2020 Division of Revenue Bill Brief

Select Committee on Appropriation

22 April 2020

Parliamentary Budget Office

PARLIAMENT OF THE REPUBLIC OF SOUTH AFRICA

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1. Purpose

The purpose of this brief is to provide analysis to assist members of the Select Committee on Appropriations in their consideration and adoption of the 2020 Division of Revenue Bill. The brief further aims to assist members in determining the consistency of the changes to the division of revenue with the fiscal framework, taking into account the service delivery obligations and priorities of all affected national departments, provincial government departments and local governments.

2. Introduction

A large majority of South Africans are dependent on government funding to deliver basic services. Many South African households have benefitted from more access to basic services since 1994. However, much more remains to be done to improve access and quality of basic services. The Covid-19 pandemic has highlighted some of the public health dangers associated with current inadequate levels of basic services and the quality of those services.

The 2020 Division of Revenue allocations have changed compared to the 2019 Division of Revenue Act (DORA), mainly as a result of unforeseen expenditure pressures from State Owned Companies (SOCs) and slower than expected economic growth. All three spheres of government have seen baseline reductions to budget allocations in the 2020 Division of Revenue Bill. Provincial and local government equitable shares have increased by 6.5 per cent and 11.5 per cent respectively.

Declines in baseline allocations were mainly as a result of reductions in provincial and local government conditional grants. The criteria used to reduce conditional grants included consideration of:

- Trends in spending and performance in prior years,
- Whether the grants are used for current or capital expenditure,
- Whether the grant allocation has grown over the years and
- Underspending patterns

It is difficult to determine the potential implication on service delivery at this stage, therefore it may be worth the Committee's consideration to request that government provide regular updates about the impact of reducing the conditional grants service delivery.

The 2020/21 baseline reduction in local government conditional grants are mainly related to infrastructure and capacity building. Audit reports issued by the Auditor General of South Africa (AGSA), have repeatedly identified poor infrastructure and lack of human capacity as challenges faced by many municipalities. Therefore, to support oversight, the Committee may consider requesting government to report whether the reductions in the baselines of the infrastructure and capacity building conditional grants would lead to further deterioration of service delivery. These reports should also include information for the Committee to evaluate their impact on efficiency and effectiveness of local government service delivery.

In an effort to determine effective and efficient spending of conditional grants, the Parliamentary Budget Office (PBO) started a series of assessments on the grant schedules attached to the Division of Revenue Bill. Preliminary findings from these assessments are that:

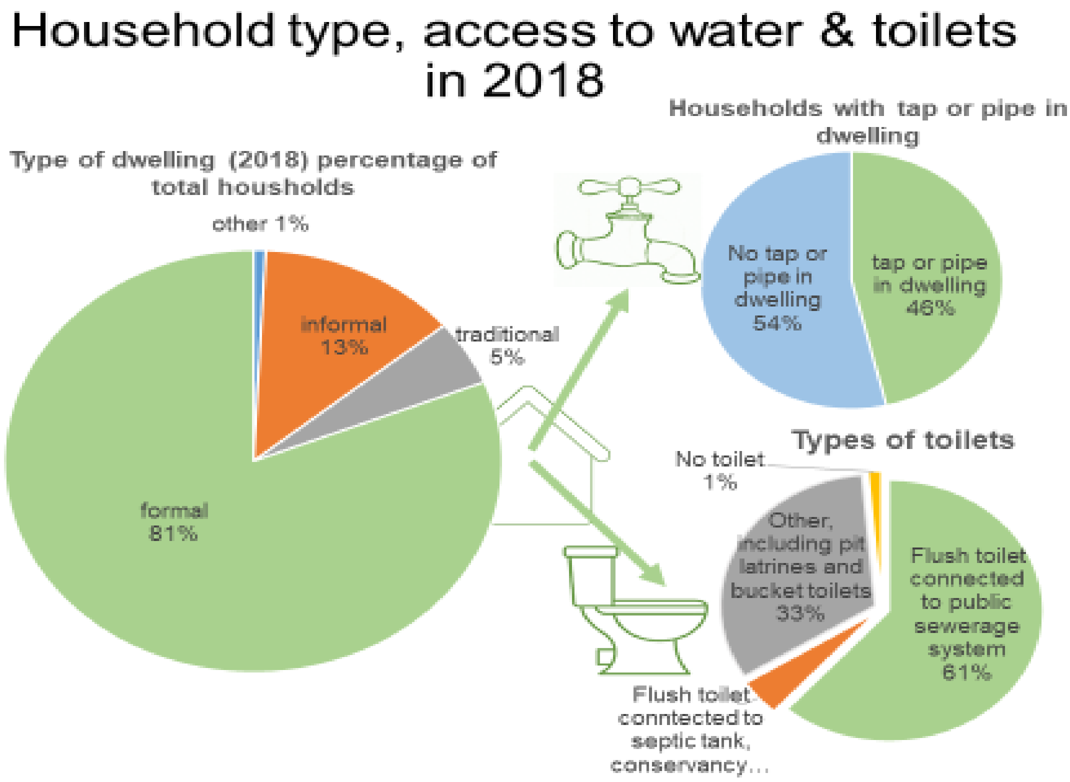
- The performance information provided by the conditional grant frameworks are insufficient to determine efficiency and effectiveness of the grants.
- The performance indicators in the conditional grant frameworks provide information mainly on outputs achieved.
- The performance indicators in the grant frameworks, do not provide impact indicators, which makes it difficult for oversight bodies, particularly Parliament, to determine the effectiveness of funds spent.
- The way in which performance is reported creates a gap in reported information of two years that affects oversight. They provide only actual performance indicators for earlier years but do not provide estimated performance data for the most recent financial year.
- Most of the conditional grant frameworks do not provide targets over the medium term

In considering the 2020 Division of Revenue Bill, the Select Committee may wish to consider taking into account the Covid19 pandemic, which could lead to major reprioritisation of funds. The Committee may also consider monitoring the process initiated by government and other stakeholders, including the South African Local Government Association and Financial and Fiscal Commission, to examine the current process of allocating budgets across spheres of government and whether the current allocation process lead to increases in potential unfunded mandates.

3. Basic Service delivery backlogs

The 2018 Stats SA General Households Survey shows that many more South African households have gained improved access to basic services over the past decade. However, the government still has much more to do to improve the level and provision of basic services. There remain large backlogs since apartheid. The growth in population and the number of households, which have grown faster than the population over the past two decades, means that there are more households to provide with basic services. The level and quality of access to these basic services also has to improve. Therefore, unless there are unexpectedly large efficiency improvements in services provision, building of services infrastructure and capacity development, even increases in expenditure to take account of inflation and population growth over the medium term will be inadequate.

Figure 3.1 Examples of basic service delivery backlogs at a national level



Source: Data from Stats SA General Household Survey, 2018

The Covid-19 pandemic has highlighted that inadequate access to basic services, such as in-dwelling taps or piped water and access to clean sanitary services, is not only a convenience but a public health issue. The percentage of South African households without adequate levels and quality of access to these basic services remains too large (see Figure 3.1).

4. 2020 Division of Revenue Bill

In 2020/21, after budgeting for debt-service costs, the contingency reserve and provisional allocations, 49.2 per cent of nationally raised funds are allocated to national government, 42.2 per cent to provinces and 8.6 per cent to local government. However, these allocations have changed since the 2019 estimated division of revenue for the 2020/21 allocations. The reasons for the change were pressures from State Owned Companies for more funds and slower than expected economic growth.

Table 4.1 shows the changes to the baseline since the 2019 budget. Total non-interest allocations are reduced by R7.8 billion of which, amongst others, provincial allocations are reduced by R7.9 billion, local government allocation are reduced by R5.4 billion and national allocations increase by R24.6 billion. Changes to the allocations since the 2019/20 revised estimates are mixed and show growth rates of between -2.4 per cent and 11.5 per cent. Provincial (PES) and local government (LGES) equitable shares grow by 6.5 and 11.5 per cent respectively in 2020/21 from the 2019/20 revised estimates. Indirect transfers to local government increase by 8.6 per cent while the direct conditional grants decrease by 2.4 per cent.

Table 4.1 Changes to the division of revenue since the 2019 Budget and growth rate from the revised 2019/20 estimates

R billion	2019/20 Revised estimate	2020/21 2019 BR	2020/21 2020 BR	Changes to the 2020/21 estimates	Growth from 2019 Revised estimate to 2020 BR
Division of available funds					
National departments	739.5	733.1	757.7	24.6	2.5%
of which:				–	
Indirect transfers to provinces	*3.9*	*5.0*	*4.1*	-0.9	3.0%
Indirect transfers to local government	*7.0*	*7.1*	*7.6*	0.5	8.6%
Provinces	612.8	657.1	649.3	-7.9	5.9%
Equitable share	505.6	542.9	538.5	-4.4	6.5%
Conditional grants	107.3	114.2	110.8	-3.4	3.3%
Local government	125.0	137.9	132.5	-5.4	6.0%
Equitable share	67.0	75.7	74.7	-1.0	11.5%
Conditional grants	44.9	48.2	43.8	-4.4	-2.4%
Non-interest allocations	1 477.3	1 539.5	1 531.7	-7.8	3.7%
Percentage shares					
National departments	*50.1%*	*48.0%*	*49.2%*		
Provinces	*41.5%*	*43.0%*	*42.2%*		
Local government	*8.5%*	*9.0%*	*8.6%*		

Source: PBO calculations from National Treasury database

From the total appropriation for 2020/21 of R1 498.2 billion, 71.2 per cent or R1 066.1 billion is transferred to other institutions to deliver services on behalf of government.

Table 4.2. shows the annual average growth rates in the allocations to the three spheres of government as well the division of transfers to provincial and local government. Non-interest allocations are estimated grow to by 3.7 per cent over the 2020 Medium Term Expenditure Framework (MTEF). When considering growth from 2017/18 growth is estimated at 5.8 per cent. Allocations to provincial and local governments are estimated to grow by 6.1 per cent and 6.5 per cent respectively over the 2020 MTEF. The highest growth rate of 9.2 per cent, over the 2020 MTEF is estimated for the local government equitable share (LGES). Direct and indirect conditional grants to provinces and local government are estimated to grow by 4.9 per cent and 2.8 per cent respectively, over the 2020 MTEF.

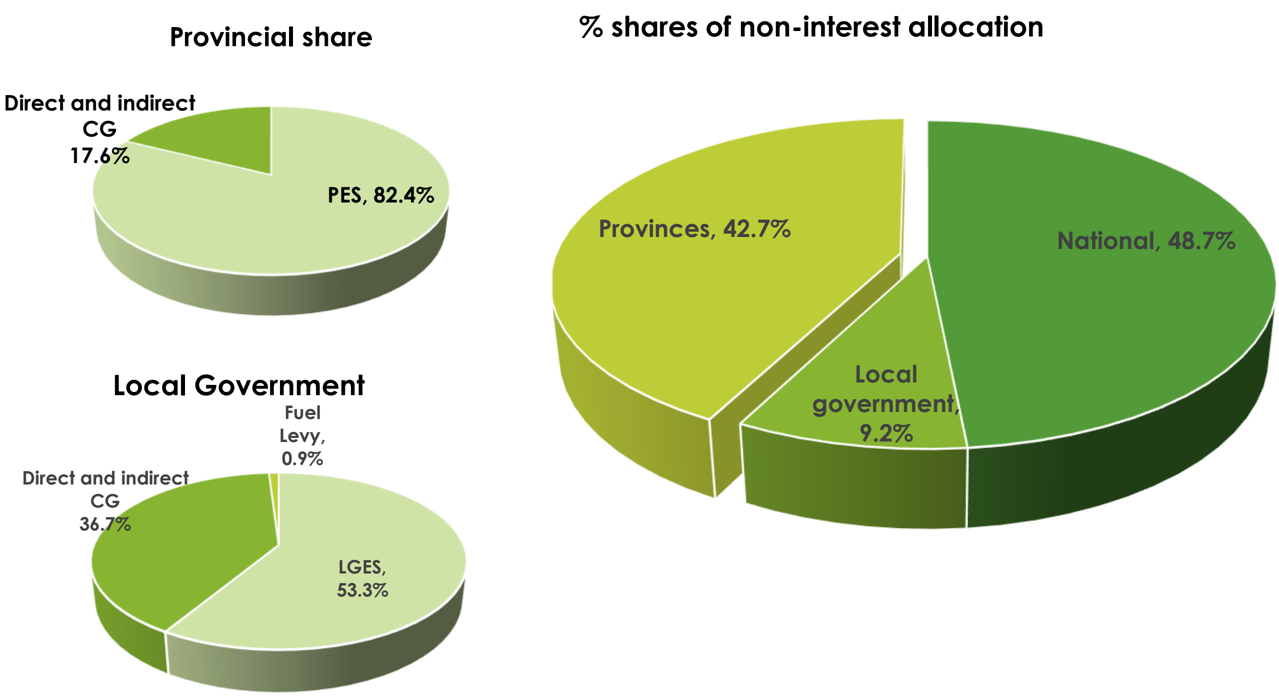
Table 4.2 Actual and estimated expenditure trends since 2017/18 and proportions of national allocation transferred to provincial and local governments (nominal R'billion)

R billion	2017/18	2018/19	2019/20 Revised estimate	2020/21	2021/22	2022/23	Average annual MTEF growth	Average annual 5-year growth	2020/21 % of non-interest allocation
				Medium-term estimates					
Division of available funds									
National	**581.0**	**622.6**	**728.5**	**746.0**	**756.8**	**784.6**	**2.5%**	**6.2%**	**48.7%**
Provinces	**542.4**	**575.9**	**616.8**	**653.3**	**696.8**	**735.8**	**6.1%**	**6.3%**	**42.7%**
Equitable share	441.3	470.3	505.6	538.5	574.0	607.6	**6.3%**	**6.6%**	**82.4%**
Direct and indirect conditional grants	101.0	105.6	111.2	114.8	122.8	128.2	**4.9%**	**4.9%**	**17.6%**
Local government	**118.9**	**126.3**	**132.0**	**140.2**	**149.7**	**159.6**	**6.5%**	**6.1%**	**9.2%**
Equitable share	55.6	60.8	67.0	74.7	81.1	87.2	**9.2%**	**9.4%**	**53.3%**
Direct and indirect conditional grants	51.5	53.0	51.9	51.4	53.4	56.3	**2.8%**	**1.8%**	**36.7%**
General fuel levy sharing with metros	11.8	12.5	13.2	14.0	15.2	16.1	**6.9%**	**6.4%**	**0.9%**
Non-interest allocations	**1 242.3**	**1 324.8**	**1 477.3**	**1 531.7**	**1 587.2**	**1 645.1**	**3.7%**	**5.8%**	**100%**

Source: PBO calculations from National Treasury database

Figure 4.1 shows the percentage shares allocated to the three spheres of government as well as the percentage of shares allocated for priority spending in the form of direct and indirect conditional grants and equitable share.

Figure 4.1 Percentage shares of non-interest allocations



Source: National Treasury database

Figure 4.1 shows that provincial and local government direct and indirect conditional grants amount to 17.6 per cent and 53.3 per cent of the total share of nationally raised revenue allocated to these spheres of government in 2020/21.

As part of government's efforts to limit growth in government expenditure and ensure sustainable public debt most conditional grants have been reduced. These reductions take into account:

- Past spending and performance
- Whether the grants funds salaries, medicines and food
- Whether there has been significant real growth in allocations in recent years.
- Where possible, the National Treasury has reduced transfers they consider more likely to go unspent or to be spent less effectively

It is unclear at this stage how these reductions will affect government's service delivery capacity. Therefore, the committee may consider requesting government to provide regular updates on the impact of the reductions on service delivery.

5. Baseline reductions over the 2020 MTEF

Table 5.1 shows the baseline reductions since the 2019 budget estimates for the Medium Term Expenditure Framework. The total reduction for 2020/21 amounts to R28. 2 billion of which programme specific reductions amount to R10.7 billion or 37.8 per cent of total reductions in 2020/21. Provincial and local government conditional grants are adjusted by R4.9 billion or 17.3 per cent and R4.6 billion or16.4 per cent respectively.

Table 5.1. 2020 Baseline adjustments since the 2019 MTEF

R million	2020/21	% share of 2020/21 estimates	2021/22	2022/23	MTEF total
2020 Budget baseline adjustments	**-28 238**		**-33 219**	**-39 341**	**-100 798**
Programme specific reductions	-10 666	37.8%	-10 596	-15 742	-37 004
Provincial equitable share	-2 349	8.3%	-2 452	-2 524	-7 325
Provincial conditional grants	-4 893	17.3%	-5 940	-7 202	-18 036
of which:					
Human settlements development grant	*-2 331*	*8.3%*	*-1 984*	*-2 402*	*-6 717*
Provincial roads maintenance grant	*-500*	*1.8%*	*-1 084*	*-1 258*	*-2 841*
Health conditional grants	*-446*	*1.6%*	*-698*	*-732*	*-1 875*
Education infrastructure grant	*-459*	*1.6%*	*-616*	*-775*	*-1 850*
Local equitable share	-1 000	3.5%	-1 100	-1 100	-3 200
Local conditional grants	-4 622	16.4%	-6 457	-7 425	-18 504
of which:					
Public transport network grant	*-1 049*	*3.7%*	*-1 570*	*-1 727*	*-4 347*
Urban settlements development grant	*-1 420*	*5.0%*	*-1 968*	*-2 554*	*-5 943*
Municipal infrastructure grant	*-989*	*3.5%*	*-894*	*-939*	*-2 822*
Water services infrastructure grant	*-426*	*1.5%*	*-541*	*-698*	*-1 665*

Source: National Treasury database

One of the largest reductions to local government grants in 2020/21 is to the public transport network grant because of the slow uptake of the grant. According to the National Treasury, only six of the thirteen cities awarded the grant successfully launched public transport systems. The three cities with the least progress – Buffalo City, Msunduzi and Mbombela – have been suspended from the grant and will not receive allocations in the 2020 MTEF period. Larger reductions are also made to grants to urban municipalities, which have more capacity to offset cuts by increasing their own-revenue investments. According to the National Treasury, grants for areas that have persistently underperformed have been reduced by larger amounts. Where possible, transfers deemed more likely to go unspent or to be spent less effectively have been reduced.

The 2020/21 proposed baseline reduction in local government conditional grants related to infrastructure makes up 16 per cent of the baseline reduction. The reduction in the baseline has taken into account past performance and conditions attached to the local government conditional grants. It is worth noting that according to AGSA reports, some of the challenges faced by local governments include poor infrastructure and lack of human capital capacity. Therefore, the Committee may wish to consider whether the reduction in the baseline of the infrastructure and capacity building conditional grants could lead to further challenges for local government. For example, slow uptake in the public transport network grant by the cities does not mean that the cities do not need better public transport infrastructure. Another factor to consider is the potential loss of economic multipliers associated with the infrastructure budget.

6. Effective and efficient spending of priority funding: Conditional Grants

Due to the importance of priority funding the PBO started a series of assessments on the grant schedules attached to the Division of Revenue Bill to determine effective and efficient spending of conditional grants. It is however acknowledged that the frameworks for conditional grants are not part of the Division of Revenue Bill, but attached to the Division of Revenue Bill to provide detailed information on each conditional grant and that business plans are also developed for conditional grants. The grant frameworks are, however, the main source of information available to analysts and the public to determine the effective and efficient spending on policy priorities.

Preliminary findings on the Education and Health grants are that:

- The performance indicators in the conditional grant frameworks provide information mainly on outputs achieved.
- The performance indicators in the grant frameworks, do not provide impact indicators, which makes it difficult for oversight bodies, particularly Parliament, to determine the effectiveness of funds spent. It is essential, specifically for oversight purposes to determine change over time, for example: universal health access, the decrease in morbidity and mortality associated with communicable on non-communicable diseases and the reduction in referrals for tertiary health care services to other provinces. It would also be useful to know, for example, the average number of patients reached by community workers.

- The way in which performance is reported creates a gap in reported information of two years that affects oversight. They provide only actual performance indicators for earlier years but do not provide estimated performance data for the most recent financial year.
- Most of the conditional grant frameworks do not provide targets over the medium term
- Functions are duplicated between direct and indirect grants in specific instances.

Regular reporting on the non-financial performance associated with this source of funding is essential for Parliament to be able to do comprehensive oversight over priority spending and performance.

7. Division of Revenue and Unfunded Mandates

In terms of the Money Bills and Related Matters Act 2009 (Money Bills Act), Parliament should take into account potential unfunded mandates between the spheres of government when considering money bills proposals from the Executive.

7.1 Unfunded Mandates

Unfunded Mandates occur when a government proposed policy or legislation leads to other spheres of government or their entities having to perform the state's functions or deliver services without funds having been allocated. Unfunded Mandates may also occur where a sphere of government does not receive funds to perform its legal mandate or part thereof.

Functions and roles (or service delivery) of all spheres of government are set-out in Schedules 4 and 5 of the Constitution of the Republic (Refer to the Appendix A). The Constitution further sets out functional areas for concurrent competencies for government spheres. The allocation of budgets between the spheres of government is assumed to be based on the constitutional provisions as set-out by these schedules and other public finance frameworks. Therefore, situations where any sphere of government is legally mandated, in terms of the Constitution or by policy pronouncement, to undertake specific functions but does not receive funds from the national revenue fund to fulfil these functions would be deemed to cause unfunded mandates.

7.2 Division of Revenue and Unfunded Mandate Consideration

Over the years in South Africa, there have been debates whether the national budget proposals, DORA (formula) in particular, lead to unfunded mandates for provincial and local government spheres. National budgets proposals are prepared within the national sphere in consultation with other spheres. This phenomenon may have also fueled debates on the influence of the provincial or local government spheres on allocations. One of the findings of the Select Committee on Appropriation's on the 2019 Division of Revenue Amendment Bill report on the 29th of November 2019 was that:

> *"The Committee also noted that provinces sharply raised the matter of the provincial equitable share formula. A number of rural provinces were of the view that the formula did not take into account the higher cost drivers of delivering services in rural areas. National Treasury indicated that the process of reviewing the provincial equitable share formula was already underway."*

And more recently on the 13th March 2020, the South African Local Government Association during their presentation at the public hearing hosted by Standing Committee on Appropriations noted that:

> *"Another matter raised was that due to community pressures, municipalities that were at the coal face of service delivery were often forced to deliver unfunded mandates, while revenue instruments stayed with the provinces. Municipalities essentially picked up the slack from the provincial government -- for example, in disaster management and primary health services.*
>
> *Electricity distribution was a municipal function in terms of the Constitution, but Eskom supplied electricity directly to about 50 per cent of the consumers, including major energy consumers. The inability to use electricity cut-offs as a means of credit control impacted on the collection of other streams of municipal revenue, such as rates and water services. Payment levels for rates and other services in areas where municipalities were electricity suppliers were typically at 80 per cent and above, but payment levels for rates and other services in areas where Eskom was the electricity supplier were typically as low as 20 per cent"*

There are indications that local governments may be taking on more responsibility in the delivery of services than provincial governments. The fact that certain government functions can be concurrently performed by more than one sphere could lead to discrepancies between the two spheres, for example, a local government could be delivering services for a mandate that a provincial government was funded to perform. Service level agreements are usually signed between Provinces and Metros to acknowledge potentially unfunded mandates. For example, some Metros may enter into service level agreements with provincial governments to provide services that are the functions of provincial departments, such as health services, housing services and others. The National Treasury in their recent presentation to Parliament also noted that government has initiated a process to review the current formula and related public finance measures used to share revenue amongst the spheres of government.

The national lockdown and related measures announced to deal with the Covid-19 pandemic means that all spheres of government and related stakeholders are required to perform functions beyond those legislated or budgeted for in the 2020 Budget. This situation could lead to potential growth of unfunded mandates for the current financial year. For example, urgent increased provision of peace and security measures, additional requests for social and security relief, administration of business rescue processes and related support processes may require immediate expenditure.

In considering the 2020 Division of Revenue Bill, it is therefore necessary for the Select Committee on Appropriations to also consider potential unfunded mandates that may be brought about by concurrent functions between spheres of government and possible implications of expenditure on the Covid19 pandemic on various spheres of government. This consideration may prove critical given the uncertainty with regard to the impact on South African society, the economy and public finances of the Covid-19 pandemic of government.

Appendix A- Constitution of South African Schedule 4 and 5

SCHEDULE 4	
Functional Areas of Exclusive Provincial Legislative Competence	
Part A	**Part B**
	The following local government matters to the extent set out in section 155(6)(a) and (7):
Administration of indigenous forests	Air pollution
Agriculture	Building regulations
Airports other than international and national airports	Child care facilities
Animal control and diseases	Electricity and gas reticulation
Casinos, racing, gambling and wagering, excluding lotteries and sports pools	Firefighting services
Consumer protection	Local tourism
Cultural matters	Municipal airports
Disaster management	Municipal planning
Education at all levels, excluding tertiary education	Municipal health services
Environment	Municipal public transport
Health services	Municipal public works only in respect of the needs of municipalities in the discharge of their responsibilities to administer functions specifically assigned to them under this Constitution or any other law
Housing	Pontoons, ferries, jetties, piers and harbors, excluding the regulation of international and national shipping and matters related thereto
Indigenous law and customary law, subject to Chapter 12 of the Constitution	Storm water management systems in built-up areas
Industrial promotion	Trading regulations
Language policy and the regulation of official languages to the extent that the provisions of section 6 of the Constitution expressly confer upon the provincial legislatures legislative competence	Water and sanitation services limited to potable water supply systems and domestic wastewater and sewage disposal systems
Media services directly controlled or provided by the provincial government, subject to section 192	
Nature conservation, excluding national parks, national botanical gardens and marine resources	
Police to the extent that the provisions of Chapter 11 of the Constitution confer upon the provincial legislatures legislative competence	
Pollution control	
Population development	
Property transfer fees	
Provincial public enterprises in respect of the functional areas in this Schedule and Schedule 5	
Public transport	
Public works only in respect of the needs of provincial government departments in the discharge of their responsibilities to administer functions specifically assigned to them in terms of the Constitution or any other law	
Regional planning and development	
Road traffic regulation	
Soil conservation	
Tourism	
Trade	
Traditional leadership, subject to Chapter 12 of the Constitution	
Urban and rural development	
Vehicle licensing	
Welfare services	

SCHEDULE 5	
Functional Areas of Exclusive Provincial Legislative Competence	
Part A	**Part B**
	The following local government matters to the extent set out for provinces in section 155(6)(a) and (7):
Abattoirs	
Ambulance services	Billboards and the display of advertisements in public places
Archives other than national archives	Cemeteries, funeral parlors and crematoria
Libraries other than national libraries	Cleansing
Liquor licenses	Control of public nuisances
Museums other than national museums	Control of undertakings that sell liquor to the public
Provincial planning	Facilities for the accommodation, care and burial of animals
Provincial cultural matters	Fencing and fences
Provincial recreation and amenities	Licensing of dogs
Provincial sport	Licensing and control of undertakings that sell food to the public
Provincial roads and traffic	Local amenities
Veterinary services, excluding regulation of the profession	Local sport facilities
	Markets
	Municipal abattoirs
	Municipal parks and recreation
	Municipal roads
	Noise pollution
	Pounds
	Public places
	Refuse removal, refuse dumps and solid waste disposal
	Street trading
	Street lighting
	Traffic and parking