W1

Explanatory memorandum to the division of revenue

Background

Section 214(1) of the Constitution requires that every year a Division of Revenue Act determine the equitable division of nationally raised revenue between national government, the nine provinces and 257 municipalities. The division of revenue process takes into account the powers and functions assigned to each sphere, fosters transparency and is at the heart of constitutional cooperative governance.

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

This explanatory memorandum to the 2019 Division of Revenue Bill fulfils the requirement set out in section 10(5) of the Intergovernmental Fiscal Relations Act that the bill be accompanied by an explanatory memorandum detailing how it takes account of the matters listed in sections 214(2)(a) to (j) of the Constitution, government's response to the FFC's recommendations, and any assumptions and formulas used in arriving at the respective divisions among provinces and municipalities. This memorandum complements the discussion of 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 2019 division of revenue.
- Part 3 sets out how the FFC's recommendations on the 2019 division of revenue have been taken into account.
- Part 4 explains the formula and criteria for the division of the provincial equitable share and conditional grants among provinces.
- Part 5 sets out the formula and criteria for the division of the local government equitable share and conditional grants among municipalities.
- Part 6 summarises issues that will form part of subsequent reviews of provincial and local government fiscal frameworks.

The Division of Revenue Bill and its underlying allocations are the result of extensive consultation between national, provincial and local government. The Budget Council deliberated on the matters discussed in this memorandum at several meetings during the year. The approach to local government allocations was discussed with organised local government at technical meetings with the South African Local Government Association (SALGA), culminating in meetings of the Budget Forum (the Budget Council and SALGA). An extended Cabinet meeting involving ministers, provincial premiers and the SALGA chairperson was held in October 2018. The division of revenue, and the government priorities that underpin it, was agreed for the next three years.

Part 1: Constitutional considerations

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

National interest and the division of resources

The national interest is captured in governance goals that benefit the nation as a whole. The National Development Plan sets out a long-term vision for the country's development. This is complemented by the strategic integrated projects overseen by the Presidential Infrastructure Coordinating Council and the 14 priority outcomes adopted by Cabinet in 2014 for the 2014–2019 medium-term strategic framework. Government is expected to adopt a new medium-term strategic framework following the 2019 elections, which will inform allocations in future years. In the 2018 *Medium Term Budget Policy Statement*, the Minister of Finance outlined how the resources available to government over the 2019 medium-term expenditure framework (MTEF) would be allocated to help achieve government's goals. Cabinet's commitment to keeping South Africa's debt on a sustainable path is coupled with commitments to achieve national priorities that must be supported in the budget. Chapter 4 of the 2018 *Medium Term Budget Policy Statement* and Chapters 5 and 6 of the 2019 *Budget Review* discuss how funds have been allocated across the three spheres of government based on these priorities. The framework for each conditional grant allocated as part of the division of revenue also notes how the grant is linked to the 14 priority outcomes.

Provision for debt costs

The resources shared between national, provincial and local government include proceeds from national government borrowing used to fund public spending. National government provides for the resulting debt costs to protect the country's integrity and credit reputation. A more detailed discussion can be found in Chapter 7 of the 2019 *Budget Review*.

National government's needs and interests

The Constitution assigns exclusive and concurrent powers and functions to each sphere of government. National government is exclusively responsible for functions that serve the national interest and are best centralised. National and provincial government have concurrent responsibility for a range of functions. Provincial and local government receive equitable shares and conditional grants to enable them to provide basic services and perform their functions. Functions may shift between spheres of government to better meet the country's needs, 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, together with conditional grants for basic service delivery.

Growth in allocations to provincial and local government have been safeguarded to reflect the priority placed on health, education and basic services, as well as the rising costs of these services as a result of higher wages, and bulk electricity and water costs. Transfers to local government have grown significantly in recent years, providing municipalities with greater resources to deliver basic services. This is in addition to local government's substantial own revenue-raising powers.

The 2019 division of revenue prioritises the sustained delivery of free basic services in municipalities and adds funds for the expansion of key social welfare programmes in provinces.

Fiscal capacity and efficiency

National government has primary revenue-raising powers. Provinces have limited revenue-raising capacity and the resources required to deliver provincial functions do not lend themselves to self-funding or cost recovery. Due to their limited revenue-raising potential, and their responsibility to implement government priorities, provinces receive a larger share of nationally raised revenue than local government. Municipalities finance most of their expenditure through property rates, user charges and fees. But their ability to raise revenue varies – rural municipalities raise significantly less revenue than large urban and metropolitan municipalities.

Local government's share of nationally raised revenue has increased from 3 per cent in 2000/01 to 9.1 per cent over the 2019 MTEF period. The local government equitable share formula incorporates a revenue adjustment factor that considers the fiscal capacity of the recipient municipality (full details of the formula are provided in part 5 of this annexure).

The mechanisms for allocating funds to provinces and municipalities are continuously reviewed to improve their efficiency. As such, government's approach to funding provincial infrastructure aims to promote better planning and implementation, and improve efficiency in the delivery of health and education infrastructure. To maximise the effect of allocations, many provincial and local government conditional grants use criteria that consider the recipient's efficiency in using allocations in the past.

Developmental needs

Developmental needs are accounted for at two levels. First, in the determination of the division of revenue, which continues to grow the provincial and local government shares of nationally raised revenue 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 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 are redistributive towards poorer provinces and municipalities. Through the division of revenue, government continues to invest in economic infrastructure (such as roads) and social infrastructure (such as schools, hospitals and clinics) to stimulate economic development, create jobs, and address economic and social disparities.

Obligations in terms of national legislation

The Constitution 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 2019 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 adjusted downwards. Allocations are assured (voted, legislated and guaranteed) for the first year and are transferred according to a payment schedule. To contribute to longer-term predictability and stability, estimates for a further two years are published with the annual proposal for appropriations. Adjusted estimates as a result of changes to data underpinning the equitable share formulas and revisions to the formulas themselves are phased in to ensure minimal disruption.

Flexibility in responding to emergencies

Government has a contingency reserve for emergencies and unforeseeable events. In addition, four conditional grants for disasters and housing emergencies allow for the swift allocation and transfer of funds to affected provinces and municipalities in the immediate aftermath of a disaster. Sections 16 and 25 of the Public Finance Management Act (1999) make specific provision for the allocation of funds to deal with emergency situations. Section 30(2) deals with adjustment allocations for unforeseeable and unavoidable expenditure. Section 29 of the Municipal Finance Management Act (2003) allows a municipal mayor to authorise unforeseeable and unavoidable expenditure in an emergency.

Part 2: The 2019 division of revenue

The central fiscal objectives over the MTEF period are to stabilise the growth of debt as a share of GDP and to strictly adhere to the planned expenditure ceiling (see Chapter 3 of the 2019 *Budget Review*). However, the most important public spending programmes that help poor South Africans, contribute to growth and generate employment have been protected from major reductions. The 2019 division of revenue reprioritises existing funds to ensure these objectives are met. Parts 4 and 5 of this annexure set out in more detail how the changes to the baseline affect provincial and local government transfers.

Excluding debt-service costs and the contingency reserve, allocated expenditure shared across government amounts to R1.44 trillion, R1.54 trillion and R1.65 trillion over each of the MTEF years. These allocations take into account government's spending priorities, each sphere's revenue-raising capacity and responsibilities, and input from various intergovernmental forums and the FFC. The provincial and local equitable share formulas are designed to ensure fair, stable and predictable revenue shares, and to address economic and fiscal disparities.

Government's policy priorities for the 2019 MTEF period

To remain within the revised expenditure ceiling set out in Chapter 3 of the 2019 *Budget Review*, existing budgets need to be reprioritised to meet government's policy goals. Priorities over the 2019 MTEF period that are funded through reprioritisations in the division of revenue include:

- Improving the implementation of the Upgrading Informal Settlements Programme by ring-fencing funds within conditional grants.
- Eradicating pit latrines in schools.
- Supporting the roll-out of free sanitary products to learners from low-income households.

These reprioritisations complement baselines that provide R1.97 trillion to provinces and R414.7 billion to local government in transfers over the 2019 MTEF period. These transfers fund basic education, health, social development, roads, housing and municipal services.

The fiscal framework

Table W1.1 presents the medium-term macroeconomic forecasts for the 2019 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

	2018/19		2019/20		2020/21		2021/22
R billion/percentage of GDP	2018 Budget	2019 Budget	2018 Budget	2019 Budget	2018 Budget	2019 Budget	2019 Budget
Gross domestic product	5 025.4	5 059.1	5 390.1	5 413.8	5 808.3	5 812.4	6 249.1
Real GDP growth	*1.5%*	*0.7%*	*1.9%*	*1.5%*	*2.1%*	*1.9%*	*2.1%*
GDP inflation	*5.4%*	*6.4%*	*5.3%*	*5.4%*	*5.5%*	*5.4%*	*5.3%*
National budget framework							
Revenue	**1 321.1**	**1 285.4**	**1 427.8**	**1 403.5**	**1 542.7**	**1 505.1**	**1 632.9**
Percentage of GDP	*26.3%*	*25.4%*	*26.5%*	*25.9%*	*26.6%*	*25.9%*	*26.1%*
Expenditure	**1 512.2**	**1 509.9**	**1 632.6**	**1 658.7**	**1 757.5**	**1 769.6**	**1 900.5**
Percentage of GDP	*30.1%*	*29.8%*	*30.3%*	*30.6%*	*30.3%*	*30.4%*	*30.4%*
Main budget balance[1]	**-191.1**	**-224.5**	**-204.8**	**-255.2**	**-214.8**	**-264.4**	**-267.6**
Percentage of GDP	*-3.8%*	*-4.4%*	*-3.8%*	*-4.7%*	*-3.7%*	*-4.5%*	*-4.3%*

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 2019 MTEF period after accounting for new policy priorities.

Table W1.2 Division of nationally raised revenue

R million	2015/16	2016/17 Outcome	2017/18	2018/19 Revised estimate	2019/20	2020/21 Medium-term estimates	2012/22
Division of available funds							
National departments	**546 065**	**555 739**	**592 686**	**638 170**	**684 735**	**733 128**	**777 674**
of which:							
Indirect transfers to provinces	3 458	3 636	3 813	4 730	4 561	4 980	5 675
Indirect transfers to local government	10 370	8 112	7 803	7 887	7 208	7 109	8 167
Provinces	**471 424**	**500 384**	**538 553**	**572 212**	**612 266**	**657 115**	**701 000**
Equitable share	386 500	410 699	441 331	470 287	505 554	542 909	578 645
Conditional grants	84 924	89 685	97 222	101 925	106 712	114 206	122 355
Local government	**98 338**	**102 867**	**111 103**	**117 258**	**127 289**	**137 881**	**149 498**
Equitable share	49 367	50 709	55 614	60 518	68 973	75 683	82 162
Conditional grants	38 313	40 934	43 704	44 271	45 149	48 171	52 154
General fuel levy sharing with metros	10 659	11 224	11 785	12 469	13 167	14 027	15 182
Provisional allocation not assigned to votes	–	–	–	–	19 210	11 376	18 904
Non-interest allocations	**1 115 827**	**1 158 990**	**1 242 341**	**1 327 640**	**1 443 500**	**1 539 500**	**1 647 077**
Percentage increase	*9.7%*	*3.9%*	*7.2%*	*6.9%*	*8.7%*	*6.7%*	*7.0%*
Debt-service costs	128 796	146 497	162 645	182 218	202 208	224 066	247 408
Contingency reserves	–	–	–	–	13 000	6 000	6 000
Main budget expenditure	**1 244 623**	**1 305 486**	**1 404 986**	**1 509 858**	**1 658 707**	**1 769 566**	**1 900 485**
Percentage increase	*10.0%*	*4.9%*	*7.6%*	*7.5%*	*9.9%*	*6.7%*	*7.4%*
Percentage shares							
National departments	*48.9%*	*48.0%*	*47.7%*	*48.1%*	*48.1%*	*48.0%*	*47.8%*
Provinces	*42.2%*	*43.2%*	*43.3%*	*43.1%*	*43.0%*	*43.0%*	*43.1%*
Local government	*8.8%*	*8.9%*	*8.9%*	*8.8%*	*8.9%*	*9.0%*	*9.2%*

Source: National Treasury

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

Table W1.3 Changes over baseline

R million	2019/20	2020/21
National departments	-1 193	-3 423
Provinces	508	-340
Local government	375	419
Allocated expenditure	**-310**	**-3 344**

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

	2019/20	2020/21	2021/22
R million	Allocation	Forward estimates	
National[1]	1 084 180	1 150 974	1 239 678
Provincial	505 554	542 909	578 645
Local	68 973	75 683	82 162
Total	**1 658 707**	**1 769 566**	**1 900 485**

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 2019 *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:

a) "An equitable division of revenue raised nationally, among the national, provincial and local spheres of government;

b) "the determination of each province's equitable share in the provincial share of that revenue; and

c) "any other allocations to provinces, local government or municipalities from the national government's share of that revenue, and any conditions on which those allocations should be made."

The act requires that the FFC table these recommendations at least 10 months before the start of each financial year. The FFC tabled its *Submission for the Division of Revenue 2019/20* to Parliament in May 2018. This submission focuses on the difficulties of sustaining equitable economic growth and development in South Africa in the face of fiscal constraints.

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. The relevant national departments are considering the recommendations that do not relate to the division of revenue, and they will respond directly to the FFC.

Recommendations that apply directly and indirectly to the division of revenue

Chapter 2: Re-engineering the Intergovernmental Fiscal Relations System

Recentralisation – implications for service delivery and intergovernmental fiscal relations

The FFC recommends, "Developing and strengthening control measures other than earmarked conditional grant funding to improve service delivery and attainment of specific priority outcomes. The control measures should be underpinned by tighter monitoring and reporting of sub-national governments on the use of grant funding and associated outcomes of such spending. National Treasury should ensure that decisive action such as withholding of funds is taken by national sector departments as soon as cases where grant funding is inefficiently and/or ineffectively spent have been detected."

Government response

Government recognises the need for appropriate control measures to ensure that conditional grants achieve their intended service delivery and priority objectives. In line with the recommendation, government is focused on monitoring outcomes and outputs, rather than inputs and activities. This reflects a shift towards monitoring the outcomes achieved through the programmes funded by grants, rather than project-by-project monitoring.

Nonetheless, the conditional grant system includes a range of grants for different objectives. It cannot be characterised as a "one-size-fits-all" system. While some grants are tightly monitored and reported, others permit greater flexibility in how grants are used (in line with the FFC's concern about the "recentralisation" of control, expressed elsewhere in this chapter of the recommendations). For example, the review of local government infrastructure grants led by the National Treasury together with the Department of Cooperative Governance, SALGA and the FFC recommended increasing differentiation in local government funding because of the differing municipal contexts. The *integrated urban development grant* introduced in 2019/20 will extend some of the fiscal reforms implemented in metropolitan municipalities to non-metropolitan cities. This grant allows municipalities discretion in allocating infrastructure investment and ensures that they are accountable for the outcomes achieved.

In terms of the annual Division of Revenue Act, the transferring officer of the grant (the department administering a conditional grant) is responsible for monitoring performance and withholding funds where necessary. However, the National Treasury is also empowered by section 216(2) of the Constitution to stop the transfer of funds to any organ of state that commits a serious or persistent breach of the measures prescribed to promote transparency, accountability and the effective financial management of the economy, debt and the public sector. A legislative framework and related policies, including guidelines and circulars, already exists to assist with early detection of issues that warrant withholding funds (by transferring officers or the National Treasury). Chapter 6 of the *Budget Review* describes complementary efforts to build municipal capacity.

Chapter 3: Provincial Fiscal Adjustment Mechanisms in Times of Protracted Fiscal Constraints – Case of the Health Sector

Accommodating maintenance in health infrastructure grants

The FFC recommends that, "The Minister of Finance, through the National Treasury, should ensure that the framework for health infrastructure conditional grants (*health facility revitalisation grant* and *National Health Insurance (non-personnel component)*) accommodate flexibility during periods of protracted fiscal constraint so that provinces can re-orientate their available capital allocations towards maintenance."

Government response

Government acknowledges that failing to maintain an asset significantly reduces its useful life, bringing forward the rehabilitation of assets. Both the *health facility revitalisation grant* and the *national health insurance indirect grant* include funds to maintain healthcare facilities. Provincial governments own and operate health facilities, therefore they are responsible for managing these assets. It is appropriate that provinces prioritise maintenance from their own revenues (including the provincial equitable share) and do not rely on transfers from national government to fund this function.

Chapter 4: The Incentive Effects of Intergovernmental Grants – Evidence from Municipalities

Greater flexibility in the use of grants

The FFC recommends that, "The Minister of Finance, through National Treasury, gives municipalities (particularly those in small towns and mostly rural municipalities (categories B3 and B4)) greater flexibility in the use of grants to encourage innovative approaches to resolving local problems."

Government response

Government agrees on the principle of applying local solutions to local problems. However, not all municipalities can take advantage of increased flexibility to innovate. As a result, government has reformed the local government fiscal framework to increase flexibility for more capable municipalities and support less capacitated municipalities to perform their basic functions. The review mentioned above concluded that expenditure should be more strictly supervised in less capacitated municipalities (including those in small towns and rural areas) and they should be provided with more support. This will minimise wastage and improve efficiency.

National and provincial departments continuously evaluate their supervision methods to strengthen them. In addition, the same review recommends improving management of the grant system as one of its key reforms and this FFC recommendation will inform that work.

Fiscal capacity

The FFC recommends that, "A fiscal capacity component be introduced to the equitable share formula to make it more efficient and incentivising. The component should incorporate two aspects:

- Recognising the revenue-raising effort of municipalities, and
- Capturing the redistributive element of addressing horizontal imbalances."

Government response

Government addressed this recommendation when the FFC, SALGA and the Department of Cooperative Governance reviewed the equitable share formula during 2012. The Constitution does not allow national government to reduce transfers to a municipality based on their success in collecting their own revenues. The formula does, however, acknowledge that there are objective differences in how much revenue different municipalities are able to raise. The local government equitable share formula addresses redistribution through the community and institutional components. These components allocate larger amounts (per household) to municipalities with a low revenue base to fund basic administrative and governance capacity, and core municipal functions.

Chapter 5: Assessing the Efficiency of Provincial Infrastructure Programmes – The Cases of Education, Health and Public Transport

Developing clear performance evaluation frameworks

The FFC recommends that, "The national sector departments of education, health and public transport develop clear performance evaluation frameworks for the provincial infrastructure grants under their control."

Government response

Government welcomes this recommendation and will explore establishing this type of framework for these infrastructure grants. The Division of Revenue Act requires national departments administering schedule 4 to 7 grants to evaluate performance and submit reports to the National Treasury after the end of the financial year. In the past, the National Treasury has provided guidance on these reports, but government has not yet developed a framework for the evaluations. The proposed framework should use information from monitoring systems already implemented through the Infrastructure Reporting Model. The framework can complement performance and expenditure reviews conducted by the National Treasury and the Department of Planning, Monitoring and Evaluation.

The National Treasury and the Department of Planning, Monitoring and Evaluation will consult the relevant departments on developing this framework for implementation in the 2020 Budget.

Publishing criteria infrastructure grants reductions

The FFC recommends that, "The Minister of Finance, through National Treasury, set and publish the criteria to be measured in monitoring and evaluating infrastructure grants. The assessment criteria regarding infrastructure cuts should also be published."

Government response

There are grant-specific frameworks that detail the required outputs and conditions. Each grant administrator monitors and evaluates performance against the relevant framework.

The criteria used to reduce each infrastructure grant in the 2018 MTEF period were published in parts 4 and 5 of the Explanatory Memorandum to the 2018 Division of Revenue. There are fewer reductions in the 2019 MTEF period, but again the details are set out in parts 4 and 5 of the Explanatory Memorandum to the 2019 Division of Revenue. These reductions are necessary to consolidate the fiscus and would not otherwise be effected.

Chapter 6: Assessing the Effectiveness of Intergovernmental Fiscal Relations Instruments in Addressing Water Challenges

Review of norms and standards

The FFC recommends that, "A review of basic norms and standards for water services and the associated Local Government Equitable Share (LGES) be undertaken by the Department of Water and Sanitation (DWS)."

Government response

Government acknowledges this recommendation. Section 27(1)(b) of the Constitution states that, "Everyone has the right to have access to sufficient food and water." The Water Services Act (1997) defines this right in terms of quantity, quality and assurance of supply. The basic services subsidy in the local government equitable share includes funding to provide free basic water (six kilolitres per poor household per month). This is the prescribed minimum water supply services necessary for households, including households in informal settlements.

The amount per household is in line with the World Health Organization standard, which stipulates 25 litres per person per day for a household of eight people. In 2009 the Constitutional Court ruled that the six kilolitres provided by the City of Johannesburg is constitutional.

The Department of Cooperative Governance intends to review the national Indigence Policy Framework, including the provision of free basic water.

Clearer statements of grant objectives

The FFC recommends that, "Clearer statements of grant objectives to achieve defined basic service levels or sustainability of services are established by the DWS."

Government response

Conditional grants to local government fund the eradication of backlogs and provision of services in line with government policy. These grants do not prescribe service levels. Grants can only fund existing government policy. The Department of Water and Sanitation's National Water Policy Review commits the department to the "development, in collaboration with the South African Local Government Association and Cooperative Governance and Traditional Affairs, of clear definitions, norms, standards and criteria for provision of basic water supply facilities to households across a range of settlement types and spatial settings".

The framework for the *municipal infrastructure grant* specifies that the grant includes providing poor households with basic water and sanitation services. In addition, the framework for the *water services infrastructure grant* specifies that the grant funds outputs including reticulated water supply, on-site sanitation, water and health, and hygiene awareness and end-user education.

Qualified staff and grant allocation

The FFC recommends that, "The allocation of conditional grants be made conditional on the employment of appropriately qualified staff with commensurate mandates."

Government response

Government agrees that appointing qualified personnel must be prioritised for municipalities to function effectively and efficiently.

Individual conditional grants can include employment provisions for municipalities before funds are transferred. The departments responsible for administering individual conditional grants can explore minimum standards for the sector funded through that grant. For example, the *integrated urban development grant* requires a low vacancy rate among section 57 managers for municipalities to be eligible to join the grant. However, these types of conditions should not compromise equity and service delivery. National and provincial governments are constitutionally required to help municipalities build capacity.

Stronger grant conditions

The FFC recommends that, "Stronger conditions be attached to financial transfers to ensure compliance and that funds allocated are properly spent for the purposes indicated. Grant funding should be withheld from municipalities that do not have the necessary measures to monitor and control water consumption, or which do not meet criteria or have valid abstraction licences. Similar procedures must be applied for water-borne sanitation projects."

Government response

Government agrees that it is important to ensure funds are spent on their intended purpose. Withholding funds is one tool to ensure compliance. The Division of Revenue Act requires that the National Treasury and the transferring officer of a grant must follow certain processes before withholding funds. Government allows provinces and municipalities to present their remedies to prevent reoccurrence and avoid the need for withholding. As a result, conditional grants are only withheld after extensive consultation with all related parties.

Low water consumption and valid abstraction licences are not currently required in grant frameworks, therefore they are not grounds for withholding transfers. Government's priority is to confirm appropriate plans for infrastructure delivery before grant funds are transferred. However, the National Treasury will engage the Department of Water and Sanitation on the possibility of including the recommended conditions in future as the grant system moves towards incentivising improved operations and maintenance. Government will also remain cognisant of the FFC's caution against using conditional grants to limit scope for innovation by municipalities.

Resumption of Blue Drop reporting

The FFC recommends that, "Roles be clarified and support provided in the following ways:

"a) By the DWS providing support to achieve safe water. The resumption of Blue Drop reporting by DWS and associated monitoring and support to municipalities is critical. Conditional grants should only be available to municipalities that can show that there is a feasible programme to achieve compliance with standards."

Government response

Government welcomes this recommendation and the Department of Water and Sanitation has committed to resume publishing the Blue Drop report in its Master Plan.

Enhancing the quality of municipal reporting

"b) By COGTA and NT continuing efforts with sector departments such as DWS to enhance the quality of municipal reporting, with an emphasis on coordinating reporting requirements so that they become an integral part of overall administrative processes. Conditional grant funding should be subject to compliance with this reporting since its absence is a primary indicator that grants are not likely to be effectively and efficiently used."

Government response

Government welcomes this recommendation and is looking forward to working with the FFC to improve the quality of municipal reporting. The publication of new municipal reporting requirements for metropolitan municipalities in Municipal Finance Management Act Circular 88 marks a significant step towards coordinated reporting. These requirements, which will be rolled out to non-metropolitan municipalities in future, are informed by a performance reporting reform initiative by the National Treasury; the Department of Cooperative Governance; the Department of Planning, Monitoring and Evaluation; and Statistics South Africa to consolidate municipal reporting requirements. The Auditor-General of South Africa and others were also consulted. The reform process included more than two years of engagement to address fragmentation and duplication across the country, and resulted in a consolidated set of indicators for metropolitan planning and reporting. The Division of Revenue Act requires compliance with reporting requirements and some grant frameworks require specific reports before the transfer of funds can occur.

Part 4: Provincial allocations

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

National transfers to provinces increase from R572.2 billion in 2018/19 to R612.3 billion in 2019/20. Over the MTEF period, provincial transfers will grow at an average annual rate of 7 per cent to R701 billion. Table W1.5 sets out the transfers to provinces for 2019/20; a total of R505.6 billion is allocated to the provincial equitable share and R106.7 billion to conditional grants, which includes an unallocated R408 million for the *provincial disaster relief grant* and the *provincial emergency housing grant*.

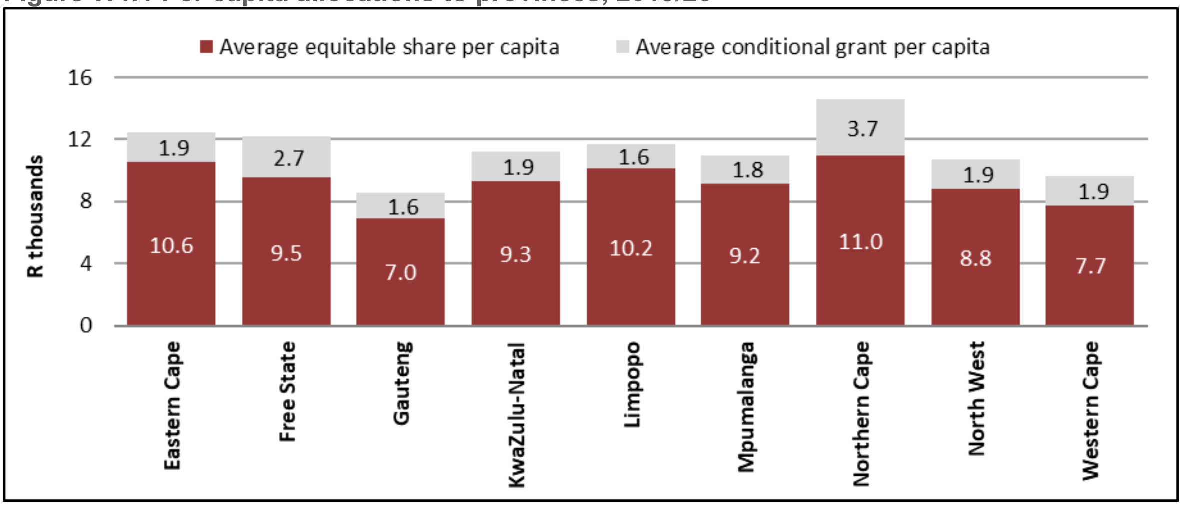
Table W1.5 Total transfers to provinces, 2019/20

R million	Equitable share	Conditional grants	Total transfers
Eastern Cape	68 824	12 079	**80 903**
Free State	28 187	7 863	**36 049**
Gauteng	102 448	23 077	**125 525**
KwaZulu-Natal	106 014	21 137	**127 151**
Limpopo	58 965	9 061	**68 026**
Mpumalanga	41 428	8 245	**49 673**
Northern Cape	13 424	4 483	**17 907**
North West	34 973	7 551	**42 524**
Western Cape	51 291	12 809	**64 099**
Unallocated	–	408	**408**
Total	**505 554**	**106 712**	**612 266**

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, 2019/20



Source: National Treasury

Changes to provincial allocations

The budget has been reprioritised in response to the weaker than expected economic and fiscal environment. To protect basic services funded by the provincial equitable share, the bulk of the reduction to provincial transfers (R3 billion) comes from a conditional grant, the *human settlements development grant*, which has a history of poor performance. This should minimise the impact on service delivery. The remaining R132.8 million of this reduction is from the equitable share as a result of the salary freeze on provincial political office bearers. The provincial equitable share is also increased by R78 million in 2019/20 for the

Sanitary Dignity Project (in addition to the R79 million added for this purpose at the time of the *Medium Term Budget Policy Statement*). The net changes to the provincial equitable share are an increase of R35.9 million in 2019/20 and decreases of R44.9 million in 2020/21 and R45.8 million in 2021/22. The provincial equitable share grows at an average annual rate of 7.2 per cent over the MTEF period, while conditional grant allocations grow by 6.3 per cent per year.

In addition to these baseline reductions, there were also several other reprioritisations and technical changes to direct conditional grants announced in the 2018 *Medium Term Budget Policy Statement* that will be implemented over the 2019 MTEF period. This includes a reprioritisation of R100 million over the MTEF period from the *comprehensive agricultural support grant* to the Agricultural Research Council for the construction of the foot and mouth disease vaccine production facility. Amounts of R30 million in 2020/21 and R30 million in 2021/22 are reprioritised from the *HIV, TB, malaria and community outreach grant* to support malaria control projects in southern Mozambique. The *education infrastructure grant*, *human settlements development grant*, *provincial roads maintenance grant* and *expanded public works programme* (EPWP) *integrated grant for provinces* have been reduced by R600 million, R400 million, R119.5 million and R41.8 million respectively over the 2019 MTEF period. These reductions have been made to assist with fiscal consolidation and to fund other government priorities.

The *school infrastructure backlogs grant*, which was due to merge with the *education infrastructure grant* in 2018/19, was extended and will continue over the 2019 MTEF period. Although the grant's performance has been sluggish, an assessment of its projects, both current and in the pipeline, revealed that merging the two grants will derail the progress made to date.

Accounting for all additions, reprioritisations and fiscal consolidation efforts, the net revisions to the provincial direct conditional grants since the 2018 *Medium Term Budget Policy Statement* amount to a reduction of R721 million in 2019/20, R1.4 billion in 2020/21 and R3 billion in 2021/22. This includes the impact of some shifts of funds to indirect grants.

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 2019 MTEF, the following amounts are allocated to the provincial equitable share respectively: R505.6 billion, R542.9 billion and R578.6 billion.

The equitable share formula

For the 2019 MTEF, the formula has been updated with data from Statistics South Africa's 2018 mid-year population estimates on age cohorts and the 2018 preliminary data published by the Department of Basic Education on school enrolment from the LURITS database. Data from the health sector and the 2017 General Household Survey for medical aid coverage and from the Risk Equalisation Fund for the risk-adjusted capitation index have also been updated. Allocation changes tend to mirror shifts in population across provinces, which result in changes in the relative demand for public services across these areas. The impact of these data updates on the provincial equitable shares will be phased in over three years (2019/20 – 2021/22).

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

Allocations calculated outside the equitable share formula

Over the 2019 MTEF period, some of the additional allocations are not in line with the weighted shares the formula produces and are therefore calculated outside of the provincial equitable share formula. These include additions that are in line with reforms in the social development sector, which see the incorporation of the conditional *social worker employment* and *substance abuse treatment* grants into the provincial equitable share. The *social worker employment grant*, which was created to help reduce the backlog in the number of unemployed social worker graduates, totals R678.9 million (R212.7 million in 2019/20, R226.9 million in 2020/21 and R239.4 million in 2021/22). The *substance abuse treatment grant*, which was created to build treatment facilities, amounts to R237 million (R74.8 million in 2019/20, R78.9 million in 2020/21 and R83.2 million in 2021/22). This change will enable provinces to fulfil the mandates of the respective grants through the equitable share. In addition, from 2020/21 the national Department of Social Development has agreed to cede the contracts it has with nine provincial food distribution centres and 84 community nutrition development centres to the nine provincial departments of social development. This will add R137.96 million (R66.8 million in 2020/21 and R71.2 million in 2021/22) to the provincial equitable share to allow provincial departments to manage these contracts.

To address the skills gap in technical capacity in the infrastructure environment, the Infrastructure Delivery Improvement Programme was introduced to assist provincial treasuries to improve the delivery of infrastructure across the country. As part of the final phase of the programme, the National Treasury provided provincial treasuries with technical assistance to oversee the implementation of the Infrastructure Delivery Management System in provinces. But the need for support will continue over the 2019 MTEF period, which is why a co-funding model has been developed to support the further capacitation of provincial treasuries. As a result, R135 million (R45 million in each of the respective years of the MTEF period) is added to the provincial equitable share. This allocation will be split equally per province.

To scale up the Sanitary Dignity Project, R157 million has been added to the equitable share in 2019/20. Of this, R79 million will be split equally among provinces, with the remainder allocated proportionally based on the number of girl learners in Grades 4 to 12 in the poorest schools (quintiles 1–3) in each province.

Over the 2019 MTEF period, R268.8 million (R86.8 million in 2019/20, R89 million in 2020/21 and R93 million in 2021/22) has been allocated to augment the capacity of provincial treasuries to support and intervene in municipalities facing financial crises. This allocation will be split equally among provinces.

Full impact of data updates on the provincial equitable share

Table W1.6 shows the full impact of the data updates on the provincial equitable share per province. It compares the target shares for the 2018 and 2019 MTEF periods. The size of each province’s share reflects the relative demand for provincial public services in each province, and the changes in shares from 2018 to 2019 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 below.

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

	2018 MTEF weighted average	2019 MTEF weighted average	Difference
Eastern Cape	13.7%	13.2%	-0.5%
Free State	5.6%	5.6%	0.0%
Gauteng	20.1%	20.9%	0.8%
KwaZulu-Natal	21.0%	20.8%	-0.2%
Limpopo	11.7%	11.5%	-0.2%
Mpumalanga	8.2%	8.2%	-0.0%
Northern Cape	2.7%	2.6%	-0.0%
North West	6.9%	7.0%	0.1%
Western Cape	10.1%	10.2%	0.1%
Total	**100.0%**	**100.0%**	**0.0%**

Source: National Treasury

Phasing in the formula

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

The equitable share formula data is updated every year and a new target share for each province is calculated, as shown in Table W1.7. The phase-in mechanism provides a smooth path to achieving these new weighted shares by the third year of the MTEF period. It takes the difference between the target weighted share for each province at the end of the MTEF period and the indicative allocation for 2019/20 published in the 2018 MTEF, and closes the gap between these shares by a third in each year of the 2019 MTEF period. As a result, one-third of the impact of the data updates is implemented in 2019/20, two-thirds in the indicative allocations for 2020/21, and the updates are fully implemented in the indicative allocations for 2021/22.

Table W1.7 Implementation of the equitable share weights

	2019/20	2019/20	2020/21	2021/22
Percentage	Indicative weighted shares from 2018 MTEF	2019 MTEF weighted shares 3-year phasing		
Eastern Cape	13.8%	13.6%	13.4%	13.2%
Free State	5.6%	5.6%	5.6%	5.6%
Gauteng	20.0%	20.3%	20.6%	20.9%
KwaZulu-Natal	21.1%	21.0%	20.9%	20.8%
Limpopo	11.7%	11.7%	11.6%	11.5%
Mpumalanga	8.2%	8.2%	8.2%	8.2%
Northern Cape	2.7%	2.6%	2.6%	2.6%
North West	6.9%	6.9%	6.9%	7.0%
Western Cape	10.1%	10.1%	10.2%	10.2%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: National Treasury

Provincial equitable share allocations

The final equitable share allocations per province for the 2019 MTEF are detailed in Table W1.8. These allocations include the full impact of the data updates, phased in over three years.

Table W1.8 Provincial equitable share

R million	2019/20	2020/21	2021/22
Eastern Cape	68 824	72 744	76 293
Free State	28 187	30 338	32 411
Gauteng	102 448	111 636	120 700
KwaZulu-Natal	106 014	113 370	120 324
Limpopo	58 965	62 986	66 779
Mpumalanga	41 428	44 475	47 389
Northern Cape	13 424	14 388	15 309
North West	34 973	37 694	40 325
Western Cape	51 291	55 278	59 115
Total	**505 554**	**542 909**	**578 645**

Source: National Treasury

Summary of the formula's structure

The formula, shown in Table W1.9, consists of six components that capture the relative demand for services across provinces and take into account specific provincial circumstances. The formula's components are neither indicative budgets nor guidelines as to how much should be spent on functions. 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 2019 Budget, the formula components are set out as follows:

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

Table W1.9 Distributing the equitable shares by province, 2019 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	14.5%	12.3%	11.3%	14.7%	7.6%	11.1%	13.2%
Free State	5.3%	5.4%	5.1%	5.3%	5.0%	11.1%	5.6%
Gauteng	18.7%	23.6%	25.5%	18.4%	34.6%	11.1%	20.9%
KwaZulu-Natal	22.0%	21.0%	19.7%	22.4%	15.9%	11.1%	20.8%
Limpopo	12.9%	10.1%	10.0%	13.3%	7.2%	11.1%	11.5%
Mpumalanga	8.4%	7.4%	7.8%	9.3%	7.4%	11.1%	8.2%
Northern Cape	2.3%	2.1%	2.1%	2.2%	2.1%	11.1%	2.6%
North West	6.6%	6.7%	6.9%	8.3%	6.4%	11.1%	7.0%
Western Cape	9.2%	11.4%	11.5%	6.3%	13.7%	11.1%	10.2%
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, the school-age population (5 to 17 years) and enrolment data. Each of these elements is assigned a weight of 50 per cent.

The methodology used to collect school enrolment numbers changed in 2017. Previously, learner enrolment numbers were based on annual surveys of schools. To ensure the formula remains equitable and fair, and reflects the most recent and officially endorsed data, it has used figures from the Department of Basic Education's data collection system, LURITS, since 2018/19. The system allows data to be verified and learners' progress to be tracked throughout their school careers. It also allows for duplicates and repetitions to be detected, improving the integrity of the numbers that are reported.

The changes are being phased in over three years to ensure provinces' allocations are stable and fair. Based on a review of the provincial equitable share formula, it was decided that the 2011 Census numbers used to capture the 5–17 age cohort should be replaced with Statistics South Africa's annual mid-year population estimates. These numbers are more up to date, which will help mitigate the shocks of updating the sub-component after a lag between Census updates. These changes will also be phased in over the 2019 MTEF period to ensure stability.

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

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

	Age cohort 5 – 17	School enrolment 2017	2018	Changes in enrolment	Weighted average 2018 MTEF	2019 MTEF	Difference in weighted average
Eastern Cape	1 859 255	1 902 213	1 881 735	-20 478	14.9%	14.5%	-0.38%
Free State	679 935	691 295	696 021	4 725	5.3%	5.3%	0.04%
Gauteng	2 458 767	2 342 025	2 360 207	18 182	18.1%	18.7%	0.60%
Kw aZulu-Natal	2 825 362	2 868 598	2 851 861	-16 737	22.3%	22.0%	-0.27%
Limpopo	1 566 223	1 768 125	1 753 297	-14 829	13.1%	12.9%	-0.22%
Mpumalanga	1 087 924	1 080 084	1 068 624	-11 461	8.4%	8.4%	-0.03%
Northern Cape	294 073	291 760	292 800	1 040	2.3%	2.3%	-0.02%
North West	880 695	827 628	831 886	4 258	6.5%	6.6%	0.15%
Western Cape	1 251 254	1 117 468	1 125 331	7 863	9.1%	9.2%	0.12%
Total	**12 903 488**	**12 889 196**	**12 861 760**	**-27 436**	**100.0%**	**100.0%**	**–**

Source: National Treasury

Health component (27 per cent)

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

The health component is presented in three parts below. Table W1.11 shows the shares of the risk-adjusted component, which accounts for 75 per cent of the health component.

Table W1.11 Risk-adjusted sub-component shares

Thousand	Mid-year population estimates 2018	Insured population 2017	Risk-adjusted index	Weighted population	Risk-adjusted shares 2018	2019	Change
Eastern Cape	6 522 734	9.9%	96.9%	5 691 913	12.8%	11.9%	-0.93%
Free State	2 954 348	14.9%	103.3%	2 595 869	5.3%	5.4%	0.10%
Gauteng	14 717 040	25.0%	105.4%	11 636 144	22.8%	24.2%	1.40%
KwaZulu-Natal	11 384 722	12.6%	98.9%	9 841 064	20.8%	20.5%	-0.29%
Limpopo	5 797 275	8.3%	91.6%	4 871 682	10.4%	10.1%	-0.26%
Mpumalanga	4 523 874	13.9%	95.7%	3 727 704	7.7%	7.8%	0.01%
Northern Cape	1 225 555	16.3%	100.7%	1 032 677	2.2%	2.2%	-0.06%
North West	3 978 955	15.5%	102.2%	3 437 395	7.1%	7.2%	0.04%
Western Cape	6 621 103	24.8%	104.0%	5 179 916	10.8%	10.8%	-0.01%
Total	**57 725 606**			**48 014 364**	**100.0%**	**100.0%**	**–**

Source: National Treasury

The risk-adjusted sub-component estimates a weighted population in each province using the risk-adjusted capitation index, which is calculated using data from the Council for Medical Schemes' Risk Equalisation Fund. The percentage of the population with medical insurance, based on the 2017 General Household Survey, is deducted from the 2018 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 column on the right in Table W1.11 shows the change in this sub-component between 2018 and 2019.

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

Thousand	Primary healthcare visits 2016/17	2017/18	Average	Share	Hospital workload patient-day equivalents 2016/17	2017/18	Average	Share
Eastern Cape	18 116	16 418	17 267	14.1%	5 531	4 328	4 930	13.7%
Free State	6 170	5 462	5 816	4.7%	1 925	1 976	1 950	5.4%
Gauteng	22 037	21 132	21 584	17.6%	8 931	7 315	8 123	22.6%
KwaZulu-Natal	29 211	28 403	28 807	23.5%	9 117	7 055	8 086	22.5%
Limpopo	15 269	14 858	15 064	12.3%	3 644	3 014	3 329	9.2%
Mpumalanga	9 449	9 160	9 305	7.6%	2 491	1 992	2 242	6.2%
Northern Cape	2 989	2 689	2 839	2.3%	761	563	662	1.8%
North West	8 010	7 455	7 732	6.3%	2 037	1 573	1 805	5.0%
Western Cape	14 413	14 140	14 277	11.6%	5 431	4 344	4 888	13.6%
Total	**125 664**	**119 717**	**122 691**	**100.0%**	**39 868**	**32 161**	**36 014**	**100.0%**

1. Some provincial numbers for patient-days and healthcare visits for 2016/17 have been restated, resulting in small variances from numbers published in 2016/17

Source: National Treasury

The output sub-component (shown in Table W1.12) uses patient load data from the District Health Information Services. The average number of visits at primary healthcare clinics in 2016/17 and 2017/18 is calculated to estimate each province's share of this part of the output component, which makes up 5 per cent of the health component. For hospitals, each province's share of the total patient-day equivalents from public hospitals in 2016/17 and 2017/18 is used to estimate their share of this part of the output sub-component, making up 20 per cent of the health component. In total, the output component is 25 per cent of the health component.

Table W1.13 shows the updated health component shares for the 2019 MTEF period.

Table W1.13 Health component weighted shares

	Risk-adjusted	Primary healthcare	Hospital component	Weighted shares		Change
Weight	**75.0%**	**5.0%**	**20.0%**	**2018**	**2019**	
Eastern Cape	11.9%	14.1%	13.7%	13.1%	12.3%	-0.80%
Free State	5.4%	4.7%	5.4%	5.2%	5.4%	0.15%
Gauteng	24.2%	17.6%	22.6%	22.4%	23.6%	1.19%
KwaZulu-Natal	20.5%	23.5%	22.5%	21.5%	21.0%	-0.42%
Limpopo	10.1%	12.3%	9.2%	10.2%	10.1%	-0.13%
Mpumalanga	7.8%	7.6%	6.2%	7.4%	7.4%	0.02%
Northern Cape	2.2%	2.3%	1.8%	2.1%	2.1%	-0.01%
North West	7.2%	6.3%	5.0%	6.7%	6.7%	0.03%
Western Cape	10.8%	11.6%	13.6%	11.4%	11.4%	-0.02%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**–**

Source: National Treasury

Basic component (16 per cent)

The basic component is derived from the proportion of each province's share of the national population. This component constitutes 16 per cent of the total equitable share. For the 2019 MTEF, population data is drawn from the 2018 mid-year population estimates produced by Statistics South Africa. Table W1.14 shows how population changes have affected the basic component's revised weighted shares.

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

Thousand	Mid-year population estimates 2017	Mid-year population estimates 2018	Population change	% population change	Basic component shares 2018 MTEF	Basic component shares 2019 MTEF	Change
Eastern Cape	6 780	6 523	-257	-3.8%	12.1%	11.3%	-0.76%
Free State	2 864	2 954	90	3.1%	5.1%	5.1%	0.02%
Gauteng	13 888	14 717	829	6.0%	24.7%	25.5%	0.79%
KwaZulu-Natal	11 077	11 385	307	2.8%	19.7%	19.7%	0.02%
Limpopo	5 791	5 797	6	0.1%	10.3%	10.0%	-0.26%
Mpumalanga	4 386	4 524	138	3.1%	7.8%	7.8%	0.03%
Northern Cape	1 203	1 226	23	1.9%	2.1%	2.1%	-0.02%
North West	3 823	3 979	156	4.1%	6.8%	6.9%	0.09%
Western Cape	6 402	6 621	219	3.4%	11.4%	11.5%	0.08%
Total	**56 215**	**57 726**	**1 510**		**100.0%**	**100.0%**	**–**

Source: National Treasury

Institutional component (5 per cent)

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

Poverty component (3 per cent)

The poverty component introduces a redistributive element to the formula and is assigned a weight of 3 per cent. The poor population includes people who fall in the lowest 40 per cent of household incomes in the 2010/11 Income and Expenditure Survey. The estimated size of the poor population in each province is calculated by multiplying the proportion of people in that province that fall into the poorest 40 per cent of South African households by the province's population figure from the 2018 mid-year population estimates. Table W1.15 shows the proportion of the poor in each province from the Income and Expenditure Survey, the 2018 mid-year population estimates and the weighted share of the poverty component per province.

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

		Current (2018 MTEF)			New (2019 MTEF)			
Thousand	Income and Expenditure Survey 2010/11	Mid-year population estimates 2017	Poor population	Weighted shares	Mid-year population estimates 2018	Poor population	Weighted shares	Difference in weighted shares
Eastern Cape	52.0%	6 780	3 528	15.6%	6 523	3 394	14.7%	-0.9%
Free State	41.4%	2 864	1 186	5.2%	2 954	1 223	5.3%	0.1%
Gauteng	28.9%	13 888	4 010	17.7%	14 717	4 249	18.4%	0.7%
KwaZulu-Natal	45.3%	11 077	5 019	22.2%	11 385	5 158	22.4%	0.1%
Limpopo	52.9%	5 791	3 061	13.5%	5 797	3 064	13.3%	-0.3%
Mpumalanga	47.3%	4 386	2 073	9.2%	4 524	2 138	9.3%	0.1%
Northern Cape	40.8%	1 203	491	2.2%	1 226	500	2.2%	-0.0%
North West	47.9%	3 823	1 831	8.1%	3 979	1 906	8.3%	0.2%
Western Cape	21.9%	6 402	1 400	6.2%	6 621	1 448	6.3%	0.1%
Total		**56 215**	**22 597**	**100%**	**57 726**	**23 079**	**100.0%**	**–**

Source: National Treasury

Economic activity component (1 per cent)

The economic activity component is a proxy for provincial tax capacity and expenditure assignments. Given that these assignments are a relatively small proportion of provincial budgets, the component is assigned a weight of 1 per cent. For the 2019 MTEF, 2016 GDP-R data is used. Table W1.16 shows the weighted shares of the economic activity component.

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

	Current (2018 MTEF)		New (2019 MTEF)		Difference in weighted shares
	GDP-R, 2015 (R million)	Weighted shares	GDP-R, 2016 (R million)	Weighted shares	
Eastern Cape	315 603	7.8%	331 093	7.6%	-0.2%
Free State	205 350	5.1%	217 849	5.0%	-0.1%
Gauteng	1 382 096	34.1%	1 507 082	34.6%	0.5%
KwaZulu-Natal	649 124	16.0%	692 222	15.9%	-0.1%
Limpopo	289 940	7.2%	311 686	7.2%	0.0%
Mpumalanga	305 016	7.5%	323 722	7.4%	-0.1%
Northern Cape	85 282	2.1%	90 883	2.1%	-0.0%
North West	264 616	6.5%	279 733	6.4%	-0.1%
Western Cape	552 732	13.6%	596 043	13.7%	0.1%
Total	**4 049 760**	**100.0%**	**4 350 314**	**100.0%**	**0.0%**

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 or housing emergency.

Changes to conditional grants

The overall growth in direct conditional transfers to provinces averages 6.3 per cent over the medium term. Direct conditional grant baselines total R106.7 billion in 2019/20, R114.2 billion in 2020/21 and R122.4 billion in 2021/22. Indirect conditional grants amount to R4.6 billion, R5 billion and R5.7 billion respectively for each year of the same period.

Table W1.17 provides a summary of conditional grants by sector for the 2019 MTEF period. More detailed information, including the framework and allocation criteria for each grant, is provided in the 2019 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 2017/18.

Table W1.17 Conditional grants to provinces

R million	2018/19 Adjusted budget	2019/20	2020/21	2021/22	MTEF total
Agriculture, Forestry and Fisheries	**2 849**	**2 204**	**2 378**	**2 558**	**7 140**
Comprehensive agricultural support programme	2 019	1 538	1 676	1 814	5 028
Ilima/Letsema projects	552	583	615	653	1 852
Land care programme: poverty relief and infrastructure development	278	82	87	92	261
Arts and Culture	**1 424**	**1 501**	**1 584**	**1 679**	**4 764**
Community library services	1 424	1 501	1 584	1 679	4 764
Basic Education	**17 696**	**18 569**	**20 089**	**21 470**	**60 128**
Education infrastructure	10 094	10 514	11 467	12 327	34 308
HIV and AIDS (life skills education)	243	257	271	286	813
Learners with profound intellectual disabilities	187	221	243	256	720
Maths, science and technology	370	391	413	436	1 241
National school nutrition programme	6 802	7 186	7 696	8 165	23 047
Cooperative Governance and Traditional Affairs	**340**	**131**	**138**	**146**	**415**
Provincial disaster relief	324	131	138	146	415
Provincial disaster recovery	16	–	–	–	–
Health	**41 364**	**44 989**	**49 225**	**54 088**	**148 302**
HIV, TB, malaria and community outreach	19 922	22 039	24 408	27 753	74 200
Health facility revitalisation	6 057	6 007	6 360	6 858	19 225
Health professions training and development	2 784	2 940	3 102	3 273	9 315
Human papillomavirus vaccine	200	211	223	235	669
Human resources capacitation	–	606	1 063	1 127	2 796
National tertiary services	12 401	13 186	14 069	14 843	42 097
Human Settlements	**19 045**	**19 604**	**19 825**	**20 030**	**59 459**
Human settlements development	18 267	18 780	15 937	15 397	50 114
Title deeds restoration	519	548	578	–	1 126
Provincial emergency housing	260	277	295	311	883
Informal settlements upgrading partnership	–	–	3 015	4 322	7 337
Public Works	**824**	**868**	**917**	**968**	**2 753**
Expanded public works programme integrated grant for provinces	416	437	462	489	1 389
Social sector expanded public works programme incentive for provinces	408	431	454	479	1 365
Social Development	**777**	**518**	**553**	**583**	**1 655**
Early childhood development	491	518	553	583	1 655
Social worker employment	197	–	–	–	–
Substance abuse treatment	89	–	–	–	–
Sport and Recreation South Africa	**587**	**620**	**654**	**690**	**1 964**
Mass participation and sport development	587	620	654	690	1 964
Transport	**17 026**	**17 707**	**18 843**	**20 142**	**56 692**
Provincial roads maintenance	11 036	11 382	12 093	13 021	36 496
Public transport operations	5 990	6 326	6 750	7 121	20 196
Total direct conditional allocations	**101 932**	**106 712**	**114 206**	**122 355**	**343 274**
Indirect transfers	**4 730**	**4 561**	**4 980**	**5 675**	**15 216**
Basic Education	**2 272**	**2 027**	**1 769**	**2 339**	**6 135**
School infrastructure backlogs	2 272	2 027	1 769	2 339	6 135
Health	**2 458**	**2 534**	**3 211**	**3 336**	**9 081**
National health insurance indirect	2 458	2 534	3 211	3 336	9 081

Source: National Treasury

Agriculture 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 agro-processing infrastructure and directly supporting targeted farmers.

Over the medium term, R5 billion is allocated to this grant. This excludes previously unallocated amounts (R271.5 million in 2019/20, R295.8 million in 2020/21 and R320.1 million 2021/22) that have since been reprioritised out of the grant for the implementation of a new blended finance mechanism developed by the Department of Agriculture, Forestry and Fisheries and the Land Bank to leverage both government and private funds to extend more affordable credit to black farmers. This initiative seeks to create 450 black commercial farmers over the MTEF period.

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 EPWP. Over the medium term, R261 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 R583 million allocated for 2019/20, and a total of R1.9 billion over the MTEF period.

Arts and culture grant

The *community library services grant*, administered by the Department of Arts and Culture, aims to help South Africans access information to improve their socio-economic situation. The grant is allocated to the relevant provincial department and administered by that department or through a service-level agreement with municipalities. In collaboration with provincial departments of basic education, the grant also funds libraries that serve both schools and the general public. Funds from this grant may also be used to enable the shift of the libraries function between provinces and municipalities. The grant is allocated R4.8 billion over the next three years.

Basic education grants

The *education infrastructure grant* provides supplementary funding for ongoing infrastructure programmes in provinces. This includes the maintenance of existing infrastructure and the construction of new infrastructure to ensure school buildings meet the required norms and standards. The *education infrastructure grant*'s total allocation for this period is R34.3 billion; R10.5 billion in 2019/20, R11.5 billion in 2020/21 and R12.3 billion in 2021/22. An additional R200.3 million in 2019/20 has also been earmarked in KwaZulu-Natal and the Western Cape for the reconstruction and rehabilitation of school infrastructure affected by natural disasters.

Provincial education departments have to go through a two-year planning process to be eligible to receive incentive allocations for infrastructure projects. To receive the 2019/20 incentive, the departments had to meet certain prerequisites in 2017/18 and have their infrastructure plans approved in 2018/19. 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 needed to obtain a minimum score of 60 per cent to qualify for the incentive. Table W1.18 shows the final score and incentive allocation for each province.

Table W1.18 Education infrastructure grant allocations

R thousand	Planning assessment results from 2018	2019/20 Basic component	Incentive component	Disaster recovery funds	Final allocation for 2019/20
Eastern Cape	73%	1 397 462	188 071	–	1 585 532
Free State	65%	645 415	188 071	–	833 485
Gauteng	70%	1 286 645	188 071	–	1 474 715
KwaZulu-Natal	72%	1 798 773	188 071	200 319	2 187 162
Limpopo	58%	1 050 160	–	–	1 050 160
Mpumalanga	58%	731 792	–	–	731 792
Northern Cape	72%	451 747	188 071	–	639 817
North West	53%	902 484	–	–	902 484
Western Cape	83%	921 261	188 071	–	1 109 331
Total		**9 185 736**	**1 128 423**	**200 319**	**10 514 478**

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 and electricity on behalf of provinces. This grant is allocated R6.1 billion over the medium term in the Planning, Information and Assessment programme, including an additional R2.8 billion to provide safe and appropriate sanitation at schools. An allocation of R2 billion in 2019/20 will be used to replace 59 inappropriate and unsafe schools with newly built schools, provide clean water to 227 schools and provide appropriate sanitation to 717 schools.

The *national school nutrition programme grant* seeks 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 6.3 per cent, with a total allocation of R23 billion.

The *maths, science and technology grant* resulted from the merging of the *Dinaledi schools grant* and the *technical secondary schools recapitalisation grant*. This grant, in its fourth year, appears to be gaining some traction. It has increased the provision of ICT, workshop equipment and machinery apparatus to schools around the country, which should lead to better outcomes in maths and science in the long term. The grant's total allocation is R1.2 billion over the medium term.

The *HIV and AIDS (life skills education) programme grant* provides for life skills training, and sexuality and HIV/AIDS education in primary and secondary schools. It is fully integrated into the school system, with learner and teacher support materials provided for Grades 1 to 9. The grant's total allocation is R813 million over the medium term.

The *learners with profound intellectual disabilities grant* is in its second year of implementation and aims to expand access to education for learners with profound intellectual disabilities. Over the MTEF period, the grant will provide access to quality, publicly funded education to more than 10 000 such learners by recruiting 230 outreach team members and nine provincial grant coordinators. After starting with an allocation of R72 million in 2017/18, this grant has been allocated R719.9 million over the MTEF period.

Cooperative governance grant

The *provincial disaster relief 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 declared, without the need for the transfers to be gazetted first. The reconstruction of infrastructure damaged by disasters is funded separately through ring-fenced allocations in sector grants. Mitigation strategies against the ongoing drought have, in part, been funded by this grant.

To ensure that sufficient funds are available in the event of a disaster, section 21 of the 2019 Division of Revenue Bill allows for funds allocated to the *municipal disaster relief grant* to be transferred to provinces if funds in the *provincial disaster relief 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 2019 MTEF period, a total of R415 million has been allocated to the *provincial disaster relief grant*.

Health grants

The *national tertiary services grant* provides strategic funding to enable provinces to plan, modernise and transform tertiary hospital service delivery in line with national policy objectives. The grant operates in 29 tertiary hospitals across the nine provinces. Patient referral pathways often cross provincial borders and, as a result, many patients receive care in neighbouring provinces if the required services are not available in their home province. The urban areas of Gauteng and the Western Cape receive the largest shares of the grant because they provide the largest proportion of high-level, sophisticated services. The grant is allocated R42.1 billion over the medium term: R13.2 billion in 2019/20, R14.1 billion in 2020/21 and R14.8 billion in 2021/22 and will be used to fund medical specialists, equipment, and advanced medical investigation and treatment according to approved service specifications. The national Department of Health has reviewed the allocation criteria under this grant to ensure continued fairness in allocations to provinces and will be embarking on a consultation process with provinces on the new allocation model. It is anticipated that the new model will be implemented in the 2020 MTEF period.

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 2019 MTEF period, a total of R19.2 billion has been allocated to this grant. The health facility revitalisation component of the *national health insurance indirect grant* is allocated R4.3 billion over the medium term. Cabinet has approved additional allocations to this component to fund the planning and construction of the planned new academic hospital in Polokwane, in response to the need to strengthen tertiary healthcare services in Limpopo and expand the platform for training new health professionals.

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

Table W1.19 Health facility revitalisation grant allocations

R thousand	Planning assessment results from 2018	2019/20			Final allocation for 2019/20
		Basic component	Incentive component	Disaster recovery funds	
Eastern Cape	70%	576 912	208 076	-	784 988
Free State	55%	498 713	-	-	498 713
Gauteng	56%	859 028	-	-	859 028
KwaZulu-Natal	63%	1 145 421	208 076	-	1 353 497
Limpopo	50%	457 951	-	-	457 951
Mpumalanga	50%	344 915	-	-	344 915
Northern Cape	49%	386 706	-	-	386 706
North West	53%	508 549	-	-	508 549
Western Cape	74%	604 550	208 076	-	812 626
Total		**5 382 745**	**624 228**	**–**	**6 006 973**

Source: National Treasury

The *health professions training and development grant* funds the training of health professionals, and the development and recruitment of medical specialists. It enables the shifting of teaching activities from central to regional and district hospitals. The baseline for this grant is protected over the MTEF period, with an allocation of R9.3 billion over the medium term.

The *HIV, TB, malaria and community outreach grant* supports HIV/AIDS prevention programmes and specific interventions, including voluntary counselling and testing, prevention of mother-to-child transmission, post-exposure prophylaxis, antiretroviral treatment and home-based care. In the 2016 MTEF, the grant's scope was extended to include tuberculosis. In the 2018 Budget, a sub-component for community outreach services was introduced, so that funds used to support community health workers can be explicitly earmarked. This will help ensure that this cadre of workers is better integrated into national health services. This year, two new components are added to the grant. The first aims to strengthen the continued fight against malaria in three provinces. The second component enables the Department of Health to monitor the activities and outcomes of the TB portion of the grant. The grant's total baseline amounts to R74.2 billion over the medium term.

The *national health insurance indirect grant* continues to fund all preparatory work for universal health coverage, as announced in 2017/18. Over the 2019 MTEF period, this will be done through three components: health facilities revitalisation and two integrated components (personal services and non-personal services). The personal services component funds priority services for national health insurance, which include:

- Expanding access to school health services, focusing on optometry and audiology.
- Contracting general practitioners based on a set annual amount per patient instead of fees per service provided.
- Providing community mental health services, maternal care for high-risk pregnancies, screening and treatment for breast and cervical cancer, hip and knee arthroplasty, cataract surgeries and wheelchairs.

However, due to slow spending in the personal services component in 2018/19, R2.8 billion has been reprioritised from this component towards the new *human resources capacitation grant* over the MTEF period. This leaves the personal services component with allocations of R2.3 billion over the MTEF.

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. The non-personal services component is allocated R2.4 billion over the medium term to continue to fund initiatives to strengthen health information systems, clinics, and centralised chronic medicines dispensing and distribution.

The new *human resources capacitation grant*, previously a component within the *national health insurance indirect grant* announced in the 2018 *Medium Term Budget Policy Statement*, will now be transferred as a direct grant. It will enable provincial departments of health to fill critical posts in health facilities. These posts have been jointly prioritised between the respective provincial departments and the national department. A total of R2.8 billion has been allocated to this grant over the MTEF period.

In 2018/19, the human papillomavirus vaccine component of the *national health insurance indirect grant* became a standalone direct grant to provinces. Over the course of 2017, the national Department of Health worked to ensure that provincial departments were ready to take over the provision of this service and preserve the high coverage ratios that were achieved under this component. Over the 2019 MTEF period, a total of R669 million has been allocated to the *human papillomavirus vaccine grant*.

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. The grant's baseline is reduced by R3 billion over the MTEF period – R1 billion in 2020/21 and R2 billion in 2021/22 – in order to stabilise the growth of national debt. Over the 2019 MTEF period, a total of R50.1 billion has been allocated to this grant.

This grant is allocated using a formula with three components:

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

Table W1.20 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 that provinces must 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 W1.20 Human settlements development grant formula calculation

Components	Housing needs component	Poverty component	Population component	Grant formula shares
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%**	**13.7%**	**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%	10.0%	9.0%	7.3%
Free State	**5.9%**	**6.2%**	**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%**	**22.6%**	**23.7%**	**28.5%**
Ekurhuleni	9.1%	6.2%	6.1%	8.2%
City of Johannesburg	10.5%	8.1%	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%**	**18.9%**	**19.8%**	**18.3%**
eThekwini	7.0%	6.2%	6.6%	6.8%
Other KwaZulu-Natal municipalities	11.0%	12.7%	13.2%	11.6%
Limpopo	**4.4%**	**11.8%**	**10.4%**	**6.5%**
Mpumalanga	**6.2%**	**7.9%**	**7.8%**	**6.7%**
Northern Cape	**1.9%**	**2.1%**	**2.2%**	**2.0%**
North West	**10.0%**	**7.8%**	**6.8%**	**9.2%**
Western Cape	**12.7%**	**9.0%**	**11.2%**	**11.8%**
City of Cape Town	9.3%	5.6%	7.2%	8.3%
Other Western Cape municipalities	3.4%	3.4%	4.0%	3.5%
Total	**100%**	**100%**	**100%**	**100%**

Source: 2011 Census and General Household Survey

Government is committed to intensifying its efforts to upgrade informal settlements in partnership with communities. To promote this objective, a new window with specific conditions relating to informal settlement upgrading will be introduced in the *human settlements development grant* in 2019/20. This window amounts to 15 per cent of the formula-based grant allocation to each province. The funds ring-fenced for each province will be a minimum expenditure requirement, allowing them to invest more if necessary. This new window will require provinces to work with municipalities to identify and prioritise informal settlements for upgrading in 2019/20 and to submit a plan for each settlement to be upgraded, prepared in terms of the National Upgrading Support Programme's methodology. The window also requires the use of a partnership approach that promotes community ownership and participation in the upgrades.

This window serves as a planning and preparatory platform for the introduction of a new informal settlements upgrading grant in 2020/21. The new grant will be created by reprioritising funds from the *human settlements development grant*. Initial amounts of R3 billion in 2020/21 and R4.3 billion in 2021/22 have been set aside for this new grant in the outer years of the MTEF period. Further details on the new grant are discussed in Part 6. A similar approach is being taken in the *urban settlements development grant*, discussed in Part 5, with the creation of an informal settlements upgrading window in 2019/20 and the intention to introduce a separate grant for metropolitan municipalities in the outer years of the MTEF period.

In addition to the allocations determined through the formula, a total of R2.5 billion is ring-fenced within the *human settlements development grant* over the MTEF period to upgrade human settlements in mining towns in six provinces. These allocations respond to areas with significant informal settlement challenges, with a high proportion of economic activity based on the natural resources sector.

The *human settlements development grant* previously had funds ring-fenced for the eradication of the pre-2014 title deeds registration backlog. Given the slow progress to date, along with the impairment it had on the functioning on the property market, the *title deeds restoration grant* has been introduced to accelerate the backlog eradication process. The grant was introduced in 2018/19 and has a baseline of R1.1 billion over the first two years of the 2019 MTEF period. The grant comes to an end in 2020/21 and an indicative allocation of R609.6 million in 2021/22 will be phased back into the *human settlements development grant*.

A *provincial emergency housing grant* was also introduced in 2018/19 to enable the department 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 Emergency Housing Programme. In 2019/20, the grant's purpose has been expanded to fund the repair of houses damaged in disasters, if those repairs are cheaper than the cost of relocating households to temporary shelter that would have been funded through the grant. Over the 2019 MTEF period, a total of R882.9 million has been allocated to this grant.

Public works grants

The *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 R1.4 billion over the MTEF period.

Social development grants

The *early childhood development grant* is now in its third year. It plays a part in government's prioritisation of early childhood development, as envisioned in the National Development Plan. The grant has two distinct objectives: improve poor children's access to early childhood programmes and ensure that early childhood centres have adequate infrastructure. The grant baseline totals R1.7 billion over the MTEF period.

The *social worker employment grant* and the *substance abuse treatment grant* have been phased out, with funding incorporated into the provincial equitable share over the 2019 MTEF period. This will allow provinces to use their equitable share to start operating facilities built through the *substance abuse treatment grant*, and employ social workers previously funded through the *social worker employment grant*.

Sport and recreation grant

The *mass participation and sport development grant* aims to increase and sustain mass participation in sport and recreational activities in the provinces, with greater emphasis on provincial and district academies. The grant is allocated R2 billion over the MTEF period.

Transport grants

The *public transport operations grant* subsidises commuter bus services. It helps ensure that provinces meet their contractual obligations and provide services efficiently. The public transport contracting and regulatory functions may be assigned to certain metropolitan municipalities during 2019/20. If this takes place, funds for this grant will be transferred directly to the assigned municipality. The grant is allocated R20.2 billion over the MTEF period.

The *provincial roads maintenance grant* has three components. The largest component enables provinces to expand their maintenance activities, while the other two allow provinces to repair roads damaged by floods and rehabilitate roads that are heavily used in support of electricity production. The component for heavily used roads comes to an end in 2019/20. From 2020/21, the allocation will be part of the grant's incentive baseline. Grant allocations are determined using a formula based on provincial road networks, road traffic and weather conditions. These factors reflect the different costs of maintaining road networks in each province. The grant requires provinces to follow best practices for planning, and to use and regularly update road asset management systems.

The performance indicators for the incentive portion of the grant, based on traffic loads, safety engineering and visual condition indicators, came into effect in 2017/18. The total allocation for the MTEF period is R36.5 billion.

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 2019/20 budgets, and to promote better accountability and transparency by ensuring that all national allocations are included in municipal budgets.

Over the 2019 MTEF period, R414.7 billion will be transferred directly to local government and a further R22.5 billion has been allocated to indirect grants. Direct transfers to local government over the medium term account for 9 per cent of national government's non-interest expenditure. When indirect transfers are added to this, total spending on local government increases to 9.4 per cent of national non-interest expenditure.

Table W1.21 Transfers to local government

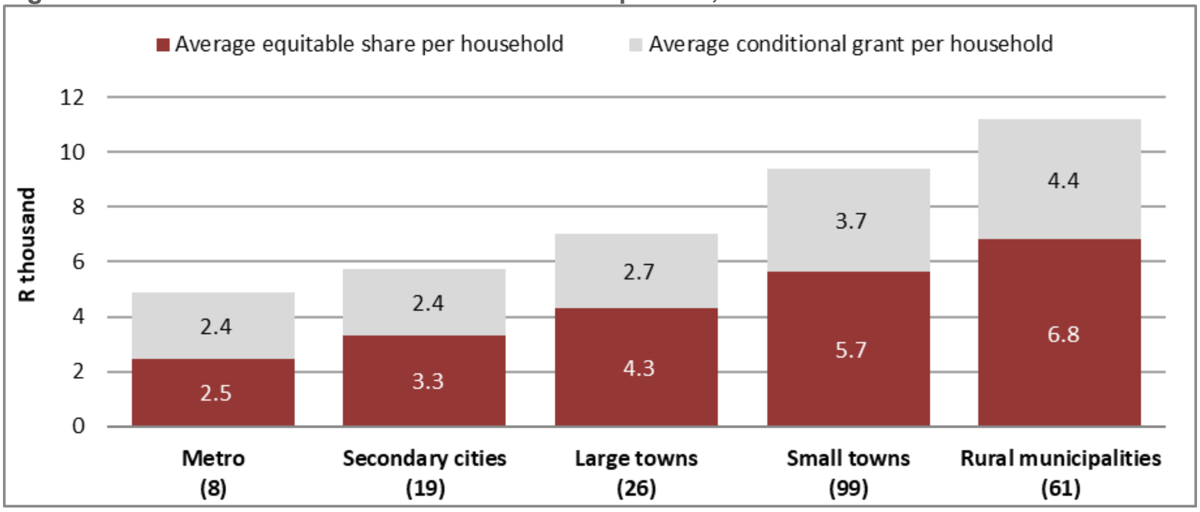
R million	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
		Outcome		Adjusted budget		Medium-term estimates	
Direct transfers	**98 338**	**102 867**	**111 103**	**119 971**	**127 289**	**137 881**	**149 498**
Equitable share and related	**49 367**	**50 709**	**55 614**	**62 732**	**68 973**	**75 683**	**82 162**
Equitable share formula[1]	44 211	45 259	49 928	56 722	62 648	69 017	75 136
RSC levy replacement	4 337	4 567	4 795	5 073	5 357	5 652	5 963
Support for councillor remuneration and ward committees	819	883	891	937	969	1 015	1 064
General fuel levy sharing with metros	**10 659**	**11 224**	**11 785**	**12 469**	**13 167**	**14 027**	**15 182**
Conditional grants	**38 313**	**40 934**	**43 704**	**44 771**	**45 149**	**48 171**	**52 154**
Infrastructure	37 044	39 259	41 888	42 919	43 252	46 167	50 039
Capacity building and other	1 268	1 675	1 815	1 851	1 897	2 004	2 115
Indirect transfers	**10 370**	**8 112**	**7 803**	**7 887**	**7 208**	**7 109**	**8 167**
Infrastructure	10 119	8 093	7 699	7 795	7 087	6 981	8 032
Capacity building and other	251	19	103	92	122	128	135
Total	**108 708**	**110 979**	**118 905**	**127 858**	**134 497**	**144 990**	**157 666**

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

Source: National Treasury

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, the proportion of revenue from transfers and own revenues varies dramatically across municipalities, with poor rural municipalities receiving most of their revenue from transfers, while urban municipalities raise the majority of their own revenues. This differentiation in the way municipalities are funded will continue in the period ahead. 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, 2019/20*



**Reflects funds allocated through Division of Revenue Bill. Allocations to district municipalities are reassigned to local municipalities where possible.*
Source: National Treasury

Changes to local government allocations

Over the next three years there is strong growth in allocations to the local government equitable share, while growth in conditional grants recovers following significant reductions made in the 2018 MTEF. As a result, total direct allocations to local government grow at an annual average rate of 7.6 per cent over the MTEF period. The changes to each local government allocation are summarised in Table W1.22.

Table W1.22 Revisions to direct and indirect transfers to local government

R million	2019/20	2020/21	2021/22	2019 MTEF Total revisions
Technical adjustments	**-6**	**-5**	**4**	**-7**
Direct transfers	**–**	**–**	**–**	**–**
Municipal infrastructure	-918	-939	-1 013	-2 870
Integrated urban development	918	939	1 013	2 870
Urban settlements development	265	-2 718	-4 102	-6 555
Informal settlements upgrading partnership	–	2 985	4 384	7 369
Integrated national electrification programme	-265	-268	-282	-815
Indirect transfers	**-6**	**-5**	**4**	**-7**
Integrated national electrification programme	-8	-9	–	-17
Regional bulk infrastructure	0	2	3	5
Water services infrastructure	2	1	1	4
Additions to baselines	**548**	**1 045**	**1 433**	**3 026**
Direct transfers	**548**	**1 045**	**1 433**	**3 026**
Public transport network	354	1 045	1 433	**2 832**
Municipal disaster recovery	194	–	–	**194**
Reductions to baseline	**-223**	**-662**	**-12**	**-896**
Direct transfers	**-173**	**-112**	**-12**	**-296**
Urban settlements development	-100	-100	–	-200
Integrated urban development	-61	–	–	-61
Expanded public works programme integrated	-12	-12	-12	-35
Indirect transfers	**-50**	**-550**	**–**	**-600**
Integrated national electrification programme	-50	-550	–	-600
Total change to local government allocations				
Change to direct transfers	375	933	1 421	2 730
Change to indirect transfers	-56	-555	4	-607
Net change to local government allocations	**319**	**378**	**1 425**	**2 123**

1.Excludes provisional allocation of R514 million in 2020/21 that was provisionally assigned to local government in the 2018 MTEF but has subsequently been reallocated

Source: National Treasury

In the process of determining the baseline for the outer year (2021/22) of the 2019 MTEF period, the local government equitable share allocation has grown by 8.6 per cent, well above the standard 5.5 per cent baseline increase. This difference is equivalent to an amount of R2.3 billion in that year. This will cover the anticipated increase in the costs of providing free basic services to a growing number of households, and takes account of likely above-inflation increases in the costs of bulk water and electricity. It will also allow for above-inflation increases in the allocations to poorer and rural municipalities through the redistributive components of the equitable share formula.

A total of R295.9 million has been cut from direct local government conditional grant allocations for the MTEF period ahead to fund other government priorities. Indirect grants to local government have been reduced by an additional R600 million.

An amount of R60.7 million is shifted from the incentive component of the *integrated urban development grant* in 2019/20 and added to the *municipal disaster recovery grant* to fund the repair of roads damaged by floods in Joe Gqabi District Municipality in the Eastern Cape.

A total of R2.8 billion is added to the *public transport network grant* for the construction of a new public transport corridor on the MyCiti bus network in Cape Town. This corridor, connecting Mitchells Plain and Khayelitsha to the city, was approved through the Budget Facility for Infrastructure and will be implemented over a nine-year period.

Technical adjustments to grants include the shifting of:

- R2.9 billion over the MTEF period from the *municipal infrastructure grant* to a new *integrated urban development grant*.
- R814.5 million over the MTEF period from the *integrated national electrification programme (municipal) grant* to the *urban settlements development grant*, as electrification projects in municipal licenced areas in metropolitan municipalities will now be funded as part of this integrated grant.
- R3 billion in 2020/21 and R4.4 billion in 2021/22 from the *urban settlements development grant* to create a new *informal settlements upgrading partnership grant: municipal*.

The local government equitable share

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

Over the 2019 MTEF period, the local government equitable share, including the *RSC/JSB levies replacement grant* and *special support for councillor remuneration and ward committees,* amounts to R226.8 billion (R69 billion in 2019/20, R75.7 billion in 2020/21 and R82.2 billion in 2021/22). Due to previous increases, as well as the revised baseline for 2021/22, the local government equitable share grows at an average annual rate of 9.4 per cent over the MTEF period.

Updating the estimated cost of services and household numbers

Rising household numbers and the rapid growth in the cost of bulk services are the main drivers of above-inflation cost increases in the local government equitable share. The National Energy Regulator of South Africa (NERSA) will only approve new bulk electricity tariffs for 2019/20 after the Division of Revenue Bill has been tabled, but Eskom has applied for tariff increases significantly above inflation. In the absence of approved tariff increases for the period ahead, the equitable share formula uses the previously approved Multi Year Price Determination of an 8 per cent annual bulk price increase for electricity in its calculations.

If higher bulk electricity price increases are approved, these will be offset, at least partially, by slower growth in household numbers. Statistics South Africa has revised and improved its demographic projections. The 2017 General Household Survey (published in June 2018) includes restated figures for household numbers in previous years. These revised figures show population growth that is somewhat slower than previous estimates. Previous editions had estimated annual household growth at between 3.2 per cent and 3.3 per cent between 2012 and 2016, and these estimates had been used in the local government equitable share formula. The revised estimates for the same period estimate annual household growth of between 2.6 per cent and 2.8 per cent, with household growth in 2017 increasing slightly to 2.9 per cent.

In recent years, municipalities have benefited from equitable share funding that has grown faster than actual increases in electricity costs (in 2017/18 the formula calculation used a bulk electricity price increase of 8 per cent, but NERSA only approved a bulk price increase of 0.3 per cent for the municipal financial year, and in 2018/19 a bulk increase of 8 per cent was used in the formula, but the actual increase was only 7.3 per cent). Municipalities have also benefited from increased allocations that were provided to cover household growth projections that were higher than the revised estimates in the 2017 General Household Survey. If the increase in the bulk price of electricity for 2019/20 is higher than the 8 per cent used in the formula calculation, then municipalities will be expected to offset this against the benefit they have derived from previous above-cost increases in equitable share allocations. To provide for the possibility of larger cost increases in future, amounts of R1 billion in 2020/21 and R1.1 billion in 2021/22 remain unallocated.

Formula for allocating the local government equitable share

The portion of national revenue allocated to local government through the equitable share is determined in the national budget process and endorsed by Cabinet (the vertical division). Local government's equitable share is divided among the country's 257 municipalities, using a formula (the horizontal division) to ensure objectivity.

Following a review of the previous formula by the National Treasury, the Department of Cooperative Governance and SALGA, in partnership with the FFC and Statistics South Africa, the current formula for the local government equitable share was introduced in 2013/14. The formula's principles and objectives were set out in detail in the Explanatory Memorandum to the 2013 Division of Revenue.

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. If this monthly household income is to be shown in 2019 terms, this is equivalent to about R3 530 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.

From 2019/20, the number of households per municipality used to calculate indicative allocations for the outer years of the MTEF 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 2017 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 incomes. Although the total number of households in each municipality is adjusted every year to account for growth, the share of those households that are subsidised for free basic services through the formula remains constant (but the number of households subsidised increases annually in line with estimated household growth). In 2019/20, a total of 10.1 million households are funded through the basic services subsidy.

The basic services component provides a subsidy of R408.61 per month in 2019/20 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 W1.23 and includes an allocation of 10 per cent for service maintenance costs.

Table W1.23 Amounts per basic service allocated through the local government equitable share, 2019/20

	Allocation per household below affordability threshold (R per month)			Total allocation per service (R million)
	Operations	Maintenance	Total	
Energy	78.73	8.75	87.48	10 612
Water	121.39	13.49	134.87	16 362
Sanitation	91.19	10.13	101.32	12 292
Refuse removal	76.44	8.49	84.94	10 304
Total basic services	**367.75**	**40.86**	**408.61**	**49 571**

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 W1.23 is updated annually based on the following:

- The electricity cost estimate is made up of bulk and other costs. Bulk costs are updated based on the bulk price determination approved by the National Energy Regulator of South Africa. As the bulk price increase for municipalities for 2019/20 will only be announced after the 2019 Budget is tabled, the 8 per cent annual increase approved for the previous multi-year price determination period has been used to calculate equitable share allocations. Other electricity costs are updated based on the National Treasury's inflation projections in the 2018 *Medium Term Budget Policy Statement*.

- The water cost estimate is also made up of bulk and other costs. Bulk costs are updated based on the average increase in bulk tariffs charged by water boards (although not all municipalities purchase bulk water from water boards, their price increases serve as a proxy for the cost increases for all municipalities). The approved average tariff increase for bulk water from water boards in 2018/19 was 9.9 per cent. Other costs are updated based on the National Treasury's inflation projections in the 2018 *Medium Term Budget Policy Statement*.
- The costs for sanitation and refuse removal are updated based on the National Treasury's inflation projections in the 2018 *Medium Term Budget Policy Statement*.

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

The basic services component

BS = basic services subsidy x number of poor households

Funding for each basic service is allocated to the municipality (metro, district or local) that is authorised to provide that service. If another municipality provides a service on behalf of the authorised municipality, it must transfer funds to the provider in terms of section 29 of the Division of Revenue Act. The basic services component is worth R49.6 billion in 2019/20 and accounts for 79.1 per cent of the value of the local government equitable share.

The institutional component

To provide basic services to households, municipalities need to be able to run a basic administration. Most municipalities should be able to fund the majority of their administration costs with their own revenue. But, because poor households are not able to contribute in full, the equitable share includes an institutional support component to help meet some of these costs. To ensure that this component supports municipalities with limited revenue-raising abilities, a revenue adjustment factor is applied so that 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.

This component consists of a base allocation of R7 million, which goes to every municipality, and an additional amount that is based on the number of council seats in each municipality. This reflects the relative size of a municipality's administration and is not intended to fund the costs of councillors only (the 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 8.3 per cent of the equitable share formula and is worth R5.2 billion in 2019/20. This component is also complemented by special support for councillor remuneration in poor municipalities, which is not part of the equitable share formula.

The community services component

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

The allocation for this component is split between district and local municipalities, which both provide community services. In 2019/20, the allocation to district and metropolitan municipalities for municipal health and related services is R9.85 per household per month. The component's remaining funds are allocated to local and metropolitan municipalities based on the number of households in each municipality.

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

The community services component accounts for 12.5 per cent of the equitable share formula and is worth R7.8 billion in 2019/20.

The revenue adjustment factor

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

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

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

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

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

In 2019/20 this grant increases by 8.4 per cent for district municipalities authorised for water and sanitation and 2.8 per cent for unauthorised district municipalities. The different rates recognise the various service-delivery responsibilities of these district municipalities and the fact that the allocations to unauthorised municipalities have an average growth rate below inflation. To reduce the inequities in this grant's allocations, which result from it being based on previous own revenue collections, the 2017 Explanatory Memorandum to the Division of Revenue announced adjustments to redistribute funds to the 13 district municipalities with the smallest allocations from this grant. These adjustments were implemented over a two-year period, from 2017/18 to 2018/19.

Special support for councillor remuneration and ward committees

Councillors' salaries are subsidised in poor municipalities. The total value of the support provided in 2019/20 is R969 million, calculated separately to the local government equitable share and in addition to the funding for governance costs provided in the institutional component. The level of support for each municipality is allocated based on a system gazetted by the Minister of Cooperative Governance and Traditional Affairs, which classifies municipal councils into six grades based on their total income and population size. Special support is provided to the lowest three grades of municipal councils (the smallest and poorest municipalities).

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

As a result of the below-inflation increase in councillor salaries of 4 per cent per year in 2018/19, there is a small surplus on the previously budgeted amounts for councillor remuneration. Amounts of R14 million in 2019/20 and R15 million in 2020/21 are therefore shifted back into the local government equitable share formula to distribute.

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 R45.1 billion in 2019/20 to R48.2 billion in 2020/21 and R52.2 billion in 2021/22.

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 or housing emergency.

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 R161.6 billion over the 2019 MTEF period.

Table W1.24 Infrastructure grants to local government

R million	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
		Outcome		Adjusted budget		Medium-term estimates	
Direct transfers	**37 044**	**39 259**	**41 888**	**42 919**	**43 252**	**46 167**	**50 039**
Municipal infrastructure	14 956	14 914	15 891	15 288	14 816	15 660	16 831
Integrated urban development	–	–	–	–	857	939	1 013
Urban settlements development	10 554	10 839	11 382	11 306	12 045	9 717	9 373
Informal settlements upgrading partnership	–	–	–	–	–	2 985	4 384
Integrated city development	251	267	292	294	310	327	352
Public transport network	5 953	5 593	6 107	6 287	6 468	7 495	8 367
Neighbourhood development partnership	584	592	658	602	621	655	704
Integrated national electrification programme	1 980	1 946	2 087	1 904	1 863	1 977	2 131
Rural roads asset management systems	97	102	107	108	114	120	127
Regional bulk infrastructure	–	1 850	1 829	1 957	2 066	2 180	2 344
Water services infrastructure	2 305	2 831	3 305	3 769	3 669	3 871	4 161
Municipal disaster recovery	186	140	26	1 190	194	–	–
Energy efficiency and demand-side management	178	186	203	215	227	240	253
Indirect transfers	**10 119**	**8 093**	**7 699**	**7 795**	**7 087**	**6 981**	**8 032**
Integrated national electrification programme	3 613	3 526	3 846	3 262	3 374	3 063	3 821
Neighbourhood development	13	15	28	29	31	33	35
Water services infrastructure	659	298	852	1 616	644	679	730
Regional bulk infrastructure	4 858	3 422	2 974	2 887	3 038	3 207	3 447
Bucket eradication	975	831	–	–	–	–	–
Total	**47 163**	**47 352**	**49 588**	**50 714**	**50 338**	**53 148**	**58 072**

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. Although the grant’s baseline is reduced by R917.6 million in 2019/20, R939.2 million in 2020/21 and R1 billion in 2021/22 to allow for the creation of the *integrated urban development grant*, the total allocations for this conditional grant still amount to R47.3 billion over the 2019 MTEF period and grow at an average annual rate of 3.3 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.

Data used in the municipal infrastructure grant formula

Component	Indicator used in the formula	Data used (all data is from the 2011 Census)
B	Number of water backlogs	Number of poor households[1] that do not have adequate access to water (adequate access defined as piped water either inside their dwelling, in the yard or within 200 meters of their dwelling)
	Number of sanitation backlogs	Number of poor households that do not have adequate access to sanitation (adequate access defined as having a flush toilet, chemical toilet, pit toilet with ventilation or ecological toilet)
	Number of roads backlogs	Number of poor households
	Number of other backlogs	Number of poor households that do not have access to refuse disposal at Reconstruction and Development Programme levels of service
P	Number of poor households	Number of poor households
E	Number of poor households	Number of poor households
N	Number of 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

Table W1.25 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 W1.25 Municipal infrastructure grant allocations per sector

Municipal infrastructure grant (formula)	Component weights	Value of component 2019/20 (R million)	Proportion of municipal infrastructure grant per sector
B-component	**75.0%**	**10 065**	**67.9%**
Water and sanitation	72.0%	7 247	48.9%
Roads	23.0%	2 315	15.6%
Other	5.0%	503	3.4%
P-component	**15.0%**	**2 013**	**13.6%**
Sports	33.0%	664	4.5%
E-component	**5.0%**	**671**	**4.5%**
N-component	**5.0%**	**671**	**4.5%**
Constant		**1 130**	**7.6%**
Ring-fenced funding for sport infrastructure		**266**	**1.8%**
Total		**14 816**	**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 Sport and Recreation South Africa. These earmarked funds amount to R798.5 million over the MTEF period (R266.2 million in 2019/20, R266.2 million in 2020/21 and R266.2 million in 2021/22). 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.

Integrated urban development grant

In 2019/20, a new *integrated urban development grant* for urban local municipalities is created to support spatially aligned public infrastructure investment that will lead to functional and efficient urban spaces. The grant will be administered by the Department of Cooperative Governance and extends some of the fiscal reforms already implemented in metropolitan municipalities to non-metropolitan cities. The *integrated urban development grant* recognises that municipalities differ in terms of their context and introduces a differentiated approach to encourage integrated development in cities. The grant aims to enable and incentivise municipalities to invest more non-grant funding in infrastructure projects in intermediate cities.

The conditions for this grant were piloted in two cities through a window in the *municipal infrastructure grant* framework in 2018/19. In 2019/20, it becomes a separate grant, with seven cities receiving allocations from this grant instead of the *municipal infrastructure grant*. Under the *integrated urban development grant,* municipalities will no longer require approval for individual projects to be funded through the grant. Instead, their capital investments must be aligned to a three-year capital programme that is aligned with a 10-year capital expenditure framework.

This is a new type of grant in that municipalities must meet certain qualification criteria in order to participate. Municipalities can apply to join the grant in terms of a process set out in section 27(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.

In addition to the two pilot municipalities (Polokwane and uMhlathuze), five local municipalities qualified to participate in the grant from 2019/20: Mogale City, Ray Nkonyeni, Sol Plaatje, Stellenbosch and Drakenstein. Other cities may apply to join the grant in future years. 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 be shifted 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.

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

Performance-based component weighted indicators for integrated urban development grant

Indicator	Discussion	Weight	Scores
1. Non-grant capital as a percentage of total capital expenditure	Encourages cities to increase their capital investment funded through own revenue and borrowing	40%	1 if 70% or higher 0 if 30% or lower Linear scale in between
2. Repairs and maintenance expenditure as percentage of operating expenditure	Rewards cities that take good care of their existing asset base	30%	1 if 8% or higher
3. Asset management plan	Must have a plan in place, 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
4. Land-use applications in priority areas 5. Building plan 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 2019/20	0%	1 if 50% or higher 0 if 10% or lower Linear scale in between

The total allocations for the *integrated urban development grant* are R856.9 million in 2019/20, R939.2 million in 2020/21 and R1 billion in 2021/22.

Table W1.26 Formula for integrated urban development grant incentive component

	Once-off planning allocation (R 000)	Perfomance 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	3 205	72%	10%	No	-	70%	29 957	33 162
Drakenstein	1 054	82%	6%	Yes	-	91%	12 854	13 908
Mogale City	3 513	19%	0%	No	-	0%	-	3 513
Polokwane[1]	10 144	41%	0%	Yes	-	41%	-	10 144
Ray Nkonyeni	1 847	22%	0%	Yes	-	30%	7 398	9 244
Sol Plaatje	1 494	22%	0%	No	-	0%	-	1 494
Stellenbosch	1 073	81%	0%	Yes	-	70%	10 034	11 107
Total	**22 330**						**60 242**	**82 572**

1. Polokwane does not qualify for an incentive allocation as it did not meet all of the qualification criteria for the grant. It remains part of the grant as it was a pilot municipality in 2018/19, but the city must implement a performance improvement plan

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. From 2019/20, cities will be 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 will report on one agreed set of indicators that will be used by multiple stakeholders to monitor progress on the integrated and functional outcomes, rather than reporting separately to each department. These reforms will progressively be extended to non-metropolitan municipalities over the medium term.

As discussed under the *human settlements development grant* in Part 4, a new window is being introduced for the upgrading of informal settlements. In 2019/20, this new window amounts to 20 per cent of the *urban settlements development grant.* The window sets a minimum amount each city must spend on informal settlement upgrades and requires cities to work in partnership with communities. The introduction of this window serves as a planning and preparatory platform for a new informal settlements upgrading grant, planned for 2020/21. Provided the new window is a success, the new grant will be created through the reprioritisation of funds from the *urban settlements development grant.* Initial amounts of R3 billion in 2020/21 and R4.4 billion in 2021/22 have been set aside for this new grant in the outer years of the MTEF period. Further details on the new grant are discussed in Part 6.

Electrification in municipalities, including in the eight metropolitan municipalities, has been funded through the *integrated national electrification programme (municipal) grant*. However, cities have also been implementing electrification projects in informal settlements using the *urban settlements development grant*, despite funds not having originally been allocated to the grant for this purpose. To align funding with municipalities' needs, the *integrated national electrification programme (municipal) grant* allocations to metropolitan municipalities will be incorporated into the *urban settlements development grant* from 2019/20. This will allow these funds to also be used for informal settlement upgrades, making use of the skills and experience of the municipalities that implement these projects. In 2019/20, the cities will be allocated their indicative *integrated national electrification programme (municipal) grant* allocations, as was gazetted in the terms of the 2018 Division of Revenue Act. This will ensure cities are adequately funded for any planned commitments for 2019/20. From 2020/21 the funds inherited from the *integrated national electrification programme (municipal) grant* will be allocated through the *urban settlements development grant* formula.

The *urban settlements development grant* is allocated R31.1 billion over the medium term. The allocation per municipality 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 capacity-building guideline published by the Department of Human Settlements. Because this grant was reduced by a smaller proportion than the *municipal infrastructure grant* in the 2018 MTEF period, the *urban settlements development grant* is reduced by R100 million in 2019/20 and R100 million in 2020/21 in order to fund other government priorities.

Integrated city development grant

The grant provides a financial incentive for metropolitan municipalities to use their infrastructure investment and regulatory instruments to achieve more compact and efficient urban spaces. The grant's incentive allocations are based on performance measures of good governance and administration, as well as an assessment of a city's built environment performance plan. Cities are required to adopt performance plans that provide a strategic overview of their plans for the built environment, and how their infrastructure programmes and projects within their functional mandate and approved integration zones will transform spatial development patterns over time. Including a peer-reviewed assessment score in the allocation criteria for this grant provides a tangible reward for cities that improve the quality of their plans. Total allocations over the 2019 MTEF period amount to R989.2 million and grow at an average annual rate of 6.2 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. The grant is allocated R22.3 billion over the medium term.

A formula-based grant allocation has been implemented since 2016/17. This 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.

The allocations for this grant are determined through a formula, used to determine 95 per cent of the allocations, and a performance-based incentive component introduced in 2019/20, which accounts for the remaining 5 per cent.

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.

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 they must have spent more than 80 per cent of their 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 2019/20 is set out in Table W1.27 below. 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 W1.27 Public transport network grant

	Oper-ational public transport system	Grant spent in 2017/18	Eligible for incentive	Coverage of direct costs from farebox	Average weekday passenger trips (% of population)	City's contri-bution (% of property rates)	Raw scores for incentive	Incentive allocation for 2019/20 (R 000)
Minimum threshold	**Yes**	**80%**		**35.0%**	**1%**	**2%**		
Buffalo City	No	26%	No	0.0%	0.00%	0.0%	-	**-**
Cape Town	Yes	100%	Yes	41.1%	1.48%	5.2%	0.287	**160 487**
City of Johannesburg	Yes	98%	Yes	38.5%	0.95%	3.4%	0.130	**99 394**
City of Tshwane	Yes	93%	Yes	21.5%	0.24%	1.3%	-	**-**
Ekurhuleni	Yes	66%	No	16.8%	0.13%	2.7%	-	**-**
eThekwini	No	67%	No	0.0%	0.00%	0.0%	-	**-**
George	Yes	100%	Yes	41.8%	5.61%	4.8%	0.555	**45 831**
Mangaung	No	63%	No	0.0%	0.00%	0.0%	-	**-**
Mbombela	No	70%	No	0.0%	0.00%	0.0%	-	**-**
Msunduzi	No	83%	No	0.0%	0.00%	0.0%	-	**-**
Nelson Mandela Bay	Yes	90%	Yes	11.4%	0.03%	0.7%	-	**-**
Polokwane	No	82%	No	0.0%	0.00%	0.0%	-	**-**
Rustenburg	No	88%	No	0.0%	0.00%	0.0%	-	**-**
Total							1.000	**305 712**

Source: National Treasury

Table W1.28 sets out how the final allocation for each municipality is determined, taking account of both the formula and incentive components.

Table W1.28 Formula for the public transport network grant

	Base 20%	Demand-driven factors 75%			Subtotal: base and demand driven factors	Perfomance 5%	100%
	Equally shared	Population component shares	Regional gross value added component shares	Public transport users component shares		Incentive component (R 000)	Grant allocations[1] (R 000)
Buffalo City	7.7%	3.3%	2.8%	3.1%	**3.8%**	–	**234 465**
Cape Town	7.7%	16.3%	15.8%	13.9%	**13.0%**	160 487	**957 645**
City of Johannesburg	7.7%	19.3%	25.2%	20.5%	**17.8%**	99 394	**1 187 518**
City of Tshwane	7.7%	12.7%	15.0%	14.0%	**12.0%**	–	**731 751**
Ekurhuleni	7.7%	13.8%	9.5%	14.9%	**11.1%**	–	**679 153**
eThekwini	7.7%	15.0%	15.8%	18.0%	**13.7%**	–	**840 549**
George	7.7%	0.8%	0.5%	0.2%	**1.9%**	45 831	**163 499**
Mangaung	7.7%	3.3%	2.4%	3.2%	**3.8%**	–	**229 596**
Mbombela	7.7%	2.6%	1.9%	2.4%	**3.3%**	–	**198 919**
Msunduzi	7.7%	2.7%	1.5%	2.4%	**3.2%**	–	**194 665**
Nelson Mandela Bay	7.7%	5.0%	4.7%	3.6%	**4.9%**	–	**298 143**
Polokwane	7.7%	2.7%	1.5%	1.3%	**2.9%**	–	**179 433**
Rustenburg	7.7%	2.4%	3.5%	2.3%	**3.6%**	–	**218 911**
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**95.0%**	**305 712**	**6 114 248**

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

In addition to the formula and performance incentive, R2.8 billion is added to the *public transport network grant* over the medium term. This addition is for the City of Cape Town's new phase of the MyCiti public transport network approved through the Budget Facility for Infrastructure. The facility seeks to support quality public investments through robust project appraisal, effective project development and execution, and sustainable financing arrangements. The process includes engaging with relevant stakeholders, the National Treasury and the Presidential Infrastructure Coordinating Commission. This additional amount will fund a new public transport corridor for the MyCiti network, linking the underserved areas of Khayelitsha and Mitchells Plain to the city centre.

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, with the aim of creating a platform to stimulate third-party public and private investment. In metropolitan municipalities, the focus is on upgrading urban hubs in townships. The National Treasury has led a process, in collaboration with other stakeholders including the Department of Rural Development and Land Reform and the Department of Cooperative Governance, to identify a cohort of non-metropolitan municipalities to implement new projects as part of this grant. The National Treasury will be partnering with these municipalities to identify, plan and implement infrastructure upgrades in targeted urban hub precincts. The allocations for this grant in the 2019 MTEF period amount to R2.1 billion, made up of R2 billion for the direct capital component and R98 million for the indirect technical assistance component.

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. It has both direct and indirect components. In areas where municipalities have the capacity to implement projects themselves, funds are transferred through a direct grant. In other areas, the Department of Water and Sanitation implements projects on behalf of municipalities through an indirect grant.

A total of R4.4 million will be shifted from the department’s accelerated community infrastructure programme, which is being phased out, into the indirect component of this grant over the medium term. This shift will strengthen project management and grant administration.

The grant has a total allocation of R13.8 billion over the medium term, comprising R11.7 billion and R2.1 billion for the direct and indirect components respectively.

Regional bulk infrastructure grant

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

The Department of Water and Sanitation has put a moratorium on new projects funded through this grant so it can prioritise existing projects, particularly those that have been in construction for a long time. A total of R5.3 million is shifted from the department’s accelerated community infrastructure programme into the indirect component of this grant over the medium term to strengthen project management and grant administration. In 2019/20, R318.5 million of the indirect portion of the grant will be ring-fenced for the bulk infrastructure needed to complete the eradication of all bucket sanitation systems in formal residential areas that were in existence in 2014.

The grant has a total allocation of R16.3 billion over the medium term, consisting of R6.6 billion and R9.7 billion for the direct and indirect components respectively.

Integrated national electrification programme grants

These grants aim to provide capital subsidies to municipalities to electrify poor households and fund bulk infrastructure to ensure the constant supply of electricity. Allocations are based on the backlog of un-electrified households and administered by the Department of Energy. The grant only funds bulk infrastructure that serves poor households. The national electrification programme has helped provide 91 per cent of all poor households with access to electricity, as reported in the 2016 Community Survey (up from the 85 per cent reported in the 2011 Census). To sustain this progress, government will spend R16.2 billion on the programme over the next three years. A total of R6 billion is allocated to the *integrated national electrification programme (municipal) grant* over the 2019 MTEF period, after the shift of funds for metropolitan municipalities to the *urban settlements development grant* (described above). The *integrated national electrification programme (Eskom) grant* is allocated R10.3 billion over the medium term. It is reduced by R50 million in 2019/20 and R550 million in 2021/22 to fund other government priorities and manage the growth of the national deficit. The reduction was effected on this grant because it has a higher baseline than the *integrated national electrification programme (municipal) grant*.

Energy efficiency and demand-side management grant

The *energy efficiency and demand-side management grant* funds selected municipalities to implement energy-efficiency projects, with a focus on public lighting and energy-efficient municipal infrastructure. From 2019/20, provision is made for municipalities to use funding from the *energy efficiency and demand-side management grant* for planning and preparing for the Energy Efficiency in Public Infrastructure and Building programme. This 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 their *energy efficiency and demand-side management grant* funding to develop a project pipeline and thereby strengthen the market for energy service 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 (COP21).

This new 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 R719.3 million over the 2019 MTEF period.

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. The grant is allocated R113.9 million in 2019/20, R120.5 million in 2020/21 and R127.1 million in 2021/22.

Municipal disaster recovery grant

After the initial response to a disaster has been addressed, including through funding from the *municipal disaster relief grant* discussed below, the repair of damaged municipal infrastructure is funded through the *municipal disaster recovery grant*. In 2019/20, this grant is allocated R194 million for the repair of damage to municipal infrastructure caused by floods in KwaZulu-Natal and the Eastern Cape. If further disasters occur that require recovery projects to be funded through this grant, additional allocations may be made to it in future.

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 relief grant*. A total of R6.4 billion is allocated to capacity-building grants and other current transfers to local government over the medium term.

Table W1.29 Capacity building and other current grants to local government

R million	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
		Outcome		Adjusted budget	Medium-term estimates		
Direct transfers	**1 268**	**1 675**	**1 815**	**1 851**	**1 897**	**2 004**	**2 115**
Municipal disaster relief	–	118	341	349	335	354	373
Municipal demarcation transition	4	297	140	–	–	–	–
Municipal systems improvement	–	–	–	23	–	–	–
Municipal human settlements capacity	100	–	–	–	–	–	–
Municipal emergency housing	–	–	–	140	149	159	168
Infrastructure skills development	124	130	141	141	149	158	167
Local government financial	452	465	502	505	533	562	593
Expanded public works programme integrated grant for municipalities	588	664	691	693	730	771	814
Indirect transfers	**251**	**19**	**103**	**92**	**122**	**128**	**135**
Municipal systems improvement	251	19	103	92	122	128	135
Total	**1 520**	**1 695**	**1 919**	**1 943**	**2 018**	**2 132**	**2 250**

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.

Total allocations amount to R1.7 billion over the MTEF period and grow at an average annual rate of 5.5 per cent.

Infrastructure skills development grant

The *infrastructure skills development grant* develops capacity within municipalities by creating a sustainable pool of young professionals with technical skills related to municipal services, such as water, electricity and town planning. The grant places interns in municipalities so they can complete the requirements of the relevant statutory council within their respective built environment fields. The interns can be hired by any municipality at the end of their internship.

The grant's total allocations amount to R474 million over the 2019 MTEF period and grow at an average annual rate of 5.6 per cent.

Municipal systems improvement grant

The *municipal systems improvement grant* funds a range of projects in municipalities in support of the Back to Basics strategy, including helping municipalities set up adequate record management systems, drawing up organograms for municipalities and reviewing their appropriateness relative to their assigned functions, implementing the Integrated Urban Development Framework and assisting municipalities with revenue collection plans. From 2019/20, the grant also supports the implementation of the municipal standard chart of accounts. The Department of Cooperative Governance implements the indirect grant. Grant allocations amount to R121.6 million in 2019/20, R128.2 million in 2020/21 and R135.3 million in 2021/22, and R73 million and R80 million is unallocated for 2020/21 and 2021/22.

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 on the basis of this performance as well as the labour intensity of the work opportunities created. The number of bands in which labour intensity are recorded in the formula have 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's baseline is reduced by R11.9 million in 2019/20, R11.7 million in 2020/21 and R11.6 million in 2021/22 in order to fund other government priorities. The impact of these reductions will be spread across municipalities in line with the grant's formula. The grant is allocated R2.3 billion over the MTEF period.

Municipal disaster relief grant

The *municipal disaster relief 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 21 of the Division of Revenue Bill allows for funds allocated to the *provincial disaster relief 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 MTEF period, R1 billion is available for disbursement through this grant. To ensure that sufficient funds are available for disaster relief, clause 20(6) 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

When introduced in 2018/19, the *municipal emergency housing grant* was intended to enable the Department of Human Settlements to rapidly respond to emergencies by providing temporary housing in line with the Emergency Housing Programme. From 2019/20, the purpose of the grant will be extended to repair damage to permanent structures following the immediate aftermath of a disaster, in instances where the repairs would be cheaper than the cost of relocation and provision of temporary shelter. The approval of funding for repairs will be subject to an assessment report. The grant remains limited to funding emergency housing and repairs following the immediate aftermath of a disaster, and not the other emergency situations listed in the Emergency Housing Programme. This grant is allocated R149.1 million in 2019/20, R158.8 million in 2020/21 and R167.5 million in 2021/22.

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 during 2019/20 as part of the ongoing review and refinement of the intergovernmental fiscal framework. Provinces and municipalities will be consulted on all proposed changes.

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 periodic review of the formula to assess its continued appropriateness and equity continues in 2019. The Technical Committee on Finance and the Budget Council are consulted as part of this work.

Over the course of the year, work on the review of the equitable share will continue. Now that the new data-collection methodology for education is part of the formula, the next step is to interrogate the component's alignment with government's education policy vision. Work on the disparity in costs in the delivery of services across the country will also continue, led by the FFC. The National Treasury will work with the national Department of Health and Statistics South Africa to fully understand the available health information data and the dynamics of delivering services in the health sector. Over the course of 2019, the provincial equitable share review task team, with representatives from the National Treasury, Statistics South Africa, provincial treasuries and the FFC, will further explore the poverty component and look into deprivation as a possible measure. This will be coupled with technical changes to the formula to ensure stability.

National health insurance policy work

South Africa aims to make significant strides towards universal health coverage though the progressive implementation of national health insurance, as outlined in the National Health Insurance White Paper, which government adopted in 2017. Subsequently, the draft bill was released for public comment and government is working on finalising it for tabling to Parliament following Cabinet approval. The bill, when promulgated, will provide the legal foundation for establishing the National Health Insurance Fund. This is likely to have significant implications for provincial finances, which are being discussed through consultative structures like the Technical Committee on Finance. Parallel to the legislative foundation, efforts to strengthen the health system in preparation for national health insurance will continue through developing and piloting provider payment mechanisms, expanding the national insurance beneficiary registry, addressing human resource capacity in public health facilities, and purchasing and providing a prioritised set of health services.

The role of provinces in promoting economic development

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

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. In 2018, the Budget Council Lekgotla and the Technical Committee on Finance agreed on a strategy for provinces in special economic and industrial development zones. Provinces agreed to assist the special economic zones in strengthening their tenant base so that they can raise more revenue and be less reliant on transfers. In 2019, there may be a need to revise legislation regarding the zones' scheduling as entities in terms of the Public Finance Management Act so that they can receive more support from government in their early stages and later become self-financing entities.

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. During 2018, the National Treasury provided support to all provinces with metropolitan municipalities to have joint planning sessions and share plans and information. This process has revealed that there are still a lot of gaps in the alignment of the spatial development frameworks between provincial and municipal government. Work to improve coordination and address these gaps will continue in 2019/20.

The National Treasury is also exploring how the budget process can be used to address spatial planning issues. A paper on options to improve the coordination of infrastructure funding with spatial development objectives will be presented to the National Treasury's intergovernmental structures during 2019.

Scholar transport

Government conducted a study on the delivery of scholar transport services during 2018. A steering committee with members from the Department of Basic Education; the Department of Transport; the Department of Planning, Monitoring and Evaluation; and the National Treasury has been established to take this work forward. The report revealed several data gaps and inconsistencies in the way services are delivered and reported on in different provinces, making it difficult to establish a common national approach to improving the service. Two work streams will be established during 2019. The first will deal with the data gaps and attempt to determine whether the function should be led by the transport or basic education sector. The second work stream will deal with the costing of the service and will provide input during the 2020 Budget process.

New informal settlements upgrading grants for provinces and municipalities

Informal settlement upgrades will intensify over the medium term. This 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. Following the introduction of dedicated windows to fund informal settlement upgrades in the provincial *human settlements development grant* and the municipal *urban settlements development grant* in 2019/20, the Department of Human Settlements is leading the design of two new informal settlements upgrading grants for provinces and municipalities that will be introduced in the 2020 MTEF period.

The design of the new grants will draw on the lessons learnt from implementing the grant windows in 2019/20. Provinces, municipalities and other interested stakeholders will also provide feedback on the new grant structures. Indicative baselines have been set aside for the new grant in the outer years of the 2019 MTEF period. These baselines grow from informal settlements upgrading programme windows in the *human settlements development grant* and *urban settlements development grant* worth 15 per cent and 20 per cent of each grant respectively in 2019/20, to separate grants equivalent to 30 per cent and 50 per cent of the previous grants by 2021/22. The new grants will fund the progressive upgrading of informal settlements from areas of plight and deprivation into liveable, integrated, functional, inclusive and sustainable human settlements.

Local government transfers

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

Potential future 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:

- Refining the methodology used to update household growth estimates, taking account of updated data from Statistics South Africa, and possibly using district-level data.
- Improving the responsiveness of the formula to the different functions assigned to district and local municipalities. 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.

Review of local government infrastructure grants

As part of the ongoing review of local government infrastructure grants, the National Treasury, the Department of Cooperative Governance, SALGA and the FFC will work closely to implement the reform agenda agreed to through the review, including:

- Improving the administration of conditional grants by national department.
- Further consolidating conditional grants.
- Increasing differentiation in the grant system, so that grants are more aligned to the different circumstances found across the country’s 257 municipalities.
- Identifying ways to incorporate incentives for improved asset management into the grant system.

Review of municipal capacity support system

Government invests more than R2.5 billion per year in various forms of capacity-building support to local government. Despite this, an increasing number of municipalities are in some form of distress, financial crisis, state of mismanagement or have been placed under an intervention. This indicates that the current system of capacity support is not producing the intended results. The intention to review this system was announced in the 2018 *Medium Term Budget Policy Statement*.

The review will be conducted during 2019/20 and will examine all aspects of the local government capacity building and support system and how the system operates as a whole. It will identify overlaps, duplications and gaps in the system and propose how these should be rectified. The review is expected to result in proposed changes to the configuration of funding for capacity building as well as the activities funded. Parliament will be updated on the review's progress in the 2019 *Medium Term Budget Policy Statement*.

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 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.

Development charges

Despite their potential as an alternative option for financing infrastructure, municipalities have not fully used development charges due to uncertainty surrounding the regulatory frameworks. Development charges are once-off infrastructure access fees imposed on a land owner as a condition of approving a land development that will substantially increase the use of or need for municipal infrastructure engineering services. They are based on the concept that urban growth and expanded land use creates the need for additional infrastructure services, therefore the developer should pay the incidence costs. To deal with the regulatory framework's challenges, the National Treasury is amending the Municipal Fiscal Powers and Functions Act (2007) to incorporate the regulation of development charges. The draft amendment bill will be submitted to Cabinet shortly and is expected to be published for public comment during the second quarter of 2019.

Municipal borrowing

The original municipal borrowing policy of 1999 has been through an extensive process of review and consultation with various stakeholders. The final draft revised policy will be submitted to Cabinet shortly and is expected to be published in 2019. Among others, the policy framework makes specific recommendations on the role of development finance institutions in financing creditworthy municipalities. It proposes that these finance institutions should play a complementary and supportive role to transactions rather than competing directly with private financiers on price. The framework suggests that development finance institutions should establish clear and measurable development impact indicators for their municipal operations in general, and for specific transactions.

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