



Financial and Fiscal Commission

Submission on the 2017 Medium Term Budget Policy Statement

For an Equitable Sharing of National Revenue

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List of Acronyms

ARV	Antiretroviral
Cogta	Department of Cooperative Governance and Traditional Affairs
CHW	Community health worker
CHWP	Community Health Worker Programme
CWP	Community Work Programme
TB	Tuberculosis
DBSA	Development Bank of Southern Africa
DRG	Diagnosis Related Group
EPWP	Expanded Public Works Programme
FFC	Financial and Fiscal Commission
GDP	Gross domestic product
ICT	Information and communication technology
IDC	Industrial Development Corporation
LGES	Local government equitable share
MTBPS	Medium Term Budget Policy Statement
MTEF	Medium Term Expenditure Framework
MTSF	Medium Term Strategic Framework
NERSA	National Energy Regulator
NDP	National Development Plan
NHI	National Health Insurance
NRF	National Research Fund
NSFAS	National Student Financial Aid Scheme
NTSG	National Tertiary Services Grant
PES	Provincial equitable share
PSET	Post-school education and training
RSC levy	Regional services council levy
SAA	South African Airways
SABC	South African Broadcasting Corporation
SADC	Southern African Development Community
SANRAL	South African National Roads Agency
SAPO	South African Post Office
SETAs	Sector Education and Training Authorities
SIBG	School Infrastructure Backlogs Grant
SME	Small or medium enterprise
SOE	State-owned enterprise
U&U	Unforeseen and unavoidable

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1. BACKGROUND

- 1.1. The Medium Term Budget Policy Statement (MTBPS) is a key milestone laying the foundation for meaningful engagement with budget proposals from the executive that will culminate in the Budget to be tabled in February 2018.
- 1.2. The 2017 MTBPS was formulated against the backdrop of an economy mired in low growth. Gross domestic product (GDP) growth projections have been revised downwards for 2017, 2018, 2019 and 2020, from 1.3% to 0.75%, 2% to 1.1%, 2.2% to 1.5% and a final figure, published for the first time, of 1.9% for 2020. Low and fragile growth acts as a dead weight on the country's ability to raise tax revenues. In light of the downward revisions to growth forecasts and the associated revenue growth forecasts, coupled with virtually unchanged growth in the level and structure of government expenditure, it is no surprise that the outcome for the next three years will be an increase in budget deficits and public debt.
- 1.3. Also worrying is that while the global economy appears to be in recovery, South Africa is missing out on the benefits of the global upswing. It is growing less than its emerging economy counterparts and below the global average of 3.6% in 2017 and 3.7% in 2018. Growth in sub-Saharan Africa is also poised to recover to 2.6% in 2017, which exceeds the growth levels projected for South Africa.
- 1.4. The present environment of fragile low growth makes it difficult to tackle the socio-economic challenges of unemployment, poverty and inequality. The economy desperately needs an alternative growth trajectory to the current one if social ills are to be remedied. If the status quo is maintained, and as the MTBPS notes, per capita GDP will continue to decline as it has for the last two years, with no realistic prospect of addressing the national development goals of eradicating pervasive poverty (which affects roughly 30.4 million South Africans predominantly in rural areas and from marginalised groups), reducing entrenched inequality (reducing the Gini coefficient from 0.68 to 0.6) and reducing unemployment (currently at 27.7% to 6%).
- 1.5. It is against this background that this Submission on the 2017 MTBPS is made by the Financial and Fiscal Commission (hereafter the Commission or FFC) in terms of section 4(4c) of the Money Bills Amendment Procedure and Related Matters Act (2009). The Submission is also made in terms of part 1, section (3)(1) of the Financial and Fiscal Commission Act (2003) as amended. This provides for the Commission to act as a consultative body for, and to make recommendations to, organs of state in the national, provincial and local spheres of government on financial and fiscal matters.
- 1.6. As illustrated in the Submission, the Commission finds both positive and negative features in the 2017 MTBPS, as well as inherent risks.
 - Positively, the MTBPS was impressively candid about the current dire economic situation, and the fact that the expenditure ceiling remains sacrosanct.
 - On the negative side, the 2017 MTBPS was impressively disappointing in its failure to outline a coherent plan of action to address these issues prior to the Budget in February 2018. In many instances it is lacking in detail, leaving the

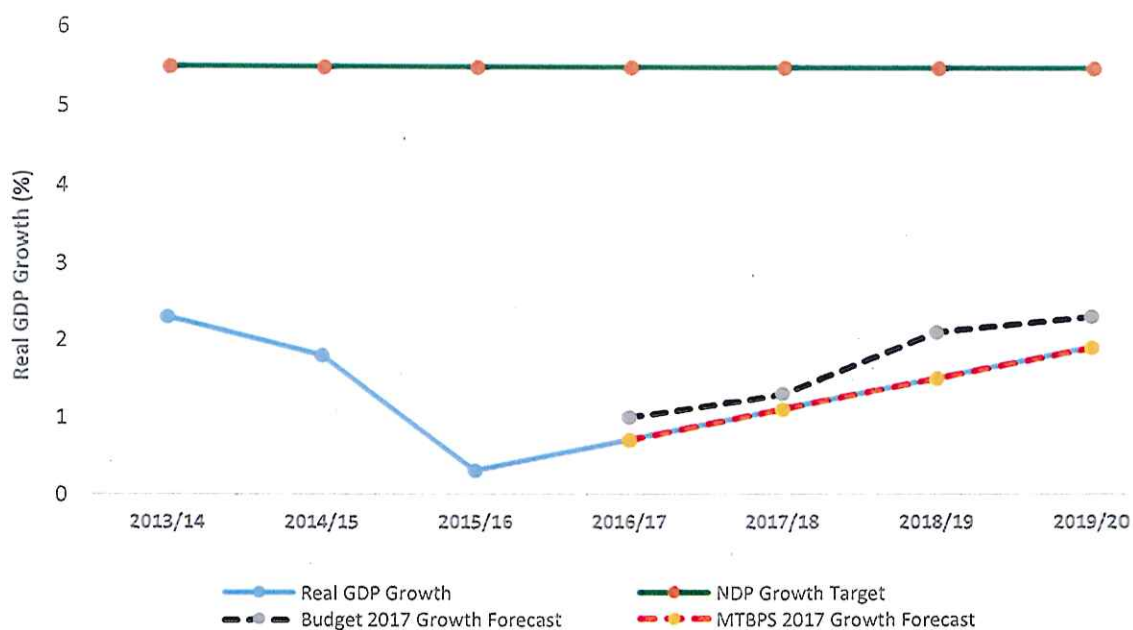
country to wait for February. The Commission appreciates that the aim of the MTBPS is to set the scene for the February 2018 budget, but this year there is just too much that has been left unsaid. The document details the severity of the current state of affairs but does not balance this with confidence-building aspects, a hallmark of previous (MTBPS) statements.

- 1.7. The key risk from the Commission's perspective is the threat to the stability of the fiscal system. This lies in a lack of whole-of-government commitment as demonstrated by the continued policy uncertainties outlined in the Minister of Finance's speech. Unless there is a show of policy coherence and decisive support, the markets will not buy government statements and promises. The principal fiscal risk, brought starkly to bear by the reaction to 2017 MTBPS presentation, is the inability to control an upward trend in the ratio of public debt to GDP. More germane to the Commission is that an unstable fiscal framework compromises subnational governments. The success of South Africa's Intergovernmental Fiscal Relations system is built on the twin pillars of buoyant revenue collection and a stable fiscal framework.

2. ECONOMIC OUTLOOK AND OVERVIEW OF PUBLIC FINANCES

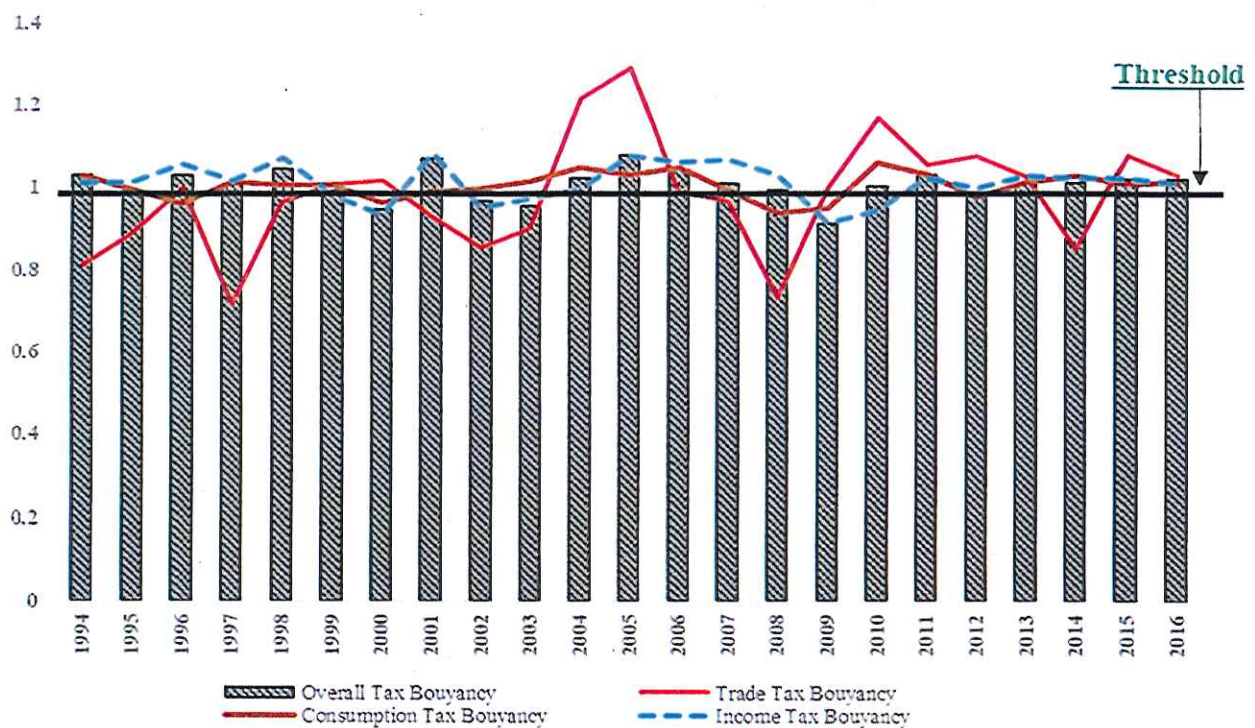
2.1. Economic Growth and Employment

- 2.1.1. The recovery in global manufacturing and trade that commenced in 2016 has persisted into the first half of 2017. As a result of this recovery and stronger domestic demand growth in advanced economies, China, and other large emerging market economies global growth is projected to grow from 3.6% in 2017 to 3.7% in 2018. Improvements in investment, trade, and industrial production, together with strengthening business and consumer confidence are expected to support this recovery. Despite the global upswing, South Africa's economy continues to struggle. The national Budget presented in February 2017 projected that GDP would grow by 1% in 2017, eventually rising to 2.3% by the 2019/20 financial year. However, perceptions of weakening governance and rising policy uncertainty have heightened concerns that South Africa's economic growth will falter over the medium term. In line with these concerns, and for the third consecutive year, South Africa's medium-term growth forecasts have been revised downwards (see Figure 1). The current and projected growth rates are insufficient to significantly reduce poverty. The projections of negative per capita growth for 2017 and 2018 mean poverty rates will remain fairly consistent with 2016 levels. This is detrimental to South Africans, particularly the poor, for whom a growing economy is necessary for jobs, decent wages, and a sustainable system of social grants.

Figure 1. Actual and projected growth in GDP, 2013/14 – 2019/20

Source: National Treasury – National Budget 2017 and October 2017 Medium-Term Budget Policy Statement.

2.1.2. South Africa's subdued growth stands in sharp contrast to its emerging market peers and the rest of sub-Saharan Africa, where economic growth between 2017 and 2020 is expected to average more than 4% and 2.5% respectively. From a fiscal policy perspective, the low-growth trap presents significant constraints to government's plans to raise the revenues needed to ensure the long-term sustainability of the country's fiscal balance. Figure 2 shows that South Africa's tax buoyancy – the measure of the extent to which tax revenues vary with economic growth – has steadily declined since 2011. The continued deterioration of South Africa's tax buoyancy weakens the effectiveness of the tax system to support the objective of ensuring the sustainability of fiscal policy. Furthermore, continued decline in tax buoyancy limits the degree to which government can utilise taxes as a stabilisation tool that mitigates against cyclical variations in GDP over the course of the business cycle.

Figure 2. Actual and projected growth in GDP and tax buoyancy 1994–2016

Source: South African Reserve Bank

2.1.3. For the first time since 2009, South Africa experienced a technical recession as GDP shrank by 0.7% in the first quarter of 2017, following a contraction of 0.3% in the fourth quarter of 2016. In an unprecedented occurrence since 1994 all sectors, with the exception of mining and agriculture, contracted in the first quarter of 2017. The slowdown in sectoral output was exacerbated by further contraction in the real output of the secondary sector while the real value added by the tertiary sector contracted for the first time since the second quarter of 2009. The deceleration of real output of the secondary sector in the first quarter of 2017 was widespread. Manufacturing production contracted for a third successive quarter as weak domestic demand and low business confidence continued to constrain output growth. Real output also declined in the construction sector as well as in the sector supplying electricity, gas and water. Real economic activity also contracted in all the tertiary subsectors in the first quarter of 2017 as weak demand resulted in significant decline in the gross value added by the commerce sector.

The picture in the second quarter of 2017 was different as economic growth rebounded, advancing at an annualised rate of 2.5% following two successive quarters of contraction. Figure 3 shows that this reversal was largely due to better performance in the agriculture and mining sectors. The recovery also reflected a turnaround in the real output of both the secondary and the tertiary sectors. Following the easing of adverse conditions brought about by the 2015 drought, real agricultural output increased at a brisk pace on the back of a record domestic maize crop harvest. The rebound in the real

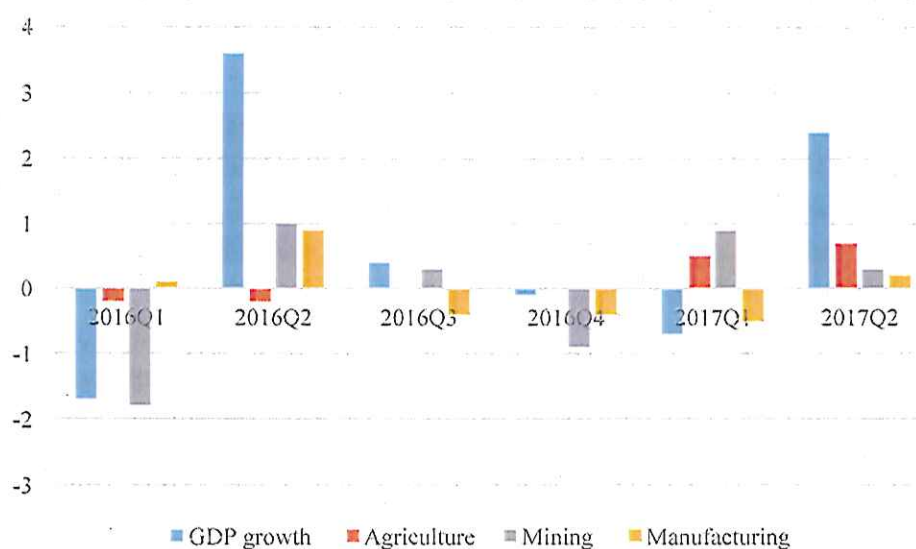
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output of the secondary sector in the second quarter of 2017 was largely as a result of an increase in the real gross value added by the manufacturing sector, following three consecutive quarters of contraction.

The recovery in commodity prices since the first quarter of 2016, combined with reduced supply disruptions, has improved the short-term outlook of the mining sector. However, production remains muted by historical standards. Uncertainty around contentious proposals for the ownership structure and allocation of prospecting rights in the Department of Mineral Resources' new mining charter has added to existing challenges in an industry grappling with declining investor confidence, significantly reduced levels of much-needed capital investment and rising operational costs.

The recovery also extended to the manufacturing sector, which expanded by 1.5% during the second quarter of 2017, due to increased domestic demand for food and beverages, cars and automotive parts, and accessories and transport equipment. Electricity, gas, and water also increased by 8.8% as a result of energy demand from factories and mines, and easing water constraints.

Figure 3. Contributions to growth in GDP, 2016Q1–2017Q2

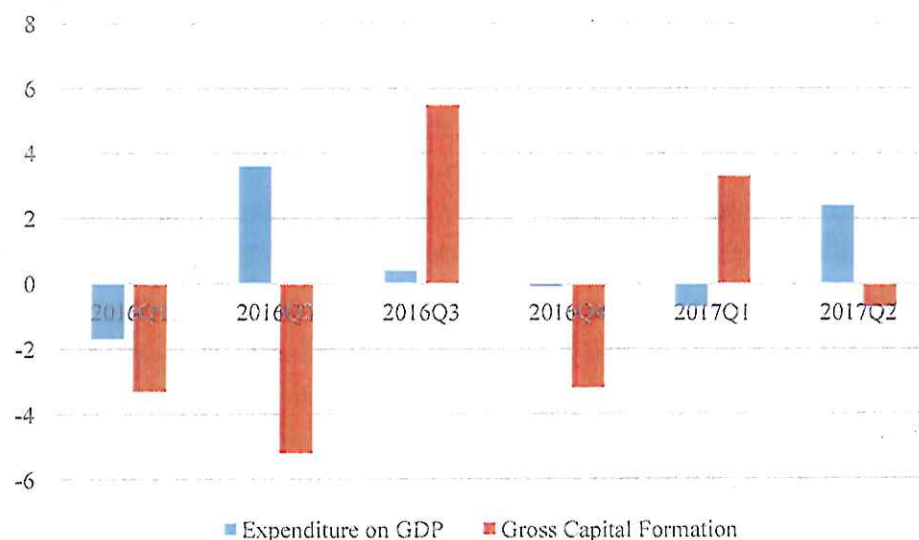


Source: Statistics South Africa (2017), Gross domestic product: Second quarter 2017

2.1.4. The trend in South Africa's economic performance since the first quarter of 2016 suggests general weakness in the levels of overall demand. Subsequently, South Africa's productive sectors have grappled with low capacity utilisation rates, an outcome that has limited the need to expand existing production lines. The net effect is an environment in which weak appetite for private investment coexists with low domestic savings to finance additional investment. Given the high capital intensity of the economy, a large fraction of the savings is allocated to maintaining existing capital stock, leaving very little savings for new investments. Figure 4 shows that the contribution of gross capital

formation between the first quarter of 2016 and the second quarter of 2017 has been negative for the better part of the period as a result of the factors explained above.

Figure 4. Contribution of gross capital formation to growth, 2016Q1–2017Q2



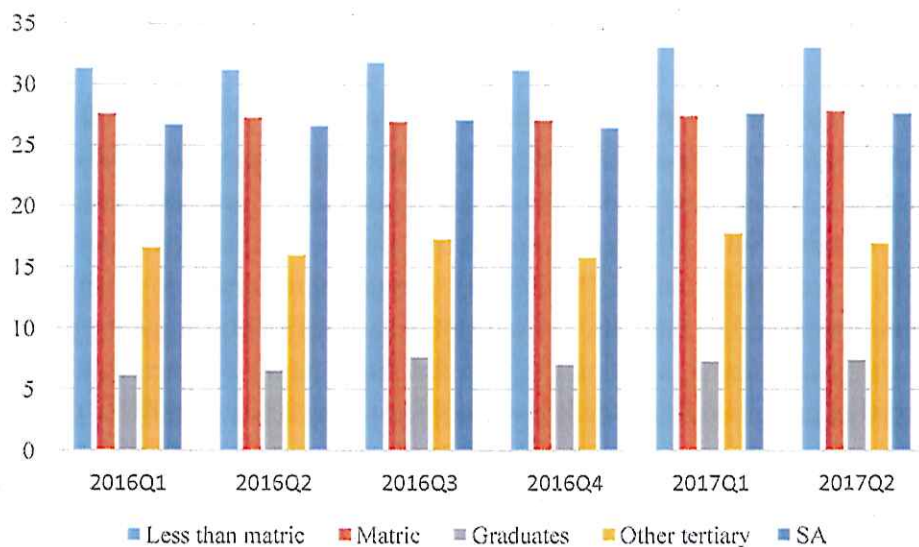
Source: Statistics South Africa (2017), *Gross domestic product: Second quarter 2017*.

2.1.5. South Africa's current account deficit narrowed from 5% of GDP in the first quarter of 2016 to 2.4% of GDP in the second quarter of 2017. The trade balance was the main driver in the reduction of the current account deficit. It remained positive between February and July 2017, and reached a high of a R10.6 billion trade surplus in June. Exports rose 4.4% year-on-year between January and July 2017, compared to a 2.2% growth in imports owing to the more favourable terms of trade, a consequence of both higher commodity prices and a stronger rand. Overall the narrowing current account deficit reduces South Africa's vulnerability to international capital flows and is therefore welcomed. However, of major concern is that the financial account remains characterised by weak foreign direct investment and is dominated by portfolio investment. Without a significant reversal in the country's growth trajectory, further downgrades by ratings agencies could result in more capital outflows. This could place additional pressure on the rand and bond yields, thus ensuring that the current account deficit will remain a major source of external vulnerability for South Africa.

2.1.6. The current levels of economic growth remain too fragile to reduce the stubbornly high unemployment rates. The Statistics South Africa Quarterly Labour Force Survey for the second quarter of 2017 shows that both employment and unemployment decreased resulting in the unemployment rate remaining unchanged from the first quarter of 2017. The absorption rate declined by 0.4 of a percentage point and labour force participation declined by 0.6 of a percentage point quarter on quarter. The not economically active population increased by 306 000, of which 83 000 were discouraged work seekers. Compared to the same quarter last year, employment increased by 3.6% while unemployment grew by 9.6%. This led to an increase in the unemployment rate by 1.1

percentage points to 27.7% in the second quarter of 2017. This means that unemployment remains one of the biggest challenges that the country is facing. There are far more unemployed low-skilled and semi-skilled workers than there are unemployed skilled workers. Figure 5 shows the unemployment rate by education status from the first quarter of 2016 to the second quarter of 2017.

Figure 5. Unemployment rate by education status, 2012Q1-2017Q2



Source: Statistics South Africa (2017), Quarterly Labour Force Survey: Second Quarter 2017.

Government has devised a number of entrepreneurship, training, and active labour market programmes in an attempt to solve the unemployment challenge. The Jobs Fund has facilitated over 70 000 jobs in a period spanning five years, the Expanded Public Works Programme and Community Work Programme employ more than five million people on a short-term basis, and in 2014/15 the Employment Tax Incentive Programme supported close to 700 000 jobs. Notwithstanding these extensive endeavours, the net jobs generated by these programmes overall remains unknown because of the lack of a clear monitoring framework to evaluate their performance against objectives. An effective coordination system that is based on integrated information systems to design, monitor, and evaluate these programmes is urgently required.

2.2. Public Finance Developments

2.2.1. The 2017 MTBPS was delivered in the context of a Cabinet reshuffle in March that was followed by negative market reactions. A week after this event, Standard and Poor's (S&P) downgraded South Africa's long-term foreign currency credit rating from an investment-grade rating (BBB-) to a sub-investment (or junk) rating (BB+). Fitch did the same but went a step further to downgrade South African debt to sub-investment grade for both the foreign and the local currency rating. Both rating agencies justified their actions based on governance concerns. The downgrades mean that South Africa has ceased to be an investment-grade rated country for the first time in 18 years. The

aftermath of the downgrades also saw significant bond disinvestment by institutional investors. This included the exclusion of South African government bonds from JP Morgan's Emerging Market Bond Index and Government Bond Index. This translated into outflows of US\$1.5 billion, according to NKC African Economics. Capital outflows also saw yields on 10-year Treasury bonds increase by 40 basis points, while the rand depreciated by 5% within days. While bond yields have settled slightly, they remain higher than before the reshuffle. This suggests that investors still consider South Africa's long-term debt to have become riskier and wish to be compensated for this risk with higher yields.

- 2.2.2. Premised on the weaker-than-expected growth outlook, the 2017 Budget proposed expenditure containment and new revenue measures in alignment with the ongoing fiscal consolidation. The primary goal of the fiscal consolidation exercise is to stabilise the debt to GDP ratio within three years, given that public debt has increased significantly since 2009. According to the 2017 Budget, government aimed to stabilise the gross government debt to GDP ratio at 53% of GDP in 2018/19, thus enabling the phasing in of necessary fiscal measures over the next few fiscal years. However, the 2017 MTBPS announced that gross national debt is now projected to reach over 60% of GDP by 2022, with debt service costs reaching 15% of main budget revenue by 2020/21. Public finance literature postulates that sustainable levels of public debt in emerging market economies tends to limit prudent debt targets to 40–55% of GDP, subject to the ability to raise revenue, growth potential and the types of fiscal risks a country faces¹. This means that at the current level, government debt is now considered unsustainable. However, for positive debt dynamics to be realised, higher growth rates must be achieved. The debt level is vulnerable because it is likely to increase significantly faster in the event of weaker economic growth.
- 2.2.3. In terms of expenditure containment, the spending ceiling was reduced by R10.2 billion which amounted to 0.2% of GDP and by R15.9 billion representing 0.3% of GDP for 2017/18 and 2018/19 respectively. After five years of fiscal consolidation, there have been some positive results, the primary deficit has been reduced from 2.3% of GDP in 2012/13 to 0.5% by 2016/17. According to the 2017 MTBPS, the main budget deficit, will now be 4.7% of GDP in 2017/18, compared with a 2017 Budget projection of 3.5%. Over the medium term, the main budget deficit is expected to stabilise at 4.6% of GDP. The primary deficit will now stabilise at 0.7% of GDP. The preliminary estimates for 2016/17, which show that the primary balance will be close to a surplus, might not materialise.
- 2.2.4. The 2017 Budget showed that total government expenditure amounts to 33% of GDP and compares very well with the average of emerging economies. However, a key distinguishing factor is that it is skewed towards current spending. The wage bill, for

¹ See Fall, F, Hoeller, P, Fournier, JM and Bloch, D. 2015. Prudent debt targets and fiscal frameworks. *OECD Economic Policy Papers*, <http://dx.doi.org/10.1787/5jrxxtjmmmt9f7-en>.

instance, accounts for approximately 35% of total expenditure translating into 14% of GDP. Between 2008/09 and 2016/17, compensation spending increased by about 37% in real terms, or 4.1% a year. About a quarter of the increase resulted from expanded employment, with the remaining three-quarters due to higher remuneration. In addition to the wage bill, debt service costs amount to 10% of the budget. These two expenditure items account for almost half of the total expenditure, thus seriously restraining the ability of government to meet the physical and social infrastructure investment needs essential to enhancing growth. Government is acutely aware of this and the fiscal consolidation approach incorporates restraining the wage bill. In line with this, government has frozen the recruitment of civil servants and only permitted the replacement of indispensable workers to limit the growth of the wage bill. In addition to this, government could increase the effectiveness and productivity of the public service by reallocating vacant positions to important sectors such as education and health.

In order to increase fiscal space, more effective government spending would be required. In this regard, the efforts of the office of the Chief Procurement Officer in modernising and centralising government procurement practices is welcomed. Endeavours to improve supply chain management and reduce the cost of procuring goods and services must continue. Full adherence to public procurement procedures and spending rules could provide spending savings and reduce the risks of mismanagement of public finances and corruption.

2.2.5. The main risks to debt sustainability emanate from further conceivable ratings downgrades and the increasing contingent liabilities in state-owned enterprises (SOEs). Since 2012, the profitability of SOEs has decelerated owing to a mix of operational inefficiencies, governance failures and weak demand. These factors have accelerated their dependence on borrowing to fund operations. This means that a number of these entities are heavily indebted, with inadequate cash to service their debt obligations and run their operations. Without any credible plans to shore up short-term recovery in earnings, creditors are now progressively reluctant to roll over maturing debt or extend new loans, even with government guarantees. Government has been compelled to step in to bail out some of these entities.

2.2.6. Government guarantees and exposure to SOEs has been accelerating in recent years. Total government exposure to public institutions, independent power producers and public-private partnerships increased from R326.9 billion in 2014/15 to R445 billion in 2016/17. Similarly, total guarantees issued to public institutions, independent power producers and public-private partnerships increased from R679.9 billion in 2014/15 to R688.8 billion in 2016/17. The governance failures in most SOEs and the recent downgrade to sub-investment level are resulting in creditors taking a tough stance. Consequently, SOEs are either struggling to raise debt, or are compelled to refinance debt at higher rates. This results in liquidity complications that translate into greater demands on the fiscus. Owing to these factors, total interest payments by state-owned companies are projected to increase from R49.8 billion in 2016/17 to R69.3 billion by 2019/20. This means that some of the SOEs will experience cash flow problems that will



hamstringing their ability to settle their obligations. Further downgrades could trigger interest rates hikes and depreciation of the exchange rate, thus exacerbating the situation. Table 1 shows that government exposure to SOEs is accelerating.

Table 1. Government guarantee exposure, 2014/15–2016/17

	2014/15		2015/16		2016/17	
	Guarantee	Exposure	Guarantee	Exposure	Guarantee	Exposure
Eskom	350	149.9	350	174.6	350	218.2
SANRAL						
DBSA	12.9	4.1	13.9	4.4	12.7	4.2
Land Bank	6.6	2.1	6.6	5.3	11.1	5.4
IDC	1.6	0.3	2	0.2	1.9	0.2
South African Post Office	1.9	0.3	4.4	1.3	4.4	3.9
South African Airways	14.4	8.4	14.4	14.4	19.1	17.9

Source: South Africa National Treasury (2017), Budget Review 2017

The largest exposure is to Eskom. Since 2010, the government has extended R350 billion, which translates to 8% of GDP, as guarantees to Eskom. The state guarantee supports Eskom's capital investment programme. However, weak governance at Eskom is undermining financial performance such that a qualified audit opinion and a violation of some debt covenants with lenders have ensued. The financial performance of Eskom is highly depended on its ability to recover costs through tariff increases and deal decisively with defaulting clients. However, Eskom forecasts that electricity sales growth over its planning period will be flat, thus revenue growth will be secured primarily through tariff increases. Eskom's tariff increases in the last two years have outstripped the rate of inflation. While the National Energy Regulator (NERSA) has tried to limit the increases, a recent Supreme Court of Appeal decision has allowed Eskom to recover retrospective revenue, over and above price increases agreed upon through a multi-year tariff calculation system. There are risks that sales growth will perform below projections, or decline as households and businesses improve their energy efficiency. If that materialises, Eskom could apply for even steeper tariff increases. The higher tariffs could slow down economic activity thus restricting tax revenue collection and retarding the closing of the fiscal deficit and stabilisation of debt.

Government has extended its R350 billion guarantee from 2017 to 2023 because of delays in Eskom's capital investment programme. Eskom has also applied for tariff increases to accumulate through regulatory clearing account application. NERSA is expected to rule on both Eskom's application for a tariff increase for 2018/19 as well as its regulatory clearing account application. The uncertainty regarding the scale of future tariff hikes poses significant risks to Eskom's financial position and increases government exposure.

2.2.7. Government has also issued a R19.1 billion guarantee facility to South African Airways (SAA). Government guarantees to SAA have increased rapidly from R14.4 billion in

2014/15 to R19.1 billion in 2016/17, making its default the most important risk. A total recapitalisation of R10 billion will be provided in 2017/18. An amount of R5.2 billion has already been provided, with the remaining R4.8 billion to be transferred in 2018. These funds will be used for working capital and to settle debt, enabling the airline to reduce its interest expenses. Notwithstanding these capital allocations, government's exposure to SAA debt is still significant at R15 billion. The risk is that if SAA's financial fortunes do not improve, there will be further calls on the remaining guarantee. In addition, government has recapitalised the South African Post Office (SAPO) by R3.7 billion. The 2017/18 expenditure is expected to breach the ceiling by R3.9 billion as a result of the large appropriations for SAA and the SAPO

- 2.2.8. Contingent liabilities in SOEs could derail the fiscal consolidation course. Fiscal slippage would in all likelihood result in further downgrades thus hiking the cost of public debt and crowding out other growth-enhancing expenditures. Downgrades could also result in significant international capital outflows, putting pressure on the exchange rate and inflation, and consequently on household budgets and consumption. A persistent pattern of poor governance in several large state-owned companies, contributes to concerns about policy uncertainty. Addressing these concerns would bolster confidence, supporting higher levels of investment and growth. Good corporate governance of state-owned enterprises is critical to achieving growth objectives and efficient infrastructure delivery.

3. FISCAL FRAMEWORKS AND REVENUE PROPOSALS

3.1. Overview of the Fiscal Framework

3.1.1. The proposed 2018 medium-term estimates are presented under a depressed macroeconomic outlook with severely weaker revenue projected and high debt service costs. This situation imposes severe constraints on the broader fiscal framework and the ability of government to fulfil its developmental objectives as outlined in the National Development Plan. Table 2 outlines the proposed fiscal framework for the 2018 Medium Term Expenditure Framework (MTEF) period.

3.1.2. In the current 2017/18 financial year real growth in expenditure (at 2.6%) is projected to far outstrip growth in revenue which is expected to decline by 0.6%. Revenue is projected to fall short by R50.8 billion relative to estimates at the time of the tabling of the 2017 Budget in February. Over the 2018 MTEF period, growth in revenue is projected to recover to an estimated real annual average of 2.3%. The projected upswing in revenue growth will be driven by tax measures which will be announced when the 2018 Budget is tabled in February. According to projections, the new tax measures will inject an additional R48.3 billion into the system. Real annual average growth in expenditure is set to slow marginally to 2.1%. Growth in expenditure is driven by growth in debt service costs (projected to grow by a real annual average of 5.2%), with spending on non-interest allocations (which includes spending on basic and social services) projected to exhibit more restrained growth (real annual average growth of 1.7% per annum).

3.1.3 Over the two outer years of the 2018 MTEF period allocations in respect of the contingency reserve, which have been adversely affected due to bailouts to SOEs, will be rebuilt over the 2018 MTEF period. However, allocations in this regard are projected to only reach R8 billion by 2020. Given policy uncertainty on a number of fronts, such as higher education and the potential for student protests to erupt strongly in respect of fee-free higher education, as well as the pending finalisation of the public sector wage agreement – which has historically placed strain on the fiscus – the lack of the fiscal buffer provided by the contingency reserve will severely constrain government's flexibility in addressing these imminent challenges. The key components of the fiscal framework are discussed in greater detail below.

Table 2. Consolidated fiscal framework, 2014/15–2020/21

R' billion/percentage of GDP	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
Main budget revenue	965.5	1,076.2	1,137.6	1,193.5	1,294.5	1,398.9	1,502.1
Main budget expenditure	1,131.9	1,244.6	1,305.5	1,413.1	1,516.6	1,642.0	1,767.4
<i>of which:</i>							
Non-interest allocation	1,017.1	1,115.8	1,159.0	1,249.8	1,333.5	1,438.7	1,544.1
Debt service costs	114.8	128.8	146.5	163.3	183.1	203.3	223.4
Contingency reserve	–	–	–	–	3.0	5.0	8.0
Main budget balance	-166.44	-168.39	-167.84	-219.64	-222.05	-243.13	-265.31
As % of GDP	-4.3%	-4.1%	-3.8%	-4.7%	-4.5%	-4.6%	-4.6%
Primary balance	-51.65	-39.59	-21.34	-56.30	-38.99	-39.84	-41.96
As % of GDP	-1.3%	-1.0%	-0.5%	-1.2%	-0.8%	-0.7%	-0.7%
Consolidated budget balance	-134.6	-142.2	-147.5	-203.0	-193.1	-208.1	-225.8
As % of GDP	-3.5%	-3.4%	-3.3%	-4.3%	-3.9%	-3.9%	-3.9%

Source: MTBPS, 2017.

3.2. Non-Interest Allocations: Division of Revenue

3.2.1. Table 3 summarises the division of non-interest allocations amongst the three spheres of government. These allocations finance the delivery of basic and social services and are generally comprised of discretionary, equitable share and conditional grant allocations. Whilst projected real growth of non-interest allocations in the current financial year (2017/18) is 2.6%, real growth in this type of expenditure will slow over the 2018 MTEF period, particularly in 2018/19, where a 0.6% increase is projected. This constrained

growth will require strong efforts by government departments to enhance the efficiency and effectiveness of their spending.

Table 3. Division of Revenue amongst the three spheres of government, 2014/15–2020/21

R billion	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	Real Annual Average Growth 2018/19–2020/21
Division of available funds	Outcome		Revised	Medium-term estimates				
National departments	490.0	546.1	555.7	603.5	633.1	683.5	729.2	0.9%
Provinces	439.5	471.4	500.4	538.2	575.8	617.8	663.9	1.6%
Equitable share	359.9	386.5	410.7	441.3	471.7	506.6	543.7	1.6%
Conditional grants	79.6	84.9	89.7	96.9	104.1	111.2	120.1	1.8%
Local Government	87.6	98.3	102.9	112.6	121.6	132.4	143.0	2.6%
Equitable share	41.6	49.4	50.7	57.0	62.7	69.0	75.7	4.1%
General fuel levy sharing with metropolitan municipalities	10.2	10.7	11.2	11.8	12.5	13.2	14.0	0.4%
Conditional grants	35.8	38.3	40.9	43.8	46.4	50.3	53.3	1.1%
Total	1,017.1	1,115.8	1,159.0	1,254.3	1,330.5	1,433.7	1,536.1	1.4%

Source: 2017 MTBPS, Commission's calculations.

3.2.2. Over the medium term, the main driver of growth in non-interest allocations will be allocations to the local government sphere (projected to grow by a real annual average of 2.6%) and, to a lesser extent, provincial allocations which are set to grow by 1.6% per annum in real terms.

3.2.3. In terms of the proportion of total revenue allocated to the three spheres, there has been an increase in the share allocated to the local sphere, which received 8.6% of the division of revenue amongst the spheres in 2014 and is projected to receive 9.3% by the end of the 2018 MTEF period. This has occurred alongside a reduction (from 48.2% to 47.5%)

in the proportion consumed by the national sphere. The shares allocated to the provincial sphere have remained constant at 43%.

3.2.4. Of the total transfers to provinces, 82% is in respect of the provincial equitable share (PES) and 18% is for provincial conditional grants. This proportional split between the PES and provincial conditional grants has remained, and is projected to remain, relatively stable until the end of the 2018 MTEF period. In terms of real growth, however, average increases in conditional grant allocations have tended to outpace increases in PES allocations over the period reviewed (2014 until 2020). For example in 2017 real growth in the PES allocation is 1.8% relative to a real 2.4% increase in conditional grant allocations. The Commission notes the growth in conditional grants and reiterate the caution expressed at the time of the 2016 MTBPS (and a sentiment expressed as far back as 2000), which is that while conditional grants can be an effective avenue to channel much-needed funding to subnational spheres, there are definite drawbacks to excessive growth in this type of grant. This includes the fact that in a decentralised system, excessive use of these fiscal levers can dilute the autonomy of subnational governments and allow national departments to unduly influence the priorities of provincial and local governments.

3.2.5. Related to this, the Commission notes the growing phenomenon of earmarking (or ring-fencing) within a number of provincial conditional grants and directing certain allocations to selected provinces. While the principle of earmarking is not entirely intolerable, it is of greater concern that government continuously seeks to address provincial delivery deficiencies through tighter expenditure discretion. Earmarking funding within a conditional grant creates excessive rigidity and curtails the ability of provinces to adjust their allocations in accordance with their specific circumstances. This arrangement also blurs lines of responsibility and accountability between national and provincial government. Further, singling out allocations within conditional grants to selected provinces has implications for equity. It is therefore imperative that government follows a clear framework that outlines priorities which are implemented through the PES and conditional grant earmarking. The 2017 MTBPS indicates that components of the various provincial conditional grants will be ring-fenced, namely the Direct Health Facility Revitalisation Grant, the infrastructure component of the indirect National Health Insurance Grant, the direct Education Infrastructure Grant and the provincial Roads Maintenance Grant.

Over the initial two years of the 2018 MTEF period, proposed baseline changes to national government allocations reflect a potential spike in indirect grants to provinces (R2.8 billion in 2018/19 and R3 billion in 2019/20). As alluded to above and as previously recommended by the Commission in its Submission for the 2016/17 Division of Revenue, utilisation of indirect grants should be a last resort. Rather poor service delivery performance should be addressed at its core as opposed to shifting the location of delivery.

3.2.6. Two new provincial conditional grants, both related to human settlements, will be introduced with the 2018 Budget. The one grant will be focussed on addressing the

backlog in title deeds over a three-year period, while the second new grant will provide emergency funding in line with the requirements of housing policy. Further detail regarding adjustments to provincial conditional grants are provided in Section 4.

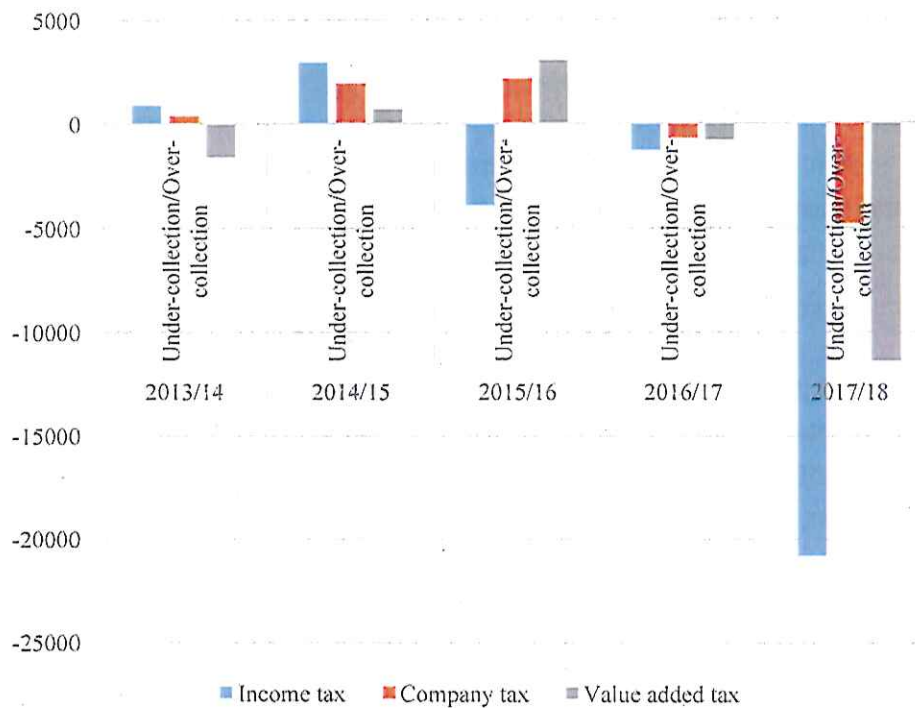
- 3.2.7. The three-stage review of the PES, which was initiated in 2016, is underway. With a view to ensuring the appropriateness of and alternatives for the data underlining the components of the formula, learner enrolment figures, which were previously based on yearly surveys of schools, will now be collected through a tracking system developed by the Department of Basic Education. The new data will be phased in over a three-year period so as to insulate provinces from potential adjustments to their allocations resulting from the use of the new data. The Commission welcomes the improvements to the data sources underpinning the PES formula, as well as attempts to protect provinces through a phased implementation of any changes.
- 3.2.8. In contrast to provinces, the bulk of the transfers to municipalities are channelled through the local government equitable share (LGES) allocation. The proportional allocation in respect of the LGES has increased since 2014 when it comprised 47.5% of total transfers to the current 50.6% and projections indicate that by 2020, it will comprise 52.9% of the total transfers to municipalities. The increase in the proportion allocated in respect of the LGES is offset by reductions in the proportions allocated to local government conditional grants (the proportion allocated will decline from 40.9% as at 2014/15 to a projected 37.2% by 2020/21).
- 3.2.9. In terms of growth, the Commission welcomes the strong real increases in the LGES allocation. As at 2017/18 real growth in the LGES is 6.5%. Whilst real growth slows over the 2018 MTEF period, mainly as a result of overall low growth projections, increases in the LGES are set to remain at or above 4%. Given that the LES is aimed at supplementing the cost associated with the delivery of free basic services to indigent households, the priority attached to this transfer is commendable.
- 3.2.10. The general fuel levy sharing with metropolitan municipalities is the replacement for the abolished regional services council (RSC) levy and is allocated to the eight metropolitan municipalities. The proportional allocation of total local government transfers in respect of the fuel levy, exhibits a decline over the period reviewed – from 11.6% as at 2014/15 to a projected 9.8% by 2020/21. The drop in the proportional allocation occurs alongside marginal real annual average growth of 0.4% projected over the 2018 MTEF period.

3.3. Revenue and Tax Proposals

- 3.3.1. In 2017/18, the total tax revenue under collection against budget estimates is projected to reach a historic R50.1 billion. Historically, there has been sustained over-collection of tax revenues driven mainly by growth in key sectors of the economy, increased rate of taxation, higher than expected public and private sector wage settlements, strong household demand, the depreciation of the exchange rate and relatively low inflation, amongst other factors. Poor economic performance has resulted in the reversal of most of these such that in a space of less than five years, an over-collection of more than R7

billion in tax revenue has degenerated into a shortfall of more R50 billion. The highest under-collection is projected to be recorded in personal income tax (-R20.8 billion), domestic taxes on goods and services (-R11.4 billion) and company tax (-R4.8 billion). Virtually all tax instruments are projected to perform poorly. This means that increasing the tax rate of personal income tax has probably reached its limit, similarly increasing company tax is more likely to stifle the fragile growth. Efforts to raise more tax revenue should now concentrate on expanding the tax bases through the reduction of deductions, credits and allowances and improving tax revenue efficiencies through lowering compliance costs for small businesses. There is also scope to broaden the VAT base and improve its compliance. Figure 6 shows tax revenue under-collection and/or over-collection against budget estimates between 2013/14 and 2017/18.

Figure 6. Under-collection and over-collection of the main tax revenue instruments against budget estimates, 2013/14–2017/18.



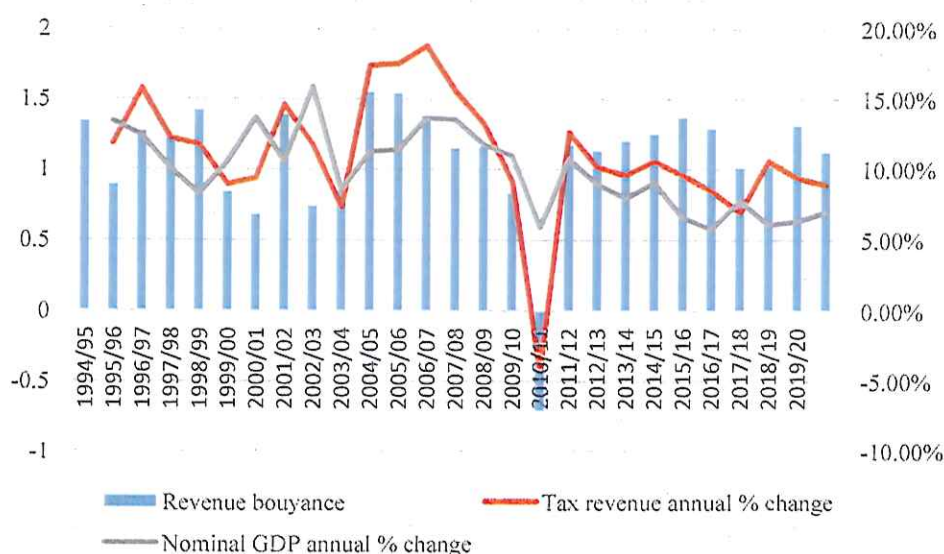
Source: South Africa National Treasury (2015–2017), Budget Reviews 2015, 2016, 2017 and MTBPS 2017.

3.3.2. The medium term projections show that the total tax revenue shortfall against budget estimates will amount to R69.3 billion in 2018/19 and R89.4 billion in 2019/20. The total tax revenue shortfall in the medium term will therefore amount to R209 billion. It is important to note that these projections assume that the growth rate will moderately increase in the medium term. This means that there is a risk of further revenue slippage if the projected growth rates fail to materialise and consequently tax buoyance does not improve. The annual percentage change in tax revenues has fallen over the past two and a half decades. Between 1994/95 and 2007/08, the average tax revenue annual percentage change was 13.29%. Between 2008/09 and 2019/20, it fell to 8.48%.

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Similarly, between 1994/95 and 2007/08, the average nominal GDP annual percentage was 11.78%. Between 2008/09 and 2019/20, it falls to 7.76%. This means that the key components that are supposed to drive the expansion of revenue associated with economic growth are performing poorly, resulting in the shortfall. The strong correlation between tax revenue and economic growth, as demonstrated by the tandem movements of the variables discussed, means that raising sustainable tax revenues will require improvements in economic growth rates. Figure 7 shows the trends in revenue tax buoyance, nominal GDP annual percentage growth change and tax revenue annual percentage growth between 1994/95 and 2019/20.

Figure 7. Revenue tax buoyance, nominal GDP annual percentage growth change and tax revenue annual percentage growth change, 1994/95–2019/20



Source: South Africa National Treasury (2016), Tax Statistics 2016, and MTBPS 2017.

3.3.3. The 2017 MTBPS did not announce any measures to raise more revenues to plug the revenue gap. It only mentioned that a team of Cabinet ministers will consider some of the proposals to support public finances. This could create a sense that there is a lack of coherence and urgency regarding how the situation will be resolved in the eyes of the credit rating agencies who are monitoring such metrics closely for their next decision on South Africa's credit rating. The key challenges to raising more revenues relate to low growth and lack of trust in the effectiveness of government spending. Restoring confidence in public institutions and ensuring greater effectiveness of public policies will be key to generating capacity to raise more taxes.

3.4. Unallocated Resources and Economic Classification

3.4.1. Unallocated reserves (see Table 4) are meant to serve as a fiscal buffer for government in times of unplanned emergencies. In previous submissions, the Commission raised concern about the danger of excessive drawdowns on these resources with a risk of low reserves should an emergency arise. The Standing Committee on Appropriations

adopted the Commission's recommendation to avoid drawdowns on the contingency reserve in its submission on the 2015 MTBPS.

- 3.4.2. The contingency reserve over the 2018/19 MTEF has declined significantly in the 2017 MTBPS when compared with the 2017 Budget. The amounts being put aside are far from adequate (R3 billion in 2018/19, increasing to R8 billion in 2020/21) for government to mitigate any unforeseen events, especially if risks identified to the expenditure ceiling materialise. These risks include more funds required to finance higher education, higher than anticipated wage settlement agreements and further ratings downgrades. The decline of the contingency reserve is to offset the revenue shortfalls and reduce borrowing. The Commission is of the view that a policy of reducing the contingency reserve in an environment of increased uncertainty and rising social demands limits the fiscal buffer that is necessary to protect public finances.

Table 4. Adjustments to unallocated reserves, 2015/16–2020/21

R'billion	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
Budget 2015	5	15	45			
MTBPS 2015		2.5	9	15		
Budget 2016		6	10	15		
MTBPS 2016			6	10	20	
Budget 2017			6	10	20	
MTBPS 2017				3	5	8

Source: Budget Review (2014, 2015, 2016), MTBPS (2013, 2014, 2015, 2016).

- 3.4.3. Table 5 provides details of the economic classification of consolidated government expenditure. Over the period reviewed (2017/18 to 2020/21), not surprisingly compensation of employees records the highest real average annual growth rate. Disaggregating this average growth to real year-on-year growth, the following trends are notable:
- 3.4.4. The compensation budget is increasing in real terms over the 2018/19 MTEF period. The growth of the compensation budget over this period suggests government could be budgeting for a wage bargaining agreement that is within a 1–2% range above CPI. These projections assume government will maintain the existing headcount figures, which have declined by 22 000 since 2012/13. Should the wage bargaining agreement be in excess of the predicted range, government's fiscal position could worsen, leading to a higher debt to GDP ratio. The Commission is of the view that both government and unions should aim to reach a settlement that supports government's current fiscal position as this would be in the best interests of the country. The Commission also reiterates a previous recommendation that the personnel costs of employees should be linked to productivity.
- 3.4.5. The spending on goods and services is increasing on average by 1.2% over the 2018/19 MTEF period. Government has been implementing cost containment measures since 2012/13 to curb spending on non-core goods and services. For the period 2012/13–

2016/17, spending reductions on non-core goods and services amounted to R1.9 billion. The Commission does not agree with government's sentiment that reductions in goods and services have reached a peak and cannot be reduced any further. Strict adherence to existing cost containment measures should continue and reductions in non-core spending areas such as catering, travel and subsistence, advertising, conference facilities and consultants should be encouraged. In particular the Commission is of the view that government should leverage innovative e-communication technologies to further reduce the R9.3 billion spent on travel and subsistence in 2016/17.

- 3.4.6. Transfers and subsidies form the second largest category of the government budget after compensation of employees, with allocations amounting to R505 billion in 2017/18. Transfers and subsidies increase by 1.8% in real terms over the 2017/18 MTEF period. This is largely as a result of government maintaining expenditure growth on key programmes such as social grants and transfers to provinces and municipalities.

Table 5. Real growth in government consolidated expenditure by economic classification

R'billion	2016/17	2017/18	2018/19	2019/20	2020/21	Real Annual Average Growth Rate
Compensation of employees	510	549.3	587.9	629.9	677.8	1.8%
Goods and services	208.1	220	236.4	255.8	270.2	1.2%
Transfers and subsidies	472.9	505.1	543.1	584.8	627.1	1.8%
Payments capital assets	93.6	102.4	105.1	109.3	113.8	-0.5%
Real year-on-year growth (%)		2016/17– 2017/18	2017/18– 2018/19	2018/19– 2019/20	2019/20– 2020/21	
Compensation of employees		2.2%	1.6%	1.5%	2.0%	
Goods and services		0.19%	2.03%	2.61%	0.03%	
Transfers and subsidies		1.28%	2.10%	2.08%	1.63%	
Payments capital assets		3.88%	-2.79%	-1.60%	-1.48%	

4. REFLECTIONS ON ALLOCATIVE EFFICIENCY, CHALLENGES AND OPPORTUNITIES WITHIN KEY PRIORITY AREAS


4.1. Medium Term Strategic Framework Goals and Delivery Progress

- 4.1.1. Through the medium term strategic framework (MTSF), which covers a five year period, the government sets priorities and targets to be achieved by the year 2019. Currently, the government is in the third year of the MTSF, so it is important to undertake an assessment of the progress made to date and the possibility of attaining set targets. Table 6 highlights some of the key MTSF targets per sector and progress made.

Table 6. Selected MTSF priorities and delivery progress against the NDP

Sector	Priority	MTSF Target	Progress	NDP targets
Economic growth	GDP growth	5% by 2019	Average growth of 1.9% between 2010 and 2016	5.4%
Employment and job creation	Employment growth	To increase by 350 000 per year in 2014 to 2015 – rate of employment growth to increase, targets set annually	Average of 296 000 new job opportunities per annum for the past three years	11 million more jobs with annual targets set on a rising scale
	Expanded Public Works Programme work opportunities	Six million	4 185 426 work opportunities	
	Community Work Programme work opportunities	One million	Just over one million annual cumulative work opportunities	
Health	Increasing the number of people on antiretrovirals	5.1 million	3.8 million	
	Raising life expectancy at birth	63 years	63 years	
Education	Grade 12 learners qualifying for university entrance	250 000	162 374	450 000
	Students enrolled at universities by 2019	1.07 million	985 212	1.62 million
Socio-economic (poverty)	Decrease percentage of the population living below the lower bound poverty line by 2019	To 22% – lower bound	25% – lower bound	
Human settlements	Municipalities accreditation/assignment	49	More than 49 accredited for level 1 and 2, zero for level 3 assignment	
	Adequate housing	1.4 million units	For the past 3 years 285 806	

Source: Commission's compilation.



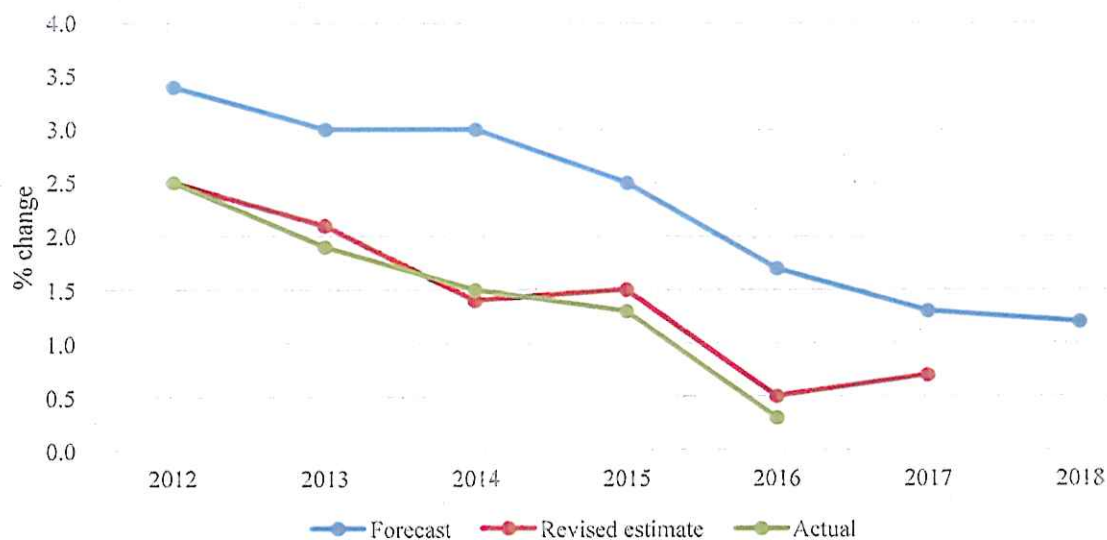
- 4.1.2. Table 6 shows mixed results with respect to the progress to date. Set targets over the MTSF period are closer to attainment in some areas, while a lot of work remains in others. Attaining several of the targets is directly or indirectly dependent on economic growth. There are a number of reasons for slow economic growth and these include South Africa's vulnerability to external shocks (particularly during times of low commodity demand and prices). A strategy to mitigate vulnerability to external shocks is to increase value addition in South African exports. South Africa will be able to create some sustainable job opportunities and employment through economic growth.
- 4.1.3. With respect to health, good progress has been made to date in terms of increasing the number of people on ARVs and increasing life expectancy. The target for increasing life expectancy to 63 has been achieved, while the target to increase the number of people on ARVs could be achieved in 2019. While good progress has been made, there should be a stronger emphasis on prevention.
- 4.1.4. In the education sector, achievement of the MTSF targets is possible by increasing the number of learners qualifying for university entrance and students enrolled at universities. This progress on health and education is good and provides opportunities for the population to live longer and be better educated. However, it also provides a challenge as more resources will be required from the fiscus. For example, more matric learners passing with university entrances will increase the number of students in universities. Therefore, while the government is in the process of finding funding solutions for free university education, it must also think of how an increase in the number of students will be funded in future to ensure that learners who perform well enough in matric to qualify for university entrance are not lost from the system for financial reasons. Overall the Commission notes the good progress made in achieving the MTSF policy targets and recommends that further attention is placed on improving the quality of outcomes.

4.2. Accelerating Economic Growth

- 4.2.1. Economic growth acceleration was the central priority of the 2016 MTBPS, however reaching the set growth targets remains a wishful desire. The 2017 MTBPS growth forecast is far below the 5.5% NDP target and estimates made in recent budgets.
- 4.2.2. To accelerate growth, the economy requires a package of effective stimulus measures which re-ignite short term demand and investment, but also importantly, foster sustainable development. Many of policy priorities outlined in the Presidency's mandate paper and the 2017 MTBPS are geared towards promoting growth. Key among these interventions is a repeated focus on job creation and small business development, infrastructure expansion and maintenance as well as education and skills improvement. These have been identified as key drivers of growth in many budget statements and yet the economy remains unresponsive, as illustrated in Figure 8.
- 4.2.3. A number of factors explains this hiatus. First, the amount of funding allocated to growth interventions may be too small to make a meaningful impact. Second, the outcome associated with interventions are either poor or negligible because of inefficiencies and

poor programme design. Lastly, the severity of structural impediments (as indicated in the 2017 MTBPS) outweighs the spending effect on the economy so that any expansionary measure is suppressed by underlying weaknesses.

Figure 8. MTBPS GDP growth rate estimates and targets 2012–2018



Source: Compiled from MTBPS documentation.

4.2.4. A low growth environment provides government with ample opportunity in which to lay a foundation for buoyant growth in the up-turn by assessing and addressing fundamental economic growth constraints. Preparations for accelerated growth should therefore entail a comprehensive review of direct and indirect budget programmes aimed at promoting growth with a view to terminating non-performing programmes, consolidating similar ones and redirecting the focus towards high impact areas. Concerted efforts to understand the nature of structural barriers, and a holistic approach to addressing such impediments could also provide a solid foundation for long-term sustainable growth. In particular, there is need to reinforce the role of the Competition Commission in driving the agenda of structural economic reforms. These interventions should be accompanied by wholesale improvement and greater commitment to good governance, financial management, rule of law and effective accountability.

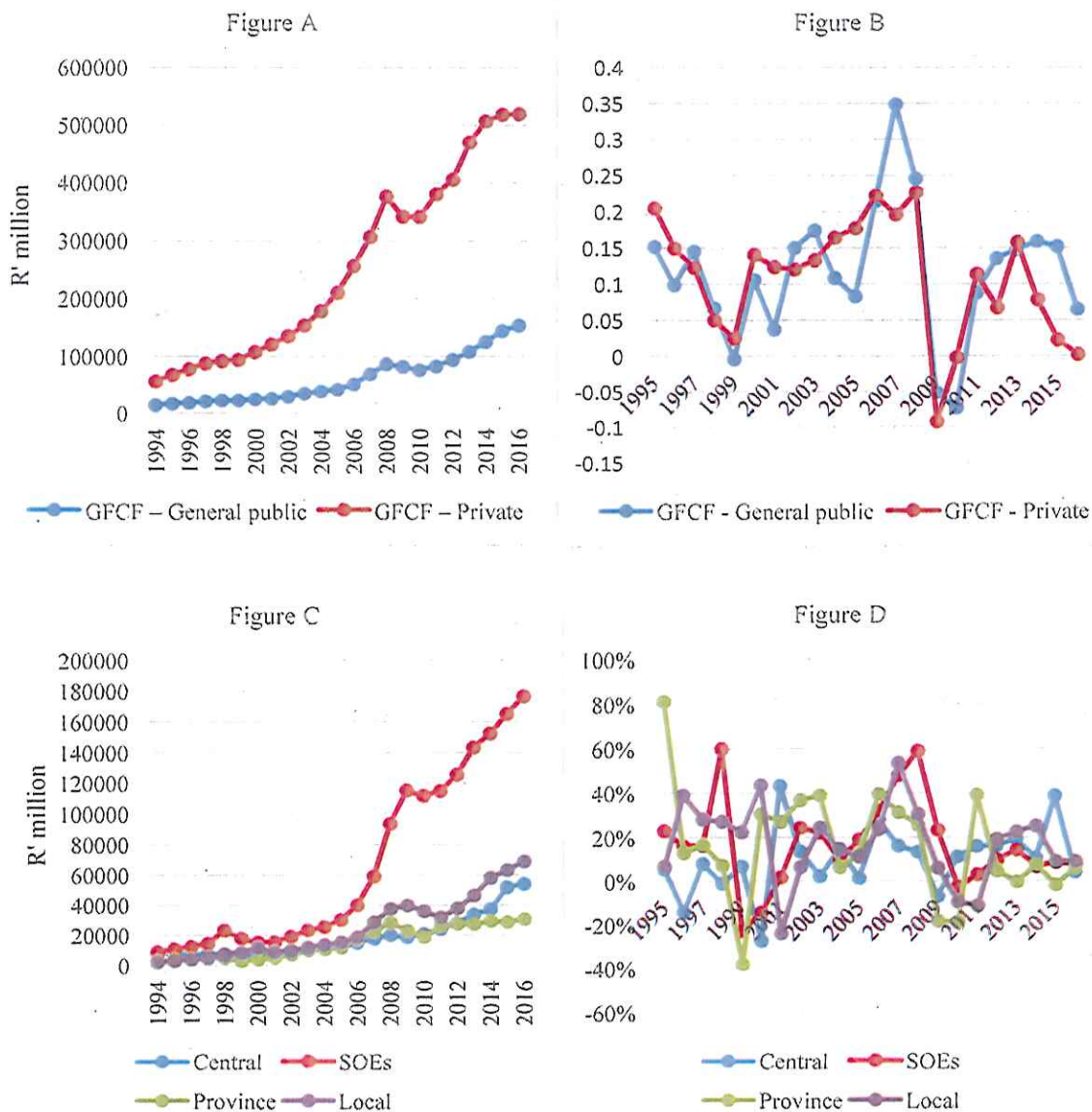
4.3. Infrastructure Investment

4.3.1. Government has been spending approximately R300 billion per annum on infrastructure since 2009 and the 2017 MTBPS proposes a further R900 billion capital spend over the 2018 MTEF. A great proportion of infrastructure investment is driven by SOEs, many of which are beleaguered by the challenges of endemic corruption and project cost overruns. Spending deficiencies at this level undermines government's efforts to move goods from road to rail, to speedily unlock a critical growth constraint and to change the composition of expenditure towards social outlays.

4.3.2. The Commission reiterates its concerns regarding the distributional inequity of SOE infrastructure spend as this serves to reinforce regional development inequities and

uncoordinated development planning. Figure 8 uses Gross Fixed Capital Formation as a proxy for infrastructure investment by sector and levels of government. As is evident from Figure 9, the private sector in Figure A and SOEs in Figure C, are the dominant drivers of capital formation. Growth patterns between the public and private sector seem to follow a uniform trajectory while that of government institutions shows an inconsistent trend (see Figure 9 D). The fluctuating growth pattern suggests that government lacks a sustained focus in addressing various categories of infrastructure, or capital budget is used as an adjustment tool for remedying pressures in other spending areas. In the absence of additional funding for new infrastructure greater emphasis should be placed on improving the quality of capital stock delivered, the maintenance of existing stock, and reducing cost overruns on ongoing projects. The Commission welcomes a redirected focus of provincial capital funding towards maintenance.

Figure 9. Gross Fixed Capital Formation trajectory by sector and sphere 1994–2016



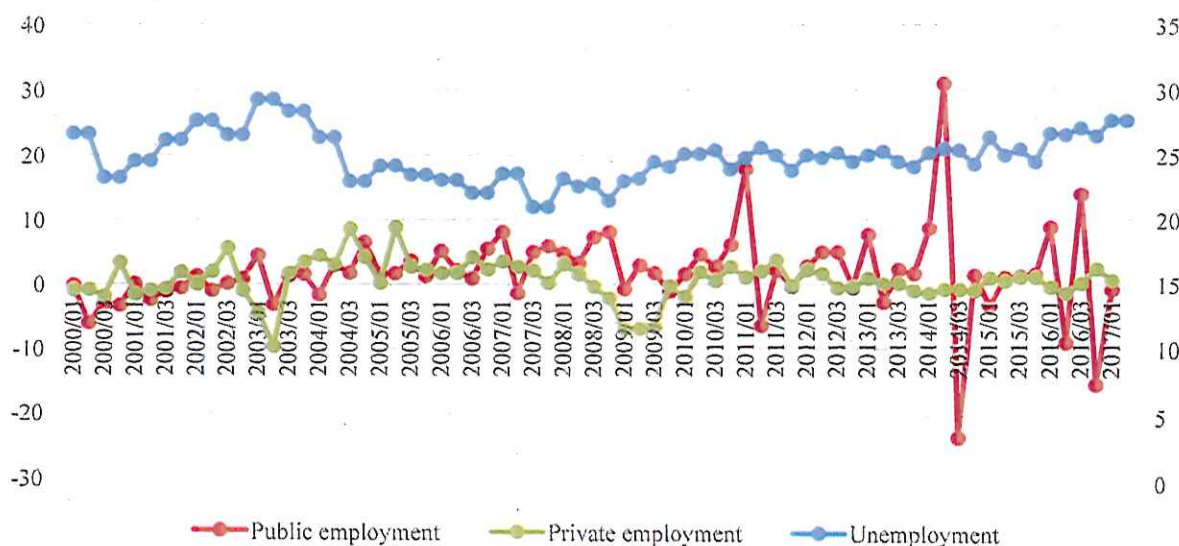
Source: Regional Explorer Database.

4.4. Job Creation

4.4.1. Employment creation remains one of South Africa’s most elusive developmental goals, unresponsive to both fiscal interventions and economic upswings. With the ongoing bleak economic climate, private and public employment undergoes fluctuating cycles of job shedding and generation but the net effect is rising unemployment approaching levels last experienced in 2002 (see Figure 10).

4.4.2. The increases take place amidst the background of five million job opportunities having been created through EPWP and the CWP (see Table 6). As with economic growth, employment challenges are generally attributable to structural issues pertaining to low education and skills levels. As a result, the downswings gravely affect low-skilled employees in the main. The 2017 Budget provides little cushion for people who have been laid-off as a result of the downturn, apart from existing, regular social relief programmes, insurance benefits and indirect job creation initiatives such as small business development. Budget responses to the nature of unemployment affecting South Africa should emphasise the design of policy or programmes which offer industry appropriate skills or re-skilling to the unemployed and laid-off. Unemployment insurance benefits should provide options for re-skilling through the various Sector Education and Training Authorities (SETAs). The government’s direct employment initiatives including the EPWP, CWP and Community Health Worker programme are also welcome interventions but should not be seen as an adequate response to job losses. Instead, programmes should focus on improving job content and quality, training participants and monitoring the transition rate to formal employment. In its 2017/18 Submission to Division of Revenue, the Commission recommended that government should narrow the focus of public employment programmes and target unemployed people with no prior work experience and access to social grants.

Figure 10. Unemployment rate and changes in public and private employment, 2000–2017



Source: Regional Explorer Database.

4.5. Health

4.5.1. The Commission welcomes the introduction of funding for the Community Health Worker Programme (CHWP) under the comprehensive HIV, AIDS and TB conditional grant. A ring-fenced allocation of R4 billion is allocated towards CHWP over the 2018 MTEF. This allocation will assist in ensuring budget stability for CHWs and health promotion in poor communities. The Department of Health needs to ensure that the programme is standardised across all provinces and targeted at poor communities or districts with a higher disease burden and limited access to health facilities. It is also important that part of the funding is directed towards improving training and expanding the focus of the programme from targeting a single population grouping or disease to offering a comprehensive bundle of services.

4.5.2. Additional funding of R24 million is further earmarked through the National Tertiary Services Grant (NTSG) over the MTEF to expand the piloting of Diagnosis Related Groups² (DRGs) in the Western Cape. This pilot is currently limited to selected areas within the province. Thus additional funding will ensure that the project becomes province-wide with the required capacity. The Commission welcomes this proposal as DRGs will ensure better costing, case mix and improved budget and expenditure control. Expanding the pilot will broaden lessons learned by the government (as different areas have different circumstances) to ensure the seamless rolling out of the project nationwide. Furthermore, the Commission supports the proposal to earmark 25% to 40% of the direct Health Facility Revitalisation Grant and the indirect National Health Insurance (NHI) Grant for the maintenance of infrastructure, to address the growing deterioration of facilities.

4.6. Basic Education

4.6.1 The Commission notes and welcomes the proposed additional adjustment to the PES baseline to address cost pressures that are experienced by schools arising from increasing municipal costs and for additional educators to continue expanding universal access to Grade R. The Commission, however, recommends that schools should be encouraged to explore alternatives to reduce operational costs in the long run, where feasible. Examples include investing in boreholes for water and solar energy.

4.6.2 The Commission further supports the proposed reduction in the School Infrastructure Backlogs Grant (SIBG), as it underperforms. However, the Commission's research on the performance of direct and indirect grants in 2015 found that indirect grants generally perform poorly compared with direct grants. Therefore, one of the recommendations made for the 2016/17 Division of Revenue, which the Commission wants to reiterate in this submission, is that the National Treasury and line departments consider using indirect grants as a measure of last resort while continuing to build capacity in provinces and municipalities. The Commission also supports the proposal that part of the funding

² A patient classification system that standardises prospective payments to hospitals and encourages cost containment.



reduced from the SIBG be allocated to the Education Infrastructure Grant (which is a direct grant) for the maintenance of existing school infrastructure. This ensures that the funding will be used within the education sector.

4.7. Human Settlements

4.7.1. In its last 2017/18 Submission to the MTBPS, the Commission indicated that the funding and provision for human settlements has to be implemented in a coordinated and sustainable way based on a forward-looking vision (including areas of future growth due to migration patterns and urbanisation). The Commission reiterates this recommendation and the need to improve coordination with respect to all relevant departments and programmes.

4.7.2. During 2016/17, ten municipalities were assisted with capacity building for level 1 and 2 accreditation, a good performance compared to 2015/16, where not a single municipality received support for level 1 and 2 accreditation. The Commission supports this capacity building achievement as it represents movement towards implementation of its recommendations on accrediting municipalities with the housing function. The Commission is also aware that the national Department of Human Settlements is busy with a revised framework for the housing function assignment. The Commission is, however, concerned that the revised function shift approach is yet to be finalised and this continues to create uncertainty, particularly for metropolitan municipalities. The Commission therefore reiterates its recommendation made in the 2016 MTBPS Submission that the Department of Human Settlements should finalise a revised framework for the housing function shift without further delay.

4.7.3. To reduce the title deeds backlog, it is proposed that a new grant be introduced. The Commission supports this development as the country's title deeds backlog remains high, and the proposed grant will be a direct conditional grant to provinces that have demonstrated good performance. With respect to the indirect component, the Commission recommends a capacity building programme so that those provinces deemed to lack capacity are capacitated in order to receive this funding as a direct grant. The Commission also notes and support the establishment of a grant for emergency housing in line with the housing policy.

5. SPECIAL ISSUES: HIGHER EDUCATION, BROADBAND AND STATE-OWNED ENTITIES

5.1. Higher Education

5.1.1. Allocations to the learning and culture function, which includes post-school education and training (PSET), basic education and arts, sports recreation and culture, is projected to grow by a real annual average of 2% over the 2018 MTEF period. Relative to growth in the other allocations under this functional area, PSET illustrates the strongest real annual average growth of 2.5% over the 2018 MTEF period. Whilst the Commission welcomes this relative prioritisation of PSET, the delayed finalisation of the outcome

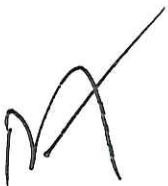
and recommendations of the Heher Commission of Inquiry into Higher Education and Training, which looked into the feasibility of free higher education and training in South Africa, creates uncertainty for higher education institutions and students.

In 2017, government pronounced that the increase in university fees would only apply to students from households with incomes greater than R600 000, thus effectively exempting all National Student Financial Aid Scheme (NSFAS) qualifying students and those falling in the “missing middle”. Unfortunately, the 2017 MTBPS is silent on whether similar provisions will be made in 2018 and decisions have been deferred to the 2018 Budget. Delaying decisions to February 2018 creates uncertainty and places pressure on the ability of higher education institutions, students and households to effectively budget and plan for the 2018 academic year.

- 5.1.2. With respect to NSFAS, the 2017 MTBPS notes that if the funding scheme were to consider covering the full cost of study of, for example, 30% of undergraduate students in addition to the R11.4 billion that is currently available, NSFAS would require an additional R10.7 billion. In addition to the funding shortfalls that may arise as result of covering the full cost of study through NSFAS, the Commission is concerned about the key challenge that the funding scheme continues to face when it comes to recovering funds from its debtors. A poor recovery rate has implications for how many students the scheme is able to assist, as well as the sustainability of the scheme in the long term. As proposed in the Commission’s submission on the 2017 Appropriations Bill earlier this year, options around differentiating repayment periods and interest rates charged on outstanding amounts should be explored as avenues for improving the recovery rate. In addition, consideration should be given to linking repayment periods and interest charges more closely to earning levels.
- 5.1.3. Overall, on the issue of fee-free higher education, and as articulated to the Heher Commission in March 2017, the Commission is of the view that the PSET grant and loan system should continue to be strengthened so as to avoid financial barriers to accessing tertiary education. The Commission cautions against the implementation of a blanket student subsidy, however, as it may serve to perpetuate inequalities since it disproportionately benefits wealthier students.
- 5.1.4. Higher education institutions facilitate research and innovation and in this vein, the Commission is concerned with the tightening squeeze on resources available to universities. In addition to the pressures outlined above, the recent reduction in National Research Foundation (NRF) funding to rated researchers is a case in point. Announced in October 2017, with reductions being effected as soon as January 2018, resources to fund research associated with postgraduate studies will be significantly constrained.

5.2. Broadband

- 5.2.1. Greater investment in information and communication technology (ICT) can facilitate employment and inclusive growth, as well as access to service delivery, by enabling



poor and rural communities to be reached. On the other hand, poor connectivity or poor broadband infrastructure, especially in under-resourced communities, serves to effectively exclude these communities from the potential benefits and opportunities that are associated with greater connectivity. A key barrier, particularly in respect of the small and medium enterprises (SMEs) sector, to doing business relates to the affordability and reliability of internet access.

5.2.2. In order to roll out high speed mobile and broadband services, mobile operators and wireless service providers require more spectrum³ to be released by government. Given the above, the continued delay in assigning spectrum comes with significant social and economic implications for South Africa and threatens government's ability to achieve the target of broadband for all, as outlined in the National Integrated ICT Policy White Paper.

5.2.3. The Commission welcomes references within MTBPS 2017 regarding (a) work that is underway to license broadband spectrum and (b) that the bulk of the additional telecommunication spectrum is ready to be allocated immediately. However, the Commission would have preferred these statements to be accompanied by clear delivery and progress timelines to provide clarity on exactly when these processes will be finalised.

5.3. State-Owned Entities

5.3.1. The financial health of SOEs have had a direct bearing on the public finances of the country. Continuous cash injections to assist ailing SOEs have placed undue stress on the fiscal framework, with R13.7 billion being redirected from funding potentially more productive aspects of service delivery. Poorly performing SOEs have also significantly endangered South Africa's sovereign credit rating which has implications for the cost of borrowing and the general attractiveness of South Africa as an investment destination.

5.3.2. The size of the guarantees provided to major SOEs, namely Eskom, Transnet, South African Post Office (SAPO), Telkom, SA National Roads Agency Limited (SANRAL), South African Airways (SAA) and South African Broadcasting Corporation (SABC), were projected to increase at the time of the 2017 Budget tabled in February (see Figure 10). The likelihood of the upward trajectory illustrated in Figure 11 has been confirmed in the 2017 MTBPS.

³ According to the National Integrated ICT Policy White Paper, spectrum refers to frequencies that are used to transmit sound and data for cellular radio, radio-paging, satellite communication, over-the-air broadcasting and other services.

Figure 11. Total government guarantees to major SOEs, 2006/07–2019/20

Source: Budget Review 2017.

5.3.3. In the 2017 MTBPS speech, the Minister of Finance indicated a range of actions that will be undertaken to turn around the performance of SOEs. These include ensuring that the boards of directors overseeing SOEs are capable and qualified – a longstanding, unrealised goal of government. Whilst improvement in SOE governance is sorely required, the Commission is of the view that such efforts should be complemented by parent departments playing a stronger role in overseeing SOEs and timeously reigning in non-performers.

5.3.4. The Minister of Finance also alluded to stricter controls around the granting of guarantees. Whilst detail on these measures has yet to be provided, the Commission is of the view that the implementation of a set of uniform rules and procedures to guide the granting of guarantees and bailouts can assist in minimising government's exposure to risk. These measures can however only be effective if controls are stringent enough to lessen the moral hazard that has been created through a historical trend of continuous, almost automatic, bailouts that have prevailed in South Africa. To ensure greater accountability, and therefore more prudent use of public funds, a set of uniform rules and procedures to inform the granting of guarantees and bailouts should: (a) consider the public value of the services provided by the SOE (b) assess the historical performance of the entity (c) outline in detail the procedures for monitoring performance under the guarantee/bailout as well as corrective measures and sanctions should performance be sub-optimal or where an SOE does not meet the conditions of the guarantee granted to it. Appropriate disincentives should also be applied to ensure that parent departments act proactively and timeously to ensure a turnaround in SOE performance, thereby limiting the need for future guarantees.

6. REVIEW OF ACTUAL SPENDING BY NATIONAL DEPARTMENTS AND PROVINCIAL GOVERNMENT – 1 APRIL TO 30 SEPTEMBER 2017

6.1. Expenditure smoothing implies government spending that is evenly distributed through the four quarters of the financial year. If such smoothing were to occur, it would be

expected that total expenditure up to September would be at 50% of the main budget. This would of course differ depending on whether a government programme is recurrent or capital-expenditure driven. Expenditure smoothing would most likely lead to an improved quality of spending and a reduced level of unauthorised spending

- 6.2. Table 7 shows aggregate spending and the percentage spent six months into the 2017/18 financial year. Total government spending is approximately 1% below the norm of 50%. Spending by all votes also approximates the 49% mark (R373 billion of the main budget). With respect to the provincial equitable share, 50% of the total amount has been transferred.
- 6.3. Using selected national departments that are driving government priorities (education, health) and key built environment programmes for example, transport, energy, and water and sanitation, government has spent R184.9 billion which is 1% above to the norm. An assessment of individual departmental performance shows somewhat uneven spending patterns. On the one hand certain departments such as Higher Education far exceed the norm, whereas others such Human Settlements and Rural Development have recorded spending rates of below 40%.
- 6.4. Excessive deviations below or above the norm are undesirable from an expenditure smoothing perspective. Unless a department's in-year cash management plan explicitly identifies under- or over-spending as a chosen spending profile, departments should attempt to remain within the confines of spending performance guidelines.



Table 7. Aggregate spending and deviation from the norm (April – September 2017)

R'million	2016/17		
	Main budget	Actual spending April – September	% Spending
Total	1 409 215	686 212	49%
Total appropriation by vote	767 038	373 382	49%
Total direct charges against the National Revenue Fund	636 178	312 830	49%
General fuel levy	11 785	3 928	33%
Debt service costs	162 353	78 626	48%
Provincial equitable share (National Treasury)	441 331	220 666	50%
Selected key budget votes	363 329	184 954	51%
7 Public Works	7 038	3 393	48%
15 Basic Education	23 409	12 631	54%
16 Health	36 468	18 132	50%
17 Higher Education and Training	52 308	38 316	73%
21 Correctional Services	22 814	10 681	47%
25 Police	87 025	42 110	48%
26 Agriculture, Forestry and Fisheries	6 807	3 433	50%
28 Economic Development	797	423	53%
29 Energy	8 113	4 395	54%
31 Human Settlements	33 464	13 064	39%
33 Rural Development and Land Reform	10 184	3 772	37%
37 Transport	59 795	27 642	46%
42 Water and Sanitation	15 107	6 962	46%
Provincial level	551 919	226 563	41%
Education	223 924	93 070	42%
Health	177 875	76 992	43%
Social Development	19 024	7 390	39%
Other	131 096	49 111	37%

Source: MTBPS 2017, Commission's calculations.

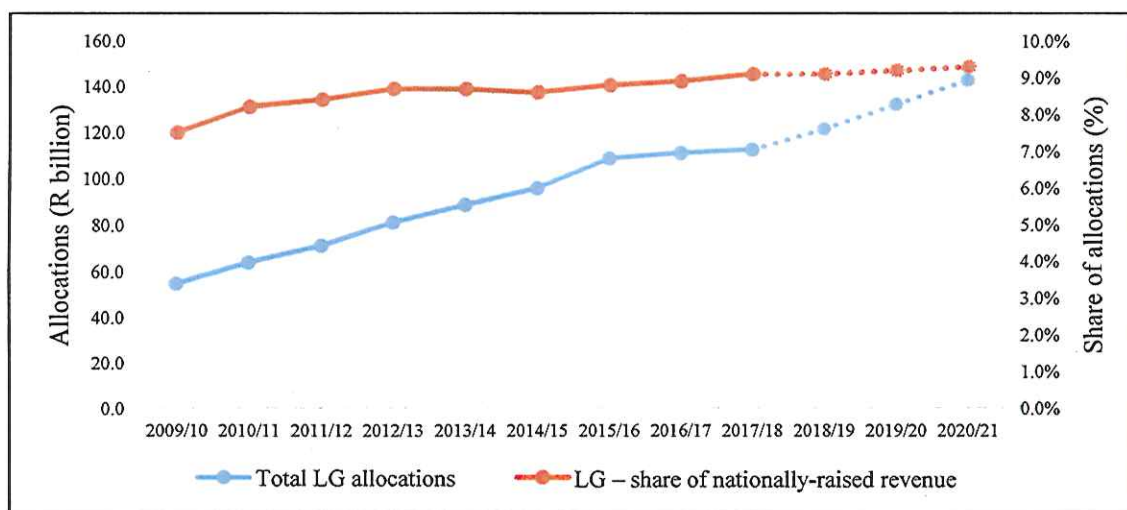
7. LOCAL GOVERNMENT ISSUES

7.1. Overview of Local Government Allocation

7.1.1. The Commission takes note of the increase in the total amount of funds allocated to the local government sphere. The allocations and percentage shares that accrue to the local government sector are presented in Figure 12. Over the period 2009/10 to 2017/18, the total amount of allocations has doubled from R54.6 billion to R112.6 billion, and is anticipated to increase to R143 billion in 2020/21. The share of nationally-raised revenue that the sphere receives has increased from 7.5% in 2009/10 to 9% in the 2017/18 financial year. Over the 2018 MTEF the total allocations are expected to increase by R21.4 billion. Over the next three years, the allocations are set to grow in real terms by 2.6% on average.

7.1.2. The Commission welcomes the confirmation of the additional R1.9 billion to the baseline of local government allocations as announced in the 2017 budget. The bulk of this amount (R1.5 billion) is set to be allocated through the LGES. These additional resources will not only raise the share of the local government allocations (to 9.3% by 2020/21), but it will significantly cushion the poor from the risks associated with low economic growth.

Figure 12. Total local government allocation (R'billion) (2009/10–2019/20)



Source: Division of Revenue Bill, 2013; 2017 and 2017 MTBPs.

7.2. Local Government Equitable Share, General Fuel Levy and Conditional Grants

7.2.1. The allocations to the local government sphere are in three forms: the local government equitable share, the general fuel levy and conditional grants. The allocations for each of these components is presented in Table 8.

Table 8. Medium Term Expenditure Framework Division of Revenue (R'million)

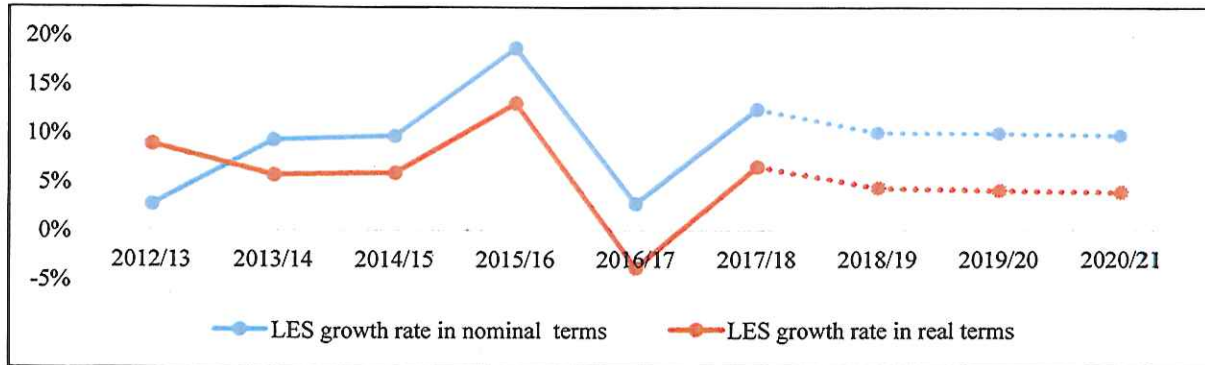
R'million	2013/14	2014/15	2015/16	2016/17	2017/18 revised estimate	2018/19	2019/20	2020/21	Real average growth rate (2018/19 - 2020/21)
	Outcome				Mid-term expenditure estimates				
Local government total allocations	88 541	95 820	108 708	111 079	112 578	129 066	138 491	142 961	2.6%
Equitable share and related ¹	38 964	41 592	49 367	51 169	57 012	62 732	67 473	75 683	4.1%
General fuel levy sharing with metros	9 613	10 190	10 659	11 224	11 785	12 469	13 167	14 027	0.4%
Conditional grants	39 963	44 037	48 683	48 686	43 781	53 865	57 851	53 251	1.2%

Source: 2017 MTBPS.

MX

7.2.2. The local government equitable share allocations continue to grow. In the next three years both the nominal and real LGES allocations are envisaged to increase but the growth rate (both nominal and real) is set to be restrained over the MTEF (see Figure 13). In fact, over the MTEF, the LGES allocations are set to increase by 4.1%, a slight drop from the 5% noted in the 2017 MTEF.

Figure 13. Growth in LGES allocation

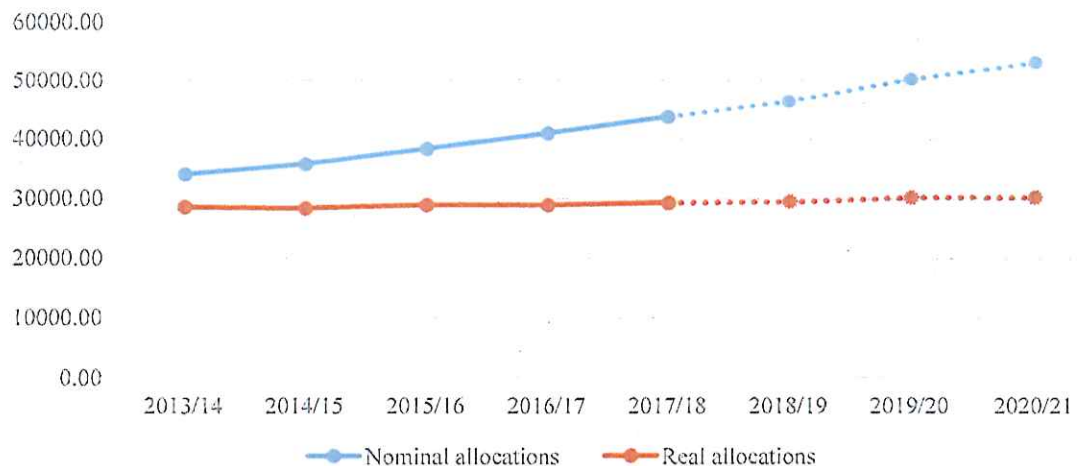


Source: Division of Revenue Bill, 2017

7.2.3. The Commission welcomes the increase in allocations via the LGES window, and notes that the formula continues to redistribute funds and allocate more resources to poor households. However the Commission remains concerned at the continued subdued growth rates of the LGES. To ensure that this does not compromise the delivery of basic services, municipalities may need to promote more efficient utilisation of the available resources, and find other alternative revenue sources.

7.2.4. The general fuel levy is shared between metropolitan municipalities. Over the MTEF, the fuel levy is set to increase from R12.5 billion in 2018/19 to R14 billion in 2020/21. In real terms, its growth rate will amount to 0.4% on average over the 2018 MTEF.

7.2.5. Over the 2018/19–2020/21 period the local government sector is set to receive an allocation of R150 billion in the form of conditional grants. The progression of nominal and real conditional grants allocation over the 2018/19–2020/21 period is shown in Figure 14. This suggests that conditional grants will continue to experience a positive but very low, real growth rate trajectory.

Figure 14. Local government conditional grant allocations (R'-billion)

Source: Commission's Calculations based on 2017 MTBPS.

7.2.6. The Commission welcomes indications from government that it will introduce performance incentives within the municipal infrastructure grant for intermediate cities and within the Public Transport Network Grant. This is in line with the Commission's two previous recommendations, i.e. that there is a need to approach grant funding in a differentiated manner; and that for large cities grants should be coupled with incentives, while for struggling municipalities, grants should be coupled with support programmes. The Commission would like to underscore the point that incentives should be based on clearly defined (but differentiated) performance indicators.

7.3. In sum, the Commission emphasises that municipalities should review internal management structures so that resources transferred to them are used efficiently and effectively. Municipalities need to improve their revenue management, billing and debt management systems, impose cost reflective tariffs, avoid incidences of underspending, and inefficient procurement processes.

8. REVISED DIVISION OF REVENUE 2017/18

8.1. Annually government makes adjustments to the budget approved in February. The purpose of the adjustments is to cater for unforeseen and unavoidable (U&U) expenditure. Declared unspent funds amount to R1.7 billion in 2017/18, which is a slight increase when compared to R1.3 billion declared in the 2016/17 revised division of revenue. With respect to underspending, it has remained unchanged at R3 billion.

8.2. U&U expenditure amounts to R586 million. U&U of R500 million will be used for water and sanitation programmes, in particular to implement the water supply scheme and upgrade the capacity of water transfer schemes. The Commission supports initiatives and programmes by government to extend access to water supply to address issues of access and backlogs within the sector. However, the Commission is concerned that the indirect component of the grant is being used to address water and sanitation programmes, given

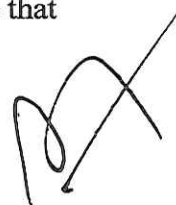
the findings of a Commission study⁴ in 2016/17. The findings highlighted the fact that direct grants performed better than indirect grants. Therefore, the Commission recommended the need for the continued building of capacity of provinces and municipalities, with the use of indirect grants as a last resort.

- 8.3. Further, U&U expenditure, the Commission notes that government has earmarked funding of about R19.8 million that has been added to the Comprehensive HIV, AIDS and Tuberculosis Grant, to assist the funding gap that is weakening the effectiveness of the malaria programme. Additionally South Africa has been identified by the African Union and the Southern African Development Community (SADC) as being eligible for malaria elimination given our significant achievements in reducing malaria morbidity and mortality. The Commission submits that government funding for malaria is critical to further accelerate progress towards malaria elimination. Furthermore, effective national malaria programmes are key to achieving the goals set out in the Global Technical Strategy for Malaria. The Commission would like to reiterate the Submission made to the Division of Revenue Bill 2017 with regards to Comprehensive HIV/Aids and TB grant. In the Submission, the Commission noted the baseline reduction by R327.3 million over the 2017 MTEF. The Commission, cautioned the baseline reductions to this grant, given that the grant was already under pressure due to the increased uptake of people on ARVs every year and the extension of the scope of the grant, in 2016, to include tuberculosis (TB).
- 8.4. Roll-overs amount to R217 million, a further decrease when compared to R412 million in 2016/17. The Department of Cooperative Governance and Traditional Affairs (Cogta) has the largest roll-over and has also increased the extent of its roll-overs from R27.9 million in 2016/17 to 73.2 million in 2017/18. These roll-overs by Cogta include R27.9 million for the Municipal Demarcation Transition Grant. This grant was rolled over in the year 2016/17 as the indirect grant. However, it was not spent as mechanisms and processes towards this being an indirect grant were not agreed upon. Hence in 2017/18 it has been rolled over (again) as a direct grant. The Commission notes these changes as they are aligned with the FFC's previous recommendation on the use of indirect versus direct grants in the intergovernmental fiscal framework.

9. MAJOR RISKS AND MITIGATION

- 9.1. The principal fiscal risk, brought starkly to bear by the reaction to 2017 MTBPS presentation, is the inability to control an upward trend in the ratio of public debt to GDP. This is caused by running budget deficits as a percentage of GDP well in excess of the growth in GDP in itself. Of necessity, if the budget deficit and associated borrowing requirement grows faster than the GDP itself, this is bound to raise the ratio of public debt as a percentage of GDP. This in turn raises the risk of default on that debt in the sense that

⁴ FFC Submission for the 2016/17 Division of Revenue: A Review of the Direct and Indirect Conditional Grants.



the interest payable on public debt rises to the point where it crowds out the ability of government to spend on anything else, including vital social needs. In turn, again, a heightened risk of default on government debt causes ratings agencies to reduce the country's credit rating. This raises long-term interest rates, exacerbating the manner in which interest payments on government debt crowd out other forms of government spending.

9.2. There are a number of key factors heightening the risk of a rising budget deficit and public debt. Many of the issues are related to one another and can be conveniently clustered into revenue and expenditure (both Opex and Capex) categories. The principal ones are:

- The first fiscal risk lies not so much with the expenditure side as with the *revenue side of the equation*. What the figures produced in 2017 MTBPS clearly illustrated is that relying on personal tax to fund the budget through higher personal tax rates, has largely been exhausted. Government's tax collection from personal tax this year is now budgeted to be R21 billion less than budgeted for in February. Much of the reduced economic growth in the past year has been derived from the fact that the top marginal tax rate was effectively increased from 41% to 45%. At this level we are clearly seeing great resistance to tax compliance and associated restructuring of remuneration to avoid paying such a high personal tax rate. The government is clearly going to be forced to look for alternative sources of tax revenue to fund the tax shortfall in coming years. The most obvious alternative is to increase the rate of VAT. Bearing in mind that budgeted revenue from VAT is just over R300 billion, a 1% increase in the VAT rate from 14% to 15%, equivalent to an increase of 7.2% in VAT, would theoretically raise R21 billion. However, this is likely to be severely contested by trade unions and groups concerned with the interests of the poor. Consequently, the government has a huge challenge in terms of raising sufficient revenue to plug the revenue shortfall.
- The second major fiscal risk rests with *public sector remuneration*. If only the government had redirected its expenditure towards infrastructural developmental projects rather than bloating a public service which is frequently seen to be inefficient and incompetent and overly remunerated in relation to its productivity, one would have seen significantly superior outcomes for development in South Africa within the same budget. In 2015, a three-year public sector wage agreement was reached which absorbs the full R65 billion set aside for the contingency reserve in the three-year budgetary forecast produced in February 2015. Again, if only those funds had been redirected towards social upliftment, the country's fiscal situation and the results of its fiscal policy, would have been seen to be much more effective. Much of the negative reaction to 2017 MTBPS was derived from the fact that the numbers show no attempt at reigning in the magnitude of public sector remuneration growth in such a way as to bring about a declining trend in the ratio of budget deficit to GDP. Clearly, the government is terrified of the public sector unions and is preparing itself to

accommodate a deal next year that runs counter to the concept of fiscal consolidation necessary to placate the credit ratings agencies.

- The third specific fiscal risk has been mentioned above in the form of the *pressure being brought to bear on funding free tertiary education*. In the broader scheme of fiscal risks, note that this need not be the biggest. Estimates vary surrounding the potential cost of free tertiary education, with a figure somewhere between R30 billion and R60 billion being estimated. This is a sizeable amount which exacerbates the potential increase in public debt. The funding of the proposed National Health Insurance project is another such specific area of focus which could be considered a major fiscal risk in the longer term. The Commission is reluctant, however, to cite this as one of the top five fiscal risks because it is far from being settled and is of such a long-term nature as not to loom large as a fiscal risk in the short term. Nonetheless, in terms of its magnitude, expenditure in the order of R250 billion to R400 billion can be expected on such a project.
- The fourth major fiscal risk is *on an affordable set of infrastructure project spending* such as the procurement of train carriages and its suitability for South Africa's rail network.
- The fifth key risk is the *drain on the fiscus stemming from soft budget constraints afforded what are considered to be key state-owned enterprises*. Government's continued bailout and raising the guarantees of institutions such as Eskom and SAA has had the undoubted effect of shifting resources away from programmes of higher priority. This is while lip-service is paid to turnaround strategies that actually work, thus undermining the credibility of government's commitment to ensuring proper governance and operational efficiencies transform the SOEs in order to fulfil their intended goals. This has multiple effects, namely:
 - a. *Entrenching corruption increases the burden on citizens*. Still to be quantified is the extent of cost overruns in the building of Medupi and Khusile power stations, as well as the malfeasance of the past year, in driving up electricity prices. In an era where there is surplus electricity and demand is falling, we are witnessing higher than inflation adjustment to electricity tariffs faced by consumers. Furthermore, issues of corruption and Eskom's monopoly have adversely affected the potential gains South Africa was making in becoming an emerging market leader in renewables. The loss of investment and skilled jobs within the renewables sector is well documented.
 - b. *The credibility of government's fiscal plan*. In the Commission's 2016 Submission on the MTBPS, explicit calls were made for government to ensure that it identifies which assets to dispose of, commits to a tangible plan and date, and ensures that such plans are concluded. We now have the current Minister stating that disposal of assets will be made known by March 2018. This underscores an uncoordinated policy stance wherein the Ministry of Finance has noted it would not be in government's best interest to completely

disinvest from Telkom, that brings in close to a billion rands in dividends, and the Minister stating that assets will be disposed of but with an option to buy back later. For a government that needs to undertake crucial structural adjustment measures (before external forces impose them), such uncertainty around the disposal of assets does little for investor confidence in laying out investment that could generate positive spin-offs in an era of consolidation.

- The sixth and final risk is *perceived corruption and state capture*. The essence of the damage brought by these factors is that government is being compelled to purchase goods and services to execute its functions at a premium, compared with market-related prices. The premium then goes to the beneficiary of corruption or capture. Estimates vary as to the magnitude of this. In certain instances it can be as much as 100% or more on the market-related price. In other instances clearly there is no capture and market-related prices are indeed paid. It has been suggested that state capture can amount to as much as R150 billion or more, equivalent to almost 10% of government spending. At the time of the 'Fees Must Fall' campaign, it was suggested that free tertiary education would cost around R40 billion and could be afforded if just a quarter of state capture were eliminated.

10. CONCLUDING REMARKS AND RECOMMENDATIONS

10.1. The 2017 MTBPS has been crafted in very difficult circumstances characterised by downward economic growth forecasts and rising impatience with social outcomes deemed by the population to fall short of expectation.

10.2. Overall, this year's MTBPS contrasts the conflicting objectives between social development and fiscal consolidation in the short term. However, the question becomes will South Africa achieve higher growth through its fiscal stance? The Commission notes that growth is considerably lower in the economy than was projected in February 2017. Hence efforts to improve the fiscal framework should ultimately be premised on re-igniting growth through embarking on structural reforms. Current economic growth estimates fall short of the required growth rate to fulfil the expectations of the National Development Plan and compares unfavourably with the global economy.

10.3. The Commission makes the following set of recommendations:

1. Anticipating the impact of the economic downswing on low-skilled workers government must continue to strengthen its public employment programmes by:
 - a) Developing a monitoring framework for public employment programmes in order to evaluate their performance against their objectives;
 - b) Developing an effective coordination system for public employment programmes based on integrated information systems to design, monitor and evaluate these programmes; and



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 - b) Developing an effective coordination system for public employment programmes based on integrated information systems to design, monitor and evaluate these programmes; and
 - c) Targeting unemployed people with no prior work experience or access to social grants.
2. More effective government spending must be prioritised by:
 - a) Improving supply chain management to reduce the costs of procurement; and
 - b) Full adherence to public procurement procedures and spending rules to provide spending savings and reduce the risks of mismanagement.
3. Efforts to raise more tax revenue should focus on:
 - a) Expanding the tax base through the reduction of deductions, credits and allowances; and
 - b) Improving tax revenue efficiencies by lowering compliance costs for small businesses.
4. Unallocated contingency reserves should be safe guarded should an emergency arise, therefore:
 - a) Government should avoid further drawdowns on the contingency reserve, which acts as a fiscal buffer to protect public finances, in this environment of increased uncertainty and rising social demands.
5. Spending on non-core goods and services should be reduced further by:
 - a) Adhering strictly to cost-containment measures;
 - b) Achieving reductions in catering, travel and subsistence, advertising, conference facilities and consultants; and
 - c) Leveraging innovative e-communication technologies to further reduce the R9,3 billion spent on travel and subsistence in 2016/17.
6. The Department of Human Settlements should ensure that the finalisation of the revised framework for the housing function shift is completed without further delay.



7. Improvement in the governance of state-owned entities is sorely required, and should be complemented by parent departments playing a stronger oversight role, and timeously reigning in non-performers.
8. To ensure greater accountability and therefore more prudent use of public funds, a set of uniform rules and procedures to inform the granting of guarantees and bailouts should:
 - a) consider the public value of the services provided by the SOE;
 - b) assess the historical performance of the entity; and
 - c) outline in detail the procedures for monitoring performance under the guarantee/bailout as well as corrective measures and sanctions should performance be sub-optimal or where an SOE does not meet the conditions of the guarantee granted to it. Appropriate disincentives should also be applied to ensure that parent departments act proactively and timeously to ensure a turnaround in SOE performance, thereby limiting the need for future guarantees.

10.4. The Commission looks forward to continued strengthening of its relationship with Parliament and engaging with the legislature concerning the substance of this Submission.

For and on behalf of the Financial and Fiscal Commission



Professor Daniel Plaatjies

Chairperson

9/11/2017

