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 2021 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 2021 division of revenue.
- Part 3 sets out how the FFC's recommendations on the 2021 division of revenue have been taken into account.
- Part 4 explains the formula and criteria for dividing the provincial equitable share and conditional grants among provinces.
- Part 5 sets out the formula and criteria for dividing the local government equitable share and conditional grants among municipalities.
- Part 6 summarises issues that will form part of subsequent reviews of provincial and local government fiscal frameworks.

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

Budget Council and SALGA). The division of revenue, along with the government priorities that underpin it, was agreed for the next three years at a Cabinet meeting in October 2020.

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:

- Economic transformation and job creation
- Education, skills and health
- Consolidating the social wage through reliable and quality basic services
- Spatial integration, human settlements and local government
- Social cohesion and safe communities
- Building a capable, ethical and developmental state
- 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 implementation plan for the National Development Plan for the current administration. In responding to the aftermath of the COVID-19 pandemic, in October 2020, the President introduced an economic recovery plan for South Africa that aims to:

- Create jobs, primarily through infrastructure investment and mass employment programmes
- Reindustrialise the economy, focusing on growing small businesses
- Accelerate economic reforms to unlock investment and growth
- Fight crime and corruption
- Improve the capability of the state.

In the 2020 *Medium Term Budget Policy Statement* (MTBPS), the Minister of Finance outlined how the resources available to government over the 2021 medium-term expenditure framework (MTEF) period would be allocated to help achieve government's goals in a difficult economic environment. Chapter 4 of the 2020 MTBPS and Chapters 5 and 6 of the 2021 *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 2021 *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 2021 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 9.4 per cent over the 2021 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 2021 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 determining the division of revenue, which mostly grows the provincial and local government shares of nationally raised revenue faster than inflation, and second, in the formulas used to divide national transfers among municipalities and provinces. Developmental needs are built into the equitable share formulas for provincial and local government and included in specific conditional grants, such as the *municipal infrastructure grant*, which allocates funds according to the number of households in a municipality without access to basic services. Various infrastructure grants and the capital budgets of provinces and municipalities aim to boost economic and social development.

Economic disparities

The equitable share and infrastructure grant formulas redistribute funds towards poorer provinces and municipalities (parts 4 and 5 of this annexure provide statistics illustrating this). Through the division of revenue, government continues to invest in economic infrastructure (such as roads) 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 2021 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 2021 division of revenue

The central fiscal objectives over the MTEF period are to:

- Narrow the deficit and stabilise the debt-to-GDP ratio, primarily by controlling non-interest expenditure growth;

- Provide continued support to the economy and public health services in the short term, without adding to long-term spending pressures;
- Improve the composition of spending, by reducing growth in compensation while protecting capital investment (see Chapter 3 of the 2021 *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 2021 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 R1.54 trillion in 2021/22, R1.53 trillion in 2022/23 and R1.53 trillion in 2023/24. 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 2021 *Budget Review*. Reductions to previously announced spending levels were made across all three spheres of government to fit within the revised expenditure ceiling. The 2020 MTBPS announced that provincial transfers have been reduced by R221.8 billion over the MTEF period and transfers to local government have been reduced by R17.7 billion.

Following the 2020 MTBPS, further changes were made. In total, the provincial equitable share has been reduced by R205.9 billion over the medium term. Direct conditional grants to provinces have been reduced by a net R10.7 billion, as the reduction of R13.5 billion is partly offset by reprioritisations and additions of R2.6 billion. The local government reductions comprise R14.7 billion from the local government equitable share, R2.7 billion from the general fuel levy sharing with metropolitan municipalities and R2 billion in reductions to direct conditional grants.

To limit growth in government expenditure and ensure public debt is sustainable, several local government infrastructure grants that are likely to go unspent or to be spent less effectively have been reduced. Grants that have persistently underperformed have been reduced by larger amounts. Parts 4 and 5 of this annexure set out in more detail how the changes to the baseline affect provincial and local government transfers.

As outlined in the 2020 MTBPS, the proposed reductions to the wage bill discussed in Chapters 3 of the *Budget Review* represent the largest reductions to national and provincial allocations. Relative to the 2020 Budget, the provincial equitable share will be reduced by R58.3 billion in 2021/22, R83.5 billion in 2022/23 and R64.1 billion in 2023/24. This wage freeze has lowered the national and provincial shares of the division of revenue and increased that of local government 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 2021 MTEF period that are funded through reprioritisations in the division of revenue include addressing shortfalls in the funding of the appointment of medical interns in the health sector.

These reprioritisations complement baselines that provide R1.9 trillion to provinces and R432.6 billion to local government in transfers over the 2021 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 2021 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

	2020/21		2021/22		2022/23		2023/24
R billion/percentage of GDP	2020 Budget	2021 Budget	2020 Budget	2021 Budget	2020 Budget	2021 Budget	2021 Budget
Gross domestic product	5 428.2	4 921.0	5 759.0	5 352.2	6 126.3	5 666.3	5 997.2
Real GDP growth	*0.9%*	*-8.3%*	*1.4%*	*5.4%*	*1.7%*	*1.9%*	*1.6%*
GDP inflation	*4.3%*	*4.2%*	*4.6%*	*3.2%*	*4.6%*	*3.9%*	*4.1%*
National budget framework							
Revenue	**1 398.0**	**1 200.8**	**1 484.3**	**1 351.7**	**1 580.9**	**1 453.7**	**1 522.0**
Percentage of GDP	*25.8%*	*24.4%*	*25.8%*	*25.3%*	*25.8%*	*25.7%*	*25.4%*
Expenditure	**1 766.0**	**1 804.2**	**1 850.7**	**1 834.3**	**1 940.2**	**1 870.8**	**1 911.0**
Percentage of GDP	*32.5%*	*36.7%*	*32.1%*	*34.3%*	*31.7%*	*33.0%*	*31.9%*
Main budget balance[1]	**-368.0**	**-603.4**	**-366.4**	**-482.6**	**-359.3**	**-417.2**	**-389.0**
Percentage of GDP	*-6.8%*	*-12.3%*	*-6.4%*	*-9.0%*	*-5.9%*	*-7.4%*	*-6.5%*

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 2021 MTEF period after accounting for new policy priorities.

Table W1.2 Division of nationally raised revenue

R million	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
		Outcome		Revised estimate		Medium-term estimates	
Division of available funds							
National departments	**592 640**	**634 314**	**749 718**	**804 484**	**763 304**	**736 286**	**738 988**
of which:							
Indirect transfers to provinces	*3 813*	*3 909*	*3 941*	*4 160*	*4 401*	*4 944*	*4 882*
Indirect transfers to local government	*7 803*	*7 887*	*7 024*	*6 865*	*7 055*	*8 200*	*8 481*
Provinces	**538 553**	**571 954**	**613 450**	**628 311**	**639 469**	**643 343**	**646 824**
Equitable share	441 331	470 287	505 554	520 717	523 686	524 088	525 304
Conditional grants	97 222	101 667	107 896	107 594	115 783	119 255	121 520
Local government	**111 103**	**118 488**	**122 986**	**138 528**	**138 093**	**146 098**	**148 423**
Equitable share	55 614	60 758	65 627	84 483	77 999	83 085	83 570
Conditional grants	43 704	45 262	44 191	40 018	45 477	47 679	49 419
General fuel levy sharing with metros	11 785	12 469	13 167	14 027	14 617	15 335	15 433
Provisional allocation not assigned to votes[1]					11 645	32 093	33 219
Non-interest allocations	**1 242 295**	**1 324 756**	**1 486 154**	**1 571 323**	**1 552 511**	**1 557 821**	**1 567 455**
Percentage increase	*7.2%*	*6.6%*	*12.2%*	*5.7%*	*-1.2%*	*0.3%*	*0.6%*
Debt-service costs	162 645	181 849	204 769	232 852	269 741	308 013	338 591
Contingency reserves	–	–	–	–	12 000	5 000	5 000
Main budget expenditure	**1 404 940**	**1 506 605**	**1 690 923**	**1 804 174**	**1 834 252**	**1 870 833**	**1 911 046**
Percentage increase	*7.6%*	*7.2%*	*12.2%*	*6.7%*	*1.7%*	*2.0%*	*2.1%*
Percentage shares							
National departments	*47.7%*	*47.9%*	*50.4%*	*51.2%*	*49.5%*	*48.3%*	*48.2%*
Provinces	*43.4%*	*43.2%*	*41.3%*	*40.0%*	*41.5%*	*42.2%*	*42.2%*
Local government	*8.9%*	*8.9%*	*8.3%*	*8.8%*	*9.0%*	*9.6%*	*9.7%*

1. 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	2021/22	2022/23
National departments	-5 566	-61 546
Provinces	-52 482	-87 347
Local government	-4 349	-5 347
Allocated expenditure	**-62 397**	**-154 239**

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	2021/22 Allocation	2022/23 Forward estimates	2023/24
National[1]	1 232 567	1 263 661	1 302 172
Provincial	523 686	524 088	525 304
Local	77 999	83 085	83 570
Total	**1 834 252**	**1 870 833**	**1 911 046**

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 2021 *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 2021/22* to Parliament in July 2020. This year's theme is "sustainable financing of social and economic infrastructure and services". The 2021/22 recommendations cover the following areas: the intergovernmental fiscal system in the context of social services; economic and social development in the context of COVID-19; sustainable financing of South Africa's public healthcare system and national health insurance; and access to quality and inclusive social services for vulnerable groups.

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: Intergovernmental Fiscal System in the Context of Social Services

Updating the provincial equitable share formula

The FFC recommends the following: "Government should consider balancing the current benefit of the simplicity in the PES [provincial equitable share] formula with a move towards improving the distribution of the overall formula by acknowledging the higher costs of providing services to vulnerable groups and the greater demand for services from certain demographic groups. The proportional distribution mechanism should remain in the PES, but higher weights should be considered for funding vulnerable groups in determining education and health components. This would not result in a change of the overall pool available for education and health, but rather acknowledge and explicitly fund provinces that face greater needs for education and health services given their socio-demographic profiles. This can be achieved as follows:

i. In the education component, differentiate the school-age population by gender, income and location, and apply a higher weighting for funds for the vulnerable groups. This should be applied also to the data on learner enrolment.

ii. The output sub-component of the health component should differentiate between gender and age of the person using the health service. Higher weights for funding should be applied to persons over the age of 65, women aged between 15 and 49 and children below 5, than for males aged between 5 and 65.

iii. The respective weightings for specific groups should be determined by government and informed by consultations with the respective provinces.

iv. The poverty component in the current PES formula should be updated with the latest income and expenditure data from the 2014/15 Living Conditions Survey undertaken by Stats SA."

Government response

Government agrees that an appropriate balance is needed in the provincial equitable share formula between simplicity and more complexity to capture differentiation among provinces. The ability to apply more differentiation in the formula is subject to credible and reliable information being available and officially endorsed. The current review of the provincial equitable share is evaluating ways to introduce more differentiation into the formula. Given that the FFC is part of the working group, it would be appreciated if it could provide more details on how the above suggestions for more detail in the formula can be practically implemented, bearing in mind the availability of official data to do so. This will provide the working group with an opportunity to assess the impact of allocations per province based on the suggested approaches.

With regard to the education and health components, the suggested differentiation approaches will be explored in collaboration with the national departments of basic education and health. The respective weightings for specific groups will be discussed in the working group, in which provincial treasuries are represented. With regard to the use of the 2014/15 Living Conditions Survey data in the provincial equitable share formula, one of the components that is being reviewed is the poverty component. Different methodologies to account for poverty across the provinces are being explored, including replacing the 2010/11 Income and Expenditure Survey data with the 2014/15 Living Conditions Survey data. Preceding this, however, is the need to determine the appropriate purpose of the poverty component in the formula. The data used in the new poverty component needs to support that policy direction.

Costing specific norms and standards in the education and health sectors

The FFC recommends the following: "The departments of basic education and health should urgently pursue efforts to cost the current norms developed in education and healthcare. This should be done by incorporating the reporting of the costs of specific inputs in the delivery of provincial services through current provincial reporting formats. This would constitute the implementation of a 'bottom-up' approach to costing. Government should also use the methods outlined in this report to calculate cost estimates of specific norms and standards. These cost estimates should initially be used to determine provincial expenditure or under-expenditure performance and, in the long term, be considered for incorporation into the PES formula."

Government response

Government acknowledges the benefits of costing the current norms developed in the education and health sectors and supports increased data-driven approaches to resource allocation in both sectors. In the health sector, for example, the National Treasury and the national Department of Health jointly commissioned several primary healthcare costing studies that included top-down, bottom-up and normative methods in 2016. These studies were based on the primary healthcare service package. The National Treasury has also commissioned a review of the health component of the provincial equitable share formula to ensure that it responds adequately to the need and demand for healthcare services. The main focus of the review is updating and refining the risk-adjustment component to ensure that variations in demographics, disease burden and geographical factors are better accounted for.

The incorporation of a "bottom-up approach to costing" into the provincial equitable share formula is, however, not supported. It runs the risk of basing allocations on inefficient spending practices as the basis of the costing would be actual spending rather than the set norms and standards for each service. A formula allocation that is meant to fund all provinces must use aggregates to a certain extent to arrive at fairer allocations. The exact cost of providing services differs for each province because of the various factors that influence the cost of providing those services. Therefore, the expectation that the cost parameters in an allocative formula should reflect the true cost of delivering services is unrealistic. At best, an allocative formula can consider all quantifiable cost drivers to arrive at a reasonable cost estimate. This is what the ongoing review intends to achieve and government will engage the FFC on its proposed approaches as part of this process.

Chapter 3: Economic and Social Development in the Context of COVID-19

Macroeconomic and fiscal framework

The FFC recommends the following: "The Minister of Finance should develop (and execute) a clear, coherent and comprehensive macroeconomic framework that is in line with the President's economic and social support response package to COVID-19. The Minister should consider the position taken in the government document, 'Towards an Economic Strategy for South Africa', to strengthen the continuity, consistency and credibility of the economic and fiscal stance. These policy positions should be clearly represented in monetary figures, in the 2021/22 Appropriation Bill and Division of Revenue Bill for implementation in the forthcoming Money Bills as per section 77 of the Constitution."

Government response

Government agrees with the need to align the macroeconomic framework with the President's economic and social support response package to the COVID-19 pandemic. The 2020 MTBPS charted a course for South Africa's economic recovery. Government's central policy goals over the medium term are to position the economy for faster and broad-based economic growth and to return the public finances to a sustainable position.

Working with its social partners in business, labour and civil society, government has begun implementing an economic recovery plan, with immediate measures to boost confidence and investment, and longer-term reforms to promote sustained higher economic growth. Many of the reforms in the economic recovery plan are drawn from government's long-term structural reform agenda outlined in the *Economic*

Transformation, Inclusive Growth and Competitiveness: Towards a Growth Plan Strategy paper that the National Treasury released in 2019.

The plan has four priority interventions: infrastructure rollout, energy generation, employment stimulus and supporting industrial growth. Parallel to this, government will implement structural reforms such as modernising network industries, reducing barriers to entry and increasing regional integration and trade. The National Treasury estimates that these reforms, combined with measures to create an enabling environment for small business and investment, can raise growth to over 3 per cent by 2030 and create over 1 million jobs.

The Infrastructure Fund will complement the economic recovery plan's focus on capital investments. Government has committed R100 billion over 10 years from 2019/20 (of which R18 billion is over the medium term) to this blended finance fund, which is designed to crowd in private-sector finance and expertise to support infrastructure delivery. To improve infrastructure planning and fast-track a project pipeline, an Investment and Infrastructure Office has been created in the Presidency.

To ensure successful implementation of the economic recovery plan, the Presidency and the National Treasury have established Operation Vulindlela, a joint initiative tasked with coordinating and accelerating the implementation of priority reforms. The initiative will be staffed by a full-time technical team that draws on additional expertise and capacity in the public and private sectors. This will ensure that possible delays are quickly identified and addressed and that implementation across different departments and entities is well coordinated and sequenced.

The 2021 *Budget Review* provides a more detailed account of the macroeconomic framework.

Transforming the economy

The FFC recommends the following: "After reviewing the economic situation leading up to the COVID-19 crisis, the Commission is convinced that a fundamental structural transformation of the economy is inevitable. Therefore, the ministers of finance, of economic development and trade and industry, and of labour should jointly address the economic barriers, social inequality, and societal polarisation by adopting a localised product value chain approach. The expression of this approach should be found in the incentive grants frameworks of both provincial and local conditional grants, as hard conditions to permit procurement of goods only if they are made or assembled locally within the South African borders, to stimulate the domestic economy and encourage job growth while taking international trade agreements into account."

Government response

Government agrees with the need to grant local producers priority in public procurement. An objective of the Public Procurement Bill is to advance economic opportunities for previously disadvantaged people, women, youth, people with disabilities and small businesses, and to promote local production. Government is committed to finalising the Public Procurement Bill during 2021/22 and reviewing the full range of national, provincial and municipal provisions. Amendments to conditional grant frameworks can only be considered once the bill is enacted and a preference points framework that is fair, equitable, transparent, competitive and cost-effective and promotes efficient administration is developed.

Boosting economic growth through provision of support to emerging farmers

The FFC argues that "with the right infrastructural and financial support from the state, emerging farmers can be catalysts for local economic development and growth with the added benefits of food security in facing the COVID-19 crisis. Hence, the Minister of Finance and the Minister of Cooperative Governance and Traditional Affairs should use reprioritised, consolidated funds to establish an indirect grant and task team for basic services and local economic development. The reprioritisation should be clearly stated in the money bills over the 2021 medium-term expenditure framework (MTEF)."

Government response

Government agrees that emerging farmers are critical for local economic development and growth and fostering food security, but does not support the introduction of an indirect grant for capacity building. A substantial amount of funds is already flowing through the *comprehensive agricultural support programme grant, Ilima/Letsema projects grants* and *land care programme grant* to support communities and newly established and emerging farmers with infrastructure, financial support and increased productivity. Furthermore, government intends to reduce the number of indirect grants in the provincial and local government grant systems. These undermine the subsidiarity outlined in the Constitution. Government and the beneficiaries of agriculture-related funding need to ensure that these funds are used optimally and that farmers are introduced to more innovative technological methodologies that can transform them into more competitive and economically active participants.

In the 2019 Budget, government introduced a blended finance instrument (grant and loan funding) with the aim of unlocking and enhancing agricultural production by black commercial producers. This is a joint initiative by the Department of Agriculture, Land Reform and Rural Development and the Land Bank. The instrument is designed to cover both long-term and medium-term loans and decrease the reliance on grant funding by using the grant funding to subsidise the cost of borrowing and increase access to loan facilities. The Department Agriculture, Land Reform and Rural Development provides technical support to farmers and sits on the funding forum that assesses and approves applications for grant funding.

Chapter 4: Sustainable Financing of South Africa's Public Healthcare System and National Health Insurance

Enabling policy and legislative framework for public healthcare

The FFC recommends the following: "The ministers of health and finance must ensure that an enabling policy and legislative framework, aligned among the spheres of government, is put in place with due regard to setting norms and standards, and is enforced with proper oversight by the established technical committees. The Minister of Finance should include these deliberations in annexure W1 of the Division of Revenue Bill with implications on the bill, as well as the *Budget Review* document."

Government response

Government agrees that clear and well-designed policies and legislative frameworks for the intergovernmental fiscal arrangements are critical for the successful implementation of healthcare. It has raised this issue in written inputs to the National Health Insurance White Paper and Bill and in engagements with the Department of Health, the Presidency and other key stakeholders. Any reforms to the provincial fiscal framework (health conditional grants and the health component of the provincial equitable share formula) to support the implementation of national health insurance reforms will strive to ensure that emerging expenditure responsibilities are appropriately provided for. Provinces will be consulted on potential reforms through appropriate intergovernmental fiscal forums, such as the Budget Council and Budget Forum. Details of these deliberations and reforms will be contained in annexure W1 of the annual Division of Revenue Bill.

Chapter 5: Putting the Last First: Vulnerability and Access to Quality and Inclusive Social Services

Strengthening funding for early childhood development centres

The FFC recommends the following: "Government should take urgent steps to strengthen funding for ECD [early childhood development] in South Africa. Particular priority should be given to funding all non-profit, non-centre-based ECD programmes serving quintiles 1 to 3. Related to this, the process and requirements for registration should be simplified, and specific and appropriate registration requirements for non-centre-based ECD programmes should be finalised with haste."

Government response

Government agrees with this recommendation. The Department of Social Development is currently undertaking the Vangasali campaign, which aims to identify all unregistered ECD facilities across the country and prepare them for registration. The department will use the additional funding allocated to the *early childhood development grant* from the presidential employment initiative in 2020/21 to help ECD facilities register and to develop a database of registered and unregistered centres and practitioners.

To streamline the registration process, a new registration framework was piloted and will be implemented in phase 2 of the Vangasali campaign.

The subsidy component of the current ECD conditional grant framework subsidises non-centre-based services at a rate of R6 multiplied by the number of sessions, multiplied by the number of qualifying children attending as agreed to in the service-level agreement. A total of R1.5 billion was added to the ECD conditional grant in the 2020 MTEF budget to increase the subsidy for centre-based services.

Targeted support to non-profit ECD programmes

The FFC recommends the following: "Government should ensure further targeted support to non-profit ECD programmes in quintiles 1 to 3 focusing on infrastructure upgrades, to enable these centres to register and receive subsidies and for funding for basic early education equipment, which will enhance the early learning programme and prepare young children for formal schooling from Grade R to Grade 12, and beyond, into tertiary training."

Government response

Government acknowledges that infrastructure that meets applicable norms and standards is a major barrier to the registration of ECD programmes. The ECD grant includes an infrastructure component that provides supplementary funding to provinces to support maintenance upgrades of unregistered and conditionally registered ECD centres in poor wards. This component was repurposed in 2020/21 to fund COVID-related expenses. For 2021/22, the component will return to supporting maintenance upgrades of ECD centres. Provinces are tasked with implementing the ECD function, so it is their responsibility to prioritise funding from their equitable share to provide additional support for their ECD programmes.

As part of phase 3 of the Vangasali campaign, the Department of Social Development will explore opportunities to enter into partnerships with donor organisations to help ECD programmes meet the infrastructure norms and standards for registration. Furthermore, the mechanisms for delivering the ECD function will be reviewed in line with the Department of Basic Education's takeover in 2022/23.

Supporting inclusive education

The FFC recommends the following: "To support the implementation of inclusive education in South Africa, the DBE [Department of Basic Education] must spearhead the development of a holistic funding framework to ensure a uniform approach to funding learners with special educational needs, irrespective of the type of school they attend."

Government response

Government acknowledges this recommendation. The Department of Basic Education is developing funding norms and standards for inclusive education. This ongoing process aims to provide a holistic funding framework and a uniform approach to funding learners with special education needs.

Part 4: Provincial allocations

Provincial government receives two forms of allocations from nationally raised revenue, the equitable share and conditional grants. Sections 214 and 227 of the Constitution require that an equitable share of nationally raised revenue be allocated to provincial government to provide basic services and perform its allocated functions. The equitable share is an unconditional transfer to provinces and constitutes their main source of revenue. Due to their limited revenue-raising abilities, provinces receive 41.9 per cent of nationally raised revenue over the medium term. In addition, they receive conditional grants to help them fulfil their mandates. Transfers to provinces account for over 90 per cent of provincial revenue.

This section outlines national transfers to provinces for the 2021 MTEF period, including the fiscal consolidation measures announced in the 2020 MTBPS, and 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 R628.3 billion in 2020/21 to R639.5 billion in 2021/22. Over the MTEF period, provincial transfers will grow at an average annual rate of 1 per cent to R646.8 billion in 2023/24. Table W1.5 sets out the transfers to provinces for 2021/22. A total of R523.7 billion is allocated to the provincial equitable share and R115.8 billion to conditional grants.

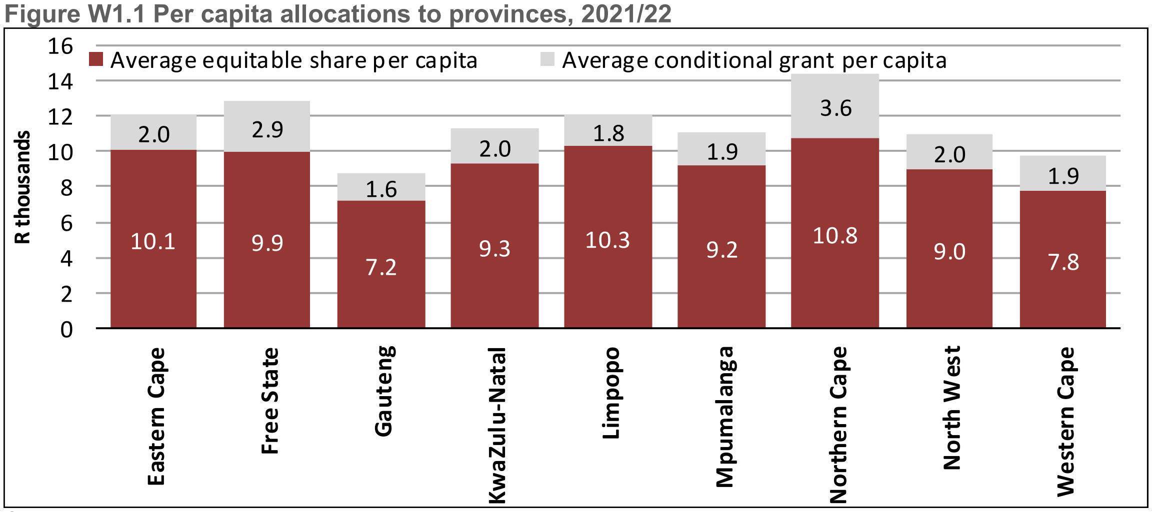
Table W1.5 Total transfers to provinces, 2021/22

R million	Equitable share	Conditional grants	Total transfers
Eastern Cape	68 060	13 296	81 357
Free State	29 055	8 459	37 514
Gauteng	111 429	24 968	136 398
KwaZulu-Natal	107 126	22 734	129 861
Limpopo	60 028	10 523	70 551
Mpumalanga	42 828	8 913	51 741
Northern Cape	13 919	4 685	18 604
North West	36 793	8 222	45 014
Western Cape	54 448	13 530	67 978
Unallocated		451	451
Total	**523 686**	**115 783**	**639 469**

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, 2021/22



Source: National Treasury

Changes to provincial allocations

For the 2021 MTEF period, revisions to the provincial fiscal framework reflect a combination of reprioritisations, reductions in compensation of employees and fiscal consolidation reductions 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.

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

R million	2021/22	2022/23	2023/24	MTEF total revision
Technical adjustments	**2**	**2**	**–**	**3**
Direct transfers	**92**	**2**	**–**	**93**
Provincial equitable share: Reversal of compensation	1 714	2 100		3 813
Technical changes to direct conditional grants[1]	-1 622	-2 098	–	
Indirect transfers	**-90**	**–**	**–**	**-90**
Ilima/Letsema projects				–
National health insurance indirect	-90	–	–	-90
Additions to baselines	**9 514**	**936**	**80**	**10 529**
Provinicial equitable share	8 000	–	–	8 000
HIV, TB, malaria and community outreach	1 500	900	–	2 400
Health facility revitalisation grant	14	36	80	129
Reductions to baselines	**-60 707**	**-86 317**	**-69 132**	**-216 156**
Direct transfers	**-60 374**	**-86 184**	**-69 027**	**-215 585**
Provinicial equitable share	-58 303	-83 466	-64 095	-205 864
Comprehensive agricultural support programme	-44	-57	-104	-205
Ilima/Letsema projects	-17	-22	-39	-78
Land care programme: poverty relief and infrastructure development	-2	-3	-6	-11
HIV and AIDS (life skills education)	-10	-13	-24	-47
Maths, science and technology	-10	-13	-24	-47
Provincial disaster relief	-6	-8	-14	-27
HIV, TB, malaria and community outreach	-1 252	-1 655	-2 840	-5 747
Health facility revitalisation	-154	-155	-160	-469
Human resources and training grant	-72	-73	-255	-400
National health insurance	-12	-15	-28	-55
National tertiary services	-382	-560	-1 178	-2 120
Expanded public works programme integrated grants for provinces	-17	-23	-41	-81
Social sector expanded public works programme incentive for provinces	-17	-22	-40	-80
Community library services	-51	-67	-121	-239
Mass participation and sport development	-25	-32	-58	-114
Indirect transfers	**-333**	**-132**	**-105**	**-571**
School infrastructure backlogs	-12	-21	-303	-336
Total change to provincial government allocations				
Change to direct transfers	-50 769	-85 247	-68 947	-204 962
Change to indirect transfers	-423	-132	-105	-661
Net change to provincial government allocations	**-51 192**	**-85 379**	**-69 052**	**-205 623**

1. The conditional grants affected are in agriculture, education, health, sport, and transport sectors due to reprioritisations and compensation of employees reductions

Source: National Treasury

Transfers to provincial governments are reduced by R220 billion over the 2021 MTEF period, of which direct transfers are reduced by R219.4 billion and indirect transfers are reduced by R571 million. In the 2020 MTBPS reductions of R60 billion in 2021/22, R85.6 billion in 2022/23 and R64.1 billion in 2023/24 for the provincial equitable share were announced. These include reductions to compensation of employees to reduce the wage bill and reductions to meet fiscal consolidation objectives.

More recently, these reductions have been revised to take account of changes to both categories of reductions. An amount of R3.8 billion has been reallocated to the provincial equitable share as a result of compensation of employees reductions that should have been accounted for in conditional grants that fund compensation of employees. These reductions were initially included in the compensation of employees reductions made to the provincial equitable share, but have since been corrected. In addition, to make provision for the reversal of reductions that were made to infrastructure allocations, changes were made to the allocations of other programmes in government, including the provincial equitable share.

An amount of R8 billion has been added to the provincial equitable share over the medium term to allow provinces to cover the costs of responding to the pandemic.

An amount of R140 million has been reprioritised from the *health facility revitalisation grant* and the *national health insurance indirect grant* towards the *human resources and training grant* to fund the shortfall of appointing medical interns funded within the conditional grant.

Table W1.6 reflects changes in the allocations of the conditional grants over the 2021 MTEF period, including reductions that have been made to conditional grant allocations. As part of efforts to redirect spending towards infrastructure, reductions that were made to conditional grants that fund infrastructure in the 2020 MTBPS have been reversed. Where reductions were made to allocations of conditional infrastructure grants, the following principles were applied:

- There is evidence of underspending in previous financial years.
- Service delivery will not be significantly affected if the conditional grant is reduced.
- The conditional grant is not being used to respond to the pandemic.

From 2021/22, the component that was created in the *human settlements development grant* for the upgrading of informal settlements will be a new stand-alone *informal settlements upgrading partnership grant*. Details on this change are provided under the section on conditional grants.

After accounting for these changes, the provincial equitable share grows at an average annual rate of 0.3 per cent over the MTEF period, while direct conditional grant allocations grow at an average annual rate of 4.1 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 2021 MTEF period, the following amounts are allocated to the provincial equitable share respectively: R523.7 billion, R524.1 billion and R525.3 billion.

The equitable share formula

The equitable share formula consists of six components that account for the relative demand of services and take into consideration 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 2021 MTEF, the formula has been updated with data from Statistics South Africa’s 2020 mid-year population estimates on population and age cohorts and the 2020 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. At the time of determining the equitable share for each province, the 2019 General Household Survey was not published, so data from the 2018 General Household Survey was used instead. This change was discussed in meetings held with the Technical Committee for Finance and the Budget Council, and endorsed by Cabinet.

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 (2021/22 – 2023/24).

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 2021 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, 2021 MTEF

	Education	Health	Basic share	Poverty	Economic activity	Institu-tional	Weighted average
	48.0%	**27.0%**	**16.0%**	**3.0%**	**1.0%**	**5.0%**	**100.0%**
Eastern Cape	13.7%	12.2%	11.3%	14.8%	7.7%	11.1%	12.7%
Free State	5.3%	5.4%	4.9%	5.1%	5.0%	11.1%	5.5%
Gauteng	19.9%	24.2%	26.0%	18.8%	34.3%	11.1%	21.7%
KwaZulu-Natal	21.5%	20.6%	19.3%	22.0%	16.0%	11.1%	20.4%
Limpopo	12.6%	9.9%	9.8%	13.0%	7.4%	11.1%	11.3%
Mpumalanga	8.3%	7.4%	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%	6.8%	6.9%	8.3%	6.4%	11.1%	7.1%
Western Cape	9.8%	11.4%	11.8%	6.5%	13.6%	11.1%	10.5%
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.

As a result of the review of the provincial equitable share formula, the data used for the school-age population sub-component was changed. The use of Statistics South Africa's annual mid-year population estimates for the five-year-old to 17-year-old age cohort has being phased in over three years, from 2019/20 to 2021/22. 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 now fully phased in. Table W1.8 shows the combined effect of updating the education component with new enrolment and age cohort data on the education component shares.

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

Thousand	Age 5-17	School enrolment 2019	2020	Changes in enrolment data	Weighted average 2020 MTEF	2021 MTEF	Difference in weighted average
Eastern Cape	1 901	1 841	1 841	-0	14.0%	13.6%	-0.40%
Free State	724	714	718	4	5.3%	5.3%	-0.07%
Gauteng	2 965	2 440	2 500	60	19.4%	19.9%	0.49%
KwaZulu-Natal	3 034	2 841	2 864	23	21.6%	21.5%	-0.08%
Limpopo	1 680	1 753	1 758	5	12.7%	12.5%	-0.18%
Mpumalanga	1 165	1 095	1 107	13	8.4%	8.3%	-0.07%
Northern Cape	318	298	303	5	2.3%	2.3%	0.00%
North West	1 004	852	863	10	6.8%	6.8%	0.05%
Western Cape	1 449	1 186	1 240	55	9.5%	9.8%	0.26%
Total	**14 240**	**13 021**	**13 195**	**174**	**100.0%**	**100.0%**	**–**

Source: National Treasury

Health component (27 per cent)

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

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

Table W1.9 Risk-adjusted sub-component shares

Thousand	Mid-year population estimates 2020	Insured population 2018	Risk-adjusted index	Weighted population	Risk-adjusted shares 2020	2021	Change
Eastern Cape	6 734	10.0%	96.9%	5 870	11.9%	11.8%	-0.13%
Free State	2 929	16.2%	103.3%	2 534	5.1%	5.1%	0.00%
Gauteng	15 488	23.9%	105.4%	12 425	24.8%	24.9%	0.15%
KwaZulu-Natal	11 532	12.4%	98.9%	9 991	19.9%	20.0%	0.14%
Limpopo	5 853	8.2%	91.6%	4 923	10.2%	9.9%	-0.36%
Mpumalanga	4 680	12.6%	95.7%	3 914	7.8%	7.9%	0.04%
Northern Cape	1 293	16.1%	100.7%	1 092	2.2%	2.2%	0.02%
North West	4 109	13.5%	102.2%	3 634	7.2%	7.3%	0.04%
Western Cape	7 006	25.1%	104.0%	5 459	10.9%	11.0%	0.10%
Total	**59 622**	**–**	**–**	**49 843**	**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 2020 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 W1.9 shows the change in this sub-component between 2020 and 2021.

Table W1.10 Output sub-component shares

Thousand	Primary healthcare visits 2018/19	2019/20	Average	Share	Hospital workload patient-day equivalents 2018/19	2019/20	Average	Share
Eastern Cape	16 606	16 423	16 514	13.8%	4 388	4 296	4 342	13.3%
Free State	5 299	5 386	5 343	4.5%	2 126	2 171	2 148	6.6%
Gauteng	20 905	21 320	21 113	17.7%	7 467	7 649	7 558	23.2%
KwaZulu-Natal	28 525	28 365	28 445	23.8%	7 143	7 106	7 125	21.9%
Limpopo	14 336	14 344	14 340	12.0%	3 010	3 012	3 011	9.2%
Mpumalanga	9 253	9 225	9 239	7.7%	1 898	1 871	1 884	5.8%
Northern Cape	2 719	2 730	2 724	2.3%	573	586	580	1.8%
North West	7 446	7 708	7 577	6.3%	1 610	1 678	1 644	5.0%
Western Cape	14 083	14 357	14 220	11.9%	4 297	4 236	4 267	13.1%
Total	**119 173**	**119 859**	**119 516**	**100.0%**	**32 512**	**32 605**	**32 559**	**100.0%**

Source: National Treasury

The output sub-component (shown in Table W1.10) uses patient load data from the District Health Information Services. The average number of visits to primary healthcare clinics in 2018/19 and 2019/20 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 2018/19 and 2019/20 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 W1.11 shows the updated health component shares for the 2021 MTEF period.

Table W1.11 Health component weighted shares

	Risk-adjusted	Primary healthcare	Hospital component	Weighted shares		Change
Weight	**75.0%**	**5.0%**	**20.0%**	**2020**	**2021**	
Eastern Cape	11.8%	13.8%	13.3%	12.3%	12.2%	-0.13%
Free State	5.1%	4.5%	6.6%	5.3%	5.4%	0.05%
Gauteng	24.9%	17.7%	23.2%	24.0%	24.2%	0.19%
KwaZulu-Natal	20.0%	23.8%	21.9%	20.5%	20.6%	0.09%
Limpopo	9.9%	12.0%	9.2%	10.2%	9.9%	-0.30%
Mpumalanga	7.9%	7.7%	5.8%	7.5%	7.4%	-0.02%
Northern Cape	2.2%	2.3%	1.8%	2.1%	2.1%	0.02%
North West	7.3%	6.3%	5.0%	6.7%	6.8%	0.06%
Western Cape	11.0%	11.9%	13.1%	11.4%	11.4%	0.03%
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 2021 MTEF, population data is drawn from the 2020 mid-year population estimates produced by Statistics South Africa. Table W1.12 shows how population changes have affected the basic component's revised weighted shares.

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

Thousand	Mid-year population estimates 2019	2020	Population change	% population change	Basic component shares 2020 MTEF	2021 MTEF	Change
Eastern Cape	6 712	6 734	22	0.3%	11.4%	11.3%	-0.13%
Free State	2 887	2 929	41	1.4%	4.9%	4.9%	-0.00%
Gauteng	15 176	15 488	312	2.1%	25.8%	26.0%	0.16%
KwaZulu-Natal	11 289	11 532	243	2.1%	19.2%	19.3%	0.13%
Limpopo	5 983	5 853	-130	-2.2%	10.2%	9.8%	-0.36%
Mpumalanga	4 592	4 680	88	1.9%	7.8%	7.8%	0.04%
Northern Cape	1 264	1 293	29	2.3%	2.2%	2.2%	0.02%
North West	4 027	4 109	82	2.0%	6.9%	6.9%	0.04%
Western Cape	6 844	7 006	161	2.4%	11.6%	11.8%	0.11%
Total	**58 775**	**59 622**	**847**	**–**	**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 2020 mid-year population estimates. Table W1.13 shows the proportion of the poor in each province from the Income and Expenditure Survey, the 2020 mid-year population estimates and the weighted share of the poverty component per province.

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

Thousand	Income and Expendi-ture Survey 2010/11	Current (2020 MTEF) Mid-year population estimates 2019	Poor popula-tion	Weighted shares	New (2021 MTEF) Mid-year population estimates 2020	Poor popula-tion	Weighted shares	Difference in weighted shares
Eastern Cape	52.0%	6 712	3 492	14.9%	6 734	3 504	14.8%	-0.1%
Free State	41.4%	2 887	1 195	5.1%	2 929	1 212	5.1%	0.0%
Gauteng	28.9%	15 176	4 381	18.7%	15 488	4 471	18.8%	0.2%
KwaZulu-Natal	45.3%	11 289	5 115	21.8%	11 532	5 225	22.0%	0.2%
Limpopo	52.9%	5 983	3 162	13.5%	5 853	3 094	13.0%	-0.5%
Mpumalanga	47.3%	4 592	2 170	9.3%	4 680	2 211	9.3%	0.1%
Northern Cape	40.8%	1 264	515	2.2%	1 293	527	2.2%	0.0%
North West	47.9%	4 027	1 929	8.2%	4 109	1 968	8.3%	0.1%
Western Cape	21.9%	6 844	1 496	6.4%	7 006	1 532	6.5%	0.1%
Total		**58 775**	**23 457**	**100.0%**	**59 622**	**23 744**	**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 2021 MTEF, 2018 GDP-R data is used. Table W1.14 shows the weighted shares of the economic activity component.

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

	Current (2019 MTEF)		New (2020 MTEF)		Difference in weighted shares
	GDP-R, 2017 (R million)	Weighted shares	GDP-R, 2018 (R million)	Weighted shares	
Eastern Cape	358 627	7.7%	375 489	7.7%	-0.0%
Free State	234 505	5.0%	243 139	5.0%	-0.1%
Gauteng	1 593 874	34.3%	1 672 745	34.3%	0.1%
KwaZulu-Natal	746 360	16.0%	778 763	16.0%	-0.1%
Limpopo	340 273	7.3%	359 885	7.4%	0.1%
Mpumalanga	348 987	7.5%	366 839	7.5%	0.0%
Northern Cape	96 487	2.1%	100 120	2.1%	-0.0%
North West	301 477	6.5%	313 645	6.4%	-0.0%
Western Cape	632 990	13.6%	663 276	13.6%	0.0%
Total	**4 653 579**	**100.0%**	**4 873 899**	**100.0%**	**0.0%**

Source: National Treasury

Full impact of data updates on the provincial equitable share

Table W1.15 shows the full impact of the data updates on the provincial equitable share per province, after the six updated components have been added together. It compares the target shares for the 2020 and 2021 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 2020 to 2021 respond to changes in that demand. The details of how the data updates affect each component of the formula are described in detail in the sub-sections above.

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

	2020 MTEF weighted average	2021 MTEF weighted average	Difference
Eastern Cape	13.0%	12.7%	-0.2%
Free State	5.5%	5.5%	-0.0%
Gauteng	21.4%	21.7%	0.3%
KwaZulu-Natal	20.3%	20.4%	0.0%
Limpopo	11.5%	11.3%	-0.2%
Mpumalanga	8.2%	8.2%	-0.0%
Northern Cape	2.6%	2.6%	0.0%
North West	7.0%	7.1%	0.0%
Western Cape	10.4%	10.5%	0.1%
Total	**100.0%**	**100.0%**	**0.0%**

Source: National Treasury

Phasing in the formula

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

The equitable share formula data is updated every year and a new target share for each province is calculated, as shown in Table W1.16. The phase-in mechanism provides a smooth path to achieving the new weighted shares by the third year of the MTEF period. It takes the difference between the target weighted share for each province at the end of the MTEF period and the indicative allocation for 2021/22 published in the 2020 MTEF, and closes the gap between these shares by a third in each year of the 2021 MTEF period. As a result, one third of the impact of the data updates is implemented in 2021/22 and two thirds in the indicative allocations for 2022/23. The updates are thus fully implemented in the indicative allocations for 2023/24.

Table W1.16 Implementation of the equitable share weights

Percentage	2021/22 Indicative weighted shares from 2020 MTEF	2021/22	2022/23	2023/24
		2021 MTEF weighted shares 3-year phasing		
Eastern Cape	13.1%	13.0%	12.9%	12.7%
Free State	5.6%	5.5%	5.5%	5.5%
Gauteng	21.1%	21.3%	21.5%	21.7%
KwaZulu-Natal	20.5%	20.5%	20.4%	20.3%
Limpopo	11.5%	11.5%	11.4%	11.3%
Mpumalanga	8.2%	8.2%	8.2%	8.2%
Northern Cape	2.6%	2.7%	2.7%	2.7%
North West	7.0%	7.0%	7.0%	7.1%
Western Cape	10.3%	10.4%	10.5%	10.5%
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 2021 MTEF, there are no new adjustments that are being allocated outside of the provincial equitable share formula. Table W1.17 provides a summary of the allocations made outside the provincial equitable share that carry through from previous financial years and a short description of how these amounts are allocated among provinces.

Table W1.17 Allocations outside the provincial equitable share formula

R million	2020/21 Adjusted budget	2021/22 Medium-term estimates	2022/23	2023/24	Allocation criteria
Food relief shift	67	71	75	78	Allocated equally among the provinces
Social worker employment grant shift	227	239	251	262	Allocated in terms of what provinces would have received had the grant continued
Substance abuse treatment grant shift	79	83	87	91	Allocated in terms of what provinces would have received had the grant continued
Municipal intervention support	89	93	97	102	Allocated equally among the provinces
Gender-based violence and sexually transmitted infections support shift	93	109	114	119	Allocated based on the non-profit organisations located in the 27 priority districts
Social worker additional support shift	113	139	146	153	Allocated according to areas of high prevalence of gender-based violence, substance abuse and issues affecting children
Sanitary Dignity Programme	209	217	226	236	Allocated proportionately based on the number of girl learners per province in quintiles 1 to 3 schools
Infrastructure delivery improvement programme shift	45	45	47	49	Allocated equally among the provinces
Total	**921**	**997**	**1 042**	**1 088**	

Source: National Treasury

Final provincial equitable share allocations

The final equitable share allocations per province for the 2021 MTEF period are detailed in Table W1.18. These allocations include the full impact of the data updates, phased in over three years, and the allocations that are made separately from the formula.

Table W1.18 Provincial equitable share

R million	2021/22	2022/23	2023/24
Eastern Cape	68 060	67 428	66 899
Free State	29 055	29 008	29 005
Gauteng	111 429	112 561	113 870
KwaZulu-Natal	107 126	106 928	106 895
Limpopo	60 028	59 621	59 306
Mpumalanga	42 828	42 798	42 835
Northern Cape	13 919	13 928	13 959
North West	36 793	36 939	37 144
Western Cape	54 448	54 876	55 390
Total	**523 686**	**524 088**	**525 304**

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 4.1 per cent over the medium term. Direct conditional grant baselines total R115.8 billion in 2021/22, R119.3 billion in 2022/23 and R121.5 billion in 2023/24. Indirect conditional grants amount to R4.4 billion, R4.9 billion and R4.9 billion respectively for each year of the same period.

Table W1.19 provides a summary of conditional grants by sector for the 2021 MTEF period. More detailed information, including the framework and allocation criteria for each grant, is provided in the 2021 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 2019/20.

Table W1.19 Conditional grants to provinces

R million	2020/21 Revised estimate	2021/22	2022/23	2023/24	MTEF total
Agriculture, Land Reform and Rural Development	**1 695**	**2 238**	**2 287**	**2 325**	**6 850**
Comprehensive agricultural support programme	1 191	1 558	1 592	1 618	4 768
Ilima/Letsema projects	423	597	610	620	1 828
Land care programme: poverty relief and infrastructure development	81	83	85	86	255
Basic Education	**17 216**	**20 701**	**21 649**	**22 583**	**64 932**
Education infrastructure	8 787	11 689	12 229	12 768	36 687
HIV and AIDS (life skills education)	187	242	241	242	725
Learners with profound intellectual disabilities	243	243	249	260	753
Maths, science and technology	333	412	425	433	1 270
National school nutrition programme	7 666	8 115	8 504	8 879	25 498
Cooperative Governance	**138**	**140**	**145**	**146**	**431**
Provincial disaster relief	138	140	145	146	431
Health	**52 107**	**52 062**	**53 068**	**52 617**	**157 747**
HIV, TB, malaria and community outreach	27 222	27 585	27 910	27 090	82 585
Health facility revitalisation	6 315	6 445	6 886	7 235	20 566
National tertiary services	14 013	13 708	14 000	14 024	41 732
National health insurance grant: health professionals	246	269	272	272	813
Human resources and training grant	4 309	4 054	3 999	3 997	12 050
Human Settlements	**15 454**	**17 604**	**18 305**	**19 112**	**55 020**
Human settlements development	14 892	13 403	13 858	14 469	41 730
Title deeds restoration	163	–	–	–	–
Provincial emergency housing	400	311	326	340	977
Informal settlements upgrading partnership	–	3 890	4 121	4 303	12 314
Public Works and Infrastructure	**834**	**837**	**858**	**861**	**2 556**
Expanded public works programme integrated grant for provinces	421	422	433	435	1 290
Social sector expanded public works programme incentive for provinces	414	414	425	426	1 266
Social Development	**1 411**	**1 057**	**1 192**	**1 242**	**3 491**
Early childhood development	1 411	1 057	1 192	1 242	3 491
Sports, Arts and Culture	**1 521**	**2 087**	**2 156**	**2 175**	**6 417**
Community library services	1 153	1 496	1 554	1 571	4 620
Mass participation and sport development	368	591	602	604	1 797
Transport	**17 217**	**19 057**	**19 596**	**20 460**	**59 113**
Provincial roads maintenance	10 467	11 937	12 506	13 057	37 499
Public transport operations	6 750	7 121	7 090	7 403	21 614
Total direct conditional allocations	**107 594**	**115 783**	**119 255**	**121 520**	**356 558**
Indirect transfers	**4 160**	**4 401**	**4 944**	**4 882**	**14 227**
Agriculture, Land Reform and Rural Development	**36**	**–**	**–**	**–**	**–**
Ilima/Letsema indirect	36	–	–	–	–
Basic Education	**2 415**	**2 284**	**2 403**	**2 079**	**6 765**
School infrastructure backlogs	2 415	2 284	2 403	2 079	6 765
Health	**1 710**	**2 118**	**2 541**	**2 803**	**7 462**
National health insurance indirect	1 710	2 118	2 541	2 803	7 462

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 2021 MTEF period, R4.8 billion is allocated to this grant, and the baseline grows at an average annual growth rate of 10.8 per cent from R1.2 billion in 2020/21 to R1.6 billion in 2023/24. The reductions for this grant are equivalent to 3.8 per cent of the grant's baseline in 2021/22, 4.8 per cent in 2022/23 and 6 per cent in 2023/24.

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, R255 million is allocated to this grant. The reductions for this grant are equivalent to 3.1 per cent of the grant's baseline in 2021/22, 3.9 per cent in 2022/23 and 6 per cent in 2023/24.

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 2021 MTEF period. Previously, the *Ilima/Letsema indirect grant* was created in this grant to make provision for the Department of Agriculture, Land Reform and Rural Development to pay the Human Sciences Research Council directly for a National Food and Nutrition Survey that is being conducted on behalf of provinces. The funds for *Ilima/Letsema indirect grant* are allocated until the end of 2020/21. The reductions for *Ilima/Letsema projects* grant are equivalent to 2.7 per cent of the grant's baseline in 2021/22, 3.4 per cent in 2022/23 and 6 per cent in 2023/24.

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 is R36.7 billion over the 2021 MTEF period. The reductions for this grant are equivalent to 0.2 per cent of the grant's baseline in 2021/22 and 0.2 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 2021/22 incentive, the departments had to meet certain prerequisites in 2019/20 and have their infrastructure plans approved in 2020/21. 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 W1.20 shows the final score and incentive allocation for each province.

Table W1.20 Education infrastructure grant allocations

R thousand	Planning assessment results from 2020	2021/22		Final allocation for 2021/22
		Basic component	Incentive component	
Eastern Cape	75%	1 562 877	78 100	1 640 977
Free State	79%	814 187	78 100	892 287
Gauteng	77%	1 511 108	78 100	1 589 208
KwaZulu-Natal	82%	2 042 392	78 100	2 120 492
Limpopo	75%	1 256 470	78 100	1 334 570
Mpumalanga	75%	1 083 375	78 100	1 161 475
Northern Cape	78%	555 245	78 100	633 345
North West	85%	1 080 384	78 100	1 158 484
Western Cape	91%	1 079 998	78 100	1 158 098
Total		**10 986 036**	**702 900**	**11 688 936**

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 R6.8 billion over the medium term in the Planning, Information and Assessment Programme. An allocation of R2.3 billion in 2021/22 will be used to replace

21 inappropriate and unsafe schools with newly built ones and provide appropriate sanitation services to 1000 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 per cent, with a total allocation of R25.5 billion. Reductions to this grant are equivalent to 0.1 per cent of the grant's baseline in 2021/22 and 0.1 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 reductions to this grant are equivalent to 2.5 per cent of the grant's baseline in 2021/22, 3.2 per cent in 2022/23 and 5.2 per cent in 2023/24.

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 R725 million over the medium term. The fiscal consolidation reductions to this grant are equivalent to 6.4 per cent of the grant's baseline in 2021/22, 8.1 per cent in 2022/23 and 8.9 per cent in 2023/24.

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 R753 million over the 2021 MTEF period. Reductions to this grant are equivalent to 5.3 per cent of the grant's baseline in 2021/22 and 6.1 per cent in 2022/23.

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 classified, without the need for the transfers to be gazetted first (also see the discussion under Part 6). To ensure that sufficient funds are available in the event of a disaster, section 20 of the 2021 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 2021 MTEF period, R431 million has been allocated to the *provincial disaster relief grant*.

Health grants

In response to the ongoing COVID-19 pandemic, a new COVID-19 component was created in the *HIV, TB, malaria and community outreach services grant* in the 2020 special adjustments budget. The funds were only allocated in-year for 2020/21, with no additional funding being allocated for the 2021 MTEF.

South Africa is seeking to roll out COVID-19 vaccines as widely as possible during 2021, with the Minister of Health recently announcing plans to achieve herd immunity through vaccinations in three phases over the next 12 months. COVID-19 vaccinations will require close collaboration between the spheres of government. The national Department of Health will coordinate the vaccination campaign and be responsible for procuring and distributing vaccines across the country. Provincial departments will predominantly be responsible for administering the vaccines. To this end, R9 billion is allocated over two years, split between the national and provincial departments of health. The national Department of Health is allocated R6.6 billion for procuring and distributing the vaccines (which includes smaller amounts for other areas such as communication, training and monitoring and evaluation). Provinces are allocated R2.4 billion from the COVID-19 component within the *HIV, TB, malaria and community outreach grant* for the administration of the vaccine to subsidise the service delivery costs.

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 2021 MTEF period, the national Department of Health has reprioritised R204 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 2021/22 allocations for these provinces and left unallocated for 2022/23 and 2023/24. 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 *human resources and training 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 the *national tertiary services* grant and is working with provinces to develop a new allocation model to ensure continued fairness in allocations. The grant is allocated R41.7 billion over the medium term: R13.7 billion in 2021/22, R14 billion in 2022/23 and R14 billion in 2023/24. The fiscal consolidation reductions to this grant are equivalent to 6.7 per cent of the grant's baseline in 2021/22, 8.5 per cent in 2022/23 and 7.7 per cent in 2023/24.

The *health facility revitalisation grant* funds the construction and maintenance of health infrastructure, including large projects to modernise hospital infrastructure and equipment, general maintenance and infrastructure projects at smaller hospitals, and the refurbishment and upgrading of nursing colleges and schools. Over the 2021 MTEF period, R20.6 billion has been allocated to this grant. In 2019 the Budget Facility for Infrastructure evaluated two requests from the Western Cape Department of Health to fund the construction of the Tygeberg Regional Hospital and Klipfontein Hospital. The funding requests were approved and, included in the allocation of the grant is an addition of R129.4 million for these projects over the 2021 MTEF. The fiscal consolidation reductions to this grant are equivalent to 2.7 per cent of the grant's baseline in 2021/22, 2.6 per cent in 2022/23 and 2.2 per cent in 2023/24.

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 W1.21 sets out the final score and the incentive allocation per province.

Table W1.21 Health facility revitalisation grant allocations

R thousand	Planning assessment results from 2020	2021/22		Final allocation for 2021/22
		Basic component	Incentive component	
Eastern Cape	79%	622 222	63 366	685 588
Free State	77%	546 611	63 366	609 977
Gauteng	75%	902 505	63 366	965 871
KwaZulu-Natal	83%	1 184 364	63 366	1 247 730
Limpopo	75%	692 167	63 366	755 533
Mpumalanga	76%	393 699	63 366	457 065
Northern Cape	50%	379 637	–	379 637
North West	79%	555 556	63 366	618 922
Western Cape	98%	661 499	63 366	724 865
Total		**5 938 260**	**506 928**	**6 445 188**

Source: National Treasury

The *human resources and training grant* has two components and has been allocated R4.1 billion in 2021/22, R4 billion in 2022/23 and R4 billion in 2023/24. The training component funds the training of health sciences professionals, including specialists, registrars and their supervisors. The statutory human resources component funds intern and community service posts, as well as some posts previously funded from the equitable share. Over the 2021 MTEF period, similar to the *national tertiary services grant*, R76 million has been ring-fenced in the training component of this grant for the development and expansion of tertiary services in Eastern Cape, Limpopo, Mpumalanga Northern Cape and North West provinces. The funds have been allocated to these provinces for 2021/22, 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 2020 MTEF, the *human papillomavirus vaccine grant* was merged into the *HIV, TB, malaria, community outreach grant* and a separate component was created within the grant to continue funding human papillomavirus vaccinations. Two new components for mental health services and oncology are introduced in the grant in 2021/22, with funds reprioritised from the national health insurance: personal services component for the two outer years of the 2020 MTEF period. Over the 2021 MTEF period, the mental health services component is allocated R317 million and the oncology component is allocated R336 million. The grant's total baseline amounts to R82.6 billion over the medium term. The fiscal consolidation reductions to this grant are equivalent to 6.6 per cent of the grant's baseline in 2021/22, 8.1 per cent in 2022/23 and 9.5 per cent in 2023/24.

The *national health insurance indirect grant* continues to fund all preparatory work for universal health coverage, as announced in 2017/18. Over the 2021 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. This component is allocated R2 billion over the medium term to continue funding initiatives to strengthen health information systems, clinics, and the dispensing and distribution of centralised chronic medicines. The indirect grant is allocated a total of R7.5 billion over the 2021 MTEF period. The fiscal consolidation reductions to this grant are equivalent to 12.7 per cent of the grant's baseline in 2021/22, 4.2 per cent in 2022/23 and 7.6 per cent in 2023/24.

Funds for contracting health professionals were previously shifted from the personal services component of the indirect grant to create a new direct *national health insurance grant*. The contracting of health professionals in former national health insurance pilot sites was previously administered at national level, but 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 R813 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 2021 MTEF period, a total of R41.7 billion has been allocated to this grant. The fiscal consolidation reductions to this grant are equivalent to 0.1 per cent of the grant's baseline in 2021/22 and 0.1 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 W1.22 shows how the *human settlements development grant* formula calculates the shares for each province and the metropolitan municipalities within the provinces. Section 12(6) of the Division of Revenue Act requires provinces to gazette how much they will spend within each accredited municipality (including the amounts transferred to that municipality and the amounts spent by the province in that municipal area). Funds for mining towns and disaster recovery are allocated separately from the formula.

Table W1.22 Human settlements development grant formula calculation

Components	Housing needs 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. This component remained in place in 2020/21, serving as a planning and preparatory platform for the introduction of a new *informal settlements upgrading grant: province* in 2021/22. This new stand-alone grant, which replaces the component, is allocated R12.3 billion over the 2021 MTEF period.

A total of R543 million is ring-fenced within the *human settlements development grant* in 2021/22 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 came to an end in 2020/21. It has been incorporated back into the *human settlements development grant* for 2021/22. Provinces must continue to eradicate their registration backlogs using funds from the *human settlements development grant*.

A *provincial emergency housing grant* was also introduced in 2018/19 to enable the department to rapidly respond to emergencies by providing temporary housing in line with the Emergency Housing Programme. However, the grant is limited to funding emergency housing following the immediate aftermath of a disaster, and not the other emergency situations listed in the 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 2021 MTEF period, a total of R977 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 4 per cent of the grant's baseline in 2021/22, 5 per cent in 2022/23 and 8.6 per cent in 2023/24.

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 4 per cent of the grant's baseline in 2021/22, 5 per cent in 2022/23 and 8.6 per cent in 2023/24.

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 development centres have adequate infrastructure. The grant baseline totals R3.5 billion over the 2021 MTEF period; the conditional grant has not been reduced. A portion of the funds allocated for the maintenance component of the grant, for the two outer years of the 2021 MTEF period, will remain unallocated as they will be informed by the outcomes of the infrastructure assessments that need to be conducted in each province. As a result, 81 per cent of the allocations in this component in 2022/23 and 72 per cent in 2023/24 remain unallocated.

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 R4.6 billion over the next three years. The fiscal consolidation reductions to this grant are equivalent to 5.6 per cent of the grant's baseline in 2021/22, 6.8 per cent in 2022/23 and 7.2 per cent in 2023/24.

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 R30 million each year 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 R1.8 billion over the medium term. The fiscal consolidation reductions to this grant are equivalent to 4.8 per cent of the grant's baseline in 2021/22, 6 per cent in 2022/23 and 8.7 per cent in 2023/24.

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 R21.6 billion over the MTEF period.

The *provincial roads maintenance grant* is a supplementary grant that supports the cost of maintaining provincial roads. Provinces are expected to fund the construction of new roads from their own budgets and supplement the cost of maintaining and upgrading existing roads. Grant allocations are determined using a formula based on provincial road networks, road traffic and weather conditions. These factors reflect the varying costs of maintaining road networks in each province. The grant requires provinces to follow best practices for planning, and to use and regularly update 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 2021/22. 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 2021 to revise the incentive component in time to determine allocations from the R1.7 billion unallocated incentive pool in 2022/23. The total allocation for the MTEF period is R37.5 billion.

Part 5: Local government fiscal framework and allocations

This section outlines the transfers made to local government and how these funds are distributed between municipalities. Funds raised by national government are transferred to municipalities through conditional and unconditional grants. National transfers to municipalities are published to enable them to plan fully for their 2021/22 budgets, and to promote better accountability and transparency by ensuring that all national allocations are included in municipal budgets. Over the 2021 MTEF period, R432.6 billion will be transferred directly to local government and a further R23.7 billion has been allocated to indirect grants. Direct transfers to local government over the medium term account for 9.4 per cent of national government's non-interest expenditure. When indirect transfers are added to this, total spending on local government increases to 10 per cent of national non-interest expenditure.

Table W1.23 Transfers to local government

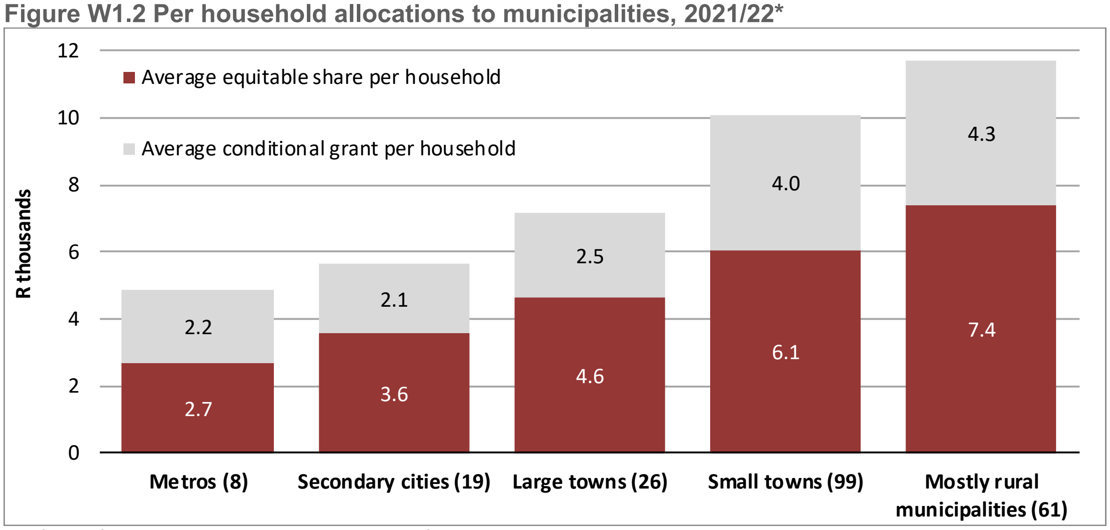
R million	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
		Outcome		Revised estimate		Medium-term estimates	
Direct transfers	**111 103**	**118 488**	**122 986**	**138 528**	**138 093**	**146 098**	**148 423**
Equitable share and related	**55 614**	**60 758**	**65 627**	**84 483**	**77 999**	**83 085**	**83 570**
Equitable share formula[1]	49 928	55 072	59 301	77 863	71 028	75 795	75 964
RSC levy replacement	4 795	4 795	5 357	5 652	5 963	6 249	6 524
Support for councillor remuneration and ward committees	891	891	969	969	1 009	1 041	1 082
General fuel levy sharing with metros	**11 785**	**12 469**	**13 167**	**14 027**	**14 617**	**15 335**	**15 433**
Conditional grants	**43 704**	**45 262**	**44 191**	**40 018**	**45 477**	**47 679**	**49 419**
Infrastructure	41 596	43 568	42 322	37 905	43 143	45 267	46 977
Capacity building and other	2 107	1 694	1 870	2 113	2 333	2 412	2 442
Indirect transfers	**7 803**	**7 887**	**7 024**	**6 865**	**7 055**	**8 200**	**8 481**
Infrastructure	7 699	7 795	6 913	6 745	6 920	8 060	8 335
Capacity building and other	103	92	111	120	135	140	147
Total	**118 905**	**126 375**	**130 010**	**145 393**	**145 148**	**154 298**	**156 904**

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

Source: National Treasury

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

Figure W1.2 Per household allocations to municipalities, 2021/22*



**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

As a result of the reductions announced in the 2020 MTBPS, the growth in allocations to the local government equitable share is below inflation over the next three years. Conditional grants, however, grow above inflation.

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

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

R million	2021/22	2022/23	2023/24	2021 MTEF total revisions
Technical adjustments	**–**	**–**	**–**	**–**
Direct transfers	**–**	**–**	**–**	**–**
Municipal infrastructure	-15	–	–	-15
Integrated urban development	15	–	–	15
Reductions to baselines	**-4 523**	**-5 402**	**-9 736**	**-19 661**
Direct transfers	**-4 349**	**-5 347**	**-9 697**	**-19 393**
Local government equitable share	**-3 063**	**-4 128**	**-7 487**	**-14 677**
Local government equitable share	-3 063	-4 128	-7 487	-14 677
General fuel levy sharing with metros	**-565**	**-750**	**-1 360**	**-2 676**
Conditional grants	**-721**	**-469**	**-850**	**-2 039**
Municipal infrastructure	-329	–	–	-329
Integrated urban development	-21	–	–	-21
Public transport network	-282	-352	-639	-1 273
Rural roads asset management systems	-5	-6	-11	-21
Energy efficiency and demand-side management	-9	-12	-22	-43
Local government financial management	-23	-30	-54	-106
Expanded public works programme	-31	-41	-74	-146
Infrastructure skills development	-6	-8	-15	-30
Municipal disaster relief	-15	-20	-35	-70
Indirect transfers	**-174**	**-55**	**-39**	**-268**
Integrated national electrification programme	-170	-50	-30	-250
Neighbourhood development partnership grant (technical assistance)	-4	-5	-10	-19
Total change to local government allocations				
Change to direct transfers	-4 349	-5 347	-9 697	-19 393
Change to indirect transfers	-174	-55	-39	-268
Net change to local government allocations	**-4 523**	**-5 402**	**-9 736**	**-19 661**

Source: National Treasury

Technical adjustments in Table W1.24 summarise the shifting of funds between different local government allocations, but do not change the total amount allocated to local government. One technical change is made in 2021/22: a shift of R15 million from the *municipal infrastructure grant* to the *integrated urban development grant* for sport infrastructure for one of the participating intermediate cities.

The local government equitable share is reduced by R14.7 billion over the 2021 MTEF period as part of the fiscal consolidation measures announced in the 2020 MTBPS (R3.1 billion in 2021/22, R4.1 billion in 2022/23 and R7.5 billion in 2023/24). This reduction will affect the indicative allocations for individual municipalities.

Due to fiscal consolidation measures announced in the 2020 MTBPS, reductions to local government conditional grants were determined, taking account of the factors described in Part 2 of this annexure. The reductions to direct conditional grants to local government total R2 billion over the 2021 MTEF period. Of this amount, government redirected R329 million from the *municipal infrastructure grant* and R21 million from the *integrated urban development grant* to fund the once-off gratuity for non-returning councillors within the budget vote of the Department of Cooperative Governance in 2021/22. Indirect grants to local government have been reduced by a total of R268 million over the medium term. 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.

Over the 2021 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 R244.7 billion (R78 billion in 2021/22, R83.1 billion in 2022/23 and R83.6 billion in 2023/24). Due to fiscal consolidation measures announced in the 2020 MTBPS, the local government equitable share declines at an average annual rate of 0.4 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

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

where

LGES is the local government equitable share

BS is the basic services component

I is the institutional component

CS is the community services component

RA is the revenue adjustment factor

C is the correction and stabilisation factor

The basic services component

This component helps municipalities provide free basic water, sanitation, electricity and refuse removal services to households that fall below an affordability threshold. Following municipal consultation, the formula's affordability measure (used to determine how many households need free basic services) is based on the level of two state old age pensions. When the 2011 Census was conducted, the state old age pension was worth R1 140 per month, which means that two pensions were worth R2 280 per month. A monthly household income of R2 300 per month in 2011 has therefore been used to define the formula's affordability threshold. Statistics South Africa has calculated that 59 per cent of all households in South Africa fall below this income threshold. However, the proportion in each municipality varies widely. In 2021 terms, this monthly income is equivalent to about R3 852 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 2019 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. The subsidy is allocated to 96 per cent of households below the poverty threshold in 2021/22, 94 per cent in 2022/23 and 88 per cent in 2023/24. These adjustments are done to ensure that the effect of the reductions over the MTEF period is spread across all the components of the formula. While the formula will fund fewer households, the impact on service delivery should be minimal because municipalities have not yet extended the provision of free basic services to reach all poor households. The basic services subsidy will fund:

- 10.2 million households in 2021/22.
- 10.3 million households in 2022/23.
- 9.8 million households in 2023/24.

The basic services component provides a subsidy of R460.12 per month in 2021/22 for the cost of providing basic services to each of these households. The subsidy includes funding for the provision of free basic water (six kilolitres per poor household per month), energy (50 kilowatt-hours per month) and sanitation and refuse removal (based on service levels defined by national policy). The monthly amount provided for each service is detailed in Table W1.25 and includes an allocation of 10 per cent for service maintenance costs.

Table W1.25 Amounts per basic service allocated through the local government equitable share, 2021/22

	Allocation per household below affordability threshold (R per month)			Total allocation per service (R million)
	Operations	Maintenance	Total	
Energy	89.84	9.98	99.83	12 215
Water	140.16	15.57	155.73	19 055
Sanitation	100.15	11.13	111.28	13 616
Refuse removal	83.96	9.33	93.28	11 414
Total basic services	**414.11**	**46.01**	**460.12**	**56 301**

Source: National Treasury

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

The electricity cost estimate is made up of bulk and other costs. Bulk costs are updated based on the bulk multi-year price determination approved by the National Energy Regulator of South Africa. 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. As the bulk price increase for 2021 were only be announced after the 2021 Budget was finalised. The equitable share formula continues to use the 9.9 per cent bulk tariff increase that was used when the baseline for this year was calculated in the 2020 MTEF period. Other (non-bulk) electricity costs are updated based on the National Treasury's inflation projections in the 2020 MTBPS.

The water cost estimate is also made up of bulk and other costs. Bulk costs are updated based on the average increase in bulk tariffs charged by water boards (although not all municipalities purchase bulk water from water boards, their price increases serve as a proxy for the cost increases for all municipalities). The average increase in tariffs for bulk water from water boards in 2020/21 was 8.9 per cent. As the bulk price increase for 2021 will only be announced after the 2021 Budget is tabled, the equitable share formula continues to use the 9.9 per cent bulk tariff increase that was used when the baseline for this year was calculated in the 2020 MTEF period. Other costs are updated based on the National Treasury's inflation projections in the 2020 MTBPS.

The costs for sanitation and refuse removal are updated based on the National Treasury's inflation projections in the 2020 MTBPS.

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

The basic services component

BS = basic services subsidy x number of poor households

Funding for each basic service is allocated to the municipality (metro, district or local) that is authorised to provide that service. If another municipality provides a service on behalf of the authorised municipality, it must transfer funds to the provider in terms of section 28 of the Division of Revenue Act. The basic services component is worth R56.3 billion in 2021/22 and accounts for 79.3 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 2021/22, this component consists of a base allocation of R7.7 million, which goes to every municipality, and an additional amount that is based on the number of council seats in each municipality. This reflects the relative size of a municipality's administration and is not intended to fund the costs of councillors only (the Minister of Cooperative Governance and Traditional Affairs determines the number of seats recognised for the formula). The base allocation acknowledges that there are some fixed costs that all municipalities face.

The institutional component

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

The institutional component accounts for 8.3 per cent of the equitable share formula and is worth R5.9 billion in 2021/22. 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 2021/22, the allocation to district and metropolitan municipalities for municipal health and other services is R10.81 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 12.4 per cent of the equitable share formula and is worth R8.7 billion in 2021/22.

The revenue adjustment factor

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

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

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

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

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

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

Correction and stabilisation factor

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

Ensuring the formula balances

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

Details of new allocations

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

Other unconditional allocations

RSC/JSB levies replacement grant

Before 2006, district municipalities raised levies on local businesses through a Regional Services Council (RSC) or Joint Services Board (JSB) levy. This source of revenue was replaced in 2006/07 with the *RSC/JSB levies replacement grant*, which was allocated to all district and metropolitan municipalities based on the amounts they had previously collected through the levies. The *RSC/JSB levies replacement grant* for metropolitan municipalities has since been replaced by the sharing of the general fuel levy. The *RSC/JSB levies replacement grant* is allocated R18.7 billion over the 2021 MTEF period.

In 2021/22, the grant increases by 6.6 per cent for district municipalities authorised for water and sanitation and 2.2 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 2021/22 is R1 billion, calculated separately to the local government equitable share and in addition to the funding for governance costs provided in the institutional component. The level of support for each municipality is allocated based on a system gazetted by the Minister of Cooperative Governance and Traditional Affairs, which classifies municipal councils into six grades based on their total income and population size. Special support is provided to the lowest three grades of municipal councils (the smallest and poorest municipalities).

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

Conditional grants to local government

National government allocates funds to local government through a variety of conditional grants. These grants fall into two main groups: infrastructure and capacity building. The total value of conditional grants directly transferred to local government increases from R45.5 billion in 2021/22 to R47.7 billion in 2022/23 and R49.4 billion in 2023/24.

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 R158.7 billion over the 2021 MTEF period.

Table W1.26 Infrastructure grants to local government

R million	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
		Outcome		Revised estimate	Medium-term estimates		
Direct transfers	**41 596**	**43 568**	**42 322**	**37 905**	**43 143**	**45 267**	**46 977**
Municipal infrastructure	15 891	15 288	14 816	14 491	15 593	16 852	17 595
Integrated urban development	–	–	857	936	1 009	1 075	1 123
Urban settlements development	11 382	11 306	11 655	10 572	7 405	7 352	7 676
Informal settlements upgrading partnership	–	–	–	–	3 945	4 181	4 365
Public transport network	6 107	6 287	6 370	4 389	6 515	6 767	6 794
Neighbourhood development partnership	658	569	592	479	567	593	619
Integrated national electrification programme	2 087	1 904	1 860	1 359	2 003	2 119	2 212
Rural roads asset management systems	107	108	114	108	110	115	115
Regional bulk infrastructure	1 829	1 963	2 029	2 006	2 156	2 281	2 381
Water services infrastructure	3 305	4 777	3 669	3 368	3 620	3 701	3 864
Municipal disaster recovery	26	1 151	133	–	–	–	–
Energy efficiency and demand-side management	203	215	227	196	221	231	232
Indirect transfers	**7 699**	**7 795**	**6 913**	**6 745**	**6 920**	**8 060**	**8 335**
Integrated national electrification programme	3 846	3 262	3 124	1 983	2 824	3 638	3 821
Neighbourhood development partnership	28	29	50	63	91	101	101
Water services infrastructure	852	1 616	644	591	730	771	805
Regional bulk infrastructure	2 974	2 887	3 094	4 108	3 275	3 550	3 607
Total	**49 296**	**51 363**	**49 235**	**44 650**	**50 063**	**53 327**	**55 312**

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 R344 million in 2021/22. This reduction includes an amount of R15 million shifted to the *integrated urban development grant* to fund sport infrastructure in Polokwane Local Municipality and an amount of R329 million that has been reprioritised to fund a once-off councillor gratuity for non-returning councillors. The total allocations for this grant amount to R50 billion over the 2021 MTEF period and grow at an average annual rate of 6.7 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	Input for horizontal calculation	Proxy used in 2021 (corresponding with data available from 2011 Census)
B	Number of water backlogs	Water access: poor household[1] report having access to piped water either inside their dwelling,in the yard or within 200 metres of their dwelling)
	Number of sanitation backlogs	Sanitation access: poor household report flush toilet, chemical toilet, pit toilet with ventilation (VIP) or ecological toilet)
	Number of roads backlogs	Roads backlog: number of poor households
	Number of other backlogs	Refuse access: poor households reports that refuse is mainly removed by local authorities or a private company once a week(urban, traditional, and farms). It should be noted that acceptable service standards differ in areas. For traditional and farms the following additions apply: removed by local authority/private company/community members less often than once a week: communal refuse dump: and communal contained/central collection point. For farms the following further additions applies: own refuse dump
P	Number of poor households	Number of poor households
E	Number of poor households	Number of poor households
N	Number of 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 (income of less than R2 300 per month in 2011 Census data)

Table W1.27 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 W1.27 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%**	**10 657**	**68.3%**
Water and sanitation	72.0%	7 673	49.2%
Roads	23.0%	2 451	15.7%
Other	5.0%	533	3.4%
P-component	**15.0%**	**2 131**	**13.7%**
Sports	33.0%	703	4.5%
E-component	**5.0%**	**710**	**4.6%**
N-component	**5.0%**	**710**	**4.6%**
Constant		**1 130**	**7.2%**
Ring-fenced funding for sport infrastructure		**253**	**1.6%**
Total		**15 593**	**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 2021 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.

From 2021/22, municipalities will be allowed to use up to 5 per cent of their allocations to fund the development of infrastructure asset management plans. This is a pragmatic approach to building the necessary asset management capabilities in municipalities. It allows for phased-in and systematic reforms to incentivise municipalities to start appropriately budgeting for the repairs and maintenance of municipal infrastructure. To make use of this provision, municipalities will need to submit a business plan to the Department of Cooperative Governance, accompanied by a copy of its audited asset register. The business plan will also have to be endorsed by the relevant national department.

Integrated urban development grant

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

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

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

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

- Management stability (low vacancy rates among senior management).
- Audit findings.
- Unauthorised, irregular, fruitless and wasteful expenditure.
- Capital expenditure.

- Reporting in terms of the Municipal Finance Management Act.

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

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 that has been approved by municipal council and updated in the last three years	30%	1 if yes for all three 0 if no for any of the three
4. Land-use applications in priority areas	Due to the lack of available data, these indicators, which are intended to reward spatial targeting of investment, remain dormant in 2021/22		1 if 50% or higher 0 if 10% or lower
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 2021/22		Linear scale in between

The total allocations for this grant amount to R3.2 billion over the 2021 MTEF period and grow at an average annual rate of 5.8 per cent. These allocations include a net reduction of R6 billion in 2021/22, following an addition of R15 million for sport infrastructure in Polokwane Municipality and R21 billion reprioritised from the grant to fund a once-off councillor gratuity for non-returning councillors.

Table W1.28 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 percent-age of total capital spend	Mainten-ance spend	Asset manage-ment plan	Land use and building plans in priority areas	Weighted score	Total incentive (R 000)	
uMhlathuze	3 393	30%	10%	20%	–	14%	18 075	21 468
Drakenstein	1 110	20%	20%	30%	–	17%	21 088	22 198
Mogale City	3 719	10%	20%	20%	–	12%	15 063	18 782
Polokwane	11 209	10%	10%	20%	–	10%	12 050	23 259
Ray Nkonyeni	1 951	10%	20%	–	–	7%	9 038	10 989
Sol Plaatje	1 576	10%	30%	–	–	10%	12 050	13 627
Stellenbosch	1 130	30%	10%	20%	–	14%	18 075	19 206
Steve Tshwete	1 574	30%	10%	30%	–	17%	21 088	22 662
Total	**25 662**					**100%**	**126 528**	**152 190**

Source: Department of Cooperative Governance

Urban settlements development grant

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

The grant is allocated R22.4 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. This grant no longer has an informal settlements upgrading component as the new *informal settlements upgrading partnership grant* is introduced in 2021/22.

Informal settlements upgrading partnership grant

Upgrading informal settlements remains 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. As discussed under the *human settlements development grant* in Part 4, a component was introduced in 2019/20 for this purpose. The component served as a planning and preparatory platform for the introduction of a new *informal settlements upgrading partnership gran*t in 2021/22. The component set a minimum amount for each city to spend on informal settlement upgrades and required cities to work in partnership with communities to develop and complete their informal settlements upgrading strategies.

The new *informal settlements upgrading partnership grant* is introduced with an allocation of R3.9 billion in 2021/22, R4.2 billion in 2022/23 and R4.4 billion in 2023/24.

Programme and project preparation support grant

The *integrated city development grant* has been repurposed to support metropolitan municipalities in developing a pipeline of investment-ready capital programmes and projects. This will be done by establishing and institutionalising an effective and efficient system of programme and project preparation and the allocation of a growing level of municipal resources for preparation activities. Accordingly, in 2021/22 the grant will be renamed the *programme and project preparation support grant*. The renamed grant is allocated R1 billion over the 2021 MTEF period and grows at an average annual rate of 5.9 per cent.

Over the MTEF period, the National Treasury will work on finalising the consolidation of this grant with the *neighbourhood development partnership grant*. This is intended to streamline support provided to programme and project preparation in municipalities, improve the efficiency and effectiveness of grant administration within the department, and reduce the reporting requirements for municipalities.

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 R20.1 billion over the medium term. The grant has been reduced by R282 million in 2021/22 and R352 million in 2022/23 and R639 million in 2023/24. These fiscal consolidation reductions to this grant are equivalent to 4.1 per cent of the grant's baseline in 2021/22, 4.9 per cent in 2022/23 and 8.6 per cent in 2023/24.

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 2021/22 is set out in Table W1.29. 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 W1.29 Public transport network grant

	Oper-ational public transport system	Grant spent in 2019/20	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 2021/22 (R 000)
Minimum threshold	**Yes**	**80%**		**35.0%**	**1.0%**	**2.0%**		
Buffalo City	No	100%	No	0.0%	0.00%	0.0%	–	–
City of Cape Town	Yes	96%	Yes	29.2%	1.08%	6.1%	0.147	121 950
City of Johannesburg	Yes	89%	Yes	25.3%	0.78%	3.8%	0.063	70 703
City of Tshwane	Yes	93%	Yes	11.4%	0.48%	2.0%	0.001	939
Ekurhuleni	Yes	100%	Yes	4.9%	0.06%	0.8%	–	–
eThekwini	No	94%	No	0.0%	0.00%	0.0%	–	–
George	Yes	100%	Yes	21.6%	5.07%	5.2%	0.437	60 486
Mangaung	No	100%	No	0.0%	0.00%	0.0%	–	–
Mbombela	No	97%	No	0.0%	0.00%	0.0%	–	–
Msunduzi	No	142%	No	0.0%	0.00%	0.0%	–	–
Nelson Mandela Bay	Yes	68%	No	16.0%	0.41%	2.5%	-	-
Polokwane	No	95%	No	0.0%	0.00%	0.0%	–	–
Rustenburg	No	43%	No	0.0%	0.00%	0.0%	–	–
Total							**0.648**	**254 078**

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 W1.30 sets out how the final allocation for each municipality is determined, taking account of both the formula and incentive components.

Table W1.30 Formula for the public transport network grant

	Base 20%	Demand-driven factors 75%			Subtotal: base and demand-driven factors	Performance 5%	100%
	Equally shared	Population component shares	Regional gross value added component shares	Public transport users component shares		Incentive component (R 000)	Grant allocations[1] (R 000)
Buffalo City[2]	7.7%	3.3%	2.8%	3.1%	0.0%	–	–
City of Cape Town	7.7%	16.3%	15.8%	13.9%	15.2%	121 950	855 640
City of Johannesburg	7.7%	19.3%	25.2%	20.5%	20.6%	70 703	1 064 862
City of Tshwane	7.7%	12.7%	15.0%	14.0%	14.0%	939	675 462
Ekurhuleni	7.7%	13.8%	9.5%	14.9%	13.0%	–	628 569
eThekwini	7.7%	15.0%	15.8%	18.0%	16.0%	–	772 712
George	7.7%	0.8%	0.5%	0.2%	2.5%	60 486	183 379
Mangaung	7.7%	3.3%	2.4%	3.2%	4.6%	–	223 648
Mbombela[2]	7.7%	2.6%	1.9%	2.4%	0.0%	–	–
Msunduzi[2]	7.7%	2.7%	1.5%	2.4%	0.0%	–	–
Nelson Mandela Bay	7.7%	5.0%	4.7%	3.6%	5.9%	–	285 086
Polokwane	7.7%	2.7%	1.5%	1.3%	3.7%	–	178 544
Rustenburg	7.7%	2.4%	3.5%	2.3%	4.4%	–	213 649
Unallocated incentive							–
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**254 078**	**5 081 552**

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, R3.4 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 2021 MTEF period amount to R2.1 billion, made up of R1.8 billion for the direct capital component and R292 million for the indirect technical assistance component. The fiscal consolidation reductions to the indirect component of this grant are equivalent to 4 per cent of the component's baseline in 2021/22, 5 per cent in 2022/23 and 8.6 per cent in 2023/24.

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 allocated R11.2 billion over the 2021 MTEF period. The indirect component has a total allocation of R2.3 billion over the medium term.

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 grant has a total allocation of R17.3 billion over the 2021 MTEF period, consisting of R6.8 billion and R10.4 billion for the direct and indirect components respectively. The indirect component includes R367 million for the completion of bucket eradication projects in 2021/22.

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 R16.6 billion on the programme over the 2021 MTEF period.

The *integrated national electrification programme (municipal) grant* has a total allocation of R6.3 billion over the medium term and grows at an average annual rate of 17.6 per cent. The *integrated national electrification programme (Eskom) grant* is allocated R10.3 billion over the medium term and grows at an average annual rate of 11.6 per cent. It is reduced by R170 million in 2021/22, R50 million in 2022/23 and R30 million in 2023/24 to fund other government priorities. The reductions to this grant are equivalent to 5.7 per cent of the grant's baseline in 2021/22, 1.4 per cent in 2022/23 and 0.8 per cent in 2023/24.

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 R684 million over the medium term. The fiscal consolidation reductions to this grant are equivalent to 4 per cent of the grant's baseline in 2021/22, 5 per cent in 2022/23 and 8.6 per cent in 2023/24.

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 R5 million in 2021/22, R6 million in 2022/23 and R11 million in 2023/24 to fund other government priorities. The grant is allocated R110 million in 2021/22, R115 million in 2022/23 and R115 million in 2023/24. The fiscal consolidation reductions to this grant are equivalent to 4 per cent of the grant's baseline in 2021/22, 5 per cent in 2022/23 and 8.6 per cent in 2023/24.

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 R7.6 billion is allocated to capacity-building grants and other current transfers to local government over the medium term.

Table W1.31 Capacity building and other current grants to local government

R million	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
		Outcome		Revised estimate	Medium-term estimates		
Direct transfers	**1 968**	**1 670**	**1 870**	**2 113**	**2 333**	**2 412**	**2 442**
Municipal disaster relief	341	–	–	204	359	371	373
Municipal emergency housing	–	38	147	159	168	175	183
Infrastructure skills development	141	141	149	144	155	159	160
Local government financial management	502	505	533	545	552	566	569
Programme and project preparation support	292	294	310	314	341	361	377
Expanded public works programme integrated grant for municipalities	691	693	730	748	759	778	781
Indirect transfers	**103**	**92**	**111**	**120**	**135**	**140**	**147**
Municipal systems improvement	103	92	111	120	135	140	147
Total	**2 071**	**1 762**	**1 981**	**2 233**	**2 469**	**2 552**	**2 589**

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 R23 million in 2021/22, R30 million in 2022/23 and R54 million in 2023/24 to fund other government priorities. Total allocations to this grant amount to R1.7 billion over the 2021 MTEF period. The fiscal consolidation reductions to this grant are equivalent to 4 per cent of the grant's baseline in 2021/22, 5 per cent in 2022/23 and 8.6 per cent in 2023/24.

Infrastructure skills development grant

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

This grant is reduced by R6 million in 2021/22, R8 million in 2022/23 and R15 million in 2023/24 to fund other government priorities. Its total allocations amount to R474 million over the 2021 MTEF period. The fiscal consolidation reductions to this grant are equivalent to 4 per cent of the grant's baseline in 2021/22, 5 per cent in 2022/23 and 8.6 per cent in 2023/24.

Municipal systems improvement grant

The *municipal systems improvement grant* funds a range of projects in municipalities in support of the implementation of the district development model approach and the back to basics strategy, including helping municipalities set up adequate record management systems, drawing up organograms for municipalities and reviewing their appropriateness relative to their assigned functions, implementing the Integrated Urban Development Framework, and assisting municipalities with revenue collection plans and the implementation of the municipal standard chart of accounts. The Department of Cooperative Governance implements the indirect grant. The grant's total allocations amount to R422 million over the 2021 MTEF period and grow at an average annual rate of 10 per cent.

In 2021/22, roughly a third of the grant's baseline will be used to support the institutionalisation of the district development model adopted by Cabinet in August 2019. The model is a method of government operating in unison, focusing on the municipal district and metropolitan spaces as the impact areas of joint planning, budgeting and implementation. In 2021/22, the grant will fund:

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

In the outer years of the MTEF period, 10 per cent of the grant's baseline is unallocated. This amount will be used to fund diagnostic assessments and the development of institutional improvement plans for the remaining 23 district areas.

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 R31 million in 2021/22, R41 million in 2022/23 and R74 million in 2023/24 to fund other government priorities. The impact of these reductions will be spread across municipalities in line with the grant's formula. The grant is allocated R2.3 billion over the MTEF period. The fiscal consolidation reductions to this grant are equivalent to 4 per cent of the grant's baseline in 2021/22, 5 per cent in 2022/23 and 8.6 per cent in 2023/24.

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 20 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.

The grant's baseline is reduced by R15 million in 2021/22, R20 million in 2022/23 and R35 million in 2023/24 to fund other government priorities. These fiscal consolidation reductions are equivalent to 4 per cent of the grant's baseline in 2021/22, 5 per cent in 2022/23 and 8.7 per cent in 2023/24. Over the 2021 MTEF period, R1.1 billion is available for disbursement through this grant. To ensure that sufficient funds are available for disaster relief, section 17(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, R526 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 2021/22 as part of the ongoing review and refinement of the intergovernmental fiscal framework. Provinces and municipalities will be consulted on all proposed changes.

Cross-cutting reforms

Improving intergovernmental coordination on infrastructure investment

Public infrastructure investments can play a major role in transforming South Africa's spatial development patterns. This requires a significant improvement in intergovernmental coordination in planning and budgeting for infrastructure. The National Treasury is working with provinces to ensure that their investments in schools, roads, health facilities and housing are made in locations that align with the spatial development plans of municipalities. Municipalities must be consulted and agree on the location and bulk services requirements of all provincial infrastructure projects. Joint planning sessions have been held between provinces and municipalities, and support in this area will continue in 2021/22. National departments will also be supported to participate in intergovernmental planning and to review sector policies and funding strategies to promote better alignment with spatial development frameworks. This is in line with the Cabinet-approved district development model.

In 2021/22, 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

In 2021/22, 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 following the declaration of a disaster. In addition to addressing the problems and inefficiencies within the existing system, the review 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. For the 2021 Budget, this review has culminated in government relaxing the requirement for funds from the disaster grants to be used only after a disaster has been declared. For the initial response, funds may now be released when a disaster is classified. This is to allow for a quick response to the disaster; however, for significant or long-term disasters, a declaration is required to use resources from the disaster grant. This relaxation is being piloted for one financial year. Based on the lessons learnt, a decision will then be made on the funding approach for disasters.

Review of the provincial fiscal framework

Review of the provincial equitable share formula

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

The provincial equitable share task team, made up of representatives from the National Treasury and provincial treasuries, is reviewing the formula. The task team partners with sector departments, Statistics South Africa and the FFC on different components of the review. It reports to the Technical Committee on Finance, and the Budget Council considers and approves any proposed changes to the formula. During 2021/22, the review will focus on:

- 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.
- Revising the poverty component in 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 and increasingly channelling health budgets via this fund are 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 initiative 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. The National Treasury and the Department of Health will continue to work together during 2021 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 early childhood development function from the social development to the basic education sector

Following the President's announcement in the 2019 State of the Nation Address, South Africa will introduce two years of compulsory pre-schooling for all children before they enter Grade 1. The departments of Basic Education and Social Development and other partners are working closely to oversee the migration of the responsibility for early childhood development from the social development sector to the basic education sector and to introduce the compulsory pre-schooling. In 2020/21, these partners conducted an early childhood development audit to determine the need across all affected age groups and the quality of provision of these services. In 2021/22, the policy function will shift from the Department of Social Development to the Department of Basic Education, while the function's administration is envisaged to be shifted in 2022/23.

Shift of agricultural colleges to national government

For agricultural colleges to be accredited as higher education colleges in terms of the Higher Education Act (1997), the function of administering these colleges needs to move from provinces to the national government. The Department of Higher Education and Training is coordinating with the Department of Agriculture, Land Reform and Rural Development and its provincial counterparts to prepare for this proposed function shift. In 2020/21, the National Treasury worked with provincial treasuries, the Department of Agriculture, Land Reform and Rural Development and the Department of Higher Education and Training to assess the financial impacts of the proposed shift. Not all requirements of a function shift in terms of Treasury Regulations and section 42 of the Public Finance Management Act, as well as relevant legislation and regulations relating to higher education and training have been met, so the function shift will most likely be implemented in the 2022 Budget.

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. It includes participants from provincial treasuries and sector departments, the Department of Small Business Development, the Department of Cooperative Governance and SALGA.

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 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. As proposed by the Minister of Finance, the Budget Forum held a special lekgotla on 11 December 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.

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

The Budget Forum lekgotla resolved that all matters pertaining to the Local Government Functional and Fiscal Framework must be addressed collaboratively by the National Treasury, the Department of Cooperative Governance and Traditional Affairs and SALGA. A joint work programme has been agreed on to deal with key outstanding issues impeding the effective functioning of the fiscal system for local government. Moreover, as mandated by the Budget Forum lekgotla, a collaborative policy and administrative infrastructure workstream looking into infrastructure funding and asset management support work is under way in 2021. These will help to resolve contentious issues and build consensus.

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.
- Conducting research to inform the review of the fairness of the equitable share formula and cost elements applied in the formula.

Review of local government infrastructure grants

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

- Improving the administration of conditional grants by national 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. This will be the focus of the Budget Forum lekgotla's 2021 infrastructure stream.

Review of the municipal capacity support system

Government is reviewing the system of capacity building 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, which will identify ways to improve implementation capability in South Africa. The review plans to:

- Support the National Treasury to achieve its goals of enhancing and coordinating prudent financial management, and improving integration and coordination across government.
- Provide common understanding within government of what the current capacity-building system is by mapping the various capacity-building measures undertaken by the different parts of government and their interrelationship.
- Promote innovation in the system.
- Identify opportunities to improve the cost-effectiveness of the capacity-building measures within the system, including reducing administrative costs and duplications.
- Enhance improved municipal performance.

The National Treasury appointed a service provider in November 2020 and inputs were made at an inception meeting of a multisectoral Steering Committee on 20 January 2021. Although the review outcomes will lead to widespread consultation, detailed studies and projects for prioritised components of the capacity-building system for implementation, certain emerging components may inform initial changes to the capacity-building system in the 2022 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

Development charges are important components of a sustainable municipal infrastructure financing system, especially for cities and large urban municipalities. Development charges are used to finance land intensification. Despite their potential as an alternative option for financing infrastructure, municipalities have not fully used development charges due to uncertainty surrounding the regulatory frameworks. A municipality imposes these once-off charges on a landowner applying for land development approval. The charges are based on the concept that urban growth and expanded land use lead to increased infrastructure demand. To allow municipalities to mobilise own revenue resources to fund municipal infrastructure needs and support economic growth, the draft Municipal Fiscal Powers and Functions Amendment Bill proposes new, uniform regulations for levying development charges, strengthening municipalities' revenue-raising framework. The National Treasury received comments in 2020 and is addressing them. It will then submit the bill to Cabinet and Parliament for consideration in 2021.

The draft legislation can be accessed on the National Treasury website: http://www.treasury.gov.za/legislation/draft_bills.

Municipal borrowing

The National Treasury has updated the original municipal borrowing policy framework and will shortly submit it to Cabinet for approval. The proposed changes aim to increase the term maturity of borrowing, improve the secondary market for the trade of municipal debt instruments, and define development finance institutions' role to avoid crowding out the private sector.

Complementary to this process, initiatives that aim to promote infrastructure financing, such as the Infrastructure Fund, have been launched. As a blended finance mechanism, the Infrastructure Fund is designed to use government grants to leverage private sector investment. In addition, project preparation structures are in place to help project owners and sponsors adequately prepare projects for funding through the Infrastructure Fund.

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