W1

Explanatory memorandum to the division of revenue

Background

Section 214(1) of the Constitution requires that the nationally raised revenue be divided equitably between national government, the nine provinces and 257 municipalities. This is outlined in the annual Division of Revenue Act. The division of revenue takes into account the powers and functions assigned to each sphere; fosters transparency, predictability and stability; and is at the heart of constitutional cooperative governance.

The principles underpinning the equitable sharing and allocation of nationally raised revenue are prescribed in the Intergovernmental Fiscal Relations Act (1997). 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 2022 Division of Revenue Bill fulfils the requirement set out in section 10(5) of the Intergovernmental Fiscal Relations Act. This Act requires that the bill is accompanied by an explanatory memorandum detailing how the Bill takes account of each of the matters listed in section 214(a) to (j) of the Constitution; government's response to the FFC's recommendations submitted to the Minister in terms of section 9 of the Act or as a result of consultations with the FFC; and any assumptions and formulae used in arriving at the respective shares. Moreover, this memorandum complements the discussion on 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 2022 division of revenue.
- Part 3 sets out how the FFC's recommendations on the 2022 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 2021.

Part 1: Constitutional considerations

Section 214 of the Constitution requires that the annual Division of Revenue Act be enacted after 10 key principles outlined in sub-sections 2(a) to (j) are considered. The 10 constitutional principles considered in the 2022 division of revenue are briefly noted below.

National interest and the division of resources

The National Development Plan sets out the national interest by outlining a long-term vision for the country through which South Africa can advance inclusive economic transformation. To achieve this vision, South Africa needs to use the division of resources in a manner that draws on the energies of its people; builds and grows an inclusive economy; builds capabilities; enhances the capacity of the state; and promotes leadership and partnerships throughout society. The 2019–2024 Medium Term Strategic Framework outlines the plan and outcome-based monitoring framework for implementing South Africa's national development priorities for the sixth administration.

In the 2021 *Medium Term Budget Policy Statement* (MTBPS), the Minister of Finance outlined how the resources available to government over the 2022 medium-term expenditure framework (MTEF) would be allocated to help achieve government's priorities, as outlined in the 2021 State of the Nation Address (SONA). These priorities are as follows:

- Defeat the COVID-19 pandemic.
- Accelerate economic recovery through implementing the economic recovery plan.
- Implement economic reforms to create sustainable jobs and drive inclusive growth.
- Fight corruption and strengthen the state's capability.

These priorities have informed the division of resources between the three spheres of government over the 2022 MTEF period. Chapter 4 of the 2021 MTBPS and Chapters 5 and 6 of the 2022 *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 14 priority outcomes.

Provision for debt costs

The resources shared between national, provincial and local government include proceeds from national government borrowing used to fund public spending. Gross loan debt is expected to increase from R4.35 trillion (69.5 per cent of GDP) in 2021/22 to R4.69 trillion (72.8 per cent of GDP) in 2022/23 and will peak at R5.43 trillion (75.1 per cent of GDP) in 2024/25. To protect and maintain the country's integrity and credit reputation, it is important that national government provide for the resulting debt costs. Chapter 7 of the 2022 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 and provincial government have concurrent responsibility for a range of functions, such as school education, health services, social welfare services, housing and agriculture. For these functions, national government is mainly responsible for providing leadership, policy formulation, including setting norms and standards, and oversight and monitoring, while the provincial government is mainly responsible for implementation in line with the nationally determined framework.

National government is exclusively responsible for functions that serve the national interest and are best centralised, including national defence, the criminal justice system (safety and security, courts), higher education and administrative functions (home affairs, collection of national taxes). 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 in line with legislative prescripts 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 the 2022 MTEF period, R2.56 trillion or 52 per cent of non-interest spending is allocated to provinces and local government. Of this, R2.05 trillion or 41.7 per cent is allocated to the provincial sphere, while R506.7 billion or 10.3 per cent is allocated to the local sphere of government. This is to continue funding the local and provincial government priorities over the 2022 MTEF period, which include health, education and basic services and funding the rising costs of these services as a result of population growth and higher bulk electricity and water costs.

Fiscal capacity and efficiency

Fiscal capacity refers to the revenue-raising power of each sphere of government. National government has limited revenue-raising powers and large spending responsibilities. As such, it receives the biggest share of the nationally raised revenue, after taking into account the contingency reserve and debt servicing costs. Provinces have limited revenue-raising capacity and large spending responsibilities so receive the second-largest share of nationally raised revenue. Municipalities, on the other hand, have extensive revenue-raising powers, through property rates, user charges and fees. The revenue raised by municipalities provides for basic services such as sanitation, waste management, 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.

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-raising capacity, many rural municipalities will depend on transfers for most of their funding. This is done through the local government equitable share formula, which 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 mechanisms for allocating funds to provinces and municipalities are regularly reviewed to improve their efficiency. For the 2022 MTEF, changes will be made to the health component of the provincial equitable share, informed by the recent review of the formula that was undertaken by the National Treasury in collaboration with Department of Health and the Government Technical Advisory Centre. These changes will be phased in over three years to allow provinces to adjust to the impact of the changes on their allocation (full details of the review and outcome are provided in Part 4 of this annexure). To maximise the effect of allocations, conditional grant allocations to provincial and local government are informed by the recipient's efficacy and efficiency in using allocations in the past.

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), allocating R630.2 billion over the 2022 MTEF period, and social infrastructure (such as schools, hospitals and clinics), allocating R147.6 billion over the 2022 MTEF period. This is 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 2022 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 unforeseen and unavoidable events. In addition, four conditional grants for disasters and housing emergencies (*provincial disaster response grant; provincial emergency housing grant; municipal disaster response grant, municipal emergency housing grant*) allow government to allocate and transfer funds to affected provinces and municipalities in the immediate aftermath of a disaster. Over the 2022 MTEF period, R3.1 billion is allocated to these grants. Furthermore, various legislation, such as sections 16 and 25 of the Public Finance Management Act (1999), provide for the allocation of funds, including adjustment allocations to deal with emergency, unforeseeable and unavoidable situations. 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 2022 division of revenue

Medium-term fiscal policy is focused on reducing the budget deficit and stabilising the debt-to-GDP ratio. Over the medium term, restoring fiscal sustainability requires continued restraint in expenditure growth and reforms to raise economic growth. The 2022 Budget proposes:

- Additional allocations to address immediate spending pressures, including extending the *special COVID-19 social relief of distress grant* for 12 months until March 2023, and bolstering provincial transfers for health and education.
- Setting aside a portion of higher-than-expected revenue to narrow the budget deficit. This mitigates the impact of higher interest rates on debt-service costs and improves the longer-term debt outlook.
- Supporting economic growth through a range of reforms, including the infrastructure-build programme financed through innovative funding mechanisms and supported by improved technical capabilities (see Chapter 3 of the 2022 *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 2022 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 R1.66 trillion in 2022/23, R1.60 trillion in 2023/24 and R1.67 trillion in 2024/25. 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.

Increase in non-interest spending

Given the improved tax revenue estimates experienced in 2021/22, and projected increases in tax revenue over the 2022 MTEF period, government proposes a small increase in non-interest spending compared with the 2021 Budget projections. Total main budget non-interest expenditure is projected to increase by R282.3 billion over the 2022 MTEF period as follows: R110.6 billion in 2022/23, R84.6 billion in 2023/24 and R87.1 billion in 2024/25.

Following the 2021 MTBPS, further changes were made to the fiscal framework. The provincial equitable share has been increased by R53 billion over the medium term. Direct conditional grants to provinces have been increased by R5.4 billion. The local government direct transfers increase to R30.7 billion, comprising R28.9 billion from the local government equitable share and R1.8 billion in increases to direct conditional grants.

Several provincial and local government infrastructure grants that are likely to go unspent based on historical spending trends are being reprioritised to other priorities. Parts 4 and 5 of this annexure set out in more detail how the changes to the baseline affect provincial and local government transfers.

Reprioritisations

Existing budgets need to be reprioritised to meet government's policy goals while remaining within the revised expenditure ceiling. Priorities over the 2022 MTEF period that are funded through reprioritisations in the division of revenue include addressing shortfalls in funding for appointing medical interns in the health sector.

These reprioritisations complement baselines that provide R2.04 trillion to provinces and R481.3 billion to local government in transfers over the 2022 MTEF period. These transfers fund 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 2022 Budget. It sets out the growth assumptions and fiscal policy targets on which the fiscal framework is based.

Table W1.1 Medium-term macroeconomic assumptions

R billion/percentage of GDP	2021/22 2021 Budget	2021/22 2022 Budget	2022/23 2021 Budget	2022/23 2022 Budget	2023/24 2021 Budget	2023/24 2022 Budget	2024/25 2022 Budget
Gross domestic product	5 911.3	6 251.5	6 258.2	6 441.3	6 623.6	6 805.3	7 233.7
Real GDP growth	*5.4%*	*6.0%*	*1.9%*	*1.9%*	*1.6%*	*1.7%*	*1.8%*
GDP inflation	*3.2%*	*5.9%*	*3.9%*	*1.1%*	*4.1%*	*3.9%*	*4.5%*
National budget framework							
Revenue	**1 351.7**	**1 549.1**	**1 453.7**	**1 588.0**	**1 522.0**	**1 660.2**	**1 774.2**
Percentage of GDP	*22.9%*	*24.8%*	*23.2%*	*24.7%*	*23.0%*	*24.4%*	*24.5%*
Expenditure	**1 834.3**	**1 896.0**	**1 870.8**	**1 975.3**	**1 911.0**	**1 992.0**	**2 096.6**
Percentage of GDP	*31.0%*	*30.3%*	*29.9%*	*30.7%*	*28.9%*	*29.3%*	*29.0%*
Main budget balance[1]	**-482.6**	**-346.9**	**-417.2**	**-387.2**	**-389.0**	**-331.8**	**-322.4**
Percentage of GDP	*-8.2%*	*-5.5%*	*-6.7%*	*-6.0%*	*-5.9%*	*-4.9%*	*-4.5%*

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 2022 MTEF period after accounting for new policy priorities.

Table W1.2 Division of nationally raised revenue

R million	2018/19	2019/20 Outcome	2020/21	2021/22 Revised estimate	2022/23	2023/24 Medium-term estimates	2024/25
Division of available funds							
National departments	**634 314**	**749 775**	**790 495**	**831 142**	**824 712**	**770 910**	**805 662**
of which:							
Indirect transfers to provinces	*3 882*	*2 927*	*3 056*	*3 954*	*4 612*	*4 550*	*4 015*
Indirect transfers to local government	*6 337*	*5 565*	*4 100*	*4 903*	*8 055*	*8 481*	*8 862*
Provinces	**571 954**	**613 450**	**628 807**	**661 196**	**682 539**	**667 310**	**690 157**
Equitable share	470 287	505 554	520 717	544 835	560 757	543 149	562 018
Conditional grants	101 667	107 896	108 090	116 361	121 782	124 161	128 138
Local government	**118 488**	**122 986**	**137 098**	**135 310**	**150 630**	**160 514**	**170 147**
Equitable share	60 758	65 627	83 102	75 724	87 311	94 087	101 486
Conditional grants	45 262	44 191	39 969	44 969	47 983	50 994	52 534
General fuel levy sharing with metros	12 469	13 167	14 027	14 617	15 335	15 433	16 127
Provisional allocation not assigned to votes[1]	–	–	–	–	5 569	28 295	32 078
Non-interest allocations	**1 324 756**	**1 486 211**	**1 556 400**	**1 627 648**	**1 663 450**	**1 627 028**	**1 698 044**
Percentage increase	*6.6%*	*12.2%*	*4.7%*	*4.6%*	*2.2%*	*-2.2%*	*4.4%*
Debt-service costs	181 849	204 769	232 596	268 306	301 806	334 979	363 515
Contingency reserve	–	–	–	–	10 000	5 000	5 000
Unallocated reserve	–	–	–	–	–	25 000	30 000
Main budget expenditure	**1 506 605**	**1 690 980**	**1 788 996**	**1 895 954**	**1 975 257**	**1 992 007**	**2 096 559**
Percentage increase	*7.2%*	*12.2%*	*5.8%*	*6.0%*	*4.2%*	*0.8%*	*5.2%*
Percentage shares							
National departments	*47.9%*	*50.4%*	*50.8%*	*51.1%*	*49.7%*	*48.2%*	*48.4%*
Provinces	*43.2%*	*41.3%*	*40.4%*	*40.6%*	*41.2%*	*41.7%*	*41.4%*
Local government	*8.9%*	*8.3%*	*8.8%*	*8.3%*	*9.1%*	*10.0%*	*10.2%*

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 are accommodated by small increases in non-interest spending.

Table W1.3 Changes over baseline

R million	2022/23	2023/24
National departments	88 426	31 921
Provinces	39 195	20 486
Local government	4 532	12 091
Allocated expenditure	**132 153**	**64 498**

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	2022/23 Allocation	2023/24 Forward estimates	2024/25
National[1]	1 327 188	1 354 771	1 433 054
Provincial	560 757	543 149	562 018
Local	87 311	94 087	101 486
Total	**1 975 257**	**1 992 007**	**2 096 559**

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 2022 *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 2022/23* to Parliament in May 2021. The 2022/23 recommendations cover the following areas: countering the economic and fiscal impacts of the COVID-19 pandemic; measuring the effectiveness of government expenditure; impact of the COVID-19 pandemic on the local economy; addressing gender inequality through gender budgeting in the public sector; existing social grant system; food security during the COVID-19 pandemic; water and sanitation access, distribution efficiencies and tariff setting; role of intergovernmental oversight and support in avoiding a section 139 intervention; and improving the delivery of infrastructure projects through effective leadership.

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 are normally referred to the officials to whom they were addressed, who are requested to respond directly to the FFC. However, for this cycle of recommendations, the FFC frustrated the process to allow for the referral of the recommendations so recommendations were not referred. 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: Measuring the Macroeconomic and Fiscal Impacts of COVID-19 in South Africa

Supporting local demand and localised products

The FFC recommends the following: "The 2022/23 Division of Revenue should, in promoting economic growth, be more specific in supporting local demand and localised product procurement in order to support value chains, as endorsed by the President in the State of the Nation Address (SONA) towards economic transformation and development. The Minister of Finance should explore the use of the budget as an instrument to incentivise localised product procurement. The Commission, in its 2021/22 Annual Submission for the Division of Revenue (Chapter 3, Recommendation 2), also recommended the concept of a localised product value chain approach towards growth. This was further agreed to in the 2021 W1 Annexure: Explanatory Memorandum to the Division of Revenue."

Government response

The Minister of Finance, within the available legislative mandate, has ensured that promotion of local products through procurement is provided for. Section 217 of the Constitution provides for organs of state to implement a procurement policy providing for categories of preference in the allocation of contracts when contracting for goods and services. However, it requires that national legislation prescribe a framework within which the preferential procurement policy must be implemented. To effect this requirement, the Minister of Finance issued the Preferential Procurement Policy Framework Act (2000) to ensure that procurement is utilised as lever to address broader government socioeconomic objectives. Regulation 8 of the Preferential Procurement Regulations of 2017 makes provision to address local production and content. Furthermore, the objective of the Public Procurement Bill is to ensure that the state uses procurement to promote local production. In addition, chapter 4 of the bill makes provision for preference measures to set aside the allocation of contracts to promote locally manufactured goods.

Chapter 4: The Impact of the COVID-19 Pandemic on the Local Economy

Supporting municipalities to embrace e-government (digitalisation)

The FFC recommends the following: "National Treasury, through the Municipal Systems Improvement Grant (MSIG), should support municipalities to embrace e-government (digitalisation) and diversify their revenue mix as part of building the financial resilience of local government."

Government response

The Department of Cooperative Governance is responsible for the grant and setting its conditions.

Chapter 7: COVID-19 and Food Security

Continuation of school feeding programme during COVID-19

The FFC recommends the following: "The Minister of Finance, in the Division of Revenue, should continue supporting the Department of Basic Education (DBE) in school-feeding programmes during COVID-19."

Government response

The Division of Revenue Bill provides an allocation and a grant framework for the *national school nutrition programme grant*.

Chapter 9: The Role of Intergovernmental Oversight and Support in Avoiding a Section 139 Intervention

Allocation and review of capacity-building grants

The FFC recommends the following: "As part of National Treasury's review of capacity-building grants, financial support to build capacity and institutional systems (such as the Finance Management Grant and the Municipal Systems Improvement Grant):

i. should be disproportionately directed at lesser-resourced, poorer and more rural municipalities;

ii. should make every effort to ensure that capacity-building efforts are comprehensively consulted with and agreed to with a municipality;

iii. should either link capacity-building efforts to a municipality-specific diagnosis of capacity challenges or deficits, or be specifically aimed at addressing challenges picked up through intergovernmental monitoring; and

iv. should consider the consolidation of all capacity-building grants into one financial flow that is specifically linked to overall intergovernmental 'support' of municipalities. This will assist in the administrative and reporting burden placed on both grant administrating departments and receiving municipalities, and will further assist in streamlining the overall conditional grant framework."

Government response

Government notes the recommendations, which to a large extent, echo the findings that emerged from the diagnostic review of capacity-building initiatives. Work is being undertaken to implement the review findings; however, it should be highlighted that to ensure their effectiveness, the recommendations emanating from the Diagnostic Review need to be phased in.

Monitoring and reporting

The FFC recommends the following: "Given that the current monitoring and support framework is applied uniformly across local government, government should reconsider its current approach to explore the principle of a differentiated method to municipalities when it comes to financial and non-financial reporting requirements, overall monitoring and support."

Government response

Reporting in general falls outside the scope of the Division of Revenue. Reporting on conditional grants, which is an issue for the Division of Revenue Act, cannot be done outside the overall reporting norms and standards.

Chapter 10: Leadership, Management and Governance for Sustainable Public Service Delivery

Compliance with legislation

The FFC recommends the following: "The Minister of Finance, in the Division of Revenue, should ensure that commitment to compliance with legislation and policy frameworks is formalised with all participants in an infrastructure project prior to the commencement of the project, with financial consequences for compliance failures clearly set out. This will ensure that policies and clear regulatory frameworks are in place to avoid judiciary involvement and pronouncing on what should be done on policy matters that could have been easily resolved through policy and legislation."

Government response

Each grant framework clearly articulates the roles and responsibilities of the different role players. Moreover, sections 17 to 19 of the 2021 Division of Revenue Act outline the financial consequences of withholding, stopping and reallocations.

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 41.4 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 95 per cent of provincial revenue.

This section outlines national transfers to provinces for the 2022 MTEF period announced in the 2021 MTBPS and 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 R661 billion in 2021/22 to R682.5 billion in 2022/23. Over the MTEF period, provincial transfers will grow at an average annual rate of 1.4 per cent to R690.2 billion in 2024/25. Table W1.5 sets out the transfers to provinces for 2022/23. A total of R560.8 billion is allocated to the provincial equitable share and R121.8 billion to conditional grants, which includes an unallocated amount of R471 million for the *provincial disaster response grant* and the *provincial emergency housing grant*.

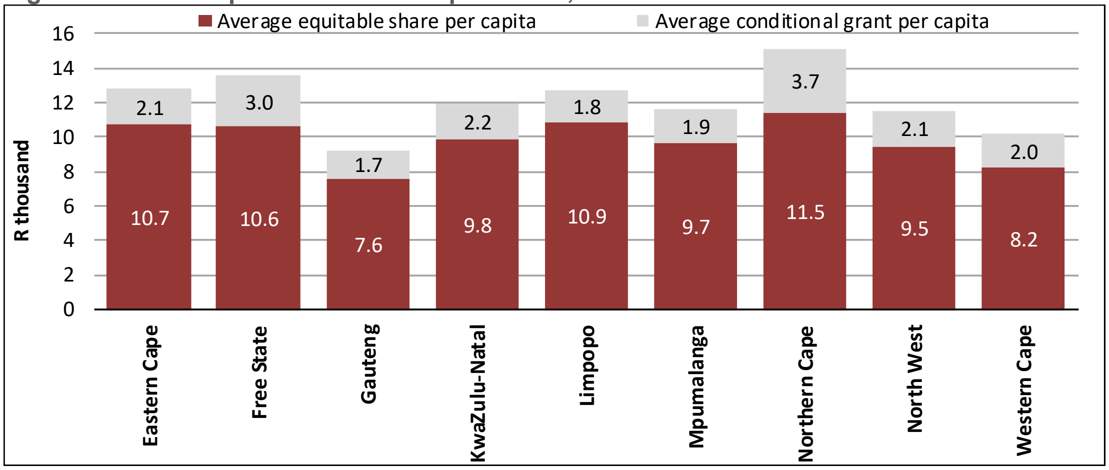
Table W1.5 Total transfers to provinces, 2022/23

R million	Equitable share	Conditional grants	Total transfers
Eastern Cape	72 231	13 850	86 081
Free State	31 107	8 737	39 845
Gauteng	120 042	26 503	146 545
KwaZulu-Natal	114 509	25 041	139 551
Limpopo	64 056	10 741	74 796
Mpumalanga	45 962	9 060	55 022
Northern Cape	14 942	4 795	19 737
North West	39 540	8 568	48 108
Western Cape	58 367	14 016	72 383
Unallocated		471	471
Total	**560 757**	**121 782**	**682 539**

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, 2022/23



Source: National Treasury

Changes to provincial allocations

Funds have been added to provincial transfers to allow provinces to cover the cost of the non-pensionable cash gratuity to public-service employees resulting from the 2021 wage agreement. As mentioned in the 2021 MTBPS, R20.5 billion has been set aside in 2022/23 as a preliminary carry-through allocation for national and provincial departments to continue the payment of the once-off cash gratuity if no new wage agreement is reached in 2022. Of this amount, R14.7 billion has been allocated to provinces, with R13.9 billion added to the provincial equitable share and R809 million added to several provincial conditional grants that cover compensation of employees.

Additional funding was added to the provincial equitable share over the next three years after the tabling of the 2021 MTBPS. This includes R24.6 billion to support provincial education departments in addressing educator numbers and other shortfalls within the sector (R9 billion in 2022/23, R7.6 billion in 2023/24 and R8 billion in 2024/25). A further R12.7 billion (made up of R6.2 billion in 2022/23 and R6.5 billion in 2023/24) is added for the provincial education departments to continue hiring assistants in schools as part of the presidential employment initiative. An amount of R15.6 billion is added for provincial departments of health to continue to respond to the COVID-19 pandemic and to reduce the impact of budget reductions on essential medical goods and services (R7.4 billion in 2022/23, R3.4 billion in 2023/24 and R4.7 billion in 2024/25). For the social sector, R988 million has been added to fund non-profit organisations that are already contracted by the provincial departments of social development, with R204 million in 2022/23, R358 million in 2023/24 and R426 million in 2024/25.

Additions to provincial conditional grants over the MTEF period made after the 2021 MTBPS include R3.3 billion added to the *human resources and training grant* to address the funding shortfall for medical interns and community service doctors; R1 billion is added in 2022/23 to the COVID-19 component of the *district health programmes grant* to fund the continuation of the COVID-19 vaccine rollout by provinces; and R2.1 billion is added over the next two years for repairing infrastructure damaged by floods and storms in KwaZulu-Natal in 2019 and 2020. This disaster funding is added to the *human settlements development grant* for repairs of houses, the *education infrastructure grant* for repairs of schools and the *provincial roads maintenance grant* for repairs of provincial roads.

Other changes include reprioritisation of funds and reductions, mainly in conditional grants. To address a funding shortfall for medical internship and community services posts in provinces over the 2022 MTEF period, R745 million has been reprioritised to the *human resource and training grant*. This funding is made available by reprioritising R345 million from the *health facility revitalisation grant* and R400 million from the *national health insurance indirect grant* over the 2022 MTEF period. In addition, R1.7 billion has been reduced from the *provincial roads maintenance grant* in 2022/23. These funds were set aside in the baseline of the conditional grant in the 2021 MTEF as an incentive portion that is allocated to provinces based on their performance within the grant. For 2022/23, the incentive portion will not be allocated to the provinces as the process of developing clear and objective criteria by the sector is being finalised.

Changes have also been made to conditional grants to accommodate structural changes and function shifts. The *HIV, TB, malaria and community outreach grant* will be renamed the *district health programmes grant*. It will still be used for the same purpose, but the number of components within the grant will be reduced to two. The mental health services component and oncology services component of the previous grant will be shifted to the *national health insurance grant*.

In the social development sector, the early childhood development programme will be transferred to the education sector from April 2022. As a result, the *early childhood development grant* will be moved from the Department of Social Development to the Department of Basic Education. The name of the *provincial disaster relief grant* will be amended to the *provincial disaster response grant*. The proposed name change does not change the main objective of the grant; it merely aligns the existing actions and processes that are followed by the National Disaster Management Centre in responding to disasters, including providing relief where it is needed. Further details on all these changes are provided in the conditional grants section.

Table W1.6 provides a summary of the changes to the provincial allocations.

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

R million	2022/23	2023/24	2024/25	MTEF total
Technical adjustments	**–**	**–**	**–**	**–**
Direct transfers	**332**	**332**	**332**	**996**
District health programmes	-219	-224	-234	-676
Health facility revitalisation	-115	-115	-115	-345
Human resources and training	248	248	248	745
National health insurance	418	423	433	1 273
Indirect transfers	**-332**	**-332**	**-332**	**-996**
National health insurance indirect	-332	-332	-332	-996
Additions to baselines	**40 603**	**20 174**	**14 066**	**74 842**
Direct transfers	**40 603**	**20 174**	**14 066**	**74 842**
Provincial equitable share	36 669	17 845	13 124	67 638
Comprehensive agricultural support programme	7	–	–	7
Early childhood development	1	–	–	1
Education infrastructure	155	326	–	480
HIV and AIDS (life skills education)	1	–	–	1
Learners with profound intellectual disabilities	6	–	–	6
Maths, science and technology	0.3	–	–	0.3
National school nutrition programme	4	–	–	4
District health programme	1 331	–	–	1 331
Health facility revitalisation	9	–	–	9
Human resources and training	1 202	1 234	942	3 378
National health insurance	4	–	–	4
National tertiary services	306	–	–	306
Human settlements development	398	475	–	873
Community library services	19	–	–	19
Mass participation and sport development	2	–	–	2
Provincial roads maintenance	490	294	–	784
Indirect transfers	**0.3**	**–**	**–**	**0**
School infrastructure backlogs	0.3	–	–	0
Reduction to baselines	**-1 740**	**-20**	**-30**	**-1 790**
Direct transfers	**-1 740**	**-20**	**-30**	**-1 790**
Provincial roads maintenance	-1 740	-20	-30	-1 790
Total change to provincial government allocations				–
Change to direct transfers	39 195	20 486	14 368	74 049
Change to indirect transfers	-332	-332	-332	-996
Net change to provincial government allocations	**38 864**	**20 154**	**14 036**	**73 053**

Source: National Treasury

After accounting for these changes, the provincial equitable share grows at an average annual rate of 1 per cent over the MTEF period, while direct conditional grant allocations grow at an average annual rate of 3.3 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 2022 MTEF period, the following amounts are allocated to the provincial equitable share respectively: R560.8 billion, R543.1 billion and R562 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.

In addition to the annual data updates that are made to the provincial equitable share formula components, changes are being made to the components as part of the most recent review of the formula. The review, which started at the end of 2016, is being carried out in a phased manner. The changes to enrolment data and mid-year population estimates for the education component have been fully phased in. The most recent phase of the review involves updating the health component with a newly designed risk-adjusted index to inform the risk profile of each province. These changes, which will be phased in over the 2022 MTEF period, are explained under the health component section below.

For the 2022 MTEF the rest of the formula has been updated with data from Statistics South Africa’s 2021 mid-year population estimates on population and age cohorts and the 2021 preliminary data published by the Department of Basic Education on school enrolment from the Learner Unit Record Information Tracking System (LURITS) database. Data from the health sector for 2018/19 and 2019/20 that was used in the 2021 MTEF and the 2019 General Household Survey for medical aid coverage is also used to update the formula. At the time of determining the equitable share for each province, the 2020 General Household Survey was not published, so data from the 2019 General Household Survey was used instead. The most recent health sector data that was submitted by the Department of Health for 2020/21 shows a significant decline in the use of healthcare facilities (attributed to the COVID-19 pandemic) as well as a lack of reporting for some of the facilities. As a result, the data for 2018/19 and 2019/20 is used for the output sub-component as it better captures the use of the health facilities for the different provinces.

Both the changes that have been made as a result of the review of the formula and the annual data updates were discussed in meetings held with the Technical Committee for Finance and the Budget Council, and endorsed by Cabinet. The changes in the allocations 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 (2022/23–2024/25).

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 2022 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, 2022 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	13.5%	12.7%	11.2%	14.6%	7.6%	11.1%	12.8%
Free State	5.2%	5.5%	4.9%	5.1%	5.0%	11.1%	5.5%
Gauteng	20.0%	23.1%	26.2%	19.0%	34.5%	11.1%	21.5%
KwaZulu-Natal	21.5%	20.7%	19.3%	22.0%	15.9%	11.1%	20.4%
Limpopo	12.6%	10.3%	9.8%	13.0%	7.4%	11.1%	11.4%
Mpumalanga	8.3%	7.6%	7.9%	9.3%	7.5%	11.1%	8.2%
Northern Cape	2.2%	2.1%	2.2%	2.2%	2.0%	11.1%	2.6%
North West	6.8%	6.8%	6.9%	8.3%	6.5%	11.1%	7.1%
Western Cape	9.8%	11.2%	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.

The school-age population data is updated using the 2021 mid-year population estimates data obtained from Statistics South Africa. The enrolment data is obtained from the Department of Basic Education's LURITS system, with the most recent data collected in 2021. These subcomponents are used to calculate a weighted share for the education component for each of the provinces. 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 2020	2021	Changes in enrolment data	Weighted average 2021 MTEF	2022 MTEF	Difference in weighted average
Eastern Cape	1 920	1 841	1 846	5	13.6%	13.5%	-0.11%
Free State	726	718	725	7	5.3%	5.2%	-0.04%
Gauteng	3 033	2 500	2 558	58	19.9%	20.1%	0.15%
KwaZulu-Natal	3 090	2 864	2 891	27	21.5%	21.5%	-0.02%
Limpopo	1 703	1 758	1 798	40	12.5%	12.6%	0.04%
Mpumalanga	1 179	1 107	1 134	27	8.3%	8.3%	0.02%
Northern Cape	320	303	304	1	2.3%	2.2%	-0.02%
North West	1 019	863	872	10	6.8%	6.8%	-0.01%
Western Cape	1 468	1 240	1 262	22	9.8%	9.8%	0.00%
Total	**14 459**	**13 195**	**13 390**	**195**	**100.0%**	**100.0%**	**–**

Source: National Treasury

Health component (27 per cent)

For the 2022 MTEF, changes will be made to the health component based on the review of the provincial equitable share formula. Currently, the health component uses a risk-adjusted sub-component and an output component to estimate each province's share of the health component.

The risk-adjusted sub-component estimates a weighted population in each province using the risk-adjusted index. 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. This index was introduced into the health component in a previous review of the formula in 2010 and has not been updated since. Data on the consumption of healthcare services, disaggregated by age and gender, was used to estimate the relative cost of the healthcare needs of the population for each province. For the purpose of the health component, the risk-adjusted index also accounted for the burden of delivering healthcare services to population living with HIV and maternity.

Extensive technical work has been carried out to redesign the risk-adjusted index. The first part of the technical work entailed a literature review to understand the variables that are suitable for the risk-adjusted index, followed by identifying data sources that would be required to estimate these variables.

The approach to selecting the variables was guided by the principles that the variables would need to be evidence based, represent material differences in healthcare needs between provinces, and use data that is easily updateable and that had to be drawn from official statistics. In the event that there was no official statistics to provide the data, the health sector had to endorse using alternative data sources. Details on each of the newly selected variables are provided below:

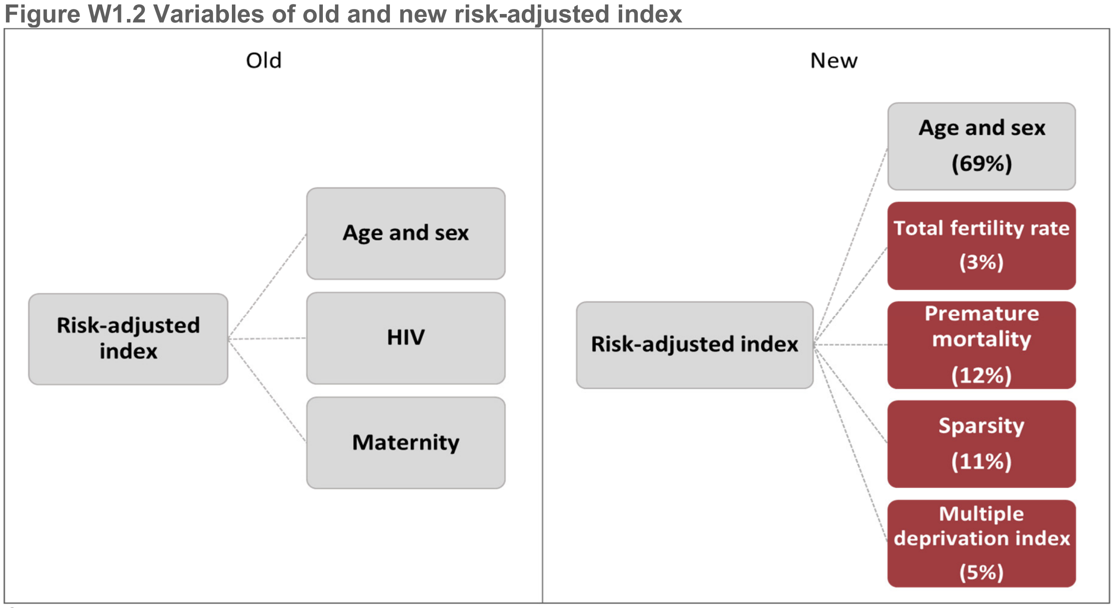
- *Age and sex:* Age and sex are used to inform both the old and the new risk-adjusted index. The variable measures the relative cost of providing healthcare services for the uninsured population, by age and sex. Members of the population of a different sex and at different stages of life have different healthcare needs. Children tend to incur higher healthcare costs in their first year of life compared to subsequent years and the elderly have higher healthcare costs than younger people. The relative cost is calculated by determining the relative resource requirements associated with each combination of sex and age band. To achieve this, the Government Employees Medical Scheme data on claims from 2018 was used to determine this relative cost of a particular age and sex band as equivalent data on resource use by age and sex is not available in the public sector. The population data, disaggregated by age and sex, was obtained from the mid-year population estimates, and the general household survey data was used to separate out the uninsured population.
- *Total fertility rate:* The previous risk-adjusted index took into consideration maternity, that is, the additional burden of providing healthcare services to pregnant women. The current risk-adjusted index continues to do so, but uses the total fertility rate. It is an important factor to adjust for, given the significant amount of healthcare resources that are dedicated to focus on maternal and child health. Total

fertility rate takes this a step further as it accounts for the number of times a woman is expected to give birth in her lifetime. The total fertility rate for each province is obtained from Statistics South Africa.

- *Premature mortality:* The current risk-adjusted index does not account for any other burden of disease beyond HIV. Premature mortality is used as a proxy to measure the burden of disease in each of the provinces. A higher premature mortality implies a higher rate of disease burden and therefore a higher need for healthcare services. The causes of death include HIV, heart disease and road traffic accidents. The premature mortality is defined as deaths occurring before a person reaches the age of 65 in order to account for a shorter life expectancy and a higher disease burden. The provincial mortality data from Statistics South Africa was used to calculate the premature mortality variable for each province.
- *Sparsity:* The population sparsity in an area is used to account for the additional costs of delivering healthcare in areas with low population density. This has an impact on the demand for health services in areas that are geographically remote as there are fewer people using healthcare services due to the limited access, mainly owing to limited transport infrastructure. This makes the per capita costs of delivering services in such areas higher than in areas of high usage. Statistics South Africa data was used to measure the population density at municipal level. The municipalities were ranked from the least densely populated to the most densely populated and divided into quintiles, with each quintile containing 20 per cent of the country's population. Each province's population distribution across the quintiles was then used to determine the sparsity variable for each of province.
- *Multiple deprivation index:* The new risk-adjusted index also captures the differences in the social determinants of health between provinces that have a bearing on population health through a multiple deprivation index. The level of deprivation for each of the provinces is captured by considering the highest level of education, the state of the living environment and a measure for the poor population based on the ownership of various assets or household goods. A combination of these factors was then used to construct a multiple deprivation index for each of the provinces, with data obtained from the 2016 Community Survey.

These five variables were assigned different weights, adding up to 100 per cent. These weights were used to arrive at a final risk-adjusted index for each of the provinces. Figure W1.2 provides a summary of both the variables that were used to inform the current risk-adjusted index, and the variables that were selected to inform the redesigned risk-adjusted index and the weights that were assigned to the variables in the new index. HIV has been removed as a standalone variable and is accounted for in the age and sex variable and premature mortality.

Figure W1.2 Variables of old and new risk-adjusted index



Source: National Treasury

All the data used for the variables is easily updatable, but will be updated at different intervals. The age and sex, sparsity and multiple deprivation index variables will be updated periodically as these variables do not change significantly from year to year. The data on the total fertility rate and premature mortality will form part of the annual technical data updates that are made to the health components. Table W1.9 shows the changes between the old and the new risk-adjusted index. These changes will be phased in over the next three years to give provinces time to adapt to the changes in their equitable share resulting from the changes in the risk-adjusted index. A third of the changes will be implemented in 2022/23, two-thirds in 2023/24 and 100 per cent of the changes will be implemented in 2024/25.

Table W1.9 Changes to the risk-adjusted index

	Risk-adjusted shares			Risk-adjusted index (with one-third of the changes)
	Old	New	Difference	
Eastern Cape	97%	119%	22.0%	104%
Free State	103%	112%	9.0%	106%
Gauteng	105%	87%	-18.0%	99%
KwaZulu-Natal	99%	102%	3.0%	100%
Limpopo	92%	114%	22.0%	99%
Mpumalanga	96%	105%	9.0%	99%
Northern Cape	101%	116%	15.0%	106%
North West	102%	110%	8.0%	105%
Western Cape	104%	90%	-14.0%	99%

Source: National Treasury

The resulting risk-adjusted index is applied to the uninsured population. The percentage of the population with medical insurance, based on the 2019 General Household Survey, is deducted from the 2020 mid-year population estimates to estimate the uninsured population per province. The column on the right in Table W1.10 shows the change in this sub-component between 2021 and 2022.

Table W1.10 Risk-adjusted sub-component shares

Thousand	Mid-year population estimates[1] 2021	Insured population 2019	Risk-adjusted index (with one-third of the changes)	Weighted population	Risk-adjusted shares 2021 MTEF	2022 MTEF	Change
Eastern Cape	6 726	10.8%	104.1%	6 245	11.8%	12.4%	0.65%
Free State	2 936	14.7%	106.2%	2 661	5.1%	5.3%	0.21%
Gauteng	15 801	24.9%	99.1%	11 763	24.9%	23.4%	-1.52%
KwaZulu-Natal	11 643	13.1%	100.1%	10 123	20.0%	20.1%	0.10%
Limpopo	5 880	9.9%	99.1%	5 248	9.9%	10.4%	0.57%
Mpumalanga	4 738	12.6%	98.7%	4 087	7.9%	8.1%	0.28%
Northern Cape	1 305	19.3%	105.7%	1 113	2.2%	2.2%	0.02%
North West	4 164	16.3%	104.8%	3 651	7.3%	7.3%	-0.02%
Western Cape	7 113	24.1%	99.3%	5 358	11.0%	10.7%	-0.29%
Total	**60 305**	**0.0%**	**–**	**50 250**	**100.0%**	**100.0%**	**–**

1. The population estimates were informed by a data set that StatsSA shared with National Treasury on population, used to inform the mid-year population estimates, and not the data from the 2021 mid-year population estimates publication. This data is used in different components of the formula

Source: National Treasury

The output sub-component (shown in Table W1.11) uses patient load data from the District Health Information Services. The average number of visits to primary healthcare clinics in 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. As mentioned above, this data was used in the 2021 MTEF and is used for the 2022

MTEF due to the decline in use of healthcare facilities and the lack of reporting for some facilities as seen in the 2021/22 data due to the COVID-19 pandemic. 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 Output sub-component shares

Thousand	Primary healthcare visits 2019/20	2020/21	Average	Share	Hospital workload patient-day equivalents 2019/20	2020/21	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

These methods work together to balance needs (risk-adjusted component) and demands (output component). Table W1.12 presents the health component in three parts, with the updated shares of the risk-adjusted component, which accounts for 75 per cent of the health component, and the output component, which accounts for 25 per cent of the health component.

Table W1.12 Health component weighted shares

Weight	Risk-adjusted 75.0%	Primary healthcare 5.0%	Hospital component 20.0%	Weighted shares 2021 MTEF	2022 MTEF	Change
Eastern Cape	12.4%	13.8%	13.3%	12.2%	12.7%	0.49%
Free State	5.3%	4.5%	6.6%	5.4%	5.5%	0.16%
Gauteng	23.4%	17.7%	23.2%	24.2%	23.1%	-1.14%
KwaZulu-Natal	20.1%	23.8%	21.9%	20.6%	20.7%	0.08%
Limpopo	10.4%	12.0%	9.2%	9.9%	10.3%	0.42%
Mpumalanga	8.1%	7.7%	5.8%	7.4%	7.6%	0.21%
Northern Cape	2.2%	2.3%	1.8%	2.1%	2.1%	0.02%
North West	7.3%	6.3%	5.0%	6.8%	6.8%	-0.02%
Western Cape	10.7%	11.9%	13.1%	11.4%	11.2%	-0.22%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**–**

Source: National Treasury

Basic component (16 per cent)

The basic component is derived from each province's share of the national population. This component constitutes 16 per cent of the total equitable share. For the 2022 MTEF, population data is drawn from the 2021 mid-year population estimates produced by Statistics South Africa. Table W1.13 shows how population changes have affected the basic component's revised weighted shares.

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

Thousand	Mid-year population estimates[1] 2020	2021	Population change	% population change	Basic component shares 2021 MTEF	2022 MTEF	Change
Eastern Cape	6 734	6 726	-8	-0.1%	11.3%	11.2%	-0.14%
Free State	2 929	2 936	7	0.2%	4.9%	4.9%	-0.04%
Gauteng	15 488	15 801	312	2.0%	26.0%	26.2%	0.22%
KwaZulu-Natal	11 532	11 643	112	1.0%	19.3%	19.3%	-0.03%
Limpopo	5 853	5 880	28	0.5%	9.8%	9.8%	-0.07%
Mpumalanga	4 680	4 738	58	1.2%	7.8%	7.9%	0.01%
Northern Cape	1 293	1 305	12	0.9%	2.2%	2.2%	-0.01%
North West	4 109	4 164	55	1.3%	6.9%	6.9%	0.01%
Western Cape	7 006	7 113	107	1.5%	11.8%	11.8%	0.05%
Total	**59 622**	**60 305**	**683**	**0.0%**	**100.0%**	**100.0%**	**–**

1. The population estimates were informed by a data set that StatsSA shared with National Treasury on population, used to inform the mid-year population estimates, and not the data from the 2021 mid-year population estimates publication. This data is used in different components of the formula

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 2021 mid-year population estimates. Table W1.14 shows the proportion of the poor in each province from the Income and Expenditure Survey, the 2021 mid-year population estimates and the weighted share of the poverty component per province.

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

Thousand	Income and Expenditure Survey 2011/12	2021 MTEF Mid-year population estimates 2020[1]	Poor population	Weighted shares	2022 MTEF Mid-year population estimates 2021[1]	Poor population	Weighted shares	Difference in weighted shares
Eastern Cape	52.0%	6 734	3 504	14.8%	6 726	3 499	14.6%	-0.2%
Free State	41.4%	2 929	1 212	5.1%	2 936	1 215	5.1%	-0.0%
Gauteng	28.9%	15 488	4 471	18.8%	15 801	4 562	19.0%	0.2%
KwaZulu-Natal	45.3%	11 532	5 225	22.0%	11 643	5 275	22.0%	-0.0%
Limpopo	52.9%	5 853	3 094	13.0%	5 880	3 108	13.0%	-0.1%
Mpumalanga	47.3%	4 680	2 211	9.3%	4 738	2 239	9.3%	0.0%
Northern Cape	40.8%	1 293	527	2.2%	1 305	532	2.2%	-0.0%
North West	47.9%	4 109	1 968	8.3%	4 164	1 994	8.3%	0.0%
Western Cape	21.9%	7 006	1 532	6.5%	7 113	1 555	6.5%	0.0%
Total		**59 622**	**23 744**	**100.0%**	**60 305**	**23 980**	**100.0%**	**–**

1. The population estimates were informed by a data set that StatsSA shared with National Treasury on population, used to inform the mid-year population estimates, and not the data from the 2021 mid-year population estimates publication. This data is used in different components of the formula

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 2022 MTEF, 2019 GDP-R data is used. Table W1.15 shows the weighted shares of the economic activity component.

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

	2021 MTEF GDP-R, 2018 (R million)	Weighted shares	2022 MTEF GDP-R, 2019 (R million)	Weighted shares	Difference in weighted shares
Eastern Cape	375 489	7.7%	387 332	7.6%	-0.1%
Free State	243 139	5.0%	252 763	5.0%	-0.0%
Gauteng	1 672 745	34.3%	1 750 062	34.5%	0.1%
KwaZulu-Natal	778 763	16.0%	806 843	15.9%	-0.1%
Limpopo	359 885	7.4%	374 064	7.4%	-0.0%
Mpumalanga	366 839	7.5%	381 915	7.5%	-0.0%
Northern Cape	100 120	2.1%	103 349	2.0%	-0.0%
North West	313 645	6.4%	329 363	6.5%	0.1%
Western Cape	663 276	13.6%	691 934	13.6%	0.0%
Total	**4 873 899**	**100.0%**	**5 077 625**	**100.0%**	**0.0%**

Source: National Treasury

Full impact of data updates on the provincial equitable share

Table W1.16 shows the full impact of the data updates on the provincial equitable share per province, after the six updated components have been added together. It compares the target shares for the 2021 and 2022 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 2021 to 2022 respond to changes in that demand. The details of how the data updates affect each component of the formula are described in detail in the sub-sections above.

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

	2021 MTEF weighted average	2022 MTEF weighted average	Difference
Eastern Cape	12.7%	12.8%	0.0%
Free State	5.5%	5.5%	0.0%
Gauteng	21.7%	21.5%	-0.2%
KwaZulu-Natal	20.4%	20.4%	0.0%
Limpopo	11.3%	11.4%	0.1%
Mpumalanga	8.2%	8.2%	0.1%
Northern Cape	2.6%	2.6%	-0.0%
North West	7.1%	7.1%	-0.0%
Western Cape	10.5%	10.5%	-0.0%
Total	**100.0%**	**100.0%**	**0.0%**

Source: National Treasury

Phasing in the formula

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

The equitable share formula data is updated every year and a new target share for each province is calculated, as shown in Table W1.17. The phase-in mechanism provides a smooth path to achieving the new weighted shares by the third year of the MTEF period. It takes the difference between the target weighted share for each province at the end of the MTEF period and the indicative allocation for 2022/23 published in the 2021 MTEF, and closes the gap between these shares by a third in each year of the 2022 MTEF period. As a result, one third of the impact of the data updates is implemented in 2022/23 and two thirds in the indicative allocations for 2023/24. The updates are thus fully implemented in the indicative allocations for 2024/25.

Table W1.17 Implementation of the equitable share weights

	2022/23	2022/23	2023/24	2024/25
Percentage	Indicative weighted shares from 2021 MTEF	2022 MTEF weighted shares 3-year phasing		
Eastern Cape	12.9%	12.9%	12.8%	12.8%
Free State	5.5%	5.5%	5.5%	5.5%
Gauteng	21.5%	21.4%	21.4%	21.5%
KwaZulu-Natal	20.4%	20.4%	20.4%	20.4%
Limpopo	11.4%	11.4%	11.4%	11.4%
Mpumalanga	8.2%	8.2%	8.2%	8.2%
Northern Cape	2.7%	2.7%	2.7%	2.7%
North West	7.0%	7.1%	7.1%	7.1%
Western Cape	10.5%	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. 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 2022 MTEF period, R12.7 billion for the education sector is allocated outside the provincial equitable share formula for the presidential employment initiative. Table W1.18 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 W1.18 Allocations outside provincial equitable share formula

	2021/22	2022/23	2023/24	2024/25	Allocation criteria
R million	Adjusted budget	Medium-term estimates			
Food relief shift	71	75	78	81	Allocated equally among the provinces
Social worker employment grant shift	239	251	262	273	Allocated in terms of what provinces would have received had the grant continued
Substance abuse treatment grant shift	83	87	91	95	Allocated in terms of what provinces would have received had the grant continued
Municipal intervention support	93	97	102	106	Allocated equally among the provinces
HIV Prevention Programmes	109	114	119	124	Allocated based on the non-profit organisations located in the 27 priority districts
Social worker additional support shift	139	146	153	159	Allocated according to areas of high prevalence of gender-based violence, substance abuse and issues affecting children
Sanitary Dignity Programme	217	226	236	246	Allocated proportionately based on the number of girl learners per province in quintiles 1 to 3 schools
Infrastructure delivery improvement programme shift	45	47	49	51	Allocated equally among the provinces
Education sector presidential employment initiative	6 000	6 194	6 458	–	Allocations are based on each provincial education department’s projected capacity to employ assistantsin schools in line with the objectives of the initiative
Total	**6 997**	**7 236**	**7 546**	**1 137**	

Source: National Treasury

Final provincial equitable share allocations

The final equitable share allocations per province for the 2022 MTEF period are detailed in Table W1.19. These allocations include the full impact of the data updates, phased in over three years, and the allocations that are made separately from the formula.

Table W1.19 Provincial equitable share

R million	2022/23	2023/24	2024/25
Eastern Cape	72 231	69 779	71 842
Free State	31 107	30 109	31 109
Gauteng	120 042	116 264	120 760
KwaZulu-Natal	114 509	110 786	114 373
Limpopo	64 056	62 073	64 127
Mpumalanga	45 962	44 595	46 220
Northern Cape	14 942	14 434	14 895
North West	39 540	38 298	39 702
Western Cape	58 367	56 810	58 991
Total	**560 757**	**543 149**	**562 018**

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 3.3 per cent over the medium term. Direct conditional grant baselines total R121.8 billion in 2022/23, R124.2 billion in 2023/24 and R128.1 billion in 2024/25. Indirect conditional grants amount to R4.6 billion, R4.5 billion and R4 billion respectively for each year of the same period.

Table W1.20 provides a summary of conditional grants by sector for the 2022 MTEF period. More detailed information, including the framework and allocation criteria for each grant, is provided in the 2022 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 2020/21.

Table W1.20 Conditional grants to provinces

R million	2021/22	2022/23	2023/24	2024/25	MTEF total
Agriculture, Land Reform and Rural Development	**2 238**	**2 294**	**2 325**	**2 429**	**7 049**
Comprehensive agricultural support programme	1 558	1 599	1 618	1 691	4 908
Ilima/Letsema projects	597	610	620	648	1 879
Land care programme: poverty relief and infrastructure development	83	85	86	90	261
Basic Education	**21 936**	**23 008**	**24 151**	**24 895**	**72 053**
Early childhood development	1 235	1 193	1 242	1 298	3 733
Education infrastructure	11 689	12 384	13 094	13 342	38 820
HIV and AIDS (life skills education)	242	242	242	253	736
Learners with profound intellectual disabilities	243	256	260	272	788
Maths, science and technology	412	425	433	453	1 310
National school nutrition programme	8 115	8 508	8 879	9 278	26 665
Cooperative Governance	**140**	**145**	**146**	**152**	**444**
Provincial disaster response	140	145	146	152	444
Health	**52 462**	**56 252**	**54 183**	**56 171**	**166 606**
District health programme grant	27 753	29 023	26 866	28 072	83 961
Health facility revitalisation	6 435	6 780	7 120	7 361	21 261
Human resources and training grant	4 298	5 449	5 479	5 367	16 295
National health insurance grant	269	694	695	717	2 105
National tertiary services	13 708	14 306	14 024	14 654	42 984
Human Settlements	**17 604**	**18 702**	**19 586**	**19 970**	**58 259**
Human settlements development	13 403	14 256	14 944	15 118	44 318
Informal settlements upgrading partnership	3 890	4 121	4 303	4 496	12 920
Provincial emergency housing	311	326	340	355	1 021
Public Works and Infrastructure	**837**	**858**	**861**	**900**	**2 619**
Expanded public works programme integrated grant for provinces	422	433	435	454	1 322
Social sector expanded public works programme incentive for provinces	414	425	426	446	1 297
Sport, Arts and Culture	**2 087**	**2 176**	**2 175**	**2 272**	**6 623**
Community library services	1 496	1 573	1 571	1 641	4 785
Mass participation and sport development	591	604	604	631	1 839
Transport	**19 057**	**18 347**	**20 733**	**21 349**	**60 428**
Provincial roads maintenance	11 937	11 256	13 330	13 613	38 200
Public transport operations	7 121	7 090	7 403	7 735	22 229
Total direct conditional allocations	**116 361**	**121 782**	**124 161**	**128 138**	**374 081**
Indirect transfers	**3 954**	**4 612**	**4 550**	**4 015**	**13 177**
Basic Education	**2 397**	**2 403**	**2 079**	**2 172**	**6 653**
School infrastructure backlogs	2 397	2 403	2 079	2 172	6 653
Health	**1 557**	**2 209**	**2 471**	**1 843**	**6 523**
National health insurance indirect	1 557	2 209	2 471	1 843	6 523

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 2022 MTEF period, R4.9 billion is allocated to this grant, and the baseline grows at an average annual growth rate of 2.8 per cent, from R1.6 billion in 2022/23 to R1.7 billion in 2024/25. In 2022/23, R7 million is added to this grant for the non-pensionable cash gratuity for public-service employees.

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, R261 million is allocated to this grant.

The *Ilima/Letsema projects grant* aims to boost food production by helping previously disadvantaged farming communities. The grant's baseline is R1.9 billion over the 2022 MTEF period.

Basic education grants

Following the President's announcement in the 2019 State of the Nation Address that the responsibility for early childhood development centres will be migrated from the Department of Social Development to the Department of Basic Education, the departments have been working closely to oversee the migration of the function. In 2020 and 2021 extensive work was done by the two sectors, including developing and signing proclamations at national and provincial level, and identifying the budget, posts and all relevant assets and infrastructure to be transferred from the social development sector to the basic education sector. In addition, consultations were held with all relevant stakeholders, and the Technical Committee for Finance was briefed on the progress made on the migration of the function at different stages. The function shift will come into effect on 1 April 2022. As part of the funds that have been identified to be transferred, the *early childhood development grant* will now be administered by the Department of Basic Education. As a result, the allocations for this grant to the provinces have now been included in the conditional grant allocations of the education sector.

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 R3.7 billion over the 2022 MTEF period. A portion of the funds allocated for the maintenance component of the grant are unallocated for 2023/24 and 2024/25 as they will be informed by the outcomes of the infrastructure assessments that need to be conducted in each province. In 2022/23, R764 000 is added to this grant for the cash gratuity for public-service employees.

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. Over the 2022 MTEF period, R38.3 billion is allocated to the grant. This includes R145 million in 2022/23 and R326 million in 2023/24 earmarked for repairing school infrastructure damaged by natural disasters in KwaZulu-Natal. In 2022/23, R10 million is added to this grant for the cash gratuity for public-service employees.

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 2022/23 incentive, the departments had to meet certain prerequisites in 2020/21 and have their infrastructure plans approved in 2021/22. The national Department of Basic Education and the National Treasury assessed the provinces' infrastructure plans. The national departments, provincial treasuries and provincial departments of basic education undertook a moderation process to agree on the final scores. Provinces needed to obtain a minimum score of 60 per cent to qualify for the incentive. Table W1.21 shows the final score and incentive allocation for each province.

Table W1.21 Education infrastructure grant allocations

R thousand	Planning assessment results from 2021	2022/23 Basic component	2022/23 Incentive component	Final allocation for 2022/23
Eastern Cape	81%	1 636 416	105 043	1 741 459
Free State	78%	852 978	105 043	958 021
Gauteng	79%	1 581 802	105 043	1 686 845
KwaZulu-Natal	83%	2 282 909	105 043	2 387 952
Limpopo	60%	1 315 811	–	1 315 811
Mpumalanga	61%	1 134 360	–	1 134 360
Northern Cape	75%	581 892	105 043	686 935
North West	85%	1 131 582	105 043	1 236 625
Western Cape	97%	1 131 034	105 043	1 236 077
Total		**11 648 783**	**735 302**	**12 384 085**

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 R6.7 billion over the medium term in the Planning, Information and Assessment Programme.

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 4.6 per cent, with a total allocation of R26.7 billion. In 2022/23, R4 million is added to this grant for the cash gratuity for public-service employees.

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. Over the medium term, R1.3 billion is allocated to the grant. In 2022/23, R265 000 is added to this grant for the cash gratuity for public-service employees.

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 R736 million over the medium term. In 2022/23, R1 million is added to this grant for the cash gratuity for public-service employees.

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 R788 million over the 2022 MTEF period. In 2022/23, R6 million is added to this grant for the cash gratuity for public-service employees.

Cooperative governance grant

The *provincial disaster response 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. To ensure that sufficient funds are available in the event of a disaster, section 20 of the 2022 Division of Revenue Bill allows for funds allocated to the *municipal disaster response grant* to be transferred to provinces if funds in the *provincial disaster response 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 medium term, R444 million has been allocated to the *provincial disaster response grant*.

Health grants

The Department of Health has proposed structural changes to the *HIV, TB, malaria and community outreach grant* to address challenges managing the multiple components under this conditional grant. Six of the components will be collapsed to form two main components: a comprehensive HIV/AIDS component (made up of the HIV/AIDS and the TB components) and a district health component (made up of the community outreach, malaria, HPV and COVID-19 components). The components that were previously created for mental health services and oncology services will be shifted from this conditional grant to the direct *national health insurance grant*. They were originally created for the preparation of implementing national health insurance and will be better placed in this grant. The name of the conditional grant will be changed from the *HIV, TB, malaria and community outreach grant* to the *district health programmes grant.* The grant will continue to support 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. Over the medium term, the *district health programmes grant* is allocated R84 billion. In 2022/23, R331 million is added to this grant for the cash gratuity for public-service employees.

The health sector continues to be severely affected by the COVID-19 pandemic. The COVID-19 component, which was created to respond to the pandemic, has been merged with other components in the district health component of the grant, but the allocation will be ring-fenced to ensure that the Department of Health can still track the progress of the vaccine rollout. In 2022/23, R1 billion is added to the grant for this purpose. A total allocation of R1.9 billion in 2022/23 has been ring-fenced for the country's COVID-19 response.

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. In the 2021 MTEF, R205 million was unallocated for 2022/23, and these funds have now been allocated to the Eastern Cape, Limpopo, Mpumalanga and the North West provinces to develop and expand tertiary services. 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 grant is allocated R43 billion over the medium term: R14.3 billion in 2022/23, R14 billion in 2023/24 and R14.7 billion in 2024/25.

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. An amount of R345 million has been reprioritised from the grant to the *human resource and training grant* to fund the shortfall on medical internship and community services posts. Over the 2022 MTEF period, R21.3 billion has been allocated to this grant.

Like the *education infrastructure grant* discussed previously, a two-year planning process is 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 involving the national departments, provincial treasuries and provincial departments of health to agree on the final scores. Provinces had to obtain a minimum score of 60 per cent to qualify for the incentive. Funds for the incentive component in the outer years are shown as unallocated. Table W1.22 sets out the final score and the incentive allocation per province.

Table W1.22 Health facility revitalisation grant allocations

R thousand	Planning assessment results from 2021	2022/23		Final allocation for 2022/23
		Basic component	Incentive component	
Eastern Cape	83%	665 365	65 465	730 829
Free State	82%	576 982	65 465	642 446
Gauteng	78%	993 395	65 465	1 058 859
KwaZulu-Natal	92%	1 324 449	65 465	1 389 913
Limpopo	75%	534 702	65 465	600 166
Mpumalanga	87%	397 846	65 465	463 310
Northern Cape	50%	444 942	–	444 942
North West	82%	587 027	65 465	652 491
Western Cape	98%	731 126	65 465	796 590
Total		**6 255 830**	**523 716**	**6 779 546**

Source: National Treasury

The *human resources and training grant* has two components and has been allocated R5.4 billion in 2022/23, R5.5 billion in 2023/24 and R5.4 billion in 2024/25. The training component funds the training of health sciences professionals, including specialists, registrars and their supervisors. The statutory human resources component funds internship and community service posts, as well as some posts previously funded from the equitable share. In recent years, the health sector has continued to face pressure in covering the costs associated with the placement of the growing number of medical graduates. The need for internship and community services posts has increased mainly due to students returning from Cuba and a higher number of medical students graduating in South Africa. As a result, funds were reprioritised from the *health facility revitalisation grant* and the *national health insurance indirect grant* to address the shortfall. After the tabling of the 2021 MTBPS, a further R3.3 billion was added to this grant, consisting of R1.1 billion in 2022/23, R1.2 billion in 2023/24 and R942 million in 2024/25. In the 2021 MTEF, R25.1 million was unallocated for 2022/23 in the training component. This amount has now been allocated to the Eastern Cape, Limpopo, Mpumalanga, the Northern Cape and the North West provinces to develop and expand tertiary services. In 2022/23, R109 million is added to this grant for the cash gratuity for public-service employees.

The *national health insurance indirect grant* continues to fund all preparatory work for universal health coverage, as announced in 2017/18. Over the 2022 MTEF period, this will be done through three components: the health facility revitalisation component and two integrated components (personal services component and non-personal services component). The personal services component funds priority services for national health insurance, which include:

- Expanding access to school health services, focusing on optometry and audiology.
- Providing 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 R1.9 billion over the medium term to continue funding initiatives to strengthen health information systems, clinics, and the dispensing and distribution of centralised chronic medicines.

Similar to the *health facility revitalisation grant*, R300 million has been shifted from this grant to the *human resources and training grant* to fund internship and community service posts. The indirect grant is allocated R6.5 billion over the 2022 MTEF period.

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 being carried out at provincial level, with the requirement that provinces submit claims for the costs they incurred. Transferring these funds to the provinces allows them to pay contractors directly. The contracting of health professionals will continue to be funded in the direct *national health insurance grant*.

In addition, the grant will fund the provision of mental health services and oncology services. These components have been shifted, along with the funding, from the *district health programmes grant* (the former *HIV, TB, malaria and community outreach grant*). They will not be standalone components, but will be part of the activities that are funded through the grant. This is part of a continuation of shifting of funds for mental health services and oncology services to the *national health insurance grant* that started in the 2021 MTEF, where changes were made during the 2021 MTBPS to accommodate the shift of funding for these services from the *national health insurance indirect grant* to this grant. Over time, provinces have showed readiness to take on the delivery of these services and they will be more appropriately placed as part of the preparatory work for national health insurance. The grant's baseline is R2.1 billion over the medium term.

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 2022 MTEF period, a total of R44.3 billion has been allocated to this grant. This includes R398 million in 2022/23 and R475 million in 2023/24 earmarked for repairing houses affected by natural disasters in KwaZulu-Natal.

This grant is allocated using a formula with three components:

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

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

Table W1.23 Human settlements development grant formula calculation

Components	Housing needs	Poverty	Population	Grant formula
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

A total of R548 million is ring-fenced within the *human settlements development grant* in 2022/23 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.

In 2021/22 the *informal settlements upgrading partnership grant* was created to intensify efforts to upgrade informal settlements in partnership with communities. The conditional grant is dedicated to increasing investment in in-situ informal settlement upgrading, which includes identifying informal settlements for upgrades, providing households with tenure and providing municipal engineering services. Over the 2022 MTEF period, R12.9 billion is allocated to the grant.

The *provincial emergency housing grant* enables the Department of Human Settlements 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. The grant's purpose was also previously 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 2022 MTEF period, a total of R1 billion 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 *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 2022 MTEF period.

Sport, arts and culture grants

The *community library services grant*, administered by the Department of Sport, Arts and Culture, aims to help South Africans access information to improve their socioeconomic situation. The grant is allocated to the relevant provincial department and administered by that department or through a service-level agreement with municipalities. In collaboration with provincial departments of basic education, the grant also funds libraries that serve both schools and the general public. Funds from this grant may also be used to enable the shift of the libraries function between provinces and municipalities. The grant is allocated R4.8 billion over the next three years. This grant's baseline grows by 3.1 per cent over the medium term. In 2022/23, R19 million is added to this grant for the cash gratuity for public-service employees.

The *mass participation and sport development grant* aims to increase and sustain mass participation in sport and recreational activities in the provinces, with greater emphasis on provincial and district academies. The grant is allocated R1.8 billion over the medium term. This grant's baseline grows by 2.2 per cent over the medium term. In 2022/23, R2 million is added to this grant for the cash gratuity for public-service employees.

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 R22.2 billion over the 2022 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 roads asset management systems.

The incentive portion of the grant is allocated based on performance indicators relating to traffic loads, safety engineering and visual condition indicators. For 2022/23, the incentive portion will not be allocated to the provinces as the process of developing clear and objective criteria by the sector is being finalised. As a result, the incentive allocation will be reduced from the grant for 2022/23, reducing the overall baseline from R12.5 billion to R11.3 billion. The total allocation for the 2022 MTEF period is R38.2 billion. This includes R490 million in 2022/23 and R294 million in 2023/24 earmarked for KwaZulu-Natal for repairing provincial roads affected by natural disasters.

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 2022/23 budgets, and to promote better accountability and transparency by ensuring that all national allocations are included in municipal budgets. Over the 2022 MTEF period, R481.3 billion will be transferred directly to local government and a further R25.4 billion has been allocated to indirect grants. Direct transfers to local government over the medium-term account for 9.8 per cent of national government's non-interest expenditure. When indirect transfers are added to this, total spending on local government increases to 10.3 per cent of national non-interest expenditure.

Table W1.24 Transfers to local government

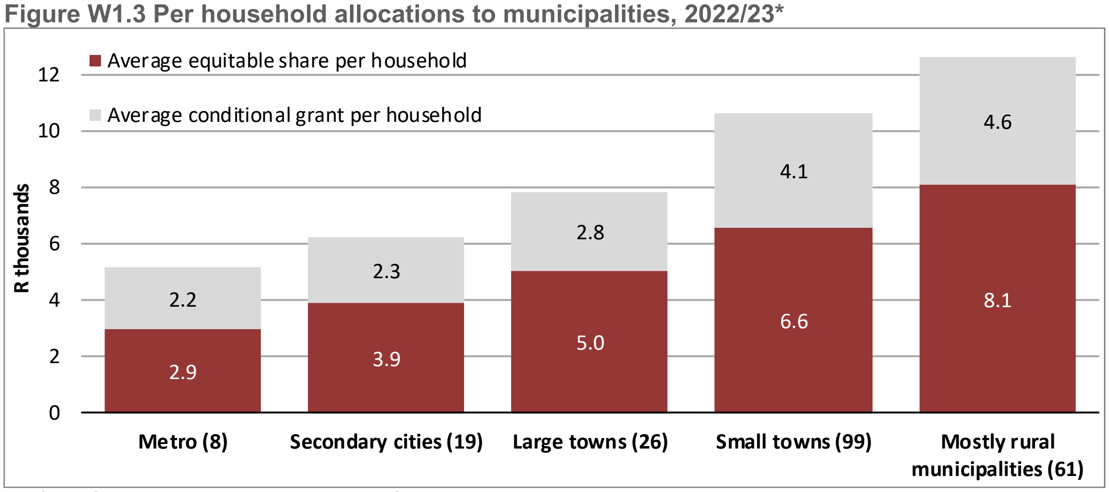
R million	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
		Outcome		Adjusted budget		Medium-term estimates	
Direct transfers	**118 488**	**122 986**	**137 098**	**137 585**	**150 630**	**160 514**	**170 147**
Equitable share and related	**60 758**	**65 627**	**83 102**	**77 999**	**87 311**	**94 087**	**101 486**
Equitable share formula[1]	55 072	59 301	76 482	71 028	80 023	86 491	93 556
RSC levy replacement	4 795	5 357	5 652	5 963	6 249	6 524	6 817
Support for councillor remuneration and ward committees	891	969	969	1 009	1 040	1 071	1 114
General fuel levy sharing with metros	**12 469**	**13 167**	**14 027**	**14 617**	**15 335**	**15 433**	**16 127**
Conditional grants	**45 262**	**44 191**	**39 969**	**44 969**	**47 983**	**50 994**	**52 534**
Infrastructure	43 568	42 322	37 901	42 636	45 571	48 551	49 982
Capacity building and other	1 694	1 870	2 068	2 333	2 412	2 442	2 552
Indirect transfers	**6 358**	**5 591**	**4 194**	**7 727**	**8 055**	**8 481**	**8 862**
Infrastructure	6 266	5 480	4 074	7 592	7 915	8 335	8 709
Capacity building and other	92	111	120	135	140	147	153
Total	**124 846**	**128 576**	**141 292**	**145 313**	**158 685**	**168 995**	**179 010**

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 W1.3 Per household allocations to municipalities, 2022/23*



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

Source: National Treasury

Changes to local government allocations

Allocations to local government increase by R31.5 billion relative to the indicative allocations in the 2021 Budget. No fiscal consolidation reductions were proposed in the 2021 MTBPS. However, as a result of the additional allocations due to higher-than-expected revenue collection by the South African Revenue Service in 2021/22, and further increases in tax revenue estimates over the 2022 MTEF period, the growth in direct conditional grants allocations over the next three years is just above inflation, at an average annual rate of 5.3 per cent. The growth in indirect grants is slightly above inflation, at an annual average rate of 4.7 per cent.

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

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

R million	2022/23	2023/24	2024/25	2022 MTEF total revisions
Technical adjustments	**–**	**–**	**–**	**–**
Direct transfers	**–**	**–**	**–**	**–**
Local government equitable share	**–**	**–**	**–**	**–**
Equitable share formula	1	10	17	28
Support for councillor remuneration and ward committees	-1	-10	-17	-28
Municipal infrastructure	-10	–	–	-10
Integrated urban development	10	–	–	10
Indirect transfers	**–**	**–**	**–**	**–**
Additions to baselines	**5 294**	**12 204**	**15 059**	**32 557**
Direct transfers	**4 227**	**10 517**	**14 163**	**28 907**
Local government equitable shar	4 227	10 517	14 163	28 907
Equitable share formula	4 227	10 517	14 163	28 907
Conditional grants	**1 067**	**1 687**	**896**	**3 650**
Neighbourhood development partnership	800	856	–	1 656
Public transport network	–	–	621	621
Regional bulk infrastructure	241	511	275	1 026
Municipal disaster recovery	26	321	–	347
Indirect transfers	**–**	**–**	**–**	**–**
Reductions to baselines	**-907**	**-113**	**–**	**-1 020**
Direct transfers	**-762**	**-113**	**–**	**-875**
Local government equitable share	**–**	**–**	**–**	**–**
General fuel levy sharing				**–**
Conditional grants	**-762**	**-113**	**–**	**-875**
Municipal infrastructure grant				–
Public transport network	-754	-105	–	-859
Neighbourhood development partnership				–
Energy efficiency and demand-side management	-8	-8	–	-16
Indirect transfers	**-145**	**–**	**–**	**-145**
Regional bulk infrastructure	-95	–	–	-95
Integrated national electrification programme	-50	–	–	-50
Total change to local government allocations				
Change to direct transfers	4 532	12 091	15 059	31 682
Change to indirect transfers	-145	–	–	-145
Net change to local government allocations	**4 387**	**12 091**	**15 059**	**31 537**

Source: National Treasury

Over the medium term, R1 billion is added to the direct *regional bulk infrastructure grant* for George Local Municipality to implement the potable water security and remedial works project. This is funded from the Budget Facility for Infrastructure.

Over the next two years, R1.7 billion is added to the direct *neighbourhood development partnership grant (capital)* to continue funding government's response to job losses due to the impacts of the COVID-19 pandemic. This is funded from the presidential employment initiative.

An amount of R347 million is allocated over the next two years to fund the introduction of the *municipal disaster recovery grant*. The grant is introduced to fund the repair of municipal infrastructure in KwaZulu-Natal that was damaged by natural disasters that took place between October 2019 and January 2020.

Reprioritisations are made within the vote of the Department of Mineral Resources and Energy, affecting two grants: R8 million in 2022/23 and 2023/24, respectively, is reprioritised from the *energy efficiency and demand-side management grant* and R50 million in 2022/23 is reprioritised from the *integrated national electrification programme (Eskom) grant.* The details are discussed under the 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 2022 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 R282.9 billion (R87.3 billion in 2022/23, R94.1 billion in 2023/24 and R101.5 billion in 2024/25). Due to additional allocations to local government following higher-than-projected tax revenue estimates as a result of the commodity boom, the local government equitable share grows at an average annual rate of 10.3 per cent over the next three years.

Formula for allocating the local government equitable share

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

Structure of the local government equitable share formula

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

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

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

Structure of the local government equitable share formula

LGES = BS + (I + CS)xRA ± C

where

LGES is the local government equitable share

BS is the basic services component

I is the institutional component

CS is the community services component

RA is the revenue adjustment factor

C is the correction and stabilisation factor

The basic services component

This component helps municipalities provide free basic water, sanitation, electricity and refuse removal services to households that fall below an affordability threshold. Following municipal consultation, the formula's affordability measure (used to determine how many households need free basic services) is based on the level of two state old age pensions. When the 2011 Census was conducted, the state old age pension was worth R1 140 per month, which means that two pensions were worth R2 280 per month. A monthly household income of R2 300 per month in 2011 has therefore been used to define the formula's affordability threshold. Statistics South Africa has calculated that 59 per cent of all households in South Africa fall below this income threshold. However, the proportion in each municipality varies widely. In 2022 terms, this monthly income is equivalent to about R4 010 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 2020 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. However, due to baseline reductions over the years, the basic services subsidy could not be fully funded, as the reductions had to spread across all components of the formula to minimise the impact on service delivery. However, over the MTEF period ahead, the subsidy is allocated to 100 per cent of households below the poverty threshold. The basic services subsidy will fund:

- 10.9 million households in 2022/23.
- 11.2 million households in 2023/24.
- 11.5 million households in 2024/25.

The basic services component provides a subsidy of R488.42 per month in 2022/23 for the cost of providing basic services to each of these households. The subsidy includes funding for the provision of free basic water (six kilolitres per poor household per month), energy (50 kilowatt-hours per month) and sanitation and refuse removal (based on service levels defined by national policy). The monthly amount provided for each service is detailed in Table W1.26 and includes an allocation of 10 per cent for service maintenance costs.

Table W1.26 Amounts per basic service allocated through the local government equitable share, 2022/23

	Allocation per household below affordability threshold (R per month)			Total allocation per service (R million)
	Operations	Maintenance	Total	
Energy	96.3	10.70	107.04	13 997
Water	151.4	16.82	168.22	21 998
Sanitation	104.4	11.60	115.95	15 163
Refuse removal	87.5	9.72	97.20	12 711
Total basic services	**439.6**	**48.84**	**488.42**	**63 869**

Source: National Treasury

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

The electricity cost estimate is made up of bulk and other costs. Bulk costs are updated based on the bulk multi-year price determination approved by the National Energy Regulator of South Africa. Eskom requested approval for municipal bulk tariff increases of 20.5 per cent in 2022/23, 15 per cent in 2023/24 and 10 per cent in 2024/25. The regulator rejected this revenue application at the end of September 2021 and in October 2021 Eskom filed an application in the High Court to review this decision. The High Court review requires the regulator to urgently finalise and approve the Eskom revenue application for at least one year, as required by law. The timeframes for the review allow for a decision to be made in time for implementation by 1 April 2022 but not prior to the finalisation of the Budget. As the bulk price increase for 2022 will only be announced after the Budget is finalised, the equitable share formula continues to use the 8.9 per cent bulk tariff increase that was used when the baseline for this year was calculated in the 2021 MTEF period. Other (non-bulk) electricity costs are updated based on the National Treasury's inflation projections in the 2021 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 2021/22 was 7.9 per cent. As the bulk price increase for 2022 will only be announced after the 2022 Budget is tabled, the equitable share formula continues to use the 10.5 per cent bulk tariff increase that was used when the baseline for this year was calculated in the 2021 MTEF period. Other costs are updated based on the National Treasury's inflation projections in the 2021 MTBPS.

The costs for sanitation and refuse removal are updated based on the National Treasury's inflation projections in the 2021 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 R63.9 billion in 2022/23 and accounts for 79.8 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 2022/23, this component consists of a base allocation of R8 million, which goes to every municipality, and an additional amount that is based on the number of council seats in each municipality. From 2022/23, the number of council seats is updated to reflect the councillor numbers that took effect on the date of the 2021 local government elections. 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 8.1 per cent of the equitable share formula and is worth R6.5 billion in 2022/23. 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, stormwater 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 2022/23, the allocation to district municipalities for municipal health and related services is R11.27 per household per month. The component's remaining funds are allocated to local and metropolitan municipalities for other services, 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 12.1 per cent of the equitable share formula and is worth R9.7 billion in 2022/23.

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 R19.6 billion over the 2022 MTEF period.

In 2022/23, 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. As indicated above, from 2022/23, the number of councillors per municipality is updated to reflect the councillor numbers that took effect on the date of the 2021 local government elections. The total value of the support provided in 2022/23 is R1.1 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 R48 billion in 2022/23 to R51 billion in 2023/24 and R52.5 billion in 2024/25.

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 R169.1 billion over the 2022 MTEF period.

Table W1.27 Infrastructure grants to local government

R million	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
		Outcome		Revised budget		Medium-term estimates	
Direct transfers	**43 568**	**42 322**	**37 901**	**42 636**	**45 571**	**48 551**	**49 982**
Municipal infrastructure	15 288	14 816	14 491	15 593	16 842	17 595	18 385
Integrated urban development	–	857	936	1 009	1 085	1 123	1 173
Urban settlements development	11 306	11 655	10 572	7 405	7 352	7 676	8 021
Informal settlements upgrading partnership	–	–	–	3 945	4 181	4 365	4 561
Public transport network	6 287	6 370	4 389	5 175	6 013	6 689	7 720
Neighbourhood development partnership	569	592	479	1 318	1 393	1 475	647
Integrated national electrification programme	1 904	1 860	1 359	2 003	2 119	2 212	2 311
Rural roads asset management systems	108	114	108	110	115	115	121
Regional bulk infrastructure	1 963	2 029	2 006	2 237	2 521	2 892	2 763
Water services infrastructure	4 777	3 669	3 368	3 620	3 701	3 864	4 038
Municipal disaster recovery	1 151	133	–	–	26	321	–
Energy efficiency and demand-side management	215	227	193	221	223	224	243
Indirect transfers	**6 266**	**5 480**	**4 074**	**7 592**	**7 915**	**8 335**	**8 709**
Integrated national electrification programme	3 262	3 124	1 983	2 824	3 588	3 821	3 993
Neighbourhood development partnership	48	46	63	181	101	101	105
Water services infrastructure	581	548	305	730	771	805	841
Regional bulk infrastructure	2 375	1 761	1 724	3 857	3 455	3 607	3 769
Total	**49 834**	**47 801**	**41 975**	**50 228**	**53 487**	**56 886**	**58 691**

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 total allocations for this grant amount to R52.8 billion over the medium term and grow at an average annual rate of 5.6 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.

Table W1.28 Data used in the municipal infrastructure grant formula

Component	Input for horizontal calculation	Proxy used in 2022 (corresponding with data
B	Number of water backlogs	Water access: Poor households[1] report having access to piped water inside their dwelling, in the yard or within 200 meters of their dwelling
	Number of sanitation backlogs	Sanitation access: Poor households report flush toilet, chemical toilet, pit toilet with ventilation or ecological toilet
	Number of road backlogs	Roads backlog: Number of households
	Number of other backlogs	Refuse access: Poor households report that refuse is mainly removed by local authorties or a private company once a week (urban, traditional and farms). It should be noted that acceptable services standards differ by area. For traditional and farms the following conditions apply: removed by local authority /private company / community members less than once a week, communal refuse dump and communal contained/ central collection point For farms the following further addition 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 poor households in nodal areas	Allocated to the 27 priority districts identified by Cabinet as having large backlogs. Allocation is based on total households (not poor households)

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

Table W1.29 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 W1.29 Municipal infrastructure grant allocations per sector

Municipal infrastructure grant (formula)	Component weights	Value of component 2022/23 (R million)	Proportion of municipal infrastructure grant per sector
B-component	**75.0%**	**11 602**	**68.9%**
Water and sanitation	54.0%	6 265	37.2%
Roads	17.3%	2 001	11.9%
Other	3.8%	435	2.6%
P-component	**15.0%**	**2 320**	**13.8%**
Sports	33.0%	766	4.5%
E-component	**5.0%**	**773**	**4.6%**
N-component	**5.0%**	**773**	**4.6%**
Constant		**1 130**	**6.7%**
Ring-fenced funding for sport infrastructure		**243**	**1.4%**
Total		**16 842**	**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 Sport, Arts and Culture. These earmarked funds amount to R749 million over the MTEF period (R243 million in 2022/23 and R253 million each year of the two outer years of the 2022 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.

In 2021/22 municipalities were allowed to use up to 5 per cent of their allocations to fund the development of infrastructure asset management plans. This was intended to build 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 had to submit a business plan to the Department of Cooperative Governance, accompanied by a copy of their audited asset register.

Despite this and other measures implemented to support municipalities, poor performance remains prevalent in this grant with 39 (18 per cent) municipalities that receive funds from this grant having spent less than 70 per cent of their cumulative grant allocations over the past four financial years (2017/18–2020/21). For this reason, over the 2022 MTEF period, the department will introduce an indirect component of the grant allowing the department to directly appoint an implementation agent to expedite the implementation of infrastructure projects on behalf of the identified municipalities. Further details regarding the criteria that will be used, including the conditions, and responsibilities of the transferring officer and receiving officer are contained in the grant framework.

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.

Table W1.30 Performance-based component weighted indicators for integrated urban development grant

Indicators	Purpose	Weight	Scores
Non-grant capital as a percentage of total capital expenditure	Encourage cities to increase their capital investments funded through own revenue and borrowing	40%	1 if 70% or higher 0 if 30% or lower Linear scale in between
Repairs and maintenance expenditure as percentage of operating expenditure	Reward cities that take good care of their existing asset base	30%	1 if 8% or higher
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
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 2022/23		1 if 50% or higher 0 if 10% or lower
Building plans 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 2022/23		Linear scale in between

Source: National Treasury

The total allocations for this grant amount to R3.4 billion over the 2022 MTEF period and grow at an average annual rate of 5.2 per cent.

Table W1.31 Formula for integrated urban development grant incentive component

	Planning allocation (R 000)	Performance incentive						Total for incentive and planning (R 000)
		Non-grant capital as percentage of total capital spend	Maintenance spend	Asset management plan	Land use and building plans in priority areas	Weighted score	Total incentive (R 000)	
uMhlathuze	3 674	20%	30%	20%	–	15%	21 022	24 697
Drakenstein	1 193	20%	20%	30%	–	15%	21 022	22 216
Mogale City	4 029	10%	30%	20%	–	13%	18 019	22 049
Polokwane	11 680	10%	20%	20%	–	11%	15 016	26 696
Ray Nkonyeni	2 107	10%	10%	10%	–	7%	9 010	11 117
Sol Plaatje	1 700	10%	30%	0%	–	9%	12 013	13 713
Stellenbosch	1 215	40%	10%	30%	–	17%	24 026	25 241
Steve Tshwete	1 698	30%	10%	20%	–	13%	18 019	19 717
Total	**27 298**					**100%**	**138 147**	**165 445**

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 R7.4 billion in 2022/23, R7.7 billion in 2023/24 and R8 billion in 2024/25. 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.

Informal settlements upgrading partnership grant

Upgrading informal settlements remains a priority over the medium term. The *informal settlements upgrading partnership grant* is allocated R4.2 billion in 2022/23, R4.4 billion in 2023/24 and R4.6 billion in 2024/25. Informal settlements upgrading 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. This grant requires cities to work in partnership with communities to develop and complete their informal settlements upgrading strategies.

Programme and project preparation support grant

The *programme and project preparation support grant* supports metropolitan municipalities in developing a pipeline of investment-ready capital programmes and projects. This is 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. The grant is allocated R1.1 billion over the 2022 MTEF period and grows at an average annual rate of 4.9 per cent.

Public transport network grant

The *public transport network grant*, administered by the Department of Transport, helps cities create or improve public transport systems in line with the National Land Transport Act (2009) and the Public Transport Strategy. This includes all integrated public transport network infrastructure, such as bus rapid transit systems, conventional bus services, and pedestrian and cycling infrastructure. The grant also subsidises the operation of these services. It is allocated R20.4 billion over the medium term. The grant has been reduced by R754 million in 2022/23 and R105 million in 2024/25. These reductions are aligned to the City of Cape Town's revised implementation plan and cashflow projections for the MyCiTi public transport network, funded through the Budget Facility for Infrastructure through this grant. This grant grows at an annual average rate of 14.3 per cent over the 2022 MTEF period.

The allocations for this grant are determined through a formula, which determines 95 per cent of the allocations, and a performance-based incentive component 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 2022/23 is set out in Table W1.32. 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 W1.32 Public transport network grant

	Oper-ational public transport system	Grant spent in 2020/21	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 2022/23 (R 000)
Minimum threshold	**Yes**	**80%**		**35.0%**	**1.0%**	**2.0%**		
City of Cape Town	Yes	96%	Yes	24.3%	1.05%	9.2%	0.196	159 469
City of Johannesburg	Yes	100%	Yes	18.3%	1.16%	3.9%	0.064	70 331
City of Tshwane	Yes	95%	Yes	6.9%	0.03%	1.6%	–	–
Ekurhuleni	Yes	100%	Yes	3.8%	0.06%	0.0%	–	–
eThekwini	No	100%	No	0.0%	0.00%	0.0%	–	–
George	Yes	89%	Yes	18.0%	5.13%	5.0%	0.397	54 095
Mangaung	No	100%	No	0.0%	0.00%	0.0%	–	–
Nelson Mandela Bay	Yes	61%	No	6.7%	0.18%	2.4%	–	–
Polokwane	No	80%	No	0.0%	0.00%	0.0%	–	–
Rustenburg	No	96%	No	0.0%	0.00%	0.0%	–	–
Total							**1**	**283 895**

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 W1.33 sets out how the final allocation for each municipality is determined, taking account of both the formula and incentive components.

Table W1.33 Formula for the public transport network grant

	Base 20%	Demand-driven factors 75%			Subtotal: base and demand-driven factors	Performance 5%	Fiscal consolidation reductions	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)
City of Cape Town	7.7%	16.3%	15.8%	13.9%	15.2%	159 469	–	979 261
City of Johannesburg	7.7%	19.3%	25.2%	20.5%	20.6%	70 331	–	1 181 159
City of Tshwane	7.7%	12.7%	15.0%	14.0%	14.0%	–	–	753 681
Ekurhuleni	7.7%	13.8%	9.5%	14.9%	13.0%	–	–	702 334
eThekwini	7.7%	15.0%	15.8%	18.0%	16.0%	–	–	863 393
George	7.7%	0.8%	0.5%	0.2%	2.5%	54 095	–	191 410
Mangaung	7.7%	3.3%	2.4%	3.2%	4.6%	–	–	249 894
Nelson Mandela Bay	7.7%	5.0%	4.7%	3.6%	5.9%	–	–	318 543
Polokwane	7.7%	2.7%	1.5%	1.3%	3.7%	–	–	199 496
Rustenburg	7.7%	2.4%	3.5%	2.3%	4.4%	–	–	238 721
Unallocated incentive								
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**283 895**	**–**	**5 677 892**

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

In addition to the formula and performance incentive, R621 million is allocated through the *public transport network grant* over the medium term for Phase 2A of the City of Cape Town's MyCiTi public transport network, linking the underserved areas of Khayelitsha and Mitchells Plain to the city centre. This project is funded 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. The amount allocated for the MyCiTi network over the 2022 MTEF period is aligned to the revised implementation plan and cashflow projections for the project.

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 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 partner with these municipalities to identify, plan and implement infrastructure upgrades in targeted urban hub precincts. The grant is allocated R3.8 billion over the 2022 MTEF period, made up of R3.5 billion for the direct capital component and R307 million for the indirect technical assistance component. This allocation includes an additional allocation of R1.7 billion over the 2022 MTEF period for metropolitan municipalities to continue to create jobs through labour-intensive projects as part of government's response to the impacts of COVID-19.

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

The direct component of this grant is allocated R11.6 billion over the 2022 MTEF period. The indirect component has a total allocation of R2.4 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. This grant has a direct and indirect component. In areas where municipalities have the capacity to implement projects themselves, funds are transferred through a direct component. In other areas, the Department of Water and Sanitation implements projects on behalf of municipalities through an indirect component. A parallel programme, funded by the Department of Water and Sanitation, also funds water boards for the construction of bulk infrastructure. Though not part of the division of revenue, these projects still form part of the Department of Water and Sanitation's larger programme of subsidising the construction of regional bulk infrastructure for water and sanitation.

The direct component of the grant has a total allocation of R8.2 billion over the 2022 MTEF period. This includes additional amounts of R241 million in 2022/23, R511 million in 2023/24 and R275 million in 2024/25 allocated to George Local Municipality from the Budget Facility for Infrastructure to fund the continued implementation of the potable water security and remedial works project approved in the 2021 MTBPS. The indirect component has a total allocation of R10.8 billion over the 2022 MTEF period and the grant declines at an annual average rate of 0.8 per cent.

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 R18 billion on the programme over the 2022 MTEF period.

The *integrated national electrification programme (municipal) grant* has a total allocation of R6.6 billion over the 2022 MTEF period and grows at an average annual rate of 4.9 per cent. The *integrated national electrification programme (Eskom) grant* is allocated R11.4 billion over the medium term and grows at an average annual rate of 12.2 per cent. It is reduced by R50 million in 2022/23 to fund other government priorities. The reductions to this grant are equivalent to 0.6 per cent of the grant's baseline in 2022/23.

Energy efficiency and demand-side management grant

The *energy efficiency and demand-side management grant* funds selected municipalities to implement projects with a focus on public lighting and energy-efficient municipal infrastructure. The grant continues to make provision for municipalities to use funding 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 R690 million over the medium term. The baseline reductions of R16 million to this grant are equivalent to 3.5 per cent of the grant's baseline in 2022/23 and 3.4 per cent in 2023/24. There are no baseline adjustments in 2024/25.

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 allocated R115 million in 2022/23 and 2023/24 respectively and R121 million in 2024/25.

Municipal disaster recovery grant

After the initial response to a disaster has been addressed, including through funding from the *municipal disaster response grant* discussed below, repairing damaged municipal infrastructure is funded through the *municipal disaster recovery grant*. Over the first two years of the 2022 MTEF period, this grant is allocated R347 million: R26 million in 2022/23 and R321 million in 2023/24. This allocation will fund the repair of municipal infrastructure in KwaZulu-Natal damaged by various natural disasters. Applications to fund recovery projects through this grant following more recent disasters will be finalised in the next budget process, including the adjustments budget process, as additional allocations may be made to the grant in future.

Capacity-building grants and other current transfers

Capacity-building grants help to develop municipalities' management, planning, technical, budgeting and financial management skills. Other current transfers include the *EPWP integrated grant for municipalities*, which promotes increased labour intensity in municipalities, and the *municipal disaster response grant*. A total of R7.8 billion is allocated to capacity-building grants and other current transfers to local government over the medium term.

Table W1.34 Capacity building and other current grants to local government

R million	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
		Outcome		Revised budget	Medium-term estimates		
Direct transfers	**1 670**	**1 870**	**2 068**	**2 333**	**2 412**	**2 442**	**2 552**
Municipal disaster response	–	–	151	359	371	373	389
Municipal emergency housing	38	147	166	168	175	183	191
Infrastructure skills development	141	149	144	155	159	160	167
Local government financial management	505	533	545	552	566	569	594
Programme and project preparation support	294	310	314	341	361	377	394
Expanded public works programme integrated grant for municipalities	693	730	748	759	778	781	816
Indirect transfers	**92**	**111**	**120**	**135**	**140**	**147**	**153**
Municipal systems improvement	92	111	120	135	140	147	153
Total	**1 762**	**1 981**	**2 187**	**2 469**	**2 552**	**2 589**	**2 705**

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 prioritises supporting municipalities with challenges in processes, procedures and systems to effectively implement the Act, to improve compliance and areas of weakness identified in the financial management capability maturity model. Total allocations to this grant amount to R1.7 billion over the 2022 MTEF period, with an allocation of R566 million in 2022/23, R569 million in 2023/24 and R594 million in 2024/25.

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. The grant aims to collaborate with other sectors, such as the Department of Water and Sanitation and the Department of Cooperative Governance, with the primary objective of improving *infrastructure skills development grant* services. In addition, a shared services model should exist between municipalities to ensure an effective management of the grant. Total allocations for this grant amount to R486 million over the 2022 MTEF period, with an allocation of R159 million in 2022/23, R160 million in 2023/24 and R167 million in 2024/25.

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 R440 million over the 2022 MTEF period and grow at an average annual rate of 4.2 per cent.

Over the next three years, the grant will allocate a third of the grant's baseline to continue 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 2022/23, 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.

Over the 2022 MTEF period, R60 million or 14 per cent of the grant's baseline is unallocated. This amount will be used to fund the rollout of a prototype staff establishment project and support municipalities in the rollout of training on municipal staff regulations. These regulations provide a uniform framework that seeks to ensure that only people with professional and technical skills are appointed across municipalities based on fair, efficient, effective and transparent human resource management systems.

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 is 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 is allocated R2.4 billion over the MTEF period, with an allocation of R778 million in 2022/23, R781 million in 2023/24 and R816 million in 2024/25.

Municipal disaster response grant

The *municipal disaster response 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 response grant* to be transferred to municipalities if funds in the municipal grant have already been exhausted, and vice versa. The Bill also allows for more than one transfer to be made to areas affected by disasters, so that initial emergency aid can be provided before a full assessment of damages and costs is conducted.

Over the 2022 MTEF period, R1.1 billion is available for disbursement through this grant: R371 million in 2022/23, R373 million in 2023/24 and R389 million in 2024/25. There are no budget adjustments to the grant's baseline over the period, and the grant grows at an average growth rate of 2.8 per cent. To ensure that sufficient funds are available for disaster response, section 20(7) 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 2022 MTEF period, R550 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 2022/23 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 2022/23. 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. Since then, the National Treasury has enhanced the infrastructure reporting tool to show budgets and expenditures for social projects implemented by provinces according to location (district, local or city). This is essential for data analysis and transparency, as well as for achieving value for money, as it allows one to see which localities are prioritised more by particular sectors.

In 2022/23, 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. The next step entails including long-term infrastructure projects across the three spheres of government that have not yet been approved (this will occur in 2022 and be implemented in 2023) to ensure the appropriateness of projects that must be undertaken in accordance with metropolitan spatial development frameworks. The aim is to consolidate infrastructure investment by the whole of government, both for projects whose budgets have already been approved and those whose budgets have not yet been approved.

In 2022/23, the National Treasury will continue to 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 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. Furthermore, in the 2022 Division of Revenue Bill reforms have been made to allow for the Minister of Finance to approve, if it cannot reasonably be delayed, unforeseeable and unavoidable expenditure provided for in the contingency reserve.

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. The review of the health component was completed in 2021/22 and will be implemented from 1 April 2022. In 2022/23 the review will focus on:

- Implementing the updated risk-adjusted factor within 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.

Preparing for national health insurance implementation

Government continues to prepare for the implementation of national health insurance. The implications that establishing the National Health Insurance Fund and increasingly channelling health budgets via this fund are likely to have for provincial finances are being discussed through consultative structures like the Technical Committee on Finance. In parallel, efforts to strengthen the health system 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 *national health insurance indirect grant* that will help facilities meet the envisaged standards required for national health insurance accreditation. The experience gained from this pilot will inform future efforts to improve quality. From 2022/23, funding for mental health and oncology services will be shifted from the *district health programmes grant* to the direct *national health insurance grant* to closely align these allocations to the implementation of national health insurance, for which they were originally intended.

Streamlining provincial conditional grants

In 2022, the National Treasury will work with the Department of Transport to ensure that the incentive component within the *provincial roads maintenance grant* is equitably allocated using the most recent road data available. Furthermore, the National Treasury will work with the Department of Basic Education to determine how to incorporate the *school infrastructure backlogs grant* into the *education infrastructure grant*. Given the creation of standalone informal settlements upgrading grants, government needs to review the human settlements grants that used to include allocations to informal settlement upgrading to determine programmes to be funded in those grants as such upgrading was a big component of the grants.

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. While the Economic Development Coordination Forum is reorganising following the merger of the Department of Economic Development into the Department of Trade, Industry and Competition, the National Treasury-led City Forum for Economic Development Managers is engaging provincial departments of economic development on issues of mutual interest every quarter to ensure coherence in policy implementation. The forum includes participants from provincial departments of economic development and their agencies; sector departments; the Department of Small Business Development; the Department of Cooperative Governance; the Presidency; the Department of Trade, Industry and Competition; financing institutions; metropolitan municipalities; secondary cities; and SALGA.

Review of the local government fiscal framework

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

The inability of municipalities to maintain and manage their infrastructure contributes to municipal service delivery failures. Although funding has been made available to municipalities to address the huge backlog of infrastructure needs, including changing grant conditions to allow funds to be spent on refurbishments, few municipalities have taken advantage of the provision. To help municipalities improve their asset management practices, the Budget Forum has endorsed the creation of an indirect component of the *municipal infrastructure grant* over the 2022 MTEF period, with 2022/23 being a pilot project. A precondition underpinning the in-year conversion is the existence of a capacity-building plan between the Department of Cooperative Governance and the identified municipalities. No funds will be allocated to this newly created indirect grant at the beginning of 2022/23, but funds may be transferred during the year once the Department of Cooperative Governance has identified municipalities that require this intervention.

Complementary to this process, the National Treasury, in collaboration with the Department of Cooperative Governance, will introduce a process to test the use of asset management indicators in the in-year stopping and reallocation process. To test the use of incentives in non-metropolitan municipalities in the short term without tampering with the allocation methodologies used in the annual determination of allocations, from 2022/23 onwards, the in-year stopping and reallocation process will take into account several non-financial performance indicators related to asset management to determine the reallocation of stopped funding. The process currently relies primarily on expenditure performance.

Furthermore, 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.

Review of the municipal capacity-building system

The National Treasury conducted a diagnostic study on the capacity-building system for local government during 2021. It found that the focus needs to shift from building capacity to a broader measure of developing capability. While capacity is closely linked to individual improvements – for example, developing skills – measures of capability consider a broader range of factors, including the environment in which the individual works and the systems and processes they use. Furthermore, the report revealed several data gaps, duplications in efforts and inconsistencies in the way programmes are designed and reported on across the three spheres of government, making it difficult to establish a common national approach to improving support. This has implications for the way the state designs support and the type of resources it provides to local government.

In 2022, the National Treasury is leading the second phase of the review in collaboration with the Department of Cooperative Governance and SALGA through a working group and a multi-departmental steering committee. In addition, extensive plans are in place for municipal consultation through workshops and focus groups. National and provincial sector departments will also be consulted. Using these inputs from national, provincial and municipal stakeholders, in addition to extensive data analysis and research into domestic and international literature, government is building an evidence base to inform policy decisions regarding changes to the capacity-building system.

It is envisaged that this collaborative and research-based process will introduce a clear structure for the capacity-building system. By October 2022, recommended proposals on how to improve the system's efficiency and effectiveness will be presented to the Budget Forum. After the Budget Forum and Cabinet have made changes and given approval, the proposals will be communicated clearly to all stakeholders before they are implemented, starting in the 2023 Budget.

Review of the environmental health services function

In 2021, the Department of Health, together with SALGA and the Department of Cooperative Governance and Traditional Affairs, hosted the World Environmental Health Day Commemoration and National Environmental Health Indaba. During the event, challenges relating to the provision and delivery of the environmental health services function were discussed. Following from these discussions, the World Environmental Health Day Commemoration and National Environmental Health Indaba Declaration on how these shortcomings can be addressed were adopted and signed. These statements outline various ways in which affected stakeholders (including the Department of Health, the Department of Cooperative Governance and Traditional Affairs, SALGA, and the National Treasury) can contribute to addressing the challenges that are encountered in rendering this function.

Due to a variety of factors, municipalities are unable to provide efficient, equitable and effective municipal health services. Climate change impacts and recent disease outbreaks will likely further increase environmental burdens of diseases, so environmental health systems should be strengthened to better prevent and manage disease outbreaks. To strengthen environmental health systems, in 2022, the stakeholders will focus on:

- Strengthening intergovernmental relations among environmental health authorities, as well as collaborations with communities, training institutions, non-governmental organisations and private businesses concerned with environmental health.
- Conducting a full costing analysis to inform budgeting for municipal health services.
- Improving the formula for allocating funds to municipalities for municipal health services to ensure that funds follow the function. District municipalities are currently allocated funds for municipal health services, but this function is sometimes performed by local municipalities, so the formula needs to be responsive to the various functions assigned to districts and local municipalities

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 to 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, as they 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. To address this uncertainty, amendments to the Municipal Fiscal Powers and Functions Act (2007) are proposed. The Municipal Fiscal Powers and Functions Amendment Bill proposes new, uniform regulations for levying development charges, so strengthening municipalities' revenue-raising framework. This will allow municipalities to mobilise own revenue resources to fund their infrastructure needs and support economic growth.

The National Treasury commissioned public consultations for the Bill in 2020. The Presidency has furnished the National Treasury with a final Socio Economic Impact Assessment System Certification and recommended that the Bill be presented to Cabinet. The refined Bill was submitted to the Office of the State Law Advisors for a legal opinion. The Bill is presently being processed through the Cabinet processes with a view to obtaining approval to submit it to Parliament for further processing in 2022. The draft legislation is available 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. The updated policy proposes changes that 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. The policy will be presented to Cabinet for approval in 2022.

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.