FINANCIAL
AND FISCAL
COMMISSION

MEDIA **STATEMENT**

FINANCIAL
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COMMISSION

For an Equitable Sharing
of National Revenue

FINANCIAL AND FISCAL COMMISSION

The Commission is a body that makes recommendations and gives advice to organs of state on financial and fiscal matters. As an institution established by the Constitution, it is an independent, juristic person subject only to the Constitution itself, the Financial and Fiscal Commission Act, 1997 (Act No. 99 of 1997), as amended, and relevant legislative prescripts. The Commission may perform its functions on its own initiative or on request of an organ of state.

The vision of the Commission is to provide influential advice for equitable, efficient, and sustainable intergovernmental fiscal relations between the national, provincial and local spheres of government. This relates to the equitable division of revenue among the three spheres of government and to the related service delivery of public services to South Africans.

Through focused research, the Commission aims to provide proactive, expert and independent advice on promoting the intergovernmental fiscal relations system, using evidence-based policy analysis to ensure the realisation of constitutional values. The Commission reports directly to Parliament and the provincial legislatures. Government must consider the Commission's recommendations and decide the extent to which they will be implemented when the National Budget is tabled.

The Commission consists of Commissioners appointed by the President:
The Chairperson and Deputy Chairperson, three representatives of provinces, two representatives of organised local government, and two other persons.

In exercising its duties, the Commission pledges its commitment to the betterment of South Africa for all South Africans.

INTRODUCTION

The Financial and Fiscal Commission tables its recommendations for the 2024/25 Division of Revenue as the South African economy is confronted by a series of global and domestic challenges that are weighing heavily on public finances. These challenges include, amongst others, slowing global growth, geopolitical tensions, rising inflation, acute power challenges, inefficiencies in state-owned enterprises (SOEs), high unemployment, and climate change. These challenges highlight the importance of inclusive growth, which has become central to economic development, raising living standards and generating more opportunities across society. A healthy and financially sound fiscus is required to achieve inclusive growth. This means that South Africa's fiscal situation, riddled with governance issues and constrained by a resource-depleted budget, must be addressed.

As we move on from the COVID-19 pandemic faced in the last three years, its effects continue to have a bearing on the global economy. One of the most enduring legacies of the pandemic has been rapidly rising prices, particularly food and energy, that took effect in the early phases of the pandemic and subsequently accelerated due to the war between Russia and Ukraine. As a result, the global economy finds itself in a period characterised by high inflation and high levels of both public and private debt. In South Africa, increased global food and fuel prices have resulted in inflation rates overshooting the 3-6 per cent inflation target band set by the South African Reserve Bank (SARB).

The resultant upsurge in global inflation since 2021 is the most severe in over three decades and has triggered an unprecedented policy response. In South Africa, the policy response from the SARB has been relentless, culminating in ten consecutive interest rate hikes between November 2021 and May 2023. This steep hiking cycle has put pressure on middle-class consumers and, in turn, hamstrung consumer demand, dampened investment and stifled economic growth. It also implies that government policies require a precise appreciation of how inflation impacts various societal groups. The exploration of how fiscal policy should respond to curtail inflation, while supporting the vulnerable, is critical.

South Africa also continues to face an unprecedented energy crisis. Eskom has responded to this crisis by instituting devastating loadshedding that is undermining the economic recovery from COVID-19, while interest rates rise in response to high inflation. In 2022, there were 200 days of loadshedding. In the first quarter of 2023, there was only one day of no loadshedding, and increasingly prolonged blackouts have become the norm. A swift resolution of the electricity crisis is urgently warranted entailing reforms in the energy sector and a massive turnaround of Eskom. However, immediate action is also required to eradicate inefficiencies in other major SOEs, particularly those operating in the transport and logistics sectors.

Under the theme of ***"Improving service delivery and inclusivity in an environment of expenditure moderation"***, the Financial and Fiscal Commission's Annual Submission for the 2024/25 Division of Revenue focuses on a number of key issues. These include, examining the impact of inflation on public finances; evaluating the effect of SOEs and social security on the sustainability of public finances; vital subnational issues on learner teacher support materials (LTSM) and learner transport; climate change; spatial inequalities, local economic development (LED); as well as municipal cost recovery, and the affordability of basic services.

The submission consists of six chapters divided into two parts: Part 1, comprising chapters 1 and 2, focuses on financial and fiscal matters, and Part 2, comprises four chapters concentrating on subnational issues.

FINDINGS and RECOMMENDATIONS

The Commission's research has led to several key findings relating to the Commission's thematic focus:

Part 1: Financial and Fiscal Matters: Evidence Informed Policymaking

Chapter 1 investigates the sources and spillovers of global inflation and fiscal sustainability. In addition to examining international inflation trends, sources, and the international inflation spillovers on the South African economy, the chapter investigates how inflation shocks affect South Africa's public debt dynamics. The Commission recommends that fiscal policy support be implemented, attuned, and aligned with a credible medium-term fiscal framework and that the social protection system be strengthened to protect vulnerable segments of the population, especially those exposed to the negative impact of rising inflation, including higher energy, fuel and food prices. In the interim though, National Treasury and the Department of Social Development must address the challenges of access constraints related to the current social protection measures, particularly the Special COVID-19 Social Relief of Distress (SRD) Grant.

Chapter 2 focuses on the impact of SOEs and the basic income grant (BIG) on fiscal sustainability. In addition to reviewing the state of South Africa's major SOE, the risks they pose to fiscal sustainability, and examining possible SOE reforms, this chapter also determines the fiscal feasibility of a BIG in South Africa. Several recommendations are made on how the SOE environment can be improved – these range from reducing risks from quasi-fiscal activities, avoiding excessive and discretionary resource extraction from SOEs, reducing fiscal risks from SOEs' borrowing, tightening monitoring, reporting, accounting, and control, improving the transparency of SOEs' operations and establishing a centralised holding company. With respect to the BIG, the Commission advises that a well-informed determination formula be used to recalculate the value of the SRD Grant. Furthermore, we recommend that government (via the Minister of Social Development and the South African Social Security Agency) account to the public for the underspending recorded in the Adjustment Appropriation Bill and the Second Adjustment Appropriation Bill amounting to R1.8 billion and R3.7 billion, respectively.

Part 2: National Focus: Optimising Inter-Governmental Fiscal Instruments

Chapter 3 focuses on reviewing LTSM and learner transport in South Africa. The provision of LTSM is vital to improve educational outcomes and this chapter assesses the policy and funding regime underpinning the provision of LTSM in South Africa. This chapter also examines demand and supply dynamics for learner transport and the resultant implications of changing learner numbers in provinces. It also evaluates funding challenges faced by provinces concerning learner transport; and assesses if provinces adhere to norms, standards, and learner transport regulations. In relation to LTSM, the Commission advises government to finalise its policy on LTSM, strengthen funding and implement and fund a national programme aimed at improving reading for meaning. Regarding learner transport, the recommendations relate to the improvement of data collection and reporting and the importance of overhauling the funding model that underpins the provision of learner transport.

Chapter 4 assesses the response to climate change at the local government level. It seeks to ascertain whether municipal plans and budgets are climate responsive and sensitive. In this regard, the Commission calls on the Minister of Finance to create an enabling framework to ensure that government budgets are climate sensitive and geared towards green budgeting. We also advise that the national departments of Forestry, Fisheries & Environment (DFF&E) and Cooperative Governance and Traditional Affairs (COGTA) should spearhead integration, coordination, and implementation of climate change responses that are in line with the national agenda of transitioning to a low carbon and resilient economy. Complementing these activities, the Department of Monitoring and Evaluation (DPME) and the Presidential Climate Commission (PCC) should monitor, evaluate and report on the progress made by subnational governments in integrating climate change response into their respective planning documents. Importantly, climate change responses should also be mainstreamed across infrastructure grant framework specifications to achieve more climate-resilient infrastructure.

Chapter 5 looks at the stark spatial divides that continue to characterise post-Apartheid South Africa. This is done by investigating spatial inequalities and the efficacy of municipal spending in driving local economic development (LED). Employing municipal mapping, the chapter develops an appropriate tool to assist municipalities in their strategies for improved revenue collection and LED. The chapter utilises ArcGIS to map the areas of municipal borders to assess each municipality geographically. Illustrative data is also used to show the large spatial inequalities across South African municipalities. A key recommendation flowing from this chapter is that to overcome persistent challenges municipalities face in the context of the rapidly changing economic environment, the Ministers of COGTA and Finance should critically review the local government fiscal framework. A differentiated approach is needed to ensure the local government fiscal framework is well-tailored to overcome unique issues confronting individual municipalities. To achieve this, the Commission believes that the fiscal framework may need to be radically, rather than incrementally, reconfigured.

Chapter 6 concentrates on municipal cost recovery and the affordability of basic services. The chapter aims to assess the extent to which municipalities recover the costs of providing services and the relationship between cost recovery and the affordability of services. It also examines whether a municipality's socioeconomic profile affects cost recovery. The Commission recommends that National Treasury, in consultation with the South African Local Government Association (SALGA), COGTA, and provincial governments should urge local municipalities to apply effective revenue enforcement and credit control mechanisms and improve billing and accounting systems to increase payment and cost coverage levels. Furthermore, officials responsible for managing municipal finances, should possess the competencies and skills required to perform their roles. Additionally, COGTA, in consultation with SALGA, should ensure that the credit control systems of Eskom and municipalities are aligned by means of a memorandum of understanding (MOU), and that Eskom should assist municipalities with credit control via electricity disconnections within areas supplied by Eskom. Finally, the Commission recommends that the National Treasury urge municipalities to incorporate the aspect of affordability in their tariff setting processes through using the tariff setting tool developed by National Treasury and which includes a component for testing the affordability of tariffs to customers.

Report available for direct download at: www.ffc.co.za

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RECOMMENDATIONS

The Commission, in its Submission for the 2024/25 Division of Revenue, makes the following recommendations:

CHAPTER 1: ESCALATING GLOBAL INFLATION: THE SOURCES, SPILLOVERS AND FISCAL SUSTAINABILITY:

1. With respect to fiscal policy, the National Treasury should continue to focus fiscal consolidation on expenditure and revenue mix appropriate for debt reduction. This should be done by targeting a primary surplus to significantly reduce debt, foster economic growth and restore fiscal sustainability. Moreover, the Commission recommends that National Treasury crafts a medium-term fiscal framework that must maintain long-term debt sustainability through consolidation, improving debt transparency, advancing debt management functions, and enhancing revenue collection and spending efficiency.

2. With respect to social protection, National Treasury, in conjunction with the Department of Social Development (DSD), should design a comprehensive social security programme to protect those segments of the population particularly exposed to the negative impact of rising inflation, including higher energy, fuel and food prices. In the interim, National Treasury and the DSD should address the challenges of access constraints of the current social protection measures, particularly the Special COVID-19 Social Relief of Distress (SRD) Grant

CHAPTER 2: REGARDING THE IMPACT OF STATE-OWNED ENTERPRISES AND BASIC INCOME GRANT ON FISCAL SUSTAINABILITY:

REGARDING SOEs

1. *Reducing risks from quasi-fiscal activities*
   In collaboration with the relevant SOE's parent departments, National Treasury should eliminate fiscal risks emanating from the imposition of quasi-fiscal burdens by avoiding policies that result in such obligations or abolishing them if they are already in place. The reduction of discretionary fiscal governance in SOEs requires the following:
   - Liberalising the prices of goods and services provided by SOEs in competitive markets and regulating prices in monopolistic or oligopolistic markets at levels that would enable them to generate sufficient profit.
   - Subjecting SOEs to the same labour and employment regulations; eradicating any local content obligations for the SOEs,rationalising procurement procedures; and appraising SOEs' investment decisions.
   - 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.

2. *Avoiding Excessive and/or Discretionary Resource Extraction from SOEs*
   In collaboration with the relevant SOEs' parent departments, National Treasury should reduce excessive resource extraction, which reduces the SOEs' competitiveness, through:
   - The establishment of explicit and progressive guidance to SOEs on expected rates of return and the distribution or reinvestment of profits.
   - Instituting a predetermined dividend policy in the form of a fixed percentage of annual profits and linking the pay-out to the achievement of the desired capital structure for each SOE.

3. *Reducing fiscal risks from SOEs' borrowing*
   SOEs require access to financing to maintain their operations and undertake investments. Fiscal rules that necessitate SOEs to run balanced budgets render them competitive relative to other private sector companies operating in the same sector. SOEs should therefore be allowed to charge higher prices to cover financing costs. However, National Treasury should establish safeguards to prevent

SOEs from becoming too leveraged and should not provide preferential access to finance and contractual terms to SOEs. They should, instead, introduce transparent and non-discretionary controls on borrowing to ensure the SOEs remain liquid and solvent. The provision of government guarantees by the National Treasury should be subject to assisting SOEs in obtaining financing for projects with significant public benefit. National Treasury should establish an aggregate debt ceiling for each sector to be approved by Parliament. Government guarantees should then only be granted to SOEs subject to an in-depth and explicit appraisal of their ability to service the debt. The SOEs should be charged fees comparable to those imposed on any guarantees granted to private sector companies, as is the case, for instance, in Australia. Borrowing controls should be premised on clear, predetermined, and impartial benchmarks that evaluate the SOEs' capacity to service their debts. This should entail the size and structure of the SOEs' liabilities, their interest burden, debt repayment schedules, operational profitability, the size of their contingent and known future liabilities, the liquidity of their assets, and the volatility of their revenues. The evaluation must also forecast how the new capital structure will impact these indicators. At a minimum, the indicators used by National Treasury for evaluating the SOEs must incorporate the ratio of gross liabilities to revenue, debt denominated in foreign currency to foreign exchange reserves, interest payable to revenue, and liquid assets to short-term liabilities. The indicators should be standardised and weighted for making approval decisions.

4. *Monitoring, reporting, accounting, and control*

In collaboration with the relevant SOEs' parent departments, National Treasury should obligate SOEs to implement effective systems to monitor the execution of their budgets and provide detailed reports in this regard. National Treasury should acquire human and technical resources required to monitor the SOEs, safeguard their adherence to financial and reporting obligations, scrutinise budgets and reports, and provide appropriate feedback on necessary remedial action where necessary. National Treasury must make it mandatory for SOEs to submit a consolidated set of statements that will enable statistical analysis. A separate statement must be prepared on targets for the government and SOEs and evaluated using different criteria. Government spending on SOEs should be assessed on whether it achieved aims such as macroeconomic growth and fiscal stability, and the SOEs' budgetary allocations must be evaluated on their profitability, efficiency, and liquidity. National Treasury should strengthen their SOEs' asset and liability management capabilities. This should ensure that SOEs boards have the necessary skill set to prioritise this.

5. *Improving the transparency of SOEs' operations*

Public disclosure and appropriate distribution of detailed information on SOEs' operational and financial performance are critical for good governance. Moreover, examination by external stakeholders significantly increases the SOEs' accountability and discourages political complicity or flagrant corruption. National Treasury should institute reforms aimed at improving transparency, focusing on the following:

- More declaration of the SOEs' contingent and future liabilities and the results of sensitivity and risk analyses.
- Safeguarding that the SOEs' quarterly and annual reports include sections analysing their performance during the corresponding period.

6. *Establishment of a centralised holding company*

There is theoretical and empirical evidence that a centralised holding company, that monitors or controls SOEs, improves its performance and reduces fiscal risk. Holdings with corporate structures may not automatically produce better results than a well-staffed centralised unit within National Treasury. However, a centralised holding company is critical to reducing monitoring costs. National Treasury should establish a centralised holding company that will operate with tight ex-ante controls regarding debt and capital expenditure plans to minimise the fiscal risk inherent in the operation of SOEs.

REGARDING THE BASIC INCOME GRANT

7. *Recalculate the COVID SRD*
   The Minister of Social Development and the Minister of Finance should reconsider recalculating the COVID social relief of distress grant amount with a well-informed determination formula. The Commission notes the static and arbitrary amount value of R350 attached to the social relief of distress grant. The Commission encourages a recalculation of the amount that takes into consideration the cost-of-living crisis and unemployment. Moreover, a permanent basic income support structure is needed when considerations are made about the value of the income support.

8. *Account for recorded public underspending*
   The Minister of Social Development and the South African Social Security Agency should account to the public for underspending recorded in the adjustment's appropriation bill and the second adjustments appropriation bill amounting to R1.8 billion and R3.7 billion, respectively. The results suggest that a growing number of South Africans are jobless and need income support. However, the reduced intake for the social relief of distress grant points to the misadministration of the budget allocated to the Department of Social Development. The grant is not merely an exercise of convenience, but an essential lifeline. The Commission notes that difficulties are associated with eligibility requirements, but urges a level of reliability in the administration of grants. The underutilised allocation could have also serviced other spending pressures in the budget.

9. *Develop a correspondence policy tool*
   The Minister of Social Development should develop a policy tool that interlinks access to complementary social and economic opportunities with opportunities such as the expanded public works programme (EPWP). The Commission envisages policy tools that can link social grant recipients to employment, training and education opportunities. The tools would enable coordination between state initiatives aimed at improving the behaviour and economic status of beneficiaries. The Minister should use the grant beneficiary demographic data at its disposal to track the success of the social grant network system. Data inefficiencies in the current administration make the proper monitoring and evaluation of the grant system burdensome and difficult. The Commission urges proper record-keeping and information dispensation at the Department of Social Development, as accurate reports are the only way to dismantle obstacles in the system and identify threats.

CHAPTER 3: REGARDING LEARNER TEACHER SUPPORT MATERIALS AND LEARNER TRANSPORT IN SOUTH AFRICA:

WITH RESPECT TO LTSM

1. The Minister must ensure that the draft LTSM policy, which has been stalled since 2014, is finalised and approved.

2. Funding for LTSMs should be prioritised, especially for quintiles 1, 2 and 3 schools. National funding norms need to be developed to guide spending on LTSM per child, per phase – foundation, intermediate, senior and FET. Moreover, specific priority should be given to the provision of LTSMs for learners with special educational needs.

3. LTSMs are critical in improving reading for meaning. The Minister of Basic Education must fund a national programme that aims to improve reading for meaning and which is uniformly implemented across the nine provinces. Lessons from successful local initiatives must be drawn on to determine which approaches are likely to succeed.

4. To aid improved monitoring and oversight of LTSMs (particularly textbooks) and to achieve the goal of universal coverage, the Minister of Basic Education must expand the modules contained in the South African School Administration and Management System (SA-SAMS) to include LTSM.

WITH RESPECT TO LEARNER TRANSPORT

5. The national and provincial departments of transport and basic education should improve data collection and reporting and ensure that accurate data on learner transport, including annual demand and expenditure, is reported and made publicly available through annual reports.

6. Infrastructure delivery should be planned holistically and coordinated to ensure that, where possible, the need for learner transport is kept to a minimum, particularly in areas experiencing an inward migration of learners. This requires coordination between the various infrastructure delivery plans such as human settlements and school infrastructure. Furthermore, provincial treasuries and provincial education departments (PEDs) must ensure that school infrastructure delivery plans for building new schools in provinces prioritise areas with sustained higher demand for learner transport or with higher learner transport beneficiaries.

7. The national and provincial treasuries, in consultation with provincial departments of transport and basic education, should develop a new funding model for learner transport. Such a model must also include flexibility for provinces to address emergency contracts to provide learner transport.

8. The provincial departments responsible for learner transport should develop systems to verify the number of learners transported through the learner transport programme annually to ensure that annual changes are captured and accounted for (learners pass primary and move to secondary schools, learners pass matric while some drop out).

CHAPTER 4: REGARDING THE ASSESSMENT OF THE RESPONSE TO CLIMATE CHANGE IN LOCAL GOVERNMENT:

1. The Minister of Finance should create an enabling framework to ensure government budgets are climate sensitive and incorporate green budgeting measures across budget cycles, budget circulars, the medium term expenditure framework (MTEF), as well as Municipal Finance Management Act (MFMA) and Public Finance Management Act (PFMA) processes. Climate change indicators and targets should inform this process.

2. The National Department of Forestry, Fisheries & Environment (NDFF&E) and Cooperative Governance and Traditional Affairs (COGTA) should spearhead integration, coordination, and implementation of climate change responses so that it is in line with the national agenda on transitioning to a low carbon and resilient economy. The Department of Monitoring and Evaluation (DPME) and the Presidential Climate Commission (PCC) must monitor, evaluate and report on the progress made by subnational governments in integrating climate change responses in their respective planning documents. Committees at the legislatures and municipal councils should exercise their oversight role by ensuring that integration, coordination, and implementation of climate change responses take effect.

3. National Treasury, together with COGTA and the National Department of Public Works and Infrastructure (DPW&I), should, as a starting point, revise formats for the infrastructure grant frameworks to include climate change response specifications to be able to gradually achieve climate resilient infrastructure, with a strategic approach in the medium to long term of incorporating climate change mitigation and adaptation measures to all infrastructure related projects.

CHAPTER 5: REGARDING THE INVESTIGATION INTO SPATIAL INEQUALITIES AND THE EFFICACY OF MUNICIPAL SPENDING IN DRIVING LOCAL ECONOMIC DEVELOPMENT:

1. The Commission recommends that to overcome persistent challenges municipalities face in the context of the rapidly changing economic environment, the Minister of COGTA and the Minister of Finance should critically review the local government fiscal framework. A differentiated approach is needed to ensure the policy is well-tailored to overcome unique issues individual municipalities face. To achieve this, the fiscal framework may need to be radically, rather than incrementally, reconfigured.

2. Careful attention must be given to the funding mechanism of conditional grants and the Commission thus recommends that COGTA and National Treasury develop an appropriate funding mechanism or funding plan in a targeted and phased approach, which enhances the capacity of municipalities to spend conditional grants effectively. The District Development Model (DDM) must be strengthened and financed for local government to fulfil its developmental role.

3. The Commission recommends that any future framework development on local economic development (LED) should include the aspect of skills development through the revitalisation of mentorship/apprenticeship programmes to address the country's unskilled labour issue.

CHAPTER 6: REGARDING MUNICIPAL COST RECOVERY AND THE AFFORDABILITY OF BASIC SERVICES:

1. National Treasury, in consultation with the South African Local Government Association (SALGA), COGTA, and provincial governments should urge local municipalities to apply effective revenue enforcement and credit control mechanisms and improve billing and accounting systems to increase payment and cost coverage levels. Officials responsible for managing municipal finances should possess the competencies and skills required to perform their roles. In addition, municipalities should apply the prescripts of various legislation such as the Municipal Systems Act, Municipal Property Rates Act, Municipal Structures Act, MFMA, and other municipal service provision by-laws to enforce payment from residents.

2. CoGTA, in consultation with SALGA, should ensure that the credit control systems of Eskom and municipalities are aligned by means of a memorandum of understanding (MOU), and that Eskom should assist municipalities with credit control via electricity disconnections within areas supplied by Eskom. This is a reiteration of a previous recommendation.

3. The Commission recommends that COGTA should engage SALGA about incorporating innovative approaches in the "Asisho! Let's Say it" campaign to increase awareness about the importance of paying for municipal services. In addition to using television to disseminate the message, other forms of media such as national and community radio stations, billboards, sending prompts via WhatsApp, SMS, and email, and inserts in newspapers should be used to reach a wider audience.

4. The Commission recommends that the National Treasury should urge municipalities to assess the affordability of the total municipal bill as part of the municipal tariff setting process. This can be done using the tariff setting tool developed by National Treasury, which includes a component for testing the affordability of tariffs to customers.

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