Financial and Fiscal Commission

Submission on the 2023 Budget

For an Equitable Sharing of National Revenue

28 February 2023

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1. Budget 2023: Addressing Energy Crisis, Unemployment and Economic Growth

1.1. This submission by the Financial and Fiscal Commission is made in terms of Sections 214, 218, 228, 229 and 230 of the Constitution of the Republic of South Africa (1996) and Section 35 of the Intergovernmental Fiscal Relations (IGFR) Act (1998), as well as S4(4c) of Money Bills Amendment Procedure and Related Matters Act or MBARARMA (Act 9 of 2009), as amended. It comprises the commission's recommendations made to Parliament, provincial legislatures and any other authorities determined by national legislation on financial and fiscal matters in terms of the revenue trends and tax proposals, the Division of Revenue Bill, the Appropriation Bill (including the Second Adjustments Appropriation Bill for the 2022/23 financial year) and the Eskom Debt Relief Bill of 2023.

1.2. During the 2023 State of Nation Address, the President underscored vital issues facing the country with interventions to be undertaken by the government to address them. More specifically, the President acknowledged that persistent load shedding is impeding the economy's recovery and that National Treasury to devise a solution to Eskom's R400 billion debt to reduce the severity of load shedding by purchasing diesel fuel. In this regard, The Eskom Debt Relief Bill attributes to the Vote of the National Treasury: R78 billion for the 2023/24 financial year, R66 billion for the 2024/25 financial year, and R40 billion for the 2025/26 financial year as a loan with conditions to Eskom. At the determination of the Minister of Finance regarding the progress on compliance, these loans can be converted into ordinary shares. In addition, for the 2025/26 financial year, R70 billion of the Eskom debt will be a direct charge against the National Revenue Fund through a debt takeover arrangement as determined by the Minister.

It is worth noting that in 2019, the government had made R23 billion provisional allocation per year to Eskom to service its debts and meet its redemption requirements (2019 Budget Review). In addition, a special appropriation with conditions responsible by the Department of Public Enterprises at R59 billion was allocated to assist Eskom with its financial obligations over the medium term. These experiences raise doubts that adopting the same approach, i.e. special appropriations, even with conditions, to address the structural issues at Eskom would yield a different outcome in 2023.

1.3. The government also made provisions in terms of tax relief towards alleviating the energy crisis at approximately R13 billion in 2023/24, R9 billion of which is to incentivise household rooftop solar for individuals and expansion of section 12B - renewable energy incentive for businesses. The remaining R4 billion is by not adjusting the general fuel levy. However, the 2023 Budget is silent about the President's declaration of the State of Disaster, and no budget response on the expansion of his cabinet by appointing a minister of electricity to the Presidency to oversee all aspects of the electricity crisis response, including the work of the National Energy Crisis Committee.

1.4. The challenge of unemployment continues to be persistent and disproportionately impacts the youth, exacerbating intergenerational poverty and inequality. The President highlighted efforts to mobilise greater levels of investment, which is essential to growing the economy and creating jobs. Contrary to the President's address, the 2023 Budget did not place emphasis on the Employment Tax Incentive, the Social Employment Fund and the National Youth Service to expand employment opportunities.

1.5. To counter the rising cost of living, structural poverty, and hunger, R36 billion has been allocated for the extension of the Covid relief fund for a year. As per the President's address, other existing social grants would be increased to cushion the poor against rising inflation. However, the 2023 Budget did not clarify how to develop a permanent mechanism of targeted basic income support for the most vulnerable within the fiscal constraints. Budget 2023 is equally silent on the persistent underspending of the SRD Grant, which resulted in an R3.7 billion reduction in the 2nd Adjustments Appropriation Bill allocation for Social Development.

1.6. The commission appreciates the adoption of its recommendation made in the previous budget submissions to lower and maintain policy consistency in the personal income tax and corporate income tax regimes. This is to allow households and businesses battered by Covid-19, civil unrest, natural disasters and load-shedding, as well as the system of tax collection and administration at the South African Revenue Service (SARS), to recover and improve efficiency.

1.7. In terms of fighting crime and corruption in the President's address, the 2023 Budget, despite fiscal consolidation, will increase provisions for peace and security to R711 billion. The police budget is increased by R7.8 billion. At the same time, R1.3 billion is added to the budget of the National Prosecuting Authority and R100 million to the Special Investigating Unit for implementing the recommendations of the State Capture Commission and finance increased witness protection measures and establish a digital forensic data centre, amongst other things.

1.8. In line with the 2022 medium-term budget policy statement (MTBPS), the amendment to Section 7 of the Division of Revenue Bill to allow provinces to pledge conditional grants as a means to strengthen state capacity and leverage private sector resources in the delivery of public infrastructure, is continuing with a pilot study. The 2023 Budget attributes the fastest-growing expenditure item by function to community development at 8 per cent over the 2023 MTEF to the additional funding allocated to the Local Government Equitable Share (LGES) and infrastructure, most notably R8 billion is given for the basic component of the LGES. It should be noted, however, that no significant changes were made to the number of households provided for in terms of Free Basic Services, and the 2022 census update has yet to be made available. The increase in the LGES funding is mainly due to the significant rise in electricity approved by NERSA in January, which has impacted the allocation of free basic electricity.

1.9. Broadly in line with the 2022 medium-budget policy statement and the President's state of the nation address, Budget 2023 maintained its balance in nominal terms between the current spending priorities and social obligations while pursuing fiscal sustainability. However, it does not address the real fundamental economic imbalances, inefficiencies, deficiencies and governance failures. The Eskom Debt Relief Bill, which simply absorbs Eskom's debt stock into the fiscus, lacks specific, real conditions on operational improvements, nor has any transformative targets regarding policy, implementation, and performance. In providing the commission's recommendations on the revenue trends and tax proposals, the Division of Revenue Bill, the Appropriation Bill and the Eskom Debt Relief Bill of 2023 in terms of its constitutional mandate, this document is divided into nine sections as follows:

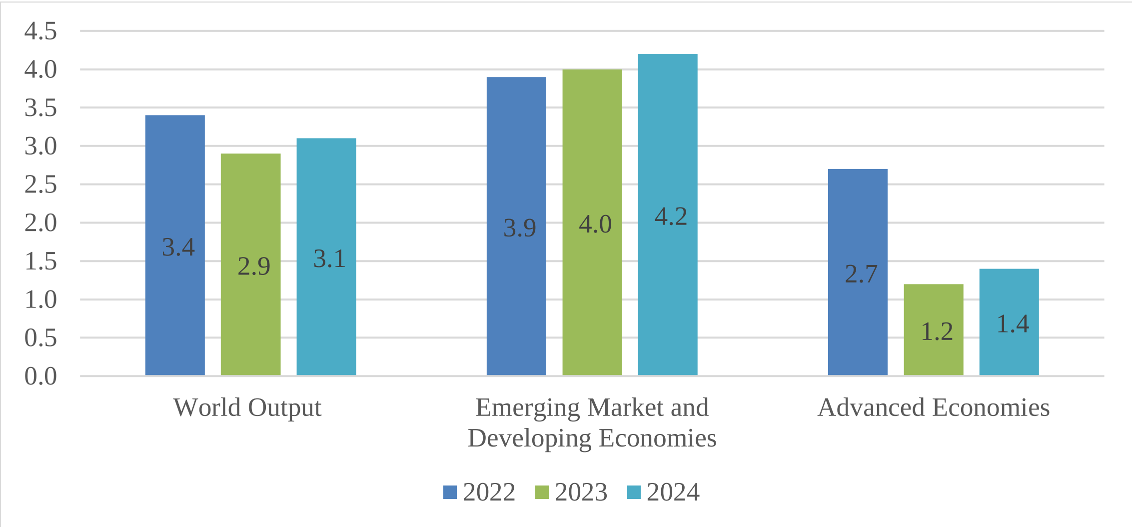
Section 2 provides an overview of South Africa's economic outlook and prospects. This is followed by Section 3, which analyses the overall fiscal framework and revenue proposals underlying Budget 2023. Section 4 focuses on allocations in the national sphere (Appropriation Bill). Sections 5 and 6 assess Budget 2023 in terms of the division of revenue matters pertaining to provinces and local government, respectively. Section 7 looks at the issues related to public institutions and investment. Section 8 concludes.

2. Economic Overview and Prospects

Global Economic Outlook

2.1. According to IMF's World Economic Outlook (2023), global economic growth is set to slow down in 2023 from an estimated 3.4 per cent in 2022 to 2.9 per cent in 2023, then rise to 3.1 per cent in 2024 (see Figure 1). Central banks' interest rate increases to contain price inflation and the conflict between Russia and Ukraine will negatively affect economic activity.

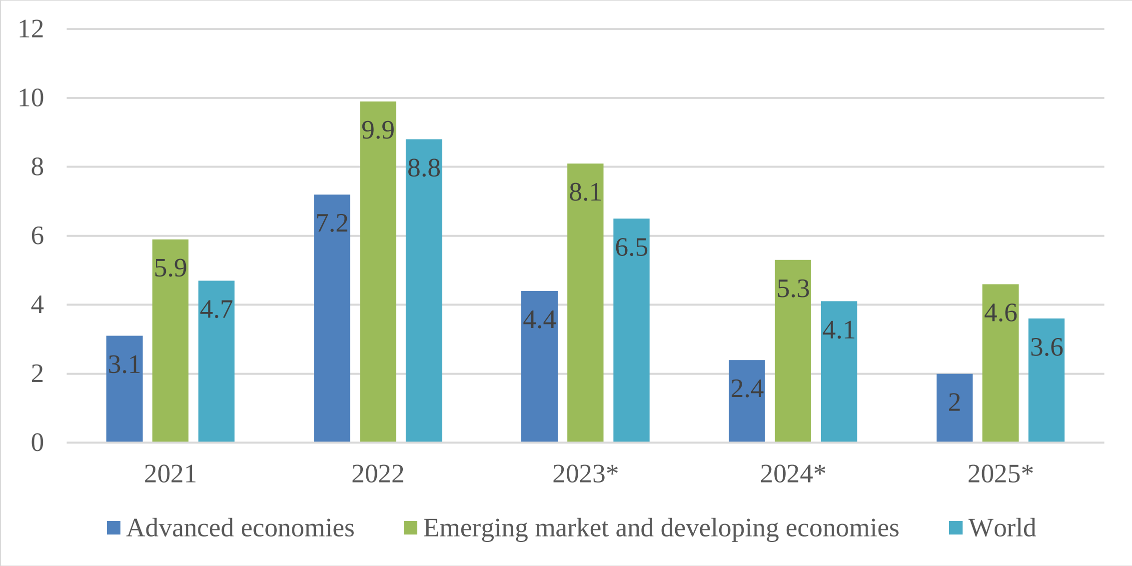
Figure 1: Global economic projections (%)



Source: IMF World Economic Outlook (2023)

2.2. Although the growth trajectory in Emerging Market and Developing Economies (EMDE) remains positive from 3.9 per cent in 2022 to 4.0 per cent in 2023, high debt levels arising from the pandemic, uneven growth patterns and higher borrowing costs exacerbate the downside risk of some of the EMDE.

Figure 2: Inflation rate, average consumer prices (Annual percentage change)



Source: IMF data, 2023

2.3. Inflation over the medium term is expected to remain elevated (see Figure 2), especially on essential items of food and utility, despite marginal declines in prices of fuel and nonfuel commodities, notably in the United States, the euro area, and Latin America.

Domestic Economic Outlook

2.4. Gross domestic output increased by 1.6 per cent in the third quarter of 2022. Expectations are that the fourth quarter of 2022 will show similar improvements, but the improvements in gross domestic output may not continue beyond 2023 as South Africa battles an energy crisis. Given the external uncertainties, growth will likely remain volatile over the medium term. The combination of external and domestic risks means low growth will likely persist and may have a defining impact on the domestic economic outlook and public finances.

Figure 3: Growth in the real GDP, quarter-on-quarter change (%, seasonally adjusted)

Source: Statistics South Africa, 2022

2.5. On the production side of the economy, most industries recovered from the economic downturn in 2020 and the first half of 2021, with the agriculture industry showing a bounce back of 19.2 per cent in quarter 3 of 2022. Transport and finance industries have improved growth performance since the global pandemic, increasing by 3.7 per cent and 1.9 per cent, respectively. Fuel prices continue to skyrocket due to the Russian invasion of Ukraine, and Eskom continues to battle energy supply challenges. International and domestic pressures may constrain future domestic production over the medium term.

Table 1: Industry value added on GDP (% change quarter-on-quarter, seasonally adjusted)

	2020	**2021**				**2022**		
	Q4	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**
Agriculture, forestry and fishing	7.1	6.1	11.3	-24.7	16.4	-2.4	**-11.1**	19.2
Mining	-1.3	4.1	2.0	-1.1	-3.2	-2.1	**-3.5**	2.1
Manufacturing	5.5	0.4	-1.8	-4.3	2.4	5.0	**-5.7**	1.5
Electricity, gas and water	0.5	-0.6	0.6	0.3	-3.1	2.0	**-1.2**	**-2.1**
Construction	2.3	0.2	-1.6	-1.1	-2.6	-0.8	**-2.0**	3.1
Trade, catering and accommodation	1.5	0.9	3.2	-4.4	3.9	3.1	**-1.0**	1.3
Transport, storage and communication	4.6	-2.8	6.7	-1.6	2.9	1.8	2.4	3.7
Finance, real estate and business services	2.8	0.9	-0.5	1.2	-0.7	1.8	2.5	1.9
General government services	0.2	0.2	-0.5	0.3	-0.3	1.4	**-1.5**	0.3
Personal services	1.6	1.0	2.7	0.3	2.5	0.8	0.1	**-1.2**

Source: Statistics South Africa 2022

2.6. Household consumption expenditure is the only component that experienced a decline of 0.3 per cent in quarter 3 of 2022. The decline is likely a consequence of rising food prices in recent months. Net exports contributed 4.2 per cent to growth in expenditure in the third quarter of 2022—the positive contribution results from improved trade in minerals, base metals, vegetables, and paper products. However, the recovery may be limited by persistent power outages, constrained agricultural production, rising prices, and the slow government response to natural disasters.

Table 2: Expenditure on GDP (% change quarter-on-quarter, seasonally adjusted)

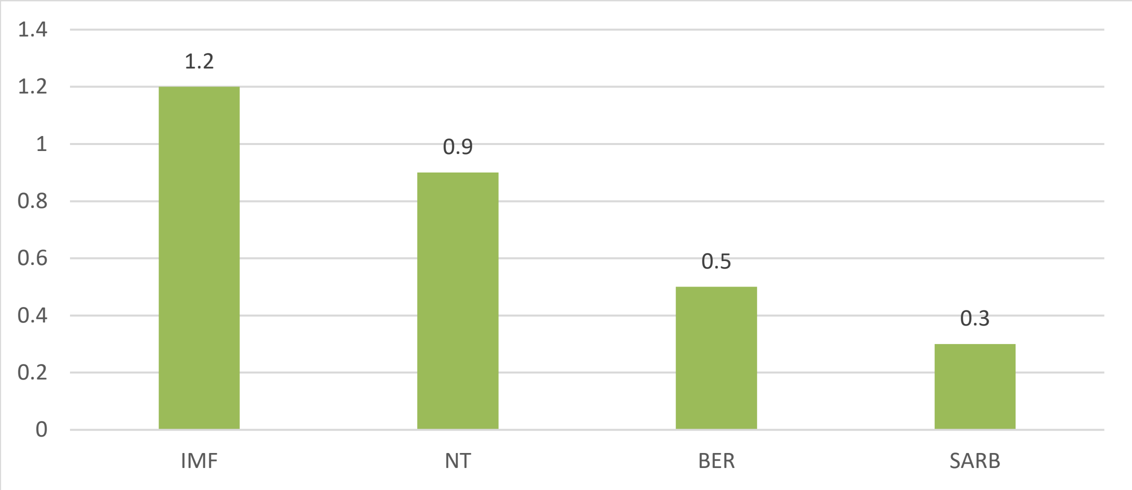
	2020	**2021**				**2022**		
	Q4	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**
Household consumption	3.1	0.5	1.6	-2.8	3.0	1.2	0.6	**-0.3**
General government consumption	0.7	-0.6	0.4	0.5	0.2	1.1	**-0.8**	0.5
Gross fixed capital formation	5.3	-3.1	-0.3	-1.1	1.6	3.4	0.4	0.3
Exports of goods and services	6.1	1.7	3.0	-6.9	8.3	3.8	**-0.2**	4.2
Imports of goods and services	10.9	6.7	0.2	-3.4	8.4	5.1	5.5	0.6

Source: Statistics South Africa 2022

2.7. Growth is expected to remain constrained and low in the current year. The South African Reserve Bank (SARB) revised downward the growth forecast to 0.3 per cent for 2023. Worse assumptions on stable energy provision primarily drive the downward revision by the South African Reserve Bank (SARB). Despite the announcement of the energy support package to assist households and firms struggling with the impact of load-shedding, many sectors of the economy will continue to be negatively affected by the energy crisis. The National Treasury (NT) has forecast growth to be at 0.9 per cent in

2023, reflecting its optimistic assumptions about the work of operation Vulindlela and critical reforms the government is implementing in crucial areas of the economy, particularly energy and transport and the improving state capability. The International Monetary Fund (IMF) forecasts the growth to be 1.2 per cent in 2023. However, power shortages and structural constraints will weigh on South Africa's economic growth over the medium term. The power shortages will offset any progress in addressing any structural rigidities and constrain reforms implemented by the government. Power shortages are likely to delay investment decisions, thus dampening growth.

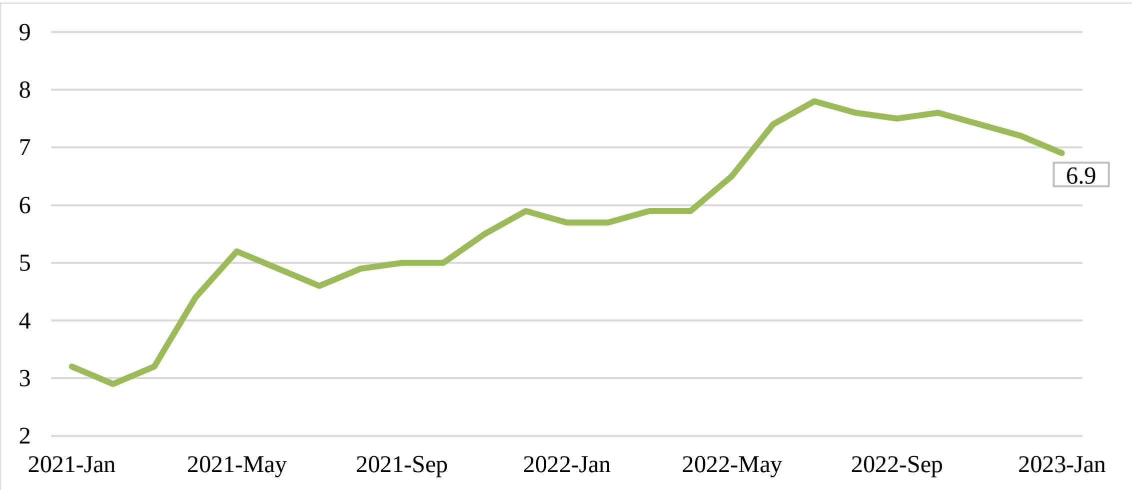
Figure 4: South Africa Growth Rate Forecasts for 2023, per cent



Source: Commission compilation from reports

2.8. The rising price levels present a significant threat to the south African economy. Although the economy was beginning to show a recovery, it was still volatile and susceptible to disruptions. Consumer prices have reached record high levels, breaching the South African Reserve Bank mid-point. Inflation has remained above the SARB mid-point of 6 per cent (see Figure 5). The South African Reserve Bank (SARB) has increased interest rates to stabilise prices. The increase in interest rates will increase South Africa's debt servicing costs, thus requiring the policymakers to strike a balance between growing debt in the face of rising inflation.

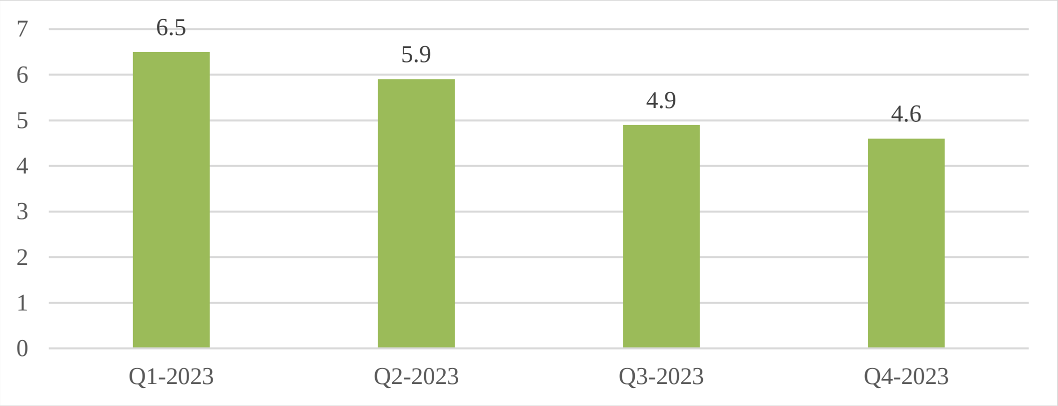
Figure 5: CPI headline year-on-year rates, per cent



Statistics South Africa, 2023

2.9. Inflation is expected to moderate in 2023 as the reserve bank continues to implement monetary policy tightening. The SARB expects headline inflation for 2023 to remain unchanged at 5.4 per cent and is slightly higher at 4.8 per cent for 2024. The SARB expects that monetary policy tightening will bring inflation below the mid-point in the second quarter of 2023 to 5.9 per cent and 4.9 per cent in quarter 3 of 2023. Despite the optimistic forecast by SARB, the risk of inflation remains elevated. The Russia-Ukraine conflict may escalate, load-shedding may have broader price effects on the cost of doing business and living, and administered prices may continue to rise, further fuelling inflation.

Figure 6: SARB forecast headline inflation

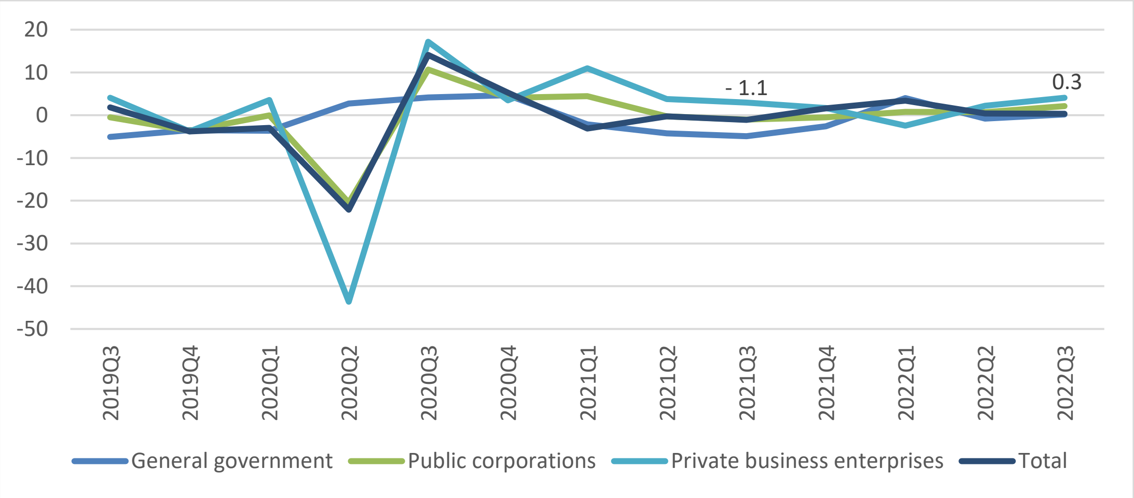


Source: South African Reserve Bank, 2023

Investment

2.10. The levels of fixed investment in South Africa have been muted for a considerable time and continue on a disappointing trajectory. Total gross fixed capital formation improved underwhelmingly post-COVID, moving from negative 1.1 per cent in quarter 3 of 2021 to 0.3 per cent in quarter 3 of 2022. The Presidency and the Development Bank of South Africa are stewarding an investment project drive worth R340 billion in energy, water, transport and telecommunications industries to improve and create infrastructure development. A significant impediment to the progress of infrastructure development remains skills, mismanagement and corruption.

Figure 7: Investment (% change quarter-on-quarter change, seasonally adjusted)



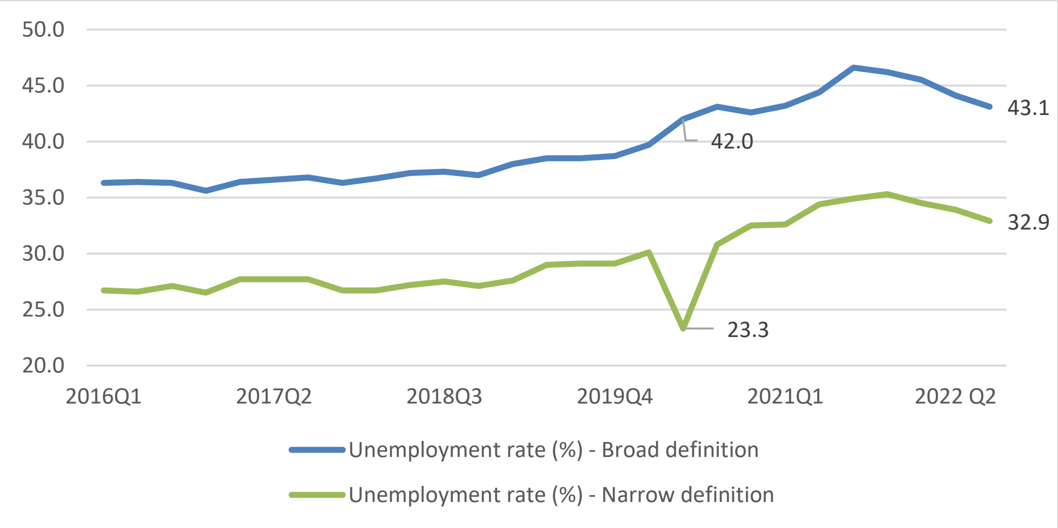
Source: Statistics South Africa, 2023

2.11. The low levels of growth in gross fixed capital formation, particularly that of the general government's contribution, remain a significant challenge and impediment to the long-term recovery of economic growth. On the other hand, boosting private investment by private businesses requires addressing policy uncertainty and fiscal sustainability. The intensity and frequency of power outages in recent months continue to reduce business confidence to unsustainable levels, likely to lead to reduced production and a contraction in the size of the domestic economy.

Employment

2.12. Structural challenges in the labour market and weak economic growth have undermined progress in reducing poverty, unemployment and inequality. Both the expanded and official unemployment rates have continued to decline since 2021. The official unemployment rate went from a record-high 35.3 per cent in the fourth quarter of 2021 to 32.9 per cent in the third quarter of 2022 – a welcomed drop for many South Africans. In the expanded definition of unemployment, unemployment in the third quarter dropped one percentage point from 33.9 to 32.9 per cent compared to quarter 2 of 2022.

Figure 8: Unemployment rate (%)

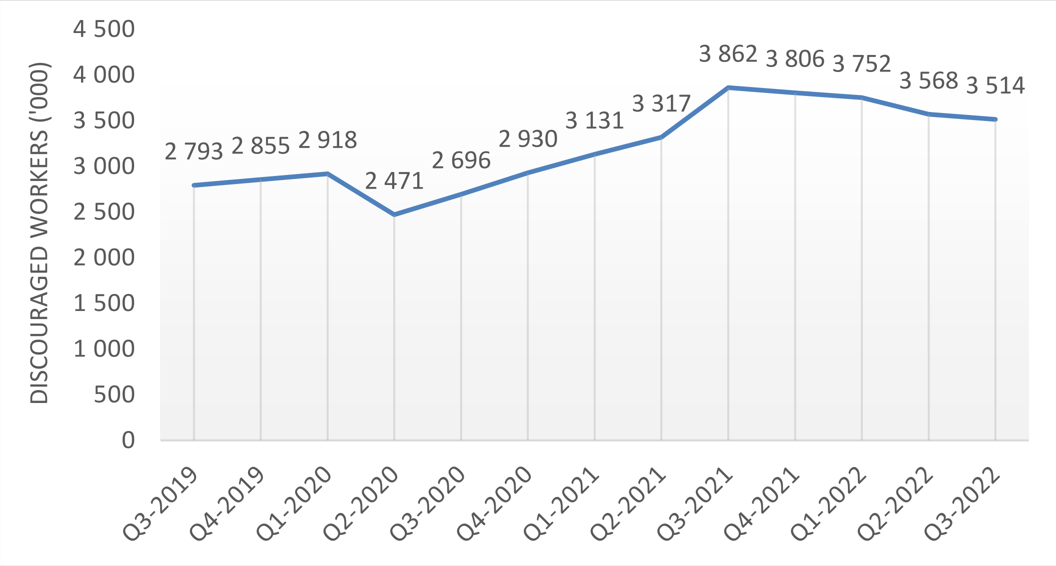


Source: Statistics South Africa (2022)

2.13. Despite the Presidential Youth Employment Initiative and several tax breaks afforded to businesses that employ youth, youth aged 15 to 24 and 25 to 34 years recorded the highest unemployment rates of 59.6 per cent and 40.5 per cent, respectively, in quarter 3 of 2022. A further worrying picture is that 34.5 per cent of youth aged 15 to 24 are not in employment, education or training.

2.14. Figure 9 shows that the number of discouraged workers increased dramatically since the onset of the Covid-19 pandemic, from 2.4 million to 3.8 million within a year from quarter 2 of 2020. Since then, the number of discouraged workers has decreased somewhat to 3.5 million in the third quarter of 2022 but has not yet returned to pre-pandemic levels.

Figure 9: Discouraged Workers



Source: Stats SA QLFS, November 2022

Recommendations

- The commission notes that South Africa will continue on a low growth path over the medium term, and growth still faces risks. The energy crisis adds to existing challenges and offsets the effect of ongoing structural reforms. The commission recommends that the government prioritise resolving the energy challenges as it will impact investment decisions.
- As highlighted in the MTBPS submission by the commission, stimulating growth and economic recovery requires addressing the long-standing structural constraints, supporting growth-inducing activities and eradicating inefficiencies and corruption.

3. Fiscal Framework and Revenue Proposals

Overview of the 2023 fiscal framework

3.1. The 2023 Budget presents improvements in fiscal projections. The estimated budget deficit for 2022/23 lowered to 4.2 per cent of GDP, compared to the previous estimate of 6 per cent of GDP projected in the 2022 Budget. Revenue projections exceed 2022 Budget estimates due to strong collections from personal incomes and corporate profitability. Over the MTEF period, consolidated non-interest expenditure is projected to contract at an annual average of 1 per cent. A consolidated budget deficit of 4 per cent of GDP is projected in 2023/24, narrowing to 3.2 per cent of GDP in 2025/26. Compared to the 2022 Budget, 57 per cent of the higher-than-expected revenue is projected to reduce the fiscal deficit over the next two years. The government is committed to narrowing the budget deficit to achieve fiscal sustainability and debt stabilisation.

3.2. Various pressures over the MTEF period will impact the fiscal position. The poor and inefficient financial performance of State-Owned Entities continues to put pressure on public expenditure. Government debt is projected to increase due to the Eskom debt-relief arrangement. As a result of the Eskom debt relief and increasing market lending rates, debt-service costs will increase from R307.2 billion in 2022/23 to R397.1 billion in 2025/26. A narrowing tax base owing to rising unemployment may weigh on public expenditure and increase the budget deficit and borrowing requirements.

Table 3: Consolidated government fiscal framework, 2023 MTEF

	2022/23	2023/24	2024/25	2025/26
R billion/percentage of GDP	**Revised estimate**	**Medium-term estimates**		
Revenue	**1892.7**	**1958.9**	**2077.8**	**2225.3**
	28.5%	*28.0%*	*27.9%*	*28.0%*
Expenditure	**2168.8**	**2242.6**	**2359.7**	**2477.4**
	32.6%	*32.0%*	*31.7%*	*31.2%*
Budget balance	**-276.1**	**-283.7**	**-282.0**	**-252.1**
	-4.2%	*-4.0%*	*-3.8%*	*-3.2%*
Debt-service costs	**307.2**	**340.5**	**362.8**	**397.1**
	4.6%	*4.9%*	*4.9%*	*5.0%*
Gross Domestic Product (est.)	**6651.3**	**7005.7**	**7452.4**	**7938.5**

Source: National Treasury, 2023

3.3. Table 4 shows that over the MTEF period, capital payments will receive a total allocation of R373.52 billion representing an average growth of 11.5 per cent between 2023/24 to 2025/26. Capital transfers will receive a total allocation of R269.58 billion over the MTEF period, representing an average growth of 7.6 per cent. Compensation of employees will grow by an average of 4.2 per cent over the MTEF period, and the average growth of goods and services will be 4.9 per cent. Compensation of employees makes up the largest component of the current account.

Table 4: Allocations by economic classification

	2022/23	2023/24	2024/25	2025/26	Total 2023 MTEF
R billion	**Revised estimate**	**Medium-term estimates**			
OPERATING ACCOUNT					
Current payments	**1949.90**	**2040.77**	**2097.80**	**2191.32**	**6329.89**
Compensation of employees	690.37	701.17	728.75	760.61	2190.52
Goods and services	292.96	305.19	317.59	335.79	958.57
Interest payments	316.03	349.46	372.38	406.98	1128.81
Current transfers and subsidies	**650.54**	**684.96**	**679.09**	**687.94**	**2051.99**
CAPITAL ACCOUNT					
Capital receipts	0.21	0.31	0.27	0.28	0.86
Capital payments	91.90	110.67	125.23	137.62	373.52
Capital transfers	80.69	82.10	92.45	95.03	269.58
Capital financing requirement	-172.38	-192.46	-217.41	-232.37	-642.24

Source: National Treasury, 2023

Revenue trends and tax proposals

3.4. Tax revenue is forecasted to increase from R1.56 trillion in 2021/22 to R1.69 trillion in 2022/23, reflecting an upward revision of R93.7 billion from the 2022 Budget estimate and R10.3 billion from the 2022 Medium Term Budget Policy Statement (MTBPS) estimate as shown in Figure 10 below. Corporate income tax collections continue to be driven by elevated commodity prices. Increasing earnings and employment levels are boosting personal income tax collection. Import prices are supported by growth in value-added import tax (VAT). Improvements in tax administration are also playing a pivotal role in additional revenue collection.

Figure 10: Budget Revenue, 2019/20-2025/26

Source: National Treasury Budget Review, 2023

3.5. Over the next three years, revenue is forecasted to grow by R351 billion, reaching R2.04 trillion in 2025/26. However, higher revenue collection is closely correlated with economic growth. Since real GDP growth has been revised to 0.9 per cent for 2023 and will average 1.4 per cent in the next three years, revenue collection is likely to be subdued.

3.6. Tax policy has been anchored on protecting the tax base and efficiency-based reforms. Whereas tax incentives have been largely reduced, some have been retained and expanded upon by the 2023 Budget to address specific market failures. The 2023 Budget provides tax relief of R13 billion to enhance the clean energy transition, augment the electricity supply and restrain the negative impact of hikes in fuel prices. Inflation-related amendments have also been instituted to the personal income tax tables, the retirement tax tables, transfer duties and excise duties for alcohol and tobacco.

3.7. The tax incentives to enhance clean energy targeted only solar panels and excluded solar batteries. Individuals can only claim a rebate to the value of 25 per cent, capped at a maximum of R15 000 per individual. These two factors severely limit the impact of this tax incentive and mean that it will only have minimal effect in encouraging individuals to migrate to renewable energy initiatives.

Recommendations

- The Commission welcomes the fiscal framework and revenue proposals of the 2023 Budget. Specifically, the Commission appreciates the adoption of its recommendation made in the previous budget submissions to lower and maintain policy consistency in the personal income tax and corporate income tax regimes. This is to allow households and businesses battered by Covid-19, civil unrest, natural disasters and load-shedding, as well as the system of tax collection and administration at the South African Revenue Service (SARS), to recover and improve efficiency.

4. 2023 Appropriation Bill

4.1. The 2022 Appropriation Bill makes provision for the appropriation of funds from the National Revenue Fund for the state's requirements in relation to the 2023/24 financial year.

4.2. The total appropriation by vote amounts to R1.077 trillion in 2023/24 (or R3.3 trillion over the next three years). This allocation represents a marginal decline of 0.7 per cent when compared to the revised estimate for 2022/23. Looking forward, over the rest of the MTEF period, this reduction is not maintained, with positive, albeit sluggish growth of just under 2 per cent projected for 2024/25 and a relatively stronger 5.1 per cent being projected for 2025/26.

4.3. From an economic classification perspective, the commission notes the following:

i. As expected in South Africa's multilevel, decentralised system of government, the largest spending item for national government is transfers and subsidies, which amount to R1.4 trillion in 2023/24. Sixty-one (61) per cent of transfers and subsidies are comprised of equitable share and conditional grant allocations to provinces and municipalities. In 2023/24, the transfers and subsidies to local government in particular are set to grow by just under 11 per cent. The commission welcomes the emphasis on transfers to the local government sphere as this is where basic services such as water, sanitation, and electricity, are delivered.

ii. In support of government's emphasis on public infrastructure investment as a driver of growth, payments for capital assets is the fastest growing economic classification item in 2023/24. More broadly, over and above payments for capital assets, the national government is projected to spend a total of R157.7 billion on infrastructure in 2023/24 (totalling R507.5 billion over the next three years). The national departments driving this spending in 2023/24 are mainly the Transport (R47.2 billion), Human Settlements (R32.2 billion) and Water and Sanitation (R17.9 billion) votes. The bulk of this amount (on average, 92 per cent) will take the form of transfers to subnational government and other entities which will actually implement the infrastructure projects.

iii. Current payments are projected to increase from R574 billion to R608 billion between 2022/23 and 2023/24. The driver of the growth in current payments is interest, which is expected to grow by 10.8 per cent between 2022/23 and 2023/24. Compensation of employees is projected to decline slightly (by 1.9 per cent) in 2023/24. Of the R45.6 billion allocated to assist with the carry through costs of the 2022/23 public service wage agreement, R14.973 million is budgeted for 2023/24. The bulk of this is to assist provinces (R10.2 billion). National government departments are allocated R4.8 billion in this regard. The commission notes with concern that transfers and subsidies to higher education institutions are projected to decline by 3.7 per cent in 2023/24–this is discussed further below.

Table 5. Growth in Selected Expenditure Items by Economic Classification, 2022/23-2025/26

R million	Revised Est.	Medium-Term Expenditure Estimates			2022/23-2023/24	2023/24-2024/25	2024/25-2025/26
	2022/23	2023/24	2024/25	2025/26			
Current Payments	**574.373**	**607.536**	**643.342**	**689.171**	**5.8%**	**5.9%**	**7.1%**
Compensation of Employees	187.124	183.566	193.274	202.913	-1.9%	5.3%	5.0%
Good and Services	79.881	83.276	86.979	88.925	4.3%	4.4%	2.2%
Interest	307.369	340.694	363.088	397.333	10.8%	6.6%	9.4%
Transfers and Subsidies	**1 346.481**	**1 400.171**	**1 430.858**	**1 503.846**	**4.0%**	**2.2%**	**5.1%**
Provinces	694.598	695.072	720.463	754.672	0.1%	3.7%	4.7%
Municipalities	148.090	164.145	174.556	183.511	10.8%	6.3%	5.1%
Higher Education Institutions	51.873	49.944	56.271	56.921	-3.7%	12.7%	1.2%
Households	247.189	270.246	249.299	265.548	9.3%	-7.8%	6.5%
Payments for Capital Assets	**16.160**	**18.401**	**18.301**	**19.091**	**13.9%**	**-0.5%**	**4.3%**

Source: ENE Summary Table No. 3. National Treasury, 2023

4.4. In absolute terms, the largest appropriation at the national sphere is the **Social Development** vote, which will receive R263 billion in 2023/24. This is followed by the Cooperative Governance vote (at R121.7 billion), Higher Education and Training at R110.8 billion, and the Police vote at R102.1 billion.

i. With respect to Social Development, the allocation for 2023/24 is projected to grow by 8.8 per cent relative to 2022/23. The growth in allocation is driven by the extension of the Covid-19 Social Relief of Distress (SRD) grant, which has been extended again, this time up until 31 March 2024. The extension of this grant for another year is the biggest spending pressure facing the government in 2023/24. To fund this commitment, an additional R36.1 billion is added to the Social Development Vote. As stated in its 2022 MTBPS Submission, the commission's view is that the continuous extension of the grant allows on the one hand, for markets to align themselves with the government's medium-term plan but, on the other hand, it leaves much room for uncertainty, especially among the poor, that rely on social grants to secure their livelihoods. An additional R6 billion is added to this vote to make provision for adjustments to the value of social security grants. The two smallest grants, namely the Child Support Grant and the Grant-in-aid are set to increase slightly more (5.2 per cent) than the rest of the social security grants (which increase by between 5 and 5.1 per cent in nominal terms). No increases are projected for the Covid-19 Social Relief of Distress Grant. Given rising food and other cost of living increases affecting households, the commission advises that government finalises the unresolved issue of sustainable and permanent support for unemployed individuals between the ages of 18 and 59, especially since those individuals that have been able to access the SRD grant have not seen any increase in the value of the grant since its inception.

ii. The allocation to the **Cooperative Governance** Vote is projected to increase by 11 per cent in 2023/24. Additional funding is largely directed at the local government equitable share allocation, which is channelled to municipalities and is aimed at covering the operational and maintenance costs associated with the provision of free basic services to indigent households. The commission welcomes the protection of funding for the delivery of basic services which form an integral part of the social wage package provided to indigent households.

iii. In the 2022 Budget, additional funding of R32.6 billion was allocated via the Department of **Higher Education and Training** (DHET) to the National Student Financial Aid Scheme (NSFAS) for strengthening fee-free higher education through the (1) continuation of bursaries to existing students from households earning below R350 000 per annum and (2) funding for new entrants into the system. The 2022 Budget Review, the 2022 MTBPS and the 2023 SoNA all make reference to the development of a new and sustainable higher education funding model to be introduced in 2023.

Given the strain placed on the fiscus by the fee-free higher education policy, the commission had hoped more information regarding this aspect would have been forthcoming in the 2023 Budget, especially in terms of how the missing middle will be accommodated. However, the budget is silent on this. In terms of the numbers, the overall allocation to the DHET vote is projected to grow by 1.1 per cent. However, an assessment of national spending by economic classification shows that transfers and subsidies to higher education institutions (HEIs) will decline by 3.7 per cent in 2023/24. In this regard, current transfers and subsidies, specifically to technical and vocational education and training (TVET) colleges, will decline from R4.1 billion in 2022/23 to R3.8 billion in 2023/24. In addition, capital transfers to both universities and TVET colleges are projected to see a significant reduction from R4.4 billion in 2022/23 to R1.2 billion in 2024/25. According to the DHET vote in the 2023 ENE, the reduction is a result of (a) shifting a portion of funds to 2024/25 when HEIs are better able to spend and (b) shifting funds for the Community Education and Training (CET) infrastructure. The commission expresses concern about (a) the lack of progress and comments on the new higher education funding model and (b) how the spending reductions will affect TVET colleges in particular.

4.5. Positive growth is projected for allocations to the **Basic Education** vote over the next three years. The commission expresses concern about the poor quality of basic education in South Africa, as evidenced by statistics around the ability of Grade 4 learners to read for meaning. Based on 2016 Progress in International Reading and Literacy Study (PIRLS) data, 78 per cent of Grade 4 learners could not read for meaning. Recent statistics released by the Reading Panel, indicate that this has worsened to an estimated 82 per cent as at 2022. This presents a serious threat to the success and future progression of learners along the human capital pipeline, especially in terms of the quality of the students that will progress to the post-school education and training phase and the effect that this will eventually have on the overall skills profile of South Africa. The commission welcomes the much-needed focus on ECD in the form of the proposed increases to the ECD conditional grant, plans to provide resource packages and to strengthen monitoring and oversight of the DBE over ECD.

4.6. The allocation to the **Health** Vote is projected to decline from a revised estimate of R62.1 billion in 2022/23 to R60.1 billion in 2023/24. This includes a reduction in the health allocation contained in the social wage package, thus implying that free healthcare will be affected by this reduction. Given the backlogs in the health sector (related to, for example, surgery and oncology) exacerbated as a result of the Covid-19 pandemic, the commission advises Parliament to understand how this reduction will impact the poor who rely on the public healthcare system.

Table 6. Allocations and growth for selected national votes

R million	Revised estimate	Medium Term Estimates			Nominal Growth		
	2022/23	2023/24	2024/25	2025/26	2022/23-2023/24	2023/24-2024/25	2024/25-2025/26
Cooperative Governance	109 499.1	121 698.3	129 717.9	136 475.9	11.1%	6.6%	5.2%
Home Affairs	11 096.2	10 863.3	10 508.9	11 010.9	-2.1%	-3.3%	4.8%
Public Works and Infrastructure	8 028.7	8 782.1	9 167.6	9 569.0	9.4%	4.4%	4.4%
Basic Education	29 593.2	31 782.7	33 026.4	34 928.7	7.4%	3.9%	5.8%
Higher Education and Training	109 537.6	110 781.6	121 657.1	125 241.1	1.1%	9.8%	2.9%
Health	62 108.8	60 111.4	62 444.3	65 357.9	-3.2%	3.9%	4.7%
Social Development	241 703.2	263 029.2	242 104.5	258 000.3	8.8%	-8.0%	6.6%
Justice and Constitutional Development	20 482.0	20 793.9	21 599.6	22 541.1	1.5%	3.9%	4.4%
Office of the Chief Justice	1 344.9	1 304.5	1 361.0	1 419.8	-3.0%	4.3%	4.3%
Police	102 555.0	102 137.7	109 065.3	114 920.5	-0.4%	6.8%	5.4%
Agriculture, Land Reform and Rural Development	17 533.6	17 254.3	18 106.2	18 884.7	-1.6%	4.9%	4.3%
Employment and Labour	4 098.3	4 092.2	3 902.4	4 097.5	-0.1%	-4.6%	5.0%
Forestry, Fisheries and the Environment	8 834.8	9 873.6	9 570.3	9 777.8	11.8%	-3.1%	2.2%
Human Settlements	33 415.5	34 942.4	36 292.7	38 074.7	4.6%	3.9%	4.9%
Science and Innovation	9 145.3	10 874.2	10 523.7	10 105.0	18.9%	-3.2%	-4.0%
Small Business Development	2 532.9	2 574.8	2 690.3	2 810.6	1.7%	4.5%	4.5%
Trade, Industry and Competition	10 839.7	10 922.5	10 588.7	11 062.0	0.8%	-3.1%	4.5%
Transport	94 880.9	79 552.4	86 705.4	94 138.3	-16.2%	9.0%	8.6%
Water and Sanitation	16 682.2	22 257.3	24 180.1	25 884.6	33.4%	8.6%	7.0%
Total appropriation by vote	**1 084 609.1**	**1 077 437.8**	**1 097 744.5**	**1 153 439.2**	**-0.7%**	**1.9%**	**5.1%**

Source: ENE Summary Table No. 2. (2023)

4.7. As indicated in the 2023 Budget Review, public infrastructure investment will be relied upon to kickstart economic growth. The 2023 SONA highlighted the importance of infrastructure investment to South Africa's economic recovery, and Budget 2023 reaffirms this stance with strengthened funding towards infrastructure evident across various national votes, notably the departments of Transport and Water and Sanitation. Given the strategic importance of these two sectors to economic growth and development, the commission welcomes the government's plans:

i. The allocation to the **Transport** vote declined from R94.9 billion in 2022/23 to R79.6 billion in 2023/24. According to the Transport Budget vote contained in the 2023 ENE, cuts are to be effected to the Civil Aviation programme and, more specifically, to the Aviation Oversight sub-programme, which is responsible for monitoring the performance of the Airports Company of South Africa (ACSA), the Air Traffic and Navigation Services Company and the South Africa Civil Aviation Authority in line with the legislative framework. The Rural and Scholar Transport subprogramme (located under the Public Transport Programme) is also projected to decline in 2023/24. The commission sees these programmes as critical in ensuring safety in the sector and would advise that cuts should be focussed on non-essential spending items. Notwithstanding the reduced allocation to the Transport vote, this department dominates in respect of infrastructure spending over the next three years (R47.2 billion in 2023/24, R51.5 billion in 2024/25 and R56 billion in 2025/26). The focus will be specifically on the rehabilitation of provincial roads and reducing the rehabilitation backlog on national roads. In respect of provincial roads, spending will be directed via the Maintenance Component of the Road Maintenance Grant, while the South African National Roads Agency (Sanral) will focus on the national roads.

ii. The **Water and Sanitation** vote increases dramatically by 33 per cent between 2022/23 and 2023/24. The increase in resources is driven by planned infrastructure projects relating to water resources and bulk infrastructure.

4.8. Based on the purpose of the departments of **Trade, Industry and Competition** (which is in part to facilitate access to sustainable economic activity and employment for all South Africans), **Employment and Labour** (to play a significant role in reducing unemployment, poverty and inequality) and **Small Business Development** (to lead and coordinate an integrated approach to the promotion and development of entrepreneurship among SMMEs) these three departments, should be at the centre of developments to reignite growth and drive employment in South Africa. An assessment of the budgets and allocation trends characterising these three departments raises questions as to whether they are fit for purpose. For example, when comparing the Small Business Development vote to other strategic departments, it has a relatively small budget of R2.6 billion. In terms of annual average growth trends over the next three years, the Trade, Industry and Competition and Employment and Labour votes are both projected to grow by under 1 per cent per annum.

4.9. According to the Minister of Finance's 2023 Budget speech, significant emphasis will be placed on fighting crime and corruption–this will include funding to increase warm bodies for policing to support the implementation of the findings of both the State Capture Commission and the Financial Action Task Force evaluation. Focussing on the **Police** vote, a marginal decline of under 1 per cent is noted in 2023/24, however growth picks up strongly during the outer two years of the MTEF period, where allocations to the vote are projected to grow by 6.8 per cent and 5.4 per cent in 2024/25 and 2025/25 respectively. The additional resources are partly aimed at funding a trainee recruitment drive whereby 5000 police trainees will be recruited annually over the next three years. Further additional funds are aimed at providing for cost-of-living adjustments. Based on high levels of crime in South Africa, the commission welcomes the emphasis on recruiting additional resources. However, the quality of these institutions must be emphasised to improve.

4.10. The National Development Plan identifies **Science, Technology and Innovation** (STI) as primary drivers of economic growth, job creation and socio-economic reform. To this end, the commission welcomes the strong growth of 18 per cent in the allocation to this vote in 2023/24. According to the STI vote contained in the 2023 ENE, increased funding will be directed at building research infrastructure, which is critical if South Africa intends to build a competitive national system of innovation.

4.11. The **Forestry, Fisheries and Environment** vote sees a strong increase in allocations of just under 12 per cent in 2023/24. According to the 2023 budget vote of this department, the focus of the department over the next three years is to implement the National Waste Management strategy and promote the enactment of the National Climate Change Bill. The commission welcomes these steps as they promote more environmentally friendly and sustainable development.

2022 Second Adjustments Appropriation Bill

4.12. The Minister tabled a Second Adjustments Appropriation Bill which aims to effect adjustments to the appropriation of money from the National Revenue Fund for the requirements of the State in respect of the 2022/23 financial year. The Second Adjustment Appropriation Bill amounts to R9.5 billion and focuses on four aspects, namely:

a. The Budget Speech indicated that the Bill proposes an allocation of R45.6 billion for carry-through costs associated with the 2022/23 public service wage increase. However, the Bill proposes R4.5 billion in assistance to national departments to assist with the carry-through costs associated with the 2022/23 public service wage increase. Wage costs and wage bill settlements remain a serious risk to the fiscus. The commission welcomes work being done by the DPSA and National Treasury so as to propose a single remuneration framework for the public sector.

b. A total of R8.4 billion in bailouts for the following state-owned entities, namely R1 billion for South African Airways (SAA), R2.4 billion for the South African Post Office (SAPO) and R5 billion for the Land Bank. Continued bailouts to underperforming SOEs are fiscally unsound, especially in the current constrained environment.

c. R300 million for the political parties fund. According to the Home Affairs Vote in the 2023 ENE, funds are provided to political parties participating in Parliament and provincial legislatures via the Represented Political Parties' Fund. Allocations to this Fund amount to R157.8 million in 2019/20, R162.7 million in 2020/21, and R166.8 million in 2021/22. With the additional R300 million from the Second Adjustments Appropriation Bill, this Fund will be allocated a total of R642.1 million in 2022/23. While general elections are scheduled to take place in 2024, for the sake of transparency, budget documentation must be clear and specific on the reasons necessitating changes to allocations, especially where changes are significant.

d. R3.783 billion is unspent within the Social Development Vote, specifically in relation to the SRD grant (R3.7 billion) and its associated administrative costs (R83.7 million). The 2023 Budget Review notes that the lower-than-anticipated spending is as a result of improved means testing. The unspent amount effectively reduces the Second Adjustments Appropriation Bill from just over R13 billion to R9.5 billion.

Recommendations

With respect to the 2023 Appropriation Bill:

- The commission appreciates the government's efforts to balance the protection of the social wage package (the extension of the SRD grant and increased funding for the delivery of basic services such as water and sanitation) alongside the provision of growth-inducing allocations to public infrastructure investment and funding additions to fight crime and corruption.
- As part of its oversight efforts, Parliament must seek to understand how strategic departments will absorb reductions in their budgets and further how the reductions are likely to affect service delivery. Here focus should be placed on, amongst others, the departments of health, transport and the DHET. Departments must, as far as possible, ensure that reductions are applied to non-essential spending items.
- Timelines need to be devised for the finalisation of new funding framework for the higher education sector. During Budget 2022, MTPBS 2022 and the 2023 SONA, the new funding framework was discussed. A lack of continuity on this issue is observed as no mention is made of this aspect in the 2023 Budget.

With respect to the Second Adjustments Appropriation Bill for 2022/23:

- Specifically, on the bailouts to the three SOEs, the commission's stance remains unchanged in that it fundamentally views bailouts as fiscally unsound and, as recommended in its submission on the 2022 Special Appropriation Bill, the government must devise systems of accountability and measures of control to mitigate SOEs from indulging in moral hazard behaviour. It is worth noting that the pre-conditions and conditions required for bailouts, including financial and operational reporting by the SOEs, have been implemented with limited outcomes.
- In the spirit of accountability and oversight, future bills must be accompanied by more information and an explanation of the proposed adjustments. The level of information currently available in the 2023 ENE and the 2023 Budget Review documents prevent a thorough analysis and understanding of the rationale underpinning the adjustment decisions taken. To this end:
  - Parliament must exercise oversight with more information on what necessitated the additional R300 million allocated to the Represented Political Parties' Fund, which grows significantly from R166.8 million in 2021/22 to R642.1 million in 2022/23.
  - At the time of the first Adjustment Bill tabled in October 2022, R1.8 billion was unspent due to a lower-than-anticipated take-up of the SRD grant due to more stringent grant eligibility criteria being applied. The Second Adjustment Appropriation Bill reduces the Social Assistance programme and specifically the SRD grant by a further R3.7 billion, again as a result of improved targeting. In light of the persistent unemployment and worsening socio-economic conditions that prevail and which disproportionately affects poor households, the commission is concerned about the progressive erosion in

the number of people that are accessing this grant as a result of the tightening of the eligibility criteria.

5. 2023 Division of Revenue Bill – Provinces

Overview of provincial government allocations

5.1. Table 7 below depicts the trajectory of the provincial fiscal framework from 2021. Over the 2023 MTEF, the total provincial allocation is R2.2 trillion increasing from R2 trillion in the 2022 MTEF. This represents a nominal growth of 9.5 per cent.

5.2. The total allocation for provinces in 2022 budget for 2022/23 was R658.4 billion and was revised upwards to R684.5 billion in 2022 MTBPS and was driven mainly by adjustments made both in the equitable share and conditional grants mainly because of disasters and human resources and training.

5.3. For 2023/24, the 2022 MTBPS projected a total allocation of R684.4 billion for provinces (R556.4 billion equitable share and R128.0 billion for conditional grants). In the 2023 budget, the total allocation for provinces has been revised upwards to R694.0 billion (an additional allocation of R9.6 billion). Adjustment is mainly on the provincial equitable share to accommodate the 2022/23 public servants wage increase costs. A total of R31.1 billion has been added for employee compensation over the 2023 MTEF.

Table 7. Provincial fiscal framework trajectory from 2021/22

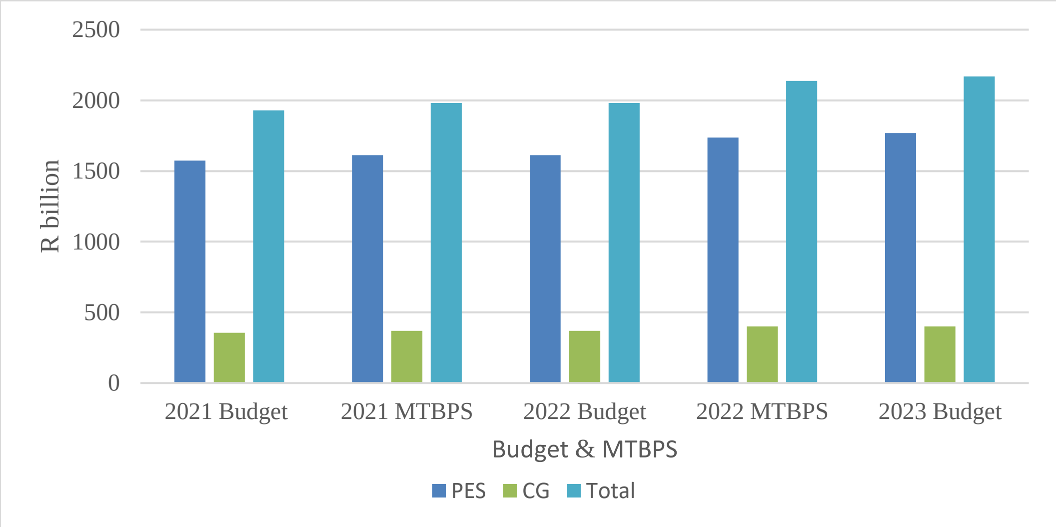
R billion	2021/22	2022/23	2023/24	2024/25	2025/26	2023 MTEF
2021 budget						
PES	523.7	524.1	525.3			1 573.1
Conditional grants	115.8	119.3	121.5			356.6
Total	**639.5**	**643.4**	**646.8**			**1 929.7**
2021 MTBPS						
PES	544.8	538.8	525.3	548.9		1 613.0
Conditional grants	116.4	119.6	121.9	127.2		368.7
Total	**661.2**	**658.4**	**647.2**	**676.1**		**1 981.2**
2022 budget						
PES	544.8	538.8	525.3	548.9		1 613
Conditional grants	116.4	119.6	121.9	127.2		368.7
Total	**661.2**	**658.4**	**647.2**	**676.1**		1 981.7
2022 MTBPS						
PES		560.8	556.4	576.5	602.9	1 735.8
Conditional grants		123.7	128.0	133.0	140.4	401.4
Total		**684.5**	**684.4**	**709.5**	**743.3**	**2 137.2**
2023 Budget						
PES		**570.9**	567.5	587.5	614.3	1 769.3
Conditional grants		**123.7**	127.5	133.0	140.4	400.9
Total		**694.6**	**694.0**	**720.5**	**754.7**	**2 170.2**

Source: Budget Review, 2021, 2021 and 2023.

5.4. Figure 11 gives a graphical depiction of provincial allocations. The upward adjustments made in the 2022 budget, 2022 MTBPS and 2023 budget in the provincial allocations have been mainly to cover the compensation of employees and to restore infrastructure damaged by natural disasters, not for service delivery. Therefore, there have not been significant adjustments for the actual services delivery, population growth and inflation.

5.5. While the commission supports funding for repairs and maintenance of infrastructure damaged by floods, it is of the view that emphasis should be given on adaptation strategies to address natural disasters.

Figure 11. Total provincial MTEF allocations - PES and conditional grants

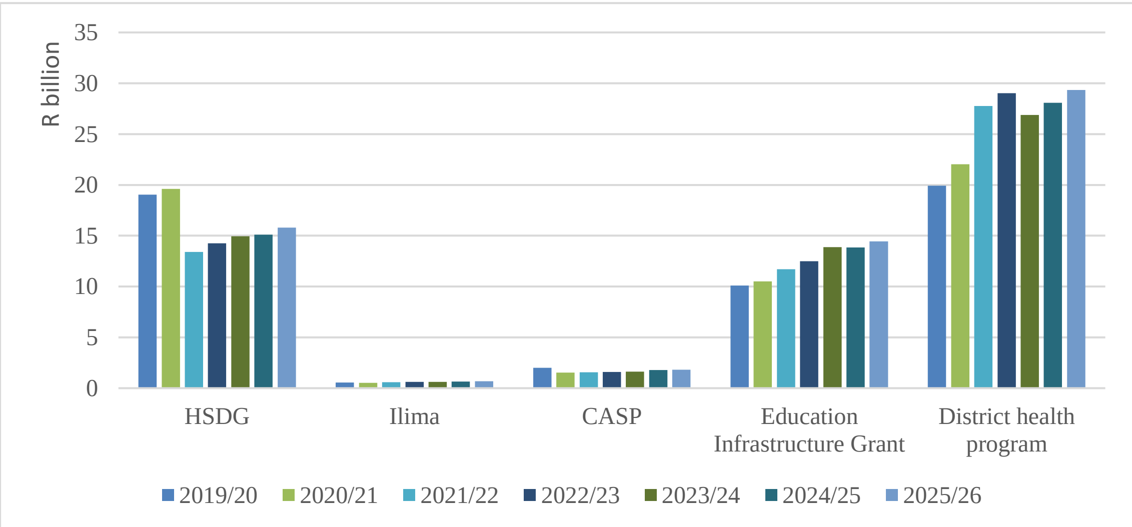


Source: Budget Review, 2021, 2021 and 2023

Conditional grants for provinces

5.6. The total provincial conditional grants allocation for the 2023/24 financial year amounts to R127.5 billion, increasing from R123.7 billion in the 2022/23 financial year (representing a nominal increase of R3.8 billion, an increase of 3.1 per cent).

Figure 12. Key provincial conditional grant allocations



Source: Budget Review, 2019/20 – 2025/26; FFC Own Calculations

5.7. Figure 12 depicts the growth trajectory of selected key provincial conditional grants. The human settlements development grant (HSDG), which experienced a significant reduction in 2021/22 (from R19.6 billion in 2020/21 to R13.4 billion in 2021/22), has been allocated R45.9 billion over the 2023 MTEF. While the allocation for the HSDG has increased from R13.4 billion in 2021/22 to R14.3 billion in 2022/23 and is projected to increase to R14.9 billion in 2023/24, allocation remains far below the 2020/21 allocation of R19.6 billion. This implies a continued reduced pace of reducing housing backlogs and improving housing and living conditions for poor households. Furthermore, it should be noted that allocation for 2023 also includes R523.3 million added to HSDG from the provincial emergency housing grant.

5.8. The commission also notes with concerns the shifting of provincial emergency housing grants from provinces to the National Department of Human Settlements from the 2023/24 financial year as it is of the view that provinces are better placed to understand and implement the necessary supports closer to the emergencies.

5.9. Ilima/Letsema and Comprehensive Agricultural Support Programme (CASP) exhibit steady growth over the 2023 MTEF, while Education Infrastructure Grant shows a slight decrease in the allocation for 2023/24. Over the 2023 MTEF, the Education Infrastructure grant is allocated R42.1 billion.

5.10. District health programme which is for HIV/AIDS, TB, Malaria and Community Outreach, has shown a decline in 2023/24 to R26.8 billion from R29.0 billion in 2022/23 (a decrease of 7.6 per cent). The commission is concerned with this reduction of funding given the expanded and important role of the grant as it supports HIV/AIDS prevention programmes and specific interventions, which include counselling and testing, prevention of mother-to-child transmission, ARV treatment and home-based care.

Recommendations

- The commission notes with concern the 7.6 per cent decrease in the district health program and recommends that the Department of Health elaborate on how it would likely affect service delivery and management, given the expanded scope of the district health program.
- While the commission supports funding for emergency housing needs due to flooding, it reiterates its previous recommendation that the provinces and municipalities should develop and implement adaptation and mitigation strategies to address natural disasters in the long term.
- The commission notes with concern the shifting of provincial and municipal emergency housing grants to the national department of human settlements. The commission recommends that shifting conditional grants from provincial and local government spheres to the national sphere should be the last resort as lower spheres of governments are better positioned to understand delivery needs.

6. 2023 Division of Revenue Bill – Local Government

Overview of local government allocation

6.1. Local government is faced with numerous challenges. One of these challenges is the political environment in that municipalities find themselves. The results of the 2021 elections were that 66 (31 per cent) of the 213 contested municipalities had hung councils. These have resulted in many parties forming a coalition council. Even though there are advantages to these alliances, it is also fraught with many disadvantages and has resulted in many service delivery disruptions (FFC, 2021). Many calls for interventions have been made to develop strategies to help strengthen the local sphere.

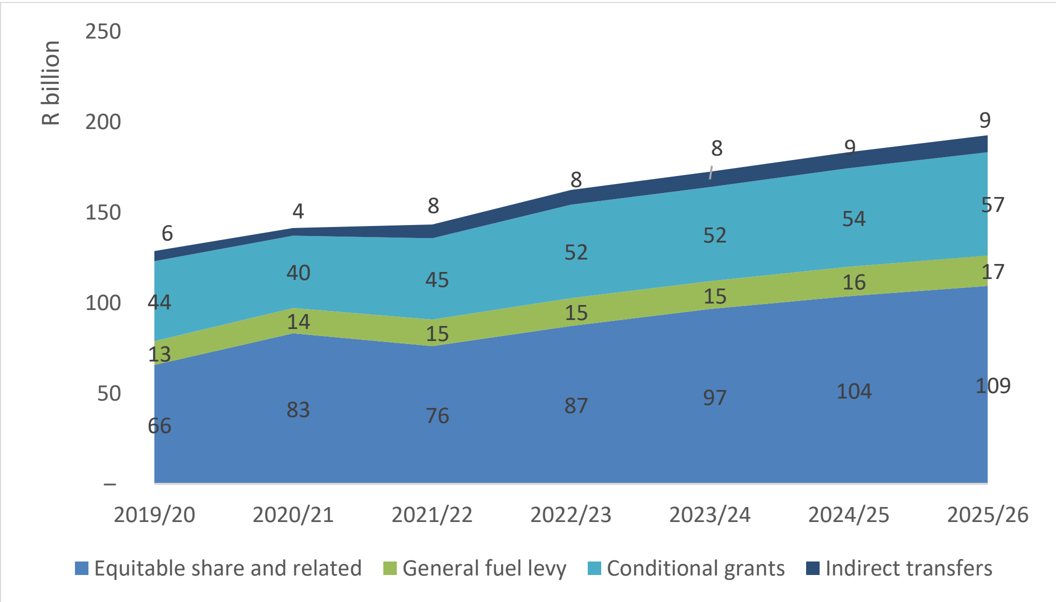
6.2. To assist municipalities with their developmental role and improve service delivery, municipalities need to strengthen municipal finance and investments with support from both national and provincial governments. This will aid in cohesive planning between the three spheres of government to achieve the country's growth goals. Resulting in broader economic activity and reversing current unemployment trends by promoting social and economic development activities.

6.3. Given the insufficient capacity and the other insurmountable challenges engulfing local government, the commission notes the ongoing work being completed in reviewing the conditional grant system and supports the government's endeavours in supporting municipalities.

Local government equitable share and formula

6.4. Over the 2023 MTEF, the local government sphere is set to receive total transfers amounting to R512.7 billion in direct transfers and R26.6 billion in indirect local government conditional grant transfers. The allocation through the local government equitable share (LGES) is R301.417 billion, R163.589 billion as conditional grants, and R48.409 billion as fuel levies. Figure 13 below illustrates the various allocations to local government. The vertical division of revenue share of local government allocations is expected to increase over the MTEF, from 9.7 per cent in 2023/24 to a double-digit of 10.1 per cent in 2024/25 and 2025/26.

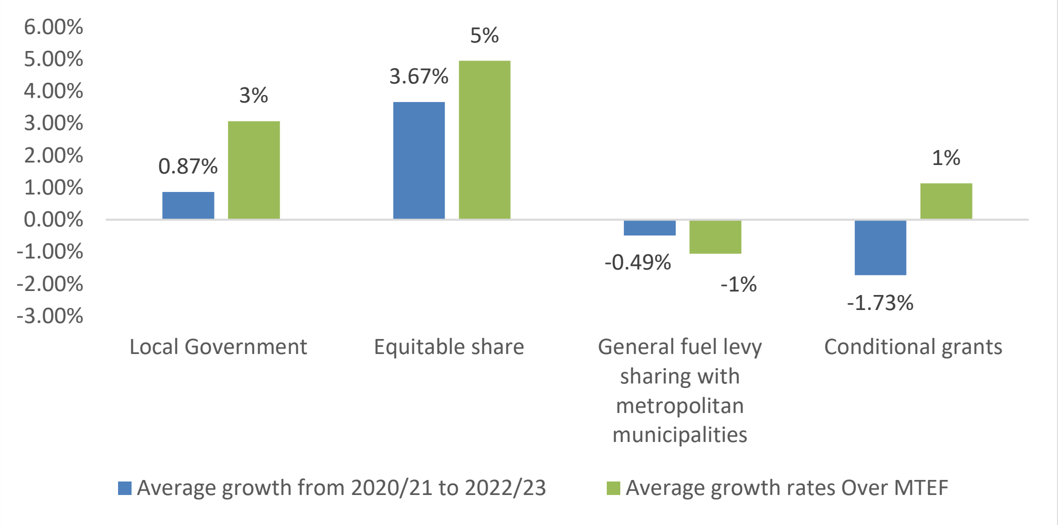
Figure 13: Allocation to Local Government, 2019/20-2025/26



Source: National Treasury Database, 2023

6.5. Figure 14 below shows that the increase in LGES allocation is the main driver behind the positive real growth of 3 per cent. The commission welcomes the government's efforts to keep LGES growth rates positive in real terms.

Figure 14: Local government average real growth rates



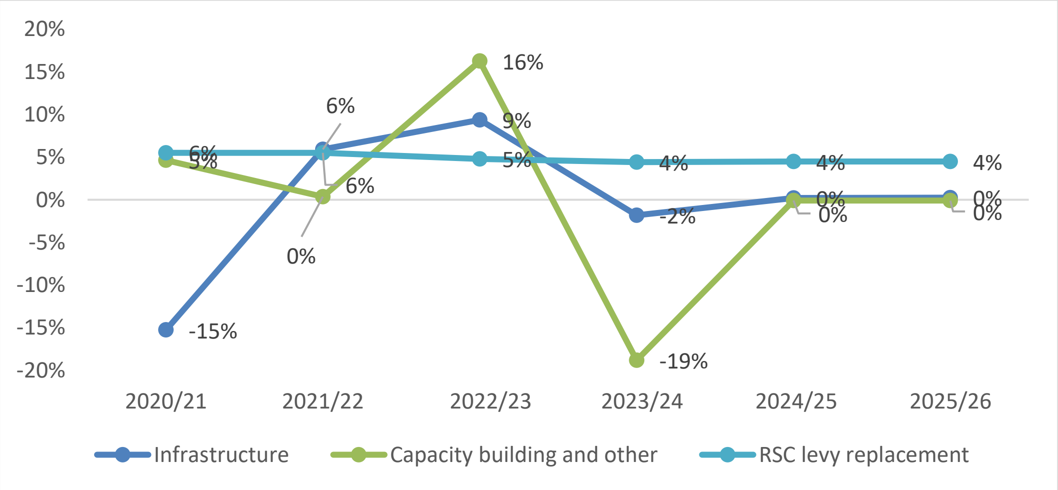
Source: National Treasury Data Base; FFC Own Calculations

6.6. District municipalities are the recipients of the RSC replacement grant funding. Since 2019/20, the annual growth rate has been a 3:1 ratio between C2 and C1 municipalities. The commission 2023/24 DoRA annual submission highlighted that this approach is skewed and, in certain instances, under-allocated funds to district municipalities. The commission notes that National Treasury will equalise the growth rates for this allocation to C1 and C2 municipalities and that this will be an interim solution until the review of Section 84 of the Municipal Structures Act is finalised.

Local Government Conditional Grants

6.7. The local government sector is set to receive R163.589 billion as direct conditional grants and R26.6 billion in indirect grants over the 2023 MTEF, with infrastructure grants accounting for 95.7 per cent of the allocations and capacity grants at 4.3 per cent. Figure 15 below compares the real growth rates of infrastructure and capacity grants with the local government equitable share allocations. The results show a steady decline in real growth rates of the municipal conditional grants in 2023/24, with no growth in the outer years of the MTEF.

Figure 15: Real growth rate in the three local government transfer windows



Source: National Treasury Data Base; FFC Own Calculations

6.8. Over the 2023 MTEF, COGTA will provide support to municipalities that experience project implementation challenges. This support is through the indirect component of MIG, where the department will appoint an implementation agent to implement the identified infrastructure projects for the municipalities. Municipalities are identified based on the previous four years' expenditure performance below 70 per cent of the main allocation. The FFC notes that additional work is still required on monitoring and evaluation of this new component to improve transparency. In addition, COGTA needs to advise on the process for the future implementation of infrastructure projects.

6.9. The commission notes the discontinuation of the Municipal Emergency Housing Grant, and the funding will be shifted to the National Department of Human Settlement in an attempt to broaden its scope and allow flexibility and timely response to housing emergencies. In principle, the commission supports this approach by the government as it gives the department flexibility in carrying out its mandate related to the emergency housing programme and is in line with the commission's stance on the proliferation of grants in the intergovernmental system.

6.10. The commission welcomes additions to the baseline on direct conditional grants are noted; on Urban Settlement Grant (R2.2 billion), Public Transport Network Grant (R461 million), and Regional Bulk Infrastructure Grant (R3.85 billion) over the 2023 MTEF as they are key to service delivery and boosting economic growth.

Recommendations

- The FFC recommends that the review of capacity-building and infrastructure grants consider that capacity-building efforts are comprehensively consulted with and agreed to with a municipality; it should link capacity-building actions to a municipality-specific diagnosis of capacity challenges or deficits. It should consider the consolidation of local government conditional grants into an integrated financial flow.

- The commission notes the proposed increase in the total allocation to the local government's equitable share over the medium term. However, the FFC would like to reemphasise the previous recommendation of fundamentally reviewing the local government transfers, especially from the perspective of the vertical division of revenue. This review should also include a proper re-examination of the assumptions used in the local government White Paper.

- The FFC would like to stress the need to determine the roles and functions of the role players in the District Development Model and the funding requirements/responsibilities to eliminate any ambiguity.

7. Public-sector institutions and investment

Guarantees to state-owned entities (SOEs)

7.1. SOEs continue to face considerable hurdles in fulfilling their developmental mandates. The challenges they encounter entail, among other things, a lack of clarity in objectives, a multiplicity of mandates within their business models, improper costing of mandates, complex and decentralised oversight model, governance interference manifested in political appointments of boards and senior management, non-adherence to international best practices in corporate governance dictates, severe breaches of procurement policies, and weaknesses in oversight by line ministries and SOEs boards.

7.2. The SOEs reflect weak financial performance. Most of the major SOEs experienced sharp declines in the value of their assets, which constitutes a fiscal risk for the government as they require fiscal transfers to cover their losses and recapitalise their balance sheets.

7.3. In 2022/23, total contingent liabilities are projected to reach R1.07 trillion, of which R590 billion will be government guarantees to SOEs. It is worth noting that contingent liability relating to SOEs has risen from R84.4 billion in 2008/09 to R590.3 billion in 2022/23.

7.4. The government will service over R184.4 billion of Eskom's debt in the next three years and take up to R70 billion of Eskom's debt in 2025/26. Consequently, the gross borrowing requirement will accelerate from R515.6 billion in 2023/24 to R555 billion in 2025/26. Any guaranteed debt settled as part of the debt-relief arrangement will reduce government guarantee exposure to Eskom. This exposure is expected to decline by R118.9 billion by the outer year.

7.5. As a result of Eskom's debt relief measures, total contingent liabilities are projected to decelerate to R1.02 trillion and R904 billion in 2024/25 and 2025/26, respectively. Similarly, government guarantees to SOEs will decelerate from R516 billion in 2024/25 to R410 billion in 2025/26, as shown in Figure 16 below. However, government guarantees to SOEs remain very high, accounting for over 50 per cent of total contingencies in 2023/24 and 2024/25. Contingent liabilities are increasingly driven by government guarantees to SOEs, constituting a significant risk to the fiscus, particularly when SOEs' weak financial and operational performance.

Figure 16: Contingent Liabilities and government guarantees to SOEs, 2012/13-2025/26

Source: National Treasury Budget Review, 2023

7.6. Whereas government guarantees to public institutions are forecasted to decelerate by R81.4 billion to R478.5 billion by 31 March 2023, the government's guarantee exposure will accelerate by approximately R800 million and reach R396.1 billion. Government exposure to state-owned enterprises is very high, particularly to Eskom. The government's guarantees exposure to Eskom, increased from R298 billion in 2020/21 to R337 billion in 2022/23. The total government guarantee exposure is forecasted to increase from R385 billion in 2020/21 to R396 billion in 2022/23, as shown in Table 8 below.

Table 8: Government guarantees and exposure to SOEs, 2019/20-2022/23

R billion	2020/21		2021/22		2022/23	
	Guarantee	Exposure	Guarantee	Exposure	Guarantee	Exposure
Public institutions	581.6	384.7	559.9	395.3	478.5	396.1
Eskom	350.0	298.3	350.0	313.0	350.0	337.8
SANRAL	37.9	37.4	37.9	42.0	37.9	28.6
Trans-Caledon Tunnel Authority	43.0	13.2	25.0	9.6	25.0	8.7
South African Airways	19.1	6.7	19.1	2.8	19.1	0.3
Land and Agricultural Bank of South Africa	9.6	2.4	9.6	1.9	8.1	0.4
Development Bank of Southern Africa	10.0	4.9	9.9	5.2	9.9	5.5
Transnet	3.5	3.8	3.5	3.8	3.5	3.8
Denel	6.9	3.4	3.4	3.5	3.4	0.3
South African Express	0.2	0.0	0.0	0.0	0.0	0.0
Industrial Development Corporation	0.5	0.1	0.5	0.1	0.5	0.1
South African Reserve Bank	100.0	13.7	100.0	12.8	20.0	10.0

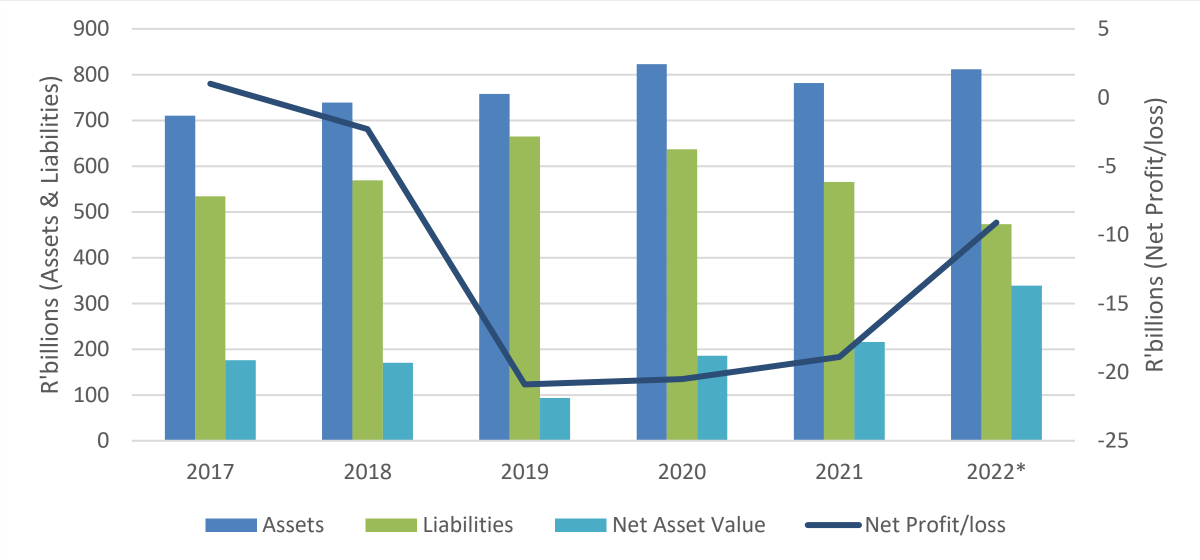
Source: National Treasury Budget Review, 2023

7.7. The high level of government guarantees is mainly attributed to SOEs' poor governance; inappropriate business models, policy uncertainty; costly policy decisions. The failure to address the problem source when financing decisions are made translates into ill-advised guarantee support. The government is continuously confronted by consecutive guarantee applications and financing requests with no tangible results to justify them. Consequently, government guarantees have continued while the SOEs' financial performance has deteriorated. This unhealthy virtuous cycle has been reoccurring as weak SOEs' financial performance has led to more government guarantees to SOEs ensuing in higher fiscal vulnerability, higher financing costs, and deteriorating credit rating outcomes.

Eskom

7.8. The financial health of Eskom, as measured by key financial ratios, reflects weak economic performance. The earnings before interest, taxes, depreciation, and amortisation (EBIDTA) margin for Eskom, which measures its operating profit as a percentage of its revenue, declined from 25.57 per cent in 2018 to 16.06 per cent in 2021, implying that Eskom's operating costs are very high compared to total revenue. The latest EBIDTA calculated using Eskom interim results for the six months ended 30 September 2021 shows a significant improvement to 33.22 per cent. The debt-to-equity ratio for Eskom, which measures the degree to which a company is financing its operations through debt as opposed to own funds, increased from 2.77 in 2018 to 3.5 in 2019 and remained high at 2.25 in 2021. This means that Eskom uses more debt than equity to fund its business. Eskom's net loss increased from R2.3 billion in 2018 to R20.9 billion in 2019. It remained high at R20.5 billion in 2020 before marginally declining to R18.934 billion in 2021 until its net loss at R12.3 billion in 2022.

Figure 17: Asset, liabilities and profit/loss margins for Eskom, 2017-2022



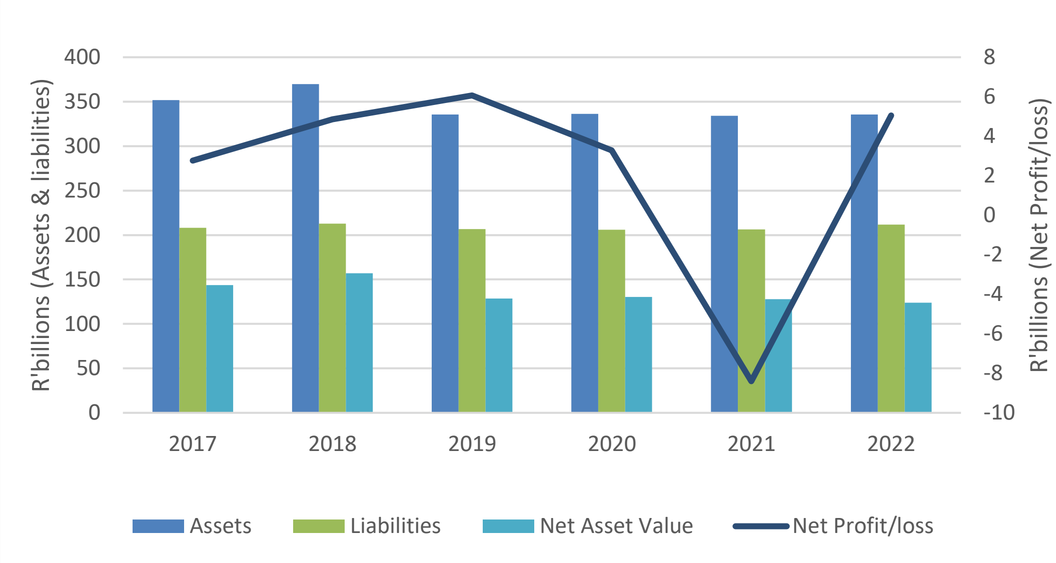
Source: Eskom Annual Reports, various editions
Note: *2022 figures are based on Eskom interim results for the six months ended 30 September 2021

Transnet

7.9. Transnet is a prominent player in the freight logistics industry and the transportation of goods in South Africa and some parts of Africa. Transnet is beset by historical and structural challenges, paramount of which is the disproportionate transport demand requirements of inland mining deposits far from the ports. Its core mandate is to provide ports, rail, and pipeline infrastructure operations efficiently. The financial health of Transnet, as measured by key financial ratios, also reflects weak economic performance as the profitability and solvency ratios are deteriorating. The EBIDTA margin for Transnet decreased from 45.6 per cent in 2019 to 28.9 per cent in 2021, reflecting less profitability. The debt-to-equity ratio increased from 0.43 in 2018 to 0.49 in 2019, implying that Transnet increasingly uses debt than equity to fund its business. It improved marginally to 34.3 in 2022.

7.10. Transnet's operational performance has declined recently, and its financial position remains marginally constrained. Over the four-year horizon between 2017 and 2021, Transnet's net value decreased from R143 million to R129 million. Transnet posted a net loss of R8.4 billion in 2020/21. In 2022, Transnet made a profit of R5 billion, resulting primarily from higher revenue as the economy recovered and a reduction in recognised third-party claims related to litigation or customer claims. The Special Appropriation Act (2022) provided Transnet with R2.9 billion to accelerate locomotive repair and maintenance. The Adjustments Appropriation Act (2022) further provided R2.9 billion to Transnet to restore infrastructure damage caused during the April 2022 floods in KwaZulu-Natal, and this work is underway. The 2023 Budget provides conditional in-year allocations to Transnet to reduce contingent liabilities and enable the railway entity to support economic growth.

Figure 18: Asset, liabilities and profit/loss margins for Transnet, 2017-2022



Source: Transnet Annual Reports, various editions

Denel

7.11. Denel is an aerospace and military technology conglomerate and the largest of South Africa's state-owned arms companies. Despite government support, Denel remains financially distressed and unable to fulfil its financial obligations. It was declared insolvent in 2021 with an accelerated debt of R3.4 billion. The severe liquidity state and the absence of sovereign support have led to a further credit rating downgrade. The government provided R3.4 billion to Denel through the Special Appropriation Act (2022) with set conditions relating to implementing its turnaround plan and clarity on a sustainable business model. These funds can only be disbursed if Denel substantially meets the conditions before the end of March 2023.

South African Airways

7.12. South African Airways (SAA) is the flag carrier airline of South Africa. The 2020 budget allocated R16.4 billion to SAA over the 2020 medium-term expenditure framework period for state-guaranteed debt and interest costs. To implement the business rescue plan, an additional R10.5 billion was allocated to SAA in the 2020 MTBPS. The partial sale of SAA is yet to be finalised, subject to the approval of R3.5 billion to settle historical liabilities by the National Treasury. SAA exited business rescue in April 2021 and restarted domestic and regional operations. It has not submitted financial statements for the most recent year. The government has significantly reduced its contingent liability exposure to SAA, and the airline is expected to no longer require government guarantees by the end of 2022/23. An additional R1 billion will be allocated during 2022/23 to assist SAA with any outstanding obligations from the agreement reached between the rescue practitioners and the airline's creditors.

Development Bank of Southern Africa

7.13. The Development Bank of Southern Africa (DBSA) funds large-scale infrastructure projects. It generated a net profit of R3.8 billion in 2021/22, reflecting an improvement to the R1.4 billion profit for 2020/21. The improved profitability is primarily attributed to increased net interest income as domestic interest rates rose. The bank experienced a 64 per cent decline in approved loans from R39.7 billion in 2018/19 to R14.4 billion in 2020/21. The DBSA sovereign credit rating downgrades in 2020 increased the bank's funding cost. Disbursements declined to R13.5 billion in 2021 from R15.4 billion in 2019/20. Whereas the bank achieved 95 per cent (R12.9 billion) of its disbursement targets of R13.5 billion, it only achieved 6 per cent (R44 million) of its R700 million disbursement target for under-resourced municipalities.

Industrial Development Corporation

7.14. The Industrial Development Corporation (IDC) funds industrial development and enhances economic integration across the continent. It improved its profitability and liquidity in 2021/22. It increased its loan disbursement to R7.2 billion, reflecting an increase of 14 per cent compared with 2020/21. In supporting businesses affected by the outbreak of public violence in July 2021 and the KwaZulu-Natal floods in 2022, the IDC established a recovery fund. The fund has approved 96 transactions worth R2 billion, of which R1.5 billion was disbursed by the end of 2021/22. In addition, the IDC committed R6.6 billion to transformation funding in 2021/22, compared with R3.9 billion in 2020/21.

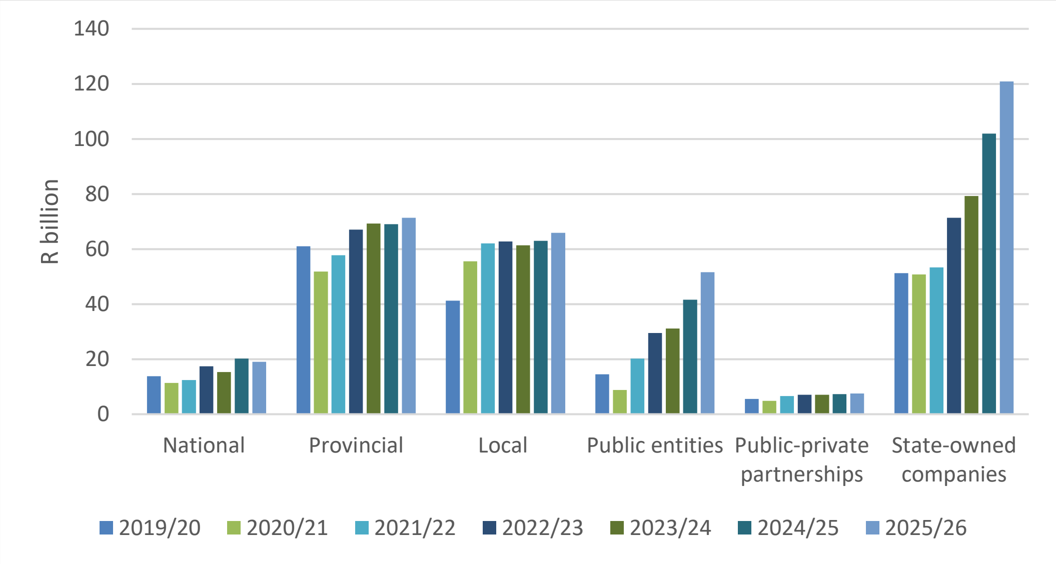
7.15. After posting back-to-back net profit losses in 2019 (-R400 million) and 2020 (R3.1 billion), the IDC reported a net profit for two successive years; the IDC group generated a net profit of R6.3 billion in 2021/22. This was attributed to increased investment activity and broader economic recovery. The COVID-19 pandemic resulted in impairments and write-offs on IDC's investments in 2020. The downgrades to the sovereign credit rating resulted in shrinking borrowing capacity and rising borrowing costs.

7.16. The Land Bank finances the agricultural sector. It remains in financial distress following a default on its debt in 2020/21. It generated a net profit of R1.4 billion for 2021/22, compared to a net loss of R747 million in 2020/21. This resulted from actions to address poorly performing investments and decreased administrative fees. The Land Bank finances the agricultural sector. It remains in financial distress following a default on its debt in 2020/21. The Land Bank has since reduced its debt by 29 per cent, from R40.6 billion to R29.2 billion, through capital repayments. The 2020 adjustments budget allocated R3 billion to the Land Bank. The 2022/23 fiscal framework allocated an R5 billion conditional allocation to the Land Bank.

Public Sector Infrastructure Spending

7.17. The figure below illustrates public sector infrastructure investment from 2019/20 to 2025/26. Public infrastructure investment is expected to increase over the MTEF period. The commission supports the increased funding for infrastructure investment as it will promote longer-term growth prospects. However, as noted in previous submissions by the commission, the government should remain committed to improving the management of infrastructure spending, given that mismanagement, wasteful expenditure, cost overruns, delayed project completion, and defective workmanship often characterise public infrastructure projects.

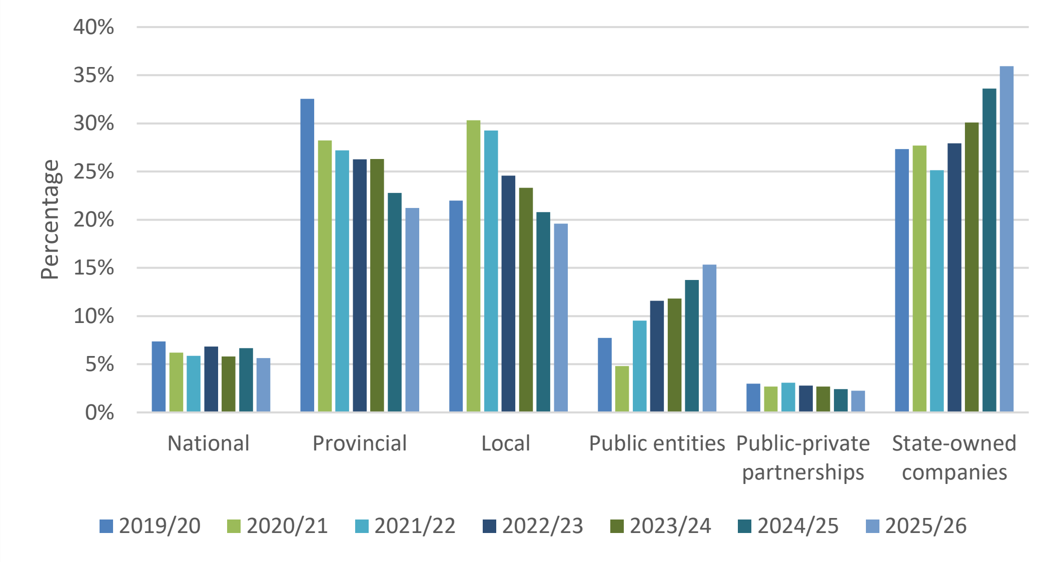
Figure 19: Public infrastructure investment



Data source: National Treasury, Budget Review, 2019/20 – 2025/26

7.18. Regarding the shares of public infrastructure investment, state-owned companies make up the largest share at 27.9 per cent in 2022/23. The national sphere's share has remained relatively stable since 2019/20. The provincial share has been decreasing, from 32.6 per cent in 2019/20 to 26.3 per cent in 2022/23, and will continue to decline over the MTEF period. The share of the local government sphere is also on the decline, which is concerning given the huge infrastructure backlogs in municipalities (new infrastructure and rehabilitation and maintenance of existing infrastructure). The shares of public infrastructure investment in public entities and state-owned companies are increasing, indicating that the government is increasingly implementing public infrastructure investment through public entities and state-owned companies. As noted in previous submissions made by the commission, this increasing trend is concerning, given the poor performance of public entities and state-owned companies.

Figure 20. Public infrastructure investment shares



Data source: National Treasury, Budget Review, 2019/20 – 2025/26

Recommendations

- The commission recommends improving corporate and fiscal governance through reforms that enable SOEs' management boards the operational autonomy they require to make profit-maximising decisions and eliminating political interference to enhance operational transparency.
- The commission recommends the establishment of explicit and progressive guidance to SOEs on expected rates of return and the distribution or reinvestment of profits.
- The commission reiterates its recommendation that decisive judgement is made to deliver on return-to-investment effectively and efficiently. Failing which, dysfunctional SOEs should be restructured, sold off or shut down.

8. Concluding Remarks and Recommendations

8.1. Although the commission acknowledges and appreciates the multitudes of internal and external constraints and challenges under which Budget 2023 was crafted, certain aspects of the legislation may be inconsistent with the principles of fiscal discipline and credibility. Specifically, with regards to the Eskom Debt Relief Bill, the commission remembers that in 2019, a special appropriation with conditions responsible by the Department of Public Enterprises and Minister at R59 billion was allocated to assist Eskom with its financial obligations. This does not include the R23 billion allocation per year over the MTEF to make urgent operational improvements. These experiences raise doubts that adopting the same approach, i.e. special appropriations, even with conditions, to address the structural issues at Eskom, would yield a different outcome in 2023.

With respect to the 2023 fiscal framework and revenue proposals

8.2. The commission welcomes the fiscal framework and revenue proposals of the 2023 Budget. Specifically, the commission appreciates the adoption of its recommendation made in the previous budget submissions to lower and maintains policy consistency in the personal income tax and corporate income tax regimes. This is to allow households and businesses battered by Covid-19, civil unrest, natural disasters and load-shedding, as well as the system of tax collection and administration at the South African Revenue Service (SARS), to recover and improve efficiency.

With respect to the 2023 Appropriation Bill

8.3. In terms of the 2023 Appropriation Bill, the commission appreciates the government's efforts to balance the protection of the social wage package (the extension of the SRD grant and increased funding for the delivery of basic services such as water and sanitation) alongside the provision of growth-inducing allocations to public infrastructure investment and funding additions to fight crime and corruption.

8.4. As part of its oversight efforts, Parliament must seek to understand how strategic departments will absorb reductions in their budgets and further how the reductions are likely to affect service delivery. Here focus should be placed on, amongst others, the departments of health, transport and the DHET.

8.5. Timelines need to be devised for the finalisation of new funding framework for the higher education sector. During Budget 2022, MTPBS 2022 and the 2023 SONA, the new funding framework was discussed. A lack of continuity on this issue is observed as no mention is made of this aspect in the 2023 Budget.

With respect to the 2022 Second Adjustments Appropriation Bill

8.6. Specifically, on the bailouts to the three SOEs, the commission's stance remains unchanged in that it fundamentally views bailouts as fiscally unsound and, as recommended in its submission on the 2022 Special Appropriation Bill, the government must devise systems of accountability and measures of control to mitigate SOEs from indulging in moral hazard behaviour. It is worth noting that the pre-conditions and conditions required for bailouts, including financial and operational reporting by the SOEs, have been implemented with limited outcomes.

With respect to the 2023 Division of Revenue Bill – Provinces

8.7. The commission notes with concern the 7.6 per cent decrease in the district health program and recommends that the Department of Health elaborate on how it would likely affect service delivery and management, given the expanded scope of the district health program.

8.8. While the commission supports funding for emergency housing needs due to flooding, it reiterates its previous recommendation that the provinces and municipalities should develop and implement adaptation and mitigation strategies to address natural disasters in the long term.

8.9. The commission notes with concern the shifting of provincial and municipal emergency housing grants to the national department of human settlements. The commission recommends that shifting conditional grants from provincial and local government spheres to the national sphere should be the last resort as lower spheres of governments are better positioned to understand delivery needs.

With respect to the 2023 Division of Revenue Bill – Local Government:

8.10. The FFC recommends that the review of capacity-building and infrastructure grants consider that capacity-building efforts are comprehensively consulted with and agreed to with a municipality; it should link capacity-building actions to a municipality-specific diagnosis of capacity challenges or deficits. It should consider the consolidation of local government conditional grants into an integrated financial flow.

8.11. The commission notes the proposed increase in the total allocation to the local government's equitable share over the medium term. However, the FFC would like to reemphasise the previous recommendation of fundamentally reviewing the local government transfers, especially from the perspective of the vertical division of revenue. This review should also include a proper re-examination of the assumptions used in the local government White Paper.

8.12. The FFC would like to stress the need to determine the roles and functions of the role players in the District Development Model and the funding requirements/responsibilities to eliminate any ambiguity.

With respect to Public-sector institutions and investment:

8.13. The commission recommends improving corporate and fiscal governance through reforms that enable SOEs' management boards the operational autonomy they require to make profit-maximising decisions and eliminating political interference to enhance operational transparency.

8.14. The commission recommends the establishment of explicit and progressive guidance to SOEs on expected rates of return and the distribution or reinvestment of profits.

8.15. The commission reiterates its recommendation that decisive judgement is made to deliver on return-to-investment effectively and efficiently. Failing which, dysfunctional SOEs should be restructured, sold off or shut down.

Approved by:

Dr Patience Nombeko Mbava

Chairperson

Date: 27 February 2023

Financial and Fiscal Commission's Special Report on Financial Action Task Force's (FATF) decision to greylist South Africa for money laundering and terrorist financing.

On 24 February 2023, no more than two days after the tabling of the 2023 budget, the Financial Action Task Force (FATF) announced its decision to place South Africa on the greylist money laundering and terrorist financing. The Commission understands that such a judgement is not made on the legislation of one country alone in isolation, but in view of the international community, current global dynamics and financial trajectories, trade relations and international politics. More specifically, it is worth noting that in the same announcement to greylist South Africa, FATF suspended the membership of the Russian Federation for the *illegal, unprovoked and unjustified full-scale military invasion of Ukraine*:

> *"The FATF strongly condemns the Russian Federation's war of aggression against Ukraine. Over the past year, the Russian Federation has intensified its inhumane and brutal attacks targeting critical public infrastructure. The FATF is also deeply concerned by the reports of arms trade between the Russian Federation and United Nations sanctioned jurisdictions, and malicious cyber-activities emanating from Russia.*
>
> *The Russian Federation's actions unacceptably run counter to the FATF core principles aiming to promote security, safety, and the integrity of the global financial system."*

The Commission notes that in October 2021, FATF, led by the International Monetary Fund, conducted a thorough study and investigative report on South Africa's measures to combat money laundering and terrorist financing and concluded:

> *"South Africa has a solid legal framework for combating money laundering and terrorist financing but significant shortcomings remain. In particular, the country needs to pursue money laundering and terrorist financing in line with its risk profile, including by proactively seeking international cooperation, detecting and seizing illicit cash flows, and improving the availability of beneficial ownership information. Authorities need to make better use of the financial intelligence products provided by South Africa's financial intelligence unit. The country should also improve the application of the risk-based approach by obligated entities and supervisors."*

More specifically, the 2021 evaluation outcome emphasised that most of the 11 immediate outcomes that an effective Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) system of controls should achieve are of moderate or low levels of effectiveness:

With respect to FATF's decision to greylist South Africa:

- The Commission is of the view that South Africa's policy, regulation and legislative environment is sufficient as confirmed by the FATF itself. The issue is with governance – the consistency between the decision of direction taken by the government, and its actions of implementation in terms of the legislation. Hence, the Commission recommends that before any legislation is enacted on the matter, legislature must have considered the recommendations of the factors emphasised above.