Financial and Fiscal Commission Submission on the 2019 Medium Term Budget Policy Statement

For an Equitable Sharing of National Revenue

05 Novermber 2019

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List of Acronyms

FFC	Financial and Fiscal Commission
GDP	Gross domestic Product
LGES	Local Government Equitable Share
MTBPS	Medium Term Budget Policy Statement
MTEF	Medium Term Expenditure Framework
MTSF	Medium Term Strategic Framework
NDP	National Development Plan
NHI	National Health Insurance
PES	Provincial Equitable Share
SOC	State Owned Company
SONA	State of the Nation's Address
PIT	Personal Income Tax
BCI	Business Confidence Index
BER	Bureau for Economic Research
CCI	Consumer Confidence Index
IMF	International Monitory Fund
ASGISA	Accelerated and Shared Growth Initiative
IPAP	New Growth Path, Industrial Policy Action Plan
NIPF	National Industrial Policy Framework
SAA	South African Airways
SAPO	South African Post Office (SAPO)
SABC	South African Broadcasting Corporation

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1. BACKGROUND

1.1. The 2019 Medium Term Budget Policy Statement (MTBPS) is framed in an economic environment characterised by muted economic growth. The economy avoided a technical recession by posting a modest 3.1 per cent growth (compared to negative 3.2 per cent in the first quarter of 2019) in the second quarter (April-June) of 2019. Despite this rebounding of the economy in the second quarter of 2019, growth is still fragile, with growth prospects revised downwards by many financial institutions. National Treasury has revised Gross Domestic Product (GDP) growth downwards to 0.5 per cent for this year from 1.5 per cent as at the time of the February 2019 Budget; World Bank from 1.3 per cent to 0.8 per cent and IMF from 1.2 per cent to 0.7 per cent.

1.2. The present environment of low fragile growth is making it difficult to tackle the triple challenges of high unemployment, poverty and inequality. According to the "Poverty Trends in South Africa" report by Statistics South Africa, despite the general decline in poverty between 2006 and 2011, poverty headcount rose from a series low of 53.2 per cent in 2011 to 55.5 per cent in 2015. The Gini Coefficient[1], which measures income inequality stands at 0.696. The official unemployment rate currently at 29.1 per cent, is the highest in 11 years since 2008. The country faces enormous pressures to address these social ills. To address these challenges, higher, inclusive and sustained growth is imperative. The Commission underscores the sentiments expressed by the Minister of Finance in his MTBPS address that, at this juncture, it is imperative to "chart a course that is strategic, sober, careful and inclusive." In the recent past, government has launched a number of initiatives to tackle the challenges of poverty, unemployment and inequality head-on. Among these, are the Jobs Summit of 2018, the Investment Summit of 2018, establishment of a team of investment envoys in 2018, appointment of the Commission of Inquiry to deal with corruption, and more recently, the setting up a presidential economic advisory panel. The strengthening of government institutions (e.g. SARS and the NPA) and attempts to fight corruption, reorganise and reorient state machinery towards key developmental imperatives are vital steps towards inclusive development.

1.3. In his June 2019 SONA address the President identified seven priority areas that the sixth administration would focus on in responding to the above challenges. Seven priorities for the next five years include; economic transformation and job creation, education, skills and health, consolidating the social wage through reliable and quality basic services, spatial integration, human settlement and local government, social cohesion and safe communities, a capable ethical and developmental state and a better Africa and the World. The President has also launched a District Development Model to improve service delivery to communities. More recently, the Minister of Finance put forward an "Economic Strategy for South Africa" paper to engage South Africans on the possible pathway to economic growth. It is early days yet on all these initiatives,

[1] The Gini Coefficient is a measure of inequality, ranging from zero (equality) to one (utterly unequal).

but if they are executed well, the Commission notes that these initiatives have the potential to "reposition the Republic to grow and thrive".

1.4. The economy continues to face many internal and external risks. On the domestic front, the fiscal metrics continue to deteriorate. Economic growth is faltering under enormous pressures, including: government revenue under-collection; a deteriorating budget balance and debt position; inefficiencies in the way resources are used by different spheres of government; high incidences of corruption; inefficiencies in government procurement processes; lack of service delivery and delivery capability; intermittent electricity supplies; and infrastructure that is inadequately built even when budgeted for or maintained. The public sector wage bill remains a significant albatross on the country's public finances. It is important for the government to revive discussions on a social compact with its employees to find a sustainable solution for South Africa's growth and development. Public sector trade unions need to be engaged earnestly on the government wage bill. Policy and implementation uncertainty, (particularly around land reform, e-Tolls, State Owned Companies) and contradictions within government on addressing critical issues do not bode well for growth and business confidence and the country's fiscal credibility. To restore business confidence, the MTBPS should have articulated public finance policy decisions unambiguously and without contradictions. The SOCs that continue to haemorrhage state resources remains the most significant risk to the fiscus. The challenges facing State Owned Companies (SOCs) should be addressed head-on, decisively and with urgency.

1.5. Although South Africa's current economic miseries are driven predominantly by domestic factors, the slowing down of the global economy is not assisting either. Following an expansion of 3.6 per cent in 2018, global GDP is projected to slow down to 3.2 per cent in 2019 and 3.5 per cent in 2020. The trade wars between China and USA that show no signs of easing, continue to weigh down global economic growth.

1.6. The aforementioned background clearly indicates that the 2019 MTBPS has been one of the toughest to craft in democratic South Africa. The economic situation is dire; the expectations for service delivery at their highest – the revenue and expenditure details that will follow and be announced in the 2020 Budget must show decisive remedies in sustainable implementation. While the government has always endeavoured to protect social spending and the delivery of basic services, the current bleak economic situation has forced the government to make very difficult choices and trade-offs; balancing its socio-economic objectives against building a solid foundation for sustainable economic growth. To bring about this balance, the MTBPS articulates government's three-pronged strategy of reprioritisation expenditure and debt containment. The Commission supports the thrust of the 2019 MTBPS to strike a balance between protecting the social welfare needs of a growing population on the one hand and growing the economy on the other.

1.7. This submission by the Commission comments on the MTBPS as presented by the Minister of Finance on 30 October 2019. The Commission makes this Submission in terms of Section 4 (4c) of the Money Bills Amendment Procedure and Related Matters

Act (2018), which requires Committees of Parliament to consider recommendations by the Financial and Fiscal Commission (the Commission) when dealing with money bills and related matters. The Submission is also made in terms of Part 1 (3) {1} of the Financial and Fiscal Commission Act (2018) as amended, which 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.

1.8. In line with the request of the Standing and Select Committees on Appropriations and Finance, the Commission submission focusses on the following issues: Section 2 examines the economic outlook of the country and provides an overview of its public finances. Section 3 provides an overview of the fiscal framework through an analysis of revenue and expenditure over the 2019 Medium Term Expenditure Framework (MTEF) period and the trends in the division of revenue of the three spheres of government for the period 2016/17 to 2022/23. Section 4 reviews actual spending undertaken by the national and provincial government between 1 April and 30 September 2018. Section 5 provides a breakdown of local government finances while Section 6 refers briefly to the revised Division of Revenue for 2017 and 2018. Section 7 contains an analysis of "allocative efficiency", and the challenges and opportunities in the key priority sectors. In section 7, the following topics/areas are examined, namely economic growth and the recently announced Economic Strategy paper by National Treasury; infrastructure investment; and education, health and human settlements. Section 8 provides an analysis of the performance of State-Owned Companies. Section 9 concludes with a set of recommendations from the Commission.

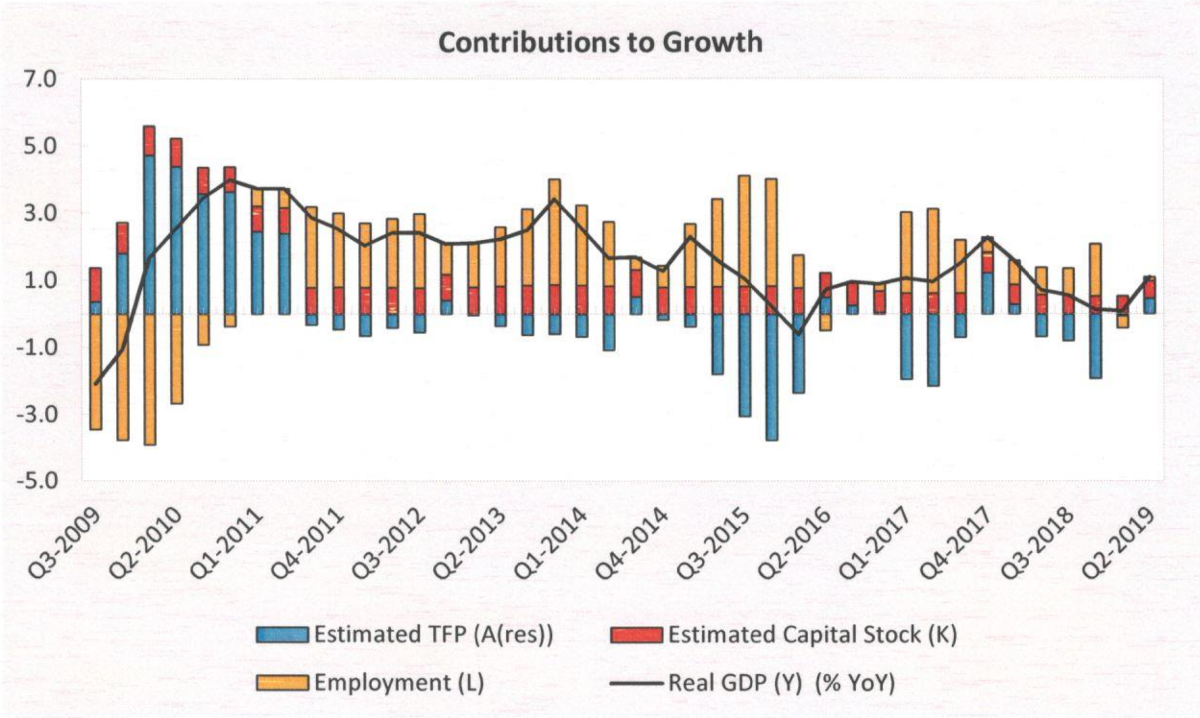
2. ECONOMIC OUTLOOK AND PUBLIC FINANCES OVERVIEW

The Economy: a mixed picture with tenuous signs of recovery

2.1. South Africa's economic growth prospects remain bleak, despite some feeble signs of recovery. While the global economy decelerates due to weakened international trade activity and receding demand, at home, years of institutional deterioration, governance failures and policy uncertainty or indecisiveness on the part of government have all impaired the demand and supply sides of the economy. In the first quarter of this year, the South African economy contracted by 3.1 per cent on a seasonally adjusted and annualised quarter-on-quarter basis, and a meagre 0.1 per cent year-on-year basis, the fragile economic environment is compounded by revenue underperformance. Gross tax revenue is projected to fall short of the 2019 Budget by R52.5 billion in 2019/20 and R84 billion in 2020/21. With the weak economic and low tax base, any fiscal space and fiscal policy responses are limited, at least in the near future. This leaves fiscal reprioritisation and fiscal consolidation through restructuring as the only viable options for restoring fiscal credibility for a sustainable future of South Africa.

2.2. As shown in Figure 1, in the second quarter of 2019 South Africa's economic trajectory remained weak with tenuous signs of improvement in terms of Total Factor Productivity (TFP) and capital stock accumulation (K). Total Factor Productivity (TFP) is a measure of productivity, market competitiveness and efficiency of the economy, in respect of policies and institutions, whereas capital stock is a measure of the quantity of infrastructure and machinery. As indicated in Figure 1, it is worth noting that after the 2008-2009 financial crisis in Q3 2011, the South African economy entered into an era of policy uncertainty and institutional failure as Total Factor Productivity (TFP) started its trend of decreasing. Although small, the recent positive trend in the contribution of Total Factor Productivity (TFP) and capital stock to economic growth, suggests that South Africa is has started on the right direction and it is important that the current growth momentum is intensified and hastened.

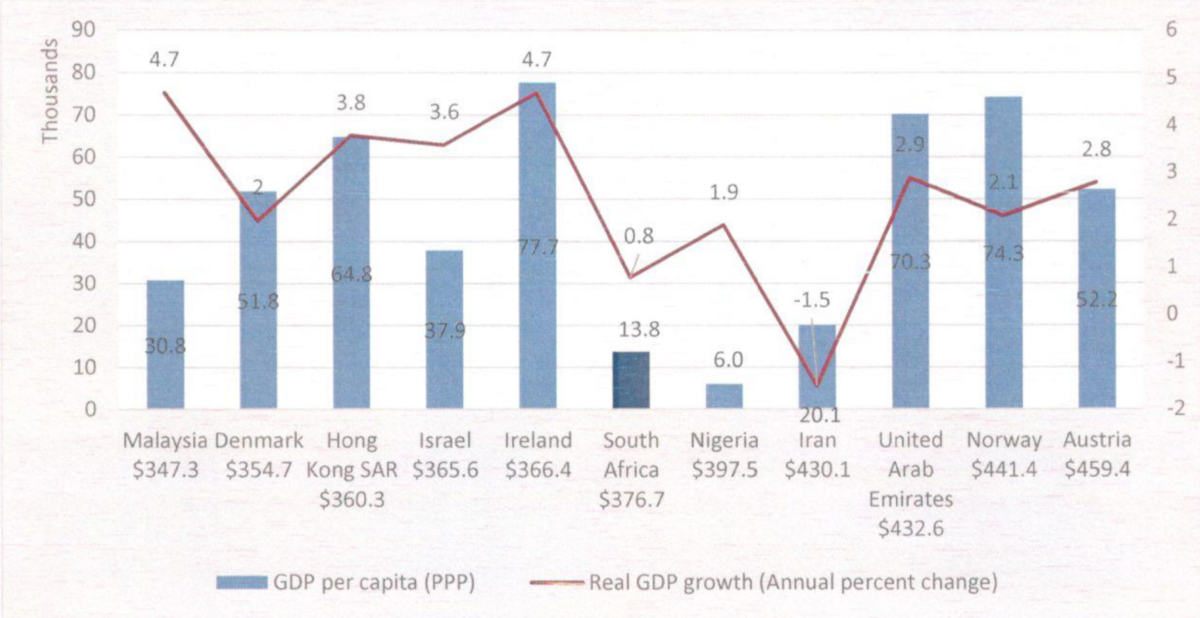
Figure 1: Contributions to growth using a production function approach*, Q3 2009 - Q2 2019



Source: *South African Reserve Bank, SARB (2019) and own calculations.*
Note: *In Macroeconomics, the aggregate production function is an estimation framework to distinguish how much of economic growth to attribute to changes in factor allocation as Capital Stock (K), Employment (L) and Estimated Total Factor Productivity (A), the residual contribution (res).*

2.3. While the economy is relatively sophisticated (roughly 23 per cent of GDP in the tertiary sector of finance) and open to world trade - South Africa is lagging behind its peers in terms of real welfare (measured in income per person (GDP per capita) and growth performance (The World Bank, 2018)). As shown in Figure 2, South Africa ranks second-lowest after Nigeria in terms of the GDP per capita measure; and performed only better than Iran in terms of real GDP growth.

Figure 2: Relative GDP performance of South Africa compared to countries with similar market value of GDP in billion, 2018

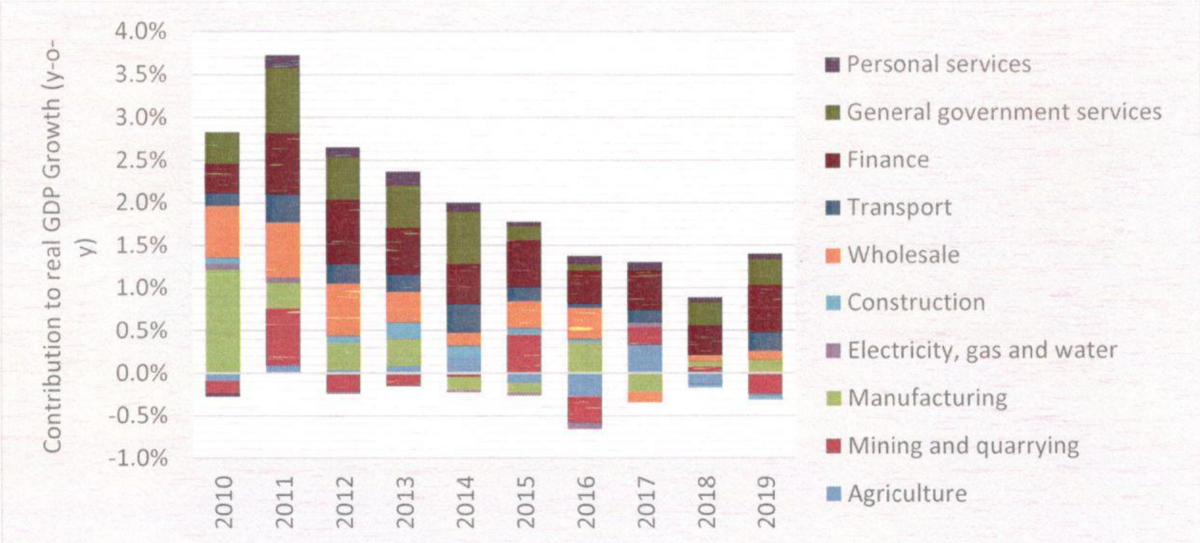


Source: *IMF, World Economic Outlook database (October 2018).*
Notes: *Market value of GDP is measured in GDP, current prices (Billions of U.S. dollars); GDP per capita (PPP) is measured in purchasing power parity; international dollars per capita)*

2.4. It is important that the government continues to take bold, and informed steps to eliminate implementation inefficiencies and policy uncertainties surrounding developments in public institutions. Fiscal leakages in public institutions have become endemic in dysfunctional state-owned companies and ineffective departments. Success in reforming public institutions will assist to restore confidence and attract investments into the domestic economy and ultimately boost economic growth. Without growth, South Africa will continue to be fiscally strained, with public debt, debt-service costs and budget deficits escalating to even more unsustainably thresholds.

2.5. On the supply side, the mining and quarrying and construction industries declined in the second quarter of 2018-2019 against a backdrop of receding demand both in international and domestic markets (Figure 3). On the demand side (Figure 4), the contribution of private consumption to growth on a year-on-year basis increased marginally, from 0.5 per cent in Q1 2019, to 0.9 per cent in Q2 2019 due to a re-adjustment of the business cycle. The contribution of Government consumption to growth was sustained at 0.3 per cent, while the contribution of public investment to growth softened slightly from 0.5 per cent in Q1 2019 to 0.4 per cent in Q2 2019, maintaining its positive position. Private investment remained in the negative territory for Q2 2019, declining at negative 0.3 per cent.

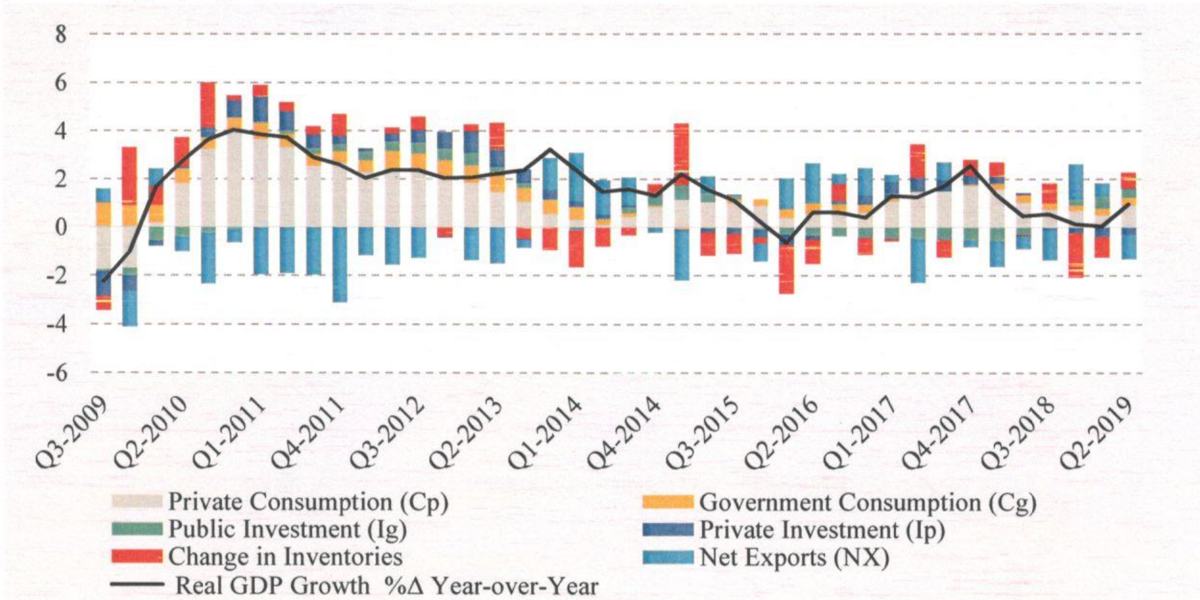
Figure 3: Contribution to real GDP growth from Q2 2010 to Q2 2019 by industry, year-on-year



Source: *Stats SA: Seasonally adjusted and annualised quarterly gross domestic product by industry at constant 2010 prices (R million), own calculations.*

Note: *Agriculture includes forestry and fishing; Mining includes quarrying; Wholesale includes retail, motor trade, catering and accommodation; Transport includes storage and communication; Finance includes real-estate and business services.*

Figure 4: Source of growth contributions to real GDP by aggregate demand, year-on-year change (%), Q3 2009 – Q2 2019



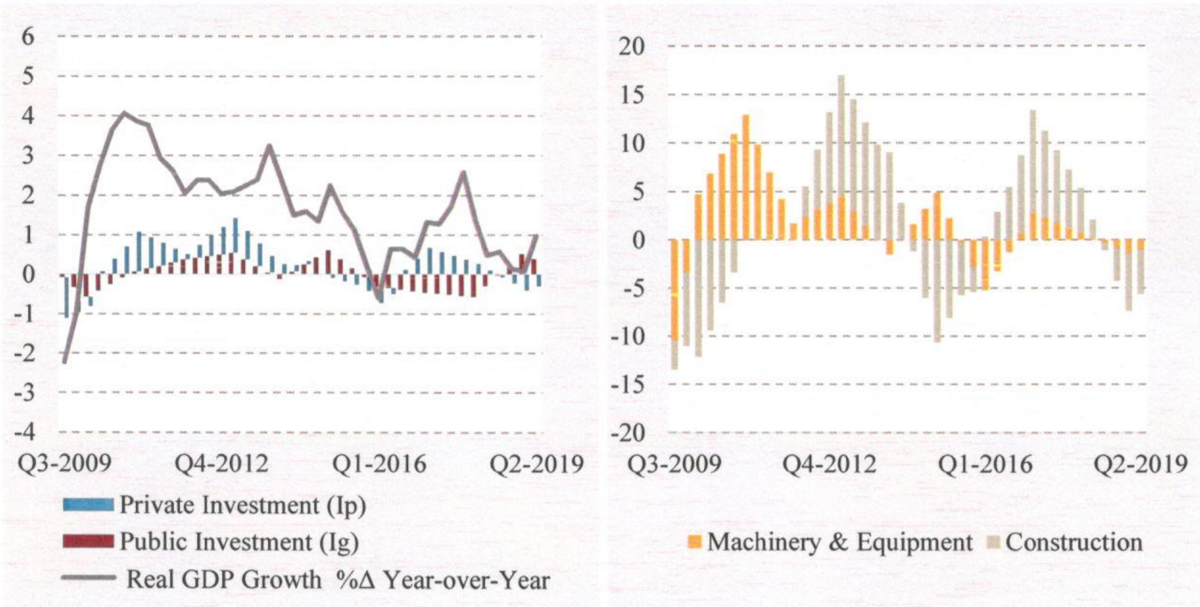
Source: *South African Reserve Bank, SARB (2019) and own calculations.*

Notes: *Investment is mainly comprised of machinery & equipment, and construction; In terms of machinery & equipment, it includes transport equipment, computer and related equipment, research and development and computer software; construction includes residential and non-residential buildings, and construction works.*

2.6. After the negative carries in inventory as a contribution to growth in Q4 2018 and Q1 2019, firms and household began restocking at 0.7 per cent in Q2 2019, thereby accounting for the economic growth and a possible uptick in consumption in the near future. External demand or net exports retreated by 1.0 per cent in Q2 2019 after two positive quarters prior due to trade seasonality.

2.7. Capital formation is critical for future growth. Private investments in machinery and equipment, (which are vital to the production of goods and services on the supply side), remains muted, albeit to a lesser extent than private construction. Private investment in construction has suffered major declines in the recent quarters as concerns over the future growth prospects of the economy have not augured well for the building of additional structures to accommodate households and businesses (Figure 5).

Figure 5: GDP growth and the contributions of public and private investments (left); Growth Rate of Private Investment in Real GDP by components (Year-over-Year) (right)



Source: *South African Reserve Bank, SARB (2018) and own calculations.*
Notes: *Public Investment includes both general government and public corporations. Public machinery and equipment include transport equipment, computers and related equipment, software, cultivated biological resources and mineral exploration. Construction includes residential and non-residential buildings and construction works.*

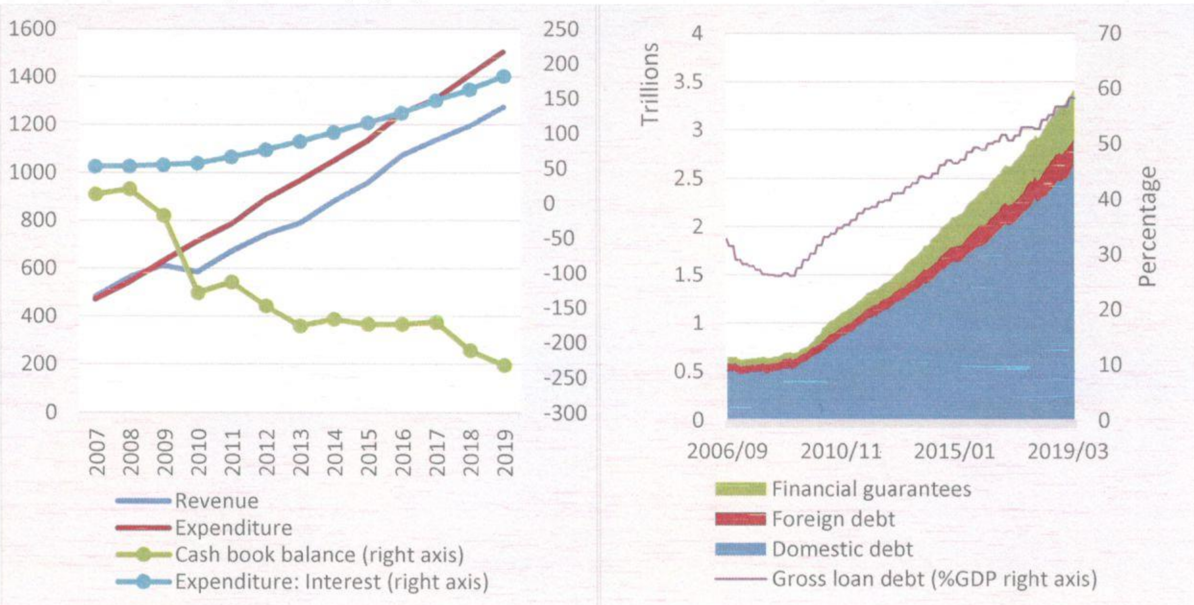
Anatomy of a Fiscal Crisis

2.8. During the post- 2008-2009 financial crisis, government revenue and expenditure trends have diverged with a focus on social functions of education, social development and health were effected. However, the government's priority investments funded through fiscal expansion have not yielded the anticipated socio-economic results and outcomes and the deep-seated challenges of poverty, inequality and unemployment have continued to deepen. At the same time, governance failures, fiscal leakages and corruption have become endemic.

2.9. According to the "Poverty Trends in South Africa" report by Statistics South Africa, despite the general decline in poverty between 2006 and 2011, poverty headcount rose from a series low of 53.2 per cent in 2011 to 55.5 per cent in 2015. The Gini Coefficient, a measure of income inequality, is 0.696. The official unemployment rate rose to 29.1 per cent - its highest level since 2003.

2.10. The Commission has noted the fiscal consolidation commitments made by the government to curb spending and expand tax revenue in the past: On the expenditure side, fiscal measures included the setting of expenditure ceiling; cost-containment; cuts in conditional grants to provinces and the local government and budget reductions over the medium terms expenditure framework (MTEF). On the revenue side, the measures included an increase in the marginal income tax rate from 40 per cent to 45 per cent to the highest income bracket in 2017/18, increase in value-added tax (VAT) from 14 per cent to 15 per cent, and the introduction of the sugar tax. However, despite these announcements, total expenditure has remained far higher than total revenue, resulting in continued deterioration of the cash book balance and a rising debt position (see Figure 6, left).

Figure 6: Government revenue, expenditure, cash balance and interest (left); and gross loan debt decomposition (right)



Source: *SARB (2019).*
Note: *Cashbook balance before borrowing = total revenue – total expenditure*

2.11. In a nutshell, total government expenditure exceeds total revenue, resulting in an annual budget deficit. The projected budget deficit for 2019/20 will increase from 4.5 per cent to 5.9 per cent of GDP, and from 4.3 per cent to 6.5 per cent for the 2020/21 financial year. South Africa's gross loan debt stock has grown from a little over 25 per cent of GDP in 2008 to over 50 per cent in less than a decade, without any prospects of decelerating (see Figure 6, right). With the addition of government guarantees as contingent liabilities to Eskom and several other state-owned companies in financial distress, it is now certain that the debt-to-GDP ratio will exceed 60 per cent of GDP in the 2020/21 financial year. By National Treasury's estimation, total debt is expected to rise to R4.5 trillion in the next three years or over 70 per cent of GDP by 2022/23, with already high a debt-service costs increasing at 13.7 per cent over the MTEF. By the end of this three-year framework, debt service costs will be bigger than spending on health and economic development.

2.12. To sum up, the above discussion shows an economy heading towards implosion. There is an urgent need for decisive and urgent steps to be taken to grow the economy. On 27th August 2019, National Treasury published a plan titled "Towards an Economic Strategy for SA" aimed at charting a way forward for growing the South African economy, addressing the high and increasing unemployment through policy reforms, promoting labour-intensive growth, and creating a globally competitive marketplace. The five themes of focus in the document are as follows:

i. Modernising network industries to improve competitiveness and inclusive growth in Electricity and energy planning, Telecommunications, Transport and Water

ii. Lowering barriers to entry and addressing distorted patterns of ownership through increased competition and small business growth

iii. Prioritising labour-intensive growth in sectors such as agriculture and services, including tourism

iv. Implementing focused and flexible industrial and trade policy; and

v. Promoting export competitiveness and harnessing regional growth opportunities.

The Economic Strategy document further emphasised several building blocks of long-run sustainable growth, including:

- Improving educational outcomes throughout the educational life-cycle, with a particular focus on early childhood development.
- Implementing youth employment interventions such as continued support for government programmes that incentivise job creation that facilitate school-to-work transition.
- Expanding effective, affordable, and integrated public transport systems and prioritising targeted housing and urban development interventions to overcome spatial legacies.

In this Section, the Commission reflects on the National Treasury Economic Strategy for Africa Paper.

Commission's Reflections on the National Treasury Economic Strategy for South Africa

2.13. The Commission is of the view that the strategy is an addition to, and complements the socio-economic policy frameworks of the Reconstruction and Development Programme (RDP) and Growth Employment and Redistribution (GEAR). The

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Commission cautions against a reactionary approach that deflects and destabilises state delivery machinery and is of the view that programmes if they are introduced and abandoned haphazardly translate into resource wastage. The view of the Commission is that the strategy should ideally have commenced by conducting a stocktaking analysis of the development policy landscape and status quo. It should have then proceeded to appraise the obstacles that prevented a successful implementation of previously adopted policy interventions. This would have ensured that there was a better comprehension of the reasons why previous policy interventions failed to yield the projected targets.

2.14. The strategy correctly identifies the structural impediments to growth and employment. However, it implicitly assumes that growth will be inclusive and employment-intensive, and does not demonstrate how this will be ensured structurally within the economy. It does not include township economies explicitly, equating rurality to agriculture, and does not explicitly consider any support for the informal sector. The strategy also lacks specific details on some of the strategic interventions that are vital for economic revival. For example, the strategy correctly identifies lack of tertiary skills but fails to mention the specific fields where the tertiary skills are lacking. It also recommends support for employment-intensive sectors but fails to mention specific measures or incentives for labour-intensive production. The highly concentrated exports sector is correctly identified as a major constraint to growth in the strategy but there are no specific measures or incentives mentioned to diversify the export base.

2.15. The Economic Strategy document further identifies education as one of several building blocks for long-run sustainable growth. The Commission notes that education, alongside with health and social development and human settlements development, has always been at the forefront of South Africa's strategic policy priorities for development and growth since the dawn of our democracy. However, despite investing in these at the cost of fiscal deficits and state borrowing, the real issue which remains is the lack on impacts and outcomes, whether it be in terms of labour market outcomes (e.g. high and increasing unemployment) or the educational outcomes itself (e.g. low international scores on crucial subjects of mathematics and science). Hence, there is a need to take the broader view of the "social determinants of educational outcomes" as a gateway to understanding and therefore, devising impactful policies for long-run sustainable growth.

2.16. The proposal of implementing youth employment interventions such as continued support for government programmes that incentivise job creation (e.g. learnerships, tax incentives) and apprenticeships that facilitate school-to-work transition, based on close cooperation between institutions of learning and the private sector is supported.

2.17. Expanding effective, affordable, and integrated public transport systems and prioritising targeted housing and urban development interventions to overcome historical spatial legacies is supported. The potential benefits of a transport-oriented development in relations to urban-housing development and township development are well-appreciated by the Commission. However, the document should also consider policies and policy implications for the development of rural areas with a low concentration of population, for those living in areas of vast landmass of South Africa.

2.18. The proposal of addressing the skills constraint through short-term solutions (such as the easing of immigration regulations for individuals with tertiary qualifications from accredited institutions) misses a fundamental point regarding what measures are needed to follow with speed. The nature of unemployment in South Africa is a structural one, exacerbated by ceaseless joblessness within the labour market, due to lack of new job opportunities; employers' unwillingness to hire, train, and nurture; exorbitant employment flexibility costs (hiring and firing costs); and other labour market rigidities.

2.19. The Commission supports the proposal of delivering a capable state supported by a new compact between the government, private sector, and other social partners based on credibility, capability, capacity and certainty. The Commission also emphasises the importance of governance, parliamentary scrutiny and accountability through consequence management in ensuring delivery in a performing state.

2.20. The fundamental building block of a stable macroeconomic policy framework is underpinned by a flexible exchange rate, inflation targeting, and credible and sustainable fiscal policy is concurred with the Commission. What a "credible" and "sustainable" fiscal policy means in real implementation must be defined. Going forward there must be delivery on the targeted reduction of fiscal deficits and borrowing levels to establish trust in South African fiscal management, thereby rebuilding credibility and sustainability.

2.21. The strategy does not clearly articulate the role and impact of institutions whereas most of its proposals will require coordination and concerted effort by government and private sector partners. There are no explicit effective incentives to promote such cooperation and improved coordination. There is also no concrete assessment of the current configuration of the intergovernmental system in order to evaluate its appropriateness and effectiveness in advancing the implementation of the innovative interventions proposed. The Commission notes initiatives for the administrative capacity of the state for the successful implementation of the strategy. The Commission recommends a delicate balance that allows for sternness when it comes to ensuring fiscal prudence, value for taxpayers' money but also flexibility to allow for institutional and intergovernmental system innovative solutions. It is the view of the Commission that to give effect to this plan or any plan aimed at spearheading transformation, decisive decisions for government's fiscal intent need to be made now and announced in the 2020 Budget.

2.22. The Commission notes that the Economic Strategy paper has made repeated references to the triple challenges of poverty, inequality and unemployment[2]. However, inclusive

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[2] The word "unemployment" was mentioned fourteen times in the Economic Strategy paper, "inequality" fifteen times and "poverty" eleven times.

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growth is escaping us as South Africans in the furtherance of our developmental imperatives. The Commission is calling for decisive and cogent responses in terms of fiscal reprioritisation and consolidation in reducing government expenditure – especially on non-essential deliveries and factors of wage bill, sales of government assets, restructuring of state-owned companies (SOCs); and ultimately a reduction of the debt-to-GDP ratio anchored in the economic structural reforms that would make this reduction sustainable.

3. Fiscal Frameworks and Revenue Proposals

Overview of the Fiscal Framework

3.1. As discussed above, the 2019 medium-term estimates are presented under a depressed macroeconomic outlook with projected weaker revenue and higher debt services costs. This situation imposes constraints on the broader fiscal framework as shown in Table 1, which outlines the proposed fiscal framework for the 2020 MTEF period. The 2020 MTEF will be characterised by moderate growth increases with a real annual average growth of 1.5 per cent being projected. In total, Government is expected to spend R5.728 trillion over the three years relative to a revenue envelope of R4.579 trillion. The bulk of resources are allocated in respect of non-interest allocations in the form of equitable share and conditional grant funding. The key components of the fiscal framework are discussed in greater detail below[3].

Table 1: Consolidated fiscal framework, 2016/17-2022/23

R billion/percentage of GDP	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
Main budget revenue	**1137,90**	**1196,37**	**1274,74**	**1359,08**	**1425,91**	**1525,60**	**1627,88**
Main budget expenditure	**1305,49**	**1404,99**	**1506,73**	**1683,35**	**1801,21**	**1909,45**	**2017,72**
Non-interest expenditure	1158,99	1242,34	1324,88	1479,62	1568,45	1644,88	1718,58
Debt-service costs	146,50	162,65	181,85	203,73	232,76	264,57	299,13
Main budget balance	**-167,58**	**-208,62**	**-231,99**	**-324,27**	**-375,31**	**-383,85**	**-389,83**
As % of GDP	-3,8%	-4,4%	-4,7%	-6,2%	-6,8%	-6,5%	-6,2%
Primary balance	**-21,09**	**-45,97**	**-50,14**	**-120,54**	**-142,55**	**-119,28**	**-90,70**
As % of GDP	-0,5%	-1,0%	-1,0%	-2,3%	-2,6%	-2,0%	-1,4%

Source: MTBPS, 2019.

Non-Interest Allocations: Division of Revenue

3.2. Table 2 summarises the division of non-interest allocations amongst the three spheres of government. These allocations finance the delivery of basic and social services and generally comprise of discretionary, equitable share and conditional grant allocations. After accounting for the national debt, there are estimated receipts of R1.563 trillion to share amongst the three spheres in the 2020/21 financial year. The budget available for

[3] The components of debt service and consolidated budget deficit have already been discussed above as part of the economic outlook and that discussion is not repeated here.

sharing is projected to increase to R 1,639 trillion in the 2021/22 financial year and R1.713 trillion in the outer year.

3.3. Over the 2020 MTEF period, the division of revenue amongst the three spheres will generally be characterised by positive growth in nominal rand amount terms, however with an annual average change of -1.4% in real terms being projected, after having accounted for inflation. Over the medium term, the main driver of this negative growth will be allocations to the national government sphere (projected to grow by a real annual average of -2,9 per cent). As noted in MTBPS 2019, allocations to the local and provincial spheres have been prioritised due to the importance attached to the provision of education, health and basic services such as electricity, water and sanitation and refuse removal. It should be noted though that within these sectors, there are areas of a reduction in budget in nominal rand terms.

Table 2: Division of revenue amongst the three spheres of government, 2016/17-2022/23

R billion	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	Real Average annual growth 2019/20 – 2022/23
	Outcome			Revised	Medium-term estimates			
Division of available funds								
National departments	**555,74**	**592,69**	**634,44**	**742,78**	**757,43**	**766,16**	**796,20**	-2,9%
Provinces	**500,38**	**538,55**	**571,95**	**612,82**	**651,46**	**694,85**	**731,06**	0,7%
Equitable share	410,70	441,33	470,29	505,55	540,98	576,66	607,55	0,9%
Conditional grants	89,69	97,22	101,67	107,26	110,48	118,19	123,51	-0,5%
Local government	**102,87**	**111,10**	**118,49**	**127,21**	**132,39**	**143,03**	**152,25**	0,8%
Equitable share	50,71	55,61	60,76	68,97	74,68	81,06	87,21	2,7%
General fuel levy sharing with metropolitan municipalities	11,22	11,79	12,47	13,17	14,03	15,18	16,09	1,5%
Conditional grants	40,93	43,70	45,26	45,07	43,68	46,78	48,95	-2,3%
Total	**1158,99**	**1242,34**	**1324,88**	**1479,62**	**1562,45**	**1638,88**	**1712,58**	-1.4%

Source: 2019 MTBPS, Commission's calculations.

Consolidated government expenditure Economic Classification

3.4. Table 3 provides details of the economic classification of consolidated government expenditure. Over the 2020 MTEF, the compensation budget will register an average of one per cent growth. The growth in compensation will slow down from 3% in 2019/20 to 0% in 2022/23 reflecting government's objective of containing the wage bill. Although government has previously not been able to realise savings from voluntary redundancies of public servants the MTBPS announced new measures to provide the wage bill, i.e. freezing of salaries of ministers, MECs and other senior civil servants. The Commission welcomes these initiatives and calls for extending these measures to SOCs and local governments. The Commission cautions that the historical wage bill benefits over the last decade alluded to in the Minister of Finance's MTBPS speech are unsustainable. The Commission has advised previously that wage increases should be linked to productivity. In its efforts to strengthen the link between pay and performance, government should note a recommendation in the Commission's submission on the 2016/17 DoR which called for a framework for measuring productivity as the first step to benchmark improvements in the public-sector productivity. There is also a need to reinvigorate efforts at establishing a social compact between labour and government to solve the wage bill that is pro-growth positions.

Table 3: Real Growth of Consolidated Government Expenditure by Economic Classification

R billion	2019/20	2020/21	2021/22	2022/23	Real Annual Average Growth Rate
Current payments	**1093,81**	**1180,96**	**1275,55**	**1363,86**	2%
Compensation of employees	630,68	675,20	717,56	758,52	1%
Goods and services	252,18	264,35	284,94	297,30	1%
Transfers and subsidies	**593,04**	**626,26**	**665,51**	**700,32**	1%
Payments for capital assets	**90,07**	**97,64**	**105,84**	**114,69**	3%
	2018/19-2019/20	**2019/20-2020/21**	**2020/21-2021/22**	**2021/22-2022/23**	
Current payments	**3%**	**3%**	**3%**	**2%**	
Compensation of employees	3%	2%	1%	0%	
Goods and services	3%	0%	2%	-1%	
Transfers and subsidies	**3%**	**0%**	**1%**	**0%**	
Payments for capital assets	5%	3%	3%	3%	

Source: 2019 MTBPS, Commission's calculations.

3.5. The Commission notes the 1% real growth in the goods and services component. Costs containment measuring appear to be bearing fruit. The growth rate on goods and services has fallen from 3% in 2019/20 to -1% in 2022/23. The Commission notes that corruption in this spending item is extensive and it is important that cost containment initiatives by the Chief Procurement office are matched by broader government efforts to rid government of corruption. The establishment of the Commission of Inquiry into corruption is endorsed as is the practical implementation efficiencies to accompany the simplifying of procurement processes. The Commission cautions that in all of these measures, sight must not be lost of the overall imperative of service delivery and the necessity of inputs goods and services provisions that are required for this.

3.6. Allocations in respect of capital assets increase by 3 per cent on average over the 2020 MTEF period. This is a welcomed development as economic growth will only be realised if there are adequate capital investments. The government should be extremely vigilant regarding underspending of capital grants as this offsets government's pursuit of infrastructure-led growth.

Revenue and Tax Proposals

3.7. Revenue collection has been underperforming for the last five years. Sluggish growth and governance weaknesses at the South African Revenue Service (SARS) have translated in revenue shortfalls since 2014/15. In 2018/19, revenue shortfall amounted

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to R14.5 billion, compared to the 2019 Budget estimate. Revenue collection is projected to weaken further over the medium term. The revenue projections over the medium term reflect a shortfall of R52.5 billion in 2019/20, which is widespread entailing an R25 billion under-collection of personal income tax (PIT), an R12 billion shortfall in value-added tax (VAT) receipts and an R10 billion underperformance of corporate income tax (CIT). The projected revenue shortfalls for 2020/21 and 2021/22 are R84 billion and R114.7 billion respectively.

3.8. Government revenue has declined by about 0.2 percentage points of GDP to 25.7 per cent of GDP in 2018/19 compared to 25.9 per cent in 2016/17, mainly because the PIT grew at a slower rate than in previous years. Whereas GDP grew from 0.4 per cent in 2016, 1.4 per cent in 2017 and 0.4 per cent in 2018, it did not translate into an increase in the Tax-to-GDP ratio. The tax elasticity has reduced over time and now is at a ratio of 1:1, meaning that tax buoyancy has decreased and that the percentage change in GDP is now only exactly matched by the percentage change in tax revenue take. This means that the sustained increase in economic growth and employment that is urgently required to improve revenue collection must be greater to ensure that government to meet its social-economic objectives.

3.9. Making the situation more problematic, the scope for increasing government revenue by raising taxes is becoming more restricted, particularly because more tax hikes are most likely to impact negatively on the economy's performance as people economise on consumption and hence on spending that generates tax revenue collection. The largest fraction of tax revenue is collected through direct taxes, and in particular through PIT. However, significant progressivity gains from the PIT are most likely to be constrained because of the limited buoyancy recently. Moreover, the highest marginal tax rate for higher incomes, currently at 45 per cent, is near to the maximum range of 50–60 per cent, as determined by literature[4]. This means that additional increases in PIT could have perverse incentives such as tax avoidance or evasion, particularly if taxpayers believe that their taxes are not efficiently spent on public service delivery.

3.10. The tax burden carried by households has increased over time, with total personal income tax as a proportion of GDP rising from 8.6 per cent in 2013/14 to 9.8 per cent in 2017/18 and being projected to reach 10.5 per cent in 2021/22. However, the tax burden on companies, which includes CIT as well as dividend and interest withholding tax, declined from 5 per cent of GDP in 2010/11 to 4.7 per cent in 2017/18. The Commission is of the view that while the rising tax burden on households is not necessarily negative for the economy, provided that the components increased provide the correct incentives to behaviour and benefits in terms of economic growth - the spending efficiency and effectiveness of the tax revenue collected is critical matter. When, for instance, households feel that they have to acquire private sector services for healthcare, education and security because of the failure of the public sector to offer these services efficiently and effectively, then the rising tax burden for households is

[4] See "Fiscal Policy and Income Inequality." IMF Policy Paper, Washington, DC.

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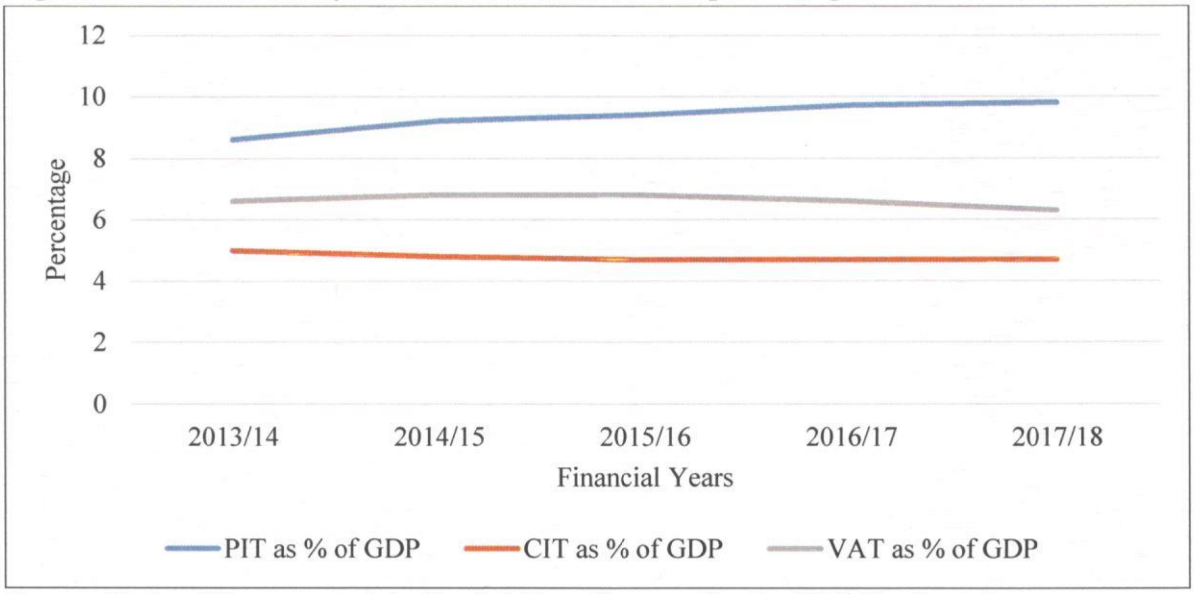
viewed as untenable. Figure 7 below shows the tax burden for the main revenue sources for the period spanning 2013/14-2017/18.

Figure 7: Tax revenue by main revenue source as a percentage of GDP, 2013/14-2017/18



Source: National Treasury and the South African Revenue Service 2018 Tax Statistics

3.11. The Commission recommends the strengthening of the ongoing efforts of addressing weaknesses in tax administration and increasing tax administration capacity including enhancing capacity to confront tax base erosion and profit shifting will translate into a reduction in revenue leakages.

4. Review of Actual Spending by National Departments and Provincial Government – 1 April to 30 September 2019

4.1. An expenditure smoothing assumption implies government spending evenly distributed accross the four quarters of the financial year.Following this, the expectation is that by September, each government department should have spent about 50 percent of its main budget. However, there are exceptions, given that all institutions project their quarterly expenditure based on their planned programme activities.

4.2. Table 4 below shows aggregate spending and percentage spent six months into 2019/20 financial year. Total government spending stood at 47 percent (R816 billion), slightly below the assumption of 50 percent, likewise with debt service costs at 49 percent, whilst spending by overall budget votes reached 50 percent. At the provincial level, spending on the priority sectors (education, health and social development) stood at 48 percent (R303 billion) although spending on the provincial equitable share was 50 percent of the main budget.

4.3. Focusing on selected national departments that are driving government priorities (education, health) and key built environment programmes, for example, transport, energy and water and sanitation, national government departments, they have spent 46 percent (R207 billion) on average. The Departments of Higher Education and Training

(DHET) and Basic Education spent 71 percent and 58 percent respectively. The DHET spending is due to amongst others: the increase in scheduled transfer payments to higher education institutions, Technical and Vocational Education and Training (TVET) colleges and the National Student Financial Aid Scheme. On the basic education budget vote high spendng is attributable to among others: the roll out of bursaries awarded to poor and working class families as well as to eradication unsafe school structures through the building of schools including maintaining the school infrastructure. On the other hand, departments of Environmental Affairs, Water Affairs, and Human Settlements as well Rural Development and Land Reform registered spending rates below 40 percent.

Table 4: Aggregate spending (April-September 2019)

R million	Main budget	Actual spending April to September	% Spending
Total	1 658 707	816 063	47
Total appropriation by vote	900 300	448 659	50
Total direct charges against the National Revenue Fund	743 850	367 404	49
General Fuel Levy	13 167	4 389	33
Debt service costs	202 208	99 517	49
Provincial equitable share (National Treasury)	505 554	252 777	50
Selected key budget votes	457 116	207 930	46
10 Public Service and Administration	1 002	449	45
11 Public Works	7 809	3 778	48
14 Basic Education	24 505	14 317	58
15 Higher Education and Training	89 498	63 507	71
16 Health	51 461	24 997	49
18 Correctional Services	25 408	11 384	45
23 Police	97 595	46 396	48
24 Agriculture, Forestry and Fisheries	7 665	3 879	51
26 Energy	7 440	3 096	42
27 Environmental Affairs	7 530	2 711	36
32 Telecommunications and Postal Services	1 685	762	45
34 Trade and Industry	10 059	4 357	43
35 Transport	64 194	30 073	47
36 Water and Sanitation	16 440	6 121	37
38 Human Settlements	33 879	12 958	38
39 Rural Development and Land Reform	10 946	4 384	40
Provincial Level	63 247	303 231	48
Education	256 875	125 326	49
Health	209 529	103 821	49
Social Development	22 146	10 447	46
Other functions	143 527	63 637	44

Source: MTBPS 2019; Commission Calculations

5. Local Government Issues

Overview of Local Government Allocation

5.1. The 2019 MTBPS is tabled during a period where the President, in his 2019 state of the nation's address introduced a district-based service delivery model, which is to improve coordination and planning among national, provincial and local governments. This new approach will have implications for the 2020 MTEF allocations to particularly the local government, as there will be a need to align the local government funding model to the new delivery model. The Commission welcomes the new approach as it will potentially improve coordination and planning among the three spheres of government and ensure integrated service delivery. However, the Commission underscores the need for government to consider the current weaknesses in the local government capability when implementing this model, particularly in district municipalities. Over 60 percent of district municipalities are declared dysfunctional and poorly capacitated. There is therefore a need to address these challenges directly and immediately to enesure benefits of the newly announced service delivery model.

5.2. Over the 2020 MTEF the local government is set to receive a total allocation of R427.7 billion, which is lower (by R20.5billion) compared to the allocation that was announced as planned in the 2019 budget. The indicated cuts in budget plans are accompanied by a downward revision of the percentage share to be received by the local government in 2020/21 and 2021/22, from 9.0 percent to 8.6 percent and 9.2 percent to 8.9 percent, respectively. The newly announced planned allocations are projected to increase at a real annual average growth rate of 0.8 percent, to decline annually at 1.2 percent in 2020/21, and to grow at 2.6 percent in 2021/22, and 1.1 percent in 2022/23. The Commission notes the reductions in the planned local government total allocations. However, it cautions about the implications of the cuts on service delivery and is of the view that considering the declining share of local government allocations from the nationally raised revenue, government may need to prioritise own revenue raising capacity in the local government, in order to improve resources in the sector to ensure service delivery. In its 2020/21 Annual Submission to the Division of Revenue, the Commission identified supplementary revenue sources for local government that some municipalities can exploit.

Local Government Equitable Share, Conditional Grants and Fuel Levy

5.3. The local government sphere receives its allocations from nationally raised revenues in three forms, that is, the LGES, general fuel levy and conditional grants. The allocations and real average growth rate for each of these components are shown in Table 5.

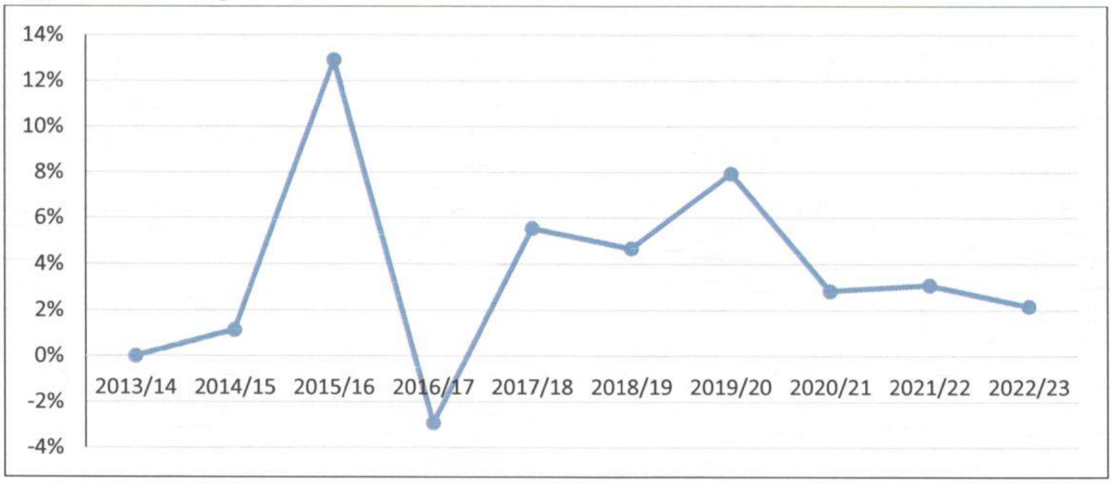
5.4. As shown in Table 5, the total LGES allocation is envisaged to increase from R127.2 billion in 2019/20 to R132.4 billion in 2020/21 and to increase to R152.2 in 2022/23. Over the next three years, these allocations are expected to grow at a decreasing rate in real terms. The Commission welcomes the nominal increase in the allocations but remains concerned about the projected decline in the real growth rate, as it may have an adverse effect on service delivery, which is essential in maintaining and improving service delivery to communities. The Commission remains concerned about the expected decline in the real growth rates of the LGES in outer years (2021/22 and 2022/23). This may have a negative impact on the provision of basic services, as the sector is subjected to increasing cost pressures, due to, inter alia, bulk electricity and water price increases above inflation, and the growth in the number of poor households and population. The Commission is of the view that while there is a need to ensure that the functions of local government are equitably funded from nationally raised revenues, municipalities should also efficiently utilise the available resources and where possible, optimise their existing own revenue bases.

Table 5: MTEF Division of Revenue Focussing on Local Government

	2016/17	2017/18	2018/19	2019/20 Revised estimate	2020/21	2021/22	2022/23	Real Average growth rate (2019/20-2022/23)
R'billions	Outcome				2019 MTBPS			
Local Government Total Allocations	**102,9**	**111,1**	**118,5**	**127,2**	**132,4**	**143,0**	**152,2**	**0,8%**
Equitable share and related	50,7	55,6	60,8	69,0	74,7	81,1	87,2	2,7%
General fuel levy sharing with Metros	11,2	11,8	12,5	13,2	14,0	15,2	16,1	1,5%
Conditional grants	40,9	43,7	45,3	45,1	43,7	46,8	49,0	-2,3%

Source: MTBPS 2019

Figure 8: Real growth in LGES allocation

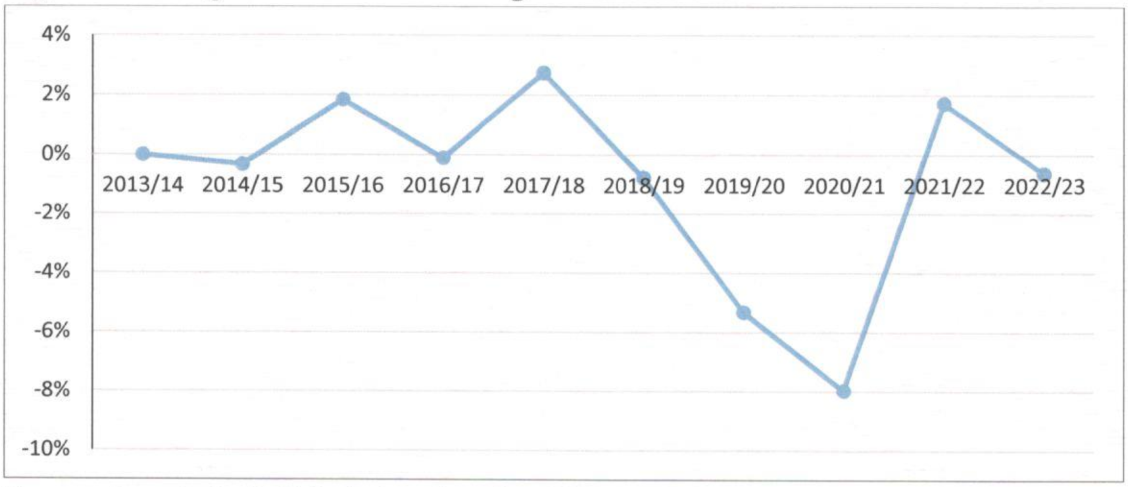


Source: Division of Revenue Bill, 2019; MTBS 2019.

5.5. The general fuel levy is shared between metropolitan municipalities. For the 2020 MTEF, this allocation is envisaged to increase by an annual average (in real terms) of 1.5 percent from R 13.2 billion in 2019/20 to R 16.1 billion in 2022/23.

5.6. Over the 2020 MTEF, the conditional allocations to the local government sector are projected to increase from R45 billion in 2019/20 to R49 billion in 2022/23. For this period, these allocations are envisaged to be lower than the allocations that were originally projected in the 2019 budget. A total amount of R 139.4 billion is projected for the 2020 MTEF, which projection is less by R3.2 billion. Following an increase in the real growth rate of conditional grants to the local government sector in the year 2020/21, a decline of 0.6 percent is expected for the period 2022/23 (see Figure 8). The Commission notes the projected cuts on the local government conditional allocations and is of the view that the reductions should be implemented with caution, to ensure that service delivery is not adversely affected and that indeed efficiencies are realised. Also, the Commission emphasises the need to consider past performance of the grants and avoid cutting on infrastructure grants as they are key for service delivery and economic growth. The new Infrastructure Fund hosted by the Development Bank of Southern Africa announced in the Minsiter's speech to enhance efficiency in infrastructure implementation is noted in this regard. The Commission welcomes this initiative and is of the view that a thorough assessment of the historical divers of the underinvestment is carried out in order to ensure efficient use of the grant.

Figure 9: Real growth in conditional grant allocations



Source: Commission's Calculations based on 2019 MTBPS.

6. Revised Division of Revenue 2019/2020

6.1. Annually government adjusts the budget that was approved in February. The purpose of the adjustments is to cater for unforeseen and unavoidable expenditure. Declared unspent funds returned to the fiscus amount to R3.909 billion in 2019/20, which is a significant increase when compared to R328.8 million declared as unspent in the 2018/19 budget. A total of R1.184 billion in the revised budget framework is projected to remain underspent by the end of the 2019/20 financial year. A decline when compared to the project undespending of R2.7 billion in the adjustment budget of the 2018/19 financial year. The large amounts of unspent funds are registered in departments such as Higher Education and Training (R897 100 million), due to among low capital expenditure by the universities and Technical and Vocational Education and Training (TVET) colleges, and Department of Health (R346 000 million) as a result of among others, the low expenditure to National Health Insurance programmes respectively. The Commission is concerned by the slow expenditure on these programmes in particular, given the critical role they play in addressing funding shortfalls at higher institutions of learning as well as imminent health reforms through the NHI.

6.2. Reported roll –overs amount to R344.9 million in 2019/2020, which is an increase compared to the previous year at R258.0 million5 when it comes to roll overs. The largest roll overs are registered by the Department of Water and Sanitation (DWS) at R241.927 million, and Department of Health at R89 300 million which is 70 percent and 25 percent of the total roll overs for this year respectively. For the DWS, the amount is for the Vaal River System pollution intervention project in the Emfuleni municipality in Gauteng. Whilst for the Department of Health it is for payments for capital assets under the health facility revitalisation component of the national health insurance indirect grant. The Commission welcomes the completion of these initiatives in protecting and improving water quality services in the country. Likewise, with programmes by the Department of Health, given the imminent introduction of the NHI by government. However, the Commission would like note that funds were allocated to the relevant departments in the 2018/19 budget for these purposes and should have been used in that financial year in order to deliver the services to citizens. Further the Commission would like to re-iterate the importance of using roll overs as per the Treasury Regulations so as to avoid wasteful and fruitless expenditure.

7. Reflections on Allocative Efficiency, Challenges and Opportunities within Key Priority Areas

Infrastructure investment

7.1. Both public and private infrastructure investment is key for long-term economic growth and employment creation. The structure of capital investment in South Africa is defined in terms of the institutions driving investment. The period leading to the 2009 financial crises was characterised by rapid increase in gross fixed capital formation with the private sector contributing almost 72 percent of the total investments while public corporations contributed approximately 12 percent. The contribution of the public sector has since increase to just over 20 percent by 2017 as government intensified efforts to reignite the economy through infrastructure spending while private infrastructure investment is waning. Public infrastructure delivery management weaknesses remain a key challenge holding back investment returns to the economy. Public infrastructure projects are characterised by cost overs, completion delays and poor workmanship. Government needs to build the required capacity to manage infrastructure projects effectively in order to maximise the economic benefits associated with capital investment. Government infrastructure investment is also one of the key factors determining the level of private sector investment because the investment of the two sectors must be complementary to secure inclusive growth and because the private sector views public investment as an indicator of confidence.

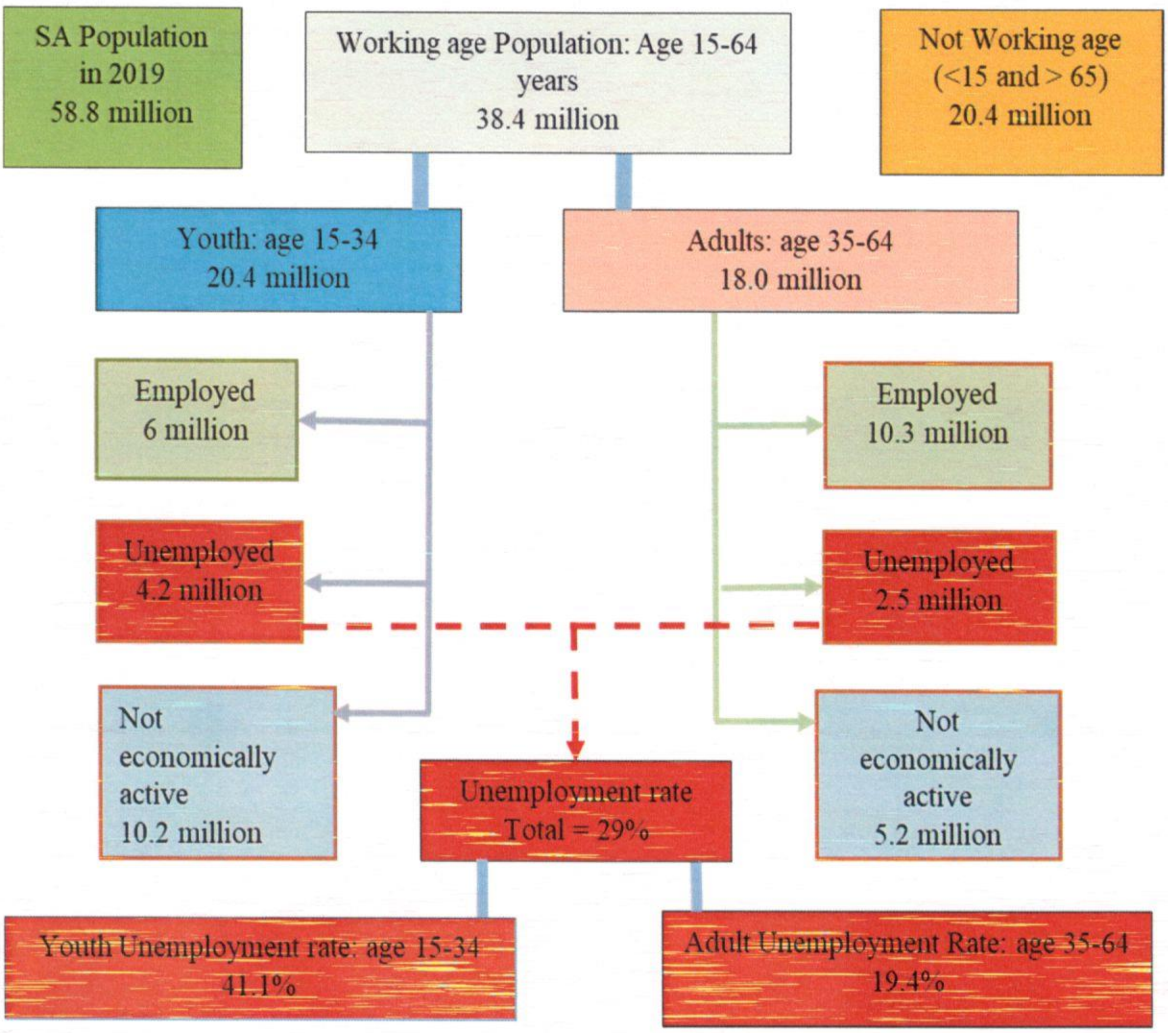
[5] Section 6.4 permits roll-overs (as follows amongst others): to unspent funds on payments for capital assets so as to finalise projects or the acquisition of assets already in progress.

7.2. The Commission welcomes the Budget Facility for Infrastructure introduced in the 2019 Budget has already reportedly begun to yield results. Infrastructure funding has identified projects across budget votes to the tune of R500 billion that will be implemented through a blended public and private sector finance. Whereas these efforts are commendable, it is the Commission's view that it is imperative that the national infrastructure delivery improvement must not be seen to disincentivise capacity development within provincial and local government. Further, the public sector component of the infrastructure fund must foster equitable distribution of infrastructure projecst and adhere to the equitable sharing principles espoused in the Constitution.

Job creation

7.3. One of South Africa's biggest challenges is unemployment, and particularly youth unemployment. Almost one in three individuals are unemployed in South Africa. 4.2 million young people, that is, around 41 percent are jobless in South Africa. With a large youthful population, the country has not been able to take advantage of this abundant resource. The structure of the South African labour force is shown in Figure 10 below.

Figure 10: Labour Market Indicators in Quarter 2 of 2019



Source: Quarterly Labour Force Survey Q 2019

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7.4. Government has instituted Active Labour Market Policies (ALMP) such as the Expanded Public Employment programmes to address the unemployment challenge. However, unemployment cannot be eradicated by ALMP alone as public employment programs and incentive schemes are meant to provide temporary unemployment relief as transitory assistance only. The Commission recommends that greater emphasis should be focused on the structural determinants of labour market demand and absorption to ensure long-term sustainable labour market outcomes. These determinants include: removing labour market rigidities, lowering the costs of labour force flexibility, and strengthening practical and technical skills development. It is worth noting that the labour market should not be seen as a singular market for workers, but as an integral part of the economic value chain and socio-economic development – within which workers have options in terms of their participation.

7.5. The Commission notes the labour market interventions proposed in the Medium Term Budget Policy Statement and the Economic Strategy Paper published by National Treasury promoting youth employment programmes, the labour-intensive sectors of agriculture and tourism and leveraging procurement to support industrialisation. However, the Commission noted that many of the proposed interventions are already institutionalised within the government delivery architecture. From the policy documents there is no clarity regarding how the proposed interventions would be different from the existing ones in place and to what end and extend. Details in this regard should be made explicitly available in the 2020 Budget and the preparations leading up to it, should be so aligned.

7.6. The Commission further cautions that the industries identified as employment-intensive e.g. agriculture, manufacturing, mining and tourism are modernising and increasingly needing more skilled labourers. These sectors may no longer be assumed to have the ability to absorb unskilled job seekers. Government efforts should be aimed at supporting strategically chosen sectors through the lens of improving productivity and market competitiveness through practical skills development programmes. It is the view of the Commission that successful implementation of the economic strategy needs effective reprioritisation and restructuring of state administrative capacity in this regard.

7.7. To further address the challenge of unemployment, the President launched a Job Summit in 2018. The subsequent section briefly reflects on these outcomes of this Summit.

The Jobs Summit

7.8. At the 2018 Jobs Summit, Social Partners developed a Framework Agreement to address the crisis of unemployment in the country. The Framework Agreement established a Presidential Jobs Committee, which receives quarterly reports on the implementation of action plans and monitors the status of unemployment and take remedial action when required. Also established was a joint technical committee of the Presidential Jobs Committee which is to use a monitoring and evaluation framework, and ensure sustained collaboration amongst Social Partners and that progress reports are published.

7.9. The commitments that were made in the Summit Framework Agreement were:

i. **Economic Sector Specific Interventions:** To secure substantially faster growth, agriculture, mining and manufacturing sectors were identified as key drivers of exports and investment. Interventions proposed as economic enablers supportive of the growth of firms, co-operatives, SMMEs and worker enterprises across all sectors of the economy include: procurement interventions to strengthen domestic demand; identify and implement import replacement and export enhancement; expand industrial financing and upgrading; develop private and public sector collaboration and establish distressed firm fund.

ii. **Small, Medium and Micro Enterprises (SMME) Interventions** Around 70 to 80 per cent of SMMEs fail in the first year of operation and only about half survive the next five years. Commitments were made at the Jobs Summit to assist small businesses, through township supplier development programmes, enterprise supports, upscaling and re-capitalisation of SMME credit guarantee schemes, as well as development of youth entrepreneurship,

iii. **Education and Skills Interventions:** Yellowwoods and DG Murray Trust (DGMT) a joint role initiative, will fast-track, and scale-up existing programmes designed to achieve universal access to quality, affordable Early Childhood Development (ECD). Interventions to support "drop outs" and matrics to have the competencies for employment and self-employment were also committed by expanding access to TVET and Community Colleges, develop and implement infrastructure installation, repair and maintenance plan, curriculum development, transition of NEETS onto pathways for employment and income.

iv. **Inclusive Growth Interventions:** Social partners agreed to explore opportunities for building more inclusive and cooperative workplace by ensuring worker equity representation on company boards; disclosure of executive pay and bonuses for transparency; understanding the gender pay gap; addressing custom fraud and illegal imports; and enhancement of socio-economic impact assessments.

v. **Public and Social Interventions:** Public employment interventions such as the Expanded Public Works programmes shall be strengthened in combination of employment tax incentive and training layoff scheme, monitored by social audits as part of the monitoring and evaluation. Social Partners have also committed to anti-corruption strategy of the government to ensure credibility of public and social interventions.

Education, health and Human Settlements

7.10. Post school education and training remains one of the major fiscal pressures for the government due to growing demand for university and college education. According to the 2019 MTBPS, higher education and training will receive R375 billion in the next three years mainly for the implementation of fee free higher education. Fee free higher education was announced in December 2017 to be implemented as from 2018 to qualifying students.

7.11. To date, the government does not have a clear fee-free higher education policy and sustainable funding plan to facilitate roll out. Hence the scope of qualifying students is subject to change. Funding has been sourced mainly from cutting and reprioritising funding from other programmes. The Commission therefore reiterates its recommendation that government should develop a comprehensive fee-free higher education policy and clear plan on how such policy will be rolled out and funded going forward to address uncertainty in the institutions of higher learning. Furthermore, the Commission recommends that the funding of higher education and training also be aligned to relevant skills and training programmes that are in line with future needs and demands.

7.12. Health remains a key priority of government with a revised MTBPS allocation of R222.7 billon over the 2020 MTEF. This represents a 8 percent increase in nominal terms when compared to the 2019 MTBPS. The key priory within the health sector is the implementation of the National Health Insurance (NHI) which is planned to be rolled out in 2026. The NHI pilot evaluation report reveals a number of challenges encountered. These challenges range from spending capabilities, clarity on the roles of the different spheres and institutions in the sector and clarity on funding issues. The Commission notes the presidential leadership in this regard and the accelerated planning of the health sector for NHI and supports efforts that will resolve the challenges without delays. Such challenges affect the readiness for NHI implementation in 2026 and as such the sector amelioration efforts are fully endorsed. The 2019 MTBPS makes no specific announcement of budget adjustment to NHI grants in the face of it the imminent implementation. It is the view of the Commission that NHI funding should be targeted at activities that are initmately related to setting up of the fund – including administrative, institutional and organisational functions. The Commission further recommends that government implement the action plan to address any remaining challenges and recommendations outlined in the NHI pilot evaluation report.

8. Special issues: State Owned Companies

8.1. State owned companies continue to place the public finance of the country at risk. Their performance is cause for concern for the Commission. The challenges facing SOCs are a by-product of poor leadership, mismanagement, governance, corruption and revenue deficits. The subsequent section reviews performance of SOCs at the time of the 2019 MTBPS.

Government Contingent Liabilities and State-Owned Entities

8.2. Over the medium term, government's net loan debt will reach an estimated R3.47 trillion or 55.5 percent of GDP in 2021/22. Contingent liabilities will reach an estimated R1.015 trillion in 2021/22, constituting almost a third of governments net loan debt Guarantees to state owned entities (SOEs) will reach an estimated R552

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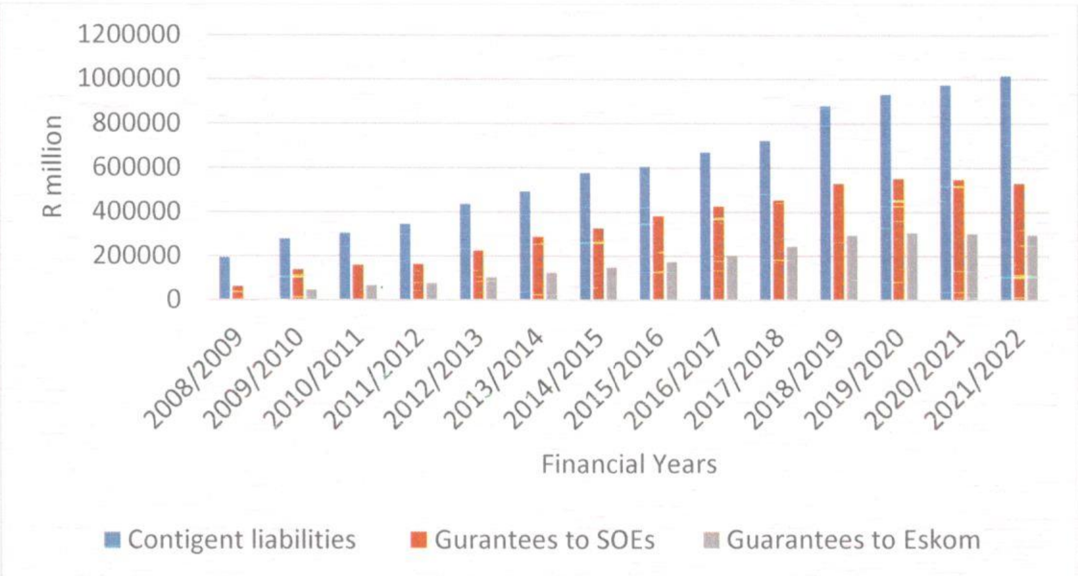
billion in 2019/20, accounting for more than a third of the total government contingent liabilities. This means that guarantees to state-owned companies are one of the key drivers of government contingent liabilities and constitute a major risk to the fiscus. Guarantees to Eskom are estimated to account for over half (56 percent) of the total government guarantees to SOCs. Recently, parliament approved the Special Appropriation Bill, seeking additional financial support for Eskom at R26 billion in 2019/20 financial year and R33 billion in the 2020/21 financial year to assist Eskom in maintaining its going-concern status.

8.3. The 2019 MTBPS revised in year expenditure upwards by R44.5 billion. A large fraction constituting over 80 percent of this revision (R36.8 billion) is allocated to the financial support for SOCs: R26 billion in the Special Appropriation Bill for Eskom; R5.5 billion for South African Airways; R3.2 billion for the South African Broadcasting Corporation; R1.8 billion for Denel; and R300 million for South African Express Airways. These bailouts are substantially accelerating government debt. There is also an additional risk that these SOCs will require additional funding in very near future i coherent and effective measures are not decisively implemented to urgently restructure them and make them financially viable.

8.4. Figure below shows a significant increase in government contingent liabilities, guarantees to SOCs and guarantees to Eskom between 2008/09 and 2018/19. Government guarantees to SOCs have increased by 740 percent from R63 billion in 2008/09 to an estimated R529 billion in 2018/19. Guarantees to Eskom have increased by 531 percent from R47 billion in 2008/09 to an estimated R295 billion in 2018/19.

Figure 11: Government contingent liabilities, guarantees to SOCs and guarantees to Eskom



Source: National Treasury Budget Review (various)

8.5. The high level of contingent liabilities and the high probability of significant amount of these contingent liabilities materialising owing to the financial distress of Eskom, in particular, and other SOCs, in general, represents not only a risk to the public finances but also to South Africa's sovereign credit rating. Already South Africa's credit ratings are cause for concern. Standard & Poor and Fitch rating agencies, currently place South Africa at sub-investment level as shown in Table 6 below. Moody's Investor Services on 1 November 2019, put South Africa's rating on "negative outlook", narrowingly staving off "junk status".

Table 6: South Africa's Credit Ratings

Ratings category	Foreign Currency denominated debt			Local currency (Rand)denominated debt		
	Moody's	Standard & Poor	Fitch	Moody's	S&P	Fitch
Investment grade	A3	A-	A-	A3	A-	A-
	Baa1	BBB+	BBB+	Baa1	BBB+	BBB+
	Baa2	BBB	BBB	Baa2	BBB	BBB
	Baa3	BBB-	BBB-	Baa3	BBB-	BBB-
Sub-investment grade	Ba1	BB+	BB+	Ba1	BB+	BB+
	Ba2	BB	BB	Ba2	BB	BB
	Ba3	BB-	BB-	Ba3	BB-	BB-

8.6. Credit ratings have severe financial and economic ramifications for the economy and public finances. The Eskom Restructuring Blue print was presented by the Minister of Enterprises on the 29th October 2019 and needs to be demonstrated to be credible in terms of practical implementation.

8.7. The Commission welcomes the shift in government policy to conditional loan financial support to SOCs, replacing bailouts. National treasury has announced that SOCs will now be required to undergo structural changes in order to obtain further fiscal support. In particular, the Commission welcome the 28 conditions that have been attached to the Special Appropriation Bill for Eskom. The Commission welcomes this policy shift because it promises to accelerate the implementing the necessary structural reforms by SOCs.

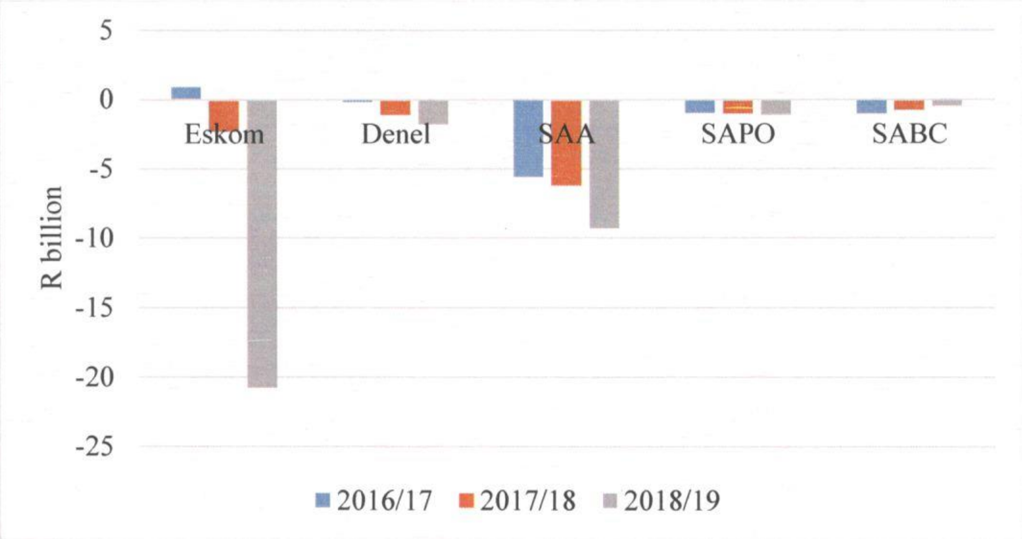
8.8. The Commission recommends that government should minimise contingent liabilities by indeed subjecting government loans to SOCs to stringent conditionalities aligned to sound turnaround plans and detailed and explicit implementation performance targets.

Financial Health of State-Owned Entities

8.9. The Public Finance Management Act requires SOCs to generate adequate financial resources from their operations to fulfil their mandates. Several SOCs are in poor financial health. Eskom, Denel, South African Airways (SAA), South African Post Office (SAPO) and the South African Broadcasting Corporation (SABC) have all posted losses for at least two successive years. Eskom has posted a cumulative loss of R23.1 billion between 2017/18 and 2018/19. Denel has posted a cumulative loss of

R3.1 billion between 2016/17 and 2018/19, SAA (-R21.1 billion[6]), SAPO (-R3.093 billion) and the SABC (-R2.265 billion). The deteriorating financial position of these entities constitute a major risk to the economy and its public finances. Figure 12 below shows the profit/loss magnitude for the selected SOCs discussed above.

Figure 12: Profit/loss for selected SOCs, 2016/17-2018/19

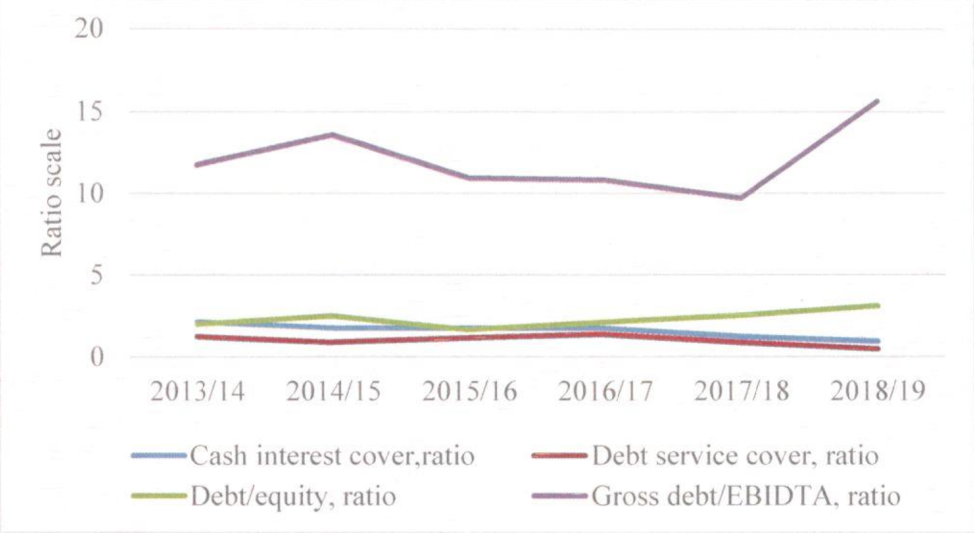


Source: SOCs Annual Reports (Various)

8.10. Eskom debt service cover ratio, a measure of the cash flow available to pay current debt obligations, decreased from 1.24 in 2013/14 to 0.47 in 2018/19. Eskom cash interest cover ratio, a measure of the ease with which an organization can pay interest on its outstanding debt, declined from 2.15 in 2013/14 to 0.94 in 2018/19. This means that Eskom is not generating enough income to pay its interest payments. ESKOM gross debt to EBIDTA ratio, a measure of the ability of an organization to cover its short term and long-term debt, accelerated from 11.77 per cent in 2013/14 to 15.64 per cent in 2018/19. This means that Eskom is indebted and could not be able to service its debt, and therefore would have a lower credit rating and have to offer higher yields on bonds.

[6] The last annual report to be published by SAA was for 2017. The annual reports for 2018 and 2019 have not yet been published. Premised on the financial trends of the last few years persisted, projections were calculated for 2017/18 and 2018/19.

Figure 13: Eskom Debt Ratios, 2013/14-2018/19



Source: Eskom Annual Reports (various)

8.11. Eskom debt to equity, cash interest cover, debit service cover and gross debt/EBIDTA ratios, which are measures of sufficient cash flow to cover debt servicing and ability to pay debt, all reflect the fact that Eskom is highly indebted. Figure show the trends in Eskom debt ratios for the period spanning 2013/14 and 2018/19.

Eskom Special Paper

8.12. Eskom indeed constitutes South Africa's biggest SOC economic risk, in addition to the fragile state of the institution as a government entity, it poses risks as a contributor to sluggish South African growth. In February 2019, government announced the separation of Eskom into three entities: electricity generation, transmission and distribution to facilitate cost efficiencies, optimal investment in infrastructure, improved operational performance and reliability of supply. Whereas, there has not implementation of the legal separation of the utility, government has now set a two-phase timeline for restructuring Eskom. According to a special paper on the roadmap for Eskom, the first phase entails separating the generation, transmission and distribution functions into separate, wholly owned subsidiaries with independent Boards by 31 March 2020. The second phase involves the completion of the legal separation of distribution and generation functions by 31 December 2021.

8.13. The special paper on the roadmap for Eskom is aimed at:

- Outlining actions to overcome the current crisis at Eskom
- Defining the key steps required to transforming the electricity supply system
- Restoring Eskom's finances
- Changing Eskom's cost structure to enable provision of affordable electricity
- Detailing the process through which the restructuring of Eskom will take place

8.14. The view of the Commission is that the plan is a step in the right direction in restructuring Eskom. The plan articulates how Eskom will relinquish monopoly of the electricity industry. Its transmission unit will now be a separate entity under the control of a state holding company, paving the way for private generators to supply the national grid.

8.15. The plan does not contain some crucial details. The view of the Commission is that there should be made available options analysis of the comparison of costs and the benefits of Eskom's unbundling, in order to allow for an evaluation the true financial and economic value and risks. The transition from the existing dependence on fossil fuels to the mix of electricity energy sources should be quantified therein. As well as an analysis of costs pressures as they relate to the entity'sstaff contingent and the cost structure of procurement of goods and services.

8.16. The 2019 MTBPS did not provide details on any of Eskoms debt relief measure plans. Instead, it set several preconditions before debt relief will be considered.

8.17. The conditions require Eskom to:

- ✓ Demonstrate measurable progress in instilling rigorous cash management discipline, and in achieving operational efficiencies in the business.
- ✓ Show that all business units are managing operations within their means.
- ✓ Create the three new functional entities, with the separation of the transmission function being the priority.
- ✓ Appoint new Boards and CEOs with the requisite skills for the three entities, who are accountable for the independent operation of each entity.

SOCs Accountability and Governance

8.18. Besides Eskom, the audit outcomes of state-owned entities are deteriorating. According to the 2017/18 consolidated Auditor General report on National and Provincial Audit Outcomes, the Independent Development Trust received a disclaimed opinion for the third year in a row and the SABC regressed from an adverse opinion to a disclaimed opinion. According to the Auditor General (AG), audits for SAA, Denel, the South African Nuclear Energy Corporation group and SA Express were not completed on time.

8.19. Whereas the AG noted a slight improvement in the financial health of the SOEs, the SABC, the Petroleum Oil and Gas Corporation and the South African Post Office reported that they were unlikely to continue with their operations in future without financial assistance. The AG further reported 88 percent of the 16 SOEs audited by AGSA had material findings. These entities also disclosed R1,9 billion in irregular expenditure. The irregular expenditure of SOEs not audited by the AG amounted to R28,4 billion, which included R19,6 billion at Eskom and R8,1 billion at Transnet.

8.20. The Commission recommends the implementation of consequences for transgressions for SOCs. The appointments at SOCs board and executive levels should be conditional on the appropriate mix of skills and experience. Boards and chief executive officers should be held accountable for the delivery and financial results of the SOCs. Government in conjunction with parliament should provide strong oversight that entails strong in-year monitoring of SOCs.

9. Concluding Remarks

9.1. The 2019 MTBPS has been tabled in bleaker conditions than the 2018 MTBPS or in 2019 Budget statement. Growth is projected to be at 0.7 per cent, while unemployed has risen to levels never seen in the past decade. The South African economy is trapped in a precarious growth trajectory where the fiscal metrics are spiralling out of control. The fiscal and economic trajectory over the medium term are unsustainable. To return South Africa to a sustainable fiscal path, the Financial and Fiscal Commission believes that the government must take bold, decisive and immediate action to restore fiscal credibility and boost confidence on the economy. Policy and implementation certainty are the cornerstone of restoring confidence and fiscal credibility. The challenges require bold interventions, particularly regarding SOCs.

9.2. There is a need for re-orientation of the public finances and to ensure decisive implementation decision making. Revenue collection has consistently failed to reach its projected targets. Debt is the fastest growing expenditure. There is a need to revisit whether South Africa needs explicit fiscal rules and whether government should legislate the rules for granting government guarantees. The Commission cautions that public debt should be used for investing in productive growth activities with guaranteed future economic returns higher than that of the opportunity costs of debt or debt-service costs.

9.3. Initiatives to catalyse economic growth are steps in the right direction. Overall, the 2019, MTBPS re-affirms and reflects the major thrust and spirit of the recommendations that the Commission has been making in the past decade or so: that growth and employment in South Africa can only be achieved by combining fiscal consolidation and investment. The Commission fully supports the position of government contained in the MTBPS of emphasizing the need to lower the debt trajectory, narrow the budget deficit, and raising the quality of spending. These will not be "missteps" if decisively implemented.

9.4. The Commission notes and support efforts by government to protect social spending and rebuild institutions. The Commission further notes the publication of the Economic Strategy paper which is a critical attempt to focussing action in the achievement of economic growth. As the Commission has noted before it is important that government carries through these initiatives. The Commission continues to be concerned that the government remains wanting on implementation.

9.5. More specifically the Commission supports:

- Measures of tightening the budget
- Building government institutions and the macro reorganisation of government
- re-directing government spending towards activities that directly or indirectly create jobs
- the protection of social expenditures; and
- the proposed MTBPS adjustments estimates.

9.6. The Commission implores government to make bold, cogent and decisive actions in support of the initiatives aimed at restoring economic growth and creating employment.

Beyond dealing with unemployment per se, focus must firmly be on the impact of initiatives on employment creation, poverty and inequality. There is an imperitive to improve on policy implementation beyond the telecommunications spectrum licencing, tourism e-visa system and Integrated Resources Plan. Public service delivery that impacts positively on the lives and livelihoods of citizens is essential. On SOCs, time is of essence. Government has to restore governance systems in SOCs and take bold steps to close shop on those whose social or economic value is negative. Government is implored to continue to reprioritise and rebuild state capabilities and state institutions.

For and on behalf of the Financial and Fiscal Commission

Professor Daniel Plaatjies

Chairperson

Financial and Fiscal Commission

Date: 4/11/2019