W1

Explanatory memorandum to the division of revenue

Background

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

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

This explanatory memorandum to the 2020 Division of Revenue Bill fulfils the requirement set out in section 10(5) of the Intergovernmental Fiscal Relations Act that the bill be accompanied by an explanatory memorandum detailing how it takes account of the matters listed in sections 214(2)(a) to (j) of the Constitution, government's response to the FFC's recommendations, and any assumptions and formulas used in arriving at the respective divisions among provinces and municipalities. This memorandum complements the discussion of the division of revenue in Chapter 6 of the *Budget Review*. It has six sections:

- Part 1 lists the factors that inform the division of resources between national, provincial and local government.
- Part 2 describes the 2020 division of revenue.
- Part 3 sets out how the FFC's recommendations on the 2020 division of revenue have been taken into account.
- Part 4 explains the formula and criteria for dividing the provincial equitable share and conditional grants among provinces.
- Part 5 sets out the formula and criteria for dividing the local government equitable share and conditional grants among municipalities.
- Part 6 summarises issues that will form part of subsequent reviews of provincial and local government fiscal frameworks.

The Division of Revenue Bill and its underlying allocations are the result of extensive consultation between national, provincial and local government. The Budget Council deliberated on the matters discussed in this memorandum at several meetings during the year. The approach to local government allocations was discussed with organised local government at technical meetings with the South African Local Government

Association (SALGA), culminating in meetings of the Budget Forum (made up of the Budget Council and SALGA). The division of revenue, and the government priorities that underpin it, was agreed for the next three years at a Cabinet meeting in October 2019.

Part 1: Constitutional considerations

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

National interest and the division of resources

The national interest is captured in governance goals that benefit the nation. The National Development Plan sets out a long-term vision for the country's development, including for economic development, environmental sustainability and building a capable and developmental state. It also sets goals for specific provincial and local government functions, including basic education, health, agriculture, human settlements, electricity, water and sanitation. In the June 2019 State of the Nation Address, the President set out the following seven priorities for this administration:

1. Economic transformation and job creation
2. Education, skills and health
3. Consolidating the social wage through reliable and quality basic services
4. Spatial integration, human settlements and local government
5. Social cohesion and safe communities
6. Building a capable, ethical and developmental state
7. A better Africa and world.

These priorities have informed deliberations in the budget process on how resources will be allocated between the different spheres of government. They will also form the basis of the next five-year implementation plan for the National Development Plan, which is expected to be published by the Department of Planning, Monitoring and Evaluation in 2020.

In the 2019 *Medium Term Budget Policy Statement* (MTBPS), the Minister of Finance outlined how the resources available to government over the 2020 medium-term expenditure framework (MTEF) period would be allocated to help achieve government's goals in a difficult economic environment. Chapter 4 of the 2019 MTBPS and Chapters 5 and 6 of the 2020 *Budget Review* discuss how funds have been allocated across the three spheres of government based on these priorities. The framework for each conditional grant also notes how the grant is linked to the seven priorities.

Provision for debt costs

The resources shared between national, provincial and local government include proceeds from national government borrowing used to fund public spending. National government provides for the resulting debt costs to protect the country's integrity and credit reputation. Chapter 7 of the 2020 *Budget Review* provides a more detailed discussion.

National government's needs and interests

The Constitution assigns exclusive and concurrent powers and functions to each sphere of government. National government is solely responsible for functions that serve the national interest and are best centralised. National and provincial government have concurrent responsibility for a range of functions. Provincial and local government receive equitable shares and conditional grants to enable them to provide basic services and perform their functions. Functions may shift between spheres of government to better meet the country's needs, which is then reflected in the division of revenue. Changes continue to be made to various national transfers to provincial and local government to improve their efficiency, effectiveness and alignment with national strategic objectives.

Provincial and local government basic services

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

Over half of non-interest spending is allocated to provinces and local government. These allocations also grow at a faster rate than those to national departments over the 2020 MTEF period, reflecting the priority placed on health, education and basic services, as well as the rising costs of these services as a result of population growth and higher bulk electricity and water costs.

Fiscal capacity and efficiency

National government has primary revenue-raising powers, with it collecting most of the largest taxes such as income taxes, value-added tax, fuel levies and customs and excise duties. The difference between the assignment of revenue-raising powers and spending responsibilities between the spheres of government is compensated for through the transfer of nationally raised revenue to provinces and local government.

Provinces have limited tax-raising powers. Licences for vehicles and gambling are their largest sources of own tax revenue. Provincial functions such as basic education, public healthcare and social welfare do not lend themselves to self-funding or cost recovery. Due to their limited revenue-raising ability, and their responsibility to implement costly services at no or low fees to most recipients, provinces receive a larger share of nationally raised revenue than local government.

Municipalities are assigned significant own revenue-raising powers, including the collection of property rates, which is a tax equivalent to more than 1 per cent of gross domestic product (GDP) and is worth slightly more than nationally collected revenue from customs duties. Municipalities also provide services such as electricity and water, the costs of which can be recovered through tariffs. As a result, local government finances most of its expenditure through property rates, user charges and fees. However, the ability of individual municipalities to raise revenue varies greatly – rural municipalities raise significantly less revenue than large urban and metropolitan municipalities. The design of the local government fiscal framework acknowledges that, as a result of their lower own revenue capacity, many rural municipalities will depend on transfers for most of their funding. The local government equitable share formula incorporates a revenue adjustment factor that considers the fiscal capacity of each recipient municipality (full details of the formula are provided in Part 5 of this annexure). The equitable share also provides funding to enable all municipalities to provide free basic water, electricity, sanitation and waste management services to poor households. To support the expansion of these services, local government's share of nationally raised revenue has increased from 3 per cent in 2000/01 to 8.8 per cent over the 2020 MTEF period.

The mechanisms for allocating funds to provinces and municipalities are regularly reviewed to improve their efficiency. To maximise the impact of allocations, many provincial and local government conditional grants consider the recipient's efficiency in using previous allocations. The reductions in planned transfers over the 2020 MTEF period also took account of past performance of conditional grants, both in terms of their spending levels and their efficiency in meeting their objectives with the funds that were spent.

Developmental needs

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

Economic disparities

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

Obligations in terms of national legislation

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

The 2020 MTEF, through the division of revenue, continues to fund the delivery of provincial, municipal and concurrent functions through a combination of conditional and unconditional grants.

Predictability and stability

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

Flexibility in responding to emergencies

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

Part 2: The 2020 division of revenue

The central fiscal objectives over the MTEF period are to stabilise the growth of debt as a share of GDP and to strictly adhere to the planned expenditure ceiling (see Chapter 3 of the 2020 *Budget Review*). However, the most important public spending programmes that help poor South Africans, contribute to growth and create jobs have been protected from major reductions. The 2020 division of revenue reprioritises existing funds to ensure these objectives are met.

Excluding debt-service costs and the contingency reserve, allocated expenditure shared across government amounts to R1.53 trillion in 2020/21, R1.59 trillion in 2021/22 and R1.65 trillion in 2022/23. The division of these funds between the three spheres takes into account government's spending priorities, each sphere's revenue-raising capacity and responsibilities, and input from various intergovernmental forums and the FFC.

The provincial and local equitable share formulas are designed to ensure fair, stable and predictable revenue shares, and to address economic and fiscal disparities.

Reductions to transfers

The fiscal objectives that determined the spending envelope are set out in Chapter 3 of the 2020 *Budget Review*. Reductions to previously announced spending levels were made across all three spheres of government to fit within the revised expenditure ceiling. The 2019 MTBPS announced that provincial transfers have been reduced by R20.3 billion over the MTEF period and transfers to local government have been reduced by R20.5 billion.

Following the 2019 MTBPS, further changes were made. In total, the provincial equitable share has been reduced by R7.3 billion through a 2 per cent reduction in all non-compensation spending per year and a R5.2 billion reduction in compensation of employees. Direct conditional grants to provinces have been reduced by a net R13.3 billion, as the reduction of R16.2 billion is partly offset by reprioritisations of R2.9 billion. The local government reductions comprise R3.2 billion from the local government equitable share and R16.8 billion in reductions to direct conditional grants.

All direct conditional grants have been lowered, except for the *early childhood development grant* and the *learners with profound intellectual disabilities grant*. To manage the impact on services, the amount reduced from each grant considers:

- Past spending and performance.
- Whether it funds salaries, medicines and food.
- Whether there has been significant real growth in allocations in recent years.

Larger reductions are also made to grants to urban municipalities, which have more capacity to offset the effect of cuts by increasing their own revenue investments. Parts 4 and 5 of this annexure set out in more detail how the changes to the baseline affect provincial and local government transfers.

The proposed changes to the wage bill discussed in Chapter 3 of the *Budget Review* are not yet reflected in the allocations to national and provincial departments shown in the Division of Revenue Bill. Once these changes are agreed in the Public Service Co-ordinating Bargaining Council, they will be implemented in the 2020/21 adjustment budget and 2020 MTBPS. This will reduce the national and provincial shares, and increase the local government share, of the division of revenue in relative terms.

Reprioritisations

To meet policy objectives while remaining within the revised expenditure ceiling, existing budgets need to be reprioritised to meet government's policy goals. Priorities over the 2020 MTEF period that are funded through reprioritisations in the division of revenue include:

- Increasing the per-child subsidy for early childhood development services from R15 per day to R17 per day in 2020/21, rising to R18.57 per day by 2022/23.
- Addressing shortfalls in the funding of community outreach services in the health sector.
- Supporting the continued rollout of free sanitary products to learners from low-income households.
- Repairing wastewater treatment infrastructure in the Vaal River System.

These reprioritisations complement baselines that provide R2.07 trillion to provinces and R426.4 billion to local government in transfers over the 2020 MTEF period. These transfers fund many core policy priorities, including basic education, health, social development, roads, housing and municipal services.

The fiscal framework

Table W1.1 presents the medium-term macroeconomic forecasts for the 2020 Budget. It sets out the growth assumptions and fiscal policy targets on which the fiscal framework is based.

Table W1.1 Medium-term macroeconomic assumptions

R billion/percentage of GDP	2019/20 2019 Budget	2019/20 2020 Budget	2020/21 2019 Budget	2020/21 2020 Budget	2021/22 2019 Budget	2021/22 2020 Budget	2022/23 2020 Budget
Gross domestic product	5 413.8	5 157.3	5 812.4	5 428.2	6 249.1	5 759.0	6 126.3
Real GDP growth	*1.5%*	*0.6%*	*1.9%*	*0.9%*	*2.1%*	*1.4%*	*1.7%*
GDP inflation	*5.4%*	*4.2%*	*5.4%*	*4.3%*	*5.3%*	*4.6%*	*4.6%*
National budget framework							
Revenue	**1 403.5**	**1 344.8**	**1 505.1**	**1 398.0**	**1 632.9**	**1 484.3**	**1 580.9**
Percentage of GDP	*25.9%*	*26.1%*	*25.9%*	*25.8%*	*26.1%*	*25.8%*	*25.8%*
Expenditure	**1 658.7**	**1 682.3**	**1 769.6**	**1 766.0**	**1 900.5**	**1 850.7**	**1 940.2**
Percentage of GDP	*30.6%*	*32.6%*	*30.4%*	*32.5%*	*30.4%*	*32.1%*	*31.7%*
Main budget balance[1]	**-255.2**	**-337.5**	**-264.4**	**-368.0**	**-267.6**	**-366.4**	**-359.3**
Percentage of GDP	*-4.7%*	*-6.5%*	*-4.5%*	*-6.8%*	*-4.3%*	*-6.4%*	*-5.9%*

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

Table W1.2 sets out the division of revenue for the 2020 MTEF period after accounting for new policy priorities.

Table W1.2 Division of nationally raised revenue

R million	2016/17 Outcome	2017/18 Outcome	2018/19 Outcome	2019/20 Revised estimate	2020/21 Medium-term estimates	2021/22 Medium-term estimates	2022/23 Medium-term estimates
Division of available funds							
National departments	**555 643**	**592 640**	**634 322**	**739 463**	**757 725**	**768 870**	**797 832**
of which:							
Indirect transfers to provinces	*3 636*	*3 813*	*3 909*	*3 941*	*4 060*	*4 824*	*5 076*
Indirect transfers to local government	*8 112*	*7 803*	*7 770*	*7 024*	*7 628*	*7 229*	*8 161*
Provinces	**500 384**	**538 553**	**571 954**	**612 817**	**649 256**	**691 951**	**730 690**
Equitable share	410 699	441 331	470 287	505 554	538 472	573 990	607 554
Conditional grants	89 685	97 222	101 667	107 263	110 785	117 962	123 137
Local government	**102 867**	**111 103**	**118 488**	**125 020**	**132 529**	**142 442**	**151 445**
Equitable share	50 709	55 614	60 758	66 973	74 683	81 062	87 213
Conditional grants	40 934	43 704	45 262	44 879	43 819	46 198	48 147
General fuel levy sharing with metros	11 224	11 785	12 469	13 167	14 027	15 182	16 085
Provisional allocation not assigned to votes[1]	–	–	–	–	-7 786	-16 077	-34 887
Non-interest allocations	**1 158 893**	**1 242 295**	**1 324 763**	**1 477 299**	**1 531 724**	**1 587 186**	**1 645 080**
Percentage increase	*3.9%*	*7.2%*	*6.6%*	*11.5%*	*3.7%*	*3.6%*	*3.6%*
Debt-service costs	146 497	162 645	181 849	205 005	229 270	258 482	290 145
Contingency reserves	–	–	–	–	5 000	5 000	5 000
Main budget expenditure	**1 305 390**	**1 404 940**	**1 506 613**	**1 682 304**	**1 765 994**	**1 850 668**	**1 940 225**
Percentage increase	*4.9%*	*7.6%*	*7.2%*	*11.7%*	*5.0%*	*4.8%*	*4.8%*
Percentage shares							
National departments	*47.9%*	*47.7%*	*47.9%*	*50.1%*	*49.2%*	*48.0%*	*47.5%*
Provinces	*43.2%*	*43.4%*	*43.2%*	*41.5%*	*42.2%*	*43.2%*	*43.5%*
Local government	*8.9%*	*8.9%*	*8.9%*	*8.5%*	*8.6%*	*8.9%*	*9.0%*

1. Includes proposed compensation reductions, support to Eskom, amounts for Budget Facility for Infrastructure projects and other provisional allocations
Source: National Treasury

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

Table W1.3 Changes over baseline

R million	2020/21	2021/22
National departments	24 597	-8 804
Provinces	-7 858	-9 049
Local government	-5 352	-7 056
Allocated expenditure	**11 387**	**-24 910**

Source: National Treasury

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

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

R million	2020/21 Allocation	2021/22 Forward estimates	2022/23
National[1]	1 152 840	1 195 617	1 245 459
Provincial	538 472	573 990	607 554
Local	74 683	81 062	87 213
Total	**1 765 994**	**1 850 668**	**1 940 225**

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

Source: National Treasury

The 2020 *Budget Review* sets out in detail how constitutional considerations and government's priorities are taken into account in the division of revenue. It describes economic and fiscal policy considerations, revenue issues, debt and financing considerations, and expenditure plans. Chapter 6 focuses on provincial and local government financing.

Part 3: Response to the FFC's recommendations

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

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

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

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

The act requires that the FFC table these recommendations at least 10 months before the start of each financial year. The FFC tabled its *Submission for the Division of Revenue 2020/21* to Parliament in May 2019. This year's theme is "reprioritising local government finances". The 2020/21 recommendations cover the following areas: local government financing framework, municipal government capacity building, local government sustainability, infrastructure management and efficiency, investment and developmental challenges in the local government sector.

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

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

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

Government's responses to the first and second categories are provided below. Recommendations that do not relate to the division of revenue have been referred to the officials to whom they were addressed – the Minister of Cooperative Governance and Traditional Affairs and the President of SALGA – and they will respond directly to the FFC. All the FFC recommendations can be accessed at www.ffc.co.za.

Recommendations that apply directly and indirectly to the division of revenue

Chapter 2: Reviewing the Local Government Fiscal Framework

Supplementary revenue sources for local government

The FFC recommends the following: "The Minister of Finance should take steps (including piloting) to add the following supplementary revenue sources to the list of allowable taxes for different types of municipalities in a differentiated manner that could include the development charges, tourism levies, land value capture mechanisms, tourism levies and fire levies. Fire service levies in particular should be considered for the municipalities that are to be authorised for this function. The greater potential for expansion of own revenue sources in urban areas should be compensated for by changes to the division of revenue to increase transfers to rural areas."

Government response

Government supports this recommendation. Additional revenue sources to municipalities should be fully explored. Government has prioritised various reforms to supplement the revenue sources of municipalities. These include:

- Amending the Municipal Fiscal Powers and Functions Act (2007) to ensure development charges are uniformly regulated. Government acknowledges that, despite their potential scope to generate substantial revenue and support the provision of infrastructure to unlock growth, development charges have not been fully explored due to lack of clarity on how they should be levied. The legislative amendments contained in the draft Municipal Fiscal Powers and Functions Amendment Bill, published for comment in January 2020, address this challenge.
- Updating the municipal borrowing policy framework to clarify the funding instruments that municipalities are allowed to use to leverage their borrowing. These include, among others, land value capture mechanisms, tax increment financing, project finance and the use of public-private partnerships.

Furthermore, the Municipal Fiscal Powers and Functions Act already allows municipalities to apply to the Minister of Finance to levy additional taxes such as the tourism levies and fire levies recommended by the FFC. The act also allows the Minister of Finance to introduce new municipal taxes on his own initiative. Applications from municipalities to implement new revenue sources provide a good mechanism for piloting new revenue sources like these as it ensures that the pilot municipalities are ready and willing to implement the new taxes. To be considered by the Minister of Finance, an application to introduce additional taxes must include the following:

- What the revenue from the proposed new municipal tax will be used for.

- Its compliance with section 229(2)(a) of the Constitution, which requires that municipal taxes not prejudice national economic policy.
- The tax base, the desired tax rate, people liable for the tax and tax relief measures.
- The tax collecting authority.
- Particulars of any consultations conducted, including consultations with, where applicable, a provincial government, organised local government and municipalities, and the outcomes of the consultations.

Government also agrees that future increases in own revenue collection in urban areas will create scope for government to reduce transfers to these municipalities and use those funds to increase transfers to rural municipalities that have less potential to increase their own revenues. This stance is reflected in the way reductions to transfers have been implemented in the 2020 MTEF, with larger reductions made to urban grants.

Land value capture

The FFC recommends that, "The Minister of Finance should proactively inform municipalities on various land value capture mechanisms that municipalities can take advantage of in order to supplement their current own revenue sources."

Government response

Government views land value capture mechanisms as strategic funding tools for local government. These mechanisms should be used to augment municipal revenues to fund investment in infrastructure needed to support development. The National Treasury has called on municipalities to use all available options to increase their own revenues for several years in the *Budget Review* and the MTBPS.

Municipalities, including the City of Johannesburg and the City of Cape Town, are already implementing land value capture mechanisms such as tax incremental financing and development rights.

Government agrees that further information can enable more municipalities to take advantage of these mechanisms. It continues to research and analyse various land value capture mechanisms to better advise municipalities on their implementation.

Chapter 3: Municipal Government Capacity Building

Municipal functionality

The FFC recommends that, "The Minister of COGTA, the Minister of Finance and the President of SALGA jointly lead the development of a government-wide accepted definition of 'municipal functionality'. The definition should be based on the six factors put forward by the Commission: maintenance and performance of systems, processes and practices in governance, service delivery, financial management, leadership, political management, and human resources. Further, they should ensure that the accepted indices for measuring dysfunctionality should be explicit. Indicators of dysfunctionality should be chosen carefully and should exclude factors that are outside the current control of municipality. This definition can be used across government, including in targeting capacity support grants and further differentiating conditional grants."

Government response

Government supports the proposal of a collaborative process to better understand and define municipal functionality. The Minister of Finance has proposed that a special local government Budget Forum lekgotla be held in May or June 2020 to discuss issues affecting the structure of the local government fiscal framework. The proposed agenda for this lekgotla includes a discussion on municipal functionality, and officials from the Department of Cooperative Governance, SALGA, the National Treasury and the FFC will work together to prepare options on how municipal viability should be understood and measured.

Capacity building

The FFC recommends that, "Based on an assessment of the specific needs of a municipality, the Minister of Finance and Minister of COGTA jointly, and in consultation with provincial governments, should prioritise technical support for new systems, innovative business process redesign and change management."

Government response

Government agrees with the recommendation. When new systems, innovative business process redesign and change management are introduced, technical support to local government is necessary. The new municipal Standard Chart of Accounts (mSCOA) is an example of prioritising technical support in implementing new systems. mSCOA significantly changed municipal financial management as it introduced a standard chart of accounts for the first time. This required changes to the way municipalities recorded transactions, so that transactions would be comparable across all municipalities. To facilitate this change, government provided mSCOA training and training manuals, guidelines and an interactive multimedia learning webpage, which is on the National Treasury Municipal Financial Management Act website (mfma.treasury.gov.za).

Government also invests more than R3 billion each year in capacity building and support to local government. In 2019/20, a review of the capacity building and support system of local government was announced. This review will identify overlaps, gaps and duplications and propose systematic measures to rectify them. The main work of the review is expected to be concluded during 2020.

Minimum competency

The FFC recommends that, "The Minister of Finance should conduct regular assessments of the minimum competency regulations to determine their impact and whether there are tangible improvements as a result of complying."

Government response

Government agrees on the need to review the impact of its programmes and policies. Reviews should take place after an initiative has had sufficient time to have a measurable impact. The Municipal Regulations on Minimum Competency Levels were amended by the Minister of Finance, acting with the agreement of the Minister of Cooperative Governance and Traditional Affairs (COGTA), through a gazette published on 26 October 2018. As such, it is too soon to review the impact of the minimum competency regulations. Their impact will be reviewed in due course.

Chapter 4: Local Government Infrastructure Management and Efficiency

Local government infrastructure management and efficiency

The FFC recommends that, "The Minister of COGTA and the Minister of Finance jointly should, as part of the ongoing local government infrastructure grant reforms, strengthen the linkage between technical project planning processes and budgeting and foster smooth intergovernmental infrastructure coordination, including the following:

(i) Time-bound plans for consolidating all municipal infrastructure grants into the respective existing sector-specific grants and thereby provide the key sector department with the authority to carry out their infrastructure support mandate;

(ii) Clarification of roles and responsibilities especially in the delivery of water and electricity services between local municipalities and district municipalities on the one hand, and public entities, including the water authorities and Eskom respectively. With respect to specific local geographic areas, these roles and responsibilities must receive further expression in a Memorandum of Understanding. This will enable more direct targeting of funding for services in the Division of Revenue Act."

Government response

Government acknowledges the need to consolidate municipal infrastructure grants and to strengthen the linkages between the technical project planning process and the budgeting. The review of local government infrastructure grants has identified consolidation and rationalisation in the number of grants received by each municipality as a key area for reforming the grant system. A number of reforms have been made to the infrastructure grant system in this regard. As early as 2015, two separate public transport grants to cities – one for capital and one for operational expenditures – were merged into a consolidated *public transport network grant*. This began the process of reducing duplication in the grant system. It also enhanced the link between capital investment and the sustainability of ongoing operational costs. This was followed by the rationalisation of four overlapping water and sanitation grants into two grants, each with direct and indirect components. The *regional bulk infrastructure grant* remains a stand-alone grant to fund large bulk-water and sanitation projects. The *municipal water infrastructure grant,* the *water services operating subsidy grant* and the *rural households infrastructure grant* were merged into one grant – the *water services infrastructure grant* – to fund construction and refurbishment of reticulation schemes and on-site services in rural municipalities. This responded to the concerns over duplication and fragmentation in water and sanitation grants. Most recently, the electrification funds for metropolitan municipalities from the *Integrated National Electrification Programme (municipal) grant* were shifted into the *urban settlements development grant*. This responds to several challenges noted by the Department of Mineral Resources and Energy with the grant, including problems in coordinating the timing of projects with the provision of other services and will help reduce the reporting burden for cities.

As the various grants in the system serve different purposes, the consolidation and rationalisation process requires extensive consultation before grants can be merged. Grant consolidation must not adversely affect projects already being implemented through one of the affected grants (for example, as a result of changed conditions in the merged grant). It is therefore not appropriate to set definitive timelines on when grants will be consolidated, but government is committed to achieving the vision of a differentiated grant system that recognises the varying contexts faced by different types of municipalities while reducing the number of separate grants each municipality receives.

Government also agrees that sector departments must carry out their infrastructure support and oversight mandates, whether this is for a sector-specific grant or as part of a consolidated grant that more holistically funds municipal infrastructure investment plans. The Division of Revenue Act (2019) includes new requirements that sector departments must be consulted on their responsibilities with respect to consolidated conditional grants before the draft frameworks are submitted to the National Treasury. This new requirement, which came into effect in preparing the 2020/21 conditional grant frameworks, should strengthen coordination between national departments.

Government agrees that greater clarity on roles and responsibilities in the delivery of water and electricity is needed. Sections 29(2) and (3) of the Division of Revenue Act make provision for district and local municipalities to agree on their respective roles and responsibilities in providing services. Section 29(2) requires that district municipalities providing a service must, before implementing any capital project for water, electricity, roads or other municipal service, consult the local municipalities within whose area of jurisdiction the project will be implemented. Section 29(3) requires that district municipalities ensure they do not duplicate any function provided by a local municipality and must transfer funds for the provision of services to the relevant local municipality providing the service. Section 29(5) requires that district and local municipalities must agree to a payment schedule for funds that must be transferred from the district municipality to the local municipality for functions they perform on behalf of the district municipality. However, the Division of Revenue Act can only allocate transfers to the municipality formally assigned the responsibility for a function. The conclusion of an agreement between the district and local municipalities allows for smoother transfers between them, but would not allow national government to transfer funds directly to a municipality that is not assigned the relevant function.

The Department of Mineral Resources and Energy is developing an electrification master plan, which will provide guidance on which areas should be electrified by Eskom and which by municipalities. However, the final decision on whether electricity distribution licences are granted to municipalities or Eskom is determined by the National Energy Regulator of South Africa.

Infrastructure inspectorate

The FFC recommends that, "The Minister of COGTA should establish an infrastructure inspectorate through the Municipal Infrastructure Support Agency (MISA) to assess management performance processes and capacity within municipalities to implement grant-funded and non-grant-funded infrastructure projects on a continuous basis."

The FFC also recommends that, "The MISA inspectorate should undertake infrastructure delivery management capability assessments, quality inspections of new and existing built infrastructure, project management and delivery audits and advise on alternative approaches, materials or technologies for infrastructure delivery through the development of infrastructure blueprints for various types of municipal facilities."

Finally, the FFC recommends that, "The Minister of COGTA should align inspectorate assessments to the Division of Revenue Bill conditions for allocation, reporting and the disbursement of grants. This must be in line with the recently established Budget Facility for Infrastructure Programme criteria for appraising and budgeting for infrastructure projects."

Government response

Government acknowledges the need for improved oversight of the implementation of municipal infrastructure projects. The infrastructure inspectorate proposed by the FFC would require significant institutional capacity to implement successfully. As a result, the decision of whether an inspectorate is the best mechanism through which to improve oversight, and whether this capacity should be located in MISA or another institution, needs to be considered carefully. The National Treasury has recommended to MISA that it ask the Department of Planning, Monitoring and Evaluation to conduct a formal review of MISA's operational efficiency. This independent assessment will identify which activities are improving municipal infrastructure delivery and which are not. This will help us to identify where there is scope to reprioritise resources within MISA to fund new activities such as the work of the proposed inspectorate.

Developments in late 2019 are likely to affect MISA's ability to implement significant new programmes in the short term. However, this recommendation will be considered further within government during 2020. In the meantime, government will continue to implement measures to review and strengthen municipal capacity building and to improve coordination and project management capacity, as described in the responses to other recommendations.

Shared project management capacity in district municipalities

The FFC recommends that, "The Minister of Finance, jointly with the Minister of COGTA, MECs for Finance and other provincial government departments, should within a district municipality area pull together the various project management resources present from GTAC, MISA, MIG administration and the respective municipal PMUs, to create a shared project management facility to improve the oversight capacity in respect of projects and to protect the financial interest of local government against contractor misconduct."

Government response

Government agrees on the importance of improving the coordination of infrastructure delivery. President Ramaphosa launched pilots of the district development model in O.R. Tambo District Municipality, eThekwini Metropolitan Municipality and Waterberg District Municipality. The model aims to develop and implement One Plan for each district or metropolitan area that coordinates the efforts of different stakeholders within the respective municipality. This includes better coordination of project management capacity, as recommended by the FFC.

To complement efforts to improve project implementation, government is also investing in improved capacity to prepare projects. Sound project preparation will make implementation much smoother. Additional support and funding for project preparation is being made available through a new facility at the Development Bank of Southern Africa, established in support of the Infrastructure Fund. Government has also introduced dedicated grant funding for project preparation in metropolitan municipalities (this may be extended to other municipalities in future). From 2020/21, metropolitan municipalities will be funded for infrastructure project and programme preparation costs through the *integrated city development grant*, on condition that they meet certain requirements with respect to their project and programme preparation and authorisation processes and that they contribute funds from their own resources.

Part 4: Provincial allocations

Provincial government receives two forms of allocations from nationally raised revenue, the equitable share and conditional grants. Sections 214 and 227 of the Constitution require that an equitable share of nationally raised revenue be allocated to provincial government to provide basic services and perform its allocated functions. The equitable share is an unconditional transfer to provinces and constitutes their main source of revenue. Due to their limited revenue-raising abilities, provinces receive 43 per cent of nationally raised revenue. In addition, they receive conditional grants to help them fulfil their mandates. Transfers to provinces account for over 90 per cent of provincial revenue.

This section outlines national transfers to provinces for the 2020 MTEF period, including the fiscal consolidation measures announced in the 2019 MTBPS, as well as other changes that were effected after it was tabled, both to the equitable share and conditional grants. Having taken the revisions to the provincial fiscal framework into account, national transfers to provinces increase from R612.2 billion in 2019/20 to R649.3 billion in 2020/21. Over the MTEF period, provincial transfers will grow at an average annual rate of 6 per cent to R730.7 billion in 2022/23. Table W1.5 sets out the transfers to provinces for 2020/21. A total of R538.5 billion is allocated to the provincial equitable share and R110.8 billion to conditional grants.

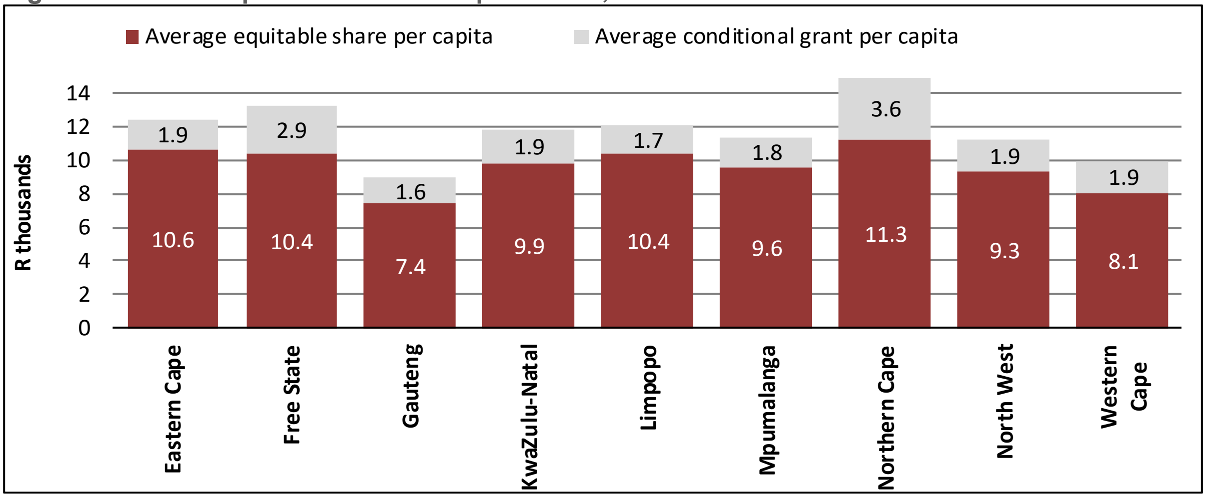
Table W1.5 Total transfers to provinces, 2020/21

R million	Equitable share	Conditional grants	Total transfers
Eastern Cape	71 415	12 488	83 903
Free State	30 017	8 239	38 256
Gauteng	112 118	23 935	136 053
KwaZulu-Natal	111 442	22 011	133 453
Limpopo	62 329	9 890	72 219
Mpumalanga	44 105	8 312	52 417
Northern Cape	14 290	4 542	18 832
North West	37 548	7 743	45 291
Western Cape	55 208	13 191	68 398
Unallocated	–	433	433
Total	**538 472**	**110 785**	**649 256**

Source: National Treasury

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

Figure W1.1 Per capita allocations to provinces, 2020/21



Source: National Treasury

Changes to provincial allocations

For the 2020 MTEF, revisions to the provincial fiscal framework reflect a combination of fiscal consolidation reductions and reprioritisations in order to respond to the fiscal pressures faced by government while ensuring that provinces are able to deliver on their mandates. Table W1.6 provides a summary of the changes to the provincial fiscal framework.

The proposed changes to the wage bill discussed in Chapter 3 of the *Budget Review* are not yet reflected in the allocations to provinces in this annexure. Once effected, they will result in reductions to the provincial equitable share in the 2020/21 adjustment budget. These reductions will be fully offset by lower compensation spending by provinces as a result of the revised wage agreement.

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

R million	2020/21	2021/22	2022/23	MTEF total revision
Technical adjustments	**-2 503**	**-2 669**	**–**	**-5 172**
Direct transfers	**-1 930**	**-1 997**	**666**	**-3 261**
Provincial equitable share: grant reprioritisations	121	145	123	390
Provincial equitable share: CPI inflation adjustment	-2 503	-2 669	–	-5 172
Ilima/Letsema projects	-36	–	–	-36
Health facility revitalisation grant	199	6	–	205
HIV, TB, malaria and community outreach	223	456	475	1 154
Human papillomavirus vaccine	-223	-235	-244	-702
National health insurance grant: health professionals	289	300	311	900
Human settlements development	3 015	–	–	3 015
Informal settlements upgrading partnership	-3 015	–	–	-3 015
Indirect transfers	**-573**	**-672**	**-666**	**-1 911**
Ilima/Letsema indirect	36	–	–	36
National health insurance indirect	-609	-672	-666	-1 947
Additions to baselines	**656**	**794**	**944**	**2 393**
Direct transfers	**656**	**794**	**944**	**2 393**
Provinicial equitable share	293	320	362	976
Early childhood development	362	473	582	1 418
Reductions to baselines	**-6 930**	**-8 025**	**-9 295**	**-24 251**
Direct transfers	**-6 584**	**-7 846**	**-9 087**	**-23 517**
Provinicial equitable share	-2 349	-2 452	-2 524	-7 325
Comprehensive agricultural support programme	-154	-194	-233	-581
Ilima/Letsema projects	-31	-39	-48	-118
Land care programme: poverty relief and infrastructure development	-4	-5	-7	-17
Community library services	-105	-95	-83	-283
Education infrastructure	-459	-616	-775	-1 850
HIV and AIDS (life skills education)	-24	-27	-34	-85
Maths, science and technology	-12	-13	-14	-39
National school nutrition programme	-30	-40	-53	-123
HIV, TB, malaria and community outreach	-244	-278	-291	-812
Health facility revitalisation	-191	-206	-216	-612
Statutory human resources, training and development	-11	-67	-70	-147
National tertiary services	–	-148	-156	-304
Human settlements development	-2 331	-1 984	-2 402	-6 717
Informal settlements upgrading partnership	–	-432	-453	-885
Expanded public works programme integrated grants for provinces	-42	-49	-51	-142
Social sector expanded public works programme incentive for provinces	-41	-48	-50	-139
Mass participation and sport development	-57	-69	-75	-201
Provinicial roads maintenance	-500	-1 084	-1 258	-2 841
Public transport operations	–	–	-295	-295
Indirect transfers	**-346**	**-179**	**-208**	**-734**
School infrastructure backlogs	-33	-44	-46	-123
National health insurance indirect	-314	-135	-162	-611
Total change to provincial government allocations				
Change to direct transfers	-7 858	-9 049	-7 477	-24 385
Change to indirect transfers	-920	-851	-874	-2 644
Net change to provincial government allocations	**-8 778**	**-9 900**	**-8 351**	**-27 029**

Source: National Treasury

Transfers to provincial governments are reduced by R27 billion over the 2020 MTEF period, of which direct transfers are reduced by R24.4 billion and indirect transfers are reduced by R2.6 billion.

The 2019 MTBPS announced a reduction of R7.3 billion in the provincial equitable share over the MTEF period, which is equivalent to 2 per cent of non-compensation expenditure funded by the equitable share. More recently, the effect of lower estimates of consumer price index inflation on projected compensation spending have allowed a further reduction of R2.5 billion in 2020/21 and R2.7 billion in 2021/22 from the provincial equitable share.

For the 2020 MTEF period, there are several increases to the provincial equitable share as a result of reprioritisations. To continue rolling out the Sanitary Dignity Programme, which was introduced in the 2019 MTEF period, R652 million has been added. A total of R398 million has been reprioritised from national government to provinces to continue to employ social workers in areas with high levels of gender-based violence, substance abuse and social problems affecting children, and an additional R315 million has been reprioritised to continue supporting non-profit organisations in implementing social behaviour change programmes to address social and structural drivers of HIV, TB and sexually transmitted infections. Further details of these allocations are contained in the provincial equitable share section, under the description of allocations made outside the formula. Where funds have been reprioritised from provincial conditional grants, these changes are reflected as technical adjustments in Table W1.6, while funds reprioritised from allocations to other spheres are shown as additions to the provincial fiscal framework.

Several technical adjustments to conditional grants are shown in Table W1.6. In the 2019/20 adjustment budget, an indirect *Ilima/Letsema grant* was created to fund the National Food and Nutrition Survey, conducted by the Human Sciences Research Council, which will benefit provinces and national government. This survey will establish a baseline for poverty and food security that can be used to improve the targeting of poverty-relief programmes. This indirect grant will continue in 2020/21 and R36 million has been shifted from the direct *Ilima/Letsema projects grant* to the newly created indirect component to complete the survey. The 2019/20 adjustment budget announced that the contracting of health professionals to implement national health insurance would shift from being funded through the *national health insurance indirect grant* to being funded through the direct *national health insurance grant*. This shift continues over the 2020 MTEF period, and R900 million is allocated to this grant over the three years. Funds for the completion of a project in Limpopo have been shifted from the *national health insurance indirect grant* to the direct *health facility revitalisation grant*. The introduction of a separate *informal settlements upgrading partnership grant* has been delayed until 2021/22, so the indicative baseline for this grant in 2020/21 has been shifted back to the *human settlements development grant*.

Over the 2020 MTEF period, R1.4 billion has been added to the *early childhood development grant* to increase the subsidy paid for children receiving early childhood development services and to provide for additional children to access these services. Several reprioritisations and technical changes to conditional grants that were announced in the 2019 MTBPS will be implemented over the 2020 MTEF period. These include a reprioritisation of R255 million over the MTEF period from the *comprehensive agricultural support grant* to the Department of Agriculture, Land Reform and Rural Development to support animal and plant health to sustain exports. The funds will be used to improve laboratory capacity, border control and inspections by the national department. Funds are also reprioritised out of the *human settlements development grant* to support efforts to address pollution in the Vaal River system.

Reductions to provincial conditional grants, made as part of the fiscal consolidation announced in the 2019 MTBPS, were determined taking account of the factors described in Part 2 of this annexure. The details are discussed under individual grants. The *provincial roads maintenance grant* has been reduced by R500 million in 2020/21 and this amount has been set aside as a provisional allocation to fund disaster recovery projects.

Including all of the additions, reductions and technical changes, the provincial equitable share grows at an average annual rate of 6.3 per cent over the MTEF period, while direct conditional grant allocations grow at an average annual rate of 4.7 per cent.

The provincial equitable share

The equitable share is the main source of revenue through which provinces are able to meet their expenditure responsibilities. To ensure that allocations are fair, the equitable share is allocated through a formula using objective data to reflect the demand for services across all nine provinces. For each year of the 2020 MTEF period, the following amounts are allocated to the provincial equitable share respectively: R538.5 billion, R574 billion and R607.6 billion.

The equitable share formula

The equitable share formula consists of six components that account for the relative demand of services and take into consideration the change of demographics in each of the provinces. The structure of the two largest components, education and health, is based on the demand and the need for education and health services. The other four components enable provinces to perform their other functions, taking into consideration population size of each province, the proportion of poor residents in each province, the level of economic activity and the costs associated with running a provincial administration. For the 2020 MTEF, the formula has been updated with data from Statistics South Africa’s 2019 mid-year population estimates on population and age cohorts and the 2019 preliminary data published by the Department of Basic Education on school enrolment from the Learner Unit Record Information and Tracking System (LURITS) database. Data from the health sector, the 2018 General Household Survey for medical aid coverage and the Risk Equalisation Fund for the risk-adjusted capitation index is also used to update the formula. Allocation changes tend to mirror shifts in population across provinces, which result in changes in the relative demand for public services across these areas. The impact of these data updates on the provincial equitable shares will be phased in over three years (2020/21 – 2022/23).

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

Summary of the formula’s structure

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

For the 2020 Budget, the formula components are set out as follows:

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

Table W1.7 Distributing the equitable shares by province, 2020 MTEF

	Education	Health	Basic share	Poverty	Economic activity	Institu-tional	Weighted average
	48.0%	**27.0%**	**16.0%**	**3.0%**	**1.0%**	**5.0%**	**100.0%**
Eastern Cape	14.0%	12.3%	11.4%	14.9%	7.7%	11.1%	13.0%
Free State	5.3%	5.3%	4.9%	5.1%	5.0%	11.1%	5.5%
Gauteng	19.4%	24.0%	25.8%	18.7%	34.3%	11.1%	21.4%
KwaZulu-Natal	21.6%	20.5%	19.2%	21.8%	16.0%	11.1%	20.3%
Limpopo	12.7%	10.2%	10.2%	13.5%	7.3%	11.1%	11.5%
Mpumalanga	8.4%	7.5%	7.8%	9.3%	7.5%	11.1%	8.2%
Northern Cape	2.3%	2.1%	2.2%	2.2%	2.1%	11.1%	2.6%
North West	6.8%	6.7%	6.9%	8.2%	6.5%	11.1%	7.0%
Western Cape	9.5%	11.4%	11.6%	6.4%	13.6%	11.1%	10.4%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: National Treasury

Education component (48 per cent)

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

In 2018/19, the data source for enrolment numbers was changed as part of the review of the provincial equitable share, from the SNAP survey to the Department of Basic Education’s data collection system, LURITS. The LURITS system allows data to be verified and learners’ progress to be tracked throughout their school careers. It also allows for duplicates and repetitions to be detected, improving the integrity of the numbers that are reported. When the changes were implemented in the 2018 MTEF, the data was phased in over three years, with the 2018 MTEF and the 2019 MTEF enrolment numbers including data from the old SNAP survey. This phased approach is now complete, and from 2020/21 only the LURITS data is used to update learner enrolment numbers.

As a result of the review of the formula, the data used for the school-age population sub-component has also changed. From 2019/20, the use of Statistics South Africa’s annual mid-year population estimates for the five-year-old to 17-year-old age cohort is being phased in. This data is updated yearly, unlike the 2011 Census data, which was used to update the school-age population previously. This will help limit the shocks of updating the sub-component after a lag between Census updates. This change is being phased in over three years, ending in 2021/22. In 2020/21, the data used to update the age cohort sub-component takes two thirds of its data from the mid-year population estimates and one third from the 2011 Census. From 2021/22, the data used comes only from the mid-year population estimates. Table W1.8 shows how this phase-in is calculated and the age cohort numbers used in the formula.

Table W1.8 Age-cohort sub-component, data phase-in, 2020 MTEF

Thousand	2011 Census Ages 5-17	Mid-year population estimates (MPYE): Ages 5-17			Blended data used in provincial equitable share formula	
		2018	2019	Change	2020/21 (1/3 Census, 2/3 MYPE)	2021/22 (MYPE data only)
Eastern Cape	1 856	1 865	1 881	16	1 873	1 881
Free State	657	725	714	-11	695	714
Gauteng	2 232	2 913	2 941	28	2 704	2 941
KwaZulu-Natal	2 759	2 959	2 924	-35	2 869	2 924
Limpopo	1 536	1 626	1 644	18	1 608	1 644
Mpumalanga	1 054	1 156	1 149	-7	1 117	1 149
Northern Cape	289	305	305	1	300	305
North West	825	993	990	-2	935	990
Western Cape	1 175	1 405	1 425	20	1 341	1 425
Total	**12 383**	**13 945**	**13 974**	**28**	**13 443**	**13 974**

Source: National Treasury

Table W1.9 shows the combined effect of updating the education component with new enrolment and age cohort data on the education component shares.

Table W1.9 Impact of changes in school enrolment on the education component share

Thousand	Age 5-17	School enrolment		Changes in enrolment data	Weighted average		Difference in weighted average
		2018 (phased-in)	2019 LURITS		2019 MTEF	2020 MTEF	
Eastern Cape	1 873	1 882	1 841	-40	14.5%	14.0%	-0.48%
Free State	695	696	714	18	5.3%	5.3%	-0.01%
Gauteng	2 704	2 360	2 440	80	18.7%	19.4%	0.74%
KwaZulu-Natal	2 869	2 852	2 841	-11	22.0%	21.6%	-0.46%
Limpopo	1 608	1 753	1 753	-0	12.9%	12.7%	-0.18%
Mpumalanga	1 117	1 069	1 095	26	8.4%	8.4%	-0.01%
Northern Cape	300	293	298	5	2.3%	2.3%	-0.02%
North West	935	832	852	21	6.6%	6.8%	0.11%
Western Cape	1 341	1 125	1 186	60	9.2%	9.5%	0.33%
Total	**13 443**	**12 862**	**13 021**	**159**	**100.0%**	**100.0%**	**–**

Source: National Treasury

Health component (27 per cent)

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

The health component is presented in three parts below. Table W1.10 shows the shares of the risk-adjusted component, which accounts for 75 per cent of the health component.

Table W1.10 Risk-adjusted sub-component shares

Thousand	Mid-year population estimates 2019	Insured population 2018	Risk-adjusted index	Weighted population	Risk-adjusted shares 2019	Risk-adjusted shares 2020	Change
Eastern Cape	6 712	10.0%	96.9%	5 851	11.9%	11.9%	0.05%
Free State	2 887	16.2%	103.3%	2 498	5.4%	5.1%	-0.32%
Gauteng	15 176	23.9%	105.4%	12 175	24.2%	24.8%	0.54%
KwaZulu-Natal	11 289	12.4%	98.9%	9 781	20.5%	19.9%	-0.59%
Limpopo	5 983	8.2%	91.6%	5 033	10.1%	10.2%	0.10%
Mpumalanga	4 592	12.6%	95.7%	3 841	7.8%	7.8%	0.05%
Northern Cape	1 264	16.1%	100.7%	1 068	2.2%	2.2%	0.02%
North West	4 027	13.5%	102.2%	3 561	7.2%	7.2%	0.09%
Western Cape	6 844	25.1%	104.0%	5 333	10.8%	10.9%	0.06%
Total	**58 775**	**–**	**–**	**49 141**	**100.0%**	**100.0%**	**–**

Source: National Treasury

The risk-adjusted sub-component estimates a weighted population in each province using the risk-adjusted capitation index, which is calculated using data from the Council for Medical Schemes' Risk Equalisation Fund. The percentage of the population with medical insurance, based on the 2018 General Household Survey, is deducted from the 2019 mid-year population estimates to estimate the uninsured population per province. The risk-adjusted index, which is an index of each province's health risk profile, is applied to the uninsured population to estimate the weighted population. Each province's share of this weighted population is used to estimate their share of the risk-adjusted sub-component. The column on the right in Table W1.10 shows the change in this sub-component between 2019 and 2020.

Table W1.11 Output sub-component shares

	Primary healthcare visits				Hospital workload patient-day equivalents			
Thousand	2017/18	2018/19	Average	Share	2017/18	2018/19	Average	Share
Eastern Cape	16 418	16 606	16 512	13.8%	4 328	4 388	4 358	13.5%
Free State	5 462	5 299	5 381	4.5%	1 976	2 126	2 051	6.3%
Gauteng	21 132	20 905	21 019	17.6%	7 315	7 467	7 391	22.9%
KwaZulu-Natal	28 403	28 525	28 464	23.8%	7 055	7 143	7 099	22.0%
Limpopo	14 858	14 336	14 597	12.2%	3 014	3 010	3 012	9.3%
Mpumalanga	9 160	9 253	9 207	7.7%	1 992	1 898	1 945	6.0%
Northern Cape	2 689	2 719	2 704	2.3%	563	573	568	1.8%
North West	7 455	7 446	7 450	6.2%	1 573	1 610	1 592	4.9%
Western Cape	14 140	14 083	14 111	11.8%	4 344	4 297	4 321	13.4%
Total	**119 717**	**119 173**	**119 445**	**100.0%**	**32 161**	**32 512**	**32 336**	**100.0%**

Source: National Treasury

The output sub-component (shown in Table W1.11) uses patient load data from the District Health Information Services. The average number of visits to primary healthcare clinics in 2017/18 and 2018/19 is calculated to estimate each province's share of this part of the output component, which makes up 5 per cent of the health component. For hospitals, each province's share of the total patient-day equivalents at public hospitals in 2017/18 and 2018/19 is used to estimate their share of this part of the output sub-component, making up 20 per cent of the health component. In total, the output component is 25 per cent of the health component.

Table W1.12 shows the updated health component shares for the 2020 MTEF period.

Table W1.12 Health component weighted shares

	Risk-adjusted	Primary healthcare	Hospital compo-nent	Weighted shares		Change
Weight	**75.0%**	**5.0%**	**20.0%**	**2019**	**2020**	
Eastern Cape	11.9%	13.8%	13.5%	12.3%	12.3%	-0.02%
Free State	5.1%	4.5%	6.3%	5.4%	5.3%	-0.07%
Gauteng	24.8%	17.6%	22.9%	23.6%	24.0%	0.47%
KwaZulu-Natal	19.9%	23.8%	22.0%	21.0%	20.5%	-0.53%
Limpopo	10.2%	12.2%	9.3%	10.1%	10.2%	0.08%
Mpumalanga	7.8%	7.7%	6.0%	7.4%	7.5%	0.00%
Northern Cape	2.2%	2.3%	1.8%	2.1%	2.1%	-0.00%
North West	7.2%	6.2%	4.9%	6.7%	6.7%	0.05%
Western Cape	10.9%	11.8%	13.4%	11.4%	11.4%	0.02%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**–**

Source: National Treasury

Basic component (16 per cent)

The basic component derives from each province's share of the national population. This component constitutes 16 per cent of the total equitable share. For the 2020 MTEF, population data is drawn from the 2019 mid-year population estimates produced by Statistics South Africa. Table W1.13 shows how population changes have affected the basic component's revised weighted shares.

Table W1.13 Impact of the changes in population on the basic component shares

	Mid-year population estimates		Population change	% population change	Basic component shares		Change
Thousand	**2018**	**2019**			**2019 MTEF**	**2020 MTEF**	
Eastern Cape	6 523	6 712	190	2.9%	11.3%	11.4%	0.12%
Free State	2 954	2 887	-67	-2.3%	5.1%	4.9%	-0.21%
Gauteng	14 717	15 176	459	3.1%	25.5%	25.8%	0.33%
KwaZulu-Natal	11 385	11 289	-96	-0.8%	19.7%	19.2%	-0.51%
Limpopo	5 797	5 983	185	3.2%	10.0%	10.2%	0.14%
Mpumalanga	4 524	4 592	68	1.5%	7.8%	7.8%	-0.02%
Northern Cape	1 226	1 264	38	3.1%	2.1%	2.2%	0.03%
North West	3 979	4 027	48	1.2%	6.9%	6.9%	-0.04%
Western Cape	6 621	6 844	223	3.4%	11.5%	11.6%	0.17%
Total	**57 726**	**58 775**	**1 049**	**–**	**100.0%**	**100.0%**	**–**

Source: National Treasury

Institutional component (5 per cent)

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

Poverty component (3 per cent)

The poverty component introduces a redistributive element to the formula and is assigned a weight of 3 per cent. For this component, the poor population is defined as people who fall into the lowest 40 per cent of household incomes in the 2010/11 Income and Expenditure Survey. The estimated size of the poor population in each province is calculated by multiplying the proportion of people in that province who fall into the poorest 40 per cent of South African households by the province's population figure from the 2019 mid-year population estimates. Table W1.14 shows the proportion of the poor in each province from the Income and Expenditure Survey, the 2019 mid-year population estimates and the weighted share of the poverty component per province.

Table W1.14 Comparison of current and new poverty component weighted shares

Thousand	Income and Expenditure Survey 2010/11	Current (2019 MTEF) Mid-year population estimates 2018	Poor population	Weighted shares	New (2020 MTEF) Mid-year population estimates 2019	Poor population	Weighted shares	Difference in weighted shares
Eastern Cape	52.0%	6 523	3 394	14.7%	6 712	3 492	14.9%	0.2%
Free State	41.4%	2 954	1 223	5.3%	2 887	1 195	5.1%	-0.2%
Gauteng	28.9%	14 717	4 249	18.4%	15 176	4 381	18.7%	0.3%
KwaZulu-Natal	45.3%	11 385	5 158	22.4%	11 289	5 115	21.8%	-0.5%
Limpopo	52.9%	5 797	3 064	13.3%	5 983	3 162	13.5%	0.2%
Mpumalanga	47.3%	4 524	2 138	9.3%	4 592	2 170	9.3%	-0.0%
Northern Cape	40.8%	1 226	500	2.2%	1 264	515	2.2%	0.0%
North West	47.9%	3 979	1 906	8.3%	4 027	1 929	8.2%	-0.0%
Western Cape	21.9%	6 621	1 448	6.3%	6 844	1 496	6.4%	0.1%
Total		**57 726**	**23 079**	**100.0%**	**58 775**	**23 457**	**100.0%**	**–**

Source: National Treasury

Economic activity component (1 per cent)

The economic activity component is a proxy for provincial tax capacity and expenditure assignments. Given that these assignments are a relatively small proportion of provincial budgets, the component is assigned a weight of 1 per cent. For the 2020 MTEF, 2017 GDP-R data is used. Table W1.15 shows the weighted shares of the economic activity component.

Table W1.15 Current and new economic activity component weighted shares

	Current (2019 MTEF) GDP-R, 2016 (R million)	Weighted shares	New (2020 MTEF) GDP-R, 2017 (R million)	Weighted shares	Difference in weighted shares
Eastern Cape	331 093	7.6%	358 627	7.7%	0.1%
Free State	217 849	5.0%	234 505	5.0%	0.0%
Gauteng	1 507 082	34.6%	1 593 874	34.3%	-0.4%
KwaZulu-Natal	692 222	15.9%	746 360	16.0%	0.1%
Limpopo	311 686	7.2%	340 273	7.3%	0.1%
Mpumalanga	323 722	7.4%	348 987	7.5%	0.1%
Northern Cape	90 883	2.1%	96 487	2.1%	-0.0%
North West	279 733	6.4%	301 477	6.5%	0.0%
Western Cape	596 043	13.7%	632 990	13.6%	-0.1%
Total	**4 350 314**	**100.0%**	**4 653 579**	**100.0%**	**0.0%**

Source: National Treasury

Full impact of data updates on the provincial equitable share

Table W1.16 shows the full impact of the data updates on the provincial equitable share per province, after the six updated components have been added together. It compares the target shares for the 2019 and 2020 MTEF periods. The size of each province's share reflects the relative demand for provincial public services in that province, and the changes in shares from 2019 to 2020 respond to changes in that demand. The details of how the data updates affect each component of the formula are described in detail in the sub-sections above.

Table W1.16 Full impact of data updates on the equitable share

	2019 MTEF weighted average	2020 MTEF weighted average	Difference
Eastern Cape	13.2%	13.0%	-0.2%
Free State	5.6%	5.5%	-0.1%
Gauteng	20.9%	21.4%	0.5%
KwaZulu-Natal	20.8%	20.3%	-0.5%
Limpopo	11.5%	11.5%	-0.0%
Mpumalanga	8.2%	8.2%	-0.0%
Northern Cape	2.6%	2.6%	-0.0%
North West	7.0%	7.0%	0.1%
Western Cape	10.2%	10.4%	0.2%
Total	**100.0%**	**100.0%**	**0.0%**

Source: National Treasury

Phasing in the formula

The annual updates to the official data used to calculate the provincial equitable share formula result in changes to each province's share of the available funds. These changes reflect the changing balance of service delivery demands among the provinces, and the annual data updates are vital to ensuring that allocations can respond to these changes. However, provinces need stable and predictable revenue streams to allow for sound planning. As such, the new shares calculated using the most recent data are phased in over the three-year MTEF period.

The equitable share formula data is updated every year and a new target share for each province is calculated, as shown in Table W1.17. The phase-in mechanism provides a smooth path to achieving the new weighted shares by the third year of the MTEF period. It takes the difference between the target weighted share for each province at the end of the MTEF period and the indicative allocation for 2020/21 published in the 2019 MTEF, and closes the gap between these shares by a third in each year of the 2020 MTEF period. As a result, one third of the impact of the data updates is implemented in 2020/21 and two thirds in the indicative allocations for 2021/22. The updates are thus fully implemented in the indicative allocations for 2022/23.

Table W1.17 Implementation of the equitable share weights

Percentage	2020/21 Indicative weighted shares from 2019 MTEF	2020/21	2021/22	2022/23
		2020 MTEF weighted shares 3-year phasing		
Eastern Cape	13.4%	13.3%	13.1%	13.0%
Free State	5.6%	5.6%	5.6%	5.5%
Gauteng	20.6%	20.8%	21.1%	21.4%
KwaZulu-Natal	20.9%	20.7%	20.5%	20.3%
Limpopo	11.6%	11.6%	11.5%	11.5%
Mpumalanga	8.2%	8.2%	8.2%	8.2%
Northern Cape	2.7%	2.7%	2.6%	2.6%
North West	6.9%	7.0%	7.0%	7.0%
Western Cape	10.2%	10.3%	10.3%	10.4%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: National Treasury

Allocations calculated outside the equitable share formula

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

For the 2020 MTEF, three new adjustments are allocated outside the provincial equitable share formula. In the social development sector, R398 million has been reprioritised from national government to continue to employ social workers in areas with a high prevalence of gender-based violence, substance abuse and issues affecting children. The allocations to the provinces are based on the prevalence of these problems, population and geographic size, and the number of sites offering social work services. In addition, R315 million has been reprioritised from the Department of Social Development for provinces to continue to help non-profit organisations implement Social Behaviour Change Programmes to address social and structural drivers of HIV, TB and sexually transmitted infections. To scale up the Sanitary Dignity Programme, which provides sanitary products to indigent girl learners, funds were added to the equitable share in 2019/20. To continue rolling out this programme, R652 million has been added to the provincial equitable share over the 2020 MTEF period. These funds are proportionally allocated to the provinces based on the number of girl learners in Grades 4 to 12 in the poorest schools (quintiles 1–3) in each province.

Table W1.18 provides a summary of the allocations made outside the provincial equitable share in the 2020 MTEF period and a short description of how these amounts are allocated among provinces.

Table W1.18 Allocations outside provincial equitable share formula

	2019/20	2020/21	2021/22	2022/23	Allocation criteria
R million	**Adjusted Budget**	**Medium-term estimates**			
Food relief shift	–	67	71	75	Allocated equally among the provinces
Social worker employment grant shift	213	227	239	251	Allocated in terms of what provinces would have received had the grant continued
Substance abuse treatment grant shift	75	79	83	87	Allocated in terms of what provinces would have received had the grant continued
Municipal intervention support	87	89	93	97	Allocated equally among the provinces
Gender-based violence and sexually transmitted infections support shift	–	93	109	114	Allocated based on the non-profit organisations located in the 27 priority districts
Social worker additional support shift	–	113	139	146	Allocated according to areas of high prevalence of gender-based violence, substance abuse and issues affecting children
Sanitary Dignity Programme	157	209	217	226	Allocated proportionately based on the number of girl learners per province in quintiles 1 to 3 schools
Infrastructure delivery improvement programme shift	45	45	45	47	Allocated equally among the provinces
Total	**576**	**921**	**997**	**1 042**	

Source: National Treasury

Final provincial equitable share allocations

The final equitable share allocations per province for the 2020 MTEF period are detailed in Table W1.19. These allocations include the full impact of the data updates, phased in over three years, and the allocations that are made separately from the formula.

Table W1.19 Provincial equitable share

R million	2020/21	2021/22	2022/23
Eastern Cape	71 415	75 306	78 841
Free State	30 017	31 897	33 657
Gauteng	112 118	121 121	129 908
KwaZulu-Natal	111 442	117 755	123 544
Limpopo	62 329	66 256	69 935
Mpumalanga	44 105	46 996	49 724
Northern Cape	14 290	15 207	16 068
North West	37 548	40 174	42 682
Western Cape	55 208	59 276	63 194
Total	**538 472**	**573 990**	**607 554**

Source: National Treasury

Conditional grants to provinces

There are four types of provincial conditional grants:

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

Changes to conditional grants

The overall growth in direct conditional transfers to provinces averages 4.7 per cent over the medium term. Direct conditional grant baselines total R111 billion in 2020/21, R118 billion in 2021/22 and R123 billion in 2022/23. Indirect conditional grants amount to R4.1 billion, R4.8 billion and R5.1 billion respectively for each year of the same period.

Table W1.20 provides a summary of conditional grants by sector for the 2020 MTEF period. More detailed information, including the framework and allocation criteria for each grant, is provided in the 2020 Division of Revenue Bill. The frameworks provide the conditions for each grant, the outputs expected, the allocation criteria used for dividing each grant between provinces, and a summary of the grants' audited outcomes for 2018/19.

Table W1.20 Conditional grants to provinces

R million	2019/20 Adjusted budget	2020/21	2021/22	2022/23	MTEF total
Agriculture, land reform and rural development	**2 159**	**2 153**	**2 320**	**2 392**	**6 865**
Comprehensive agricultural support programme	1 538	1 522	1 620	1 672	4 814
Ilima/Letsema projects	538	549	614	632	1 795
Land care programme: poverty relief and infrastructure development	82	82	86	88	257
Basic Education	**18 569**	**19 564**	**20 773**	**21 738**	**62 076**
Education infrastructure	10 514	11 008	11 710	12 255	34 973
HIV and AIDS (life skills education)	257	247	259	262	767
Learners with profound intellectual disabilities	221	243	256	266	765
Maths, science and technology	391	401	423	438	1 262
National school nutrition programme	7 186	7 666	8 125	8 516	24 308
Cooperative Governance	**131**	**138**	**146**	**153**	**438**
Provincial disaster relief	131	138	146	153	438
Health	**45 524**	**49 267**	**53 917**	**56 537**	**159 721**
HIV, TB, malaria and community outreach	22 039	24 387	27 931	29 405	81 723
Health facility revitalisation	6 007	6 368	6 658	7 034	20 060
Human papillomavirus vaccine	157	–	–	–	–
National tertiary services	13 186	14 069	14 694	15 294	44 057
National health insurance grant: health professionals	289	289	300	311	900
Statutory human resources, training and development	3 846	4 155	4 333	4 494	12 982
Human Settlements	**19 604**	**17 493**	**17 614**	**18 317**	**53 425**
Human settlements development	18 780	16 621	13 414	13 871	43 905
Title deeds restoration	548	578	–	–	578
Provincial emergency housing	277	295	311	326	932
Informal settlements upgrading partnership	–	–	3 890	4 121	8 011
Public Works and Infrastructure	**868**	**834**	**871**	**903**	**2 609**
Expanded public works programme integrated grant for provinces	437	421	440	456	1 316
Social sector expanded public works programme incentive for provinces	431	414	432	447	1 292
Social Development	**518**	**915**	**1 057**	**1 192**	**3 164**
Early childhood development	518	915	1 057	1 192	3 164
Sports arts and culture	**2 121**	**2 076**	**2 205**	**2 307**	**6 588**
Community library services	1 501	1 479	1 584	1 667	4 730
Mass participation and sport development	620	597	621	640	1 858
Transport	**17 768**	**18 343**	**19 058**	**19 597**	**56 998**
Provincial roads maintenance	11 442	11 593	11 938	12 507	36 037
Public transport operations	6 326	6 750	7 121	7 090	20 961
Total direct conditional allocations	**107 263**	**110 785**	**117 962**	**123 137**	**351 883**
Indirect transfers	**3 941**	**4 060**	**4 824**	**5 076**	**13 961**
Agriculture, land reform and rural development	**45**	**36**	**–**	**–**	**36**
Ilima/Letsema indirect	45	36	–	–	36
Basic Education	**1 987**	**1 736**	**2 295**	**2 424**	**6 456**
School infrastructure backlogs	1 987	1 736	2 295	2 424	6 456
Health	**1 909**	**2 288**	**2 529**	**2 652**	**7 469**
National health insurance indirect	1 909	2 288	2 529	2 652	7 469

Source: National Treasury

Agriculture, land reform and rural development grants

The *comprehensive agricultural support programme grant* aims to support newly established and emerging farmers, particularly subsistence, smallholder and previously disadvantaged farmers. The grant funds a range of projects, including providing training, developing agro-processing infrastructure and directly supporting targeted farmers. Over the 2020 MTEF period, R255.1 million is reprioritised from the grant to the Department of Agriculture, Land Reform and Rural Development to fund improved laboratory capacity, border control and inspections. Although funds have been reprioritised from this grant, over the 2020 MTEF period R4.8 billion is allocated to this grant, and the baseline grows from R1.5 billion in 2020/21 to R1.7 billion in 2022/23. The fiscal consolidation reductions for this grant are equivalent to 5 per cent of the grant's baseline in 2020/21, 6 per cent in 2022/23 and 7 per cent in 2022/23.

The *land care programme grant: poverty relief and infrastructure development* aims to improve productivity and the sustainable use of natural resources. Provinces are also encouraged to use this grant to create jobs through the Expanded Public Works Programme. Over the medium term, R257 million is allocated to this grant. The fiscal consolidation reductions for this grant are equivalent to 5 per cent of the grant's baseline in 2020/21, 6 per cent in 2022/23 and 7 per cent in 2022/23.

The *Ilima/Letsema projects grant* aims to boost food production by helping previously disadvantaged farming communities. The grant's baseline is R1.8 billion over the 2020 MTEF period. This includes R36 million in 2020/21, which is allocated through the *Ilima/Letsema indirect grant* to complete the National Food and Nutrition Survey. These funds were previously ring-fenced in the direct *Ilima/Letsema projects grant*, and this shift will allow the national Department of Agriculture, Land Reform and Rural Development to pay the Human Sciences Research Council directly for the survey. The fiscal consolidation reductions for this grant are equivalent to 5 per cent of the grant's baseline in 2020/21, 6 per cent in 2021/22 and 7 per cent in 2022/23.

Basic education grants

The *education infrastructure grant* provides supplementary funding for ongoing infrastructure programmes in provinces. This includes maintaining existing infrastructure and building new infrastructure to ensure school buildings meet the required norms and standards. The grant's total allocation for this period is R35 billion: R11 billion in 2020/21, R11.7 billion in 2021/22 and R12.3 billion in 2022/23. The fiscal consolidation reductions for this grant are equivalent to 4 per cent of the grant's baseline in 2020/21, 5 per cent in 2022/23 and 5.9 per cent in 2022/23.

Provincial education departments have to go through a two-year planning process to be eligible to receive incentive allocations for infrastructure projects. To receive the 2020/21 incentive, the departments had to meet certain prerequisites in 2018/19 and have their infrastructure plans approved in 2019/20. The national Department of Basic Education and the National Treasury assessed the provinces' infrastructure plans. The national departments, provincial treasuries and provincial departments of basic education undertook a moderation process to agree on the final scores. Provinces needed to obtain a minimum score of 60 per cent to qualify for the incentive. Table W1.21 shows the final score and incentive allocation for each province.

Table W1.21 Education infrastructure grant allocations

R thousand	Planning assessment results from 2019	2020/21		Final allocation for 2020/21
		Basic component	Incentive component	
Eastern Cape	77%	1 470 728	73 386	1 544 114
Free State	70%	767 043	73 386	840 429
Gauteng	90%	1 424 371	73 386	1 497 757
KwaZulu-Natal	93%	1 922 796	73 386	1 996 182
Limpopo	75%	1 182 978	73 386	1 256 364
Mpumalanga	84%	1 021 295	73 386	1 094 681
Northern Cape	80%	523 882	73 386	597 268
North West	65%	1 016 624	73 386	1 090 010
Western Cape	91%	1 017 776	73 386	1 091 162
Total		**10 347 489**	**660 478**	**11 007 967**

Source: National Treasury

The national Department of Basic Education uses the indirect *school infrastructure backlogs grant* to replace unsafe and inappropriate school structures and to provide water, sanitation services and electricity on behalf of provinces. This grant is allocated R6.5 billion over the medium term in the Planning, Information and Assessment Programme. An allocation of R1.7 billion in 2020/21 will be used to replace 40 inappropriate and unsafe schools with newly built ones, provide clean water to 432 schools and provide appropriate sanitation services to 1 033 schools.

The *national school nutrition programme grant* aims to improve the nutrition of poor school children, enhance their capacity to learn and increase their attendance at school. The programme provides a free daily meal to learners in the poorest schools (quintiles 1 to 3). To provide meals to more children, while still providing quality food, growth in the grant's allocations over the MTEF period averages 5.8 per cent, with a total allocation of R24.3 billion. The fiscal consolidation reductions to this grant are equivalent to 0.4 per cent of the grant's baseline in 2020/21, 0.5 per cent in 2021/22 and 0.6 per cent in 2022/23.

The *maths, science and technology grant* provides for ICT, workshop equipment and machinery to schools, which should lead to better outcomes in maths and science in the long term. The grant's total allocation is R1.3 billion over the medium term. The fiscal consolidation reductions to this grant are equivalent to 3 per cent of the grant's baseline in 2020/21, 3 per cent in 2021/22 and 3 per cent in 2022/23.

The *HIV and AIDS (life skills education) programme grant* provides for life skills training, and sexuality and HIV/AIDS education in primary and secondary schools. The programme is fully integrated into the school system, with learner and teacher support materials provided for Grades 1 to 9. The grant's total allocation is R767 million over the medium term. The fiscal consolidation reductions to this grant are equivalent to 8.8 per cent of the grant's baseline in 2020/21, 9.5 per cent in 2021/22 and 11.5 per cent in 2022/23.

The *learners with profound intellectual disabilities grant* aims to expand access to education for these learners. Over the MTEF period, the grant will provide access to quality, publicly funded education to such learners by recruiting outreach teams. This grant has been allocated R765 million over the 2020 MTEF period.

Cooperative governance grant

The *provincial disaster relief grant* is administered by the National Disaster Management Centre in the Department of Cooperative Governance. It is unallocated at the start of the financial year. The grant allows the National Disaster Management Centre to immediately release funds (in-year) after a disaster is declared, without the need for the transfers to be gazetted first. The reconstruction of infrastructure damaged by disasters is funded separately through ring-fenced allocations in sector grants. Strategies to mitigate the effects of the ongoing drought have, in part, been funded by this grant.

To ensure that sufficient funds are available in the event of a disaster, section 21 of the 2019 Division of Revenue Bill allows for funds allocated to the *municipal disaster relief grant* to be transferred to provinces if funds in the *provincial disaster relief grant* have already been exhausted, and vice versa. The bill also allows for more than one transfer to be made to areas affected by disasters so that an initial payment for emergency aid can be made before a full assessment of damages and costs has been completed. Over the 2020 MTEF period, R438 million has been allocated to the *provincial disaster relief grant*.

Health grants

The *national tertiary services grant* provides strategic funding to enable provinces to plan, modernise and transform tertiary hospital service delivery in line with national policy objectives. The grant operates in 29 tertiary hospitals across the nine provinces and continues to fund medical specialists, equipment, and advanced medical investigation and treatment according to approved service specifications. Patient referral pathways often cross provincial borders and, as a result, many patients receive care in neighbouring provinces if the required services are unavailable in their home province. For the 2020 MTEF period, the national Department of Health has reprioritised R176 million within this conditional grant to develop and expand tertiary services in the Eastern Cape, Limpopo, Mpumalanga and the North West. The funds have been ring-fenced in the 2020/21 allocations for these provinces and left unallocated for 2021/22 and 2022/23. These developmental allocations will allow the provinces to develop their capacity in offering tertiary services within their facilities. A similar approach to allocating developmental funds is taken in the statutory human resources component of the *statutory human resources, training and development grant* and further details on the amounts ring-fenced are discussed under this grant. The urban areas of Gauteng and the Western Cape continue to receive the largest share of the grant because they provide the largest proportion of high-level, sophisticated services.

The national Department of Health has reviewed the allocation criteria under this grant and is working with provinces to develop a new allocation model to ensure continued fairness in allocations. The grant is allocated R44.1 billion over the medium term: R14.1 billion in 2020/21, R14.7 billion in 2021/22 and R15.3 billion in 2022/23. The fiscal consolidation reductions to this grant are equivalent to 1 per cent of the grant's baseline in 2021/22 and 1 per cent in 2022/23.

The *health facility revitalisation grant* funds the construction and maintenance of health infrastructure, including large projects to modernise hospital infrastructure and equipment, general maintenance and infrastructure projects at smaller hospitals, and the refurbishment and upgrading of nursing colleges and schools. A total of R199 million in 2020/21 and R5.7 million in 2021/22 has been shifted from the *national health insurance indirect grant: health facility revitalisation component* to this grant for upgrades to Pietersburg Hospital in Limpopo. These funds were initially part of the Limpopo allocations in the *national health insurance indirect grant.* The province will now undertake the upgrades, so the funds will be transferred directly to the province. Over the 2020 MTEF period, R20 billion has been allocated to this grant. The fiscal consolidation reductions to this grant are equivalent to 3 per cent of the grant's baseline in 2020/21, 3 per cent in 2021/22 and 3 per cent in 2022/23.

Like the *education infrastructure grant* discussed previously, a two-year planning process is also required for provinces to access this grant's incentive component. The national Department of Health and the National Treasury assessed the provinces' infrastructure plans. This was followed by a moderation process between the national departments, provincial treasuries and provincial departments of health to agree on the final scores. Provinces had to obtain a minimum score of 60 per cent to qualify for the incentive. Funds for the incentive component in the outer years are shown as unallocated. Table W1.22 sets out the final score and the incentive allocation per province.

Table W1.22 Health facility revitalisation grant allocations

R thousand	Planning assessment results from 2019	2020/21		Final allocation for 2020/21
		Basic component	Incentive component	
Eastern Cape	73%	610 773	58 760	669 533
Free State	62%	527 985	58 760	586 745
Gauteng	70%	909 450	58 760	968 210
KwaZulu-Natal	80%	1 212 654	58 760	1 271 414
Limpopo	60%	683 713	58 760	742 473
Mpumalanga	69%	365 162	58 760	423 922
Northern Cape	50%	409 404	–	409 404
North West	73%	538 398	58 760	597 158
Western Cape	86%	640 033	58 760	698 793
Total		**5 897 570**	**470 082**	**6 367 652**

Source: National Treasury

The *human resources capacitation grant* and the *health professions training and development grant* have been merged to create a new *statutory human resources, training and development grant* from 2020/21. The conditional grant has two components and has been allocated R4.2 billion in 2020/21, R4.3 billion in 2021/22 and R4.5 billion in 2022/23. The health professions training and development component funds the training of health sciences professionals, including specialists, registrars and their supervisors (who were previously funded from the *health professions training and development grant*). The statutory human resources component will fund intern and community service posts (which were previously funded from the *human resources capacitation grant*), as well as some posts previously funded from the equitable share. When the *human resources capacitation grant* was introduced, it was primarily meant to fund the shortfall in funding for interns and community service posts, but its scope expanded to include other vacant posts in the health sector. These non-statutory posts will now be funded through the provincial equitable share. Therefore, the grant will be able to fund some additional internship and community service posts that were previously funded from the equitable share. Over the 2020 MTEF period, similar to the national tertiary services grant, R65 million has been ring-fenced in the health professions training and development component of this grant for the development and expansion of tertiary services in the Eastern Cape, Limpopo, Mpumalanga, the Northern Cape and the North West. The funds have been allocated to these provinces for 2020/21, and are left unallocated for the outer two years of the MTEF period.

The *HIV, TB, malaria and community outreach grant* supports HIV/AIDS prevention programmes and specific interventions, including voluntary counselling and testing, prevention of mother-to-child transmission, post-exposure prophylaxis, antiretroviral treatment and home-based care. In the 2016 MTEF, the grant's scope was extended to include tuberculosis. In the 2018 Budget, a sub-component for community outreach services was introduced, so that funds used to support community health workers could be explicitly earmarked. This will help ensure that these workers are better integrated into national health services. In 2020/21, R800 million has been reprioritised to the community outreach services component from the HIV and AIDS component of the grant to cover a shortfall in the salaries of community health workers in that year. In 2019/20, two new components were added to the grant, to strengthen the continued fight against malaria in three provinces and to monitor the activities and outcomes of the TB portion of the grant. In the 2020 MTEF, the *human papillomavirus vaccine grant* has been merged into the *HIV, TB, malaria, community outreach grant* and a separate component will be created within the grant to continue funding human papillomavirus vaccinations. Two new components for mental health and oncology will be introduced in 2021/22, with funds of R452 million reprioritised from the national health insurance: personal services component for the two outer years of the 2020 MTEF period. The grant's total baseline amounts to R82 billion over the medium term. The fiscal consolidation reductions to this grant are equivalent to 1 per cent of the grant's baseline in 2020/21, 1 per cent in 2021/22 and 1 per cent in 2022/23.

The *national health insurance indirect grant* continues to fund all preparatory work for universal health coverage, as announced in 2017/18. Over the 2020 MTEF period, this will be done through three components: health facility revitalisation and two integrated components (personal services and non-personal services). The personal services component funds priority services for national health insurance, which include:

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

Non-personal services will test, and scale up when ready, the technology platforms and information systems needed to ensure a successful transition to national health insurance. In 2020/21, this component will also pilot new initiatives to improve the quality of health in preparation for accreditation to deliver national health insurance services. The non-personal services component is allocated R2.2 billion over the medium term to continue funding initiatives to strengthen health information systems, clinics, and the dispensing and distribution of centralised chronic medicines. This indirect grant is allocated a total of R7.5 billion over the 2020 MTEF period. The fiscal consolidation reductions to this grant are equivalent to 9.8 per cent of the grant's baseline in 2020/21, 4 per cent in 2021/22 and 4.7 per cent in 2022/23.

In the 2019/20 adjustment budget, funds for contracting health professionals were shifted from the personal services component of the indirect grant to create a new direct *national health insurance grant*. The contracting of health professionals in former national health insurance pilot sites was previously administered at national level, but the contracting was being carried out at provincial level with the requirement that provinces submit claims for the costs they incurred. Transferring these funds to provinces allows them to pay contractors directly. The contracting of health professionals will continue to be funded in the direct *national health insurance grant* over the MTEF period through an allocation of R900 million.

Human settlements grants

The *human settlements development grant* seeks to establish habitable, stable and sustainable human settlements in which all citizens have access to social and economic amenities. Over the 2020 MTEF period, a total of R44 billion has been allocated to this grant. The fiscal consolidation reductions to this grant are equivalent to 13.1 per cent of the grant's baseline in 2020/21, 12.9 per cent in 2021/22 and 14.8 per cent in 2022/23.

This grant is allocated using a formula with three components:

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

Table W1.23 shows how the *human settlements development grant* formula calculates the shares for each province and the metropolitan municipalities within the provinces. Section 12(6) of the Division of Revenue Act requires provinces to gazette how much they will spend within each accredited municipality (including the amounts transferred to that municipality and the amounts spent by the province in that municipal area). Funds for mining towns and disaster recovery are allocated separately from the formula.

Table W1.23 Human settlements development grant formula calculation

Components	Housing needs component	Poverty component	Population component	Grant formula shares
Description	**Weighted share of inadequate housing**	**Share of poverty**	**Share of population**	**Weighted share of grant formula**
Component weight	**70.0%**	**20.0%**	**10.0%**	
Eastern Cape	**10.1%**	**13.7%**	**12.7%**	**11.1%**
Nelson Mandela Bay	1.6%	2.1%	2.2%	1.8%
Buffalo City	2.2%	1.6%	1.5%	2.0%
Other Eastern Cape municipalities	6.3%	10.0%	9.0%	7.3%
Free State	**5.9%**	**6.2%**	**5.3%**	**5.9%**
Mangaung	1.4%	1.5%	1.4%	1.5%
Other Free State municipalities	4.4%	4.6%	3.9%	4.4%
Gauteng	**30.9%**	**22.6%**	**23.7%**	**28.5%**
Ekurhuleni	9.1%	6.2%	6.1%	8.2%
City of Johannesburg	10.5%	8.1%	8.6%	9.8%
City of Tshwane	6.8%	4.8%	5.6%	6.3%
Other Gauteng municipalities	4.5%	3.5%	3.4%	4.2%
KwaZulu-Natal	**18.0%**	**18.9%**	**19.8%**	**18.3%**
eThekwini	7.0%	6.2%	6.6%	6.8%
Other KwaZulu-Natal municipalities	11.0%	12.7%	13.2%	11.6%
Limpopo	**4.4%**	**11.8%**	**10.4%**	**6.5%**
Mpumalanga	**6.2%**	**7.9%**	**7.8%**	**6.7%**
Northern Cape	**1.9%**	**2.1%**	**2.2%**	**2.0%**
North West	**10.0%**	**7.8%**	**6.8%**	**9.2%**
Western Cape	**12.7%**	**9.0%**	**11.2%**	**11.8%**
City of Cape Town	9.3%	5.6%	7.2%	8.3%
Other Western Cape municipalities	3.4%	3.4%	4.0%	3.5%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: 2011 Census and General Household Survey

In 2019/20, the structure of the *human settlements development grant* was changed to intensify efforts to upgrade informal settlements in partnership with communities. To promote this objective, a new component was introduced with specific conditions relating to such upgrades.

The new component amounts to 15 per cent of the formula-based grant allocation to each province. The funds ring-fenced for each province are a minimum expenditure requirement, allowing them to invest more if necessary. The component requires the use of a partnership approach that promotes community ownership and participation in the upgrades. Provinces are required to work with municipalities to identify and prioritise informal settlements for upgrading and to submit a plan for each settlement to be upgraded, prepared in terms of the National Upgrading Support Programme's methodology.

This component will remain in place in 2020/21, serving as a planning and preparatory platform for the introduction of a new *informal settlements upgrading grant* in 2021/22. The new grant will be created by reprioritising funds from the *human settlements development grant*. A similar approach is being taken in the *urban settlements development grant*, discussed in Part 5, with an informal settlements upgrading component and the intention to introduce a separate grant for metropolitan municipalities in the outer years of the MTEF period.

A total of R544 million is ring-fenced within the *human settlements development grant* in 2020/21 to upgrade human settlements in mining towns in six provinces. These allocations respond to areas with significant informal settlement challenges, with a high proportion of economic activity based on the natural resources sector.

The *human settlements development grant* previously had funds ring-fenced for the eradication of the pre-2014 title deeds registration backlog. Given the slow progress to date, along with the impairment it had on the functioning of the property market, the *title deeds restoration grant* was introduced to accelerate the backlog eradication process. The grant was introduced in 2018/19 and comes to an end in 2020/21. It has an allocation of R578 million in 2021/22, which has been indicatively incorporated back into the *human settlements development grant* baseline in that year.

A *provincial emergency housing grant* was also introduced in 2018/19 to enable the department to rapidly respond to emergencies by providing temporary housing in line with the Emergency Housing Programme. However, the grant is limited to funding emergency housing following the immediate aftermath of a disaster, and not the other emergency situations listed in the programme. In 2019/20, the grant's purpose was expanded to fund the repair of houses damaged in disasters, if those repairs are cheaper than the grant's funding of relocating households to temporary shelter. Over the 2020 MTEF period, a total of R932 million has been allocated to this grant.

Public works and infrastructure grants

The *expanded public works programme (EPWP) integrated grant for provinces* incentivises provincial departments to use labour-intensive methods in infrastructure, environmental and other projects. Grant allocations are determined upfront based on the performance of provincial departments in meeting job targets in the preceding financial year. The grant is allocated R1.3 billion over the MTEF period. The fiscal consolidation reductions to this grant are equivalent to 9 per cent of the grant's baseline in 2020/21, 10 per cent in 2021/22 and 10.1 per cent in 2022/23.

The *social sector EPWP incentive grant for provinces* rewards provinces for creating jobs in the preceding financial year in the areas of home-based care, early childhood development, adult literacy and numeracy, community safety and security, and sports programmes. The grant's allocation model incentivises provincial departments to participate in the EPWP and measures the performance of each province relative to its peers, providing additional incentives to those that perform well. The grant is allocated R1.3 billion over the MTEF period. The fiscal consolidation reductions to this grant are equivalent to 9 per cent of the grant's baseline in 2020/21, 10 per cent in 2021/22 and 10.1 per cent in 2022/23.

Social development grants

The *early childhood development grant* supports government's prioritisation of early childhood development, as envisioned in the National Development Plan. The grant aims to improve poor children's access to early childhood programmes and ensure that early childhood centres have adequate infrastructure. The grant baseline totals R3.2 billion over the 2020 MTEF period, which includes an additional R1.4 billion. For 2020/21, the additional allocations have been used to increase the per-child subsidy from R15 per day to R17 per day in 2020/21. The subsidy is then projected to increase in line with inflation to R17.77 in 2021/22 and R18.57 in 2022/23.

The grant additions cover the cost of increasing the per-child subsidies funded from the provincial equitable share in 2020/21 as well as those funded directly from the grant. The additions also fund a small expansion in access to early childhood development services, which can be implemented by increasing the number of subsidies for centre-based early childhood development services or by providing subsidies for non-centre-based early childhood development services. The allocation of funds in the maintenance component of the grant, for the two outer years of the 2020 MTEF period, will be informed by the outcomes of the infrastructure assessments that need to be conducted in each province. As a result, 80 per cent of the allocations in this component remain unallocated in these two outer years.

Sports, arts and culture grants

The *community library services grant*, administered by the Department of Sports, Arts and Culture, aims to help South Africans access information to improve their socio-economic situation. The grant is allocated to the relevant provincial department and administered by that department or through a service-level agreement with municipalities. In collaboration with provincial departments of basic education, the grant also funds libraries that serve both schools and the general public. Funds from this grant may also be used to enable the shift of the libraries function between provinces and municipalities. The grant is allocated R4.7 billion over the next three years. The fiscal consolidation reductions to this grant are equivalent to 6.6 per cent of the grant's baseline in 2020/21, 5.7 per cent in 2021/22 and 4.7 per cent in 2022/23.

The *mass participation and sport development grant* aims to increase and sustain mass participation in sport and recreational activities in the provinces, with greater emphasis on provincial and district academies. Over the MTEF period, an amount of R90 million has been reprioritised within this grant to support the Netball World Cup, which will be hosted in the Western Cape in 2023. The grant is allocated R1.9 billion over the medium term. The fiscal consolidation reductions to this grant are equivalent to 8.8 per cent of the grant's baseline in 2020/21, 10 per cent in 2021/22 and 10.5 per cent in 2022/23.

Transport grants

The *public transport operations grant* subsidises commuter bus services. It helps ensure that provinces meet their contractual obligations and provide services. Most of the contracts subsidised through this grant continue to operate on long-standing routes that link dormitory towns and suburbs established under apartheid to places of work. The grant allows provinces to renegotiate contracts and routes, and/or to devolve the function and funding to municipalities. This provides an opportunity for routes to be restructured in line with new settlement patterns and to promote more integrated urban development patterns in future. The grant is allocated R21 billion over the MTEF period. The fiscal consolidation reductions to this grant are equivalent to 4 per cent of the grant's baseline in 2022/23.

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

The incentive portion of the grant is meant to be based on performance indicators relating to traffic loads, safety engineering and visual condition indicators. However, the Department of Transport was unable to provide updated data on the incentive calculation in time to determine incentive allocations for 2020/21. As a result, the full grant is allocated through the formula described above. The Department of Transport and the National Treasury agree that the grant should be used to incentivise improved performance in provincial roads departments and will work together in 2020 to revise the incentive component in time to determine allocations from the R1.6 billion unallocated incentive pool in 2021/22. The total allocation for the MTEF period is R36 billion. The fiscal consolidation reductions to this grant are equivalent to 8.3 per cent of the grant's baseline in 2021/22 and 9.1 per cent in 2022/23. This grant has been reduced by R500 million in 2020/21 and this amount has been set aside as a provisional allocation to fund disaster recovery projects during the same year.

Part 5: Local government fiscal framework and allocations

This section outlines the transfers made to local government and how these funds are distributed between municipalities. Funds raised by national government are transferred to municipalities through conditional and unconditional grants. National transfers to municipalities are published to enable them to plan fully for their 2020/21 budgets, and to promote better accountability and transparency by ensuring that all national allocations are included in municipal budgets.

Over the 2020 MTEF period, R426.4 billion will be transferred directly to local government and a further R23.4 billion has been allocated to indirect grants. Direct transfers to local government over the medium term account for 8.8 per cent of national government's non-interest expenditure. When indirect transfers are added to this, total spending on local government increases to 9.3 per cent of national non-interest expenditure.

Table W1.24 Transfers to local government

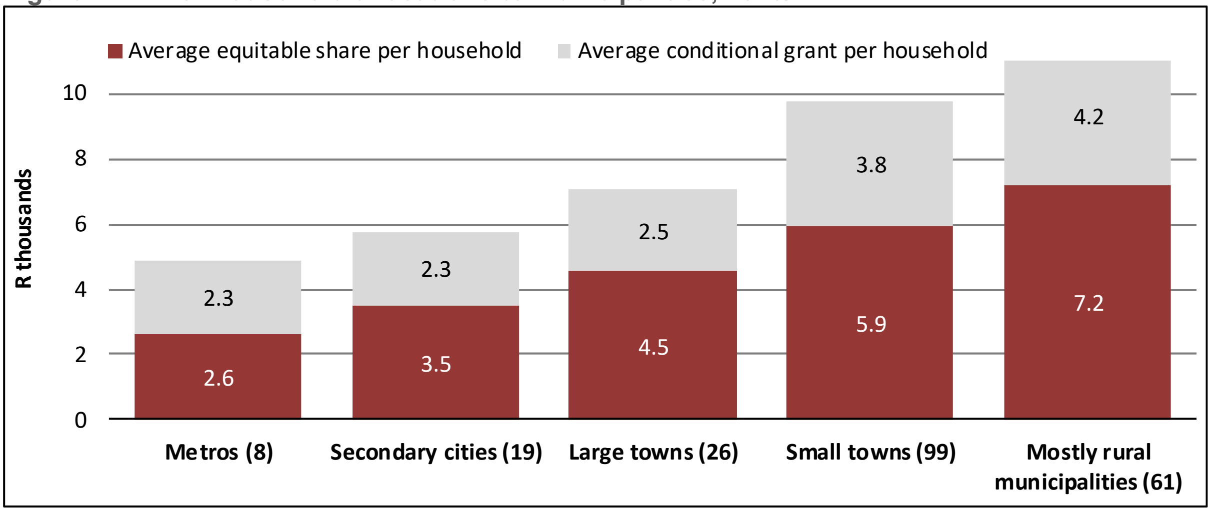
R million	2016/17	2017/18 Outcome	2018/19	2019/20 Adjusted budget	2020/21	2021/22 Medium-term estimates	2022/23
Direct transfers	**102 867**	**111 103**	**118 488**	**127 209**	**132 529**	**142 442**	**151 445**
Equitable share and related	**50 709**	**55 614**	**60 758**	**68 973**	**74 683**	**81 062**	**87 213**
Equitable share formula[1]	45 259	49 928	55 072	62 648	68 063	74 090	79 913
RSC levy replacement	4 567	4 795	4 795	5 357	5 652	5 963	6 249
Support for councillor remuneration and ward committees	883	891	891	969	969	1 009	1 051
General fuel levy sharing with metros	**11 224**	**11 785**	**12 469**	**13 167**	**14 027**	**15 182**	**16 085**
Conditional grants	**40 934**	**43 704**	**45 262**	**45 068**	**43 819**	**46 198**	**48 147**
Infrastructure	39 259	41 888	43 862	43 172	41 860	44 130	45 998
Capacity building and other	1 675	1 815	1 400	1 897	1 959	2 067	2 149
Indirect transfers	**8 112**	**7 803**	**7 770**	**7 024**	**7 628**	**7 229**	**8 161**
Infrastructure	8 093	7 699	7 699	6 913	7 500	7 093	8 020
Capacity building and other	19	103	71	111	128	135	140
Total	**110 979**	**118 905**	**126 258**	**134 233**	**140 157**	**149 671**	**159 605**

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

Source: National Treasury

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

Figure W1.2 Per household allocations to municipalities, 2020/21*



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

Source: National Treasury

Changes to local government allocations

Over the next three years, above-inflation growth in allocations to the local government equitable share continues, while growth in conditional grants is slower as a result of reductions announced in the 2019 MTBPS. As a result, total direct allocations to local government grow at an annual average rate of 6.6 per cent over the MTEF period.

The changes to each local government allocation are summarised in Table W1.25.

Table W1.25 Revisions to direct and indirect transfers to local government

R million	2020/21	2021/22	2022/23	2020 MTEF Total revisions
Technical adjustments	**–**	**–**	**–**	**–**
Direct transfers	**-330**	**-60**	**-70**	**-460**
Municipal infrastructure	-206	-52	-57	-316
Urban settlements development	2 835	–	–	2 835
Integrated urban development	56	52	57	166
Neighbourhood development partnership	-30	-60	-70	-160
Informal settlements upgrading partnership	-2 985	–	–	-2 985
Indirect transfers	**330**	**60**	**70**	**460**
Neighbourhood development partnership	30	60	70	160
Regional bulk infrastructure	400	–	–	400
Water services infrastructure	-100	–	–	-100
Additions to baselines	**250**	**–**	**–**	**250**
Indirect transfers	**250**	**–**	**–**	**250**
Regional bulk infrastructure	250	–	–	250
Reductions to baselines	**-5 083**	**-7 823**	**-8 262**	**-21 168**
Direct transfers	**-5 022**	**-6 996**	**-7 982**	**-20 001**
Local government equitable share	**-1 000**	**-1 100**	**-1 100**	**-3 200**
Local government equitable share	-1 000	-1 100	-1 100	-3 200
Conditional grants	**-4 022**	**-5 896**	**-6 882**	**-16 801**
Municipal infrastructure	-783	-842	-882	-2 506
Water services infrastructure	-426	-541	-698	-1 665
Urban settlements development	-1 270	-1 968	-2 554	-5 793
Integrated national electrification programme	-119	-128	-134	-380
Integrated urban development	-47	-51	-53	-151
Public transport network	-1 049	-1 570	-1 727	-4 347
Neighbourhood development partnership	-65	-77	-81	-224
Integrated city development	-10	-11	-11	-31
Rural roads asset management systems	-12	-13	-13	-38
Informal settlements upgrading partnership	–	-438	-459	-898
Regional bulk infrastructure	-174	-187	-196	-558
Energy efficiency and demand-side management	-22	-23	-24	-68
Local government financial management	-17	-18	-19	-53
Expanded public works programme	-23	-24	-26	-73
Infrastructure skills development	-5	-5	-5	-15
Indirect transfers	**-61**	**-826**	**-279**	**-1 167**
Integrated national electrification programme	-61	-826	-279	-1 167
Total change to local government allocations				
Change to direct transfers	-5 352	-7 056	-8 052	-20 461
Change to indirect transfers	519	-766	-209	-457
Net change to local government allocations	**-4 833**	**-7 823**	**-8 262**	**-20 918**

Source: National Treasury

Technical adjustments in Table W1.25 summarise the shifting of funds between different local government allocations, but do not change the total amount allocated to local government. These changes to the grants include the shifting of:

- R400 million in 2020/21 from the *municipal infrastructure grant*, the *water services infrastructure grant* and the *urban settlements development grant* to the indirect *regional bulk infrastructure grant* to assist in funding the rehabilitation of wastewater treatment infrastructure in the Vaal River System.
- R160 million from the direct *neighbourhood development partnership grant* to the indirect component of the grant over the MTEF period.
- R3 billion that had been indicatively allocated to the new *informal settlement upgrading partnership grant* in 2020/21. This amount is shifted back to the *urban settlements development grant* following the decision to extend the informal settlements window within this grant for another year.
- R166 million over the 2020 MTEF period from the *municipal infrastructure grant* to the *integrated urban development grant* for the entry of one additional municipality into the grant.

In addition to funds shifted from other local government grants, R250 million has been added to the indirect *regional bulk infrastructure grant* in 2020/21 to assist with addressing pollution in the Vaal River System. These funds were reprioritised from allocations in other spheres of government.

The local government equitable share is reduced by R3.2 billion over the 2020 MTEF period as part of the fiscal consolidation measures announced in the 2019 MTBPS. The reductions in 2020/21 and 2021/22 eliminate the unallocated funds set aside in the equitable share to provide for possible higher increases in bulk costs. As a result, these reductions will not affect the indicative allocations for individual municipalities.

Reductions to local government conditional grants, due to fiscal consolidation measures announced in the 2019 MTBPS, were determined taking account of the factors described in Part 2 of this annexure. These reductions to direct conditional grants to local government total R16.8 billion over the 2020 MTEF period. Indirect grants to local government have been reduced by R1.2 billion over the medium term, through a reduction to the indirect *integrated national electrification programme grant*. The details are discussed later under individual grants.

The local government equitable share

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

In the process of determining the baseline for the outer year (2022/23) of the 2020 MTEF period, the local government equitable share allocation has grown by 7.6 per cent, well above the standard 4.8 per cent baseline increase. The difference is equivalent to an amount of R2.2 billion in that year. This should cover the anticipated increase in the costs of providing free basic services to a growing number of households, and accounts for likely above-inflation increases in the costs of bulk water and electricity. It will also allow for above-inflation increases in allocations to poorer and rural municipalities through the redistributive components of the equitable share formula.

Over the 2020 MTEF period, the local government equitable share, including the Regional Service Council/Joint Service Board (*RSC/JSB) levies replacement grant* and *special support for councillor remuneration and ward committees grant,* amounts to R243 billion (R74.7 billion in 2020/21, R81.1 billion in 2021/22 and R87.2 billion in 2022/23). Due to previous increases, as well as the revised baseline for 2022/23, the local government equitable share grows at an average annual rate of 8.1 per cent over the MTEF period.

Formula for allocating the local government equitable share

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

Structure of the local government equitable share formula

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

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

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

Structure of the local government equitable share formula

LGES = BS + (I + CS)xRA ± C

where

LGES is the local government equitable share

BS is the basic services component

I is the institutional component

CS is the community services component

RA is the revenue adjustment factor

C is the correction and stabilisation factor

The basic services component

This component helps municipalities provide free basic water, sanitation, electricity and refuse removal services to households that fall below an affordability threshold. Following municipal consultation, the formula's affordability measure (used to determine how many households need free basic services) is based on the level of two state old age pensions. When the 2011 Census was conducted, the state old age pension was worth R1 140 per month, which means that two pensions were worth R2 280 per month. A monthly household income of R2 300 per month in 2011 has therefore been used to define the formula's affordability threshold. Statistics South Africa has calculated that 59 per cent of all households in South Africa fall below this income threshold. However, the proportion in each municipality varies widely. In 2020 terms, this monthly income is equivalent to about R3 700 per month. This threshold is not an official poverty line or a required level to be used by municipalities in their own indigence policies. If municipalities choose to provide fewer households with free basic services than they are funded for through the local government equitable share, then their budget documentation should clearly set out why they have made this choice and how they have consulted with their community during the budget process.

The number of households per municipality, and the number below the poverty threshold, is updated annually. The number of households per municipality used to calculate indicative allocations for the outer years of the MTEF period is updated based on the growth experienced between the 2001 Census and the 2016 Community Survey. Provincial growth rates are then rebalanced to match the average annual provincial growth reported between 2002 and 2018 in the annual General Household Survey. Statistics South Africa has advised the National Treasury that, in the absence of official municipal household estimates, this is a credible method of estimating the household numbers per municipality needed for the formula. Statistics South Africa is researching methods for producing municipal-level data estimates, which may be used to inform equitable share allocations in future.

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

The basic services subsidy is typically allocated to 100 per cent of households that fall below the poverty threshold. This is the case in 2020/21 and 2021/22. In 2022/23, the subsidy is allocated to 99.4 per cent of households below the poverty threshold to ensure that the effect of the reduction in that year is spread across all the components of the formula. The number of households that receive free basic services should not be affected because municipalities have not yet extended the provision of free basic services to reach all poor households. The basic services subsidy will fund:

- 10.4 million households in 2020/21.
- 10.6 million households in 2021/22.
- 10.8 million households in 2022/23.

The basic services component provides a subsidy of R435.04 per month in 2020/21 for the cost of providing basic services to each of these households. The subsidy includes funding for the provision of free basic water (six kilolitres per poor household per month), energy (50 kilowatt-hours per month) and sanitation and refuse removal (based on service levels defined by national policy). The monthly amount provided for each service is detailed in Table W1.26 and includes an allocation of 10 per cent for service maintenance costs.

Table W1.26 Amounts per basic service allocated through the local government equitable share, 2020/21

	Allocation per household below affordability threshold (R per month)			Total allocation per service (R million)
	Operations	Maintenance	Total	
Energy	84.30	9.37	93.66	11 645
Water	130.38	14.49	144.86	18 011
Sanitation	96.21	10.69	106.90	13 290
Refuse removal	80.65	8.96	89.61	11 141
Total basic services	**391.53**	**43.50**	**435.04**	**54 087**

Source: National Treasury

The formula uses the fairest estimates of the average costs of providing each service that could be derived from available information. More details of how the costs were estimated can be found in the discussion paper on the proposed structure of the new local government equitable share formula, available on the National Treasury website. The per-household allocation for each of the basic services in Table W1.26 is updated annually based on the following factors.

The electricity cost estimate is made up of bulk and other costs. Bulk costs are updated based on the bulk price determination approved by the National Energy Regulator of South Africa. In March 2019, the regulator approved tariff increases of 9.4 per cent in 2019/20, 8.1 per cent in 2020/21 and 5.2 per cent in 2021/22. However, Eskom submitted an application to the court to increase the bulk tariffs. While the court has found merit in Eskom's case, it has ruled that the matter is not urgent. The court will only rule on the merits of the case after the 2020 Budget has been tabled. Due to uncertainty about the exact tariffs for the municipal financial years (which are different to those for national financial years) and the pending court decision, the equitable share formula continues to use the 8 per cent bulk tariff increase in 2020/21 and 2021/22 that was used when the baselines for these years were calculated in the 2018 and 2019 MTEF periods. The electricity cost estimate for 2022/23 is calculated using an electricity price bulk increase of 8.9 per cent, which is the average annual tariff increase for the National Energy Regulator of South Africa's multi-year price determination period of 1 April 2019 to 31 March 2022. Other (non-bulk) electricity costs are updated based on the National Treasury's inflation projections in the 2019 MTBPS.

The water cost estimate is also made up of bulk and other costs. Bulk costs are updated based on the average increase in bulk tariffs charged by water boards (although not all municipalities purchase bulk water from water boards, their price increases serve as a proxy for the cost increases for all municipalities). The average tariff increases for bulk water from water boards in 2019/20 was 10.4 per cent. Other costs are updated based on the National Treasury's inflation projections in the 2019 MTBPS.

The costs for sanitation and refuse removal are updated based on the National Treasury's inflation projections in the 2019 MTBPS.

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

The basic services component

BS = basic services subsidy x number of poor households

Funding for each basic service is allocated to the municipality (metro, district or local) that is authorised to provide that service. If another municipality provides a service on behalf of the authorised municipality, it must transfer funds to the provider in terms of section 29 of the Division of Revenue Act. The basic services component is worth R54.1 billion in 2020/21 and accounts for 79.5 per cent of the value of the local government equitable share formula allocation.

The institutional component

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

In 2020/21, this component consists of a base allocation of R7.4 million, which goes to every municipality, and an additional amount that is based on the number of council seats in each municipality. This reflects the relative size of a municipality's administration and is not intended to fund the costs of councillors only (the Minister of Cooperative Governance and Traditional Affairs determines the number of seats recognised for the formula). The base allocation acknowledges that there are some fixed costs that all municipalities face.

The institutional component

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

The institutional component accounts for 8.2 per cent of the equitable share formula and is worth R5.6 billion in 2020/21. This component is also complemented by special support for councillor remuneration in poor municipalities, which is not part of the equitable share formula.

The community services component

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

The allocation for this component is split between district and local municipalities, which both provide community services. In 2020/21, the allocation to district and metropolitan municipalities for municipal health and other services is R10.39 per household per month. The component's remaining funds are allocated to local and metropolitan municipalities based on the number of households in each municipality.

The community services component

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

The community services component accounts for 12.3 per cent of the equitable share formula and is worth R8.4 billion in 2020/21.

The revenue adjustment factor

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

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

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

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

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

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

Correction and stabilisation factor

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

Ensuring the formula balances

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

Details of new allocations

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

Other unconditional allocations

RSC/JSB levies replacement grant

Before 2006, district municipalities raised levies on local businesses through a Regional Services Council (RSC) or Joint Services Board (JSB) levy. This source of revenue was replaced in 2006/07 with the *RSC/JSB levies replacement grant*, which was allocated to all district and metropolitan municipalities based on the amounts they had previously collected through the levies. The *RSC/JSB levies replacement grant* for metropolitan municipalities has since been replaced by the sharing of the general fuel levy. The *RSC/JSB levies replacement grant*'s value increases every year.

In 2020/21, the grant increases by 7.2 per cent for district municipalities authorised for water and sanitation and 2.4 per cent for unauthorised district municipalities. The different rates recognise the various service-delivery responsibilities of these district municipalities.

Special support for councillor remuneration and ward committees

Councillors' salaries are subsidised in poor municipalities. The total value of the support provided in 2020/21 is R969 million, calculated separately to the local government equitable share and in addition to the funding for governance costs provided in the institutional component. The level of support for each municipality is allocated based on a system gazetted by the Minister of Cooperative Governance and Traditional Affairs, which classifies municipal councils into six grades based on their total income and population size. Special support is provided to the lowest three grades of municipal councils (the smallest and poorest municipalities).

The Minister of Cooperative Governance and Traditional Affairs last gazetted a notice on the determination of upper limits of salaries in December 2018. This is due to an ongoing review of wages which has resulted in a wage freeze for 2020/21. Using this last notice for maximum remuneration for part-time councillors, cost savings of R46 million are realised in 2020/21, with savings of R55 million carried through in 2021/22 and R63 million in 2022/23. A total of R164 million over the 2020 MTEF period is therefore shifted from support for councillor remuneration and ward committees to the local government equitable share formula.

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

Conditional grants to local government

National government allocates funds to local government through a variety of conditional grants. These grants fall into two main groups: infrastructure and capacity building. The total value of conditional grants directly transferred to local government increases from R43.8 billion in 2020/21 to R46.2 billion in 2021/22 and R48.1 billion in 2022/23.

There are four types of local government conditional grants:

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

Infrastructure conditional grants to local government

National transfers for infrastructure, including indirect or in-kind allocations to entities executing specific projects in municipalities, amount to R155 billion over the 2020 MTEF period.

Table W1.27 Infrastructure grants to local government

R million	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
		Outcome		Adjusted budget		Medium-term estimates	
Direct transfers	**39 259**	**41 888**	**43 862**	**43 172**	**41 860**	**44 130**	**45 998**
Municipal infrastructure	14 914	15 891	15 288	14 816	14 671	15 937	16 852
Integrated urban development	–	–	–	857	948	1 015	1 075
Urban settlements development	10 839	11 382	11 306	12 045	11 282	7 405	7 352
Informal settlements upgrading partnership	–	–	–	–	–	3 945	4 181
Integrated city development	267	292	294	310	317	341	361
Public transport network	5 593	6 107	6 287	6 468	6 446	6 797	7 119
Neighbourhood development partnership	592	658	569	602	559	567	593
Integrated national electrification programme	1 946	2 087	1 904	1 863	1 859	2 003	2 119
Rural roads asset management systems	102	107	108	114	108	114	121
Regional bulk infrastructure	1 850	1 829	1 963	2 066	2 006	2 156	2 281
Water services infrastructure	2 831	3 305	4 777	3 669	3 445	3 620	3 701
Municipal disaster recovery	140	26	1 151	133	–	–	–
Energy efficiency and demand-side management	186	203	215	227	218	230	243
Indirect transfers	**8 093**	**7 699**	**7 699**	**6 913**	**7 500**	**7 093**	**8 020**
Integrated national electrification programme	3 526	3 846	3 846	3 124	3 001	2 994	3 688
Neighbourhood development partnership	15	28	28	50	63	95	106
Water services infrastructure	298	852	852	644	579	730	771
Regional bulk infrastructure	3 422	2 974	2 974	3 094	3 857	3 275	3 455
Bucket eradication	831	–	–	–	–	–	–
Total	**47 352**	**49 588**	**51 561**	**50 085**	**49 360**	**51 224**	**54 018**

Source: National Treasury

Municipal infrastructure grant

The largest infrastructure transfer to municipalities is made through the *municipal infrastructure grant*, which supports government’s aim to expand service delivery and alleviate poverty. The grant funds the provision of infrastructure for basic services, roads and social infrastructure for poor households in all non-metropolitan municipalities. The grant’s baseline is reduced by R783 million in 2020/21, R842 million in 2021/22 and R882 million in 2022/23. The fiscal consolidation reductions to this grant are equivalent to 5 per cent of the grant’s baseline in 2020/21, 5 per cent in 2021/22 and 5 per cent in 2022/23. These reductions do not include an amount of R166 million shifted to the *integrated urban development grant* over the 2020 MTEF period, following approval for Steve Tshwete Local Municipality to participate in the programme from 2020/21. In 2020/21, R150 million is reprioritised from this grant to the indirect *regional bulk infrastructure grant* for the Vaal River system intervention. The total allocations for this grant amount to R47.5 billion over the 2020 MTEF period and grow at an average annual rate of 4.3 per cent.

The *municipal infrastructure grant* is allocated through a formula with a vertical and horizontal division. The vertical division allocates resources between sectors and the horizontal division takes account of poverty, backlogs and municipal powers and functions in allocating funds to municipalities. The five main components of the formula are described in the box below.

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

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

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

P Public municipal service infrastructure (including sport infrastructure)

E Allocation for social institutions and micro-enterprise infrastructure

N Allocation to the 27 priority districts identified by government

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

Data used in the municipal infrastructure grant formula

Component	Indicator used in the formula	Data used (all data is from the 2011 Census)
B	Number of water backlogs	Number of poor households[1] that do not have adequate access to water (adequate access defined as piped water either inside their dwelling, in the yard or within 200 metres of their dwelling)
	Number of sanitation backlogs	Number of poor households that do not have adequate access to sanitation (adequate access defined as having a flush toilet, chemical toilet, pit toilet with ventilation or ecological toilet)
	Number of roads backlogs	Number of poor households
	Number of other backlogs	Number of poor households that do not have access to refuse disposal at Reconstruction and Development Programme levels of service
P	Number of poor households	Number of poor households
E	Number of poor households	Number of poor households
N	Number of households in nodal areas	Allocated to the 27 priority districts identified by Cabinet as having large backlogs. Allocation is based on total households (not poor households)

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

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

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

Table W1.28 Municipal infrastructure grant allocations per sector

Municipal infrastructure grant (formula)	Component weights	Value of component 2020/21 (R million)	Proportion of municipal infrastructure grant per sector
B-component	**75.0%**	**9 966**	**67.9%**
Water and sanitation	72.0%	7 176	48.9%
Roads	23.0%	2 292	15.6%
Other	5.0%	498	3.4%
P-component	**15.0%**	**1 993**	**13.6%**
Sports	33.0%	658	4.5%
E-component	**5.0%**	**664**	**4.5%**
N-component	**5.0%**	**664**	**4.5%**
Constant		**1 130**	**7.7%**
Ring-fenced funding for sport infrastructure		**253**	**1.7%**
Total		**14 671**	**100.0%**

Source: National Treasury

The *municipal infrastructure grant* includes an amount allocated outside of the grant formula and earmarked for specific sport infrastructure projects identified by the Department of Sports, Arts and Culture. These earmarked funds amount to R759 million over the MTEF period (R253 million in each year of the 2020 MTEF period). In addition, municipalities are required to spend a third of the P-component (equivalent to 4.5 per cent of the grant) on sport and recreation infrastructure identified in their own integrated development plans. Municipalities are also encouraged to increase their investment in other community infrastructure, including cemeteries, community centres, taxi ranks and marketplaces.

Integrated urban development grant

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

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

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

Municipalities must meet certain criteria and apply to receive the *integrated urban development grant* instead of the *municipal infrastructure grant in* terms of a process set out in section 27(5) of the Division of Revenue Act. The qualification criteria cover the following areas:

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

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

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

Performance-based component weighted indicators for integrated urban development grant

Indicator	Purpose	Weight	Scores
1. Non-grant capital as a percentage of total capital expenditure	Encourages cities to increase their capital investment funded through own revenue and borrowing	40%	1 if 70% or higher 0 if 30% or lower Linear scale in between
2. Repairs and maintenance expenditure as percentage of operating expenditure	Rewards cities that take good care of their existing asset base	30%	1 if 8% or higher
3. Asset management plan	Must have a plan in place, has been approved by municipal council and updated in the last three years	30%	1 if yes for all three 0 if no for any of the three
4. Land-use applications in priority areas 5. Building plan applications in priority areas	Due to the lack of available data, these indicators, which are intended to reward spatial targeting of investment, remain dormant in 2020/21	0%	1 if 50% or higher 0 if 10% or lower Linear scale in between

The allocations for the *integrated urban development grant* are R948 million in 2020/21, R1 billion in 2021/22 and R1.1 billion in 2022/23. These allocations include additions of R56 million in 2020/21, R52 million in 2021/22 and R57 million in 2022/23, following the addition of Steve Tshwete Local Municipality to the pool of municipalities participating in the grant. The allocations for 2020/21 include R15 million in funds ring-fenced for sports infrastructure projects. These funds were shifted from the *municipal infrastructure grant*. The fiscal consolidation reductions to this grant are equivalent to 5 per cent of the grant's baseline in 2020/21, 5 per cent in 2021/22 and 5 per cent in 2022/23.

Table W1.29 Formula for integrated urban development grant incentive component

	Planning allocation (R 000)	Perfomance incentive						Total for incentive and planning (R 000)
		Non-grant capital as percentage of total capital spend	Maintenance spend	Asset management plan	Land use and building plans in priority areas	Weighted score	Total incentive (R 000)	
uMhlathuze	3 183	80%	7%	No	–	65%	52 680	55 863
Drakenstein	1 048	76%	5%	Yes	–	85%	22 678	23 725
Mogale City	3 488	14%	2%	No	–	0%	–	3 488
Polokwane	10 222	21%	2%	No	–	0%	–	10 222
Ray Nkonyeni	1 834	22%	3%	No	–	5%	2 335	4 170
Sol Plaatje	1 484	15%	2%	No	–	0%	–	1 484
Stellenbosch	1 067	79%	1%	No	–	40%	10 865	11 932
Steve Tshwete	1 782	74%	1%	Yes	–	70%	31 761	33 543
Total	**24 108**						**120 319**	**144 428**

Source: Department of Cooperative Governance

Urban settlements development grant

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

As discussed under the *human settlements development grant* in Part 4, a new component was introduced in 2019/20 for the upgrading of informal settlements. It sets a minimum amount each city must spend on informal settlement upgrades and requires cities to work in partnership with communities. The component has been extended for one more year, to 2020/21, and amounts to 20 per cent of the *urban settlements development grant.* The extension of this component serves as a planning and preparatory platform for a new *informal settlements upgrading partnership grant*, planned for 2021/22. Provided the component is a success, the new grant will be created through the reprioritisation of funds from the *urban settlements development grant.* Initial amounts of R3.9 billion in 2021/22 and R4.2 billion in 2022/23 have been set aside for this new grant in the outer years of the MTEF period. Further details on the new grant are discussed in Part 6.

The *urban settlements development grant*, including allocations for the new *informal settlements upgrading partnership grant*, is allocated R34.2 billion over the medium term. The allocation per municipality is based on the *municipal infrastructure grant* formula. Up to 3 per cent of the grant may be used to fund municipal capacity in the built environment in line with the Department of Human Settlements' capacity-building guideline. Because this grant has been previously reduced by a smaller proportion than the *municipal infrastructure grant*, the *urban settlements development grant* is reduced by R1.3 billion in 2020/21, R2 billion in 2021/22 and R2.7 billion in 2022/23 in order to fund other government priorities. The fiscal consolidation reductions to the *urban settlements development grant* are equivalent to 13.1 per cent of the grant's baseline in 2020/21, 21 per cent in 2021/22 and 25.8 per cent in 2022/23. Reductions to the *informal* *settlement upgrading partnership grant* are equivalent to 10 per cent of the grant's baseline in 2021/22, and 9.9 per cent in 2022/23. In 2020/21 R150 million is reprioritised from the *urban settlements development grant* to the indirect *regional bulk infrastructure grant* for the Vaal River system intervention.

Integrated city development grant

The 2019 MTBPS announced that, subject to certain conditions, programme and project preparation funding would be provided to metros through the grant system. Following consultations with cities, including through the City Budget Forum and a workshop, it has been agreed that cities will be able to use at least half of their *integrated city development grant* allocations for programme and project preparation activities in 2020/21. The remaining allocations from this grant can be used to complete planned investments funded from the grant, so that the full grant amount can be allocated to programme and project preparation activities from 2021/22.

In order to be eligible to use these funds for project preparation costs, metros will need to:

- Submit a letter to the National Treasury indicating their commitment to establishing and institutionalising an effective system of programme and project preparation.
- Prove they have not had an adverse or disclaimed audit opinion in the last two financial years.
- Have formally adopted council resolutions on adopting the Cities Infrastructure Delivery and Management Systems guidelines, establishing a programme and project approval committee, and committing to co-financing contributions and budget management arrangements.

Total allocations over the 2020 MTEF period amount to R1 billion and grow at an average annual rate of 5.2 per cent. The fiscal consolidation reductions to this grant are equivalent to 3 per cent of the grant's baseline in 2020/21, 3 per cent in 2021/22 and 3 per cent in 2022/23.

Public transport network grant

The *public transport network grant*, administered by the Department of Transport, helps cities create or improve public transport systems in line with the National Land Transport Act (2009) and the Public Transport Strategy. This includes all integrated public transport network infrastructure, such as bus rapid transit systems, conventional bus services, and pedestrian and cycling infrastructure. The grant also subsidises the operation of these services. It is allocated R20.4 billion over the medium term. The grant has been reduced by R1 billion in 2020/21, R1.6 billion in 2021/22 and R1.7 billion in 2022/23. These fiscal consolidation reductions to this grant are equivalent to 14 per cent of the grant's baseline in 2020/21, 18.8 per cent in 2021/22 and 19.5 per cent in 2022/23.

Of the 13 cities that have been receiving the grant, three have been in the planning phase since the introduction of the grant in the 2006 MTEF period. These three cities have been suspended from the grant for the 2020 MTEF period, but this should have a minimal impact on service delivery because the cities were not transporting any passengers through this grant. The suspended cities are Buffalo City, Mbombela and Msunduzi.

Despite support provided by the national Department of Transport, the cities of Cape Town, Johannesburg and eThekwini have not been able to scale up rollout to levels that justify their baseline allocations. As a result, the department proposed reductions to their allocations, based on performance and the ability of the cities to cover the shortfall from own revenue.

The allocations for this grant are determined through a formula, which determines 95 per cent of the allocations, and a performance-based incentive component introduced in 2019/20, which accounts for the remaining 5 per cent. The formula increases certainty about the extent of national funding that municipalities can expect when planning their public transport networks, and encourages cities to make more sustainable public transport investments.

To qualify for an allocation from the performance incentive, a city must have an operational municipal public transport system approved by the national Department of Transport and it must have spent more than 80 per cent of its grant allocation in the previous financial year. Incentive allocations are then calculated based on the coverage of costs from fares, passenger trips and the city's own financial commitment to the system. Cities must exceed the minimum threshold in at least one of these three indicators. The calculation of the performance incentive allocations for 2020/21 is set out in Table W1.30 below. The raw scores for the cities are weighted using the sum of the base and formula components to account for the size of the city.

Table W1.30 Public transport network grant incentive

	Oper-ational public transport system	Grant spent in 2018/19	Eligible for incentive	Coverage of direct costs from farebox	Average weekday passenger trips (% of population)	City's contri-bution (% of property rates)	Raw scores for incentive	Incentive allocation for 2020/21 (R 000)
Minimum threshold	**Yes**	**80%**		**35.0%**	**1.00%**	**2%**		
Buffalo City	No	99%	No	0.0%	0.00%	0.0%	–	–
City of Cape Town	Yes	89%	Yes	41.6%	1.61%	6.3%	0.466	201 785
City of Johannesburg	Yes	86%	Yes	35.2%	1.13%	3.9%	0.063	37 062
City of Tshwane	Yes	100%	Yes	29.9%	0.15%	1.6%	–	–
Ekurhuleni	Yes	76%	No	0.0%	0.00%	0.0%	–	–
eThekwini	No	63%	No	0.0%	0.00%	0.0%	–	–
George	Yes	99%	Yes	34.3%	6.20%	8.9%	0.461	29 513
Mangaung	No	75%	No	0.0%	0.00%	0.0%	–	–
Mbombela	No	100%	No	0.0%	0.00%	0.0%	–	–
Msunduzi	No	100%	No	0.0%	0.00%	0.0%	–	–
Nelson Mandela Bay	Yes	94%	Yes	27.5%	0.80%	2.4%	0.010	1 683
Polokwane	No	69%	No	0.0%	0.00%	0.0%	–	–
Rustenburg	No	79%	No	0.0%	0.00%	0.0%	–	–
Total							**1.000**	**270 043**

Source: National Treasury

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

Table W1.31 sets out how the final allocation for each municipality is determined, taking account of both the formula and incentive components.

Table W1.31 Formula for the public transport network grant

	Base 20%	Demand-driven factors 75%			Subtotal: base and demand driven factors	Perfomance 5%	Fiscal consolidation reductions	100%
	Equally shared	Population compo-nent shares	Regional gross value added compo-nent shares	Public transport users compo-nent shares		Incentive compo-nent (R 000)		Grant allocations [1] (R 000)
Buffalo City[2]	7.7%	3.3%	2.8%	3.1%	3.8%	–	-247 346	–
City of Cape Town	7.7%	16.3%	15.8%	13.9%	13.0%	201 785	-97 766	944 974
City of Johannesburg	7.7%	19.3%	25.2%	20.5%	17.8%	37 062	-133 451	1 051 518
City of Tshwane	7.7%	12.7%	15.0%	14.0%	12.0%	–	–	771 954
Ekurhuleni	7.7%	13.8%	9.5%	14.9%	11.1%	–	–	716 466
eThekwini	7.7%	15.0%	15.8%	18.0%	13.7%	–	-103 087	783 643
George	7.7%	0.8%	0.5%	0.2%	1.9%	29 513	–	153 645
Mangaung	7.7%	3.3%	2.4%	3.2%	3.8%	–	–	242 210
Mbombela[2]	7.7%	2.6%	1.9%	2.4%	3.3%	–	-209 848	–
Msunduzi[2]	7.7%	2.7%	1.5%	2.4%	3.2%	–	-205 360	–
Nelson Mandela Bay	7.7%	5.0%	4.7%	3.6%	4.9%	1 683	–	316 207
Polokwane	7.7%	2.7%	1.5%	1.3%	2.9%	–	–	189 292
Rustenburg	7.7%	2.4%	3.5%	2.3%	3.6%	–	–	230 939
Unallocated incentive						–	-52 466	–
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**95.0%**	**270 043**	**-1 049 324**	**5 400 848**

1. Excludes additional funds for Cape Town allocated through the Budget Facility for Infrastructure
2. These three cities are suspended from the grant
Source: National Treasury

In addition to the formula and performance incentive, R4 billion is allocated through the *public transport network grant* over the medium term for the City of Cape Town's MyCiti public transport network, approved through the Budget Facility for Infrastructure. The facility seeks to support quality public investments through robust project appraisal, effective project development and execution, and sustainable financing arrangements. The process includes engaging with relevant stakeholders, the National Treasury and the Presidential Infrastructure Coordinating Commission. This additional amount will fund a new public transport corridor for the MyCiti network, linking the underserved areas of Khayelitsha and Mitchells Plain to the city centre.

Neighbourhood development partnership grant

The *neighbourhood development partnership grant* supports municipalities in developing and implementing urban network plans. The grant funds the upgrading of identified precincts in order to stimulate third-party public and private investment. In metropolitan municipalities, the focus is on upgrading urban hubs in townships. The National Treasury, in collaboration with other stakeholders, including the Department of Agriculture, Rural Development and Land Reform and the Department of Cooperative Governance, has identified a cohort of non-metropolitan municipalities to implement new projects as part of this grant. The National Treasury will be partnering with these municipalities to identify, plan and implement infrastructure upgrades in targeted urban hub precincts. The allocations for this grant in the 2020 MTEF period amount to R2 billion, made up of R1.7 billion for the direct capital component and R263 million for the indirect technical assistance component. An amount of R160 million, consisting of R30 million in 2020/21, R60 million in 2021/22 and R70 million in 2022/23, has been shifted from the direct component to the indirect component. The fiscal consolidation reductions to this grant are equivalent to 10 per cent of the grant's baseline in 2020/21, 11 per cent in 2021/22 and 10.9 per cent in 2022/23.

Water services infrastructure grant

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

The direct component of this grant is reduced by R426 million in 2020/21, R541 million in 2021/22 and R698 million in 2022/23. Although these reductions mean that the implementation of some projects will be delayed, they will not negatively impact water augmentation projects in drought-affected municipalities. This component of the grant has a total allocation of R10.8 billion over the 2020 MTEF period. The fiscal consolidation reductions to this grant are equivalent to 11 per cent of the grant's baseline in 2020/21, 13 per cent in 2021/22 and 15.9 per cent in 2022/23.

The indirect component of this grant is reduced by R100 million in 2020/21, with a total allocation of R2.1 billion over the medium term. Of this amount, R106 million is allocated to municipalities in the Free State and Northern Cape to complete outstanding bucket eradication projects and R181 million is allocated for drought relief projects.

Regional bulk infrastructure grant

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

The direct component of this grant is reduced by R174 million in 2020/21, R187 million in 2021/22 and R196 million in 2022/23. An amount of R650 million is added to the indirect component of this grant to accelerate the implementation of repairs to the sewerage system in Emfuleni Local Municipality, which is currently spilling raw sewage into the Vaal River, and a further R100 million is reprioritised within the grant for the Vaal River intervention. This component also includes R241 million for the completion of bucket eradication projects. The fiscal consolidation reductions for this grant are equivalent to 8 per cent of the grant's baseline in 2020/21, 8 per cent in 2021/22 and 7.9 per cent in 2022/23.

The grant has a total allocation of R17 billion over the medium term, consisting of R6.4 billion and R10.6 billion for the direct and indirect components respectively.

Integrated national electrification programme grants

These grants aim to provide capital subsidies to municipalities to provide electricity to poor households and fund bulk infrastructure to ensure a constant supply of electricity. Allocations are based on the backlog of households without electricity and administered by the Department of Mineral Resources and Energy. The grant only funds bulk infrastructure that serves poor households. The national electrification programme has helped provide 91 per cent of all poor households with access to electricity, as reported in the 2016 Community Survey (up from the 85 per cent reported in the 2011 Census). To sustain this progress, government will spend R15.7 billion on the programme over the next three years.

The *integrated national electrification programme (municipal) grant* is reduced by R119 million in 2020/21, R128 million in 2021/22 and R134 million in 2022/23. It has a total allocation of R6 billion over the medium term and grows at an average annual rate of 4.4 per cent. The fiscal consolidation reductions to this grant are equivalent to 6 per cent of the grant's baseline in 2020/21, 6 per cent in 2021/22 and 5.9 per cent in 2022/23.

The *integrated national electrification programme (Eskom) grant* is allocated R9.7 billion over the medium term and grows at an average annual rate of 5.7 per cent. It is reduced by R61 million in 2020/21, R826 million in 2021/22 and R279 million in 2022/23 to fund other government priorities. The reductions to this grant are equivalent to 2 per cent of the grant's baseline in 2020/21, 21.6 per cent in 2021/22 and 7 per cent in 2022/23.

Energy efficiency and demand-side management grant

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

This approach will also allow municipalities to benefit from donor financing. A Guarantee Fund from the Nationally Appropriated Mitigation Action Facility has been jointly established with funding from the German and United Kingdom governments to help private energy service companies obtain loans to implement the Energy Efficiency in Public Infrastructure and Building Programme. The programme will have significant long-term effects on energy savings, carbon emissions and the market for energy-efficient technologies. The grant is allocated R691 million over the medium term. The fiscal consolidation reductions to this grant are equivalent to 9 per cent of the grant's baseline in 2020/21, 9 per cent in 2021/22 and 8.9 per cent in 2022/23.

Rural roads asset management systems grant

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

The Department of Transport will continue to work with the *municipal infrastructure grant* administrators to ensure that municipal roads projects are chosen, prioritised and approved using roads asset management systems data wherever possible. This grant is reduced by R12 million in 2020/21, R13 million in 2021/22 and R13 million in 2022/23 to fund other government priorities. The grant is allocated R108 million in 2020/21, R114 million in 2021/22 and R121 million in 2022/23. The fiscal consolidation reductions to this grant are equivalent to 10 per cent of the grant's baseline in 2020/21, 10 per cent in 2021/22 and 9.9 per cent in 2022/23.

Capacity-building grants and other current transfers

Capacity-building grants help to develop municipalities' management, planning, technical, budgeting and financial management skills. Other current transfers include the *EPWP integrated grant for municipalities*, which promotes increased labour intensity in municipalities, and the *municipal disaster relief grant*. A total of R6.6 billion is allocated to capacity-building grants and other current transfers to local government over the medium term.

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

R million	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
		Outcome		Adjusted budget	Medium-term estimates		
Direct transfers	**1 675**	**1 815**	**1 400**	**1 897**	**1 959**	**2 067**	**2 149**
Municipal disaster relief	118	341	–	335	354	373	391
Municipal demarcation transition	297	140	–	–	–	–	–
Municipal systems improvement	–	–	23	–	–	–	–
Municipal emergency housing	–	–	38	149	159	168	175
Infrastructure skills development	130	141	141	149	153	162	168
Local government financial management	465	502	505	533	545	575	596
Expanded public works programme integrated grant for municipalities	664	691	693	730	748	790	819
Indirect transfers	**19**	**103**	**71**	**111**	**128**	**135**	**140**
Municipal systems improvement	19	103	71	111	128	135	140
Total	**1 695**	**1 919**	**1 470**	**2 008**	**2 087**	**2 203**	**2 289**

Source: National Treasury

Local government financial management grant

The *local government financial management grant*, managed by the National Treasury, funds the placement of financial management interns in municipalities and the modernisation of financial management systems. This includes building in-house municipal capacity to implement multi-year budgeting, linking integrated development plans to budgets, and producing quality and timely in-year and annual reports. The grant supports municipalities in the implementation of the Municipal Finance Management Act and provides funds for the implementation of the municipal standard chart of accounts.

This grant is reduced by R17 million in 2020/21, R18 million in 2021/22 and R19 million in 2022/23 to fund other government priorities. Total allocations amount to R1.7 billion over the MTEF period and grow at an average annual rate of 3.8 per cent. The fiscal consolidation reductions to this grant are equivalent to 3 per cent of the grant's baseline in 2020/21, 3 per cent in 2021/22 and 3 per cent in 2022/23.

Infrastructure skills development grant

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

This grant is reduced by R5 million in each year of the 2020 MTEF period. The grant's total allocations amount to R482 million over the 2020 MTEF period and grow at an average annual rate of 3.9 per cent. The fiscal consolidation reductions to this grant are equivalent to 3 per cent of the grant's baseline in 2020/21, 3 per cent in 2021/22 and 3 per cent in 2022/23.

Municipal systems improvement grant

The *municipal systems improvement grant* funds a range of projects in municipalities in support of the Back to Basics strategy, including helping municipalities set up adequate record management systems, drawing up organograms for municipalities and reviewing their appropriateness relative to their assigned functions, implementing the Integrated Urban Development Framework, and assisting municipalities with revenue collection plans and the implementation of the municipal standard chart of accounts. The Department of

Cooperative Governance implements the indirect grant. The grant's total allocations amount to R404 million over the 2020 MTEF period and grow at an average annual rate of 8.1 per cent.

EPWP integrated grant for municipalities

This grant promotes the use of labour-intensive methods in delivering municipal infrastructure and services. To determine eligibility for funding, municipalities must have reported performance on the EPWP, including performance in the infrastructure, social and environment and culture sectors and on the full-time equivalent jobs created in these sectors in the last 18 months. A formula then determines allocations on the basis of this performance as well as the labour intensity of the work opportunities created. The number of bands in which labour intensity are recorded in the formula have been expanded from seven to eight, providing an incentive for labour-intense projects to further increase their intensity. The formula is weighted to give larger allocations to rural municipalities. The grant's baseline is reduced by R23 million in 2020/21, R24 million in 2021/22 and R26 million in 2022/23. The impact of these reductions will be spread across municipalities in line with the grant's formula. The grant is allocated R2.4 billion over the MTEF period and grows at an average annual rate of 3.9 per cent. The fiscal consolidation reductions to this grant are equivalent to 3 per cent of the grant's baseline in 2020/21, 3 per cent in 2021/22 and 3 per cent in 2022/23.

Municipal disaster relief grant

The *municipal disaster relief grant* is administered by the National Disaster Management Centre in the Department of Cooperative Governance as an unallocated grant to local government. The centre is able to disburse disaster-response funds immediately, without the need for the transfers to be gazetted first. The grant supplements the resources local government would have already used in responding to disasters. To ensure that sufficient funds are available in the event of disasters, section 21 of the Division of Revenue Bill allows for funds allocated to the *provincial disaster relief grant* to be transferred to municipalities if funds in the municipal grant have already been exhausted, and vice versa. The bill also allows for more than one transfer to be made to areas affected by disasters, so that initial emergency aid can be provided before a full assessment of damages and costs is conducted. Over the MTEF period, R1.1 billion is available for disbursement through this grant. To ensure that sufficient funds are available for disaster relief, clause 20(6) of the Division of Revenue Bill allows funds from other conditional grants to be reallocated for this purpose, subject to the National Treasury's approval.

Municipal emergency housing grant

The *municipal emergency housing grant* is intended to enable the Department of Human Settlements to rapidly respond to emergencies by providing temporary housing and repairs in line with the Emergency Housing Programme. The grant is limited to funding emergency housing and repairs following the immediate aftermath of a disaster, and not the other emergency situations listed in the programme. Over the MTEF period, R502 million is available for disbursement through this grant.

Part 6: Future work on provincial and municipal fiscal frameworks

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

This part of the annexure describes the main areas of work to be undertaken during 2020/21 as part of the ongoing review and refinement of the intergovernmental fiscal framework. Provinces and municipalities will be consulted on all proposed changes.

Review of the provincial equitable share formula

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

The periodic review of the formula to assess its continued appropriateness and equity continues in 2020. During the year, the review will focus on:

- Refining options for a revised poverty component in the formula.
- Developing options for how the formula can account for costs associated with being in a rural location.
- Working with the Department of Health to revise and update the risk-adjusted factor as part of a broader overhaul of the health component.
- Working with the Department of Basic Education to develop options for how to account for the different funding needs of different types of schools and learners.

The formula is being reviewed by a provincial equitable share task team made up of representatives from the National Treasury and provincial treasuries. The task team partners with sector departments, Statistics South Africa and the FFC on different components of the review. The task team reports to the Technical Committee on Finance, and the Budget Council considers and approves any proposed changes to the formula.

Preparing for national health insurance implementation

South Africa aims to make significant strides towards universal health coverage through the progressive implementation of national health insurance, as outlined in the National Health Insurance White Paper, which government adopted in 2017, and the National Health Insurance Bill, which was tabled in 2019 and is currently being considered in Parliament. Establishing the National Health Insurance Fund is likely to have significant implications for provincial finances, which are being discussed through consultative structures like the Technical Committee on Finance. In parallel, efforts to strengthen the health system in preparation for national health insurance will continue, including developing and piloting provider payment mechanisms, expanding the national insurance beneficiary registry, and purchasing and providing a prioritised set of health services. Government is also piloting a new quality improvement activity within the non-personal services component of the *NHI indirect grant* that will help facilities meet the envisaged standards required for NHI accreditation. The experience gained from this pilot will inform future efforts to improve quality. Two grants related to capacity development in the health sector have been merged in 2020/21, and the National Treasury and the Department of Health will work together during 2020 to develop a strategy for further reforms to the structure of all the health conditional grants to ensure that they are aligned to support NHI implementation.

Shift of nursing and agricultural colleges to national government

For nursing colleges and agricultural colleges to be accredited as higher education colleges in terms of the Higher Education Act (1997), the function for administering these colleges needs to move from provinces to national government. The Department of Higher Education and Training is coordinating with the departments of Health and Agriculture, Land Reform and Rural Development, as well as their provincial counterparts to prepare for this proposed function shift. The National Treasury will work with provincial treasuries and the FFC to assess the financial impacts of the proposed shift.

The role of provinces in promoting economic development

All three spheres of government must work with businesses and other relevant stakeholders to provide an enabling environment for faster and more inclusive economic growth. An Economic Development Coordination Forum has been established to improve the coordination of economic development initiatives between provincial and national governments. This forum is chaired jointly by the National Treasury and the Department of Trade, Industry and Competition, and includes participants from provincial treasuries and sector departments, as well as the Department of Small Business Development, the Department of Cooperative Governance and SALGA. This year, the forum will establish work streams to examine data for economic development, policy and alignment issues, and township economic development (including industrial parks).

Improving intergovernmental coordination on infrastructure investment

Public infrastructure investments can play a major role in transforming South Africa's spatial development patterns. This requires a significant improvement in intergovernmental coordination in planning and budgeting for infrastructure. The National Treasury is working with provinces to ensure that their investments in schools, roads, health facilities and housing are made in locations that align with the spatial development plans of municipalities. Municipalities must be consulted and agree on the location and bulk services requirements of all provincial infrastructure projects. Progress has been made in holding joint planning sessions between provinces and municipalities, and support in this area will continue in 2020. National departments will also be supported to participate in intergovernmental planning and to review sector policies and funding strategies to promote better alignment with spatial development frameworks.

The National Treasury will review provincial infrastructure sector funding policies and propose how grants, incentives and other funding sources can best be structured to strengthen funding coordination to achieve spatial development objectives.

Disaster funding

The National Treasury will work with the National Disaster Management Centre to review the funding of disaster response and recovery activities. Climate change will make extreme weather events more common, and the disaster funding system needs to adapt to this new reality. The current system is designed to allow for the rapid release of funds immediately following the declaration of a disaster, and to fund the repair or reconstruction of infrastructure after an event. While there are problems and inefficiencies within the existing system that need to be addressed through this review, it must also consider how to place greater emphasis on being prepared before disasters occur. The system also needs to be adapted to respond better to long-running disasters such as drought conditions that may last for several years.

New informal settlements upgrading grants for provinces and municipalities

Informal settlement upgrades are a priority over the medium term. This is an inclusive process through which informal residential areas are incrementally improved, formalised and incorporated into the city or neighbourhood by extending land tenure security, infrastructure and services to residents of informal settlements.

Following the introduction of dedicated components to fund informal settlement upgrades in the provincial *human settlements development grant* and the municipal *urban settlements development grant* in 2019/20, the Department of Human Settlements is leading the design of two new informal settlements upgrading grants for provinces and municipalities, which will be introduced in the 2021 MTEF period. These separate grants were intended to be introduced in 2020/21, but additional time is needed for provinces and municipalities to complete their informal settlements upgrading strategies. These strategies will guide how spending on the new grant will be prioritised. Having an additional year will allow the design of the new grants to draw on the lessons learnt from a full year of implementing the components within the existing grants. The design of the new grants will include consultations with provinces, municipalities, community organisations and other interested stakeholders. These consultations will also address the respective roles of provinces and municipalities in upgrading informal settlements.

Review of the local government fiscal framework

Budget Forum lekgotla

The local government fiscal framework refers to all of the revenue sources that are available to local government and all the expenditure responsibilities that they have. A well-designed fiscal framework allows each municipality to balance its revenue sources against its expenditure responsibilities. Many stakeholders have expressed concern that elements of the current local government fiscal framework make it difficult for municipalities to balance their revenues with their expenditure responsibilities. The Minister of Finance has therefore proposed that the Budget Forum hold a special lekgotla in 2020 to review the structure of the framework and to agree on which issues in local government are attributable to the structure of the fiscal framework and which are related to other factors such as problems in governance, intergovernmental relations and the assignment of functions between spheres. This will help to resolve contentious issues and build consensus.

The Budget Forum is chaired by the Minister of Finance and includes Members of the Executive Council (MEC) responsible for finance in each province and SALGA. In order to facilitate improved cooperation across sectors, the Minister and MECs responsible for cooperative governance are also invited to participate in meetings of the Budget Forum. The Chairs of Parliament's Standing and Select Committee on Appropriations and Finance and as well as representatives of the FFC are invited to attend.

Items for the lekgotla will be prepared in a collaborative process that includes inputs from officials from all of the participating organisations. The outcomes are expected to inform a reform agenda for the local government fiscal framework over the next five years that will complement the ongoing reforms discussed below.

Refinements to the local government equitable share formula

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

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

Review of local government infrastructure grants

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

- Improving the administration of conditional grants by national departments.
- Further consolidating conditional grants.
- Increasing differentiation in the grant system, so that grants are well aligned to the different circumstances found across the country's 257 municipalities.
- Reviewing grant formulas to ensure that allocations are equitable across the different types of municipalities that receive allocations from differentiated grants, such as the *urban settlements*

development grant (for metros), the *integrated urban development grant* (for intermediate cities) and the *municipal infrastructure grant*.

- Identifying ways to incorporate incentives for improved asset management into the grant system.

Review of the municipal capacity support system

Government is reviewing the system of capacity support provided to municipalities. It invests public funds of more than R3 billion in capacity support for municipalities every year through a broad range of grants and programmes. These various forms of capacity development and support tend to be planned and managed separately from one another. The National Treasury is managing the review, with the aim of identifying ways to improve the impact of this spending. Preliminary results may inform initial changes to the capacity-building system in the 2021 Budget.

Reforms to local government own revenue sources

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

Development charges

Despite their potential as an alternative option for financing infrastructure, municipalities have not fully used development charges due to uncertainty surrounding the regulatory frameworks. These once-off charges are imposed by a municipality on a land owner applying for land development approval. The charges are based on the concept that urban growth and expanded land use creates the need for additional infrastructure services, so the developer should pay the incidence costs. To deal with the regulatory framework's challenges, the National Treasury is amending the Municipal Fiscal Powers and Functions Act to incorporate the regulation of development charges. The draft amendment bill has been submitted to Cabinet and was published for public comment in January 2020. The due date for submitting comments is 31 March 2020. Parallel to the public participation process, the National Treasury intends to undertake provincial and national workshops to provide clarity on the technical provisions of the draft bill. The draft legislation can be accessed on the National Treasury website: http://www.treasury.gov.za/legislation/draft_bills.

Municipal borrowing

The 2017 update to the Policy Framework for Municipal Borrowing and Financial Emergencies will be submitted to Cabinet shortly.

The updates aim to address the limitations of the original policy framework of 2000 and to respond to the changing needs and conditions in the municipal borrowing market by permitting the use of innovative infrastructure financing mechanisms. The updated policy framework makes specific recommendations on the role of development finance institutions in financing creditworthy municipalities. It proposes that these institutions should play a developmental, complementary and supportive role to transactions rather than competing directly with private financiers. It also suggests that development finance institutions should establish clear and measurable development impact indicators for their municipal operations in general, and for specific transactions. Each institution must, well in advance of any proposed lending to a municipality, obtain written agreement from the National Treasury that specifically outlines the development objectives and indicators of the loan, before entering into any transaction.

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