FINANCIAL
AND FISCAL
COMMISSION

Financial and Fiscal Commission Submission on the 2022 Budget

For an Equitable Sharing of National Revenue

04 March 2022

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1. Background

1.1. This Submission on the 2022 Division of Revenue (DoR) Bill is made in terms of Section 214 (1) of the Constitution of the Republic of South Africa (1996) and Section 35 of the Intergovernmental Fiscal Relations (IGFR) Act (1998) as well as S4(4c) of Money Bills Amendment Procedure and Related Matters Act or MBARARMA (Act 9 of 2009), as amended.

1.2. In March 2020, the COVID-19 pandemic reached South Africa. Responding to and containing this health crisis and its wide-ranging socio-economic impacts has dominated the government's plans and priorities over the past two years and will continue to do so over the foreseeable future. The government has had to go to extraordinary measures to ensure funding to purchase vaccines and ensure income and other support for the most vulnerable. The pandemic and the associated lockdown have redefined the vulnerable as people's lives and livelihoods were lost. The shocks brought on by the COVID-19 pandemic have led to contractions in the gross domestic product (GDP), increased debt levels and high unemployment and income losses – all of which have served to exacerbate inequality and poverty further.

1.3. The outbreak of the July 2021 civil unrest in KwaZulu-Natal and Gauteng caused strain on the government, as public resources had to be further extended in the form of provisions of income support to households and to aid the recovery of businesses, especially small and medium-sized enterprises.

1.4. As with the 2021 Budget and then the 2021 Medium Term Budget Policy Statement, Budget 2022 is premised on balancing the priorities of placing South Africa on the path to economic and social recovery and restoring the sustainability of public finances. The multifaceted social and economic impacts of the COVID-19 pandemic over the last two years mean that Budget 2022 is tabled in a fiscally constrained environment, making the fulfilment of these priorities challenging.

2. Fiscal Framework and Revenue Proposals

Overview of the 2022 fiscal framework

2.1. Over the MTEF, the consolidated government spending is expected to grow at an annual average of 3.2%. A consolidated budget deficit of 6% of GDP is projected for 2022/23, narrowing to 4.2% of GDP in 2024/25. The projected moderate increases in government spending aim to reduce the budget deficit. The poor and inefficient financial performance of State-Owned Entities still weighs on public finances and rising budget deficit. A narrowing tax base due to rising unemployment may pressure public spending, increase the budget deficit, and increase borrowing requirements. Debt servicing costs will exceed R300 billion per year from 2022/23, becoming the fastest-growing spending item.

Table 1: Consolidated government fiscal framework

	2021/22	2022/23	2023/24	2024/25
R billion/percentage of GDP	**Revised estimate**	**Medium-term estimates**		
Revenue	**1721.3**	**1770.6**	**1853.2**	**1977.6**
	27.5%	*27.5%*	*27.2%*	*27.3%*
Expenditure	**2077.0**	**2157.3**	**2176.8**	**2281.8**
	33.2%	*33.5%*	*32.0%*	*31.5%*
Budget balance	**-355.7**	**-386.6**	**-323.6**	**-304.2**
	-5.7%	*-6.0%*	*-4.8%*	*-4.2%*
Debt-service costs	***268.3***	***301.8***	***335.0***	***363.5***
	4.3%	*4.7%*	*4.9%*	*5.0%*
Gross Domestic Product (est.)	***6251.5***	***6441.3***	***6805.3***	***7233.7***

Source: National Treasury, 2022

2.2. Table 2 shows that over the MTEF period, capital payments will receive an allocation of R327.7 billion representing an average growth of 12.2% over the 2022/23 to 2024/25 period. Capital transfers will receive a total allocation of R260 billion over the MTEF period, representing an average growth of 7.9%. The average growth of employees' compensation will be 1.8% over the MTEF period, and the average growth of goods and services will be 2.6% over the MTEF. Spending on the compensation of employees and spending on transfer and subsidies are the two largest components of the current account.

2.3. The 2022 Budget presented a consolidated expenditure framework and functional allocation that revised estimates upwards compared to the 2021 Budget. The spending allocation for the Learning and Culture function received R25.41 billion for the 2021/22 financial year and has the most significant increase relative to other functions. This increase supports policy priorities in higher education and teacher retention in basic education. The social development function receives an allocation of R24.1 billion, which is mainly driven by the extension of the Social Relief of Distress grant.

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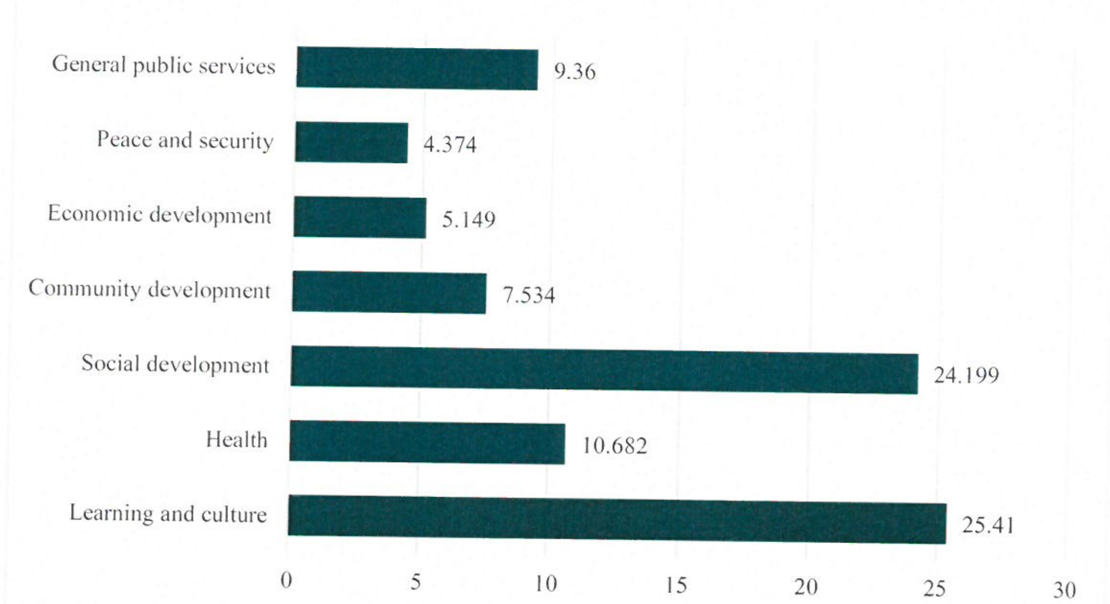
Table 2: Allocations by economic classification

R billion	2021/22	2022/23	2023/24	2024/25	Total MTEF
	Revised estimate	Medium-term estimates			
OPERATING ACCOUNT					
Current payments	**1 847.30**	**1 936.30**	**1 926.10**	**2 013.90**	5 876.30
Compensation of employees	665.1	682.5	675	702	2 059.50
Goods and services	277.9	284.8	281.6	299.9	866.2
Interest payments	276.9	310.8	343.7	372	1 026.50
Current transfers and subsidies	627.4	658.2	625.8	640	1 924.00
CAPITAL ACCOUNT					
Capital receipts	0.2	0.2	0.2	0.2	0.7
Capital payments	82.2	102.4	109.1	116.2	327.7
Capital transfers	73	81.4	86.8	91.8	260

Source: National Treasury, 2022

Figure 1: Change between the 2021 Main Budget and revised estimate in 2022 Budget for the 2021/22 financial year



Source: National Treasury 2022

2.4. Allocations across functions support the implementation of existing policy priorities around protecting the vulnerable. However, over the MTEF period, real spending in education, health, and social development may decrease after inflation over the MTEF, impacting the reversal of protection of vulnerable sections of society. The decreases in spending over the MTEF may also affect the number of people employed in these functions. The budget cuts must consider the effect of these cuts on employment, a balance between budget cuts and employment preservation.

Table 3: Real consolidated non-interest expenditure by function

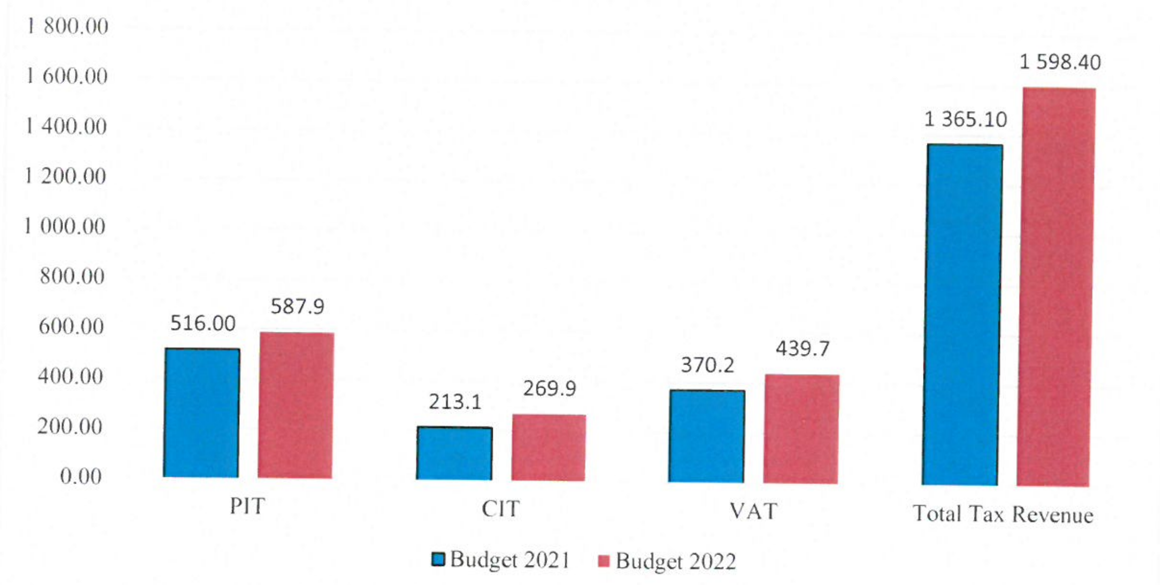
R billion	Total allocation between 2021 Budget and 2022 Budget		Change between MTBPS 2021 and Budget 2022	Average annual change 2021/22 to 2024/25
	2021/22 Main Budget	2021/22 Revised estimate		
Learning and culture	389.8	415.2	25.4	-1.1%
Health	227.7	238.4	10.7	-1.8%
Social development	280.4	304.6	24.2	-2.5%
Community development	204.2	211.7	7.5	3.4%
Economic development	187.7	192.9	5.1	4.2%
Peace and security	214.0	218.4	4.4	-3.1%
General public services	62.4	71.7	9.4	-4.9%
Consolidated non-interest expenditure	**1566.1**	**1652.8**	**86.7**	
Consolidated non-interest expenditure including payments for financial assets	**1662.7**	**1727.4**	**64.7**	
Consolidated non-interest expenditure excluding compensation of employees	935.5	987.8	52.3	

Source: National Treasury, Budget Review 2022; FFC Own Calculations

Revenue trends and tax proposals

2.5. The increase in commodity prices has improved the in-year revenue outlook resulting in higher-than-expected revenue collection. Gross tax revenue for 2021/22 is R61.7 billion above projections. The upward revision shows an improvement in Personal Income Tax (PIT), Company Income Tax (CIT), and Value Added Tax (VAT).

Figure 2: Tax Revenue Budget 2021 and Budget 2022 (R billion)



Source: National Treasury, 2022

2.6. The government is restructuring the corporate income tax system without negatively impacting net revenue collections. The corporate income tax rate is reduced by one percentage point to 27%. The rationale for the reduction is that the relief provided through a reduction in corporate tax can divert the savings towards investment to create jobs and support an inclusive recovery. The Commission notes that South Africa has been experiencing low investment, contributing to sluggish growth while decreasing corporate taxes and encouraging further research on alleviating the structural constraints and uncertainties impacting investor behaviour.

2.7. On revenue, the Commission notes that tax policy has focused on broadening the tax base, improving administration, and lowering tax rates over the past two years. As outlined in Budget 2022, the government intends to continue with this approach by avoiding tax rate increases where possible. The Commission supports this stance to grow the tax base instead of a rate-based approach.

2.8. The government is also expanding the employment tax incentive to encourage businesses to employ young people. The incentive increases to a maximum of R1 500 monthly in the first 12 months and from R500 to a maximum of R750 in the second 12 months of eligibility. The Commission welcomes the expansion of the incentive to address youth unemployment, subject to impact monitoring and evaluation of its implementation and outcome.

Recommendations

- The Commission welcomes the fiscal framework and revenue proposals of the 2022 Budget and aims to narrow the budget deficit and stabilise the debt. The Commission also welcomes the tax proposals of not increasing taxes, as this will provide much-needed relief to households in the face of price increases.
- The Commission further encourages investigating the relationship and driver between tax reduction and revenue, to ensure the growth-optimality of guiding changes in the tax regimes.

3. 2022 Appropriation Bill

3.1. The 2022 Appropriation Bill makes provision for the appropriation of funds from the National Revenue Fund for the state's requirements in relation to the 2022/23 financial year.

3.2. Total appropriation by vote amounts to R1.057 trillion in 2022/23 (or R3.1 trillion over the next three years). This allocation represents a nominal increase of 3% when compared to the revised estimate for 2021/22. However, the positive growth does not last beyond 2022/23, when total allocation is projected to decline by 4% before recovering in 2024/25. Considering these trends, it is clear that the benefits of increased, and in some cases, temporary, funding will be limited to 2022/23. National departments will feel the pinch of constrained resources more strongly in 2023/24.

3.3. Focussing on 2022/23, the increase in the total appropriation by vote is driven mainly by funding priorities in the Social Development, Higher Education and Training and Cooperative Governance votes. Table 4 illustrates the allocations, year-on-year, and average growth rates across a selection of key Votes, whilst the rest of the section discusses key developments characterising specific national votes.

3.4. In absolute terms, the largest allocation at the national sphere is the **Social Development** vote, which will receive R257 billion in 2022/23, primarily to fund the social protection programmes. More specifically, three new developments will be effected over the next three years.

i. First is the temporary, twelve-month extension of the Social Relief of Distress (SRD) grant, calculated at a projected cost of R44 billion, which is made possible by additional resources from higher than anticipated revenue collection. Government is clear that this extension is temporary and will end in March 2023. Given the effects of the health and economic crisis, the extension of this grant which provides income relief to 10.5 million people, is supported.

ii. Second, the Child Support Grant (CSG) will be extended to provide support for double orphans, starting in 2023/24. The extension of this grant is geared at promoting the care of orphans within families instead of foster care.

iii. Third, social security grants will be adjusted in line with inflation as of 2023/24.

Table 4. Allocations and growth for selected national votes

R million	Revised estimate	Medium-term expenditure estimates			2021/22-2022/23	2022/23-2023/24	202324-2024/25	Average growth 2022/2023-2024/2025
	2021/22	2022/23	2023/24	2024/25				
Cooperative Governance	98,984.9	111,364.9	119,225.8	127,419.4	12.5%	7.1%	6.9%	8.8%
Home Affairs	9,431.4	9,406.0	9,332.6	9,751.7	-0.3%	-0.8%	4.5%	1.1%
Basic Education	28,256.6	29,560.2	30,388.0	31,406.7	4.6%	2.8%	3.4%	3.6%
Higher Education and Training	97,522.5	109,514.9	113,235.2	119,647.9	12.3%	3.4%	5.7%	7.1%
Health	65,108.7	64,531.0	60,620.5	62,157.6	-0.9%	-6.1%	2.5%	-1.5%
Social Development	233,697.9	257,001.4	221,042.0	232,975.0	10.0%	-14.0%	5.4%	0.5%
Justice and Constitutional Development	19,508.7	20,021.9	19,802.2	20,692.4	2.6%	-1.1%	4.5%	2.0%
Office of the Chief Justice	1,241.8	1,265.8	1,232.9	1,288.3	1.9%	-2.6%	4.5%	1.3%
Police	100,473.8	100,695.3	99,018.8	104,373.7	0.2%	-1.7%	5.4%	1.3%
Agriculture, Land Reform and Rural Development	18,023.3	17,287.7	17,387.7	18,168.6	-4.1%	0.6%	4.5%	0.3%
Employment and Labour	3,783.5	3,956.0	3,983.5	3,772.6	4.6%	0.7%	-5.3%	0.0%
Forestry, Fisheries and the Environment	7,544.9	8,947.9	8,947.2	9,348.9	18.6%	0.0%	4.5%	7.7%
Human Settlements	31,624.8	33,024.7	34,457.6	35,508.7	4.4%	4.3%	3.1%	3.9%
Small Business Development	2,637.1	2,563.1	2,569.9	2,685.3	-2.8%	0.3%	4.5%	0.7%
Trade, Industry and Competition	11,727.0	10,859.3	10,887.7	10,553.3	-7.4%	0.3%	-3.1%	-3.4%
Transport	65,286.5	69,125.9	76,894.6	81,645.0	5.9%	11.2%	6.2%	7.8%
Water and Sanitation	17,735.1	18,539.7	20,155.2	20,913.3	4.5%	8.7%	3.8%	5.7%
Total appropriation by vote	**1,025,806.5**	**1,057,028.6**	**1,013,672.6**	**1,059,387.2**	**3.0%**	**-4.1%**	**4.5%**	**1.2%**

Source: ENE Summary Table No. 2.

3.5. The Commission supports these interventions to bring a breath of relief to poor and vulnerable households who rely on social security grants especially given the detrimental effects of COVID-19. Regarding possibilities around a more permanent replacement for the SRD grant, the Commission notes that the technical work to identify fiscally feasible and financially viable options to replace SRD is incomplete and ongoing. For the Commission, a key consideration regarding the viability of any potential replacement for the SRD grant will be the long-run, dynamic, economic impact and implementation of such a universal grant would have on the sustainability of the fiscus.

3.6. The Department of Higher Education and Training (DHET) allocation will increase from R98 billion in 2021/22 to R110 billion in 2022/23. Additional funding of R32.6 billion is directed at the National Student Financial Aid Scheme (NSFAS) for strengthening fee-free higher education through (1) continuation of bursaries to existing students from households earning below R350 000 per annum and (2) funding new entrants into the system. The additional funding for 2022/23 is made possible due to the revenue windfall. The underlying risk that government should bear in mind is the sustainability and ability of the government to continue with this support over the medium term, especially if revenue recovery is not realised. If revenue collection is poor, the DHET will be under severe pressure. The 2022 Budget Review refers to developing a new higher education funding model to be introduced in 2023. The Commission acknowledges the strain placed on the fiscus by the fee-free higher education policy and thus awaits the contents of the new funding model. In light of the high unemployment characterising South Africa and the pivotal role that TVET colleges play in building artisanal skills, the Commission welcomes the increased allocation to this programme which averages 2.7% per annum in nominal terms over the next three years.

3.7. Positive growth is projected for allocations to the **Basic Education** vote over the next three years. However, given that this is a concurrent function with implementation primarily executed within provinces, the Commission is hopeful that this positive growth can be replicated across the nine provincial departments.

3.8. As a result of the shortfalls in provincial education compensation budgets, additional funding is being added to the provincial equitable share allocation to assist provinces. However, as noted in the 2022 Budget Review, slow growth (of 1.9%) for the compensation of employees over the medium term will result in fewer teachers and increased class sizes in some provinces. Factors such as the capability of teachers and class size, amongst others, influence pupils' learning outcomes. Thus, if this scenario is realised, it threatens the sector's performance and provision of quality education. It is also more likely to affect poorer, lesser resourced schools that cannot rely on school fees to pay teachers. To this end, the Commission welcomes the additional R24.6 billion added to the PES to address teacher shortages. Should teachers be hired, it creates future funding obligations. Should the sector face slower or negative growth over the coming years, education department budgets will be under severe pressure.

3.9. A notable development within the basic education sector is the shift of ECD from the Department of Social Development to the Department of Basic Education by April 2022/23. This function shift will result in a baseline increase of R3.7 billion over the next three years. International and national research have established the positive spillovers of investing in quality early learning programmes for the individual and society. Investing in ECD is also less costly than interventions later in the human capital pipeline. Now that ECD will be part of the formal schooling system, the Commission recommends that early learning be afforded the priority it deserves. To this end, outstanding issues integral to the shifting of this function, including the funding model and the implications of the shift for the existing ECD workforce, must receive urgent attention.

3.10. Over the medium term, the **Health** vote will continue focusing on the COVID-19 pandemic with the roll-out of its vaccination strategy. Funding amounting to R8.8 billion over the next three years is allocated in respect of the phased implementation of the National Health Insurance (NHI). Much of the funding is geared at ensuring the readiness of the sector for the NHI implementation. As indicated in the 2022 Estimates of National Expenditure, one of the department's objectives over the next three years is to enable the passing of the NHI Bill through Parliament. The Commission supports the principle of universal health coverage and looks forward to progress in this regard.

3.11. In terms of community development, strong increases are noted in the **Cooperative Governance** vote. The increased funding will be used to strengthen the equitable share allocations to municipalities by a projected R28.9 billion over the next three years. Given the role that municipal services such as water, sanitation, electricity and refuse removal play in social and economic development, the Commission welcomes the government's efforts to protect this pool of funding.

3.12. The 2022 SONA highlighted the importance of infrastructure investment to South Africa's economic reconstruction and recovery. Budget 2022 reaffirms this stance with strengthened funding towards infrastructure evident across the Departments of Water and Sanitation and Transport:

i. The **Water and Sanitation** vote is allocated R59.6 billion over the MTEF. Total expenditure is expected to increase at an average annual rate of 5.6% cent, from R17.7 billion in 2021/22 to R20.9 billion in 2024/25, mainly due to additional allocations of R5.3 billion over the medium term for capital projects involving water resource and regional bulk infrastructure. The Commission welcomes the increase in the funding for regional water resources because water is critical for the health and safety of our people and fundamental to growth and development.

ii. The **Transport** vote allocation will increase by 7.7% over the MTEF from R65.4 billion in 2021/22 to R81.7 billion in 2024/25, mainly to fund road infrastructure. A large fraction of the vote allocation (R76.4 billion) will be transferred to the South African National Roads Agency (Sanral) to upgrade, strengthen and maintain the national road network. Over the MTEF period, 59.3% (R45.3 billion) of allocations will fund upgrading, strengthening, and refurbishing the national non-toll roads network. R2.8 billion is allocated for the R573 (Moloto Road) development corridor, R3.7 billion for the N2 Wild Coast project, and R2.1 billion is allocated to fund reduced tariffs for the Gauteng freeway improvement project. The Commission welcomes the allocation for road infrastructure because it enables and facilitates the trade of goods and services critical for economic growth and development.

iii. The **Trade and Industry** vote total allocation is expected to decrease at an average annual rate of 3.7%, from R11.8 billion in 2021/22 to R10.6 billion in 2024/25. The vote received additional allocations amounting to R2.1 billion in 2021/22. Of this amount, R800 million was to create work opportunities through the presidential employment initiative, and R1.3 billion was to respond to the social unrest in July 2021 and the negative impact of the COVID-19 pandemic. The Commission welcomes the additional allocations for job creation and inclusive growth and the support to resuscitate businesses that had their operations decimated by the social unrest.

iv. The **Employment and Labour** vote will receive R677.2 million over the first two years of the MTEF period for the pathway management network for supporting the presidential employment initiative. The Commission welcomes this initiative, subject to monitoring and evaluation of implementation and outcome.

3.13. Budget 2022 attempts to address some of the shortfalls affecting key departments within the peace and security cluster, which came to the fore during the July 2021 civil unrest. To this end, R8.7 billion has been added to the **Police** budget. This funding will be used to recruit and train 12 000 individuals for entry-level constable positions to meet the police-population benchmark ratio of 1:450 (one police officer to 450 people). The Commission welcomes the capacitation of the South African Police Services, particularly for its Detective Services and Visible Policing programmes.

3.14. Despite projected reductions in allocations to the **Home Affairs** vote, the Commission welcomes the reprioritisation of R10 million in 2022/23 to spearhead the simplification of the visa regime.

Recommendations

- The Commission welcomes the government's twin approach of prioritising funding for social protection alongside increases for key votes within the economic development cluster. Since the additional funds are temporary as the revenue windfall, the spending of these functions must be expeditiously executed with impacts.
- The Commission cautions that certain increases across some sectors will create recurring funding obligations for departments – this includes NSFAS funding for existing bursary holders and the new cohort of students entering institutions of higher learning as well as the R24.6 billion allocated to hire teachers. Should revenue recovery not be realised, departments will be under severe pressure to implement beyond the 2022 financial year, where it is already showing a decline in allocation. Therefore, the Commission advises the department to be aware of this potential threat and be proactive in developing contingency plans to accommodate such a scenario.
    - In particular, we emphasise the urgency of ensuring that the processes related to the introduction of the new higher education funding model unfold swiftly and are concluded in time for introducing the new funding model in time for the 2023/24 financial year.

4. 2021 Division of Revenue Bill – Provinces

Overview of provincial government allocations

4.1. Table 5 below depicts the trajectory of the provincial fiscal framework since the outbreak of the COVID-19 pandemic and the crises-induced supplementary/adjustment budget in 2020. After tabling a total provincial budget allocation of R649 billion in 2020/21, the Minister of Finance revised the allocation downwards to R645 billion during the 2020 supplementary budget to account for the stagnating economic growth and revenue. The lingering effects of the crises on the economy necessitated further baseline cuts to the provincial fiscal framework in the 2020 MTBPS and 2021 Budget.

4.2. For the 2021/22 financial year, instead of the R691 billion forward allocation proposed in the 2020 Budget, the MTBPS projected to allocate R629 billion, revised upward to R639 billion in the 2021 Budget supported by revenue collection recovery. The allocation has since revised upwards to R661 billion (because of inflationary and special COVID-19 budget adjustments) but still falls short of the projected estimate of R691 billion in the 2020 Budget.

Table 5. Provincial fiscal framework trajectory since the COVID-19 pandemic

	2020/21	2021/22	2022/23	2023/24	2024/25	MTEF
2020 budget						
PES	538,472	573,990	607,554			1,720,016
Conditional grants	110,785	117,962	123,137			351,884
Total	**649,256**	**691,951**	**730,690**			**2,071,897**
2020 supplementary budget						
PES	538,472					
Conditional grants	106,823					
Total	**645,295**					
2020 MTBPS						
PES	520,717	513,973	521,988	523,111		,559,072
Conditional grants	107,594	115,381	119,766	122,452		357,599
Total	**628,311**	**629,354**	**641,754**	**645,563**		**1,916,671**
2021 budget						
PES	520,717	523,686	524,088	525,304		1,573,078
Conditional grants	107,594	115,783	119,260	121,520		356,563
Total	**628,311**	**639,469**	**643,343**	**646,824**		1,929,636
2021 MTBPS						
PES		544,800	538,800	525,300	548,900	1,613,000
Conditional grants		116,400	119,600	121,900	127,200	368,700
Total		**661,200**	**658,400**	**647,200**	**676,100**	**1,981,700**
2022 Budget						
PES			560,577	543,149	562,018	1,665,744
Conditional grants			121,782	124,161	128 138	245,943
Total			**682,359**	**667,310**	**690,156**	**2,039,825**

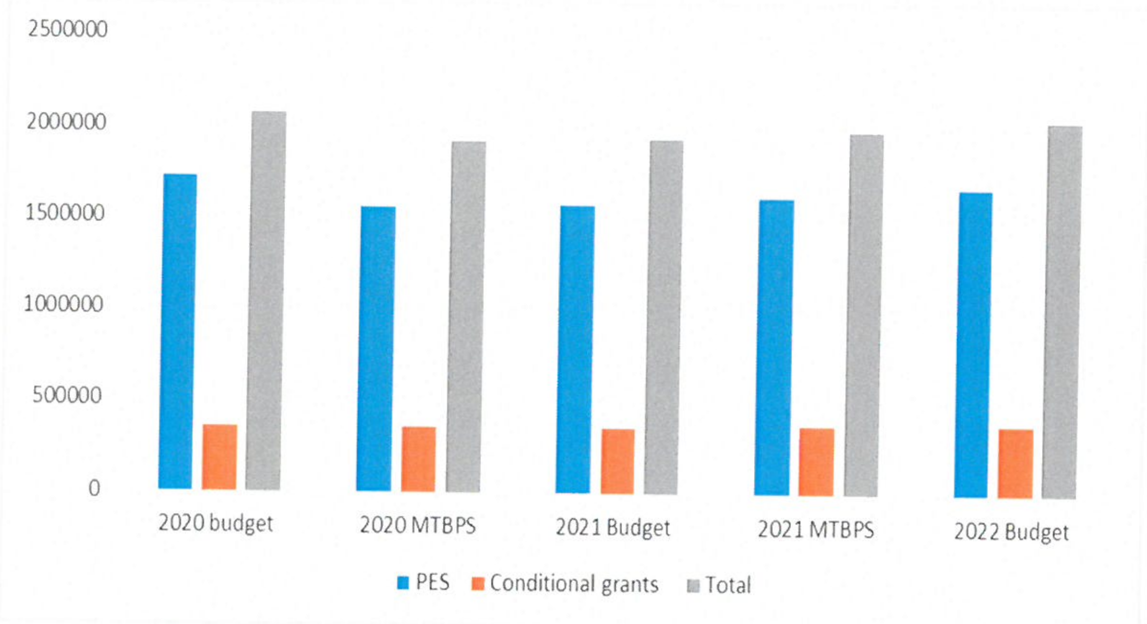
Source: Budget Review, 2020, 2021 and 2022.

4.3. The forward estimates of the 2021 MTBPS were cautiously optimistic in anticipation of muted economic recovery and in consideration of debt and cost of employment (COE) reduction goals to improve fiscal stability, projecting a total provincial allocation of R1.98 trillion over the MTEF period.

4.4. The 2022 Budget proposes allocating a total of R2.039 trillion to provinces because of over R50 billion in adjustments to cater to the appointment of teachers and education assistants and strengthen the health care responses to the COVID-19 pandemic in implementation.

4.5. Figure 3 gives a graphical depiction of the static provincial allocations despite the upward adjustments made in the 2022 Budget, without adjusting for inflation and population growth (service demands). Whereas expenditure moderation is inevitable, provinces and governments as a whole must develop a systematic method of assessing and reporting the impact of declining allocation (in real terms) on the delivery of basic services. These are indicators such as learner-teacher ratios, the quantity of leaner support material, medical supply shortages or inventory. In this way, both the national and provincial legislature would be able to direct resources (as they become available) to service areas severely affected by cost increases.

Figure 3. Total provincial MTEF allocations - PES and conditional grants



Source: Budget Review, 2020, 2021 and 2022

Conditional grants for provinces

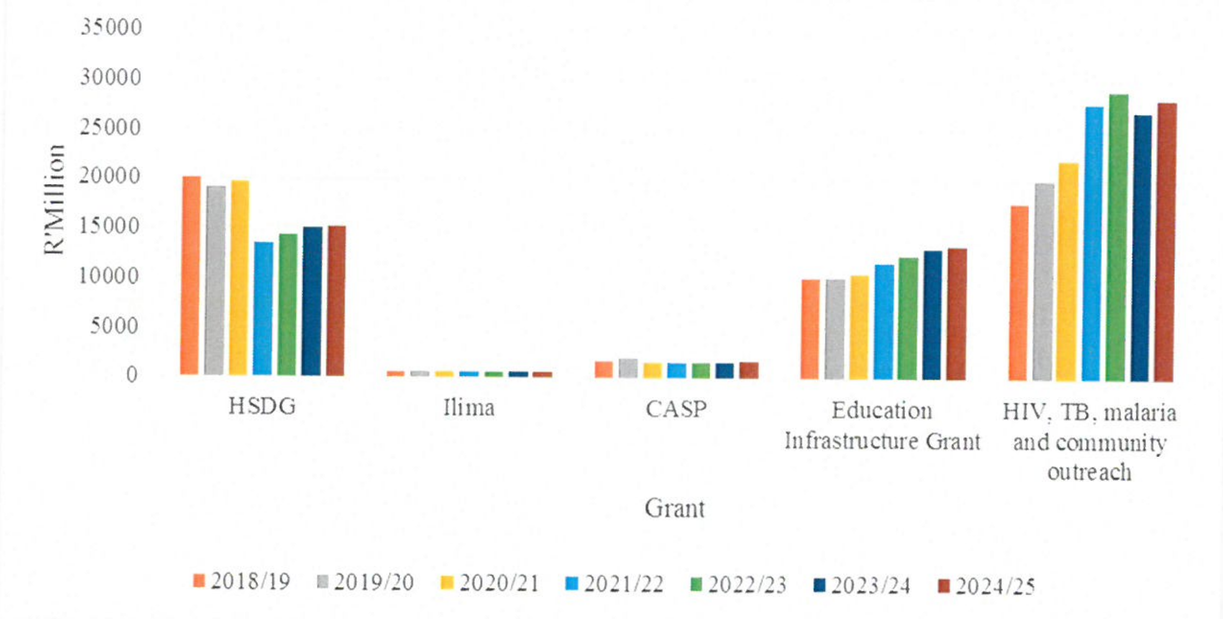
4.6. The total provincial conditional grants allocation for the 2022/23 financial year amounts to R121.8 billion, increasing from R116.4 billion in the 2021/22 financial year (a nominal increase of R5.4 billion).

4.7. Figure 4 below depicts the growth trajectory of some of the key and most significant provincial conditional grants. The Human Settlement Development grant, a pivotal instrument to address historical and growing housing backlogs, has been reduced from R19.6 billion in 2020/21 to R13.4 billion in 2021/22, before increasing over the 2022 MTEF.

4.8. Education Infrastructure grant is exhibiting a steady increase as it is key in addressing the necessary infrastructure needs at schools. The HIV/AIDS, TB, Malaria and Community Outreach grant, which changed to the District Health Programmes grant, has shown significant growth over the past few years. While the Commission commends the protection of the District Health Programmes grant, it is of the view that prioritisation of spending should be focussed on hospital systems and healthcare facilities.

4.9. Whereas the agriculture grants have been historically marred by underspending, it is concerning that their allocations remain relatively insignificant considering that agriculture is identified as one of the pillars of the Economic Reconstruction and Recovery Plan. The two grants (Illema and Comprehensive Agriculture Support Programme (CASP)) are projected to receive R1.8 billion and R4.9 billion over the MTEF, respectively, representing 2% of the total provincial conditional grant's allocation.

Figure 4. Key provincial conditional grant allocations



Source: Budget Review, 2018/19 – 2024/25; FFC Own Calculations

Recommendations

- The Commission recommends that provinces identify selected delivery indicators and provide assessments of service levels using the 2020 financial year as a point of reference to determine the impact of static allocations on service delivery. The assessments must also incorporate provincial conditional grant delivery targets set out in the 2020 DoRA in comparison to the year of the evaluation as the benchmark.
- The Commission notes that despite the R24.6 billion over the 2022 MTEF for provincial education departments to address the shortage of teachers, the Commission recommends that the government consider the carry through cost for teachers going forward.

5. 2021 Division of Revenue Bill – Local Government

Overview of local government allocation

5.1. 2022 will be a challenging year for municipalities as the 2021 municipal elections resulted in municipalities having hung councils forming coalitions. While coalition councils have advantages such as providing checks and balances and allowing diverse and potentially innovative solutions. However, there are also risks such as policy uncertainties, lack of intra-cooperative governance and coherence in the execution of municipal functions, resulting in suboptimal service delivery within the local sphere of government. The Commission urges the government to ensure that people are always at the centre of decision-making, including programmes and resources in place that will capacitate councillors better to perform their mandated functions.

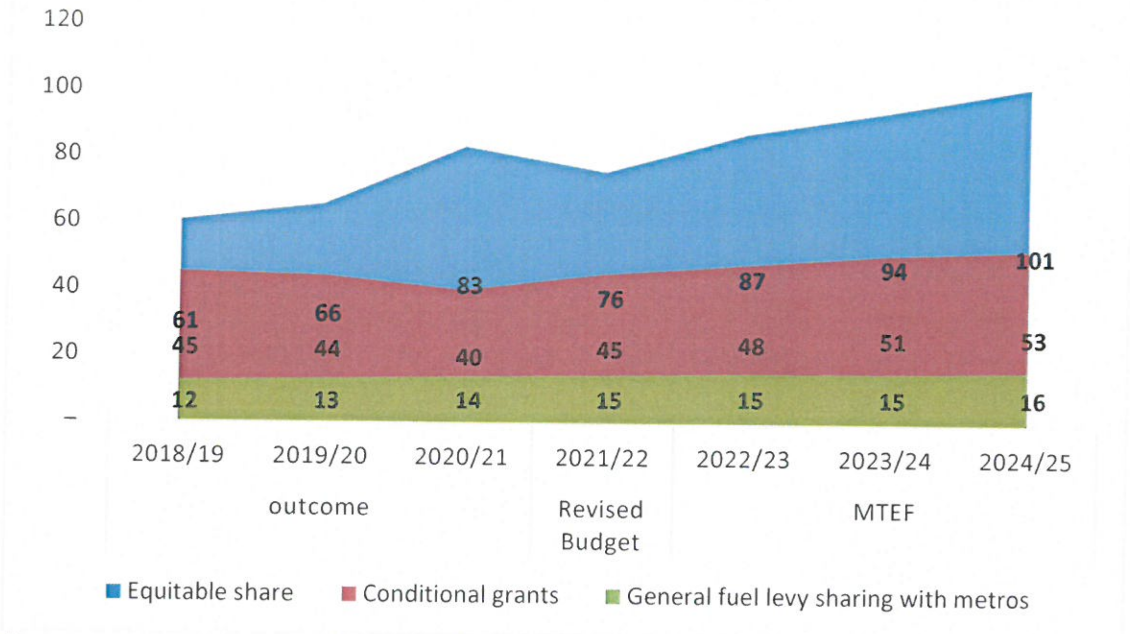
5.2. All these changes are taking place against the backdrop of COVID-19, which amplified challenges related to access to basic services (water, electricity, and sanitation) with wider fiscal gaps - municipalities (68%) are in financial distress. In addressing some of these challenges, the Commission notes and welcomes the review of the Local Government Capacity Building system, which started in 2021 with its implementation envisaged to kick start in 2023. The Commission is of the view that such initiatives will enhance municipal performance and move the local government sector forward and quicken the recovery process.

5.3. Another welcomed development in the local government sphere is strengthening own municipal revenue through development charges, which plays a critical role in financing infrastructure-related projects and boosting economic growth. The Commission welcomes this approach as it aligns with the FFC 2020/21 Submission for the Division of Revenue for revenue sources to supplement municipal revenue. The Commission further stresses that these reviews should be synchronised with the District Development Model (DDM), which seeks to address critical issues of municipal finances service delivery failures.

Local government equitable share and formula

5.4. Over the 2022 MTEF, the Local Government sphere is set to receive total transfers amounting to R481.2 billion in direct transfers and R25 billion in indirect local government conditional grant transfers. R282.9 billion is allocated through the local government equitable share (LES), R151.5 billion as conditional grants, and R46.8 billion in the form of fuel levies. The vertical division of revenue share of local government allocations is expected to increase over the MTEF, from 9% in 2022/23 to double-digit of 10% 2023/24. The increase in the allocations will alleviate some of the pressures the poor municipalities face and subsidise their operations to provide basic services to poor households. The Commission welcomes this reallocation and stresses that municipalities must improve on the efficiency of spending with monitoring, reporting and evaluation to fulfil their constitutional mandate. National and provincial spheres should strengthen the capability of municipalities to improve their efficiency.

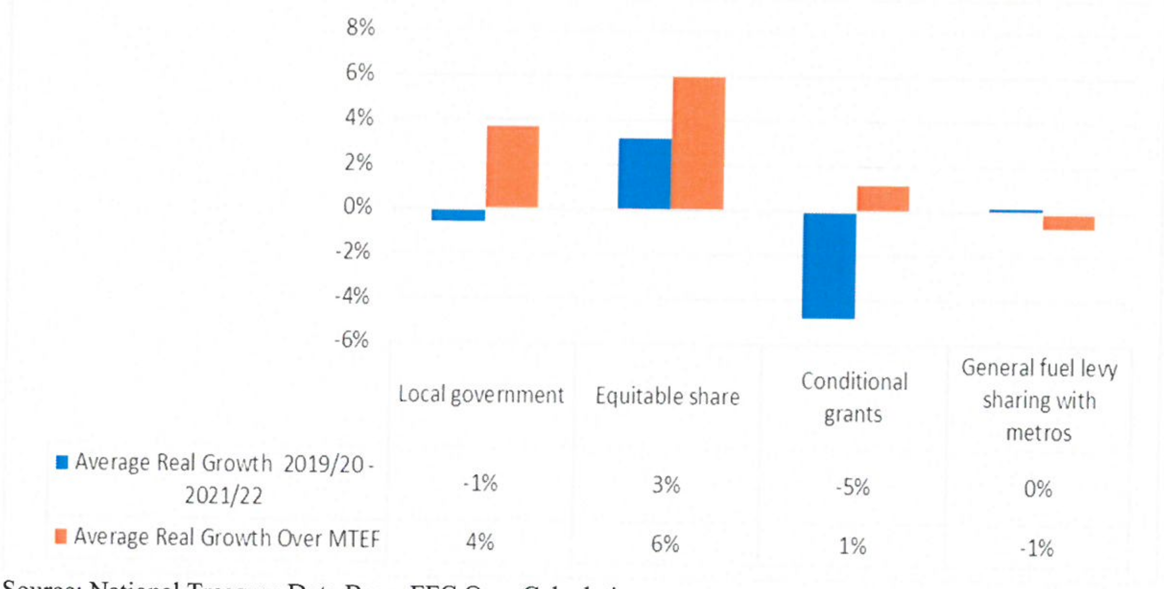
Figure 5. Allocations to the local government



Source: National Treasury Database; FFC Own Calculations

5.5. Figure 6 below shows that the increase in LES allocation is the main driver behind the positive real growth of 6%. The Commission welcomes the government's efforts to keep LES growth rates above inflation as it will go a long way in offsetting the ever-increasing costs of basic services and enable the delivery of basic services to poor households.

Figure 6. Local government average real growth rates



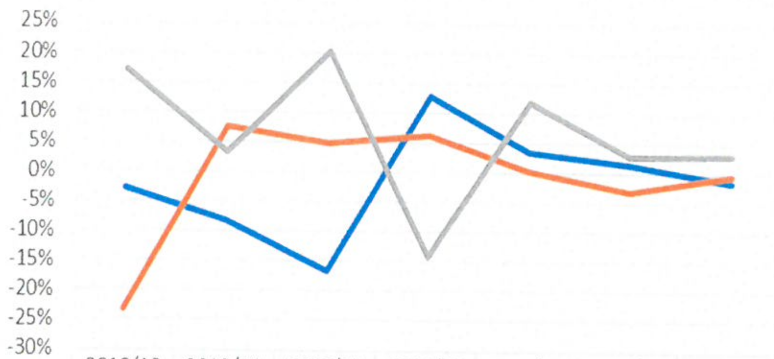
	Local government	Equitable share	Conditional grants	General fuel levy sharing with metros
Average Real Growth 2019/20 - 2021/22	-1%	3%	-5%	0%
Average Real Growth Over MTEF	4%	6%	1%	-1%

Source: National Treasury Data Base; FFC Own Calculations

Conditional grants for local government

5.6. The local government sector is set to receive R151.5 billion as direct conditional grants and R25.5 billion in indirect grants over the 2022 MTEF, with infrastructure grants accounting for 95% of the allocations and capacity grants at 5%. Figure 7 below compares the real growth rates of infrastructure and capacity grants with the local government equitable share allocations. The results show a steady decline in real growth rates of the infrastructure grant over the MTEF, while the capacity grants are at a standstill and even negative growth rate in 2023/24. The Commission notes the long-overdue reviews of capacity-building systems and infrastructure grants undertaken by the government. In its previous submissions, the Commission recommended, among other things, the need for conditional grants with a similar purpose to be streamlined to maximise efficiency.

Figure 7. Real growth rate in the three local government transfer windows



	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
		Outcome		Revised Budget		MTEF	
Total Infrastructure grants	-3%	-8%	-17%	13%	3%	2%	-1%
Total Capacity building grants	-23%	8%	5%	6%	0%	-3%	0%
equitable share formula	17%	3%	20%	-14%	12%	3%	3%

Source: National Treasury Data Base; FFC Own Calculations

5.7. Additions to the baseline on direct conditional grants are noted over the 2022 MTEF at R3.6 billion, mainly comprised of the *Neighbourhood Development Partnership Grant* (R1.6 billion), *Regional Bulk Infrastructure* (over R1 billion), and the *Public Transport Network Grant* (R621 million). The Commission welcomes the additions to these infrastructure-related grants as they are in line with the Economic Recovery Plan (ERP) for boosting economic growth and employment opportunities.

5.8. However, reductions to the *Public Network Grant* (R859 billion), *the Energy Efficiency Demand and demand-side management* (R16 million), the indirect grant -*Regional Bulk Infrastructure* (R95 million), and the *Integrated National Electrification Programme* (R50 million) over the 2022 MTEF, due to underspending, are of concern. The Commission is of the view these reductions send a negative signal to what the government is trying to accomplish by investing in catalytic infrastructure projects.

Recommendations

- The Commission welcomes the government's efforts to keep LES growth rates above inflation as it will go a long way in offsetting the ever-increasing costs of basic services and enable the delivery of basic services to poor households.
- Commission notes and welcomes the reviews of capacity-building systems and infrastructure grants. The Commission is of the view that such initiatives will enhance municipal performance and move the local government sector forward and quicken the recovery process.

- The Commission further stresses that these review initiatives should be synchronised with the District Development Model (DDM), which seeks to focus development initiatives through districts.
- Lastly, the Commission stresses that municipalities must improve the efficiency of spending with cooperative supports from the national and provincial spheres of government through monitoring, reporting and evaluation to fulfil their constitutional mandates.

6. Achieving a balance between economic and social recovery and ensuring sustainable public finances

6.1. Economic and social recovery and sustainable public finance are three complementary objectives that reinforce and depend on each other. As with many complementary goals, the direction of causality between the three is not always clear. Governments across the world are juggling all three simultaneously with the hope for simultaneous improvement. South Africa's initial response to the COVID-19 pandemic holds lessons for a balanced and synchronised approach to recovery while maintaining stable public finances.

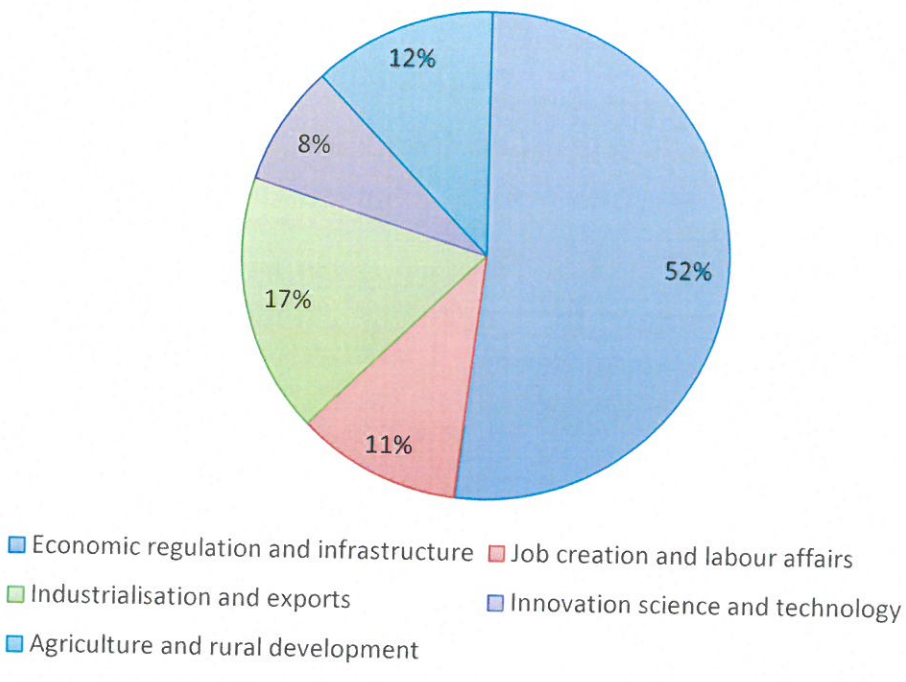
6.2. As this Submission indicates, the economy is yet to recover to the levels seen in 2017, the unemployment rate has reached a record high of 34.9%, and public finances remain under pressure, exemplified by growing demands, rising debt and sluggish revenue. In navigating these three complimentary objectives, the Budget 2022 placed stronger emphasis on a people-centred or social recovery by allocating over R1.1 trillion of the total budget to social wage programmes and boosting consumption and investment by halting fuel and Road Accident Fund (RAF) levy increments and reducing CIT rate to 27%. The R3.5 billion relief from fuel levy and RAF levy capping will stimulate demand for consumer goods. At the same time, firms are likely to invest in new technology or capital from the tax savings. However, the actual impact and outcome will depend on the implementation of the budget. The Commission is of the view that government should publish the underlying research papers pertaining to tax changes to allow public scrutiny.

6.3. The 2022 Budget further provides for the expenditure side economic recovery levers through the economic function. This function receives R227 billion in the 2022/23 financial year growing to R256 billion in the outer year, representing 8.4% growth in nominal terms. Figure 8 shows that the economic function expenditure is dominated by economic regulation and infrastructure at 52%, followed by industrialisation (17%) and agriculture at 12%. As with other growth-supporting measures, the impact of this expenditure depends on the design and efficacy of the programmes. In its Submission for the 2022/23 Division of Revenue, the Commission highlighted infrastructure management and delivery flaws as a key factor impinging on infrastructure spending effects on the economy. Delays in completion of projects, poor workmanship and rectification budgets erode the potential growth effects of infrastructure spending.

6.4. The Commission welcomes ongoing reforms to improve public investment management processes, especially the Infrastructure Fund, which is set to receive a provisional allocation of R17 billion over the MTEF. This fund aims to crowd-in private investment and fast track approval processes for large-scale infrastructure projects. As much as the fund is likely to unblock infrastructure delivery bottlenecks, it is equally crucial that the allocation and application processes adhere to established IGFR principles of equity and fairness. Projects funded through the fund must be equitably distributed across provinces and districts to avoid entrenching spatial development inequities via a national custodian department for accountability, to minimise the risks of losing focus of the fund associated with extrabudgetary allocations.

6.5. It is further worth noting that the composition of economic function expenditure or the priorities thereof is not entirely aligned to the Economic Reconstruction and Recovery Plan, especially in relation to the priorities identified as high impact job creation interventions, namely, infrastructure roll-out, localisation through industrialisation and food security. By way of example, allocations to Programme 6: Industrial financing of the Department of Trade, Industry and Competition (DTIC) are aimed at recovery to pre-COVID-19 levels. However, allocations to manufacturing incentives for product and systems development are projected to decrease by 9% and 6.3% over the MTEF, respectively. Similarly, the 2022/23 allocation to the food security and agrarian reform program under programme 3 in the Department of Agriculture, Land Reform and Rural Development declines by 10.5% when compared to the 2021/22 appropriation before increasing.

Figure 8. Share of economic function expenditure



Source: Estimates of National Expenditure, 2022.

Recommendations

- The Commission reiterates its recommendation in the 2022/23 Annual Submission that the budget process focuses on aligning the allocations to the Economic Reconstruction and Recovery Plan – informed by comprehensive budget and expenditure reviews.

7. Concluding Remarks

Considering the significant internal and external constraints that Budget 2022 was crafted under, the Commission broadly supports Budget 2022 and the government's continued commitment to consolidating public finances while supporting the pandemic response, job creation, and social protection. The Commission would like to emphasise the following points further:

i. In terms of South Africa's growth prospects, the Commission is of the view that it is improbable that the economy will return to pre-pandemic production levels within the year as predicted by the National Treasury. This is because, despite growth between 2020Q3 and 2021Q2, the trend remains temperamental as the latest GDP figures showed a significant 1.5% decline in 2021Q3. In terms of levels, the current productivity is equivalent to that last seen in 2016 at real prices.

ii. On revenue, the Commission notes that tax policy has focused on broadening the tax base, improving administration, and lowering tax rates over the past two years. As outlined in Budget 2022, the government intends to continue with this approach by avoiding tax rate increases where possible. The Commission supports this stance to grow the tax base instead of a rate-based approach.

iii. The Commission welcomes the government's decision to use a portion of the revenue windfall to lower the gross borrowing requirement and reduce debt issuances. However, the Commission cautions that debt stabilisation risks remain elevated and pose significant challenges to public finances. Some of the challenges include rising inflation (both on the domestic and international prices pressures), expectations that higher interest rates could increase borrowing costs and the resurgence of COVID-19 infections resulting in spending pressures.

iv. The increase in non-interest spending over the MTEF period 2022-2025 is accommodated by the shift in trajectory to follow zero-based budgeting due to improving tax revenue collections. Furthermore, the increases are directed at pro-poor spendings, such as the extension of the SRD grant, the continuation of bursaries for students benefiting from the NSFAS, and the presidential employment initiative. The Commission supports this as it is a balanced approach that does not jeopardise the path to deficit reduction and fiscal consolidation while seeking to support economic growth.

v. The Commission applauds the government's efforts to stimulate employment growth through various interventions such as public employment programmes tax incentives, implementing programmes to address the skills constraint and making it easier to do business. However, it should be noted that while labour market interventions and public employment programmes have successfully created short-term and permanent jobs (in some instances), this has not translated into changing the macro-level picture of unemployment. In this regard, more significant structural reforms focused on artisanal skills are required to address unemployment in the long run.

vi. The SRD Grant has been extended multiple times over the past two years. The Commission looks forward to the outcome of the ongoing technical work on the different replacement options for the SRD grant as announced in the 2022 SoNA. When evaluating various options, key considerations for the Commission will be the long-run viability, market dynamics, and effects on the fiscus. Given that the SRD will be stopped in March 2023, it would also be useful for the government to have a definite timeline around this issue's decision-making process.

vii. Provinces and municipalities, in particular, are responsible for the delivery of critical social and basic services. Moreover, municipalities are responsible for the delivery of free basic services to indigent households. Given the important role that the delivery of these services plays in facilitating social and economic development, the Commission thus welcomes the strong growth in the allocation to the sub-national spheres of government while urging for more value-for-money via monitoring and evaluation of spending.

viii. Fraud, corruption and fiscal mismanagement (in the form of fruitless and wasteful expenditure) remain rampant. Findings by the Commission of Inquiry into State Capture, the Special Investigating Unit's report into allegations of corruption and misuse of public funds related to personal protective equipment (PPE) for the COVID-19 pandemic and the Auditor-General (AG) confirm this. According to the AG's 2020/21 Public Finance Management Act (PFMA) report, irregular expenditure was R177.4 billion, and fruitless and wasteful expenditure at R2.7 billion. At the local government level, the 2019/20 Municipal Finance Management Act (MFMA) report cites irregular expenditure at R22.7 billion and fruitless and wasteful expenditure at R2.1 billion. These staggering amounts in dubious use suggests that better spending with higher value could be achieved through improving compliance and efficiency. The government must take decisive and prompt actions against the perpetrators of these wastages and leakages to send a clear message that the government is serious about addressing this challenge.

ix. With respect to progress towards the goals of economic and social recovery alongside fiscal sustainability, the Commission is of the view that Budget 2022 has placed stronger emphasis on a people-centred or social recovery by allocating over R1.1 trillion of the total budget to social wage programmes. The budget further provides for expenditure side economic recovery levers through the economic functions, which is set to receive R227 billion in 2022/23. Much of this funding is focused on infrastructure. As with other growth-supporting measures, the impact of this expenditure depends on the design and efficacy of the programmes – to this end, infrastructure management and delivery flaws are key factors hampering the potential economic gains that can be derived from infrastructure spending. There is also a need to address the misalignment between the spending within the economic function relative to the priorities identified as high impact, job-creating interventions in the Economic Reconstruction and Recovery Plan.

Approved by:

Signature: ____________________

Dr Patience Nombeko Mbava

Chairperson Date: 4 March 2022