REPORT OF THE STANDING COMMITTEE ON APPROPRIATIONS ON THE DIVISION OF REVENUE BILL [B4 –2017] (NATIONAL ASSEMBLY –SECTION 76), DATED 14 MARCH 2017

The Standing Committee on Appropriations (the Committee), having considered the ***Division of Revenue Bill*** [B4—2017] (National Assembly), referred to it on 9 March 2017 and classified by the JTM as a section 76 Bill, reports as follows:

1. Introduction

Section 214(1) of the Constitution, 1996 (the Constitution) requires that every year a Division of Revenue Act (DORA) determines the equitable division of nationally raised revenue among the three spheres of government. This is intended to foster transparency and ensure smooth intergovernmental relations. The Intergovernmental Fiscal Relations Act, No. 97 of 1997 prescribes the process for the determination of an equitable sharing and allocation of revenue raised nationally. Sections 9 and 10 (4) of this Act set out the consultation process to be followed with the Financial and Fiscal Commission (FFC), including the process of considering recommendations made with regard to the equitable division of nationally raised revenue.

In giving effect to section 73 of the Constitution, the Money Bills Amendment Procedures and Related Matters Act, No. 9 of 2009 (the Money Bills Act) was enacted. In line with section 7(1) and Section 7(3) of the Money Bills Act, the Minister of Finance tabled the 2017 National Budget including the 2017 Division of the Revenue Bill on 22 February 2017. The Bill was then referred to the Standing Committee on Appropriations (the Committee) in line with Section 9 (2) of the Money Bills Act.

The Committee received a briefing on the Bill from the National Treasury and also had engagements with the Financial and Fiscal Commission (FFC), and the South African Local Government Association (SALGA). In line with Section 9 (5) (b) of the Money Bills Act, the Committee has a responsibility to hold public hearings on the Division of Revenue Bill. To this end, adverts calling for public submissions on the Bill were published in print media from 3 to 9 March 2017 and the Committee also sent out invitations to interested parties which have made submissions to the Committee before. Submissions from the following organisations or interest groups were received:

- Equal Education; and
- Rural Health Advocacy Project.

2. Allocations of the Division of Revenue Bill for the 2017 Medium Term Expenditure Framework

The 2017 Budget proposals seek to maintain a balance between government's spending commitments, particularly in higher education, health and social protection, and ensuring the long-term health of the public finances. These measures are aimed at contributing to the vision of the National Development Plan (NDP). South Africa's development objectives, expressed in the National Development Plan, rely on achieving higher economic growth and using public resources effectively.

The Budget proposals indicate that Gross Domestic Product growth will gradually improve from 0.5% in 2016 to 1.3% in 2017 and 2.0% in 2018, supported by moderately stronger global growth, more favourable weather conditions, reliable electricity supply, recovering business and consumer confidence, and stabilising commodity prices.

While the positive trajectory marks a break with several years of declining growth, the projected rate of growth is not high enough to markedly reduce unemployment, poverty and inequality. Inclusive growth requires broad-based transformation to break down structural impediments to new economic activities, enable millions of black South Africans to generate income and accumulate capital, and raise per capita incomes across the board.

The 2017 budget includes measures to protect spending on core social obligations and these entail the following:

- The 2017 Budget lowers the spending ceiling by R10 billion in 2017/18 and R15.6 billion in 2018/19. This will be achieved through reduced national department operating budgets; lower transfers to entities, provinces and local government; and reallocations.
- Existing headcount and recruitment must be managed within the adjusted ceiling.
- Over the medium term, the Office of the Chief Procurement Officer aims to save R25 billion by renegotiating contracts with government's top 100 suppliers, consolidating spending on common goods, using technology to reduce duplication and cutting red tape.
- Proposals include the trimming down of large conditional grants to provinces and municipalities. The *human settlements development grant*, the *health facility revitalisation grant,* the *educational infrastructure grant, the water services infrastructure grant,* the *public transport network grant* and the *municipal infrastructure grant* are to be reduced.
- Guidelines have been developed that will support departments and entities to improve the treatment and disclosure of unauthorised expenditure, irregular, fruitless and wasteful expenditure.

- Compliance management and oversight of accounting officers, as set out in the Public Finance Management Act (1999), is to be reinforced.

The Constitution sets out specific criteria for the sharing of nationally raised revenue between national, provincial and local spheres of government. The constitutional principles taken into account when deciding on the Division of Revenue include the national interest, provision of debt costs, national government's needs and interest, provincial and local government basic services. Other important issues include fiscal capacity and efficiency, developmental needs, economic disparities, obligations in terms of national legislation, predictability and stability; and flexibility in terms of responding to emergencies.

The Division of Revenue Bill classifies Schedule 1 to 7 (equitable share and conditional grants) in order to divide revenue between the three spheres of government. Table 1 below provides the legal division of nationally raised revenue among these three spheres of government.

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

Spheres of Government	**Column A**	**Column B**	
	2017/18	**Forward Estimates**	
		2018/19	**2019/20**
	R'000	**R'000**	**R'000**
National[1.]	910 872 117	987 928 992	1 076 814 856
Provincial	441 331 122	471 522 489	506 103 653
Local[2]	57 012 141	62 731 845	69 273 465
TOTAL	**1 409 215 380**	**1 522 183 326**	**1 652 191 974**

1. *National share includes conditional allocations to provincial and local spheres, general fuel levy sharing with metropolitan municipalities, debt-service costs and the contingency reserve.*
2. *Local share includes an unallocated amount of R1.8 billion in 2019/20 that is not included in the forward estimates of local allocations in Schedule 3*

The Division of Revenue Bill proposes that the most important public spending programmes that help poor South Africans, generate employment and contribute to growth have been protected from major reductions. The 2017 division of revenue reprioritises existing funds to ensure these objectives are met despite a lower expenditure ceiling.

2.1 Main Budget Allocations

The main budget expenditure has increased from R1.307 trillion for the 2016/17 financial year to R1.409 trillion for the 2017/18 financial year. The main budget framework provides for average annual growth of 8.1 per cent in the main budget allocations over the next three years. Non-interest allocations for the three spheres of government grow at an average annual rate of 7.3 per cent over the Medium Term Expenditure Framework (MTEF). For the 2017/18, national government is allocated 47.5 per cent of available funds after debt costs and the contingency reserve have been provided for, provincial government is allocated 43.4 per cent of available funds and local government is allocated 9.1 per cent of available funds.

Table 2: Division of Nationally Raised Revenue, 2013/14 – 2019/20

R billion	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	Average annual MTEF growth
		Outcome		Revised estimate	Medium-term estimates			
Division of available funds								
National departments	**453,4**	**490,0**	**546,1**	**557,5**	**590,2**	**631,4**	**681,6**	**6,9%**
of which:								
Indirect transfers to provinces	*2,7*	*5,8*	*3,5*	*3,7*	*4,3*	*1,8*	*1,9*	*-20,1%*
Indirect transfers to local government	*5,9*	*8,3*	*10,4*	*7,8*	*7,3*	*7,6*	*8,0*	*0,8%*
Provinces	**410,6**	**439,5**	**471,4**	**500,4**	**538,2**	**578,6**	**621,0**	**7,5%**
Equitable share	336,5	359,9	386,5	410,7	441,3	471,5	506,1	7,2%
Conditional grants	74,1	79,6	84,9	89,7	96,8	107,1	114,9	8,6%
Local government	**82,6**	**87,6**	**98,3**	**103,3**	**112,5**	**121,5**	**132,3**	**8,6%**
Equitable share	39,0	41,6	49,4	51,2	57,0	62,7	69,3	10,6%
Conditional grants	34,0	35,8	38,3	40,9	43,7	46,3	49,8	6,8%
General fuel levy sharing with metros	9,6	10,2	10,7	11,2	11,8	12,5	13,2	5,5%
Non-interest allocations	**946,6**	**1 017,1**	**1 115,8**	**1 161,1**	**1 240,9**	**1 331,5**	**1 434,9**	**7,3%**
Percentage increase	*7,9%*	*7,5%*	*9,7%*	*4,1%*	*6,9%*	*7,3%*	*7,8%*	
Debt-service costs	101,2	114,8	128,8	146,3	162,4	180,7	197,3	10,5%
Contingency reserve	–	–	–	–	6,0	10,0	20,0	
Main budget expenditure	**1 047,8**	**1 131,9**	**1 244,6**	**1 307,4**	**1 409,2**	**1 522,2**	**1 652,2**	**8,1%**

Source: National Treasury 2017

National Treasury submitted that priorities over the 2017 MTEF period that are funded through reprioritisations in the division of revenue include:

- Strengthening specialised tertiary health services for children through a new paediatric hospital.
- Preserving the school nutrition initiative by countering the effects of rapid food price inflation.
- increasing the number of children receiving meals.

- Providing free basic services to poor households.
- Promoting access to social housing through increased subsidies.
- Introducing a new social worker employment grant. Introducing a new grant to educate learners with profound intellectual disabilities.

2.2 Summary of changes in transfers to provinces and municipalities

National Treasury indicated that provincial baselines remain unchanged compared to indicative figures contained in the 2016 MTBPS. To protect basic services funded by the provincial equitable share when effecting budget reductions of R6.8 billion in the provincial fiscal framework as published in 2016, only 23.5 per cent (R1.6 billion) of this is applied to the equitable share, despite its accounting for more than 80 per cent of transfers to provinces while the remaining R5.2 billion of the reduction comes from provincial conditional grants. National Treasury submitted that reductions were biased against grants with a history of under-spending.

In addition, a number of grants funding essential services, such as the *national school nutrition programme grant*, the *early childhood development grant* and the *public transport operations grant* were not reduced.

National Treasury indicated that over the medium term the following additions were made to ensure provinces and municipalities can serve growing populations, namely, R7.3 billion to the Provincial Equitable Share mainly for education and health, R5.1 billion for the local government equitable share for basic services including a R1.8 billion provisional allocation, R390 million is added to the *National School Nutrition Programme Grant* and R1 billion to the Integrated National Electrification Programme Grant.

Table 3: Conditional Grants to provinces 2016/17 to 2019/20

Table 6.3 Conditional grants to provinces

R million	2016/17	2017/18	2018/19	2019/20
Direct conditional grants[1]				
Comprehensive agricultural support programme	1 642	1 646	1 751	1 876
Ilima/Letsema projects	491	522	552	583
Community library services	1 357	1 420	1 499	1 580
Education infrastructure	9 933	10 046	13 390	14 141
Maths, science and technology	362	365	386	408
National school nutrition programme	6 060	6 426	6 802	7 186
Comprehensive HIV/Aids and TB	15 291	17 558	19 922	22 039
Health facility revitalisation	5 273	5 654	5 916	6 247
Health professions training and development	2 477	2 632	2 784	2 940
National tertiary services	10 847	11 676	12 395	13 178
Human settlements development	18 284	19 969	21 115	22 338
Mass participation and sport development	556	586	618	653
Provincial roads maintenance	10 478	10 754	11 536	12 182
Public transport operations	5 400	5 723	5 990	6 326
Other direct grants	1 242	1 852	2 436	2 614
Total direct conditional grants	**89 692**	**96 829**	**107 092**	**114 292**
Indirect transfers	**3 654**	**4 258**	**1 765**	**1 864**
School infrastructure backlogs	2 181	2 595	–	–
Comprehensive agricultural support programme indirect	212	–	–	–
National health insurance indirect	1 261	1 663	1 765	1 864

1. Excludes provisional allocations
Source: National Treasury 2017

Direct conditional grant baselines total R96.829 billion in 2017/18, R107.092 billion in 2018/19 and R114.292 billion in 2019/20. Indirect conditional grants amount to R4.258 billion, R1.765 billion and R1.864 billion respectively for each year of the same period. Changes to provincial allocations over the 2017 MTEF include:

- Implementation of an incentive component within the provincial roads maintenance grant to improve performance;
- National School Nutrition Programme benefits from additional R390 million to mitigate food price inflation and additional learners;
- The *social workers employment grant* to hire social workers to improve access to social services; *early childhood development grant* will improve access and conditions of this service and a *learners with profound intellectual disabilities grant* to improve education opportunities for learners with these disabilities;
- Reprioritising R660 million over the MTEF period from the *human settlements development grant* to the Social Housing Regulatory Agency;

- Extension of the *school infrastructure backlogs grant* which was to be merged with the *educationinfrastructure grant* in 2017/18, to allow time for projects to be completed and for the thorough assessment of the grant transition process.

Local government grants fall into two main groups: infrastructure and capacity building. The total value of conditional grants directly transferred to local government increases from R43.727 billion in 2017/18 to R46.270 billion in 2018/19 and R49.836 billion in 2019/20.

Table 4: Conditional Grants to local government 2016/17 to 2019/20

R million	2016/17	2017/18	2018/19	2019/20
Equitable share and related[1]	**51 169**	**57 012**	**62 732**	**67 473**
General fuel levy sharing with metros	**11 224**	**11 785**	**12 469**	**13 167**
Direct conditional grants	**40 863**	**43 727**	**46 270**	**49 836**
Municipal infrastructure	14 914	15 891	16 788	17 734
Water services infrastructure	2 845	3 329	3 559	3 757
Urban settlements development	10 839	11 382	11 956	12 631
Integrated national electrification programme	1 946	2 087	2 204	3 328
Public transport network	5 593	6 160	6 583	6 962
Neighbourhood development partnership	624	663	702	741
Local government financial management	465	502	531	561
Regional bulk infrastructure	1 850	1 865	2 060	2 175
Municipal demarcation transition	297	112	–	–
Other direct grants	1 488	1 735	1 887	1 947
Total direct transfers	**103 255**	**112 524**	**121 470**	**130 477**
Indirect transfers	**7 824**	**7 338**	**7 596**	**8 015**
Integrated national electrification programme	3 526	3 846	3 962	4 182
Neighbourhood development partnership	22	28	29	31
Regional bulk infrastructure	3 479	2 774	2 881	3 037
Water services infrastructure	362	587	608	642
Municipal systems improvement	84	103	115	122
Bucket eradication programme	350	–	–	–

1. Excludes provisional allocations
Source: National Treasury 2017

With regards to municipal grants, several conditional grants have been merged in previous years and the consolidation trend is expected to continue. Proposed changes to municipal allocations for the 2017 MTEF include the following:

- I Government's intention to introduce a new funding model for district municipalities once the Department of Cooperative Governance has completed its review of their functional role.

- National Treasury working with the Department of Energy and Department of Human Settlements to consolidate electrification funding for metropolitan municipalities into the urban settlements development grant.
- The Bucket Eradication Programme Grant ends in 2016/17 and all remaining projects will be completed through existing grants. In 2017/18 R385.6 million is allocated for bucket eradication projects in the *Regional Bulk Infrastructure Grant* and the *Water Services Infrastructure Grant.*

2.3 Main Changes to 2017 Division of Revenue Bill

The 2017 Division of Revenue Bill continues with emphasis on reprioritisation within the existing fiscal envelope so as to ensure that the state's policy objectives are met despite a lower expenditure ceiling.

The main policy issues considered and adjusted into the 2017 Division of Revenue Bill clauses include:

- Clause 21(1) is changed to make it easier for indirect allocations to be converted to direct transfers in-year (will make it easier for provinces to complete projects);
- Clause 21(2) clarifies the criteria for the in-year conversion of direct grants to indirect. These include: national departments must demonstrate capacity; province/municipality must have a history of underperformance; efforts must have been made to develop their capacity; and it will prevent under-expenditure or improve delivery;
- Clause 21(4) clarifies that, when possible, an allocation converted in-year should be used to implement the same project(s) that were planned prior to the conversion;
- A new sub-clause is added to clause 35 that allows transferring officers to delegate their powers and responsibilities in terms of this Act. This is intended to make grant management more efficient in national departments;
- Reducing reporting requirements by no longer requiring the submission of draft capacity reports; and
- Clarifying that withholding is done to prevent underspending by the receiving officer (and not the transferring officer).

National Treasury in its briefing to the Committee on the Bill indicated that there is a technical error in the Bill. National Treasury indicated that the error resulted in the zero being omitted from all the municipal codes in Schedule 3 of the Bill and the Annexures and Appendixes to the Bill.

3. Stakeholder and Public Inputs on the 2017 Division of Revenue Bill

3.1Financial and Fiscal Commission

The submission by the Financial and Fiscal Commission (the Commission) acknowledged the economic background underlying the budget and alluded to low growth below the National Development Plan target which constrains government's ability to address unemployment, inequality and poverty. The Commission highlighted that social and fiscal risks remain high and encouraged government's efforts to exercise fiscal discipline and improve the composition and quality of spending.

The Commission noted the revisions in Clauses 21(1), (2) and (4) of the Bill on the in-year conversion of allocations and acknowledged that this aims to reduce inefficiencies in the management of conditional grants. However, the Commission was concerned that the definition of thresholds for conditions under which direct grants are converted to indirect grants is not clear and may lead to partiality. The Commission was of the view that the use of indirect grants may have an unintended negative impact on the repairs and maintenance of infrastructure due to national departments delivering infrastructure on behalf of municipalities. National departments were encouraged to strengthen oversight and monitoring mechanisms instead of relying on indirect grants.

The Commission welcomed the removal of a sub-section under Clause 27(2)(d) and the addition of clause 35(5) and (6) to improve grant administration by allowing transferring officers to delegate powers and responsibilities subject to the same constraints allowed for the National Treasury and provincial treasuries. The Commission was of the view that this will prevent inconsistencies and accountability problems. The Commission also welcomed an addition to Clause 23(2)(b) which provides for the correction of under-payments to municipalities within ten days thus preventing disruptions in service delivery.

With regard to the division of revenue at national level, the Commission noted the R5 billion proposed increase in the MTEF outer year for higher education and also welcomed the pilot project for a mixed funding scheme to accommodate the missing middle. The Commission welcomed the sustained spending on infrastructure and the introduction of the new infrastructure budgeting facility which aims to address planning and execution challenges which undermine the effectiveness of infrastructure projects. It was of the view that the facility should be extended to infrastructure projects undertaken by local government and also aligned with the existing sub-national planning and co-ordination processes. It was highlighted

that infrastructure investment is mainly driven by State Owned Entities with a share of 45 per cent whilst provinces and municipalities account for 20 per cent and 18 per cent respectively.

The Commission welcomed the fact that there were no total baseline adjustments to the provincial fiscal framework and noted that the provincial equitable share (PES) and conditional grants are expected to grow on average above the rate of inflation over the 2017 MTEF. The Commission indicated that although the real growth in PES and conditional grants was insufficient to address backlogs in education and health, provinces should still be able to marginally expand the delivery of constitutionally mandated basic services. The Commission welcomed the stabilisation of the provincial wage bill and felt that there is a need for linkages between wage increases and productivity through a framework for measuring public sector productivity. The Commission also welcomed the review of the PES formula which is expected to cover the funding burden of poorer schools, assessment of data reliability and the cost of service provision.

The Commission welcomed the strong growth in the local equitable share (LES) and in particular the addition for offsetting the increasing costs of basic services. The Commission viewed the effective spending of the LES as having significant redistributive effects in terms of service delivery to the poor. The Commission emphasised that municipalities can be compensated for the rising costs of basic service only if the true cost of municipal operating and maintenance services is used and reference was made to a model on true costs of basic services developed jointly with the South African Local Government Association. The Commission also welcomed the recognition of discrepancies in the funding of District Municipalities (DMs) and the interim measures for relieving funding bottlenecks faced by 13 DMs. The Commission was of the view that a long term sustainable funding model for DMs should be found and that this model should be based on a clear identification of the powers and functions of the DMs.

In terms of provincial conditional grants, the Commission noted with concern the reduction in the baseline of the Human Settlements Development grant and was of the view that this would negatively affect the performance of the sector in terms of housing units delivered and thus widen the gap between housing needs and delivery in the affordable housing market. With regard to the R3.6 billion ring-fenced for upgrading informal settlements in mining towns, the Commission re-iterated its recommendation for a rental tenure option or a balanced mix given that mining areas comprise mainly of migrant labour who may prefer rental over ownership. The Commission also encouraged government to partner with the mining sector for the upgrading of informal settlements in mining towns in a way that is less of a burden to the fiscus. The Commission supported the proposed devolving of the public transport contracting and regulatory function to metros and recommended that careful consideration be

made to the baseline to ensure that metros are not disadvantaged. Furthermore, the Commission recommended that the decision to devolve be communicated soon to the affected metros to facilitate planning and contracting.

The Commission was concerned about the base line reductions in the Health Facility Revitalisation grant given its importance to the construction and maintenance of health infrastructure in line with the National Health Insurance reforms underway and HIV/AIDS and TB grant given the increased uptake of people on ARVs every year. With regard to the closure of the direct component of the National Health Insurance (NHI) grant, the Commission noted that the direct NHI grant has been plagued by poor spending problems due to poor supply chain management systems, weak human resource capacity and the lack of delegation powers at district levels. The Commission was of the view that this points to a need for far reaching reforms which also address pre-existing operational and institutional challenges at provincial level before the NHI is rolled out. The Commission proposed that the National Department of Health should use the indirect NHI grant to build the capacity of health district offices given their central role in the implemantation of the NHI programme. The Commission also encouraged government to implement the NHI reforms in a sequential manner and made reference to stewardship and governance, pooling, purchasing and benefits design.

In terms of education grants, the Commission welcomed the increase in the allocation for the National School Nutrition Programme (NSNP) which accommodates inflation and the expansion of access of nutrition to poor learners in public schools. However, there were concerns about the reduction in the Maths, Science and Technology grant given its critical role towards the improvement of educational outcomes. The Commission welcomed the introduction of the new grant for learners with profound intellectual disabilities in line with meeting international and local obligations of an inclusive society for all persons. The Commission indicated that the grant will address amongst other things issues of accessibility to public transport, the physical condition of schools as well as professional capacity.

The MTEF allocations of R1.3 billion for Early Childhood Development and R591.3 million for the new social worker employment grant were also welcomed by the Commission. The Commission proposed that government should clarify if provinces can use the social worker employment grant to fund Non-Government Organisations that are in need of social workers as the grant framework was not clear on this. Furthermore, the Commission was of the view that departments should be discouraged from designing scholarship programs linked to guaranteed employment as this could lead to financial mismanagement especially if the graduates were not budgeted for in compensation budgets of the departments.

In terms of local government conditional grants, the Commission was overall concerned about the baseline reductions to the Municipal Infrastructure Grant (MIG), the Water Services Infrastructure Grant (WSIG), the Urban Settlements Development Grant (USDG) and the Public Transport Operations grant. The Commission highlighted that it has repeatedly recommended that reductions should target underperforming grants however the MIG and USDG were amongst the best performing grants. The Commission was concerned that the reductions affect key municipal deliverables. In addition, it was highlighted that the WSIG was affected the most by the reductions despite the increase in its scope for the inclusion of sanitation and the Commission contrasted this to sanitation backlogs which remain high especially in rural areas and the government target of universal access to sanitation by 2014.

The Commission also welcomed government's focus areas to turnaround the local government, namely, the Municipal Standard Charts of Accounts for improving financial management; supply chain improvements for minimising irregular expenditure and corruption; guidelines for setting tariffs to minimise disparities in costs of services and tariffs; and improved asset management and asset maintenance. The Commission also alluded to the issue of escalating consumer debt which affects the fiscal viability and financial health of municipalities as well as municipal debt affecting the operations of public entities owed large sums of money by municipalities. The Commission indicated that currently ESKOM is owed R10 billion by municipalities whilst municipalities are owed R113 billion as of June 2016 by national and provincial spheres, businesses and households. In this regard, the Commission implored the task team examining intergovernmental debt to speedily resolve the issue.

3.2 South African Local Government Association

The South African Local Government Association (SALGA) in its submission acknowledged the work done by National Treasury in drafting the 2017 budget in difficult conditions and stated that it supported the theme of transformation for inclusive growth. It further stated that the theme of the 2017 budget resonates with some of the analysis and resolutions taken at its National Executive Conference which was held in November 2016. The resolutions taken at the said conference included the following:

- Finding alternative revenue instruments to enhance the financial viability and health of municipalities;
- Finding measures to deal with the increasing debt currently standing at R117 billion;
- Building municipal capacity to manage both debtors and creditors;
- Finding suitable measures to resolve Eskom issues;

- Working with National Treasury and the South African Revenue Service (SARS) in better profiling municipal clients and better manage their payment records;
- Lobbying for increased allocations to the sector in line with the Cost of Basic Service Study recommendations; and
- Providing differentiated support to small struggling municipalities and districts.

SALGA in its submission on the Bill stated that the division of revenue achieved a substantial redistribution of revenue raised through taxes in relatively wealthy (mainly urban) areas to areas where demand for subsidized public services is the highest. Thus, most rural municipalities receive twice the allocation per household than what is transferred to metropolitan municipalities. SALGA submitted that it supported the general thrust of the 2017 budget however it would continue engaging with the relevant stakeholders on the following areas:

- The consideration by National Treasury of the recommendations of the study conducted by SALGA and the FFC on the Cost of Basic Services so that the Equitable Share review process factors some of the recommendations made;
- Of continuous concern is the allocation to local government which amounts to 9.1 per cent of the overall budget with (5 per cent Equitable Share, 3 per cent grants, 1 per cent indirect transfers, and 1 per cent of the fuel levy);
- There is a need for a continuous review of the allocation methods to address the fact that a number of municipalities are economically and financially unviable. The challenges faced by these municipalities cannot be addressed through the demarcation instrument;
- SALGA will engage with National Treasury on the cost of traded services and the tariff increases granted by the National Energy Regulator South Africa (NERSA); and
- The increasing debt to municipalities has to be resolved as a matter of urgency otherwise it undermines the financial stability of local government.

3.3Equal Education

Equal Education (EE) in its submission on the 2017 Division of Revenue Bill highlighted concerns around the Equitable Share Formula with specific focus on redress, rurality and scholar transport within the basic education sector. It further commented on the progress by National Treasury on the recommendations made by the Committee regarding the possible introduction of a conditional grant for scholar transport.

EE submitted that the cost of providing quality education in rural provinces was substantially higher due to its historic underfunding and dire economic circumstances, as well as the geographic, infrastructural and demographic characteristics. EE further stated that while the 2017/18 budget should be lauded for taking some steps towards meeting the pressing needs in the Early Childhood Development and Higher Education Sectors, it however fails to comprehensively address the funding in education and other social services in a pro-poor manner across provinces, i.e. the link between poverty and rurality. EE further submitted that in the exercise of revising the Equitable Share Formula, National Treasury should consider the true cost of providing adequate rural education, so as to ensure that those most in need receive most aid.

Ordinary public schools in South Africa are organised in a system ranging from 1 to 5, with 5 being the most affluent and 1 being the poorest. Schools in quintile 1 to 3 are no fee schools therefore their funding comes from the state. EE submitted that a disproportionately high number of quintile 1 to 3 schools were located in rural provinces thus rendering the cost of education substantially higher than in urban provinces.

With regard to the schools transport system, EE submitted that the challenges were still prevalent despite the fact that it had made recommendations to the Committee in its submission on the 2016 Division of Revenue Bill. EE further reiterated the following key issues which impacted on effective funding and planning for scholar transport:

- Ineffective coordination between the Departments of Transport and the Department of Basic Education;
- Inaccurate and inconsistent data on the number of learners in need of scholar transport;
- Consistent under-funding and under-budgeting for scholar transport by provinces, particularly rural provinces.

Equal Education made the following recommendations on the 2017 Division of Revenue Bill:

- That National Treasury makes a solid commitment to revising the Equitable Share Formula (ESF) to:
  - Take into account the costs of education provisioning in rural areas,
  - Increasing the poverty component of the formula;
- The timeframe for the Equitable Share review be made public;
- The Review should include a period of public consultation on proposed models for the new ESF;

- EE recommends that the Committee reiterate its previous recommendation on the 2015 Division of Revenue Bill that a conditional grant should be properly considered for scholar transport; and
- EE recommends that the Committee call National Treasury to account on all the steps taken toward the design and implementation of a conditional grant, including steps to engage relevant stakeholders.

3.4Rural Health Advocacy Project

The submission by Rural Health Advocacy Project (RHAP) focused on aspects of the budget that relate to the health of rural communities. RHAP noted that health expenditure has grown in real terms by about 1.3 per cent between 2012/13 and 2018/19 and that expenditure is driven by the expansion of ART programmes and increased drug prices. RHAP also observed that there is continued pressure on health budgets due to high drug prices and cost of employment increases. They also highlighted that there is a rising burden of non-communicable diseases and unless this is planned for it could result in massive downstream costs to the health systems.

RHAP made reference to the Minister of Finance's announcement that rural provinces will continue to receive a higher per capita proportion of the equitable share allocation and questioned the adequacy and effectiveness of the PES. RHAP argued the inadequacy of allocations by citing rural population data related to levels of inequity and people who live below the poverty line in rural areas as well as statistics related to understaffing in rural health care. They also highlighted the higher costs of service delivery in rural areas due to poor road infrastructure and distances due to geographic remoteness. Nonetheless, RHAP welcomed the announcement for the exploration of adding rural-focused indicators to the PES formula to further strengthen the equity of intergovernmental transfers. They also indicated that more clarity was needed on the risk equalization component of the PES formula.

With regard to the effectiveness of the PES, RHAP was of the view that there are serious flaws in the way health is funded and alluded to provinces having full discretion on how the PES is allocated within the province. RHAP was of the view that some provinces allocate far smaller portions of PES towards health which thus results in poor health facilities. They were concerned that the allocation process at the provincial level is non-transparent and vulnerable to priority-setting that is out of tune with the national goals of equity and transformation. Furthermore, they were of the view that health allocations to those most in need are further complicated by another layer of decision-making at provincial departments of health. RHAP also cautioned against ill-considered cost-cutting measures and cited that rural health care facilities serving the most impoverished communities have been cut to skeleton staffing levels

whilst outreach services to clinics and households have also come to a halt. RHAP purported that whilst National Treasury's call for cutting costs came with a proviso for protecting frontline health professionals, there have been instances of post rationalisation and organogram reviews occurring outside of the public domain with little or no consultation of communities and that this has affected health care delivery to the most vulnerable.

RHAP argued for targeted funding to address historical inequities and unmet need and highlighted changes in disease patterns supported by a Statistics South Africa report which alluded to 60 per cent of deaths being due to non-communicable diseases. RHAP was of the view that the current funding system with its gaps and inefficiencies highlighted above caters little for rural communities with regard to diabetes, hypertension, cancer and mental health illness. They alluded to the predicament that rural citizens often face in spending their own scarce resources on travel to reach a facility that may not have medicine in stock, a doctor on call, or an allied health professional on the organogram. Although RHAP welcomed the launch of the NHI and hoped that it would address these challenges they were concerned about the lack of clarity about the NHI and the role of provinces and district health services in its implementation. RHAP highlighted potential risks to a single purchaser model where the fund purchases services from health care providers and alluded to the possibility of expenditure over runs as patients abandon under resourced district health services. In summary RHAP emphasised that radical transformation includes how health care is funded and maintained, and that rural communities need a reliable, functional, accessible, and comprehensive health care service.

4. Findings and Observations

4.1 The Committee notes that the 2017 Budget lowers the spending ceiling by R10.2 billion in 2017/18 and R15.9 billion in 2018/19. This will be achieved through reduced national department operating budgets; lower transfers to entities, provinces and local government; and reallocations.

4.2 The Committee acknowledges the utilisation of incentive grants in improving spending performance for provinces and municipalities. In addition, the incentives now also explicitly include performance measures as part of their allocation criteria following the Committee's previous recommendations. The Committee is of the view that provinces and municipalities currently scoring lower in incentives frameworks should be supported so that they are not unfairly disadvantaged in future resource allocations.

4.3 The Committee notes work underway in reforming and consolidating conditional grants including baseline reductions in a number of conditional grants. The Committee views the provision of continued support to provinces and local government with regards to the reforms and budget reductions in conditional grants as critical in ensuring the sustainable provision of basic services.

4.4 The Committee notes work underway in introducing a new funding model for District Municipalities and supports the Financial and Fiscal Commission's view that a long term sustainable funding model for district municipalities should be found based on a clear identification of the powers and functions of the district municipalities

4.5 The Committee welcomes new conditional grants, namely, the social workers employment grant, the early childhood development grant, and a learners with profound intellectual disabilities grant and views these as positive contributions in enhancing government's social support package and calls for close monitoring of these grants to ensure their success. Whilst the Committee welcomes the new early childhood development grant, it emphasises that there should be close collaboration between the Departments of Social Development, Basic Education and Health in this regard.

4.6 The Committee notes the concerns raised by the Financial and Fiscal Commission on the impact of the downward revision of allocations for the Human Settlements Development Grant (HSDG) and Water Services Infrastructure Grant (WSIG) which negatively affects houses delivered per allocation and efforts at addressing sanitation backlogs and eradicating the bucket system. However, the Committee views the complete eradication of the bucket system as urgent and wants clear timeframes on the completion of this programme.

4.7 The Committee further notes the Financial and Fiscal Commission's submission that the use of indirect grants may have an unintended negative impact on the repairs and maintenance of infrastructure due to national departments delivering infrastructure on behalf of municipalities. The Committee is of the view that there should be proper transfer of ownership of completed infrastructure by national departments to municipalities.

4.8 The Committee remains concerned about consumer debt owed to municipalities including national and provincial spheres of government and is of the view that this undermines the financial viability of municipalities' especially rural and poor municipalities. The Committee is also very concerned about intergovernmental debt

whereby municipalities also owe significant amounts to state entities such as ESKOM and the Water Trading Entity and is of the view that this jeopardises the operations of public entities. The Committee notes the work underway by the inter-ministerial committee in dealing with the issue including reviving best practices in debt management however it is of the view that this process should be expedited as a matter of urgency.

4.9 The Committee notes the initiatives undertaken by South African Local Government Association that point to improvements in municipal operations. However, the Committee calls for stricter application of consequence management in municipalities, the need to elevate the role of municipalities in economic development, enforcement of municipal by-laws and formulating innovative technology solutions and other legal mechanisms in dealing with municipal debt and revenue collection.

4.10 The Committee notes concerns raised by the Rural Health Advocacy Project around the lack of transparent resource allocation in the health sector at provincial level and concerns around the effectiveness of budget allocations vis-à-vis the health needs of rural communities. The Committee will be holding meetings with the national and provincial health departments on the effective co-ordination and alignment of national and provincial spheres of government in the delivery of health services so as to ensure value for money, efficient planning and resource allocation. The Committee will invite the Rural Health Advocacy Project to form part of these discussions.

4.11 The Committee notes Equal Education's submission that the cost of providing quality education in rural provinces is substantially higher due to their history of underfunding and their continued challenging economic conditions including infrastructure backlogs and high unemployment. The Committee also notes National Treasury's submission that work is underway in addressing issues on funding services in rural areas through the review of the provincial equitable share formula.

4.12 The Committee notes with concern Equal Education's submission with regard to the schools' transport system wherein it highlights ineffective coordination between the Departments of Transport and the Department of Basic Education; inaccurate and inconsistent data on the number of learners in need of scholar transport and under-funding and under-budgeting for scholar transport by provinces, particularly rural provinces. The Committee notes government's response that the Departments of Basic Education and Transport still need to finalise the assignment of the scholar transport function.

4.13 The Committee notes Equal Education's submission that a disproportionately high number of quintile 1 to 3 schools were located in rural provinces thus rendering the cost of education substantially higher than in urban provinces. The Committee is the view that the quintile system needs to be significantly improved so that it does not disadvantage poor learner's who reside in urban areas.

4.14 The Committee notes that there is a technical error in the Bill. National Treasury indicated that the error resulted in the zero being omitted from all the municipal codes in Schedule 3 of the Bill and the Annexures and Appendixes to the Bill. The Committee agreed that this be corrected by the Minister of Finance in the National Assembly as per Section 14 of the Money Bills Act which provides that the House may consider amendments proposed by Minister to make technical corrections.

5. Recommendations

The Standing Committee on Appropriations having considered the 2017 Division of Revenue Bill recommends as follows:

5.1 That the Minister of Finance should ensure the following:

5.1.1 That the National Treasury in partnership with the Department of Planning, Monitoring and Evaluation, civil society and relevant stakeholders develop systems to enhance monitoring and implementation effectiveness including value for money principles in all conditional grants whose baselines have been reduced.

5.1.2 That the National Treasury strengthen budget formulation and planning in provinces with specific reference to the principles of openness, transparency and public participation. This should include public outreach and education programmes on the review and finalisation of the provincial equitable share formulas.

5.1.3 That the National Treasury in partnership with the Financial and Fiscal Commission research and develop instruments and mechanisms that will allow for the ring fencing of budget allocations for government departments and entities to pay their outstanding municipal debts and municipal services.

5.1.4 That the Minister of Finance should ensure that National Treasury effects corrections to the technical error in Schedule 3 of the Bill.

5.2 That the Ministers of Finance, Basic Education, and Transport should ensure the following:

- That the scholar transport function within provinces is clearly assigned with defined sector roles for the Departments of Basic Education and Transport.
- That there is effective coordination between the Department of Transport and the Department of Basic Education;
- That there is reliable, accurate and consistent data on the number of learners in need of scholar transport; and
- That budget allocations are responsive and aligned to scholar transport needs and requirements in provinces.

5.3 That the Minister of Finance and Minister of Cooperative Governance should ensure that the National Treasury and Department of Cooperative Governance develop systems and mechanisms to ensure that cost reflective tariffs are sufficiently communicated to communities and phased in with due consideration to the ability of household to absorb these costs.

6 Committee's Recommendation on the Bill

The Standing Committee on Appropriations having considered the ***Division of Revenue Bill*** [B4—2017] (National Assembly) referred to it and classified by the JTM as a section 76 Bill, reports that it has agreed to the Bill without amendments.

7 Conclusion

The responses, by the relevant Executive Authorities, to the recommendations as set out in section 5 above must be sent to Parliament within 60 days of the adoption of this report by the National Assembly.

Report to be considered.

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Ms YN Phosa, MP **Date**
Chairperson: Standing Committee on Appropriations

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