FINANCIAL
AND FISCAL
COMMISSION

Financial and Fiscal Commission Submission on the 2021 MTBPS

For an Equitable Sharing of National Revenue

15 November 2021

Financial and Fiscal Commission
Montrose Place (2nd Floor), Bekker Street,
Waterfall Park, Vorna Valley, Midrand,
Private Bag X69, Halfway House 1685
www.ffc.co.za
Tel: +27 11 207 2300
Fax: +27 86 589 1038

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List of acronyms

AENE	Adjusted Estimates of National Expenditure
ETI	Employment Tax Incentive
COE	Compensation of Employees
GDP	Gross Domestic Product
MIG	Municipal Infrastructure Grant
MTBPS	Medium Term Budget Policy Statement
MTEF	Medium Term Expenditure Framework
PAYE	Pay As You Earn
SAA	South African Airways
SANRAL	South African National Roads Agency
SARB	South African Reserve Bank
SARS	South African Revenue Services
SASRIA	South African Special Risk Insurance Association
SOE	State Owned Enterprise
SRD	Social Relief of Distress Grant
TALAB	Tax Administration Laws Amendment Bill

1. Submission Summary

1.1. This submission is prepared in terms of Section 4 (4c) of the Money Bills Amendment Procedure and Related Matters Act (Act 9 of 2009) as amended, which requires Parliamentary Committees to consider any recommendations of the Financial and Fiscal Commission (FFC) (hereafter the Commission) when considering Money Bills. It is also made in terms of the FFC Act (1997) as amended, which requires the Commission to respond to any requests for recommendations by any organ of state on financial and fiscal matters.

1.2. The Commission welcomes the 2021 MTBPS tabled by the Minister of Finance, especially given the context of declining investor confidence compounded by the recent nationwide civil unrest - atop of a prolonged precarious country fiscal position. In particular, the Commission notes the government's efforts to maintain a modest expenditure growth while making sure that core spending areas are preserved.

Economic prospect

1.3. The recent economic green shoots exemplified by positive GDP growth in the first and second quarters of 2021 auger well as a foundation for a sustained economic recovery and a stable fiscal path. However, threats to economic recovery continue to mount as pre-existing structural bottlenecks that severely constrained growth deepen. Intermittent energy supplies, unresolved corruption, poor policy-making and execution etc. culminate in the loss of confidence or increased borrowing costs for the bonds we issue. South Africa can and must seek to avoid withdrawing its fiscal support to vulnerable citizens and the domestic economy too early and still signal to the public that its debt levels are sustainable in the long run, by eliminating leakages and executing reprioritisations that are productive and constructive.

1.4. Global Covid-19 vaccination acceleration and the resultant opening of major economies are poised to improve the near-term economic growth outlook. The World Bank projects that the global economy will increase by 4% in 2021, while the IMF has upwardly revised South Africa's growth outlook from 3.8% to 4% - slightly different to the South African Reserve Bank growth estimate of 4.2%. Economic growth prospects have since improved as the 2021 MTBPS projects a much stronger growth outlook of 5.1% in 2021. However, it is worth emphasising that despite the positive growth prospects - economic activity in terms of real Gross Domestic Product (GDP) as at quarter 2 of 2021 remained at the level last experienced in the last quarter of 2017.

Tax collection surplus and expenditure adjustments

1.5. With near-term improved economic growth prospects, total tax receipts are expected to improve from R1.365 trillion as tabled in the 2021 Budget to R1.485 trillion. The country is already reaping the benefits of tax collection recovery used to finance the extension of the Social Relief of Distress Grant in the amount of R32 billion. Whereas growth in tax collection associated with this economic recovery is a welcome development, the government must continue to focus on improving tax compliance and narrowing the tax-to-GDP gap. Closing the tax gap must be accompanied by stringent efforts to stem tax base erosion and profit shifting and broaden governance measures to improve tax efficiency. Incessant, unresolved corruption and widespread fiscal leakages have made the taxpayers and businesses despondent towards tax morality. The Commission agrees that the revenue windfall should not be fully committed to further expanding expenditures that have already grown far beyond our means of revenue. Instead, the revenue windfall should be used to defray as much as possible the structural budget deficit and offload the growing debt-service costs with redemption requirements.

Debt and debt-service costs

1.6. National debt and State-Owned Enterprises (SOEs) remain a glaring binding constraint to growth and risk to fiscal sustainability. Debt-service cost is the fastest growing expenditure line item with a 10% annual average growth rate over the 2022 MTEF and account for 12% of total consolidated total spending in 2021, rising to 16% in 2024/25. The detrimental effect of debt-service costs crowding-out social programmes could lead to the total collapse of basic and social services as funds intended for core spending are diverted to servicing debt. While the Commission acknowledges the difficulties in moderating debt growth within a subdued economic environment and recommends improvements in cost-efficiencies of spending and closing the fiscal leakages to offset the growing deficit and debt.

Investment for future growth

1.7. The 2021 MTBPS proposes R500 billion MTEF allocation for general government infrastructure investment, in line with the President's economic recovery plan and infrastructure-led growth strategy. Infrastructure allocation is the fasted growing expenditure line item of total non-interest spending, growing at an annual average growth rate of 9.7% over the 2022 MTEF. Much as the Commission welcomes the concerted focus on growth through public infrastructure investment, the government has a poor track record of impacts and outcomes. Many of the funded infrastructure projects are characterised by cost overruns, wasteful contracting, maladministration, malicious compliance and noncompliance, completion delays and poor workmanship.

Expenditure management reforms

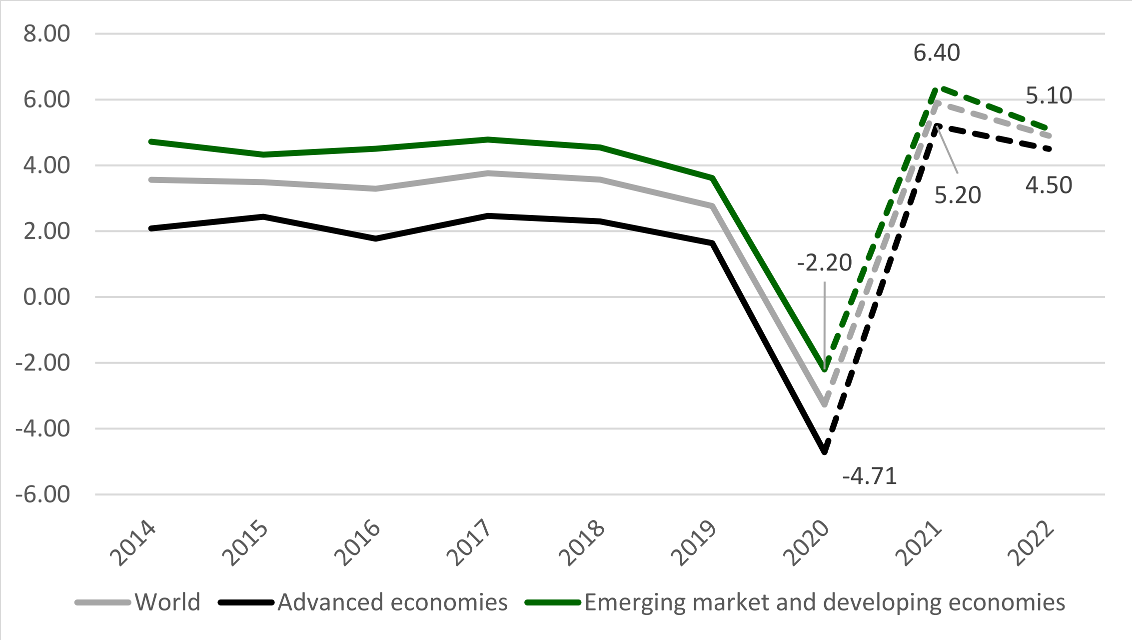
1.8. Expenditure management is beset by weak linkages between policy-making, planning, budgeting and execution. Financial misalignments of crucial programs, poor controls environment and uncertainties of allocated resources are evident by the unexplained cuts on conditional grants and funding of unviable SOEs over the last decade. As the budget implementation process unfolds with the weak institutional framework for controlling and managing expenditure, the process becomes susceptible for leakages to keep many unproductive projects and activities afloat. In its 2021 Submission for the Division of Revenue, the Commission highlighted the potential risk of regression on socio-economic rights due to budget cuts. Expenditure management reforms can help improve broader reprioritisation and determine spending floors necessary to meet the requisite delivery outcomes related to socio-economic rights.

2. Economic Overview

The global view

2.1. The International Monetary Fund (IMF) 2021 report expects global economic growth to grow 5.9% in 2021 and 4.9% in 2022. The projections for emerging markets and developing economies are revised for 2021 from 6.3% to 6.4%. In contrast, the IMF revised down its forecasts for advanced economies, reflecting the mutating pandemic developments and the adapting changes in policy stances undertaken by different countries. Vaccination access has emerged as a critical driver of global recovery despite unequal access to vaccination and countries' vaccine drive and rollout. Some countries are already on a path of resuming all economic activity (almost all advanced economies), while some still face resurgent infections and rising COVID death tolls.

Figure 1: Gross domestic product, constant prices

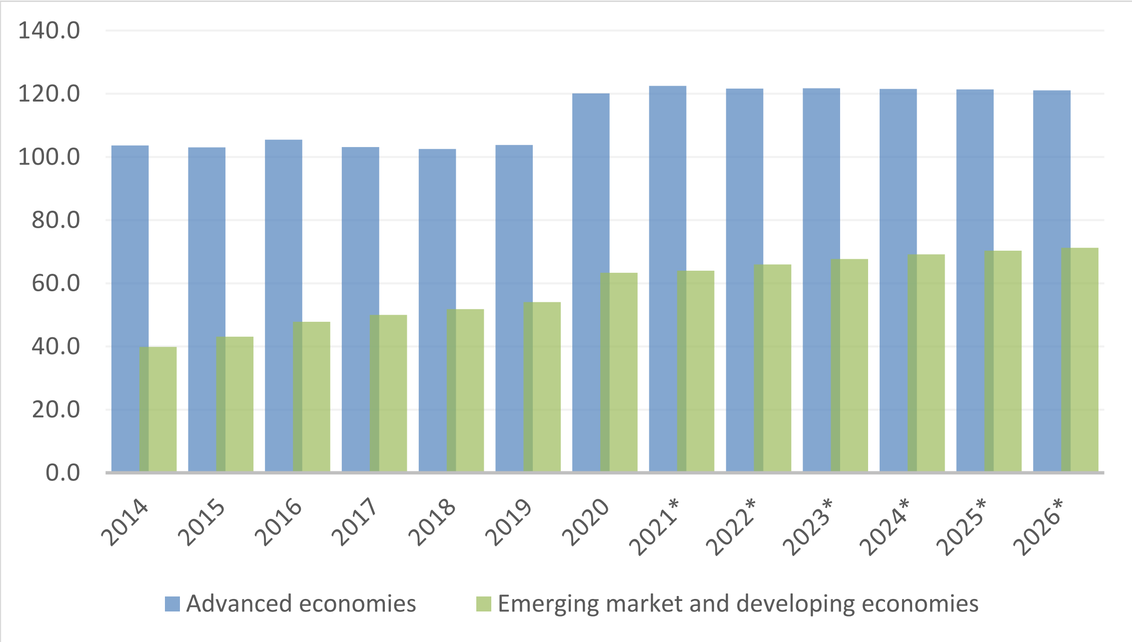


Note: Dotted lines are forecast values
Source: International Monetary Fund

2.2. The economic recovery is set to continue into 2022, with global growth starting to moderate to 4.9% and 4.5% for advanced economies (see Figure 1). The recovery is accelerating in developed economies as many countries are heading for widespread vaccination and reopening all economic activities. The growth of the emerging market and developing economies is estimated to moderate to 5.1% in 2022, as the effects of the pandemic gradually diminish and benefit from commodity prices due to improved external demand.

2.3. Public debt, which was already at high levels before the pandemic, increased in 2020 due to the extraordinary fiscal support measures and declining tax revenues during the onset. Public debt for advanced economies grew from 103.8% of GDP in 2019 to 120.1% of GDP in 2020. Public debt is forecasted to moderate at 122.5% of GDP in 2021 before decreasing to 121.7% in 2022 (see Figure 2). As the impacts of the pandemic subside because of the vaccination rollout, a gradual move towards a stabilising macroeconomic environment to achieve price certainty and public debt sustainability is required. In emerging markets and developing economies, average public debt increased from 54.1% of GDP in 2019 to 63.4% in 2020. Worryingly, public debt is projected to continue to rise into the future in emerging markets and developing economies.

Figure 2: General government gross debt % of GDP



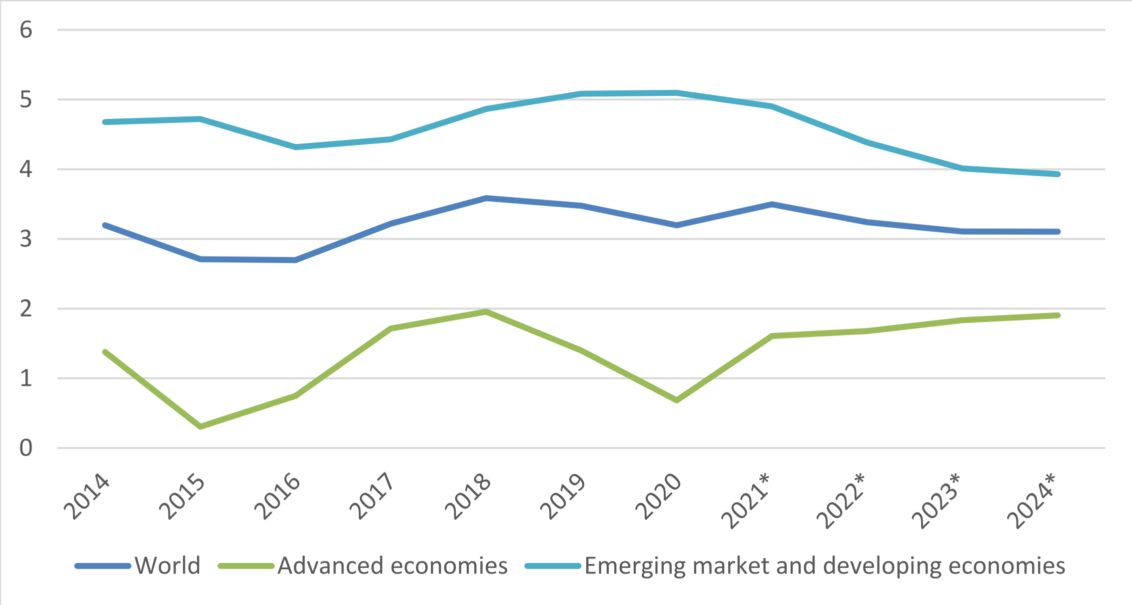
*Note: *Years represent forecasts*
Source: International Monetary Fund

2.4. High public debt can have a significant adverse effect on economic activity. It requires more taxes to finance and drives up real interest rates, which crowds out private capital formation and investments. Some developing countries are already facing the imminent threat of costly debt defaults or distressed debt restructurings (e.g. Brazil), leading to the collapse of the fiscal and, ultimately, the public system. Therefore, policymakers in emerging and developing economies will have to balance the risks of large and growing debt burdens and the pace of stepping down the fiscal supports for COVID-19.

2.5. Inflation is forecasted to remain elevated into 2022 in some emerging markets and developing economies. In emerging markets and developing economies, inflation is expected to be at 4.9% in 2021 before moderating at 4.0% in 2022 (see Figure 3). The rises in oil prices, and a recovery in demand, are expected to return current account balances (increase in trade volumes) to surpluses and increase inflation in many oil-exporting countries. In advanced economies, inflation is forecasted to increase to 1.6%.

2.6. The global economic outlook and prospects continue to face uncertainty and are subject to various risks. The possible spread of COVID-19 and repeated outbreaks are still possible, especially considering the emergence of new variants in many developing countries due to the slow pace of vaccination. Similarly, increased debt levels make the financial system vulnerable to a sudden increase in interest rates, which could stem from a rise in risk aversion, inflation, or expectations of much-too-early monetary tightening.

Figure 3: Inflation rate, average consumer prices (Annual percent change)

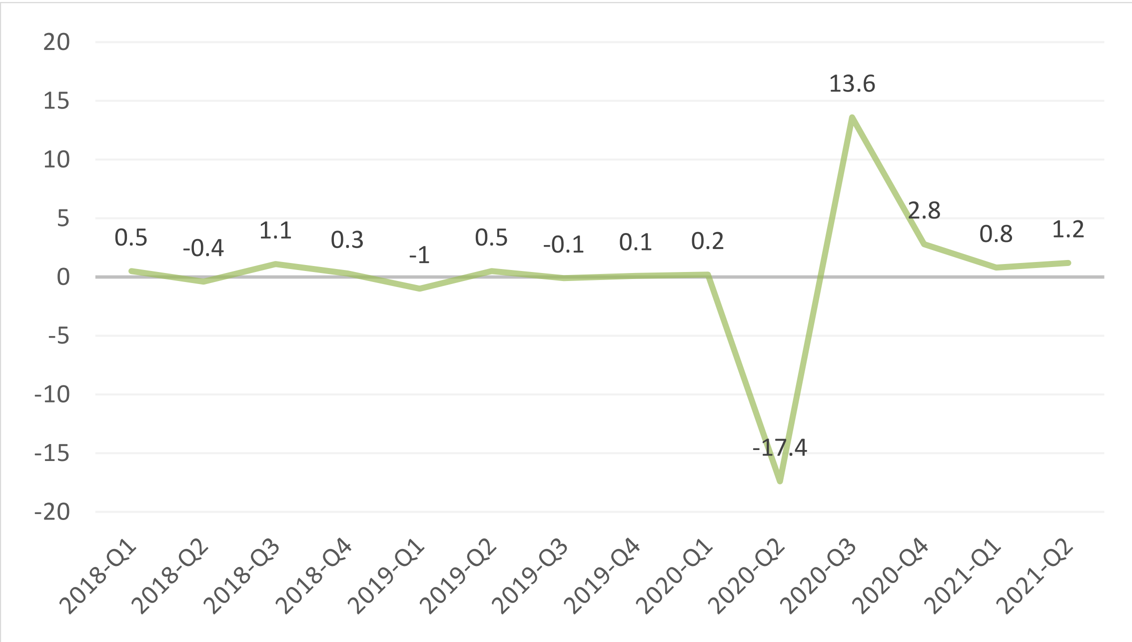


Source: International Monetary Fund

The domestic view

2.7. South Africa's real GDP has increased for the fourth quarter in a row, recovering at a faster-than-expected pace. Real gross domestic product (expenditure side) increased by 1.2% in the second quarter of 2021, and this follows an increase of 0.8% in the first quarter of 2021. However, the possibility of a fourth wave of Covid-19 infections that could lead to stricter lockdown measures amid vaccine hesitancy, electricity-supply constraints, and the slow pace of structural reforms could dampen output in the third quarter. The unrest and damage to property that occurred in KwaZulu-Natal and parts of Gauteng have significantly impacted South Africa's path to recovery.

Figure 4: GDP % change quarter-on-quarter (seasonally adjusted)



Source: Statistics South Africa

2.8. On the demand side, growth in real final consumption expenditure by households alongside an increase in real gross fixed capital formation in the second quarter of 2021 has supported the recovery, following a contraction in the first quarter. General government spending contracted further in the second quarter. Final household consumption increased by 0.5% in the second quarter of 2021 and contributed 0.3% to total growth (see Table 1). Final consumption expenditure by the government experienced a decrease of 0.1% in the second quarter of 2021. As shown by gross fixed capital formation, investment experienced an increase of 0.9%, resulting in a contribution of 0.1% to total growth in the second quarter of 2021. Net exports contributed 0.9% to total growth, attributed by a 4.0% increase in exports of goods and services.

Table 1: Growth rates in expenditure on GDP (% change quarter-on-quarter)

	2019				2020				2021	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Households' consumption	-0.2	0.9	0.1	0.5	0.6	-20.7	18.1	3.1	1	0.5
General government consumption	1.6	0.9	0.9	0.1	0.5	-0.2	0.1	0.6	-0.4	-0.1
Gross fixed Capital formation	1.3	-0.9	1.2	-3.4	-3.1	-21.8	12.8	5.3	-3.1	0.9
Exports of goods and services	-6.6	0.1	-0.7	0.3	-0.6	-29.8	27.9	6	1	4
Imports of goods and services	-0.9	3.9	-2	-2.6	-4.4	-18.4	-0.8	11.2	6.5	0.4

Source: Statistics South Africa

2.9. On the production side, the agriculture sector recorded strong growth in the second quarter of 2021. The agriculture, forestry and fishing sectors increased by 6.2% in the second quarter of 2021 and transport, storage and communication increased by 6.9 in the second quarter. The increase in transport, storage and communication is potentially driven by the gradual opening of the economic activity. Manufacturing activity decreased by 0.8% due to weak domestic demand, rising input costs, electricity supply disruptions, and raw material shortages.

Table 2: Growth rates in industry value added and GDP (% change quarter-on-quarter)

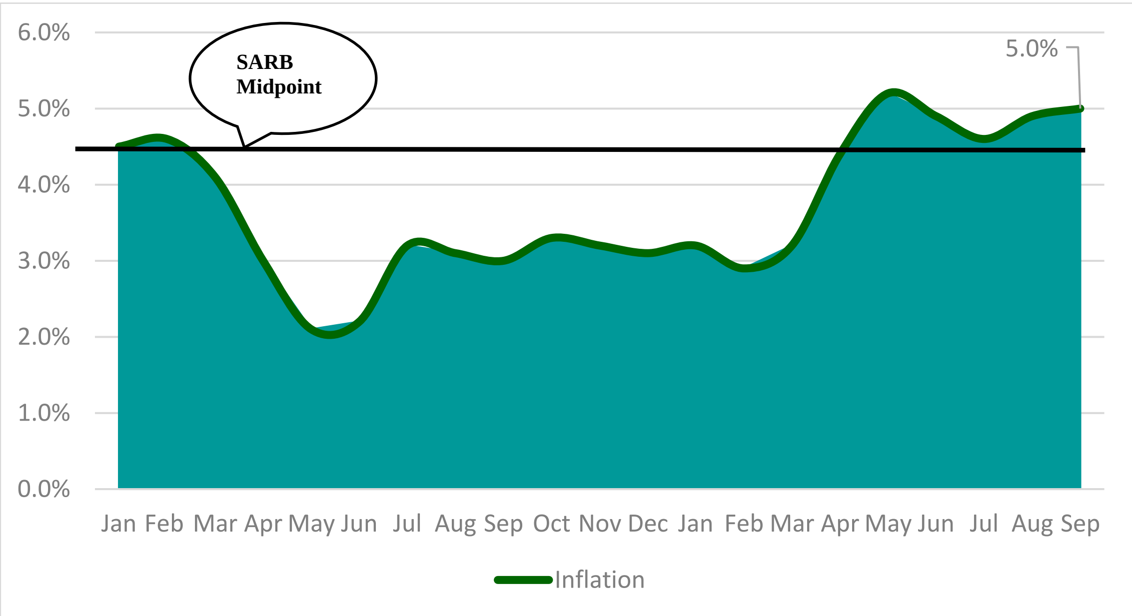
	2019	2020				2021	
	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Agriculture, forestry and fishing	0.2	9.8	-4.3	-0.1	6.6	-1	6.2
Mining	1.3	-4.7	-31.1	45	-0.9	4.3	1.9
Manufacturing	-0.6	-0.6	-31.4	35.3	5.3	0.5	-0.8
Electricity, gas and water	-1.6	-0.9	-11.6	12.6	-0.1	-0.3	0.7
Construction	-1.5	-2.5	-29.9	16	1.5	2.6	2.2
Trade, catering and accommodation	-1.1	-0.8	-26.7	25.1	1.5	2.6	2.2
Transport, storage and communication	-1	-1.3	-26.7	17.3	2.9	-1.1	6.9
Finance, real estate and business services	2.2	2.7	-10.5	6.6	2.9	1.3	-0.4
General government services	-0.2	0.2	-0.3	0.2	0.2	0.3	-0.9
Personal services	-0.2	-0.3	-5.9	4.1	1.7	0.6	2.5

Source: Statistics South Africa

2.10. In the 2021 MTBPS, the government has committed to implementing reforms that could create a competitive economy and boost long-term growth, which the Commission welcomes. Some of these reforms are in electricity, water, telecommunications, and transport. The Commission looks forward to these growth-enhancing agendas; however, noting that the pace of implementing such reforms has been disappointing and slow. It is also important to secure a consistent energy supply in the short-and-medium term to sustain growth.

2.11. Headline, consumer price inflation, accelerated from a low of 2.1% in May 2020 to 5.2% a year later before decelerating to 4.9% in August 2021 (see Figure 5). In both the Annual Submissions for the 2021 and 2022 Division of Revenue, the Commission emphasised the risk that throughout the waves of the COVID-19 pandemic, accelerating headline consumer price inflation was primarily due to core-inflation items: fuel, food, electricity etc. which increased faster than non-core items. And although inflation has remained within the midpoint of the South African Reserve Bank target, some of the short-term supply-push inflation risks include international crude oil prices and higher domestic electricity and other associated costs. Furthermore, the long-term inflation risks foreseen by the Commission include a permanently weaker currency due to the lower-investment grade, underwhelming growth prospect, higher domestic import tariffs and escalating wage demands.

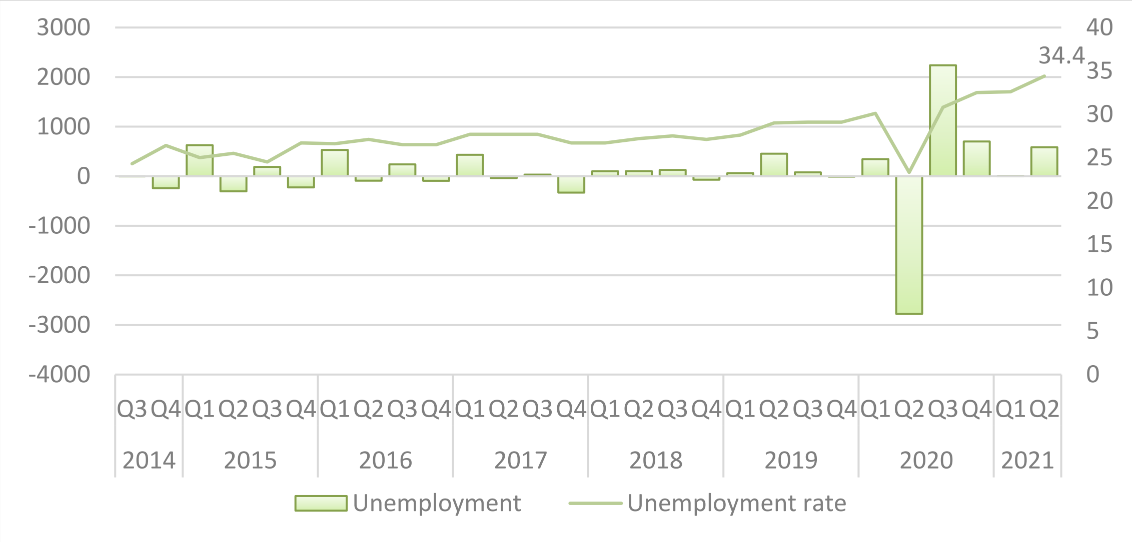
Figure 5: CPI headline year-on-year rates



Source: Statistics South Africa

2.12. The recovery in employment has so far been sluggish, as the scaring of our labour market is made permanent by the pandemic. The official unemployment rate for people actively looking for jobs is at a record high of 34.8% in the second quarter, with discouraged persons' unemployment rate at 44.4% in the second quarter of 2021. The Presidential employment initiative phase 2 received is provisionally allocated R11 billion to boost employment creation. The Covid-19 crisis has hit South Africa's labour market hard, causing both massive cyclical and structural under-employment, exposing long-standing structural weaknesses in the labour market, a testament to our failing education system that is not fit-for-purpose. South Africa's employment problem is mainly structural, reflecting a mismatch between existing labour supply and demand at prevailing market wages.

Figure 6: Unemployment rate 2014 – 2021



Source: Statistics South Africa

2.13. The economic outlook and recovery are still highly uncertain, with significant risks around the pandemic path and the slow rollout of vaccination. It is necessary that efforts to pursue widespread vaccination be intensified. In addition, to further support the recovery, policymakers will have to continue undertaking growth-enhancing reforms and steering the economy onto an inclusive development path.

Recommendations

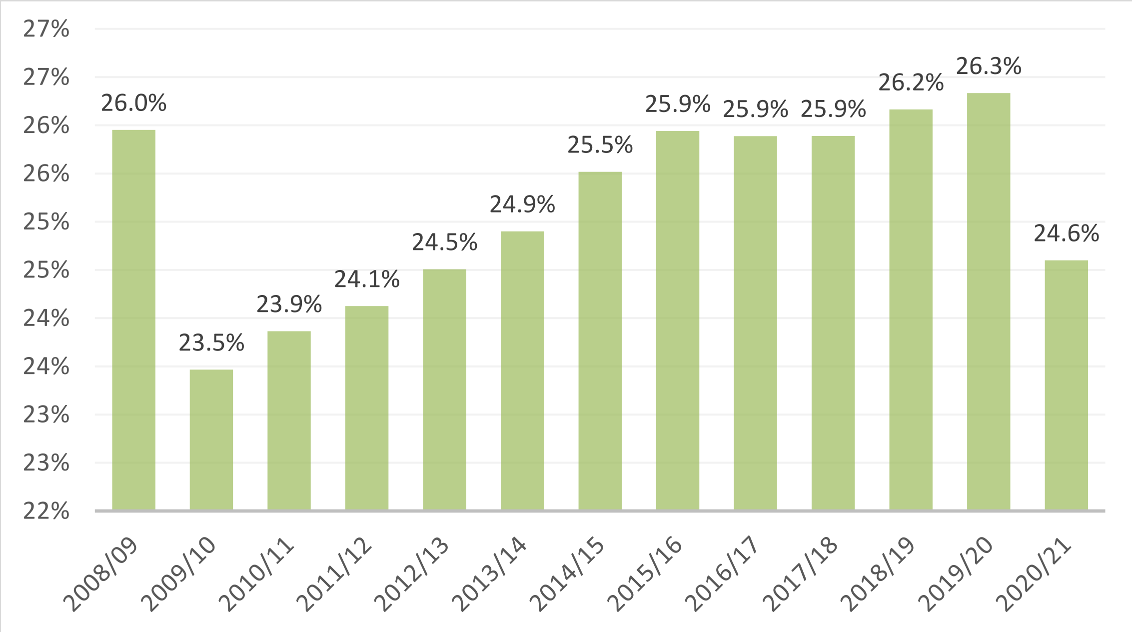
- The long-term growth prospects of the country require addressing structural constraints. Government should implement economic reforms that can help unlock private sector investment and create more jobs. Such reforms should promote economic transformation, support labour-intensive growth, and create a competitive economy. The Commission notes the reforms outlined in the MTBPS – focusing mainly on SOEs restructuring and encourages other crucial dimensions of structural transformation through fiscal and public finance management for greater productivity and value within the public sector - not cost.

3. Fiscal Outlook

Revenue Performance and Outlook

3.1. Although the economy has begun with a tentative recovery, and in-year tax revenue collection increased to higher than estimated in the 2021 Budget, government expenditure remains high for the tax base for every financial year over the medium term. South Africa's tax-to-GDP ratio for the 2020/21 financial year stands at 24.6% and is forecasted to only rebound to the pre-COVID 19 levels of 26.3% in the 2027/28 fiscal year. This is in spite of the estimated tax revenue for 2021/22 being revised higher by R120.3 billion.

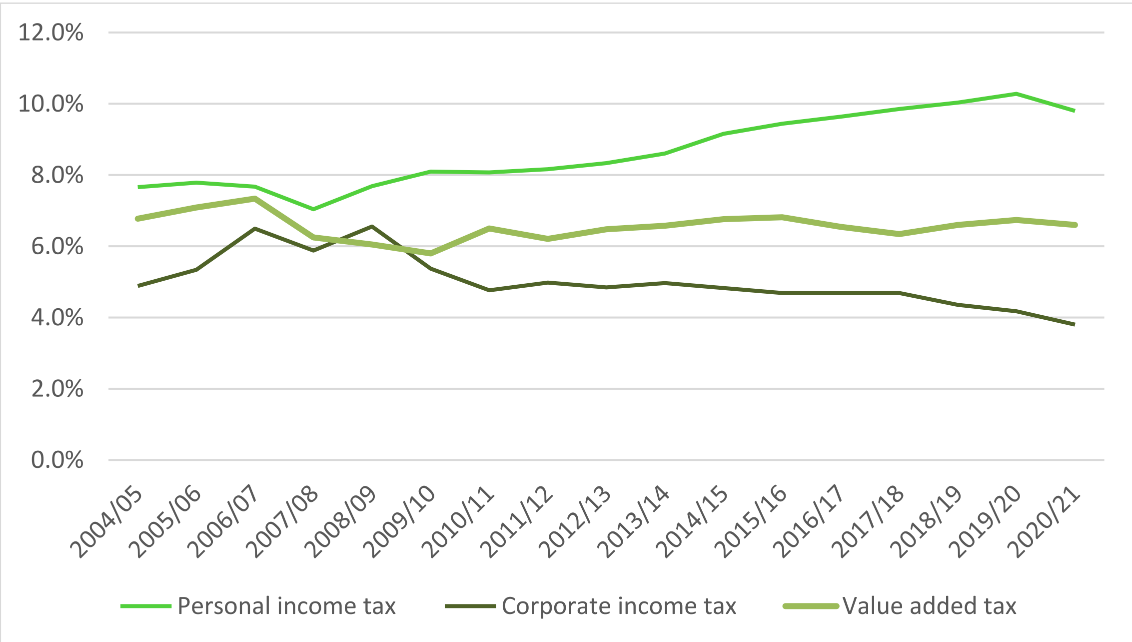
Figure 7: Tax as % of GDP



Source: South Africa Revenue Service

3.2. The Commission sees that the commodity prices cycle is unlikely to persist in the medium- or the long term, so the revenue windfall should not circumvent difficult fiscal adjustments. Personal Income Tax (PIT) collections continue to be challenged by sluggish employment and lower wage growth. As shown in the Commission's Annual Submission research for the 2021 and 2022 Division of Revenue, the corporate income tax has been falling since the 2008 global financial crisis, as it continues to decline.

Figure 8: Main revenue source as % of GDP



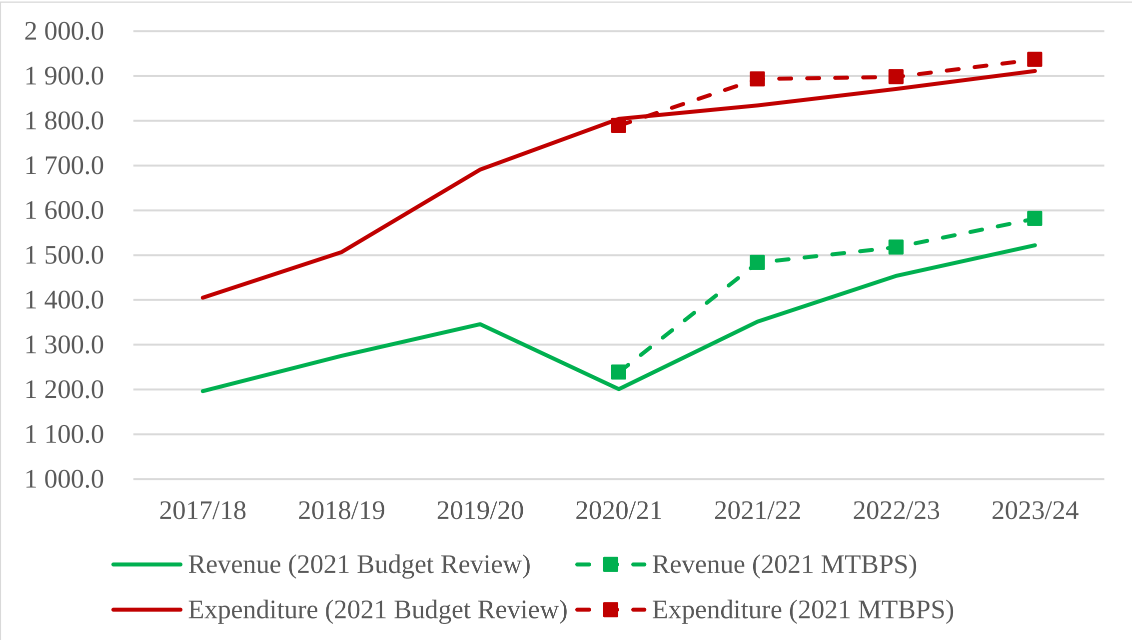
Source: South African Revenue Service

The adjusted fiscal framework

3.3. The fiscal framework as tabled in the 2021 MTBPS is in line with the four main priorities stated by the President during the 2021 Budget Speech. Namely, to save the lives and livelihoods of South Africans by providing massive health responses and providing relief to households and businesses in response to the COVID-19 pandemic and accelerating economic recovery through the Economic Recovery and Reconstruction Plan while stabilising public finances over the medium-term and eradicating corruption. South Africa can and must seek to avoid withdrawing its fiscal support too early and still signal to the public that its debt level is sustainable in the long run by eliminating leakages and executing reprioritisations that are productive and constructive.

3.4. Figure 9 shows that through containing expenditure at the margins and increased tax revenue buoyed by the commodity cycle, the main budget revenue and expenditure narrowed towards an envisaged primary balance in 2024/25. The first primary budget surplus since 2018 has been recorded during the first quarter of the 2021/2022 financial year. It is important to note that this narrowing of the budget deficit was despite the Personal Income Tax relief efforts made for the 2021 financial year with the bracket adjustment and the company tax reduction to facilitate the recovery. Based on this empirical evidence, the Commission believes that the government should continue growing the tax base instead of hiking the tax rate.

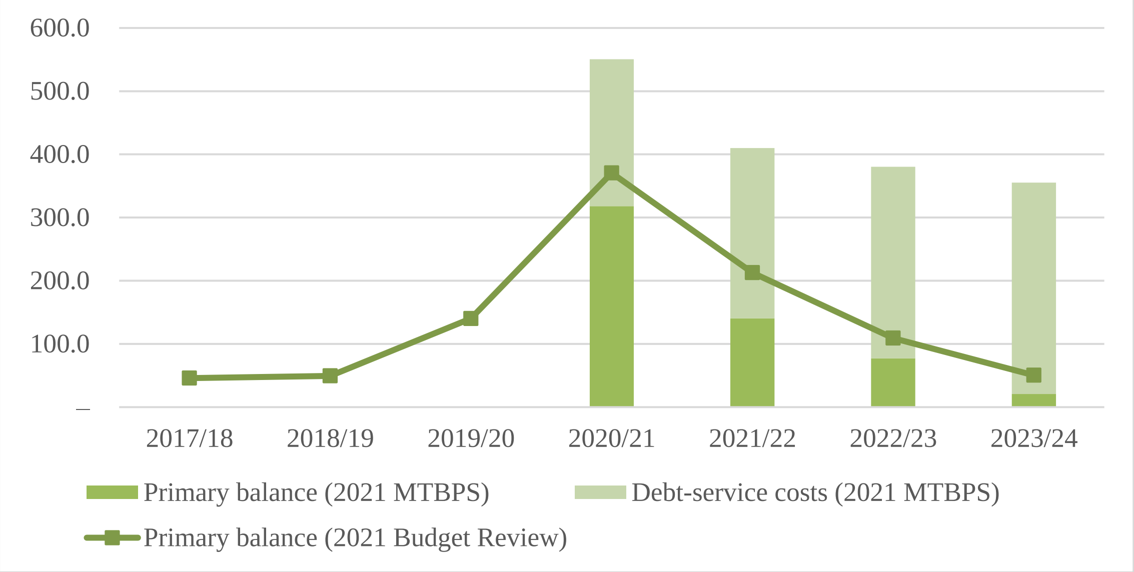
Figure 9: Main budget revenue and expenditure, 2021 Budget vs 2021 MTBPS (R billion)



Source: National Treasury

3.5. Despite the narrowing primary balance (i.e. before debt-service costs) in the 2021 MTBPS relative to the 2021 Budget Review estimates, due to stubbornly high rates of debt-service costs. At just shy of five (5) per cent of GDP or R389 billion, R338 billion of which are debt-service costs, the net main budget balance is therefore still deep in the negative territory over the medium term. The Commission encourages more active management of the debt portfolio to stabilise debt by securing domestic debt instead of foreign debt due to the expected volatilities and losses on foreign currency transactions attributed to the weakened South African rand.

Figure 10: Primary deficit and debt-service costs, 2021 Budget vs 2021 MTBPS (R billion)



Source: National Treasury

3.6. South Africa's economy must grow in tandem with the tax base to improve the fiscal framework by generating higher revenue envelop and aggressively eliminating the leakages and unproductive use of scarce resources. The economy has experienced immense instability accompanied by structural declines in real GDP per capita even prior to the onset of COVID-19. The Minister of Finance has emphasised the need for structural reforms, particularly in the electricity supply industry, mass industrialisation for job creation, as well as promoting a green economy. Mobilising both public sector and private sector investments for an infrastructure-led recovery is crucial in realising this vision of transformation.

3.7. Overall, South Africa's fiscal prospect remains precarious, with a projected primary surplus at 0.2% of GDP in 2024/25, due to the marginal recovery in GDP (albeit from a lower base in post-COVID than pre-COVID) and the revenue windfalls from mining profits. A glimpse of relief to alleviate the budget pressure appeared as a lower public sector wage deal was in sight in August. However, uncertainty remains as the legal process associated with public-service compensation and wage negotiations dwell on, notwithstanding that several state-owned companies and municipalities still have insufficient funds to cover operational expenses.

Highlights of the Tax Matters and Revenue Laws Amendment Bills

3.8. The key tax proposals within the Rates Bill include changes to personal income tax (PIT) brackets and rebates, excise taxes, fuel levies and carbon taxes. The PIT brackets and rebates are proposed to increase by 5 per cent (more than inflation of 4 per cent), which aims to provide tax relief, especially for lower- and middle-income households.

3.9. Notable changes to consumption-based taxes include an 8 per cent increase for excise duties on alcohol and tobacco as well as the Carbon Tax rate, which shall increase from R127 to R134 for the 2021 calendar year.

3.10. In an effort to curb the abuse of the Employment Tax Incentive (ETI), a programme implemented to encourage youth employment; the state proposed an amendment to the definition of "employee", which clarifies the ability for an employer to be eligible for the tax incentive. Employees need to participate in work as stipulated in the employment contract actively and must be documented in the employer's records as envisaged by the Basic Conditions of Employment Act.

3.11. A notable proposal affecting the corporate sector is to restrict the balance of assessed losses to offset the firm's taxable income. Currently, taxpayers can offset the amount of taxable income due by carrying all assessed losses forwards into a new financial year, thereby reducing the tax burden on the firm. The Taxation Laws Amendment Bill (TLAB) proposes that businesses are only able to carry over 80 per cent of their assessed losses into the next financial year and are subject to 20 per cent of the taxable income in the current financial year. As fewer accrued losses are carried over, more profits are available for taxation, increasing the corporate tax base, allowing scope to decrease the corporate tax rate from 28% to 27%, which aims to promote investor confidence and business activities.

3.12. In addressing the hardship faced by South African businesses, the state released the Emergency Tax Measures in Response to the Continuing COVID-19 Pandemic and Recent Unrest. This measure included a reinstatement of the Employee Tax Incentive (ETI) for another limited four-month period. And for small or medium-sized businesses, it was proposed that the payment deferral of employees' tax liability (PAYE) be reinstated for an additional three-month period. The relevant principles applying to this tax relief measure include a deferral of payment of 35% of the PAYE liability without the imposition of administrative penalties and interest for late payment.

Recommendations

- The Commission supports the economic reforms tabled by the Minister of Finance, focusing on improving competitiveness through lowering the barriers to entry and developing logistics infrastructure to create employment, over bailing out state-owned companies that have been tested and failed for many years.
- During the Second Special Appropriation Bill, the Commission noted the additional spending needed to counter the economic consequence of the pandemic and social unrest. The Commission remains firm on its stance that the need to exercise financial restraint to achieve fiscal prudence must not come at a net cost for the socio-economic conditions of our people to regress. South Africa can and must seek to avoid withdrawing its fiscal support too early and still signal to the public that its debt level is sustainable in the long run by eliminating leakages and executing reprioritisations that are productive and constructive.

- The Commission supports the amendments found in the Tax Laws Amendments Bill, Tax Administration Laws Amendment Bill, Draft Rates Bill, and the proposals in the Emergency Tax Measures to combat the COVID-19 pandemic. The proposed amendments act to curb circumvention of current tax rules and increase the tax base, assisting with higher revenue collection. At the same time, there are specific measures, such as the Emergency Tax Measures and the changes to the rates and thresholds of the PIT tables, that seek to provide additional assistance to those adversely affected by the pandemic.

4. 2021 Adjustment Appropriation Bill

4.1. The aim of the Adjustments Appropriation Bill is to effect adjustments to the appropriations made in the Appropriation Bill of a particular year. The 2021 Adjustment Appropriation Bill thus effects changes to the appropriation of funds in respect of 2021/22. These adjustments are also referred to as in-year spending adjustments.

4.2. The 2021 Adjustment Appropriation Bill is preceded by a Second Special Appropriation Bill that was tabled in August 2021 and prompted by a combination of the ongoing and multiple impacts of the Covid-19 pandemic and the civil unrest that occurred during July 2021. The Second Special Appropriation Bill proposed additional spending of R32.850 billion – the bulk of which (R26.7 billion) was to fund the extension of the Social Relief of Distress Grant located under the Social Development Vote.

4.3. The 2021 Adjustment Appropriation Bill proposes additional adjustments to spending: R15.023 billion to vote appropriations and R26.936 billion to estimates of direct charges against the National Revenue Fund.

4.4. In terms of the adjustments to vote appropriations, the following is highlighted:

- Total appropriation by vote increases by R15.023 billion from an initial appropriation of R980.584 billion to R1.028 trillion for 2021/22
- R5.833 billion is in respect of public sector salary adjustments for national government departments (classified as significant and unforeseeable economic and financial events). The most considerable additions were to the labour-intensive Police (R2.868 billion) and Defence (R1.313 billion) votes, which account for 72% of the R5.833 billion.
- R102.6 million is in respect of unforeseeable and unavoidable expenditure. Of this amount, R50.5 million is for the SA National Roads Agency (Transport Vote) as a result of loss of toll revenue, while R40 million was to cover the cost of PPE required during the local government elections - allocated to the Electoral Commission of South Africa located under Home Affairs.
- Regarding expenditure earmarked in the 2021 Budget Speech for future allocation, the bulk of the adjustment (R11 billion) relates to funding for Phase 2 of the Presidential Employment Initiative, which will see a specific focus on youth employment (referred to as the Youth Employment Intervention). The bulk of the funds in respect of the youth employment intervention will be allocated via the National Treasury, Trade, Industry

and Competition and Agriculture, Land Reform and Rural Development votes. Given current record levels of unemployment, spending via this initiative is welcomed. Additional earmarked expenditure announced in the 2021 Budget Speech related to R2.342 billion for the purchase of vaccines.

- Rollovers amount to R2.8 billion. A portion of the rollovers amounting to R250 million, which emanates from the Agriculture, Land Reform and Rural Development and the Sports, Arts and Culture votes, relates to Phase 1 of the Presidential Employment Initiative. Care must be taken to ensure that reasons for not spending the full amount resulting in rollovers are addressed to avoid a wasteful repetition of this in Phase 2 of the rollout.
- Declared unspent funds amounting to R1.95 billion is driven mainly by the Transport Vote, where R1.34 billion relates to the Public Transport Network Grant underspent. The root causes of the challenges characterising this grant need to be established and addressed as issues around performance have been raised consistently in the 2020 MTBPS and the 2021 Budget Review[1].

Table 3: Adjusted Appropriation for Selected Key Votes, 2021/22

			2021/22 Adjustments Appropriation (R'billion)					
Selected Key Votes	**Approp.**	**Special Approp.**	**Rollovers**	**Amounts Ann. in Budget**	**Declared Unspent Funds**	**Other Adjust-ments**	**Total Adj. Approps.**	**Adj. Approps.**
Home Affairs	8.7	-	-	-	-	0.7	0.7	9.4
National Treasury	41.1	3.9	-	0.8	- 0.3	-	0.6	45.5
Public Works & Infra.	8.3	-	-	-	-	0.0	0.0	8.4
Basic Education	27.0	-	0.2	-	-	0.0	0.2	27.2
Higher Education &Training	97.8	-	-	0.2	- 0.1	-	0.1	97.9
Health	62.5	-	-	2.4	- 0.2	0.0	2.2	64.8
Social Development	205.2	26.7	-	0.2	-	0.0	0.2	232.1
Women, Youth & Persons with Disabilities	0.8	-	-	0.4	-	0.0	0.4	1.2
Defence	46.3	0.7	-	-	-	1.8	1.8	48.8
Police	96.4	0.3	1.0	-	-	2.9	3.9	100.5
Agri., Land Reform and Rural Develop.	16.9	-	0.2	0.8	-	0.1	1.1	18.0
Employment and Labour	3.5	-	-	0.3	-	0.1	0.3	3.8
Human Settlements	31.7	-	0.0	-	-	0.0	0.0	31.7
Science & Innovation	8.9	-	-	0.1	-	0.0	0.1	9.0
Tourism	2.4	-	-	0.1	-	0.0	0.1	2.5
Trade, Industry & Comp.	9.7	1.3	-	0.8	- 0.0	0.0	0.8	11.8
Transport	66.7	-	-	-	- 1.3	0.1	- 1.3	65.4
Water & Sanitation	16.9	-	0.6	0.2	-	0.0	0.8	17.7
Total Approp. by Vote	**980.6**	**32.9**	**2.8**	**7.1**	**- 2.0**	**7.0**	**15.0**	**1 028.5**

Source: AENE, Introductory Table No. 2.

[1] *2021 Budget Review noted that of the local government grants, this grant experienced the largest proportional reduction (of R1.3 billion), because only six of the 13 cities receiving the grant have successfully launched public transport systems.*

4.5. In terms of adjustments to estimates of direct charges against the National Revenue Fund, the following is noted:

- The largest upward adjustment of R21.149 billion is to the PES, largely to provide public sector salary adjustments of R14.679 billion.
- Downward adjustments are made to debt-service costs (revised down by R507.139 million) and magistrates' salaries which are reduced by R30 million.
- An R2.9 billion adjustment is made to assist Denel in settling repayments. This adjustment is made in terms of Section 70 of the PFMA, which relates to guarantees, indemnities and securities by cabinet ministers[2].

4.6. The adjustments outlined above are offset against: (a) Drawing down on the contingency reserve in the amount of R9.039 billion, (b) R4 billion from Infrastructure Funds not assigned to votes, (c) Projected national government underspending amounting to R3.775 billion and (d) R2.5 billion in respect of local government repayments to the National Revenue Fund.

4.7. Taken together, the total expenditure appropriated in the main budget (2021 Appropriation Bill) amounted to R1.834 trillion. The Second Special Appropriation Bill saw an upward adjustment of R32.850 billion, and this 2021 Adjustment Appropriation Bill adjusts expenditure upwards by R26 billion. This increases the total estimated expenditure for 2021/22 to R1.893 trillion. Therefore, the main budget, non-interest spending, sees a net upward adjustment of R59.4 billion due to the total adjustments effected between the 2021 MTBPS and the 2021 Budget.

Recommendations

- Overall, the 2021 adjustments were dominated by the following aspects - making provision to cover the increased costs associated with the 2021 public service wage agreement, implementing the Youth Employment Intervention, assisting Denel to meet its obligations and provide for the purchase of vaccines. In addition, income support through the extension of the Social Relief of Distress Grant was the overriding focus of the adjustments proposed through the 20201 Second Special Appropriation Bill in August. The Commission supports the 2021 Adjustment Appropriation Bill and makes the following comments:
    - In respect of adjustments for wage increases, the purchase of vaccines and, to a lesser extent, the assistance provided to Denel, these can be seen as necessary adjustments where the government had limited flexibility. Notwithstanding, the need to restructure SOCs remains a long-standing challenge requiring urgent

[2] *Section 70 of the PFMA states that: "A Cabinet member, with the written concurrence of the Minister… may issue a guarantee, indemnity or security which binds the National Revenue Fund in respect of a financial commitment incurred or to be incurred by the national executive. The section further states that any payment under a guarantee, indemnity or security issued in terms of the above, "is a direct charge against the National Revenue Fund, and any such payment must in the first instance be defrayed from the funds budgeted for the department that is concerned with the issue of the guarantee, indemnity or security in question".*

action as they continue to drain already stretched state resources. In addition, the Commission awaits the details of the public sector remuneration strategy, which is currently under development. The Commission is optimistic that the strategy will propose a sustainable solution to balancing public sector wage bill requirements relative to competing for expenditure demands in a fair manner to all parties concerned.

- The Commission welcomes the second phase of the Presidential Employment Initiative that has a distinct focus on youth employment. Given the current dire levels of unemployment facing youth in South Africa, it is anticipated that this programme will bring relief and build additional skills that could assist in gaining full-time employment.
- The sentiment expressed by the Commission in its Submission to Parliament on the Second Special Appropriation Bill, 2021 is reiterated here: Whilst the Commission agreed with the adjustment required to extend the Social Relief of Distress Grant, given the experience of the implementation and relief brought by the grant, there was a need for the Minister of Finance to consider the policy options and affordability of some form of income protection/Basic Income Grant. This will enable better planning and prevent the need for stopping/reintroducing support measures for poor and vulnerable South Africans.

5. 2021 Division of Revenue Amendment Bill – Provinces

Overview of provincial government allocation

5.1. The 2021 MTBPS proposes a total provincial allocation of R1.9 trillion over the 2022 MTEF, representing a nominal 3% increase from the 2021 budget allocation. Data below shows that the 2022 allocations to the province are yet to recover to the 2020/21 total provincial baseline allocation. Compared to the 2021 budget, provincial total allocation has been revised upwards by R20 billion in the 2021 MTBPS mainly to cater to CoE adjustments. In line with the government goals of budget consolidation, the equitable share is projected to decrease slightly in 2022/23 and 2023/24 before recovering to a level above the 2021 MTBPS revised allocation. The decrease is mainly based on the assumption that provincial CoE baselines shall remain repressed. The growth rate of provincial conditional grant allocations is also expected to remain stagnant over the 2022 MTEF as the government continues with expenditure moderation. The Commission further welcomes the proposal to rationalise various sub-components of the HIV, TB, Malaria and Community Outreach Grant. This will minimise grant administration and provide provinces sufficient flexibility to spend the grant in accordance with their respective needs. The Commission is currently conduction research on repurposing and realigning the system of conditional grants to both the design of grants and the efficacy thereof.

Table 4: Provincial allocations – comparison to the 2020/21 baseline

Provincial budget allocations	2020/21	2021/22	2022/23	2023/24	2024/25
2020 budget					
PES	538 472	573 990	607 554		
Conditional grants	110 785	117 962	123 137		
Total	**649 256**	**691 951**	**730 690**		
2020 supplementary budget					
PES	538 472				
Conditional grants	106 823				
Total	**645 295**				
2020 MTBPS					
PES	520 717	513 973	521 988	523 111	
Conditional grants	107 594	115 381	119 766	122 452	
Total	**628 311**	**629 354**	**641 754**	**645 563**	**-**
2021 budget					
PES	520 717	523 686	524 088	525 304	
Conditional grants	107 594	115 783	119 260	121 520	
Total	**628 311**	**639 469**	**643 343**	**646 824**	
2021 MTBPS					
PES		544 800	538 800	525 300	548 900
Conditional grants		116 400	119 600	121 900	127 200
Total		**661 200**	**658 400**	**647 200**	**676 100**

Source: (National Treasury, 2020 – 2021)

Recommendations

- The Commission believes that expenditure moderation must be followed by comprehensive reports from the affected government departments indicating to Parliament how they intend to manage tighter budgets and cushion delivery of essential social services.

6. 2021 Division of Revenue Amendment Bill – Local Government

6.1. The 2021 MTBPs was presented shortly after the local government elections. The elections resulted in 66 (31%) of the 213 contested municipalities having hung councils[3], i.e., more than double the 27 hung councils borne out of the 2016 elections. Many hung councils will most likely end in coalition local governments.

6.2. Although coalition councils have advantages (such as providing checks and balances or allowing a wider range of views), coalition councils have many disadvantages (instability, uncertainty, or lack of common ideology and purpose), which may result in suboptimal service delivery. If post-2016 coalitions are anything to go by, they caused service delivery in many municipalities to ground to a halt. In this regard, the Commission implores coalition councils to shun political bickering and place people at the centre of their decisions. As councils are being constituted, government and other stakeholders are called upon to set in motion programmes and resources to capacitate new councillors. The LGFF will also experience additional pressures as non-returning

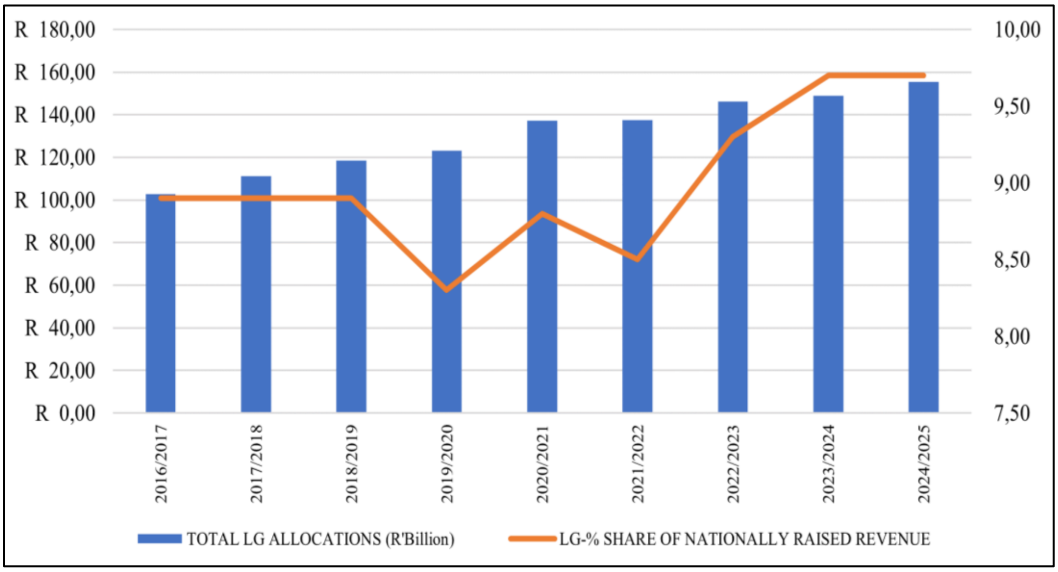
[3] A hung council refers to when no party has won the majority of the seats therefore making the parties with the most votes or seats as the key decision-makers or known as a coalition municipality.

councillors are paid their once-off gratuities. The February budget statement proposed reprioritisation of monies from the municipal infrastructure grant and the integrated urban development grant, to fund the gratuities of non-returning councillors.

Local government fiscal framework changes

6.3. Over the 2021 MTEF, the local government sector is allocated R450.6 billion, divided into R254 billion in the form of unconditional grants and R149.7 billion in conditional grants (see Table 1 below). The total allocations are projected to decrease by 0.12% over the MTEF in real terms. Considering the poor growth in local government transfers, the Commission underscores the importance of prioritising own revenue-raising capacity in the local government sector to ensure sustainable service delivery. Municipalities should be encouraged to pursue alternative revenue sources.

Figure 11: LG share of nationally raised revenue



Source: Commission calculations from National Treasury MTBPs data

Table 5: Division of Revenue Focusing on Local Government and Real Growth Rates

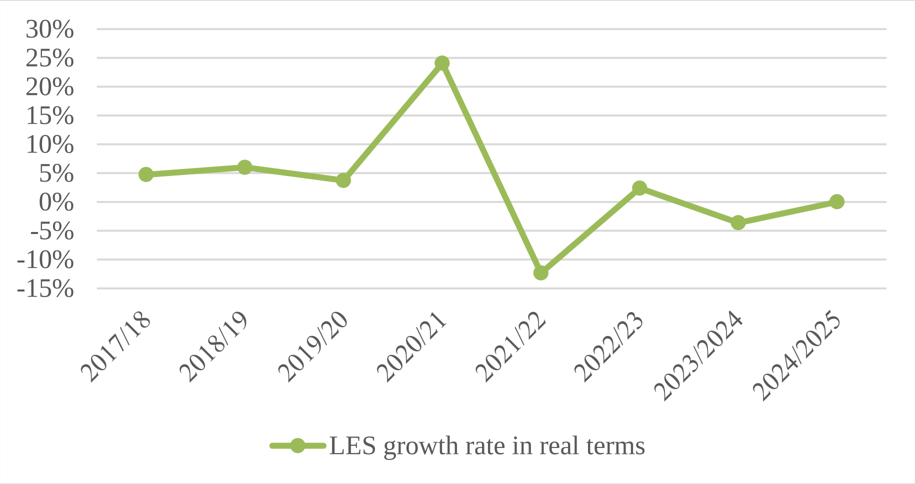
	Outcome			Revised	MTEF			
R billion	**2018/19**	**2019/20**	**2020/21**	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**Total MTEF**
Local government	118.5	123	137.1	137.6	146.3	148.9	155.4	450.6
Equitable share	60.8	65.6	83.1	78	83.1	83.6	87.3	254
General fuel levy	12.5	13.2	14	14.6	15.3	15.4	16.1	46.9
Conditional grants	45.3	44.2	40	45	47.9	49.9	51.9	149.7
Real Growth Rates	**2019/20**	**2020/21**	**2021/22**	**Average 2019-2022**	**2022/23**	**2023/24**	**2024/25**	**Average MTEF**
Local government	-0.2%	5.9%	-3.3%	0.8%	2.2%	-2.5%	-0.1%	-0.1%
Equitable share	3.8%	20.3%	-9.6%	4.8%	2.4%	-3.6%	0.1%	-0.4%
General fuel levy	1.5%	1.2%	0.4%	1.0%	0.8%	-3.6%	0.1%	-0.9%
Conditional grants	-6.1%	-14.1%	8.4%	-4.0%	2.4%	-0.2%	-0.4%	0.6%

Source: Commission calculations from National Treasury MTBPs data

The local government equitable share and conditional grants

6.4. The total LGES allocation is expected to increase from R78.0 billion in 2021/22 to R87.3 billion in 2024/25. On average, the LGES will register a -0, 4% growth over the 2021 MTEF (Figure 2). The Commission is concerned with this projected decrease in the LGES allocations. In a way, such a trend will compromise the progressive realisation of basic rights of poor and vulnerable households who depend on transfers for services.

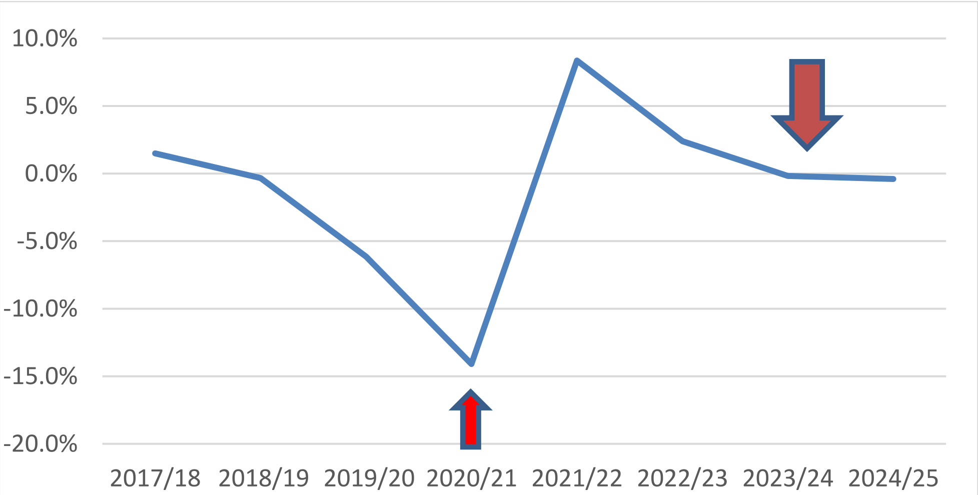
Figure 12: LES Real Growth Rates



Source: Commission calculations from National Treasury MTBPs data

6.5. A total of R149.8 billion is set to be transferred to municipalities in the form of conditional grants over the 2021 MTEF. In real terms are set to grow by 2.4% in the 2022/23 financial year, and in the two outer years (2023/24 and 2024/25), transfers through this window are set to record negative growth rates of -0.2% and -0.4%, respectively (see Figure 3 below). The FFC notes with concern this slow average growth (average 0.6%) over the 2021 MTEF. This will likely have detrimental effects on service delivery and the recovery process in the sector. Ideally, conditional grants should exhibit upward growth over the 2021 MTEF in line with the government's partly infrastructure driven economic recovery plan.

Figure 13: Local government conditional grants – real growth rates



Source: Commission calculations from National Treasury MTBPs data

6.6. The FFC welcomes the additional allocation of R841 million to the direct component of the neighbourhood development partnership grant (NDPG) allocated for the Presidential Youth Employment Initiative to create jobs given the high levels of unemployment in the country, especially for the youth. However, the Commission would recommend some consolidation of grants meant to support labour-intensive delivery of infrastructure services to municipalities.

6.7. The Commission notes the in-year conversion of a component of the MIG to an indirect grant in municipalities identified as in crisis. Although the targeted municipalities are in crisis, in principle, the FFC would like to caution the government against converting direct to indirect grants as it assumes government departments would perform better. The Commission's previous submissions have shown that indirect grants do not necessarily perform better than direct grants. On the contrary, the Commission found out that direct grants perform better than indirect grants. The FFC highlighted the need to have principles in place to guide the reclassification of grants from direct to indirect (and vice versa). FFC also underscores the need for building municipalities' capacity so that they can utilise direct grants and that the use of indirect grants should be a matter of last resort.

6.8. Municipalities are still dealing with the uncertainties emerging from the Covid-19 crisis. The impact of the Covid-19 pandemic on the sector has been devastating. The pandemic exposed numerous deficiencies in the local government space. Many municipalities are in distress and face substantial debt burdens. The Commission encourages municipalities to challenge the traditional way of doing things and focus on maximising efficiencies and pursuing policies that leave no one behind. The Commission is concerned with the projected decrease in the real growth rate of the LGES allocations. This will have a negative impact on service delivery and compromise the progressive realisation of basic rights of poor and vulnerable households who count on transfers for their basic needs. The lacklustre growth in conditional grants will also compromise the government's infrastructure-led recovery process.

Recommendations

- The Commission implores coalition councils to shun adversarial politics and place people at the centre of their decisions.
- The government should set in motion programmes and resources to capacitate new councillors.
- The Commission recommends the government protect the LES as its continuous decline will compromise gains achieved in the progressive realisation of basic rights.

7. Fiscal Risk Statement

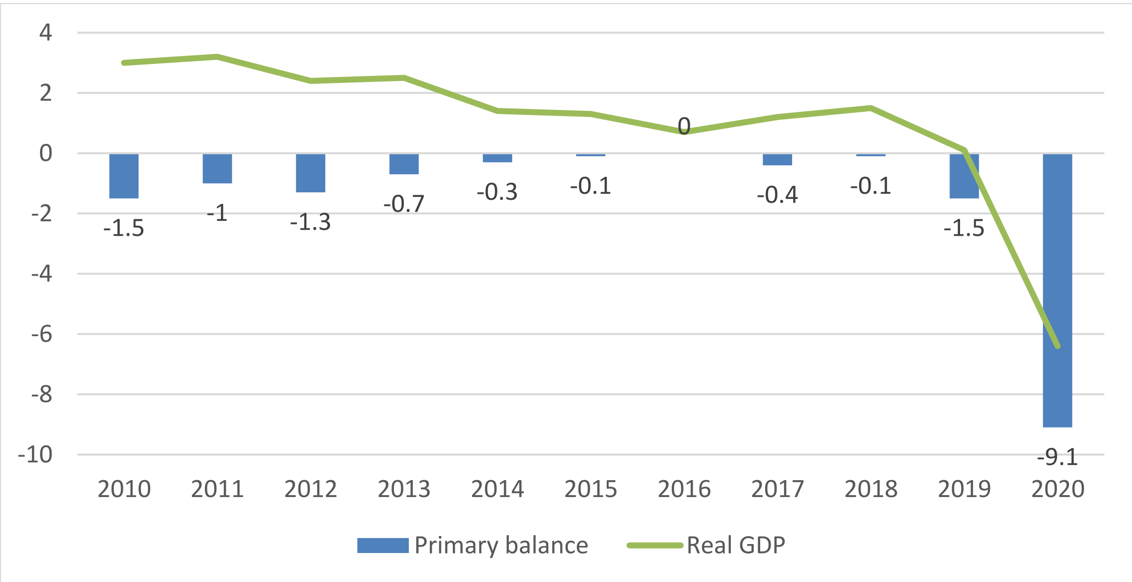
Debt management risks

7.1. A mixture of lacklustre GDP growth paralleling elevated and growing public debt, as well as surging debt-service costs, is presenting a significant risk to the sustainability of public finances. South Africa has been experiencing swelling government debt for more than a decade. The 2021 Medium Term Budget Policy Statement (MTBPS) is projecting that government debt will stabilise at 78.1 per cent of GDP in 2025/26, compared with the 95.3 per cent of GDP target forecasted in 2020 MTBPS. This is partly because of the short-term relief offered by the improved 2020/21 revenue collections as well as the benchmarking and rebasing of South Africa's national accounts by Statistics South Africa (Stats SA) and the South African Reserve Bank (SARB). Consequently, the gross loan debt as a ratio of GDP at 69.9 per cent is below the initially budgeted target of 81.9 per cent for 2021/22.

7.2. The increasing level of public debt is resulting in debt-service costs accounting for a growing share of expenditure. Consequently, debt-service costs were the fastest-growing item in the 2021 Budget. The 2021 MTBPS states the debt-service costs will increase by an average of 10.8 per cent over the MTEF period. As a share of the main budget expenditure, debt-service costs will increase from 14.2 per cent in 2021/22 to 17.9 per cent in 2024/25. This is resulting in fewer resources available for funding other government priorities. Most importantly, the increase in real interest rates on long-term government bonds means there is a real possibility of further debt-cost rising as the debt stock is refinanced.

7.3. The progression of the public debt-to-GDP ratio is fundamentally a function of the primary balance, which is essentially the interest rate that government pays on its debt in relation to the GDP growth rate. In the past decade, the government has constantly posted a primary balance deficit while the GDP growth has also been sluggish, as shown in Figure 14 below. The Covid-19 pandemic shock severely impacted economic growth, and therefore tax revenues exacerbated the primary deficit and interest rate differential. This means that the stabilisation of government debt will require an uninterrupted period in which the primary budget must be surplus, given that the economy's potential growth rate remains very low.

Figure 14: The primary balance and GDP growth rate, 2010-2020



Source: National Treasury Budget Reviews, various editions

7.4. In contrast, the real interest rate on the public debt average is relatively high, and a relatively higher primary surplus would be required to stabilise the government debt. The government has forecasted that real interest rates will moderate and GDP growth will improve. A primary balance between 1.6 per cent and 1.8 per cent of GDP will suffice to stabilise the debt. If economic growth improves, stabilising debt will be eased. However, if debt-service costs continue to increase, it will become more challenging. In essence, a persistent increase in government debt and the interest rate will translate into an increased debt burden, thus straining public finances and the economy.

7.5. Historical data on the primary balance shows that a primary surplus of more than 1.5 per cent of GDP persisted for more than a decade between 1998 and 2008. This means that considering past achievements, the primary surplus required to stabilise public debt could be achieved, and therefore the public debt is currently sustainable. However, adjudicating debt sustainability by financial metrics such as the size of the debt-to-GDP ratio can be misleading because of their arbitrary nature. This makes the trajectory of the debt-to-GDP ratio more critical than its ratio when conducting debt sustainability analysis. The government debt trajectory in South Africa remains very high. According to the International Monetary Fund (IMF) data, South Africa's increase in government debt is the second-highest compared with 19 peer emerging market economies. Moreover, South Africa has the third-highest projected level of gross government debt for 2023 when compared with these economies.

7.6. The economy's potential growth is meagre, and the real interest rate on public debt is rising, implying an upward trend in the trajectory of the debt-to-GDP ratio. This also means a significant fiscal adjustment will be required to move the primary balance from the current primary deficit of -4.1 per cent of GDP for 2021 to the necessary primary surplus of more than 1.5 per cent. It is also worth noting that the macroeconomic strength and, therefore, sustainability of the public finances requires a reduction in the stock of government debt instead of merely stabilisation. In this context, larger primary surpluses will be needed to improve the GDP growth differential dynamics.

Contingent liabilities

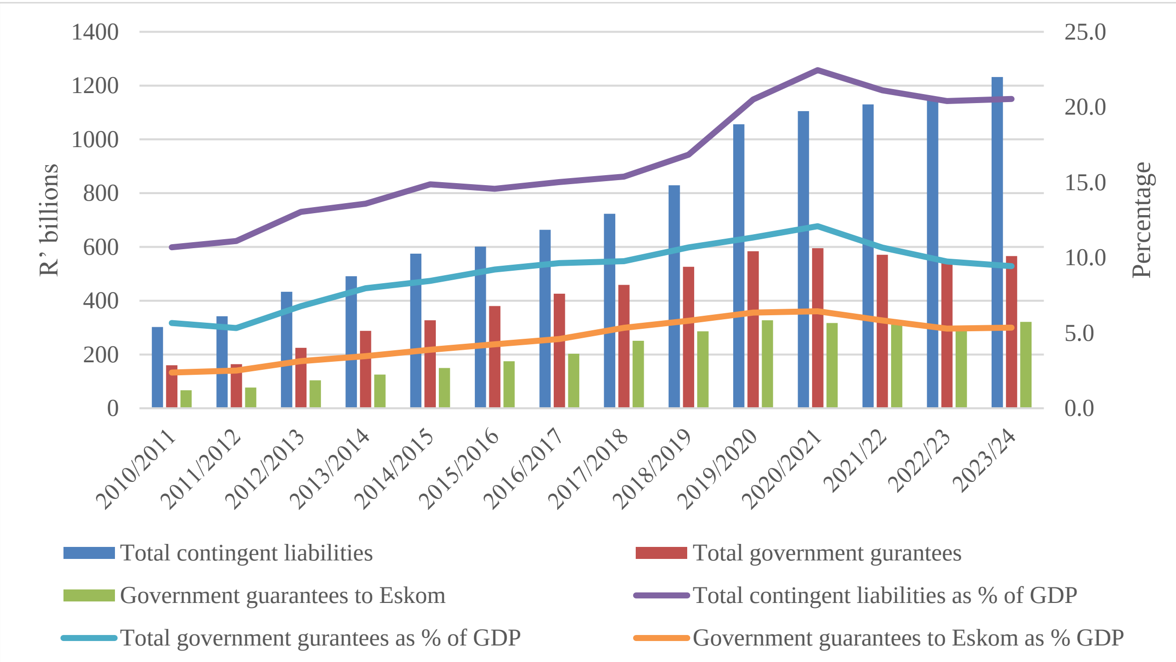
7.7. Contingent liabilities are obligations that only occur when specific discrete events take place in the future and are therefore differentiated from direct liabilities where the settlement date is agreed upon when the nominal obligation is made. This means they pose a risk relating to the increase in government debt resulting from unforeseen commitments that may materialise. Contingent liabilities, therefore, represent high significant economic and fiscal costs. In the 2021 MTBPS, contingent liabilities amount will reach R1.2 trillion or 20.5 per cent of GDP in 2023/24. This represents a significant fiscal risk because if a contingent liability materialises, funds must be redirected from the fiscus committed elsewhere in the budget for spending.

7.8. Government guarantees are legally binding responsibilities offered by a government to accept liability for servicing debt on behalf of another entity under specific conditions, usually a default by that entity. The substantial accumulation of guarantees represents the risk of a fiscal shock because the government could lack adequate resources to service commitments emanating from guarantees. This risk is aggravated during times of crisis because of its correlated nature. Government guarantees to state-owned entities (SOEs) amounted to 53.8 per cent of total contingent liabilities in 2020/21. According to the 2021 MTBPS, in 2023/24, the total amount for approved guarantee to SOEs is R566 billion, and more may be needed as the Covid-19 shock continues to weaken the finances of many SOEs. The lack of financial performance of SOEs is putting considerable pressure on public finances. Contingent liabilities to SOEs represent a rating weakness that could translate to a credit rating downgrade for South Africa.

7.9. The 2021 budget review reported that SOEs continue to suffer from poor growth, high costs and elevated debt servicing costs, and several of them were at the brink of defaulting on their debts. The Zondo Commission of Inquiry into allegations of state capture in the public sector, including organs of state, has exposed corruption at the highest levels of entities such as Transnet, Eskom, SAA and Denel. The poor performance of SOEs, poor and unstable leadership, corruption, wasteful expenditure and mismanagement of funds and operational challenges confronting various major SOEs means that these entities will continue to require government guarantees in order to continue to survive.

7.10. The government's policy stance on ownership and control of SOEs appears to be shifting towards some form of privatisation. The government has announced the sale of 51 per cent of South African Airways to a private consortium. Permission has also been granted by the government to independent power producers to increase self-generation without obtaining a licence from 1MW to 100MW. These developments represent a major policy shift from government ownership and control of SOEs that could lessen the requirements for guarantees to SOEs.

Figure 15: Contingent liabilities, total government guarantees, and government guarantees to Eskom, 2010/11-2023/24



Source: National Treasury MTBPS, various editions

7.1. Government guarantees to SOEs remains a significant risk to South Africa's debt sustainability and to the economy. Government guarantees to Eskom, in particular, remain very high (see Figure X below). Government guarantees to SANRAL, the Trans-Caledon Tunnel Authority and South African Airways (SAA) are also relatively substantial.

Recommendations

- The Commission encourages the government to continue promoting a growth-friendly, fiscal consolidation geared towards stabilising and reducing government debt by reforming the evaluation criteria for granting government guarantees to SOEs. The first step would be to establish an SOE governance framework with public reporting criteria that clearly defines detailed and precise profitability and non-financial objectives for transparency.

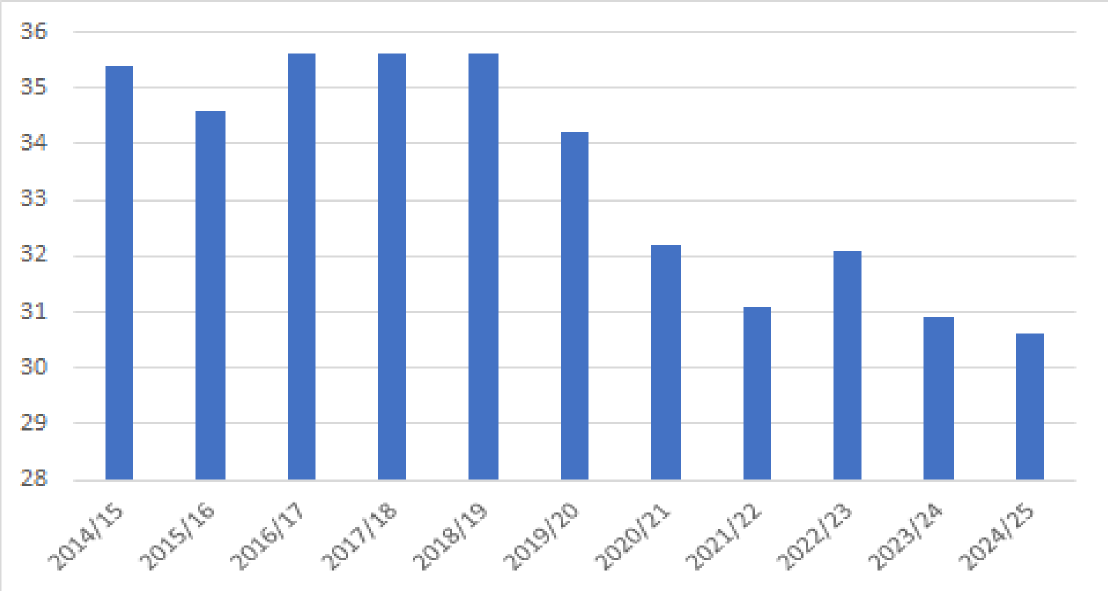
8. Compensation Data

The drivers of rising compensation spending

8.1. Compensation of employees (CoE) continues to be one of the largest expenditure items from the fiscus. According to the National Treasury, public-service CoE absorbed 41% of government revenue in 2019/20, which increased to 47% in 2020/21[4]. This implies that per R1000 of government revenue in 2019/20, R410 was spent on CoE. In 2020/21, R470 was spent on CoE for every R1000 of government revenue. This clearly indicates that allowing the wage bill to continue rising at this rate is not sustainable.

8.2. Figure 16 shows that the CoE as a percentage of total expenditure has been above 35% between 2016/17 and 2018/19 and decreased to just over 34% in 2019/20. A further decrease is projected for 2021/22, increasing to 2022/23, at R665.2 billion.

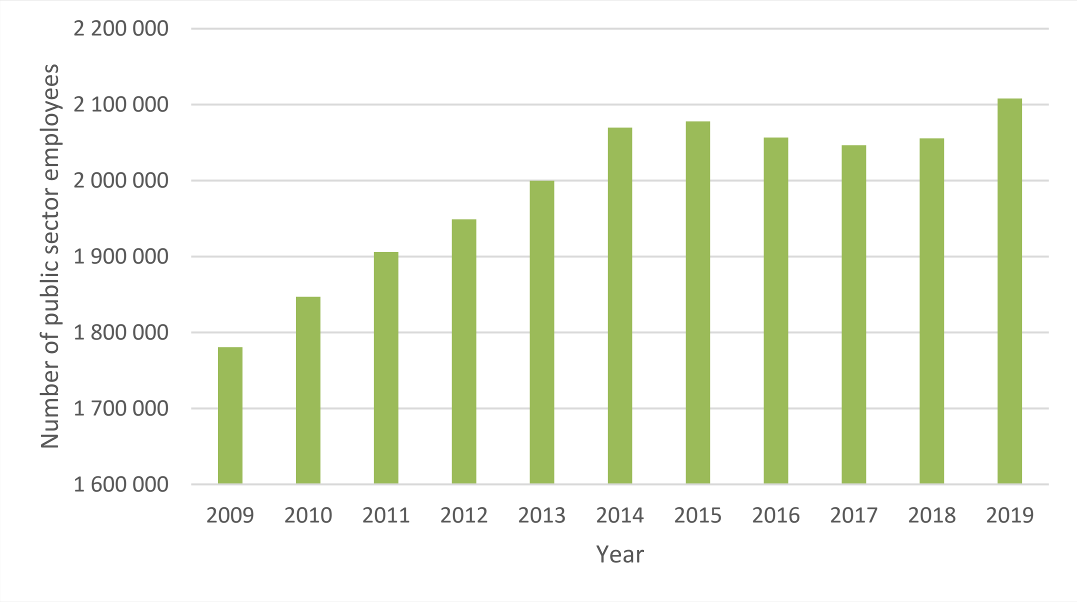
Figure 16: Compensation of employees as a percentage of total expenditure (%)



Data Source: National Treasury, 2021 Medium Term Budget Policy Statement

[4] *National Treasury, 2021- Budget Review*

Figure 17: Number of public sector employees from 2009-2019

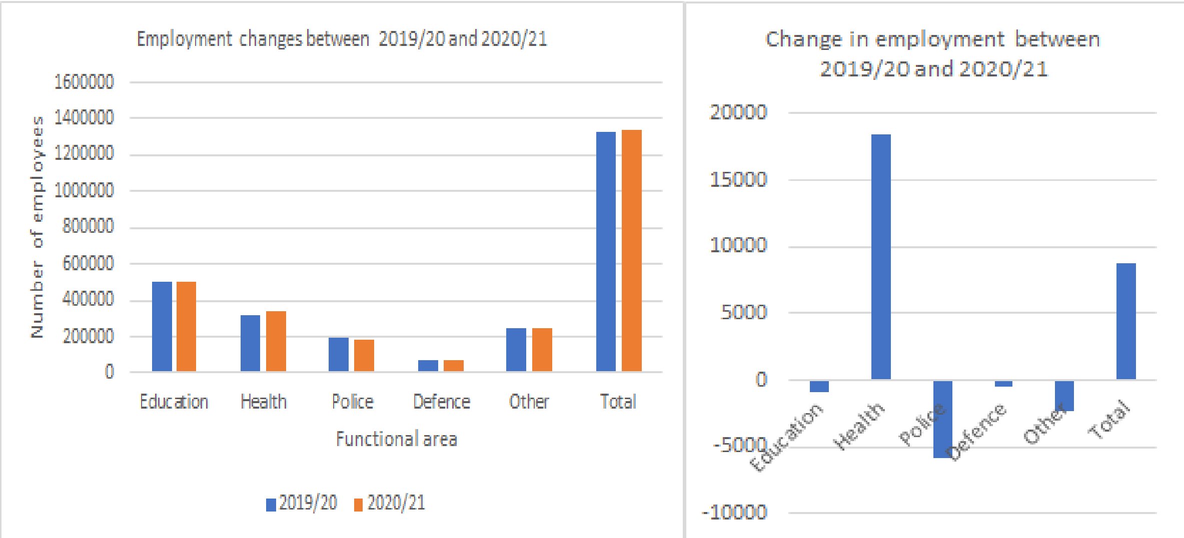


Data Source: Statistics South Africa, Quarterly Employment Statistics, 2009-2019

8.3. Key drivers for the CoE to increase over recent years include the salary adjustments, which have been growing above inflation and the increased headcounts. While the government has no systems to measure public sector productivity, it is doubtful if the increase in public sector employees is associated with improved productivity.

8.4. In 2020, the government had reduced the number of public sector employees mainly in police, education and defence but increased employees in health due to the COVID-19 pandemic, as illustrated in Figure 18. This reduction in public sector employees is insignificant to result in a material reduction in the CoE.

Figure 18: Changes in employment between 2019/20 and 2020/21



Data source: National Treasury, 2021 Medium Term Budget Policy Statement

8.5. The government has been implementing fiscal consolidation in recent years. The Commission is of the view that reducing public spending is key to achieving fiscal consolidation measures to boost public sector productivity.

Recommendations

- The Commission recommends that the government should develop a long-term plan in an incremental manner to address unsustainable public sector wage bill and that the plan should seek to improve public sector productivity at a lower cost.

9. 2021 MTBPS and the FFC's Recommendations

9.1. The gradual relaxation of Covid-19 economic restrictions, both locally and globally, marks the beginning of the much needed economic recovery in South Africa, enunciated by the 5.1% expected growth rate in 2021. However, it is important to recognise the reality: the country's economic activity remains at the level last seen in 2017, nearly four years backwards. Structural reforms must accompany the long walk to economic recovery to ensure sustainable and inclusive growth. The Commission notes the reforms outlined in the MTBPS – focusing mainly on SOEs restructuring and encourages other crucial dimensions of structural transformation through fiscal and public finance management for greater productivity and value within the public sector - not cost.

9.2. The Commission further welcomes the R59 billion upward adjustment effected to the 2021 budget made possible by the windfall tax collection in the mining sector. The Commission agrees that the revenue increase should not be committed to spending automatically, thereby distracting the need to stay within the path of fiscal sustainability by eliminating leakages and executing reprioritisations that are productive and constructive.

9.3. When it comes to provincial and local government allocations, the Commission notes the R20 billion upward adjustment made to the provincial equitable share the projected negative growth rate in local government allocations over the 2022 MTEF. While expenditure moderation is necessary for public finances and debt stabilisation, the executive must keep Parliament updated on its impact on access to and quality of basic services. The Commission reiterates its stance on the need for the executive to report timeously on how social services are affected by slow budget growth and historical budget cuts.

9.4. SOEs continues to pose a serious risk to fiscal sustainability. The Commission notes the equity injection/ recapitalisation of R3 billion to Denel in the 2021 MTBPS and the nearly exhausted drawdowns on Eskom's credit guarantee facility. SoE recapitalisation continues despite the government's commitment to end the fruitless bailouts. The Commission appreciates the difficult position under which the government finds itself concerning SoEs. Still, bailout undermines the fiscal integrity of the budget and exacerbates sovereign credit risks for the country. There is a need to find a lasting solution to the SoE governance and performance crises by dealing with the underlying accountability failures, capacity inadequacies, and corruption.