W1

2023 BUDGET REVIEW

EXPLANATORY MEMORANDUM TO THE DIVISION OF REVENUE

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

EXPLANATORY MEMORANDUM TO THE DIVISION OF REVENUE

BACKGROUND

Section 214(1) of the Constitution requires that the nationally raised revenue be divided equitably between national government, the nine provinces and 257 municipalities. This is outlined in the annual Division of Revenue Act. The division of revenue takes into account the powers and functions assigned to each sphere; fosters transparency, predictability and stability; and is at the heart of constitutional cooperative governance.

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

This explanatory memorandum to the 2023 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 the bill takes account of each of the matters listed in section 214(a) to (j) of the Constitution; government's response to the FFC's recommendations submitted to the minister in terms of section 9 of the act or as a result of consultations with the FFC; and any assumptions and formulas used in arriving at the respective shares. Moreover, this memorandum complements the discussion on the division of revenue in Chapter 6 of the *Budget Review*. It has six sections:

- Part 1 lists the factors that inform the division of resources between national, provincial and local government.
- Part 2 describes the 2023 division of revenue.
- Part 3 sets out how the FFC's recommendations on the 2023 division of revenue have been taken into account.
- Part 4 explains the formula and criteria for dividing the *provincial equitable share* and conditional grants among provinces.
- Part 5 sets out the formula and criteria for dividing the *local government equitable share* and conditional grants among municipalities.
- Part 6 summarises issues that will form part of subsequent reviews of provincial and local government fiscal frameworks.

The Division of Revenue Bill and its underlying allocations are the result of extensive consultation between national, provincial and local government. The Budget Council deliberated on the matters discussed in this memorandum at several meetings during the year. The approach to local government allocations was discussed with organised local government at technical meetings with the South African Local Government Association (SALGA), culminating in meetings of the Budget Forum (made up of the Budget Council and SALGA). The division of revenue, along with the government priorities that underpin it, was agreed for the next three years at a Cabinet meeting in October 2022.

PART 1: CONSTITUTIONAL CONSIDERATIONS

Section 214 of the Constitution requires that the annual Division of Revenue Act be enacted after 10 key principles outlined in sub-sections 2(a) to (j) are considered. The 10 constitutional principles considered in the 2023 division of revenue are briefly noted below.

NATIONAL INTEREST AND THE DIVISION OF RESOURCES

The National Development Plan sets out the national interest by outlining a long-term vision for the country through which South Africa can advance inclusive economic transformation. To achieve this vision, South Africa needs to use the division of resources in a manner that draws on the energies of its people; builds and grows an inclusive economy; builds capabilities; enhances the capacity of the state; and promotes leadership and partnerships throughout society. The 2019–2024 Medium Term Strategic Framework outlines the plan and outcome-based monitoring framework for implementing South Africa's national development priorities for the sixth administration.

In the 2022 *Medium Term Budget Policy Statement* (MTBPS), the Minister of Finance outlined how the resources available to government over the 2023 medium-term expenditure framework (MTEF) period would be allocated to help address government's areas of immediate focus. These focus areas are as follows:

- Achieve fiscal sustainability by narrowing the budget deficit and stabilising debt.
- Promote economic growth by increasing spending on policy priorities such as security and infrastructure.
- Reduce fiscal and economic risks, including through targeted support to key public entities and building fiscal buffers against future shocks.

These focus areas have informed the division of resources between the three spheres of government over the 2023 MTEF period. Chapter 4 of the 2022 MTBPS and Chapters 5 and 6 of the 2023 *Budget Review* discuss how funds have been allocated across the three spheres of government based on these focus areas. The framework for each conditional grant also notes how the grant is linked to government's 14 priority outcomes.

PROVISION FOR DEBT COSTS

The resources shared between national, provincial and local government include proceeds from national government borrowing used to fund public spending. Gross loan debt is expected to increase from R4.73 trillion (71.1 per cent of GDP) in 2022/23 to R5.06 trillion (72.8 per cent of GDP) in 2023/24 and will peak at R5.84 trillion (73.6 per cent of GDP) in 2025/26. To protect and maintain the country's integrity and credit reputation, it is important that national government provide for the resulting debt costs. Chapter 7 of the 2023 *Budget Review* provides a more detailed discussion.

NATIONAL GOVERNMENT'S NEEDS AND INTERESTS

The Constitution assigns exclusive and concurrent powers and functions to each sphere of government. National and provincial government have concurrent responsibility for a range of functions, such as school education, health services, social welfare services, housing and agriculture. For these functions, national government is mainly responsible for providing leadership, formulating policy (including setting norms and standards) and providing oversight and monitoring, while provincial government is mainly responsible for implementation in line with the nationally determined framework.

National government is exclusively responsible for functions that serve the national interest and are best centralised, including national defence, the criminal justice system (safety and security, courts), higher education and administrative functions (home affairs, collection of national taxes). Provincial and local government receive equitable shares and conditional grants to enable them to provide basic services and perform their functions. Functions may shift between spheres of government in line with legislative prescripts to better meet the country's needs, which is then reflected in the division of revenue. Changes continue to be made to various national transfers to provincial and local government to improve their efficiency, effectiveness and alignment with national strategic objectives.

PROVINCIAL AND LOCAL GOVERNMENT BASIC SERVICES

Provinces and municipalities are responsible for providing education, health, social development, housing, roads, electricity and water, and municipal infrastructure services. They have the autonomy to allocate resources to meet basic needs and respond to provincial and local priorities, while giving effect to national objectives. The division of revenue provides equitable shares to provinces and local government to enable them to meet their basic service obligations. In addition, conditional grants are provided to enable them to improve and expand services.

Over the 2023 MTEF period, R2.69 trillion or 51.3 per cent of non-interest spending is allocated to provinces and local government. Of this, R2.17 trillion or 41.5 per cent is allocated to provinces, while R521.7 billion or 10 per cent is allocated to local government. This is to continue funding local and provincial government priorities over the medium term, which include health, education and basic services, and funding the rising costs of these services as a result of population growth and higher bulk electricity and water costs.

FISCAL CAPACITY AND EFFICIENCY

Fiscal capacity refers to the revenue-raising power of each sphere of government. National government has limited revenue-raising powers and large spending responsibilities. As such, it receives the biggest share of the nationally raised revenue, after taking into account the contingency reserve and debt-servicing costs. Provinces have limited revenue-raising capacity and large spending responsibilities so they receive the second largest share of nationally raised revenue. Municipalities, on the other hand, have extensive revenue-raising powers, through property rates, user charges and fees. The revenue raised by municipalities provides for basic services such as sanitation, waste management, electricity and water, the costs of which can be recovered through tariffs. As a result, local government finances most of its expenditure through property rates, user charges and fees.

The ability of individual municipalities to raise revenue varies greatly – rural municipalities raise significantly less revenue than large urban and metropolitan municipalities. The design of the local government fiscal framework acknowledges that, as a result of their lower own revenue-raising capacity, many rural municipalities will depend on transfers for most of their funding. This is done through the local government equitable share formula, which incorporates a revenue adjustment factor that considers the fiscal capacity of each recipient municipality (full details of the formula are provided in Part 5 of this annexure).

The mechanisms for allocating funds to provinces and municipalities are regularly reviewed to improve their efficiency. To maximise the effect of allocations, conditional grant allocations to provincial and local government are informed by the recipient's efficacy and efficiency in using allocations in the past.

DEVELOPMENTAL NEEDS

Developmental needs are accounted for at two levels. First, in determining the division of revenue, which mostly grows the provincial and local government shares of nationally raised revenue faster than inflation, and second, in the formulas used to divide national transfers among municipalities and provinces. Developmental needs are built into the equitable share formulas for provincial and local government and included in specific conditional grants, such as the *municipal infrastructure grant*, which allocates funds according to the number of households in a municipality without access to basic services. Various infrastructure grants and the capital budgets of provinces and municipalities aim to boost economic and social development.

ECONOMIC DISPARITIES

The equitable share and infrastructure grant formulas redistribute funds towards poorer provinces and municipalities (parts 4 and 5 of this annexure provide statistics illustrating this). Through the division of revenue, government continues to invest in economic infrastructure (such as roads), allocating R107.2 billion over the 2023 MTEF period, and social infrastructure (such as schools, hospitals and clinics), allocating R262.3 billion over the 2023 MTEF period. This is to stimulate economic development, create jobs and address economic and social disparities.

OBLIGATIONS IN TERMS OF NATIONAL LEGISLATION

The Constitution gives provincial governments and municipalities the power to determine priorities and allocate budgets. National government is responsible for developing policy, fulfilling national mandates, setting national norms and standards for provincial and municipal functions, and monitoring the implementation of concurrent functions.

The 2023 MTEF, through the division of revenue, continues to fund the delivery of provincial, municipal and concurrent functions through a combination of conditional and unconditional grants.

PREDICTABILITY AND STABILITY

Provincial and local government equitable share allocations are based on estimates of nationally raised revenue. If this revenue falls short of estimates within a given year, the equitable shares of provinces and local government will not be reduced. Allocations are assured (voted, legislated and guaranteed) for the first year and are transferred according to a payment schedule. To contribute to longer-term predictability and stability, estimates for a further two years are published with the annual proposal for appropriations. Adjusted estimates as a result of changes to data underpinning the equitable share formulas and revisions to the formulas themselves are phased in to ensure minimal disruption.

FLEXIBILITY IN RESPONDING TO EMERGENCIES

Government has a contingency reserve for unforeseen and unavoidable events. In addition, two conditional grants for disasters and housing emergencies (*provincial disaster response grant* and *municipal disaster response grant*) allow government to allocate and transfer funds to affected provinces and municipalities in the immediate aftermath of a disaster. Over the 2023 MTEF period, R1.6 billion is allocated to these grants. Furthermore, various pieces of legislation, such as sections 16 and 25 of the Public Finance Management Act (1999), provide for the allocation of funds (including adjustment allocations) to deal with emergency, unforeseeable and unavoidable situations. 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 2023 DIVISION OF REVENUE

Medium-term fiscal policy is focused on reducing the budget deficit and stabilising the debt-to-GDP ratio. Over the medium term, restoring fiscal sustainability requires continued restraint in expenditure growth and reforms to raise economic growth. The 2023 Budget proposes:

- Additional allocations to address immediate spending pressures, including extending the *COVID-19 social relief of distress grant* for 12 months until March 2024, and bolstering provincial transfers for health and education.
- Setting aside a portion of higher-than-expected revenue to narrow the budget deficit. This mitigates the impact of higher interest rates on debt-service costs and improves the longer-term debt outlook.
- Supporting economic growth through a range of reforms, including the infrastructure-build programme financed through innovative funding mechanisms and supported by improved technical capabilities (see Chapter 3 of the 2023 *Budget Review*).

The most important public spending programmes that help poor South Africans, contribute to growth and create jobs have been protected from major reductions. The 2023 division of revenue reprioritises existing funds to ensure these objectives are met.

Excluding debt-service costs and the contingency reserve, allocated expenditure shared across government amounts to R1.70 trillion in 2023/24, R1.74 trillion in 2024/25 and R1.82 trillion in 2025/26. The division of these funds between the three spheres takes into account government's spending priorities, each sphere's revenue-raising capacity and responsibilities, and input from various intergovernmental forums and the FFC. The provincial and local equitable share formulas are designed to ensure fair, stable and predictable revenue shares, and to address economic and fiscal disparities.

INCREASE IN NON-INTEREST SPENDING

Given the improved tax revenue estimates experienced in 2022/23 and projected increases in tax revenue over the 2023 MTEF period, government proposes a small increase in non-interest spending compared with the 2022 Budget projections. Total main budget non-interest expenditure is projected to increase by R128.4 billion over the 2023 MTEF period as follows: R37.1 billion in 2023/24, R42.1 billion in 2024/25 and R49.3 billion in 2025/26.

Several provincial and local government infrastructure grants that are likely to go unspent based on historical spending trends are being reprioritised to other priorities. Parts 4 and 5 of this annexure set out in more detail how the changes to the baseline affect provincial and local government transfers.

REPRIORITISATIONS

Existing budgets need to be reprioritised to meet government's policy goals while remaining within the revised expenditure ceiling.

These reprioritisations complement baselines that provide R2.17 trillion to provinces and R521.7 billion to local government in transfers over the 2023 MTEF period. These transfers fund core policy priorities, including basic education, health, social development, roads, housing and municipal services.

THE FISCAL FRAMEWORK

Table W1.1 presents the medium-term macroeconomic forecasts for the 2023 Budget. It sets out the growth assumptions and fiscal policy targets on which the fiscal framework is based.

Table W1.1 Medium-term macroeconomic assumptions

R billion/percentage of GDP	2022/23		2023/24		2024/25		2025/26
	2022 Budget	2023 Budget	2022 Budget	2023 Budget	2022 Budget	2023 Budget	2023 Budget
Gross domestic product	6 441.3	6 651.3	6 805.3	7 005.7	7 233.7	7 452.4	7 938.5
Real GDP growth	*1.9%*	*2.0%*	*1.7%*	*1.0%*	*1.8%*	*1.7%*	*1.9%*
GDP inflation	*1.1%*	*3.7%*	*3.9%*	*4.3%*	*4.5%*	*4.6%*	*4.6%*
National budget framework							
Revenue	**1 588.0**	**1 703.6**	**1 660.2**	**1 759.2**	**1 774.2**	**1 868.1**	**2 007.7**
Percentage of GDP	*24.7%*	*25.6%*	*24.4%*	*25.1%*	*24.5%*	*25.1%*	*25.3%*
Expenditure	**1 975.3**	**2 004.0**	**1 992.0**	**2 034.6**	**2 096.6**	**2 137.9**	**2 266.5**
Percentage of GDP	*30.7%*	*30.1%*	*29.3%*	*29.0%*	*29.0%*	*28.7%*	*28.6%*
Main budget balance[1]	**-387.2**	**-300.4**	**-331.8**	**-275.4**	**-322.4**	**-269.9**	**-258.8**
Percentage of GDP	*-6.0%*	*-4.5%*	*-4.9%*	*-3.9%*	*-4.5%*	*-3.6%*	*-3.3%*

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

Table W1.2 sets out the division of revenue for the 2023 MTEF period after accounting for new policy priorities.

Table W1.2 Division of nationally raised revenue

R million	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
	Outcome			Revised estimate	Medium-term estimates		
Division of available funds							
National departments	**749 797**	**790 545**	**822 956**	**854 446**	**828 572**	**835 665**	**877 920**
of which:							
Indirect transfers to provinces	*2 927*	*2 886*	*3 670*	*4 612*	*4 178*	*4 447*	*4 763*
Indirect transfers to local government	*5 565*	*4 100*	*5 702*	*7 172*	*8 481*	*8 862*	*9 259*
Provinces	**613 450**	**628 777**	**660 799**	**694 598**	**695 072**	**720 463**	**754 672**
Equitable share	505 554	520 717	544 835	570 868	567 528	587 500	614 271
Conditional grants	107 896	108 060	115 964	123 730	127 544	132 963	140 402
Local government	**122 986**	**137 098**	**135 625**	**147 786**	**163 972**	**174 382**	**183 330**
Equitable share	65 627	83 102	76 169	83 711	96 546	103 772	109 368
Conditional grants	44 191	39 969	44 839	48 740	51 992	54 484	57 113
General fuel levy sharing with metros	13 167	14 027	14 617	15 335	15 433	16 127	16 849
Provisional allocation not assigned to votes[1]	–	–	–	–	1 505	3 901	3 977
Non-interest	**1 486 233**	**1 556 420**	**1 619 380**	**1 696 829**	**1 689 120**	**1 734 411**	**1 819 899**
Percentage increase	*12.2%*	*4.7%*	*4.0%*	*4.8%*	*-0.5%*	*2.7%*	*4.9%*
Debt-service costs	204 769	232 596	268 072	307 157	340 460	362 840	397 074
Contingency reserve	–	–	–	–	5 000	5 000	5 000
Unallocated reserve	–	–	–	–	–	35 693	44 533
Main budget expenditure	**1 691 002**	**1 789 016**	**1 887 451**	**2 003 986**	**2 034 580**	**2 137 945**	**2 266 506**
Percentage increase	*12.2%*	*5.8%*	*5.5%*	*6.2%*	*1.5%*	*5.1%*	*6.0%*
Percentage shares							
National department	*50.4%*	*50.8%*	*50.8%*	*50.4%*	*49.1%*	*48.3%*	*48.3%*
Provinces	*41.3%*	*40.4%*	*40.8%*	*40.9%*	*41.2%*	*41.6%*	*41.6%*
Local government	*8.3%*	*8.8%*	*8.4%*	*8.7%*	*9.7%*	*10.1%*	*10.1%*

1. Infrastructure fund and other provisional allocations
Source: National Treasury

Table W1.3 shows how changes to the baseline are spread across government. The new focus areas are accommodated by small increases in non-interest spending.

Table W1.3 Changes over baseline

R million	2023/24	2024/25
National departments	57 662	30 003
Provinces	27 762	30 306
Local government	3 458	4 235
Allocated expenditure	**88 882**	**64 544**

Source: National Treasury

Table W1.4 sets out schedule 1 of the Division of Revenue Bill, which reflects the legal division of revenue between national, provincial and local government. In this division, the national share includes all conditional grants to provinces and local government in line with section 214(1) of the Constitution, and the allocations for each sphere reflect equitable shares only.

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

R million	2023/24	2024/25	2025/26
	Allocation	Forward estimates	
National[1]	1 370 506	1 446 673	1 542 867
Provincial	567 528	587 500	614 271
Local	96 546	103 772	109 368
Total	**2 034 580**	**2 137 945**	**2 266 506**

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

The 2023 *Budget Review* sets out in detail how constitutional considerations and government's priorities are taken into account in the division of revenue. It describes economic and fiscal policy considerations, revenue issues, debt and financing considerations, and expenditure plans. Chapter 6 focuses on provincial and local government financing.

PART 3: RESPONSE TO THE FFC'S RECOMMENDATIONS

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

- "An equitable division of revenue raised nationally, among the national, provincial and local spheres of government;
- the determination of each province's equitable share in the provincial share of that revenue; and
- any other allocations to provinces, local government or municipalities from the national government's share of that revenue, and any conditions on which those allocations should be made."

The act requires that the FFC table these recommendations at least 10 months before the start of each financial year. The FFC tabled its *Submission for the Division of Revenue 2023/24* to Parliament in May 2022. This year's theme is "Addressing socio-economic vulnerabilities through fiscal transparency and strategy". The 2023/24 recommendations cover the following areas: strategies for preventing corruption in the public sector and funding for anti-corruption agencies; youth unemployment and intergovernmental fiscal relations; debt sustainability in South Africa; inequality in South Africa's labour market; social grants; public-sector wage bill;

provincial equitable share formula; system of provincial conditional grants; constitutional right to basic education; effectiveness of independent fiscal institutions; and powers, functions and funding framework of district municipalities.

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

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

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

Government's responses to the first and second categories are provided below. Recommendations that do not relate to the division of revenue are normally referred to the officials to whom they were addressed, who are requested to respond directly to the FFC. All the FFC recommendations can be accessed at www.ffc.co.za.

RECOMMENDATIONS THAT APPLY DIRECTLY AND INDIRECTLY TO THE DIVISION OF REVENUE

CHAPTER 7: A REVIEW OF THE PROVINCIAL EQUITABLE SHARE FORMULA – RESPONSIVENESS TO THE CHANGING SOCIAL STRUCTURE

Review of provincial equitable share formula

The FFC recommends the following: "In line with the Commission's recommendation on a costed norms approach, full costing exercises should be undertaken by all provinces, particularly for the provision of education and health. The costing results will be used to determine allocations by provinces to these key functional areas. This will ensure consistency and fully informed resource allocation."

Government response

The Technical Committee on Finance Lekgotla held in June 2022 recommended that provinces review the service model or options that are best suited to the uniqueness of each province. In addition, provinces were recommended to investigate other methodologies that can be used to allocate the provincial equitable share (PES) while maintaining the principles embedded in the PES allocation.

Alignment of infrastructure delivery plans and programmes

The FFC recommends the following: "The national Department of Basic Education, as a custodian of conditional grants (particularly indirect grants and being responsible for capital spending), and all provincial departments of Basic Education, as recipients of the PES and being responsible for school infrastructure delivery and maintenance, should improve the coordination of infrastructure delivery plans and programmes to ensure alignment."

Government response

In line with its oversight role, the National Treasury, alongside the Department of Basic Education and the provincial treasuries, will monitor the coordination and alignment of infrastructure delivery plans and programmes.

CHAPTER 8: REPURPOSING AND REALIGNING THE SYSTEM OF PROVINCIAL CONDITIONAL GRANTS

Review of conditional grants scheduling

The FFC recommends the following: "National Treasury, in conjunction with the national departments responsible for conditional grants, must revise the Division of Revenue Act's system of grant scheduling as it creates no fiscal incentives for provinces to reveal their expenditure preferences or sustain expenditure previously funded by conditional grants. Instead, government must invest the capacity to improve overall grant design, taking account of all good grant design imperatives, such as types of grants and their implications, pre-grant introductory due diligence, sunset clauses, conditioning schemes and allocation methodologies."

GOVERNMENT RESPONSE

The National Treasury, in collaboration with provincial treasuries and sector departments, is reviewing all conditional grants to determine if the existing grant system is structured efficiently to provide efficient service delivery, roll out infrastructure, build capacity, and provide operational support.

ALIGNMENT OF OUTPUTS, OBJECTIVES AND OUTCOMES

The FFC recommends the following: "National Treasury, in conjunction with the national departments responsible for conditional grants, should undertake three-yearly reviews of their respective grants to ensure alignment across grant objectives, conditions and grant outcomes. These reviews must be informed by an overarching conditional grants guideline, setting out the circumstances under which grants are introduced and terminated, applicable minimum and type conditions, and the applicable minimum outputs. Further, there should be a mandatory grant introduction and termination pre-assessment by the Financial and Fiscal Commission to determine suitability, impact on the fiscal framework and overall grant outcome. Grant conditions are generally administrative, while the outputs are seemingly unconnected to the long-run outcomes."

GOVERNMENT RESPONSE

In collaboration with grant-administering sector departments and provinces, the National Treasury is reviewing conditional grants in the system and will examine ways to tighten the requirements for introducing grants, designing them, and phasing them out or closing them out as part of this process.

ALLOCATION CRITERIA

The FFC recommends the following: "The Department of Basic Education, in conjunction with National Treasury, must update the allocation formula for the Education Infrastructure Grant to ensure the alignment of grant needs indicators with grant objectives and further streamline expected and reported grant outputs to improve focus and ease of monitoring. At the very least, the allocation criteria may include learner enrolment, learner densities by area, index of schools with access to learning infrastructure and travel time to schools. The actual formula must be published in the grant framework for transparency purposes."

GOVERNMENT RESPONSE

The conditional grant review is examining the allocation criteria used to determine each province or municipality's share of a grant.

COMPARTMENTALISATION OF CONDITIONAL GRANTS

The FFC recommends the following: "The Department of Health and other custodians of grants with multiple components must halt the over-compartmentalisation of provincial health responsibilities through multiple grant funding windows unrelated to the main objective of the main grant. Conditional grants must, as a matter of principle, accommodate not more than two sub-components or take the shape of a traditional block grant to allow provinces the flexibility to prioritise within the set sub-functional responsibility. Sub-components that are unrelated to the main grant objective must be incorporated into the *provincial equitable share* and be monitored through the normal budget and accountability system instead of subdividing or itemising provincial health responsibilities to be funded by grant sub-components. The formulae for the newly restructured HIV/AIDS grant must be published in the grant framework for transparency purposes."

GOVERNMENT RESPONSE

The *HIV, TB, malaria and community outreach grant* has been renamed the *district health programmes grant* and its components reduced to two. The grant review will identify grants and functions that need to be shifted to the *provincial equitable share*.

CHAPTER 11: DISTRICT MUNICIPALITIES: POWERS, FUNCTIONS AND FUNDING FRAMEWORK

EFFECTIVENESS OF INDEPENDENT FISCAL INSTITUTIONS

The FFC recommends the following: "National Treasury should immediately abolish the Regional Services Council Replacement Grant and combine the Local Government Equitable Share for district municipalities and the Regional Services Council Replacement Grant under one funding instrument."

GOVERNMENT RESPONSE

Abolishing the *Regional Services Council replacement grant* and including its baseline in the local government equitable share baseline will negatively affect the finances of district municipalities without the water and sanitation function, as this grant is their main source of revenue.

The redesign of the funding framework for district municipalities must align with the outcomes of the Department of Cooperative Governance's ongoing review of sections 84 and 85 of the Municipal Structures Act (1998), which aims to address the current ambiguity in the functions performed by local and district municipalities. Designing a new funding formula based on the review's outcomes will require consultation with all district municipalities. In addition, the new funding formula should be based on a realistic costing of the core functions of all districts, which will require extensive technical work. Introducing a revised funding framework in the 2023 Division of Revenue Bill is thus unfeasible.

PART 4: PROVINCIAL ALLOCATIONS

Provincial government receives two forms of allocations from nationally raised revenue, the equitable share and conditional grants. Sections 214 and 227 of the Constitution require that an equitable share of nationally raised revenue be allocated to provincial government to provide basic services and perform its allocated functions. The equitable share is an unconditional transfer to provinces and constitutes their main source of revenue. Due to their limited revenue-raising abilities, provinces receive 41.5 per cent of nationally raised revenue over the medium term. In addition, they receive conditional grants to help them fulfil their mandates. Transfers to provinces account for over 97 per cent of provincial revenue.

This section outlines national transfers to provinces for the 2023 MTEF period announced in the 2022 MTBPS and changes that were effected after it was tabled, both to the equitable share and conditional grants. Having taken the revisions to the provincial fiscal framework into account, national transfers to provinces increase from R694.6 billion in 2022/23 to R695.1 billion in 2023/24. Over the MTEF period, provincial transfers will grow at an average annual rate of 2.8 per cent to R754.7 billion in 2025/26. Table W1.5 sets out the transfers to provinces for 2023/24. A total of R567.5 billion is allocated to the *provincial equitable share* and R127.5 billion to conditional grants, which includes an unallocated amount of R146 million for the *provincial disaster response grant*.

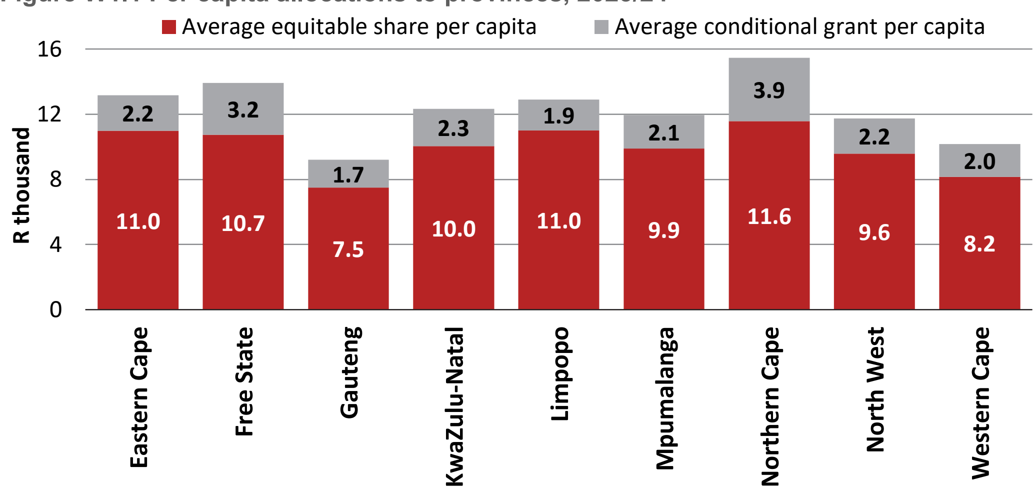
Table W1.5 Total transfers to provinces, 2023/24

R million	Equitable share	Conditional grants	Total transfers
Eastern Cape	73 292	14 637	87 928
Free State	31 380	9 280	40 660
Gauteng	120 752	27 437	148 189
KwaZulu-Natal	115 948	26 320	142 267
Limpopo	65 349	11 329	76 678
Mpumalanga	46 674	9 734	56 408
Northern Cape	15 150	5 095	20 245
North West	40 096	9 093	49 190
Western Cape	58 886	14 474	73 360
Unallocated		146	146
Total	**567 528**	**127 544**	**695 072**

Source: National Treasury

The provincial fiscal framework takes account of the different pressures facing each province and allocates larger per capita allocations to poorer provinces, and provinces with smaller populations.

Figure W1.1 Per capita allocations to provinces, 2023/24



Source: National Treasury

CHANGES TO PROVINCIAL ALLOCATIONS

For the 2023 MTEF period, revisions to the provincial fiscal framework reflect additions, shifting of funds to national government following the closure of the *housing emergency grant* and realignment of Budget Facility for Infrastructure (BFI) funding to align with the required cash flows. Table W1.6 provides a summary of the changes to the provincial fiscal framework.

Additional funding was added to the *provincial equitable share* over the next three years. This includes R20 billion to help provincial education departments cover shortfalls in compensation budgets within the sector (R5.7 billion in 2023/24, R6.7 billion in 2024/25 and R7.6 billion in 2025/26). An additional R23.5 billion (made up of R7.5 billion in 2023/24, R7.8 billion in 2024/25 and R8.1 billion in 2025/26) is added for provincial health departments for compensation of employees, healthcare services backlogs including antiretroviral therapy and TB, laboratory services, medicine and other goods and medical supplies.

After the tabling of the 2022 MTBPS, additional funding was added to the *provincial equitable share* over the 2023 MTEF period. This consists of R31.1 billion for the carry through costs following the implementation of the 2022/23 public-service wage (R10.2 billion in 2023/24, R10.4 billion in 2024/25 and R10.5 billion in 2025/26). An amount of R1.8 billion is added through the BFI for the Coega Special Economic Zone for building a new bulk sewer connection pipeline, upgrading bulk infrastructure and building critical bulk water (return effluent) infrastructure. Furthermore, R631 million is added in 2023/24 to fund arrears in the compensation of izinduna in KwaZulu-Natal.

Additions to provincial conditional grants over the MTEF period include R1.6 billion added to the *early childhood development grant* to increase the number of children accessing the early childhood development subsidy, provide pre-registration support to early childhood development centres, and pilot a nutrition support programme and a results-based service delivery model. An amount of R1.5 billion is added to the *education infrastructure grant* through the BFI for the Gauteng Schools Project and a further R283 million is added in 2023/24 for repairing school infrastructure damaged by the April 2022 floods in KwaZulu-Natal and the Eastern Cape. An amount of R1.5 billion is added to the *national school nutrition programme grant* to ensure that the meals provided to almost 9 million learners meet the nutritional requirements. A total of R10.8 billion is added to the *provincial roads maintenance grant.* This consists of R6.8 billion to address the refurbishment backlog of provincial roads, R3.7 billion added through the BFI to build rural bridges under the Welisizwe Rural Bridges Programme and R307 million for the carry through costs for the repairs of damaged provincial roads in the Eastern Cape and KwaZulu-Natal resulting from the April 2022 floods. Through the BFI, R153 million is added to *comprehensive agricultural support programme grant* for agri-hubs in KwaZulu-Natal.

Other changes include shifting R1.1 billion from the *provincial emergency housing grant* to the vote of the national Department of Human Settlements following the grant's closure. This shift will give the Department of Human Settlements the flexibility to respond to housing emergencies timeously. These funds were part of the provincial baselines in the 2022 MTBPS. The BFI funding within the *health facility revitalisation grant* component of the *national health insurance indirect grant* has been rescheduled, with a net increase of R629 million brought forward over the medium term.

Table W1.6 Revisions to direct and indirect transfers to provincial government

R million	2023/24	2024/25	2025/26	MTEF total revision
Additions to baselines				
Direct transfers	**28 102**	**30 662**	**33 968**	**92 732**
Provincial equitable share	24 379	25 481	27 074	76 934
Comprehensive agricultural support programme	8	86	58	153
Early childhood development	–	587	985	1 572
Education infrastructure	778	503	498	1 779
National school nutrition programme	400	500	600	1 500
Provincial roads maintenance	2 537	3 504	4 753	10 794
Indirect transfers	0	**433**	**569**	**1 002**
School infrastructure backlogs	0	0	0	1
National health insurance indirect	–	432	569	1 001
Reduction to baselines	**-372**	**–**	**–**	**-372**
Indirect transfers	**-372**	**–**	**–**	**-372**
National health insurance indirect	-372	–	–	-372
Total change to provincial government allocations	**27 730**	**31 094**	**34 537**	**93 361**
Change to direct transfers	28 102	30 662	33 968	92 732
Change to indirect transfers	-372	433	569	629
Net change to provincial government allocations	**27 730**	**31 094**	**34 537**	**93 361**

Source: National Treasury

After accounting for these changes, the *provincial equitable share* grows at an average annual rate of 2.5 per cent over the MTEF period, while direct conditional grant allocations grow at an average annual rate of 4.5 per cent.

THE PROVINCIAL EQUITABLE SHARE

The equitable share is the main source of revenue through which provinces are able to meet their expenditure responsibilities. To ensure that allocations are fair, the equitable share is allocated through a formula using objective data to reflect the demand for services across all nine provinces. For each year of the 2023 MTEF period, the following amounts are allocated to the *provincial equitable share* respectively: R567.5 billion, R587.5 billion and R614.3 billion.

THE EQUITABLE SHARE FORMULA

The equitable share formula consists of six components that account for the relative demand of services and take into consideration changing demographics in each of the provinces. The structure of the two largest components, education and health, is based on the demand and the need for education and health services. The other four components enable provinces to perform their other functions, taking into consideration the population size of each province, the proportion of poor residents in each province, the level of economic activity and the costs associated with running a provincial administration.

In addition to the annual data updates that are made to the provincial equitable share formula components, changes are being made to the components as part of the most recent review of the formula. The review, which started at the end of 2016, is being carried out in a phased manner. The changes to enrolment data and mid-year population estimates for the education component have been fully phased in. The most recent phase of the review involved updating the health component with a newly designed risk-adjusted index to inform the risk profile of each province. These changes are being phased in over the 2022 MTEF period (2022/23–2024/25).

For the 2023 MTEF, the rest of the formula has been updated with data from Statistics South Africa's 2022 mid-year population estimates on population and age cohorts and the 2022 preliminary data published by the Department of Basic Education on school enrolment from the Learner Unit Record Information Tracking System (LURITS) database. Data from the health sector for 2019/20 and 2020/21 and the 2021 General Household Survey for medical aid coverage is also used to update the formula.

The provincial equitable share formula continues to be reviewed. Further details of this review are discussed in Part 6.

SUMMARY OF THE FORMULA'S STRUCTURE

The formula's six components, shown in Table W1.7, capture the relative demand for services across provinces and take into account specific provincial circumstances. The components are neither indicative budgets nor guidelines as to how much should be spent on functions. Rather, the education and health components are weighted broadly in line with historical expenditure patterns to indicate relative need. Provincial executive councils determine the departmental allocations for each function, taking into account the priorities that underpin the division of revenue.

For the 2023 Budget, the formula components are set out as follows:

- An *education component* (48 per cent), based on the size of the school-age population (ages five to 17) and the number of learners (Grades R to 12) enrolled in public ordinary schools.
- A *health component* (27 per cent), based on each province's risk profile and health system caseload.
- A *basic component* (16 per cent), derived from each province's share of the national population.
- An *institutional component* (5 per cent), divided equally between the provinces.
- A *poverty component* (3 per cent), based on income data. This component reinforces the redistributive bias of the formula.
- An *economic activity component* (1 per cent), based on regional gross domestic product (GDP-R, measured by Statistics South Africa).

Table W1.7 Distributing the equitable shares by province, 2023 MTEF

	Education	Health	Basic share	Poverty	Economic activity	Institu-tional	Weighted average
	48.0%	**27.0%**	**16.0%**	**3.0%**	**1.0%**	**5.0%**	**100.0%**
Eastern Cape	13.3%	13.4%	11.0%	14.4%	7.6%	11.1%	12.8%
Free State	5.2%	5.5%	4.8%	5.0%	5.0%	11.1%	5.5%
Gauteng	20.7%	21.2%	26.6%	19.3%	34.5%	11.1%	21.4%
KwaZulu-Natal	21.2%	20.7%	19.0%	21.7%	15.9%	11.1%	20.2%
Limpopo	12.6%	11.2%	9.8%	13.1%	7.4%	11.1%	11.7%
Mpumalanga	8.2%	8.0%	7.8%	9.3%	7.5%	11.1%	8.3%
Northern Cape	2.2%	2.3%	2.2%	2.2%	2.0%	11.1%	2.7%
North West	6.8%	7.1%	6.9%	8.3%	6.5%	11.1%	7.1%
Western Cape	9.7%	10.6%	11.9%	6.6%	13.6%	11.1%	10.3%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: National Treasury

EDUCATION COMPONENT (48 PER CENT)

The education component has two sub-components, accounting for school-age population (five to 17 years) and enrolment data. Each element is assigned a weight of 50 per cent.

The school-age population data is updated using the 2022 mid-year population estimates data obtained from Statistics South Africa. The enrolment data is obtained from the Department of Basic Education's LURITS system, with the most recent data collected in 2022. These sub-components are used to calculate a weighted share for the education component for each of the provinces. Table W1.8 shows the combined effect of updating the education component with new enrolment and age cohort data on the education component shares.

Table W1.8 Impact of changes in school enrolment on the education component share

Thousand	Age 5-17	School enrolment 2021	School enrolment 2022	Changes in enrolment data	Weighted average 2022 MTEF	Weighted average 2023 MTEF	Difference in weighted average
Eastern Cape	1 881	1 846	1 824	-22	13.5%	13.3%	-0.25%
Free State	721	725	727	2	5.2%	5.2%	-0.02%
Gauteng	3 190	2 558	2 602	44	20.0%	20.7%	0.66%
KwaZulu-Natal	3 047	2 891	2 880	-11	21.5%	21.2%	-0.23%
Limpopo	1 698	1 798	1 797	-1	12.6%	12.6%	-0.05%
Mpumalanga	1 146	1 134	1 144	10	8.3%	8.2%	-0.09%
Northern Cape	322	304	305	2	2.2%	2.2%	0.01%
North West	1 026	872	875	2	6.8%	6.8%	0.01%
Western Cape	1 484	1 262	1 242	-20	9.8%	9.7%	-0.04%
Total	**14 515**	**13 390**	**13 396**	**6**	**100.0%**	**100.0%**	**–**

Source: National Treasury

HEALTH COMPONENT (27 PER CENT)

The health component uses a risk-adjusted capitation index and output data from public hospitals to estimate each province's share of the health component. These methods work together to balance needs (risk-adjusted capitation) and demands (output component).

The health component is presented in three parts below. Table W1.9 shows the shares of the risk-adjusted component, which accounts for 75 per cent of the health component.

Table W1.9 Risk-adjusted sub-component shares

Thousand	Mid-year population estimates 2022	Insured population 2021	Risk-adjusted index (with one-third of the changes)	Weighted population	Risk-adjusted shares 2022 MTEF	Risk-adjusted shares 2023 MTEF	Change
Eastern Cape	6 677	10.6%	116.9%	6 979	12.4%	13.5%	1.1%
Free State	2 922	16.3%	110.1%	2 692	5.3%	5.2%	-0.1%
Gauteng	16 099	24.0%	87.9%	10 752	23.4%	20.8%	-2.6%
KwaZulu-Natal	11 538	10.5%	102.1%	10 544	20.1%	20.4%	0.3%
Limpopo	5 941	8.2%	110.6%	6 035	10.4%	11.7%	1.2%
Mpumalanga	4 720	9.1%	103.9%	4 457	8.1%	8.6%	0.5%
Northern Cape	1 309	19.6%	114.4%	1 203	2.2%	2.3%	0.1%
North West	4 187	15.3%	108.9%	3 860	7.3%	7.5%	0.2%
Western Cape	7 212	23.7%	92.4%	5 085	10.7%	9.9%	-0.8%
Total	**60 605**	**0.0%**	**0.0%**	**51 608**	**100.0%**	**100.0%**	**0.0%**

Source: National Treasury

The risk-adjusted sub-component estimates a weighted population in each province using the risk-adjusted index. The percentage of the population with medical insurance, based on the 2018 General Household Survey, is deducted from the 2022 mid-year population estimates to estimate the uninsured population per province. The risk-adjusted index, which is an index of each province's health risk profile, is applied to the uninsured population to estimate the weighted population. Each province's share of this weighted population is used to estimate their share of the risk-adjusted sub-component. The last column in Table W1.9 shows the change in this sub-component between 2022 and 2023.

Table W1.10 Output sub-component shares

Thousand	Primary healthcare visits				Hospital workload patient-day equivalents			
	2020/21	2021/22	Average	Share	2020/21	2021/22	Average	Share
Eastern Cape	12 951	13 693	13 322	13.5%	3 276	4 084	3 680	13.1%
Free State	4 810	4 772	4 791	4.9%	1 709	1 947	1 828	6.5%
Gauteng	16 964	18 648	17 806	18.1%	6 361	6 834	6 598	23.4%
KwaZulu-Natal	22 810	23 906	23 358	23.7%	5 539	6 139	5 839	20.7%
Limpopo	12 389	12 753	12 571	12.8%	2 493	2 660	2 576	9.2%
Mpumalanga	7 320	7 734	7 527	7.7%	1 579	1 733	1 656	5.9%
Northern Cape	2 214	2 333	2 274	2.3%	510	577	543	1.9%
North West	6 300	6 606	6 453	6.6%	1 512	1 631	1 571	5.6%
Western Cape	9 590	10 950	10 270	10.4%	3 629	4 075	3 852	13.7%
Total	**95 347**	**101 394**	**98 370**	**100.0%**	**26 608**	**29 680**	**28 144**	**100.0%**

Source: National Treasury

The output sub-component (shown in Table W1.10) uses patient load data from the District Health Information Services. The average number of visits to primary healthcare clinics in 2019/20 and 2020/21 is calculated to estimate each province's share of this part of the output component, which makes up 5 per cent of the health component. For hospitals, each province's share of the total patient-day equivalents at public hospitals in 2019/20 and 2020/21 is used to estimate their share of this part of the output sub-component, which makes up 20 per cent of the health component. In total, the output component is 25 per cent of the health component.

Table W1.11 presents the health component in three parts, with the risk-adjusted component, which accounts for 75 per cent of the health component, and the output component, which accounts for 25 per cent of the health component.

Table W1.11 Health component weighted shares

Weight	Risk-adjusted	Primary healthcare	Hospital component	Weighted shares		Change
	75.0%	5.0%	20.0%	2022 MTEF	2023 MTEF	
Eastern Cape	13.5%	13.5%	13.1%	12.7%	13.4%	0.8%
Free State	5.2%	4.9%	6.5%	5.5%	5.5%	-0.1%
Gauteng	20.8%	18.1%	23.4%	23.1%	21.2%	-1.9%
KwaZulu-Natal	20.4%	23.7%	20.7%	20.7%	20.7%	-0.0%
Limpopo	11.7%	12.8%	9.2%	10.3%	11.2%	1.0%
Mpumalanga	8.6%	7.7%	5.9%	7.6%	8.0%	0.4%
Northern Cape	2.3%	2.3%	1.9%	2.1%	2.3%	0.1%
North West	7.5%	6.6%	5.6%	6.8%	7.1%	0.3%
Western Cape	9.9%	10.4%	13.7%	11.2%	10.6%	-0.6%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**0.0%**

Source: National Treasury

BASIC COMPONENT (16 PER CENT)

The basic component is derived from each province's share of the national population. This component constitutes 16 per cent of the total equitable share. For the 2023 MTEF, population data is drawn from the 2022 mid-year population estimates produced by Statistics South Africa. Table W1.12 shows how population changes have affected the basic component's revised weighted shares.

Table W1.12 Impact of the changes in population on the basic component shares

Thousand	Mid-year population estimates[1]		Population change	% population change	Basic component shares		Change
	2021	2022			2022 MTEF	2023 MTEF	
Eastern Cape	6 726	6 677	-49	-0.7%	11.2%	11.0%	-0.14%
Free State	2 936	2 922	-15	-0.5%	4.9%	4.8%	-0.05%
Gauteng	15 801	16 099	298	1.9%	26.2%	26.6%	0.36%
KwaZulu-Natal	11 643	11 538	-105	-0.9%	19.3%	19.0%	-0.27%
Limpopo	5 880	5 941	61	1.0%	9.8%	9.8%	0.05%
Mpumalanga	4 738	4 720	-17	-0.4%	7.9%	7.8%	-0.07%
Northern Cape	1 305	1 309	4	0.3%	2.2%	2.2%	-0.00%
North West	4 164	4 187	23	0.6%	6.9%	6.9%	0.00%
Western Cape	7 113	7 212	99	1.4%	11.8%	11.9%	0.10%
Total	**60 305**	**60 605**	**300**	**0.0%**	**100.0%**	**100.0%**	**–**

1. The population estimates were informed by a data set that StatsSA shared with National Treasury on population, used to inform the mid-year population estimates, and not the data from the 2021 mid-year population estimates publication. This data is used in different components of the formula

Source: National Treasury

INSTITUTIONAL COMPONENT (5 PER CENT)

The institutional component recognises that some costs associated with running a provincial government and providing services are not directly related to the size of a province's population or factors included in other components. It is therefore distributed equally between provinces, with each province receiving 11.1 per cent. This component benefits provinces with smaller populations, especially the Northern Cape, the Free State and the North West, because the allocation per person for these provinces is much higher in this component.

POVERTY COMPONENT (3 PER CENT)

The poverty component introduces a redistributive element to the formula and is assigned a weight of 3 per cent. For this component, the poor population is defined as people who fall into the lowest 40 per cent of household incomes in the 2010/11 Income and Expenditure Survey. The estimated size of the poor population in each province is calculated by multiplying the proportion of people in that province who fall into the poorest 40 per cent of South African households by the province's population figure from the 2022 mid-year population estimates. Table W1.13 shows the proportion of the poor in each province from the Income and Expenditure Survey, the 2022 mid-year population estimates and the weighted share of the poverty component per province.

Table W1.13 Comparison of current and new poverty component weighted shares

Thousand	Income and Expendi-ture Survey 2011/12	2022 MTEF			2023 MTEF			Difference in weighted shares
		Mid-year population estimates 2021[1]	Poor popula-tion	Weighted shares	Mid-year population estimates 2022	Poor popula-tion	Weighted shares	
Eastern Cape	52.0%	6 726	3 499	14.6%	6 677	3 474	14.4%	-0.1%
Free State	41.4%	2 936	1 215	5.1%	2 922	1 209	5.0%	-0.0%
Gauteng	28.9%	15 801	4 562	19.0%	16 099	4 648	19.3%	0.3%
KwaZulu-Natal	45.3%	11 643	5 275	22.0%	11 538	5 228	21.7%	-0.3%
Limpopo	52.9%	5 880	3 108	13.0%	5 941	3 141	13.1%	0.1%
Mpumalanga	47.3%	4 738	2 239	9.3%	4 720	2 231	9.3%	-0.1%
Northern Cape	40.8%	1 305	532	2.2%	1 309	534	2.2%	0.0%
North West	47.9%	4 164	1 994	8.3%	4 187	2 005	8.3%	0.0%
Western Cape	21.9%	7 113	1 555	6.5%	7 212	1 577	6.6%	0.1%
Total		**60 305**	**23 980**	**100.0%**	**60 605**	**24 046**	**100.0%**	**–**

1. The population estimates were informed by a data set that StatsSA shared with National Treasury on population, used to inform the mid-year population estimates, and not the data from the 2021 mid-year population estimates publication. This data is used in different components of the formula
Source: National Treasury

ECONOMIC ACTIVITY COMPONENT (1 PER CENT)

The economic activity component is a proxy for provincial tax capacity and expenditure assignments. Given that these assignments are a relatively small proportion of provincial budgets, the component is assigned a weight of 1 per cent. For the 2023 MTEF, 2019 GDP-R data is used. Table W1.14 shows the weighted shares of the economic activity component.

Table W1.14 Current and new economic activity component weighted shares

	2022 MTEF		2023 MTEF		Difference in weighted shares
	GDP-R, 2019 (R million)	Weighted shares	GDP-R, 2020 (R million)[1]	Weighted shares	
Eastern Cape	387 332	7.6%	387 332	7.6%	0.0%
Free State	252 763	5.0%	252 763	5.0%	0.0%
Gauteng	1 750 062	34.5%	1 750 062	34.5%	0.0%
KwaZulu-Natal	806 843	15.9%	806 843	15.9%	0.0%
Limpopo	374 064	7.4%	374 064	7.4%	0.0%
Mpumalanga	381 915	7.5%	381 915	7.5%	0.0%
Northern Cape	103 349	2.0%	103 349	2.0%	0.0%
North West	329 363	6.5%	329 363	6.5%	0.0%
Western Cape	691 934	13.6%	691 934	13.6%	0.0%
Total	**5 077 625**	**100.0%**	**5 077 625**	**100.0%**	**0.0%**

1. The latest available data on GDP-R is the 2019 series
Source: National Treasury

FULL IMPACT OF DATA UPDATES ON THE PROVINCIAL EQUITABLE SHARE

Table W1.15 shows the full impact of the data updates on the *provincial equitable share* per province, after the six updated components have been added together. It compares the target shares for the 2022 and 2023 MTEF periods. The size of each province's share reflects the relative demand for provincial public services in that province. The changes in shares from 2022 to 2023 respond to changes in that demand. The details of how the data updates affect each component of the formula are described in detail in the sub-sections above.

Table W1.15 Full impact of data updates on the equitable share

	2022 MTEF weighted average	2023 MTEF weighted average	Difference
Eastern Cape	12.9%	12.9%	0.0%
Free State	5.5%	5.5%	-0.0%
Gauteng	21.4%	21.3%	-0.1%
KwaZulu-Natal	20.4%	20.4%	0.0%
Limpopo	11.4%	11.5%	0.1%
Mpumalanga	8.2%	8.2%	0.0%
Northern Cape	2.7%	2.7%	0.0%
North West	7.1%	7.1%	0.0%
Western Cape	10.4%	10.4%	-0.0%
Total	**100.0%**	**100.0%**	**0.0%**

Source: National Treasury

PHASING IN THE FORMULA

The annual updates to the official data used to calculate the provincial equitable share formula result in changes to each province's share of the available funds. These changes reflect the changing balance of service delivery demands among the provinces, and the annual data updates are vital to ensuring that allocations can respond to these changes. However, provinces need stable and predictable revenue streams to allow for sound planning.

As such, the new shares calculated using the most recent data are phased in over the three-year MTEF period.

The equitable share formula data is updated every year and a new target share for each province is calculated, as shown in Table W1.16. The phase-in mechanism provides a smooth path to achieving the new weighted shares by the third year of the MTEF period. It takes the difference between the target weighted share for each province at the end of the MTEF period and the indicative allocation for 2023/24 published in the 2022 MTEF, and closes the gap between these shares by a third in each year of the 2023 MTEF period. As a result, one third of the impact of the data updates is implemented in 2023/24 and two thirds in the indicative allocations for 2024/25. The updates are thus fully implemented in the indicative allocations for 2025/26.

Table W1.16 Implementation of the equitable share weights

Percentage	2023/24	2023/24	2024/25	2025/26
	Indicative weighted shares from 2022 MTEF	2023 MTEF weighted shares 3-year phasing		
Eastern Cape	12.8%	12.9%	12.9%	13.0%
Free State	5.5%	5.5%	5.5%	5.5%
Gauteng	21.4%	21.3%	21.4%	21.3%
KwaZulu-Natal	20.4%	20.4%	20.2%	20.2%
Limpopo	11.4%	11.5%	11.6%	11.6%
Mpumalanga	8.2%	8.2%	8.2%	8.3%
Northern Cape	2.7%	2.7%	2.7%	2.7%
North West	7.1%	7.1%	7.1%	7.1%
Western Cape	10.5%	10.4%	10.4%	10.3%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: National Treasury

ALLOCATIONS CALCULATED OUTSIDE THE EQUITABLE SHARE FORMULA

In addition to allocations made through the formula, the *provincial equitable share* includes allocations that have been determined using other methodologies. These allocations are typically introduced when a new function or additional funding is transferred to provinces. National government indicates separately how much funding has been allocated to each province for this specific purpose. Funds are also added through this approach when a priority has been identified through the national budget process and provincial government performs the function or when a conditional grant is absorbed into the equitable share.

For the 2023 MTEF period, R1.8 billion for the Coega Special Economic Zone is allocated outside the provincial equitable share formula for a water security programme that will construct and upgrade bulk infrastructure. A further R631 million is allocated in 2023/24 to fund arrears in the compensation of izinduna. Table W1.17 provides a summary of the allocations made outside the *provincial equitable share* that carry through from previous financial years and a short description of how these amounts are allocated among provinces.

Table W1.17 Allocations outside provincial equitable share formula

R million	2022/23 Adjusted budget	2023/24	2024/25 Medium-term estimates	2025/26	Allocation criteria
Food relief shift	74 521	77 806	81 300	84 942	Allocated equally among the provinces
Social worker employment grant shift	250 635	261 681	273 433	285 683	Allocated in terms of what provinces would have received had the grant continued
Substance abuse treatment grant shift	87 167	91 009	95 096	99 356	Allocated in terms of what provinces would have received had the grant continued
Municipal intervention support	97 371	101 663	106 228	110 987	Allocated equally among the provinces
HIV Prevention Programmes	114 000	119 024	124 370	129 941	Allocated based on the non-profit organisations located in the 27 priority districts
Social worker additional support shift	146 100	152 539	159 390	166 530	Allocated according to areas of high prevalence of gender-based violence, substance abuse and issues affecting children
Sanitary Dignity Programme	225 574	235 516	246 093	257 118	Allocated proportionately based on the number of girl learners per province in quintiles 1 to 3 schools
Infrastructure delivery improvement programme shift	47 115	49 192	51 401	53 703	Allocated equally among the provinces
Education sector presidential employment initiative	6 194 000	6 457 600	–	–	Allocations are based on each provincial education department's projected capacity to employ assistants in schools in line with the objectives of the initiative
BFI: Coega	–	298 000	632 000	848 000	Allocated only to Eastern Cape
KZN Izinduna		631 083			Allocated only to KwaZulu-Natal
Total	**7 236 483**	**8 475 112**	**1 769 310**	**2 036 262**	

Source: National Treasury

FINAL PROVINCIAL EQUITABLE SHARE ALLOCATIONS

The final equitable share allocations per province for the 2023 MTEF period are detailed in Table W1.18. These allocations include the full impact of the data updates, phased in over three years, and the allocations that are made separately from the formula.

Table W1.18 Provincial equitable share

R million	2023/24	2024/25	2025/26
Eastern Cape	73 292	76 022	79 620
Free State	31 380	32 369	33 735
Gauteng	120 752	125 438	131 095
KwaZulu-Natal	115 948	118 858	123 812
Limpopo	65 349	67 974	71 502
Mpumalanga	46 674	48 437	50 752
Northern Cape	15 150	15 718	16 463
North West	40 096	41 765	43 843
Western Cape	58 886	60 920	63 448
Total	**567 528**	**587 500**	**614 271**

Source: National Treasury

CONDITIONAL GRANTS TO PROVINCES

There are four types of provincial conditional grants:

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

CHANGES TO CONDITIONAL GRANTS

The overall growth in direct conditional transfers to provinces averages 4.5 per cent over the medium term. Direct conditional grant baselines total R127.5 billion in 2023/24, R133 billion in 2024/25 and R140.4 billion in 2025/26. Indirect conditional grants amount to R4.2 billion, R4.4 billion and R4.8 billion respectively for each year of the same period.

Table W1.19 provides a summary of conditional grants by sector for the 2023 MTEF period. More detailed information, including the framework and allocation criteria for each grant, is provided in the 2023 Division of Revenue Bill. The frameworks provide the conditions for each grant, the outputs expected, the allocation criteria used for dividing each grant between provinces, and a summary of the grants' audited outcomes for 2021/22.

Table W1.19 Conditional grants to provinces

R million	2022/23 Revised estimate	2023/24	2024/25	2025/26	MTEF total
Agriculture, Land Reform and Rural Development	**2 294**	**2 333**	**2 516**	**2 596**	**7 445**
Comprehensive agricultural support programme	1 599	1 626	1 777	1 825	5 228
Ilima/Letsema projects	610	620	648	677	1 946
Land care programme: poverty relief and infrastructure development	85	86	90	94	271
Basic Education	**23 124**	**25 329**	**26 485**	**28 093**	**79 907**
Early childhood development	1 193	1 242	1 885	2 341	5 469
Education infrastructure	12 501	13 872	13 845	14 438	42 155
HIV and AIDS (life skills education)	242	242	253	264	758
Learners with profound intellectual disabilities	256	260	272	284	817
Maths, science and technology	425	433	453	473	1 358
National school nutrition programme	8 508	9 279	9 778	10 293	29 350
Cooperative Governance	**97**	**146**	**152**	**159**	**457**
Provincial disaster response	97	146	152	159	457
Health	**56 252**	**54 183**	**56 171**	**58 687**	**169 041**
District health programme grant	29 023	26 866	28 072	29 330	84 268
Health facility revitalisation	6 780	7 120	7 361	7 691	22 172
Human resources and training grant	5 449	5 479	5 367	5 607	16 452
National health insurance grant	694	695	717	749	2 161
National tertiary services	14 306	14 024	14 654	15 310	43 988
Human Settlements	**19 172**	**19 246**	**19 614**	**20 493**	**59 354**
Human settlements development	14 256	14 944	15 118	15 796	45 858
Informal settlements upgrading partnership	4 121	4 303	4 496	4 697	13 496
Provincial emergency housing grant	796	–	–	–	–
Public Works and Infrastructure	**858**	**861**	**900**	**940**	**2 701**
Expanded public works programme integrated grant for provinces	433	435	454	475	1 364
Social sector expanded public works	425	426	446	466	1 338
Sport, Arts and Culture	**2 176**	**2 175**	**2 272**	**2 374**	**6 821**
Community library services	1 573	1 571	1 641	1 715	4 927
Mass participation and sport development	604	604	631	659	1 894
Transport	**19 756**	**23 270**	**24 853**	**27 058**	**75 181**
Provincial roads maintenance	12 665	15 867	17 117	18 976	51 960
Public transport operations	7 090	7 403	7 735	8 082	23 220
Total direct conditional allocations	**123 730**	**127 544**	**132 963**	**140 402**	**400 909**
Indirect transfers	**4 612**	**4 178**	**4 447**	**4 763**	**13 389**
Basic Education	**2 403**	**2 079**	**2 172**	**2 269**	**6 520**
School infrastructure backlogs	2 403	2 079	2 172	2 269	6 520
Health	**2 209**	**2 099**	**2 275**	**2 494**	**6 868**
National health insurance indirect	2 209	2 099	2 275	2 494	6 868

Source: National Treasury

AGRICULTURE, LAND REFORM AND RURAL DEVELOPMENT GRANTS

The *comprehensive agricultural support programme grant* aims to support newly established and emerging farmers, particularly subsistence, smallholder and previously disadvantaged farmers. The grant funds a range of projects, including providing training, developing agri-processing infrastructure and directly supporting targeted farmers. Over the 2023 MTEF period, R5.2 billion is allocated to this grant, and the baseline grows at an average annual growth rate of 4.5 per cent, from R1.6 billion in 2023/24 to R1.8 billion in 2025/26. This includes R8 million in 2023/24, R86 million in 2024/25 and R58 million in 2025/26 added through the BFI for agri-hubs in KwaZulu-Natal.

The *land care programme grant: poverty relief and infrastructure development* aims to improve productivity and the sustainable use of natural resources. Provinces are also encouraged to use this grant to create jobs through the Expanded Public Works Programme. Over the medium term, R271 million is allocated to this grant.

The *Ilima/Letsema projects grant* aims to boost food production by helping previously disadvantaged farming communities. The grant's baseline is R1.9 billion over the 2023 MTEF period.

BASIC EDUCATION GRANTS

The *early childhood development grant* supports government's prioritisation of early childhood development, as envisioned in the National Development Plan. The grant aims to improve poor children's access to early childhood programmes and ensure that early childhood development centres have adequate infrastructure. The grant baseline totals R5.5 billion over the 2023 MTEF period. A portion of the funds allocated for the maintenance component of the grant are unallocated for 2024/25 and 2025/26 as they will be informed by the outcomes of the infrastructure assessments that will be conducted in each province. Over the same period, a portion of the additional funds are unallocated in the subsidy component to pilot a nutrition support programme and a results-based service delivery model.

The *education infrastructure grant* provides supplementary funding for ongoing infrastructure programmes in provinces. This includes maintaining existing infrastructure and building new infrastructure to ensure school buildings meet the required norms and standards. Over the 2023 MTEF period, R42.2 billion is allocated to the grant. This includes R609 million in 2023/24 earmarked for repairing school infrastructure damaged by natural disasters in the Eastern Cape and KwaZulu-Natal.

Provincial education departments go through a two-year planning process to be eligible to receive incentive allocations for infrastructure projects. To receive the 2023/24 incentive, the departments had to meet certain prerequisites in 2021/22 and have their infrastructure plans approved in 2022/23. The national Department of Basic Education and the National Treasury assessed the provinces' infrastructure plans. The national departments, provincial treasuries and provincial departments of basic education undertook a moderation process to agree on the final scores. Provinces had to obtain a minimum score of 60 per cent to qualify for the incentive. Table W1.20 shows the final score and incentive allocation for each province.

Table W1.20 Education infrastructure grant allocations

R thousand	Planning assessment results from 2022	2023/24		Final allocation for 2023/24
		Basic component	Incentive component	
Eastern Cape	81%	1 719 632	109 673	1 829 305
Free State	78%	889 595	109 673	999 268
Gauteng	80%	2 146 947	109 673	2 256 620
KwaZulu-Natal	80%	2 825 079	109 671	2 934 750
Limpopo	61%	1 371 984	–	1 371 984
Mpumalanga	69%	1 184 469	–	1 184 469
Northern Cape	81%	607 576	109 673	717 249
North West	75%	1 179 049	109 673	1 288 722
Western Cape	91%	1 180 389	109 673	1 290 062
Total		**13 104 720**	**767 709**	**13 872 429**

Source: National Treasury

The national Department of Basic Education uses the indirect *school infrastructure backlogs grant* to replace unsafe and inappropriate school structures and to provide water, sanitation services and electricity on behalf of provinces. This grant is allocated R6.5 billion over the medium term in the Planning, Information and Assessment Programme.

The *national school nutrition programme grant* aims to improve the nutrition of poor school children, enhance their capacity to learn and increase their attendance at school. The programme provides a free daily meal to learners in the poorest schools (quintiles 1 to 3). To provide meals to more children, while still providing quality food, growth in the grant's allocations over the MTEF period averages 6.6 per cent, with a total allocation of R29.3 billion.

The *maths, science and technology grant* provides for ICT, workshop equipment and machinery to schools, which should lead to better outcomes in maths and science in the long term. Over the medium term, R1.4 billion is allocated to the grant.

The *HIV and AIDS (life skills education) grant* provides for life skills training, and sexuality and HIV/AIDS education in primary and secondary schools. The programme is fully integrated into the school system, with learner and teacher support materials provided for Grades 1 to 9. The grant's total allocation is R758 million over the medium term.

The *learners with profound intellectual disabilities grant* aims to expand access to education for these learners. This grant has been allocated R817 million over the 2023 MTEF period to provide access to quality, publicly funded education to such learners by recruiting outreach teams.

COOPERATIVE GOVERNANCE GRANT

The *provincial disaster response grant* is administered by the National Disaster Management Centre in the Department of Cooperative Governance. It is unallocated at the start of the financial year. The grant allows the National Disaster Management Centre to immediately release funds (in-year) after a disaster is classified, without the need for the transfers to be gazetted first. To ensure that sufficient funds are available in the event of a disaster, section 20 of the 2023 Division of Revenue Bill allows for funds allocated to the *municipal* *disaster response grant* to be transferred to provinces if funds in the *provincial disaster response grant* have already been exhausted, and vice versa. The bill also allows for more than one transfer to be made to areas affected by disasters, so that an initial payment for emergency aid can be made before a full assessment of damages and costs has been completed. Over the medium term, R457 million has been allocated to the *provincial disaster response grant*.

HEALTH GRANTS

The *district health programmes grant* consists of two main components: a comprehensive HIV/AIDS component (made up of the former HIV/AIDS and TB components) and a district health component (made up of the former community outreach, malaria, HPV and COVID-19 components). The grant supports HIV/AIDS prevention programmes and specific interventions, including voluntary counselling and testing, prevention of mother-to-child transmission, post-exposure prophylaxis, antiretroviral therapy and home-based care. Over the medium term, the grant is allocated R84.3 billion.

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 29 tertiary hospitals across the nine provinces and continues to fund medical specialists, equipment, and advanced medical investigation and treatment according to approved service specifications. Patient referral pathways often cross provincial borders and, as a result, many patients receive care in neighbouring provinces if the required services are unavailable in their home province. In the 2022 MTEF, R73 million was unallocated for 2023/24, and these funds have now been allocated to the Eastern Cape, Limpopo, Mpumalanga and the North West provinces to develop and expand tertiary services in their facilities.

A similar approach to allocating developmental funds is taken in the training component of the *human resources and training grant.* Further details on the amounts ring-fenced are discussed under this grant. The urban areas of Gauteng and the Western Cape continue to receive the largest share of the grant because they provide the largest proportion of high-level, sophisticated services. The grant is allocated R44 billion over the medium term: R14 billion in 2023/24, R14.7 billion in 2024/25 and R15.3 billion in 2025/26.

The *health facility revitalisation grant* funds the construction and maintenance of health infrastructure, including large projects to modernise hospital infrastructure and equipment, general maintenance and infrastructure projects at smaller hospitals, and the refurbishment and upgrading of nursing colleges and schools. Over the 2023 MTEF period, R22.2 billion has been allocated to this grant.

Like the *education infrastructure grant* discussed previously, a two-year planning process is required for provinces to access this grant's incentive component. The national Department of Health and the National Treasury assessed the provinces' infrastructure plans. This was followed by a moderation process involving the national departments, provincial treasuries and provincial departments of health to agree on the final scores. Provinces had to obtain a minimum score of 60 per cent to qualify for the incentive. Funds for the incentive component in the outer years are shown as unallocated. Table W1.21 sets out the final score and the incentive allocation per province.

Table W1.21 Health facility revitalisation grant allocations

R thousand	Planning assessment results from 2022	2023/24		Final allocation for 2023/24
		Basic component	Incentive component	
Eastern Cape	83%	695 296	78 195	773 491
Free State	80%	602 597	78 195	680 792
Gauteng	79%	1 038 555	78 195	1 116 750
KwaZulu-Natal	94%	1 383 930	78 192	1 462 122
Limpopo	71%	552 983	–	552 983
Mpumalanga	82%	415 255	78 195	493 450
Northern Cape	51%	465 311	–	465 311
North West	79%	613 468	78 195	691 663
Western Cape	94%	805 103	78 195	883 298
Total		**6 572 498**	**547 362**	**7 119 860**

Source: National Treasury

The *human resources and training grant* has two components and has been allocated R5.5 billion in 2023/24, R5.4 billion in 2024/25 and R5.6 billion in 2025/26. The training component funds the training of health sciences professionals, including specialists, registrars and their supervisors. The statutory human resources component funds internship and community service posts, as well as some posts previously funded from the equitable share. In the 2022 MTEF, R26 million was unallocated for 2023/24 in the training component. This amount has now been allocated to the Eastern Cape, Limpopo, Mpumalanga, the Northern Cape and the North West provinces to develop and expand tertiary services.

The *national health insurance indirect grant* continues to fund all preparatory work for universal health coverage, as announced in 2017/18. Over the 2023 MTEF period, this will be done through three components: the health facility revitalisation component and two integrated components (personal services component and non-personal services component). The personal services component funds priority services for national health insurance, which include:

- Expanding access to school health services, focusing on optometry and audiology.
- Providing maternal care for high-risk pregnancies, screening and treatment for breast and cervical cancer, hip and knee arthroplasty, cataract surgeries and wheelchairs.

Non-personal services will test, and scale up when ready, the technology platforms and information systems needed to ensure a successful transition to national health insurance. This component is allocated R2 billion over the medium term to continue funding initiatives to strengthen health information systems, clinics, and the dispensing and distribution of centralised chronic medicines. The indirect grant is allocated R6.9 billion over the 2023 MTEF period.

Funds for contracting health professionals were previously shifted from the personal services component of the indirect grant to create a new direct *national health insurance grant*. The contracting of health professionals in former national health insurance pilot sites was previously administered at national level but being carried out at provincial level, with the requirement that provinces submit claims for the costs they incurred. Transferring these funds to the provinces allows them to pay contractors directly. The contracting of health professionals will continue to be funded in the direct *national health insurance grant*.

In addition, the grant funds the provision of mental health services and oncology services. These components were shifted, along with the funding, from the *district health programmes grant* in the 2022 MTEF. They are not standalone components, but part of the activities that are funded through the grant. This is part of a continuation of shifting funds for mental health services and oncology services to the *national health insurance grant* that started in the 2021 MTEF, where changes were made during the 2021 MTBPS to accommodate the shift of funding for these services from the *national health insurance indirect grant* to this grant. Over time, provinces have showed readiness to take on the delivery of these services and they will be more appropriately placed as part of the preparatory work for national health insurance. The grant's baseline is R2.2 billion over the medium term.

HUMAN SETTLEMENTS GRANTS

The *human settlements development grant* seeks to establish habitable, stable and sustainable human settlements in which all citizens have access to social and economic amenities. Over the 2023 MTEF period, R45.9 billion has been allocated to this grant. This includes R475 million in 2023/24 earmarked for repairing houses affected by natural disasters in KwaZulu-Natal.

This grant is allocated using a formula with three components:

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

Table W1.22 shows how the *human settlements development grant* formula calculates the shares for each province and the metropolitan municipalities within the provinces. Section 12(6) of the Division of Revenue Act requires provinces to gazette how much they will spend within each accredited municipality (including the amounts transferred to that municipality and the amounts spent by the province in that municipal area). Funds for mining towns and disaster recovery are allocated separately from the formula.

Table W1.22 Human settlements development grant formula calculation

Components	Housing needs	Poverty	Population	Grant formula
Description	**Weighted share of inadequate housing**	**Share of poverty**	**Share of population**	**Weighted share of grant formula**
Component weight	**70.0%**	**20.0%**	**10.0%**	
Eastern Cape	**10.1%**	**13.9%**	**12.7%**	**11.1%**
Nelson Mandela Bay	1.6%	2.1%	2.2%	1.8%
Buffalo City	2.2%	1.6%	1.5%	2.0%
Other Eastern Cape municipalities	6.3%	10.2%	9.0%	7.3%
Free State	**5.9%**	**6.1%**	**5.3%**	**5.9%**
Mangaung	1.4%	1.5%	1.4%	1.5%
Other Free State municipalities	4.4%	4.6%	3.9%	4.4%
Gauteng	**30.9%**	**22.5%**	**23.7%**	**28.5%**
Ekurhuleni	9.1%	6.2%	6.1%	8.2%
City of Johannesburg	10.5%	8.0%	8.6%	9.8%
City of Tshwane	6.8%	4.8%	5.6%	6.3%
Other Gauteng municipalities	4.5%	3.5%	3.4%	4.2%
KwaZulu-Natal	**18.0%**	**19.0%**	**19.8%**	**18.4%**
eThekwini	7.0%	6.2%	6.6%	6.8%
Other KwaZulu-Natal municipalities	11.0%	12.8%	13.2%	11.6%
Limpopo	**4.4%**	**12.0%**	**10.4%**	**6.5%**
Mpumalanga	**6.2%**	**7.9%**	**7.8%**	**6.7%**
Northern Cape	**1.9%**	**2.0%**	**2.2%**	**2.0%**
North West	**10.0%**	**7.8%**	**6.8%**	**9.2%**
Western Cape	**12.7%**	**8.7%**	**11.2%**	**11.8%**
City of Cape Town	9.3%	5.5%	7.2%	8.3%
Other Western Cape municipalities	3.4%	3.2%	4.0%	3.4%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: 2011 Census and General Household Survey

A total of R253 million is ring-fenced within the *human settlements development grant* in 2023/24 to upgrade human settlements in mining towns in four provinces. These allocations respond to areas with significant informal settlement challenges, with a high proportion of economic activity based on the natural resources sector.

The *informal settlements upgrading partnership grant* intensifies efforts to upgrade informal settlements in partnership with communities. The grant is dedicated to increasing investment in in-situ informal settlement upgrading, which includes identifying informal settlements for upgrades, providing households with tenure and providing municipal engineering services. Over the 2023 MTEF period, R13.5 billion is allocated to the grant.

The *provincial emergency housing grant* enables the Department of Human Settlements to rapidly respond to emergencies by providing temporary housing in line with the Emergency Housing Programme. However, the grant is limited to funding emergency housing following the immediate aftermath of a disaster, and not the other emergency situations listed in the programme. The grant's purpose was also previously expanded to fund the repair of houses damaged in disasters if those repairs are cheaper than the grant's funding of relocating households to temporary shelter. From 2023/24, this grant ceases to exist as funds are shifted to the vote of the national department to give the department the flexibility to respond timeously to housing emergencies.

PUBLIC WORKS AND INFRASTRUCTURE GRANTS

The *expanded public works programme (EPWP) integrated grant for provinces* incentivises provincial departments to use labour-intensive methods in infrastructure, environmental and other projects. Grant allocations are determined upfront based on the performance of provincial departments in meeting job targets in the preceding financial year. The grant is allocated R1.4 billion over the MTEF period.

The *social sector EPWP incentive grant for provinces* rewards provinces for creating jobs in the preceding financial year in the areas of home-based care, early childhood development, adult literacy and numeracy, community safety and security, and sports programmes. The grant's allocation model incentivises provincial departments to participate in the EPWP and measures the performance of each province relative to its peers, providing additional incentives to those that perform well. The grant is allocated R1.3 billion over the 2023 MTEF period.

SPORT, ARTS AND CULTURE GRANTS

The *community library services grant*, administered by the Department of Sport, Arts and Culture, aims to help South Africans access information to improve their socioeconomic situation. The grant is allocated to the relevant provincial department and administered by that department or through a service-level agreement with municipalities. In collaboration with provincial departments of basic education, the grant also funds libraries that serve both schools and the general public. Funds from this grant may be used to enable the shift of the libraries function between provinces and municipalities. The grant is allocated R4.9 billion over the next three years. This grant's baseline grows by 2.9 per cent over the medium term.

The *mass participation and sport development grant* aims to increase and sustain mass participation in sport and recreational activities in the provinces, with greater emphasis on provincial and district academies. The grant is allocated R1.9 billion over the medium term. This grant's baseline grows by 3 per cent over the medium term.

TRANSPORT GRANTS

The *public transport operations grant* subsidises commuter bus services. It helps ensure that provinces meet their contractual obligations and provide services. Most of the contracts subsidised through this grant continue to operate on long-standing routes that link dormitory towns and suburbs established under apartheid to places of work. The grant allows provinces to renegotiate contracts and routes, and/or to devolve the function and funding to municipalities. This provides an opportunity for routes to be restructured in line with new settlement patterns and to promote more integrated urban development patterns in future. The grant is allocated R23.2 billion over the 2023 MTEF period.

The *provincial roads maintenance grant* is a supplementary grant that supports the cost of maintaining provincial roads. Provinces are expected to fund the construction of new roads from their own budgets and supplement the cost of maintaining and upgrading existing roads. Grant allocations are determined using a formula based on provincial road networks, road traffic and weather conditions. These factors reflect the varying costs of maintaining road networks in each province. The grant requires provinces to follow best practices for planning, and to use and regularly update roads asset management systems.

The incentive portion of the grant is allocated based on performance indicators relating to traffic loads, safety engineering and visual condition indicators. The total allocation for the 2023 MTEF period is R52 billion. This includes R601 million in 2023/24 earmarked for the Eastern Cape and KwaZulu-Natal for repairing provincial roads affected by natural disasters. Over the medium term, R3.7 billion is allocated for building rural bridges and R6.8 billion for refurbishing provincial roads.

PART 5: LOCAL GOVERNMENT FISCAL FRAMEWORK AND ALLOCATIONS

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 2023/24 budgets, and to promote better accountability and transparency by ensuring that all national allocations are included in municipal budgets.

Over the 2023 MTEF period, R521.7 billion will be transferred directly to local government and a further R26.6 billion has been allocated to indirect grants. Direct transfers to local government over the medium term account for 10 per cent of national government's non-interest expenditure. When indirect transfers are added to this, total spending on local government increases to 10.6 per cent of national non-interest expenditure.

Table W1.23 Transfers to local government

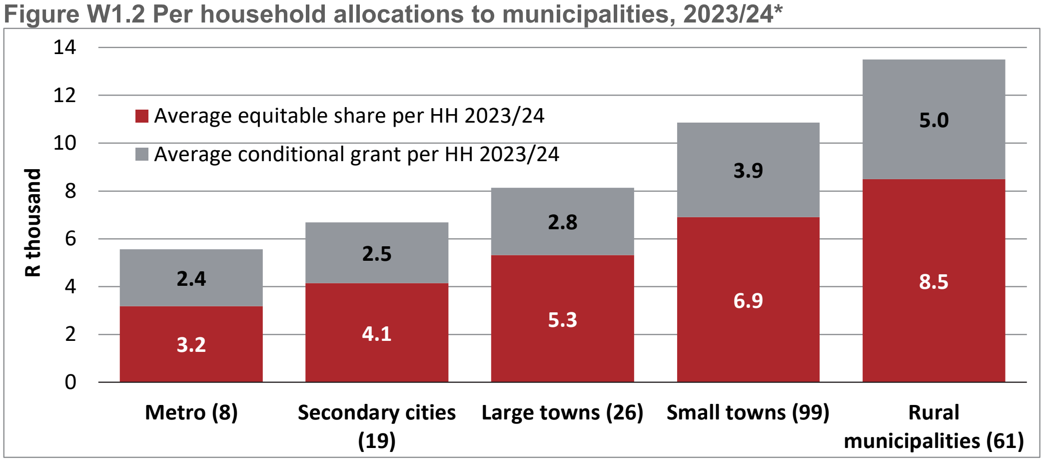
R million	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
		Outcome		Adjusted budget		Medium-term estimates	
Direct transfers	**122 986**	**137 098**	**135 625**	**154 188**	**163 972**	**174 382**	**183 330**
Equitable share and related	**65 627**	**83 102**	**76 169**	**87 311**	**96 546**	**103 772**	**109 368**
Equitable share formula[1]	59 301	76 482	69 197	80 023	88 978	95 853	101 099
RSC levy replacement	5 357	5 652	5 963	6 249	6 524	6 817	7 123
Support for councillor remuneration and ward committees	969	969	1 009	1 040	1 044	1 102	1 146
General fuel levy sharing with metros	**13 167**	**14 027**	**14 617**	**15 335**	**15 433**	**16 127**	**16 849**
Conditional grants	**44 191**	**39 969**	**44 839**	**51 542**	**51 992**	**54 484**	**57 113**
Infrastructure	42 322	37 901	42 635	48 857	49 733	52 123	54 646
Capacity building and other	1 870	2 068	2 204	2 685	2 259	2 361	2 467
Indirect transfers	**5 591**	**4 194**	**7 727**	**8 171**	**8 481**	**8 862**	**9 259**
Infrastructure	5 480	4 074	7 592	8 030	8 335	8 709	9 099
Capacity building and other	111	120	135	140	147	153	160
Total	**128 576**	**141 292**	**143 352**	**162 359**	**172 453**	**183 244**	**192 589**

1. Outcome figures for the equitable share reflect amounts transferred after funds have been withheld to offset underspending by municipalities on conditional grants. Rollover funds are reflected in the year in which they were transferred

Source: National Treasury

The local government fiscal framework responds to the constitutional assignment of powers and functions to this sphere of government. The framework refers to all resources available to municipalities to meet their expenditure responsibilities. National transfers account for a relatively small proportion of the local government fiscal framework, with the majority of local government revenues being raised by municipalities themselves through their substantial revenue-raising powers. However, each municipality varies dramatically, with poor rural municipalities receiving most of their revenue from transfers, while urban municipalities raise the majority of their own revenues. This differentiation in the way municipalities are funded will continue in the period ahead. As a result, transfers per household to the most rural municipalities are more than twice as large as those to metropolitan municipalities.

Figure W1.2 Per household allocations to municipalities, 2023/24*



**Reflects funds allocated through the Division of Revenue Bill. Allocations to district municipalities are re-assigned to local municipalities where possible*

Source: National Treasury

CHANGES TO LOCAL GOVERNMENT ALLOCATIONS

Allocations to local government increase by R14.3 billion. No fiscal consolidation reductions were proposed in the 2022 MTBPS. The growth in direct allocations to municipalities over the next three years is just above inflation, at an average annual rate of 7.4 per cent. The growth in indirect allocations is just below projected average inflation over the same period, at an average annual rate of 4.3 per cent.

The changes to each local government allocation are summarised in Table W1.24.

Table W1.24 Revisions to direct and indirect transfers to local government

R million	2023/24	2024/25	2025/26	2023 MTEF total revisions
Technical adjustments	–	–	–	–
Direct transfers	–	–	–	–
Local government equitable share	–	–	–	–
Equitable share formula	28	11	17	56
Support for councillor remuneration and ward committees	-28	-11	-17	-56
Conditional grants	–	–	–	–
Integrated urban development	50	54	58	162
Municipal infrastructure	-50	-54	-58	-162
Additions to baselines	**3 777**	**4 434**	**6 059**	**14 270**
Direct transfers	**2 460**	**2 286**	**3 335**	**8 080**
Local government equitable share	2 460	2 286	3 335	8 080
Equitable share formula	2 460	2 286	3 335	8 080
Conditional grants	**1 317**	**2 149**	**2 724**	**6 190**
Urban settlements development	473	772	963	2 208
Public transport network	105	40	316	461
Regional bulk infrastructure	739	1 337	1 445	3 521
Reductions to baselines	**-319**	**-199**	**-213**	**-731**
Direct transfers	–	–	–	–
Conditional grants	**-319**	**-199**	**-213**	**-731**
Public transport network	–	-8	-13	-21
Regional bulk infrastructure	-136	–	–	-136
Municipal housing emergency	-183	-191	-200	-574
Total change to local government allocations				
Change to direct transfers	3 458	4 235	5 846	13 539
Change to indirect transfers	–	–	–	–
Net change to local government allocations	**3 458**	**4 235**	**5 846**	**13 539**

Source: National Treasury

Over the medium term, R8.1 billion is added to the *local government equitable share* to increase coverage of the provision of free basic services.

Over the medium term, R2.2 billion is added to the *urban settlements development grant* to fund the implementation of projects in the eThekwini Metropolitan Municipality and the City of Johannesburg, funded from the BFI. Further details are discussed in the conditional grants section.

Over the medium term, R461 million is added to the *public transport network grant* to align funding with the revised implementation plan and cash flow projections for the City of Cape Town's MyCiTi public transport network project, funded from the BFI. A total of R21 million in the outer years is reprioritised from this grant to fund the rollout of the single integrated ticketing system.

An amount of R136 million is reduced from the direct *regional bulk infrastructure grant* in 2023/24, while R1.4 million is added in 2024/25 to align funding with the revised implementation plan and cash flow projections for George Local Municipality's potable water security and remedial works project, funded from the BFI. Over the medium term, R3.4 billion is added to the same grant to fund three other water projects funded from the BFI. Further details are discussed in the conditional grants section.

The *municipal emergency housing grant* ceases to exist as funds are shifted to the vote of the Department of Human Settlements. These funds formed part of the baseline to local government conditional grants in the 2022 MTBPS.

THE LOCAL GOVERNMENT EQUITABLE SHARE

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

Over the 2023 MTEF period, the local government equitable share, including the Regional Service Council/Joint Service Board (RSC/JSB) levies replacement grant and the special support for councillor remuneration and ward committees grant, amounts to R309.7 billion (R96.5 billion in 2023/24, R103.8 billion in 2024/25 and R109.4 billion in 2025/26). Due to above-inflation electricity tariff increases and increasing household growth rates over the medium term, R8.1 billion has been added to the local government equitable share, which grows at an average annual rate of 7.8 per cent over the next three years.

FORMULA FOR ALLOCATING THE LOCAL GOVERNMENT EQUITABLE SHARE

The portion of national revenue allocated to local government through the equitable share is determined in the national budget process and endorsed by Cabinet (the vertical division). Local government's equitable share is divided among the country's 257 municipalities, using a formula to ensure objectivity (the horizontal division). The principles and objectives of the formula are set out in detail in the Explanatory Memorandum to the 2013 Division of Revenue.

STRUCTURE OF THE LOCAL GOVERNMENT EQUITABLE SHARE FORMULA

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

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

Each of these components is described in detail in the sub-sections that follow.

Structure of the local government equitable share formula

$$LGES = BS + (I + CS) \times RA \pm C$$

where

LGES is the local government equitable share
BS is the basic services component
I is the institutional component
CS is the community services component
RA is the revenue adjustment factor
C is the correction and stabilisation factor

THE BASIC SERVICES COMPONENT

This component helps municipalities provide free basic water, sanitation, electricity and refuse removal services to households that fall below an affordability threshold. Following municipal consultation, the formula's affordability measure (used to determine how many households need free basic services) is based on the level of two state old age pensions. When the 2011 Census was conducted, the state old age pension was worth R1 140 per month, which means that two pensions were worth R2 280 per month. A monthly household income of R2 300 per month in 2011 has therefore been used to define the formula's affordability threshold. Statistics South Africa has calculated that 59 per cent of all households in South Africa fall below this income threshold. However, the proportion in each municipality varies widely. In 2023 terms, this monthly income is equivalent to about R4 216 per month. This threshold is not an official poverty line or a required level to be used by municipalities in their own indigence policies. If municipalities choose to provide fewer households with free basic services than they are funded for through the *local government equitable share*, then their budget documentation should clearly set out why they have made this choice and how they have consulted with their community during the budget process.

The number of households per municipality, and the number below the poverty threshold, is updated annually. The number of households per municipality used to calculate indicative allocations for the outer years of the MTEF period is updated based on the growth experienced between the 2001 Census and the 2016 Community Survey. Provincial growth rates are then rebalanced to match the average annual provincial growth reported between 2002 and 2021 in the annual General Household Survey. Statistics South Africa has advised the National Treasury that, in the absence of official municipal household estimates, this is a credible method of estimating the household numbers per municipality needed for the formula. Statistics South Africa is researching methods for producing municipal-level data estimates, which may be used to inform equitable share allocations in future.

The proportion of households below the affordability threshold in each municipality is still based on 2011 Census data. This is because the 2016 Community Survey did not publish data on household income. The total number of households in each municipality is adjusted every year to account for growth. Although the share of households subsidised for free basic services through the formula remains constant, the number of households subsidised increases annually in line with estimated household growth.

The basic services subsidy is typically allocated to 100 per cent of households that fall below the poverty threshold. However, due to baseline reductions over the years, and the rapid growth in the cost of bulk services, the basic services subsidy could not be fully funded, as the reductions had to spread across all components of the formula to minimise the impact on service delivery. Over the MTEF period ahead, the subsidy is allocated to 100 per cent of households below the poverty threshold. The basic services subsidy will fund:

- 11.2 million households in 2023/24.
- 11.5 million households in 2024/25.
- 11.8 million households in 2025/26.

The basic services component provides a subsidy of R528.29 per month in 2023/24 for the cost of providing basic services to each of these households. The subsidy includes funding for the provision of free basic water (six kilolitres per poor household per month), energy (50 kilowatt-hours per month) and sanitation and refuse removal (based on service levels defined by national policy). The monthly amount provided for each service is detailed in Table W1.25 and includes an allocation of 10 per cent for service maintenance costs.

Table W1.25 Amounts per basic service allocated through the local government equitable share, 2023/24

	Allocation per household below affordability threshold (R per month)			Total allocation per service (R million)
	Operations	Maintenance	Total	
Energy	111.1	12.34	123.40	16 556
Water	162.7	18.08	180.79	24 256
Sanitation	109.7	12.19	121.90	16 355
Refuse removal	92.0	10.22	102.19	13 710
Total basic services	**475.5**	**52.83**	**528.29**	**70 878**

Source: National Treasury

The formula uses the fairest estimates of the average costs of providing each service that could be derived from available information. More details of how the costs were estimated can be found in the discussion paper on the proposed structure of the new local government equitable share formula, available on the National Treasury website. The per household allocation for each of the basic services in Table W1.25 is updated annually based on the following factors.

The electricity cost estimate is made up of bulk and other costs. Bulk costs are updated based on the bulk multi-year price determination approved by the National Energy Regulator of South Africa (NERSA). With the recently announced NERSA electricity tariffs, the free basic electricity subsidy in the *local government equitable share* is calculated based on an 20.7 per cent tariff increase in 2023/24 and a 14.7 per cent increase in 2024/25. In the absence of an approved tariff increase in the outer year of the MTEF period, the formula assumes an increase of 17.7 per cent in 2025/26. This is the average of the approved increases for the first two years of the MTEF period.

Municipal financial years differ from national financial years, so Eskom typically charges municipalities on average 2 per cent above the approved tariff for Eskom customers to recover revenue lost in the first three months. For this reason, an extra R2.8 billion has been added to the local government equitable share formula for 2023/24 and 2024/25 as a precautionary measure should municipal electricity tariffs exceed those approved by NERSA.

Other (non-bulk) electricity costs are updated based on the National Treasury's inflation projections in the 2022 MTBPS.

The water cost estimate is also made up of bulk and other costs. Bulk costs are updated based on the average increase in bulk tariffs charged by water boards (although not all municipalities purchase bulk water from water boards, their price increases serve as a proxy for the cost increases for all municipalities). The average increase in tariffs for bulk water from water boards in 2022/23 was 8.6 per cent. As the bulk price increase for 2023 will only be announced after the 2023 Budget is tabled, the equitable share formula continues to use the 8.9 per cent bulk tariff increase that was used when the baseline for this year was calculated in the 2022 MTEF period. Other costs are updated based on the National Treasury's inflation projections in the 2022 MTBPS.

The costs for sanitation and refuse removal are updated based on the National Treasury's inflation projections in the 2022 MTBPS.

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

The basic services component

BS = basic services subsidy x number of poor households

Funding for each basic service is allocated to the municipality (metro, district or local) that is authorised to provide that service. If another municipality provides a service on behalf of the authorised municipality, it must transfer funds to the provider in terms of section 28 of the Division of Revenue Act. The basic services component is worth R70.9 billion in 2023/24 and accounts for 80.9 per cent of the value of the local government equitable share formula allocation.

THE INSTITUTIONAL COMPONENT

To provide basic services to households, municipalities need to be able to run a basic administration. Most municipalities should be able to fund the majority of their administration costs with their own revenue. But, because poor households are unable to contribute in full, the equitable share includes an institutional support component to help meet some of these costs. To ensure that this component supports municipalities with limited revenue-raising abilities, a revenue adjustment factor is applied so that municipalities with less potential to raise their own revenue receive a larger proportion of the allocation. The revenue adjustment factor is described in more detail later in this annexure.

In 2023/24, this component consists of a base allocation of R8 million, which goes to every municipality, and an additional amount that is based on the number of council seats in each municipality. In 2023/24, the number of council seats is updated to reflect the councillor numbers that took effect on the date of the 2021 local government elections. This component reflects the relative size of a municipality’s administration and is not intended to fund the costs of councillors only (the Minister of Cooperative Governance and Traditional Affairs determines the number of seats recognised for the formula). The base allocation acknowledges that there are some fixed costs that all municipalities face.

The institutional component

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

The institutional component accounts for 7.6 per cent of the equitable share formula and is worth R6.8 billion in 2023/24. This component is also complemented by special support for councillor remuneration in poor municipalities, which is not part of the equitable share formula.

THE COMMUNITY SERVICES COMPONENT

This component funds services that benefit communities rather than individual households (which are provided for in the basic services component). It includes funding for municipal health services, fire services, municipal roads, cemeteries, planning, stormwater management, street lighting and parks. To ensure this component assists municipalities with limited revenue-raising abilities, a revenue adjustment factor is applied so that these municipalities receive a larger proportion of the allocation.

The allocation for this component is split between district and local municipalities, which both provide community services. In 2023/24, the allocation to district municipalities for municipal health and related services is R11.85 per household per month. The component's remaining funds are allocated to local and metropolitan municipalities for other services, based on the number of households in each municipality.

The community services component

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

The community services component accounts for 11.6 per cent of the equitable share formula and is worth R10 billion in 2023/24.

THE REVENUE ADJUSTMENT FACTOR

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

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

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

Based on this index, municipalities were ranked according to their per capita revenue-raising potential. The top 10 per cent of municipalities have a revenue adjustment factor of zero, which means that they do not receive an allocation from the institutional and community services components. The 25 per cent of municipalities with the lowest scores have a revenue adjustment factor of 100 per cent, which means that they receive their full allocation from the institutional and community services components. Municipalities between the bottom 25 per cent and top 10 per cent have a revenue adjustment factor applied on a sliding scale, so that those with higher per capita revenue-raising potential receive a lower revenue adjustment factor and those with less potential have a larger revenue adjustment factor.

The revenue adjustment factor is not based on the actual revenues municipalities collect, which ensures that this component does not create a perverse incentive for municipalities to under-collect revenue to receive a higher equitable share.

Because district municipalities do not collect revenue from property rates, the revenue adjustment factor applied to these municipalities is based on the *RSC/JSB levies replacement grant* allocations. This grant replaces a source of own revenue previously collected by district municipalities and it is still treated as an own revenue source in many respects. Similar to the revenue adjustment factor for local and metropolitan municipalities, the factor applied to district municipalities is based on their per capita *RSC/JSB levies replacement grant* allocations. District municipalities are given revenue adjustment factors on a sliding scale – those with a higher per capita *RSC/JSB levies replacement grant* allocation receive a lower revenue adjustment factor, while those with lower allocations have a higher revenue adjustment factor.

CORRECTION AND STABILISATION FACTOR

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

ENSURING THE FORMULA BALANCES

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

DETAILS OF NEW ALLOCATIONS

In addition to the three-year formula allocations published in the Division of Revenue Bill, a copy of the formula, including the data used for each municipality and each component, is published online (http://mfma.treasury.gov.za/Media_Releases/LGESDiscussions/Pages/default.aspx).

OTHER UNCONDITIONAL ALLOCATIONS

RSC/JSB LEVIES REPLACEMENT GRANT

Before 2006, district municipalities raised levies on local businesses through a Regional Services Council (RSC) or Joint Services Board (JSB) levy. This source of revenue was replaced in 2006/07 with the *RSC/JSB levies replacement grant*, which was allocated to all district and metropolitan municipalities based on the amounts they had previously collected through the levies. The *RSC/JSB levies replacement grant* for metropolitan municipalities has since been replaced by the sharing of the general fuel levy. The *RSC/JSB levies replacement grant* is allocated R20.5 billion over the 2023 MTEF period and grows at an average annual rate of 4.5 per cent.

In 2017/18, adjustments were made to the grant to redistribute funds to the 13 district municipalities that were receiving less than R40 million per year from this grant. To fund increased allocations to these district municipalities, the growth rates of the 10 district municipalities with the largest allocations were reduced so that they received two-thirds of their original growth rate in 2017/18 and one-third of their original growth rate in 2018/19. In recognition that the two categories of district municipalities have varying service-delivery responsibilities, from 2019/20, different growth rates of a 3:1 ratio were applied to allocations to district municipalities authorised for water and sanitation (C2) and unauthorised district municipalities (C1), respectively. These two changes combined have significantly affected the per household *RSC/JSB levies replacement grant* allocations, including under-allocating funds to some districts and over-allocating to others. To address this, from 2023/24 the growth rates for allocations to C1 and C2 district municipalities will be equalised. The application of a single growth rate for all district municipalities should see the allocations for C1 municipalities grow in line with inflation – which hasn't been the case since 2019 – and will stop districts moving further up and down the per household rankings.

This revised allocation methodology will be in place until the Department of Cooperative Governance finalises its review of section 84 of the Municipal Structures Act to streamline the powers and functions of district municipalities. The review aims to clarify the roles and responsibilities of district municipalities and inform the development of objective criteria to apply when determining allocations from this grant.

SPECIAL SUPPORT FOR COUNCILLOR REMUNERATION AND WARD COMMITTEES

Councillors' salaries are subsidised in poor municipalities. The total value of the support provided in 2023/24 is R1 billion, calculated separately to the *local government equitable share* and in addition to the funding for governance costs provided in the institutional component. The level of support for each municipality is allocated based on a system gazetted by the Minister of Cooperative Governance and Traditional Affairs, which classifies municipal councils into six grades based on their total income and population size. Special support is provided to the lowest three grades of municipal councils (the smallest and poorest municipalities).

A subsidy of 90 per cent of the gazetted maximum remuneration for a part-time councillor is provided for every councillor in grade 1 municipalities, 80 per cent for grade 2 municipalities and 70 per cent for grade 3 municipalities. In addition to this support for councillor remuneration, each local municipality in grades 1 to 3 receives an allocation to provide stipends of R500 per month to 10 members of each ward committee in their municipality. Each municipality's allocation for this special support is published in the Division of Revenue Bill appendices.

CONDITIONAL GRANTS TO LOCAL GOVERNMENT

National government allocates funds to local government through a variety of conditional grants. These grants fall into two main groups: infrastructure and capacity building. The total value of conditional grants directly transferred to local government increases from R52 billion in 2023/24 to R54.5 billion in 2024/25 and R57.1 billion in 2025/26.

There are four types of local government conditional grants:

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

INFRASTRUCTURE CONDITIONAL GRANTS TO LOCAL GOVERNMENT

National transfers for infrastructure, including indirect or in-kind allocations to entities executing specific projects in municipalities, amount to R182.6 billion over the 2023 MTEF period.

Table W1.26 Infrastructure grants to local government

R million	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
		Outcome		Revised budget		Medium-term estimates	
Direct transfers	**42 322**	**37 901**	**42 636**	**48 857**	**49 733**	**52 123**	**54 646**
Integrated urban development	857	936	1 009	1 085	1 172	1 227	1 284
Municipal disaster recovery	133	–	–	3 319	321	–	–
Municipal infrastructure	14 816	14 491	15 593	16 842	17 545	18 331	19 150
Informal settlements upgrading partnership	–	–	3 945	4 273	4 365	4 561	4 765
Urban settlements development	11 655	10 572	7 405	7 352	8 149	8 793	9 343
Energy efficiency and demand-side management	227	193	221	223	224	243	253
Integrated national electrification programme	1 860	1 359	2 003	2 120	2 212	2 311	2 415
Neighbourhood development partnership	592	479	1 318	1 293	1 475	647	676
Public transport network	6 370	4 389	5 175	6 013	6 794	7 752	8 369
Rural roads asset management systems	114	108	110	115	115	121	126
Regional bulk infrastructure	2 029	2 006	2 237	2 521	3 496	4 099	4 045
Water services infrastructure	3 669	3 368	3 620	3 701	3 864	4 038	4 219
Indirect transfers	**5 480**	**4 074**	**7 592**	**8 030**	**8 335**	**8 709**	**9 099**
Integrated national electrification programme	3 124	1 983	2 824	3 588	3 821	3 993	4 172
Neighbourhood development partnership	46	63	181	201	101	105	110
Regional bulk infrastructure	1 761	1 724	3 857	3 470	3 607	3 769	3 938
Water services infrastructure	548	305	730	771	805	841	879
Total	**47 801**	**41 975**	**50 228**	**56 888**	**58 068**	**60 832**	**63 745**

Source: National Treasury

MUNICIPAL INFRASTRUCTURE GRANT

The largest infrastructure transfer to municipalities is made through the *municipal infrastructure grant*, which supports government's aim to expand service delivery and alleviate poverty. The grant funds the provision of infrastructure for basic services, roads and social infrastructure for poor households in all non-metropolitan municipalities. The total allocations for this grant amount to R55 billion over the medium term and grow at an average annual rate of 4.4 per cent. The *municipal infrastructure grant* is allocated through a formula with a vertical and horizontal division. The vertical division allocates resources between sectors and the horizontal division takes account of poverty, backlogs and municipal powers and functions in allocating funds to municipalities. The five main components of the formula are described in the box below.

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

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

B Basic residential infrastructure (proportional allocations for water supply and sanitation, roads and other services such as street lighting and solid waste removal)

P Public municipal service infrastructure (including sport infrastructure)

E Allocation for social institutions and micro-enterprise infrastructure

N Allocation to the 27 priority districts identified by government

Allocations for the water and sanitation sub-components of the basic services component are based on the proportion of the national backlog for that service in each municipality. Other components are based on the proportion of the country's poor households located in each municipality. The formula considers poor households without access to services that meet sector standards to be a backlog.

Table W1.27 Data used in the municipal infrastructure grant formula

Component	Input for horizontal calculation	Proxy used in 2023 (corresponding with data available from 2011 Census)
B	Number of water backlogs	Water access: Poor households[1] report having access to piped water inside their dwelling, in the yard or within 200 meters of their dwelling
	Number of sanitation backlogs	Sanitation access: Poor households report flush toilet, chemical toilet, pit toilet with ventilation or ecological toilet
	Number of road backlogs	Roads backlog: Number of households
	Number of other backlogs	Refuse access: Poor households report that refuse is mainly removed by local authorties or a private company once a week (urban, traditional and farms). It should be noted that acceptable services standards differ by area. For traditional and farms the following conditions apply: removed by local authority / private company / community members less than once a week, communal refuse dump and communal contained / central collection point. For farms the following further addition applies: own refuse dump
P	Number of poor households	Number of poor households
E	Number of poor households	Number of poor households
N	Number of poor households in nodal areas	Allocated to the 27 priority districts identified by Cabinet as having large backlogs. Allocation is based on total households (not poor households)

1. Poor household defined as a monthly household income of less than R2 300 per month in 2011 Census data
Source: National Treasury

Table W1.28 sets out the proportion of the grant accounted for by each component of the formula.

The constant component provides a R5 million base to all municipalities receiving *municipal infrastructure grant* allocations.

Table W1.28 Municipal infrastructure grant allocations per sector

Municipal infrastructure grant (formula)	Component weights	Value of component 2023/24 (R million)	Proportion of municipal infrastructure grant per sector
B-component	**75.0%**	**12 122**	**69.1%**
Water and sanitation	54.0%	6 546	37.3%
Roads	17.3%	2 091	11.9%
Other	3.8%	455	2.6%
P-component	**15.0%**	**2 424**	**13.8%**
Sports	33.0%	800	4.6%
E-component	**5.0%**	**808**	**4.6%**
N-component	**5.0%**	**808**	**4.6%**
Constant		**1 130**	**6.4%**
Ring-fenced funding for sport infrastructure		**253**	**1.4%**
Total		**17 545**	**100.0%**

Source: National Treasury

The *municipal infrastructure grant* includes an amount allocated outside of the grant formula and earmarked for specific sport infrastructure projects identified by the Department of Sport, Arts and Culture. These earmarked funds amount to R758 million over the MTEF period (R253 million in each year of the three years of the 2023 MTEF period). In addition, municipalities are required to spend a third of the P-component (equivalent to 4.5 per cent of the grant) on sport and recreation infrastructure identified in their own integrated development plans. Municipalities are also encouraged to increase their investment in other community infrastructure, including cemeteries, community centres, taxi ranks and marketplaces.

Over the 2023 MTEF period, municipalities will continue to be allowed to use up to 5 per cent of their allocations to fund the development of infrastructure asset management plans. This is intended to build the necessary asset management capabilities in municipalities. It allows for phased-in and systematic reforms to incentivise municipalities to start appropriately budgeting for the repairs and maintenance of municipal infrastructure. To make use of this provision, municipalities must submit a business plan to the Department of Cooperative Governance, accompanied by a copy of their audited asset register.

To support municipalities experiencing project implementation challenges, over the 2023 MTEF period, the Department of Cooperative Governance will use the indirect component of the grant to directly appoint an implementation agent to expedite the implementation of infrastructure projects on behalf of identified municipalities. Further details regarding the criteria that will be used, including the conditions, and the responsibilities of the transferring officer and receiving officer are contained in the grant framework.

INTEGRATED URBAN DEVELOPMENT GRANT

The *integrated urban development grant* is allocated to selected urban local municipalities in place of the *municipal infrastructure grant*. The grant recognises that municipalities differ in terms of their context and introduces a differentiated approach to encourage integrated development in cities. It is intended to:

- Support spatially aligned public infrastructure investment that will lead to functional and efficient urban spaces.
- Enable and incentivise municipalities to invest more non-grant funding in infrastructure projects in intermediate cities.

The grant extends some of the fiscal reforms already implemented in metropolitan municipalities to non-metropolitan cities and is administered by the Department of Cooperative Governance.

Municipalities must meet certain criteria and apply to receive the *integrated urban development grant* instead of the *municipal infrastructure grant* in terms of a process set out in section 26(5) of the Division of Revenue Act. The qualification criteria cover the following areas:

- Management stability (low vacancy rates among senior management).
- Audit findings.
- Unauthorised, irregular, fruitless and wasteful expenditure.
- Capital expenditure.
- Reporting in terms of the Municipal Finance Management Act.

To remain in the grant, cities must continue to meet or exceed the entry criteria. If they do not do so, they will be placed on a performance improvement plan. If they still do not meet the criteria in the subsequent year, they will shift back to receiving grant transfers through the *municipal infrastructure grant*, which comes with closer oversight and support from national and provincial departments. The base allocations a municipality receives through the *municipal infrastructure grant* and the *integrated urban development grant* will be the same and are determined in terms of the *municipal infrastructure grant* formula described above. Over the 2023 MTEF period, the 3 per cent planning baseline will be used to undertake planning and programme management activities.

In addition to the basic formula-based allocation, municipalities participating in the *integrated urban development grant* are eligible to receive a performance-based incentive component, which is based on performance against the weighted indicators set out below.

Table W1.29 Performance-based component weighted indicators for integrated urban development grant

Indicators	Purpose	Weight	Scores
Non-grant capital as a percentage of total capital expenditure	Encourage cities to increase their capital investments funded through own revenue and borrowing	40%	1 if 70% or higher 0 if 30% or lower Linear scale in between
Repairs and maintenance expenditure as percentage of operating expenditure	Reward cities that take good care of their existing asset base	30%	1 if 8% or higher
Asset management plan	Must have a plan in place that has been approved by municipal council and updated in the last three years	30%	1 if yes for all three 0 if no for any of the three
Land-use applications in priority areas	Due to the lack of available data, these indicators, which are intended to reward spatial targeting of investment, remain dormant in 2023/24		1 if 50% or higher 0 if 10% or lower
Building plans applications in priority areas	Due to the lack of available data, these indicators, which are intended to reward spatial targeting of investment, remain dormant in 2023/24		Linear scale in between

Source: National Treasury

The total allocations for this grant amount to R3.7 billion over the 2023 MTEF period and grow at an average annual rate of 5.8 per cent. The above-inflation growth rate can be attributed to the inclusion of George Local Municipality as a grant participant over the 2023 MTEF period.

Table W1.30 Formula for integrated urban development grant incentive component

	Planning allocation (R 000)	Performance incentive						Total for incentive and planning (R 000)
		Non-grant capital as percent-age of total capital spend	Mainten-ance spend	Asset manage-ment plan	Land use and building plans in priority areas	Weighted score	Total incentive (R 000)	
uMhlathuze	3 843	30%	30%	20%	–	15%	21 240	25 084
Drakenstein	1 243	10%	20%	30%	–	11%	15 930	17 174
Mogale City	4 215	10%	20%	20%	–	9%	13 275	17 491
Polokwane	12 234	10%	30%	20%	–	11%	15 930	28 164
Ray Nkonyeni	2 201	10%	10%	30%	–	9%	13 275	15 476
Sol Plaatje	1 775	10%	30%	10%	–	9%	13 275	15 050
Stellenbosch	1 266	30%	10%	20%	–	11%	15 930	17 197
Steve Tshwete	1 772	30%	10%	20%	–	11%	15 930	17 702
George	1 423	20%	30%	20%	–	13%	18 585	20 009
Total	**29 973**					**100%**	**143 373**	**173 346**

Source: Department of Cooperative Governance

URBAN SETTLEMENTS DEVELOPMENT GRANT

The *urban settlements development grant* is an integrated source of funding for infrastructure for municipal services and upgrades to urban informal settlements in the eight metropolitan municipalities. It is allocated as a supplementary grant to cities (schedule 4, part B of the Division of Revenue Act), which means that municipalities are expected to use a combination of grant funds and their own revenue to develop urban infrastructure and integrated human settlements. Cities report their progress on these projects against the targets set in their service-delivery and budget implementation plans. Since 2019/20, cities have been required to report in line with the requirements of the Municipal Finance Management Act Circular 88. This is the result of a process led by the National Treasury to rationalise and streamline built environment reporting for the eight metropolitan municipalities. Cities report on one agreed set of indicators used by multiple stakeholders to monitor progress on the integrated and functional outcomes, rather than reporting separately to each department.

The grant is allocated R26.3 billion over the medium term and grows at an average annual rate of 8.3 per cent. An additional amount of R2.2 billion is allocated to eThekwini Metropolitan Municipality and the City of Johannesburg from the BFI over the same period. eThekwini Metropolitan Municipality is allocated R88 million in 2023/24 and R118 million in 2024/25 for the implementation of phase 1 of the Avoca Node Programme, which involves upgrading roads and stormwater infrastructure. The City of Johannesburg is allocated R385 million in 2024/25, R654 million in 2024/25 and R963 million in 2025/26 for the implementation of the Lufhereng Mixed Use Development Programme. These funds will be used to build municipal connection links for bulk electrical, water, sanitation, roads and stormwater infrastructure that will serve 30 000 housing units.

The allocation per municipality (excluding the BFI allocations) is based on the *municipal infrastructure grant* formula. Up to 3 per cent of the grant may be used to fund municipal capacity in the built environment in line with the Department of Human Settlements' capacity-building guideline.

INFORMAL SETTLEMENTS UPGRADING PARTNERSHIP GRANT

Upgrading informal settlements remains a priority over the medium term. The *informal settlements upgrading partnership grant* is allocated R4.4 billion in 2023/24, R4.6 billion in 2024/25 and R4.8 billion in 2025/26. Informal settlements upgrading is an inclusive process through which informal residential areas are incrementally improved, formalised and incorporated into the city or neighbourhood by extending land tenure security, infrastructure and services to residents of informal settlements. This grant requires cities to work in partnership with communities to develop and complete their informal settlements upgrading strategies.

PROGRAMME AND PROJECT PREPARATION SUPPORT GRANT

The *programme and project preparation support grant* supports metropolitan municipalities in developing a pipeline of investment-ready capital programmes and projects. This is done by establishing and institutionalising an effective and efficient system of programme and project preparation and the allocation of a growing level of municipal resources for preparation activities. The grant is allocated R1.2 billion over the 2023 MTEF period and grows at an average annual rate of 4.5 per cent.

PUBLIC TRANSPORT NETWORK GRANT

The *public transport network grant*, administered by the Department of Transport, helps cities create or improve public transport systems in line with the National Land Transport Act (2009) and the Public Transport Strategy. This includes all integrated public transport network infrastructure, such as bus rapid transit systems, conventional bus services, and pedestrian and cycling infrastructure. The grant also subsidises the operation of these services. It is allocated R22.9 billion over the medium term and grows at an average annual rate of 11.7 per cent. Reprioritisations are made within the vote of the Department of Transport, affecting this grant. To fund the rollout of a single integrated ticketing system, R8 million in 2024/25 and R13 million in 2025/26 are reprioritised from this grant.

The allocations for this grant are determined through a formula, which determines 95 per cent of the allocations, and a performance-based incentive component, which accounts for the remaining 5 per cent. The formula increases certainty about the extent of national funding that municipalities can expect when planning their public transport networks and encourages cities to make more sustainable public transport investments.

To qualify for an allocation from the performance incentive, a city must have an operational municipal public transport system approved by the national Department of Transport and it must have spent more than 80 per cent of its grant allocation in the previous financial year. Incentive allocations are then calculated based on the coverage of costs from fares, passenger trips and the city's own financial commitment to the system. Cities must exceed the minimum threshold in at least one of these three indicators. The calculation of the performance incentive allocations for 2023/24 is set out in Table W1.31. The raw scores for the cities are weighted using the sum of the base and formula components to account for the size of the city.

Table W1.31 Formula for the public transport network grant

	Base 20%	Demand-driven factors 75%			Subtotal: base and demand-driven factors	100%
	Equally shared	Population component shares	Regional gross value added component shares	Public transport users component shares		Grant allocations[1] (R 000)
City of Cape Town	10.0%	17.8%	16.8%	16.4%	15.3%	903 845
City of Johannesburg	10.0%	21.1%	26.9%	22.0%	20.7%	1 227 523
City of Tshwane	10.0%	13.9%	16.0%	15.1%	14.0%	830 319
Ekurhuleni	10.0%	15.1%	10.1%	16.4%	13.1%	773 213
eThekwini	10.0%	16.4%	16.9%	19.0%	16.1%	952 337
George	10.0%	0.9%	0.5%	0.2%	2.4%	144 823
Mangaung	10.0%	3.6%	2.5%	3.3%	4.6%	270 028
Nelson Mandela Bay	10.0%	5.5%	5.0%	3.8%	5.9%	346 376
Polokwane	10.0%	3.0%	1.6%	1.3%	3.6%	213 978
Rustenburg	10.0%	2.6%	3.7%	2.4%	4.4%	257 603
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**5 920 045**

1. Excludes additional funds for Cape Town allocated through the Budget Facility for Infrastructure
Source: National Treasury

In the formula for the grant, a base component accounts for 20 per cent of total allocations and is divided equally among all participating cities – this ensures that smaller cities in particular have a significant base allocation to run their transport system regardless of their size. The bulk of the formula (75 per cent) is allocated based on three demand-driven factors, which account for the number of people in a city, the number of public transport users in a city (the weighting of train commuters is reduced as trains are subsidised separately through the Passenger Rail Authority of South Africa) and the size of a city's economy.

Table W1.32 sets out how the final allocation for each municipality is determined, taking account of both the formula and incentive components.

In addition to the formula and performance incentive, R4.8 billion is allocated through the *public transport network grant* over the medium term for Phase 2A of the City of Cape Town's MyCiTi public transport network, linking the underserved areas of Khayelitsha and Mitchells Plain to the city centre. This project is funded through the BFI. This allocation includes additions of R105 million in 2023/24, R40 million in 2024/25 and R316 million in 2025/26, which align with the City of Cape Town's revised implementation plan and cash flow projections for the project over the 2023 MTEF period.

NEIGHBOURHOOD DEVELOPMENT PARTNERSHIP GRANT

The *neighbourhood development partnership grant* supports municipalities in developing and implementing urban network plans. The grant funds the upgrading of identified precincts to stimulate third-party public and private investment. In metropolitan municipalities, the focus is on upgrading urban hubs in townships. The National Treasury, in collaboration with other stakeholders, including the Department of Agriculture, Rural Development and Land Reform and the Department of Cooperative Governance, had identified a cohort of non-metropolitan municipalities to implement new projects as part of this grant. The National Treasury will continue to partner with these municipalities to identify, plan and implement infrastructure upgrades in targeted urban hub precincts. The grant is allocated R3.1 billion over the 2023 MTEF period, made up of R2.8 billion for the direct capital component and R316 million for the indirect technical assistance component. This allocation includes an additional allocation of R856 million in 2023/24 made in the 2022 Budget for metropolitan municipalities to continue to create jobs through labour-intensive projects as part of government's response to the impacts of the COVID-19 pandemic.

WATER SERVICES INFRASTRUCTURE GRANT

This grant, administered by the Department of Water and Sanitation, aims to accelerate the delivery of clean water and sanitation facilities to communities that do not have access to basic water services. It provides funding for various projects, including the construction of new infrastructure and the refurbishment and extension of existing water schemes. This grant has a direct and indirect component. In areas where municipalities have the capacity to implement projects themselves, funds are transferred through a direct component. In other areas, the Department of Water and Sanitation implements projects on behalf of municipalities through the indirect component.

Over the 2023 MTEF period, the direct component of this grant is allocated R12.1 billion and the indirect component is allocated R2.5 billion.

REGIONAL BULK INFRASTRUCTURE GRANT

This grant supplements the financing of the social component of regional bulk water and sanitation infrastructure. It targets projects that cut across several municipalities or large bulk projects within one municipality. The grant funds the bulk infrastructure needed to provide reticulated water and sanitation services to individual households. It may also be used to appoint service providers to carry out feasibility studies, related planning or management studies for infrastructure projects. This grant has a direct and indirect component. In areas where municipalities have the capacity to implement projects themselves, funds are transferred through a direct component. In other areas, the Department of Water and Sanitation implements projects on behalf of municipalities through an indirect component. A parallel programme, funded by the Department of Water and Sanitation, also funds water boards for the construction of bulk infrastructure. Though not part of the division of revenue, these projects still form part of the Department of Water and Sanitation's larger programme of subsidising the construction of regional bulk infrastructure for water and sanitation.

The direct component of the grant is allocated R11.6 billion over the 2023 MTEF period and grows at an average annual rate of 17.1 per cent. The overall allocation includes additional amounts from the BFI over the same period. Sol Plaatje Local Municipality is allocated

R86 million in 2023/24, R492 million in 2024/25 and R574 million in 2025/26 to refurbish and renew old water supply infrastructure. Drakenstein Local Municipality is allocated R305 million in 2023/24, R593 million in 2024/25 and R481 million in 2025/26 to upgrade sanitation infrastructure. Nelson Mandela Bay is allocated R348 million in 2023/24, R250 million in 2024/25 and R390 million in 2025/26 to avert the water supply crisis from the ongoing drought over the short term. The programme includes fixing water leaks, upgrading the water treatment works, borehole exploration and development, and upgrading a bulk water pipeline.

George Local Municipality's BFI allocation for its potable water security and remedial water project is reduced by R135.7 million in 2023/24 and R1.4 million in 2024/25 to align with the municipality's revised implementation plan and cash flow projections. This project is allocated R375 million in 2023/24 and R276 million in 2024/25.

The indirect component of this grant is allocated R11.3 billion over the 2023 MTEF period and grows at an average annual rate of 4.3 per cent.

INTEGRATED NATIONAL ELECTRIFICATION PROGRAMME GRANTS

These grants aim to provide capital subsidies to municipalities to provide electricity to poor households and fund bulk infrastructure to ensure a constant supply of electricity. Allocations are based on the backlog of households without electricity and administered by the Department of Mineral Resources and Energy. The grant only funds bulk infrastructure that serves poor households. The national electrification programme has helped provide 91 per cent of all poor households with access to electricity, as reported in the 2016 Community Survey (up from the 85 per cent reported in the 2011 Census). To sustain this progress, government will spend R18.9 billion on the programme over the 2023 MTEF period.

The *integrated national electrification programme (municipal) grant* is allocated R6.9 billion over the 2023 MTEF period and grows at an average annual rate of 4.4 per cent. The *integrated national electrification programme (Eskom) grant* is allocated R12 billion over the medium term and grows at an average annual rate of 5.2 per cent.

ENERGY EFFICIENCY AND DEMAND-SIDE MANAGEMENT GRANT

The *energy efficiency and demand-side management grant* funds selected municipalities to implement projects with a focus on public lighting and energy-efficient municipal infrastructure. The grant continues to make provision for municipalities to use funding for planning and preparing for the Energy Efficiency in Public Infrastructure and Building Programme. The programme aims to create a market for private companies to invest in the large-scale retrofitting of municipal infrastructure, and then be paid back through the savings on energy costs achieved. This has the potential to unlock energy and cost savings on a much larger scale. Municipalities can use 15 per cent of this grant funding to develop a project pipeline and thereby strengthen the market for energy companies that offer this service. This scaling up of energy-efficiency retrofits is a key part of meeting the goals in the National

Climate Change Response Strategy and the United Nations Framework Convention on Climate Change.

This approach will also allow municipalities to benefit from donor financing. A Guarantee Fund from the Nationally Appropriated Mitigation Action Facility has been jointly established with funding from the German and United Kingdom governments to help private energy service companies obtain loans to implement the Energy Efficiency in Public Infrastructure and Building Programme. The programme will have significant long-term effects on energy savings, carbon emissions and the market for energy-efficient technologies. The grant is allocated R720 million over the medium term and grows at an average annual rate of 4.3 per cent.

RURAL ROADS ASSET MANAGEMENT SYSTEMS GRANT

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

The Department of Transport will continue to work with the *municipal infrastructure grant* administrators to ensure that municipal roads projects are chosen, prioritised and approved using roads asset management systems data wherever possible. This grant is allocated R115 million in 2023/24, R121 million in 2024/25 and R126 million in 2025/26.

MUNICIPAL DISASTER RECOVERY GRANT

After the initial response to a disaster has been addressed, including through funding from the *municipal disaster response grant* discussed below, repairing damaged municipal infrastructure is funded through the *municipal disaster recovery grant*. This grant is allocated R321 million in 2023/24 to fund the repair and reconstruction of municipal infrastructure in KwaZulu-Natal damaged by natural disasters.

CAPACITY-BUILDING GRANTS AND OTHER CURRENT TRANSFERS

Capacity-building grants help to develop municipalities' management, planning, technical, budgeting and financial management skills. Other current transfers include the *EPWP integrated grant for municipalities*, which promotes increased labour intensity in municipalities, and the *municipal disaster response grant*. A total of R7.5 billion is allocated to capacity-building grants and other current transfers to local government over the medium term.

Table W1.32 Capacity building and other current grants to local government

R million	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
		Outcome		Revised budget		Medium-term estimates	
Direct transfers	**1 870**	**2 068**	**2 204**	**2 685**	**2 259**	**2 361**	**2 467**
Municipal disaster response	–	151	330	764	373	389	407
Municipal emergency housing	147	166	66	55	–	–	–
Infrastructure skills development	149	144	155	159	160	167	175
Local government financial management	533	545	552	566	569	594	621
Programme and project preparation support	310	314	341	361	377	394	411
Expanded public works programme integrated grant for municipalities	730	748	759	778	781	816	853
Indirect transfers	**111**	**120**	**135**	**140**	**147**	**153**	**160**
Municipal systems improvement	111	120	135	140	147	153	160
Total	**1 981**	**2 187**	**2 339**	**2 825**	**2 406**	**2 514**	**2 627**

Source: National Treasury

LOCAL GOVERNMENT FINANCIAL MANAGEMENT GRANT

The *local government financial management grant*, managed by the National Treasury, funds the placement of financial management interns in municipalities and the modernisation of financial management systems. This includes building in-house municipal capacity to implement multi-year budgeting, linking integrated development plans to budgets, and producing quality and timely in-year and annual reports. The grant supports municipalities in the implementation of the Municipal Finance Management Act and provides funds for the implementation of the municipal standard chart of accounts. This grant prioritises supporting municipalities with challenges in processes, procedures and systems to effectively implement the act and to improve compliance and areas of weakness identified in the financial management capability maturity model. Over the 2023 MTEF period, R1.8 billion is allocated to this grant.

INFRASTRUCTURE SKILLS DEVELOPMENT GRANT

The *infrastructure skills development grant* develops capacity within municipalities by creating a sustainable pool of young professionals with technical skills in areas such as water, electricity and town planning. The grant places interns in municipalities so that they can complete the requirements of the relevant statutory council within their respective built environment fields. The interns can be hired by any municipality at the end of their internship. The grant aims to collaborate with other sectors, such as the Department of Water and Sanitation and the Department of Cooperative Governance, with the primary objective of improving *infrastructure skills development grant* services. In addition, a shared services model should exist between municipalities to ensure effective management of the grant. Total allocations for this grant amount to R501 million over the 2023 MTEF period.

MUNICIPAL SYSTEMS IMPROVEMENT GRANT

The *municipal systems improvement grant* funds a range of projects in municipalities in support of the implementation of the district development model approach and the back to basics strategy, including helping municipalities set up adequate record management systems, drawing up organograms for municipalities and reviewing their appropriateness relative to their assigned functions, implementing the Integrated Urban Development Framework, and assisting municipalities with revenue collection plans and the implementation of the municipal standard chart of accounts. The Department of Cooperative Governance implements the indirect grant. The grant's total allocations amount to R460 million over the 2023 MTEF period and grow at an average annual rate of 4.5 per cent.

Over the next three years, a third of the grant's baseline will be allocated to continue supporting the institutionalisation of the district development model adopted by Cabinet in August 2019. The model is intended to improve coordination between national, provincial and local government, focusing on the municipal district and metropolitan spaces as the impact areas of joint planning, budgeting and implementation. In 2023/24, the grant will fund:

- Comprehensive institutional diagnostic assessments of the 21 district municipalities that are water service authorities. The purpose of the diagnostic assessments is to determine skills, systems, performance, institutional gaps and the main constraints impeding effective municipal performance.
- The development of institutional improvement/support plans that will inform all future capacity development programmes and municipal support initiatives to enhance the continued rollout of the model.

EPWP INTEGRATED GRANT FOR MUNICIPALITIES

This grant promotes the use of labour-intensive methods in delivering municipal infrastructure and services. To determine eligibility for funding, municipalities must have reported performance on the EPWP, including performance in the infrastructure, social and environment and culture sectors and on the full-time equivalent jobs created in these sectors in the last 18 months. A formula then determines allocations based on this performance as well as the labour intensity of the work opportunities created. The number of bands in which labour intensity is recorded in the formula has been expanded from seven to eight, providing an incentive for labour-intense projects to further increase their intensity. The formula is weighted to give larger allocations to rural municipalities. The grant is allocated R2.5 billion over the 2023 MTEF period, with an allocation of R781 million in 2023/24, R816 million in 2024/25 and R853 million in 2025/26.

MUNICIPAL DISASTER RESPONSE GRANT

The *municipal disaster response grant* is administered by the National Disaster Management Centre in the Department of Cooperative Governance as an unallocated grant to local government. The centre is able to disburse disaster-response funds immediately, without the need for the transfers to be gazetted first. The grant supplements the resources local government would have already used in responding to disasters. To ensure that sufficient funds are available in the event of disasters, section 20 of the Division of Revenue Bill allows for funds allocated to the *provincial disaster response grant* to be transferred to municipalities if funds in the municipal grant have already been exhausted, and vice versa. The bill also allows for more than one transfer to be made to areas affected by disasters, so that initial emergency aid can be provided before a full assessment of damages and costs is conducted.

Over the 2023 MTEF period, R1.2 billion is available for disbursement through this grant: R373 million in 2023/24, R389 million in 2024/25 and R407 million in 2025/26. There are no budget adjustments to the grant's baseline over the period, and the grant decreases by an average annual rate of 19 per cent. This is due to the additional funding of R393 million that was added in 2022/23 following the depletion of most disaster funding before the end of the financial year.

To ensure that sufficient funds are available to respond to disasters, section 20(7) of the Division of Revenue Bill allows funds from other conditional grants to be reallocated for this purpose, subject to the National Treasury's approval.

MUNICIPAL EMERGENCY HOUSING GRANT

The *municipal emergency housing grant* is intended to enable the Department of Human Settlements to rapidly respond to emergencies by providing temporary housing and repairs in line with the Emergency Housing Programme. The grant is limited to funding emergency housing and repairs following the immediate aftermath of a disaster, and not the other emergency situations listed in the programme. From 2023/24, this grant ceases to exist as funds are shifted to the vote of the national department to give the department the flexibility to respond timeously to housing emergencies.

PART 6: FUTURE WORK ON PROVINCIAL AND MUNICIPAL FISCAL FRAMEWORKS

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

This part of the annexure describes the main areas of work to be undertaken over the 2023 MTEF period as part of the ongoing review and refinement of the intergovernmental fiscal framework. Provinces and municipalities will be consulted on all proposed changes.

CROSS-CUTTING REFORMS

REVIEW OF THE CONDITIONAL GRANTS SYSTEM

In the Budget Forum and Budget Council meetings on 7 February 2022, several issues were raised regarding conditional grants, including the proliferation of grants and indirect conditional grants, frequent underspending on infrastructure grants, and duplication and fragmentation in both the provincial and municipal grant systems. In response, the Minister of Finance proposed a review of both municipal and provincial conditional grants.

The purpose of this review is to determine if the existing grant system is structured efficiently to provide efficient service delivery, roll out infrastructure, build capacity and provide operational support. The review will structure discussions about reforming the grant system based on the findings of the grants' impact. It will ask:

- Does the system fund the right things?
- Does it fund the things correctly?
- Does the system respond adequately to the differentiated approach at the provincial and local levels?

Following a thorough stakeholder consultation process, several research areas were identified and literature reviews conducted to gain insights into conditional grant programs and recent trends. Once all the reviews have been completed, stakeholders will be consulted on the findings. This will be followed by in-depth data collection and analysis to make evidence-based recommendations for reform. The proposed reforms will be considered in the 2024 Budget process, for implementation in the 2024 Budget. For this reason, there are no large-scale changes to conditional grants in the 2023 Budget.

IMPROVING INTERGOVERNMENTAL COORDINATION ON INFRASTRUCTURE INVESTMENT

Public infrastructure investments can play a major role in transforming South Africa's spatial development patterns. This requires a significant improvement in intergovernmental coordination in planning and budgeting for infrastructure. The National Treasury is working with provinces to ensure that their investments in schools, roads, health facilities and housing are made in locations that align with the spatial development plans of municipalities. Municipalities must be consulted and agree on the location and bulk services requirements of all provincial infrastructure projects. Joint planning sessions have been held between provinces and municipalities, and support in this area will continue in 2023/24. National departments will also be supported to participate in intergovernmental planning and to review sector policies and funding strategies to promote better alignment with spatial development frameworks. This is in line with the Cabinet-approved district development model. Since then, the National Treasury has enhanced the infrastructure reporting tool to show budgets and expenditures for social projects implemented by provinces according to location (district, local or city). This is essential for data analysis and transparency, as well as for achieving value for money, as it allows one to see which localities are prioritised more by sectors.

In 2023/24, the National Treasury will continue to review provincial infrastructure sector funding policies and propose how grants, incentives and other funding sources can best be structured to strengthen funding coordination to achieve spatial development objectives. The next step entails including long-term infrastructure projects across the three spheres of government that have not yet been approved to ensure the appropriateness of projects that must be undertaken in accordance with metropolitan spatial development frameworks. The aim is to consolidate infrastructure investment by the whole of government, both for projects whose budgets have already been approved and those whose budgets have not yet been approved.

In 2023/24, the National Treasury will continue to work with the National Disaster Management Centre to review the funding of disaster response and recovery activities. Climate change will make extreme weather events more common, and the disaster funding system needs to adapt to this new reality. The current system is designed to allow for the rapid release of funds following the declaration of a disaster. In addition to addressing the problems and inefficiencies within the existing system, the review must consider how to place greater emphasis on being prepared before disasters occur. The system also needs to be adapted to respond better to long-running disasters such as drought conditions that may last for several years.

REVIEW OF THE PROVINCIAL FISCAL FRAMEWORK

REVIEW OF THE PROVINCIAL EQUITABLE SHARE FORMULA

The Constitution stipulates that provinces are entitled to a share of nationally raised revenue to deliver on their mandates. Provincial funds are allocated using a formula that considers the spread of the burden of service delivery across provinces. The provincial equitable share formula contains weighted elements that reflect government priorities and incorporates elements to redress inequality and poverty across provinces.

The provincial equitable share task team, made up of representatives from the National Treasury and provincial treasuries, is reviewing the formula. The task team partners with sector departments, Statistics South Africa and the FFC on different components of the review. It reports to the Technical Committee on Finance, and the Budget Council considers and approves any proposed changes to the formula. The review of the health component was completed in 2021/22 and the reforms are being phased in over three years from 2022/23. In 2023/24, the review will focus on:

- Implementing the updated risk-adjusted factor within the health component.
- Working with the Department of Basic Education to develop options for how to account for the different funding needs of different types of schools and learners.

PREPARING FOR NATIONAL HEALTH INSURANCE IMPLEMENTATION

Government continues to prepare for the implementation of national health insurance. The implications that establishing the National Health Insurance Fund and increasingly channelling health budgets via this fund are likely to have for provincial finances are being discussed through consultative structures like the Technical Committee on Finance. In parallel, efforts to strengthen the health system will continue, including developing and piloting provider payment mechanisms, expanding the national insurance beneficiary registry, and purchasing and providing a prioritised set of health services. Government is also piloting a new quality improvement initiative within the non-personal services component of the *national health insurance indirect grant* that will help facilities meet the envisaged standards required for national health insurance accreditation. The experience gained from this pilot will inform future efforts to improve quality.

STREAMLINING PROVINCIAL CONDITIONAL GRANTS

Over the 2023 MTEF period, the National Treasury will work with the Department of Basic Education to allocate the funds that have been shifted from the *school backlogs infrastructure grant* to the *education infrastructure grant* as a result of the former being incorporated into the latter. Currently, these funds remain unallocated within the *education infrastructure grant*. Furthermore, the National Treasury will work with the Department of Transport and the Department of Public Works and Infrastructure to allocate the funding in the *provincial roads maintenance grant* for the construction of rural bridges under the Welisizwe Rural Bridges Programme. These funds for rural bridges are unallocated for 2024/25 and 2025/26 to allow more provinces to make submissions for their rural bridges projects. In 2023/24, the National Treasury will work with the Department of Health to shift funding from the *national health insurance grant* to the relevant grants where health programmes are funded.

THE ROLE OF PROVINCES IN PROMOTING ECONOMIC DEVELOPMENT

All three spheres of government must work with businesses and other relevant stakeholders to provide an enabling environment for faster and more inclusive economic growth. While the Economic Development Coordination Forum is reorganising following the merger of the Department of Economic Development into the Department of Trade, Industry and Competition, the National Treasury-led City Forum for Economic Development Managers is engaging provincial departments of economic development on issues of mutual interest every quarter to ensure coherence in policy implementation. The forum includes participants from provincial departments of economic development and their agencies; sector departments; the Department of Small Business Development; the Department of Cooperative Governance; the Presidency; the Department of Trade, Industry and Competition; financing institutions; metropolitan municipalities; secondary cities; and SALGA.

REVIEW OF THE LOCAL GOVERNMENT FISCAL FRAMEWORK

REFINEMENTS TO THE LOCAL GOVERNMENT EQUITABLE SHARE FORMULA

Government continues to work with stakeholders to improve the local government equitable share formula. Areas of work in the period ahead include:

- Improving the responsiveness of the formula to the different functions assigned to district and local municipalities. This work depends on the availability of credible official records of the functions assigned to each sphere of government. Policy and administrative work under way in the National Disaster Management Centre could help improve the targeting of funding for fire services.
- Reviewing and updating how the special support for councillor remuneration is calculated. This support is calculated separately from the rest of the equitable share formula but transferred with equitable share allocations. Support is only provided to small and poor municipalities, and the data used for determining eligibility needs to be updated.

A working group, comprising the Department of Cooperative Governance, the National Treasury and SALGA, with technical support from the FFC and Statistics South Africa, has identified areas for possible refinements that could not be accommodated in the 2012/13 formula review due to data availability.

Over the 2023 MTEF period, the National Treasury with the support of the working group will undertake the following reforms to refine the local government equitable share formula:

- Basic services component: Introduce a cost differential model, which takes into account factors such as distances, topography and settlement type.
- Community services component: Introduce a separate component in the *local government equitable share* for municipal health services, and an explicit sub-component for the firefighting function.
- Institutional component: Develop an objective criterion which municipalities can be benchmarked against in relation to their administrative functions and the policy options related to financing infrastructure in small and rural municipalities.

REVIEW OF THE MUNICIPAL CAPACITY-BUILDING SYSTEM

As part of the ongoing review of local government capacity-building programmes, the National Treasury, the Department of Cooperative Governance, SALGA and the FFC will work closely to implement the reforms agreed to through the review, including:

- Following a change management approach to tackling systems within the broader local government capacity-building system, starting with an inward approach within the National Treasury.
- Building on existing National Treasury work and seeking improvements in capacity building in parallel with new capability development initiatives.
- Following a new framework for sustainable capability development that emphasises collaboration, a problem-led approach and a whole-municipality (fully integrated) approach.
- Improving the administration of capacity-building grants and programmes, including rationalising them.

REFORMS TO LOCAL GOVERNMENT OWN REVENUE SOURCES

Municipalities play a critical role in boosting economic growth and providing an enabling environment for job creation by providing well-maintained and functioning infrastructure services. However, municipalities are finding it increasingly difficult to build the infrastructure required for growth and to meet the demands of rapid urbanisation. The National Treasury continues to explore how cities and other municipalities with a significant own revenue base can use a broader package of infrastructure financing sources to meet their developmental mandate. The National Treasury is implementing the reforms discussed below.

NORMS AND STANDARDS FOR ELECTRICITY SURCHARGES

Section 8 of the Municipal Fiscal Powers and Functions Act (2007) gives the Minister of Finance the power to prescribe compulsory national norms and standards for imposing municipal surcharges. To date, the minister has not prescribed such norms and standards. However, their absence does not restrict a municipality from imposing surcharges. Concerns have been raised that the process that municipalities must follow to impose municipal surcharges is unclear, with some municipalities having been legally challenged when they levy surcharges.

Electricity has been the largest component of service charges from which municipalities generate their revenue; however, this revenue source has been declining over the years due to electricity becoming unaffordable (caused by rapid increases in bulk tariffs). The National Treasury is conducting research to develop compulsory national norms and standards for regulating municipal surcharges on electricity and to determine a list of supplementary or replacement sources of revenue for electricity surcharges. These norms and standards will provide clarity and guidance for all municipalities and ensure that the process of determining electricity surcharges is transparent and the surcharges imposed are affordable. This work started in May 2022 and is anticipated to be completed in June 2023.

DEVELOPMENT CHARGES

Development charges are important components of a sustainable municipal infrastructure financing system, especially for cities and large urban municipalities, as they are used to finance land intensification. Despite their potential as an alternative option for financing infrastructure, municipalities have not fully used development charges due to uncertainty surrounding the regulatory frameworks. To address this uncertainty, amendments to the Municipal Fiscal Powers and Functions Act are proposed. The Municipal Fiscal Powers and Functions Amendment Bill proposes new, uniform regulations for levying development charges, thereby strengthening municipalities' revenue-raising framework. This will allow municipalities to mobilise own revenue resources to fund their infrastructure needs and support economic growth.

Once enacted, these amendments will create legal certainty for municipalities to levy development charges, regulate their applicability and create a more standardised, equitable and sustainable framework for development charges. The bill was submitted to Parliament in September 2022 and is awaiting processing. Once the bill has been processed, the amendments will be effective from the next municipal financial year (commencing 1 July).

MUNICIPAL BORROWING

The National Treasury has updated the original municipal borrowing policy framework. The updated policy proposes changes that aim to increase the term maturity of borrowing, improve the secondary market for the trade of municipal debt instruments, and define development finance institutions' role to avoid crowding out the private sector. The framework was endorsed by Cabinet on 17 August 2022. It has been presented and discussed at various stakeholder engagements and is available on the National Treasury's website. The updated municipal borrowing policy framework will be implemented in line with the recommendations that were endorsed at the Budget Forum Lekgotla meeting on 23 July 2021. To clarify the role of development finance institutions, engagements have commenced on developing a matrix of developmental objectives with development finance institutions.

The National Treasury continues to publish the Municipal Borrowing Bulletin on a quarterly basis. Copies can be obtained from www.mfma.treasury.gov.za