Briefing to the the Standing and Select Committees on Appropriations on the Division of Revenue Amendment Bill and Adjustments Appropriation Bill

Financial and Fiscal Commission

9 July 2020

For an Equitable Sharing of National Revenue

INTRODUCTION

- The Coronavirus pandemic has caused an unprecedented shock to the economy and people's livelihoods.
- It has amplified and compounded existing structural fragilities in the economy and pushed the already fragile fiscal metrics downward faster than anything ever seen since the financial crisis a decade ago. On the social front, it has amplified the existing inequalities, condemned many people into poverty and unemployment and has made it increasingly difficult to be on course in attaining the national priorities, and NDP and sustainable development goals.
- It has turned the February 2020 budget upside down and made the fiscal framework tabled in February no longer attainable
- In response, on 24 June 2020, the Minister of Finance presented a special adjustments budget (the 2020 Division of Revenue Amendment Bill and Adjustments Appropriation Bill). An adjustment budget is simply a technical adjustment tool to take into account Covid-19 induced changes in the economy; government's response to the health crisis caused by Covid-19 as well as the economic impact. It is not a policy statement. The policy statement is expected in October (i.e. MTBPS).
- In line with the request from the Standing and Select Committees on Appropriations, the Commission makes this submission on the 2020 Division of Revenue Amendment Bill and the Adjustments Appropriation Bill in terms of Section 214 (1) of the Constitution and Section 35 of the Intergovernmental Fiscal Relations Act (1998) as well as S4(4)(c) of MBAPARMA (2009), as amended.

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PRESENTATION OUTLINE

- The macroeconomic and fiscal outlook;
- The technical changes to the Division of Revenue Amendment Bill and Adjustments Appropriation Bill,
- Changes to the Adjustments Appropriation Bill
- Changes to the Division of Revenue Bill
- Conclusion

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BACKGROUND: MACROECONOMIC AND FISCAL POLICY OUTLOOK

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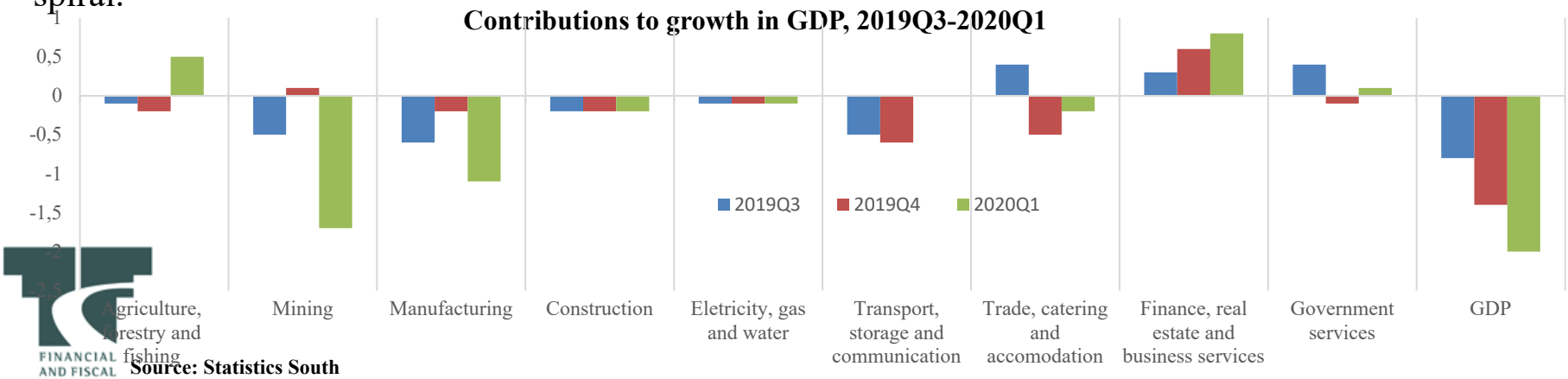
DOMESTIC ECONOMY IN DEEP RECESSION

- The economy has entered into a deeper recession after GDP growth contracted by 2% in 2020Q1, a 3rd consecutive quarter of negative growth. On the supply side, labour intensive sectors - manufacturing and construction, and strategic sectors - trade and transport negatively contributed to GDP for three consecutive quarters. On the demand side, gross fixed capital formation also negatively contributed to GDP for three consecutive quarters.
- Real GDP growth is projected to contract by 7.2% in 2020, primarily due to the Covid-19 impact.
- SA's growth challenges are structural but the policy dilemma is that financing of the required reforms to boost growth are hamstrung by the constrained fiscal and debt situation, which itself primarily results from SA's prolonged slow growth.
- Slow growth has translated into tax revenue growth contraction which together with increasing spending has resulted in a ballooning budget deficit, triggering fears of an unsustainable public debt spiral.

Contributions to growth in GDP, 2019Q3-2020Q1



Source: Statistics South Africa, 2020

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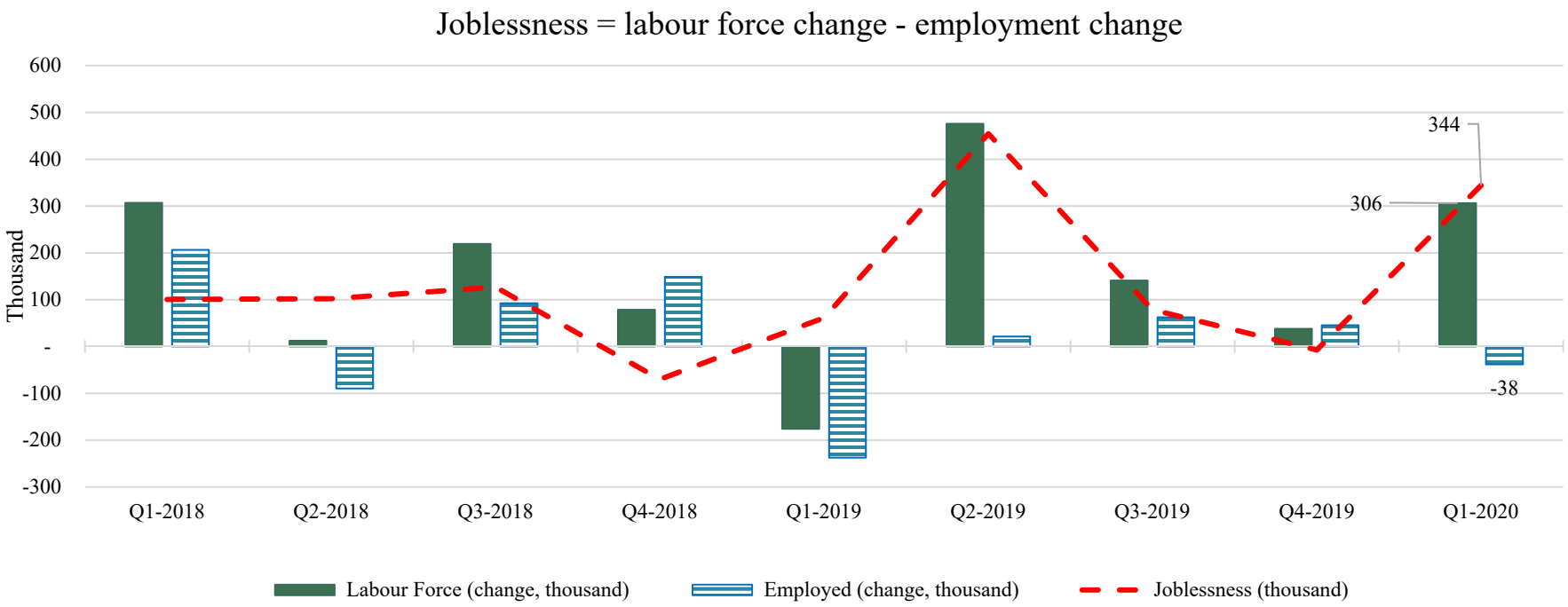
COVID-19 IMPACT: CHANGES IN EMPLOYMENT AND JOBLESSNESS, Q4 2019 – Q1 2020



- 38 000 jobs were lost in Q1 2020, with the addition of 306 000 entrants in the same quarter unable to find jobs in the labour market.
- Hence, the total estimated unemployment increased by 344 000 resulting in 7.07 million unemployed individuals in South Africa.

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Source: Statistics South Africa, Quarterly Labour Force Survey (Q1 2020) and own calculations

COVID-19 IMPACT: CHANGE IN EMPLOYMENT BY OCCUPATION AND INDUSTRY, Q4 2019 – Q1 2020

by Occupation	2019Q4-2020Q1 (change, thousand)	by Industry	2019Q4-2020Q1 (change, thousand)
Manager	4	Agriculture	-21
Professional	-22	Mining	6
Technician	-44	Manufacturing	-15
Clerk	-59	Utilities	-4
Sales and services	15	Construction	-7
Skilled agriculture	-10	Trade	71
Craft and related trade	33	Transport	-17
Plant and machine operator	11	Finance	-50
Elementary	44	Community and social services	-33
Domestic worker	-9	Private households	30
Other	-2	Other	2
Total employed	-38	**Total employed**	-38

- The data illustrates that job types such as clerk, technician and professional suffered the most losses during the period under review, losing 59 000, 44 000 and 22 000 jobs, respectively. Meanwhile, elementary (e.g. messengers, package and luggage porters and deliverers), craft, related trade and sales and services increased, potentially due to essential services nature.
- In terms of jobs by industry, finance, community and social services and agriculture suffered the most job losses, whereas the trade industry gained.

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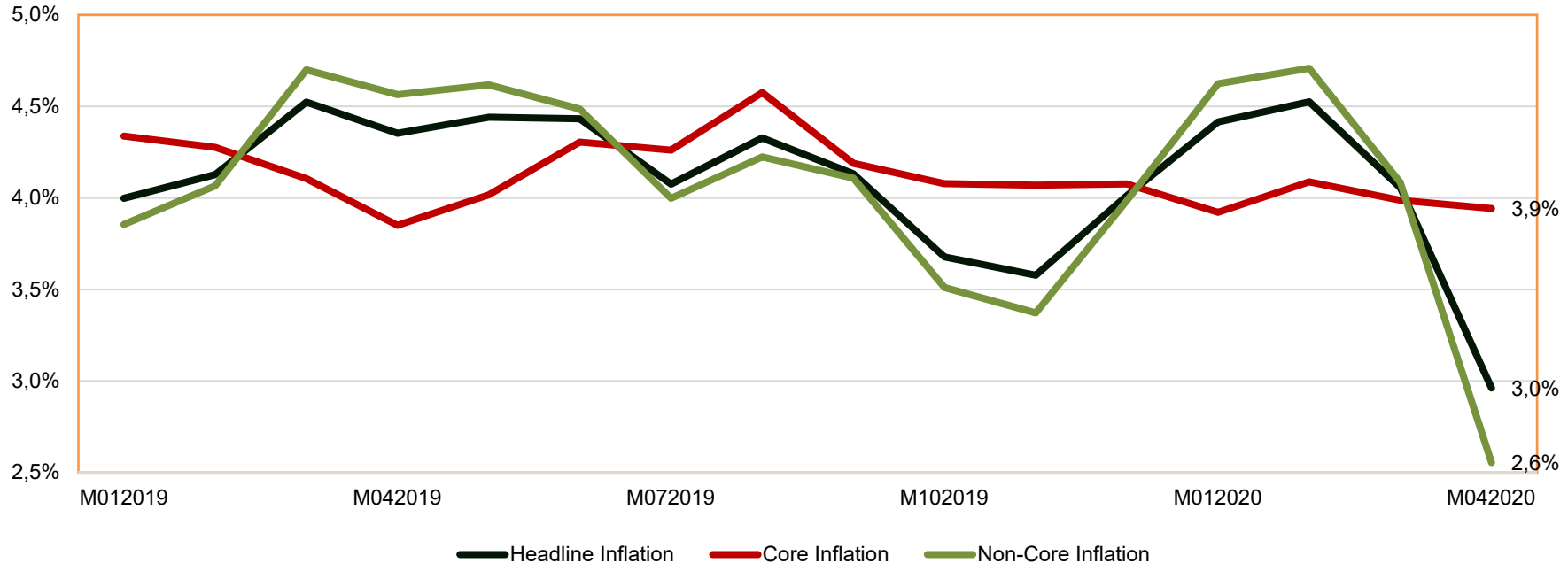
Source: Statistics South Africa, Quarterly Labour Force Survey (Q1 2020) and own calculations

COVID-19 IMPACT: FINANCIAL STABILITY AND CORE INFLATION



- Due to the sharp decline in economic activities and transactions, prices become more stable. Headline inflation is now at the lower-bound of the targeting range at 3 per cent.
- However, Core inflation which includes: food, non-alcoholic beverages, clothing and footwear, housing and utilities, health, public transport, communication and education items saw a higher price inflation for these essential items during the COVID-19 pandemic.

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Source: Statistics South Africa, Quarterly Labour Force Survey (Q1 2020) and own calculations

FISCAL OUTLOOK AND DOWNSIDE RISKS

- Consolidated budget deficit will more than double from 6.8% to 15.7% of GDP for 2020/21. Government debt will increase from 81.8% GDP in 2020/21 to 86% in 2022/23 in the active scenario. Debt service costs will increase to 22% of government revenues in 2020/21 from 15% in 2019/20.
- Primary budget balance, a fiscal effort measure, is projected to narrow to -2.3% of GDP in 2022/23, compared to the -1% of GDP in the 2020 Budget, reflecting a big conundrum regarding how to stabilise the public debt trajectory. High debt service costs coupled with a weak growth outlook means that the primary budget balance needs to improve in the medium term to a surplus in order to stabilise the debt ratio. This rests on government's ability to push for unpopular but much-needed reforms that could take time and face many hurdles in such unprecedented times.
- The historical budget deficits basically emanated from increased financial support for SOEs. Some SOEs (Eskom in particular) continue to face financial difficulties that may require further government support, representing a contingency liability risk to the fiscus.
- Furthermore, debt accumulation has largely financed wage and interest bill increases, as opposed to growth-enhancing investments. The rising wage and interest bill will crowd out other social and investment spending priorities, worsening longer-term economic growth prospects.
- The fiscal space has been depleted by high debt levels, contingent liabilities, and an increasing interest bill. This means that responding to any economic shock will require larger adjustments than would otherwise be desirable in the context of subdued growth.

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POLICIES TO BOOST GROWTH

At the Macro level -Growth friendly and expenditure based consolidation of public finances by reducing unproductive spending, focusing on compensation costs, interests costs and rationalising supporting SOEs.

- Deterrence of transfer pricing and profit shifting, strengthening tax administration and reducing certain tax breaks.
- Reducing policy and regulatory uncertainty through greater consistency in policy statements and structural measures to strengthen governance in SOEs.
- On the wage bill, the Commission reiterates its previous stance that the debate should be guided by what the SA context shows to be the best size and shape of the public sector. Also noting that efforts to partially contain the wage bill through voluntary retirements are not succeeding, there is a need to factor in different scenarios into the growth trajectory going forward (e.g. if negotiations succeed/fail, what will be the impact on growth).

At the Micro level:- Reducing distortions in product and labour markets by increasing competition, including seeking strategic equity partnership with the private sector, labour market flexibility and removing regulations that allow market dominance.

- Improve provision of inputs and their quality such as stabilising the financial situation of input oriented SOEs, in general, and Eskom in particular, to reduce fiscal burden, ensuring reliable electricity supply, efficient pricing and allowing private sector participation as well as enabling competitive use of spectrum to private sector participants as well as more clarity on land reform.
- Strengthening institutions through restoring the integrity of key state institutions, empowering prosecuting authorities and tax collection and prosecution authorities. Fighting corruption and governance by enhancing the autonomy of anti-corruption agencies

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TECHNICAL CHANGES

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ASSESSMENT OF THE 2020 DOR AMENDMENT BILL

- Overall the structure and most aspects of the Bills remain stable.
- Taken together FFC supports the technical changes and clauses in the two Bills as they enhance accountability (timelines for provincial responses, reporting on remedial action, consultation on transfer amounts and payment schedule), flexibility in the implementation and adjustments.

Adjustment to DoR Amendment Bill	FFC View
Clause 5(3)(b) is added to the amendment bill and states that in addition to the dates of transfer (municipality's equitable share) referred to in the bill, the National Treasury may, after consultation with the national department responsible for local government and by notice in the Gazette, determine one or more dates of transfer.	FFC notes this amendment and is of the view that whilst it would create flexibility in terms of transferring funds, caution should be exercised that the determination of more dates of transfer does not result in inconsistencies in financial processes in place/reporting mechanisms as well as in meeting objectives of how monies ought to be spent.
There is also Substitution of Column A of Schedules 1 and 3, Parts A and B of Schedule 4,Parts A and B of Schedule 5, Parts A and B of Schedule 6, and Part A of Schedule 7 on the Amendment bill	FFC also notes the substitutions of column A of Schedules 1 and 3, Parts A and B of Schedule 4,Parts A and B of Schedule 5, Parts A and B of Schedule 6, and Part A of Schedule 7 on the amendment bill, due to the adjustments and reprioritisations made in the 2020/21 adjustment budget. The FFC would like to reiterate its previous stance on the potential negative consequences created by these reprioritisations on service delivery programmes as well as allocations of over the 2020 MTEF respectively

ASSESSMENT OF THE 2020 ADJUSTMENT APPROPRIATIONS BILL

Adjustment to Appropriation Bill	FFC View
Clause 6 (Authorisation of Expenditure) and all its subsections have been removed in the adjustment appropriation bill	FFC is of the view that this clause is vital, as it allowed the Minister to approve expenditure if it cannot be reasonably delayed without affecting service delivery. However financial discipline and transparency must be ensured
Clause 7(Spending before commencement of Appropriation Act for 2021/22) financial year have been removed in the adjustment appropriation bill	FFC is of the view that whilst this is due to the adjustment budget that took place in 2020/21, it is still imperative that forecasts/estimates as per the original clause 7 should remain for planning and budgeting purpose/ as well planning for forward estimates.

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CHANGES TO THE ADJUSTMENTS APPROPRIATION BILL

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ADJUSTMENTS TO MAIN BUDGET FRAMEWORK

2020/21			
R'billion/% of GDP	Budget 2020	Revised	Net Adjustment (R'billion)
	1,398.0	1,099.5	
Main budget revenue	25.8%	22.6%	-298.48
	1,766.0	1,809.2	
Main budget expenditure	32.5%	37.2%	43.18
	1,536.7	1,572.7	
Non-interest expenditure	28.3%	32.4%	36.01
	229.3	236.4	
Debt-service costs	4.2%	4.9%	7.17
	-368.0	-709.7	
Main budget balance	-6.8%	-14.6%	-341.66
	-138.7	-473.2	
Primary balance	-2.6%	-9.7%	-334.49

- Commission notes that even prior to Covid-19, slow growth had impacted on government revenues, leading to a rising deficit and debt which has constrained government's ability to invest in society and the economy
  - Covid-19 has further exacerbated these challenges with fiscal space further deteriorating and estimates showing that the main budget deficit will more than double from 6.8% of GDP to 14.6% of GDP
- On the revenue side, government has indicated that beyond 2020/21, it will seek to achieve a primary surplus by 2023/24 – this will necessitate tax increases
  - Commission notes that at the time of Budget 2020, promising avenues for increasing tax revenue (for example taxing the digital economy and new environmental taxes and reforms) were highlighted– it is unclear whether these will still be pursued. Further details on how tax revenue increases will be achieved is expected to be detailed in MTBPS 2020

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ADJUSTMENT BY ECONOMIC CLASSIFICATION

	2016/17	2017/18	2018/19	2019/20			
	Actual outcome			Revised Estimate	Budget 2020	Adjusted Budget	Net Adjustment
Current payments	359 886,6	385 287,8	414 284,5	455 634,7	265,72	267,544	1,824
Transfers and subsidies	923 264,5	985 429,7	1 063 332,9	1 149 078,8	1,215,936	1,228,251	12,315
Payments for capital assets	15 598,5	15 232,9	14 469,2	13 573,2	15,303	14,582	-721
Payments for financial assets	6 640,5	18 989,5	14 526,0	64 017,4	42,552	45,565	3,013

- Transfers and subsidies component sees largest adjustment (increase of R12.3 billion) - bulk of increase is to vulnerable households (increased social payments) and transfers to local government
  - Commission supports these adjustments – especially support to municipalities as they are key to implementing response to Covid-19
- Net increase to current payments mainly driven by additions to goods and services (R2.4 billion) whilst compensation (COE) sees a R591 million reduction
  - Commission notes that Budget 2020 indicated intention to cut COE – the extent to which this will be achieved is questionable
- R3 billion added to recapitalise the Land Bank
  - Persistent financial assistance to ailing SOEs divert funds from critical areas of service delivery
  - Commission believes reforms to SOEs are long overdue – efforts to stabilise, re-purpose, rationalise SOEs are urgent

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ADJUSTMENT BY FUNCTION CATEGORY

R'million	Budget 2020	Revised	Net Adjustment
General public services	618 840	619 599	759
Economic development	88 381	80 886	-7 496
Learning and culture	151 543	138 364	-13 179
Health	55 516	58 430	2 914
Peace and security	207 006	212 991	5 985
Community development	219 727	221 835	2 108
Social development	198 497	223 837	25 341
Total	**1 539 511**	**1 555 941**	**16 431**

- Largest net increases are to Social Development (net increase of R25.3 billion) and Peace and Security (net increase of R5.9 billion) and Health (net increase of R2.9 billion)
  - The Commission acknowledges the importance of these essential, frontline sectors in directly responding to Covid-19 and scaling up and maintaining social assistance interventions to vulnerable households
- General public service increases by R 759 million.
  - The function is supporting the provision of quarantine sites for people who test positive for COVID-19 and repatriation of South Africans stranded abroad
- The biggest reduction is to Learning and Culture with a net decrease of R13.1 billion

➢ The FFC notes the adjustment by function category and the difficult balance that government has tried to achieve

➢ The Commission supports the prioritisation of funding towards fighting Covid-19 while protecting livelihoods and the economy.

➢ However, the Commission is wary of the extent of the health department adjustment, given its centrality to fighting Covid-19.

➢ Science and Innovation cannot be relegated to outer years allocation as it will play a pivotal role in determining the new economy and our global competitiveness.

➢ The commission is not certain whether the allocation towards economic recovery is actually sufficient.

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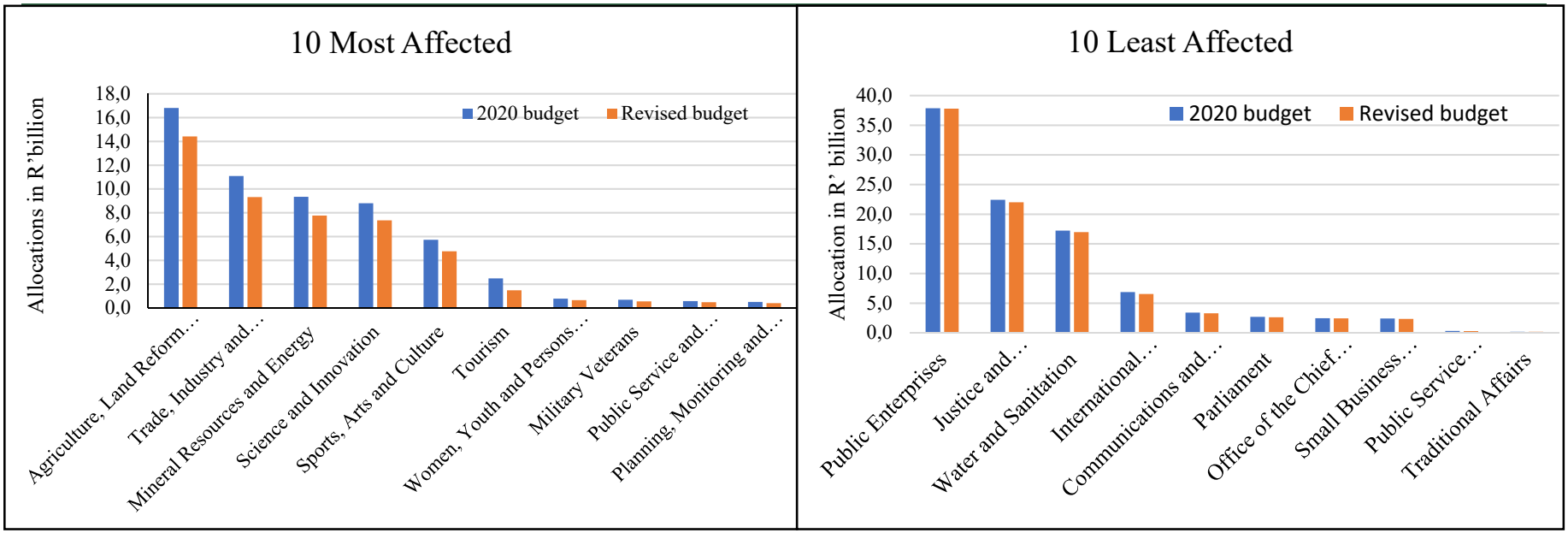
REPRIORITISATION BY VOTE: ADJUSTED BUDGET VS 2020 BUDGET



- Government reprioritisation was also evaluated in terms of helping the nation achieve on set priorities namely: Economic transformation and job creation; Education, skills and health; Consolidating the social wage through reliable and quality basic services; Spatial integration, human settlements and local government; Social cohesion and safe communities; A capable, ethical and developmental state
- Despite Covid-19, reprioritisation should be consistent and aligned to government set priorities and be a bridge to achieving NDP and Sustainable development goals.
- Aggressive reprioritisation from agriculture, Trade and industry, Science and innovation, Tourism and Women, youth and persons with disabilities will, in the long run negate achieving some of the above priorities.

REPRIORITISATION BY VOTE: ADJUSTED BUDGET VS 2020 BUDGET

In the outer years the Commission implores government to prioritise some votes to ensure that national priorities are not neglected

- Agriculture; a lever for growth, rural development (through supporting, especially subsistence and emerging farmers), ensures food security, and the land reform programme is to address directly issues of poverty and inequality.
- Science and Innovation; primary driver of economic growth and has the potential to influence technological change, research into disaster response measures and Covid 19 issues (in terms of testing for potential vaccine treatment as well as machinery/equipment such as ventilators) and catalysing research into the digital economy.
- Trade and Industry: Key to building a dynamic industrial and globally competitive economy
- Women, Youth and persons with Disabilities: Crucial role in building social cohesion and ensuring inclusive growth. Considering the increase in GBV, gender inequalities and discrimination, it is key in the fight against this scourge.
- Transport; realisation of improved social and economic development, baseline cuts will affect among others the improvement of the transport network and the mobility of people and service provision as well as the maintenance of the provincial road networks.
- Small business development; given the important role of Department of Small Business it will be important for the Commission to note the decrease with concern, and implore that their allocation be reconsidered with the other departments

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REPRIORITISATION BY VOTE: ADJUSTED BUDGET VS 2020 BUDGET

- Tourism: Although Covid-19 grounded this sector, it is vital that in outer years it is prioritised as it provides plenty of opportunities for employment, and contribution underpinning growth.
- Education, Skills and Health: whilst reprioritisations have been made towards the health and the education sectors in line with Covid-19 related impacts, reprioritisations away have also meant delay in provision of infrastructure related activities. Such as reprioritisations of funds from the Education Infrastructure as well the Health Facility Revitalisation respectively.
- Water and Sanitation: Consolidating the social wage through reliable and quality basic services; reprioritisations in the water and sanitation services are in line with hygiene requirements related to Covid-19 impact, however day to day operations related to maintenance ad rehabilitation services should continue

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ADJUSTMENTS ON SELECTED VOTES

R million	Voted (Main appropriations)	Adjusted appropriation	Net adjustment
Agriculture, Land Reform and Rural Development	16810,056	14416,312	-2393,744
Basic Education	25328,232	23233,034	-2095,198
Employment and Labour	3637,749	3375,829	-261,92
Health	55515,997	58429,523	2913,526
Human Settlements	31324,916	29063,977	-2260,939
Public Enterprises	37849,355	37787,484	-61,871

- The department of Agriculture, Land Reform and Rural Development vote sees a decrease of R 2.3 billion from R16.8 billion in the main budget to R14.4 billion in the adjustment budget. The commission is concerned since this vote plays an important role in food security.
- The health department vote is important in responding to Covid-19, it see an increase of R 2.9 billion. The commission calls for continued commitment to prioritise public health to save lives.
- Human settlement decreases of R2.2 billion. The commission is concerned given the housing need in the country
- Public enterprise vote sees a net adjustment decrease of R 61.8 million. The commission supports the decrease but continues to express concern about the stability of some SOE's under this department which continue to be a burden of country's fiscus.

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ADJUSTMENTS ON SELECTED VOTES

R million	Voted (Main appropriations)	Adjusted appropriation	Net adjustment
Public Works and Infrastructure	8070,796	8070,796	0
Science and Innovation	8797,393	7361,893	-1435,5
Small Business Development	2406,783	2339,783	-67
Tourism	2480,984	1480,984	-1000
Trade, Industry and Competition	11082,138	9310,71	-1771,428
Traditional Affairs	173,399	170,399	-3
Transport	62047,249	57406,825	-4640,424

- Public works and infrastructure vote remains unchanged in the adjustment budget. The commission commends this as it reflect government intention to use infrastructure to spur economic growth.
- The department of Small Business Development sees a net adjustment decrease of R67 million. Although this adjustment is relatively small and the commission is concerned about it. The department is important for employment creation and economic growth. It is also important for the supporting small business which may be under strain due to Covid-19.
- The department of Transport sees a net adjustment decrease of R4.6 billion. The containment of measures of Covid-19 have resulted in limited movement during higher levels of lockdown and may have provided space for some reprioritisation.. However, caution should be exercised towards infrastructure related to day to day operational maintenance and rehabilitation of the programmes.

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ADJUSTMENTS ON SELECTED VOTES

R million	Voted (Main appropriation)	Adjusted appropriation	Net Adjustment
Communications and Digital Technologies	3394,537	3283,106	-111,431
Cooperative Governance	96233,988	107188,495	10954,507
Higher Education and Training	116856,889	107000,116	-9856,773
Mineral Resources and Energy	9337,028	7763,001	-1574,027
Social Development	197718,275	223192,157	25473,882
Water and Sanitation	17216,227	16959,227	-257

- The Communications and Digital Technologies vote sees a decrease in the adjustment budget. The digital technology will be important going forward for teaching and learning, businesses etc. The commission is concerned that decreases may hinder widespread internet penetration and the creation of a digital economy.
- The Water and Sanitation vote see a decrease of R257 million. This is one of the smaller decrease in the votes. The commission notes that access to water and sanitation remains an important objective of government. Access to water and sanitation is also more important during this time of Covid-19 as it mitigates against the spread of virus.
- The Social Development vote sees an increase in its appropriation of R25.4 billion. This is expected given the different 'special grants' announced by the President

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CHANGES TO THE DIVISION OF REVENUE BILL

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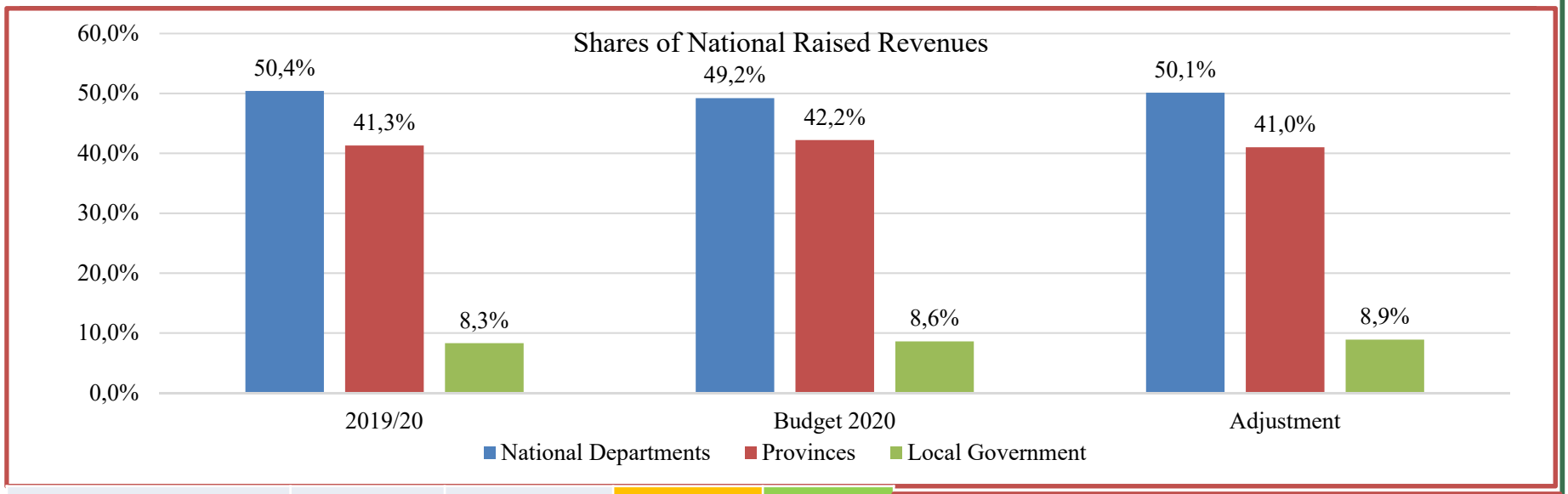
DIVISION OF REVENUE



R billions	Budget 2020	Adjustment	Net change	% change
National Departments	757,7	790,3	32,60	4,3%
Provinces	649,3	645,3	-4,00	-0,6%
PES	538,5	538,5	0,00	0,0%
Conditional grants	110,8	106,8	-4,00	-3,6%
Local Government	132,5	139,9	7,40	5,6%
LES	74,7	85,7	11,00	14,7%
Conditional grants	43,8	40,2	-3,60	-8,2%
Fuel Levy	14	14	0,00	0,0%

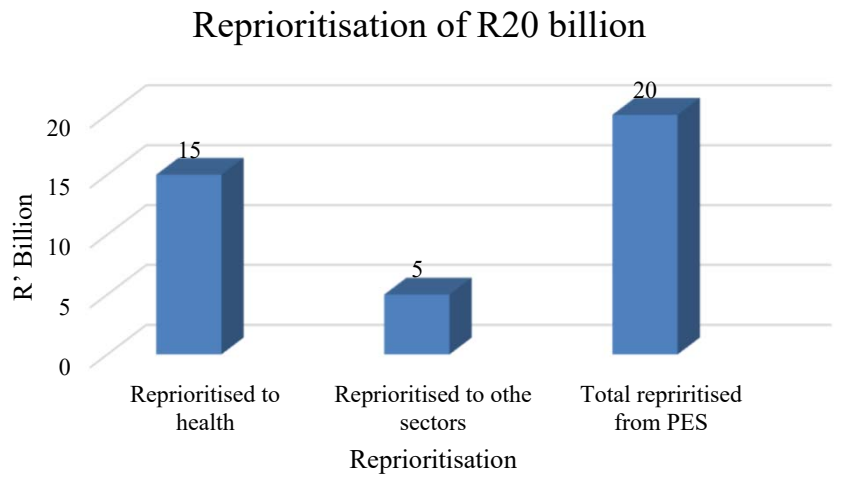
- Local Government and national spheres shares of nationally raised revenues adjust upwards slightly and provincial shares contract compared to Budget 2020
- National departments gain R32.6 billion (4.3%); provinces net loss of R4 billion (-0.6%), while LG receive net increase of R7.4 billion (5.6%).

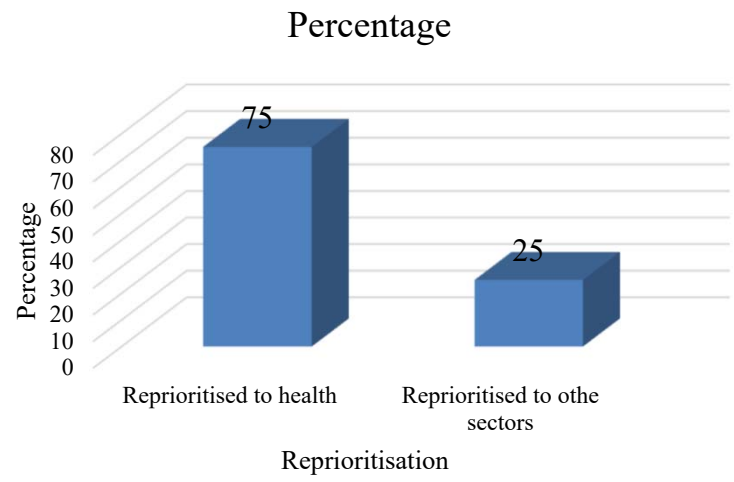
KEY PROVINCIAL FUNCTIONS AND CHALLENGES

- Provinces are responsible for social services which include education, health and social development and economic services like agriculture and roads and transport
- Prior to the outbreak of Covid-19 pandemic these provincial functional areas were facing a number of challenges:
  - Education: In basic education, there are still inequalities with respect to access to quality education for all, whereas enrolment rates are high, and learners from poorer schools continue to be disproportionately affected by a poor quality education and education environment
  - Health: Structural issues, funding and inequality challenges and increasing number of people living with HIV, hence a plan to rollout the NHI and increasing the number of people receiving ARVs
  - Agriculture: Lack of adequate government support to facilitate production and market access – this affects especially small and emerging farmers' ability to sustain their farming activities
  - Roads and Transport: Road implementation and maintenance backlogs: increased roads use, low investment, and poor maintenance have led to higher transportation cost and transport bottlenecks
- Covid-19 has amplified these challenges and has the potential of delaying efforts aimed at addressing the existing inequalities especially with respect to access to quality education and healthcare as well as the implementation of reforms such as NHI and infrastructure projects

Provincial Transfers Changes: PES – February vs Adjusted Budget

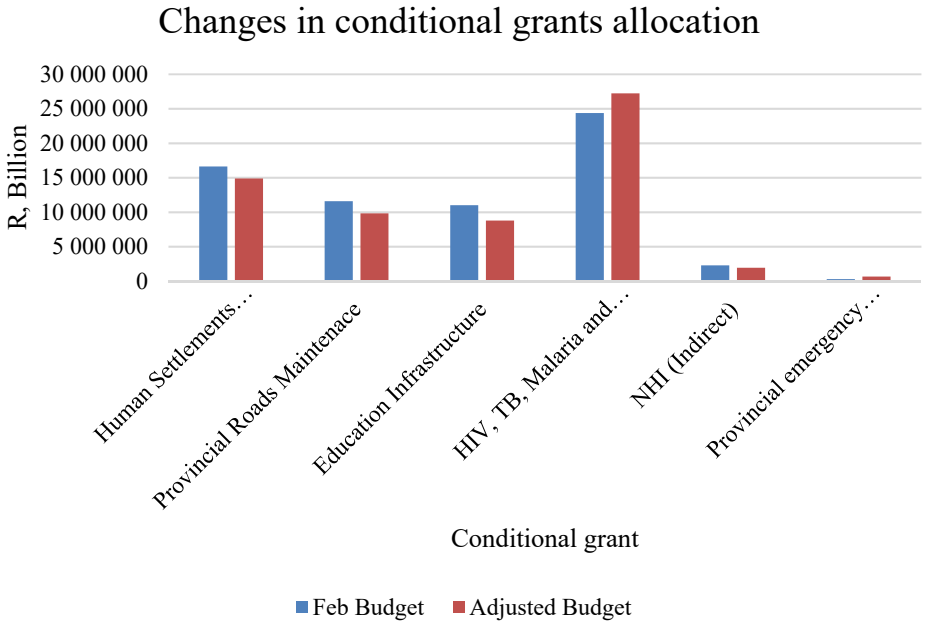
- Allocations through the Provincial Equitable Share have not changed – 2020 February Budget compared to the Adjusted Budget
  - However, provinces have committed to reprioritise R20 billion from the PES to the Covid-19 response from their own budgets given their respective disease profile risks
- The criteria for reprioritising the R20 billion is not clearly determined and this may result in unevenness in the services delivered by provinces. In the absence of a uniform criteria it is important for provinces to report to Parliament on the reprioritisation criteria used.
- Out of R20 billion-R15 billion (75%) will be reprioritised to health and R5 billion (25%) to other sectors and reprioritisation across all provinces follows this pattern, again there is no clear criteria followed to determine these uniform proportions given different circumstances of provinces

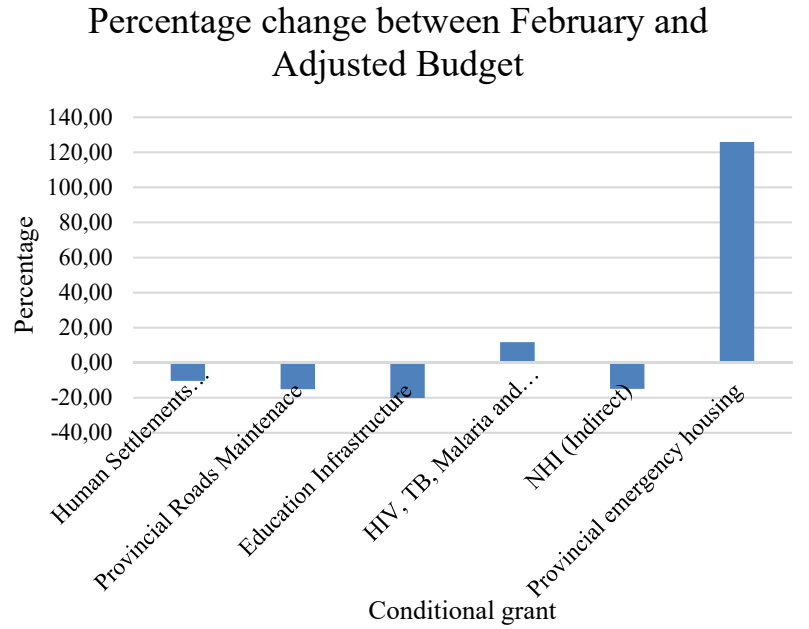




Provincial Transfers Changes: Conditional Grants February vs Adjusted Budget

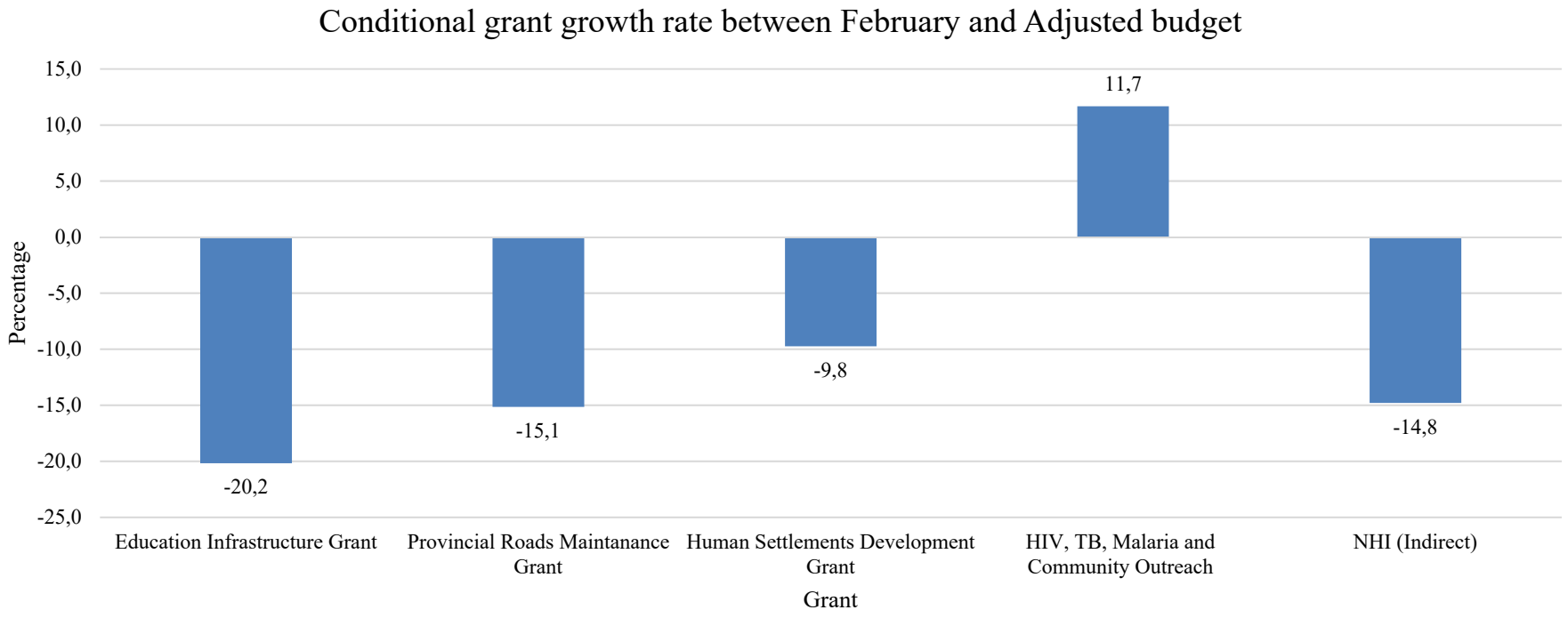
- There have been changes with respect to conditional grants to provinces as a result of Covid-19
  - Significant downwards changes have been made on Human Settlements Development Grant (-10.40%), Provincial Roads Maintenance grant (-15.15%), Education Infrastructure grant (20.18%) and the National Health Insurance grant (indirect component) (14.93%)
  - HIV, TB, Malaria and Community outreach and Provincial Emergency Housing grants are adjusted upwards by 11.67% and 125.82% to assist in fighting Covid-19





Conditional grants growth rate: February vs Adjusted budget

- Percentage adjustments between Budget 2020 and Adjusted Budget for some grants are quite severe and are indicated below.
  - Education Infrastructure grant is the most affected grant with -20.2% growth rate, followed by the Provincial Roads Maintenance grant with -15.1% growth
  - HIV, TB, Malaria and Community Outreach is the only provincial grant with a positive growth rate of 11.7%



Provincial Transfers Changes: Previous cuts trend and implications of Supplementary budget on service delivery

- Some of major provincial conditional grants have been reduced in the past few years due to fiscal consolidation process. The downward adjustments due to Covid-19 will negatively affect infrastructure delivery and maintenance, and efforts by government to deal with poverty
- including
  - Human Settlements Development Grant – Aimed at establishing habitable, stable and sustainable human settlements in which all citizens have access to social amenities
    - The grant has been significantly reduced in the past few years, with a major cut implemented R7.2 billion in 2018
  - Education Infrastructure Grant – It was established for the construction, maintenance and refurbishment of education infrastructure and schools
    - This grant's allocation was reduced significantly by R3.6 billion in 2018 MTEF
  - NHI (indirect component) – This grant seeks to replace, refurbish and maintain infrastructure in the national health pilot districts
    - In 2018 MTEF, this grant was reduced by R309 million
  - Provincial Road Maintenance grant – To supplement provincial investments for road infrastructure maintenance including routine, periodic and special maintenance, part of this grant is distributed as an incentive per level of service efficiency achieved in road project investments
    - In 2020/21, allocation to this grant will be reduced by R500 million

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CHALLENGES IN THE LOCAL GOVERNMENT

- Before the outbreak of COVID-19 , the South African local government was crippled by a number of challenges, and generally failing to effectively and efficiently fulfil its constitutional mandate. The challenges include :
  - Underspending on capital budgets, lack of institutional capacity, declining own revenue collection, lack of accountability, poor financial management and governance, among others
- In the 2018/19 Audit Report, AGSA also underscored the pervasiveness of these challenges and further flags issues pertaining to poor financial management and non-compliance:
  - Increase in irregular expenditure(R32,1billion), funds allocated for service delivery are being used for salary bills, increasing use consultants (costly), lack of compliance (evident in 91% of the municipalities), poor infrastructure maintenance and delays in completion of projects
- The poor performance in the local government sector is compounded by lack of effective oversight by national and provincial governments
  - Some municipalities are placed under section 139 intervention repeatedly, but show no signs of improvement after intervention
- The Commission is of the view that these challenges should not be overlooked when dealing with COVID-19 as they could hamper the success of the COVID-19 interventions

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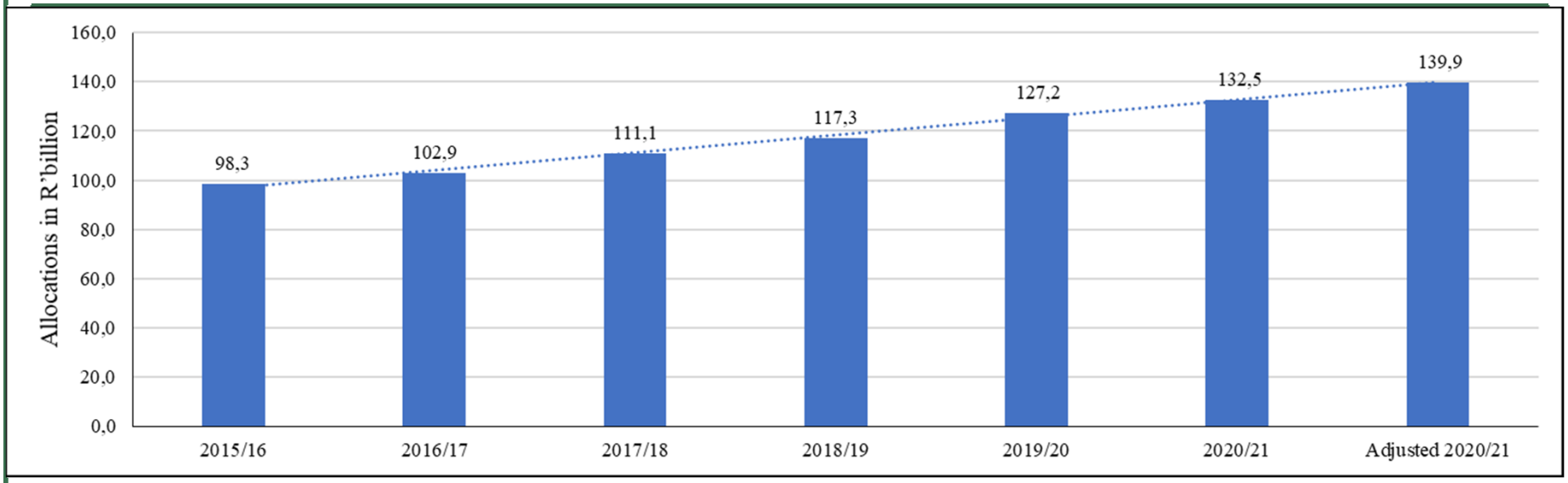
LOCAL GOVERNMENT ALLOCATION:2020 FEBRUARY BUDGET VS ADJUSTED BUDGET



- Total allocation to the local government has increased over the years, from R102,9 billion in 2016/17 to R132,4 billion in 2020/21,
  - In the Adjusted Budget, the allocations grow by 5,6% and 3,9% in nominal and real terms respectively
  - The increase is mainly due to the additional R11 billion provided through the Local Government Equitable Share

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Local Government Equitable Share :February 2020 budget vs Adjusted budget

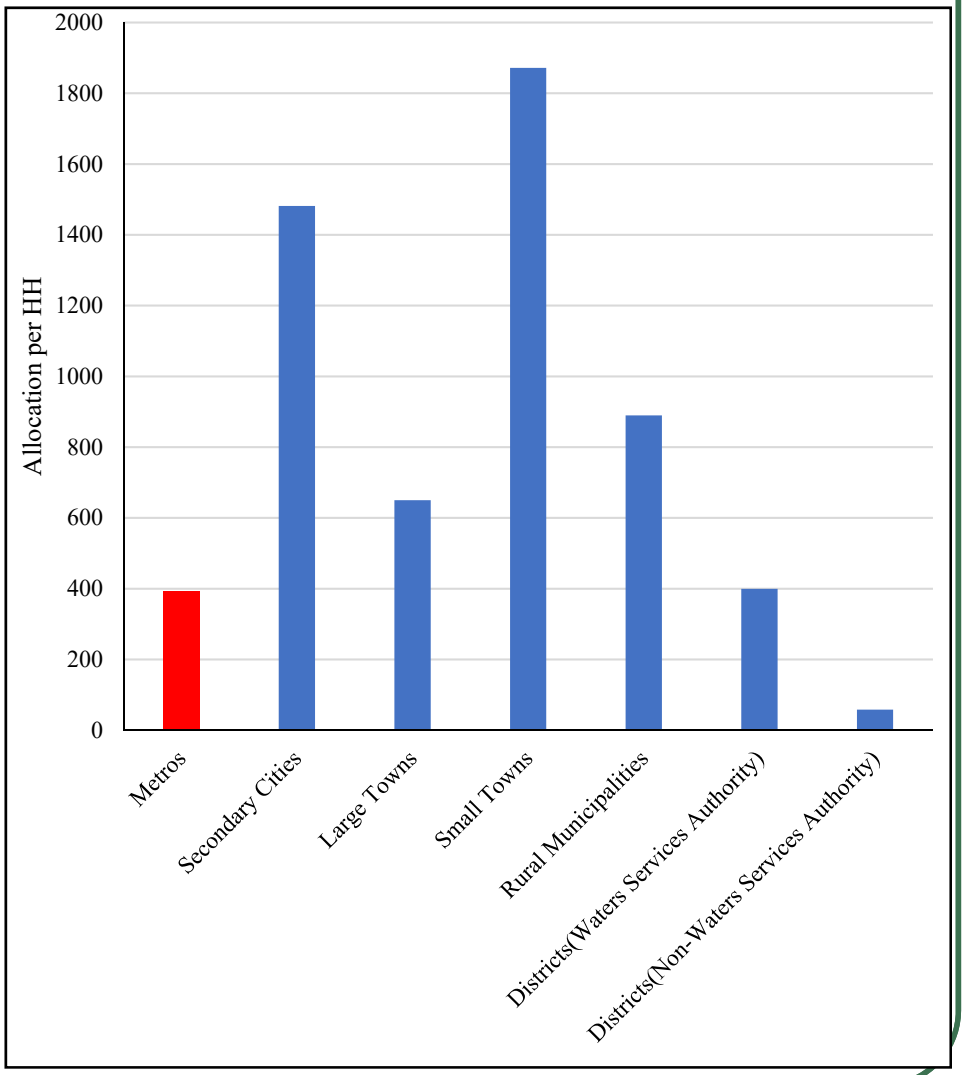
•President announced an additional allocation of R20 billion to local government

- The Adjusted Budget provides for only R11 billion additional funds, while the remaining amount is secured through repurposing funds within various LG grants
- The R11 billion is distributed across 257 municipalities, through the community services component of the LGES

• In terms of growth rates from 2020 Budget to Adjusted Budget

- Rural municipalities and small towns recorded the highest growth rate (19%) followed by large towns and secondary cities, large towns growing at 16% and metros by 14%

—In terms of allocations per households, Metros receive the second lowest (to Non- Water Services Authority DMs).



LOCAL GOVERNMENT EQUITABLE SHARE :2020 FEBRUARY BUDGET VS ADJUSTED BUDGET CONT'

- The Commission notes the R11 billion added to LG through the LGES. The Commission is of the view that as the rationale for this injection is to compensate municipalities for the loss of revenue due to Covid-19, allocating this money through the LGES formula may not adequately compensate those municipalities experiencing the deepest revenue shortfalls (in this case metros). In reality, rural municipalities realise less revenue loses since their own revenue base is very limited. Metros have experienced a disproportionate effect of Covid-19 in terms of revenue loses (as they rely predominately on own revenues); and in terms of Covid induced expenditure needs (emergency shelter, water, health facilities), and as engines for economic growth.
- The Commission is of the view that this allocation should rather have been allocated through a conditional grant that would balance rural-urban needs in the context of the pandemic, and also so that the R11 billion acts a stimulus for cities as engines of growth.
- In addition, there is a need to attach conditions to this allocation, in order to ensure that the funds are not used for salaries or other non Covid-10 related expenditure.

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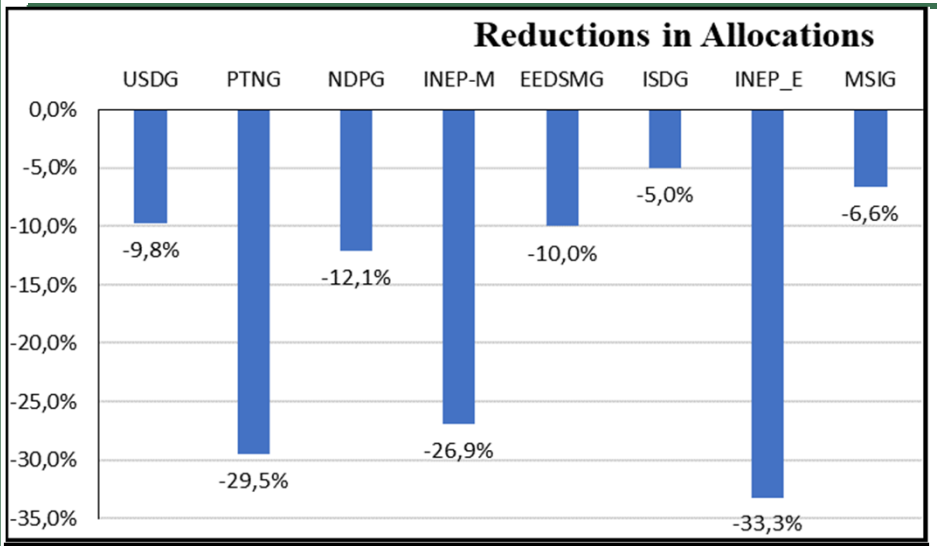
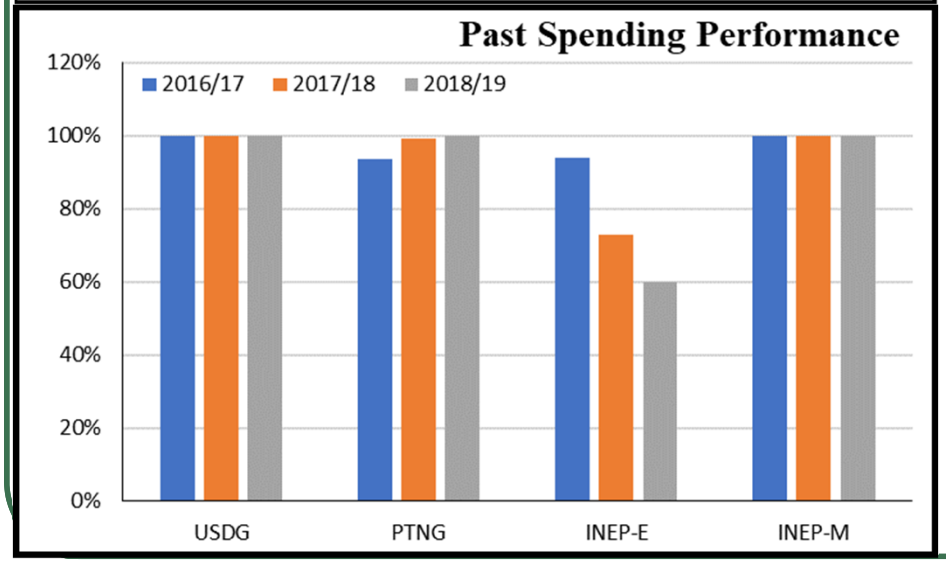
Conditional Grants: February 2020 Budget vs Adjusted Budget

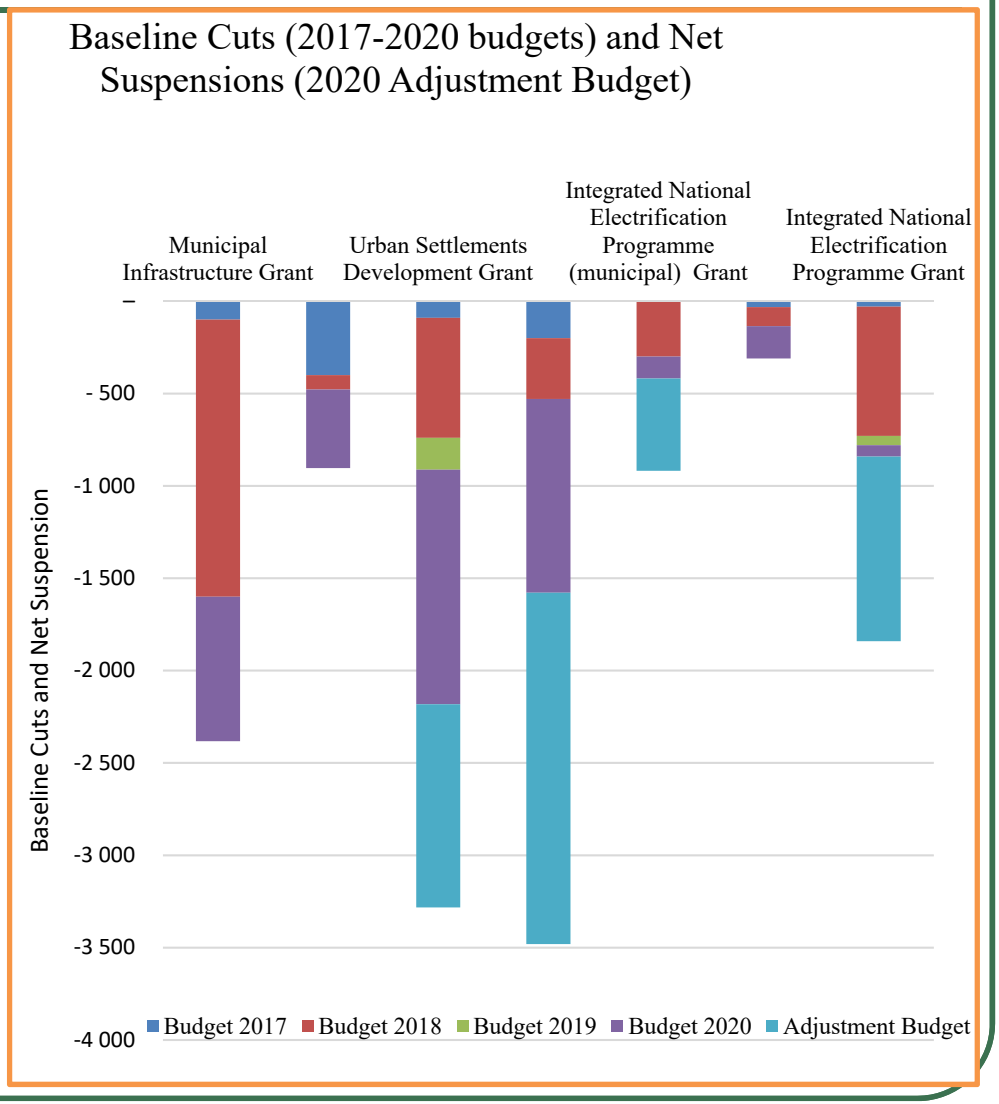




- Allocations through conditional grants declined by 8,9% from R51,4 billion in the 2020 Budget to R46,8billion in the Adjusted Budget
  - Reductions are mainly in infrastructure grants, with INEP-E (33,3%), INEP-M (26,6%) and PTNG (29,5%) being the most affected
  - Most of the grants also had funds reprioritised within, while some have been repeatedly affected by cuts in the successive 2017-2020 budgets
- The past spending performance on affected infrastructure grants is generally at 100%
- There has been under-spending in INEP-E
  - Grant recorded annual average spending of 76% over the past three years, with annual spending declining over the years to 60% in 2018/19
- The Commission acknowledges the need to make funds available for Covid-19 interventions, but is of the view that the cuts should be targeted at under-performing grants to minimise the effect on services delivery
  - The recurring reductions in performing grants such as the USDG, PTNG and INEP_M are a cause of concern as this has negative effects on project planning, infrastructure maintenance and it creates uncertainties for future growth enhancing projects

ADDITIONAL MESSAGES ON DoR

- The Commission notes that some grants have been affected repeatedly by reprioritisations and baseline cuts over time
- Cuts compound uncertainties on governments in terms of planning; affect infrastructure investment and asset care
- In the long run they will affect service delivery and ultimately derail the achievement of NDP goals
- There is therefore a need for a thorough assessment of the implications of the repeated reprioritisation and budget cuts on some grants



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ADDITIONAL MESSAGES ON DoR

- While the Commission acknowledges that reprioritisation was necessary to make funding available to address challenges associated with Covid-19, the Commission is of the view that
  - Reducing infrastructure grants aimed at rehabilitating and maintaining social and economic infrastructure such as schools and provincial roads would likely exacerbate the deterioration of infrastructure, and this has a potential of escalating costs in the future and affect outcomes
  - Education Infrastructure grant (reduced by over 20%) is key with respect to reconstruction, maintenance and refurbishment of education and schools. This grant is needed more now than before given the high number of schools vandalised and destroyed during the lockdown period
  - The Commission recommends that the infrastructure rehabilitation and maintenance be prioritised in the outer years of the 2020 MTEF and that government should provide clear funding and delivery plan for delayed 2020/21 infrastructure projects, and infrastructure maintenance
- The Commission has also noted with concern the quality and reliability of data used in calculation of different components of Human Settlements grant (drawn from 2010 Household Survey and 2011 Census) and in transport sector grants. In the review of the PES, this has to be considered.

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CONCLUDING REMARKS

CONCLUDING REMARKS

- The Adjustment Budget should not be viewed as a policy statement, but rather technical adjustments to take into account changes, forced by the Covid-19 pandemic. The havoc caused by Covid-19, on an already fragile economy warrants an Adjustment Budget. The deepening recession has resulted in unprecedented revenue shortfall.
- Revenues available for sharing are diminishing at a faster pace. This is making it difficult to finance reforms that will boost growth and improve the fiscal metrics. A bold reform agenda is required in future budgets, anchored on fighting corruption, strengthening the capacity of state to coordinate and monitor, restoring the integrity of key state institutions, and improving policy implementation
- Government needs to reconsider the sequencing of phases for managing the pandemic. Support for investment and employment (phase 2) must be underpinned by economic reforms (phase 3) to achieve effective targeting of interventions.
- While the Covid-19 pandemic has amplified some of the challenges to the fiscus, State Owned Entities continue to pose a serious risk to the fiscus. Measures to reform these should be accompanied by clear recovery plans, with clear timeframes, monitorable deliverables and strengthening of the center's ability to monitor reforms.
- Given the diminishing traditional revenue sources and tax revenue, there is need for all the spheres of government to enhance revenue mobilisation, and appraise parliament on measures they undertake to enhance their revenues

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CONCLUDING REMARKS

- There is a need to enhance transparency and leverage the capacity (of elected officials and citizens) for oversight and abilities to monitor spending particularly in the local government sector. An increase in resources in an environment fraught with challenges of irregular and wasteful spending can have unintended perverse effects.
- On infrastructure budgets that have experienced reprioritisation/reductions, especially rehabilitation and maintenance budgets, it is important that outer years of the 2020 MTEF see these prioritised, and that government should provide clear funding and delivery plan for delayed 2020/21 infrastructure projects, and infrastructure maintenance.
- The criteria for reprioritising the R20 billion in provinces is not clearly determined and this may result in unevenness in the services delivered to households in different provinces. In the absence of a uniform criteria it is important for provinces to report to Parliament on the reprioritisation criteria used by each province.
- The additional R11 billion to municipalities should compensate those municipalities carrying a disproportionate burden of revenue shortfalls from the pandemic, and such resources should ideally be allocated through a conditional transfer mechanism that also balances the needs of both rural and urban municipalities, and catalyses economic growth. Allocating this money through the LES carries the additional risk of funds being diverted to salaries.
- Despite the disruptions caused by the Covid-19 pandemic, reprioritisations should prioritise set national priorities and be aligned to NDP and sustainable development goals in the long run
- Finally, the Commission advises that the adjustments budget be passed as soon as is possible, in order to give government institutions certainty regarding their budget baselines and for planning.

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LIST OF ACRONYMS

USDG	Urban Settlements Development
PTNG	Public transport network
NDPG	Neighbourhood development partnership
INEP-M	Integrated national electrification programme (M)
EEDSMG	Energy efficiency and demand-side management
ISDG	Infrastructure skills development
INEP-E	Integrated national electrification programme (Eskom)
MSIG	Municipal systems improvement
LGES	Local Government Equitable Share