FINANCIAL AND FISCAL COMMISSION

For an Equitable Sharing of National Revenue

MEDIA STATEMENT

2023/24

SUBMISSION FOR THE DIVISION OF 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.

Good morning, ladies and gentlemen. Welcome to this media briefing. My name is Dr Patience Nombeko Mbava, Chairperson of the Financial and Fiscal Commission. Today I have the pleasure of presenting the Commission's recommendations for the Annual Submission for the Division of Revenue 2023/24, tabled at Parliament.

Two years have passed since the onset of the COVID-19 pandemic. South Africa is experiencing growing concerns of deteriorating fiscal performance and persistently poor service delivery outcomes on its public finances. Signs of a slow recovery in growth have largely been thwarted by recent events, including the civil unrest in KwaZulu-Natal and Gauteng during July 2021, ever-mutating COVID-19 strains and more recently, the Ukraine-Russia war and floods in KwaZulu-Natal. Inflation is expected to continue to rise in 2022. Unemployment, having reached a record high of 34.9% in 2021, remains stubborn.

In terms of public finances, the government faces significant debt and growing debt service costs. These costs are currently the largest public expenditure item, and essentially serve to divert funds from more productive, service delivery-related spending.

Over the past two years, the government has tried to balance the maintenance of fiscal sustainability with the need to provide social protection in the face of rising unemployment and inequality. This balancing act has been challenging. Not only has the COVID-19 pandemic highlighted the country's vulnerable fiscal position, but it has also further exacerbated it and exposed deep-seated delivery challenges. This was evident as many of the relief interventions introduced during the pandemic were marred by a myriad of delivery shortcomings, irregularities, fruitless and wasteful spending, and a deepening of corruption.

Under the theme of "***Addressing socioeconomic vulnerabilities through fiscal transparency and strategy***", the Financial and Fiscal Commission's Annual Submission for the 2023/24 Division of Revenue focuses on how the elements of good governance and coherent, goal-oriented long-term planning across the intergovernmental fiscal relations system in key sectors can serve to buoy growth and development.

The Submission comprises three parts, structured according to 11 chapters, as follows:

Part 1: Combatting corruption and unemployment

Chapter 1 draws from case studies and a combination of budget and institutional analyses. It hones in on strategies to prevent corruption in the public sector and evaluates funding models that support anti-corruption agencies. The Commission is of the view that the prerequisite for any measure to fight corruption and move towards support for anti-corruption reforms is consistent political will for good governance and accountability. The Presidency needs to renew the governance structure of the anti-corruption agencies through the National Anti-corruption Strategy to eliminate duplication and optimise anti-corruption impact given the funding framework. A Public Procurement Authority (PPA) should be established to organise and manage the public procurement process through policy and join with society to champion anti-corruption reforms.

Chapter 2 covers economic and fiscal monitoring. It tackles the stubborn challenge of youth unemployment in South Africa. The chapter aims to understand and evaluate the effectiveness of various public institutions and intergovernmental fiscal relations instruments in addressing youth development and unemployment challenges. In this regard, the Commission welcomes the expansion of the Employment Tax Incentive (ETI). An integrated, well-coordinated skills-to-jobs programme by the relevant Ministers of the Department of Employment and Labour, the Department of Higher Education and Training, and the Department of Women, Youth and Persons with Disabilities will go a long way to bolster the impact for job creation as opposed to multiple disjointed, isolated efforts. National Treasury and the Jobs Fund should consider other alternative funding channels that take the limitations faced by the youth regarding access to capital to provide challenge funds into account. And the proportion of gross fixed capital expenditure in the budget should be systematically monitored to increase with job creation.

Part 2: Economic and fiscal monitor – evidence-informed policymaking

Chapter 3 evaluates debt sustainability in South Africa. The level of indebtedness facing South Africa and the associated risks of unstable debt are investigated, and the fiscal outlook is forecasted. The Commission recommends that the Minister of Finance rein in the rising debt service costs by maintaining fiscal discipline and adopting a more aggressive stance toward active debt management and debt negotiations. This can be achieved through quality expenditure and investment reviews and reforms acting as signals to boost investor confidence in our financial and fiscal credibility.

Chapter 4 looks at affluence and inequalities in South Africa. It investigates the extent of earnings inequality and identifies key shortfalls in the current policy environment. The Commission emphasises the importance of addressing inequality in the labour market through large-scale job creation and investment to bring about more equitable wage growth across different sectors of the economy. The Commission calls upon Statistics South Africa to increase the transparency of data and harmonisation of datasets to allow for more comparable, accessible and reliable income statistics for evidence-informed policymaking.

Chapter 5 looks at the effects of social grants on household behaviour and expenditure patterns. The effectiveness of the grant system in South Africa is considered on the grounds of poverty and inequality reduction but rarely on consumption. In this regard, the Commission call upon the recalculation of the amount of the Child Support Grant; partnering with the private sector to support child support policy intentions; integrating social grants into existing social development programme and an in-depth investigation into the current social grant network.

Chapter 6 investigates public sector wage trends in South Africa. This research was prompted by the exponential growth in the public sector wage bill that has, over the years, exceeded both the GDP growth rate and tax collection revenue. This chapter seeks to determine the country's wage trends and understand the size and shape of the wage bill. The Commission invites the government to consider balancing notch progression and cost-of-living adjustments and pressures to the fiscus during wage negotiation. The Commission recommends that National Treasury commissions further research to determine the drivers of the distribution of wages with demographic decompositions.

Part 3: Sub-national focus – Reviewing and refining Division of Revenue instruments

Chapter 7 looks at what happens to the provincial equitable share (PES) allocation once it reaches the provinces. While weights are assigned to various components within the PES formula, there is little analysis concerning what happens to the funding once it is at the provinces' discretionary disposal. In line with the Commission's recommendation on the costed norms approach, complete costing exercises should be undertaken by all provinces, particularly in terms of the coordination of infrastructure delivery plans and programmes to ensure alignment of education and health provisions to function, output and outcome. This includes undertaking skills audits to identify the skills gap with respect to the old and the new curriculum to identify and develop the teachers' required training and placement programmes.

Chapter 8 examines a 25-year review of provincial conditional grants that was conducted with the aim of understanding whether there is a need to repurpose and/or realign the provincial conditional grants to better align them with the constitutional prescripts around intergovernmental fiscal transfer design. The Commission recommends that the government invest in the capacity to improve overall grant design and conduct three-yearly reviews to revise the grant framework, taking into account all the imperatives of a good grant design. Such as types of grants and their implications, pre-grant introductory due diligence, sunset clauses, conditioning schemes and allocation methodologies. Specifically, the Department of Health and other custodians of grants with multiple components must halt the over-compartmentalisation of provincial health responsibilities through multiple grant funding windows unrelated to the main objective of the main grant.

Chapter 9 uses basic education as a case study to tackle the issue of value for money. The analysis reflects on how spending on basic education should be reprioritised to ensure that the essential elements related to the right to basic education are protected. The Commission reiterates its previous recommendations that a proper costing of the delivery of education services be undertaken to address the cost drivers of education and differences in spending pressures across provinces to assess the adequacy of basic education spending. Availability and access to credible, reliable, consistently collected and easily comparable financial and non-financial data is critical for research to better understand the impact of government spending and assess school performance.

Chapter 10 considers that fiscal governance, particularly independent fiscal institutions, can play a central role in improving fiscal performance. In this regard, the Commission recommends the government improve the mandate, independence, functions and compliance of independent fiscal institutions.

Chapter 11 focuses on local government, examining the topical issue of the District Development Model, which is positioned to improve planning and coordination across the three spheres of government. The Commission is of the view that section 84 of the Municipal Structures Act should be reviewed and repealed to streamline the powers and functions of district municipalities to correspond with those of local municipalities. The same for section 85 of the Municipal Structures Act, to allow an adjustment of powers and functions by the Member of the Executive Council for Local Government to be followed by the adjustment of funding. Furthermore, it should immediately abolish the Regional Services Council Replacement Grant and combine the Local Government Equitable Share for district municipalities and the Regional Services Council Replacement Grant under one funding instrument.

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Recommendations

The Commission, in its Submission for the 2023/24 Division of Revenue, makes the following recommendations:

1. Regarding strategies for preventing corruption in the public sector and funding for anti-corruption agencies:

   - The prerequisite for any measure to fight corruption and move towards support for anti-corruption reforms is consistent political will for good governance and accountability. Political leadership and a commitment to fight corruption should therefore come from the highest office and the top levels of a country's political system, with the following understanding of accountability:

     - Accountability should identify who needs to be accountable to whom and for what? For instance, accountability of political leaders and public officials to organisational effectiveness and efficiency through compliance measures, rules and ethics codes, and oversight bodies taking their legislated responsibilities seriously and committing to repelling corruption by taking swift action and imposing sanctions when the need arises.

   - The Presidency, in line with political commitment at the top, needs to renew the governance structure of the anti-corruption agencies, through the National Anti-corruption Strategy, on the need for reconfiguration and coordination among the existing institutional arrangements to repel duplication in these anti-corruption institutions for optimum results, including a reconfigured or dedicated funding framework for the anti-corruption agencies or institutions as a sign of commitment towards the support of anti-corruption agencies.

   - The Presidency should consider establishing a Public Procurement Authority (PPA) that is mandated to show greater transparency and standardisation of government contracts, to organise and manage the public procurement process (rules, regulations, guidelines and policies) and implement a general public procurement policy on behalf of the government, guided by the principles of transparency, fairness and equity, as contained in the Constitution.

   - A dedicated or joint civil society organisation should be established that educates and empowers society about the dangers and adverse effects of corruption and advocates for anti-corruption reforms as bottom support to the top-down approach (political will).

2. Regarding youth unemployment and intergovernmental fiscal relations:

   - The Commission welcomes the expansion of the Employment Tax Incentive (ETI). To better target and increase the impact of the incentive, the Commission recommends revising the employee eligibility age from 18 to 29 years old. The age group 24−34 years has a relatively high rate of individuals not in employment, education or training (NEET) compared to 15- to 24-year-olds. National Treasury can also consider deepening the ETI to encourage hiring young women whose NEET rate is relatively higher than that of their male counterparts for both youth categories. The NEET group represents the most vulnerable section of the youth.

   - The Department of Employment and Labour, the Department of Higher Education and Training, and the Department of Women, Youth and Persons with Disabilities should coordinate all labour markets and skills programmes. The Department of Women, Youth and Persons with Disabilities has a mandate to enable the empowerment and socioeconomic upliftment of the youth and women. Well-coordinated labour market interventions could bolster the impact of existing labour market programmes through more significant integration and leveraging of initiatives.

   - National Treasury and the Jobs Fund should consider other alternative funding channels that take the limitations faced by the youth regarding access to capital to provide challenge funds into account. The challenge funding principle of the Jobs Fund disadvantages those small and medium businesses that have no access to capital. The match challenge fund is a financing mechanism to allocate (donor) funds for specific purposes using competition among organisations as the lead principle. Proposals are assessed against transparent and predetermined criteria. Successful applicants must usually match a certain percentage of the grant with own financing.

- The proportion of gross fixed capital expenditure in the composition of the budget should be systematically increased. Consumption expenditure should be reduced. There is also a need to remove structural and institutional rigidities that impact on private investment in the reduction of unemployment.

3. Regarding debt sustainability in South Africa:

- The fiscus, through the Minister of Finance, must strive to rein in rising debt service costs, which comprise a substantial portion of the budget, detracting from allocations for the provision of essential services.
- The Minister of Finance must exercise and maintain fiscal discipline, via active debt management and regular reporting regarding debt accumulation, costs and sustainability under the current strained debt conditions. Such discipline should be exercised throughout all spheres of government.
- Weak productivity in expenditure should be addressed in order to create job-enhancing, income-generating growth (i.e. inclusive growth) through quality expenditure and investment-enticing reforms.
- Investor confidence must be boosted and promoted through signalling that public debt is sustainable in the long run to reduce sovereign risk ratings and thereby the cost of debt, as well as to ensure the continuation of economic support.

4. Regarding inequality in South Africa's labour market:

- Policies aimed at reducing inequality should, as a point of departure, be targeted at reducing inequality in the labour market. This requires policies that enable large-scale job creation and more equitable wage growth across different sectors of the economy, which, in turn, may require greater investment into labour-intensive industries that are able to absorb low-skilled workers into the labour market.
- Statistics South Africa should increase its efforts to increase the transparency of data and harmonisation of datasets to allow for more comparable, accessible and reliable income statistics. Transparency should extend to data collection, data cleaning and imputation methods applied.

5. Regarding social grants:

- The recalculation of the amount of the Child Support Grant
- Partnering with the private sector to support child support policy intentions
- Integrating social grants into existing social development programmes
- An in-depth investigation into the current social grant network

6. Regarding the public sector wage bill:

- The Department of Public Service and Administration, through the bargaining council, should consider balancing notch progression and cost-of-living adjustments and pressures to the fiscus during wage negotiation. The Commission highlights that the growth of the wage bill has largely been driven by wage increases relative to the increase in the number of employees.
- Wage growth at the top end of the wage distribution in the public service has not been excessive, but after 2010, it appears that wages for those in the bottom 20% of the distribution fell in real terms, potentially widening the wage gap in the sector. The Commission recommends that National Treasury commissions further research to determine what is driving the decreases in real terms of wages for

those at the bottom distribution of wages.

- The demographic composition of the public sector has changed over time, but the proportion of young people has not grown. The Commission recommends that the Department of Public Service and Administration, together with the Department of Women, Youth and Persons with Disabilities, develops frameworks to guide the public sector on the inclusion of youth in public service.

7. Regarding the provincial equitable share formula:

- In line with the Commission's recommendation on a costed norms approach, full costing exercises should be undertaken by all provinces, particularly for the provision of education and health. The costing results will be used to determine allocations by provinces to these key functional areas. This will ensure consistency and fully informed resource allocation.
- The national Department of Basic Education, as a custodian of conditional grants (particularly indirect grants and being responsible for capital spending), and all provincial departments of Basic Education, as recipients of the PES and being responsible for school infrastructure delivery and maintenance, should improve the coordination of infrastructure delivery plans and programmes to ensure alignment.
- The national Department of Basic Education should undertake skills audits to identify the skills gap with respect to the old and the new curriculum, and based on the audit results:
  a) Identify the number of teachers who need to be trained and the funding requirements
  b) Develop and implement a training programme.

8. Regarding the system of provincial conditional grants:

- National Treasury, in conjunction with the national departments responsible for conditional grants, must revise the Division of Revenue Act's system of grant scheduling as it creates no fiscal incentives for provinces to reveal their expenditure preferences or sustain expenditure previously funded by conditional grants. Instead, government must invest the capacity to improve overall grant design, taking account of all good grant design imperatives, such as types of grants and their implications, pre-grant introductory due diligence, sunset clauses, conditioning schemes and allocation methodologies.
- National Treasury, in conjunction with the national departments responsible for conditional grants, should undertake three-yearly reviews of their respective grants to ensure alignment across grant objectives, conditions and grant outcomes. These reviews must be informed by an overarching conditional grants guideline, setting out the circumstances under which grants are introduced and terminated, applicable minimum and type conditions, and the applicable minimum outputs. Further, there should be a mandatory grant introduction and termination pre-assessment by the Financial and Fiscal Commission to determine suitability, impact on the fiscal framework and overall grant outcome. Grant conditions are generally administrative, while the outputs are seemingly unconnected to the long-run outcomes.
- The Department of Basic Education, in conjunction with National Treasury, must update the allocation formula for the Education Infrastructure Grant to ensure the alignment of grant needs indicators with grant objectives and further streamline expected and reported grant outputs to improve focus and ease of monitoring. At the very least, the allocation criteria may include learner enrolment, learner densities by area, index of schools with access to learning infrastructure and travel time to schools. The actual formula must be published in the grant framework for transparency purposes.
- The Department of Health and other custodians of grants with multiple components must halt the over-compartmentalisation of provincial health responsibilities through multiple grant funding windows unrelated to the main objective of the main grant. Conditional grants must, as a matter of principle, accommodate not more than two sub-components or take the shape of a traditional block grant to allow provinces the flexibility to prioritise within the set sub-functional responsibility. Subcomponents that are unrelated to the main grant objective must be incorporated into the provincialequitable share and be monitored through the normal budget and accountability system instead ofsubdividing or itemising provincial health responsibilities to be funded by grant sub-

components.The formulae for the newly restructured HIV/Aids grant must be published in the grant framework for transparency purposes.

9. Regarding the constitutional right to basic education:

- The Commission reiterates its previous recommendations that a proper costing of the delivery of education services be undertaken to address the cost drivers of education and differences in spending pressures across provinces to assess the adequacy of basic education spending.
- Government needs to protect the redistributive nature of the basic education funding system in the face of potential basic education budget constraints.
- Availability and access to credible, reliable, consistently collected and easily comparable financial and non-financial data is critical to conduct research to better understand the impact of government spending and to assess school performance. To this end, the Commission acknowledges the government's work to implement a school-level data collection instrument in the form of the South African School Administration and Management System. The Commission recommends that the Department of Basic Education leverages the collection of this data and other sources of school-level data to compile a consolidated basic education sector database that integrates the financial and non-financial aspects of basic education.
- The Minister for Basic Education should use the matrix as the foundation of a framework to consult broadly with stakeholders to agree on a guide for spending prioritisation in the basic education sector that is underpinned by a socioeconomic rights approach.

10. Regarding the effectiveness of independent fiscal institutions:

- With respect to improving the mandate and functions of independent fiscal institutions in South Africa:
  - Forecasting or validating macroeconomic and fiscal variables
  - Costing of legislation and policy
  - Monitoring fiscal rules or objectives
- With respect to improving the independence of independent fiscal institutions in South Africa:
  - Establishment of minimum standards for independent fiscal institutions
  - Access to information
- With respect to improving the compliance and impact of independent fiscal institutions in South Africa:
  - Improvement of the compliance or explanation of deviance from the recommendations principle
  - Formal consultations on budget formulation and execution

11. Regarding the powers, functions and funding framework of district municipalities:

- The Department of Cooperative Governance and Traditional Affairs should speedily review and repeal section 84 of the Municipal Structures Act to streamline the powers and functions of district municipalities to correspond with those of local municipalities.
- The Department of Cooperative Governance and Traditional Affairs should review and amend section 85 of the Municipal Structures Act to allow an adjustment of powers and functions by the Member of the Executive Council for Local Government to be followed by the adjustment of funding.
- National Treasury should immediately abolish the Regional Services Council Replacement Grant and combine the Local Government Equitable Share for district municipalities and the Regional Services Council Replacement Grant under one funding instrument.