FINANCIAL AND FISCAL COMMISSION

# SUBMISSION TO THE STANDING COMMITTEE ON APPROPRIATIONS ON THE 2021 APPROPRIATION BILL AND SPECIAL APPROPRIATION BILL

11 MAY 2021

# BACKGROUND

- The stated purpose of the 2021 Budget is to strike a balance between **economic recovery and restoring public finances** as alluded to in the 2020 MTBPS
- The President's **four major priorities** stated in the 2021 SONA are to:
  1. **Defeat (contain and overcome) the coronavirus pandemic** by strengthening the health system and undertaking a massive vaccination programme;
  2. **Accelerate economic recovery** to overcome **poverty** and hunger, **inequality** and **unemployment**. The COVID-19 relief announced last year remains ongoing
  3. **Implement economic reforms to create sustainable jobs** and drive inclusive growth through the Economic Reconstruction and Recovery Plan (ERRP), including the Infrastructure Investment Plan
  4. **Fight corruption and strengthen the state**.
- The 2021 Appropriation Bill is being considered at a time when the economy is starting to show slight signs of recovery albeit not on the scale of pre-Covid growth rates
  - Notwithstanding, **unemployment rate remains stubbornly high and poverty** and **inequalities** have deepened
- The Commission makes this submission on the 2021 Appropriation and Special Appropriation Bills
  - in terms of Section 214 (1) of the Constitution and Section 35 of the Intergovernmental Fiscal Relations Act (1997), as well as S4(4c) of MBAPARMA (Act 9 of 2009), as amended

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# Presentation Outline

- Fiscal Framework and the Appropriation Bill
- Context within which the Appropriation Bill is Tabled
- Major Revisions and Innovations Contained in the 2021 Appropriation Bill
  - Adjustments to Votes and Implications
  - Key Risks and Opportunities and the 2021 Appropriation Bill
- Infrastructure Allocations in the 2021 Appropriation Bill
- State Owned Entities and the 2021 Appropriation Bill
- Comment on the Special Appropriation Bill
  - Health
  - Social Development
  - Public Enterprises
- Concluding Remarks

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# THE FISCAL FRAMEWORK: THE APPROPRIATION BILL

# 2021 Division of Revenue: Expenditure Defrayed from the National Revenue Fund

| R million | 2021/22 2020 Budget | 2021 Budget | Difference |
|---|---|---|---|
| **Debt-service costs (National Treasury)** | **258 482.1** | **269 741.1** | **11 259.1** |
| **Infrastructure fund not assigned to votes** | **4 000.0** | **4 000.0** | **-** |
| **Provisional allocation for Eskom restructuring** | **33 000.0** | **-** | **(33 000.0)** |
| **Provisional reduction to fund Land Bank allocation** | **-** | **(5 000.0)** | **(5 000.0)** |
| **Compensation of employees and other adjustments** | **(54 929.1)** | **-** | **54 929.1** |
| **Contingency reserve** | **5 000.0** | **12 000.0** | **7 000.0** |
| Total appropriation by vote | 743 614.6 | 741 325.6 | (2 289.0) |
| Total direct charges against the NRF ex. transfers | 25 255.3 | 21 978.3 | (3 277.0) |
| Provisional allocation for contingencies | 1 852.6 | 12 645.2 | 10 792.6 |
| **Total appropriation before subnational transfers** | **770 722.4** | **775 949.0** | **5 226.6** |
| **Provincial equitable share** | **573 989.5** | **523 686.4** | **(50 303.2)** |
| **Provincial conditional grants** | **117 961.5** | **115 782.5** | **(2 179.0)** |
| **General fuel levy sharing with Local government** | **15 182.5** | **14 617.3** | **(565.2)** |
| **Local government Equitable share and conditional grants** | **127 259.5** | **123 475.8** | **(3 783.7)** |
| **Main budget expenditure** | **1 850 668.5** | **1 834 252.2** | **(16 416.3)** |

*Source: Commission's own calculation using National Treasury Budget Review Statistical Annexure 2020/21*

- Total national appropriation by vote reduced by R2.3 billion in the 2021 Budget. Before subnational transfers, however, gained by R5.2 billion due to provisional allocation for contingencies (i.e. Covid-19 response)
- Provincial equitable share and conditional grants were adjusted downward by R50.3 billion and R2.2 billion from the 2020 to 2021 Division of Revenue Bills, respectively
- Local government equitable share, conditional grants and general fuel levy declined by R4.3 billion in total.
  - ➢ **In comparison to these between the 2020 and 2021 Budgets, revenue shortfall for the 2021/22 financial year is estimated at R132.6 billion**

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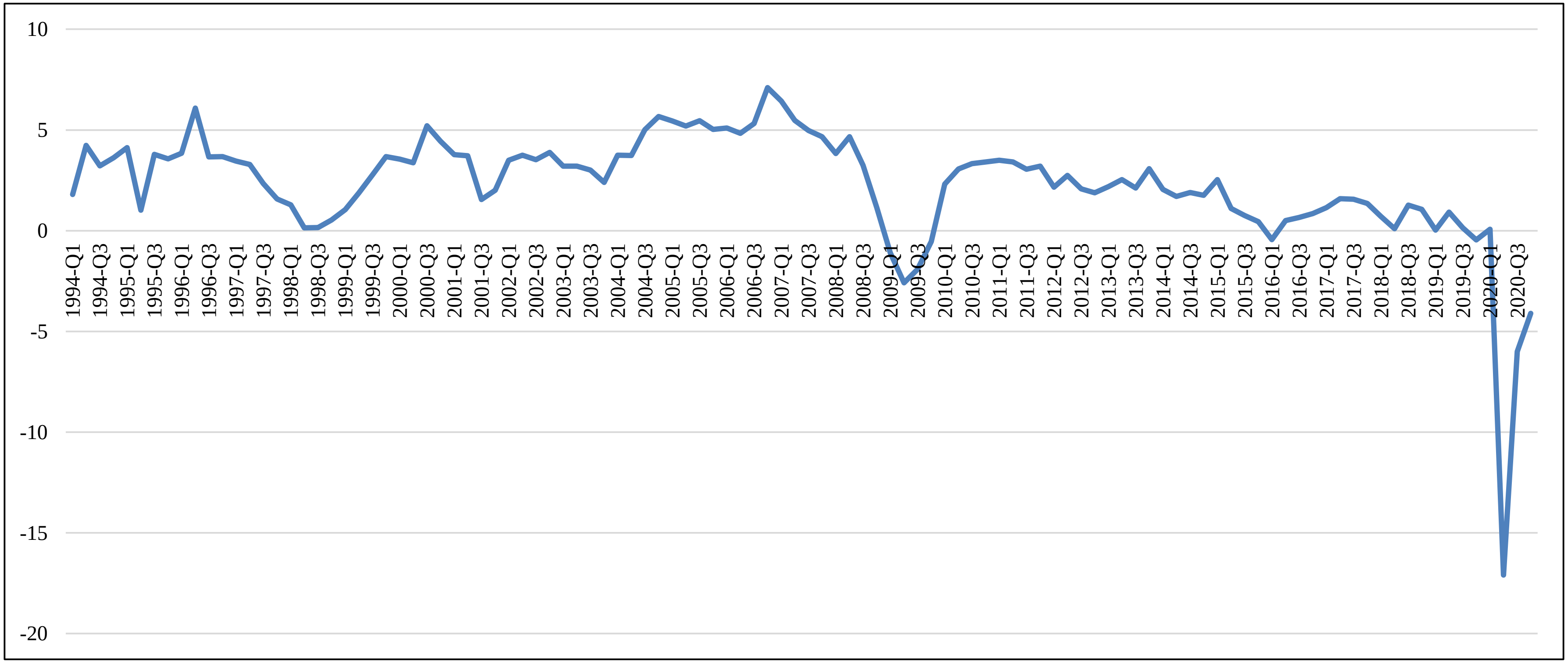
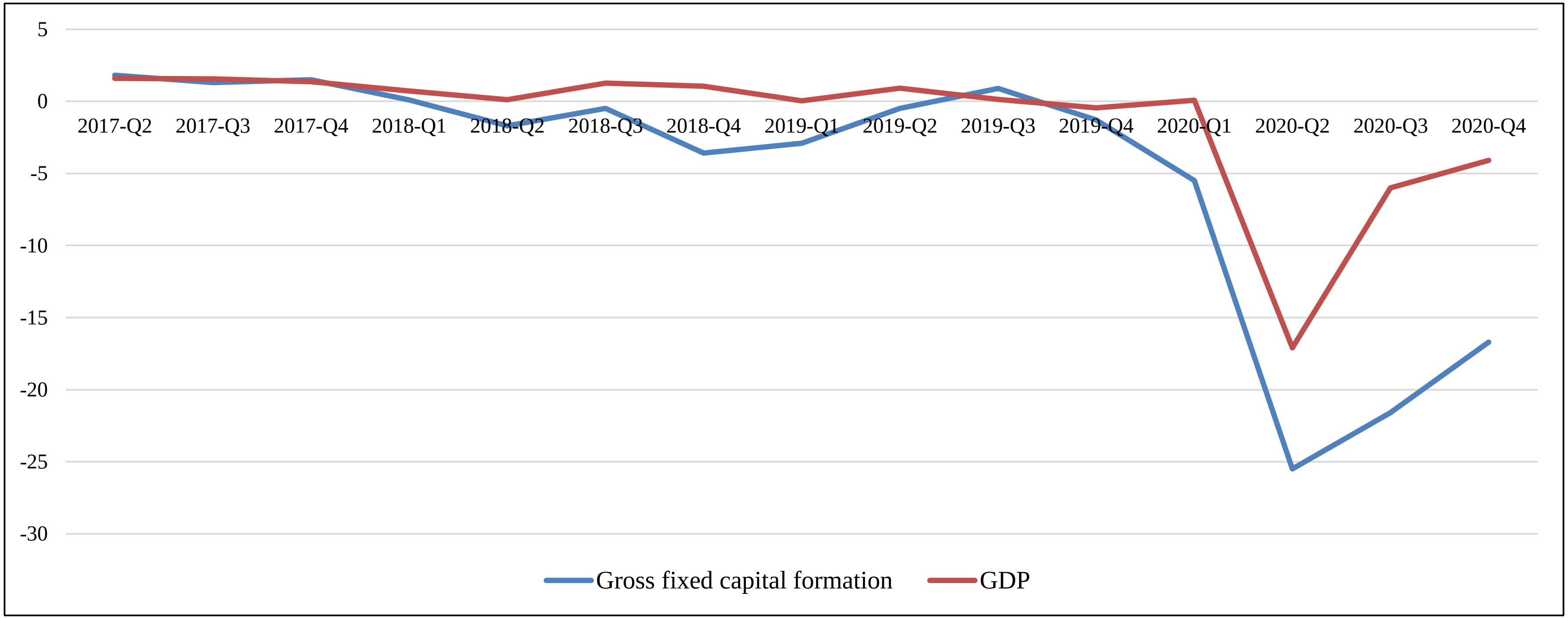
# Context within which the Appropriation Bill is Tabled

# Real Gross Domestic Product Growth (Y/Y % Change)



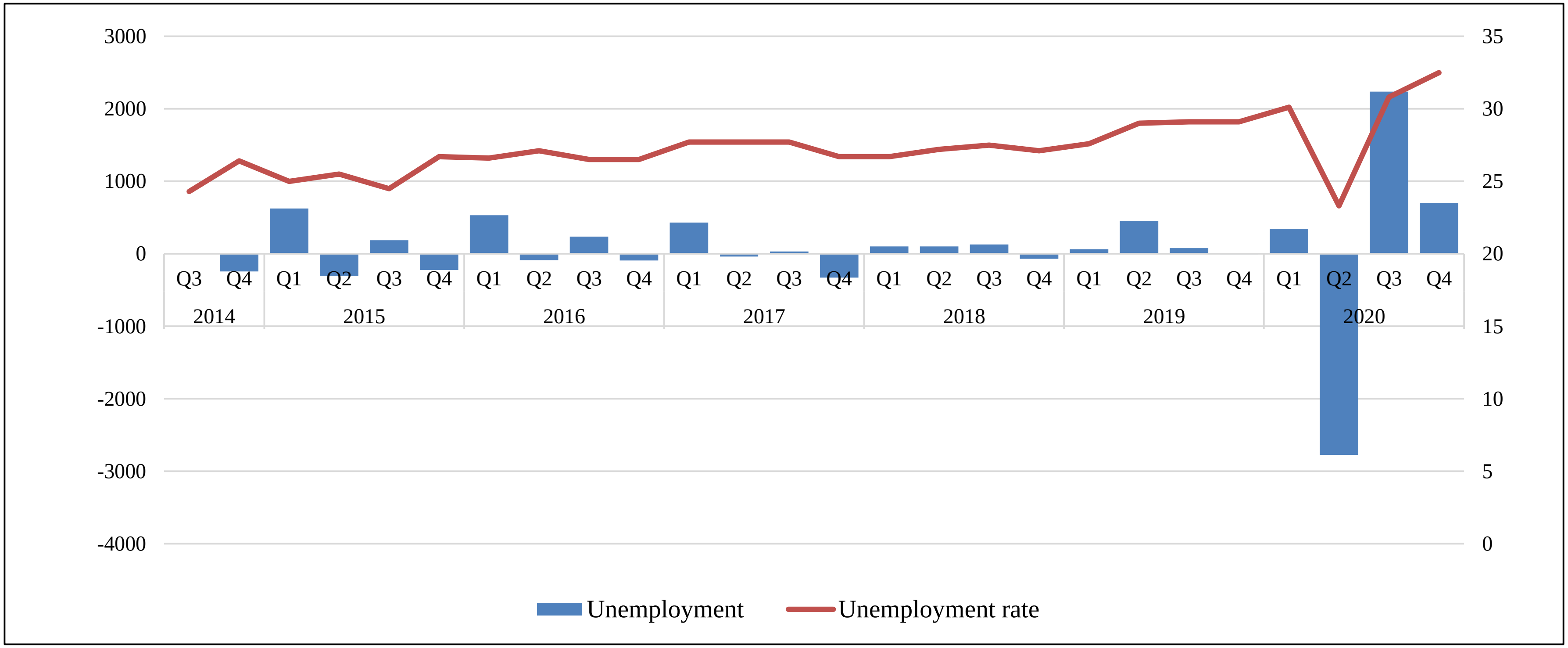

- Signs of an economic recovery are beginning to emerge as lockdown restrictions have been gradually eased in recent months, allowing most business activities to resume
- In the third quarter of 2020, GDP contracted by 6.0% year-on-year (y/y)  and in the fourth quarter of 2020, GDP contracted by 4,1% year-on-year

# Gross Fixed Capital Formation (Investment) (% Y/Y)




- Gross Fixed Capital Formation (GFCF) is showing signs of recovery, this is after decreasing by 25,5% in second quarter 2020 and decreasing by 21.6% in third quarter year-on-year (y/y)
- The recovery continued in the fourth quarter of 2020, GFCF contracted by 16.7% year-on-year (y/y) showing similar trend of recovery with GDP. Although there are signs of a recovery, it may take time for the economy to recover to pre-COVID output levels

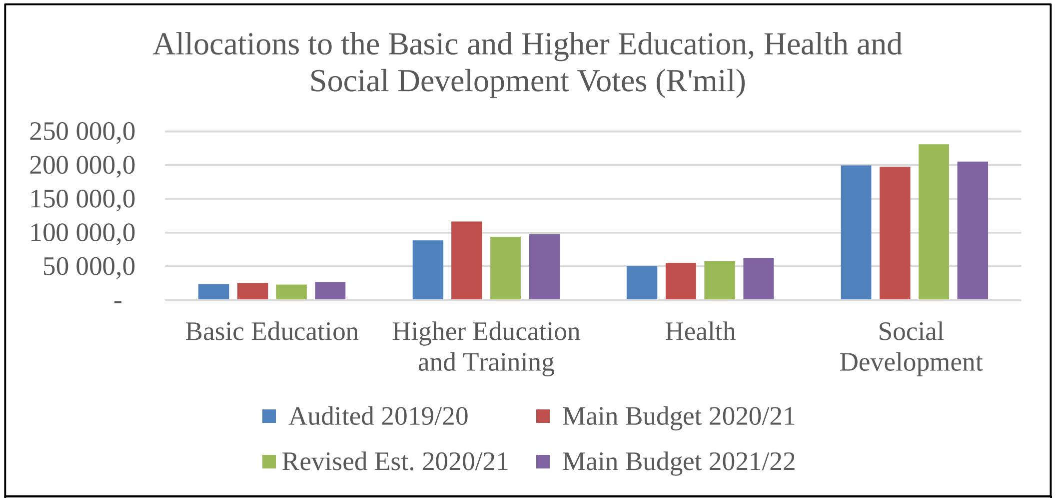
# CHANGES IN UNEMPLOYMENT (Q-TO-Q CHANGES)

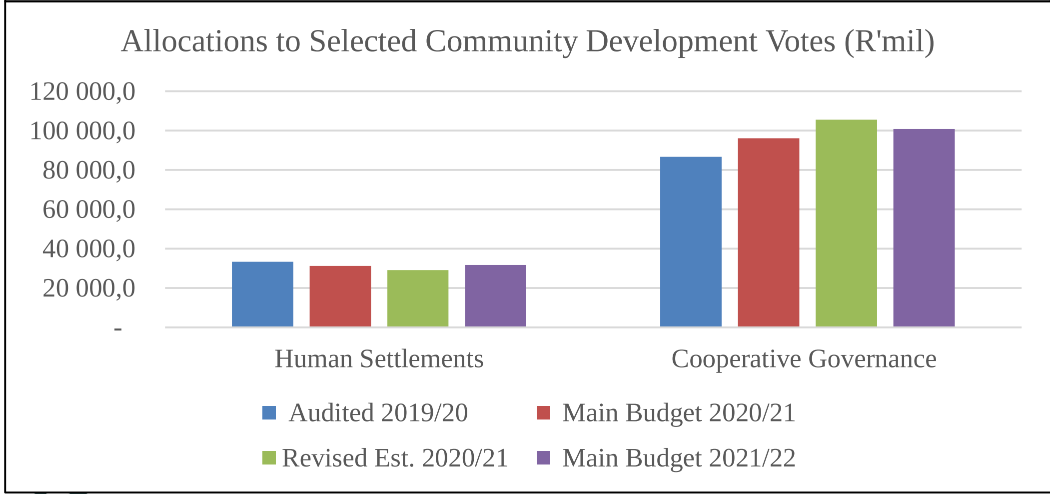



- The official unemployment rate increased by 1,7 percentage points to 32,5% in quarter 4 of 2020 compared to quarter 3 of 2020
- The number of unemployed (job losses) increased by 2,2 million in third quarter 2020 following a decrease of 2,8 million in the second quarter 2020. The number of unemployed persons increased by 701 000 in quarter 4

# Major Revisions and Innovations Contained in the 2021 Appropriation Bill

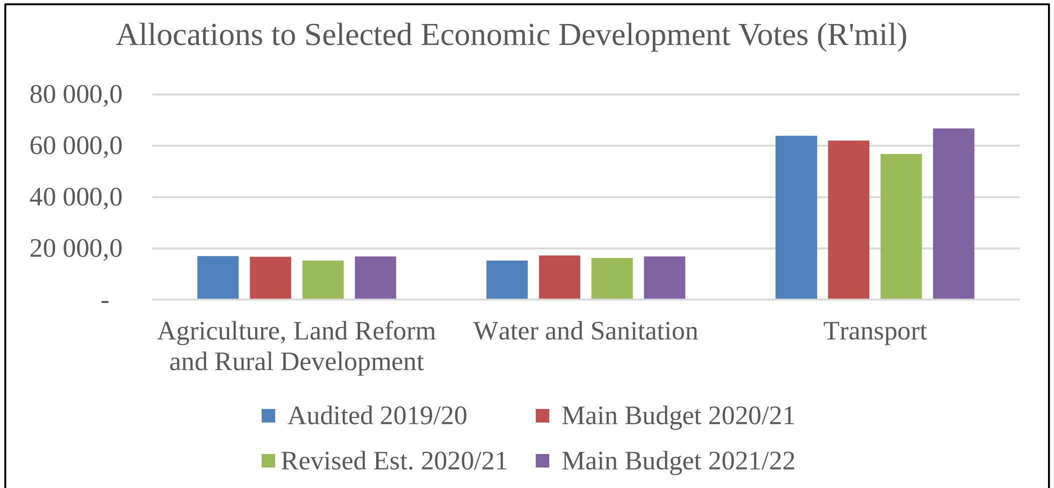
# ADJUSTMENTS TO VOTES AND IMPLICATIONS

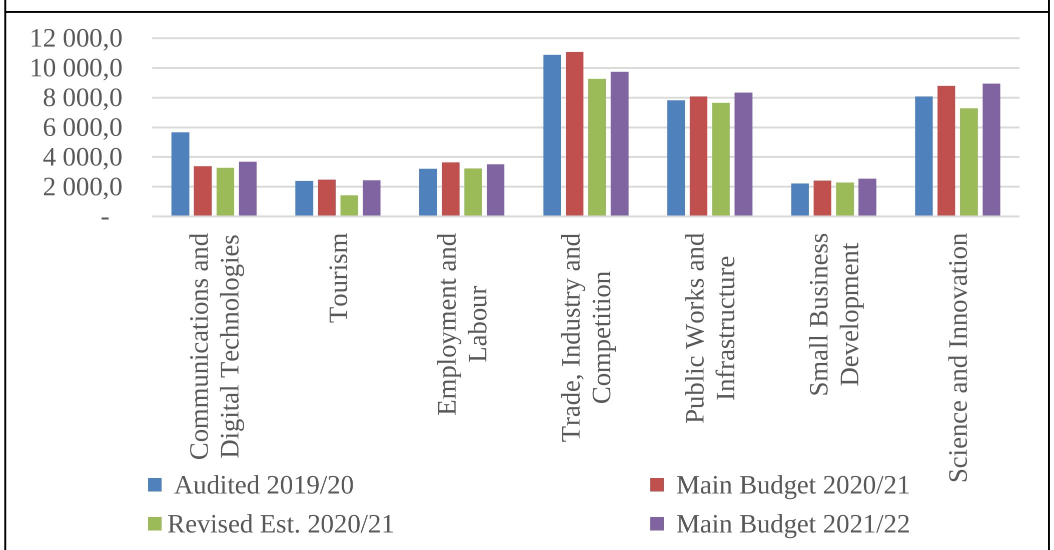



- Real growth in Basic Education Vote is maintained in 2021/22
- Marginal recovery to Higher Education Vote but allocation falls short of level of funding allocated at time of February 2020 Budget
- Health Vote sees progressive, real increase across period reviewed
- Decline in Social Development Vote goes beyond the phasing out of temporary, Covid-19 related grants
- Cooperative Governance (of which LES is largest component) declines in 2021/22 – expected given additional funds to LG in 2020
    - When comparing 2021 allocation to both February 2020 Budget and 2019 Budget allocation, real growth is evident
- Human Settlement increased slightly from Main Budget 2020/21.

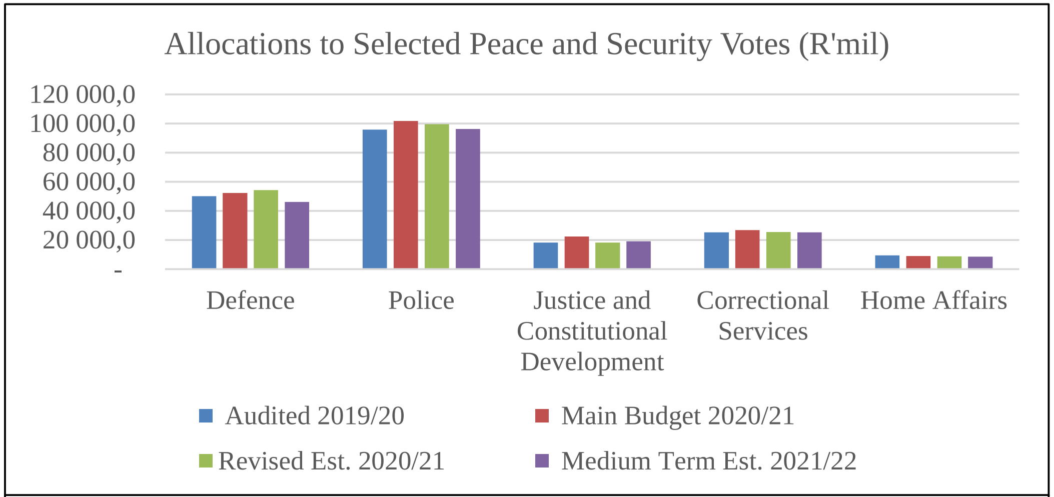
# Adjustments to Votes and Implications

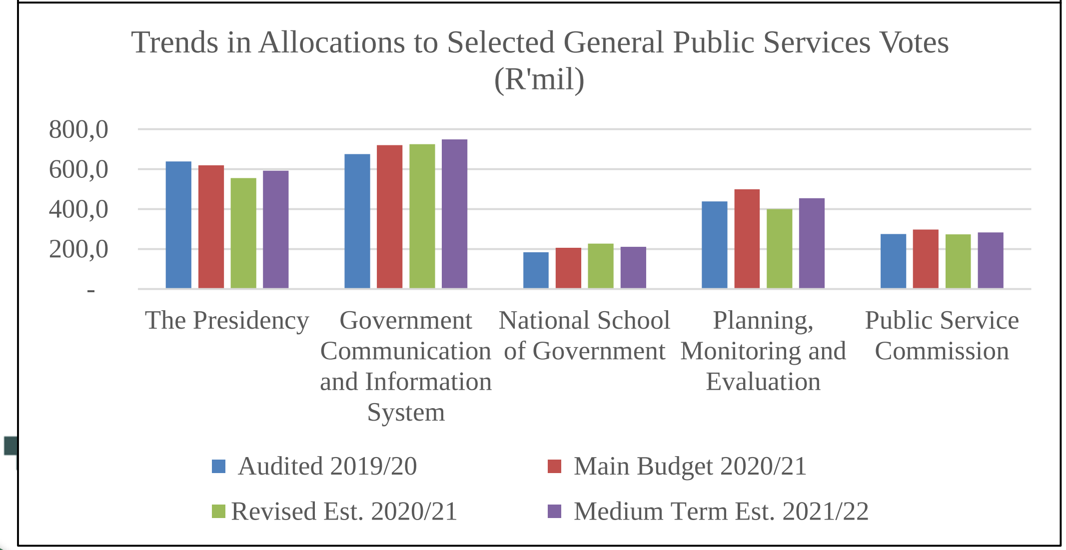



- Allocations to both the Agriculture, Land Reform and Rural Development votes recover relative to 2020 revised estimate but decline relative to allocation at time of February 2020 Budget
- Transport Vote shows strong recovery relative to 2020 revised estimate and the February 2020 Budget
- Following deprioritisation during the revised estimate, Tourism Vote set to recover but when compared to February 2020 Budget, Budget 2021 allocation reflects a real decline
- Whilst Trade, Industry and Competition Vote increases marginally relative to 2020 revised estimate, when compared to February 2020 Budget and 2019 Budget, significant declines are evident
- Recovery in 2021 appropriation to Science and Innovation relative to 2020 revised estimate

# Adjustments to Votes and Implications




- The 2021 Budget allocations to Defence, Police and Correctional Services show a real decline when compared to 2020 revised estimate, and the February 2020 Budget.
- Home Affairs Vote sees consistent real decline in allocations whether compared to the February 2020 Budget or 2020 revised estimate
- Most votes in general public services cluster recover relative to allocations in SAB

# Key Risks and the 2021 Appropriation Bill

- Covid-19 baseline reductions are likely to interrupt or reduce service delivery levels in votes such as Police, Social Development
- Appropriations for compensation of employees are premised on the assumption that the wage freeze announced during the Budget will be effected. The outcome of the ongoing wage bargaining negotiations may necessitate adjustments to COE and appropriations across all votes
- Votes which are crucial for economic recovery continue to receive a small proportion of the total appropriation, despite the priority placed on the economic reconstruction and economic recovery plan
  - The Departments of Industry, Trade and Competition and Small Business Development receive an appropriation of R9.7 billion and R2.5 billion respectively
  - Over 80% of appropriations to these votes are comprised of transfers and subsidies
  - The Commission is concerned that the greater portion of the transfers finance compensation of employees, leaving little resources for economic recovery

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# Key Opportunities and the 2021 Appropriation Bill

- Cuts in baseline allocations to votes or appropriations provide departments with an opportunity to conduct self initiated expenditure reviews:
  - Terminate ineffective programmes
  - Consolidate duplicate programmes
- Expenditure reviews must be linked to the broader economic reconstruction and recovery plan
  - Resources can be directed towards priority intervention areas or sectors
- Parliament must scrutinise the expenditure plans of departments to ensure that the recovery plan finds expression in the allocations and delivery plans
  - Clear and measurable performance indicators must be identified and monitored under an ‘umbrella’ theme through Parliament’s oversight mechanism
- Government should appropriate allocations to SOEs through the Special Appropriation Bill - so that conditions accompanying the bail outs can be clearly spelled out and made public
  - Generally appropriations to SOEs are currently incorporated under the Public Enterprise Vote

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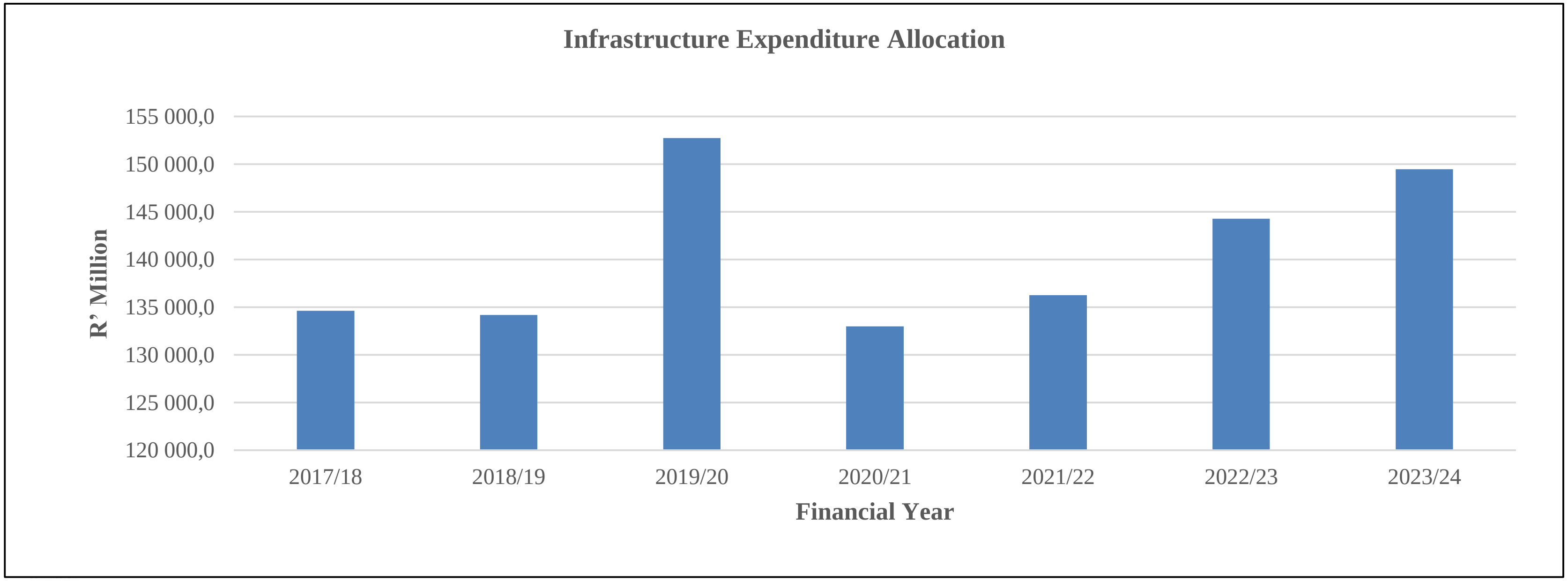
# INFRASTRUCTURE ALLOCATIONS

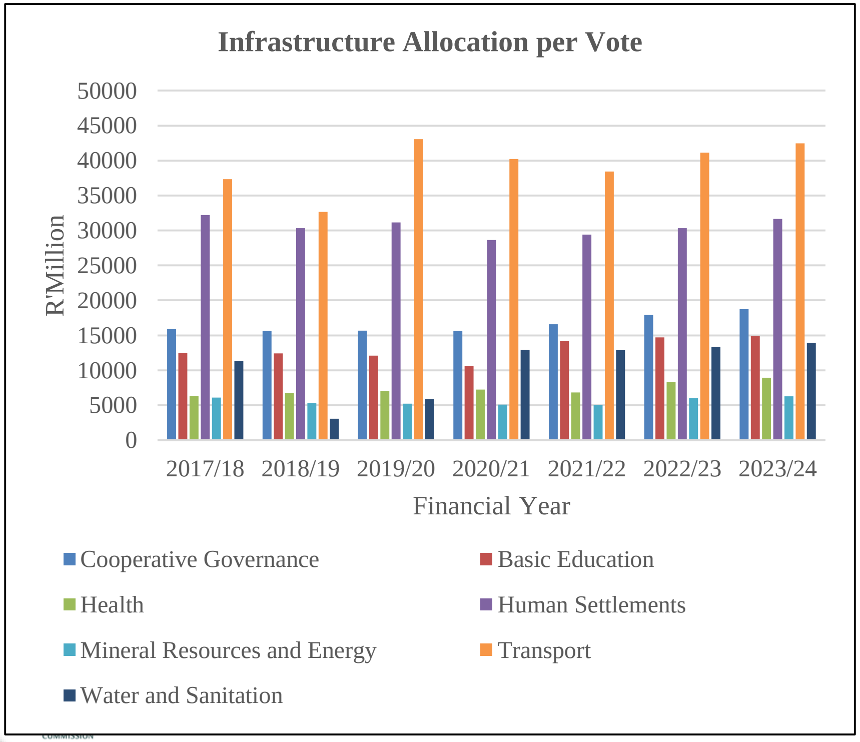
# Public Sector Infrastructure Spending

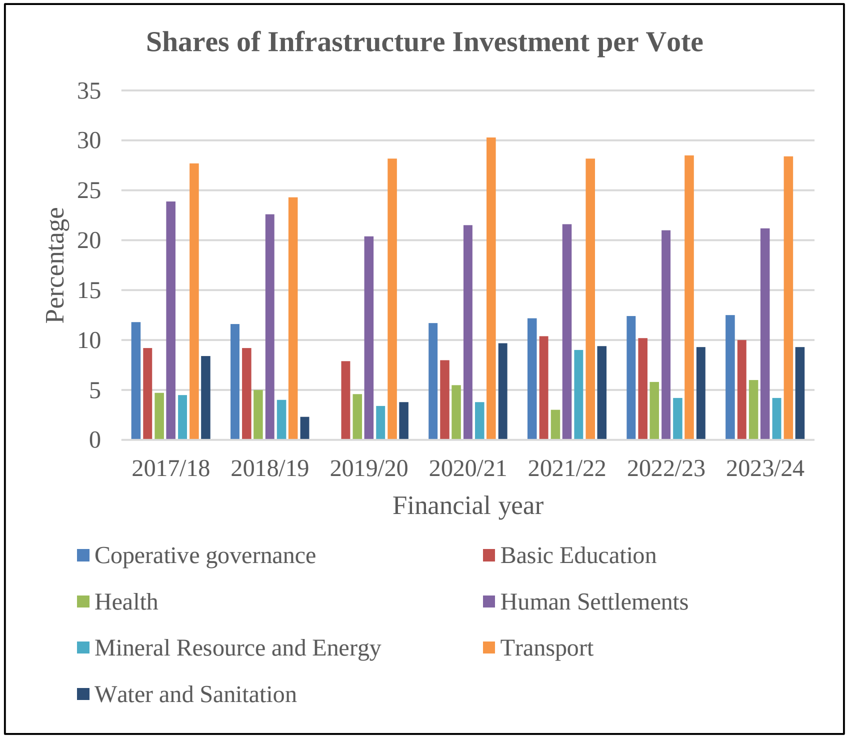
- Both public and private sector infrastructure investment are key for economic growth
- One of the key enablers of private investment is adequate and reliable public infrastructure
  - Therefore the government increases chances of attracting domestic and foreign investment if public/government invests adequately in infrastructure such as roads, water and electricity
  - The highest level of infrastructure investment, as shown in the figure was in 2019/20 – and it is not to be matched over the MTEF period



# Public Sector Infrastructure Spending

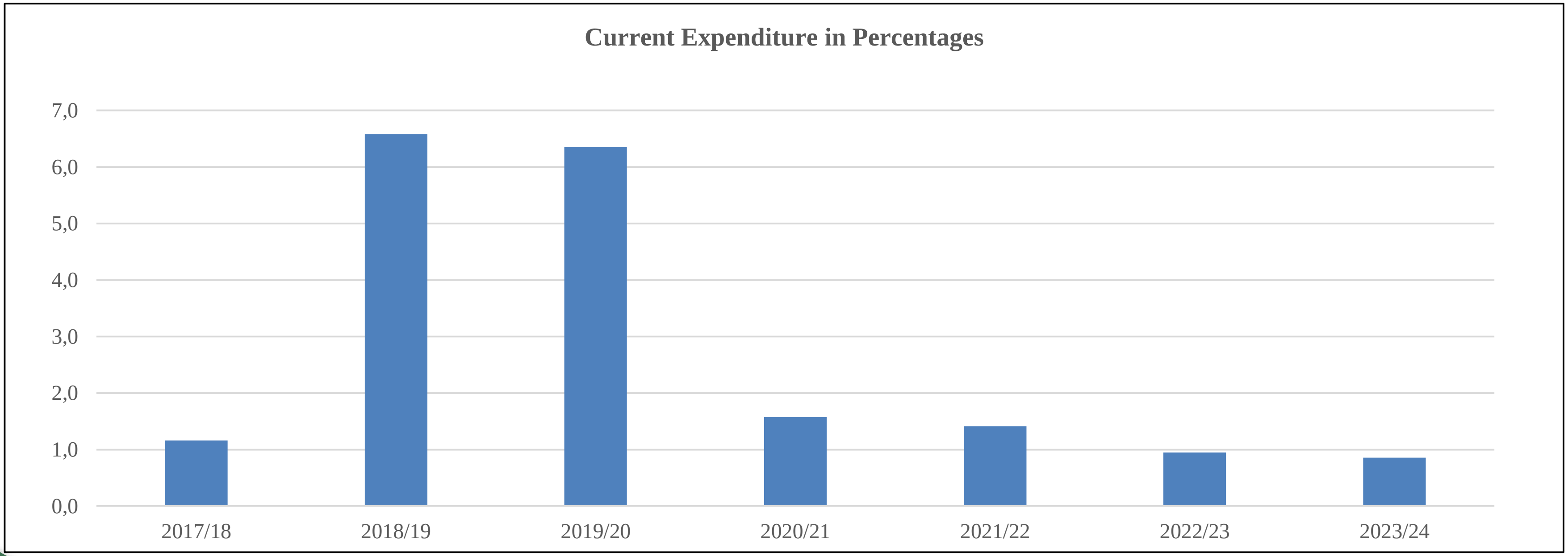
- With respect to infrastructure spending per vote – the Transport vote is allocated a large portion of public infrastructure followed by the Human Settlements
  - However, there has been a slight decline in share of infrastructure investment for transport vote in 2021/22 (and onward) compared to 2020/21



# Public Sector Infrastructure Spending

- The percentage of public infrastructure investment allocated for maintenance and to repair existing infrastructure assets decreases in 2021/22 to 1.4% (from 1.6% in 2020/21)
  - This is a material decrease compared to 6.3% in 2019/20
  - This is a concern as neglecting or not prioritizing maintenance of existing infrastructure could have a negative impact on the provision of basic services, foreign investment and future costs of replacement of infrastructure



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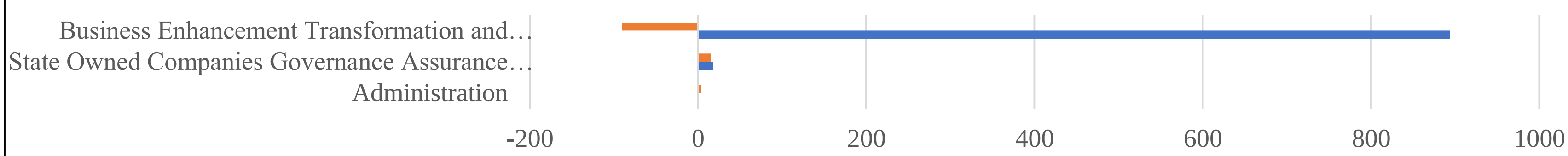
# STATE OWNED ENTITIES

# SOEs Expenditure Trends

Expenditure average growth rate, 2017/18-2020/21 and 2020/21-2023/24)




| | Administration | State Owned Companies Governance Assurance and Perfomance | Business Enhancement Transformation and Industrialisation |
|---|---|---|---|
| Average Growth Rate (2020/21-2023/24) | 3,9 | 14,9 | -90,4 |
| Average Growth Rate (2017/18-2020/21) | -0,4 | 18,2 | 894 |

Average Growth Rate (2020/21-2023/24) Average Growth Rate (2017/18-2020/21)

- The expenditure for the Business Enhancement Transformation and Industrialisation programme decelerates by 90.4% between 2021/22 and 2023/24, reflecting the once-off substantial payments for financial assets - R31.7 billion for Eskom and R4.3 billion to SAA in 2021/22. The programme accounts for 99% of the total expenditure for the department. The continuing financial support for these ailing SOEs, without any guidance framework to it, poses risks to fiscus.
- The expenditure for the State Owned Companies Governance Assurance and Performance programme increases at an average annual rate of 14.9% between 2021/22 and 2023/24 to cater for the establishment of a secretariat for the Presidential State-owned Enterprises Council, tasked with repositioning SOEs and the development of a Government Shareholder Management Bill aimed at strengthening the governance of SOEs. This demonstrates government's effort to meaningfully address a plethora of challenges afflicting most SOEs.

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# FINANCIAL SUPPORT TO SOEs

- The weak financial positions of most SOEs are translating into serious liquidity shortfalls, triggering government bailouts:
  - The R31.7 billion allocated to Eskom for 2021/22 is additional to the R56 billion that was allocated to Eskom for 2020/21 for restructuring the entity
  - R16.4 billion was allocated to SAA over the 2020 MTEF period to settle legacy state-guaranteed debt and associated interest costs, R10.3 billion was allocated for 2020/21, with R4.3 billion and R1.8 billion allocated for 2021/22 and 2022/23 respectively. In September 2020, the business rescue plan increased the funding requirement to R19.3 billion
  - Denel used an allocation of R1.8 billion in 2019/20 to restart operations, repay some legacy creditors, and settle interest and bridging loans. Additional funding of R576 million was allocated for 2020/21 to settle interest and repay government-guaranteed debt
  - R3 billion was allocated for Land Bank in 2020/21, and an additional R7 billion was identified as additional funding required to support the restructuring of the entity. Proposed allocations are R5 billion in 2021/22, and R1 billion in each of the two subsequent years
- The massive financial support to SOEs is undermining the SA fiscal consolidation exercise and increasing the debt burden. Eskom, in particular continues to be a significant strain to the fiscus. According to the latest financial annual report, on average, Eskom will require Government financial support equalling about R1 billion per week in 2021

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# SOEs Risks to Fiscus

- Government exposure to SOEs is high and represents a significant risk to debt sustainability and public finances - warranting a framework for supporting SOEs that is conditional on improving governance and meeting clear quantitative operational and financial performance goals
- Contingent liabilities related to SOEs are high and could translate into a credit rating downgrade for South Africa, because of the large size and high probability of migrating onto the government's balance sheet. This requires a framework for quantifying and limiting risk in respect of SOEs' contingent liabilities
- The SOEs governance failure manifesting in inefficiency, corruption, and financial mismanagement, underscores the need for legislative and governance reforms for SOEs focusing on centralized oversight; appointment procedures for SOE board members; a performance management framework and procurement regulation
- Most SOEs are experiencing severe financial and operational challenges resulting from corruption and weak accountability, highlighting the need to accelerate the restructuring of SOEs, in particular Eskom, premised on a thorough appraisal of existing expenditures, and of the mandates and policies they are based upon - to ensure future efficiency, effectiveness, and affordability/profitability

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# COMMENT ON THE 2021 SPECIAL APPROPRIATION BILL

# 2021 Special Appropriation Bill

- Aim of the Special Appropriation Bill is to appropriate additional amounts or effect adjustments to specific Votes
- The 2021 Special Appropriation Bill contains additions to the Health and Social Development Votes and an adjustment to the Public Enterprises Vote:
  - **Health**: An amount of R1.250 billion is to be appropriated in terms of section 16 (1) of the PFMA to the National Department of Health - to procure COVID-19 vaccines and implement research. R1.1 billion will be committed through Communicable and Non-Communicable Disease management, and R150 million will be used for Health System Governance and Human Resources
    - Given the imperative to reduce COVID-19 infections, the Commission agrees with this special appropriation
  - **Social Development**: R2.826 billion is allocated to the Social Development Vote to fund the extension of the Special COVID-19 Social Relief of Distress Grant
    - Given the income relief provided through this grant, the Commission agrees with this special appropriation

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# SPECIAL APPROPRIATION BILL [CONT.]

- **Public Enterprises Vote**:
  - SAA has been in a business rescue process for 16 months, but this restructuring process has largely excluded its subsidiaries including Mango, SAA Technical (aircraft maintenance), Air Chefs (in-flight catering), and SAA Cargo (air freight)
  - The Special Appropriation Bill provides for additions to the DPE vote for funding for SAA subsidiaries through the SAA business rescue process:
    - SAA SOC Ltd: Purchase of equity: Implementation of business rescue plan is allocated R2,7 billion
    - SAA Technical SOC Ltd is allocated R1,66 billion
    - Mango Airlines SOC Ltd is allocated R819 million
    - Air Chefs SOC Ltd is allocated R218 million
  - SA's airline industry has been severely affected by Covid-19 and the subsequent introduction of strict government measures to curb the spread of the virus
    - Whereas the restrictions have been relaxed, demand for travel remains muted because of, amongst other factors, the slow rollout of vaccines and a shift to working from home and via video conferencing. This is expected to derail the recovery of the industry, affecting all players, including SAA, which was already struggling before the Covid-19 pandemic
  - Mango Airlines is facing a cashflow crisis resulting in the temporal suspension of operations pending the availability of additional funding

# CONCLUDING REMARKS AND RECOMMENDATIONS

# CONCLUDING REMARKS

- The economy is **starting to show signs of recovery but it may take a long time to get back to pre-Covid growth rates**
  - Although investment and GDP growth rates are still in a negative territory on a year-on-year basis, these have started to show signs of recovery as lockdown restrictions have been gradually eased in recent months
  - The projected growth recovery which started in recent quarters, follows a severe collapse in key economic sectors in the first part 2020 - this has had adverse impacts on employment, and other key economic fundamentals
- As noted in its Submission on the 2021 DoR Bill, the Commission would like to reiterate that whilst cognisant of the Covid-19 circumstances and the quickened fiscal deterioration, there remains concern around long standing issues of financial and performance dysfunctionality – **fiscal leakages, wastage and inefficiencies**. To start addressing these, requires:
  - I. A decisive and coherent strategy and political will
  - II. Implementation of the fiscal consolidation, targeting cuts at areas of underspending and questionable performance
  - III. Eradication of duplication of functions – ie, the merging to (not "or",) closing of departments and public entities
  - IV. Investment in the use of technology and other areas of improving the capability of public sector personnel
  - V. Eradication of contract mismanagement and procurement irregularities
  - VI. Zero Based Budgeting, based on expenditure reviews and mindful of the importance of pricing and costing public services

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**Consequence management** and **accountability** mechanisms must be effective

# CONCLUDING REMARKS [CONT.]

- The 2021 Budget in **promoting growth** and **avoiding retrogression of the socio-economic conditions of citizens**, should be more specific in **supporting local demand and localised product procurement in order to support value chains**
- The Commission notes the adjustments to Votes for 2021/22 and reiterates its recommendation that Parliament receive **regular reporting on the implications of budget cuts** especially when considering section 32 reports – departments should indicate **how cuts are being absorbed, which aspects of delivery are being affected**
- Infrastructure investment is key for economic growth and employment
  - Investment in 2021/22 shows insignificant increase, when compared to 2020/21 and is not projected to improve greatly over the MTEF period
  - Percentage of total public infrastructure **investment allocated for the maintenance of existing infrastructure for 2021/22 has significantly decreased** compared to three previous financial years – this holds negative implications for the lifespan of the infrastructure, infrastructure performance, service delivery and future costs
- The massive financial support to SOEs is undermining the fiscal consolidation exercise and increasing the debt burden – the impact of Covid-19 is most likely to worsen the financial position of most SOEs, thus potentially increasing fiscal support requirements for SOEs
- On the Division of Revenue and Appropriation, the 2021 Budget as policy statement can only **ultimately be assessed in terms of its final outcomes** – equally for the revenue estimates. The Commission notes the **heightened uncertainty** in the 2021 Budget consolidation and the **precariousness** in striking the balance between **tax, expenditure and debt level changes -** mindful of cushioning **the impact on the socio-economic condition of citizens**.

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