



FINANCIAL
AND FISCAL
COMMISSION

For an Equitable Sharing
of National Revenue

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2023/24

**SUBMISSION FOR THE
DIVISION OF REVENUE**



Submission for the 2023/24 Division of Revenue

For an Equitable Sharing of National Revenue

We, the Commissioners, hereby submit the Financial and Fiscal Commission's researched recommendations for the 2023/24 Division of Revenue in accordance with the obligations placed upon us by the Constitution of the Republic of South Africa

Dr Patience Nombeko Mbava – Chairperson
Mr Michael Sachs – Deputy Chairperson
Prof Lourens Jacobus Erasmus
Prof Trevor Fowler
Mr Sikhumbuzo Eric Kholwane
Ms Nthabeleng Khawe
Prof Aubrey Mokadi
Mr Mandla Nkomfe
Ms Elizabeth Cornelia Rockman

Financial and Fiscal Commission

Montrose Place (2nd Floor), Bekker Street,
Waterfall Park, Vorna Valley, Midrand,

Private Bag X69, Halfway House 1685

www.ffc.co.za

Tel: +27 11 207 2300
Fax: +27 86 589 1038

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ACRONYMS

ACRONYM	DEFINITION
ABMS	Anti-bribery Management System
ACA	Anti-corruption Agency
ACCC	Anti-corruption Coordinating Committee
ACTT	Anti-corruption Task Team
AG	Auditor-General
ATR	Annual Training Report
BIG	Basic Income Grant
CoGTA	Department of Cooperative Governance and Traditional Affairs
CPI	Consumer Price Index
CSG	Child Support Grant
DBE	Department of Basic Education
DCEC	Directorate on Corruption and Economic Crime
DDM	District Development Model
DG	Disability Grant
DiD	Difference-in-Difference
DJ&CS	Department of Justice and Constitutional Development
DPRU	Development Policy Research Unit
DPSA	Department of Public Service and Administration
DPWI	Department of Public Works and Infrastructure
DSA	Debt Sustainability Analysis
DSD	Department of Social Development
ECD	Early Childhood Development
EMBI	Emerging Market Bond Index
EPWP	Expanded Public Works Programme
ERRP	Economic Reconstruction and Recovery Plan
ETI	Employment Tax Incentive
FIC	Financial Intelligence Centre
FTI	Full-time Equivalent
GDP	Gross Domestic Product
GFN	Gross Financing Needs
GIACC	National Centre for Governance, Integrity and Anti-corruption
GLC	Government-linked Company
HPC	High-performance Computing
ICU	International Corruption Unit
IDP	Integrated Development Plan

ACRONYM	DEFINITION
IFI	Independent Fiscal Institution
IGRF	Intergovernmental Fiscal Relations
ILO	International Labour Organisation
IMF	International Monetary Fund
IPCMC	Independent Police Complaints and Misconduct Commission
LED	Local Economic Development
LFS	Labour Force Survey
LGES	Local Government Equitable Share
MACC	Malaysian Anti-corruption Commission
MEC	Member of the Executive Committee
MoU	Memorandum of Understanding
MSA	Municipal Structures Act
MTBPS	Medium-term Budget Policy Statement
MTEF	Medium-term Expenditure Framework
NACP	National Anti-corruption Plan
NACS	National Anti-corruption Strategy
NACSAP	National Anti-corruption Strategy and Action Plan
NCA	National Crime Agency
NDP	National Development Plan
Nedlac	National Economic Development and Labour Council
NEET	Not in Education, Employment or Training
NIDS	National Income Dynamic Survey
NPA	National Prosecuting Authority
NSC	National Senior Certificate
NSFAS	National Student Financial Aid Scheme
NTB	National Tender Board
NYC	National Youth Commission
NYDA	National Youth Development Agency
OACP	Organisational Anti-corruption Plan
OAG	Office of the Auditor-General
OECD	Organisation for Economic Cooperation and Development
OLS	Ordinary Least Squares
OPG	Older Persons Grant
OSD	Occupation-specific Dispensation
PALMS	Post-apartheid Labour Market Series
PAYE	Pay-As-You-Earn
PCAC	Presidential Commission Against Corruption

ACRONYM	DEFINITION
PERSAL	Personnel Salary
PES	Provincial Equitable Share
PIT	Personal Income Tax
PPA	Public Procurement Authority
PPACA	Public Procurement Anti-corruption Agency
PPE	Personal Protective Equipment
PSC	Public Service Commission
PTR	Pupil-teacher Ratio
PYEI	Presidential Youth Employment Intervention
QES	Quarterly Employment Survey
QLFS	Quarterly Labour Force Survey
RAF	Road Accident Fund
RRA	Rwanda Revenue Authority
RSC	Regional Services Council
SANRAL	South African National Road Agency Limited
SAPBO	South African Parliamentary Budget Office
SAPS	South African Police Service
SARB	South African Reserve Bank
SARS	South African Revenue Service
SA-SAMS	South African School Administration and Management System
SASSA	South African Social Security Agency
SBU	Shanduka Black Umbrellas
SETA	Sector Education and Training Authority
SIU	Special Investigating Unit
SMG	State Maintenance Grant
SMME	Small, Medium and Micro Enterprises
SOE	State-owned Entity
SONA	State of the Nation Address
SRD	Special Relief of Distress
Stats SA	Statistics South Africa
TFP	Total Factor Productivity
TVET	Technical and Vocational Education and Training
UIF	Unemployment Insurance Fund
UYF	Umsobomvu Youth Fund
VAR	Vector Autoregression
WID	World Inequality Database
WSP	Workplace Skills Plan



THE FINANCIAL AND FISCAL COMMISSION

The Commission is a body that makes recommendations and gives advice to organs of state on financial and fiscal matters. As an institution created in the Constitution, it is an independent, juristic person subject only to the Constitution itself, the Financial and Fiscal Commission Act, 1997 (Act No. 99 of 1997), as amended, and relevant legislative prescripts – and may perform its functions on its own initiative or on request of an organ of state.

The vision of the Commission is to provide influential advice for equitable, efficient and sustainable intergovernmental fiscal relations between the national, provincial and local spheres of government. This relates to the equitable division of government revenue among the three spheres of government and to the related service delivery of public services to South Africans.

Through focused research, the Commission aims to provide proactive, expert and independent advice on promoting the intergovernmental fiscal relations system, using evidence-based policy analysis to ensure the realisation of constitutional values. The Commission reports directly both to Parliament and the provincial legislatures, who hold government institutions to account. Government must respond to the Commission's recommendations and the extent to which they will be implemented at the tabling of the annual National Budget in February.

The Commission consists of women and men appointed by the President: the Chairperson and Deputy Chairperson, three representatives of provinces, two representatives of organised local government, and two other persons. The Commission pledges its commitment to the betterment of South Africa and South Africans in the execution of its duties.

Foreword

The Submission for the Division of Revenue 2023/24 is tabled by the Financial and Fiscal Commission (FFC) in terms of section 214(1) of the Constitution of the Republic of South Africa, 1996 (as amended), Section 3 of the Financial and Fiscal Commission Act, 1997 (Act No. 99 of 1997), Section 9 of the Intergovernmental Fiscal Relations Act, 1997 (Act No. 97 of 1997) and Section 4(c) of the Money Bills and Related Matters Act, 2009 (Act No. 9 of 2009) (as amended). The FFC is an independent, juristic constitutional institution that reports directly to Parliament and provincial legislatures.

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Through focused research, the Commission aims to provide proactive, expert and independent advice on promoting the intergovernmental fiscal relations system, using evidence-based policy analysis to ensure the realisation of constitutional values. The Commission reports directly both to Parliament and the provincial legislatures, who hold government institutions to account. Government must respond to the Commission's recommendations and the extent to which they will be implemented at the tabling of the 2022 Medium-term Budget Policy Statement in October 2022, leading up to the annual budget for the 2023/24 financial year to Parliament and legislatures.

We, the undersigned, hereby submit the Financial and Fiscal Commission's submission with recommendations for the 2023/24 Division of Revenue in accordance with the obligations placed upon us by the Constitution of the Republic of South Africa.

For and on behalf of the Commission

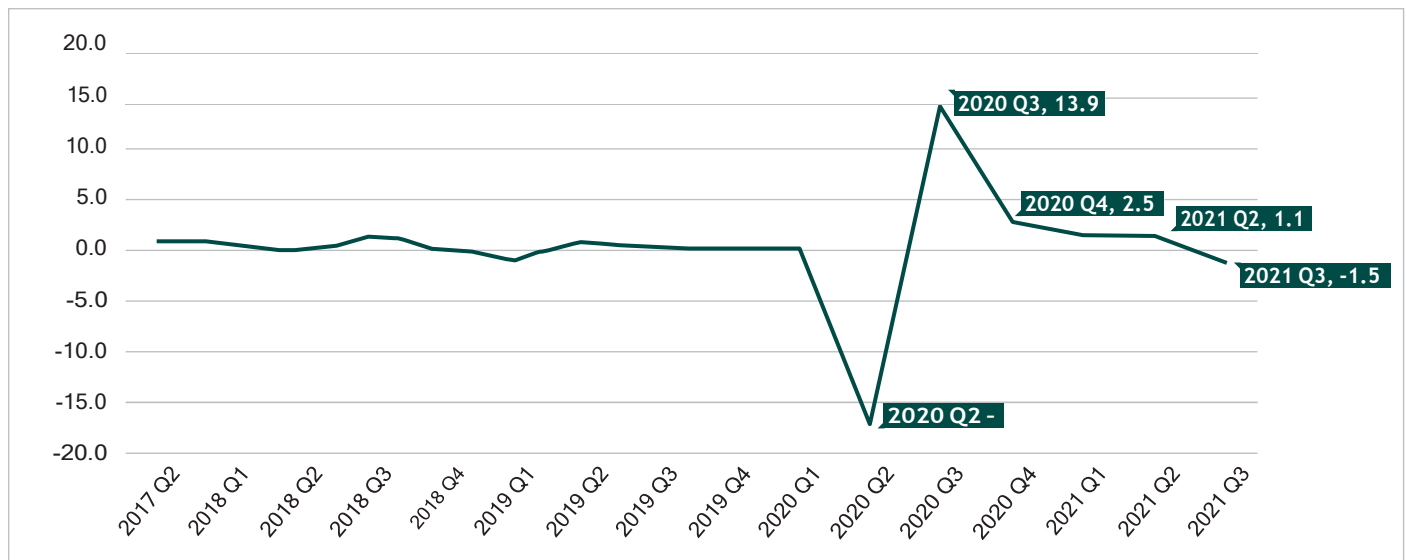


Dr Patience Nombeko Mbava
Chairperson

INTRODUCTION

South Africa is experiencing growing concerns of deteriorating fiscal performance and the persistently poor service delivery outcomes of public finances. Signs of a slow recovery in growth (see Figure a) have largely been thwarted by recent events, including, for example, the civil unrest in KwaZulu-Natal and Gauteng during July 2021, ever-mutating COVID-19 strains and, more recently, the Ukraine-Russia war and floods in KwaZulu-Natal. Inflation is expected to continue to rise in 2022. Unemployment, having reached a record high of 34.9% in 2021, remains stubborn (see Figure b).

Figure a: Gross domestic product (GDP) (quarter-on-quarter changes)



Source: Commission's Submission on Budget Review 2022

Figure b: Unemployment rate



Source: Commission's Submission on Budget Review 2022

In terms of public finances, the government faces significant debt and growing debt service costs. These costs are currently the largest public expenditure item, and essentially serve to divert funds from more productive and service delivery-related spending (see Table a).



Table a: Main budget framework

R billion as a percentage of GDP	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
	Outcome			Revised estimate	Medium-term estimates		
Main budget revenue	1,275.3 23.5%	1,345.9 23.7%	1,238.4 22.2%	1,549.1 24.8%	1,588.0 24.7%	1,660.2 24.4%	1,774.2 24.5%
Main budget expenditure	1,506.6 27.8%	1,691.0 29.7%	1,789.0 32.1%	1,896.0 30.3%	1,975.3 30.7%	1,992.0 29.3%	2,096.6 29.0%
Of which: Debt service costs	181.8	204.8	232.6	268.3	301.8	335.0	363.5
Main budget balance	-231.3 -4.3%	-345.1 -6.1%	-550.6 -9.9%	-346.9 -5.5%	-387.2 -6.0%	-331.8 -4.9%	-322.4 -4.5%
Primary balance	-49.5 -0.9%	-140.3 -2.5%	-318.0 -5.7%	-78.6 -1.3%	-85.4 -1.3%	3.2 0.0%	41.1 0.6%

Source: Budget Review, 2022

Over the past two years, the government has tried to balance the maintenance of fiscal sustainability alongside the need to provide social protection in the face of rising unemployment and inequality. This balancing act has been challenging. Not only has the COVID-19 pandemic highlighted, but also further exacerbated, the country's vulnerable fiscal position, and exposed deep-seated delivery challenges. This was evident as many of the relief interventions introduced during the pandemic were marred by a myriad of delivery shortcomings, irregularities, fruitless and wasteful spending, and a deepening of corruption. This submission document focuses on 11 areas, which, the Commission believes, if adjusted in line with the research conducted, can serve to position South Africa on a path of sustainable social and economic recovery. Under the theme of "Addressing socio-economic vulnerabilities through fiscal transparency and strategy", this year's submission hones in on how the element of good governance and coherent, goal-oriented long-term planning in key sectors can serve to buoy growth and development.

The submission focuses on a range of issues across the intergovernmental fiscal relations system, and is divided into three parts:

- Part 1: Combatting corruption and unemployment
- Part 2: Economic and fiscal monitor
- Part 3: Reviewing and refining division of revenue instruments

Part 1, comprising Chapter 1 and Chapter 2, focuses on curbing corruption and youth unemployment, respectively. Various corruption measures indicate that corruption within the South African public sector is severe and contributes to, among others, income inequalities, the inequitable distribution of resources and inefficient social welfare programmes. Drawing from case studies and a combination of budget and institutional analyses, Chapter 1 hones in on strategies for preventing corruption in the public sector, as well as an evaluation of funding models supporting anti-corruption agencies. Chapter 2 tackles the stubborn challenge of youth unemployment, in South Africa. While general unemployment reached 34.9% in 2021, youth unemployment is a staggering 66.5% for youth aged 15-24 years and 43.8% for youth aged 25-34 years, using the official definition. The chapter aims to understand and evaluate the effectiveness of various public institutions and intergovernmental fiscal relations instruments in addressing youth development and unemployment challenges.

Part 2 of the submission is made up of four chapters, two of which are central to macroeconomic debates in South Africa, while the other two explore the very relevant public sector challenges of income support to the poor and the ever-increasing public sector wage bill. Chapter 3 evaluates debt sustainability in South Africa. The level of indebtedness facing South Africa and the associated risks of unstable debt are investigated. This is done with the aim of concluding whether or not the public sector is in debt distress. Persistent high levels of economic inequalities in South Africa impact on the power asymmetries that embed social exclusions and create social unrest. This serves to undermine sustainable economic growth and threaten constitutional democracy. There is thus a need for carefully tailored, structural policies that are both growth enhancing and inequality reducing. To this end, Chapter 4 looks at affluence and inequalities in South Africa. It investigates the extent of earnings inequality and identifies key shortfalls in the current policy environment. Chapter 5 looks at the effects of social grants on household behaviour and expenditure patterns. The effectiveness of the grant system in South Africa is considered on the grounds of poverty and inequality reduction, but rarely on consumption. This chapter evaluates whether social grants facilitate the inclusion of disenfranchised individuals into the economy and how they affect the fiscal envelope. In Chapter 6 of the submission, the Commission investigates public sector wage trends in South Africa. This research is prompted by the exponential growth in the public sector wage bill that has, over the years, exceeded both the GDP growth rate and tax collection revenue. This chapter thus seeks to determine the country's wage trends and understand the size and shape of the wage bill.

Part 3 of the submission shifts the focus to subnational issues of concern. Chapter 7 and Chapter 8 review the two primary components of the provincial fiscal framework; the provincial equitable share (PES) formula and provincial conditional grants. Chapter 7 looks at what happens to the PES allocation once it reaches the province. While weights are assigned to various components within the PES formula, there is little analysis concerning what happens to the funding once it is at the (discretionary) disposal of provinces. The other challenge often raised by provinces is the responsiveness (or lack thereof) of the PES formula and funding to the changing social structure. In Chapter 8, a 25-year review of provincial conditional grants is conducted with the aim of understanding whether there is a need to repurpose and/or realign the grants to better align them with the constitutional prescripts around intergovernmental fiscal transfer design. The study identifies the changes in the number of conditional grants over the past 25 years, looking at reasons for the constant and abrupt introduction, reclassification and termination of grants, including reluctance to incorporate long-existing grants into the PES.

Using basic education as a case study, Chapter 9 tackles the issue of value for money. The largest share of consolidated spending is allocated to basic education. This chapter looks at whether the sizeable resources allocated to this sector are being used efficiently. Alongside the consideration of value for money and in recognition of the fact that access to basic education is a justiciable right enshrined in the South African Constitution, the analysis also reflects on how spending on basic education should be reprioritised to ensure that the most essential elements related to the right to basic education are protected.

This is important given the high probability of a tighter fiscal framework over the next few years. The starting point for Chapter 10 is the view that fiscal governance, and particularly independent fiscal institutions (IFIs), can play a central role in improving fiscal performance. Using seven international case studies, this analysis tests this assertion and evaluates how IFIs have affected fiscal outcomes. Lastly, focusing on local government, Chapter 11 looks at the topical issue of the District Development Model (DDM), which is positioned to improve planning and coordination across the three spheres of government. District municipalities are envisaged to play a leading role in the implementation of the DDM. Unfortunately, this is against the backdrop of district municipalities that are dysfunctional, with many in financial distress. The pertinent question and focus of this chapter is whether district municipalities can, in fact, take on the leading role as envisaged by the DDM.

The Commission makes the following recommendations:

1. Regarding strategies for preventing corruption in the public sector and funding for anti-corruption agencies:
 - The prerequisite for any measure to fight corruption and move towards support for anti-corruption reforms is consistent political will for good governance and accountability. Political leadership and a commitment to fight corruption should therefore come from the highest office and the top levels of a country's political system, with the following understanding of accountability:
 - Accountability should identify who needs to be accountable to whom and for what? For instance, accountability of political leaders and public officials to organisational effectiveness and efficiency through compliance measures, rules and ethics codes, and oversight bodies taking their legislated responsibilities seriously and committing to repelling corruption by taking swift action and imposing sanctions when the need arises.
 - The Presidency, in line with political commitment at the top, needs to renew the governance structure of the anti-corruption agencies, through the National Anti-corruption Strategy, on the need for reconfiguration and coordination, among the existing institutional arrangements to repel duplication in these anti-corruption institutions for optimum results, including a reconfigured or dedicated funding framework for the anti-corruption agencies or institutions as a sign of commitment towards the support of anti-corruption agencies.
 - The Presidency should consider establishing a Public Procurement Authority (PPA) that is mandated to show greater transparency and standardisation of government contracts, to organise and manage the public procurement process (rules, regulations, guidelines and policies) and implement a general public procurement policy on behalf of the government, guided by the principles of transparency, fairness and equity, as contained in the Constitution.
 - A dedicated or joint civil society organisation should be established that educates and empowers society about the dangers and adverse effects of corruption, and advocates for anti-corruption reforms as bottom support to the top-down approach (political will).
2. Regarding youth unemployment and intergovernmental fiscal relations:
 - The Commission welcomes the expansion of the Employment Tax Incentive (ETI). To better target and increase the impact of the incentive, the Commission recommends revising the employee eligibility age from 18 to 29 years old. The age group 24–34 years has a relatively high rate of individuals not in employment, education or training (NEET) compared to 15- to 24-year-olds. National Treasury can also consider deepening the ETI to encourage hiring young women whose NEET rate is relatively higher than that of their male counterparts for both youth categories. The NEET group represents the most vulnerable section of the youth.
 - The Department of Employment and Labour, the Department of Higher Education and Training, and the Department of Women, Youth and Persons with Disabilities should coordinate all labour markets and skills programmes. The Department of Women, Youth and Persons with Disabilities has a mandate to enable the empowerment and socio-economic upliftment of the youth and women. Well-coordinated labour market interventions could bolster the impact of existing labour market programmes through more significant integration and leveraging of initiatives.
 - National Treasury and the Jobs Fund should consider other alternative funding channels that take the limitations faced by the youth regarding access to capital to provide challenge funds into account. The challenge funding principle of the Jobs Fund disadvantages those small and medium

businesses that have no access to capital. The match challenge fund is a financing mechanism to allocate (donor) funds for specific purposes using competition among organisations as the lead principle. Proposals are assessed against transparent and predetermined criteria. Successful applicants must usually match a certain percentage of the grant with own financing.

- The proportion of gross fixed capital expenditure in the composition of the budget should be systematically increased. Consumption expenditure should be reduced. There is also a need to remove structural and institutional rigidities that impact on private investment in the reduction of unemployment.

3. Regarding debt sustainability in South Africa:

- The fiscus, through the Minister of Finance, must strive to rein in rising debt service costs, which comprise a substantial portion of the budget, detracting from allocations for the provision of essential services.
- The Minister of Finance must exercise and maintain fiscal discipline, via active debt management and regular reporting regarding debt accumulation, costs and sustainability under the current strained debt conditions. Such discipline should be exercised throughout all spheres of government.
- Weak productivity in expenditure should be addressed in order to create job-enhancing, income-generating growth (i.e. inclusive growth) through quality expenditure and investment-enticing reforms.
- Investor confidence must be boosted and promoted through signalling that public debt is sustainable in the long run to reduce sovereign risk ratings and thereby the cost of debt, as well as to ensure the continuation of economic support.

4. Regarding inequality in South Africa's labour market:

- Policies aimed at reducing inequality should, as a point of departure, be targeted at reducing inequality in the labour market. This requires policies that enable large-scale job creation and more equitable wage growth across different sectors of the economy, which, in turn, may require greater investment into labour-intensive industries that are able to absorb low-skilled workers into the labour market.
- Statistics South Africa should increase its efforts to increase the transparency of data and harmonisation of datasets to allow for more comparable, accessible and reliable income statistics. Transparency should extend to data collection, data cleaning and imputation methods applied.

5. Regarding social grants:

- The recalculation of the amount of the Child Support Grant
- Partnering with the private sector to support child support policy intentions
- Integrating social grants into existing social development programmes
- An in-depth investigation into the current social grant network

6. Regarding the public sector wage bill:

- The Department of Public Service and Administration, through the bargaining council, should consider balancing notch progression and cost-of-living adjustments and pressures to the fiscus during wage negotiation. The Commission highlights that the growth of the wage bill has largely been driven by wage increases relative to the increase in the number of employees.

- Wage growth at the top end of the wage distribution in the public service has not been excessive, but after 2010, it appears that wages for those in the bottom 20% of the distribution fell in real terms, potentially widening the wage gap in the sector. The Commission recommends that National Treasury commissions further research to determine what is driving the decreases in real terms of wages for those at the bottom distribution of wages.
 - The demographic composition of the public sector has changed over time, but the proportion of young people has not grown. The Commission recommends that the Department of Public Service and Administration, together with the Department of Women, Youth and Persons with Disabilities, develops frameworks to guide the public sector on the inclusion of youth in public service.
7. Regarding the provincial equitable share formula:
- In line with the Commission's recommendation on a costed norms approach, full costing exercises should be undertaken by all provinces, particularly for the provision of education and health. The costing results will be used to determine allocations by provinces to these key functional areas. This will ensure consistency and fully informed resource allocation.
 - The national Department of Basic Education, as a custodian of conditional grants (particularly indirect grants and being responsible for capital spending), and all provincial departments of Basic Education, as recipients of the PES and being responsible for school infrastructure delivery and maintenance, should improve the coordination of infrastructure delivery plans and programmes to ensure alignment.
 - The national Department of Basic Education should undertake skills audits to identify the skills gap with respect to the old and the new curriculum, and based on the audit results:
 - a) Identify the number of teachers who need to be trained and the funding requirements
 - b) Develop and implement a training programme.
8. Regarding the system of provincial conditional grants:
- National Treasury, in conjunction with the national departments responsible for conditional grants, must revise the Division of Revenue Act's system of grant scheduling as it creates no fiscal incentives for provinces to reveal their expenditure preferences or sustain expenditure previously funded by conditional grants. Instead, government must invest the capacity to improve overall grant design, taking account of all good grant design imperatives, such as types of grants and their implications, pre-grant introductory due diligence, sunset clauses, conditioning schemes and allocation methodologies.
 - National Treasury, in conjunction with the national departments responsible for conditional grants, should undertake three-yearly reviews of their respective grants to ensure alignment across grant objectives, conditions and grant outcomes. These reviews must be informed by an overarching conditional grants guideline, setting out the circumstances under which grants are introduced and terminated, applicable minimum and type conditions, and the applicable minimum outputs. Further, there should be a mandatory grant introduction and termination pre-assessment by the Financial and Fiscal Commission to determine suitability, impact on the fiscal framework and overall grant outcome. Grant conditions are generally administrative, while the outputs are seemingly unconnected to the long-run outcomes.
 - The Department of Basic Education, in conjunction with National Treasury, must update the allocation formula for the Education Infrastructure Grant to ensure the alignment of grant needs indicators with grant objectives and further streamline expected and reported grant outputs to improve focus and ease of monitoring. At the very least, the allocation criteria may include learner enrolment, learner densities by area, index of schools with access to learning infrastructure and travel time to schools. The actual formula must be published in the grant framework for transparency purposes.
 - The Department of Health and other custodians of grants with multiple components must halt the over-compartmentalisation of provincial health responsibilities through multiple grant funding windows unrelated to the main objective of the main grant. Conditional grants must, as a matter of

principle, accommodate not more than two sub-components or take the shape of a traditional block grant to allow provinces the flexibility to prioritise within the set sub-functional responsibility. Sub-components that are unrelated to the main grant objective must be incorporated into the provincial equitable share and be monitored through the normal budget and accountability system instead of subdividing or itemising provincial health responsibilities to be funded by grant sub-components. The formulae for the newly restructured HIV/Aids grant must be published in the grant framework for transparency purposes.

9. Regarding the constitutional right to basic education:

- The Commission reiterates its previous recommendations that a proper costing of the delivery of education services be undertaken to address the cost drivers of education and differences in spending pressures across provinces to assess the adequacy of basic education spending.
- Government needs to protect the redistributive nature of the basic education funding system in the face of potential basic education budget constraints.
- Availability and access to credible, reliable, consistently collected and easily comparable financial and non-financial data is critical to conduct research to better understand the impact of government spending and to assess school performance. To this end, the Commission acknowledges the government's work to implement a school-level data collection instrument in the form of the South African School Administration and Management System. The Commission recommends that the Department of Basic Education leverages the collection of this data and other sources of school-level data to compile a consolidated basic education sector database that integrates the financial and non-financial aspects of basic education.
- The Minister for Basic Education should use the matrix as the foundation of a framework to consult broadly with stakeholders to agree on a guide for spending prioritisation in the basic education sector that is underpinned by a socioeconomic rights approach.

10. Regarding the effectiveness of independent fiscal institutions:

- With respect to improving the mandate and functions of independent fiscal institutions in South Africa:
 - Forecasting or validating macroeconomic and fiscal variables
 - Costing of legislation and policy
 - Monitoring fiscal rules or objectives
- With respect to improving the independence of independent fiscal institutions in South Africa:
 - Establishment of minimum standards for independent fiscal institutions
 - Access to information
- With respect to improving the compliance and impact of independent fiscal institutions in South Africa:
 - Improvement of the compliance or explanation of deviance from recommendations principle
 - Formal consultations on budget formulation and execution

11. Regarding the powers, functions and funding framework of district municipalities:

- The Department of Cooperative Governance and Traditional Affairs should speedily review and repeal section 84 of the Municipal Structures Act to streamline the powers and functions of district municipalities to correspond with those of local municipalities.
- The Department of Cooperative Governance and Traditional Affairs should review and amend section 85 of the Municipal Structures Act to allow an adjustment of powers and functions by the Member of the Executive Council for Local Government to be followed by the adjustment of funding.
- National Treasury should immediately abolish the Regional Services Council Replacement Grant and combine the Local Government Equitable Share for district municipalities and the Regional Services Council Replacement Grant under one funding instrument.

PART 1

Combatting
corruption and
unemployment



CHAPTER 1:

Strategies for preventing corruption in the public sector and funding for anti-corruption agencies

1.1 Introduction

Corruption is a global problem that exists in varying degrees in different countries. Numerous corruption indicators suggest that the challenge of corruption in South Africa is vast and deep seated. The Commission of Inquiry into State Capture (2021) found that the government is the biggest procurer of goods and services, estimated at over R800 billion a year. The Commission found that individuals pursued personal interests by not following or grossly abusing procurement processes and procedures. The COVID-19 pandemic created an additional opportunity for corruption in South Africa, where individuals took advantage of concessions made for emergency procurement, using irregular and corrupt practices. The Auditor-General (AG) found that irregular and corrupt practices, in the form of the irregular appointment of service providers and overpricing related to the procurement of goods and services to combat the pandemic, were endemic (Auditor-General, 2020 of South Africa, 2020).

Corruption alters public spending on goods and services, negatively affecting the quality of public services. According to Transparency International (2014), corruption undermines inclusive development and growth by promoting the inefficient allocation of scarce resources. It also affects the equitable distribution of resources, exacerbates income inequalities, and undermines the effective targeting of social welfare programmes to the needy as funds are diverted from these programmes by well-connected people for their private gain. Corruption shifts public spending away from essential public services, thus leaving fewer resources available for the state to fulfil the socio-economic rights of citizens as enshrined in the Constitution. The National Development Plan (NDP) (National Planning Commission, 2010), the “government’s development blueprint document”, underscores the point that corruption undermines good governance and the effective operation of government. The opportunity cost of resources lost to corruption is poor economic growth, growing unemployment, poverty and inequality. The NDP believes that fighting corruption and enhancing accountability should be the core to realising sustainable and inclusive development and building a capable and developmental state. There is, therefore, an urgent need to effectively eradicate corruption if the country is to prosper.

There is no single, precise definition of corruption as it manifests in diverse forms (e.g. bribery, embezzlement, graft and patronage) (Enste and Heldman, 2017; Hashem, 2014). Although various indices (e.g. the Corruption Perception Index published annually by Transparency International) have been used to measure corruption, it is a phenomenon that cannot be measured in absolute terms (Jajkowicz and Drobiszova, 2015). According to Transparency International (2014), corruption is the “abuse of public office for private gain”. This definition is accepted in many jurisdictions as it encapsulates many forms of corruption (Enste and Heldman, 2017; Timofeyev, 2011; Hashem, 2014). In South Africa, the Prevention and Combatting of Corrupt Activities Act (2004) defines the general offence of corruption as:

“Any person who, directly or indirectly, accepts or gives or agrees or offers to accept or give any form of gratification from any other person, whether for the benefit of themselves or for the benefit of another person to act personally or by influencing another person to act in a manner that amounts to be illegal, unauthorised, designed to achieve an unjustified result, or any other unauthorised or improper inducement to do or not to do anything.”

This definition implies that corruption is any conduct by a person entrusted with responsibilities in any office, who violates those duties to obtain undue gratification for themselves or other persons. The Public Service Commission (2011) lists seven common manifestations of corruption in South Africa: fraud and bribery, mismanagement of government funds, abuse of government resources, identity document fraud, procurement irregularities, appointment irregularities and unethical behaviour. This chapter denotes bribery, embezzlement, facilitation payment, fraud, collusion, extortion, patronage, clientelism and nepotism as manifestations of corruption.

Although South Africa has put together a range of laws, strategies and institutions to combat corruption, the challenge is severe and is exacerbating. This chapter aims to examine the efficacy of alternative corruption prevention strategies and the effectiveness of the funding frameworks of various public sector anti-corruption agencies in addressing corruption in South Africa, and alternative strategies and measures used elsewhere to eradicate corruption.

1.2 Problem statement

According to Transparency International (2020), South Africa's corruption levels have increased dramatically. Out of 180 countries assessed in 1995, South Africa's Corruption Perception Index stood at 56, and almost 30 years later (in 2020), the score had declined to 44 (an index closer to zero is classified as being most corrupt, and one closer to 100 is considered least corrupt). The cost of corruption in the country is also huge, whatever yardstick is used. Manyaka and Nkuna (2014) indicated that the Consumer Goods Council of South Africa loses between R50 and R150 billion annually to corruption. Corruption Watch (2016) notes that R25 to R30 billion of the annual government budget is lost to tender-related corruption.

Despite the devastating effects of the COVID-19 pandemic on peoples' lives and livelihoods, it also became an arena for corrupt and fraudulent practices in South Africa. The Special Investigating Unit (SIU) (2021) reported that COVID-19-related procurement of goods and services by the three spheres of government resulted in irregular spending of over R7.8 billion. While procurement can play a transformative role by advancing service delivery to the poor and to vulnerable individuals, the Commission of Enquiry into State Capture (2021) notes that procurement processes in South Africa were grossly manipulated and abused to advance the interests of individuals at the expense of the deserving groups. The Commission of Enquiry and the SIU's reports also noted that goods and services not needed were procured in some instances, or monies were paid to service providers before work was undertaken. Instructions issued through the National Treasury Regulations for deviations from procurement processes were frequently ignored. Procurement using allowed deviations became the norm rather than the exception, and exposed government systems to corrupt practices and fraud. While officials did not carry out standard due diligence exercises during procurement processes, they also ignored National Treasury's pricing guidelines. In many instances, suppliers were awarded contracts for higher personal protective equipment (PPE) pricing than was prescribed by National Treasury. Those in positions of authority interpreted the declaration of a national disaster as permitting them to forgo compliance with emergency procurement. In conclusion, the reports noted that public sector procurement in South Africa is inundated by bribery, fronting, bid rigging, collusive bidding, misconduct and maladministration; actions that undermine the mandates of the various spheres of government and – ultimately – service delivery.

These corrupt activities occur against the background of many structures and institutions established to prevent and eradicate corruption (e.g. the Special Investigating Unit, the Public Protector, the National Prosecuting Agency and the Financial Intelligence Centre). Despite these institutions being in place, the problem of corruption continues to be on the rise (Davis, 2014; Nkuna and Manyaka, 2014; Webb, 2005). While the statistics on corruption highlighted above are alarming, little attention has been given to the effectiveness of the measures adopted to eradicate corruption. The objectives of this chapter were to evaluate

the effectiveness of the funding models for selected anti-corruption institutions; review international case studies of strategies that the government can adopt to prevent or eradicate public sector corruption; and recommend steps and mechanisms that can be put in place to prevent or eradicate corruption.

1.3 Research methodology and data

To achieve the objectives of the research, a combination of research methods was used:

- Review international case studies: International case studies were reviewed to understand the steps and measures used elsewhere to eradicate corruption in the public sector.
- Budget and institutional analysis: The chapter adopted a budget analysis approach to fully understand the efficacy of the funding frameworks and institutional arrangements of the selected anti-corruption institutions in combatting corruption. This approach will use secondary data from various reports and planning documents of the selected institutions.

1.4 Literature review

This section reviews the literature on corruption. It begins by articulating the conceptual framework of corruption, followed by a theoretical analysis of the costs of corruption. This is followed by an institutional analysis of the literature that identifies the institutional weaknesses that allow corruption to thrive. Lastly, this section reviews the literature on steps that have been adopted elsewhere to combat corruption.

1.4.1 Conceptualisation of corruption

As noted above, corruption is the “abuse of power for private gains” (Transparency International, 2020). It often assumes various forms and dimensions in different countries, e.g. bribery, embezzlement, facilitation payment, fraud, collusion, extortion patronage, clientelism and nepotism (Menocal et al., 2014; Public Service Commission, 2011). Naidoo (2012) suggests that corruption includes extortion, abuse of power, conflict of interest, abuse of privileged information, favouritism and nepotism in the South African context. The Public Service Commission (2011) identified seven critical manifestations of corruption in the South African public service: fraud and bribery, mismanagement of government funds, abuse of government resources, identity document fraud, procurement irregularities, appointment irregularities and unethical behaviour.

1.4.2 Cost of corruption

The costs associated with corruption are huge and place a burden on economic development. Corruption, if not addressed, leads to theft, wastage and the misuse of scarce resources. It also entrenches elite privileges and inequality (World Bank, 2020). Public sector corruption has direct and indirect effects on the effectiveness of institutions. According to KPMG (2016), the direct costs include funds wasted on inflated procurement contracts, prices and stolen public assets. Indirect costs include inefficiencies resulting from deteriorating institutions and criminal activities. Corruption in South Africa has affected public revenue and expenditure (Naidoo, 2012). The allocation of resources has been distorted, which has affected government performance. While there are no precise estimates of the costs of corruption, the statements below suggest that corruption in South Africa is costly:

- In the last 20 years, South Africa has lost R700 billion to corruption, equivalent to more than half of the annual budget (Open Society Initiative for Southern Africa, 2017).
- In 2017, the government channelled R967 billion through public procurement, which equated to 19.5% of the gross domestic product (GDP) (Zondo Commission, 2021).
- In 2017, National Treasury noted that more than 50% of the annual R800 billion budget was lost due to the intentional abuse of the system (Institute for Security Studies, 2021)
- In 2021, in response to the COVID-19 pandemic, the SIU investigated cases of maladministration and corruption to a total value of R14.3 billion. With the R14.3 billion under investigation, about R2.1 billion has been referred to the Special Tribunal to set the contracts aside and recover losses (SIU, 2021).

The Auditor-General, which conducts regular audits on national, provincial and local governments on how budgets were adhered to, found that, in 2019/20 (see Table 1.1), the national and provincial governments registered R18.2 billion in unauthorised expenditure¹ (mainly due to overspending of the budgeted amounts). Transgressions in supply chain management processes and legislation resulted in R54.34 billion in irregular expenditure². According to the Auditor-General of South Africa (2020), this was a result of a culture of no consequences for non-compliance established by political and administrative leadership, resulting in an environment that was vulnerable to misappropriation, fraud and corruption, wastage and the abuse of funds. In the same year, R2.39 billion was recorded as fruitless and wasteful³ expenditure due to interest and penalties for late payment to creditors, litigation claims and procurement irregularities (procuring higher than market-related prices). The Auditor-General of South Africa (2020) alludes to the R2.39 billion fruitless and wasteful expenditure that could have been avoided if reasonable care had been taken, now lost to national and provincial governments to deliver on their respective mandates.

Similarly, at the local government level, in 2019/20, the Auditor-General of South Africa (2020) reported R3.47 billion in fruitless and wasteful expenditure due to interest and penalties charged for late payments, which resulted in material financial losses, litigation and claims, as well as write-offs on assets. Non-compliance with supply chain management processes (preference points not being applied, procurement without following competitive bidding and inadequate contract management) resulted in irregular expenditure of R26 billion. The unauthorised expenditure stood at R22 billion due to outstanding audits at the cut-off date.

Table 1.1: Government unlawful expenditure for 2019/20

2019/20	Fruitless and wasteful expenditure	Irregular expenditure	Unauthorised expenditure
Local government	R3.47 billion	R26 billion	R22 billion
National and provincial government	R2.39 billion	R54.34 billion	R18.2 billion
Total	R5.86 billion	R80.34 billion	R38.2 billion

Source: Auditor-General of South Africa (2020)

Prior to the amendment of the Public Audit Act in 2019, the Auditor-General, over the years, constantly withheld clean audit certification based on material irregularities found with no consequence management, mainly because of a lack of monitoring by the accounting officers in terms of identifying irregularities, which, in turn, exacerbated corruption. In strengthening the accountability mechanisms, the Public Audit Act was amended in 2019 so that the Auditor-General could report on material irregularities (procurement and payments, interest and penalties, revenue management, investments and assets) and take action against accounting officers who fail to take remedial action by issuing a certificate of debt for losses to be recovered from the accounting officer.

¹ According to the Public Finance Management Act (PFMA) (Republic of South Africa, 1999) and Auditor-General of South Africa (2020), unauthorised expenditure means expenditure not in accordance with the purpose of a vote or, in the case of the main division, not in accordance with the purpose of the main division. Unauthorised expenditure therefore occurs when departments used more funds than had been allocated (in other words, overspending) or used allocated funds for purposes other than those intended. Budget provisions can also be made for items that do not involve cash (non-cash items), such as reducing the value at which assets are reflected in the financial statements or other types of potential financial losses.

² Irregular expenditure is expenditure that was not incurred in the manner prescribed by legislation. Such expenditure does not necessarily mean that money was wasted or that fraud was committed. It is an indicator of non-compliance in the process that needs to be investigated by management to determine whether it was an unintended error, negligence, or done with the intention to work against the requirements of legislation. Through such investigation, it is also determined who is responsible and what the impact of the non-compliance is. Based on the investigation, the next steps are determined. One of the steps can be condonement if the non-compliance had no impact and negligence was not proven. Alternatively, if negligence was proven, the steps can be disciplinary action, the recovery of any losses from the implicated officials, or even cancelling a contract or reporting it to the police or an investigating authority.

³ According to PFMA (Republic of South Africa, 1999) and the Auditor-General of South Africa (2020), fruitless and wasteful expenditure is expenditure that was made in vain and would have been avoided had reasonable care been exercised. Fruitless and wasteful expenditure is money that is lost to the state or that could be permanently lost if not recovered. It is also a good indicator of the financial management of the public purse.

For a matter to be classified as a material irregularity, there needs to be irregularity (non-compliance, fraud or theft), and the irregularity must have an impact (loss, misuse or harm). National and provincial government material irregularities for 2019/20 amounted to R6.9 billion (due to non-compliance in procurement processes resulting in the overpricing of goods and services procured, resulting in the appointed supplier not delivering, payment for goods or services not received or being of a poor quality, invoices or claims not paid on time resulting in interest or penalties, revenue not being billed, debt not being recovered and inefficiencies).

Material irregularities in local government (2019/20) stood at R2 billion (due to non-compliance in procurement processes resulting in the overpricing of goods and services, payment for goods or services not received or invalid salary payments, creditors not being paid on time, resulting in interest on penalties, revenue not being billed, debt not being recovered, the loss of investments and assets not safeguarded). The Auditor-General of South Africa further states that these material irregularities identified in government are not complex issues, but rather basic disciplines and processes that should be in place in government, such as procuring at the best price, paying for what was received, making payments on time, recovering the revenue owed to the state, safeguarding assets, and using government resources efficiently and effectively. These material irregularities could have been avoided if preventative controls had been in place. Furthermore, while the Auditor-General has been given amended powers to implement various measures, the success of its powers will only be evident when a culture of responsiveness, consequences, good governance and accountability becomes the norm, rather than the ideal. Most importantly, if those in leadership or accountability positions are unethical, disregard governance issues, as well as compliance and control, and are not committed to transparency and accountability, which filters through the lower levels and ranks of government, a culture of poor discipline, impunity and non-delivery will occur. It is also worth pointing out that the amended powers of the Auditor-General, as per the Public Audit Act of 2019, consider non-compliance with legislation or contravention of legislation as fraud, theft or breach of fiduciary responsibilities.

1.4.3 *Institutional analysis, funding, and capacity issues related to corruption*

Weak governance institution is one fundamental cause of corruption (Malyniak et al., 2014; Menocal et al., 2014). According to the World Bank (2020), various countries and cities across the globe have opted for institutional approaches in the fight against corruption, as this has been identified as key in addressing corruption. One such city is Hong Kong, which has established a single agency to fight corruption. However, this method has not been successful in other countries and has fallen short due to limited budgetary, human and financial resources. In sub-Saharan African countries, legal and institutional frameworks have been in place, but have not been effective, or adequately addressed corruption (Chikova, 2020). Some of the reasons for the limited resources appropriated to these institutions are funding and human resource capacity. Chikova (2020) argues that anti-corruption units and measures to prevent, fight and prosecute corruption on the African continent are grossly underfunded or are overseen by executive government branches that are less autonomous.

In South Africa, despite the various structures and institutions whose mandate is to combat corruption, the challenge of corruption continues to escalate (Davis, 2014; Manyaka and Nkuna, 2014; Webb 2005). Weak governance systems and regulation applications, lack of complementary preventative and investigative measures, resource constraints and inadequate personnel training have rendered these institutions ineffective in combating corruption (Malyniak et al., 2014; Menocal et al., 2014). Thus, corruption will thrive where there are weak institutions and the weak application of regulations. The Public Service Commission (2011) notes that limited resources hamper various departments' investigations of alleged corruption cases. The absence of coordination and a clear delineation of responsibilities among anti-corruption institutions results in inefficient mandate overlaps (DPSA, 2003; The Presidency, 2020; Pillay, 2017). These institutions' broad mandates and lack of cooperation and coordination limit their effectiveness. For instance, according to South Africa's Corruption Assessment Report (2003) and the Review of South Africa's Anti-Corruption Agencies by the Public Service Commission (2001), the SIU has a broad mandate, which overlaps with other agencies, such as the Public Protector and the Asset Forfeiture Unit (DPSA, 2003; Public Service Commission, 2001). Furthermore, these two reports state that non-compliance with legislation by organs of state, lack of resources by agencies that

are supposed to deal with corruption, the non-existence of a central database of incidents of corruption or cases related to corrupt activities due to the non-collation of information by agencies, as well as a lack of preventative and reactive measures, have negatively affected all efforts to combat corruption.

The National Treasury report on the Public Sector Management Review of the Supply Chain (National Treasury, 2015) revealed the perennial violation of supply chain management processes, which has become the norm in the public service, such as high prices paid for goods and services. These contracts favour certain suppliers, collusion, unethical behaviour, non-performance, and poor-quality products and services, with 45% of supply chain activities conducted manually. This has increased the risk of fraud and corruption. The National Treasury report (National Treasury, 2015) also indicates other obstacles to the fight against corruption in South Africa, such as a lack of consequence management, inexperienced leadership, a high staff turnover and a lack of motivation, a lack of clarity on the roles and responsibilities of technical officials of government and political office bearers, and political interference. The various reports of the Auditor-General over the years also emphasised a lack of accountability and leadership, inappropriate planning by officials, the lack of internal controls and supervision, the lack of political oversight, and the monitoring of budgets as obstacles to the fight against corruption (Auditor-General of South Africa, 2020; Odeku 2019). According to Odeku (2019) and the Auditor-General of South Africa (2020), if government officials apply the basic principles of accountability, such as internal controls and good governance, and leadership adheres to its legislated responsibilities and commits to taking swift actions when the Auditor-General notifies it of material irregularities, corruption will be eradicated. In concurring with the arguments above, the National Anti-corruption Strategy report (Republic of South Africa, 2020) assessed the status quo of the country with regard to corruption and corrupt activities in identified sectors (such as local government, health, transport, energy, water, education, information, and communication technology (ICT)) as the most vulnerable to corrupt activities. Contributing factors to their vulnerability were highlighted as ineffective processes and systems in place, conflict of interest, misrepresentation of information and fraud, collusion between officials and private individuals, inadequate fraud and corruption detection strategies, lack of effective consequence management, ineffective collaboration with stakeholders, and weaknesses in the regulatory environment and monitoring. According to the report, these contributing factors cause the collapse of governance and its integrity systems, resulting in billions of rands lost to irregular contracts.

Another matter closely related to non-compliance in South Africa is the lack of political support in combating corruption in government (Manyaka and Nkuna, 2014; Sebake, 2020). Naidoo (2012) supports this notion by noting that, while anti-corruption measures are in place in South Africa, they often fail because there is no political will to implement comprehensive anti-corruption strategies. In South Africa, over the years, the anti-corruption agencies have been weakened by chronic political interference in the leadership and operations of their activities (Pillay, 2017). Similarly, Phahlane (2021) also argues that a significant cause of the weakened institutional capacity to manage the scourge of corruption in South Africa is the lack of political will and ethical leadership. Some of the reasons for lack of political will are politicians being corrupt themselves and being fearful of consequences. Lekubu (2021) supports these arguments by further stating the lack of ethics and accountability by those in authority has resulted in corruption in the country. Corroborating the above statements are the repeated reports on audit outcomes by the Auditor-General across government departments regarding the lack of credible financial statements, and poor performance due to a lack of accountability, a lapse in oversight and lack of controls relating to compliance consequence management. The situation is dire for local government despite various interventions and strategies, such as consultants, additional monitoring, and the Auditor-General assisting within its mandate to support municipalities on accountability processes. This called for the leadership to set the tone of ethical and accountable leadership (Auditor-General, 2020). The lack of ethical and non-accountable leadership filters down to lower levels, resulting in a culture of poor accountability and impunity. Lekubu (2021) is of the view that ethics and morality are founded on integrity, competence, responsibility, accountability, fairness and transparency, including anticipating and preventing or avoiding corrupt practices. Therefore, ethical leadership can be achieved through an institutional or organisational culture that is anchored on ethical behaviour.

Transparency International (2014) defines political will as the “demonstrated credible intent of political leaders”, i.e. a demonstration by political leaders of their intention to address challenges facing society, such as corruption, by a political pledge to effect reforms. Transparency International (2014) states that political leadership and a commitment to fight corruption are prerequisites for initiating and sustaining reforms to eradicate corruption. Transparency International lists components that show whether the country has the political will or a lack thereof (a weak or non-existent legal or institutional framework, inadequate allocation of powers and resources, poor governance, weak accountability, and the lack of appropriate sanctions and enforcement). Table 1.2 shows the characteristics of a country with a political will, which is the political commitment to fight corruption and apply anti-corruption efforts, and its associated outcomes.

Table 1.2: Political commitment and associated characteristics

Government initiative	This characteristic relates to where the impetus to implement reforms comes from. “Home-grown” initiatives to fight against corruption show that the government sees the issue as necessary and is willing to do something about it. On the one hand, externally imposed or imported anti-corruption initiatives face the challenge of building true commitment and ownership among political leaders.
Degree of analytical rigour	Anti-corruption policies that are decided on or implemented utilising evidence-based analyses of the options and related costs and benefits are likely to represent a higher degree of willingness to act and achieve positive results. On the other hand, window dressing anti-corruption measures are likely to be implemented without considering the country’s context, needs and costs. They show a lack of commitment to achieving change effectively.
Mobilisation efforts	Efforts to mobilise support from other stakeholders (such as civil society organisations and the private sector) in the implementation of reforms are also seen as a sign of strong political will by political actors.
Long-term public commitment and allocation of resources	The amount of human and financial resources allocated to support the reform, its goals and objectives also offer some insights into the level of political will. If new anti-corruption agencies are created, but they suffer from underfunding and a shortage of personnel, this can indicate that political will is half-hearted. In the long run, policymakers often see anti-corruption strategies as a one-shot endeavour or a symbolic gesture. It is also essential to look into resource allocation for the anti-corruption strategy or institution.
Application of credible sanctions	Without well-crafted sanctions, corruption cannot be reduced. Therefore, a practical, proportionate and enforced sanctions regime signals a serious commitment to fight corruption and a higher political will. On the other hand, symbolic and selective sanctions point to a lesser degree of political will.
Learning and adaptation	Establishing a process of tracking and monitoring the progress and results of anti-corruption policies and programmes is also relevant. This allows one to adapt the strategies to emerging circumstances. It also shows a certain commitment to learning from past experiences to monitor achievements more transparently.

Source: Transparency International (2014)

Transparency International (2014) argues that, often, the political will to fight corruption comes from the top, but bottom-up approaches (empowering and mobilising citizens) can also solicit political will. That is, civil society is actively engaged and committed through advocacy, education and training on corruption, reporting corruption and efforts that can exert pressure on political leaders to act against corruption and initiate anti-corruption reforms

1.4.4 Steps and measures to eradicate corruption

As highlighted elsewhere in this chapter, there are anti-corruption institutions in South Africa whose mandate is to curb corruption. The Anti-corruption Task Team (ACTT) was established in 2010, consisting of anti-corruption institutions. The ACTT aimed to coordinate the anti-corruption agenda established across different government structures. However, the Open Society Initiative for Southern Africa (2017), in its assessment of the anti-corruption institutions of South Africa, found that the ACTT is an advisory body that lacks powers, is mainly dominated by government executive management, and is “overly subjected to the whims of the executive”. Evidence of the ACTT structure indicates unstable leadership by the executive towards efforts to eradicate corruption, hence its failure. Advocacy of corruption and its adverse effects on the country are also weak due to poor levels of awareness; thus, the public ambivalence by society at large (Open Society Initiative for Southern Africa, 2017). Hope (2020) and Manyaka and Nkuna (2014) propose strengthening institutions through anti-corruption policy frameworks and strategies that are multifaceted and sustainable, promoting political will and ethical leadership to ensure that anti-corruption measures are mainstreamed and implemented. According to the NDP (National Planning Commission, 2020), South Africa has favoured a multi-agency approach to dealing with corruption as the independence of a single anti-corruption agency can be compromised by political interference. The NDP further recommended various measures to address corruption, including reviewing the mandates and functions of current structures, putting additional funding resources in place and employing skilled personnel.

The United Nations (2004) published toolkits that governments or agencies involved in anti-corruption efforts could use. Although these toolkits are not blueprints for fighting corruption, they offer suggestions and information on how other countries have successfully used them to combat corruption. In implementing these toolkits, governments first need to assess the nature and scope of corruption problems, develop an anti-corruption strategy, set overall priorities, and develop a comprehensive framework with specific programmes and activities. Progress should be monitored throughout the process, and information about what is or is not adequate should be used to reconsider and modify each element of the strategy. These toolkits cover prevention, enforcement, institution building, awareness-raising, empowerment, anti-corruption legislation and monitoring. South Africa adopted the National Anti-corruption Strategy (2020–2030) (NACS), using the United Nations (2004) toolkits as guidelines. Thus, the NACS is premised on preventing corruption based on good governance, transparency, integrity management, accountability in society and the early detection of potentially corrupt practices to supplement the reactive measures executed by law enforcement agencies and other anti-corruption communities. According to the NACS, the political will of those who serve in public office and ethical leadership in all sectors of society are crucial in eliminating corruption. Not only that, the NACS highlighted various challenges that need to be addressed for South Africa to become a corrupt-free country: lack of coordination by the anti-corruption institutions, the need for improving transparency and accountability in the use of the public procurement system, and the need to empower citizens in combatting corruption through awareness campaigns. It further proposed that the President champions the NACS with the support of the compact social system. The strategy document envisages that the NACS will commence its implementation phase in 2020/21. Its implementation would require establishing an overarching body that will play an oversight role and monitor the roll-out of the strategy. However, to date, no progress or update regarding its performance or outcomes as envisaged.

The Commission of Inquiry into State Capture (2021) highlighted South Africa’s procurement processes as being grossly manipulated and abused, given that no specialised oversight body has been given the specific mandate to fight corruption in all spheres of procurement. Thus, the Commission of Inquiry recommended the need to establish an independent Public Procurement Anti-corruption Agency (PPACA), free from political oversight and subjected only to Constitutional Law, to re-establish trust in the procurement of goods. It will also monitor activities in the procurement of services. Further, the Commission of Inquiry

recommended the creation of a procurement officer's profession, to which all officials who work in procurement would belong, with qualifications and the necessary training and experience required for membership in the profession. The training and qualification will include standards of integrity and a commitment to resist the mismanagement of funds and corruption. Where a member has mismanaged funds, they would be referred to a Tribunal Agency that acts as the disciplinary committee of the profession, with the power to strike a member from the roll or impose any other disciplinary sanctions as the case may require.

1.5 Review of international case studies on steps and measures to eradicate corruption in the public sector

This section reviews case studies of measures or steps other countries have successfully adopted to prevent or eradicate corruption-related activities in the public sector. These include legislative changes, judiciary reforms, public finance management reforms, the establishment of an anti-corruption commission and budgets or funding reforms for institutions mandated to fight and prevent corruption, reconfigurations of existing institutions that fight corruption, reforms in the public procurement systems, accountability mechanisms, active citizens' involvement, monitoring, evaluation and political will, as well as ethics and integrity. A variety of countries were chosen as case studies from Africa, South America, Europe and Asia, as indicated in Figure 1.1. The findings for each country are summarised in Table 1.3:

Figure 1.1: Case study countries

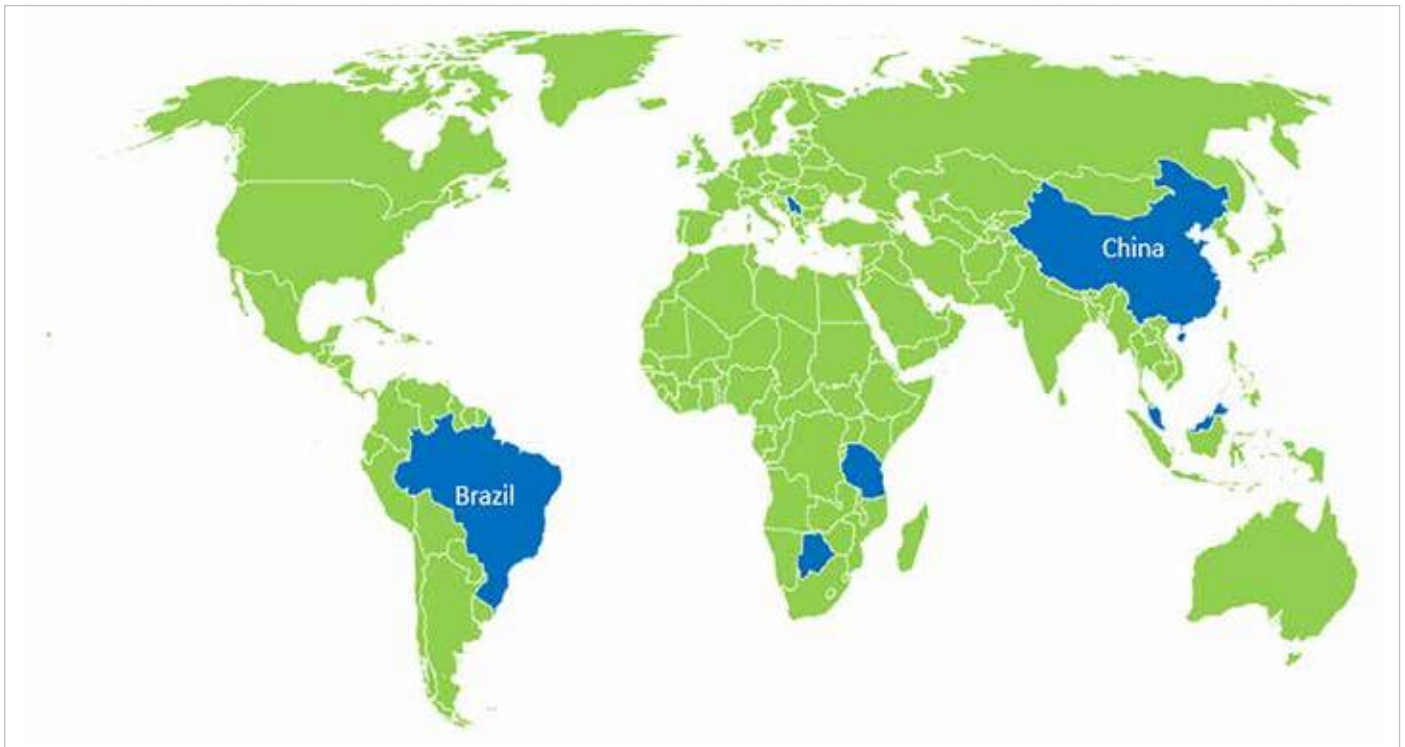


Table 1.3: Country case studies on measures to eradicate corruption

Country	Findings
United Kingdom (World Bank, 2020)	<p>In 2015, the UK's National Crime Agency warned that the scale of laundering criminal proceeds was a real threat to the UK's economy and reputation. The government's Anti-corruption Plan (2014) aimed to more effectively tackle those who engaged in corruption or launder their corrupt funds in the UK and return the proceeds of corruption. In the UK, about 50 agencies with different and competing mandates investigated international corruption and the proceeds of global corruption. No new agency was created, but existing ones were reconfigured. The UK established the International Corruption Unit through a reconfiguration of expertise within existing institutional arrangements. This enabled dedicated investigation and intelligence unit allocation within existing law enforcement agencies. The outcome was the establishment of the International Corruption Unit (ICU) within the National Crime Agency (NCA). The ICU was given dedicated staff and a budget, and its capacity was enhanced, including support from the NCA, which yielded positive results.</p>
Malaysia (World Bank, 2020)	<p>Malaysia's anti-corruption efforts received a significant boost in 2018 with the new government's election. The government's first step was to set up the National Centre for Governance, Integrity and Anti-corruption (GIACC) as the special Cabinet committee for anti-corruption (JKKMAR) secretariat, reporting directly to the Prime Minister. The GIACC, in consultation with other agencies and departments, formulated and launched the National Anti-corruption Plan (NACP) and is currently overseeing its implementation. The primary enforcement agency continues to be the Malaysian Anti-corruption Commission (MACC), the two being the central anti-corruption bodies in the country. The NACP outlines the government's strategies and measures for combatting corruption, strengthening governance, integrity and transparency in government operations. The five-year plan has six strategic thrusts:</p> <ul style="list-style-type: none"> • Strengthening political integrity - strengthening the Parliament: Re-introducing the Parliamentary Services Act 1963 to provide greater independence and autonomy to Parliament to ensure checks and balances on the functioning of the executive. • Accountability and effectiveness of public service delivery - asset declaration: For all executives to declare assets extended to members of Parliament. The asset declaration information has been published on the MACC portal. • Efficiency and transparency in public procurement – procurement reform: Efforts on various procurement reforms are on track with a plan to table the Procurement Act in Parliament in 2020. • Enhancing the credibility of the legal and judicial system - strengthening the Judiciary: Special courts were established to expedite trials on corruption cases. • Institutionalising the credibility of law enforcement agencies - Independent Police Complaints and Misconduct Commission (IPCMC): The draft IPCMC Bill was under discussion with the Chambers of Attorney-General. • Inculcating good governance in corporate entities - Ombudsman: The Ombudsman Act, in draft stages, was meant to replace the Public Complaints Bureau to improve the management of public complaints in Malaysia. <p>Additional initiatives included the following:</p> <ul style="list-style-type: none"> • Reform of Government-linked Companies (GLCs): The Ministry of Finance is finalising guidelines for senior management, a Chairman and Board of Directors in GLCs and subsidiary companies, banning all political appointments in GLCs. • Support letters: A new policy has been introduced that forbids politicians from issuing support letters for government tenders and projects. • Organisational Anti-corruption Plan (OACP) and Anti-bribery Management System (ABMS): It is compulsory for all government agencies to have an OACP specific to their workflow, and the implementation of the ABMS was launched government-wide after a pilot project in 2021.

Country	Findings
Botswana (UN, 2004; Chikova, 2020)	<p>The Corruption and Economic Crime Act 1994 of Botswana provided for the establishment of a Directorate on Corruption and Economic Crime (DCEC) with an extensive mandate that includes the investigation of alleged or suspected offences, the apparent or suspected infringement of fiscal and revenue laws, the conduct of any person that may be connected with or conducive to corruption, the examination of the practices and procedures of public bodies established to eliminate those that may be conducive to corrupt practices, the education of the public about the evils of corruption, and the fostering of public support against corruption.</p> <p>The Act also creates several offences, including the possession of unexplained property. The early division of responsibilities into the investigation (operations), prevention (mainly management advice) and education (including public relations) followed a pattern adopted successfully elsewhere. The government funds the directorate. Funding for the directorate has been increasing, especially towards efforts to fight corruption and improve corruption scores for the country. An Intelligence Group was established to supplement information gained from public complaints. A reporting centre for receiving messages from the public became fully operational in March 1995. By 1998, there were five branches, each headed by an Assistant Director. The branches were responsible for Prosecutions and Training, Investigations, Intelligence and Technical Support, Administration, Development and Financial Investigations, Corruption Prevention and Public Education.</p>
Tanzania (UK Aid, 2015)	<p>In curbing corruption in Tanzania, the government adopted the following five measures at the national level:</p> <ul style="list-style-type: none"> • An in-depth diagnostic study of the causes and extent of corruption in the country through the Presidential Commission Against Corruption (PCAC), commonly known as the Warioba Commission. • Involvement of all stakeholders in brainstorming, formulating and proposing the basic structure and content of a strategy to combat corruption in the country. • Political will, developing sector-specific action plans against corruption, and setting out priority areas to attack corruption. • Mainstreaming with the ongoing reforms in the country. • Developing and building capacities in institutions directly charged with combatting corruption, i.e. the Prevention of Corruption Bureau and the Institutionalising Coordinating, Evaluation, and Monitoring Unit. <p>Good governance has two distinct dimensions: The political dimension relates to the degree of genuine commitment to good governance. The technical dimension refers to efficiency and public management issues.</p> <p>The government instituted or formed a Good Governance Coordinating Unit in 2001 within the President's Office that will coordinate all good governance programmes in the country to establish the evaluation and monitoring of all activities undertaken in the good governance reforms, including the National Anti-corruption Strategy and Action Plan (NACSAP). It is about harmonisation, consistency, uniformity and close follow-up of the implementation of action plans as set out in the timeframe matrix of each sector. This also assisted in terms of determining budget allocation requirements for the action plans identified by each sector-specific implementation programme. The overall objective of the coordination was to measure performance and compare the perception indicators, access and transparency from the initial diagnostics so that those involved could see which areas have shown improvements and why. Tanzania's vision of good governance is contained in the government's policy paper, Vision 2025.</p>

Country	Findings
China (United Nations, 2011)	<p>Since the start of the 21st century, China has been prominent in the work of combatting corruption and building a clean government. It adopted the principle of addressing both the symptoms and root causes of corruption, enforcing comprehensive treatment, giving simultaneous stresses to punishment and prevention, prioritising prevention, and establishing the national anti-corruption strategy by setting up and perfecting a punishment system.</p> <p>In 2007, China established the following:</p> <ul style="list-style-type: none"> • The National Bureau of Corruption, which aims to organise and coordinate the national work of corruption prevention, make overall plans in this regard, formulate relevant policies, examine, coordinate and direct the work of corruption prevention in enterprises, public institutions, social groups, intermediate agencies and other social organisations, and take charge of international cooperation and technical assistance in this regard. Some provinces and municipalities also established corruption prevention bureaux. • The Implementation Outline aimed to establish and improve the corruption, punishment and prevention system to ensure that leading cadres work cleanly and honestly, including codes of conduct and ethical rules for party members who hold leading positions. China publicises exemplary public officials' deeds through news media, films and television programmes, and holds meetings to promote their meritorious deeds. China also compiles educational materials, shoots films warning people against corrupt behaviour, holds relevant exhibitions, and organises corrupt officials to give speeches from their own experiences. • China promotes clean governance education for civil servants, mainly to help them build correct concepts, urge them to abide by laws and consciously abide by regulations, perform official duties honestly and consolidate their moral defence line of resisting corruption in their minds. China, makes cadre training and education a routine task. Public officials should execute duties with integrity as a critical content of such education and training, making it a required course for leading cadres of all levels. • Integrity education for university, middle school and primary school students fosters their moral consciousness and legal concepts of integrity, honesty and lawfulness, and raises their awareness of integrity. e.g. visual images and exciting activities are more often used in primary and secondary schools. Universities frequently resort to more rational forms of thinking, analysing, reasoning and discussions in their integrity education programmes.
Brazil Transparency International (2019)	<p>Various reforms have been conducted in curbing corruption in Brazil. In 2013, new anti-corruption legislation was adopted. It established civil and administrative liability to companies engaged in corruption and the existing personal liability of its directors and staff. The law prohibits companies from offering or giving an unfair advantage to domestic or foreign public officials or related third parties. The Anti-corruption Law imposes severe sanctions, including fines that can reach 20% of a company's gross annual revenues. In 2004, the federal government created the Transparency Portal to increase transparency in public administration, enabling citizens to track the allocation of public money and play a monitoring role in this process. The Transparency Portal has been instrumental in supporting the direct social control of the government's activities. The media and watchdog groups have been using the portal's information to denounce wrongdoings and monitor how the federal government spends public money.</p> <p>Brazil does not have a single institution responsible for curbing corruption. Several bodies share this task at the federal and regional levels. The lack of a single anti-corruption institution leads to the increased relevance of inter-institutional cooperation mechanisms. The National Strategy for Combatting Corruption and Money Laundering was established in 2003. The Forum's main aim was to discuss anti-corruption within the government. Although civil society participation remains limited, it gathers specialists from several public bodies from all branches of power, and the federal, state and municipal levels. They decide on action plans, which may involve conducting a study, drawing legislation, or monitoring the implementation of a policy.</p>

Country	Findings
Rwanda (Khan and Pillay, 2019; Bozzini, 2013; Chêne, 2008; World Bank, 2020)	<p>Since the 1994 genocide, Rwanda has undergone a painful reconstruction process, including rebuilding governance systems, structures and institutions. Rwanda has performed relatively well in terms of government effectiveness, compared to several of its neighbours. The fight against corruption has also been led by the country's highest institutions and has followed a top-down approach. The establishment of new laws and institutions, sensitisation campaigns and public calls for integrity have mostly come from the highest levels of government, including from the President, with the Rwandan government's effectiveness being rated the highest in sub-Saharan Africa at 95%. However, for these commitments at a higher level to be sustained in the long term, accountability structures need to be strengthened and transparency in the management of public affairs enhanced.</p> <p>Since the late 1990s, top government officials have seen the fight against corruption as essential in stopping the cycle of violence that previously culminated in genocide. The perception of corruption as endangering society underpinned the government's zero tolerance for corruption policy. That perception is also reflected in the link between corruption and injustice that factored into creating the Office of the Ombudsman to lead the anti-corruption movement.</p> <p>Corruption opportunities have been further curtailed by improving the application of business regulations. The revision of Rwanda's public procurement rules and the creation of the National Tender Board (now Rwanda's Public Procurement Authority) enabled Rwanda to establish greater transparency and standardisation in the state's contract with the private sector.</p> <p>The fight against corruption is one of the government's official priorities. Consistent policy and efforts to combat corruption have demonstrated the political will to fight corruption. Both members of the political elite and civil servants were prosecuted when allegations of corruption were brought against them. There have been several cases of high-ranking officials being forced to resign, be dismissed or charged when involved in corruption activities, such as anti-corruption measures and institutions. The government has several anti-corruption measures at the national level. These include establishing the following:</p> <ul style="list-style-type: none"> • The Office of the Ombudsman, which monitors transparency and compliance with regulations in all governmental sectors. The Ombudsman has taken a strong stand against corruption and regularly exposes fraud, malpractice and corruption cases. • The Anti-corruption Unit of the Rwanda Revenue Authority (RRA) has a good Code of Conduct and extensive and active internal campaign mechanisms to raise staff awareness of this code. The RRA also has effective disciplinary procedures to promote a culture of integrity within the institution. • The Auditor-General and the National Tender Board (NTB) (now called Public Procurement Authority). These institutions identify corruption cases while the police and National Prosecutor's Office prosecute the actual acts of corruption. The NTB was established in 1997 to organise and manage the public procurement process and implement the general public procurement policy on behalf of the government. The guiding principles for the NTB's operations are transparency, economy and equity. The NTB issues and manages procurement rules, regulations, guidelines and policies. The body is currently serving as the procurement agency for most government purchases, including those made by parastatals and international donors. The Office of the Auditor-General (OAG) was established in 1999 to audit government adherence to fiscal controls.

1.6 Key lessons learnt from the literature review and case studies in combatting corruption

Some key lessons can be learnt from the international experiences regarding measures and steps that need to be in place to prevent and eradicate corruption-related activities. The prerequisite for any measure to fight corruption and move towards support for anti-corruption reforms is consistent political will for good governance and accountability, i.e. ethical and accountable leadership and a commitment to fight corruption should come from the highest office or the top levels of a country's political system, which should be through the following:

- Enhancing institutional capabilities to conduct checks and balances, and ensure accountability, where accountability identifies who needs to be accountable to whom and for what; for instance, accountability of political leaders and public officials to organisational effectiveness and efficiency through compliance measures, rules and ethics codes, as well as oversight bodies taking their legislated responsibilities seriously and committing to repelling corruption by taking swift action and imposing sanctions when the need arises.
- Genuine political commitment to the governance structures of the anti-corruption agencies. Establishing an anti-corruption agency is not a panacea to addressing corruption. National corruption strategies should be established to assess whether an anti-corruption agency is needed. An alternative can also be found among the existing institutional arrangements through reconfiguration and coordination to avoid duplication and execute effective results on time to support enforcement agencies, including a long-term commitment to allocating human and financial resources in support of anti-corruption agencies to realise anti-corruption efforts. The literature points out that having anti-corruption agencies in place that suffer from underfunding and a shortage of personnel and skills indicate that political will is “half-hearted”, with policymakers seeing these agencies and their strategies as “symbolic gestures”. Once anti-corruption strategies are implemented, tracking and monitoring the progress are needed.
- As is the case in Rwanda, corruption opportunities in the procurement system can be prevented by establishing a public procurement authority (PPA). The mandate of the PPA in Rwanda is clear: to show greater transparency and standardisation of government contracts. The PPA organises and manages the public procurement process and implements the public procurement policy on behalf of the government. The guiding principles for the PPA are transparency, economy and equity. The PPA issues and manages procurement rules, regulations, guidelines and policies. The PPA in the Rwandan case is similar to what the Zondo Commission proposes, as discussed elsewhere in this chapter. The chapter highlights that there is no single specialised oversight body with a specific mandate to fight corruption in all spheres of procurement.
- There is a need for bottom-up approaches through a dedicated civil society organisation that empowers citizens by educating society about the dangers or adverse effects of corruption, e.g. that it negatively affects their lives and the economy. The organisation should be involved in public awareness campaigns, emphasising the importance of reporting corruption. The collective effort of the organisation should be able to advocate for anti-corruption reforms, which will put pressure on political leaders to act against corruption.
- South Africa can also learn from some specific countries, such as the Rwandan case study, given the similar characteristics they share. Since the 1994 genocide, Rwanda has undergone a painful reconstruction process through rebuilding governance systems, structures and institutions. Rwanda has performed relatively well in government effectiveness in fighting corruption, led by the highest office (the President) and has followed a top-down approach. The introduction

of new laws and institutions, sensitisation campaigns and public calls for integrity have mostly come from the highest levels of government, including the President. The government has several anti-corruption measures at the national level, such as the Office of the Ombudsman and the Public Procurement Authority. These institutions identify corruption cases, while the police and the National Prosecutor's Office prosecute the actual acts of corruption.

From the Tanzanian case study, South Africa can learn from the development of the NACSAP, which has similarities with the NACS in South Africa. Tanzania's NACSAP includes the following:

- The involvement of all stakeholders in brainstorming, formulating and proposing the basic structure and content of the strategy to combat corruption in the country.
- Political will.
- Developing sector-specific action plans against corruption.
- Mainstreaming anti-corruption reforms in the country.
- Developing and building capacities in institutions directly charged with combatting corruption, i.e. the Prevention of Corruption Bureau, and the Institutionalising, Coordinating, Evaluation and Monitoring Unit.

1.7 Findings

This section uses budget analysis tools to examine the adequacy and efficacy of government allocations to institutions meant to prevent and eradicate corruption. The analysis focuses on the following anti-corruption agencies: the National Prosecuting Authority (NPA), the Financial Intelligence Centre, the Special Investigation Unit and the Public Protector.

1.7.1 Institutional overview

The Department of Justice and Constitutional Development (DJ&CD)'s Budget Vote funds five programmes. Programme 4 is the NPA, with four sub-programmes, including the Asset Forfeiture Unit and the Witness Protection Office. Programme 5 is Auxiliary Services, with the Public Protector⁴ as one of its sub-programmes. Other than these five programmes, the DJ&CD has entities such as the SIU⁵. What is notable about these institutions is that they are reported within various budget votes of government departments, with the Asset Forfeiture Unit and the Witness Protection Office reported as sub-programmes of the NPA (see Table 1.4). National Treasury's Budget Vote has the Financial Intelligence Centre⁶ as one of its nine programmes.

4 The Public Protector of South Africa was established in terms of section 181 of the Constitution, which mandates the institution to strengthen constitutional democracy by investigating any conduct in state affairs, or the public administration in any sphere of government, which is alleged or suspected to be improper or to result in any impropriety or prejudice, report on that conduct and take appropriate remedial action.

5 The SIU derives its mandate from the Special Investigating Unit and Special Tribunals Act of 1996. The Unit's principal functions are to investigate serious malpractice, maladministration and corruption in connection with the administration of state institutions, and to take or assist in instituting appropriate and effective action against wrongdoers.

6 The Financial Intelligence Centre serves to combat financial crime, including money laundering and terror financing activities, and to gather intelligence for national security, defence and the combatting of crime.

Table 1.4: Anti-corruption institutions and their purpose

Responsible department	Sub-programmes	Purpose
Justice and Constitutional Development Vote	National Prosecuting Authority	
	<ul style="list-style-type: none"> National Prosecutions Service 	Primarily responsible for general and specialised prosecutions and the appeals that might follow. These include resolving criminal matters outside of the formal trial process and considering dockets brought by the police where people have not been charged.
	<ul style="list-style-type: none"> Asset Forfeiture Unit 	Seizes assets acquired from the proceeds of crime or have been part of an offence through a criminal or civil process.
	<ul style="list-style-type: none"> Witness Protection Office 	Provides temporary protection, support and related services to vulnerable and intimidated witnesses and associated persons in judicial proceedings in terms of witness protection.
	Public Protector of South Africa	
	<ul style="list-style-type: none"> Investigations 	Focuses on rooting out improper conduct and maladministration in all state affairs.
	<ul style="list-style-type: none"> Stakeholder Management 	Ensures that the Public Protector of South Africa's services are accessible to all persons and communities. The programme also aims to assist state organs in establishing internal complaints-handling mechanisms
	Special Investigation Unit programmes	
	<ul style="list-style-type: none"> Investigations and Legal Counsel 	Ensures adequate execution of the mandated service delivery of the SIU in line with the Special Investigating Units and Special Tribunals Act, 1996 (Act 74 of 1996); investigates severe malpractices or maladministration in connection with the administration of state institutions, state assets and public money.
	<ul style="list-style-type: none"> Market Data Analytics and Prevention 	Implementing relevant and proactive initiatives to prevent the reoccurrence of fraud and corruption cases due to systematic weaknesses in the public sector and to positively influence South African citizens' behaviour.
National Treasury	Financial Intelligence Centre (FIC)	
	<ul style="list-style-type: none"> Delivery of intelligence on financial crimes and regulatory services in terms of the Financial Intelligence Centre Act (2001) 	Focuses on enhancing compliance with the FIC Act. Delivery of intelligence on financial crime and FIC Act-related regulatory services, focusing on the improved production and utilisation of financial intelligence products.
	<ul style="list-style-type: none"> Enablement of financial intelligence regulatory capabilities 	Enhances the ability to deliver services to internal clients and other identified stakeholders, thus significantly contributing to the FIC becoming a sustainable and capable organisation.

Source: Annual Performance Plans of various institutions; National Treasury (2021)

1.7.2 Institutional financing

In terms of funding arrangements, the budget allocations of the main institutions established to combat corruption vary widely (see Table 1.5). What can be noted from Table 1.5 is that the compensation of employees accounts for a significant portion of the budget of virtually all these institutions. Over the years, this line item has remained above 80% for the NPA, 60-70% for the Public Protector, 60-80% for the SIU and 50-56% for the FIC. The most significant portion of the budget dedicated to compensation of employees can plausibly be explained by the skill sets required in these institutions, especially in the areas of specialised investigations and prosecutions. However, caution should be exercised, as high compensation of employees' budgets can crowd out other critical corruption-busting measures that these institutions are tasked to conduct, such as research, early detection mechanisms and prevention, monitoring and evaluation efforts, and educational awareness campaigns.

Table 1.5: Budget allocations of the anti-corruption institutions

R million	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
NPA's budget of	3 742.9	3 799.4	4 009.2	4 266.9	4 446.2	4 487.6	4 543.6
NPA compensation of employees	3 202.8	3 317.2	3 442.0	3 659.7	3 836.6	3 865.1	3 895.9
Public Protector's budget	345.2	321.6	366.4	325.7	331.9	340.9	345.2
Public Protector compensation of employees	238.9	238.2	252.8	249.9	251.8	257.7	258.3
SIU budget	536.9	619.9	502.9	702.1	907.8	1 069.1	1 325.8
SIU compensation of employees	362.1	399.6	431.5	521.2	708.7	854.4	1 093.9
FIC budget	251.9	262.3	307.7	342.1	347.6	332.7	334.1
FIC compensation of employees	155.5	160.7	187.8	186.6	187.6	197.9	195.0

Source: National Treasury (2021)

1.7.3 Budget analysis by sub-programme

1.7.3.1 National Prosecutions Authority (NPA)

The NPA has four sub-programmes: the National Prosecution Services, Asset Forfeiture Unit, Office for Witness Protection Services and Support Service (see Table 1.6). The National Prosecution Services, which is mandated to prosecute corruption, dominates the NPA's budget as it accounts for 80% of the expenditure of these four sub-programmes. Its average share remains 80% over the Medium-term Expenditure Framework (MTEF). The Asset Forfeiture Unit and the Office for Witness Protection play a critical role in the fight against corruption by acquiring assets that are proceeds of crime and corruption, providing temporary protection to vulnerable witnesses in judicial proceedings. The average expenditure of these two units account for 3% and 5%, respectively, over the years under analysis, and 4% over the MTEF. These figures are very low, given that protecting witnesses is essential for the success of various cases, especially those associated with corruption and organised crime. However, what is worth noting is that Support Services, which provides corporate support services to the NPA in terms of finance, human resources, and information communication and technology, among other things, is the second-largest expenditure programme (after National Prosecution Services), accounting for an average share of 12% over the past four years. It is expected to decrease to 10% over the MTEF period.

Table 1.6: NPA's sub-programmes – real values

R million	Audited outcome				Average percentage share	MTEF			Average percentage share (MTEF)
	2017/18	2018/19	2019/20	2020/21		2021/22	2022/23	2023/24	
National Prosecution Services	1 975.3	1 973.4	1 994.6	1 974.8	80%	2 043.3	1 979.5	1 915.3	81%
Asset Forfeiture Unit	84.8	82.4	78.7	102.5	3%	108.6	105.2	102.0	4%
Office for Witness Protection	127.4	124.9	119.6	112.1	5%	110.2	107.5	105.3	4%
Support Services	321.9	270.5	293.9	324.2	12%	260.7	255.1	251.3	10%
Total	2 509.4	2 451.3	2 486.7	2 513.6	100%	2 522.8	2 447.3	2 373.9	100%

Source: National Treasury (2021) and Commission's calculations

In terms of real growth rates, these sub-programmes have generally recorded low average growth rates over the years under review (2018/19 to 2020/21), except for the Asset Forfeiture Unit at 8% (see Table 1.7). Even over the MTEF period, negative real growth rates are expected for all the programmes, except for the Asset Forfeiture Unit, which has an envisaged 0% average growth rate. Overall, the four programmes are envisaged to register negative growth rates of -3% over the MTEF period. This is a worrying trend, given the importance of these sub-programmes in the fight against crime and corruption. This may also mean that the impact of the NPA in the fight against corruption will be severely undermined by allocations that are contracting in real terms.

Table 1.7: NPA real growth rates

Subprogrammes	Audited outcome			2017/18– 2019/20 average real growth rates	MTEF			MTEF average real growth rates
	2018/19	2019/20	2020/21		2021/22	2022/23	2023/24	
National Prosecution Services	0%	1%	-1%	0%	3%	-3%	-3%	-1%
Asset Forfeiture Unit	-3%	-5%	30%	8%	6%	-3%	-3%	0%
Office for Witness Protection	-2%	-4%	-6%	-4%	-2%	-2%	-2%	-2%
Support Services	-16%	9%	10%	1%	-20%	-2%	-1%	-8%
Total average	-5%	0%	8%	1%	-3%	-3%	-2%	-3%

Source: National Treasury (2021) and Commission's calculations

1.7.3.2 The Public Protector

The Public Protector has three programmes: Administration, Investigations and Stakeholder Management. The two programmes that deal directly with corruption are Investigations, which deal with reported maladministration cases and improper conduct in state institutions and government, and Stakeholder Management, which ensures that the Public Protector's services are accessible to all communities, including strengthening Ombudsman-related services in South Africa. As can be expected, Investigations dominate the Public Protector's budget, with an average budget of over 50% for the three years under review (see Table 1.8). The trend is projected to remain the same over the MTEF period.

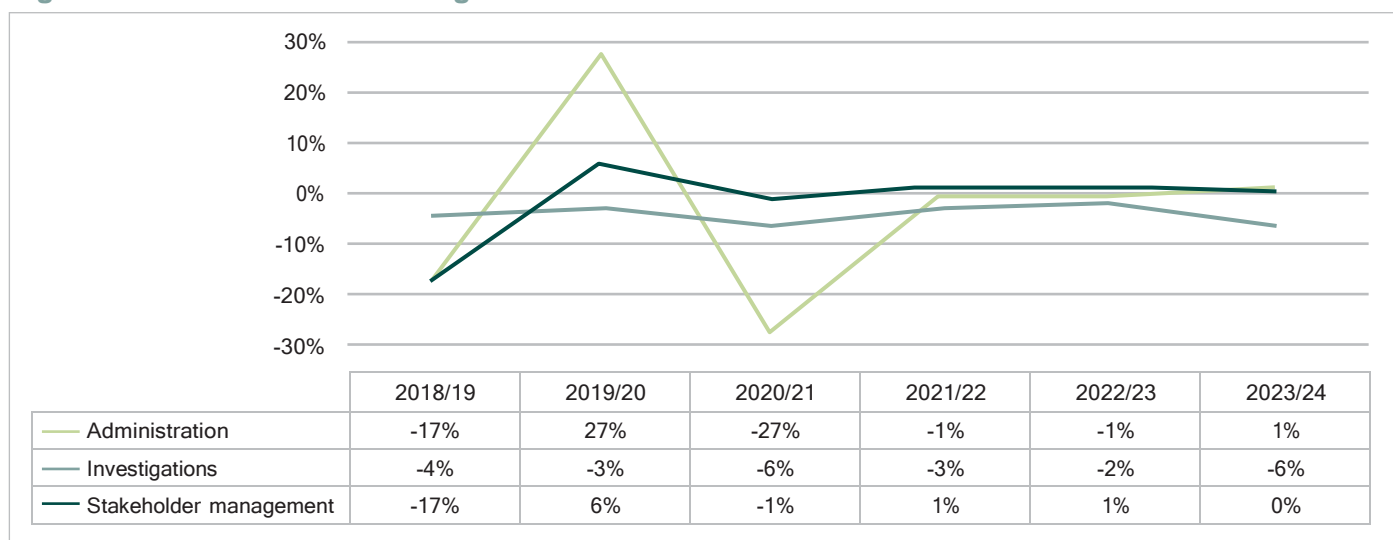
The second-biggest programme is Administration, with an average budget of over 40% over the entire review period, and the MTEF period. Administration mainly focuses on information technology, human resources and skills, ensuring that the Public Protector's mandate is effectively delivered. Stakeholder Management receives the lowest budgetary share, and has consistently registered an average expenditure share of 4% over the last three years. This trend could be concerning given the critical role that this programme is mandated to deliver, such as public awareness on what the Public Protector is about so that communities can report cases of maladministration.

Table 1.8: Public Protector programmes – real values

R million	Audited outcome				Average percentage share	Medium-term expenditure estimate			Average percentage share
	2017/18	2018/19	2019/20	2020/21		2021/22	2022/23	2023/24	
Administration	100.1	83.0	105.6	77.2	41%	76.8	76.0	76.9	41%
Investigations	122.0	116.6	113.6	106.6	52%	103.4	101.5	95.1	54%
Stakeholder management	9.3	7.7	8.2	8.1	4%	8.2	8.3	8.4	4%
Total	236.1	236.4	227.3	191.9	96%	188.3	185.9	180.4	100%

Source: National Treasury (2021) and Commission's calculations

In terms of real growth rates, these sub-programmes have recorded negative growth rates (-10%), which is expected to persist over the MTEF period (-4%) (see Figure 1.2).

Figure 1.2: Public Protector real growth rates

Source: National Treasury (2021) and Commission's calculations

1.7.3.3 Special Investigating Unit (SIU)

The SIU has three programmes: Administration (financial management, human capital, information and communication technology, communication and stakeholder management, and audit risk), Investigations and Legal Counsel (central case registration and monitoring, case assessment, case management and investigations, and forensic, legal and litigation) and Market Data Analytics and Prevention (market data analytics, prevention and advisory, and awareness). Investigations and Legal Counsel accounted for the most significant average budget expenditure in the years under review at 67%. This share is expected to increase by 72% over the MTEF period (Table 1.9). This is followed by Administration, where the average budget share stood at 31% in the last three years. This share is expected to decrease to 25% over the MTEF period. Market Data Analytics and Prevention accounted for merely 2% over the years under analysis. Its average share is expected to maintain a steady rate at 3% over the MTEF period. Given that the purpose of this programme is to implement measures to prevent the reoccurrence of fraud and corruption and increase public awareness of anti-corruption efforts, its average share should not be lower than Administration.

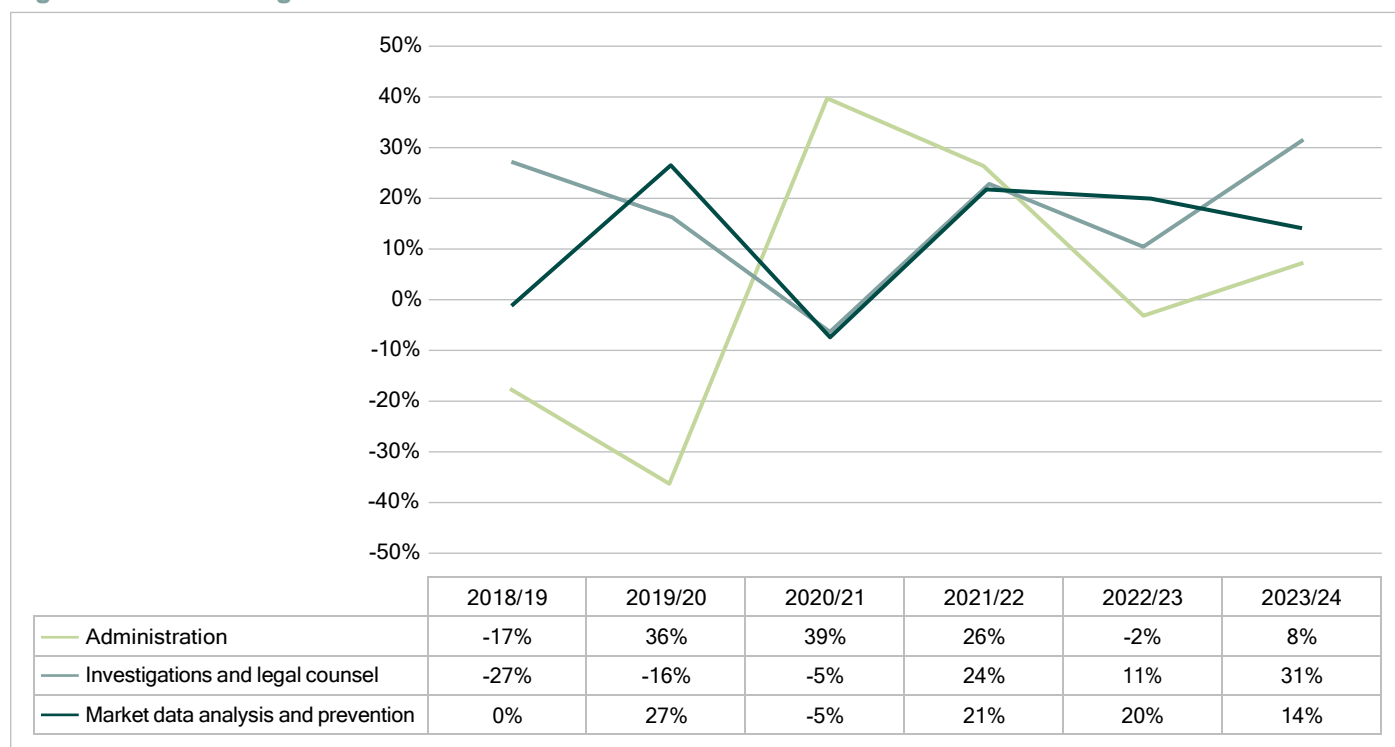
Table 1.9: SIU programmes – real values

R million	Audited outcome				Average percentage share	Medium-term expenditure estimate			Average percentage share
	2017/18	2018/19	2019/20	2020/21		2021/22	2022/23	2023/24	
Administration	155.8	128.7	81.8	113.7	31%	142.8	140.0	151.5	25%
Investigations and Legal Counsel	204.2	260.1	301.6	286.4	67%	356.0	396.2	518.9	72%
Market Data Analysis and Prevention	—	11.2	14.2	13.5	2%	16.3	19.6	22.3	3%
Total	360.0	400.0	397.6	413.6	100%	515.1	555.8	692.7	100%

Source: National Treasury (2021) and Commission's calculations

Generally, the allocations of the SIU's programmes have registered favourable average real growth rates over the last three years (at 5%) and at about 17% over the MTEF period. What is notable is the extraordinary average real growth rate increase in the Investigations and Legal Counsel (22%) and Market Data Analytics (18%) programmes over the MTEF period (see Figure 1.3). This indicates that more attention is given to the core programmes of the SIU in terms of investigating cases of maladministration and corruption, and providing advice and awareness on anti-corruption measures.

Figure 1.3: SIU real growth rates



Source: National Treasury (2021) and Commission's calculations

1.7.3.4 Financial Intelligence Centre

The FIC has three programmes: Administration provides strategic leadership and services to staff to ensure that the organisation is managed efficiently. Delivery of Intelligence on Financial Crimes and Regulatory Services focuses on criminal prosecutions relating to non-compliance, identifies crimes and perpetrators, and assets derived from the proceeds of crime, and provides operational intelligence, including administering the FIC Act and giving advice on matters of strategy and policy relating to money laundering and terrorist financing. Enablement of Financial Intelligence Regulatory Capabilities covers the internal units that enable the efficient, effective and economic functioning of the FIC's service delivery processes through its corporate services.

The FIC's expenditure programme is dominated by the Delivery of Intelligence on Financial Crimes and Regulatory Services, with an average share of 56%. This share is expected to remain the same over the MTEF period (Table 1.10). This is commendable given the critical functional role fulfilled by this programme, such as criminal prosecution relating to non-compliance. The second-largest expenditure is in Enablement of Financial Intelligence Regulatory Capabilities, with an average expenditure share of 25% over the years under analysis. This share is expected to grow by 2% over the MTEF period to 27%. Administration takes the lowest average share with an average expenditure share of 18%. This is projected to decrease to 17% over the MTEF period. What is notable is the close similarity of functional programmes (Administration and Enablement of Financial Intelligence Regulatory Capabilities), which are supportive. Caution should be exercised that there are no overlaps or duplication among these programmes. When these two programmes are combined, they make up over 40% of the average share expenditure.

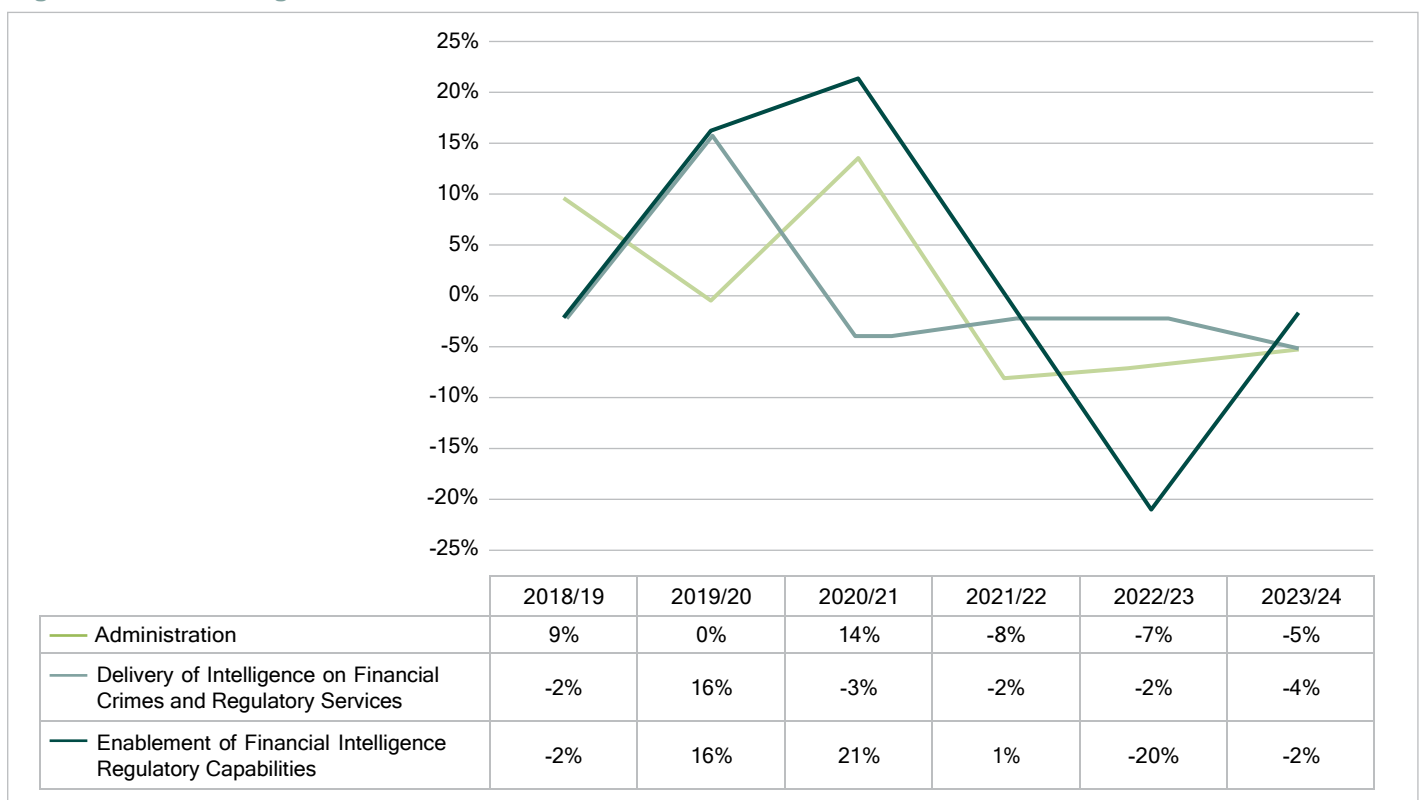
Table 1.10: Financial Intelligence Centre programmes – real values

R million	Audited outcome				Average percentage share	Medium-term expenditure estimate			Average percentage share MTEF
	2017/18	2018/19	2019/20	2020/21		2021/22	2022/23	2023/24	
Administration	29.8	32.6	32.6	37.0	18%	34.2	31.9	30.4	17%
Delivery of Intelligence on Financial Crimes and Regulatory Services	97.6	95.9	111.0	107.1	56%	105.1	103.3	98.7	56%
Enablement of Financial Intelligence Regulatory Capabilities	41.5	40.8	47.4	57.4	25%	58.0	46.2	45.5	27%
Total	56.3	56.4	63.6	67.2	99%	65.7	60.5	58.2	100%

Source: National Treasury (2021) and Commission's calculations

Regarding real growth rates, it is concerning that Delivery of Intelligence on Financial Crimes and Regulatory Services continues to constantly record negative growth rates in the years under review and over the MTEF period (see Figure 1.4). The negative growth rate of this programme is concerning. Given this critical role, it is tasked with closing the loopholes in the South African financial system, especially related to money laundering, and strengthening efforts to combat the financing of terrorism. An overall negative average growth rate (-5.3%) over the MTEF period is recorded in all the programmes of the FIC, which has negative implications for the institution in terms of delivering on its mandate of combating money laundering and the financing of terrorists and related activities, as well as the enforcement of the Act, among other functions.

Figure 1.4: FIC real growth rates



Source: National Treasury (2021) and Commission's calculations

In summary, what is notable in the institutions investigated above is that there are several overlaps in the mandates of these agencies. For example, the SIU, Public Protector and NPA (the Asset Forfeiture Unit) have similar functional programmes that investigate and identify crimes and perpetrators, and assets derived from the proceeds of crime. Such overlaps call for effective mechanisms for the coordination and rationalisation of mandates and programmes.

In terms of funding arrangements, the budget allocations of these institutions vary, with the most significant chunk of the budget taken by compensation of employees. That can be explained by the specialised skill set required for these agencies. On the other hand, these risks crowd out different programmes and services essential to eradicating corruption, such as research, prevention, monitoring and evaluation, and educational awareness campaigns. Generally, what is noted with concern from these institutions is that support programmes or administration consume the second-largest share of their budgets, relative to other core subprogrammes, such as the Asset Forfeiture Unit and the Office of Witness Protection Services within the NPA. Likewise, the Stakeholder Management programme in the Public Protector accounts for the lowest total average share. Yet, it is critical to raise public awareness of what the Public Protector does. A similar pattern can be observed in the SIU, where Administration takes the second-largest portion of the total budget, and Market Data Analytics and Prevention takes the lowest share. This latter programme is about implementing measures to prevent fraud and corruption in the public sector, and increasing public awareness of anti-corruption efforts. Likewise, the FIC has an Administration programme offering support services to the institution, while the Enablement of Financial Intelligence Regulatory Capabilities also offers service delivery through corporate services. Therefore, caution should be exercised to ensure no overlaps or duplication among these programmes.

1.8 Conclusion

South Africa has committed itself to various national and international commitments to eradicate corruption. To that effect, multiple legislations, policies and institutional frameworks are in place, which should repel corruption. However, corruption continues to escalate. The main reason for the failure to effectively address corruption is the lack of accountable and ethical leadership and the lack of consequence management. There is also weak oversight and monitoring by the political and administrative leadership. Reports of the Auditor-General, National Treasury, the SIU and the Zondo Commission, among others, and other reviews, repeatedly indicate that the material irregularities found in all three spheres of government are due to accountability failures. The absence of an independent procurement authority and anti-corruption agency with limited political support frustrates the country's efforts to fight corruption. The existing institutions are subject to chronic political interference.

In terms of institutional analysis, what is notable is that the institutions investigated have similar programmes and have mandates that overlap (such as in the SIU, the Public Protector and the NPA), limiting their efficiency and the effective execution of their tasks. In terms of budget analysis, it was found that the budget allocations of these institutions vary and are within the budget votes of various government departments, with a significant portion of the budget taken by the compensation of employees, which, on the other hand, crowds out other programmes and services that play an essential role in eradicating corruption such as research, prevention, monitoring and evaluation, as well as educational awareness campaigns. Generally, in the budgeting programmes of these institutions, what is notable is that support programmes or administration consume the second-largest total average share of the budget, compared to the institutions' main programmes – such as the Asset Forfeiture Unit and the Office of the Witness Protection Services in the NPA, the Stakeholder Manager programme in the Public Protector, and Market Data Analytics and Prevention in the SIU. In terms of total average real growth rates, these institutions and their programmes recorded negative growth rates, which will impact on the execution of their mandate related to combatting corruption-related activities.

The following key lessons were learnt from the country case studies and the literature reviewed for this chapter:

- Legislative and public finance management reforms are critical in the fight against corruption.
- Establishing anti-corruption agencies or reconfiguring the existing agencies is a crucial factor in addressing corruption.
- Adequate budgets or funding streams are the cornerstones for the effectiveness of institutions mandated to fight and prevent corruption.
- Reforms in the public procurement systems and accountability mechanisms are vital to combat procurement-related corruption, which is endemic in South Africa.
- The active citizenry, public awareness and education programmes in institutions of learning and for government officials on the effects of corruption, and its prevention and eradication, are critical for South Africa.
- The political will, ethics and integrity institutionalisation in government and society is a critical lever for South Africa's fight against corruption.

1.9 Recommendations

The Commission makes the following recommendations:

1. *The prerequisite for any measure to fight corruption and move towards support for anti-corruption reforms is consistent political will for good governance and accountability. Political leadership and a commitment to fight corruption should therefore come from the highest office and the top levels of a country's political system, with the following understanding of accountability:*
 - *Accountability should identify who needs to be accountable to whom and for what? For instance, accountability of political leaders and public officials to organisational effectiveness and efficiency through compliance measures, rules and ethics codes, and oversight bodies taking their legislated responsibilities seriously and committing to repelling corruption by taking swift action and imposing sanctions when the need arises.*

The government has established various structures and institutions to prevent and eradicate corruption, despite corruption levels remaining on the rise. The literature points to the fact that, where there is a lack of political support to combat corrupt activities coming from the highest office (The Presidency), institutions and structures meant to curb corruption become weak due to non-compliance and lack of enforcement. In light of the international arguments above, even though the National Anti-corruption Strategy is currently in place, to support these institutions, strengthening and protecting their independence requires a genuine and consistent political commitment to good governance by the highest level of office in government (The Presidency) and its top political leaders, where tough sanctions are imposed on those who are found guilty of corrupt activities. Further, the Auditor-General is of the view that it has done everything within its mandate to support government departments, including the accountability process through the material irregularity process, but it is not working, and as such, leadership should set the tone at the top cause if those in leadership or accountability positions are unethical, disregard governance issues, as well as compliance and control, and are not committed to transparency and accountability that filters through the lower levels and ranks of the government where, inevitably, a culture of poor discipline, impunity and non-delivery will occur.

2. *The Presidency, in line with political commitment at the top, needs to renew the governance structure of the anti-corruption agencies, through the National Anti-corruption Strategy, on the need for reconfiguration and coordination, among the existing institutional arrangements to repel duplication in these anti-corruption institutions for optimum results, including a reconfigured or dedicated funding framework for the anti-corruption agencies or institutions as a sign of commitment towards the support of anti-corruption agencies.*

In some of the anti-corruption institutions or agencies investigated, it was found that they have similar programmes, with mandates overlapping due to a lack of coordination, limiting their efficiency and the effective execution of their tasks. Not only that, in terms of the budget analysis, it was found that the budget allocations of these institutions vary and are within the budget votes of various government departments. This is an indication of the need for a clear funding framework for these anti-corruption agencies that is streamlined. South Africa adopted the National Anti-corruption Strategy (2020–2030) (NACS) and highlights that lack of coordination by the anti-corruption institutions has hampered efforts towards eradicating corruption and ensuring its implementation. The NACS suggests, among other things, a single high-level entity that would be responsible for the coordination and implementation of anti-corruption measures. Poor funding leads to a half-hearted execution of the mandate, while lack of independence leads to political interference. Therefore, there is a need for a review of the funding framework of the anti-corruption institutions. Similarly, their independence should be guaranteed. The Presidency should lead in supporting the independence of these institutions.

3. *The Presidency should consider establishing a Public Procurement Authority (PPA) that is mandated to show greater transparency and standardisation of government contracts, to organise and manage the public procurement process (rules, regulations, guidelines and policies) and implement a general public procurement policy on behalf of the government, guided by the principles of transparency, fairness and equity, as contained in the Constitution.*

Government is one of the country's largest procurers of goods and services. Procurement per se has the potential to be a transformative tool, while it can also be fertile ground for corruption. Various reports reviewed in this chapter indicated that the many incidences of procurement-related corruption around the COVID-19 process have only demonstrated that procurement-related corruption in South Africa has reached epidemic proportions. Further, the case study reviewed shows that corruption activities can be curtailed through the establishment of a Public Procurement Authority (PPA) as it allows greater transparency and standardisation in the government's contract. Establishing a PPA will go a long way towards demonstrating the political will to tackle corruption and assist in coordinating efforts to address procurement-related corruption across all spheres of government. A PPA will promote a culture of compliance with procurement regulations and consequence management and create an environment that limits misappropriation, fraud and corruption, wastage and abuse of funds. One of the major issues identified as a challenge in the drafting of the NACS was the need to improve the transparency and accountability of the public procurement system to ensure transparency and efficient use of public resources.

4. *A dedicated or joint civil society organisation should be established that educates and empowers society about the dangers and adverse effects of corruption, and advocates for anti-corruption reforms as bottom support to the top-down approach (political will).*

Empirical evidence shows that the bottom-up approach in tackling corruption is essential, as is the top-down approach. A bottom-up approach is when society is part and parcel of efforts to combat corruption. The organisation should be involved in public awareness campaigns, emphasising the importance of reporting corruption. Also, in the drafting of the National Anti-corruption Strategy, the need to empower citizens to combat corruption through awareness campaigns was identified as a major challenge. The collective effort of the organisation should be able to advocate anti-corruption reforms, which will put pressure on political leaders to act against corruption.

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CHAPTER 2:

Youth unemployment and intergovernmental fiscal relations: The case of South Africa

2.1 Introduction

South Africa's estimated population stands at 59.6 million, of which 64% is aged between 0 and 34 years. Youth is defined as that section of the population between 14 and 35 years old. The proportion of the population aged 15-34 years stands at 35.1% (20.6 million) (Stats SA, 2018). South Africa is currently experiencing a demographic transition: a phenomenon where declining mortality and fertility shift the country's population structure. Demographic shifts have created a lower ratio of dependents to working-age adults. Other countries that have undergone this transition have benefitted from economic growth, known as the demographic dividend, which has resulted from this lowered dependency ratio.

Over the past decade, South Africa has experienced slow economic growth and high unemployment rates. The prevailing high levels of unemployment have affected the youth more than other sections of the population. There is broad consensus that youth unemployment in South Africa is at a crisis level and constitutes a national emergency. The high level of youth unemployment can lead to an increased feeling of exclusion and frustration, resulting in instability. Youth unemployment is estimated at 66.5% for youth aged 15-24 years and 43.8% for youth aged 25-34 using the official definition (excluding discouraged work-seekers), compared to the 35.3% of national unemployment (Stats SA, 2022). The 2022 Quarterly Labour Force Survey (QLFS) indicates that, among young people aged 15-24, about 32.8% were classified as not in education, employment or training (NEET), with the majority being female at 34.4%. The poor record of youth employment represents an economic tragedy and poses a significant threat to the stability and eventual health of the South African democracy.

The prevailing high levels of unemployment are not the outcome of a lack of effort from a wide range of sectors and stakeholders in trying to address youth unemployment. A wide range of policies and interventions have focused on addressing the challenge of youth unemployment. Interventions have included using intergovernmental fiscal instruments such as conditional grants and equitable share allocations to boost employment creation. The Employment Tax Incentive (ETI), Expanded Public Works Programme (EPWP) and the recently established Jobs Fund to contribute to the objective of job creation are other interventions. Youth employment interventions include a variety of private sector and civil society interventions, such as the Harambee youth employment accelerator. However, the youth still face several constraints as they navigate their entry into the labour market in South Africa. The challenges faced by the youth in entering the labour market can be categorised into three key types of challenges that negatively impact the transition from education to employment: supply-side challenges, demand-side challenges and institutional challenges.

Supply-side challenges can be perceived as deficiencies in the youth's educational and skills levels, and can be attributed to factors such as: a poor-quality education system, weak foundational, practical and artisanal skills, low completion rates and high dropout rates at the school level.

Demand-side challenges are a result of some of the following factors: a low levels of economic growth, and a structurally skewed labour market that is biased towards senior, experienced workers, combined with a broken value-chain industry. A decrease in the relative demand for low-skilled labour has occurred because of the decline in sectors that constitute the lesser skill-intensive parts of the South African economy.

Institutional challenges can be considered market failures and uncoordinated labour market interventions, resulting in initiatives that seem successful at a micro level, but appear to have no significant impact on reducing the high unemployment rate among young people in the country. Such challenges stem from a lack of information on available jobs and weak employment services (e.g. counselling and career guidance), a lack of explicit coordination between actors like the National Youth Development Agency (NYDA), the Jobs Fund, the Department of Employment and Labour, and the Presidency.

Still, the youthfulness of South Africa's population presents both opportunities and risks for South Africa regarding its potential contribution to economic growth and stability. If properly harnessed, the youthfulness of the population has the potential to drive South Africa's economic transformation. Education, skills development and job creation have become crucial for South Africa's future. The commitment to education is shown by the increase in student funding from R11.8 billion in the 2016/17 financial year to R36.2 billion in the 2020/21 financial year (NSFAS, 2020; 2021). The exponential growth in funding is primarily driven by introducing fee-free higher education in South Africa. For instance, in 2019, the National Student Financial Aid Scheme (NSFAS) – an entity in the fee-free regime – supported over 720 000 students, constituting 42% university and 70% technical and vocational education and training (TVET) college registrations. The government's financial commitment is because of the wide recognition of a positive correlation between skills, education, productivity and economic growth. Young people's education and skills development improve their capacities and capabilities to participate in the labour market and enhance their employment opportunities. The development of any country depends, among other things, on the number of persons in employment and how productive they are at work.

Against this background, this chapter of the submission contributes to policy debates on youth employment in South Africa. It also contributes to the understanding of different skills development and training programmes that have been set up through various publicly funded institutions to facilitate entry into the labour market. Generally, it aims to understand the effectiveness of the fiscal framework and relevant public institutions in addressing youth development and unemployment challenges.

2.2 Fiscal framework: spending and taxes

A wide range of policy efforts, interventions and programmes are being implemented to deal with youth and overall unemployment. The interventions to address youth unemployment include the Employment Tax Incentive. This tax incentive intends to stimulate demand for young workers. The Expanded Public Works Programme has youth targets and different training programmes led by public sector agencies and civil society. Table 2.1 summarises various publicly funded institutions that are aimed at addressing skills shortages, and youth unemployment and development. The interventions are funded through various intergovernmental fiscal instruments. For example, the EPWP is funded through transfers and subsidies.

Table 2.1: Summary of key youth employment interventions

Intervention	Purpose
Employment Tax Incentive	The ETI is a tax incentive that aims to encourage employers to employ the youth. It was implemented with effect from 1 January 2014. It aims to reduce the employer's cost of hiring young people through a cost-sharing mechanism with the government, allowing the employer to reduce the amount of Pay-As-You-Earn (PAYE), while leaving the wage received by the employee unaffected.
Jobs Fund	One of the main objectives of the Jobs Fund is to co-finance projects by public, private and non-governmental organisations that can significantly contribute to the objective of job creation. It involves using public resources to catalyse innovations and investments on behalf of different stakeholders in activities that contribute directly to employment creation in South Africa.
Extended Public Works Programme	The EPWP is a government intervention aimed at contributing to government's priorities of decent work and sustainable livelihoods, education, health, rural development, food security and land reform, and the fight against crime and corruption. The objective is to create work opportunities for poor and unemployed people in South Africa. In this intervention, public bodies from all spheres of government and the non-governmental sector (supported by government incentives) are anticipated to create work opportunities for the unemployed in South Africa through delivering public and community services.
National Youth Development Agency	The NYDA operates in a context of legislative frameworks, such as the National Youth Development Agency Act, the National Youth Policy and the Integrated Youth Development Strategy, as adopted by the Youth Convention of 2006. The institution was established to address youth development issues at the national, provincial and local government levels.
Sector Education and Training Authority	The Sector Education and Training Authority (SETA) is a vocational skills training organisation in South Africa. There are currently 21 SETAs in different sectors in South Africa. Each SETA has the responsibility for managing and creating learnerships, internships, skills programmes and apprenticeships within their jurisdiction.

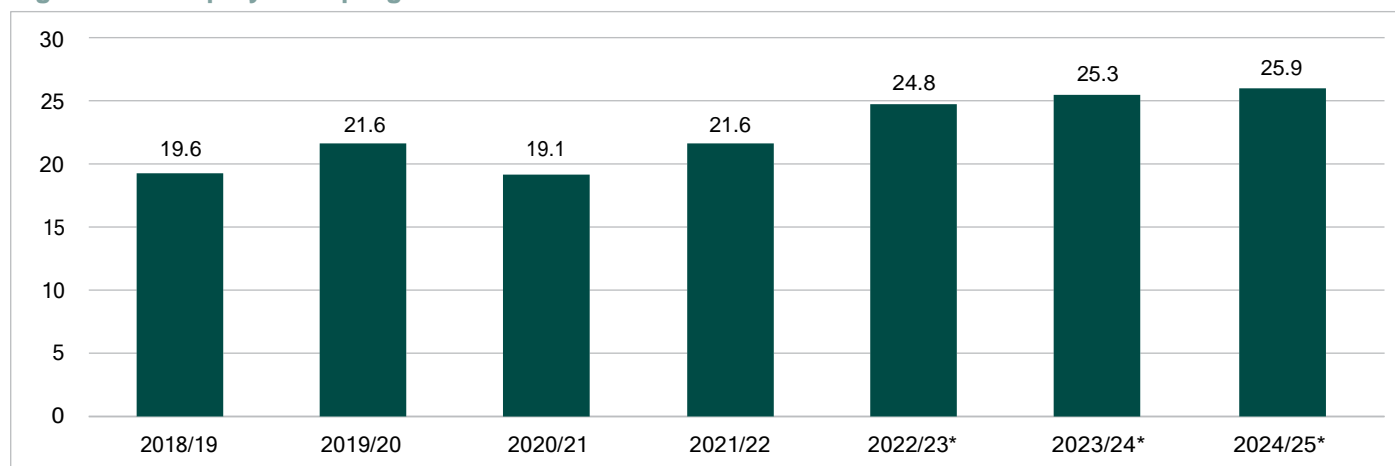
Source: Commission's compilation

These government interventions aim to tackle the high unemployment rate from two fronts. Firstly, from the demand side, by increasing economic growth and job opportunities, and secondly, from the supply side, by improving the workforce's skills. Despite policy and programmatic attention focusing on both the demand and supply sides, South Africa has not shifted the youth unemployment challenge over the past two decades.

The government has committed significant resources to promote the growth and employment needed to build on recovery following a deep contraction due to COVID-19. The government aims to stimulate the economy through public employment programmes and tax incentives while implementing reforms that ease the skills constraint and make it easier to do business. Figure 2.1 shows that the government allocated R24.8 billion for employment programmes¹ for 2022/23. The allocation increased from an estimated expenditure of R21.6 billion in 2021/22. Over the Medium-term Expenditure Framework (MTEF) period (2022/23 to 2024/25), the government plans to spend R76 billion on employment programmes. Some of this expenditure will be through the Presidential Youth Employment Intervention (PYEI).

¹ Employment programmes include the EPWP, the Community Works Programme and the Jobs Fund

Figure 2.1: Employment programmes R' billion



Source: National Treasury, 2022

The PYEI is part of the Presidential Employment Stimulus Programme. The PYEI is a multi-sector action plan or programme that addresses South Africa's chronic youth unemployment challenge. The funding framework used for the PYEI is in the form of conditional grants and increases in equitable shares. An amount of R18.4 billion has been allocated in 2022/23 and 2023/24 to support youth employment and the creation of short-term jobs under the Presidential employment initiative. In the 2022/23 financial year, R9 billion has been allocated with a target of 513 905 short-term jobs, and in 2023/24, R9.4 billion has been allocated, targeting 515 905 short-term jobs. Short-term jobs play an important role in providing work experience for the youth and first-time entrants, and facilitate entry into the labour market. Short-term employment also plays a vital part in providing income support, mitigating the effects of poverty and boosting household consumption. Despite the critical role played by short-term work, sustainable long-term work still offers more benefits.

Table 2.2: Presidential Youth Unemployment Programme

Department	Name of initiative	2022/23		2023/24	
		Budget allocation (R' 000)	Targeted short-term jobs	Budget allocation (R' 000)	Targeted short-term jobs
National Treasury:	Metro Presidential Employment				
Neighbourhood Development Partnership Grant	Programme Innovation Grant Placemaking in Townships, Informal Settlements and Inner Cities	800 000	33 000	855 600	33 000
Employment and Labour	Pathway Management Network	304 934	127 500	372 234	127 500
Trade, Industry and Competition	Social Employment Fund	861 566	33 000	787 941	35 000
National Treasury:	Basic Education: Presidential				
Provincial Equitable Share	Employment Initiative	6 199 000	250 000	6 463 000	250 000
Higher Education and Training	Graduate Placement in Universities	94 500	3 000	99 225	3 000
Higher Education and Training	National Skills Fund: Pay for Performance Model	100 000	8 000	110 000	8 000
Sport, Arts and Culture	Creative Sector Support	440 000	24 405	462 000	24 405
Women, Youth and Persons with Disabilities	National Youth Service	200 000	35 000	250 000	35 000
Total		9 000 000	513 905	9 400 000	515 905

Source: National Treasury, 2022

Employment programmes include the EPWP, the Community Works Programme and the Jobs Fund Sustainable labour market participation for younger employees has become increasingly important because it facilitates broader economic inclusion. Long-term employment can promote long-term decisions such as investment in human capital and assets. Sustainable work means achieving living and working conditions that support people in engaging and remaining in work throughout extended working life. The PYEI gives the youth work experience and income, but remains limited in addressing long-term youth unemployment.

2.3 Research methodology and data

2.3.1 Budget analysis

The research project uses budget analysis to determine the effectiveness of the fiscal framework in addressing the challenge of youth development and employment. The budget analysis will also look at the funding framework and performance of programmes directed at youth unemployment. The budget analysis describes expenditures trends. From these, inferences are drawn on the efficiency of the fiscal framework.

The research uses secondary data from National Treasury and other official statistics sources. Secondary data analysis is a convenient and powerful tool for a research project that addresses broad questions such as youth unemployment. A major advantage of using secondary data is the breadth of data available. Government keeps a large scale of spending data on labour market interventions that would otherwise be difficult and time consuming to collect. Another significant advantage of using secondary budget data is that a consistent framework often guides the data collection process over several fiscal periods.

The research project adopts an institutional analysis approach – an institutional analysis method for identifying policy instruments and interventions facilitating youth labour market participation. The term institution refers to different entities, including organisations and the rules used to structure the functioning of the labour market. The institutional analysis looks at how effectively the established institutions support youth development and employment. Some organisations that facilitate the youth labour market participation include the NYDA and the SETAs.

2.3.2 Econometric model

The research estimates the effect of government spending on unemployment in South Africa. This study uses an ordinary least squares (OLS) model. Data is firstly tested for stationarity using the Dickey-Fuller and the augmented Dickey-Fuller tests. The study adopts the model outlined in Baxter and King (1993), as discussed further by Fatas and Mihov (2001), who regressed employment against fiscal and non-fiscal variables.

Unemployment is modelled as a function of fiscal policy variables (government consumption spending, government investment spending and tax). This is expressed as follows:

$$Unemp = \beta_0 - \beta_1_{govspending} - \beta_2_{govinvestment} + \beta_{3tax} + \varepsilon$$

The variables are converted to logarithms to remove trends. The study uses annual time series data covering the period 2000 to 2021. OLS regression is a common technique for estimating coefficients of linear regression equations, which describe the relationship between one or more independent quantitative variables and a dependent variable.

2.4 Findings

The role of government spending as a source of growth and reduction of unemployment continues to be widely debated in both developing and developed countries. Theoretically, government spending can reduce unemployment by increasing aggregate demand and the rate of economic growth. In other words, the level of unemployment depends on aggregate demand. In this theoretical framework, the government pursues an expansionary fiscal policy to boost demand for workers. The South African government has committed significant resources to support employment and economic growth.

The econometric model presented below shows that government investment (gross fixed capital formation) reduces unemployment, and government spending has not decreased unemployment. Several reasons can explain the relationship between government spending and unemployment. Some of the key reasons include unemployment being structural and the pattern of South Africa's labour market structure. Other reasons include the effect of the expenditure being related to the crowding-out effect of spending.

The study reviewed a selected number of labour market interventions to determine their effectiveness in addressing youth unemployment. Labour market interventions play an important role in facilitating entry into the labour market and broader economic participation. The evidence shows that, even though labour market interventions have resulted in some economic opportunities at a micro-level for young people, these interventions have had no significant impact on reducing the high unemployment rate. Policy and coordination need to break the silo approaches between government departments to promote better efficiencies and synergies.

2.4.1 *Impact of government spending on unemployment*

The evidence shows that government spending positively affects unemployment, which means that increases in government spending have not reduced unemployment. The effect of government expenditure could be related to the crowding-out effect of spending. Rising public sector spending drives down or eliminates private sector spending, which is needed to generate jobs.

Government investment has a negative sign, which means that government investment has a decreasing effect on unemployment. Government investment expenditure therefore reduces unemployment. The government must focus more on investment expenditure that creates employment for the people than on consumption expenditure. In other words, the proportion of gross fixed capital formation expenditure in the composition of the budget profile should increase progressively. Consumption expenditure should be reduced. There is a need to remove structural and institutional rigidities (unemployment benefits, employment protection and minimum wage legislation) that impact on private investment and the reduction of unemployment.

The evidence that increases in public spending may not reduce unemployment corroborates with an earlier study by Murwirapachena et al. (2013), who showed, using a vector autoregression (VAR) model, that government consumption expenditure and tax positively affect unemployment, while government investment expenditure has a negative impact on unemployment in South Africa. More recently, Onodugo et al. (2017) showed that capital expenditure and private sector investment, in both the medium and the long term, are catalysts towards the reduction of unemployment.

Table 2.3: Impact of government spending on unemployment

Dependent variable: log Unemployment				
Method: Ordinary Least Squares				
Variable	Coefficient	Standard error	t-statistic	Probability
C	26.483	3.814	6.943	0.0000
Government spending	0.187*	0.092	2.038	0.0565
Gross fixed capital formation	-0.782***	0.171	-4.572	0.0002
Tax	0.281	0.311	0.902	0.3789
R-squared	0.769	Mean dependent variable		25.70768
Adjusted R-squared	0.730	Standard deviation dependent variable		2.067177
Standard error of regression	1.073	Akaike information criterion		3.142263
Sum squared resid	20.734	Schwarz criterion		3.340635
Log likelihood	-30.565	Hannan-Quinn criterion		3.188994
F-statistic	19.968	Durbin-Watson statistics		1.283634

Note: *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Source: Commission's estimates

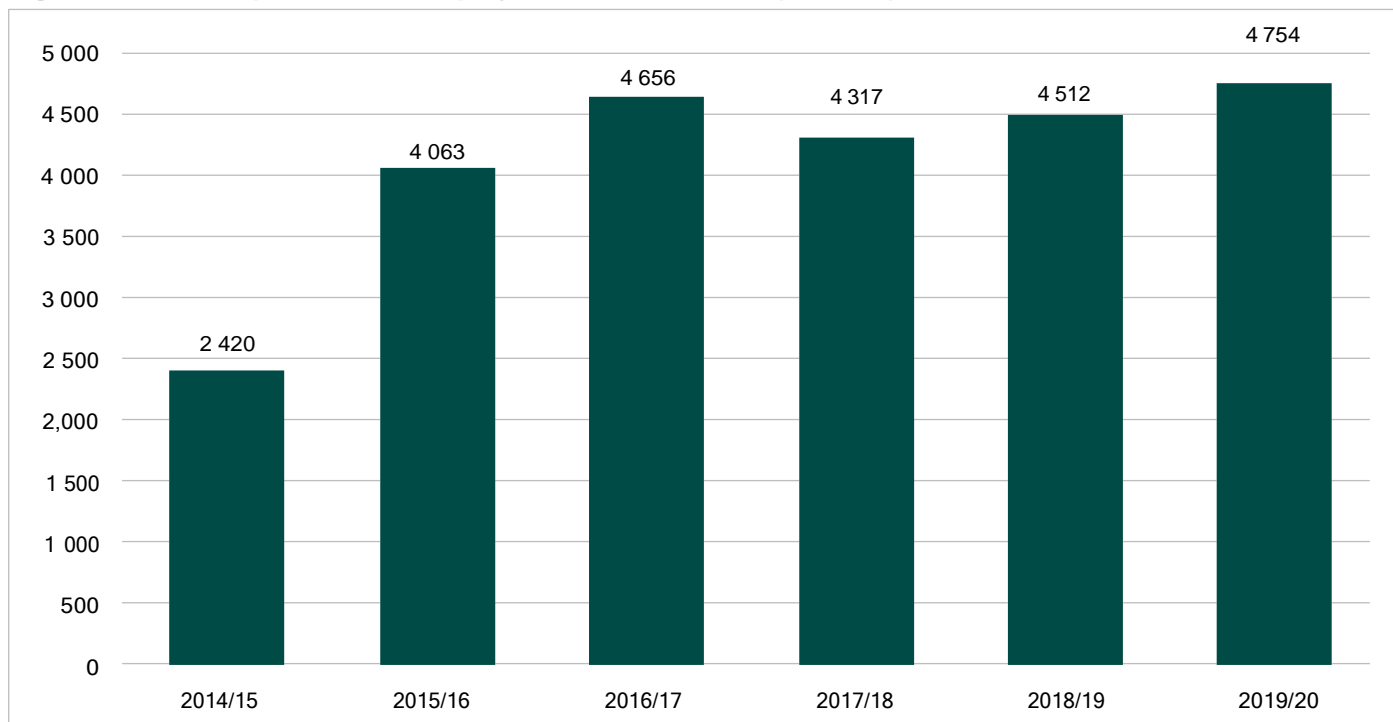
The effect of government spending on unemployment can also result from the structural nature of South Africa's unemployment. Structural unemployment results from shifts in the economy and workers who lack the entry-level and appropriate skills required for them to find employment. Conversely, cyclical unemployment is related to swings in the business cycle and periods of negative growth, such as recessions. In other words, cyclical unemployment is associated with the low demand for goods and services. In a simple Keynesian macroeconomic model, the solution to cyclical unemployment during a recession is expansionary fiscal policy, such as tax cuts to stimulate consumption and investment, or direct increases in government spending that would shift the aggregate demand curve to the right. However, South Africa's unemployment has been persistent over long periods and has not been responsive to increases in government spending. The implication is that the scope for fiscal policy interventions to boost employment seems to have diminished.

2.4.2 Employment Tax Incentive

The Employment Tax Incentive (ETI) is a South African wage subsidy intervention with tax relief for hiring young workers who are paid less than R6 000 per month. It is designed as a tool to combat high levels of youth unemployment. Figure 2.2 shows the amount claimed by taxpayers under the ETI. In 2014/15, R2.42 billion was claimed from the incentive. The amount increased to R4.65 billion in 2016/17, before decreasing to R4.31 billion in 2017/18. The moderate increases in the ETI's claims indicate that the uptake has been slow, with only a small number of taxpayers claiming the incentive. The low tax expenditure values and number of beneficiaries imply that this incentive may not be appropriate for achieving its objective.

In the 2022 budget, National Treasury announced that the ETI was to be expanded to encourage businesses to increase youth employment. The expansion of the ETI is through a 50% increase in the maximum monthly value to R1 500 that can be claimed. Further to the expansion, the government must investigate whether it should publish the number of corporate beneficiaries of incentives and the related amounts to enhance tax expenditure transparency. Publishing beneficiaries will enrich understanding and research on tax incentive dynamics and efficiency.

Figure 2.2: Tax expenditure – employment tax incentive (millions)



Source: National Treasury, 2022

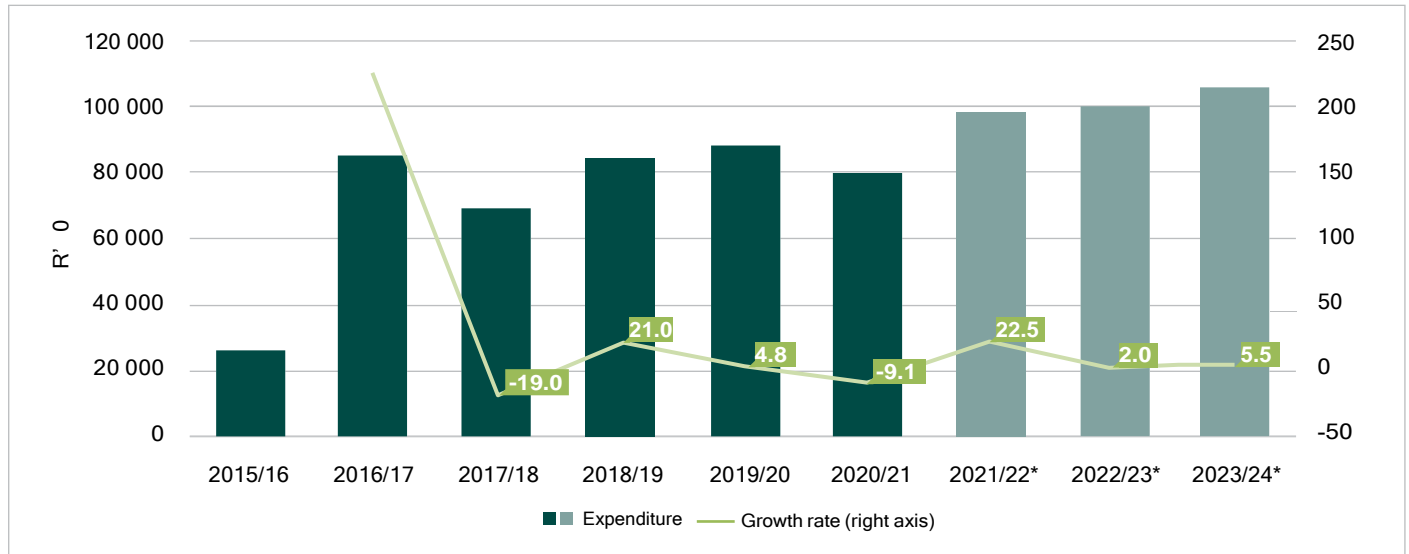
Empirical studies that examine the effect of the ETI on youth unemployment show mixed results. An early survey of Ranchhod and Finn (2014) found that the subsidy had no statistically significant impact on youth employment. This study used the approach of comparing ETI- and non-ETI-claiming firms before and after the introduction of the ETI. In contrast to these findings, Rankin and Chatterjee (2016) found a positive effect of the ETI on overall job creation for youth, particularly in small firms, when they examined ETI-claiming firms. A more recent study by Borat et al. (2020) estimates the impact of the ETI using individual and company tax returns for the period 2013–2016. The study uses a difference-in-difference methodology, combined with propensity score matching. The impact of the ETI is statistically significant, but small in magnitude. When employment levels decrease, the paper estimates that for every one job lost in a non-ETI-claiming firm, ETI-claiming firms only lost between 0.51 and 0.66 jobs on average.

The general understanding has been that high unemployment may result from wage levels that are too high. The labour cost, particularly the labour of new entrants where productivity is unknown, is a key determinant of unemployment, especially for youth who lack experience. The existing labour market regimes, therefore, unfairly penalise new entrants. The introduction of the ETI aims to reduce the cost of employing the youth, which results in a reduction of youth unemployment, as employers would have an incentive to hire younger workers. The evidence of the effectiveness of the ETI is not conclusive, but, on balance, it seems to suggest that it contributes to youth employment. The ETI shows some level of incentivising short-term employment by the private sector in South Africa. There is a need to consider expanding and deepening the employment tax incentive to encourage hiring in the private sector, particularly for those facing more constraints to labour market integration, such as young people and women. The expansions should focus on increased uptake among small businesses and should include additional efforts to evaluate the impact and understand firm behaviour to strengthen effectiveness.

2.4.3 National Jobs Fund

The Jobs Fund offers a targeted programme of support for effective labour market interventions that promise job creation in the short to medium term and the uptake of successful job creation models by the market in the long term. At its establishment, the Jobs Fund was capitalised with R9 billion to support initiatives that pilot innovative approaches to employment creation. The multi-year investment leverages complementary funding from public and private sector project partners. It operates as a “challenge fund” and allocates matching grants following a competitive, open and transparent application process. A challenge fund is a financing mechanism to allocate (grant) funds for specific purposes using competition among organisations as the lead principle. Proposals are assessed against transparent and predetermined criteria. Successful applicants must usually match a certain percentage of the grant with own financing.

Figure 2.3: Jobs Fund expenditure



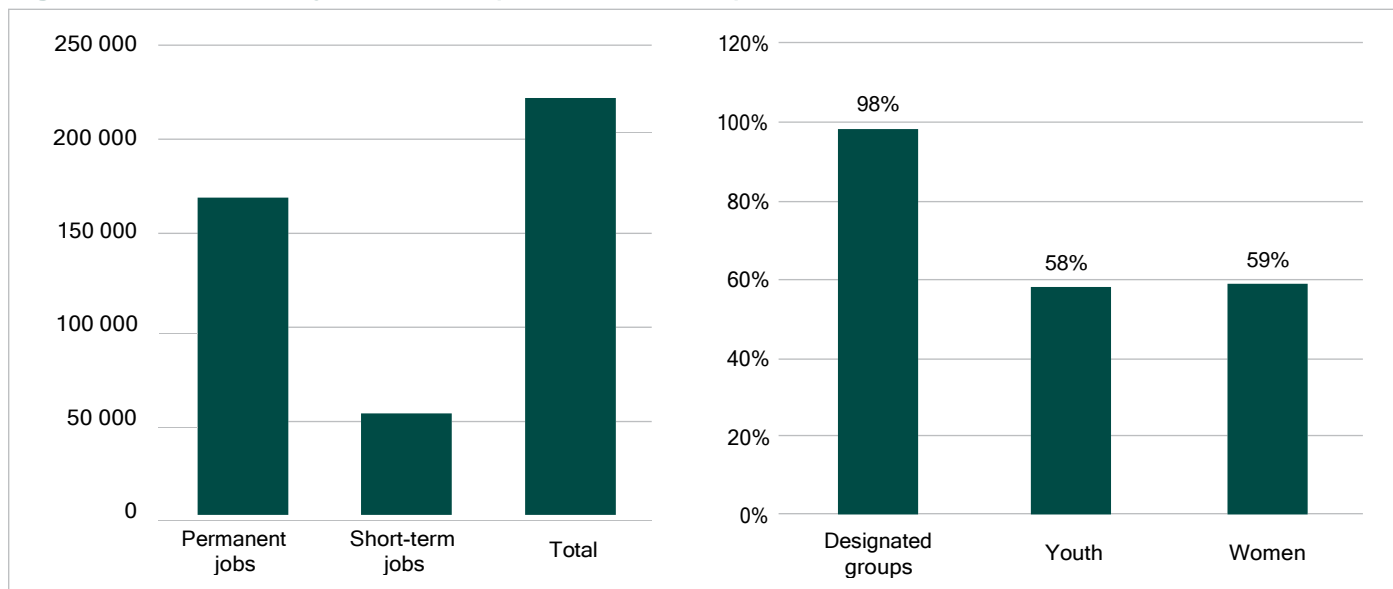
Source: National Treasury, 2022

The Jobs Fund explores options for tackling barriers to job creation by providing public funding through four funding options: enterprise development, support for work seekers, institutional capacity building and infrastructure investment. Figure 2.3 shows expenditure in the Jobs Fund for the period starting in 2015/16. The Jobs Fund expenditure increased from R26.2 million in 2016/17 to R80 million 2020/21. This represents an average expenditure growth rate of 45% from 2016/17 to 2020/21. In the MTEF period (2021/22 to 2023/24), average expenditure growth is estimated to be at 10%.

The Jobs Fund aims to complement other efforts by both the public and the private sector with targeted programmes of support for effective labour market interventions. It supports interventions with the promise of job creation in the short- to medium-term. The goal is to achieve successful job creation interventions that the government and the private sector can replicate to achieve maximum impact over the long term.

Figure 2.4 shows that the Jobs Fund has created 220 000 jobs as of March 2019. In these jobs, 76.2% (167 676) are permanent jobs and 24.5% (53 891) are short-term jobs. The Jobs Fund targets designated groups such as women and the youth, and some of the largest projects approved aim at youth employment. In the jobs created by the Jobs Fund, the youth accounted for 58%, and women accounted for 59%. Designated individuals accounted for 98% of those who benefited from the jobs created. The Jobs Fund shows elements of success in creating employment at a micro-level. The success in targeting the youth and women is commendable, but this has not translated into a change in the overall unemployment trend in South Africa.

Figure 2.4: Number of jobs created (as of March 2019)



Source: National Treasury, 2022

Box 1: Case study on Jobs Fund employment creation

The Jobs Fund has been funding innovative approaches to addressing unemployment in South Africa. This has included funding three quite different business incubators: A2Pay, the Awethu Project and Shanduka Black Umbrellas (SBU). As business incubators, these companies help new and start-up companies to develop by providing services such as management training, access to finance and networks.

A2Pay, the Awethu Project and SBU were first awarded funding by National Treasury's Jobs Fund in 2011. Over the three-year Jobs Fund funding period, each incubator had a jobs target for growth in incubating employment. A2Pay created 2 868 jobs (against a target of 3 128), the Awethu Project created 239 jobs (against a target of 1 000) and SBU created 294 jobs (against a target of 157).

Incubation training and mentorship is vital for young entrepreneurs and helps new entrepreneurs obtain important business knowledge and develop a wide range of personal and business skills that are vital for success as both an entrepreneur and a participant in the labour market. Incubation (including public sector funding for incubation) is one effective approach to address youth unemployment.

One of the key constraints identified by the Jobs Fund to scale up the impacts of the business incubators is the shortage of opportunity-driven entrepreneurs in South Africa. A strategy is needed to enhance the role of the basic and higher education systems in providing a foundation for opportunity-driven entrepreneurship. It requires integrating entrepreneurship into the curriculum of both the general schooling and the higher education system. Other weaknesses that undermined the optimal achievement of its objectives include poor support with networking, inconsistencies in the mentoring approach, and challenges in assisting with access to finance.

One of the critical limitations of the Jobs Fund is that it uses the principle of “match challenge funding” to support the facilitation of employment. Access to capital is one of the critical constraints to the youth starting their own businesses and creating their own employment. Facilitating access to capital is essential to address youth unemployment, either directly by enabling the youth to start their own businesses to employ themselves, or indirectly by helping existing firms expand and hire youth. The youth is affected more by lower rates of financial inclusion than adults. They have not accumulated savings or assets as collateral, which is a pre-condition for most traditional loans

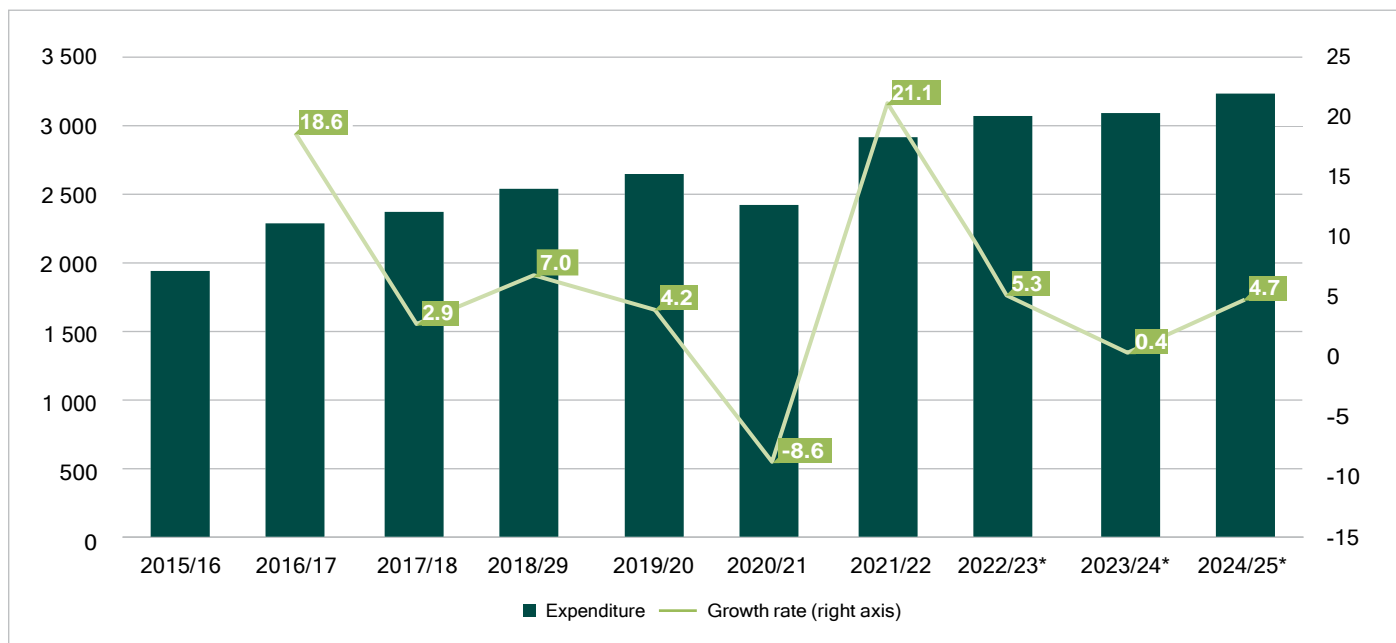
The match funding principle of the Jobs Fund disadvantages those small and medium businesses that do not have access to capital. The conclusion is that there is a need to consider alternative funding channels that take the limitations faced by the youth regarding access to capital into account. Accompanying this must be a general improvement of the business climate, the entrepreneurship ecosystem, access to financing and investing in skills. The government can encourage self-employment and support micro and small enterprises by addressing barriers to entry and lack of competition.

2.4.4 Extended Public Works Programme

Public works programmes are popular development interventions due to their potential “double dividend” of transferring income to the poor, while at the same time creating public infrastructure. South Africa’s EPWP is one of the government’s key labour market interventions that aim to provide work opportunities and training, while alleviating poverty. The EPWP is a nationwide programme aimed at poverty alleviation through the systematic use of public expenditure to boost productive employment and develop marketable skills among targeted groups. It has three key objectives: providing work to the unemployed, building the skills base of the unskilled, and building public infrastructures such as roads, schools and other amenities. Figure 2.5 shows the expenditure trends from the 2015/16 financial year. These trends show that the growth rate slowed from 7% in 2018/19 to 4.2% in 2019/20.

The slowdown in expenditure can be associated with lockdown regulations to curb the spread of the coronavirus, which had a profound impact on economic activity and the labour market. Despite the slowdown in expenditure, the EPWP remains a crucial tool to protect the most vulnerable against shocks and develop skills, while improving local infrastructure and promoting social and economic development. The EPWP has created 55 368 full-time equivalent (FTE)² work at the national level. The wages paid to employees on EPWP projects are calculated by multiplying the minimum wage rate by the person's days of work. The EPWP has positive welfare effects by providing income to participants and potential benefits in the labour markets and service delivery.

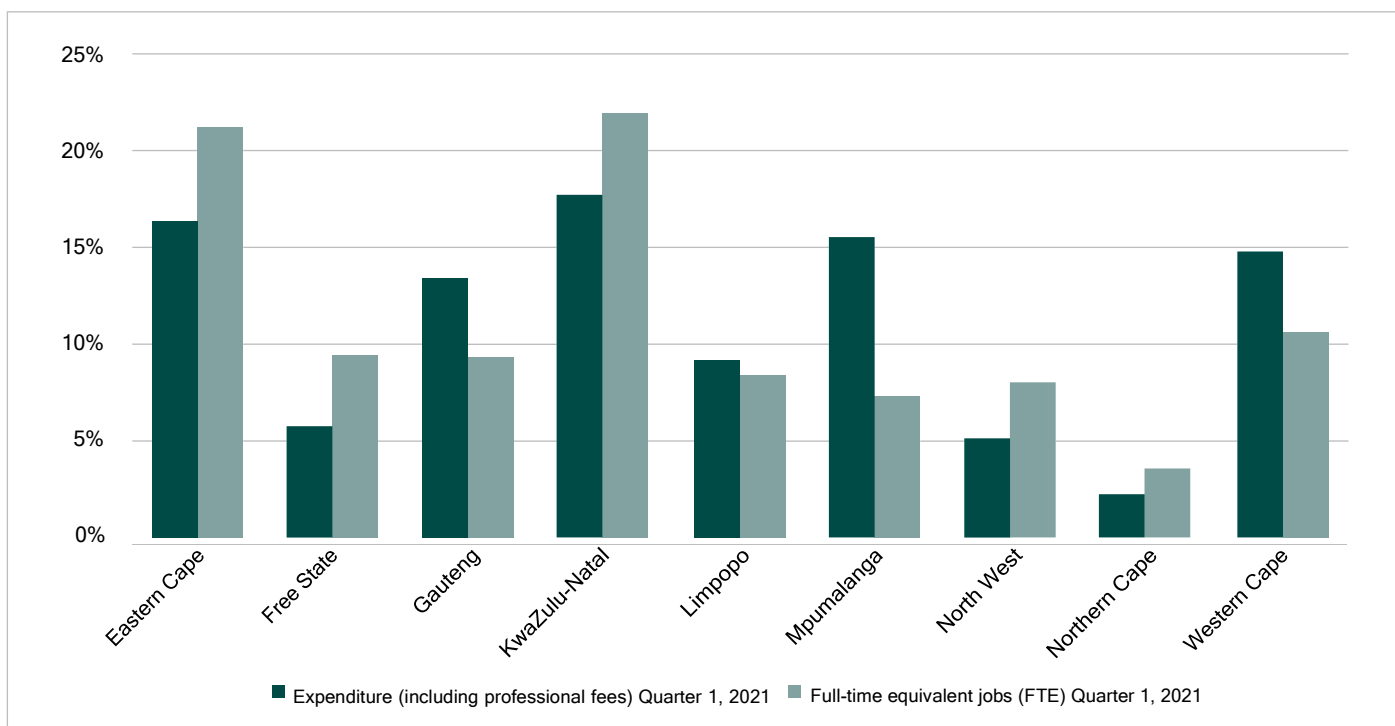
Figure 2.5: Extended Public Works Programme expenditure



Source: National Treasury, 2022

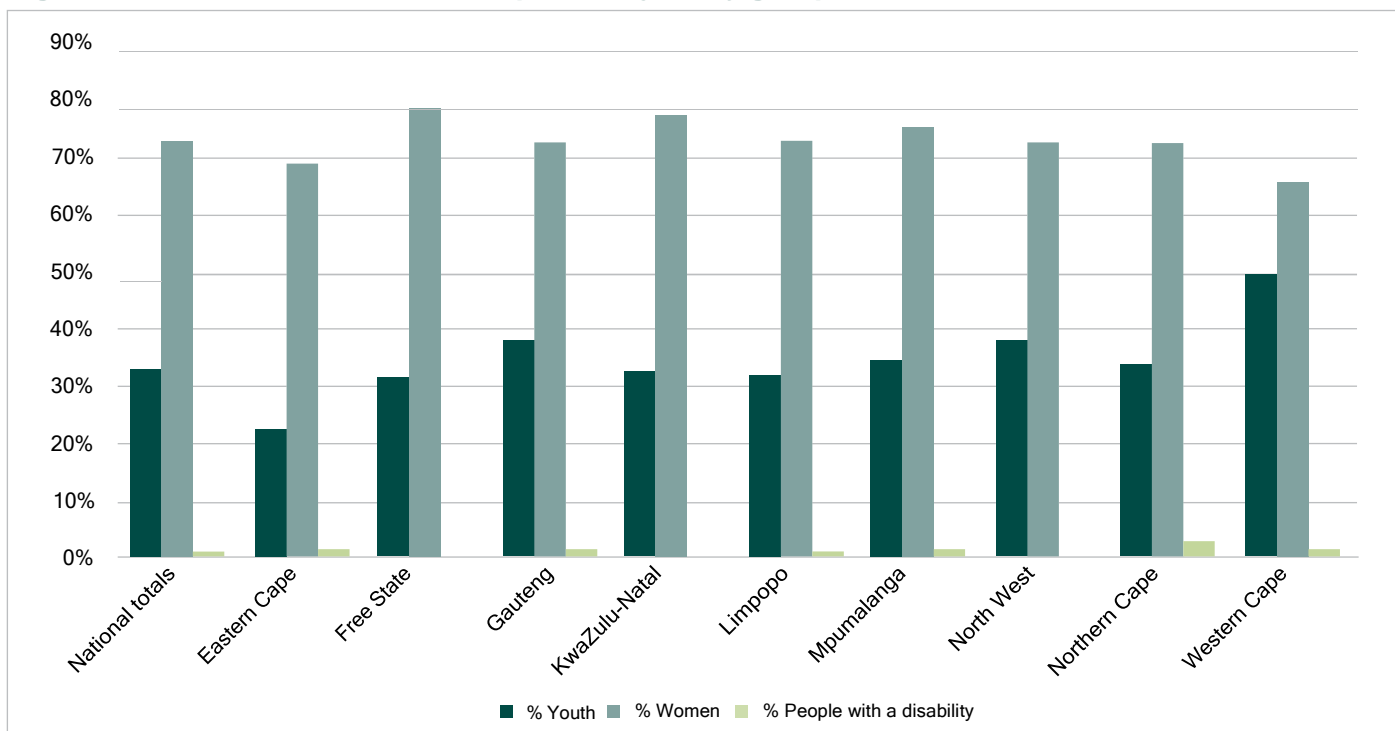
² Full-time equivalent work is where one person-year of work is equal to 230 paid working days, including paid training days. A work opportunity is paid work created for an individual for any period of time. The same individual can be employed on different projects. Each period of employment will be counted as a work opportunity.

Figure 2.6: EPWP expenditure and full-time equivalent jobs by province



Source: Department of Public Works and Infrastructure (2021 Quarter 1)

Figure 2.7: Distribution of full-time equivalent jobs by group



Source: Department of Public Works and Infrastructure (2021 Quarter 1)

The EPWP is one way provincial and local governments can respond to service delivery issues and local unemployment. Figure 2.6 shows the provincial expenditure distribution and the percentage of FTE jobs created for the first quarter of 2021. KwaZulu-Natal and Eastern Cape accounted for 22.1% and 21.3% of FTE jobs created in the first quarter of 2021, respectively. The Northern Cape and Mpumalanga accounted for 3.6% and 7.3% of FTE jobs created in the first quarter of 2021, respectively. Provinces such as Gauteng, the Western Cape, Mpumalanga and Limpopo have higher spending than the number of jobs created. Rural areas such as the Eastern Cape, Free State and KwaZulu-Natal are doing comparatively well in creating FTE jobs.

Public employment programmes are critical in addressing some of the barriers young people face in gaining meaningful skills and accessing decent work. South Africa aims to boost youth employment through the EPWP by reaching 40% women and 30% youth. The national average of youth who benefited from work and training is 32.72%, and the national average of women who benefited is 79.9%. Figure 2.7 shows that, despite accounting for 21.3% of FTE jobs, the Eastern Cape has a lower percentage of youth benefitting from EPWP work at 22.4%. The Western Cape has a relatively higher number of youth benefitting from EPWP work and training at 49.32%, even though it created only 10.5% FTE jobs.

The uneven success in targeting the youth and designated groups indicates limited collaboration and cooperation. Improved targeting of participants through community participation and strengthening collaboration can enhance the effectiveness of enabling youth participation. Synergies among lead departments and other stakeholders, introducing greater uniformity and standardisation across the various EPWP projects through universal principles is essential.

The programme is not aimed at tackling the structural roots of the unemployment problem, but focuses on short-term work opportunities because of the constrained nature of work in some industries, where it is most commonly involved (such as once-off maintenance projects). Creating temporary rather than sustained employment (which would be more suitable in the context of South Africa's unemployment challenge) means that the EPWP is limited in its ability to address the deeper problem of unemployment in South Africa.

To address the challenge of unemployment sustainability, which is primarily structural rather than cyclical, South Africa requires, among other things, inclusive economic growth. A stable macroeconomic policy environment, foreign direct investment, an infrastructure base, an education system and regulatory frameworks are essential for economic growth. Government should implement growth-enhancing structural reforms that promote economic transformation, support labour-intensive growth and create a globally competitive economy.

2.4.4.1 EPWP Incentive Grant

The EPWP Incentive Grant is an intergovernmental fiscal instrument that encourages labour-intensive methods and approaches at a provincial and municipal level. The EPWP Incentive Grant aims to provide additional funds to those provinces and municipalities, creating more work using their available budgets. The grant incentivises provinces and municipalities that employ a certain number of low-skilled, unemployed persons willing to work, defined as the EPWP target group.

Figure 2.8: EPWP Incentive Grant for Provinces and Municipalities



Source: National Treasury, 2022

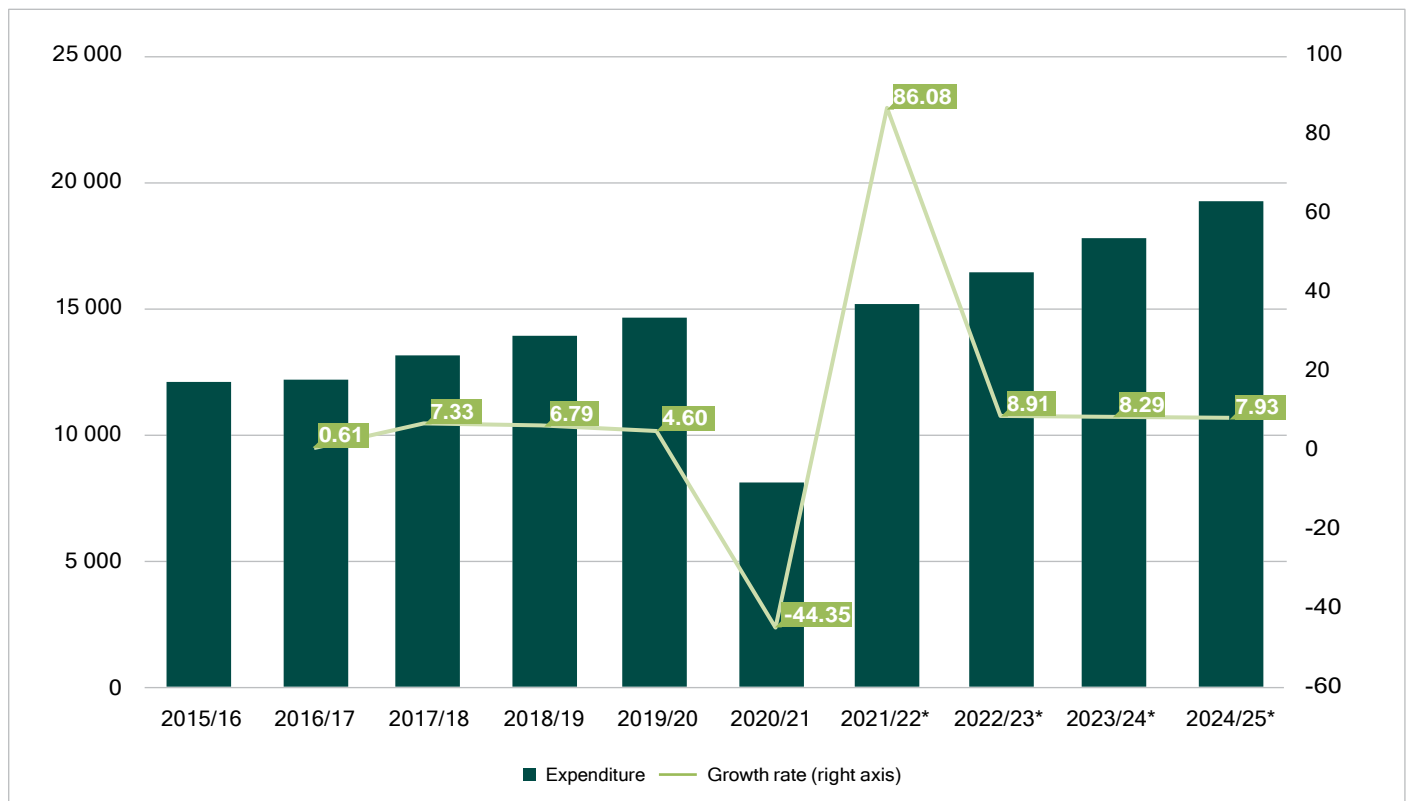
Figure 2.8 shows that local municipalities received a significant proportion of the EPWP Incentive Grant. In the 2019/20 financial year, municipalities received 47.3% of the EPWP Incentive Grant through the EPWP Integrated Grant for Municipalities. Provinces received 27% and 27.4% of the grant through the social sector EPWP Incentive Grant for provinces and the EPWP Integrated Grant for Provinces, respectively. The incentive grant has primarily benefitted rural municipalities because the minimum threshold is set at zero for FTE jobs created. The minimum number of FTE jobs created is part of the eligibility criteria to receive the incentive grant.

The incentive grant is fraught with many challenges, including non-compliance with the Division of Revenue Act, delays in implementing grant-funded projects, delays in reporting grant-funded projects in the EPWP reporting system, and poor spending performance (DPWI, 2020). Eligible provinces and municipalities must submit quarterly non-financial reports on a prescribed template by the timelines stipulated in the clauses of the Division of Revenue Act. Another risk area identified by the Auditor-General is corruption and fraud in the EPWP in recruiting participants and reporting incorrect participants into the EPWP reporting system.

2.4.5 Sector Education and Training Authority

Skills development can potentially contribute to structural transformation and economic growth by enhancing employability and labour productivity. South Africa has a strong policy focus and significant financial commitment to education and skills development. The focus has mainly been on the context of government seeking to overcome backlogs and expand access, while also creating institutions that are focused primarily on the terrain of skills development. Institutions focusing on skills are developed because of limited skills development for workers and to address the struggle the youth and unemployed face in accessing the labour market. The SETA is one of the vehicles used to improve skill levels.

Figure 2.9: SETA expenditure



Source: National Treasury, 2022

The primary function of the SETAs is to facilitate skills development by establishing learning programmes such as learnerships, skills programmes, internships and other strategic learning initiatives. Currently, 21 SETAs are responsible for managing and creating learnerships, internships, unit-based skills programmes and apprenticeships within their jurisdictions. Figure 2.9 shows the overall SETA expenditure trend from national revenue. The expenditure growth rate decreased from 6.97% in 2018/19 to 4.6% in 2019/20. In the 2020/21 financial year, the expenditure growth rate is estimated to decrease by 44.35%. The decrease in expenditure may be associated with measures taken amid the COVID-19 shock.

The SETAs are not directly involved in the creation of employment. Their mandate requires each SETA to identify priority skills needed in each sector in which they operate, and develop sector skills plans and annual training plans. The plans intend to signal to education, training and skills development providers and learners which skills are currently needed or in oversupply. These sector plans help inform the Workplace Skills Plan (WSP) and the Annual Training Plan (ATP) provided to SETAs by employers. Still, the challenge around skills development for employment continues in that there is no system to predict what skills the economy requires. While employers submit the ATR to the SETA for payments, SETAs have limited capacity to evaluate the ATR against the WSP to determine its relevance.

The SETAs have to strengthen and deepen their relationship and coordination with other entities, focusing on skills development, and foster a relationship with the TVET sector, which already plays a necessary (but constrained) role in skills development. Furthermore, there is a need to develop a monitoring framework and database that can provide indicators to track the implementation of the skills development processes within the SETA environment. The implementers should develop an indicator protocol with definitions (mapping outcomes), scope and data sources, and quality guidelines to gather comparable data across all SETAs.

The lack of coordination of labour market programmes and the absence of a robust private sector voice contribute to significant inefficiencies. Different departments offer similar programmes for similar target groups or offer potentially complementary programmes without exploiting such complementarities. Some programmes underperform in their potential to support job seekers, and synergies are not used to create comprehensive support for them.

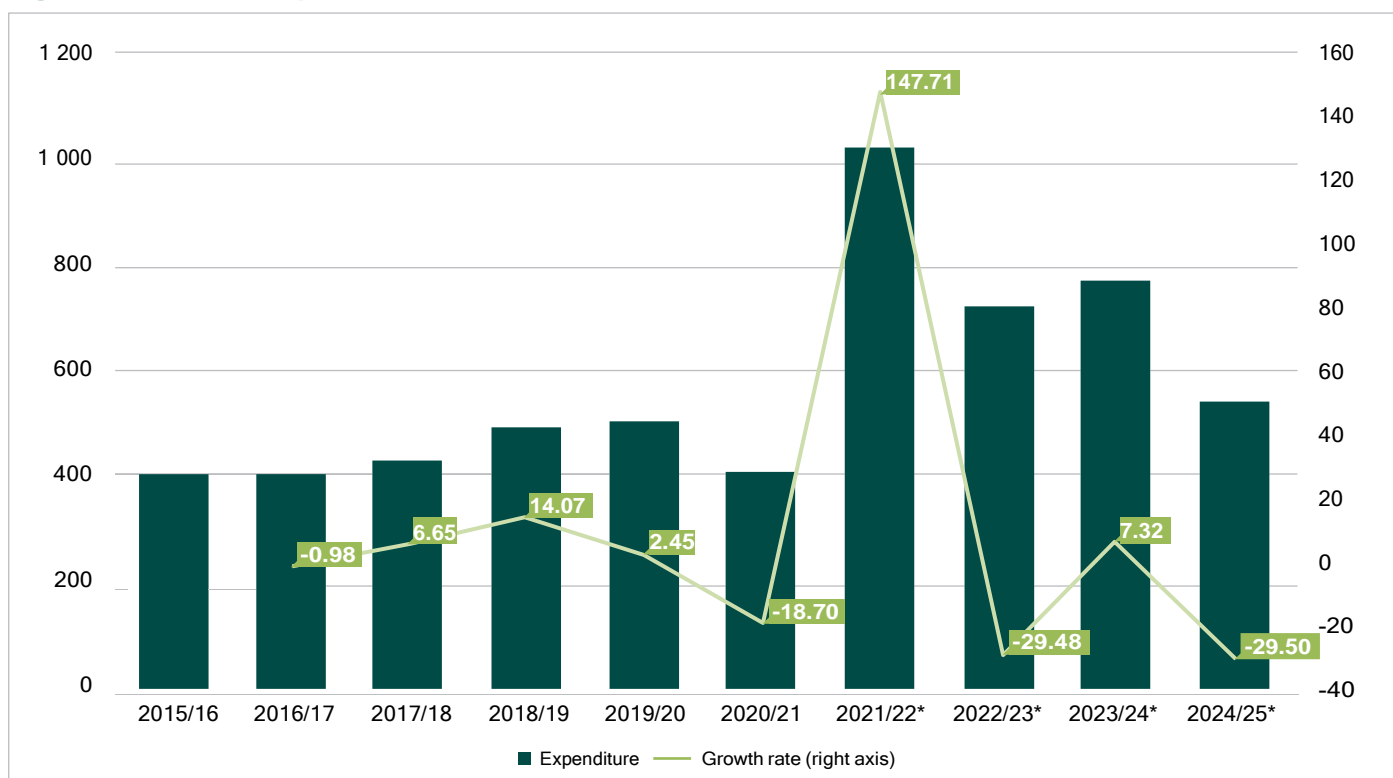
To maximise the support for job seekers, government can consider strengthening partnerships on training between the EPWP and the SETAs to provide accredited training programmes for low-skilled workers. Many labour market programmes place the public sector at the centre of employment creation, which is costly and unsustainable, instead of working with the private sector to identify how to leverage labour and product markets.

2.4.6 National Youth Development Agency

In South Africa, youth entrepreneurship received a considerable boost after establishing the Umsobomvu Youth Fund (UYF) in 2001. The objective was to stimulate an entrepreneurial mindset among young people and assist them with business funding and market access. In 2009, the UYF merged with the National Youth Commission (NYC) to give birth to the National Youth Development Agency. This agency was established to respond to various challenges experienced by young people in the country, such as unemployment, drug and alcohol abuse, and a lack of entrepreneurship.

The NYDA is an entity of the Department of Women, Youth and Persons with Disabilities. The Department of Women, Youth and Persons with Disabilities is mandated by section 9(3) of the Constitution to further the participation of women, youth and people with disabilities in interventions that enable their empowerment and socio-economic upliftment. In this context, the NYDA mobilises stakeholders such as the government, the private sector and civil society to prioritise youth development, and identify and implement long-lasting solutions that address youth development challenges.

Figure 2.10: NYDA expenditure trends



Source: National Treasury, 2022

The Department of Women, Youth and Persons with Disabilities transfers allocations to the NYDA through its mainstreaming Youth and Persons with Disabilities Rights and Advocacy Programme. Figure 2.10 shows the expenditure trend of the NYDA from 2015/16 to 2023/24. The expenditure growth rate is estimated to decrease by 29.4% in 2022/23 after increasing by 147.71% in 2021/22, following a decrease of 18.7% in 2020/21. In 2024/25, expenditure will decrease by 29.5%, following an increase of 7.32% in 2023/24.

The NYDA designs and implements programmes to improve the lives of young people and avail opportunities to youth. The National Youth Service (NYS) programme is one of the initiatives through which the NYDA plays an important role in promoting youth inclusion. The NYS programme is a government initiative aimed at engaging South African youth in community service activities to strengthen service delivery, build patriotism, promote nation-building, foster social cohesion and assist the youth in acquiring the occupational skills necessary to access sustainable livelihood opportunities. In the 2022 State of the Nation Address, the President announced that the NYS will recruit its first cohort of 50 000 young people during 2023, creating opportunities for young people to contribute to their communities, develop their skills and grow their employability. The NYS also assists in developing young people to create employment for others.

Facilitating entrepreneurial training for the youth is essential in improving self-employment endeavours. The NYDA Grant programme aims to provide young entrepreneurs with an opportunity to access financial and non-financial business development support to establish or grow their businesses. The aim is to respond to the challenges of youth unemployment and low total entrepreneurship activity among the youth (NYDA, 2020). Table 2.4 shows the number of beneficiaries supported through the NYDA Grant programme. In the 2018/19 financial year, 1 103 youth-owned businesses were supported. The number of youth-owned businesses supported decreased to 1 000 in 2019/20. It is crucial to strengthen and scale up the number of youth-owned enterprises supported. Small and medium enterprises' access to domestic finance could also help foster entrepreneurship and stimulate formal job creation.

Table 2.4: Number of youth supported by the NYDA

	Actual achievement 2018/19	Actual achievement 2019/20	Actual achievement 2020/21
Number of youth-owned enterprises supported through the NYDA Grant programme	1 103	1 000	2 316
Number of beneficiaries supported with business development support services offered by the NYDA	23 942	20 000	4 859
Number of jobs created and sustained through supporting entrepreneurs and enterprises	5 025	3 500	8 653
Number of jobs facilitated through placements in job opportunities	5 474	10 000	4 962

Source: NYDA, 2020

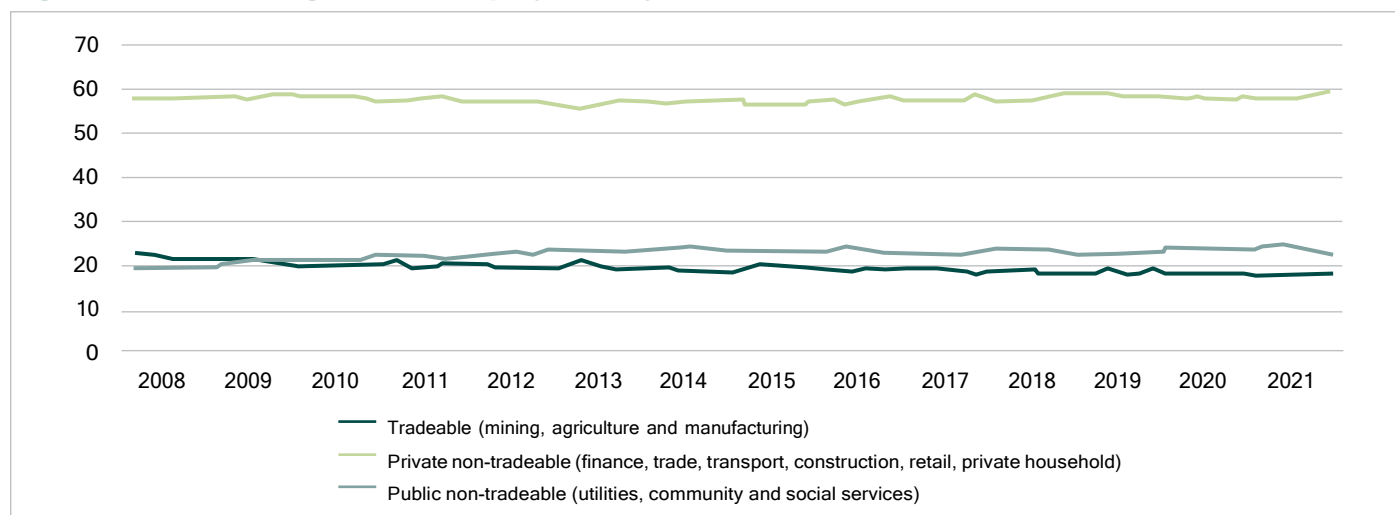
It is essential to address teaching entrepreneurial skills, attributes and behaviour that are often not adequately integrated into school curricula or not taught on different levels. The NYDA can play an essential role in mobilising reforms of education systems to strengthen entrepreneurial skills. Governments and education authorities should include self-employment as a viable alternative within an overall career advice structure.

2.4.7 Labour market structural changes

Even though labour market interventions have resulted in some economic opportunities at a micro level for young people, they have no significant impact on reducing the high unemployment rate. The evidence suggests that youth unemployment is a multifaceted problem. The challenge of youth unemployment is driven by labour market structural changes, a poor education system and uncoordinated labour market interventions. It is also related to community, household and individual issues. Conventional labour market interventions that centre on education, training and wage subsidies are necessary, but inadequate on their own to address the youth unemployment challenge. Labour market interventions may be suitable for addressing supply-side challenges and preparing job seekers to enter the labour market. Their effect will remain limited if there is no corresponding increase in the supply of jobs.

South Africa's high unemployment and low growth rates can be associated with the decline of the non-mineral tradable sector since the early 1990s. The weakness in export-oriented sectors has denied South Africa growth and employment creation opportunities. This pattern of structural change is also a key driver of unemployment because tradable activities (including manufacturing and agriculture) are intensive in low-skilled labour, compared to services. The ongoing pattern of structural change implies a significant decrease in the relative demand for low-skilled labour because the declining sectors constitute the least skill-intensive parts of the South African economy.

Figure 2.11: Percentage of total employment by sector



Source: Commission's calculations based on Statistics South Africa Quarterly Labour Force Survey, 2002

The limited skills among the youth, coupled with low secondary school completion rates, mean that many young people are at a considerable disadvantage in finding employment in an economy that is biased towards high-skill service activities. The share of total employment in tradeable activities decreased from more than 23% of employment in Quarter 1 of 2008 to 18% in Quarter 3 of 2021. Public non-tradeable activities' share of total employment increased from 19.5% in Quarter 1 of 2008 to 23% in Quarter 3 of 2021. At the same time, private non-tradeable activities' share of total employment increased. The evidence shows that a key difficulty facing youth seeking to enter the labour market is that South Africa's labour market favours skilled employees. In the late 1990s and early 2000s, the country's economy shifted from labour-intensive tradeable economic activities to technology-intensive non-tradeable economic activities.

Box 2: The case for manufacturing

An export-oriented strategy that is focused on manufacturing will generate growth and be labour absorbing for South Africa. Manufacturing is known to provide massive employment, especially for low-skilled job seekers. However, productivity and intensified import competition are identified as key hinderances to manufacturing. A comparative analysis between South Africa and Malaysia will underscore the possibilities manufacturing can play in addressing unemployment, while also promoting equity.

South Africa and Malaysia are both medium-sized economies with a deep racially divided past, in which an ethnic majority controlled the polity, but economic power lies with an ethnic minority. The output per worker (productivity per worker) and total factor productivity (TFP) were similar, including human capital and dependence on mining. But these economies underwent different paths of economic evolution. While Malaysia was undergoing industrialisation, South Africa was deindustrialising. In 1998, approximately 12% of South Africa's total labour force was employed in manufacturing, compared to about 8% in Malaysia. Since then, Malaysia has industrialised by leaps and bounds, with this figure reaching 16% a decade later. In South Africa, by contrast, the proportion of the workforce employed in manufacturing has steadily come down and resulted in high unemployment.

Table 2.5: Snapshot of South Africa and Malaysia coefficients

Country		Y/L	(K/Y) ^a	H/L	A	Mining share as a percentage of GDP
South Africa	ZAF	0.250	0.959	0.568	0.460	0.111
Malaysia	MYS	0.267	1.004	0.592	0.450	0.103

Source: Hall and Jones, 1999

The expansion of manufacturing in Malaysia has been both growth and equity promoting with a similar output per worker and human capital as South Africa. Expanding manufacturing can be one of the solutions to addressing the unemployment problem in South Africa. To address the competitive prices, South Africa requires a combination of monetary and fiscal policies that will allow the South African Reserve Bank (SARB) to run a modified inflation targeting framework which allows considerations of competitiveness to affect its decision-making. Putting it more bluntly, SARB will need to develop views about the equilibrium real exchange rate – where 'equilibrium' refers to satisfactory outcomes in terms of tradable output and employment – and steer exchange rates accordingly.

The high unemployment and low growth rates in South Africa are linked to the non-mineral tradable sector (Rodrik, 2008). The result has been a higher absorption of skilled workers into the labour market than low-skilled workers. Many young people in South Africa are unskilled or lack the skills required in the labour market. But the demand for high-skilled workers means that those with high qualifications are more likely to find employment. The research shows that the challenge of youth unemployment is a structural issue that requires long-term solutions, such as massive structural economic reforms.

2.5 Conclusion

The youth unemployment situation in South Africa has become dire, and has received substantial attention from both policy and research. The policy frameworks and interventions that support youth employment remain uncoordinated, without solid implementation plans or overall accountability. A more integrated and impactful approach to pathing young people to the labour market is required. This encompasses a basic education system that is significantly improved, with the ultimate result of inclusive economic growth.

There is a need to develop a solid social compact to address youth unemployment, which brings employers, training providers, trade unions, government and other relevant stakeholders on board to support, reconfigure existing programmes and develop a new approach to youth employment. Furthermore, a need

arises to reduce programmes and departmental duplication to enhance the effectiveness of labour market interventions. Programme duplication, lack of coordination and implementation failures have seriously hindered education, skills training, and youth development and employment.

Interventions must be better coordinated and scaled up where evidence of success is available. The EPWP is an essential point of contact with unemployed youth. It could be leveraged to path young people into other services, back into the training system or employment support programmes. To achieve effective pathing of the youth, coordinating and developing a monitoring framework and database, which can track and trace beneficiaries, are necessary.

The ETI is currently the only primary intervention targeting employers on the demand side. Although evidence on outcomes is mixed, on balance, it shows promise for job creation among small businesses. If the intervention is extended, it should focus on better uptake among small businesses and include additional efforts to evaluate the impact and understand firm behaviour.

The ETI can potentially mitigate the effects of the national minimum wage on the youth by subsidising employers hiring the youth. There is a need to expand and deepen the employment tax incentive to encourage hiring in the private sector, particularly for those facing more constraints to labour market integration, such as young people and women. Alongside an intervention like the ETI, there is a need to promote job creation and youth employment among employers. The Jobs Fund could continue to play a leading role in facilitating employment creation.

Self-employment is one of the mechanisms that South Africa can use to address the challenge of unemployment. Facilitating entrepreneurial training for the youth is essential in improving self-employment endeavours. The SETAs have to strengthen and deepen their relationship and coordination with other entities that focus on entrepreneurial skills development. Equally important is strengthening and scaling up the number of youth-owned enterprises supported through the NYDA Grant programme. Small and medium enterprises' access to finance could also help foster entrepreneurship and stimulate formal job creation.

Lastly, the general lack of coordination of labour market programmes and the absence of a robust private sector voice contribute to significant inefficiencies. Different departments offer similar programmes for similar target groups or offer potentially complementary programmes without exploiting such complementarities within their respective responsibilities.

The government needs a task team to investigate how current institutions and available funds can be coordinated to work together for the quality mass training of all trades that are in demand (electricians, plumbers, boilermakers, welders, millwrights, riggers, pipefitters, mechanics etc.) - an incentive scheme can be used for the private sector to offer apprenticeships to youth in trade training programmes before a quality assured trade test is performed. Parastatals such as Eskom, Transnet and others have successfully been used in the past for such programmes.

2.6 Recommendations

The Commission makes the following recommendations:

1. *The Commission welcomes the expansion of the Employment Tax Incentive (ETI). To better target and increase the impact of the incentive, the Commission recommends revising the employee eligibility age from 18 to 29 years old. The age group 24–34 years has a relatively high rate of individuals not in employment, education or training (NEET) compared to 15- to 24-year-olds. National Treasury can also consider deepening the ETI to encourage hiring young women whose NEET rate is relatively higher than that of their male counterparts for both youth categories. The NEET group represents the most vulnerable section of the youth.*

The Commission notes that the ETI has shown evidence to incentivise employment by the private sector in South Africa. The Commission also welcomes the extension of the ETI through a 50% increase of the maximum value. Targeting the most vulnerable sections of the youth population will maximise the impact of the incentive. The expansion also requires an understanding of firm behaviour and drivers of uptake; therefore, working with small firms to enhance their ability to employ youth.

2. *The Department of Employment and Labour, the Department of Higher Education and Training, and the Department of Women, Youth and Persons with Disabilities should coordinate all labour markets and skills programmes. The Department of Women, Youth and Persons with Disabilities has a mandate to enable the empowerment and socio-economic upliftment of the youth and women. Well-coordinated labour market interventions could bolster the impact of existing labour market programmes through more significant integration and leveraging of initiatives.*

The Commission notes that the lack of the central coordination of labour market programmes and the absence of a robust private sector voice contribute to significant inefficiencies. There is a need to coordinate efforts and streamline labour market programmes to help with the inclusion of the private sector, which could maximise the impact of labour market interventions. A more integrated and impactful approach to supporting youth employment could reduce youth unemployment.

The Commission also notes that public employment programmes form a critical component of an employment strategy for youth, primarily because they guarantee work and income, and are a vital connection point for young people seeking jobs. The EPWP can connect young participants to other “pipeline” employment and training opportunities. Connecting young work-seekers to further employment opportunities requires greater coordination and cooperation of stakeholders and other line departments.

3. *National Treasury and the Jobs Fund should consider other alternative funding channels that take the limitations faced by the youth regarding access to capital to provide challenge funds into account. The challenge funding principle of the Jobs Fund disadvantages those small and medium businesses that have no access to capital. The match challenge fund is a financing mechanism to allocate (donor) funds for specific purposes using competition among organisations as the lead principle. Proposals are assessed against transparent and predetermined criteria. Successful applicants must usually match a certain percentage of the grant with own financing.*

The Commission notes that self-employment is one alternative that should be encouraged for young people. Access to capital is a significant constraint confronting young people venturing into self-employment. The Jobs Fund is an important organisation that supports entrepreneurial activity or businesses with the potential to create massive employment. The match funding principle does not help those young people who do not have access to capital. Developing alternative funding channels that consider the capital constraints faced by young people would maximise the impact of the Jobs Fund.

4. *The proportion of gross fixed capital expenditure in the composition of the budget should be systematically increased. Consumption expenditure should be reduced. There is also a need to remove structural and institutional rigidities that impact on private investment in the reduction of unemployment.*

The Commission shows that spending on gross fixed capital formation contributes to the reduction of unemployment. Therefore, capital payments that capture the government’s contribution to capital formation and spending on new infrastructure and upgrades, additions, rehabilitation and the refurbishment of existing infrastructure should be progressively increased.

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PART 2

Economic and
fiscal monitor:
Evidence-informed
policymaking



CHAPTER 3:

Assessing debt sustainability in South Africa

3.1 Introduction

South Africa faces high uncertainty with respect to its public debt levels, cost of debt and future debt path. Economic growth, while already in a slow-growing period, deteriorated in 2020 as a result of the devastation of the COVID-19 pandemic. The onset of the pandemic contributed to higher debt and government spending to mitigate the effects of the associated lockdown levels. According to the Budget Review 2022, economic growth rebounded to 4.8% in 2021. Still, the medium-term projections are weak, averaging 1.8% per annum over the following three years (National Treasury, 2022). In addition, debt levels are estimated to continue climbing to over 75% of gross domestic product (GDP) in 2024/25 before stabilising, with debt service costs increasing by an average annual growth rate of 10% over the next few years, crowding out spending on critical services and projects.

In terms of the fiscal stance, pro-growth consolidation was proposed in February 2021 to rein in debt and debt service costs. Following these plans, over the course of 2021, South Africa experienced a third and fourth wave of the virus, and social unrest in July, resulting in an increased need for government expenditure. Improved revenue collection, detailed in the 2022 Budget Review, is assisting the government with its consolidatory goals, including its aim for a primary surplus in 2023/24. However, further unprecedented events, such as international conflicts or new COVID-19 variants, may threaten fiscal plans and economic recovery. Overall, fiscal assumptions are frequently subject to change, impacting on debt levels. As a result, the path of debt remains uncertain, given fiscal vulnerabilities and the rapidly changing economic climate. These factors motivate an investigation into debt sustainability in South Africa.

Debt sustainability seeks to investigate the level of indebtedness and associated risks of unstable debt to decide whether the public sector is in debt distress or not. This chapter aims to provide a rounded assessment of public debt sustainability in South Africa. A variety of quantitative tools are employed in this chapter to examine the context of debt, key indicators of sustainability, and forecasting the debt path.

3.2 Problem statement and research questions

As debt has been rising rapidly in South Africa, its sustainability, as well as its impact on economic growth, is in question. Thus, the aim of this chapter is to understand debt and its sustainability in South Africa, particularly amid the volatile economic conditions over the last few years. The analysis investigates key indicators surrounding the cost of debt, economic growth rates, adjustments in the primary balance and debt accumulation.

The chapter is guided by four research objectives, outlined below and examined in the four-part results analysis:

1. Assess what constitutes sustainable debt in the South African context
2. Determine whether debt in South Africa is currently sustainable and whether there is a need for future concern
3. Assess the relationship between debt and growth, and whether debt is detrimental to economic growth beyond a certain level of debt
4. Make forecasts of debt, from its determinants, in order to assess its future path

3.3 Research methodology and data

Secondary macroeconomic data is sourced from a range of sources, including the South African Reserve Bank (SARB), Statistics South Africa, National Treasury, the World Bank and the International Monetary Fund (IMF).

Firstly, a descriptive analysis is provided to assess the context of debt and levels of debt costs to assess the ability to service debt. In addition, by examining the composition, holdings and cost of debt in South Africa, one can better understand the quality and context of borrowing.

Following the descriptive analysis, sustainability and public sector solvency is assessed through various indicators, such as comparisons of the real interest rate on debt to the economic growth rate, as well as examinations of the growth rate of debt, and Bohn's¹ model-based sustainability method of assessing the relationship between the primary balance and debt. This method estimates whether the primary surplus relative to GDP is a positive function of debt (i.e. whether $\beta > 0$). Following Kaur and Mukherjee (2012) and Debrun et al. (2019), the regression equation can be described in Equation 3.1.

$$PB_t = \alpha_0 + \beta D_{t-1} + \alpha_1 GDPGAP_t + \alpha_2 EXPGAP_t + \varepsilon_t \dots \quad (3.1)$$

where PB_t is the primary balance, D_{t-1} is debt in the previous period, and $GDPGAP_t$ and $EXPGAP_t$ represent the output and expenditure gap, respectively.

Following this, the nonlinear relationship between debt and growth is assessed. One can investigate a level of government debt, which adversely affects economic growth. Following Kaur and Mukherjee (2012), the regression equation is defined in Equation 3.2.

$$GDP\ growth_t = \beta_0 + \beta_1 Debt_t + \beta_2 Debt_t^2 + \beta_3 INV_t + \beta_4 INFL_t + \beta_5 RIR_t + \beta_6 TRADE_t + \beta_7 DEF_t + \varepsilon_t \dots \quad (3.2)$$

where GDP growth is the GDP growth rate, Debt is the public debt-to-GDP ratio, INV is real gross fixed capital investment, INFL is the inflation rate, RIR is the real interest rate, TRADE is international trade as a percentage of GDP and DEF is the budget deficit-to-GDP.

Following these assessments of sustainability, the IMF's debt sustainability analysis (DSA) template is applied to the case of South Africa to make projections of the debt path. This method accounts for GDP, inflation, exchange rates, current account balances, public sector revenues and expenditures over the past 12 years, and assumptions for these variables over a five-year horizon. Moreover, the breakdown of the debt portfolio, including maturity and currency composition, is described in the analysis. These factors allow for projections based on detailed assumptions. Furthermore, the methodology caters for alternative scenarios and stress tests.

3.4 Results

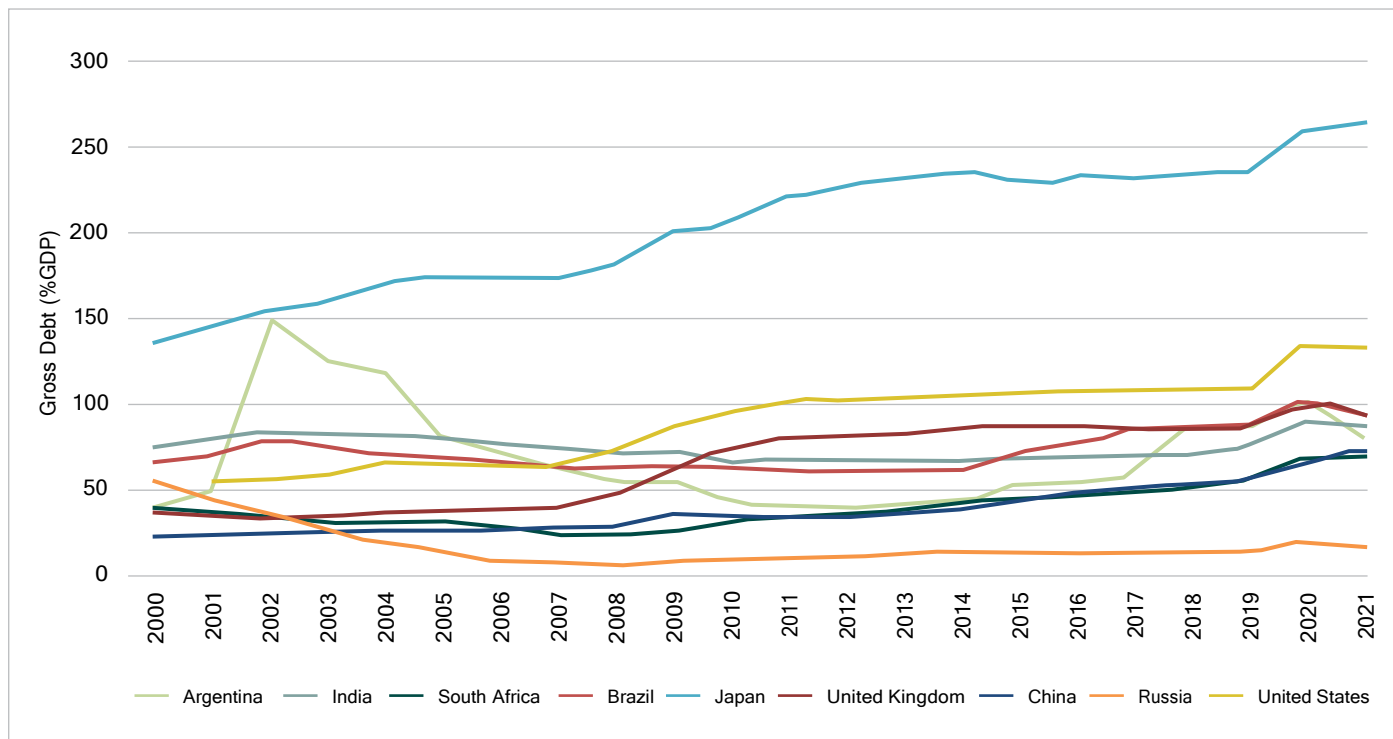
3.4.1 Descriptive analysis

Compared to international debt levels, South Africa's debt levels do not appear abnormal. Debt levels in advanced economies such as Japan, the United States and the United Kingdom are substantially higher, as shown in Figure 3.1. However, when examining interest rates, both the Treasury bill and government bond rates for these advanced economies are lower than in South Africa.

¹ Bohn has studied public debt, as well as fiscal sustainability, and is popular among the literature. See Bohn (2005).

The interest rates were recorded at just below 4% and 10% for Treasury bills and government bonds, respectively, in South Africa in 2021, whereas Japan's low interest rates are close to zero. Other emerging economies, such as India, Russia and Brazil, face similarly high interest rates to South Africa. Despite a gross loan debt of around 69% of GDP in 2021, the cost of servicing debt would be substantially higher than Japan's debt-to-GDP of over 263%. In other words, the cost of debt is relatively more expensive in South Africa.

Figure 3.1: International comparison of debt levels



Data sourced from the IMF World Economic Outlook (2022)

Over the last ten years, gross debt-to-GDP has doubled, increasing from 35.1% to 70.7% in 2020/21. According to the 2022 Budget Review, in 2021/22, debt-to-GDP has fallen slightly to 69.5%. It should be noted that the stock of debt has not fallen, and has rather increased from R3.9 trillion to R4.3 trillion, but GDP has grown since the previous year, and thus skews the ratio downwards.

The majority (90%) of South Africa's debt is domestic, although the proportion of foreign debt has grown. The advantage of having a higher proportion of domestic debt is that the exchange rate risk is mitigated as most of the debt is held in domestic currency. This reduces the overall risk of the portfolio. Additionally, a developed domestic market serves to broaden the investor base. Domestic marketable debt, which makes up the majority (99.5%) of total domestic debt, consists primarily of government bonds (fixed-rate and inflation-linked bonds). Treasury bills, combined, form 12% of marketable domestic debt.

South African domestic marketable government bonds are mostly supported by foreign investors, pension funds and monetary institutions (National Treasury, 2020). On 31 March 2020, foreign investors held the largest share of fixed-rate bonds (41%). After almost two years of the pandemic, by the end of March 2022, foreign investors had decreased their holdings of fixed-rate bonds to 33%, while monetary institutions and other financial institutions held approximately 20% each (National Treasury, 2022b). For inflation-linked bonds, 46% is held by pension funds, using them to match long-term liabilities, as well as to hedge against inflation, followed by monetary institutions, private self-administered funds and other financial institutions, which hold 18% each.

The reduction in bonds held by foreign investors, particularly in fixed-rate bonds, maybe due to several reasons, exacerbated by the pandemic, such as the increase in risk in South African bonds, changes to the exchange rate, or the fact that investors may need to withdraw funds for themselves. Regardless, this lowers the range of resources available for South Africa. On one hand, an increase in the local holdings of bonds may reduce the risk of the debt portfolio and reduce the likelihood of default. On the other hand, local institutions are most likely charging a relatively high premium, resulting in further spending on the cost of borrowing. Additionally, higher domestic borrowing can place pressure on institutional investors and banks to absorb more government debt, which may dampen financial stability (Panizza, 2008).

Various macroeconomic factors play a role in influencing debt levels and debt costs. Economic growth deteriorated to -6.4% in 2020 due to the onset of the virus and the lockdown levels, having already been low and stagnant in prior years (Statistics South Africa, 2021). Weak growth worsens debt dynamics, as GDP can be considered a form of repayment capacity. It will also tend to increase the debt-to-GDP ratio due to a lower denominator. Additionally, weaker growth is typically associated with lower cyclical revenues and more primary expenditure, deteriorating the primary balance. Although growth recovered to 4.9% in 2021, growth estimates for the medium term are weak (National Treasury, 2022; Statistics South Africa, 2022). Growth is forecasted to be 2.1% in 2022, before falling to 1.6% in 2023.

Inflation in 2021 and 2022 is currently higher than in 2020. In 2021, Consumer Price Index (CPI) inflation was measured at 4.5%, in comparison to 3.3% in 2020 (National Treasury, 2022). It is projected to rise further to 4.8% in 2022 and to hover around 4.5% over the medium term. Higher inflation generally improves debt dynamics as it is associated with higher growth or stimulated demand. However, high inflation may lead to higher interest rates to control inflation, thereby worsening the dynamics. As a result, there can also be a policy trade-off between fighting inflation and debt sustainability.

Regarding fiscal constraints, consolidatory reforms, through reprioritising spending and budget cuts, intend to rein in debt and rising debt costs. In 2021, South Africa's economy faced pressures as a result of civil unrest, a protracted third wave of the pandemic, as well as temporary international travel bans at the onset of the fourth wave. Fortunately, a tax windfall cushioned the additional expenditure required throughout the year. In the 2022 budget, the government maintains its stance to stabilise debt and commits a portion of the higher-than-anticipated revenue towards reducing the deficit and lowering the borrowing requirement. However, continued unprecedented events, such as further waves of the pandemic or intensifying international conflicts, may affect consolidatory reforms to reduce debt service costs. Such future uncertainty will likely negatively impact debt dynamics. Furthermore, South Africa's substantial contingent liabilities add stress to an already pressured fiscal position.

3.4.2 *Indicators of sustainability in South Africa*

In Table 3.1, debt has risen dramatically over the last five years. Debt-to-revenue indicates that the debt stock rose to more than three times government revenue (317.8%) in 2020/21. Such high debt relative to repayment capacity, being GDP and revenue, acts as an indicator of potential solvency issues. Similarly, rising debt service costs, consisting of interest payments, has also substantially risen as a proportion of GDP and revenue, indicating that South Africa may be heading for liquidity concerns should this trajectory continue. Gross financing needs (GFN) comprise the main budget balance (i.e. total revenue minus total expenditure, including interest), which is currently in deficit, and debt redemptions. In other words, it is the amount of financing necessary to cover the deficit and amortisation of debt. The GFN to GDP and revenue have changed for the worse over the last five years, indicating strained financing conditions.

Table 3.1: Trends in debt, debt service costs and gross financing needs

Year	Debt-to-GDP	Debt-to-revenue	Debt service costs to GDP	Debt service costs to revenue	GFN to GDP	GFN to revenue
2005/06	31.4%	126.2%	3.2%	12.2%	1.9%	7.5%
2010/11	35.1%	147.2%	2.3%	9.8%	5.3%	22.2%
2015/16	48.9%	187.6%	2.9%	12%	4.5%	18.6%
2020/21	70.7%	317.8%	4.2%	18.8%	11.1%	49.9%

Source: Commission's own calculations using National Treasury's Budget (2022) data.

Projections over the medium term, according to the 2022 budget, estimate debt-to-GDP to rise from 69.5% in 2021/22 to 75% in 2023/24 before stabilising. Debt service costs will also be rising rapidly, from 4.3% in 2021/22 to a projected 5% of GDP in 2024/25, crowding out budget allocations to social spending that aim to address rife poverty and inequality. The GFN fell substantially to 6.6% of GDP in 2021/22 due to high revenue collections being partly used to reduce the deficit and borrowing requirement.

The interest-growth differential is a frequently used indicator in debt sustainability analysis, comparing the growth rate of the economy to the interest rate on debt. Time series of these indicators in South Africa are presented in Figure 3.2.

Figure 3.2: Real growth rate vs real interest rate



Data sourced from the World Bank (2022), ranging from 1961 to 2020. Real interest rates are calculated from lending rates adjusted for inflation. The World Bank's real GDP is calculated at 2015 prices.

From Figure 3.2, comparisons of the real growth rate and real interest rate indicate unfavourable debt conditions. Since 2014, the real interest rate has been persistently higher than the growth rate. Given that interest rates are associated with a higher cost of debt, and lower growth would be associated with a higher debt-to-GDP ratio, the analysis does not favour debt sustainability (Turner and Spinelli, 2013). The size of this differential is also important as a larger, positive differential – when the interest rate is much higher than the growth rate – indicates that debt is more likely to be unsustainable. In theory, a positive differential implies that a primary fiscal surplus is needed to reduce the ratio or stabilise debt (Checherita-Westphal, 2019). Combined with a persistent primary balance deficit since 2010, debt conditions in South Africa may be unstable and associated with rising debt.

In its recovery from the COVID-19 shock, economic growth rebounded to 4.9% in 2021, which may serve to close the interest-growth differential. However, this should be interpreted with caution as it simply reflects the change in GDP from 2020, in which GDP sharply contracted as a result of the pandemic, to 2021. Additionally, growth is expected to be weak over the medium term, averaging 1.8% per annum (National Treasury, 2022). After a period of low interest rates, they are predicted to begin to rise again and, therefore, widen the interest-growth differential again.

Estimating the reaction of the fiscus to levels of public debt is often examined in debt sustainability assessments as a measure of government solvency (see Bohn, 2005; Kaur and Mukherjee, 2012; Debrun et al., 2019). In Table 3.2, the results of a regression analysis of the primary balance on the previous years' debt level, as well as on the expenditure and output gap, are presented. In theory, if the slope of the coefficient on public debt is positive and very steep, this means that the government responds quickly to an increase in debt by raising the primary balance (i.e. towards a surplus) and indicates a greater concern for government solvency. On the other hand, if the slope is relatively flat, the government is more relaxed about satisfying the solvency condition and is not reacting strongly to changes in debt levels.

Table 3.2: Conditional response of the primary balance to public debt

	(1)	(2)
	Primary balance	Primary balance
Debt _{t-1}	-0.042	0.133***
Expenditure gap	-1.547***	-0.361*
Output gap	0.358**	0.337***
Deficit		-4.084***
R-squared	0.659	0.928
Durbin-Watson Statistic (DWS)	0.506	1.623

Notes: Data is sourced from the South African Reserve Bank (2022) with a range from 1998 to 2021. The expenditure and output gaps are calculated using the HP filter. Primary balance, debt, expenditure gap and output gap are all expressed as a ratio of GDP, which has been rebased to 2015. A dummy variable for the years in deficit is included in Column 2. Constants are included, but not presented.

In Table 3.2, allowing for a control for the years in deficit, the primary balance tends to increase (i.e. move towards a surplus or reduce the deficit) when debt rises. The coefficient on debt is significant and positive, indicating responsiveness of the primary balance to changes in debt, and is thereby an attempt to meet the public sector's solvency constraints. A one unit increase in debt-to-GDP leads to a 0.13 unit increase in the primary balance to GDP. This result, however, should be interpreted in the context of the higher interest-growth differential, as shown earlier. Therefore, although the result indicates that the fiscus reacts positively to increases in debt, the response may, on average, not be strong enough.

Furthermore, there is a positive relationship between the primary balance and the output gap. In other words, the primary balance tends to improve (i.e. move towards a surplus or consolidatory fiscal stance) when output is above trend, potentially indicating a countercyclical behaviour. Inversely, when output is below trend, the primary balance tends to deteriorate due to expansionary fiscal behaviour. Additionally, expenditure above trend is associated with a worsening primary balance, as expected. Adjusting for the presence of unit roots in the data yielded similar relationships to that in Table 3.2.

It should be noted that changes in the primary balance are actions by only one agent, the state, and can thus change rapidly over time, based on numerous factors, such as changes in the fiscal approach or political reasons. Additionally, the regression analysis only accounts for the reaction over the past 20 years, and does not determine or inform any future behaviour of the government. Nevertheless, it is necessary to examine and consider the general trend of fiscal behaviour in the past.

Also associated with sustainability are indicators of refinancing risks, comprising average time to maturity and debt maturing in one year as a percentage of the total, as well as market risks, including interest rate risks and exchange rate risks. These risks are presented in Table 3.3.

For domestic debt, the average time to maturity for government bonds has fallen over the last few years (from 192 months in 2018), but remains relatively high at over 13 years (SARB, 2022). The proportion of foreign and domestic government bonds maturing in one year is very low, being only 2%. Overall, refinancing risks for government bonds are relatively low.

Table 3.3: Financing and market risks

Refinancing risk (for government bonds)	
Average time to maturity	162 months (domestic), 155 months (foreign)
Debt maturing in one year (percentage of total)	2%
Interest rate risk (for government bonds)	
Fixed rate-to-floating rate	282% (domestic)
Floating rate-to-total	26% (domestic)
Debt exposed to refixing	28% (domestic only) or 26% (foreign and domestic)
Exchange rate risk	
Foreign currency debt to total debt	10.3%
Short-term foreign debt (percentage of reserves)	1.7%

Notes: Data sourced from the SARB (Quarterly Bulletin March 2022) and the Commission's own calculations. Reserves are gross gold and other foreign reserves. Values are taken for the period ending 31 December 2021.

Debt exposed to interest rate refixing consists of all debt maturing in one year, since it is exposed to the possibility of being rolled over, as well as floating-rate debt, being inflation-linked bonds, in South Africa, where interest rates are subject to changes in inflation in order to protect investors. As much as 26% of all government bonds are exposed to refixing. Exchange rate risk is low due to a relatively low proportion of foreign currency debt and relatively little short-term foreign debt, which is buffered by substantial gold and foreign reserves. These indicators represent some favourable characteristics of South Africa's debt profile.

Despite this, the Emerging Market Bond Index (EMBI), measured by JP Morgan, another market risk indicator, has risen by almost 200 basis points since 2019 to 513 in 2020. This is South Africa's highest yearly EMBI recorded over the last two decades, reflecting market uncertainty. Additionally, South Africa's sovereign credit rating faces a negative outlook and experienced downgrades throughout 2020, with a BB- rating from both the Standard and Poor's (S&P's) and Fitch's rating scales, and a Ba2 rating from Moody's (Trading Economics, 2022). Credit rating downgrades, and thus higher risk premiums, are associated with a higher cost of debt, negatively impacting on repayment abilities and sustainability.

3.4.3 Debt-growth nexus

Given the weak growth and high debt levels in South Africa over recent years, combined with the effects of the COVID-19 pandemic, an updated analysis into the impact of debt on growth is examined.

Table 3.4: Impact of debt on economic growth

	(1)	(2)	(3)
	GDP growth rate	GDP growth rate	GDP growth rate
Debt (% GDP)	0.713***	0.530**	0.523**
Debt ² (% GDP)	-0.009***	-0.006***	-0.007***
Inflation (CPI)		-0.109*	-0.136**
Surplus/deficit (% GDP)		0.314**	0.345*
Trade (% GDP)		0.059*	0.046
Gross fixed capital formation (growth rate)		0.165***	0.159***
Real interest rate			-0.077
R-squared	0.22	0.70	0.72
Durbin-Watson Statistic	1.00	1.92	2.07
Observations	60	60	60

Notes: Coefficients are rounded to three decimal places. Data is sourced from the World Bank (2022) and SARB (2022). The sample is 1961–2020. Constants are included, but not presented.

The regressions presented in Table 3.4 show a significant non-linear impact of debt on economic growth. In all three columns, debt is associated with rising GDP. However, the negative sign on debt-squared indicates that its effect on GDP is lessened as debt grows. Column 1 presents a simple regression of the GDP growth rate on debt and its square without the presence of other explanatory variables. Debt has a positive effect on growth until a turning point of approximately 40%, after which additional increases in debt are associated with lower growth rates.

Column 2 controls for other variables (inflation, the budget surpluses and deficits, trade and gross fixed capital formation, a proxy for investment). The relationship between debt and growth remains the same – with an approximate turning point of 44%. Additionally, higher growth rates of investment have a positive impact on growth, while higher inflation is associated with lower growth. It is possible that high inflation may be followed by measures that reduce demand through higher interest rates, and, consequently, reduce growth. Interestingly, movements towards a budget surplus, or a reduction in the deficit, have a positive and significant impact on economic growth. In the context of high deficits and low growth, such a result is worth noting, while the government attempts to consolidate. Increases in trade, being the sum of exports and imports of goods and services in the economy, are also associated with higher GDP growth. Column 3 includes a control for the real interest rate, a proxy for the cost of debt, to assess whether this alters the relationship between debt and growth. The impact of debt on growth remains relatively unchanged with the added control. It has been theorised that debt service costs may reduce growth due to overhang effects or the crowding out of capital and investment (Elbadawi et al., 1997; Clements et al., 2003). However, in this analysis, the real interest rate, as well as other proxies for the cost of debt, tended to have no significant impact on growth. Similarly, Saungweme and Odhiambo (2020) find no impact of debt service costs on economic growth in South Africa.

It should be noted that high debt does not always have deleterious effects of growth, but that, in the case of South Africa, higher debt over the last 60 years has been associated with low growth levels. This may be due to the poor quality of public spending and investment associated with this debt.

Additionally, the results may be due to the presence of a debt overhang, where current investment and consumption are disincentivised as a result of a higher expected tax burden, reducing growth as a consequence (Krugman, 1988; International Monetary Fund, 2018). Alternatively, debt may result from the financing of public expenditure and investment, which crowds out private investment and consumption due to shifts in resources from the private to the public sector (Buffie et al., 2012). Moreover, low levels of public investment efficiency and low rates of return on public capital may lower the levels of output produced, which lowers growth. Again, the debt-growth relationship is vital for sustainability as low growth may bring solvency and repayment concerns.

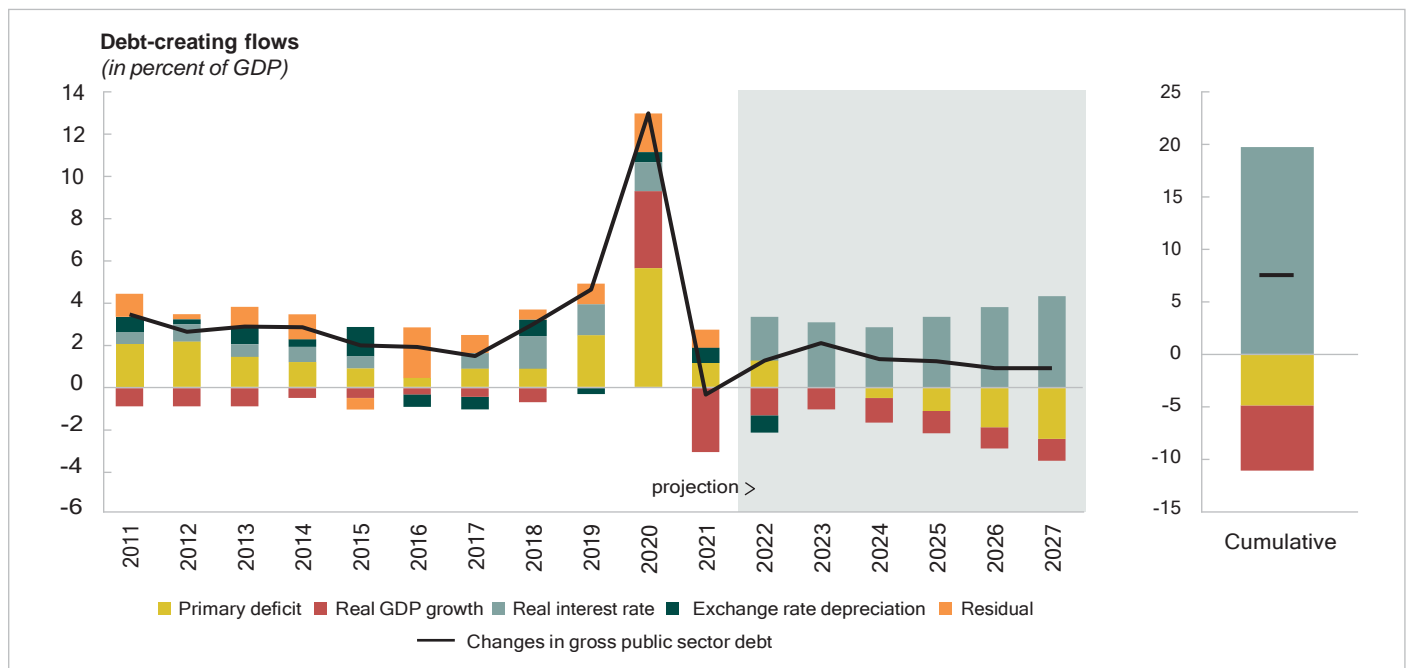
That being said, it is impossible to determine causality as the relationship between debt and growth runs in both directions. As noted in the literature, debt and growth can interact in a cyclical fashion, such that concerns about debt sustainability lead to financing concerns. Consequently, concerns of economic growth arise, which create worries of larger fiscal deficits. This can result in an increase in the risk premium, which, ultimately, further raises debt concerns. Nevertheless, the above regression analysis indicates that policymakers should consider the productivity of public spending and investment as it relates to improving growth.

3.4.4 Forecasts of the debt path in South Africa

To investigate projections of debt, the IMF's debt sustainability analysis template is customised to the case of South Africa along with various assumptions stemming from South Africa's current debt profile, National Treasury's estimates for the medium term and the IMF's projections for South Africa's economic growth. The projections below include assumptions about the future debt profile, where some existing debt is carried over and new debt issued follows a diverse profile of one-, two-, five- and ten-year bonds. Overall, debt is projected to be split so that approximately 10% is short term and 90% is long term. Additionally, these scenarios account for new foreign debt to be issued, alongside new domestic debt, maintaining an approximate 90:10 split between domestic and foreign debt in total.

From an initial projection, presented in Figure 3.3, the change in debt depends on movements in the real interest rate, exchange rate, primary balance, and real GDP growth. From 2011, the primary deficit has largely contributed to rising debt, while growth reduced the debt burden. Growth has been relatively weak over this period, however, and contributed to increasing debt in 2020 as a result of the large recession. In 2021, the rebound in the growth rate resulted in a small decline in the debt-to-GDP ratio. From 2022, however, this ratio begins to rise, increasing at a decreasing rate from 2023 onwards. The projection over the next six years suggests that recoveries in growth, as well as reductions in the primary deficit, to an estimated small primary surplus in 2024, will lessen the debt burden. However, increases in the real interest rate, or the cost of debt, will serve to counteract these effects. The relationship between debt and the exchange rate can also be seen in Figure 3.3, where the depreciation of the exchange rate raises the debt ratio. A strengthening of the rand post-pandemic would result in more favourable debt conditions. However, future projections of the exchange rate remain very uncertain. As a result, future assumptions about exchange rate trends remain neutral.

Figure 3.3: Debt-creating flows



The baseline scenario, presented in Figure 3.4, predicts that gross public debt-to-GDP will continue to rise to 77% of GDP in 2027., higher than National Treasury’s Budget 2022 projection for debt-to-GDP to stabilise in 2024/25 at 75.1%. Although debt-to-GDP fell slightly at the end of 2021, this does not mean that debt itself has fallen. Rather, GDP has grown much larger in comparison to 2020, which experienced a severe recession as a result of the pandemic. The GFN, as a proportion of GDP, fell from 11% in 2020 to approximately 6.7% in 2021, mainly as a result of a smaller budget deficit and a rebound in GDP. National Treasury predicted a similar estimate for the gross financing requirement in the 2021 Medium-term Budget Policy Statement (MTBPS). The GFN is predicted to rise again in this model to over 7% and 11% in 2022 and 2023, respectively, and to continue to increase over the forecasted horizon. These estimates for GFN are consistently higher, and therefore more pessimistic than those of National Treasury, which is aiming to keep its borrowing requirements low over the medium term. Therefore, the results presented should be interpreted with some caution as financing needs are sensitive to changes in revenue, expenditure, debt redemptions and interest rates.

A historical scenario, in which real GDP growth, the real interest rate and the primary balance are set to their historical averages, and a constant primary balance scenario, which sets the primary balance as constant from the first year of the projection, are also presented in Figure 3.4. Debt is projected to be ultimately higher under both alternative scenarios, reaching approximately 90% of GDP under the constant primary balance scenario in 2027. In other words, should the primary balance remain at its 2021 estimate and there be no further consolidation, debt would reach 90% of GDP. The divergence of the two alternative scenarios from the baseline implies that it may be difficult to sustain the planned adjustment.

Figure 3.4: Alternative scenarios for a future debt profile

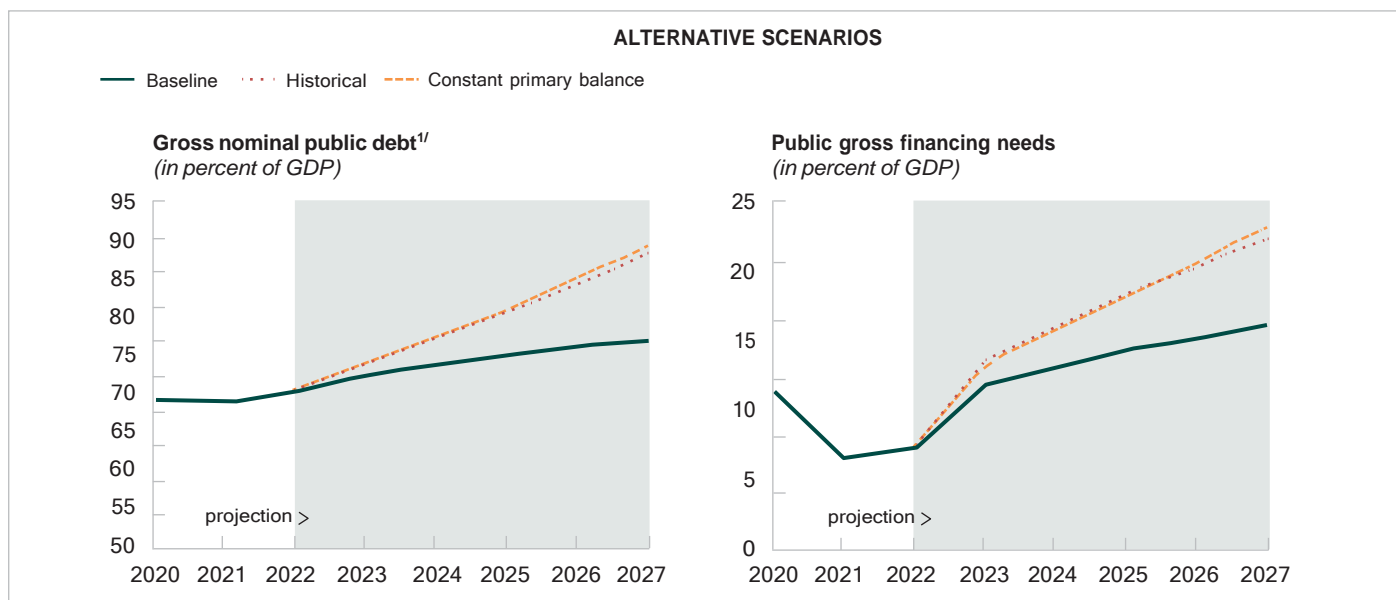
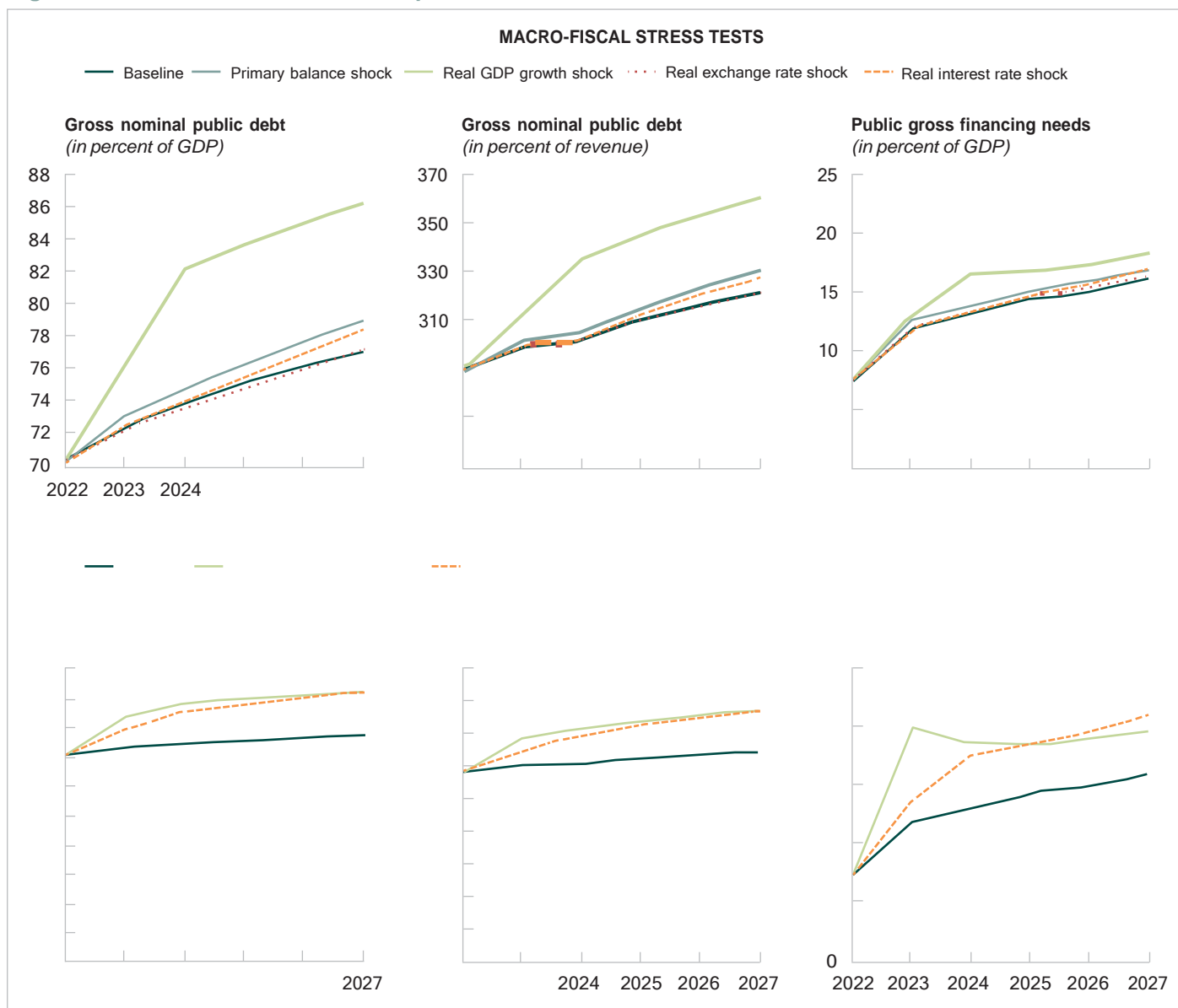


Figure 3.5: Stress tests for the debt profile



Various stress tests are presented in Figure 3.5 for this alternative debt profile. Shocks to GDP would be the most hazardous to debt ratios and to the GFN. Moreover, a combined macro-fiscal shock, comprising simultaneous shocks to the interest rate, exchange rate, growth rate and primary balance, result in substantially higher debt, as a proportion of GDP and revenue, and GFN. Similarly, a contingent liability shock, affecting growth, inflation and the interest rate, would have damaging effects on these projections.

From all the scenarios displayed above, the DSA indicates that shocks to GDP, exchange rate, interest rate, primary balance and contingent liabilities would cause high risks to the overall debt level, as well as to gross financing needs. Additionally, risks associated with market perception are moderately high, particularly due to the rising EMBI for South Africa. Very low risks are associated with public debt held by non-residents and foreign currency debt, given that South Africa's debt profile is mostly domestic debt with substantial holdings by residents.

Given that forecasts are based on assumptions about the future and other forward-looking estimates of other macroeconomic variables, the forecasts may be subject to error, given that they are judgements under uncertainty. Moreover, the past two years have consisted of frequent shocks to the economy, which have affected the fiscal path. As a result, further outbreaks of COVID-19 or other unprecedented events may alter the forecasts.

3.4.5 *Discussion on fiscal management*

These rising debt levels and debt service costs, seen throughout the chapter, bring about debate on the correct fiscal actions. The Fiscal Responsibility Bill was proposed in 2020 to impose fiscal rules for debt management, including mandated primary surpluses, cuts to employee compensation and expenditure ceilings when debt-to-GDP exceeds certain thresholds. There is, however, apprehension over the implementation of top-down rules. Some reasons include that such rules may be difficult to enforce or that they may not always be appropriate as debt sustainability is a function of many factors and conditions aside from the debt level. Nevertheless, given the evidence from the analysis above, there is a need for fiscal discipline to rein in debt and debt service costs through expenditure management and frequent reporting on fiscal sustainability. Additionally, the IMF (2022) suggested setting a credible debt anchor as a government goal to keep debt below a certain level over time to assist in consolidatory efforts and limit debt accumulation. Although debt is most likely already unsustainable and will climb over the next few years, a debt anchor may restore fiscal credibility and investor confidence by not allowing debt to significantly climb over National Treasury's projections for the medium term.

With regard to restoring the economy and promoting macro stability, the state will need assistance from other social partners to achieve its goals, particularly for the implementation of the Economic Reconstruction and Recovery Plan (ERRP). In the 2022 State of the Nation Address (SONA), the President highlighted the need to develop a new social compact to tackle poverty, inequality and joblessness. Government, business, labour and community will, thus, have to work together to identify the trade-offs and contributions each partner will need to make to address these challenges. A new social compact will need to coordinate on areas, including the rolling out of infrastructure, overcoming the pandemic, increasing the country's energy generation capacity and implementing an employment stimulus. Over recent years, the National Economic Development and Labour Council (Nedlac) has facilitated responses from the social partners relating to the COVID-19 pandemic, supporting Eskom for inclusive growth, and addressing critical skills to address occupational shortages. At present, reviewing labour market regulations to provide assistance and promote greater hiring in small businesses, reducing red tape in the business environment, addressing the way forward with the provision of social relief, and assessing the state of the state-owned entities are some of the issues the social partners must continue to collaborate on. Ultimately, addressing efficiency and growth through action from all social partners can assist in strengthening the economy and alleviate the fiscal burden, promoting sustainability.

3.5 Conclusion

From the literature and analysis, a sustainable debt path in South Africa is one where the fiscus is committed to stabilising debt via mitigating debt service costs, adjusting the primary balance and seeking improved growth and productivity in the economy, while protecting the needs of its population. From the trends shown in the analysis, debt sustainability has been relatively weak.

According to the results, South Africa faces several debt sustainability indicators that are not in its favour. Some of the indicators that do not favour sustainability include sharp increases in debt stock and debt service costs, particularly as measures of GDP and revenue, weak growth against high interest rates, indications of unproductive debt, and vulnerabilities to macroeconomic shocks. Regression analysis reveals inconclusive results of the reaction of the primary balance to rising debt, but there is some indication of a fiscal concern in the past to fulfil the solvency condition and to consolidate, or close, a fiscal gap when debt increases. Nevertheless, South Africa finds itself in unfavourable debt conditions with a high interest-growth differential. Among those that indicate a promise for sustainability are the debt profile, mostly consisting of domestic debt, and relatively low refinancing and exchange rate risks.

Further analysis into the debt-growth nexus examines the impact of debt on economic growth. High debt levels are associated with deteriorating growth. This result indicates the possibility of a debt overhang or inefficiencies in public spending. At the same time, it is noted that the debt-growth relationship runs in both directions. Additionally, projections of the debt path indicate that debt levels are vulnerable to adverse shocks to the primary balance, growth rate and interest rate, as well as to deviations from the proposed fiscal consolidation over the medium term. Such shocks may act to destabilise the debt path and raise financing needs.

Overall, the results provide relevant and updated information pertaining to South Africa's debt sustainability, factoring into account the rapidly changing economic climate. Such results are important to consider in policy analysis as they directly affect fiscal decisions, including choices regarding budget re-prioritisation given the growing debt service costs that detract from core spending. The results are vital in the context of the constrained fiscus, which must balance the stabilisation of debt and fiscal policy without sacrificing the provision of vital services, such as education, health and social security. Over the medium term, fiscal consolidation is likely to be harsh on South Africans, therefore underlining the necessity to carefully consider the budget and its priorities without compromising the basic rights of the public.

3.6 Recommendations

The Commission makes the following recommendations:

1. *The fiscus, through the Minister of Finance, must strive to rein in rising debt service costs, which comprise a substantial portion of the budget, detracting from allocations for the provision of essential services.*

The Commission supports the pro-growth fiscal consolidation that aims to stabilise and reduce government debt. The Commission encourages measures that reverse rising debt trends and, therefore, welcomes National Treasury's strategy to reduce the borrowing requirement. Given that debt service costs will continue to consume a growing proportion of GDP and revenue over the medium term, careful attention to budget and debt financing is needed to ensure that interest expenditure does not rise above 20% of revenue and to slow the annual growth rate of debt service costs, currently averaging 10% per annum. If left unaddressed, interest expenditure and redemptions will continue to consume fiscal space and crowd out expenditure on the provision of basic services and socio-economic rights.

2. *The Minister of Finance must exercise and maintain fiscal discipline via active debt management and regular reporting regarding debt accumulation, costs and sustainability under the current strained debt conditions. Such discipline should be exercised throughout all spheres of government.*

The proposition of the Fiscal Responsibility Bill in 2020 brought debate on whether to mandate fiscal action subject to debt thresholds. While stringent top-down rules may be difficult to implement, the Commission recognises a need to exercise and maintain fiscal discipline.

It is thus recommended that the Minister of Finance report to Parliament more regularly regarding the cost of debt, debt accumulation and fiscal sustainability to keep its members and the public informed, notwithstanding the existing reporting measures, such as the Fiscal Risk Statement. Additionally, an active supervision of debt is encouraged through proper expenditure management and monitoring to help government assess and swiftly implement appropriate fiscal actions subject to the economic context, levels of debt, debt service costs and other drivers of debt. Moreover, thorough expenditure management assists in preventing fiscal leakages, which contribute to the build-up of debt and ease the difficult budget decisions under consolidation.

Furthermore, the Commission notes the importance of examining the fiscal framework, given that activities at the subnational level impact the national fiscal status. Placing greater responsibility at the provincial and local level, accompanied by thorough reporting on expenditure management, may help to enforce greater accountability in instances of overspending and wastage, which contributes to the build-up of national debt levels.

3. *Weak productivity in expenditure should be addressed in order to create job-enhancing, income-generating growth (i.e. inclusive growth) through quality expenditure and investment-enticing reforms.*

The Commission stresses that long-term growth prospects require addressing structural constraints. The Commission thus welcomes reforms that entice private sector investment (such as addressing corruption vulnerabilities and ensuring energy security), create a competitive economy (e.g. reducing regulatory barriers to support small- and medium-sized businesses and accelerating reforms in mining, tourism and network industries), and ultimately result in greater value and productivity in the public sector.

Although spending is constrained, quality and unambiguous spending on reforms may reverse stagnant growth and high unemployment. Once again, proper expenditure management is needed to prevent leakages and fruitless spending.

The Commission further encourages the formation of a new social compact among the social partners (business, labour, community and government) to approach the necessary reforms, aligning with the Economic Reconstruction and Recovery Plan, to address the country's economic challenges.

4. *Investor confidence must be boosted and promoted through signalling that public debt is sustainable in the long run to reduce sovereign risk ratings and thereby the cost of debt, as well as to ensure the continuation of economic support.*

The Commission notes that vital role that the risks associated with government bonds plays in the cost of debt. Not only does the cost of debt rise with higher debt levels, but also with rising market uncertainty of the sustainability of the fiscus. Therefore, it is imperative for the Minister of Finance to send a signal to the public that debt is sustainable in the long run to maintain investment and fiscal support. Additionally, a credible debt anchor, such as that recommended by the IMF, could assist in raising fiscal support and credibility. This entails setting a government goal to ensure that debt does not substantially rise above National Treasury's debt projections for the medium term, particularly while the country remains in a weakened economic state.

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CHAPTER 4:

Affluence and inequality in South Africa's labour market

4.1 Introduction

The COVID-19 pandemic has brought many of South Africa's challenges to the forefront of the policy agenda. Not only has poverty and inequality worsened, but it has exposed and exacerbated many of the country's structural and fiscal vulnerabilities, such as high unemployment and rising public debt obligations. The South African government is committed to debt stabilisation through the reprioritisation of public spending (National Treasury, 2021). However, the government needs to carefully balance fiscal consolidation with its duty to protect the basic socio-economic rights enshrined in the Constitution. The Economic Reconstruction and Recovery Plan (ERRP), implemented in response to the devastating economic consequences of COVID-19, emphasises, among others, the need for inclusive economic development (Ramaphosa, 2020).

Fostering inclusive economic growth in South Africa implies greater participation in economic activity from a greater portion of the population. Currently, millions of South Africans are excluded from contributing their full potential to the economy because they cannot find work that matches their skills set. Unemployment is a key driver of income inequality, both of which have remained stubbornly high in the post-apartheid era. This is despite redistributive fiscal policy tools, such as the provision of the "social wage", which extends protection to the most vulnerable groups. Well-targeted government grants have played a crucial role in reducing poverty. However, it appears that slow and stagnant economic growth over the past decade – alongside suppressed and unequal growth in wages – has limited the extent to which cash transfers can reduce income inequality. When inequality is high and persistent, large segments of the population continue to be excluded, which constrains aggregate performance and undermines the inclusive growth needed to put South Africa on a sustainable development path.

Understanding how labour market income is distributed in South Africa, particularly at the top end of the distribution, should inform economic policies. However, without reliable data on top incomes, it is impossible to gain a better understanding of the amount of income a person must have to be considered affluent and how large this affluent portion of society is. This raises concerns for fiscal policy, in particular, since it is this portion of the population that funds the fiscus through direct taxes, such as personal income tax (PIT). Over 90% of the South African government's PIT revenues are paid by the top richest decile of the population (Inchauste et al., 2017). The PIT accounts for approximately 37.8% of total tax revenue (Financial and Fiscal Commission, 2021), implying that government revenue is heavily dependent on – and susceptible to changes in the incomes of – a small and relatively affluent portion of society. In the context of the "missing middle" and shrinking tax base, this could potentially undermine South Africa's fiscal sustainability and credibility in the long run.

Earnings inequality is a key driver of overall income inequality in South Africa. The scope of this chapter is thus confined to investigating income inequality and affluence using data from South Africa's labour market. The chapter is structured as follows: First, the relationship between income inequality and fiscal policy is briefly noted as this provides a key rationale for reducing income inequality from the outset. Second, the rise in income inequality in the post-apartheid era is shown using household survey data and standard inequality measures, such as the Lorenz curve, Gini coefficient and Palma ratio.

Third, trends in the distribution of income are provided to show the stark contrast in earnings growth at the very top of the income distribution. These findings are discussed taking into account theoretical explanations in the literature and, importantly, in light of prevailing measurement issues that arise from using survey data. Demographic, gender-based and spatial dimensions of income inequality are also considered to emphasise that policies need to be sensitive to a range of intersecting vulnerabilities. In the final section of this chapter, secondary data is drawn upon to note the impact of COVID-19 on the labour market.

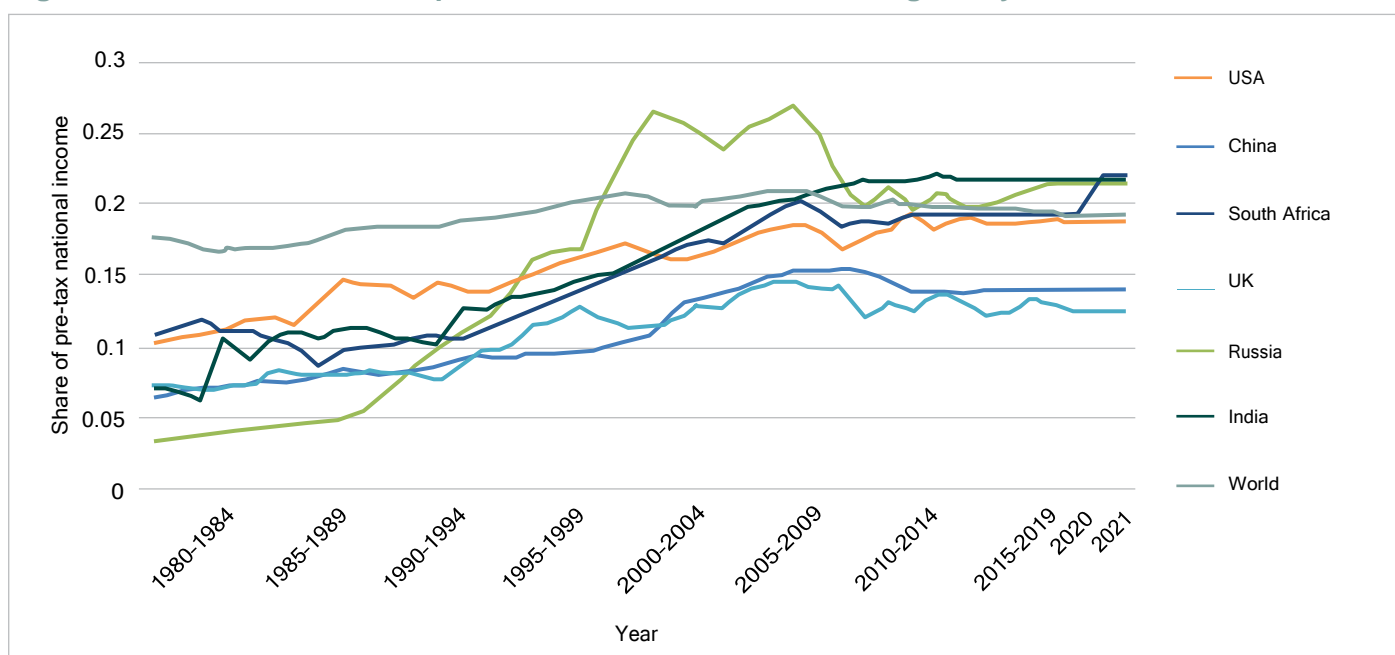
The aim of this chapter is to investigate the extent of earnings inequality in South Africa and identify key shortfalls in the current policy environment. The chapter concludes with policy recommendations aimed at, firstly, fostering more equitable wage growth and inclusivity in the labour market, and secondly, improving the transparency and availability of reliable income data, particularly at the top of the distribution. The analysis of this chapter follows a quantitative approach using statistical tools to measure income inequality from the Post-apartheid Labour Market Series (PALMS) dataset.

4.2 Results

4.2.1 The rise of income inequality globally

There has been a remarkable rise in top-income percentile shares on a global scale, particularly since the 1980s (Atkinson and Piketty, 2010). This rise in top incomes relative to those at the bottom and middle of the income distribution is associated with the rise in globalisation, the removal of trade barriers and “winner takes all” pay structures (Atkinson and Piketty, 2010). In the United States, for example, the share of national income accruing to the top 1% increased from 9% in 1976, to 20% in 2011 (Alvaredo et al., 2013).

Figure 4.1: The rise in the 99th percentile’s share of total income globally, 1980–2021



Note: Pre-tax national income is the sum of all pre-tax personal income flows that accrue to the owners of production factors (labour and capital) before taking any taxes and transfers into account, but after taking pensions into account. The base unit is the individual. Shares are provided in percentages.

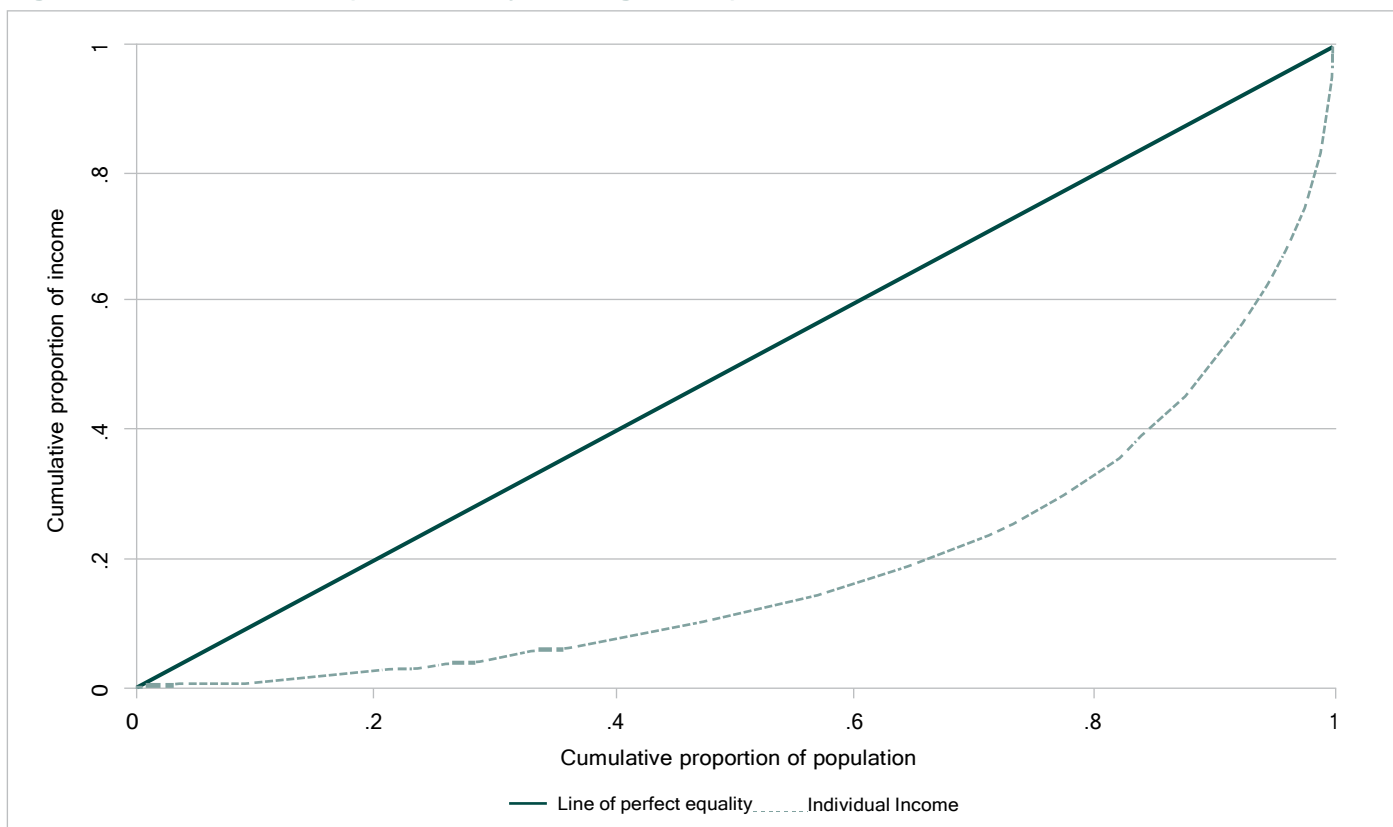
Source: World Inequality Database

4.2.2 Earnings inequality in South Africa

Earnings inequality in South Africa should be viewed from the perspective of a highly segmented labour market, increasingly characterised by job and wage polarisation (Bhorat et al., 2020). The changing composition of sectors in the economy since South Africa's transition to democracy affected the aggregate demand for labour, which is an important feature of understanding increasing polarisation in the labour market. Structural transformation has occurred in the movement away from an economy centred around agricultural, mining and manufacturing sectors, to one dominated by services and finance sectors (Bhorat and Khan, 2018). Since the end of apartheid, when neo-liberal economic policies were introduced, growth in the agricultural industry has largely stagnated and manufacturing has seen a decline. Significant employment losses in the agricultural sector can partly be explained by labour market institutions, such as the imposition of minimum wage laws, which increase the costs of labour and reduce the demand for labour (Bhorat et al., 2014).

A preliminary investigation into earnings levels in the domestic labour market suggests that the average person in 2017, which is the latest year of available data in PALMS, earned a pre-tax income of R8 896 per month.¹ When the population is ordered from poorest to richest, earnings at the 50th percentile (p50) of the distribution – i.e. the median monthly earnings – stood at R3 582 per month in real terms. This is considerably lower than the mean, which indicates that the majority of the population actually earns below average and that relatively few high incomes at the top of the distribution drive average earnings higher up the distribution.

Figure 4.2: Lorenz curve (real monthly earnings, 2017)



Source: PALMS, Commission's calculations

¹ This is when outliers in the data are excluded. This figure is likely to be understated due to the large amount of missing earnings data, particularly at the top end of the earnings distribution. For instance, Assouad et al. (2018) estimated the average monthly pre-tax income in 2016 to be approximately R16 000 (in real terms), although their estimates refer to overall income and not only wage income.

Figure 4.2 illustrates the well-known Lorenz curve, which is a simple graphic representation of the distribution of income in a given society. With the population ordered from poorest to richest, the Lorenz curve shows the cumulative proportion of income received (on the y-axis) for each cumulative portion of the population (on the x-axis) (Shifa and Ranchhod, 2019). If everyone were to receive the same income, the Lorenz curve would be a straight line at 45° - the “line of equality”. The further away the Lorenz curve lies from the line of equality, the more unequally income is distributed. Figure 4.2 suggests that 90% of the population cumulatively receives roughly half of all income produced in the labour market. The Gini coefficient is another widely used measure of inequality, which is closely associated to the Lorenz curve (Shifa and Ranchhod, 2019). It calculates the area between the line of equality and the Lorenz curve (the deviation from equality), divided by the area under the diagonal (the maximum possible departure from equality) (Van der Berg, 2014).

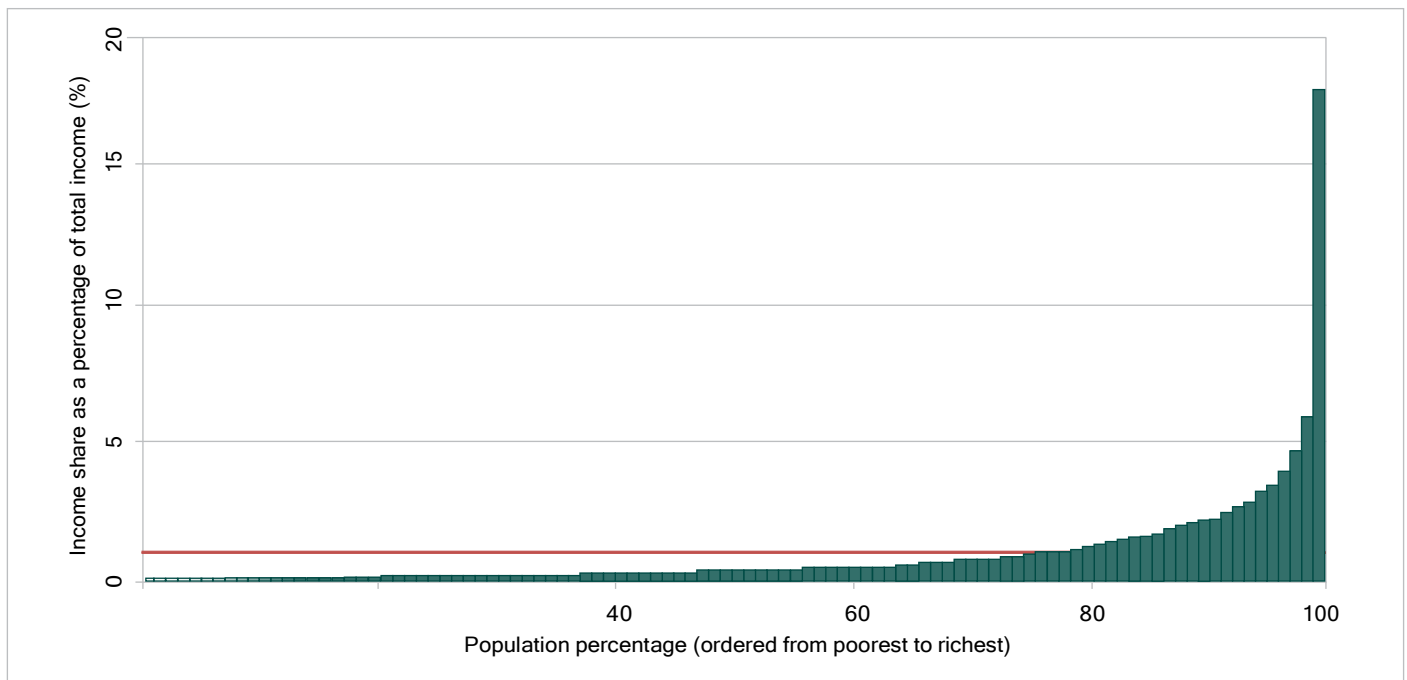
From the above Lorenz curve, the corresponding Gini coefficient is estimated at 0.62.² Although this figure can still be interpreted as a high degree of inequality, it is likely to be understated due to the fact that high-income earners have a greater tendency to misreport, understate or refuse survey questions relating to their personal income, which results in a number of missing earnings observations for these affluent individuals. To overcome hurdles of missing earnings data at the top end of the income distribution, researchers often need to use imputation methods or draw on wider sets of data. The reason for this is that poor and affluent individuals do not obtain income from the same sources. For example, social grants are an important source of income for poor household, while income derived from capital are more prevalent among affluent individuals (at the upper end of the income distribution), who are able to draw on a greater variety of income sources, i.e. they are not completely reliant on labour market income.

Therefore, studies that have used tax return data in conjunction with household survey data are able to get a better representation of overall income inequality. To compare, drawing on a wider range of data sources (including tax administrative data), the income Gini coefficient has been estimated at 0.67 (Orthofer, 2016). This disparity illustrates how drastically the measure of inequality changes depending on the data used and how income is defined. Given that income is defined narrowly in this study, as it is restricted to labour market income only, this brief comparison not only illustrates important limitations in this research, but also highlights some of the underlying complexities that arise when measuring inequality. Although a greater number of researchers are now incorporating tax data for more robust analyses of inequality, these data are not always readily available to the public.

The discussion so far highlights two important preliminary points relevant for policymakers that seek to ensure that policies are tailored well enough to reduce inequality. Firstly, numerous complexities arise when measuring income inequality that needs to be accounted for. This should be done in a transparent manner, such that underlying research methodologies used to measure inequality can be widely understood. For instance, the fact that earnings imputation methods in Statistics South Africa’s Quarterly Labour Force Survey (which form part of PALMS) are not publicly available to researchers makes it difficult to overcome certain limitations (Kerr and Wittenberg, 2019). Overall, there is a need for greater harmonisation of data and data cleaning processes, which cannot be achieved without data transparency. Secondly, policies aimed at reducing inequality must be informed by specific drivers of inequality and target them. In this respect, income inequality has largely been targeted through cash transfers to the poor. However, earnings inequality is a major driver of income inequality, thus such policies do not target the drivers of inequality, but rather the outcome of inequality. It is thus better and more efficient for policies to tackle the underlying causes of inequality. In light of the fiscal strain the economy is currently undergoing, this is undoubtedly a more sustainable solution.

² Flagged outliers and missing earnings in PALMS v. 3.3 are excluded from this calculation.

Figure 4.3: Distribution of monthly earnings (2017)



Source: PALMS, Commission's calculations

Between 2012 and 2016, the World Inequality Database (WID) provided evidence that the top decile in South Africa took home approximately 63% of total national income (Alvaredo et al., 2018)³. Investigating earnings inequality from the labour market, in particular, using decile shares in PALMS, shows that, in 2017, the top 10% of earners received 49% – almost half – of total monthly earnings in real terms. The bottom 50% of the population (i.e. the poorest half of the population) received a share of only 11%. Delineating share further into percentiles shows that the income share of the top 1% was about 17%, as shown in Figure 4.3.

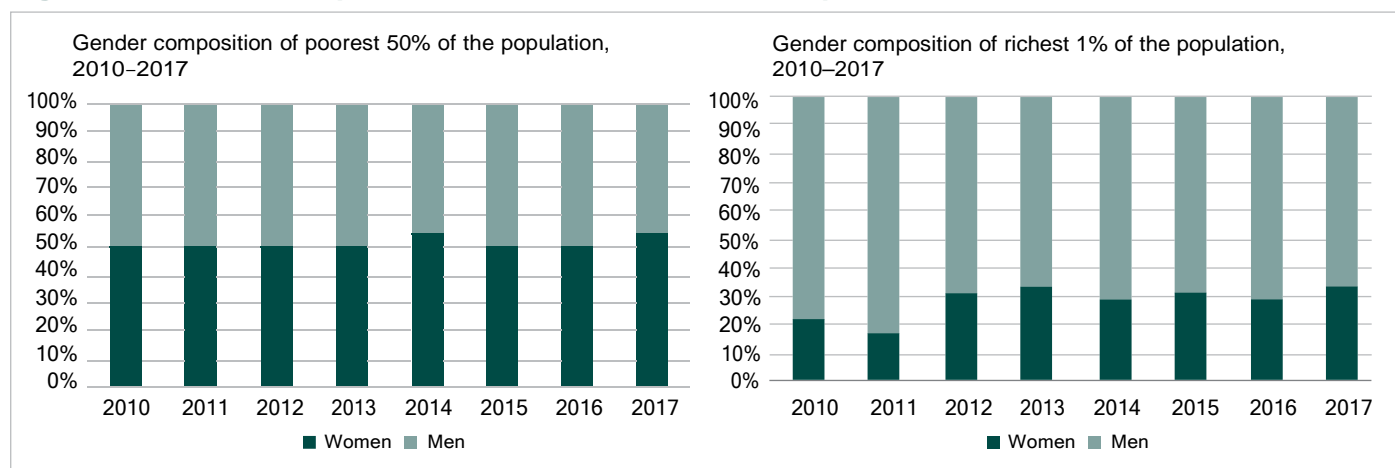
The red line in Figure 4.3 illustrates the line of equality, which is the share of labour market income received if everyone earned the same amount. The rand amount of monthly income required to enter the top 10% of earners in this scenario is just above R20 000, while to enter the top 1%, this amount is approximately R63 000 (in 2017 and before tax). Comparing these figures to those obtained from the WID yields stark contrasts. The WID's figures show that, to enter the top 10%, one needs a monthly income of about R29 000, while to enter the top 1%, one's monthly income should exceed R150 000. This demonstrates the importance of drawing from a wider range of data sources to better capture the extent of earnings inequality, particularly at the top end of the income distribution where income data is often lacking (Hundenborn et al., 2019). These disparities also illustrate the degree of arbitrariness that accompanies the use of thresholds to measure concepts such as affluence and richness.

4.2.3 Gender and racial dimensions of earnings inequality

Before investigating earnings trends in the post-apartheid era, it is necessary to briefly consider certain demographic characteristics of earnings inequality in South Africa. Disaggregating monthly earnings across genders reveals the gender wage gap. On average, in 2017, males earned R10 164 per month, while females earned R7 274 – approximately 30% less than their male counterparts. A growing body of literature has pointed to the fact that intersecting inequalities matter for a deeper understanding of why inequalities persist (Stats SA, 2019).

³ This is when a wider definition of income is used, i.e. income is not only restricted to income earned in the labour market.

Figure 4.4: Gender compositions of the bottom 50% and top 1%, 2010–2017

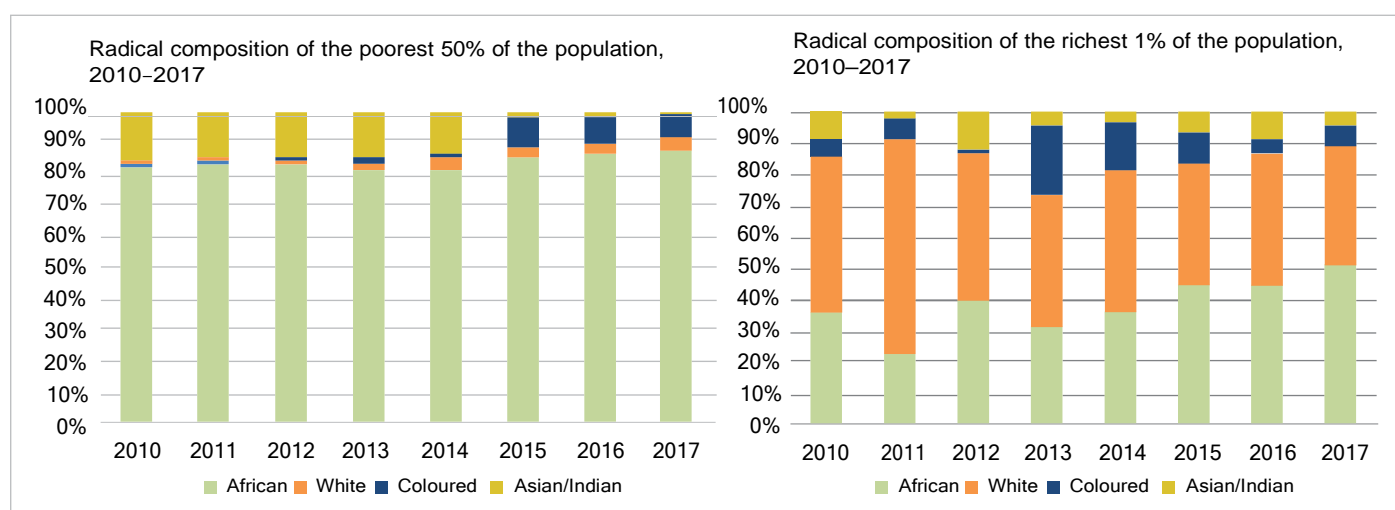


Source: PALMS, Commission's calculations

Figure 4.4 shows the proportion of men and women who make up the bottom 50%, the top 10% and the top 1% of the income distribution, respectively. More women than men make up the poorest half of the population. Men make up a large portion of the top 10%, and an even greater portion of the top 1%. Between 2010 and 2017, the ratio of women to men has remained relatively stable for both the bottom 50% and top 10%. However, over the same period, more women have gradually started entering the top 1%: women only made up about one-fifth of the richest 1% of the population in 2010. This figure increased to just over 30% in 2017.

Earnings inequality is still high across racial groups as well. Whites, who make up less than 10% of the sample population, earn on average R20 420 per month; Asian/Indians earn on average R16 969 per month, and Coloureds earn on average of R7 615 per month. The African population – about 70% of the sample and by far the largest group – still have the lowest monthly earnings at R7 072 on average.

Figure 4.5: Racial compositions of the bottom 50% and top 1%, 2010–2017



Source: PALMS, Commission's calculations

Figure 4.5 takes the racial composition of the income distribution into account. What is striking is that more than 80% of the poorest half of the population is African, and that this figure has increased to almost 90% between 2010 and 2017. In simple terms, more African workers have entered the bottom 50% of the income distribution. The rise in the African population in the top 1% can be interpreted as the rise in the “black elite” that has occurred since the end of apartheid. Although the fact that fewer white individuals are in the top 10% and 1% in 2017, compared to 2010, is an encouraging development. It must be remembered that whites make up a small portion of the South African population – less than 10% – while Africans make up over 70% of individuals in this sample.

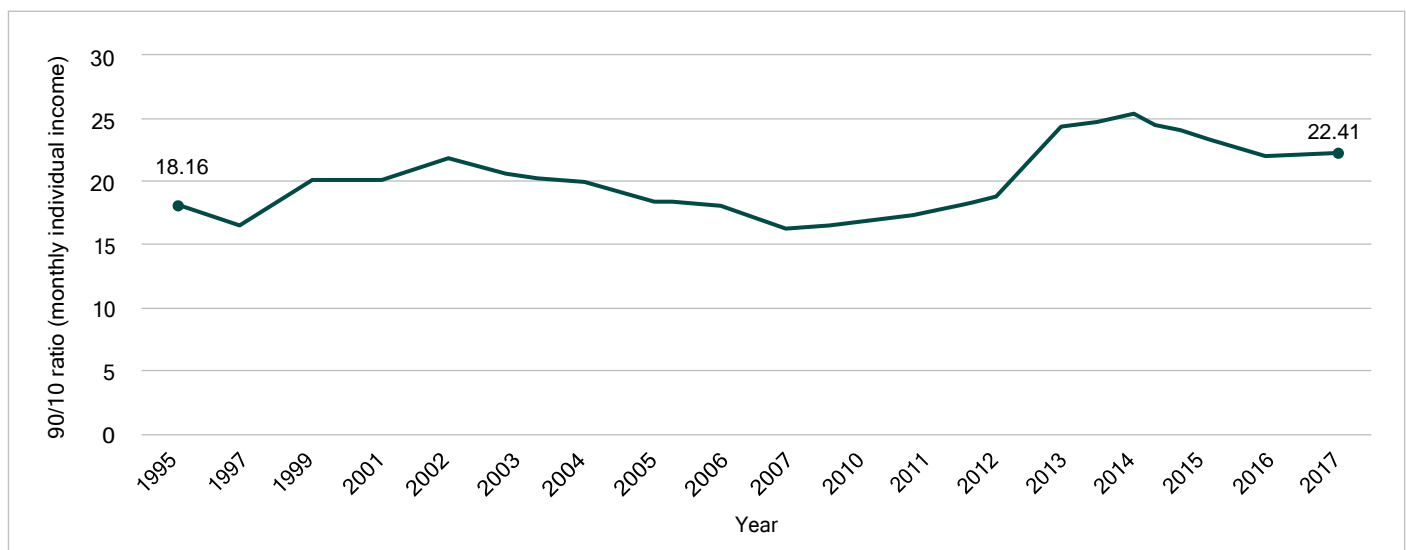
Altogether, these graphs illustrate how, almost three decades since the end of apartheid, both earnings inequality and affluence are still highly segregated along racial lines.

It is worth noting that earnings inequality also intersects across both racial and gender lines. For instance, African women earn the least on average R5 859 per month, while white men earn the most, at R22 912 per month. Interestingly, gender inequality is a persisting feature across different groups in the sample: on average, women earn at least 20% less than men across all racial groups. Income differences across genders is most stark in the Asian/Indian group, where women earn approximately 35% less than men, on average.

4.2.4 Post-apartheid trends in the distribution of earnings

Figure 4.6 displays the p90/p10 earnings ratio between 1995 and 1997. It essentially tells us how much richer the top decile is than the bottom decile over this time period. In 1995, the top decile was approximately 18 times richer than the bottom decile. By 2017, however, the labour market income of the top decile was about 22 times greater than the income at the bottom decile. Thus, the upward trend shows that the earnings gap between the 10th and 90th percentiles has widened, suggesting that the “rich” have become relatively more affluent in post-apartheid South Africa. Compared to Organisation for Economic Cooperation and Development (OECD) countries, the Palma ratio was estimated at 9.6 in 2015, i.e. the top decile is approximately 9.6 times richer than the bottom decile in these countries – not as rich as the bottom decile compared to South Africa (OECD, 2015). Persistently high levels of inequality not only affect the social cohesion of society, but are also detrimental to long-term economic growth (Stiglitz, 2012).

Figure 4.6: Increasing earnings inequality in the post-apartheid era, 1995–2017

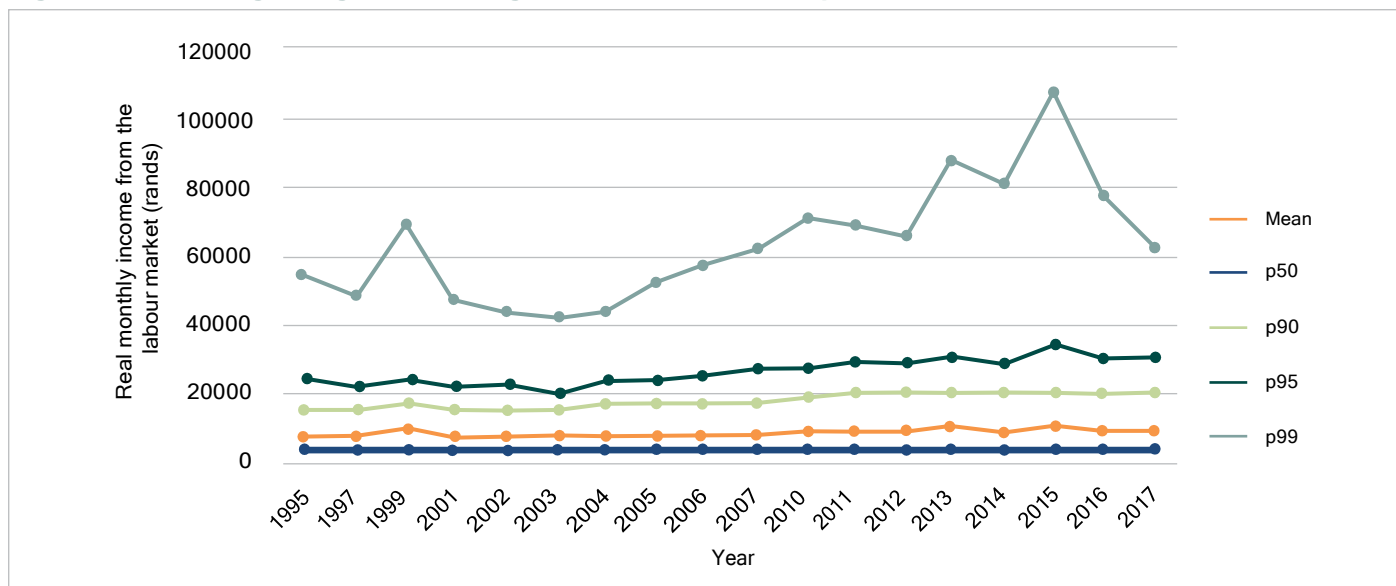


Source: PALMS, Commission's calculations

Investment in human capital is an important transmission mechanism between inequality and growth. In South Africa, despite significant public spending on education, poor and low-income households still struggle to access quality education, implying lower social upward mobility. Furthermore, evidence shows that, even after fiscal redistribution in South Africa, income inequality remains stubbornly high (Maboshe and Woolard, 2018). This suggests that there is scope for further investigation into alternative policy measures to combat unequal wage growth and reduce inequality.

Such policies should aim to be both growth-enhancing and inequality reducing. One such policy initiative would be to focus on improving the integration of unskilled labour to offset the impact of the rise in low-wage, low-skill, precarious forms of work prevalent at the bottom of the income distribution.

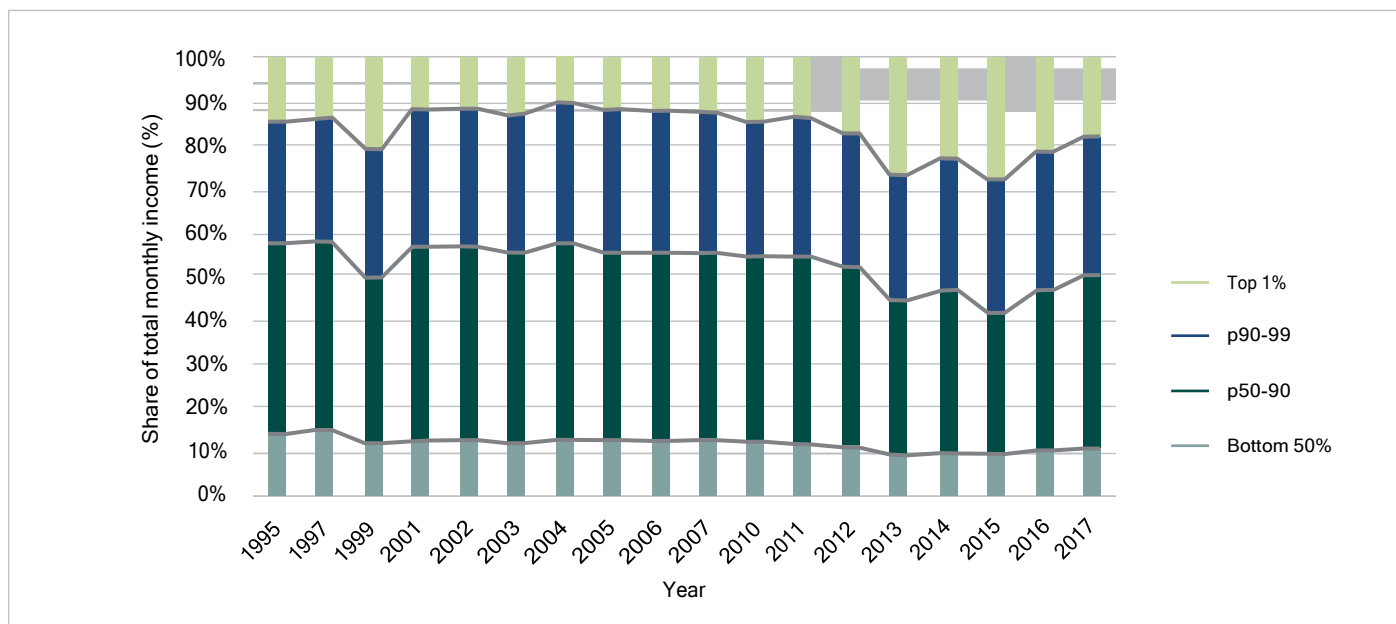
Figure 4.7: Earnings stagnation and growth across income percentiles, 1995–2017



Source: PALMS, Commission’s calculations

From Figure 4.7, wage growth appears to be slow across most of the income distribution, apart from incomes at the very top 1%. A combination of low and stagnant wages, and rising living costs reduces the purchasing power of low-income workers over time. While recent evidence shows that income redistribution (through progressive taxation and social spending) cancelled out some of the income losses of the poor, this was not substantial enough to turn into income gains. Furthermore, it did not mitigate the substantial rise in incomes at the top of the distribution. However, it is important to note that the drastic volatility in income growth of the top 1% (p99), as illustrated by the kinks, is more likely a reflection of different surveys and changes in the data collection process, rather than actual growth in earnings over those years.

Figure 4.8: Share of total income earned by income group, 1995–2017



Source: PALMS, Commission’s calculations

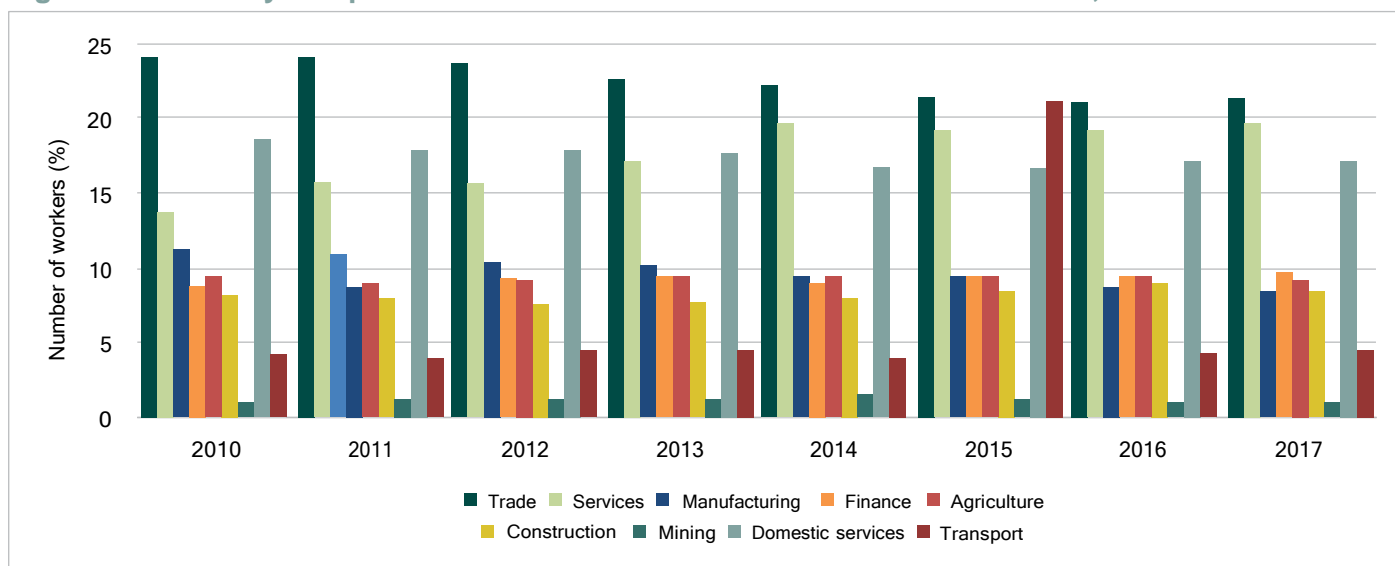
Figure 4.8 shows the distribution of earnings across income groups, expressed as a proportion of total monthly (real) earnings, between 1995 and 2017. The poorest half (bottom 50%) of the population receives the smallest proportion of income from the labour market relative to other income groups. Figure 4.8 suggests that the poorest half of the population’s share of total income gradually decreased over the post-apartheid era from approximately 14% in 1995, to 10.8% in 2017.

The share of total income of the top 10% (excluding the top 1%) appears to have remained relatively stable in the post-apartheid period, but has actually increased from 28.4% to 31.8%. The share of the upper-middle class (p50 to p90) has decreased notably from 43% to 39%. Over the same period, the share of the top 1% increased from approximately 14% to almost 18%. Even in times of economic downturn, top incomes appear to have grown disproportionately from the rest of the distribution. Understanding the evolution and dynamics of these income’s shares should inform policies aimed at reducing inequality. Overall, the bottom 90% of the population’s earnings share (i.e. when the population is ordered from poorest to richest) has decreased in the post-apartheid era. From a policy perspective, it is critically important for the government to enhance data transparency. This can be achieved by improving access to datasets, as well as access to key documentation explaining the various techniques that were used to prepare datasets, such as certain imputation methods applied to earnings data in the Quarterly Labour Force Survey that have not yet been clarified (Kerr and Wittenberg, 2019). Overall, there is a need for greater harmonisation of data, which cannot be achieved without data transparency.

4.2.5 Earnings inequality, affluence and industry composition

Since the end of apartheid, when neo-liberal economic policies were introduced, growth in the agricultural industry has largely stagnated and manufacturing has seen a decline. Significant employment losses in the agricultural sector can partly be explained by labour market institutions, such as the imposition of minimum wage laws, which increase the costs of labour and reduce the demand for labour (Bhorat et al., 2014). The increase in the top 1 percentile shares in post-apartheid South Africa may be attributed to an increase in the supply of unskilled labour and the decline of industries that demand lower skills.

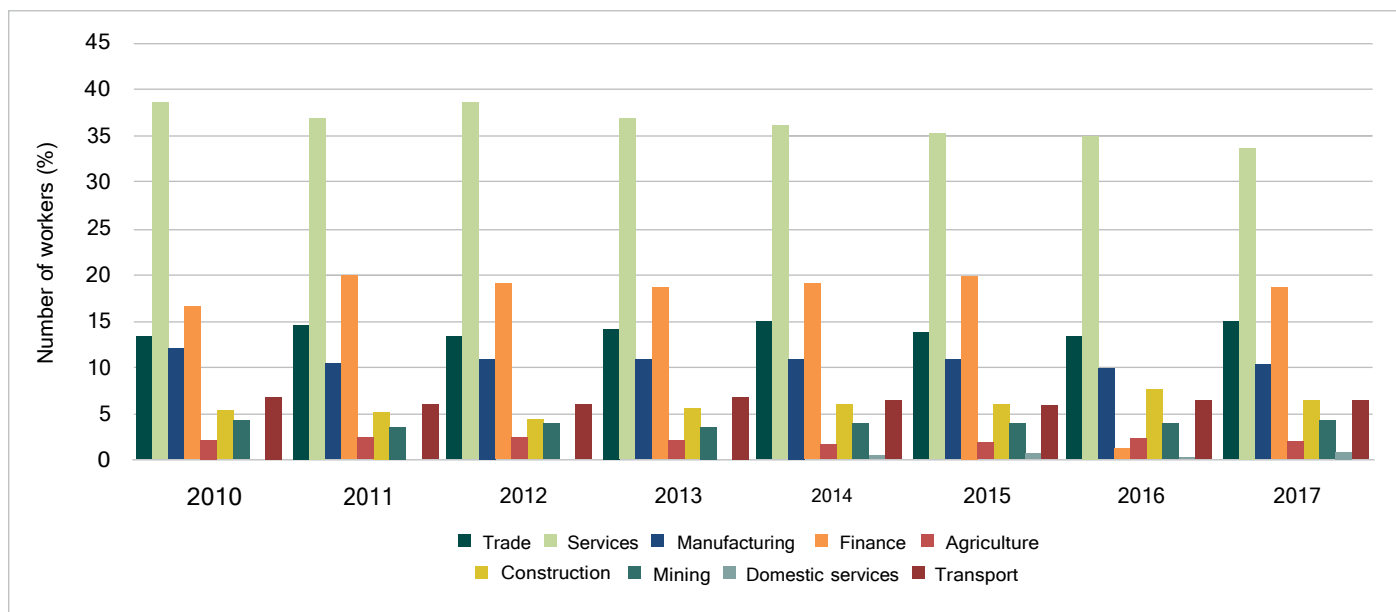
Figure 4.9: Industry composition of the bottom 50% of the income distribution, 2010–2017



Source: PALMS, Commission’s calculations

Figure 4.9 shows the proportion of low-income workers across industries in South Africa. Between 2010 and 2017, trade and domestic services were dominant industries of employment for the poorest half of the population. What is also notable is that more and more low-income workers have taken up employment in the services sector, which has grown substantially when measured in terms of number of employees.

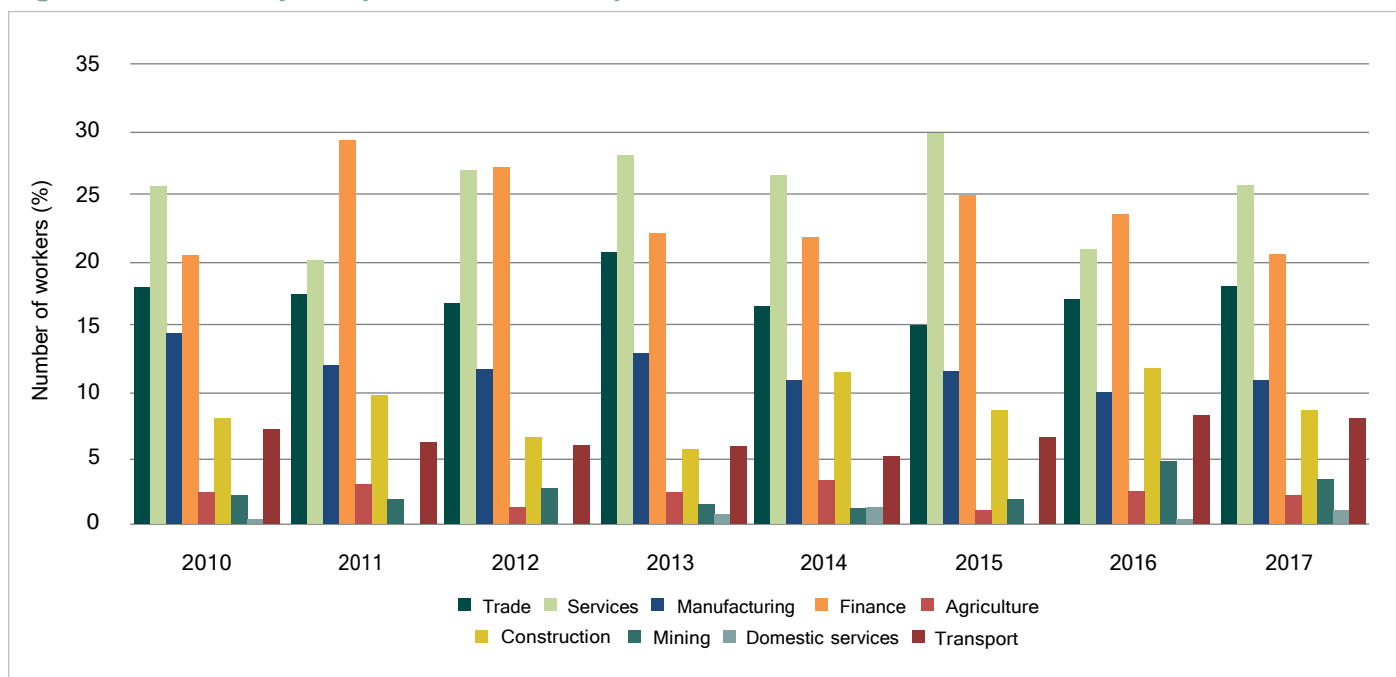
Figure 4.10: Industry compositions of the top 10% of the income distribution, 2010–2017



Source: PALMS, Commission’s calculations

Figure 4.10 shows the industries in which the more affluent portion of the population tend to work. The top 10%, in particular, are more likely to work in services compared to other industries. The figure also illustrates how the finance industry becomes more important higher up the income distribution: those in the top 10% are approximately twice as likely to work in finance than those in the bottom half of the income distribution.

Figure 4.11: Industry compositions of the top 1% of the income distribution, 2010–2017



Source: PALMS, Commission’s calculations

Once again, Figure 4.11 shows that, in terms of industry composition, the richest 1% of the population have worked mostly in services between 2010 and 2017. However, finance plays an even greater role now, and in 2011, 2012 and 2016, appears to have surpassed services in terms of the number of affluent employees working in these industries. Interestingly, noticeably more workers in the top 1% work in trade, compared to the top 10%.

Given the smaller sample size used for the industry analysis, one should exercise caution when attempting to interpret these trends or reach any definitive conclusions. Nonetheless, three general observations can be noted. Domestic services is an important source of employment for the poorest half of the population, and other studies have shown that this form of work is almost entirely undertaken by women. The services industry remains an important area of work throughout the income distribution. The finance industry tends to be geared to employ only the most affluent individuals in South Africa.

The above graphs should be viewed in light of the fact that, in the post-apartheid era, the contribution of services to overall gross domestic product (GDP) has expanded rapidly compared to other sectors of the economy, from 34.4% in 1994 to approximately 47% in 2016 (Bhorat and Khan, 2018). Evidence shows that, since 2001, most employment creation has been rooted in the growth of service jobs (Bhorat and Khan, 2018). The services sector is characterised by many low-wage jobs and relatively few skilled high-wage jobs, giving rise to increasing job polarisation between employees with different skillsets (Davis and Van Seventer, 2020). Diverging growth patterns across sectors have predominantly been driven by global forces, such as increased international trade associated with globalisation, and the surge of labour-replacing technologies (i.e. automation) that have reduced the demand for semi-skilled labour and increased the demand for skilled labour (Davis and Van Seventer, 2020). Increased competition from abroad has contributed to the decline in manufacturing output as more and more jobs in the middle of the earnings distribution have disappeared (Bhorat and Rooney, 2017).

4.2.6 COVID-19 and inequality in the labour market

Due to data constraints, a major limitation in this chapter is that it does not include an analysis of the impact of the COVID-19 pandemic on income inequality. The pandemic has undoubtedly had an unprecedented impact on South Africa's economy, with wide-ranging ramifications not only for the country's fiscal credibility, but also for the economic wellbeing of millions.

Vulnerable groups were particularly susceptible to job losses, depriving them of an income from the labour market. The number of job losses that occurred during the first national lockdown amounted to approximately three million, which represents an 18% decline in employment. Following the easing of restrictions, there is evidence of the labour market recovering to pre-pandemic levels of active employment. However, in the third quarter of 2021, the official unemployment rate still stood unacceptably high at 34.9% (Stats SA, 2021). The unequal impact of lockdown restrictions and job losses has been well documented since the onset of the pandemic (Casale and Shepherd, 2021). A concerning development since the onset of COVID-19 is the surge in school dropout rates. It is estimated that, by May 2021, 650 000 to 750 000 children between the seven and 17 were not attending school (Shepherd and Mohohlwane, 2021). This is likely to have a significant impact on the labour market, given that persons with higher educational attainment are more easily absorbed into the labour market. The COVID-19 pandemic has exacerbated many of South Africa's socio-economic challenges, fostering deeper economic and social exclusion and undermining all previous policy efforts to reduce inequality.

4.3 Conclusion

Globally, income inequality has increased since the 1980s across both developed and developing economies, albeit at different rates and to varying degrees. There is little evidence of this upward trend slowing down, which raises concerns for the sustained economic growth in the future, since high levels of inequality constrain aggregate economic performance. Inequality thus remains a key development challenge globally. In South Africa, persistently high levels of economic inequality, evidenced from the labour market, translate into power asymmetries that embed social exclusion and create social unrest, undermining sustainable economic growth and threatening our constitutional democracy. In order for economic growth to be inclusive and sustainable, widespread joblessness and inequality in wage growth must be prioritised in the policy agenda.

Considering demographic features of earnings inequality in South Africa, there is a small black elite that has started entering the top 1% in the post-apartheid era – although given the size of the African population, this is not reflective of the majority. In fact, there is evidence that, in 2017, almost 90% of the poorest half of the population is African. Although more women have started entering the top 1% between 2010 and 2017 – which may imply some degree of social upward mobility at the top end of the distribution – women still make up the majority of the poorest half of the population and only about one-third of the top 1%. Inequality and degrees of affluence are thus still highly segregated along racial and gender dimensions.

In South Africa, earnings inequality was already extremely high and persistent prior to the onset of the COVID-19 pandemic, which caused severe disruptions in economic activity and resulted in record levels of unemployment. In 2017, almost half of all income earned in the labour market went to 10% of the population. This affluent portion's share of total income has increased since the end of apartheid, while the bulk of the population's income shares has decreased proportionately. This is concerning, especially in light of drastic inequalities that occur, even within the top decile of earners, particularly wage inequality within the top 1%. Evidence shows that wage growth has been predominantly slow and stagnant across most of the earnings distribution, with the exception of the richest 1% of the South African working-age population, who have experienced substantial income gains in the post-apartheid period. This suggests that the labour market in South Africa is geared towards rewarding more affluent individuals with higher paying jobs that demand a more specialised skills set. For instance, the growth in the services sector, associated with globalisation and, in particular, financialisation, has been accompanied with a rise in the finance industry and a decline in manufacturing.

Amid a decade of poor growth performance, increasing fiscal pressures and global economic shocks that have impacted negatively on the domestic economy, it is now more important than ever before that policies prioritise reducing the wage inequality by fostering employment and greater inclusivity in the labour market. According to much evidence from the literature, inequality in the labour market is a key driver of overall inequality in South Africa. The ability of the government to foster inclusive growth hinges on its ability to effect structural changes in the domestic labour market, which impact positively on both employment outcomes and wage growth. Importantly, if reducing inequality is to be taken seriously, wage growth cannot continue to be unequal across the earnings distribution. This is especially critical in light of rising fuel prices and increasing living costs, which tend to erode the purchasing power of all but a few affluent individuals at the top of the distribution, whose income growth can keep up with inflation. If the rest of the less affluent population keep getting left behind, the historical structures of inequality in South Africa that favour the interests of a small elite will be perpetually reinforced.

There is thus a need for carefully tailored, structural policies that are both growth enhancing and inequality reducing. However, for policy to be well targeted, further understanding is needed of the factors that drive income growth across the earnings distribution, particularly among earners at the very top of the distribution. However, comprehensive, accessible and nationally represented data on top earnings in South Africa is still lacking among survey data. Although there has been much progress made on measuring top incomes

globally, a brief comparison of measurements from different data sources and varying methodologies reveals stark contrasts, which undermine the reliability of earnings estimates and trends. Data transparency and accessibility is quintessential for evidence-based policymaking and should therefore be prioritised.

4.4 Recommendations

The Commission makes the following recommendations:

1. *Policies aimed at reducing inequality should, as a point of departure, be targeted at reducing inequality in the labour market. This requires policies that enable large-scale job creation and more equitable wage growth across different sectors of the economy, which, in turn, may require greater investment into labour-intensive industries that are able to absorb low-skilled workers into the labour market.*

Earnings inequality is an important driver of overall inequality in South Africa, which has remained unacceptably high in the post-apartheid era. This not only constrains South Africa's growth potential, but could also undermine fiscal credibility in the long run. Policies currently aimed at redistributing income are insufficient to reduce income inequality and foster inclusive economic growth. Given that inequality in earnings remains an important driver of overall income inequality, policy measures to reduce inequality should support activity in the labour market. Such policies include, but are not limited to strengthening linkages between the labour market and social transfer system (creating employment incentives), revising labour regulations that disincentivise employment, and reducing barriers to self-employment, in line with President Ramaphosa's State of the Nation Address, 2022, which mentions regulatory reform to cut red tape and adopt measures that assist small businesses.

Importantly, given the skewed industrial structure of the South African economy, with the growth in service sector jobs only benefitting relatively few top earners in the financial industry, fostering more equitable wage growth requires both supply- and demand-side considerations. From the supply side, the workforce needs to be upskilled through ongoing training and education. However, upskilling the workforce can only be realised in the long term. Thus, greater focus could be placed on demand-side considerations, i.e. how to increase the demand for low-skilled workers. This could be achieved by attracting investment into industries that demand more labour over capital, making South Africa's economy less capital intensive. In this context, promoting growth in labour-intensive manufacturing appears to be an appropriate solution. The design of such policies necessitates close collaboration between government departments so that mechanisms to reduce inequality are better integrated into the broader policy agenda. This is particularly important given that policies aimed at reducing inequality need to be sensitive to intersecting vulnerabilities along racial and gender dimensions.

2. *Statistics South Africa should increase its efforts to increase the transparency of data and harmonisation of datasets to allow for more comparable, accessible and reliable income statistics. Transparency should extend to data collection, data cleaning and imputation methods applied.*

Data transparency and accessibility are of the utmost importance for evidence-based policymaking and are currently lacking when it comes to understanding income inequality in South Africa, especially income derived from the labour market. Income statistics vary drastically, depending on the type of data sources used, as well as how income is defined.

PALMS provides important labour income data at the individual level, but one cannot, with accuracy, measure top incomes, which is due to missing data, or unknown imputations made by Statistics South Africa. This is particularly the case for PALMS and creates a major limitation to gaining a better, more comprehensive understanding of the extent of earnings inequality and its underlying dynamics in the South African labour market. The latter information is necessary to inform fiscal policies, particularly those of a redistributive nature.

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CHAPTER 5:

The effects of social grants on household behaviour and expenditure patterns

5.1 Introduction

The Bill of Rights is the cornerstone of democracy in South Africa. It encapsulates the rights of all citizens and emphasises democratic values of equality, human dignity and freedom. Social grants constitute one channel through which the Bill of Rights can be achieved. South Africa's social grant system has expanded immensely since 1994, yet a large proportion of the country is still impoverished. Moreover, grants are often the primary source of income in low-income households. The effectiveness of grant systems is considered on the grounds of poverty and inequality reduction, but rarely on applied methods such as consumption.

The decisions of individuals and households on how they use their incomes affect their ability to participate in the economy. This research will evaluate whether social grants facilitate the inclusion of disenfranchised individuals into the economy and how it affects the fiscal envelope. Understanding the history and nature of the social grant system is paramount to conceptualising the current state. The literature review establishes the timeline of the South African social security network and documents all commissions that have investigated the network over time. A section on how social grants affect consumption and enhance livelihoods is included in the literature review. This chapter discusses the quantum of the social grants budget, as well as the current nature and distribution of grants. Furthermore, research is conducted to determine whether social grants bring stability to incomes and consumption, and whether grant recipients purchase goods conducive to economic prosperity.

The research concludes with recommendations to improve the current social grant programme by considering a more efficient grant allocation amount, integrating social development policies with grants, and encouraging an inquiry into the existing social grant system.

5.2 Research methodology and data

As this research paper studies changes in income at the household and individual level over time, the most appropriate panel dataset available is the National Income Dynamic Survey (NIDS). The NIDS dataset was initiated in 2008 with a sample of 28 000 individuals in 7 300 households. It was the first individual, longitudinal and nationally representative household survey in South Africa that collects data biannually. The biannual data is categorised into waves.

The first subsample of data is noted as Wave 1, which occurred in 2008, and the latest wave, Wave 5, occurred in 2017. The survey questions include a range of demographic and socio-economic variables that are useful to this study. Wave 1 to 5 will be used in econometric estimation. Data from the South African Social Security Agency (SASSA) describes the current nature of social grants and their distribution among recipients.

The methodology used to achieve the aims of this research will encompass descriptive statistics and econometric modelling. The descriptive section investigates the changes in the number of social grant recipients from 2020 to 2021, the latest distribution of social grants within the SASSA network and the macro-fiscal impact of social grants since 2011.

The Child Support Grant (CSG) is the largest in the system and supports more than 60% of all South African children. Therefore, the CSG is the only grant considered during estimation. A difference-in-difference analysis is assessed by observing how the consumption patterns change over the panel for individuals with and without a CSG. The actual effect of the implementation of social grants is calculated as the difference in consumption of the grant recipients (CSGConsumption), before and after execution, subtracted from the difference in consumption by non-grant recipients (NonCSGConsumption), before and after implementation. The actual effect is illustrated by Equation 5.1. Time t describes the policy implementation period, while $t-1$ describes the period before, and $t+1$ notes the period after implementation.

Equation 5.1:

$$\begin{aligned} \text{Actual effect} &= (\text{CSGConsumption}_{t+1} - \text{CSGConsumption}_{t-1}) \\ &\quad - (\text{NonCSGConsumption}_{t+1} - \text{NonCSGConsumption}_{t-1}) \end{aligned}$$

Total consumption is calculated by totalling all expenditure, including utilities, connectivity, sin products¹, transport expenses, healthcare and education. Consumption baskets are not weighted, but a total of all personal spending is calculated to determine how consumption spending differs by income level.

5.3 Findings

5.3.1 History of the South African social grants system

Although only enshrined in the Constitution of 1996, social assistance programmes have been in existence since 1919. The first four social assistance programmes implemented by the Apartheid government were the Military Pensions (1919), Social Pensions (1928), Pensions for War Veterans (1941) and Family Allowances for Large, Poor Families (1947) (Van der Berg et al., 2010). These programmes were widely discriminatory and not universal in any manner.

The first social grant implemented in South Africa was the Military Pensions in 1919. Military pensions were imposed to benefit the soldiers of World War I (Vanderstraeten, 2014). During the 1920s, the “poor white” problem was highly prominent, and policymakers realised that intervention through social policy would be the primary response to alleviate poverty. Following the recommendations of the 1926 Commission on Old Age Pensions and National Insurance, the government implemented the Social Pensions Grant in 1928, which allowed white and coloured individuals over the age of 65 to receive a state-funded pension. These pensions were subject to a stringent means test. The test evaluated the individual’s income from remuneration, the remuneration of their spouse and the value of their property. The amount of social pension received per applicant depended on their financial level as the aim of the programme was to top up recipients’ incomes to reach a poverty line (Devereux, 2007). The rationale of “civilised labour” was used to exclude African individuals from the social pension programme. Policymakers argued that individuals living in relatively urban and modern areas had adjusted their lifestyles and consumption behaviour accordingly. Therefore, they required social assistance to maintain their level of consumption during retirement. This narrative largely excluded the African population. Policymakers considered black individuals to be rural. Therefore, they did not require additional assistance to maintain their consumption levels and were excluded from the programme (Van der Berg, 1998).

The universality of social assistance among South Africans took a significant leap forward by implementing the Pensions for War Veterans in 1941. The pension was delivered to all veterans of World War II.

¹ Sin products are goods considered harmful to health, such as alcohol and tobacco.

This included African individuals for the first time. Although the benefit received was well less than that received by white and coloured war veterans, the government catered for African veterans and their dependants for the first time (Seekings, 2000). The Children Protection Act of 1913 was a fundamental cog in initiating the State Maintenance Grant (SMG) of 1947. The SMG was intended to provide state-funded financial support to large, low-income families. The programme was still vastly discriminatory as it initially only included white households, but was later extended to coloured and Indian families (CASE, 2000). Unfortunately, the SMG programme did not maintain the universal inclusion pace of the Pensions for War Veterans programme. Nevertheless, its success in reducing poverty inspired a new universally inclusive child support grant.

5.3.2 Post-apartheid enquiries regarding social welfare

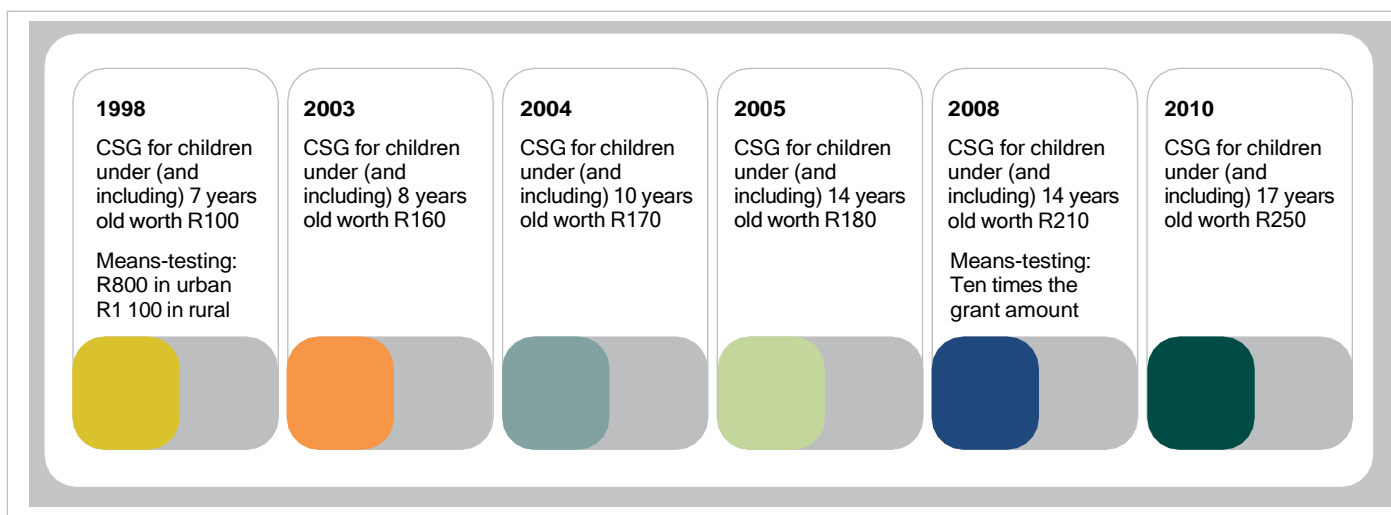
5.3.2.1 The Lund Committee and the Child Support Grant

In 1996, the Lund Committee was established to investigate the current child welfare system under the SMG. It was tasked to investigate the possibility of increasing parental support through a maintenance system, explore alternative poverty-alleviating strategies instead of the sole reliance on social security, and identify methods to optimally target children and families in need (Lund, 2008). The main recommendation of the Lund Committee was that the existing SMG be replaced with a child support grant. This approach reduced the fiscal burden on the state as the CSG was lower in monetary value than the SMG, but provided more extensive social welfare benefits and targeted more disadvantaged children, particularly those living in informal settlements and rural areas (CASE, 2000). The CSG was introduced in April 1998 to all children aged seven and below with significant conditions for payout. These conditions included passing a means test, holding a valid identity document and birth certificate of the child for whom the grant was intended, the child's clinic card proving immunisation, and stipulating to primary caregivers that they should participate in income-generating programmes (CASE, 2000).

The CSG is intended to be a universal grant for all children who require assistance. As stipulated in the Constitution, all persons under the age of 18 are considered children. Limited fiscal scope and a growing grant base resulted in a trade-off between the size of the grant and the number of recipients the state could accommodate (Triegaardt, 2005). Therefore, the initial age limit of seven and under had to be adjusted to achieve this mandate in steps.

Finally, the objective of including all socio-economically vulnerable children in the CSG programme was achieved in 2010. The initial CSG was R100 per child under seven in 1998. Five years later, children under eight were included in the system, with the grant increasing by R60 over the period. In 2004, a R10 increase in the monthly grant was allowed with additional coverage for children ten years old and younger. By 2005, the most extensive coverage step since implementation occurred as children 14 years old and younger became eligible for the R180 grant. The means test level remained constant for the decade preceding the CSG roll-out. Therefore, the Department of Social Development decided to increase the means test to ten times the grant amount, irrespective of the type of area in which the applicant resided. In 2010, all children - aged 0 to their last month of being 17 - became eligible for the CSG (Eyal and Burns, 2019).

Figure 5.1: Timeline of the universality of the CSG



Source: Commission's illustration adapted from Eyal and Burns, 2019:216

This added eligibility among recipients, and the higher means test allowed more socio-economically vulnerable children to be included, increasing grant uptake and favourable labour market outcomes. When observing the effect of the CSG on female labour market participation, recipients of the CSG are more likely to participate in the labour force and less likely to be unemployed (Eyal and Woolard, 2011). The recommendations of the Lund Committee have made a long-lasting impact on the social welfare system, especially concerning children.

In a vulnerable society such as South Africa, social assistance is required to mitigate the losses experienced in the labour and goods market. Therefore, another committee was established to comprehensively examine the social assistance framework in its entirety.

5.3.2.2 The Taylor Committee and the Basic Income Grant

The government established the Taylor Committee in 2002 to provide recommendations on an integrated and comprehensive social security system in South Africa. The committee differentiated the total social welfare system into three spheres: social assistance, which contains all grants provided to citizens; social insurance, which consists of the Unemployment Insurance Fund (UIF), Workman's Compensation Fund and Road Accident Fund (RAF); and informal insurance, which categorises all cash-in-kind transfers. The Commission's main finding was that the lack of appropriate policy to address income poverty creates vast limitations to developing socio-economic programmes in South Africa. The Commission, therefore, recommended the implementation of a Basic Income Grant (BIG) that is large enough to supplement the incomes of unemployed individuals receiving insufficient or no income. The BIG is intended to empower individuals to the point where they can accept high-risk, high-earning opportunities to break their current cycle of poverty. This is required to propel South Africans out of poverty and stimulate economic growth (Taylor Commission, 2002).

Although the recommendation of the BIG was not initially accepted, there has been an overwhelming demand for the implementation of a BIG due to the current state of the economy and gaps in the social assistance system since the COVID-19 pandemic. Due to the demand, the government has tasked departments to investigate the feasibility of the BIG in the current economic environment. An expert panel was established as part of an International Labour Organisation (ILO) initiative, together with the Department of Social Development (DSD), to examine the salience and feasibility of BIG options for South Africa.

The panel concluded that income support in a basic income support grant is the most efficient and swiftest method to assist 18- to 59-year-old South Africans living in extreme poverty. The expert panel recommends that a targeted BIG be implemented in phases to reduce pressure on the fiscus, while alleviating poverty. The panel advises that the BIG's financing occurs through the various tax streams available to the government (Department of Social Development, 2021). The National Economic Development and Labour Council (Nedlac) supports the recommendation of a targeted BIG to reduce the costs and funding requirements of the policy in a feasibility report of its own. The Nedlac report also notes that if funding is obtained from the reallocation of public expenditure, there will be trade-offs as spending on health, social development and education accounts for 56% of current government expenditure (Deloitte & Touche South Africa, 2021).

5.3.3 *The World Bank social assistance programmes and systems review*

The World Bank released a South African social assistance programmes and systems review in October 2021. The review notes the vastly unequal nature of the country as the economy is considered upper-middle-income. In contrast, the persistent developmental problems present in the economy are similar to lower-income economies. South Africa's social assistance network serves as an extensive socio-economic intervention in addressing deprivation. The review finds that the social assistance programme serves as a substitute for inclusivity and provides relief against structural issues such as chronic poverty and unemployment. The World Bank recognises that social assistance programmes will always have room for improvement if poverty is present in the country. The review's primary recommendations focus on the financial feasibility of broader reforms and utilising existing programmes as low-hanging fruits to maximise policy outcomes without additional spending.

5.3.4 *Changes in consumption, poverty and inequality due to social grant receipt*

South Africa's social grant system reduces poverty and inequality among qualifying recipients tremendously, while eradicating destitution among vulnerable households. The additional income provided by social grants improves health and education, and increases savings and investment in productive assets for recipients.

Significant decreases in poverty and inequality are noted to substantiate these efficiency claims, including improved levels of education and nutrition among recipients (Samson et al., 2004). Social grants correlate with improved nutrition levels and reduced morbidity, stunting and wasting among recipients. The additional income allows for increased quantity and quality of food consumption compared to that enjoyed by non-recipients (Gertler and Boyce, 2001). These results are consistent for CSG and Older Persons' Grant (OPG) recipients (Delany et al., 2008; Case and Deaton, 1998). Healthier students and individuals are more productive. Therefore, social grants impact on the immediate needs of recipients and households, and have a sustained impact on the socio-economic development of the household. Adequate nutrition is pertinent to young children's cognitive and physical development; thus, the social costs of malnutrition among children are long-lasting and much larger than the fiscal costs to the South African economy (Neves et al., 2009). Decreased productivity attributed to malnutrition also affects the economic output. Studies from low-income countries in Asia estimate that gross domestic product experiences a 2–4% decline due to malnutrition (Horton, 1999; Food and Agricultural Organisation, 2002).

Notably, social grants increase investment in health and education due to improved nutrition. School fees and uniforms are the second-highest expenditure item among CSG recipients, apart from food (Delany et al., 2008). Moreover, this phenomenon substantiates claims that social assistance improves education among recipients, which transcends to long-term human capital investments. Empirical international evidence suggests that social assistance improves physical capital investment as households are more likely to improve their living conditions and invest in better housing – especially among rural recipients. Recipients are also more likely to invest in smallholding farming opportunities (Martinez, 2005).

These outcomes are not uniform among all recipients. The pooling of grant income to household income and the gender of the grant recipient are crucial to achieving the positive associated welfare outcomes. The pooling of family income that include grant income is more likely to improve welfare. Increasing the budget capacity of households with social assistance will assist in long-term decision making that will enhance welfare substantially (Delany et al., 2008; Case, 2001). On the other hand, female grant recipients are associated with children's higher welfare outcomes when compared to male grant recipients (Lund, 2002).

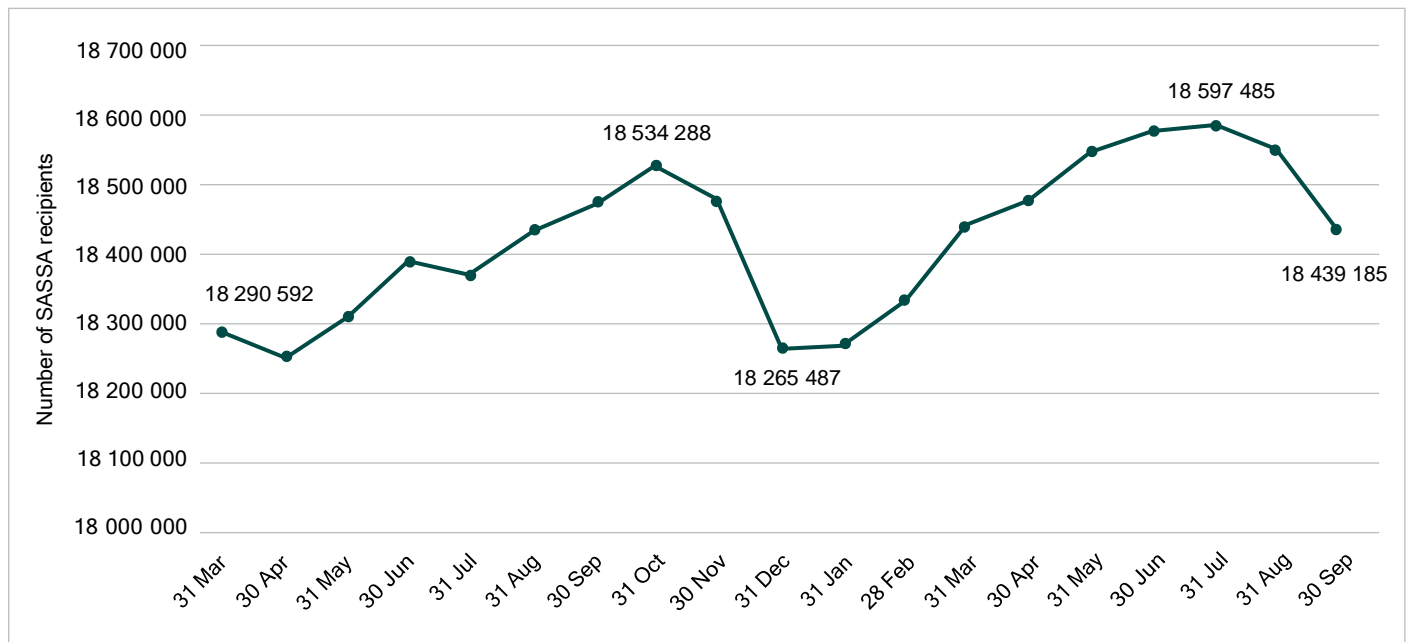
Unfortunately, empirical research does not prove that social assistance programmes always result in economic growth. Critically, there is no evidence that it impedes it either (Bourguignon, 2004). Perotti (1992) suggests no statistically significant correlation between social assistance programmes and economic growth, while research conducted by the Organisation for Economic Cooperation and Development (OECD) in 2001 offers opposing results. The OECD finds positive and statistically significant correlations between social grants and economic growth – but this is limited to specific grants (Arjona et al., 2001). Ultimately, social grants enable recipients to participate in the economy and purchase additional consumables and investment opportunities that they could not otherwise afford. The receipt of social grants serves a guaranteed level of income that assists with intertemporal changes in consumption due to economic shocks, such as unexpected job losses or steep price increases in staple foods. The stability of household consumption allows individuals to actively seek employment in the labour market as the fear of not meeting the minimum consumption needs of the household is offset. Therefore, the South African social grant system facilitates the movement of discouraged and previously economically inactive individuals into the labour market (Kingdon and Knight, 2000; Keswell, 2004). If the increased participation in the labour market is successful, individuals will experience less poverty and increased consumption of productive assets and goods.

Using a pseudo panel dataset from the 2001, 2002 and 2003 Labour Force Surveys of Statistics South Africa, Neves et al. (2009) observed the effects of social grants on the financial activity of recipients. The research found that social grant recipients experienced increased savings from 2001. Social grant recipients are more likely to save their money in bank accounts and stokvels than non-recipients. On the contrary, non-recipients are more likely to own higher interest-earning investments, such as retirement annuities and unit trusts. The authors also noted that grant recipients are less likely to borrow and secure credit. This chapter does not control the income level of recipients and non-recipients; therefore, no casual results are inferred. Nonetheless, the research supports the concept of increased savings due to social assistance among recipients.

5.3.5 *Financial and fiscal impacts on the national budget*

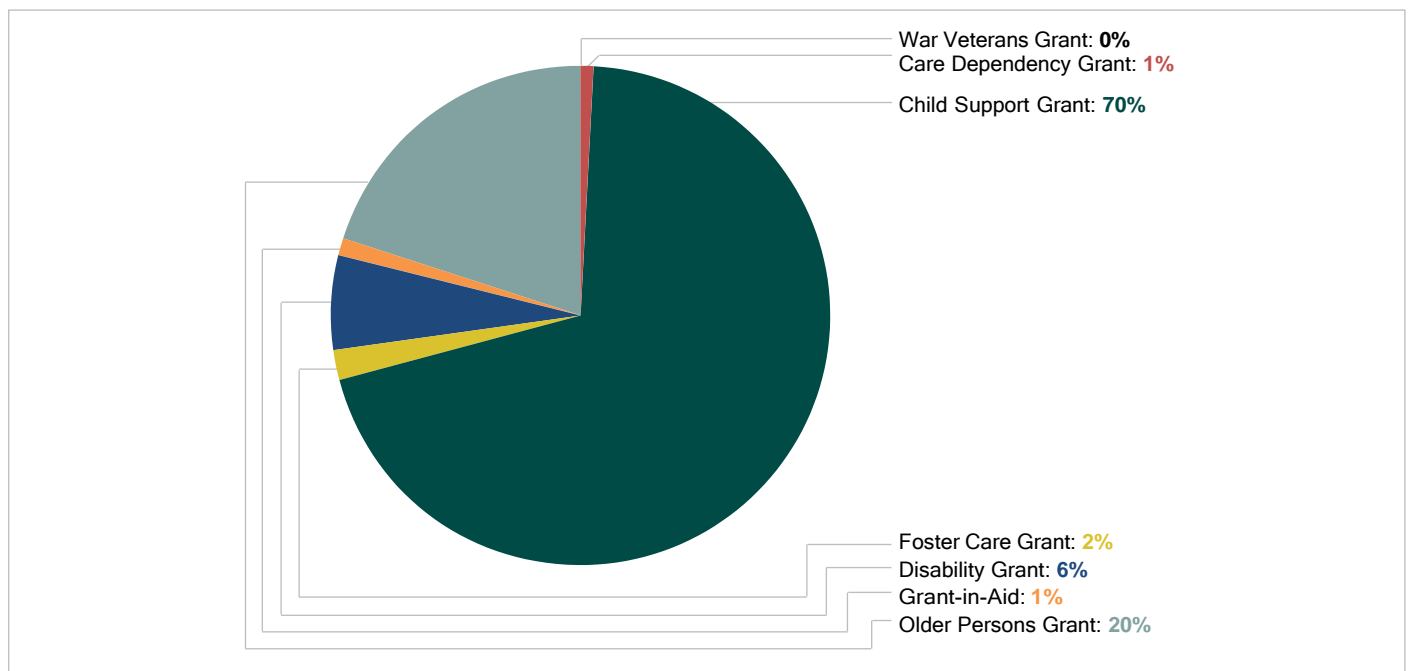
As of September 2021, 18 439 185 individuals were receiving monthly grants in the SASSA network (SASSA, 2021). The number of SASSA grant recipients has increased significantly since the President declared a national state of disaster in response to the COVID-19 pandemic on 15 March 2020. During the national state of disaster, the state increased grant payments to existing grant recipients and introduced two grants that would be available to vulnerable individuals who were not previously recipients of social assistance. The Temporary Disability Grant and the COVID-19 Special Relief of Distress (SRD) Grant would be implemented until the end of October 2020. Neither of these newly implemented grants was subject to a means test (Financial and Fiscal Commission, 2021). In Figure 5.2, the most considerable amount of grant recipients is observed during October 2020, which corresponds with the final grant increases and availability of temporary grants, as announced under the national state of disaster. Following public outcry for continuous assistance, SRD Grant payments were extended to April 2021. A sharp decline in grant recipients is noted after October 2020, but recipients have steadily increased since January 2021. Recently, the President announced the reinstatement of the SRD Grant for the period August 2021 to March 2023.

Figure 5.2: The number of SASSA grant recipients between 2020 and 2021



Source: Commission’s calculations (based on SASSA, 2021)

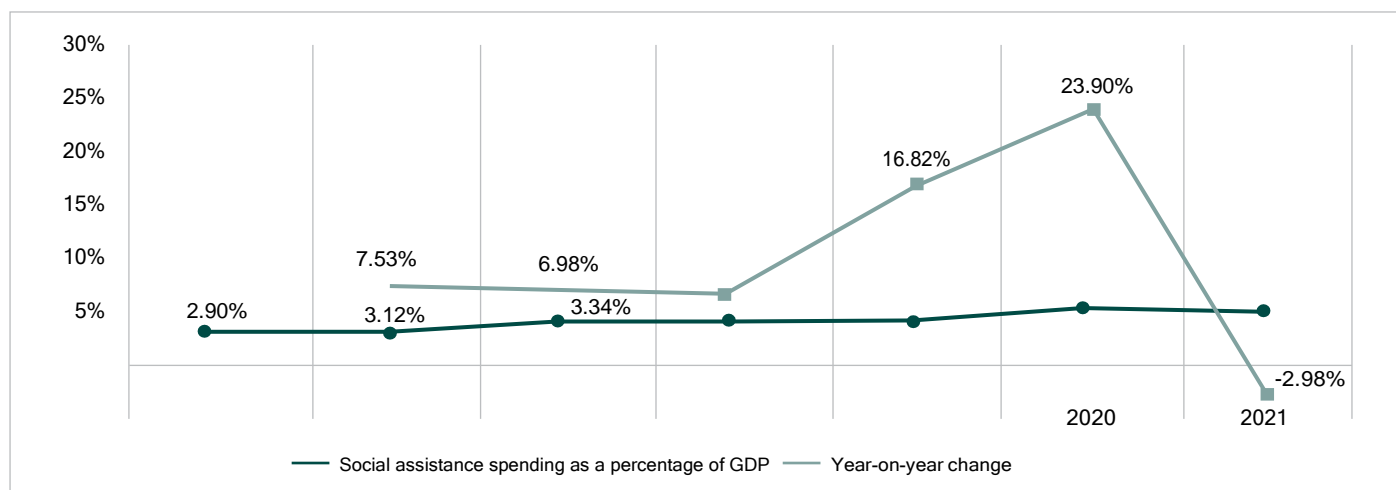
Figure 5.3: The distribution of grants 2021



Source: Commission’s calculations (based on SASSA, 2021)

The three largest grants in circulation are the CSG, the OPG and the Disability Grant (DG). The receipt of the CSG is considered widely successful as there are almost 13 million children in the system in South Africa, with approximately 22 million children in total (Statistics South Africa, 2020). This means that nearly 60% of all children in South Africa are recipients of the CSG of R480 per month. The second-largest and highest-paying grant in circulation is the OPG, which provides for over 3.7 million of the elderly population. The current monthly OPG supplied by the state is R1 980 per month for individuals aged 60 to 75, while those older than 75 receive an additional R90. The third-largest grant recipient group is that of the DG, which benefits more than one million people, who receive a monthly amount of R1 985.

Figure 5.4: Social assistance spending as a percentage of GDP

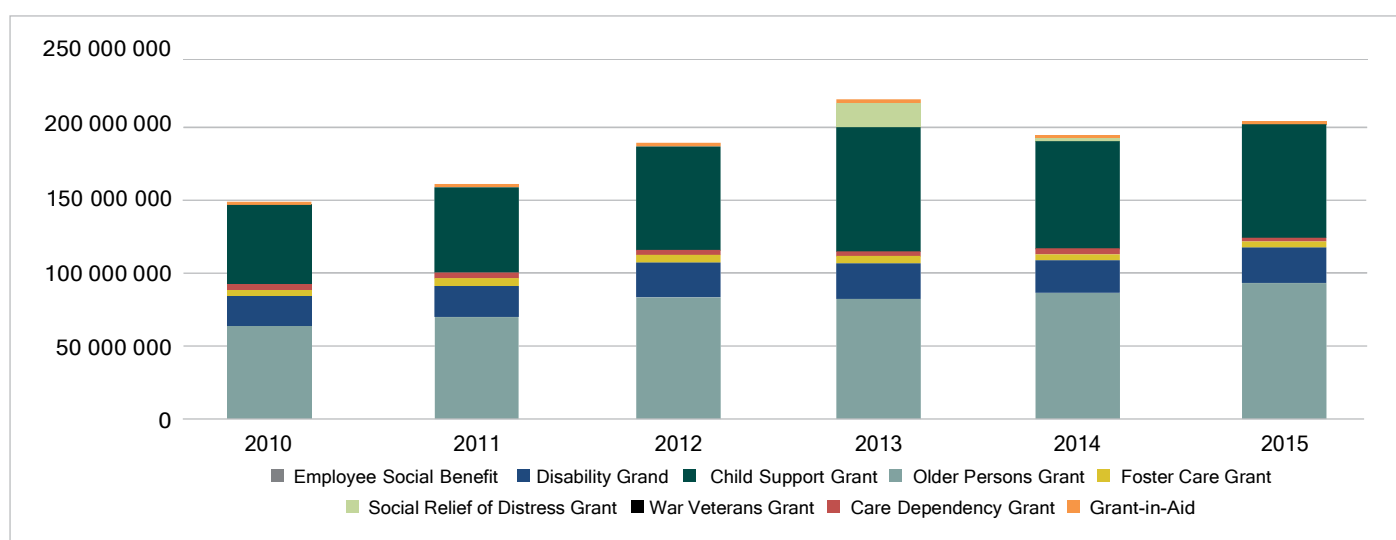


Commission’s calculations (based on National Treasury Vote 19: Department of Social Development, 2018; 2021, 2022)

Social assistance spending in South Africa, viewed as a percentage of gross domestic product (GDP), has increased annually since 2015. Notably, the year-on-year change has superseded the inflation rate range (between 3 and 6%) during the period, suggesting that the state is providing more grants to needy citizens. Social assistance is intended to intervene where the labour market fails to allow all citizens to participate actively in the economy. In the case of South Africa, this intervention is warranted due to the remnants of apartheid that manifest as structural issues in the economy. The expansion of the social assistance programme during 2019 and 2020 emphasises a struggling economy with an increasing number of citizens living below the means test.

The budget allocated to the Department of Social Development for 2021/22 is R19.5 billion (National Treasury, 2021). The bulk of social grant payments out of the R19.5 billion allocated is prioritised to the OPG (R86 million), then the CSG (R73 million), while the DG cost just under R24 million to implement in 2021/22. The budget for social assistance in 2020/21 was R25 million larger due to the temporary increases in existing grants and the establishment of two temporary grants to mitigate the effects of the COVID-19 pandemic: the COVID-19 SRD Grant and the Temporary Disability Grant.

Figure 5.5: The South African budget allocation for social assistance



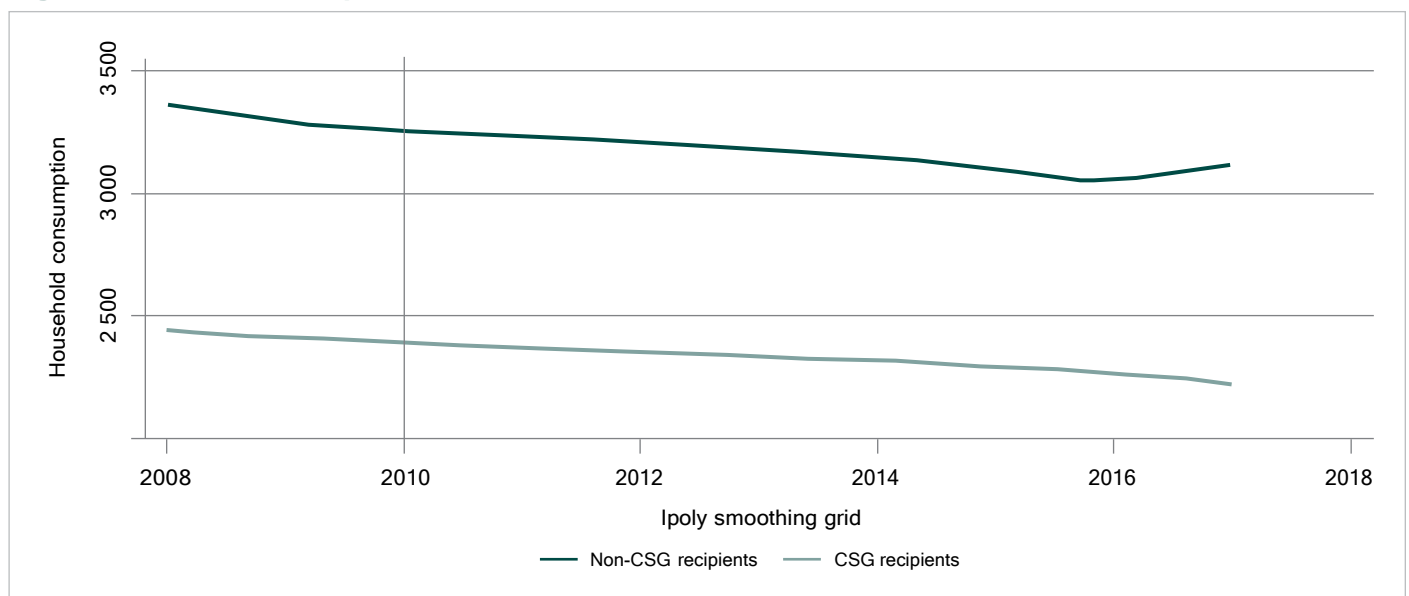
Commission’s calculations: National Treasury Vote 19: Department of Social Development, 2022

Due to the highly unequal nature of the South African economy, especially in terms of skills distribution and employment, the lower-income deciles were disproportionately affected by the lockdown. Grants are particularly targeted at the poorest of the population; thus, using grant increases to mitigate shocks in consumption due to the pandemic was widely successful. The CSG, in particular, appeared to be vastly pro-poor at the beginning of the lockdown period (Köhler and Borat, 2020). One of the most praised government interventions during the first and second waves of the pandemic was implementing the COVID-19 SRD Grant. The grant focused on including poor individuals who were not eligible for other forms of social grants in the national social assistance programme – this would include over six million COVID-19 SRD Grant recipients. A crucial part of the COVID-19 SRD Grant was that recipients were not subjected to a means test; the grant was thus universal. State-funded social assistance was the primary form of income for 80% of households with job losers during the lockdown period (Financial and Fiscal Commission, 2021). The effectiveness of the universal COVID-19 SRD Grant in alleviating poverty by bringing financial stability to households in times of crisis adds to the momentum of the universal BIG.

5.3.6 Consumption trends of CSG and non-CSG recipients

In 2010, the CSG was made eligible for all children 17 years and younger whose primary caregivers fall under the means test. Therefore, 2010 is considered the base year of estimation in this research study. To conduct a difference-in-difference analysis, a control and treatment group is required so that the causal effect of grant income on changes in consumption can be calculated. Individuals receiving the CSG from 2010 onwards are categorised as the treatment group, while non-recipients are classified as the control group.

Figure 5.6: Real consumption² trends of South Africans between 2008 and 2017



Source: Commission's calculations using NIDS Wave 1 to 5

Figure 5.6 depicts the actual consumption of non-CSG recipients and CSG recipients from 2008. The increase in eligibility of CSG recipients is duly noted with a respective increase in consumption in 2010. A sustained and steep decrease in household consumption is observed among recipients throughout the sample. During 2016 and 2015, the differences in consumption between the treatment and control groups begin to diverge sharply.

² Values are inflated to 2017 rand values. Inflating percentages are used in the estimation, from the survey year to 2017: 2015 = 17.8%; 2012 = 37.2%; 2010 = 51.1%; 2008 = 74.5%

The difference-in-difference (DiD) estimations regarding the consumption of grant recipients are promising. Table 5.1 observes four models of DiD. In Model 1, a positive and statistically significant coefficient of the consumption of grant recipients is estimated. Notably, all four models are statistically significant at the 1% level. Model 2, which controls for income, and Model 3, which controls for income and gender, suggest that grant receipts can consume even more under the additional controls than in Model 1. Under Model 4, which controls for the income, gender and age of the recipient, the coefficient of grant recipient consumption remains positive, although slightly smaller than in Model 3. The positive coefficients associated with income align with the consensus that increased income will increase consumption. Furthermore, the literature supports the negative and statistically significant coefficients of male grant recipients on household consumption, which suggests that female recipients have higher welfare outcomes.

Table 5.1: Difference-in-difference estimates of CSG recipients

	(1)	(2)	(3)	(4)
Treatment	-1587.728*** (71.644)	-1612.743*** (99.130)	-1747.497*** (101.107)	-1838.978*** (101.298)
Post	-2145.385*** (30.220)	-2807.185*** (34.943)	-2809.951*** (34.937)	-2793.544*** (34.927)
Treatment x Post	815.273*** (78.462)	932.741*** (118.555)	944.213*** (118.544)	937.636*** (118.463)
Income		0.171*** (0.001)	0.171*** (0.001)	0.170*** (0.001)
Male			-255.040*** (37.837)	-244.946*** (37.819)
Age				12.233*** (0.972)
Constant	5084.574***	5066.849***	5207.122***	4883.260***
N	330831	113192	113192	113192
R ²	0.022	0.207	0.208	0.209

Note: Standard errors in parentheses * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$

Source: Commission's calculations using NIDS Wave 1 to 5

Increased spending on food, accompanied by added investment in health care, education and welfare-improving assets, is imperative in ensuring sustained economic development. Social grants are intended to increase consumption and spending in these facets of socio-economic development. Observing nominal food spending between CSG recipients and non-recipients over time suggests that the increased inclusion of children aged 14 years and older as CSG recipients has tremendously increased food consumption among poorer households. CSG recipients observed a significant increase in consumption from 2009, even surpassing the amount of food spending among non-recipients. Table 5.2 summarises the DiD analysis of food consumption among grant recipients. Estimates note that CSG recipients have responded positively to the expansion of the CSG at the 1% significance level. However, the size of the estimates declines with control variables. The positive effect of the CSG on food consumption suggests that the grant is fulfilling its intended policy consequences.

Table 5.2: Difference-in-difference estimates of CSG recipients' food consumption

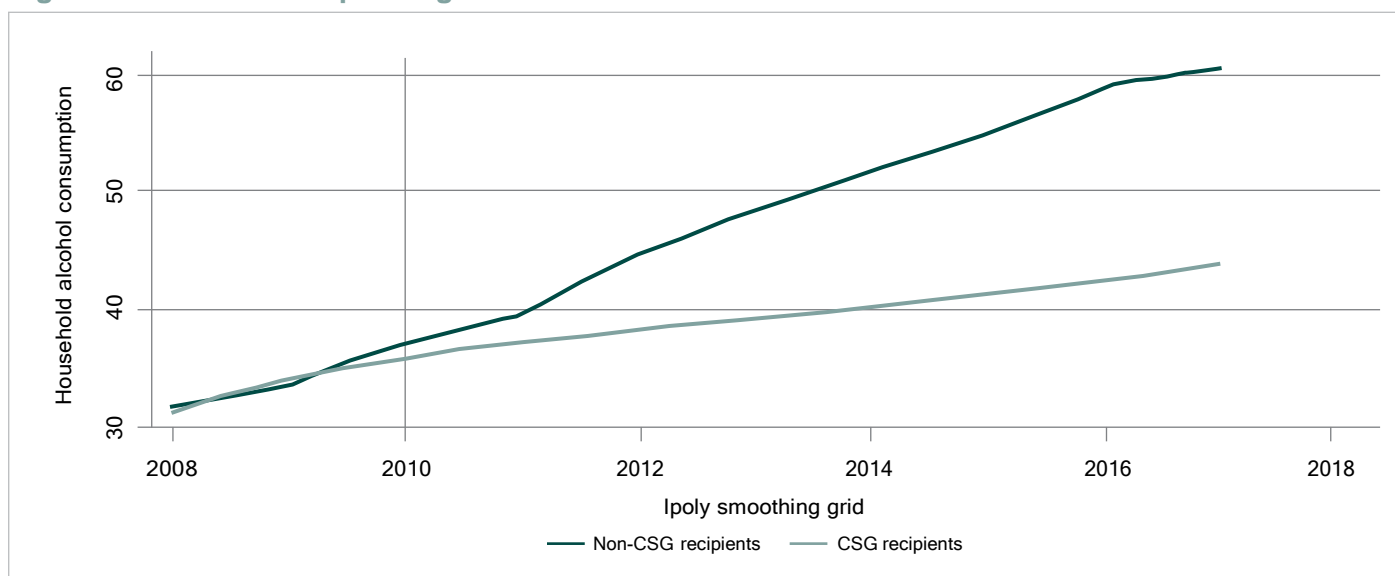
	(1)	(2)	(3)	(4)
Treatment	-227.413*** (-12.01)	-205.682*** (-8.78)	-244.792*** (-10.24)	-249.278*** (-10.41)
Post	-358.045*** (-49.46)	-319.478*** (-32.43)	-320.238*** (-32.51)	-319.429*** (-32.42)
Treatment x Post	191.473*** (9.23)	70.321** (2.51)	73.581*** (2.63)	73.258*** (2.61)
income		0.031*** (120.83)	0.031*** (120.77)	0.031*** (120.49)
Male			-74.164*** (-8.29)	-73.672*** (-8.23)
Age				0.600*** (2.61)
Constant	1/09.671*** (258.90)	1/34.512*** (208.50)	1/75.257*** (183.77)	1/59.371*** (154.07)
N	330999	113308	113308	113308
R ²	0.008	0.123	0.124	0.124

Note: Standard errors in parentheses * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$

Source: Commission's calculations using NIDS Wave 1 to 5

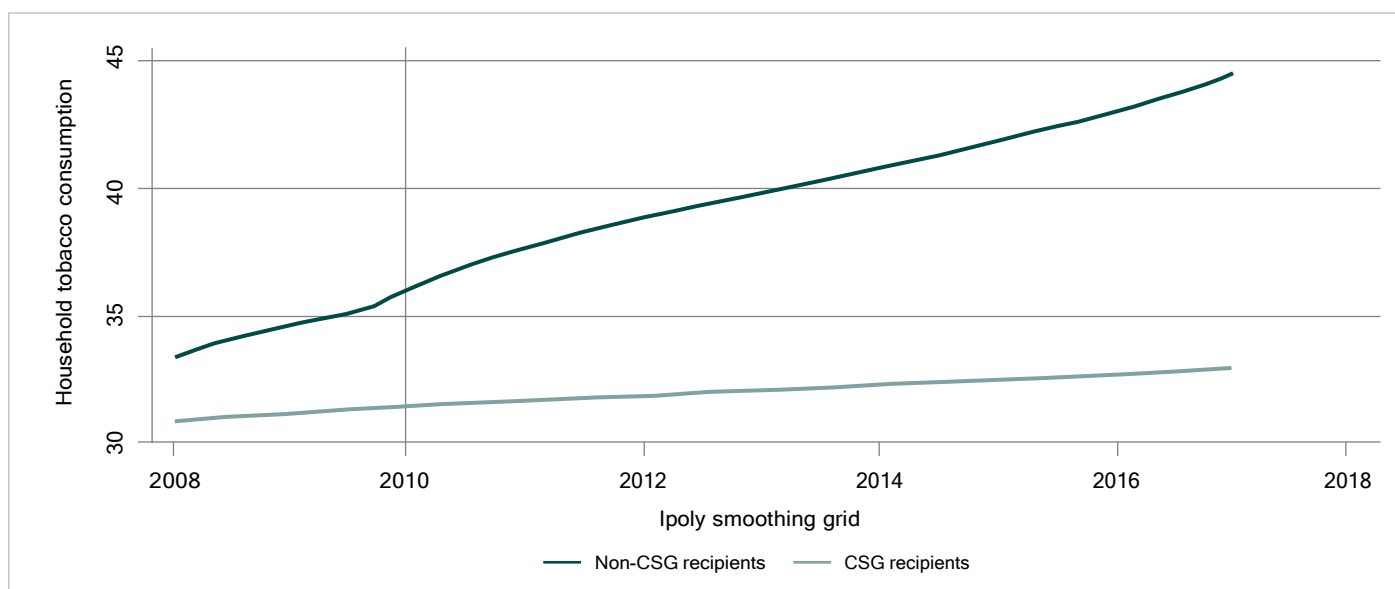
Regarding health care expenditure such as medical aid, medicine and doctors' appointments, the consumption of CSG recipients has increased with the expansion of the grant – this holds to the 1% significance level (see Appendix 5.2). However, educational spending has declined with grant expansion, including spending on early childhood education and books. The CSG's negative effect on educational expenditure is statistically significant to the 10% level (see Appendix 5.1). A large part of the country relies on public-funded health care and education programmes. Most South Africans do not earn enough to make use of private health care and education opportunities for themselves or their children. Therefore, the phenomenon of CSG recipients substituting their increased incomes from grants for food or other household items instead of economically productive assets such as education or initiatives that improve their level of health is rational. Social grants enhance the welfare of recipients by providing financial assistance that is intended to directly improve the living standards of individuals. Any spending that is not conducive to welfare is not the intention of social assistance programmes. Therefore, it is imperative that most recipients' consumption are welfare-improving and not centred around non-conductive goods such as alcohol, tobacco and gambling.

Figure 5.7: Household spending on alcohol between 2008 and 2017



Source: Commission's calculations using NIDS Wave 1 to 5

Figure 5.8: Household tobacco spending between 2008 and 2017



Source: Commission's calculations using NIDS Wave 1 to 5

In nominal terms, expenditure on alcohol among CSG recipients has been increasing over time, but at a significantly lower rate than among non-recipients. Interestingly, expenditure on alcohol among recipients was higher among non-recipients between 2008 and 2009. However, this changed vastly after the grant expansion of 2010. Non-recipients consumed vastly more alcohol after 2010 than recipients – this also holds for expenditure on tobacco products. The CSG recipients and non-recipients have increased their expenditure on tobacco products over time, with non-recipients experiencing a steeper curve throughout. With regard to sin products such as alcohol and tobacco, the DiD equations suggest that alcohol and tobacco consumption has increased with the expansion of the CSG. The estimates are only statistically significant at the 10% significance level when no control variables are considered. In models that use control variables, the results are insignificant. This suggests that alcohol and tobacco consumption may increase with grant receipt, but the occurrence is not uniform across all recipients.

5.4 Conclusion

The South African CSG successfully facilitates the inclusion of disenfranchised individuals into the economy. The research findings suggest that CSGs reduce poverty and inequality in South Africa and increase the consumption of the poor. Improving consumption is an immediate and tangible policy intention of social grants. It is encouraging that the current social grant programme provides sustained increases in consumption among grant recipients, simultaneously assisting with stabilising household incomes and consumption. The social grant system is undergoing immense year-on-year expansion, thus increasing the national budget demand.

Social grants are fundamental in ensuring that the constitutional rights of citizens are met. Still, the limited fiscal scope of the government limits the ability of policies to attain optimal welfare outcomes. The government should reassess the current fiscal structure and reduce financial leakages to offer more funds to its social assistance programme. Ideally, the social assistance programme should expand to include all South Africans living in poverty, and the grant size should sustain an individual for a month. Through this, the grant will provide for the immediate needs of citizens, further allowing individuals to enjoy a measure of economic freedom and pursue welfare-maximising opportunities.

5.5 Recommendations

The Commission makes the following recommendations:

1. *The recalculation of the amount of the CSG*

Currently, the amount of the CSG is not calculated using a specific metric or policy intended amount. Upon creating the CSG, the total budget allocated for the grant was divided among the number of recipients, and the grant amount was calculated. The DSD has maintained this method, while increasing grants incrementally on an annual basis based on fiscal capacity. The Commission recommends that the method calculation of the CSG be reconsidered to accommodate the basic needs of children. An example of this is to increase the CSG of R480 to the food poverty line of R624. This would meet at least the monthly caloric needs of children. Alternatively, the DSD could evaluate a basket of goods that accommodate food and partial non-food needs, such as shelter and utilities as the basis of the CSG. However, noting the current strain on the budget, the Commission recommends that the CSG increase at the inflation rate until a more optimal grant amount is determined.

2. *Partnering with the private sector to support child support policy intentions*

The government can engage with the private sector regarding the policy outcomes of the CSG and how it benefits the economy. The private sector may nudge grant recipients to purchase goods aligned with policy intentions and mitigate inefficiencies associated with unconditional cash transfers. Incentives include continued public education on fortified food items with higher nutritional value. This can be achieved by improving packaging for better consumer understanding or increasing awareness at the critical customer interaction points.

3. *Integrating social grants into existing social development programmes*

The World Bank released a South African social assistance programmes and systems review in October 2021. Its recommendations to improve the existing system and maximise benefits are by integrating social grants into existing developmental goals. For example, the CSG can be combined with early childhood development (ECD) opportunities and education. Recipients should be made aware of various ECD centres available to them and given additional resources to benefit their child's early development, such as education on child nutrition and health care, a safe space for the child to learn and play while the parent seeks work or works, and providing a valuable opportunity for the child to develop critical social skills at a young age. The Commission supports this recommendation as it is a means to improve expenditure efficiency and maximise social outcomes without further spending.

4. *An in-depth investigation into the current social grant network*

This research notes that the CSG offers immense relief to millions of South Africans. Previous research conducted by the Commission suggests that the COVID-19 SRD Grant has similar poverty-reducing effects. Grants are often studied individually due to the complexity of their specific policy intentions. An extensive investigation into all grants within the network would inform the current discourse on social development. The DSD has currently only researched a basic income support grant's static effectiveness and fiscal impact. The Commission recommends that the Minister of Social Development commences an extensive investigation into the current social security network. The inquiry must consider the dynamic effects of all grants on household and business behaviour, how grants interact within the grant network to minimise poverty, and the fiscal and economic implications of the BIG.

Appendices

Appendix 5.1: Difference-in-difference estimates of CSG recipients' education spending

	(1)	(2)	(3)	(4)
Treatment	-33.103 (-1.56)	14.069 (0.41)	-11.641 (-0.33)	-11.641 (-0.33)
Post	-169.552*** (-20.85)	-266.326*** (-18.44)	-266.826*** (-18.48)	-266.826*** (-18.48)
Treatment x Post	-65.928*** (-2.83)	-82.042** (-2.00)	-79.898* (-1.94)	-79.898* (-1.94)
Income		0.019*** (49.83)	0.019*** (49.79)	0.019*** (49.79)
Male			-48.754*** (-3.72)	-48.754*** (-3.72)
Constant	365.451*** (49.26)	352.997*** (28.95)	379.782*** (26.82)	379.782*** (26.82)
N	330999	113308	113308	113308
R ²	0.002	0.025	0.025	0.025

Note: Standard errors in parentheses * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$

Source: Commission's calculations using NIDS Wave 1 to 5

Appendix 5.2: Difference-in-difference estimates of CSG recipients' health spending

	(1)	(2)	(3)	(4)
Treatment	-162.728*** (-14.08)	-170.119*** (-9.60)	-184.252*** (-10.20)	-184.252*** (-10.20)
Post	-87.608*** (-19.82)	-157.804*** (-21.19)	-158.079*** (-21.22)	-158.079*** (-21.22)
Treatment x Post	47.790*** (3.77)	86.886*** (4.10)	88.065*** (4.16)	88.065*** (4.16)
Income		0.016*** (83.39)	0.016*** (83.35)	0.016*** (83.35)
Male			-26.800*** (-3.96)	-26.800*** (-3.96)
Constant	247.740*** (61.45)	213.498*** (33.95)	228.221*** (31.24)	228.221*** (31.24)
N	330999	113308	113308	113308
R ²	0.003	0.063	0.063	0.063

Note: Standard errors in parentheses * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$

Source: Commission's calculations using NIDS Wave 1 to 5

Appendix 5.3: Difference-in-difference estimates of CSG recipients' alcohol spending

	(1)	(2)	(3)	(4)
Treatment	-19.749*** (-6.75)	-18.498*** (-4.83)	-10.241*** (-2.62)	-10.241*** (-2.62)
Post	9.860*** (8.81)	10.063*** (6.24)	10.224*** (6.35)	10.224*** (6.35)
Treatment x Post	9.862*** (3.08)	7.724* (1.68)	7.036 (1.53)	7.036 (1.53)
Income		0.002*** (45.47)	0.002*** (45.61)	0.002*** (45.61)
Male			15.659*** (10.70)	15.659*** (10.70)
Constant	47.533*** (46.56)	47.527*** (34.92)	38.924*** (24.63)	38.924*** (24.63)
N	330999	113308	113308	113308
R ²	0.001	0.019	0.020	0.020

Note: Standard errors in parentheses * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$

Source: Commission's calculations using NIDS Wave 1 to 5

Appendix 5.4: Difference-in-differences estimates of CSG recipients' tobacco spending

	(1)	(2)	(3)	(4)
Treatment	-20.149*** (-8.40)	-18.625*** (-5.18)	-14.706*** (-4.01)	-17.782*** (-4.84)
Post	-11.296*** (-12.31)	-13.615*** (-9.01)	-13.539*** (-8.96)	-12.984*** (-8.59)
Treatment x Post	11.608*** (4.42)	6.045 (1.41)	5.718 (1.33)	5.496 (1.28)
Income		0.002*** (48.57)	0.002*** (48.64)	0.002*** (48.02)
Male			7.431*** (5.41)	7.768*** (5.66)
Age				0.411*** (11.66)
Constant	59.617*** (71.22)	64.205*** (50.29)	60.123*** (40.55)	49.230*** (28.10)
N	330999	113308	113308	113308
R ²	0.001	0.022	0.022	0.023

Note: Standard errors in parentheses * $p < 0.1$; ** $p < 0.05$; *** $p < 0.01$

Source: Commission's calculations using NIDS Wave 1 to 5

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CHAPTER 6

Investigating wage trends in South Africa: An assessment of the public sector wage bill

6.1 Introduction

Wages in South Africa's public sector have grown relatively rapidly over the last two decades. Indeed, since 2004, the public sector wage bill has grown at an average rate of 10.5% per year, which is almost double the inflation rate, and also considerably above the pace of growth in gross domestic product (GDP) per capita (National Treasury, 2020). Public sector employment has also expanded since the early 2000s, and recent estimates show that, by 2020, it accounted for close to 20% of total employment, depending on which sectors of government are included (Bhorat et al., 2021). At the same time, research that compares earnings across the public and private sectors suggests that, relative to the private sector, the average public sector worker receives a wage premium of over 20% (Kerr and Wittenberg, 2017; 2021). These observed increases, in both wages and employment, have generated an aggregate public sector wage bill in South Africa that now commands a substantial share of the budget, accounting for 35% of government's consolidated spending in 2019 (National Treasury, 2020). As such, there are concerns around the impact of the growing wage bill on the country's finances.

A set of stylised facts thus emerges regarding South Africa's public sector wage bill. First, it has grown rapidly since the mid-2000s. In addition, average public sector earnings far exceed those of the private sector. Second, over a similar period, public sector employment has expanded. Third, this has led to the public sector wage bill commanding a relatively large proportion of government spending, potentially crowding out other government expenditure items. Taken together, these factors have generated a discussion around the fact that the growth of the public sector wage bill could create an unsustainable financial situation and needs to be carefully managed (World Bank, 2020). Crucially, this concern was behind the government's recent decision to "freeze" the wage bill and not implement annual increases in 2020/21, despite these increases being agreed to in the three-year wage agreement signed with trade unions in 2018.

Understanding the changing composition of the wage bill is central to managing it. This chapter addresses the issues raised above in more detail. The chapter is structured as follows: Section 6.2 details the problem statement and research questions being addressed by this chapter. Section 6.3 discusses the research methodology and data used to address the objective of the research. Section 6.4 compares South Africa's public sector employment and earnings figures to international aggregates to assess whether South Africa's public sector could be characterised as unusual. Section 6.5 provides a basic description of the wage bill and how it has changed over time in relation to several key fiscal markers. Section 6.4 studies the composition of the wage bill by examining various characteristics of both public service employment and earnings over time. Section 6.6 uses a basic multivariate analysis to examine the determinants of earnings in the public service, and draws on pre-existing work to compare public and private sector earnings. Section 6.7 concludes this chapter and provides some recommendations.

In terms of the wage trends for the broader labour market, the factors influencing wage outcomes for many South Africans have not changed substantially over the years. For example, low educational attainment by African females results in poor absorption rates into high-paying jobs for these groups. Hence, those key determinants were explored in this study.

To address the key research question, three models are employed by using the Personnel Salary (PERSAL) datasets for national and provincial government, Post-apartheid Labour Market Series (PALMS data) and the government's financial statistics (Stats SA, 2020). Model 1, 2 and 3 examine the relationship of the wage bill to revenue, expenditure and GDP, respectively.

The overall aim of this study is to inform and provide policymakers and legislators with a better understanding of the structure of the wage bill. Finding the underlying drivers of the high wage bill is critical in reforming the currently untenable public finance situation. It is also important for government to consider the persistent socioeconomic deterioration because of poor labour market outcomes for many groups. Considering the influences of such factors on wages will therefore assist in designing appropriate policies to transform wage trends.

6.2 Problem statement

Wages in South Africa's public sector have grown relatively rapidly over the last two decades. Indeed, since 2004, the public sector wage bill has grown at an average rate of 10.5% per year, which is almost double the inflation rate, and also considerably above the pace of growth in GDP per capita (National Treasury, 2020). Public sector employment has also expanded since the early 2000s, with recent estimates suggesting that, in 2020, it accounted for close to 20% of total employment, depending on which sectors of government are included (Bhorat et al., 2021). At the same time, research that compares earnings across the public and private sectors suggests that, relative to the private sector, the average public sector worker receives a wage premium of over 20% (Kerr and Wittenberg, 2017).

The observed increases in both wages and employment have generated an aggregate public sector wage bill in South Africa that now commands a substantial share of the budget, accounting for 35% of government's consolidated spending in 2019 (National Treasury, 2020). As such, there are concerns about the impact of this growing wage bill on the country's finances. The issues described here highlight the importance of understanding the different drivers of South Africa's growing wage bill. For example, work by National Treasury has already shown that the rapid observed growth in the wage bill has been driven only partially by an increase in employment, and can largely be attributed to rising real wages.

6.3 Research questions

The key aim of this study is to determine the South African wage trends and understand the size and shape of the wage bill. The specific research objectives addressing the research questions are the following:

- What are the components of a sustainable wage bill?
- What wage trend exists in South Africa, and what vital socioeconomic factors changed with it (i.e. gender and race dynamics)?
- How has the wage formation in South Africa changed in comparison to other economies?
- How can one understand the determinants of public wages?

6.4 Research methodology and data

This section describes the empirical model and data used for this study. The empirical model aims to rigorously estimate the public sector wage premium, using a two-stage Heckman employment model, correcting for selection bias from 2008 to 2020. This study uses the Labour Force Survey (LFS), the Quarterly Labour Force Survey (QLFS), PERSAL data and national financial statistics to run numerous econometric models in an empirical analysis.

6.4.1 Data

This analysis makes use of various data sources. Section 6.4.2 examines the South African public sector in relation to various international and cross-country aggregates, where this relies on publicly available data from the Organisation for Economic Cooperation and Development (OECD), the International Monetary Fund (IMF) and the World Bank. Here the analysts rely on a standardised definition of public sector employment for ease of making cross-country comparisons. However, the bulk of the work in this chapter uses individual-level, longitudinal administrative (payroll) data from the South African government's PERSAL system. This dataset only covers the population of civil servants in South Africa working in national and provincial departments, and national entities.¹ As a result, the dataset does not cover the entire public sector - specifically, it excludes workers in state-owned entities (SOEs), local government and extra-budgetary institutions like the Unemployment Insurance Fund (UIF), South African Revenue Service (SARS), and the Road Accident Fund (RAF), whose data is kept in separate databases. The PERSAL employment numbers are therefore slightly lower than would be the case if the full public sector were included. To avoid confusion, the group of public sector employees in the PERSAL database is referred to specifically as the "public service".

This dataset is currently not available in the public domain and was provided by the Department of Public Service Administration (DPSA) and National Treasury for analysis by the Financial and Fiscal Commission specifically for the report on which this chapter is based. As such, some brief notes about the data, and how it is treated, are useful for context. The dataset includes individual-level records for every month of each financial year, but for ease of use and processing, the first calendar month of data in each year (January 2008 to January 2020) is selected. As such, variation in outcomes within a given year is not considered, but only across years, for the period under review. The PERSAL data in its original form is organised into several separate files of varied structure, size and content. The analysis makes use of three files: the headcount file, the national expenditure file and the provincial expenditure file. These datasets include records for filled and vacant posts, and all vacant posts are omitted. For each year, the national and provincial expenditure files are collapsed at the individual level - combining various earnings categories into a single "gross earnings variable". This dataset is then merged with the relevant headcount file.² For an extremely small subset of workers, the merging process does not successfully match the same employee across the headcount and expenditure files, in which case that observation is dropped.

The full dataset consists of over 18.5 million observations, spanning 14 years (2007 to 2020), and includes a wide range of information on public service employees. For example, the data includes information on employee earnings (basic salary, pension and provident fund contributions, medical aid and other allowances, overtime payments and other bonuses), age, population group, gender, citizenship status, as well as a range of occupation-specific variables, including government department, salary band, years of service, job title and full-time versus part-time status. Constructing, cleaning and analysing this dataset requires considerable computing power, given the large number of observations. In this regard, the analysts acknowledge the assistance of the University of Cape Town's High-performance Computing (HPC) Centre³, without which this work would not have been feasible.

There are several advantages to using PERSAL data relative to other sample datasets, such as the QLFS, to analyse public sector employment and wage issues. First, it covers the population of workers in the public service as defined above, so the analysis does not need to concern itself with sample-based inference issues such as representivity and estimation precision. Second, it is administrative in nature, which implies an absence of measurement error or item non-response (missing data) in variables of interest, such as

¹ National entities include Statistics South Africa (Stats SA), the South African Police Service (SAPS) and the National Prosecuting Authority (NPA).

² In very few instances, for a given year, multiple records per worker were identified in the headcount files. This suggests that some workers work in multiple occupations during the same period. Through the merging and appending process described here, this aspect of the data is accounted for to ensure that the number of workers is not over- or under-counted. To this end, any references to a worker's gross monthly earnings include all earnings from all jobs, regardless of the number of jobs they have.

³ See: hpc.uct.ac.za for more details.

earnings, which typically need to be accounted for in analyses of survey data. Third, because workers are uniquely identified by an eight-digit PERSAL number, the dataset has a longitudinal element that allows the analysts to conduct a broader range of statistical analysis (although this element is not used in this chapter). To the analysts' knowledge, this is the first empirical study to make use of the PERSAL dataset at the individual level.

6.4.2 Approach and methods

The focus is on providing a comprehensive account of the public sector wage bill over a 14-year period. As explained above, the work in this paper is quantitative in nature and relies on two main sources of data. The first is cross-country data, which allows one to use comparable estimates of public sector employment and compensation to compare South Africa's public sector to that of countries around the world, and to relevant country groups. Secondly, the primary basis for the analysis presented is PERSAL data, which is examined at the individual level and allows one to conduct relatively detailed quantitative work. To the analysts' knowledge, no other quantitative analysis exists that analyses this data at such a disaggregated level.

The majority of the quantitative work in this paper is descriptive in nature, aiming to clearly establish the broad trends in public service employment and earnings between 2007 and 2020, and to provide insight into what has influenced the observed outcomes. Given that the analysts have access to a large, detailed administrative dataset, they are able to examine various demographic and labour market categories to disaggregate employment and earnings composition, both in a given year and over time. Crucially, the analysis uses individual-level data to do this. The analysts view one of their contributions in this case as having put together a clean, functional dataset that covers the complete population of public service workers. In addition, they are able to look at changes across the full earnings distribution, which is important when dealing with questions about where wage gains in the public sector have accrued over time. This includes, for example, looking at employment composition at different pay grades, as well as measuring the extent to which wage increases versus employment increases have contributed to overall increases in the wage bill.

Beyond this descriptive work, Section 6.5 employs standard econometric techniques to measure the determinants of wages in the public service, contingent on the demographic and labour market information contained in the data. Here use is made of basic Mincerian earnings function regression models to examine the determinants of wages among these workers and how these have changed over the period. This allows the analysts to control for a range of individual-level characteristics and measure how earnings return varies across specific sub-groups, as well as over time. For example, one can assess how the marginal returns to gender change over the period (i.e. the gender wage gap), where one sees that, when controlling for a range of available demographic and labour market variables, the earnings gap between men and women in the public service had narrowed to become almost non-existent by 2020. This work is contrasted with results from similar analyses on public and private sector earnings using sample-based household survey data. Importantly, attempts at directly comparing results from PERSAL and QLFS data are limited by major differences in these datasets and require more detailed work than has been undertaken here.

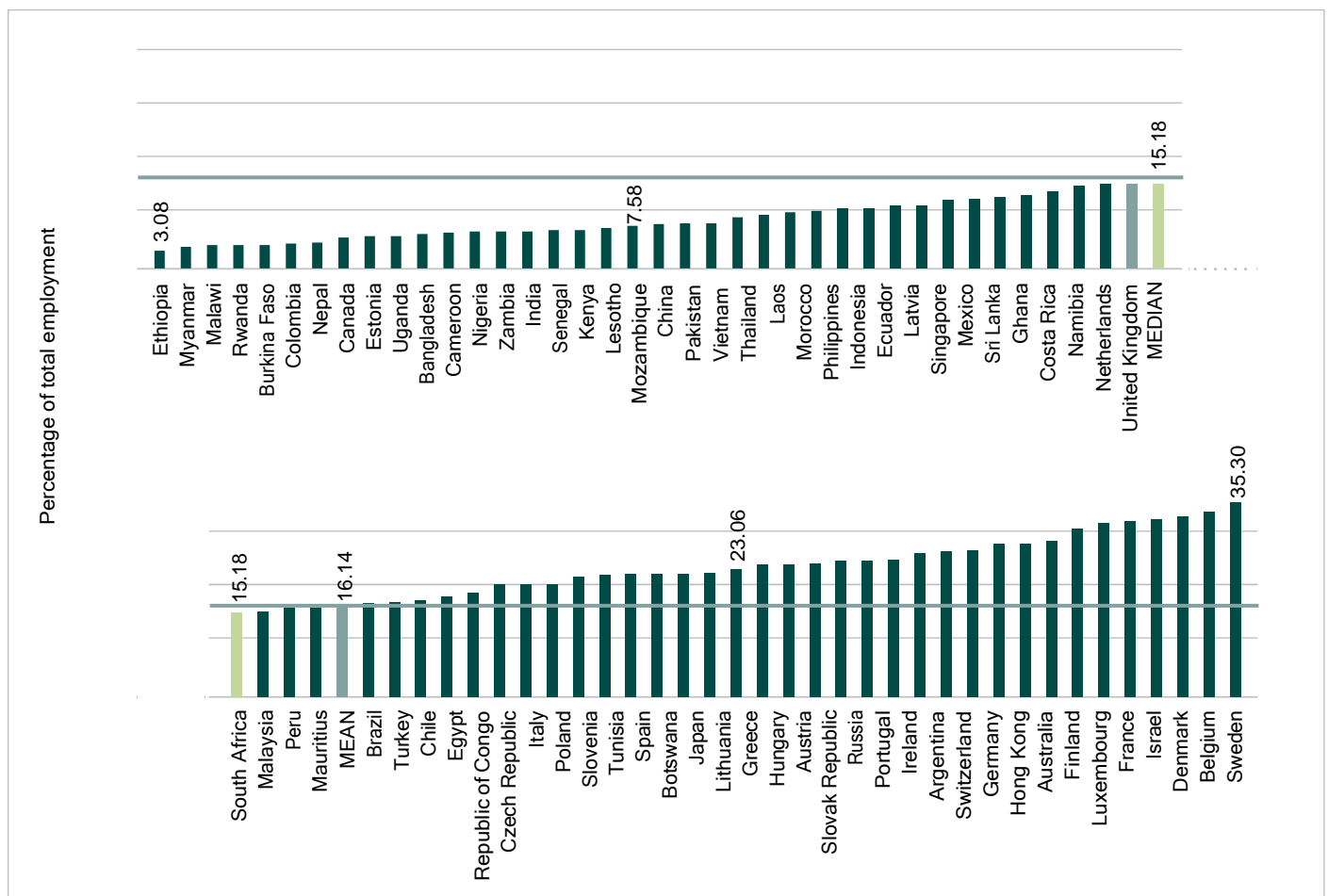
6.5 South Africa's public sector in context

In order to provide some basic context, this section uses cross-country data to assess South Africa's public sector employment and wage bill relative to international aggregates. Two points are worth noting at the outset regarding the cross-country data presented. Firstly, the data comes from various international institutions and relies on a definition of the "public sector" that corresponds most directly to South Africa's national and provincial departments and public entities, but does not include local government or state-owned companies. Secondly, comparisons of government employment should be interpreted with some

caution, given that this is influenced by each country’s system of governance and constitutional framework. Nevertheless, the data provides a useful starting point for thinking about the size and remuneration of South Africa’s public sector.

In Figure 6.1, data from the OECD (2022) is used, as well as additional data compiled by De Vries et al. (2021) to compare the size of the public sector across 76 countries. The range of public sector employment shares is large, between 3% (Ethiopia) and 35% (Norway), with a mean and median of 15%. South Africa’s public sector employment share is measured at 15.1% and is thus in the middle of the distribution of countries sampled here. This suggests that, while the public sector in South Africa may have grown over the last decade or so, it does not appear to be unusually large in international terms. The impression that the country has a bloated public sector purely in terms of employment numbers does not appear to be correct. However, this may be sensitive to the inclusion of local government employment and employment in state-owned companies in the calculations, which could push the share up closer to 20%.

Figure 6.1: Public sector employment as a share of total employment, selected countries: 2018



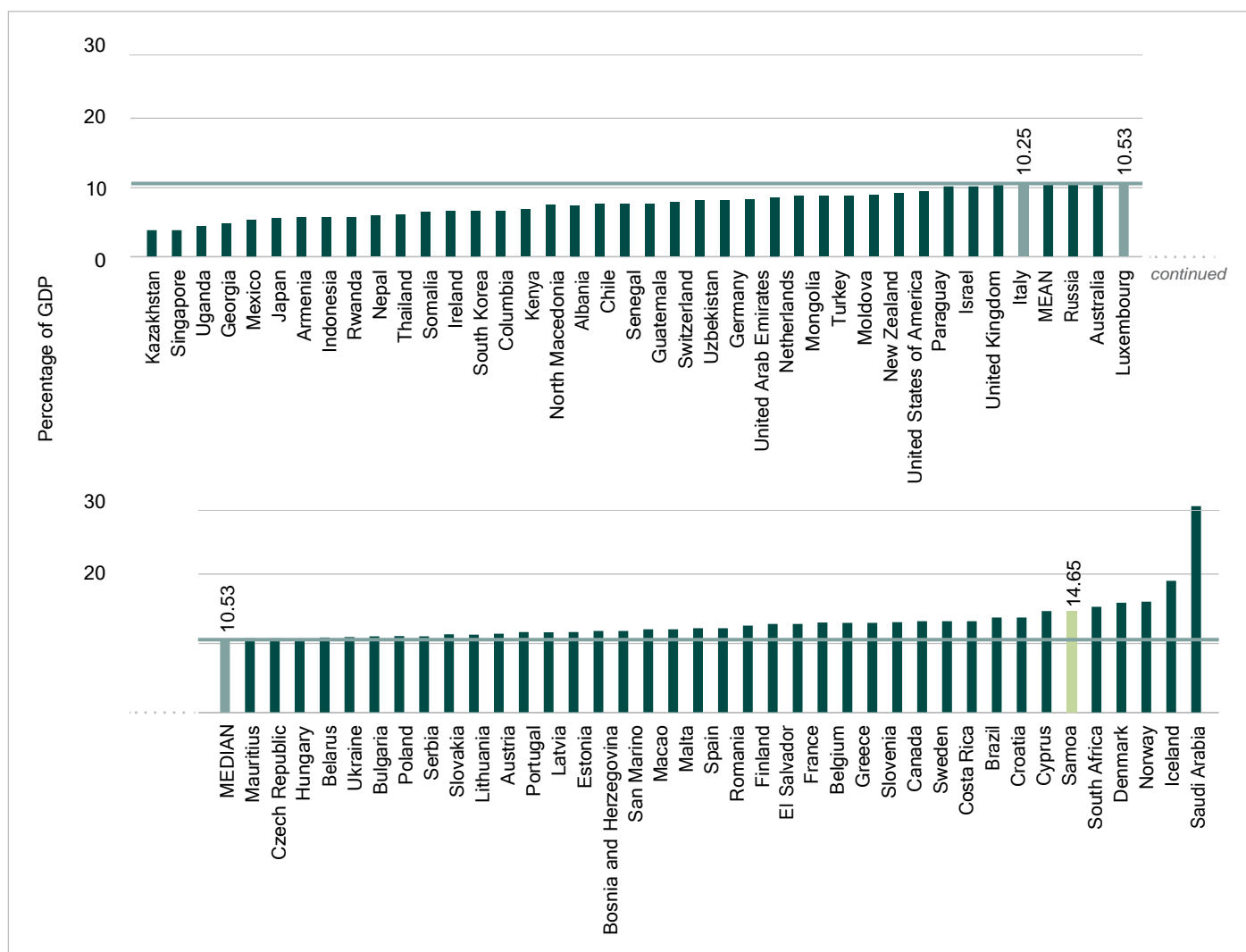
Note: Sample includes 76 countries. The definition of public sector is based on the IMF’s categorisation of “general government”.

Source: Commission’s calculations based on OECD (2022) and De Vries et al. (2021)

It is already suspected from the points made in the introduction that public sector earnings in South Africa are relatively high, and indeed the cross-country data appears to confirm this. In Figure 6.2, use is made of data from the IMF on public sector compensation, where the public sector wage bill is measured as a percentage of country GDP for 75 countries. In the sample of countries for which data is available, the range of the compensation ratio varies between 3% and 29%, with both mean and median levels of compensation measuring approximately 10% of GDP. South Africa has the sixth-highest level of public

sector compensation among the countries in this sample, at 14.6% of GDP, far above both the group mean and the median. In relation to earnings, the general impression that South Africa spends a large proportion of its national income on the compensation of public servants, relative to its international counterparts, appears to be correct.

Figure 6.2. Compensation of public employees as a share of GDP, selected countries: 2020



Note: Sample includes 75 countries.

Source: Commission's calculations based on IMF (2021)

Using the same IMF data as above, it is useful to examine how public sector compensation in South Africa has changed over time. The Commission is interested to see whether it has always been as high as in Figure 6.2, or if the recent period is in some way unique. In Figure 6.3, the same variable – public sector compensation as a percentage of GDP – is plotted for South Africa over nearly ten decades (1993 to 2020) to examine longer-term trends. The graph shows that public sector compensation was very high in 1993, but dropped sharply in the mid-1990s to reach a level around 10% of GDP during the early- to mid-2000s. In 2008, the wage bill increased dramatically. This may have been partly a result of the global financial crisis, which impacted negatively on GDP, and would thus increase the measures ratio. However, it is primarily due to an administrative change in pay schedules that resulted in large wage increases for specific public sector employees. Public sector compensation continued to increase, relative to GDP, throughout the 2010s, and by 2020, it had risen to a level only previously seen in 1993, at over 14%.

Figure 6.3. Public sector compensation as a percentage of GDP, South Africa: 1993–2020

Note: The definition of public sector is based on the IMF's categorisation of "general government".

Source: Commission's calculations based on IMF (2021).

To consolidate the key points above, this section is concluded with Table 6.1, which compares public sector employment and compensation data from South Africa against various country-income group averages. The table includes data on government employment as a share of total employment, compensation as a share of GDP, and compensation as a share of total government expenditure. As points of comparison, lower-middle-income, upper-middle-income and high-income countries are identified. As shown above, public sector employment in South Africa is not unusually high by global standards. Measuring 15% of total employment it is at the global median, and the mean of other upper-middle-income countries. Public sector employment in South Africa is also lower than the high-income country average of 23%, but above the lower-middle-income country average of 9%. This data appears to confirm that South Africa is not an outlier relative to global and comparator country averages.

Table 6.1. Government employment and compensation, by country group: 2021

Country income group (sample size)	Employment (percentage of total employment)	Compensation (percentage of GDP)	Compensation (percentage of total expenditure)
Lower middle income (20)	9.21	10.19	35.87
Upper middle income (16)	15.04	8.93	27.44
High income (33)	22.94	11.02	24.14
South Africa	15.18	14.65	33.58
Global median (75)	15.19	10.53	25.87

Source: IMF (2021); Commission's calculations.⁴

The data on compensation, however, emphasises that South Africa is certainly atypical in this regard, both in relation to other upper-middle-income countries and the global median. Measured as a percentage of GDP, public sector compensation in South Africa (14.65%) is substantially higher than the global median (10.53%), and even exceeds the average level of compensation in high-income countries (11.02%). Indeed, relative to GDP, the data here confirms that public sector pay in South Africa is excessive, not only when compared to economies at a similar stage of economic development, but compared to all countries in the

⁴ Countries included Argentina, Australia, Austria, Bangladesh, Belgium, Botswana, Brazil, Burkina Faso, Cameroon, Canada, Chile, China, Colombia, Costa Rica, Czech Republic, Denmark, Ecuador, Egypt, Estonia, Ethiopia, Finland, France, Germany, Ghana, Greece, Hong Kong, Hungary, India, Indonesia, Ireland, Israel, Italy, Japan, Kenya, Laos, Latvia, Lesotho, Lithuania, Luxembourg, Malawi, Malaysia, Mauritius, Mexico, Morocco, Mozambique, Myanmar, Namibia, Nepal, Netherlands, Nigeria, Norway, Pakistan, Peru, Philippines, Poland, Portugal, Republic of Korea, Russia, Rwanda, Senegal, Singapore, Slovak Republic, Slovenia, South Africa, Spain, Sri Lanka, Sweden, Switzerland, Thailand, Tunisia, Turkey, Uganda, United Kingdom, Vietnam and Zambia.

sample. Finally, looking at compensation in relation to total government expenditure, the picture is similar, but slightly less extreme. The public sector wage bill in South Africa remains above the global average, as well as above the mean of high-income and upper-middle-income countries, but is marginally lower than the average for lower-middle-income countries.

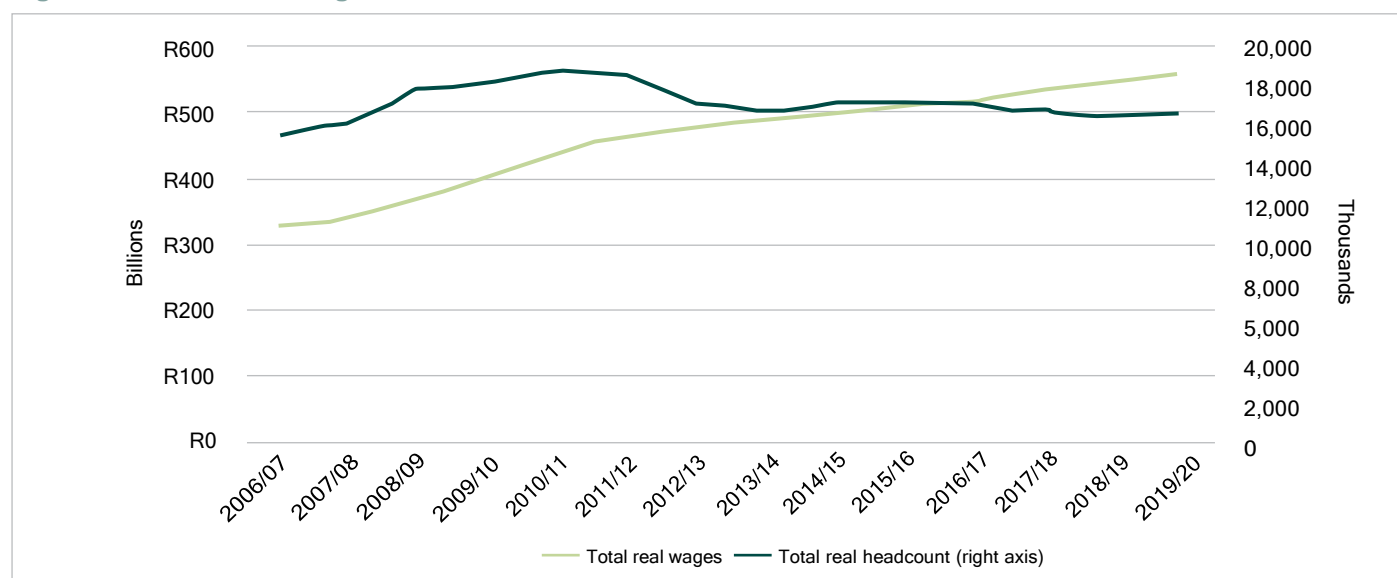
6.6 Results

This section focuses on public sector earnings from two different angles. First, the PERSAL data is used to compute a series of multivariate regression models, which enable the analysts to estimate return differentials within the public service, both across various sub-groups and over time. This approach allows one to estimate the correlational relationship between a given worker-level characteristic, such as gender, age or department, and wages, while holding all other observable characteristics constant. Second, it draws on existing work that uses household survey data to compare the determinants of wages in the public sector to those in the private sector. However, some basic descriptive analyses of public sector wages are important to provide background to the main results.

6.6.1 Descriptive analysis of national and provincial government

Figure 6.4 depicts the total real wages compared to the number of employed individuals in the public sector. The total real wage curve shows a steady incline in wages since 2006. In contrast, the number of employed individuals has not changed very much. There has only been a slight decline in the number of employees since 2012. It appears that the public sector has always maintained the size of the wage bill. In addition, there seems to have been a steady convergence of the wages of the number of employed individuals since 2006. A divergence, however, starts to occur from 2016. After 2016, a clear trade off takes place between the number of salaries compared to the number of employed public servants. This indicates that employment has stagnated or even declined since 2016, and the salary range per person has increased.

Figure 6.4: Total real wages vs headcount



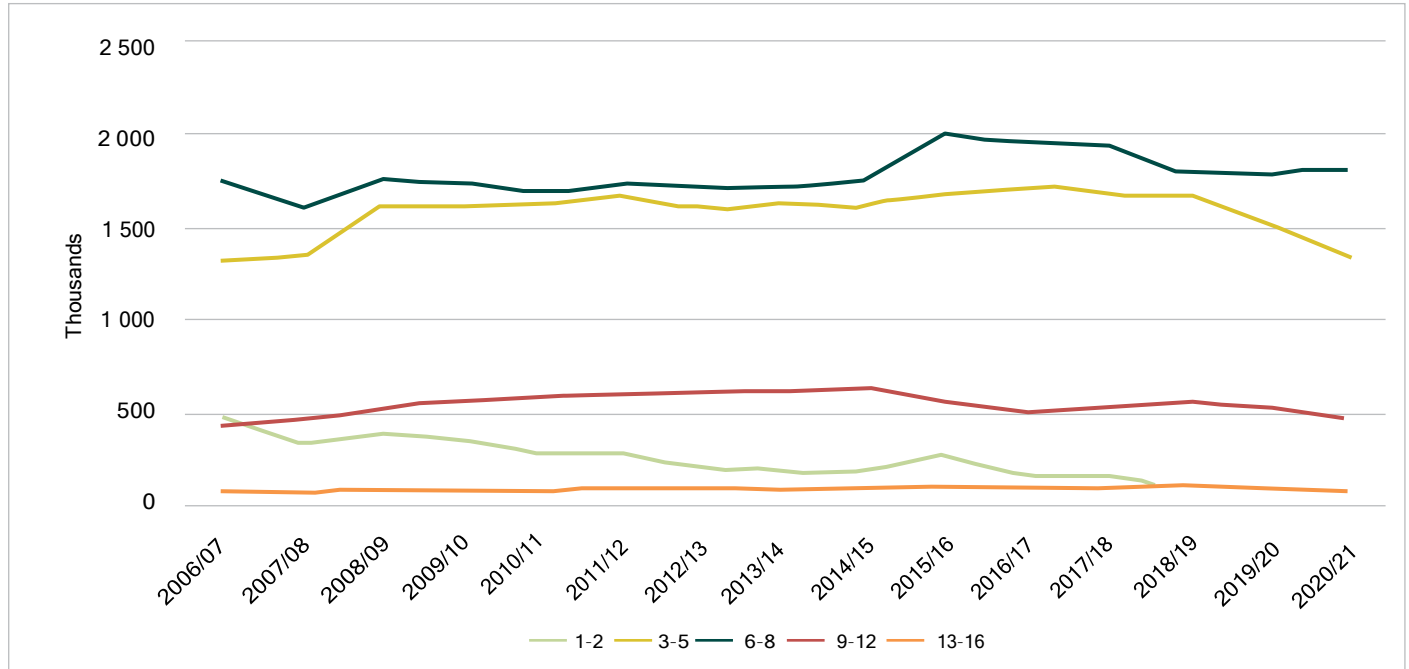
Note: CPI headline (2016 = 100)

Source: Commission's calculation (based on National Treasury, 2021)

The wage bill reached close to R600 billion in 2020. This is particularly concerning given the decline of the economic climate before COVID-19, and more rapidly due to the pandemic. Furthermore, remuneration is used as a tool to induce and incentivise increased productivity. However, this method can only work if employees are given a fair workload. Once a rapid trade off starts taking place, workers may not be able to manage the given workload or excel at it, because they are overburdened. A factor that needs to be

appreciated is that productivity is directly affected by rapid trade off dynamics that are witnessed in the national and provincial spheres of government. On the other hand, departments may be experiencing diminishing returns to excessively high employment. Departments may have too many redundant positions filled, which has put pressure on the wage bill, and has negatively affected productivity, and have therefore reduced the number of positions that were previously filled.

Figure 6.5: Headcount per salary band

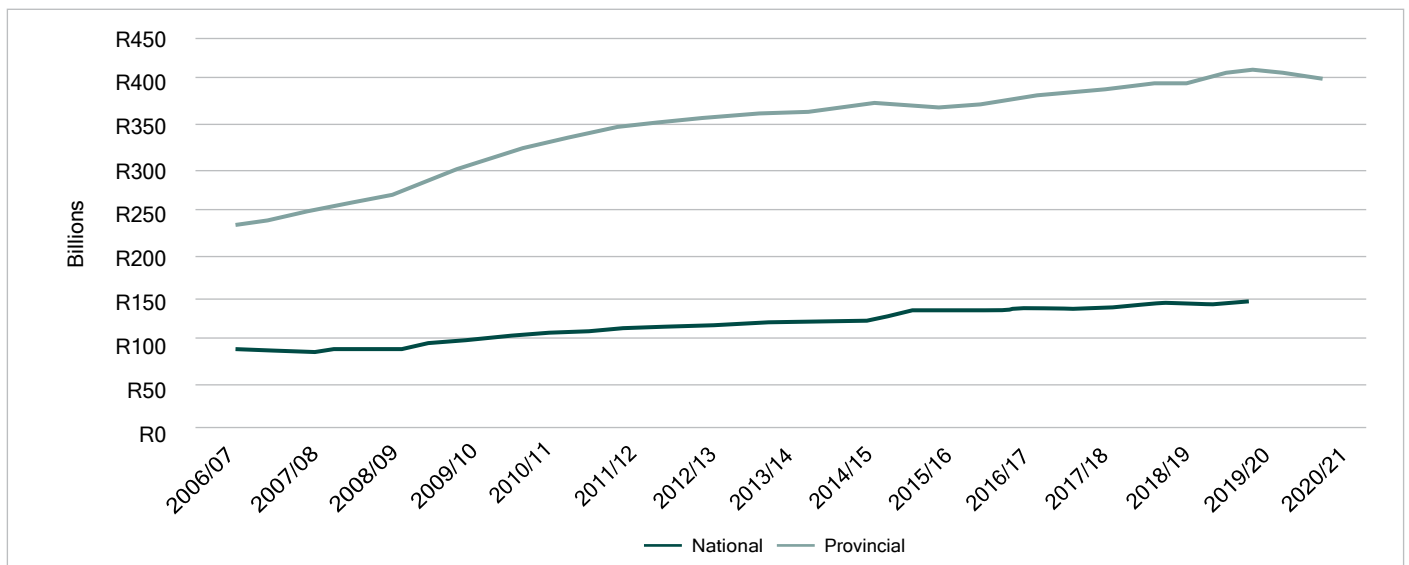


Note: CPI headline (2016 = 100)

Source: Commission's calculations (based on National Treasury, 2021).

According to Figure 6.5, the number of employed individuals is concentrated in the middle of the wage bill. This could indicate that the public sector prefers relatively skilled individuals. Interestingly, the number of low-skilled workers has declined since 2006, which may indicate that the sector has become increasingly dependent on outsourcing low-skilled services from the private sector, such as domestic services.

Figure 6.6: Provincial and national annual real wage bill



Note: CPI headline (2016 = 100)

Source: Commission's calculation (based on National Treasury, 2021)

When decomposing total wages and analysing the national and provincial spheres of government, Figure 6.6 indicates that the provincial sphere of government has a much larger wage bill. This is as a result of a bigger payload, since some of the largest departments are paid through the provincial wage bill, i.e. teachers and healthcare workers. Therefore, the speed rather than the size at which the wage bill has increased may be the biggest concern. Judging by the steepness of the red curve in Figure 6.6, the year-on-year increases in the provincial sphere are much larger than in the national sphere. This may lead to trade offs that affect the provincial sphere of government.

6.6.2 *Estimates of the determinants of wages in the public service*

To analyse the determinants of wages within the South African public service, use is made of the individual-level nature of the PERSAL data and year-specific multivariate regression models are estimated using ordinary least squares (OLS) method to the specification of a canonical Mincerian wage function. The magnitude and statistical significance⁵ of each estimate is then compared, both within and between years to examine the association between wages and a given worker-level characteristic, how this relationship compares to that of other characteristics, and how this relationship has varied over time. Specifically, the following specification is estimated with robust standard errors:

$$\log(wage)_{it} = \alpha_{it} + \beta D_{it} + \gamma L_{it} + \delta X_{it} + \varepsilon_{it} \quad (1)$$

where $\log(wage)_{it}$ represents the natural logarithm of worker i 's gross real monthly wage in year t and D_{it} , L_{it} and X_{it} represent three vectors of observable covariates pertaining to worker-level demographics, labour market and department-specific covariates, respectively. These include a wide array of characteristics available in the data, including gender, race, age, national or provincial department, sector, occupational level, number of job records, a full versus part-time indicator, and years of service. Although typical Mincerian wage function models include a measure of education quantity and years of experience as the covariates of interest, these variables are unfortunately not available in the PERSAL data, and are therefore not included in these models. Finally, ε_{it} represents the regression error term. Although this regression is run for every year of data available, the analysts have focused on estimates in three specific years in the period: 2007, 2013 and 2020. However, the year-specific results for every year from 2007 to 2020 are presented in Table 6.A2 in the appendix.

Table 6.2 presents the year-specific model estimates of the conditional correlational relationship between wages in the public service and the vector of demographic covariates, D_{it} . First, a significant but small gender wage gap can be observed in 2007; i.e. the average female employee in the public service earned 3.5% less than the average male employee in this year. Importantly, given the multivariate nature of these models, this earning differential is not explained by differences in other characteristics between men and women such as age, occupational level, years of service, sector or department.⁶ This conditional gap is more than eight times smaller than that observed in the overall South African labour market, estimated to have been 29% as of February 2020 (Hill and Köhler, 2021), although the model specifications differ. By 2013, this public service gender wage gap had reduced to 1.9%, and by 2020, it had almost disappeared (0.5%). In terms of race, Asian/Indian workers, on average, exhibited the highest wage premium of approximately 9%, relative to African/black workers, and remained relatively constant over the nearly 15-year period, followed by that observed for white workers (4 to 8%), all else being constant. On the other hand, the average Coloured worker earned a similar wage as African/black workers over the period, all else being constant. In terms of age, similar to studies of the formal private sector labour market, a positive,

⁵ It is likely that most, if not all, year-specific model estimates will be statistically significant, simply given the very large number of observations per model.

⁶ However, this differential may be explained by unobservable covariates that have not been controlled for in the model, such as years of education and total labour market experience.

non-linear wage premium was observed for older workers. However, the magnitude of the premium is small. Specifically, one additional year in age is associated with a 1 to 2% higher wage, which decreases as age increases. Lastly, it should be noted that these models exhibit very large coefficient of determination values (R^2), which suggests that the characteristics contained in these three covariate vectors alone explain between 73 and 79% of the variation in wages among South African public service workers.

Table 6.2: Mincerian earnings function regression estimates of demographic covariates: 2007, 2013 and 2020

Covariates	(1) 2007	(2) 2013	(3) 2020
Gender			
Male	0.035*** (0.001)	0.019*** (0.001)	0.005*** (0.001)
Race			
Asian/Indian	0.092*** (0.002)	0.087*** (0.002)	0.087*** (0.002)
Coloured	0.017*** (0.001)	-0.005*** (0.001)	-0.006*** (0.001)
White	0.063*** (0.001)	0.041*** (0.001)	0.076*** (0.001)
Age (years)			
Age	0.011*** (0.000)	0.010*** (0.000)	0.017*** (0.000)
Age squared	-0.000*** (0.000)	-0.000*** (0.000)	-0.000*** (0.000)
Constant	8.237*** (0.006)	8.180*** (0.006)	8.825*** (0.020)
Observations	996 535	1 236 679	1 118 063
R ²	0.776	0.786	0.738

Commission's calculations (based on PERSAL, 2006/07; 2012/13; 2019/20)

Notes: [1] This figure presents a plot of the estimated regression coefficients from specification (1) estimated using OLS.

[2] The outcome variable is the natural logarithm of real gross monthly wages.

[3] Data includes the population of workers in all national and provincial government departments, as well as national entities in South Africa.

[4] Data for January of each year is used.

[5] Capped spikes represent 95% confidence intervals.

[6] Reference groups are as follows: female; African/black.

[7] Complete results for all years are presented in Table 6.A1 in the appendix.

[8] Robust standard errors are presented in parentheses.

[9] * $p < 0.10$; ** $p < 0.05$; *** $p < 0.01$.

Table 6.3 presents the year-specific model estimates of the conditional correlational relationship between wages in the public service and the vector of labour market covariates, L_{it} . First, considering occupational or skill levels, a positive and steep wage gradient is found with respect to skills in every year. In 2007, relative to so-called unskilled workers, on average, semi-skilled workers earned 37.5% more, rising to 100% more for skilled technical workers, 172% more for professionally qualified workers, 230% more for senior management workers, and 262% more for top management workers. The magnitudes of these

premiums remained largely constant over the period, with the exception of a premium reduction of earners at the top of the distribution: senior and top management workers. This trend might imply a reduction in earnings inequality with respect to skills. However, a more detailed analysis is required to reach such conclusions. Regarding other labour market characteristics, it was found that, in every year assessed, the average worker earns higher wages if they are employed in more than one job, are employed on a full-time basis (full-time workers earned 50% more in 2007, reducing to 28% in 2020), and have more experience working in the public service. Interestingly, regarding the latter, a positive, relatively linear, but not very steep wage gradient was found with respect to experience in 2007. For instance, one to five years of service is associated with 14% higher wages, compared to less than one year of experience, on average, increasing to 28% for more than 40 years of service. In 2013 and 2020, however, the shape of this gradient became non-linear.

Table 6.3: Mincerian earnings function regression estimates of labour market covariates: 2007, 2013, and 2020

Covariates	(1) 2007	(2) 2013	(3) 2020
Occupational/skill level			
Other	-0.051*** (0.019)	0.271*** (0.013)	-0.437*** (0.018)
Semi-skilled (Level 3-5)	0.375*** (0.001)	0.432*** (0.001)	0.414*** (0.001)
Skilled technical (Level 6-9)	0.997*** (0.001)	1.008*** (0.001)	0.898*** (0.001)
Professionally qualified (Level 10-12)	1.717*** (0.002)	1.661*** (0.002)	1.581*** (0.001)
Senior management (Level 13-14)	2.291*** (0.003)	2.207*** (0.003)	1.945*** (0.003)
Top management (Level 15-16)	2.618*** (0.011)	2.721*** (0.007)	2.408*** (0.008)
Number of job records			
Two job records	0.877*** (0.051)	1.220*** (0.041)	1.382*** (0.058)
Three job records	1.393*** (0.109)	1.857*** (0.073)	2.663*** (0.073)
Four job records	1.769*** (0.059)	2.255*** (0.181)	2.375*** (0.286)
Five job records			3.541*** (0.004)
Full-time versus part-time			
Full-time	0.501*** (0.003)	0.845*** (0.003)	0.277*** (0.017)
Years of service			
1-5 years	0.144*** (0.001)	0.091*** (0.001)	0.056*** (0.003)
6-10 years	0.212*** (0.001)	0.136*** (0.001)	0.170*** (0.003)

Covariates	(1) 2007	(2) 2013	(3) 2020
11-15 years	0.219*** (0.001)	0.155*** (0.002)	0.182*** (0.003)
16-20 years	0.253*** (0.001)	0.162*** (0.002)	0.173*** (0.003)
21-25 years	0.260*** (0.002)	0.164*** (0.002)	0.207*** (0.003)
26-30 years	0.270*** (0.002)	0.177*** (0.002)	0.088*** (0.030)
31-35 years	0.277*** (0.002)	0.162*** (0.002)	0.199*** (0.003)
36-40 years	0.279*** (0.004)	0.146*** (0.003)	0.181*** (0.004)
41+ years	0.280*** (0.012)	0.121*** (0.009)	0.149*** (0.007)
Constant	8.237*** (0.006)	8.180*** (0.006)	8.825*** (0.020)
Observations	996 535	1 236 679	1 118 063
R ²	0.776	0.786	0.738

Commission's calculations (based on PERSAL, 2006/07; 2012/13; 2019/20)

Notes: [1] This figure presents a plot of the estimated regression coefficients from specification (1) estimated using OLS.

[2] The outcome variable is the natural logarithm of real gross monthly wages.

[3] Data includes the population of workers in all national and provincial government departments, as well as national entities in South Africa.

[4] Data for January of each year is used.

[5] Capped spikes represent 95% confidence intervals.

[6] Reference groups are as follows: unskilled (Level 1–2); one job record; less than one year of service.

[7] Complete results for all years are presented in Table 6.A1 in the appendix.

[8] Robust standard errors are presented in parentheses.

[9] * $p < 0.10$; ** $p < 0.05$; *** $p < 0.01$.

Finally, Table 6.4 presents the year-specific model estimates of the conditional correlational relationship between wages in the public service and the vector of department-specific covariates, X_{it} . First, in 2020, it is found that the average worker in every provincial government earns lower wages than the average national department worker. However, the magnitude of this differential is relatively small, ranging between 2% in Gauteng and Mpumalanga, to 7% in the Free State and Limpopo. This was not the case in preceding years. In both 2007 and 2013, provincial department workers of most (six) provinces earned similar or higher wages, on average, compared to national department workers. In terms of sector, in 2020, a notable wage premium for public service workers was observed in the agriculture sector. For this year, it was found that workers in every other sector earned less than those in the agriculture sector, from 1% less for those in criminal justice, finance and health, to 16% less for those in home affairs. This was not the case in 2007 and 2013, however. The premium for workers in the agriculture sector is still evident for most sectors in these periods.

Table 6.4: Mincerian earnings function regression estimates of department-specific covariates: 2007, 2013 and 2020

Covariates	(1) 2007	(2) 2013	(3) 2020
National or provincial department			
Eastern Cape	-0.018*** (0.002)	0.028*** (0.002)	-0.053*** (0.002)
Free State	-0.013*** (0.002)	-0.002 (0.002)	-0.067*** (0.002)
Gauteng	0.000 (0.002)	0.034*** (0.002)	-0.016*** (0.002)
KwaZulu-Natal	0.013*** (0.002)	-0.015*** (0.002)	-0.028*** (0.002)
Limpopo	-0.032*** (0.002)	0.030*** (0.002)	-0.071*** (0.002)
Mpumalanga	0.022*** (0.002)	0.048*** (0.002)	-0.018*** (0.002)
North West	0.027*** (0.005)	0.007*** (0.002)	-0.031*** (0.002)
Northern Cape	0.025*** (0.003)	-0.005** (0.002)	-0.034*** (0.002)
Western Cape	-0.001 (0.002)	0.042*** (0.002)	-0.042*** (0.002)
Sector			
Arts/sport	-0.047*** (0.005)	0.006 (0.004)	-0.047*** (0.004)
Criminal justice	-0.014*** (0.002)	0.017*** (0.002)	-0.012*** (0.002)
Economic/environment	0.022*** (0.003)	0.013*** (0.003)	-0.073*** (0.003)
Education	-0.090*** (0.002)	0.021*** (0.002)	-0.017*** (0.002)
Finance	0.022*** (0.004)	-0.025*** (0.004)	-0.007* (0.004)
Foreign affairs	0.017** (0.007)	-0.023*** (0.006)	-0.077*** (0.006)
General administration	-0.034*** (0.003)	-0.044*** (0.003)	-0.095*** (0.003)
Health	-0.021*** (0.002)	-0.014*** (0.002)	-0.009*** (0.002)
Home affairs	0.005 (0.004)	-0.186*** (0.003)	-0.156*** (0.003)
Infrastructure	-0.016*** (0.002)	-0.039*** (0.002)	-0.075*** (0.003)
Other	0.315*** (0.010)	0.391*** (0.011)	0.357*** (0.022)
Welfare	-0.022*** (0.003)	-0.105*** (0.003)	-0.034*** (0.003)

Covariates	(1) 2007	(2) 2013	(3) 2020
Constant	8.237*** (0.006)	8.180*** (0.006)	8.825*** (0.020)
Observations	996 535	1 236 679	1 118 063
R ²	0.776	0.786	0.738

Commission's calculations (based on PERSAL, 2006/07; 2012/13; 2019/20)

Notes: [1] This figure presents a plot of the estimated regression coefficients from specification (1) estimated using OLS.

[2] The outcome variable is the natural logarithm of real gross monthly wages.

[3] Data includes the population of workers in all national and provincial government departments, as well as national entities in South Africa.

[4] Data for January of each year is used.

[5] Capped spikes represent 95% confidence intervals.

[6] Reference groups are as follows: national departments; agriculture sector.

[7] Complete results for all years are presented in Table 6.A1 in the appendix.

[8] Robust standard errors are presented in parentheses.

[9] * $p < 0.10$; ** $p < 0.05$; *** $p < 0.01$.

6.6.3 Public and private sector wages: stylised facts from household survey data

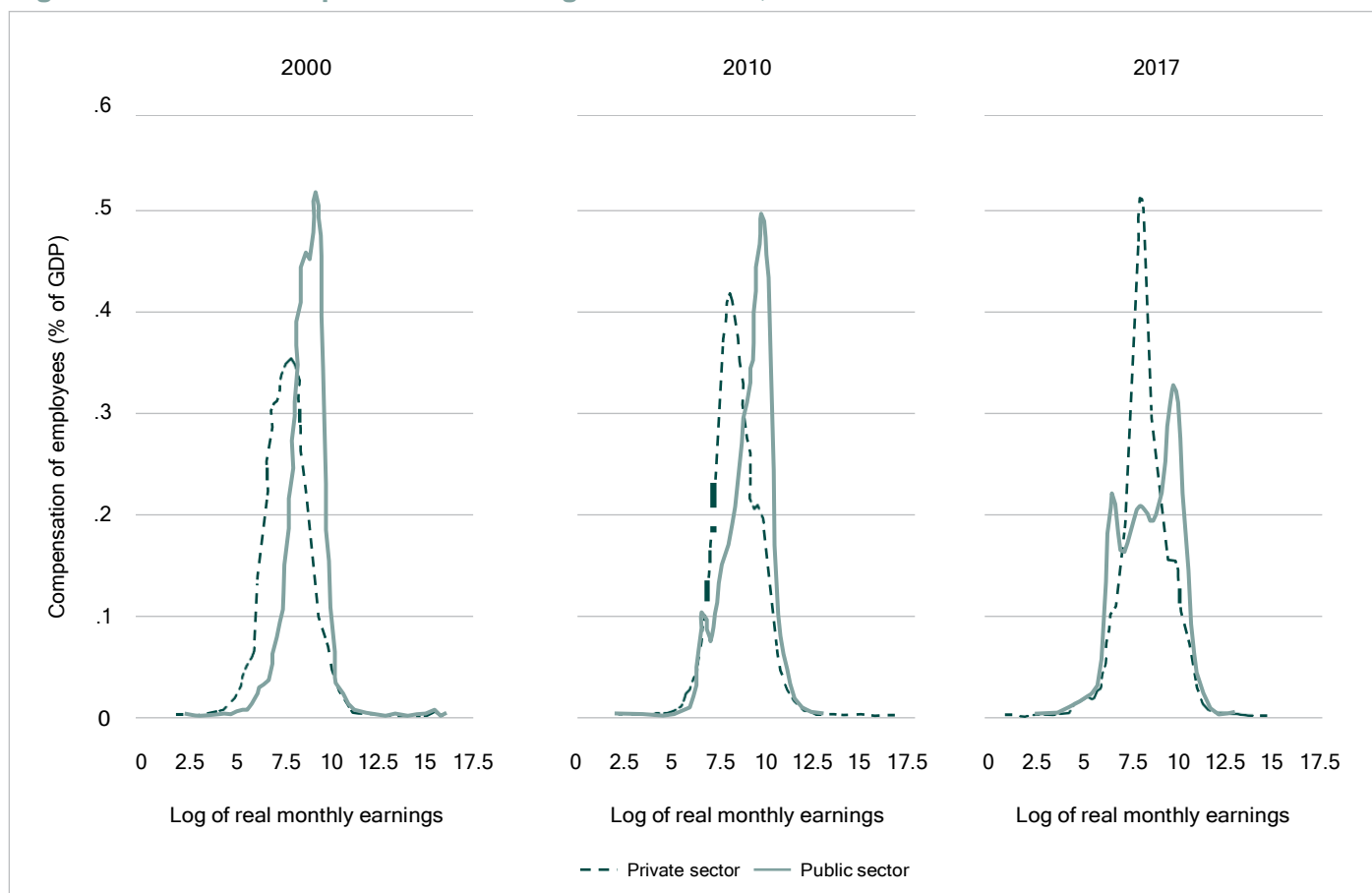
This chapter has described the various ways in which public service employment and wages have changed over the last 15 years, and has provided a relatively detailed analysis of the underlying dynamics. Importantly, the various trends observed are linked to broader debates about employment in South Africa. In this regard, several analytical issues emerge. First, while employment growth over the last two decades has come principally from more jobs being added in the private sector, the observed growth in public sector employment means that this part of the labour market has come under increased scrutiny. Second, as documented at various points in this chapter, empirical evidence not only indicates that the wage levels of public service workers has risen, but – as noted in the introduction – the wage premium for public sector workers has been shown to be high and significant (Kerr and Wittenberg, 2017; Bhorat et al., 2015). Third, within the debate around the public sector wage bill, its impact on the fiscus – and indeed the fiscal consolidation path – has become a central feature of the discussion around South Africa's public finance challenges.

It is within this context that some additional observations and points of discussion about public sector wages are provided in relation to the private sector. However, there are two critical points to note about the work presented in this sub-section: First, the results rely on data from the QLFS, produced by Bhorat et al. (forthcoming), thus both the sample of government employees and the nature of the data on wages differs from the PERSAL dataset used above. It is also noted that the QLFS sample for the private sector includes formal and informal sector workers, as well as the self-employed and those working part-time. The wage trends and levels presented below should therefore not be compared directly to those based on PERSAL data. Second, it is noted that the time period covered in the analysis using QLFS data (2000-2017) does not correspond directly to the period covered above (2007-2020).

The discussion then begins with a simple overview of the wage distribution that compares public and private sector wages at three points over an 18-year period: 2000, 2010 and 2017. The kernel density plots in Figure 6.7 suggest that the wage distributions of the public and private sectors are fundamentally different. Specifically, for all selected years, the distribution of public sector wages is to the right of the private sector, confirming that wages are higher in the public sector than in the private sector. In addition,

the variance of earnings has increased in the public sector – the shape of the wage distribution has changed from a single spike to a more spread-out double spike. Put differently, the gap between higher and lower earners in the public sector appears to have grown, with wage gains at the top and a slightly larger concentration of lower-paid workers. Kwenda and Ntuli (2018) speculate that this latter observation may be a result of an increase in the use of outsourced workers in government departments, who are still counted as working for the public sector.

Figure 6.7: Private and public sectors wage distribution, 2000 and 2017



Source: *Bhorat et al. (forthcoming)*.

Notes: There is no wage data for 2008 and 2009. The base period for real earnings is December 2017. Outliers have been removed.

To compare the rand amounts of reported wages in both sectors, Table 6.5 reports the mean and median monthly wages for the years examined above: 2000, 2010 and 2017. The public sector mean wage is significantly higher than the private sector mean wage in all the years considered. However, the ratio between the two sectors has narrowed – from 1.96 in 2000 to 1.39 in 2017. This was mainly due to mean wages increasing by 51.70% in the private sector between 2000 and 2010, compared to by only 18.07% in the public sector. In 2000, the median pay for public sector workers was three times greater than for private sector workers. However, by 2017, this ratio had decreased to 1.57. This decrease was caused by an overall increase of 34.49% in median private sector wages, but also a decline in median public sector pay. At first glance, this data would seem to indicate that, despite a fairly significant aggregate wage gap between the public and private sector – with the former paying significantly more – this gap has narrowed since 2000. In particular, the initial evidence would seem to suggest that the real wages decline at the median in the public sector accounts for this trend in the public and private wage differential.

Table 6.5: Public and private sector mean and median real wages, rands per month: 2000–2017

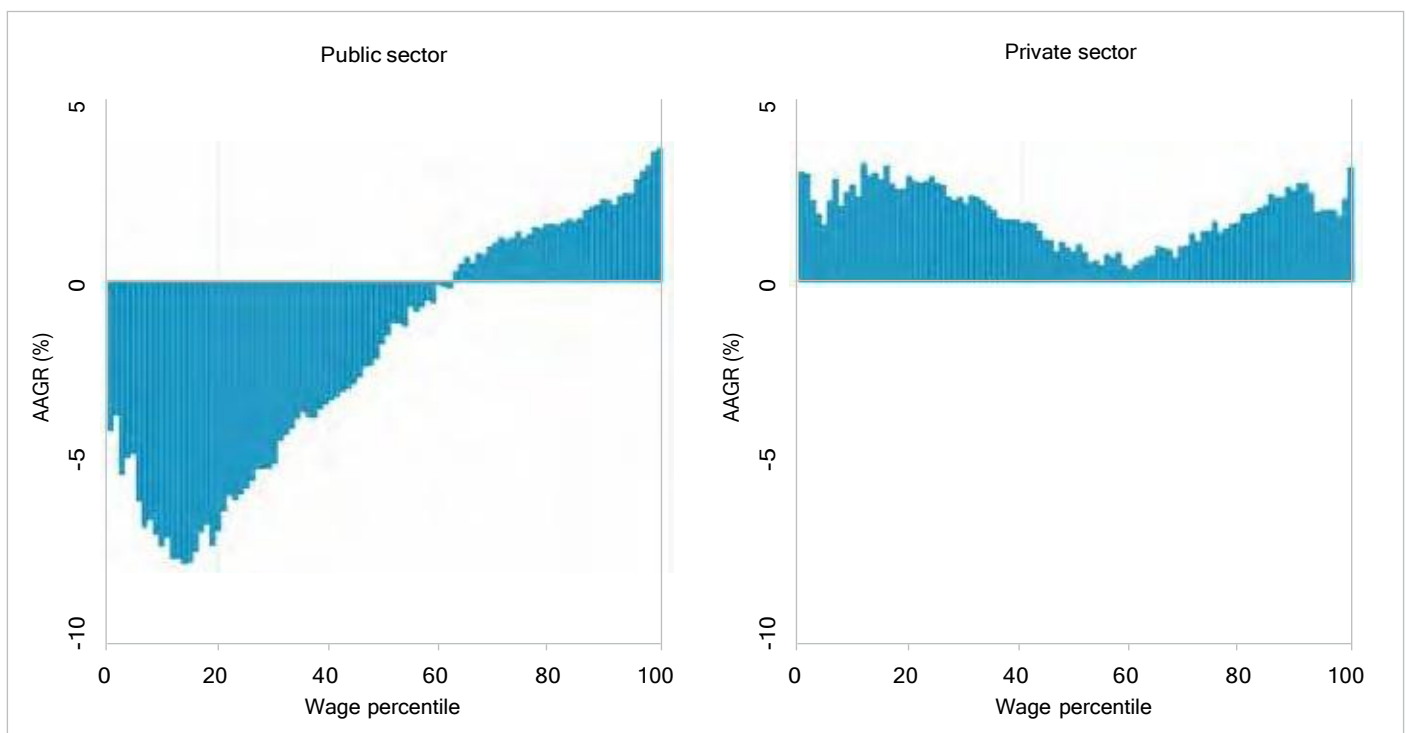
Year	2000	2010	2017	2000–2010	2010–2017	2000–2017
	Mean			Mean (percentage change)		
Public	10 863	12 826	11 368	18.07	-11.36	4.65
Private	5 556	8 428	8 167	51.70	-3.09	47.00
Ratio	1.96	1.52	1.39			
	Median			Median (percentage change)		
Public	7 807	9 955	5 500	27.50	-44.75	-29.55
Private	2 602	3 806	3 500	46.25	-8.04	34.49
Ratio	3.00	2.62	1.57			

Source: *Bhorat et al. (forthcoming)*.

Notes: There is no wage data for 2008 and 2009. The base period for real earnings is December 2017. Outliers have been removed

The observed wage shifts at the mean and the median, however, mask changes in real wages across the distribution. To this end, Figure 6.8, provides a more nuanced picture of wage growth in the public and private sectors, showing the average annual wage growth rate between 2000 and 2017 across the percentiles of the wage distribution. The results are quite striking. This would seem to indicate that real wage growth in the public sector has only occurred for workers from the 60th percentile onwards. Indeed, there has been real wage erosion for all public sector employees below the 6th. decile of the wage distribution - with declines by as much as 7% over the period. In turn, the private sector wage distribution graph reproduces the evidence from *Bhorat et al. (2021)* of the presence of wage polarisation in the South African labour market, with growth at the lower and upper end, but not in the middle.

Figure 6.8: Average annual real wage growth, public and private sector, by percentile: 2000–2017

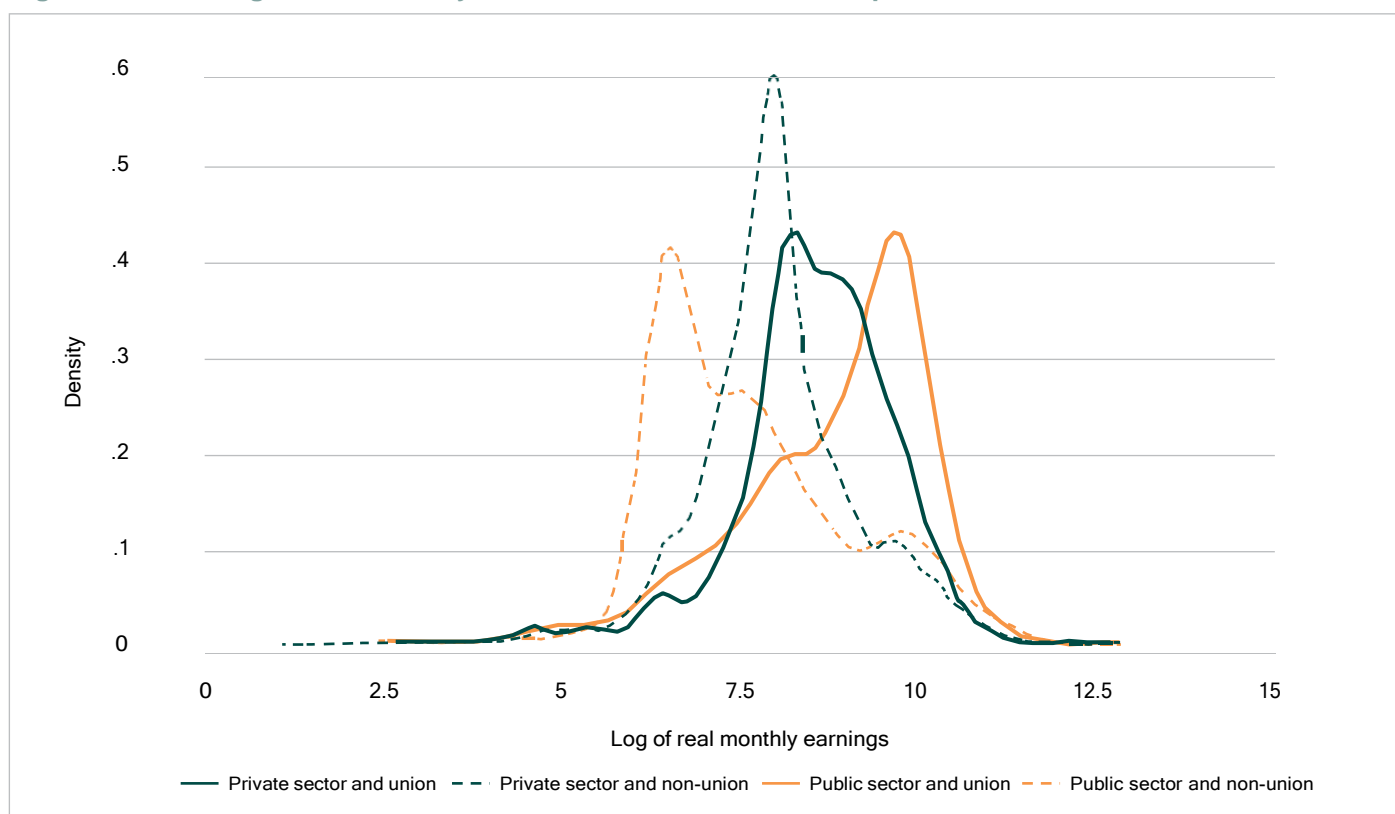


Source: *Bhorat et al. (forthcoming)*.

Three key initial results are clear from this descriptive overview of wages. First, while the public sector pays more than the private sector at the mean and median, this raw real wage gap has declined since 2000. Second, it is clear that the wage distribution of the public sector labour market is located significantly to the right of that of the private sector. Finally, wage growth dynamics indicates the emergence of an elite worker in the public sector, who has been afforded significant wage increases – relative to employees in the bottom half of the wage distribution in government. Similar dynamics are not observed in the private sector.

The final section of this public and private sector comparison briefly compares wages across the two sectors by union status, and gender.⁷ Union status appears to matter in the determination of average wages. As a result, public sector unionisation levels have high impacts on the public sector wage premium. Indeed, examining the wage distributions of trade union and non-union members in Figure 6.9, it is clear that union members (regardless of sector) earn more than non-union members, where this is evidenced by the union wage distributions being to the right of the non-union curves. Moreover, as expected, public sector union members earn more than their private sector counterparts. This may be an early indication of the greater bargaining power of public sector unions. The importance of belonging to a union in the public sector is highlighted when one examines the wage distribution of non-union members. Out of the four different groups, non-union members in the public sector earn, on average, the least. In contrast, non-union private sector workers have the highest peak (indicating a high proportion of workers) out of all the groups considered.

Figure 6.9. Earning distribution by sector and union membership, 2017



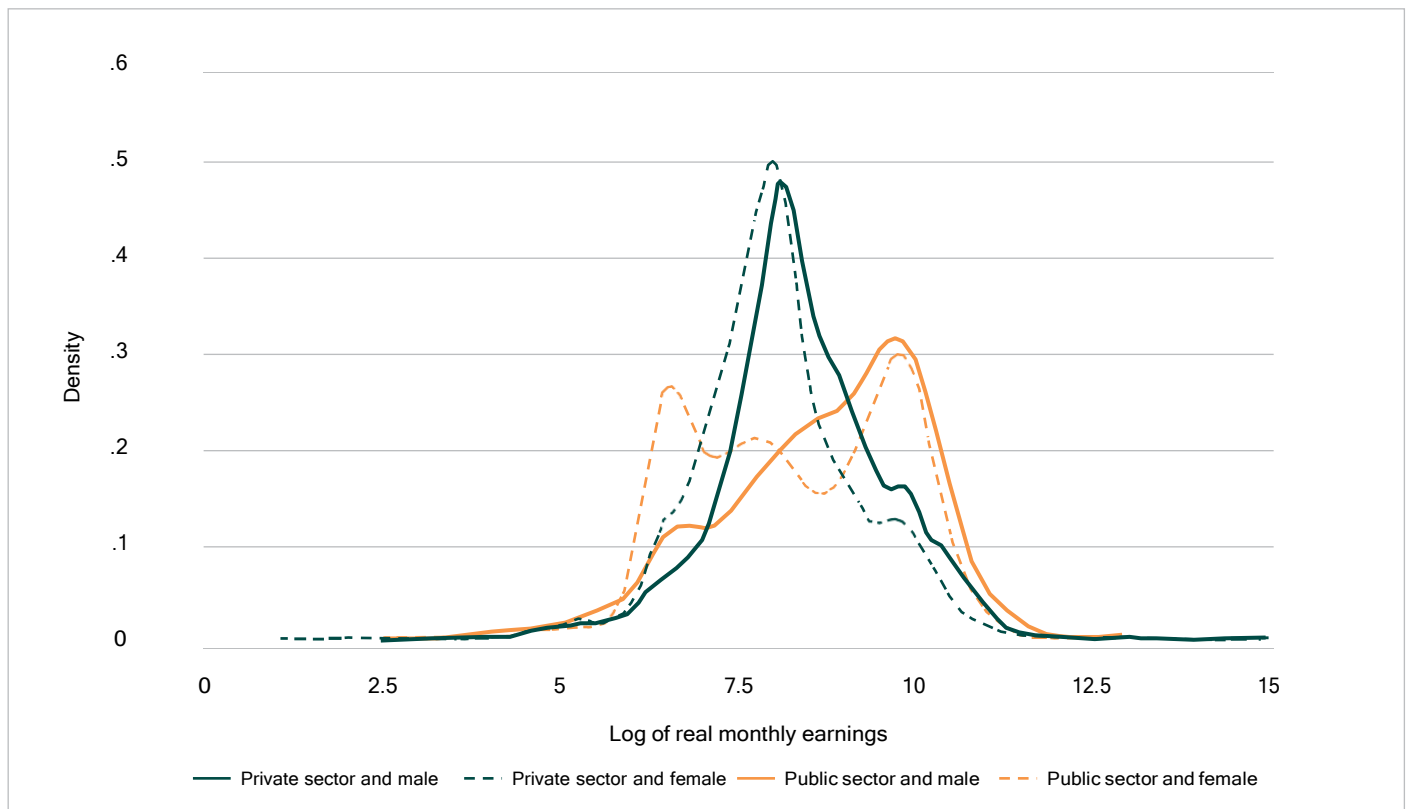
Source: *Bhorat et al. (forthcoming)*.

Notes: There is no wage data for 2008 and 2009. The base period for real earnings is December 2017. Outliers have been removed.

⁷ A more detailed and comprehensive account of public and private sector wage differentials and their determinants can be found in Kerr and Wittenberg (2017).

Lastly, the earnings distribution is considered by gender in both the public and private sectors in Figure 6.10. It can be noted here that both public sector curves are to the right of the private sector curves, indicating that, regardless of gender, public sector workers earn more than their private sector counterparts. Moreover, in both sectors, there is evidence that males earn more than females, although the differences do not appear to be very large, with the male and female curves being close together (the exception is at the lower end of the public sector wage distribution, where there is a big gap between the female and male curves). Taken on its own, gender appears to remain a relevant determinant of wages in South Africa, in both the public and the private sectors. However, as has been shown earlier in this section, when controlling for other variables, the gender wage gap in the public sector becomes very small. This is in contrast to work on the private sector, which suggests that the gender wage gap remains important, even when controlling for the relevant demographic and labour market characteristics (Bhorat and Goga, 2013).

Figure 6.10: Earning distribution by sector and gender, 2017



Source: Bhorat et al. (forthcoming).

Notes: There is no wage data for 2008 and 2009. The base period for real earnings is December 2017. Outliers have been removed.

6.6.4 Public sector wage sustainability

Three OLS models will be used to estimate the wage bill sustainability. A standard earnings function of the following form will be run:

$$\text{Model 1: } \frac{w}{rev} = \phi + \ln rev + \ln exp + \ln gdp + \varepsilon_j$$

$$\text{Model 2: } \frac{w}{exp} = \gamma + \ln rev + \ln exp + \ln gdp + \ln cap + \varepsilon_j$$

$$\text{Model 3: } \frac{w}{gdp} = \omega + \ln rev + \ln exp + \ln gdp + \varepsilon_j$$

Where $\frac{w}{rev}$, $\frac{w}{exp}$ and $\frac{w}{gdp}$ represent the wage bill⁸ to revenue ratio, wage bill to expenditure ratio and wage bill to GDP ratio, respectively. $\ln rev$, $\ln exp$, $\ln gdp$ and $\ln cap$ represent log revenue, log expenditure, log nominal GDP and log capital, respectively.

In Model 1, it is observed that, as national revenue and expenditure increases, the wage bill to revenue ratio increases. This indicates that a large portion of the government's revenue is absorbed by the wage bill. To control the wage bill to revenue ratio, revenue should increase more proportionally than the wage bill. This could be achieved by programme-based budgeting systems, where remuneration packages and employment changes are determined after revenue has been determined, instead of arbitrarily increasing the wage bill based on a budget (Nyakundi et al., 2016; National Pay Commission, 2018).

Table 6.6: Wage bill sustainability regression

Covariates	Model 1		Model 2			Model 3
	(1) Estimate	(2) Estimate	(1) Estimate	(2) Estimate	(3) Estimate	(1) Estimate
Dependant variable	wage to revenue	wage to revenue	wage to expenditure	wage to expenditure	wage to expenditure	wage to GDP
(Ln) revenue	1.981* (0.953)	1.104 (0.658)		1.8698* (0.863)		
(Ln) expenditure	1.714*** (0.559)	0.846 (0.590)	0.656 (0.547)	1.535** (0.495)	1.25 (1.044)	
(Ln) GDP		-3.353** (0.893)	-4.609*** (0.834)			3.474* (1.756)
(Ln) capital					-0.503*** (0.103)	0.165 (0.214)
Constant	1.127 (2.516)	10.907** (2.796)	15.576*** (2.268)	1.668 (2.299)	22.746*** (4.445)	-4.293** (4.835)
Number of observations	15	14	14	15	15	14
R ²	0.317	0.688	0.8386	0.269	0.649	0.750
Probability > F	0.016	0.001	0.000	0.015	0.000	0.000

Source: Commission's calculations

***Significant at 1%

** Significant at 5%

* Significant at 10%

Note: The marginal effect in this table represents the change in y for each unit change in x from its mean value (\bar{x}), holding other variables constant.

⁸ The wage bill refers to the national and provincial wage bill spending only.

According to the results in Model 2, as national expenditure increases, so does the wage bill to expenditure ratio. This suggests that the wage bill increases proportionally to national expenditure. Furthermore, the results for Model 2 show that the wage bill to expenditure decreases as GDP and national capital increases, indicating that GDP had a direct effect on national expenditure during the studied period. Lastly, the coefficient for revenue in Model 2 shows that a 1% increase in revenue leads to a 0.87% increase in the wage bill to expenditure ratio.

To control the wage bill to expenditure ratio, a rise in expenditure should cause a rise in the wage bill. Improvements in budgeting techniques used to estimate compensation frameworks are therefore needed. Likewise, emphasis should be put on the contribution wage expenditure has made to the economy. Focus should therefore be given to improving productivity using performance-based revenue budgeting (National Pay Commission, 2018). The results of Model 3 suggest that, as GDP and capital investment rises, the wage bill to GDP ratio increases. This suggests that the wage bill has risen more sustainably than GDP during the observed period. The implication would be that the wage bill has increased at a higher than proportional rate to the increase in GDP. Therefore, wage rises have not matched productivity levels during the observed period. This may lead to inflationary effects (National Pay Commission, 2018).

6.7 Conclusions

This chapter aims to provide a detailed analysis of the public sector wage bill in South Africa. It does so by focusing on four main questions: First, how do South Africa's public sector wage trends compare internationally? Second, to what extent is the size of the wage bill in South Africa impacting the overall fiscal framework? Third, what is the composition of the wage bill, and how has it changed over time? Fourth, what are the key determinants of wages in the public and private sectors? To interrogate these issues, the Commission has used quantitative data over a 14-year period, primarily relying on individual-level, longitudinal, administrative payroll data from the government's Personnel Salary system. This dataset includes 18.5 million observations, covering the population of civil servants in South Africa working in national and provincial departments and national entities. In addition to constructing a clean and manageable individual-level dataset, the findings in relation to these four questions are summarised below.

Using publicly available data, which allows for cross-country comparisons, two key features of South Africa's public sector are highlighted. First, public sector employment (as a share of total employment) in South Africa is in line with comparator country estimates, and close to the global average and median, suggesting that it is not an outlier in this regard. Second, in contrast to this, the data on public sector compensation shows that South Africa's public sector wage bill is significantly higher than that in the economies of comparator countries. Of the 75 countries in the sample, compensation (as a share of GDP) was the sixth-highest, and far above the mean or median value. Similarly, if countries are grouped by income level, South Africa's public sector wages are higher than other upper-middle-income countries across both the measures used.

Using PERSAL data, which covers the majority of South Africa's public sector employees, it can be seen that the total wage bill has grown by 78% in real terms between 2007 and 2020, and as of the latter year, is equivalent to nearly 10% of GDP – the highest level in the post-apartheid period. Its growth has far outstripped that of real GDP in levels or per-capita terms. When compared to other fiscal measures, including government expenditure and revenue, the wage bill has also increased in relative terms. Overall, although both growth in employment and wages affect the growth of the wage bill, the latter has been the driver (mean wages grew by 42% over the period, compared to 25% employment growth). This suggests that there is reason for concern regarding the pressures that the wage bill places on South Africa's fiscus.

There have been a range of important compositional shifts in the public sector over the 2007-2020 period. These are divided up into employment and wage shifts. Broadly, it is noted that both employment and wage increases contributed to the rising wage bill over time, but that, on aggregate, rising real wages have been the most dominant driver, especially over the last five years when employment levels have not grown. Female and black/African employees have increased as a share of the public service, making up 61% and 81% of all employees, respectively, in 2020. Various shifts at the departmental level and by skill type have been observed. Criminal justice, education, and health are by far the largest sectors, together employing 86% of all public service employees in 2020 and accounting for most (90%) of the increase in employment over the period.

Geographically, national departments account for the largest employment share (28%) and, together with the provincial departments in Gauteng and KwaZulu-Natal, account for over 70% of the total increase in employment. On average, real gross monthly wage has grown by 42% over the period, from R23 489 to R33 239, and growth has been highest in the agriculture (81%), health (68%), home affairs (68%) and infrastructure (67%) sectors. Relative to 2007, wages across virtually the entire distribution have grown at a real rate of about 2.8% in the average year. However, real wages below the 20th percentile have decreased. Concerningly, a significant compositional shift was observed towards higher-earning employees. In real terms, the highest earning 20% of employees in 2007 expanded in size to include nearly 50% of all employees by 2020.

Finally, to assess the key determinants of wages in the public sector, a set of standard multivariate regression models was conducted following a Mincerian earnings function specification. The results highlight a number of both similar and distinct determinants of wages in the South African civil service compared to those observed for the overall or private sector labour market. A relatively small gender wage gap was observed, estimated at 3.5% in 2007 and virtually zero in 2020. This was much smaller than estimates observed for the overall labour market. Asian/Indian employees, on average, earn the highest wage premium. This premium has persisted throughout the period. A positive and non-linear, albeit small wage premium was found for older workers. Evidence of a positive and very steep wage gradient with respect to skills was found in every year, with top management employees earning 241% more than so-called unskilled workers in 2020. However, dynamics over time is suggestive of a reduction in these earning differentials. Expectedly, on average, workers who work more than one job, work on a full-time basis, and have more experience working in the public service earn higher wages. Notably, in 2020, a wage premium was observed for national department workers relative to all provincial departments, and for workers in the agriculture sector relative to all other sectors. However, in both cases, the magnitudes of the premiums are small and have varied over time. Lastly, it is compelling that the observable characteristics in the models alone explain most (73% and 79%) of the variation in wages among South African public service workers. Finally, wage determinants in the private sector are presented in recent work by Borat et al. (forthcoming).

There is a large scope for future work, which can exploit the disaggregated level and longitudinal nature of the PERSAL data. For instance, this analysis has only considered gross wages, so future work ought to consider analysing within and between-group trends in the composition of gross wages, including all deductions and benefits. Additionally, the multivariate analysis can be extended to analyse the determinants of wages in the public service across the entire wage distribution, not just at the mean. Several insightful decomposition techniques can also be employed to examine earning differentials between certain worker groups. Lastly, future work ought to exploit the longitudinal nature of the individual-level data, which can be used to conduct a variety of panel econometric analyses, such as constructing transition matrices of outcomes and fixed effects regression, to name a few.

6.8 Recommendations

The Commission makes the following recommendations:

1. *The Department of Public Service and Administration, through the bargaining council, should consider balancing notch progression and cost-of-living adjustments and pressures to the fiscus during wage negotiation. The Commission highlights that the growth of the wage bill has largely been driven by wage increases relative to the increase in the number of employees.*

Both real wage growth and employment have driven the increase in the wage bill over the last 14 years, but wage growth plays a greater role. The vast majority of public sector workers have experienced significant real wage gains during the period reviewed here, specifically those earning at a level that falls between the 20th and 99th percentile. Understanding the nature of these increases in relation to employment composition, and how realistic limits on wage increases can be agreed upon, will be important to keeping the overall wage bill at a manageable level. However, this must be balanced against the provision of critical public services, for example in education, healthcare and criminal justice. Therefore, it requires hard negotiation and acceptance by different stakeholders of real costs between the expansion of services and an unsustainable wage bill.

2. *Wage growth at the top end of the wage distribution in the public service has not been excessive, but after 2010, it appears that wages for those in the bottom 20% of the distribution fell in real terms, potentially widening the wage gap in the sector. The Commission recommends that National Treasury commissions further research to determine what is driving the decreases in real terms of wages for those at the bottom distribution of wages.*

A large shift in the public sector wage distribution has been observed below the 20th percentile. Indeed, after 2010, it appears that wages for those in the bottom 20% of the distribution fell in real terms, but it is unclear whether this is due to an actual decrease in wages for existing workers (this is extremely unlikely) or due to new, lower-paid workers being hired. More research is required to understand this dynamic.

3. *The demographic composition of the public sector has changed over time, but the proportion of young people has not grown. The Commission recommends that the Department of Public Service and Administration, together with the Department of Women, Youth and Persons with Disabilities, develops frameworks to guide the public sector on the inclusion of youth in public service.*

While the proportion of women in the public service has risen significantly over the period, it is noted that the proportion of younger workers has declined. This should be highlighted as a point of discussion.

Appendix

Table 6.A1: The South African public service wage bill relative to GDP and select government budget items, 2007–2020

	Wage bill (R billions)	GDP (R billions)	GDP per capita (R)	General government expenditure (R billions)	Tax revenue (R billions)	Public debt interest payments (R billions)
2007	316	5 110	104 126	812	1 140	118
2008	339	5 100	102 514	871	1 190	109
2009	407	5 120	101 401	911	1 220	106
2010	434	5 370	104 833	966	1 130	109
2011	449	5 560	106 955	1 010	1 210	123
2012	463	5 650	106 987	1 060	1 260	134
2013	478	5 790	107 949	1 110	1 310	144
2014	486	5 840	107 157	1 130	1 370	157
2015	490	5 970	107 845	1 130	1 430	170
2016	497	6 040	107 588	1 170	1 440	180
2017	517	6 130	107 485	1 180	1 490	193
2018	528	6 170	106 680	1 200	1 520	208
2019	550	6 210	105 694	1 220	1 550	218
2020	563	5 920	99 390	1 220	1 580	237

Commission's calculations. Source: PERSAL (2006/07 to 2019/20), World Bank (2021), StatsSA (2020a; 2021a; 2021b).

Notes: [1] Wage data includes the population of workers in all national and provincial government departments, as well as national entities in South Africa.

[2] Wage data for January of each year is used.

[3] Wage bill refers to the sum of gross monthly wages paid to workers before taxation and deductions multiplied by 12 to reflect an annual amount.

[4] All data is deflated to December 2021 rands using Statistics SA's Consumer Price Index (CPI) headline data.

Table 6.A2: Mincerian earnings function regression estimates, 2007–2020

	(1) 2007	(2) 2008	(3) 2009	(4) 2010	(5) 2011	(6) 2012	(7) 2013	(8) 2014	(9) 2015	(10) 2016	(11) 2017	(12) 2018	(13) 2019	(14) 2020
Gender														
Male	0.035*** (0.001)	0.024*** (0.001)	0.027*** (0.001)	0.016*** (0.001)	0.021*** (0.001)	0.018*** (0.001)	0.019*** (0.001)	-0.001* (0.001)	0.007*** (0.001)	0.005*** (0.001)	-0.006*** (0.001)	-0.006*** (0.001)	0.006*** (0.001)	0.005*** (0.001)
Race														
Asian/Indian	0.092*** (0.002)	0.073*** (0.002)	0.086*** (0.002)	0.058*** (0.002)	0.076*** (0.002)	0.082*** (0.002)	0.087*** (0.002)	0.075*** (0.002)	0.067*** (0.002)	0.069*** (0.002)	0.060*** (0.002)	0.056*** (0.002)	0.087*** (0.002)	0.087*** (0.002)
Coloured	0.017*** (0.001)	0.028*** (0.001)	0.012*** (0.001)	0.000 (0.001)	0.001 (0.001)	-0.003*** (0.001)	-0.005*** (0.001)	0.002 (0.001)	-0.008*** (0.001)	-0.008*** (0.001)	-0.004*** (0.001)	-0.002* (0.001)	-0.006*** (0.001)	-0.006*** (0.001)
White	0.063*** (0.001)	0.050*** (0.001)	0.052*** (0.001)	0.042*** (0.001)	0.046*** (0.001)	0.041*** (0.001)	0.041*** (0.001)	0.046*** (0.001)	0.047*** (0.001)	0.049*** (0.001)	0.050*** (0.001)	0.046*** (0.001)	0.068*** (0.001)	0.076*** (0.001)
Age (years)														
Age	0.011*** (0.000)	0.010*** (0.000)	0.014*** (0.000)	0.013*** (0.000)	0.010*** (0.000)	0.009*** (0.000)	0.010*** (0.000)	0.013*** (0.000)	0.016*** (0.000)	0.019*** (0.000)	0.016*** (0.000)	0.013*** (0.000)	0.017*** (0.000)	0.017*** (0.000)
Age squared	-0.000*** (0.000)	-0.000*** (0.000)	-0.000*** (0.000)	-0.000*** (0.000)	-0.000*** (0.000)	-0.000*** (0.000)	-0.000*** (0.000)	-0.000*** (0.000)	-0.000*** (0.000)	-0.000*** (0.000)	-0.000*** (0.000)	-0.000*** (0.000)	-0.000*** (0.000)	-0.000*** (0.000)
National or provincial department														
Free State	0.005*** (0.001)	-0.065*** (0.002)	-0.024*** (0.001)	-0.014*** (0.002)	0.005*** (0.001)	-0.031*** (0.001)	-0.031*** (0.001)	-0.031*** (0.001)	0.007*** (0.001)	0.011*** (0.001)	-0.002 (0.001)	-0.014*** (0.001)	0.013*** (0.002)	-0.015*** (0.002)
Gauteng	0.019*** (0.001)	-0.065*** (0.001)	-0.001 (0.001)	0.011*** (0.001)	0.021*** (0.001)	0.001 (0.001)	0.005*** (0.001)	0.015*** (0.001)	0.033*** (0.001)	0.044*** (0.001)	0.106*** (0.001)	0.015*** (0.001)	0.053*** (0.001)	0.037*** (0.001)
KwaZulu-Natal	0.031*** (0.001)	-0.006*** (0.001)	0.008*** (0.001)	0.012*** (0.001)	0.021*** (0.001)	-0.020*** (0.001)	-0.043*** (0.001)	-0.006*** (0.001)	0.006*** (0.001)	0.016*** (0.001)	0.014*** (0.001)	0.017*** (0.001)	0.032*** (0.001)	0.025*** (0.001)
Limpopo	-0.014*** (0.001)	-0.038*** (0.001)	0.685*** (0.001)	0.067*** (0.001)	0.010*** (0.001)	-0.049*** (0.001)	0.002 (0.001)	0.000 (0.001)	0.008*** (0.001)	0.028*** (0.001)	0.031*** (0.001)	0.031*** (0.001)	0.036*** (0.001)	-0.018*** (0.001)
Mpumalanga	0.040*** (0.001)	-0.008*** (0.002)	-0.002 (0.001)	0.044*** (0.001)	0.088*** (0.001)	0.021*** (0.001)	0.020*** (0.001)	0.038*** (0.001)	0.039*** (0.001)	0.042*** (0.001)	0.051*** (0.001)	0.045*** (0.001)	0.056*** (0.001)	0.035*** (0.001)
National departments														
National departments	0.018*** (0.002)	-0.024*** (0.002)	-0.016*** (0.002)	-0.010*** (0.002)	0.010*** (0.002)	-0.018*** (0.002)	-0.028*** (0.002)	0.004** (0.002)	0.000 (0.002)	0.025*** (0.001)	0.037*** (0.002)	0.015*** (0.001)	0.062*** (0.002)	0.053*** (0.002)
North West	0.045*** (0.005)	-0.006 (0.006)	-0.011*** (0.001)	0.019*** (0.001)	0.014*** (0.001)	-0.018*** (0.001)	-0.021*** (0.001)	0.012*** (0.001)	0.023*** (0.001)	0.037*** (0.001)	0.028*** (0.001)	0.046*** (0.001)	0.065*** (0.002)	0.022*** (0.002)
Northern Cape	0.043*** (0.002)	-0.058*** (0.002)	-0.016*** (0.002)	0.001 (0.002)	-0.010*** (0.002)	-0.044*** (0.002)	-0.033*** (0.002)	-0.009*** (0.002)	0.004** (0.002)	0.015*** (0.002)	0.016*** (0.002)	0.018*** (0.002)	0.035*** (0.002)	0.019*** (0.002)

	(1) 2007	(2) 2008	(3) 2009	(4) 2010	(5) 2011	(6) 2012	(7) 2013	(8) 2014	(9) 2015	(10) 2016	(11) 2017	(12) 2018	(13) 2019	(14) 2020
Western Cape	0.018*** (0.001)	-0.026*** (0.002)	0.015*** (0.002)	0.012*** (0.002)	0.044*** (0.001)	0.011*** (0.001)	0.014*** (0.001)	0.017*** (0.001)	0.039*** (0.001)	0.049*** (0.001)	0.053*** (0.001)	0.042*** (0.001)	0.056*** (0.002)	0.011*** (0.002)
Sector														
Arts/sport	-0.047*** (0.005)	-0.004 (0.005)	-0.033*** (0.004)	-0.047*** (0.004)	-0.036*** (0.004)	-0.006 (0.004)	0.006 (0.004)	0.013*** (0.004)	-0.002 (0.004)	0.007** (0.003)	-0.006* (0.003)	-0.015*** (0.004)	-0.035*** (0.004)	-0.047*** (0.004)
Criminal justice	-0.014*** (0.002)	0.057*** (0.002)	0.031*** (0.002)	0.057*** (0.002)	0.032*** (0.002)	0.003 (0.002)	0.017*** (0.002)	0.068*** (0.002)	0.035*** (0.002)	0.028*** (0.002)	0.015*** (0.002)	0.015*** (0.002)	0.047*** (0.002)	-0.012*** (0.002)
Economic/ environment	0.022*** (0.003)	0.011*** (0.003)	-0.008*** (0.003)	0.006** (0.003)	-0.010*** (0.004)	-0.008*** (0.003)	0.013*** (0.003)	-0.022*** (0.003)	-0.033*** (0.003)	-0.050*** (0.003)	-0.024*** (0.003)	-0.064*** (0.003)	-0.065*** (0.003)	-0.073*** (0.003)
Education	-0.090*** (0.002)	-0.051*** (0.002)	-0.027*** (0.002)	0.066*** (0.002)	0.034*** (0.002)	0.018*** (0.002)	0.021*** (0.002)	0.019*** (0.002)	0.008*** (0.002)	0.017*** (0.002)	-0.001 (0.002)	-0.012*** (0.002)	0.026*** (0.002)	-0.017*** (0.002)
Finance	0.022*** (0.004)	0.063*** (0.004)	-0.013*** (0.004)	-0.012*** (0.004)	-0.019*** (0.004)	-0.043*** (0.004)	-0.025*** (0.004)	-0.006* (0.003)	-0.010*** (0.003)	-0.001 (0.003)	-0.008** (0.003)	0.012*** (0.004)	-0.005 (0.003)	-0.007* (0.004)
Foreign affairs	0.017** (0.007)	0.032*** (0.007)	0.058*** (0.007)	0.073*** (0.007)	-0.025*** (0.007)	-0.028*** (0.007)	-0.023*** (0.006)	-0.012* (0.006)	-0.018*** (0.006)	0.013* (0.007)	-0.026*** (0.007)	-0.028*** (0.007)	-0.057*** (0.006)	-0.077*** (0.006)
General administration	-0.034*** (0.003)	-0.026*** (0.003)	-0.074*** (0.003)	-0.059*** (0.003)	-0.022*** (0.003)	-0.006** (0.003)	-0.044*** (0.003)	-0.046*** (0.003)	-0.036*** (0.003)	-0.038*** (0.003)	-0.030*** (0.003)	-0.050*** (0.003)	-0.048*** (0.003)	-0.095*** (0.003)
Health	-0.021*** (0.002)	0.044*** (0.002)	0.003* (0.002)	0.063*** (0.002)	0.027*** (0.002)	-0.013*** (0.002)	-0.014*** (0.002)	0.009*** (0.002)	0.003 (0.002)	0.013*** (0.002)	0.039*** (0.002)	0.004** (0.002)	0.040*** (0.002)	-0.009*** (0.002)
Home affairs	0.005 (0.004)	0.014*** (0.004)	-0.052*** (0.004)	-0.105*** (0.003)	-0.182*** (0.003)	-0.214*** (0.003)	-0.186*** (0.003)	-0.183*** (0.003)	-0.207*** (0.003)	-0.181*** (0.003)	-0.194*** (0.003)	-0.175*** (0.003)	-0.188*** (0.003)	-0.156*** (0.003)
Infrastructure	-0.016*** (0.002)	-0.023*** (0.002)	-0.049*** (0.002)	-0.041*** (0.002)	-0.055*** (0.002)	-0.071*** (0.002)	-0.039*** (0.002)	-0.070*** (0.002)	-0.057*** (0.002)	-0.039*** (0.002)	-0.051*** (0.002)	-0.053*** (0.002)	-0.073*** (0.003)	-0.075*** (0.003)
Other	0.315*** (0.010)	0.398*** (0.011)	0.429*** (0.011)	0.448*** (0.011)	0.421*** (0.011)	0.416*** (0.012)	0.391*** (0.011)	0.289*** (0.010)	0.265*** (0.010)	0.253*** (0.010)	0.209*** (0.009)	0.148*** (0.008)	0.547*** (0.021)	0.357*** (0.022)
Welfare	-0.022*** (0.003)	0.008*** (0.003)	-0.009*** (0.002)	-0.003 (0.003)	-0.020*** (0.003)	-0.043*** (0.003)	-0.105*** (0.003)	-0.069*** (0.003)	-0.047*** (0.003)	-0.025*** (0.002)	-0.033*** (0.003)	-0.032*** (0.002)	-0.033*** (0.003)	-0.034*** (0.003)

	(1) 2007	(2) 2008	(3) 2009	(4) 2010	(5) 2011	(6) 2012	(7) 2013	(8) 2014	(9) 2015	(10) 2016	(11) 2017	(12) 2018	(13) 2019	(14) 2020
Occupational level														
Unskilled (Level 1-2)	1.768*** (0.019)	1.556*** (0.019)	1.545*** (0.026)	1.610*** (0.032)	1.229*** (0.018)	1.358*** (0.019)	1.389*** (0.013)	1.544*** (0.013)	1.844*** (0.010)	1.742*** (0.010)	1.994*** (0.005)	2.155*** (0.005)	1.675*** (0.016)	2.018*** (0.018)
Semi-skilled (Level 3-5)	0.426*** (0.019)	0.212*** (0.019)	0.241*** (0.026)	0.284*** (0.032)	-0.032* (0.018)	0.113*** (0.019)	0.161*** (0.013)	0.349*** (0.013)	0.620*** (0.010)	0.533*** (0.010)	0.816*** (0.005)	0.990*** (0.005)	0.485*** (0.016)	0.851*** (0.018)
Skilled technical (Level 6-9)	2.342*** (0.019)	2.126*** (0.020)	2.103*** (0.026)	2.190*** (0.032)	1.817*** (0.018)	1.930*** (0.019)	1.935*** (0.013)	2.093*** (0.014)	2.392*** (0.010)	2.280*** (0.010)	2.515*** (0.006)	2.680*** (0.005)	2.075*** (0.017)	2.382*** (0.018)
Professionally qualified (Level 10-12)	1.048*** (0.019)	0.857*** (0.019)	0.879*** (0.026)	0.915*** (0.032)	0.573*** (0.018)	0.704*** (0.019)	0.737*** (0.013)	0.884*** (0.013)	1.183*** (0.010)	1.093*** (0.010)	1.342*** (0.005)	1.506*** (0.005)	0.986*** (0.016)	1.336*** (0.018)
Senior management (Level 13-14)	2.668*** (0.022)	2.468*** (0.022)	2.656*** (0.028)	2.810*** (0.034)	2.319*** (0.020)	2.425*** (0.019)	2.449*** (0.015)	2.607*** (0.015)	2.891*** (0.011)	2.770*** (0.011)	2.969*** (0.007)	3.149*** (0.007)	2.546*** (0.019)	2.845*** (0.020)
Top management (Level 15-16)	0.051*** (0.019)	-0.131*** (0.019)	-0.132*** (0.026)	-0.093*** (0.032)	-0.411*** (0.018)	-0.290*** (0.018)	-0.271*** (0.013)	-0.098*** (0.013)	0.186*** (0.009)	0.092*** (0.010)	0.427*** (0.005)	0.578*** (0.005)	0.056*** (0.016)	0.437*** (0.018)
Number of job records														
Two job records	0.877*** (0.051)	0.924*** (0.054)	1.064*** (0.042)	1.061*** (0.044)	1.065*** (0.041)	1.084*** (0.042)	1.220*** (0.041)	0.990*** (0.037)	0.808*** (0.037)	0.709*** (0.038)	0.839*** (0.028)	0.559*** (0.026)	1.090*** (0.046)	1.382*** (0.058)
Three job records	1.393*** (0.109)	1.537*** (0.084)	1.639*** (0.060)	1.812*** (0.148)	1.665*** (0.076)	1.775*** (0.064)	1.857*** (0.073)	1.406*** (0.083)	1.355*** (0.066)	1.568*** (0.128)	1.300*** (0.039)	1.232*** (0.046)	2.328*** (0.055)	2.663*** (0.073)
Four job records	1.769*** (0.059)	2.042*** (0.173)	2.083*** (0.305)		2.046*** (0.113)	1.886*** (0.181)	2.255*** (0.181)	1.833*** (0.161)	1.925*** (0.181)	1.503*** (0.206)	1.885*** (0.252)	1.785*** (0.303)		2.375*** (0.286)
Full-time versus part-time														
Full-time	0.501*** (0.003)	0.726*** (0.003)	0.675*** (0.003)	0.672*** (0.003)	0.670*** (0.004)	0.735*** (0.003)	0.845*** (0.003)	0.595*** (0.003)	0.567*** (0.003)	0.553*** (0.003)	0.421*** (0.005)	0.256*** (0.004)	0.300*** (0.016)	0.277*** (0.017)

	(1) 2007	(2) 2008	(3) 2009	(4) 2010	(5) 2011	(6) 2012	(7) 2013	(8) 2014	(9) 2015	(10) 2016	(11) 2017	(12) 2018	(13) 2019	(14) 2020
Years of service														
11-15 years	0.075*** (0.001)	0.060*** (0.001)	0.033*** (0.001)	0.043*** (0.001)	0.043*** (0.001)	0.066*** (0.001)	0.064*** (0.001)	0.041*** (0.001)	0.037*** (0.001)	0.034*** (0.001)	0.071*** (0.001)	0.076*** (0.001)	0.083*** (0.001)	0.127*** (0.001)
16-20 years	0.109*** (0.001)	0.083*** (0.001)	0.051*** (0.001)	0.074*** (0.001)	0.049*** (0.001)	0.072*** (0.001)	0.072*** (0.001)	0.051*** (0.001)	0.062*** (0.001)	0.071*** (0.001)	0.130*** (0.001)	0.098*** (0.001)	0.074*** (0.001)	0.117*** (0.001)
21-25 years	0.116*** (0.001)	0.069*** (0.001)	0.039*** (0.001)	0.093*** (0.001)	0.054*** (0.001)	0.079*** (0.001)	0.074*** (0.001)	0.047*** (0.001)	0.055*** (0.001)	0.050*** (0.001)	0.128*** (0.001)	0.112*** (0.001)	0.100*** (0.001)	0.152*** (0.001)
26-30 years	0.126*** (0.002)	0.072*** (0.002)	0.042*** (0.001)	0.123*** (0.001)	0.057*** (0.001)	0.082*** (0.001)	0.086*** (0.001)	0.070*** (0.001)	0.088*** (0.001)	0.090*** (0.001)	0.075*** (0.026)	0.065*** (0.023)	-0.007 (0.032)	0.032 (0.030)
31-35 years	0.133*** (0.002)	0.070*** (0.002)	0.046*** (0.002)	0.166*** (0.002)	0.055*** (0.002)	0.079*** (0.002)	0.071*** (0.002)	0.058*** (0.002)	0.073*** (0.002)	0.073*** (0.002)	0.136*** (0.002)	0.132*** (0.001)	0.104*** (0.002)	0.143*** (0.002)
36-40 years	0.135*** (0.004)	0.062*** (0.004)	0.049*** (0.004)	0.173*** (0.004)	0.042*** (0.003)	0.054*** (0.003)	0.055*** (0.003)	0.056*** (0.003)	0.082*** (0.003)	0.085*** (0.003)	0.141*** (0.002)	0.121*** (0.002)	0.088*** (0.002)	0.125*** (0.002)
41+ years	0.135*** (0.012)	0.067*** (0.011)	0.020* (0.010)	0.137*** (0.010)	0.049*** (0.009)	0.058*** (0.007)	0.030*** (0.009)	0.031*** (0.007)	0.050*** (0.007)	0.055*** (0.007)	0.110*** (0.006)	0.091*** (0.005)	0.063*** (0.006)	0.094*** (0.006)
6-10 years	0.067*** (0.001)	0.067*** (0.001)	0.038*** (0.001)	0.041*** (0.001)	0.038*** (0.001)	0.052*** (0.001)	0.045*** (0.001)	0.041*** (0.001)	0.046*** (0.001)	0.047*** (0.001)	0.087*** (0.001)	0.074*** (0.001)	0.061*** (0.001)	0.114*** (0.001)
< 1 year	-0.144*** (0.001)	-0.152*** (0.001)	-0.116*** (0.001)	-0.138*** (0.001)	-0.184*** (0.001)	-0.100*** (0.001)	-0.091*** (0.001)	-0.099*** (0.001)	-0.101*** (0.001)	-0.089*** (0.001)	-0.107*** (0.002)	-0.093*** (0.002)	-0.114*** (0.003)	-0.056*** (0.003)
Constant	8.313*** (0.020)	8.343*** (0.020)	8.363*** (0.026)	8.403*** (0.033)	8.855*** (0.019)	8.728*** (0.019)	8.571*** (0.014)	8.578*** (0.014)	8.247*** (0.011)	8.276*** (0.011)	8.217*** (0.006)	8.326*** (0.006)	8.685*** (0.009)	8.390*** (0.010)
Observations	996 535	1 040 838	1 136 063	1 165 008	1 168 974	1 220 277	1 236 679	1 221 668	1 216 633	1 222 366	1 053 228	1 087 709	1 097 394	1 118 063
R-squared	0.776	0.733	0.787	0.766	0.760	0.781	0.786	0.730	0.770	0.769	0.776	0.774	0.713	0.738

Commission's calculations. Source: PERSAL (2006/07 to 2019/20)

Notes: [1] Each column presents the regression coefficients from specification (1) estimated using OLS.

[2] The outcome variable is the natural logarithm of real gross monthly wages.

[3] Data includes the population of workers in all national and provincial government departments, as well as national entities in South Africa.

[4] Data for January of each year is used.

[5] Number of observations vary over time due to missing covariate data.

[6] Robust standard errors are presented in parentheses.

[7] * $p < 0.10$; ** $p < 0.05$; *** $p < 0.01$.

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PART 3

Sub-national
focus: Reviewing
and refining
Division of Revenue
instruments



CHAPTER 7:

A review of the provincial equitable share formula – Responsiveness to the changing social structure

7.1 Introduction

The Constitution of the Republic of South Africa established three distinct, yet interdependent spheres of government (national, provincial and local). It further assigned expenditure responsibilities to each sphere of government. Such functions are either exclusive to one sphere of government or concurrent (between spheres of government). Since the Constitution assigns all three spheres of government functions, it is essential that funding is made available to each of them to discharge their respective responsibilities. Accordingly, the Constitution further provides that each sphere of government is entitled to a share of nationally raised revenue. All provinces in South Africa are therefore constitutionally entitled to a share of a general-purpose equitable share of nationally raised revenue to fulfill their obligations, as stipulated in the Bill of Rights and schedule 4 and 5 of the Constitution over and above conditional grants.

Two processes are vital in sharing nationally raised revenue in South Africa: vertical and horizontal revenue division. The vertical division of revenue is a political process that considers various functions and responsibilities assigned to each sphere of government and national priorities. The vertical division determines the share of the nationally raised revenue allocated to the national, provincial and local governments. The local government equitable share formula is utilised to allocate resources available for the local government sphere. For provinces, once the vertical division of revenue has been completed and determined, the total provincial equitable share pool is allocated horizontally across all nine provinces using the provincial equitable share formula (PES) proposed by the Financial and Fiscal Commission in 1996.

The PES formula has six components: health, education, basis, poverty, institutional and economic activity. A weighting is assigned to each component. Since 1996, the PES formula has been subjected to various reviews, aimed at improving resource distribution and equity, among other things. While components of the PES, including assigned weights, are clearly understood, not much analysis has been undertaken concerning what happens after PES funding is left at the disposal of provinces. There is a need to understand whether provinces disregard the weightings provided by the PES formula; hence the question of adequacy concerning the education and health functional areas. The other challenge often raised by provinces is the responsiveness (or lack thereof) of the PES formula and funding to the changing social structure. When learners migrate from one province to another, the PES formula internalises and adjusts resources through the education component to follow learners' movement, but it fails to consider other necessary intergovernmental fiscal instruments. Specific objectives of this research are as follows:

- Review and analyse expenditure patterns for health and education for all provinces
- Evaluate and analyse social structure changes in provinces for education and how the PES and other fiscal instruments respond to such changes

7.2 Research methodology and data

The research method used includes the following:

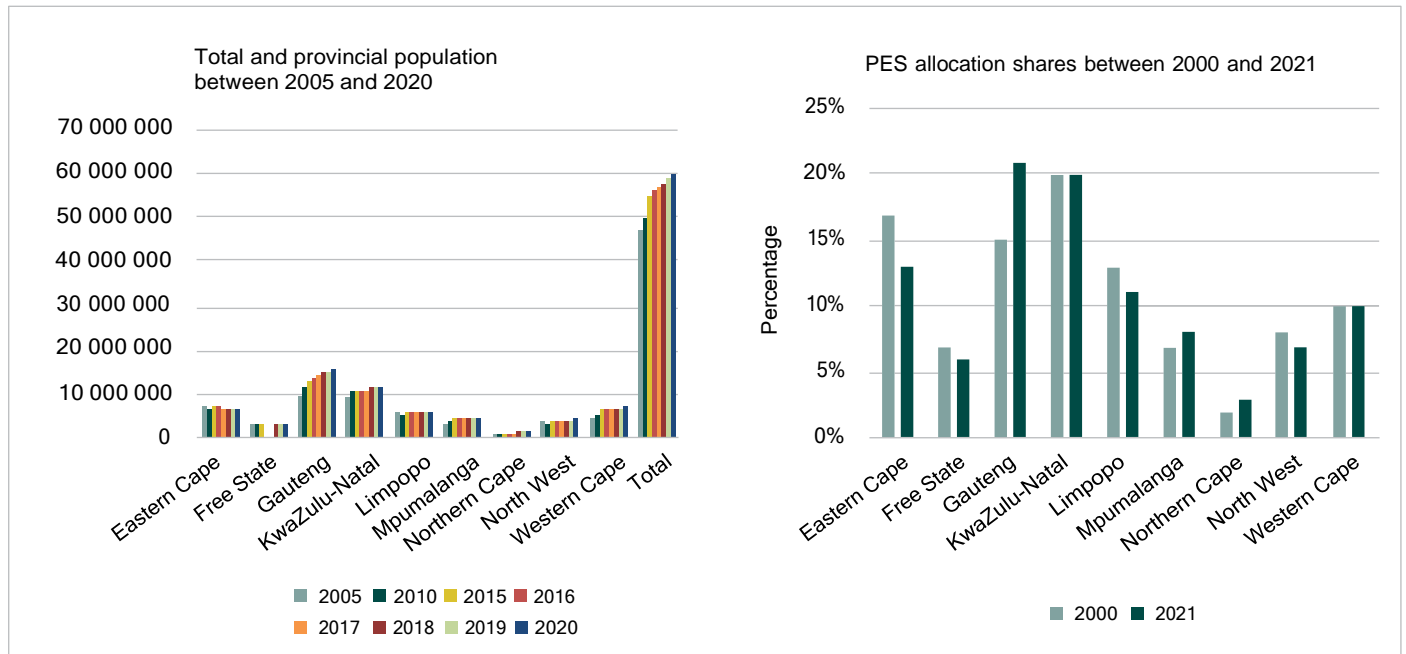
- An analysis of the PES from 2000 to 2021.
- An analysis of all provinces' expenditures on education and health from 2012 to 2021: Since the education and health components are dominant in the PES formula, and, in most cases, provinces are of the view that PES funding is inadequate, undertaking this analysis will indicate how much these two sectors are underfunded. This analysis will also determine whether provinces follow the PES formula and weightings in their allocation of resources or whether they ignore it and allocate more resources to other sectors or activities. The analysis will also assist in determining the extent to which provinces use their own raised revenue in the funding of education and health services.
- An evaluation of social structure changes and resource requirements, and whether the PES recognises those changes' full impact. This chapter analyses changes in learners' enrolment, as well as the number of schools and teachers in a province.
- Engaged with key stakeholders (mainly relevant officials from the provinces) to gain a full understanding of provinces' adjustment strategy when facing inadequate resources. In this instance, a case study approach was utilised using the Eastern Cape. This province was chosen based on the following: significant declining learners' enrolment numbers, a significant decrease in the number of schools, a stagnant decrease in the number of teachers and significant decreasing PES allocation shares.

7.3 Findings

7.3.1 Population and provincial equitable shares

Population (both the numbers and profile or characteristics) is one of the critical indicators in the PES formula in South Africa. Profile or characteristics include ages (e.g. schoolgoing age) and uninsured population. It is therefore key to understand how provincial populations and demographics change over time, and to analyse whether resources from the PES respond to those changes. Figure 7.1 illustrates the population growth per province from 2005 to 2020, and the PES allocation in 2000 and 2021. Gauteng has the highest population, followed by KwaZulu-Natal. Between 2005 and 2020, Gauteng had the highest population growth (from 9 018 000 in 2005 to 15 488 137 in 2020), followed by the Western Cape (from 4 645 600 in 2005 to 7 005 741 in 2020). Concerning the PES shares of provinces, Gauteng and KwaZulu-Natal have the most significant shares, in line with their population numbers. Gauteng's share is the highest at 21% in 2021 (increasing from 15% in 2000), while KwaZulu-Natal's share remains the second highest, even though it has remained constant at 10% between 2000 and 2021. When comparing the shares of provinces in 2000 and 2021, it is notable that the shares of the Eastern Cape, Free State, Limpopo and North-West have decreased, which may be a result of migration patterns.

Figure 7.1: Population and provincial equitable share allocation



Source: Statistics South Africa, 2005, 2010, 2015 and 2020; National Treasury, 2000 and 2021

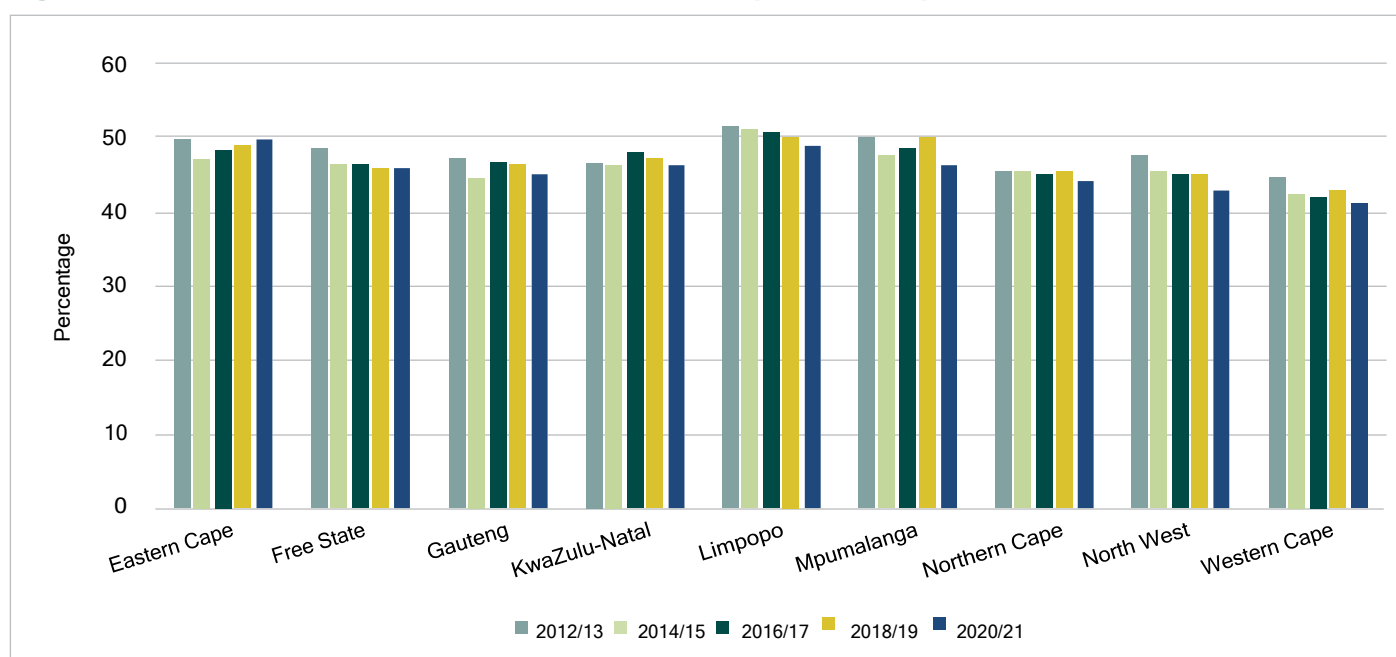
7.3.2 Allocation of resources from the provincial equitable share to education and health

To determine whether provinces allocate adequate resources or significantly deviate from the PES formula weighting when allocating resources to education and health, the analysis undertaken included calculating and analysing the percentage of funding allocated to education and health by provinces and comparing this with the weights contained in the PES formula.

According to the PES formula, the education component carries the highest weight of 48%. Provinces have discretion on how much to allocate to education; hence, different provinces allocate different funding percentages from the PES to education. Notable from Figure 7.2 is that Limpopo consistently allocated more than 48% of its equitable share to education in all the years. The Eastern Cape and Mpumalanga allocated more than 48% to education in many years (in only two and three years, where the Eastern Cape and Mpumalanga’s allocations were below 48%). The Western Cape and Gauteng consistently allocated less than 48% of their PES funding to education.

There is inconsistency in the percentage each province allocates to education. For example, the Eastern Cape allocated 49.3%, 47.4% % to education in 2013/14, 2014/15 and 2015/16, respectively, which may be as a result of the lack of costing needs or systems to guide the smooth allocation of resources.

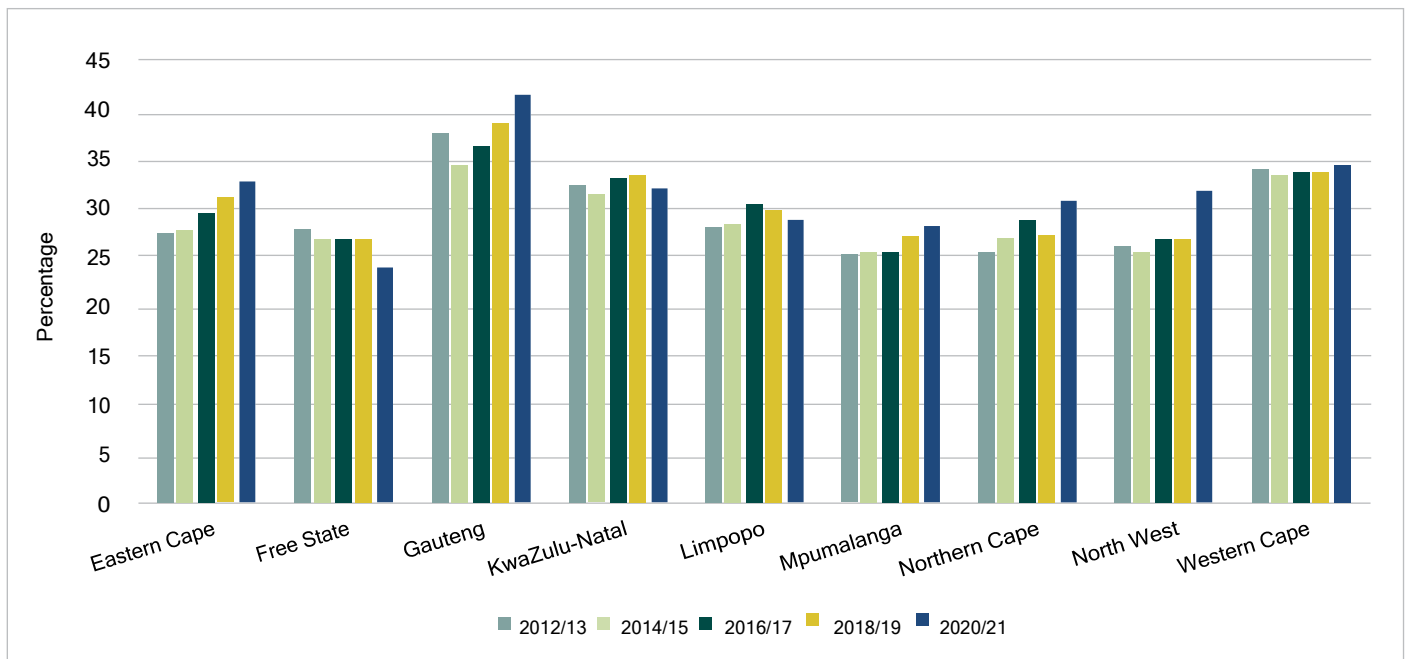
Figure 7.2: Provincial allocation of resources from the provincial equitable share to education



Source: National Treasury, 2012–2021

For health, the PES formula's weight is 27%. While provinces have discretion on how to reprioritise funding from the PES once it is at their disposal, the expectation is that there should be insignificant deviations. Figure 7.3 illustrates how provinces allocate funding from the PES to health needs. Many provinces (Gauteng, Western Cape KwaZulu-Natal, Limpopo and the Eastern Cape) allocated more than 27% of their PES funding to health between 2012/13 and 2020/21. Gauteng has never allocated less than 33% of its PES funding to health since 2012/13. In 2020/21, Gauteng allocated over 41% of its PES funding to health, which confirms the COVID-19-induced health needs. Even provinces that have been allocating fewer resources to health were not allocating far less than 27% of the PES. This shows the health expenditure pressures faced by all the provinces. It is key to note that provinces that were allocating relatively less to education, such as the Western Cape and Gauteng, allocated more to health, which shows that they prioritise health over education. KwaZulu-Natal has been allocating relatively fewer resources from the PES to education, but a significantly higher percentage of its PES to health. While this could improve health care delivery and outcomes, it compromises the quality of education, especially given the increasing number of learners in these provinces. Furthermore, there are inconsistencies in the percentages of PES funding allocated to health by provinces. For instance, Gauteng allocated 34.6% in 2014/15, which was increased to 37.7% in 2015/16. This may be as a result of a lack of costing for health services.

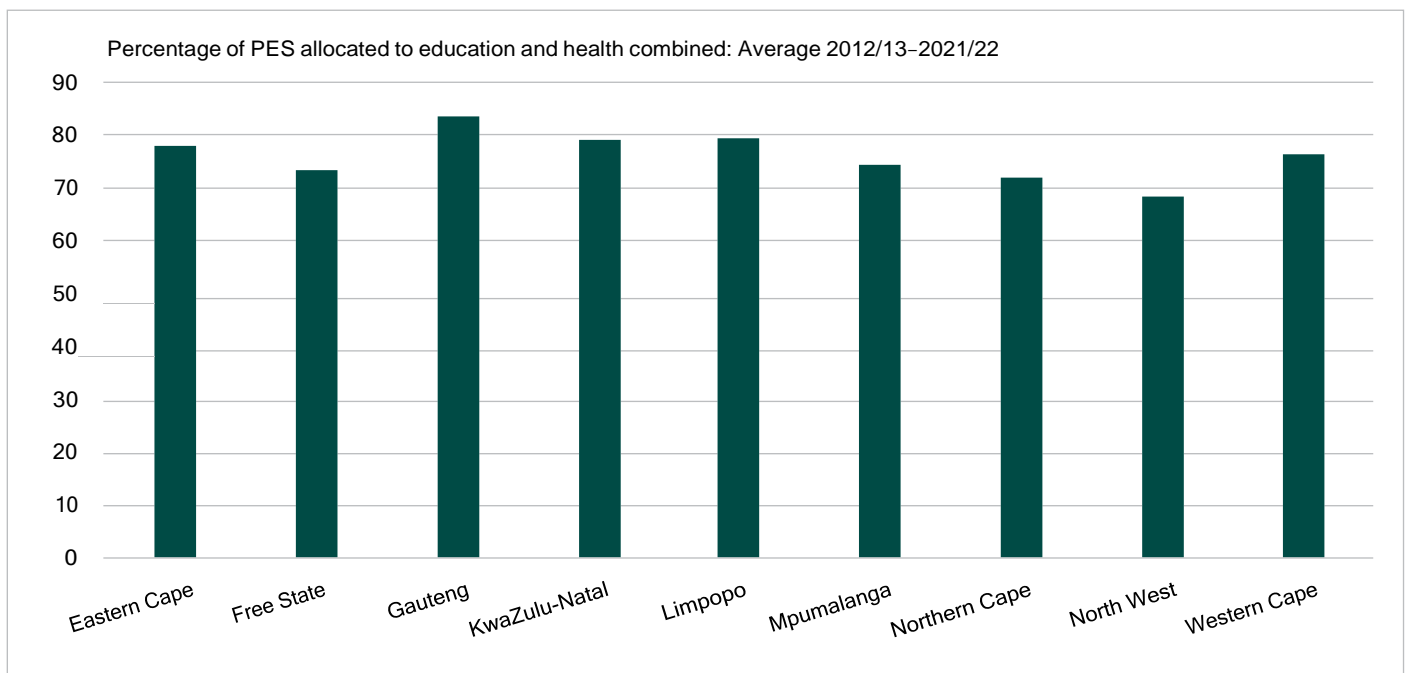
Figure 7.3: Provincial allocation of resources from the provincial equitable share to health



Source: National Treasury, 2012–2021

According to the PES formula, combined weights for education and health are 75%. However, due to expenditure needs pressures in these two sectors, most provinces allocate and spend more resources in these sectors. For example, Gauteng allocates more than 80% of its PES funds to education and health, as illustrated in Figure 7.4. Therefore, it is clear that provinces move resources between education and health in prioritisation and utilise the funding provided for other activities (e.g. economic development and poverty). Moving financial resources from other functional areas to education and health has serious implications for the funding of other key sectors and activities, such as economic development.

Figure 7.4: Provincial allocation of resources from the provincial equitable share: education and health combined



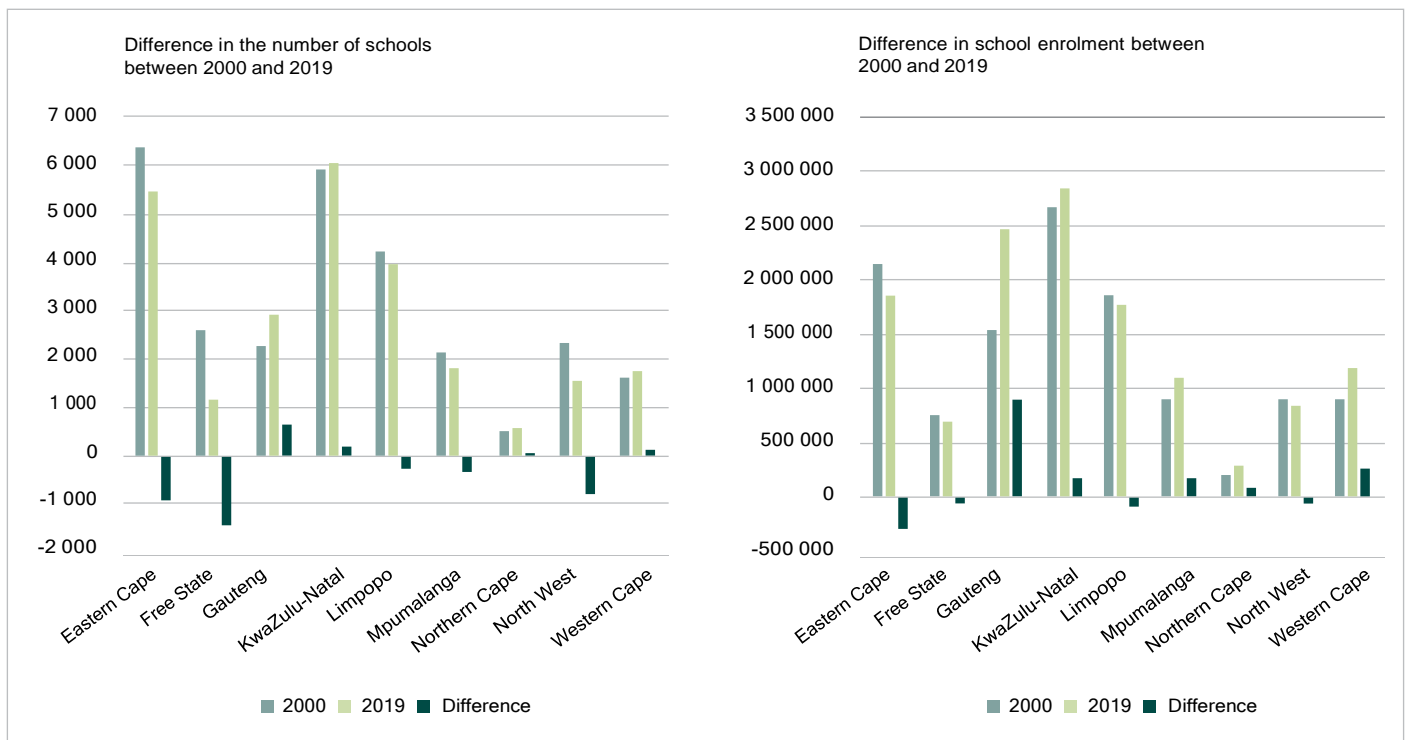
Source: National Treasury, 2012–2021

7.3.3 *Social structure changes and resources requirement and allocation*

To determine the extent to which resource and expenditure allocation responds to changes in social structure, the analysis undertaken included a closer look at changes in the number of schools and learners' enrolment per province against the number of teachers remaining in the employment of a province. An expectation was that changes in social structure should inform financial and human resource requirements. For example, a decrease in the number of learners and schools in a province should decrease the number of teachers required. In contrast, an increase in the number of learners and schools should lead to the need for more teachers. The intergovernmental fiscal instruments need to recognise changes in social structures (the PES and conditional grants).

Over recent years, there have been changes in the number of schools in provinces, mainly due to learners' movement between provinces, leading to some provinces losing learners, while others are gaining learners. Some schools had to be closed and merged, primarily in provinces losing a significant number of learners, while a need for more schools arose in provinces receiving more learners. Figure 7.5 shows the number of schools per province between 2000 and 2019. The total number of schools decreased by 2 196 nationally (from 27 194 in 2000 to 24 998 in 2019). Provinces with the highest reduction in the number of schools are the Free State, Eastern Cape, and North-West, with decreases of 1 461, 926 and 794, respectively. The decrease in the number of schools in the Eastern Cape and North-West corresponds to the decreasing number of learners over the same period, while in the Free State, there was only a slight decrease in the number of learners. The number of schools in Gauteng increased significantly from 2 270 in 2000 to 2 913 in 2019, which corresponds to a significant increase in enrolment numbers, indicating a need for new schools in the province. In the Western Cape, there was an increase in enrolment and the number of schools. There is a positive relationship between the number of learners and the number of schools in a province. Since the PES uses school enrolment numbers, it plays a vital role in ensuring that provinces with more learners receive a higher share. However, there is no alignment between the PES and other complementary intergovernmental fiscal instruments, such as school infrastructure grants, to ensure the availability of adequate funding for the development of new school infrastructure. This is key to avoid learners overcrowding and not compromising the quality of education. The intergovernmental system currently utilises a formula that considers enrolment numbers to allocate resources through the PES, but fails to link the PES with other necessary and complementary grants. Furthermore, in provinces that are losing a significant number of learners, like the Eastern Cape, new schools are needed in some areas or districts, so infrastructure grants should be directed to those districts with higher new school needs or high school backlogs, including mud schools. Provinces also noted a lack of coordination of plans in some instances between the national Department of Basic Education and the provincial departments of Education with respect to some infrastructure grants within the sector (particularly the Accelerated School Infrastructure Development Initiative, an indirect infrastructure grant).

Figure 7.5: Difference in the number of schools and enrolment between 2000 and 2019



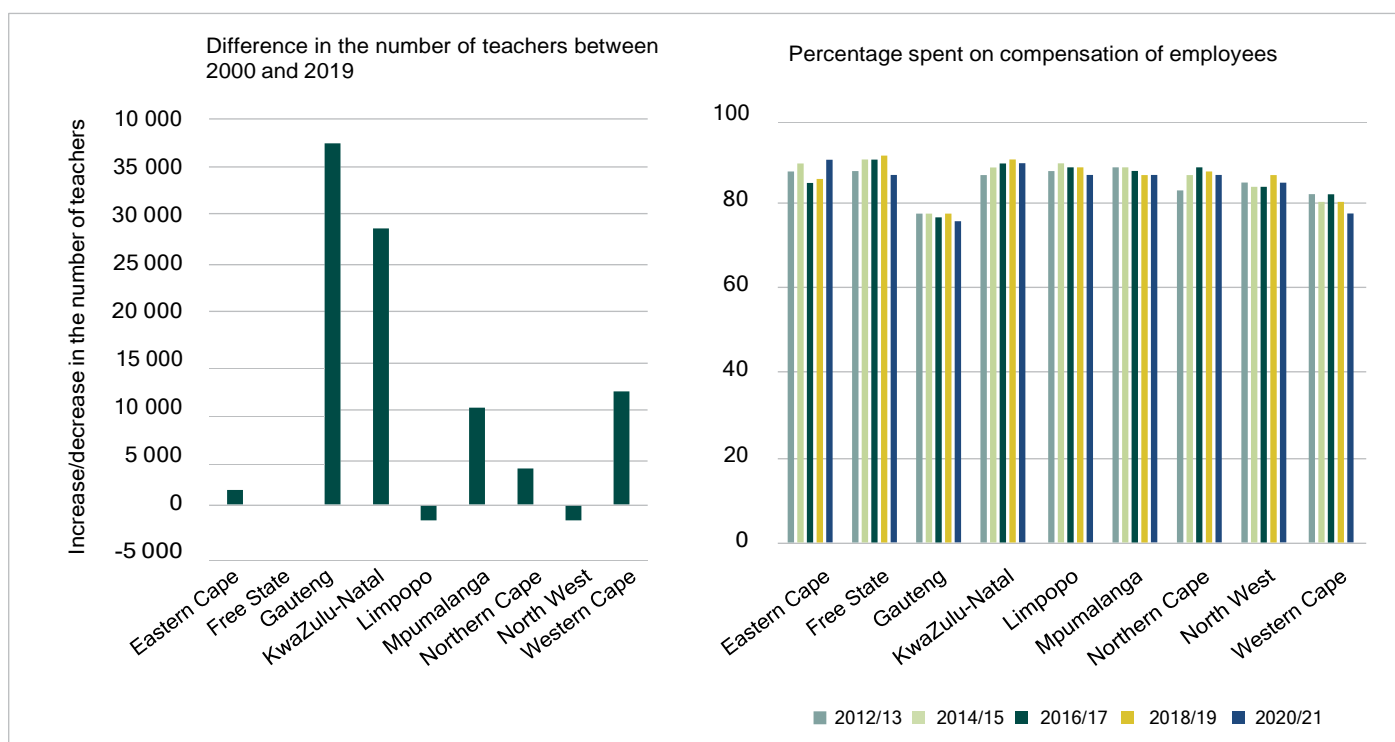
Source: Department of Education, 2000 and 2019

Concerning the number of teachers per province between 2000 and 2019, Gauteng, the Western Cape and KwaZulu-Natal show significant growth in line with increasing enrolments. The number of teachers in Limpopo and North-West is declining given decreases in schools and learners’ enrolment numbers.

The number of teachers in the Eastern Cape and Free State has increased between 2000 and 2019, even though the number of schools and learners’ enrolment has declined significantly. An increasing number of teachers, given a decreasing learners’ enrolment, implies decreasing resources from the PES, while costs on employee compensation increase, putting provinces under pressure. For these two provinces, for example, the percentage spent on compensation of employees has been increasing in the last few years, as illustrated in Figure 7.6. This indicates that, in some instances, while learners move between provinces, the mobility of teachers is limited.

Engagements with key stakeholders from the Provincial Treasury further revealed that it takes time to transfer teachers to other schools within a province following a school’s closure. This analysis shows that as the learners’ enrolment numbers inform the PES allocation. Provinces with decreasing learners’ enrolment receive fewer resources, while compensation of employees remains high. This indicates that the government should consider key factors other than learners’ enrolment numbers when allocating resources, or at least some intergovernmental fiscal instruments are needed to address this resource gap. The PES, in its current form, relies mainly on learners’ numbers and profiles, and disregards other key issues, including the inability of teachers to follow learners’ migration patterns and historical teacher-learner ratios in different provinces.

Figure 7.6: Difference in the number of teachers and percentage spent on compensation of employees



Sources: Department of Education, 2000 and 2019

7.34 How provinces adjust to inadequate financial resources

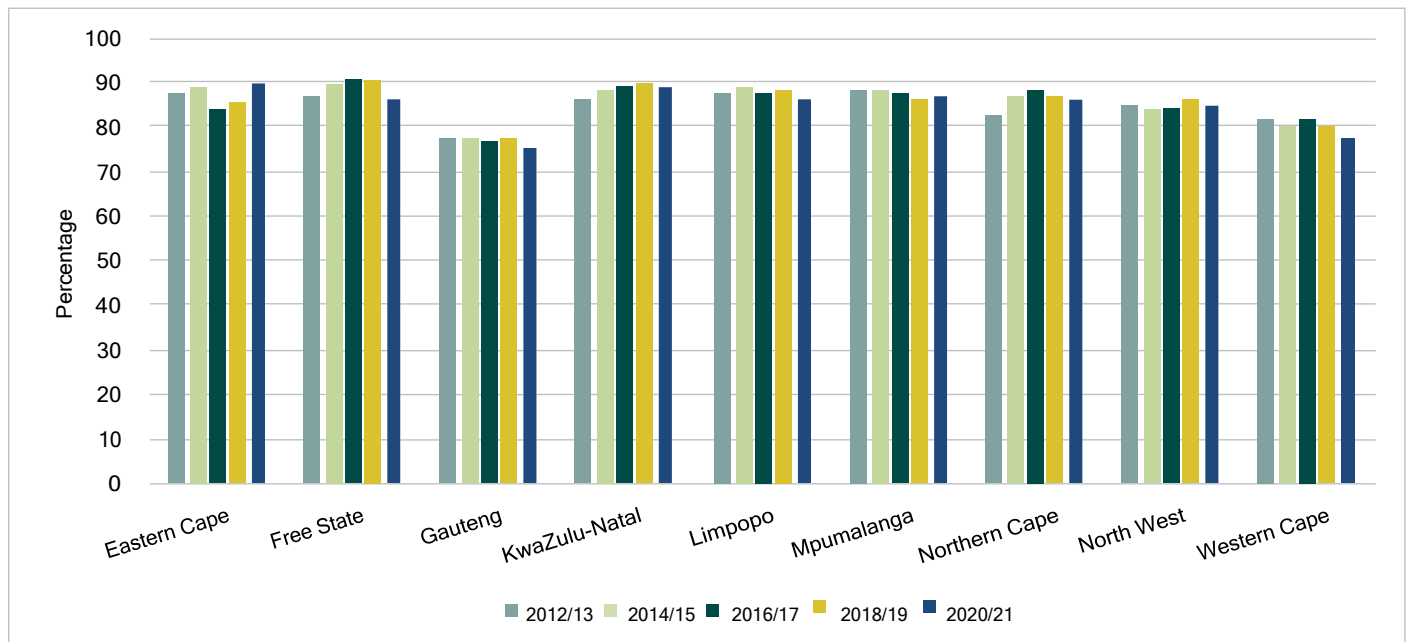
Provinces have limited revenue-raising capacity and powers; hence the reliance on intergovernmental fiscal transfers in the form of the PES and conditional grants. Funding from the PES is mainly for education and health, and provinces commonly face challenges in these two sectors. Provinces prioritise education and health over other key functional areas such as poverty and economic activities as provinces spend more than 75% of their PES funding on education and health.

Provinces spend a significant percentage on compensation of employees in these two functional areas (see Figure 7.7). For instance, the Eastern Cape spent over 90% of its education allocation from the PES on compensation of employees in 2020/21, leaving very little for infrastructure.

There are a number of key drivers contributing to provinces' high spending on the compensation of employees. These include wage bargaining processes that are not factored into the PES as agreements, and have significant financial implications on personnel expenditure on both education and health. The other major factor that contributes to high personnel costs in provinces, which was identified during stakeholder engagements, is the teachers' skills gap. School curricula and subject content are consistently revised and improved to ensure their relevance. However, some teachers, particularly those who are older and were trained to deliver an older and more outdated curriculum, find it very difficult to deliver on the new curriculum. This necessitates the employment of new teachers who are able to deliver and teach according to the new curriculum. This increases personnel costs as provinces, in this instance, have to pay both teachers (those trained on the old curriculum and those trained on the new curriculum).

One of the activities or projects provinces compromise is the provision and maintenance of school infrastructure (stakeholder engagement with one of the provinces confirmed this), which implies that provinces rely on conditional grants for infrastructure maintenance and delivery.

Figure 7.7: Percentage of the provincial equitable share spent on compensation of employees in the education sector



Source: National Treasury, 2012–2020

Engagements with key stakeholders revealed that provinces also reduce funding on goods and services (which includes learner support material) when faced with funding challenges, since it is difficult to reduce compensation of employees. This compromises the quality of education as a shortage of learner support material affects education quality. Stakeholder engagement also revealed that, in some instances, provinces delay the replacement of teachers (e.g. when they retire), which compromises the quality of education. KwaZulu-Natal, for example, indicated that it is unable to afford and replace over 6 000 teachers currently. The Eastern Cape also indicated that there were just over 54 000 vacant teachers' posts in 2021. For 2022, this number was re-adjusted and reduced due to funding pressure. Freezing teachers' posts as result of funding constraints will have a detrimental effect on the quality of education outcomes. Provinces also confirmed that, in an attempt to deal with funding pressure on education and health, own revenue, which is very limited, is used and cuts are made on funding to other departments.

7.4 Conclusion

Most provinces consistently allocate closer to or more than 48% of their PES funding to education, with a few (including Gauteng and the Western Cape) consistently allocating less. Findings reveal that many provinces have been allocating more than 27% of their PES funding to health. For example, Gauteng has not allocated less than 33% of its PES funding to health since 2012/13. This shows the health expenditure pressures faced by all provinces. It is key to note that provinces such as the Western Cape and Gauteng, which were allocating relatively less funds to education, allocate more to health, which shows that they prioritise health over education. While this could improve health care delivery and outcomes, it compromises education quality, especially given the increasing number of learners in these provinces. Furthermore, there are inconsistencies in the percentages of PES funding allocated to education and health by provinces. This may be as a result the absence of costing of education and health services.

Study findings also reveal a lack of coordination of infrastructure delivery plans between the national Department of Basic Education as a custodian of indirect grants (responsible for capital spending as part of the delivery of school infrastructure) and the provincial departments of Basic Education (recipients of PES funding and responsible for the operational spending on infrastructure delivered by the national Department of Basic Education through indirect grants). Analysis reveals that a large percentage of PES funding, both on education and health, is spent on personnel (compensation of employees) due to a number of reasons, including public sector wage agreements, which are not taken into account when determining the PES to provinces. With respect to education, the other contributing factor to higher personnel costs is the teachers' skills gap as a result of the revised and improved school curriculum (some teachers, particularly those who are older and who were trained to deliver on an older and outdated curriculum, find it very difficult to deliver on the new curriculum. This necessitates the employment of new teachers who are able to deliver and teach according to the new curriculum. This increases personnel costs as provinces, in this instance, have to pay both sets of teachers.

7.5 Recommendations

The Commission makes the following recommendations:

1. *In line with the Commission's recommendation on a costed norms approach, full costing exercises should be undertaken by all provinces, particularly for the provision of education and health. The costing results will be used to determine allocations by provinces to these key functional areas. This will ensure consistency and fully informed resource allocation.*

Currently, and from the analysis, the allocation of resources by provinces does not appear to be informed by any costing; hence, there are inconsistencies with respect to resources allocated to education and health from the PES. Costing the provision of these activities could assist in resource allocation and identifying gaps.

2. *The national Department of Basic Education, as a custodian of conditional grants (particularly indirect grants and being responsible for capital spending), and all provincial departments of Basic Education, as recipients of the PES and being responsible for school infrastructure delivery and maintenance, should improve the coordination of infrastructure delivery plans and programmes to ensure alignment.*

Currently, the national Department of Basic Education implements its own infrastructure delivery plan, which is not aligned with the provincial infrastructure delivery plans, particularly with respect to the Accelerated Schools Infrastructure Development Initiative, an indirect grant that improves coordination between the national Department of Education and the provincial departments of Basic Education, will ensure that infrastructure delivery plans are aligned and provinces can adequately plan for the maintenance of school infrastructure developed through indirect grants.

3. *The national Department of Basic Education should undertake skills audits to identify the skills gap with respect to the old and the new curriculum, and based on the audit results:*
 - a) *Identify the number of teachers who need to be trained and the funding requirements*
 - b) *Develop and implement a training programme.*

One of the challenges highlighted is skills gaps, as some teachers were trained on an old and outdated curriculum. With the new curriculum and developments implemented within the education sector, the skills gap necessitates the employment of new teachers as some teachers in the system are unable to teach according to the new curriculum, which increases personnel costs. Training teachers who are already in employment implies that there will be no need for new teachers, and this will reduce pressure on personnel costs.

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CHAPTER 8:

Repurposing and realigning the system of provincial conditional grants

8.1 Background

Conditional or special purpose grants in South Africa date back as far as 1994 when the Primary School Nutrition Grant (now called the National School Nutrition Programme) was introduced under the auspices of the Department of Health to address health deficiencies among schoolgoing children and to improve learners' dietary allowance (FFC, 2006). At the time of its introduction, the programme was seen as a temporary school-level poverty relief measure that was to be gradually replaced by the fruits of a broader reconstruction and development programme.

This grant underwent numerous iterations and evaluations over its 26 years of existence, but remains an integral part of provincial conditional grants allocation - accounting for a 7% share of the total grant allocations in the 2021/22 financial year. Whereas the grant facilitates the implementation of a national priority - as one of the fundamental objectives of conditional grants - its permanency and inefficacy violates some of the crucial principles of conditional grants. These weaknesses are not unique to the School Nutrition Programme or Grant, but permeates across the entire system of provincial conditional grant transfers. It is within this context that the study evaluates provincial conditional grants against the selected principles and design imperatives of intergovernmental transfers.

This evaluation is imperative for several reasons. First, conditional grants constitute a sizable portion (17%) of total provincial revenue (National Treasury, 2021). Second, there is an ongoing tension as to whether provincial expenditure mandates or concurrent functions should be funded through discretionary transfers (equitable share) or conditional grants, and what the optimal quantum of conditional transfer should be relative to the equitable share. Third, the system of conditional grants is haphazard - characterised by proliferation, the arbitrary introduction of new grants or their sub-components, repurposing and termination, and objectives overloading. Fourth, several conditional grants suffer from design shortcomings, such as overlapping objectives and the failure to address vertical and horizontal fiscal spillovers or externalities as intended (FFC, 2006). For instance, Gauteng often laments the inadequacy of the National Tertiary Services Grant in addressing interprovincial patient referrals and the heavy cost burden imposed on the health function by interprovincial health service demands. Last and most importantly, conditional grants must be subjected to regular equity, efficiency, predictability, flexibility and accountability tests to ensure the overall integrity of the system and alignment with best practices.

The study is in line with the Commission's research theme of strengthening budgetary institutions to improve fiscal and delivery performance post-COVID-19 in so far as improving effective expenditure management and overall outcomes is concerned. One of the vexing challenges of effective expenditure management that manifest through conditional grants is cost revelation. Conditional grants are generally introduced with little or no cost estimate, while purportedly intended to fund national priorities. Conditional grants are commenced with limited budget allocations to minimise underspending risks and priority drift. Similarly, conditional grants tend to carry the heaviest burn of fiscal consolidation. When there are budget cuts, conditional grants are the first to be cut (FFC, 2020). The total conditional grants cut for the 2021 budget amounted to R10 billion, representing 10% of total conditional allocations.

A combination of small initial allocation and slow growth, in addition to baseline and budget cuts, result in a thinly spread distribution of resources across recipient provinces and within spending programmes. The allocated funds are often too little to make an impact and elongate the completion of programmes or achievement of outcomes. If the principle of conditional grants is to finance national priorities, it is instructive to evaluate why some conditional grants have been in existence for more than 20 years and yet remain a national priority. From a budget institution perspective, the assessment will determine whether prioritisation mechanisms or inherent design features are able to trigger the necessary budget adjustments or accountability levers when the intended outcomes fail to materialise. This study therefore seeks to conduct a 25-year review of provincial conditional grants with a specific focus on the following:

- The number and quantum of funding, including a proportional share of grants to the equitable share
- The number of conditional grants introduced, terminated, rationalised or reclassified and incorporated into the provincial equitable share
- The alignment between grant design and policy objectives
- Grant performance and accountability
- Fairness of the allocation criteria on selected conditional transfers

8.2 Problem statement

Conditional grants are an important funding instrument for provincial concurrent expenditure mandates, which should arguably be funded through discretionary national transfers. However, the nature of intergovernmental fiscal relations, particularly revenue and expenditure assignments, and the resulting vertical and horizontal imbalances, as well as inter-jurisdictional disparities in South Africa, calls for redistributive transfers to achieve equity objectives with respect to the funding, access and delivery of services. Special-purpose grants have emerged as a preferred instrument by national government to finance what are purportedly regarded as national priorities (or the incentivised provision of specific services), rather than addressing overall equity goals. As a result, the system of conditional grants is fragmented, disconnected from unconditional transfers and fails to meet the intended delivery outcomes and correct lingering fiscal and delivery imbalances (Ter-Minassian, 1997), despite more than 20 years of implementation.

Government has paid little attention to the design of individual conditional grants or the system as a whole. The efficacy of the system depends on whether grants are matching or non-matching, and whether allocation conditionalities are input or output-based. Matching requirements can be either open-ended, providing the receiving authority the discretion to determine the level of matching resources, or close-ended, where the transferring authority sets the prescribed matching limit. Whereas matching grants promote local ownership of the funded programme, they tend to disadvantage and create a fiscal burden for the receiving jurisdiction with limited fiscal capacity, and therefore impinge on the overall outcomes (Boadway and Shah, 2007). This is particularly the case with most schedule 4 grants, which are allocated without due regard to the province's ability to meet the matching requirements. In many instances, the matching requirements are not explicitly stipulated. Further poor design considerations increase the fungibility effect of the grants, especially where the expenditure needs of the funded programmes exceed the conditional grant allocation. Yet, government continues to make incremental allocations to long-existing grants and create miniscule new grants without due regard to design implications for overall delivery outcomes and the functionality of the system. Some of the conditional grants are allocated incrementally on the basis of a historical baseline devoid of relevant expenditure needs indicators.

Similarly, poor design considerations means that the various conditional grants are unable to address spillovers and externalities. Matching grants are unsuited to deal with uneven fiscal and delivery disparities, yet the South African system of conditional grants makes no distinction. The result of this design shortcoming is that the conditional grant system functions sub-optimally, characterised by poor spending,

incentives and accountability for results, protracted existence with unmet goals, incorrect classification, intermittent changes and deficient (old, dated, opaque and inequitable) allocation criteria. The framework for intergovernmental fiscal transfers makes no provision for the regular review of conditional grants to ensure that the system influences provinces' fiscal decisions as intended, and that the objectives of national government and those stipulated in section 214 of the Constitution are achieved.

8.3 Rationale for conditional grants

At the most general level, governments utilise conditional grants as part of a broader package of intergovernmental transfers to address vertical and horizontal fiscal imbalance. Vertical imbalances arise from imbalances in the allocation of revenue-raising responsibilities and expenditure mandates between the national government and sub-national governments, where the national government retains major tax handles, leaving sub-national governments with limited fiscal capacity (Ma, 2007). Horizontal imbalances emanate from the variation in fiscal capacity and expenditure needs across sub-national governments, resulting in a fiscal gap that needs to be addressed through central transfers. Plugging horizontal fiscal gaps is often justified on the basis that national government must maintain minimum levels of services, but often impinges on the diversity of sub-national expenditure composition, and often leads to allocative inefficiencies, as well as top-down planning. The extent to which ensuing vertical or horizontal fiscal imbalances is addressed by conditional or unconditional transfers is a subject of statute and negotiation, and a process of evolving intergovernmental fiscal relations. Chapter 7 of this submission provides a detailed discussion on vertical and horizontal fiscal imbalances.

For the purpose of this chapter, it is important to note that the proportion of conditional fiscal transfers to unconditional or general-purpose grants, and the alignment between the two is crucial for the overall efficacy of conditional grants system. As Brun and Khdari (2016) note, choosing between unconditional and conditional transfers is a crucial public policy choice that is often neglected, even though the proportional balance between the two transfers has serious implications for fiscal incentives in a decentralised system of government. On the expenditure side, conditional transfers may result in what is widely recognised in literature as the “flypaper effect”: the exponential rise in sub-national government expenditure as a result of national transfers, as opposed to an increase in own revenue, passing the buck, and pork barrelling, among other things. On the revenue front, transfers may cause inefficiencies in the tax effort.

8.3.1 Types of conditional grants

The type of conditional grant has important implications for the design, induced incentives, anticipated outputs, outcomes and impact, as well as the overall ease of implementation, yet little regard is often paid to the shape conditional grants take. Essentially, there are three types of conditional grants, as shown in Table 8.1.

Table 8.1: Types of conditional grants

Non-matching	Grants allocated without any requirements for contribution by the sub-national government as long as funds are utilised for the intended purpose.
Matching (open-ended)	The national government matches a proportion of funding allocated or spent by the sub-national government on a specific expenditure programme without any limit placed on the amount of available assistance or expenditure by the sub-national government. The cost to national government varies according to the size of the sub-national expenditure.
Matching (close-ended)	Similar to the above, but the national government places a limit on the amount of available assistance or the contribution by the sub-national government.

Source: Chen et al., 2015; Spahn, 2012

With conditional grants, there is always a risk that associated conditions do not always match sub-national or local preferences. Matching grants thus become a useful fiscal instrument to reveal local preferences and induce sub-national governments to produce the right amount of services. According to Bird and Smart (2002), matching grants make sub-national government susceptible to national control, but they also promote local involvement, commitment and accountability. The size of the matching rate or cost paid by national government depends on the size of the spillovers, while the matching rate faced by sub-national government depends on the degree of central government interest in the funded programme, as well as the degree of local enthusiasm, ability to support the programme and the capacity to raise matching revenue (Bird and Smart, 2002). The biggest challenge with matching grants, as noted by Bahl (2002) is determining the matching share. If the sub-national matching share is set too high, the buy-in rate will be low; if the national matching share is set too low, opportunity for local resource mobilisation and project ownership will be lost. Further, matching grants are less likely to entrench fiscal disparities and impose significant administrative and compliance costs to jurisdictions with limited fiscal capacity if the matching rate is not progressive.

8.3.2 Principles and design issues for conditional grants

One of the key design considerations in the administration of conditional grants noted by Spahn (2012) is the need to clearly specify intended policy objectives for the national government and the receiving sub-national government from the onset, and translate such objectives into measurable indicators. This is especially true because of unresolved arguments over whether the purpose of conditional grants is to influence the fiscal decisions of the sub-national governments or to meet the actual delivery objectives of the funder (FFC, 2000). Further, setting clear goals is necessary for the effective exchange of information and risk mitigation, which, in turn, improves coordination and provides a guideline for the desirable intervention where implementation is weak (Tompson, 2011). This design imperative must be preceded by an ex ante allocation assessment to ensure that certain preconditions, i.e. administrative and implementation capacity, are met before the grant commences.

In the formulation of performance measures, it is important that expected outputs, as far as possible, are few, negotiated between the two parties (the funder and the recipient) and linked to the policy area being supported by the grant. Achieving these linkages is not always possible in a context where the delivery chain is vague and subject to control by multiple authorities, or where the overarching policy is susceptible to economic and political changes. Similarly, performance measurements go hand in hand with sanctions and rewards. If there are no sanctions, the conditional aspect of the funding becomes irrelevant.

Another design imperative related to performance measurements is deciding whether a conditional grant is input- or output-based. Input-based conditional grants specify the expenditure items (i.e. technical standards) eligible for funding, whereas output-based grants place the emphasis on the link between grant funding and delivery performance. Shah (2006) argues that input-based grants are intrusive and impinge on sub-national autonomy, in contrast to output-based grants, which promote local autonomy, budget flexibility and accountability.

Differentiation is another important design consideration that is often overlooked. There is a need to adapt grant conditions to the varying sub-national conditions, especially where local preferences differ, instead of using a one-size-fits-all approach. In the case of matching grants, differentiation may be achieved by setting a progressive matching rate to favour poor jurisdictions. Other important design considerations include the need to decide on the allocation criteria, performance assessment measures and monitoring framework, recourse measures when conditions are not met and a system for managing conflict. This is achieved through an effective process of intergovernmental coordination, largely influenced by the overall design of intergovernmental relations (Sengupta et al., 2018).

The joint development of conditional grant objectives, applicable conditions and anticipated outcomes helps improve harmonious intergovernmental fiscal relations and promote accountable governance.

8.4 Methodology

The methodology used for this study is a combination of budget analysis (with budget data spanning 25 years) and the qualitative assessment of the conditional grant design as set out in the Division of Revenue Act: conditional grant frameworks against a set of pre-identified principles and best practice design imperatives.

Grant design issues are analysed qualitatively based on the analytical framework from the foregoing literature review and as outlined below:

- Overarching objective clearly specified with expected termination date (potential conflict, duplication with existing grant)
- Rationale for the conditional grant
 - Vertical or horizontal equalisation
 - Addressing spillovers (has the size of the spillover been estimated)
 - Redistribution
 - Infrastructure development
 - Economies of scale
 - Capacity building
 - Information revelation
 - Stimulate reforms
- Type of conditional grant
 - Non-matching
 - Open-ended matching (matching rate and progressivity)
 - Close ended matching
- Grant design evaluation criteria
 - Pre-grant introduction due diligence
 - Measurable objectives
 - Outputs negotiated and agreed to between the two parties
 - Input- or output-based conditionalities (number of conditions)
 - Differentiation
 - Autonomy (planning, budgeting and implementation)
 - Moral hazard risks
 - Adverse selection risks

The quantitative element focuses on all provincial conditional grants using a matrix that shows the total number and allocation, the number and type of grants, introduced, reclassified, terminated or incorporated into the provincial equitable share per year. The reasons for these changes will be analysed through document analysis; in particular, Annexure W1 (explanatory memorandum to the Division of Revenue Act) of the Budget Review.

To ascertain the fairness of the allocation criteria, the study uses a combination of per-capita grant allocations per province and an analysis of variance to determine the significance of variation in provincial allocations for selected grants.

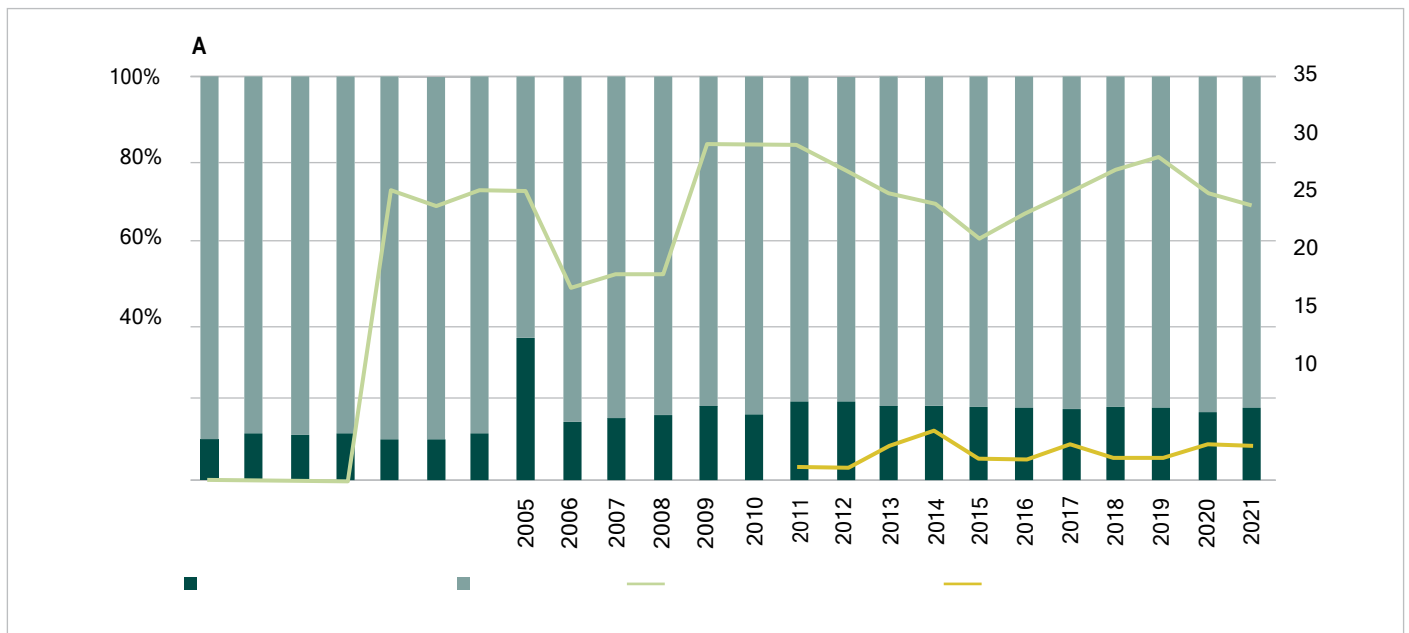
This exercise is limited to the three largest grants (by allocation size) in the education (the Education Infrastructure Grant), health (the HIV/Aids Grant) and human settlements (the Human Settlement Development Grant) sectors. Collectively, these grants account for nearly 50% of the total provincial conditional grant allocations.

8.5 Results

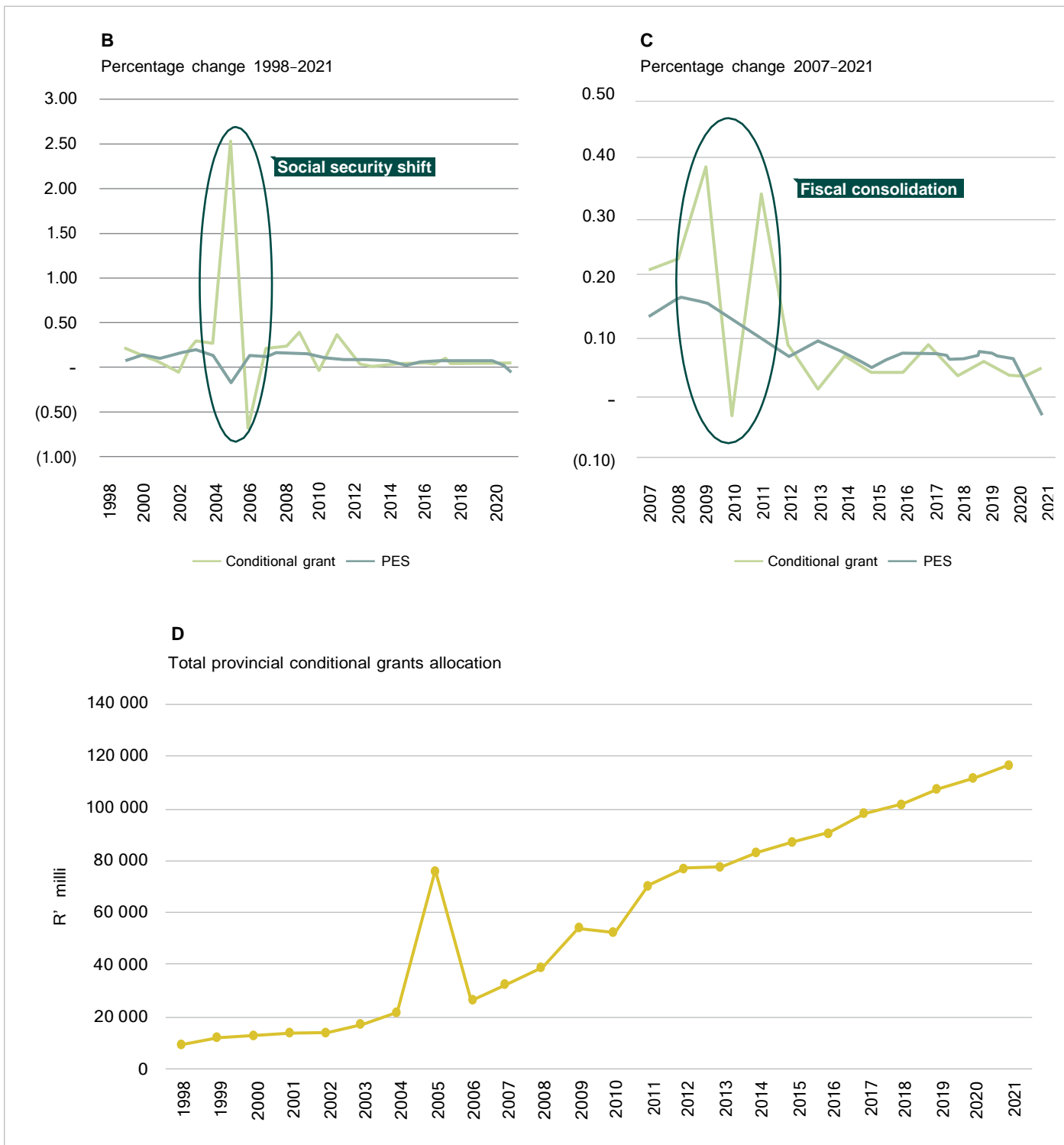
Conditional grants were first introduced in South Africa’s intergovernmental system in 1998/99 with a consolidated health sector that was intended to address spillover effects associated with the skewed distribution of specialised health facilities and the training of medical professionals. The 2002/03 financial year saw the introduction of provincial conditional grant frameworks as part of the reform to address the non-transferring of funds and chronic underspending. Thus, the frameworks sought, among other things, to limit the number of conditional grants to spending areas not funded by the equitable share, eliminate small conditional grants, impose stricter and more consultative requirements for national governments prior to introducing grants, subject conditional grants to the budget process, focus on outputs rather than inputs, and – more importantly – foster best practices in the design, planning and monitoring of conditional grants.

A fundamental change in the provincial conditional grant framework took effect in the 2006 Medium-term Expenditure Framework (MTEF) following the shift of the social security grant function from the provincial government to the national government, and the establishment of the Social African Social Security Agency (SASSA) to administer social grants. Between 2007 and 2011, the number of conditional grants increased from 18 to 29 with total allocations doubling from R31 billion to 75 billion. The rapid rise in allocations coincided with a period of rapid economic growth and the 2008 global financial crisis, which triggered subsequent and rolling budget cuts and budget reprioritisation on conditional grants as a result of fiscal consolidation (FFC, 2013). Notwithstanding the budget cuts, conditional grant allocations on the whole have been growing, albeit at a declining rate, as seen from Figure 8.1D.

Figure 8.1: Share of conditional to total national transfers 1998–2021



Continued on following page



Source: Adopted from National Treasury, 1998– 2021

With regard to grant continuity, the study finds that 85 provincial conditional grants have been introduced, with an average lifespan of 5.6 years. At least 27 of these grants existed for one year only, while four existed for more than 20 years, almost becoming a permanent financing instrument. It is unclear whether the average lifespan of 5.6 years is sufficient for any of the conditional grants to achieve their intended objectives, or whether the once-off grants are temporary enough to result in the anticipated outcomes. The accompanying conditional grant frameworks seldom stipulate the expected duration of the grant at inception. A significant grant activity is noticeable in the health sector, where several grants have seemingly been introduced and terminated abruptly. Out of the 24 grants introduced over past 20 years, only five are currently active.

Turning to grant schedule or grant type, the majority (47) of the provincial conditional grants are classified as schedule 5 or non-matching grants, whereas 16 are categorised as schedule 4 or matching grants. About seven grants were introduced as schedule 6 or indirect/in-kind grants, while five are listed as schedule 7 or disaster relief grants. According to the literature, non-matching grants bear resemblance to the traditional “block grants”, which afford sub-national government the autonomy to spend within a broader national priority, but accompanied by strict conditions. In the 2002/03 financial year, the South African government set out a principle that would see recurring concurrent provincial mandates being funded through block grants, while specific-purpose grants were to be used as an option of last resort.

None of the 47 schedule 5 grants approximate features of a block grant. Instead, some of the expenditure responsibilities that can be considered recurring concurrent provincial mandates (infrastructure, compensation of employees and training) are funded through schedule 4 or matching grants without an explicit matching rate that varies with the type of expenditure and fiscal capacity of each province. Broadly, there is no discernible practical distinction between schedule 4 and schedule 5 provincial conditional grants, especially in relation to conditions that influence sub-national fiscal decisions and induce performance incentives.

8.5.1 Grant design analysis

Table 8.2 outlines the results of the grant design characteristics of the three largest provincial conditional grants as per the assessment criteria set out in the methodology. The results are drawn from the respective grant frameworks outlined in the Division of Revenue Bill. A detailed analysis for each grant is provided below.

Table 8.2: Overall grant design assessment

Assessment criteria	Education Infrastructure Grant	HIV/Aids Grant	Human Settlement Development Grant
Rationale			
Vertical or horizontal equalisation	✓	✓	✓
Addressing spillovers	x	x	x
Redistribution	✓		
Infrastructure development	✓		
Economies of scale	x	✓	x
Capacity building	✓	✓	✓
Information revelation	x	x	x
Stimulate reforms	-	-	✓
Type of grant			
Non-matching	-	✓	✓
Open-ended matching	✓		
Close-ended matching			
Matching rate	x		
Design characteristics			
Pre-grant introduction due diligence	x	x	x
Termination date	x	x	x
Measurable objectives	✓	✓	✓
Outputs negotiated and agreed to between the two parties	-	-	-
Differentiation	x	x	x
Autonomy (planning, budgeting and implementation)	✓	✓	✓
Moral hazard risks	✓	✓	✓
Adverse selection risks	✓	✓	✓
Conditionalities			
Input-based/focused			
Output-based/focused			
Administrative	✓	✓	✓
Number of conditions	20	23	25

Source: Commission's compilation (based on the Division of Revenue of Bill, 2021)

Education Infrastructure Grant

The Education Infrastructure Grant was introduced in 2011 following the disintegration of the Infrastructure Grant for Provinces (formerly known as the Provincial Infrastructure Grant) into three sectoral infrastructure grants, including the Education Infrastructure Grant, the Health Infrastructure Grant and the Provincial Roads Maintenance Grant, overseen by National Treasury. The Infrastructure Grant for Provinces came into effect in 2000, purely as a transfer system for the construction and rehabilitation of roads, schools and health facilities. The grant framework and/or documentation underpinning the introduction of the grant is not explicit about the overarching rationale of the grant. However, it can be deduced from the grant evaluation framework set out in this study that its overall aim was infrastructure development, as well as vertical and horizontal equalisation; notwithstanding that, the vertical and horizontal gaps were not estimated. As noted earlier, the capacity-building element can also be implied, as a portion of the grant was used for the appointment of permanent staff in provincial infrastructure units.

The separation of the grant into three marked a transition of the Infrastructure Grant for Provinces from a block grant (associated with greater provincial spending autonomy and fundability) into a somewhat specific and open-ended matching conditional grant in that provinces were expected to supplement the allocations through their own revenue. There is, however, no specified matching rate in any of the grant frameworks, as the literature suggests. Further review of the Estimates of Provincial Expenditure and Revenue indicates no provincial supplementary contribution to the Education Infrastructure Grant over and above the allocated national transfer (for further probing through interviews).

Whereas the establishment thrust of the Education Infrastructure Grant is unquestionable, there is no record of due diligence having been carried out prior to its commencement. Due diligence ordinarily entails estimating the need and costs, implementation capacity and risk assessments, as well as agreement on the expected delivery outputs, among other things. The only notable needs estimation was in respect of the backlog component used in the computation of Education Infrastructure Grant's provincial shares, computed using the School Survey of Needs and a 1998 report on hospital revitalisation, as well as the rural factor (to emphasise redistribution), with the following weighting split: 18:40:42 (National Treasury, 2001). In the absence of estimates of need and costs, the termination date has not been set, thus increasing the likelihood of grant entitlement, non-termination risks and soft budget constraints (consistent under-provision of service emboldened by unbridled grant allocations). Non-termination risks are further aggravated by concessions to use part of the grant for personnel costs.

The Education Infrastructure Grant scores well in respect of measurable objectives in that the grant framework clearly spells out the expected outputs in terms of numbers, but the actual number of outputs is not set out upfront in the conditional grant frameworks. Expected deliverables are outlined during yearly planning and budgeting processes, informed by the size of the allocation, and reported retrospectively in the grant frameworks as achievements. This design feature implies that provinces have greater planning autonomy and control over the spending of the grant, but the absence of clearly set global targets subjects the grant to risks of protracted existence, under-provision (piecemeal interventions) and moral hazards.

The conditions associated with Education Infrastructure Grant are administrative in nature and generally devoid of allocation (eligibility) and spending (utilisation) conditions. They are neither input-based nor output-focused. Put differently, there are no conditions stipulating the criteria for a province to be eligible for the grant, and the inputs to be purchased or outputs to be achieved. Refer to Table 8.2 for extracts on selected conditions for the Education Infrastructure Grant. Many of the conditions are qualitative and process-oriented, seeking only to manage the flow of funds to provinces, rather than influence expenditure decisions and eliminate inherent disincentives associated with the type and nature of the grant.

HIV/Aids Grant

The HIV/Aids, TB, Malaria and Community Outreach Grant (known as the HIV/Aids Grant) evolved from a multi-sectoral approach, focused on integrated support and care to children and young people affected by the virus. The Department of Health was responsible for testing and counselling, the Department of Education took care of life skills programmes in schools and the Department of Social Development was responsible for home-based care. With the 2004 grant reforms, explained earlier, the grant was introduced as part of the national comprehensive response to the HIV/Aids epidemic, first focusing on the prevention of mother-to-child transmission, and later (2010) becoming one of the biggest antiretroviral funding programmes in the world. The grant has since increased in scope to include several other components, some of which are unrelated to the HIV/Aids pandemic. In 2016, tuberculosis (TB) was added. A community outreach services component and malaria elimination were added in 2018. Human papillomavirus (2019), mental health services and oncology services were included in 2021. In 2020, the COVID-19 component was included. The rationale for this grant can be summed up as vertical equalisation since the programme supports a national programme, which provinces may not have been able to fund from their own resources.

As such, the HIV/Aids Grant is regarded as a schedule 5 (Part A) grant (meaning the functional area of exclusive provincial legislative competence) or a non-matching grant, which should ideally be transferred to a province through a general-purpose transfer (provincial equitable share). Schedule 5 (Part A) functions constitute competencies over which provinces exercise an exclusive legislative mandate, and should therefore be funded through the provincial equitable share. However, it appears that the HIV/Aids Grant may have been wrongly classified, since HIV/Aids treatment falls under the health function, which is a concurrent function under schedule 4 (Part A) of the Constitution. The type and classification of the grant matters for the achievement of the overall grant objectives and efficacy. Exclusive provincial competencies may not be financed through a conditional grant, especially in cases where provinces have legislated responsibilities.

Similar to the Education Infrastructure Grant, the HIV/Aids Grant has no stipulated sunset clause; understandably, because of the high HIV/Aids prevalence at 20.4 of the population. With regard to the other design characteristics, the HIV/Aids Grant appears to have a poorly constructed outcome statement, which is misaligned to the broader national health goals, such as the eradication or reduction of HIV prevalence or improving life expectancy. The outputs are, however, clearly measurable, whereas the conditions only focus on utilisation parameters and exclude eligibility criteria. In total the HIV/Aids Grant has a mixture of 23 administrative and output-based conditions with which provinces must comply. Some of these conditions are complex and impose a significant burden on the recipients.

Human Settlement Development Grant

The Human Settlement Development Grant dates back to 1994. It was formerly known as the Housing Subsidy, which was aimed at providing housing subsidies to low-income earning households as part of Reconstruction and Development Programme. In 2005, the Housing Subsidy and the Human Settlement Redevelopment Grant were amalgamated to make way for the Integrated Housing and Human Settlement Development Grant, which was changed to the Human Settlement Development Grant in 2010. This grant supports the goal of the National Housing Policy to eradicate inadequate houses and homelessness; a competency that is shared across all three spheres of government. Its rationale can therefore be implied as vertical equalisation because provinces and municipalities are less likely to prioritise the function through their own revenue. The grant is, however, classified as a schedule 5 (Part A) grant in what appears to be a recurring grant classification misstep. Proper classification of the grant is complicated by the unwillingness of the provinces to devolve the housing function to municipalities, which are devoting a substantial amount of their own revenue to housing-related services (i.e. water reticulation, roads and stormwater drainage).

Whereas the 2021 Human Settlement Development Grant framework states that the programme is a long-term intervention with an unspecified termination period, the 2010 budget reported that informal settlements would have been eradicated by 2014, spelling the end of the grant. That the grant continues to exist in 2021 is a clear indication of unrealistic target setting, but numerous reviews of this grant by the Commission pointed to continuous underspending and significant under-delivery (FFC, 2016).

8.5.2 Allocation criteria assessment

Equity or fairness in allocation is one of the fundamental principles of the design of fiscal transfers and is a key constitutional requirement. As mentioned earlier, section 214 of the Constitution states that an Act of Parliament provides for the equitable division of nationally raised revenue among the three spheres of government and any other allocations to sub-national governments from the national government. Equity implies that the allocations to sub-national government must vary proportionally to the expenditure needs and inversely with the fiscal capacity of each jurisdiction (Shah, 2006). Equalisation in respect of conditional grants seeks to ensure that all provinces, rich or poor, large or small, have a roughly equal capacity to meet their responsibilities so that, in turn, all South Africans can have equal access to basic services. Horizontal equalisation is complex, however, since it commonly entails factors that are not easily measurable. Eliminating inter-jurisdictional disparities requires a comprehensive fiscal equalisation programme to equalise fiscal capacity to a national average standard, and provides reimbursement for differential expenditure needs and costs arising from the cost of provision rather policy differences, i.e. service level (Shah, 2006). Further, Schroeder and Smoke (2002) note the difficulties associated with measuring need and formulating a common standard for fiscal capacity. Below we provide a brief analysis of the allocation criteria of the three provincial conditional grants under review, with particular emphasis on expenditure needs considerations and distributional equity.

The allocation criteria for the Education Infrastructure Grant is based on the computed historical shares of the Infrastructure Grant for Provinces (the former Provincial Infrastructure Grant) that was phased out in 2010. The Infrastructure Grant for Provinces itself inherited a criterion that was used to distribute the Provincial Infrastructure Grant, incorporating three main determining factors with equal (1/3) weightings. These factors include the equitable share formulae, education and health backlogs based on the 1998 school survey of need and the health facility condition report, and the roads component computed based on the provincial share of untarred roads (National Treasury, 2004). In later years, a distance factor was added to the criteria to compensate the Northern Cape for the high cost of service provision due to its size, but it is not clear how the component is incorporated into the formula. The allocation formula for the Education Infrastructure Grant is given as follows:

$$EIG_i = PES_i.33.3 + (B_i (E_i. 0.60 + H_i. 0.40))33.3 + R_i.33.3$$

As can be deduced, the Education Infrastructure Grant's allocation formula is bereft of the school infrastructure-specific needs indicators that are necessary to improve learning outcomes, such as buildings, laboratories, equipment, the territorial distribution of learners, amenities and travel time. By way of observing the data, the allocation criteria show a significant redistributive bias towards the three poorest and most rural provinces. KwaZulu- Natal, the Eastern Cape and Limpopo accounted for more than 50% of the Education Infrastructure Grant allocations in 2011. The proportional distribution of the allocations continued to change with the passage of time, with funding increasingly shifting away from the rural provinces. This is largely attributable to provincial population shifts captured by the provincial equitable share factor. By way of example, the provincial equitable share of the Eastern Cape declined from 15.1% in 2011 to 13.1% in 2020. In the same period, the province's Education Infrastructure Grant share decreased from 17.6% to 14%, while Gauteng's share increased from 8.4% to 13.6%.

The allocation criteria for the HIV/Aids Grant is based on the provincial share of the population, HIV prevalence and the estimated number of Aids cases. The grant framework is, however, silent on the weightings assigned to each factor in the criteria. Analysed data, which shows the proportional distribution of the HIV/Aids Grant suggests high HIV/Aids prevalence in Gauteng and KwaZulu-Natal. The respective provincial distribution of the grant tends to mimic the provincial equitable share, seemingly making the grant criteria population biased. As mentioned earlier, the HIV/Aids Grant has since been expanded with multiple sub-components, each with different allocation criteria. The criteria for some of the sub-components are susceptible to manipulation and lack objectivity. For instance, the allocation criteria for the mental health service component suggest that allocations are based on an approved business plan and a combination of mental health prevalence, where provinces with the greatest need are prioritised, as well as the number of contracted health professionals and defined reduction in mental health backlogs. Basing allocations on the reduction of backlogs when the grant objective is to reduce forensic mental health observation is not only counterintuitive, but creates perverse incentives. Similarly, using personnel contracting as an indicator of need may penalise provinces that are unable to attract the requisite experts.

The allocation criteria of the Human Settlement Development Grant are given as follows:

$$HSDGi = IHi. 0.70 + PHi.0.20 + Pi.0.10... \text{ where,}$$

IHi is the proportion of inadequate housing in province i , PH is the proportion of poor households in province i and P is the proportion of the total population in province i , used as indicators of need. Informal dwellings constitute people living in informal settlements, backyard dwelling and traditional houses. According to the above formulation, Gauteng and KwaZulu-Natal account for just under half of the Human Settlement Development Grant allocation, in line with high housing in those provinces. As with the HIV/Aids Grant, the total proportional shares mirror the provincial equitable shares, despite inadequate housing being weighted at 70% in the formula.

8.6 Conclusion

The system of conditional grants in South Africa has been beset by poor design considerations from its inception. Grants are seemingly introduced to manage provincial government's fiscal mismanagement rather than induce certain fiscal incentives, such as encouraging provinces to allocate funds for the maintenance of education infrastructure in the case of the Education Infrastructure Grant or improve integrated spatial planning in the case of the Human Settlement Development Grant using their general-purpose grant.

Conditional grants suffer several design flaws, such as poorly formulated output and outcome statements, the lack of pre-grant introductory due diligence to ascertain the size of the need and the timeframe required to address the priority, failure to promote local ownership and endanger continuous reliance on the part of provinces, and an inordinately high number of administrative conditions devoid of eligibility requirements and utilisation conditions in some instances.

The share of provincial conditional grants to total provincial transfers has remained relatively stable, however, masking significant variations in the number and sub-components of conditional grants. Government is introducing numerous sub-components within selected grants such as the HIV/Aids Grant, not only deviating from the original grant's objective, but also eroding the baseline allocation of the main grant and adding an administrative burden on recipient provinces. For instance, many of the sub-components of the National Health Insurance and HIV/Aids grants, as shown in this study, are unrelated to the rolling out of the National Health Insurance or the reduction of HIV prevalence.

The study notes the importance of finding an optimal balance between general-purpose and specific-purpose conditional grants, and risk associated with the excessive use of a grant, particularly the potential to encroach into the responsibilities of sub-national government. Conditional grants, as a proportion of

total transfers to provinces, constituted 20% in 2021, increasing from 13% in 2000/01. However, such a proportional share is not informed by vertical and horizontal imperatives, partly because vertical and horizontal fiscal gaps are unknown. The expenditure responsibilities of provinces are not fully costed to establish whether a 20% share is detrimental to provinces' fiscal integrity.

The size and number of conditional grants has increased significantly over a 20-year period, increasing from just under R20 billion in 2000 to over R120 billion in 2021. A total of 85 provincial conditional grants have been introduced, with an average lifespan of 5.6 years. At least 27 of these grants existed for only one year, while four have existed for more than 20 years. A shorter grant life span implies haphazardness in the manner in which grants are introduced, but also suggest that grants may be terminated without reaching their intended objectives. It is, however, worth noting that some of the once-off grants have been incorporated into the provincial equitable share or other conditional grants. This begs the question whether such grants have successfully incentivised provincial preference revelation, i.e. sustained baseline funding of the policy priority funded by the once-off grant.

Grant conditioning schemes make no specific distinction between different categories of grants, thus making grant schedules, as per Division of Revenue Act, meaningless and immaterial. Notwithstanding, 16 grants are classified as schedule 4 grants, which, in the literature, are regarded as matching grants, but the grant frameworks outline neither the matching requirements nor the matching rate. Similarly, 46 grants are classified as schedule 5 grants, which accordingly resemble non-matching grants in the literature, yet the associated conditions are no different from those of the matching grants. Schedule 6, or the so-called indirect grant, and schedule 7 grants are inconsistent with the literature and therefore bear no significance to the overall conditional grant system.

The Commission (FFC, 2006) made similar observations in relation to the National Tertiary Services Grant, noting that it bears no direct relationship to the removal of spillovers, nor does it appear to have been properly costed. Scheduling schemes may also be inconsistent with the Constitution with regard to schedule 5 grants in the sense that exclusive provincial mandates are funded through conditional grants.

Whereas the allocation criteria seem to direct funding in accordance with the policy intentions, some of the needs indicators used in the allocation criteria, especially in relation to the Education Infrastructure Grant and the HIV/Aids Grant, are unrelated to the grant objective and are seemingly overwhelmed by the use of the provincial equitable shares in their allocation formulae. The practice of employing permanent staff through conditional grants is emerging as a growing grant design flaw, which is likely to destabilise provincial budgets or increase compensation of employees' expenditure when grants cease to exist.

8.7 Recommendations

The Commission makes the following recommendations:

1. *National Treasury, in conjunction with the national departments responsible for conditional grants, must revise the Division of Revenue Act's system of grant scheduling as it creates no fiscal incentives for provinces to reveal their expenditure preferences or sustain expenditure previously funded by conditional grants. Instead, government must invest the capacity to improve overall grant design, taking account of all good grant design imperatives, such as types of grants and their implications, pre-grant introductory due diligence, sunset clauses, conditioning schemes and allocation methodologies.*

This recommendation seeks to improve grant design with the general principles of grant classification, to acknowledge that matching grants in the context of provinces are impractical given the limited revenue-raising autonomy, and to minimise the potential risk of violating the Constitution in respect of financing exclusive provincial mandates.

2. *National Treasury, in conjunction with the national departments responsible for conditional grants, should undertake three-yearly reviews of their respective grants to ensure alignment across grant objectives, conditions and grant outcomes. These reviews must be informed by an overarching conditional grants guideline, setting out the circumstances under which grants are introduced and terminated, applicable minimum and type conditions, and the applicable minimum outputs. Further, there should be a mandatory grant introduction and termination pre-assessment by the Financial and Fiscal Commission to determine suitability, impact on the fiscal framework and overall grant outcome. Grant conditions are generally administrative, while the outputs are seemingly unconnected to the long-run outcomes.*

The aim of this recommendation is to minimise the long-run objective drift of grants, to minimise overly administrative conditions, improve alignment between output and long-run grant outcomes, and to disincentivise national government departments from itemising funding for concurrent provincial mandates.

3. *The Department of Basic Education, in conjunction with National Treasury, must update the allocation formula for the Education Infrastructure Grant to ensure the alignment of grant needs indicators with grant objectives and further streamline expected and reported grant outputs to improve focus and ease of monitoring. At the very least, the allocation criteria may include learner enrolment, learner densities by area, index of schools with access to learning infrastructure and travel time to schools. The actual formula must be published in the grant framework for transparency purposes.*

The rationale for this recommendation is to improve allocative efficiency by directing resources where the school infrastructure needs are greatest, as determined by relevant needs indicators.

4. *The Department of health and other custodians of grants with multiple components must halt the over-compartmentalisation of provincial health responsibilities through multiple grant funding windows unrelated to the main objective of the main grant. Conditional grants must, as a matter of principle, accommodate not more than two sub-components or take the shape of a traditional block grant to allow provinces the flexibility to prioritise within the set sub-functional responsibility. Sub-components that are unrelated to the main grant objective must be incorporated into the provincial equitable share and be monitored through the normal budget and accountability system instead of subdividing or itemising provincial health responsibilities to be funded by grant sub-components. The formulae for the newly restructured HIV/Aids grant must be published in the grant framework for transparency purposes.*

This recommendation intends to reinforce the original grant objective, particularly that of HIV/Aids prevention, rather than curative interventions, to foster the expenditure autonomy of the province in respect of managing the disease, to reduce the grant's administration burden and to avoid multiple allocation criteria within the same grant.

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CHAPTER 9:

Budgets, performance, efficiency and the constitutional right to basic education

9.1 Introduction and problem statement

Access to education is widely accepted, internationally, as a fundamental human right. The Constitution of South Africa (Republic of South Africa, 1996) stipulates that:

29. (1) Everyone has the right –

(a) to a basic education, including adult basic education; and

(b) to further education, which the state, through reasonable measures, must make progressively available and accessible.

(2) Everyone has the right to receive education in the official language or languages of their choice in public educational institutions where that education is reasonably practicable...

The provisions of the Constitution essentially qualify access to basic education as a fundamental socioeconomic right. An aspect of these provisions that has been heavily emphasised by legal rights scholars (McConnachie et al., 2017) is that the provision in section 29(1a) is not conditional on “progressive realisation”, as some other such clauses are in the Constitution. This is interpreted to mean that the right to basic education is one that must be realised immediately and at all times.

The right to education is viewed as a facilitative or multiplier right, as it can yield both individual (prospects for earning an income, career advancement and greater employment opportunities) and societal benefits (these include lower levels of crime, higher levels of equality, and economic growth and stability). As such, the provision of education is considered a “merit” good in that the consumption of education by an individual has positive benefits (positive externalities) on other members of society. Therefore, it is important that the government ensures the efficient and effective provision of education services towards achieving its social and economic goals and objectives, as well as ensuring that the basic socioeconomic rights of its citizens are being fulfilled.

South Africa allocates a significant portion of its consolidated spending to basic education. However, over the last few years and, more specifically, since the onset of the COVID-19 pandemic, spending on basic education has been impacted by the need to reprioritise and cut spending across government. This has been driven by increased pressure on tax revenue and moves towards fiscal consolidation driven by slow economic growth and various economic shocks. As a result, key basic education funding sources, such as the provincial equitable share and basic education-related conditional grants, have been reduced or subjected to slower real growth. It is anticipated that this relative stagnation in spending will continue over the medium term, as government tries to rein in its debt levels and the accompanying interest associated with such debt.

The question of resources, especially financial resources, is central to any discussion on the fulfilment of socioeconomic rights such as basic education – it enables the practical implementation and enforcement of rights (Dawson and McLaren, 2015; Waris and Latif, 2015). With the growing need for fiscal prudence, due to continued social and economic challenges, there is a justifiable concern that the fulfilment of basic rights is being compromised due to declining allocations to services, such as basic education. However,

funding cannot be viewed narrowly without factoring in the consideration of the prudent utilisation of existing scarce public resources and whether such resources are being used efficiently and effectively to achieve intended outputs and outcomes. In other words, government does not only need to ensure adequate allocations to education services, but also the efficient and effective spending of such allocations to deliver on the socioeconomic right to education. Any concession on adequacy and efficiency can compromise the required delivery of basic education services.

Unfortunately, a historical trend of inefficient spending and poor educational performance begs the need for a closer look at the link between spending and outcomes to ultimately determine the impact of a tight fiscal framework on the basic education sector and the fulfilment of the socioeconomic right to education. Thus, the focus of this analysis is to understand the budget trends and educational outputs and outcomes that have characterised the basic education sector to date to understand the relationship between the two, assess the efficiency of current education spending and reflect on how spending on basic education can be reprioritised to ensure that the most essential elements related to the right to basic education are protected. This is important given the high probability of a tighter fiscal framework over the next few years.

This research is seen as the first step towards a comprehensive assessment of the impact of basic education spending and resources on outcomes. By assessing the efficiency of education spending and education outcomes, this assessment focuses on the use of existing resources and whether it is being spent prudently to achieve its intended goals. This is important given the tight fiscal framework, where one needs to make the best use of existing resources to achieve the desired outcomes. The research does not focus on the adequacy of basic education spending, which is a related, but separate issue.

9.2 Chapter objectives

The objectives underpinning this analysis are as follows:

- Examine levels and trends in budget allocation in the basic education sector in South Africa
- Examine educational performance in the basic education sector in South Africa from 2000
- Examine the link between resources and performance in the sector to determine the efficiency of education spending and thus comment on the aspect of value for money
- Comment on the implications of the above trends in relation to the constitutional imperatives around the right to basic education and the protection of a basic level of service

9.3 Approach

A multi-pronged methodological approach will be used to fulfil the research objectives. Firstly, with respect to examining the trends in basic education budget allocations and educational performance, the approach will be descriptive in nature with the analysis examining – graphically and statistically – trends in budget allocations and performance over time. Secondly, the approach will be to examine the link between resources and outputs and outcomes, and to estimate the efficiency of the use of such resources, the research made use of the stochastic frontier analysis (SFA) method. The SFA is a statistical parametric method that estimates the “production” of schools where the success with which schools convert a given set of inputs (financial or physical resources) into education outputs and outcomes will be determined over a period of time. This analysis will essentially show the changes in education productivity and efficiency over time. The statistical nature of the method allows one to determine the impact that education resources (spending or otherwise) have on the attainment of education outcomes, and which factors impact relatively more on education outcomes.

Finally, building from the efficiency analysis and given the government's stance on the need to rein in spending over the next few years, the analysis adopts a socioeconomic rights lens and proposes a spending prioritisation framework for the basic education sector. The spending prioritisation framework is based on an assessment of international law in the form of the covenants to which South Africa is party, linking what international law and covenants prescribe to what is happening in our own legislative and policy domain, and drawing on relevant South African case law, especially because, in South Africa, given the justiciability of our constitutionally enshrined socioeconomic rights, the courts have played a role in helping to add flesh to our understanding of what the content of certain rights should entail.

9.4 Issues with data availability and quality

The research initially envisaged the analysis of trends in education expenditure and outcomes, and the assessment of education efficiency using school-level data over a 10-year period from 2008 to 2018. In this regard, the following departments were approached for the following data sources:

Dataset	Source	Key components and variables
School or outcome and descriptive data		
Schools master list	Department of Basic Education	Learner and teacher numbers by provinces, quintiles and school types (for calculating per-learner and per-educator allocations)
National Senior Certificate (matric)	Department of Basic Education	Aggregate matriculation numbers across provinces, school types and quintiles
School input or expenditure data		
PERSAL data	National Treasury	Personnel expenditure by school and personnel classifications
School non-personnel allocations	Department of Basic Education	Fiscal non-personnel allocation by provinces to schools

As indicated above, the data required for an analysis of schooling outcomes and public resource allocation is not available from a single institutional source, or a single dataset. Instead, there are a range of datasets from different government departments that provide different pieces of the information that is needed. At the core of the analysis was the use of administrative data at the level of schools from two main sources: education system data from the Department of Basic Education and public expenditure data from National Treasury.

However, the frequency and quality of the data received from the respective departments varied considerably across the requested years for analysis, i.e. variables and information was not consistent over the 10-year period at the school level. One of the reasons for this was the change in the data collection method used by the Department of Basic Education (DBE) from the Annual Survey of Schools from 2008 to 2014 to the South African School Administration and Management System (SA-SAMS) from 2015 onwards. This made it difficult to reconcile the data from both collection instruments and resulted in issues of data quality. Furthermore, the national DBE does not keep a comprehensive dataset of non-personnel allocations at the school level, thus necessitating the research team to source such data directly from the provincial education departments, with varying levels of success. From this experience, it is clear that, while the administrative systems for public finance and education collect very useful information, more needs to be done to integrate these data sources in a systematic way.

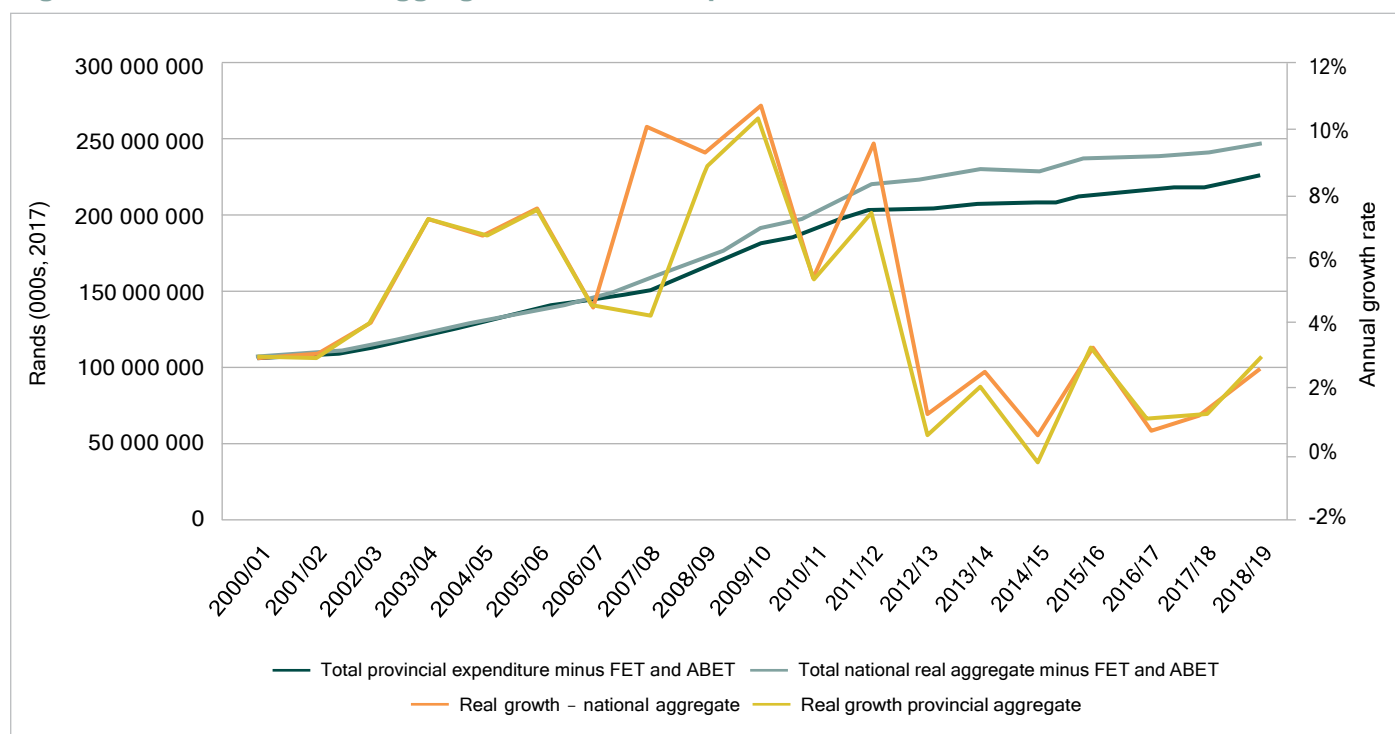
Given these data constraints, the analysis was regrettably confined to just two years, i.e. 2013 and 2018, where all required variables were available and consistent. While not ideal, the use of the trends of these two years allowed one to capture the period prior to 2013 and following the stagnation in allocations to basic education. Therefore, one can get a good sense of the impact of allocation changes on outcomes and efficiencies related to the period of fiscal consolidation. Finally, it should be noted that the analysis focuses on secondary schools. This is due to using the National Senior Certificate (NSC) pass rate as an output measure, which is not available at primary school level.

9.5 Presentation of findings

9.5.1 Budget allocations to basic education over time

Figure 9.1 shows the trends in basic education spending from 2000/01 to 2018/19. The global financial crisis that began in 2008, along with a decline in public service delivery, infrastructure and governance, led to low rates of real growth in South Africa's gross domestic product (GDP) – often below the rate of population growth – with corresponding negative effects for public finances through lower tax revenues. Having repeatedly missed its fiscal targets, National Treasury signalled an intention to engage in “fiscal consolidation” from 2014, yet the actual debt-to-GDP ratio continued to exceed targeted values in the national budget. At the same time, expenditure growth stagnated in many areas, including education, as shown in Figure 9.1. With the COVID-19 pandemic, the fiscal situation has worsened significantly, due to international and local measures that restricted economic activity. The corresponding expectation is that reductions to planned expenditure will now be even greater. As one part of such reductions, the 2021 Medium-term Budget Policy Statement (MTBPS) indicated the intention to cut basic education expenditure in nominal terms, which implies sizeable cuts in real and real-per-pupil terms.

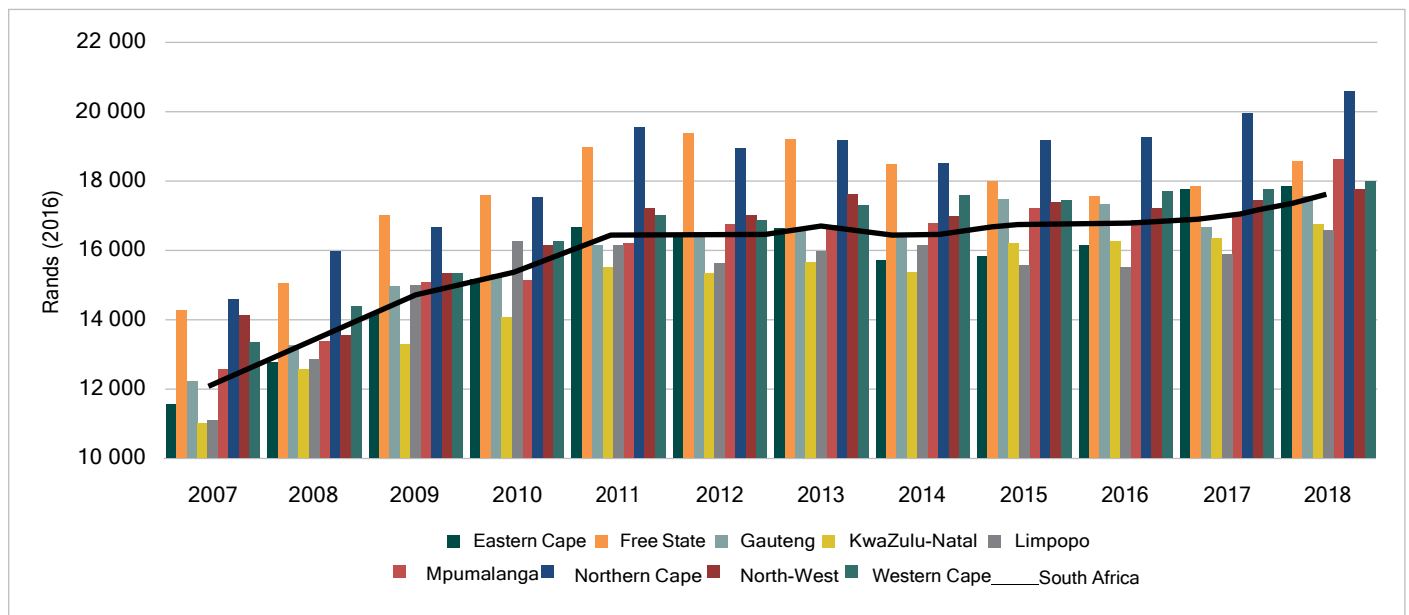
Figure 9.1: Growth in real aggregate education expenditure: 2000/01–2018/19



Source: Mahabir and Muller (2021)

Figure 9.1 confirms that the impact of fiscal consolidation on basic education allocations became more apparent from 2012/13 and is likely to continue along a similar trend over the medium term. Figure 9.2 extends this analysis to look at the impact of such expenditure consolidation measures on total real spending per pupil across provinces from 2007/08 (the year of the global financial crisis) to 2018/19. One can notice the relative flatness of the curve of real growth in per-pupil education spending from around 2011 onwards. Furthermore, one can also notice that several provinces, including Limpopo and Mpumalanga, have consistently spent below the average national level of real per-pupil spending. Towards the end of the period, even the Eastern Cape, KwaZulu-Natal and Gauteng tended towards lower levels of real per-pupil spending, a possible indication of the impact of the fiscal consolidation measures.

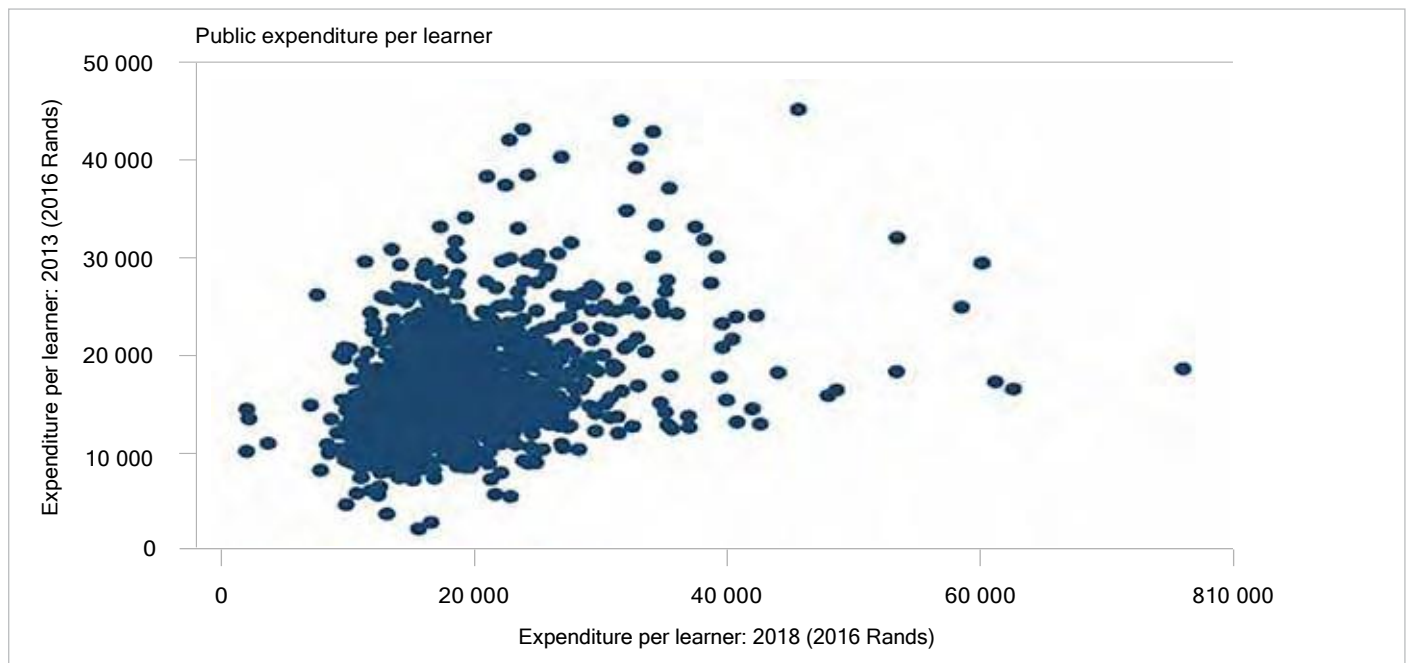
Figure 9.2: Growth in real education expenditure per pupil: 2007/08–2018/19



Source: Mahabir and Muller (2021)

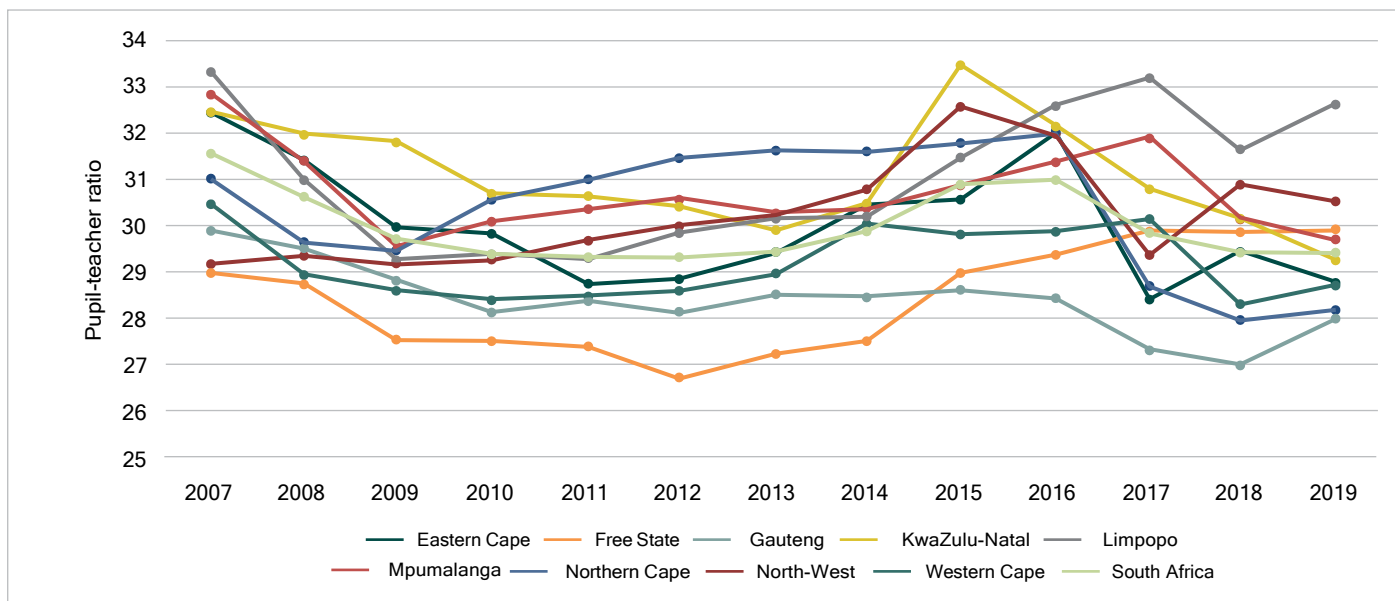
Figure 9.3 shows the variation in real expenditure per pupil between 2013 and 2018, where one sees both sizeable variation within years and broad consistency across years in real expenditure per pupil across schools. The former confirms the differences in resource allocations at the school level, while the latter shows that such allocations tend to be consistent over time.

Figure 9.3: Real expenditure per learner by school: 2013 and 2018



One of the key contributors to improved education performance is the quantity and quality of available teachers. As such, the use of the pupil-teacher ratio (PTR) can provide an indicator of resource availability and can possibly be a determinant of education performance. Figure 9.4 shows the PTR across provinces from 2007 to 2019. As indicated, there is substantial variation across provinces, with the Western Cape, the Free State and Gauteng having lower PTRs than the national average, while KwaZulu-Natal, North West and Limpopo have higher PTRs relative to the national average over the period.

Figure 9.4: Pupil-teacher ratio across provinces: 2007 to 2019



Source: Mahabir and Muller (2021)

Figure 9.5 shows the PTR between 2013 and 2018 within the sample of “ordinary public schools” used in the efficiency analysis. One can notice large variation across schools, which is also relatively stable over time. That is, most schools retain their position in the PTR distribution, thus suggesting that schools with higher (or lower) PTRs tend to remain so over time.

Figure 9.5: Pupil-teacher ratio (2013 and 2018)

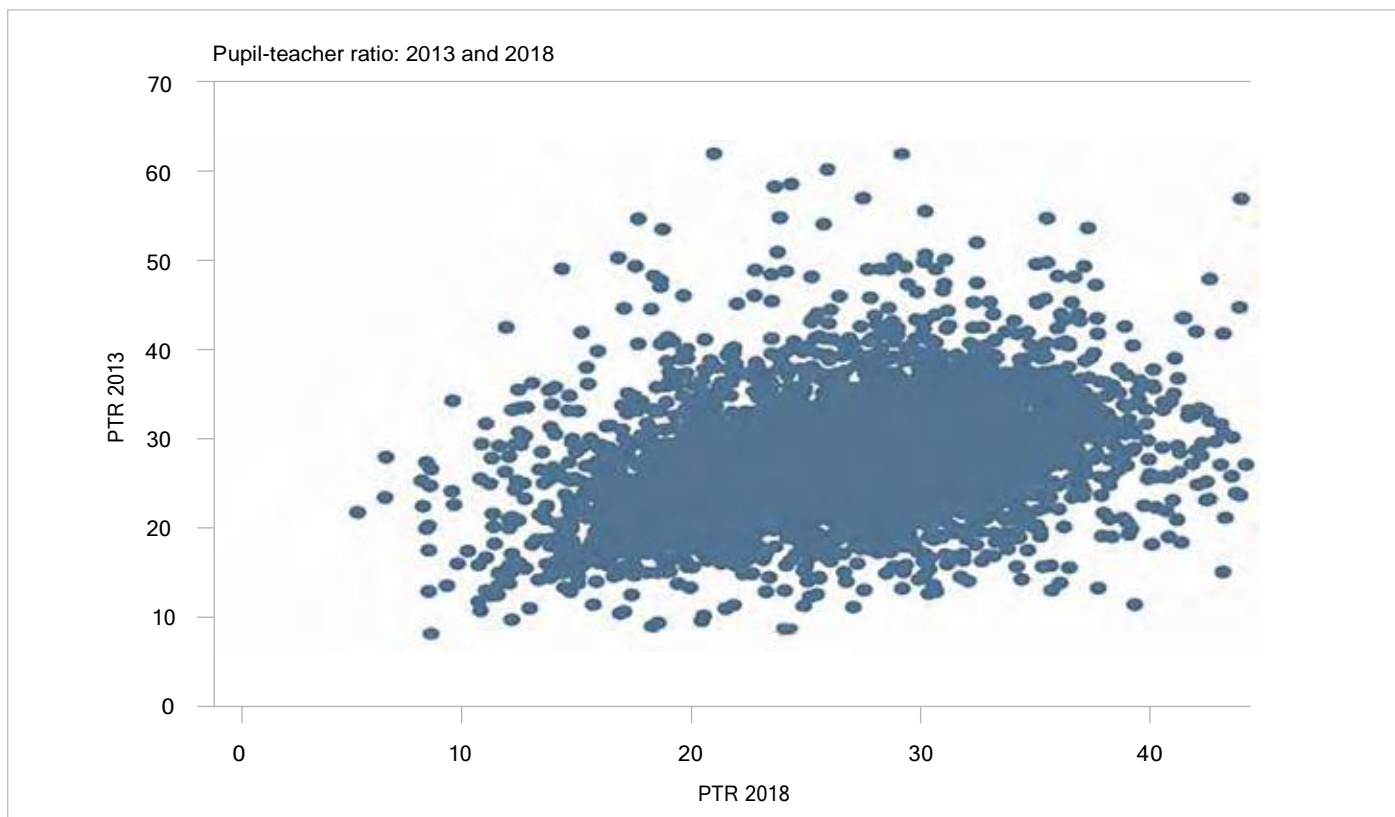


Table 9.1 shows two measures of resources: expenditure per learner and the PTR by quintile. While per-learner expenditure indeed increases with lower quintile status, the PTR is notably lower for Quintile 5 schools relative to all other quintiles. This draws attention to the nuances of resource availability beyond only the direct examination of public expenditure averages.

Table 9.1: Resource measures by quintile (2013 and 2018)¹

Quintile	PTR				Real expenditure per learner in 2016 Rands			
	2013		2018		2013		2018	
	Mean	Number of schools	Mean	Number of schools	Mean	Number of schools	Mean	Number of schools
1	28.31	1 311	26.88	1 370	15.306	1 291	18.918	1 305
2	28.10	1 371	27.29	1 398	15.468	1 350	17.267	1 358
3	29.02	1 066	28.29	1 062	15.504	1 057	17.657	1 035
4	28.53	421	27.71	315	15.146	409	18.016	292
5	23.89	546	22.42	433	15.527	538	15.988	423
Average	27.92	4 715	26.97	4 578	15.410	4 645	17.774	4 413

Another measure to consider is non-educator personnel expenditure by quintile.² Anecdotal expectation was that such expenditure would be regressive across quintiles, because fee-charging schools have less stringent need to prioritise educator salaries. As Table 2 shows, that is indeed the case with the average in the top two quintiles being almost double that in the lowest three quintiles.

Table 9.2: Non-educator personnel expenditure (2016 rands)

Quintile	2018			2013		
	Mean	Standard deviation	Frequency	Mean	Standard deviation	Frequency
1	831.66	1 135.96	1.371	520.35	637.13	1.335
2	749.43	980.77	1.408	480.98	572.43	1.387
3	918.33	1 194.29	1.067	605.19	879.14	1.079
4	1 539.90	1 825.91	321	1 027.95	1 247.34	427
5	1 480.00	1 354.54	439	1 062.71	1 098.72	552
Average	937.75	1 217.27	4.606	636.05	840.38	4.780

Another measure of resource allocation that is significant for policy purposes is the distribution of expenditure across provinces and quintiles. Table 9.3 shows (for 2013) that there is significant variation within some provinces, but also across provinces. A pattern that is consistent with past literature is that per-pupil personnel expenditure in wealthier provinces (Gauteng and the Western Cape) is substantially higher for higher-quintile schools. In other words, it is regressive.

¹ The differences in real expenditure per learner in 2013 and 2018 suggest large increases. However, a separate analysis shows that, over that period, there was only approximately a 5% real increase in national real per-learner expenditure. The differences in this table may therefore be the result of sample selection or/and data quality issues in the student numbers obtained from the DBE.

² Recall that our definition of non-educator personnel expenditure was all Personnel Salary database (PERSAL) expenditure that was not included in the personnel categories used in the main query. Unfortunately, the dataset did not have rank codes that could have been used to specify different categories of personnel.

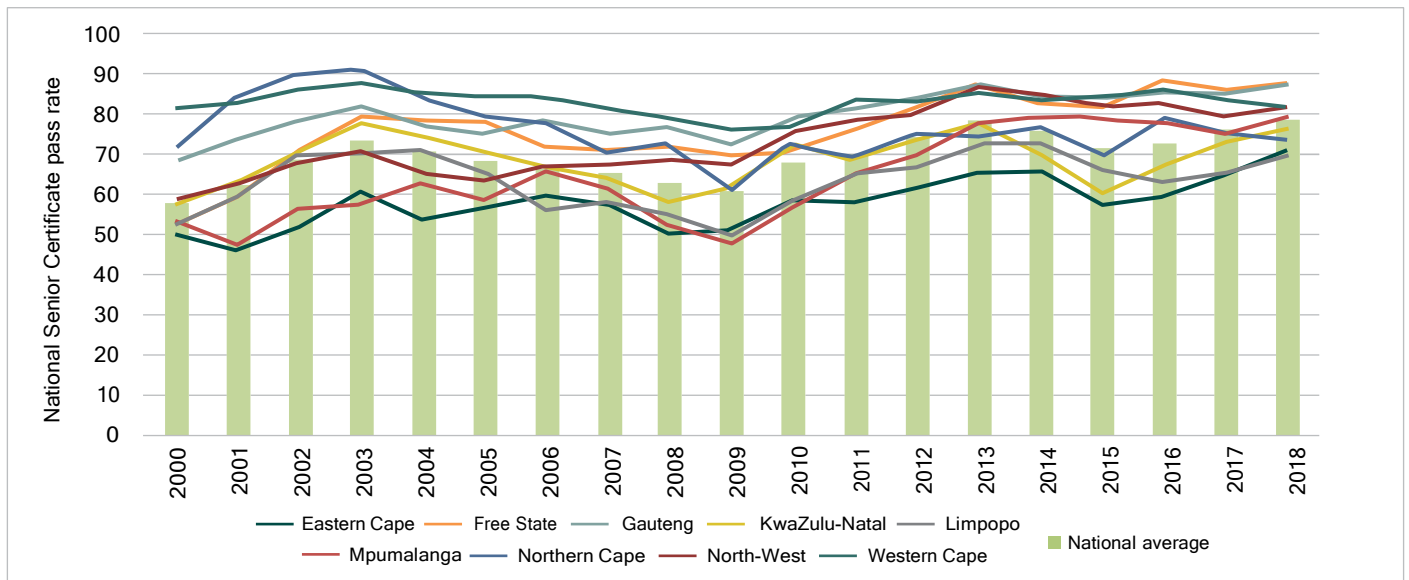
Table 9.3: Per pupil educator expenditure by province and quintile, 2013 (in 2016 Rands)

Province	Quintile					Average
	1	2	3	4	5	
Eastern Cape	9 461.73	11 513.48	12 351.10	11 716.88	12 224.45	11 460.20
	3 104.31	3 899.63	4 520.51	2 141.32	2 239.59	4 094.06
	154	157	302	17	34	664
Free State	13 462.10	12 441.28	12 790.60	12 385.05	12 881.68	12 928.65
	2 984.82	3 187.82	3 573.45	1 697.50	2 391.01	3 048.25
	75	48	54	14	33	224
Gauteng	8 618.01	9 966.74	10 666.77	10 732.47	11 574.55	10 771.92
	3 528.31	1 883.31	2 063.97	2 416.92	1 988.09	2 402.06
	39	56	86	120	178	479
KwaZulu-Natal	9 696.30	10 159.26	10 187.40	10 976.60	11 464.43	10 257.15
	2 670.64	2 635.00	3 182.90	2 175.48	1 869.20	2 727.53
	306	364	278	117	118	1 183
Limpopo	12 614.07	12 562.28	11 737.58	11 367.64	12 212.67	12 450.35
	3 133.97	3 346.80	3 057.61	1 431.15	2 151.09	3 209.61
	491	543	176	11	16	1 237
Mpumalanga	11 192.49	10 814.08	11 071.33	12 607.35	12 385.40	11 168.87
	2 593.61	2 096.16	1 562.02	2 178.44	1 768.61	2 361.61
	174	111	24	16	12	337
Northern Cape	10 335.81	10 804.65	10 272.01	9 974.80	11 176.34	10 528.96
	1 803.21	2 920.80	1 649.21	1 793.29	1 148.23	1 940.15
	10	15	9	22	19	75
North West	11 873.54	11 055.63	10 949.30	11 282.76	11 712.27	11 234.45
	3 986.43	4 205.49	3 437.36	3 984.41	2 434.17	3 790.25
	46	53	85	30	6	220
Western Cape	8 921.87	9 482.09	9 686.84	10 051.35	10 421.78	10 056.27
	1 043.20	1 030.18	1 149.14	1 057.33	1 271.19	1 235.18
	13	23	53	71	131	291
Average	11 220.53	11 422.40	11 282.32	10 868.59	11 418.11	11 284.96
	3 318.59	3 285.62	3 597.47	2 308.40	1 949.21	3 171.96
	1 308	1 370	1 067	418	547	4 710

9.5.2 Educational outcomes

The preceding section provided trends in expenditure and potential inputs into the attainment of education outcomes. This section shows some trends of education outcomes over time and from the data used in the quantitative approach. Figure 9.6 shows the percentage of the matric passes across provinces, relative to the national average. One can notice that the Eastern Cape and Limpopo consistently had pass rates below the national average across the period. The performance of provinces such as KwaZulu-Natal and the Northern Cape tended to regress over the period, while the pass rates in North West tended to improve over time relative to the national average.

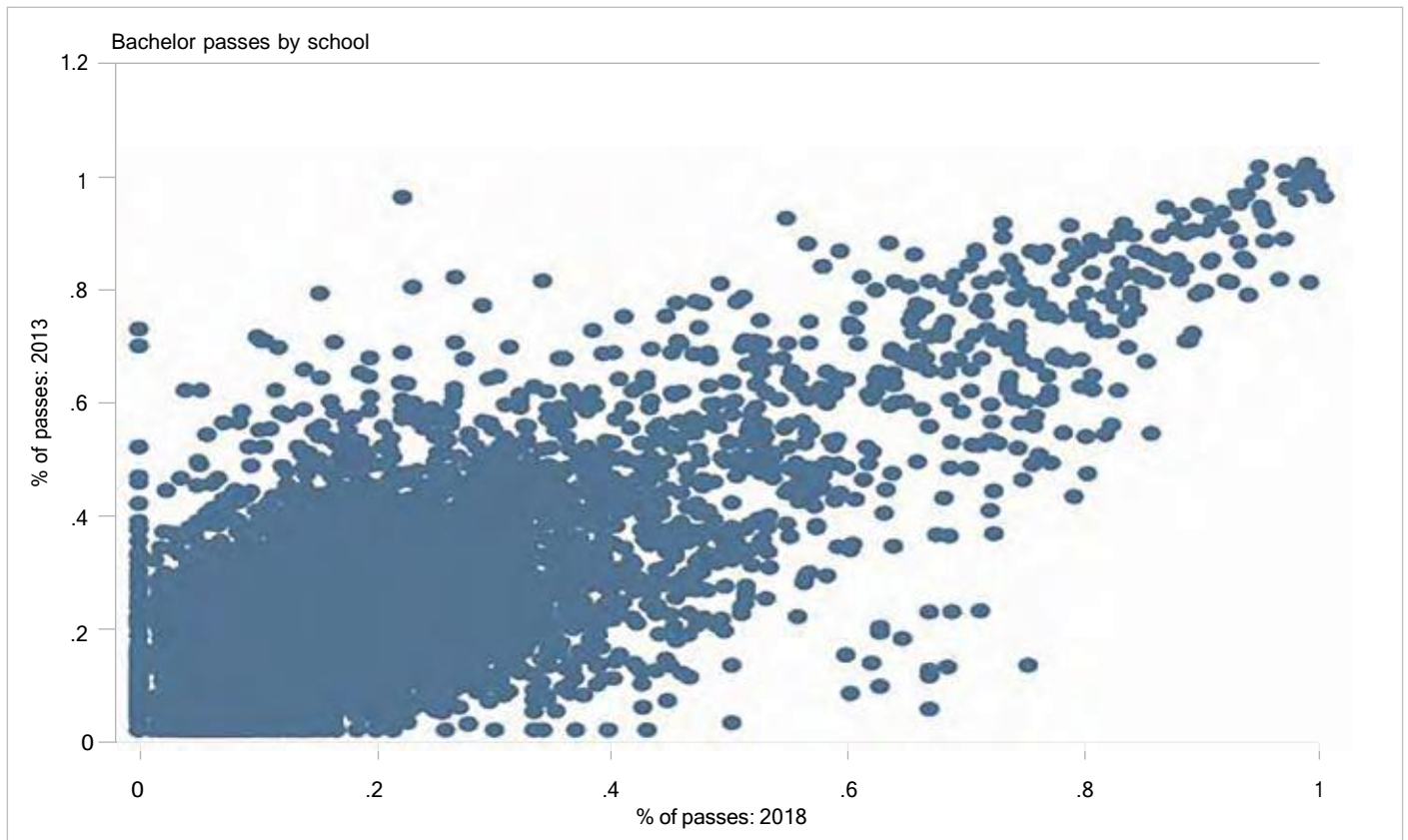
Figure 9.6: National Senior Certificate pass rates by province: 2000 to 2018



Source: Department of Basic Education (2000–2018)

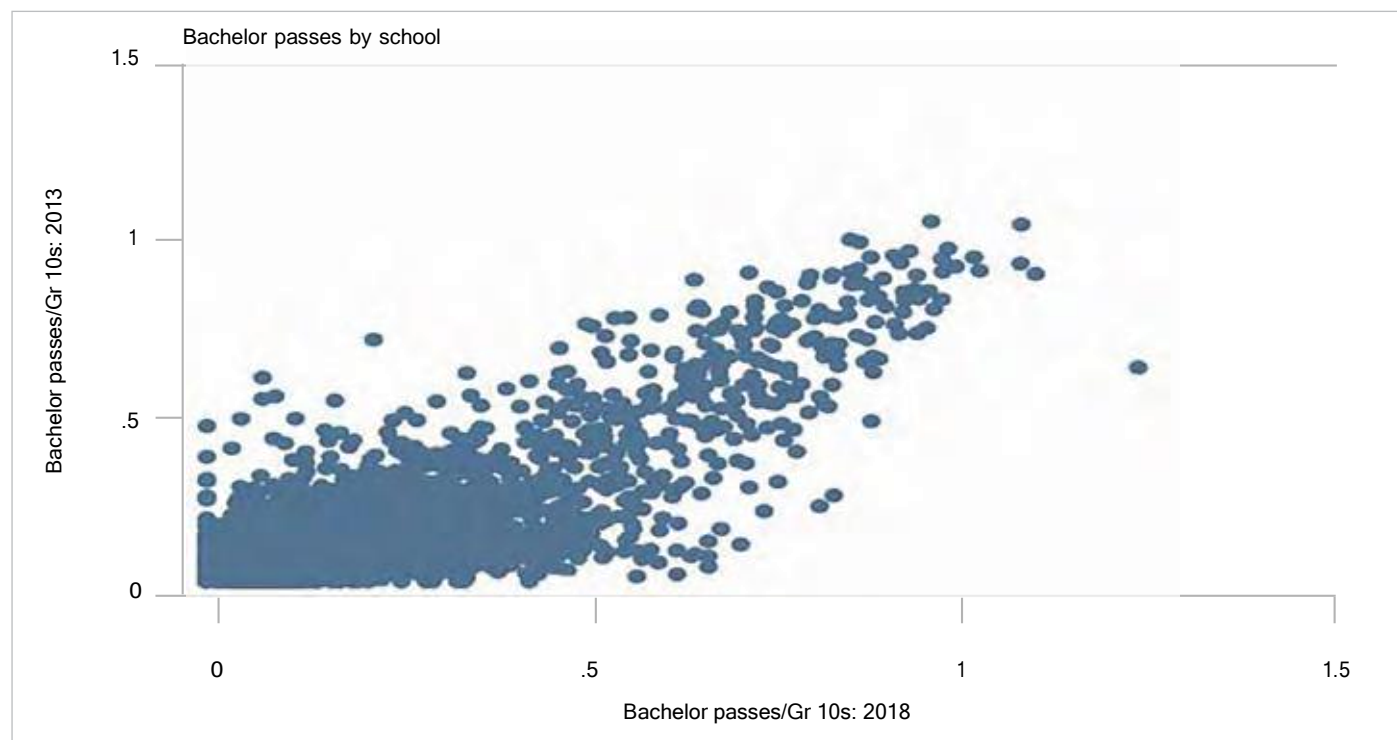
Alongside variations and patterns in resource allocation, one sees even greater variation, but also consistent patterns in measures of educational achievement. Figure 9.7 extends the analysis in Figure 9.6 by comparing the percentage of learners who wrote the NSC examination and obtained bachelor passes in 2013 to 2018, by school. The use of the “bachelor pass” qualification applies a level of “quality” of the pass rates in matric, where such passes allow a pupil university access. The analysis shows that the vast majority of public ordinary schools have bachelor pass rates below 40% in both years, and school “performance” in one year is strongly associated with or predictive of performance five years later.

Figure 9.7: Bachelor passes (percentage of Grade 12 learners)



Using the qualification of “bachelor pass” rates in comparing school performance does not take account of either drop-outs or the possibility that weaker students are not registered for examinations. In order to partially account for this, Figure 9.8 adapts the analysis in Figure 9.7 by expressing NSC bachelor passes as a proportion of Grade 10 students. The scatter plot of that variable in Figure 9.7 shows a similar pattern across years to Figure 9.8.

Figure 9.8: Bachelor passes (percentage of Grade 10 learners)



A strong association between socioeconomic status of schools or learners is reflected in educational achievements by quintile, as shown in Table 9.4. An initial interpretation suggests that the socioeconomic status of learners, proxied here by quintiles, plays a sizeable role in determining educational outcomes, as performance is relatively higher in Quintile 5 schools relative to the other quintiles. That could be through benefits that accrue directly to the learner separately from the school. A simple example would be conducive learning environments at home and assistance from more highly educated parents with school work, or through the school itself, which is better resourced thanks to fees paid by parents of higher socioeconomic status. The trends in Table 9.4 also show unevenness in changes across a five-year period, with little change in the aggregate percentage of bachelor passes in the 5th quintile from 2013 to 2018, but a decline in the other four quintiles over that period, i.e. declining performance over the period in non-Quintile 5 schools.

Table 9.4: School performance across quintiles

Quintile	Bachelor passes (percentage)			
	2018		2013	
	Mean	Number of schools	Mean	Number of schools
1	15.8	1395	18.7	1395
2	17.1	1431	20.5	1431
3	19.2	1127	20.8	1127
4	29.2	453	31.8	453
5	51.4	569	51.6	569
Average	22.2	4975	24.7	4975

9.5.3 Examining the link between resources and outcomes – Stochastic frontier analysis

This section provides a summary of the SFA method used to estimate efficiency in resource use across schools. As mentioned, the SFA method is a statistical method that estimates school “production” relative to its resource use. It allows one to determine how well a school uses its existing resources relative to its outputs. For the purposes of the modelling, school output was given by the total number of bachelor passes achieved per school over the total number of Grade 10 pupils for a particular year. This measure accounts for the quality of passes (bachelor level passes) and crudely accounts for drop-out rates (using total Grade 10 pupils). Total real non-personnel expenditure per pupil, total real personnel expenditure per pupil and the PTRs per school were used as “inputs” in the model. The model also controlled for the socioeconomic characteristics of schools by including school quintile dummies.

Four estimations were undertaken to determine the impact of resource use on outcomes and to compute the efficiency of resource use. The first two estimations simply looked at the impact of resource use (inputs) in the form of the two expenditure variables and the PTR on outcomes, while the last two models included quintile dummies to potentially account for socioeconomic differences across schools. In terms of the results of the former, across all models, a higher PTR was associated with worse school outcomes. This suggests that better school performance is associated with a lower number of pupils being taught by a teacher.

Both the non-personnel expenditure and the personnel expenditure variables have a negative impact on school outcomes (pass rates). The coefficients on the expenditure variables, however, reflect the need for caution and nuance in interpretation. On the face of it, one might then conclude that higher expenditure is associated with substantially worse performance. It is useful to understand why that would be a mistake. The most progressive component of education expenditure is the allocations based on the quintile system: by virtue of the formula, it is necessarily the case that higher non-personnel expenditure is associated with lower socioeconomic status of learners. Since it is widely accepted that lower socioeconomic status is associated, on average, with lower educational outcomes, it follows that, in the South African context, one would expect to find the non-personnel expenditure associated with worse outcomes.

An additional challenge in interpretation is that the estimated coefficients represent associations that are conditional on other variables included in the model. Consider the negative coefficient on the public personnel expenditure variable. For that component of expenditure, there is no explicitly progressive formula and, indeed, a number of studies have raised concerns that personnel expenditure unduly favours higher-quintile schools. However, if one interprets the coefficient as representing the association conditional on the PTR, the interpretation is more complicated: given a particular PTR, more public personnel expenditure is associated with lower outcomes. In this more nuanced reading, the coefficient could reflect unmeasured socioeconomic variables: schools with lower public personnel expenditure for a given PTR may be raising the funds from private sources (notably school fees) and therefore have students from higher socioeconomic backgrounds. As mentioned in Section 9.1.4, the analysis was significantly constrained by the availability and quality of the datasets received. As such, it was not possible to account for the many complex variables that capture the socioeconomic statuses and backgrounds of pupils in schools, as well as school infrastructure conditions and quality. It is likely that these unobserved factors are impacting on the analysis.

While the data constraints and their implications for the analysis are emphasised, the modelling framework offers a sense of the efficiency of the resource use across schools, if not being able to fully quantify the level of efficiency. Table 9.5 shows the average efficiency scores generated from each of the models for 2013 and 2018 across the different school quintiles. Overall, average efficiency across both periods and across the models appears to be similar, ranging from 59% to 61% on average. In the first two models that estimate a basic production function of traditional school inputs and output (not accounting for socioeconomic differences across schools), one can notice a greater variation in the estimated efficiency

scores across the different school quintiles. In 2013, the average efficiency score for Quintile 1 schools was 0.55 in both basic models, with a progressive increase in efficiency levels with higher quintiles. Quintile 5 schools had the highest efficiency score at 0.68, followed by Quintile 4 schools at 0.65. These results can be impacted on by the absence of factors that take the socioeconomic statuses of schools into account.

The efficiency results of the basic school production function models therefore appear to support the notion that higher-quintile schools are more efficient than lower-quintile schools, but, at least in the simple models, this is likely to be misleading. The expanded models represented in columns 3 and 4 attempt to better account for the differences in operating circumstances across the different school quintiles. Even with the significant limitations of using only quintiles as environmental variables to proxy for socioeconomic factors, the efficiency scores of lower-quintile schools increase, on average, while the efficiency scores of higher-quintiles schools decrease on average. As a result, differences in school efficiency and productivity are less pronounced than in the basic models.

Table 9.5: Average efficiency scores by quintile

School type	General time varying model – simple model	Time varying true random effects – simple model	General time varying model – expanded model	Time varying true random effects – expanded model
	Efficiency score 2013			
Quintile 1 School	0.55	0.55	0.60	0.60
Quintile 2 School	0.57	0.58	0.60	0.61
Quintile 3 School	0.59	0.60	0.60	0.61
Quintile 4 School	0.64	0.65	0.59	0.60
Quintile 5 School	0.68	0.68	0.60	0.61
Average score	0.61	0.61	0.60	0.61
	Efficiency score 2018			
Quintile 1 School	0.55	0.54	0.59	0.59
Quintile 2 School	0.57	0.57	.060	0.60
Quintile 3 School	0.59	0.59	.060	0.59
Quintile 4 School	0.64	0.64	.058	0.58
Quintile 5 School	0.68	0.68	0.59	0.59
Average score	0.61	0.60	0.59	0.59

Comparison of efficiency scores over the two periods does not suggest any notable change in the magnitude of average efficiency over time, suggesting stagnant productivity in education over the five-year period. Figure 9.9 offers a comparison of distributions across both years for the efficiency scores generated from the expanded models in Column 4. Recall the suggestion that this model better captures social, economic and demographic factors in the generation of efficiency scores. Therefore, the results in Figure 9.9 should provide a better depiction of efficiency changes from 2013 to 2018. The efficiency scores at the lower end to the middle of the efficiency distribution appear similar, suggesting no changes in efficiency across both periods at these levels. There appears to be a slight reduction in the density at the upper end of the distribution, suggesting that there tended to be a slight decrease in the efficiency of schools performing relatively well from 2013 to 2018, but the overall picture is very similar in terms of school productivity and efficiency across both periods.

Figure 9.9: Histograms – comparison of efficiency scores: 2013 and 2018 expanded true random effects

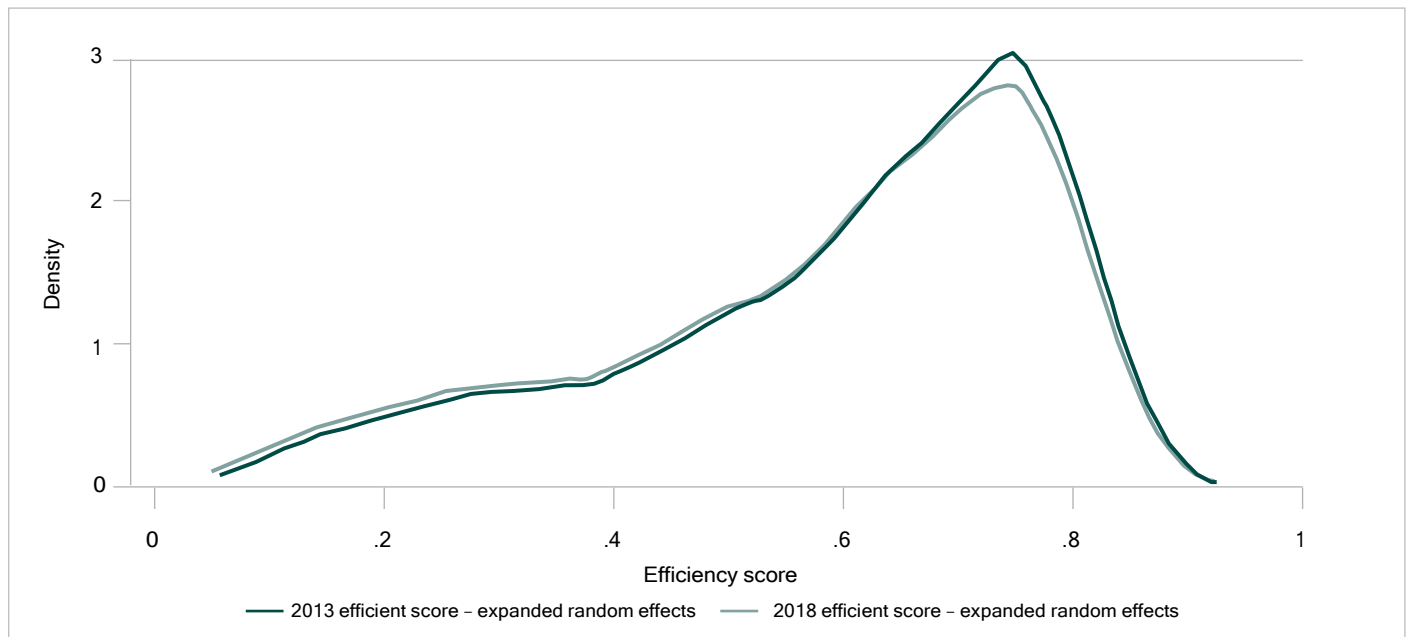
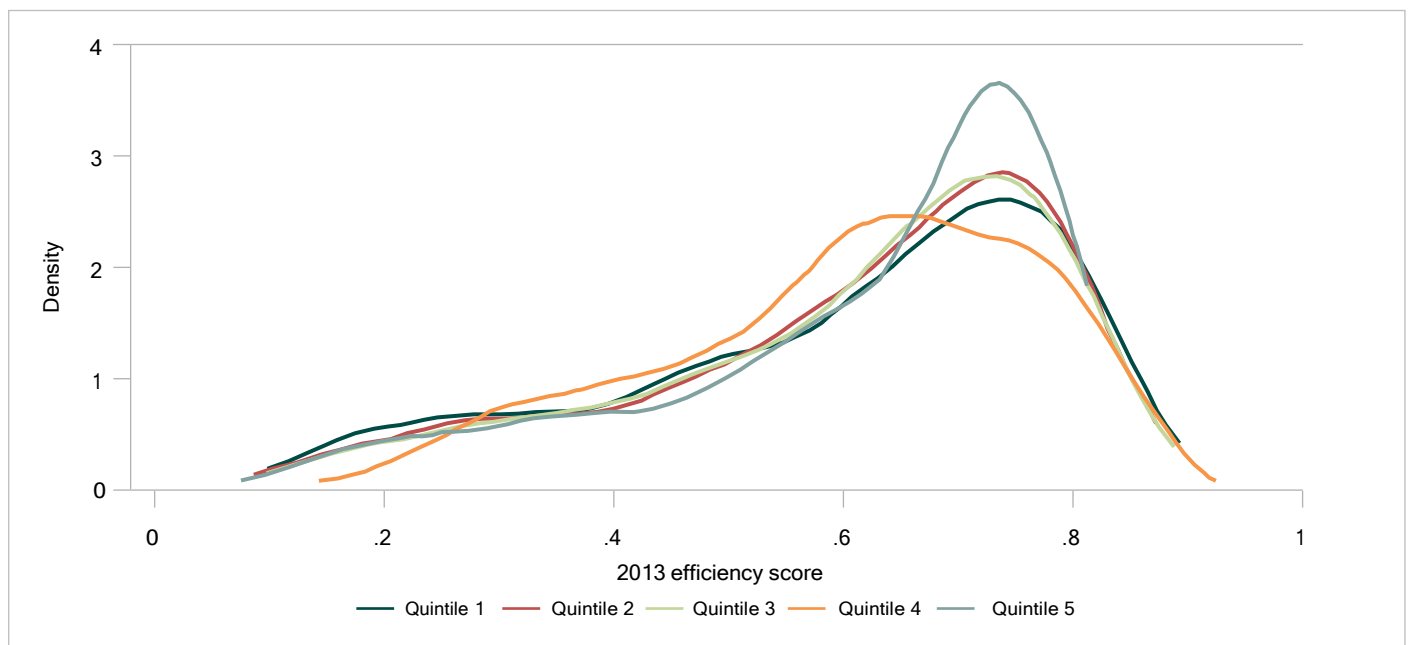


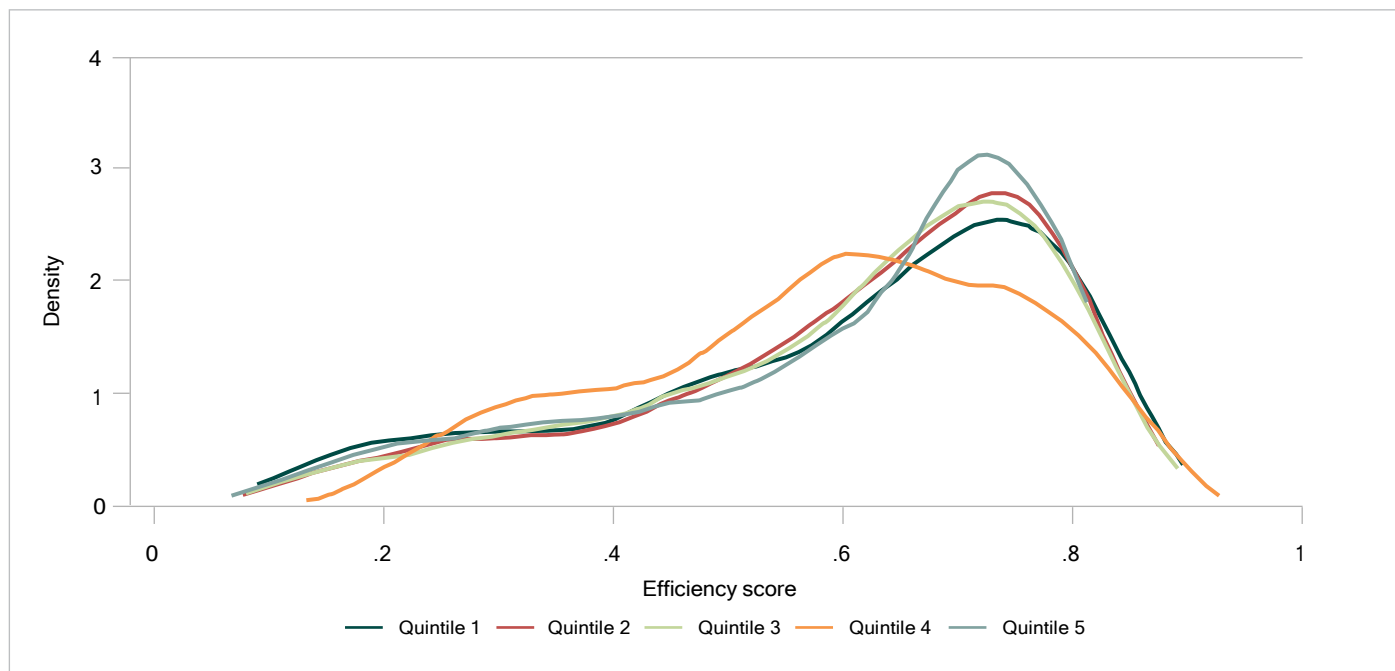
Figure 9.10 illustrates the distribution of efficiency scores generated from the “expanded” model for 2013 for each of the school quintiles. This allows for the comparative analysis of the performance of schools using the efficiency scores generated as an indicator. The distributions of efficiency scores are not dramatically different across quintiles, but there are some clear differences in shape. Quintile 4 schools are relatively under-represented at the lower and higher levels of estimated efficiency compared to those in other quintiles, while Quintile 5 schools are more likely to be at the higher levels of the distribution, but also (to a lesser degree) at the lower end.

Figure 9.10: Histograms by quintile – 2013 efficiency scores from the expanded true random effects model



A similar pattern can be observed for 2018.

Figure 9.11: Histograms by quintile – 2018 efficiency scores from the expanded true random effects model



9.5.4 The foundation of a framework for prioritising spending on basic education

Alongside the need to use public resources as efficiently as possible is the need to prioritise the services underpinning the justiciable socioeconomic rights enshrined in the Constitution. Without commenting on the aspect of adequacy, it is clear from the preceding analysis that a substantial share of national resources is allocated to basic education. The fiscal constraints facing South Africa mean that wide-ranging, real cuts and/or slower growth are probable across a number of sectors over the next few years. The question is how then do we ensure that, despite these developments, we protect our constitutionally enshrined socioeconomic rights?

Human rights literature provides guidance on how this can be done. It centres on the idea of protecting the core or essential elements associated with a right, be it education, or any other socioeconomic right. The logic is that, even in times of fiscal constraint, governments must strive to protect spending on these essential elements. The identification and protection of these essential elements help to clarify a level below which, spending on socioeconomic rights will not be compromised. A strong link is thus envisaged between budget decisions and the realisation or maintenance of access to socioeconomic rights. This section of the chapter thus proposes using a socioeconomic rights lens to first identify the essential components associated with the right to basic education and then use those components to develop a budget prioritisation framework that seeks to guide decision makers, particularly during times of fiscal constraint.

Evidence from South Africa's public health sector proves that it is possible to protect spending on key items during a period of fiscal constraint. In 2012, the Minister of Health implemented a set of budget non-negotiables to protect national priorities in provincial budgets. Schreiber quotes the then Minister of Health (Minister Aaron Motsoaledi) as defining the non-negotiable items as "...things that can never be negotiated – if they were not there, it could not be said that there is a functioning health system in the country" (Schreiber, 2018). As is the case with all concurrent functions, while the Minister of Health did not have the authority to direct how provincial health departments utilise their unconditional equitable share allocation, the approach was to set standards or norms and find ways to persuade provincial health

departments to comply (Schreiber, 2018). As confirmed in Chapter 3 of the 2017 South African Health Review, implementing the concept of non-negotiable budget items as part of a broader package to protect health spending during a period of fiscal constraint worked – analysis shows that the “...non-negotiable items were above overall growth in the provincial health departments, indicating that they have indeed been relatively protected” (Blecher et al., 2017, p. 31).

What complicates this matter in the case of basic education is that the South African Constitution does not define the right to basic education, let alone what the essential elements should entail. However, by drawing from human rights literature, South African education legislation, applicable case law and inputs from education experts and practitioners, it is possible to flesh out a skeleton of what the essential elements ought to be. Given the provision in section 39 of the Constitution that allows international law to be used when interpreting socioeconomic rights, and as has been done by various authors, this analysis uses the 4 A scheme developed by Tomasevski (2001) as an analytical framework (Veriava and Paterson, 2020; Skelton, 2013; Merabe, 2015). The 4 A scheme is grounded in international law and incorporates what most of the covenants to which South Africa is signatory require countries to focus on when it comes to education. The 4 A’s cover the themes of availability, accessibility, acceptability and adaptability – each of these elements have sub-themes, which further define the essence of each of the A’s (see Table 9.6). For example, the aspect of availability is given further expression through various sub-themes, including infrastructure and teachers.

Table 9.6: Essential components associated with the right to education as per the 4 A scheme

Availability	Accessibility	Acceptability	Adaptability
Government-funded education system	Education is not discriminatory	The content of education is non-discriminatory	
Adequate infrastructure	Education is made accessible to all by addressing economic and physical barriers	The content is culturally appropriate	Education is flexible and able to respond to the different needs of children
Trained teachers able to provide an education	Positive steps are taken to include the most marginalised communities and children	Education is of a sufficiently high quality	Education is able to respond to the changing needs of society
Learner-teacher support materials		The school environment is safe	

Source: Tomasevski (2001)

Following from the guidance provided by the 4 A scheme, the elements of education infrastructure, teachers, learner-teacher support materials, funding for the poorest and most vulnerable (economic accessibility), learner transport, learner safety, overall quality and inclusive education are the initial elements deemed especially important in the case of the right to basic education.

Following from this, there are various South African court rulings that confirm the importance of a number of the initial essential elements listed above. These are summarised in Table 9.7 and highlight, in particular, the intrinsic importance of the provision of infrastructure, teachers, learner-teacher support materials, learner transport and special needs education in protecting the right of learners to a basic education.

Table 9.7: Summary of relevant court cases and rulings

Area	Court Ruling
Infrastructure	Concerning infrastructure, the 2019 case of <i>Equal Education and Another versus Minister of Basic Education and Another</i> , the court held that the provision of safe and decent infrastructure is “indisputably [an] integral component of the right to basic education”.
Teaching, non-teaching staff and learner-teacher support materials	In the 2013 outcome of the <i>Centre for Child Law vs Minister of Basic Education</i> case, the court found that the provision of teaching, non-teaching staff and teaching resources are critical to extending the right to basic education. In 2014, the <i>Basic Education for All vs Minister of Basic Education</i> case that arose due to the late delivery of textbooks in Limpopo found that, central to the right to education, is that each learner should have a textbook for each subject at the beginning of the school year.
Learner-teacher support materials	Also in 2014, the outcome of the <i>Madzodzo vs Minister of Basic Education</i> case (which arose as a result of the failure of the Eastern Cape provincial education department to provide age- and grade-appropriate furniture), the court indicated that the right to education requires a range of educational resources, which includes schools, classrooms, teachers, teaching materials and appropriate facilities for learners.
Learner transport	The <i>Tripartite Steering Committee vs Minister of Basic Education</i> case, which was heard in 2015, found that transport for learners who live far from a school or who cannot afford the cost of transport, must be provided at the state’s expense.
Special needs education	In the <i>Western Cape Forum for Intellectual Disability vs Government of RSA</i> , the state’s failure to adequately fund and provide equal education opportunities for learners with disabilities was recognised. This gave rise to the establishment of the <i>Learners with Profound Intellectual Disabilities conditional grant</i> in 2017/18.

Given that the aforementioned elements are highlighted in international agreements (via the 4 A scheme) and various legal precedents have been set regarding their importance, the next step was to seek advice from various stakeholders in the education field. Generally, the stakeholders interacted with agreed with the centrality of the items viewed as essential. Additional points raised included advice on specific elements that require emphasis, as well as how some of the essential elements could be practically linked to the budget and spending programmes of provincial education departments. These included the following:

With respect to infrastructure, water, sanitation and appropriate classrooms should receive relatively higher priority than other aspects of education infrastructure such as sports facilities. This does not mean to imply that sporting, laboratory and library facilities are not important – indeed, they play a critical role in promoting the health of learners and producing learners that can adapt to the changing needs of society. Rather, the contention is that if choices are limited, preference should be placed on the most essential infrastructure.

In terms of supporting the aspect of quality of education, emphasis should be placed on providing disproportionately more resources to early learning and the overall foundation phase of schooling, especially in the areas of reading and writing.

To capture the element of economic accessibility and therefore the provision of funding to the poorest, most vulnerable learners, emphasis should be placed on the annually gazetted per-learner amounts determined by the national Department of Basic Education.

Taking into consideration the aspects outlined above, Table 9.8 outlines the proposed essential elements associated with the right to basic education, alongside the relevant education legislation, policy or regulations that exist in South Africa. Also included are the applicable court rulings that serve to further confirm the recognition of these elements as essential to the right to a basic education. Finally, Table 9.8 makes a proposal on where in the budget these items find expression.

Table 9.8: Linking the proposed essential elements to the budget

ICESCR: 4 A scheme	RSA policy, legislation, regulation	RSA case law	Proposed essential component: expression in education budgets
1. Availability			
Infrastructure	Minimum Norms and Standards for School Infrastructure	Madzodzo vs Minister of Basic Education, 2014	Spending on educational infrastructure, specifically water, sanitation and inappropriate structures
Teachers	Employment of Educators Act	Centre for Child Law vs Minister of Basic Education, 2013	Spending on personnel
Learner-teacher support materials	Draft Policy for Provision and Management of Learner-teacher Support Materials	Basic Education for All vs Minister of Basic Education, 2014	Spending on learner-teacher support materials forms part of the annually gazetted per-learner amounts
2. Accessibility			
Economic accessibility	SA School Funding Norms and Standards		Spending on most vulnerable (Quintiles 1, 2 and 3) via the per learner funding amounts gazetted annually
Physical, geographical accessibility	National Learner Transport Policy	Tripartite Steering Committee vs Minister of Basic Education, 2015	Public and/or scholar transport is listed as an item that may be funded using the annually gazetted per-learner amount
3. Acceptability			
Quality	Curriculum Assessment Policy Statements	No court cases to report	Spending disproportionately on Early Childhood Development and the Foundation Phase - emphasis on reading and writing
Safety	Section 28 of the Constitution on the rights of the child	No court cases to report	An element of safety (security services) can be financed using the annually gazetted per-learner amount (School Funding Norms and Standards)
4. Adaptability			
Inclusive education system	White Paper 6: Building an Inclusive Education and Training System	Western Cape Forum for Intellectual Disability vs Government of RSA	Spending on inclusive education/ special needs education

Following on from Table 9.8, the per-learner amount is particularly important – not only does it include the elements mentioned above, it is also central to the government’s no-fee policy. In accordance with the National Norms and Standards for School Funding, the education sector uses a quintile-based approach to funding learners, whereby Quintile 1 includes the neediest schools and Quintile 5 relates to the most affluent schools. If a school is declared a no-fee school, compulsory school fees may not be charged and the school is placed in one of the five national quintiles. According to the Norms and Standards, learners in Quintile 1, 2 and 3 schools should not pay school fees. The school then receives a per-learner allocation aligned to the gazetted per-learner amounts determined by the Minister of Basic Education on an annual basis. In terms of the annually gazetted per-learner amounts, learners in Quintile 1 to 3 are funded relatively more than those based in Quintile 4 and 5 schools. The per-learner allocations are essentially aimed at providing funding for non-personnel, non-capital items of spending and, as outlined above, this must be used to pay for learner-teacher support materials, school utility bills and a host of other items, as outlined in Table 9.9.

Table 9.9: Outline of items that per-learner amounts can be used to fund

Category of spend	Example
Learner support material	Textbooks, library books, charts, models, computer hardware and software, television sets, video recorders, Home Economics equipment, science laboratory equipment, musical instruments, learner desks and chairs
Non-learner support material equipment	Furniture (excluding learner desks and chairs), paper copier machines, telephones, fax machines, intercom systems, equipment for connectivity within the school and to the internet, hardware tools, cleaning equipment, first aid kits, overalls for cleaners and grounds staff, sporting equipment, electrical accessories
Consumable items of an educational nature	Stationery for learners
Consumable items of a non-educational nature	Stationery for office use, paper, cleaning materials, petrol, food
Services relating to repairs and maintenance	Building repair work, equipment repairs and maintenance, light bulbs
Other services	Television licences, internet service providers, school membership of educational associations, postage, telephone calls, electricity, water, rates and taxes, rental of equipment, audit fees, bank charges, legal services, advertising, security services, public or scholar transport, vehicle hire, insurance, copying service

Source: Republic of South Africa, 2006, p. 27

Table 9.10 outlines the per-learner amounts over the period 2014 to 2021. Given the effect of the COVID-19 pandemic and the need for government to focus spending on responding to and managing the impacts of the pandemic, the per-learner amount was not adjusted in 2021.

Table 9.10: Annual per-learner thresholds

Year	Quintiles 1-3	Quintile 4	Quintile 5
2014	R1 059	R530	R183
2015	R1 116	R559	R193
2016	R1 177	R590	R204
2017	R1 243	R623	R215
2018	R1 316	R660	R228
2019	R1 390	R697	R241
2020	R1 466	R735	R254
2021	R 1 466	R735	R254

Source: Department of Basic Education, 2014–2021

While provinces are meant to use these amounts as a minimum threshold below which they do not fund, the following, based on tables 9.11, 9.12 and 9.13 is noted:

- KwaZulu-Natal has been funding all quintiles below the national threshold since 2014
- The Northern Cape has funded its Quintile 1 to 3 learners below the national threshold amount since 2015
- Mpumalanga has funded all quintiles below the national threshold amount since 2016
- As at 2021, the Eastern Cape is funding all quintiles below the nationally determined threshold amounts

Table 9.11: Provincial per-learner funding relative to the nationally set threshold, 2014–2016

Province	2014			2015			2016		
	Quintile 1–3	Quintile 4	Quintile 5	Quintile 1–3	Quintile 4	Quintile 5	Quintile 1–3	Quintile 4	Quintile 5
Eastern Cape	R1 059	R530	R183	R1 059	R530	R183	R1 177	R590	R204
Free State	R1 059	R530	R240	R1 116	R559	R240	R1 177	R590	R240
Gauteng	R1 059	R530	R530	R1 116	R559	R559	R1 177	R590	R590
KwaZulu-Natal	R932	R509	R175	R955	R522	R179	R955	R522	R179
Limpopo	R788	R395	R136	R646	R320	R130	R1 102	R590	R204
Mpumalanga	R1 059	R530	R183	R1 116	R559	R193	R1 010	R503	R173
Northern Cape	R1 059	R631	R294	R1 070	R662.51	R309.13	R1 125	R698.16	R326.20
North West	R1 059	R605	R183	R1 116	R605	R193	R1 177	R605	R204
Western Cape	R1 059	R567	R244	R1 116	R595	R269	R1 144	R573	R198
National threshold	R1 059	R530	R183	R1 116	R559	R193	R1 177	R590	R204

Source: Department of Basic Education, 2014–2016

Table 9.12: Provincial per-learner funding relative to the nationally set threshold, 2017–2019

Province	2017			2018			2019		
	Quintile 1–3	Quintile 4	Quintile 5	Quintile 1–3	Quintile 4	Quintile 5	Quintile 1–3	Quintile 4	Quintile 5
Eastern Cape	R1 177	R590	R204	R1 316	R660	R228	R1 390	R697	R241
Free State	R1 243	R623	R240	R1 316	R660	R240	R1 390	R697	R241
Gauteng	R1 243	R623	R623	R1 316	R660	R660	R1 390	R697	R697
KwaZulu-Natal	R955	R522	R179	R955	R522	R179	R955	R522	R179
Limpopo	R1 241	R621	R205	R1 316	R660	R228	R1 390	R697	R241
Mpumalanga	R1 059	R530	R183	R1 285	R650	R226	R1 340	R679	R235
Northern Cape	R1 177	R736	R346	R1 243	R778.38	R366.35	R1 134	R734	R345
North West	R1 243	R623	R215	R1 316	R660	R228	R1 390	R697	R241
Western Cape	R1 243	R993	R369	R1 316	R1 055	R390	R1 390	R1 129	R376
National threshold	R1 243	R623	R215	R1 316	R660	R228	R1 390	R697	R241

Source: Department of Basic Education, 2017–2019

Table 9.13: Provincial per-learner funding relative to the nationally set threshold, 2020–2021

Province	2020			2021		
	Quintile 1–3	Quintile 4	Quintile 5	Quintile 1–3	Quintile 4	Quintile 5
Eastern Cape	R1 466	R735	R254	R 870	R436	R151
Free State	R1 466	R735	R254	R1 536	R770	R266
Gauteng	R1 466	R735	R735	R1 466	R735	R735
KwaZulu-Natal	R955	R522	R179	R 955	R522	R179
Limpopo	R1 466	R735	R254	R1 536	R770	R266
Mpumalanga	R1 370	R692	R240	R977	R486	R168
Northern Cape	R1 134	R765	R354	R1 247	R845.33	R392.89
North West	R1 466	R735	R254	R1 536	R770	R266
Western Cape	R1 466	R1 200	R395	R1 536	R1 267	R417
National threshold	R1 466	R735	R254	R1 466	R735	R254

Source: Department of Basic Education, 2020–2021

While the per-learner amount encompasses a number of the elements that can be considered essential to the right to basic education, it is clear from the above example that this funding instrument is characterised by a number of challenges, including personnel payments that negatively impact upon the ability of provincial departments to align funding with national threshold amounts. From a human rights perspective, it is important to protect spending on public services underpinning socioeconomic rights. However, this cannot be done without due consideration of the challenges that might hamper those various spending items, and which may serve to undermine the potential benefits of protecting existing or increased levels of funding.

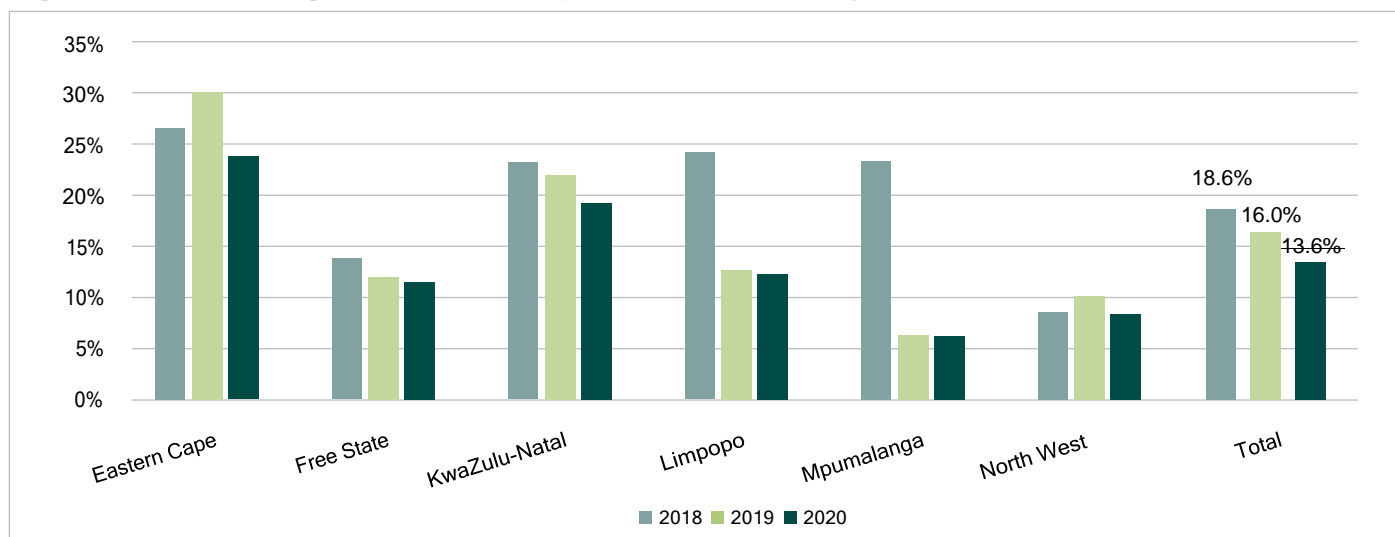
A similar example can be made with respect to the funding instruments and implementation processes surrounding education infrastructure. While education infrastructure has the ability to augment the quality of education and its outcomes, particularly through facilitating better instruction, improving learner outcomes and reducing drop-out rates (Barrett et al., 2019; Teixeira et al., 2017), in South Africa, this area is characterised by a lack of compliance with government's infrastructure norms and standards. The minimum norms and standards for educational infrastructure were endorsed in 2013, obligating the government to provide various types of infrastructure within specified timeframes (see Table 9.14).

Table 9.14: Education infrastructure targets as contained in the norms and standards on school infrastructure

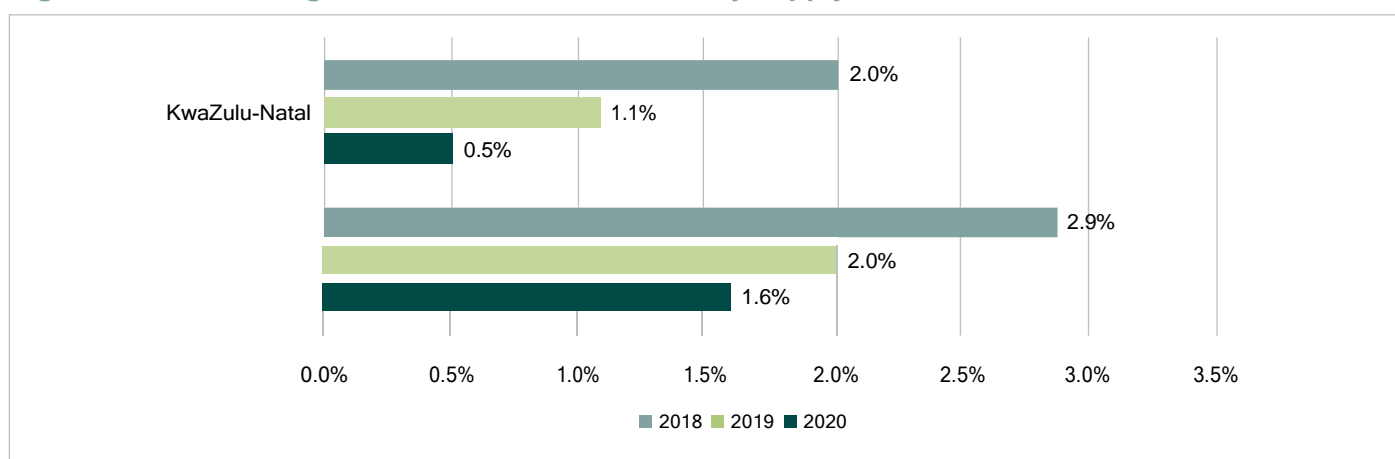
Dimension of infrastructure	Implementation timeframe	Anticipated date for achievement
All schools built entirely from mud, asbestos, metal or wood	Three years from date of publication (end of 2013)	2016
All schools that do not have access to any form of power supply, water supply or sanitation		
The availability of classrooms, electricity, water, sanitation, electronic connectivity, perimeter security	Seven years from date of publications (end of 2013)	2020
Libraries and laboratories for science, technology and life sciences	Ten years from date of publication (end of 2013)	2023
Compliance with all other norms and standards	Before 31 December 2030 (end of 2013)	

Source: Department of Basic Education, 2013

An assessment of school infrastructure delivery data (see Figure 9.12, Figure 9.13 and Table 9.15) highlights the delays in the government's compliance with the infrastructure norms and standards. While progress is noted in respect of declines in those schools that have pit latrines as their only source of sanitation (see Figure 9.12), the very existence of pit latrines runs contrary to the provision of high-quality, safe and dignified education, and therefore supports the suggestion referred to elsewhere in this chapter to provide relatively more priority to spending on water and sanitation. A discussion on public infrastructure is incomplete without reflecting on government's long-standing challenge around efficiently and effectively managing these types of projects, a problem that is not unique to the basic education sector. In rolling out infrastructure projects, government departments often rely on numerous implementing agents and consultants who are not incentivised to keep to time and cost guidelines. Coupled with limited oversight by sector departments, this type of delivery model easily gives rise to irregularities and fiscal misappropriation.

Figure 9.12: Percentage of schools with pit latrines as the only source of sanitation, 2018 to 2020

Source: Commission's calculations based on DBE NIEMS Reports, 2018–2020

Figure 9.13: Percentage of schools without electricity supply, 2018 to 2020

Source: Commission's calculations based on DBE NIEMS Reports, 2018–2020

Table 9.15: Percentage of schools without access to sports, laboratories and library facilities, 2018–2020

Province	Percentage of schools without sports facilities			Percentage of schools without laboratory facilities			Percentage of schools without library facilities		
	2018	2019	2020	2018	2019	2020	2018	2019	2020
Eastern Cape	61.62	64.54	64.54	66.78	93.08	93.06	92.99	92.19	92.19
Free State	30.96	29.7	29.7	71.96	69.83	69.74	63.29	50.88	51
Gauteng	22.56	22.53	22.53	66.67	76.84	66.57	36.76	36.15	36.15
KwaZulu-Natal	54.5	54.35	54.28	88.58	88.51	88.51	75.82	73.44	73.44
Limpopo	32.34	32.51	32.51	88.58	94.00	94	93.48	83.81	92.93
Mpumalanga	28.45	29.19	30.13	87.64	87.62	87.47	80.76	56.98	79.21
Northern Cape	30.68	31.07	31.62	80.04	76.84	76.47	68.95	61.78	60.82
North West	25.56	25.53	25.53	80.37	79.85	79.85	76.01	51.08	74.38
Western Cape	25.19	25.12	25.03	66.78	66.32	66.02	44.78	37.54	37.54
Total	34.64	34.95	35.1	81.02	80.29	80.19	70.31	74.18	74.16

Source: Commission's calculations based on DBE NIEMS Reports, 2018–2020

The point of presenting greater detail around the per-learner amount, as well as education infrastructure, is to emphasise that a number of the items that fall within the essential elements list are characterised by various challenges – be it spending, implementation or coordination challenges. Thus, the point of this chapter is not to recommend that no essential items should be cut or that essential items need to be indiscriminately protected, irrespective of the fiscal position in which South Africa finds itself. Rather, it is to highlight the critical spending elements, from a human rights perspective, and propose that those elements are not only protected, but are also used to guide prioritisation within the sector. More importantly, the analysis conveys the need to ensure that the inefficiencies that could be hampering spending on essential elements need to be identified and addressed if the full range of benefits possible from this spending is to be realised.

9.6 Conclusion and recommendations

The Commission acknowledges the need for fiscal consolidation in the face of a tight fiscal framework and the range of economic shocks that have impacted on the economy. While this is a necessary requirement to protect the state's long-term finances, the government has the equally important obligation to ensure that its role in the economy through the delivery of key social and basic services is maintained. This ensures that citizens' rights to basic social necessities are maintained. However, in the face of resource constraints, there is a possibility that the ability to maintain the required standard of service delivery might be compromised, thus raising concerns about the ability of the government to ensure that the socioeconomic rights to key social services, such as basic education, are maintained. While the Commission has brought attention to the potential impact of budget cuts on maintaining the socioeconomic right to basic education, it is also important, in the face of such budget constraints, to investigate how the current use of resources can be improved to maintain the required standards. Therefore, assessing the efficiency of current resource use in basic education provision is imperative in assessing how the sector can deal with budget constraints and whether it is possible to maintain education delivery standards.

The first part of this chapter attempted to link resource use in basic education to education outcomes so as to measure the efficiency of basic education spending. This was done through a combination of descriptive statistics with an econometric methodology in the form of the SFA. While the analysis was constrained due to a lack of quality and frequency of the data, the results suggest that there is room for improvement in the use of the current level of resources. It is important to note that the analysis in this chapter does not address the issue of adequacy, which is a critically important, but separate issue. This chapter focuses on value for the money that is currently being invested in basic education, and understanding whether there is room to improve the efficient use of those resources. This type of analysis is particularly important, given the existing fiscal constraints facing government and the high probability that education budgets may face real reductions and/or slower growth over the medium term. Unfortunately this type of analysis is data intense, and accessing credible public sector data has proven challenging.

The second part of this chapter initiated a discussion on how to protect the socioeconomic rights contained in the Bill of Rights in a fiscally constrained environment. Using a socioeconomic rights lens, this section outlined a list of essential elements associated with the right to a basic education. The reality, however, is that these essential elements are fraught with implementation and other challenges, which would mean that additional funding may not have the intended impact or outcome. So, while it is important to include socioeconomic rights considerations in budgeting and spending decisions, these should not be considered separately from value for money or other relevant aspects, including, for example, implementation challenges. To be clear, the use of a socioeconomic rights lens for budgeting and ensuring the protection of socioeconomic rights, does not imply that cuts should never happen. Appropriate budget responses must be implemented in the event of inefficiencies, duplication or any other valid reason. This chapter thus develops the beginnings of a framework that can be used to generate further debate and hopefully agreement within the education sector on those elements that can be considered essential to the right to basic education. Furthermore, the chapter advises that these elements be used as a prioritisation framework within the sector, and thus – where appropriate – should be protected during periods of slower growth or budget reductions.

The Commission makes the following recommendations:

1. *The Commission reiterates its previous recommendations that a proper costing of the delivery of education services be undertaken to address the cost drivers of education and differences in spending pressures across provinces to assess the adequacy of basic education spending.*

It is important to emphasise that, while spending efficiency can be improved in education, the research does not directly address the issue of the adequacy of education allocations. The issue of adequacy of spending is a complex, but imperative matter. The Commission has made it clear that the current provincial equitable share formula does not account for cost drivers and cost differences across provinces and, as a result, one cannot determine whether the basic education allocations are a true reflection of expenditure needs. A proper costing framework and exercise needs to be undertaken to determine the adequacy of basic education spending and to appropriately quantify the impact of budget cuts on the delivery of basic education services.

2. *Government needs to protect the redistributive nature of the basic education funding system in the face of potential basic education budget constraints.*

Existing evidence suggests that, if expenditure cuts were to be implemented, they should be apportioned in a way that reduces existing inequities in the system - such as relatively high personnel expenditure allocations to Quintile 5 schools - rather than exacerbating them. Schools that perform relatively better and have a higher quantity and quality of resources are in a better position to absorb budget constraints vis-à-vis poorly performing and poorly resourced schools. It is important that Quintile 1 to 3 schools are protected from budget issues. The impact of funding cuts to schools is likely to have asymmetric impacts across quintiles, with a greater negative impact on lower quintile schools.

3. *Availability and access to credible, reliable, consistently collected and easily comparable financial and non-financial data is critical to conduct research to better understand the impact of government spending and to assess school performance. To this end, the Commission acknowledges the government's work to implement a school-level data collection instrument in the form of the South African School Administration and Management System. The Commission recommends that the Department of Basic Education leverages the collection of this data and other sources of school-level data to compile a consolidated basic education sector database that integrates the financial and non-financial aspects of basic education.*

Currently, different institutions are responsible for different aspects of education data. While this is not an issue per se, it makes it difficult to get a consolidated education dataset for analysis and results in certain departments, giving more attention to their responsible areas at the expense of data quality. For example, the South African School Administration and Management System has a financial section. However, it is under-reported, as the Department does not make its completion compulsory.

4. *The Minister for Basic Education should use the matrix as the foundation of a framework to consult broadly with stakeholders to agree on a guide for spending prioritisation in the basic education sector that is underpinned by a socioeconomic rights approach.*

The Constitution and the rights enshrined therein are of paramount importance and should guide the government's plan of action. While spending requirements will always outweigh available resources, it is important, particularly in a fiscally constrained environment, at the very least, to protect the essential elements associated with the right to basic education. Such prioritisation cannot be afforded in isolation and should encompass reforms and corrective action to eliminate inefficiency in terms of implementation, coordination and other challenges.

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CHAPTER 10:

Independent fiscal institutions and their effectiveness: Cross-country evidence, common features and policy lessons for South Africa

10.1 Background

The aptitude of policymakers to constantly adjust policy levers to fulfil well-defined objectives is a two-edged sword. On the one hand, it enables auspicious reactions to unpredicted events. On the other, it rescinds optimum but time-inconsistent obligations and allows distorted incentives to be translated into damaging policy biases. The manifestation of excessive government deficits and escalating public debts, dating back to as early as the 1970s, is testimony that unrestrained fiscal discretion could translate into detrimental economic consequences. An emerging body of literature shows the prospective benefits of restricting control over and above standard democratic constraints and how it could be accomplished (Beetsma and Debrun, 2018).

The failure of rules-based monetary policy, resulting from the financial innovations of the 1980s, necessitated the delegation of monetary policy to non-elected experts who established independent central banks. The official restrictions on fiscal discretion through the fiscal rules followed after that. Initially, only a few countries subjected fiscal policy to quantitative limitation. However, the phenomenon quickly gained momentum, and the unprecedented proliferation of fiscal rules followed. Presently, the International Monetary Fund (IMF) has data on approximately 80 countries that implement fiscal policy within an official framework consisting of some fiscal rules (IMF, 2017).

The natural progression, given this context, is that the institutions embraced for monetary policy could and should be adopted for fiscal policy as well. Independent fiscal institutions (IFIs) can play a similar role as independent monetary institutions. In any case, the frustration with the planning and function of rules-based fiscal frameworks is translating into an increasing number of countries establishing IFIs. IFIs are self-governing public institutions with a remit to objectively evaluate and offer non-partisan advice on fiscal policy and performance. These institutions are responsible for enhancing sound fiscal policy and sustainable public finances in conjunction with fiscal rules.

Against this background, fiscal governance has firmly surfaced as a prospective resolution to weak fiscal performances. Trends in fiscal balance, government debt, and real gross domestic product (GDP) growth reveal that fiscal performances spanning the past ten years reflect the inability of various governments to manage their budget deficits and fiscal consolidation properly, as well as its effects (Ball et al., 2013). The importance of fiscal governance instruments for stabilising fiscal policy emanates from the ability of strict fiscal rules, IFIs, the strong legitimacy of fiscal transparency, and medium-term budgetary frameworks to impact on fiscal outputs. The role of IFIs in improving fiscal performance is particularly gaining traction. Institutional reforms are fundamental in modifying the decision calculus of policymakers to improve the prospects of fiscal policy in supporting macroeconomic stability. IFIs and fiscal rules have become the backbone of public financial management.

Robust fiscal governance implementation thus offers a critical intervention and implications for improving fiscal performance. This chapter examines the historical context and progression of IFIs and their key features, using international case studies, reviewing existing evidence relating to the relationship between their characteristics and their effectiveness in strengthening fiscal outcomes and distilling critical lessons for South Africa.

The objectives of this chapter are twofold:

- Examine how IFIs execute their essential mandate and functions and how it impacts on fiscal performance
- Distil lessons for South Africa based on the review of the design and operational features of IFIs around the world.

10.2 Research methodology and data

This study employs a descriptive research methodology, applying quantitative and qualitative methods to assess if and how IFIs influence fiscal outcomes. Cross-country evidence in the form of seven international case studies is used to ascertain the following:

- A review of available evidence on the relationship between the characteristics and effectiveness of IFIs and fiscal outcomes
- Critical features of IFIs, focusing on best practices
- Mapping out options and observations regarding existing IFIs relating to their mandates and functions, coverage, operational characteristics, degree of independence, composition, and institutional models, as well as their compliance and impact

The case studies consist of the following IFIs¹:

- The High Council of Finance, Belgium
- The Parliamentary Budget Officer, Canada
- The National Assembly Budget Office, Korea
- The Council for Budget Responsibility, Slovakia
- The Congressional Budget Office, USA
- The Office for Budget Responsibility, UK
- The Parliamentary Budget Office, Uganda
- The Financial and Fiscal Commission, South Africa
- The Parliamentary Budget Office, South Africa

The selection criteria for these IFIs are premised on the number of years of operation, tasks carried out, and diverse regional and contextual environments. The Financial and Fiscal Commission (FFC) and the South African Budget Parliamentary Office (SAPBO) case studies compare South Africa with the international IFIs assessed. The case studies are supplemented with interviews with subject experts.

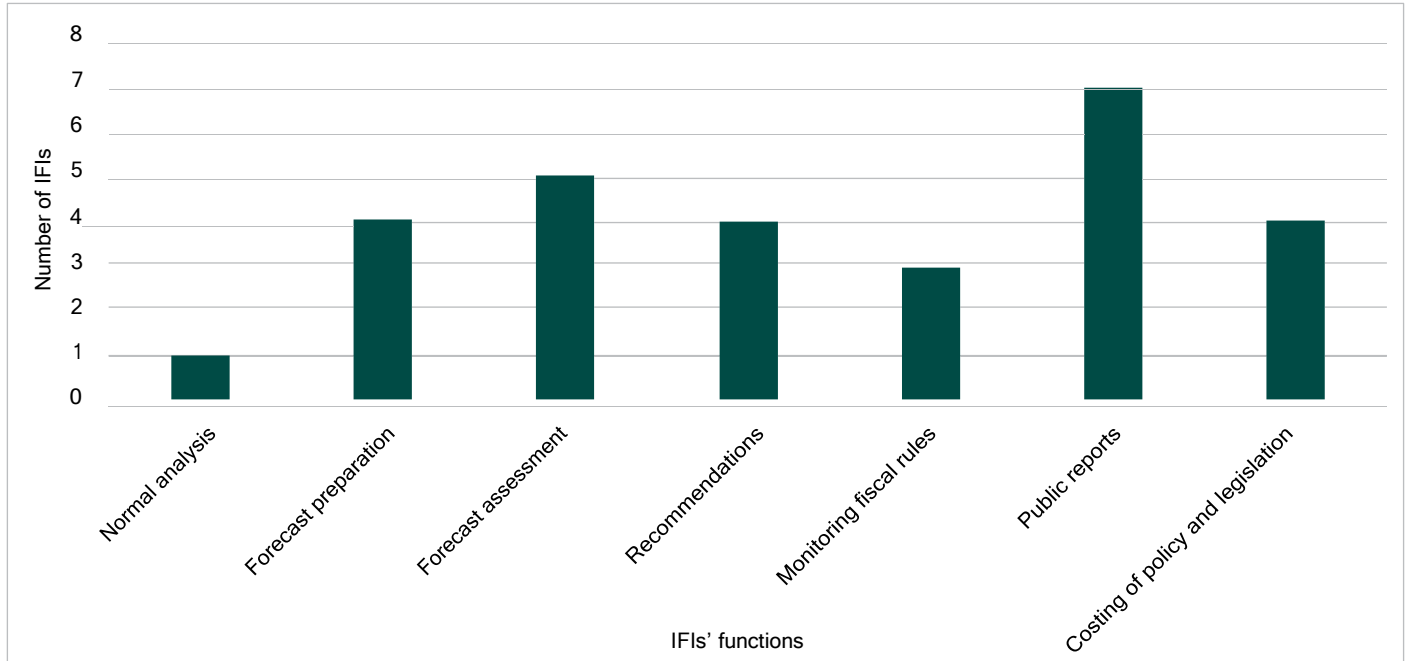
¹ The details of the case studies are contained in the technical report version of this paper which is available on the FFC website

10.3 Findings and policy lessons

10.3.1 Mandate and functions

Figure 10.1 shows the results of IFIs assessed in terms of seven functions: normative analysis, forecasting preparation, forecast assessment, recommendations, monitoring fiscal rules, issuance of public reports, and costing of policy and legislation.

Figure 10.1: Assessment of IFIs: Mandates and related functions



Source: Commission's own compilation.

The results presented in Figure 10.1 show that almost three-quarters (five out of seven) of the IFIs examined are mandated to assess macroeconomic and budgetary forecasts. In contrast, over half (four out of seven) are mandated to undertake independent macroeconomic and fiscal variable forecasts. Less than half (three out of seven) are responsible for monitoring compliance with fiscal rules. More than half (four out of seven) prepare and provide recommendations to fiscal authorities on budgets and related assumptions. All IFIs assessed are obligated to publish public reports on their findings. More than half (four out of seven) conduct the costing of policy and legislation.

The results also show that the South African Parliamentary Budget Office conducts normative analysis, offers recommendations, and issues public reports. It is not mandated to assess budgetary forecasts or undertake independent forecasts of budgetary variables like most of the IFIs assessed. It also does not monitor fiscal rules, nor does it conduct costing of legislation and policy.

The analysis shows that, while the IFIs perform a broad spectrum of tasks as outlined above, they most certainly contribute to monitoring the compliance of fiscal rules, producing or validating macroeconomic and fiscal forecasting, and cost policy and legislation. In providing or endorsing budget forecasting, IFIs minimise the compulsion for policymakers to employ subjective economic forecasts for their budget plans. The designation of the monitoring of fiscal rules to IFIs contributes to fiscal discipline. Real-time costing of policy and legislation by IFIs improves fiscal discipline and transparency in public finances during the policy-making process. These essential functions of IFIs are currently not performed by either the SAPBO or the Commission. The literature and personal interviews with experts on the IFIs' mandates and functions underscore a need for the SAPBO and the Commission to be more actively involved in medium-term budgetary frameworks and planning through the production or endorsement of macroeconomic and fiscal forecasts, the monitoring of fiscal rules, and the costing of policy and legislation.

Policy lessons

Country-specific mandates and functions

The assessment of the seven IFI international case studies has shown that, in defining and determining mandates and functions, it is crucial to consider both country-specific factors and the capacity of the IFIs to fulfil their mandates. For instance, the establishment of the Congressional Budget Office in the USA was premised on a set of reforms triggered by tense legislative-executive relations during the Nixon administration and aimed at reclaiming budgetary powers from the government to the legislature (Joyce, 2011). In the South African context, this policy lesson highlights the need to review the mandates and functions of the Commission and SAPBO to improve fiscal governance and fiscal outcomes.

Broad, clear and implementable mandates and functions

The assessment also revealed that the mandate of an IFI should be comprehensive, clearly defined, and implementable. In this regard, specific duties allocated to an IFI should be entirely consistent with the mandate. A broad mandate is vital in capturing several conceivably changing sources and expressions of the deficit bias.

In the context of rules-based frameworks, it is essential to stipulate the mandate and functions of an IFI to improve compliance with the rules. A rules-based fiscal framework in the context of an IFI is self-reinforcing. Whereas a rules-based framework enables monitoring and communication to the public, an IFI promotes compliance by offering impartial forecasts, validating the terms of an escape clause, and assessing targets conveyed in structural provisions. This policy lesson highlights the need to establish fiscal rules and empower the Commission and SAPBO to monitor government compliance.

Coordination of fiscal policy

In a decentralised government like South Africa, the role of an IFI should primarily pertain to the general government while monitoring sub-national governments and enhancing the coordination of fiscal policy within the entire government. Given that decentralisation increases coordination and common-pool issues, the role of an IFI should be to assuage these challenges. Whereas the scope of an IFI could be limited by the nature of intergovernmental arrangements, impartial analyses of intergovernmental transfers and recommendations on the distribution of fiscal effort to attain central government's target can enhance collaboration between central and sub-national governments, which is vital in improving compliance with fiscal policy rules. This policy lesson underscores the need to strictly align the Commission's mandate and functions to this role.

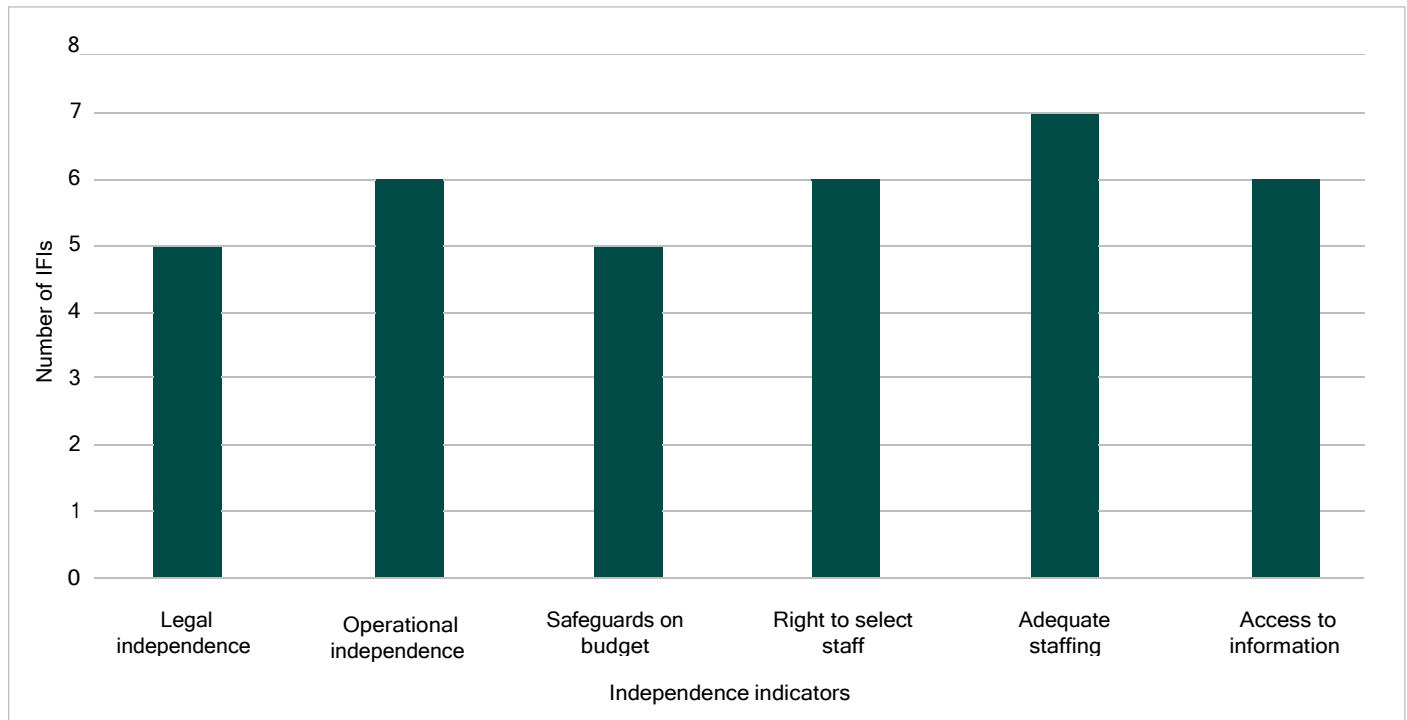
Equitable distribution of non-renewable resources

In resource-rich countries, such as South Africa, IFIs should assist in crafting a financially viable and intergenerationally equitable expenditure path by restricting the political manoeuvring of commodity price cycles and the projected reserves of non-renewable resources. An IFI, in this context, should assuage instant spending pressures driven by cyclical peaks in commodity prices. This policy lesson highlights the need to review the mandate and functions of SAPBO and the Commission, and empower these institutions with legislative powers in determining the role of non-renewable resources.

10.3.2 Independence

Figure 10.2 shows the independence assessment results of the IFIs using six indicators: legal independence, operational independence, safeguards on budgets, right to select own staff, adequate staffing, and access to information.

Figure 10.2: Assessment of IFIs: Independence



Source: Commission's own compilation.

The results presented in Figure 10.2 show that almost three-quarters (five out of seven) of the IFIs assessed enjoy legal independence, while nearly all (six out of seven) enjoy operational autonomy. Almost three-quarters (five out of seven) of the IFIs can safeguard their budgets, almost all (six out of seven) can hire their staff, and all (seven out of seven) have adequate staff to fulfil their mandates and perform their duties. Almost all (six out of seven) have access to the information required to accomplish their objectives.

The results also show that SAPBO and the Commission enjoy high independence. Their independence is guaranteed in legislation. They can safeguard their budgets, hire their staff, and have adequate staff to perform their duties and access the information required to achieve their goals. However, the Commission and SAPBO do not have complete operational independence because they are under the executive and legislature, respectively. This means that a procedure of continually evaluating the independence of these IFIs is required. This mechanism will be crucial in detecting any changes impeding the effectiveness and independence of these IFIs in the form of a set of minimum standards. The literature and engagements with experts at IFIs corroborate the need to agree on minimum standards for SAPBO and the Commission to reinforce their independence.

The analysis further shows that the Commission and SAPBO enjoy a relatively good flow of information from the national government. However, the data on budgetary procedures at state-owned entities is still scarce. The same goes for the methodological details on how the government performs the costing of its policy measures. The deliberations with experts at IFIs, as well as the review of literature, underscore the need to strengthen access to information for the Commission and SAPBO.

Policy lessons

Legislative provisions against political interference

Guarantees against political interference are crucial in safeguarding the independence of IFIs. This is particularly important for IFIs mandated to make recommendations on sensitive fiscal matters. These guarantees should include the following:

- Legislative provisions forbidding public authorities from giving instructions to IFIs
- Legislative provisions for senior members of IFI to be chosen through merit-based selection criteria
- Legislative provisions for long and non-renewable terms of office for senior management
- Legislative provisions for dismissal procedures
- Legislative provisions for access to information

Predictable funding proportional to the mandate of the IFI

The financing of the IFI should not be at the discretion of the executive. This could be achieved by either making appropriation for the IFI a separate line item in the budget or safeguarding multi-year financing for the IFI.

Legislative provisions for the IFIs' channels of influence

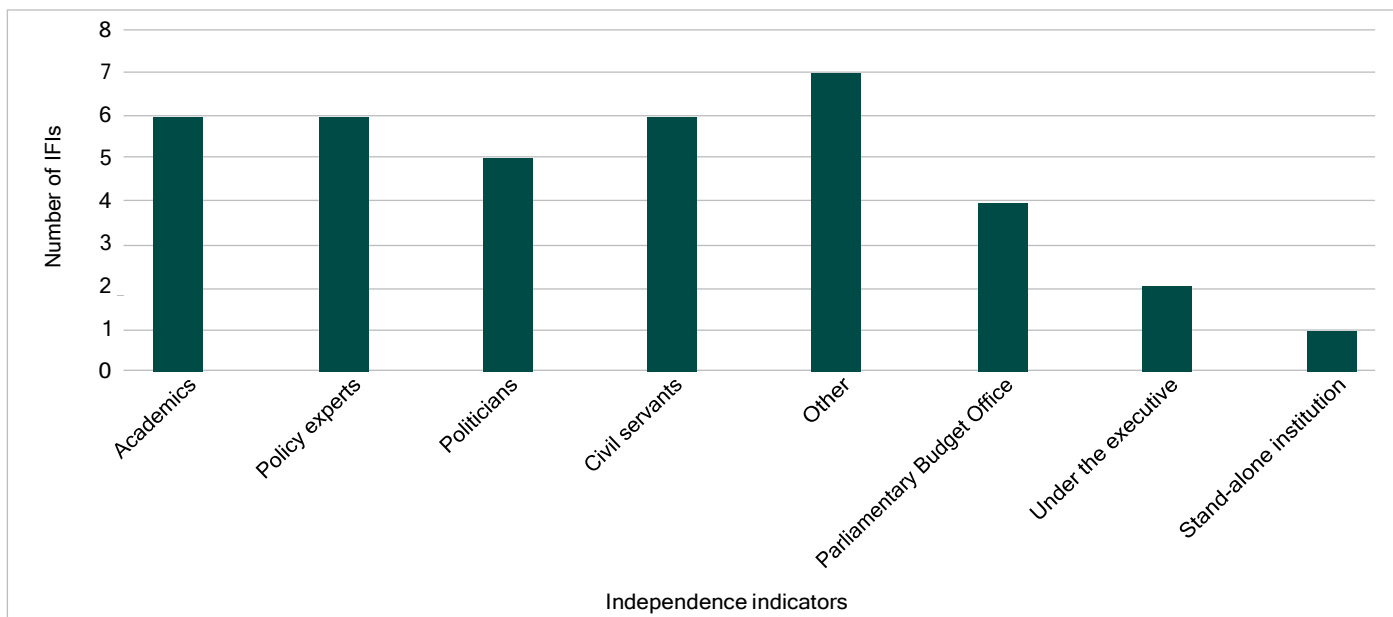
Specific legislative provisions for the IFIs' freedom to communicate its work is vital. There should be specific legislative provisions for unrestricted access to the media for the IFI. The IFI should also be legally obligated to publish, in advance, the calendar of its publications and press conferences to eliminate misunderstandings related to the timing of communications as being purposely sympathetic or unfavourable to the executive.

IFIs' inputs to the budget process

The IFIs' inputs into the budget should be prescribed in legislation. This should be through legislative provisions that limit the requests for the costing of policy and legislation and ad-hoc analyses of the capacity of the IFI to enable it to develop its work programme independently. The IFIs should be given legislative power to decline some requests. In the South African context, these policy lessons highlight the need to strengthen the independence of SAPBO and the Commission through legislation and predictable funding.

10.3.3 *Composition and institutional models*

The results in Figure 10.3 show the composition and institutional model assessment using five indicators for composition: academics, policy experts, politicians, civil servants, and others. Three indicators are used for institutional models: the Parliamentary Budget Office, under the executive, and a stand-alone institution.

Figure 10.3: Assessment of IFIs: Composition and institutional models

Source: Commission's own compilation.

The results in Figure 10.3 show that almost three-quarters (six out of seven) of the IFIs assessed have academics as senior members, nearly all (six out of seven) have policy experts as senior members, almost three-quarters (five out of seven) have politicians as senior members, and nearly all (six out of seven) have civil servants as senior members. All the IFIs assessed have other senior members who do not fall squarely into the abovementioned categories. In terms of institutional models, the majority of the IFIs assessed (four out of seven) are parliamentary budget offices, the minority (two out of seven) are under the executive, and only one (one out of seven) is a stand-alone institution. The results also show that most senior members of SAPBO are academics, policy experts, and civil servants. The analysis shows that SAPBO follows the best international practice in the constitution of its senior management teams.

Policy lessons

Composition

For IFIs to be able to enhance fiscal outcomes over time and safeguard their independence, they should be composed of senior members who are experts in the management of public finances, supported by staff who are capable of collecting relevant data, and offering vital inputs and mandated analyses, as well as administrative functions. The senior members of the IFIs and the technical staff should have proficiency in economic forecasting and public finance management. The international best practise expressed in this policy lesson is followed by SAPBO.

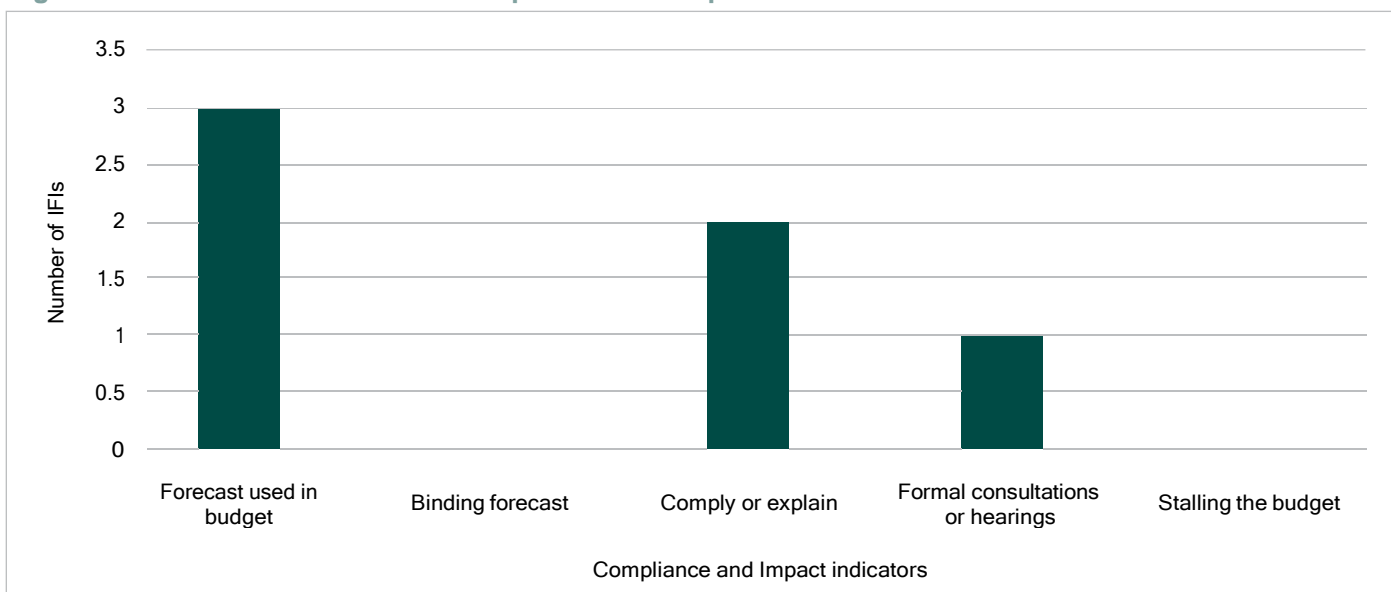
Institutional models

The stand-alone institution model should be preferred to alternative models because it offers the best guarantee of legal and functional independence. Moreover, it is more likely than other models to entail a solid legal foundation and independent personnel policy, including, conceivably, employment and remuneration beyond the limitations of the civil service. SAPBO and the Commission are under the legislature and the executive, respectively. This underscores the need to create stand-alone IFIs in South Africa to improve fiscal governance.

10.3.4 Compliance and impact

Figure 10.4 shows the compliance and impact assessment results of the IFIs using five indicators: forecasts used in the budget, binding forecasts, comply or explain, formal consultations or hearings, and stalling of the budget process.

Figure 10.4: Assessment of IFIs: Compliance and impact



Source: Commission's own compilation.

The results in Figure 10.4 show that less than a third (three out of seven) of the IFIs assessed produce macroeconomic and fiscal forecasts that are used in the budget, less than a third (two out of seven) require fiscal authorities to either comply or explain any deviations from the forecasts and recommendations of IFIs, while only one (one out of seven) is mandated to have formal consultations or hearings as part of the budget formulation to interact directly with the stakeholders responsible for budget preparation. None of the IFIs assessed were mandated to produce forecasts that are binding for fiscal policy. Similarly, none of the IFIs assessed were permitted to halt the budgetary process if it has serious reservations about it.

The results also show that SAPBO does not produce macroeconomic and fiscal forecasts that are used in the budget. It is also not mandated to make formal recommendations that require fiscal authorities to either comply or explain any deviations from them, nor is it mandated to have formal consultations or hearings as part of the budget formulation to interact directly with the stakeholders responsible for budget preparation. It is also not mandated to produce forecasts that are binding for fiscal policy, nor is it empowered to halt the budgetary process if it has serious reservations about it.

Forecasting and monitoring of fiscal rules

It is complicated to quantitatively evaluate the impact of IFIs on fiscal outcomes. However, the evidence presented in the international case studies carried out in this chapter suggests that these institutions play a valuable role in budgetary processes. Their impact on fiscal outcomes is mainly through their leading functions, producing, endorsing, or assessing macroeconomic forecasts to underpin budgetary planning and the monitoring of compliance with fiscal rules. According to the evidence presented in the case studies, the accuracy of macroeconomic forecasting appears to have improved in tandem with the IFIs' role of producing and endorsing macroeconomic and budgetary forecasts. In South Africa, in the past ten years, the policy planning process has been characterised by consistent overestimation of GDP growth, and in recent times, inflation has been overpredicted. The national government's budgets have consistently been optimistic regarding GDP growth since 2008/09, and budget projections have overestimated inflation since 2016. These consistent errors in projections could have influenced policy decisions, such as planned expenditures, and public and private wage negotiations (see Hausmann et al., 2022). This underscores the need for SAPBO and the Commission to validate macroeconomic and fiscal forecasts and to monitor fiscal rules, as articulated above.

Comply or explain principle

IFIs are advisory entities, and their evaluations and recommendations are directed at fiscal authorities who are expected to consider them in their budget formulation deliberations. The means through which to balance the advisory role of IFIs, while preserving government's prerogative to manage fiscal policy, is through the comply or explain principle, which is essentially an obligation on government to publicly explain the justifications for deviating from recommendations offered by an IFI.

The comply or explain principle is vital in impacting fiscal outcomes through the public debate it triggers. It ensures that fiscal authorities act transparently and responsibly in fiscal matters. This eventually improves the operationalisation of transparency and accountability associated with scrutiny from IFIs. The comply or explain principle plays a pre-emptive role because fiscal authorities adopt potential conflicts with the IFIs in their proposals.

In South Africa, the comply or explain principle is only applicable to the Commission and not SAPBO. This highlights the need to extend it to cover SAPBO. There is also a need to strengthen the current comply or explain principle with regard to specific timelines, scope, degree of coverage, and extent, as well as legal ramifications for contravention.

Policy lessons

Compliance and impact

For an IFI to impact fiscal outcomes, it should monitor compliance with national fiscal rules and produce, or at least validate, macroeconomic and budgetary forecasts used for budget preparation. The IFI should also have a right to comment and issue recommendations on any fiscal policy issue to which fiscal authorities should, by law, comply with or explain any deviations. This policy lesson highlights the need for the mandates and functions of SAPBO and the Commission to be reviewed to cater for the crucial tasks for compliance and impact.

Transparency and impact

An IFI should enhance fiscal transparency by increasing the level of understanding of the government's underlying financial position and the risks around it. This policy lesson underscores the need to improve the accessibility of information for SAPBO and the Commission.

10.4 Conclusion

IFIs are swiftly evolving into robust fiscal institutions and budgetary frameworks that significantly impact fiscal outcomes. These institutions have become more prominent and relevant in the aftermath of the global financial crisis and COVID-19 pandemic. Whereas they were initially associated primarily with advanced economies, their prevalence has permeated into middle- and low-income economies.

Emerging market economies such as South Africa are confronted by distinctive macroeconomic and fiscal management challenges, including vulnerability to external shocks and natural disasters. These challenges require prudent budgeting and forecasting, coupled with fiscal buffers, to be resolved. IFIs can enhance the implementation of these prerequisites through conservative fiscal projections that encompass the effects of exogenous economic shocks. They can also assist in anchoring budget formulation and implementing fiscal rules or other sustainable objectives, thus ensuring that public funds are closely aligned to sustainable and long-term benefits.

In contrast with independent central banks, who exercise complete discretion to establish designated policy instruments to attain their monetary policy goals, IFIs are fiscal watchdogs that cannot bite because they have no explicit mandate that directly affects fiscal policy. In essence, therefore, their effectiveness is primarily determined by how loud and how quickly these fiscal watchdogs bark. Their efficacy is

essentially reliant on their ability to influence policymakers to choose sound fiscal policies by promoting fiscal transparency to improve accountability and inhibit devious shifts in fiscal policy while highlighting consciousness regarding the ramifications of destructive fiscal policy paths. In practical terms, IFIs are effective if they execute specific functions that enable them to produce well-defined outputs, including fiscal policy analysis, recommendations, assessments, and forecasts.

At the fundamental level, effective IFIs should be equipped with sufficient human and financial resources to enable them to execute specific functions and produce their respective outputs in support of their mandates, which are favourable to enhancing fiscal policy outcomes.

The assessment of the IFIs shows that they have relatively been able to influence fiscal outcomes, which is subject to their design, resourcing, and mandates. Those IFIs that are highly protected from government interference, with more flexibility to hire their staff and control their budgets, anchor recommendations in fiscal rules or any quantitative objectives, can achieve more substantial fiscal outcomes.

The analysis of this study shows that there are helpful policy lessons for South Africa. The key policy message is that, in reforming its IFIs, South Africa must ensure that it effectively contributes to formulating and executing more sustainable and stabilising fiscal policies.

10.5 Recommendations

With respect to improving the mandate and functions of IFIs in South Africa, the Commission makes the following recommendations:

1. *Forecasting or validating macroeconomic and fiscal variables*

IFIs improve the accuracy of budgetary and macroeconomic forecasts. SAPBO and the Commission should endorse government macroeconomic and fiscal forecasts. The forecasts should also be supported by extensive engagements and information sharing between National Treasury, SAPBO, and the Commission. The endorsement process must be formalised through a Memorandum of Understanding (MoU). The MoU should establish documents for which endorsement is carried out, general criteria for endorsement, including baseline and planned scenarios, timelines and requirements for information exchange, and modalities for issuing an endorsement.

2. *Costing of legislation and policy*

The costing of policies and legislation is crucial for the quality of the budgetary forecasts, and ensures robust public debate on fiscal policy. SAPBO and the Commission should cost all government policies or legislation that impact on fiscal policy. The costing of government policy and legislation must first establish the baseline – determining how the activity affected by the policy measure would be expected to develop in the absence of the measure. Secondly, it should estimate the static effect - the fiscal impact of the new policy or legislation before allowing for any behavioural or economic responses. Thirdly, it should estimate the behavioural or first-round effect - capturing the behavioural reactions of specific groups that are directly affected by the policy or legislation change.

3. *Monitoring fiscal rules or objectives*

There is empirical evidence of the impact of IFIs on conformity with fiscal rules and, by extension, budgetary restraint. This establishes the complementarity of IFIs and fiscal rules. Government should develop fiscal rules or objectives. SAPBO and the Commission should monitor compliance with the fiscal rules or objectives. The monitoring of fiscal rules should be supported by legislation that provides for SAPBO and the Commission to publish timely assessments of fiscal rules, both forward-looking and backwards-looking, and covering all fiscal rules in force.

With respect to improving the independence of IFIs in South Africa, the Commission makes the following recommendations:

1. *Establishment of minimum standards for IFIs*

The minimum standards for IFIs are crucial in spelling out details on what independence should imply. They ensure that the IFIs have an adequate mandate, which is commensurate with the required resources, is excellent and timely, and reinforces more widely applicable binding comply or explain procedures. Government should establish a process of periodically reviewing the operational independence of SAPBO and the Commission. This process should entail an effective mechanism comprising a set of minimum standards to detect any changes impeding the operational independence of these institutions. An infringement procedure, as a legal instrument to enforce the minimum standards, should also be established to ensure effective implementation. Moreover, the government should enhance the independence of SAPBO and the Commission by ensuring legal safeguards by providing continuous and predictable funding set out for a multi-annual period and equipping these institutions with the flexibility to use their budgets.

2. *Access to information*

Access to information is one of the primary safeguards for the functional independence of IFIs, which is critical for their effectiveness. The Commission and SAPBO should be provided with timely and comprehensive access to relevant information, including the methodologies, assumptions, and data used by National Treasury in budgetary planning. National Treasury should provide a standard set of data and additional data upon the request of the Commission and SAPBO. The Commission and SAPBO should participate in committees at the national level that deal with accounting and statistical issues related to government fiscal data. Access to information should also be codified in legal provisions and reinforced through specific mechanisms with all levels of government and all government entities. Any restrictions on access to information should be legislated. The access to information should be formalised in an MoU between National Treasury, the Commission, and SAPBO.

With respect to improving the compliance and impact of IFIs in South Africa, the Commission makes the following recommendations:

1. *Improvement of the compliance or explanation of deviance from recommendations principle*

The comply or explain principle is vital for triggering public debate, putting pressure on fiscal authorities to act transparently and responsibly on fiscal matters, which enhances their transparency and accountability. The legal basis for the compliance and explanation of deviance from the recommendation principle for the Commission must be strengthened and extended to cover SAPBO. The government must be obliged to respond to the assessment of the Commission and SAPBO within deadlines defined by legislation. The comply or explain principle should cover all reports issued by SAPBO and the Commission. The role of the Commission and SAPBO should be reinforced through the right to initiate an adequate legal remedy if governments deliberately flout fiscal rules. National Treasury's response to the Commission and SAPBO should contain all the relevant information, including the proper degree of detail, to ensure its full effectiveness.

2. *Formal consultations on budget formulation and execution*

The interaction between the IFIs and the government during the budget formulation process is crucial. The evaluation of fiscal projections by IFIs improves their accuracy to produce a credible and sustainable medium-term budgetary plan. The Commission and SAPBO should be formally consulted on budget formulation and execution. National Treasury should prepare the projection of the economy and the budget under unchanged policies and present them to the Commission and SAPBO for evaluation. The resultant interaction between National Treasury, the Commission, and SAPBO should produce a medium-term budgetary plan. This consultation process should be formalised in an MoU between National Treasury, the Commission and SAPBO.

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CHAPTER 11:

District municipalities: Powers, functions and funding framework

11.1 Background

The Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996), provides for the establishment of three interrelated, but also distinct and independent spheres (national, provincial and local) of government. The Municipal Structures Act, 1998 (Act No. 117 of 1998) (MSA), makes provision for a single-tier (i.e. metropolitan) and a two-tier (district and local) system of local government. District municipalities share executive and legislative authority with local municipalities within their jurisdictions. The Constitution (i.e. sections 229, 155 and 156) and other pieces of legislation allocate a range of powers and functions to municipalities, including district municipalities. The Constitution mandates municipalities to provide services to communities in a sustainable manner, and promote social and economic development and a safe and healthy environment, as well as the involvement of communities and community organisations in matters of local governance. Although this mandate sounds achievable, in reality, many municipalities are unable to fulfil their constitutional mandate. District municipalities, in particular, are in a dire situation and their fiscal health remains precarious. In 2018, almost 20% of district municipalities were dysfunctional. In August 2021, the Department of Cooperative Governance and Traditional Affairs (CoGTA) reported that eight district municipalities were dysfunctional and that five of these were under administration (BusinessTechSA, 2021). Dysfunctional district municipalities are characterised by several challenges, including lack of capacity (both individual and institutional), poor financial management, (e.g. mispending, and poor budgeting and supply chain management), poor governance (i.e. poor accountability, corruption, fraud and political interference) and poor record of service delivery (e.g. due to financial constraints, poor infrastructure and poor maintenance). Many district municipalities are also categorised as financially distressed. According to National Treasury (2019), in 2018/19, 163 municipalities were identified as being financially distressed; 27 of these were district municipalities. In other words, over 60% of district municipalities were in financial distress.

The funding model for district municipalities has been criticised for not being responsive to their mandate. District municipalities are primarily funded through the Regional Services Council (RSC) Replacement Grant. When this grant was introduced in 2006/7, it was meant to be a temporary measure. The idea was to replace this grant with a permanent funding model for district municipalities. However, reality shows that the RSC Replacement Grant is now a permanent feature of the district municipalities funding framework. Questions abound on the effectiveness of the RSC Replacement Grant to the needs of district municipalities. It also begs the question: Is the current district funding framework appropriate for the mandate of this tier of local government?

In addition, as district municipalities share executive and legislative authority with local municipalities in their jurisdictions, and members of the Executive Council (MECs) responsible for local government have adjusted and re-adjusted the functions of district municipalities over many years, two additional questions can be posed: Is the current funding model for district municipalities aligned to their powers and functions? If not, what is the optimal funding framework for district municipalities that takes into account their powers and functions? The purpose of this study is to examine these questions with a view to recommending a funding model for district municipalities that takes into account their powers and functions, and their role in local economic development. Establishing an appropriate and responsive funding model for district municipalities is more critical now than at any time before. First, the performance of district municipalities leaves much to be desired. Many are unable to perform their constitutional mandate efficiently and effectively, while a

significant number of districts are barely viable, and are dysfunctional and distressed. Service delivery failures in district municipalities are widespread. Their role in supporting local municipalities is limited, resulting in many MECs shifting their functions to local municipalities. This has given rise to a gradual hollowing of the district tier of local government. Consequently, many have even questioned the need for this municipal structure. Secondly, and since district municipalities are envisaged to play a critical role in the roll-out of the District Development Model (DDM), a viable district structure is essential for its success. In fact, in the DDM, districts are seen as the “landing strip” for all the role players (CoGTA, 2020). The DDM seeks to reverse service delivery failures at the local level through improved coordination, budgeting and planning. In the DDM, district municipalities are envisaged to play a leading role in coordinating, planning and budgeting for district-wide projects. Functions such as the coordination of district-wide projects, undertaking district-wide planning and spearheading local economic development (LED) are all mandates of district municipalities, which the DDM is envisaged to reinforce and provide much need impetus.

11.2 Research methodology and data

The study follows a case study approach. First, the study relied on secondary data to analyse the changes in the funding framework for district municipalities. Similarly, budget analysis and correlation coefficients are used to examine whether the funding framework is aligned to the functions and powers of district municipalities.

The above analysis is supplemented with primary data collected from a sample of six of the 44 districts. Integrated Development Plan (IDP) managers of the sampled districts were interviewed to solicit their views on the efficacy of the funding model of district municipalities and the alignment of the funding model, and powers and functions. In addition, their views on what they think is an appropriate funding model was solicited. The following district municipalities were selected:

- West Coast District Municipality (Western Cape)
- Alfred Nzo District Municipality (Eastern Cape)
- John Taolo Gaetsewe District Municipality (Northern Cape)
- Dr Kenneth Kaunda District Municipality (North West)
- Gert Sibande District Municipality (Mpumalanga)
- Waterberg District Municipality (Limpopo)

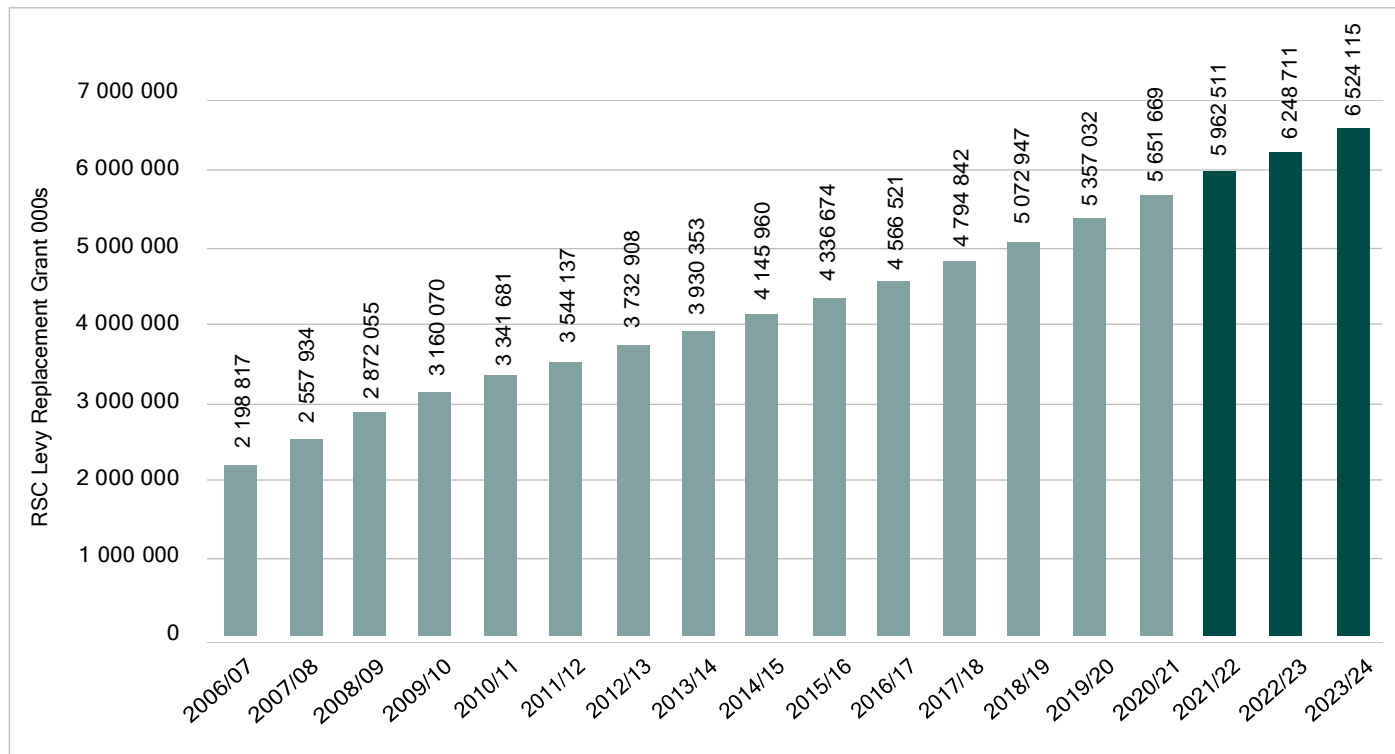
11.3 Findings

11.3.1 Funding framework for district municipalities: Is it efficient and appropriate?

The district municipality tier of local government consists of two types of district municipalities: districts that do not provide bulk water supply services (C1) and district municipalities that supply bulk water services (C2). As in other municipal categories, the funding framework for district municipalities comprises four funding sources: government transfers, investment, borrowings and other own revenue. On average, own revenue accounts for almost 20% of their income, and transfers constitute about 75%. Investment income and borrowing account for insignificant proportions of district municipalities’ financial resources. Government transfers to district municipalities consist of the RSC Replacement Grant and the local government equitable share (LGES). Some districts do not receive the basic services component of the LGES, particularly those that are not water and sanitation authorities, and as such, rely mainly on the RSC Replacement Grant to fund their operations. The LGES is allocated through a formula that considers the size of district municipalities (proxied by the number of councillors) and community services provided. The challenge regarding the funding of district municipalities relates largely to the RSC replacement component.

The RSC Replacement Grant was introduced in 2006 to replace the RSC and Joint Services Board levies that were abolished in June 2006. Although the grant was established as a temporary measure while a suitable replacement was being sought, it has lasted for longer than many subsequent conditional grants. To date, a permanent replacement has not been found. Currently, the RSC Replacement Grant is funding almost 25% of district municipalities' budgets. Since the inception of the RSC Replacement Grant 15 years ago, district municipalities have received close to R59 billion through this grant.

Figure 11.1: Evolution of the Regional Services Council Replacement Grant

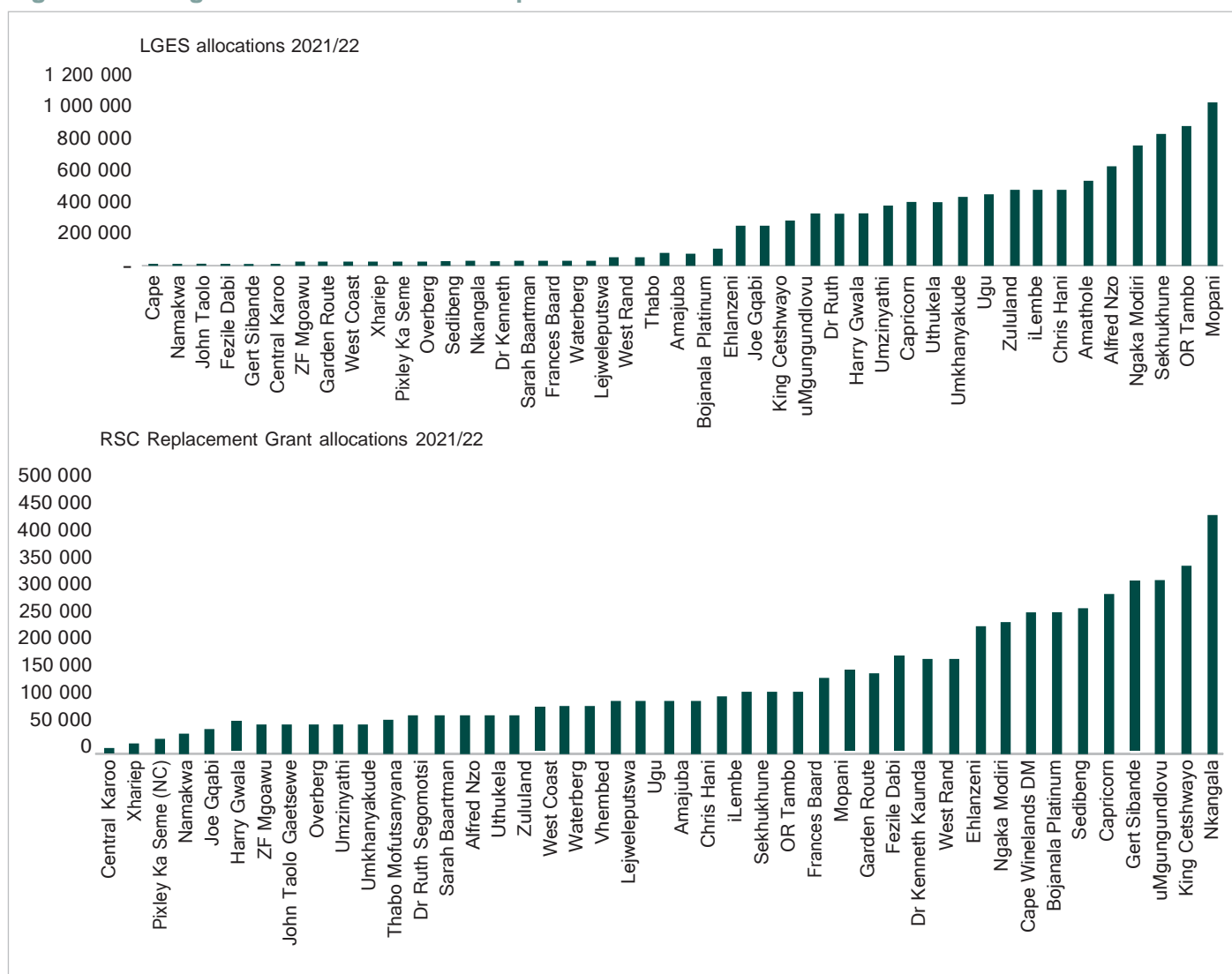


Source: Commission's representation

The RSC Replacement Grant has received a lot of criticism from several fronts, including the following:

- The RSC levy is blamed for being regressive because it is based on the historical revenue-raising capacity of district municipalities. Allocations for this grant are based on previous collections, thus perpetuating historical inequalities as areas previously classified as “homelands” that generated smaller revenues continue to receive smaller amounts. Thus, the RSC Replacement Grant has replicated the historical distributional patterns.
- The RSC Replacement Grant exhibits glaring biases in its distribution across district municipalities (Figure 11.2). There is a huge variation in the size of allocations across the 44 district municipalities. For instance, during 2021/22, the highest allocation recorded was R438.2 million for the Amathole District Municipality, and the lowest allocation was R14.9 million for the Central Karoo District Municipality. It is important to underscore the fact that this variation is not directly linked to population size, number of indigents or any of the objective factors. It is only based on historical collection patterns. Figure 11.2 compares allocations through the RSC Replacement Grant and the LGES formula. The rankings of district municipalities in both transfer windows is distinctly different. The more objective LGES ranking exhibits a different pattern from the RSC Replacement Grant.

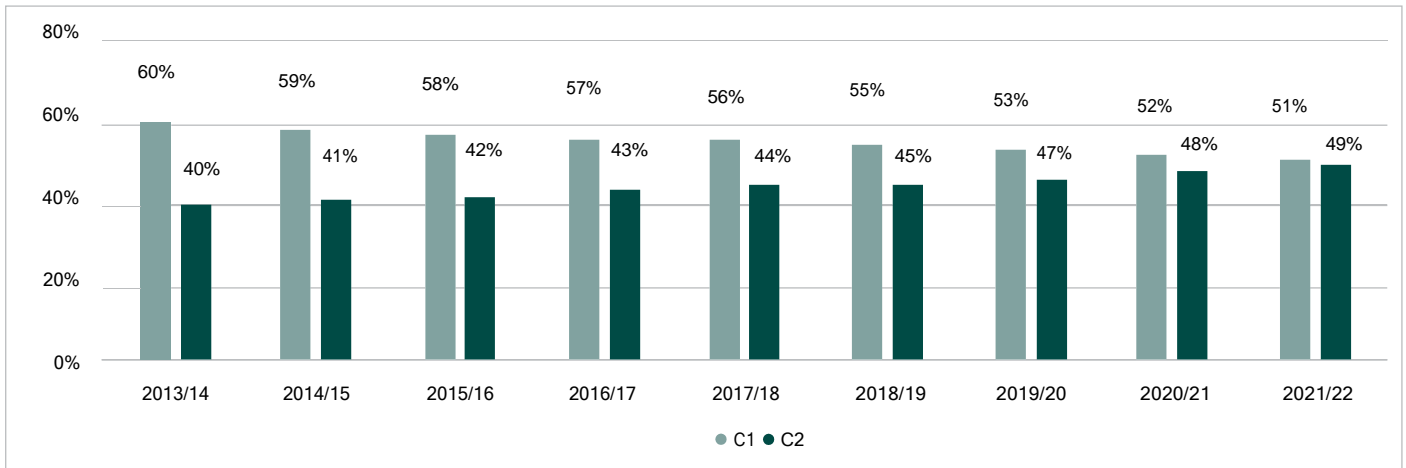
Figure 11.2: Regional Services Council Replacement Grant allocation 2021/22



Source: Commission's calculations

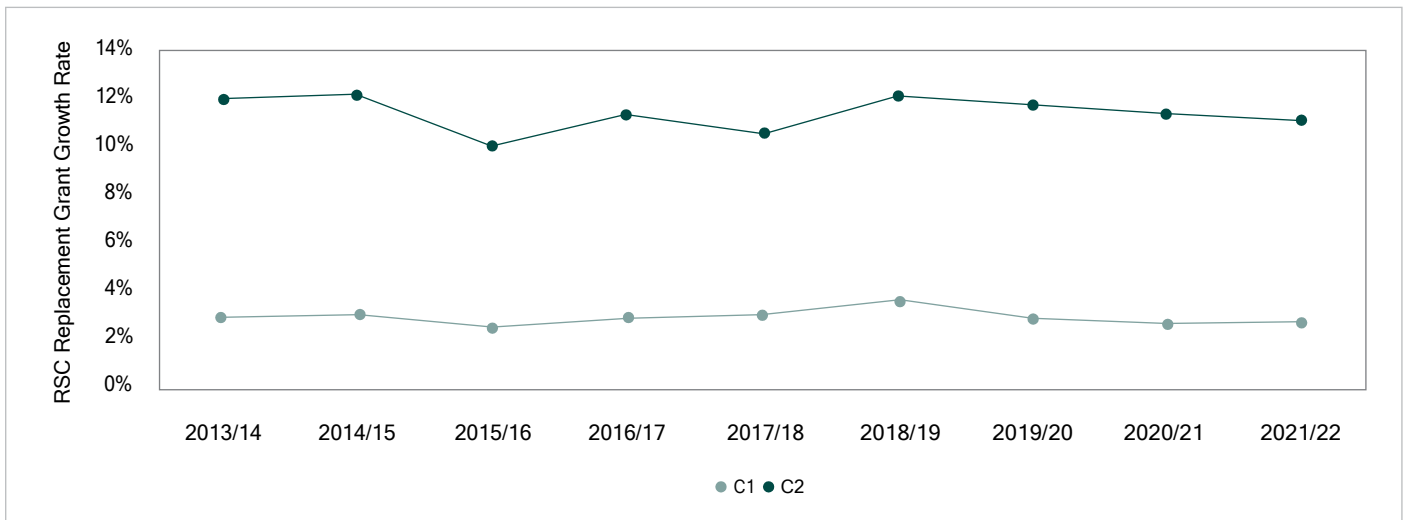
The growth trajectory of the RSC Replacement Grant shows significant disparities between C1 and C2 district municipalities. The differentiated annual growth rate has resulted in the share of allocations going to C2 district municipalities increasing from 40% in 2013/14 to 49% in 2021/22, while the share of C1 district municipalities declined from 60% to 51% during the same period (Figure 11.3). The approach to the growth of the RSC Replacement Grant has also been differentiated. The RSC levy continues to grow at the ratio of 1:3, i.e. for C2 to C1 district municipalities. This differentiated growth pattern has meant that the allocations to C1 district municipalities have been growing below the inflation rate, while the allocations to C2 district municipalities have consistently grown above the inflation rate (Figure 11.4). The low growth of the Replacement Grant for C1 district municipalities has made it difficult for them to provide adequate services.

Figure 11.3: Share of Regional Services Council Replacement Grant in C1 and C2 district municipalities



Source: Commission’s calculations

Figure 11.4: Growth trajectory of the C1 and C2 district municipalities



Source: Commission’s calculations

To sum up, the foregoing analysis of the district municipalities funding framework points to several gaps, especially on the RSC replacement levy component. The Replacement Grant is neither non-objective nor an inefficient way of distributing funds. This allocation is not driven by any objective or modern criteria. The misalignment of the funding framework of district municipalities, which remained unresolved, will not only affect the viability of district municipalities, but also their ability to fulfil their constitutional obligations. There is therefore a need for a long-term sustainable funding model for district municipalities, which should be based on district municipalities’ functions. Developing a sustainable funding model for district municipalities will require a clear specification of district municipalities’ powers and functions, a proper appreciation of the situational context and interrelationship with local municipalities, and a clear link between funding and functions. The next section examines the link between district municipalities’ funding and functions.

11.3.2 Powers and functions

The Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996), provides for the establishment of three distinct and independent, but also interrelated spheres (national, provincial and local) of government. The Municipal Structures Act, 1998 (Act No. 117 of 1998), makes provision for a single-tier (i.e. metropolitan) and a two-tier (district and local) local government system. District municipalities share municipal executive and legislative authority with local municipalities within their jurisdiction. Many have questioned the idea of the sharing of executive authority, i.e. how can executive authority be effectively and efficiently shared (Steytler, 2003)?

The Constitution (i.e. sections 229, 155 and 156 and other pieces of legislation) allocates a range of powers and functions to municipalities, including district municipalities. Chapter 5 of the MSA, in particular, details the functions and powers of municipalities, and the division of those powers and functions between district and local municipalities. It also deals with the adjustment of those functions and powers. Section 84 of the MSA (as amended) divides the powers and functions of district and local municipalities. According to the MSA, district municipalities share the provision of all four basic services (water, electricity, refuse removal and sanitation) with local municipalities. Section 84 of the MSA assigns the following 12 responsibilities to district municipalities:

- District IDP
- Basic services
 - Bulk water supply
 - Bulk electricity supply
 - Bulk sewerage
 - Solid waste disposal
- Municipal roads
- Passenger transport regulation
- Municipal airports
- Municipal health
- Fire fighting
- Fresh produce and abattoirs
- Cemeteries and crematoria
- Tourism promotion
- Municipal public works
- Receipt and allocation of grants

Section 84(3) of the MSA allows the Minister of CoGTA, and after consultation with the Cabinet member responsible for a particular functional area and the provincial MEC for local government, to authorise a transfer of power and authority (albeit subject to national legislation) from a district to a local municipality to perform the functions of providing water, sanitation, electricity and municipal health services. On the other hand, Section 85(1) provides for the MEC responsible for CoGTA in a province to adjust all other functions of district municipalities and local municipalities, except for the four national functions of providing water, sanitation, electricity and municipal health services. The MEC can transfer these other functions from a district to a local municipality, or vice versa. Of major concern is that no criteria are applied in such adjustments. The MEC responsible for local government has unfettered discretion in the transfer of functions.

Implications of the powers and functions set-up and authorisations

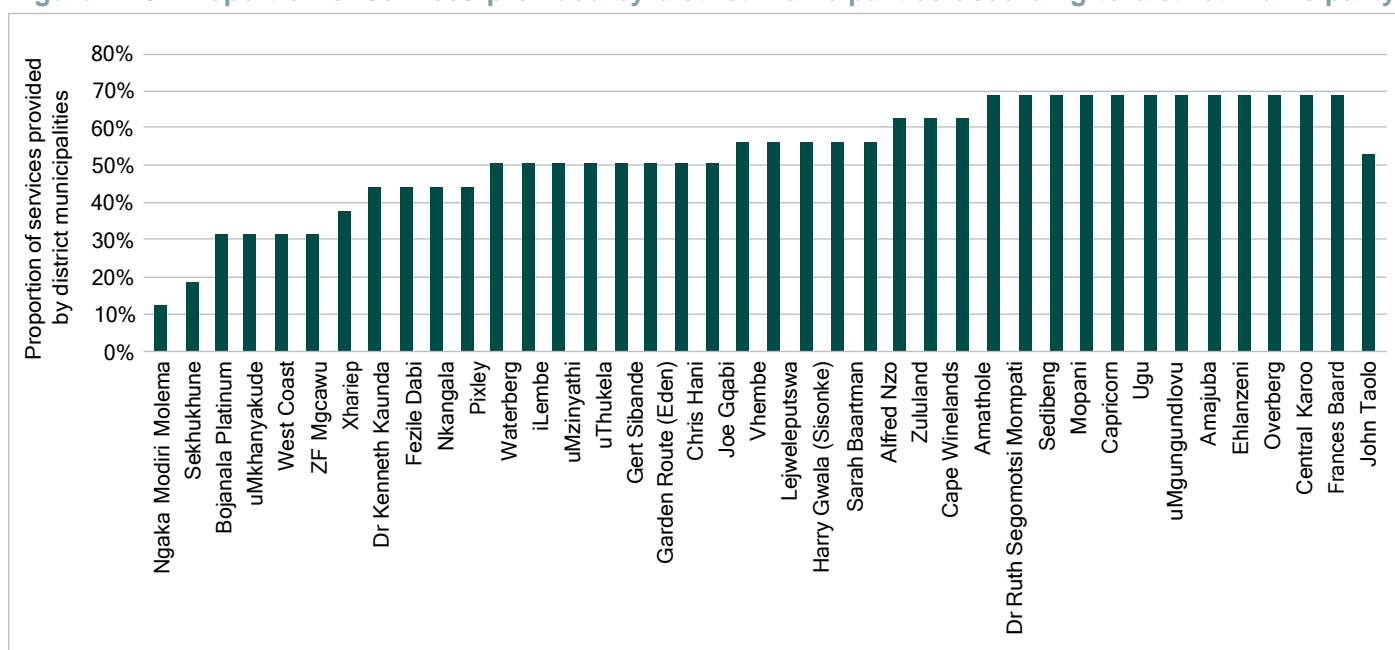
The current legislation on the division of powers and functions, as well as their authorisations, gives rise to many challenges, including the following:

- Lack of a clear and consistent approach to the allocation of functions and powers: This approach makes it complex to fund the system in a fair, objective and sustainable manner.
- Inefficient overlaps and duplications: The sharing of functions between local and district municipalities has given rise to inefficient overlaps and duplications. The sharing has resulted in the inadequate provision of certain services as either a district or a local municipality will assume that the other will provide such services.
- Lack of accountability: The sharing of functions has resulted in an accountability gap in that neither takes full accountability for their activities.

- **Uncertainty:** The adjustment of functions by the Minister and MECs has resulted in some service delivery challenges. When municipalities anticipate adjustments in the division of powers and functions in compliance with section 84 of the MSA, they tend to not prepare a proper IDP or budget for the long term. Long-term investment decisions are often deferred, thus compromising service delivery. Among staff, the adjustment of functions may result in job insecurity, which, in turn, leads to unnecessary resignations and low work morale.
- **Lack of monitoring:** The adjustment processes are not monitored. The Minister of CoGTA has no power to monitor “how adjustments are taking place, between whom and upon what motivation” (Moseki, 2021). The local government parent ministry has no monitoring or oversight role in the process of transferring functions. In addition, Moseki (2021) notes: “It is not clear what have been the triggers for adjustment requests by MECs, and whether due processes are uniformly followed in a transfer of a function.”
- **Finances following function:** In many cases, the division of powers and functions between district and local municipalities results in funding not following function. A case in point is firefighting, which is funded through the LGES. In many instances, when district municipalities perform this function, local municipalities do not transfer the LGES allocations meant for this function.

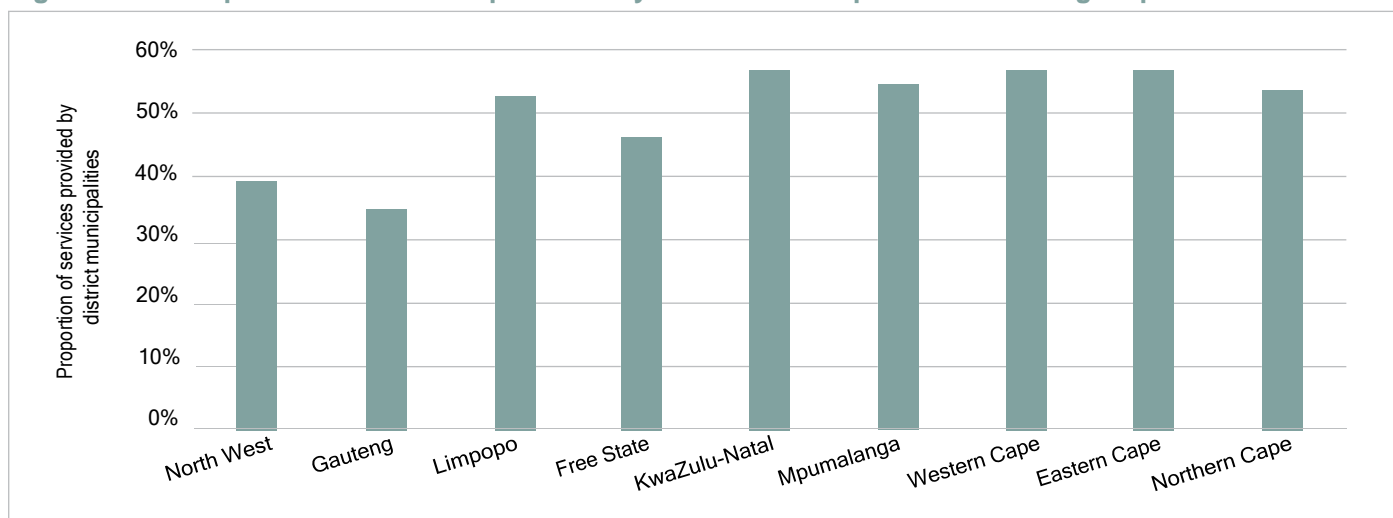
Perhaps one crucial question to ask at this point is whether there is a link between the division of powers and functions, and the funding framework of district municipalities. Before honing in on this question, it is necessary to first examine the current powers and functions of district municipalities. Figure 11.5 and 11.6 present the percentage of services provided by each district municipality (Figure 11.5) and the district municipalities in each province (Figure 11.6). The two figures show wide variation in the actual functions of district municipalities. On average, district municipalities provide 53% of the services they are assigned. At one extreme is Ngaka Modiri Molema District Municipality, which only provides 13% of the services that DMs could provide. On the other extreme is John Taolo District Municipality, which provides 69% of these services. The provincial distribution also shows some wide disparities. District municipalities in Gauteng, North West and the Free State perform the lowest proportion of functions. This means that, over time, the MECs for local government in these provinces have transferred most of the functions to their local municipalities. However, in KwaZulu-Natal, the Eastern Cape and Western Cape, it would seem that the shift has been in the opposite direction, as these provinces perform a significantly higher proportion of functions.

Figure 11.5: Proportion of services provided by district municipalities according to district municipality



Source: Commission's calculations

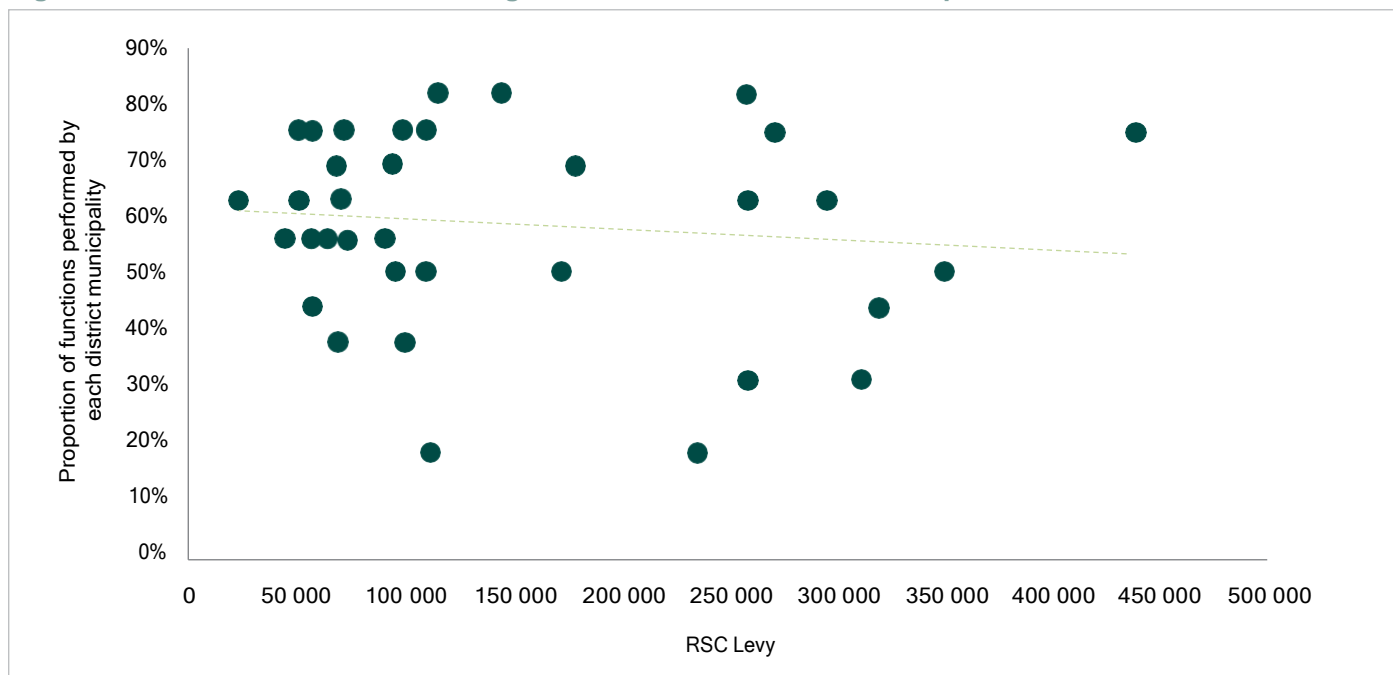
Figure 11.6: Proportion of services provided by district municipalities according to province



Source: Commission's calculations

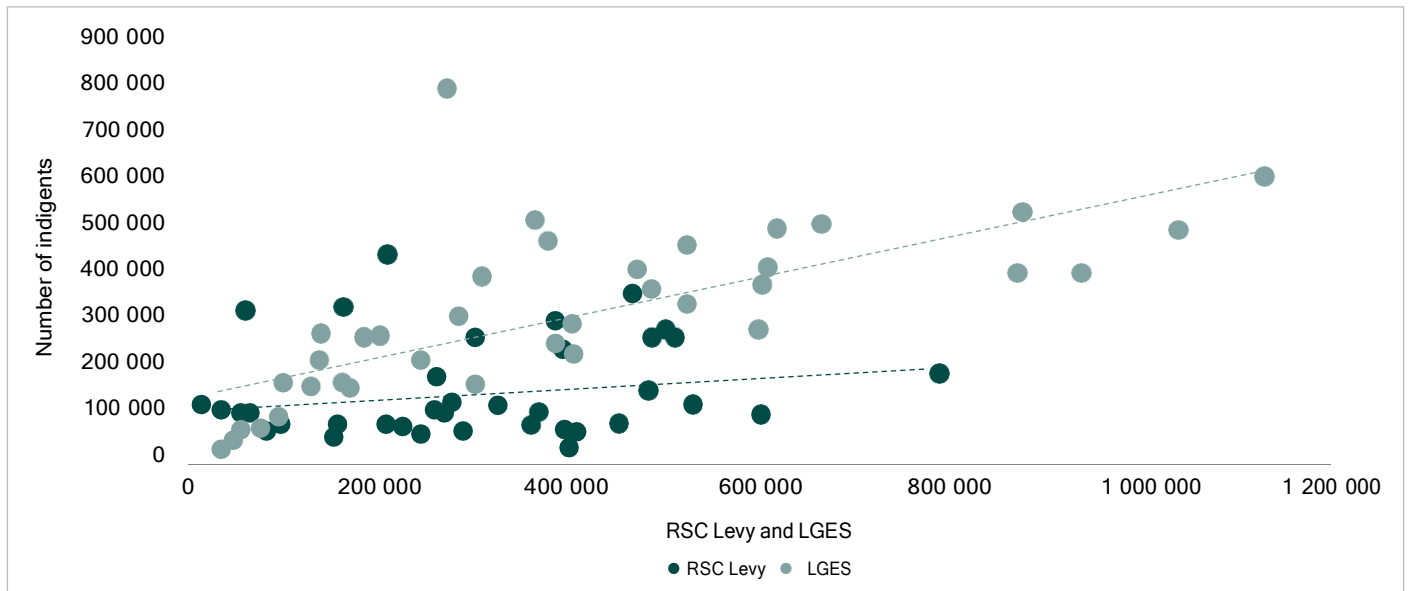
The link between the functions and the requisite funding instruments is an important one for any government structure that receives transfers. The principle of funding following function is a pillar of an efficient transfer system. Figure 11.7 and Figure 11.8 test this principle regarding the RSC Replacement Grant. Figure 11.7 shows the correlation between the proportion of functions provided by district municipalities and the RSC Replacement Grant. This figure simply shows that the link between the two variables is weak and even slightly negative. This means, to a certain extent, that district municipalities with fewer functions are allocated disproportionately larger RSC replacement grants than district municipalities with more functions. Figure 11.8 shows a weak link between the RSC Replacement Grant and the number of indigents. The expectation is that the RSC levy would serve the poor. This is the case regarding the LGES, as shown by its positive correlation with the number of indigents.

Figure 11.7: The link between funding instruments for district municipalities and functions



Source: Commission's calculations

Figure 11.8: The link between funding instruments for district municipalities and the number of indigents



Source: Commission's calculations

While Figure 11.5 and Figure 11.6 show that the powers vested in the MEC responsible for local government as contained in section 84 of the MSA has created a de facto asymmetrical system of allocation of functions across districts, Figure 11.7 and Figure 11.8 confirm the absence of objective criteria in the allocation of the RSC Replacement Grant and the absence of a clear link between the RSC Replacement Grant and functions performed by district municipalities. This analysis points to two conclusions. Firstly, the foregoing analysis suggests that the adjustments and re-adjustments of functions between district and local municipalities in many provinces have rendered the funding framework for district municipalities unfair, inefficient, and ineffective. Secondly, the analysis suggests a need for a long-term sustainable funding model for district municipalities, which should be based on their functions.

11.3.3 Towards a funding framework for district municipalities

The preceding sections of this chapter highlight the challenges associated with the division of powers and functions between district and local municipalities. The sometimes-blurred division of functions between local and district municipalities has resulted in overlaps and duplications. This has not only caused inefficiencies in the delivery of services, but has also created accountability deficits in the system. There is, therefore, a need to review the MSA, in particular section 84, to streamline the division of powers and functions between district and local municipalities.

The foregoing discussion has also emphasised the inefficiencies associated with the funding model for district municipalities. The RSC Replacement Grant, which accounts for over 20% of the budgets of district municipalities, is unfair, inefficient and unsustainable. It renders many district municipalities unviable and unable to fulfil their constitutional obligations. This funding window is not based on any objective criteria, save for the pre-2006 collection rates. As has been underscored above, there is a need for a sustainable funding model for district municipalities.

The Constitution (and other enabling pieces of legislation) is clear on the role of district municipalities. Besides the provision of bulk services, district municipalities have an important role to play in local economic development, as well as planning and coordinating development in the local sphere. As noted above, district municipalities are envisaged to play a crucial role in the roll-out of the DDM. According to

CoGTA, “the role of local government being the closest sphere to the people remains most critical in the DDM...”. Although there will be many role players (all three spheres of government, sector departments, state entities, etc.) in the roll-out of the DDM, its success will depend, among other factors, on strong, viable and sustainably resourced district municipalities. The funding model of district municipalities should ideally respond to these new imperatives.

First, the Commission proposes a review of section 84 of the MSA to streamline the powers and functions of district municipalities relative to the powers and functions of local municipalities. Second, the powers invested in the MECs responsible for local government to adjust the functions of local and district municipalities (section 84 of the MSA) should be repealed so that there is some standardisation of the powers and functions of district municipalities. A standardisation of these powers and functions will ensure an efficient funding model for district municipalities.

The Commission proposes a new funding model for district municipalities that is anchored on the following principles:

- Equity
- Efficiency
- Objectivity
- Predictability
- Accountability
- Political acceptability
- Simplicity and transparency
- Funding follows function

The funding model should amalgamate the LGES portion for district municipalities and the RSC Replacement Grant into one funding window. The horizontal distribution of resources through this window should be based on a formula. The Commission proposes the following four components of the district municipalities funding model:

- Bulk services component: This component will be used to defray costs associated with the purchase of bulk services such as water, electricity, refuse removal and sanitation for poor households. Ideally, this funding component should be based on a district municipality’s population of indigents and its size
- Institutional and community services: Presently, all district municipalities are receiving this allocation
- Local economic development component: District municipalities should ideally play a crucial role in local economic development (e.g. promoting tourism)
- District-wide planning, coordination and reporting

11.3.4 *Summary of the interviews*

Powers and functions

The 1998 White Paper on Local Government, section 83 of the Local Government: Municipal Structures Act of 1998, and the Intergovernmental Fiscal Relations (IGFR) Act of 2005 outline the roles of the district municipalities. The municipalities have been assigned 16 powers and functions to perform. From the stipulated powers and functions, many districts perform about 10 to 14 powers and functions. This is due to the sharing of functions, the adjustment of powers and functions by MECs and insufficient funds. The district and local municipalities share powers due to insufficient capacity. The sharing of powers and functions between the local and district municipalities has some negative implications, such as poor cooperation between the parties and unfunded mandates. The most-shared function between local and district municipalities is the firefighting function and LED (tourism). District municipalities are faced with

the challenge of MECs adjusting powers and functions. The adjustment is mostly related to the bulk service supply of water. As a result, they lose their funding for bulk infrastructure. The IDP Manager of the Alfred Nzo District Municipality recommends that the district be capacitated sufficiently to resolve the issue of sharing powers and functions. The IDP Manager of the Kenneth Kaunda and John Taolo district municipalities recommends that clear legislation and the consequences of not abiding by legislation should be stipulated. Another recommendation came from the West Coast District Municipality. The delegate recommends that district municipalities should be provided with the opportunity and funding from the national pool of funds to execute the mandated functions assigned to them in terms of sections 83 and 84 of the MSA to solve the sharing of powers and functions. Lastly, the manager for the Gert Sibande District Municipality calls on section 85 of the MSA, which grants powers to the MECs of local government to adjust the powers and functions of district and local municipalities, to be reviewed as some of the adjustments are not objective and are driven by political pressure.

Funding framework

According to the analysis of the interviews with officials from the selected district municipalities, they are all faced with funding challenges. The district municipalities are operating on a limited budget and with insufficient funds. This hampers the districts from fully performing their constitutional mandates. The allocated funds to district municipalities do not correspond with the powers and functions they have to perform, which results in funding not following the functions. Another challenge is that district municipalities are not getting any benefits for the export activities operating in their regions, and are being denied the petrol levy, even in districts that have major roads such as the N1. Poor district municipalities are allocated less resources than those doing well. Therefore, the current funding model does not promote equality. A new funding model needs to be generated to promote fairness and equity.

Local economic development

The district municipalities' role in the LED space is to coordinate and facilitate platforms, while establishing new ventures that allow them to grow and develop. Districts build a conducive environment for sustainable and inclusive economic development. Supporting small, medium and micro enterprises (SMMEs) with stipends, engaging mines to monitor social labour plans, and providing production inputs to upcoming agricultural and tourism programmes are some of the strategies that district municipalities have been using effectively to promote LED. However, the districts have not been completely effective as they are faced with the challenge of inadequate funding and the inability to charge capital on the projects they initiate. Budget constraints, the lack of relevant instruments to measure actual district growth, the uncoordinated approach of investors and a lack of access to economic opportunities are some of the major factors hindering the success of the LED strategies.

Views on the District Development Model

According to delegates from the selected district municipalities, the DDM is a well-constructed model that will assist the three spheres of government to co-plan, co-budget and co-implement. The DDM has the potential to make a difference, provided that it is legislated, and current legislated planning instruments are repealed. Some of the government officials interviewed believe that the DDM will be able to solve the powers and functions, funding and service delivery issues if it is effectively implemented. If resources are channelled towards projects and programmes that will achieve a greater impact, and create more economic spin-offs and more sustainable job opportunities, the model will allow them to maximise impact and align the resources at their disposal. However, the lack of capacity, both in terms of human and financial resources, is noted as a factor that may hinder the successful roll-out and implementation of the DDM.

11.4 Conclusion

The main objective of this chapter was to evaluate the appropriateness of the current district funding model, examining whether the model is aligned with the powers and functions of district municipalities so as to enable the recommendation of an alternative funding framework and a suite of measures that would enhance the role of district municipalities in the DDM.

Findings from the analysis show that the current funding model for district municipalities is not equitable, efficient or objective, and is not aligned to the powers and functions performed by district municipalities. The analysis shows that most district municipalities in South Africa suffer from shared functions with local municipalities, and are subject to the adjustment of powers and functions by the MECs of local government, as set out in section 85 of the MSA. The sharing of powers and functions has more often than not resulted in the duplication of functions, and confusion over who should be providing certain services in the local government sphere. This confusion leads to delays in the delivery of basic services, and sometimes in the local government sphere completely failing to deliver such services to the end-users.

The adjustment of powers and functions by the MECs of local government, on the other hand, often results in the necessary funds not following the adjusted functions to the receiving municipalities. This leads to a financial burden on the side of the receivers as they are now compelled to adjust their already thin budgets to accommodate the newly allocated function(s).

On the issue of district municipalities' funding framework, the chapter finds that the current framework, i.e. the LGES and RSC Replacement Grant, do not speak to the realities of district municipalities, i.e. the funding is not sufficient to meet the district municipalities' needs; hence the inability of the sector to fully render their constitutional mandates. The chapter finds that, more times than not, the current framework is not aligned to district municipalities' powers and functions. Therefore, district municipalities are often compelled to take on unfunded mandates, which continues to harm them financially.

Lastly, on the issue of whether district municipalities are well capacitated to play the leading role as envisaged by the DDM, the chapter finds that, while the DDM is a policy worth pursuing, there are factors that may hamper the roll-out and successful implementation of this plan. These factors include the following:

- Many district municipalities in South Africa are still dysfunctional. As a leading player in the model, one would expect the model to be led by a strong and well-functioning institution. It is important, therefore, for government to change the status quo of district municipalities to enable them to play the role as envisaged by the DDM
- The lack of clarity of powers and functions in the local government sector still causes wasteful duplication, uncertainty, and sometimes competition between district and local municipalities. These conflicts do not allow for an environment of good communication, cooperation and coordination in the local government sphere; factors that cannot allow the DDM to thrive.
- The adjustment of powers and functions by the MECs of local government renders district municipalities less functional, causing confusion and uncertainty among key players in local government.
- Lastly, the lack of or limited institutional, financial and human resources capacity, in the district municipalities leaves a lot to be desired. This is, in fact, found to be the main reason why the majority of district municipalities in the country are dysfunctional. Weak institutions, therefore, may not do justice to the roll-out of the DDM.

Having noted these weaknesses and factors that may hinder district municipalities from playing the role envisaged by the DDM, it is important to underscore and summarise some of the policy options that this chapter has advanced, and which government can pursue to optimise the role of district municipalities in the DDM.

First, the institutional weakness that renders many district municipalities dysfunctional should be uprooted. This includes reviewing the current funding framework to align the funding of district municipalities with the powers and functions performed.

Secondly, the capacity of district municipalities should be strengthened as this will prepare them to play a leading role in the DDM. District municipalities should be capacitated so that they can effectively coordinate development planning, while helping weaker municipalities to provide services, as well as making them well conversant with what the DDM entails.

Lastly, as a matter of urgency, clarity needs to be provided on the functions and powers of district municipalities. In line with the White Paper on Local Government, district municipalities' powers and functions should encompass district-wide planning, the coordination of strategic development and intergovernmental relations policy issues, the provision of technical assistance to local municipalities, the development of district-wide planning frameworks, the provision of district-wide services, and the provision of bulk water, sanitation, refuse removal and services to district management areas.

In conclusion, the analysis supports the need for a new funding model for district municipalities and a review of sections 84 and 85 of the MSA. In the view of the Commission, these are the main issues that may affect the roll-out and successful implementation of the DDM. If issues around the funding framework are resolved, and the powers and functions of district municipalities are well defined and standardised, the DDM may prove to be the change South Africans have been longing for.

11.5 Recommendations

The Commission makes the following recommendations:

1. *The Department of Cooperative Governance and Traditional Affairs should speedily review and repeal section 84 of the Municipal Structures Act to streamline the powers and functions of district municipalities to correspond with those of local municipalities*

The empirical analysis points to uncertainty and lack of clarity of municipal powers and functions within the two-tier local government system as one of the main reasons municipalities are unable to fulfil their constitutional mandates. As such, repealing section 84 of the MSA will help stabilise and better manage the environment for adjusting powers and functions, and better inform the local government funding model.

There is a need for a long-term sustainable funding model for district municipalities, which should be based on the outcomes of the review of district municipality functions being undertaken by the Department of Cooperative Governance and Traditional Affairs. Developing a sustainable funding model for district municipalities will require a clear specification of their powers and functions, a proper appreciation of the situational context and interrelationship with local municipalities, and a clear link between funding and functions. The Commission recommends that clarity on the functions and powers of district municipalities is needed as the first key step.

2. *The Department of Cooperative Governance and Traditional Affairs should review and amend section 85 of the Municipal Structures Act to allow an adjustment of powers and functions by the Member of the Executive Council for Local Government to be followed by the adjustment of funding.*

The Member of the Executive Council for Local Government in a province may, subject to other provisions, adjust the division of functions and powers between a district and a local municipality as set out in section 85(1) or (2), allocating any of the remaining functions and powers vested in the district municipality to the local municipality and vice versa. The exercise of these powers by the Member of the Executive

Council has the potential effect of creating a de facto asymmetrical system of allocation across district municipalities.

In the analysis of the interviews with the district municipalities, the Commission discovered a lack of formal service-level agreements in cases where municipalities perform functions on behalf of provinces and national departments, translating into unfunded (or underfunded) mandates. Unfunded mandates result in the diversion of financial resources from municipal core functions. The division of powers envisaged in section 84 of the Municipal Structures Act has been adjusted and re-adjusted in many provinces, making it difficult to find a fair funding model for district municipalities.

It is also advisable that some legally binding agreement is entered into between the parties involved prior to accepting and implementing assigned and delegated additional functions or powers.

- 3. National Treasury should immediately abolish the Regional Services Council Replacement Grant and combine the Local Government Equitable Share for district municipalities and the Regional Services Council Replacement Grant under one funding instrument.*

This funding window should be distributed among municipalities using a formula anchored on the principles suggested by the Commission and the components proposed by the Commission. The principles and critical parameters should be consulted widely before adoption. The current funding model is not pro-poor. The research analysis showed a negative correlation between the number of indigents and the Regional Services Council Replacement Grant, meaning that a district municipality with a high poverty level is allocated less funds. To a certain extent, district municipalities with fewer functions are given disproportionately larger Regional Services Council replacement grants than district municipalities with more functions.

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FINANCIAL AND FISCAL COMMISSION

2nd Floor, Montrose Place, Bekker Street, Waterfall Park, Vorna Valley, Midrand, South Africa
Private Bag X69, Halfway House, 1685

Midrand Office: Tel: +27 11 207 2300
Cape Town Office: Tel: +27 21 487 3780

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