent of its households below the poverty line (R800 a month in 2001 prices), so 17 per cent is added to the proportion of poor households in each municipality to calculate the poverty factor. The poverty factor is used to adjust the allocated amount for each municipality based on the size of its council.

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

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

The revenue-raising capacity correction

Local government is granted substantial own-revenue raising powers in the Constitution (particularly through property rates and surcharges on services) and it is expected that municipalities will fund much of their own administrative costs and cross-subsidise some of the provision of services to indigent residents. Given the different levels of poverty across South Africa, the ability to raise own revenues differs across municipalities. The formula does not expect all municipalities to be able to achieve the same levels of cross-subsidisation from their own revenues.

To account for the varying fiscal capacities of municipalities, this component takes into account income from property rates and the fuel levy sharing with metropolitan municipalities. In the absence of proper information on property valuation rolls across the spectrum of municipalities and as an interim measure, past actual property rates collected between 2004/05 and 2006/07 have been used as a baseline for determining the ability of each municipality to raise revenue from property rates. The formula does not take account of any changes in the levels of revenue collection after 2006/07 to avoid penalising municipalities that have improved their revenue collection efforts. The projected capacity of a municipality to raise revenue from property rates is assumed to be the average of past revenue collection grown to reflect the impact of inflation. Further work on how revenue-raising capacity should be accounted for in the formula will take place as part of the longer-term review of the local government equitable share formula described in part 6 below. In the case of the general fuel levy sharing with metropolitan municipalities, the revenue-raising capacity correction is calculated using the allocations gazetted for the 2011 MTEF (with a uniform increase across all municipalities assumed for 2014/15).

To achieve greater horizontal equity in the allocation system and to acknowledge the revenue-raising constraints faced by smaller municipalities, a differentiated "tax" rate on property rates income is applied. The applicable tax rate for a municipality is based on the level of per capita own operating revenue (again, calculated based on 2004/05 to 2006/07 figures). Own operating revenue is the difference between past actual total operating revenue and income from grants and subsidies. The tax rates range from 1 per cent for municipalities with the lowest operating revenue per capita to 7 per cent for municipalities with the highest operating revenue per capita. The "tax" applied to each municipality's predicted revenue from property rates is calculated using the following formula (with a cut-off at a maximum of 7 per cent for municipalities with operating revenue per capita above R2 500):

"Tax rate" = 1 + 6/2 500 * [operating revenue per capita]

The application of the revenue-raising capacity correction in the local government equitable share formula means that municipalities are expected to cross-subsidise between 1 per cent and 7 per cent of the cost of providing basic services to poor households.

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

Correction and stabilisation factor

With the publication of three-year budget allocations, a guarantee mechanism is applied to the indicative outer-year baseline amounts with the aim that, as far as possible given the overall budget constraints and the need to amend the formula, the formula ensures that municipalities do not receive substantially less than the indicative allocations published in the previous MTEF. In the 2012 MTEF, allocations for 2012/13 were calculated to guarantee that municipalities received at least 90 per cent of the amount indicated for 2012/13 in the schedules to the 2011 Division of Revenue Act (in keeping with the guarantees provided in 2011). In the schedules of the 2012 Division of Revenue Act, the applicable guarantees are 100 per cent for the 2012/13 allocations, 90 per cent for the 2013/14 allocations and no guarantee on the indicative 2014/15 allocations published.

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

Changes in 2012

A total of R2.2 billion has been added to the local government equitable share over the 2012 MTEF. Of this, R960 million is for the anticipated above-inflation increase in the cost of basic services in 2013/14 and 2014/15 (2012/13 cost increases have already been provided for through previous additions to the local government equitable share). These additional basic services funds have been allocated through the local government equitable share formula.

An extra R1.2 billion is for municipalities to pay stipends to ward committee members and to increase support from the national fiscus for councillor salaries in grade 1-3 municipalities (the lowest three of the six municipal grades). Ward committees are an important part of local democracy, and the funding provided for stipends will enable greater community participation in local government. Increased support for the remuneration of councillors, to be phased in over the MTEF, will enable these municipalities to use more of their own funds for basic services. These allocations are not calculated as part of the local government equitable share formula. Details of how these funds are calculated and the level of support provided are outlined below.

Other considerations in applying the formula

The formula outlined above has to be rescaled to make allowance for powers and functions, and to ensure the overall budget balances.

Powers and functions

Local government is divided into category A, B and C municipalities.[1] The division of powers and functions differs between the categories. To deal with these differences, the model ensures that basic service allocations go to the municipality that is authorised to perform that function. To enhance transparency in the budget process, the local government equitable share and *municipal infrastructure grant* (MIG) allocations to district municipalities are published per unauthorised local municipality in the district municipality. This allows local municipalities without authorisation for these functions to see what funds have been allocated to district municipalities to enable them to provide these services in their area.

Balancing allocations

The horizontal division of allocations between municipalities depends on the size of the overall allocation to local government, which is determined through a separate consultative process to determine the equitable share of nationally raised revenue for each of the three spheres of government (the vertical division). As the horizontal division's allocations may not add up precisely to the amount allocated to the local government equitable share, such allocations need to be adjusted to fit within available resources.

Rescaling the BS, D and I components

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

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

This adjustment factor is calculated to ensure that the system balances

Measurement issues

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

Poverty

Household income is used to estimate poverty at municipal level because it allows for cross-tabulation of poverty against servicing levels. Over 90 per cent of funds allocated through the formula are based on the service-delivery needs of poor households. The formula uses a household poverty line of R800 per month (in 2001 prices).

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

Service levels

The basic services subsidy for poor households is a key determinant of allocations in the current formula. In the absence of accurate data on the costs of providing services in all municipalities, these allocations are based on assumptions about the relative costs of services. As outlined in the basic services section above, it is assumed that providing alternate services to households that did not have services when Census 2001 was conducted is 45 per cent of the cost of providing full services. After the adjustment factor and other components are applied, the actual subsidies per basic service made available through the equitable share are set out in Table W1.26.

Table W1.25 Number of poor households

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

Source: 2001 Census

Table W1.26 Actual average monthly basic services subsidies per poor household

Monthly	Serviced households			Households not connected to services		
Rand	2012/13	2013/14	2014/15	2012/13	2013/14	2014/15
Electricity	208.32	223.23	240.04	93.74	100.45	108.02
Water	138.88	148.82	160.03	62.50	66.97	72.01
Sanitation	138.88	148.82	160.03	62.50	66.97	72.01
Refuse	138.88	148.82	160.03	62.50	66.97	72.01
Total	**624.95**	**669.68**	**720.12**	**281.23**	**301.35**	**324.05**

Other unconditional allocations

RSC/JSB levies replacement grant

Before 2006, district municipalities raised levies on local businesses through an RSC or JSB levy. This source of revenue was replaced in 2006/07 with the *RSC/JSB levies replacement grant*, which was allocated to all district and metropolitan municipalities based on the amounts they had previously collected through the levies. The value of the grant increases every year. In the 2012 MTEF, the grant increases by 9 per cent a year for municipalities authorised for water and sanitation and 3 per cent for unauthorised municipalities. The different rates recognise the different service-delivery responsibilities of these district municipalities.

Special support for councillor remuneration and ward committees

Councillors' salaries are subsidised in poor municipalities. This support is calculated separately to the local government equitable share and is in addition to the governance costs funding provided in the institutional support component. The level of support for each municipality is determined by its grading in terms of the classification system used in the Government Gazette, which determines the upper limits of salaries, allowances and benefits of different members of municipal councils. The gazette, published annually by the Minister of Cooperative Governance and Traditional Affairs, classifies municipal councils into six grades based on their total income and population size. Special support is provided to the lowest three grades of municipal councils (the smallest and poorest municipalities). Increased support for councillor remuneration is being phased in over the 2012 MTEF. The proportion of councillors' salaries subsidised through this allocation for different grades of municipalities is shown in Table W1.27. All subsidy levels are based on the gazetted upper maximum levels for part-time councillors.

Table W1.27 Subsidy levels provided for councillor remuneration

Municipal grade	2012/13	2013/14	2014/15
1	80.0%	90.0%	90.0%
2	55.0%	70.0%	80.0%
3	50.0%	55.0%	70.0%

In addition, each municipality in grades 1 to 3 receives an allocation to provide stipends of R500 per month to 10 members of each ward committee in their municipality. Each municipality's allocation for this special support is published in the appendices to the Division of Revenue Bill.

Conditional grants to local government

National government allocates funds to local government through a variety of conditional grants. Conditional grants fall into two main groups: infrastructure and capacity-building. The total value of conditional grants directly transferred to local government increases from R30.4 billion in 2012/13, to R33.7 billion in 2013/14 and R36.9 billion in 2014/15.

Conditional grants to local government are being reconfigured to address the differences between rural and urban municipalities. In 2011, a new *urban settlements development grant* was created by merging the *MIG cities grant* with a portion of the *human settlements development grant*. This new grant funds infrastructure development in metropolitan municipalities related to upgrading informal settlements. Several other grants also provide for specific rural and urban challenges:

- The *rural households infrastructure grant* is an indirect transfer to build on-site water and sanitation facilities in rural municipalities.
- The *public transport infrastructure and systems grant* funds integrated transport networks in cities.
- The *rural roads asset management grant* is for rural district municipalities to establish the systems needed to monitor and maintain rural roads.

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 R33 billion, R36.6 billion and R39.8 billion for each of the 2012 MTEF years.

Table W1.28 Infrastructure transfers to local government, 2008/09 – 2014/15

R million	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
		Outcome		Revised estimate		Medium-term estimates	
Direct transfers	**18 562**	**18 759**	**20 870**	**24 846**	**28 029**	**31 222**	**34 301**
Municipal infrastructure grant	6 986	8 788	9 704	11 444	13 882	14 643	15 764
Urban settlements development grant	3 572	4 418	4 968	6 267	7 392	9 077	10 546
Integrated national electrification programme	589	900	1 033	1 097	1 151	1 315	1 488
Public transport infrastructure and systems grant	2 920	2 418	3 699	4 803	4 988	5 550	5 871
Neighbourhood development partnership grant	181	508	832	750	578	598	591
2010 FIFA World Cup stadiums development grant	4 295	1 661	302	–	–	–	–
Rural roads asset management grant	9	13	10	35	37	39	41
Municipal drought relief grant	9	54	320	450	–	–	–
Indirect transfers	**2 038**	**2 763**	**2 682**	**3 781**	**4 956**	**5 348**	**5 509**
Integrated national electrification programme	1 241	1 616	1 720	1 738	1 879	1 983	2 099
Neighbourhood development partnership grant	80	70	50	100	80	55	58
Regional bulk infrastructure grant	441	577	851	1 686	2 517	2 922	3 351
Backlogs in water and sanitation at clinics and schools	186	350	–	–	–	–	–
Backlogs in the electrification of clinics and schools	90	149	–	–	–	–	–
Rural households infrastructure grant	–	–	62	258	480	389	–
Total	**20 600**	**21 522**	**23 552**	**28 627**	**32 984**	**36 571**	**39 810**

Municipal infrastructure grant

The largest infrastructure transfers are through the *municipal infrastructure grant*, which supports government's aim to expand service delivery and alleviate poverty. The MIG funds the provision of infrastructure for basic services, roads and social infrastructure for poor households in all non-metropolitan municipalities. The total allocations for this grant grow to R13.9 billion, R14.6 billion and R15.8 billion over the 2012 MTEF.

The MIG 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. The five main components of the formula are described in the box below. A minimum allocation of R5 million ensures that a reasonable minimum allocation is made to poor municipalities.

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

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

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

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

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

E Allocation for social institutions and micro-enterprises infrastructure

N Allocation to all nodal municipalities

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

Each component is allocated using data from the 2001 Census. Allocations for basic services sub-components are based on the proportion of the national backlog for that basic service in each municipality. Other components are based on the proportion of the country's poor households located in each municipality. Table W1.28 sets out the proportion of the grant accounted for by each component of the MIG formula.

Table W1.29 Municipal infrastructure grant allocations per sector

Municipal infrastructure grant (formula)	Component weights	Proportion of MIG per sector
B Component	**75.0%**	
Water and sanitation	72.0%	54.0%
Roads	23.0%	17.3%
Other	5.0%	3.8%
P Component	**15.0%**	
Sports	100.0%	15.0%
E Component	**5.0%**	**5.0%**
N Component	**5.0%**	**5.0%**

In the 2011 division of revenue, the P-component (15 per cent of the MIG) was ring-fenced for municipal sport and recreation infrastructure. This ring-fencing continues in 2012. Sport and Recreation South Africa is working with other departments and SALGA on proposals to further improve sports infrastructure in municipalities.

In 2014/15, the *rural households infrastructure grant* will be incorporated into the MIG through a separate component, outside of the current grant formula. This will ensure that only those rural municipalities selected for participation in the current *rural households infrastructure grant* programme will receive additional MIG funds from 2014/15.

Urban settlements development grant

The *urban settlements development grant* was introduced for the eight metropolitan municipalities in 2011/12 as an integrated source of infrastructure funding to upgrade urban informal settlements. The grant combines basic services funding (previously allocated through the MIG) with part of the basic services portion of the *human settlements development grant* (previously allocated to provinces). This shift reflects the importance of upgrading informal settlements and coordinating housing and basic services projects, and perhaps most significantly, government's policy to devolve more housing authority to cities. The total *urban settlements development grant* is allocated R7.4 billion in 2012/13, R9.1 billion in 2013/14 and R10.5 billion in 2014/15.

The public transport infrastructure and systems grant

The *public transport infrastructure and systems grant* is administered by the Department of Transport. The grant aims to help cities create new and improve existing public transport and non-motorised transport infrastructure. This includes the provision of bus rapid transit systems. The grant has an allocation of R5 billion in 2012/13, R5.5 billion in 2013/14 and R5.9 billion in 2014/15.

The rural roads asset management grant

The *rural roads asset management grant* is administered by the Department of Transport to improve rural transport infrastructure. In 2012/13, the grant will fund the collection of accurate data on the condition of rural roads in line with the Road Infrastructure Strategic Framework for South Africa. This data will guide investments to improve these roads. Rural district municipalities are funded to collect data on the condition and usage of all the municipal roads in their area so that the spending of infrastructure funds (from the MIG and elsewhere) can be properly planned to maximise their impact. The grant has an allocation of R37.3 million in 2012/13, R39.2 million in 2013/14 and R41.4 million in 2014/15.

The rural households infrastructure grant

The *rural households infrastructure grant* is an indirect grant through which the Department of Human Settlements provides on-site solutions for water and sanitation in rural areas where it is not feasible to provide households with piped services due to dispersed settlement patterns. This grant was introduced through pilots in 2010/11. From 2014/15, the grant will be incorporated into the MIG and transferred directly to municipalities.

The neighbourhood development partnership grant

The *neighbourhood development partnership grant* seeks to develop community infrastructure and create a platform for private investment to improve the quality of life in townships. The grant is administered by National Treasury and is allocated R658.1 million in 2012/13, R653 million in 2013/14 and R649.5 million in 2014/15 for both the technical assistance (indirect) and capital (direct) grant.

The integrated national electrification programme

To sustain the progress in connecting poor households to electricity, government will spend about R10 billion over the next three years on the national electrification programme. Of this, municipalities will spend R4 billion and Eskom will spend R6 billion on behalf of municipalities. This programme was instrumental in the connection of 80 per cent of all households to the national electricity grid as reported in the 2007 Community Survey.

The regional bulk infrastructure grant

This grant supplements the financing of the social component of regional bulk water and sanitation. It targets projects that cut across the boundaries of several municipalities. The grant supplements regional bulk collection and wastewater treatment works. It may also be used to appoint service providers to carry out feasibility studies, related planning or management studies for infrastructure projects. The grant has been augmented with R1.9 billion earmarked to fund projects in Sekhukhune, Sedibeng and OR Tambo municipalities. The grant has an allocation of R2.5 billion in 2012/13, R2.9 billion in 2013/14 and R3.4 billion in 2014/15.

Capacity-building grants and other current transfers

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

Table W1.30 Capacity building and other current transfers to local government, 2008/09 – 2014/15

R million	2008/09	2009/10	2010/11	2011/12 Revised estimate	2012/13	2013/14	2014/15
Direct transfers	**1 366**	**2 132**	**1 951**	**1 886**	**2 400**	**2 440**	**2 577**
Municipal systems improvement grant	200	200	212	220	230	243	257
Financial management grant	180	300	365	424	403	425	449
2010 FIFA World Cup host city operating grant	–	508	210	–	–	–	–
Water services operating subsidy grant	986	849	664	542	562	421	450
Expanded public works programme integrated grant for municipalities	–	100	280	420	599	702	744
Infrastructure skills development grant	–	–	–	–	75	100	106
Electricity demand side management grant	–	175	220	280	200	200	200
Municipal disaster grant	–	–	–	–	330	350	371
Indirect transfers	**380**	**326**	**314**	**247**	**133**	**313**	**328**
Financial management grant: DBSA	50	–	–	–	–	–	–
Electricity demand side management grant	–	75	109	119	–	–	–
Water services operating subsidy grant	330	251	205	128	133	313	328
Total	**1 746**	**2 458**	**2 264**	**2 133**	**2 533**	**2 753**	**2 905**

Financial management grant

The *financial management grant*, under the National Treasury vote, funds the modernisation of financial management, including building in-house municipal capacity to implement multi-year budgeting, linking integrated development plans to budgets, producing quality and timely in-year and annual reports, and generally supporting municipalities in the implementation of the Municipal Finance Management Act. Total allocations for the *financial management grant* amount to R1.3 billion over the 2012 MTEF.

Infrastructure skills development grant

This new grant, piloted by the National Treasury, places interns with technical skills in municipalities. Interns will spend two years in a well-capacitated municipality or entity gaining skills and experience, and will then be transferred to a rural municipality with poor capacity to complete their internship. This programme will increase the pool of qualified engineers and scientists working in municipalities and will give rural municipalities the opportunity to hire these skilled personnel when they have completed their internships. The first cohort of interns in this programme began working in January 2012. The allocations for this grant over the MTEF are R75.5 million in 2012/13, R100 million in 2013/14 and R106 million in 2014/15.

Municipal systems improvement grant

The *municipal systems improvement grant* provides funding to non-metropolitan municipalities to help them implement their individual local government turnaround strategies. The grant is administered by the Department of Cooperative Governance and is allocated R230.1 million in 2012/13, R242.7 million in 2013/14 and R257.3 million in 2014/15.

Expanded public works programme integrated grant for municipalities

Due to its slow uptake, the focus of this grant has shifted. Funds will be transferred up-front for projects, which will avoid previous problems with underspending. The grant will be allocated through a formula based on past performance – thereby preserving an incentive effect – with a bonus to give bigger allocations to poor, rural municipalities. The grant will also have simplified planning and reporting requirements. The grant is allocated R599.2 million in 2012/13, R701.9 million in 2013/14 and R743.9 million in 2014/15.

The electricity demand-side management grant

The *electricity demand-side management grant* was introduced for three years following load shedding in 2008. Due to the continued importance of promoting energy efficiency (for the environment and energy security), the grant has been extended for another three years. It will fund selected municipalities to implement demand-side management projects, with a focus on public lighting and the energy efficiency of municipal buildings. The grant has an allocation of R200 million in 2012/13, R200 million in 2013/14 and R200 million in 2014/15.

The water services operating subsidy

The *water services operating subsidy* is a grant with schedule 6 (direct) and schedule 7 (in-kind) components to fund water schemes. The grant covers staff-related costs, direct operating and maintenance costs, and infrastructure refurbishment. Allocation per municipality is based on the operational budget for each scheme and the funding requirements identified in the transfer agreement. The Department of Water Affairs administered these schemes before 1994, which are now being transferred to municipalities. At the end of 2009/10, 59 agreements had been signed, 4 903 staff transferred and 1 643 schemes (including rudimentary schemes) with a total asset value of about R6.4 billion transferred to municipalities. In the 2012 MTEF, R2.2 billion is allocated for the *water services operating subsidy* (direct and indirect transfers). This grant enables the transfer of staff operating water schemes from national government to municipalities. It is a transitional grant that is expected to be phased out over time.

Municipal disaster grant

The conditional *municipal disaster grant* was introduced in the 2011 MTEF. This grant is allocated to the National Disaster Management Centre in the Department of Cooperative Governance as an unallocated grant to local government. The centre is able to disburse disaster response funds immediately – without the need for the transfers to be gazetted first. Over the 2012 MTEF, R1.1 billion is available for disbursement through this grant.

Part 6: Future work on provincial and municipal fiscal frameworks

Release of the 2011 Census results

Census data is used to calculate many allocations to provinces and municipalities. As a result, data updates are likely to have a significant impact on allocations, especially the local government equitable share, which still largely relies on Census 2001 data. Although the date for the release of the Census 2011 data has not been confirmed, in 2012, National Treasury will assess the potential impact and make the necessary adjustments to smooth the new data’s incorporation. When the data is officially released, National Treasury will engage with relevant stakeholders on potential revisions to the formulas.

National health insurance

The national health insurance green paper was released during 2011 and the period for public comments has closed. Government will release a white paper, after which new legislation and amendments will be introduced. The exact changes to the intergovernmental system are not yet known, but intergovernmental transfer mechanisms and applicable legislation will need to be revised to allow for a fund or funds that purchase health services from accredited providers. The accreditation of providers is a sector issue, however, the structure of the fund will have significant consequences for the structure of the intergovernmental system. These will be considered as the national health insurance debate evolves.

Review of the local government fiscal framework

The current system of local government is just over a decade old – an appropriate time to evaluate the fiscal framework's effectiveness in supporting the performance of local government. Government has already created a stable, predictable and transparent system of intergovernmental transfers. Building on this foundation in the second decade of democratic local government, revisions will be explored to ensure the fiscal framework is more effective at promoting efficient and equitable service delivery.

Over the last decade, municipalities have made significant strides both in building their institutions and delivering services. However, municipalities have also failed to achieve their full potential. There are many reasons for this that are not related to the fiscal framework, but finances do play an important role. Government is reviewing how the fiscal system has affected the performance of local government in the past and what reforms are needed to create the right incentives for better-performing local government.

Infrastructure transfers

National Treasury and the Department of Cooperative Governance will consult with stakeholders during 2012 to identify the cause of slow spending and uneven delivery on local government infrastructure grants. Reforms will be developed and consulted on to improve the functioning of conditional infrastructure grants.

To appropriately reform the system, a much greater focus is needed on understanding the challenges faced by different types of municipalities and how the fiscal system can help address these challenges. The differentiated approach evolving in the system of conditional grants (separate grants for rural and urban municipalities) is likely to be extended further.

Local government equitable share

National Treasury, the Department of Cooperative Governance and SALGA, with support from the FFC, have formed a workgroup to review the local government equitable share. This workgroup will develop and consult on proposals for a new local government equitable share during 2012.

Government is aware of the criticism of the local government equitable share formula and shares many of these concerns, particularly the problem of outdated data due to the time-lag between censuses. The formula review will consider these matters and proposals for a new formula will include elements that can more easily reflect changes in municipalities between censuses.

The revised local government equitable share formula must allocate resources among municipalities in a manner that better enables local government to deliver basic services to poor residents. Improving service delivery cannot, however, be achieved through changes to the equitable share formula alone. Municipalities need to prioritise basic services in their budgets and operations and support should be provided to municipalities with capacity challenges.

Municipal taxation

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

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

Municipal Property Rates Act

The Municipal Property Rates Act regulates the power of municipalities to impose rates on properties. Since the act came into operation in 2005, several implementation challenges have become apparent. The Department of Cooperative Governance has proposed amendments to the act to improve its implementation and to minimise legal ambiguities. The Municipal Property Rates Amendment Bill was published for public comment on 9 June 2011. The Department of Cooperative Governance is in the process of finalising the act’s amendments.

Municipal Fiscal Powers and Functions Act

The Municipal Fiscal Powers and Functions Act, which came into effect on 7 September 2007, deals with the regulation of all municipal taxes other than property rates. The act aims to promote predictability, certainty and transparency of municipal fiscal powers and functions, and to ensure that these powers and functions are exercised in line with the provisions of section 229 of the Constitution. The act deals with three broad issues: applications for new taxes by municipalities (section 5), national norms and standards for municipal surcharges (section 8) and verification of municipal taxes that existed prior to the act (section 12).

Application for a new municipal tax

Section 5 of the Municipal Fiscal Powers and Functions Act provides for a municipality, a group of municipalities or organised local government to apply for a new municipal tax. A municipality cannot impose any new municipal tax if that tax has not been authorised by the Minister of Finance in terms of section 5. Any application for a new tax must include reasons for the proposed tax and the manner in which the revenue from the tax will be used.

To date, two applications that comply with the requirements of section 5 of the Municipal Fiscal Powers and Functions Act have been received by National Treasury. The first application is for the introduction of a rural development levy in areas where municipalities struggle to implement the valuation rolls necessary to impose municipal rates. The other application proposes the introduction of a local business tax for businesses operating within the jurisdiction of metropolitan municipalities.

Regulation of surcharges

Section 8 of the Municipal Fiscal Powers and Functions Act, which deals with the norms and standards for imposing surcharges on municipal services, becomes effective from the date that the Minister of Finance gazettes these regulations. This section has not been activated. Surcharges currently form part of a tariff (when section 8 regulations are introduced, these will be split). Due to the interrelationship between tariffs and surcharges, the regulations applying to both are aligned.

It is important that the National Treasury's regulatory processes regarding surcharges be aligned to the regulatory processes of sector departments regarding municipal tariffs. Although most sectors have some form of regulation in place, municipal regulatory oversight roles have been limited and largely unsuccessful. Most sector departments (the Department of Energy and the Department of Water and Environmental Affairs) have instituted processes to improve their regulatory oversight responsibilities, either directly or through a regulator (for example, the National Energy Regulator of South Africa).

Authorisation of municipal taxes that existed prior to the act

According to section 12 of the Municipal Fiscal Powers and Functions Act, a municipality had to apply to the Minister of Finance by 7 September 2009 for the authorisation of taxes that existed before the act was enacted.

Municipalities provided National Treasury with the potential taxes that were levied prior the commencement of the act. Each application was assessed. Preliminary determinations on how each application should be dealt with were approved by the minister, and published in a government notice for public comment and submitted to Parliament.

Written comments on the preliminary determinations by the Minister of Finance, as published in the Government Gazette, were received from various stakeholders. Based on this consultation process, the minister gazetted the final rulings in early 2012. These rulings will be subject to review by the Minister of Finance after five years in terms of section 10(2) of the act.

Amendment of the Municipal Fiscal Powers and Functions Act

Since its implementation, certain gaps in the act were identified, which will require additions. National Treasury will review the act during 2012/13 to ensure its smooth implementation.

Sharing of the general fuel levy

The RSC and JSB levies were replaced in 2006/07 with the *RSC/JSB levies replacement grant*, which was allocated to both district and metropolitan municipalities. In 2009/10, the sharing of the general fuel levy was introduced as a permanent replacement to the former RSC and JSB levies for metropolitan municipalities. District municipalities still receive the *RSC/JSB levies replacement grant*.

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

The 2012/13 allocation takes the redemarcation that came into effect with the 2011 local government elections into consideration, which resulted in the number of metropolitan municipalities increasing from six to eight and some metropolitan's boundaries expanding. The fuel sales data, which is used to determine the metropolitan municipalities' allocations, has been updated accordingly to ensure that changes to the municipal boundaries are reflected in the fuel sales data used to calculate allocations.

The sharing of the general fuel levy is a source of municipal own revenue for metropolitan municipalities as it involves sharing a revenue source rather than the allocation of funds from national government's revenue. The sharing of the general fuel levy therefore does not form part of the Division of Revenue Bill. The fuel levy allocations are approved annually by the Minister of Finance and published in the Government Gazette, as prescribed in terms of the Taxation Laws Amendment Act (2009).