FINANCIAL
AND FISCAL
COMMISSION

SUBMISSION ON THE 2019 APPROPRIATION BILL

"For an Equitable Sharing of National Revenue"

10 July 2019

Contents

List of Acronyms

GDP	Gross Domestic Product
MTEF	Medium Term Expenditure Framework
MTSF	Medium Term Strategic Framework
NHI	National Health Insurance
SOCs	State-Owned Companies
ENE	Estimates of National Expenditure
MTBPS	Medium Budget Policy Statement

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1. Background

1.1. This Submission is made in terms of Section 4 (4) (2) of the Money Bills Amendment Procedure and Related Matters Act (Act 13 of 2018) which requires Parliamentary Committees to consider any recommendations of the Financial and Fiscal Commission (hereafter the Commission or FFC) when processing the Appropriation Bill[1].

1.2. The FFC has a constitutional mandate to make recommendations to Parliament, provincial legislatures, organised local government, and other organs of state on financial and fiscal matters. In executing its mandate, the FFC is also guided by the Financial and Fiscal Commission Act No. 99 of 1997 as amended (Financial and Fiscal Commission Amendment Act 4 of 2015), Section 3.

1.3. In line with the request from the Standing Committee on Appropriations, this submission is focused on the following seven areas:

- A broad overview of the economic outlook, investment and job creation
- Revisions and additions contained in the 2018 Appropriation Bill
- An assessment of the 2018 Appropriation Bill with regard to baseline changes across votes and risks to the fiscal framework
- An assessment of the 2018 Appropriation Bill with regard to effecting government's five priority areas in the Medium Term Strategic Framework
- An assessment of infrastructure investment in national government
- An assessment of major challenges and opportunities of State Owned Companies funded through the 2018 Appropriation Bill
- An assessment of possible or existing institutional arrangements, policy areas or mechanisms that can stimulate cost efficiencies.

1.4. In addition, this submission pays particular attention to the implications of the Appropriations Bill on gender mainstreaming, inequality and rural development.

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[1] The Appropriation Bill is a piece of legislation that serves to appropriate money from the National Revenue Fund for the requirements of national government and to provide for subordinate matters incidental thereto.

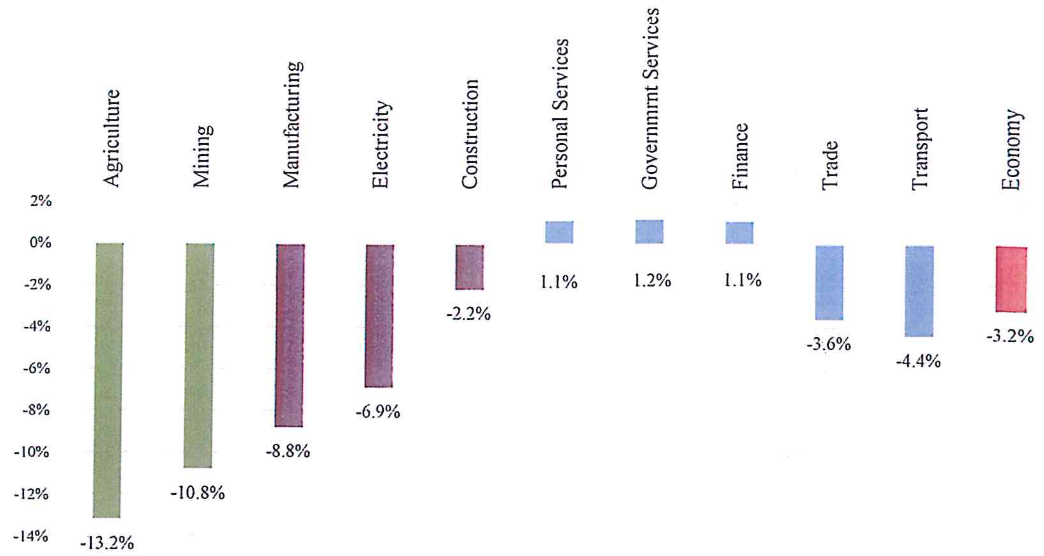
2. Context within which the 2019 Appropriations Bill is Tabled

2.1. When the FFC commented on the 2019 Division of Revenue Bill in February 2019, it noted that South Africa's economic prospects had deteriorated as the country's real long-term growth had continued to decelerate, beleaguered by recessionary scares and negative outlooks by credit rating agencies. Years of institutional deterioration due to governance failures and policy uncertainties has caused structural degeneration on both the demand and supply side of the economy, coupled with the financial, operational and governance crises in key SOCs. At that time, key domestic risks noted included weak investment as evidenced by the declining contribution of gross fixed capital to gross domestic product (GDP), high unemployment, policy uncertainty, and domestic politics in the period leading to the national elections held in May 2019.

2.2. The tabling of the 2019 Appropriation Bill comes at a time when this situation remains largely unchanged, if not bleaker. Following an increase in GDP of 1.4 percent in the last quarter of 2018, the economy has shrunk by 3.2 percent in the first quarter of 2019. This represents the largest decline since the onset of the 2008/09 global financial crises where the South African economy contracted by 6.9 percent in the first quarter of 2009. Whilst the February 2019 growth projections were already muted, forecasting 1.5 percent for 2019, 1.7 percent in 2020 and 2 percent in 2021, these growth rates will, in all likelihood, not be attainable and be revised down even further.

2.3. The lacklustre performance of the economy in the first quarter of 2019 was driven mainly by the poor performance of the primary sectors (agriculture and mining), followed by the secondary sectors (manufacturing and electricity) and then trade and transport (Figure 1). In the main, the low sectoral growth was largely attributable to the intermittent electricity supply that characterised the first quarter of the year. The financial and governance challenges facing Eskom imply that the risk related to electricity supply will remain for the foreseeable future.

Figure 1: 2019 First Quarter GDP Growth



2.4. All in all, it appears that the positive sentiment that existed in February and which was generated by various presidential initiatives such as the investment envoys and the investment and jobs summit, seems to have lost momentum. Whilst the constrained economic environment that South Africa faces has in part been driven by a slowing global economy[2], much of South Africa's economic woes are of a domestic nature.

2.5. Policy uncertainty, particularly around the key issues of land reform and continued poor performance of SOCs which continue to pose a serious risk to the fiscus, are concerns. Government needs to ensure that events in the political arena (such as divergent views within the ruling party regarding the independence of the South African Reserve Bank) do not put the country's public finances and institutions charged with managing these resources further at risk. If this is not managed, progress that has been made within the public finance system will be eroded.

2.6. As is the norm during an election year, two State of the Nation Addresses (SoNA) are delivered: one in February (prior to the tabling of the budget) and one in June, post the elections. A SoNA spells out

[2] Following an expansion of 3.0 percent in 2018, world gross product growth (equal to total global GDP) is projected to slow to 2.7 percent in 2019 and 2.9 percent in 2020.

the overarching policy direction and plan of action that will guide government activities for the year. The June SoNA focused on the five year term of the sixth administration. As such, the policy priorities outlined in the SoNAs are critical in that they are meant to set the scene for the manner in which resources will be used over the financial year/s.

i. The February SoNA, which preceded the tabling of the 2019 Budget, identified five priority areas to guide government's activities over the 2019 financial year. The post-election SoNA identified an additional two priorities (Table 1) that will underpin all programmes and policies across government.
ii. Specifically, the June SoNA places an explicit emphasis on spatial integration, human settlements and local government. The Commission is hopeful that the inclusion of this priority is indicative of a greater and more coherent focus on government's land reform programme, especially since the report of the Presidential Advisory Panel on Land Reform and Agriculture has been finalised.
iii. The Commission welcomes efforts aimed at fighting corruption and building a capable and ethical civil service. In this regard, the various commissions of inquiry and the restructuring and streamlining of government departments are positive developments. To build on this and as recommended by the Commission in its February submission to Parliament, there is a need for the whole of government to continually evaluate all aspects of their spending plans to ensure that inefficiencies in service delivery systems are eliminated – this is particularly important in big spending areas such as health, education, electricity and water and sanitation.
iv. Whilst SOCs continue to pose the major risk to the fiscus and notwithstanding that Eskom's poor performance and load shedding contributed to the decline in growth during the first quarter, the June SoNA was particularly silent in respect of providing either an update on the unbundling of Eskom or any specific timelines as to when this process will happen. From the Commission's point of view, the Eskom challenge represents the culmination of serious deficits in governance, leadership, efficiency (leakages and billing problems) and effectiveness (poor maintenance of infrastructure) in the management of public resources.

Table 1. Priorities Articulated in State of the Nation Addresses in February and June 2019

Priority Areas Outlined in February SoNA	Priority Areas Outlined in June SoNA
1. Accelerate inclusive economic growth and job creation	1. Economic transformation and job creation
2. Improve the education system	2. Education, skills and health
3. Improve the conditions of life for all South Africans, especially the poor	3. Consolidating the social wage through reliable and quality basic services
4. Step up the fight against corruption and state capture	4. Social cohesion and safe communities
5. Strengthen the capacity of the state to address the needs of the people	5. Capable, ethical and developmental state
	6. Spatial integration, human settlements and local government
	7. A better Africa and world

Source: FFC's Compilation

2.7. Whilst the Commission agrees with the general thrust of the 2019 Appropriation Bill it recommends that given the fiscal constraints facing government, that concerted efforts be made to identify areas of innovation and cost saving so as ensure fiscal sustainability going forward. Elsewhere in this document the Commission suggests a number of areas for improving efficiencies within the public sector.

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

Baseline Changes and Service Delivery Implications of the 2019 Appropriation Bill

3.1. The 2019 Appropriation Bill is being considered just after the 2019 national elections, which led to several administrative changes within Government. These changes include, among other things, a reconfiguration of national Government departments such as combining agriculture with rural development and land Reform;

department of trade industry with the department of economic development; department of mineral resources with energy; department of human settlements with that of water and sanitation; and the department of sports with the department of arts and culture. The Commission welcomes the reconfiguration of the national departments and this development is likely to improve Government efficiencies and effectiveness through streamlining Government operations, and more importantly it will reduce pressure on the fiscus. However, the Commission cautions Government on the likely disruptions this will cause on the operations of the affected departments, especially during the transition period.

3.2. These changes are likely to have a significant effect on the appropriation of funds for the financial year 2019/20 and the 2019 MTEF allocations and spending performance of the affected departments. In terms of the 2019 Appropriation Bill, Government has increased the total baseline for national Government departments by 3%. Table 2 below presents the baseline changes in the 2019 Appropriation Bill and over the last three years for selected key national departments. It is clear that, although there has been an overall increase, there are cuts in some departments. For example, the baseline for the department of energy is reduced by 2%, and this department experienced a very high cut (17%) in the 2018/19 budget. The Commission acknowledges the need to reduce spending, given the current economic conditions, however, it remains concerned about the reductions in key sectors such as energy, as they could have adverse effects on service delivery and on the economy going forward.

3.3. Of the selected votes, the baselines for departments of Water and Sanitation, Women, Public Works, Human Settlements, Energy and Correctional Services appear to have been the most targeted for the reductions over the last three years, with real average reductions of 11%, 8%, 12%, 12% and 7%, respectively. The Commission notes that all these departments have been affected by the 2019 reconfigurations and are all critical for service delivery. It emphasizes the need to ensure that these departments are well resourced to deal with the changes and continue to deliver services. The Commission underscores the need for these departments to use those limited resources more efficiently.

3.4. Considering the strategic importance of gender mainstreaming and rural development as was noted in the SoNA, baseline reductions in the departments of Woman and Rural development are cause for concern. As South Africa is facing unprecedented gender violations, it is imperative that the department of Women is well resources to champion the cause of women and ensure that this department is enabled to effectively catalyze the mainstreaming of gender in other line departments. The appropriations should also respond to the land reform imperatives as this has the potential to create many jobs in the country. Financial prioritization must however always be matched by service delivery increase.

Table 2: Baseline changes 2016/17-2019/20

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

Source: ENE, 2019 and Commission's calculations

CHANGES TO SPENDING OUTCOMES

3.5. Table 3 below presents the spending outcomes for the period 2016/17 to 2018/19. Over this period, most departments appear to have spent 99% or more of their allocated budgets. There are however departments that spent below the national average, including the departments of Basic education (97.7%), Justice and Constitutional Development (98.9%), Energy (98.4%), Water and Sanitation (96.8%)

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and Rural Development and Land Reform (98.0%). The Commission notes that except for the department of Basic education, all the underperforming departments have been affected by the 2019 reconfiguration and is of the view that Government should be cautious in the implementation of the changes to ensure that they have no undesirable effects on service delivery.

3.6. For the year 2018/19, the national average spending increased to 99.4%. There has also been a decline in the performance of some of the departments such as the departments of health (98.9%), and Water and Sanitation (93.4%). The decline in the spending performance for the departments of water and sanitation is explained by the underspending in allocations for water infrastructure development. This is concerning for the Commission given the significant backlogs in water services and the deteriorating state of the existing water infrastructure.

Table 3: Aggregate spending and deviations from the final budget for the period 2015/16 - 2018/19

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

Source: *ENE, 2019 and Commission's calculations*

3.7. There are various fiscal risks that are likely to have a negative effect on the spending plans set out in the 2019 Appropriation Bill. The Commission is of the view that these fiscal risks should be addressed and failure to do so will undermine core service delivery functions.

3.8. Over years, the Government has invested significantly in public infrastructure. However, returns to such investments have not always generated the desired outcomes. Some of the reason for those are attributable to poor project planning including maintenance plans which have often been inadequate. Poor project planning and lack of maintenance of infrastructure poses a serious risk to current and future appropriations, as additional resources will be required to address infrastructure failures owing to the compounding cumulative effect of infrastructure deterioration.

3.9. The financial position of state-owned companies (SOCs) poses a serious risk to the appropriations. Eskom in particular poses the most risk to the economy and appropriations. As noted above challenges around electricity supply were responsible for the drop in economic activity in the first quarter of 2019. Eskom has a R440bn debt and R45bn of the debt falls due in 2019. Government has proposed an additional appropriation for Eskom in the near future. Other SOCs, like SABC are also in line for bailouts. Due to the financial distress faced by several SOCs, contingency reserves has been revised upwards in the 2019/20 appropriations bill by R6 billion.

3.10. Over years, the public sector wage bill has continued to exert pressure on the public sector budget as well as crowd out other government expenditure priorities. Government states that the compensation of employees accounts for more than 35% of consolidated public spending and has been a major driver of the fiscal deficit. In the 2018 MTPBS, a shortfall of about R300 billion was projected if employee numbers remain. Government still continues to wrestle with the idea of rationalising the civil services to contain the huge wage bill.

GOVERNMENT'S RESPONSE TO THESE RISKS

3.11. Government has responded to the above risks in many ways, including:

(a) A concerted drive towards restructuring and renewal of economic growth. The Commission notes many developments in this regard. There are efforts to encourage domestic and international private sector investment, restoring business confidence, improving the planning and implementation of infrastructure projects, as well as rebuilding state institutions. On infrastructure led growth, this will be done through initiatives such as the Budget Facility for Infrastructure (BFI), which is supported by a technical task team that will review complex national capital projects with aim of ensuring delivery and of improving value for money on these infrastructure projects. The Development Bank of Southern Africa (DBSA), the Government Technical Advisory Centre and the Presidential Infrastructure Coordinating Commission were allocated R625 million for project preparation to build capacity and strengthen project planning. These institutions will play an oversight role to the capital infrastructure projects. In line with the above, an infrastructure fund would be established over the three years and an allocation R5 billion was proposed to fund capital infrastructure projects such as the construction of academic hospitals, water and sanitation services, energy sector investments, and the expansion of an integrated public transport network. The Commission welcomes these developments.

(b) On the wage bill, the government will reduce the compensation ceiling by R9 billion in 2019/20 compared to the R15 billion in 2018/19. These reductions reflect faster than expected declines in headcounts. Government proposed spending cuts amounting to R50.3 billion over the medium term on the compensation of employees as efforts to streamline the civil service gain momentum. In addition, the Commission has recommended, among other things, stricter management of headcounts, discouraging the filling of non-critical vacant posts, and limiting the hiring of personnel in administrative and managerial positions.

(c) In relation to Eskom, government announced its reconfiguration; Eskom will be split into three operating entities: generation, transmission and distribution under Eskom Holdings, so as to encourage competitive behaviour in the electricity sector and strengthen oversight in the sector. The separation of Eskom into three operating entities is in line with White Paper on Energy policy of 1998. Over the next three years, R69 billion has been provisionally allocated to Eskom for its reconfiguration. In addition, the Eskom's board is to sign a new shareholder compact and the executive remuneration will be linked to performance.

3.12. The Commission welcomes the above measures taken by government to mitigate fiscal risks to the fiscus. The Commission notes that it is important for government to have specific timelines on these initiatives and a clear plan for recapitalisation of these SOCs given that most of them are struggling financially.

3.13. With respect to the BFI, the Commission support this approach as it is in line with its previous submissions on this matter, where the Commission submitted that quality governance and institutional architecture play a pivotal role to public infrastructure outcomes. However, the Commission is of the view that these plans on institutional architecture and reconfiguration should cascade down to subnational governments as there is also a breakdown to the infrastructure value chain which in turn impede the provision of service delivery.

4. Transformation and Inclusive Growth in the 2019 MTEF

4.1. PROMOTING ECONOMIC GROWTH

(a) In its submission for the Division of Revenue Amendment Bill and the 2018 Medium Term Budget Policy Statement, the Financial and Fiscal Commission noted the precarious situation facing the economy. The Commission underscored the fact that, "Years of institutional decay due to governance failure, policy incoherence and uncertainty causing a structural degeneration on both the demand and supply side of the economy, coupled with the financial, operational and governance crises of key developmental State-Owned Enterprises (SOCs), have dissipated the momentum for growth despite fiscal countercyclical manoeuvres where expenditure exceeds revenue". What the Commission had projected then was realised in June 2019, when the economy contracted by 3.2 per cent in the first quarter of 2019; the worst economic decline since the 2008/09 Financial Crisis.

(b) Faced with the threat of a technical recession and prolonged stagnation of the economy, in his State of the Nation Address the president noted that faster growth is needed to attract more investment, stimulate the economy, and address the triple challenges of poverty, inequality and unemployment. In this submission the Commission reiterates its position as was stated in the 2018 Adjustments Appropriation, MTBPS and Division of Revenue Bill submissions that even though the Government was committed to implementing growth-enhancing reforms by

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strengthening private-sector investment, improving the planning and implementation of infrastructure projects, rebuilding state-own enterprises through shake-up within the executive arm, and appointing commissions of inquiries to investigate corruption, swifter and bolder changes are required.

(c) The Commission commends government for adopting its recommendation on identifying "low hanging fruits" industries where the country has clear competitive advantage for an export-oriented growth strategy. These include high-value manufacturing exports (motor vehicles), agricultural exports (fresh fruits and nuts), finance and tourism.

(d) The concept of engaging in the Fourth Industrial Revolution into cyberspace and information and Communication Technology (ICT) is welcomed, though it is cautioned that intellectual property rights and information privacy must be protected and preserved under section 14 of the Constitution. South Africa must strengthen its cybersecurity and cybercrime investigation capabilities by enhancing its ICT skills specific education and training to advance labour supply with qualified ICT skills to take up their positions, turning this new industrial revolution into a new labour-absorbent market for employment from the micro- to the macro- level.

(e) In the 2019 SoNA, the President envisaged that through local densification, greater investment in public transport and housing programmes, and more mixed-income developments as special economic zones can reshape cities as engines of economic growth. The Commission agrees with. However, such a development strategy must be accompanied by a functioning local government base with complementary basic services. To this end, the FFC's 2020/21 Annual Submission for the Division of Revenue tabled on the 30 May 2019 in parliament on the city region development model gives meaning to this proposal.

4.2. JOB CREATION

(a) According to the Quarterly Labour Force Survey, South Africa's unemployment rate increased from 23.2 per cent in the 1st quarter of 2008 to 27.6 per cent in the 1st quarter of 2019. Employment has

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largely remained stagnant as only 1.853 million jobs were created over this period, against 3.684 million new labour market entrants. The labour market is particularly not friendly for young people. There are currently more than 7.7 million (75 per cent) economically inactive youths between the ages of 15-24 out of 10.3 million youths. Moreover, it is estimated that 32.4 per cent (approximately 3.3 million) of the young people are not in employment, education or in training institutions (NEET) – implying that close to one in three young South Africans are completely disengaged from the labour force and excluded from the mainstream economy.

(b) Although the Commission is adamant that job creation shall remain stagnant, it welcomes efforts by government to crating decent jobs through prioritising skills development and education. In his SoNA address, the President envisaged the economy growing faster than the population growth rate in order to make a dent on unemployment. The current population growth is 1.5% and the target is thus easily achievable. It may be a question of the target set too low and unfortunately it won't make a dent on employment, poverty and inequality. The NDP had set a target of GDP growth of 5% to make a positive impact on employment. This new target is a great departure from the NDP. To make a significant impact on the unemployment the economy has to consistently grow by margins far larger than the population growth rate.

Table B.4 Employment by level (full-time equivalents)

Salary level	Non-OSD		Average annual growth	OSD		Average annual growth
	2008/09	2016/17		2008/09	2016/17	
01 - 04	231 239	175 966	-3.4%	80 980	74 633	-1.0%
05 - 08	143 584	207 340	4.7%	529 514	566 549	0.8%
09 - 12	36 434	39 365	1.0%	132 018	170 864	3.3%
13 - 16	7 021	9 011	3.2%	2 514	10 778	20.0%
Total	**418 278**	**431 682**	**0.4%**	**745 026**	**822 824**	**1.2%**

Source: National Treasury (PERSAL data)

(c) The Commission further notes that according to data table above (Table B.4 from the 2017 Annexure B of the MTBPS), the state's human resource capacity has become top-heavy through the occupation specific dispensation (OSDs) at the expense of expanding entry- and junior-level positions. It has had perverse incentives on employment creation, besides inflating the public sector wage bill.

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4.3. HEALTH

(a) Health remains an important priority for the 2019 appropriations, accounting for 13.9% of the total MTEF consolidated expenditure. For 2019/20 the health budget allocation is R222 billion, of which 19.2%, 16.4% and 44.5% is allocated to central hospitals, provincial hospitals and district health services respectively. Implementation of the National Health Insurance is a key priority within the health sector, having also been accentuated in the State of Nation Address by the President.

(b) The Commission welcomes the government's recommitment to meeting the universal access to healthcare goals as espoused in the NDP. It is however a concern that the rolling out of NHI is not moving at a pace that is likely to meet government's delivery target. Since the introduction of NHI White Paper in 2011, the implementation process has been beset by countless challenges including underspending of NHI conditional grants, constant repurposing of conditional grants (moving from direct into indirect grants and vice versa) as well as ongoing policy uncertainties regarding the of role various role players in the delivery of health care, flow of funding and applicable health package. Efforts to improve health human resources and infrastructure are welcome but this is nearly insufficient to deal with the magnitude of the reforms going forward. An amount equal to R2.8 billion has been reprioritised within the NHI indirect grant to fund critical health professional posts and community services posts within health care facilities. It is unclear if any of the posts filled are directly linked to the implementation of NHI.

4.4. EDUCATION

(a) Education is poised to remain South Africa's apex development goal in the foreseeable future. The 2019 budget allocates R262 billion to the basic education sector and a further R113 billion to post education and training which equates to 16% and 7% of total consolidated budget respectively. The 6th June SoNA placed a policy emphasis on making sure that children can read and write with comprehension by the age 10. Numerous comparative studies have indicated consistently that South Africa's performance in relation to pupil literacy and numeracy is considerably poor. This does not bode well for the country's developmental ambitions and adaptive capabilities to the fourth industrial revolution as outlined in the SoNA.

(b) The Commission notes with concern the continuous lack of improvements in education outcomes and its overall impact on the skills base of the country, despite receiving a sizeable amount of the budget allocations annually. In particular, there are growing levels of attrition at both basic education level and the post-school training institutions. It is worrying that just under 40% of children who enter school each year complete matric. The National Student Financial Aid Scheme is inundated with beneficiaries who are studying towards skills that are at risk of being displaced by the digital revolution. Low education attainment levels reinforce inequality and undermine the country's transformation endeavors.

(c) The recent results of the General Household Survey revealed a worrying trend, in which the older generation (35 years and older) are better skilled relative to younger people (15 to 35 years). This phenomenon implies that skills are increasingly obtained outside the education system and that the investments in education fail to yield the desired results. It is also an indictment that unemployment is rampant among young people in South Africa. A growing trend of skills acquisition at older age or outside the education system deprives the economy of the productivity gains when people enter the labour market and may create adverse incentives, as people leave school early to enter the labour market. Government will have to carry the cost of an inefficient education system by putting additional investment into programs which incentivise training or employment of unskilled people. In order for the South African economy to achieve sustainable long-term growth, the education system must produce the necessary skills, especially among the youth. It is a considered view of the Commission that the underlying reasons for this worrying phenomenon must be investigated and resolved as a matter of urgency and available resources be channeled into improving education throughput rates.

4.5. AGRICULTURE

(a) Agriculture and rural development receive 1.8% of the total consolidated budget or just over R30 billion in the 2019 budget. Agriculture plays a crucial role in employing low and semi-skilled labour. The contribution of the sector to national output and employment has been gradually declining from a peak of 3.9% and 11% in the 1994 to 2.2% and 5.5% in 2017. The decline is partly attributable to a natural shift in economic activity associated with urbanisation. However, South Africa still has considerable amounts of people living in the rural areas (estimated at 40%). Many of the rural populations have seemingly disengaged from agriculture. According to the General Household Survey, only 15% of South African household are involved in agriculture, with most engaged in food production from backyard gardens. Government agriculture support programs need to priorities small scale commercial agriculture production that create jobs. Public interventions in this regard should prioritise access to quality education, health and skills development.

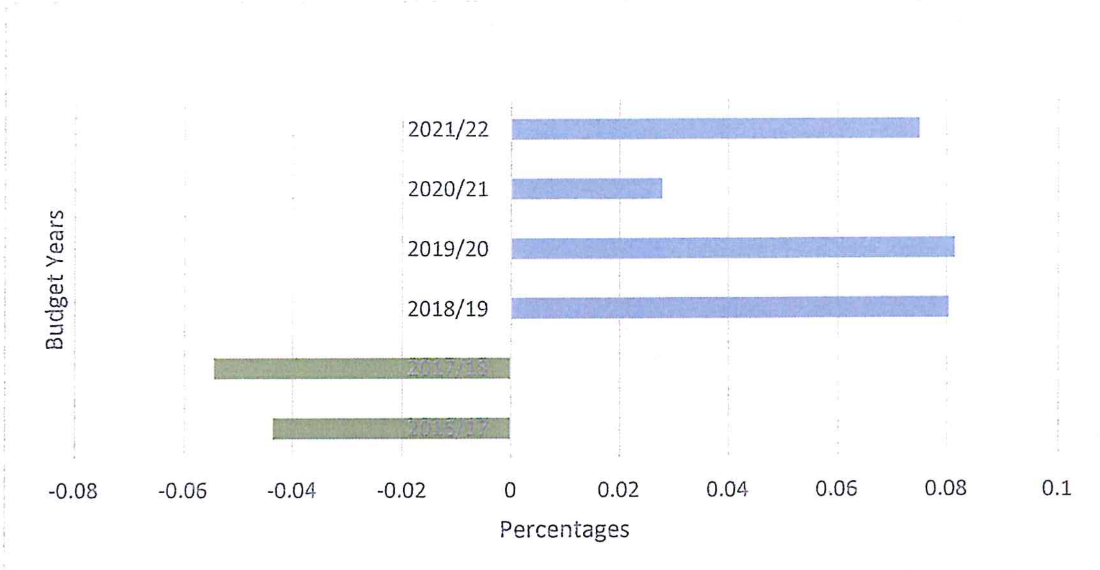
4.6. IMPROVED PUBLIC SERVICE

a) The President in his June SoNA re-emphasised the need to build a capable state that will deliver quality public service, free from corruption and maladministration. The recent Auditor General report on the financial performance of municipalities highlighted the unrelenting gross mismanagement and poor governance prevailing within state organs. Unfortunately, the responsibility for improving public services cannot be institutionalised within the budget framework. Addressing these failures requires political commitment to legislated performance management guidelines and consequence management.

5. Infrastructure Allocations Provided for in 2019 Appropriation Bill

5.1. Public sector expenditure on infrastructure will increase to R864.9 billion over the 2019 medium-term expenditure framework (MTEF) period. , The annual breakdown is R276 billion in 2019/20, R283 billion in 2020/21 and R305 billion in 2021/22. The allocations will increase, in nominal terms, reflecting an average annual growth rate of 6.1 percent over the 2019 MTEF period. Figure 2 below shows the annual growth rate of public sector infrastructure investment for the period spanning 2016/17 to 2021/22. The Commission reiterates its position that public sector expenditure on infrastructure is crucial for economic growth and access to quality basic infrastructure.

Figure 2: Public-sector infrastructure expenditure average annual nominal growth rates, 2016/17-2021/22

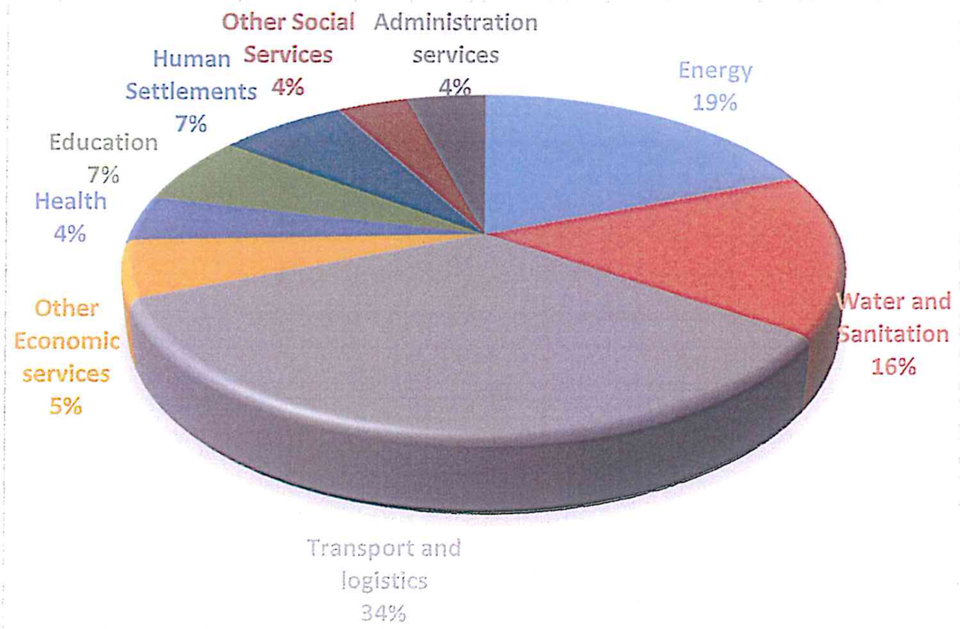


Source: National Treasury Budget Review, 2019

5.2. In 2019/20, the transport and logistic sector is allocated over a third of the total public-sector infrastructure investment (34 percent), followed by energy sector (19 percent), and water and sanitation (16 percent). The allocation of public-sector infrastructure investment to the transport and logistics is increasing, in nominal terms, by 14 percent over the 2019 MTEF, followed by the water and sanitation (7.6 percent) and energy (1.4 percent). The annual growth rate of the allocation of the transport and logistic sector reflects that it is increasing at a decreasing rate. While the allocation to transport and logistics sector is increasing by 21.5 percent in 2019/20, it only increases by 11.1 percent in 2021/22.

5.3. A similar trend holds true for the energy sector. Allocations to other economic services; education; human settlements; other social services and administration services all show marginal increases, in nominal terms, over the 2019 MTEF whereas the allocation to health sector shows a marginal decline. Figure 2 below shows the sectoral spread of public sector infrastructure investment for 2019/20. The Commission welcomes the targeting of public-sector infrastructure investment to growth enhancing sectors.

Figure 3: Public-sector infrastructure expenditure by sector, 2019/20

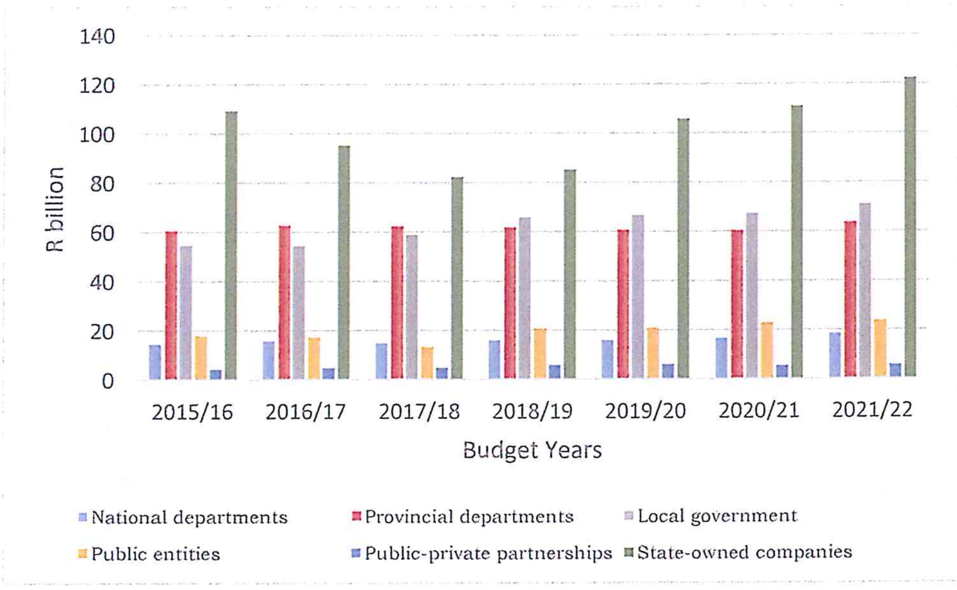


Source: National Treasury Budget Review, 2019

5.4. The state-owned companies (SOCs) account for the largest allocation of the public-sector infrastructure investment. In 2019/20, SOCs accounted for 38.3 percent of the total public-sector infrastructure investment, followed by local government (24.2 percent), and provincial departments (22 percent). The allocation of public-sector infrastructure investment by SOCs will also record significant growth, in nominal terms, over the 2019 MTEF at 13.09 percent, while the local departments will only register a growth of 2.54 percent and provincial governments 1.12 percent. Figure 3 below shows public sector expenditure. The Commission is hopeful that the governance and financial reforms of SOCs will translate into efficient infrastructure spending and higher rates of return to investment.

5.5. To improve infrastructure delivery, the Commission has recommended in its 2020/21 submission to the Division of Revenue that infrastructure delivery inspectorates should be established for the local sphere to assess management performance processes and capacity within municipalities to implement grant-funded and non-grant-funded infrastructure projects on a continuous basis. In addition, the inspectorates should undertake quality inspections of new and existing built infrastructure, project management and delivery audits and advise on alternative approaches, materials or technologies for infrastructure delivery through the development of infrastructure blueprints for various types of municipal facilities.

Figure 4: Public sector infrastructure expenditure for local, provincial and national spheres; state owned companies; and other public entities, 2015/16-2021/22



Source: National Treasury Budget Review, 2019

5.6. Building on the Budget Facility for Infrastructure initiative, and to further enhance the capacity of infrastructure value chain process, government is in the process of establishing a Project Preparation Facility geared towards improving the identification and preparation of good education, health, water, energy, and communication infrastructure projects. The 2019 Budget allocated R625 million for the new facility. Furthermore, government aims to establish an Infrastructure Fund in partnership with the private sector, development finance institutions and other multilateral development banks. The allocation for this is estimated at R100 billion over the next ten years.

5.7. These initiatives are broadly in line with the Commission's submission on the 2018 Division of Revenue and the 2018 Fiscal Framework and Revenue Proposals, for government to reprioritise infrastructure funding and execution. The Commission reemphasises the importance of improving the quality of capital stock delivered, maintaining existing stock and reducing cost overruns on current projects.

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

6.1. State-owned companies(SOCs) remain the largest driver of public capital investment, with a projected spending of R339 billion over the 2019 MTEF. The bulk of these funds are used for the ongoing expansion of the Eskom electricity generation capacity as well as the upgrading and expansion of the transport network. Close to 71 per cent of the total SOE infrastructure spending (R105.8 billion) in 2019/20 is attributable to the Eskom and Transnet build programme. The remainder comprises of allocations to the South African National Roads Agency limited (SANRAL) and the Passenger Rail Agency of South Africa (PRASA) for the upgrades and maintenance of non-tolled national roads and modernisation of the rail network respectively.

6.2. When SOCs are efficiently and effectively managed, they are well placed to support and sustain economic transformation and catalyse national development. The inverse also holds true. If poorly managed and governed, they burden the country with significant costs. Most of the SOCs are not being managed in a sustainable manner. Even after discounting the impact of sluggish economic growth on company returns, public allegations of corruption and mismanagement have significantly contributed to a deterioration in the finances of several major large SOCs. The collapse of one or more major SOE would have catastrophic economic and fiscal ramifications for the country.

6.3. A number of SOCs have large government guarantees while their long-term viability is uncertain. More recently, owing to poor governance and a lack of remedial reforms, capital markets have held back on lending to some entities. As a result, many of these entities are in a precarious financial position which will likely require consistent cash injection from the fiscus for them to continue operating.

6.4. Government guarantees declined marginally from R475.7 billion in 2016/17 to R469.8 billion in 2017/18 before increasing to R483.1 billion in 2018/19. Government guarantee exposure which is the total amount of borrowing and accrued interest made by the entities against the guarantee, has increased by 10.6 per cent from R290.4 billion in 2016/17 to R321.3 billion in 2017/18, before further increasing by 15.9 per cent to R372.4 billion in 2018/19 as shown in Table 1 below.

6.5. This means that while government guarantees have remained relatively flat, government guarantee exposure has notably increased, in turn increasing the contingent liabilities to government and constituting a risk to sustainability of the fiscus. A high level of contingent liabilities translates into a higher risk premium on, and increased costs of, sovereign debt. The Commission is of the view that guarantees should not be viewed as an easy option or a default response to avoid managing risks.

6.6. Given that guarantees are not exposed to the same level of scrutiny in the budget process as regular spending, the Commission advises oversight mechanisms of guarantees should be strengthened to reduce the risk of unintended consequences from materialising. As recommended in its submission on the 2018 Appropriation Bill, the Commission reiterates its call on the National Treasury to review the framework and process in terms of which government guarantees are granted. The Commission is also of the view that the role it plays, as given by section 218(2) of Constitution, when it comes to the legislation governing the conditions for guarantees need to strongly be considered.

Table 1. Total Guarantees to State-Owned Entities

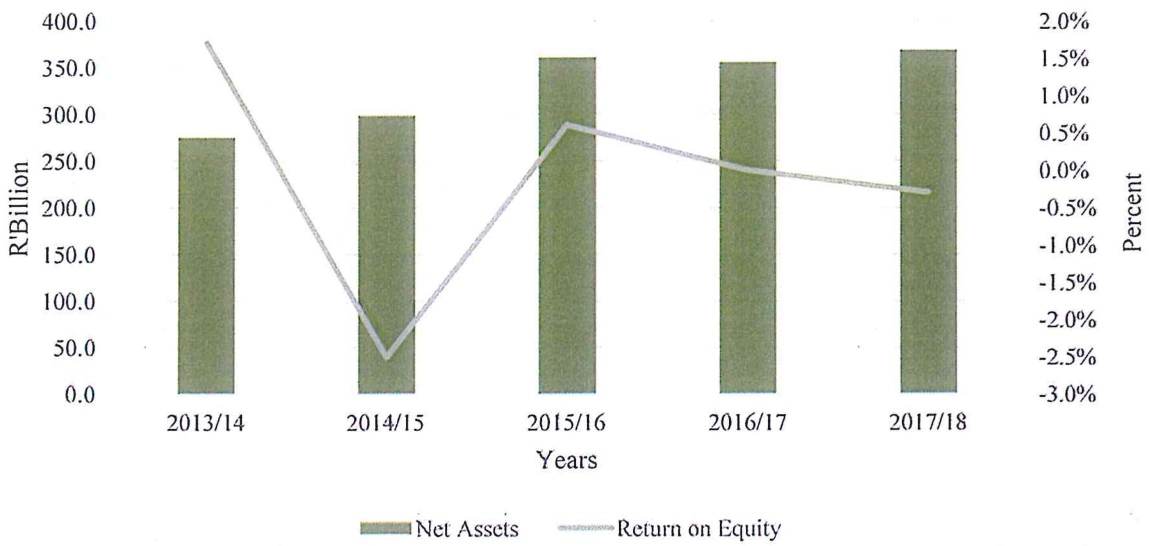
	2016/17		2017/18		2018/19	
R billion	**Guarantee**	**Exposure**	**Guarantee**	**Exposure**	**Guarantee**	**Exposure**
Eskom	350.0	202.8	350.0	244.7	350.0	294.7
SANRAL	38.9	29.4	38.9	30.4	38.9	30.3
Trans-Caledon Tunnel Authority	25.6	20.9	25.7	18.9	43.0	14.9
South African Airways	19.1	17.8	19.1	11.1	19.1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

Source: National Treasury (2019)

6.7. Between 2016/17 and 2018/19, Eskom consistently accounted for the majority of government's contingent liabilities. In 2016/17, guarantees to Eskom amounted to R350 billion, which is 73.5 per cent of total government guarantees to SOCs. In 2018/19, this figure declined slightly to 72.4 per cent. In 2018/19, Eskom used an additional R50 billion of its guarantees. Given the serious financial challenges that Eskom faces, where it may not be able to meet its interest and capital payments, government has put aside a provisional allocation of R23 billion per annum in the medium-term fiscal framework. This provisional allocation is intended to provide fiscal support for the reorganisation of the electricity sector, where priority will be given to the creation of a transmission company by establishing a subsidiary of Eskom Holdings with an independent board appointed by mid-2019. The Commission is of the view that a clear process along with timelines needs to be devised to guide the unbundling of Eskom.

6.8. Overall, the financial position of SOCs remains worrisome. Whilst the combined net asset value improved slightly from R355.5 billion in 2016/16 to R368.3 billion in 2017/18, their profitability as measured by return on equity has deteriorated. Return on equity decelerated sharply from 1.7 per cent in 2013/14 to -2.5 per cent in 2014/15, before slightly recovering to 0.6 per cent in 2015/16, as shown in Figure 1. In 2017/18 the return on equity remains slightly below zero per cent. This poor performance represents a definite and significant risk to fiscal sustainability.

Figure 5. Combined Balance Sheets of SOCs



Source: National Treasury (2019)

7. Opportunities for Efficiencies and Cost Savings

7.1. In a fiscal constrained environment, doing more with less should be the norm rather than the exception and there should be no room for complacency on this. Efficiency is not only about reducing public spending, but more importantly, it is about improving productivity and spending public resources in the smartest way possible.

7.2. In reality, the level of inefficiency in the public sector remains high and growing. The AG report paints a very grim picture of the inefficiencies in government operations across the three spheres of government. The 2017/18 AG's report estimated unauthorized expenditure by provincial and national governments at R2.1-billion, a 38% rise in comparison to the previous year. The bulk of this amount was due to overspending. Fruitless and wasteful expenditure and irregular expenditure were R2.5-billion and R51-billion respectively. Inefficiency is also a deep-rooted problem within SOCs and a major factor in their state of dysfunctionality.

7.3. However, many recent developments and proposals made by Government to promote public sector efficiency are commendable and steps in the right direction. These initiatives include:

- The recent reconfiguration of a number of government departments
- Efforts to link public sector wages with productivity.
- Proposals to redefine and align the mandates of SOCs.
- Efforts to professionalise and rationalize the public service
- Reforms at the South African Revenue Service

7.4. Previously the Commission has underscored the importance of modernising the public sector and leveraging on new technologies as well as minimising unnecessary outsourcing of services and tasks that can be performed by civil servants as possible mechanisms for enhancing efficiency in the public sector. The room to improve public sector efficiency and savings is abundant. The Commission proposes the following additional measures:

- Support for oversight bodies: The support of political leaders is vital for public sector efficiency. Previous FFC research has indicated that many oversight bodies lack the skills and expertise to hold the executive to account. There is a need to resource political institutions so that they are able to hold the executive to account and ensure that value for money is derived from public resources.

- ***Incentives to the civil service:*** It is important that efforts to have a lean and professional civil service are accompanied by the development of an incentive regime (especially non-monetary incentives) that will motivate public servants to change behavior towards high performance and efficiency.

- ***Benchmarking:*** Government departments may differ, but comparing their operations may be useful to improve efficiency and costs savings.

8. Concluding Remarks

8.1. In its 2018 Submission to the Appropriations Bill, the Commission noted with great concern the gloomy environment in which the budget was presented. The environment was characterised by low economic growth, revenue under collection and policy uncertainties. The government then had to make very difficult choices and trade-offs to balance achievements on the socio-economic objectives and putting the country onto a solid, more stable financial and fiscal footing. The 2019 budget was, albeit, presented in similar conditions, if not worse. The economic headwinds have become stronger. As noted, the first quarter of 2019 recorded one of the lowest growth rates (-3.2%) since the 2008 financial crisis. The economy is perhaps the biggest challenge and risk to the 2019 Appropriations Bill. More and more people have found themselves in a state of unemployment and policy uncertainties evident last year, remain unchanged today, especially around the key issues of land reform, and SOCs. The contingent liabilities of state owned companies compounded by the rising demands for additional bailouts is likely to have a toll on the stability of the public finances. Events playing out in the political arena are not helping the situation either, but only help to compound the uncertainties and risks to the economy and the stability of the public finances. The inconsistent messages regarding the independence of the South African Reserve Bank is a case in point. Taken together all these challenges are likely to feed into the unfavourable assessments by rating agencies, with dire consequences on an already fragile economy.

8.2. The Commission notes government efforts to address these challenges head on as pronounced during both the 2019 budget and 2 SoNA addresses by the country's President. In particular the Commission takes note of the following measures:

- Efforts to improve the governance of state-owned enterprises
- Attempts at reconfiguring and rationalising the state machinery, and
- Efforts to confront the scourge of corruption through the Commissions of inquiry

8.3. In addition to these measures, the positive sentiments expressed towards the 6th Administration by the general populace and international community will go a long way towards boosting business confidence, and thus economic growth.

8.4. The Commission is in agreement with the general thrust of the Appropriation Bill. FFC understands the tough choices that the government has to make. The government is treading a fine balancing act of diminishing revenues available for sharing on one hand, and maintaining the social wage on the other. In a fiscally constrained environment, prioritisation and efficient spending are the hallmarks of any appropriations. The government, both in the budget and SoNA has drawn policy priority areas to guide its activities going forward. The 2019 budget identified five priority areas to guide and underpin all government programmes and policies over the 2019 financial year, while the post-election SoNA placed on record two additional priorities. Although education and health remain top priorities for the 2019 appropriations, the SoNA has an explicit emphasis on spatial integration, human settlements and local government.

8.5. In the health sector, National Health Insurance implementation remains the key priority. This recommitment to the universal access to healthcare as espoused in the NDP, is commendable. The concern though is that the government is unlikely to meet its delivery targets due to the slow pace of the NHI roll out. It is important that the government improves spending of NHI conditional grants, irons out policy uncertainties regarding the roles of various players in the delivery of health care, and ensures that there is a clear and direct link between filling posts and the implementation of the NHI.

8.6. On education, the 6th administration SoNA underscored the importance of making sure that 10 year old children are able to read and write with comprehension. Internationally, South Africa has not compared well in terms of pupil literacy and numeracy. The Commission cannot overemphasise the need for improved education outcomes especially in the face of acute unemployment rates obtaining in the country and given the country's ambitions to transition into the fourth industrial revolution.

8.7. The land reform program has the potential to create employment, reduce poverty and inequalities. To realise these opportunities inherent in the agriculture sector and the land reform program in particular, the Government should ensure that agriculture support programs need to prioritise small scale commercial agriculture production.

8.8. For sustainable growth, efficient infrastructure delivery is a key imperative. Infrastructure delivery is often undermined by high levels of inefficiency and underspending on the capital accounts of different spheres of government. To improve infrastructure delivery, the Commission has recommended in its 2020/21 submission to the Division of Revenue that infrastructure delivery inspectorates should be established for the local sphere to assess management performance processes and capacity within municipalities to implement grant-funded and non-grant-funded infrastructure projects on a continuous basis.

8.9. As SOCs remain the largest driver of public capital investment, it is important that government realises the returns on such investments. A number of SOCs have large government guarantees while their long-term viability is uncertain. While government guarantees have remained relatively flat, exposure has notably increased, in turn increasing government's contingent liabilities and constituting a risk to the sustainability of the fiscus. Given that guarantees are not exposed to the same level of scrutiny in the budget process as regular spending, the Commission advises that oversight mechanisms of guarantees should be strengthened to reduce the risk of unintended consequences from materialising. As Eskom poses a greater risk to government's contingent liabilities, the Commission is of the view that a clear process, along with timelines, needs to be devised to guide the unbundling of Eskom.

8.10. All these efforts to improve outcomes in health, education, agriculture, infrastructure delivery or in SOCs should be supported by efforts to improve the efficiency and performance of the public service. The reconfiguration and proposal to rationalise the civil service are all efforts in the right direction. To improve public service performance, there is a need to strengthen accountability structures in order for them to effectively hold the executive to account, as well as improve on consequence management. The recent AG report has indicated that weaknesses in accountability structures and lack of consequence management are some of the drivers of poor audit outcomes. In addition, the Commission underscores the importance of benchmarking government operations.

For and on behalf of the Financial and Fiscal Commission

Professor Daniel Plaatjies

Chairperson