**Report of the Select Committee on Appropriations on the Proposed Division of Revenue and Conditional Grant Allocations to Provinces and Municipalities as Contained in the 2022 Medium Term Budget Policy Statement, Dated 02 December 2022**

Having considered the 2022 Medium Term Budget Policy Statement, and in compliance with section 6(10) of the Money Bills and Related Matters Act, No. 9 of 2009 (as amended), the Select Committee on Appropriations reports as follows:

**1. Introduction**

The Minister of Finance (the Minister) tabled the Medium Term Budget Policy Statement (MTBPS) on 26 October 2022, outlining the budget priorities of government for the medium term estimates. According to section 6(10) of the Money Bills and Related Matters Act No 9 of 2009 (as amended), committees on appropriations must, within 30 days after the tabling of the MTBPS or as soon as reasonably possible thereafter, report on the proposed division of revenue and conditional grant allocations to provincial and local government as contained in the MTBPS. This report must contain -

* The spending priorities of national government for the next three years;
* The proposed division of revenue between the different spheres of government and between arms of government within a sphere for the next three years; and
* The proposed substantial adjustments to conditional grants to provinces and local government, if any.

Upon tabling of the 2022 MTBPS, the Committee considered the proposed division of revenue and conditional grant allocations to provinces and municipalities contained therein; and will conduct further consultations after the tabling of the 2023 Division of Revenue Bill by the Minister of Finance.

**2. Revised medium term expenditure priorities**

The proposed division of revenue shows that government remains committed to avail considerable resources to core functions and social priorities, despite slower spending growth in recent years in line with fiscal consolidation. The medium term changes to spending are largely driven by government’s decision to extend the COIVD-19 Social Relief of Distress (SRD) Grant by one year until 31 March 2024.

Additional funding will be provided by government for safety and security to increase the number of police, boost the investigation and prosecution of serious crimes, and safeguard the country’s borders and seas. Government has committed to support the implementation of the recommendations of the Zondo Commission of Inquiry into State Capture. Further allocations will be made to address shortfalls in the compensation of employees (COE) budget in provincial education, retain additional health workers appointed during the COVID-19 pandemic and support the provision of free municipal basic services. More funds will be allocated to rehabilitate damaged municipal infrastructure and address the backlog in the refurbishment of provincial roads. Government has also reprioritised functions and reallocated budgets to fund cost pressures and urgent policy priorities within departments and entities.

The proposed division of revenue demonstrates that provinces are responsible for basic education and health services, roads, housing, social development, and agriculture. On the other hand, municipalities provide basic services such as water, sanitation, electricity reticulation, roads and community services. Provincial and municipal governments face multiple pressures from rising costs of basic and social services over the medium term as government contains spending growth, and weak economic growth affects other revenue and funding sources.

The current proposed division of revenue shows that consolidated government spending is projected to increase from R2.21 trillion in 2022/23 to R2.48 trillion in 2025/26, growing at an annual rate of 4 percent. Learning and culture, which is allocated R1.43 trillion over the period, accounts for the largest share of this growth.

**3. The proposed division of revenue**

Table 1 below shows that, over the next three years, government proposes to allocate on average 48.4 percent of available non-interest expenditure to national departments, 41.4 percent to provinces and 10.1 percent to local government.

|  |  |
| --- | --- |
| **Proposed Division of Revenue**  | **2023 Medium Term Estimates** |
| **2023/24** | **2024/25** | **2025/26** |
| **R billion** | **R billion** | **R billion** |
| **National allocations** |  **817.7** | **822.2** |  **859.1** |
| **Provinces**  |  **684.3** | **709.5** |  **743.3** |
| Equitable share |  556.4 | 576.5 |  602.9 |
| Conditional grants |  128.0 | 133.0 |  140.4 |
| **Local governments** |  **164.9** | **174.6** |  **183.5** |
| Equitable share |  95.1 |  102.4 |  109.4 |
| General fuel levy sharing with metropolitan municipalities |  15.4 |  16.1 |  16.8 |
| Conditional grants |  54.4 |  56.1 |  57.3 |
| Provisional allocations not assigned to votes |  36.5 |  38.0 | 39.3 |
| Unallocated reserves | 0 | 41.3 | 47.3 |
| Non-interest allocations | 1 703.4 | 1 785.6 | 1 872.5 |
| Debt-service costs | 332.2 | 352.9 | 380.7 |
| Contingency reserve | 6.0 | 6.0 | 10.0 |
| **Main budget expenditure** | **2 041.6** | **2 144.5** | **2 263.2** |
| Percentage shares |  |  |  |
| National departments | 49.1% | 48.2% | 48.1% |
| Provinces | 41.1% | 41.6% | 41.6% |
| Local government | 9.9% | 10.2% | 10.3% |

**Table: 1: Proposed division of revenue framework**

**4. The provincial equitable share**

The provincial equitable share (PES), the main revenue source for provinces, is made up of six components, namely education, health, basic, institutional, poverty and economic activity. To ensure fair funding allocations to each province, the PES formula is updated annually to reflect demographic changes and demand for services based on need.

The National Treasury has indicated that the changes introduced in 2022/23, as a result of the review of the health component, would continue to be phased in over the 2023/24 and 2024/25 financial years. The PES task team, made up of representatives from the National Treasury and provincial treasuries, is reviewing the education component in partnership with relevant departments and agencies.

**Table 2: Proposed provincial equitable share allocations**

|  |  |  |  |
| --- | --- | --- | --- |
| **Province** | **2023/24** **R million** | **2024/25** **R million** | **2025/65** **R million** |
| Eastern Cape | 71 682 | 74 059 | 77 422 |
| Free State | 30 815 | 31 798 | 33 157 |
| Gauteng | 118 566 | 123 219 | 128 844 |
| KwaZulu-Natal | 113 240 | 116 758 | 121 688 |
| Limpopo | 64 175 | 66 774 | 70 276 |
| Mpumalanga | 45 834 | 47 581 | 49 882 |
| Northern cape | 14 878 | 15 441 | 16 182 |
| North West | 39 373 | 41 027 | 43 091 |
| Western Cape | 57 822 | 59 844 | 62 359 |
| **Total** | **556 385** | **576 501** | **602 900** |

**5. Changes to provincial conditional grant allocations**

The MTBPS proposes several changes to the structure of provincial conditional grants over the medium term. Over the next three years, R1.6 billion will be added to the Early Childhood Development (ECD) Grant to strengthen the Department of Education’s oversight and monitoring capacity and to improve and expand ECD services in provinces. A sum of R1.5 billion is added to the National School Nutrition Programme Grant, to continue providing nutritious meals to 9 million learners each school day. In order to address backlogs in the refurbishment of provincial roads, R7.1 billion will be added to the Provincial Roads Maintenance Grant.

The following funding has been added to several conditional grants through the Budget Facility for Infrastructure (BFI) funding:

* R144 million to the Comprehensive Agricultural Support Programme (CASP) Grant to KwaZulu-Natal Agri-Hub.
* R1.5 billion to the Education Infrastructure Grant for the Gauteng Schools Programme.
* R3.7 billion to the Provincial Roads Maintenance Grant for the building of modular steel bridges in rural areas.
* R1.8 billion is allocated to the Coega Development Corporation for a water security programme involving the construction and upgrading of bulk infrastructure, benefiting the Eastern Cape Province.
* The BFI allocation for the Limpopo Central Hospital has been rescheduled. This is done within the National Health Insurance (NHI) Indirect Grant to align the allocations with the cash-flow requirement of the project. The current baselines are rescheduled with the amounts of - R372 million, R432 million and R569 million over the 2023 MTEF.

**6. Changes to the structure of local government allocations**

Over the Medium Term Expenditure Framework (MTEF) period, R523 billion will be transferred to local government, including R161.8 billion in conditional grants. The largest transfer to municipalities is the local government equitable share (LGES), which grows by 9 percent in 2023/24, 7.6 percent in 2024/25 and 6.8 percent in the 2025/26 financial years, respectively. These above-inflation increases account for growth in household numbers, and higher bulk water and electricity costs. To increase coverage of the provision of free basic services, an additional allocation of R5.3 billion has been added to the LGES over the MTEF.

The proposed division or revenue shows that the LGES formula has been updated to account for projected household growth and increases in the cost of services. The formula will be refined over the 2023 MTEF period through a review of the cost factors driving basic services, the creation of a fire services sub-component and estimates of household growth. This refinement, which is part of the five-year local government reform plans, adopted by the Budget Forum in 2021, will be underpinned by high-quality, credible and verifiable data.

An additional allocation of R2.8 billion is proposed to the Municipal Disaster Recovery Grant to fund the repair and reconstruction of municipal infrastructure damaged by the April 2022 floods. With respect to the Public Transport Network Grant, funds amounting to R8 million in 2024/25, and R13 million in 2025/26, are reprioritised to fund the roll-out of the Single Integrated Ticketing System.

With regard to BFI rescheduling, additions of R105 million in 2023/24, R40 million in 2024/25 and R316 million in 2025/26 are proposed to the Public Transport Network Grant to align with the revised implementation plan and cash-flow projections for the City of Cape Town’s MyCiTi public transport network. There is also a proposed reduction of R136 million in 2023/24 and an addition of R1 million in 2024/25 to the Regional Bulk Infrastructure Grant to align with the revised implementation plan and cash-flow projections for the George Local Municipality’s Potable Water Security and Remedial Works project. Over the 2023 MTEF, a sum of R6.5 billion will be allocated to several municipalities (eThekwini Metropolitan Municipality, City of Johannesburg Metropolitan Municipality, Drankenstein Local Municipality, Sol Plaatjie Local Municipality and Nelson Mandela Bay Metropolitan Municipality) to fund municipal infrastructure projects approved through the sixth window of the BFI. A further allocation of R8.1 billion is made through the BFI over the 2023 MTEF to three municipalities through the Indirect Regional Bulk Infrastructure Grant.

**7. Update on long-term borrowing for municipalities**

The MTBPS indicates that Cabinet approved the updated municipal borrowing policy framework in August 2022. This framework will support the development and growth of an efficient and liquid market for municipal borrowing by: (i) introducing reforms needed to expand the scope of municipal borrowing and attract more investors to municipal debt markets; (ii) clarifying the role of development finance institutions (DFIs) to ensure that they do not crowd out the private sector; and (iii) outlining infrastructure financing mechanisms for municipalities. The National Treasury will lead consultations with stakeholders such as DFIs and commercial banks on how to implement these changes.

To complement the borrowing reforms, Cabinet has also approved the Municipal Fiscal Powers and Functions Amendment Bill for tabling in Parliament. This Bill will improve and standardise the regulations of development charges, a source of municipal revenue charged to developers for connecting new developments to municipal services.

**8. Building capability for service delivery**

National Treasury submitted that, in order to help municipalities to build capacity and function efficiently, government had spent R9.1 billion across 40 state agencies in the 2019/20 financial year. Following the National Treasury’s review of this capacity-building system, government is developing a multi-year programme to improve its outcomes and cost effectiveness. In addition, with the support of the Government Technical Advisory Centre (GTAC), the National Treasury will finalise the design of a revised programme and agree on an integrated approach to local government capability development during 2023.

In summary, over the 2023 MTEF period, additional funding will be provided for health, education, safety and security and infrastructure investment. Municipalities will receive support to cover cost increases in free basic services. Moreover, government is working to improve the efficiency of spending.

1. **Observations and Findings**

While considering and deliberating on the proposed division of revenue and conditional grant allocations to provinces and municipalities as contained in the 2022 MTBPS, the Select Committee on Appropriations observed the following:

* 1. The Committee notes the proposed allocation of 48.4 percent of the available non-interest expenditure to national departments, 41.4 percent to provincial government and 10.1 percent to local government over the next three years.
	2. The Committee takes note of the 2023 MTEF proposed provincial equitable share allocations for compensation of employees (COE) within the education sector. These are R5.7 billion in 2023/24, R6.7 billion in 2024/25 and R7.6 billion in the 2025/26 financial years, respectively. The Committee further notes the proposed allocation for the health sector to cover COE, service backlogs, including for anti-retroviral and tuberculosis treatment, laboratory services and other goods and services plus medicines and medical supplies.
	3. The Committee welcomes the fact that additional funding will be provided for safety and security to increase the number of police, boost the investigation and prosecution of serious crimes, and safeguard the country’s borders and seas; as well as government’s commitment to support the implementation of the recommendations of the Zondo Commission of Inquiry into State Capture over the 2023 MTEF.
	4. The Committee also notes that the proposed division of revenue shows that consolidated government spending is projected to increase from R2.21 trillion in 2022/23 to R2.48 trillion in 2025/26, growing at an annual rate of 4 percent. Learning and culture, which is allocated R1.43 trillion over the period, accounts for the largest share of this growth.
	5. The Committee welcomes the fact that the proposed division of revenue for the 2023 MTEF proposes several changes to the structure of provincial conditional grants, including the addition of R1.6 billion to the Early Childhood Development (ECD) Grant to strengthen the Department of Basic Education’s oversight and monitoring capacity and to improve and expand ECD services in provinces; the addition of R1.5 billion to the National School Nutrition Programme Grant, to continue providing nutritious meals to 9 million learners each school day; and the addition of R7.1 billion to the Provincial Roads Maintenance Grant to address the backlog of provincial roads refurbishment.

9.6 Whilst the Committee remains concerned about the poor spending of some provincial conditional grants, it welcomes the additional funding being proposed to several provincial conditional grants through the Budget Facility for Infrastructure (BFI); including the Comprehensive Agricultural Support Programme (CASP) for KwaZulu-Natal, the Education Infrastructure Grant for Gauteng, the Provincial Roads Maintenance Grant for rural bridges, the National Health Insurance Indirect Grant for the Limpopo Central Hospital, and the Coega Development Cooperation for water services, which will benefit the Eastern Cape.

9.7 The Committee welcomes the approval of the updated municipal borrowing policy framework by Cabinet in August 2022; as this framework will support the development and growth of an efficient and liquid market for municipal borrowing.

9.8 The Committee further welcomes the Cabinet approval of the Municipal Fiscal Powers and Functions Amendment Bill to complement the above borrowing reforms; as the Bill will assist to improve and standardise the regulations of development charges; a source of municipal revenue charged to developers for connecting new developments to municipal services.

9.9 The Committee welcomes the proposed above-inflation increases to local government allocations over the 2023 MTEF, and the fact that R523 billion will be transferred to local government, including R161.8 billion in conditional grants, over the same period.

9.10 The Committee notes that the largest transfer to municipalities is the local government equitable share and that this will continue to grow by 9 percent in 2023/24, 7.6 percent in 2024/25 and 6.8 percent in the 2025/26 financial years, respectively.

9.11 The Committee welcomes the proposed allocation of R2.8 billion to the Municipal Disaster Recovery Grant to fund the repair and reconstruction of municipal infrastructure damaged by the April 2022 floods and disasters.

9.12 The Committee notes the proposed funding over the 2023/24 MTEF for the Public Transport Network Grant, amounting to R8 million in 2024/25 and R13 million in 2025/26, respectively, and that the money is reprioritised to fund the roll-out of the Single Integrated Ticketing System.

9.13 The Committee notes the fact that, over the 2023 MTEF, R6.5 billion will be earmarked for several municipalities, including the eThekwini Metropolitan Municipality, the City of Johannesburg Metropolitan Municipality, the Drankenstein Local Municipality, the Sol Plaatjie Local Municipality and the Nelson Mandela Bay Metropolitan Municipality, to fund municipal infrastructure projects approved through the sixth window of the BFI.

9.14 The Committee notes the South African Local Government Association’s (Salga’s) assertion that the functions allocated to local government by the Constitution outweigh functions allocated to the other two spheres of government; and yet it receives the lowest share of the nationally raised revenue over the MTEF.

9.15 The Committee further notes Salga’s view that the current under-funding of local government, and the consequent financial distress, is a direct result of the fiscal assumptions contained in the Local Government White Paper of 1998, many of which have proven to be incorrect, or have not been implemented as envisaged.

9.16 The Committee notes Salga’s recommendation that any envisaged bail-out to Eskom in the MTEF allocations must be comprehensive enough to also consider the debt owed by municipalities to the entity; and that government should consider offsetting debt owed to Eskom by financially distressed municipalities against any bail-out appropriated to the entity, with conditions.

**10. Recommendations**

After considering and deliberating on the proposed division of revenue and conditional grant allocations to provinces and municipalities as contained in the 2022 MTBPS and submissions by stakeholders, the Select Committee on Appropriations recommends as follows:

10.1 The provincial departments of education and health should ensure that the proposed additional allocations for the 2023 Medium Term Expenditure Framework (MTEF) through the provincial equitable share (PES), which is earmarked for compensation of employees, service delivery backlogs, anti-retroviral and tuberculosis treatment, laboratory services and other goods and services, medicines and medical supplies, are spent according to approved plans and that all funded vacant posts are filled to improve frontline service delivery.

10.2 More resources should be set aside over the 2023 MTEF for safety and security, in order to increase police visibility, boost the investigation and prosecution of serious crimes, and safeguard the country’s borders and seas, as well as for the implementation of the recommendations of the Zondo Commission of Inquiry into State Capture.

10.3 The Department of Basic Education should develop mechanisms to ensure that the proposed additional amount of R1.6 billion is spent effectively and efficiently to strengthen oversight and monitoring capacity to improve the implementation of the Early Childhood Development Grant to expand early childhood development services in provinces over the 2023 MTEF period. The Committee again reiterates its previous recommendation that intensifying investment of resources at the early stages of education is crucial for the future of this country. Parliament and provincial legislatures will continue to monitor progress in this regard.

10.4 The Department of Basic Education, together with its provincial counterparts, should ensure that proper processes and systems are developed and implemented to address under-spending on crucial conditional grants and ensure that the proposed R1.5 billion allocated to the National School Nutrition Programme Grant is effectively spent to continue providing nutritious meals to 9 million learners each school day for the 2023 MTEF.

10.5 The National Treasury, together with its provincial counterparts, should ensure that mechanisms to continuously improve provincial conditional grant expenditure are implemented, as articulated in the conditional grant frameworks, to achieve value for money, particularly for the proposed additional grant funding earmarked through the Budget Facility for Infrastructure (BFI). These include funding for the Comprehensive Agricultural Support Programme (CASP) for KwaZulu-Natal, the Education Infrastructure Grant for Gauteng, the Provincial Roads Maintenance Grant for rural bridges, the National Health Insurance Indirect Grant for the Limpopo Central Hospital, as well as the Coega Development Corporation for water services in the Eastern Cape.

10.6 The National Treasury, together with the Department of Cooperative Governance, provincial departments of cooperative governance and the South African Local Government Association (Salga), should expedite the review of the capacity-building system for local government as well as the development of a multi-year programme to improve basic service delivery outcomes and cost effectiveness. The National Treasury should also fast-track the design of a revised programme and agree on an integrated approach to local government capability development for the 2023 MTEF.

10.7 The National Treasury, together with the Department of Cooperative Governance, provincial treasuries and provincial cooperative governance departments and the South African Local Government Association (Salga), should ensure that proper plans are continuously implemented to improve the quality of spending and performance in local government to achieve value for money; in light of the proposed allocation amounting to R523 billion, including R161.8 billion in conditional grants.

10.8 Although the Committee believes that a proper review of local government transfers is necessary to address the structural under-funding of the sphere; it supports the proposed above-inflation increases in local government allocations over the Medium Term Expenditure Framework (MTEF) period. Parliament and provincial legislatures will continue to monitor progress in this regard to ensure that the aspirations contained in the Local Government White Paper of 1998 are eventually realised.

10.9 The National Treasury, together with the Department of Cooperative Governance and its provincial counterparts, should put proper mechanisms in place to ensure that the much-needed relief funding earmarked for disaster recovery promptly reaches the deserving beneficiaries/victims; and improve the expenditure for the proposed additional allocation of R2.8 billion to the Municipal Disaster Recovery Grant to fund the repair and reconstruction of municipal infrastructure damaged by the April 2022 floods.

10.10 The Department of Cooperative Governance, together with its provincial counterparts and the South African Local Government Association (Salga), should always ensure that municipalities plan in advance for the proposed R8.1 billion of the Indirect Regional Bulk Infrastructure Grant earmarked for some municipalities over the MTEF period in order to avoid the return of funds back to the fiscus without delivering services.

10.11 The National Treasury, together with the Department of Cooperative Governance and its provincial counterparts should ensure that proper planning and monitoring is conducted to avoid wasteful and fruitless expenditure as well as corruption for the proposed R6.5 billion earmarked for the eThekwini Metropolitan Municipality; the City of Johannesburg Metropolitan Municipality; the Drankenstein Local Municipality; the Sol Plaatjie Local Municipality and the Nelson Mandela Bay Metropolitan Municipality, to fund municipal infrastructure projects approved through the sixth window of the Budget Facility for Infrastructure (BFI) over the MTEF.

10.12 The National Treasury and Cabinet should ensure that a concerted effort is exerted to address the financial challenges experienced by municipalities in financial distress. Furthermore, a portion of the higher than anticipated revenue generated should be utilised to alleviate financial pressures for these municipalities; with such an intervention being accompanied by stringent conditions to enforce accountability, and improved oversight.

10.13 The Committee is of the view that, for government to realise its infrastructure-led economic recovery plan, proper alignment of budgets and infrastructure plans is key for all spheres of government. Therefore, government should continue to intensify the implementation of the economic recovery strategies to assist businesses in distress and address Eskom challenges, as electricity supply is critical for growth over the medium term period. Parliament and provincial legislatures will continue to monitor progress in this regard.

The Democratic Alliance (DA), the Economic Freedom Fighters (EFF) and the Freedom Front Plus (FF+) reserved their positions on the Report.

Report to be considered.