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national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

RESPONSES TO ISSUES RAISED BY PROVINCIAL LEGISLATURES IN THEIR NEGOTIATING MANDATES ON THE 2015 DIVISION OF REVENUE BILL

BACKGROUND

At the meeting of the Select Committee on Appropriations on 21 April 2014 provinces presented their negotiating mandates on the 2015 Division of Revenue Bill. The negotiating mandates and committee reports from 5 provinces had comments and recommendations directed at the National Treasury. This document provides responses from the National Treasury to those recommendations.

NATIONAL TREASURY RESPONSES

1. EASTERN CAPE PROVINCIAL LEGISLATURE

a. Much as there has been a review of the Local Government Equitable Share formula there has been little reprieve for municipalities. A backlogs portion should be considered.

The new Local Government Equitable Share formula is pro-rural as the basic services component of the formula subsidises the cost of providing basic services to all poor households (households earning less than two old age pensions per month irrespective of whether these households have access to infrastructure for municipal services or not). The previous formula only provided a partial subsidy for households not connected to services. The institutional and community services components of the formula and the revenue adjustment factor that applies to them ensures that most of the funds from this part of the formula are provided to municipalities with limited revenue bases to run their administrations, and provide general services.

The extension of municipal infrastructure to provide services to households that do not yet have access is funded through conditional grants, including the Municipal Infrastructure Grant, Integrated National Electrification Grant and a variety of water and sanitation grants. One of the key determinants of how much of these grant funds are allocated to an individual municipality is the extent of backlogs in the municipality, with more funds allocated to municipalities with high levels of backlogs. In municipalities with poor capacity to implement infrastructure projects more funds will be allocated through indirect grants so that national departments can build infrastructure on behalf of these municipalities.

b. The under-funded mandates such as library services grant in the municipalities are contributing to the adverse audit outcomes in the municipalities as municipalities are obligated to use their own funds to sustain these services and then they get punished by the Auditor-General.

The libraries function is assigned to provinces in terms of the Constitution and this function is funded through a conditional grant to provinces. In some cases however municipalities perform the function on behalf of provinces, in these cases a service level agreement between the province and municipalities should stipulate the funds for the function that will be transferred to the municipality to enable them to perform the function.

There should not be any correlation between under-funded mandates and adverse audit outcomes. However National Treasury is aware that in some cases the Auditor-General has raised issues where a municipality is performing a function that is assigned to a province without being paid to do so by the province. In such cases National Treasury encourages provinces and municipalities to reach an agreement about the services to be performed by the municipality and the funds to be transferred by the province. If there is a failure to meet the terms of such an agreement then National Treasury can be requested to mediate.

c. **Provincial Division of Revenue Bill should also be brought to the municipalities for consultation and inputs thereof.**

The legislative process for considering the national Division of Revenue Bill is prescribed by the Money Bills Amendment Procedure and Related Matters Act. National Treasury agrees that municipalities be consulted as part of this process. Municipalities are also consulted, through the South African Local Government Association (SALGA), in the preparation of the Bill. At least two drafts of the Bill are shared with SALGA for their inputs before the Bill is tabled and SALGA are invited to attend the meetings where conditional grant frameworks are agreed upon.

National Treasury also supports the idea that provinces should consult the municipalities in their province as part of the process of compiling their own budget documents. Provinces are required in terms of section 30(2) of the Division of Revenue Bill to include all transfers to municipalities in their budget documents and to gazette these. This ensures transparency and predictability regarding the funds a municipality should expect to receive from a province and assists municipalities to plan and compile their own budgets.

d. **The amount of money allocated for roads maintenance is insufficient as some districts need good road networks to continue with the agricultural economy.**

National Treasury is aware of the challenges with road maintenance. The review of local government infrastructure grants is exploring how the rules around roads funding in the Municipal Infrastructure Grant can be changed to allow funds to be used for road maintenance as well as the construction of new roads. The Rural Roads Asset Management Grant funds the collection of data on the condition and usage of municipal roads and this data should be used to plan where maintenance funds are spent so that they have maximum impact.

Provinces receive the Provincial Roads Maintenance Grant which is allocated based on the extent of the road network in each province as well as the climatic conditions that affect the levels of maintenance required on that network. Provinces are required to plan the use of these funds based on data they collect on the condition and usage of their road networks so that maintenance funds are prioritized to the parts of their network most in need of maintenance.

In some cases, the lack of spending on road maintenance is the result of a lack of prioritization in the budgets of municipalities. Also, maintenance tends to be the first area to be cut where there are budget shortfalls elsewhere. To promote improved maintenance spending, National Treasury has issued guidelines and norms for how maintenance should be budgeted for and has changed the municipal budget formats so that we are better able to monitor how maintenance is budgeted for. The Back to Basics strategy of the Department of Cooperative Governance also emphasizes the importance of prioritizing spending on maintenance.

e. **The water provisioning system together with its associated infrastructure maintenance is expensive, the Municipal Water Infrastructure Grant (MWIG) together with other water services associated grants are not enough for proper provisioning of the water and sanitation services.**

Water and sanitation funding is provided through Municipal Infrastructure Grant, Regional Bulk Infrastructure Grant, Urban Settlements Development Grant, Municipal Water Infrastructure Grant, Water Services Operating Subsidy, and the Rural Households Infrastructure Grant. The total combined allocations available through these grants amounts to R34.5 billion in both direct and indirect grants to municipalities in 2015/16 with the majority of these funds going towards the provision of water and sanitation services. The Local Government Equitable Share also subsidises the costs of providing free basic water and sanitation to indigent households with R19.4 billion for operational costs over and above the grant funding.

For non-poor households and businesses, water and sanitation services should be funded through tariffs on these services collected by municipalities. This means it is vital that municipalities charge cost-reflective tariffs and collect the monies owed to them.

Taken together, the transfers and own revenues available to municipalities should be sufficient to fund water services provided by municipalities. In many cases municipalities are not even able to spend their full grant allocations.

f. **The alignment of the financial years for Provincial and Local spheres of governments affects the manner in which municipalities are expected to plan. Provincial departments at the end of their financial year dump funds in municipalities who are then expected to spend these monies in under three months.**

The issue of alignment of financial years was debated when the Municipal Systems Act and Municipal Financial Management Act were enacted. The financial management and other reforms implemented since 2006 have sought to address the complexities caused by different financial years. The national Division of Revenue Act and grant frameworks take this into account as it applies to the planning and budgeting processes. However some provinces and municipalities have still not fully implemented these reforms. The following measures are intended to smooth the difference between financial years and prevent fiscal dumping:

a) The allocations in national and provincial budgets are published for a medium term period, these are supported by cash flow and transfer dates. Such information is obtainable from each grant manager.

b) Provinces are required to implement proper planning and budgeting processes that also addresses the timing of resource allocations and transfers to municipalities. Such information must be made available to all municipalities over a medium terms basis and cash flow plans that show transfer dates also communicated as part of this reform.

c) The planning and budgeting cycle allows for policy decisions to be taken and communicated for implementation in a staggered manner at a municipal level.

Appropriation of allocations, publishing of detailed grants and their allocations support this process. Changes to the national and provincial spheres of government process, taking into account the need for municipalities to consult with communities also feature in this discussion and process.

g. **Institutional Support Grant system has collapsed and Treasury has not been able to effectively support municipalities and this has had a negative impact on revenue collection and audit outcomes.**

The Municipal Finance Management Act and Municipal Systems Act place accountability on municipalities to ensure revenue is collected and that they have sound financial management practices in place. The role of national government is to ensure that support is provided to municipalities to enable them to fulfil these roles. This is done through the grant system as well as other support programmes, including the Financial Management Improvement Programme.

The Municipal Systems Improvement Grant administered by Department of Cooperative Governance and the Financial Management Grant administered by National Treasury both fund institutional support . Conditions attached to these grants and spending thereof have been aligned to the legislative requirements and risk of duplication of resources and support have been mitigated. These grants do support implementation of audit action plans and capacity building efforts of officials working in municipalities. Municipalities have been requested to provide support plans that reflect the areas and usage of these grants. The grant system is therefore geared to supporting municipalities to address their audit findings and improve revenue collection.

h. **The municipal demarcation grant is appreciated but should not be limited to three years but to five years at the minimum.**

The allocation of the Municipal Demarcation Transition Grant for a period of three years is in line with a recommendation of the Financial and Fiscal Commission (FFC). In it's recommendations for the 2015/16 Division of Revenue, the FFC recommended that a grant of this nature should only be allocated for three years, one year preceding the change in municipal boundaries and two years following the change. National Treasury agreed with this recommendation as it helps to ensure that municipalities work as quickly as possible to amalgamate their systems and policies. The benefits of municipal mergers should come through improved efficiency in the consolidated municipality and not due to additional grant funding from national government.

i. **Some of the grants which stimulate development and only allocated to Metros should also be considered for the secondary cities like, Lukhanji (Queenstown), Mthatha, Grahamstown and Aliwal North. There is no support for urban development in these secondary cities.**

The respective municipalities that three of the four towns named above fall under (Lukhanji, King Sabata Dalindyebo and Makana local municipalities) have all previously received allocations for the Neigbourhood Development Partnership Grant. This grant funds economic improvement programmes in township economies. The only one of these municipalities not to have received an allocation form this grant is Maletswai. All municipal areas receive the Municipal Infrastructure Grant and Integrated National Electrification Programme Grant, which fund infrastructure for basic services including water, electricity and roads, all of which are essential for any economic development to take place. In this way the grant system ensures municipalities are able to develop the basic services infrastructure that is required for any economic growth and development to be possible.

j. **Municipalities felt that SALGA should be used as part of the consultation process in relation to municipalities.**

SALGA is consulted throughout the process of preparing the budget. See response to issue (c) above for further details.

k. **There are municipalities that were affected by natural disasters as far back as 2007 but because of the bureaucracy red tape the money allocated for recovery has not been accessed by the affected municipalities.**

The issue relates to a disaster in Ikwezi Local Municipality that took place in 2007/08. National Treasury has referred the matter to the National Disaster Management Centre, who is responsible for assessing disaster claims and recommending payments, and asked them to follow-up with the municipality to establish what happened in this case.

l. **Treasury Department with other relevant Provincial Departments should play a more active role at the initial stages of the IDP process not at the late stages as it is currently happening, this will lead to better IDPs.**

National Treasury agrees on the important role provincial departments and treasuries can play in supporting the development of IDPs. Extensive guidance and training has been offered to municipal officials by provincial and national government. The Department of Cooperative Governance is also responsible for ensuring further training and guidance is provided in ensuring a robust IDP process and community consultation process exists.

The links between the planning and budgeting process are also crucial for successful implementation of IDPs and guidance offered by treasuries also talks to this alignment. This alignment is operationised in the Service Delivery and Budget Implementation Plans that municipalities are required to compile.

m. **National Treasury has threatened to withhold the equitable share of some municipalities because of outstanding ESKOM bills. The non-payment by municipalities to Eskom is viewed in a serious light. Much as National Treasury seeks to assist ESKOM with payment of the bills by municipalities, some other means of doing this should be considered instead of withdrawing the Equitable Share**

Equitable share funds have only been withheld from municipalities with a record of consistently failing to pay funds they owe to their creditors. These creditors include a range of businesses and state owned entities, not just Eskom. National Treasury is also assisting the affected municipalities to draw up repayment plans and to examine the root causes that led to municipalities accumulating these large debts. These lessons could be used to help prevent other municipalities getting into a similar position in future.

More detailed information on the withholding of equitable share funds is contained in the National Treasury response to the Select Committee of Appropriations that was submitted on 20 May 2015.

Recommendations

a. **Intergovernmental relations processes must be intensified.**

National Treasury agrees with this recommendation and is working with provincial treasuries and SALGA to strengthen the functioning of intergovernmental forums. This includes holding an annual Budget Council Lekgotla between the Minister of Finance and MECs for Finance to discuss strategic issues and to build better working relationships between national and provincial governments. There will also be an additional meeting of the Budget Forum in June 2015 to discuss policy and strategic issues affecting local government.

b. **National Treasury must ensure there is capacity to spend the grants when they are allocated.**

National Treasury agrees that capacity should be an important factor when allocating grant funds. Each grant has its own allocation mechanism that takes account of the capacity of provinces and municipalities in different ways. To take some of the largest infrastructure grants for example:

- The Education Infrastructure Grant and the Health Facility Revitalisation Grant require that provinces have infrastructure units that comply with an agreed organogram and skills requirements. The grants also provide that grant funds can be used to fund the employment of personnel in these infrastructure units.
- The Municipal Infrastructure Grant allows municipalities to spend up to 5 per cent of the grant on a project management unit to improve capacity. Municipalities can also request additional capacity support through the Municipal Infrastructure Support Agent.

2. FREE STATE PROVINCIAL LEGISLATURE

a. **Having noted that the Free State, in particular Xhariep District is a predominantly rural and poor whose structural outlay represents significant challenges and constraints to the economic performance of the province and the benefits that are supposed to accrue there from.**

The intergovernmental fiscal system acknowledges that levels of economic performance are very different in different parts of the country. As a result, some areas will be able to generate significant resources from their local economies to fund services while others will not. As a result the intergovernmental fiscal system is designed so that provincial governments are funded mainly through transfers of nationally raised revenues (on average 97 per cent of provincial budgets are funded from transfers), so that they can provide health, education, social and other services irrespective of how poor an area may be. Some municipalities raise significant own revenues, but others cannot and are given larger subsidies (on a per household basis) through the local government equitable share.

Under the two-tier system, municipal functions are shared between district and local municipalities. Funding for a function is allocated to a municipality assigned to perform a function. In the case of Xhariep District Municipality basic municipal services such as water, sanitation, electricity and refuse removal are assigned to the local municipalities. Funds for free basic services (through the equitable share) and infrastructure (through conditional grants) are therefore allocated to the municipalities that are responsible for performing these functions. In Xhariep District Municipality most of the grant funding is therefore allocated to these local municipalities rather than to the district municipality (which still receives institutional support and some general funding).

Municipalities in the area of the Xhariep District Municipality are allocated R1.6 billion in transfers over the 2015 MTEF. The proportion of households below the affordability threshold (equivalent to 2 old age pensions) used in the local government equitable share formula is 67 per cent in Xhariep District Municipality, which is above the national average of 59 per cent.

Municipalities in Xhariep District Municipality get an average of R4 993 per household though the equitable share formula, compared to a national average of R2 935 per household. On a per household basis, allocations to municipalities in Xhariep District Municipality are 70 per cent higher than the national average. This is because the local government equitable share formula allocates additional funds to small municipalities and provides greater support to poorer municipalities.

b. Some provincial roads must be handed over to the national Department of Roads and Transport

The Committee of Transport Officials (COTO) has agreed that 11 000 kilometres of provincial roads in the Free State should be proclaimed national roads. This decision is based on an assessment of the use of the roads, which found that in terms of the Road Infrastructure Strategic Framework for South Africa classification their use indicates they should be classified as national roads.

Roads from other provinces (e.g. Limpopo and the Eastern Cape) have been transferred to national government in the past. This change will mean that the number of lane kilometres that the Free State Province will be responsible for will be reduced. This could affect the distribution of funds between the provinces, but not the total amount available in the grant.

3. GAUTENG PROVINCIAL LEGISLATURE

a. That fiscal rebalancing which includes cost containment measures and intensified efforts to improve efficiency in expenditure to realise government's programmes in a tight fiscal space, should be continued.

National Treasury agrees with this recommendation and will continue to ensure spending remains within the revised expenditure ceiling set in the 2014 Medium Term Policy Statement and 2015 Budget. Measures to promote efficiency, limit costs and reprioritise funding towards urgent priorities will continue to be strengthened as a means of ensuring government is able to achieve its objectives within this spending ceiling.

b. That infrastructure investments should be monitored for expeditious spatial integration of the urban poor into the mainstream of city life, through investment in transport infrastructure and the connecting corridors of development.

National Treasury agrees on the importance of promoting spatial integration through the way infrastructure investments are made in our cities. The Division of Revenue Bill requires metropolitan municipalities to prepare Built Environment Performance Plans that set out how a city's infrastructure investments will be used to promote spatial transformation in the integration zones identified by the city. All infrastructure conditional grants must then be aligned with these plans, including the Public Transport Network

Grant that funds the construction of new public transport networks that will connect households to opportunities along these corridors. Cities' progress in implementing grant-funded projects is monitored by the transferring national department responsible for the grant, but the overall capital programme of the city (which includes funding from cities own revenues) is monitored by National Treasury. The Integrated City Development Grant is an incentive grant designed to encourage cities to do what is necessary to achieve these spatial transformation goals. Over time this grant will be used to reward and encourage cities that make measurable progress in achieving spatial integration.

4. LIMPOPO PROVINCIAL LEGISLATURE

a. Proper planning and capacity to spend on conditional grants must be encouraged across all receiving departments. Parliament and Provincial Legislatures should therefore ensure that expenditure on conditional grants is closely monitored on continuous basis.

National Treasury supports this recommendation and provides information on the spending of conditional grants through monthly and quarterly expenditure reports that can assist legislatures in this important work. The national departments responsible for administering conditional grants also compile quarterly non-financial performance information that can assist in monitoring how effectively and efficiently funds have been used to deliver services.

Proper planning on provincial infrastructure grants is promoted through the Infrastructure Delivery Improvement Programme and rewarded through the incentive-based allocations in the health and education sectors. Provincial roads and transport departments are also required to use some of the same planning procedures as well as using data on the usage and condition of different roads in the province to plan their maintenance spending through the Provincial Roads Maintenance Grant.

b. National Departments and Provincial Treasuries should continuously empower provincial departments and municipalities to efficiently spend on their allocations

National Treasury supports this recommendation and there are a range of measures in place to build the capacity of provinces and municipalities.
For provinces these include:

a) Infrastructure Delivery Improvement Programme
b) Sector-specific support from national sector departments
c) (see financial capacity building in response to a.)

For municipalities these include:

a) Municipal Infrastructure Support Agent
b) Financial Management Improvement Programme
c) Infrastructure Skills Development Grant
d) Financial Management Grant
e) Municipal Systems Improvement Grant
f) Municipal Human Settlements Capacity Grant

c. Empowerment of financial management units is critical to ensure sound financial management. Appropriate skills should therefore be accordingly provided to personnel responsible for financial management.

National Treasury agrees that appropriately skilled financial management team will improve financial management outcomes and this is why a number of interventions have taken place to improve these outcomes while other interventions are in the pipeline.

Financial management and CFOs competency framework, jointly issued by DPSA and NT goes into detail of the kind of skills and competencies that CFOs, and the financial management team, require to carry out the function expected of them. This is the guideline that all departments and provincial treasuries should be using when making appointment to their financial teams.

In addition to this the Office of the Accountant General offers training to CFOs that covers Supply Chain Management, to improve and appropriately monitor procurement; Management and Cost accounting, in order to improve understanding of financial statements; systems overview to better understand information they have and need as well as introduction to the Basic Account Systems (BAS). Budget training and support is also offered and this starts with two courses offered by National Treasury: Essentials for Budget Formulation and Budget Analysis.

Recent skill audit conducted is now a stage where provinces are identifying training programmes that must be undertaken to the skills gap identified in the report. NT has also indicated that there will be engagements to establish the support that NT can provide to provinces.

5. MPUMALANGA PROVINCIAL LEGISLATURE

a. Full allocation of the equitable share to the province needs to consider daily migration of the bordering countries citizens that utilise health, education and social development facilities.

The calculation of the equitable share currently accounts for daily migrants making use of health, education and social development facilities in South Africa.

The health component of the PES, uses the output data from public hospitals so as to capture the demand that these hospital face. If they treat more people within a province, they will get more money, regardless of where the patients originate. As such if bordering countries citizens are making use of public health system in Mpumalanga this will show up in the public health output for the province and will be factored into the PES. In addition to the likelihood of an average person in Mpumalanga having medical aid, the risk adjusted capitation is also factored into the calculation of health component of PES. As such, daily migration is currently reflecting in this component.

The Education component, like the health, also reflects daily migration of neighbouring countries citizens. Education component uses the school age population 5 – 17 years, based on the 2011 census and the enrolment data from the Department of Basic Education's School Realities survey. This survey reports the number of student enrolled in schools, irrespective of their country of origin, and as such capture the effects of daily migration into affected provinces.

The way it is provincial equitable share is calculated therefore, reflects the effects of daily migration into provinces that border other countries and experience daily migration of bordering countries citizens making uses of public services such as health and education.

APPROVAL OF NATIONAL TREASURY INPUT:

MNgqaleni

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NATIONAL TREASURY
DATE: 25/04/2015