1. **REPORT OF THE SELECT COMMITTEE ON APPROPRIATIONS ON THE DIVISION OF REVENUE BILL [B4-2017], DATED 9 MAY 2017**

The Select Committee on Appropriations, having considered the *Division of Revenue Bill* [B4 – 2017] (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 G Gordhan, tabled the Bill in the National Assembly on 22 February 2017. On 15 March 2017, the Bill, with technical corrections to schedule 3 (pages 31, 32, 37, 38, 39 and 40), was transmitted to the National Council of Provinces and referred to the Committee.

Subsequent to the briefing by National Treasury on the Bill, the Committee, in compliance with section 214(2) of the Constitution, consulted the Financial and Fiscal Commission (FFC) and the South African Local Government Association (SALGA). Moreover, the Committee also ensured that all nine provinces were briefed and they fully participated in the processing of the Bill. Also consulted was the Parliamentary Budget Office. The Committee further scheduled public hearings on 02 May 2017 in line with section 9(5)(b) of the Money Bills Act. Print media advertisements were placed nationally in all 11 official languages, calling for submissions from interested parties and stakeholders. During the public hearing the Committee received and considered written and oral submissions from the University of Stellenbosch’s Economics Department, Eskom, the Financial and Fiscal Commission and the South African Local Government Association (Salga). Thereafter, the Committee received and considered negotiating mandates from provinces on 03 May 2017 and final mandates on 09 May 2017.

1. **The 2017 Division of Revenue allocations**

The Bill is a product of the South African Constitution guided by section 214(1), which mandates that the revenue raised nationally must be shared equitably between the national, provincial and local spheres of government. The Bill was the outcome of an extensive consultative process between the three spheres of government. The table below shows how the Bill divides the nationally raised revenue among these spheres.

**Table 1: 2017 Medium Term Expenditure Framework (MTEF) Division of Revenue**

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

The 2017 Budget amounts to R1.4 trillion, which is an increase of R101.8 billion or 7.8 percent when compared to the previous financial year. As indicated by the table above, over the Medium Term Expenditure Framework (MTEF) period, the budget is expected to increase to R1.7 trillion by the 2019/20 financial year, at an average rate of 8.3 percent. For the 2017/18 financial year, including the contingency reserve, debt service costs and provincial and local government conditional transfers, the national allocation amounted to R910.9 billion or 64.6 percent of the revenue allocation. The second largest share, R441.3 billion or 31.3 percent, went to provinces and the local sphere of government received R57 billion or 4 percent. When the contingency reserve, debt service costs and provincial and local government conditional transfers are excluded, the national equitable share amounts to 47.5 percent; provincial allocation totalled 43.4 percent; and local government received 9.1 percent.

Even though local government received the smallest share of nationally raised revenue, the allocation over the 2017 MTEF grows faster, at 8.6 percent on average, than the national allocation growth of 6.9 percent and the 7.5 percent provincial allocation growth. Despite the fact that the local government receives the smallest share, it is based on the rationale that municipalities have greater potential to raise own revenues compared to provinces and national departments; while the growth in the allocation is aligned to the government’s commitment to ensure that the provision of basic services, particularly to poor households, is maintained and that access continues to be expanded.

1. **Provincial Government allocations**

The total transfer to provinces amounted to R538.2 billion in the 2017/18 financial year, of which the equitable share amounted to R441.3 billion and conditional grants totalled R96.8 billion. The equitable share allocation to provinces grows above the targeted inflation rate of 6 percent for the 2017 MTEF.

The table below shows the total allocation of the provincial equitable share (PES) to provinces in the 2017/18 financial year, and the estimated PES allocations in the outer years.

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

|  |  |  |
| --- | --- | --- |
| **Province** | **Column A** | **Column B** |
| **Provincial equitable share allocations** | **Conditional Grants**  | **Total Transfers**  | **Forward Provincial Equitable Share Estimates** |
| **2017/18****(R'000)** | **2017/18****(R’000)** | **2017/18****(R’000)**  | **2018/19** **(R'000)** | **2019/20** **(R'000)** |
| Eastern Cape | 61 847 808 |  11 297 | 73 145 | 66 166 631 | 70 960 874 |
| Free State | 24 521 941 | 7 267 | 31 789 | 26 284 534 | 28 165 434 |
| Gauteng | 86 642 989 | 20 828 | 107 471 | 93 030 417 | 100 227 355 |
| KwaZulu-Natal | 93 756 530 | 18 824 | 112 581 | 99 740 600 | 106 840 842 |
| Limpopo | 51 960 337 | 7 885 | 59 845 | 55 385 632 | 59 370 905 |
| Mpumalanga | 36 081 680 | 7 183 | 43 264 | 38 488 633 | 41 214 353 |
| Northern Cape |  11 719 981 | 4 289 | 16 009 |  12 501 131 | 13 418 100 |
| North West | 30 329 643  | 7 552 | 37 882 | 32 472 636 | 34 857 190 |
| Western Cape | 44 470 213 | 11 580 | 56 050 | 47 452 275 | 51 048 600 |
| **Unallocated** | **0** | 123 | **123** | **0** | **0** |
| **TOTAL** | **441 331 122** | **96 829** | **538 160** | **471 522 489** | **506 103 653** |

From the above table, it can be seen that KwaZulu-Natal has been allocated the highest equitable share over the MTEF, followed by Gauteng. The Northern Cape receives the lowest allocation. For the 2017/18 financial year, provincial conditional grant allocations total R96 289 billion, including an unallocated amount of R123 million.

* 1. **Provincial Government allocations: Equitable share, conditional grants, indirect transfers**

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

**Table 3: Provincial Government allocations: Equitable share, conditional grants, indirect transfers**

|  |  |  |
| --- | --- | --- |
| **Provincial Government allocation****(R’million)** | **2016/17 Revised Estimates** | **Medium-Term Estimates** |
| **2017/18** | **2018/19** | **2019/20** |
| Equitable Share  | 410 699  | 441 331 | 471 522 | 506 104 |
| Conditional Grants | 89 692 | 96 829 | 107 092 | 114 892 |
| Indirect transfers to provinces | 3 654 | 4 258 | 1 765 | 1 864 |
| **Total** | **500 391** | **538 160** | **578 614** | **620 995** |

The above table indicates that the 2017 Division of Revenue’s overall growth of direct conditional transfers to provinces is buoyant, averaging 8.6 percent over the MTEF period. Direct conditional baselines total R96.8 billion in 2017/18, R107.1 billion in 2018/19 and R114.9 billion in 2019/20. Indirect conditional grants amount to R4.25 billion and R1.76 billion and R1.86 billion, respectively, for each year of the MTEF.

**3.2 Major changes to the provincial conditional grant framework**

The Bill also contains the introduction of new conditional grants, ring-fencing of grant funds, the termination of the National Health Insurance Grant, the reconfiguration of the School Infrastructure Backlogs Grant and reductions and additions to conditional grant baselines. These are explained below:

**3.2.1 New grants**

The following new grants have been introduced:

(a) The Learners with Profound Intellectual Disabilities Grant is introduced in 2017/18 with the aim of expanding access to education for learners with intellectual disabilities. The Grant is allocated a total of R478.3 million over the 2017 MTEF of which R72.0 million is allocated in 2017/18, R185.5 million in 2018/19 and R220.8 million in 2019/20;

(b) The Early Childhood Development Grant, which was introduced the previous year, comes into operation this year with an allocation of R1.3 billion over the 2017 MTEF; and

(c) The Social Worker Employment Grant aims to reduce the number of unemployed social work graduates, while the need for social workers across the country continues to increase. This Grant receives a total of R591.3 million over the 2017 MTEF. The funds have been reprioritised from the national Department of Social Development, who previously used the funds to subsidise the education of social workers.

**3.2.2 Ring-fencing of grant funds**

Funds have been prioritised for the repair of infrastructure damaged by floods and natural disasters and for the upgrading of human settlements in mining towns with regard to the following grants:

1. R131.8 million of the 2017/18 allocation for the Comprehensive Agricultural Support Programme Grant has been ring-fenced for the repair of damaged infrastructure caused by floods;
2. R3.6 billion is ring-fenced over the 2017 MTEF under the Human Settlements Development Grantfor the upgrade of human settlements in mining towns in six provinces. These allocations are in response to significant informal settlement challenges in areas where a high proportion of economic activity is centred around the natural resources sector;
3. A total of R134.3 million has been ring-fenced over the 2017 MTEF under the Human Settlements Development Grantfor the repair of infrastructure damaged by natural disasters; and
4. A total of R480 million has been ring-fenced over the medium term under the Provincial Roads Maintenance Grantfor the repair of infrastructure damaged by floods.

**3.2.3 Termination of grant**

The National Health Insurance (NHI) Grant has been terminated as the initial phase of the NHI that it was funding has been completed. . The national Department of Health will in future fund all preparatory work for the NHI under the National Health Insurance **Indirect** Grant*.* This will eliminate duplications between the direct and indirect grants.

**3.2.4 Reconfiguration of grant**

The School Infrastructure Backlogs Grant,which is an indirect grant transfer was to merge with the Education Infrastructure Grant in 2017/18, but the merge has been postponed for another year to allow time for projects to be completed and for a thorough assessment of the grant transition process to be concluded.

**3.2.5 Reductions to baselines**

Reductions are weighted towards grants that have a history of underspending or infrastructure grants that can defer implementation. Reductions have been effected to the following grants over the 2017 MTEF:

1. Comprehensive Agricultural Support Programme Grant- a total of R235.9 million, of which R135.5 million will be allocated to the Department of Agriculture, Forestry and Fisheries for an agricultural census to assess the farming landscape in South Africa;
2. Community Library Services Grant– R20.8 million in 2017/18;
3. Maths, Science and Technology Grant – R63 million;
4. Health Facility Revitalisation Grant– R363.6 million*;*
5. Comprehensive HIV, AIDS and TB Grant– R327.3 million; and the
6. Human Settlements Development Grant– R871 million in 2017/18.

**3.2.6 Additions to baselines**

Additions have been effected to the following grants over the 2017 MTEF:

(a) The National School Nutrition Programme Grantreceives an additional R390 million over the 2017 MTEF to preserve the quality of food provided and to expand access to qualifying learners. The additional allocation was also made to counter the impact of rising food inflation over the past year; and the

(b) Comprehensive HIV, AIDS and TB Grantreceives an additional R1 billion in 2019/20 to make provision for the continued expansion of antiretroviral treatment in response to the universal test-and-treat policy.

1. **Local Government allocations**

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

**Table 4: Transfers to Local Government**

|  |  |  |
| --- | --- | --- |
| **Local Government allocation** | **2016/17 Revised Estimates** | **Medium-Term Estimates** |
| **2017/18** | **2018/19** | **2019/20** |
| Equitable Share  | 51 169 | 57 012 | 62 732 | 67 473 |
| Conditional Grants | 40 863 | 43 727 | 46 270 | 49 836 |
| General fuel levy sharing Metros | 11 224 | 11 785 | 12 469 | 13 167 |
| Indirect transfers to local government | 7 824 | 7 338 | 7 596 | 8 015 |
| **Total** | **111 079** | **119 862** | **129 066** | **138 491** |

1. *Excludes provisional allocations*

The table above shows that over the MTEF period, R366.3 billion will be transferred directly to local government including R23 billion of indirect grants. In total, R4.3 billion has been added to local government allocations over the MTEF period. The major changes to the local government allocations include the following:

* The local government equitable share which assists municipalities in providing free basic services to their residents has been revised upwards by R3.3 billion. A further R1 billion will be added to the Integrated National Electrification Programme (Municipal) Grant in 2019/20.
* Over the MTEF period, transfers to local government are reduced by R2.8 billion in total, including R2.5 billion from direct grants and R241 million from indirect grants. The affected urban and rural grants where small reductions have been made include the Public Transport Network Grant; the Water Services Infrastructure Grant; the Municipal Infrastructure Grant; and the Urban Settlements Development Grant. It is important to note that, even though there are proposed reductions, the grants continue to grow by at least 5 percent per year over the 2017 MTEF period.
* Funds from the Expanded Public Works Programme Integrated Grant to municipalities have been reprioritised to expand the mandate of the Commission for Conciliation, Mediation and Arbitration. Moreover, funds have been reprioritised from the indirect Integrated National Electrification Programme (Eskom) Grant to fund the management of nuclear waste. Furthermore, small amounts from the indirect Regional Bulk Infrastructure Grant will be reprioritised to augment funding for water catchment management agencies.
* After accounting for all reductions and additions, direct transfers to local government increase by R1.5 billion over the MTEF period. This includes reductions on indirect transfers to local government of R240.9 million over the MTEF. The breakdown of the net changes to local government allocations are as follows: a decrease of R878.5 million in 2017/18, followed by an increase of R75 million in 2018/19 and an increase of R2.3 billion in the 2019/20 financial year.
1. **Submissions by Stakeholders and the Public**

The submissions from the stakeholders covered a variety of issues. These included the clarification of clauses and conditional grant expenditure. The stakeholders who appeared before the Committee include the Financial and Fiscal Commission (FFC), the South African Local Government Association (Salga), Eskom, University of Stellenbosch’s Bureau for Economic Research.

**5.1 Financial and Fiscal Commission**

In its submission, the Financial and Fiscal Commission (the Commission) acknowledged that the Bill had been crafted in an environment of exceptionally difficult domestic and global conditions. Also, the Commission noted and welcomed continuous emphasis on fiscal consolidation and the resulting impact on overall budget credibility. Furthermore, they noted 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 subsection 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 would 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 that 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 percent whilst provinces and municipalities account for 20 percent and 18 percent, 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 government 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 could 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 the 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 are comprised 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 to the affected metros soon, to facilitate planning and contracting.

The Commission was concerned about the baseline 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 in the HIV/AIDS and TB Grant, given the increased yearly uptake of people on ARVs. 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 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 implementation 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.

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 whether 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 programmes 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 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.

The Commission also welcomed government’s focus areas to turn around the local government sector, namely, the Municipal Standard Chart 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 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 the national and provincial spheres, businesses and households. Of this amount, R6 billion is owed by national and provincial government. In this regard, the Commission implored the task team examining intergovernmental debt to speedily resolve the issue.

**5.2 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 analyses 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 Services Study recommendations; and providing differentiated support to small struggling municipalities and districts.

Salga further stated that the division of revenue achieved a substantial redistribution of revenue raised through taxes in relatively wealthy (mainly urban) areas to areas where the demand for subsidised 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 issues:

* 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 in some of the recommendations made;
* Of continuous concern is the allocation to local government which amounts to 9.1 percent of the overall budget with (5 percent equitable share, 3 percent grants, 1 percent indirect transfers and 1 percent 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 of 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.

**5.3 University of Stellenbosch Department of Economics**

The University of Stellenbosch (US) Economics Department’s submission covered the macroeconomic environment. The US submitted that the country was going to experience stagnant to low economic growth regardless of the prediction of 1.3 percent by National Treasury. The US estimated that the GDP growth was likely to be at 2 and 2.2 percent in 2018 and 2019, respectively. On high unemployment, the US stated that it has remained high at 24.5 percent on average for the past two decades. Furthermore, the US submitted that inequality remains high, with millions of South Africans dependent on grants.

The US added that the public debt was high at ±50 percent of GDP. On the credit rating downgrades by rating agencies, S&P and Fitch, the US submitted that this will limit spending ability. Coupled with the decreasing levels of investment and high total debt, increased interest repayments mean less funds to spend on social services. The US added that the low economic growth would put tax revenue collections under pressure. The low employment growth and lack of income growth will further amplify pressure on tax revenue generation which will highly contribute to the South African Revenue Service missing the tax target.

Asked whether budget allocations are in line with the Constitutional mandate, the US confirmed that budget allocations were in compliance with the government mandate and within the fiscal limits. The sector-specific allocations focus on sectors highlighted in the National Development Plan. These include additional allocations to Higher Education and Training, Infrastructure and Economic Development. Regarding provincial allocations, the US reported a marginal decline in compensation of employees - from 60.4 percent to 59.8 percent from 2015 to 2016. The US concluded that they have noted the decline in the Human Settlements Development Grant and the Health Facility Revitalisation Grant and predicted that several grants will face cuts over the 2017 MTEF.

**5.4 Submissions on electrification challenges**

The Committee also received submissions on the Integrated National Electrification Programme Grants (schedule 5 and 6). The schedule 5 grant is transferred to municipalities and the schedule 6 grant to Eskom.

**5.4.1 Eskom**

Eskom reported that, as at the end of November 2016, the overdue municipal electricity debt was R10.2 billion and, as at 31 March 2017, the debt had decreased to R9.4 billion. On the current debt, Eskom reported that the total municipality debt inclusive of current consumption is R15.3 billion as at the end of March 2017. The total amount overdue by the top 10 municipalities was reported to be R6.2 billion; whereas the top 20 overdue municipalities were overdue by R7.4 billion. These municipalities were in three provinces, Free State (R4.570 billion); Mpumalanga (R2.096 billion) and North West (R814 million). Eskom also reported that there were 63 and 89 municipalities that were overdue by more than R10 million and R500 000.00, respectively.

Eskom further submitted that they and the municipalities have co-existing rights to distribute, reticulate and supply electricity within municipal areas pursuant to the respective distribution licenses issued to them by the National Energy Regulator of South Africa (Nersa). Eskom emphasised that municipalities do not have a greater Constitutional right than Eskom to distribute, reticulate, and supply electricity.

**5.4.2 South African Local Government Association**

Salga expatiated its earlier submission by indicating that whilst Eskom is owed just a little more than R10 billion, municipalities were owed R117 billion (R76 billion by households, R6 billion by government, R27 billion by the business sector, and R8 billion by others), according to the Public Finance Management Act’s (PFMA) section 71 Report published on 30 September 2016.

Salga further submitted to the Committee that the complexity of the escalating debt situation required an urgent solution at a constitutional, structural and systemic level to ensure that both Eskom and municipalities are financially sustainable. Salga further submitted that there was a disagreement on the constitutional authority of municipalities for electricity reticulation due to the absence of service delivery agreements between Eskom and municipalities as required by the Municipal Systems Act and the Electricity Regulation Act. This leads to municipalities being unable to levy surcharges and exercise credit control in Eskom supply areas.

**5.4.3 Financial and Fiscal Commission**

The Commission’s submission on the electrification matter confirmed the content of both the Eskom and Salga submissions. With regards to the top 20 defaulting municipalities, the Commission brought to the attention of the Committee that 65 percent of defaulters as at February 2017 were still the same as those who were identified in December 2014. The Commission expressed concern over the fact that even some national and provincial government departments were not complying with the 30 day payment rule as per section 38(1) of the PFMA and Treasury Regulations 8.2.3 of 2001 and Treasury Instruction Note No. 34.

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:

**6.1 Negotiating Mandates**

6.1.1 Eastern Cape supported the Bill, raising inputs and concerns.

6.1.2 Free State voted negotiated in favour of the Bill, with proposals.

6.1.3 Gauteng negotiated in favour of the Bill, with recommendations.

6.1.4 KwaZulu-Natal supported the Bill.

6.1.5 Limpopo supported the Bill, with recommendations.

6.1.6 Mpumalanga negotiated in favour of the Bill, with a recommendation.

6.1.7 Northern Cape negotiated in favour of the Bill, with recommendations.

6.1.8 North West negotiated in favour of the Bill, with recommendations.

6.1.9 Western Cape supported the Bill.

**6.2 Final Mandates**

6.2.1 Eastern Cape voted in favour of the Bill.

6.2.2 Free State’s final was still outstanding.

6.2.3 Gauteng supported the Bill.

6.2.4 KwaZulu-Natal supported the Bill.

6.2.5 Limpopo voted in favour of the Bill.

6.2.6 Mpumalanga voted in favour of the Bill.

6.2.7 Northern Cape voted in favour of the Bill.

6.2.8 North West voted in favour of the Bill.

6.2.9 Western Cape voted in favour of the Bill.

1. **Observations**

7.1 The Bill contains the introduction of new conditional grants, ring-fencing of grant funds, the termination of the National Health Insurance Grant, the reconfiguration of the School Infrastructure Backlogs Grant and reductions and additions to some conditional grant baselines. The newly introduced grants and ring-fencing in some grants were, however, funded by reprioritising funds away from the under-spending grants or government programmes.

7.2 Over the 2017 MTEF the National School Nutrition Programme Grant and the Comprehensive HIV, AIDS and TB Grant receive additional funding of R390 million and R1 billion, respectively.

7.3 Despite small reductions that have been made to certain local government grants, the grants affected continue to grow by at least 5 percent per year over the 2017 MTEF period.

7.4 The Committee noted the revisions in clauses 21(1), (2) and (4) of the Bill on the in-year conversions of allocations. The revisions are aimed at reducing inefficiencies in the management of conditional grants.

7.5 The Committee noted the R5 billion additional allocation to the Department of Higher Education over the MTEF as well as the pilot project for a mixed funding scheme to accommodate the students in the missing middle.

7.6 Despite adjustments and reductions to provincial equitable shares and conditional grants, direct and indirect allocations to the provincial sphere still grow at above the rate of inflation over the 2017 MTEF period.

7.7 While the increases in the local government equitable share are welcomed, this does not necessarily address the challenges of municipalities with a low revenue base, given the current economic conditions.

7.8 The Committee welcomed the introduction of the Municipal Standard Chart of Accounts which is an attempt to improve the financial capacity of South African municipalities.

7.9 The Committee has noted the conflicting calls to review the current local government equitable share formula. These are calls to put more emphasis on rural conditions as against urban conditions, the vastness of the areas as against the population or even the accuracy of the population figures utilised.

7.10 The Committee noted the concerns raised by provinces in their negotiating mandates over the termination of the Bucket

 Eradication Grant, given the current rates at which informal settlements are

 growing.

7.11 The Committee noted that there might be challenges of coordination within the various spheres of government when it comes to disaster management. These challenges contribute to late interventions or even under-spending of the disaster funds.

7.12 The Committee has noted that, despite the establishment of the Inter-Ministerial Task Team and the Technical Task Team, the following issues between Eskom and Salga remain unresolved:

7.12.1 The disagreements between Salga and Eskom on the constitutional authority of municipalities for electricity reticulation as well as the absence of service delivery agreements between Eskom and municipalities in areas where Eskom supply electricity.

7.12.2 Eskom credit control mechanisms for municipal bulk accounts are not aligned with municipal credit control by-laws and cycles.

7.12.3 Structural issues such as municipal debt.

7.13 The Committee noted the issues that were raised by provinces in their submission of the negotiating mandates. These included the need to review the current formulas for calculating the equitable shares among the spheres of government; funding for the district municipalities and maintenance and repair of certain municipal infrastructure.

1. **Recommendations**

8.1 The reprioritisation of funds away from under-spending conditional grants is not a sustainable practice in the long term, and for this reason National Treasury and relevant sector departments should ensure that they prioritise building capacity to spend the allocated funds.

8.2 To ensure that the revisions in clauses 21(1), (2) and (4) of the Bill on the in-year conversions of allocations reduce inefficiencies in the management of conditional grants, transferring officers should ascertain beforehand that recipients have the capacity to spend.

8.3 National Treasury, together with the Department of Cooperative Governance and Traditional Affairs, should ensure that municipalities with a low revenue base are duly given technical and financial support, where possible.

8.4 Within 30 days after the adoption of this Report by the House, the Inter-Ministerial Task Team should provide a progress report on the resolution of issues between Eskom and Salga.

8.5 The Department of Water and Sanitation should report to the Committee, within three months after the adoption of this Report by the House, about measures in place to mitigate against any unintended consequences of the termination of the Bucket Eradication Grant. Given the current rapid increase in informal settlements in some areas.

8.6 Within three months after the adoption of this Report by the House, both National Treasury and the Department of Cooperative Governance should report to the Committee about the measures that might be considered to address the municipalities’ electricity debt to Eskom.

8.7 Within three months after the adoption of this Report by the House, the Department of Public Works, National Treasury and the Department of Cooperative Governance should report to the Committee about the measures that might be considered to address the national and provincial departments’ debt to municipalities.

8.8 National Treasury should, on a regular basis, report to the Committee on any progress with regard to the implementation of the Municipal Standard Chart of Accounts, which is an attempt to improve the financial capacity of South African municipalities.

1. **Conclusion**

Having considered the *Division of Revenue Bill* [B4 - 2017] and submissions made by stakeholders and provinces, the Committee recommends the adoption of *the Division of Revenue Bill* [B4 - 2017] without amendments.

Report to be considered.