

# A Review of Direct and Indirect Conditional Grants in South Africa – Case Study of Selected Conditional Grants

## CHAPTER 3



# A Review of Direct and Indirect Conditional Grants in South Africa – Case Study of Selected Conditional Grants

Sabelo Mtantato<sup>47</sup> and Sasha Peters<sup>48</sup>

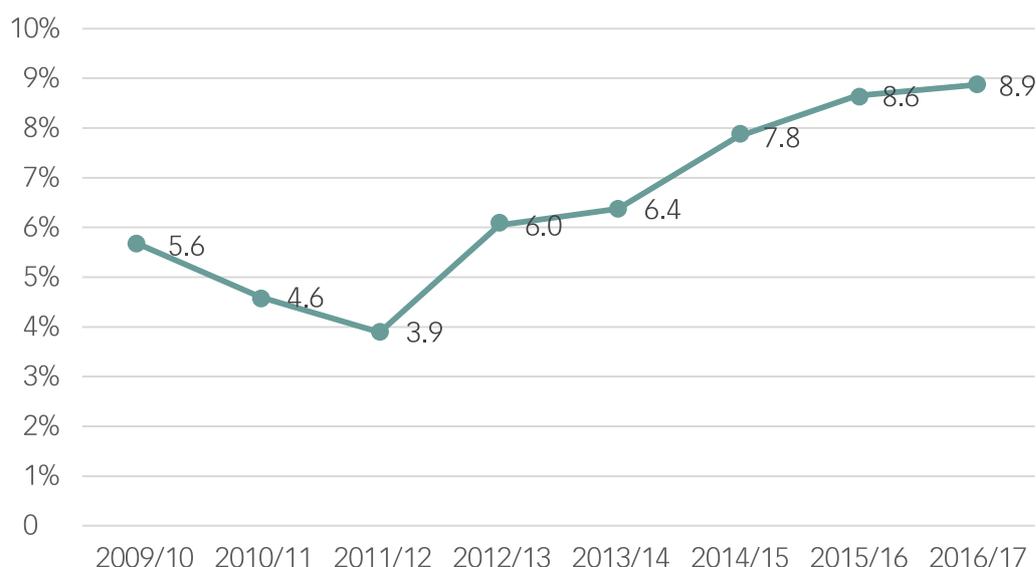
## 3.1 Introduction

Intergovernmental fiscal transfers are a dominant feature of public finance in many countries, including South Africa. This is mainly because in countries with more than one level (or sphere) of government, national government is able to raise more revenue compared to subnational governments. Sections 227(1) (a) and (b) of South Africa's Constitution of 1996 state that local government (and each province) is entitled to an equitable share and may receive other allocations from national government revenue, either conditionally or unconditionally. Conditional grants are either direct or indirect. Direct conditional grants are transferred directly into the bank account of the recipient (for example, to a municipality) and must be used for the stated purpose and comply with stipulated conditions and reporting. In the case of indirect grants, a national sector department or public entity performs a function on behalf of a municipality or province. Thus no funds are transferred to the province or municipality concerned, but any infrastructure developed becomes the responsibility of the relevant subnational government.

## 3.2 Problem Statement

In 1998/99, transfers in the form of direct and indirect conditional grants were introduced mainly to ensure adequate funding of national policy priorities. Provincial and local government conditional grants have been key for funding infrastructure provision and reducing infrastructure backlogs. The share of indirect grants to direct grants is increasing at a phenomenal rate, from 3.9% in 2011/12 to 6.4% in 2013/14, and is projected to reach 8.9% in 2016/17 (Figure 12).

**Figure 12: Share of indirect grants to direct grants**



Source: National Treasury (2013a, 2014)

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<sup>47</sup> Address correspondence to [sabelo@ffc.co.za](mailto:sabelo@ffc.co.za).

<sup>48</sup> Email Address: [sasha@ffc.co.za](mailto:sasha@ffc.co.za).

Indirect grants are mostly used to fund infrastructure because, historically, municipalities have not performed well in developing infrastructure. The practice – of national government implementing infrastructure projects on behalf of municipalities that lack capacity – may result in service delivery but carries some risks. These include weakened accountability, and poor maintenance budgeting and planning. To establish whether changing the form of conditional grants improves performance, the Financial and Fiscal Commission (the Commission) undertook a study to assess the funding and performance of specific education-, health-, sanitation- and electricity-related conditional grants.

### 3.3 Aim and Objectives

This chapter examines whether changing the form of conditional grants (from direct to indirect) improves spending on and delivery of infrastructure, by assessing the funding and performance of specific education-, health-, sanitation- and electricity-related conditional grants. The chapter's two specific objectives are:

- to evaluate and analyse changes in the schedules of conditional grants (direct and indirect) using the funding for infrastructure for schools, health, sanitation and electrification as a case study; and
- to quantify the growth and analyse the performance to date of these grants.

### 3.4 Research Methodology

#### 3.4.1 Study approach

The quantitative analysis of selected grants in the sanitation, energy, education and health sectors used both a direct measure of service delivery approach and an expenditure approach. For the direct measure of service delivery approach, an indicator used is the share of households provided with a service (in this case, infrastructure delivered) and having access to a service; a discrepancy between annual service delivery targets and the actual delivery over a period of time is used as an indicator for performance. An expenditure approach entails analysing the spending of funds allocated for a function or programme. An indicator used in this approach is under-spending, with performance assessed by comparing budget allocations and expenditure.

The growth in direct and indirect grants was analysed over seven years from 2004/05 to 2016/17. For the education-, health- and sanitation-related infrastructure conditional grants, the analysis covers a period of three or four years, depending on when grant was introduced. The oldest of the selected grants is the Integrated National Electrification Programme (INEP), which is analysed back to 2006/07.

**Table 10: Description of selected infrastructure grants**

Sector department	Name of grant	Rationale and brief description
<b>Municipal conditional grants</b>		
Department of Water and Sanitation	Rural Household Infrastructure Grant (RHIG)	Previously administered by the Department of Human Settlements, the RHIG was introduced in 2010/11 to support municipalities in addressing rural basic sanitation backlog. The RHIG has both direct and indirect components.
Department of Energy	Integrated National Electrification Programme (INEP)	The INEP provides capital subsidies to Eskom and municipalities for addressing the electrification backlog of occupied residential dwellings, installing bulk infrastructure, and rehabilitating and refurbishing electricity infrastructure. The INEP has direct and indirect components: direct grants are to municipalities deemed to have adequate capacity; indirect grants to municipalities deemed to lack capacity to implement the electrification programme.
<b>Provincial conditional grants</b>		
National and Provincial Department of Education	School Infrastructure Backlogs Grant (SIBG) and Education Infrastructure Grant (EIG)	The SIBG is an indirect grant implemented by the national Department of Basic Education (DBE) on behalf of provincial education departments. The grant provides funding for the Accelerated Schools Infrastructure Delivery Initiative, which is an ongoing programme aimed at implementing basic safety norms and standards in schools. The EIG is a direct grant to provincial education departments that is used to supplement the school infrastructure programme in provinces.
National and Provincial Department of Health	National Health Grant (NHG)	The NHG is an indirect grant with three components to support: (i) infrastructure projects, (ii) the national health insurance scheme pilot sites and (iii) the roll-out of the human papillomavirus vaccine.
	Health Facilities Revitalisation Grant (HFRG)	The HFRG component is used to accelerate the construction, maintenance, upgrading and rehabilitation of new and existing health infrastructure, and to supplement expenditure on infrastructure delivered through public-private partnerships.

### **Brief description of selected infrastructure grants**

The four conditional infrastructure grants chosen (two provincial and two local government grants) are briefly described in Table 10.

#### **3.4.2 Justification for selected grants**

The provision of sanitation services in South Africa, especially in rural areas, remains a challenge. It is funded through the RHIG, which has been affected by changes to its scheduling over recent years. Furthermore, a direct component was recently introduced, and so the grant now has indirect and direct components. INEP also has both indirect and direct components: the indirect is for Eskom (agent) and the direct for municipalities that have adequate capacity. Comparing performance under these two different arrangements will therefore be insightful.

Education (SIBG and EIG) and health (NHG and HFRG) infrastructure grants were chosen because education and health account for the largest share of provincial budgets (more than 40% goes on education and more than 30% on health). Addressing infrastructure backlogs in these two sectors is a national priority, and a large part of infrastructure is funded through conditional grants. Furthermore, these grants consist of both direct and indirect components. The HFRG is important not only for addressing backlogs but also for implementing National Health Insurance, one of the biggest reforms within the health sector.

## 3.5 Overview of Key Infrastructure Backlogs in South Africa

### 3.5.1 School infrastructure

Despite the government's efforts to invest heavily in education over the past two decades, the sector continues to face challenges, as reflected by its performance and dilapidated public school infrastructure. The current policy focuses on "improving the functioning of the education system, mainly through procedural reforms and easing of resource constraints in specific areas – including school-related infrastructure" (Centre for Child Law, 2014: 1). Data from the Department of Basic Education (DBE) indicates large backlogs in basic services, particularly with respect to water, electricity and sanitation in the Eastern Cape, KwaZulu-Natal and Free State, with very slow progress between 2009 and 2011 (Table 11).

**Table 11: Basic infrastructure backlog at schools (2009–2011)**

Province	Percentage of public schools without					
	Water		Electricity		Library	
	2009	2011	2009	2011	2009	2011
<b>Eastern Cape</b>	19.5	19.3	20.6	20.6	90.0	90.0
<b>Free State</b>	15.2	14.7	15.1	14.9	74.0	74.0
<b>Gauteng</b>	0.0	0.1	0.6	0.6	41.0	41.0
<b>KZN</b>	10.4	10.6	26.7	26.6	79.0	80.0
<b>Limpopo</b>	8.1	6.6	7.4	5.8	93.0	93.0
<b>Mpumalanga</b>	6.4	6.9	13.2	11.8	81.0	83.0
<b>Northern Cape</b>	2.6	2.6	5.3	5.3	81.0	81.0
<b>North West</b>	1.0	1.0	3.6	3.6	70.0	71.0
<b>Western Cape</b>	0.0	0.0	0.1	0.1	47.0	47.0

Source: DBE (2009, 2011)

Due to the high backlogs, the DBE committed to spend R8.2-billion between April 2011 and March 2014 to improve school infrastructure throughout the country. In 2011/12, these funds were located through the newly established SIBG, an indirect grant, and the EIG<sup>49</sup>, a direct grant.

### 3.5.2 Health infrastructure

In 1995, the Council for Scientific and Industrial Research (CSIR) undertook a national audit on health facilities on behalf of the Department of Health (DoH) (CSIR, 1996). The audit found that about 17% and 12% of public health facilities required substantial repair and replacement respectively. In some provinces, the situation was much worse; for example, in Limpopo about 24% of public health facilities needed to be replaced or condemned. In 1998, the Hospital Rehabilitation and Reconstruction programme was introduced, with the aim of replacing equipment and facilities in hospital and constructing new hospitals. A Hospital Revitalisation programme, outlined in the Ten Point Plan Strategic Framework (1999–2004), was

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<sup>49</sup> The EIG was created from the restructuring of the infrastructure grant to provinces.

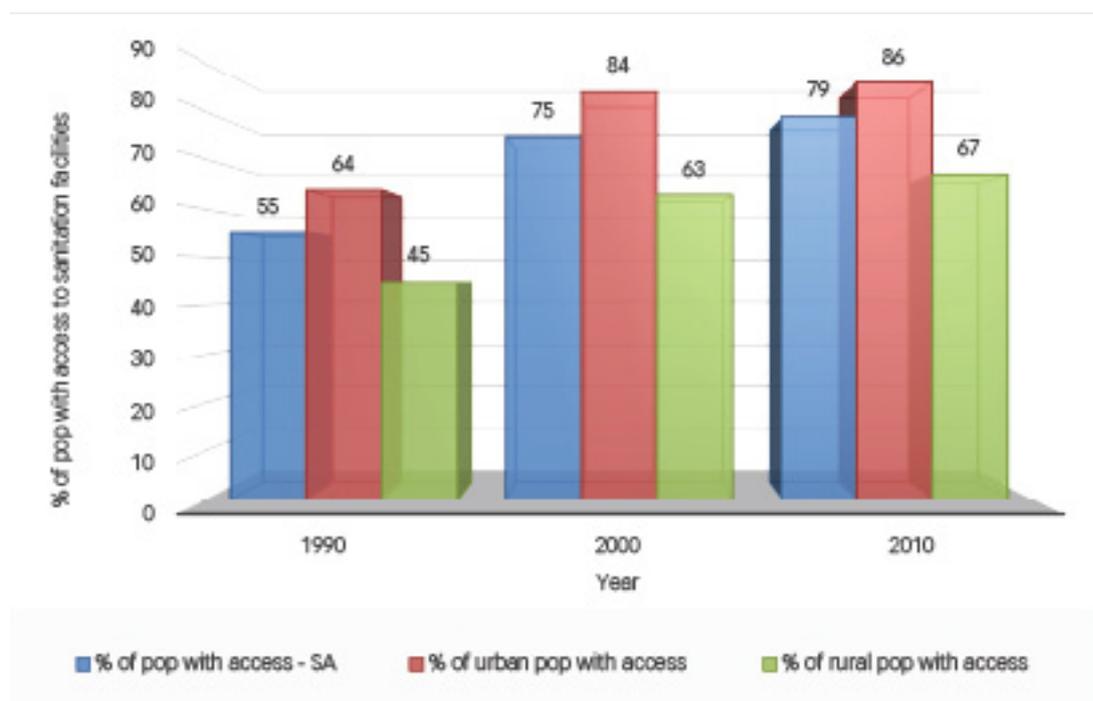
intended to improve infrastructure, health technology, organisational management and service quality (DoH, 2000). The number of hospitals that participated in this programme was 40 in 2008 and 27 in 2009.

### 3.5.3 Provision of sanitation

#### Sanitation backlogs and progress

Since 1990, sanitation services and facilities have improved nationally and in urban areas, but backlogs remain high in rural areas (Figure 13 and Table 12).

**Figure 13: Percentage improvement in sanitation facilities (1990–2010)**



Data source: Trading Economics<sup>51</sup>

**Table 12: Sanitation backlog by province in 2011**

Province	Percentage of backlog
Eastern Cape	40%
Free State	23%
Gauteng	11.1%
KwaZulu-Natal	32.3%
Limpopo	62.2%
Mpumalanga	42.8%
North West	42.4%
Northern Cape	24.3%
Western Cape	9.0%

Source: Stats SA (2012)

<sup>50</sup> <http://www.tradingeconomics.com/south-africa/improved-sanitation-facilities-rural-percent-of-rural-population-with-access-wb-data.html>

As Figure 13 shows, between 1990 and 2010, access to sanitation facilities improved from 55% to 79% nationally and from 64% to 86% in urban areas. However, access in rural areas remained much lower, at 67% in 2010. Challenges to improving sanitation delivery in rural areas include the topography and widely dispersed settlement patterns, which make building the necessary infrastructure and connecting households very expensive, and sometimes unaffordable. The four provinces with the highest sanitation backlogs are predominantly rural: Limpopo, Mpumalanga, North West and the Eastern Cape (Table 12). In response, the RHIG was introduced over the 2010 Medium Term Expenditure Framework.

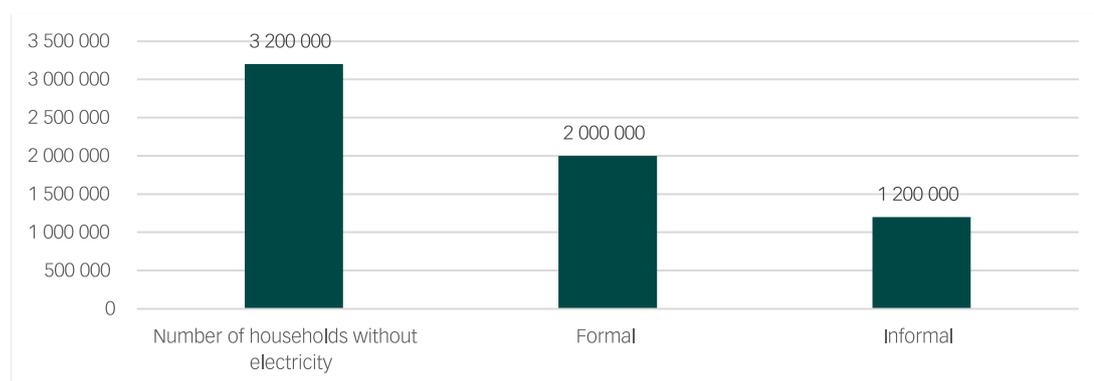
### 3.5.4 Provision of electricity

#### Electrification backlogs and progress

In 1994, when the democratic government took over, only 36% of South African households had access to electricity. The majority of South Africans were using inferior and unhealthy sources of energy such as coal and (in rural areas) wood. From 1994, through the Reconstruction and Development Programme, the government undertook to rectify the historical inequities in the provision of basic services to households. The target was to provide access to electricity to an additional 2.5 million households by 2000. The emphasis was on the electrification of previously disadvantaged and rural areas, as well as schools and clinics.

Between 2002 and 2011, South African households connected to the main electricity supply increased by 6%, from 77% to 83% (Stats SA, 2011). The INEP was introduced in 2006/07 with the intention of achieving universal access to electrification of households by 2014, but a review by the Department of Energy (DoE) in 2012 found that over three million households remained without access to electricity (Figure 14). The aim of achieving universal access has now shifted from 2014 to 2025.

**Figure 14: Electrification backlog in South Africa (2013)**



Source: DoE (2013)

According to the DoE, of the households without access to electricity, 75% are within the area supplied by Eskom and 25% within the area supplied by municipalities. In other words, municipalities still have to provide electricity to about 850 000 households, while Eskom is responsible for over 2.5 million households.

### 3.6 Overview of Trends Direct and Indirect Grants

Table 13 details the total value of direct and indirect conditional grants allocated between 2004/05 and 2016/17.

**Table 13: Allocations in respect of direct and indirect grants**

	Direct Grants (R million)	Indirect Grants (R million)
<b>2004/05</b>	68 291	1 707
<b>2005/06</b>	25 539	1 753
<b>2006/07</b>	35 065	1 436
<b>2007/08</b>	47 316	2 034
<b>2008/09</b>	60 396	2 418
<b>2009/10</b>	70 800	3 088
<b>2010/11</b>	119 093	2 940
<b>2011/12</b>	95 737	2 770
<b>2012/13</b>	103 529	7 271
<b>2013/14</b>	110 263	8 390
<b>2014/15</b>	118 090	13 139
<b>2015/16</b>	128 853	14 510
<b>2016/17</b>	137 309	14 349
<b>Real annual average growth over the period</b>	0.3%	13.0%

Source: National Treasury (2005, 2006, 2007, 2008, 2009, 2010, 2011, 2012, 2013a, 2014)

The monetary value of direct grants may be much greater than that of total indirect grants, but indirect grants are growing at a faster pace. Between 2004/05 and \*2016/17, indirect grants grew by 13% in real terms and 19% in nominal terms, significantly outpacing the marginal growth of 0.3% in direct grants. From a low base of R1.7-million in 2004/05, indirect grants are projected to reach just over R14-billion by 2016/17. This is a sign of greater centralisation and control over spending by national government.

### 3.7 Performance Analysis of Selected Infrastructure Grants

The analysis of selected conditional grants covers the direct and indirect components and looks at both the financial and non-financial performance.

#### 3.7.1 Financial performance of selected infrastructure grants

##### Education

SIBG and EIG were both implemented in 2011/12. As Table 14 shows, the direct grant (EIG) has performed better than the indirect grant (SIBG). Nevertheless, the spending of SIBG has improved since 2011/12, reaching just over 70% in 2013/14, but more needs to be done to ensure better spending.

**Table 14: SIBG and EIG financial performance**

Year	SIBG – Indirect grant			EIG – Direct grant		
	Allocation (R'mil)	Expenditure (R'mil)	Percentage of allocation spent	Allocation (R'mil)	Expenditure (R'mil)	Percentage of allocation spent
2011/12	700	76	10.87%	5 311	5 539	104.29%
2012/13	2 065	859	41.63%	5 802	5 454	94.00%
2013/14	1 931	1 370	70.95%	6 643	6 928	104.29%
<b>Total</b>	4 696	2 305	49.08%	17 756	17 921	100.93%

##### Health

###### *Indirect Grant: National Health Grant (NHG)*

As from 2013/14, the NHG has two components, one for national health insurance and one for health facility revitalisation (National Treasury, 2013b). The aim of the health facility revitalisation component is to accelerate the construction, maintenance, upgrading and rehabilitation of new and existing health infrastructure, and to supplement expenditure on infrastructure delivered through public-private partnerships. Of the R440-million adjusted appropriated, only R182.7-million was spent (the adjustment includes R167-million which was converted to the direct grant to KwaZulu-Natal and Northern Cape provincial health departments and a declared "saving" of R200-million arising from slow spending). At end December 2014 (in terms of the December in-year monitoring), spending was R352.4-million out of the R717-million adjusted budget. The national DoH has again adjusted the allocation, shifting R262-million to the direct grant. The rationale for creating the NHG was to fast-track priority projects and improve spending on and performance of health infrastructure. However, the national DoH has also taken over a number of smaller and diverse projects, which provinces could manage on their own, but does not have the necessary capacity to manage these projects.

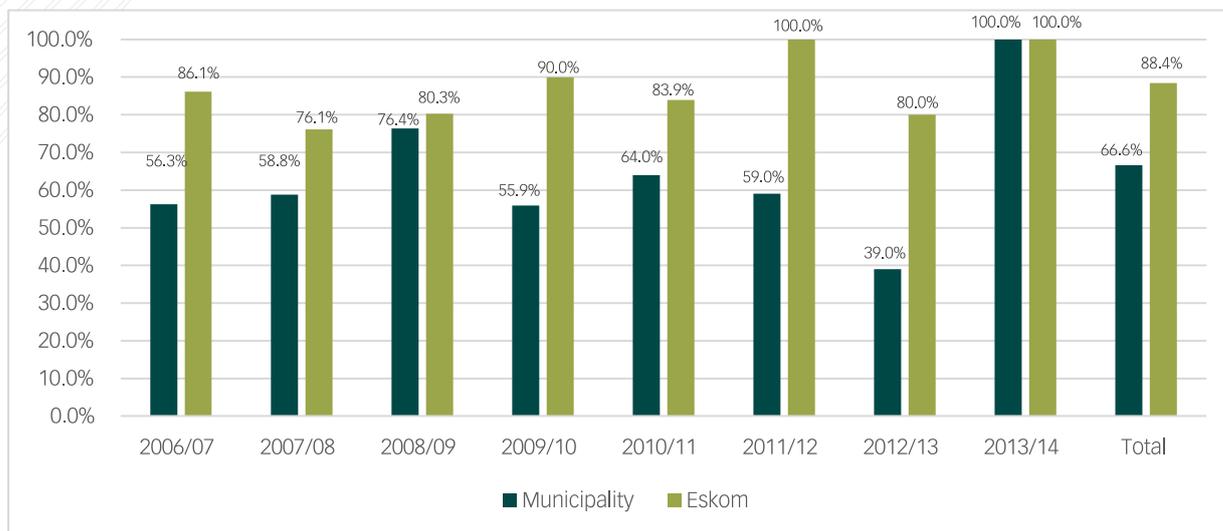
###### *Direct: Health Facilities Revitalisation Grant (HFRG)*

This grant funds the construction and maintenance of health infrastructure and was created in 2013/14 through the merger of three health infrastructure grants: the hospital revitalisation grant, the health infrastructure grant and the nursing colleges and schools grant. In 2013/14, the grant ring-fenced components corresponding to the previous grants that it replaced. The spending performance for the three components was: 88% (health infrastructure), 83% (hospital revitalisation) and 69% (nursing colleges and schools). From 2014/15, these separate components fall away in order to provide greater flexibility for provinces. Provinces will be able to shift funds between projects during the year, so that delays in one project do not result in underspending on the grant as a whole (National Treasury, 2013b).

## Electricity

The INEP has an indirect component implemented by Eskom and a direct component implemented by municipalities. As Figure 15 shows, between 2006/07 and 2013/14, the indirect component outperformed the direct component of this grant. This could be because, unlike many other indirect conditional grants, this particular one is spent by an agency (i.e. Eskom) not a national department.

**Figure 15: Spending performance of the direct and indirect components of the INEP**



## Sanitation

The RHIG was introduced as an indirect grant in 2010/11 and did not perform well until 2013/14 (Table 15). In each financial year, spending increased between February and March (Figure 16), which could indicate fiscal dumping<sup>51</sup> by the national department.

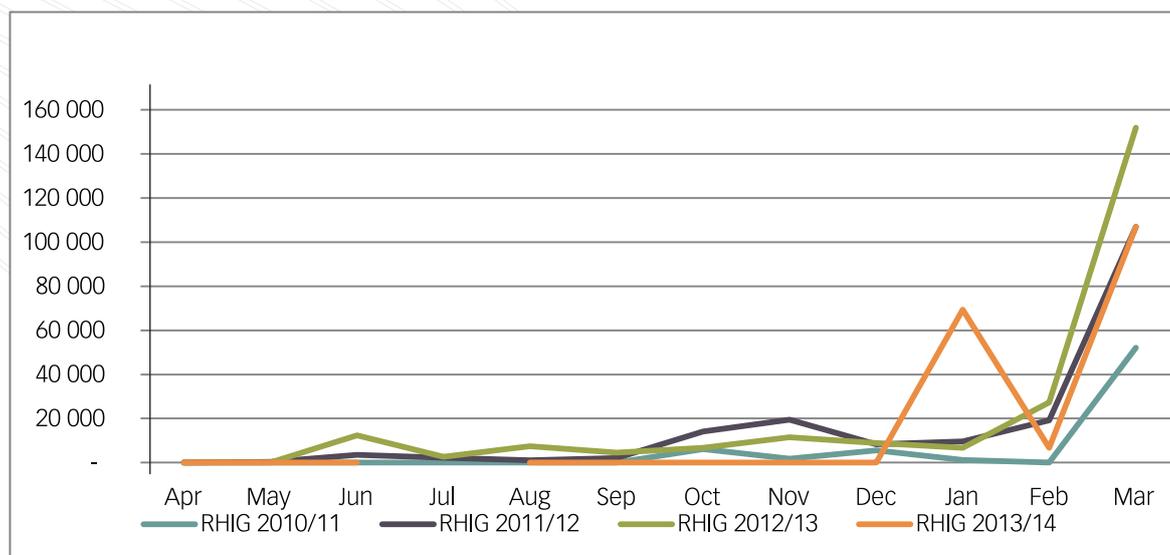
**Table 15: Budget and expenditure of the RHIG (2010/11–2013/14)**

Year	Allocation (R'mil)	Expenditure (R'mil)	% of Allocation Spent
2013/14	240.4	215.3	89.56%
2012/13	340.6	205.6	60.36%
2011/12	258	187.3	72.60%
2010/11	100	62	62.00%
<b>Total</b>	<b>939</b>	<b>670.2</b>	<b>71.37%</b>

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<sup>51</sup> Fiscal dumping is when departments rush to spend their remaining allocated funds before the end of the financial year and is not considered an acceptable practice.

**Figure 16: RHIG spending (2010/11–2013/14)**



### 3.7.2 Non-financial performance of selected infrastructure grants

In analysing the non-financial performance of selected infrastructure grants, the key challenges included the non-availability/incompleteness of data on targets or delivery, which made determining the actual performance difficult. In some cases, data on targets and delivery was available but inconsistent (for example data contained in annual reports, departments' Annual Performance Plans and presentations made to Parliament).

#### Education grants (SIBG)

Unlike the SIBG, assigning specific measurable outcomes directly to the EIG direct grant is not possible because its goal is to provide supplementary funding to provinces for education infrastructure. Table 16 shows the targets and delivery for eradicating inappropriate schools and for providing water, sanitation and electricity to schools.

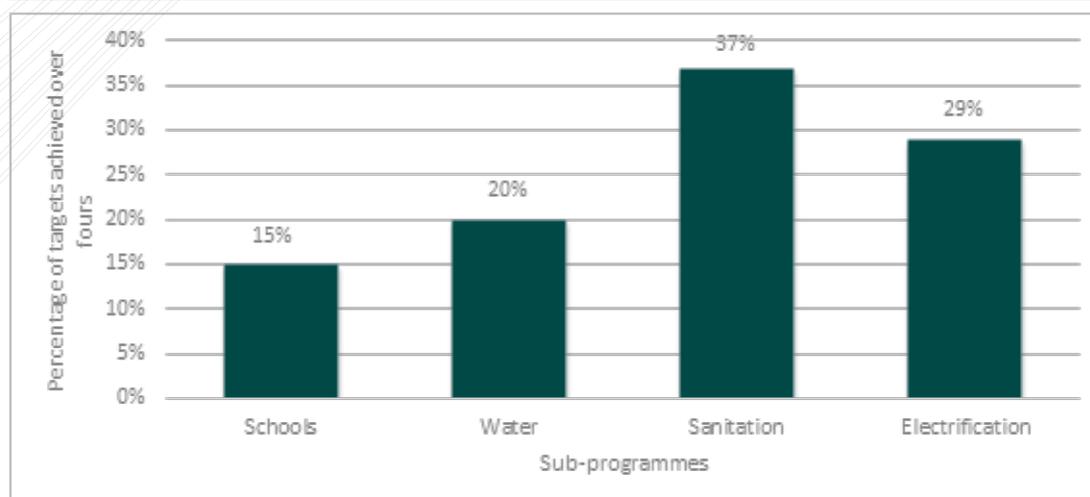
**Table 16: Schools infrastructure backlogs grant: targets and delivery since 2011/12**

Targets and completed since 2011/12	2011/12	2012/13	2013/14	2014/15 (September 2014)	2015/16
<b>Sub-programme – Inappropriate Schools</b>					
Total Target: 510 (496)	Not available	49	140	150	171
Number completed: 75 (15%)	In progress: 49	17 (35%)	36 (26%)	22 (15%)	
<b>Sub-programme – Water</b>					
Total Target: 1120	188	932	Not available	Not available	
Number completed: 225 (20%)	In progress 161	156 (17%)	49	20	
<b>Sub-programme – Sanitation</b>					
Total Target: 741	354	387	Not available	Not available	
Number completed: 275 (37%)	In progress 214	188 (53%)	64	23	
<b>Sub-programme – Electrification</b>					
Total Target: 914 (916)	231	683	Not available	Not available	
Number completed: 265 (29%)	In progress 168	144 (21%)	77	44	

Source: DBE (2014)

By September 2014, as Figure 17 clearly illustrates, none of the SIBG sub-programmes had come close to meeting their targets.

**Figure 17: Summary of the SIBG performance**



### Health infrastructure conditional grants

The targets set and the actual 2013/14 delivery for the health infrastructure conditional grants are shown in Tables 17 and 18. The extent to which the targets were met cannot be assessed because the reporting on delivery of the infrastructure grants (Table 18) does not correspond to the targets set (Table 17).

**Table 17: Health infrastructure grants target (2013/14)**

Grant name	2013/14 Targets
Hospital Revitalisation Grant	<ul style="list-style-type: none"> <li>Number of new replacement facilities constructed: 68</li> <li>Number of facilities procured health technology equipment: 15</li> <li>Number of facilities funded for organisational development and quality assurance: 27</li> </ul>
Health Infrastructure Grant	<ul style="list-style-type: none"> <li>Number of health facilities planned, designed and constructed: 200</li> </ul>

**Table 18: Health infrastructure grants delivery (2013/14)**

Grant name	Delivery 2013/14
Health Facility Revitalisation Grant	<ul style="list-style-type: none"> <li>587 health facilities planned including designed</li> </ul>
	<ul style="list-style-type: none"> <li>845 facilities on different stages of construction</li> </ul>
	<ul style="list-style-type: none"> <li>406 on retention</li> </ul>
	<ul style="list-style-type: none"> <li>352 maintained facilities</li> </ul>
National Health Grant: Health Facility Revitalisation component	<ul style="list-style-type: none"> <li>102 clinics selected to get additional space 79 completed</li> </ul>
	<ul style="list-style-type: none"> <li>340 FET colleges students appointed through Development Bank of Southern Africa and resumed work in Gauteng, KwaZulu-Natal and Mpumalanga provinces</li> </ul>
	<ul style="list-style-type: none"> <li>Feasibility studies for Limpopo Academic Hospital and Chris Hani Baragwanath hospitals finalised</li> </ul>

## Electrification grant (INEP)

The indirect component of the INEP relates to Eskom, while the direct component relates to municipality-provided connections. As Table 19 shows, the targets for 2008/9, 2009/10 and 2010/11 were not available for Eskom.

**Table 19: Number of household connection targets and actual connections (2006/07–2013/14)**

Targets and delivery	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
<b>ESKOM</b>								
<b>Target</b>	70 962	92 521				99 403	114 224	157 839
<b>Delivery</b>	75 560	102 432	68 208	100 379	136 597	106 061	118 926	174 521
<b>Percentage</b>	106%	111%				107%	104%	111%
<b>MUNICIPALITIES</b>								
<b>Target</b>	76 305	66 875	48 447	76 263	84 235	99 505	73 847	87 231
<b>Delivery</b>	74 253	66 131	46 381	67 002	54 872	48 491	47 204	89 771
<b>Percentage</b>	97%	99%	96%	88%	65%	49%	64%	103%

Eskom has exceeded its annual target every year for which data is available, while the performance of municipalities has fluctuated. Nevertheless, the 83% average over the eight years is not a bad performance for municipalities.

## Sanitation grant (RHIG)

As Figure 18 illustrates, the RHIG has not performed well, as only half (46% and 47% respectively) of the planned toilets were delivered in 2010/11 and 2012/13 and about two-thirds (69%) in 2011/12. In 2013/14, the units delivered exceeded units planned because of a large number of units that were started in the previous financial year.

**Figure 18: Number of RHIG units targeted and delivered since 2010/11**

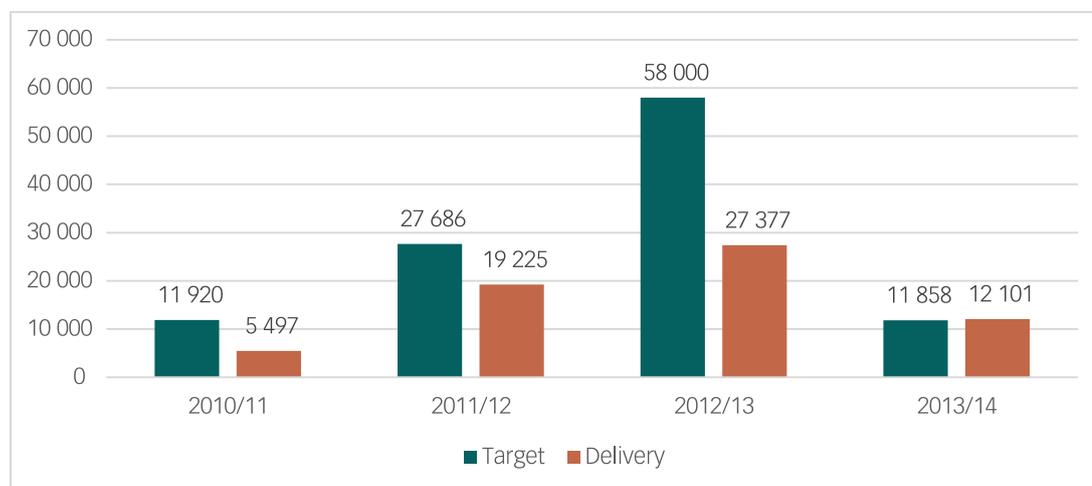


Table 20 provides a summary of both financial (expenditure) and non-financial (infrastructure delivery) performance for the selected education, health, electrification and sanitation grants.

**Table 20: Summary of financial and non-financial performance of selected infrastructure grants**

Sector	Grant category	Financial performance	Non-financial performance	Recent developments
Education	Direct (EIG)	Good	Cannot be directly determined	Average spending was above 100% over three years (2011–2013).
	Indirect (SIBG)	Poor	Poor	Due to poor spending since its introduction, allocation has been reduced in 2015 Medium Term Expenditure Framework. Over three years (2011–2013), spending was at 49%.
Health	Direct (NHG)	Good	Cannot be directly determined – non-alignment of targets and delivery	In 2013/14, the direct component was divided into three grants, for health infrastructure, hospital revitalisation, and nursing colleges and schools grants. Spending was 88% for health infrastructure and 83% for hospital revitalisation.
	Indirect (HFRG)	Poor	Cannot be directly determined – non-alignment of targets and delivery	In 2013/14 spending was at 41.5%. R167-million was converted into direct grants to KwaZulu-Natal and Northern Cape provincial health departments. In 2014/15, an allocation of R262-million was shifted to the direct grant.
Electrification	Direct (INEP)	Good	Good	Over the period 2006/7–2013/14), spending of the indirect component outperformed the direct component. This could be because, unlike many other indirect conditional grants, the grant is spent by an agency (i.e. Eskom) rather than a national department. Similarly, non-financial performance was better for Eskom (indirect grant) than municipalities (direct grant). Most years Eskom exceeded its target for households connected, whereas municipalities averaged just over 83%.
	Indirect (INEP)	Good	Good	
Sanitation	Direct (RHIG)	Cannot be determined (2013/14)	Cannot be determined (2013/14)	The RHIG was an indirect grant since its inception in 2010/11 and did not perform well until 2013/14 when the direct component was introduced.
	Indirect (RHIG)	Poor (but improving)	Poor (but improving)	

Provinces and municipalities appear to be better than national government at ensuring grant funding is spent. In some instances, determining the actual performance is difficult because the data relating to targets and actual delivery is either not available or incomplete. However, from the available data the following can be highlighted:

- The indirect education grant partially achieved its targets.
- Reporting on health grant outcomes was not aligned to targets.
- The electrification indirect grant performed better than the direct grant. This could be because the grant is implemented by a specialised agency (Eskom), not a national department. The direct grant was used to achieve 83% of household connection targets in seven years. This good performance could be because municipalities have been implementing these projects for a number of years.
- The sanitation indirect grant performance improved. It is too early to determine the performance of the direct component.

Some of the reasons for the poor performance of indirect conditional grants include:

- (i) A lack of capacity even at national level. The lack of capacity in provinces and municipalities is one of the main reasons for national departments implementing indirect grants. Yet, in some instances, national departments do not have the capacity and rely on implementing agents.
- (ii) Implementing agents do not always have sufficient technical capacity (DBE, 2014).
- (iii) Poor planning processes, which should include identifying grant beneficiaries (i.e. communities and households).

### 3.8 Conclusions and Recommendations

Provincial and local government conditional grants are key for funding infrastructure provision and reducing infrastructure backlogs in various sectors, including education, health, sanitation and electrification. Indirect grants to provincial and local government are increasing and growing at a faster rate than direct grants. No principles or policies exist to guide the reclassification of grants from direct to indirect (and vice versa), despite numerous recent reclassifications. Nevertheless, key aspects, which should guide government in assigning grants direct/indirect status, emerged from an assessment of the performance of grants in the education, health, electricity and sanitation sectors. With respect to financial performance, the analysis shows that direct grants outperform indirect grants. The one exception is the electrification indirect grant, which is implemented by an agency and not a national sector department.

With respect to managing direct and indirect conditional grants, the Commission recommends that:

1. National Treasury and line departments consider the use of indirect grants as a measure of last resort while continuing to build capacity in provinces and municipalities.
2. Clear criteria are developed to guide the scheduling and rescheduling of conditional grants, taking into account:
  - a. Historical financial performance
  - b. Non-financial performance
  - c. Time period before converting a direct grant to an indirect grant. The responsible government sphere should be given sufficient time (at least three years) to administer and implement a direct grant before considering conversion to an indirect grant. Such conversion must be implemented on a differentiated approach
3. Comprehensive capacity-building plans are developed, with clearly determined targets and time-frames, in cases where indirect grants are considered as a result of poor capacity within a province or municipality.

### 3.9 References

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