6

2023 BUDGET REVIEW

DIVISION OF REVENUE AND SPENDING BY PROVINCES AND MUNICIPALITIES

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

CHAPTER 6

DIVISION OF REVENUE AND SPENDING BY PROVINCES AND MUNICIPALITIES

In brief

- Provinces and municipalities provide a range of critical social and economic services. Over the next three years, they will focus on improving service delivery.
- Over the medium-term expenditure framework (MTEF) period, after providing for debt-service costs, the contingency reserve and provisional allocations, 48.6 per cent of nationally raised funds are allocated to national government, 41.5 per cent to provincial government and 10 per cent to local government.
- Direct transfers to provinces and municipalities over the medium term have been increased by R92.7 billion and R14.3 billion respectively. These funds help address various spending pressures.
- Government is strengthening the regulatory environment and support to subnational government to help address challenges in those spheres.

OVERVIEW

National government transfers more than half of nationally raised revenues to the nine provinces and 257 municipalities so they can perform their mandated functions. The 2023 Budget strikes a balance between building institutional capacity and ensuring real growth in transfers to provinces and municipalities to meet the needs of growing populations. The provinces are responsible for basic education, health, roads, human settlements, social development and agriculture. Municipalities provide basic services such as water, sanitation, electricity reticulation, roads and community services.

The 2023 Budget increases allocations for all three spheres of government to assist with urgent spending pressures. Over the medium term, direct provincial allocations will increase by R92.7 billion to R2.17 trillion. This increase consists of R76.9 billion added to the provincial equitable share and R15.8 billion added to direct conditional grants. Local government allocations will increase by a total of R14.3 billion, made up of R8.1 billion in the local government equitable share and R6.2 billion in direct conditional grants. This takes the total direct allocation to R521.7 billion over the same period. These allocations alleviate some of the financial pressures, particularly in health, education and basic services, where the costs of providing services are rising.

DIVISION OF REVENUE

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

Table 6.1 sets out the division of revenue over the MTEF period. Over the next three years, of the funds available after providing for debt-service costs and the contingency reserve, 48.6 per cent is allocated to national government, 41.5 per cent to provincial government and 10 per cent to local government. National transfers to the provinces will increase from

R695.1 billion in 2023/24 to R754.7 billion in 2025/26. Over the MTEF period, provincial transfers will grow at an average annual rate of 2.8 per cent. In 2023/24, a total of R567.5 billion is allocated to the provincial equitable share and R127.5 billion to conditional grants.

Allocations to local government increase by R14.3 billion over the medium term. Direct allocations to municipalities grow just above inflation, at an average annual rate of 5.9 per cent, while indirect allocations grow at an annual average rate of 4.3 per cent.

Table 6.1 Division of nationally raised revenue

R billion	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	Average annual MTEF growth
	Outcome			Revised estimate	Medium-term estimates			
Division of available funds								
National departments	**749.8**	**790.5**	**823.0**	**854.4**	**828.6**	**835.7**	**877.9**	**0.9%**
of which:								
Indirect transfers to provinces	*2.9*	*2.9*	*3.7*	*4.6*	*4.2*	*4.4*	*4.8*	*1.1%*
Indirect transfers to local government	*5.6*	*4.1*	*5.7*	*7.2*	*8.5*	*8.9*	*9.3*	*8.9%*
Provinces	**613.4**	**628.8**	**660.8**	**694.6**	**695.1**	**720.5**	**754.7**	**2.8%**
Equitable share	505.6	520.7	544.8	570.9	567.5	587.5	614.3	2.5%
Conditional grants	107.9	108.1	116.0	123.7	127.5	133.0	140.4	4.3%
Local government	**123.0**	**137.1**	**135.6**	**147.8**	**164.0**	**174.4**	**183.3**	**7.4%**
Equitable share	65.6	83.1	76.2	83.7	96.5	103.8	109.4	9.3%
Conditional grants	44.2	40.0	44.8	48.7	52.0	54.5	57.1	5.4%
General fuel levy sharing with metros	13.2	14.0	14.6	15.3	15.4	16.1	16.8	3.2%
Provisional allocation not assigned to votes[1]	–	–	–	–	1.5	3.9	4.0	
Non-interest allocations	**1 486.2**	**1 556.4**	**1 619.4**	**1 696.8**	**1 689.1**	**1 734.4**	**1 819.9**	**2.4%**
Percentage increase	*12.2%*	*4.7%*	*4.0%*	*4.8%*	*-0.5%*	*2.7%*	*4.9%*	
Debt-service costs	204.8	232.6	268.1	307.2	340.5	362.8	397.1	8.9%
Contingency reserve	–	–	–	–	5.0	5.0	5.0	
Unallocated reserve	–	–	–	–	–	35.7	44.5	
Main budget	**1 691.0**	**1 789.0**	**1 887.5**	**2 004.0**	**2 034.6**	**2 137.9**	**2 266.5**	**4.2%**
Percentage increase	*12.2%*	*5.8%*	*5.5%*	*6.2%*	*1.5%*	*5.1%*	*6.0%*	
Percentage shares								
National	*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. Includes amounts for Budget Facility for Infrastructure projects and other provisional allocations
Source: National Treasury

The division of revenue redistributes substantial resources from urban areas to fund rural services, which are often provided at high cost. It also subsidises services to millions of poor households in towns and cities through allocations to urban municipalities and provinces. Metropolitan municipalities account for 70.1 per cent of personal income tax revenue but receive only 32.6 per cent of local government transfers. In contrast, the 61 mostly rural local municipalities account for only 5.7 per cent of personal income tax revenues but receive 27.3 per cent of transfers to local government.

Changes to conditional grants in the 2023 Budget include the discontinuation of the conditional emergency housing grants for provinces and municipalities. The baselines of these two grants are shifted to the Department of Human Settlements. This will allow the department to respond quickly in the event of an emergency housing need. Over the 2023 MTEF period, R1.6 billion has been allocated to the programme. This includes R523.3 million allocated in 2023/24, R546.8 million allocated in 2024/25 and R571.3 million allocated in 2025/26.

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

STRENGTHENING PARTNERSHIPS TO DEVELOP CAPABILITY

National government is taking two approaches to expanding the tools that provinces and municipalities can use to improve spending and service delivery. The first approach seeks to streamline existing capability development programmes within government and forge new partnerships to increase their effectiveness. The second approach entails supporting the capability to deliver infrastructure across state institutions.

The National Treasury has developed a comprehensive set of public financial management leadership development initiatives for provincial members of the executive council, heads of departments and senior officials in provinces. In collaboration with the National School of Government, the National Treasury is sponsoring public financial management leadership training for provincial executives. To date, 120 of 150 executives have received training and development through the school. National government is coordinating with subnational governments to ensure that each province has a fully functional public financial management and budgetary executive ready to deliver effective services within a changing public finance landscape and a fiscally constrained environment.

In 2022 the National Treasury piloted training on change leadership and transversal management under the Cities Support Programme. Going forward, the National School of Government will offer these courses to local governments and public service organisations. Through this partnership, the school also strengthens its relationships with existing institutions such as the Municipal Institute of Learning in eThekwini and the Tshwane Leadership and Management Academy.

Through the Infrastructure Delivery Management System, provinces have created infrastructure units and institutionalised best practices. To improve service delivery, national government is supporting the subnational institutionalisation of the system. Accredited training programmes are being implemented as part of capacity-building initiatives. These focus on planning, budgeting, supply chain management, performance and risk management. In addition, an Infrastructure Delivery Management System curriculum is being developed for qualifications at a higher certificate level aligned with the Higher Education Qualification Framework.

PROVINCIAL REVENUE AND SPENDING

Provinces are responsible for providing social services, including public basic education for 13.4 million learners and healthcare for 50.8 million South Africans who do not have private insurance. Most recipients access these services free of charge or at very low cost. Provinces do not have significant taxation powers, and transfers through division of revenue accounted for about 97 per cent of provincial revenues in 2021/22.

Over the MTEF period, R31.1 billion is added for employee compensation in the provincial equitable share for the carry-through costs of the 2022/23 public-service wage increase. Of this amount, R10.2 billion is added in 2023/24, R10.4 billion in 2024/25 and R10.5 billion in 2025/26. An additional R20 billion goes to the education sector over the medium term.

In the health sector, R23.5 billion is added over the medium term. This funding will be used for antiretroviral therapy and to address backlogs in tuberculosis and other healthcare services, mitigate wage pressures, and fund laboratory services, medicine and other goods and medical supplies. In 2023/24, R7.5 billion is allocated, followed by R7.8 billion in 2024/25 and R8.1 billion in 2025/26.

Table 6.2 Provincial equitable share

R million	2022/23	2023/24	2024/25	2025/26	Average annual MTEF growth
	Estimate	Medium-term estimates			
Eastern Cape	73 593	73 292	76 022	79 620	2.7%
Free State	31 727	31 380	32 369	33 735	2.1%
Gauteng	122 060	120 752	125 438	131 095	2.4%
KwaZulu-Natal	116 697	115 948	118 858	123 812	2.0%
Limpopo	65 241	65 349	67 974	71 502	3.1%
Mpumalanga	46 754	46 674	48 437	50 752	2.8%
Northern Cape	15 219	15 150	15 718	16 463	2.7%
North West	40 255	40 096	41 765	43 843	2.9%
Western Cape	59 322	58 886	60 920	63 448	2.3%
Total	**570 868**	**567 528**	**587 500**	**614 271**	**2.5%**

Source: National Treasury

The provincial equitable share formula is made up of six components: education, health, basic, institutional, poverty and economic activity. A review of the formula led to changes to the health component in the 2022 MTEF period. One-third of the changes were implemented in 2022/23, another third will be implemented in 2023/24 and all changes will be implemented in 2024/25. The education component is currently being reviewed.

Table 6.3 Conditional grants to provinces

R million	2022/23	2023/24	2024/25	2025/26	MTEF total
	Revised estimate	Medium-term estimates			
Direct conditional grants					
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 grant: poverty relief and infrastructure development	85	86	90	94	271
Early childhood development grant	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) grant	242	242	253	264	758
Learners with profound intellectual disabilities grant	256	260	272	284	817
Maths, science and technology grant	425	433	453	473	1 358
National school nutrition programme	8 508	9 279	9 778	10 293	29 350
Provincial disaster response grant	97	146	152	159	457
District health programmes 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 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	–	–	–	–
Mass participation and sport development grant	604	604	631	659	1 894
Expanded public works programme integrated grant for provinces	433	435	454	475	1 364
Social sector expanded public works programme incentive grant for provinces	425	426	446	466	1 338
Community library services	1 573	1 571	1 641	1 715	4 927
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 grants	**123 730**	**127 544**	**132 963**	**140 402**	**400 909**
Indirect transfers	**4 612**	**4 178**	**4 447**	**4 763**	**13 389**
School infrastructure backlogs	2 403	2 079	2 172	2 269	6 520
National health insurance indirect	2 209	2 099	2 275	2 494	6 868

Source: National Treasury

MUNICIPAL REVENUE AND SPENDING

The local government fiscal framework responds to the constitutional assignment of powers and functions to this sphere. The framework refers to all resources available for 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 raised through their own powers. Between 2017/18 and 2021/22, own revenues accounted for an average of 82 per cent of total municipal revenues. However, revenue-raising capacity varies dramatically, with poor rural municipalities receiving most of their revenue from transfers.

In 2023/24, R164 billion is allocated as direct transfers to local government, while a further R8.5 billion is allocated to be spent by national departments on behalf of municipalities.

Of the direct transfers, 68.3 per cent will be transferred as unconditional funds for municipalities to use according to the priorities determined by their councils through their budget processes. The remaining 31.7 per cent will be transferred through conditional grants. In 2023/24, government is funding free basic services to 11.2 million households at a cost of R70.9 billion.

Table 6.4 Transfers to local government

R million	2022/23	2023/24	2024/25	2025/26	MTEF total
	Adjusted Budget	Medium-term estimates			
Equitable share and related	**87 311**	**96 546**	**103 772**	**109 368**	**309 686**
General fuel levy sharing with metros	**15 335**	**15 433**	**16 127**	**16 849**	**48 409**
Direct conditional grants	**51 542**	**51 992**	**54 484**	**57 113**	**163 588**
Integrated urban development	1 085	1 172	1 227	1 284	3 684
Municipal disaster recovery	3 319	321	–	–	321
Municipal disaster response	764	373	389	407	1 169
Municipal infrastructure	16 842	17 545	18 331	19 150	55 026
Energy efficiency and demand-side management	223	224	243	253	720
Integrated national electricification programme	2 120	2 212	2 311	2 415	6 938
Informal settlements upgrading partnership	4 273	4 365	4 561	4 765	13 691
Municipal emergency housing	55	–	–	–	–
Urban settlements development	7 352	8 149	8 793	9 343	26 286
Infrastructure skills development	159	160	167	175	501
Local government financial management	566	569	594	621	1 783
Neighbourhood development partnership	1 293	1 475	647	676	2 798
Programme and project preparation support	361	377	394	411	1 182
Expanded public works programme intergrated	778	781	816	853	2 451
Public transport network	6 013	6 794	7 752	8 369	22 915
Rural roads asset management systems	115	115	121	126	362
Regional bulk infrastructure	2 521	3 496	4 099	4 045	11 640
Water services infrastructure	3 701	3 864	4 038	4 219	12 120
Total direct transfers	**154 188**	**163 972**	**174 382**	**183 330**	**521 684**
Indirect transfers	**8 171**	**8 481**	**8 862**	**9 259**	**26 602**
Municipal systems improvement	140	147	153	160	460
Integrated national electricification programme	3 588	3 821	3 993	4 172	11 986
Neighbourhood development partnership	201	101	105	110	316
Regional bulk infrastructure	3 470	3 607	3 769	3 938	11 315
Water services infrastructure	771	805	841	879	2 526

Source: National Treasury

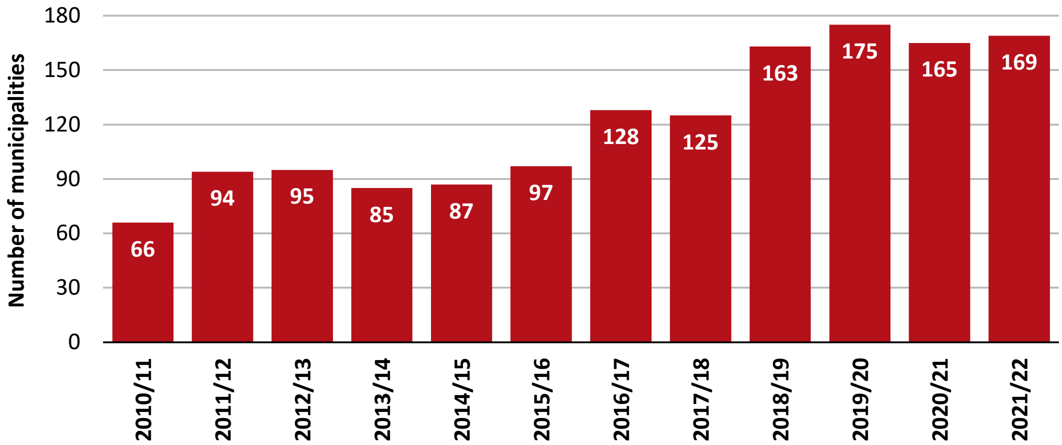
Measures to cushion poor households from electricity tariff increases

The National Energy Regulator of South Africa has approved a bulk electricity tariff increase of 18.7 per cent for Eskom, effective from 1 April 2023. Because the municipal financial year begins on 1 July, Eskom often charges municipalities higher rates than its other customers to recover revenue lost in the first three months of its financial year. An additional R1.1 billion is allocated to the electricity component of the local government equitable share formula in 2023/24 to offset this additional charge for the households that receive free basic electricity within municipalities.

Municipal financial management

The National Treasury's 2022 *State of Local Government Finances* report found that 169 municipalities were in financial distress at the end of 2021/22. The report noted a continued pattern of deterioration: only 66 of the 257 municipalities had been in financial distress at the end of 2010/11. Revenue management was the most prevalent factor contributing to this financial distress.

Figure 6.1 Municipalities in financial distress



Source: National Treasury

Most outstanding municipal revenues are owed mostly by households, followed by commercial customers and government institutions. Households' debt has been increasing over time and threatens the sustainability of different services.

Municipalities in turn owed water boards and water trading entities more than R15 billion – and owed Eskom approximately R39.8 billion as at 30 June 2022. Municipal arrears for bulk electricity are increasing rapidly.

Figure 6.2 Municipal debtors, 2021/22

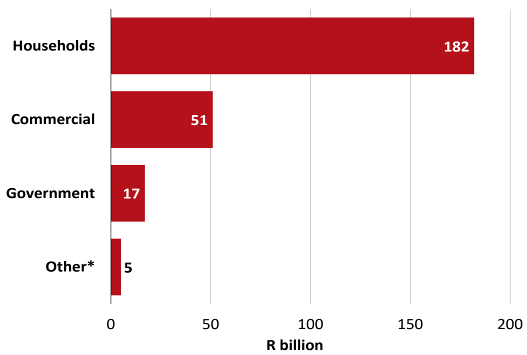
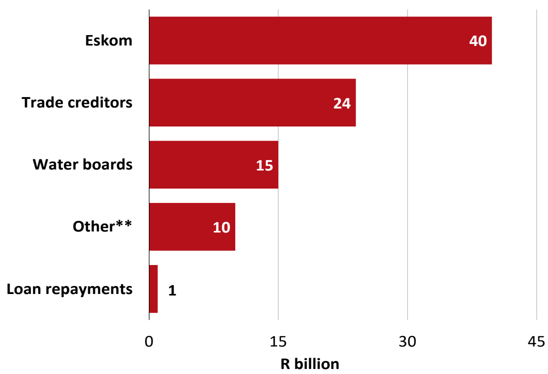


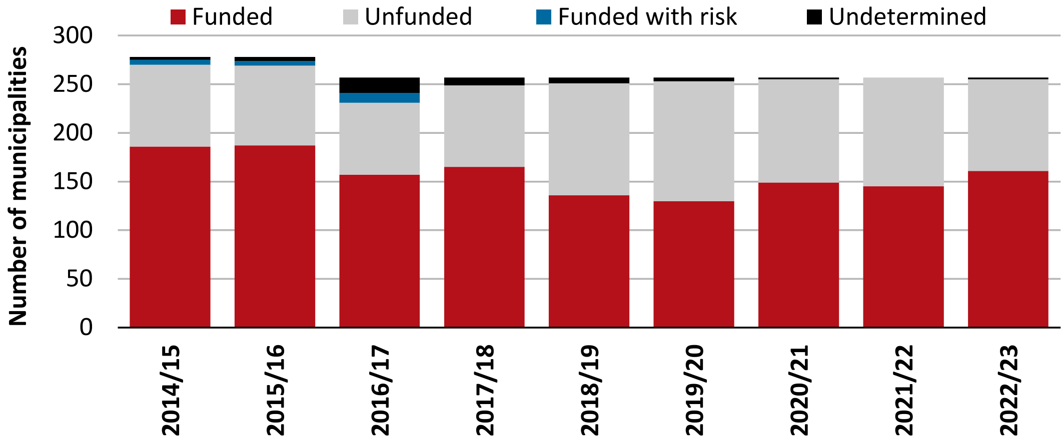
Figure 6.3 Municipal creditors, 2021/22



**Includes rental and equipment leases income, interest on arrears and other recoveries, and outstanding payments from national or provincial government for projects carried out by municipalities on their behalf*
***Includes PAYE deductions, output VAT less input VAT, pensions or retirement and Auditor-General*
Source: National Treasury

Many municipalities fail to adopt funded budgets, which means they will not be financially sustainable and implies that they lack credible financial management, although Figure 6.4 shows a marginal improvement in the last three years. In 2021/22, 112 municipal councils voted to adopt budgets that they knew were not funded, making some form of financial distress inevitable. Elected councils are responsible for determining and budgeting for municipal priorities. Neither national nor provincial government can compel local governments to adopt different budgets, although they may advise that their proposed budgets are unfunded. National and provincial engagements with municipalities are used to identify areas for improvement in these budgets, and advisors from the National Treasury-funded Municipal Finance Improvement Programme provide in-person assistance.

Figure 6.4 Municipalities with unfunded budgets



Source: National Treasury

The Municipal Finance Management Act (2003) mandates provincial intervention when a municipality, as a result of its own financial crisis, is unable to meet its obligations to provide basic services or fulfil financial commitments. If the provincial government cannot or does not adequately intervene, then national government is obligated to do so.

At present, 43 municipalities are in financial and service delivery crisis, requiring intervention from national and provincial government. These municipalities are struggling to meet their mandated obligations and provide an acceptable level of service to their communities. The Eastern Cape and North West provinces contain the highest number of municipalities in crisis.

A series of inductions is under way to educate new council members about national and provincial financial interventions and how they benefit the municipality. Thirty-one of the 43 municipal councils have been inducted and the National Treasury is developing 14 financial recovery plans. In addition, these municipalities are receiving technical support to improve their revenue collection and management. The National Treasury has trained these and other municipalities on how to develop and apply tariffs, budget funding plans and property rate reconciliation tools. The National Treasury is also working with provincial treasuries to identify municipalities nearing financial crisis to provide targeted support. Members of the Municipal Finance Improvement Programme have been assigned to six provincial treasuries to enhance their support capacity.

Strengthening municipal governance and financial management

A number of national initiatives aim to improve municipal governance, service delivery and financial management. Public trust is eroding as a result of substandard municipal services, deteriorating infrastructure and perceptions that public money is wasted. To help address this, the National Treasury and the Department of Cooperative Governance will work with their provincial and municipal counterparts on the following:

- Government is reviewing the municipal finance management regulatory framework, including the Municipal Property Rates Act (2004), Municipal Systems Act (2000) and Municipal Finance Management Act. The review aims to improve consistency in municipal financial policies, reduce incidents of unfunded budgets, strengthen revenue collection and management, and address irregular expenditure with associated consequences. It is expected to be completed during 2023/24, after which legislation and regulations will be amended and developed as needed.
- The consequence management and accountability framework developed by the National Treasury is now in effect. It outlines processes and procedures required for municipalities and municipal entities to enforce accountability in relation to financial misconduct and financial offences.

Norms and standards for municipal electricity surcharges

The National Treasury is developing compulsory national norms and standards to regulate municipal surcharges on electricity and identify alternative sources of revenue to replace electricity surcharges.

The process to be followed by municipalities in order to impose municipal surcharges is currently unclear and some municipalities have been legally challenged when they levy surcharges. Electricity is the largest component of service charges from which municipalities generate their revenue. This revenue source has been declining over the years as electricity prices increase and reliability of supply declines. Moreover, a gradual shift to renewable forms of energy by households and business will have significant implications for municipalities. As a result, the municipal electricity market is changing structurally, and it is necessary to reconsider how related revenues are charged and collected. There are also indications that some municipalities are considering surcharges for customers supplied directly by Eskom, although customers are resistant to this idea.

The compulsory norms and standards will provide clarity for municipalities and ensure that the process of determining surcharges is transparent and results in affordable surcharges. This work started in May 2022 and a draft for consultation is expected by June 2023.

CONCLUSION

The 2023 MTEF period provides for targeted allocations to provinces and municipalities, with an emphasis on key basic services. Despite significant financial support provided to subnational governments over the years, they are mostly still not able to optimise resource use and improve service delivery. National government is improving the tools available to provinces and municipalities to assist in improving efficiency, building strong capable institutions and spending more effectively to fulfil their mandates. To be effective, these reforms will require political will, good governance and better financial controls.