Briefing to the Select Committee on Appropriations on the financial and fiscal impact of Covid-19

Financial and Fiscal Commission:
For an Equitable Sharing of National Revenue

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Contents

Acronyms

CASP	Comprehensive Agricultural Support Programme Grant
Cogta	Department of Cooperative Governance and Traditional Affairs
Covid-19	Coronavirus disease of 2019
DBSA	Development Bank of Southern Africa
DPME	Department of Performance Monitoring and Evaluation
EMDEs	Emerging Market And Developing Economies
EPWP	Expanded Public Works Programme
FFC	Financial and Fiscal Commission
GDP	Gross Domestic Product
GEPF	Government Employees Pension Fund
HIV	Human Immunodeficiency Virus
IMF	International Monetary Fund
MIG	Municipal Infrastructure Grant
MTBPS	Medium Term Budget Policy Statement
MTEF	Medium Term Expenditure Framework
NHI	National Health Insurance
NHLS	National Health Laboratory Service
PIC	Public Investment Corporation
PSET	Post School Education And Training
RBIG	Regional Bulk Infrastructure Grant
SANRAL	South African National Roads Agency
SARB	South African Reserve Bank
SARS	Severe Acute Respiratory Syndrome
SASSA	South African Social Security Agency
SCoA	Select Committee on Appropriations
SMMEs	Small, Medium And Micro-Enterprises
SOEs	State Owned Enterprises
TB	Tuberculosis
UIF	Unemployment Insurance Fund
WSIG	Water Services Infrastructure Grant

List of Tables

List of Figures

Section 1: Introduction

The 2020 budget was formulated against the backdrop of a deteriorating economic environment. The economy was facing economic headwinds from both international and domestic fronts. In 2019 the economy registered an overall 0.2 per cent growth rate. After registering -0.8 per cent and -1.4 per cent growth rates in the last two quarters of 2019, the economy had effectively slipped into a technical recession. This poor growth trajectory has pushed more South Africans into poverty and unemployment and lowered the value of their average incomes. The incomes available for households to sustain themselves and invest in their future has diminished at an accelerated pace.

The events post the 2020 February budget have already made 2020 one of the most difficult years in South Africa's recent economic history. First, the economy has suffered immense setbacks as a result of the Covid-19 pandemic. On 5 March 2020, the pandemic reached the shores of South Africa and forced most economic activities to a standstill. Almost three weeks after the first case of the coronavirus was identified, a national state of disaster was declared on 23 March 2020. This was followed three days later, on 26 March 2020, by a national lockdown to contain the spread of the virus and flatten the epidemic curve. As of 2 June 2020, South Africa had 35 812 confirmed cases and 755 Covid-19 related deaths, and the coronavirus continues to spread relentlessly.

Second, at the same time as the country was attempting to contain the spread of Covid-19, Moody's downgraded South Africa's sovereign debt rating to junk status on 27 March 2020. The cost of losing the last investment grade rating, coupled with the Covid-19 pandemic have weighed down all prospects for a growth turnaround in 2020. Many growth forecasts are already pointing to a bleak future. According to different forecasts, South Africa's GDP growth in 2020 is expected to slow down significantly. Forecasts to date range from -5.4 per cent to -20.4 per cent (see Figure 3). The Covid-19 pandemic has caused unprecedented disruptions to the socio-economic landscape of South Africa, as it is doing in most other countries. Governments across the world have been forced to make difficult choices between protecting lives on the one hand, and livelihoods and economies on the other. The pandemic has turned South Africa's February 2020 budget upside down as the need to deal with health challenges, deliver on essential services, protect households against wage and livelihood losses, and businesses against falling markets have taken precedence over the planned budget.

The Covid-19 pandemic has caused an unprecedented health shock. It has put the health sector and its budget under tremendous pressure. The needs of that sector have been amplified many times. Health care access, specifically, effective ambulance systems, intensive care units (ICUs) equipped with ventilators and drugs are needed. There is also a need for construction of field hospitals/clinics

especially in cities. The need for investment in COVID-19 related technologies cannot be overemphasized as well as in research capacity.

Budgetary changes have become unavoidable and it is anticipated the Minister of Finance will present an adjustment budget in the near future. It is against this background and pending budget adjustments that the Select Committee on Appropriations (SCoA) has requested the Commission to brief it on the financial and fiscal implications of the Covid-19 pandemic. The Commission makes this submission in terms of Section 4 (4c) of the Money Bills Amendment Procedure and Related Matters Act, 2009 (Act No. 9 of 2009) and Part 1 (3) {1} of the Financial and Fiscal Commission Act, 1997 (Act No. 99 of 1997, as amended by Act No. 25 of 2003 and Act No. 4 of 2015) (FFC Act). The FFC Act provides for the Commission to act as a consultative body for, and to make recommendations on financial and fiscal matters to organs of state in the national, provincial and local spheres of government.

In line with the request from the SCoA, this submission is focused on the following four areas:

- Assessment of macroeconomic and fiscal outlook;
- Assessment of the revenue and expenditure proposals as contained in the 2020 Budget;
- Assessment of Government's fiscal and monetary responses to Covid-19 on growth and transformation;
- Reprioritisation for Covid-19 pandemic: An FFC perspective.

Section 2: The Covid-19 pandemic and the macroeconomic and fiscal policy outlook

Global economy

Within a short space of time, Covid-19 has turned the global economy upside down. In many countries companies, offices, airports, schools and shops have been closed in order to contain the spread of the Covid-19 virus. In many ways, Covid-19 presents stark choices between life and death, and the economy. The current situation is such that forecasting global growth is almost impossible because economic outcomes are a function of unpredictable factors that interact in ways hard to foresee. The unknown aspects of Covid-19 include, among others, the trail of the pandemic, efforts to develop a vaccine, effectiveness of containment efforts, level of supply interruptions and productivity losses, impact of the contraction in global financial market conditions, changes in spending patterns, behavioural changes, confidence effects, and volatile commodity prices.

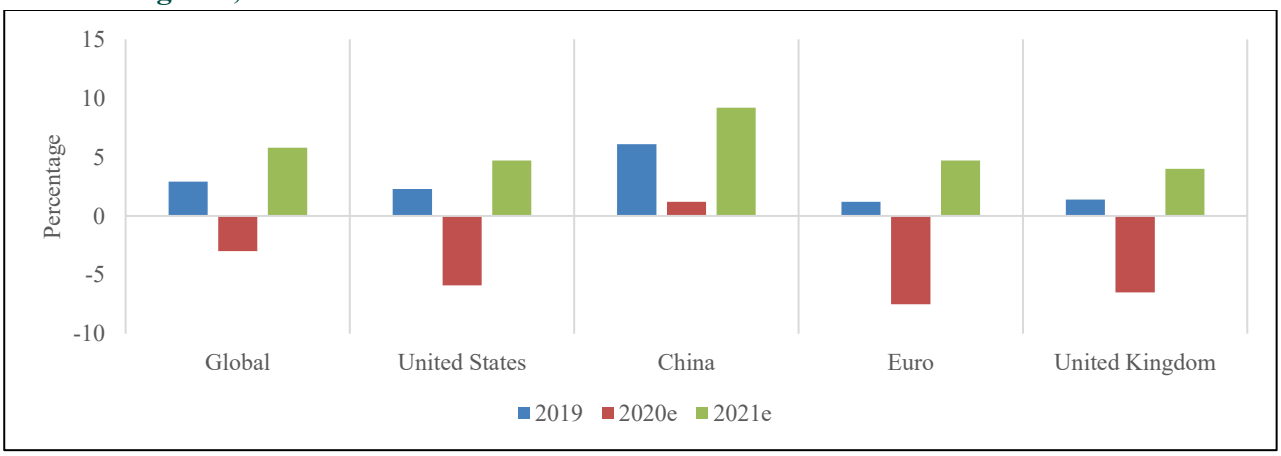
Global growth had already slowed before the onset of Covid-19. In 2019, the global economy grew by 2.4 per cent, the lowest rate since the global financial crisis of a decade ago[1]. This sluggish growth was driven largely by weak global trade and investment. This impacted both advanced economies as well as emerging market and developing economies (EMDEs). Geopolitical tensions, intensifying social unrest and weather-related disasters also weighed down global economic activity. While consensus on a rebound in global activity in 2020 existed, this projected pickup was already in doubt, because it was premised on a recovery in a few large EMDEs, whereas growth was projected to decelerate in China, the Euro area, and the United States. The outbreak and spread of Covid-19 means that this rebound will not only fail to materialise, but global economic activity will instead contract in 2020.

Initial data indicates that the economic impact of Covid-19 is widespread and is shifting the global economy towards a recession. Global growth is estimated to contract by 3.0 per cent in 2020, and this projection surpasses the economic deceleration that was recorded during the 2009 global financial crisis. The downturn in economic activity in the United States is projected at -5.9 per cent, in the Euro area at -7.5 per cent, in the United Kingdom at -6.5 per cent, and in China at 1.2 per cent. These are key South Africa's trading partners. The economic slowdown in these economies will, in all likelihood, negatively impact the South African economy. The deep contraction in most of South African trading partners is shown in Figure 1 below. Contractions of a similar magnitude are also projected for other countries as localised outbreaks combined with strict containment measures weigh

[1] See IMF World Economic Outlook, April 2020

down most economic activities. Brazil's growth is forecasted at -5.3 per cent, Mexico (-6.6 per cent), Russia (-5.5 per cent), and Nigeria (-3.4 per cent)[2].

Figure 1: Economic outlook projections for the world, United States, China, Euro area, and United Kingdom, 2019-2021



Source: IMF World Economic Outlook, 2020

The effect of Covid-19 on global growth is estimated to be more severe in relation to other pandemics because the Covid-19 virus is significantly more contagious and the integration of the Chinese economy into the global economy is more extensive. In comparison to the Severe Acute Respiratory Syndrome (SARS) outbreak in 2002, China today plays a much bigger role in global output, trade, commodity markets and international tourism.

Countries around the world have responded with massive monetary and fiscal responses to the fight against the Covid-19 virus. Central banks have taken bold steps to provide further monetary accommodation, boost liquidity, and ensure the smooth functioning of financial markets. Huge fiscal stimulus packages to lessen the economic impacts of the virus have been deployed globally to support households and the business sector. However, aggressive containment measures, heightened uncertainty, financial market turmoil, and stringent cross-border travel restrictions are most likely to weaken global growth in the short to medium term.

Global growth is projected to recover to 5.8 per cent in 2021[3]. However, the recovery in 2021 hinges on the pandemic fading in the second half of 2020, allowing containment measures to be slowly lifted and restoring consumer and investor confidence. The strength of the recovery is extremely uncertain because aspects that underpin it may simply not materialise, and worse global growth outcomes are possible, depending on the pathway of the pandemic and the severity of the associated economic and financial consequences.

[2] *Op cit*
[3] *Op cit*

The implication for South Africa emanating from the global economic outlook are twofold: First, through the disruption in trade and value chains, particularly affecting commodity export. Second, through foreign financing flows reduction.

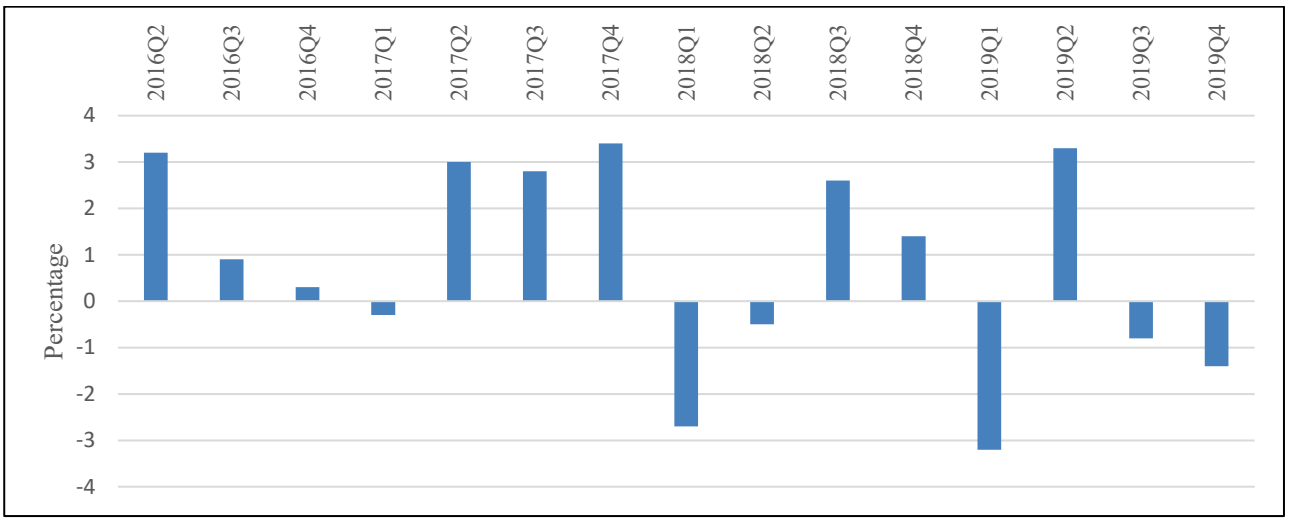
Domestic economy

South Africa is in a difficult position. The economy is confronted by three key hurdles: First, economic growth has been consistently sluggish because private investment, exports, and productivity have been relatively flat. Second, public finances are characterised by deteriorating fiscal and debt positions and inefficient spending. Third, most state-owned entities (SOEs) are experiencing major financial and operational difficulties and efforts to bail them out are draining the fiscus. Consequently, unemployment has remained high, with poverty and inequality barely reducing.

The South African economy contracted by 1.4 per cent on a seasonally adjusted annual rate (SAAR) in the fourth quarter of 2019. Seven out of ten sectors recorded a reduction in production during this quarter. Given a downward revision to the third quarter of 2019 growth rate from -0.6 per cent quarter-on-quarter (QoQ) SAAR to -0.8 per cent, this means that the country is in its second technical recession (two successive quarters of negative growth) in two years. The previous recession was recorded in the first two quarters of 2018 when power outages inhibited growth significantly. The South African economy grew by 0.2 per cent in 2019. This is the lowest growth rate since the global financial crisis of ten years ago. Electricity disruptions weighed on both industry and services. The finance, real estate and business services sector was the only major contributor to growth on an annual basis, expanding by 2.3 per cent in 2019. Agriculture contracted by -6.9 per cent, construction by -3.3 per cent, electricity, gas and water by -2 per cent gross fixed capital formation by -0.9 per cent, exports by -2.5 per cent and imports by -0.5 per cent. Consumer spending was the main driver behind economic growth on an annual basis in 2019, with household consumption rising by 1.0 per cent[4]. South Africa's economic performance reflects high levels of volatility anchored on a low trend (Figure 2).

[4] See Statistics South Africa Gross Domestic Product (GDP), Q4 2019

Figure 2: South Africa quarter-to-quarter GDP growth, 2016 Q2 – 2019 Q4



Source: Statistics South Africa, 2020

South Africa's real GDP has been negative since 2015, and is forecast to remain negative until 2021, implying a worsening standard of living for South Africans. The sluggish growth is a reflection of a number of constraints including persistent policy uncertainty, constrained fiscal space, subdued business confidence, infrastructure bottlenecks, and weakening external demand.

Whereas external factors could explain the underperformance of the economy, the divergence of growth in South Africa compared to other similar EMDEs suggest that domestic factors have played an important role.

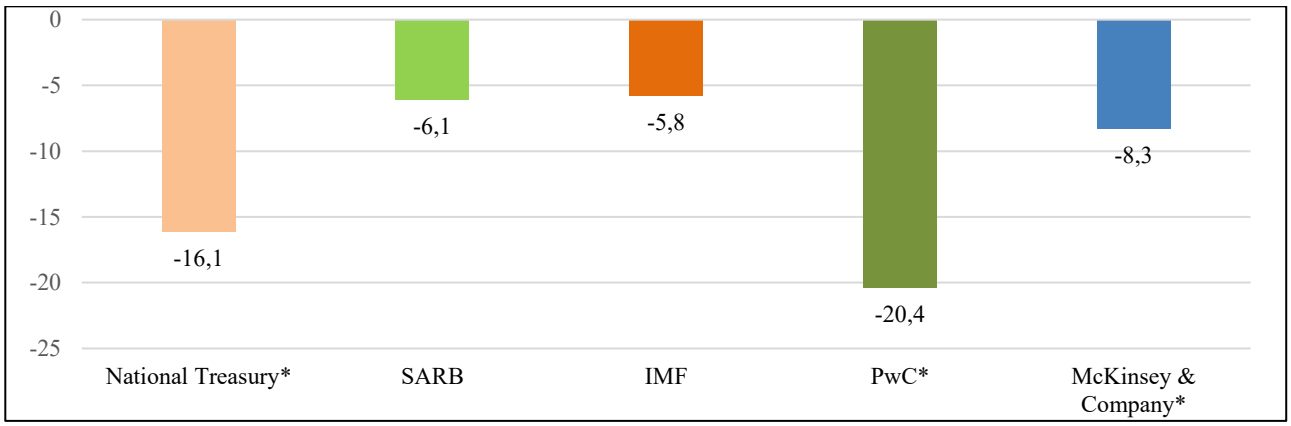
The South African economy thus entered 2020 on a fragile footing before the dramatic external developments related to the Covid-19 pandemic emerged. Projections and scenarios by both public and private institutions show that Covid-19 will push the country into a deep economic contraction this year. The second quarter of 2020 will largely capture the economic impact of the restrictive measures (lockdown), and is expected to play a defining role in this year's growth outcome. Preliminary evidence shows that, while the restrictive measures to contain the Covid-19 pandemic have been effective in containing the spread of the virus, the economic ramifications will be severe. Aggressive monetary stimulus and a substantial fiscal relief package will keep businesses afloat and prevent a large proportion of the population from becoming destitute, economic production will nevertheless be severely negatively affected in 2020. Consumer spending, which is the engine of growth, is expected to decelerate substantially because the lockdown prevents certain types of consumption, while job losses and lower profits constrain spending over the longer term. Public investment is expected to decrease, the fiscal support package will result in a marked increase in government spending, and government consumption is projected to increase.

The latest forecasts show that in 2020, South Africa's real GDP will contract by -6.2 per cent (South African Reserve Bank), between -5.4 and up to -16.1 per cent (National Treasury), between -6.9 and up to -8 per cent (World Bank), -5.8 per cent (International Monetary Fund), between -8.4 and up to

-20.4 per cent (PwC), and between -2.1 and up to -8.3 per cent (McKinsey & Company) as shown in Figure 3. The deep contraction will result primarily from disruptions in household and business spending on transport, food and beverages, and entertainment, as well as prolonged pressure on exports. South Africa's recent sovereign credit downgrade is likely to exacerbate this outlook.

Much uncertainty surrounds the strength of the recovery expected in 2021, primarily because much depends on the pathway of the pandemic, and the gravity of its economic and financial ramifications. The South African Reserve Bank (SARB) expects the economy to recover and post 2.2 per cent GDP growth in 2021 and a further 2.7 per cent in 2022. The IMF projects the GDP growth to be as high as 4 per cent in 2021, a rate last achieved before the global financial crisis of ten years ago. It is worth noting that the enduring uncertainty about contagion, falling business and consumer confidence, business closures and structural shifts in companies and household behaviour (e.g. social distancing), supply chain disruptions and weakness in aggregate demand could temper the rebound.

Figure 3: Projections for GDP growth in South Africa, 2020



Source: National Treasury, South African Reserve Bank, IMF, PwC, McKinsey & Company
*NB *projection of worst-case scenario by institution*

South Africa's sovereign credit rating is critical in determining the cost of borrowing for the country in capital markets. Moody's Investor's Service downgraded South African local currency sovereign credit rating from Baa3 to Ba1, one notch below investment grade in March 2020. This downgrade aligned Moody's rating with 2017's sub-investment grading by Fitch Ratings and S&P of South Africa. Against the backdrop of a deteriorating fiscal position and weak trend growth, the sovereign credit rating downgrade by Moody's to sub-investment grade means increased costs of borrowing will further worsen debt sustainability prospects. Moreover, the slump in economic activity will result in a notable revenue underperformance while efforts to contain the virus will necessitate an increase in unplanned spending.

Fitch Ratings also downgraded South Africa's long-term, foreign currency sovereign credit rating from BB+ to BB while maintaining the outlook at negative. Fitch is now the only ratings agency that considers both South Africa's foreign currency and local currency issuer default ratings two notches below investment grade. South Africa runs the risk of sliding down a slippery slope in which the

inability to address concerns raised by ratings agencies pushes it deeper into junk territory. The inability to halt the country's slide deeper into junk will have a severe impact on the country's economic future. Table 1 shows the long-term rating scales comparison for South Africa's credit ratings.

Table 1: South Africa credit ratings: Long-term rating scales comparison

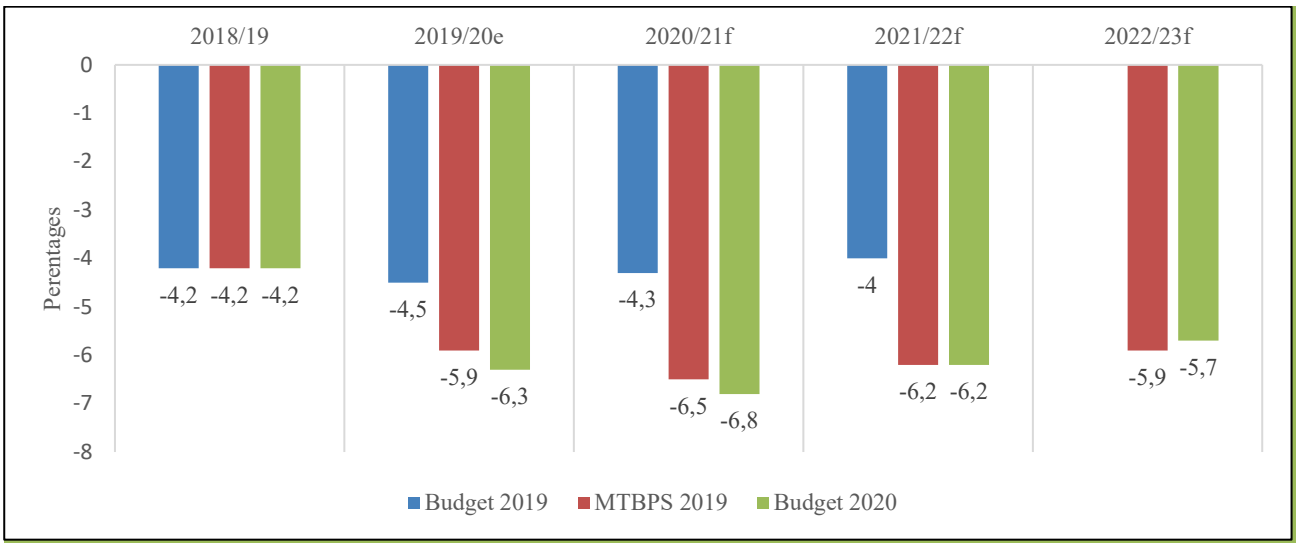
Description	S&P	Moody's	Fitch	Grade
Prime	AAA	Aaa	AAA	Investment
High Medium Grade	AA+	Aa1	AA+	
	AA	Aa2	AA	
	AA-	Aa3	AA-	
Upper Medium Grade	A+	A1	A+	
	A	A2	A	
	A-	A3	A-	
Lower Medium Grade	BBB+	Baa1	BBB+	
	BBB	Baa2	BBB	
	BBB-	Baa3	BBB-	
Speculative	BB+	Ba1 Negative outlook *	BB+	Speculative
	BB	Ba2	BB Negative Outlook *	
	BB- Stable Outlook *	Ba3	BB-	
Highly Speculative	B+	B1	B+	
	B	B2	B	
	B-	B3	B-	

Source: World Government Bonds, 2020
*NB: * represents South Africa's credit rating*

Government debt and liabilities

South Africa's fiscal position remains dire. The fiscal trajectory is unsustainable. The tax base is faltering, unproductive spending is rising, and taxable income is diminishing. The situation will be exacerbated further by increasing borrowing costs. The fiscal deficit has widened to its largest point since the 1990s. This has left South Africa with no fiscal space to spare. Some of the key drivers of the fiscal deficit relate to weaknesses in public enterprises that are weighing on the fiscus through bailouts or administrative interventions. There are massive differences to deficit projection in the 2019 Budget, 2019 MTBPS and 2020 Budget as shown in Figure 4. This demonstrates a substantial deterioration in fiscal metrics. This fiscal slippage has impacted negatively on South Africa's sovereign credit rating and resulted in severe economic consequences as detailed above.

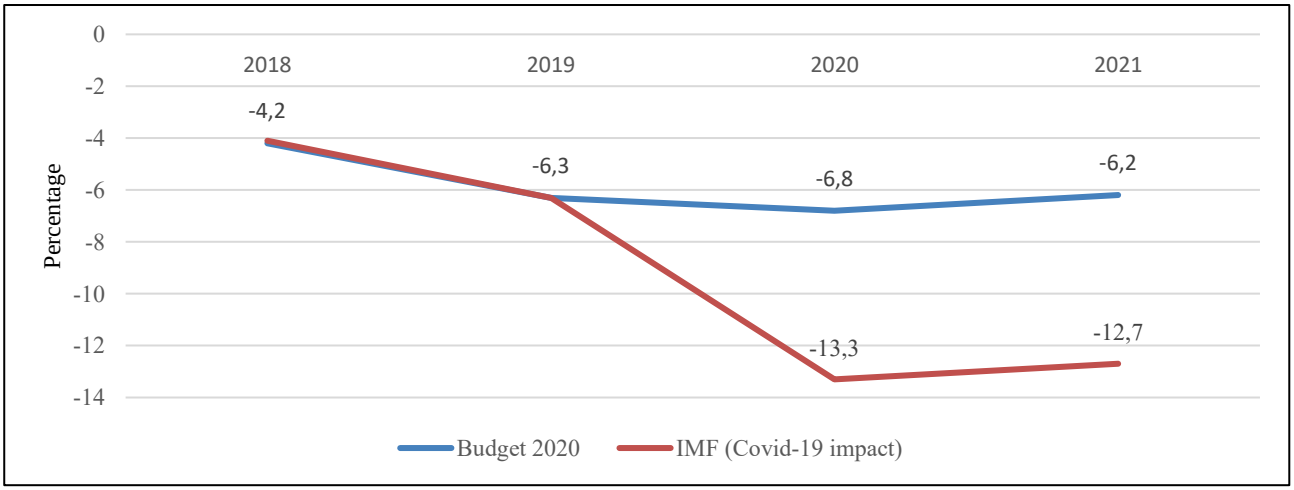
Figure 4: South Africa budget deficits as a percentage of GDP projections, 2018/19-2022/23



Source: National Treasury, 2019 and 2020

As previously stated, the Covid-19 pandemic is expected to have a significant negative impact on South Africa's economic growth. Government tax revenues will also fall as a result of deceleration in economic activity and trade. Spending on health and support to households and businesses is increasing to lessen the health and economic impacts of Covid-19. The fiscal position in 2020, therefore, is set to become significantly more expansionary. The overall fiscal deficit is estimated to widen. Whereas the 2020 Budget projected the fiscal deficit to widen from -4.2 per cent of GDP in 2018 to -6.8 per cent of GDP in 2020 before marginally narrowing to -6.2 per cent of GDP in 2021, the IMF projects that because of the Covid-19 pandemic, the fiscal deficit will widen from -4.1 per cent of GDP in 2018 to -13.3 per cent of GDP in 2020 before recovering to -12.7 per cent of GDP in 2021 (Figure 5).

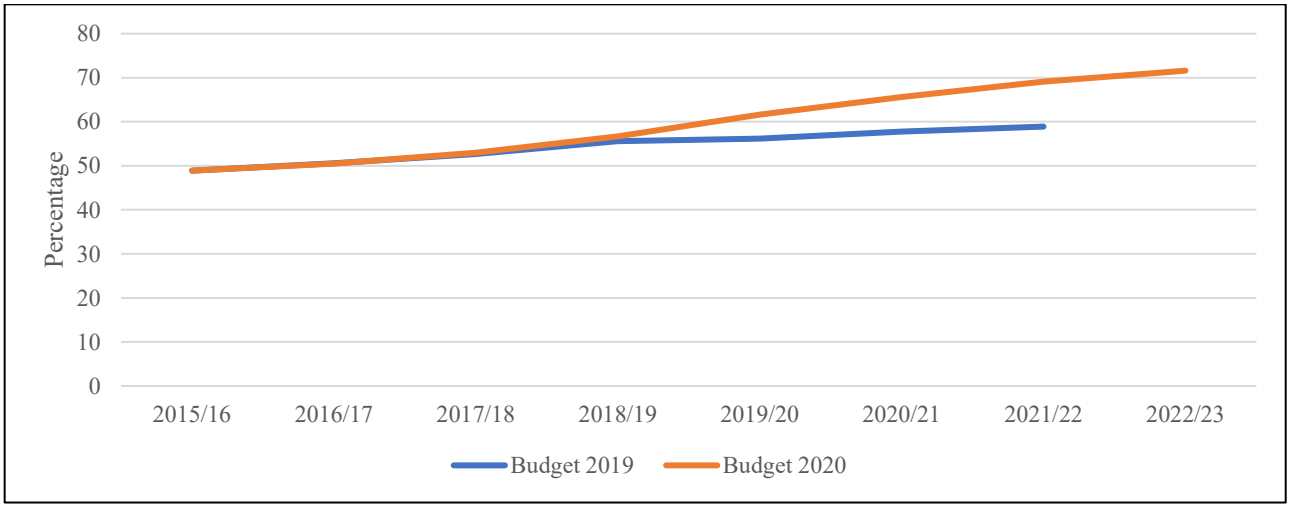
Figure 5: Budget deficit as percentage of GDP, 2018-2021



Source: National Treasury, 2020; IMF, 2020

Government debt trajectory has worsened as a result of sustained weakening in the growth outlook and the materialisation of contingent liabilities from SOEs. Government debt is expected to increase by R869 billion over the medium term to R4.38 trillion, or 71.6 per cent of GDP, by 2022/23. Net debt will reach 67.8 per cent of GDP over the same period. Contingent liabilities are expected to increase from R879.6 billion in 2018/19 to R1.02 trillion by 2021/22. Almost 80 per cent of the increase in contingent liabilities results from SOE loan guarantees, necessitated by their persistent cash deficits and weak balance sheets. Guarantees to SOEs amount to 10.5 per cent of GDP. Several SOEs have required significant budget transfers and may require more if adequate and decisive corrective actions are not taken. Figure 6 shows the huge differences to government debt between the 2019 Budget and 2020 Budget.

Figure 6: Government debt as a percentage of GDP, 2015/16-2022/23



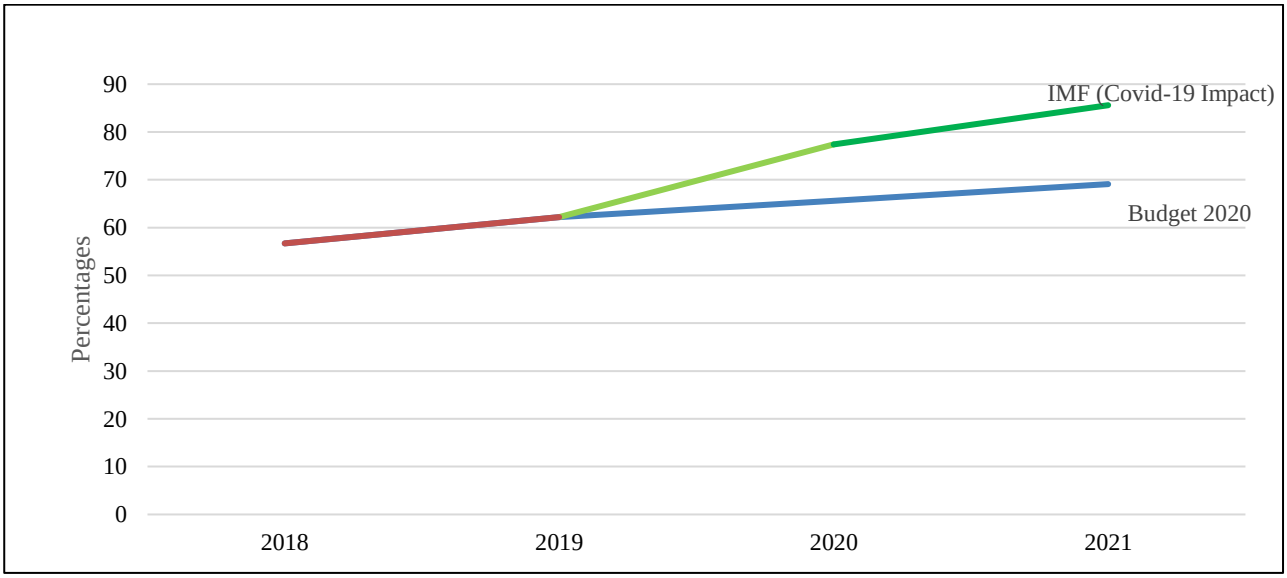
Source: National Treasury, 2019 and 2020

The debt outlook projections are premised on support to Eskom for continuity of electricity supply, fiscal consolidation considerations and implementation of growth-enhancing reforms. If these assumptions do not materialise, the debt trajectory could deteriorate. On the positive side, debt outlook could benefit from the large rand denomination and long maturities of government debt as well as the deep local institutional investor base.

The current debt levels, contingent liabilities, and increasing interest costs expenditure have completely exhausted the fiscal space necessary for responding to shocks, resulting in larger adjustments in an environment of sluggish growth. The Covid-19 outbreak and its financial and economic consequences are expected to cause a major increase in the public debt ratios in South Africa as compared with previous projections. Whereas the 2020 Budget projected government debt to increase from 56.7 per cent of GDP in 2018 to 69.1 per cent of GDP in 2021, the IMF estimates that government debt will increase from 56.7 per cent of GDP in 2018 to 85.6 per cent in 2021 because of the impact of Covid-19 (Figure 7). The preliminary projections by the Commission show that in 2021, South Africa' debt-to-GDP ratio will exceed hundred per cent of its GDP at 104.2 per cent relative to the 2020 Budget projection of 69.1 per cent as shown in Figure 7 below. The only fiscal

instrument under government's direct control to stabilise the debt-to-GDP ratio is that of the primary budget balance. For South Africa to maintain its debt at its current level of 62.2 per cent in 2019 for 2020, and should all else be equal, the FFC estimates that the country will have to maintain a primary surplus equivalent of 9.3 per cent of its GDP in 2020. Failing this, the debt-to-GDP ratio will reach 84.1 per cent in 2020.

Figure 7: Government debt as a percentage of GDP, 2018-2021



Source: National Treasury (2020), IMF (2020), FFC (2020)

Section 3: Overview of FFC's response to revenue and expenditure proposals in the 2020 Budget

Section 3 recaps the Commission's response to government's revenue and expenditure plans as contained in the February 2020 Budget, which the Commission presented to the Standing Committee on Finance on 3 March 2020 and to the SCoA on 4 March 2020.

Revenues

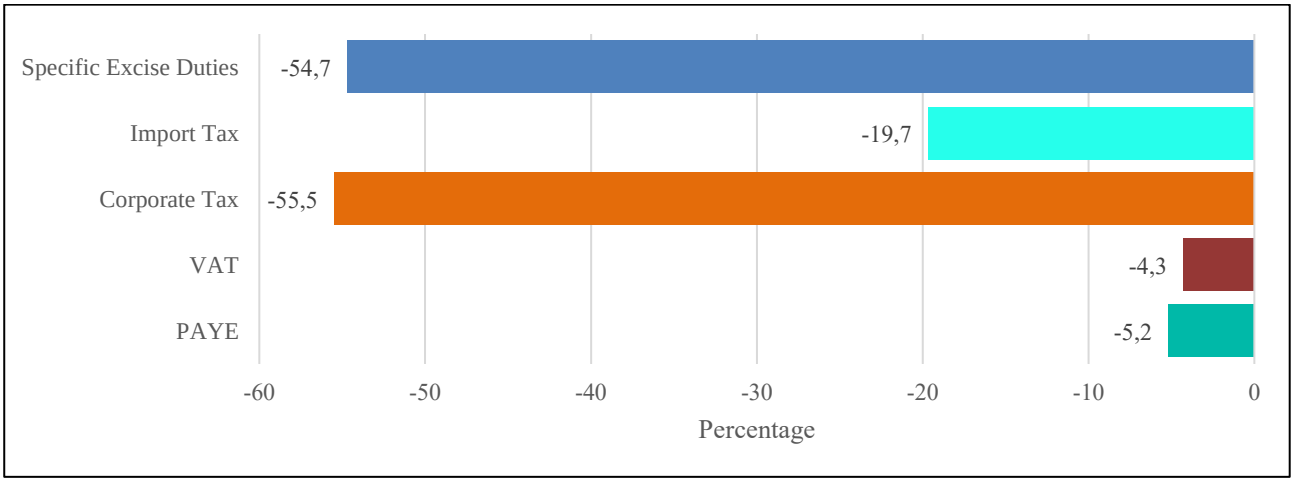
The Budget 2020 highlighted that this is a challenging time for tax administrations and the taxpayers they serve and from whom they collect taxes. On the one hand, there is the need to provide support, through the tax system, to boost a struggling economy; on the other, is the imperative to find additional sources of funding to support such measures. Tax revenues are confronted with multiple challenges emanating from cash flow as a result of extending deadlines to pay tax as well as absolute costs, arising from permanently foregoing tax that would otherwise have been payable.

The South African Revenue Service (SARS) has projected that revenue performance will be lower by between 15 and 20 per cent than forecast in the February 2020 Budget. This translates to a revenue under-recovery of R285 billion[5]. Preliminary assessment by SARS shows an under-recovery of around R9 billion for April 2020, reflecting a year-on-year decline of -8.8 per cent. This revenue under-recovery results from declines in income tax (-5.2 per cent), corporate taxes (-55.4 per cent), VAT (-4.3 per cent), import tax (-19.7 per cent), and specific excise duties (-54.7 per cent) as shown in Figure 8.

The current policy imperatives dictate, for now, an increase in public expenditure to make available health facilities to control the pandemic in an environment of low tax revenue. The Commission recommends that tax policy should prioritise fiscal support to ensure that the economy survives the pandemic because under the current circumstances increasing tax revenues is not a feasible policy option.

[5] See Statement by SARS Commissioner dated 5 May, 2020

Figure 8: Tax revenue under-recovery, April 2020



Source: SARS, 2020

Expenditure

To manage cost pressures, Budget 2020 reduced various baselines (Table 2). Reductions amounting to R160 billion will be implemented over the next three years with the bulk of this amount (61 per cent) projected to come from downward adjustments of baseline wage bill estimates. The largest portion of wage bill reductions are projected to come into effect in the outer year of the MTEF period (2022/23). There will be R101 billion of programme baseline reductions. Of the total R160 billion of baseline savings, R111 billion will be allocated to pressing priorities. Over half of this amount (55 per cent) will go towards financially supporting SOEs, particularly Eskom and South African Airways, while 20 per cent is in respect of additions to government programme allocations. Most (73 per cent) of the addition to SOEs will be allocated in 2020/21.

Table 2: Baseline shifts in Budget 2020

	MTEF total	2020/21	2021/22	2022/23
Baseline reductions and reallocations	-261	-66	-88	-107
Programme baseline reductions	-101	-28	-33	-39
Wage bill reductions	-160	-38	-55	-67
Baseline allocations	111	59	30	22
Financial support for state-owned entities	60	44	14	2
Net change in adjustments announced in 2019 Budget	27	8	8	12
Programme allocations	24	7	8	8
Allocated in 2020 Budget	**4 764**	**1 532**	**1 587**	**1 645**
Plus: Contingency reserve	15	5	5	5
2020 Budget non-interest expenditure	**4 779**	**1 537**	**1 592**	**1 650**
Change in non-interest expenditure since 2019 Budget	*-156*	*-9*	*-61*	*-86*

Source: The National Treasury, Budget Review 2020.

Expenditure by functional category

As a result of low growth, stubbornly high poverty and unemployment, and the need to assist ailing SOEs, Budget 2020 presented consolidated expenditure and functional allocation figures that were revised down when compared to projections as at the time of MTBPS 2019. As reflected in Table 3, aggregate consolidated expenditure over the next three years was revised downwards by R155.3 billion relative to what was anticipated at the time of the 2019 MTBPS. Likewise, the aggregate allocation by function was reduced from R5.5 trillion to R5.3 trillion over the next three years. This is a reduction of R133 billion (R19.8 billion in 2020/21, R50.1 billion for 2021/22 and R63.9 billion in 2022/23) when compared to the 2019 MTBPS projections. As can be expected, these adjustments have had a ripple effect in terms of allocations across the various functional categories, with significant reductions in the majority of functional categories, particularly learning and culture, health, and peace and security. Social development on the other hand saw an increase of R30.7 billion in Budget 2020 relative to what was contained in the MTBPS 2019.

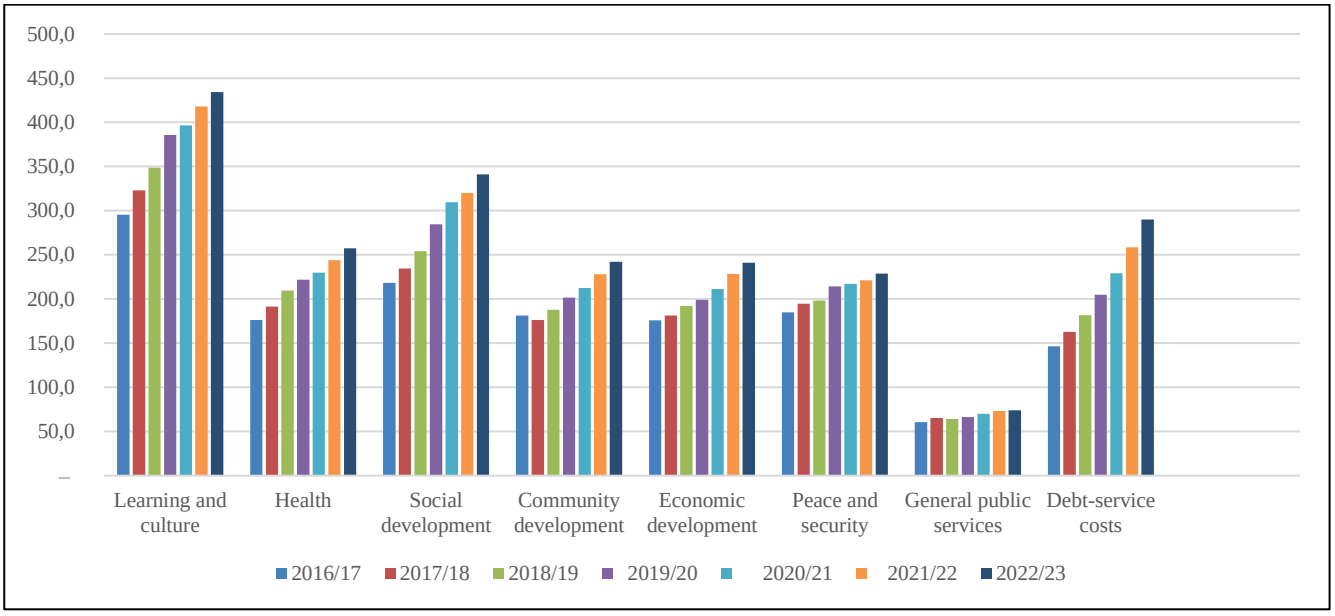
Table 3: MTBPS 2019 versus Budget 2020

R billion	**Total allocations for period: 2020/21 to 2022/23**		**Change between MTBPS 2019 and Budget 2020**
Functional category	**2019 MTBPS**	**2020 Budget**	
Learning and culture	1 306.5	1 248.4	-58.1
Health	768.6	731.2	-37.3
Social development	939.8	970.5	30.7
Community development	688.6	682.7	-5.9
Economic development	704.1	680.7	-23.5
Peace and security	702.3	667.1	-35.2
General public services	224.4	217.3	-7.1
Payments for financial assets	142.5	145.1	2.5
Allocated by function	**5 476.7**	**5 342.9**	**-133.8**
Debt-service costs	796.5	777.9	-18.6
Contingency reserve	18.0	15.0	-3.0
Consolidated expenditure	**6 291.2**	**6 135.8**	**-155.3**

Source: MTBPS 2019 and Budget Review 2020

Drilling deeper into the functional allocations contained in Budget 2020, Figure 9Figure 9 illustrates the allocations to the various functional categories, including debt service costs. As is evident, the amounts allocated in respect of debt service costs now exceed allocations to critical areas of spending such as community development and economic development, and, towards the end of the MTEF period, this item is projected to eclipse even allocations to health.

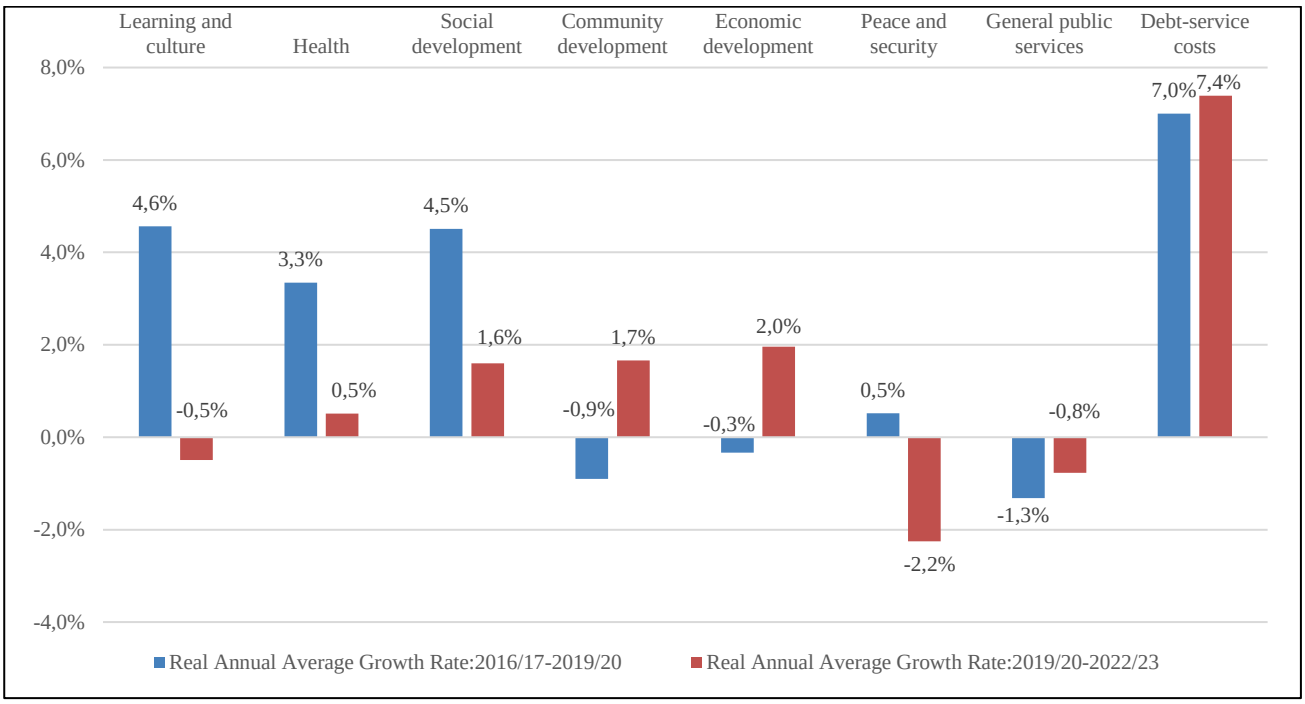
Figure 9: Allocations to the main functional categories, 2016/17 to 2022/23 (R billion)



Source: FFC calculations based on Budget Review 2020.

Figure 10 presents real annual average rate growth in spending in various functional categories over two periods – 2016/17 to 2019/20 and 2019/20 up until the end of the current MTEF period (i.e., 2022/23). The trends reflected in Figure 10 provide a sense of how the relative priority attached to the various functional categories have changed over time. Between 2016/17 and 2019/20, growth in spending by allocation was driven predominantly by learning and culture (mainly post school education and training (PSET)), social development (mainly social security funds) and health. These grew significantly above inflation (4.6 per cent, 4.5 per cent and 3.3 per cent respectively). Over the next three years, the emphasis shifted from this social focus. There is relatively stronger real annual average growth projected for the economic development function (2.0 per cent) and community development (1.7 per cent). Social development continues to see real growth, driven by social protection, consisting mostly of social grant payments (1.6 per cent). These shifts are, however, dwarfed by the real annual average growth of 7.4 per cent projected for debt service costs over the next three years. In terms of functional categories that are projected to decline over the next three years, the peace and security and, to a lesser degree, the general public services function, seem to bear the brunt of reprioritisation over the next three years.

Figure 10: Real annual average growth over the periods 2016/17-2019/20 and 2020/21-2022/23



Source: The National Treasury, MTBPS 2017, 2018, 2019 and Budget Review 2020.

Expenditure by economic classification

As reflected in Table 4, Budget 2020 attempts to reverse some of the historical trends in the composition of expenditure with notably slower growth projected for compensation of employees and relatively strong real growth projected for capital spending. Real annual average growth in current payments is projected to slow down to under -1 per cent per annum over the next three years, mostly driven by wage growth moderation. As was the case previously, expenditure in growth remains driven by rapid growth in debt service costs of, on average, 7 per cent per annum. The next three years will see government rein in spending on compensation and shift emphasis to capital spending. To this end, real growth in compensation spending is projected to decline by a percentage point per annum over the next three years. Conversely capital spending is set to grow by a real annual average of 4.8 per cent per annum over the 2020 MTEF period. Both goods and service and transfers and subsidies will experience slower real growth over the next three years.

Table 4: Consolidated expenditure by economic classification, 2016/17 to 2022/23

R billion	Audited outcome 2016/17	Revised estimate 2019/20	MTEF estimate 2022/23	Real annual average growth rate - 2016/17-2019/20	Real annual average growth rate - 2019/20-2022/23
Current payments	**872.0**	**1,095.9**	**1,286.3**	**3.2%**	**0.9%**
Compensation of employees	510.3	629.2	697.1	2.6%	-1.0%
Goods and services	208.1	251.7	288.5	1.9%	0.1%
Interest and rent on land	153.6	215.0	300.7	7.0%	7.0%
of which: debt-service costs	*146.5*	*205.0*	*290.1*	7.0%	7.4%
Transfers and subsidies	**472.9**	**599.7**	**713.4**	**3.5%**	**1.4%**
Payments for capital assets	**93.6**	**82.8**	**109.0**	**-8.2%**	**4.8%**
Buildings and other capital assets	72.8	63.7	85.7	-8.5%	5.6%
Machinery and equipment	20.8	19.1	23.3	-7.1%	2.2%
Total	**1 445.7**	**1 843.5**	**2 136.0**	**3.7%**	**0.5%**
Contingency reserve	–	-	5.0		
Consolidated expenditure	**1 445.7**	**1 843.5**	**2 141.0**	**3.7%**	**0.5%**

Source: National Treasury, Budget Review 2020

At its March presentation, to the SCoA, the Commission welcomed attempts to better manage the public sector wage bill and the strong emphasis on capital spending, but it indicated that the extent to which potential gains from these steps would be realised were uncertain. Compensation of employees spending dominates provincial budgets and should government not realise the R160 billion projected savings, the effect on provinces, which are also responsible for the delivery of education and health, will be severe. As a result, the Commission had raised this as a critical risk in the 2020 Budget. In addition the Commission had asked whether there was a fairer way to distribute the burden of consolidation and specifically whether the bulk of the need to reduce expenditure must fall only on teachers, nurses, soldiers and prosecutors.

Expenditure by vote

The total appropriation by vote will see a significant reduction in real annual average growth – from a strong 4.6 per cent per annum over the period 2016/17 to 2019/20, to a projected decline of -1.3 per cent per annum over the next three years. Over the 2020 MTEF period, cooperative governance, social development and the small business votes are projected to show relatively stronger real growth of between 2 and 3.5 per cent. Despite allocations being more constrained, the seven years (2016/17 to 2022/23) reviewed show that there are certain departments whose budgets are relatively protected and have experienced real growth over the period, while others have been under relatively more pressure in that they experienced real annual average reductions. Table 5 provides more detail.

Table 5: Prioritisation of votes, 2016/17 to 2019/20 and 2019/20 to 2022/23

Selection of relatively pressurised votes	Selection of relatively protected votes

Vote	Real annual average growth rate - 2016/17-2019/20	Real annual average growth rate - 2019/20-2022/23	Vote	Real annual average growth rate - 2016/17-2019/20	Real annual average growth rate - 2019/20-2022/23
Statistics South Africa	-3.7%	-0.1%	Cooperative governance	3.4%	3.5%
Agriculture, land reform and rural development	-0.6%	-2.0%	Social development	3.2%	2.4%
Human settlements	-1.0%	-5.4%	Small business development	18.4%	2.1%
Trade, industry and competition	-4.3%	-5.9%	National School of Government	23.3%	3.2%

Source: National Treasury, Budget Review 2020

Government's efforts to protect allocations to the local government sphere as reflected in positive, above inflation growth to cooperative governance is noteworthy, given that the delivery of basic services to indigent households takes place at municipal level. Likewise for maintaining the safety net of the poor through higher than inflation allocations to social development which translates into social grant funding to the poorest of the poor. That these measures take place against strong real growth in allocations to the small business development vote highlights the attempts by government to promote future growth and job creation.

As noted under the previous section, cuts to the agriculture, land reform and rural development vote potentially disable a lever for growth and also imply that resources to assist the poor in rural areas are under pressure. Pressure on the human settlements vote are largely the result of reductions in the conditional grant allocations to this department. The strong real cuts to the trade, industry and competition vote are surprising given the need to support growth and job creation in the country. Cuts could result from concerns regarding impact and relative cost, also factoring in analyses from the Department of Planning, Monitoring and Evaluation (DPME) and spending review evaluations. Of concern is the apparent erosion of the allocations to Statistics South Africa (StatsSA) especially given its role as producer of official statistics that form the basis for decision-making across government and business. Given the fourth industrial revolution and the growing importance of data as tools and assets, StatsSA should play a leading role in positioning government in this context.

Section 4: An assessment of growth and transformation of government's fiscal and monetary responses to Covid-19

As noted above, the Covid-19 pandemic has caused unprecedented disruption to the economy, health and socio-political fabric of the country. Before the Covid-19 outbreak, the country was already grappling with economic headwinds from both the domestic and international environments. The transmission of Covid-19 on economic activity in South Africa has occurred through various channels:

- Disruption in trade and value chains;
- Foreign financing flows reduction;
- The direct impact of Covid-19 on economic activity; and
- Disruptions resulting from containment and mitigation lockdown measures imposed by government.

Table 6 describes the combined direct lockdown implications by sector.

Table 6: Combined direct Lockdown Implications of Sector

Mild decline (0-10%)	Moderate decline (-10 to -30%)	Large decline (-30% to -60%)	Severe decline (larger than -60%)
Agriculture, forestry and fishing		Mining and quarrying	Machinery and equipment (manufacturing)
	Food and nonalcoholic beverages (manufacturing)	Education services	Alcoholic beverages and tobacco
		Textiles, clothing, leather and footwear	Iron steel metal products (manufacturing)
		Paper, paper products	Wood, wood products (manufacturing)
Pharmaceuticals hygiene and cleaning (manufacturing)	Petroleum (manufacturing)	Basic chemicals, fertilizer, paint and other (manufacturing)	Nonmetallic minerals and products (cement and concrete)

Finance and insurance, computing services	Plastic, glass(manufacturing)	Wholesale, retail trade	Tyres, rubber products (manufacturing)
Electricity and gas	Real estate, legal and other accounting support services	Transport and storage	construction
Health services		Rentals, research, manufacturing services other business services	Recreation and community services
			Accommodation and catering

Government has responded by implementing a number of fiscal measures to mitigate the socio-economic impact on businesses and households. This section evaluates government response to the Covid-19 crisis.

Fiscal and monetary responses for transformation and growth

In his 2020/21 Budget speech, the Minister of Finance tabled a budget of R1.95 trillion with plans to boost economic growth. Government announced a range of measures to stimulate the economy including structural reforms, improving spending efficiency and stabilising public finances through moderating wage bill growth, debt and contingent liabilities. The accompanying revenue estimates to finance the expenditure programme is a combination of R1.5 trillion in tax revenue and R326 billion in debt. Table 7 shows the projected consolidated fiscal framework over the 2020/21 MTEF under a constraint growth environment. As can be seen from the table, the budget provided little impetus for economic growth with expenditure growing at a negative rate in real terms i.e. when inflation is taken into account.

Table 7: Consolidated fiscal framework under a constraint environment

R billion	2019/20	2020/21	2021/22	2022/23	Real average growth
	Revised estimate	Medium-term estimates			
Revenue	1 517.00	1 583.90	1 682.80	1 791.30	-0.0031%
% of GDP	29.40%	29.20%	29.20%	29.20%	
Expenditure	1 843.50	1 954.40	2 040.30	2 141.00	-0.0141%
% of GDP	35.70%	36.00%	35.40%	34.90%	
Budget balance	-326.6	-370.5	-357.5	-349.7	-0.0641%
% of GDP	-6.30%	-6.80%	-6.20%	-5.70%	
Real GDP growth	0.3%	0.9%	1.3%	1.6%	

Source: National Treasury, 2020

The fiscal framework tabled in February 2020 is no longer attainable due to the Covid-19 induced economic shutdown and slump. Table 8 suggests that revenue may decline by R83 billion under the 6 per cent GDP contraction scenario or R222 billion under the 16 per cent scenario assuming that the tax buoyancy rate remains the same.

Table 8: Revenue and deficit shortfall estimates based on projected GDP contraction scenarios

R billion	2020/21 Budget	Revised GDP contraction estimates		
		6%	12%	16%
GDP	R 5 428	R 5 151	R 4 776	R 4 559
Main budget revenue	R 1 398	R 1 315	R 1 232	R 1 176
Revenue as % of GDP	25.80%	25.80%	25.80%	25.80%
Revenue shortfall		R -83	R -165.63	R -222
Main budget expenditure	R 1 766	R 1 766	R 1 766	R 1 766
Main budget balance deficit	R -368	R -451	R -534	R -590

Source: National Treasury 2020 and FFC compilation

As a general rule the standard response to short- and long-run output declines is fiscal and monetary policy stimulus in order to encourage private sector economic activity, especially when the economy is unable to self-correct through automatic stabilisers (i.e. unemployment insurance and welfare). Unlike fiscal and monetary expansion, discretionary fiscal and monetary stimulus (economic stimulus in general) is not intended to replace the private sector, but instead to direct government deficit spending, tax cuts, lower interest rate and money supply into certain sectors of the economy with the intention of stimulating private consumption and investment which in turn increases economic activity and tax receipts to finance government spending programmes. The principle behind the economic stimulus response effect is for the private sector to fight off the recession as opposed to government incurring huge deficits and risky monetary expansion.

For the economic stimulus to be effective it needs to satisfy a number of underlying principles:

- First, it must be timely i.e. implemented as early and rapidly as possible in the downturn;
- Second, it must be well targeted at individuals and organisations that can spend the money swiftly;
- Third, it must be intentionally bold in size and scope than necessary rather than being small;
- Fourth, the stimulus needs to be temporary in nature to avoid unnecessary deficit and potential overheating of the economy.

The extent to which the stimulus satisfies these principles has a bearing on their precise impact on the economy. For instances, tax cuts generally induce more growth among the poor than the rich in the short term because the former tend to spend a large percentage of their income. Similarly, infrastructure spending is more likely to bring about long-term economic benefits than a short-term economic boost due to the long gestation period of such spending.

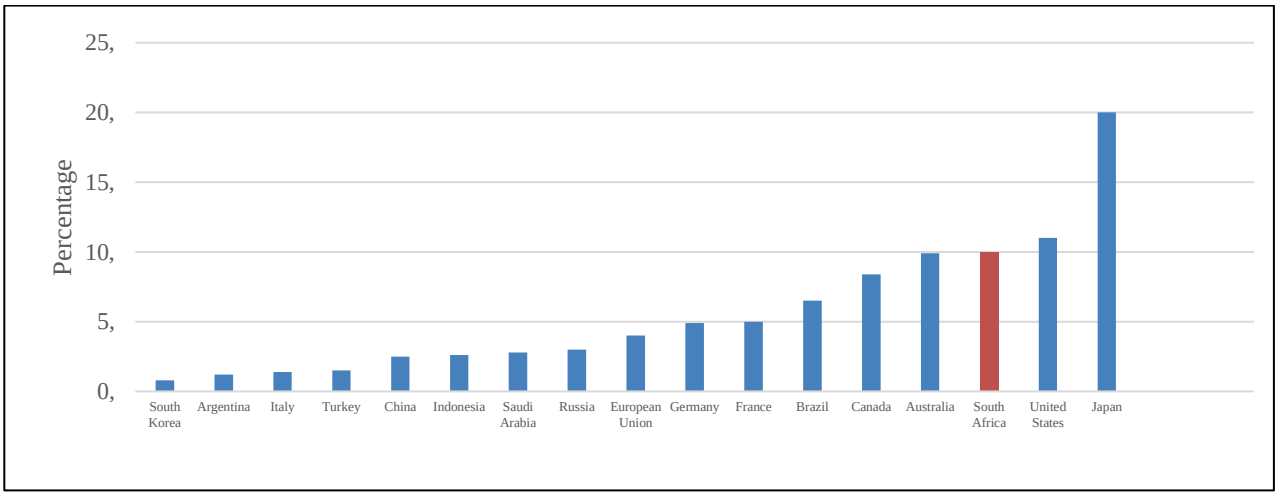
Some of the policy areas that meet the criteria for effective economic stimulus are:

- Augmenting existing unemployment insurance benefits in terms of benefit period and the relief amount;
- Providing nutritional support to low income households and the unemployed;
- Providing fiscal relief to subnational governments through grants in order to maintain service levels;

- Providing direct cash payment to vulnerable households to meet basic needs;
- Implementing a public works programme (or subsidised jobs) for unemployed people; and
- Introducing housing assistance measures to prevent drastic increase in eviction and homelessness.

The government has introduced a range of fiscal and monetary policy interventions to address the faltering effect of Covid-19 on the economy. According to the National Treasury the intervention amounts to R1 trillion, consisting of R500 billion in fiscal support and R500 billion in monetary and financial market interventions. The fiscal intervention alone is equivalent to 10 per cent of GDP and purportedly larger than the economic interventions seen in the developed and developing G20 countries.

Figure 11: Covid-19 fiscal intervention in G20 countries as a percentage of GDP – April 2020



Source: IMF

Table 9 gives a breakdown of the fiscal response package. As can be seen the fiscal response package comprises a combination of sub national relief transfers, cash grants, employment preservation and credit extensions to support private sector activity both for the formal and informal sector.

Table 9: Breakdown of Covid-19 fiscal response package

Expenditure	**Amount (R billion)**
Health – Covid-19 intervention	R20
Municipal allocation	R20
Social and basic income grant	R50
Job creation and support for SMEs and informal sector	R100
Salary income support (UIF)	R40
Tax relief	R70
Business loan guarantee scheme	R200
Total	**R500**

Source: Presidency 2020

The cost of Covid-19 tax relief measures is estimated at R70 billion. This arises from tax deferrals without penalties and interests, employee tax incentive extensions as well as the temporary suspension of the Skills Development Levy. This figure includes R5 billion for case-by-case applications for deferrals but excludes a projection of a decline in general compliance due to business struggling with cash flow, and unable to repay the deferred payments during the current fiscal year, or defaulting and/or failing completely. This means that the total impact of the tax relief measures is likely to be much higher than the R70 billion in initial assessment.

In respect of monetary policy, the measures introduced in response to the Covid-19 economic crisis comprise:

- Interest rate reduction of 225 basis points;
- Relaxation of regulations for credit extension;
- Repurchasing of bonds in the secondary market; and
- Case by case payment holidays to support debtors.

Different financial service providers have announced payment holidays and credit period extensions for their respective customers. The precise breakdown of the R500 billion monetary policy response is not clear and information on it is sketchy. For instance, data on the number of people approved for payment holidays and the amount of bonds repurchased[6] for Covid-19 purposes is not readily and publicly available.

Table 10 outlines the breakdown of funding sources to cover the fiscal response package. The spending and funding composition has a bearing on whether the response package is effective or not in minimising the attendant social and economic costs or stimulating economic activity.

Table 10: Funding source for Covid-19 fiscal response

Source	R billion
Credit guarantee scheme	R200
Budget reprioritisation	R130
Borrowing from multilateral finance institutions for business support	R95
Transfers and subsidies from social security funds	R60
2020/21 Social development baseline budget	R15
Total	**R500**

Source: Presidency, 2020 and National Treasury, 2020.

Government has been especially vigilant not to label both the fiscal and monetary responses an economic stimulus. By definition, a stimulus implies an injection of additional resources or liquidity over and above the existing baseline budget or money supply. On the contrary, economic relief entails provision of rapid response or provision of aid to alleviate the impact of a catastrophe. The Covid-19 economic crisis has greatly prejudiced the income earning potential of businesses and households and necessitated relief to prevent slippage into total collapse, social deprivation or state poverty. Much of

[6] Bond repurchasing is part of open market monetary policy operations to regulate the supply of money in the economy.

the fiscal and monetary responses constitute an income replacement from production and employment losses rather than an active stimulus to increase productivity and employment. From Table 10, it can be deduced that only the R95 billion borrowing from the multilateral institutions will constitute direct injection or spending in the national budget and the economy. This means that the Covid-19 stimulus falls far short of the expected boost to the economy. According to National Treasury, the total Covid-19 borrowing requirement will be allocated towards business support and jobs protection. Government will need to commit to budget earmarking in order for the funding to be strictly assigned to business support.

The R200 billion business loan guarantee is a contingent liability that will increase government guarantee exposure from the current R484 billion to R684 billion. The R130 billion represents a shift in spending priority from the existing budget while the social security funds constitute drawdowns or income replacement from work stoppages and layoffs. While Covid-19 has turned Budget 2020 upside down, there is nevertheless no discernible baseline increase to the R1.95 trillion budget tabled in February 2020 arising from the R500 billion Covid-19 fiscal response, especially considering the anticipated revenue shortfalls.

Similarly, the extent to which the monetary response package finds its way into the economy depends on a number of intervening variables such as the household debt to income ratio and the qualifying criteria for the loan guarantee scheme and payment holidays. The effect of interest rate reductions on growing the economy depends on whether households use the relief to increase spending or use it to offset the high household debt to income ratio estimated at 72.8 per cent. Likewise, access to the loan guarantee scheme depends on credit eligibility criteria set by the different banks. The economic impact of the response will ultimately depend on the number of businesses that apply and qualify for the scheme. This is also true for the credit payment holidays offered by financial service providers. High indebtedness levels are likely to neutralise the mitigating effects of monetary responses to the crisis. Overall, the gamut of government's fiscal and monetary response package can be classified as "gap filling" or relief rather than stimulus. The projected employment losses (ranging between three and seven million people) suggest that the social security package may be insufficient to deal with the magnitude of the crisis.

By way of focus, the fiscal and monetary responses are targeted as policy interventions known to effectively bolster aggregate demand and reduce economic hardships during recession. R50 billion has been earmarked for improved child care support and direct cash transfer to the unemployed. A further R40 billion provision is made for social services relief to sub national governments while R100 billion is set aside for job creation through small business and the informal sector. Various government departments have initiated country wide food parcel programmes that have benefited a number of people. The food parcel programme, however, is poorly coordinated and targeted despite government efforts to centralise food donations and distribution.

A deeper analysis suggests that the fiscal response package is inadequate. According to different forecasts, South Africa's GDP growth in 2020 is expected to slow down significantly. Forecasts to

date range from -5.4 per cent to -20.4 per cent. This implies that the fiscal and monetary support warranted to revitalise the economy must be substantial and commensurate with the magnitude of the forecast economic contraction. As indicated earlier, the size of the current fiscal response package largely constitutes income replacement rather than new injection.

Whereas the SARB does not have a mandate to fund government directly, it does have the authority to conduct open market operations. As the central monetary and financial authority, it is the only institution with the ability to intervene in the capital market under conditions of distress. Therefore a more aggressive bond purchase programme by SARB is feasible and warranted, and would substantially strengthen liquidity in the markets[7].

Government should consider its total balance sheet in supporting an economy that is on the brink of collapse. Assets on the national balance sheet include the Public Investment Corporation (PIC), Government Employees Pension Fund (GEPF), Unemployment Insurance Fund (UIF), the National Revenue Fund, and SARB foreign exchange reserves.

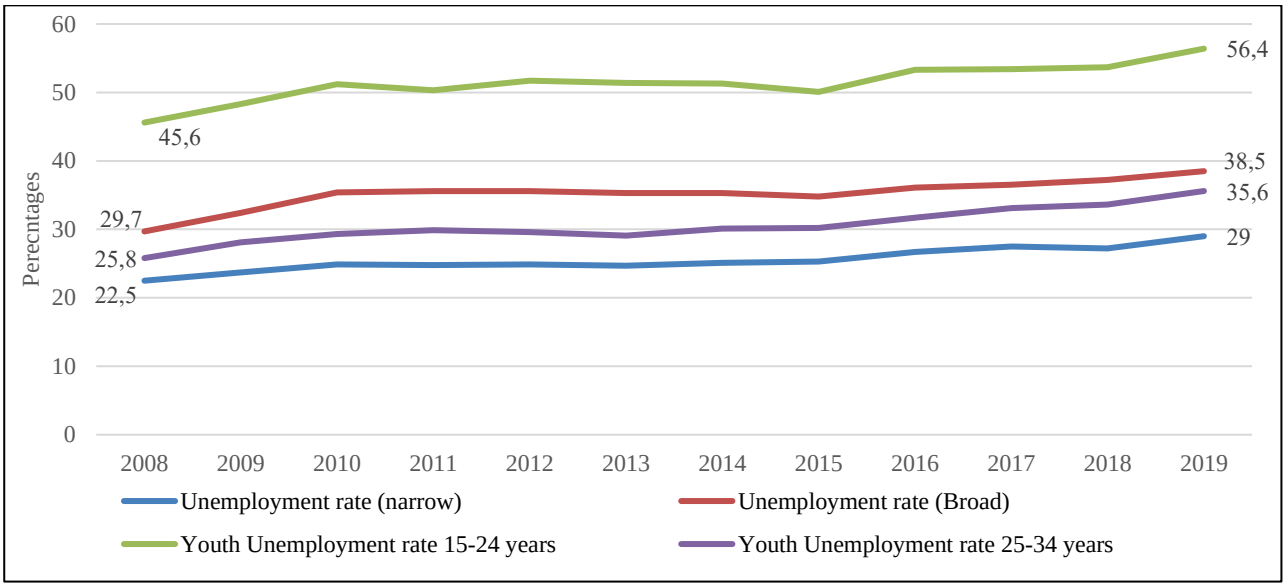
The R50 billion allocation to poor households accounts for only ten per cent of the R500 billion package. This amount is very small in a context in which more than half of the population (30.4 million people) lived below the poverty line[8] in 2015, according to Statistics South Africa. In other countries, such transfer income to impoverished households have accounted for up to 50% of stimulus packages. The R325 monthly grant is below the food poverty line of R561. The humanitarian relief in the form of food parcels is woefully inadequate in a country considering poverty levels noted above.

The R95 billion earmarked for business support, job creation and protection is inadequate given the scale of projected job losses. This is further exacerbated by the fact that pre-Covid-19, the economy was already plagued by a very high unemployment rate. More than half (56.4 per cent) of young people aged 15-24 years are unemployed as shown in Figure 12 below.

Figure 12: Unemployment rate in South Africa, 2008-2019

[7] See Donaldson, A. 2020. *Monetary management, financial markets and public debt*. Covid-19 Economic Ideas. https://covid19economicideas.org/2020/04/09/monetary-management-financial-markets-and-public-debt-responding-to-covid-19-and-the-economic-standstill/

[8] See Statistics South Africa. 2017. *Poverty Trends in South Africa*: An examination of absolute poverty in South Africa between 2006 and 2015. Pretoria, Government Printing Works.



Source: Statistics South Africa

The Commission commends the immediate response to cushion businesses and households from the sudden impact of the lockdown. Without government intervention, several businesses would have faced sharp declines in liquidity, limiting their ability to pay rent, salaries and intermediate goods. Vulnerable households would have fallen deeper into poverty and many would not have employment. These measures can be considered "first round" responses to the crisis.

Details of the criteria for distributing both the fiscal and monetary stimulus are currently scanty as government is yet to finalise the adjustment budget. It is imperative that both the fiscal and monetary responses comply with revenue sharing principles outlined in section 214 a-j of the Constitution – particularly, in respect to equity. The fiscal and monetary response must be distributed equitably across the sub national governments and business sector. In this regard, the Commission recommends that the health and municipal allocations, in particular, should be distributed equitably across provinces and municipalities, using either the respective equitable share formulae or temporary conditional grant allocations on the basis of Covid-19 case load. Government must also consider standardising the application requirements for the loan guarantee scheme and earmark the proportional benefit share for each province to ensure regional/spatial equity.

The Commission further notes that the economy is likely to experience an L-shaped recovery characterised by persistent unemployment and stagnant growth. Such a predicament will require sequenced and sustained fiscal and monetary responses which may further require relaxation of the ongoing fiscal consolidation stance in the short to medium term. The resultant high debt could pay for itself through higher tax revenue if the deficit spending is well targeted at stimulating private sector activity and addressing the inherent structural weaknesses in the economy. The government will have to make a difficult trade-off between attaining fiscal stability and bolstering a stagnant economy. A return to fiscal stability will entail significant expenditure cuts in government spending. The Commission thus proposes that government's fiscal response should be guided by the following sequence:

- In the short to medium term the response package must be directed at supporting the health care system – reimbursing provinces for the additional cost burden imposed by Covid-19 screening, testing and hospitalisation. Interventions must focus on preventing socio-economic hardships, ensuring food security and preserving livelihood strategies for the poor, unemployed and the vulnerable households (child headed households and the elderly).
- In the long run post, Covid-19 (recovery phase), the Commission notes that the government may have to implement fiscal stimulus packages to boost the economy through consumption and investment spending. The extent of the fiscal package will depend on the fiscal space (ability to borrow, raise taxes or to deploy off-budget transactions such as pension funds and direct borrowing from the reserve bank) and the longevity of the phase. A protracted economic recovery will need drastic readjusting of expenditure priorities and generous stimulants for private sector activity. In the absence of a fiscal space for a robust fiscal and monetary stimulus, government will have to focus strategically on structural transformation in respect of improving education completion rates and outcomes, reskilling the unemployed, reorienting higher education towards digital skills, strengthening manufacturing capabilities, reducing high levels of concentration in the economy, strengthening the capacity of the state and reviewing the means testing across the board. This will necessitate a review of institutional efficiency and of the "right sizing" of government, including its entities.

The reform agenda

The Commission welcomed the reforms advocated in the National Treasury paper: "Economic transformation, inclusive growth, and competitiveness: Towards an Economic Strategy for South Africa". It is the view of the Commission that the reforms are relevant t because they are broadly pro-growth and they support, among other things, competitiveness and higher productivity. However, implementing these reforms will compete with other initiatives such as land expropriation without compensation, establishment of the national health insurance (NHI) and extension of tax incentives to selected industries, highlighting the importance of prioritisation and sequence of the reforms.

Social assistance and fiscal redistribution, sizeable and effectively targeted, play a fundamental role in containing the rise in inequality. The Commission is of the view that slow growth makes fiscal redistribution alone grossly insufficient to address the country's inequalities. The Commission recommends that the cycle of low growth and high inequality must be broken through bold actions aimed at giving poor South Africans better access to good jobs so that they can fully participate in the economy. It is the only way to strengthen its social contract, where the political rights gained with democracy are met with people sharing in the nation's wealth.

The Commission recommends that the reform agenda should actively initiate a number of policy interventions, including:

- Improving governance and fighting corruption:

State capture has weakened institutions and increased inefficiencies by distorting the playing field for investors, reduced tax revenue, and created incentives to circumvent regulations to deviate from good public procurement practices. According to Transparency International, in 2019 South Africa is ranked 70 out of 180 countries with a score of 44 out of 100 in terms of corruption. According to the Global Corruption Barometer in 2019, 64 per cent of South Africans think corruption increased in the previous 12 months and 18 per cent public service users paid a bribe in the previous 12 months. Estimates by the Auditor-General of irregular and wasteful expenditure amounts to approximately 1 per cent of GDP. Undoing the culture of non-adherence to already existing good laws and regulations, and enhancing the independence of anti-corruption agencies would reinforce their efficacy and accountability, and benefit the economy. There is an urgent need to rebuild institutional frameworks and institutional capacity. Advancing corporate governance and developing checks and balances such as customer due diligence, beneficial ownership, and asset declarations will support the ongoing governance initiatives. Efforts to expedite criminal prosecution against those engaged in corrupt activities should be further intensified. So far, there have been relatively few high-profile prosecutions of individuals accused of corruption. Given the depth and breadth of state capture and corruption, sustained efforts, particularly the establishment of credible deterrence mechanisms, will be required to tackle corruption.

- Limiting tertiary education subsidies to only poor households:
  Shifts in education spending towards additional tertiary education subsidies have been ongoing since 2016. However, international evidence from most emerging markets shows that tertiary education spending is regressive not only in absolute terms, but also gravitates towards profiting non poor households disproportionately[9]. The reason for this is that poor students are most likely to have weaker educational backgrounds than non-poor students and are less incentivised to pursue tertiary education. Since students who complete tertiary education typically earn higher wages, non-poor households who can afford tertiary education have an incentive to pay for it without any subsidisation. Subsidising students from non-poor household who have an incentive to pay for tertiary education in the first place, means that less financial resources are available to support those that need them the most.

- Exposing South Africa's large conglomerates to foreign competition:
  Several economic sectors, including manufacturing and banking, are dominated by a handful of big players with significant market power. High concentration has inhibited the emergence of smaller firms, which are powerful job creators. In the past decade, SMEs have shrunk in importance relative to large firms. There is a need for more competition for the large conglomerates in order to enable SMEs to enter the mainstream economy and reduce input costs and profits that are associated with declining economic growth.

[9] See International Monetary Fund. 2014. "Fiscal Policy and Income Inequality." IMF Policy Paper. Washington, DC: IMF.

- Land Reform and agriculture for food security:
  In line with best international experiences, land reform should focus on enhancing agricultural productivity, improving land administration to strengthen security of tenure, and reducing poverty. At the same time, there is a need to mitigate any potential negative effects of land reform on the agricultural base and the financial spill overs from changes in the value of land as collateral. The government will have to finely balance social and economic considerations when deciding the type of land to be redistributed and the modalities surrounding the process to make land tenure more productive. The Commission's submission for the 2018 Budget recommended that government consolidate grants aimed at assisting land reform and supporting agriculture into one funding programme for emerging land reform farmers under the Department of Agriculture, Forestry and Fisheries, which has more expertise in the area of agriculture in order to address land reform challenges pertaining to resources for planning and aligning land reform with human settlements, agriculture and infrastructure; training land reform farmers in technical and business skills; and establishing selection criteria for land reform beneficiaries that are applied uniformly across all the provinces**.**

- Reducing the cost of broadband and assignment of high-demand spectrum:
  South Africa has slower internet speeds and higher data prices than most country comparators. There is a need to expedite the permanent allocation of broadband spectrum through auctions and leveraging private sector capabilities[10]. A more cost-efficient network would foster technology adoption and innovation, with broader spill overs. Broadband cost reduction will facilitate introduction of e-learning in public ordinary schools, thus reducing the need for investment in physical infrastructure. In its submission to the 2013/14 division of revenue the Commission recommended that government institutionalise e-learning programme budgeting and invest in work force to roll out the implementation of digital education.

- Strengthening capacity of state:
  To strengthen the capacity of state, it is important that state machinery is reorganised to minimise duplication, sharpen coordination and adopt new technologies to improve efficiencies. It is also important for the state to invest in its key resource: frontline staff. The pandemic has amplified the importance of investing in key public servants such as nurses, doctors, police officers, soldiers, refuse removal workers, who are in the forefront of efforts to combat Covid-19 and keep essential services running. They have done this at their own risk and that of their families. Similarly, as we move towards a society where policy making is increasingly driven by data and information, this requires a refocussing by government to attach priority to functions such as research and innovation, which previously may have been relatively deprioritised. Thus in building a capable state it is critical for government to invest

[10] The Commission notes that some have been released in response to Covid-19

in frontline, research and innovation employees. The Covid-19 pandemic has shown that social risks of return of such workers are immense.

- Review of "means tests":
  Covid-19 has changed many things and turned people's lives upside down. Many people have found themselves in poverty, with no incomes, unemployed and highly indebted. Even before Covid-19, the deteriorating economic situation meant that many people were neither able to sustain themselves nor invest in their future. Elsewhere in this document, the Commission notes that the R325 monthly grant is below the food poverty line of R561; an indication that the cost of raising a family has increased. It is against this that the Commission underscores the need for a comprehensive and consultative review of various "means tests": e.g. financial eligibility for various forms of grants or relief, student support, or even basic services in municipalities.

Section 5: Where will the money come from? Reprioritisation in response to Covid-19

Responding to the Covid-19 pandemic will require significant resources and a rethink of expenditure priorities going forward. Government has put together a social relief and economic support package worth R500 billion. Of the R500 billion, R130 billion must come from a reprioritisation of existing baselines. The Commission is of the view that reprioritised funds should be focussed on strengthening the Department of Health to enable it to respond effectively to the pandemic, as well as other departments that are assisting in this regard. Further to that, the process of reprioritisation should ensure that support provided to vulnerable households and businesses are enhanced.

In addition, the Commission's decisions to reprioritise funding away from budget baselines or not, were informed by the following factors:

- Rights based approach: Protecting spending that caters for the basic rights of people (e.g. spending on basic services: water and sanitation, refuse removal);
- Equity and fairness: Balance rural vs urban (spatial equity), formal vs informal service provision. For example, a grant dedicated to urban areas may be a better candidate for reprioritisation than a grant focussing on rural areas, depending on its purpose;
- Spending performance: Reprioritising spending that exhibits consistent underspending, irregular or wasteful spending;
- Impact: Reprioritising spending that would have the least impact on livelihoods and the economy. Good examples include travel, subsistence allowances, training and catering;
- Spending composition: Whether spending is for capacity building or infrastructure; for new or existing infrastructure; for social relief to the poor or not; critical to bolstering or restructuring the economy or not; and whether it is Covid-19 related or not.
    - If spending is for new infrastructure, not related to Covid-19 and has minimal impact on the people's health, livelihoods (e.g. basic services) or economy (SMMEs), the Commission proposes either reprioritisation away, delaying or postponing or reorienting such spending to Covid-19.
    - If spending is for non-essential capacity building programmes the Commission proposes it be postponed.
    - Covid-19 related capital spending (such as ventilators, hospital beds and other equipment, and upgrading and reconfiguration of buildings and institutions to serve as health care facilities as well as on water and sanitation (essential basic services)) should not be reduced.

  - Spending that will in future increase the wage bill of non-Covid-19 related areas staff, the Commission proposes it be postponed.
  - Spending on activities that may compound the spread of Covid-19 like are also seen as potential areas for deferment.
- High perennial growth: The Commission looked at historical growth in allocations. In the Commission's view, where growth was excessive in the past, the concerned spending item becomes a good candidate for moderation.

The Commission proposes a three pronged approach to reprioritisation focussing on adjustments:

- By department;
- By economic classification of spending common to most departments (for example personnel spending, goods and services, infrastructure); and
- By conditional grant.

In each instance decision makers need to distinguish between essential departments/spending and non-essential. Here essential is deemed to be those departments/items of spending that relate directly to fighting Covid-19. Second, essential departments/items of spending include those departments that assist in providing social relief to poor and vulnerable households. Third, those department/activities that are essential to buoying and driving the economy and directing government, coordination, planning and spending during this time. The three approaches are discussed below. Table 11 provides a summary of the spending items that the Commission proposes be assessed as candidates for reprioritisation. The amounts reflected in Table 11 are aggregate pockets of funding that national departments plan to spend over the next three years and therefore funding that could be adjusted over the coming period. Essentially this section points out areas and categories of spending that provide opportunity for reprioritisation. In each instance, the precise amounts that can be reprioritised will need to be determined by sector departments in consultation with National Treasury, and other relevant decision makers, for example provincial departments and provincial treasuries and municipalities.

Table 11: Overview of spending items that FFC recommends for consideration in reprioritisation

Item of spending (R million)	2020/21	2021/22	2022/23	Total over MTEF period: 2020/21-2022/23
Compensation of employees by national departments	187 668.1	200 116.5	208 736.4	596521.0
Goods and services spending by national departments	77 891.4	83 642.8	84 630.8	246 165.0
of which:				
Travel and subsistence	6 156.0	6 476.0	6 574.4	19 206.4
Training and development	1 158.2	1 121.4	1 137.7	3 417.3
Catering	295.3	423.9	328.9	1 048.0
Total infrastructure spending by national departments	136 096.3	145 126.1	152 187.6	433 409.9
of which:				
New infrastructure by national departments	4 930.1	6 196.6	6 828.9	17 955.6
Existing infrastructure by national departments	6 356.9	5 670.8	5 185.0	17 212.7
Total conditional grants spending	154 603.3	164 159.3	171 283.8	490 046.4
of which:				
Conditional grants to provinces	110 784.8	117 961.5	123 136.7	351 883.0
Conditional grants to municipalities	43 818.6	46 197.7	48 147.1	138 163.4

Source: ENE 2020 data

Reprioritisation by national departments

In the first instance departments can be divided into those that are essential to, and at the forefront of fighting Covid-19 and providing social relief, especially to the poor and vulnerable. This automatically prioritises departments such as health, social development, water and sanitation. In terms of assisting with the effects of Covid-19 and the lockdown, other departments such as police and defence are important in ensuring compliance with lockdown regulations. Then there are departments that are essential to propping up the economy – departments like transport, small business development, energy and agriculture. There are departments that are priority departments due to the changing nature of the world we live in, such as departments of Communication and Digital Technologies, Statistics South Africa and Science and Innovation. So the first step will be for government to determine departments that are priority relative to other departments, who, at this time, can be considered non-essential. An example of a department that would not be considered priority is the Department of Sports, Arts and Culture since, due to the requirements around social distancing, there will be limits on participation in team sports and visiting cultural places which is related to the core mandate of this department. The non-essential departments should then be subjected to more aggressive reprioritisation relative to their more essential counterparts. Even within priority/essential departments, there may be room for reducing allocations. For example, the Department of Planning, Monitoring and Evaluation should play a central role in assisting with coordination and innovative planning across the three spheres to ensure more effective allocation of resources during this extraordinary time. However, an assessment of this department's spending performance shows an average trend of underspending (average of 93% of budget spent – see Table 12) over the period

2016/17 to 2019/20. Thus, despite the centrality of this department, there is space for reprioritisation, and even for focus on its programmes that may be central or not.

Table 12: Average spending performance of national departments

Vote	Average spending over the period 2016/17-2019/20	Vote	Average spending over the period 2016/17-2019/20
The Presidency	96.0%	Civilian Secretariat for the Police Service	94.8%
Parliament	101.2%	Correctional Services	99.8%
Cooperative Governance	96.6%	Defense	100.0%
Government Communication and Information System	99.0%	Independent Police Investigative Directorate	99.9%
Home Affairs	100.0%	Justice and Constitutional Development	99.1%
International Relations and Cooperation	97.7%	Military Veterans	91.9%
National School of Government	98.4%	Office of the Chief Justice	99.3%
National Treasury	100.0%	Police	99.6%
Planning, Monitoring and Evaluation	92.5%	Agriculture, Land Reform and Rural Development	98.0%
Public Enterprises	97.0%	Communications and Digital Technologies	87.6%
Public Service and Administration	96.6%	Employment and Labour	95.7%
Public Service Commission	100.4%	Environment, Forestry and Fisheries	98.0%
Public Works and Infrastructure	99.2%	Human Settlements	99.6%
Statistics South Africa	99.9%	Mineral Resources and Energy	98.7%
Traditional Affairs	95.6%	Science and Innovation	99.4%
Basic Education	98.2%	Small Business Development	96.3%
Higher Education and Training	100.0%	Sports, Arts and Culture	97.7%
Health	99.1%	Tourism	98.5%
Social Development	99.7%	Trade, Industry and Competition	99.4%
Women, Youth and Persons with Disabilities	99.2%	Transport	97.6%
		Water and Sanitation	98.4%

Source: FFC calculations based on ENE 2020 data

Table 13 shows the proposed allocations by function over the next three years. The following points are noted:

- Within the learning and culture functional category, for example, in the context of Covid-19, the activities related to the Department of Sports, Arts and Culture are relatively less essential than those offered by the Departments of Basic Education and Higher Education and Training. Thus within the learning and culture category there is more room to effect cuts aggressively in Sports, Arts and Culture during the reprioritisation process;
- The Departments of Health and Social Development are both pertinent in the context of addressing the challenges related to Covid-19. In terms of the social development functional category, it may be possible to divert funds from the Department of Women, Youth and Persons with Disabilities towards the Department of Social Development, since the latter also includes a focus on women, youth and people with disabilities;
- All departments in the community development functional area are essential when it comes to fighting Covid-19 as it covers sectors such as water and sanitation as well as human settlements;
- The economic development function is a critical function both in achieving South Africa's developmental goals and responding to the Covid-19 pandemic. The general objective and mandate of this group of departments directly relates to employment, business and trade, agriculture and finance. The economic development function departments are expected to

collectively and individually to play a much more strategic role in facilitating and implementing government's response to Covid-19– within this function though there may be room for reprioritisation;

- The peace and security cluster is key during the period of Covid-19 as it ensures compliance with lockdown regulations (particularly defence and police), while the Department of Home Affairs operations have reduced, it ensures that services such as issuing of death and birth certificates, for example, are not compromised;
- Within the general public services category, the Commission is of the view that some institutions in this cluster such as the Department of Cooperative Governance and Traditional Affairs, the National School of Government, and the Public Service Commission are not as essential for the fight against Covid-19 as others mentioned above. The Commission recommends that a substantial fraction of the proposed spending for these institutions should be considered for reprioritisation.

Table 13: Proposed allocations over the 2020 MTEF period by functional category

R billion	MTEF estimates			Total over the 2020 MTEF period	Real average growth rate 2020/21-2022/23
Functional category	**2020/21**	**2021/22**	**2022/23**		
Learning and culture	396.4	417.8	434.2	1 248.4	-0.5%
Health	229.7	244.0	257.6	731.2	0.5%
Social development	309.5	320.1	340.9	970.5	1.6%
Community development	212.3	228.2	242.2	682.7	1.7%
Economic development	211.5	228.2	240.9	680.7	2.0%
Peace and security	217.0	221.3	228.8	667.1	-2.2%
General public services	70.0	73.2	74.1	217.3	-0.8%

Source: Budget Review 2020

Many departments oversee entities. These entities should be subjected to a process similar to national government departments. So apart from general reductions to aspects of goods and services and infrastructure-related spending, a process of distinguishing the essential from the non-essential should be conducted. Entities such as the South African Social Security Agency (SASSA), the National Health Laboratory Service (NHLS), and the South African Revenue Service (SARS) are core to addressing impacts of Covid-19 and should be relatively more protected.

Reprioritisation by economic category of spending

Compensation of employees

Compensation is a major cost driver across government departments. Government has attempted to reign in this component of spending over the years. The Commission recommends that Government focus on appropriately moderating salary increases during the current period. This should be done in a way that brings about spending efficiency but does not threaten the income of lower level personnel, especially frontline staff, who are critical in the fight against Covid-19. During this time, public servants such as nurses, doctors, police officers, soldiers, refuse removal workers, have been at the

forefront of efforts to combat Covid-19 and keep essential services running. This has been done at the risk of own and their families' health and wellbeing.

Based on Table 14, it is noteworthy that departments in the peace and security cluster allocate significantly more to personnel relative to other functional categories.

Table 14: Planned personnel spending of national departments over the 2020 MTEF period

	Medium-term expenditure estimates			Total Over 2020 MTEF	% of MTEF
Category (R million)	**2020/21**	**2021/22**	**2022/23**	**2021/22-2022/23**	**total**
Learning and culture	11 273.08	12 003.13	12 522.19	**35 798.39**	6.0%
Health	905.8	958.7	991.2	**2 855.67**	0.5%
Social development	659.04	702.52	733.61	**2 095.18**	0.4%
Community development	2 817.04	2 999.28	3 129.05	**8 945.38**	1.5%
Economic development	13 670.30	14 551.02	15 185.08	**43 406.40**	7.3%
Peace and security	150 219.23	160 221.46	167 135.21	**477 575.91**	80.1%
General public services	8 123.67	8 680.34	9 040.09	**25 844.10**	4.3%
Total	187 668.1	200 116.5	208 736.4	**596 521.02**	100.0%

Source: FFC calculations based on 2020 ENE summary table number 8.

Goods and services

Goods and services spending contain an array of items that could be considered non-essential in relation to the Covid-19 challenge and subsequent lockdown restrictions. For example, spending on good and services includes provision for items such as advertising, catering, travel and subsistence, training and development. These items of spending are not only of less strategic importance in terms of service delivery but may not be utilised due to restrictions on movement and the need for social distancing. The opportunities brought about by technology are also making travel, workshops and conferences less important in conducting productive activity going forward. Over the 2020 MTEF period, total government spending on goods and services is projected to reach R835 billion over the next three years, with departments focussing on health care, economic development, and peace and security as the drivers of such spending, thus implying that there may be room for reprioritisation within these departments' programmes, albeit that they are essential for responding to the Covid-19 pandemic. Honing in on total goods and services spending by national departments, estimates of national expenditure (ENE) data shows that the 41 departments are projected to spend R246 billion over the next three years. As shown in Table 15, the peace and security departments are responsible for 57 per cent of total goods and services spending by the 41 national departments.

Table 15: Spending on goods and services by national departments

Category (R million)	Medium-term expenditure estimates			Total Over 2020 MTEF	% of MTEF Total
	2020/21	2021/22	2022/23	2021/22-2022/23	
Learning and culture	3 361.45	3 549.27	3 787.84	10 699	4.3%
Health	2 102.9	2 268.9	2 290.32	6 662	2.7%
Social development	486.58	522.71	541.49	1 551	0.6%
Community development	6 722.29	7 068.45	7 360.06	21 151	8.6%
Economic development	15 242.26	16 153.59	16 630.70	48 027	19.5%
Peace and security	44 400.32	46 971.50	48 796.14	140 168	56.9%
General public services	5 575.50	7 108.39	5 224.29	17 908	7.3%
Total	**77 891.4**	**83 642.8**	**84 630.8**	**246 165**	**100.0%**

Source: FFC calculations based on 2020 ENE individual votes.

Government should also allow payments for goods and services to be incurred. This should be supplemented by the mandatory scrutiny of goods and service expenditures with the aim of identifying savings from travelling, workshops and other state events as well as deferrals such as acquisitions of premises, furniture, etc. for non-essential services. There is a delicate balance to be struck between accrued liabilities and private sector solvency. Caution must be exercised to ensure that Covid-19 response measures, such as debt relief loans to small and medium enterprises, are not undermined by the failure of government to make timely payment for goods and services rendered.

Particular components in the goods and service category that could be significantly reduced include travel, training and catering expenditures. Over the next three years national government departments plan to spend approximately R23 billion on these three goods and services items. Some detail is provided on these below. The Commission is further of the view that there are additional goods and services related items that present space for reprioritisation, including spending on entertainment, workshops and conferences and spending on consumables such as stationary, printing, office supplies.

Travel and subsistence: Travel and subsistence spending is projected at R19.2 billion over the next three years. Table 16 provides a sense of these costs by function. The driver of these items of spending are departments within the peace and security function, specifically the police and defence departments. In the economic development cluster, the main driver of travel and subsistence is the Department of Agriculture, Land Reform and Rural Development. Caution must be exercised when reprioritising from this item in respect of the police and defence departments as they are key to ensuring compliance with lockdown regulations and restrictions.

Table 16: Travel and subsistence spending by national departments over the 2020 MTEF period

Category (R million)	Medium-term expenditure estimates			Total over 2020 MTEF	% of MTEF Total
	2020/21	2021/22	2022/23	2021/22-2022/23	
Learning and culture	410.08	420.25	433.67	1 263.99	6.6%
Health	113.3	122.4	124.30	360.01	1.9%
Social development	97.77	108.90	110.74	317.40	1.7%
Community development	277.87	291.49	303.78	873.13	4.5%
Economic development	1 276.93	1 351.76	1 407.87	4 036.56	21.0%
Peace and security	3 037.68	2 987.47	3 152.74	9 177.89	47.8%
General public services	942.34	1 193.69	1 041.34	3 177.37	16.5%
Total	**6 156.0**	**6 476.0**	**6 574.4**	**19 206.35**	100.0%

Source: Commission calculations based on 2020 ENE Excel Spreadsheet of Individual Votes.

Training and Development: Projections show that on aggregate, the 41 national departments will spend R3.4 billion on training over the next three years (R1.2 billion in 2020/21; R1.1 billion in 2021/22; R1.1 billion in 2022/23) (Table 17). Within the peace and security functional area, spending on training and development is driven by the police and defence departments. While these two departments are key during the Covid-19 period, the Commission proposes that even for them, this spending presents a good opportunity for reprioritisation and that where planned training is not essential, the funds be diverted to fighting Covid-19.

Table 18: Proposed spending on training and development by functional category over the 2020 MTEF period

Category (R million)	Medium-term expenditure estimates			Total over MTEF	% of MTEF total
	2020/21	2021/22	2022/23	2021/22-2022/23	
Learning and culture	58.85	59.54	62.20	180.58	5.3%
Health	23.0	27.4	28.4	78.75	2.3%
Social development	8.89	9.28	9.64	27.80	0.8%
Community development	141.41	149.72	155.67	446.80	13.1%
Economic development	392.50	362.72	377.19	1 132.40	33.1%
Peace and security	468.39	455.44	442.25	1 366.08	40.0%
General public services	65.17	57.33	62.41	184.91	5.4%
Total	**1 158.2**	**1 121.4**	**1 137.7**	**3 417.32**	**100.0%**

Source: Commission calculations based on 2020 ENE individual votes.

Catering: With respect to catering, national departments plan to spend R1 billion over the next three years (R295 million 2020/21; R424 million in 2021/22; R329 million in 2022/23). This is a non-essential item of spending that should be reprioritised. Table 19 illustrates the spread of catering spending across the 41 national departments. The figure is categorised by function. Again the driver of this item of spending are departments in the peace and security function, specifically the department of Police. Also within the economic development cluster, the department of agriculture,

land reform and rural development is the main driver of catering spending. This is an area where reprioritisation must be effected.

Table 19: National departments' spending on catering over the 2020 MTEF period, categorised by function (R million)

Category (R million)	Medium-term expenditure estimates			Total Over 2020 MTEF	% of MTEF Total
	2020/21	2021/22	2022/23	2021/22-2022/23	
Learning and culture	40.16	43.24	44.58	127.97	12%
Health	4.0	4.7	4.8	13.51	1%
Social development	10.51	11.16	11.66	33.33	3%
Community development	24.54	25.92	27.21	77.67	7%
Economic development	60.61	63.98	66.14	190.72	18%
Peace and security	105.56	111.93	114.69	332.18	32%
General public services	49.89	162.99	59.76	272.63	26%
Total	**295.3**	**423.9**	**328.9**	**1 048.02**	**100%**

Source: Commission calculations based on 2020 ENE individual votes.

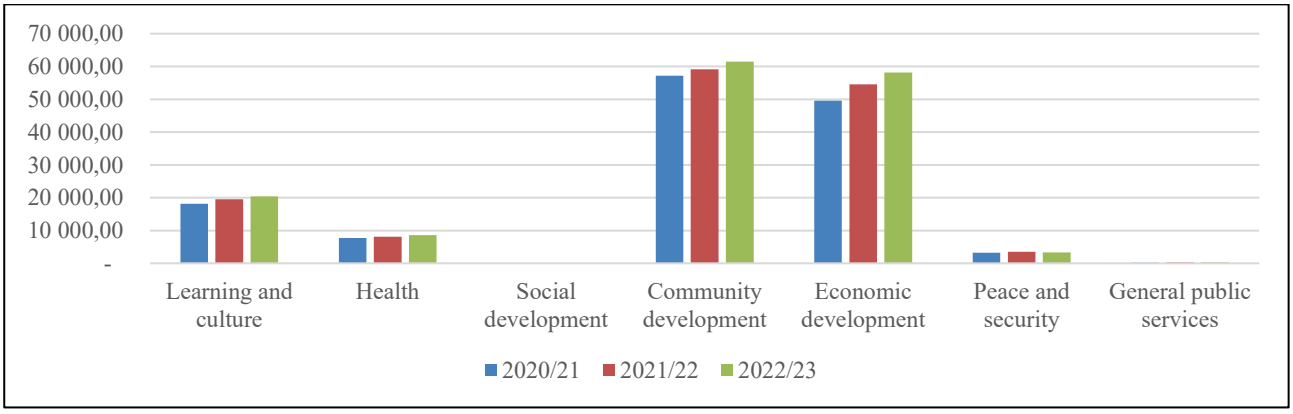
Infrastructure

Infrastructure spending has traditionally been utilised as a lever for promoting growth. Unfortunately, South Africa's built programme has largely been characterised by corruption, poor workmanship and implementation delays. Given the current situation there are two scenarios in which infrastructure spending can be reduced. The first relates to the suspension of new projects, especially where such infrastructure is not essential in the fight against Covid-19, and in the delivery of essential basic services like water and sanitation. The second scenario is with respect to existing infrastructure where consideration could be given to delaying spending on non-essential maintenance, upgrading or rehabilitation.

The 2020 MTEF public infrastructure expenditure is R815 billion. National departments are planning to spend R433 billion of this amount (R136.1 billion in 2020/21; R145.1 billion in 2021/22; and 152.2 billion in 2022/23). Figure 13 provides an indication of which functional categories are planning to spend on infrastructure. Over the next three years, departments in the community development and economic development categories are the drivers of infrastructure spending. The key drivers in the community development cluster are the Departments of Human Settlements and Cooperative Governance and Traditional Affairs, particularly on water and sanitation. In the economic development category, the Departments of Transport and Mineral Resources and Energy account for the largest spending on infrastructure and there is potential for reprioritisation within the latter cluster. With respect to transport, allocations are intended to improve the transport network and the mobility of people and service provision, to reduce transport costs and facilitate regional trade. The funding is also geared at improving and constructing non-toll roads, to construct the N2 Wild Coast highway, upgrade the Moloto Road, to maintain the provincial road network, modernise the rail network and to fund the integrated public transport networks in ten cities across the country. In the case of the Department of Mineral Resources and Energy, spending is in respect of the integrated national

electrification programme to assist households with electricity connections as well as supporting initiatives on renewable energy programmes. Funds will also be spent on upgrading municipal infrastructure with energy efficient technologies.

Figure 13: Infrastructure spending by national departments over the 2020 MTEF period (by function in R million)



Source: 2020 ENE 2020, summary table 7a and 7b

As mentioned above, the current situation facing South Africa warrants the suspension of, at the very least, new infrastructure projects, so as to redirect resources towards fighting Covid-19. The suspension of infrastructure projects should exclude infrastructure that is critical to the fight against Covid-19. Health equipment such as ventilators, hospital beds and other equipment, and upgrading and reconfiguration of buildings and institutions to serve as health care facilities as well as on water and sanitation (essential basic services). According to 2020 ENE data, of the R433 billion, an estimated R18 billion is for new infrastructure projects over the next three years (Table 20**Error! Reference source not found.**). These allocations provide space for reprioritisation. An assessment of which of the new infrastructure projects can be deemed non-essential, and therefore deferred and funding reprioritised, is required. For example, under water and sanitation services, almost all new projects are at a pre-feasibility stage and could be postponed as they focus more on improving efficiency in the delivery of water and sanitation services. In respect of human settlements, phase 2 funding for social housing programme could be considered for reprioritisation, and/or the project itself could be redefined to respond to Covid-19 challenges.

There are also significant infrastructure projects located or shared between departments and departmental entities. For example, government committed R100 billion, including R10 billion over the next three years, to the infrastructure fund in Budget 2020. This includes new funding, new guarantees and repackaging of existing projects. The fund focuses on blended-finance projects and aims to increase private sector investment in public infrastructure and contribute to higher economic growth, productivity and employment creation. These projects include both government and nongovernment contributions and these projects are at various stages either at feasibility, design, procurement or construction phase. These include areas like student accommodation, social housing, rail freight branch lines, embedded electricity generation, municipal bulk infrastructure, construction of hospitals, school infrastructure, provincial road infrastructure and upgrades of national roads and

broadband rollout etc. The fund's implementation unit will be housed in the Development Bank of Southern Africa (DBSA). According to the 2020 Budget Review, over the next three years, the DBSA will identify, plan and package at least five blended-finance mega projects (valued at over R200 billion), using the funds committed by government to close funding gaps and reduce risks for the private sector. These projects include both government and nongovernment contributions. These include areas like student accommodation, social housing, independent water production, rail freight branch lines, embedded electricity generation, municipal bulk infrastructure and broadband rollout etc. In the budget review 2020, R100 million is under provisional allocations not assigned to votes. Government will need to rethink the quantum of funding committed to this fund and moderate it and redirect funds towards fighting Covid-19.

Table 20: National departments' planned spending on new and existing infrastructure over the 2020 MTEF period

	MTEF estimates			
R million	**2020/21**	**2021/22**	**2022/23**	**Total over MTEF**
New infrastructure assets	4 930.1	6196.6	6 828.9	**17 955.6**
Existing infrastructure assets	6 356.9	5 670.8	5 185.0	**17 212.7**
of which				
Upgrading and additions	4 164.5	4 309.6	4 050.8	**12 524.9**
Rehabilitation renovations and refurbishment	1 519.6	737.2	864.2	**3 121.0**
Maintenance and repair	672.8	624.0	269.9	**1 566.7**

Source: 2020 ENE, summary table 7a and 7b.

As mentioned above, consideration could be given to reprioritising different types of spending on existing infrastructure. Over the next three years, national departments plan to spend R17.2 billion on existing infrastructure projects (Table 20). On the economic development cluster, for example, infrastructure spending on the South African National Roads Agency: Non-toll network can be cut for reallocation. The South African National Roads Agency (SANRAL) plays a crucial role in the upgrading, maintenance and strengthening of roads. The component of spending allocated to SANRAL for upgrading of road infrastructure can be delayed and allocated to Covid-19 interventions.

While reprioritisation of spending on existing infrastructure projects may be an option, the Commission advises that caution be exercised with respect to possible reductions to funding for maintenance and rehabilitation of existing infrastructure as this could imply its further deterioration, and the costs could be increased substantially by the delay, depending on the type and urgency of maintenance and rehabilitation. If government pursues this option, decisions should be based on facility condition assessments or asset lifecycle data so as to determine whether maintenance can be feasibly delayed or not.

Consideration could also be given to options around reprioritising infrastructure funds within a sector. For example funds allocated for infrastructure related to the National Health Insurance (NHI) could be used in the health sector for personnel protection equipment (PPE). However, it should be noted that shifting of funds that have been allocated for new infrastructure delivery to assist in government's

responses to Covid-19 will have their own fiscal implications, since planned infrastructure delivery will have to be postponed for future years. This has implications on infrastructure backlogs, future costs of capital acquisition and long-term economic recovery.

Reprioritisation from conditional grants

Conditional grants are critical intergovernmental transfers that provide necessary resources to sub national governments to assist in rolling out national priorities. Conditional grants are generally infrastructure related but there are also capacity-related conditional grants. An assessment of conditional grants and conditionalities underpinning grants could provide space for reprioritisation. Provincial and municipal conditional grants are administered by national departments and Table 21 and Table 22 list the national departments involved in such grants respectively. Over the next three years, R490 billion in conditional grants will be channelled to provinces and municipalities.

Table 21: Total provincial conditional grants funding by national departments

R million	Medium-term expenditure estimates			Total over MTEF 2020/21-2022/23
Department	**2020/21**	**2021/22**	**2022/23**	
Cooperative Governance	138.5	146.1	153.0	437.6
Public Works and Infrastructure	834.3	871.4	902.8	2 608.6
Basic Education	19 564.3	20 773.3	21 737.9	62 075.5
Health	49 267.2	53 916.6	56 537.0	159 720.8
Social Development	915.1	1 056.7	1 191.9	3 163.7
Agriculture, Land Reform and Rural Development	2 153.4	2 319.7	2 392.0	6 865.1
Human Settlements	**17 493.5**	**17 614.4**	**18 317.4**	**53 425.3**
Sports, Arts and Culture	2 075.7	2 204.9	2 307.5	6 588.1
Transport	18 342.8	19 058.3	19 597.2	56 998.3
Total	**110 784.8**	**117 961.5**	**123 136.7**	**351 883.0**

Source: ENE 2020

Table 22: Total municipal conditional grants funding by national departments

R million	Medium-term expenditure estimates			Total over MTEF 2020/21-2022/23
	2020/21	**2021/22**	**2022/23**	
Cooperative Governance	15 973.1	17 325.2	18 318.4	51 616.6
National Treasury	1 575.0	1 644.4	1 717.5	4 936.9
Public Works and Infrastructure	748.0	790.0	819.1	2 357.1
Human Settlements	11 440.7	11 517.7	11 708.2	34 666.6
Mineral Resources and Energy	2 076.7	2 233.1	2 362.0	6 671.8
Transport	6 554.3	6 911.0	7 240.2	20 705.4
Water and Sanitation	5 450.8	5 776.4	5 981.8	17 208.9
Total	**43 818.6**	**46 197.7**	**48 147.1**	**138 163.4**

Source: ENE 2020

A summary of which conditional grants present opportunities for reprioritisation follows. The inputs are arranged by functional category so as to provide a context as to which sectors will be affected by reprioritisation. Again, in determining the essential from the non-essential, and in addition to the criteria presented above, the Commission focussed on which grants are key to responding to the health challenge presented by Covid-19, those that relate to the provision of social relief to the poor and then those that are critical to economic growth. The lower priority conditional grant are suggested for more aggressive cuts. The Commission also considered that within priority grants there may be components of funding that are not essential at this particular time – in those instances, reprioritisation is recommended.

The conditional grants the Commission recommends as candidates for reprioritisation/refocussing are listed in Table 23.

Table 23: Conditional grants recommended for potential reprioritisation or refocussing

R 000	Department	Grant	MTEF Allocations (R 000)			Proposed Allocation over 2020 MTEF
Function			**2020/21**	**2021/22**	**2022/23**	
Learning and Culture	Sports Art and Culture	Community Library Services Grant	1 479 093	1 584 073	1 667 002	4 730 168
		Mass Participation and Sport Development Grant	596 617	620 807	640 472	1 857 896
	Basic Education	National School Nutrition Programme	7 665 887	8 125 341	8 516 464	24 307 692
		HIV/AIDS	246 699	258 542	262 204	767 445
		Mathematics Science and Technology	400 862	422 909	438 488	1 262 259
		Education Infrastructure Grant	11 007 967	11 710 298	12 255 026	34 973 291
		School Infrastructure Backlogs Grant	1 736 413	2 295 101	2 424 189	6 455 703
Community Development	Human Settlements	Urban Settlements Development Grant	11 281 871	7 404 711	7 352 723	26 039 305
		Human Settlements Development Grant	16 620 732	13 413 593	13 870 574	43 904 899
	Cooperative Governance	Municipal Infrastructure grant	14 671 101	15 936 791	16 852 001	47 459 893
	Water and Sanitation	Regional Bulk Infrastructure Grant	2 005 605	2 156 025	2 280 772	6 442 402
		Water Services Infrastructure Grant	3 445 165	3 620 327	3 701 019	10 766 511
Health	Health	National Tertiary Services Grant	14 068 863	14 694 223	15 293 501	44 056 587
		Health Facility Revitalisation Grant	6 367 652	6 658 028	7 033 913	20 059 593
		NHI Indirect Grant	740 400	727 328	734 350	2 202 078
Economic Development	Agriculture Land Reform & Rural Development	Comprehensive Agricultural Support Grant	1 522 190	1 619 895	1 671 590	4 813 675
	Transport	Provincial Roads Maintenance Grant	11 593 174	11 937 511	12 506 785	36 037 470
		Public Transport Operations Grant	6 749 581	7 120 808	7 090 432	20 960 821
		Public Transport Network Grant	6 445 848	6 796 572	7 119 154	20 361 574
	National Treasury	Integrated City Development Grant	317 499	341 312	360 886	1 019 697
		Neighborhood Development Partnership Grant	559 442	566 611	593 074	1 719 127
		Financial Management Grant	544 862	574 829	596 005	1 715 696
	Public Works & Infrastructure	EWP Integrated Grant for Municipalities	748 039	789 982	819 088	2 357 109
		Social Sector EPWP Incentive Grant for Provinces	413,583	431,536	447,058	1,292,177

Source: 2020 Division of Revenue Bill Annexures in Excel Format

Learning and culture conditional grants

Table 24 provides a description of the conditional grants within the learning and culture category that are recommended for reprioritisation.

Table 24: Summary of performance and 2020 MTEF allocations of Learning and Culture Conditional Grants where reprioritisations are proposed

R 000		% of budget spent			MTEF Allocations		
Depart-ment	**Grant**	**2016/17**	**2017/18**	**2018/19**	**2020/21**	**2021/22**	**2022/23**
Sports, Art and Culture	Community Library Services Grant			97.5%	1 479 093	1 584 073	1 667 002
	Mass Participation and Sport Development Grant			79.0%	596 617	620 807	640 472
Basic Education	National School Nutrition Programme	95.3%	96.1%	98.3%	7 665 887	8 125 341	8 516 464
	HIV/AIDS	94.7%	96.0%	93.4%	246 699	258 542	262 204
	Maths Science and Technology	98.2%	87.3%	96.3%	400 862	422 909	438 488
	Education Infrastructure Grant	95.8%	98.7%	96.1%	11 007 967	11 710 298	12 255 026
	School Infrastructure Backlogs Grant	60.3%	101.6%	91.8%	1 736 413	2 295 101	2 424 189

Source: Division of Revenue Bill 2020, various annual reports

The following are the Commission's proposals as to how these grants could be reprioritised in light of the Covid-19 pandemic.

Education Infrastructure Grant: This is a supplementary grant whose purpose is to assist provinces to (a) accelerate construction, maintenance, upgrading and rehabilitation of new and existing infrastructure; (b) assist provinces to enhance capacity to deliver; (c) address damages to infrastructure; (d) assist in achieving compliance with the minimum norms and standards for school infrastructure. It is advised that the purpose of this grant be adjusted and narrowed to focus only on:

- Essential maintenance, upgrading and rehabilitation within schools, especially related to water and sanitation. The caution expressed earlier in this document applies here: in determining what maintenance/upgrading/rehabilitation is essential and what can be delayed, provincial education departments should rely on facility condition assessments or asset lifecycle data;
- Addressing damages to infrastructure: The Department of Basic Education notes that as at 19 May 2020, 1577 schools across South Africa had experienced acts of vandalism, burglary or destruction. It is thus recommended that this grant be refocused on assisting provincial education departments to address the most pressing areas of damage, especially damages that threaten the safety and hygiene of learners and schools staff as schools reopen.

Schools Infrastructure Backlogs Grant: This is an indirect grant, i.e. it is spent by the National Department of Basic Education on behalf of provincial education departments. Its purpose is the eradication of all inappropriate school infrastructure, provision of water, sanitation and electricity to schools. It is proposed that the bulk of this grant be refocused on ensuring provision of water and sanitation in schools. Ensuring proper hygiene is key in fighting Covid-19; provision of water and sanitation is therefore essential as schools begin phased reopening. Funding in this regard should be

specifically focussed on those provinces where backlogs in school water and sanitation are most severe.

The Commission's analysis of provincial infrastructure (including education) value chains reveal that there is a lack of oversight at key delivery points, and that this increases incentives to engage in fiscal misappropriation. The Commission therefore explicitly highlights the need for strong oversight and accountability to ensure that funding achieves what it is intended for. The current environment may impact traditional oversight mechanisms such as, for example, site visits. The education sector will need to think innovatively as to how standards of accountability can maintained and even improved.

Non-infrastructure Grants

National School Nutrition Grant: The purpose of this conditional grant is to provide nutritious meals to targeted learners, especially learners in quintile 1, 2 and 3 schools. This conditional grant is essential. During the initial stages of the lockdown, the national school nutrition programme was not active as learners were not at school. A phased approach to the reopening of schools implies that this programme (and funding) will also restart slowly, focussing on Grades 12 and 7 and then pick up steam as more grades/learners return. In relation to the 1557 cases of schools burglaries, the Department of Education has indicated that the common targets within these schools have been ICT equipment but also nutrition centres, specifically food items. It is thus recommended that in the short term when schools are not operating at full capacity, a portion of the funding from this grant be used for assisting those schools that have been affected by these burglaries. Efforts could focus on replenishing food items and providing assistance where kitchen utensils, equipment and facilities – components not covered by the grant – have been damaged.

HIV/AIDS (Lifeskills Education) Grant: The purpose of this grant is to (a) support South Africa's HIV prevention strategy through the provision of sex education, access to reproductive health services for learners, and supporting the provision of a health and wellness programme for educators; (b) mitigate the impact of HIV and TB through the provision of a caring, supportive and enabling environment for learners and educators; and (c) reduce the vulnerability of children to HIV, TB and STIs with a particular focus on orphaned children and girls. While this is the smallest grant in the sector, there are potential components that could be halted and the related funding reprioritised. For example, the grant guidelines indicate that 20 per cent of the allocation be used for advocacy and social mobilisation through hosting events. Given the current restriction on social distancing and group gatherings, spending on this element of the grant can be cut and redirected to more essential spending.

Maths, Science and Technology Grant: The purpose of this grant is to provide support and resources to schools, teachers, and learners for the improvement of mathematics, sciences and technology teaching and learning at selected public schools. Allocations via this grant are made according to the following:

- 20-25 per cent of resources towards ICT resources;

- 19-20 per cent of resources towards the supply and/or repair/maintenance/replacement of workshop machinery, equipment and tools;
- 19-25 per cent for laboratory equipment;
- 15-19 per cent of resources for teacher support;
- 15 per cent for learner support;
- 6 per cent for DBE-Cuba Mathematics, Science and Technology Subjects Support Programme; and
- 1 per cent for grant administration.

While this is one of the smaller grants within the sector, slight reductions are possible and should be considered. For example, with respect to funding for the teacher support component, aspects of the funding are related to training and can thus be deferred and the funding reprioritised. In respect of learner support, this entails allocations to fund the participation of learners in Olympiads/fairs/expos/learner camps. For now, the funding of these activities should be halted and funding reprioritised to where needed. The provision of off-site and digitised support material and equipment may be considered in such reprioritisation.

Mass Participation and Sport Development Grant: The purpose of this conditional grant is to facilitate sport and active recreation participation and empowerment with relevant stakeholders. This conditional grant is targeted at school and community sport, sport club development, sport academies, the construction of a national training centre, and preparations for the Netball World Cup in 2023. According to the grant framework, allocations via this grant must be used as follows: school sport (40 per cent), community sport (39 per cent), sport academies (9 per cent), transversal matters (4 per cent) and management (8 per cent). Due to restrictions on team sport and that these activities are, in the context of Covid-19, deemed relatively non-essential, it is recommended that funding in respect of this grant can be largely reprioritised. In deciding on the extent on which to reprioritise funding away from this grant government should consider that this grant allows for the hiring of staff on a three-year basis. This provision is allowed for under the management component of the grant and therefore to assist provinces with these staff costs, the 8 per cent allocated in respect of the management component could be protected.

Community Library Services Grant: The purpose of this grant is to transform urban and rural community library infrastructure, facilities and services. The grant focuses on different types of infrastructure (building new libraries, maintenance and upgrading of existing libraries) as well as capacity building. There are also funds earmarked within this grant for the shift of function from provinces to municipalities. Given the focus on infrastructure and the fact that due to restrictions on movement and group activities, libraries are not operating at full capacity, funding under this conditional grant should be considered for reprioritisation. While construction of new libraries can be delayed, an assessment of urgent maintenance and rehabilitation needs should be undertaken and those funds should not be reprioritised.

Health Conditional Grants

Table 25 provides a description of the conditional grants within the health functional category that are recommended for reprioritisation.

Table 26 Summary of performance and 2020 MTEF allocations of Health Conditional Grants where reprioritisation is proposed

	Spending performance			Allocations			
R million	**2016/17**	**2017/18**	**2018/19**	**2019/20**	**2020/21**	**2021/22**	**2022/23**
Department of Health							
National Tertiary Services Grant	-	97.%	98%	13 185 528	14068863	14694223	15293501
Health Facility Revitalisation Grant	95%	94%	66%	6 006 973	6 367 652	6 658 028	7 033 913
National Health Insurance Indirect Grant (HFR)	84%	91%	98%	289288	288 840	300 089	311 147

National Tertiary Services Grant: This grant is aimed at enabling provinces to plan, modernise and transform tertiary hospital service delivery in accordance with national policy objectives. The grant funds medical specialists, equipment and advanced medical investigation and treatment across all nine provinces. For the 2020 MTEF period, the national Department of Health has reprioritised R176 million of this conditional grant towards developing tertiary services in the Eastern Cape, Limpopo, Mpumalanga and North West. The department has planned to ring-fence the remainder for other provinces for the 2020/21 allocation. Given the ongoing health crisis and the demands it is placing on all provincial health facilities, significant reprioritisation of the grant towards Covid-19 related services can be considered. The grant can help with ramping up the preparedness of provincial hospitals for a potential surge in Covid-19 patients.

The *Health Facility Revitalisation Grant:* The purpose of this grant is to fund the construction and maintenance of health infrastructure. This includes large projects to modernise hospital infrastructure and equipment, general maintenance and infrastructure projects in smaller hospitals. Large hospital infrastructure spending can be delayed for funding Covid-19 health interventions. Expenditure on refurbishment and upgrading of nursing colleges and schools can also be deferred to allow for Covid-19 related expenditure.

The *Department of Health: National Health Insurance Indirect Grant:* The purpose of this grant is to ensure appropriate health infrastructure that is in line with national and provincial objectives. This includes upgrading, refurbishing and new infrastructure in line with the objective of the NHI. A total of R199 million in 2020/21 and R5.7 million will be transferred directly to Limpopo province from the NHI for upgrades of Pietersburg Hospital. The health facility revitalisation component of the grant can be reprioritised towards Covid-19 related spending. For example, spending on upgrading and refurbishing of health facilities can be reprioritised towards ensuring preparedness for a surge of Covid-19 patients.

Community Development Conditional Grants

This functional area has a number of conditional grants which are spent by municipalities and provinces. Table 27 presents spending and allocations.

Table 27: Summary of performance and 2020 MTEF allocations of Community Development Conditional Grants where reprioritisation is proposed

	Spending performance			Allocations			
R million	**2016/17**	**2017/18**	**2018/19**	**2019/20**	**2020/21**	**2021/22**	**2022/23**
Human Settlements							
Urban Settlements Development Grant	100%	100%	100%	12 045	11 282	7 405	7 353
Municipal Emergency Housing Grant	-	-	61%	149	159	168	175
Human Settlements Development Grant	100%	100%	100%	18 780	16 621	13 414	13 871
Water and Sanitation							
Regional Bulk Infrastructure Grant	98%	97%	82%	2 066	2 006	2 156	2 281
Water Services Infrastructure Grant	95%	97%	95%	3 669	3 445	3 620	3 701
Department of Cooperative Governance							
Provincial Disaster Relief Grant	_	_	_	131	138	146	153
Municipal Disaster Relief Grant	_	_	_	335	354	373	391
Municipal Infrastructure Grant	99%	93%	92%	92%	14 671	15 937	16 852

Source: Division of Revenue Bill 2020, various annual reports

The *Urban Settlements Development Grant* is aimed at supplementing capital budget of metros in order to implement infrastructure projects that promote integrated and sustainable urban development and also assist in the upgrading of informal settlements. Although the performance of this grant over the past three years has been good with 100 per cent spending, the USDG conditions require municipalities to allocate at least 20 per cent of their USDG funds for upgrading of informal settlements through the UISP, and the Commission believes these funds can be reprioritised to respond to the Covid-19 challenge. The Covid-19 pandemic is hitting metros and intermediate cities hard, making it very necessary to redirect resources from this grant for Covid-19 purposes in metros and intermediate cities.

The *Human Settlements Development Grant* is a direct grant to provinces established for the progressive realisation of access to adequate housing. The grant has been performing well in the past three years recording 100 per cent spending. For 2019/20, the HSDG has been allocated R18.7 billion but the 2020/21 allocation has decreased to R16.6 billion as part of fiscal consolidation and is expected to decrease further in outer years. Covid-19 has amplified housing challenges across the country. Thus a significant portion of this grant can be redirected for decongesting densely populated areas in urban areas and providing water and sanitation in rural areas.

The *Water Services Infrastructure Grant (WSIG)* takes both a direct and indirect grant form. It is designed to fund the establishment of new infrastructure and the refurbishment of existing infrastructure. Over the 2020 MTEF, the grant is R10.8 billion in direct form, and R2.1 billion in indirect form. The main condition attached to this grant is that the scope of the funded project must be aligned to, and not duplicate any existing or planned project funded through other grants or municipal own revenue. The conditions also allow for the use of the grant to fund drought relief

intervention based on a plan approved by the Department of Water and Sanitation (DWS). To use funds from WSIG, DWS and National Treasury should consider allowing for reprioritising to Covid-19 of the funds that would have been used for drought relief interventions.

The *Regional Bulk Infrastructure Grant (RBIG)* also has a direct and indirect component. It targets projects that cut across several municipalities, or large bulk projects within a municipality for water and sanitation reticulation to households. For the 2019/20 period, municipalities received an allocation of R5.2 billion through this grant, of which R2.1 billion was in direct form and R3.1 billion in indirect form. Over the 2020 MTEF, the grant is R17.0 billion, with R6.4 billion in direct form and R10.6 in indirect form. The conditions of this grant require that all projects funded through it be included in in the municipal integrated development plan and water services development plan and should be linked to projects financed through MIG and WSIG. Similarly to the WSIG, the direct component of this grant allows for use of funds for drought relief interventions based on a business plan approved by the DWS. As for the WSIG, DWS and National Treasury should consider reprioritising to Covid-19 funds that would have been used for drought relief interventions in the absence of drought related need.

The *Municipal Infrastructure Grant (MIG)* is a direct grant and aims to finance establishment of the infrastructure for basic services, roads and social infrastructure for poor households in non-metropolitan municipalities. The grant is distributed through a formula and allocates 75 per cent of the funds for the provision of basic services, and 72 per cent specifically towards water and sanitation. The main condition of this grant is that it must only be used to fund MIG registered projects. The conditions indicate that MIG priorities set by municipalities can only be changed in-year, interchangeable with other MIG registered projects after municipal council approval and Department of Cooperate Governance and Traditional Affairs (CoGTA). For the period 2019/20, the grant was R14.8 billion, and is R47.5 billion over the 2020 MTEF. Over the period 2016/17 to 2018/19, the grant recorded an average spending of 94 per cent. The conditions of this grant do not give much flexibility for emergency cases as all projects funded through MIG must form part of the MIG implementation plan. However, given that the allocation formula of the grant prioritises water and sanitation, it is likely that all non-metropolitan municipalities have water and sanitation related projects in their IDPs and MIG implementation plans. The Commission is of the view that under circumstances such as the Covid-19 pandemic, the Departments of Cooperative Governance and Traditional Affairs, Water and Sanitation, and National Treasury could consider allowing municipalities to fast-track the implementation of 2020/21 water and sanitation projects and make alteration on the descriptions of planned projects to support government Covid-19 responses.

Economic Development Conditional Grants

Table 28 presents conditional grant allocations in the Economic Development functional area.

Table 29 Summary of performance and 2020 MTEF allocations of Economic Development Conditional Grants where reprioritisation is proposed

	Spending performance			Allocations			
R million	**2016/17**	**2017/18**	**2018/19**	**2019/20**	**2020/21**	**2021/22**	**2022/23**
Agriculture, Land Reform and Rural Development							
Comprehensive Agricultural Support Programme Grant (CASP)	-	88%	91%	1 032 853	1 120 645	1 203 487	1 254 142
Department of Transport							
Provincial Roads Maintenance Grant:	93%	100%	100%	10 649 325	11 593 174	11 937 511	12 506 785
Public Transport Network Grant	93%	99%	100%	6 468.2	6 445.8	6 796.6	7 119.2
Public Transport Operations Grant	-	98%	-	6 326	6 750	7 121	7 090
National Treasury							
Integrated City Development Grant	-	100%	100%	310	317	341	361
Local Government Financial Management Grant	-	100%	100%	532 822	544 862	574 829	596 005
Infrastructure Skills Development Grant	-	85%	98%	149 416	153 192	161 618	167 571
Neighbourhood Development Partnership Grant	-	-	98%	601 672	559 442	566 611	593 074
Department of Public Works							
Expanded Public Works Programme	_	97%	100%	437	421	440	456
Social Sector EPWP Incentive Grant	_	99%	97%	431	414	432	447
EPWP Integrated Grant for municipalities	-	100%	100%	730 046	748 039	789 982	819 088

The C*omprehensive Agricultural Support Programme Grant (CASP)* provides support for newly established and emerging farmers with a focus on subsistence, smallholder and previously disadvantaged farmers. Subsistence and smallholder farming play an important role in poverty alleviations especially in rural areas. Over the 2020 MTEF period, R255.1 million is reprioritised from the grant to fund improved laboratory capacity, boarder control and inspection. This grant can be further targeted to ensure necessary support for smallholder and subsistence farmers and meet their liquidity requirements in mitigating the effects of Covid-19 lockdown of smallholder farmers' access to markets and value chains.

The *Provincial Roads Maintenance Grant:* The purpose of this grant is to support the cost of maintaining provincial roads. The grant is specifically for the cost of maintenance (not construction) which includes upgrading existing roads. While the maintenance of existing roads remains important, upgrading of existing roads can be deferred. The upgrading of existing infrastructure may not be urgent during this pandemic. The grant allocation can be cut so that funds intended for upgrading of existing road infrastructure can be reallocated towards support public transport Covid-19 interventions.

The *Public Transport Operations Grant:* The purpose of this grant is to subsidise commuter bus services so that provinces can provide public transport services. This conditional grant, which is

supplementary, is a national contribution to subsidised service contracts entered by the provincial departments of transport and public transport operators for the provision of affordable subsidised transport services. While public transport subsidies are important in reducing the cost of transport for poor commuters, there is an opportunity for slight cuts given the travel restrictions which are likely to be in place for a considerable time. The cuts can be reallocated to ensure that public transport complies with transport sanitisation requirements.

The *Public Transport Network Grant:* The purpose of this grant is to fund the infrastructure and operations of integrated public transport networks in 13 cities across South Africa. Over the medium term, allocations to the grant are expected to increase to support planning and construction in the ten cities, and fund the indirect operating costs of services in Johannesburg, Nelson Mandela Bay, Ekurhuleni, Tshwane, Cape Town and George, which have begun operating rapid transit bus services on new routes. There is an opportunity for significant reprioritisation of this grant. The construction of the new bus routes can be delayed, and the funds reprioritised towards the fight against Covid-19.

The *Integrated City Development Grant:* This is a supplementary grant for infrastructure. Its purpose is to financially incentivise metropolitan municipalities to address compact urban spatial programmes. The grant has conditions which include allocations for programme and project preparations. Over the MTEF, R1 billion has been allocated to the grant; R317 million in 2020/21, R341 million in 2021/22 and R361 million in 2022/23. Thus part of the spending on this grant can be delayed in the case of municipalities that have not started with planning, and reprioritised for infrastructure related to Covid-19 in the municipalities.

The *Neighbourhood Development Partnership Grant (capital)* has a direct conditional grant and an indirect component (technical assistance). The grant supports municipalities to develop and implement urban network plans, and funds the upgrading of identified precincts in order to stimulate third-party public and private investment. In metropolitan municipalities, the focus is on upgrading urban hubs in townships. The grant also has a portion to fund new projects in non-metropolitan municipalities. Its framework states that a portion of non-metropolitan municipalities has been identified so as to implement new projects to form part of this grant funding. This creates an opportunity for the funding of this portion of the grant to be redirected to essential services infrastructure in the municipalities in the fight against Covid-19.

The *Local Government Financial Management Grant (capacity conditional grant*) funds the placement of financial management interns in municipalities and the modernisation of financial management systems. Thus the grant supports municipalities in the implementation of the Municipal Finance Management Act and provides funds for the implementation of the municipal standard chart of accounts. The grant plays a critical role in making sure that municipal finances are in line with the MFMA while also recruiting graduates to assist in the process. The placement of interns can be delayed so that municipalities can channel such funding to Covid-19. The Commission believes there is room to reprioritise from capacity building grants, especially non-essential capacity building.

The *Infrastructure Skills Development Grant* develops capacity within municipalities by creating a sustainable pool of young professionals with technical skills in areas such as water, electricity and town planning thus capacitating municipalities so as to improve their infrastructure delivery activities. As with other capacity building grants, a significant portion of this grant can be reprioritised and be directed to municipal infrastructure delivery activities that are addressing Covid-19 challenges.

The *Expanded Public Works Programme (EPWP)* integrated grant for provinces is a specific purpose conditional grant. The purpose of the grant is to incentivise provincial departments to use labour-intensive methods in creating jobs in infrastructure, environmental and other projects. Grant allocations are determined upfront based on the performance of provincial departments in meeting job targets in the preceding financial year. Covid-19 is causing many people to lose their jobs and livelihoods. The Commission believes that with Covid-19, it is important that funds should be reprioritised to and within this grant.

The *Social Sector EPWP Incentive Grant* is a specific purpose grant for provinces. It incentivises provincial sector departments to expand jobs in social sector programmes (e.g. home-based care, early childhood development, adult literacy and numeracy, community safety and security, and sports programmes). These grant components are an essential service during the Covid-19 pandemic and should clearly refocus in alleviating pressures faced by households in alleviating hunger through jobs in the sectors specifically highlighted by these grants. These grants can be merged into one as their objectives are similar to the EPWP grant for municipalities which is one grant funding various components as stated above. These two grants (EPWP for provinces as well as the Social Sector EPWP grant for provinces) total R2.6 billion over the MTEF. The merging of grants with similar purpose is in line with the Commission's recommendations to streamline conditional grants with same purpose to avoid duplication and enhance effectiveness. The same principle has been applied below, to the EPWP grant for provinces where the grant includes labour intensive job creation as well as focus on social sector programmes, and the same could be done for provinces.

The *EPWP Integrated* Grant *for municipalities* is a specific purpose grant to build capacity. The purpose of the grant is to incentivise municipalities to create jobs by using labour intensive methods (roads and building maintenance, basic services infrastructure such as water and sanitation reticulation, social and economic infrastructure, tourism, cultural industries, social services programmes, community safety programmes, waste management and parks). Thus, the allocation of the grant is based on labour intensive jobs created and performance. Some components of the grant can be reprioritised such as tourism and cultural services given the restrictions on the movement of people and social gatherings with jobs reprioritised to the essential services of water and sanitation reticulation for hygiene especially in hot spot areas including refocus on awareness campaigns of the impact of Covid-19.

Section 6: Concluding remarks

The 2020 Budget was crafted in very difficult circumstances characterised by rapidly weakening economic growth. This poor growth trajectory has forced average incomes to diminish at an accelerated pace, pushing many South Africans into abject poverty. By the close of 2019 the economy had slipped into a technical recession, the second in a decade. In the new year, the economy continued to face severe global and domestic headwinds that weighed down any prospects for a turnaround in the short term. Since the 2020 Budget, the economy has suffered from two other setbacks: it lost its last investment grade rating as the Covid-19 pandemic reached the shores of the country. Covid-19 and the necessitated has spread aggressively across the country causing unprecedented carnage to the economy, as it has stalled most economic activity. The government has been forced to make stark choices between protecting lives on the one hand, and livelihoods and the economy on the other. It is in the context of Covid-19 that the SCoA requested a briefing from the Commission on the financial and fiscal implications of the pandemic. The request is also in anticipation of an adjustment budget being presented in the near future.

The submission focused on four thematic areas:

- Assessment of macroeconomic and fiscal outlook;
- Assessment of the revenue and expenditure proposals as contained in the 2020 Budget;
- Assessment of government's fiscal and monetary responses to Covid-19 on growth and transformation; and
- Reprioritisation for Covid-19 pandemic.

On the macroeconomic and fiscal outlook, the Commission underscores the importance of ramping up public health expenditure to cope with the surging need for health services and to slow the spread of the virus. Macroeconomic policy, especially in the context of Covid-19, should curb economic losses, safeguard the most vulnerable groups, and ensure a rapid economic growth rebound as the pandemic fades. Policy should target measures that ease business and household liquidity restrictions. At a more pragmatic level, policy should first focus on reprioritising public sector functions by reorganising the state through restructuring programmes found to have irregularities, fraud and corruption, tackling inefficiencies in essential services delivery, reviewing and rationalising non-essential public service functions, and diverting resources to essential services. Macroeconomic policy should also begin to reprioritise economic development by reorganising market industries and market productivity by reorganising incentives.

Regarding revenue and expenditure proposals as contained in the 2020 Budget, the Commission underscores the following key points:

- From a functional perspective, the Commission notes the shift from a purely "social sector" focus over the 2016/17 to 2019/20 period to greater emphasis on economic development, community development and social development over the next three years. The Commission

welcomes this approach as it will ensure a combination of financing to ensure on the one hand, provision of a safety net to the poor (social security grants and basic services) alongside interventions to grow the economy;

- The rapid growth in debt service costs outstrips and crowds out spending on all aspects of government service delivery programmes. Projections indicate that by the end of the 2020 MTEF period, spending on debt service costs will exceed spending on health and community development;
- The assessment of spending by economic classification highlights government's attempts to rein in spending on personnel while at the same time increasing spending on capital. However the extent to which reductions in the wage bill can be effected and, if achieved, the effect it will have, especially within personnel intensive provincial departments like education and health, caused the Commission to raise the wage bill as a key risk within the 2020 Budget. In addition the Commission also raised the issue of fairness in terms of placing the burden of achieving consolidation solely on public servants;
- The analysis by vote highlights that there are certain votes which over the period reviewed can be categorised into those that are relatively protected versus those that seem to be under pressure (reductions). The current strained economic environment calls for careful prioritisation to ensure that all resources, big or small, are allocated in the best possible way.

On government's fiscal and monetary responses to Covid-19, the Commission commends government for launching a formidable intervention programme (10% of GDP), and a programme that protects life, livelihoods and the economy. Although the gamut of government's fiscal and monetary response package can be classified as "gap filling" or relief rather than stimulus, the Commission commends the immediate response by government to cushion businesses and households from the impact of the lockdown. The Commission would like to underscore the following key points:

- The Commission is of the view that government's fiscal and monetary responses are targeted at policy areas proven to reduce economic distress. The scale of certain programmes need to be increased for maximum impact. The health sector which is reeling under immense pressure due to Covid-19 and it is therefore crucial that support for this sector is informed by proper costing for maximum impact.
- Only R95 billion could be considered a fiscal stimulus. This means that the Covid-19 stimulus falls far short of the expected positive shock for the economy. GDP growth in 2020 will contract significantly (between -5.4 per cent to -20.4 per cent). Fiscal and monetary support must therefore be commensurate with the magnitude of the forecasted economic contraction. The R95 billion earmarked for business support, job creation and protection is not adequate given the scale of projected job losses. The projected employment losses[11] suggest that the

[11] In its presentation to Joint Standing Committee and Select Committee on Finance and Appropriations on 30 April 2020, NT indicated that from a different perspective, the employment impacts that could be realised range between approx. 690 000 and 1.79 million full-time equivalent (FTE) jobs loses. Dondo Mogajane, the National Treasury's director-general, noted that the country's unemployment rate could reach as high as 40% 4 May 2020 on 702. Nedbank forecasts that 1.6 million jobs will be shed in the country in 2020 compared to between 800,000- 900,000 jobs lost after

social security package may be insufficient to deal with the magnitude of the crisis. During the pre-COVID-19, the economy was already plagued by very high unemployment rates with more than half (56.4 per cent) of young people aged 15-24 years jobless.

- It is imperative that both the fiscal and monetary responses comply with revenue sharing principles outlined in section 214 a-j of the Constitution – particularly, in respect to equity. The fiscal and monetary response must be distributed equitably across the sub national governments and business sector. In this regard, the Commission recommends that the health and municipal allocations, in particular, should be distributed equitably across provinces and municipalities, using either the respective equitable share formulae or temporary conditional grant allocations on the basis of Covid-19 case load.
- The Commission believes that government should consider its total balance sheet in supporting an economy that is on the brink of collapsing. Assets on the national balance sheet include the Public Investment Corporation (PIC), Government Employees Pension Fund (GEPF), Unemployment Insurance Fund (UIF), the National Revenue Fund, and SARB foreign exchange reserves.
- The Commission is of the view that a more aggressive bond purchase programme by SARB is feasible and warranted as it would substantially strengthen the liquidity in the markets.

The Commission further implores government to start planning for the post Covid-19 recovery phase, as it will be required to implement a fiscal stimulus package to boost consumption and investment. The expectation is that the fiscal space will be limited to stimulate the economy and get a V-shaped recovery. In the absence of a fiscal space for a robust fiscal and monetary stimulus the government will need to focus more on structural transformation by improving education completion rates and outcomes, reskilling the unemployed, reorienting higher education towards digital skills, strengthening manufacturing capabilities. Additional reform measures should include the following:

- Fighting corruption and improving governance;
- Limiting tertiary education subsidies to only poor households;
- Reducing high levels of concentration in the economy;
- Improving land reform and agriculture for food security;
- Reducing the cost of broadband and assignment of high-demand spectrum;
- Strengthening the capacity of State (efficiencies);
- Reviewing of “means tests” ”/eligibility criteria for support programs across the board.

Finally, the submission grappled with the reprioritisation issue. Where will the R130 billion be reprioritised from to fight the pandemic? After looking at government as a whole, and noting areas that could be reprioritised, the Commission also noted that the process should be guided by a set of consistent, albeit flexible, principles. The Commission scrutinised each vote, functional category or grant on the basis of the following six key factors:

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in the 2009 global financial recession. Business for SA on 6 May 2020, noted that between one million and four million formal and informal sector jobs are at risk

- *Rights based approach:* Spending that protects the basic rights of people should be protected (e.g. spending on basic services: water and sanitation, refuse removal);
- *Equity and fairness:* Reprioritising should ensure there is spatial, vertical and horizontal equity and fairness;
- *Spending performance:* Reprioritising should target consistent underperformance without any basis;
- *Impact:* Reprioritising spending should have the least impact on people's livelihoods and the economy;
- *Spending composition:* In determining where to prioritise, decision makers need to distinguish between essential departments or items of spending relative to non-essential. Essential spending is classified as (a) those departments/items of spending that relate directly to fighting Covid-19; (b) those departments/items of spending that assist in providing social relief to poor and vulnerable households; and (c) those department/items of spending that are essential to igniting economic growth and directing government coordination, planning and spending during this time. Thus non-essential departments/items of spending should be subjected to relatively more aggressive reprioritisation. The Commission identified a number of areas for reprioritization;
- *High perennial growth:* The Commission looked at historical growth in allocations. In the Commission's view, where growth was excessive in the past, the concerned spending item becomes a good candidate for moderation.

The Commission noted that the following areas present opportunities for reprioritisation:

- Government should determine essential departments from non-essential ones with the latter being subjected to more aggressive reprioritisation. Even within priority departments, there may be space to reduce spending and reprioritise funds.
- Government needs to reprioritise public sector infrastructure spending by postponing infrastructure projects that are still at a pre-feasibility stage and are not directly related to the infrastructure needed for Covid-19. Investment in new infrastructure that is not related to Covid-19 imperatives can be postponed. The reprioritisation should however be done with caution, as delaying the implementation of some of the infrastructure projects will result in an increase in service delivery backlogs and future costs;
- Similarly on infrastructure, reprioritisation of spending on existing infrastructure is possible but is recommended with caution as deferral of such spending can lead to degradation of existing assets. If this option is selected, it should be based on sound data and information regarding the condition of the asset or asset lifecycle data;
- Government expenditure on goods and services that are not critical for service delivery provides more room for reprioritisation of spending. During this time of restriction, expenditure on goods and services which are not essential can be cut. Government demand for non-essential goods and services is likely to decrease, resulting in underspending;
- Restrictions on public gatherings are likely to result in less spending on non-essential items such as venue booking, catering etc;

- Training and development which is critical for service delivery must be undertaken, while training and development expenditure that is not essential for service delivery and/or fighting Covid-19 should be deferred;
- Travel and subsistence for government should be limited to essential government work related to fighting the virus. But reprioritisation from travel and subsistence from those departments considered as non-essential in the fight against Covid-19 is necessary; and
- Catering and non-essential events can be postponed since the lockdown restrictions limit unnecessary public gatherings. Reprioritising funds from non-essential catering and events is unlikely to have an adverse impact on service delivery.

On conditional grants, and following the criteria above that also do apply to government department programmes and entities, the Commission has identified 23 grants where there is room for reprioritisation towards addressing the pandemic. These grants cut across all functional categories and across the provincial and local spheres.

Finally, the Commission advises that the adjustments budget once tabled, be passed as soon as is possible, in order to give government institutions certainty regarding their budget baselines and for them to be able to plan accordingly for service delivery against both decreases and increases in spending areas.

For and on behalf of the Financial and Fiscal Commission

Professor Daniel Plaatjies
Chairperson: Financial and Fiscal Commission