Local Government and Budget 2004

Prepared for the South African Local Government Association

Executive Summary

This report performs an analysis on the division of revenue to local government. Analyses were performed on the equitable share allocations at a micro level and on the equitable share formula and conditional grants. Data for this report has been extracted from the Division of Revenue Act, 2003 (Act 7 of 2003) Division of Revenue Bill, 2004 (Bill 4 of 2004), Budget Reviews 2001 –2004, Intergovernmental Fiscal Reviews 2001 and 2003.

The key findings can be listed as follows:

- There are numerous and large changes between the Local Government Equitable Share (LGES) that is stated in the Division of Revenue Act, 2003 (Act 7 of 2003) and the Division of Revenue Bill (Bill 4 of 2004).
    - There is no obvious trend with regard to the above changes, some municipalities have seen the LGES increase, while others have seen theirs decrease.
    - The Census data has not appeared to impact on the size of the LGES to individual municipalities.
    - The larger, wealthier metros have all seen their LGES allocations increase, while this is not the same for the less wealthy metros.
    - There are a significant number of nodal municipalities receiving less in the DORB 2004 than gazetted in the DORA 2003.
    - In total, the LGES shown in the Division of Revenue Bill 2004 for the 2005/06 budget year is lower than the same amount shown in the Division of Revenue Act 2003 for 104 Category B municipalities.
- There are unexplained changes to the size of variables set at policy level within the equitable share formula. There is also a lack of transparency surrounding what factors are driving the changes.
- There are insufficient data sets to perform a meaningful analysis of trends in either the equitable share or conditional grants. This is due to the time horizons involved and that these grants have continually evolved since their introduction.
    - The conditional grant system has been rationalised and restructured for the 2004/05 budget year.
- Conditional Grants to Local Government increase from approximately R5bn in 2003/04 to R6.7bn in the 2006/07 budget year. This is an increase of 11% over the medium term.

- Infrastructure grants form the bulk of infrastructure grants and increase from R4.1bn to nearly R6bn over the medium term.
- Capacity building grants will be capped at R750mn from 2005/06 onwards.
- In 2003/04 the Consolidated Municipal Infrastructure Programme (CMIP), the community based Public Works programme and the Urban Transport Fund together amounted to R2.64bn. In 2004/05 the Municipal Infrastructure Grant which replaces these grants amounts to R4.5bn.
- A commonality between the equitable share and the municipal infrastructure grant is that an individual municipality receives a share of funding as a proportion of the allocation to all municipalities, rather than their allocation being needs based.
- The MIG introduces a requirement that municipalities split infrastructure expenditure at a ratio of 80:20 between new and rehabilitated infrastructure. This raises the question of whether the 20% will be sufficient to meet the very urgent needs of maintaining existing infrastructure in municipalities. This ratio creates the incentive for municipalities to expand infrastructure but does not ensure an adequate amount is provided for maintenance.
- There is insufficient data and transparent descriptions of MIG formula to perform a comprehensive critical analysis of its structure.
- There is little discussion in the Budget Review 2004 explaining why applications for the restructuring grants were of a “poor quality and standard”. This should be researched, especially as large resources are being allocated for this purpose and the need for capacity building to ensure successful implementation of the Municipal Finance Management Act (Act 56 of 2003).
- The S-grant share of the equitable share formula may encourage municipalities to expand services without considering the maintenance implications. The Municipal Infrastructure Grant (MIG) may compound this as it encourages municipalities to spend on expansion and rehabilitation at a ratio of 80:20 therefore encouraging municipalities to use the MIG to expand services to the poor in the knowledge that they will be legible for a greater share of the s-grant allocations.

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1. Introduction.

This document summarises some of the key findings from a review of the 2004 budget figures. This report has been written for the purposes of the South African Local Government Association (SALGA) to use in their deliberations on the budget.

This report is structured as follows:

- **Section One** analyses the equitable share formula and provides a discussion on the changes in the formula and provides some proposals for future development of these transfers.
- **Section Two** analyses the allocations to municipalities table in the Division of Revenue Act 2003 (Act 7 of 2003) and the 2004 Division of Revenue Bill (Bill 4 of 2004). These discussions include an analysis of the impact of the census 2001 data (compared to the use of census 1996) on the allocations to municipalities, and
- **Section Three** provides a discussion on conditional grants to local government.

The Budget review 2004 and similar documentation shows overall trends in total equitable share, however there is a need to take this analysis down to a micro (municipal) level. Therefore this analysis uses data from the Intergovernmental Fiscal Review 2003, the Budget 2004, Division of Revenue Act 2003 (Act 7 of 2003), the 2004 Division of Revenue Bill (Bill 4 of 2004) and the Estimates of National Expenditure 2004 and sourced analyses from IDASA and the Financial and Fiscal Commission to assist providing recommendations to SALGA.

Researchers have maintained absolute objectivity, however the researchers were forced to make assumptions due to constraints caused by data formats and availability.

The reader is requested to note that often the researchers could not reconcile totals within the documents described above and irregularities were experienced.

Section One: Local Government Equitable Share[1]

The local government equitable share (LGES) has evolved since it started in 1997. For purposes of comprehensiveness this section summarises some of the key changes to the equitable share formula including the introduction of funding "windows" since detailed information on the shares has been published consistently in Budget Reviews and Intergovernmental Fiscal Reviews.

The earliest detail of the contents of the formula can be found in the Budget Review 2001. The formula consists of two components, the I-grant and the S-grant. As is at present, the I-grant is

[1] All information from this section that is not stated as proposals or recommendations are either from Whelan (2004) or Budget Reviews and Intergovernmental Fiscal Reviews from 2001 to 2004.

an institutional grant, allocated to municipalities to assist with administering their activities. The S-grant is designed to meet the operating costs of providing basic services to low income houses. These components have not changed, however the parameters of the formulae used to calculate the s-grant and the I-grant have changed over the years. The following discussion captures these trends.

I-grant	
2001	$I = I_0 P^{\gamma} - 0.05(y - 180)P$
2002	$I = I_0 P^{\gamma} - 0.075(y - 250)P$
2003	$I = I_0 P^{\gamma} - 0.075(y - 250)P$
2004	$I = I_0 P^{\gamma} - 0.075(y - 250)P$
$0.075(y - 250)$	This section of the formula suggests that when the per capita income of the population increases above R250, on average the population can afford to pay 7.5% of their income to municipal rates. The income threshold changed from R180 in 2001, to R250 in 2002 and the level income expected to go to property rates increased from 5% to 7.5%.

The following figures were available for the parameters of the I-grant formula per Budget Review

I_0 (see discussion point (a) below).

2001	**2002**	**2003**		**2004**	
R61 750	"42% increase"	B	R195 397	04/05: 05/06: 06/07:	R175 684 R181 392 R186 799
		C	R329 818	04/05: 05/06: 06/07:	R266 612 R273 153 R279 053
γ	The scale parameter has remained constant at 0.25				

The figures below were introduced in 2003 and have remained constant.

Ave per monthly per capita threshold	250
Population cut-off	5000
Per capital floor	R250

S-grant

Formula has remained constant: $S = \alpha\beta LH$

α by Budget Review (section below shows changes as they were introduced)

	2001		**2002**		**2003**		**2004**	
Urban	98/99:	0.6	03/04:	1	03/04:	1		

	99/00:	0.7			04/05:	1		
	00/01:	0.7			05/06:	1		
	01/02:	0.8					05/06:	1
Rural	98/99:	0.1	05/06:	1	03/04:	0.7		
	99/00:	0.25			04/05:	0.85		
	00/01:	0.25			05/06:	1		
	01/02:	0.4					05/06:	1

β by Budget Review (see discussion point B, below)

	2003		**2004**	
	03/04:	1,3582		
	04/05:	1,3582	04/05:	0,559
	05/06:	1,3582	05/06:	0,835
			06/07:	0,909

L by budget review

2001	**2002**	**2003**	**2004**
R86	R86	R1 032	R1032

Nodal Allocations (amounts in millions) – The split of 65% to rural and 35% to Urban of the total Nodal allocation remains constant, but actual amounts were not shown from 2001, 2003 or 2004.

2002	**Rural**		**Urban**	
	02/03:	R130	02/03:	R70
	03/04:	R137, 8	03/04:	R74,2
	04/05:	R146, 2	04/05:	R78,7

Free Basic Services window introduced in 2003 – no figures shown in 2003 or 2004, but formula introduced in 2004 budget review.			
Guaranteed amount has remained constant at 70% of previous years allocation. This guarantee was adjusted to go to municipalities the function was legally assigned to after changes functions assigned.			
R293 allocations			
2001:	•2000/01 R447m incorporated into LGES •2001/02 R293 grant incorporated into Provincial and LGES, of R463m, LGES got R358M to be determined separately from I and S grants, municipalities were guaranteed R293 over three years.		
No figures mentioned in 2002 or 2003.			
2004 base line allocations:		03/04:	R396m
		04/05:	R263m
		05/06:	R184m
		06/07:	R129m and thereafter no longer exist

1.1 Points for discussion

(a) The I_0 adjusts this grant to the total amount available for equitable share to local government and is ultimately decided by the extent of the total allocation to local government from the national government equitable share. However the difference in the value of this parameter between 2003 and 2004 is noticeable. The amount stated in the 2003 budget review, for the 2003/04 budget year is not matched by the same figure in the 2004 budget review and that value (in the budget review 2003) is not even equalled by the figures provided for the 2006/07 budget year, the budget review 2004.

(b) The β is ultimately decided by the total allocation of equitable share to local government. This parameter adjusts the individual equitable shares paid to municipalities to the total amount available for local government. However, this parameter has changed significantly between the first time and second time it was published (2003 versus 2004). The 2003 budget review published figures that were drastically changed in the 2004 budget.

No explanations for the above changes are provided and it is not clear what is driving these changes. A cynical reading of these changes would suggest that National Government intends decreasing the local government equitable share as a percentage of nationally distributed equitable share.

With regards to the LGES windows:

- The free basic services (FBS) formula is well constructed to capture the needs of the poor, however there is a lack of transparency around the actual figures used in the formula and how these are calculated.
- The structure of the FBS may encourage municipalities to maintain a high level of poor houses that receive basic services. Both the FBS and the S-grant are structured in a way that results in municipalities with more poor households receiving a larger s-grant and FBS allocation. Therefore incentive to expand services to poor households exists. However there is no explicit incentive to ensure that maintenance and operational costs are considered. This is a potentially dangerous situation for the long-term sustainability of municipalities and an area of fiscal risk for national government, especially considering recent amendments to s139 of the constitution.
- There is a lack of clarity in the budget reviews on the Nodal allocations. These figures were clearly shown in the 2002 budge review, but have been lacking since. The Division of Revenue Bill does not provide details of these allocations.
- One of the advantages of proving budget information over the medium term expenditure framework is to create certainty in funding which allows organs of state to plan better, however there appears to be a lack of consistency in terms of the parameters of the LGES formulae.

2 Section two: Quantitative assessments of the LGES allocations

The researchers used information from the Division of Revenue Act (Act 7 of 2003), from here on referred to as DORA and the 2004 Division of Revenue Bill (Bill 4 of 2004), from here on referred to as DORB, to access data on which a quantitative analysis of the local government equitable share (LGES) could be performed.

A regression analysis was performed on the data to establish the extent that Census data has impacted on the equitable share allocations. This analysis showed there was a weak, but positive relationship between population increases and LGES increases.

The tables below are based on LGES allocations in the DORA and DORB. Population data is taken from the DORA, DORB, the 2003 Intergovernmental Fiscal Review and Budget Review 2004. The researchers attempted to assess the distributive equitability of the equitable share. There are seven tables revealing interesting changes in the data. For most of the tables, the analysis compares the LGES allocations in DORA and DORB for LGES allocations between

2004/05 and 2005/06. In other words, the tables show how LGES allocations for the same year have changed between being table in the DORA 2003 and DORB 2004. The analysis is confined to these two years, as the there were no other years data that overlapped between the two documents.

In all the tables below the per capita averages were calculated using *Census 1996* data for the DORA allocations and *Census 2001* for the DORB allocations.

2.1 Changes by Metro

Table 1 shows the changes in allocations stated in DORB and DORA in absolute terms and per capita.

Table 1: Changes between DORA 2003 and DORB 2004 LGES by Metro				
	LGES changes R'000		Per Capita Changes	
	2004/05	**2005/06**	**2004/05**	**2005/06**
Cape Town	R 33,422	R 96,609	R 3.88	R 25.43
Nelson Mandela	R 476	**-R 11,035**	**-R 5.53**	**-R 17.22**
eThekwini	R 1,861	R 73,402	**-R 14.84**	R 7.89
Ekurhuleni	R 97,811	R 210,280	R 20.68	R 65.38
Johannesburg	R 129,628	R 267,392	R 22.12	R 64.03
Tshwane	R 33,584	R 97,544	R 1.65	R 33.45

Points of interest are:

- Nelson Mandela metro is the only municipality that appears to be receiving a smaller LGES for 2005/06 than it was expecting a year ago. Their 2005/06 allocation has decreased by R11mn between the DORA and DORB.
- On a per capita basis eThekwini and Nelson Mandela are both receiving less that what they could have expected a year ago. eThekwini can expect to receive a per capita decrease in the 2004/05 budget year, while Nelson Mandela may have to settle with a per capita decrease for both 2004/05 and 2005/06. (This shows that eThekweni's population has increased).

2.2 Changes aggregated to Provinces

Table 1 shows how the LGES allocations have changed between DORA and DORB aggregated to the provincial level.

Table 2: Changes between DORA 2003 and DORB 2004 LGES by Province				
	LGES changes R'000		Per Capita Changes	
	2004/05	**2005/06**	**2004/05**	**2005/06**
Western Cape Municipalities	R 45,473	R 129,030	**-R 0.12**	R 17.78
Northern Cape Municipalities	R 2,154	**-R 51,507**	R 6.94	**-R 47.14**
Eastern Cape Municipalities	R 6,374	**-R 467,230**	R 4.73	**-R 49.53**
Free State Municiaplities	R 2,668	**-R 248,214**	**-R 7.88**	**-R 101.17**
KwaZulu-Natal Municipalities	R 89,122	R 367,120	**-R 7.00**	R 21.31
Mpumalanga Municipalities	R 54,980	R 173,019	R 4.86	R 44.85
Limpopo Municipalities	R 75,233	R 310,113	R 2.84	R 44.32
North West Municipalities	R 4,360	R 18,294	**-R 15.73**	**-R 12.88**
Gauteng Municipalities	R 319,638	R 714,544	R 16.70	R 58.11

Points of interest are:

- The LGES has decreased the most to municipalities in Northern Cape, Eastern Cape and Free State between DORA and DORB.
- On a per capita basis, the above provinces are again the hardest hit, with Free State faring particularly badly.
- Table A2 [See annexure] shows the Provincial Equitable Share allocations, when compared in the same way as in Table 1, have all increased. The provinces in which the LGES allocations have decreased (Table 1) will all, according to DORB, receive larger equitable share allocations than shown in DORA, however relative to the other provinces, these provinces' allocations will increase the least.

2.4 Changes to Nodes

Table 3 shows the changes in allocations to the rural nodes. The 2003 budget review identified a number of municipalities that would receive additional LGES allocations, the rural district municipalities identified to receive these allocations are identified below:

Table 3: Changes between DORA 2003 and DORB 2004 LGES to Rural Nodes

	LGES changes R'000		Per Capita Changes	
	2004/05	**2005/06**	**2004/05**	**2005/06**
Central Karoo Municipalities	R 564	R 273	**-R 7.66**	**-R 13.25**
Kalahari-Kgalagadi Cross Border Municipalities	R 152	**-R 10,401**	R 7.52	**-R 67.84**
Chris Hani District Municipalities	R 1,006	**-R 67,579**	R 6.48	**-R 77.52**
Ukhahlamba Municipalities	R 407	**-R 30,080**	**-R 13.50**	**-R 104.77**
O.R. Tambo District Municipalities	R 1,876	**-R 164,352**	**-R 10.96**	**-R 112.11**
Afred Nzo District Municipalities	R 624	**-R 60,553**	**-R 2.15**	**-R 113.92**
Thabo Mafutsanyana Municipalities	R 584	**-R 72,539**	**-R 22.47**	**-R 125.67**
Ugu Municipalities	R 1,825	R 22,099	**-R 12.06**	R 14.69
Umzinyathi Municipalities	R 2,033	R 5,446	**-R 9.25**	**-R 3.49**
Zululand Municipalities	R 13,479	R 47,409	R 0.83	R 41.79
Umkhanyakude Municipalities	R 1,298	R 21,884	**-R 19.47**	R 13.89
Sekhukhune Cross Boundary Municipalities	R 22,102	R 66,636	R 14.11	R 59.05
Eastern Municipalities	R 581	R 18,558	R 12.07	R 43.39

Points of interest are:

- The list in table three shows the municipalities that were identified to receive additional funding from the Nodal Allocation window added to the LGES formula, however just under half of these districts will receive less in the 2005/06 budget year, than they were expecting to receive a year ago.
- For both budget years analysed, the per capita allocations have decreased in the majority of municipalities.

2.5 The Biggest Positive Changes

Tables 4.1 and 4.2 show the municipalities that have gained the most in absolute terms from the new allocations in the DORB. Table 4.1 bases the analysis on the increases in changes to the 2004/05 allocation, while Table 4.2 bases this analysis on 2005/06 figures. Table 4.2 shows which municipalities are in this exclusive club for both budget years.

Table 4.1: Top 10 increases between DORA 2003 and DORB 2004 LGES to Municipalities based on 2004/05 LGES allocations

	LGES changes R'000	
	2004/05	**2005/06**
Thembisile	R 15,733	R 29,566
uMhlathuze	R 15,832	R 29,551
Dr JS Moroka	R 16,533	R 30,636
Merafong	R 17,750	R 35,089
Emfuleni	R 18,889	R 45,538
Polokwane	R 21,757	R 49,554
Cape Town	R 33,422	R 96,609
Tshwane	R 33,584	R 97,544
Ekurhuleni	R 97,811	R 210,280
Johannesburg	R 129,628	R 267,392

Table 4.2: Top 10 increases between DORA 2003 and DORB 2004 LGES to based on 2005/06 allocations.

		LGES changes R'000	
	Top 10 for 04/05?	**2004/05**	**2005/06**
Thembisile	Yes	R 15,733	R 29,566
Dr JS Moroka		R 16,533	R 30,636
Merafong	Yes	R 17,750	R 35,089
Emfuleni	Yes	R 18,889	R 45,538
Polokwane	Yes	R 21,757	R 49,554
eThekwini		R 1,861	R 73,402
Cape Town	Yes	R 33,422	R 96,609
Tshwane	Yes	R 33,584	R 97,544
Ekurhuleni	Yes	R 97,811	R 210,280
Johannesburg	Yes	R 129,628	R 267,392

Points of interest are:

- Eight municipalities receive the biggest increases in both years.
- All the Gauteng based metros are in this top ten list for both comparisons.

2.6 Biggest Losers

Tables 5.1 and 5.2 show the municipalities that have experienced the biggest changes to their allocations. As for the previous section, the analysis in Table 5.1 is based on the 2004/05 allocations and Table 5.2 is based on the 2005/06 allocations.

Table 5.1: Top 10 decreases between DORA 2003 and DORB 2004 LGES to Municipalities based on 2004/05 LGES allocations

	LGES changes R'000	
	2004/05	**2005/06**
Bohlabela	-R 14,746	-R 7,020
O.R. Tambo District Municipality	-R 7,667	-R 69,934
Amatole District Municipality	-R 4,832	-R 35,351
Chris Hani District Municipality	-R 3,615	-R 27,552
Vhembe District Municipality	-R 2,898	R 13,325
Afred Nzo District Municipality	-R 2,707	-R 25,837
Mopani District Municipality	-R 2,134	R 13,077
Central District Municipality	-R 2,110	-R 5,117
Bophirima District Municipality	-R 1,641	-R 9,420
Ukhahlamba District Municipalities	-R 1,480	-R 12,231

Table 5.2: Top 10 decreases between DORA 2003 and DORB 2004 LGES to based on 2005/06 allocations.

		LGES changes R'000	
	Top 10 for 04/05?	**2004/05**	**2005/06**
O.R. Tambo District Municipality	Yes	-R 7,667	-R 69,934
Mangaung		R 777	-R 58,965
Maluti-a-Phofung		R 194	-R 42,724
Matjhabeng		R 134	-R 37,911
Amatole District Municipality	Yes	-R 4,832	-R 35,351
Chris Hani District Municipality	Yes	-R 3,615	-R 27,552
Afred Nzo District Municipality	Yes	-R 2,707	-R 25,837
Buffalo City		R 773	-R 25,713
Umzimvubu		R 2,376	-R 24,572
King Sabata Dalindyebo		R 2,256	-R 21,766
Mnquma		R 1,743	-R 16,391

Points of interest are:

- The municipalities that are amongst the ten biggest losers in both comparisons are district municipalities from the Eastern Cape.
- The majority of the municipalities with the ten biggest decreases based on the 2004/05 comparisons are district municipalities.

2.6 Biggest Gainers and Losers per capita – Category B

Tables 6.1, 6.2, 6.3 and 6.4 show the B municipalities whose allocations have increased and decreased the most when comparing the DORA and DORB allocations. The analyses that were performed to provide these tables were limited to Category B municipalities. Table 6.1 and 6.2 show the municipalities whose allocations increase the most, for Table 6.1 the analysis is based on 2004/05 budget allocations and for Table 6.2 the analysis is based on the 2005/06 allocations. Similarly, Tables 6.3 and 6.4 show the municipalities whose allocations have decreased the most per capita, Table 6.3 is based on 2004/05 allocations and Table 6.4 is based on the 2005/06 allocations.

The municipalities in shaded font are municipalities with areas that should receive additional nodal allocations.

Table 6.1: Top 10 Per Capita increases between DORA 2003 and DORB 2004 LGES to Municipalities based on 2004/05 LGES allocations

	2004/05	2005/06
Kareeberg (NC)	R 87.50	-R 62.06
Merafong (G)	R 83.90	R 166.27
Dr JS Moroka (Mpumalanga)	R 72.73	R 130.93
Karoo Hoogland (NC)	R 65.65	-R 82.85
Ubuntu (NC)	R 64.62	-R 63.79
Westonaria (G)	R 56.14	R 151.82
Thembisile (Mpumalanga)	R 55.76	R 108.72
Molopo (NW)	R 51.83	-R 16.92
Richtersveld (NC)	R 46.72	-R 25.26
Matjhabeng (FS)	R 43.09	-R 47.01
Bushbuckridge (Limpopo)	R 37.43	R 52.79
Siyathemba (NC)	R 35.43	-R 74.84
Groblersdal (Limpopo)	R 35.24	R 70.64
Vulamehlo (KZN)	R 33.91	R 9.65
Molemole (Limpopo)	R 32.96	R 73.24
Ngqushwa (EC)	R 30.86	-R 46.77

Table 6.2: Top 16 Per Capita increases between DORA 2003 and DORB 2004 LGES to Municipalities based on 2005/06 LGES allocations

	2004/05	2005/06
Merafong (G)	R 83.90	R 166.27
Westonaria (G)	R 56.14	R 151.82
Dr JS Moroka (Mpumalanga)	R 72.73	R 130.93
Thembisile (Mpumalanga)	R 55.76	R 108.72
Polokwane (Limpopo)	R 26.00	R 78.95
Molemole (Limpopo)	R 32.96	R 73.24
uMhlathuze (KZN)	R 22.79	R 72.35
Groblersdal (Limpopo)	R 35.24	R 70.64
Dipaleseng (Mpumalanga)	R 20.05	R 67.77
Lepelle-Nkumpi (Limpopo)	R 30.27	R 66.42
Mogalakwena (Limpopo)	R 19.35	R 65.87
Delmas (Mpumalanga)	R 18.57	R 62.70
Newcastle (KZN)	R 23.84	R 61.21
Emfuleni (G)	R 19.70	R 59.85
Moretele (NW)	R 11.18	R 57.88
Seme (Mpumalanga)	R 15.27	R 57.73

Table 6.3: Top 16 Per Capita decreases between DORA 2003 and DORB 2004 LGES to Municipalities based on 2004/05 LGES allocations

	2004/05	2005/06
Mookgapong (Limpopo)	-R 127.38	-R 114.11
Matatiele (KZN)	-R 90.15	-R 54.83
Tokologo (FS)	-R 80.02	-R 208.38
Ventersdorp (NW)	-R 78.15	-R 86.12
Plettenberg Bay (WC)	-R 67.06	-R 43.82
Kokstad (KZN)	-R 66.06	-R 22.23
Khai-Ma (NC)	-R 63.34	-R 94.79
Nala (FS)	-R 60.19	-R 135.99
Letsemeng (FS)	-R 59.07	-R 124.32
Thaba Chweu (Mpumalanga)	-R 53.50	-R 75.42
Inyala/Mtubatuba (KZN)	-R 51.34	-R 34.40
Koukamma (EC)	-R 50.06	-R 84.90
Laingsburg (WC)	-R 46.21	-R 73.48
Naledi (FS)	-R 43.86	-R 184.25
Mier (NC)	-R 42.83	-R 146.28
Dihlabeng (FS)	-R 41.99	-R 86.07

Table 6.4: Top 16 Per Capita decreases between DORA 2003 and DORB 2004 LGES to Municipalities based on 2005/06 LGES allocations

	2004/05	2005/06
Tokologo (FS)	-R 80.02	-R 208.38
Naledi (FS)	-R 43.86	-R 184.25
Mohokare (FS)	R 3.71	-R 147.19
Mier (NC)	-R 42.83	-R 146.28
Tswelopele (FS)	-R 15.48	-R 144.88
Setsoto (FS)	-R 39.47	-R 143.29
Mantsopa (FS)	-R 33.56	-R 140.53
Nala (FS)	-R 60.19	-R 135.99
Renosterberg (NC)	R 21.24	-R 134.10
Maluti-a-Phofung (FS)	-R 7.21	-R 127.09
Gamagara (NC)	-R 24.91	-R 126.67
Letsemeng (FS)	-R 59.07	-R 124.32
Masilonyana (FS)	R 9.56	-R 121.56
Hantam (NC)	-R 11.81	-R 118.27
Thembelihle (NC)	-R 16.40	-R 118.04
Nketoana (FS)	R 15.56	-R 117.46

Points of interest are:

- For comparisons based on 2004/05 and the 2005/06 allocations there are in total five different areas due to receive additional allocations from the equitable share in the list of municipalities identified as receiving the biggest decreases between DORA and DORB.
- There is only one municipality from a Nodal area whose LGES allocation increase per capita is in the top 10 largest per capita increases based on the 2005/06 allocations.
- No distinct pattern can be established with regards to which areas appear in these top ten gainers and losers. However, worth noting is that based on the 2005/06 allocations all municipalities whose allocations change the most downwards between DORA and DORB are either in the Northern Cape or Free State – does this show a possible policy shift?

Section Three: Conditional Grants Analysis

3.1 Conditional Allocations

The majority of conditional grants are transferred from National government to local government. Conditional Grants are used to:

- integrate national priorities into municipal budgets
- promote national norms and standards,
- address backlogs and regional disparities in municipal infrastructure.
- effect transition by supporting capacity building and restructuring of municipalities (Budget Review 2004).

Based on data derived from the *Estimates of National Expenditure*, total Conditional grants transferred from National government to Local government will increase from approximately R 5 billion in 2003/04 to around R6, 7 billion in the 2006/07 year. In other words, conditional grants will increase, on average by 11 percent over the medium term.

There are essentially two types of conditional grants namely infrastructure grants and capacity building grants. Infrastructure grants are capital transfers used to fund infrastructure expenditure and to relieve the backlog in disadvantaged areas. Infrastructure grants are also seen as way to stimulate economic growth in underprivileged areas and promote job creation. Capacity grants are given to local government to enable municipalities and other local government institutions to build their institutional capacity in order to deliver services in a more efficient, effective and economical way.

Table 1 shows that infrastructure grants are expected to increase from R 4,1 billion to almost R 6 billion in the medium term. Capacity grants are expected to decrease between 2003/04 and 2004/05 and thereafter stabilise. According to the Budget Review 2004, capacity building grants will be capped at R750 million in the two outer years, as government feels that once the grants have helped to build capacity they should be phased down.

Table 7: Types of conditional grants

R ' 00	**Expenditure Outcome**				**Medium Term Expenditure Framework**		
	Audited 2000/01	**Audited 2001/02**	**Preliminary Outcome 2002/03**	**Adjusted Appropriation 2003/04**	**2004/05**	**2005/06**	**2006/07**
Infrastructure Grants	2,054	2,276	3,337	4,155	4,986	5,589	5,987
Capacity Building Grants	275	331	399	901	723	748	748
Total	**2,604**	**2,939,**	**4,135**	**5,056**	**5,709**	**6,338**	**6,735**

Source: Compiled from the Estimates of National Expenditure (2004)

Table 8, below shows the sources of conditional grants from National government to Local government. The Department of Provincial and Local government accounts for the majority of transfers to Local government. It is evident that conditional grants from the DPLG are expected to increase substantially over the medium term as the conditional grant system is rationalized.

Table 3: Changes between DORA 2003 and DORB 2004 LGES to Rural Nodes				
	LGES changes R'000		Per Capita Changes	
	2004/05	**2005/06**	**2004/05**	**2005/06**
Central Karoo Municipalities	R 564	R 273	**-R 7.66**	**-R 13.25**
Kalahari-Kgalagadi Cross Border Municipalities	R 152	**-R 10,401**	R 7.52	**-R 67.84**
Chris Hani District Municipalities	R 1,006	**-R 67,579**	R 6.48	**-R 77.52**
Ukhahlamba Municipalities	R 407	**-R 30,080**	**-R 13.50**	**-R 104.77**
O.R. Tambo District Municipalities	R 1,876	**-R 164,352**	**-R 10.96**	**-R 112.11**
Afred Nzo District Municipalities	R 624	**-R 60,553**	**-R 2.15**	**-R 113.92**
Thabo Mafutsanyana Municipalities	R 584	**-R 72,539**	**-R 22.47**	**-R 125.67**
Ugu Municipalities	R 1,825	R 22,099	**-R 12.06**	R 14.69

Umzinyathi Municipalities	R 2,033	R 5,446	**-R 9.25**	**-R 3.49**
Zululand Municipalities	R 13,479	R 47,409	R 0.83	R 41.79
Umkhanyakude Municipalities	R 1,298	R 21,884	**-R 19.47**	R 13.89
Sekhukhune Cross Boundary Municipalities	R 22,102	R 66,636	R 14.11	R 59.05
Eastern Municipalities	R 581	R 18,558	R 12.07	R 43.39

Table 8: Sources of conditional grants (Compiled from National Estimates of Expenditure (2004)

	Expenditure Outcome				Medium Term Expenditure Framework		
	Audited 2000/01	**Audited 2001/02**	**Preliminary Outcome 2002/03**	**Adjusted Appropriation 2003/04**	**2004/05**	**2005/06**	**2006/07**
Department of Provincial and Local Government							
Municipal Systems Improvement Programme		41,235	93,831	150,993	182,243	200,000	200,000
Consolidated Municipal Infrastructure Programme (CMIP)	851,100	996,002	1,670,767	2,246,253			
Municipal Infrastructure Grant				47,000	4,445,943	5,192,602	5,987,058
Local Economic Development Grant	77,909	86,944	110,565	117,000			
Integrated Sustainable Rural Development Grant		33,018	31,980				
Disaster Relief		2,500					
Total	**929,009**	**1,159,699**	**1,907,143**	**2,561,246**	**4,628,186**	**5,392,602**	**6,187,058**
Department of Public Works							
Community Based Public Works Programme	374,000	357,129	259,820	262,357			
Total	**374,000**	**357,129**	**259,820**	**262,357**	**0**	**0**	**0**
National Treasury							
Local Government Restructuring Grant	225,000	230,250	151,000	539,000	342,900	350,000	350,000
Financial Management Grant	50,000	60,000	154,230	210,830	197,998	198,740	198,657
Total	**275,000**	**290,250**	**305,230**	**749,830**	**540,898**	**548,740**	**548,657**
Sports and Recreation							
Sports and Recreation Facilities		36,104	83,780	123,432	132,270		
Total	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Minerals and Energy							
National Electrification Programme			224,763	248,246	247,577	258,000	
Total	**0**	**0**	**224,763**	**248,246**	**247,577**	**258,000**	**0**
Transport							
Urban Transport Fund	22,109	38,211	39,744	9,100			
Total	**22,109**	**38,211**	**39,744**	**9,100**	**0**	**0**	**0**
Water Affairs and Forestry							
Implementation of Water Services Projects Grant	725,278	757,211	999,099	1,101,812	160,279	138,679	
Institutional Support	3,900	5,153					
Total	**729,178**	**762,364**	**999,099**	**1,101,812**	**160,279**	**138,679**	**0**
Total of all Conditional Grant to Municipalities	**2,329,296**	**2,607,653**	**3,735,799**	**4,932,591**	**5,576,940**	**6,338,021**	**6,735,715**

In 2004/05, the Consolidated Municipal Infrastructure Programme (CMIP), Local Economic Development Grant (LED), the Community based Public Works Programme and the Urban Transport Fund will be incorporated into the MIG. Over the medium term, other grants such as the Recreation and Sport facilities Programme, Water Services Project Grant and the Electrification grant will be incorporated into the medium term.

In 2003/04, the CMIP, Local Economic Development Grant (LED), the Community based Public Works Programme and the Urban Transport Fund, together amounted R 2, 64 billion. In 2004/05, the MIG is expected to amount to R4, 5 billion, which is substantially more than the combined grants. This signals the national government's confidence in the MIG grant structure and its ability to redress infrastructural backlogs.

3.2. Infrastructure grants

One of the tasks of National Treasury has been to review the system of conditional grants in South Africa and restructure the system to ensure that transfers occur more efficiently and effectively. Under the old system, CMIP – the main infrastructural grant – was transferred to municipalities with certain conditions attached. These conditions included, amongst others:

- funds could only be used for the specific municipal infrastructure .
- the project used a labour intensive approach to construction.
- the municipality submitted an operational plan to the province and council resolutions approving the IDP project.
- the assets should be maintained by the municipality.

CMIP was allocated on a poverty-weighted formula. The actual formula was never published and therefore the allocation criteria remain unclear. The maintenance costs of the infrastructure were not funded by CMIP.

The aim of the restructuring process is to rationalize the number of grants within the system of intergovernmental transfers. A new formula based Municipal Infrastructure Grant (MIG) began in the 2004/05 budget-year. The MIG will be used to support municipal capital budgets to fund municipal infrastructure, to upgrade existing infrastructure, primarily for the benefit of poor households (DORA, 2004)

The 2004 Budget review has published the formula and discusses the phasing in of the MIG grant. The formula is need-based, which means that it determines the allocation due to each municipality based on the infrastructure and service backlogs. In contrast to CMIP, which funded a specific project, the MIG will be in the form of an allocation that supplements a municipality's capital budget.

Although, the MIG is still a conditional grant, it does provide municipalities' with greater flexibility when structuring their capital budget. The conditions attached to the MIG are that:

- municipalities should prioritise basic service delivery infrastructure in residential areas.

- the municipal council approve a 3 –year capital plan linked to the IDP and budget by a specified date.
- district municipalities report on all transfers from district municipalities to local municipalities.
- municipalities prioritise all existing commitments made on the CMIP and DWAF capital programmes.
- labour intensive methods of construction are used, and
- municipalities adhere to reporting requirements.

The conditions attached to the MIG are not as restrictive as those that were attached to CMIP, in that municipalities can use the grant to fund any capital project as long as it has been approved in the IDP and are included in the Capital budget.

The MIG consists of five components namely a basic residential infrastructure (**B**), public municipal service infrastructure (**P**), allocations for social institutions (**E**), allocations to all nodal municipalities (**N**), and finally a negative or positive allocation related to the past performance of each municipality relative to grant conditions (**M**). Each component will be allocated a particular weighted share of the MIG grant. For example, in 2004/05, 75 per cent of the MIG will be spent on the basic residential infrastructure, 15 per cent on the public municipal service infrastructure, 5 per cent on allocations for social institutions and micro enterprises and finally 5 percent is reserved for nodal municipalities.

The formula is constructed as follows:

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

Where $MIG_{(F)}$ is the allocation per municipality. Each component of the MIG is discussed below.

(i) Basic residential infrastructure grant (B)

The basic residential infrastructure grant component is calculated by weighting four sectors, water and sanitation, electricity, roads and other. Each sector weighting is calculated by taking into consideration the backlog of infrastructure within the municipality as a proportion of all municipalities in South Africa. For example the water and sanitation factor takes into account all households with 'less than basic access to water and sanitation'. Data from the 2001 Census has been used to estimate the infrastructure grants. The **B** component promotes equity in the allocation of the grant between municipalities. Poorly developed municipalities will tend to attract a higher allocation in terms of the basic residential infrastructure grant. However this measure will tend to underestimate the grant in municipalities where there is large and rapid influx of people (e.g. metros) as calculations will be based on outdated census data.

(ii) Public municipal service infrastructure (P)

The public municipal service infrastructure takes into account the number of poor households in the municipality as a proportion of the total number of poor households in South Africa. Poverty data is based on imputed household expenditure and the poverty threshold is currently set at R1100. The **P** component also requires that municipalities split their expenditure between new and rehabilitated infrastructure in an 80:20 ratio. The split will motivate municipalities to spend not only on new infrastructure but also on repairing and rehabilitating older infrastructure, which can still be put to productive use. **However, it is important to question whether spending only 20 percent of the P component on rehabilitating infrastructure is sufficient to redress the large need for rehabilitating existing municipal infrastructure.** Furthermore, National government should provide some clarification as to how they arrived at the 80:20 ratio.

This discussion needs to be expanded in a separate document, but Section Two of this report showed that the s-grant provides an incentive for municipalities to expand infrastructure and that there is an absence of incentives or a funding window to cover the costs of maintenance. The P component compounds these problems, as the 80% of new expenditure is likely to be spent in residential areas that are presently impoverished and unlikely to be able to afford to pay for the services. Therefore the incentive exists for municipalities to expand infrastructure using the MIG attracting poor people to the municipality so they can access more fiscal resources through the S-grant. It may be hasty to speculate what expenditure will be forfeited as a result, but it is reasonable to suggest the formulae are, unintentionally, implicitly structured in a way that ensures municipalities remain dependant on the national fiscus, even though it is an explicit policy objective to make municipalities financially independent.

(iii) Allocations for social institutions and micro-enterprises infrastructure (E)

This component, again takes into account the number of poor households in a municipality as a proportion of the total number of poor households in South Africa. No information is given in the 2004 Budget Review on what constitutes a 'social institution' or even what type of 'micro-enterprise infrastructure' the grant can be spent on.

(iv) Allocations to all nodal municipalities (N)

This component promotes the acceleration of infrastructure development in the nodal areas identified by the President in the 2001. The **N** component is calculated by taking into account the number of poor households in nodal areas in the municipality as a proportion of the total number of poor households in all nodal areas. In order to ascertain, the effectiveness of this allocation, municipalities should be required to report on the outcomes of the nodal allocations.

(v) Allocation related to the past performance of each municipality (M)

The 2004 Budget Review provides no explanation for the basis on which this allocation will be calculated. Presumably, the allocation will be higher for those municipalities, which have complied with, grant condition. Thus, this allocation is biased in favor of well-capacitated municipalities, who will expect to receive a higher **M** allocation. It is important to note that any calculation should take into account a municipality's ability to develop capacity over time. National treasury needs to provide more information on the M component of the formula.

By 2006/07, the MIG is expected to reach R5,98 billion or an increase of R 1,5 billion from 2004/05. Although municipalities will be able to substantially increase their investment in infrastructure, there has been very little published on how municipalities will finance the maintenance costs of the new infrastructure. **The MIG does not provide any allocation for maintaining infrastructure**. If municipalities are unable to finance the costs of maintenance out of their own operation budgets, then the new infrastructure is liable to fall into disrepair. The cost of maintaining capital infrastructure in municipalities needs to be researched. Furthermore, a framework showing how these maintenance costs will be financed should be developed.

3.3. Capacity grants

The largest capacity grant from National government to local government is the Local Government Restructuring grant. The Local Government Restructuring grant assists in the restructuring and modernisation of the institutional structure of large municipalities. The budget Review (2004) states that the initial take-up rate for the restructuring grant was slow and the applications from eligible municipalities were of a 'poor quality and standard'. **It is important to establish why the initial take up rate was slow.** The restructuring grant is crucially important whether to municipalities which have increase substantially in size after the demarcation process. National government needs to review the application process and perhaps provide technical support during the application process.

The Financial Management Grant supports reforms in municipal financial management systems and budgeting practices. The Financial management grant was first introduced in 2000 and it is envisaged that by the end of 2004 all municipalities will be participating in the grant. The Financial Management Grant will remain constant at around R200 million over the medium term. The availability of the Financial Management grant is a key factor for the successful implementation of the Municipal Finance Management Act (MFMA). National government will need to ensure that adequate funds for training in both budgeting and financial management techniques are made available to all municipalities during the implementation of the MFMA.

Transfers through capacity grants will be capped at R750 million in the 2005/06 and 2006/07 years. The figures reported in the 2004 budget review provide no indication of how effective these capacity grants have been. It has become apparent that there is a need for a

comprehensive review of the *effectiveness* of these grants. This review should help pinpoint specific areas within municipalities where capacity still needs to be built.

Table 9 shows the total allocation of capacity grants

		Medium Term Expenditure		
	Adjusted Appropriation 2003/04	**2004/05**	**2005/06**	**2006/07**
Local Government Restructuring Grant	539,000	342,900	350,000	350,000
Financial Management Grant	210,830	197,998	198,740	198,659
Municipal Systems Improvement Programme	150,993	182,243	200,000	200,000
Total: Capacity Building Grants	**900,823**	**723,141**	**748,740**	**748,659**

Source: Compiled from Estimates of National Expenditure (2004)

3.4. Special purpose allocations to provinces

In addition to direct transfers from National government to Local Government, National government also transfers resources to provinces in order for them to assist municipalities in building capacity. There are two special purpose allocations to the provinces from the DPLG relevant to local government. First, the Local government Capacity Building grant helps to assist municipalities to build their institutional capacity and improve their systems for sustainable service delivery. In 2004/05, the Local Government Capacity Building Fund Grant amounted to R220 million. From 2005/06, the Local Government Capacity Building Fund will be phased out and incorporated directly into the equitable share transferred to municipality. This change signals of national government's commitment to review and consolidate all intergovernmental transfers in order to promote efficiency within the system of transfers.

Second, the Provincial Project Management Capacity for Municipal Infrastructure Grant, which provides support to manage the implementation of the MIG on behalf of the Department to ensure sustainability of MIG projects. The Provincial Project Management Capacity Grant amounts to R41 million in the 2004/05 year. This amount is expected to increase to R46 million by 2006/07. Previously, the provinces were allocated a project management capacity grant for the CMIP.

3.5. Conditional grants discussion

At present, there is a huge amount of reform taking place within the system of conditional grant transfers to local government. Most of these reforms aim to rationalise the existing system of conditional grants and improve the efficiency of the system of transfers. However, during periods of reform, it becomes extremely difficult to identify trends in the amount of resources transferred from national to local government at a disaggregated municipal level. The overall trend shows that infrastructure grants will increase substantially over the medium term. There are two distinct reasons for this, first almost all the existing infrastructure grants will be consolidated into the MIG

by 2006/07. Second, infrastructural grant transfers from national to local government are expected to increase over the medium term.

However, the single biggest concern remains the lack of any provision for maintenance costs of infrastructure on the part of national government. Over the medium term, municipalities will be required to use the MIG to invest in new infrastructure however it is worrying to note that some municipalities may not be able to fund the maintenance costs of these projects. This is certainly a pressing issue that needs to be considered by all stakeholders.

4. Conclusion

In preparing this report, researchers have analysed publicly available resources to assess trends and patterns in the allocation of the LGES and conditional grants. The primary information sources were budget reviews and the schedules to division of revenue bills and acts.

The study found a number of changes between allocations legislated in the DORA 2003 and what is shown in the DORB 2004. A substantial number of municipalities (including nodal municipalities) can expect to receive less LGES in 2004/05 if the DORB 2004 is passed with its existing LGES allocations than they were expecting to receive after the DORA 2003 legislated their LGES allocations.

A key technical advantage of publishing forward budget year's data in the form of medium term estimates is to allow municipalities to plan with certainty how they will allocate resources to achieve their mandates. There are no conditions attached to the LGES and municipalities can be expected to factor their LGES over the medium term when planning to meet community needs. However if all these 104 category B municipalities use the DORA 2003 allocated LGES medium term estimates to cover the cost of promises in their Integrated Development Plans, those plans will have to be rewritten.

In addition to the lack of consistency of funding shown between DORA 2003 and DORB 2004 are a number of unexplained changes to the LGES formula. Local government needs a clearer idea of the factors affecting their equitable share of nationally distributed revenue to provide more constructive recommendations in this regard.

The LGES has been criticised as the formulae do not show a direct link between the cost of providing a service and the amount a municipality receives. Instead the LGES is based on a share the municipality will receive in comparison to other municipalities in terms of what is left over for local government after national and provincial government have received their shares of the revenue. In addition, the newly formed Municipal Infrastructure Grant is formula based and distributed to municipalities as a share of a total, rather than based on a need. Substantial resources have been made available for the Municipal Infrastructure Grant, which replaces previous more needs based grants. However, given the way in which revenue is distributed