W1

Website annexure to the 2009 Budget Review

Explanatory memorandum to the division of revenue

Background

The allocation of resources to the three spheres of government is a critical step in the budget process, required before national government, nine provinces and 283 municipalities can determine their own budgets. The allocation process needs to take into account the powers and functions assigned to the three spheres of government. The process for making this decision is at the heart of cooperative governance as envisaged in the Constitution.

To foster transparency and ensure smooth intergovernmental relations, section 214(1) of the Constitution requires that every year a Division of Revenue Act determine the equitable division of nationally raised revenue between the three spheres of government. The Intergovernmental Fiscal Relations Act (1997) prescribes the process for determining the equitable sharing and allocation of revenue raised nationally. Sections 9 and 10(4) of the act set out the consultation process to be followed with the Financial and Fiscal Commission (FFC), including the process of considering recommendations made with regard to the equitable division of nationally raised revenue.

This explanatory memorandum to the 2009 Division of Revenue Bill fulfils the requirement set out in section 10(5) of the Intergovernmental Fiscal Relations Act that requires the Division of Revenue Bill to be accompanied by an explanatory memorandum detailing how the bill takes account of the matters listed in section 214(2) (a) to (j) of the Constitution, government's response to the recommendations of the FFC, and any assumptions and formulas used in arriving at the respective divisions among provinces and municipalities. This explanatory memorandum contains five parts:

- Part 1 describes the division of resources between the three spheres of government.
- Part 2 sets out how the FFC's recommendations on the 2009 division of revenue have been taken into account.

- Part 3 explains the formula and criteria for the division of the provincial equitable share and for conditional grants to provinces.
- Part 4 sets out the formula and criteria for the division of the local government equitable share and conditional grants between municipalities.
- Part 5 summarises issues that will form part of subsequent reviews of provincial and local government fiscal frameworks.

This memorandum should be read with the Division of Revenue Bill. The Division of Revenue Bill and its underlying allocations are the culmination of extensive consultation processes between national, provincial and local government. The Budget Council deliberated on the matters discussed in this memorandum at its August 2008 lekgotla and at several other meetings during the year. The approach to local government allocations was discussed with organised local government at several technical meetings with the South African Local Government Association (SALGA), culminating in a meeting of the Budget Forum (Budget Council plus SALGA) on 2 October 2008. An extended Cabinet meeting involving ministers, provincial premiers and the chairperson of SALGA was held on 8 October 2008, and agreed on the final budget priorities and the division of revenue for the next three years.

Part 1: The 2009 division of revenue

The 2009 medium-term expenditure framework (MTEF) recognises the important developmental role played by provincial and local government and continues to strengthen their ability to provide social and municipal basic services and perform the functions allocated to them in line with section 214(2)(a) to (j) of the Constitution. Excluding debt service costs and the contingency reserve, allocated expenditure to be shared between the three spheres amounts to R677.3 billion, R720.2 billion and R762.1 billion over each of the MTEF years. These allocations take into account government's spending priorities, the revenue-raising capacity and functional responsibilities of each sphere, and inputs from various intergovernmental forums and the recommendations of the FFC. Further, the design of the equitable share formulas for both provincial and local governments are such that these spheres have desirable, stable and predictable revenue shares, and economic and fiscal disparities are addressed.

Government's policy priorities for the 2009 MTEF

Government's major budget priorities over the MTEF include:

- Enhancing the quality of education
- Improving the provision of health care, particularly for the poor, to reduce infant, child and maternal mortality rates
- Reducing the levels of crime and enhancing citizen safety
- Expanding the built environment to improve public transportation and meet universal access targets in housing, water, electricity and sanitation
- Decreasing rural poverty by taking steps to raise rural incomes and improve livelihoods by extending access to land and support for emerging farmers.

In addition to these priorities, policy focuses on three cross-cutting themes: support for increased employment creation, initiatives to improve the capacity of the state and, over the longer term, steps to reduce carbon emissions and mitigate the effects of climate change.

Provinces play a key role with respect to improving access to better-quality services, supporting labour-intensive services and infrastructure programmes, and investing in infrastructure and services that raise the long-term growth potential of the economy and facilitate higher exports.

Provinces have limited revenue-raising capacity and rely largely on national transfers to fund the functions that seek to achieve government's strategic objectives. Additional resources are directed towards areas where there is a clear spending impact or to protect buying power in critical areas of service delivery. Local government plays a key role with respect to broadening access to household services such as water, sanitation, electricity and to eliminate informal settlements.

The division of revenue for the 2009 MTEF remains supportive of pro-poor policy programmes that are designed to progressively roll out infrastructure and services in municipalities.

Table W1.1 shows how the additional allocations are apportioned to the different priority areas across the three spheres of government.

Table W1.1 2009 Budget priorities – additional MTEF allocations

R million	2009/10	2010/11	2011/12	Total
Provincial equitable share Includes school education, health care and welfare services	5 585	7 364	11 849	**24 798**
Local government equitable share	491	614	1 829	**2 934**
Education, health and welfare				
Higher education, National Student Financial Aid Scheme and recapitalisation of technical high schools	548	764	1 597	**2 909**
School nutrition programme	583	1 322	2 097	**4 002**
Hospitals and tertiary services	204	360	397	**961**
Comprehensive HIV and Aids	200	325	407	**932**
Social grants and SASSA	2 510	4 231	6 433	**13 174**
Housing and built environment				
Housing grants	711	804	2 146	**3 662**
Municipal infrastructure and related services	755	851	2 690	**4 295**
Infrastructure grant to provinces	453	1 234	2 456	**4 143**
Cultural institutions (Freedom Park)	200	134	–	**334**
Economic infrastructure and investment				
Public transport, roads and rail infrastructure	1 377	1 796	3 221	**6 394**
Communications infrastructure including ICT for 2010 FIFA World Cup	570	601	415	**1 586**
2010 FIFA World Cup stadiums	281	217	–	**497**
Eskom loan	30 000	20 000	–	**50 000**
Gautrain loan	4 200	–	–	**4 200**
Public Enterprises (South African Airways)	1 560	–	–	**1 560**
Industrial development and productive capacity of the economy				
Industrial development and regulatory capacity	364	647	623	**1 634**
Land and agrarian reform	197	305	1 277	**1 779**
Justice, crime prevention and policing				
Policing personnel, facilities and 2009 elections	300	900	2 600	**3 800**
Justice and occupation-specific dispensation for legally qualified personnel	150	225	300	**675**
Correctional Services personnel	300	300	300	**900**
International relations and defence				
Defence account and Waterkloof Air Base renovations	541	150	250	**941**
Foreign Affairs capacity and African Renaissance Fund	225	65	230	**520**
Public administration capacity				
Home Affairs and entities	235	316	677	**1 227**
Border control	100	300	500	**900**
Expanded public works programmes - Public Works	81	360	309	**749**
Other adjustments	7 743	3 613	9 758	**21 114**
Total policy adjustments	**60 463**	**47 797**	**52 361**	**160 621**

1. Includes R 461million in 2011/12 for the 3 new metros share of the general fuel levy.

The fiscal framework

Table W1.2 presents medium-term macroeconomic forecasts for the 2009 Budget. It sets out the growth assumptions and fiscal policy targets on which the fiscal framework is based.

Table W1.2 Medium-term macroeconomic assumptions, 2008/09 – 2011/12

	2008/09		2009/10		2010/11		2011/12
R billion	2008 Budget	2009 Budget	2008 Budget	2009 Budget	2008 Budget	2009 Budget	2009 Budget
Gross domestic product	2 286.9	2 304.1	2 506.9	2 474.2	2 758.6	2 686.3	2 953.0
Real GDP growth	*4.0%*	*2.6%*	*4.2%*	*1.4%*	*4.7%*	*3.4%*	*4.1%*
GDP inflation	*7.5%*	*8.6%*	*5.2%*	*5.9%*	*5.1%*	*5.0%*	*5.6%*
National budget framework							
Revenue	625.4	611.1	692.9	643.0	759.0	709.1	781.2
Percentage of GDP	*27.3%*	*26.5%*	*27.6%*	*26.0%*	*27.5%*	*26.4%*	*26.5%*
Expenditure	611.1	633.9	681.6	738.6	744.7	792.4	849.0
Percentage of GDP	*26.7%*	*27.5%*	*27.2%*	*29.9%*	*27.0%*	*29.5%*	*28.7%*
Main budget balance[1]	-14.3	-22.8	-11.3	-95.6	-14.3	-83.3	-67.7
Percentage of GDP	*-0.6%*	*-1.0%*	*-0.5%*	*-3.9%*	*-0.5%*	*-3.1%*	*-2.3%*

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

Table W1.3 sets out the division of revenue for the 2009 MTEF after taking into account new policy priorities.

Table W1.3 Division of revenue between spheres of government, 2005/06 – 2011/12

R million	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12
		Outcome		Revised estimate	Medium-term estimates		
National departments	192 425	210 168	242 632	288 277	343 077	352 788	361 255
Provinces	156 665	181 331	208 669	247 729	284 519	309 704	335 925
Equitable share	*135 292*	*150 753*	*172 862*	*204 010*	*231 051*	*253 670*	*272 934*
Conditional grants	*21 374*	*30 578*	*35 808*	*43 719*	*53 468*	*56 034*	*62 991*
Local government	16 682	26 501	37 321	43 620	49 698	57 722	64 964
Equitable share[1]	*9 643*	*18 058*	*20 676*	*25 560*	*23 847*	*29 268*	*31 890*
Conditional grants	*7 038*	*8 443*	*16 645*	*18 060*	*19 052*	*20 912*	*24 543*
General fuel levy sharing with metropolitan municipalities	–	–	–	–	*6 800*	*7 542*	*8 531*
Non-interest allocations	**365 772**	**418 000**	**488 622**	**579 626**	**677 295**	**720 214**	**762 145**
Percentage increase	*14.4%*	*14.3%*	*16.9%*	*18.6%*	*16.9%*	*6.3%*	*5.8%*
State debt cost	50 912	52 192	52 877	54 281	55 268	60 140	66 826
Contingency reserve	–	–	–	–	6 000	12 000	20 000
Main budget expenditure	**416 684**	**470 192**	**541 499**	**633 907**	**738 563**	**792 354**	**848 971**
Percentage increase	*13.1%*	*12.8%*	*15.2%*	*17.1%*	*16.5%*	*7.3%*	*7.1%*
Percentage shares							
National departments	*52.6%*	*50.3%*	*49.7%*	*49.7%*	*50.7%*	*49.0%*	*47.4%*
Provinces	*42.8%*	*43.4%*	*42.7%*	*42.7%*	*42.0%*	*43.0%*	*44.1%*
Local government	*4.6%*	*6.3%*	*7.6%*	*7.5%*	*7.3%*	*8.0%*	*8.5%*

1. With effect from 2006/07, the local government equitable share includes compensation for the termination of RSC/JSB levies for metros and district municipalities. From 2009/10 the RSC levies replacement grant will only be allocated to district municipalities.

Table W1.4 shows how additional resources are divided among the three spheres of government. The new priorities and additional allocations are accommodated through reprioritisation and growth in the resource envelope.

Table W1.4 Changes over baseline, 2009/10 – 2011/12

R million	2009/10	2010/11	2011/12
National departments	45 138	32 105	24 299
Provinces	13 293	12 842	21 650
Local government	2 032	2 850	6 412
Allocated expenditure	**60 463**	**47 797**	**52 362**

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

Table W1.5 Schedule 1 of the Division of Revenue Bill, 2009/10 – 2011/12

	2009/10	2010/11	2011/12
	Column A	Column B	
R million	Allocation	Forward estimates	
National[1, 2]	483 665	509 416	544 147
Provincial	231 051	253 670	272 934
Local	23 847	29 268	31 890
Total	**738 563**	**792 354**	**848 971**

1. *National share includes conditional grants to provinces and local government, general fuel levy sharing with metropolitan municipalities, debt service cost and the contingency reserve.*
2. *The direct charges for the provincial equitable share are netted out.*

The 2009 *Budget Review* sets out in detail how the constitutional issues and government's priorities are taken into account in the 2009 division of revenue. It focuses on the economic and fiscal policy considerations, revenue issues, debt and financing considerations, and expenditure plans of government. Aspects of national, provincial and local government financing are discussed in some detail in Chapters 7 and 8. For this reason, this memorandum should be read with the 2009 *Budget Review*.

Part 2: Response to the recommendations of the FFC

Section 214 of the Constitution and section 9 of the Intergovernmental Fiscal Relations Act (1997) require the FFC to make recommendations in April every year, or soon thereafter, on the division of revenue for the coming budget. The FFC complied with this obligation by tabling its submission entitled *Submission for the Division of Revenue 2009/10* to Parliament in June 2008. This part of the explanatory memorandum complies with the Constitution and section 10 of the Intergovernmental Fiscal Relations Act by setting out how government has taken into account the FFC's recommendations when determining the division of revenue for the 2009 MTEF.

The 2009/10 recommendations are divided into three parts. Part A deals with national-provincial fiscal relations matters relating to financing of basic education and health care, transport and bottlenecks hampering housing delivery. Part B deals with local government fiscal relations matters pertaining to augmenting local government revenue, electricity pricing, generation and distribution and World Cup 2010 transport infrastructure. Part C covers intergovernmental data issues.

Part A: National-provincial fiscal relations

Education: The financing of basic education

FFC proposal on the re-ranking of schools

The FFC recommends that government should review the method used to inform the national quintile ranking of schools. Rather than classifying schools according to the ward or neighbourhood in which they are located, the method should take into account the socioeconomic circumstances of the learners (with particular reference to inequality and poverty).

Government response

Government agrees with the FFC that the socioeconomic circumstances of learners should be taken into account. It is the intention of the Department of Education to, in addition to the two poorest quintiles (1 and 2), phase-in the no-fee schools policy to quintile 3, which will extend coverage to 60 per cent of schools. The department is also working on a policy to provide assistance to schools up to quintile 5 that accommodate very poor learners.

FFC proposal on learner transport

The FFC recommends that national norms and standards for the provision of learner transport should be established. This will be possible once the location of this function has been clearly demarcated between the national departments of Education and Transport. This responsibility should be clarified as a matter of urgency. In the interim, all provinces should implement the statutory provisions that ensure learners are afforded the opportunity of equal access to the right to education, irrespective of their province of residence and irrespective of whether they reside in a rural or urban area.

Government response

Government agrees with the recommendations of the FFC. The functional responsibilities with respect to learner transport are those of the Department of Education, which is responsible for the provision of scholar transport, while the Department of Transport is responsible for regulatory requirements with respect to all public transport. Once the function has been clarified, scholar transport needs are to be included in the integrated transport plans at local government level and aligned with the Public Transport Strategy.

Financing of health care

FFC proposal on fiscal performance of community health clinics subprogramme

The FFC recommends that, just as the 2008 Division of Revenue Act requires that indicative allocations to schools and hospitals be gazetted with the tabling of provincial budgets, this practice be extended to clinics and other public health care facilities, as and when they fall under provincial control.

Government response

Government agrees that allocations per primary health care facility should be published when provincial budgets are tabled. Given the capacity constraints in certain provinces, attention is currently being given to ensuring compliance with existing requirements with respect to indicative allocations for schools and hospitals.

FFC proposal on infrastructure for primary health care and health outcomes

The FFC recommends that greater emphasis be placed on improving the quality of service provided at clinics and funding the maintenance of existing primary health care facilities. A need for the construction of clinics in poorly serviced rural and urban informal settlements still remains.

The FFC also recommends that the health components of the *infrastructure grant to provinces* should be aligned to the roll-out of infrastructure through *municipal infrastructure grants*.

Government response

Government agrees that emphasis should be placed on improving the quality of health services provided at clinics. In this regard, government introduced in the 2008 Budget a special allocation for complementary infrastructure (water, sanitation and electricity) that targets primary health care facilities. In addition, roads expenditure in provinces has increased sharply over the past few years and this trajectory is to be maintained over the MTEF. Part of this expenditure is targeted at not only ensuring access to health facilities but also to ensuring access to other social services and economic opportunities.

Government recognises that it is exceedingly important that other inputs (staffing, equipment, drugs and medicines) be managed in a manner that ensures optimal outcomes. Health maintenance budgets, albeit from a low base, are budgeted to increase sharply over the medium term.

Government agrees that appropriate coordination between provincial and municipal infrastructure grants will result in optimal outcomes from infrastructure investments. In general, municipal infrastructure developments support social infrastructure. To address misalignment where this exists, government introduced the electricity, water and sanitation grants to ensure that municipal infrastructure supports health and the schools infrastructure programme.

Transport

FFC comments on the classification and earmarking of roads

The FFC recommends that the process of classifying roads among the national, provincial and municipal spheres of government should be accelerated in line with the classification framework already established. The premiers of provinces with roads earmarked for incorporation into the national road system should make the necessary applications without further delay.

Government response

Government supports the recommendation that the road classification process be accelerated in line with the established framework. Delays could lead to unintended consequences, such as underinvestment in the function or lack of proper maintenance.

Housing

FFC comments on addressing the bottlenecks hampering housing delivery

The FFC reiterates its previous recommendation that government should address housing delivery bottlenecks to reduce underspending in provinces. In cases where municipalities have the capacity to administer housing programmes, they should be accredited to do so, because delays in such accreditation and transfer of funds are the primary bottlenecks hampering housing service delivery. The FFC accordingly recommends that the accreditation of municipalities with adequate capacity should be accelerated in line with the *integrated housing and human settlement development grant* framework.

Government response

In its quest to streamline and accelerate service delivery, government is reviewing the powers and functions of provinces and local government. The location of the housing function will be addressed as part of this review. In the interim, steps are taken to publish allocations that are transferred to municipalities for housing over the next three years to improve planning and speed up delivery.

Part B: Local fiscal relations

Augmenting local government revenue

FFC comments on replacements for RSC levies

The FFC recommends that, in light of the abolition of the Regional Services Council (RSC) levy, which formed a significant source of municipal revenue, the replacement revenue source for municipalities should be a tax that enhances the fiscal autonomy and discretion of local governments; strengthens the accountability of local government regarding the administration and use of the proposed tax base; yields an adequate and buoyant revenue stream for municipalities in the face of cyclical instability; and maintains macroeconomic balance.

Government response

Government agrees that it is important that reforms to the fiscal framework for local government ensure that the fiscal autonomy of municipalities is not compromised but enhanced and supports the principles proposed to underpin the choice(s) for replacement sources of revenue for the RSC levy.

However, the revenue capacities of individual municipalities need to be taken into account, because a replacement revenue instrument that is purely in the form of a tax is unlikely to achieve the desired goal of enhancing local government fiscal autonomy for poorly resourced and rural municipalities, and will at best reproduce the existing inequalities in local government own-revenue generation.

As part of a package of reforms, the VAT zero-rating of municipal property rates and other VAT reforms were introduced from 1 July 2006. Further reforms under consideration include the sharing of the general fuel levy and/or transfer duty in the medium term, a local business tax in the longer-term, as well as grants as a guaranteed revenue source for municipalities or categories of municipalities.

Electricity pricing generation and distribution

FFC comments on the restructuring of the electricity distribution industry

The slow pace at which the restructuring process is unfolding poses great concerns for stakeholders affected by the process, especially municipalities that are currently distributing electricity. The impact of the potential loss of a crucial revenue source from electricity distribution for municipalities will need to be adequately addressed. To ensure the commitment and full buy-in from all participants involved in the restructuring process, further guidelines on the participation of municipalities and Eskom in the regional electricity distributors (REDs) need to be worked out.

The FFC recommends that government should address the potential loss of a crucial revenue source for local government as a result of the establishment of REDs. The proposed restructuring process needs to factor in current reforms to the fiscal framework and the greater developmental role envisaged for local government. There is a need to review legislation as it concerns the transfer of assets, the national pricing framework and the establishment of the REDs.

Government response

Government acknowledges that the slow pace of the restructuring of the electricity distribution industry is a concern and is currently addressing the outstanding policy and legislative issues, including an asset transfer framework for transferring Eskom's and municipalities' assets to REDs. The asset transfer framework prescribed in the Municipal Finance Management Act (2003) (MFMA) deals with municipal assets generally. Government will also address any possible financial and other risks for Eskom and municipalities.

Government agrees that the reforms in the electricity distribution industry need to take into consideration reforms in the fiscal framework as well as the role of local government in its developmental capacity.

FFC comments on electricity investments and electricity pricing policy

The FFC recommends that government should work with the National Energy Regulator of South Africa to put in place a financing framework that deals effectively with electricity pricing. Such a framework should capture the scarcity of the resource in a pricing environment that reflects costs, efficiency, stability and eventually, externalities.

Given that reforms in the electricity pricing structure will necessitate an increase in electricity prices, such higher electricity prices will adversely impact on poor households with access to electricity as well as raise the cost to government of extending basic access to electricity for poor households. As such, government will need to increase annual funding for the rollout of services under the free basic electricity programme.

For greater efficiency of resource allocation, technological innovation and increased investment in renewable energy sources, government will need to increase funding resources set aside for such purposes and enhance incentives with a view to establishing and implementing a framework that encourages new forms of electricity generation technologies to enter the market; expands opportunities to consumers to access such forms of energy; allows non-utility developers equal market opportunity to compete with established providers; and incorporates financial incentives to expand production and distribution capacity, and to effect savings through improving end-user efficiency.

Government response

Government agrees that the electricity (generation) price should reflect costs, efficiency, stability and, eventually, externalities – that is, reflect marginal rather than historical costs. The Department of Minerals and Energy recently released a draft electricity pricing policy framework to harmonise electricity pricing. The implications of higher prices for the cost of providing free basic electricity to poor households will be taken into account as part of the division of revenue.

Government has acknowledged the need to promote greater efficiency of resource allocation, technological innovation and increased investment in renewable energy sources. Tax incentives to encourage the uptake and development of renewable energy, such as accelerated depreciation allowances, are already in place. The 2008 *Budget Review* proposed the imposition of a 2c/kWh tax on the sale of electricity generated from non-renewable sources, to be collected at source by the producers/generators of electricity. The 2008 *Medium Term Budget Policy Statement* pointed out that the electricity levy should be seen as the first step towards the introduction of a more comprehensive emissions-based carbon tax. Implementation of the levy has been postponed to 1 July 2009 to coincide with the commencement of the next municipal financial year.

This measure will serve the dual purpose of helping to manage the current electricity supply shortages and protecting the environment. The 2008 *Budget Review* also announced that government would make funds available to support programmes aimed at encouraging the more efficient use of electricity, generation from renewable sources, installation of electricity-saving devices and co-generation projects. The adjusted appropriation for 2008/09 made available R180 million for electricity demand-side management and R20 million for retrofitting government buildings to improve energy efficiency. The 2008 *Medium Term Budget Policy Statement* also points out that funds will be earmarked as part of the 2009 Budget for electricity demand-side management.

World Cup 2010 transport infrastructure

FFC recommendation on the financing of public transport

The FFC recommends that spending on public transport infrastructure for 2010 should be linked to broader city development plans. The FFC proposes a better resourced *public transport infrastructure and systems grant* that must continue after the 2010 FIFA World Cup. Projects funded under this arrangement should be selected based on full appraisal of economic, environmental and social costs/benefits; and funding mechanisms to cover maintenance costs of constructed 2010 facilities should be developed.

Government response

Government supports the recommendation that projects funded through the *public transport infrastructure and systems grant* should be selected based on full appraisal of economic, environmental and social costs/benefits. Government further supports recommendations that key performance indicators relating to access to public transport, efficiency and effectiveness be developed.

The existing *public transport infrastructure and systems grant* will continue beyond 2010 as outlined in the 2008 *Budget Review*. The grant is aligned to the Public Transport Strategy, which provides guidance on the creation of integrated public transport networks throughout South Africa up to 2020. Moreover, projects funded under this grant are part of the integrated transport plans contained in the integrated development plans of municipalities.

Government is of the view that the costs relating to maintenance of constructed 2010 FIFA World Cup facilities should be provided by municipalities.

Part C: Intergovernmental data issues

Performance monitoring framework

FFC proposal on education

With respect to measuring the costs of basic education, the FFC recommends that to assess the pro-poor impact of school funding norms, the Department of Education should make publicly available and accessible the funding norms of no-fee schools in line with new provisions of the 2008 Division of Revenue Act requiring indicative allocations by school. Provincial education departments should be enabled to report on budgets and spending on learner transport in line with the new economic reporting format.

Government response

Government agrees with the FFC on the recommendation to make public and accessible the funding norms of no-fee schools. Provision is made in the National Norms and Standards for School Funding that provinces must gazette the resource targeting list which includes a list of schools with their

Education Management Information System numbers, names, poverty score, school allocation, no-fee status, section 21 status, and the national quintile in which they are situated. The list of no-fee schools per province, per allocation and per location is also published annually, and is available on the Department of Education's website.

Government also supports the recommendation that provincial education departments should report on budget and expenditure in terms of learner transport and that more focus should be placed on non-financial reporting on the programme itself. This will ensure that the performance monitoring framework works effectively.

FFC proposal on health

In line with international and national practice and the specific reference in the National Health Act (2003), Section 2(c)(iv) on the rights of vulnerable groups, the FFC recommends that health statistics for vulnerable groups –such as the proportion of women with access to antenatal care; the availability, affordability and accessibility of health facilities for TB, HIV and Aids; and data concerning children, older persons and persons with disabilities – should be collected and improved using the South African Statistical Quality Assurance Framework.

Government response

Government supports this recommendation and would like to indicate that the Department of Health has proposed that a TB nationwide prevalence survey be conducted. The survey will also incorporate HIV testing and determine the socioeconomic risk factors to ensure interventions implemented are comprehensive. The survey will assist in capturing appropriate data on vulnerable groups affected by TB and also assist government in strengthening the TB programme and/or HIV and Aids interventions.

FFC proposal on public works and transport

The FFC recommends that, in accordance with the prescripts of the expanded public works programme, job-creation target groups such as women, youth and people with disabilities should be included in the reporting of the outcomes measures for all conditional infrastructure grants to provinces and municipalities.

Government response

The recommendation for reporting on targets is supported. Some of these indicators can possibly be reported on as part of the conditional grant frameworks prescribed in terms of the Division of Revenue Act.

FFC proposal on housing

With respect to the performance framework on housing, the FFC recommends that all provincial departments receiving the *integrated housing and human settlement development grant* should comply with the measurable outputs related to reporting requirements detailed in the housing conditional grant framework and published annually in the Division of Revenue Act. To enable measurement of housing delivery, the following should be reported on: the number of houses completed separate from those under construction; the proportion and number of these houses completed that are occupied; the proportion and number of these properties that have been transferred to their occupiers; and the value of these houses and norms regarding average construction time. The FFC also recommends that all provincial departments assigned the housing function should provide financial and non-financial output and impact data to a subprogramme level, so that data can be analysed for every component of the housing subsidy programme (e.g. project-based, People's Housing Process, social housing, rural housing etc).

Government response

Government agrees with the recommendation that all provincial departments receiving the *integrated housing and human settlement development grant* should comply with the measurable outputs related to reporting requirements. The Department of Housing annually revises the quarterly reporting template for provinces into sector-specific information relating to delivery on the housing instruments in alignment with the business plans for a specific year.

With regards to the recommendation made on the provision of financial and non-financial output and impact data at subprogramme level, government embarked on a process to review the key deliverables under each of the housing programmes approved for implementation during the 2005/06 financial year. This was to determine the standard key output indicators to be used for business planning by provinces from 2006/07 onwards. The final approved business plan template includes the four major categories of interventions, which are classified as financial interventions, incremental housing programmes, social and rental housing programmes and rural housing programmes, as outlined in the new comprehensive housing plan.

The details of the budget allocation at housing programme level and the expenditure thereof is available through the provincial business plans and the housing subsidy system. This information is accessible to both the national and provincial housing departments.

Local government

FFC proposal on local government data requirements

National and provincial government departments, agencies and other organs of state should eliminate duplicate data requests submitted to municipalities.

Uniform definitions should be established between national and provincial organs of state and municipalities with careful consideration given to the purpose of collecting and producing statistics. The interpretation should reflect the purpose and mandate of the department collecting the data and be concurrent with the legislation guiding those organs of state.

A national coordinating body should be established to coordinate and rationalise the data collection activities of local governments. The national body should recommend and implement data collection standards according to the South African Statistical Quality Assessment Framework principles.

Government response

A national coordinating body already exists in the form of the Local Government Data Collection Forum that was established in response to the need to rationalise data collection from local government. The Forum will take the lead as a national coordinator in terms of setting standards, collection and capturing of data, quality assurance and dissemination of data.

In addition, the challenges related to duplication are of a temporary nature, and will decline as the different stakeholders begin to work more closely with each other, and once the mandates of the different role players with regards to the collection of municipal data are worked out and agreed upon. These matters are currently being addressed.

Part 3: Provincial allocations

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

Of the R47.8 billion added to the provincial baseline over the next three years, the provincial equitable share baselines are revised upwards by R24.8 billion and conditional grants are increased by R23.0 billion over the next three years. National transfers to provinces increase from R247.7 billion in 2008/09 to R284.5 billion in 2009/10. Over the three-year period provincial transfers will grow at an average annual rate of 11.9 per cent to R335.9 billion in 2011/12.

Table W1.6 below sets out the total transfers to provinces for the 2009/10 financial year, which amounts to R284.5 billion, with R231.1 billion allocated to the provincial equitable share and R53.5 billion to conditional grants.

Table W1.6 Total transfers to provinces, 2009/10

R million	Equitable share	Conditional grants	Total transfers
Eastern Cape	35 940	5 400	**41 341**
Free State	14 236	3 552	**17 788**
Gauteng[1]	38 897	17 551	**56 448**
KwaZulu-Natal	49 990	8 828	**58 818**
Limpopo	29 861	4 119	**33 981**
Mpumalanga	19 005	3 101	**22 107**
Northern Cape	6 193	1 778	**7 971**
North West	16 121	3 161	**19 282**
Western Cape	20 807	5 978	**26 785**
Total	**231 051**	**53 468**	**284 519**

1. Inclusive of the Gautrain Rapid Rail Link loan.

Provincial equitable share

A sizeable amount of nationally raised revenue is allocated to provinces through the equitable share. At 78.5 per cent of total provincial revenue and 81.2 per cent of national transfers in 2009/10, the equitable share constitutes the main source of revenue for meeting provincial expenditure responsibilities. The proposed revisions of R5.6 billion, R7.4 billion, and R11.8 billion bring the equitable share allocations to R231.1 billion in 2009/10, R253.7 billion in 2010/11, and R272.9 billion in 2011/12. These revisions result in the provincial equitable shares increasing 13.3 per cent between 2008/09 and 2009/10, and 11.3 per cent over the MTEF in nominal terms.

Policy priorities underpinning equitable share revisions

The additions to baseline equitable shares provide for inflation and policy adjustments. Inflation adjustments are intended to protect the real value of spending. In this regard, inflation adjustments are for critical programmes targeting the poor, including higher costs associated with medical goods and services, as well as learner and teacher support materials.

Policy adjustments in education support improved teaching and learning in public schools; progressively extend the no-fee schools policy (which presently exempts quintile 1 and 2 learners from paying school fees) to quintile 3 schools; reduce the teacher:learner ratio in quintile 1 schools; and ensure that public schools are more inclusive by catering for learners with disabilities.

Increased allocations are intended to ensure that the public health sector meets the needs of society. Allocations are set aside to stabilise the occupation-specific dispensation being implemented for nurses and to enable the phasing-in of this dispensation for doctors and specialists. Two main TB aspects are prioritised: funding teams to track people who have left extreme- and multidrug-resistant TB treatment to return them to therapy, and strengthening TB programme teams at provincial and district office level. Funds are also made available to roll out new vaccines aimed at reducing infant and child mortality. A general provision is also made to improve and support the rendering of primary health care services.

Social welfare services will be scaled up to meet the growing welfare needs of communities, with a focus on expanding early childhood development.

The equitable share also provides for improved maintenance of provincial roads and various programmes aimed at boosting economic development.

The equitable share formula

An objective redistributive formula is used to divide the equitable share among provinces. The formula is reviewed and updated with new data annually. For the 2009 MTEF, the formula has been updated with data from the 2008 Mid-year Estimates, the 2008 Education Snap Survey, the 2007 General Household Survey, the 2006 GDP-R and the 2005 Income and Expenditure Survey. The 2007 Community Survey data were used to update the basic and poverty components. The 2007 General Household Survey was used to update the health component, the 2008 Snap Survey to update the education component and the 2006 GDP-R data to update the economic activity component.

Table W1.7 Comparing 2007 Community Survey and 2008 mid-year population estimates

	2007 Community Survey	2008 Mid-year population estimates	Population Change	Current	New	Change
Eastern Cape	6 528	6 579	51	13.5%	13.5%	0.05%
Free State	2 773	2 878	105	5.7%	5.9%	0.19%
Gauteng	10 450	10 447	-3	21.5%	21.5%	-0.09%
KwaZulu-Natal	10 261	10 106	-155	21.2%	20.8%	-0.40%
Limpopo	5 239	5 275	36	10.8%	10.8%	0.03%
Mpumalanga	3 643	3 590	-53	7.5%	7.4%	-0.14%
Northern Cape	1 058	1 126	68	2.2%	2.3%	0.13%
North West	3 272	3 425	153	6.7%	7.0%	0.29%
Western Cape	5 279	5 262	-17	10.9%	10.8%	-0.08%
Total	**48 503**	**48 687**	**184**	**100.0%**	**100.0%**	**–**

Because the formula is largely population driven, the allocations it generates are sensitive to and capture shifts in population across provinces. Shifts in population in turn lead to changes in the relative demand for public services across the provinces. When the revised population figures are included, the weighted equitable shares of provinces are revised over the MTEF as per table W1.8.

Table W1.8 Changes in weighted shares due to data updates

	2009 MTEF weighted shares 3-year phasing		
	2009/10	2010/11	2011/12
Eastern Cape	-0.05%	-0.24%	-0.43%
Free State	0.03%	-0.04%	-0.10%
Gauteng	0.03%	0.28%	0.53%
KwaZulu-Natal	-0.16%	-0.21%	-0.27%
Limpopo	-0.01%	-0.10%	-0.19%
Mpumalanga	0.00%	-0.01%	-0.03%
Northern Cape	0.01%	0.01%	0.01%
North West	0.16%	0.21%	0.25%
Western Cape	-0.01%	0.10%	0.22%

Summary of the structure of the formula

The formula (Table W1.9) consists of six components that capture the relative demand for services between provinces and take into account specific provincial circumstances. The components of the formula are neither indicative budgets nor guidelines as to how much should be spent on those functions in each province or by provinces collectively. Rather, the education and health components are weighted broadly in line with historical expenditure patterns to provide an indication of relative need. Provincial executive councils have discretion regarding the determination of departmental allocations for each function, taking into account the priorities that underpin the division of revenue. For the 2009 Budget, the distribution of the weights by component remains unchanged as set out below:

- An *education share* (51 per cent) based on the size of the school-age population (ages 5-17) and the number of learners (Grade R to 12) enrolled in public ordinary schools
- A *health share* (26 per cent) based on the proportion of the population with and without access to medical aid
- A *basic share* (14 per cent) derived from each province's share of the national population
- An *institutional component* (5 per cent) divided equally between the provinces
- A *poverty component* (3 per cent) reinforcing the redistributive bias of the formula
- An *economic output component* (1 per cent) based on GDP by region (GDP-R) data.

Table W1.9 Distributing the equitable shares by province

	Education	Health	Basic share	Poverty	Economic activity	Institu-tional	Weighted average
	51%	26%	14%	3%	1%	5%	100%
Eastern Cape	16.8%	13.8%	13.5%	16.7%	7.8%	11.1%	15.2%
Free State	5.7%	5.8%	5.9%	6.1%	5.4%	11.1%	6.0%
Gauteng	15.1%	20.5%	21.5%	15.0%	33.6%	11.1%	17.4%
KwaZulu-Natal	23.0%	21.2%	20.8%	22.2%	16.3%	11.1%	21.5%
Limpopo	14.2%	11.4%	10.8%	14.2%	6.8%	11.1%	12.8%
Mpumalanga	8.5%	7.5%	7.4%	8.7%	6.8%	11.1%	8.2%
Northern Cape	2.2%	2.3%	2.3%	2.6%	2.2%	11.1%	2.7%
North West	6.5%	7.2%	7.0%	8.2%	6.4%	11.1%	7.1%
Western Cape	8.2%	10.2%	10.8%	6.2%	14.6%	11.1%	9.2%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

The weights assigned to the education (51 per cent) and health components (26 per cent) are derived from average provincial spending on education and health in total provincial spending for the past three years, excluding conditional grants.

Phasing-in of the formula

For the 2009 Budget, to mitigate the impact of new data updates on provincial equitable shares, the new weighted shares are phased in over the MTEF. Table W1.10 shows the revised weighted provincial equitable shares for the period 2008/09 to 2011/12.

Table W1.10 Implementation of the equitable share weights, 2008/09 – 2011/12

	2008/09	2009/10	2010/11	2011/12
	weighted shares	2009 MTEF weighted shares 3-year phasing		
Percentage				
Eastern Cape	15.8%	15.6%	15.4%	15.2%
Free State	6.2%	6.2%	6.1%	6.0%
Gauteng	16.6%	16.9%	17.1%	17.4%
KwaZulu-Natal	21.7%	21.6%	21.6%	21.5%
Limpopo	13.0%	12.9%	12.9%	12.8%
Mpumalanga	8.2%	8.2%	8.2%	8.2%
Northern Cape	2.7%	2.7%	2.7%	2.7%
North West	6.9%	7.0%	7.0%	7.1%
Western Cape	8.9%	9.0%	9.1%	9.2%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Education component

The education component is intended to enable provinces to fund school education, which amounts to about 90 per cent of provincial education spending. The formula uses school-age population (5 to 17 years), based on Census 2001, and actual enrolment drawn from the 2008 Snap Survey to reflect relative demand for education, with each element assigned a weight of 50 per cent. Although consideration was given to update the school-age cohort with 2007 Community Survey results, the method used for the survey does not allow for the collection of this data with greater reliability. Table W1.11 shows the impact of updating the education component with the 2008 SNAP survey enrolment data.

Table W1.11 Comparison of new and old education component weighted shares

	Revised education component				New weighted average	Old weighted average	Difference in weighted average
	2008 School enrolment	Age cohort 5 - 17	% share school enrolment	% share age cohort 5 - 17			
Eastern Cape	2 080	2 152	17.0%	16.6%	16.8%	16.9%	-0.12%
Free State	671	760	5.5%	5.9%	5.7%	5.7%	0.00%
Gauteng	1 894	1 893	15.5%	14.6%	15.1%	14.9%	0.15%
KwaZulu-Natal	2 771	3 013	22.6%	23.3%	23.0%	23.1%	-0.16%
Limpopo	1 765	1 799	14.4%	13.9%	14.2%	14.1%	0.03%
Mpumalanga	1 052	1 075	8.6%	8.3%	8.5%	8.5%	-0.09%
Northern Cape	266	281	2.2%	2.2%	2.2%	2.2%	0.02%
North West	779	865	6.4%	6.7%	6.5%	6.4%	0.15%
Western Cape	962	1 095	7.9%	8.5%	8.2%	8.1%	0.03%
Total	**12 239**	**12 933**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**–**

Health component

The health component addresses the need for provinces to deliver health care. As all citizens are eligible for health services, the provincial shares of the total population form the basis for the health share. Within the health component, people without medical aid are assigned a weight four times that of those with medical aid, on the grounds that the former group is likely to use public health care more. The health component is updated for population with medical aid using the 2007 General Household Survey. The 2008 mid-year population estimates are used to update the subcomponent "people without medical aid". Table W1.12 shows the impact of the revised weighted shares of the health component.

Table W1.12 Comparison of new and old health component weighted shares

	Old			New			Difference in weighted shares
	Population with medical aid	Population without medical aid	Weighted shares	Population with medical aid	Population without medical aid	Weighted shares	
Eastern Cape	713	24 536	14.9%	752	23 309	13.8%	-1.06%
Free State	439	10 072	6.2%	468	9 639	5.8%	-0.39%
Gauteng	2 058	30 200	19.0%	2 021	33 704	20.5%	1.50%
KwaZulu-Natal	1 062	35 420	21.5%	1 178	35 710	21.2%	-0.32%
Limpopo	374	20 052	12.0%	385	19 559	11.4%	-0.58%
Mpumalanga	367	12 488	7.6%	420	12 680	7.5%	-0.05%
Northern Cape	131	3 884	2.4%	164	3 848	2.3%	-0.06%
North West	468	11 240	6.9%	359	12 264	7.2%	0.35%
Western Cape	893	15 400	9.6%	1 087	16 700	10.2%	0.61%
Total	**6 505**	**163 292**	**100.0%**	**6 834**	**167 413**	**100.0%**	**–**

Poverty component

The poverty component introduces a redistributive element within the formula and is assigned a weight of 3 per cent. The poor population comprises persons who fall in quintiles 1 and 2 based on the 2005 Income and Expenditure Survey. Each province's share is then expressed as the percentage of the "poor" population residing in that province, where the population figure is drawn from the 2008 Community Survey. Table W1.13 shows the impact of the revised weighted shares of the poverty component.

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

	Old				New				Difference in weighted shares
	IES Survey 2000 (Q1+Q2)	Basic component value	Poor population	Weighted shares	IES Survey 2005 (Q1+Q2)	Basic component value	Poor population	Weighted shares	
Eastern Cape	56.4%	6 528	3 684	20.0%	49.8%	6 579	3 279	16.7%	-3.28%
Free State	45.7%	2 773	1 268	6.9%	41.7%	2 878	1 200	6.1%	-0.76%
Gauteng	21.9%	10 450	2 288	12.4%	28.1%	10 447	2 938	15.0%	2.56%
KwaZulu-Natal	43.0%	10 261	4 408	23.9%	43.2%	10 106	4 363	22.2%	-1.68%
Limpopo	56.3%	5 239	2 949	16.0%	52.9%	5 275	2 788	14.2%	-1.80%
Mpumalanga	36.9%	3 643	1 343	7.3%	47.7%	3 590	1 712	8.7%	1.44%
Northern Cape	44.0%	1 058	465	2.5%	44.9%	1 126	506	2.6%	0.05%
North West	37.9%	3 272	1 241	6.7%	46.9%	3 425	1 608	8.2%	1.46%
Western Cape	14.6%	5 279	769	4.2%	23.1%	5 262	1 215	6.2%	2.02%
Total		**48 503**	**18 415**	**100.0%**		**48 687**	**19 608**	**100.0%**	**–**

Economic activity component

The economic activity component is a proxy for provincial tax capacity and is assigned a weight of 1 per cent. For the 2009 MTEF, 2006 GDP-R data is used. Table W1.14 shows the impact of the revised weighted shares of the economic activity component.

Table W1.14 Comparison of new and old economic activity component weighted shares

	Old		New		Difference in weighted shares
	GDP-R, 2005 (R million)	Weighted shares	GDP-R, 2006 (R million)	Weighted shares	
Eastern Cape	122 021	7.9%	136 668	7.8%	-0.08%
Free State	84 068	5.5%	94 269	5.4%	-0.05%
Gauteng	519 017	33.7%	585 114	33.6%	-0.11%
KwaZulu-Natal	251 286	16.3%	283 655	16.3%	-0.03%
Limpopo	103 697	6.7%	118 865	6.8%	0.09%
Mpumalanga	102 378	6.7%	118 825	6.8%	0.17%
Northern Cape	33 380	2.2%	37 613	2.2%	-0.01%
North West	97 627	6.3%	112 234	6.4%	0.10%
Western Cape	225 779	14.7%	253 815	14.6%	-0.09%
Total	**1 539 253**	**100.0%**	**1 741 058**	**100.0%**	**–**

Institutional component

The institutional component recognises that some costs associated with running a provincial government, and providing services, are not directly related to the size of a province's population. It is therefore distributed equally between provinces. It constitutes 5 per cent of the total equitable share, of which each province receives 11.1 per cent.

Basic component

The basic component is derived from the proportion of each province's share of the national population and is assigned a weight of 14 per cent. For the 2009 MTEF, population data are drawn from the 2008 mid-year population estimates.

Table W1.15 shows the impact of the revised weighted shares of the basic component.

Table W1.15 Comparison of new and old basic component weighted shares

	Old		New		Difference in weighted shares
	2007 Community Survey	Weighted shares	2008 Mid-year population estimates	Weighted shares	
Eastern Cape	6 528	13.5%	6 579	13.5%	0.05%
Free State	2 773	5.7%	2 878	5.9%	0.19%
Gauteng	10 450	21.5%	10 447	21.5%	-0.09%
KwaZulu-Natal	10 261	21.2%	10 106	20.8%	-0.40%
Limpopo	5 239	10.8%	5 275	10.8%	0.03%
Mpumalanga	3 643	7.5%	3 590	7.4%	-0.14%
Northern Cape	1 058	2.2%	1 126	2.3%	0.13%
North West	3 272	6.7%	3 425	7.0%	0.29%
Western Cape	5 279	10.9%	5 262	10.8%	-0.08%
Total	**48 503**	**100.0%**	**48 687**	**100.0%**	**–**

Conditional grants to provinces

There are three types of provincial conditional grants. Schedule 4 sets out general grants that supplement various programmes partly funded by provinces, such as infrastructure and central hospitals. Transfer and spending accountability arrangements differ, as more than one national or provincial department may be responsible for different outputs expected from the grant, so accountability is broader and more comprehensive, and related to entire programmes. Schedule 5 grants are conditional grants, with specific responsibilities for both the transferring and receiving provincial accounting officers. A Schedule 8 grant, introduced for 2009/10, is intended to provide provinces and municipalities to meet or exceed prescribed targets.

Changes to conditional grant framework

A number of changes are effected to the provincial fiscal framework for the 2009 MTEF. Several new conditional grants were introduced in 2008/09, and these will be continued as part of the 2009 MTEF, namely the *Ilima/Letsema projects* under the Agriculture vote, and the *overload control grant* and *Sani Pass grant*, both under the Transport vote.

The 2009 Budget introduces five new grants: the *expanded public works programme incentive grant*, aimed at providing incentives for provinces and municipalities to increase spending on labour-intensive programmes; the *public transport operations grant* to allow for improved monitoring and control of expenditure related to bus subsidies and other transport-related issues; the *technical secondary schools recapitalisation grant* to provide for the refurbishment of such schools; and the *health disaster response (cholera) grant* and *housing disaster relief grant* to deal with the costs attributable to various natural disasters. These grants are discussed in more detail below. The *FET college sector recapitalisation grant* is phased into the provincial equitable share from 1 April 2009. The programmes funded through this conditional grant continue as part of the provincial education departments’ normal responsibilities and funding thereof continues in provincial budgets.

A new transitional conditional grant was introduced (*devolution of property rate funds grant*) in 2008/09 to ensure that provinces take over the responsibility of paying the property rates and municipal charges of properties that were administered by national government on their behalf.

Table W1.16 shows the revisions to provincial conditional grants which provide for policy and inflation adjustments. Revisions to conditional grant baseline allocations totalling R7.7 billion, R5.5 billion and R9.8 billion or R23.0 billion over the MTEF bring the new conditional grant baselines to R53.5 billion in 2009/10, R56.0 billion in 2010/11 and R63.0 billion in 2011/12. Included in this is a loan of R4.2 billion in 2009/10 to the Gauteng government for the Gautrain Rapid Rail Link project.

Table W1.17 provides a summary of conditional grants by sector for the 2009 MTEF. More detailed information, including the framework and formula for each grant, is provided in Appendix W1 of the 2009 Division of Revenue Bill. The frameworks provide the conditions for each grant, the outputs expected, the allocation criteria used for dividing each grant between provinces, a summary of the audit outcome in 2007/08 and any other material issues to be addressed.

Table W1.16 Revisions to conditional grant baseline allocations, 2009/10 – 2011/12

R million	2009/10	2010/11	2011/12	2009 MTEF Total revisions
Agriculture	**197**	**305**	**577**	**1 079**
Agricultural disaster management	60	–	–	**60**
Comprehensive agricultural support programme	87	105	177	**369**
Ilima/letsema projects	50	200	400	**650**
Education	**583**	**1 402**	**2 297**	**4 282**
National school nutrition programme	583	1 322	2 097	**4 002**
Technical secondary schools recapitalisation	–	80	200	**280**
Health	**454**	**685**	**804**	**1 943**
Comprehensive HIV and Aids	200	325	407	**932**
Health disaster response (cholera)	50	–	–	**50**
Hospital revitalisation	124	265	339	**728**
National tertiary services	81	95	58	**233**
Housing	**861**	**804**	**2 146**	**3 812**
Housing disaster relief	150	–	–	**150**
Integrated housing and human settlement development	711	804	2 146	**3 662**
National Treasury	**4 653**	**1 234**	**2 456**	**8 343**
Infrastructure grant to provinces	453	1 234	2 456	**4 143**
Gautrain loan	4 200	–	–	**4 200**
Public Works	**151**	**400**	**800**	**1 351**
Expanded public works programme incentive	151	400	800	**1 351**
Transport	**809**	**647**	**720**	**2 176**
Gautrain rapid rail link	325	23	–	**349**
Public transport operations	483	624	720	**1 828**
Total	**7 708**	**5 478**	**9 801**	**22 987**

Table W1.17 Conditional grants to provinces, 2008/09 – 2011/12

R million	2008/09	2009/10	2010/11	2011/12
Agriculture	**868**	**877**	**1 117**	**1 437**
Agricultural disaster management	137	60	–	–
Comprehensive agricultural support programme	614	715	862	979
Ilima/letsema projects	66	50	200	400
Land care programme grant: poverty relief and infrastructure development	51	51	55	58
Arts and Culture	**324**	**441**	**494**	**524**
Community library services	324	441	494	524
Education	**2 909**	**2 572**	**3 931**	**4 978**
Education disaster management	22	–	–	–
Further education and training college sector recapitalisation	795	–	–	–
HIV and Aids (life skills education)	165	177	188	199
National school nutrition programme	1 927	2 395	3 663	4 579
Technical secondary schools recapitalisation	–	–	80	200
Health	**14 091**	**15 578**	**18 013**	**19 172**
Comprehensive HIV and Aids	2 885	3 476	4 312	4 633
Forensic pathology services	595	492	557	590
Health disaster response (cholera)	–	50	–	–
Health professions training and development	1 679	1 760	1 865	1 977
Hospital revitalisation	2 798	3 186	3 881	4 172
National tertiary services	6 134	6 614	7 398	7 799
Housing	**9 921**	**12 592**	**15 027**	**17 222**
Housing disaster relief	–	150	–	–
Integrated housing and human settlement development	9 921	12 442	15 027	17 222
National Treasury	**7 384**	**13 449**	**11 315**	**13 091**
Infrastructure grant to provinces	7 384	9 249	11 315	13 091
Gautrain loan	–	4 200	–	–
Provincial and Local Government	**30**	**–**	**–**	**–**
Internally displaced people management grant	30	–	–	–
Public Works	**889**	**1 148**	**1 496**	**1 962**
Devolution of property rate funds	889	997	1 096	1 162
Expanded public works programme incentive	–	151	400	800
Sport and Recreation South Africa	**279**	**402**	**426**	**452**
Mass sport and recreation participation programme	279	402	426	452
Transport	**7 024**	**6 409**	**4 215**	**4 153**
Gautrain rapid rail link	3 266	2 833	341	–
Overload control	9	10	11	–
Public transport operations	2 984	3 532	3 863	4 153
Sani Pass roads	30	34	–	–
Transport disaster management	735	–	–	–
Total	**43 719**	**53 468**	**56 034**	**62 991**

Agriculture grants

To scale up the grant to support food security and expand the provision of agricultural support services, R369 million is added to the *comprehensive agricultural support programme* over the MTEF: R87 million in 2009/10, R105 million in 2010/11 and R177 million in 2011/12. In addition, the programme aims to further expand farm infrastructure for dipping, fencing, and rehabilitation of irrigation schemes where these could be viable.

The *Ilima/Letsema projects grant* is intended to boost food production. The grant is aimed at assisting previously disadvantaged South African farming communities to achieve an increase in agricultural production. Amounts of R50 million in 2009/10, R200 million in 2010/11 and R400 million in 2011/12 are added to this grant.

An *agriculture disaster management grant* is earmarked to compensate farmers for the effects of drought, veld fires, cold spells, hailstorms and floods. An amount of R60 million is allocated to this grant in 2009/10.

Education grants

The Department of Education administers the *national school nutrition programme grant* and the *HIV and Aids (life skills) programme grant*. The *FET recapitalisation grant* will be phased into the provincial equitable share from 1 April 2009.

The *national school nutrition programme* seeks to improve nutrition of poor school children, enhance active learning capacity and improve attendance in schools. Over the MTEF R4 billion is added to this grant to respond to higher food prices and to feed more children by ensuring that all quintile 1-3 primary school learners can be fed on all school days, and to progressively expand the programme to secondary schools.

The *HIV and Aids (life skills) programme grant* provides for life skills training, sexuality and HIV and Aids education in primary and secondary schools. This grant is allocated R177 million in 2009/10, R188 million in 2010/11 and R199 million in 2011/12. The programme is fully integrated into the school system, with learner and teacher support material provided for grades 1 to 9.

A new conditional grant, *the technical secondary schools recapitalisation grant*, will be made available to provinces from 2010/11. This grant, amounting to R80 million in 2010/11 and R200 million in 2011/12, provides for equipment and facilities in technical high schools.

Health grants

The health sector accounts for nearly two-thirds of the total provincial conditional grants. The sector accounts for five conditional grants with a total allocation of over R15 billion annually.

The *national tertiary services grant* aims to provide strategic funding to enable provinces to plan, modernise, and transform the tertiary hospital service delivery platform in line with national policy objectives. The grant operates in 27 hospitals across the nine provinces, concentrated in urban Gauteng and Western Cape. Consequently, the Western Cape and Gauteng receive the largest shares of the grant as they provide the largest proportion of these high-level, sophisticated services for the benefit of the health sector countrywide. The *national tertiary services grant* is allocated an additional R233 million over the MTEF to address inflation-related increases on goods and services purchased in tertiary hospitals

The *hospital revitalisation programme* plays a key role in transforming and modernising infrastructure and equipment in hospitals. The grant also includes a component aimed at improving systems for medical equipment, and support management development initiatives, including personnel, procurement delegations and financial management capacity. An additional R728 million is added to this grant over the MTEF to compensate for the effects of inflation and ensure that hospitals are appropriately equipped and modernised.

The *health professions training and development grant* funds the costs associated with the training of health professionals, and the development and recruitment of medical specialists. It enables the shifting of teaching activities from central to regional and district hospitals. This grant is allocated R1.8 billion in 2009/10, R1.9 billion in 2010/11 and R2.0 billion in 2011/12.

The *comprehensive HIV and Aids grant* enables the health sector to develop a specific response to HIV and Aids. In addition to HIV and Aids prevention programmes, the grant supports specific interventions that include voluntary counselling and testing, prevention of mother-to-child transmission, post-exposure prophylaxis and home-based care. This grant receives an additional R932 million over the medium term to meet demand arising from the more rapid take-up of antiretroviral medication. Additions to baseline bring the total planned spending on this programme to R12.4 billion over the period.

The *forensic pathology services grant* assists with the transfer of medico-legal mortuaries from the South African Police Service to the health sector and to provide comprehensive forensic pathology services for the criminal justice system. Amounts of R492 million in 2009/10, R557 million in 2010/11 and R590 million in 2011/12 are allocated to this grant.

The *health disaster response (cholera) grant* will assist with the recent cholera outbreaks in Limpopo. An amount of R50 million is allocated to this grant in 2009/10.

Housing grants

The *integrated housing and human settlement development grant* facilitates the establishment of habitable, stable and sustainable human settlements in which all citizens have access to social and economic amenities. The programme targets eradication or formalisation of informal settlements on a phased basis by 2014. Despite progress made thus far, there are still about 1.8 million families living in informal dwellings. The *integrated housing and human settlement development grant* is allocated an additional R3.7 billion over the MTEF to speed up housing delivery and to raise the value of the housing subsidy in order to keep pace with higher inflation. The additional amounts take the total housing grant over the next three years to R44.7 billion.

The *housing disaster relief grant* will assist with the rebuilding of roofs damaged during the recent disaster in KwaZulu-Natal. An amount of R150 million is allocated to this grant in 2009/10.

National Treasury grants

The *infrastructure grant to provinces* augments provincial funding to accelerate construction, maintenance and rehabilitation of new and existing infrastructure in education, roads, health and agriculture, and also contributes to rural development. The grant also focuses on the application of labour-intensive methods in delivery to maximise job creation and skills development.

In line with government's commitment to sustain social and economic infrastructure investment in provinces, the *infrastructure grant to provinces* is revised upwards by R4.1 billion over the period to address school infrastructure needs, including extending grade R infrastructure, upgrading schools for learners with special needs, the construction of school libraries, laboratories, sports fields and increased maintenance.

Within the infrastructure grant for provinces, provision is made for specific earmarking for education related infrastructure. Amounts of R100 million in 2010/11 and R400 million in 2011/12 are set aside for grade R infrastructure to ensure that classroom space is available. This is coupled with a further R200 million in 2010/11 and R800 million in 2011/12 to recapitalise schools through upgrading of infrastructure, securing school facilities, increasing maintenance and providing new books and equipment in libraries and laboratories.

The *infrastructure grant to provinces* is further stepped up by R100 million in 2009/10, R200 million in R2010/11 and R320 million in 2011/12 to provide for the rehabilitation of the Mpumalanga coal haulage route and the development of the R33 road network to Medupi Power Station in Limpopo to ensure efficient movement of machinery and equipment for the power station.

Arts and culture grants

Community library services provide direct access to information and knowledge, contributing to education and self-empowerment. The *community library services grant* amounts to R441 million in 2009/10, R494 million in 2010/11 and R524 million in 2011/12 to transform urban and rural community library infrastructure facilities and services.

Sports and recreation grants

The *mass sport and recreation participation programme grant*, which amounts to R402 million in 2009/10, R426 million in 2010/11 and R452 million in 2011/12, promotes mass participation by historically disadvantaged communities in a selected number of developmental sporting activities. Within this, amounts of R187 million in 2009/10, R198 million in 2010/11 and R210 million in 2011/12 are earmarked for specific legacy projects.

Transport grant

The Department of Transport is allocated R2.8 billion in 2009/10 and R341 million in 2010/11 as a contribution to the construction of the Gautrain Rapid Rail Link.

Two grants introduced as part of the 2008 Adjustments Budget, the o*verload control grant* and *Sani Pass roads grant* will continue as part of the 2009 Budget. The o*verload control grant* will fund initiatives to ensure the preservation of road infrastructure through the reduction of overloading practices. The *Sani Pass roads grant* will assist with the development of road infrastructure projects that promote regional integration and development between South Africa and Lesotho. The *overload control grant* receives R10 million in 2009/10 and R11 million in 2010/11. The *Sani Pass roads grant* is allocated R34 million in 2009/10.

A new conditional grant, the *public transport operations grant*, will be introduced as part of the 2009 Budget for the subsidisation of commuter bus services. Although the payment of bus subsidies to operators was previously funded on an agency arrangement between national and provincial government, recent legal action places a greater responsibility on government to ensure contractual obligations are met. This grant will amount to R11.5 billion over the MTEF.

Public works grants

The *devolution of property rate funds grant* was introduced in 2008/09 to ensure that provinces take over the responsibility of paying property rates and municipal charges on properties that were administered by national government on their behalf. The grant is allocated R889 million in 2008/09, R997 million in 2009/10, R1.1 billion in 2010/11 and R1.2 billion in 2011/12. The grant is expected to be phased into the provincial equitable share in about four years.

The 2009 Budget introduces a new grant on the Public Works vote: the *expanded public works programme incentive grant* provides incentives to provinces and municipalities to increase spending on labour-intensive programmes. It receives R151 million in 2009/10, R400 million in 2010/11 and R800 million in 2011/12 for provinces.

Part 4: Local government fiscal framework and allocations

Municipalities have a constitutional mandate to deliver crucial services that meet the public service needs of all while facilitating local economic development. Significant progress has been made in ensuring that municipalities are efficiently funded to continue to roll out infrastructure and services on a sustainable basis. Following the revision and implementation of a new equitable share formula during 2005/06 and the ongoing review of the local government fiscal framework, local government's share of nationally raised revenue continues to increase.

As part of the continuing review, the sharing of the general fuel levy is phased in over the next three years. The local government equitable share formula is also adjusted to improve horizontal equity in the allocation system, resulting in considerable increases in the allocations to poorly resourced municipalities over the MTEF.

National transfers to municipalities are published to enable them to plan fully for their 2009 budgets, and to promote better accountability and transparency by ensuring that all national allocations are included in municipal budgets. Local government equitable share and *municipal infrastructure grant* allocations to district municipalities that are water services authorities, and which consequently receive allocations on behalf of unauthorised local municipalities, are published in the relevant district municipality to enhance transparency in the budget process. Allocations are published for both the national and municipal financial years.

Revisions to the local government grant baselines for the 2009 MTEF are shown in table W1.18.

Table W1.18 Transfers to local government: revisions to baseline, 2009/10 – 2011/12

	2009/10	2010/11	2011/12	2009 MTEF
R million	Medium-term estimates			Total revisions
Equitable share	**491**	**614**	**1 368**	**2 473**
General fuel levy sharing with metros	**–**	**–**	**461**	**461**
Infrastructure transfers	**1 320**	**1 668**	**3 475**	**6 463**
2010 FIFA World Cup stadiums development grant	261	202	–	463
Integrated national electrification programme	36	69	89	194
Public transport and infrastructure grant	93	325	417	835
Municipal infrastructure grant	755	851	2 690	4 295
Electricity demand-side management	175	220	280	675
Current transfers	**221**	**568**	**1 108**	**1 898**
2010 FIFA World Cup host city operating grant	20	14	–	34
Expanded Public Works Programme incentive	202	554	1 108	1 864
Total	**2 032**	**2 850**	**6 412**	**11 294**

National allocations to local government (Table W1.19) grow from a revised allocation of R43.6 billion in 2008/09 to R49.7 billion in 2009/10, R57.7 billion in 2010/11 and R65.0 billion by 2011/12. The share of nationally raised revenue for local government rises from 7.5 per cent in 2008/09, to 8.5 per cent in 2011/12. In addition, R2.9 billion in 2009/10, R2.8 billion in 2010/11 and R3.6 billion in 2011/12 are made available as a grant-in-kind to local government, mostly for infrastructure projects administered on behalf of municipalities.

Table W1.19 National transfers to local government, 2005/06 – 2011/12

R million	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12
		Outcome		Revised estimate		Medium-term estimates	
Equitable share	9 643	18 058	20 676	25 560	23 847	29 268	31 890
of which							
RSC/JSB replacement grant - district municipalities [1]	–	*7 000*	*8 045*	*9 045*	*3 307*	*3 493*	*3 672*
Water and sanitation operating subsidy: direct transfer	165	386	642	986	979	570	380
Direct transfers	**16 682**	**26 501**	**37 321**	**43 620**	**49 698**	**57 722**	**64 964**
Equitable share and related	9 808	18 444	21 317	26 545	24 825	29 838	32 270
General fuel levy sharing with metropolitan municipalities	–	–	–	–	6 800	7 542	8 531
Infrastructure transfers	6 286	7 447	15 128	16 677	16 864	19 001	22 446
Capacity-building and other current transfers	588	610	875	397	1 209	1 341	1 717
Indirect transfers [2]	**1 753**	**1 436**	**2 027**	**2 267**	**2 879**	**2 843**	**3 598**
Infrastructure transfers	783	943	1 484	1 948	2 744	2 843	3 598
Capacity-building and other current transfers	970	493	543	319	135	–	–
Total	**18 435**	**27 937**	**39 347**	**45 886**	**52 578**	**60 566**	**68 562**
Year-on-year growth							
Equitable share and related		*88.0%*	*15.6%*	*24.5%*	*-6.5%*	*20.2%*	*8.2%*
General fuel levy sharing with metropolitan municipalities		–	–	–	–	*10.9%*	*13.1%*
Infrastructure transfers (direct and indirect)		*18.7%*	*98.0%*	*12.1%*	*5.3%*	*11.4%*	*19.2%*
Capacity-building and other current transfers (direct and indirect)		*-29.2%*	*28.6%*	*-49.5%*	*87.7%*	*-0.3%*	*28.1%*

1. *With effect from 2006/07, the local government equitable share includes compensation for the termination of Regional Services Council (RSC) and Joint Services Board (JSB) levies for metros and district municipalities. From 2009/10 the RSC levies replacement grant for district municipalities will remain in place pending the outcome of the local government policy review.*
2. *In-kind transfers to municipalities.*

The local government equitable share

The local government equitable share continues to play a vital role in assisting municipalities to fulfil their service provision responsibilities, in particular to assist poor households. The significant improvements in access to services such as water, sanitation and electricity shown in the 2007 Community Survey (*Statistics South Africa*) are evidence of an increasingly productive local government sphere. The local government equitable share allocations continue to supplement municipal own-revenues for the provision of the necessary basic level of services to each poor household within their localities.

Given the limited funds available to all spheres and significant service delivery challenges, government is accelerating efforts to better assist municipalities to improve planning and financial capacity, achieve greater efficiency in delivery, and expand service access to households residing in predominantly rural and poorly resourced municipal areas.

The additional R2.5 billion results in the equitable share increasing from R19.5 billion in 2008/09 (excluding the RSC levies replacement grant/general fuel levy sharing with metros) to R31.9 billion in 2011/12. In the context of these efforts, the equitable share formula allocations (excluding RSC levy replacement for district municipalities and special support for councillor remuneration for municipalities on Grades 1 to 3) grow by an annual average of 19.7 per cent over the next three years to R20.3 billion in 2009/10, R25.5 billion in 2010/11 and R27.9 billion in 2011/12.

Equitable share formula

The structure and components of the formula are summarised in the text box below:

Structure of the local government equitable share formula

Grant = BS + D + I – R ± C

where

BS is the basic services component

D is the development component

I is the institutional support component

R is the revenue-raising capacity correction and

C is a correction and stabilisation factor.

The basic services component

The purpose of the *basic services component* is to assist municipalities in providing basic services to poor households and with meeting municipal health service needs for all. For each of the subsidised basic services there are two levels of support: a full subsidy for poor households that are connected to municipal services, and a partial subsidy for households that are not yet connected to the municipal networks, currently set at a third of the cost of the subsidy to serviced households.

The characteristics of the basic services component are:

- Supporting poor households earning less than R800 per month in 2001 prices.
- Distinguishing between poor households connected to services and those that are not connected to services and may be provided with alternatives.
- Recognising water reticulation, sanitation, refuse removal and electricity reticulation as the core services.
- Providing for municipal health services to all households.

The basic services component

*BS=[Water Subsidy 1*Poor with Water + Water Subsidy 2*Poor without Water] +*

*[Sanitation Subsidy 1*Poor with Sanitation + Sanitation Subsidy 2*Poor without Sanitation] +*

*[Refuse Subsidy 1*Poor with Refuse + Refuse Subsidy 2*Poor without Refuse] +*

*[Electricity Subsidy 1*Poor with Electricity + Electricity Subsidy 2*Poor without Electricity] +*

*[Municipal Health Services*Total number of households]*

The institutional support component

The average low- or medium-capacity municipality (those operating in rural areas or small towns without a significant urban core), spends more than half of its own revenue on administrative and governance costs, leaving a much reduced-portion available for the provision of actual services. Given the existing capacity challenges in these municipalities, the *institutional support component* of the equitable share formula provides assistance in meeting some of these requirements. It is a supplement designed to augment, but not fully cover, institutional costs. While all municipalities receive institutional support, government is continuously working to ensure that such funding is appropriately allocated where it is most needed.

The institutional component

There are two elements to the institutional component: administrative capacity and local electoral accountability. The grant therefore is as follows:

I = Base allocation + [Admin support * Population] + [Council support * Number of seats]

Where the values used in the formula are:

I = R350 000 + [R1*population] + [R36 000* councillors]

The “base allocation” is an amount that will go to every municipality (except for a district management area). The second term of this formula recognises that costs go up with population (in terms of the 2001 Census). The third term is a contribution to the cost of maintaining councillors for the legislative and oversight role. The number of “seats” that will be recognised for purposes of the formula is the one determined by the Minister for Provincial and Local Government for purposes of elections and composition.

The revenue-raising capacity correction

To account for the varying fiscal capacities of municipalities, the formula must account for each municipality’s ability to raise revenue for the purposes of fulfilling its constitutional mandate. This component therefore takes into account income from property rates, the general fuel levy for metropolitan municipalities and the RSC/JSB levy replacement grant for district municipalities. In the absence of proper information on property valuation rolls across the spectrum of municipalities and as an interim measure, previous actual property rates collected have been used as a basis for determining future capacity to collect income from this source. In the case of the general fuel levy and the RSC/JSB replacement grant, allocations were separately determined for each municipality and are used as published for the MTEF.

To achieve greater horizontal equity in the allocation system and to accommodate the bigger service level responsibilities of larger municipalities, as well as the greater revenue-raising constraints faced by smaller municipalities, a differentiated “tax” rate on property rates income is applied on the basis of demonstrated revenue raising capacity of the municipalities. The applicable “tax” rate for a municipality (Table W1.20) is based on the estimated level of per capita own operating revenue, while own operating revenue is the difference between past actual total operating revenue and income from grants and subsidies. The estimates are based on actual financial outcomes of municipalities for the period 2004/05 to 2006/07 as captured in the National Treasury’s local government database. Population numbers used are those reported in the 2001 Census.

Table W1.20 Differentiated "tax" rates

Operating revenue per capita Rand	Tax rate on property rates
0 – 500	1.5%
501 – 1000	2.5%
1001 – 1500	3.5%
1501 – 1750	5.5%
1751 – 2000	6.5%
2001 – 2225	7.5%
2226 – 2500	8.5%
2501 – 5000	9.5%

The income from the general fuel levy and the RSC/JSB levy replacement grant of metropolitan and district municipalities is “taxed” at 6 per cent.

Stabilising constraint

With the publication of three-year budget allocations, a guarantee mechanism is applied to the indicative outer-year baseline amounts with the aim of ensuring that municipalities are given what was indicated in the previous MTEF round of allocations, as far as this is possible, given overall budget constraints. An additional constraint is to ensure that allocations are not negative due to the revenue-raising correction. In the case of the 2009 MTEF the applicable guarantees are 100 per cent and 90 per cent on the allocations for the first two years of the MTEF cycle, respectively. This means that for 2009/10 municipalities are guaranteed to receive 100 per cent of the allocations published in the Division of Revenue Act (2009). For 2010/11 the minimum that a municipality can expect to receive is 90 per cent of what is published in the act.

Other considerations in applying the formula

The formula, as outlined above, has to be rescaled to make allowance for intricacies in the allocation process. In particular, powers and functions must be taken into account, and the overall budget must balance.

a) Powers and functions

The local government system has a number of asymmetries, not only between different categories of municipalities, but also within the same category of municipalities. Firstly, there is the broad division of the sphere into Category A, B and C municipalities. Secondly, the division of powers and functions between Category B and C municipalities differs – and this is also true between the different Category B municipalities within the same Category C district. In order to deal with these differences the model has to ensure that the allocations made in terms of the “basic services” component go to the municipality that actually performs the function.

b) Balancing allocations

The “horizontal division” of allocations made between municipalities depends on the size of the overall allocation that is made to the local government sphere, normally determined through a separate consultative process to determine the equitable share of nationally raised revenue for each of the three spheres of government (i.e. the “vertical division”). Since there is no guarantee that allocations made in terms of the vertical division add up precisely to the amount allocated to the local government equitable share, such allocations need to be adjusted to fit within the constraints outlined above.

Rescaling of the BS, D and I components

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

Grant = Adjustment Factor*(BS + D + I) – R ± C

This adjustment factor is calculated so as to ensure that the system balances.

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

Measurement issues

The integrity of the data is as important as the set of equations in determining whether the allocations meet the constitutional requirement of equity. A process is already underway to update the equitable share formula with the latest available data on population, household numbers, service access and poverty. Nevertheless, the principle of equity is stringently maintained in the current formula, ensuring that measurement is done in a manner that does not arbitrarily discriminate between municipalities.

a) Poverty

The "income" method is used to estimate poverty at a municipal level as it allows for a cross-tabulation of poverty against servicing levels. The majority (over 90 per cent) of funds allocated to each municipality through the formula are aimed at service delivery for poor households.

b) Servicing levels

A key element of the current formula is the subsidy received by poor households for various services delivered to them. The subsidy amounts in the current formula use a study conducted by the Department of Provincial and Local Government (see Table W1.21) and updated for the general increase in the bulk price of electricity in 2008. In addition, municipal health services are subsidised at an amount of R18 a year for all households.

Table W1.21 Service costs

Service costs per month	1998 Estimates	2008 Estimates	
Rand		Serviced households	Households not connected to services
Electricity	36.0	45.0	16.0
Water	20.0	30.0	10.0
Sanitation	10.0	30.0	10.0
Refuse	20.0	30.0	10.0
Total	**86.0**	**135.0**	**46.0**

The basic services component is by far the largest component of the local government equitable share. At about 92 per cent of the formula, it amounts to R18.7 billion, R23.5 billion and R25.8 billion over the MTEF period ahead.

When the *adjustment factor* and other components of the formula are applied, the formula calculates actual subsidies per basic service that are much higher than what is listed in Table W1.21 as cost of providing the service. Table W1.22 contains the actual average monthly basic services subsidies per poor household produced by the formula, i.e. rescaled amounts.

Table W1.22 Actual average monthly basic services subsidies per poor household

Monthly	Serviced households			Households not connected to services		
Rand	2009/10	2010/11	2011/12	2009/10	2010/11	2011/12
Electricity	136.9	172.0	188.4	50.6	63.3	69.2
Water	97.0	122.1	133.8	28.9	36.0	39.4
Sanitation	64.0	80.9	88.7	42.7	53.3	58.2
Refuse	60.3	76.3	83.7	44.5	55.6	60.7
Total	**358.1**	**451.2**	**494.5**	**166.7**	**208.1**	**227.6**

The actual average monthly subsidy for a basket of the four basic services for poor households *with access* to the services is approximately R358, R451 and R494 over the next three years. This is considerably higher than the R135 estimated cost of providing a basket of the four basic services per month as illustrated in Table W1.21.

The actual average monthly subsidy for a basket of the four basic services for poor households *without access* to the services is approximately R167, R208 and R228 over the next three years. This is also much higher than the R46 estimated cost of providing a basket of four alternative basic services per month as illustrated in Table W1.21, i.e. prior to rescaling to the overall amount available for distribution through the equitable share formula.

Similarly, the actual average annual subsidy per household for the provision of municipal health services is R48, R62 and R68 over the next three years compared to the estimated cost of R18 per year.

c) Revenue-raising capacity

Regular reporting on financial information is now a legal requirement under the MFMA, enforcement of which is actively assisted by the work of the Auditor General. Given that the quality of the previous imputation method has been decreasing as a result of outdated Census data, while the extent and quality of municipal financial reporting gets steadily better, it is important to start making an appropriate shift. Actual revenue information can now be more reliably used to estimate revenue-raising capacity until credible information in the municipal property valuation rolls is readily available. Estimates are based on the 2004/05 and 2005/06 financial statements of municipalities as captured in the National Treasury’s local government database.

Funding poorly resourced municipalities through the equitable share formula

From 2009 onwards, the local government equitable share formula will be reviewed to ensure that poorly resourced municipalities are appropriately supported. The first step in this reform process, to be introduced from 2009/10, is to apply differentiated tax rates to measure the revenue-raising capacity of municipalities. Further work in 2009 will include a review of existing components (basic services, institutional support and revenue-raising correction components), investigating alternatives for activating the development (D) component of the formula and the possible updating of the formula with the results of the 2007 Community Survey (2001 Census results are currently being used).

The water service operating subsidy

The *water services operating subsidy* is a Schedule 6 and 7 grant used to fund water schemes and the staff involved in the operations of the schemes through the Department of Water Affairs and Forestry's trading account. These are the schemes that were administered by the department prior to 1994 and are now being transferred to municipalities. To date, 95 per cent of water schemes, and 50 per cent of staff have been transferred to municipalities. In addition, 57 agreements have been signed, 3 236 staff transferred and 1 698 schemes with a total asset value of about R5 932 million transferred to municipalities.

The grant covers staff-related costs and direct operating and maintenance costs, while provision is also made for the refurbishment of infrastructure. The allocation per municipality is according to the operational budget for each scheme and the funding requirements identified and agreed on in the transfer agreement.

In the 2009 MTEF, R2.1 billion is allocated for the *water services operating grant (direct and indirect transfers)*. The grant is phased into the local government equitable share over the period ahead as the water schemes and the remaining staff are transferred to municipalities.

Conditional grants to local government

National government provides conditional grant funding to municipalities on the basis of their varying fiscal capacities to deliver on their responsibilities to eradicate backlogs in crucial infrastructure and essential basic services, and to support municipal capacity-building and other operational initiatives. The total of conditional grants directly transferred to local government, including the *water operating subsidy*, increase from R19.1 billion in 2009/10, R20.9 billion in 2010/11 and R24.5 billion in 2011/12.

Infrastructure conditional grants to local government

National transfers for infrastructure, including indirect or in-kind allocations to entities executing specific projects, amount to R19.6 billion, R21.8 billion and R26 billion for each of the 2009 MTEF years.

Table W1.23 Infrastructure transfers to local government, 2005/06 – 2011/12

R million	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12
		Outcome		Revised estimate		Medium-term estimates	
Direct transfers	**6 286**	**7 447**	**15 128**	**16 677**	**16 864**	**19 001**	**22 446**
Municipal infrastructure grant	5 436	5 938	8 754	8 620	11 085	12 529	15 069
Public transport infrastructure and systems	242	518	1 174	3 170	2 418	4 290	5 149
National electrification programme	297	391	462	494	933	1 020	1 097
Neighbourhood development partnership grant	–	–	41	80	582	630	840
2010 FIFA World Cup stadiums development	–	600	4 605	4 295	1 661	302	–
Disaster relief	311	–	–	–	–	–	–
Rural transport grant	–	–	–	9	10	10	11
Electricity demand-side management	–	–	–	–	175	220	280
Municipal drought relief grant	–	–	91	9	–	–	–
Indirect transfers[1]	**783**	**943**	**1 484**	**1 948**	**2 744**	**2 843**	**3 598**
Regional bulk infrastructure	–	–	300	450	612	839	1 475
Backlogs in the electrification of clinics and schools	–	–	45	90	150	–	–
Backlogs in water and sanitation at clinics and schools	–	–	105	210	350	–	–
National electrification programme	783	893	973	1 151	1 478	1 769	1 902
Neighbourhood development partnership grant	–	50	61	47	80	125	100
Electricity demand-side management	–	–	–	–	75	110	120
Total	**7 070**	**8 390**	**16 612**	**18 625**	**19 608**	**21 845**	**26 043**

1. In-kind transfers to municipalities.

In addition to funding for municipal infrastructure, public transport infrastructure and the national electrification programme, there is continuing funding for water services regional bulk infrastructure, 2010 FIFA World Cup stadium development, water and sanitation services to schools and clinics, and the electrification of schools and clinics. The MTEF also sees the introduction of the *electricity demand side management grant* and a *rural transport infrastructure grant*.

Municipal infrastructure grant

The largest infrastructure transfers are through the *municipal infrastructure grant* (MIG), which supports government's objective of expanding the delivery of services, as well as alleviating poverty. The grant was introduced as a Schedule 4 grant in the Division of Revenue Act in 2004/05 as it supplements municipal allocations for infrastructure. While the allocations and spending patterns have increased over the years, it has become evident that the design and administration processes of the grant are inconsistent with the prevailing municipal environment, resulting in less than optimal results. Experience gained over the last eight years has shown that there are qualitative differences between South Africa's 283 municipalities. The demographic, economic, infrastructural and institutional challenges facing these categories of municipalities differ significantly. Yet the current approach to funding municipal infrastructure assumes that municipalities are the same.

In this context, government has identified a need to reconceptualise the way in which municipalities are funded to better leverage the capacity of the state as a whole to achieve basic service delivery targets. Cabinet approved the introduction of the *municipal infrastructure grant (cities)* by splitting the MIG into two parts. This decision allows a differentiated funding approach to be introduced to account for significant differences in context, challenges and capabilities between larger urban municipalities and smaller, more rural municipalities.

Adopting a differentiated funding approach will allow national regulation of funding to respond to the generic challenges of different types of municipalities, as well as the specific issues faced by individual municipalities. The *MIG (cities)* focuses on enabling cities to more effectively manage, support and account for built environment outcomes. Greater discretion over the selection and implementation of capital projects, as part of their own capital investment programmes, will be matched with oversight of their entire programme performance rather than solely project inputs. This means that larger urban municipalities will be required to commit to the achievement of specific, measurable developmental outcomes arising from their entire capital programme. Smaller, more rural municipalities will largely continue to operate under the existing MIG framework, with innovations to improve expenditure outcomes introduced over time to address capacity and resource deficiencies.

Cabinet has approved the introduction of the new funding arrangements from 1 April 2009. Although the formula used to determine the allocations between the two groups of municipalities is the same, different conditions will be placed on these two groups of municipalities. The *MIG (cities)* will focus the municipalities and national stakeholders on outputs and outcomes to be achieved from the overall capital investment programme of the cities. This grant will be phased in starting with the metros in 2009/10 and bringing in 21 large cities over the next two years.

The formula for allocating the grant has not changed. A constant component is phased in over three years to ensure that a reasonable minimum allocation is made to poor municipalities. This constant was introduced in the 2008 Budget and the last two years of its phase-in period are 2009/10 and 2010/11, from which point all municipalities receive a minimum allocation of R5 million. The formula includes both a vertical and horizontal division. The vertical division allocates resources to sectors or other priority areas; the horizontal division is determined based on a formula that takes account of poverty, backlogs, and municipal powers and functions. There are five main components of the formula, as demonstrated in the box below.

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

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

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

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

P Public municipal service infrastructure (new and rehabilitation of existing ones)

E Allocation for social institutions' and micro-enterprises' infrastructure

N Allocation to all nodal municipalities

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

The total MIG allocations grow to R11.1 billion, R12.5 billion and R15.1 billion over the MTEF. This represents real growth of 11.9 per cent during the period. The initial allocations for the *MIG (cities)* are R2.2 billion, R2.6 billion and R3.1 billion. The remaining allocations (R8.9 billion, R9.9 billion and R12 billion) will flow to the rest of the municipalities maintaining the current requirements of the grant.

The full incorporation of the electricity programme (which includes both municipal and Eskom programmes) into the MIG is, however, deferred until the completion of the restructuring of the electricity distribution industry.

The public transport infrastructure and systems grant

The *public transport infrastructure and systems grant* is administered by the Department of Transport. The grant is focused towards cities hosting the 2010 FIFA World Cup, and to other cities to provide for the improvement of new and existing public transport and non-motorised transport infrastructure. This includes the provision of bus rapid transit systems in cities. The grant is allocated R2.4 billion, R4.3 billion and R5.1 billion over the next three years.

The rural transport services and infrastructure grant

The *rural transport services and infrastructure grant* is administered by the Department of Transport. The grant is aimed at improving rural infrastructure by upgrading rural access roads, construction of pedestrian bridges and walkways, rural freight logistics facilities and intermodal public transport facilities. This grant was created in 2008/09 and is allocated R9.8 million, R10.4 million and R11.1 million over the next three years.

The neighbourhood development partnership grant

The *neighbourhood development partnership* grant seeks to develop community infrastructure and create a platform for private-sector investment that improves the quality of life in townships. The grant is administered by National Treasury and is allocated R662 million, R755 million and R940 million for the 2009 MTEF for technical assistance and capital projects.

The integrated national electrification programme grant

To sustain the current progress, particularly for poor households, government plans to spend R8.1 billion over the next three years on its national electrification programme. Of this, R3 billion will be spent by municipalities directly and R5.1 billion by Eskom on behalf of municipalities. This programme was instrumental in the connection of 80 per cent of all households in the country to the national electricity grid as reported in the 2007 Community Survey.

Electricity demand-side management grant

The grant is aimed at addressing energy-efficiency demand-side management in residential dwellings, government and commercial buildings to reduce the burden on the national grid, reducing the risk of planned and unplanned power cuts. The grant has been allocated R980 million over the MTEF period.

Regional bulk infrastructure grant

This grant supplements the financing of the social component of regional bulk water and sanitation cutting across several municipal boundaries. In the case of sanitation, it supplements regional bulk connection as well as regional wastewater treatment works. The grant has an allocation of R612 million, R839 million and R1.5 billion over the next three years.

Backlogs in water and sanitation at clinics and schools grant

This grant has been created to eliminate the backlog in access to water and sanitation services at schools and clinics. The sanitation backlogs were eradicated in December 2008 and the grant will focus on the eradication of backlogs in schools to meet the December 2010 target. An amount of R350 million is available for ensuring access for all identified schools in 2009/10.

Backlogs in the electrification of clinics and schools grant

The grant provides funding to the amount of R150 million for connecting schools and clinics across the country with the national electricity grid by the end of the 2009/10 fiscal year. In 2007/08 an additional 51 clinics were connected with a total expenditure of R24 million. The grant will continue till the end of 2009/10.

2010 FIFA World Cup stadiums development grant

The purpose of the grant is to provide funding for the design and construction of new stadiums and the upgrading of existing ones in 2010 FIFA World Cup host cities. The construction and upgrading of stadiums are underway to meet the final target date of December 2009. The grant has been allocated R1.9 billion for 2009/10 and 2010/11.

Capacity-building and other current transfers

The *capacity-building grants* were set up to assist municipalities in building management, planning, technical, budgeting and financial management skills. The 2009 Budget expands the capacity support programme to assist weaker or poorer municipalities to progressively implement financial management reforms. Total allocations for capacity-building grants amount to R500 million in 2009/10, R577 million in 2010/11 and R609 million in 2011/12.

The *financial management grant* funds the modernisation of financial management, including building in-house municipal capacity to implement multi-year budgeting, linking integrated development plans to budgets, producing quality and timely in-year and annual reports, and generally supporting municipalities in the implementation of the MFMA. Total allocations amount to R1.1 billion over the three-year cycle.

Other current transfers include the *2010 FIFA World Cup host city operating grant*. This is a new grant aimed at assisting cities with the hosting of the 2009 Confederations Cup and the 2010 FIFA World Cup. The grant has been allocated R508 million in 2009/10 and R210 million in 2010/11.

The *expanded public works programme incentive for municipalities grant* is a new grant aimed at providing municipalities with incentives to increase the number of employment opportunities on infrastructure projects under the expanded public works programme to maximise job creation and skills development. The grant is allocated R202 million, R554 million and R1.1 billion over the MTEF period.

Table W1.24 Capacity building and other current transfers to local government, 2005/06 – 2011/12

R million	2005/06	2006/07 Outcome	2007/08	2008/09 Revised estimate	2009/10	2010/11 Medium-term estimates	2011/12
Capacity building transfers	**654**	**663**	**928**	**430**	**500**	**577**	**609**
Direct transfers	**588**	**610**	**875**	**380**	**500**	**577**	**609**
Restructuring grant	255	265	530	–	–	–	–
Financial management grant	133	145	145	180	300	365	385
Municipal systems improvement grant	200	200	200	200	200	212	225
Indirect transfers[1]	**66**	**53**	**53**	**50**	**–**	**–**	**–**
Financial management grant	66	53	53	50	–	–	–
Other current transfers	**904**	**440**	**490**	**286**	**845**	**764**	**1 108**
Direct transfers	**–**	**–**	**–**	**17**	**709**	**764**	**1 108**
Internally displaced people management grant	–	–	–	17	–	–	–
2010 FIFA World Cup host city operating grant	–	–	–	–	508	210	–
Expanded public works programme incentive grant for municipalities	–	–	–	–	202	554	1 108
Indirect transfers[1]	**904**	**440**	**490**	**269**	**135**	**–**	**–**
Water and sanitation operating grant	904	440	490	269	135	–	–
Total	**1 558**	**1 103**	**1 418**	**716**	**1 344**	**1 341**	**1 717**

1. In-kind transfers to municipalities.

Part 5: Future work on provincial and municipal fiscal frameworks

Refinement of the local government fiscal framework

The local government fiscal framework has evolved over time, with a number of notable changes to enhance the ability of municipalities to perform their developmental and service delivery responsibilities. Additional refinement of the framework includes further reforms to the local government equitable share formula and infrastructure grants, and the gradual implementation and maturing of significant pieces of legislation affecting municipal financial capacity. These issues are discussed in more detail below.

Policy process to review provincial and local government

The Department of Provincial and Local Government is developing a provincial government policy framework and reviewing the local government policy framework.

The review began in July 2007. The findings, now being compiled by the department, draw on three main sources: written submissions from the public, independent research, and the experiences of practitioners and experts interviewed for the process. These sources have provided the basis for an objective assessment of how these two spheres of government have performed their core mandates.

The review has set out to answer three basic questions:

- How well have these two spheres performed their core constitutional mandates?
- Are those mandates still the right ones in the current context?

- What should be done to improve the effectiveness of these levels of government?

Introducing the sharing of the general fuel levy with metros as primary replacement for RSC levies

From the 2009 Budget, the general fuel levy will be shared between national government and metropolitan municipalities. The sharing of the general fuel levy is an appropriate primary replacement for the former RSC levies, with several advantages. The general fuel levy is of sufficient size to serve as a primary replacement as the total revenue generated from the general fuel levy was R26 billion in 2008/09, with the 2010/11 amount estimated at R29 billion. The growth in the general fuel levy is on average 6 per cent annually. Similar to the former RSC levies, the base (fuel sales) is linked to economic activity, linking the subsequent fuel levy allocation on the extent of economic growth taking place within the municipal jurisdiction. The equity and flexibility over the base is therefore maintained. Although the sharing of the general fuel levy with metros will be treated as unconditional to enhance fiscal autonomy, municipalities should attempt to direct these resources, similar to that of the former RSC levies, towards basic services and infrastructure development in under-serviced communities, specifically to transport infrastructure given the link between fuel sales and road usage.

The sharing of the general fuel levy also remedies several of the discrepancies that existed in the former RSC levy system. Taking this into consideration, the allocation of the fuel levy corrects situations where municipalities benefited unfairly from the RSC levy as fuel sales offer an equitable and more accurate depiction of economic activity (fuel sales and share of RSC levy grant are similar for four of the six metros). To facilitate a smooth transition from the *RSC levy replacement grant* system to the sharing of the general fuel levy system based on fuel sales and prevent any possible shocks to municipal revenues, implementation will be phased-in over the three year period beginning with the MTEF, for full implementation in 2012/13. This approach will also limit the impact to national government in forfeiting funds to make the sharing of the general fuel levy possible.

Refer to Annexure C of the 2009 *Budget Review* for additional information on implementation and allocation of the sharing of the general fuel levy to individual metropolitan municipalities.

National government will continue to compensate Category C (district) municipalities through the *RSC levy replacement grant*. For the 2009 MTEF, R10.5 billion (R3.3 billion in 2009/10, R3.5 billion in 2010/11 and R3.7 billion in 2011/12) will remain as part of the *RSC levy replacement grant* for Category C municipalities. Reforms will however be made to the replacement grant in future to make it more reflective of the extent of service delivery responsibilities of the municipality rather than historical RSC levy collection rates. Further revisions to the local government fiscal framework, including determining appropriate funding for district municipalities, will be informed by the outcomes of the Department of Provincial and Local Government's White Paper policy review process.

Implementation of the Municipal Fiscal Powers and Functions Act

The Municipal Fiscal Powers and Functions Act (2007) is one of the final building blocks in the process of creating a regulatory framework that will facilitate proper coordination of fiscal policy objectives across all spheres of government. The two primary purposes of the act are to provide for the authorisation of taxes, levies and duties that municipalities may impose under section 229(1)(b) of the Constitution, and to regulate the exercise by municipalities of their powers to impose surcharges on fees for municipal services in accordance with section 229(1)(a) of the Constitution. The act regulates all municipal taxes except for property rates, which are regulated by the Municipal Property Rates Act.

In terms of section 12(1) of the Municipal Fiscal Powers and Functions Act, by 7 September 2009 a municipality must apply to the Minister of Finance for the authorisation of an existing tax, other than a regional establishment levy or regional services levy imposed under the Regional Services Council Act (1985) or the KwaZulu and Natal Joint Services Act (1990) imposed by that municipality prior to the commencement of the Municipal Fiscal Powers and Functions Act. If a municipality fails to comply with the regulation, such a tax will lapse. National Treasury has put in place processes to assist municipalities in formalising applications to authorise existing taxes prior to the 7 September 2009 deadline.

Work is also under way to put in place norms and standards on municipal surcharges as provided in section 8 of this legislation. These will be developed simultaneously with developments under way to improve the regulation of tariffs for key municipal services, such as electricity reticulation, water and sanitation. The National Treasury will over the next few years work in close consultation with the several sector departments, such as the Department of Water Affairs, Minerals and Energy and Environmental Affairs, as well as regulatory bodies such as the National Energy Regulator of South Africa and SALGA to develop frameworks that will harmonise the tariff and surcharge structures.

Implementation of the Municipal Property Rates Act

The Municipal Property Rates Act (2004) regulates the power of municipalities to impose rates on properties in accordance with section 229(1)(a) of the Constitution. The act makes provision for certain properties that were previously excluded from rating to be liable to pay property rates, such as agricultural properties, public service infrastructure and properties falling in certain rural areas. Any rate levied on newly rateable property must be phased-in over a period of three financial years.

Municipalities were given four years to implement this act – a period that expires on 1 July 2009. To fully implement the legislation, municipalities must have their rates policy adopted by council, introduce a new valuation role based on market value and undergo the necessary consultation process. To date, 85 municipalities have implemented new valuation rolls in terms of the act. The majority of the municipalities (about 67 per cent) are targeting 1 July 2009 as implementation date. The national and provincial departments responsible for local government are providing support to municipalities to meet the 1 July 2009 deadline.

Various amendments have been made to the Municipal Property Rates Act through the Local Government Laws Amendment Act (2008) to facilitate smooth implementation. The Municipal Property Rates Act makes provision for national government to issue regulations, including prescribing ratios between residential and non-residential properties and upper limits to the annual increase of property rates (sections 19 and 20 of the act respectively).

Reforms of the water and electricity distribution industries

The restructuring and reform of the water and electricity distribution industries is necessary to improve the functioning and performance of both sectors, particularly in smaller municipalities with limited scope for achieving efficiencies of scale and scope. A movement towards regionalisation of both sectors seems to be a possible way forward in achieving the necessary economies of scale and the accumulation of appropriate skills and specialisation, the lack of which has hampered the ability of smaller municipalities to deliver these services. Any sector restructuring should be in line with existing legal and fiscal frameworks. Moreover, the financial condition of municipalities currently performing these functions must not be adversely affected.

The restructuring of the water industry is still in its initial phases while the restructuring of the electricity distribution industry is more advanced.

In October 2006, government agreed that six REDs should be established as public entities. The Electricity Regulation Amendment Act (2007) clarified the roles of local government in the electricity reticulation service, equating electricity reticulation and distribution. Government and other interested parties are working together to resolve outstanding policy issues, including the methodology of determining shareholding in a RED and the valuation and compensation methodology for Eskom and municipal assets to be transferred into a RED.

Re-determination of provincial and municipal boundaries

The Municipal Demarcation Board processed a number of requests for changes to municipal boundaries during the 2008 calendar year in preparation for the 2009 national and provincial elections and the 2011 local elections. The requests consisted mainly of boundary changes, changes in the status of three local municipalities to become metropolitan municipalities and the disestablishment of district management areas that will be incorporated into adjacent local municipalities. The Board finalised its work on 30 August 2008 and submitted the changes to the Independent Electoral Commission to assess whether voter representation would be affected as part of the process to determine the effective date of the re-determinations. Most of the proposed changes have been determined to only become effective after the 2011 local elections and will be considered for the 2011 or 2012 Budget.

In addition, legislative processes are under way to bring Merafong Local Municipality back from North West into Gauteng. Future fiscal frameworks for provinces and local government will have to be adjusted to accommodate these and other similar requests that might occur involving re-determination of the borders of former cross-boundary municipalities.

It is anticipated that future allocations of provinces and municipalities will continue to be affected by the work of the Municipal Demarcation Board.

Updates to formulas

Although the 2007 Community Survey is available, one of the current challenges in the local government equitable share formula is that it is biased towards municipalities with large population numbers. As poorly resourced municipalities have smaller populations, but higher levels of poverty, this aspect should also be taken into consideration. The equitable share formula should therefore achieve an appropriate balance between (i) urban challenges resulting from large-scale urbanisation and strong economic activity levels and (ii) rural challenges resulting from past inequities, high poverty (in percentage terms) and low economic activity levels. It is proposed that a detailed review of the local government equitable share be undertaken in conjunction with updating the 2001 Census information with 2007 Community Survey results for possible implementation from the 2010 or 2011 Budget.

It is very important that these outstanding matters, which have fiscal implications for local government, be concluded to ensure further stability in municipal finances.