FINANCIAL
AND FISCAL
COMMISSION

BRIEFING ON 2019 APPROPRIATION BILL

10 July 2019

For an Equitable Sharing of National Revenue

OUTLINE OF 2019/20 SUBMISSION CHAPTERS

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COMMISSION

1. Background and Role of the Commission

- Submission made in terms of S4(4c) of MBPARMA (Act 9 of 2009)
  - Requires Parliamentary Committees to consider any recommendations of FFC during deliberations on Money Bills
- Also made in terms of FFC Act of 1997 as amended
  - Requires that FFC responds to any requests for recommendations by any organ of state on any financial and/or fiscal matter(s) relevant to its mandate
- What is the FFC?
  - Permanent statutory body established in terms of Section 220 of Constitution
  - Independent and subject only to Constitution and the law
  - Must function in terms of an act of Parliament
    - Financial and Fiscal Commission (FFC) Act1997 as amended
- The Commission makes recommendations to Parliament on the equitable division of nationally raised revenue and on any other financial and fiscal matter

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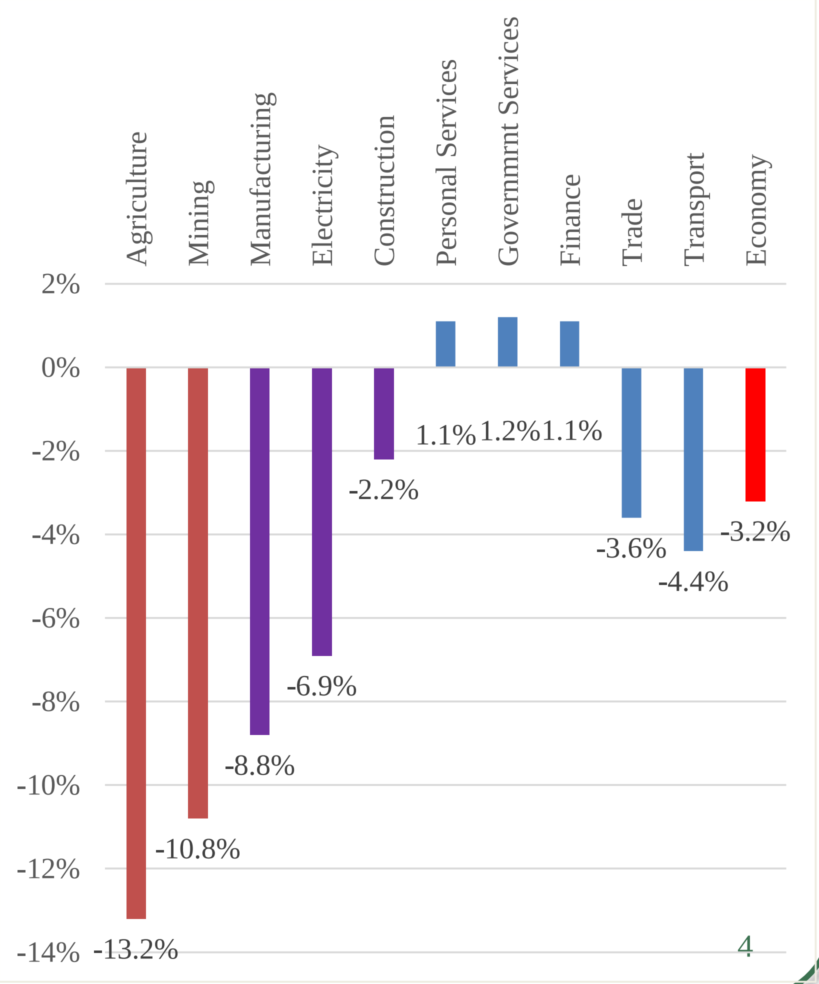
2. Context within which the 2019 Appropriation Bill is Tabled

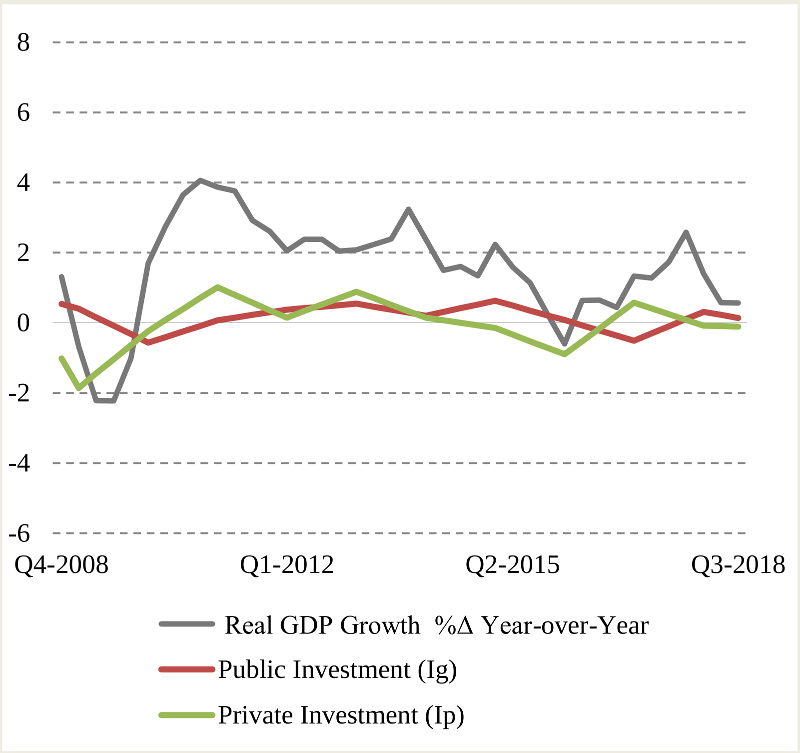
- The Appropriation Bill is a piece of legislation that serves to appropriate money from the National Revenue Fund for the requirements of national government and to provide for subordinate matters incidental thereto
- When the FFC commented on 2019 DoR Bill in February 2019, it noted that:
  - SA's economic prospects had deteriorated as real long-term growth had continued to decelerate and that years of institutional deterioration due to governance failures and policy uncertainties has caused structural degeneration
  - Operational and governance crises existed in key SOCs
  - Key domestic risks included: weak investment, high unemployment, huge wage bill, policy uncertainty, and domestic politics in the lead up to national elections held in May 2019
  - The 2019 Appropriation Bill comes at a time when this situation remains largely unchanged, if not bleaker. Following an increase in GDP of 1.4% in the last quarter of 2018, the economy has shrunk by 3.2% in the first quarter of 2019

2019 First Quarter GDP Growth



2. Context within which the 2019 Appropriation Bill is Tabled [cont.]

GDP growth and the contributions of public and private investments



- Positive sentiment that existed in February and which was generated by various presidential initiatives such as the investment envoys and the investment and jobs summit, seems to have lost momentum
- Whilst the constrained economic environment that SA faces has in part been driven by a slowing global economy, much of the challenges are domestic in nature:
  - Policy uncertainty particularly around the key issues of land reform and continued poor performance of SOCs continue to pose serious risks to the fiscus
  - Government needs to ensure that events in the political arena do not put the country's public finances and institutions charged with managing these resources further at risk

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3. Major Revisions, Additions and Innovations Contained in the 2019 Appropriation Bill and Service Delivery

Baseline Changes and Service Delivery Implications of the 2019 Appropriation Bill

- The 2019 Appropriation Bill is being considered just after the 2019 national elections, which led to several administrative changes within government
  - The changes include, among other things, a reconfiguration of national government departments by combining some of the departments
- The Commission welcomes the reconfiguration of the national departments and this development is likely to improve government efficiencies and effectiveness through streamlining government operations, and more importantly it will reduce pressure on the fiscus
  - These changes will not necessitate new appropriations. Its only a technical correction
- In the 2019 Appropriation Bill, Government has increased the total baseline for national departments by 3%
- Although there has been an overall increase, there are cuts in some departments
  - For example, the baseline for the department of Energy is reduced by 2%, and this department experienced a very high cut (-17) in the 2018 budget

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Baseline Changes and Service Delivery Implications of the 2019 Appropriation Bill [Cont.]

- The Commission acknowledges the need to reduce spending, given the current economic conditions
  - However, it remains concerned about the reductions in key sectors such as Energy, as they could have adverse effects on service delivery going forward

		Nominal growth rates			2019 Appropriation	Average real growth rates
Vote	**National Department**	**2016/17**	**2017/18**	**2018/19**	**2019/20**	**2016/17-2018/19**
11	Public Works	-6%	-3%	-1%	-1%	-8%
13	Women	0%	-1%	-2%	0%	-6%
14	Basic Education	-1%	0%	-8%	4%	-9%
15	Higher Education and Training	12%	0%	20%	0%	5%
16	Health	-1%	0%	1%	0%	-5%
17	Social Development	1%	-1%	0%	-1%	-5%
18	Correctional Services	-1%	-1%	-2%	0%	-7%
23	Police	0%	0%	-1%	-1%	-6%
24	Agriculture, Forestry and Fisheries	0%	2%	0%	1%	-5%
25	Economic Development	-2%	12%	27%	3%	7%
26	Energy	-2%	0%	-17%	-2%	-12%
36	Water and Sanitation	-7%	-6%	-6%	0%	-11%
38	Human Settlements	-8%	-3%	-9%	1%	-12%
39	Rural Development and Land Reform	-3%	-3%	-2%	-1%	-8%

Aggregate Spending and Deviations from the Final Budget

	Audited outcome			Average	Revised Estimates
Departments	**2015/16**	**2016/17**	**2017/18**	**2015/16-2017/18**	**2018/19**
11. Public Works	99,5%	98,3%	99,2%	99,0%	99,9%
13. Women	100,7%	98,9%	99,3%	99,6%	100%
14. Basic education	97,7%	95,8%	99,7%	97,7%	99,9%
15. Higher Education and Training	100,1%	99,6%	100,8%	100,1%	100,0%
16. Health	99,3%	99,7%	99,5%	99,5%	98,9%
17. Social development	98,9%	99,6%	99,4%	99,3%	99,9%
18. Correctional Services	100,0%	99,8%	99,9%	99,9%	100,0%
21.Justice and Constitutional Development	99,1%	99,1%	98,5%	98,9%	100,0%
23. Police	100,0%	100,0%	99,8%	99,9%	100,0%
24. Agriculture, Forestry and Fisheries	99,9%	99,6%	98,3%	99,3%	100,0%
25. Economic Development	99,8%	98,6%	99,8%	99,4%	100,0%
26. Energy	98,3%	99,5%	97,5%	98,4%	99,3%
36. Water and Sanitation	97,3%	97,9%	96,8%	96,8%	93,4%
38. Human Settlements	98,3%	99,6%	99,7%	99,2%	99,4%
39. Rural Development and Land Reform	99,1%	99,4%	95,5%	98,0%	100,0%
National Average	**99,2%**	**99,0%**	**98,9%**	**99,0%**	**99,4%**

- Over the period 2015/16 to 2017/18, most departments appear to have spent 99% or more of their allocated budgets
- There are however departments that spent below the national average, such as
  - Basic Education (97.7%), Justice and Constitutional Development (98.9%), Energy (98.4%), Water and Sanitation (96.8%) and Rural Development and Land Reform (98.0%)

Aggregate Spending and Deviations from the Final Budget [Cont.]

- The Commission notes that except for the Department of Basic Education, all the underperforming departments have been affected by the 2019 reconfiguration and is of the view that government should be cautious in the implementation of the changes to ensure that they have no undesirable effects on service delivery
- For the year 2018/19, the national average spending increased to 99.4%
  - There has also been a decline in the performance of some of the departments such as in departments of health (98.9%), and water and sanitation (93.4%)
  - The decline in the spending performance for the departments of water and sanitation is explained by the underspending in allocations for water infrastructure development
- This is concerning for the Commission given the significant backlogs in water services and deteriorating state of the existing water infrastructure
- Baseline reductions in the Departments of Women and Rural Development are cause for concern
  - As South Africa is facing unprecedented gender violations, it is imperative that the Department of Women is well resources to champion the cause of women and ensure that this Department is enabled to effectively catalyze the mainstreaming of gender in other line departments
  - The Appropriation Bill should also respond to the land reform imperatives as this has the potential to create many jobs in the country

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Risks to the 2019 Appropriation Bill

- There are various fiscal risks that are likely to have a negative effect on the 2019 Appropriation Bill. The poor performance of the economy is perhaps the greatest risk to the Appropriation Bill
- Other risks include: poor infrastructure delivery, poor project planning including maintenance plans which has often been inadequate; The precarious financial position of SOCs; the huge the public sector wage bill. The Commission is of the view that these fiscal risks should be addressed and failure to do so will undermine core service delivery functions
- On SOCs, the Commission notes that it is important for government to have specific timelines on these initiatives (e.g. unbundling of Eskom) and a clear plan for recapitalisation of SOCs given that most of them are struggling financially
  - The Commission notes the request by the Minister of Finance to amend the Appropriation Bill to include the allocation of R17.7 billion to Eskom – the Commission advises the Committee to amend the Bill accordingly as this aligns processes with legislative requirements. Further the Commission cautions that amendments in respect of authorising guarantees does not become the norm
- On the wage bill, efforts to rationalize the civil service are worth noting. The Commission has recommends additional measures such as stricter management of headcounts, discouraging the filling of non-critical vacant posts, and limiting the hiring of personnel in administrative and managerial positions

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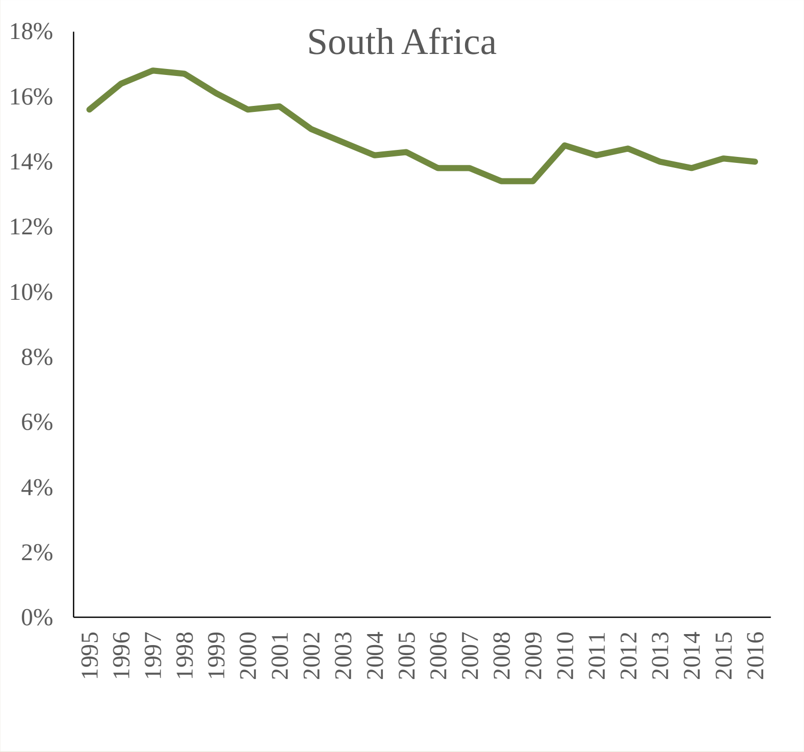
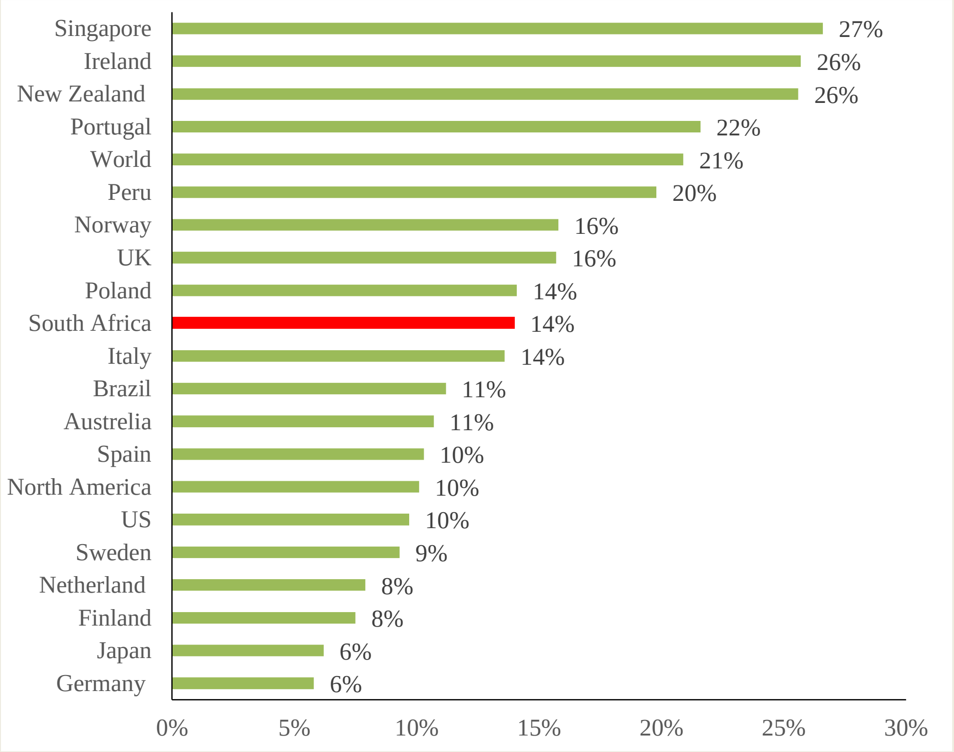
Wage Bill: Share of Employee Compensation in Public Spending





- Employee compensation generally declining
- Central government expenditure going to government employees is higher in comparison to other countries

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4. Transformation and Inclusive Growth in the 2019 MTEF

Promoting Economic Growth

- Faster growth is needed to attract more investment to stimulate the economy, such that more jobs can be created to raise the revenues needed for addressing the hereditary issues of poverty, inequality and unemployment
- The Commission applauds the government for adopting the recommendation to identify, explore and invest in industries where there is clear competitive advantage for an export-oriented growth strategy. These include high-value manufacturing exports (motor vehicles), agricultural exports (fresh fruits and nuts), finance and tourism
- South Africa must strengthen its cybersecurity and cybercrime investigation capabilities by enhancing its ICT skills specific education and training in order to advance labour supply to take up their positions with qualified ICT skills in the Fourth Industrial Revolution
- The Commission agrees with the President that local densification, greater investment in public transport and housing programmes development must be accompanied by a functioning local government base with complementary basic services
  - Hence, the FFC's 2020/21 Annual Submission for the Division of Revenue tabled on the 30 May 2019 in Parliament, focused on "Repositioning Local Government Public Finances"

Job Creation

- Between 1st quarters of 2008 and 2019, job creation remained stagnant as only 1.853 million jobs were created over the period compared to the 3.684 million new entrants in the labour force
- Moreover, it is estimated that 32.4% (approximately 3.3 million) of the young cohort, are Not in Employment, Education and Training (NEET) – meaning that close to one in three young South Africans are completely disengaged from the labour force without any sign of converging into the economic mainstream in the immediate future
- The Commission further notes that the state's human resource capacity has become top-heavy through the occupation specific dispensation (OSDs) at the cost of expanding entry- and junior-level positions. This resulted in costly public sector wage bill, discontinuity of legacy for skills and knowledge and inefficiencies of the public sector, culminating towards muted employment creation

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Health

- Health remains one of priorities for the 2019 appropriations
  - Accounting for 13.9% of the total MTEF consolidated expenditure, with budget allocation of R222 billion
- While the Commission welcomes government's commitment towards universal access to healthcare goal, it has a concern with respect to the slow pace at which National Health Insurance (NHI) is being rolled out and this is likely to affect the meeting of government's delivery targets
- Implementation of the NHI has a number of challenges, these include
  - Poor performance/spending of NHI conditional grants
  - Continuous rescheduling/changing the purpose of NHI – direct to indirect grant
  - Ongoing policy uncertainties with respect to the role of various player, flow of funding and applicable health package
- An amount of R2.8 billion has been reprioritised within the NHI indirect grant to fund critical health professional posts and community services posts
  - While the Commission supports this initiative, it recommends that there must a clear and direct link between filling posts and the implementation of the NHI

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EDUCATION

- The 2019 budget allocates R262 billion and R113 billion to the basic and post education respectively
  - This represents a 16% for basic education and 7% for post education of total consolidated budget
- The June 2019 SoNA placed emphasis on ensuring that children can read and write with comprehension by age 10
- While the Commission welcomes the fact that education remain one of key priorities, it notes with concern the continuous lack of improvements in education outcomes despite increasing financial resources
  - Only 40% of children who enter school each year complete matric and a high number of the National Student Financial Aid Scheme (NSFAS) beneficiaries are studying towards skills that are at risk of being displaced by the digital revolution

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Agriculture

- Agriculture and rural development receives 1.8% of the total consolidated budget – just over R30 billion in 2019 budget
- While the sector plays a crucial role in employing low and semi-skilled labour, its contribution to the national output has shown a decline over recent years
- A number of people living in rural areas seem to have disengaged from agricultural activities – data from the General Household Survey indicates that of 40% people in rural areas, only 15% of households are involved in agriculture
- The Commission is of the view that government agricultural support programs need to prioritise small scale commercial agriculture production

IMPROVED PUBLIC SERVICE

- The June 2019 SoNA emphasized the need to build a capable state that will deliver quality public service, free from corruption and maladministration
  - However, the practice shows different results, for example, the recent AG report on the financial performance of municipalities
  - Unfortunately, the responsibility for improving public services cannot be institutionalized within the budget framework
- The Commission is of the view that adressing these failures requires political commitment to legislated performance management guidelines and consequence management

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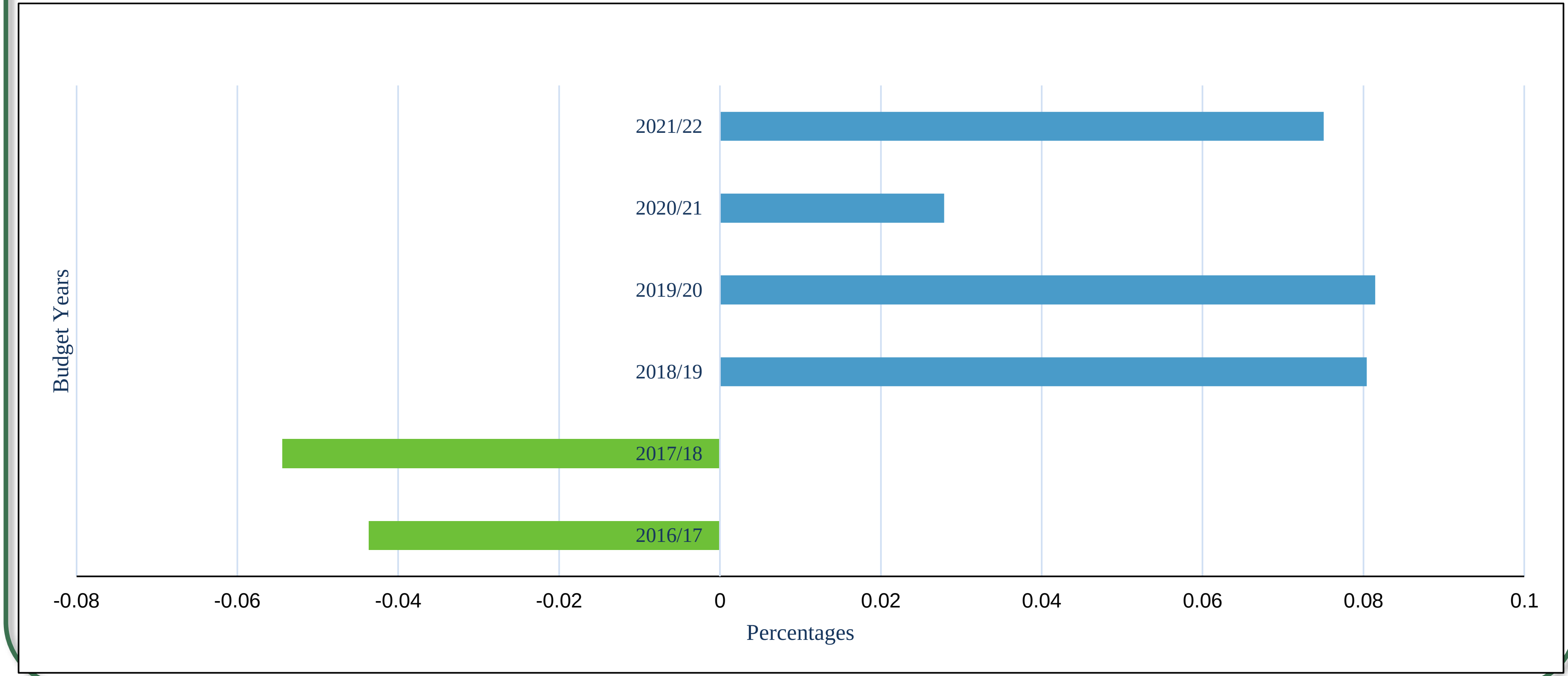
5. Infrastructure Allocations Provided for in 2019 Appropriation Bill

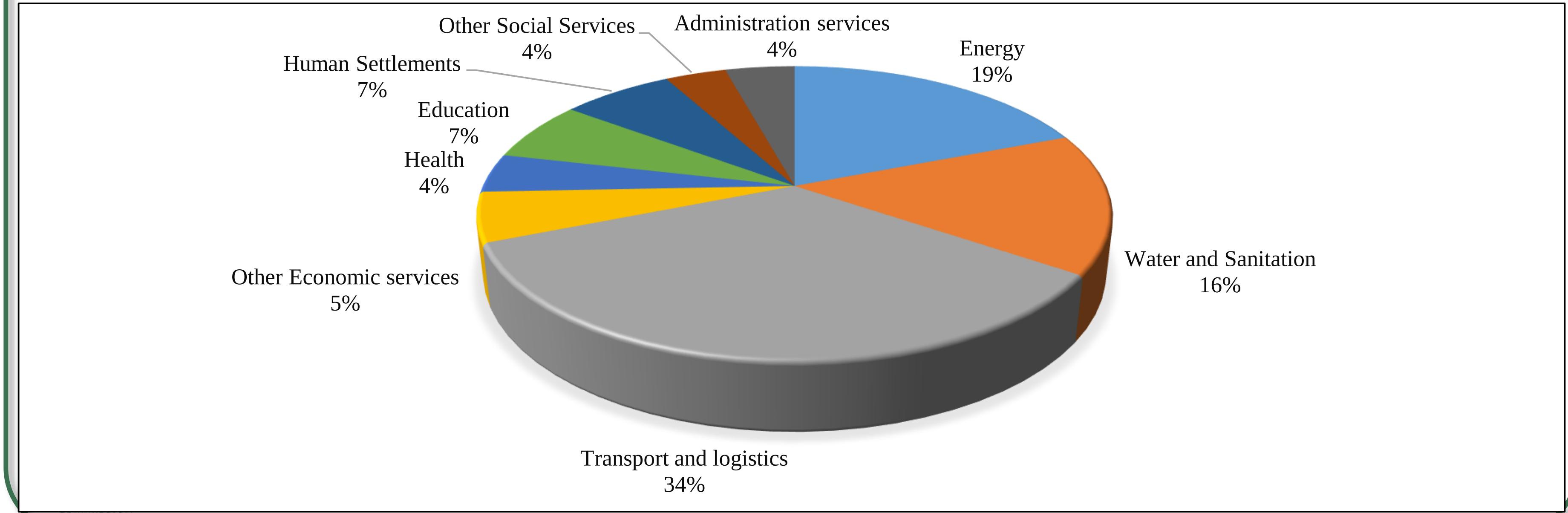
Infrastructure Expenditure Growth Rates are Declining

- Public sector expenditure on infrastructure will increase to R864.9 billion over the 2019 medium-term expenditure framework (MTEF) period. It will increase by 8.1% between 2018/19 and 2019/20, declining by 2.8% between 2019/20 and 2020/21, and increasing by 7.5% between 2020/21 and 2021/22



Infrastructure Investment Targeting Transport, Energy and Water

- In 2019/20, the transport and logistic sector is allocated over a third of the total public-sector infrastructure investment. The allocation to transport and logistics sector is increasing by 21.5% in 2019/20 and by 11.1% in 2021/22
- Allocations to other economic services; education; human settlements; other social services and administration services all show marginal increases, in nominal terms, over the 2019 MTEF whereas the allocation to health sector shows a marginal decline



Road Infrastructure Investment

- Road infrastructure is one of the key priority sectors for government over the 2019 MTEF period. Major investments in roads are with respect to the following:
  - the upgrading, strengthening and maintaining of non-tolled national roads amounts to R36.5 billion has been allocated for non-toll roads
  - for the construction of two bridges on the N2 Wild Coast project, R3.2 billion is allocated while R19.8 billion goes to the general road strengthening and maintenance
  - the provincial roads maintenance grant is allocated R36.5 billion to fund the resealing and rehabilitating of provincial roads, including R526 million for the maintenance of coal haulage roads in Mpumalanga.
- Despite these investments on roads, the road infrastructure network in South Africa remains in a very poor state and very costly to replace

Strengthening backlog for roads in poor and very poor condition							
	Paved			Gravel			
	% in poor and v.poor condition	length	cost (R million)	% in poor and v.poor condition	length	cost (R million)	Total cost (R million)
National	11.93	2 239	19 027	0	-	-	**19 027**
Provincial	22.26	15 301	130 028	65.67	94 131	18 826	**148 854**
Metropolitan municipalities	4.16	1 658	8 290	8.48	1 227	245	**8 535**
Local municipalities	3.62	1 363	4 089	28.54	86 245	17 249	**21 338**
Total		**20 561**	**161 434**		**181 603**	**36 320**	**197 754**

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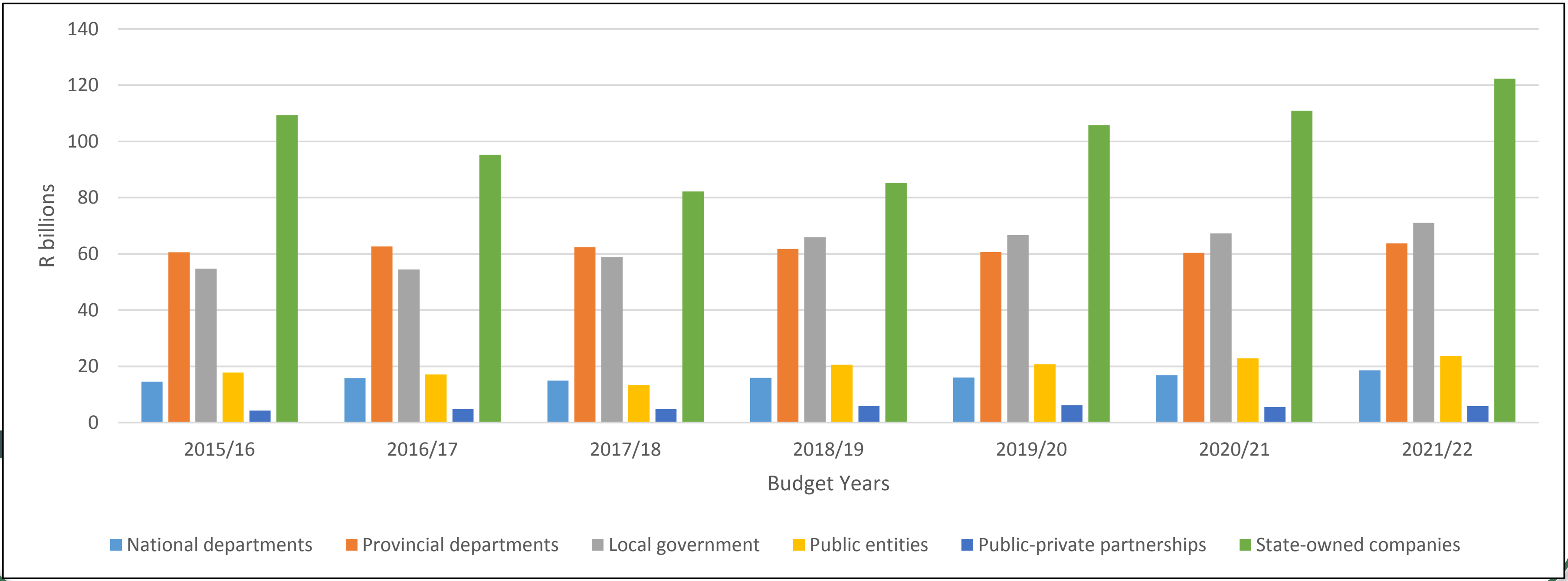
6. Challenges and Opportunities of State Owned Companies Funded Primarily Through 2019 Appropriation Bill

SOCs Takes Largest Portion of Infrastructure Investment

- In 2019/20, SOCs accounted for 38.3% of the total public-sector infrastructure investment, followed by local government at 24.2%, and provincial departments at 22%
- The allocation of public-sector infrastructure investment by SOCs will grow significantly, in nominal terms, over the 2019 MTEF at 13.09%, while the local departments will only grow by 2.54% and provincial governments by 1.12%



SOCs Challenges and Opportunities [Cont.]

- A number of SOCs have large government guarantees while their long-term viability is uncertain
- While government guarantees have remained relatively flat, exposure has notably increased, in turn increasing government's contingent liabilities and constituting a risk to the sustainability of the fiscus
- Given that guarantees are not exposed to the same level of scrutiny in the budget process as regular spending, the Commission advises that oversight mechanisms of guarantees should be strengthened to reduce the risk of unintended consequences from materialising

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SOCs Challenges and Opportunities [Cont.]

	2016/17		2017/18		2018/19	
R billion	**Guarantee**	**Exposure**	**Guarantee**	**Exposure**	**Guarantee**	**Exposure**
Eskom	350.0	202.8	350.0	244.7	350.0	294.7
SANRAL	38.9	29.4	38.9	30.4	38.9	30.3
Trans-Caledon Tunnel Authority	25.6	20.9	25.7	18.9	43.0	14.9
South African Airways	19.1	17.8	19.1	11.1	19.1	17.3
Land and Agricultural Bank of South Africa	11.1	3.8	9.6	3.8	9.6	2.5
Development Bank of Southern Africa	12.5	4.1	12.2	4.1	11.4	4.4
South African Post Office	4.4	4.0	4.2	0.4	–	–
Transnet	3.5	3.8	3.5	3.8	3.5	3.8
Denel	1.9	1.9	2.4	2.4	3.4	3.4
South African Express	1.1	0.8	1.1	0.9	1.2	0.2
Industrial Development Corporation	0.4	0.2	0.4	0.1	0.5	0.2
South African Reserve Bank	3.0	–	–	–	0.3	–
Total	**475.7**	**290.4**	**469.8**	**321.3**	**483.1**	**372.4**

- Eskom poses a greater risk to government's contingent liabilities
  - In 2018/19 guarantees to Eskom accounted for 72.4% of the total government guarantees to SOCs
- The Commission is of the view that a clear process, along with timelines, needs to be devised to guide the unbundling of Eskom

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7. Improving Public Sector Efficiency

- Improving efficiencies should be the hall mark of public sector service delivery. doing more with less should be the norm than the exception and there should be no room for complacency on this
- In reality, the level of inefficiency in the public sector remains high and growing. The AG report paints a very grim picture of the inefficiencies in government operations across the three spheres of government
- Many recent developments and proposals made by government to promote public sector efficiency are commendable including:
  - The recent reconfiguration of a number of government departments; Efforts to link public sector wages with productivity; Proposals to redefine and align the mandates of SOCs; Efforts to professionalise and rationalize the public service; and Reforms at the South African Revenue Service
- In addition, the Commission underscores the importance of modernising the public sector and leveraging on new technologies as well as minimising unnecessary outsourcing of services and tasks that can be performed by civil servants
- The Commission would also recommend increased support for oversight bodies to effectively hold executives to account as well as carrying out benchmarking exercises within the public sector

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CONCLUSION

- In its 2019 Submission to the Appropriation Bill, the Commission noted with great concern the gloomy environment in which the budget was presented
- The 2019 budget was presented under similar conditions, if not worse.
- The economy is perhaps the biggest challenge and risk to the 2019 Appropriation Bill
- More and more people have found themselves in a state of unemployment. Policy uncertainty evident last year, remain unchanged today, especially around the key issues of land reform, and the risks to the fiscus posed by precarious state of SOCs
- Events playing out in the political arena are not helping the situation either, but only help compound the uncertainties and risks to the economy and the country's public finances. The inconsistent messages regarding the independence of the South African Reserve Bank is a case in point

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Conclusion [Cont.]

- The Commission notes government efforts to address these challenges head on as pronounced during both the 2019 budget and two SoNA addresses by the country's President
  - In particular the Commission takes note of the following measures:
    - Efforts to improve the governance of state-owned enterprises
    - Attempts at reconfiguring and rationalising the state machinery
    - Efforts to confront the scourge of corruption through the Commissions of inquiry
- The Commission is in agreement with the general thrust of the Appropriation Bill. FFC understands the tough choices that the government has to make. Government is treading a fine balancing act of diminishing revenues available for sharing on one hand, and maintaining the social wage on the other
- Although education and health remain top priorities for the 2019 appropriations, the Commission welcomes the prioritisation articulated in the SoNA and explicit emphasis on spatial integration, human settlements and local government

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CONCLUSION [CONT.]

- On health the Commission is concerned that government is unlikely to meet its delivery targets due to the slow pace of the NHI roll out. It is important that the government improves spending of NHI conditional grants, irons out policy uncertainties regarding the roles of various players in the delivery of health care, and in addition, ensures that there is a clear and direct link between filling posts and the implementation of the NHI
- In order for the South African economy to achieve sustainable long term growth the education system must produce the necessary skills, especially among the young. The Commission is of the view that the underlying reasons for this worrying educational outcomes should be investigated and resolved as a matter of urgency and available resources be channeled into improving education throughput rates
- On SOCs, the Commission advises that oversight mechanisms of guarantees should be strengthened to reduce the risk of unintended consequences from materialising
  - On Eskom the Commission is of the view that a clear process, along with timelines, needs to be devised to guide the unbundling of Eskom
- The Commission notes government efforts to improve efficiency. In addition the Commission recommends that benchmarking exercise within government are encouraged, and oversight bodies across all spheres are supported in order for them to effectively hold the executive to account

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