**2022 DIVISION OF REVENUE BILL**

**Responses to recommendations contained in the Negotiating Mandates from Provincial Legislatures**

The Select Committee on Appropriations held a virtual meeting on 04 May 2022 to consider the negotiating mandates on the Division of Revenue Bill, 2022, that were submitted by provincial legislatures. Representatives of National Treasury participated in the meeting and gave verbal comments on some of the recommendations made and also undertook to provide written replies on the recommendations raised by provincial legislatures in their negotiating mandates. These written comments are provided below.

Where recommendations fall within the mandate of other departments, National Treasury will refer these to the relevant stakeholders.

**EASTERN CAPE**

No recommendations.

**FREE STATE**

The province raised the following concerns:

**Interest rate charged on outstanding debt owed to Eskom -the interest rate of 2.5% plus prime rate charged by Eskom to municipalities on outstanding debt is astronomical and even payment plan agreements entered into with municipalities are unrealistic, there is a need for intervention by the Minister of Trade and Industry together with the Minister of CoGTA as well as the Minister of Finance to find a suitable solution in assisting municipalities to emerge out of this financial distress.**

In terms of the PMFA, Eskom is entitled to charge interest on outstanding debt. As a result of pressure from the Inter-Ministerial Task Team (previously chaired by the Minister of CoGTA) previously set up to deal with Eskom matters, the interest rate has been reduced from prime plus 5% to prime plus 2.5%. An interest charge is a punitive measure to deter defaulters from not paying on time. Some municipalities disregarded the rule and are now facing astronomical debt, their overdue debts attracting huge interest. Based on the performance of the current account, Eskom is also willing to suspend the accumulation of interest. This is on a case-by-case basis.

**Water Boards: - the amendment to the Division of Revenue Act does not address in totality the challenges faced by municipalities in relation to debt owed, for example, disputes by municipalities with Water Boards regarding payment of their debt. The Committee is also uncertain on whether is a process in place for quality assurance, and if such a process exist, how is it going to unfold.**

To address water sector issues, including the debt owed to water boards, an Inter-Ministerial Committee (IMC) has been established. It is chaired by the Deputy President, but the committee has not yet met. CoGTA was instructed by Eskom's current Political Task Team (PTT) to establish a panel of service providers to assist municipalities with disputes. Debt owed by and to municipalities is handled by the panel. The committee must guard against municipalities that raise disputes as a way to delay settlement. National Treasury recommends that municipalities settle the undisputed portion of the debt and then raise the dispute either through the Intergovernmental framework relations (IGFR) process or the Municipal Finance Management Act (MFMA) process.

**Basic Services Component:- the National Treasury should review the formula on the Basic Services component as the increase in municipal debt is a clear indication that most municipalities are unable to collect revenue.**

In the Local Government Equitable Share (LGES), the Basic Services Component enables municipalities to provide free basic services to households, with subsidies for all poor households. Our findings are that the coverage rate of free basic services by municipalities does not match the allocation to municipalities. Statistics SA's Non-Financial Census of municipalities in 2021 also echoed our findings that municipalities provide free basic services to a significantly lower number of households than those provided for. Only 2.9 million households were reported as indigent/poor in the Non-Financial Census report, with 2.4 million receiving free basic services. Furthermore, our analysis found that municipalities incur considerably lower costs when it comes to providing these basic services than we have provided for in the LGES.

Therefore, rising municipal debt is not necessarily indicative of inadequate funding for free basic services in municipalities, but of ineffective credit control measures.

**Decline in rural municipalities and their inability to be self-sufficient: - there is a need for national and provincial governments to assist municipalities in developing programmes that will unlock or make the environment conducive for economic activities.**

The recommendation is noted and welcomed. At the municipal level, service provision remains the cornerstone of revenue generation and National Treasury also acknowledges its broader responsibility to support municipalities, and this entails supporting the development of coherent approaches that assist in improving services. Support mechanisms include regulatory interventions, manuals, guidance, circulars, workshops, seminars, training, internship programmes, grants, and hands-on support to municipalities. The Expanded Public Works Programme is one example of a programme that can assist in creating an environment for economic activity. This programme awards incentive grants for labour intensive projects, and these projects are designed to create the most jobs.

The conditional grants review currently underway will also assist in this regard as we aim to evaluate how efficiently public funds are being used to meet the set policy objectives. The questions to be addressed in this regard include what impact rurality has on the performance of the grant system, as well as how the allocation criteria can be better reformed so that they benefit economic development at the provincial and municipal levels. Further reforms that are likely to bring in private sector resources and expertise will improve value for money.

**District Development Model: the role to be played by the District Development Model in improving rural municipalities is unclear. There is a need for development of clear terms of references between the three (3) spheres of Government in this regard.**

We will share the recommendation with the Department of Cooperative Governance, which is currently leading three pilots of the model.

**Provincial Roads Maintenance Grant - the Provincial Roads Maintenance Grant allocation is insufficient to maintain and upgrade provincial roads within the Free State Province. Road infrastructure is key in resuscitating economic opportunities and provincial government need to make more funds available to invest in road infrastructure.**

It is also important to note that the Provincial Roads Maintenance Grant is a schedule 4 grant, which means that it is a grant that is meant to supplement the provincial budget on road maintenance. Provinces are expected to fund the construction of new roads from their own budget and supplement the cost of maintaining and upgrading these roads through the grant.

**Surrendering of Funds to other provinces: - money surrendered to the National Revenue Fund must not diverted to other Provinces but rather be utilised within Province to municipalities that are in dire need of funding. If funds are not redirected within the Province, it disadvantages communities that can be assisted. This regulation should be relook into.**

Funding is stopped from a province or municipality that is underspending or non-compliant with the conditions of the grant. The funding is then reallocated to a municipality or province that has the ability to spend that funding. Before consideration of municipalities outside of the province is given, municipalities within the district or province that are prepared to spend are given priority. If the funding is reallocated to municipalities within the same province that do not have the ability to spend that funding, the funds are still going to be underspent at the end of the financial year.

**The formula of Division of Revenue Act (DoRA): the underlying factor in the DoRA formula is encouraging people to migrate to urban areas and rural remain underdeveloped and Impoverished and this Act seems to be subtly re-introducing the apartheid spatial planning system.**

Both the provincial and local government equitable share formulas take into account the relative demand for services and the change in demographics in each province and municipality. These formulas are therefore not solely based on population. The funding is allocated based on where qualifying people/households are based on official data, meaning the Division of Revenue Act is reactionary to the migration that has already occurred. The migration of people is caused by other factors such as poor service delivery and lack of economic opportunities amongst others that are outside of the mandate of the Division of Revenue Act.

**Sustainability of municipalities’ fiscal services: there is a need to relook into allocation formula to municipalities that are and have a high unemployment rate with no economic growth activities. The committee is of the view that a fact-finding mission should be undertaken to Xhariep District Municipality to look revitalising the economic growth in that District as it is in a serious financial distress.**

Municipalities with a high unemployment rate and no economic growth benefit from the revenue adjustment factor applied to community services and institutional components of the formula. To reflect the most recent dynamics in each municipality, the data from the 2022 Census will be updated to the formula.

On reviving the economy in that district as it is in a state of financial distress, recent arguments have suggested that a grant system that doubles as a catalyst for economic development, through government transfers, will have a significant multiplier effect and improve long-term financial sustainability, especially for infrastructure. The conditional grants review will examine whether the current and future grant system should continue to target backlogs, and what type of backlogs, or whether greater economic rationale can be applied to the grants, and how this might be done.

**Delay in approving business plans: The delay by National Treasury in approving Business Plans, has a negative impact on the timeous and effective spending of conditional grants as it might result in roll-overs and forfeiture of funds to other provinces.**

Transferring officers (the department responsible for administering the grant(s)) are responsible for approving business plans. Therefore, national sector departments, such as the Departments of Water and Sanitation, Energy, Human Settlements, Health and Basic Education are responsible for approving of business plans for grants that they are administering. National Treasury is only responsible for approving business plans for the grants under the National Treasury Vote.

**Municipal debt: National and Provincial Departments that owes municipalities on rates and taxes must be encouraged to pay as per previous payment agreements entered into.**

The National Treasury agrees that National and Provincial Departments must settle their debts to municipalities for rates and taxes. The National Treasury sent a letter to defaulting departments instructing them to settle their debts. In this process, Public Works and Infrastructure leads as they are the custodians of national and provincial buildings. Ownership and funding are the major obstacles to resolving this matter.

**Presidential Youth Employment Initiative: The Committee appreciates the increase on the allocation of the Presidential Youth Employment Initiative to address education component (in respect of shortages of teachers), to fund Covid-19 and for Social services.**

The recommendation is noted and welcomed.

**GAUTENG**

The province made the following recommendations:

**That National Treasury should ensure that within the medium-term framework that municipalities are capacitated to prudently spent monies allocated to it.**

In noting this recommendation, government has allocated R3.8 billion over the 2022 MTEF for capacity building grants administered by various sector departments. Municipal capacity is developed in terms of sound and prudent financial management and sustainable service provision. Government is currently reviewing capacity building grants and is working towards a more long-term solution that focuses less on individuals and more on building the capability of the municipality.

**That National Treasury should speed up revising the Local Government Equitable Share formula in view of municipalities becoming financial distressed due to their shrinking tax base further exacerbated by Covid-19.**

National Treasury acknowledges the catastrophic consequences of the outbreak of Covid-19 and will convene the committee to discuss speeding up the refinements to the Equitable Share formula in consultation with the Department of Cooperative Governance (DCoG), South African Local Government Association (SALGA) and the Financial and Fiscal Commission (FFC).

**That National Treasury through the Municipal Systems Improvement Grant, should support municipalities to embrace digitization and diversify their revenue as part of building financial resilience of local government.**

National Treasury agrees with the principle of revenue diversification, embracing digitisation, and building financial resilience, and will forward the recommendation of the Committee to DCoG, which administers the Municipal Systems Improvement Grant (MSIG).

**That National Treasury should make available guidelines for the management of funds earmarked for Presidential Youth Employment Initiatives to bolster the legislature’s endeavour to conduct oversight.**

The guideline will be shared with the province.

**That National Treasury should ensure fair and equitable distribution of resources to areas impacted by disasters.**

Funding available to areas affected by disasters is through internal reprioritisation, immediate response funding, reprioritisation of existing conditional grants and budget requests. In terms of the Disaster Management Act, the National Disaster Management Centre (NDMC) will verify assessments that are currently being undertaken. The budget provides different mechanisms to do this, in year and over the MTEF period. The budget allocations will be based on the confirmed costing by the NDMC and budget availability.

**That National Treasury should develop mechanism to ensure funds earmarked for Covid-19 and disaster relief are expended for their intended purposes.**

The grant frameworks already contain conditions for the use of funds for the intended purposes, however, if funds are not used in line with the set conditions, there should be consequence management for officials that are transgressing. Moreover, National Treasury introduced a manual reporting system to monitor expenditures earmarked for Covid-19, with provinces and municipalities required to report on covid related expenditure on a weekly basis. Municipalities were advised to record all funding and expenditure pertaining to the Covid-19 pandemic when budgeting and transacting, as per the Annexure to MFMA Circular No. 99 and mSCOA Circular No. 9.

**That National Treasury should ensure that all spheres of government comply with the provision of the PFMA to ensure that 8% of the value of assets is set aside for maintenance.**

National Treasury agrees that it is important for all spheres of government to adequately invest in maintenance. Although the PFMA does not prescribe that 8 per cent of the value of assets in set aside for maintenance, organs of state should ensure that when putting together their budgets they make adequate provision for maintenance in line with national norms and standards.

**That National Treasury should continue striking a delicate balance in the allocation of resources in view of competing priorities.**

Recommendation is noted.

**The Portfolio Committee acknowledges the role the Vaal River system plays in the economy of Gauteng and urges National Treasury to ensure that there is value for money on funds allocated for its rehabilitation.**

The National Treasury shares the committee's concerns regarding the perennial delay in resolving Vaal River related issues. In response to another rollover request National Treasury received, a meeting has been set up with the Department of Water and Sanitation to get a comprehensive assessment of the challenges and mitigation strategies.

**That National Treasury should ensure the build-up of contingency reserves to mitigate disasters the world has become susceptible to due to climate change.**

Organs of state when implementing projects, the budgeting guideline request that in their planning also consider climate mitigation as climate change is a reality. Disaster response is reactionary and organs of state should be proactive in dealing with the effects of climate change.

**KWAZULU-NATAL**

No recommendations.

**LIMPOPO**

No recommendations.

**MPUMALANGA**

The province made the following recommendations:

**Whilst the Committee notes that the task team has resolved to prioritise the review of the Health Component, the National Treasury must ensure that the revised formula accounts for rurality and population of each province.**

The recommendation from the Committee is noted regarding taking into account the cost of providing services in rural areas.

The Committee is aware of the fact that several attempts have been made by the task team in general to look at ways of accounting for the costs of providing services in rural areas, and whilst there isn’t a stand-alone instrument that does that in the formula, the changes that have been made in the health component are a step towards addressing this particular issue. As part of the technical work that was done particularly on the review of the risk adjusted index for the health component, part of the process was exploring variables that would best capture the health care needs of the population in the provinces, including the burden of providing services to members of the population who reside in rural areas. As part of the work that has been done, a set of variables were selected that would inform the risk adjusted index, and two variables in particular were selected to account for the cost of providing services in low population density areas and the impact of different socioeconomic factors on members of the population. Details of the variables are as follows:

* Sparsity – the population density in an area was used to account for the additional costs of delivering healthcare in areas with low population density. The main reason for this is that areas of low population density tend to be geographically remote as there are fewer people using the healthcare services due to limited access, mainly owing to limited transport infrastructure. This makes the per capita cost of delivering services in such areas much higher than areas where there are high levels of population density. The population density was measured at municipal level for all the provinces.
* Multiple deprivation index – this variable is used to account for how different socio-economic factors have an impact on the need for health care by members of the population. The level of deprivation of members of the population is determined by taking into consideration the level of education, the state of the living environment and a measure of poverty based on the ownership of various assets. A combination of these was then used to determine a deprivation index for each province.

Both variables might not have a measure called rurality in both of them, but their inclusion is a step towards addressing the challenges that provinces face in providing services in a rural area. These variables do make a difference when drawing a comparison between the challenges that are often cited of providing services in rural areas and what the variables are addressing. For example, one challenge that has often been cited with providing services in a rural area is the level of access that members of the population have to different facilities as well as the access that provincial governments have to those rural areas to provide services. The sparsity variables begins to respond to this by accounting for the costs related to providing services in areas of low population density areas, which are often geographically remote and rural in nature.

**The National Treasury working with Provincial Treasuries must ensure that the transfer process is carried out smoothly and that the transfer of the budget is accompanied by transfer of functions and human resource.**

The recommendation by the Committee is noted. The process leading up to the early childhood development function shift taking effect from 1 April 2022, included preparatory work done jointly by the social development and education sectors at both national and provincial level. There was a Project Management Team that was established that met on a regular basis and in addition to that, the following inter-departmental and inter-provincial technical teams were set up to carry put the migration of the function shift:

* Human resource management and labour relations
* Finance and budgets
* Movable and immovable assets
* Data, information, monitoring and evaluation
* Legislation, policies, contracts and claims etc.
* Stakeholder management and communication
* ECD Programme implementation

These technical teams met on regular basis and were responsible for matters such as the identification of the budgets to be transferred, identification of the posts responsible for the function, identification of assets and infrastructure to me migrated, amongst other things. Joint status reports on progress were provided at various stages, including the agreements reached by the two sectors on what should be migrated along with the function shift.

**NORTHERN CAPE**

The province made the following recommendations:

**It is still not clear how to immediately access funding when disasters occur in the Agricultural sector. National Treasury together with the responsible Departments must avail such information to the Portfolio Committees on Finance.**

The immediate funding to respond to disaster is available in the Provincial Disaster Response Grant. However, first the affected province must apply to the National Disaster Management Centre (NDMC) and the NDMC will have to verify the costing of the response and make recommendation of the funding to be released.

**In addition to the lack of funding available when disasters occur in the Agricultural sector, the long-term effects of such disasters, and this due to climate change, are not considered. Thus, the Committee recommends that the Division of Revenue Bill, in future, includes funding to combat the effects of long-term impact of disasters brought about by climate change in this sector.**

Organs of state when implementing projects, the budgeting guideline request that in their planning also consider climate mitigation as climate change is a reality. Disaster response is reactionary, and organs of state should be proactive in dealing with the effects of climate change. In terms of recovery and reconstruction, which is a long-term response after disaster has occurred, the conditional grants are used for that purpose, as an example the funding allocated to KwaZulu-Natal in the current Bill for disasters that occurred in 2019 and 2020.

**The Committee acknowledges the progress made in terms of the review of the Provincial Equitable Share formula. However, the Northern Cape cannot be treated the same as other Provinces due to its geographical size, as it is the biggest province geographically making it one of the vastest provinces in terms of distance with challenges in delivering services and business acquisition. The Committee continuously request that the Northern Cape must be allocated more funding due to the challenges experienced as a result of these distances to deliver services. The Committee therefore recommends that in the review process of the Provincial Equitable Share formula, the geographical spread of the Province is seriously taken into consideration. Furthermore, the Committee requests the plan, criteria and timeframes of the ongoing review process as well as regular updates on progress made.**

The Provincial Equitable Share formula consists of six components that account for the relative demand of services and take into consideration the change of demographics in each of the provinces The formula therefore attempts to take into consideration the needs of the population using public services. As part of the technical work that was done particularly on the review of the risk adjusted index for the health component, part of the process was exploring variables that would best capture the health care needs of the population in the provinces, including the burden of providing services to members of the population who reside in rural areas. As part of the work that has been done, a set of variables were selected that would inform the risk adjusted index, and one particular variable was selected to account for the cost of providing services in low population density areas. Details of the variables are as follows:

* Sparsity – the population density in an area was used to account for the additional costs of delivering healthcare in areas with low population density. The main reason for this is that areas of low population density tend to be geographically remote as there are fewer people using the healthcare services due to limited access, mainly owing to limited transport infrastructure. This makes the per capita cost of delivering services in such areas much higher than areas where there are high levels of population density. The population density was measured at municipal level for all the provinces.

The inclusion of this variable is a step towards addressing the challenges that provinces face in providing services in areas where there is limited access to services due to limited transport infrastructure. The variable does make a difference, when drawing comparison between the challenges that are often cited of providing services in where there is vast distances to be travelled and what the variable is addressing. For example, one challenge that has often been cited with providing services in a rural areas is the level of access that members of the population have to different facilities as well as the access that provincial governments have to those rural areas to provide services. The sparsity variables begins to respond to this by accounting for the costs related to providing services in areas of low population density areas, which are often geographically remote in nature.

**There were several concerns raised by the communities during the public hearing of**

**which the Committee recommends must be addressed in the Bill, namely:**

* **Stricter measures must be included in the Bill and Regulations to ensure that municipalities spend conditional grants for the intended purposes and not misuse it once it is transferred.**

There are already strong measures in the Division of Revenue Bill to ensure that municipalities do not waste conditional grants. These measures include withholding transfers, stop and re-allocating portions or all of its grant allocation, or recoup the misappropriated grant amount from its equitable share. All stakeholders agree that the implementation of legislation to deal with consequence management and impose accountability is not sufficient, particularly in cases of poor financial management and waste of public funds. Therefore, SALGA, the Department of Cooperative Governance and the National Treasury, will collaboratively work together to ensure that all existing legislative requirements with respect to addressing financial misconduct are adhered to.

* **NGO’s, in especially the Namakwa Region, are experiencing challenges in assisting women and children that are abused. It is thus recommended that more funding must be allocated in the amendment Bill to Social Services that will provide training and proper counselling facilities.**

The province, when determining its budget, must allocate more resources towards social services if there are challenges, it is the province that decides how it allocated resources between the different sectors within the province from their equitable share.

* **There are further challenges where the food nutrition scheme funding to some schools is being released very late. The Committee recommends that stricter measures must be included in the Bill to ensure that this funding must be released speedily.**

The conditional grant framework for the National School Nutrition Programme Grant already makes provision for how provinces should implement the conditional grant. The National School Nutrition Programme Grant is a direct grant and it is the responsibility of the provincial department of education to make funding available timeously. If the funding is released late, the reasons thereof should be investigated and, if necessary, the necessary consequence management should be instituted by the provincial department of education.

* **Challenges are experienced by the old age and disabled centres to reach far lying areas thus, funding is requested for transport to reach venues.**

The provincial government, particularly the provincial department of social development, would be better placed to advise the Committee on how this challenge may be addressed. Moreover, if additional funding is required, the province when putting together its budget should allocate more resources towards this area as it is the province that decides on the funding for the different sectors within the province from their equitable share.

* **Challenges are experienced at some of the old age and disabled centres to reach far lying areas and they receive little allocations for feeding. Funding is therefore requested for transport to reach venues and increased allocations to receive adequate meals.**

The provincial government, particularly the provincial department of social development, would be better placed to advise the Committee on how this challenge may be addressed. Moreover, if additional funding is required, the province when putting together its budget should allocate more resources towards this area as it is the province that decides on the funding for the different sectors within the province from their equitable share.

**The Committee recommends that the MEC: Finance must re-negotiate at MINMEC level the allocation to the province to ensure that the uniqueness of the Northern Cape and its challenges for service delivery are adequately addressed.**

Recommendation is noted.

**NORTH WEST**

The province made the following recommendations:

**National Treasury create a conditional grant for municipalities in the North West province for record management and billing systems.**

The issue of record management and billing systems is not unique to municipalities in the province of North West, and although these should be funded out of municipal operating budgets, the Municipal Systems Improvement Grant (MSIG) supports municipalities with enhancing their records management and information and communication technology (ICT) infrastructure. This is entailed in the MSIG framework as a criterion for allocations. Municipalities are therefore urged to apply to DCoG using the timelines specified in the Bill.

**That the policy on the rehabilitation and maintenance of roads in the province be revised so that implementation occurs.**

This would be the responsibility of the relevant sector department in the province that is responsible for road maintenance. If implementation is not happening, there should be consequence management.

**The appointment of service providers at departments be in accordance with the Public Finance Management Act of 1999, in relation to plans being carried out timeously within a financial year.**

It is the responsibility of department implementing to appoint service providers timeously and within available legislation, and if that does not happen, there should be consequence management.

**The budget that is allocated for road infrastructure in the province must be increased, as it is insufficient.**

It is important to note that the Provincial Roads Maintenance Grant is a schedule 4 grant, which means that it is a grant that is meant to supplement the provincial budget on road maintenance. Provinces are expected to fund the construction of new roads from their own budget and supplement the cost of maintaining and upgrading these roads through the grant.

**WESTERN CAPE**

No recommendations.