6

Provincial and municipal expenditure

In brief

- Over the next three years, after providing for debt-service costs and the contingency reserve, 47.9 per cent of nationally raised funds are allocated to national government, 43.1 per cent to provincial government and 9 per cent to local government.
- Allocations to provinces and municipalities will grow more slowly than in the past.
- Provinces have to focus on finding efficiencies and cost savings in goods and services, personnel costs, and allocations to provincial entities.
- Funding for free basic services through the local government equitable share has been protected.
- A larger proportion of funding for infrastructure in cities should come from their own resources and expanded partnerships with the private sector.

Division of revenue

Provinces and municipalities must reduce costs while improving delivery of basic services

Fiscal constraints mean that transfers to provinces and municipalities will grow more slowly in the period ahead than they have in the past. Accordingly, provincial and local governments must renew their focus on core service delivery functions and reduce costs without adversely affecting basic services. The National Treasury is working with provinces and municipalities to improve the performance of conditional grants. Similar work is being done to help cities mobilise their own revenues and borrowing to finance the infrastructure investments needed to accelerate economic growth and build a more inclusive economy.

The Constitution requires a division of nationally raised resources between national, provincial and local government. The division takes into account the powers and functions assigned to each level of government.

Provincial governments are responsible for implementing national policies for education, health, social development, agriculture, roads and human settlements. They are also responsible for their own governance and administration, including being answerable to the legislature and coordinating service delivery with local government.

Local governments are responsible for providing basic services such as water and sanitation, electricity reticulation, refuse removal, storm water management, municipal transport and roads, community services (such as parks, sport and recreation) and street lighting. They also provide free or subsidised basic services to poor households.

43.1 per cent of funds go to provincial government and 9 per cent to local government

Table 6.1 summarises the division of revenue for the 2015 Budget. These allocations are made through the Division of Revenue Bill, which is tabled with the national budget. The share of revenue allocated to each sphere remains stable over the period ahead. Over the next three years, of the funds available after providing for debt costs and the contingency reserve, 47.9 per cent are allocated to national government, 43.1 per cent to provincial government and 9 per cent to local government.

Table 6.1 Division of nationally raised revenue, 2011/12 – 2017/18

R million	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
		Outcome		Revised estimate		Medium-term estimates	
Division of available funds							
National departments	**389 376**	**420 015**	**453 171**	**491 368**	**522 992**	**553 778**	**586 087**
of which:							
Indirect transfers to provinces	700	2 315	2 693	4 116	3 458	3 596	3 967
Indirect transfers to local government	2 660	4 548	5 523	8 536	10 395	10 634	10 916
Provinces	**355 824**	**380 929**	**410 572**	**439 661**	**468 159**	**496 259**	**526 382**
Equitable share	289 628	310 741	336 495	359 922	382 673	405 265	428 893
Conditional grants	66 197	70 188	74 077	79 739	85 485	90 994	97 490
Local government	**68 251**	**76 430**	**82 836**	**89 076**	**99 753**	**103 936**	**110 017**
Equitable share	33 173	37 139	38 964	43 290	50 208	52 869	55 512
Conditional grants	26 505	30 251	34 258	35 595	38 887	39 844	42 720
General fuel levy sharing with metropolitan municipalities	8 573	9 040	9 613	10 190	10 659	11 224	11 785
Non-interest allocations	**813 451**	**877 374**	**946 579**	**1 020 105**	**1 090 904**	**1 153 973**	**1 222 486**
Percentage increase	*10.0%*	*7.9%*	*7.9%*	*7.8%*	*6.9%*	*5.8%*	*5.9%*
Debt-service costs	76 460	88 121	101 185	115 016	126 440	140 971	153 376
Contingency reserve	–	–	–	–	5 000	15 000	45 000
Main budget expenditure	**889 911**	**965 496**	**1 047 764**	**1 135 122**	**1 222 345**	**1 309 944**	**1 420 862**
Percentage increase	*11.7%*	*8.5%*	*8.5%*	*8.3%*	*7.7%*	*7.2%*	*8.5%*
Percentage shares							
National departments	*47.9%*	*47.9%*	*47.9%*	*48.2%*	*47.9%*	*48.0%*	*47.9%*
Provinces	*43.7%*	*43.4%*	*43.4%*	*43.1%*	*42.9%*	*43.0%*	*43.1%*
Local government	*8.4%*	*8.7%*	*8.8%*	*8.7%*	*9.1%*	*9.0%*	*9.0%*

Source: National Treasury

Transfers to provinces and local government are made through the equitable share and conditional grants. The equitable shares are determined by formulas that take into account demographic and developmental factors. Conditional grants are designed to achieve specific objectives, and provinces and municipalities must meet certain criteria to receive grants and fulfil conditions when spending them.

Spending patterns show improvement across national, provincial and local government

Spending has improved across national, provincial and local government. In 2013/14, national expenditure amounted to R582.6 billion (excluding direct charges) out of a total adjusted appropriation of R589 billion. This represents underspending of 1.1 per cent. Provincial government underspent its adjusted budget of R430.9 billion for 2013/14 by R6.2 billion (1.4 per cent), compared with underspending of R7.8 billion (1.9 per cent) in the previous year. Municipalities spent R19.9 billion (90.6 per cent) of their infrastructure grants in the 2013/14 municipal financial year, up from 82.2 per cent in 2012/13.

The *Explanatory Memorandum to the Division of Revenue* sets out the provincial and municipal allocations, details the equitable share formula, and explains how the division takes into account the recommendations of the Financial and Fiscal Commission. The memorandum is available as Annexure W1 of the *Budget Review* on the National Treasury website (www.treasury.gov.za).

Funding provinces

Total spending reduced by R25 billion over next two years

Transfers to provinces are made up of the provincial equitable share and conditional grants. The provincial equitable share forms the largest component of transfers to provinces, accounting for 81.8 per cent of the total medium-term allocation. Compared with the 2014 Budget projections, aggregate national spending has been reduced by a total of R25 billion over the next two years. As a result, provincial transfers will grow at a slower annual average of 6.2 per cent between 2015/16 and 2017/18 compared with 7.3 per cent between 2011/12 and 2014/15.

Table 6.2 Provincial equitable share, 2015/16 – 2017/18

R million	2015/16	2016/17	2017/18
Eastern Cape	54 312	57 368	60 069
Free State	21 757	22 775	23 979
Gauteng	73 413	78 237	83 602
KwaZulu-Natal	82 254	86 885	91 430
Limpopo	45 377	48 121	50 502
Mpumalanga	31 030	32 971	35 113
Northern Cape	10 138	10 730	11 397
North West	26 151	27 676	29 493
Western Cape	38 242	40 501	43 308
Total	**382 673**	**405 265**	**428 893**

Source: National Treasury

Growth rate of equitable share depends on population growth and demand for services

The provincial equitable share will grow at an average annual rate of 6 per cent over the medium-term expenditure framework (MTEF) period. The rate of growth varies across provinces, however, because the equitable share formula factors in differences in demand for services. Gauteng, for example, which has experienced significant in-migration, has the fastest-growing equitable share, increasing by an average of 7.1 per cent each year over the MTEF period. The slowest-growing equitable share is that of Free State, which grows at an average annual rate of 5.1 per cent because its population is growing more slowly.

Over half of revenue generated by provinces is from motor vehicle licences

Provinces also generate their own revenue, which in 2014/15 made up 3 per cent of provincial budgets and grew at an average annual rate of 12 per cent between 2010/11 and 2013/14. Over half of the revenue generated by provinces is from motor vehicle licences.

Over the past four years, growth in government spending has slowed. This trend has affected the composition of provincial budgets. Cost-saving measures put in place resulted in goods and services declining from 19.2 per cent of provincial budgets in 2010/11 to 18.7 per cent in 2013/14, and unauthorised expenditure decreasing by 65 per cent between 2009/10 and 2013/14. Additional ways to reduce costs will include, for example, requiring textbooks to be returned at the end of the school year so that only unusable textbooks are replaced in the following year.

Above-inflation wage increases mitigated by reductions in provincial headcount

Between 2010/11 and 2013/14, the share of provincial budgets taken up by compensation of employees increased from 58.4 per cent to 59.9 per cent. This was because wages in the public sector grew faster than inflation. The effect of above-inflation wage increases was particularly pronounced in health and education, which require a large number of employees to provide services. Provinces have managed this cost escalation by reducing, to the extent that it does not inhibit service delivery, the number of public servants employed. The total number of staff employed by provinces peaked at 920 826 in 2012 and declined to 915 569 in 2014.

In 1999 there were 101 provincial entities; today there are 52

Provincial entities, which deliver a range of services such as roads and economic development on behalf of provinces, were allocated a total of R8.4 billion in 2014/15. The number of entities has been reduced from 101 in 1999 to 52 at present. This has in turn reduced administration costs as functions were shifted to established departments and entities, or were consolidated to improve efficiency. Further cost-saving measures being explored include introducing a new framework to govern remuneration within these agencies.

These and other trends in provincial budgets are discussed in greater detail in the *Provincial Budgets and Expenditure Review*, available on the National Treasury’s website (www.treasury.gov.za).

Grants for education infrastructure, HIV/AIDS and libraries grow rapidly over medium term

Table 6.3 summarises conditional grants to provinces. Over the medium term these grants, which are administered and transferred by national departments to their provincial counterparts, total R274 billion. Taking into account the reductions to the baseline announced in the 2014 MTBPS, direct conditional grants to provinces still grow at a robust annual average rate of 6.9 per cent in the period ahead. Growth in some priority grants such as the *education infrastructure grant*, *comprehensive HIV and Aids grant* and *community library services grant* exceeds 12 per cent per year.

Changes to conditional grants in the 2015 Budget include the creation of a *maths, science and technology grant* to replace the *Dinaledi schools grant* and the *technical secondary schools recapitalisation grant*. The new grant will allow the Department of Basic Education to provide a more comprehensive programme of support to schools to improve teaching and learning outcomes in maths, science and technology.

The 2015 Budget also ring-fences funds within three conditional grants to provide for repairs to damage caused by the earthquake centred in the City of Matlosana in the North West in August 2014.

Provinces have continued to spend a greater proportion of their infrastructure budgets each year. In 2013/14, provincial government departments spent 92.9 per cent of their infrastructure budgets, up from 84.7 per cent in 2010/11.

Provinces spent 92.9 per cent of their infrastructure budgets in 2013/14

Table 6.3 Conditional grants to provinces, 2014/15 – 2017/18

R million	2014/15	2015/16	2016/17	2017/18	MTEF total
Direct conditional grants					
Comprehensive agricultural support programme	1 861	1 651	1 702	1 809	5 162
Ilima/Letsema projects	461	471	491	522	1 484
Community library services	1 016	1 311	1 367	1 453	4 131
Education infrastructure	7 327	9 518	9 774	10 331	29 622
HIV and AIDS (life skills education)	212	221	231	245	697
Maths, science and technology	319	347	362	385	1 095
National school nutrition programme	5 462	5 704	6 006	6 306	18 016
Provincial disaster	197	103	112	123	338
Comprehensive HIV and AIDS	12 102	13 737	15 467	17 440	46 644
Health facility revitalisation	5 502	5 276	5 473	5 817	16 565
Health professions training and development	2 322	2 375	2 477	2 632	7 483
National tertiary services	10 168	10 398	10 847	11 526	32 771
National health insurance	70	72	75	80	228
Human settlements development	17 084	18 203	19 884	21 060	59 147
Expanded public works programme integrated grant for provinces	349	351	402	424	1 176
Social sector expanded public works programme incentive for provinces	258	241	360	386	986
Mass participation and sport development	526	537	561	596	1 694
Provincial roads maintenance	9 361	9 851	10 138	10 808	30 797
Public transport operations	4 833	4 939	5 150	5 473	15 563
Other direct grants	310	181	117	74	372
Total direct conditional grants	**79 739**	**85 485**	**90 994**	**97 490**	**273 970**
Indirect transfers	**4 116**	**3 458**	**3 596**	**3 967**	**11 021**
School infrastructure backlogs	2 541	2 047	2 375	2 620	7 042
National health	1 575	1 411	1 221	1 347	3 979

Source: National Treasury

Changes in transfers to provinces due to function and funding shifts

The provincial equitable share is calculated using a formula that estimates the relative demand for services across provinces. The formula, which is explained in detail in Annexure W1 on the National Treasury website, has six weighted components. The data used are updated annually to ensure that changes in demographics and the use of public services are reflected in allocations. Conditional grant allocations are determined by national departments based on the needs of each sector.

Funding for provinces is based on the functions they perform. Changes in responsibility for functions are reflected in allocations. In 2015/16, the port health and further education and training (FET) colleges functions are moved from provinces to the national Departments of Health and Higher Education and Training respectively. As a result, R7.4 billion of the provincial equitable share and the full value of the FET colleges grant are reallocated to the relevant national departments. All those affected were fully consulted on these matters and, with advice from the Financial and Fiscal Commission, agreed with the amounts moved.

Responsibility for the Moloto Road is expected to be transferred to the South African National Roads Agency Limited (SANRAL) in 2015 to form part of its non-toll portfolio of roads. SANRAL will begin upgrading and improving safety on this notoriously dangerous road. As a result, over the MTEF period, R149 million has been reprioritised from the provincial roads maintenance grant to SANRAL.

A change in funding arrangements for the National Health Laboratory Services (NHLS) will also affect transfers to provinces. The NHLS functions for training and research, previously funded through fees charged to provinces, will be funded directly by the national Department of Health from 2015/16. To ensure this change does not affect provincial budgets, the fees charged for NHLS services will be reduced over the medium term to offset R1.7 billion taken out of provincial transfers. An audit will be conducted after the first year to ensure that the change is cost neutral to provinces.

To spur further improvements in performance, national government has introduced an incentive-based approach to allocating health and education infrastructure grants. The approach provides additional funds to provinces that exceed minimum standards for planning. As the planning process takes two years, 2015/16 will be the first time incentive funds are awarded, though provinces began submitting plans for these projects in 2013/14.

Funding local government

Poor and rural municipalities receive higher per capita transfers from national government

Local government raises revenue mainly from user charges, rates and taxes. Only a quarter of its overall spending is financed from the National Revenue Fund through the division of revenue. However, poor and rural municipalities rely heavily on national transfers because they have much lower tax bases than large cities. Consequently, government directs higher per capita transfers to poor and rural municipalities, while working with urban municipalities to leverage their own resources to increase investment in infrastructure.

Over the next three years, slower growth in conditional grants and above-inflation increases in bulk water and electricity costs mean that municipalities will have to reduce spending on non-core items and renew their focus on delivering basic services. To this end, the Minister of Cooperative Governance and Traditional Affairs has announced Back to Basics, an approach to improve the performance of local government. The approach guides municipalities in prioritising accountable and efficient service delivery to residents.

Transfers to local government

Transfers to local government make up 9 per cent of the total division of revenue over the medium term. The transfers have two components: the local government equitable share and local government conditional grants.

No reductions made to baseline of local government equitable share

The 2015 Budget maintains the baseline allocation for the local government equitable share. Improving access to basic services is a central policy priority, and the local government equitable share formula is structured to ensure that the cost of providing free basic services to indigent households is updated to account for above-inflation increases to electricity and bulk water charges. Municipalities should set tariffs at a level that will ensure that they can provide services to better-off households without incurring deficits.

Allocations to slow-spending and non-infrastructure grants have been reduced

The baseline allocation for local government conditional grants, however, has been reduced in the 2015 Budget as part of the fiscal adjustment announced in the 2014 *Medium Term Budget Policy Statement*. The reductions in 2015/16 range between 0.9 per cent and 5.5 per cent of the allocation for each grant, with larger reductions on slow-spending and non-infrastructure grants. To maintain planned outputs, grant administrators and municipalities need to spend funds efficiently.

Despite the overall reductions, the allocations for priority grants such as the *integrated national electrification programme grant* and the *municipal water infrastructure grant* grow significantly. Over the MTEF period, the former grows at an average annual rate of 14.9 per cent and the latter at an average annual rate of 52.2 per cent, including both direct and indirect grant allocations.

A new grant has also been introduced to subsidise the costs of municipalities that will be merged before the 2016 local government elections. This grant is allocated R139 million over the period ahead for municipalities that are being combined in KwaZulu-Natal and Gauteng. The Municipal Demarcation Board is considering further boundary changes proposed by the Minister of Cooperative Governance and Traditional Affairs. The effect of these potential changes will be considered as part of the 2016 budget process.

Review of local government infrastructure grants

Number of conditional grants will be reduced to ease reporting burden

Together with the Department of Cooperative Governance, Department of Planning, Monitoring and Evaluation, the South African Local Government Association, and the Financial and Fiscal Commission, the National Treasury is conducting a review of the local government infrastructure grant system. The first phase of the review, completed in 2014, identified two necessary reforms that will be made in 2015/16:

- The rules in *the municipal infrastructure grant* will be amended to allow funds to be used to refurbish and replace infrastructure, but only if municipalities demonstrate that assets have been maintained on a regular basis. Maintenance must be budgeted for as part of the normal business of municipalities. While the grant continues to provide for new infrastructure, there is also a need to make major improvements on systems and equipment nearing the end of their lifespan.
- The number of conditional grants will be reduced to ease the burden of grant reporting. Two public transport grants will merge in 2015/16 into a single *public transport network grant*. The number of water and sanitation grants is also likely to be reduced from 2016/17.

The next phase of the review, in 2015, will take the principles and broad outline of the grant system already agreed to in the first phase and use these to implement detailed changes to individual grants. It is likely that there will be additional consolidation of infrastructure grants to municipalities, and that these grants will be restructured to respond to the challenges facing different types of municipalities – from poor rural areas to major cities.

Municipal standard chart of accounts

Standard chart of accounts to roll out to all municipalities in 2016/17

Implementing a standard classification of municipal expenditure will improve transparency in local government accounting and enable greater comparability between budgets, enhancing the ability of national and provincial treasuries to monitor municipal spending. The National Treasury is currently piloting the standard chart of accounts in 18 areas and plans to roll out the chart to all municipalities in 2016/17.

Table 6.4 Transfers to local government, 2011/12 – 2017/18

	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
		Outcome		Revised		Medium-term estimates	
R million				estimate			
Equitable share and related	**33 173**	**37 139**	**38 964**	**43 290**	**50 208**	**52 869**	**55 512**
General fuel levy sharing with metros	**8 573**	**9 040**	**9 613**	**10 190**	**10 659**	**11 224**	**11 785**
Direct conditional grants	**26 505**	**30 251**	**34 258**	**35 595**	**38 887**	**39 844**	**42 720**
Municipal infrastructure	11 443	13 879	14 224	14 429	14 956	15 548	16 435
Municipal water infrastructure	–	–	602	536	1 804	1 186	1 773
Urban settlements development	6 267	7 392	9 077	10 285	10 554	11 076	11 708
Integrated national electrification programme	1 097	1 151	1 635	1 105	1 980	2 036	2 197
Public transport network infrastructure	4 612	4 884	5 550	5 871	5 953	6 163	6 610
Neighbourhood development partnership	738	578	586	591	607	624	663
Integrated city development	–	–	40	255	251	267	292
Water services operating subsidy	542	562	421	450	453	466	502
Expanded public works programme integrated grant for municipalities	364	662	611	595	588	664	716
Municipal demarcation transition	–	–	–	–	39	50	50
Local government financial management	385	403	425	449	452	465	502
Other direct grants	1 057	739	1 088	1 031	1 249	1 300	1 270
Total direct transfers	**68 251**	**76 430**	**82 836**	**89 076**	**99 753**	**103 936**	**110 017**
Indirect transfers	**2 660**	**4 548**	**5 523**	**8 536**	**10 395**	**10 634**	**10 916**
Integrated national electrification programme	1 165	1 879	2 141	2 948	3 613	3 776	3 946
Regional bulk infrastructure	1 260	2 523	3 261	4 005	4 922	5 324	4 855
Municipal water infrastructure	–	–	–	559	792	1 512	2 087
Other indirect grants	234	145	120	1 023	1 069	22	28

Source: National Treasury

Shaping urban development to support growth in cities

A greater share of funding for infrastructure to come from resources generated by cities themselves

The 2015 Budget begins a process of realigning public expenditure to support spatial restructuring in urban areas. South Africa's cities continue to reflect the spatial legacy of apartheid, which impedes economic growth.

Presently, 53.7 per cent of capital financing for cities comes from national government, which has over the past decade rapidly increased its transfers of infrastructure grants. In some cities these grants have displaced locally generated sources of infrastructure funding. Given fiscal constraints, the 2015 Budget does not significantly increase infrastructure grants to cities over the medium term.

In these circumstances, a greater share of the capital investment needed to transform cities needs to come from revenues generated by metropolitan municipalities themselves, in partnership with the private sector. Over the period ahead, government will use the fiscal framework and other tools at its disposal to encourage cities to use more of their own resources to expand and accelerate their investment programmes, drawing in private capital to complement these efforts.

Supporting cities to accelerate growth and integrated development

Working with the Cities Support Programme, metropolitan municipalities have identified and sequenced investments to build more integrated cities. Projects being prepared or implemented include actions to release strategically located land; provide, rehabilitate or upgrade bulk infrastructure; and develop affordable housing and public transport that will support the development of mixed-use precincts. Projects under way include:

- A “corridor of freedom” along Louis Botha Avenue in Johannesburg, where investments of R531 million will expand the Rea Vaya bus rapid transit system, develop the Watt Street transport interchange and pedestrian infrastructure, build inclusive social housing, expand and refurbish bulk infrastructure networks, improve public spaces in the Patterson Park and Balfour Park precincts, and refurbish the Orchards and Thoko Ngoma clinics.
- The Metro South East Corridor in Cape Town, where the MyCiti bus service complements the commuter rail modernisation programme. Integrated land, infrastructure and precinct development projects in Athlone, Langa, Philippi, Khayelitsha and Mitchells Plain are being prepared. These projects are being supported by upgrades to sewerage and electricity infrastructure, along with community facilities such as libraries. Alongside extensive investments to upgrade informal settlements are plans to develop 6 000 high-density social housing units in Manenberg, Hanover Park, Heideveld, Marble Flats and Langa.
- Cornubia, a mixed-income commercial and residential development in eThekwini, is under construction. A total of 28 500 housing units, 18 clusters of community facilities and 2.3 million square metres of commercial floor space are planned. The city has also developed a densification plan to complement commuter rail modernisation between Umlazi and Bridge City. Private-sector contributions will amount to R15.4 billion of the total development cost of R25.8 billion. To date, 2 668 subsidised houses have been completed and 80 hectares of serviced industrial and commercial land successfully launched, with two transport interchanges under construction. It is estimated that 387 000 construction jobs will be created and 43 000 permanent jobs sustained over 15-20 years, while the city will benefit from R240 million in additional property tax contributions annually.

Flexible grant system and performance-based infrastructure allocations

The National Treasury will introduce a new fiscal package to help large cities mobilise the resources necessary to implement strategic investment projects. All participating metros will be expected to make measurable commitments to good governance, and effective revenue and expenditure management. The National Treasury will continue to work closely with these municipalities to address specific obstacles to project implementation as they arise. The new package includes:

- Modifying the infrastructure grant system to support the development of mixed-use, mixed-income precincts. Reforms will include reducing the number of grants, introducing more flexible grant conditions and increasing the certainty of transfers over a longer time period. As a result, cities will be able to vary their long-term infrastructure-funding and borrowing strategies to scale up investment levels through a mix of grants, own revenues and private resources. These modifications will be coupled with performance-based allocations to reward cities that demonstrate progressive changes in their urban form, improve access to basic services, reduce barriers to social and economic opportunity, and improve mobility for urban residents.
- Refocusing the Neighbourhood Development Partnership Programme to support the development of economic hubs in large urban townships.
- Reforming the system of development charges to improve fairness and transparency, and reduce delays in infrastructure provision for private land developments.
- Expanding opportunities for private investment in municipal infrastructure through the Development Bank of Southern Africa increasing its origination of longer-term loans, packaging pooled

finance instruments and, where appropriate, supporting the introduction of new lending instruments such as revenue bonds.

- Reviewing the sustainability of existing own-revenue sources for metropolitan municipalities, particularly in light of their expanding responsibilities in public transport and human settlements.

Infrastructure delivery management system is being expanded

The infrastructure delivery management system used by national and provincial governments is also currently being expanded to cities to help them manage the implementation of these projects.