6

Division of revenue and spending by provinces and municipalities

In brief

- Over the next three years, after providing for debt-service costs and the contingency reserve, 48 per cent of nationally raised funds are allocated to national government, 43 per cent to provincial government and 9 per cent to local government.
- Planned spending for 2018/19 has been affected by reprioritisation and reductions undertaken since the 2017 *Medium Term Budget Policy Statement* (MTBPS). Transfers to provinces are reduced by R5.2 billion, and to local government by R3.2 billion. Reductions focus on infrastructure conditional grants.
- Provinces will intensify efforts to contain costs in the face of rising pressures, particularly in public health.
- Municipalities continue to grapple with weaknesses in financial management, with a significant number still not adopting funded budgets. National government will introduce new mechanisms to assist the turnaround of troubled municipalities over the medium term.
- Government is working with municipalities to secure investment that can help reshape South Africa's cities and accelerate economic growth. Reforms to facilitate municipal borrowing are under consideration.

Overview

In the context of a significant erosion of government's fiscal position, and large new spending commitments, the 2018 Budget makes reductions to previously announced transfers to provinces and municipalities. The extent of the adjustment will delay delivery of some planned infrastructure, and requires departments responsible for frontline services to ensure exceptional care in allocating public funds to maintain core services.

2018 Budget proposes significant reductions to provincial and municipal transfers

Over the medium-term expenditure framework (MTEF) period ahead, more than half of the revenue raised by national government will be transferred to provinces and municipalities. Provincial governments are responsible for providing basic education and health services, roads and housing, along with services in social development and agriculture. Local governments provide basic services such as water, sanitation, electricity reticulation and refuse collection, as well as roads and community

services. Investments in these services and infrastructure underpin South Africa's long-term growth potential.

Investment partnerships can help reshape South Africa's urban form

Provinces and municipalities also invest in infrastructure that can boost economic growth. Over the period ahead, large municipalities are expected to invest more of their own resources, offsetting some of the impact of reductions to infrastructure grants, while building partnerships with the private sector. Government will also review the efficiency and sustainability of its housing and public transport policies.

Division of revenue is strongly redistributive, but spending efficiency on frontline services needs to be improved

The division of revenue is strongly redistributive, shifting resources from taxes raised mainly in wealthier areas to services benefiting poor South Africans in every province and municipality. However, the efficacy of spending in many provincial departments and municipalities responsible for frontline services falls well below the required standard. Several initiatives are under way to build capacity in these areas. Over the next several years, government will implement new mechanisms to support the turnaround of the most troubled municipal institutions.

Division of revenue

Over the MTEF period ahead, after providing for debt-service costs and the contingency reserve, 48 per cent of nationally raised funds are allocated to national government, 43 per cent to provincial government and 9 per cent to local government.

Planned spending for 2018/19 has been affected by reprioritisation and reductions undertaken since the 2017 MTBPS. Transfers to provinces are reduced by R5.2 billion, and transfers to local government are reduced by R3.2 billion. Reductions focus on infrastructure conditional grants. Chapter 5 gives a more detailed breakdown of the figures summarised in Table 6.1.

Table 6.1 Baseline reductions by sphere of government, before funding fee-free higher education and training

R million	2018/19	2019/20	2020/21	MTEF total	% of baseline
National government	-18 048	-17 221	-18 177	**-53 446**	-2.1%
Provincial government	-5 182	-6 387	-6 797	**-18 366**	-1.0%
Local government	-3 152	-5 212	-5 499	**-13 863**	-3.5%
Total baseline reductions	**-26 382**	**-28 820**	**-30 473**	**-85 676**	**-1.8%**

Source: National Treasury

Over the three-year spending period, provincial direct and indirect allocations will absorb 26 per cent of the reductions, while local government direct and indirect transfers absorb 18.8 per cent. Reductions were not applied to personnel costs. As a result, the impact of spending cuts falls mostly on capital programmes. The share of the reductions borne by provinces is somewhat lower than their share of the division of revenue, because the majority of provincial budgets are spent on wages. In contrast, local government's share of the reductions is higher than their share of the division of revenue, given the large number of infrastructure grants to municipalities.

Reductions are a relatively small share of total allocations

These reductions will affect the implementation of programmes and projects, particularly for infrastructure. However, the cuts are relatively

small as a percentage of the total allocations. The average reductions over the medium term are equivalent to 1 per cent of provincial allocations and 3.5 per cent of local government allocations.

Table 6.2 Division of nationally raised revenue

R billion	2014/15	2015/16 Outcome	2016/17	2017/18 Revised estimate	2018/19	2019/20 Medium-term estimates	2020/21	Average annual MTEF growth
Division of available funds								
National departments	**490.0**	**546.1**	**555.7**	**599.9**	**628.6**	**685.9**	**736.6**	**7.1%**
of which:								
Indirect transfers to provinces	*5.4*	*3.5*	*3.6*	*3.8*	*3.8*	*4.4*	*4.7*	*7.6%*
Indirect transfers to local government	*8.1*	*10.4*	*8.1*	*7.8*	*6.9*	*7.3*	*7.7*	*-0.6%*
Provinces	**439.5**	**471.4**	**500.4**	**538.2**	**571.0**	**611.8**	**657.5**	**6.9%**
Equitable share	359.9	386.5	410.7	441.3	470.3	505.0	542.4	7.1%
Conditional grants	79.6	84.9	89.7	96.8	100.7	106.7	115.0	5.9%
Local government	**87.6**	**98.3**	**102.9**	**110.7**	**118.5**	**126.9**	**137.5**	**7.5%**
Equitable share	41.6	49.4	50.7	55.3	62.7	69.0	75.7	11.0%
Conditional grants	35.8	38.3	40.9	43.6	43.3	44.8	47.8	3.1%
General fuel levy sharing with metros	10.2	10.7	11.2	11.8	12.5	13.2	14.0	6.0%
Provisional allocation not assigned to votes	–	–	–	–	6.0	2.3	2.1	
Non-interest allocations	**1 017.1**	**1 115.8**	**1 159.0**	**1 248.8**	**1 324.1**	**1 426.9**	**1 533.6**	**7.1%**
Percentage increase	*7.5%*	*9.7%*	*3.9%*	*7.7%*	*6.0%*	*7.8%*	*7.5%*	
Debt-service costs	114.8	128.8	146.5	163.2	180.1	197.7	213.9	9.4%
Contingency reserve	–	–	–	–	8.0	8.0	10.0	
Main budget expenditure	**1 131.9**	**1 244.6**	**1 305.5**	**1 411.9**	**1 512.2**	**1 632.6**	**1 757.5**	**7.6%**
Percentage increase	*8.0%*	*10.0%*	*4.9%*	*8.2%*	*7.1%*	*8.0%*	*7.6%*	
Percentage shares								
National departments	*48.2%*	*48.9%*	*48.0%*	*48.0%*	*47.7%*	*48.1%*	*48.1%*	
Provinces	*43.2%*	*42.2%*	*43.2%*	*43.1%*	*43.3%*	*42.9%*	*42.9%*	
Local government	*8.6%*	*8.8%*	*8.9%*	*8.9%*	*9.0%*	*8.9%*	*9.0%*	

Source: National Treasury

Past performance

Underspending has stabilised across national and provincial government

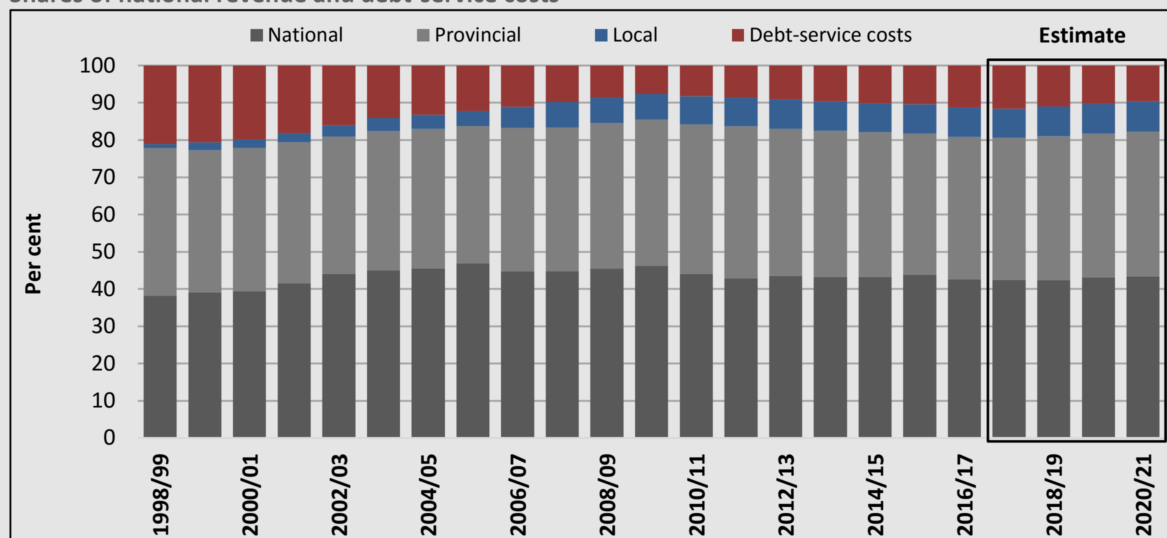
Underspending has stabilised across national and provincial government. In 2016/17, national government expenditure amounted to R716.8 billion (excluding direct charges) out of a total adjusted appropriation of R723.1 billion. This represents underspending of 0.9 per cent. Provincial government underspent its adjusted budget of R525 billion for 2016/17 by R4.7 billion (0.9 per cent), compared with R7.3 billion (1.5 per cent) in the prior year. At municipal level, the trend highlights weaknesses in planning and budgeting. Municipalities spent R24.6 billion (86.8 per cent) of their infrastructure grants in 2016/17, down from 89.1 per cent in 2015/16.

The *Explanatory Memorandum to the Division of Revenue*, published on the National Treasury website as Annexure W1 to the *Budget Review*, 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.

Debt-service costs and the division of revenue

The division of revenue is usually presented as the split of nationally collected revenue between the three spheres of government. Given growth in government's borrowing requirement, a rising share of revenue is spent on interest payments, with substantial consequences for the public finances. In 2018/19, for example, government will spend more on interest payments than on transfers to local government. The figure below shows the shares of national revenue, including debt-service costs, since the introduction of the first Division of Revenue Act two decades ago.

Shares of national revenue and debt-service costs*



**Historical numbers revised to reflect shift of social assistance function from provincial to national*
Source: National Treasury

In 1998, South Africa was reducing the debt load built up by the apartheid government. In that year, government spent 21.2 per cent of revenue on interest payments and only 0.5 per cent on transfers to local government. Over the course of the next decade, spending on interest steadily declined, accounting for less than 8 per cent of available revenue by 2009/10. Local government allocations grew at an average annual rate of 27.1 per cent between 2000 and 2010, more than double the pace of growth in government spending as a whole (13.2 per cent).

Since 2011/12, interest payments have grown faster than allocations to national, provincial or local government, crowding out space for increasing productive expenditure. On current trends, by 2020/21, government is expected to spend 12.2 per cent of available revenue on servicing debt.

Provincial revenue and spending

To adjust to reductions, provinces need to reduce spending on non-core items

Provinces, which depend on transfers from national government for over 95 per cent of their budgets, face substantial spending pressures to provide health, education and other services to growing populations. In this context, most of the reductions in transfers to provinces have been made on infrastructure grants.

The provincial equitable share, which accounts for over 80 per cent of transfers and funds operating expenditure covering the salaries of teachers and nurses, is reduced by R4.7 billion over the MTEF period. Provinces are expected to absorb the impact of these reductions by reducing spending on non-core items such as travel and consultants, and on non-priority programmes. Provincial conditional grants are reduced by R13.7 billion over the medium term.

The equitable share, which is allocated using a data-based formula, is under review. The initial phase focused on improving the quality of data used in the formula. From 2018/19, data on learner numbers will be taken from the Department of Basic Education's Learner Unit Record Information and Tracking System, which replaces the previous school

survey data. The next phase is expected to focus on refining alignment of the health and education components with national norms and standards. Any proposed changes will be incorporated after extensive consultation.

Table 6.3 Provincial equitable share

R million	2017/18	2018/19	2019/20	2020/21	Average annual MTEF growth
		Medium-term estimates			
Eastern Cape	61 848	65 500	69 807	74 411	6.4%
Free State	24 522	26 178	28 071	30 108	7.1%
Gauteng	86 643	93 384	100 923	109 092	8.0%
KwaZulu-Natal	93 757	99 264	106 364	113 998	6.7%
Limpopo	51 960	55 179	59 188	63 503	6.9%
Mpumalanga	36 082	38 468	41 395	44 555	7.3%
Northern Cape	11 720	12 475	13 404	14 405	7.1%
North West	30 330	32 392	34 789	37 372	7.2%
Western Cape	44 470	47 447	51 080	55 003	7.3%
Total	**441 331**	**470 287**	**505 020**	**542 447**	7.1%

Source: National Treasury

Over the next three years, the impact of the provincial conditional grant reductions proposed since the 2017 MTBPS is as follows:

- The *human settlements development grant* is reduced by R7.2 billion. Although this will slow the delivery of new houses and serviced sites, the sector is still expected to build 316 813 houses and upgrade 417 391 sites in informal settlements over the period. Funds are also reprioritised from the *human settlements development grant* to create emergency housing grants intended to improve responsiveness to housing needs following disasters.
- A R3.6 billion reduction to the *education infrastructure grant,* which has a history of underspending, will result in some projects being deferred.
- Small reductions to other grants are discussed in Annexure W1. These cuts mainly target areas of poor performance.

Broadening participation in the housing market

In addition to improving the living conditions of those in inadequate shelter, government's housing programme effectively brings low-income households into the housing market. The full benefits of this transfer, however, have not been realised because a large number of houses built through state subsidies are not on the deeds registry. As a result, owners cannot access the full value of their properties. To reduce this backlog more quickly, government is creating the *title deeds restoration grant,* funded through a reprioritisation from the *human settlements development grant.*

The Centre for Affordable Housing Finance estimates that about 1.8 million or 29 per cent of the 6.2 million formal properties on the deeds registry were financed by the public housing programme. This reflects assets to the estimated value of R326 billion. About 1 million state-subsidised properties still need to be registered for title deeds. Eradicating this backlog would increase the proportion of state-subsidised properties on the deeds registry to 39 per cent of the formal housing market, unlocking R180 billion of estimated value for low-income households.

Grants funding operational spending, such as purchases of medicines and food for learners, and subsidies for public transport, have been maintained. These items are already under pressure due to population growth and above-inflation cost increases.

Additional funding to expand provision of antiretroviral medication

Over the medium term, R1 billion is added to the *comprehensive HIV, AIDS and TB grant* to expand the distribution of antiretroviral medication. This grant is also reconfigured to elevate the importance of community health services – a component worth R4.4 billion to help provinces standardise the work of primary healthcare outreach teams and integrate them into the national health system.

The *national tertiary services grant* receives an additional R22.4 million over the medium term for the continuing rollout of and research on the diagnostic-related groups payment method necessary for a successful transition to national health insurance.

Table 6.4 Conditional grants to provinces

R million	2017/18 Adjusted budget	2018/19	2019/20	2020/21	MTEF total
		Medium-term estimates			
Direct conditional grants[1]					
Comprehensive agricultural support programme	1 646	1 751	1 876	2 002	5 629
Ilima/Letsema projects	522	552	583	615	1 751
Community library services	1 420	1 424	1 501	1 584	4 509
Education infrastructure	10 046	9 918	10 314	11 467	31 699
Maths, science and technology	365	370	391	413	1 175
National school nutrition programme	6 426	6 802	7 186	7 696	21 684
Comprehensive HIV, AIDS and TB	17 578	19 922	22 039	24 438	66 399
Health facility revitalisation	5 684	5 816	6 047	6 380	18 242
Health professions training and development	2 632	2 784	2 940	3 102	8 827
National tertiary services	11 676	12 401	13 186	14 069	39 655
Human settlements development	19 969	18 167	18 833	20 102	57 101
Mass participation and sport development	586	587	620	654	1 861
Provincial roads maintenance	10 754	11 036	11 482	12 113	34 630
Public transport operations	5 723	5 990	6 326	6 750	19 066
Other direct grants	1 852	3 191	3 415	3 624	10 230
Total direct conditional grants	**96 879**	**100 711**	**106 739**	**115 008**	**322 458**
Indirect transfers	**3 813**	**3 776**	**4 366**	**4 744**	**12 886**
School infrastructure backlogs	2 180	1 472	1 327	969	3 768
National health insurance indirect	1 633	2 304	3 039	3 775	9 118

1. Excludes provisional allocations
Source: National Treasury

Managing spending pressures in provinces

Provinces have been taking steps to contain costs since at least 2009/10, when the implementation of occupation-specific dispensations for educators and health professionals was not fully funded by national government. This led to overspending of provincial budgets for two years and an accumulation of unauthorised expenditure amounting to R20.9 billion at the end of 2009/10 that needed to be cleared.

Cost-containment measures have enabled provinces to reallocate R5.7 billion to education and health

Cost-containment measures were strengthened by the action plan agreed to between the Minister of Finance and the members of executive councils for finance in January 2016. The plan focused on improving revenue collection, rationalising provincial entities, and reducing administrative personnel while protecting education and health frontline employees, and cutting spending on non-core goods and services. As a result, the number of provincial employees declined from 923 646 in

2013 to 888 204 in 2017, and spending on those items classified as non-priority expenditure, which includes consultants, travel and legal fees, fell from R16.6 billion in 2016/17 to R16.1 billion in 2017/18. The savings realised from these measures have allowed provinces to reallocate R5.7 billion to education and health in their 2017/18 adjustment budgets.

The reductions discussed above will affect service delivery by delaying the rollout of some housing, school and health infrastructure projects. And reducing the provincial equitable share will make it difficult for provinces to continue to maintain education and health priorities.

Rising level of unpaid bills and medical negligence claims puts pressure on health budgets

In health, matters are compounded by the large number of unpaid invoices, which increased from R10.3 billion in 2016 to R13.8 billion in 2017, and rising medical negligence claims against the state. The value of claims against health departments grew from R43.1 billion in 2016 to R56.3 billion in 2017. Some of these claims relate to serious errors in clinical practice or hospital management, where there are compelling grounds for compensation. Others appear to be unjustified or excessive, however, and settling such claims would jeopardise government's ability to invest in improved service delivery. Claims totalling R1.1 billion were settled between 1 April and 30 November 2017.

Unpaid invoices relate mainly to the delivery of medicine, laboratory tests and medical supplies. The constrained fiscal environment makes it more difficult for provinces to pay outstanding bills. Where imported medicines are required, exchange rate volatility compounds the problem. However, provinces have been prioritising additional funding to the sector, and provincial and national health departments are working with treasuries on a three-year turnaround plan to improve financial management and governance. Some steps have already been taken, such as the Department of Health appointing a team of professionals to work with provinces on medical negligence claims.

Improving delivery of provincial infrastructure

In 2013, government introduced performance-based incentives for health and education infrastructure grants. The intention is to award financial incentives to provincial departments that successfully implement the infrastructure delivery management system, which covers legislative and regulatory requirements for planning, budgeting, procuring and managing infrastructure assets. The system has led to several improvements:

- Increased focus on school maintenance, and compliance with norms and standards.
- Better infrastructure planning, and consideration of cost-effective alternatives such as mobile service centres.
- Improved quality of information, leading to better decision making and transparency, with financial and non-financial information published on the National Treasury website.
- An increase in the number of built environment professionals in education and health infrastructure units.

Since inception, the performance-based incentives have supported the successful completion of 913 schools, 112 clinics, 50 community health centres and 137 hospitals, all in accordance with applicable norms and standards. Over the next three years, the assessment criteria will be strengthened to include integrated planning between spheres of government, as well as on targeted urban areas.

Municipal revenue and borrowing

Total direct allocations to local government grow at an annual average rate of 7.5 per cent over medium term

Allocations to the local government equitable share will continue to grow over the next three years, alongside a significant reduction in conditional grants. As a result, total direct allocations to local government grow at an annual average rate of 7.5 per cent over the MTEF period.

An amount of R3.4 billion is added to the local government equitable share over the medium term. This will fully cover the increased municipal costs of providing free basic services to a growing number of households, and takes account of likely above-inflation increases in the costs of bulk water and electricity. The additions will also allow for faster increases in the allocations to poorer and rural municipalities through the redistributive components of the equitable share formula.

Personnel spending may be crowding out the service-delivery impact of higher transfers

The new local government equitable share formula, which is now fully in operation after being phased in over five years, is significantly more redistributive towards poorer and rural municipalities. Several municipalities received higher transfers as a result of the new formula. The National Treasury examined the budgets of 11 of these rural municipalities over the period 2012/13 to 2015/16 to see how they used their increased allocations.

A large share of the higher transfers was absorbed by increased personnel spending. While these 11 municipalities saw their equitable share allocations grow at an average annual rate of 16.3 per cent, from a combined R1.6 billion in 2012/13 to R2.5 billion in 2015/16, personnel spending grew at an average annual rate of 19 per cent, from R879 million in 2012/13 to R1.5 billion in 2015/16. Staff numbers remained largely unchanged over the same period, implying that the increased spending resulted mainly from significantly higher wages for existing posts.

The local government equitable share is an unconditional transfer as required by the Constitution, and it is up to elected municipal councils to determine how they use these funds in their budgets. Individual municipalities make different choices about their budget priorities, but this analysis demonstrates the risk that funds intended to support core functions and provide free basic services to poor households are not always used for these purposes.

Communities are encouraged to engage with the choices made by their municipalities through municipal budget processes. User-friendly information on municipal budgets is available at www.municipalmoney.gov.za.

Proposed reductions to the direct local government conditional grant allocations total R13.9 billion compared with the fiscal framework projections set out in the 2017 MTBPS. Indirect grants to local government have been reduced by an additional R2.2 billion.

Sustainability of planned public transport schemes to be reviewed

The most substantial reduction has been applied to the largest grant – the *municipal infrastructure grant.* However, the structure of the formula used to allocate this grant reduces the impact of reductions on smaller municipalities. Project-based grants, such as those in the electricity and water sectors, have identified projects that will be postponed as a result of the adjustments. These changes do not affect any water augmentation projects in drought-affected areas. Reductions to the *public transport network grant* are much larger in the outer years of the MTEF period, giving the Department of Transport and the National Treasury time to review the sustainability of public transport plans, and to assess whether some cities should put projects on hold while they revisit system design.

New grant will require cities to plan for a programme of infrastructure investment

Smaller cities face some of the same urban development challenges as major metropolitan areas. These cities will be eligible for a new *integrated urban development grant* from 2019/20. Cities will have to meet planning and performance criteria to receive the grant, which will be funded through a shift of funds from the *municipal infrastructure grant*. The new grant will require cities to plan for a programme of

infrastructure investment, funded from grants and own revenues, rather than just standalone projects. This approach will be piloted in uMhlathuze and Polokwane in 2018/19.

Table 6.5 Transfers to local government

R million	2017/18 Adjusted budget	2018/19	2019/20	2020/21	MTEF total
		Medium-term estimates			
Equitable share and related[1]	**57 012**	**62 732**	**68 973**	**75 683**	**207 389**
General fuel levy sharing with metros	**11 785**	**12 469**	**13 167**	**14 027**	**39 662**
Direct conditional grants	**43 781**	**43 258**	**44 773**	**47 752**	**135 783**
Municipal infrastructure	15 891	15 288	15 734	16 599	47 621
Water services infrastructure	3 329	3 481	3 669	3 871	11 021
Urban settlements development	11 382	11 306	11 881	12 534	35 721
Integrated national electrification programme	2 087	1 904	2 128	2 245	6 277
Public transport network	6 160	6 254	6 114	6 450	18 818
Neighbourhood development partnership	663	602	621	655	1 878
Regional bulk infrastructure	1 865	1 957	2 066	2 180	6 203
Local government financial management	502	505	533	562	1 599
EPWP integrated grant for municipalities	691	693	742	783	2 218
Other direct grants	1 210	1 268	1 285	1 872	4 426
Total direct transfers	**112 578**	**118 458**	**126 914**	**137 462**	**382 833**
Indirect transfers	**7 803**	**6 896**	**7 265**	**7 664**	**21 824**
Integrated national electrification programme	3 846	3 262	3 432	3 621	10 316
Neighbourhood development partnership	28	29	31	33	93
Regional bulk infrastructure	2 974	2 881	3 037	3 204	9 123
Water services infrastructure	852	608	642	678	1 928
Municipal systems improvement	103	115	122	128	365

1. Excludes provisional allocations
Source: National Treasury

Municipal financial management

Many municipalities continue to face financial and institutional problems that result in breakdowns in service delivery and mounting debts. As at end-September 2017, the 20 municipalities with the largest outstanding commitments owed creditors R17.4 billion, but had only R1.7 billion of cash on hand. Most of these debts are owed to Eskom and water boards. Protracted non-payment undermines the financial sustainability of these state-owned entities. National and provincial departments also owe municipalities, and the Department of Public Works is working to verify and settle these debts. To date, debts totalling R4 billion have been verified and departments have paid R1.6 billion owed.

Too many municipalities still fail to adopt credible budgets

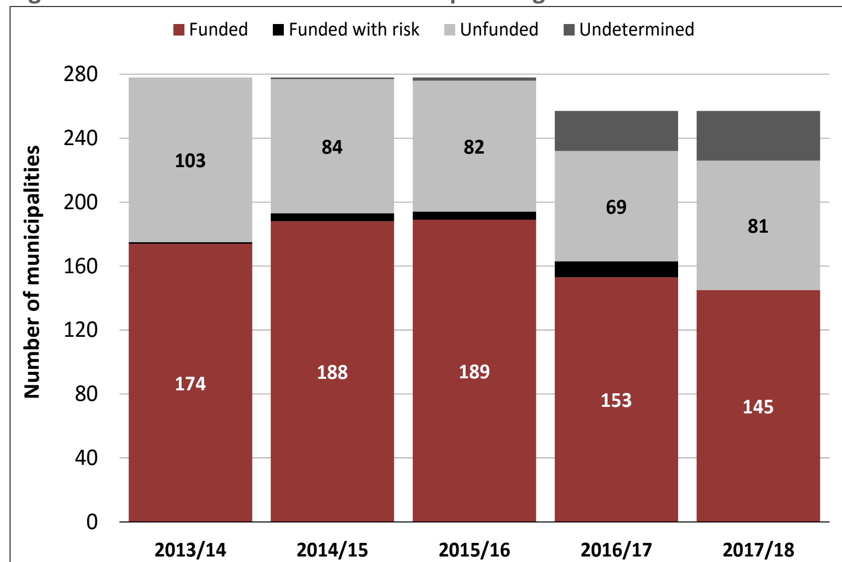
Non-payment of creditors is a symptom of deeper underlying problems. These include weaknesses in revenue collection, and underinvestment in maintenance and renewal, which compromises the reliability of basic services. Too many municipalities also fail to adopt credible budgets, meaning that even if they stick to their budgeted plans, they will not be financially sustainable.

National and provincial treasuries work with municipalities during their budget preparation processes, advising them whether their draft budgets match planned expenditure, and whether they will have enough cash to meet their commitments. This process has met with some success. In 2017, only 125 municipalities tabled funded budgets, but after going through the budget benchmarking process with treasuries, the number increased to 145.

In current year, 81 municipal councils voted to adopt budgets they knew were not funded

But the problems run deeper. In 2017/18, 81 municipal councils voted to adopt budgets that they knew were not funded, making some form of financial distress inevitable. Because local government is autonomous, elected councils are responsible for determining and budgeting for municipal priorities. Neither national nor provincial government can force local governments to adopt different budgets, despite advising them that their proposed budgets are unfunded.

Figure 6.1 Funded and unfunded municipal budgets*



**Based on assessment of adopted budgets. Where budget schedules are incomplete, assessments are reflected as "undetermined." The number of municipalities decreased to 257 from 278 in 2016*
Source: National Treasury

Government spends nearly R2 billion a year on capacity support to municipalities

The causes of municipal financial crises are complex, and the response needs careful consideration. Government spends nearly R2 billion a year on municipal capacity support. National and provincial treasuries, and other departments, provide oversight and support through the system of cooperative governance. The National Treasury has established a municipal financial recovery service as required by the Municipal Finance Management Act (2003). While there is no shortage of capacity support, there is an opportunity to achieve better results from this system.

If municipalities consistently fail to achieve their mandates, the Constitution provides for intervention

As set out in the Constitution, those elected to lead local government are accountable to residents. To run financially sustainable operations, municipalities need to demonstrate the political will to implement the changes necessary to improve their performance. Where municipalities consistently fail to achieve their mandates, the Constitution provides that provinces and/or national government must intervene.

Government will introduce a conditional grant in the outer years of the 2018 MTEF to help municipalities facing financial crises. It will only be available to local governments that have demonstrated the political will to implement reforms necessary to turn themselves around. The grant, accompanying support and intervention measures under section 139 of the Constitution, will be designed and consulted on during 2018.

Responding to the impact of drought

Severe drought conditions are affecting large parts of the country, and placing extreme strain on the supply of water to the nearly 4 million people in the City of Cape Town. Some smaller towns in the Northern Cape, Eastern Cape and Western Cape, as well as Nelson Mandela Bay Metro, are also facing severe water shortages. The drought has been classified as a national disaster by the National Disaster Management Centre. Government is committed to managing available supply to ensure basic needs are met, while implementing plans to improve long-term sustainability in a water-stressed country.

National government has been working with municipalities to respond effectively to the crisis. The appropriate immediate response to a drought of this kind is to severely curtail water usage, protect catchments, carefully recalibrate allocations and augment supply where possible. Severely reduced agricultural and urban water use will require a concerted, cooperative intergovernmental approach.

While the City of Cape Town has implemented measures such as punitive tariffs, flow restrictions, pressure management and water-loss reduction programmes, most residents of the city have also demonstrated great civic responsibility in curtailing their own water use. This is a result of expanded public awareness of the crisis, resulting in households examining and radically reducing their own consumption patterns. If the city's targeted water saving is achieved and there is some winter rain, then a "day-zero" scenario can be avoided. Although Cape Town has halved its summer usage from 1.2 billion litres per day to below 600 million litres per day, usage must be further reduced to 450 million litres per day over the remaining summer and autumn months (up to July 2018). A lengthy interruption of urban water supply would threaten public health and negatively affect most economic activities.

In Cape Town, it is not possible to build new water supply capacity at scale to significantly alleviate the short-term effects of the drought. Temporary small-scale desalination capacity is costly, and will not make a material difference to supply in time, as confirmed by international experts. The City of Cape Town and the Department of Water and Sanitation must agree on plans to develop groundwater resources, and build permanent wastewater reuse and/or desalination capacity, at an appropriate scale and in a cost-effective manner. Expertise in contracting large projects developed through the renewable energy programme has been made available to the city in procuring capacity on a larger scale.

Government stands ready to provide financial assistance where necessary:

- A provisional allocation of R6 billion has been set aside in 2018/19 for drought relief in several provinces, to assist the water sector and to augment public investment projects supported by improved infrastructure planning. Some of these funds may be allocated to support water augmentation projects in an adjustment budget, though in time the full costs of new schemes will have to be recovered from water users through tariffs.
- The Division of Revenue Act allows for conditional grant funds to be reallocated for disaster relief. Such additional funding could be used in 2017/18 for immediate interventions such as accelerating groundwater development.
- Disaster relief grants for provinces and municipalities worth R423.7 million in 2017/18 and R472.9 million in 2018/19 can be rapidly released to assist in an emergency.
- If agricultural employment is seriously destabilised, government can temporarily increase intake on the Working for Water programme. These short-term jobs will provide a substitute employment option, while helping to improve runoff in catchment areas by removing alien vegetation.

These additional sources of funding complement work already being done by national, provincial and local government from their existing budgets. These include substantial reprioritisations within municipalities to fund water augmentation projects, and conservation and demand management. The national departments of Labour and Social Development will provide assistance to communities affected by agricultural job losses.

South Africa is a water-scarce country. The draft National Water and Sanitation Master Plan published for consultation by the Department of Water and Sanitation notes that average daily consumption is 237 litres of water per person, well above the global average of 173 litres. This is despite the highly unequal pattern of water usage, with poor South Africans using far less water than wealthier suburban residents. Given the risks associated with climate change, the country must reduce consumption and make greater use of groundwater and desalination. Municipalities need to reduce leakages from their reticulation networks. Consumers will have to adjust to paying tariffs that reflect the value of water as a precious resource.

Urban renewal and growth

For some years, government has recognised the centrality of urban reform in boosting inclusive economic growth. The Integrated Urban Development Framework sets out the policy commitment to work with the private sector, communities and others to improve the productivity of South Africa's urban areas. The National Treasury has commissioned an urbanisation review, drawing on global methodologies and expertise, to explore the challenges facing South Africa's cities. The results of the review are expected to be published in the next few months.

Cities Support Programme working to scale up delivery of public transport and housing financing arrangements

The Cities Support Programme has worked across national departments and metropolitan municipalities on a programme to strengthen the metros as enablers of faster, more inclusive economic growth. At the core of this programme are efforts to reduce the social, economic and spatial divisions that continue to fragment urban economies, and the rapidly rising costs of congestion. To date, there has been significant progress in:

- Aligning metropolitan plans to spatially targeted investment programmes that supports transit-oriented urban development.
- Preparing a portfolio of catalytic projects in each metro that will support higher density and integrated land development.
- Revising public transport and housing financing arrangements to scale up delivery of specific programmes, such as bus rapid transit systems and informal settlement upgrading programmes.
- Streamlining regulatory approvals to reduce the cost of doing business.

Regulatory changes to help municipalities leverage their own revenue

Municipalities have the potential to increase their investments in the infrastructure needed to support growth, despite reductions to infrastructure grants. They can do this by leveraging their own-revenue sources through borrowing. Although the total value of outstanding long-term municipal debt increased to R66.3 billion in the first quarter of 2017/18, the proportion of municipal capital budgets funded from borrowing has fallen from 24 per cent in 2008/09 to 15 per cent in 2016/17.

Regulatory changes can help municipalities make better use of their own-revenue potential. A 2015 study by the National Treasury estimated that half of the R15 billion annual increase in municipal infrastructure spending needed to support growth could be funded through development charges. Government will soon table amendments to the Municipal Fiscal Powers and Functions Act (2007) that will clarify the rules for levying these charges, so that developers pay the full costs of the additional infrastructure needed to supply them with municipal services.

The National Treasury is also updating the policy framework on municipal borrowing. Changes to the clauses of the Division of Revenue Bill (2018) remove provisions that only allowed municipalities to borrow against future grant transfers for three years and required an onerous approval process. Instead, municipalities will be able to borrow against all their future revenues, subject to the requirements of the Municipal Finance Management Act.

The National Treasury publishes a quarterly Municipal Borrowing Bulletin at www.treasury.gov.za/mfma.