**1. REPORT OF THE SELECT COMMITTEE ON APPROPRIATIONS ON THE DIVISION OF REVENUE BILL [B2-2016], DATED 3 MAY 2016**

The Select Committee on Appropriations, having considered the ***Division of Revenue Bill***[B2 – 2016] (National Assembly-Section 76(1)), referred to it and classified by the JTM as a Section 76(1) Bill, reports as follows:

1. **Introduction and background**

Section 10(1) of the Intergovernmental Fiscal Relations Act, 1997 (No. 97 of 1997), requires that each year when the annual budget is introduced, the Minister of Finance (the Minister) must introduce in the National Assembly a Division of Revenue Bill (the Bill) for the financial year to which that budget relates. The purpose of the Bill is to provide for–

* 1. the share of each sphere of government of the revenue raised nationally for the relevant financial year;
	2. each province’s share of the provincial share of that revenue; and
	3. any other allocations to the provinces, local government or municipalities from the national government’s share of that revenue, and any conditions on which those allocations are or must be made.

According to section 7(3) of the Money Bills Amendment Procedure and Related Matters Act (Act No 9 of 2009) (the Money Bills Act) and section 76(4) of the Constitution, the Bill must be tabled in the National Assembly and thereafter it must be dealt with in accordance with the procedure established by Section 76(1) of the Constitution. In accordance with these sections, the Minister, Mr P J Gordhan, tabled the Bill in the National Assembly on 24 February 2016. On 16 March 2016 the Bill was transmitted to the National Council of Provinces and referred to the Committee.

Following a briefing by National Treasury on the Bill, the Committee scheduled public hearings for 12 April 2016 in line with section 9(5)(b) of the Money Bills Act. Advertisements were placed nationally in all 11 official languages, calling for submissions from interested parties and stakeholders. The Committee received and considered four oral submissions - by the Financial and Fiscal Commission (FFC), the South African Local Government Association (Salga) and the Congress of South African Trade Unions (Cosatu). In addition, a written submission was received from Ms Laurika Nxumalo, and duly considered. Subsequently, negotiating mandates were received from provinces on 20 April 2016 and final mandates on 3 May 2016.

1. **The 2016 Division of Revenue allocations over the Medium Term Expenditure Framework**

In light of the serious economic constraints and social pressures under which the 2016 Budget was tabled, government is required to do more with less and to find more innovative ways to execute its mandate. In order to reprioritise funds for emerging priorities and to promote fiscal consolidation, reductions have been made since the 2015 Medium Term Budget Policy Statement. Revisions to the Clauses of the Bill were on account of specific policy adjustments in 2016, and included the following:

* Clause 10(10) requires provincial departments to gazette transfers to municipalities for the Human Settlements Development Grant funded projects before the grant can be transferred to provinces.
* Clause 19 clarifies the grounds on which funds can be withheld and stopped by making explicit the linkages to Section 216 of the Constitution and Section 38(1)(b)(i) of the Municipal Finance Management Act.
* In light of the ongoing drought, Clause 20(6) has been changed to allow grants to be reprioritised to disaster relief or recovery. However, National Treasury must approve any reprioritisation and funds must remain within the same sector, for example, agriculture grants can fund disaster relief within the agriculture sector.
* In order to address corruption in procurement*,* Clause 21(2) makes provision for the conversion of a direct grant allocation (Schedule 5) to indirect grant allocations (Schedule 6) if a municipality fails to adhere to procurement procedures in terms of the Municipal Finance Management Act.
* A new Clause 38 has been added to enable National Treasury to re-gazette allocations in the event that elections are held after the start of the municipal financial year and to set in place interim measures for grant planning and spending in re-demarcated municipalities.

Table 1 below shows how the Bill divides the nationally raised revenue among the three spheres of government:

**Table 1: Equitable Division of Nationally Raised Revenue among the National, Provincial and Local Spheres of Government**

|  |  |  |
| --- | --- | --- |
| **Spheres of Government** |  **Column A** |  **Column B** |
| **2016/17****Allocation**  |  **Forward Estimates** |
| **2017/18**  | **2018/19** |
|  | **(R'000)** | **(R'000)** | **(R'000)** |
| National | 855 070 793 | 922 857 273 |  1 003 451 247 |
| Provincial | 410 698 585 | 441 831 122 | 474 851 942 |
| Local | 52 568 706  | 57 012 141 | 61 731 845 |
| **TOTAL** |  **1 318 338 084** | **1 421 700 536** |  **1 540 035 034**  |

The national share of revenue allocations grows at an increasing rate over the first two years of the 2016 Medium Term Expenditure Framework (MTEF), with growth decreasing slightly in 2018/19. Even though the provincial allocation has decreased compared to the figures projected in the 2015 Medium Term Budget Policy Statement (MTBPS), the overall provincial allocation has increased with R28 billion in 2016/17, R35.6 billion in 2017/18 and R46.0 billion in 2018/19. The allocation to local government is reduced by R300 million (0.6 per cent) from what was projected in the 2015 MTBPS, in order to make funds available for other government priorities. However, allocations increase by R1.5 billion in the 2017/18 and R3 billion in the 2018/19 financial years to assist with the rising cost of basic services. Over MTEF, national government is allocated 47.6 per cent of the total revenue, provincial government 43.2 per cent and local government 9.1 per cent.

* 1. **Provincial allocations**

The provincial equitable share (PES) increases by R33.7 billion over the MTEF, which is R14.9 billion lower than the 2015 MTBPS estimate. R3.3 billion has been reprioritised to fund emerging priorities and R11.6 billion has been trimmed to support fiscal consolidation. This is the last year cushioning is provided for provinces impacted negatively by the update of the PES formula following the 2011 census.

Table 2 below shows the total allocation of the PES to provinces in the 2016/17 financial year, and the estimated PES allocations in the outer years.

**Table 2 Provincial equitable share, conditional grants, forward estimates**

|  |  |  |
| --- | --- | --- |
| **Province** | **Column A** | **Column B** |
| **Provincial equitable share allocations** | **Forward Provincial Equitable Share Estimates** |
| **2016/17****(R'000)** | **2017/18** **(R'000)** | **2018/19** **(R'000)** |
| Eastern Cape | 58 060 456 | 61 969 363 | 65 844 586 |
| Free State | 22 994 762 | 24 590 994 | 26 134 741 |
| Gauteng | 79 599 868 | 86 412 496 | 92 199 524 |
| KwaZulu-Natal | 87 897 580 | 94 051 218 | 99 449 582 |
| Limpopo | 48 708 568 | 52 086 555 | 55 176 261 |
| Mpumalanga | 33 449 947 | 36 207 867 | 38 505 835 |
| Northern Cape |  10 862 660 |  11 733 117  | 12 421 596 |
| North West | 28 062 307 | 30 361 426 | 32 311 062 |
| Western Cape | 41 062 437 | 44 418 086 | 47 007 952 |
| **TOTAL** | **410 698 585** | **441 831 122** | **469 051 139** |

From the above table it can be seen that KwaZulu-Natal receives the highest allocation over the MTEF, followed by Gauteng. The Northern Cape receives the lowest allocation.

There is a net increase of R1.4 billion over the MTEF in direct and indirect provincial conditional grants. The major changes to the provincial conditional grant framework over the MTEF include the following:

* The scope of the Comprehensive HIV and Aids Grant was expanded to cover the treatment of tuberculosis and it has been renamed as the Comprehensive HIV, Aids and TB Grant, with an additional R1.6 billion allocated over the MTEF.
* National Health Insurance Indirect Grant was expanded to fund clinic upgrades in national health insurance pilot districts, with R4.7 billion allocated over the MTEF.
* The introduction of incentives in the Provincial Roads Maintenance Grant to reward best practices in planning and completing road maintenance. The total allocation in the 2016/17 financial year also includes R298 million for the repair of infrastructure damaged by floods.
* R700 million is added to the Public Transport Operations Grant over the MTEF for rising costs.
* Due to poor performance since its introduction in 2011, the indirect School Infrastructure Backlogs Grant will be merged with the direct Education Infrastructure Grant from 2017/18.
* The introduction of a new conditional grant in 2017/18 to expand and improve early childhood development services, with an allocation of R813 million over the MTEF.
* The Human Papillomavirus Vaccine Grant will become a direct grant in 2018/19, with R200 million being shifted from the equitable share.
* There have been reductions to several grants over the MTEF in order to fund emerging priorities. Grants that have been reduced include the Comprehensive Agriculture Support Programme (CASP) Grant; the Human Settlements Development Grant; the Health Facility Revitalisation Grant; the Community Library Grant and the Mass Participation and Sport Development Grant.

**2.2 Local government allocations**

The total transfers to local government can be seen in the table below:

**Table 3: Transfers to local government**

|  |  |  |
| --- | --- | --- |
| **R million** | **2015/16 revised estimates** | **Medium Term Estimates** |
| **2016/17** | **2017/18** | **2018/19** |
| Equitable share and related | 50 507 | 52 569 | 57 012 | 61 732 |
| General fuel levy | 10 659 | 11 224 | 11 785 | 12 469 |
| Conditional grants | 38 485 | 41 132 | 44 543 | 47 111 |
| Indirect transfers | 10 525 | 7 773 | 7 401 | 7 679 |
| **Total** | **110 176** | **112 698** | **120 741** | **128 991** |

As can be seen in table 3 above, the equitable share allocation to local government amounts to R52.6 billion in the 2016/17 financial year, which is an increase of 1.7 per cent from the adjusted allocation of R51.7 billion in the 2015/16 financial year. The local government allocation increases to R61.7 billion in the 2018/19 financial year, representing an average growth rate of 8.3 per cent over the 2016 MTEF. National Treasury indicated that the total allocation grows more slowly than cost pressures, and that they had worked with Salga, the Department of Cooperative Governance and Traditional Affairs (CoGTA) and the Finance and Fiscal Commission (FFC) to ensure that the impact of this shortfall was spread fairly across all municipalities. National Treasury further reported that the equitable share funds services for 9.2 million households, but, according to Statistics South Africa, only 5.3 million households receive free basic water.

From table 3 above it can further be seen that the transfers of direct and indirect conditional grants amount to R48.9 billion in the 2016/17 financial year, and increase to R51.9 billion and R54.8 billion, respectively, in the 2017/18 and 2018/19 financial years. The average growth rate in conditional grant transfers over the MTEF is 5.8 per cent – below the projected inflation rate of 6.0 per cent. Despite the slower growth of local government conditional grants, certain grant allocations grow significantly. Below is a list of these grants and their average growth over the MTEF:

* Water Services Infrastructure Grant (indirect component): 39.6 per cent;
* Water Services Infrastructure Grant (direct component): 18.0 per cent;
* Municipal Systems Improvement Grant (indirect component): 17.0 per cent; and
* Neighbourhood Development Partnership Grant (indirect component): 14.8 per cent.

Following an intergovernmental review of the local government infrastructure grant system conducted by National Treasury, CoGTA, Salga and the FFC, significant changes were made to the way grants are structured. These changes include the following:

* Allowing municipalities to use conditional grant funds to repair and refurbish existing infrastructure.
* Grant consolidation to reduce the number of water and sanitation grants from four to two – the Regional Bulk Infrastructure Grant to fund large projects and the Water Services Infrastructure Grant to fund reticulation schemes and on-site services in rural municipalities.
* Increased differentiation, including amending the Municipal Infrastructure Grant to require secondary cities to plan how infrastructure investments will contribute to urban development that breaks down apartheid spatial patterns.
* A new formula to allocate the Public Transport Network Grant. The previous system incentivised cities to plan overly expensive systems in the hope of receiving more funding. The new formula provides greater certainty about the long-term support, allowing cities to plan affordable and sustainable infrastructure upgrades.

With regard to the Municipal Infrastructure Grant (MIG), most stakeholders, including the Portfolio Committee on Sport and Recreation, had been unhappy with the implementation of the previous rule that the public municipal service infrastructure component (15% of the MIG) was ring-fenced for sport infrastructure. Sport and Recreation South Africa (SRSA), CoGTA and National Treasury have now agreed on the following approach: An amount of R300 million is ring-fenced within the MIG for sport infrastructure projects identified by SRSA. These funds are allocated separately to the MIG, but will be transferred as part of the MIG. Municipalities can only use these funds for the projects agreed with SRSA and must use transversal contracts set up by SRSA. A third of the component is still ring-fenced for municipalities to use for sport infrastructure projects identified in their own Integrated Development Plans.

Other major changes to the local government conditional grant framework include the following:

* Over the medium term, just over R11 billion has been shifted from indirect to direct allocations in water and sanitation to allow municipalities with capacity to implement projects themselves.
* The Bucket Eradication Programme Grant has been extended by one year to finalise bucket eradication in formal residential areas and has been allocated R350 million.
* The Municipal Systems Improvement Grant becomes an indirect grant through which CoGTA will implement capacity building projects in municipalities. The focus will be on the weakest capacity municipalities, as identified in the Back to Basics programme and will include projects such as revenue enhancement, records management and performance management systems.
* A total of R43 million will be shifted from the Municipal Infrastructure Grantto theUrban Settlements Development Grant to account for the Naledi Local Municipality becoming part of the Mangaung Metropolitan Municipality due to the redetermination of municipal boundaries.
* TheMunicipal Human Settlements Capacity Granthas been discontinued, as the housing function was not devolved to metropolitan municipalities as anticipated at the introduction of the Grant in the 2014/15 financial year.
1. **Inputs by stakeholders**

The submissions from the stakeholders covered a variety of issues. They include, among other issues, clarification of clauses, conditional grants expenditure, and withholding of funds.

**3.1 The Financial and Fiscal Commission**

The Financial and Fiscal Commission (FFC) acknowledged the difficult economic circumstances under which the 2016 Budget was crafted and commended government’s efforts to curb deficit increases and also acknowledged that cuts in allocations were inevitable. The issues raised by the FFC included the following:

* The Commission welcomed the new Clause 19, clarifying provisions for the withholding of funds, but reiterated that it was important to think very clearly about what the principle of equitable share was in terms of the Constitution.
* The Commission welcomed the declining growth of indirect grants, but found that they were still growing at a fast pace when compared to direct grants.
* The Commission welcomed the fact that its recommendation had been taken on board with the introduction of an Early Childhood Development Grant.
* The Commission was concerned about the endless changes to health grants, as this introduced uncertainty and duplications and eroded old priorities.
* The Commission supported the principle of rewarding provincial departments through an incentive component for meeting maintenance targets. However, under-capacitated provinces should not be unduly penalised.
* The Commission encouraged National Treasury, provincial treasuries and the Department of Cooperative Governance and Traditional Affairs to put mechanisms in place to monitor the Municipal Demarcation Transition Grant to make sure that these funds are strictly used for the intended purpose.
* While acknowledging that the cuts on baseline allocations were unavoidable, the Commission emphasised the need to minimise the unintended consequences of such cuts and the need to ensure that it does not compromise the delivery of free basic services and the overall government infrastructure investment programme.
* The Commission was of the view that staff verification needed to be carried out throughout the government.
* The Commission noted the downward revision of R3.5 billion over the MTEF in provincial conditional grants and supported reprioritisation in so far as cuts were equitably distributed and targeted at non-performing grants.
* The Commission highlighted that the R1.6 billion downward revision of the Human Settlements Development Grant (HSDG) would accelerate the rate of decline in houses delivered per allocation and encouraged government to support other housing programmes such as self-built and the Finance Linked Individual Subsidy Programme to reduce pressure on the HSDG.

**3.2 South African Local Government Association**

The South African Local Government Association (Salga) expressed concern at a possible withholding of the Local Government Equitable Share to 27 municipalities in the March 2016 tranche. Salga also requested the Committee’s intervention with regard to a need for a balanced approach between municipal obligations and Eskom’s alleged untenable business practices which include -

* Billing after 15 days;
* Prime plus 5% interest;
* Debts exceeding capital amounts;
* Refusal to sign Service Delivery Agreements; and
* Refusal to enforce municipal credit control in areas where they reticulate.

**3.3 Congress of South African Trade Unions (COSATU)**

Cosatu’s submission mostly covered proposals to the national Departments. The Committee welcomed the submission and indicated that it was more relevant to the Appropriation Bill which would be dealt with after the Division of Revenue Bill has been finalised.

**3.4 Ms Laurika Nxumalo’s written submission**

Ms Nxumalo proposed that there should be an allocation for a diabetic programme since fewer people were dying of HIV/AIDS in the country. She also proposed an allocation of funds to address the congestion of people that occur on the Metrorail De Wildt and Mabopane to Pretoria lines due to vandalism and maintenance issues.

**4. Observations**

4.1 The 2016 MTEF spending priorities are aligned with the National Development Plan (NDP) priorities as indicated below:

4.1.1 The NDP envisages a South Africa where life expectancy is at least 70 years, under-20s are largely HIV-free and the burden of disease is reduced. The health budget will be R168.4 billion in 2016/17, of which R31.9 billion will be for primary health care services, R88.2 billion for hospitals, and R15.9 billion for HIV/AIDS treatment and prevention.

4.1.2 The NDP calls for work towards broader social protection. Spending to support this priority is set to grow from R154.4 billion in 2015/16 to R195 billion by 2018/19, accounting for 12.9 per cent of total government spending over the MTEF period. A new early childhood development (ECD) conditional grant has been created and an additional R813 million allocated over the MTEF period to implement the Cabinet-approved early childhood development strategy.

4.1.3 In terms of the NDP government has a duty to coordinate efforts to build a skilled and capable workforce to support an inclusive growth path. Key to realising this outcome is providing access to high-quality education and training. Expenditure in higher education and training is set to increase from R64.2 billion in 2015/16 to R80.5 billion in 2018/19. Of this spending, 41.6 per cent is for university subsidies and infrastructure, which increase at an annual rate of 9.1 per cent over the medium term. Funding for the National Student Financial Aid Scheme increases from R9.2 billion in 2015/16 to R14.2 billion in 2016/17.

4.1.4 With regard to basic education, the NDP’s goal is to improve the quality of education and also to improve access to basic education. To ensure school buildings and facilities meet the gazetted minimum norms and standards, allocations to the direct Education Infrastructure Grant grow at 13 per cent over the medium term, reaching R13.5 billion in 2018/19. In addition, the indirect School Infrastructure Backlogs Grant will be incorporated into the Education Infrastructure Grant by 2017/18. By 2017/18, the grant is expected to have replaced 510 inappropriate and unsafe schools, supplied 1 120 schools with water, and provided 740 schools with sanitation and 916 schools with electricity.

4.1.5 The NDP recognises that the fragmentation in South Africa’s cities and towns imposes high costs on households and the economy. Spending in this functional group is expected to grow to R216.2 billion over the next three years, at an average annual rate of 6.7 per cent. Funds have been reprioritised across departments to priority budget areas such as the local government equitable share, which receives an additional R4 billion to expand the access of poor households to free basic services.

4.1.6 The NDP recognises the importance of building an inclusive rural economy to contribute to growing the economy and employment. Spending on the agriculture, rural development and land reform function will increase to R29.1 billion in 2018/19, at an average annual rate of 4.9 per cent, accounting for 2 per cent of total government spending over the MTEF period.

4.2 While the Committee welcomes the declining growth rate of indirect grants, it is however noted that these grants are still growing at a faster pace when compared to direct grants. This is an indication that there are still capacity challenges within other spheres of government where service delivery is supposed to take place.

4.3 While the cuts in budget baseline allocations were unavoidable, the Committee however took note of the concerns raised as well as potential unintended consequences thereof.

4.4 The R1.6 billion downward revision of the Human Settlements Development Grant has the potential to impact negatively on attempts to reduce housing backlogs, considering the current rates of urbanisation in the country. Further challenges with this grant were raised during the deliberation on the 2015 Division of Revenue Bill. In its report the Committee recommended that, within 90 days after the adoption of the 2015 Division of Revenue Bill Report, the National Treasury should facilitate a process whereby stakeholders can interact in order to resolve the outstanding issues relating to both the Human Settlements Development Grant and the Municipal Human Settlements Capacity Grant. Such stakeholders might include National Treasury, Salga, the Department of Human Settlements and the FFC.

4.5 The Committee takes note of the concerns raised by the South African Local Government Association with regard to what it calls Eskom’s untenable business practices.

4.6 The Committee takes note of what is perceived as endless changes to health conditional grants as well as the possible unintended consequences thereof. The Committee will continue to monitor both the financial and non-financial performance of the health conditional grants on a regular basis.

4.7 The Committee takes note of Ms Nxumalo’s call for government to prioritise diabetic programmes as well as the need to address congestions experienced on the Metro Rail lines at De Wildt and Mabopane.

4.8 The Committee takes note of section 21(2) of the Bill that is aimed at ensuring compliance with the procurement procedures by municipalities

1. **Provincial Mandates**

In compliance with Section 7(b) of the Mandating Procedure of Provinces Act (Act 52 of 2008), provinces were required to submit negotiating and final mandates. The provinces submitted mandates as follows:

* 1. **Negotiating Mandates**

5.1.1 Eastern Cape was in favour of the Bill.

5.1.2 Free State was in favour of the Bill and made recommendations.

5.1.3 Gauteng was in favour of the Bill and made recommendations.

5.1.4 KwaZulu-Natal supported the Bill.

5.1.5 Limpopo was in favour of the Bill and made recommendations.

5.1.6 Mpumalanga was in favour of the Bill and made a recommendation.

5.1.7 Northern Cape supported the Bill and made a comment.

5.1.8 North West was in favour of the Bill and made recommendations.

5.1.9 Western Cape supported the Bill and made a recommendation.

**5.2 Final Mandates**

5.2.1 Eastern Cape was in favour of the Bill.

5.2.2 Free State did not submit a final mandate in time for the meeting.

5.2.3 Gauteng was in favour of the Bill.

5.2.4 KwaZulu-Natal supported the Bill.

5.2.5 Limpopo did not submit a final mandate in time for the meeting.

5.2.6 Mpumalanga was in favour of the Bill.

5.2.7 Northern Cape supported the Bill.

5.2.8 North West was in favour of the Bill.

5.2.9 Western Cape supported the Bill.

1. **Recommendations**

6.1 Both the Department of Monitoring and Evaluation as well as the Department of Public Service and Administration should, within three months after adoption of this Report by the House, report to the Committee on monitoring measures they are applying to ensure that sector departments are capacitated.

6.2 The government in all spheres should ensure that the proposed cost cutting measures are also applied to mitigate any unintended consequences of the cuts in budget allocation baselines.

6.3 The National Treasury should report to the Committee, within three months after the adoption of this Report by the House, on any progress with regard to the facilitation process whereby stakeholders could interact in order to resolve the outstanding issues relating to both the Human Settlements Development Grant and the Municipal Human Settlements Capacity Grant.

6.4 Within three months after the adoption of this Report by the House, the Minister of Health should report to the Committee on how diabetic programmes are funded.

6.5 Within three months after the adoption of this Report by the House, the Minister of Transport and the Passenger Rail Agency of South Africa (Prasa) should report to the Committee on plans to address the reported congestions in Metro Rail stations at De Wildt and Mabopane respectively.

6.6 Within three months after adoption of this Report by the House, the Chief Procurement Officer should brief the Committee on measures in place to monitor compliance of municipalities with procurement procedures as well as cost cutting measures.

6.7 As part of its oversight work the Committee will convene a meeting with both Eskom and Salga as well as relevant stake holders, to address what is perceived by Salga as untenable business practices by Eskom.

**7. Conclusion**

Having considered the *Division of Revenue Bill* [B2 - 2016] and submissions made by stakeholders and provinces, the Committee recommends the adoption of the *Division of Revenue Bill* [B2 - 2016] without amendments.

Report to be considered**.**