4

Expenditure priorities

In brief

- Government spending is expected to total R5.9 trillion over the medium-term expenditure framework (MTEF) period, growing at an annual average of 7.8 per cent per year.
- Funding remains focused on ensuring access to health and education, supporting low-income households through social grants, and providing basic services such as water and electricity.
- The expenditure ceiling remains unchanged from the 2018 Budget. Of the R32.4 billion of expenditure reprioritised over the medium term, R15.9 billion goes towards faster-spending infrastructure programmes, clothing and textile incentives, and job creation under the Expanded Public Works Programme.
- The public-service wage bill constitutes the largest share of government expenditure by economic classification, crowding out other spending. The wage agreement reached in 2018 adds to these pressures.
- National and provincial government will work with municipalities to improve governance and confront weaknesses in financial management.

Introduction

Medium-term spending plans focus on reducing poverty and inequality, and boosting employment and growth

Government's three-year spending plans aim to reduce poverty and inequality, and to increase employment and inclusive growth. These priorities are set out in the National Development Plan (NDP) and the medium-term strategic framework, which guide resource allocation.

Healthcare, education, basic services and social grants continue to receive priority in allocations. Despite a constrained fiscal environment, these areas grow in real terms by 2-3 per cent per year. The wage bill remains the single largest driver of expenditure, but is projected to decline slightly as a share of total spending over the medium term.

Reprioritisation takes into account President's economic stimulus and recovery plan

The expenditure ceiling remains unchanged from the 2018 Budget. Reprioritisation takes into account the President's economic stimulus and recovery plan. To support job creation, funds are reprioritised to programmes designed to boost growth in township and rural economies, and to repair roads infrastructure. Also in line with the President's announcement, funds are allocated to fill critical vacancies in public health.

In line with PFMA, new framework will address governance and financial performance at national level

Over the medium-term expenditure framework (MTEF) period, government will intensify efforts to improve spending efficiency, increase capacity and improve governance. Over the next 12 months, the National Treasury will develop a framework to address governance and financial performance in national departments that are in distress, as prescribed by the Public Finance Management Act (1999) and the Constitution.

Expenditure priorities and pressures

Government projects total expenditure of R5.9 trillion over the 2019 MTEF period. Spending will grow by an average of 7.8 per cent a year, reaching R2.1 trillion in 2021/22. Despite moderate economic growth projections, spending growth will outpace inflation, with real non-interest expenditure growth expected to average 1.9 per cent over the period.

Table 4.1 Consolidated expenditure by function[1]

R billion	2017/18 Outcome	2018/19 Revised	2019/20	2020/21 Medium-term estimates	2021/22	Average annual growth 2018/19 – 2021/22
Learning and culture	**322.9**	**352.3**	**386.5**	**414.1**	**446.1**	**8.2%**
Basic education	231.1	247.4	264.3	283.1	307.0	7.5%
Post-school education and training	81.8	94.2	111.0	119.4	126.8	10.4%
Arts, culture, sport and recreation	9.9	10.7	11.2	11.6	12.3	4.8%
Health	**191.6**	**205.1**	**223.7**	**243.5**	**257.7**	**7.9%**
Peace and security	**194.7**	**203.6**	**213.1**	**227.0**	**242.0**	**5.9%**
Defence and state security	49.4	49.0	50.5	53.5	56.9	5.1%
Police services	93.8	99.1	105.4	112.5	119.9	6.6%
Law courts and prisons	43.2	45.7	48.8	51.8	55.2	6.5%
Home affairs	8.3	9.8	8.4	9.1	10.0	0.9%
Community development	**176.3**	**195.6**	**209.7**	**228.4**	**245.4**	**7.9%**
Economic development	**181.2**	**193.5**	**211.3**	**223.9**	**233.5**	**6.5%**
Industrialisation and exports	33.5	33.6	38.5	39.8	40.1	6.1%
Agriculture and rural development	26.0	29.4	30.7	32.4	34.1	5.1%
Job creation and labour affairs	19.9	22.2	24.3	25.3	26.9	6.7%
Economic regulation and infrastructure	87.5	92.5	100.6	108.3	114.6	7.4%
Innovation, science and technology	14.3	15.9	17.1	18.1	17.8	4.0%
General public services	**65.4**	**64.4**	**67.3**	**72.7**	**75.2**	**5.3%**
Executive and legislative organs	15.3	15.7	17.0	18.5	18.2	5.1%
Public administration and fiscal affairs	41.2	41.0	42.5	46.0	48.7	5.9%
External affairs	8.9	7.7	7.9	8.2	8.3	2.5%
Social development	**234.5**	**258.7**	**281.1**	**304.9**	**324.9**	**7.9%**
Social protection	178.0	192.6	207.2	223.0	238.6	7.4%
Social security funds	56.5	66.0	74.0	81.9	86.4	9.4%
Payments for financial assets	**20.3**	**15.1**	**6.1**	**6.7**	**7.1**	**–**
Allocated by function	**1 386.9**	**1 488.1**	**1 598.9**	**1 721.1**	**1 831.9**	**7.2%**
Debt-service costs	162.6	181.1	202.5	221.7	247.2	10.9%
Contingency reserve	–	–	7.0	8.0	12.0	–
Consolidated expenditure	**1 549.5**	**1 669.2**	**1 808.4**	**1 950.9**	**2 091.1**	**7.8%**

1. Consisting of national and provincial departments, social security funds and public entities
Source: National Treasury

Each year, government identifies programmes that are underperforming or underspending and reallocates this funding to where it is needed most. Total reprioritisation over the next three years amounts to R32.4 billion, of which R15.9 billion is allocated to faster-spending infrastructure programmes, clothing and textile incentives, and the Expanded Public Works Programme. In addition, changes to grant structures amounting to R14.7 billion will promote upgrading of informal settlements in partnership with communities. Housing subsidies amounting to R1 billion will be centralised to better support middle- and lower-income home buyers.

Total reprioritisation over MTEF period amounts to R32.4 billion

In the current year, R1.7 billion is added to infrastructure spending (including funding for school building programmes), and R3.4 billion is allocated to drought relief, mostly to upgrade water infrastructure.

In line with government's efforts to manage the wage bill, the 2018 Budget projected that compensation would grow broadly in line with inflation. The latest public-service wage agreement, however, increased wages above inflation, leaving a R30.2 billion shortfall over the period of the new agreement. These pressures need to be managed within departmental baselines. Chapter 3 and Annexure B provide detailed discussion of compensation trends and cost pressures. Baseline allocations to compensation amount to R1.8 trillion over the MTEF period.

Latest wage agreement left a R30.2 billion shortfall over three-year period

Focus on education, health, safety and social development

Over the next three years, the largest allocations are for learning and culture, social development, health, and community development. Together, these four function groups account for more than 60 per cent of government expenditure.

The fastest-growing area of spending is debt-service costs, reflecting the widening of the budget deficit and projected increases in debt. The next fastest-growing category is learning and culture, followed by health. High growth in learning and culture reflects the bursary scheme for poor and working-class students. General public services, which covers the administrative functions of government, is the slowest-growing function group; in real terms, it contracts over the period.

Owing to higher borrowing, debt service is the fastest-growing spending category

Figure 4.1 Average nominal growth in spending, 2019/20 – 2021/22

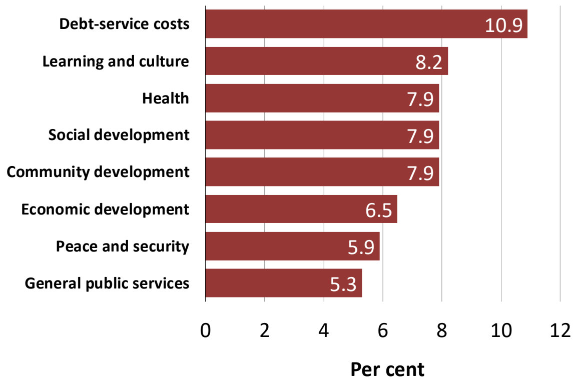
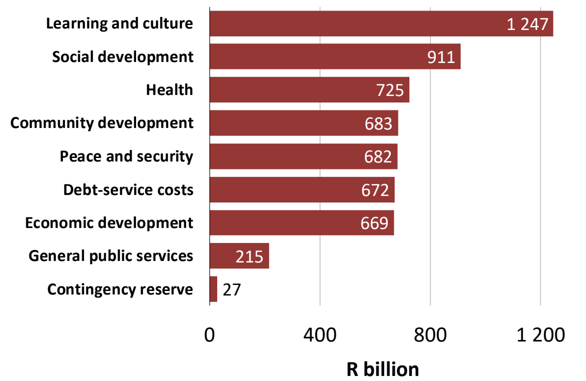


Figure 4.2 Consolidated government expenditure by function, 2019/20 – 2021/22



Source: National Treasury

The largest component of expenditure remains compensation, accounting for 34.7 per cent of the total. Transfers, about half of which go to households, makes up another third of expenditure. Transfers to households include items such as social grants and grants for land reform. As current payments and transfers have risen, they have reduced room for spending on capital goods.

Table 4.2 Consolidated expenditure by economic classification[1]

R billion	2017/18 Outcome	2018/19 Revised	2019/20	2020/21 Medium-term estimates	2021/22	Average annual growth 2018/19 – 2021/22
Current payments	**939.7**	**1 010.1**	**1 095.9**	**1 177.5**	**1 264.2**	**7.8%**
Compensation of employees	546.2	587.2	630.4	676.9	722.9	7.2%
Goods and services	223.5	234.2	254.5	268.9	283.6	6.6%
Interest and rent on land	170.0	188.8	211.0	231.7	257.8	10.9%
of which: debt-service costs	*162.6*	*181.1*	*202.5*	*221.7*	*247.2*	*10.9%*
Transfers and subsidies	**507.7**	**553.4**	**604.8**	**654.7**	**696.5**	**8.0%**
Provinces and municipalities	121.8	130.7	138.4	150.3	162.7	7.6%
Departmental agencies and accounts	29.9	27.2	28.1	31.8	33.2	6.8%
Higher education institutions	39.8	42.3	44.3	46.8	49.3	5.3%
Foreign governments and international organisations	2.1	2.3	2.7	2.6	2.5	2.3%
Public corporations and private enterprises	28.3	31.3	33.9	35.5	35.8	4.5%
Non-profit institutions	32.1	37.2	41.4	44.6	47.4	8.4%
Households	253.7	282.3	315.9	343.1	365.6	9.0%
Payments for capital assets	**81.7**	**90.6**	**94.7**	**104.0**	**111.4**	**7.1%**
Buildings and other capital assets	65.6	72.1	75.1	82.6	88.8	7.2%
Machinery and equipment	16.2	18.5	19.6	21.4	22.6	6.9%
Payments for financial assets	**20.3**	**15.1**	**6.1**	**6.7**	**7.1**	**–**
Total	**1 549.5**	**1 669.2**	**1 801.4**	**1 942.9**	**2 079.1**	**7.6%**
Contingency reserve	–	–	7.0	8.0	12.0	–
Consolidated expenditure	**1 549.5**	**1 669.2**	**1 808.4**	**1 950.9**	**2 091.1**	**7.8%**

1. Consisting of national and provincial departments, social security funds and public entities
Source: National Treasury

In-year spending adjustments

Parliament allocates funding to government annually through the Appropriation Act. In some cases, additional in-year allocations are made through the adjustments budget. For example, government could not announce detailed plans for drought relief in the 2018 Budget, but set aside funding for this purpose. Now that planning is complete, an additional R3.4 billion is allocated in 2018/19 to provide water, improve infrastructure and offset the economic costs of drought. Funding is also provided for the South African Isotope Facility at iThemba Labs and, following approval through the Budget Facility for Infrastructure, for the MyCiti Phase 2A bus programme in the City of Cape Town.

SAA and South African Post Office receive nearly R8 billion in additional funding

State-owned companies also receive additional allocations. South African Airways will receive R5 billion through a special appropriation bill to settle debt redeeming between now and March 2019. This will help to prevent a call on the airline's outstanding debt of R16.4 billion, which is guaranteed by government. In addition, R1.2 billion is allocated to South African Express Airways. The South African Post Office receives R2.9 billion to reduce debt levels. It is expected that new boards at state-owned companies will ensure higher standards of governance and more effective use of public money.

Other in-year allocations include:

- R800 million added to the *school infrastructure backlogs grant* to complete approved projects.
- R166 million added to the *national health insurance (NHI) indirect grant (health facility revitalisation)* component to procure medical equipment and to design a new academic hospital in Limpopo.
- R546 million reprioritised within the *NHI indirect grant* to address the critical shortage of medical professionals in the health sector, and to procure beds and linen for health facilities.

The revised national spending allocations are set out in the 2018 *Adjusted Estimates of National Expenditure*. Changes to conditional grants are included in the 2018 Division of Revenue Amendment Bill. Revised provincial appropriations will be tabled in provincial legislatures before the end of the current financial year.

Spending priorities by function group

Learning and culture

This function receives the largest share of spending over the MTEF period. Improving the quality of education, building scarce skills and transforming society through inclusive growth are key objectives of the NDP. Over the medium term, this function group will concentrate on early-grade reading and mathematics in basic education, and increasing graduation rates in post-secondary education and training.

Learning and culture priorities include eradicating pit latrines, focus on early grades and improving graduation rates

The most urgent priority is to eradicate pit latrines and make other improvements in school sanitation. In 2018/19, funding for sanitation projects will be reprioritised from existing school infrastructure budgets. Over the medium term, government, donors and private-sector companies will fund these projects and test new sanitation technology. For constructing and maintaining schools, including sanitation projects, R3.4 billion is allocated to the *education infrastructure grant*. Funds are also allocated to the same grant to continue repairing infrastructure damaged by storms and floods in KwaZulu-Natal in 2017.

The Department of Women has developed a framework to provide free sanitary towels to learners from low-income households. The project rollout is funded through the provincial equitable share.

The Minister of Higher Education and Training placed the National Student Financial Aid Scheme (NSFAS) under administration in August 2018. Backlogs in payments of student allowances and general administration are improving, and the 2019 application process is now proceeding smoothly despite a one-month delay. The actual costs of the new bursary programme for poor and working-class students, as well as the number of

NSFAS administration problems being resolved and application process on track first-time entrants, will only be known once the NSFAS closes out the 2018 academic year. The Department of Higher Education and Training is developing a funding framework to clarify students' food, book, transport and accommodation allowances, and the obligations required of bursary students during and after their studies.

Funds recommended through the Budget Facility for Infrastructure, and from educational institutions and the department, will support the Student Housing Infrastructure Programme. Over the next 10 years, it will provide 300 000 new beds at universities, and technical and vocational colleges.

R61.5 billion from skills levy for learnerships, internships and skills development

Over the medium term, an estimated R61.5 billion in revenue from the skills development levy will continue to expand participation in learnerships, internships and skills development programmes.

Community development

This function group finances access to water, sanitation, electricity and shelter for poor households. The local government equitable share, which finances free basic services to low-income households and some administrative costs for municipalities, is expected to grow by 9.4 per cent per year to R82.2 billion by 2021/22.

Partnering with communities to upgrade informal settlements

More than 3.1 million South Africans live in informal settlements, over half of which are in metropolitan municipalities. Over the medium term, informal-settlement upgrading will intensify.

On-site upgrading of settlements involves providing municipal services and security of tenure to households. This will encourage residents to improve their own dwellings. Public programmes and funding mechanisms will focus on allowing more flexible and differentiated improvements to settlements. Government will prioritise engagement with communities and their inclusion in upgrading, for example through helping to build and maintain infrastructure.

New conditions and ring-fenced funding for upgrading will be included in the *urban settlements development grant* for metropolitan areas and the *human settlements development grant* for provinces in 2019/20. Following the pilot phase, government intends to introduce separate metropolitan and provincial grants for informal settlement upgrading. With most electrification backlogs in metros in informal settlements, it is also proposed that allocations for the *integrated national electrification programme (municipal) grant* be incorporated into the new grant mechanism in these cities.

The finance-linked individual subsidy programme supports households whose income is too high to qualify for a government-provided house, but below the threshold to qualify for a home loan. Subsidies within the programme, administered through the National Housing Finance Corporation, will be increased, with funding shifted from the *human settlements development grant*. The *title deeds restoration grant* will be phased back into the *human settlements development grant* after 2021/22.

Support for integrated public transport networks in 13 cities

Over the medium term, public transport expenditure is expected to increase to R101.1 billion as integrated public transport networks are built and operated in 13 cities. This amount also supports rail infrastructure and provincial bus services. Small reductions are also proposed to the *human settlements development grant*, *urban settlements development grant* and *integrated national electrification programme (Eskom) grant* to fund other priorities.

Economic development

This function group aims to create jobs, and increase inclusive and sustainable economic growth. Over the medium term, it focuses on agriculture, land reform, incentives for investment in manufacturing, and research and development.

Government partnering with Land Bank to support land reform

Government is working with the Land Bank to accelerate land reform and maintain the productive use of transferred land. Under the Land Reform Programme, government will provide 30-year leases, enabling the Land Bank to extend loans to emerging farmers. Similarly, the Land Bank will use a combination of loans and grants to increase production through the Black Producers Commercialisation Programme. Funding from the *comprehensive agricultural support programme grant* will be reprioritised to produce foot-and-mouth disease vaccines.

Funds reprioritised to incentives for clothing and textile sector

The Clothing and Textile Competitiveness Programme has helped sector exports grow from R7.1 billion in 2008 to R25.1 billion in 2017. In the past nine years, 22 new leather factories have opened, creating 2 200 jobs. To augment this progress, funds will be reprioritised to the clothing and textiles production incentive from special economic zones.

Over the medium-term, funds are reprioritised to rehabilitate the national non-toll network, which is managed by the South African National Roads Agency Limited. In addition, a baseline allocation is proposed for the South African Post Office to subsidise its public-service mandate.

Peace and security

The security cluster's priorities are to fight crime and ensure territorial integrity.

The Department of Justice and Constitutional Development will reprioritise funds to Legal Aid South Africa to retain public defenders. The Integrated Justice System Modernisation Programme is intended to make South Africa safer by sharing electronic information across the justice system. Funds are reprioritised from the South African Police Service to the Department of Home Affairs to establish the Border Management Authority.

The duration of the Judicial Commission of Inquiry into Allegations of State Capture, which began its work in March 2018, has been extended to 24 months. Government will consider an allocation in the 2019 Budget to enable the commission to continue its work in 2019/20. The commission is central to efforts to eradicate corruption and improve governance.

Health

Government is strengthening community-based services to improve primary healthcare and extending health coverage to all South Africans.

An additional 2 200 critical medical posts to be created in provinces

To enhance the quality of care, the Office of Health Standards Compliance is auditing quality standards in health facilities. Over the MTEF period, an additional 2 200 critical medical posts will be created in provinces and medical student internships will expand. The Community Health Worker Programme will implement the minimum wage and funding is allocated to provinces from 2021/22 to support this. Funds are also provided to expand antiretroviral treatment in support of the universal test-and-treat policy.

Construction of a 488-bed academic hospital in Limpopo is expected to begin in 2019/20.

In preparation for national health insurance, the Department of Health and the National Treasury are working on a new payment mechanism, based on the number of patients served, for contracted general practitioners.

Health-sector budgets are generally under pressure due to an increased caseload and budget constraints. Unpaid bills and medico-legal claims pose significant risks. The Department of Heath will work with provinces to enhance the quality of the care they provide and improve their audit outcomes. The department will establish expert teams to assist provinces in mediation and litigation processes to manage medico-legal claims.

Health sector reforms

South Africa has improved health outcomes in recent years. Average life expectancy increased from 61.2 years in 2012 to 63.8 years in 2016, under-five mortality fell from 41 to 34 per 1 000 live births between 2012 and 2016, and the number of patients on antiretroviral medication increased from 2.6 million in 2013/14 to 4.2 million in 2017/18.

As the disease burden shifts from infectious to chronic diseases, government is responding with interventions such as the tax on sugary beverages and initiatives to strengthen maternal health. Nonetheless, there continue to be serious concerns about the public health sector, which is expected to meet the needs of 85 per cent of the population.

National health insurance is the policy that will drive future reform in the health sector. NHI will reshape the purchase and delivery of health services to increase the quality of care and improve equity. Although NHI pilots are being tested, problems continue to plague the public health sector, which needs to be overhauled as part of the NHI implementation.

The National Health Insurance Bill was tabled for public comment and will be resubmitted to Cabinet shortly. When enacted, it will establish the NHI Fund. To address critical staff shortages, part of the *NHI indirect grant (personal component)* will be reprioritised over the 2019 MTEF period. In-year, R350 million is reprioritised to procure specialists and critical healthcare workers, with additional amounts provided over the MTEF period.

Funding is allocated to provinces to absorb medical interns returning to South Africa after training in Cuba. In addition, funds are reprioritised to fight malaria within the *comprehensive HIV, AIDS, and TB grant.* Funds in the *indirect health facility revitalisation grant* component are reprioritised over the medium term.

Social development

Spending on social grants continues to grow as coverage increases

The social grants programme works to reduce poverty, focusing on children, the elderly and people with disabilities. The number of people covered by the various social grants grows by about 2 per cent a year.

The *early childhood development conditional grant* of R500 million per year will continue to subsidise these services for 60 000 children from low-income households and to improve early childhood development centres.

National Food Relief Programme to be provincial responsibility from 2020

Provincial departments have appointed 632 social work graduates through the *social worker employment grant* since 2017/18. This grant, along with the *substance abuse treatment grant*, will be incorporated into the provincial equitable share from 2019/20. Given the overlap with provincial functions, the National Food Relief Programme will be handed over to provinces from 1 April 2020. Provincial departments have increased their budgets for victim empowerment centres and community-based care services for children in line with additional funding allocated through the provincial equitable share in the 2018 Budget.

The South African Post Office and commercial banks now provide social grant payments. This is expected to generate savings as paypoints are consolidated and more recipients are paid through the National Payment System.

South African Post Office and commercial banks now provide social grant payments

General public services

This function group aims to build a professional state capable of transforming and developing South Africa and fulfilling its international mandate. Over the medium term, funding has been reprioritised to build capacity in the new Research and Policy Advisory Unit in the Presidency, with employees seconded from other national government departments. Funding is reprioritised to increase South Africa's contribution to the African Union, which is reforming to improve governance, institutional capability and its long-term financial viability.

Division of revenue

The proposed division of revenue prioritises large social spending programmes that support basic education, health and social welfare services in provinces and water, sanitation and electricity services in municipalities. Allocations over the period include changes to respond to the policy priorities discussed above and to rebuild municipal capacity.

Table 4.3 Division of revenue framework

	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
R billion		**Outcome**		**Revised**		**Medium-term estimates**	
Division of available funds							
National departments	**546.1**	**555.7**	**592.7**	**641.5**	**688.1**	**739.4**	**786.4**
Provinces	**471.4**	**500.4**	**538.6**	**572.2**	**613.0**	**658.6**	**704.0**
Equitable share	386.5	410.7	441.3	470.3	505.5	543.0	578.7
Conditional grants	84.9	89.7	97.2	101.9	107.4	115.6	125.3
Local government	**98.3**	**102.9**	**111.1**	**121.8**	**127.3**	**138.2**	**149.9**
Equitable share	49.4	50.7	55.6	62.7	69.0	75.7	82.2
General fuel levy sharing with metropolitan municipalities	10.7	11.2	11.8	12.5	13.2	14.0	15.2
Conditional grants	38.3	40.9	43.7	46.6	45.1	48.5	52.6
Total	**1 115.8**	**1 159.0**	**1 242.3**	**1 335.5**	**1 428.4**	**1 536.2**	**1 640.3**
Percentage shares							
National departments	48.9%	48.0%	47.7%	48.0%	48.2%	48.1%	47.9%
Provinces	42.2%	43.2%	43.3%	42.8%	42.9%	42.9%	42.9%
Local government	8.8%	8.9%	8.9%	9.1%	8.9%	9.0%	9.1%

Source: National Treasury

Over the medium term, government proposes to allocate 48.1 per cent of available non-interest expenditure to national departments, 42.9 per cent to provinces and 9 per cent to local governments. Over this period, national government resources grow by 7 per cent, provincial resources by 7.2 per cent and local government resources by 7.2 per cent.

Table 4.4 Changes to division of revenue[1]

R billion	2018/19 Revised	2019/20 Medium-term estimates	2020/21
Changes to baseline			
National allocations	**14.7**	**-0.6**	**0.1**
of which:			
Indirect grants to provinces [2]	*1.0*	*-0.2*	*0.1*
Indirect grants to local government	*1.0*	*-0.1*	*-0.1*
Provincial allocations	**1.2**	**1.2**	**1.1**
Equitable share	–	0.5	0.5
Conditional grants	1.2	0.7	0.6
Local government allocations	**1.5**	**0.4**	**0.8**
Total	**17.5**	**1.0**	**2.0**

1. Additions include the confirmation of provisional allocations in the 2018 Budget, announced but not previously included in baselines
2. Amounts may be shifted between direct and indirect grants to provinces and local government before the 2019 Budget is tabled
Source: National Treasury

Provincial allocations

New wage agreement puts pressure on provincial budgets, 60 per cent of which are spent on compensation

Transfers from the fiscus constitute over 95 per cent of provincial budgets. Provinces prioritise spending on social services such as health, basic education and social welfare. Over the MTEF period, R2 trillion will be transferred to provinces, R348.4 billion of which will be in the form of direct conditional grants. The new wage agreement will place particular pressure on provincial budgets in the period ahead, because over 60 per cent of these budgets are spent on wages.

The equitable share formula that guides nearly 80 per cent of allocations to provinces is reviewed regularly. One such review began in 2016. Changes are introduced in consultation with provincial treasuries. One of the first changes will update the population estimates guiding the formula, based on updated estimates of the school-aged population.

Table 4.5 Provincial equitable share

R million	2018/19	2019/20	2020/21	2021/22
Eastern Cape	65 500	68 816	72 750	76 299
Free State	26 178	28 184	30 340	32 414
Gauteng	93 384	102 447	111 645	120 709
KwaZulu-Natal	99 264	106 005	113 379	120 334
Limpopo	55 179	58 957	62 991	66 784
Mpumalanga	38 468	41 424	44 478	47 393
Northern Cape	12 475	13 423	14 390	15 310
North West	32 392	34 970	37 698	40 328
Western Cape	47 447	51 291	55 282	59 120
Total	**470 287**	**505 518**	**542 953**	**578 691**

Source: National Treasury

Equitable share enables provinces to expand social welfare and improve support for municipalities in distress

Funds are added to the provincial equitable share primarily to enable provinces to expand key social welfare programmes and improve their ability to support municipalities in financial distress. In addition, two social development grants are absorbed into the provincial equitable share as these programmes have been successfully rolled out in provinces.

Local government allocations

Local government to receive R146.3 billion in infrastructure conditional grants

Over the MTEF period, R415.5 billion will be transferred to local government, including R146.3 billion in infrastructure conditional grants. The largest transfer to municipalities is the local government equitable share, which grows by 9.9 per cent in 2019/20, 9.7 per cent in 2020/21 and 8.6 per cent in 2021/22. These above-inflation increases account for growth in household numbers, and higher bulk water and electricity costs.

Government will strengthen municipal capacity to improve the use of these allocations. Although the rules have been changed to allow municipalities to use grant funds to refurbish infrastructure, develop water conservation projects and maintain roads – if certain conditions are met – few municipalities have taken advantage of these provisions. The national departments that administer these grants are improving their capacity to support municipalities and to assess proposed projects.

In many areas of the country, municipal finances are under pressure. This is the result of the rising cost of delivering basic services and weak financial planning and controls, with poor management decisions leading to underinvestment in and insufficient maintenance of infrastructure. In some cases, corrupt practices have taken root in local administrations. Over the period ahead, national transfers to local government will continue to support the delivery of basic services, while incentivising improved performance and the turnaround of troubled municipalities.

Addressing the growing financial crisis in municipalities

Government is grappling with how best to respond to the growing number of municipalities in financial crisis.

In 2018/19, 113 municipalities adopted unfunded budgets, up from 83 in the prior year. In addition, municipalities owe more than R23 billion in arrears, including to Eskom and water boards. Although the primary responsibility to resolve these financial problems rests with municipalities themselves, the Constitution states that when a municipality is in financial crisis, the provincial government must intervene – and if the province is not able to, then national government must. However, few past interventions have succeeded in producing a sustained turnaround.

Government is therefore proposing the reallocation of resources to enable national and provincial treasuries to better manage interventions. This will strengthen the National Treasury's Municipal Financial Recovery Service, which prepares financial recovery plans for municipalities, and augment the capacity of provinces to implement these plans. These recovery plans set revenue and spending targets for the municipality, and identify specific revenue-raising measures.

The new grant that government had proposed to help municipalities facing financial crisis will no longer be introduced. The funds set aside for this will instead be reprioritised for other initiatives that will assist the turnaround of municipalities. Ultimately, sustainable financial recovery will require improved governance within the affected municipalities following the intervention. And better use of grants, together with improved maintenance, will also reduce pollution from wastewater treatment works, which has become a more pressing concern in a number of municipalities.

Government also provides extensive support to build municipal capacity, including over R2.5 billion per year allocated for this purpose in the budget. The growing number of distressed municipalities indicates the need to make better use of these resources. The current system will be reviewed during 2019.

Reforms to promote investment and growth

Using municipal borrowing to fund capital investment

Ample scope for creditworthy municipalities to increase borrowing for capital investment

Metropolitan areas and other large cities fund most of their operational budgets from revenues they raise themselves. There is ample scope for creditworthy municipalities with strong financial management to increase local capital investment by expanding municipal borrowing. In 2017/18, half of infrastructure spending by metros and large cities was still funded from transfers, primarily from national government.

Creditworthy municipalities have scope to expand long-term debt finance for infrastructure investment

In real terms, long-term municipal debt grew by only 9.2 per cent between 1996/97 and 2017/18. Municipal borrowing data (published in the quarterly Borrowing Bulletin available at www.treasury.gov.za) shows that municipalities are very cautious about long-term borrowing. Metros account for most of this borrowing, because they can access more credit due to their higher revenues. However, many intermediate cities and smaller municipalities with reasonably sound revenue bases are not taking advantage of long-term debt finance to invest in infrastructure.

Policy reforms to clarify the role of development finance institutions in municipal borrowing and to regulate municipal development charges are under way to broaden municipal access to private capital markets. Financing arrangements with development finance institutions and multilateral development institutions will include much needed technical assistance to improve project planning, preparation and implementation.

Municipal grant reforms to promote increased use of borrowing to fund infrastructure

Reforms to municipal grants will incentivise increased use of borrowing to fund infrastructure. A new *integrated urban development grant* will be introduced to allow intermediate cities to blend grant funds with revenues and loans they raise themselves. This new grant, alongside the *public transport network grant*, will include incentive components that promote good governance and increase investment of municipal revenues.

Making it easier to invest in South African cities

The World Bank published the second *Doing Business in South Africa* in September 2018. It compares the cost of doing business in South African cities with urban areas in China, India, Brazil, Rwanda and other countries.

Cities that have made conscious efforts to reform regulations have reduced costs of doing business

Some South African cities are making progress in reforming policies that affect businesses. But the pace of reforms has been slow. In the three years since the last study, Cape Town, eThekwini, Johannesburg, Mangaung and Nelson Mandela Bay implemented reforms. Four of the reforms improved the conditions for businesses to obtain electricity and one made it easier to transfer property. Where reforms were implemented, the results have been striking. Mangaung, for example, automated municipal processes that have halved the time needed to transfer property. As a result, Mangaung has shifted from worst to best performance in this area.

All cities have room to improve. South Africa scores below the average for BRICS (Brazil, Russia, India, China, South Africa) on three of the five measured indicators. Government will support cities to implement further reforms that support private-sector investment and can boost growth.

Conclusion

Medium-term spending plans aim to reduce poverty and inequality, and to increase job creation and inclusive growth. Reprioritisation takes account of the President’s economic stimulus and recovery plan. Healthcare, education, basic services and social grants continue to receive priority in allocations, growing in real terms by 2-3 per cent per year. The wage bill remains the single largest component of expenditure.