1

Trends in provincial budgets

Transition in provincial budgets

Provincial budgets have undergone a significant transition over the past five years. This chapter reviews these budgets and includes actual revenue and expenditure for 1996/97 to 1998/99, estimated actual outcomes for 1999/00 and budgeted amounts for 2000/01 through 2002/03. It highlights the stabilisation in provincial budgets since 1998/99 and the progress in addressing the debts accumulated in 1996/97 and 1997/98. The spending reductions required to align revenue and expenditure must be seen in the context of significant expenditure increases in 1996/97 and the reprioritisation of provincial budgets to meet government policy objectives.

Improved fiscal stance

Fiscal restraint and stringent measures to contain expenditure contributed to fiscal sustainability at provincial level. Provinces can now focus on improving the delivery of key social services and can prioritise spending on social and economic infrastructure over the next three years. The introduction of public finance reforms, including the Public Finance Management Act (PFMA), will improve accountability and efficiency of spending, ensuring that taxpayers receive value for money in the services delivered.

Key challenges

Nevertheless, the challenges facing the provinces remain considerable. The continuing spread of HIV/Aids and the floods of the past year significantly affect the ability of the provinces to provide better services, improve these services and address backlogs in infrastructure provision.

Provincial data

Chapters 1–4 and the Annexures on the provinces are based on the 2000 MTEF budgets of the national and provincial governments, as tabled in February 2000. The *Review* does not cover any additional allocations from the 2000 Adjustments Budget, nor has it been updated for the revised allocations in the 2001 *Medium Term Budget Policy Statement* (to be tabled on 30 October 2000). The *Review* complements the 2000 *Budget Review* as it analyses provincial government budgets for the transfers tabled in the 2000 Budget. This *Review* also updates the data published in the 1999 *Review.*

Provincial budget performance and challenges

Provinces in transition

Laying the foundations

Between 1994/95 and 1996/97, the newly created provinces concentrated on increasing access to services and achieving greater equity in spending, particularly on social services. The intergovernmental system was in its infancy and provincial systems and capacity were being developed. Most provinces were also involved in a complex process of amalgamating and rationalising different administrations. Outdated financial management systems, large increases in personnel costs and the need to expand the delivery of services contributed to high levels of overexpenditure in all provinces. Last year's *Review* provided an in-depth discussion of expenditure over this period.

Provincial expenditure stabilised

From 1997/98 to 1999/00, with their administrations more established, provinces could focus on stabilising provincial expenditure, paying off debt and aligning policy goals with available resources. Three-year budgeting was introduced to facilitate better planning, budgeting and expenditure management. Coordination within sectors was improved through intergovernmental forums that gave effect to the principle of cooperative governance.

Focus on value for money

The greater stability in provincial budgets establishes a firm base for enhanced provincial service delivery. Provinces can now concentrate on improving the quality of expenditure and on ensuring the effective use of funds to address pressing social needs. They are emphasising a better balance in the mix of spending, both between departments and within departmental budgets, to improve service delivery. The provinces are also focusing more on the revenue side of their budgets, as discussed elsewhere in this *Review*.

Challenges facing provinces

Backlogs remain

The backlogs in infrastructure and access to services in most provinces are well known. Efforts to address these backlogs have been hampered by a number of factors. These include increasing demand for services, rising personnel expenditure, natural disasters and macroeconomic constraints. The emphasis on social service spending has meant more progress on increasing access to basic services than on developing provincial economic infrastructure. Alleviating these backlogs remains a significant challenge over the medium term.

Impact of HIV/Aids

Sub-Saharan Africa has the highest rate of HIV infection in the world. This has both economic and social implications. Provinces, already under pressure to expand services, will have to devote more resources to dealing with the effects of HIV/Aids. These include higher health costs arising from treating HIV-positive people in the public health system, as well as meeting the growing demand for social grants when Aids patients become unable to work and the number of Aids orphans grows. At the same time, government resources will be under pressure, as economic growth will be affected by the decline in the economically active population and by constrained productive investment (due to increased spending on health care and social support). Provinces that are already underdeveloped face worsening development indicators when earning capacity declines, life expectancy is shortened and infant mortality rises.

Pressure on infrastructure

Infrastructure backlogs relate to both the building of new facilities and the maintenance of existing assets. Provinces have been unable to provide sufficient funds for rehabilitating schools and hospitals or for maintaining roads. Natural disasters in the previous three years have added to this burden. Preliminary estimates, which are yet to be verified, place the costs at more than R2 billion.

Provincial revenue and expenditure

Table 1.1 illustrates the trends in provincial budgets and the influence of the challenges outlined above. The shift from a deficit of nearly R5,5 billion in 1997/98 to surpluses in 1998/99 and 1999/00 shows the progress provinces have made in stabilising expenditure and repaying debts. Improved financial management and better planning for expenditure have allowed some provinces to make provision for contingency reserves over the next few years. The remainder of this chapter discusses the trends in revenue and expenditure, and highlights budget pressures over the next three years.

Table 1.1 Total provincial revenue and expenditure

	Actual			Estimated actual	Medium-term estimate		
R million	**1996/97**	**1997/98**	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**
Transfers from national budget	84 703	85 956	91 381	97 009	106 040	111 178	116 417
Of which: Conditional grants	*0*	*2 080*	*9 839*	*10 415*	*11 632*	*11 011*	*11 260*
Own revenue	4 089	3 458	3 440	3 994	3 640	3 907	4 177
Total provincial revenue	**88 791**	**89 414**	**94 821**	**101 003**	**109 680**	**115 084**	**120 594**
Education	36 575	38 502	38 678	40 036	43 230	45 530	48 160
Health	20 616	22 491	22 949	24 241	26 083	27 623	28 920
Welfare	15 885	17 566	18 365	19 273	20 336	20 847	21 536
Contingency reserves	0	0	0	0	470	895	1 071
All other expenditure	18 709	16 326	14 280	14 416	18 264	19 198	20 229
Total provincial expenditure	**91 785**	**94 885**	**94 272**	**97 965**	**108 383**	**114 094**	**119 916**
Surplus/(deficit)	**(2 994)**	**(5 470)**	**549**	**3 038**	**1 298**	**991**	**678**

Provincial surpluses

Progress in reducing liabilities

Over the past two years, provinces have made significant progress in reducing the debt accumulated in previous years. Table 1.1 reflects provincial deficits and surpluses from 1996/97 through 2002/03. These figures have been updated since the 1999 *Review* owing to better financial reporting in the provinces. Provinces accumulated sizeable debts during 1996/97 and 1997/98, as evidenced by the deficits in those years. The trend changed in 1998/99 when provinces ran a combined surplus of R0,6 billion. The turnaround continued in 1999/00, with a projected provincial surplus of R3,0 billion.

Since Government operates a cash accounting system and not an accrual accounting system, payments on past debt are assigned not to the year in which the debt or obligation was accrued but to the year in which it was actually spent. In terms of the Government Finance Statistics method of accounting, the redemption of debt is seen as a surplus and not as expenditure.

Surpluses are not unspent funds

For these reasons, provincial surpluses have often been incorrectly interpreted as unspent funds that could have been used for delivering services. These surpluses were, in fact, used primarily to reduce outstanding liabilities. In earlier years, some provinces accumulated overdrafts while others delayed expenditure such as payments to creditors, personnel promotions, pension contributions and tax payments to the South African Revenue Service (SARS). National government assisted the provinces by providing funds in the 1998/99 and 1999/00 Adjustments Estimates solely for addressing these debts. The additional amounts, totalling R1,0 billion and R1,4 billion in 1998/99 and 1999/00 respectively, comprise a significant portion of the surpluses in these years.

Although the surpluses are mainly to cover debt reduction, they also reflect funds that are committed, i.e. where revenue was received but expenditure has been delayed. This occurred, for instance, with some conditional grants, where funds were transferred late in the financial year.

Further debt reduction

All nine provinces make provision for further debt reduction, as evidenced by their budgeted surpluses over the MTEF period. In addition, several provinces have set aside funds in a contingency reserve, as shown in Table 1.2. The contingency reserves are largely a cushion against unanticipated expenditure. A few provinces have made provision for expenditure, such as on infrastructure development, which has yet to be allocated to specific departments. Such reserves, however, must be accompanied by proper planning for spending. These funds may also be used for further debt repayment, if necessary.

Table 1.2 Provincial surpluses and finance reserves

	2000/01		20001/02		2002/03	
R million	Surplus	Reserve	Surplus	Reserve	Surplus	Reserve
Eastern Cape	204	38	205	240	100	376
Free State	91	0	90	0	50	0
Gauteng	300	0	236	0	108	0
KwaZulu-Natal	346	0	170	0	149	263
Mpumalanga	76	193	18	302	0	429
Northern Cape	35	3	51	3	43	3
Northern Province	160	0	172	0	158	0
North West	40	234	40	349	40	0
Western Cape	46	0	8	0	30	0
Total	**1 298**	**470**	**991**	**895**	**678**	**1 071**

Adjustments to provincial budgets

Shifts in responsibilities

The evolution of the intergovernmental system has resulted in several shifts in responsibilities between the spheres of government, which affected their budgets. Thus, when making comparisons between provinces and over time, certain adjustments to Table 1.1 are needed to ensure consistency. For example, growth rates based on the table would be misleading, as both revenues and expenditures are distorted by changes in the functions of national and provincial governments, and by the introduction of conditional grants. These adjustments are shown in Table 1.3 and explained in more detail in the box below. Unless stated otherwise, the adjusted provincial totals are used throughout the *Review* for calculation and analysis of revenues and expenditure.

Adjusting provincial budgets for function shifts

Analysis of provincial budgets is distorted by three important shifts in responsibilities between the three spheres. To enable reasonable comparisons over time, the provincial budgets must be adjusted to account for these shifts.

Beginning in 1997/98, the responsibility for servicing inherited debt was shifted to the national government. In addition, the local government equitable share was introduced in 1998/99, redirecting to local government some funds that previously flowed through provincial budgets.

The most significant adjustment this year is the inclusion of information on the housing funds in the data for all years. In 2000/01, housing funds flowing to provinces from the National Housing Fund will, for the first time, be reflected in provincial budgets as a conditional grant. In the past, these funds were regarded as an agency payment and were not appropriated on provincial budgets. Including these funds only from 2000/01 would distort comparisons of revenue flows and expenditure, in particular the share of capital spending in provincial budgets. The housing transfers have therefore been added to provincial budgets for the four preceding years.

Table 1.3 Adjusted provincial revenue and expenditure

	Actual			Estimated actual	Medium-term estimate		
R million	**1996/97**	**1997/98**	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**
Total provincial revenue	88 791	89 414	94 821	101 003	109 680	115 084	120 594
Total provincial expenditure	91 785	94 885	94 272	97 965	108 383	114 094	119 916
Including:							
Housing funds	1 938	3 135	3 005	2 721	0	0	0
Excluding:							
State debt costs	1 998	0	0	0	0	0	0
Local government grants	2 238	1 999	1 132	463	463	0	0
Total adjusted revenue	**86 494**	**90 550**	**96 694**	**103 261**	**109 217**	**115 084**	**120 594**
Total adjusted expenditure	**89 488**	**96 021**	**96 145**	**100 223**	**107 920**	**114 094**	**119 916**
Percentage change							
Adjusted revenue		4,7	6,8	6,8	5,8	5,4	4,8
Adjusted expenditure		7,3	0,1	4,2	7,7	5,7	5,1
Percentage of GDP							
Adjusted revenue	13,6	12,9	12,8	12,8	12,3	12,0	11,6
Adjusted expenditure	14,1	13,7	12,7	12,4	12,2	11,9	11,6
Addendum[1]							
GDP (R million)	633 787	699 292	754 729	809 700	885 200	958 200	1 036 700
CPI change (%)	8,1	7,5	7,7	4,0	5,5	5,2	4,7

1. From the 2000 Budget Review

Provincial revenue

Transfers from national government

Transfers from national government dominate provincial revenue, representing over 95 per cent of such revenue in 2000/01. These transfers comprise numerous conditional grants and an unconditional equitable share allocation. Provinces are responsible for compiling their own budgets on the basis of the transfers plus any revenue from own sources. The formula used for determining provincial equitable shares captures the relative demand for basic services[1]. It is not intended to reflect provincial expenditure or act as a benchmark against which to measure provincial allocations.

Trends in total adjusted revenue

Table 1.3 indicates that adjusted total provincial revenues increased from R86,5 billion in 1996/97 to R103,3 billion in 1999/00, at an average rate of 6,1 per cent a year. This is equal to the average annual inflation rate during these years. However, there were significant fluctuations in this period, with a sharp increase between 1995/96 and 1996/97 followed by a real decrease between 1996/97 and 1997/98. Since 1997/98, revenues have been more stable.

Over the MTEF period, adjusted revenue is set to grow from R103,3 billion in 1999/00 to R120,6 billion in 2002/03. This represents an annual average growth rate of 5,3 per cent, slightly above the expected average inflation rate of 5,1 per cent a year.

Growth in equitable share

Given the dominance of national transfers, the distribution of revenue between spheres will affect the nature of spending and the fiscal position of the provinces. In 2000/01, the equitable share represents about 86 per cent of provincial revenue, while conditional grants form 10 per cent and own revenue approximately 4 per cent. As shown in Table 1.4, total transfers from national government grow at an average annual rate of 5,5 per cent between 1999/00 and 2002/03. The equitable share, however, grows faster than conditional grants at an average of 6,7 per cent.

Table 1.4 Average annual change in adjusted provincial revenue

	Annual average change	
Percentage change	**1996/97 – 1999/00**	**1999/00 – 2002/03**
Transfers from national government	6,4	5,5
Of which: Equitable share	*n/a*	*6,7*
Conditional grants	*n/a*	*(3,9)*
Own revenue	(0,8)	1,5
Total revenue	6,1	5,3
Consumer price index	6,4	5,1

n/a = not applicable

Conditional grants

Conditional grants are a smaller but significant proportion of provincial revenues. These grants were introduced in the 1998 Budget to support national policy priorities, particularly in the social services. Real declines over the medium term reflect the discontinuation of some grants, such as those for debt repayment, and the levelling off of others in line with policy goals.

Although successes were achieved with conditional grants, some problems did occur. Chapter 3 reviews the experience with

[1] Details of how the formula is calculated are provided in Annexure A.

conditional grants since 1998 and outlines a framework for streamlining and improving the efficiency of these grants.

Provincial own revenue

Provincial own revenue declined strongly between 1996/97 and 1999/00 by an average 0,8 per cent a year, representing a significant annual real decline of more than 7 per cent. This real decline is set to continue over the MTEF period, although it moderates somewhat. Chapter 4 deals with trends in provincial own revenues, including the potential to improve collections from existing sources and a framework for new revenues.

Trends in provincial expenditure

Growth in total spending

While total provincial revenues largely kept pace with inflation between 1996/97 and 1999/00, this was not the case with expenditure. Adjusted expenditure increased from R89,5 billion in 1996/97 to R100,2 billion in 1999/00, the average annual growth rate of 3,8 per cent being well below the corresponding inflation rate of 6,4 per cent.

This must, however, be seen in the light of the large upward adjustment of 17,8 per cent in 1996/97, when total expenditure escalated to R89,5 billion from R76,0 billion in the previous year. Thus the substantial decline in expenditure the following year, to contain overexpenditure, occurs off the inflated 1996/97 base.

Recovery in expenditure

Expenditure growth is expected to recover and exceed inflation in 2000/01, with budgeted amounts set at R107,9 billion or 7,7 per cent above the 1999/00 level. Real growth continues over the medium term, reversing the past trend of declining expenditures when provinces sought to remain within budget and repay debts. Adjusted expenditure is projected to grow at an average annual rate of 6,2 per cent, 1,1 percentage points above the expected inflation rate.

Table 1.5 Average annual change in adjusted provincial expenditure

	Annual average change	
R million	1996/97 – 1999/00	1999/00 – 2002/03
Current expenditure	4,1	5,6
Of which: Personnel	*6,3*	*5,6*
Transfers	*4,1*	*4,6*
Other current	*(4,1)*	*7,2*
Capital expenditure	0,9	9,2
Total expenditure[1]	3,8	6,2
Consumer price index	6,4	5,1

1. Includes contingency reserve amounts, which are not included in either current or capital expenditure shown above

Shifting composition of expenditure

The different demographic, economic and historical circumstances of the nine provinces and the evolving nature of intergovernmental financial relations continue to influence expenditure patterns. These trends are detailed in Chapter 2.

Addressing the composition of expenditure

Trends in overall expenditure growth mask important features of provincial spending, although general trends are mirrored in most provinces. Overall expenditure grew more slowly than inflation between 1996/97 and 1999/00, but the pattern of growth differs between categories of expenditure.

Driven by strong personnel expenditure growth in health and education, social services spending grew faster than overall provincial expenditure, capturing a larger share of provincial budgets. Non-social services and non-personnel spending bore the brunt of cost containment.

Provinces have had some success in restructuring their budgets to address provincial priorities, as reflected in Table 1.6. They have sought to control current expenditure, particularly personnel costs, in order to release funds for capital spending. Thus, future expenditure growth is driven mainly by non-personnel expenditure in the social services and by spending on infrastructure.

Table 1.6 Adjusted expenditure by economic classification

	Actual			Estimated actual	Medium-term estimate		
R million	**1996/97**	**1997/98**	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**
Current expenditure	82 941	87 649	89 221	93 499	99 461	104 228	110 086
Personnel	48 972	53 927	56 734	58 844	62 265	65 554	69 260
Transfers	19 150	20 385	20 478	21 589	23 041	23 877	24 710
Other current	14 818	13 337	12 010	13 066	14 155	14 797	16 116
Capital expenditure	6 547	8 372	6 923	6 724	7 988	8 971	8 759
Contingency reserve	–	–	–	–	470	895	1 071
Total	**89 488**	**96 021**	**96 145**	**100 223**	**107 920**	**114 094**	**119 916**
Percentage shares							
Current expenditure	92,7	91,3	92,8	93,3	92,2	91,4	91,8
Personnel	54,7	56,2	59,0	58,7	57,7	57,5	57,8
Transfers	21,4	21,2	21,3	21,5	21,4	20,9	20,6
Other current	16,6	13,9	12,5	13,0	13,1	13,0	13,4
Capital expenditure	7,3	8,7	7,2	6,7	7,4	7,9	7,3
Contingency reserve	0,0	0,0	0,0	0,0	0,4	0,8	0,9
Total	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**

Personnel expenditure

Declining as a share of spending

Personnel expenditure grew from 54,7 per cent of total spending in 1996/97 to 59,0 per cent in 1998/99. These significant increases in wage costs arose from the 1996 wage agreement and the hiring of additional staff in health and education. Personnel expenditure continues to dominate provincial expenditure, although growth in personnel spending over the MTEF period has been reduced to approximately 5,6 per cent a year. Table 1.7 shows that lower personnel numbers, particularly in the education sector, have restrained the growth in personnel expenditure.

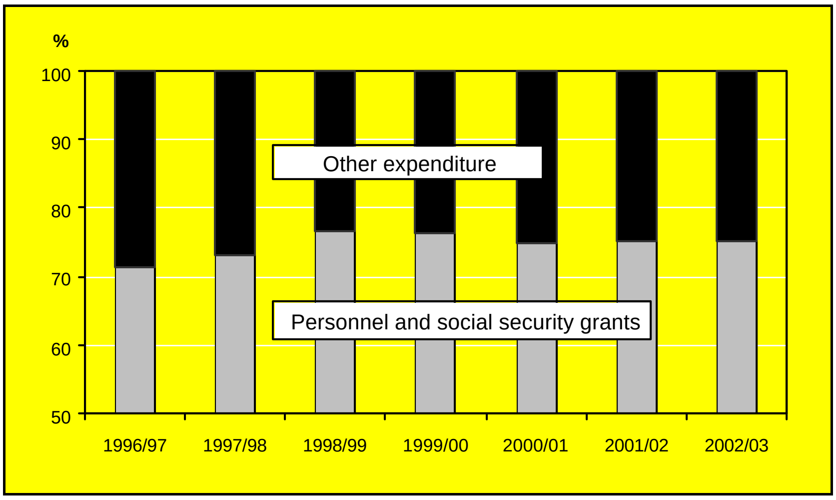
Provinces face fixed costs

In addition to personnel spending, provinces face other costs over which they have little discretion, mainly national entitlements to social security grants. Figure 1.1 reflects the combined impact of personnel and social security responsibilities. These two items consumed 76 per cent of provincial budgets in 1999/00, but this share is projected to decline slightly to about 74 per cent. Reductions in these two categories of spending contribute to the declining share of budgets allocated to social service spending over the next three years.

Table 1.7 Personnel expenditure

	Personnel expenditure		Provincial employment	
R million	**1999/00**	**2000/01**	**1999/00**	**2000/01**
Eastern Cape	10 371	10 330	136 935	130 890
Free State	4 290	4 616	61 054	57 936
Gauteng	9 185	10 161	112 851	112 836
KwaZulu-Natal	11 310	12 056	153 687	147 546
Mpumalanga	3 882	4 034	51 355	51 324
Northern Cape	1 236	1 294	14 821	64 431
Northern Province	8 366	8 721	119 465	15 462
North West	4 901	5 273	67 169	112 850
Western Cape	5 765	6 243	67 940	66 093
Total	**59 307**	**62 728**	**785 277**	**759 368**

Figure 1.1 Provincial fixed costs as a share of adjusted expenditure



Real growth in social services

Table 1.8 shows the shift in the balance of spending between social and non-social services. The three major social services programmes – education, health and welfare – grew by an average of 4,5 per cent a year between 1996/97 and 1999/00, exceeding the 3,8 per cent growth rate for total expenditure. Budgeted expenditure for social services grows more slowly than other expenditure, at an annual average rate of 5,7 per cent over the MTEF period. Social services expenditure is discussed in more detail in Chapter 2. The declining share of social services creates room in provincial budgets for addressing other provincial priorities.

Emphasis on non-social services

Between 1996/97 and 1999/00, non-social service expenditure was drastically reduced to accommodate the social services. This trend should be ameliorated over the medium term, as non-social service spending increases by nearly 6,5 per cent a year.

Table 1.8 Expenditure on social services as percentage of adjusted provincial expenditure[1]

	Actual			Estimated actual	Medium-term estimate		
Percentage	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03
Social services	81,7	81,8	83,2	83,4	83,4	83,0	83,0
Education	*40,9*	*40,1*	*40,2*	*39,9*	*40,2*	*40,2*	*40,5*
Health	*23,0*	*23,4*	*23,9*	*24,2*	*24,3*	*24,4*	*24,3*
Welfare	*17,8*	*18,3*	*19,1*	*19,2*	*18,9*	*18,4*	*18,1*
Non-social services	18,3	18,2	16,8	16,6	16,6	17,0	17,0
Total	100,0	100,0	100,0	100,0	100,0	100,0	100,0

1. Excluding contingency reserves

Focus on infrastructure

Declining share to 1999/00

The increases in social services spending, particularly spending on personnel and social security grants, had a significant negative impact on capital and maintenance expenditure. Capital spending grew by only 0,9 per cent a year between 1996/97 and 1999/00, implying not only that new investment was not being undertaken, but also that expenditure was insufficient to maintain existing infrastructure.

Prioritising infrastructure over the medium term

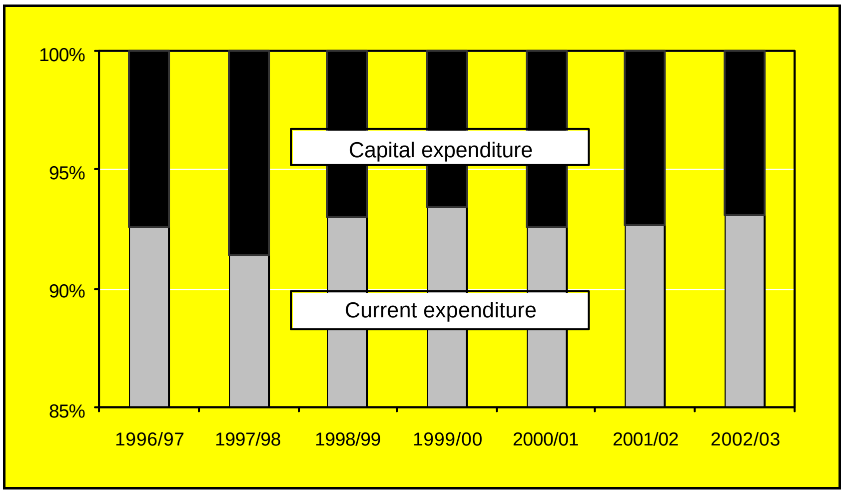
Provinces have identified the provision of infrastructure as a priority, as discussed in Chapter 2. Provincial figures now include housing allocations. The recent floods in several provinces highlighted the need to rehabilitate and upgrade social and economic infrastructure as a basis for future growth. Figure 1.2 illustrates the increasing emphasis on infrastructure provision. The MTEF budgets show that provinces should achieve a better balance between personnel, capital and operating expenditure over the next three years. Budgeted capital expenditure, including the housing funds, increases by 9,2 per cent a year over the medium term, indicating strong reprioritisation.

Medium-term spending pressures

Trade-offs between competing demands

Provinces face an array of competing demands when allocating their budgets. For one, they are committed to certain expenditures arising from current policies and national mandates. They also face historical legacies and structural rigidities in expenditure patterns, which will take time to overcome. In addition, budgets are subject to external influences that affect the patterns of demand for services and the availability of resources. To meet these challenges, provinces have sought to shift funds from current expenditure to investments in badly needed social and economic infrastructure.

Figure 1.2 Share of capital expenditure of total adjusted expenditure



Social security grants

Social security grants pose a challenge to the envisaged shifts in allocations over the medium term and to provinces' ability to keep expenditure within available resources. Increased pressure on provincial welfare budgets will be driven by:

- The phasing in of the child support grant
- Equalising access to grants across provinces
- The expectation of annual inflation-linked increases
- The impact of HIV/Aids

Increasing take-up of child support

The child support grant will impact most heavily on those provinces with relatively large child populations and where the population has had little access to state maintenance grants. Strong growth in grant expenditure is therefore anticipated in Mpumalanga, North West and Northern Province. This will have a major impact on other provincial expenditure, given the revenues projected for the medium term.

Providing support for people with HIV

Based on the 1999 National Ante-natal Survey, commissioned on behalf of the Department of Health, it is estimated that more than 3,5 million South Africans, or over 8 per cent of the population, were infected with HIV at the end of 1999/00. The rate of infection among adults is estimated to be substantially higher, at 13 per cent of all people between the ages of 20 and 64, with the highest rates of infection in KwaZulu-Natal and Mpumalanga. At current rates of infection (i.e. without substantial behavioural change), it is estimated that the number of HIV-positive people will rise to at least 6 million by 2010. Providing support to people who contracted HIV and slowing the rate at which the virus spreads will crowd out other provincial expenditures. Health and welfare budgets will be under considerable strain as the proportion of HIV-positive people in the public health system increases. The take-up of welfare grants, particularly disability and foster grants, is likely to increase more rapidly than provided for in provincial budgets.

Continued pressure on personnel

The increased expenditure on non-personnel and non-social services in the budget estimates can only be achieved if real growth in personnel budgets is modest. Several factors may undermine this assumption. In education, there is pressure to introduce a wage progression system and to upgrade the qualifications of underqualified teachers. In health, the continued existence of the system of rank and leg promotions, and the implementation of the Basic Conditions of Employment Act in the civil service (particularly overtime stipulations) may mean that wage increases will be higher than initially assumed.

Facilities backlogs

Facilities backlogs are already substantial in poor provinces, particularly in the education sector and in the maintenance of facilities. Recent flood damage and the need to repair economic infrastructure such as roads and bridges place further demands on the resources available for capital expenditure. The other spending pressures listed above will severely constrain the ability of provinces to increase the share of resources provided for the development and maintenance of infrastructure.

Issues in provincial budgeting

Improve budget preparation and policy coordination

Revised division of revenue process

A crucial decision in the budget process relates to the division of nationally raised revenue between the spheres of government and between provinces and municipalities. These decisions give effect to government priorities and reflect the responsibilities and spending pressures of each sphere. As part of the ongoing programme of budget reform, a more structured approach to determining the division of revenue is being introduced. This process should also facilitate improvements and rationalisation in the structure and planning of conditional grants.

Revised budget formats

Improved provincial budget formats is an important reform in the budget preparation process. The 1999 PFMA enables the national Treasury to establish common budget formats for all provinces. The new formats will increase transparency by highlighting relevant information and presenting it in a user-friendly manner. Six provinces are using the revised formats in 2000/01. (The formats are explained in Annexure B.)

Intergovernmental coordination

Provincial and national government have laid the foundations for an efficient intergovernmental system and have established appropriate structures to facilitate interaction, cooperation and coordination. In particular, budget reforms aim to improve the link between policy and budget processes in order to direct resources to national priorities. Joint meetings at the political and technical levels strengthen the links between sectoral policy and budget formulation. These interactions are functioning well, although the system will continue to evolve and adapt to the challenges facing Government. The next phase of the MTEF process will focus on strengthening the crucial link between policy, budgeting and service delivery.

Enhance service delivery

Focus on improved service delivery

The ultimate test of fiscal reform is the extent to which quality services are delivered to South Africans on an equitable basis. Budget constraints over the past three years, specific allocations for improving financial management and the focus on improving the effectiveness of expenditure provide the basis for improved efficiency in delivering services. Remaining priorities include better management of resources and achieving value for money over the medium term.

Non-financial indicators

An analysis of trends in provincial expenditure is incomplete without an assessment of the services delivered with that expenditure. Chapter 2 includes non-financial indicators for the social services, as a first step towards identifying the impact of provincial spending. The development of output indicators is a long process, which is dependent on the availability of quality information. The information on service delivery trends is gradually being improved to serve as a benchmark for performance evaluation.

Strengthening financial management capacity

Implementing PFMA

Inadequate capacity, particularly for financial management, has been a major concern at the provincial level. The PFMA, which applies to both the national and provincial spheres, is the cornerstone of a framework for structural improvements in the management of public finances, in line with international best practice. The PFMA sets out accountability principles that devolve responsibility for service delivery to departmental managers. It clarifies the role and duties of accounting officers and lays the foundation for improved government accounting. In particular, it establishes clear lines of accountability for intergovernmental transfers.

Strengthening accountability

The Division of Revenue Act supports the PFMA in clarifying and strengthening the trail of accountability. Technical changes to the Act clarify the accounting responsibilities of both transferring and receiving accounting officers. They require more information on proposed grants to be supplied earlier in the budget process, thus facilitating better budget planning. More frequent reporting requirements are introduced to improve monitoring. These provisions, which are discussed in Chapter 3, build on the successes with grants over the past two years and assist in addressing the initial problems.

Conclusion

Provinces have already implemented far-reaching reforms to their budgeting systems. These reforms have produced tangible results in expenditure management and will assist provinces in meeting the considerable challenges that lie ahead.

Improving budget performance is an incremental process that will continue over the next three years, supported by the development of indicators for measuring performance and by improvements in data collection.

2

Provincial expenditure

Key provincial functions

The previous chapter outlined the overall developments and trends in provincial budgets. This chapter analyses variations in expenditure between provinces, presents information on the target populations in the social services, highlights key policy developments and identifies spending pressures on provincial budgets over the next three years. It is divided into four sections – education, health, welfare and the remaining services delivered by provinces. In line with the period covered in the new provincial budget presentations, the chapter examines provincial expenditures and budgets between 1998/99 and 2002/03, with particular emphasis on the current budget.

Information on service delivery

Several reforms to the budget process and documentation have been introduced to provide more consistent information. Government's increased focus on performance reflects its commitment to accelerating service delivery at all levels. Information on provincial service delivery is, however, limited. Various sectoral technical committees are developing key delivery indicators in the social services, and the revised budget formats and reporting requirements will encourage provincial departments to improve the collection of such information.

Aggregate provincial expenditure

Table 2.1 presents aggregate adjusted expenditure by province from 1998/99 through 2002/03. These figures include a contingency reserve set aside by provinces to cater for debt repayments or other contingencies. Between 1998/99 and 1999/00, provincial expenditure increased by 4,2 per cent, in line with inflation for the year. Over the MTEF, expenditure is set to increase at 5,8 per cent a year, somewhat faster than expected inflation.

Provincial growth varies

The growth in provincial budgets varies considerably, mainly owing to the impact of the equitable share formula, the level of debt repayments and the original level of expenditure before the introduction of the equitable share formula. In Western Cape and Northern Cape, provinces with historically high per capita expenditure, average annual growth is below inflation over the medium term. In all other provinces, except Eastern Cape, expenditure grows in real terms. Some of the poorest provinces, KwaZulu-Natal, Mpumalanga and Northern Province, have annual budget growth of more than 1 per cent in real terms over the three years to 2002/03.

Table 2.1 Adjusted provincial expenditure by province

	Actual	Estimated actual	Medium-term estimate		
R million	1998/99	1999/00	2000/01	2001/02	2002/03
Eastern Cape	15 432	16 518	17 568	18 256	18 959
Free State	7 043	6 768	7 429	7 786	8 144
Gauteng	16 379	16 895	18 173	19 262	20 501
KwaZulu-Natal	18 455	19 235	21 199	22 590	23 563
Mpumalanga	6 075	6 505	6 831	7 317	7 707
Northern Cape	2 398	2 496	2 525	2 640	2 774
Northern Province	11 985	12 713	13 633	14 567	15 384
North West	7 817	8 315	8 680	9 016	9 731
Western Cape	10 561	10 778	11 412	11 764	12 083
Total, adjusted	**96 145**	**100 223**	**107 450**	**113 199**	**118 845**
Percentage change					
Eastern Cape		7,0	6,4	3,9	3,8
Free State		(3,9)	9,8	4,8	4,6
Gauteng		3,2	7,6	6,0	6,4
KwaZulu-Natal		4,2	10,2	6,6	4,3
Mpumalanga		7,1	5,0	7,1	5,3
Northern Cape		4,1	1,2	4,6	5,1
Northern Province		6,1	7,2	6,8	5,6
North West		6,4	4,4	3,9	7,9
Western Cape		2,1	5,9	3,1	2,7
Total, adjusted		**4,2**	**7,2**	**5,4**	**5,0**

Provincial variations

The structure of provincial budgets displays interesting variations by province. Table 2.2 illustrates the different proportions of provincial budgets allocated to different functions. These variations in the pattern of expenditure are influenced by often opposing factors. Key factors are:

- The demographic and socio-economic profile of the provinces (and hence different social services needs)
- Historical patterns of expenditure
- The existence of cross-boundary services
- Varying capacity
- The cost and composition of the personnel employed by provinces

Table 2.2 Share of provincial expenditure by department, 2000/01

Percentage	Education	Health	Welfare	Subtotal	Other	Total
Eastern Cape	42,0	19,2	23,8	85,1	14,9	100
Free State	41,4	24,6	17,0	83,0	17,0	100
Gauteng	37,6	33,7	14,5	85,7	14,3	100
KwaZulu-Natal	38,5	27,0	19,2	84,6	15,4	100
Mpumalanga	42,6	17,4	17,8	77,7	22,3	100
Northern Cape	38,2	16,9	25,3	80,4	19,6	100
Northern Province	45,6	17,8	18,7	82,1	17,9	100
North West	41,8	18,4	17,5	77,7	22,3	100
Western Cape	35,7	29,8	19,9	85,4	14,6	100
Average	40,2	24,3	18,9	83,4	16,6	100

Demographic and socio-economic factors

Demographic profiles and income levels are significant factors. In Northern Province, KwaZulu-Natal and other rural provinces, a higher proportion of the population is of school-going age; this drives education expenditure. These provinces are also likely to employ teachers with lower qualifications, which may reduce costs but can adversely affect educational outcomes. Many of these provinces inherited poor education systems with high repeat rates and, hence, have more children in school.

Rural provinces with high numbers of women, children and elderly people, and a smaller proportion of people with medical health insurance, face significant demands on the public health system. Yet expenditure is highest in provinces that inherited specialised care facilities, notably Gauteng and Western Cape. These facilities serve all South Africans, irrespective of where they live. Funding comes largely from grants from national government and appear on the budgets of the provinces in which they are located.

Welfare grants are targeted at pensioners, children and disabled people who fall below a certain income level. Provinces with a high proportion of pensioners and children, coupled with low average income levels, generally spend more on social security grants. However, variations in expenditure can reflect access as well as demographics. Better access to welfare grants and services is evident in the Cape provinces, for instance, where administrations were developed under the policies of the old dispensation.

Cross-boundary spillovers

Academic health services are offered only in certain provinces. Gauteng, Western Cape, KwaZulu-Natal and Free State all deliver academic health services and medical training to people from other provinces. As a result, these provinces spend an above-average proportion on health.

The analysis below on education, health and welfare does not focus on conditional grants, which are covered in the next chapter. Table 3.9 shows actual transfers in such grants in 1998/99 and 1999/00.

Education

Investing in the children

Education is one of the most significant long-term investments a country can make because it lays the foundation for a higher quality of life, greater employment opportunities and a better-skilled workforce. At almost 6 per cent of GDP, South Africa has one of the highest rates of government investment in education in the world, yet education outcomes lag behind those of comparable countries. This section analyses provincial education expenditure, identifies spending pressures and outlines the main policy developments in education over the past year.

The education story

On average, education accounts for 40 per cent of provincial budgets, reflecting its importance in stimulating growth and development. Provinces fund school education, adult basic education, early childhood development, education for learners with special needs and teacher training colleges. Between 1994 and 1998/99, provincial education departments had to integrate the different education authorities, bring personnel salaries into line and improve equality of access to education. With a clearer framework in place, the focus has now shifted to improving the quality of education, especially in poorer schools. The introduction of the *Tirisano* campaign by the Minister of Education has seen a shift to getting children into schools, ensuring that teaching takes place, restoring discipline in schools and working with communities to improve the way schools function.

Funding education

Provincial equitable shares

Education expenditure is funded primarily from the provinces' equitable shares and own revenues. The Department of Education provides a conditional grant, R202 million in 2000/01, to support improvements in financial management and the quality of education. The provincial equitable share formula includes a component that indicates the relative need for educational services. Weighted at 41 per cent, the education component includes actual school enrolment figures and the provincial distribution of the school-age population. The former identifies the target group for education services, while the latter compensates for higher enrolment rates in provinces that inherited poor education systems. The formula-based distribution of resources does not correlate with provincial education expenditures, as these are driven by relative costs, provincial preferences and historical backlogs in education services.

School fees

The South African Schools Act allows for the collection and retention of school fees from parents who can afford such payments. Parental support provides a significant injection into the public school system and enables Government to shift resources from wealthier to poorer schools. These fees are not included in provincial budgets.

Funding norms and standards

The contribution of fees to total school revenue obviously correlates with the income level of the community. Parents in wealthier communities are making larger contributions to their children's education than in the past. As a result, the norms and standards for school funding dictate that poorer schools should receive a greater share of non-personnel resources than wealthier schools. Such redistribution is a key element of education policy, as is the drive to give parents more say in the management of schools and school budgets through participation in governing bodies.

Trends in education spending

Increase in education expenditure

Table 2.3 shows that provincial education expenditure increased from R38,7 billion in 1998/99 to R43,2 billion in 2000/01, and is projected to grow to R48,2 billion by 2002/03. Despite below-inflation growth between 1998/99 and 1999/00, education expenditure has grown in real terms since 1995/96. This trend is projected to continue until 2002/03, with average annual growth of nearly 6,4 per cent over the medium term.

Provincial trends

In 1999/00, five provinces saw declines in real education expenditure (Eastern Cape, KwaZulu-Natal, Northern Province, Northern Cape and Western Cape). Over the MTEF period, expenditure growth varies from an annual average of 4,7 per cent in Mpumalanga to 8,4 per cent in KwaZulu-Natal. All provinces except Mpumalanga, Northern Cape and North West see real growth in education. Average annual growth is high in Free State (7,1 per cent), Gauteng (6,7 per cent) and Northern Province (6,7 per cent).

Table 2.3 Education expenditure by province

	Actual	Estimated actual	Medium-term estimate		
R million	1998/99	1999/00	2000/01	2001/02	2002/03
Eastern Cape	6 585	6 839	7 379	7 630	7 956
Free State	2 612	2 785	3 073	3 277	3 426
Gauteng	6 045	6 310	6 835	7 229	7 657
KwaZulu-Natal	7 124	7 299	8 158	8 809	9 306
Mpumalanga	2 624	2 809	2 907	3 103	3 222
Northern Cape	878	896	963	1 013	1 066
Northern Province	5 793	5 856	6 212	6 657	7 119
North West	3 196	3 408	3 624	3 550	3 945
Western Cape	3 822	3 835	4 078	4 263	4 462
Total, adjusted	**38 678**	**40 036**	**43 230**	**45 530**	**48 160**
Percentage change					
Eastern Cape		3,9	7,9	3,4	4,3
Free State		6,6	10,3	6,6	4,5
Gauteng		4,4	8,3	5,8	5,9
KwaZulu-Natal		2,5	11,8	8,0	5,6
Mpumalanga		7,1	3,5	6,7	3,9
Northern Cape		2,1	7,6	5,2	5,2
Northern Province		1,1	6,1	7,2	6,9
North West		6,6	6,3	(2,0)	11,1
Western Cape		0,3	6,3	4,5	4,7
Total, adjusted		**3,5**	**8,0**	**5,3**	**5,8**

1. Total provincial spending has been adjusted for certain function shifts, as described

Composition of expenditure

Education expenditure consists of two major components: personnel costs, which comprise almost 90 per cent of expenditure, and non-personnel expenditure, ranging from learner support materials (such as textbooks) to capital and maintenance expenditure (see Table 2.4).

Balance between personnel and non-personnel costs

Education is the most labour-intensive service provided by Government. After large increases in 1996/97 and 1997/98, personnel expenditure increased to a peak of 91,2 per cent of education expenditure in 1998/99. Since then, it has stabilised and is beginning to decline as a proportion of education expenditure. Slow growth in personnel expenditure over the medium term (at an average 5,3 per cent a year) allows non-personnel expenditure to grow by 15,4 per cent a year. As a result, personnel expenditure is projected to decline to 87,9 per cent of expenditure in 2002/03. The education sector aims to reduce costs to 85 per cent of total expenditure over the medium term.

Table 2.4 Education expenditure by economic classification

	Actual	Estimated actual	Medium-term estimate		
R million	1998/99	1999/00	2000/01	2001/02	2002/03
Current expenditure	38 189	39 591	42 551	44 672	47 260
Personnel	35 263	36 242	38 432	40 014	42 322
Other current	2 926	3 349	4 119	4 658	4 938
Capital	489	445	679	858	900
Total	**38 678**	**40 036**	**43 230**	**45 530**	**48 160**
Percentage share					
Current expenditure					
Personnel	91,2	90,5	88,9	87,9	87,9
Other current	7,6	8,4	9,5	10,2	10,3
Capital	1,3	1,1	1,6	1,9	1,9
Total	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**

Rationalisation and redeployment

The declining share of personnel expenditure reflects a reduction in personnel numbers, driven by a programme of rationalisation and redeployment. In 1999, the national Department of Education, on behalf of the nine provinces, signed an agreement with educator unions, which set out a process for allocating posts to schools and identifying surplus teachers, processes to redeploy these teachers and steps to terminate the contract of temporary teachers deemed to be in excess. This programme has resulted in a more equitable distribution of teachers across provinces and a reduction of almost 13 000 in total teacher numbers.

Contributing factors

Although the aggregate reduction in the personnel to non-personnel expenditure ratio is positive, the ratio remains high in certain provinces. In KwaZulu-Natal, Eastern Cape, Mpumalanga, Northern Province and North West, more than 90 per cent of education budgets are allocated to personnel in the MTEF years. This implies substantial differences between provinces in terms of non-educator inputs in teaching. These provinces inherited inefficient education systems with high failure rates and thus teach large numbers of repeaters. They also faced large classroom backlogs. Most, particularly Northern Province, moved rapidly to decrease learner to educator ratios by employing more teachers. However, not having first addressed classroom backlogs, some schools had more teachers than physical classes, and average class sizes remained high.

Non-personnel expenditure

Expenditure on complementary items such as textbooks, materials, equipment and teacher support programmes was reduced in real terms from 1996/97 to 1998/99 to accommodate increases in personnel costs. As the ratio of personnel to non-personnel expenditure begins to decrease, more resources can now be devoted to these complementary inputs. Personnel reductions saved about R700 million in 1999/00, freeing up resources for addressing classroom backlogs, providing teacher support systems and procuring new materials for learners.

Capital expenditure

Similarly, capital expenditure has been under pressure from increases in personnel costs. Given the stabilisation in personnel expenditure, provinces can now increase capital expenditure, especially on classroom building, water and sanitation in schools, and school furniture. Capital expenditure increases by nearly 26,5 per cent a year over the three years to 2002/03, but remains at just under 2 per cent of provincial education expenditure.

Table 2.5 Provincial expenditure by programme and economic classification, 2000/01

	Programme			Economic classification			Total
R million	Public ordinary schooling	Teacher training	Other	Personnel	Other current	Capital	
Eastern Cape	6 300	165	915	6 673	577	129	7 379
Free State	2 403	68	602	2 652	403	18	3 073
Gauteng	5 663	134	1 039	5 824	851	161	6 835
KwaZulu-Natal	7 124	174	861	7 345	688	125	8 158
Mpumalanga	2 454	49	404	2 654	198	55	2 907
Northern Cape	815	9	139	794	158	12	963
Northern Province	5 023	226	963	5 623	525	64	6 212
North West	3 040	53	532	3 320	241	63	3 624
Western Cape	3 294	26	759	3 547	479	52	4 078
Total	**36 115**	**902**	**6 213**	**38 432**	**4 119**	**679**	**43 230**

Public schooling

Spending on public pre-primary, primary and secondary schooling constitutes nearly 84 per cent of provincial education spending. Special education absorbs nearly 3 per cent of budgets and teacher training about 2 per cent.

Teacher training colleges

The process of incorporating teacher training institutions into the higher education sector is at an advanced stage. Some education colleges are being incorporated into technikons and universities while others are being merged to ensure better quality. The overall number of teacher training facilities is being reduced. By 2001/02, teacher training will be funded as part of the higher education sector on the budget of the national Department of Education.

Equity in education and educational outputs

Provincial differences in expenditure

Provinces not only spend differing proportions of their budgets on education but expenditure per learner also differs substantially. Some provinces spend well below the average of 40 per cent of their budgets on education but spend substantially more per learner. This is the case in Gauteng, Northern Cape and Western Cape, which all spend around 21 per cent more per learner than the provincial average. Gauteng and Northern Cape spend over 48 per cent more per learner than KwaZulu-Natal, and Western Cape 44 per cent.

Western Cape and Gauteng spend relatively low proportions on education because a smaller part of their population is of school-going age and their education systems are more efficient, with lower failure and repeater rates. Poorer provinces generally have a higher proportion of children in their population and have higher failure and repeater rates.

Spending per learner

The differences in per-learner expenditure in education are largely attributable to variations in the number of personnel per learner and in the salaries of educators. Provinces with above-average educator costs also tend to have below-average learner to educator ratios. Northern Cape, Gauteng and Western Cape not only have more teachers per learner on average, but they also pay above-average salaries. This combination pushes up education expenditure in these provinces. Individual qualifications and the agreed salary structure at national level determine educator costs, although higher pay may also reflect teacher seniority. Provinces with lower educator costs probably have relatively more underqualified teachers. Gauteng, Northern Cape, North West and Western Cape have low learner to educator ratios, while KwaZulu-Natal, Northern Province, Mpumalanga and Eastern Cape have higher ratios.

Table 2.6 Provincial variations in learners and personnel, 2000/01

		Per-learner budget (R)					
Province	Learners (1999) (000)	Personnel	Other	Total	Average employee cost	No of educators	L:E ratio
Eastern Cape	2 325	2 870	304	3 174	87 152	67 392	34,5
Free State	780	3 399	539	3 939	89 171	24 194	32,2
Gauteng	1 569	3 711	645	4 355	95 343	46 079	34,1
KwaZulu-Natal	2 772	2 650	293	2 943	92 099	70 960	39,1
Mpumalanga	931	2 852	272	3 124	88 303	25 948	35,9
Northern Cape	204	3 885	831	4 717	86 934	6 629	30,8
Northern Province	1 823	3 085	323	3 408	91 921	55 801	32,7
North West	946	3 509	321	3 830	89 300	32 490	29,1
Western Cape	963	3 682	551	4 233	100 979	26 063	37,0
Total	**12 314**	**3 121**	**390**	**3 511**	**91 546**	**355 556**	**34,6**

Matric pass rates

An analysis of matric pass rates since 1996 shows that improved educational outputs remain a medium- to long-term goal. The legacy of apartheid education, decades of neglect, underresourced schools and poorly trained teachers will take many years to overcome. After initially declining to 47 per cent in 1997, matric pass rates improved slightly to 49 per cent in 1999. Western Cape, Northern Cape and Gauteng all have pass rates above 57 per cent, while the pass rate in the remaining six provinces is below this level.

Equality in quality still far off

Much has been achieved in terms of equity in education expenditure, with more rapid growth in expenditure in poorer provinces between 1995/96 and 1999/00, and improved learner to educator ratios in poor provinces. However, equalisation of educational inputs and good quality education to the poor remain some of the most critical challenges facing the country.

Trends in learner numbers

After rapid growth in learner numbers between 1994 and 1996, enrolment has stabilised and is set to decline slightly over the next five years. This decline is due to tighter admissions criteria for under-age learners and expected improvements in pass rates. Nevertheless, a comparison of enrolment to school-age cohorts suggests that the problem of repeaters and out-of-age enrolment remains significant.

Table 2.7 Matric pass rates by province

Percentage	1996	1997	1998	1999
Eastern Cape	49	46	45	40
Free State	51	43	43	42
Gauteng	58	52	56	57
KwaZulu-Natal	62	54	50	51
Mpumalanga	47	46	53	48
Northern Cape	74	64	65	64
Northern Province	39	32	35	38
North West	70	50	55	52
Western Cape	80	76	79	79
Average	**54**	**47**	**49**	**49**

Issues in education policy

Implementing Tirisano

In July 1999, the Minister of Education acknowledged progress in the education system since 1994, but concluded that major weaknesses remained. In general, Government was not providing quality education to sufficient numbers of learners. The following were some of the aspects he identified:

- Inequality in access to education opportunities of a satisfactory standard
- Low teacher morale in many communities
- A crisis of leadership and governance in many parts of the system, especially in schools
- Poor quality of learning

Identifying focus areas

To resolve these problems, several focus areas were identified. These include improving the education system, reducing illiteracy, enhancing professionalism among teachers, improving the physical condition of schools and providing quality further and higher education. The Department of Education pledged to introduce a series of national tests at grades 3, 5, 7 and 9 to complement the matric examinations. The purpose of these tests is to monitor the performance of the education system and provide early warning of problem areas before learners reach their final school-leaving examinations.

Early childhood development

International evidence suggests that the highest returns to education expenditure are achieved in the pre-primary phase. The Department of Education is expected to publish a White Paper on Early Childhood Development later this year, which recognises the contribution of pre-school education to improved outcomes at higher levels and which will propose plans for phasing in a reception year. While eventual returns to such an investment will be high, expenditure will have to compete with other mechanisms for improving quality in the schooling system. It will also place added pressure on provincial education budgets.

Outcomes-based education

The Department of Education is committed to outcomes-based education, but shortcomings in the current vehicle for implementation, Curriculum 2005, were identified in a recent report to the Minister. The major criticisms were the following:

- Teacher training was insufficient for implementing Curriculum 2005.
- The actual curricula were too complicated to meet the diverse needs of South Africa's education system.
- Insufficient resources were devoted to the publication of new textbooks, learner support materials and teaching aids.
- Education departments lacked the capacity to develop and conduct a range of tests required to measure progress in an outcomes-based teaching environment.

Implementation will now focus on the development of materials that are simpler to implement, on improved teacher training and on assessment mechanisms. It is evident that successful implementation of outcomes-based education in all schools, particularly poor ones, will require additional resources for in-service training for teachers and for more learner support materials.

The widely diverging quality of school infrastructure is an important component of unequal access to schooling between and within provinces. A large proportion of schools do not have access to running water and sanitation facilities, and the state of school buildings in many areas is not satisfactory. *Tirisano* pledges progress in this regard as well.

Health

Health contributes to development

Health care is a key facet of South Africa's programme for enhancing human development. Creating an environment where citizens are healthy and productive contributes to the long-term development of a country and its people. Core investments in basic health care are a crucial part of improving the prospects for development.

Basic health care

Historically, the country's health sector had been geared towards a small portion of the population. South Africa developed highly sophisticated academic health facilities, while diseases such as malnutrition, tuberculosis and malaria killed thousands of infants before their first birthday. The country had to transform the health system towards a better balance between expensive tertiary and specialised care, and basic health care for all people.

HIV/Aids

In the midst of this transformation, South Africa is confronted by one of the biggest challenges yet to face the country: the spread of HIV/Aids. This disease has a devastating effect on families and communities, on the ability of the health system to cope, on productivity and on long-term prospects for growth and development. Given their role in social service delivery, provinces are at the forefront of the fight against HIV/Aids and will be most affected by the fiscal impact of the disease.

Funding health services

National transfers

Provincial governments fund health care from their equitable shares and own revenues, supplemented by conditional grants from the national Department of Health. Health grants total R5,7 billion in 2000/01, the largest share of all conditional grants. The provincial equitable share formula includes a component that reflects the relative need for basic health services. In effect, people without medical aid coverage are weighted more heavily in determining the distribution of available resources, as they are more likely to use public facilities.

Improving revenue collection

As detailed in Chapter 4, provincial health departments are taking steps to improve the collection of fees by hospitals. Though small in the context of the total health budget, hospital revenue plays an important part in drawing private resources, particularly from medical aid patients, into the public sector to supplement public funds. Provinces with large academic hospitals have better prospects of raising revenue from private patients.

Private health care

South Africa also has a vibrant private health care sector. Expenditure by the private medical scheme industry totalled approximately R25 billion in 1997, compared to the R24 billion of provincial health expenditure in 1998/99 (see Table 2.8). However, while the public sector covers the bulk of the population (just over 33 million people), about 7 to 8 million people have access to medical aid and generally use the private health care system. Medical schemes are regulated through the Medical Schemes Act of 1998.

Trends in provincial health expenditure

Growth in expenditure

Table 2.8 shows that provincial health expenditure grew by 7,6 per cent in 2000/01, and is projected to grow by an average annual 6,1 per cent over the medium term. While expenditure declines in real terms in Eastern Cape, Northern Cape and Western Cape over the MTEF period, substantial real growth is envisaged in the other provinces. Low growth in Eastern Cape health expenditure follows a very large upward adjustment in 1999/00 to accommodate promotion backlogs.

Personnel costs

Personnel costs constitute 62,3 per cent of total health spending in 2000/01, as against less than 60 per cent in 1995/96. The salary structure introduced in the 1996 salary agreement and the automatic promotions resulting from these negotiations placed greater pressure on personnel costs. As in the case of education, increasing personnel expenditure squeezed out expenditure on complementary inputs, potentially compromising quality and service delivery. Efficiency in health care spending, however, remains a critical concern.

Provinces with academic health complexes spend a smaller proportion of their funds on personnel, although Free State is an outlier in this regard. Between 1998/99 and 2000/01, personnel expenditure as a proportion of expenditure declined somewhat. However, over the medium term, the ratio again increases to 62,9 per cent. This trend applies to all provinces, except Mpumalanga and Northern Cape, which project a decreasing share for personnel. Continuing eligibility for rank and leg promotions results in high average annual increases in remuneration in addition to the annual salary adjustment. This implies continuing pressure on non-personnel inputs in health despite widespread reductions in personnel numbers.

Table 2.8 Provincial health expenditure by province

	Actual	Estimated actual	Medium-term estimate		
R million	1998/99	1999/00	2000/01	2001/02	2002/03
Eastern Cape	3 041	3 566	3 380	3 644	3 803
Free State	1 688	1 604	1 829	1 899	1 989
Gauteng	5 476	5 610	6 116	6 565	6 961
KwaZulu-Natal	4 869	5 110	5 714	5 950	6 227
Mpumalanga	1 058	1 147	1 185	1 250	1 331
Northern Cape	386	429	427	450	468
Northern Province	2 056	2 260	2 428	2 524	2 666
North West	1 345	1 388	1 601	1 752	1 868
Western Cape	3 029	3 125	3 403	3 589	3 607
Total, adjusted	**22 949**	**24 241**	**26 083**	**27 623**	**28 920**
Percentage change					
Eastern Cape		17,3	(5,2)	7,8	4,4
Free State		(5,0)	14,0	3,8	4,7
Gauteng		2,4	9,0	7,3	6,0
KwaZulu-Natal		5,0	11,8	4,1	4,7
Mpumalanga		8,4	3,3	5,5	6,5
Northern Cape		11,1	(0,4)	5,2	4,0
Northern Province		9,9	7,4	4,0	5,6
North West		3,2	15,3	9,4	6,6
Western Cape		3,2	8,9	5,5	0,5
Total, adjusted		**5,6**	**7,6**	**5,9**	**4,7**

Table 2.9 Health expenditure by economic classification

	Actual	Estimated actual	Medium-term estimate		
R million	1998/99	1999/00	2000/01	2001/02	2002/03
Current expenditure	22 148	23 373	24 538	25 665	26 987
Personnel	14 826	15 504	16 249	17 238	18 182
Other current	7 321	7 869	8 289	8 426	8 805
Capital	801	868	1 545	1 958	1 933
Total	**22 949**	**24 241**	**26 083**	**27 623**	**28 920**
Percentage share					
Current expenditure					
Personnel	64,6	64,0	62,3	62,4	62,9
Other current	31,9	32,5	31,8	30,5	30,4
Capital	3,5	3,6	5,9	7,1	6,7
Total	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**

Expenditure by programme

Table 2.10 shows the three major programmes of provincial health departments, combining administration and other programmes into the "other" category. Shifts in the classification of expenditure by programme make it difficult to interpret trends in health spending over time. However, the 2000/01 data show that district health services take up most of the health budget in provinces without academic complexes, like Mpumalanga, Northern Cape, Northern Province, North West and Eastern Cape. Eastern Cape has a small academic complex in Umtata – this is expected to grow once the new Nelson Mandela hospital comes into operation, probably in 2002/03.

Table 2.10 Provincial expenditure by programme and economic classification, 2000/01

	Programme				Economic classification		Total
R million	District health services	Provincial hospital services	Academic hospital services	Other	Personnel	Non-personnel	
Eastern Cape	1 817	1 149	53	360	2 230	1 149	3 380
Free State	674	550	361	244	1 187	642	1 829
Gauteng	1 383	1 213	2 935	586	3 599	2 517	6 116
KwaZulu-Natal	2 696	1 608	665	746	3 467	2 248	5 714
Mpumalanga	910	98	0	177	755	431	1 185
Northern Cape	251	134	–	43	280	147	427
Northern Province	1 303	527	–	597	1 533	895	2 428
North West	956	443	–	202	1 107	494	1 601
Western Cape	1 006	788	1 273	335	2 092	1 311	3 403
Total	**10 997**	**6 511**	**5 286**	**3 289**	**16 249**	**9 835**	**26 083**

Over the MTEF period, the district health services programme, including primary care, grows more rapidly (at 6,9 per cent annually) than do provincial and academic health services (at 1,1 and 1,9 per cent respectively). Therefore, district health services grow in relative importance from 39,1 per cent of total expenditure in 1998/99 to 41,6 per cent in 2001/02. The low growth in the other two expenditure programmes indicates that further rationalisation will be required. This trend is particularly evident in Gauteng and Western Cape, as these provinces shift emphasis from tertiary to district health services. Northern Province, Eastern Cape and Mpumalanga are shifting resources from provincial hospitals to district health care. These trends are in line with health policy.

Central hospitals

Determining the budget for hospitals is difficult, as these are not identified as separate cost centres. It is therefore not possible to determine whether the central hospital grant covers the targeted 76 per cent of such expenditure. Expenditure on central hospitals appears to have declined in real terms over the past four years. The division between specific functions (e.g. training, academic and specialised services) also needs to be clarified when analysing trends in hospital expenditure.

The aggregate budget of the eight largest central hospitals, which are also academic hospitals is around R3,8 billion. Individual budgets range from just under R700 million for the Chris Hani Baragwanath and Johannesburg General hospitals to R350 million for the King Edward VII and Universitas hospitals. Budgets for Pretoria Academic, Groote Schuur and Tygerburg are just under R550 million and for

Garankuwa R450 million. This total does not include other major (and associated academic) hospitals with significant budgets of between R100 million and R200 million (e.g. Kalafong, Helen Joseph, Coronation, Addington, Edendale and Prince Mshiyeni Memorial) which are not funded from this grant. Further, these budgets exclude grants (directly or indirectly) from the professional training and research grant.

The challenge facing provinces with central hospitals is to rationalise and find the optimal balance between these and other hospitals, both within the province and between provinces. Progress in this respect has been slow, resulting in delays in the distribution of specialised services in provinces that have not inherited such services. This is reflected in non-transfers in the redistribution conditional grant, where actual transfers were only R3 million out of the budgeted R49 million in 1998/99 and R48 million instead of the budgeted R151 million in 1999/00.

Rehabilitation of facilities

One of the consequences of increased personnel costs has been a decrease in expenditure on capital and maintenance. In the 2000 Budget, Government introduced the hospital rehabilitation grant to address the rehabilitation of facilities. This grant amounts to R400 million in 2000/01 and increases to R520 million over the medium term.

New hospitals

In addition to many new primary and secondary health facilities built since 1995, Government has provided conditional grant finance for the Nelson Mandela Academic Hospital (in Umtata) and the Nkosi Albert Luthuli Academic hospital (formerly the Durban Academic). In 2000/01, this grant is R273 million.

Transfers of conditional grants

While all the funds for the two major grants (central hospital and professional training) were transferred in 1999/00, Table 3.9 in the next chapter shows non-transfers of some of the grants. These include non-transfers of R94 million of the redistribution grant, R60 million of the rehabilitation grant and R170 million of the two hospital construction grants.

The table also provides information on the Integrated Nutrition Programme. Since all budgeted funds were transferred to provinces in 1999/00, actual spending has to be assessed from provincial data. Information on actual expenditure on this subprogramme is not available from eight of the nine provinces.

Equity in health

Differences in spending per capita

The proportion of expenditure allocated to health differs substantially between provinces, ranging from 17,4 per cent in Mpumalanga to 33,7 per cent in Gauteng in 2000/01. This difference relates to the concentration of tertiary services and medical training in four provinces – Free State, Gauteng, KwaZulu-Natal and Western Cape – as well as the differential availability of health services.

Cross-boundary spillovers

Because of the four-province model that existed before 1994, many health facilities, particularly academic health services, are still concentrated in the four provinces listed above. (Eastern Cape has established academic and training facilities in Umtata). However, tertiary health services cannot be replicated in each province. Many services are provided only in one province – the heart unit is based in Western Cape, the burns unit in Gauteng, and so forth. Patients from across the country will continue to use these facilities. Since the equitable share formula uses provincial demographic data to determine the relative need for health services, it does not adequately cater for this cross-boundary use of tertiary health services. Some of the health conditional grants compensate the relevant provinces for delivering these services to other provinces.

Impact of conditional grants

Table 2.11 shows the impact of the health grants, which include grants for central hospitals, professional training and research, rehabilitation of facilities, redistribution of health services, hospital construction and the Integrated Nutrition Programme. Without these grants, the disparity in spending per person without medical aid is significantly lower between provinces. Including conditional grants, expenditure ranges from R1 393 per person without medical aid in Gauteng to R492 in Mpumalanga in 2000/01 (2,8:1). Excluding conditional grants, the gap narrows from R913 in Gauteng to R433 (2,1:1) in Mpumalanga. The differential is still large, however, indicating that access to health services remains unequal.

Table 2.11 Health expenditure by province including and excluding grants, 2000/01

	Total health expenditure		Total spending per capita[2]		People without medical aid
R million	Including conditional grants	Excluding conditional grants[1]	Including conditional grants	Excluding conditional grants[1]	
Eastern Cape	3 380	3 065	583	529	5 793
Free State	1 829	1 436	844	663	2 166
Gauteng	6 116	4 010	1 393	913	4 390
KwaZulu-Natal	5 714	4 686	781	641	7 314
Mpumalanga	1 185	1 042	492	433	2 409
Northern Cape	427	370	643	557	665
Northern Province	2 428	2 201	533	483	4 554
North West	1 601	1 461	553	504	2 897
Western Cape	3 403	2 094	1 202	740	2 830
Total	**26 083**	**20 366**	**790**	**617**	**33 018**

1. Conditional grants fund services that are available to people from all provinces, and should not be attributed to the provinces where these services are physically located.

2. This column reflects spending per person without medical aid.

According to the Health Systems Trust's 1998 report, Gauteng and Western Cape had 5,3 and 6,5 public sector doctors respectively per 10 000 people, while Northern Province and Mpumalanga each had 1,5 doctors per 10 000 people. While the situation has improved somewhat with, for example, the number of public sector doctors in Northern Province increasing from 0,6 to 1,5 per 10 000 people, much remains to be done.

Personnel rigidities

The need to move health personnel between provinces and from urban to rural areas within provinces is a major challenge facing provincial health managers. Despite the introduction of a rural allowance for doctors and interns, urban-rural disparities persist. The absence of an affordable retrenchment tool has complicated redeployment and rightsizing of the personnel component. Central wage determination in the public sector, without adequate input from health and provincial managers, has also limited flexibility. Despite these limitations, Western Cape has used voluntary severance packages to restructure its health services to better effect than other provinces.

Policy issues in health

Transforming health services

The transformation of the health sector and the increased emphasis on primary services substantially affect provincial health administration and budgets. Free health care services to pregnant women and children under six, clinic building and free access to primary health care all put pressure on recurrent health expenditure, as did the implementation of the Choice on Termination of Pregnancy Act.

Tertiary services

Tertiary services are being rationalised and scaled down to accommodate the shift to primary health care services. The rationalisation of academic hospitals has been slow. The distinction between academic, central and regional hospitals is not uniformly applied between provinces. This is further complicated by the fact that a significant component of primary and secondary health services in Gauteng and, to a lesser extent, Western Cape is actually delivered in academic hospitals. Gauteng, for example, still has four major central hospitals (Chris Hani Barawanath, Johannesburg General, Pretoria Academic and Garankuwa). In addition to these hospitals, smaller but significant (in budget terms) hospitals like Coronation, Helen Joseph and Kalafong are part of the academic complexes. Similar arrangements apply in Western Cape with its three major academic complexes, and in KwaZulu-Natal.

Aligning current central hospital and health training grants to budgets represents a major challenge for health budgets. This challenge includes alignment between these and other hospital conditional grants (redistribution and rehabilitation grants). Recognising this challenge, the national Department of Health started a comprehensive review last year. This study was not completed in time for the 2001 Budget, but is expected to be incorporated into the 2002 Budget.

Community service for doctors

Restructuring the health sector is a complex process. Provinces such as Northern Province, Eastern Cape and Mpumalanga have difficulty in attracting health professionals. The shortage of health professionals, combined with supernumeraries at the lower end, is particularly acute in rural areas. The introduction of community service for doctors has helped to address inter- and intra-provincial disparities to some extent. However, the public sector as a whole has lost skilled health professionals to the private sector or other countries. The health sector faces the challenge of introducing further personnel service reforms to attract and retain the appropriate specialised health skills in the public sector.

While much has been achieved in extending basic health care to poor and deprived communities, the optimal balance between the different levels of health care must still be found. In this process, the development of human resources for the public health sector, budgetary allocations to various levels of health care and the efficiency and effectiveness of spending in the health system must be considered. The role of local government in the provision of health services must also be clarified if unfunded mandates are to be avoided.

Financial management

Much remains to be done to improve the quality of financial management in hospitals. The PFMA provides the mechanism for appointing chief executive officers to run hospitals and for improving the quality of financial management. Government has allocated R30 million in 2000/01 to improve management in health departments and hospitals.

HIV/Aids impact

Concurrent to this complex transformation, HIV/Aids is placing increased strain on the health system. In provinces such as KwaZulu-Natal, up to 40 per cent of patients in medical wards are HIV positive. Not only has the demand for health care increased substantially, but treatment for relatively simple diseases such as malaria and tuberculosis is also made substantially more expensive by the HIV/Aids epidemic. The eventual budgetary implications pose a significant risk to health budgets in the public sector.

Implementation of Basic Conditions of Service

The extension of the Basic Conditions of Service Act to the public service significantly affects personnel management in the health sector. The Act is designed to protect workers by limiting overtime work. While the principle is sound, paying health employees more for overtime and Sunday work will add to the personnel cost pressures exerted by the continued existence of rank and leg promotions.

Welfare

Reaching the poor

Welfare expenditure consists of social security payments and social welfare services. South Africa has three principal social grants: old age pensions, disability grants and child support grants. Welfare services consist of services that Government or non-governmental organisations (NGOs) provide to, among others, elderly, drug dependent, disabled or abused people.

South Africa is one of the few developing countries that provides its citizens with tax-financed and means-tested income replacement or support. Social security grants target the poor better than most other government programmes and, at 91 per cent of welfare expenditure, represent Government's primary investment in poverty alleviation.

Expanding the social security net

The most significant policy development in welfare is the expansion of the social security net after 1994. The phasing out of the state maintenance grant and the introduction of the child support grant in 1998 shifted the emphasis from a focus on elderly and disabled people to children and those with family responsibilities. It also removed a last source of racial discrimination – the unequal access to the state maintenance grant – from the welfare system.

Funding welfare

Welfare is the third largest area of expenditure at the provincial level. Over 98 per cent of welfare expenditure is funded from provincial equitable share allocations and own revenues, with a very small conditional grant from the national Department of Welfare for certain functions. The provincial equitable share formula includes a welfare component, weighted at 17 per cent, which measures the relative need for social security. It is based on the number of elderly or disabled people and children under seven, all weighted by income. It thus captures the demographic and income profile of the people at whom the major welfare grants are targeted.

Welfare services are mainly delivered through NGOs, and Government subsidises the posts of social workers. Old age homes, drug rehabilitation centres, facilities to care for disabled people, foster care programmes and orphanages are some of the services funded through these subsidies. In addition to government subsidies, many NGOs raise funds from corporate and private donations and grants.

Expenditure trends in welfare

Table 2.12 Provincial welfare expenditure by province

	Actual	Estimated actual	Medium-term estimate		
R million	1998/99	1999/00	2000/01	2001/02	2002/03
Eastern Cape	3 634	3 856	4 186	4 141	4 229
Free State	1 158	1 162	1 262	1 291	1 291
Gauteng	2 295	2 425	2 628	2 771	2 938
KwaZulu-Natal	3 984	4 051	4 068	4 341	4 412
Mpumalanga	1 087	1 156	1 214	1 274	1 344
Northern Cape	665	690	640	653	667
Northern Province	2 031	2 318	2 553	2 551	2 687
North West	1 299	1 407	1 519	1 529	1 580
Western Cape	2 211	2 208	2 266	2 296	2 388
Total, adjusted	**18 365**	**19 273**	**20 336**	**20 847**	**21 536**
Percentage change					
Eastern Cape		6,1	8,6	(1,1)	2,1
Free State		0,3	8,6	2,3	0,0
Gauteng		5,6	8,4	5,4	6,0
KwaZulu-Natal		1,7	0,4	6,7	1,6
Mpumalanga		6,4	5,1	4,9	5,5
Northern Cape		3,7	(7,3)	2,1	2,1
Northern Province		14,1	10,1	(0,1)	5,3
North West		8,3	8,0	0,7	3,3
Western Cape		(0,1)	2,6	1,3	4,0
Total, adjusted		**4,9**	**5,5**	**2,5**	**3,3**

1. Total provincial spending has been adjusted for certain function shifts.

Expenditure growth

On average, welfare expenditure grew by 4,9 per cent in 1999/00, with annual growth of 3,8 per cent over the medium term. Real declines are projected in all provinces, except Gauteng (increasing by 6,6 per cent a year) and Mpumalanga (up 5,2 per cent). These declines reflect adjustments in the grant system. Specifically, real annual declines in expenditure in Western Cape (growth of 2,6 per cent) and Northern Cape (-1,1 per cent) relate to the phasing out of the child maintenance grant and, in the latter, the tightening up of access to disability grants in line with regulations.

Provincial differences

The MTEF budget projections in some provinces probably do not accurately reflect all cost pressures. In particular, as a result of the phasing in of the child support grant, provinces with a higher proportion of poor children will see faster growth in welfare spending than will provinces such as Western Cape, Northern Cape and Gauteng. The latter have a lower proportion of poor children and also achieved substantial savings from phasing out the state maintenance grant. This possible shortfall in the budgets of poorer provinces remains a significant challenge to provincial finances over the next few years.

Composition of spending

Table 2.13 shows provincial welfare expenditure by economic classification. In 2000/01, transfer payments comprise 90,8 per cent of welfare expenditure, with the remainder being personnel (4,4 per cent), other current expenditure (4,5 per cent) and capital expenditure (0,3 per cent).

Table 2.13 Welfare expenditure by economic classification

	Actual	**Estimated actual**	**Medium-term estimate**		
R million	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**
Current expenditure	18 318	19 231	20 283	20 795	21 481
Transfer payments	16 987	17 672	18 465	18 854	19 416
Of which social security	*16 224*	*16 823*	*17 473*	*17 804*	*18 318*
Other current	1 330	1 560	1 817	1 942	2 064
Capital	47	41	53	52	55
Total	**18 365**	**19 273**	**20 336**	**20 847**	**21 536**
Percentage share					
Current expenditure					
Transfer payments	92,5	91,7	90,8	90,4	90,2
Of which social security	*88,3*	*87,3*	*85,9*	*85,4*	*85,1*
Other current	7,2	8,1	8,9	9,3	9,6
Capital	0,3	0,2	0,3	0,2	0,3
Total	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**

Transfer payments

Transfer payments consist mainly of grants to individuals and to households (social security grants). These comprise 85,9 per cent of welfare expenditure in 2000/01. Grant payments flow directly to individuals, supplementing the income of many poor households. Transfer payments also include subsidies and other payments to NGOs for the provision of welfare services, such as probation and adoption services, family counselling and homes for children and aged people.

In March 2000, 3,1 million beneficiaries received grants, as against 2,9 million a year earlier. This reflects the phasing in of the child support grant. Social security expenditure is dominated by old age grants, which comprised nearly 60 per cent of the number of beneficiaries (1,9 million) in March 2000 and nearly 70 per cent of grant expenditure. Grants to disabled people are the second most important category, numbering 611 000 in March 2000.

Grants to children and families constitute a small percentage of total grants, but are increasing rapidly as a result of the increased take-up of the child support grant. This grant is targeted at the poorest 3 million children in South Africa, and is expected to cost over R3,6 billion by 2003/04.

Capital expenditure

Given the nature of the services provided by the welfare department, capital expenditure is limited. However, unequal access to welfare institutions and backlogs resulting from uneven capital expenditure in the past have led to calls for increased capital expenditure in this sector. Over the medium term, capital expenditure is slightly higher at 0,3 per cent of total expenditure.

The dominance of grants and their associated administration cost is also reflected in the bulk of budgets being absorbed in programme 2, Social security (see Tables 2.14 and 2.15). In 2000/01, this programme comprises 89,7 per cent of total spending, leaving only a small proportion for other welfare services. While some provinces are close to the informal target that limits social security to 80 per cent, most are still far off. Western Cape spends about 83 per cent on social security and Gauteng 80 per cent. Eastern Cape, KwaZulu-Natal and Northern Province, however, continue to spend well over 90 per cent of their welfare budgets on social security.

Table 2.14 Provincial welfare expenditure by programme

	Actual	Estimated actual	Medium-term estimate		
R million	1998/99	1999/00	2000/01	2001/02	2002/03
Administration	159	208	247	256	276
Social security	16 749	17 530	18 248	18 607	19 173
Social assistance	800	815	904	976	1 015
Social welfare services	531	577	728	786	832
Social development	54	66	72	86	100
Other	73	75	136	136	140
Total	**18 365**	**19 273**	**20 336**	**20 847**	**21 536**

Equity in welfare

On average, provinces spend 18,9 per cent of their budgets on welfare (2000/01), with the range from 14,5 per cent in Gauteng to 25,3 per cent in Northern Cape. This variation partly reflects the relative numbers of the target population in the provinces. Historical differences in access to grants also influence expenditure patterns and outcomes. This explains relatively high levels of expenditure in Western Cape and Northern Cape, and relatively low levels of expenditure in poorer provinces such as Northern Province and North West. Expenditure differences highlight the remaining inequities between provinces, as shown by differences in grant coverage and in per capita welfare expenditure.

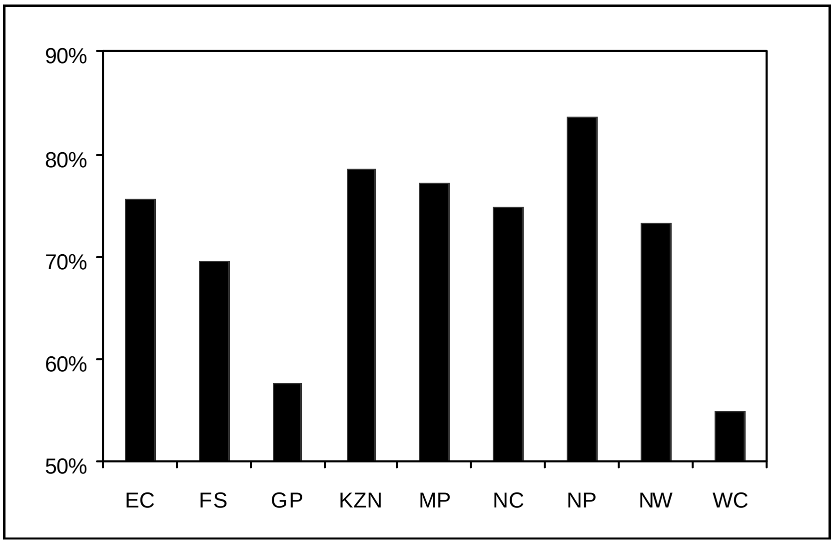
Table 2.15 Provincial welfare expenditure by province, 2000/01

R million	Social security	Other welfare	Other	Total
Eastern Cape	3 907	237	41	4 186
Free State	1 120	121	22	1 262
Gauteng	2 109	433	86	2 628
KwaZulu-Natal	3 786	234	49	4 068
Mpumalanga	1 117	70	27	1 214
Northern Cape	564	57	19	640
Northern Province	2 421	91	41	2 553
North West	1 345	98	75	1 519
Western Cape	1 879	364	23	2 266
Total	**18 248**	**1 705**	**383**	**20 336**

Coverage of elderly people

Figure 2.1 shows that the coverage of the old age grant is high and generally mirrors poverty patterns, with poorer provinces having higher coverage levels. While more than 70 per cent of elderly people in the country receive old age grants, only about 55 per cent receive grants in the richer provinces of Gauteng and Western Cape. Given the means-tested nature of the grant, coverage of the target population is estimated to be nearly complete and grant numbers should not grow faster than the elderly population.

Figure 2.1 Proportion of elderly people receiving old age grants, by province



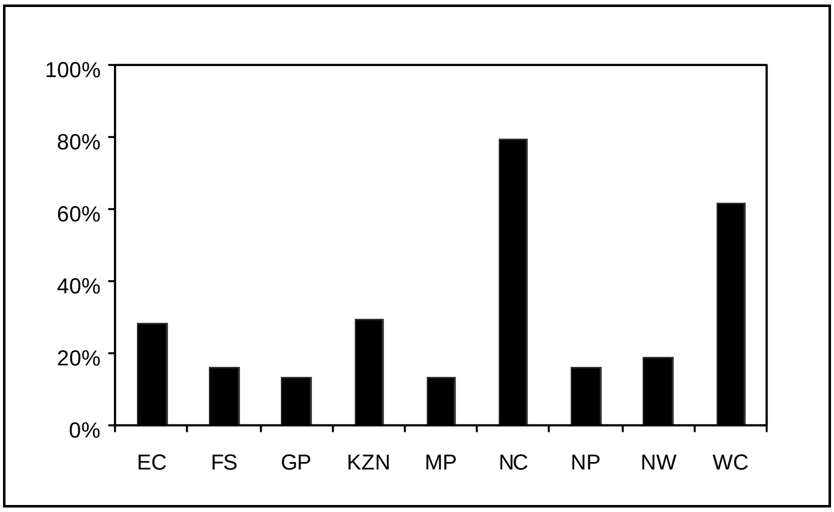
Coverage of disabled people

In contrast, disability grant coverage varies significantly between provinces and does not reflect the incidence of poverty (see Figure 2.2). Northern Cape and Western Cape have high levels of coverage, but four of the poorest provinces, Free State, Mpumalanga, Northern Province and North West, have low coverage levels. Low coverage in the poorer provinces points to significant future budgetary pressure.

Impact of child support grant

When phased in, the child support grant will become a powerful mechanism for equalising welfare expenditure between provinces, as coverage will be highest in the poor provinces. It will, however, also require poor provinces to reprioritise their budgets and will affect their other services, given the current trends in provincial budgets. Based on budget, demographic and income projections, poor provinces face a challenge in meeting the resulting financial requirements.

Figure 2.2 Proportion of disabled people receiving disability grants, by province



Policy issues in welfare

Coverage of eligible children

Several factors point towards continuing budgetary pressure for grant expenditure. First, per capita expenditure and coverage of target populations, particularly regarding disability benefits, are unequal. This shows that some poor provinces do not as yet provide adequate services to their communities, probably owing to a lack of capacity and information. Expenditure in these provinces is likely to grow in future. Second, provinces with large numbers of children qualifying for child support grants will benefit little from the phasing out of the state maintenance grant. Higher take-up of the child benefit will therefore put upward pressure on spending.

Inflation-linked grant increases

A major debate in welfare policy has been the rate at which the value of grants increases. The rate of increase of pension and disability grants has not kept pace with inflation, and many have called for inflation-linked increases in grants. This pressure must be balanced with the need to expand the social security net to communities that do not benefit fully. The higher take-up of the disability grant in poorer provinces will put pressure on welfare budgets. Similarly, the introduction of the child support grant is a major expansion of the social security net. To balance these competing interests, annual increases in grant values will have to be balanced against growth in numbers.

Reprioritisation of expenditure

Government's welfare policy is to reprioritise expenditure towards developmental services and away from "passive" income support. This challenge is formidable, given cost pressures on grants, and innovative solutions must be sought.

Unequal expenditure on welfare services

Unequal access to welfare services between provinces is clearly reflected in widely diverging per capita expenditure levels. Eradication of these inequalities will require reprioritisation within welfare budgets and also within provincial budgets. As with health and education, expenditure cannot immediately be equalised at the levels that prevailed in provinces with high per capita expenditure.

Financing welfare services

Cabinet recently approved a new model for financing welfare organisations. It aims at providing equal access to more appropriate, community-based welfare services, as against expensive curative and institution-based services. This will require substantial adjustment over the next three years. The costing of the new model is currently under way.

Responsibility for social security

As noted, welfare is a concurrent function of the national and provincial governments. While the financing and delivery of social grants are in the hands of provinces, the national Minister is responsible for policy, legislation and regulation. This division of responsibilities could lead to a mismatch between budgets and policy. Recent years saw increased efforts to coordinate policy determination with provincial financial realities. These will have to be strengthened, or responsibility for policy and financing consolidated at either the national or the provincial level.

Improving financial management and efficiency

Given the budgetary pressures in the welfare sector, management of resources and efficiency of service delivery need to be strengthened. A conditional grant to support such efforts was included on the 1999 and 2000 Budgets.

All other provincial functions

Non-social service responsibilities

Schedules 4 and 5 of the Constitution delineate functions that are the concurrent and exclusive responsibilities of provincial governments. The non-social service functions are important for promoting provincial economic development, employment and poverty alleviation. They include economic functions (trade, tourism and industry), public works, transport, roads and traffic enforcement, local government, housing and agriculture. Provincial budgets also fund safety and security, provincial administrative services, the provincial legislature, environmental affairs and sport. Given the dominance of social spending, less than 20 per cent of provincial budgets are available for these functions.

Prioritisation of other functions

Figure 2.3 shows the division of adjusted total provincial expenditure between social service and non-social service programmes. Aggregate expenditure on non-social service functions declined from 16,8 per cent of total provincial expenditure in 1998/99 to 16,6 per cent in 2000/01. Over the medium term, non-social service expenditure recovers to 17,0 per cent.

The reduction in non-social service expenditure between 1997/98 and 2000/01 is partly due to provinces repaying debts accumulated in previous years. "Other" programmes are particularly affected, since most social services expenditure items, such as teacher salaries and social security grants, are fixed costs over which provinces have little direct control.

Figure 2.3 Share of social services and other expenditure of total adjusted provincial expenditure

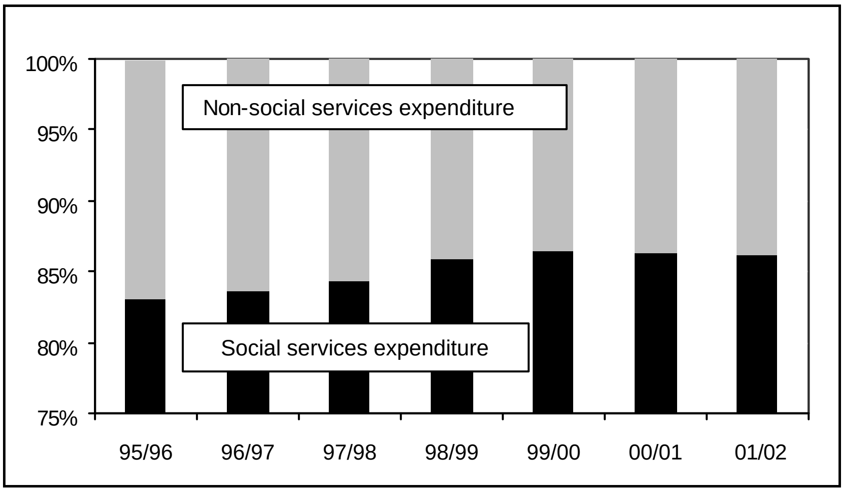


Table 2.16 Adjusted provincial expenditure on social services and non-social services functions

	Actual	Estimated actual	Medium-term estimate		
R million	1998/99	1999/00	2000/01	2001/02	2002/03
Social services	79 993	83 550	89 649	94 000	98 616
Non-social services	16 152	16 673	17 801	19 198	20 229
Of which personnel	*5 957*	*6 306*	*6 672*	*7 337*	*7 728*
Contingency reserve	0	0	470	895	1 071
Total	**96 145**	**100 223**	**107 920**	**114 094**	**119 916**

Personnel spending in non-social services

Table 2.16 illustrates the pressure exerted by personnel costs, even in the non-social services. Over the MTEF period, personnel expenditure within other functions grows at an average rate of 7,0 per cent a year, which is above the average anticipated inflation rate of 5,1 per cent. The problem is particularly pronounced in departments such as public works and agriculture.

Difficulty in comparing provincial budgets

Although programme structures across provinces are now more uniform, the structure and functions of departments differ widely within provincial own functions. This complicates budget comparisons across provinces. For example, responsibility for roads construction and maintenance is located in the transport departments of some provinces and in public works departments in others.

Budgets of other functions

Apart from provincial health, education and welfare department votes, provincial budgets contain 10 to 15 other votes. These votes are small relative to social service budgets, with the four largest components – public works and transport, local government, housing and agriculture – constituting only about 10 per cent of total provincial budgets in 2000/01. The remaining provincial votes comprise less than 4 per cent of provincial budgets and include the Premier's office, the provincial legislature, safety and security, corporate services, sport and culture, and economic and environmental affairs. Provinces have stated that investing in infrastructure is a key priority for the next three years.

Focus on infrastructure

Supported by conditional grants

It is difficult to assess how much provinces are spending on infrastructure, and to separate expenditure on new infrastructure from maintenance spending. Provinces do not apply a uniform classification for infrastructure, making it difficult to analyse provincial trends. Reforms to budget formats will improve this analysis in future. In some provinces, construction and maintenance within the social services is recorded in the vote of public works, while in others it is allocated to the relevant department. Besides health and education, the departments that play a crucial role in infrastructure development are public works, transport and housing. Table 2.17 reflects provincial capital spending. Transfers from national departments play a large role in supporting provincial infrastructure expenditure.

Table 2.17 Provincial capital expenditure

	Actual	Estimated actual	Medium-term estimate		
R million	1998/99	1999/00	2000/01	2001/02	2002/03
Eastern Cape	588	495	1 171	1 355	1 387
Free State	429	340	370	491	609
Gauteng	1 704	1 861	1 939	2 198	2 367
KwaZulu-Natal	1 452	1 342	1 434	1 549	1 462
Mpumalanga	756	699	599	627	606
Northern Cape	186	151	169	187	229
Northern Province	520	446	664	773	738
North West	509	495	827	1 057	717
Western Cape	781	896	816	735	643
Total	**6 923**	**6 724**	**7 988**	**8 971**	**8 759**

Public works and transport

Provinces do not have a uniform programme structure for these two departments: some combine and others separate the functions. In certain provinces, the transport department is responsible for road safety, maintenance and construction, while in others this is the responsibility of public works. These votes are important because a significant portion of the funds is devoted to capital expenditure.

Provinces also receive some funds from the national Department of Public Works for poverty relief and job creation programmes.

Expenditure levels

The figures in Table 217 have been adjusted to include expenditure on housing in previous years, since housing expenditure has now become a conditional grant to provinces. In 1998/99, provincial expenditure on both public works and transport was only slightly above its 1995/96 level, after receiving an early boost from the Reconstruction and Development Programme (RDP) Fund. Provinces budgeted for a marginal decrease in 1999/00, with above-inflation growth over the medium term. Provincial capital expenditure rises by 18,8 per cent in 2000/01, reflecting low expenditure figures in earlier years, success in repaying debt and reduced personnel expenditure.

Variation in expenditure across provinces

Although overall expenditure on public works and transport is rising, provincial patterns vary significantly. From 1995/96 to 1999/00, public works and transport expenditure declined sharply in Eastern Cape and KwaZulu-Natal, and most other provinces experienced a significant decrease in 1999/00. In contrast, Gauteng has made the most concerted effort to increase spending on infrastructure. In 2000/01, Gauteng plans to spend almost R2 billion on capital infrastructure.

In 2000/01, poorer provinces experience the fastest growth in capital expenditure, off a low base in 1999/00. Provinces that experienced flood damage receive a larger share of the infrastructure grant. Eastern Cape increases its capital expenditure by over 136 per cent. North West and Northern Province also see increases in capital expenditure of 67 and 49 per cent respectively. These increases are, in part, due to the new rural-focused formula for distributing housing grants and to success in repaying debt. However, some provinces do not yet have detailed plans for spending this money on capital infrastructure.

Infrastructure backlogs

Backlogs in provincial infrastructure are difficult to quantify. In 2000/01, the provincial equitable share formula has a backlog component to compensate provinces for capital backlogs, particularly in schools, health facilities and rural roads. Only continued efforts to manage personnel expenditure and to pay off provincial debt will enable provinces to address such backlogs. Northern Province, for example, has been unable to reduce the backlog of more than 15 000 classrooms over the past four years. Gauteng, on the other hand, addressed its significant classroom backlogs by building half of all classes built in the country since 1994.

Disaster relief

The R300 million conditional grant for infrastructure in 2000/01 is being distributed to provinces hit by floods and other weather-related disasters. Provincial treasuries and national and provincial departments are working together to identify the areas and facilities most in need of repair. In addition to this grant, provinces have committed their own funds to the disaster relief programme. Both Eastern and Western Cape have provided for the repair of schools and/or homes damaged by tornadoes in 1998 and 1999.

Housing development

Some provinces combine housing with local government, while others have a separate housing department. As the local government equitable share and other grants expand, provincial responsibility for local government should decline. For the first time, in 2000/01, provincial housing funds appear on provincial budgets. In the past, provincial housing boards were responsible for allocating these funds. The transfers were considered an agency payment from the national housing fund and were not reflected on provincial budgets.

Responsibility for housing function

Housing is a concurrent function of national and provincial governments, with the national Department of Housing giving policy direction. Its budget also supports the South African Housing Fund which, in terms of the Housing Act of 1997, provides subsidy payments via the provincial housing boards. Provinces administer the housing programme and provide secretarial and administrative support to the provincial housing boards. In 2000/01, R2,9 billion is budgeted for housing subsidies, a large proportion of provincial allocations to infrastructure projects.

Trends in housing subsidies

The national Department of Housing is adopting a rural focus for housing development, and the housing subsidy share of urban provinces such as Gauteng is relatively lower than that of more rural provinces. As the housing funds ultimately flow to local authorities, these subsidies should be considered in conjunction with the flow of funds for other municipal infrastructure.

Alternative delivery methods

Infrastructure development at a provincial level has a major impact on economic development and on improving the quality of life. Success in managing provincial finances and personnel costs over the past two years enables provinces to increase infrastructure spending. However, they still need to improve the quality and impact of infrastructure projects. Better planning, increased use of private sector contractors and better quality control in the delivery of infrastructure will significantly contribute to economic development in the provinces.

Conclusion

Foundation laid

The key objective of Government's fiscal and budgetary policies is to increase service delivery, particularly to the poor. Provinces' success in stabilising their finances is laying the foundation for them to achieve this objective. Still, much has to be done to improve equity and the quality of expenditure. The major challenges facing provincial governments over the next ten years are to improve the quality of schooling, provide better primary health care, increase access to social security and welfare services, and upgrade economic and social infrastructure. As pointed out in the different social services, inequitable access to services remains a problem.

Growth and employment

Financial management has improved significantly, and there is much greater equity in resources between provinces. However, long-term economic growth and higher employment will only be possible with sound macroeconomic policies, good governance and management, and higher quality services to citizens. To achieve these objectives, improved capacity at a provincial level remains the most pressing short-term objective of Government.

3

Transfers to provinces

Transfers dominate provincial budgets

Transfers from the national budget dominate provincial budgets. Provinces are given equitable shares (without conditions) to meet their expenditure responsibilities under the Constitution. The equitable shares are supplemented by conditional grants to fund functions in support of national priorities.

This chapter focuses on conditional and other grants. It provides an overview of how the system of grants evolved and an analysis of the current grant system, how it operates and the problems that have been identified. The chapter also looks at current efforts to improve the functioning of the conditional grant system.

Evolution of the grants system

Introduction of provincial transfers

Transfers included in the Division of Revenue Act

The Intergovernmental Fiscal Relations Act of 1997 formalised the current intergovernmental budget process. The Act requires the enactment of the Division of Revenue Act annually with the budget. The Division of Revenue Act enhances transparency in the allocation of national resources by setting out the equitable shares for each sphere and the division between the nine provinces. It also includes a detailed schedule of all other allocations from the budgets of national departments to provinces and local governments. The first Division of Revenue Act was enacted for the 1998 Budget.

Equitable share allocations

Formula allocates provincial equitable share

The equitable share constitutes about 88 per cent of total transfers to provinces. The formula used to allocate the provincial equitable share has seven separate components. These components allocate funds according to demographic and economic statistics, attempting to capture unique provincial circumstances, such as infrastructure backlogs and economic activity.

The components are summarised below, with the weighting of each component given in brackets:

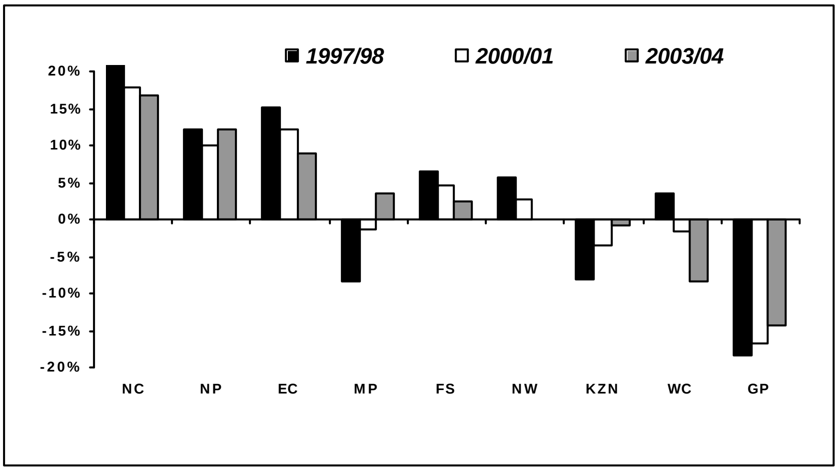
- An education share (41 per cent) based on the average school-age population (children 6–17) and the number of learners in school
- A health share (19 per cent) based on the proportion of the population without access to medical aid
- A social security component (17 per cent) based on the estimated number of people eligible according to the poverty index

- An economic activity component (8 per cent) reflecting remuneration in each province
- A basic share (7 per cent) that reflects each province's share of total population
- A backlog component (3 per cent) based on the distribution of capital needs as captured in the Schools Register of Needs, the audit of hospital facilities and the share of the rural population
- An institutional component (5 per cent) divided equally between the provinces to reflect some of the fixed costs of running a provincial legislature

Equitable share formula is redistributive

The formula is redistributive, allocating more funds per capita to the poorer, rural provinces. Northern Cape receives a higher per capita allocation to reflect the costs associated with its large land areas, sparse population and higher take-up of social security grants. The current formula is being phased in; this phasing process will be completed in 2003/04. Figure 3.1 below shows the per capita allocations to each province, expressed as a percentage above or below the national average.

Figure 3.1 Equitable share per capita, percentage above or below national average



The details of the current formula and its components are discussed in Annexure A, which is taken from the memorandum accompanying the Division of Revenue Bill (Annexure E in the 2000 *Budget Review*). The formula is not intended to yield indicative provincial budgets, as each province must draw up its own budget, reflecting its priorities within the framework of national norms and standards. Moreover, provincial budgets are funded not only by transfers from national government, but also by own revenue.

Introduction of conditional grants

Conditional grants were introduced with the 1998 Division of Revenue Act in order to:

- Provide for national priorities in the budgets of provincial and local spheres

- Promote national norms and standards
- Compensate provinces for cross-border flows and specialised services that are of nationwide benefit, such as training of medical professionals
- Effect transition by supporting capacity building and structural adjustment within recipient administrations
- Address backlogs and regional disparities in social infrastructure

Budgeting for conditional grants

A conditional grant is voted in the national budget as a transfer, and it is recorded as revenue in the provincial accounts. It is also voted in the budgets of provincial departments. The provinces are responsible for actual expenditure and financial accountability for conditional grants. The national departments are responsible for monitoring compliance with the conditions of the grants.

Agency payments

Agency payments, on the other hand, are not reflected in provincial budgets. The national department retains full accounting responsibility for these funds. Agency payments are, in essence, a payment to the provincial or local government for delivering a particular service on behalf of a national department.

This distinction between agency payments and conditional grants was not clear in 1998 and 1999, when the intergovernmental system was still in transition. Prior to the introduction of the Division of Revenue Act, most intergovernmental transfers were treated as agency payments. Many agency payments have been converted into conditional grants. The analysis of conditional grants in this chapter includes agency payments appearing in the Division of Revenue Act. The box below elaborates on intergovernmental transfers. The Division of Revenue Act also includes conditional grants and agency payments to local government, as discussed in Chapter 7.

Trends in the allocation and transfer of grants

Table 3.1 indicates both conditional grants and agency payments transferred to provinces in 1998/99 and 1999/00, as well as budgeted amounts between 2000/01 and 2002/03. In 1998/99, conditional grants to provinces, excluding improvements in conditions of service, amounted to R9,7 billion. Agency payments amounted to R4,9 billion, bringing total grants to provinces to R14,6 billion. Table 3.1 also shows which transfers were reclassified as conditional grants over the past two years.

In 1999/00, total conditional grants increased to R10,3 billion. When including agency payments, total transfers to provinces amounted to R14,7 billion in 1999/00. The budget allocations for grants decline to R13,4 billion in 2001/02. This results from the phasing out of the transitional grants, including for R293 personnel and welfare financial management, and a reduction in supplementary allocation grants.

Transfers in intergovernmental fiscal relations

Transfers are the principal way in which countries ensure that the revenues and expenditures of each level of government are approximately equal, or achieve "vertical fiscal balance". For various reasons, both economic and political, central governments usually have much greater revenue-raising capacity than do local governments. Intergovernmental transfers are one mechanism by which some of the revenues accruing to the centre are transferred to finance the fiscal gap in the budgets of lower levels of government.

In South Africa, the three spheres of government each have different revenue capacities and expenditure responsibilities. Provinces have been assigned expenditure responsibilities well beyond their revenue-raising capacities. Municipalities, while largely self-financing, still rely on transfers from other spheres. The equitable shares of revenue raised nationally are unconditional transfers that fund this fiscal gap. They enable provinces and municipalities to provide basic services in areas of concurrent and exclusive competence.

In addition to the equitable shares, the national government makes other allocations to the provincial and local spheres of government. Conditional grants are a strategy of the national government to ensure that provinces can provide a level and quality of service that is consistent with national priorities. On concurrent functions, the national government sets norms and standards and monitors whether these are being achieved. Conditional grants provide a policy instrument for national departments to intervene when subnational governments do not meet these norms and standards. These grants also address interjurisdictional spillovers to ensure that appropriate levels of service are provided.

Unlike conditional grants, agency payments are a form of outsourcing, but to a public entity. In terms of best practice, national departments can use agency payments as a strategy to implement their own function by employing other levels of government. They serve to promote efficiency and effectiveness by allowing the national department (principal), at a cost, to utilise the existing spare capacity of the agent (provincial or local governments), and allow the principal to avoid duplication.

Agency payments are essentially another means by which a national department can discharge its functions. The principal department is at all times still responsible for providing the service. Consequently, accounting responsibility remains with the transferring department. Accounting responsibility for conditional grants, on the other hand, lies with the receiving officer in the provincial or local department. These grants constitute part funding for provincial and local functions. The conditions are imposed in order to ensure that the subnational governments fulfil national policy objectives.

While these distinctions between conditional grants and agency payments hold in theory, their application in practice is not as clear cut. Before 1998/99, all intergovernmental transfers were treated as agency payments, even if they had the characteristics of a conditional grant. Since 1998/99, with the introduction of the Division of Revenue Act, some agency payments have been converted into conditional grants, and more conversions are anticipated to ensure proper accounting and accountability. It is envisaged that only conditional grants will be part of the annual Division of Revenue Act.

Only nine of 35 national departments have intergovernmental transfers on their budgets in 2000/01. Four departments – Health, Finance, Housing and Transport – account for over 80 per cent of all budgeted conditional grants and agency payments.

Health administers most grants

The Health Department, in particular, administers more grants than any other department, amounting to R5,7 billion in 2000/01 (Table 3.2) or about 43 per cent of all budgeted transfers to provinces. The central hospital and professional training and research grants, which are targeted at provinces with academic and specialised health facilities, are the two largest health grants. Other health grants support the redistribution of specialised health services, the rehabilitation of hospitals and the upgrading of hospital facilities in Eastern Cape (Nelson Mandela Academic Hospital) and KwaZulu-Natal (Nkosi Albert Luthuli Academic Hospital).

Table 3.1 Transfers to provinces, by department

R million	1998/99	1999/00	2000/01	2001/02	2002/03
Conditional grants					
Education	39	192	202	213	224
Finance	4 000	3 989	2 512	2 300	2 300
Health	4 662	5 331	5 717	5 803	5 905
Housing	7	26	3 028	3 287	3 434
Provincial and local government	951	563	463	0	0
Welfare	12	71	44	0	0
Other grants	73	93	60	140	140
Subtotal, conditional grants[1]	9 744	10 265	12 026	11 743	12,003
Agency payments					
Education	158	0	0	0	0
Housing	3 346	3 077	0	0	0
Transport	1 189	1 293	1 409	1 522	1 629
Other departments	174	78	0	0	0
Subtotal, agency payments	4 867	4 449	1 409	1 522	1 629
Total transfers	**14 612**	**14 712**	**13 435**	**13 265**	**13 632**
As percentage of total transfers					
Provincial and local government	6,5	3,3	3,4	0,0	0,0
Education	1,3	1,8	1,5	1,6	1,6
Finance	27,4	27,1	18,7	17,3	16,9
Health	31,9	36,2	42,6	43,7	43,3
Housing	23,0	21,1	22,5	24,8	25,2
Transport	8,1	8,8	10,5	11,5	11,9
Other departments	1,8	1,6	0,8	1,1	1,1
Total	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**

1. Totals for conditional grants differ from those in Table 1.1 because these exclude the local government support grant, a direct transfer to local government, and include certain grants that were neither allocated by province nor included in provincial budgets.

Distribution of grants between provinces

Table 3.3 shows how these grants are distributed between provinces in 2000/01. Gauteng receives R3,8 billion in conditional grants and agency payments in 2000/01, more than any other province. More than half of Gauteng's allocation, however, reflects health grants to support the province's tertiary and specialised care institutions. Western Cape also receives a significant allocation for this purpose. When these targeted hospital grants are excluded, these two provinces' share of total grants falls considerably.

Table 3.2 Health conditional grants

R million	1998/99	1999/00	2000/01	2001/02	2002/03
Central hospital services	3 021	3 075	3 112	3 221	3 350
Research professional training	1 060	1 118	1 174	1 216	1 264
Redistribution of specialised services	3	57	176	182	189
Hospital rehabilitation	86	153	400	500	520
Integrated nutrition programme	281	697	582	582	582
Nelson Mandela Academic Hospital	11	41	0	0	0
Nkosi Albert Luthuli Academic Hospital	200	189	273	103	0
Total	**4 662**	**5 331**	**5 717**	**5 803**	**5 905**

Table 3.3 Total transfers by province, including and excluding hospital grants, and per capita, 2000/01

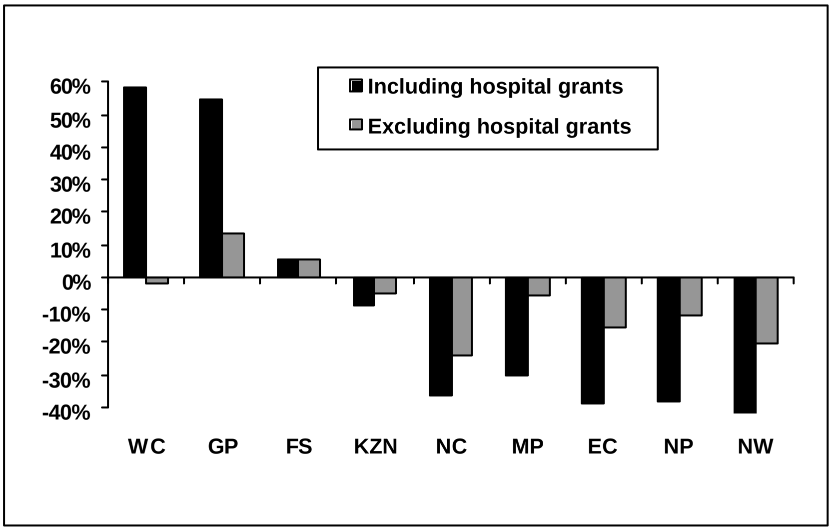
	Total transfers		Shares of transfers		
R million	Including hospital grants	Excluding hospital grants	Including hospital grants	Excluding hospital grants	Distribution of population
Eastern Cape	1 314	1 132	9,9	13,8	15,5
Free State	920	567	6,9	6,9	6,5
Gauteng	3 756	1 704	28,2	20,8	18,1
KwaZulu-Natal	2 613	1 717	19,6	20,9	20,7
Mpumalanga	737	633	5,5	7,7	6,9
Northern Cape	178	131	1,3	1,6	2,1
Northern Province	1 104	983	8,3	12,0	12,1
North West	646	545	4,8	6,6	8,3
Western Cape	2 073	793	15,5	9,7	9,7
Total	13 341	8 206	100,0	100,0	100,0
Addendum					
Unallocated grants not included above[1]	94	94			
Total, including unallocated	13 435	8 300			

1. Unallocated grants include financial management grants administered by State Expenditure and Welfare, and capacity building grant under Housing department

Per capita distribution of grants

The impact of the health grants can also be seen when the figures are reviewed on a per capita basis, as shown in Figure 3.2. Gauteng and Western Cape both receive grant funds that, when measured on a per capita basis, are significantly above the national average. All other provinces are essentially at or below the national average, indicating the strong influence of the hospital grants. When the hospital grants are not considered, the distribution of total transfers changes sharply, with funding to provinces moving closer to the national average.

Figure 3.2 Per capita allocations of total grants, above or below the national average



Unlike the equitable share allocation, which redistributes funds to poorer provinces to support the provision of basic services, conditional grants and agency payments are more targeted to meet specific programme goals. For instance, the central hospital grant supports the country's tertiary health institutions which, for historical reasons, are located primarily in Gauteng and Western Cape. Other grants, such as those supporting capacity building and certain infrastructure grants, are targeted toward poorer provinces. The next section discusses these transfers and their programme goals.

Types of conditional grants

Types of conditional grants

Conditional grants and agency payments are designed to achieve certain policy objectives. As a result, different types of grants have emerged, with three broad categories: recurrent, transitional and infrastructure grants. There is some overlap between categories as certain grants are used to accomplish several objectives.

Recurrent grants fund highly specialised

Recurrent grants represent long-term funding arrangements to support both basic service delivery and non-basic, assigned functions in provinces. These grants, with the exception of bus subsidies, fund specialised health services that are expensive to redistribute between provinces. Most grants are likely to continue for a long period, if not indefinitely, as the services and functions involved are permanent. Transitional grants, on the other hand, are generally more period specific, directed towards supporting restructuring or transitional arrangements such as capacity building. Once the goal has been achieved, these funds will either be incorporated into the equitable share or be directed elsewhere. Infrastructure grants support specific capital projects.

Types of grants

Table 3.4 shows the different types of grants since 1998/99. The share of recurrent grants increases from 38 per cent in 1998/99 to 46,6 per cent in 2000/01, and is budgeted to increase to 50 per cent in 2003/04. This results from the reduction of transitional grants from a share of 36 per cent in 1998/99 to 18,2 per cent in 2003/04, and the stabilisation of infrastructure grants. The reduction in transitional grants reflects the discontinuation of selected grants. The grants are discussed in more detail below.

Table 3.4 Grants by type

R million	1998/99	1999/00	2000/01	2001/02	2002/03
Recurrent	5 550	6 183	6 278	6 540	6 825
Transitional	5 301	4 851	3 011	2 463	2 478
Infrastructure	3 761	3 678	4 147	4 262	4 329
Total	**14 612**	**14 712**	**13 435**	**13 265**	**13 632**
Percentage share					
Recurrent	38,0	42,0	46,7	49,3	50,0
Transitional	36,3	33,0	22,4	18,5	18,2
Infrastructure	25,7	25,0	30,9	32,2	31,8
Total	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**

Table 3.5 shows how the different types of grants are distributed between provinces. Recurrent grants are more important in Gauteng and Western Cape, constituting 70,0 per cent and 71,1 per cent of total grants to these provinces. This reflects the location bias of academic and specialised hospitals. Transitional grants, which are a smaller portion of the total grants, play a bigger role in the poorer provinces. For instance, North West (39 per cent), Northern Province (40,7 per cent), and Eastern Cape (37,4 per cent) receive a higher share than do Gauteng and Western Cape.

Table 3.5 Types of grants by province, 2000/01

R million	**Recurrent**	**Transitional**	**Infrastructure**	**Total**
Eastern Cape	244	492	579	1 314
Free State	440	231	249	920
Gauteng	2 628	350	777	3 756
KwaZulu-Natal	960	646	1 007	2 613
Mpumalanga	189	204	344	737
Northern Cape	39	58	82	179
Northern Province	207	450	447	1 104
North West	96	252	298	646
Western Cape	1 474	232	367	2 073
Total	6 278	2 914	4 150	13 341
Percentage distribution				
Eastern Cape	18,6	37,4	44,0	100
Free State	47,8	25,1	27,1	100
Gauteng	70,0	9,3	20,7	100
KwaZulu-Natal	36,8	24,7	38,5	100
Mpumalanga	25,6	27,7	46,7	100
Northern Cape	21,8	32,4	45,8	100
Northern Province	18,8	40,7	40,5	100
North West	14,9	39,0	46,1	100
Western Cape	71,1	11,2	17,7	100
Total	**47,1**	**21,8**	**31,1**	**100**

Recurrent grants

Transfers of recurrent grants

Table 3.6 shows conditional grants and agency payments in the recurrent category. In 1998/99, recurrent grants totalling R5,6 billion were transferred to the provinces. Transfers in 1999/00 increased by 11,4 per cent to R6,2 billion, reflecting a significant increase in the flow of Integrated Nutrition Programme funds. Transfers for this programme included rollovers from the 1998/99 allocation. In 2000/01, the budgeted amounts for recurrent grants remain flat as a result of a reduction in the allocation for the nutrition grant compared to 1999/00 transfers. In the outer years, recurrent grants increase by about 4 per cent annually.

Table 3.6 Recurrent grants

R million	1998/99	1999/00	2000/01	2001/02	2002/03
Central hospital	3 021	3 075	3 112	3 221	3 350
Professional training	1 060	1 118	1 174	1 215	1 264
Integrated Nutrition Programme	281	697	582	582	582
Bus subsidies	1 189	1 293	1 409	1 522	1 629
Total	**5 550**	**6 183**	**6 278**	**6 540**	**6 825**

The recurrent grants include the following:

Purpose of Central Hospital grant

- *Central hospitals* – The largest in the system, this grant is a mechanism to fund provinces that support central hospitals providing specialised health care services. The aim is to make these services available to all South Africans, irrespective of where they live. The grant has been allocated to four provinces – Free State, Western Cape, KwaZulu-Natal and Gauteng – which together have ten central hospitals. The grant is conditional on non-discrimination between residents and non-residents of the provinces in which the services are located.

Health Professional and Training grant

- *Health professional and training* – This grant compensates provinces for the higher service costs associated with training health professionals, and supports research and training of all categories of health professionals. About 90 per cent of this grant is allocated to the four provinces with medical schools, based on the numbers of final year medical undergraduates. The other provinces share 10 per cent equally, to fund health training in provincial tertiary, regional or district facilities.

Integrated Nutrition Programme

- *Integrated Nutrition Programme* – Formerly known as the Primary School Nutrition Programme, this grant was originally an RDP project aimed at feeding children in poor schools. It continued as a conditional grant in 1998/99. The programme is targeted at poor provinces with high populations of school children. Eastern Cape, Northern Province and KwaZulu-Natal receive about 63 per cent of the allocation.

Subsidies for public transport services

- *Bus subsidies* – The Department of Transport administers this grant to subsidise public bus services. These subsidies have been provided by national government since before 1994. Gauteng is the largest beneficiary of this grant, receiving 40 per cent. The grant benefits residents of specific towns (e.g. Soweto) and different provinces (e.g. KwaNdebele in Mpumalanga) who travel to Johannesburg and Pretoria for work.

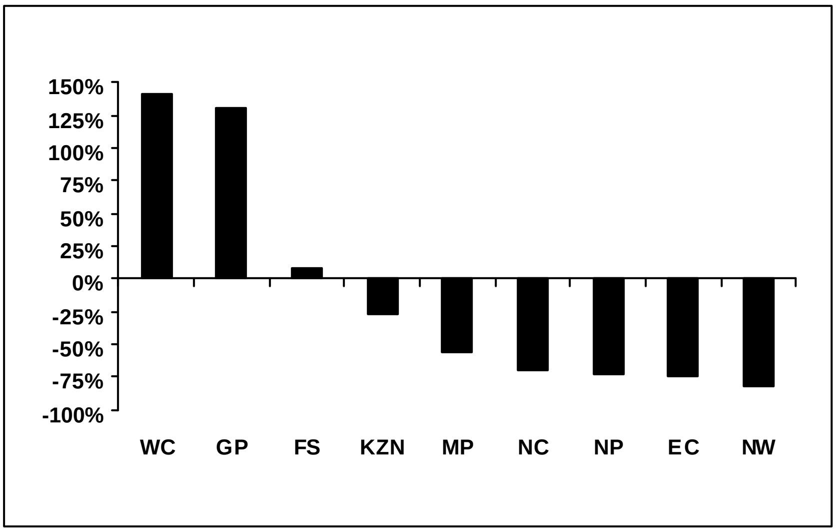
Recurrent grants fund inherited services

Recurrent grants generally fund services that existed before the new funding arrangements for provinces were introduced. The costs and benefits of these assigned functions spill over into other provinces. For reasons of economies of scale, it may not be feasible to redistribute them to other provinces. In particular, the central hospital and professional training grants were introduced because the provinces that inherited these services required more funding than the equitable share formula could provide. Recurrent grants address, among other things, spillovers that would lead to suboptimal service provision by the respective provinces.

Distribution of recurrent grants

Figure 3.3 shows that, based on per capita measurement, both the Western Cape and Gauteng shares of recurrent grants are significantly above the national average. This reflects the predominance of hospital grants and even bus subsidies, which are allocated mainly to these provinces. This trend indicates that these grants support services established as a result of the spatial policies of the old dispensation.

Figure 3.3 Per capita allocations of recurrent grants, above or below the national average



Nutrition grants targets poorer provinces

Of all the recurrent grants, only the nutrition grant has an explicit redistributional approach, targeting funds to poorer provinces. It is, in effect, a pure poverty alleviation grant aimed at feeding poor school children.

Recurrent grants are subject to soft conditions

The recurrent grants involve significant amounts of funding and are applied to important essential services. As a result, they cannot be withdrawn without a substantial and unacceptable impact on service delivery. Each grant has to be assessed individually to determine whether it can be phased out, or to establish the extent to which it can be redistributed between provinces.

Transitional grants

Transitional grants support restructuring and capacity needs

Transitional grants are used largely to address the significant restructuring problems faced by provinces after 1994. The transitional and capacity building grants mostly fund financial management improvement programmes and provide general budgetary support for provinces subject to specific conditions.

Transitional grants are being phased out

Table 3.7 shows that transitional grant transfers amounted to R5,3 billion in 1998/99, decreasing by more than 40 per cent to R2,5 billion in 2002/03. This reduction reflects the transitional nature of these grants. For instance, the allocation for R293 personnel, the contingency allocation and the welfare financial management grant phase out completely. The supplementary allocation has been gradually reduced from R2,8 billion in 1998/99 to R2,0 billion in 2001/02. Except for the supplementary allocation and contingency grants, these grants have mostly benefited provinces facing a greater restructuring challenge due to the incorporation of homeland governments.

Table 3.7 Transitional and capacity building grants

R million	1998/99	1999/00	2000/01	2001/02	2002/03
Capacity building					
Education	33	192	202	213	224
State Expenditure	69	31	57	140	140
Welfare	12	37	27	0	0
Housing capacity building	7	10	10	10	10
Subtotal	121	270	296	363	374
Provincial support					
Supplementary allocation	2 800	2 500	2 212	2 000	2 000
Contingency allocation	1 200	1 420	0	0	0
Subtotal	4 000	3 920	2 212	2 000	2 000
Local government support					
R293 transfer	0	40	0	0	0
R293 personnel	951	443	463	0	0
Subtotal	951	483	463	0	0
Other transitional					
Education textbooks	125	0	0	0	0
Manpower training	52	56	0	0	0
KZN peace initiatives	0	80	0	0	0
Human settlement	0	1	20	100	104
Other	52	42	20	0	0
Subtotal	229	179	40	100	104
Total	**5 301**	**4 851**	**3 011**	**2 463**	**2 478**

The transitional grants fund, among others, capacity building and restructuring, and provide budgetary support to provinces and local government.

Capacity building grants

- *Capacity building* – Most of the capacity building grants are focused on improving management, particularly financial management. The Department of Education administers the largest of these grants, aimed at enhancing the quality of the education system. The objective is to address the general lack of effective management systems at provincial, district and school level. The national Treasury (Department of State Expenditure) grant is aimed at overall improvement, consolidation and standardisation of the provincial financial management systems. The welfare grant focuses on improving capacity and systems for administering social security payments.

Grants for provincial budgetary support

- *Provincial support* – The supplementary allocation grant provides general budgetary support to the provinces, to encourage good budgeting and financial management practices. It is intended to enable provincial treasuries to provide leadership in the implementation of provincial budget reforms. The grant's conditions support the building of institutions and processes, in contrast to the more specific capacity building grants. The contingency allocation, on the other hand, was a direct assistance to provinces to address debts resulting from expenditure overruns in 1996/97 and 1997/98. Before receiving these funds, a province had to commit to agreed levels of expenditure and revenue, and the funds had to be used to pay outstanding liabilities. No provision has been made for further debt reduction grants over the MTEF period.

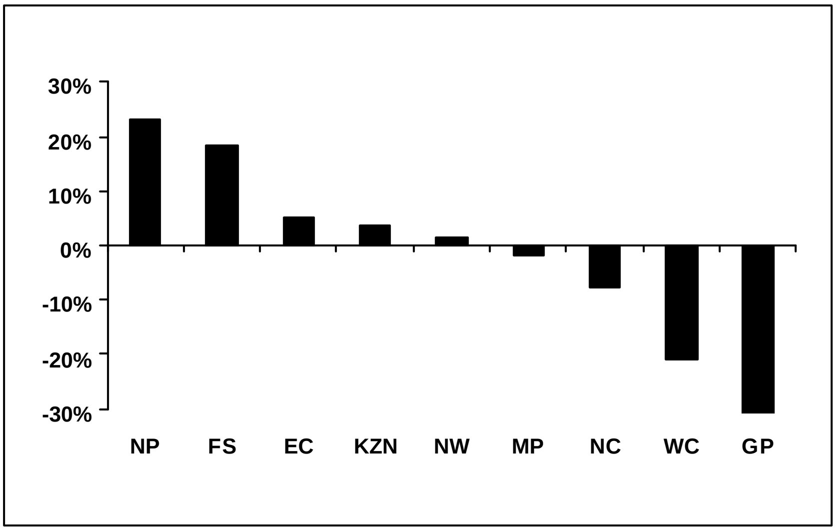
Transitional grant for R293 towns

- *Local government support* – The transitional grant for R293 towns enabled provinces to fund the personnel and operational costs of the R293 towns they inherited with the amalgamation of homelands. In 1999/00, funds for the operational costs of the R293 towns were phased into the local government equitable share. The R463 million to fund personnel remained with the provinces. The transfer of personnel to local government began in 1999/00, with R40 million allocated towards transfer costs. Transfer of staff to municipalities should be completed in the current year. The grant will phase into the equitable shares of provinces and local government, depending on the R293 personnel absorbed by each sphere.

Grants target provinces needing financial assistance

Transitional grants assist provinces and localities that lack capacity or need additional financial support. Figure 3.4 shows that these transitional grants tend to flow to the poorer provinces that incorporated former homelands and which faced serious transition problems. In these provinces, per capita allocations are above the national average, while those in Western Cape and Gauteng are significantly below the national average.

Figure 3.4 Per capita allocations of transitional grants, above or below the national average



Infrastructure grants

Use of infrastructure grants

The conditional grants and agency payments also fund social infrastructure, including housing, hospitals and schools. Table 3.8 indicates that R3,8 billion and R3,7 billion were transferred to provinces in the form of grants for infrastructure and capital programmes in 1998/99 and 1999/00 respectively. This increases to R4,1 billion (by 12,8 per cent) in 2000/01 as a result of the introduction of a R300 million provincial infrastructure grant and an increase in hospital rehabilitation funds. More than 75 per cent of the infrastructure grants were allocated for housing between 1998/99 and 1999/00.

Table 3.8 Infrastructure and capital grants

R 000	1998/99	1999/00	2000/01	2001/02	2002/03
Health					
Rehabilitation	86	153	400	500	520
Redistribution of specialised services	3	57	176	182	189
Construction: Umtata	11	41	0	0	0
Construction: Durban	200	189	273	103	0
Housing					
Housing Fund subsidies	2 880	2 941	2 998	3 177	3 320
Hostel development	75	15	0	0	0
Special Presidential Project	419	136	0	0	0
Other housing	47	0	0	0	0
Other					
Northern Cape Legislature	0	69	0	0	0
Finance: Infrastructure	0	0	300	300	300
Education: School building	39	0	0	0	0
Other	0	76	0	0	0
Total	**3 761**	**3 678**	**4 147**	**4 262**	**4 329**

The infrastructure grants to provinces are briefly discussed below:

Health rehabilitation

- *Health infrastructure grants* – The hospital rehabilitation grant was established after the 1996 audit of hospital facilities indicated a need for a major hospital reconstruction and rehabilitation programme. Through this grant, provinces can rebuild and rearrange hospital facilities, and restructure the hospital sector. Since the grant is allocated on the basis of infrastructure backlogs, poorer provinces benefit more. The Department of Health has also provided funds for the construction of academic hospitals in Eastern Cape and KwaZulu-Natal.

  Redistribution of specialised health services

  The grant for the redistribution of specialised health services also has a significant capital component. It was introduced to improve access to specialised care in provinces lacking such services and to reduce the number of referrals for specialist and subspecialist care to provinces with central hospital services. The grant is used for the acquisition of specialist equipment, specialist training, and as an incentive for specialists to relocate to these provinces.

Housing subsidies

- *Housing* – Channelled through the provinces to municipalities, the grant is aimed at addressing backlogs in housing, mainly in urban areas. Chapter 7 provides a detailed discussion of this grant.

Infrastructure grant for provinces

- *Other* – The R300 million provincial infrastructure grant under the national Treasury aims to address provincial infrastructure needs, particularly the rehabilitation and maintenance of provincial roads. However, due to the recent floods, the grant has been targeted to the reconstruction of infrastructure in affected provinces (Mpumalanga, KwaZulu-Natal, Northern Province and Eastern Cape). Still, the R300 million allocated for 2001/02 and 2002/03 should benefit all provinces, as originally planned. In 1999/00, Northern Cape received a R69 million contribution towards the construction of its legislature building.

Per capita allocation of infrastructure grants

Figure 3.5 shows the per capita impact of selectively targeted infrastructure grants. For instance, Mpumalanga benefited from the allocation of the provincial infrastructure grant to repair damage caused by the flood disaster. KwaZulu-Natal, in addition to the disaster allocation, also received a grant targeted to the construction of the Nkosi Albert Luthuli Academic Hospital. Gauteng receives the largest share of the allocation for housing subsidies. Note that, given the fixed-cost nature of infrastructure spending, per capita allocations are not always relevant.

Figure 3.5 Per capita allocations of infrastructure grants, above or below the national average

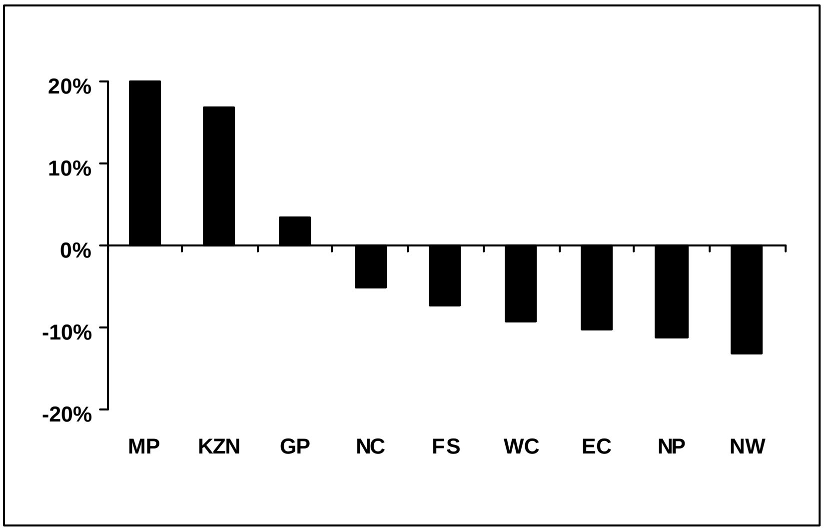


Table 3.5 shows the importance of capital grants in poorer provinces, with a range from 39 per cent in KwaZulu-Natal to 44 per cent in Eastern Cape. This compares with less than 21 per cent in Gauteng and Western Cape, which receive the bulk of the recurrent grants.

Infrastructure grants require more planning

Inadequate capacity and poor planning is the major problem with the implementation of infrastructure grants. Preparations of delivery plans often only commence after the MTEF budget allocations, resulting in significant lead-time in delivering infrastructure projects and, consequently, non-transfers and rollovers.

Transfers and spending of grants

Transfers of grants

Non-transfers of grants

Many of the problems associated with conditional grants are reflected in *non-transfers* by national departments and *underspending* by provincial (or local) governments. The actual spending of these grants has to be assessed at the provincial or local government level, where such spending takes place. This information is often not available from provincial departments or municipalities, making it impossible to determine the extent of underspending. Underspending also occurs when national departments do not transfer all the funds budgeted for this purpose. Other reasons for underspending may be the late transfer of funds by national departments.

Table 3.9 compares budget allocations and actual transfers in 1998/99 and 1999/00 for conditional grants and agency payments, and indicates the extent of non-transfers. The total non-transferred grants amounted to R547 million and R443 million (excluding direct transfers to R293 municipalities) in 1998/99 and 1999/00, respectively. Most of these funds were rolled over.

Table 3.9 Budget allocations for grants vs actual transfers to provinces

		1998/99			1999/00	
R million	**Budget**	**Actual**	**Difference**	**Budget**[1]	**Actual**	**Difference**
Health grants						
Central hospital	3 021	3 021	0	3 075	3 075	0
Professional training	1 060	1 060	0	1 118	1 118	0
Integrated Nutrition Programme	526	281	(245)	796	697	(99)
Hospital rehabilitation	100	86	(14)	214	153	(60)
Redistribution of specialised services	49	3	(46)	151	57	(94)
Nkosi Albert Luthuli Hospital	200	200	0	247	189	(58)
Nelson Mandela Academic Hospital	100	11	(89)	153	41	(112)
Education						
Financial management	100	33	(67)	192	192	0
Textbooks	200	125	(75)	0	0	0
Classroom backlogs	51	39	(12)	0	0	0
Provincial and local government	1 132	1 132	0	640	619	(20)[2]
Finance	4 000	4 000	0	3 989	3 989	0
Total grants	**10 539**	**9 991**	**(547)**	**10 574**	**10 121**	**(443)**

1. 1999/00 Budget includes rollovers of 1998/99 grants that were not transferred in that financial year.
2. This was a direct transfer to municipalities who took over R293 personnel.

Most of the non-transfers in 1998/99 were earmarked for health grants, particularly the nutrition and infrastructure grants. The total non-transfers in health grants amounted to R394 million, and increased to R423 million in 1999/00. In 1998/99, 62 per cent of the non-transfer in health was associated with the nutrition grant.

A major reason for the non-transfer of grants has been the micro-management of some grants by the national departments. As a result, decisions on allocation and spending of these grants had to be approved at national level, delaying the transfer of these grants. For instance, on the nutrition grant, the Health Department implemented stringent administrative procedures in the light of a history of fraud. The Department's process for reconciling monthly expenditure was cumbersome. It slowed down spending on the programme, confused accountability between national and provincial levels, and resulted in large rollovers. The flow of funds to provinces has improved since a predetermined payment schedule was implemented during 1999/00. However, the lack of an effective monitoring system to assess actual expenditure (and outputs) made it difficult to estimate actual expenditure per province in 1999/00 and the full extent of underspending.

Best practice principles for managing conditional grants

In assigning responsibility between spheres, the Constitution envisages a cooperative partnership, as the delivery of key social services is a concurrent responsibility. The national government has assumed the responsibility of policy-making and monitoring, whereas the provinces' key responsibility has evolved to be the implementation of national policies and priorities. Separation of responsibilities for policy and implementation between the spheres requires greater coordination in policy planning and implementation. This will avoid the creation of unfunded mandates and the failure of provinces to implement national policy priorities adequately.

Problems with conditional grants have been associated with inadequate planning before funds are allocated. Planning needs to take place at both levels of government. The national departments must bring the conditional grants into the overall planning and performance management framework that is now evolving in terms of the PFMA and budget reform requirements. Where a grant is introduced to enforce norms and standards, national departments must ensure that appropriate planning has taken place to identify the purpose of the grant, the outputs it is intended to achieve and the monitoring arrangements. The strategic plan of the national departments should incorporate planning for conditional grants, in consultation with the sphere that is expected to implement the programmes. This requires the use of the evolving intergovernmental institutions (technical committees and meetings of the Minister with the nine members of the provincial executive councils – MinMECs) for intergovernmental coordination in the formulation and implementation of government policies.

The strategic planning cycle of the national department should involve identifying the expected results, the strategies to achieve those results, the allocation of resources and the monitoring of performance. Performance information feeds through to the next round of planning to help refine strategies. Periodically, a more thorough review or evaluation is undertaken to assess whether the results sought remain appropriate and the chosen strategies have been successful. Provinces also need to incorporate service delivery planning for the conditional grant into their strategic planning framework, within the broad policy framework of the national government.

As well as planning for and monitoring conditional grants, national departments must also seek approval and funding for grants through the budget process. Best practice involves managing all conditional grants and unconditional transfers through the annual budget process within the MTEF. This ensures that grants are incorporated in the strategic planning and performance management frameworks of national departments. It also improves coordination across the full range of the national government's activities. Once planning has taken place, and the necessary financial resources secured, the next step is to negotiate performance.

Weak provincial capacity

Part of the reason national departments tended to micro-manage grants was the lack of capacity in some provinces. Problems were compounded, however, when national departments did not have a credible policy framework or norms and standards to guide provincial planning. This has been the case, for instance, in the health infrastructure grants, particularly the redistribution of specialised services and the rehabilitation grants. A further problem with the redistribution grant has been the requirement that provinces provide from their own budgets for the operational costs of the new services associated with the investment in specialised health equipment. The terms of the grant are now being amended to allow provinces to use part of the funds for running costs.

Improvements in the flow of grants

The flow of grants generally improved in 1999/00 as the Division of Revenue Act required that departments prepare payment schedules. In particular, the education grant for financial management and quality enhancement, the welfare grants and the nutrition grant flowed on schedule in 1999/00; hence, all funds allocated were transferred. In addition, national departments must increasingly monitor expected outputs rather than make decisions on how to produce those outputs, and must support provincial capacity building for the planning and management of grants.

Improving the conditional grants system

2000 Division of Revenue Act

Changes introduced in 2000 Division of Revenue Act

The 2000 Division of Revenue Act includes new provisions to promote advanced planning and enhance accountability for conditional grants. Key requirements include the following:

- National departments must have had all arrangements for this year's conditional grants finalised by 30 June 2000, including the completion of business plans, allocations between provinces and cash payment schedules. This was to ensure that planning for the grants is completed in time (preferably well before the financial year commences) to allow funds to flow to provinces.
- The receiving provincial departments must report on receipts and expenditure, on a monthly basis, to the national departments transferring grants and to the provincial treasuries. This will enhance the national departments' ability to monitor spending, which generally flows on the basis of predetermined cash flow schedules. The national departments are, in turn, expected to report quarterly to the national Treasury.
- Receiving officers in provinces and municipalities have been given statutory responsibility for complying with the conditions of the grants, and for ensuring that funds are properly managed and accounted for.
- New incentives and sanctions include empowering the Minister of Finance to convert conditional grants to the equitable share in the event of non-compliance by national departments. Moreover, the Act specifies that non-compliance constitutes financial misconduct.

These new provisions should improve planning, reporting and monitoring of conditional grants, and clarify the responsibilities of national and provincial officers administering the grants. The aim is to ensure that grant conditions are met and policy goals achieved.

New conditional grant framework

Further reforms are being introduced

In addition to the changes in the 2000 Division of Revenue Act, several reforms are gradually being introduced to address problems in the conditional grant system. These reforms will form a policy framework for conditional grants, providing for a coherent policy and guidelines on conditional grants. It is envisaged that this framework will:

- Set criteria to be used by departments in determining the necessity for a conditional grant as an option to enforce norms and standards in the delivery of basic services (this will also provide guidelines to review current grants to reduce the number of grants in the system)
- Provide best practices in designing and planning for conditional grants, distinguishing between capital and other grants to ensure proper use of multi-year planning
- Incorporate conditional grants into the normal budget preparation process, such as asking departments to include information on conditional grants in their MTEF budget submissions, for evaluation during the budget process

Conclusion

Conditional grants are an integral part of the intergovernmental fiscal system. They play an important role in funding provinces to implement national priorities and to support the transition. Problems emerging in the past two years have highlighted areas that need attention in the functioning of the system. These lessons have been incorporated in the development of the conditional grant framework, which will provide guidelines for the review of the current grant system and design, as well as for the implementation of new grants.

4

Provincial own revenue

Although provincial own revenues represented only 4 per cent of total provincial revenues in 1999/00, they remain an important source of provincial funding at the margin. The decline in provincial own revenues over the past few years has added to the pressure on provincial budgets. This chapter reviews policy and administrative issues affecting the collection of existing revenues, and the new policy framework being proposed to regulate provincial tax powers.

The Constitution gives provinces the authority to impose certain taxes, but requires national government to regulate this authority to ensure that national economic policy objectives are not undermined. Thus far, the provinces have not expanded their taxing powers. Government has first concentrated on expenditure assignment and improved administration to promote more accountable, effective and efficient use of funds.

Recently, the Budget Council proposed a regulatory framework, as required by the Constitution, which will allow the imposition of new provincial taxes. Nevertheless, the Council indicated that the first priority of provinces should be to improve the administration of current revenue sources, recognising that they offer more potential revenue than do new taxes. Taking into consideration current institutional capacity, the Budget Council explicitly rejected the option of a surcharge on the personal income tax at this stage. Cabinet endorsed this approach.

It is worth noting that provincial own revenue is generally collected by different provincial departments and/or agencies rather than by a single department or agency.

Overview and trends

Provincial own revenues declined from R4,1 billion in 1996/97 to R3,4 billion in 1998/99 and then increased to R4,0 billion in 1999/00, as shown in Table 4.1. The total for 1999/00, however, includes one-off collections in two provinces (Western Cape and Mpumalanga). Excluding these one-off receipts, which total R267 million, 1999/00 collections were R3,7 billion, or 8,3 per cent above the 1998/99 level.

Although 1999/00 own revenues break the downward slide, this trend resumes again in 2000/01. Even after adjusting for the one-off collections in 1999/00, budgeted levels still fall. At R3,6 billion, the 2000/01 own revenue levels are 12 per cent below 1996/97 collections. In KwaZulu-Natal and Northern Province, 2000/01 budgeted levels are more than a third lower than they were four years ago. Provinces are projecting above-inflation growth in the last two years of the MTEF period. As a result, provincial own revenues increase marginally as a share of total provincial revenues, from 3,3 per cent in 2001/02 to 3,5 per cent in 2002/03. Even with this growth, however, provincial own revenue represents a smaller share of total revenue over the medium term than at any time in the past.

Table 4.1 Total own revenues, by province

	Actual			Estimated actual	Medium-term estimate		
R million	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03
Eastern Cape	219	222	421	344	190	211	233
Free State	281	263	251	262	338	344	350
Gauteng	967	901	929	1 046	1 060	1 165	1 248
KwaZulu-Natal	828	641	432	613	531	589	648
Mpumalanga	216	257	194	363	193	210	225
Northern Cape	96	102	79	79	89	95	100
Northern Province	501	202	295	226	340	324	350
North West	421	304	311	328	382	395	407
Western Cape	559	565	528	733	517	574	616
Total	**4 089**	**3 458**	**3 440**	**3 994**	**3 640**	**3 907**	**4 177**
Percentage growth							
Eastern Cape		1,7	89,2	(18,3)	(44,7)	11,1	10,3
Free State		(6,7)	(4,3)	4,3	29,0	1,8	1,7
Gauteng		(6,8)	3,1	12,5	1,4	9,9	7,1
KwaZulu-Natal		(22,5)	(32,6)	41,9	(13,4)	10,9	10,0
Mpumalanga		19,1	(24,7)	87,3	(46,7)	8,6	7,3
Northern Cape		6,1	(23,0)	0,0	13,0	6,5	5,0
Northern Province		(59,6)	45,7	(23,5)	50,7	(4,7)	8,0
North West		(27,8)	2,4	5,4	16,6	3,3	3,0
Western Cape		1,1	(6,6)	39,0	(29,6)	11,0	7,4
Total		**(15,4)**	**(0,5)**	**16,1**	**(8,8)**	**7,3**	**6,9**
Percentage of total revenue							
Eastern Cape	1,4	1,5	2,6	2,1	1,1	1,1	1,2
Free State	4,7	4,3	3,7	3,8	4,5	4,4	4,3
Gauteng	7,2	6,2	6,0	6,3	5,7	6,0	6,1
KwaZulu-Natal	4,9	3,6	2,3	3,1	2,4	2,6	2,7
Mpumalanga	4,1	4,8	3,3	5,5	2,7	2,8	2,8
Northern Cape	4,4	4,7	3,6	3,2	3,5	3,5	3,5
Northern Province	4,4	1,8	2,5	1,8	2,4	2,2	2,3
North West	5,8	4,2	4,0	3,9	4,2	4,2	4,2
Western Cape	5,4	5,8	5,1	6,7	4,5	4,9	5,1
Total	**4,6**	**3,9**	**3,6**	**4,0**	**3,3**	**3,4**	**3,5**

Own revenues by type of revenue

The biggest single source of provincial own revenue, fees collected under the Road Traffic Act of 1989, represent over 44,8 per cent of budgeted collections in 2000/01. Table 4.2 shows provincial own revenues by type of fee. The Road Traffic Act fees, including motor vehicle licences and registration, driver's licences and learner's permits, grew at an annual average rate of 10,2 per cent between 1996/97 and 1999/00, or by about 4 per cent in real terms.

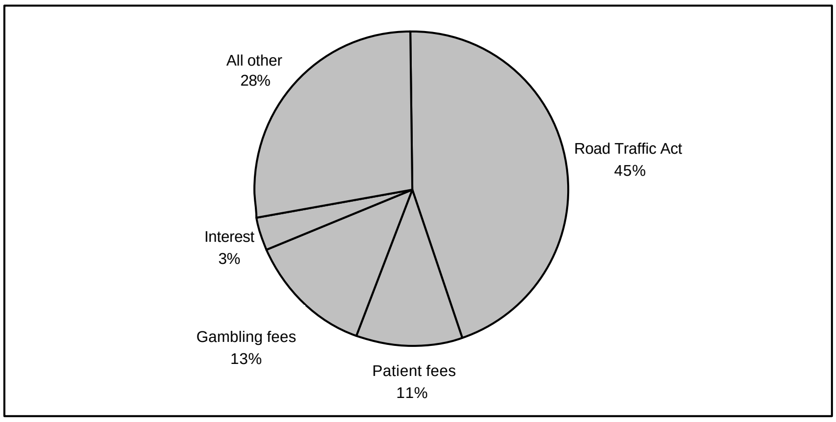
Table 4.2 Total own revenues, by type of revenue

	Actual			Estimated actual	Medium-term estimate		
R million	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03
Road Traffic Act fees	1 124	1 193	1 257	1 503	1 632	1 870	1 996
Hospital patient fees	416	362	346	325	395	430	454
Gambling[1]	401	353	403	577	468	486	545
Interest	773	367	222	292	121	116	119
All other	1 374	1 184	1 212	1 279	1 025	1 005	1 062
Total	**4 089**	**3 458**	**3 440**	**3 977**	**3 640**	**3 907**	**4 177**
Percentage growth							
Road Traffic Act fees		6,2	5,3	19,6	8,6	14,5	6,8
Hospital patient fees		(13,1)	(4,3)	(6,1)	21,4	8,9	5,6
Gambling[1]		(12,1)	14,4	42,9	(18,8)	3,9	12,1
Interest		(52,6)	(39,4)	31,7	(58,8)	(4,2)	3,3
All other		(13,8)	2,3	5,6	(19,9)	(1,9)	5,7
Total		**(15,4)**	**(0,5)**	**15,6**	**(8,5)**	**7,3**	**6,9**
Percentage of total own revenue							
Road Traffic Act fees	27,5	34,5	36,5	37,8	44,8	47,9	47,8
Hospital patient fees	10,2	10,5	10,1	8,2	10,8	11,0	10,9
Gambling[1]	9,8	10,2	11,7	14,5	12,9	12,4	13,0
Interest	18,9	10,6	6,5	7,4	3,3	3,0	2,9
All other	33,6	34,2	35,2	32,2	28,2	25,7	25,4
Total	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**

1. Gambling includes horse racing, betting and casino levies.

Hospital patient fees represent about 11 per cent of total budgeted collections in 2000/01. These fees have declined steadily since 1996/97, and were about a quarter lower in 1999/00 than in 1996/97. The decline has been widespread, affecting nearly all provinces. However, provincial budgets project strong growth in these fees in 2000/01.

Figure 4.1 Budgeted provincial revenues by type, 2000/01



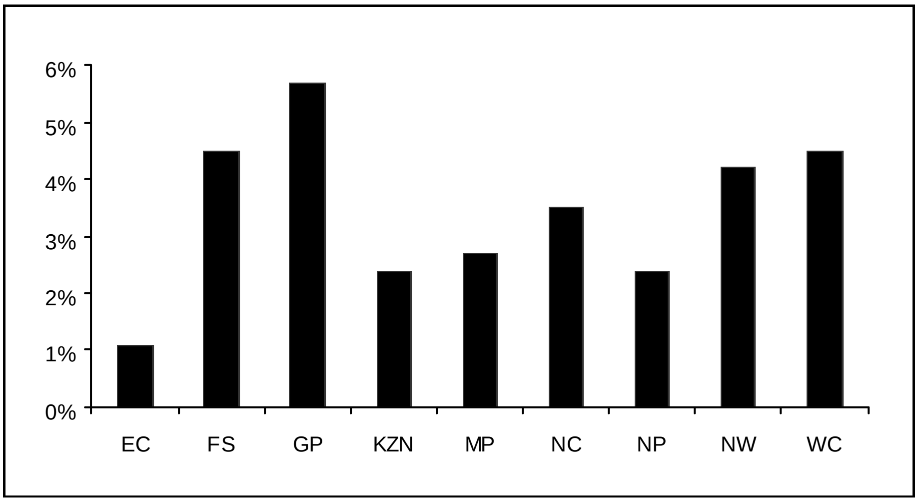
Interest on bank balances is estimated to be 3,3 per cent of collections in 2000/01. Interest receipts peaked in 1995/96, due to the rise in provincial bank balances (which reached about R7 billion) when several provinces ran budget surpluses. However, when these turned into deficits in 1996/97 and 1997/98, requiring provinces to draw down their bank balances, interest receipts fell sharply.

Variations in provincial collections

Figure 4.2 shows that the importance of own revenues varies across the provinces. An important question is whether these variations reflect differences in fiscal capacity or in fiscal effort. Fiscal capacity refers to the potential for a province to raise revenue, given its economic circumstances. A poor province cannot be expected to raise as much revenue per capita as a rich province. Fiscal effort is the degree to which a province uses its revenue potential. Low tax rates and poor collection systems indicate low fiscal effort.

Administering the collection of revenues in the provinces poses particular problems. Unlike at the national level, where the SARS is the central collection agent, revenue collection in the provinces is extremely decentralised. Each department has its own collection and administration procedures. As a result, the administrative capacities for revenue collection vary not only across provinces, but also across departments within provinces. This makes such capacities difficult to assess and complicates the coordinating role of provincial treasuries.

Figure 4.2 Provincial own revenue as percentage of total provincial revenues, 2000/01



Other revenue

The residual category of "all other" represents 28 per cent of all provincial own revenues in 2000/01. Most of these revenues are payments by provincial employees in terms of various regulations. These payments include repayments of bursaries, payments for board and lodging, and rental and utility costs for employees living in housing owned by the province. Traditional permit charges and user fees constitute only a small proportion of total provincial revenues.

Within the "all other" category, a province's receipts tend to rise and fall over time, implying that many may be one-off payments. Given their irregular nature, these revenues are difficult to project and complicate budgeting and planning.

Road Traffic Act fees

Trends in road traffic fees

The Constitution assigns provinces exclusive responsibility for provincial roads and traffic, and concurrent national and provincial responsibility for public transport, traffic registration and vehicle licensing. Motor vehicle registration and licensing, roadworthy testing, the issuing of learner's and driver's licences, and other traffic-related activities are done in terms of the Road Traffic Act of 1989 and associated regulations. Provinces have the authority to set fees and appoint registering agents to undertake specific functions on their behalf, in return for commission.

Table 4.3 shows road traffic fees from 1996/7 and medium-term projections. The aggregate revenues have grown from R1 124 million in 1996/97 to R1 503 million in 1999/00, and are projected to reach about R1 996 million by 2002/03. On average, revenues from traffic fees have grown by 6,1 and 5,4 per cent from 1996/97 to 1997/98 and 1997/98 to 1998/99, respectively. Average growth peaked from 1998/99 to 1999/00 at 19,6 per cent and is projected to moderate somewhat over the medium term.

Individual provincial growth rates show marked variations from year to year. For instance, Eastern Cape saw negative growth between 1996/7 and 1998/99, and a positive 9,4 per cent growth from 1998/99 to 1999/00, and is projecting 33,3 per cent growth in 2000/01. Free State projects a 72,3 per cent growth rate in 2000/01 and only 1 per cent a year for the following two years. KwaZulu-Natal projects a 25 per cent decline in 2000/01, followed by a recovery to 44,1 per cent in 2001/02.

The volatility of growth rates in road traffic revenues could be partly explained by either a revision of fee schedules by a province in a particular year, or inconsistent payments by a collecting agent.

Western Cape projects a relatively higher share of road traffic revenues as a percentage of total own revenue, from about 41 per cent in 1999/00 to about 65 per cent over the MTEF period. Northern Province's average of about 14 per cent is the lowest share of total own revenue.

Categories of Road Traffic Act fees

Table 4.4 details the road traffic revenues collected between 1 April 1999 and 31 March 2000. The fees can be divided into four categories: motor vehicle licences, which include both vehicles and trailers; operator licences, which include both driver's licences and learner's permits; roadworthy testing; and motor vehicle registration. Motor vehicle licensing fees generate at least 80 per cent of the total road traffic revenues, except in Northern Province (71,6 per cent).

Operator licences generate another 12 per cent of revenue, with an exceptionally large proportion of about 25 per cent in Northern Province. Vehicle registration, roadworthy applications, certificates and other fees make up the remainder.

Table 4.3 Revenue collected in terms of the Road Traffic Act

	Actual			Estimated actual	Medium-term estimate		
R million	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03
Eastern Cape	62	57	53	58	77	81	87
Free State	77	79	87	98	169	171	173
Gauteng	379	388	413	524	548	609	670
KwaZulu-Natal	205	247	275	305	228	329	344
Mpumalanga	62	74	55	65	70	74	79
Northern Cape	30	28	26	36	44	45	45
Northern Province	46	35	40	39	43	46	50
North West	62	59	55	79	121	140	140
Western Cape	202	226	251	299	331	375	409
Total	**1 124**	**1 193**	**1 257**	**1 503**	**1 632**	**1 870**	**1 996**
Percentage growth							
Eastern Cape		(7,7)	(6,8)	9,4	33,3	5,0	7,0
Free State		2,4	11,1	12,4	72,3	1,0	1,0
Gauteng		2,5	6,4	26,7	4,6	11,1	10,0
KwaZulu-Natal		20,6	11,3	10,9	(25,1)	44,1	4,6
Mpumalanga		19,1	(24,7)	16,6	8,2	6,0	6,0
Northern Cape		(7,9)	(7,7)	40,8	21,5	1,5	0,0
Northern Province		(23,5)	14,4	(1,0)	8,0	8,0	8,0
North West		(4,3)	(6,7)	42,4	53,4	15,5	0,0
Western Cape		12,4	11,0	18,9	10,8	13,1	9,3
Total		**6,1**	**5,4**	**19,6**	**8,6**	**14,5**	**6,8**
Percentage of total own revenue							
Eastern Cape	28,12	25,5	12,6	17,7	40,5	38,3	37,2
Free State	27,29	30,0	34,8	37,5	50,1	49,7	49,4
Gauteng	39,19	43,1	44,5	50,1	51,7	52,3	53,7
KwaZulu-Natal	24,73	38,5	63,5	49,7	43,0	55,8	53,1
Mpumalanga	28,64	28,6	28,6	17,8	36,2	35,3	34,9
Northern Cape	31,64	27,4	32,9	46,3	49,8	47,4	45,2
Northern Province	9,08	17,2	13,5	17,5	12,5	14,2	14,2
North West	14,77	19,6	17,8	24,1	31,7	35,4	34,4
Western Cape	36,06	40,1	47,7	40,8	64,2	65,3	66,5
Total	**27,48**	**34,5**	**36,5**	**37,8**	**44,8**	**47,9**	**47,8**

Source: Financial Management System and White Books

Motor vehicle licence fees

Higher fees for bigger vehicles

Motorists are required to pay vehicle licence fees on an annual basis, based on the weight of their vehicle. The principle behind setting higher rates for bigger vehicles weights is that road damage and, therefore, maintenance costs are directly related to vehicle weight. Fees rise in line with vehicle weight but increase significantly, by more than 50 per cent, at the 5 000 kg mark.

Because of the large number of fee categories, Table 4.5 below shows the different fees charged by each province as of 1 April 2000 for well-known vehicles, including cars, trucks, trailers and buses.

Discrepancies in fee structures

Motor vehicle licence fees for a Citi Golf, for example, vary from a low of R79 in Northern Province, to a high of R147 in Western Cape.

Generally, Northern Province charges less than all other provinces, except for passenger bus fees, where Eastern Cape and Mpumalanga charge significantly less.

Table 4.4 Fees collected in terms of the Road Traffic Act, 1999/00

R million	EC	FS	GP	KZN	MP	NC	NP	NW	WC	Total
Motor vehicle licences	84,1	83,8	513,8	276,6	92,0	42,7	51,5	85,7	289,1	1 519,5
Operator licences	15,4	13,4	68,9	42,0	16,8	4,9	17,8	14,7	34,6	228,4
Roadworthy	0,5	2,2	5,3	0,1	2,7	1,3	0,8	1,6	5,3	19,7
Vehicle registration	2,6	2,2	33,8	8,0	2,6	0,9	1,1	3,5	11,3	66,1
Other	1,4	1,4	11,5	7,8	1,3	0,3	0,6	1,3	3,7	29,3
Total	**104,0**	**103,0**	**633,2**	**334,5**	**115,3**	**50,2**	**71,9**	**106,8**	**344,0**	**1 863,0**
Percentage shares										
Motor vehicle licences	80,9	81,4	81,1	82,7	79,8	85,1	71,6	80,3	84,0	81,6
Operator licences	14,8	13,0	10,9	12,6	14,5	9,8	24,8	13,7	10,1	12,3
Roadworthy	0,4	2,2	0,8	0,0	2,3	2,6	1,2	1,5	1,5	1,1
Vehicle registration	2,5	2,1	5,3	2,4	2,3	1,9	1,6	3,3	3,3	3,5
Other	1,3	1,3	1,8	2,3	1,1	0,7	0,8	1,2	1,1	1,6
Total	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**

Source: National Traffic Information System

Note: The totals in Tables 4.3 and 4.4 for 1999/00 differ as they are based on different sources. Generally, Financial Management System amounts are lower than NaTIS amounts due to timing and deduction of commissions.

Table 4.5 Comparison of motor vehicle licence fees, 1 April 2000

Rand	Tare (kg)	EC	FS	GP	KZN	MP	NC	NP	NW	WC
Cars										
Citi Golf	844	96	122	108	144	96	117	79	108	147
Mercedes Benz C230	1 410	153	168	168	210	144	186	119	168	234
BMW 735/A	1 860	204	207	234	297	204	249	172	234	312
Trucks										
Nissan (1 tonne)	1 239	123	140	120	162	108	147	92	120	183
Toyota Dyna (5 tonne)	2 260	318	309	348	426	300	381	251	348	474
Toyota Dyna (10 tonne)	4 460	795	768	876	1 065	756	951	634	876	1 191
Peterbuilt (cab only)	8 340	3 516	4 005	3 900	4 692	3 372	4 233	2 805	3 900	5 274
Trailers										
Venter	200	45	59	54	75	48	54	40	54	69
Afrit (10 tonne)	3 300	882	1 287	960	1 182	504	1 062	704	960	1 326
Afrit (20 tonne)	6 610	2 400	2 730	2 640	3 210	2 244	2 889	1 916	2 640	3 588
Multi-passenger										
Toyota Hiace (combi)	1 560	183	189	204	252	180	219	145	204	270
Passenger bus	10 252	5 208	5 970	5 776	6 951	4 992	6 270	5 766	5 766	7 788
Double-decker bus	16 960	12 760	26 829	14 130	17 052	12 228	16 077	10 162	14 130	19 083

Source: National Traffic Information System

Regular revisions of fees

Most provinces revise motor vehicle licence fees regularly, although there are some notable exceptions. For instance, Northern Province has not increased motor vehicle licence fees since December 1992. North West increased its fees as of 1 May 1999 for the first time since

1992. Eastern Cape increased its fees in 1998 for the first time in four years, and revised them again in May 2000. Mpumalanga last revised its fees in April 1998, whereas Free State revised the fees in both May 1998 and March 2000.

Western Cape and KwaZulu-Natal updated their fees annually between 1994 and 2000, and Gauteng and Northern Cape revised their fees four times in the same period. Other categories of fees have also been revised, with a high degree of variation across provinces in terms of both frequency and level.

Vehicles concentrated in urban areas

Table 4.6 shows the number of vehicles in each province and the provincial distribution of vehicles, population and fee income. Vehicle numbers across provinces reflect the level of economic activity per province rather than population distribution. The wealthier and more urban provinces of Gauteng and Western Cape have higher per capita vehicle ownership than the other provinces. For instance, Gauteng has 37,1 per cent of all vehicles and only 18,1 per cent of the population. The poorer, rural provinces have much lower levels of vehicle ownership. Eastern Cape has only 6,8 per cent of the nation's vehicles but 15,5 per cent of the total population.

Table 4.6 Motor vehicle numbers, 1 April 2000

Thousands	EC	FS	GP	KZN	MP	NC	NP	NW	WC	Total
Light	395	350	2 205	808	323	304	126	231	1 008	5 751
Heavy	33	34	163	86	38	37	11	30	60	490
Other	29	70	131	63	48	43	14	22	77	496
Total	**457**	**453**	**2 499**	**956**	**408**	**384**	**151**	**282**	**1 146**	**6 737**
Percentage of provincial total										
Light	86,4	77,2	88,2	84,5	79,1	79,2	83,5	81,8	88,0	85,4
Heavy	7,1	7,4	6,5	9,0	9,2	9,5	7,4	10,6	5,3	7,3
Other	6,4	15,4	5,2	6,5	11,7	11,3	9,2	7,6	6,8	7,4
Total	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**
Percentage of vehicle total										
Light	5,9	5,2	32,7	12,0	4,8	4,5	1,9	3,4	15,0	85,4
Heavy	0,5	0,5	2,4	1,3	0,6	0,5	0,2	0,4	0,9	7,3
Other	0,4	1,0	1,9	0,9	0,7	0,6	0,2	0,3	1,2	7,4
Total	**6,8**	**6,7**	**37,1**	**14,2**	**6,1**	**5,7**	**2,2**	**4,2**	**17,0**	**100,0**
Addendum (percentage shares)										
Population	15,5	6,5	18,1	20,7	6,9	2,1	12,1	8,3	9,7	100,0
Road traffic revenue	5,6	5,5	34,0	18,0	6,2	2,7	3,9	5,7	18,5	100,0

Source: National Traffic Information System

National Traffic Information System

The National Traffic Information Service (NaTIS) is a computer system currently used in the implementation of the Road Traffic Act. As a uniform road traffic monitoring system across all nine provinces, it facilitates information coordination and accessibility. Its data bank contains details of each transaction, per local authority, and can issue receipts and generate statements of funds collected. The system was first implemented in the four former provinces between 1991 and

1993; the new provinces have formed the basis of the system since 1994.

A uniform monitoring system

Since all fees charged under the Road Traffic Act are processed through NaTIS, a system terminal is required for completing any transaction involving vehicle licensing and registration, operator licences or roadworthy testing. Adequately trained personnel are therefore needed to manage the system effectively. The amount of the fee charged is inputted centrally, reflecting the most recent level gazetted by a province.

NaTIS can list the vehicle licences that are coming up for renewal. Using this information, most provinces send out renewal notices to motorists. The system can also identify non-complying motorists and calculate the outstanding revenues, including penalties.

Nonetheless, on average about 8 per cent of total road traffic revenue is made up of penalties and arrears payments. A penalty fee is charged if renewal of a licence is made after the 23rd of the month following the expiry date. An arrears fee is also imposed for all renewals made in the following month or thereafter.

Appointment of local authorities and agents

All provinces, except Free State, appointed agents to administer licensing and related activities covered by the Road Traffic Act. Provinces generally use their respective local authorities for these tasks, but some also employ magistrates' offices, Home Affairs offices, post offices and private agents. KwaZulu-Natal, in particular, uses post offices in addition to its local authorities, thereby creating some competition in the appointment of agents. Free State is the only province to have developed its own internal infrastructure. In total, there are over 400 registering authorities across the country.

Provinces that use agents pay commission for their services, often as a percentage of the fees collected. However, the commissions paid by the provinces are not strictly comparable, as some provinces also provide support such as covering equipment and training costs. Other provinces use receipts from commission as general operating subsidies to the local authorities for activities not directly related to road traffic function. In general, the commission structures tend to reflect historical relationships between the provinces and their local authorities, and are frequently not accompanied by formal contracts.

The information contained in NaTIS reflects the total amount of fees collected, but not the various mechanisms employed in paying the commission. For instance, some collecting agents deduct their commission from the collected fees, whereas other provinces pay commissions separately. There have been reports of tensions in these principal-agent relationships, arising mainly from delayed payments of either the collected fees to the principal or of the commissions to the agent.

Changing structure of road traffic management

Road traffic law enforcement contributes to provincial traffic revenues through the fines imposed on traffic law offenders. Over time, underprovision for this function has resulted in generally poor infrastructure for law enforcement. Even where infrastructure has been addressed, follow-up on the imposed fines has been poor. This has been further complicated by delays in the adjudication of traffic offences cases through the judicial system.

New reforms to traffic law enforcement come into effect with the establishment of the Road Traffic Infringement Agency and the Road Traffic Management Corporation as complementary institutions. While these reforms will increase revenues from traffic fines, their ultimate objective is to improve road traffic safety by positively influencing driver behaviour.

Road Traffic Management Corporation

The Road Traffic Management Corporation Act of 1999 establishes the Road Traffic Management Corporation (RTMC), which will enter into a variety of contractual relationships with provinces, local authorities, other government departments and the private sector. These contractual relationships will determine the details not only of performance criteria for carrying out road traffic functions, but also of the exact nature of the financial flows.

Taxes and transaction fees

The Act distinguishes two types of fees:

- Motor licence fees, which it views as taxes
- All other fees, such as for motor vehicle registration and operator permits, which it views as transaction fees; these are flat fees intended to cover the cost of providing the service, such as issuing a particular licence or permit.

In terms of the Act, the RTMC will not interfere with motor vehicle licence fees, which represent over 80 per cent of road traffic revenues, but will only regulate the transaction fees.

The philosophy guiding the financing of road traffic management is that users should pay the full cost of traffic-related transactions, and that individual road traffic activities should be self-funding, based on the fees collected. A 1998 study revealed considerable cross-subsidisation between different road traffic functions. In particular, motor vehicle registration and licensing were used to subsidise motor vehicle testing and the issuing of driver's and learner's licences.

The RTMC's support will help improve management by setting and maintaining standards and policies to encourage more entrepreneurial practices, and by enforcing these through performance contracts. The Act further provides for the RTMC to take over these functions in cases of underperformance. The RTMC will also facilitate the harmonisation of fee structures across provinces. The support functions, in terms of both its personnel and in providing equipment upgrades are to be funded by a share of the transaction fees charged by the service providers.

Road Traffic Infringement Agency

The Administrative Adjudication of Road Traffic Offences Act of 1999 provides for the establishment of the Road Traffic Infringement Agency to address delays in the judicial system in adjudicating road traffic offences. The legislation effectively takes away this function from the courts and provides for a simple administrative adjudication process through the Agency.

Any cases where a fine has not been paid within a specified period will be referred to the Agency. The Agency will then impose a surcharge on the original fine and take up the responsibility of collecting the outstanding fees. Upon payment of these fees, the Agency will retain the surcharge and pay the basic fine to the originating authority – a province or municipality. This system should gradually reduce the amount of unpaid fines from the current level of about 70 per cent. It is also envisaged that the Agency's surcharge will serve as a deterrent to offenders.

Hospital patient fees

Trends in health revenue

Hospital fees are generated mainly from the sales of services to private patients in a competitive market, and thus differ from compulsory fees such as for motor vehicle licences. The sources of these user fees include the medical schemes; the Workmen's Compensation Fund; the Motor Vehicle Accident Fund; and fees for services to other government departments such as the police and justice departments, for example, for forensic services and psychiatric analyses in court cases.

Apart from hospital revenue, other health-related sources of revenue include board and lodging, parking fees, charges for hospital meals provided to non-patients, fees charged to doctors using state facilities for private patients, and revenue received from universities for sharing hospital facilities and staff in the training of medical students. These items are not addressed in this section.

Persistent decline in health revenue collections

Table 4.7 shows a persistent decline in health revenue collections between 1996/97 and 1999/00. Over this period, hospital patient fees decreased at an average annual rate of 8,6 per cent, from R416 million to R325 million. Given the generally high health inflation index, this represents a significant decline in revenue collection in the sector in real terms. Between 1998/99 and 1999/00, actual revenue collection from patient fees dropped by 6,1 per cent. The decline is most pronounced in Free State, where revenue fell by 21,5 per cent.

The main reason for the decline in hospital revenue is reduction in the number of paying patients using public sector facilities. In some facilities, medical scheme members contributed as much as 75 per cent of total revenue. The loss of these patients to the private sector has reduced the capacity for revenue by at public hospitals.

In addition, some revenue was lost when user fees were eliminated at primary health care clinics in 1996. Hospital fees were also eliminated for services to pregnant women and to children under the age of six. The revenue losses resulting from these policy choices have not been quantified, but officials maintain that the policy has also created an expectation among other patients that they are entitled to free services, even at hospitals.

Table 4.7 Hospital patient fees

	Actual			Estimated actual	Medium-term estimate		
R million	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03
Eastern Cape	41	19	24	23	34	37	41
Free State	49	43	39	31	47	52	57
Gauteng	96	84	76	71	75	80	82
KwaZulu-Natal	82	80	84	80	92	106	111
Mpumalanga	17	21	15	18	32	34	36
Northern Cape	7	5	5	6	12	12	12
Northern Province	21	23	23	22	24	26	28
North West	15	10	13	13	15	15	15
Western Cape	89	75	66	62	65	69	73
Total	**416**	**362**	**346**	**325**	**395**	**430**	**454**
Percentage growth							
Eastern Cape		(53,0)	23,0	(2,7)	45,0	10,0	10,0
Free State		(11,0)	(9,7)	(21,5)	53,1	10,0	10,0
Gauteng		(12,4)	(9,8)	(6,1)	5,7	6,7	2,5
KwaZulu-Natal		(2,5)	5,6	(5,0)	14,7	15,4	4,9
Mpumalanga		19,1	(24,7)	16,6	76,6	6,0	6,0
Northern Cape		(18,6)	(8,1)	13,4	106,9	1,5	0,0
Northern Province		13,8	0,3	(8,2)	9,7	8,0	8,0
North West		(30,9)	25,0	(0,6)	15,8	0,0	0,0
Western Cape		(15,5)	(12,2)	(6,7)	4,7	6,3	5,9
Total		**(13,1)**	**(4,3)**	**(6,1)**	**21,4**	**8,9**	**5,6**
Percentage of total own revenue							
Eastern Cape	18,9	8,7	5,7	6,8	17,7	17,5	17,5
Free State	17,3	16,5	15,6	11,7	13,9	15,0	16,2
Gauteng	9,9	9,3	8,1	6,8	7,1	6,9	6,6
KwaZulu-Natal	9,9	12,5	19,5	13,1	17,3	18,0	17,2
Mpumalanga	8,0	8,0	8,0	5,0	16,5	16,1	15,9
Northern Cape	7,0	5,4	6,4	7,3	13,3	12,7	12,0
Northern Province	4,1	11,6	8,0	9,5	7,0	7,9	7,9
North West	3,6	3,4	4,2	4,0	3,9	3,8	3,7
Western Cape	15,9	13,3	12,5	8,4	12,5	12,0	11,8
Total	**10,2**	**10,5**	**10,1**	**8,1**	**10,8**	**11,0**	**10,9**

Hospital patient fees set to improve

Although Table 4.7 shows a downward trend in hospital fees, provincial MTEF budgets project a turnaround in hospital revenue collections. Hospital fees are budgeted to rise by 21,4 per cent between 1999/00 and 2000/01, from R325 million to R395 million, and should grow by some 12 per cent a year over the medium term.

This projected improvement is partly linked to provinces renewed efforts to bolster revenue collection in the health sector, by reviewing the incentive system and allowing some hospitals to retain collected revenue. Nevertheless, given historical trends, the budgeted revenue collections may be somewhat optimistic. Sustainable improvements in revenue collection may require significant initial expenditure outlays to enable public hospitals to compete with the private sector and attract more paying patients. Although provincial budgets are showing an upward trend in health expenditure, this may not necessarily lead to notable increases in the number of paying patients in the short term.

In line with the overall revenue performance in the health sector, the rate of cost recovery in the public sector has declined considerably over the last seven years, from reported historical levels of 9,2 per cent in 1992/93 to 3 per cent in 1999/00. Current initiatives to improve the administration and collection of revenues are aimed, in part, at reversing this trend.

Incentives for hospitals to recover costs

Clearly, hospitals cannot be expected to recover all their costs, especially given their public nature and substantial state funding. However, the health departments argue that they can improve cost recovery levels with the correct incentives. They claim that their inability to retain revenues generated in the sector is a disincentive to efficient revenue collection. As public hospitals cannot retain revenue, they have no incentive to improve billing systems or pursue bad debts.

While this may be true, there are weaknesses in the systems and administrative aspects of hospital revenue collection. For example, most health departments acknowledge that their billing systems are outdated and need to be redesigned, and they lack appropriate information technology systems to support their revenue collection efforts.

Billing systems

Hospital billing systems range from itemised bills to standard amounts for the type of service rendered, depending on the quality of the information systems. Generally, outpatients pay a standard rate on the same day according to their category, while in-patients have their bills posted to them or to their medical aid schemes. Some provinces still use manual systems, while the rest are at different levels of computerisation. For instance, KwaZulu-Natal is installing a new system, Meditech, while Western Cape is installing the Hospital Information System to implement direct billing to medical schemes.

Shortcomings of the billing system

The billing system relies on the initial patient interviews, which include questions such as address and income level. However, hospitals have no mechanism for verifying the answers. When patients are admitted, their diagnosis and treatment are recorded in the patient files, which are forwarded to the billing section on discharge. Depending on the accuracy of the information, bills are subsequently sent to the patients.

The inefficiencies in the system include incomplete itemisation of services, inaccurate or incomplete patient details and late rendering of accounts. In many cases, the bills arrive only months later and some provinces do not even follow up on unpaid bills. In Western Cape, a private firm is following up unpaid bills at a commission of 25 per cent. KwaZulu-Natal has an agreement with the state attorneys to institute legal action against defaulters.

Tariff structures

The national tariff structure for health departments classifies patients according to their income level and access to medical aid. For those without medical aid, there are four categories, with the highest category paying the same fees as do people with medical aid. The definition of high income varies across provinces, ranging from above R35 000 in Eastern Cape to above R59 000 in Western Cape.

Higher-income and private patients are charged the rates determined by the Representative Association of Medical Schemes (RAMS); these reflect the cost of services. Lower-income patients without medical aid pay a monthly rate based on their ability to pay.

Revision of fees

Fees should be amended annually, although this has not happened in all provinces. For example, KwaZulu-Natal amended its fees in May 2000 (after they were last amended in August 1997), while Mpumalanga and Eastern Cape have not adjusted theirs since 1994. The Western Cape Department of Health amended its schedule in December 1999. The Provincial Health Restructuring Committee has proposed a uniform fee structure, but this has not yet been implemented.

Because of the different fee levels and definitions of patient categories, patients pay different amounts for the same service, depending on where they receive the service. The income categories are as significant a factor as the fee level. For instance, Eastern Cape fees are lower across all income categories than are Western Cape fees. However, patients with an income of R35 200 will pay more in Eastern Cape because they will be in the high-income category and will be charged the same daily rate as patients with medical aid. In Western Cape, such patients will be in the lower-income category, paying a substantially lower monthly rate.

Reforms to improve collections

In the past, some provinces have attempted to link revenue to budgeted expenditure by setting annual revenue targets for their health departments. Unfortunately, these targets tended to be too high, thus acting as further disincentives for the departments, which had no hope of achieving them. Table 4.9 below indicates the difference between targets and actual revenue. Although the provincial treasuries adjusted future years' budgets downward, the health departments continued to perform below target. Even in those provinces where treasuries did not give explicit revenue targets, revenue fell short of expectations. In fact, with few exceptions, provincial health departments have fallen short of the budgeted level of revenues over the past four years, by as much as 35–50 per cent a year.

Table 4.9 Hospital patient fees, budget vs. actual

	1996/97		1997/98		1998/99		1999/00	
R million	**Budget**	**Actual**	**Budget**	**Actual**	**Budget**	**Actual**	**Budget**	**Actual**
Eastern Cape	n/a	41	n/a	19	n/a	24	n/a	23
Free State	51,4	49	51,4	43	49,0	39	48,0	31
Gauteng	144,0	96	98,0	84	112,0	76	84,0	71
KwaZulu-Natal	75,5	82	80,9	80	95,1	84	85,7	80
Mpumalanga	10,0	17	30,0	21	21,8	15	30,0	18
Northern Cape	20,1	7	8,9	5	9,8	5	10,8	6
Northern Province	13,0	21	147,3	23	66,6	23	73,9	22
North West	42,0	15	16,0	10	14,1	13	14,1	13
Western Cape	102,3	89	82,4	75	77,5	66	88,9	62
Total (excl. EC)	**458,3**	**416**	**514,9**	**362**	**445,9**	**346**	**435,3**	**325**

n/a = not available

New incentive systems

Recognising the problems around the incentives for hospital revenue collection, the Gauteng and Western Cape Treasuries agreed with their health counterparts to implement a revenue retention scheme. In Western Cape, revenue targets were set for the medium-term budgets, 1999/00 to 2001/02, based on amounts generated in previous years. Half of any revenue above these targets is to be appropriated back to the health department in the adjustments estimate, as long as the department stays within budget. It remains to be seen whether these targets will be achieved, given that the department is budgeting for an 18 per cent increase in revenue in 1999/00, followed by further increases of 5,5 and 9 per cent in the two subsequent years (see Table 3.1).

In Gauteng, a similar agreement was reached with the Treasury, except that all the excess revenue will be appropriated back to the health department in the adjustments estimate. As part of the agreement, performance agreements were developed on the basis of past performance. The agreement may be optimistic, given that the department's revenue declined by 10,5 per cent in 1998/99, while the new target requires growth of 8,6 per cent in 1999/00, 1,2 per cent the next year and a further 9,4 per cent in the final year.

One concern is that the targets are set for the health departments as a whole, and these departments are to set targets for individual hospitals. They must then decide how these additional funds are to be apportioned between the hospitals. Although it is clearly appropriate for the departments to set hospital targets, such targets could weaken the incentives should departments use equity or other considerations in allocating funds rather than simply returning the funds to the hospital where they were generated. A hospital that does not receive the full revenue it generates may reduce its effort in future years.

Other options

Clearly, the health departments have different options for increasing their revenue generation. These include improving billing systems, actively pursuing unpaid bills, amending the fee structures for private patients to reflect costs, and reaching preferred provider agreements with medical aid schemes.

The more difficult option of attracting private patients back to the public hospitals requires a longer-term initiative. This will necessitate capital investments to address quality of care issues, such as old equipment and the aesthetic "hotel" (accommodation) aspects of the services. In addition, health departments face the political challenge of ensuring that this policy does not create an impression of different classes of health care in public facilities.

Gambling, gaming and betting

Regulatory framework

Until the new democratic dispensation, gambling had been illegal in South Africa except for the former homelands. Casinos and gambling establishments in these areas were, and still are, a significant source of own revenue for provinces that incorporated homelands. Unlike gambling, horse racing was generally permitted before the 1994 elections. Horse racing is important in only three provinces: Western Cape, Gauteng and KwaZulu-Natal, which have most of the necessary infrastructure. Other provinces also levy taxes on the industry, but to a smaller extent.

Much of the recent legislation at national and provincial level focused on gambling rather than on racing and betting. The National Gambling Act of 1996 allows national legislation to promote national norms and standards, while empowering provincial legislatures to pass regulations or laws on provincial gambling. The Act provides for the regulation and coordination of matters relating to casinos, gambling and betting. It aims at preventing provincial laws from prejudicing the economic interests of other provinces or the nation, and at promoting uniformity. It does not apply to lawful lotteries or sports pools, as these are exclusive national competencies.

National Gambling Board

The Act establishes a National Gambling Board with strong powers, but these powers have yet to be exercised fully. Although the Act was promulgated in 1996, the Gambling Board was only established two years later, by which time all provincial gambling legislation had been passed. Thus the Board could neither monitor nor promote uniformity in provincial legislation. The Board is reviewing all gambling legislation to identify discrepancies and contradictions, particularly with national legislation. Regulations will promote greater uniformity and will supersede provincial legislation. An area of particular concern is the levying and management of taxes and licence fees. The National Board and provinces are at odds about the expansion of some gambling activities, particularly about allowing gambling machines outside of casinos.

Sources of revenue

Table 4.10 presents actual and projected provincial gambling revenues, which include revenues from horse racing. Gambling contributed R577 million or 14,4 per cent of provincial own revenues in 1999/00. A growth of 42,9 per cent in gambling revenue was achieved despite sharp declines in collections in Eastern Cape, North West and Northern Province due to the closure of casinos in these provinces in May.

At R468 million, budgeted collections in 2000/01 are 18,8 per cent lower than actual collections in 1999/00. The projected decline is partly explained by the fact that Western Cape received significant one-off amounts of around R130 million in 1999/00, which were amounts outstanding from previous years.

Horse racing and casinos

Gauteng's substantial revenues before 1998/99 were entirely from horse racing. Casino-related revenues began flowing in from November 1998, and accounted for nearly a quarter of 1998/99 gambling revenues. With the introduction of casino levies, Gauteng reduced rates on racing to address the excessively high tariffs of the past. Casino revenues are likely to form a growing share of total gambling revenues over the medium term.

In Western Cape, several delays have meant that no casinos are operating yet. The increase in revenues in recent years is attributable to new applications for horse racing. The province imposes "nominal" licence fees for racing in particular, as the industry is already heavily taxed. However, its projected gambling revenue is below historical levels over the MTEF period. In Northern Cape, revenues before 1999/00 were from horse racing, but gambling is expected to boost revenues over the next three years.

As Table 4.10 shows, the projected trends in revenue from gambling bear close relation to historical performance. This could be due to the fact that, with the introduction of new legislation and the highly contestable nature of the industry, it is hard to make realistic forecasts of its revenue generating potential.

Structure of gambling tariffs

Provinces have significant autonomy to establish schedules of fees and levies. However, the National Gambling Act provides for the National Gambling Board to develop appropriate guidelines or norms and standards. The type and amount of charges differ between provinces – many charges appear similar but differ in scale, calculation or definition.

All provinces levy annually renewable licence fees on casinos, limited gambling machine operators and bingo halls. Some provinces charge a flat rate while others combine base fees and additional charges per table, machine or employee. Most provinces impose a levy on gambling revenues, which is a set rate in some provinces and a progressive scale in others. Several have separate licences for other types of gambling operations, such as limited gambling premises and junket operators, while some require equipment manufacturers, suppliers and distributors to be licensed and taxed separately. The general characteristics are as follows:

- Casino operators are charged a basic licence fee, and certain provinces charge additional amounts for the number of gaming tables, machines and gambling-related employees. Casino licence fees range from a flat rate of R50 000 to R114 000 for the basic licence renewal. Additional amounts of about R1 000 are charged per table, machine or employee. Levies on casino gambling revenue range from 5–12 per cent and are levied on gross revenue, defined as income received less any initial "float" and pay-outs to customers. Both Western Cape and KwaZulu-Natal levy a sizeable exclusivity fee on the initial capital investment in a casino, while only KwaZulu-Natal and Northern Cape incorporate development levies.

- Gambling machine operators tend to have lower flat-rate licences but higher charges per machine and higher levies on income, ranging from 10–20 per cent. Separate licence fees and levies are charged for having a gambling site.

Table 4.10 Gambling revenues

	Actual			Estimated actual	Medium-term estimate		
R million	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03
Eastern Cape	21	5	56	42	26	35	44
Free State	15	12	11	15	19	21	23
Gauteng	146	191	206	272	270	290	300
KwaZulu-Natal	41	42	41	38	57	36	67
Mpumalanga	8	23	18	21	28	33	36
Northern Cape	1	2	1	2	17	18	19
Northern Province	8	7	7	5	7	7	8
North West	135	38	32	18	25	25	25
Western Cape	27	32	32	165	19	21	23
Total	**401**	**353**	**403**	**577**	**468**	**486**	**545**
Percentage growth							
Eastern Cape		(75,2)	997,3	(25,0)	(38,9)	37,6	25,5
Free State		(19,3)	(14,3)	36,9	30,1	10,0	10,0
Gauteng		31,2	7,7	32,0	(0,6)	7,4	3,4
KwaZulu-Natal		2,0	(1,2)	(8,5)	51,6	(37,3)	86,4
Mpumalanga		198,7	(24,7)	16,6	36,7	17,4	9,0
Northern Cape		275,3	(74,5)	244,7	805,4	3,2	5,6
Northern Province		(14,5)	4,3	(32,2)	30,5	7,5	8,0
North West		(72,1)	(14,8)	(42,8)	36,4	0,0	0,0
Western Cape		17,1	0,6	414,8	(88,4)	10,4	9,6
Total		**(12,1)**	**14,4**	**42,9**	**(18,8)**	**3,9**	**12,1**
Percentage of total own revenue							
Eastern Cape	9,4	2,3	13,3	12,2	13,5	16,7	19,0
Free State	5,5	4,7	4,2	5,6	5,6	6,1	6,6
Gauteng	15,1	21,2	22,1	26,0	25,5	24,9	24,0
KwaZulu-Natal	5,0	6,5	9,6	6,2	10,8	6,1	10,3
Mpumalanga	3,6	9,1	9,1	5,7	14,6	15,8	16,0
Northern Cape	0,6	2,1	0,7	2,4	19,6	19,0	19,1
Northern Province	1,7	3,5	2,5	2,2	1,9	2,2	2,2
North West	32,0	12,4	10,3	5,6	6,5	6,3	6,1
Western Cape	4,9	5,6	6,1	22,5	3,7	3,7	3,7
Total	**9,8**	**10,2**	**11,7**	**14,4**	**12,9**	**12,4**	**13,0**

- Bingo halls are charged per seat, and in some cases per employee. The revenue levies range from 2,5–15 per cent of income, net of amounts paid out to punters.
- Other fees include an investigation fee for conducting a probity check, fees for relocating the gambling operation, fees for permission to hold a financial interest in a specific operation and charges for any amendments to the initial licence.

Administrative issues

As mentioned, several provinces are establishing systems and procedures for levying, processing and monitoring gambling revenues. Not all licences have been awarded, but even where they have, some casinos are not yet operational.

Systems and procedures for monitoring, recording and collecting revenues differ among the provinces. Most provinces do not regard the fees levied by other provinces as binding, and set their own fees. In some provinces, the provincial gambling boards set fees and manage revenue collection, while in others the treasuries fulfil this role.

Provincial gambling boards set rates

The trend is towards a greater role for provincial gambling boards in setting rates and administering collections. The process of consultation and legislative approval of fee structures is not uniform, and the period for the review of rates varies from "periodically" to five years. A few provinces simply carried over tariffs from the previous administration.

In certain provinces, gambling boards maintain separate bank accounts through which all gambling revenues are channelled. In others, payments are directly to the provincial government, but the gambling boards remain accountable for revenues collected. In addition to the annual licence fee, some provinces receive gross revenue levies monthly, while others require gambling taxes to be paid weekly. These levies pose the biggest problem in terms of administration and tracking, given the systems and procedures needed to verify income. Audited statements are unavailable as levies are paid weekly or monthly, and provinces effectively have to rely on income as declared by the operator. Total payments can be verified at year-end when financial statements are available, but this requires systems for tracking and recording individual payments.

Tracking revenues

It is even more difficult to determine or verify revenues generated by gambling machines. The National Gambling Act requires operators to maintain a central machine monitoring system to identify revenues, but this has not been enforced at provincial level. Most provincial boards have yet to employ inspectors to check premises or verify information supplied by operators.

In most provinces, gambling revenues have yet to come on stream. Thus, there is still time to introduce norms and standards to improve consistency and accountability. Some have suggested that SARS may be a more efficient and effective collection agent for some gambling revenues, particularly the levies on income. SARS collects much of the data needed to assess these taxes, as they are applied to essentially the same base as value added tax. In some provinces, however, the gambling boards may be effective collection agents and may need SARS only to share information rather than to take over the collection function.

Potential for growth in own revenues

To reverse the recent downward trend in provincial revenue collection, two main areas have to be addressed – improving the administration of existing taxes and introducing new taxes.

Role of provincial treasuries

The provincial treasuries aim to play a stronger management and oversight role in the collection of provincial own revenues. To this end, most have created separate directorates dedicated to own revenues. Provincial departments will remain responsible for collecting their fees and levies, but treasuries will promote best practice and ensure that proper incentives are in place. Most provinces can considerably improve routine practices, such as updating tariffs on a regular basis and checking whether rates are comparable with those of other provinces. Appropriate intergovernmental forums, such as MinMECs, will also support these activities.

The policy environment is generally encouraging. For one, implementation of the RTMC will help bring efficiencies to road traffic management, including the collection of fees. As more gambling licences are issued and gambling establishments begin operation, gambling revenues should rise. Regulatory oversight by the National Gambling Board should assist in this regard.

Increasing collections from patient fees will be a challenge. The pilot projects in Gauteng and Western Cape indicate a willingness to try new approaches to improve the collection of hospital patient fees. Significant increases are, however, only likely in the long run, as it will take time for investments in infrastructure to attract more private patients into public facilities.

One source of provincial revenue that is unlikely to return to previous levels is interest receipts. While most provinces have significantly reduced or eliminated their bank overdrafts, they will probably be unable to accumulate balances of the level that prevailed in 1995/96. However, some growth is expected in this area.

Introduction of new provincial taxes

New taxes

In addition to improving the administration of existing taxes, introducing new provincial taxes also offers some scope for increasing provincial tax collection. To date, the Budget Council has not supported new provincial taxes; this has been consistent with broader policy objectives and the pending development of a regulatory framework. Such a framework has now been developed, but the Budget Council continues to emphasise the need first to improve the collection of existing revenues.

National regulation of provincial taxes

The Constitution prescribes national regulation of provincial taxes, although it authorises limited taxing powers for the provinces. In general, it bars the use of tax instruments that are best allocated to other levels of government, and defines the priority of national economic interests and the oversight role of the national government. Section 228 of the Constitution requires that the power of a provincial legislature to impose taxes, levies, duties and surcharges:

- May not be exercised in a way that materially and unreasonably prejudices national economic policies, economic activity across provincial boundaries, or the national mobility of goods, services, capital or labour
- Must be regulated in terms of an Act of Parliament, which may be enacted only after any recommendations of the Financial and Fiscal Commission have been considered

Thus, the national government must ensure the integrity of national economic policy. This includes maintaining the coherence of the national tax system, and regulating the procedures for implementing provincial taxes. To this end, the Budget Council has proposed an "allowed list" approach for provincial taxation legislation; Cabinet has approved this approach.

Regulatory legislation for provincial taxes

The proposed national legislation on provincial taxation defines the regulatory procedures, but does not identify specific provincial taxes. Under the procedures, a province controls both the initiation of a provincial tax proposal and its ultimate enactment by the provincial legislature. The national government has to review the provincial proposal and determine whether it will comply with section 228.

Any province wishing to impose a new provincial tax must make a submission to the Minister of Finance at least ten months before the start of the financial year. The Minister will review the request for compliance with section 228 and with national economic policy, and consult with the provinces and other interested parties, as appropriate. Should the Minister conclude that a proposal is consistent with section 228, he will introduce separate national legislation to provide for provincial implementation of the tax proposal. The national legislation will enable any province to enact the tax at any time. It will prescribe the "manner and form" in which the tax can be implemented, including the tax base, rate band and any other terms required.

This national legislation will, in essence, be a template for provincial legislation to ensure that the tax is implemented in a uniform and consistent manner across the provinces, thereby maintaining the coherence of the general tax system. Allowable provincial differences, such as in the rate or regarding exemptions, will explicitly be identified in the national legislation. The national legislation will also set out procedures for amending the particular provincial tax. The tax will become effective in a particular province only when imposed by provincial legislation, according to the terms prescribed by the national authorising legislation.

An allowed list of taxes

Over time, this national legislation will constitute a list of taxes that any province may impose. This body of provincial tax law (the so-called "allowed list") may, at the time of the national budget, be reviewed and renewed by the Minister of Finance, similar to the laws amending taxes at the national level.

National Treasury's review of provincial tax options

Taking into account previous studies on provincial revenue options undertaken by the Financial and Fiscal Commission and the Katz Commission, the national Treasury prepared its own review of possible options for the Budget Council. The review cites options such as selective sales or excise taxes on specific services or goods, and use and permission taxes. It suggests caution about selective taxes on goods at the provincial level, because the tax base is highly mobile and serious tax evasion problems exist at lower levels of government.

Other possible provincial taxes are:

- Environmental taxes
- Presumptive business taxes on small business activity that is probably not captured by national income taxes
- Betterment taxes, which are collected from a specific group of taxpayers for a specific infrastructure improvement project from which they will benefit
- Taxes as a consideration on the right to extract mineral or petroleum products

The study notes that, for many provinces, these tax options may have only limited applicability and are not likely to produce significant revenues.

While surcharges on national tax may yield more revenues, these options were found lacking for both policy and administrative reasons. This is particularly true for the personal income tax surcharge, where the study supports the Katz Commission's conclusion in advising against this surcharge option at this time. The Budget Council proposed and Cabinet adopted this position. While the surcharge on the fuel levy is somewhat less problematic and may become more attractive in future, it still poses certain problems and risks.

The regulatory procedures distinguish between taxes and user charges. These regulations do not apply to user charges, and provinces can initiate such fees without the concurrence of national government. Fees are an appropriate form of revenue for provinces, as they are charged only to individuals receiving a good or service. In general, user charges are an efficient way of recovering the cost of publicly provided goods and services, and provide incentives to improve the quality of service delivery. Fee receipts can relieve pressures on provincial budgets without compromising national economic policies. There is widespread agreement that user charges for provincial services can be expanded without undermining Government's equity goals.

Conclusion

This chapter shows that provincial own revenue collections have declined in recent years. While provincial own revenue comprises only a small percentage of total provincial revenues, the persistent downward trend in revenue collections has contributed to the budgetary constraint facing provinces. The decline in revenue collections can be attributed to weaknesses in provincial institutional and administrative systems of provinces.

Given the need to improve revenue collection in provinces, the chapter highlights various initiatives that are under way to reverse the current trend. The first set of initiatives seeks to improve the administration of current taxes, while the second is aimed at facilitating the expansion of the provincial tax base by giving effect to section 228 of the Constitution.

Efforts to improve provincial tax administration include dedicating capacity to provincial revenue issues within treasuries and reviewing incentive systems, where appropriate. Examples include the health sector and the review of the legal and institutional frameworks of road traffic fees and gambling.

Concerning the expansion of the provincial tax base, Cabinet has approved a framework for provincial taxes. The proposed regulatory legislation will allow provinces to pass provincial tax legislation.

The chapter suggests that significant improvements in provincial own revenue collections can only come through improvements in administration.

III. LOCAL GOVERNMENT

5

Local government overview

A major transformation

The 1998 White Paper on Local Government set the stage for a series of far-reaching changes to transform municipalities. This transformation is political, administrative and financial, and includes streamlining the delivery of services.

Institutionally, the character of municipalities is changing through the redemarcation of municipal boundaries, new structural forms introduced in the Municipal Structures Act and operational changes outlined in the Municipal Systems Act. The finances of local government are being reformed through the Municipal Finance Management Bill, municipal budget reforms, the introduction of generally accepted municipal accounting practice (GAMAP), and the Property Rates Bill.

The transition has not, however, always been smooth. Many municipalities still have financial problems – some due to inefficient service delivery and high levels of poverty among residents, others because of poor management and inadequate administrative and budget systems. Operating costs are often too high and wage bills vast. These trends necessitate faster reforms and transformation.

Because this *Review* is the first to scrutinise local government in some detail, this chapter provides basic information about the role and functions of local government in the intergovernmental system. It then reviews the major policy elements of Government's approach to local government finance and the implications of these elements for revenue, expenditure and borrowing matters. Finally, it deals with the major changes affecting transformation in the financial and fiscal environment.

The role of local government

The Constitution

Constitutionally, local government is a separate sphere of government. This is reflected overtly in different systems and procedures. For example, the procurement systems of municipalities are distinct from those of national and provincial government. Municipal officials are also not part of the national and provincial public service. The local government fiscal year begins on 1 July, unlike the national and provincial fiscal year, which begins on 1 April. (Note that this *Review* refers to a municipal fiscal year as, for example, 1998-99, while the corresponding national or provincial fiscal year will be 1998/99.)

More fundamentally, however, the powers, functions, revenue bases and expenditure assignments of local government are different. National and provincial government is expected to support the capacity of municipalities to exercise their powers and to perform the functions assigned to them. These powers and functions revolve around ensuring the delivery of affordable basic services and promoting economic and social development. The notion of developmental local government, as described in the White Paper on Local Government, builds on the constitutional mandate of local government. Section 152 of the Constitution empowers local government to:

- Provide democratic and accountable local government for local communities
- Ensure the sustainable provision of services to communities
- Promote social and economic development
- Promote a safe and healthy environment
- Encourage community involvement in local government matters

Functions and finances

The Constitution assigns powers to each sphere of government. The most important municipal services include the provision of water, sanitation (and sewage disposal systems), roads, storm water drainage, refuse removal (including solid waste removal) and electricity reticulation. In practice, different local governments, in different areas, have different responsibilities. In larger urban areas, municipalities often assume responsibility for a range of functions and services, while mainly rural local governments generally provide few services independently.

Revenue sources

The Constitution also assigns revenue sources to local government and designates municipal fiscal powers and functions. The main sources of revenue are rates on property and fees (or surcharges on fees) for services provided by or on behalf of the municipality. Although other sources may be assigned in national legislation, local government may not impose income tax, value-added tax, general sales tax or customs duties.

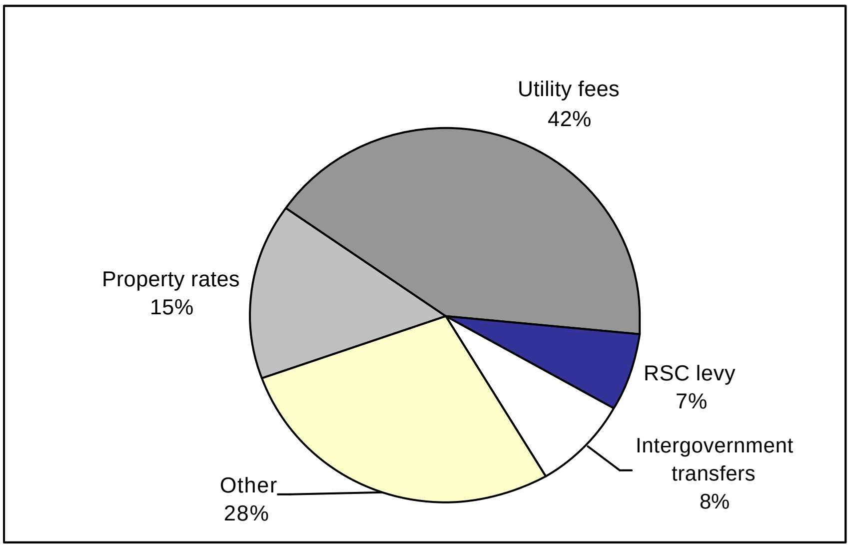
Fiscal powers

The fiscal powers of municipalities may vary considerably. The Local Government Transition Act authorises metropolitan and district councils to collect the regional services (RSC) and establishment levies (i.e. levies on payroll and turnover respectively). They may also levy tariffs on bulk services and claim agency fees from local councils for services provided on their behalf. The metropolitan councils may claim an equitable contribution from all metropolitan local councils and receive, allocate and distribute grants. These provisions do not hold for district councils but, like metropolitan municipalities, they are viewed as regional mechanisms for redistributing resources from affluent to disadvantaged areas.

Rural councils

Rural councils have little or no fiscal capacity, a limited economic base and, hence, a small tax base. The district council usually performs all the fiscal functions assigned to its rural municipalities. The demarcation process aims at amalgamating some rural and urban municipalities to promote effective service delivery in rural areas and effective planning between urban and rural areas. It also seeks to address the lack of fiscal capacity in rural councils.

Figure 5.1 Total local government revenues, 1998/99



Fiscal conditions of local government

A small but important share

Local government receives a relatively small share of revenue raised nationally. However, it represents a significant part of South Africa's public finances and has an important role in delivering basic services and socio-economic development.

Project Viability

The financial situation of most municipalities is weak and apparently deteriorating amid increasing demands for services and development. Project Viability statistics over the past two years confirm this. Coordinated by the Department of Provincial and Local Government, Project Viability has instituted a combination of strategic and operational measures aimed at restoring the financial health of municipalities. These include improved credit control, promotion of alternative service delivery mechanisms, performance management systems and performance contracts, organisational redesign, improved financial management and accounting, and promotion of local economic development.

Despite the significant financial challenges, some municipalities are stabilising their financial positions. The focus is on financial restructuring, improved financial management and better revenue collection, combined with management support programmes initiated by the national and provincial governments.

Policy framework

Basic tenets

The basic tenets of Government's policy framework for local government finances are:

- Local government is an independent and accountable sphere of government, with clear revenue and expenditure responsibilities. The role of national government in municipal finance is to provide an enabling regulatory environment within which municipalities can manage their financial affairs responsibly.
- As with national government, local governments must be fiscally disciplined in line with constitutional and legislative requirements. This means that budgeted and actual revenue and expenditure should match, and that operating revenue and expenditure should balance. Municipalities should therefore deliver services in line with their revenues.
- The Local Government White Paper points out that own revenue is the primary source of municipality income. Government is committed to this policy position. For one, local government in South Africa has relatively fewer responsibilities. In many other countries, municipalities are responsible for major social services such as health, education, welfare and security. In South Africa, most of these functions are the responsibility of national or provincial government, and there is less need for extensive transfers to municipalities. Furthermore, for municipalities to obtain more support from the national fiscus, other national budgetary priorities and allocations would have to be scaled down.
- Municipal access to capital markets must be increased. This will enhance their independence from other spheres of government, introduce discipline to their financial management, spread the burden of funding for capital investment equitably over generations, and promote efficient financing of infrastructure and allocation of capital.

Revenues

Local governments derive finance mainly from three sources: own revenue, intergovernmental flows and borrowing.

Own revenue

Municipal own revenue is obtained through property taxes, regional levies, service charges and fees. For local government as a whole, own revenue covers more than 90 per cent of operating income.

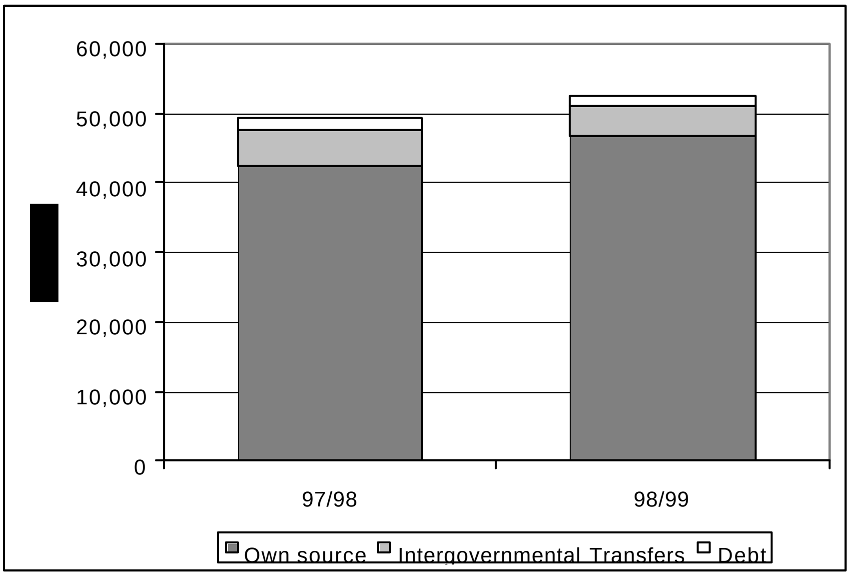
Property tax

A more coherent national approach to property tax is currently being developed. The proposed new system provides municipalities with a range of options for flexibly combining taxes on land and on improvements, according to their specific circumstances. It also entails more accessible assessment criteria and leads to a more transparent taxation processes.

RSC levies

The current RSC levies are also being reviewed. One possible development is to combine the current turnover tax on business with the levy on payrolls. The national Treasury is also exploring more effective means of collecting levies, including SARS assistance to local governments. After the demarcation, metros and district councils will be eligible for regional levy incomes, and this revenue should largely be directed at capital programmes in disadvantaged areas.

Figure 5.2 Local government projected revenues



Service charges

The national Treasury, the Department of Provincial and Local Government, and organised local government are assisting municipalities in improving revenue collection through service charges. Over the past three years, Project Viability attempted to improve information systems and help municipalities increase their revenue collection. Local government's inability to collect service charges results from the cost of basic services being out of reach of poor residents, inadequate revenue collection systems, or political and other factors that undermined the culture of payment. Despite the efforts of the Masakhane campaign and Project Viability, debt to municipalities remains significant. Municipalities must actively encourage payment for services and enforce appropriate credit control policies. Government assists them through policy interventions linked to transfers to affected municipalities, improved credit control systems, and affordable levels of service, appropriate to particular communities.

Intergovernmental flows

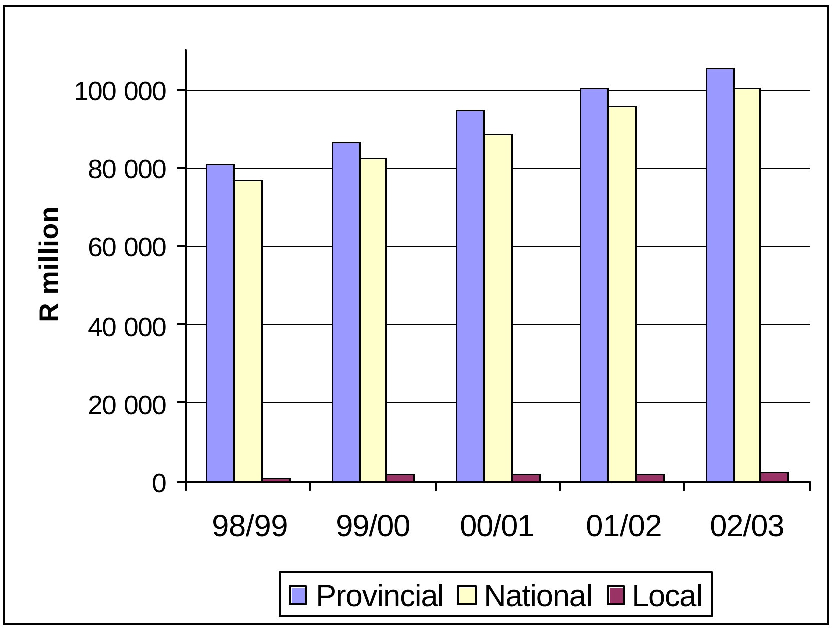
Intergovernmental transfers comprise equitable share allocations (to which local governments are entitled) and specifically targeted conditional grants and agency payments. These are discussed in some detail in Chapter 7, but a few observations are relevant here.

Equitable share

Given local government's own revenue sources, the equitable share allocation to this sphere is considerably smaller than that to provinces (see Figure 5.3). In 2000/01, the local government equitable share allocation, determined by Cabinet, will be R1 867 million, increasing to R1 997 million and to R2 130 million in the next two years.

Distributed horizontally by formula, it facilitates an equitable distribution of resources among local governments.

Figure 5.3 Equitable share allocation



Conditional grants and agency payments

The MTEF envisages that much of the conditional grants and agency payments from national departments to local governments will continue over the next three years.

Agency payments occur when local government is contracted to execute a function on behalf of national or provincial departments, such as the Community Water and Sanitation Supply Programme (CWSSP) and the CBPWP.

To align spending more closely with Government's strategic objectives, new conditional grants are being considered and some existing grants consolidated. The latest budget provides for increases of R150 million in 2000/01, R160 million in 2001/02 and R170 million in 2002/03 in the local government support grant. This will support a range of management support and capacity building initiatives administered by the Department of Provincial and Local Government.

Consolidated Municipal Infrastructure Programme

National government recognises that local governments cannot achieve major redistribution with their limited revenues. Hence, the largest municipal infrastructure grant, the CMIP, is a critical part of the redistribution funding that flows through local government.

New grants

The 2000 Budget provides for two new conditional grants. A restructuring grant will assist eligible municipalities whose financial difficulties are sizeable enough to threaten national economic development. The grant will be funded from the additional local government allocation in the 2000/01 budget framework. The total envelope for the restructuring grant is R300 million in 2000/01, R350 million in 2001/02 and R400 million in 2002/03.

The second new grant is for strategic management and capacity building. Initially, this programme will focus on building the financial management capacity of the metros and district councils, as well as implementing budget reforms. In the second stage, planning and performance management capabilities will strengthen the financial management capacity developed in stage one. The allocations are R50 million for 2000/01, R60 million for 2001/02 and R70 million for 2002/03.

Expenditure

Local government's expenditure obligations are determined by three documents that underpin the transformation of this sphere of government:

Constitutional powers

- The 1996 Constitution lists the powers and functions assigned to the local sphere in the context of its overall role in development and service delivery.

Legislative framework

- The Local Government Transition Act guides the application of these principles, dealing with various operational and financial aspects of municipal management.
- The 1998 Local Government White Paper sets the platform for the new dispensation. It sees municipalities as instruments of development, service delivery and democracy. The first two roles are particularly important from a fiscal perspective. The developmental role revolves around facilitating integrated development planning, service delivery and local economic development, ensuring participatory governance, and managing in terms of clearly specified performance indicators. The service delivery role is an extension of the developmental one. Local governments must provide services that are within their operational mandates, meet community needs, and are affordable and sustainable. Policy frameworks such as the Municipal Infrastructure Investment Programme help set service standards, allowing for differentiation in terms of what end-users can afford. The integrated development planning process ensures that local stakeholders systematically consider all the options in terms of appropriate budgeting.

A reform package introduced since the White Paper aims at continuing the transformation. The Municipal Structures Act and the Municipal Systems Act are key elements of this reform. The Structures Act designates three types of municipalities: metropolitan councils (category A), local councils (category B) and district councils (category C). Linked to the demarcation process, the Demarcation Board and provincial MECs have to consider the powers and functions, as well as the capacities, of category B and C municipalities.

National supervision and support

In the interests of macroeconomic stability and fiscal prudence, municipalities must keep their budgets within the guidelines set by the Minister of Finance. This approach will be embedded in the new Municipal Finance Management Bill, which has been released for discussion. Expecting municipalities to achieve balanced budgets, the Bill empowers the Minister to set a general expenditure limit. Exceptions can be made on special request from municipalities, if approved by the national Treasury. Excluding grant-funded capital expenditure and subsidies from other national and provincial government programmes, the 2000/01 limit was set at 5 per cent growth for both capital and operating expenditure. This limit reflects the need for further stabilisation of local government finances against the backdrop of systematic reform and capacity building in this sphere.

The medium-term aim is to ensure more realistic revenue and expenditure projections and to maintain fiscal discipline during the local government elections and amalgamation. On this basis, the MTEF provides for an allocation to local government of R6,7 billion in 2000/01, increasing to R7,7 billion in 2002/03.

Borrowing

Overall position

The White Paper on Local Government sets out Government's overall position on municipal borrowing as follows:

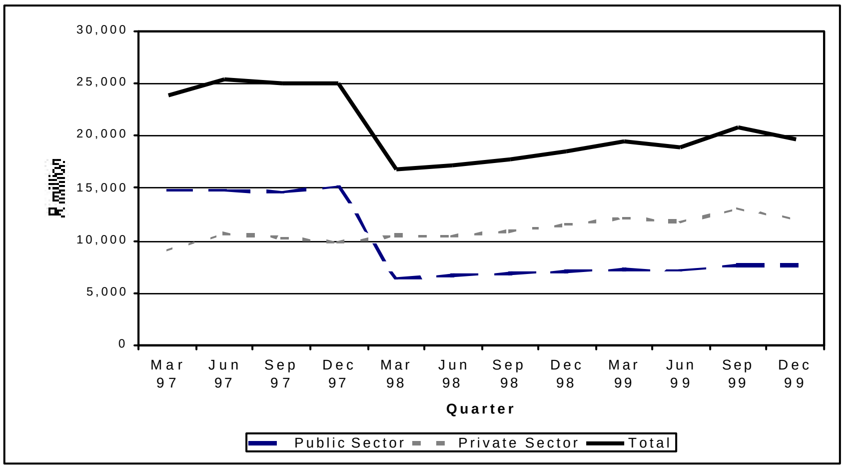
- "In order to meet infrastructure backlogs and secure access for all to basic services, additional investment in municipal infrastructure from the private sector and public sector financial intermediaries is required."
- "Ultimately, a vibrant and innovative primary and secondary market for long- and short-term municipal debt should emerge . To achieve this, national government must clearly define the 'rules of the game'."
- "Risks should not be unduly transferred to national or provincial government."

Policy and legislation

Accordingly, Government is finalising a detailed policy and legislative framework on municipal borrowing and on legal and executive intervention in the event of municipal financial failure. The framework maintains that municipalities need to strengthen their creditworthiness to attract investment from the private sector. Without this, infrastructure delivery and access to services by households and commercial and industrial enterprises will suffer.

The challenge to create a borrowing environment is pertinent because the municipal debt market has largely stagnated. Between March 1998 and March 1999, direct private sector lending to municipalities grew by R1,84 billion. Of this, almost R500 million was accounted for by one institution, the Infrastructure Finance Corporation (INCA). Over 80 per cent of this growth took the form of short-term lending. The long-term debt market – which is especially critical for infrastructure investment – has largely dried up. A major reason is the lack of clear remedies for lenders when investments are threatened by municipal financial crises. Without measures for Government to address such financial crises, it is unlikely that investor confidence can be restored to a level sufficient to create a municipal bond market.

Figure 5.4 Total outstanding municipal debt



The local government reform process

The transformation agenda

Democracy and development

As noted, the Constitution and the White Paper envision a system of local government that is efficient, democratic, developmentally oriented and an integral part of a three-sphere system of governance. To this end, Government is significantly reforming the local sphere, structurally, systemically and fiscally. According to the Local Government Transition Act, the sequence of the reform programme is as follows:

- *The pre-interim phase:* This phase involved primarily structural reforms, pursued at local level through negotiations on amalgamating racially segregated municipalities, and leading up to the first democratic local elections in 1995/96.
- *The interim phase:* This phase involved structural, fiscal and limited systemic reforms leading up to the second democratic local elections scheduled for late 2000. In particular, it involves the redemarcation of municipal boundaries; the introduction of a transparent, efficient and equitable system of intergovernmental transfers (the equitable share); and initial changes in municipal management practices such as integrated development planning, new structural options and new administrative and financial management systems and requirements.
- *The final phase:* This phase will see the election of new municipal councils and the concurrent establishment of municipalities within newly demarcated jurisdictions. A programme of far-reaching systemic and fiscal reforms will support the emergence of new, developmentally orientated municipalities. In particular, financial and strategic management reforms will be introduced and the fiscal stance of national government towards municipalities will change so as to support these new institutions while enhancing their accountability. Continued service delivery must be reconciled with the changes. In principle, the demarcation process will rationalise municipalities. The challenge is to do this while preserving and

enhancing the financial viability and creditworthiness of these new municipalities.

Local government in the intergovernmental fiscal system

Fiscal reforms

Fiscal powers and financial support should follow the functions assigned to government institutions. Reforms to the municipal fiscal system therefore track structural and systemic reforms. As structural reforms (the demarcation and establishment of new municipalities) and systems reforms (both financial and managerial) are implemented, the fiscal system seeks to accommodate these changes. To this end, the national Treasury and the Department of Provincial and Local Government are rationalising the system of intergovernmental transfers and are enhancing financial support to municipalities as they implement reforms to their financial, institutional and management systems.

Reform principles

The fiscal reforms reflect Government's key policy principles. These principles form the foundation for a responsible, supportive and empowering fiscal relationship between national and local government. In particular, they establish that intergovernmental transfers should:

- Be equitable, through promoting access to basic services by all households and treating municipalities uniformly and fairly
- Promote the efficient production and allocation of municipal services, particularly by not compensating poor municipal tax effort
- Address the negative consequences of spillover effects, such as the underfunding of regional services
- Facilitate democracy, particularly through supporting institution-building at the local level
- Be predictable, to facilitate budgeting and borrowing
- Promote accountability by the recipient authority to avoid resource wastage
- Be as simple and transparent as possible

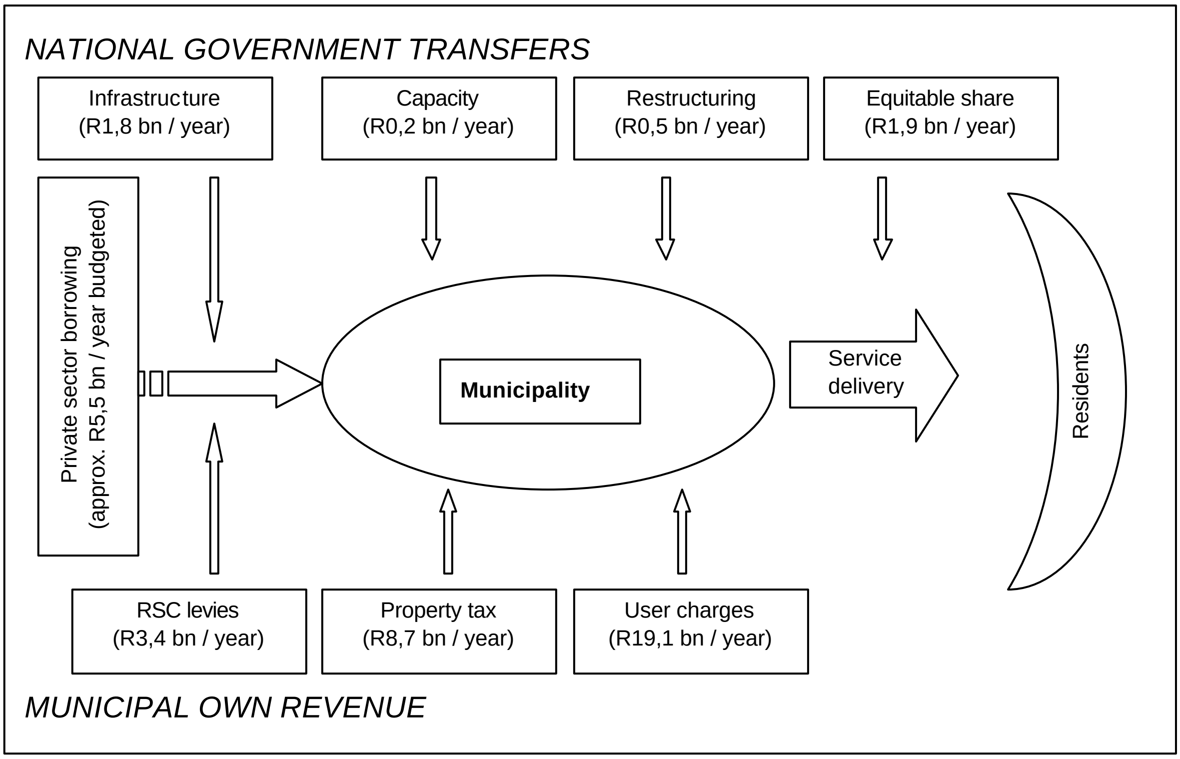
Equitable share reforms

Progress in implementing these principles includes, first, the introduction of the equitable share for local government in 1998/99. This unconditional grant to municipalities is allocated on the basis of a poverty-weighted formula. It replaced an inequitable system of intergovernmental grants that favoured formerly white municipalities.

Second, several grants for infrastructure expansion and rehabilitation have been rationalised into the CMIP. Allocations are made on the basis of individual applications, and the programme primarily benefits poor people in non-metropolitan urban areas. A number of other infrastructure grants continue to focus on rural areas.

The diagram below outlines the key pillars of the emerging intergovernmental fiscal system for local government.

Figure 5.5 Local government fiscal framework



Elements of the fiscal system

The key elements of this emerging intergovernmental fiscal system are:

- *Infrastructure investment:* The framework for infrastructure investment includes grant funding (CMIP, the CWSSP and other capital grants), own revenue funding (primarily RSC levies) and capital market borrowing. It aims at ensuring rapid delivery of basic infrastructure services to poor households. Government plans to rationalise existing capital grant programmes and to reform disbursement procedures. This is intended to improve the equity of allocations, the efficiency of spending and the sustainability of infrastructure services. It also aims at stimulating the municipal bond market by reducing lending risks and encouraging greater responsibility in decision-making by municipal borrowers.
- *Capacity grants:* Although the intention of all capacity grants is to nurture a more developmental and strategic approach by municipalities, these transfers remain fragmented and have had limited success to date. Grant support to municipalities is being consolidated in a phased programme. The first phase is evidenced by the introduction of the local government financial management grant (see below). Later phases will focus on strategic management functions, such as planning and performance management.
- *Restructuring and transition grants:* Local government policy reforms at structural and systemic levels require a fundamental shift in municipalities' approach to performing their functions. These grants assist and encourage municipalities in restructuring their organisations, functions and fiscal positions to improve the

equity and efficiency of service delivery. Given previous problems, this support is increasingly structured to avoid perverse incentives such as rewards for past poor performance. The approach differentiates between large and small municipalities on the basis of significantly different capacities and requirements. A new transition grant is being considered to share the burden of municipal amalgamation and to encourage municipalities to prepare for longer-term restructuring.

- *Equitable share:* This unconditional transfer assists municipalities in performing their assigned functions and has a strong poverty bias. The predictability of these transfers will be addressed through three-year allocations, and their targeting improved through refining the data used in identifying poor households.
- *Municipal own revenue:* Legislative measures have been proposed to improve the administration of property taxes and clarify municipal tax powers. Similar measures are being investigated with regard to RSC levies.

The elements of the fiscal framework should not be seen in isolation as they form a single, coherent framework. For instance, more effective and rapid infrastructure spending requires enhanced municipal capacity. This, in turn, requires appropriately structured and focused organisations.

Municipal Finance Management Bill

"Allow managers to manage…"

The basic philosophy underlying the Municipal Finance Management Bill is to allow "managers to manage and be held accountable," while councillors are responsible for overall policy and priority setting. It also brings local government in line with financial management reform in the public sector, as legislated in the PFMA. The Bill adds a financial management dimension to the legislative reforms in local government.

In line with the PFMA

The Bill's approach is similar to that of the PFMA, developing a framework for supervision and support of municipal finances. It also requires the establishment of a revenue fund and the preparation of timely financial statements and annual audits. Other key areas modelled on the PFMA are the responsibilities of the accounting officer, and the division of responsibility between members of council and the executive on the one hand, and the accounting officer on the other. The Bill vests several responsibilities in the accounting officer, including:

- The operation of basic financial management systems, including internal controls in the municipality and any entities under their control
- Ensuring that the municipality does not overspend its budget
- Reporting on a periodic and timely basis, including the submission of annual financial statements
- Taking effective and appropriate steps to collect all money due to the municipality and to prevent unauthorised expenditure or losses resulting from criminal conduct

Accounting officers who are negligent and make no effort to comply with these responsibilities will face strict disciplinary and criminal sanctions. The Bill also makes it an offence for a councillor to influence the accounting officer to contravene a provision of the Bill.

Governance

The Bill provides a governance framework for entities created by municipalities and allows the formation of new entities under the Companies Act of 1973. The regulations in the Bill complement Government's work on municipal service partnerships and public-private partnerships, and enables the restructuring of municipalities through the formation of corporate entities. It also prohibits the creation of municipal entities for investment speculation or for avoiding regulations. The Bill also promotes transparency and accountability through reporting, audit and governance requirements.

Municipal borrowing

In addition, the Bill provides for a new policy framework to promote municipal borrowing and for a mechanism for intervention in municipalities in financial crisis. It aims at restoring municipal access to capital markets by clarifying the legislative framework and the rights of borrowers and lenders. Several key factors drove the formulation of the borrowing and financial emergency framework in the Bill:

- Section 230 of the Constitution grants municipalities the right to borrow and creates the expectation that these rights will be coherently regulated by legislation passed by the national government. The elements of existing legislation that relate to municipal borrowing issues do not properly address the changes to the institutional and policy environment. The new Bill deals with this partial regulatory and legislative vacuum, and develops an appropriate regulatory framework.
- The stagnation in the municipal debt market, noted earlier, highlights the need for new approaches to facilitate municipal borrowing.
- Policy imperatives require clear legislation on borrowing powers. Government policy statements repeatedly emphasise that private finance will be important for municipal capital investment. Unlike the pre-1994 era, such funding will not be guaranteed by the national fiscus. Instead, municipalities will have to raise private finance on their own books and bear the responsibility for servicing the debt. To create an enabling environment for private financing of municipalities, this shift from national guarantees to local responsibility requires a legal and regulatory framework that clarifies the rights and obligations of borrowers and creditors.
- Government has to respond systematically to the increasing financial difficulties of municipalities. It is critical that the delivery of essential services, which is threatened in some cases, is maintained. National government can also not get drawn into ad hoc responses that it has neither the capacity nor the fiscal resource to sustain. It must provide municipalities with the incentives to perform their functions effectively and to manage their fiscal and financial affairs prudently. Without such a response, local

government is unlikely to attract significant investment from the private sector.

- Without adequate private sector lending, national government may be pressured to bear the full cost of basic municipal infrastructure. This will reduce its ability to deliver other social sector programmes. When, however, municipalities are able to attract long-term private capital, national government can direct resources to infrastructure extension and poverty relief in the poorest municipalities.
- Financial emergency measures will only be recommended in severe circumstances. The municipal support programme and the newly created restructuring grant and financial management grant will help municipalities to address financial problems before they become emergencies. Moreover, when lenders discover financial problems in a municipality, they often jointly agree on an approach to address the financial problems. Thus, the financial emergency measures in the Bill will be invoked only when the municipality is in a state of real crisis, after all other efforts to address its financial problems have failed.
- The Municipal Finance Management Bill and the Municipal Systems Act complete Government's legislative initiatives for reforming the local government sphere. While the Municipal Finance Management Bill provides the broad framework for improving municipal financial management, the goals of the Bill will be achieved through the promulgation of regulations. The cornerstone to these regulations is the reform of municipal budgeting.

Municipal budget reforms

Poor systems

The current system of local government budgeting and the state of financial management are generally poor. Municipal budget formats are outdated and overly detailed. The budgeting and financial reporting systems are opaque, making it impossible for stakeholders to understand the financial position of the local authority. Neither councillors nor managers can participate meaningfully in the budget preparation process. Budgets are prepared and presented in different formats and provide widely divergent information and few, if any, are linked to the municipality's strategic priorities. Moreover, comparisons between municipalities are difficult, and financial institutions and stakeholders cannot use this information for lending and investing activities.

Prescribed processes

Section 215 of the Constitution requires the national Treasury to prescribe the form of municipal budgets and to specify the information they should include. Strong financial management systems that include modern accounting practices, proactive budgeting processes, and periodic management reports are critical if local governments are to meet the service needs of their people. Therefore, the national Treasury worked with stakeholders to develop a programme of financial management and budget reforms. The planned financial management and budget reforms will support the implementation of the Municipal Finance Management Bill and the Municipal Systems Act, and contribute to the success of ongoing programs such as infrastructure grants to local governments.

Reform package

The proposed reforms will introduce the following:

- A system of multi-year budgeting to encourage better planning and to link budgeting and planning for measuring the medium- to long-term effects of policy choices
- A review of RSC levies:
  - One possible development is to combine the current turnover tax on business with the levy on payrolls.
  - The national Treasury is also exploring more effective means of collecting levies, including SARS assistance to local governments.
  - Metros and district councils remain eligible for regional levy incomes, and this revenue should largely be directed at capital programmes in disadvantaged areas.
- Standardised, uniform budget formats to encourage comparisons between municipalities and make general benchmarks possible
- Greater involvement by councillors, the executive and citizens in the budget preparation process
- Improvements in the quality of budgets presented to councils and a better understanding of the trade-offs by the general public
- Budgets that contain meaningful information to encourage reporting against set objectives and performance measures
- An in-year reporting system for early diagnosis of financial problems, so that appropriate support programmes can be implemented before problems become crises

The proposed reforms will be tested in several pilot project municipalities in 2000-01. If necessary, the reforms will then be modified before nationwide implementation. The goal of the overall financial reform programme is to build a strong financial foundation in municipalities. On that basis, advanced management capacities may be built for activities such as integrated development planning and performance management.

Conclusion

Align different reforms

The fiscal framework for local government continues to evolve in line with the overall transformation of this sphere of government. The fiscal approach is to establish a sustainable basis for delivery, development and governance in this sphere. A strategic combination of own revenue intergovernmental fiscal flows and an active borrowing environment form the essence of this approach. The current reforms support this framework.

6

Overview of municipal budgets

This chapter provides an overview of municipal budgets. It is an initial attempt to review data gathered by Government's current reporting systems. The structure and content of this information will be developed further over the next few years to cover more information and more municipalities.

Data problems

With 843 municipalities, outdated budgeting systems, inconsistent municipal accounting or budgeting practices, and weak financial management capacity, reliable financial data is not available. Data in this chapter are based primarily on self-reported financial information on "expected" revenues, expenditures, and on budgets. However, budgeted and actual figures often differ considerably. This is aggravated by the absence of a uniform budgeting standard, chart of accounts and reporting classification system.

Given this background, and in view of the four years it has taken the national Treasury to compile reliable provincial government data sets, developing good financial data for the local government sphere will be a multi-year project. The project to implement reforms to budgeting and financial statements has just been initiated. Furthermore, standard classifications for revenues and expenditures in a uniform chart of accounts will allow for benchmarking to compare South African municipalities with each other and with similar municipalities around the world.

Municipal revenue and expenditure data

Chapters 6 and 7 are based on the transfers from the 2000 MTEF budgets of the national and provincial governments, as tabled in February 2000 and the 1999/00 local government budgets. The 1999/00 local government budget data used in this chapter are from the municipal budget database maintained by the national Treasury to monitor municipal finances. Each fiscal year, municipalities report to the national Treasury their projected actual revenues and expenditures for the current year and their budget for the next year. Actual revenues and expenditures for all municipalities are currently not available. In this chapter, all summary information for fiscal years 1996-97, 1997-98, and 1998-99 represents municipalities' self reported *projected actuals* and the 1999-00 data are *budgeted*.

Information on all transfers from provinces to municipalities (e.g. transfers for the provision of primary health care services) is currently not available. Therefore, data on intergovernmental transfers to municipalities are understated.

The information on municipal revenue and expenditure is different from that reported by the South African Reserve Bank (SARB). The SARB reports on data received from surveys of approximately 60 municipalities collected quarterly by Statistics South Africa. In contrast, the summary data in this report are based on budget information reported annually by over 600 municipalities.

More detailed data, self reported by a sample of municipalities, are also presented along with an in-depth presentation of Johannesburg financial data. This sample should highlight revenue, expenditure and service trends in the local government sphere as a whole.

Issues in municipal budgeting

Strengthen financial management capacity

Lack of capacity

In many municipalities, the budgeting system is poor primarily due to a lack of financial management capacity. Budgets are presented line item by line item, one year at a time. They are prepared in different formats and provide widely divergent information and few, if any, are linked to the local government's strategic priorities. This makes it difficult for citizens and elected officials to understand how scarce resources are allocated and to depict financial trends in the municipality. This archaic approach to budgeting has also led to uncertainty about the financial status of municipalities, resulting in a drying up of the long-term municipal lending market.

Poor estimates

In most cases, municipalities overestimate revenues, failing to reduce estimates to account for undercollection of rates and tariffs. This practice has led to year-end deficits. Also, when preparing their annual budgets, municipalities often do not have accurate information on the grants and transfers they will receive from national and provincial government. Therefore, they can neither project total revenue for the fiscal year nor accurately show all revenues and expenditures on budget.

Municipalities also do not have proper processes for adjusting their budgets throughout the year. Some adjust their budgets as often as every month, reducing both financial transparency and the value of the originally adopted budget.

Another major issue in municipal budgeting is the lack of accurate cost centres. For example, few municipalities know the total cost of providing water services. They report the cost of purchasing bulk water, but do not include all the costs of reticulation, such as staffing and maintenance. Without knowing the total cost of providing a service, municipalities cannot determine fair pricing structures or accurate profits or losses.

Budgeting reforms

Priorities for reform

Government has prioritised improving budgeting in the local government sphere through the reforms discussed in Chapter 5. In summary, these reforms entail:

- Preparing three-year municipal operating and capital budgets, as in the national and provincial spheres
- Simplifying and allocating certainty in the national and provincial grants systems by municipality and on a three-year basis
- Ensuring that all revenues and expenditures are accurately shown on budget
- Introducing a standard accounting and reporting system – GAMAP

- Introducing a new municipal borrowing policy framework to develop a municipal bond market and bring the efficiencies of such a market to bear on municipalities
- Building financial management capacity and supporting municipal restructuring

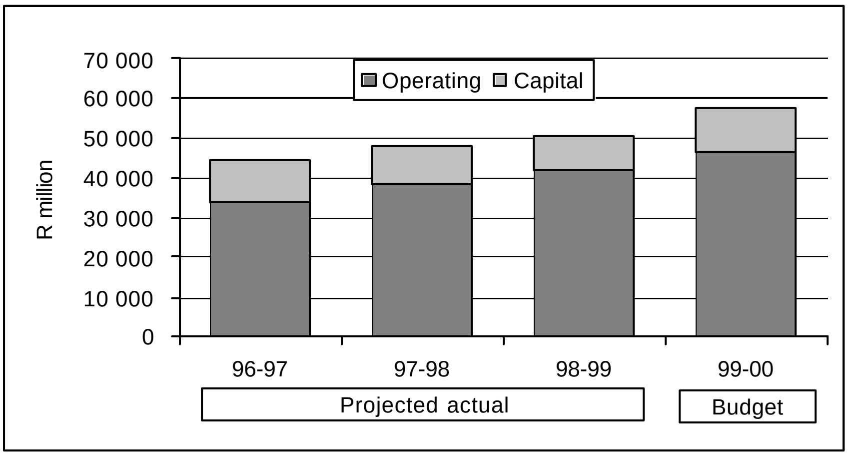
Municipal revenues and expenditures

Municipal budget summary

In 1999-00, municipal budgets totalled just over R57,4 billion. Of this, approximately 81 per cent supported the operating budget, i.e. delivery of services and overheads. The remainder was allocated to capital projects, primarily the extension of water and electricity infrastructure.

In the three years of *projected actual expenditures* shown in Figure 6.1, the average annual increase was 7 per cent. The 1999-00 budget increased by 14 per cent from the previous year. This increase, based on a comparison of *projected actual* to *budgeted* data, reflects real increases in operating and capital expenses, and uncertainty about the transfers due from national and provincial governments. Municipalities are unsure of the funds they will receive from the national and provincial departments, and are therefore unable to budget accurately. This usually results in overestimation. Thus, if past trends continue, the 1999-00 actual expenditures will probably grow by less than the projected 14 per cent.

Figure 6.1 Total municipal expenditures



Moving to three-year allocations

National government will address this problem by moving to a system of three-year allocations in municipal budgeting. This will be per municipality for all major operating and capital transfers, allowing municipalities to plan their finances and service provision more accurately.

Many grants (e.g. the CMIP) are not shown on municipal budgets. National and provincial departments also provide in-kind services (e.g. the operation of rural water systems by the Department of Water Affairs) that are not included in municipal budgets.

The ten largest municipalities account for 65 per cent of total municipal expenditure. A four-year expenditure summary is available in Table 6.1.

Table 6.1 Expenditure history of the top ten municipalities

	Projected actual			Budget
R million	96-97	97-98	98-99	99-00
Johannesburg Metro	8 299,7	6 910,0	7 144,1	8 186,8
Cape Metro	6 481,5	7 226,3	7 488,1	8 158,9
Durban Metro	5 320,1	5 703,1	6 159,4	7 016,8
Pretoria Metro	4 130,8	5 005,4	5 902,9	6 443,7
Kyalami Metro	1 378,0	1 670,2	1 863,6	2 089,5
Port Elizabeth	1 206,8	1 346,1	1 531,5	1 556,7
Pietermaritzburg	712,5	867,7	858,9	966,6
Lekoa-Vaal Metro	798,0	859,7	899,3	956,6
East London	466,9	629,5	732,2	840,2
Bloemfontein	575,5	662,5	738,1	772,8
Total	**29 369,8**	**30 880,6**	**33 318,1**	**36 988,7**

It is difficult to make comparisons between municipalities or even between years in the same municipality in the absence of a standard accounting or reporting format. This will be remedied with the introduction of GAMAP and budget reporting guidelines.

Johannesburg

Table 6.2 provides a three-year history of revenues and expenditures in the Johannesburg Metro, showing how a major municipality allocates its resources. The table also provides the surplus/(deficit) of each service provided by the municipality. Johannesburg was selected for this case study because it is one of the few municipalities that now compiles its financial data by service area.

Johannesburg also participates in the national Treasury's Budget Reform Pilot Programme, and has accordingly made substantial progress in meeting the budget reform guidelines. As the national Treasury implements its municipal budget reform programme throughout the country, all municipalities will eventually be able to supply this critical information to its elected officials and citizens.

In 1998-99, Johannesburg had a R213 million deficit in its non-trading functions, resulting in an overall deficit of R54 million. The Metro was able to turn around this situation in 1999-00, projecting a year-end surplus of R101 million. This positive situation continues in 2000-01 with a budgeted year-end surplus of R2 million.

Also of note in the Johannesburg financial data, is the performance of its trading departments. Electricity has ended each year with a surplus, although this has been declining each year. Water and sanitation has moved from a surplus in 1998-99 to a slight deficit in 1999-00 and 2000-01. Refuse has ended each of the three years with a substantial deficit.

Table 6.2 Johannesburg Metro revenues and expenditures

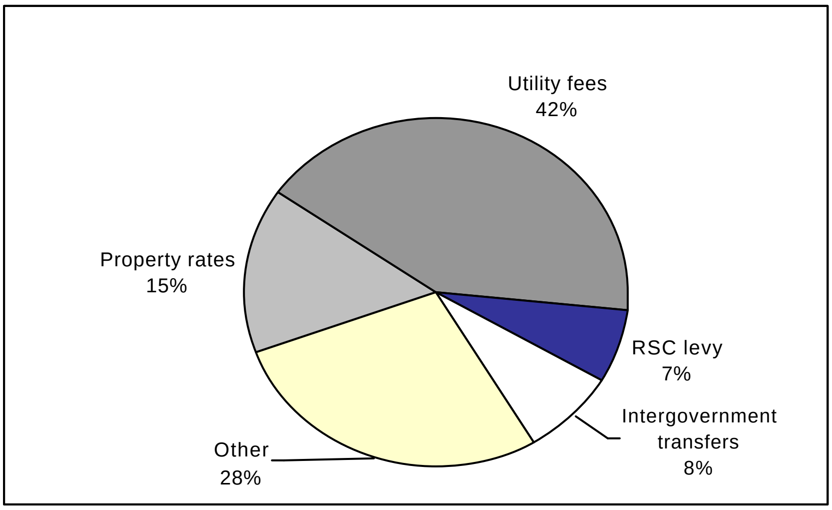
R million	1998-99 Actual	1999-00 Revised	2000-01 Budget
Expenditure			
Trading departments			
Water and sanitation	2 140,6	2 534,8	2 695,6
Refuse	361,5	410,0	447,4
Electricity	1 678,5	1 945,8	2 053,7
Subtotal	4 180,6	4 890,7	5 196,7
Other functions			
Roads	370,3	405,0	432,6
Community services	425,4	447,3	473,6
Public safety	374,6	272,4	284,8
Transport	200,1	212,6	214,7
Planning	294,3	341,4	373,8
Corporate services	787,5	681,5	715,8
Finance	584,8	444,9	429,1
Other	617,0	758,6	769,7
Subtotal	3 653,9	3 563,8	3 694,3
Total	**7 834,5**	**8 454,5**	**8 891,1**
Income			
Trading departments			
Water and sanitation	2 233,3	2 506,1	2 684,4
Refuse	255,3	274,5	289,8
Electricity	1 851,6	2 090,7	2 145,3
Subtotal	4 340,2	4 871,3	5 119,6
Other functions			
Roads	4,3	10,6	8,6
Community services	33,0	31,7	31,9
Public safety	138,6	110,7	115,2
Transport	84,4	79,9	86,6
Planning	46,7	62,4	52,6
Corporate services	45,9	349,5	360,7
Finance	2,724,5	2 842,8	2 966,4
Other	362,6	196,9	151,6
Subtotal	3,440,2	3 684,8	3 773,7
Total	**7 780,4**	**8 556,1**	**8 893,3**
Surplus/(Deficit)			
Trading departments			
Water and sanitation	92,7	(28,7)	(11,2)
Refuse	(106,2)	(135,5)	(157,6)
Electricity	173,1	144,9	91,6
Subtotal	159,6	(19,3)	(77,2)
Other functions			
Roads	(366,0)	(394,3)	(424,0)
Community services	(392,3)	(415,5)	(441,6)
Public safety	(235,9)	(161,6)	(169,5)
Transport	(115,7)	(132,7)	(128,1)
Planning	(247,5)	(278,9)	(321,2)
Corporate services	(741,5)	(332,0)	(355,2)
Finance	2 139,6	2 397,8	2 537,3
Other	(254,3)	(561,6)	(618,2)
Subtotal	(213,7)	121,0	79,5
Total	**(54,2)**	**101,6**	**2,2**

Municipal revenues

Local government revenue sources may be evaluated in terms of adequacy (sufficient to cover expenditures), responsiveness (increase with inflation), reliability (stable and predictable), and fairness (acceptable to citizens). Municipalities primarily provide trading or utility type services (e.g. water and electricity) for which consumption based fees are charged directly to users. Non-trading services are funded primarily by property taxes and payroll or transaction levies. The poor quality of revenue collection policies and systems is a major factor undermining actual revenue.

Municipalities generate, in aggregate, approximately 92 per cent of their own revenue, with the remainder provided by transfers from the national and provincial spheres. The primary sources of municipal revenue are shown in Figure 6.2.

Figure 6.2 Total local government revenues, 1998-99



Utilities provide a major source

- *Utility fees:* Gross utility fees from trading services are the main sources of municipal revenues, with electricity making up the largest share. Many municipalities use surplus fees generated by trading services to subsidise general government services. Figure 6.3 shows the surplus generated by electricity rates for a sample of municipalities. In almost every case, municipalities do not attribute full costs to their trading service accounts. The "surplus" for that sector is therefore overstated. The national Treasury will assist municipalities with implementing activity-based costing to measure surpluses or losses in their utilities.

  Revenue from utilities is classified neither by function nor by international classification. They are not comparable between municipalities or even between fiscal years in a specific municipality. They therefore offer limited scope for analysis, making it difficult, for example, to determine the impact of the reorganisation of the electricity distribution industry on overall municipal revenues.

Figure 6.3 Electricity surplus (estimated)

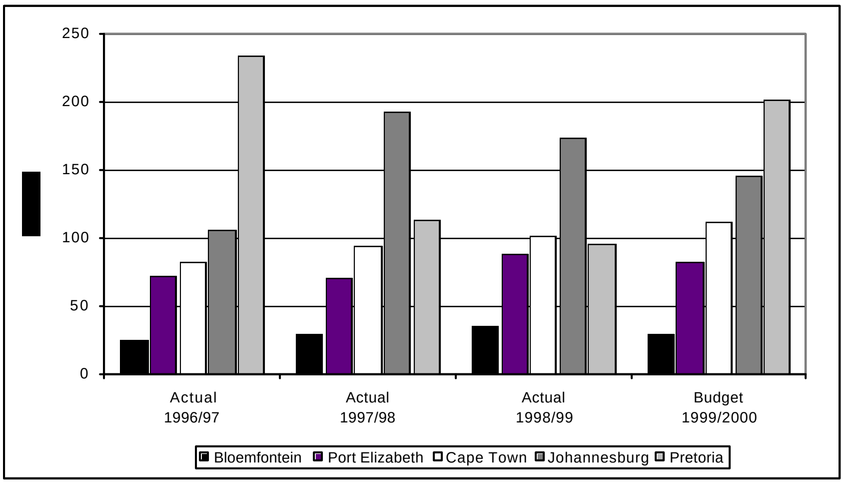
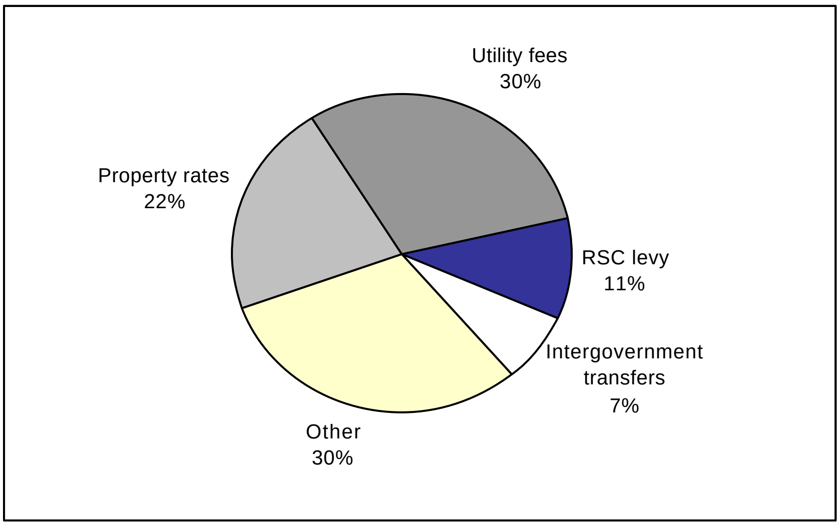


Figure 6.4 reflects the aggregate composition of municipal revenues by discounting the bulk charges from gross revenues. Although this does not reflect all costs associated with the provision of these services, the data show a closer relationship to net revenues from these services. (The aim is to address this situation with reforms to the costing methodology and other reforms to the system, as mentioned above.) After adjusting the revenues, the property rates component comprises 22 per cent of the revenue base of a municipality, intergovernmental transfers 7 per cent and RSC levies 11 per cent.

Figure 6.4 Total local government revenues net of utility costs, 1998-99



- *Property rates:* After utility fees, property rates are the next major source of revenue and constitute the largest share of general government revenue from non-trading services. Revenue from property rates is critical for funding recreation, roads, street lighting, libraries and other public good services that are not fully supported by fees.

Property rates are regulated under the various provincial by-laws that existed before democracy. The system is poorly administered in many municipalities. The Property Rates Bill, published in August 2000, creates a nationwide legal and regulatory framework for assessing property values and levying property rates.

Transfers

- *Intergovernmental transfers* comprise approximately 7 per cent of local government revenue. These transfers flow to municipalities through the equitable share, conditional grants, and capital grants such as the CMIP. The equitable share is discussed in some detail in Chapter 7, but a few brief observations are pertinent here.

  The equitable share is an unconditional transfer from the national government to municipalities, based on a formula that attempts to measure the number of households in poverty. The formula favours poor rural households, and has reduced allocations to the larger metropolitan areas, as demonstrated in Table 6.3.

Table 6.3 Equitable share allocation in selected municipalities

	1996-97	1997-98	1998-99	1999-00
R 000	Actual	Actual	Actual	Budget
Bloemfontein	16 394,4	7 992,8	10 314,8	8 993,2
Johannesburg	49 763,8	48 409,1	42 487,9	24 670,8
Port Elizabeth	30 785,2	40 823,8	21 542,5	20 661,8
Total	**96 943,4**	**97 225,7**	**74 745,3**	**54 325,8**
R increase/(decrease)		282,3	(22 480,4)	(25 996,6)
% increase/(decrease)		0	(23)	(35)

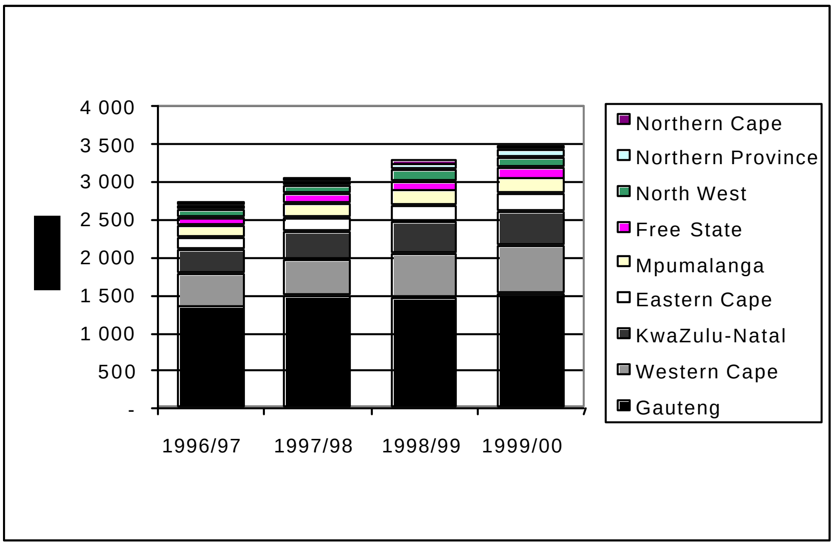
  Johannesburg, coming from a base of just under R300 million in 1993-94, receives R24,6 million in 1999-00. From 1996-97 to 1999-00, Bloemfontein and Port Elizabeth experienced reductions of nearly 50 per cent in their equitable share allocations. This loss of equitable share revenue has reduced the larger municipalities' ability to provide services to the growing number of urban poor.

- *Regional service levies* represent 11 per cent of local government revenue and are the primary source of revenue for district councils. They contribute approximately 10 per cent of the revenue of metropolitan municipalities. RSC levies comprise two components. The first component, making up two-thirds of the total levy, is the regional services levy based on turnover. The second component, a third of the total, is a regional establishment levy on payroll. Current government policy states that RSC levies should be used to fund capital infrastructure. The budgeted revenue for RSC levies, by province, is shown in Figure 6.5.

  The levy is based on self-assessment by businesses and is paid monthly to the district councils and metros. The system does not provide any means for auditing the basis of the payments and is administratively cumbersome, as it is assessed on a monthly rather than annual basis. Due to these problems in a critical revenue source, and considering the poor design of the collection mechanisms, Government is now exploring improvements to the RSC levy with plans for implementation in 2001-02.

Other revenues include interest on investments, non-trading services fees and charges (e.g. recreation or burial fees), and fines.

Figure 6.5 RSC levy by province (budgeted)



Revenue collection

Revenue collection needs attention

One of the major financial problems in the local government sphere is the lack of focus on developing adequate revenue collection systems and administration. This is reflected in antiquated billing and accounting systems and in the increasing level of outstanding debt. Failure to collect utility fees and taxes may result in:

- A year-end deficit
- Reduction in services
- Higher fees and taxes for those who do pay

Figure 6.6 shows that the level of outstanding debt in selected municipalities increased by 30 per cent from 1996-97 to 1999-00, from R741 million to R969 million.

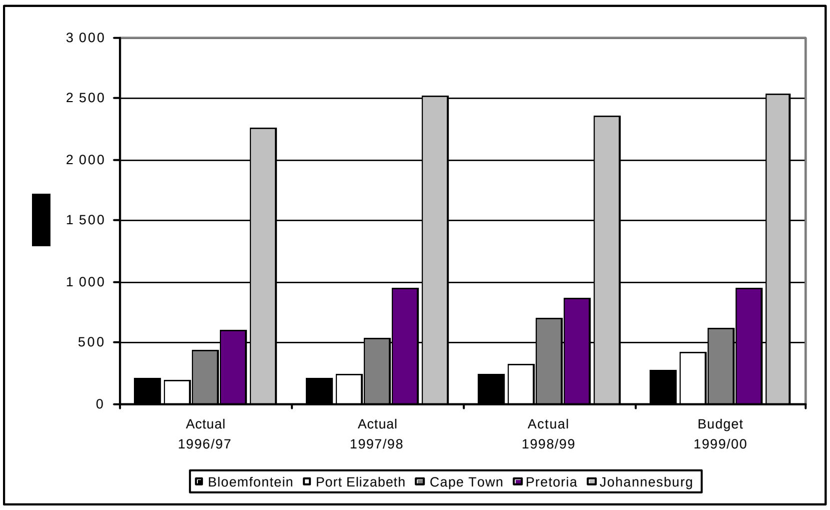
Average monthly household accounts

Municipalities receive the primary share of their revenue from households, businesses and industries that pay fees for services and from property rates based on the value of land or property. To determine the financial impact of these fees and rates on households, the national Treasury requested municipalities to report the monthly charges on the following:

- Property rates on 1 000 m^2 erven and 150 m^2 improvements
- Electricity
- Base charges and consumption charges on 1 000 units
- Water base charges and consumption charges on 30 kilolitres

- Sewer sanitation charges
- Refuse collection charges

Figure 6.6 Outstanding debtors



The total monthly household cost for these services for 12 sample municipalities is provided in Figure 6.7 and Table 6.3. For these municipalities, the average monthly household payments in July 1999 range from a high of R672,90 in Durban (KwaZulu-Natal) to a low of R449,71 in Reddersburg (Free State).

The average trend for these 12 municipalities is shown in Figure 6.8. The average monthly accounts increased by 10 per cent from 1996 to 1997 and again from 1997 to 1998, and growth slowed to 8 per cent in the following year.

Figure 6.7 Average monthly household account, July 1999

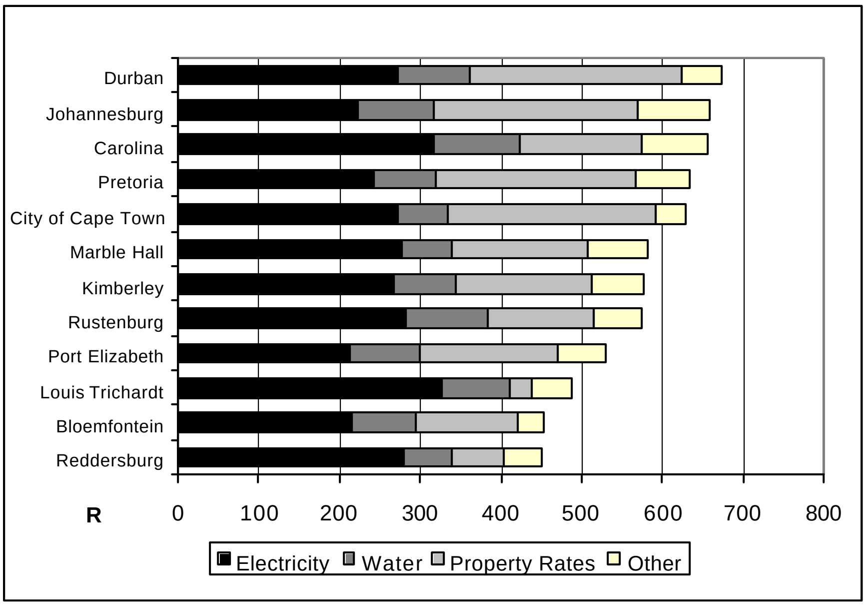
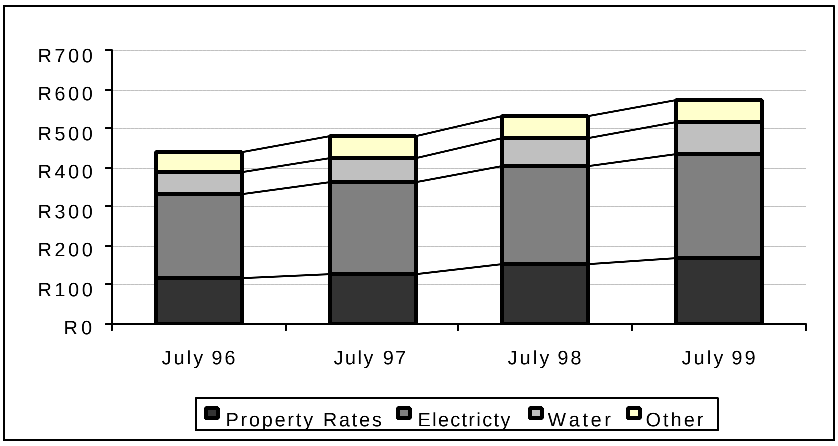


Table 6.3 Average monthly household account, July 1999

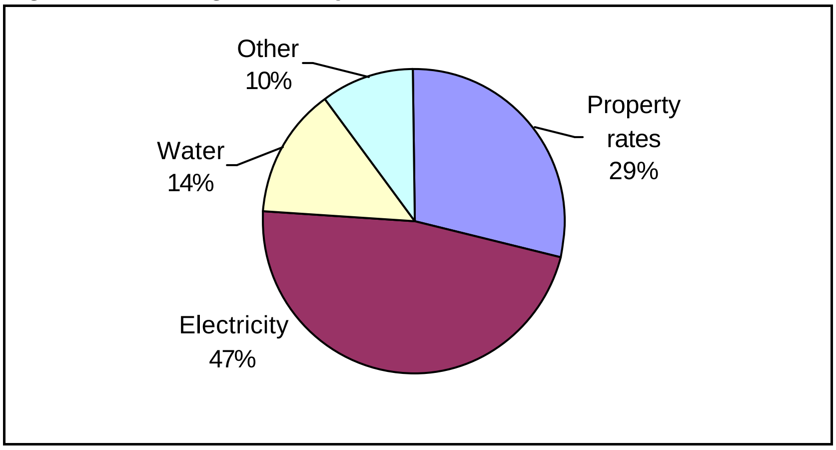
Municipality	Property	Electricity	Water	Other	Total
Durban	260	273	90	50	673
Johannesburg	253	223	94	89	659
Carolina	151	316	107	82	656
Pretoria	247	242	78	66	633
City of Cape Town	258	271	62	38	628
Marble Hall	167	278	61	74	581
Kimberley	168	268	76	64	576
Rustenburg	131	283	101	60	575
Port Elizabeth	169	213	87	59	528
Louis Trichardt	27	326	85	48	487
Bloemfontein	125	215	80	32	453
Reddersburg	65	279	60	46	450
Average	**169**	**266**	**82**	**59**	**575**

Figure 6.8 Average monthly household account



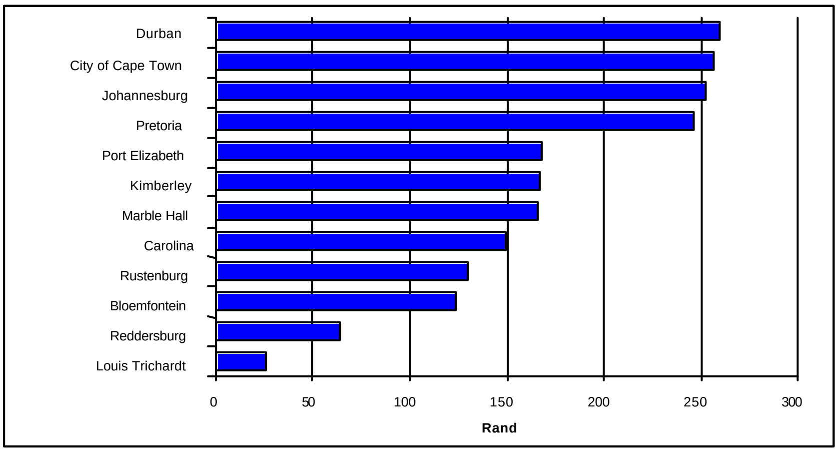
Electricity is both the main trading activity for municipalities and the largest portion of monthly charges for the average household. These charges comprise 47 per cent of the total average household account in July 1999, as shown in Figure 6.9.

Figure 6.9 Average monthly household account, 1999



The 1999 property rates, electricity and water charges for the sample municipalities are provided in Figures 6.10–12, respectively. Property rates in the surveyed municipalities for a 1 000 m^2 erven with 150 m^2 of improvements ranged from a high of R260 per month in Durban to a low of R27 per month in Louis Trichardt. The major metropolitan areas reported property rates of about R250 per month. Note that actual property rates are determined both by valuations and by the level of the rate.

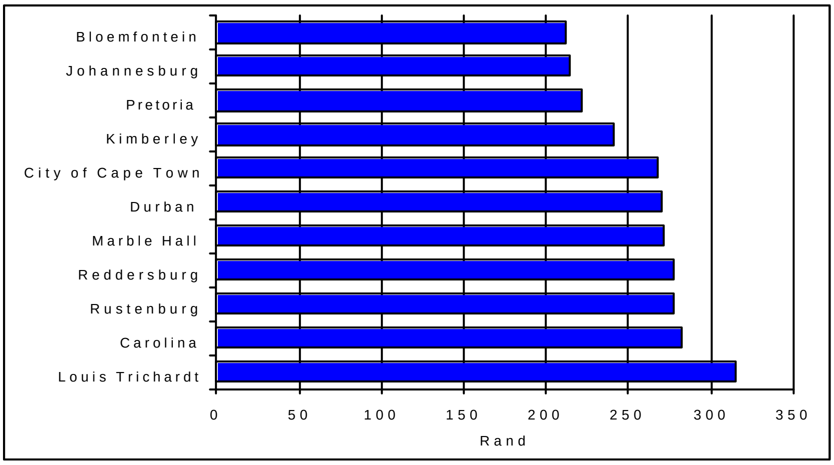
Figure 6.10 Monthly property rate charges, 1999



Domestic charges

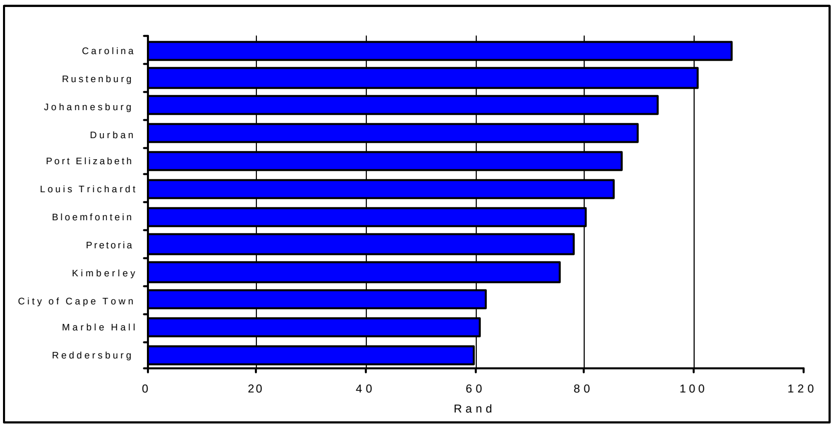
Figure 6.11 displays the monthly domestic charges for 1 000 units of electricity. Louis Trichardt, which has the lowest property rates among the selected municipalities, has the highest electricity charges. Higher charges may be due to higher costs to provide electricity, inefficiencies in service delivery or because electricity may be used to generate a surplus that can be used to keep property rates low, i.e. taxing consumption of services rather than property. This highlights the difficulty of using existing information to restructure the electricity distribution system from the national level.

Figure 6.11 Electricity charges, 1999



Monthly charges for 30 kilolitres of water in the selected municipalities range from a high of R107 in Carolina to a low of R60 in Reddersburg.

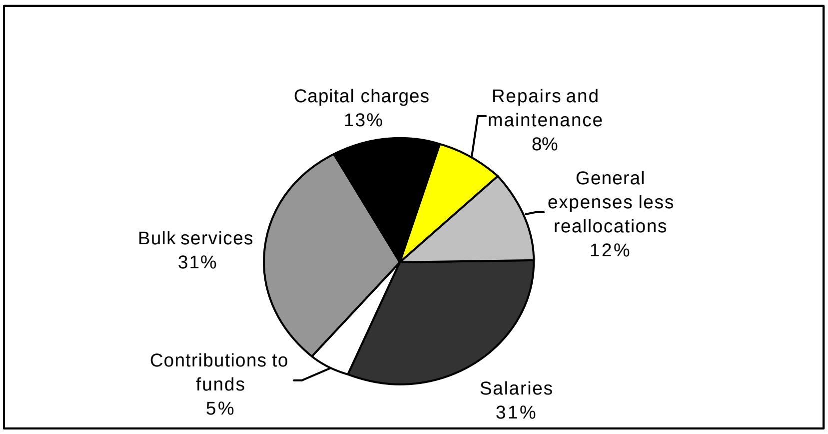
Figure 6.12 Water charges, 1999 (30 kl)



Municipal expenditures

Municipalities projected R40 billion in operating expenditures in 1998-99. Figure 6.13 shows the breakdown of these expenditures.

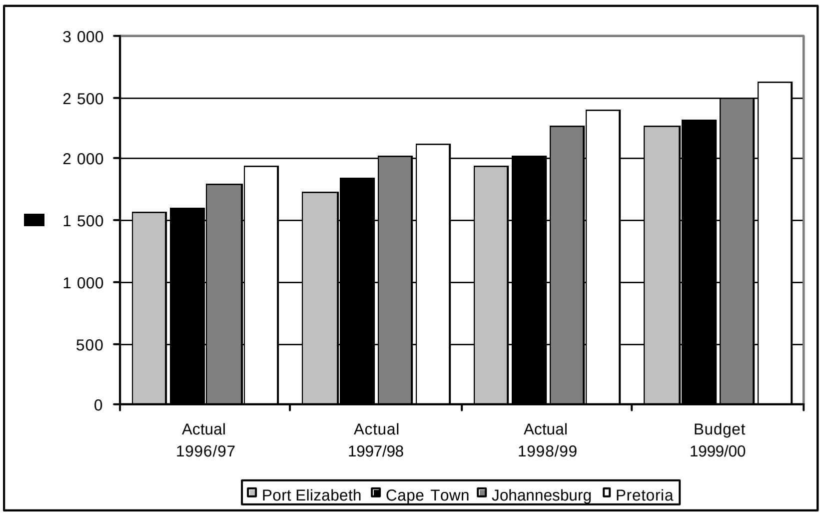
Figure 6.13 Operating expenditure, 1998-99



Salaries a large portion

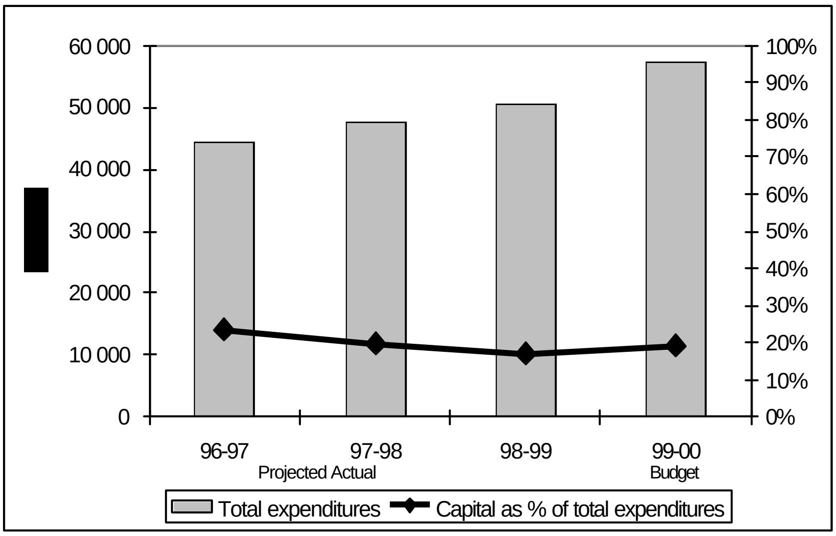
Salaries continue to take up a large portion of local government expenditure. Increases in municipal salaries are due in part to central bargaining agreements with municipal employee unions at national level. The average monthly minimum wage for four municipalities is shown in Figure 6.14. In the four cities, the average monthly minimum wage increased by 12 per cent from 1996-97 to 1997-98 and again in the next year, and 13 per cent from 1999-00. This means a cumulative increase over the four years of 41 per cent. Over the same period, the increase in the total budgets for these municipalities amounted to 29 per cent. These differences in salaries between municipalities are a critical factor that must be considered when municipalities are combined during demarcation. They will be under pressure to equalise all salaries to the highest level, creating a tremendous burden on already stretched municipal budgets.

Figure 6.14 Average monthly minimum wage



After bulk services (expenses incurred in purchasing bulk electricity and water for distribution to municipal customers), the next major expenditure item is capital projects. Figure 6.15 shows that resources directed toward capital expenditure as a percentage of total expenditure declined from 1996-97 to 1998-99. The 1999-00 budgeted amount shows a slight increase to 19 per cent of total expenditure but, as discussed earlier, the actual amount spent will probably be lower.

Figure 6.15 Capital as percentage of total expenditure



This decline in spending on capital infrastructure is a result of financial problems at the municipal level, as increasing operating expenditure and rising non-payment of rates and charges crowd out capital expenditure. Moreover, the long-term borrowing market, an important source of funds for capital projects, has stagnated with over 80 per cent of all new debt issued to municipalities between March 1998 and March 1999 being short term. This further reduced municipalities' ability to finance capital infrastructure.

Conclusion

Steady revenue and expenditure increases

The growth in municipal revenues and expenditure exceeded inflation from 1996-97 to 1999-00. Salary expenditure increased faster than the overall budget and expenditure on capital infrastructure declined as a percentage of total spending. Revenue from property rates, electricity, water and other significant sources steadily increased, as did outstanding debtors. Reforms in municipal budgeting, accounting and financial reporting should increase the availability and accuracy of information on municipal finances. These reforms will increase transparency at the local level and provide elected officials, citizens and financial institutions with a better understanding of the financial position of municipalities.

7

Transfers to local government

Own revenue not enough

Intergovernmental transfers form but one element of local government financing. Municipalities have, in principle, sufficient revenue-raising powers to fund the bulk of their expenditure. They finance over 90 per cent of their recurrent expenditure out of own revenues.

In reality, this aggregate situation disguises many differences between municipalities. For example, rural municipalities are more reliant on intergovernmental transfers (as opposed to own revenues) than are urban ones. Even among urban local governments, several would not be fully sustainable without significant transfers from the national government. Hence, the equitable share formula has been designed precisely to take these differences into account. In addition, specific conditional grants target government priorities managed through the local sphere.

This chapter outlines the evolution of and trends in such intergovernmental transfers. Note that transfers from provincial budgets are not captured in this *Review*. In some instances, such as health services transfers, these may be significant sources of income for municipalities.

Evolution of the system of fiscal transfers

Introduction of local government transfers

Transfer included in the Division of Revenue Act

The systems of transfers inherited from the previous regime were highly fragmented and inequitable, with the bulk of funds directed to formerly white municipalities. Considerable progress has been made in improving the equity and transparency of these transfers in the last five years. The Intergovernmental Fiscal Relations Act of 1997 formalised the current intergovernmental budget process. The Act requires the enactment of the Division of Revenue Act annually with the budget. The Division of Revenue Act serves to enhance transparency in the allocation of national resources by setting out the equitable shares for each sphere and the division of all transfers between the provinces. It also includes a detailed schedule of all other allocations made from the budgets of national departments to provinces and local governments. The first Division of Revenue Act was enacted for the 1998 Budget.

Context for local government transfers

Own revenue integral to municipal finance

While intergovernmental transfers are integral to local government financing, national government expects such municipalities to maximise the collection of their own revenue. Government policy dictates that municipalities failing to collect their own revenue will not be bailed out by national government.

Policy reflects municipal powers

The 1998 White Paper on Local Government justifies this policy stance on the basis of the specific role and powers of municipalities in South Africa. Unlike many other countries, South African local government is not responsible for large tax-funded social services, such as health and education. These are provincial responsibilities. In fact, well over 60 per cent of local government revenue is derived from self-funding utility services (water, sanitation and power) that generate their own revenues.

The primary sources of local government revenue are, therefore, local taxes or user charges. Grants from national government, including the equitable share and conditional grants, comprised about 7 per cent of the projected R58 billion local government expenditure in 1999-00.

There has, however, been a significant increase in allocations to the local government sphere since 1995/96. This growth has been driven by reforms to the overall framework of grants, particularly the introduction of the equitable share and the expansion of several recurrent grant programmes. The introduction of the equitable share reorganised the fiscal flows in line with coherent policy goals and good institutional practice, but did not increase these flows significantly. In 1997/98, before the introduction of the equitable share, transfers amounted to R903 million. In 1998/99, when the equitable share was introduced, they amounted to R1 024 million. Budgeted allocations in 2000/01 rose to R6,86 billion, primarily as a result of the introduction of two new recurrent grant programmes: the Local Government Restructuring Grant and the Local Government Financial Management Grant. Allocations are projected to grow to over R7,8 billion in 2002/03.

Volatility in various grants

The increase in allocations is shown in Table 7.1 and has been spread between transfers for the equitable share, infrastructure programmes and recurrent grants, with the latter two programmes experiencing the most volatility in allocations. The significant decline in infrastructure allocations in 1998-99 can be ascribed to the rationalisation of the Municipal Infrastructure Programme, the Extended Municipal Infrastructure Programme, and the Bulk and Consolidated Infrastructure Grant programmes into a single funding stream: the CMIP.

Types of transfers

National transfers to local government take two forms:

Equitable share unconditional

- *Equitable share allocations* are to all Category B municipalities, without any conditions attached. These allocations are made in terms of a policy framework described in *The Introduction of an Equitable Share of Nationally Raised Revenue for Local Government,* published by the Department of Finance in 1998. They are administered by the Department of Provincial and Local Government. The equitable share transfer is supplemented by funding for personnel in R293 towns who have been transferred to a municipality. In the past, this was supplemented by an R293 functions transfer, which has now been incorporated into the equitable share. A similar programme of incorporation is planned for the CWSSP operating transfers. These currently provide in-kind transfers to some municipalities, such as free bulk water or subsidised water to consumers, or funding the operations of water services schemes inherited from former homeland governments. Equitable share transfers amount to approximately 44 per cent of all transfers to local government in the current financial year.

- *Conditional grants and agency payments* are designed to provide for national priorities in the budgets of municipalities. This occurs through the promotion of national norms and standards, and to support the local government transition by funding capacity building and restructuring within recipient municipalities. Such grants also help to address backlogs and regional disparities in social infrastructure.

Agency payments

The framework for conditional grants to municipalities has evolved considerably since its introduction in 1994. The first phase of conditional grants were introduced as an interim measure to support the fast-track development programmes outlined in the RDP. To ensure the rapid expansion and delivery of services, and in the context of limited local government capacity, these grants were often spent directly by national departments, on behalf of municipalities. While this "agency" approach was both appropriate and successful in achieving Governments' policy objectives, numerous problems have been identified. In particular, allocations were not reflected on municipal budgets, leading to inadequate provision for ongoing operational and maintenance requirements. In addition, allocations to municipalities were often made in-year, leaving little time for adequate project planning at local level. This has been exacerbated by the single-year budgeting approach employed by municipalities.

Reforms to conditional grants

Reforms to the framework for conditional grants will address these problems in the context of wider reforms to municipal financial and strategic management practices, as outlined in the Municipal Finance Management Bill and other legislation. In particular, the redemarcation of municipal boundaries is intended to improve their capacity to plan and manage service delivery. Legislative reforms introduce three-year budgeting, alongside more effective financial management procedures. In this context, it is appropriate that the conditional grants regime enters a second phase of reform, where transfers are made directly to municipal budgets. Municipalities are to be held accountable through the democratic process, with regular auditing, and through compliance with outcomes determined in terms of national priorities.

There are two main forms of conditional grants, namely:

Infrastructure grants on application

- *Infrastructure transfers* are made to those municipalities that apply for or are selected to receive these funds. They are intended to assist municipalities to extend or rehabilitate social and residential infrastructure that provides basic services to communities. Such transfers occur either in the form of agency payments or conditional grants, and are operated and disbursed by line function departments in pursuit of specific policy objectives. Progress has been made in coordinating the number of infrastructure transfer programmes. However, considerable further work is required to ensure that the method of disbursement is equitable, that infrastructure and housing programmes are properly coordinated, that accountability for funds is clarified, and that the sustainability of investments is enhanced. Infrastructure transfers amount to approximately 27 per cent of all transfers to local government in the current financial year.

Transfers to support national priorities

- *Current transfers* are made to municipalities on an application basis in support of the policy priorities of particular national departments. A wide variety of these programmes exist, and transfers are made either as conditional grants or as agency payments. Current transfers primarily support municipal restructuring initiatives, the enhancement of the capacity of municipalities to perform their functions and the provision of subsidised bus services. The scope for rationalising the number of current transfers is considerable. Current transfers amount to approximately 29 per cent of all transfers to local government in the current financial year.

  Treasury closely monitors the devolution of certain functions, such as health services, to municipalities to ensure that adequate financial resources are also transferred to enable the municipalities to perform these functions effectively. For instance, primary health services are funded via the provincial equitable share, and any functional transfer must be accompanied by the transfer of staff and financial resources, in a process similar to R293 towns transfers. This is a lengthy and complex process, with success dependent on extensive intergovernmental and interdepartmental cooperation.

Allocation trends

Table 7.1 indicates the equitable share, conditional grants and agency payments transferred to municipalities from 1995/96, as well as budgeted amounts between 2000/01 and 2002/03. In 1998/99, total transfers to municipalities amounted to R4,19 billion. Total transfers to municipalities rose sharply from 1995/96 to 1997/98, although this reflects the inclusion of existing programmes rather than real increases. However, 1998/99 was marked by a steep decline in transfers due to the amalgamation of programmes associated with the introduction of the equitable share and the CMIP. The “core” equitable share transfers have shown the most stability over the period, while conditional grants and agency payments have been particularly volatile.

Transfers to municipalities are managed by a number of departments, with the Department of Provincial and Local Government being the primary agency. It manages the equitable share transfers, R293 grants, CMIP, the Local Economic Development (LED) Fund, the Social

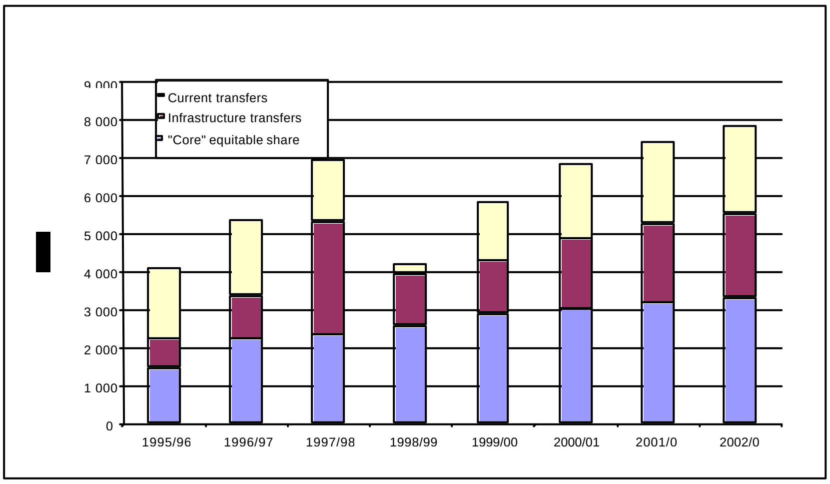
Plan Fund and the local government support grant. Other departments involved in transfers to municipalities are the Department of Water Affairs and Forestry, through the CWSSP capital and operating subsidies, the Department of Public Works, through the CBPWP, and more recently the national Treasury through the financial management and restructuring grants. The Departments of Land Affairs, Transport, and Housing also make various grants and agency payments to municipalities.

Table 7.1 National transfers to local government[1]

R million	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03
Equitable share (incl. IGGs)	830	806	903	1 024	1 673	1 867	1 997	2 130
R293 personnel[2]	560	864	883	951	463	463	463	463
R293 transfer	86	80	68	0	40	0	0	0
CWSS (Operating)	0	497	493	599	710	704	731	741
"Core" equitable share	**1 476**	**2 247**	**2 347**	**2 574**	**2 886**	**3 034**	**3 191**	**3 334**
Percentage growth	–	52	4	10	12	5	5	4
Agency transfers[1]	78	82	78	0	0	0	0	0
"Traditional" subsidies[3]	23	26	48	0	0	0	0	0
Other	48	162	45	0	0	0	0	0
CMIP (incl. MIP, EMIP, BCIG)	126	540	1 382	703	696	883	994	1 059
CWSS (Capital)	496	321	1 429	520	429	609	744	807
Community-based public works[5]	0	0	0	152	274	274	274	274
LED Fund[5]	0	0	0	0	5	75	78	81
Infrastructure transfers	**771**	**1 131**	**2 982**	**1 375**	**1 404**	**1 841**	**2 090**	**2 221**
% growth	–	47	164	(54)	2	31	14	6
Agency transfers[1]	956	1 074	1 073	0	0	0	0	0
"Traditional" subsidies[3]	59	98	85	0	0	0	0	0
Other[6]	643	600	258	0	0	0	0	0
Land development objectives	0	0	3	24	14	44	45	47
Financial management	0	0	0	0	0	50	60	70
Social Plan Fund	0	0	0	0	3	3	3	3
Spatial development initiatives	0	0	0	0	103	0	0	0
Bus subsidies	192	229	229	34	1 293	1 409	1 522	1 629
LG support grant	0	0	0	181	137	150	160	170
Restructuring grant	0	0	0	0	0	300	350	400
Current transfers	**1 850**	**2 001**	**1 648**	**239**	**1 550**	**1 956**	**2 140**	**2 319**
% growth	–	8	(18)	(85)	549	26	9	8
Total	**4 097**	**5 379**	**6 977**	**4 188**	**5 840**	**6 831**	**7 421**	**7 874**
% growth	–	31	30	(40)	39	17	9	6

1. Excludes certain agency transfers such as the Urban Transport Fund and the Settlement and Land Acquisition Grant
2. Excludes salary increases for R293 personnel
3. Includes transfers for transport, health and sports and recreation
4. Includes fire services, and library transfers
5. Poverty relief allocations, projected in outer budget years
6. Includes rural administrative infrastructure development, debt redemption and loan subsidises
7. Bus subsidies are agency payments and are mostly transferred to bus commuter agencies, not municipalities.
Source: An Equitable Share of Nationally Raised Revenue for Local Government, 1998; Budget Review, 1997 to 2000

Figure 7.1 National transfers to local government



Equitable share

A constitutional entitlement

Section 214 of the Constitution entitles local government to an equitable share of nationally raised revenue. For 2000/01, the equitable division of revenue raised among the three spheres resulted in a share of R1 867 million for local government. The MTEF increases the allocation to R1 997 million in 2001/02 and to R2 130 million in 2002/03.

Table 7.2 The vertical division of revenue

Nominal figures						Nominal change[1]		Real change[2]	
R million	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**	**Whole period**	**From last year**	**Whole period**	**From last year**
National	77 039	82 434	88 687	95 783	100 386	30,3	7,6	7,3	1,7
Provincial	80 802	86 595	94 408	100 167	105 158	30,1	9,0	7,2	3,0
Local	1 024	1 673	1 867	1 997	2 130	108,0	11,6	71,3	5,5
Total	**158 865**	**170 702**	**184 962**	**197 947**	**207 674**	**30,7**	**8,4**	**30,7**	**8,4**

1. Before adjusting for inflation
2. Nominal figures adjusted for inflation
Source: Budget Review, 2000

The equitable shares for the different spheres are determined annually by Cabinet, based on its strategic priorities. Allocations to local government have consistently been markedly smaller than those to provinces, because municipalities have considerable own revenue sources and provinces do not. However, the local government allocation is projected to grow much faster over the medium term, by a total of 71,3 per cent in real terms from 1998/99. The real change in both national and provincial shares is projected at less than 7,5 per cent over the same period. Note, however, that the increase in the local government share is off a very low base.

SALGA allocation

A small allocation is made to the South African Local Government Association (SALGA) and the remaining local government allocation is then distributed by formula among all primary municipalities.

Unlike the former approach to intergovernmental transfers, which were managed by the provinces and disbursed according to a variety of criteria, the equitable share formula has been designed to facilitate an equitable distribution of resources among municipalities. As such it has two components, namely the institutional capacity (or I) grant that supports those municipalities with limited capacity, and the services (or S) grant that supports all municipalities to deliver a basic level of service. The formula thus targets resources at municipalities that have a large number of poor households.

Table 7.3 Distribution of equitable share transfers

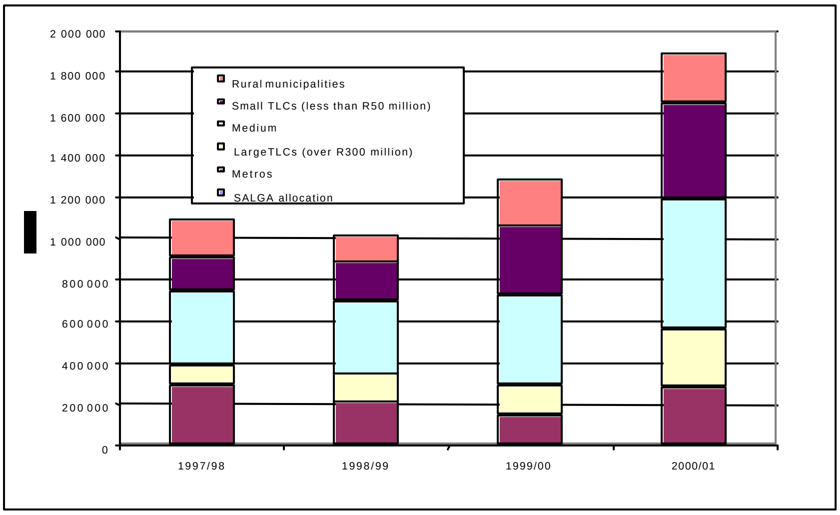
R million	1997/98	1998/99	1999/00	2000/01
SALGA allocation	5	12	13	15
Metros	291 193	209 457	146 325	283 499
Large TLCs (over R300 m)	98 166	135 613	145 499	281 890
Medium	352 276	351 413	431 332	624 581
Small TLCs (less than R50 m)	170 856	189 281	333 956	462 268
Rural municipalities	176 360	126 187	222 637	241 512
Total	**1 088 856**	**1 011 963**	**1 279 762**	**1 893 765**

Note: *Allocations are reflected in terms of the municipal financial year.*
Sources: Annual Reports on the Equitable Share, 1998 to 2000

Two components of the equitable share

Figure 7.2 shows the significant growth in the total equitable share allocation to local government, as well as the redistributive effect of the allocation formula. This resulted in a significant decline in allocations to large municipalities until 1999/00, although rising slightly in the current financial year owing to the incorporation of the R293 functions portion into the equitable share. In addition, allocations to municipalities are being more closely aligned to the actual formula-generated amounts.

Figure 7.2 Distribution of equitable share by type of municipality



I grant allocations

The first component of the equitable share is the so-called I grant, aimed at enabling eligible municipalities to maintain functioning administrations. Approximately R209 million was allocated to the I grant in 2000/01. Municipalities with higher average income levels receive smaller I grants, as they are considered to have sufficient revenue-raising capacity to finance their basic operations. Wealthy municipalities do not receive the I grant.

I grants not for very small municipalities

Eligibility for I grants is also limited to municipalities with populations in excess of 2 000 people. Jurisdictions with very low populations are considered too small to achieve the economies of scale necessary for providing public services cost-effectively. In such cases, district councils are expected to provide services. In 1999/00, municipalities with populations between 2 000 and 7 500 inhabitants received per capita I grants of over R50. The average per capita grant to municipalities with over 25 000 inhabitants averaged less than R5.

Table 7.4 Per capita I grants by population size in 1999/00

Population size of municipality	Average per capita I grant (R)	Average monthly income per capita	Average per capita I grant (R)
Less than 1 000	0,0	Less than R181	8,90
1 000–1 999	0,0	R181–R360	21,30
2 000–4 999	105,40	R361–R540	44,60
5 000–7 499	57,70	R541–R720	55,30
7 500–9 999	35,30	R721–R900	45,90
10 000–14 999	24,60	R901–R1 260	29,90
15 000–24 999	6,90	R1 261–R2 000	11,60
25 000–49 999	4,30	R2001 and more	3,50
50 000–99 999	3,70		
100 000–499 999	2,40		
500 000 +	0,10		
Average	**4,30**	**Average**	**4,30**

Source: Department of Provincial and Local Government Annual Report 1999/00

S grant allocations

S grant supports basic services

The largest part of the equitable share payments to local government is the S grant, which aims at ensuring that low-income households in all municipal jurisdictions receive access to basic municipal services. Each block of grant is equal to the estimated cost of providing "basic services" to all poor households. For purposes of this grant, poverty has been defined as households earning R800 or less per month.

In reality, more goes to rural areas

The S grants distributed to rural and urban municipalities are shown separately in tables below because of the use of different urban and rural phase-in parameters. For 1999/00, the phase-in parameter (or *alpha*) was set at 0,7 for urban and metropolitan areas and 0,25 for rural areas. It was initially proposed that the phase-in process be completed over five years for urban areas and seven years for rural areas. However, with the redemarcation of municipal boundaries, the phase-in period and the distinction between urban and rural areas are being re-evaluated. The average rural municipality actually receives a larger grant than the average urban municipality, R23,90 as against R20,50, as rural areas are generally much poorer. Since S grants are proportional to the number of poor households, the average per capita grant is higher in rural areas with high levels of poverty than in urban areas.

Table 7.5 Per capita S grants by population size and urban/rural status in 1999/00

Population size of municipality	Average per capita S grant (R)		Average monthly income per capita	Average per capita S grant (R)	
	Rural	Urban/Metro		Rural	Urban/Metro
Less than 1 000	14,20	42,20	Less than R181	32,80	87,60
1 000–1 999	16,50	41,40	R181–R360	29,30	69,50
2 000–4 999	20,50	41,00	R361–R540	23,10	57,80
5 000–7 499	16,60	43,10	R541–R720	21,40	50,10
7 500–9 999	19,40	36,20	R721–R900	15,50	38,80
10 000–14 999	16,50	42,10	R901–R1 260	10,50	31,90
15 000–24 999	19,10	32,30	R1 261–R2 000	10,10	22,60
25 000–49 999	20,10	31,80	R2001 and more	6,00	18,60
50 000–99 999	26,30	28,50			
100 000–499 999	27,50	28,00			
500 000 +	20,10	10,90			
Average	**23,90**	**20,50**	**Average**	**23,90**	**20,50**

Source: Department of Provincial and Local Government Annual Report 1999/00

R293 town personnel grant

Some of the former homeland governments did not have municipalities and thus performed municipal functions themselves. These areas are known as R293 towns, after the proclamation that established them. In 1994, R293 towns and their relevant functions and personnel were transferred to provinces, with the intention to transfer them on to local government structures as these were created. The Transfer of Staff to Municipalities Act of 1998 allows for staff to be transferred to municipalities from provinces if they perform municipal functions. In 1998/99, R951 million was allocated to fund the personnel and service commitments of these towns. In 1999/00, the funds were split into three components: R463 million for personnel expenses, R447 million for services and R40 million for an incentive grant to encourage staff transfers to municipalities. The latter two elements have now been incorporated into the equitable share for local government.

For 2000/01, an amount of R463 million (plus any salary increases over the period) has been allocated to fund the costs of R293 staff who have been transferred to municipalities or have remained with a provincial government.

Slow progress

Progress, however, has remained slow, leading Government to impose a strict cut-off date and other measures to facilitate transfers. This is the last year that this grant allocation will be made. All R293 staff not transferred by 30 September 2000 will be accommodated in the respective provinces. The funds for their salaries will be retained by that provincial government, and lost to local government. Municipalities accepting the transfer of staff will be guaranteed a three-year subsidy from the date of transfer, following which the funds will be incorporated into the equitable share for local government.

Community Water Supply and Sanitation Programme operating grants

The Department of Water Affairs and Forestry currently operates a large number of water services schemes, performing both bulk and distribution functions. Most of these schemes were inherited from the former homeland governments in 1994. The operating costs of these schemes are funded from the Water Services Trading Account, and under 1 per cent of their operating costs are recovered from bulk and retail consumers.

This grant has been funded nationally and does not flow to municipalities directly, although transfers of water are intended to reach specific groups of poor households in municipalities. The department is preparing to transfer these schemes to municipalities, in line with the requirements of the Constitution. This process will be similar to the R293 transfer programme and will take a number of years. The funds currently in the Water Services Trading Account will be used to facilitate the transfer and will eventually be integrated into the equitable share.

SALGA Allocation

National government intends to determine SALGA's allocation on a matching basis in future years, taking into account the membership contributions of municipalities. The allocation will be disbursed through a dedicated grant mechanism.

Conditional grants

Conditional grant programmes are managed by a variety of departments including Provincial and Local Government, the national Treasury, Water Affairs and Forestry, Transport, and Public Works.

Infrastructure grants

The main purpose of national government's substantial contribution to social and residential infrastructure investment by municipalities is to ensure that all households have access to at least a basic level of service. Infrastructure transfers are thus targeted at poor households.

The benefits and importance of national support for municipal infrastructure investment have repeatedly been emphasised in government policy documents. The provision of basic municipal infrastructure is often identified as a collective public good that warrants state support due to the range of benefits of infrastructure investment, particularly to poor households. These benefits include:

- Job creation and skills training, as construction tends to be labour-intensive
- Greater equity, social access and development

- Positive spin-offs for economic activity

However, the public sector alone does not have the resources to meet the infrastructure requirements of communities. Government policy has thus repeatedly emphasised the importance of leveraging private sector capital in support of municipal infrastructure investment. If correctly conceptualised, national government spending on municipal infrastructure can stimulate municipal access to capital markets, thereby crowding in additional resources for infrastructure expansion.

Core mechanisms

National funding of municipal infrastructure occurs through a number of core mechanisms. Most of these programmes are administered by national departments, who retain financial responsibility in order to fast-track development, as municipalities were initially deemed not to have the capacity to assume this.

Grants tend to be ad-hoc and allocated on a one-year basis during the course of the financial year. Many of these grants do not appear on municipal budget, raising problems of sustainability and political accountability. The grant programmes are as follows:

- The *CMIP* is operated by the Department of Provincial and Local Government. It funds the creation, extension, upgrading or rehabilitation of internal bulk, connector and internal infrastructure, and community services and facilities for low-income households to a ceiling amount of R7 000 per household. Approximately 65 per cent of expenditure is linked to the housing programme. Funding is provided to municipalities on an application basis, through the submission of an application for project assistance to provincial government. This includes a municipal council resolution approving each project. The province prioritises applications and informs municipalities with the highest priorities to prepare business plans. Once prepared, these plans are again prioritised and submitted to the Provincial Executive Council for approval. They are then submitted to the department which, if satisfied that all the requirements have been fulfilled, will recommend funding for the projects.

  Any allocation made to a municipality must be included in the municipal budget in this financial year, having not been the case previously. Funds must be used for capital projects, although a maximum amount of 3,5 per cent of each province's allocation may be utilised for programme management services.

- The *LED Fund*, operated by the Department of Provincial and Local Government, supports the job creation and poverty alleviation projects of municipalities, with a focus on social infrastructure. Municipalities submit applications for assistance in the form of a project business plan. The projects identified by the municipalities must meet the criteria of the LED Fund. The business plan acts as a contract between the department and the municipality, and the department will transfer funds directly to the municipality. Municipalities must submit monthly reports based on clear key performance indicators during the utilisation of grant funding. Thereafter the department will require quarterly project reports for the following two years.

- The *CWSS* is operated by the Department of Water Affairs and Forestry. It funds bulk, connector and internal capital infrastructure for basic water services, where a municipality lacks the required capacity, at an amount of approximately R2 200 per household. Funds may only be committed to new projects once a formal agreement has been reached between the department and the municipality regarding the responsibility for ongoing financial responsibilities for support to the project. A maximum of 5 per cent of the allocation may be used for national and regional programme management services.
- The *CBPWP*, managed by the Department of Public Works, funds job creation and poverty alleviation programmes for poor rural communities. These programmes create productive assets and provide temporary and permanent jobs. The programme is concentrated in 12 district councils in three provinces (Eastern Cape, KwaZulu-Natal and Northern Province), with 40 per cent expenditure on roads and the remainder on social or agricultural infrastructure. The department retains overall financial accountability for the programme, sets policy and employment targets, contracts with programme implementing agents, and monitors performance.
- The *South African Housing Fund* is managed by the Department of Housing, and funds the national housing programme, which provides subsidies of approximately R16 500 to low-income households. These are in the form of an agency payment to the provinces rather than a direct transfer to local government. However, the fund is closely linked to municipal infrastructure programmes. Approval of housing subsidy applications is dependent of land and infrastructure finance being made available by the relevant municipality. Developers or accredited municipalities may submit applications to the Provincial Housing Board.
- The *National Electrification Fund*, controlled by the Department of Minerals and Energy, funds grid electrification for households. At present, this off-budget transfer is financed through a levy on electricity, providing approximately R2 000 per connection. Funds are drawn primarily by Eskom, although approximately R300 million is transferred to municipalities by the National Electricity Regulator, with the managerial assistance of the Development Bank of Southern Africa.
- The *Urban Transport Fund*, managed by the Department of Transport, provides for the development of transportation infrastructure in metropolitan areas. The fund is operated as an agency payment and is disbursed at the discretion of the Department of Transport.

The small number of additional infrastructure transfers are predominantly in the form of asset transfers, such as those associated with the settlement and land acquisition grant managed by the Department of Land Affairs.

The CBPWP and the LED Fund originate from poverty relief allocations. However, other than the CWSSP, these programmes make transfers directly to municipalities on the basis of project applications. As departments manage these transfers, there is some variance in the conditions attached to them.

Trends in infrastructure transfers

The core transfers for social and residential infrastructure were reported to have peaked at R2 982 million in 1997/98. This was due to funding being channelled through the RDP Fund, although there remains some uncertainty as to whether all these funds were spent on asset creation. The incorporation of the RDP Fund led to a drop in funding of approximately 56 per cent in 1998/99 to R1 405 million. However, capital transfers are projected to grow significantly in the medium term to R2 221 million in 2002/03.

Although some of the grants discussed above are not direct transfers to local government, they do have a significant effect on municipal infrastructure investment. Of particular importance here is the South African Housing Fund. Although housing subsidies are transferred to the provinces, municipalities must provide associated public infrastructure and remain important stakeholders in housing projects. Other national programmes focusing on the development of elements of municipal infrastructure include the settlement and land acquisition grant, operated by the Department of Land Affairs, and the Urban Transport Fund operated by the Department of Transport.

Table 7.7 Capital expenditure on social and residential infrastructure at municipal level[1]

R million	Actual 1995/96	Actual 1996/97	Actual 1997/98	Actual 1998/99	Actual 1999/00	2000/01	2001/02	2002/03
Agency transfers[2]	78	82	78	0	0	*0*	0	0
"Traditional" subsidies[3]	23	26	48	0	0	*0*	0	0
Other	48	162	45	0	0	*0*	0	0
CMIP (incl. MIP, EMIP, BCIG)	126	540	1 382	703	696	*883*	994	1 059
CWSS	496	321	1 429	520	429	*609*	744	807
CBPWP[4]	0	0	0	152	274	*274*	274	274
LED Fund[4]	0	0	0	0	6	*75*	78	81
Subtotal	771,6	1 131,7	2 982,0	1 375,0	1 404,5	1 841,0	2 090,0	2 221,1
Electrification[5]	1 055,4	1 048,9	866,7	845,1	*1 400,0*	*1 400,0*	*1 400,0*	*1 400,0*
Housing	821,3	1 453,2	2 634,9	2 860,0	2 961,2	2 997,7	3 177,0	3 320
Total	**2 648,3**	**3 633,8**	**6 483,6**	**5 080,1**	**5 765,7**	**6 238,7**	**6 667,0**	**6 941,1**

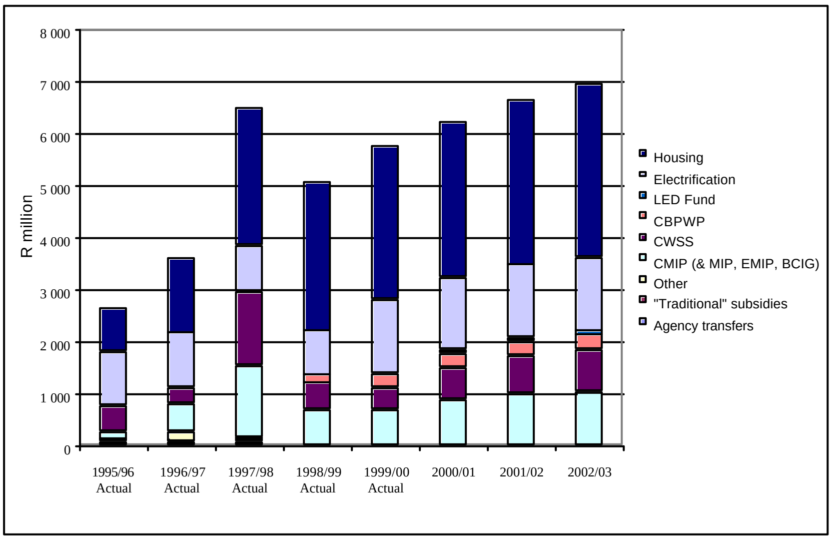
1. Excludes certain agency payments such as the Urban Transport Fund and the settlement and land acquisition grant
2. Includes transfers for transport, health and sports and recreation
3. Includes fire services and library transfers
4. Poverty relief allocations projected in outer budget years
5. Allocations from 1999/00 are preliminary and indicative only, reflecting industry cost estimates.

Electrification

Eskom currently funds the national electrification programme, although from 2001/02 this will be done through the national fiscus and on budget, due to changes in the tax regime for the utility.

Municipalities also utilise their own revenue sources for infrastructure investment. For instance, district and metropolitan council levy income (which amounted to an estimated R3,4 billion in 1998/99) should be used for this purpose.

Figure 7.3 Expenditure on social and residential infrastructure



Distribution of infrastructure transfers

Limited information available

Information on the actual distribution of infrastructure transfers to municipalities is limited. However, the Division of Revenue Act of 2000 introduced a requirement for more detailed reporting by transferring departments. The Treasury launched a major programme to improve the detail and quality of information for future years.

A Treasury survey

In the interim, the Treasury conducted a limited survey of municipal infrastructure transfers in Gauteng and Eastern Cape between 1997/98 and 1999/00. The tables and graphs below show transfers by programme to different-sized municipalities. While the categories of metropolitan, district and rural municipalities are self-explanatory, urban municipalities are distinguished by the size of their annual budgets. Large, medium and small urban municipalities are those with annual budgets exceeding R300 million, R50 million, R25 million respectively. The remainder, with budgets below R25 million, is categorised as very small urban municipalities.

Eastern Cape trends

In Eastern Cape, the Housing Fund and CMIP allocations constitute the bulk of transfers to urban municipalities, mainly to very small municipalities. The shift in allocations to these municipalities has intensified, while allocations to others have declined. Small allocations from the Urban Transport Fund have been made to large municipalities, although this has declined over the period.

Allocations from the CWSS and CBPWP form the bulk of transfers to rural and district municipalities, with increasing roles being played by CMIP and the settlement and land acquisition grant. Housing Fund grants to these municipalities have declined over the period.

In Gauteng, similar patterns are evident although, given the high level of urbanisation in the province, lttle has been received from rural infrastructure programmes. Indeed, the bulk of allocations have originated from the housing fund. Metropolitan and district municipalities have been the primary beneficiaries of infrastructure transfers via CMIP, largely due to the limited number of small municipalities in the province. Infrastructure allocations, while peaking in 1998/99, were lower in the subsequent financial year.

Figure 7.4 Infrastructure transfers to Eastern Cape municipalities by size and programme

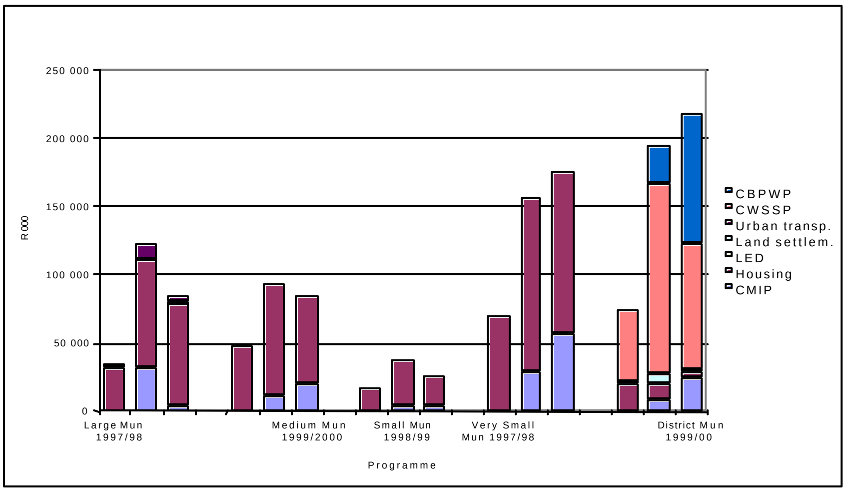
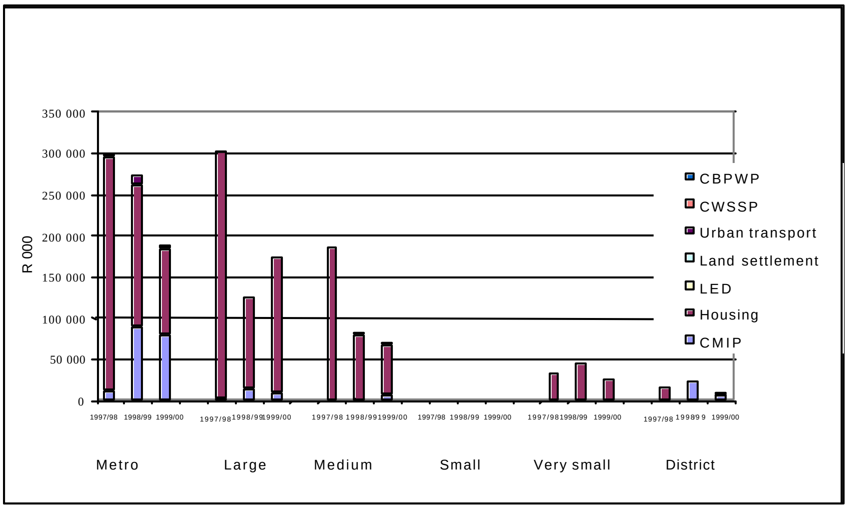


Figure 7.5 Infrastructure transfers to Gauteng municipalities by size and type



This limited survey underlines concerns that the distribution of municipal infrastructure transfers has been inequitable, and the Treasury is conducting a detailed investigation. It has been argued that, nationally, small and medium-sized urban municipalities have been the primary beneficiaries of direct national infrastructure transfers. While rural municipalities have benefited from the in-kind transfer of assets, particularly water services infrastructure, this approach has tended to undermine the sustainability of services. In particular, the full life-cycle costs of operating and maintaining the assets are not taken into account during project initiation.

Limited benefits to large urban and metro councils

Similarly, large urban and metropolitan areas have received only limited benefits from infrastructure programmes. This has primarily been due to perceptions of their greater fiscal capacity, being able to both fund investments from own revenues and access capital markets. This has led to resources being directed to weaker municipalities.

However, fiscal constraints in larger urban municipalities have often resulted in investment in poor township areas being slower than anticipated. This is of particular concern due to the pivotal role that these urban areas play in national economic development. Reforms to the current system of municipal infrastructure transfers will therefore aim at improving the predictability of funding for municipalities, the sustainability of investments and, ultimately, the effectiveness of infrastructure delivery programmes.

Despite considerable progress in the expansion of municipal infrastructure services, demand continues to outstrip supply, leading to rising backlogs in some services. Limited progress has been made in the elimination of backlogs in critical public services such as sanitation. Municipal spending on infrastructure extension and rehabilitation remains slower than anticipated due to fiscal constraints, and this has led to the erosion of the technical integrity of infrastructure networks and delays in the expansion of service delivery. Moreover, it has limited the scope of infrastructure investment, resulting in considerable underfunding of certain services in poorer areas, particularly internal road networks.

Fragmented allocation mechanisms

Current allocation mechanisms are highly fragmented and disbursement mechanisms invariably project-based and centralised. This undermines integrated development and prevents effective planning at a municipal level, and is of particular concern due to the long lead-times associated with infrastructure development. Moreover, the current approach conflicts with the recent introduction of municipal budget reforms that encourage three-year budgeting by municipalities. In some cases, these problems have reduced the ability of municipalities to anticipate allocations or integrated development projects effectively. Moreover, they have resulted in a further fragmentation of the fiscal system for municipal transfers.

Table 7.8 Infrastructure transfers to Eastern Cape municipalities by size and programme

	Large municipalities			Medium municipalities			Small municipalities			Very small municipalities			District municipalities		
R 000	1997/98	1998/99	1999/00	1997/98	1998/99	1999/00	1997/98	1998/99	1999/00	1997/98	1998/99	1999/00	1997/98	1998/99	1999/00
CMIP	0	31 716	3 789	4	11 075	19 437	26	3 593	3 650	71	29 197	56 187	0	8 555	24 366
Housing	31 512	78 528	74 291	47 676	82 332	64 126	17 403	33 918	22 061	69 181	127 989	118 831	20 545	12 091	4 621
LED	0	0	0	0	0	0	0	0	0	0	0	0	0	0	300
Land settlement	0	1 000	2 149	0	0	0	0	0	0	0	0	0	1 364	6 175	723
Urban transport	2 500	11 707	4 170	0	0	0	0	0	0	0	0	0	0	0	0
CWSS	0	0	0	0	0	0	0	0	0	0	0	0	52 485	139 842	92 669
CBPWP	0	0	0	0	0	0	0	0	0	0	0	0	0	27 170	94 590
Total	**34 012**	**122 951**	**84 399**	**47 680**	**93 407**	**83 563**	**17 429**	**37 511**	**25 711**	**69 252**	**157 186**	**175 018**	**74 394**	**193 833**	**217 269**

Table 7.9 Infrastructure transfers to Gauteng municipalities by size and programme

	Metropolitan municipalities			Large municipalities			Medium municipalities			Small municipalities			Very small municipalities			District municipalities		
R 000	1997/98	1998/99	1999/00	1997/98	1998/99	1999/00	1997/98	1998/99	1999/00	1997/98	1998/99	1999/00	1997/98	1998/99	1999/00	1997/98	1998/99	1999/00
CMIP	13 138	90 282	79 717	2 234	13 999	8 791	356	1 007	7 452	0	0	0	0	0	244	353	22 851	5 940
Housing	281 413	170 826	103 242	298 965	111 330	164 283	185 359	78 441	61 146	0	0	0	33 696	44 835	26 339	17 306	0	256
LED	0	0	0	0	0	244	0	0	179	0	0	115	0	0	0	0	0	0
Land settlement	0	0	0	0	0	0	0	1 717	0	0	0	0	0	0	0	0	0	761
Urban transport	2 010	10 921	4 800	0	0	0	0	0	0	0	0	0	0	0	0	0	113	0
CWSS	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1 585
CBPWP	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Total	**296 561**	**272 029**	**187 759**	**301 199**	**125 329**	**173 318**	**185 715**	**81 165**	**68 777**	**0**	**0**	**115**	**33 696**	**44 835**	**26 583**	**17 659**	**22 964**	**8 542**

Current transfers

A number of current transfers have been introduced to address specific issues such as capacity building and the restructuring of the local government sphere. Most of these grants are conditional and are administered by national departments. The scope and scale of current grants are significant, providing wide-ranging support for the delivery of critical public services, through the following programmes:

- The *local government restructuring grant*, managed by the national Treasury, assists large municipalities in undertaking extensive financial restructuring. These exercises benefit national economic stability and development. Eligibility for the grant is restricted to municipalities whose total annual budgets exceed R300 million. The municipalities must first demonstrate that they have undertaken a credible analysis of the potential financial difficulties or opportunities that face them. They also need to have taken significant steps for at least six months to address any fiscal imbalance. They have to develop a credible restructuring plan that addresses identified potential difficulties or opportunities. The grant goes to municipalities that are unable to contain the short- to medium-term negative effects of restructuring, and that can demonstrate positive national economic benefits of national government assistance in the restructuring programme. Disbursement is by application, and dependent on the outcome of a positive assessment. Once a municipality has agreed to the terms and conditions of the grant, funds are transferred directly to municipalities and must be included in municipal budget.

- The *local government support grant*, managed by the Department of Provincial and Local Government, funds municipal institutional and financial restructuring programmes. The programme operates under the auspices of Project Viability. For the current year, funds have been split into a Management Support Programme of R60 million, an Institutional Reorganisation Fund of R60 million and Municipal Financial Assistance of R30 million. All applications for these funds should be accompanied by a business plan, approved by the council. Such business plans will specify the purpose for which the funds will be utilised and include a clear cash flow projection for the flow of the funds from the province to the affected municipality. They must also show the expected impact on the council, and the reason why the council is unable to provide the funds.

  The Management Support Programme funds the implementation of programmes that assist in stabilising and turning around distressed local authorities. The Institutional Reorganisation Fund is for the implementation of the Change Management Design or Transformation Plan as recommended by the management support teams. The municipal financial assistance grant enables provinces to support selected municipalities in financial difficulty. The department determines the division of the grant between provincial and local spheres after consultation with SALGA. Funds are transferred to a municipality directly or to a district council.

Management Support Programme and Municipal Financial Assistance funds will be released after approval of a business plan, submitted by the province to the department. This has to indicate the number, names and funding requirements of municipalities identified for management support programmes. The Institutional Reorganisation Funds will be released once the implementation of the Change Management Design has been accepted by council resolution at municipal level.

- The *Social Plan Measures Fund* is a poverty relief allocation managed by the Department of Provincial and Local Government. Its primary purpose is to fund local economic regeneration studies in localities affected by retrenchments. The main outcome of this study will be a business plan for the municipality, which can be submitted to the Regenerating Local Economies Programme steering committee. To be eligible for assistance, a municipality must be affected by large-scale retrenchments within a company or subsector of their local economy, or indirectly affected by such retrenchments. For instance, it might experience backward migration, or be a "thriving" municipality in a region that is facing large-scale job losses. Once approved, funds are transferred directly to municipalities and included in the municipal budget.
- The *financial management grant* is managed by the national Treasury and assists metropolitan, district and large category B (primary) municipalities in building their financial and strategic management capacity. This is achieved through supporting the implementation of budgeting and financial reporting systems reforms, building their capacity for financial planning, operating and capital budgeting, and developing systems for linking outputs to resource allocation. In particular, this grant is intended to assist municipalities in developing three-year, strategic management-oriented budgets. In the longer term, this grant will help municipalities to implement the Local Government Financial Management Act, once it has been promulgated. Eligible municipalities must agree to appoint a municipal manager and a head of finance, and must submit an outline of their plans to improve financial management or to pilot budget reforms.
- The *land development objectives* grant is managed by the Department of Land Affairs. It assists municipalities in improving their strategic capacity to manage land-use development through the adoption of land development objectives in terms of the Development Facilitation Act, 1995. Funds are targeted at underresourced, poor, mainly rural or non-metropolitan municipalities that are located in provinces with regulations on land development objectives or a similar regulatory framework. Applications may be submitted by municipalities or provinces and must contain evidence of planning for land reform, provide an assessment of planning need, show a capacity for the management of risks and be cost-effective. While the grant itself is intended to support the preparation of land development objectives, this will not be the sole criterion for disbursement. The grant will be increasingly aligned with the local government financial management grant and the local government support grant.

- The *housing grant* for provincial and local government capacity building is managed by the Department of Housing and assists municipalities in implementing subsidised housing projects. The goal is to build the relevant capacity and skills among various stakeholders to perform their respective roles and responsibilities in the housing process. As such, the department primarily funds the provision of training courses to relevant stakeholders, to develop the skills required for successful housing delivery.
- *Bus subsidies* are an agency payment managed by the Department of Transport. This historical subsidy is targeted to areas that have particularly acute apartheid land-use distortions. Allocations are made subject to an agreement between national and provincial departments regarding the management and administration of subsidised bus services. The provincial departments must report on expenditures prior to the transfer of funds. These expenditures are derived from claims received from bus service operators in terms of their contracts with the departments. The contracts are either interim contracts, wherein claims are based on sales of subsidised tickets, or tender claims based on applicable "revenue kilometres" which are, in turn, monitored by outside firms. Contracting authorities are redesigning transport networks to integrate transport modes and spatial development.

Trends in current transfers

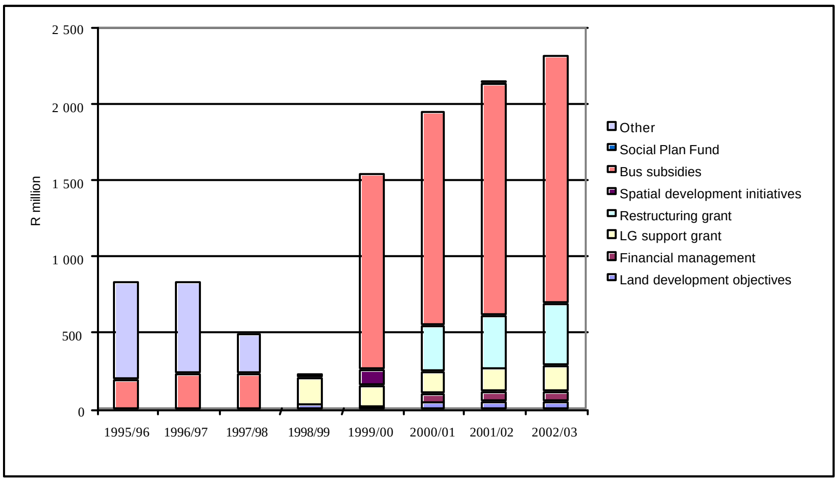
Bus subsidies

Bus subsidies are the most significant source of current transfers to municipalities in 2000/01. However, the restructuring grant accounts for the biggest portion of conditional grant allocations to municipalities, at R300 million. The social plan measures grant is the smallest current grant at R2,55 million.

Table 7.11 Current transfers to local government

	Actual					Budgeted		
R million	**1995/96**	**1996/97**	**1997/98**	**1998/99**	**1999/00**	**2000/01**	**2001/02**	**2002/03**
Land development objectives	0	0	3	24	14	44	45	47
Financial management	0	0	0	0	0	50	60	70
Subtotal Capacity	0	0	3	24	14	94	105	117
LG support grant	0	0	0	181	137	150	160	170
Restructuring grant	0	0	0	0	0	300	350	400
Subtotal Restructuring	0	0	0	181	137	450	510	570
Spatial development initiatives	0	0	0	0	103	0	0	0
Bus subsidies	192	229	229	34	1 293	1 409	1 522	1 629
Social Plan Fund	0	0	0	0	3	3	3	3
Other	643	600	258	0	0	0	0	0
Subtotal Other	835	829	487	34	1 399	1 412	1 525	1 632
Current transfers	**835**	**829**	**490**	**239**	**1 550**	**1 956**	**2 140**	**2 319**

Figure 7.6 Current transfers to municipalities



The total allocation of recurrent grants dropped from R1,1 billion in 1998/99 to R626,6 million (51,3 per cent) in 1999/00. The total allocation of recurrent grants increased by R353 million (or 56,3 per cent) to R979,6 million in 2000/01 owing to the introduction of the restructuring grant at R300 million and the financial management grant of R50 million. The total allocation of recurrent grants is projected to reach just over R1 billion in 2001/02, with average increases of 6,3 per cent projected for 2001/02 and 2002/03.

A number of these grant programmes are closely related. For instance, the local government support grant and the restructuring grant both provide assistance to municipal restructuring initiatives. The two grants complement one another, while taking cognisance of the varying needs of municipalities:

Restructuring grant

- The *restructuring grant* is R300 million in 2000/01 and increases by R50 million (or 16,6 per cent) to R350 million in 2001/02 and by another R50 million (or 14,3 per cent) in 2002/03 to R400 million. The grant supports medium-term restructuring exercises by large municipalities, with a first allocation of R225 million this year to the Greater Johannesburg Metropolitan Council.

Management and capacity support grant

- The *local government support grant* allocation dropped from R181 million in 1998/99 to R137 million in 1999/00. It increased to R150 million in 2000/01, and will increase by R10 million in each subsequent year. It funds a range of management support and capacity building initiatives in smaller municipalities. The management support programme of the local government support programme lacked financial capacity to implement the recommendations made by the management support teams. An institutional reorganisation fund of R60 million has therefore been introduced within the grant envelope. The aim is to implement the recommended change management design or transformation plans.

Other grants

A number of grants also have a close relationship with infrastructure transfers. For instance, the social plan measures grant provides direct input into the LED Fund and provides a map of how the LED Fund should be invested in municipalities.

The financial management, land development objectives and social plan measures grants jointly target municipal capacity building. A small percentage of most infrastructure transfer programmes is also directed at capacity building. For the CMIP, CWSSP and CBPWP, this amount is 3,5, 5 and 4 per cent respectively of the total transfer.

Transfers and spending of grants

Efficiency of framework

Fragmented funding

The plethora of transfers and the duplication of funding have raised concerns about the efficacy of the fiscal framework for infrastructure and current transfers. It has been argued that the approach to these transfers is incoherent, leading to current approaches to municipal infrastructure delivery and capacity building being fragmented and uncoordinated. Additionally, it has been alleged that the programmes fail to leave significant residual capacity in municipalities, as they are primarily designed to serve the needs of departments (or their consultants) to spend, rather than to improve the ability of municipalities to deliver. Many departments micro-manage grants.

Improving the conditional grants system

2000 Division of Revenue Act

Division of Revenue Act, 2000

The Division of Revenue Act, 2000, includes a number of new provisions to promote advanced planning and better accountability for conditional grants. These requirements are discussed in more detailed in Chapter 3. These provisions should improve planning, reporting and monitoring of conditional grants. They should also clarify the responsibilities of national, provincial and municipal officers administering grant programmes, to ensure that Government's policy goals are achieved.

New conditional grants system

Rationalisation

In addition to the changes to the Division of Revenue Act, several reforms are gradually being introduced to address problems in the transfer system. To address the efficiency concerns discussed above, national government is investigating the rationalisation of a number of infrastructure and current transfers. The outcome will be a single infrastructure transfer, a restructuring transfer and a capacity building transfer. These transfers will address the requirements of various aspects of national policy while encouraging an asymmetrical approach to the development of the local government system. However, transfers such as the bus subsidies are considerably more complex to transform. Nonetheless, the Department of Transport has made considerable progress in preparing for the devolution of public transport funding to municipalities.

Conclusion

Ongoing refinement

The framework of national transfers to local government is subject to ongoing review and refinement as the system of local government evolves in South Africa. To date, significant changes have been made to the system to improve its equity and efficiency. However, numerous problems remain and Government will continue to reform and streamline the transfer system. The aim is to ensure that it matches the policy objectives that underpin national and provincial governments' interfaces with the local sphere.