6

Division of revenue and spending by provinces and municipalities

In brief

- Of the funds available over the next three years after providing for debt-service costs and the contingency reserve, 47.5 per cent is allocated to national government, 43.4 per cent to provincial government and 9.1 per cent to local government.
- Transfers through the division of revenue redistribute resources from taxes raised mainly in areas of high economic activity to areas where public services are most needed.
- New conditional grants are being introduced to improve early childhood development, expand education for learners with intellectual disabilities and employ more social workers.
- Government is working to reduce costs and improve financial management in provinces and municipalities so that they can achieve more with the resources available to them.
- Metropolitan municipalities are working to change spatial development patterns that locate people far from jobs and economic opportunities.

Overview

More than half of the revenue raised by national government is transferred to the nine provinces and 257 municipalities to enable them to deliver on their mandated functions. The 2017 Budget strikes a balance between the need to make reductions to accommodate the lower expenditure ceiling, and the need to ensure real growth in transfers to provinces and municipalities so that they can provide services to growing populations. Provincial governments are responsible for providing basic education, health, roads and human settlements, along with services in social development and agriculture. Local governments provide basic services such as water, sanitation, electricity reticulation, as well as roads and community services.

In 2017, more than half of nationally raised revenue will be transferred to provinces and municipalities

Transfers made through the division of revenue redistribute resources from areas of high economic activity, where most of the country's taxes are raised, to areas where public services are most needed. The majority of government revenue raised at national level is allocated to provinces and municipalities based on the relative demand for services, rather than their ability to contribute revenue.

Provinces and municipalities plan and budget within a national policy and regulatory framework

Provincial and local governments are best placed to respond to community needs and priorities, and are responsible for drawing up their own plans and budgets. However, provinces and municipalities must adhere to national policies and regulations, including those covering financial management. The National Treasury monitors the financial management of provinces and municipalities, and provides capacity support and guidance to ensure budgets respond to spending priorities.

Containing costs – particularly compensation expenditure – is a challenge at all levels of government. Some important progress in cost reduction has been made in provincial and local government, as discussed below.

Division of revenue

Table 6.1 sets out the division of revenue over the medium-term expenditure framework (MTEF). Over the next three years, of the funds available after providing for debt-service costs and the contingency reserve, 47.5 per cent is allocated to national government, 43.4 per cent to provincial government and 9.1 per cent to local government.

Table 6.1 Division of nationally raised revenue

R billion	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	Average annual MTEF growth
		Outcome		Revised estimate		Medium-term estimates		
Division of available funds								
National departments	**453.4**	**490.0**	**546.1**	**557.5**	**590.2**	**631.4**	**681.6**	**6.9%**
of which:								
Indirect transfers to provinces	*2.7*	*5.8*	*3.5*	*3.7*	*4.3*	*1.8*	*1.9*	*-20.1%*
Indirect transfers to local government	*5.9*	*8.2*	*10.4*	*7.8*	*7.3*	*7.6*	*8.0*	*0.8%*
Provinces	**410.6**	**439.5**	**471.4**	**500.4**	**538.2**	**578.6**	**621.0**	**7.5%**
Equitable share	336.5	359.9	386.5	410.7	441.3	471.5	506.1	7.2%
Conditional grants	74.1	79.6	84.9	89.7	96.8	107.1	114.9	8.6%
Local government	**82.6**	**87.6**	**98.3**	**103.3**	**112.5**	**121.5**	**132.3**	**8.6%**
Equitable share	39.0	41.6	49.4	51.2	57.0	62.7	69.3	10.6%
Conditional grants	34.0	35.8	38.3	40.9	43.7	46.3	49.8	6.8%
General fuel levy sharing with metros	9.6	10.2	10.7	11.2	11.8	12.5	13.2	5.5%
Non-interest allocations	**946.6**	**1 017.1**	**1 115.8**	**1 161.1**	**1 240.9**	**1 331.5**	**1 434.9**	**7.3%**
Percentage increase	*7.9%*	*7.5%*	*9.7%*	*4.1%*	*6.9%*	*7.3%*	*7.8%*	
Debt-service costs	101.2	114.8	128.8	146.3	162.4	180.7	197.3	10.5%
Contingency reserve	–	–	–	–	6.0	10.0	20.0	
Main budget expenditure	**1 047.8**	**1 131.9**	**1 244.6**	**1 307.4**	**1 409.2**	**1 522.2**	**1 652.2**	**8.1%**
Percentage increase	*8.5%*	*8.0%*	*10.0%*	*5.0%*	*7.8%*	*8.0%*	*8.5%*	
Percentage shares								
National departments	*47.9%*	*48.2%*	*48.9%*	*48.0%*	*47.6%*	*47.4%*	*47.5%*	
Provinces	*43.4%*	*43.2%*	*42.2%*	*43.1%*	*43.4%*	*43.5%*	*43.3%*	
Local government	*8.7%*	*8.6%*	*8.8%*	*8.9%*	*9.1%*	*9.1%*	*9.2%*	

Source: National Treasury

The division of revenue in Table 6.1 includes R14.6 billion provisionally allocated in 2019/20, but which will only be assigned to specific programmes in the 2018 Budget, subject to approved proposals. Of this amount, R600 million has indicatively been allocated to provincial conditional grants and R1.8 billion to the local government equitable share. Transfers to provinces and local government are made through the equitable share and conditional grants. Equitable share allocations are determined by formulas that take into account demographic and developmental factors. Conditional grants are designed to achieve certain goals, and provinces and municipalities must meet specific criteria to receive grants and fulfil conditions when spending them.

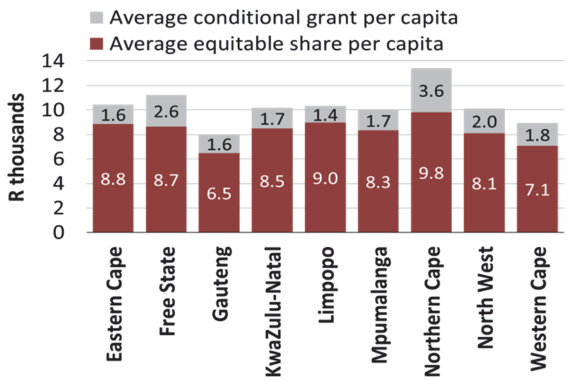
Redistribution through the division of revenue

Government redistributes substantial resources from urban areas to fund services in rural areas

The division of revenue redistributes substantial resources from the urban economy to fund services in rural areas. It also subsidises services to millions of poor households in towns and cities through considerable allocations to urban municipalities and provinces. Metropolitan municipalities account for 70 per cent of personal income tax revenue, but receive only 31 per cent of local government transfers. Similarly, the 61 mostly rural local municipalities also receive 31 per cent of transfers to local government, but account for only 5 per cent of personal income tax revenues.

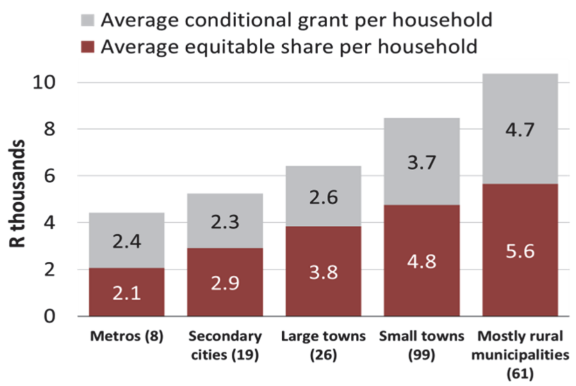
Allocations to provinces are based primarily on demand for services, established with data provided by Statistics South Africa (Stats SA). As Figure 6.1 shows, this results in higher per person allocations to more rural provinces, which tend to have high demand for public healthcare and schooling. Allocations in the provincial equitable share formula respond to high poverty rates and provide institutional support that benefits provinces with smaller populations. The allocation formulas are detailed in Annexure W1 to the *Budget Review*.

Figure 6.1 Per capita allocations to provinces, 2017/18



Source: National Treasury and Statistics South Africa

Figure 6.2 Per household allocations to municipalities,[1] 2017/18



[1]Reflects only funds allocated through division of revenue

More than 80 per cent of transfers to provinces are allocated through the equitable share. The National Treasury, in consultation with provincial treasuries, national departments, the Financial and Fiscal Commission and Stats SA, is reviewing the formula used to allocate each province’s share. At the technical level, updates will involve assessing the reliability of data and how frequently it can be updated. At the policy level, the review will consider issues such as the funding burden of poorer schools and the cost of service provision.

Per household transfers to rural municipalities are double the size of those to metros

Allocations to local government take into account the ability of municipalities to raise their own revenue to fund municipal services (through property rates and service charges). They also factor in the need to provide free basic services to poor residents and build infrastructure to extend services to those who do not have access. As a result, transfers per household to the most rural municipalities are more than twice as large as those to metropolitan municipalities (see Figure 6.2).

Past performance

Underspending has stabilised across national, provincial and local government. In 2015/16, national government expenditure amounted to R699.8 billion (excluding direct charges) out of a total adjusted appropriation of R706.4 billion. This represents underspending of 0.9 per cent. Provincial government underspent its adjusted budget of R493.8 billion for 2015/16 by R7.3 billion (1.5 per cent), compared with R6.1 billion (1.3 per cent) in the previous year. Municipalities spent R22.8 billion (89.1 per cent) of their infrastructure grants in 2015/16, down marginally from 90.4 per cent in 2014/15.

The Explanatory Memorandum to the Division of Revenue sets out the provincial and municipal allocations, details the equitable share formula, and explains how the division takes into account the recommendations of the Financial and Fiscal Commission. The memorandum is available as Annexure W1 of the *Budget Review* at www.treasury.gov.za.

Provincial revenue and spending

Allocations to provinces grow at annual average of 7.5 per cent over medium term

Allocations to provinces total R1.7 trillion over the MTEF period, growing at an average annual rate of 7.5 per cent. This is slightly higher than the annual average growth rate of 7.3 per cent in the previous MTEF period as a result of additions to enable provinces to continue to provide public health and schooling in line with population growth. To support improvements in health and education, R3 billion will be added to the equitable share in 2018/19 and R4.3 billion in 2019/20. The provincial equitable share grows at an annual average rate of 7.2 per cent over the medium term.

Table 6.2 Provincial equitable share

R million	2016/17	2017/18	2018/19	2019/20	Average annual MTEF growth
		Medium-term estimates			
Eastern Cape	58 060	61 848	66 167	70 961	6.9%
Free State	22 995	24 522	26 285	28 165	7.0%
Gauteng	79 600	86 643	93 030	100 227	8.0%
KwaZulu-Natal	87 898	93 757	99 741	106 841	6.7%
Limpopo	48 709	51 960	55 386	59 371	6.8%
Mpumalanga	33 450	36 082	38 489	41 214	7.2%
Northern Cape	10 863	11 720	12 501	13 418	7.3%
North West	28 062	30 330	32 473	34 857	7.5%
Western Cape	41 062	44 470	47 452	51 049	7.5%
Total	**410 699**	**441 331**	**471 522**	**506 104**	7.2%

Source: National Treasury

New early childhood development grant to expand access and improve facilities

Conditional grants overseen by national departments are used to fund specific programmes and account for 18.3 per cent of provincial transfers over the medium term. Changes to provincial conditional grants include:

- A new *early childhood development grant* to expand access and improve facilities for young learners. The grant is allocated a total of R1.3 billion over the MTEF period.
- A new grant in 2017/18 to fund the education of learners with intellectual disabilities.
- A new grant in 2017/18 to expand social development services by employing additional social workers.
- Pushing back the scheduled consolidation of the indirect *school infrastructure backlogs grant* (through which the Department of Basic Education delivers projects on behalf of provinces) into the direct *education infrastructure grant* from 2017/18 to 2018/19 to allow projects currently under way to be completed.
- Adding R390 million to the *national school nutrition programme grant* over the MTEF period to compensate for rising food costs and maintain the provision of daily meals to more than 9 million schoolchildren.
- Reprioritising R660 million over the MTEF period from the *human settlements development grant* to the Social Housing Regulatory Authority to speed up the provision of affordable rental housing units.

Provinces have improved infrastructure planning in response to the incentives embedded in health and education infrastructure grants. Now these incentives are being refocused to promote improved delivery.

Table 6.3 Conditional grants to provinces

R million	2016/17	2017/18	2018/19	2019/20	MTEF total
Direct conditional grants[1]					
Comprehensive agricultural support programme	1 642	1 646	1 751	1 876	5 273
Ilima/Letsema projects	491	522	552	583	1 658
Community library services	1 357	1 420	1 499	1 580	4 499
Education infrastructure	9 933	10 046	13 390	14 141	37 576
Maths, science and technology	362	365	386	408	1 160
National school nutrition programme	6 060	6 426	6 802	7 186	20 414
Comprehensive HIV/AIDS and TB	15 291	17 558	19 922	22 039	59 519
Health facility revitalisation	5 273	5 654	5 916	6 247	17 817
Health professions training and development	2 477	2 632	2 784	2 940	8 357
National tertiary services	10 847	11 676	12 395	13 178	37 248
Human settlements development	18 284	19 969	21 115	22 338	63 423
Mass participation and sport development	556	586	618	653	1 857
Provincial roads maintenance	10 478	10 754	11 536	12 182	34 471
Public transport operations	5 400	5 723	5 990	6 326	18 039
Other direct grants	1 242	1 852	2 436	2 614	6 902
Total direct conditional grants	**89 692**	**96 829**	**107 092**	**114 292**	**318 213**
Indirect transfers	**3 654**	**4 258**	**1 765**	**1 864**	**7 886**
School infrastructure backlogs	2 181	2 595	–	–	2 595
Comprehensive agricultural support programme indirect	212	–	–	–	–
National health insurance indirect	1 261	1 663	1 765	1 864	5 292

1. Excludes provisional allocations
Source: National Treasury

Reductions to several allocations are concentrated in capital rather than operational funds

To support fiscal consolidation and reprioritisation, several allocations have been reduced over the MTEF period, including R4 billion from the previous baselines of various provincial conditional grants and a R1.6 billion reduction to the provincial equitable share. These reductions mostly affect capital rather than operational funds. In total, conditional grants grow by an annual average of 8.6 per cent over the medium term.

Managing spending pressures in provinces

Spending on non-essential goods and services has fallen, but compliance with cost-containment measures varies across provinces

Provinces have made progress in implementing the cost-containment measures announced in 2013. Spending on non-essential goods and services fell in real terms by 7.1 per cent in 2014/15, 6.1 per cent in 2015/16 and is anticipated to decline by 4.5 per cent annually over the medium term. The savings realised from reduced spending on non-core items are redirected to frontline service delivery. However, the level of compliance with cost-containment measures varies across provinces and sectors, and requires continuous monitoring and enforcement.

Provinces continue to make progress in containing personnel headcounts, which have declined by 2.8 per cent since the beginning of 2016/17. This reduction was largely in non-frontline personnel. The education headcount increased by 0.6 per cent and health personnel declined by 0.6 per cent over this period. As a result, the proportion of provincial spending on personnel has declined slightly, from 60.4 per cent in 2015/16 to 59.8 per cent in 2016/17. Over the medium term, the headcount is expected to grow by about 1 per cent as more teachers and healthcare professionals are hired.

Aggregate provincial compensation budgets are projected to grow at about one percentage point above inflation over the MTEF. A wage agreement that fails to take account of fiscal constraints would undercut progress in containing wage costs and freeing funds for other areas of service delivery.

Underperforming programmes and entities

Reviews of public entities focus on sustainability, good governance and cost efficiency

In 2016/17, provinces began reviewing their public entities, focusing on sustainability, governance and on resolving overlapping mandates with departments. Most reviews are expected to be concluded by the end of 2016/17. Six provinces have started to either merge or incorporate some entities into provincial departments. The planned merger of gambling and liquor boards in several provinces, resulting in one board and one senior management team rather than two, is expected to result in annual savings of about R3 million per merger.

The National Treasury has also helped provinces complete a review of their development finance institutions and is consulting on the recommendations within government. The proposals flowing from these reviews are expected to cut administration costs, reduce reliance on transfers, and improve governance and cost effectiveness.

Improving revenue collection

Provinces working to improve own revenue collection

Provinces raised about 3.5 per cent of their own revenue in 2016/17 – mainly from motor vehicle and gambling licenses, and other service fees. Provinces are implementing integrated support programmes to improve revenue collection. As a result, they are projected to collect R18.4 billion in own revenue compared with a budgeted R16 billion for 2016/17. Successful initiatives include:

- Moving motor vehicle license renewals from municipalities to the South African Post Office and/or provincial departments
- Ensuring that weigh bridges are fully functional
- Curbing illegal gambling by appointing inspectors
- Using positive bank balances invested at the Corporation for Public Deposits to generate interest
- Improving patient billing systems
- Improving the billing system for properties rented out by provincial public works departments.

Strengthening financial management

Financial management and reporting in provinces continues to improve. The number of qualified audits for provincial departments fell from 31 in 2010/11 to 20 in 2015/16. The number of adverse or disclaimer opinions dropped from four to two over the same period.

Financial management has improved, but Auditor-General highlights serious concerns

The Auditor-General's reports do, however, continue to identify significant problems with accruals, unauthorised and irregular expenditure. The Auditor-General has called for stronger leadership within provincial financial management to remedy these issues. Better cash management is needed to ensure suppliers are paid on time, improved oversight can curb unauthorised expenditure and adherence to procurement rules can limit irregular expenditure. The National Treasury supports several training initiatives to help provincial financial managers lead this work.

Municipal revenue and spending

Municipal revenue collection and tariff setting need to be well planned

Municipalities need to balance their plans to extend and improve services with available resources. Unlike provinces, municipalities can raise substantial own revenues through property rates and service charges. Where revenue collection is not well planned or managed, or where tariffs are not properly set, serious financial problems can arise. Eskom's recent move to cut off power supply to municipalities that have not paid electricity bills is an indication of what can happen when municipalities fail to manage this risk.

The intergovernmental fiscal system is designed to take into account the varying abilities of urban and rural municipalities to raise their own revenue. Free basic services for poor households are funded through the local government equitable share. Over the 2017 MTEF period, the formula for allocating these funds will be updated with data from the 2016 Community Survey to ensure that the correct number of households in each municipality is funded. The formula is also updated annually with cost data on bulk water and electricity price increases.

Local government equitable share grows at over 10.6 per cent per year

The 2016 Community Survey confirmed that the number of households continues to grow significantly faster than the population, reflecting a trend towards smaller average household sizes. To help municipalities provide services to these households, the local government equitable share grows at an average annual rate of 10.6 per cent over the MTEF period.

Table 6.4 Transfers to local government

R million	2016/17	2017/18	2018/19	2019/20	MTEF total
Equitable share and related[1]	**51 169**	**57 012**	**62 732**	**67 473**	**187 217**
General fuel levy sharing with metros	**11 224**	**11 785**	**12 469**	**13 167**	**37 420**
Direct conditional grants	**40 863**	**43 727**	**46 270**	**49 836**	**139 833**
Municipal infrastructure	14 914	15 891	16 788	17 734	50 413
Water services infrastructure	2 845	3 329	3 559	3 757	10 646
Urban settlements development	10 839	11 382	11 956	12 631	35 969
Integrated national	1 946	2 087	2 204	3 328	7 619
Public transport network	5 593	6 160	6 583	6 962	19 704
Neighbourhood development partnership	624	663	702	741	2 106
Local government financial management	465	502	531	561	1 594
Regional bulk infrastructure	1 850	1 865	2 060	2 175	6 100
Municipal demarcation transition	297	112	–	–	112
Other direct grants	1 488	1 735	1 886	1 947	5 569
Total direct transfers	**103 255**	**112 524**	**121 470**	**130 477**	**364 471**
Indirect transfers	**7 824**	**7 338**	**7 596**	**8 015**	**22 948**
Integrated national electrification	3 526	3 846	3 962	4 182	11 991
Neighbourhood development partnership	22	28	29	31	88
Regional bulk infrastructure	3 479	2 774	2 881	3 037	8 692
Water services infrastructure	362	587	608	642	1 838
Municipal systems improvement	84	103	115	122	340
Bucket eradication programme	350	–	–	–	–

1. Excludes provisional allocations
Source: National Treasury

District municipalities play a coordination and support function for local municipalities in their area. They also provide several services directly. In 2006, the Regional Services Council and Joint Service Board levies were abolished, removing a major revenue source for district municipalities. Since then, districts have been receiving the *Regional Services Council/Joint Service Board levies replacement grant* to compensate them for funds they would have collected under the previous system.

New funding model for district municipalities to be introduced following review

Government intends to introduce a new funding model for district municipalities once the Department of Cooperative Governance has completed its review of their functional role. In the meantime, some adjustments will be made to the way the annual increases in the *Regional Services Council/Joint Service Board levies replacement grant* are determined. The growth rate of allocations to the wealthiest district municipalities will be reduced so that districts with the smallest allocations (which tend to be in very poor areas) will receive increased funding.

Conditional grants fund the expansion of municipal infrastructure to serve poor households. A review of this grant system has already resulted in several changes. These include allowing grant funds to be used to refurbish ageing infrastructure. Other rules for the appropriate use of these refurbishment funds will be introduced in 2017/18. Several conditional grants have been merged in previous years and the consolidation trend is expected to continue. The National Treasury will work with the Department of Energy and Department of Human Settlements to implement the parliamentary recommendation to consolidate electrification funding for metropolitan municipalities into the *urban settlements development grant*.

To account for the lower expenditure ceiling and make resources available for urgent priorities, four large infrastructure conditional grants are being reduced over the medium term. Despite the reductions, however, the grants continue to grow by at least 5 per cent annually over the medium term.

Managing spending pressures in municipalities

Cities taking steps to reduce spending on consultants, travel, catering, events, advertising and conferences

Municipalities are taking steps to reduce expenditure on consultants, travel and subsistence, credit cards, catering, events, advertising and conferences. For example, Ekurhuleni has budgeted to reduce advertising costs by 21 per cent, consulting fees by 17 per cent and printing and stationery costs by 8 per cent in 2016/17. Municipalities are also implementing innovative measures to ensure better financial control across business units, addressing a major source of waste and inefficiency. For example eThekwini has introduced a contract register database that provides for electronic capture, approval and independent verification of contract data. This will strengthen contract monitoring and payment.

Strengthening financial management

From 1 July, municipalities will have to capture all financial transactions in new classification framework

Municipalities benefit from several initiatives to improve financial management. These include the third phase of the National Treasury's Municipal Finance Improvement Programme, which deploys skilled personnel to assist municipalities and provincial treasuries. Each provincial treasury has also drafted a strategy to respond to the challenges facing their municipalities. The National Treasury and provincial treasuries have agreed to focus their efforts on four "game changers":

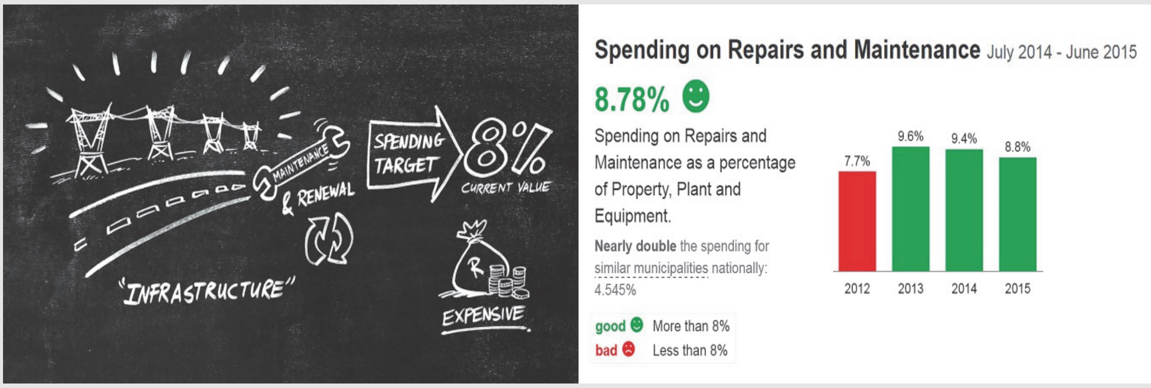
- The new Municipal Standard Chart of Accounts will improve the quality of financial information and make data from different municipalities easily comparable. From 1 July 2017 municipalities will have to capture all financial transactions in the new classification framework. For the first time, every municipality will record the same items in the same way. Each transaction will reflect what project or service it is part of, the region in which it was spent and the funding source. This information will enable better financial management and improved legislative oversight.
- Improved supply chain management can reduce irregular expenditure and procurement reforms can generate significant savings. For example, municipalities will benefit from the Office of the Chief Procurement Officer's efforts to centrally negotiate contracts for items such as software licenses and services, with potential cost savings of up to 60 per cent. Procurement reforms are discussed in Chapter 5.
- Revenue management is vital for municipal finances. In a growing number of municipalities, payments due to creditors exceed the revenue collected. Municipalities need to set tariffs at the right level to recover their costs, and ensure the correct amounts are billed and collected. The National Treasury is leading a working group to design a national revenue management framework for municipalities and working with Eskom, the National Energy Regulator of South Africa, the South African National Energy Development Institute and the

Department of Energy to develop guidelines on electricity tariff setting and demand management.

- Improved asset management is essential for continuous delivery of services and to generate associated revenue. Municipalities must adhere to financial norms and ratios that require them to spend at least 8 per cent of the value of their assets on maintenance. Government is working with municipalities on integrated infrastructure and asset management systems. Evidence of improved performance can be seen in 2016/17 municipal budgets, which anticipate a reduction in electricity losses of 7 per cent and water losses of 22 per cent.

Enhancing transparency to improve financial management in municipalities

The National Treasury publishes a wealth of municipal data, but the presentation of this material is complex. In October 2016, government launched the Municipal Money website (municipalmoney.gov.za). It provides budget information for every municipality, with easy-to-follow analysis of the information, as well as links to educational resources. It is formatted for access from a cellphone, so residents can find information anywhere, any time. This will empower users to interpret the information, use their findings to make decisions, and exercise accountability by directing questions to municipal managers and mayors.



Examples of educational resources and budget data available from municipalmoney.gov.za

Laying the foundations for more inclusive urban growth

Government is working with the private sector to improve the productivity of South Africa's largest urban areas, as part of a strategy to promote more rapid and inclusive economic growth.

Spending in targeted areas sends useful investment signals to private firms

Apartheid spatial development patterns that locate people far from economic and other opportunities remain a structural constraint to growth. The performance of public transport systems shows why changing South Africa's urban form is vital for more productive, inclusive and sustainable cities. More than 60 per cent of the lowest income-earners spend over 20 per cent, and in many cases as much as 40 per cent, of household income on public transport. The costs of operating transport systems create a large and growing financial burden for cities. Moreover, South Africans have some of the world's longest-distance commutes. Transport providers have to contend with low urban densities, high early morning and late evening one-way demand peaks (requiring vehicles to return empty), and poor seat turnover. This ultimately means low rates of cost recovery.

Following the recommendations of the National Development Plan, metropolitan municipalities now produce annual built environment performance plans that specify strategies and programmes to encourage development along corridors connecting towns and townships. The current phase of reforms focuses on using these plans to coordinate expenditure, including national grants. By focusing public spending in targeted areas, cities can begin to change their spatial form, and provide signals to private investors on the availability of bulk services and future development corridors. National, provincial and local government are also working to prepare a portfolio of catalytic, integrated development projects on strategically located urban land, including in selected township hubs.

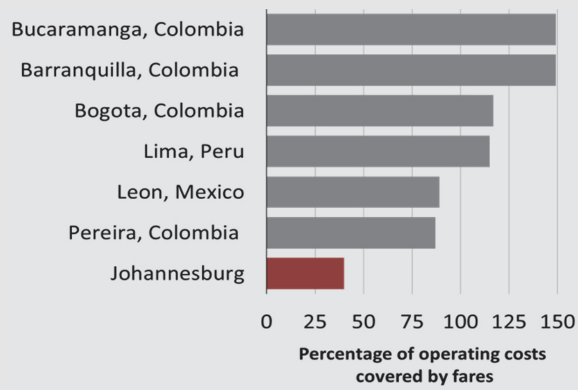
The National Treasury, in collaboration with cities, has developed the City Infrastructure Delivery and Management System to improve long-term infrastructure planning and asset management. The system will start operating in three metros in 2017/18, and will be phased in for other cities, guided by their readiness and demand for substantive reform. Government is also exploring how to better use the grant system to provide cities with incentives to improve infrastructure delivery.

Cheap, reliable and safe public transport is central to urban reform

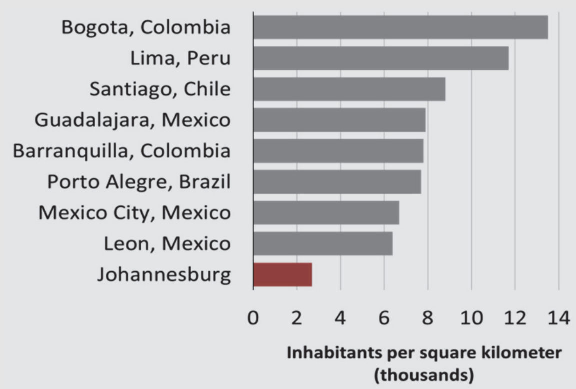
Making city public transport systems affordable for riders and ratepayers

The bus rapid transit systems now running in four South African cities are intended to provide efficient and convenient public transport links. Similar systems in other countries are able to operate with greater efficiency owing to higher densification and ridership, shorter distances and more mixed-use neighbourhoods that produce greater passenger turnover. By way of comparison, the figures below contrast Johannesburg with several Latin American metros that operate bus rapid transit systems.

Operating costs covered by fares, 2016



Urban density



Source: World Bank, National Treasury and Statistics South Africa

Because public transport in South Africa is characterised by long commutes and low off-peak demand, the first phases of bus rapid transit systems are operating at deficits that are significantly higher than anticipated. To ensure these losses do not break municipal budgets, cities are working with the Department of Transport and National Treasury to maximise efficiency. Bus routes constitute more than half of the cost of operations. Several interventions are intended to promote greater efficiency, including:

- Adjusting services to match the number of passengers on different routes at various times of day.
- Encouraging commuters to travel during off-peak times through incentives and penalties.
- Using minibus taxis to provide services in areas where formal bus services are not viable.
- Maximising revenue sources such as advertising, and identifying potential areas of cost reduction.

These measures are creating significant efficiencies, improving revenues and reducing costs. One city has increased cost coverage from revenue from 30 per cent to more than 40 per cent. Over the long term, the costs of urban public transport will depend on the success of urban spatial reform.

The residential housing sector, particularly public housing, can promote faster, more inclusive urban economic growth. The current review of the human settlements white paper focuses on these matters. It seeks to rebalance public housing programmes with initiatives that combine public subsidies, household contributions and private investment in well located developments that promote integrated communities. It also seeks to scale up programmes to support on-site upgrading of informal settlements.

To promote the ease of doing business, several metros are working to improve their construction permit, electricity provision and property registration services. Government, through the Cities Support Programme, is supporting these efforts.

Strengthening partnerships with the private sector to promote municipal borrowing

Rapid urbanisation, population growth and ageing facilities put municipalities under pressure to build new infrastructure. Municipal borrowing programmes, which are supported in government policy and legislation, can finance such investment. However, municipalities need to borrow responsibly, on the strength of their own balance sheets, without any guarantee or prospect of a bailout from national or provincial government.

The total amount of municipal debt remained stagnant at about R20 billion for the decade before the introduction of the Municipal Finance Management Act (2003) created the policy certainty needed for new lending. Since then, the value of outstanding debt has increased to R62.3 billion. Of this amount, 87 per cent is accounted for by metropolitan municipalities, 12 per cent by local municipalities and 1 percent by district municipalities. New borrowing as a proportion of capital spending, however, has been declining since 2010.

There is scope for municipalities to borrow more to invest in infrastructure that can generate revenues, which can in turn help pay off the loans. Borrowing is not presently an option for poorer rural municipalities, but municipalities with strong own revenue bases should be borrowing to invest in infrastructure.

The municipal debt market is dominated by the Development Bank of Southern Africa and commercial banks that prefer to offer loans with maturities of five to 10 years. Ideally, municipalities should be able to borrow for maturities that match the much longer life span of the roads, water and electricity systems in which they invest. Developing a municipal debt market that institutional investors can invest in over the long-term was one of the key agreements reached at the 2015 Urban Investment Partnership Conference, which included government, financial institutions and metropolitan municipalities. A working group that includes public and private-sector participants has been established to explore developing the market for financing municipal infrastructure.

As part of sharing municipal borrowing information with its stakeholders and the public, the National Treasury has started publishing a quarterly Municipal Borrowing Bulletin that is available at www.treasury.gov.za.

Summary

Division of revenue is highly redistributive, but impact depends on efficient budget choices and execution

The division of revenue system is highly effective at redistributing resources from a largely urban tax base to programmes that benefit poor households in both rural and urban areas. The impact of these allocations depends, however, on the choices made by provinces and municipalities in allocating and executing their own budgets. Government continues to strengthen financial oversight and capacity support to help improve performance.