



For an Equitable Sharing
of National Revenue

Submission for the Division of Revenue 2027/28





SUBMISSION FOR THE 2027/28 DIVISION OF REVENUE

For an Equitable Sharing of National Revenue

We, the Commissioners, hereby submit the Financial and Fiscal Commission's researched recommendations for the 2027/28 Division of Revenue in accordance with the obligations placed upon us by the Constitution of the Republic of South Africa

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THE FINANCIAL AND FISCAL COMMISSION

The Commission is a body that makes recommendations to organs of state on financial and fiscal matters. As an institution created in 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 – and 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 government 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 both to Parliament and the provincial legislatures, who hold government institutions to account. Government must respond to the Commission's recommendations and the extent to which they will be implemented at the tabling of the annual National Budget in February.

The Commission consists of women and men appointed by the President: the Chairperson and Deputy Chairperson, three representatives of provinces, two representatives of organised local government, and two other persons. The Commission pledges its commitment to the betterment of South Africa and South Africans in the execution of its duties.



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FOREWORD

The Submission for the Division of Revenue 2027/28 is tabled by the Financial and Fiscal Commission (FFC) in terms of section 214(1) of the Constitution of the Republic of South Africa, 1996 (as amended), Section 3 of the Financial and Fiscal Commission Act, 1997 (Act No. 99 of 1997), Section 9 of the Intergovernmental Fiscal Relations Act, 1997 (Act No. 97 of 1997) and Section 4(c) of the Money Bills and Related Matters Act, 2009 (Act No. 9 of 2009) (as amended). The FFC is an independent, juristic constitutional institution that reports directly to Parliament and provincial legislatures.



Dr PN Mbava
Chairperson

It is my privilege to present our 2027/28 Submission for the Division of Revenue under the theme the **"Constitutionality of the Budget Process, Fiscal Decision-Making, Resilience and Intergovernmental Fiscal Relations (IGFR)"**

The constitutional imperative that budgets promote transparency, accountability and the effective management of public debt

and the economy imposes concrete obligations on the executive to provide a main budget that accurately reflects known fiscal commitments and to incorporate foreseeable pressures into forward and strategic-level fiscal planning. The Commission identify potential policy gaps that need to be addressed to strengthen the budget process in South Africa and ensure it is in alignment with constitutional imperatives.

Payroll fraud weakens public finances and sustainability. Government strategies exist; however our research shows persistent misalignments between budgeted and actual personnel expenditures. Weak digital identity controls enable the concealment of fraudulent entries like ghost workers.

We re-examine the data used to fund the Provincial Equitable Share and the Local Government Equitable Share, both for the provinces and municipalities. Our findings show challenges in implementing these shares due to outdated data. The government's phased-in approach – where government, in spite of available updated data, implements changes to provincial shares, gradually over three years, depriving provinces of the full impact of the data update, which

accurately reflects their socio-economic realities.

Are fiscal transfers - monies allocated to municipalities - improving municipal service delivery? Challenges arise from funding constraints and governance and coordination weaknesses across the three government spheres.

Finally, South Africa's intergovernmental fiscal system aims for equitable resource allocation, but municipalities face

challenges due to fiscal governance weaknesses. Misaligned planning and budgeting cycles hinder the effectiveness of intergovernmental transfers.

For and on behalf of the Commission



Dr Patience Nombeko Mbava

Chairperson

EXECUTIVE SUMMARY

South Africa's intergovernmental fiscal system is anchored in a constitutional framework that mandates transparency, fiscal sustainability, institutional effectiveness, and the equitable functioning of fiscal transfers. Against this backdrop, the Financial and Fiscal Commission's 2027/28 Submission for the Division of Revenue adopts as its central theme the *"Constitutionality of the Budget Process, Fiscal Decision-Making, Resilience and Intergovernmental Fiscal Relations"* thereby situating fiscal analysis within the normative and legal standards prescribed by the Constitution of the Republic. This framing underscores that all elements of the budget process and intergovernmental fiscal arrangements must be assessed against these constitutional principles.

The five chapters in this submission collectively interrogate both the design and implementation of fiscal policy instruments, drawing on constitutional analysis, econometric modelling, and comparative institutional insights. A consistent finding across the studies is that, notwithstanding a robust legal and institutional architecture, substantive weaknesses persist in implementation, coordination, data integrity, and accountability mechanisms. These deficiencies constrain the effective realisation of constitutional imperatives, particularly with respect to transparency, credibility, and the sound management of public finances.

Chapter 1 evaluates fiscal transparency in South Africa's budget process from a constitutional perspective. It demonstrates that, notwithstanding a sophisticated legislative framework, the budget process exhibits persistent weaknesses in forecast reliability, disclosure of underlying assumptions, and alignment between fiscal projections and actual outcomes. Empirical evidence indicates a systematic bias towards over-optimistic growth forecasts and insufficient methodological transparency, which collectively erode the credibility of the fiscal framework. The recommendations arising from this analysis emphasise the need to institutionalise independent validation mechanisms for macroeconomic forecasts, enhance transparency in modelling assumptions, and strengthen the alignment between fiscal indicators and legislative instruments such as the Division of Revenue Bill.

Chapter 2 examines the fiscal implications of government guarantees, focusing on their impact on fiscal sustainability and transparency. The analysis finds that guarantees are managed in a fragmented and largely reactive manner, with limited integration into the core budget

framework and weak risk assessment systems. Econometric results indicate that increases in guarantee exposure contribute to rising public debt, particularly in the short term, while institutional weaknesses obscure the full extent of fiscal risk. The chapter recommends the establishment of a comprehensive and standardised policy framework governing guarantees, the introduction of explicit ceilings and risk-based provisioning mechanisms, and the development of centralised, real-time reporting systems to improve oversight and fiscal discipline.

Chapter 3 addresses inefficiencies in public sector compensation and the prevalence of ghost worker schemes. The findings reveal systemic weaknesses in personnel management, including volatile headcount variations, persistent overspending, and misalignment between authorised and actual staffing levels. These conditions create an enabling environment for fraud and undermine budget credibility. Drawing on international case studies, the chapter highlights the importance of biometric verification systems, integrated payroll databases, and regular audits. It recommends a comprehensive fraud management approach, including preventative controls, detection systems, and enforcement mechanisms, alongside the use of fiscal transfers as instruments to incentivise compliance and accountability across provinces.

Chapter 4 evaluates the Provincial and Local Government Equitable Share formulae, focusing on issues of data integrity, allocation methodology, and transparency. The analysis identifies significant shortcomings arising from the use of outdated data, phased implementation of formula updates, and the increasing use of off-formula allocations. These practices weaken the objectivity, predictability, and credibility of intergovernmental transfers, and may result in inequitable resource distribution, particularly in rapidly growing regions. The recommendations call for the prioritisation of high-quality, up-to-date data from Statistics South Africa, the elimination of discretionary deviations from formula-based allocations, and a shift away from phased implementation towards more transparent and targeted adjustment mechanisms.

Chapter 5 investigates the effectiveness of intergovernmental fiscal transfers in the context of local government performance, with reference to service delivery outcomes and institutional coordination. The findings suggest that fiscal transfers, while necessary, are insufficient to ensure improved service delivery in the absence of strong governance, coordination, and capacity. Persistent underspending of conditional grants, misalignment between planning and budgeting instruments, and a compliance-driven monitoring framework limit the developmental impact of transfers. The chapter recommends transforming monitoring systems,

particularly Section 71 reporting, into active governance tools, strengthening coordination across spheres of government, and integrating fiscal transfers with targeted capacity-building and institutional support mechanisms.

Taken together, the chapters underscore a central policy conclusion: South Africa's fiscal challenges are not primarily rooted in the absence of appropriate frameworks, but in deficiencies in implementation, coordination, and institutional capability. Addressing these structural weaknesses requires a shift from compliance-oriented approaches towards integrated, evidence-based fiscal governance systems that prioritise transparency, accountability, and measurable outcomes.

RECOMMENDATIONS

The Commission makes the following Recommendations:

Chapter 1: Evaluating Fiscal Transparency in South Africa's Budget Process from a Constitutional Perspective

1. *To enhance transparency of the Budget in line with sections 214 and 215 of the Constitution, the National Treasury must prioritise enhancing the reliability of fiscal forecasts. To achieve this, Treasury should consider leveraging independent validation mechanisms, supported by constitutional institutions, that will assist the legislature in reviewing fiscal forecasts.*
2. *The National Treasury should ensure that reliable fiscal indicators and forecasts in the Budget Review directly inform the Division of Revenue Bill and Appropriation Bill, under sections 213 and 214 of the Constitution, as this will improve policy certainty, support budget execution and strengthen the integrity of the budget.*
3. *National Treasury, in line with section 154 of the Constitution, needs to support capacity-building initiatives in subnational treasuries, and ensure that Provincial Treasuries are capacitated to support local treasuries. Furthermore, the roles and responsibilities of concurrent functions must be clarified to strengthen budget alignment between national transfers and subnational spending outcomes.*

Chapter 2: Evaluating the impact of Government guarantees on Fiscal sustainability and Transparency

4. *The National Treasury should establish and implement a clear, consistent, and comprehensive policy framework governing government guarantees, thereby giving effect to constitutional obligations under*

Sections 213(1)-(2), 214(2), 215(1) and 218, and reinforcing Parliament's mandate to exercise oversight and accountability over contingent fiscal commitments.

5. *The National Treasury should ensure that the devised guarantee framework is aligned with international best practice through the introduction of explicit guarantee ceilings, like guarantee-to-GDP thresholds, and reserves or contingency funds, to prevent unchecked growth of contingent liabilities and mitigate fiscal risks.*
6. *The National Treasury must strengthen oversight of government guarantees by establishing a real-time, centralised tracking system. This system should continuously update and disclose all guarantees and contingent liabilities within budget documentation and fiscal risk reports. Such measures will enhance transparency and reinforce Parliament's oversight obligations in managing fiscal risks.*

Chapter 3: Ghost Workers and the Public Sector Wage Bill in South Africa: Implications for Public Finance Management

7. *The Minister of Finance and the Minister of Public Service and Administration should jointly lead the integration and modernisation of government payroll and human resource systems into a unified platform with biometric and video verification, digital identity, and real-time interoperability with databases such as Home Affairs and South African Revenue Service. To enforce compliance, the Minister of Finance should link all funding (including conditional grants and intergovernmental transfers)—to mandatory biometric registration, regular audits, and strengthened governance across all spheres of government and state-owned enterprises.*
8. *The Minister of Public Service and Administration, in coordination with the Minister of Finance, must adopt a lifecycle approach to payroll fraud management integrating prevention, detection, enforcement, and monitoring, with strengthened consequence management including disciplinary action, fund recovery, and prosecution.*
9. *The Portfolio Committee on Public Service and Administration should strengthen oversight by actively monitoring the link between payroll integrity and public financial management performance. Furthermore, Portfolio Committees should require departments to submit regular reconciliations of compensation of employees expenditure, actual headcounts, and vacancy rates, and use the Estimates of National Expenditure to hold Accounting Officers accountable for persistent misalignments between approved establishments and payroll records.*
10. *The Minister of Finance should incorporate payroll fraud risk into the Fiscal Risk Statement, including an assessment of fiscal pressures from persistent gaps between budgeted and actual headcounts and*

compensation of employees, alongside progress on departmental compliance with payroll verification and consequence management.

Chapter 4: A Review of Input Data in the Provincial Equitable Share and Local Government Equitable Share

11. *Statistics South Africa should prioritise improving the quality, timeliness, and relevance of input data used in the Provincial Equitable Share and the Local Government Equitable Share formulae, while National Treasury, in the Division of Revenue Bill, should utilise input data directly provided by Statistics South Africa without subjective selection. This is to maintain the principles of transparency, objectivity, predictability, and fairness that underpin the integrity of intergovernmental fiscal relations and transfers.*
12. *National Treasury should refrain from a multi-year phasing-in approach used to implement changes in provincial allocations in the Division of Revenue Bill and move towards targeted capacity arrangements for provinces that may face challenges in absorbing rapid funding changes through conditional grants, with a clear time limit.*
13. *For the provincial equitable share formula to remain objective, transparent, and predictable, and to ensure accountability and improve monitoring, the National Treasury in the Division of Revenue Bill should reduce or eliminate the practice of allocating funds through the Provincial Equitable Share that are not determined by the formula (i.e., outside the formula).*

Chapter 5: Strengthening Governance in Intergovernmental Fiscal Transfers for Effective Local Service Delivery

14. *The National Treasury along with the Department of Cooperative Governance and Traditional Affairs should enhance its monitoring tools, particularly Section 71 reports of the Municipal Finance Management Act, into active instruments of governance, coordination and support rather than purely compliance-based reporting mechanisms.*
15. *The National Treasury should embed the institutionalisation of governance, coordinated planning and budgeting across the three spheres of government in the Division of Revenue Bill clauses and the Intergovernmental Fiscal Relations Act, as the findings show that misaligned planning cycles and weak communication between national, provincial, and local government significantly undermine the effectiveness of fiscal transfers.*
16. *National Treasury should redesign conditional grants in collaboration with CoGTA and sector departments such as Water and Sanitation to be simpler and flexible in the Division of Revenue Bill*

clauses and conditions in the grant frameworks, to better reflect and respond to differentials in municipal capacity, governance and coordination requirements.

- 17.** *By Section 154 of the Constitution, National Treasury should conditionalise specific national transfers on supports from national and provinces to local government in the Division of Revenue Bill, to strengthen capacity-building and differentiated support incentives. Particularly for weaker and rural municipalities that face structural constraints.*

Chapter 1

Evaluating Fiscal Transparency in South Africa's Budget Process from a Constitutional Perspective



Chapter 1: Evaluating Fiscal Transparency in South Africa's Budget Process from a Constitutional Perspective

Abstract

Section 215(1) of the Constitution provides that the budgets of all three spheres of government must promote transparency, accountability, and the effective financial management of the economy, debt and the public sector. This research seeks to quantitatively analyse the budget process considering these principles. First, the constitutional principles of transparency and accountability are interpreted to uncover their meaning and scope in the context of public budgeting. Thereafter, a set of fiscal indicators reflecting these principles will be used, along with data trends, to evaluate whether the budget process gives effect to the principles enshrined in Section 215 of the Constitution. The ongoing developments in the current budget reforms proposed by the National Treasury are further investigated to identify potential policy gaps that need to be addressed to strengthen the budget process in South Africa and ensure it is in alignment with constitutional imperatives.

1 Introduction

Budgeting is central to policymaking because it comprises the process of rationing resources to reflect the government's commitments and intentions. The budget process in South Africa is rooted in the constitutional principles of transparency, accountability, and the effective financial management of the economy, debt and the public sector (Section 215 of the Constitution of the Republic of South Africa, 1996 "the Constitution"). The budget process is guided by its constitutional framework and is meticulously regulated under specific legislation, most importantly the Public Finance Management Act ("PFMA") and the Municipal Financial Management Act ("MFMA").

The Minister of Finance's budget speech follows the State of the Nation Address ("SONA") delivered by the President. The SONA details how the Treasury intends to fund the President's

commitments contained in the SONA, the budget also provides an update of the state of the economy, the fiscal framework. In the budget process, aligned with sections 213 and 214 of the Constitution, the National Treasury introduces bills in Parliament that propose the funding allocations across the three spheres of government aligned with policy commitments (Parliament of the Republic of South Africa, 2011).

This research analyses the constitutional and legislative prescripts governing the budget process in South Africa and evaluates, using data and fiscal indicators, whether the budget is aligned with the constitutional principles enshrined in Section 215, in particular, transparency.

2 Literature Review

2.1 The statutory framework guiding South Africa's budget process

Since South Africa's democratic transition in 1994, a series of budget reforms have been implemented to balance institutional decision-making and promote rational budgeting for effective public expenditure that improves service delivery. The national budget plays a central role in how the government fulfils its political, economic, social and administrative functions (Norton & Elson, 2002; Gibran & Sekwat, 2009).

The system of public finances in South Africa was modernised and transformed through extensive policy reforms, culminating in a comprehensive system and budget process that is aimed at enhancing accountability and improving service delivery (Sambo, 2022). The statutory framework of the budget process in South Africa is grounded in the Constitution (Constitution of the Republic of South Africa, 1996), which is the supreme law. Section 215 of the Constitution provides the framework for national, provincial and municipal budgets. In accordance with section 215(1), the budgets of all three spheres of government must promote transparency, accountability, and the effective financial management of the economy, debt and the public sector.

Section 215(2) of the Constitution is an enabling provision for further statutory regulation over the budget process, stating that national legislation must prescribe the form of national, provincial and municipal budgets and the timing of when national and provincial budgets must be tabled (Section 215(2)(a) and (b)). Furthermore, national legislation must prescribe that the budgets of all three spheres of government must provide the sources of revenue, as well as the way in which proposed expenditure will comply with national legislation.

Key budgetary reforms since 1994 include:

- The enactment of the Intergovernmental Fiscal Relations Act (1997)
- The adoption of the Medium-Term Expenditure Framework (MTEF) (1998)
- The Public Finance Management Act (1999)
- The Municipal Finance Management Act (2003), and
- The Money Bills Amendment Procedure and Related Matters Act (2009)

The PFMA under Chapter 4 prescribes the budget process for national and provincial budgets. It regulates the process of annually appropriating funds, the tabling of the budget by the Minister of Finance and what must specifically be contained in the budget (sections 26-27)—amongst other critical aspects such as multi-year budget projections (section 28), adjustment budgets (sections 30-31), unauthorised expenditure (section 34) and unfunded mandates (section 35).

In the process of formulating the budget, National Treasury is required to engage numerous stakeholders; similarly, during deliberations on the budget and funding proposals. Parliament is also required to engage stakeholders to strengthen its understanding and scrutiny of the budget and its accompanied bills. Under section 214(2) of the Constitution, read with section 10 of the Intergovernmental Fiscal Relations Act (1997) (“IGFR Act”), the Minister must consult with the Financial and Fiscal Commission (“Commission”) prior to introducing the Division of Revenue Bill and consider the recommendations of the Commission.

2.2 Budget preparation, implementation and fiscal sustainability

The budget process, as well as its structure and execution, plays a significant role in the realisation of developmental goals. For instance, Ellis and Fender (2006) investigated the relationship between corruption in government and economic growth. A key finding that emerged from their study is that lower levels of fiscal transparency can lead to high levels of corruption and that, in turn, higher corruption is negatively associated with economic growth (Ellis & Fender, 2006).

Comparative studies have provided evidence that, in terms of budget preparation and practices, South Africa performs relatively well compared to many African countries (CABRI, 2015). The benchmarking exercise revealed South Africa’s budget process to be rooted in a sophisticated legislative framework, and that is more advanced than other African countries that were surveyed (CABRI, 2015). While the findings demonstrate significant strengths in South Africa’s budget process, they highlight an important disconnect between having a reliable institutional

framework in place and implementation of the budget. Despite the system being designed in a manner that promotes effective financial management through its MTEF framework and integrative budgeting system across the three spheres of government, issues in budget execution persist, limiting the developmental performance of the budget (CABRI, 2015; Higginson & Krause, 2022).

Cuadrado-Ballesteros and Bisogno (2022) provide empirical evidence of a statistically significant relationship between budget transparency and financial sustainability. For instance, higher transparency was associated with smaller budget deficits, lower reliance on short-term debt, higher government revenues and higher economic growth (Cuadrado-Ballesteros & Bisogno, 2022). While the model does not establish causality, the findings are relevant to the South African context, where public debt levels and the high costs of debt have reached unsustainable levels. The empirical results suggest that improving budget transparency may be critical for restoring fiscal credibility in South Africa.

Higginson and Krause (2022) find evidence that the credibility of the budget process is hampered by spending inefficiencies and corruption, which impede the realisation of constitutional goals (Higginson & Krause, 2022). The authors show that the shortfalls in South Africa's budget process may not be wholly confined to the process's design, as shortfalls in budget execution can hinder the realisation of fiscal policy and broader constitutional objectives (Higginson & Krause, 2022; Ajam & Fourie, 2014). Therefore, in the South African context, while the constitutional principles underpinning the budget process may be well reflected in the legislative process of tabling the budget, these principles may be severely undermined in the process of actually implementing the budget.

Findings from the literature appear to corroborate that South Africa's constitutional and legislative framework regulating the budget process is robust and highly regarded. However, the evidence strongly suggests that a comprehensive legal framework regulating the budget process is not sufficient to give effect to the constitutional principles enshrined in section 215 of the Constitution (Higginson & Krause, 2022). Thus, the budget process cannot be considered in isolation.

2.3 The budget process in the context of fiscal decentralisation

South Africa has a system of multi-level government derived from section 40 of the Constitution, which establishes the state as comprising three spheres of government: the

national, provincial and local spheres. Distinctly, in South Africa, federalism operates under a model of cooperative governance, which Joy (2025) describes as a “quasi-federal” system that promotes interdependence across the three spheres of government.

The principle of cooperative governance is embedded in Chapter 3 of the Constitution. Each sphere is distinctive, interrelated and independent. The Constitution also establishes a framework for how powers and functions are assigned across the three spheres of government; this is a critical basis characterising *fiscal* federalism in South Africa, because each sphere has separate revenue-raising powers, further establishing the country’s system of intergovernmental fiscal relations (IGFR).

Fiscal federalism requires that fiscal relations across all spheres of government occur at all stages of the budget process, creating processes that are interrelated but also affording sub-national spheres fiscal autonomy (Badwan & Karaev, 2017). At every sphere of government in South Africa, the Constitution recognises the functional and institutional integrity, providing a foundational constitutional basis for legislative and executive bodies (Mabugu & Rakabe, 2023). Badwan and Karaev (2017) assert that one of the cornerstones of fiscal federalism is the independence of budgets at different spheres of government, which is derived from each sphere’s ability to generate revenue and make autonomous spending decisions (Badwan & Karaev, 2017).

In South Africa, the nature of fiscal arrangements is such that tax powers are, to a large extent, centralised within the national sphere, while expenditure responsibilities are highly decentralised (Mabugu & Rakabe, 2023). It is thus essential that the IGFR system provides for vertical and horizontal fiscal balance, to ensure that each tier of government has the requisite fiscal powers and capacity to fulfil its designated responsibilities (Badwan & Karaev, 2017).

Despite this constitutional framework, the degree of federalism in South Africa remains a subject of debate, rooted in the country’s political economy (Schwella, 2016). Haysom (2016) argues that the debate is critically linked to the country’s complex societal challenges, shaped by its history of racial segregation and evolving differences of opinion on the appropriate institutional governance model (Schwella, 2016; Haysom, 2016).

The presence of concurrent functions across spheres can contribute towards coordination challenges and undermine cooperation. Ambiguity arising from concurrent functions can cause

fragmentation of functional responsibilities, IGFR transfers, and result in misalignment between subnational budgets (Mabugu & Rakabe, 2023; Ajam & Fourie, 2014).

3 Problem Statement and Research Questions

Problem Statement: *The delay of the tabling of the 2025 budget and recent reforms introduced signalled the need for a critical review of the budget process in South Africa and whether it aligns with the constitutional principles enshrined in section 215.*

Research Questions

1. What are the constitutional principles underpinning the budget process in South Africa?
2. Quantitatively, using fiscal indicators, to what extent does the budget advance the constitutional principle of transparency and the effective management of public debt?
3. How can the National Treasury's budget reforms be enhanced to ensure the budget processes are aligned with section 215 of the Constitution?

Research Objectives

1. To conduct a legal analysis of the principles guiding the budget process under the South African Constitution with a specific focus on transparency and accountability.
2. To evaluate the extent to which the budget promotes transparency and identify shortfalls.
3. To evaluate the extent to which the National Treasury's recent budget reforms give effect to section 215 of the Constitution and identify where they can be strengthened.

4 Research Methodology and Data

4.1 Research Methods

The research paper adopts a primarily quantitative to investigate budget alignment with the principles of section 215 of the Constitution, particularly the principle of transparency, using a range of fiscal indicators. The fiscal indicators used consist of real GDP growth (%) forecasts, gross debt-to-GDP (%) forecasts, and the size of the adjustment budget for selected national departmental votes. A cross-institutional analysis is conducted to compare budget forecasts from the National Treasury to those of the South African Reserve Bank (SARB) and the International Monetary Fund (IMF). Finally, the budget reform process of National Treasury will be documented through content analysis (specifically the MTEF Technical Guidelines 2026) and, based on the outcomes of the preceding analysis, policy gaps will be identified.

4.2 Data

Qualitative data sources primarily include legislation, case law, the National Treasury Budget Reviews, and academic journal articles. The data for the quantitative analysis is sourced from the National Treasury time-series budget data, the SARB and the IMF databases.

5 Findings

5.1 *The notion of fiscal “transparency” in public budgeting*

Ensuring fiscal transparency, a fundamental component enabling accountability, hinges on numerous activities beyond merely disclosing financial and fiscal information. Transparency in fiscal policy decision-making cannot be restricted to the disclosure of fiscal information; information should also be of high quality, be subjected to public and parliamentary scrutiny and include mechanisms for overseeing fiscal risks (International Budget Partnership, 2017; International Monitoring Fund, 2018).

Although transparency is a fluid concept, Piotrowski (2007) defines it generically as the open flow of information to society. Oliver (2004) argues that transparency within a government should not be confined to passive communication. Transparency should extend to actively providing more information and continuously striving to provide better quality information (Oliver, 2004). The Organisation for Economic Cooperation and Development (OECD) asserts that budget transparency requires the full disclosure of all relevant fiscal information in both a timely and systematic manner (The Organization for Economic Co-operation and Development, 2002).

Alt, Lassen and Rose (2006) describe government transparency as the degree to which citizens, the media and financial markets can observe public policies, government actions and the results of their actions. Zucolotto and Teixeira (2014) show how transparent public budgeting can play a significant role in improving political stability, emphasising that countries with a budget process that involves participation with independent institutions with constitutionally defined powers tend to be more transparent. Benito and Bastida (2009) find that there is a strong relationship between budget transparency, fighting corruption and economic development even amongst countries with diverse cultural and political landscapes (Benito & Bastida, 2009).

Transparency is a fundamental requirement for accountability to ensue. One key fiscal indicator for assessing budget transparency using data, is to measure the size of adjustment budgets. Measuring deviations in budget allocations provides useful insights into the degree of

consistency and credibility of budget allocations. An additional indicator for assessing budget transparency is deviation in economic growth forecasts in the budget, as this also allows for analysing the reliability of underlying economic assumptions.

5.2 Constitutional evaluation of the budget process using fiscal indicators

This section focuses on elements, key fiscal indicators from the data, and fiscal policy directions published in the National Treasury's Budget Review, to evaluate whether the value of transparency is being promoted as deemed necessary under the Constitution. In addition to ensuring fiscal transparency, the Constitution also importantly requires the budget to promote "the effective financial management of the economy, debt and the public sector" (Section 215). The following fiscal indicators are employed to evaluate the principles of budget transparency and the effective management of debt and the public sector: deviations in the adjustment budget; projections of debt-to-GDP (%), and projections of real GDP growth (%).

Adjustment budgets: Evaluating fiscal certainty and credibility

A credible budget is one where initial allocation is reliable, minimising the need for significant adjustments. Transparency in this context extends beyond ensuring that fiscal information is published; spending estimates also need to be accurate, consistent and reliable. Table 1 provides empirical results on percentage deviations in allocations across four selected budget votes between the period 2015/16 – 2025/26 (Main budget versus MTBPS adjustment budget). The data reveals a pattern of extreme volatility and substantial adjustments that fundamentally undermine this principle.

Public Enterprises vote:

Table 1 shows that the Public Enterprises vote has seen the most substantial adjustments amongst all departmental votes over the period under review. The substantial upward adjustment by 2281 per cent in 2018/19 was driven by a R5 billion special appropriation to settle debt obligations of South African Airways (SAA). Further significant adjustments continued in the following fiscal years, 2019/20 and in 2020/21, of 217 per cent and 105 per cent, respectively, driven by the bailouts of Eskom debt. The recurrence of such substantial deviations in the adjustment of SOEs, and the persistent need for debt bailouts, are not only evidence of weak operational capacity and financial stability of public enterprises negatively impacting service delivery, but also signal systemic failures in fiscal planning and budgeting.

The magnitude, recurrence, and volatility of these adjustments suggest that additional public investments in SOEs are not leading to long-term structural improvements in operations. Budget transparency and credibility is significantly weakened by such volatile adjustments and the lack of consistency in future budget allocations, and can further result in obscured lines of accountability.

Table 1: Deviations in Adjustment Budgets (Selected Votes), 2017/18FY – 2025/26FY

Vote	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
Public Enterprises	0%	2281%	217%	105%	0%	38%	-9%	0%	
Communications (- 2019)	0%	0%	203%						
Telecommunications and Postal Services (2015 - 2019)	221%	334%	0%						
Communications and Digital Technologies (since 2020)				-3%	5%	7%	-6%	0%	39%

Source: National Treasury Budget Reviews and MTBPS 2017 to 2025 and Author's Calculations

Communications, Telecommunications, and Postal Services votes:

The votes for Communications (discontinued after 2019) and Telecommunications and Postal Services (operational from 2015 to 2019) exhibit patterns that, while less extreme than Public Enterprises, raise distinct concerns regarding fiscal planning and departmental coordination. The data shows that the Telecommunications and Postal Services vote saw upward adjustments of 221 per cent (an additional R3.56 billion) in 2017/18 and further adjustments of 334 per cent (an additional R3.08 billion) in 2018/19. These significant adjustments reflected financial assistance and debt bailouts to the South African Post Office (SAPO).

The Communications vote recorded a 203 per cent adjustment in 2019/20, reflecting a R3.2 billion debt bailout for the South African Broadcasting Corporation (SABC). Since 2020/21, both the Department of Telecommunications and Postal Services and the Communications department have been consolidated into the Communications and Digital Technologies vote. Significant upward deviations in departmental budget in the years preceding their

discontinuation raise concerns surrounding coordination, the approaches adopted to fiscal restructuring and the continuity of fiscal spending.

Overall, these votes reveal a pattern of significant fiscal volatility culminating in structural reorganisation. When a department is failing to deliver on its mandate—as evidenced by the persistent need for extraordinary fiscal support to numerous SOEs—the appropriate response may indeed be restructuring. However, the evidence suggests that the challenge lies not only in poor fiscal planning but potentially in a broader state failure to coordinate departmental functions and monitor implementation. The absence of clear, consistent and predictable funding trajectories for these votes, the section 215 principles of transparency and the budget promoting the effective management of debt, the economy and the public sector will be severely undermined.

The recurrence of large, volatile deviations in adjustment budgets point to a culture of fiscal planning that is reactive rather than proactive, and piecemeal rather than strategic. The outcome is that transparency is compromised, undermining the credibility of the budget process but also obscuring lines of accountability, making it difficult for Parliament and the public to hold the executive to account for its fiscal decisions. This practice not only carries significant fiscal risks but also compromises the constitutionality of the budget process.

Debt management: Evaluating the effectiveness and quality of debt forecasts

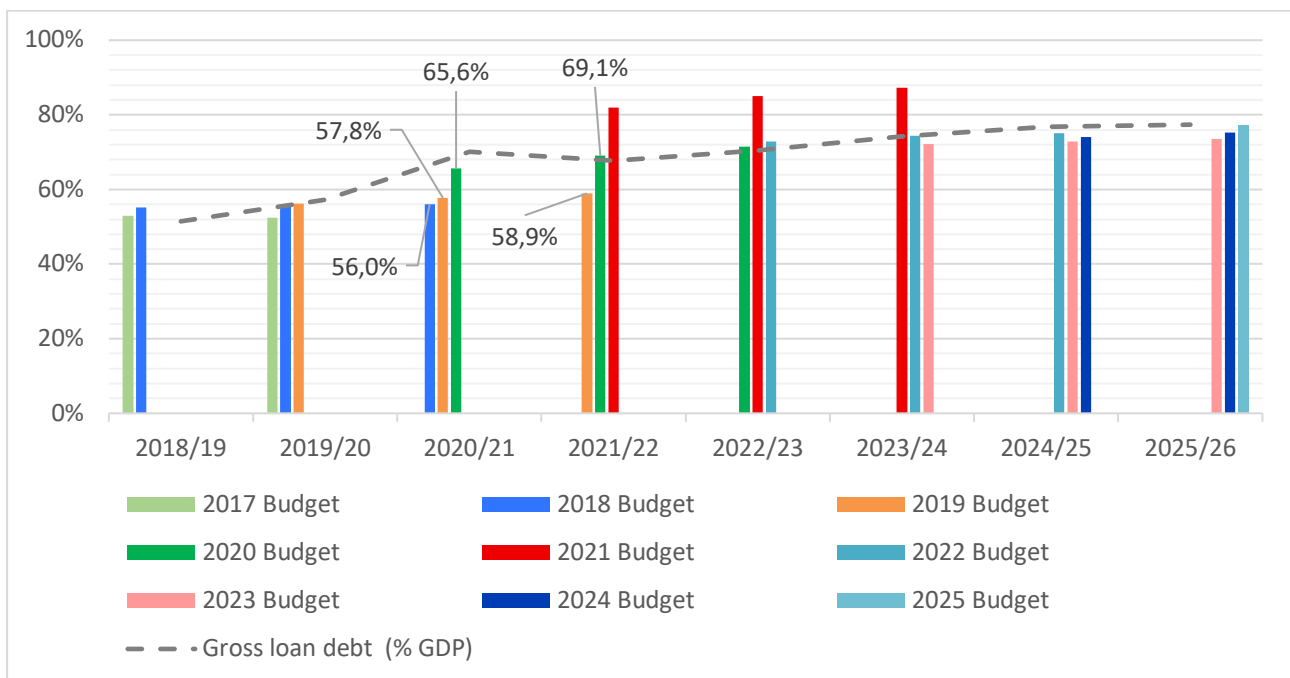
Rising public debt levels have been a longstanding concern in South Africa, particularly in recent years. Stabilising the debt-to-GDP ratio has been one of the government's core fiscal strategies for generating growth and restoring fiscal sustainability. The constitutional requirement for the budget to promote the "effective management of... public debt" in section 215 of the Constitution thus necessitates an examination of the debt trajectory and the reliability of associated forecasts provided in the Budget.

Importantly, as with all economic forecasting, debt projections are subject to considerable uncertainty. Debt projections are contingent upon a range of factors, including GDP growth outcomes, exchange rate movements, primary balance performance and global interest rate conditions. Thus, some degree of forecast revision is to be expected. However, the quality of debt forecasts—and thereby, the effectiveness of debt management in the Budget—can be quantitatively assessed along two dimensions: firstly, by assessing the direction and magnitude of the debt trajectory relative to initial projections; and secondly, evaluating

the consistency and credibility of the budget's forecasts in light of actual outcomes using trend analysis.

Figure 1 shows deviations in the outer-year budget forecasts for gross debt as a percentage of GDP from 2018/19 to 2025/26 alongside the actual outcome. The data show that debt-to-GDP has been consistently underestimated over the period under review, and as expected, notable deviations in the forecast occurred during the COVID years, with a significant inflexion point occurring between 2018/19 and 2020/21.

Figure 1: Gross Debt-to-GDP (%) Budget Forecasts across Budgets, 2018/19-2025/26



Source: National Treasury Budget Reviews 2017 to 2025, author's calculations.

The 2018 Budget projected that debt-to-GDP would peak at 56 per cent in 2020/21. However, by the 2020 Budget Review, against the backdrop of the COVID-19 pandemic, the debt trajectory had been revised sharply upward. The actual debt-to-GDP ratio for 2020/21 was 65.6 per cent, exceeding the 2018 Budget forecast by approximately 9.6 percentage points. While debt-to-GDP remains elevated, forward estimates in the Budget appear to have improved in recent years as the economy readjusted to the economic shock of the pandemic.

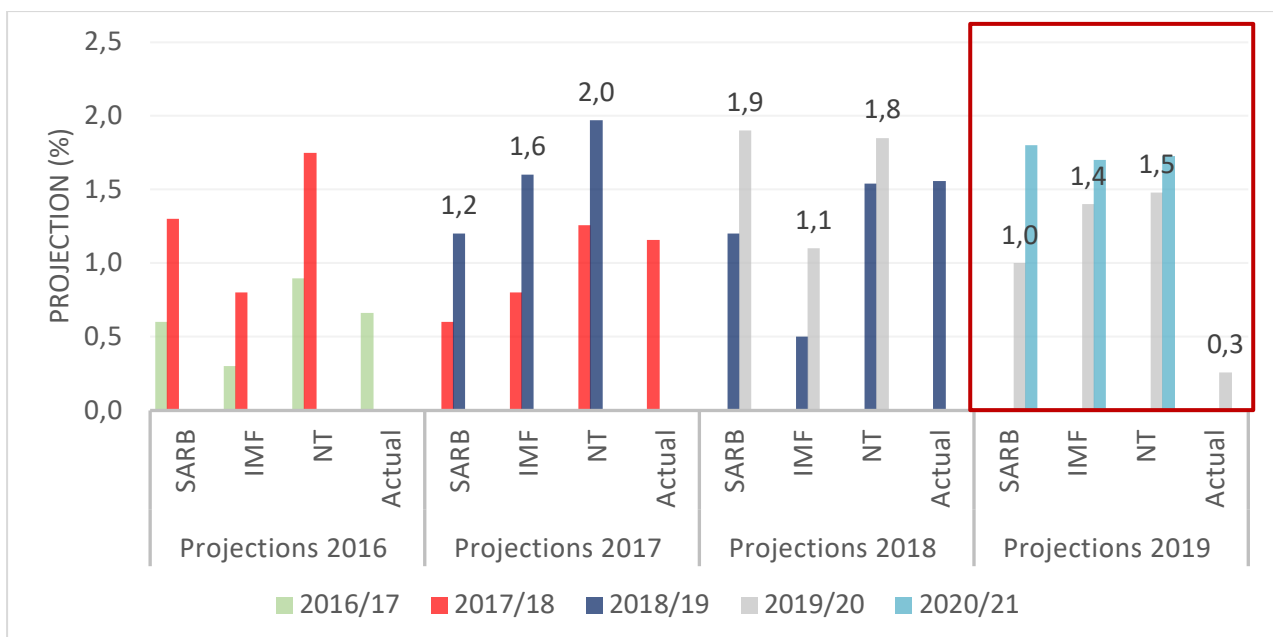
The narrowing gap between successive debt projections and actual outcomes in the post-COVID years, as well as the overestimations in the 2021 Budget, suggest a more realistic assessment of the fiscal position. Nevertheless, the elevated levels of debt on which South Africa

now rests, consistently above 70 per cent of GDP since 2022/23, represent a material change in South Africa's fiscal risk profile. At these levels, the margin for error is substantially reduced, and the economy is more vulnerable to adverse shocks, making accurate forecasting more pivotal.

Accuracy and reliability: GDP forecast deviations and cross-institutional comparisons

This section provides a detailed analysis of the National Treasury's real GDP growth forecasts compared with those of the South African Reserve Bank (SARB) and the International Monetary Fund (IMF). The analysis is structured around two central questions: first, what do selected key data points reveal about the relative accuracy and positioning of the National Treasury's forecasts relative to other institutions; and second, what longer-term trends emerge from a comparative assessment across multiple forecast cycles.

Figure 2: Comparative Growth Forecasts (%): 2016/17 – 2020/21



Source: National Treasury Budget Review, SARB and IMF projections

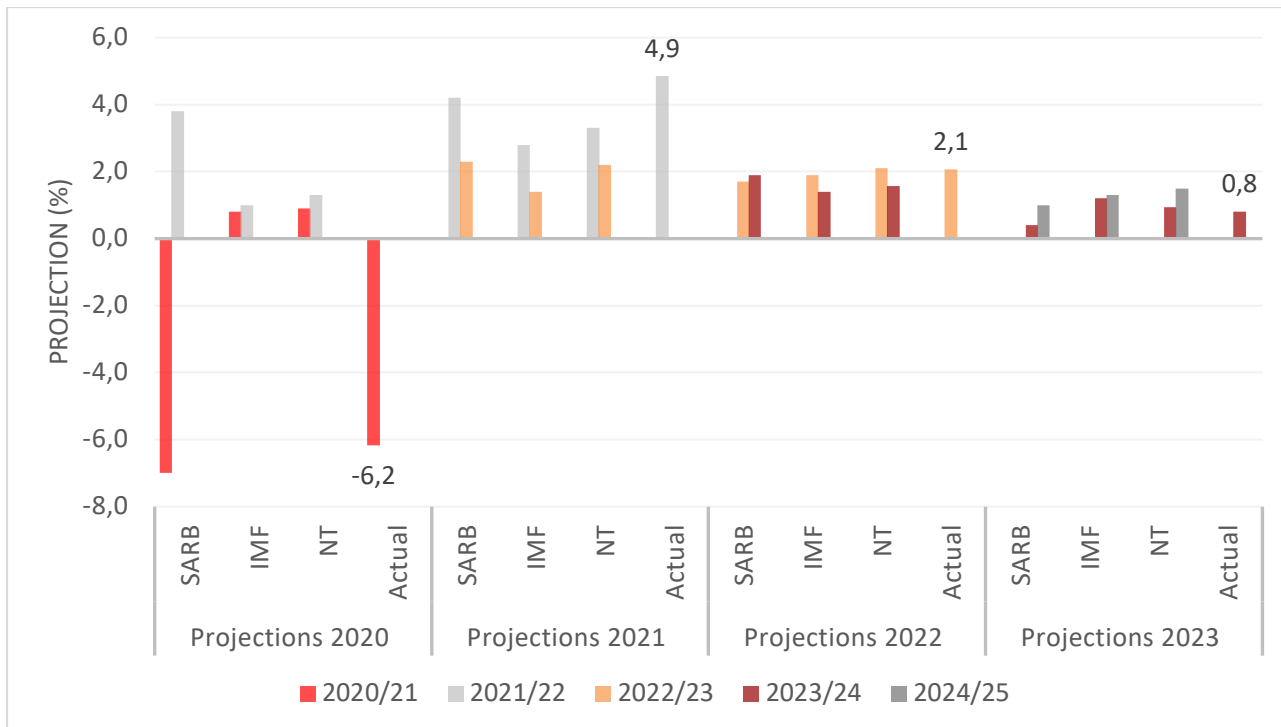
Figure 2 shows the comparative forecasts for the fiscal years 2016/17 to 2020/21. In the years preceding the pandemic, the National Treasury's GDP growth forecasts were consistently positioned at the upper bound of comparative estimates, typically exceeding those of the SARB and the IMF. For instance, National Treasury's projections for the 2018/19 fiscal year in 2017 exceeded those of SARB and the IMF by 0.8 and 0.4 percentage points, respectively. The 2019 projections for the fiscal years 2019/20 and 2020/21 reveal an apparent convergence across the

three institutions, particularly the National Treasury and the IMF, suggesting a period of relative consensus regarding the underlying economic conditions.

Figure 3 shows the comparative forecasts for the fiscal years 2020/21 to 2023/24. As expected, the pandemic year represented a significant outlier, in which National Treasury’s initial forecast in 2020 for the 2020/21 fiscal year—formulated prior to the full extent of the pandemic’s devastating economic impact being accounted for—was markedly higher than the growth that actually materialised.

The pattern of systematic over-optimism in Figure 2 and Figure 3 cannot be attributed solely to the unpredictability of the pandemic, as it was evident in the preceding years of relative economic stability and tends to continue in the post-pandemic recovery period. This persistent bias suggests that the National Treasury’s forecasting model may be underpinned by assumptions that are systematically more favourable than those adopted by peer institutions. Essentially, this pattern indicates a persistent optimism that was not shared by other credible forecasters.

Figure 3: Comparative Growth Forecasts (%): 2020/21 – 2024/25

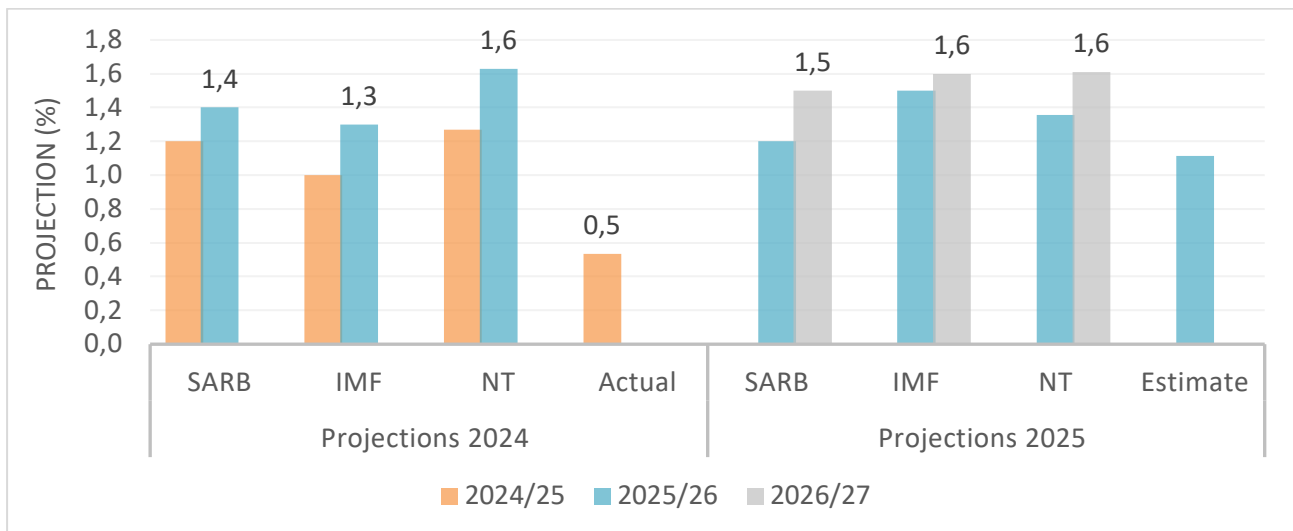


Source: National Treasury Budget Review, SARB and IMF projections

Figure 4 shows growth projections the 2024/25 to 2026/27 fiscal years allows for an assessment of whether the National Treasury has adjusted its forecasting methodology in response to past inaccuracies or whether the pattern of systematic over-optimism persists. However, a similar pattern emerges, with National Treasury forecasts on the upper-bound of growth projections.

National Treasury's growth projection, in its 2024 projection for the 2025/26 year registered at 1.6 per cent, in comparison to SARB and the IMF which projected 1.4 and 1.3 per cent growth, respectively. While real outcome of GDP growth registered lower than all three institutions expected, National Treasury's more optimist forecast in comparison once again demonstrates that domestic and global economic conditions, including risks, may not have been realistically captured in its growth forecast. It is notable that the Treasury's downward revision to the 2025/26 forecast in 2025 registered higher than the SARB's but lower than the IMF's, which may indicate marginal signs of improvement.

Figure 4: Comparative Growth Forecasts (%), 2024/25 – 2026/27



Source: National Treasury Budget Review, SARB and IMF projections

Note: There is no actual growth outcome yet for the 2025/26 financial year in the 2025 projections, thus an estimate is provided.

Overall, the analysis provides empirical insights into the reliability of forecasts in the Budget, which is a critical component of the principle of budget transparency. The analysis reveals concerning trends in the National Treasury's forecasting approach that undermine the Budget's credibility. Given that economic forecasting is highly technical and nuanced, it is not expected that projections will be entirely accurate. In this respect, some degree of deviation is acceptable. However, concern arises when growth is consistently overestimated year after year, as this may indicate unrealistic assumptions are being adopted.

Beyond the quantitative divergences in the projections, there is also a qualitative distinction between the projections. SARB, in its Monetary Policy Review and Statement of the Monetary Policy Committee, and the IMF, provide detailed information on the assumptions underpinning their growth forecasts. These include explicit assumptions regarding domestic economic developments, including exchange rate fluctuations, commodity price trajectories, and global demand conditions.

The SARB also publishes sensitivity analyses that illustrate how its forecasts would change under alternative assumptions. By contrast, the National Treasury's Budget is less forthcoming about the technical assumptions and methodologies that underpin its forecasting strategy. Compared to the SARB and IMF, the Budget discloses less information about the specific assumptions embedded in its forecasting model. While the document outlines broad economic themes and risks, it does not offer the same level of granularity regarding quantitative assumptions; rather, the National Treasury's assumptions appear to remain largely qualitative.

5.3 National Treasury 2026 MTEF budget reforms

The 2026 Medium-Term Expenditure Framework (MTEF) Technical Guidelines introduce important shifts in the budget process, aimed at enhancing both procedural compliance and the credibility of budget submissions across all national departments, constitutional institutions, public entities and provincial governments and entities (National Treasury, 2025).

The reforms contained in the document signal a deliberate move away from incremental budgeting towards a more strategic, transparent and results-driven approach with the aim of restoring fiscal discipline, ensuring resources are channelled into high-impact programmes, and overall strengthening service delivery. The guidelines outline instructions and expectations regarding how the budget process must be treated. The National Treasury's Technical Guidelines reaffirm the government's commitment to institute a disciplined, transparent, and strategic approach in the budget process, aligned with the Constitution.

The National Treasury recognises that the 2025 budget cycle brought to the fore the need for improved coordination, broader consultation and the overcoming of spending inefficiencies in the budget process—and the technical guidelines support the implementation of key budget reforms announced in the 2025 budget. In the document itself, the National Treasury reiterates

its fiscal strategy, which is to stabilise and reduce debt as a percentage of GDP (debt-to-GDP ratio), achieve a primary surplus, expand infrastructure investment and support the social wage.

According to the National Treasury, the budget process has not kept pace with the country's evolving fiscal space and institutional and political realities. Specifically, the National Treasury mentions that an approach of incrementalism has created inefficiencies and has not facilitated service delivery in various sectors. Furthermore, the 2025 budget cycle exposed critical limitations, namely, fragmented decision-making, insufficient policy-budget alignment and weak consensus of trade-offs when managing competing priorities within the context of constrained fiscal space. Thus, the use of the budget as a central policy tool directs and facilitates the implementation of the government's developmental agenda.

The Technical Guidelines set out the principles that should guide departments and public institutions in their budget preparation. These principles are summarised in

Figure 5: Principles guiding the 2026 MTEF budget reforms



Source: National Treasury 2026 MTEF Budget Reform

The terms and scope of the MTEF Technical Guidelines

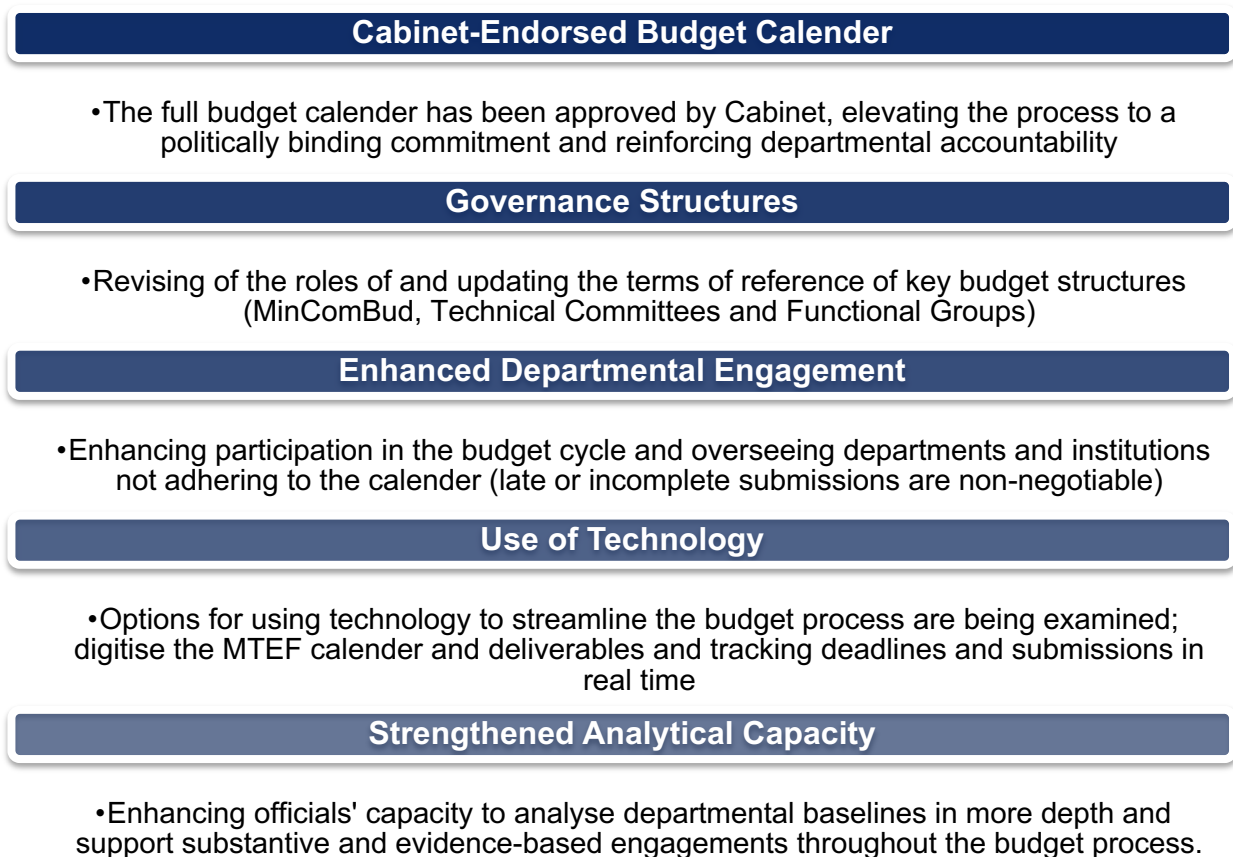
The MTEF Guidelines introduce the mechanism of Targeted and Responsible Savings (TARS) and Spending Reviews. The Treasury states that this initiative is intended to identify—and remove—low priority or underperforming programmes from the budget, with the aim of reducing aggregate expenditure. Furthermore, where appropriate, funds from these underperforming or low-priority programmes should be reallocated towards the Medium-Term Development Plan (MTDP) priorities.

The National Treasury states that multiple criteria will be used to identify programmes to be included in TARS—these include historical and current performance, previous spending review findings and alignment with the MTDP priority policies. The Cabinet must approve the

programmes selected for TARS. Only thereafter will they undergo a spending review “if required”.

According to this reform framework, the purpose of the spending review will be to initiate the process of de-implementation of the programme in the 2026/27 fiscal year. For smaller programmes (uncertain why this is determined and whether it is based on total allocation) – reviews will be implemented immediately, while bigger programmes will undergo a phased approach to de-implementation (i.e. reductions over the MTEF). However, these spending reviews will only be implemented if required, such as when historical spending reviews remain relevant, or there is agreement on the programme’s underperformance. Key interventions are summarised in Figure 6.

Figure 6: Overview of key budgetary interventions



Source: National Treasury 2026 MTEF Budget Reform

In terms of operationalising the TARS mechanism, numerous initiatives will be instituted. These include spending reviews, data-driven approaches (to eliminating “double dipping” in social grants and auditing ghost workers and payroll irregularities), update proposals on public entity (and department rationalisation), resolving inefficiencies in the public sector wage bill through

personnel expenditure reviews (to be conducted by the Department of Public Service and Administration), and instituting technical baseline analyses to ensure departments and public entities are appropriately aligned to their core mandates.

Specifically, the National Treasury highlights that Departments are expected to 1) demonstrate that performance indicators are used in monitoring progress; 2) use findings from previous spending reviews to identify potential savings; 3) incorporate insights from cross-cutting spending reviews, and 4) detail what progress has been made, and actions instituted, to implement the outcome of spending reviews.

Furthermore, baseline analysis must be incorporated. In the Technical Guidelines, the National Treasury also recognises the role of fiscal anchors in reforming and strengthening budgetary practices and fiscal sustainability, as emphasised in the Treasury's discussion document released on 12 March 2025. However, the focus is on procedural reforms rather than numerical limits, as this can improve transparency and accountability. Importantly, the National Treasury highlights the need for enhanced fiscal risk analysis, economic forecasting and oversight of budget entities for ensuring the credibility of the fiscal framework

In accordance with the Technical Guidelines, the Minister of Finance was meant to announce the selected programmes for the TARS in the 2025 MTBPS. The Cabinet is responsible for deciding, with its discretion, to close programmes, scale them back, or retain them (with the intent to enhance efficiency), based on the findings from the TARS process. Emphasis in the reforms introduced in the MTEF Technical Guidelines appears to be placed on improving programme efficiency and directing spending elsewhere, while this is crucial and must play a role, less emphasis is placed on detailing how ineffective programmes that drain the fiscus will be phased out.

Moreover, the ultimate decision-making power to eliminate spending inefficiencies rests with the Cabinet, but the document lacks detail on factors that must be considered in exercising this discretion. It is critical that this becomes transparent. In institutionalising these reforms in the budget process, the National Treasury commits to "consult widely" on macroeconomic assumptions and constraints with numerous stakeholders, including Cabinet, departments, provinces and oversight bodies.

6 Conclusion

The constitutional imperative that budgets promote transparency, accountability and the effective management of public debt and the economy imposes concrete obligations on the executive to provide a main budget that accurately reflects known fiscal commitments and to incorporate foreseeable pressures into forward and strategic-level fiscal planning. Budget transparency goes beyond the disclosure of fiscal information to also ensure the quality of the information provided. The analysis on the size of deviations in the adjustment budgets reveal a pattern of substantial and volatile adjustments, which may indicate deeper issues of policy uncertainty and a culture of fiscal reactivity. It is crucial that policy implementation be characterised by long-term strategic planning and is accompanied by consistency in funding allocations.

When substantial deviations occur repeatedly, particularly in votes where the policy challenges are well known historically and persistent, it suggests a culture of reacting to fiscal needs as and when they arise, rather than taking a fiscally strategic and proactive approach. Given that transparency is a critical component of accountability, the lack of consistency and transparency in future budget allocations and planning may further obscure accountability lines. The empirical evidence on the adjustment budget deviations thus suggests that the principle of transparency, as required by section 215, is being selectively applied, undermining the integrity of the main budget.

The budget's economic projections are critical as they serve as the foundation for revenue estimates, expenditure ceilings and the debt trajectories that are decided upon. A consistent and concerning pattern emerged across the three forecast cycles of GDP growth in the institutional cross-comparison, whereby the National Treasury's real GDP growth forecasts are systematically higher than those of the SARB and IMF. This pattern, while it does not provide evidence of deliberate misrepresentations, raises serious concerns regarding the transparency and reliability of the National Treasury's economic assumptions.

Forecasting under uncertainty inevitably produces inaccuracies. However, the empirical results show that the Budget's overoptimistic projections are not a once-off occurrence, but persist. Unreliable growth forecasts across multiple forecast cycles and in both stable and crisis periods strongly suggested that the bias is not random but rather structurally embedded in the Budget. While some degree of forecast error is unavoidable, a persistent directional bias as evidenced by the data and limited methodological transparency suggests that the Budget falls short of

promoting transparency and the effective management of debt and the economy, as mandated by the Constitution.

The National Treasury appears wholly committed to ensuring that the Budget process aligns with the constitutional principles of transparency, accountability, and responsible public debt. However, it is uncertain whether there is political will to make significant and difficult trade-offs required to realise its budget reform objectives. The current budget reforms lack rigorous, clear-cut mechanisms and specific, measurable criteria to make difficult spending trade-offs.

7 Recommendations

The Commission makes the following Recommendations:

1. *To enhance transparency of the Budget in line with sections 214 and 215 of the Constitution, the National Treasury must prioritise enhancing the reliability of fiscal forecasts. To achieve this, Treasury should consider leveraging independent validation mechanisms, supported by constitutional institutions, that will assist the legislature in reviewing fiscal forecasts.*

The Financial and Fiscal Commission is one entity, established under section 220 of the Constitution, mandated to make recommendations on financial and fiscal issues. The Intergovernmental Fiscal Relations Act (IGFR) further cements the FFC's role in the budget process. In this regard, the FFC is well-suited to provide support in reviewing and strengthening fiscal forecasts for the purposes of the budget process.

The empirical analysis shows a long-run trend of persistent overestimation of growth and underestimation of debt-related indicators, illustrating optimistic or unrealistic model assumptions, which impacts the credibility of the budget and spending decisions. To address this, Treasury should refine its macroeconomic forecasting models, adopt evidence-based assumptions, and make these quantitative assumptions transparent to allow for external, independent engagement. In this context, Treasury should strongly consider institutionalising independent validation mechanisms for forecasts.

Furthermore, the current "top-down" approach in public budgeting that characterises the South African budget process undermines the critical role that stakeholders and independent bodies play in fostering meaningful engagement in fiscal policy decisions.

2. *The National Treasury should ensure that reliable fiscal indicators and forecasts in the Budget Review directly inform the Division of Revenue Bill and Appropriation Bill, under sections 213 and 214 of the Constitution, as this will improve policy certainty, support budget execution and strengthen the integrity of the budget.*

The fiscal framework, including economic growth, revenue and debt indicators, not only inform the government's policy priorities but also directly impact fiscal spending decisions and service delivery outcomes. The evidence of substantial and recurrent volatile adjustments, pointing to reactive fiscal policy and suggesting policy uncertainty, illustrate a disconnect between the fiscal framework, the main budget and the adjustment budget.

It is crucial that policy implementation be characterised by long-term strategic planning and is accompanied by consistency in funding allocations aligned with the fiscal framework. Repeated substantial deviations in the government's spending plans as set out in the main budget have been persistent particularly in state-owned entities, despite the challenges being historically well-known. These findings suggest a culture of reacting to fiscal needs as and when they arise, rather than taking a fiscally strategic and proactive approach. Furthermore, a lack of consistency and transparency in future budget allocations and planning may further obscure accountability lines.

3. *National Treasury, in line with section 154 of the Constitution, needs to support capacity-building initiatives in subnational treasuries, and ensure that Provincial Treasuries are capacitated to support local treasuries. Furthermore, the roles and responsibilities of concurrent functions must be clarified to strengthen budget alignment between national transfers and subnational spending outcomes.*

The effectiveness of the budget process is also linked to sub-national performance. Transparency and accountability in the budget process need to be realised across all spheres of government under section 215 of the Constitution. However, concurrent functions across the national, provincial and local government spheres create ambiguities in responsibilities and undermine spending performance. Significant variation in capacity across provincial and local treasuries heightens policy fragmentation, resulting in coordination challenges and misalignment in budget execution.

National Treasury under section 154 of the Constitution must provide support to provincial governments to strengthen capacity building; similarly provinces need to be sufficiently capacitated to support local government. The Division of Revenue Bill, can be used as a strategic financial governance tool to ensure targeted allocations effectively provide support to subnational governments.

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Chapter 2

Evaluating the Impact of Government Guarantees on Fiscal Sustainability and Transparency



Chapter 2: Evaluating the impact of Government Guarantees on Fiscal Sustainability and Transparency

Abstract

This paper evaluates the impact of government guarantees on fiscal sustainability and transparency in South Africa. The study identifies key challenges, including fragmented fiscal reporting, ad hoc issuance of guarantees, and weak risk assessment and monitoring mechanisms, all of which undermine transparency, accountability, and effective fiscal oversight. Furthermore, the limited integration of guarantees into the core budget framework obscures the true extent of government exposure to fiscal risk and weakens the credibility of fiscal policy. Adopting both qualitative and quantitative research approaches, the study combined the assessment of legislative and policy frameworks with econometric analysis. A guarantee risk matrix was developed to assess the likelihood of guarantee calls, while an Autoregressive Distributed Lag (ARDL) model was used to examine the relationship between guarantees and fiscal sustainability. The findings indicate that increases in guarantee exposure contribute to rising debt levels over time, particularly when extended to financially distressed entities, with effects mainly observed in the short run. The paper concludes by recommending the establishment of a comprehensive policy framework, improved disclosure and reporting practices, explicit guarantee ceilings, and stronger risk assessment mechanisms to enhance fiscal discipline, transparency, and long-term economic stability.

1 Introduction and Background

Government guarantees represent significant contingent liabilities that can undermine South Africa's fiscal sustainability. Guarantees are not an immediate expenditure but a potential expenditure for the budget. However, if the guaranteed entity fails to honour the borrowing terms, there are fiscal implications that can impact the fiscal position, bypassing the appropriation process. In South Africa, government guarantees are not usually included directly in the national budget and fiscal framework; rather, they are considered in other documents in the Budget Review as an attached table annexure on the National Treasury website (National Treasury, 2025b).

In addition, the absence of a comprehensive, structured policy framework governing the administration of government guarantees has led to the issuance of guarantees on an ad hoc basis, often without a uniform set of criteria or established legislative procedures to guide accountability, resulting in inconsistent practices and increased fiscal risk. This has created accountability and oversight challenges for Parliament, oversight institutions, and the public, who cannot assess the country's complete exposure to fiscal risk. The current, fragmented and incomplete reporting of guarantees, and the absence of a comprehensive and uniform policy framework, create room for discretionary practices and weaken the alignment of guarantees with broader fiscal policy objectives and constitutional imperatives.

While the National Treasury has embarked on budget process reform to improve transparency, efficiency, and fiscal sustainability, concerns persist whether these reforms will adequately address the challenges regarding the administration of government guarantees. According to Herald and Hodges (2018), the fragmented approach to reporting and the decision not to integrate government guarantees in the core budget documentation conceal the impact of these commitments on public and compromise fiscal sustainability by masking the level of risk exposure. Although guarantees do not entail immediate cash outflows, their potential to materialise into obligations has historically proven costly, particularly for state-owned enterprises (SOEs) with precarious financial conditions.

When guarantees are enforced, as has often been the case with Eskom and other large SOEs like Denel and South African Airways, the resulting liabilities are absorbed by the state without prior alignment with the budget planning process. This practice diminishes the credibility of the budget process and poses long-term sustainability risks to the fiscus. According to Ngobeni et al. (2023) and Sadiki (2015), ensuring that the administration of government guarantees is within a comprehensive and uniformly structured policy framework will ensure that guarantees are issued in accordance with the prescribed statutory regulations and on a uniform criteria basis, without any politically driven motives. Strengthening the integration of government guarantees in the primary budget documents and fiscal framework in a consistent and transparent manner is essential for aligning public finance management with constitutional principles and long-term economic stability (International Monetary Fund (IMF), 2021).

This analysis aims to evaluate the extent to which government guarantees affect fiscal sustainability and transparency by examining their fiscal implications, management frameworks,

and reporting practices. It aims to identify gaps between policy intent and implementation, assess the associated fiscal risks, and propose recommendations to strengthen oversight, accountability, and long-term fiscal discipline.

2 Research Problem and Questions

The lack of uniform treatment of government guarantees within South Africa's fiscal reporting framework is a real concern for fiscal transparency, accountability and sustainability over time. These guarantees, while often necessary to support important economic sectors, are also contingent liabilities that could significantly impact public finances. The exclusion of government guarantees from the primary budget documents and fiscal framework undermines Parliament's constitutional role in authorising public expenditure and discourages effective fiscal oversight. This gap creates an illusion of fiscal prudence while actual risks accumulate outside the formal fiscal envelope. The use of different reporting channels to account for government guarantees indicates the absence of a consolidated view of the state's contingent liabilities. Therefore, this fragmented approach of reporting raises concerns regarding compliance with section 213 of the Constitution, which requires legislative oversight of state spending, and section 218, which restricts the state from incurring liabilities without proper authority. The analysis in this study was guided by the following research questions:

1. How are government guarantees accounted for in the budget or fiscal framework?
2. What proportion of government-issued guarantees have been called upon, resulting in fiscal obligations?
3. What approaches have other governments adopted to manage guarantees that are at high risk of being called, and how have they reflected these in their fiscal frameworks or budgets?
4. What measures can be adopted to enhance the transparency and reporting of government guarantees?

3 Research Methodology

This study adopted both qualitative and quantitative analysis to evaluate the impact of government guarantees on fiscal sustainability and transparency. This included a qualitative analysis of key legislative frameworks (including the Constitution, PFMA, MFMA, and National Treasury Regulations) and quantitative time-series econometric modelling to assess the impact of government guarantees on fiscal sustainability and transparency. A guarantee matrix was developed using indicators such as cumulative support, frequency of bailouts, fiscal exposure, and likelihood of guarantee calls to provide a forward-looking risk assessment. The quantitative analysis applies an Autoregressive Distributed Lag (ARDL) model to annual data, supported by

unit root and diagnostic tests to ensure robustness and reliability. Data utilised across the analyses are sourced from National Treasury and the South African Reserve Bank, covering guarantee trends, SOE bailouts, and key macroeconomic indicators over varying time periods.

4 Analysis

4.1 Case Study Insights on managing high-risk Guarantees

The study undertook a case study analysis of countries demonstrating best practices in managing guarantees with a high likelihood of being called, as well as countries whose accounting approaches are broadly comparable to those of South Africa. The key insights arising from this analysis are as follows:

- Early recognition of probable and measurable risks through provisions, strengthens fiscal sustainability by anticipating future obligations.
- Disclosure alone is insufficient; without integration into the budget process, partial transparency does not fully mitigate fiscal risk.
- Embedding guarantees within fiscal frameworks, forecasts, and strategy documents represents international best practice for proactive risk management.
- Applying clear probability and measurability criteria for provisioning enhances the credibility and consistency of financial reporting.
- Institutionalised reporting mechanisms are essential for systematically identifying, assessing, and communicating fiscal risks.
- The use of ceilings or fiscal rules helps contain the accumulation of contingent liabilities and limits overall exposure.
- Cash-based budgeting systems are inherently reactive, as fiscal costs are only recognised when guarantees are called, unless supplemented by strong disclosure and risk frameworks.

4.2 Analysis of Legislative and Regulatory Frameworks

The section below examines legislative and regulatory frameworks governing government guarantees, determining the most pertinent legislative gaps responsible for ineffective fiscal risk management.

The Constitution of the Republic of South Africa (1996)

Section 215 (1) of the Constitution sets a principle that all budgets and budgetary processes must be transparent and accountable; and that the government must ensure effective management of debt and the public sector, among other things. Guarantees significantly

contribute to public contingent debt, and, under **section 215(1)**, their issuance should not jeopardise debt sustainability. However, key to note is that the transparency of the budget in helping manage debt sustainability is constantly under scrutiny, as the National Treasury only notes these commitments in annexure Table 11 of the Budget Review, without fully disclosing them in Chapter 7 as part of the fiscal risks—concealing the real impact of these commitment on debt and fiscal sustainability; overall conceals the country's exposure to debt.

The limited transparency and incomplete disclosure of government guarantees directly undermine the principles embedded in **Section 214 (1)-(2)** of the Constitution, particularly in relation to the role of the Financial and Fiscal Commission (FFC). **Section 214(1)–(2)** requires that an Act of Parliament providing for the equitable division of nationally raised revenue be enacted after consultation with the FFC, and with due consideration of the Commission's recommendations, considering the national interest, national debt, and other national obligations. However, when guarantees, which constitute a significant portion of contingent liabilities, are not fully integrated into core fiscal risk reporting, the Commission is constrained in its ability to assess the true extent of government financial obligations. This weakens the Commission's capacity to provide informed and credible recommendations, as the fiscal framework upon which revenue-sharing decisions are based becomes incomplete and potentially misleading.

Public Finance Management Act (1999)

The PFMA in **section 70 (1)** authorises the Minister of Finance to issue guarantees for specific individual cases or a category of cases, on conditions determined and approved by the Minister. This section of the PFMA provides limited details regarding the criteria and methodology utilised for fiscal risk assessment before issuing guarantees. One key criticism is that **section 70 (1)** does not set explicit standards for risk assessment, financial viability tests, or future fiscal sustainability evaluations. In practice, this means that the risk-assessment framework is left to National Treasury guidelines rather than being embedded in the primary legislation. This, in practice, results in inconsistency, as the quality and depth of due diligence processes may vary over time, creating vulnerabilities when guarantees are extended to distressed state-owned entities (SOEs).

It is also notable that the PFMA in **section 70** does not establish a ceiling on aggregate guarantee exposure. The Act only grants the Minister the power to set conditions attached to guarantees issued but does not limit total exposure or guarantee-to-GDP ratios. As a result, significant

contingent liabilities accumulate over time, particularly as seen in sectors such as energy (via Eskom) and transport (via SANRAL and Transnet). In practical terms, the PFMA not establishing guarantee-exposure ceilings exposes the national fiscus to systemic failures of guaranteed entities, as these entities continue to request guarantees beyond their financial capacity, further mounting the guarantee portfolio without any constraint.

The PFMA is unclear about post-issuance monitoring of guarantees. Although **section 40** necessitates that public entities report on particulars including contingent liabilities, it does not establish consistent guarantee reporting requirements, nor does it require proactive disclosure on guarantee performance, default probability, or early warning indicators. Consequently, monitoring takes a reactive rather than a preventive approach. This, in turn, restricts the government's capacity to identify the early stages of financial deterioration, thereby increasing the likelihood of guarantees being called unexpectedly and, in turn, raising the associated fiscal risk.

Finally, the PFMA does not clearly provide for transparent reporting of guarantee risks. The Act requires disclosure of contingent liabilities but does not require real-time disclosure of guarantee utilisation, guarantee calls, guarantee restructuring, or the forecasting of possible fiscal risks. This ambiguity affects Parliament's oversight function and weakens accountability. In practice, this might mask the underlying financial strain in SOEs and delay remedial measures.

National Treasury Regulations (2000)

Regulation 13.1.1 states that institutions may not provide guarantees without the appropriate approval of the treasury. However, that regulation lacks formal criteria or minimum standards of analysis to guide an evaluator in deciding on a guarantee application. This oversight means that guarantees could be awarded with little to no consideration of the risk of default or the overall fiscal implications of the guarantee.

Under **Regulation 13.1.4**, the public entity is obligated to provide a report listing all contingent liabilities within its knowledge, including government guarantees. However, there are no requirements for these reports to include a set of standard metrics, such as the utilisation of the guarantee, compliance with its terms, risk grade, or any financial conditions. This reporting deficit is further exacerbated by the siloed nature of these reports, which contributes to a limited view of the exposure to risk that the guarantees present— thereby restricting the government's ability to provide timely remedial support when a public entity is in financial distress.

4.3 An Evaluation of Government Guarantees and Contingent Liabilities

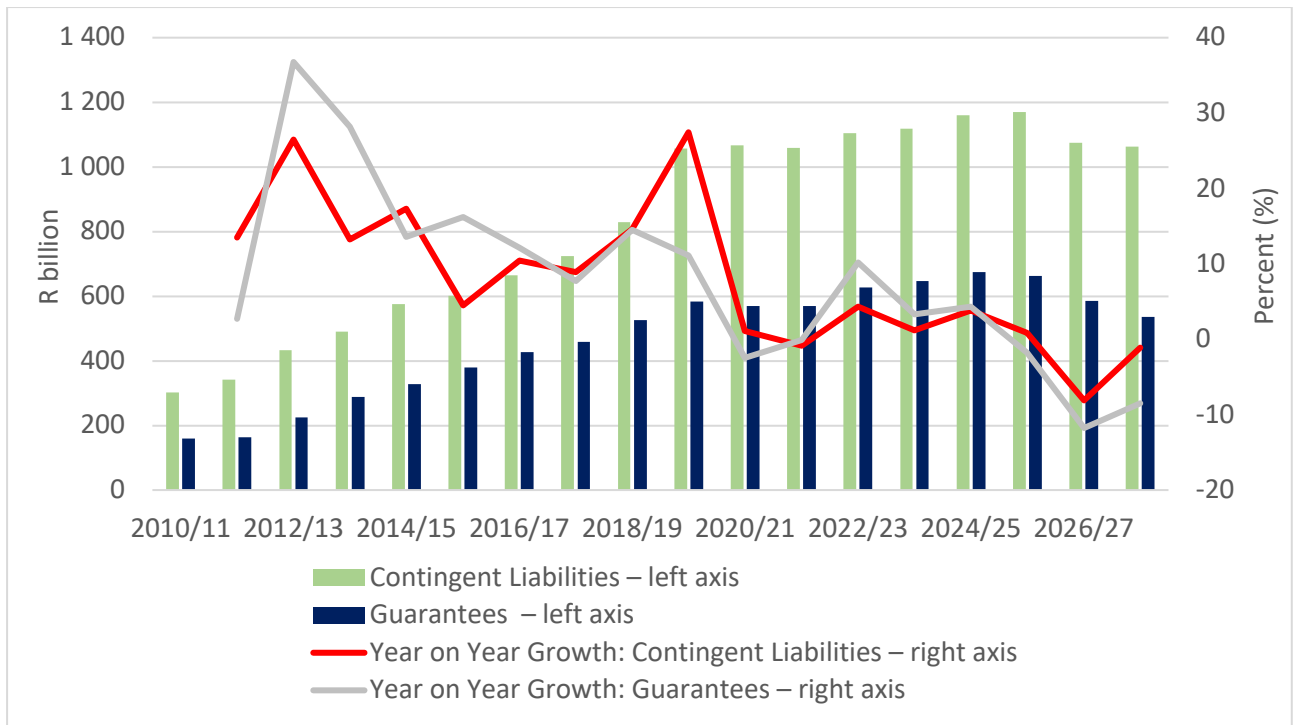
Disclosed guarantee exposure and contingent liabilities

The steady expansion of government guarantees and contingent liabilities over the past decade has exacerbated fiscal sustainability risks by increasing the likelihood that contingent exposures materialise into direct public debt. As illustrated in

Figure 7, government guarantees and contingent liabilities have grown steadily due to frequent fiscal interventions and structural weakness in SOEs—reaching a high of R663 billion and R1.2 trillion in 2025/26, respectively. In terms of growth, the data shows two sharp increases. Between 2012/13 and 2015/16, growth was largely driven by escalating financial distress of SOEs, particularly Eskom and SAA, that led to government intervention in the form of expanded guarantees. While the surge in 2019/20 occurred as the COVID-19 pandemic triggered emergency fiscal support, including additional guarantees and liquidity measures for SOEs and infrastructure projects (Ngobeni et al., 2023).

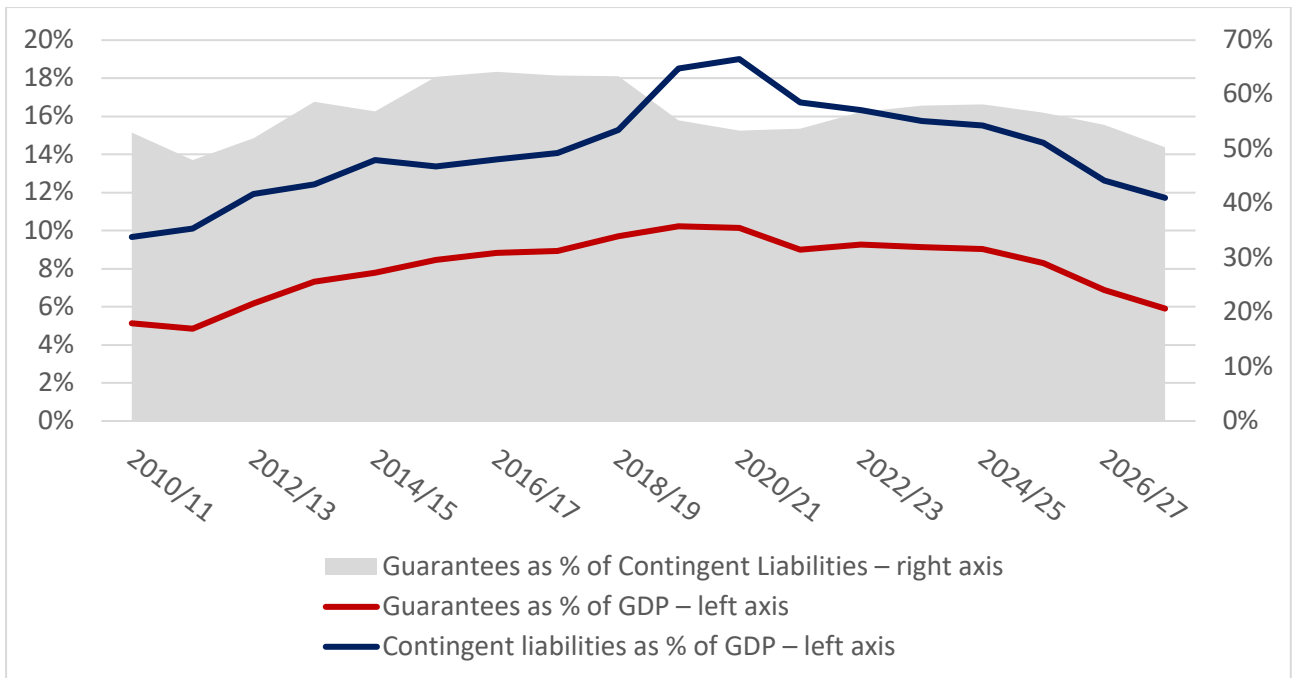
These interventions weakened the fiscal position by converting implicit risks into explicit liabilities, thereby accelerating debt accumulation and increasing debt-servicing costs. As guarantees are called, the government is required to assume the underlying obligations, leading to higher borrowing requirements and an upward shift in the debt-to-GDP trajectory. Although recent moderations in guarantee growth reflect policy reforms and targeted debt relief initiatives, the stock of outstanding guarantees remains large, sustaining elevated fiscal risk and constraining fiscal space. Consequently, the continued reliance on guarantees as a support mechanism for structurally weak SOEs poses an ongoing threat to debt sustainability unless accompanied by durable reforms that reduce the probability of guarantee calls.

Figure 7: Guarantee exposure and Contingent liabilities with Year-on-Year Growth Rates, 2010/11-2027/28



Source: National Treasury (2025a)

Figure 8: Proportion of guarantee exposure and contingent liability to GDP (%)



Source: National Treasury (2025a)

Figure 8 shows that guarantees as a share of total contingent liabilities are a predominant component, remaining continuously above 50 per cent throughout the period, peaking between 2016/17 and 2018/19 before progressively declining in the outer years of the 2025 medium term. This indicates that guarantees remain the largest and most persistent source of fiscal risk in the government's broader contingent liability portfolio. However, guarantees as a share of GDP show a more moderate pattern, rising gradually until around 2019/20—reflecting growing exposure relative to economic performance—before stabilising due to the government's plan to reduce the reliance of SOEs on guarantees, leading to slower growth in new guarantees.

Contingent liabilities remain substantial relative to GDP, posing ongoing risks to fiscal stability. Figure 8 shows that the share of contingent liabilities to GDP increased steadily, largely driven by weak economic performance and heightened support to distressed SOEs. Although this ratio has stabilised in recent years and is projected to decline in the outer years of the 2025 medium term, it remains a significant portion of the overall fiscal risk. Persistent high contingent liabilities, when considered alongside gross government debt, increase the country's effective debt burden and, therefore, raise its risk profile. This directly impacts fiscal sustainability, with reduced fiscal space and increased vulnerability to shocks stemming from accelerating debt accumulation, rising borrowing costs, constrained service delivery budgets, and potentially weakened investor confidence and sovereign credit ratings.

Guarantee Risk Matrix and Likelihood of Provision Recognition

The historical SOE bailout data show that between 2014 and 2023, the government granted R331 billion in recapitalisation, of which Eskom accounted for about 55 per cent. Recapitalisations were granted for the implementation of turnaround plans, to repay debt/government guarantees, improve liquidity and for capital expenditure (National Treasury, 2023b). Table 2 below presents a guarantee risk matrix, that measures the distribution, scale, and risk profile of guarantees. Moreover, the matrix serves as a forward-looking indicator by systematically highlighting guarantees that carry a high risk of being called, thereby enabling proactive fiscal management by creating provisions for guarantees with a high-risk profile.

The matrix results in Table 2 indicate that guarantees/bailouts to Eskom, SAA, Land Bank, SAPO, Denel, and SA Express carried significant fiscal risk due to their exposure levels and frequency. Based on the matrix, these guarantees should be recognised as provisions in future, as proven by the current Eskom debt relief agreement. However, it is also notable that during the same period, the risk associated with guarantees to SANRAL and Transnet was moderately contained, although still increasing. While the likes of SABC and DBSA remained stable, due to low cumulative support and frequency of support.

Table 2: Government Guarantee Risk Matrix

Entity	Cumulative Support (R millions)	Frequency of Support	Fiscal Exposure Level	Likelihood of Guarantee Call	Risk Category
Eskom	181 550	High (5 Years)	Very High	Very High	Critical
SAA	48 400	High (6 Years)	High	High	Critical
SANRAL	23 736	Low (1 Year)	Moderate	Moderate	Elevated
Sasria	22 000	Low (1 Year)	Moderate	Moderate	Elevated
Land Bank	13 563	High (5 Years)	Moderate	High	Severe
SAPO	10 392	High (6 Years)	Moderate	High	Severe
Denel	8 995	Moderate (4 Years)	Moderate	High	Severe
DBSA	7 912	Moderate (4 Years)	Low	Moderate	Stable
Transnet	5 837	Low (1 Year)	Moderate	Moderate	Elevated
SA Express	3 296	Moderate (4 Years)	Low	High	Severe
SABC	3 200	Low (1 Year)	Low	Low	Stable
ACSA	2 325	Low (1 Year)	Low	Low	Stable

Source: National Treasury (2023b) and Financial and Fiscal Commission's calculations

4.4 Econometric Analysis of Government Guarantees and Fiscal Sustainability

Unit Root test

The first step in estimating an ARDL model is testing for unit roots in variables. Table 3 shows results from the Augmented Dickey-Fuller (ADF) and Phillips-Perron (PP) tests. Based on the ADF test results, all variables were found to be stationary at the level. However, the PP test at the level indicates that the Fiscal_S and the Guarantee_S variable series are non-stationary. To determine the integration order of these variables, the PP test was subsequently applied to their first differences. At this stage, both the Fiscal_S and the Guarantee_S series became stationary, confirming that they are integrated of order one, I(1).

Table 3: Summary of Unit Root Tests

Variable	Augmented Dickey-Fuller	Conclusion	Phillips-Perron	Conclusion
Fiscal_S	2.367**	I(0)	-3.705**	I(1)
Guarantee_S	2.131**	I(0)	-4.096**	I(1)
Inflation	-3.946**	I(0)	-3.217**	I(0)
Economic_G	-2.229**	I(0)	-3.553**	I(0)

Asterisks: ***, ** and * denote significant levels at 1, 5 and 10%, respectively.

Source: Financial and Fiscal Commission's calculations

Order Selection Criterion

Determining the lag order is an important step in estimating the ARDL model. In this context, lag order selection criteria are employed to identify the appropriate lag length, using measures such as the Akaike Information Criterion (AIC), Schwarz Criterion (SC), Hannan–Quinn Criterion (HQIC), and the Final Prediction Error (FPE). These criteria collectively guide the selection of the optimal lag structure for the model. According to the results presented in Table 4, by considering the lowest value with an asterisk (*), the AIC value indicates the best optimal lag for the model as lag 4. A chosen criterion should minimise the asterisk figure to determine the optimal lag.

Table 4: Optimal Model Lag Selection

Lag	LL	LR	df	p	FPE	AIC	HQIC	SBIC
0	-126.833				56.8936	15.3921	15.4116	15.5882
1	-55.5174	142.63	16	0.000	.091127	8.8844	8.98184	9.86465
2	-33.0995	44.836	16	0.000	.064388	8.12935	8.30474	9.8938
3	50.5482	167.3	16	0.000	.000097*	.170803	.424144	2.71946
4	1892.76	3684.4*	16	0.000	.	-214.677*	-214.346*	-211.345*

*Asterisks: ***, ** and * denote significant levels at 1, 5 and 10%, respectively.*
 Source: Financial and Fiscal Commission's calculations

Subsequently, Table 5 presents the selected lag structure for each variable. It is important to determine each variable's lag before estimating the ARDL model to capture the true dynamics, avoid misspecification, and ensure valid cointegration testing.

Table 5: Variable Lag Selection

e(lags) [1,4]				
r1	Debt-to-GDP	Guarantees	Inflation	GDP-Growth
	2	2	0	2

Source: Financial and Fiscal Commission's calculations

Diagnostic Tests

The reliability and stability of the ARDL model are ensured by conducting diagnostic tests on the estimated parameters. Table 6 presents diagnostic test results for serial correlation and heteroscedasticity. The results reveal that the model passed all diagnostic tests, with the Breusch-Godfrey LM tests indicating that the model is not serially correlated. Moreover, the White's and Breusch-Pagan/Cook-Weisberg tests also show the absence of heteroscedasticity in the error variance.

Table 6: Diagnostic Tests

Null Hypothesis (F-statistic)	F-statistic [p-value]
Breusch–Godfrey LM: No serial correlation	2.557 [0.1098]
White's test: Homoscedasticity	19.00 [0.3918]
Breusch-Pagan/Cook-Weisberg: Homoscedasticity	2.290 [0.1304]

Source: Financial and Fiscal Commission's calculations

ARDL Bounds Test

Having established that the variables are not integrated of an order greater than the order I(1), the bounds test is formally undertaken. The ARDL bounds test for cointegration is used to determine whether a long-run relationship exists among the variables. As observed in Table 7, the F-statistic is lower than the upper and lower bounds at all significance levels, confirming the absence of cointegration among variables. This indicates that no long-run equilibrium relationship exists, challenging the assumption that budgetary overspending and the provision

of bailouts to state-owned enterprises (SOEs) are necessary to stabilise or safeguard the economy and the fiscus. Rather, the findings imply that such fiscal interventions may not produce the intended long-term economic or fiscal benefits, thereby calling into question their effectiveness as instruments for promoting fiscal sustainability. Accordingly, an ARDL specification focusing on short-run dynamics becomes the appropriate framework for analysis.

Table 7: ARDL Bounds Test

F-statistic = 1.618		
Significance Level	Lower Bound	Upper Bound
10%	2.72	3.77
5%	3.23	4.35
2.5%	3.69	4.89
1%	4.29	5.61

Asterisks: ***, ** and * denote significant levels at 1, 5 and 10%, respectively.

Source: Financial and Fiscal Commission's calculations

Moreover, the results imply that the fiscal sustainability (Fiscal_S) is more responsive to short-term shocks—particularly that the issuance of guarantees often responds to immediate financing needs or contingent liabilities rather than to long-term fiscal planning, while inflation and growth trajectories are shaped by cyclical shocks, policy interventions, and institutional reforms. Therefore, fiscal sustainability in this context is better understood through short-run adjustments and immediate responses to shocks rather than through equilibrium conditions assumed to hold consistently over time.

ARDL Model (Short-run dynamics)

The ARDL model by Pesaran et al. (2001) is widely used to capture short-run dynamic relationships among variables. Table 8 presents a summary of the ARDL estimation results.

Table 8: Summary of ARDL Output

Debt-to-GDP	Coefficient	Std.err.	t-stat	P> t	[95% conf. interval]	
Fiscal_S						
L1.	1.429262	.2091627	6.83	0.000	.956103	1.902421
L2.	-.4235255	.2047298	-2.07	0.069	-.886665	.0396056
Guarantee_S						
--.	-2.240802	3.715744	-0.60	0.561	-10.6464	6.164795
L1.	10.97264	4.769097	2.30	0.047	.1841965	21.76109
L2.	-10.3478	3.905454	-2.65	0.026	-19.18255	-1.513051
Inflation	-.2505069	.1888255	-1.33	0.217	-.6776598	.176646

Economic_G						
--.	-1.214785	.1282458	-9.47	0.000	-1.504897	-.9246725
L1.	.6770646	.275517	2.46	0.036	.0538019	1.300327
L2.	-.2220715	.1170792	-1.90	0.090	-.4869231	.0427801
_cons	12.25909	11.4881	1.07	0.314	-13.7288	38.24698
F (9, 9) = 560.74				Prob > F = 0.0000		

Asterisks: ***, ** and * denote significant levels at 1, 5 and 10%, respectively.

Source: Financial and Fiscal Commission's calculations

The estimation results indicate that an expanding stock of government guarantees, coupled with sluggish economic growth, poses a significant risk to fiscal sustainability by contributing to a rising debt-to-GDP ratio. The first lag of fiscal sustainability (Fiscal_S) is positive and significant, indicating persistent changes in debt levels over time. Whereas the second lag is negative and significant, suggesting some corrective adjustments over time, through debt stabilisation measures. For the guarantees stock (Guarantee_S), the results show that the lagged terms are significant and alternately signed. Lag one results are positive and significant, indicating that any increase in guarantee stock (Guarantee_S) negatively impacts fiscal sustainability (Fiscal_S) by raising debt-GDP over time, reflecting the fiscal burden of contingent liabilities once they materialise. The second lag of guarantees is negative and significant, suggesting subsequent fiscal adjustments, possibly due to repayments, reversals, offsetting measures or the temporary nature of guarantee exposure, which reduces the impact.

For economic growth (Economic_G), the model results show a consistently negative and significant relationship with fiscal sustainability (Fiscal_S). This implies that stronger growth reduces debt ratios by improving fiscal capacity. While the first lag results suggest that economic growth is initially associated with higher debt ratios, the overall long-run effect is debt-reducing. The negative, statistically significant second-lag coefficient highlights the stabilising effect of economic growth on debt over time. Overall, the estimation results show that the debt-to-GDP ratio is mostly determined by its own historical values, with economic growth acting as the most reliable stabilising factor, government guarantees having significant but delayed effects, and inflation having little bearing. These results highlight the need for policies that promote sustained growth and manage contingent liabilities to ensure fiscal sustainability.

Stability Test

A cumulative sum (CUSUM) was conducted to test the stability of the estimated model. As reported in Table 9, the test statistic of 0.715 is less than the critical values at the 1%, 5%, and 10% significance levels (1.1430, 0.9479, and 0.8499, respectively). This outcome provides statistical evidence that the null hypothesis cannot be rejected, thereby indicating that the model parameters are stable across the sample period.

Table 9: Cumulative Sum Test for Parameter Stability

Type	Test Statistic	Critical value		
		1%	5%	10%
Recursive	0.7151	1.1430	0.9479	0.8499

Asterisks: ***, ** and * denote significant levels at 1, 5 and 10%, respectively.

Source: Financial and Fiscal Commission's calculations

5 Conclusion

This paper evaluated the fiscal and economic implications of government guarantees, with particular emphasis on their impact on fiscal sustainability and transparency in South Africa. Government guarantees remain a key policy instrument for supporting state-owned entities and strategic sectors; however, they also constitute significant contingent liabilities that may materialise into direct fiscal obligations. In an environment characterised by weak economic growth, rising debt-service costs and constrained fiscal space, the management of guarantees has become increasingly central to safeguarding long-term fiscal sustainability.

Using the ARDL model, the findings indicate that increases in government guarantees are positively associated with higher debt-to-GDP ratios over time, particularly where guarantees are extended to financially distressed entities. The results suggest that while guarantees may provide short-term liquidity relief and support infrastructure investment, they also increase fiscal risk when governance weaknesses, operational inefficiencies and low growth persist. Furthermore, the evidence highlights that weak oversight, delayed restructuring of beneficiary entities and the absence of a clear monitoring criterion amplify the probability of guarantees being called, thereby worsening fiscal pressures.

The analysis also highlights the importance of macroeconomic fundamentals in mitigating the risks associated with contingent liabilities. Stronger economic growth and sustained primary surpluses are shown to reduce the adverse effects of guarantee shocks on public debt dynamics. Conversely, low growth and rising borrowing costs magnify fiscal vulnerabilities and limit the

government's ability to absorb contingent liability shocks without crowding out developmental expenditure.

Overall, the findings reinforce the need for strengthened institutional frameworks, enhanced transparency in reporting contingent liabilities, and stricter risk assessment before issuing guarantees. Policy reforms aimed at improving the financial sustainability of state-owned entities, accelerating structural reforms in network industries, and embedding guarantees within a credible medium-term fiscal framework are essential to contain fiscal risks. Ultimately, prudent management of government guarantees is indispensable to restoring fiscal credibility, protecting intergenerational equity, and supporting inclusive and sustainable economic growth in South Africa.

6 Recommendations

The Commission make the following recommendations:

- 4. The National Treasury should establish and implement a clear, consistent, and comprehensive policy framework governing government guarantees, thereby giving effect to constitutional obligations under Sections 213(1)-(2), 214(2), 215(1) and 218, and reinforcing Parliament's mandate to exercise oversight and accountability over contingent fiscal commitments.*

The findings show that guarantees are currently issued on an ad hoc basis, without a consistent set of criteria or procedures, thereby increasing fiscal risk and enabling discretionary, potentially politically driven decisions. Moreover, the timing and mechanism through which they translate into budgetary expenditures, such as through adjustments to budgets, special appropriations, or reallocations from contingency reserves, may not always be immediately transparent within the legislative budget process. This weakens the advisory role of the Financial and Fiscal Commission by depriving it of the complete, timely, and transparent information required to evaluate the fiscal implications of guarantees, thereby constraining its ability to provide Parliament with rigorous, evidence-based recommendations on contingent liabilities and their impact on fiscal sustainability. Therefore, a guarantee framework ensures that when guarantees are called, the resulting payments are formally appropriated and recorded through the budget process, preventing off-budget spending and ensuring that all fiscal commitments are properly authorised—via the adjustment budgets or special appropriations.

5. *The National Treasury should ensure that the devised guarantee framework is aligned with international best practice through the introduction of explicit guarantee ceilings, like guarantee-to-GDP thresholds, and reserves or contingency funds, to prevent unchecked growth of contingent liabilities and mitigate fiscal risks.*

Treating guarantees as off-budget instruments obscures their true fiscal impact and increases the risk of unexpected shocks to public finances. The use of guarantee ceilings helps contain exposure, while reserve funds provide a buffer against realised risks. Collectively, these measures strengthen fiscal discipline and contribute to long-term fiscal sustainability.

6. *The National Treasury must strengthen oversight of government guarantees by establishing a real-time, centralised tracking system. This system should continuously update and disclose all guarantees and contingent liabilities within budget documentation and fiscal risk reports. Such measures will enhance transparency and reinforce Parliament's oversight obligations in managing fiscal risks.*

There is a need to incorporate guarantees into fiscal planning and budgeting processes more effectively. The findings indicate that guarantees are generally accounted for only recognised when they are called, which obscures their true fiscal cost and delays policy responses. Therefore, adopting cost-based or accrual-informed budgeting, where feasible, would improve the accuracy of fiscal planning and ensure that the risks associated with guarantees are reflected upfront. However, this should be accompanied by standardised reporting requirements, including the disclosure of guarantee performance indicators and risk classifications, to improve oversight and enable timely policy responses.

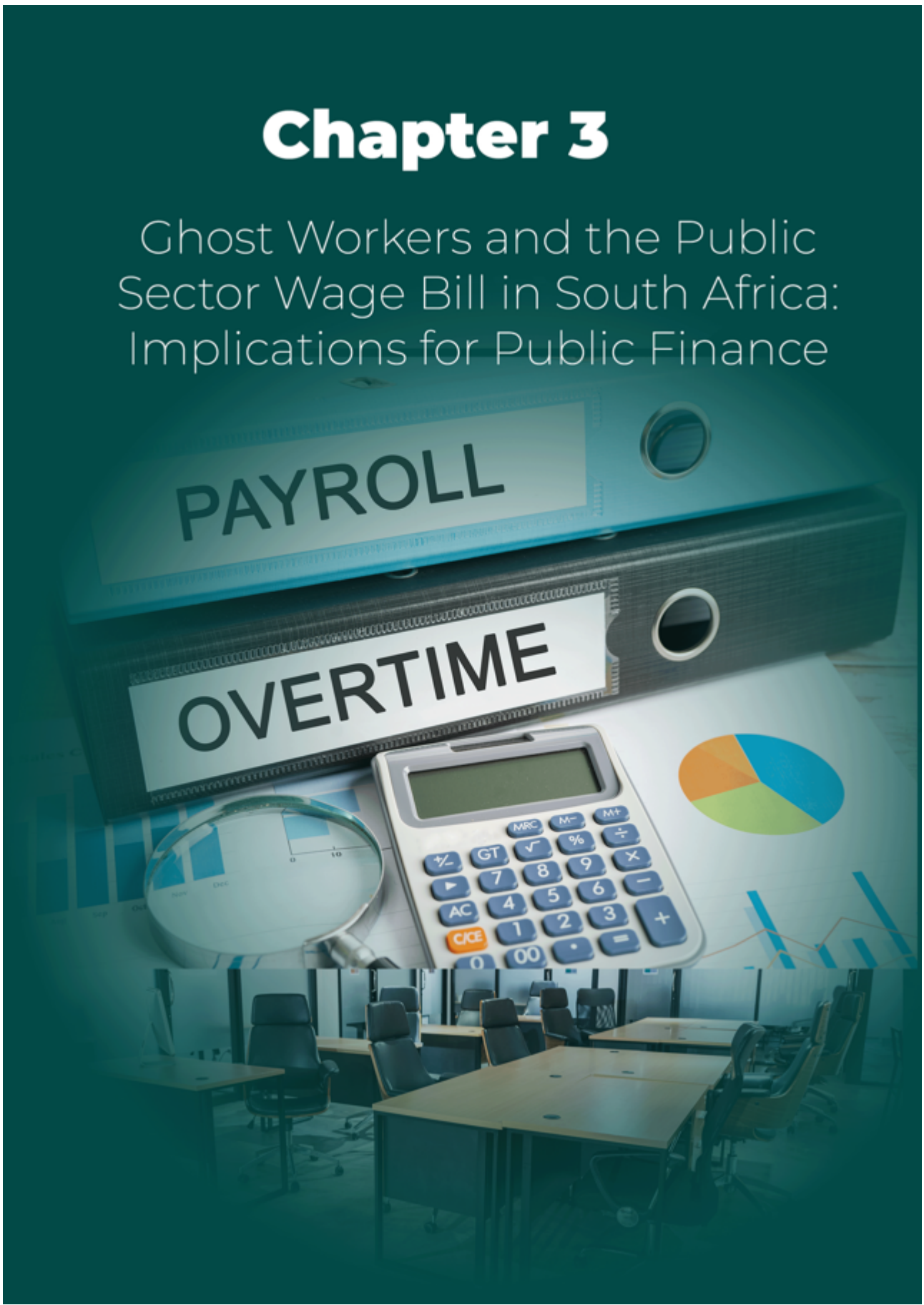
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Chapter 3

Ghost Workers and the Public Sector Wage Bill in South Africa: Implications for Public Finance



Chapter 3: Ghost Workers and the Public Sector Wage Bill in South Africa: Implications for Public Finance

Abstract

Ghost workers represent a severe form of payroll fraud that undermines public finance management (PFM) and fiscal sustainability in South Africa. This study investigates the systemic enablers of this fraud, evaluates government strategies to combat it, and analyses discrepancies between payroll records and budgeted personnel figures to assess their implications. Employing a mixed-methods approach, the research integrates a policy review with a quantitative analysis of government's PERSAL (Personnel and Salary System) payroll system and National Treasury's Estimates of National Expenditure (ENE) data from 2007/08 to 2018/19. The findings reveal that ghost worker schemes are facilitated by collusion, weak information and communication technology (ICT) controls, and fragmented oversight, as explained by fraud theory. Critically, the analysis uncovers persistent and substantial misalignments between budgeted and actual personnel expenditures—manifesting as volatile national underspending and chronic provincial overspending—that create a fiscal environment conducive to concealing fraudulent entries such as ghost workers. The study concludes that while new initiatives by the Department of Public Service and Administration (DPSA) and National Treasury are promising, a holistic strategy mandating system integration, biometric verification and digital identity systems, as well as stringent consequence management is essential to eliminate ghost workers, ensure payroll integrity, and protect the fiscus.

1 Introduction

Public finance management (PFM) plays a critical role in ensuring that governments allocate resources efficiently, deliver essential services effectively, and maintain fiscal credibility. In South Africa, the integrity of PFM is especially important given the country's intergovernmental fiscal relations (IGFR) framework, which devolves significant financial responsibilities to provinces and municipalities. However, persistent governance failures and systemic

vulnerabilities have undermined the PFM's effectiveness. Among the challenges facing the country's PFM system is the phenomenon of "ghost workers". Ghost workers are individuals who appear on government payrolls who do not genuinely exist or perform any work, with their salaries illicitly siphoned off by corrupt actors (Chêne, 2015)

This systemic issue leads to substantial financial leakage, undermines the government's ability to fund services, and exacerbates South Africa's persistently bloated public-sector wage bill. The country's public service employs more than 1.3 million workers, making it the largest employer in the country (Public Servants Association of South Africa, 2025). The wage bill to cover these employees consistently consumes a substantial portion of the national budget (often exceeding a third of consolidated government expenditure and at times around 10-15 per cent of gross domestic product), placing immense pressure on fiscal transfers, limiting fiscal space, and ultimately undermining fiscal sustainability.

The problem is not abstract. Investigations and audits have exposed ghost worker schemes across the public sector. The Passenger Rail Agency of South Africa (PRASA), for example, launched "Project Ziveze" in 2021/22, which uncovered thousands of unverified employees and reportedly saved more than R200 million in salaries (South African Government News Agency, 2022). Similar cases have emerged in local government, where weak payroll systems and fragmented oversight make municipalities particularly vulnerable. These examples illustrate both the scale of the challenge and the weaknesses in South Africa's payroll administration and internal controls.

Although the National Treasury has initiated spending reviews to improve expenditure efficiency, ghost worker-related fraud remains a persistent challenge. The continued recurrence of these cases points to deep systemic vulnerabilities in payroll management, institutional accountability, and human resource governance.

This paper aims to unpack the concept of ghost workers and examine the systemic vulnerabilities that enable this form of payroll fraud in South Africa. It will also explore detection and prevention strategies, while considering the broader implications for the public sector wage bill and fiscal sustainability.

2 Problem Statement and Research Questions

The persistence of ghost workers in South Africa's public sector, due to governance failures and systemic payroll vulnerabilities, distorts public finance management by inflating the wage bill and undermining fiscal credibility.

Research Questions

The following research questions guided the study:

1. What are the enablers within the public sector that facilitate and perpetuate ghost worker schemes?
2. What strategies have been adopted to identify and address the issue of ghost workers in the public sector in South Africa and abroad?
3. To what extent have government-led spending reviews in South Africa identified ghost worker-related inefficiencies in the public sector?
4. What insights can discrepancies between public sector payroll records and government budgeted personnel figures provide about the identification of ghost workers and the effectiveness of workforce planning and budgeting in the public sector.

3 Research Approach

To answer the research questions, a mixed-methods approach integrating qualitative and quantitative analysis was adopted.

The qualitative component involved a desktop review of academic, policy, and grey literature—including peer-reviewed articles, government publications, and media reports—to conceptualise ghost worker fraud, examine its theoretical underpinnings, assess its implications, and evaluate the South African government's response to the challenge, alongside international approaches. South Africa's response to the ghost worker issue was assessed through a review of direct and indirect strategic initiatives. Direct measures included the National Treasury's data-driven audit programme and the Department of Public Service and Administration's (DPSA) regulatory framework to eliminate ghost workers. Indirect measures included the Government Technical Advisory Centre's (GTAC) spending reviews.

The quantitative component analysed longitudinal discrepancies between payroll data from the South African government's Personnel and Salary System (PERSAL) and budgeted figures in the National Treasury's Estimates of National Expenditure (ENE) over the 2007/08–2018/19 period.

The analysis focused on headcount and compensation of employees spending across national and provincial departments.

A primary limitation of the quantitative analysis used in this paper is the distinction between identifying fiscal risk and confirming fraudulent activity. The discrepancies identified between the PERSAL and ENE datasets serve as an indicator of systemic vulnerability that may be exploited. However, while these variances flag high-risk areas for ghost worker activity, they do not constitute definitive proof of the presence of ghost workers. To move from detecting high-risk areas to confirming a ghost worker, these quantitative findings must be complemented by forensic investigations, such as physical headcounts or biometric verification. Consequently, the findings presented here should be interpreted as a measure of the opportunity for fraud rather than a census of actual fraudulent entries.

4 Literature Review

4.1 *Conceptualising ghost worker schemes*

In both the academic and policy literature, ghost workers are generally treated as a subset of payroll fraud, referring to individuals who remain on official payroll registers without rendering services (Edori & Iwene, 2025; Wells, 2002). The literature highlights different types of ghost worker fraud. Nafiu et al. (2016), in their study of Nigeria, identified several typologies that are generalisable across public and private sectors. These include fictitious employees created through false timesheets, pre-employment ghost employees added before official commencement of work, and no-show employees who collude with supervisors to share diverted salaries. Additional forms include the misuse of temporary employees—whether through bypassing hiring controls or collusion with labour agencies—fraudulent inclusion of family members, and schemes involving unclaimed or improperly terminated payroll records. These typologies are summarised in Table 10, which illustrates the range of mechanisms through which ghost worker fraud can occur, from straightforward fabrication to collusive arrangements.

Table 10: Typologies of ghost worker fraud

Type of Fraud	Description
Fictitious employee	A fabricated worker created through falsified records; payroll salary is diverted or paid into a false bank account.
Pre-employment ghost employee	An individual listed on the payroll before officially commencing employment, enabling salary diversion.
No-show ghost employee	A real employee who does not report for work but colludes with a supervisor to share the monthly salary.
Temporary employees bypassing hiring controls	Temporary staff are used to bypass hiring procedures, with local managers enabling fraudulent inclusion.
Temporary employee through an agency	Collusion between labour agencies and managers leads to invalid contracts and payroll diversion.
Family member as a ghost employee	Names of relatives (e.g., minors) are inserted into payroll records to divert funds to family-linked accounts.
Unclaimed payroll cheque	Supervisors retain the salaries of employees who were dismissed without proper termination procedures.
Termination ghost employee	Salaries of employees who resigned or left employment are fraudulently claimed due to a lack of formal exit procedures.

Source: Adapted from Nafiu et al. (2016)

From the range of typologies identified in the literature, several were particularly relevant to this study's focus. The fictitious employee and termination ghost employee schemes directly highlight weaknesses in payroll controls and human resources (HR) record-keeping, since they involve fabricated or outdated entries that persist due to poor system integration and weak oversight. The issue of unclaimed payroll cheques and pre-employment ghost employees is especially significant in South Africa's intergovernmental context, where fragmented payroll administration across provinces and municipalities increases the risk that fraudulent records remain undetected.

This study adopts several fraud theories that, taken together, provide a framework for identifying the sources of and remedies for the ghost worker problem. These theories are Cressey's Fraud Triangle, Wolfe and Hermanson's Fraud Diamond Theory, and Wilhelm's Fraud Management Lifecycle Theory.

Cressey's Fraud Triangle (Cressey, 1953) suggests that fraud occurs when three conditions converge: pressure (financial or organisational incentives), opportunity (weak controls or oversight), and rationalisation (self-justification by perpetrators). As noted by Tefurukwa and Ahafianyano (2025), Cressey's model, however, does not fully explain why only certain individuals engage in fraud despite similar pressures and opportunities. Wolfe and Hermanson's Fraud

Diamond Theory (Wolfe & Hermanson, 2004) adds a fourth element—capability—recognising that individuals in positions of authority or with technical skills are best placed to manipulate systems (Tefurukwa & Ahafiany, 2025). These behavioural frameworks are particularly useful for explaining ghost worker schemes, as they highlight how insiders with both the motive and the technical ability exploit weaknesses in payroll systems to create or sustain fraudulent employee records.

Wilhelm (2004) introduced the Fraud Management Lifecycle Theory (FMLT) as a process-oriented theoretical framework for understanding and combating fraud. The theory conceptualises fraud not as a single event but as a continuous cycle consisting of eight interconnected stages: deterrence, prevention, detection, mitigation, analysis, policy, investigation, and prosecution. By framing fraud as a lifecycle, FMLT underscores the importance of both proactive and reactive measures in managing fraud risks. Tefurukwa and Ahafiany (2025) note that the holistic approach under the FMLT aims to effectively reduce ghost worker incidents through early detection and systematic intervention.

The above frameworks provide a comprehensive lens for examining and combating the ghost worker problem in South Africa's public sector. The Fraud Triangle and Fraud Diamond Theory provide diagnostic tools for understanding the "who" and "why" behind these schemes. They help identify the specific pressures, opportunities, and capabilities that enable corrupt insiders to create fraudulent entries. The Fraud Management Lifecycle Theory then provides the crucial "how"—a systematic guide for developing a robust anti-fraud strategy. This approach moves beyond simply reacting to discovered fraud and instead builds a proactive system for deterrence, early detection, and effective prosecution, ultimately making it far more difficult for ghost worker schemes to thrive.

4.2 Systemic drivers of ghost worker fraud and their fiscal implications in the public sector

The ghost worker issue persists in the public sector due to systemic weaknesses in governance and internal controls. Studies across Sub-Saharan Africa show that fragmented payroll management systems, poor record-keeping, and inadequate accountability mechanisms allow fraudulent payroll entries to go undetected (Manyerere & Mpambije, 2022). Weak integration of information and communications technology (ICT) systems further compounds the issue, as demonstrated in Tanzania, where the absence of biometric verification has allowed ghost workers to thrive on government payrolls (Tefurukwa & Bwaki, 2022).

Another vulnerability stems from entrenched corruption and collusion within government departments and public entities. Ghost worker schemes typically require coordination among multiple officials, reflecting broader governance failures and networks of patronage. Research from Nigeria highlights how political interference and administrative complicity undermine reform efforts, even where integrated payroll systems have been introduced (Emetaram & Ofor, 2025; Chima et al., 2025). In the health sector, similar vulnerabilities in centralised data management have diverted funds meant for frontline services (Kohler, 2020).

The relationship between ghost workers and the public sector wage bill has been extensively documented, with studies highlighting how payroll fraud significantly inflates recurrent government expenditure and undermines fiscal discipline. Amoako-Tuffour (2002) argued that tolerance of payroll fraud distorts the fiscal space by forcing governments to finance artificially inflated wage bills, reducing funds available for service delivery. In Ghana, for example, ghost workers were estimated to account for 5.8 per cent of monthly salary expenditure, resulting in a misrepresentation of the true size of the public workforce and straining the national wage bill (Amoako-Tuffour, 2002). Nyaledzigbor, (2015) found a direct causal link between ghost workers and the government wage bill, where fraudulent payroll entries diverted resources from development projects.

Similarly, Oguzierem and Joab-Peterside (2017) examined the education sector in Bayelsa State, Nigeria, showing how ghost worker fraud not only bloated the wage bill in the primary and secondary education sector but also exacerbated unemployment by reducing opportunities for legitimate employment.

The adverse impact the ghost workers have on the public sector wage bill is not unique to West Africa. Comparative cases across Sub-Saharan Africa have also highlight this trend. Manyerere and Mpambije (2023) examined multiple countries (including Zimbabwe and Tanzania) and concluded that ghost workers have become symptomatic of governance weaknesses, driving bloated government wage bills across the region. In Tanzania, Tefurukwa and Ahafiany (2025) demonstrated that the proliferation of ghost workers in public health services has not only inflated wage bills but also exacerbated inequities in service delivery.

An important dimension of combating ghost worker fraud is the effectiveness of consequence management and recourse processes once irregularities are identified. Within the Fraud Management Lifecycle Theory, investigation and prosecution represent critical stages that determine whether fraud prevention efforts have credible deterrent effects. Where disciplinary

action, recovery of funds, or criminal prosecution are weak or inconsistently applied, ghost worker schemes can persist despite improvements in detection mechanisms. Studies across Sub-Saharan Africa have found that while payroll audits and biometric verification often uncover ghost workers, follow-up actions against implicated officials are frequently limited, undermining deterrence and enabling the re-emergence of payroll fraud (Manyerere & Mpambije, 2022; Kohler, 2020). Effective consequence management therefore requires clear disciplinary procedures, inter-agency cooperation, and the capacity to pursue both administrative sanctions and criminal prosecution against perpetrators.

4.3 International experiences with ghost worker schemes

Ghost worker schemes have been extensively documented across developing countries, revealing common systemic vulnerabilities and the effectiveness of targeted interventions. Nigeria's Integrated Payroll and Personnel Information System, which centralised payroll management and linked staff records to biometric data and Bank Verification Numbers, uncovered over 60 000 ghost workers between 2014 and 2016, saving the government an estimated NGN 2.29 billion monthly (Leyira & Temple, 2018; Okechukwu et al., 2021). In Ghana, ghost workers were found to consume roughly 5.8 per cent of monthly salary expenditure with a 2025 audit revealing 67 311 fraudulent employees—including 14 000 unidentified individuals and 53 311 separated staff such as retirees and deceased persons still on payroll—prompting the recovery of GHS 150.4 million and mandatory Ministry of Finance approval for all payroll-related commitments (Africa Briefing , 2025; Amoako-Tuffour, 2002; News Central, 2025). Tanzania's national verification exercise in 2016 identified 19 708 ghost employees, enabling the recovery of USD 10 million and monthly savings of TZS 4.5 billion, though subsequent audits revealed continued payroll leakages totalling TZS 141.4 billion in 2015 alone, underscoring the necessity of sustained enforcement rather than one-off exercises (Manyerere & Mpambije, 2022; Ng'wanakilala, 2016; Tefurukwa & Ahafiany, 2025).

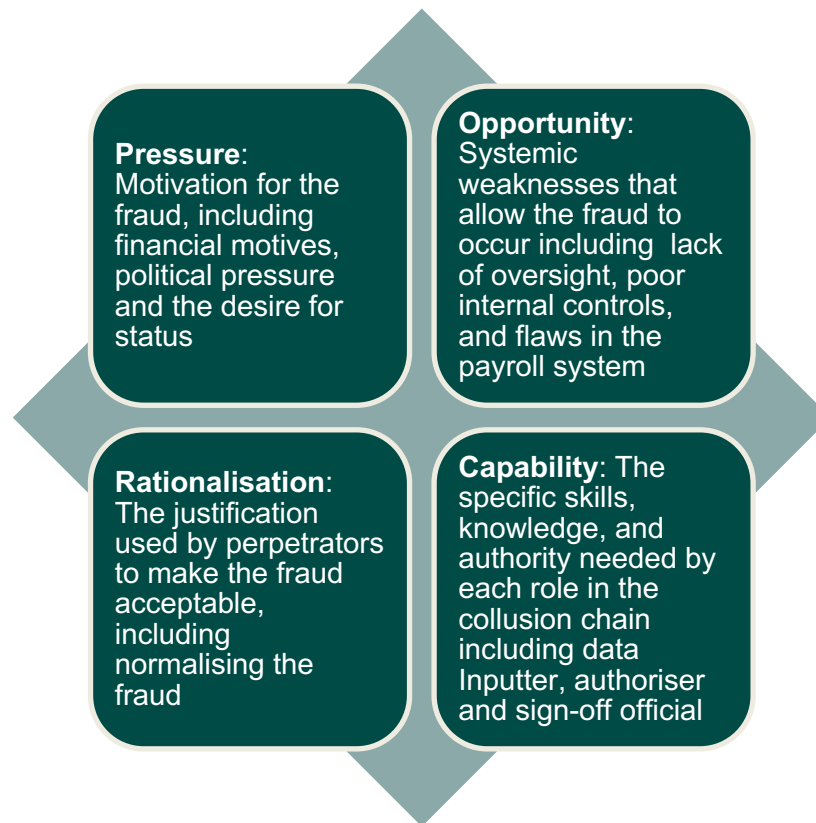
Across all three cases, common success factors emerged: biometric verification and digital system integration proved essential for detecting fictitious employees; regular, systematic payroll audits enabled sustained identification of irregularities; physical verification campaigns enhanced oversight and recovered significant funds; and robust enforcement mechanisms were critical to preventing re-emergence. Crucially, each case demonstrated that eliminating ghost workers generates substantial fiscal savings, improves budget credibility, and creates space for priority spending—lessons directly salient to South Africa's ongoing reforms.

4.4 The ghost worker problem in South Africa

Ghost worker fraud in South Africa is structured around deliberate collusion across hierarchical levels of the public service. Public Servants Association of South Africa (2025) identifies three critical stages: the Data Inputter, who fabricates or manipulates records in the PERSAL payroll system; the Authoriser, a supervisor who validates the fraudulent entry; and the Sign-off, a senior manager who formally approves payment, providing institutional legitimacy. This layered approval process, intended to deter fraud, is routinely undermined by compromised officials, weak verification systems, and outdated paper-based procedures, with some schemes linked to organised criminal syndicates embedded in government departments.

Case studies confirm this pattern: PRASA's Project Ziveze uncovered 2 143 cases of possible ghost employees, saving R200 million (South African Government News Agency, 2022). Gauteng Department of Health's 2025 Ziveze verification campaign led to the freezing of salaries of 66 employees who failed to verify their employment status (Masilela, 2025); and Polokwane Municipality's forensic investigation revealed 44 ghost workers drawing salaries alongside R128 million in irregular overtime, enabled by mismatched ID information and deep collusion between finance and HR officials over sixteen years (Thorne, 2024). These cases align closely with Fraud Diamond theory, where opportunity arises from systemic PERSAL weaknesses and poor oversight, while capability is concentrated among insiders with the authority, access, and technical skills to execute and sustain these instances of ghost worker fraud (see Figure 9).

Several cross-cutting lessons emerge in the context of the ghost worker problem in South Africa. First, employee verification is non-negotiable; regular physical and biometric verification campaigns are crucial to ensure payroll reflects the actual workforce. Second, digitised, interoperable, real-time HR systems are essential, as weak ICT platforms and mismatched ID records create persistent loopholes. Third, audit red flags must be acted upon—ignoring Auditor-General findings, as in Polokwane, allows fraud to persist for years and drain hundreds of millions of rands. Finally, collusion is a major enabler; sustained payroll fraud requires cooperation across HR, finance, and management. Tackling ghost workers therefore demands not only technical fixes but also strong accountability, cross-collaboration, and robust disciplinary measures.

Figure 9: Ghost worker fraud: A fraud diamond analysis

Source: FCC's own compilation

5 Findings

5.1 South Africa's public finance management and ghost worker interventions

South Africa's current approach to payroll integrity comprises three distinct but overlapping initiatives, each with a different primary mandate: the DPSA compliance framework seeks to strengthen departmental accountability; the National Treasury's data-driven audit enables forensic detection of fraud; and the Government Technical Advisory Centre's (GTAC) spending reviews promote efficient use of public finances. While only the first two directly target ghost workers. (the DPSA and National Treasury initiatives), all three shape the payroll environment and expose systemic vulnerabilities. However, the effectiveness of the direct anti-fraud measures is preconditioned on resolving deeper flaws in payroll administration, ICT integration, and institutional accountability.

Table 11 below synthesises the core attributes and fundamental constraints of these strategies.

The DPSA framework, formalised in September 2025, places legal responsibility for payroll integrity directly on Accounting Officers, mandating regular physical verification, robust internal controls, and strict consequence management (Department of Public Service and Administration, 2025). Its strength lies in making payroll integrity a non-negotiable legal obligation. However, the framework introduces a critical paradox: it relies on the very departmental human resource and finance units that have historically failed to ensure payroll integrity. This creates significant implementation risk, as these structures may lack the capacity, independence, or willingness to execute verification and discipline effectively. The need for such a rigid, government-wide mandate itself underscores a systemic lack of trust in existing departmental controls, suggesting the framework may struggle to overcome the entrenched institutional weaknesses it is designed to address.

National Treasury's data-driven audit initiative, revealed in 2025, represents a proactive forensic shift. It seeks to leverage PERSAL data, cross-referenced with South African Revenue Service (SARS), Department of Home Affairs (DHA), and banking records, to detect anomalies like duplicate identities, multiple bank accounts, and payments to deceased individuals (National Treasury, 2025). This initiative highlights a critical historical failure: the PERSAL system has seemingly not been functionally integrated with other essential government databases, such as those of the DHA. This lack of automated interoperability has therefore created a persistent structural vulnerability, allowing fraudulent categories like fictitious employees to go undetected due to the inability to verify basic information such as an employee's vital status. The project itself is an acknowledgment of this systemic gap, positioning integration as a necessary corrective rather than an inherent feature of payroll management.

The GTAC, an agency of National Treasury that provides technical advisory and project management support to improve public finance and infrastructure delivery, in its 2025 report *"Spending Reviews – Topics, Methodology and Findings, 2013–2025"*, consolidated findings from 276 spending reviews across national and provincial departments. The GTAC's spending reviews are constrained by their exclusively fiscal design, which limits their capacity to identify ghost worker-related inefficiencies. The reviews focus on what government spends and how efficiently, rather than on verifying the legitimacy of the individuals receiving those funds (Government Technical Advisory Centre, 2025). Despite GTAC's direct access to PERSAL data covering over R500 billion in annual expenditure and internal acknowledgements that this data could be used for forensic audits (as revealed in their publication), the institution has not utilised this data when it comes to COE and headcount variance analysis to aid in the detection of ghost

workers. This reveals a significant lag between the National Treasury's public commitment to address payroll fraud and the diagnostic actions actually taken. By failing to link expenditure inefficiencies to fraudulent activity, these publications miss a vital opportunity to fulfil long-standing policy promises, leaving a critical vulnerability in the PFM system and a major shortcoming in the effective management of public finances.

Table 11: Initiatives to strengthen public finance management and combat ghost workers

Initiative	Institution	Core Objective	Key Strength	Primary Structural Constraint
Compliance Framework for Payroll Integrity	DPSA	To enforce departmental accountability through mandatory verification and controls	Creates direct legal responsibility for Accounting Officers; mandates physical verification	Relies on the administrative capacity and integrity of historically compromised departmental HR and finance structures
Data-Driven Payroll Audit Project	National Treasury	To detect fraudulent entries by cross-referencing payroll data with other state databases	Proactive, forensic use of data; directly addresses the systemic lack of interoperability	Success is wholly contingent on achieving full system integration—a long-standing vulnerability it seeks to correct
Spending Reviews	Government Technical Advisory Centre	To promote effective and efficient use of public finances by analysing expenditure for wastage and inefficiency	Has direct, comprehensive access to and analyses core PERSAL payroll data to identify fiscal leakage	Designed exclusively for fiscal oversight, not fraud detection; represents a missed forensic opportunity despite access to key payroll data

Source: FFC's own compilation

5.2 Quantitative analysis: national government

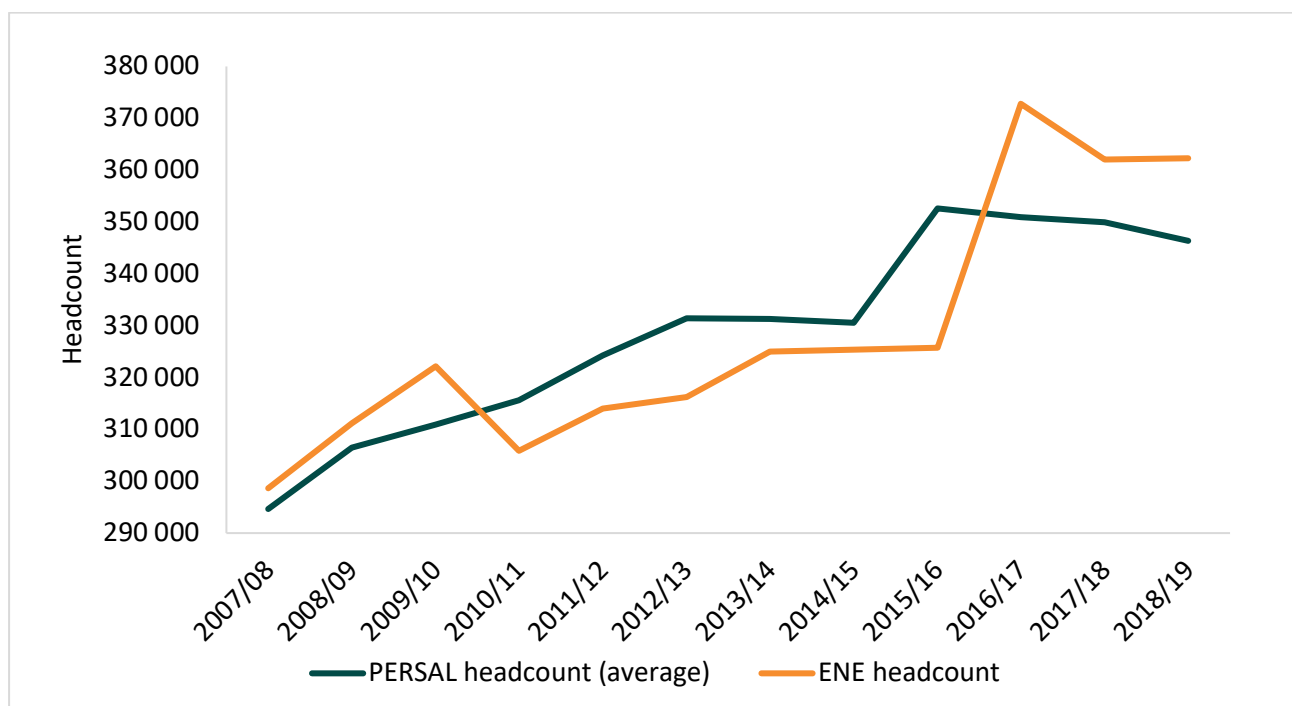
This section presents the empirical findings from the quantitative analysis assessing discrepancies between government payroll records (based on PERSAL data) and budgeted figures from the Estimates of National Expenditure (ENE) for the national government over the period 2007/08 to 2018/19.

Personnel headcount trends

The time-series data for personnel headcount confirms a clear pattern of overall workforce expansion during the period. An examination of the overall national government workforce reveals a clear upward trajectory in both the actual (PERSAL) and budgeted (ENE) headcounts between 2007/08 and 2018/19, making the public sector wage bill an escalating fiscal challenge. The two measures track each other closely, but the budgeted figures often remain slightly above the actual payroll figures, providing the general context for the negative financial

variance observed in the descriptive statistics. This underlying growth demonstrates a consistent fiscal planning challenge in capping the wage bill growth, requiring ever-larger budget allocations and restricting resources for other state functions. For workforce planning, it points to a pattern of uncontrolled or unchecked personnel growth, where capacity expansion outpaces effective management and budgetary constraints, leading to unsustainable overheads. What it reveals about the ghost worker issue is that the underlying system is fundamentally expanding, meaning any ghost workers are being inserted into a growing, rather than stable, system, potentially masking fraudulent headcounts within legitimate expansion, as clearly seen in the comparison of the actual versus budgeted figures (see Figure 10).

Figure 10: National government: actual vs. budgeted headcount



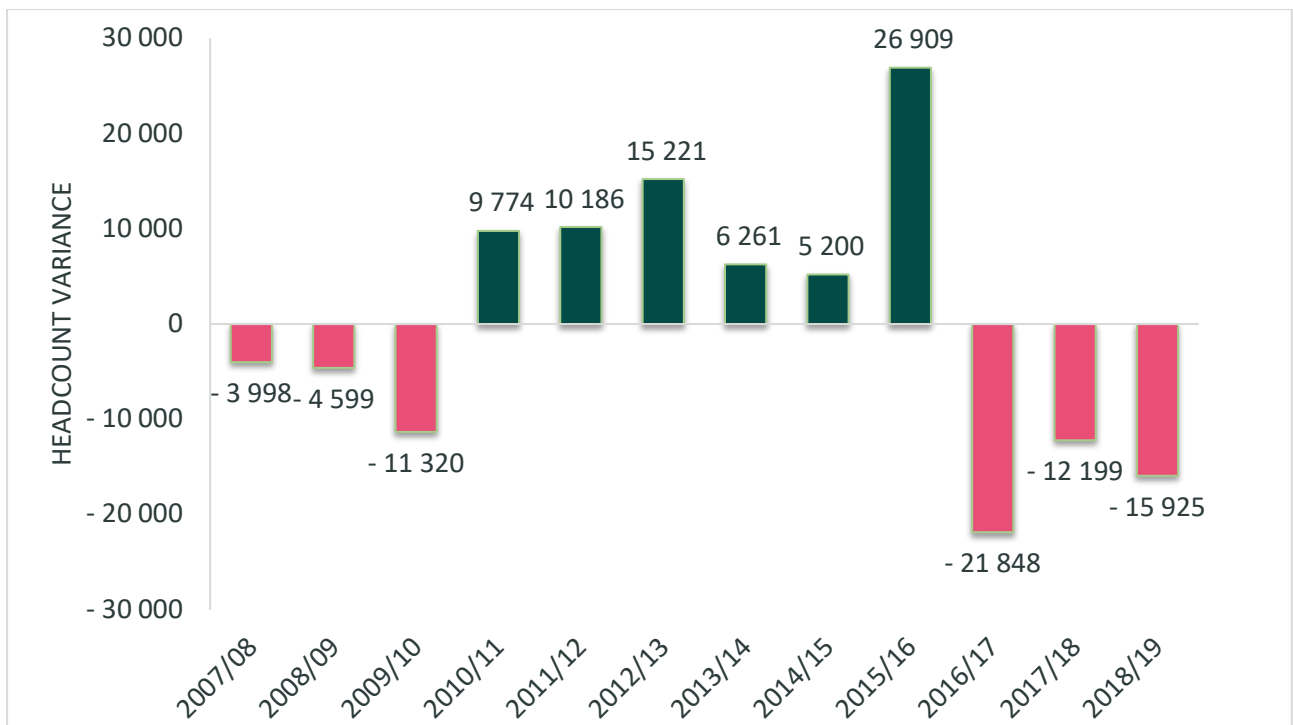
Sources: FFC calculations (based on PERSAL dataset, 2007/08 - 2018/19), National Treasury Estimates of National Expenditure, (2007a, 2010a, 2013a, 2016a)

As shown in Figure 11, the headcount variance (PERSAL headcount minus ENE budgeted headcount) shows significant volatility over the 2007/08 to 2018/19 period, indicating misalignment between staffing policy and administrative reality. Periods of significant negative variance, such as the extreme deficit of 21 848 employees in 2016/17, suggest that the government budgeted for significantly more personnel than were on the payroll, representing unutilised capacity. Conversely, the positive variances, exemplified by the peak of 26 909 employees in 2015/16, indicate substantial over-recruitment relative to the original budgetary limits. This variance instability highlights shortcomings in fiscal planning, as the budget is either

significantly overshoot (positive variance) or inflated unnecessarily (negative variance), leading to inefficient resource allocation and budget non-execution.

For workforce planning, it demonstrates a lack of control, with recruitment cycles being erratic and misaligned with budgetary forecasts, compromising capacity building and stability. Regarding the ghost worker challenge, the negative variance trend is particularly revealing—it contradicts the expectation that ghost workers would create positive variances (actual exceeding budget). Instead, the data suggests that even if ghost workers exist, their financial impact is absorbed within budgets inflated beyond legitimate staffing needs, creating a budgetary buffer that could mask potential payroll irregularities through apparent underspending.

Figure 11: National government: annual fluctuations in headcount variance



Sources: FFC calculations (based on PERSAL dataset, 2007/08 - 2018/19), National Treasury Estimates of National Expenditure (2007a, 2010a, 2013a, 2016a)

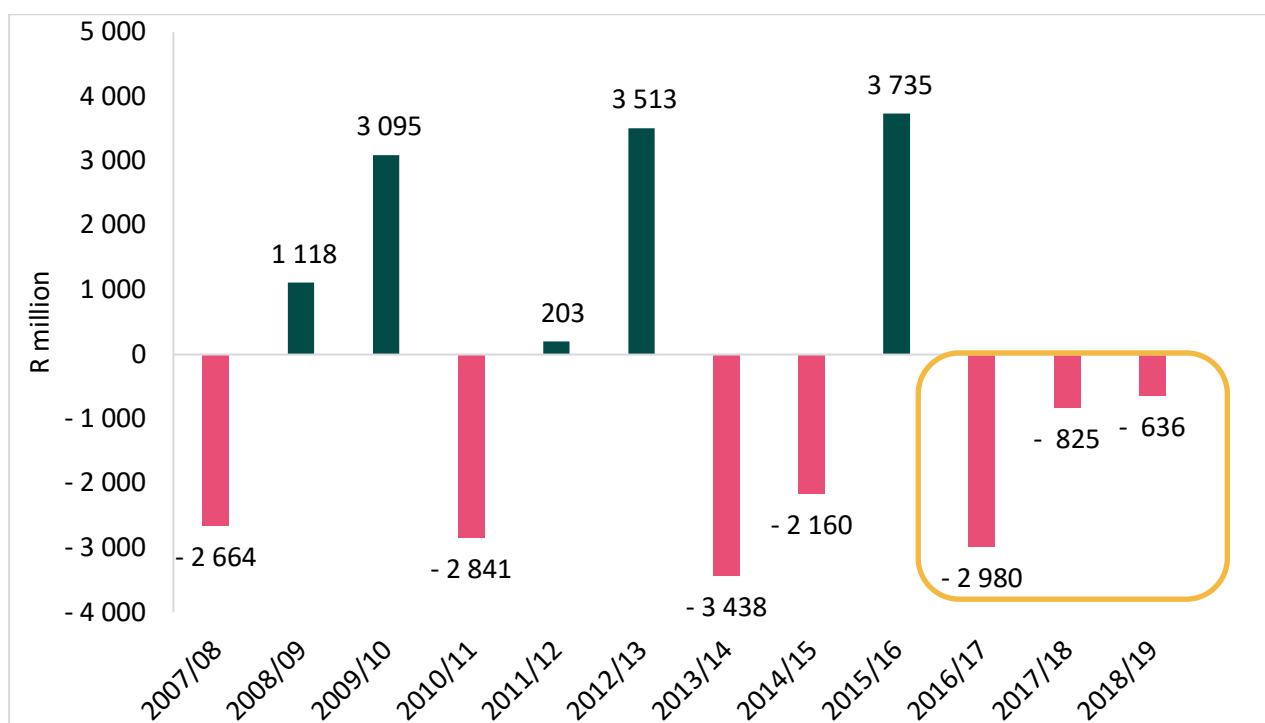
Compensation of employees' expenditure variance trends

As shown in Figure 12, the analysis of COE variance data over the period 2007/08 to 2018/19 points to persistent and deepening weaknesses in payroll and budget management. Over these twelve years, the variance repeatedly shifted between overspending and underspending. A clear turning point emerges after 2015/16, when the variance enters a prolonged period of underspending: R3.0 billion in 2016/17, R824.5 million in 2017/18, and R636.1 million in 2018/19.

This sustained shift from intermittent surpluses to consistent underspending reflects growing problems in budget planning and execution, with approved personnel budgets increasingly disconnected from actual payroll outcomes. The scale and persistence of these variances, particularly in the later years, suggest that personnel budgets are no longer functioning as reliable management tools.

The continued and significant underspending, especially in the latter part of the period, has direct and negative implications for workforce planning and service delivery. Persistent failure to spend allocated COE funds indicates that departments are unable to recruit, appoint, or retain staff at the levels assumed in the budget, even where workforce expansions are planned. Consequently, wage bill allocations do not translate into effective staffing capacity, constraining the state's ability to deliver services. Repeated underspending also distorts assessments of true personnel affordability and obscures real staffing gaps, increasing the likelihood of responses such as hiring freezes or prolonged vacancy of critical posts. Over time, this weakens institutional capacity and reinforces cycles of poor planning and execution.

Figure 12: National government: variance in compensation of employees



Note: Totals exclude Parliament and Defence votes to align with PERSAL data. Sources: FFC's calculations (based on PERSAL dataset, 2007/08 - 2018/19), National Treasury Estimates of National Expenditure (2007a, 2010a, 2013a, 2016a)

Most critically, the erratic and sizeable COE variance patterns shown in Figure 12 significantly elevate the risk of ghost worker fraud and broader financial mismanagement. Large amounts of

funding are set aside for personnel, but not clearly linked to verified staff numbers, creating vulnerabilities in the payroll system. When expenditure does not closely align with confirmed headcounts and large variances are treated as routine, it becomes easier to conceal fictitious payroll entries. The volatility of these variances further obscures the distinction between legitimate forecasting errors and deliberate manipulation of personnel costs. As a result, ghost workers could remain embedded in the system, with warning signs masked by ongoing budgeting weaknesses and poor reconciliation processes, leaving public finances exposed to leakage and abuse.

5.3 Quantitative analysis: provincial government

This section presents the empirical findings from the quantitative analysis conducted to assess discrepancies between provincial government payroll records (based on PERSAL data) and budgeted figures from the ENE for provincial government over the period 2007/08 to 2018/19.

Personnel headcount trends

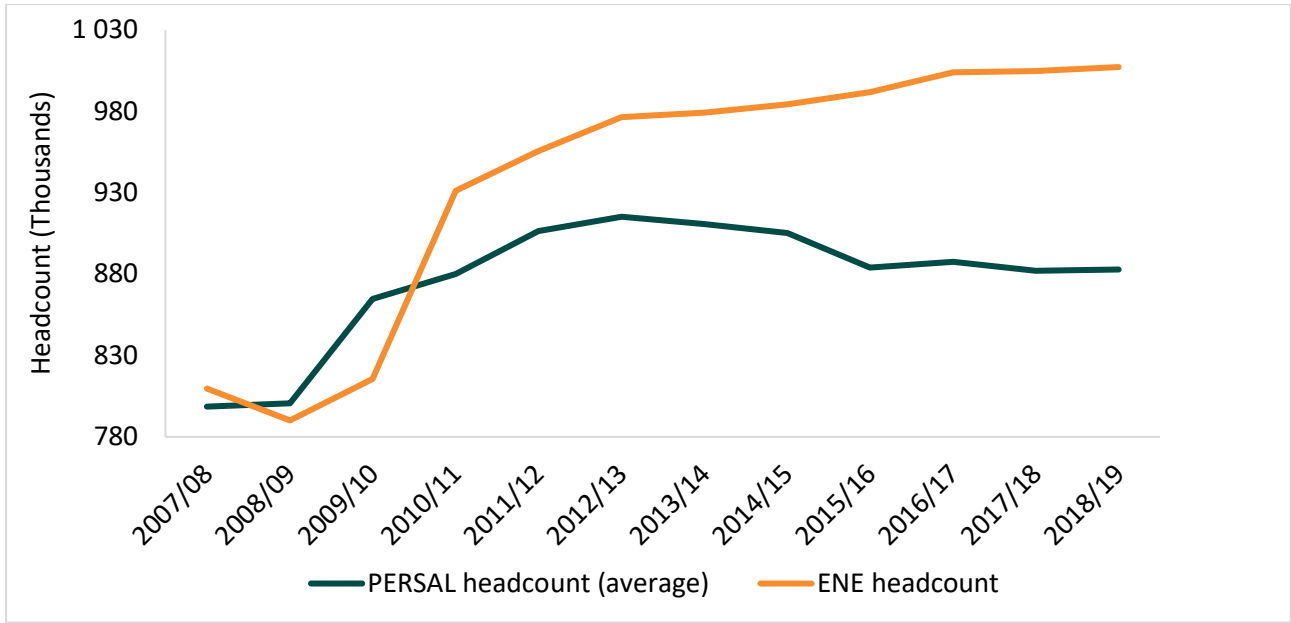
At the provincial level, the comparison between PERSAL headcount data and ENE-funded posts reveals a persistent misalignment between actual payroll figures and budgeted personnel establishments over time. As shown in

Figure 13, a clear and sustained structural change emerges from 2009/10 onwards. Beginning in 2010/11, ENE-funded posts consistently exceeded the number of employees recorded on PERSAL, and the gap between the two measures widened steadily over time. The persistence and scale of this divergence indicate that provinces continued to plan and budget for substantially larger workforces than were actually employed, pointing to entrenched weaknesses in recruitment execution, post-filling, and personnel budgeting discipline. The sustained gap between planned and actual staffing levels undermines the reliability of provincial personnel budgets. Furthermore, it suggests that large portions of approved personnel establishments are never translated into operational capacity, particularly in labour-intensive sectors such as health and education, where staffing adequacy is central to service delivery outcomes.

Critically, these trends have important implications for understanding ghost-worker risks at the sub-national level. The sustained post-2009/10 divergence challenges the assumption that ghost workers would primarily be revealed through payroll headcounts exceeding funded posts. Instead, the presence of tens of thousands of unfilled but budgeted positions creates fiscal

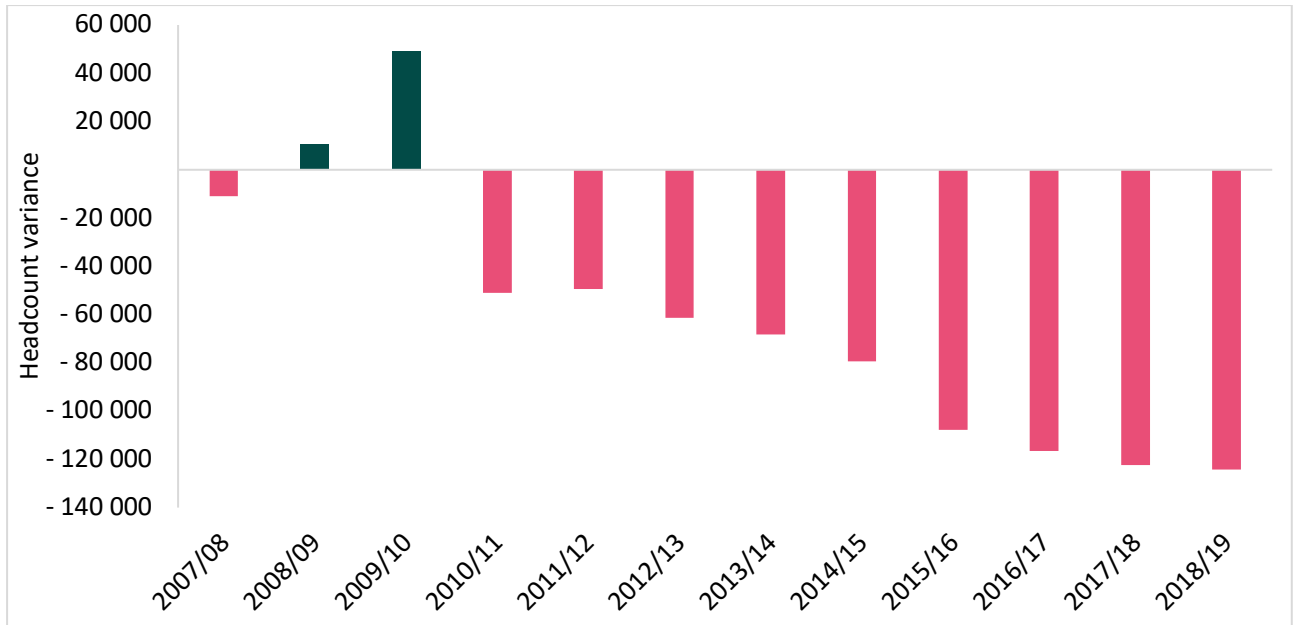
space within provincial wage bills that can absorb payroll irregularities without triggering overt overspending signals. In this environment, potential ghost workers are more likely to remain concealed within broader weaknesses in workforce planning and payroll reconciliation.

Figure 13: Provincial government: actual vs budgeted headcount



Sources: FFC's calculations (based on PERSAL dataset, 2007/08 - 2018/19), National Treasury Provincial Budget (2007b, 2010b, 2013b, 2016b)

Figure 14 shows that in 2010/11, provinces budgeted for over 51 000 more posts than were reflected in payroll records. This gap expanded to roughly 79 000 posts by 2014/15, exceeded 107 000 posts in 2015/16, and reached over 124 000 posts by 2018/19. This demonstrates a severe and growing disconnect between provincial workforce planning (budget) and payroll reality.

Figure 14: Provincial government: variance in total headcount

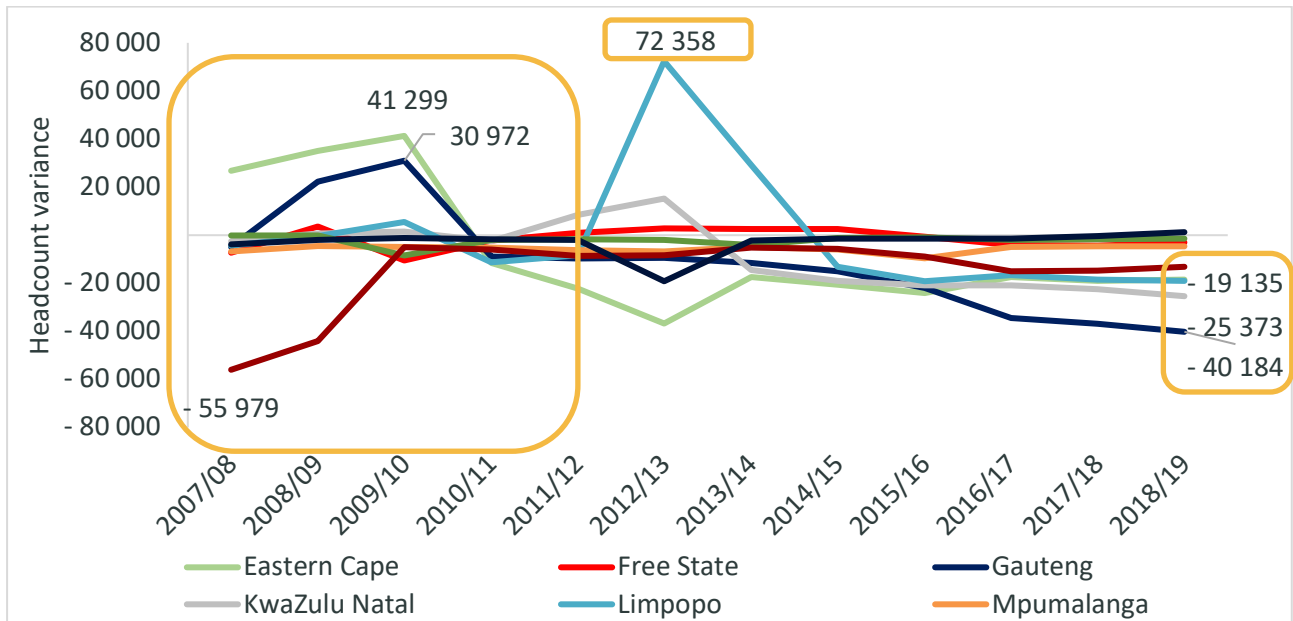
Sources: FFC's calculations (based on PERSAL dataset, 2007/08 - 2018/19), National Treasury Provincial Budget (2007b, 2010b, 2013b, 2016b)

Figure 15 reveals persistent and uneven misalignment between funded posts and actual employment across provinces, with clear risk concentrations. In the pre-2010/11 period, several large provinces recorded substantial positive variances, most notably the Eastern Cape, where actual headcount exceeded funded posts (ENE) by 41 299 in 2009/10, and Gauteng, which recorded a positive variance of 30 972 in the same year. These early deviations suggest periods of rapid payroll expansion that outpaced budgetary controls. From 2010/11 onwards, the pattern shifts decisively, with sustained and deepening negative variances dominating. Gauteng's variance deteriorated from -8 800 in 2010/11 to -40 184 by 2018/19, while the Eastern Cape remained consistently below funded levels by between 17 000 and 36 000 employees. KwaZulu-Natal followed a similar trajectory, reaching a negative variance of 25 373 employees by 2018/19. Limpopo stands out as the most volatile province, recording an exceptional positive variance of 72 358 in 2012/13, followed by a rapid return to large negative deviations, indicating episodic breakdowns in workforce and payroll controls.

Overall, the data point to structural weaknesses in provincial workforce planning and payroll governance, rather than isolated or temporary anomalies. Persistent negative variances across most provinces suggest that approved personnel establishments are increasingly out of step with implementation capacity, undermining the credibility of the ENE as a planning and

oversight tool. From a ghost worker risk perspective, early-period positive variances in provinces such as Eastern Cape and Gauteng reflect heightened exposure to irregular payroll expansion, while post-2010/11 under-execution of funded posts creates an environment in which ghost workers may be concealed within inflated or poorly reconciled post-establishment figures rather than through excess headcount.

Figure 15: Provincial government: variance in actual vs budgeted headcount by province



Sources: FFC's calculations (based on PERSAL dataset, 2007/08 - 2018/19), National Treasury Provincial Budget Statements (2007b, 2010b, 2013b, 2016b)

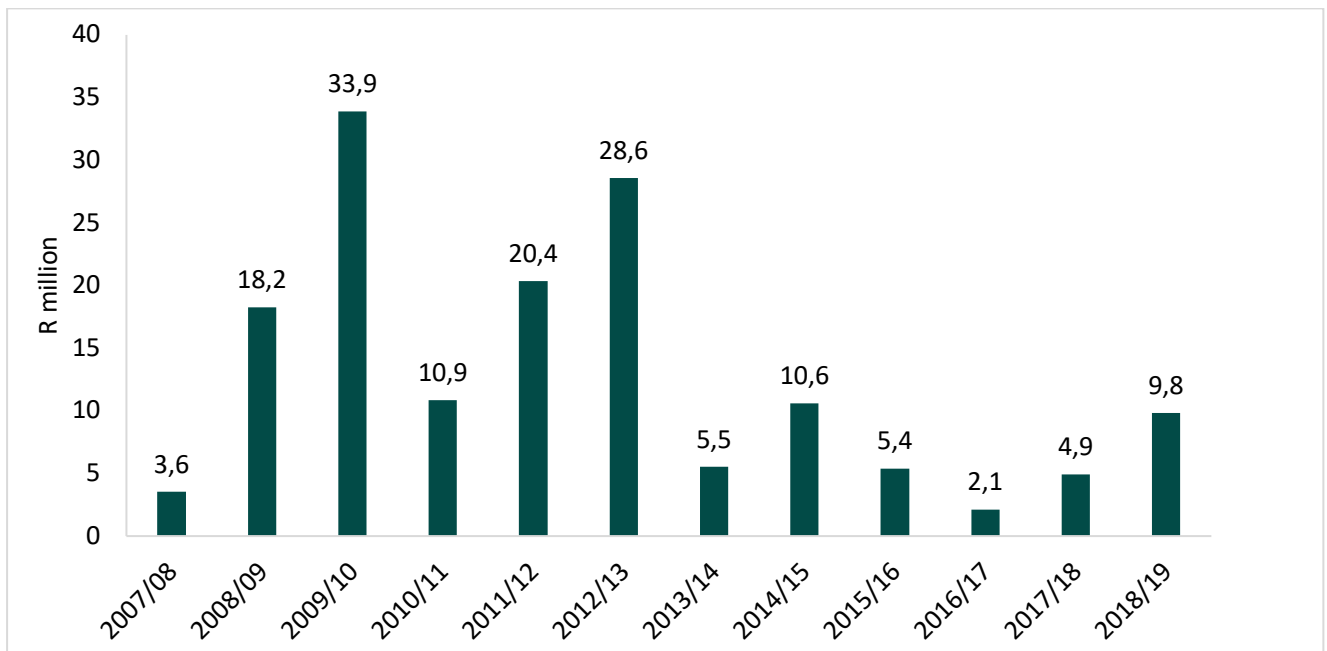
Compensation of employees expenditure variance trends

Figure 16, illustrates a predominantly positive variance trend from 2007/08 to 2018/19 at the aggregate provincial level, where actual personnel spending (PERSAL) consistently breached budgeted allocations (as outlined in the ENE). The variance began at R3.6 million in 2007/08 and escalated sharply to a peak of R33.9 million in 2009/10. Following this high point, the variance showed a general declining trend, though it remained positive, decreasing to R10.6 million in 2013/14 and reaching R9.8 million by 2018/19. This pattern indicates an initial period of significant budgetary overrun in personnel costs, followed by an apparent, though inconsistent, tightening of expenditure control. Such persistent overspending suggests that provincial departments operate with weak expenditure controls and poor forecasting, which erodes budget credibility and places upward pressure on overall provincial spending envelopes.

From a ghost worker perspective, persistent overspending on compensation is a critical risk signal. Where actual payroll expenditure consistently exceeds approved budget allocations, and

where these deviations are not corrected over time, the environment can become conducive to payroll irregularities going undetected. Positive COE variances contradicting the provincial headcounts can reflect weaknesses in payroll verification, delayed termination of employees, or fraudulent salary payments that inflate actual expenditure without commensurate provincial headcount.

Figure 16: Provincial government: variance in compensation of employees (actual vs budgeted) at provincial level



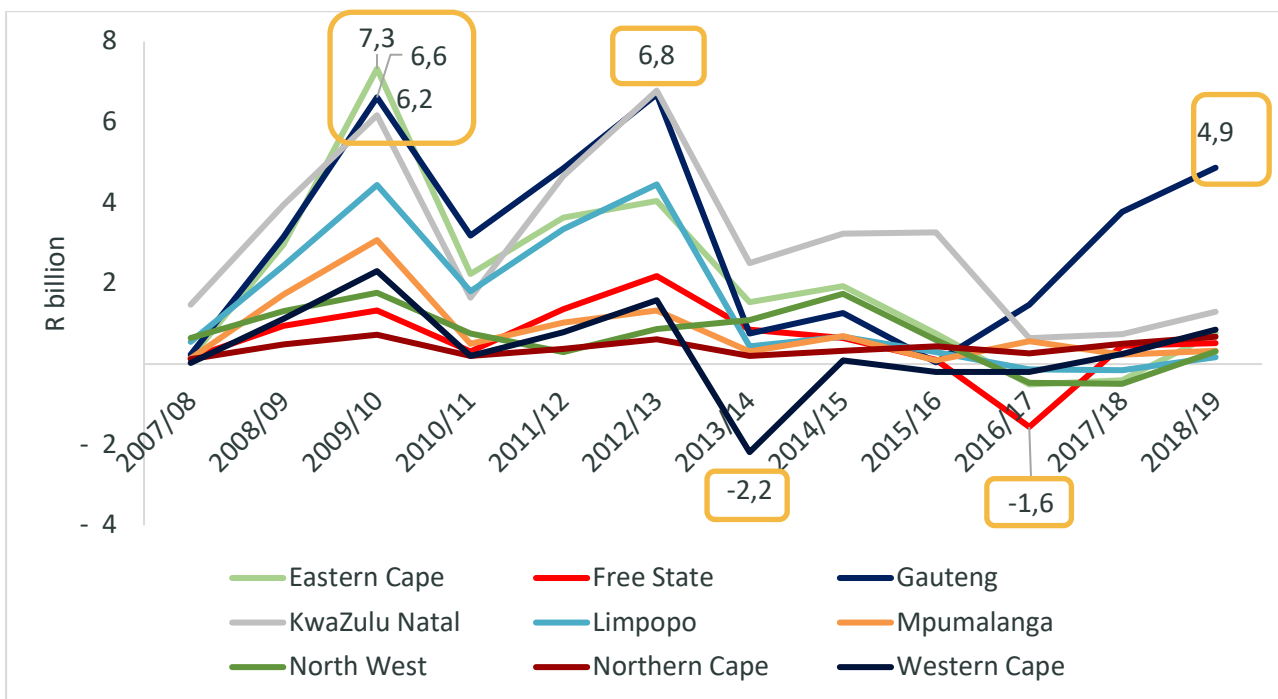
Sources: FFC's calculations (based on PERSAL dataset, 2007/08 - 2018/19), National Treasury Provincial Budget (2007b, 2010b, 2013b, 2016b)

Figure 17 shows that across the entire 2007/08–2018/19 period, most provinces record frequent and often large positive COE variances, suggesting that provincial governments have struggled to keep personnel costs within approved budget limits. Gauteng consistently stands out, with overspending reaching R6.6 billion in 2009/10, remaining elevated above R4 billion in several subsequent years, and rising again to R4.9 billion by 2018/19. KwaZulu-Natal displays a similar pattern, recording COE overruns of R6.2 billion in 2009/10, R6.8 billion in 2012/13, and R1.3 billion in 2018/19, while the Eastern Cape peaks at R7.3 billion in 2009/10 and continues to post sizeable positive variances in most years thereafter. These sustained overruns point to systemic difficulties in anticipating and controlling personnel cost drivers at the provincial level.

Figure 17 also illustrates that some provinces exhibit greater volatility or periods of underspending, indicating uneven payroll management. Limpopo shows particularly sharp fluctuations, with COE overruns exceeding R4.4 billion in some years, followed by brief periods

of underspending, including a negative variance of –R137.7 million in 2016/17. North West, Free State, and Mpumalanga generally record smaller but recurring positive variances, which cumulatively still represent material fiscal risks over time. The Western Cape is the notable exception, displaying relatively stronger expenditure control, including several years of underspending, most prominently –R2.2 billion in 2013/14, before returning to modest overspending in later years.

Figure 17: Provincial government: variance in compensation of employees (actual vs budgeted) by province



Sources: Commission's calculations (based on PERSAL dataset, 2007/08 - 2018/19), National Treasury Provincial Budget (2007b, 2010b, 2013b, 2016b)

Overall, the persistence of COE overspending across most provinces over more than a decade suggests that personnel budgets have been systematically optimistic or weakly enforced. This undermines fiscal discipline and creates opacity in payroll systems, increasing the risk that inefficient, irregular, or unverified payments—including potential ghost workers—can remain embedded in provincial compensation frameworks without timely detection.

6 Conclusion

This paper aimed to unpack the concept of ghost workers, examine systemic vulnerabilities in South Africa's public sector, explore detection strategies, and analyse the implications of payroll-budget discrepancies.

The analysis reveals critical, divergent trends in COE and personnel headcount that expose systemic risks. At the national level, the general trend shows highly volatile headcount variances alongside fluctuating periods of COE underspending and overspending throughout the 2007-2019 period. The erratic swings between positive and negative headcount variance indicate a persistent lack of control over staffing levels and poor alignment with budgetary plans. When financial management is this poor, it creates a favourable environment for fraudulent activities like ghost worker schemes to go unnoticed.

Conversely, at the provincial level, the data reveal a more structural and geographically concentrated problem. Large provinces like Gauteng, KwaZulu-Natal, and the Eastern Cape have been primary drivers of a sustained trend of COE overspending. This chronic breaching of personnel budgets directly and unnecessarily inflates the aggregate public sector wage bill. Furthermore, the sustained negative variance in provincial headcount—where funded posts consistently exceed the number of actual employees on the payroll—demonstrates challenges to translate budgetary authorisations into hired, operational staff. This combination—overspending on the cost per existing employee while systematically failing to fill authorised positions—points to severe administrative inefficiency and can undermine budgetary credibility. This inefficiency creates a dual risk: it wastes resources on an overpriced workforce, while the large pool of unfilled, budgeted posts can create the opportunity for inserting fictitious ghost employees into the system.

The data findings can be understood using the Fraud Diamond theory. The identified systemic weaknesses—volatile budgeting, chronic overspending, and the gap between planned and actual staff—directly constitute the opportunity element. They create an opaque, poorly controlled environment where fraudulent entries can be created and sustained.

This paper also showed that government strategies have failed to target the root causes of the ghost worker phenomenon. Broad fiscal reviews, like those conducted by the GTAC, analysed COE but did not verify the legitimacy of the underlying headcount, a critical oversight. Newer plans from the DPSA and National Treasury, which focus on verifying staff and linking government databases, represent a better, more targeted response and are a step in the right direction. However, the success of this initiative depends on overcoming the very system failures they are trying to fix, such as incompatible computer systems and the lack of consequences for those involved in ghost worker schemes.

Lessons from case studies in countries addressing the ghost worker challenge—specifically Nigeria, Tanzania, and Ghana—reveal several common success factors. Biometric verification and digital system integration proved essential for detecting fictitious employees, while regular, systematic payroll audits enabled the sustained identification of irregularities. Additionally, physical verification campaigns enhanced oversight and recovered significant funds, supported by robust enforcement mechanisms critical to preventing the re-emergence of fraud. Crucially, each case demonstrated that eliminating ghost workers generates substantial fiscal savings, improves budget credibility, and creates space for priority spending—lessons directly salient to South Africa's ongoing reforms

Tackling the ghost worker issue requires implementing a holistic approach grounded in Fraud Management Lifecycle Theory. This means building systems that actively prevent fraud, continuously detect it, and ensure serious consequences for those involved. For the Division of Revenue, this means that fiscal transfers to provinces should be directly tied to their performance in cleaning up their payrolls and adopting these unified anti-fraud systems, turning budget allocations into a tool for enforcing accountability and protecting public funds.

7 Recommendations

The Commission makes the following Recommendations:

- 7. The Minister of Finance and the Minister of Public Service and Administration should jointly lead the integration and modernisation of government payroll and human resource systems into a unified platform with biometric and video verification, digital identity, and real-time interoperability with databases such as Home Affairs and South African Revenue Service. To enforce compliance, the Minister of Finance should link all funding (including conditional grants and intergovernmental transfers)—to mandatory biometric registration, regular audits, and strengthened governance across all spheres of government and state-owned enterprises.*

The research findings indicate that fragmented payroll systems, weak information and communications technology controls, and limited interoperability with critical databases create significant opportunities for ghost workers to go undetected. Addressing these vulnerabilities requires an integrated system capable of real-time cross-verification of factors such as employee identities, employment status, and banking details. International experience underscores the effectiveness of such reforms: Nigeria's Integrated Payroll and Personnel Information System (IPPIIS) biometric verification removed tens of thousands of ghost workers,

while Kenya and Tanzania successfully eliminated fictitious employees by integrating human resource databases with national ID systems and implementing periodic biometric audits.

By incorporating biometrics and timestamped video records stored as immutable audit logs (i.e. permanent, tamper-proof files that cannot be altered, deleted, or manipulated), the system ensures indisputable confirmation of physical presence while providing a secure digital trail for forensic verification. Furthermore, real-time interoperability with databases including Home Affairs and South African Revenue Service would enable the immediate detection factors such as fraudulent IDs, payments to deceased persons, or salaries claimed for former employees. This approach, supported by a governance module designed to store appointment letters and performance agreements, would ensure every individual on the payroll is backed by a legitimate, accessible audit trail. By linking compliance to performance-linked funding, the Ministers of Department of Public Service and Administration and Finance can help incentivise departments, local governments, as well as state-owned entities to enhance payroll integrity and eliminate ghost workers.

8. *The Minister of Public Service and Administration, in coordination with the Minister of Finance, must adopt a lifecycle approach to payroll fraud management integrating prevention, detection, enforcement, and monitoring, with strengthened consequence management including disciplinary action, fund recovery, and prosecution.*

The research finds that ghost worker schemes are not isolated but reflect systemic governance weaknesses and institutional collusion across human resources officials, supervisors, and managers, allowing fraudulent entries to bypass approval processes. While cases like Passenger Rail Agency South Africa (salary freezes and forensic investigations) and Gauteng Health (suspensions for unverified employees) demonstrate the use of administrative sanctions, the Polokwane Municipality case illustrates how delayed or insufficient disciplinary action allows irregularities to persist, weakening deterrence. This points to a structural misalignment between system ownership and enforcement authority. A coordinated lifecycle approach is therefore needed to align technological controls with credible, consistent consequence management.

9. *The Portfolio Committee on Public Service and Administration should strengthen oversight by actively monitoring the link between payroll integrity and public financial management performance. Furthermore, Portfolio Committees should require departments to submit regular reconciliations of compensation of employees expenditure, actual headcounts, and*

vacancy rates, and use the Estimates of National Expenditure to hold Accounting Officers accountable for persistent misalignments between approved establishments and payroll records.

The quantitative analysis in this study reveals that persistent misalignments between PERSAL and Estimates of National Expenditure (ENE) data—manifesting as chronic provincial overspending and volatile national underspending—can create an environment in which conceal ghost worker fraud can be concealed. Currently, limited parliamentary scrutiny regarding these variances leaves it unclear whether they stem from technical forecasting errors or more serious instances of payroll manipulation. By institutionalising a requirement for departments to explain differences in their personnel spending and headcount at the committee level, Parliament can enforce better workforce planning, public finance management and uncover discrepancies that may point to ghost workers. This ensures that the funded posts in the ENE are treated as a firm fiscal benchmark rather than a loose projection. Strengthening this oversight role directly addresses the “opportunity” and “lack of oversight” pillars of the Fraud Diamond by ensuring that governance failures are met with immediate accountability.

10. The Minister of Finance should incorporate payroll fraud risk into the Fiscal Risk Statement, including an assessment of fiscal pressures from persistent gaps between budgeted and actual headcounts and compensation of employees, alongside progress on departmental compliance with payroll verification and consequence management.

The research provides compelling evidence that ghost worker fraud constitutes a material, quantifiable, and persistent fiscal risk that currently falls outside the formal fiscal risk framework. The longitudinal analysis of ENE–PERSAL data from 2007/08 to 2018/19 reveals sustained misalignments that directly impact fiscal credibility. For example, national compensation of employee (COE) variance fluctuated dramatically, reaching an underspend of R3.7 billion in 2015/16, while provincial COE overspending peaked at R33.9 billion in 2009/10 alongside a growing gap of over 124 000 unfilled but budgeted posts by 2018/19. Furthermore, case studies including the Polokwane Municipality c (where R500 million was drained over 16 years) and PRASA’s Project Ziveze (where R200 million was saved upon detection of ghost workers) demonstrate that these are not abstract risks but predictable, recurring fiscal shocks. By excluding payroll fraud from the Fiscal Risk Statement, National Treasury omits a known drain on the fiscus that exhibits all the characteristics of a formal fiscal risk: systemic enablers (weak ICT controls, fragmented oversight, collusion), material financial consequences, and persistence across multiple years and departments.

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Chapter 4

A Review of Input Data in the Provincial Equitable Share and Local Government Equitable Share



Chapter 4: A Review of Input Data in the Provincial Equitable Share and Local Government Equitable Share

Abstract

The provincial equitable share (PES) formula and local government equitable share (LGES) formula are key intergovernmental fiscal instruments for provinces and municipalities, respectively, as unconditional transfers. Both these formulae rely heavily on input data. This study reviews the data utilised in the PES and LGES. Using both qualitative and quantitative methods, findings highlight challenges in implementing the PES and LGES due to outdated data. Findings reveal that the government's use of a phased-in approach deprives some provinces of the full impact of the data update as true reflection of the socio-economic realities of provinces. Research evidence also show an increasing trend of funds allocated outside the PES formula, thereby undermining the transparency, credibility, and predictability of the equitable share formula as an intergovernmental fiscal instrument.

1 Introduction

The Constitution of the Republic of South Africa established three distinct but interdependent spheres of government: national, provincial, and local. The Constitution further assigns roles, functions, and expenditure responsibilities to each sphere of government. According to the Constitution, provinces, in the main, are responsible for social functions, including education and health. These provincial functions are not generating revenue for provinces. Provinces, therefore, heavily rely on fiscal transfers and spend much of their transfers on the compensation of employees, as they pay salaries to personnel in these sectors (education and health). While local government is mainly responsible for providing basic services, including water and sanitation, refuse removal, and electricity. Municipalities are expected to raise significant revenue from the provision of these services, but they differ widely in their ability to raise revenue due to several factors.

Intergovernmental fiscal transfers, therefore, play a key role in ensuring that provinces and municipalities fulfil their mandates. Key instruments in the South African intergovernmental fiscal transfer system include both conditional and unconditional grants. The current intergovernmental fiscal transfer system in South Africa reflects the revenue-raising abilities of these two spheres of government. Given that provinces are not expected to raise revenue from the social services they provide, they receive a larger share of the nationally raised revenue than municipalities do. For the 2026/27 financial year, for example, transfers to provinces amounted to 41.7 per cent of the nationally raised revenue compared to 9.4 per cent allocated to local government. Therefore, how these fiscal transfers are determined and allocated between provinces and municipalities is very important. In the South African context, the Provincial Equitable Share (PES) formula (for provinces) and the Local Government Equitable Share (LGES) formula (for municipalities) are key in determining the shares each province and municipality receives from the provincial and local government pools.

2 Research Problem and Questions

The provincial funding pool is distributed among all provinces using a PES formula with six components and assigned weights. The PES formula was developed in 1996 and has undergone several reviews. However, despite these reviews, the relevance, appropriateness, adequacy, application, and performance of the formula continue to dominate the discourse on intergovernmental fiscal reforms. The PES and LGES formulae rely heavily on data that determines how much each province and municipality receives from the funding pool. Therefore, accurate and available input data is key. Often, availability, reliability, and up-to-date data are debated and remain a challenge. Furthermore, the Commission, in its 2025/26 and 20226/27 budget submissions, raised concerns about allocations added to the provincial equitable share that were not determined by the formula. The Commission also raised concerns about the National Treasury's phasing-in approach. These practices undermine the principles of objectivity, transparency, and affordability.

The research paper, therefore, answers the following key questions:

1. How accurate, relevant, and updated is the data and components used in the PES and LGES formulae?
2. To what extent is a phased-in approach used in determining allocations for provinces?
3. To what extent has the funding outside the PES formula increased over the past 10 years?

3 Research Methodology

To answer the research questions, a combination of different methods has been used. With respect to the PES, the study has used both qualitative and quantitative approaches.

Qualitatively, a review and analysis of the structures and composition of the PES formula have been undertaken since 1996, including an analysis of how components and weighting have changed over time. Furthermore, an analysis of data sources used to determine the PES has been undertaken. Quantitatively, the study relied on data from the Division of Revenue Bill (DoRB) for various years from 2015 to 2027 to calculate the percentage gap between what a province should receive in the outer year of the medium-term expenditure framework (MTEF) and what each province receives. From the Division of Revenue Bills for the years between 2015 and 2026, the study analysed how funding and the trend of funds and programmes allocated through the PES, but not determined or calculated through the formula, have been increasing.

With respect to the LGES, a review and analysis of the structure and composition of the LGES formula has been undertaken since 1996, including a comparison of the old and new formulas. Further analysis has been undertaken regarding the data used to determine municipal allocations through the LGES, particularly the outdatedness of the poverty indicator data (affordability threshold).

4 Analysis and findings

4.1 *The current Structure and evolution of the Provincial in South Africa*

Current structure of the Provincial Equitable Share

The PES formula was introduced in 1996, aimed at ensuring fair distribution of funding to provinces. Since the introduction of the formula, there have been ongoing reviews aimed at improving its distribution and equity, among other things. The current formula for the PES in South Africa consists of six components, and each component is assigned a weighting, as shown in Table 12.

Table 12: Provincial Equitable Share formula components

Component	Weight - Percentage	Brief description
Education	48	This component is based on the size of the school-age population (between 5 and 17 years) and the number of learners between Grade R and 12, enrolled in public ordinary schools. Each subcomponent contributes 50 per cent.
Health	27	Consists of provincial risk profile, which takes into account uninsured population (75%) and output component (primary healthcare visit, 5%, and hospital workload patient day equivalent share, 20%).
Basic	16	Derived from each province's share of the national population.
Institutional	5	This is divided equally between provinces for costs associated with running a provincial government and providing services.
Poverty	3	It is determined based on income data.
Economic	1	Determined based on regional GDP.

Source: FFC's Own compilation from the Division of Revenue Bill.

Evolution of the Provincial Equitable Share Table 13A key point in this evolution is the changes in the weights assigned to some of these components. For example, in 1998, the education component was assigned a weight of 39 per cent, and this weight has changed over time; it is now 48 per cent. Similarly, the weight assigned to the health component has increased over the years, from 18 per cent in 2015 to 27 per cent in 2025. Other developments in the components of the PES include the removal of the social security component, as the function was shifted from the provinces to the national sphere of government from 2006. While the backlog component was removed from the PES formula in 2006, the poverty component was introduced.

Table 13: Changes in the provincial equitable share components and weighting between 1998 and 2025

Component	1998	1999	2000-2001	2002-2005	2006-2010	2011-2025
Education	39%	40%	41%	41%	51%	48%
Health	18%	18%	19%	19%	26%	27%
Social Security	16%	17%	17%	18%	-	-
Basic	15%	9%	7%	7%	14%	16%
Backlogs	-	3%	3%	3%	-	-
Economic activity	8%	8%	8%	7%	1%	1%
Poverty	-	-	-	-	3%	3%
Institutional	4%	5%	5%	5%	5%	5%

Source: FFC's Own compilation from Division of Revenue Bill

4.2 Data used in the determination of the Provincial Equitable Share per Province

To determine allocations to each province, outdated data are used in the PES formula. In 2024, the formula used data from the 2022 mid-year population estimates, as there were no official mid-year population data from Statistics South Africa, as shown in

Table 14. This is a challenge given the high rates of migration and urbanisation in South Africa.

Regarding the economic activity component, which uses regional gross domestic product (GDP) data, the data that was used for the 2024 allocation was also outdated. The 2019 official data was last published by Statistics South Africa and used in this component to determine provincial allocations for the 2024 MTEF. This means that data as old as five years were utilised to determine funding shares allocated to provinces.

Education component

Currently, the education component has two sub-components: the school-age population, comprising children aged 5-17, and the number of learners enrolled. Each sub-component is assigned a weight of 50 per cent. Since 2018/19, data used for learner enrolment has been derived from the Department of Basic Education (Learner unit record information & tracking system); previously, it was sourced from annual school surveys. Concerning the school-age population, data were previously derived from Statistics South Africa (Census). In recent years, there has been a shift toward using mid-year population estimates since 2019.

Table 14: Data utilised in the determination of the provincial equitable share to provinces from 2015 to 2025

Year	Education – 5-17 years age population and enrolment	Health – Insured and uninsured population, and visits and equivalent patient-days	Basic	Poverty	Economic
2015	Population - 2011 Census Enrolment - DBE 2014 School Realities Survey	Population with medical aid – 2013 GHS Uninsured population – 2014 MYPE Average number of visits and patient days - 2012/13 and 2013/14	2014 MYPE	2014 MYPE.	2013 GDP-R
2016	Population - 2011 Census Enrolment - DBE 2015 School Realities Survey	Population with medical aid insurance - 2014 GHS Uninsured population - 2015 MYPE Average visits and patient-days -	2015 MYPE	2015 MYPE	2014 GDP-R
2017	Population - 2011 Census Enrolment - DBE 2016 School Realities Survey	Population with medical aid insurance - 2015 GHS Uninsured population - 2016 MYPE. Average visits and patient-days - 2014/15 and 2015/16.	2016 MYPE	2016 MYPE.	2015 GDP-R
2018	Population - 2011 Census Enrolment - DBE 2017 LURITS database	Population with medical aid insurance - 2016 GHS Uninsured population - 2017 MYPE. Average visits and patient-days - 2015/16 and 2016/17.	2017 MYPE	2017 MYPE	2016 GDP-R
2019	Population - 2011 Census Enrolment - DBE 2017 LURITS database	Population with medical aid insurance - 2017 GHS Uninsured population - 2018 MYPE. Average visits and patient-days - 2016/17 and 2017/18	2018 MYPE	2018 MYPE	2016 GDP-R
2020	Population - 2011 Census and MYPE. Enrolment - DBE 2019 LURITS database	Population with medical aid insurance - 2018 GHS Uninsured population - 2019 MYPE. Average visits and patient-days - 2017/18 and 2018/19.	2019 MYPE	2019 MYPE	2017 GDP-R
2021	Population - MYPE Enrolment - DBE 2020 LURITS database	Population with medical aid insurance - 2018 GHS Uninsured population - 2020 MYPE. Average visits and patient-days - 2018/19 and 2019/20	2020 MYPE	2020 MYPE.	2018 GDP-R
2022	Population - 2021 MYPE Enrolment - DBE 2021 LURITS database	Population with medical aid - 2019 GHS. Uninsured population - 2020 MYPE Average visits and patient-days - 2018/19 and 2019/20	2021 MYPE	2021 MYPE	2019 GDP-R
2023	Population - 2022 MYPE Enrolment - DBE 2012 LURITS database	Population with medical aid - 2018 GHS Uninsured population - 2022 MYPE Average visits and patient-days - 2019/20 and 2020/21	2022 MYPE	2022 MYPE	2019 GDP-R
2024	Population - 2022 MYPE Enrolment - DBE 2023 LURITS database	Population with medical aid - 2022 GHS Uninsured population - 2022 MYPE Average visits and patient-days - 2021/22 and 2022/23	2022 MYPE	2022 MYPE	2019 GDP-R
2025	Population - 2024 MYP. Enrolment - DBE 2024 LURITS database	Population with medical aid - 2022 GHS Uninsured population - 2024 MYPE Average visits and patient-days - 2022/23 and 2023/24	2024 MYPE	2024 MYPE	2024 GDP-R

Data Source: National Treasury, 2015 -2025.

While the school-age population and enrolment numbers are key indicators as they are currently used in the education component of the PES, subsidisation based on affordability and poverty levels is also important. The government is currently reviewing the education component of the formula with the intention of going beyond the current two subcomponents to include other subcomponents/indicators. In the review process, one of the key indicators that can be used in the system for affordability and poverty, which the government can consider, is the quantile system. The education system in South Africa divides schools into five quintiles based on their poverty levels, as shown in Table 15.

Table 15: School quintiles

Quintile	Description
1	These are the poorest schools, typically no-fee schools which are fully funded by the government. Common challenges include overcrowding and a lack of resources.
2	Under-resourced schools that may charge school fees and normally receive partial government funding.
3	Similar to quantile 2, they are partially funded and may charge fees but still serve communities with significant socio-economic challenges.
4	These schools can be fee-paying or no-fee schools; no-fee schools receive more funding, while fee-paying schools receive less government funding support.
5	These are wealthier schools that charge higher fees and receive the least government funding.

Data Source: Department of Basic Education (DBE).

Health component

The health component uses a risk-adjusted capitation index and outputs data from the public hospitals to estimate each province's share of the health component. The risk-adjusted subcomponent estimates (75 per cent of the health component) consider the percentage of the population with and without medical insurance. While the output subcomponent uses patient load data from the District Health Information Services, it takes into account the average number of visits to primary healthcare clinics (5 per cent of the health component) and each province's share of the total patient-day equivalents at public hospitals (20 per cent of the health component). Developments in the national health insurance reforms, which is currently stalled, could affect how health is funded, including the funding through the health component of the PES (including the weight assigned to the component).

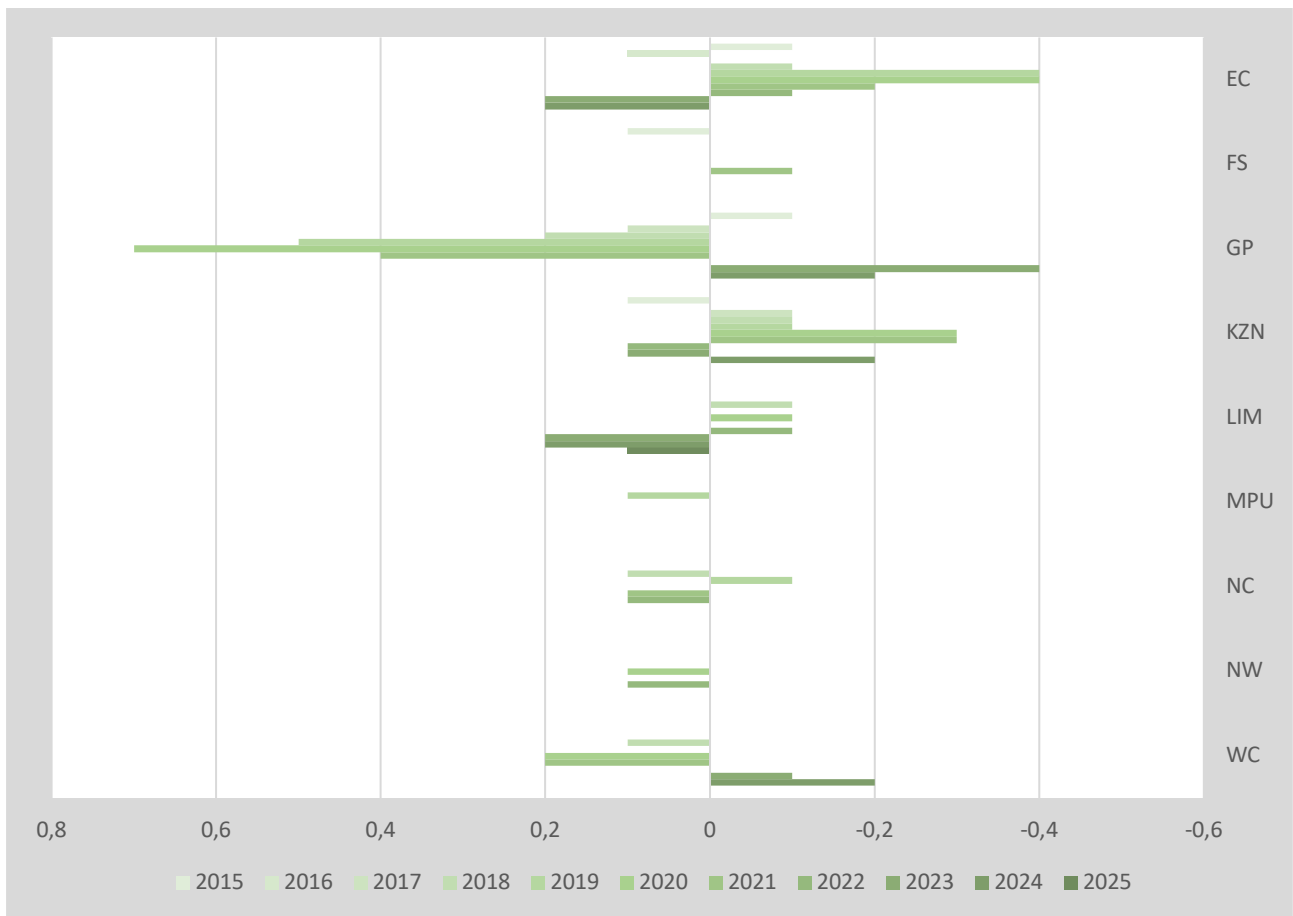
Poverty component

This component is a key part of the formula, especially given that poverty remains a significant challenge in South Africa, with approximately 37.9 per cent of the population estimated to be living below the Lower-Bound Poverty Line as of 2023 (Statistics South Africa, 2025). So, it is estimated that about 23 million people are considered poor and living on less than R1 300 per month in 2023 prices. The poverty component, assigned a weight of 3 per cent, takes into account provincial poverty levels, i.e., the poor population. For this component, the poor population is defined as people who fall within the lowest 40 per cent of household incomes in the 2010/11 Income and Expenditure Survey. The estimated size of the poor population in each province for this component is determined by multiplying the proportion of people in that province who fall into 40 per cent of South African households by the province's population figures for that year. For 2025, for example, to calculate each province's share, the proportion of people who fall into the lowest 40 per cent of household incomes in the 2010/11 is multiplied by each province's population figures for the 2024 mid-year population estimates. A major challenge, therefore, remains that the formula still uses the proportion of people falling in the lowest 40 per cent of household income in 2010/11, even though there is recent data.

4.3 Analysis of the impact of phasing in – Provincial equitable share for provinces

This sub-section provides an analysis of how available data (whether outdated or up to date) is used to determine shares of each province. While the data is available and used to calculate shares for each province, the government does not implement all changes informed by the data; instead, a phased-in approach is used, aiming to achieve the new weighted shares only by the third year of the MTEF period. In this phasing-in approach, only one-third of the impact of the data updates is implemented in the first year of the MTEF.

One of the reasons provided for a phasing-in approach is to provide a smooth path to achieving the new weighted shares by the third year of the MTEF period. This reasoning stems from the assumption that provinces need stable, predictable revenue streams to allow for sound planning. The justification for a phase-in mechanism suggests that provinces may lack the capacity to spend additional funding or could be destabilised by unexpected decreases in funding informed by socio-economic data changes. However, failure to implement the full impact of the data updates contravenes the intergovernmental fiscal principles of predictability and transparency. Therefore, a phase-in approach exacerbates funding challenges and backlog for provinces. Figure 18 illustrates the difference between the shares of the indicated allocation and the shares allocated and shows that full updates are missed in the third year of the MTEF in provinces.

Figure 18: Difference between indicated shares and allocated shares

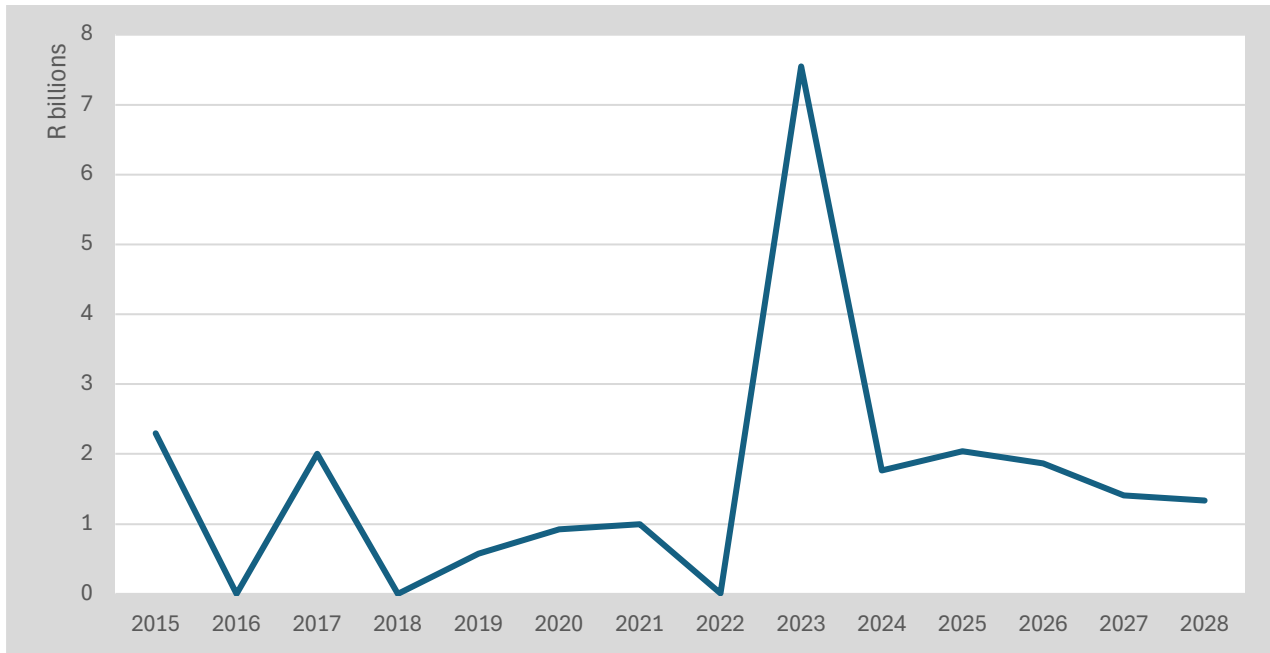
Data Source: National Treasury, 2015 - 2025.

4.4 Quantifying funding allocation outside the Provincial Equitable Share Formula

While only funding determined and calculated by the PES formula should be allocated to provinces using the PES, it is a common practice for the South African government to allocate funding for other specific programmes through the PES. Under the principle, only funding calculated through the PES formula should form part of the PES; other programmes could therefore be funded through other instruments, which include conditional grants. This practice of adding funding for other programmes in the PES for provinces undermines the transparency and predictability of the PES formula. It also raises questions about accountability and monitoring, as funding allocated through the PES is typically not earmarked and lacks a framework with measurable outputs or deliverables. Although the funding is for programmes, it loses its identity once it forms part of the PES. Figure 19 illustrates funding allocated to provinces outside the formula over the period between 2015 and 2027. Figure 19 shows that total funding allocated to provinces outside the PES formula increased from R997 million in

2021 to R7.5 billion in 2023. Contributing to this sharp increase was the addition of funding for two new programmes (Budget Facility for Infrastructure - Coega and the KwaZulu-Natal Izinduna) in the 2023/24 financial year. The allocation of funds through the PES but outside the formula is illustrated in Figure 19.

Figure 19: Funds allocated outside the PES formula between 2015 and 2028 (R billions)



Source: National Treasury, 2015 – 2026.

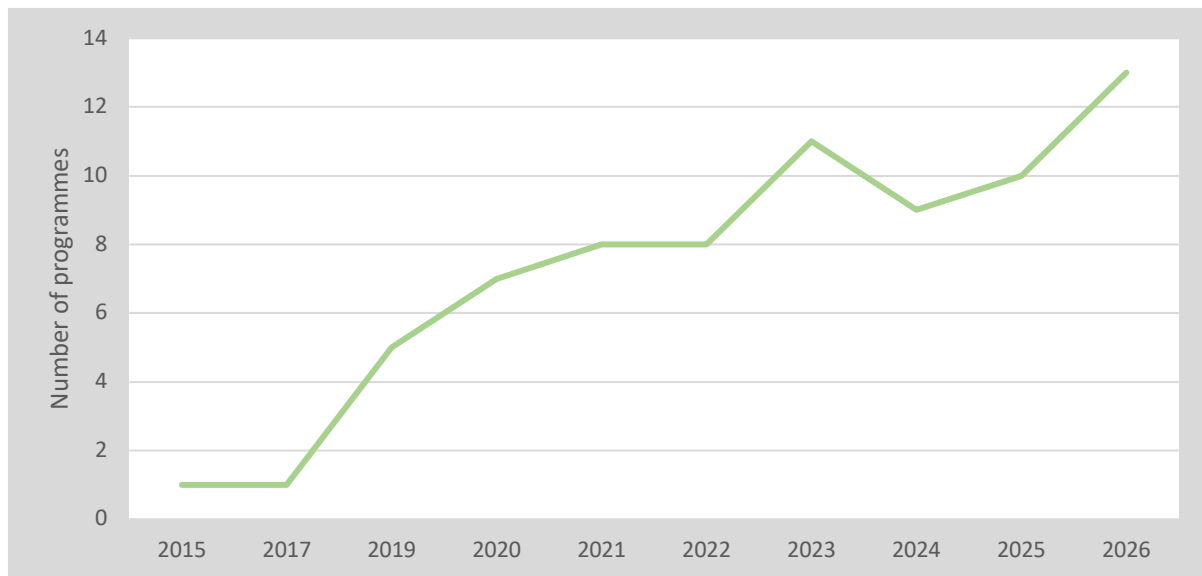
In 2015, only funding for the devolution of property rates was added to the PES allocation for provinces, which was not determined by the formula, and in 2016, no funding was allocated outside the formula. Only funding for the adult basic education programme was added to the PES in 2017, and it was only for one financial year. Table 16 also shows that a number of these programmes, which are highlighted, have been funded in this manner for the past seven years, including the following: Social Worker Employment Grant Shift, Substance Abuse, Sanitary Dignity, and Infrastructure Delivery Improvement Shift. In the 2026/27 financial year, three new programmes have been added: Early Retirement & Voluntary Exit Programmes, grade R equalisation, and reallocation from human settlements grants, increasing the number of programmes funded outside the PES formula to thirteen.

Table 16: Funding allocated outside the provincial equitable share formula by programme between 2015 and 2026

Programme	2015	2017	2019	2020	2021	2022	2023	2024	2025	2026
Social Worker employment grant shift			Y	Y	Y	Y	Y	Y	Y	Y
Social work additional					Y	Y	Y	Y	Y	Y
Food relief shift				Y	Y	Y	Y	Y	Y	Y
Substance abuse			Y	Y	Y	Y	Y	Y	Y	Y
Municipal intervention			Y	Y	Y	Y	Y	Y	Y	Y
GBV & STIs				Y	Y	Y	Y			
Sanitary Dignity Programme			Y	Y	Y	Y	Y	Y	Y	Y
Infrastructure Delivery Improvement Programme Shift			Y	Y	Y	Y	Y	Y	Y	Y
Devolution of property rates	Y									
HIV prevention								Y	Y	Y
Adult basic education		Y								
Education Sector Presidential Employment							y		Y	Y
BFI: Coega							Y	Y	Y	Y
Reallocation from human settlements grants										Y
Izinduna							Y			
Grade R Equalisation										Y
Early Retirement & Voluntary Exit Programmes										Y
Total number	1	1	5	7	8	8	11	9	10	13

Source: National Treasury, 2015 -2026.

Figure 20 shows that there has been an increasing number of programmes funded through the PES determined outside the formula, which increased significantly and reached thirteen (13) in 2026.

Figure 20: The number of programmes outside the Provincial Equitable Share Formula

Source: National Treasury, 2015 - 2026.

4.5 The current structure and evolution of the Local government equitable share

Current structure of the Local Government Equitable Share

The LGES formula was introduced in 1998 to ensure that allocations were objective, transparent, scientific, and immune to political manipulation. Allocation to municipalities through the LGES comprises three parts, each consisting of five components. Part 1 consists of the basic services component, which provides for the costs of providing basic services to poor households. The second part of the formula provides for municipalities with limited resources to afford basic administration and governance capacity and perform core municipal functions (through the Institutional, community services, and the revenue adjustment factor). The third part, through the correction and stabilisation factor, provides stability and predictability, ensuring the formula's guarantees can be met.

The current structure of the LGES formula is as follows:

$$LGES = BS + (I + CS) \times RA \pm C,$$

where

BS - Basic Services component,

I - Institutional component,

CS - Community Services component,

RA - Revenue Adjustment Factor, and

C - Correction and Stabilisation Factor

Since 1998, there have been reviews of the LGES formula, and currently, it has six components, as shown in Table 17.

Table 17: Local Government Equitable Share formula components and brief description

Component	Brief description
Basic services	Helps municipalities provide free basic water, sanitation, electricity, and refuse removal services to households below an affordability threshold.
Institutional	For municipalities to be able to run a basic administration.
Community services	funds services that benefit communities rather than individual households (which are provided for in the basic services component). It includes funding for municipal health services, fire services, municipal roads, cemeteries, planning, stormwater management, street lighting, and parks.
The revenue adjustment factor	A revenue adjustment factor is applied to the institutional and community services components of the formula to ensure that the funds assist municipalities that are least likely to be able to fund these functions from their own revenue.
Correction and stabilisation factor	Municipalities are guaranteed to receive at least 90 per cent of the indicative allocation for the middle year of the MTEF period.

Source: FFC's own compilation.

Evolution of the Local Government Equitable Share

With respect to the LGES formula, the 1998 formula (referred to as the old formula) was continuously reviewed to address various concerns and flaws, and a new formula was introduced in 2013. Table 18 shows the difference between the old and new formulas. Notable difference is the replacement of the development component with community services. The other change introduced relates to the revenue-raising component.

Table 18: Local government equitable share formula: the old and new formula

Old formula	New formula
$LGES = BS + D + I - R \pm C$	$LGES = BS + (I + CS) \times RA \pm C$
Basic services	Basic services
Development component	Community services
Institutional component	Institutional component
Revenue-raising capacity correction	Revenue adjustment factor
Correction and stabilisation factor	Correction and stabilisation factor

Source: FFC's Own compilation.

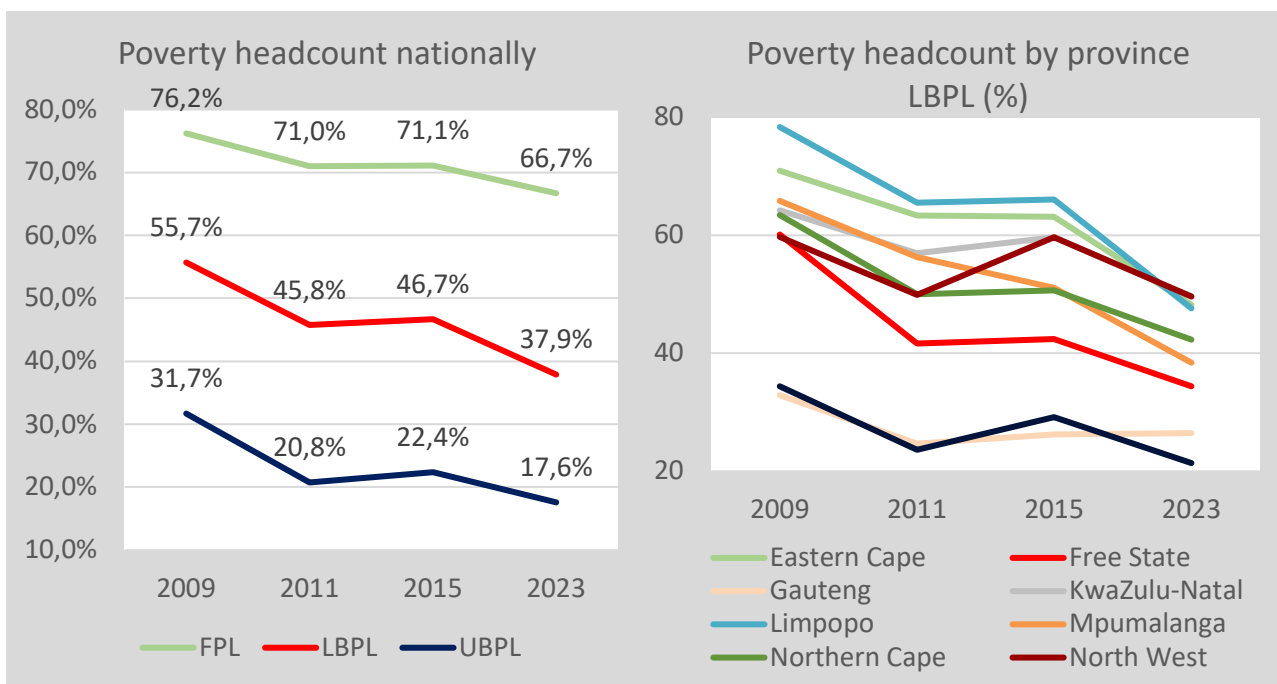
4.6 Data used to determine the Local Government Equitable Share

Among LGES, one key component is the basic services component, which aims to help municipalities provide free basic water, sanitation, electricity, and refuse removal services to households that fall below an affordability threshold. The number of households per municipality and the number below the affordability threshold are key in determining the number of poor households. The LGES for this component uses an affordability measure to determine how many households need or qualify for free basic services, based on the levels of the two state old-age pensions. For example, if the old-age pension per month was R1 150, as in 2011, multiplying it by 2 yields R2 300 to determine a household's affordability.

Poverty levels change over time due to many factors, including changes in the cost of living, inflation, and societal standards. Currently, South Africa has three levels of the National Poverty Lines (food poverty line (FPL), upper-bound poverty line (UBPL), and lower-bound poverty line (LBPL)). It is therefore important to update the national poverty lines regularly to inform policymakers and support resource allocation, ensuring that data and measurements remain relevant and effective in identifying individuals who need assistance.

Data on the national poverty lines show an improvement in South Africa over the past few years, from 2009 to 2023, as the poverty measured by the FPL, and both the UBPL and LBPL, has been declining, as illustrated in Figure 21. Figure 21 shows a decline in poverty headcount nationally and in all provinces except for Gauteng, with an insignificant increase between 2015 and 2023. While Gauteng shows a slight increase in poverty headcount between 2011 and 2023, poverty headcount levels have decreased in all other provinces over this period. This indicates that the use of the 2011 affordability threshold disadvantages some of the Gauteng municipalities but benefits municipalities from the rest of the provinces.

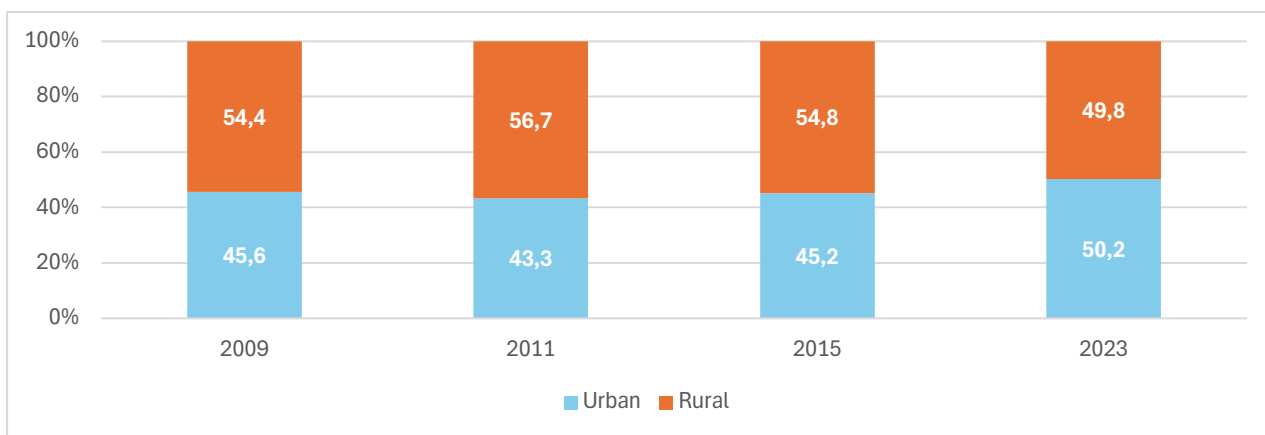
Figure 21: Poverty levels in South Africa



Source: Statistics South Africa, 2025.

With respect to poverty shares by settlement type, Figure 22 shows a declining poverty rate in rural areas, while poverty shares increase in urban areas. This trend could be attributed to urbanisation. Therefore, utilising outdated poverty-level data negatively affects urban settlements more than rural ones, as poverty shares shift due to urbanisation.

Figure 22: Poverty shares by settlement type - LBPL



Source: Statistics South Africa, 2025.

Table 19 shows poverty shares by metropolitan municipalities for the period 2009-2023, with the majority of metropolitan municipalities experiencing decreases, especially between 2015 and 2023. However, for the City of Tshwane, poverty shares have increased.

Table 19: Poverty shares by metropolitan municipalities

Municipality	2009	2011	2015	2023
City of Cape Town	18.4	14.1	16.1	12.7
Buffalo City			4.9	3.7
Nelson Mandela Bay	8	8.6	7	5.1
eThekweni	22.1	26	23.7	22.9
Mangaung		5.7	3.2	3.5
City of Johannesburg	22.3	21.3	17	21.2
Ekurhuleni	17.1	14.1	16.4	14.4
City of Tshwane	12.2	10.2	11.6	16.5

Source: Statistics South Africa, 2025.

The number of households per municipality and the number below the affordability threshold are key in determining the number of poor households. While updated data on poverty levels is key to determining shares for each municipality through the poverty component, for the 2025 poverty component, the proportion of households falling below the government's affordability threshold was still based on the 2011 Census data.

5 Conclusions

Unconditional fiscal transfers to provinces and municipalities are key to ensuring they receive adequate financial resources to deliver on their constitutional mandates. The share for each province from unconditional transfers is determined by the PES formula, while the share each municipality receives is determined by the LGES formula. The findings highlight challenges in implementing both the PES and LGES formulas due to outdated data. With respect to the PES, the government continues to use a phased-in approach, which deprives provinces of the full impact of the data update aimed to be achieved in the outer year of the MTEF. Furthermore, the government continues to allocate funding for other programmes through the PES. Funding for these programmes is not determined by the PES formula, thereby undermining the transparency, credibility, and predictability of the equitable share formula as an intergovernmental fiscal instrument. These are the challenges that must be addressed to ensure intergovernmental fiscal transfers remain equitable, transparent, credible, and predictable.

6 Recommendations

The Commission therefore makes the following recommendations:

11. *Statistics South Africa should prioritise improving the quality, timeliness, and relevance of input data used in the Provincial Equitable Share and the Local Government Equitable Share*

formulae, while National Treasury, in the Division of Revenue Bill, should utilise input data directly provided by Statistics South Africa without subjective selection. This is to maintain the principles of transparency, objectivity, predictability, and fairness that underpin the integrity of intergovernmental fiscal relations and transfers.

The use of outdated data, phased implementation, and off-formula allocations collectively creates uncertainty and weakens trust in the allocation system. In several cases, data that is two to five years old is used to determine current allocations, which fail to reflect rapid changes in migration, urbanisation, and service demand. This results in inequitable allocations, particularly disadvantaging provinces experiencing population inflows.

12. National Treasury should refrain from a multi-year phasing-in approach used to implement changes in provincial allocations in the Division of Revenue Bill and move towards targeted capacity arrangements for provinces that may face challenges in absorbing rapid funding changes through conditional grants, with a clear time limit.

The findings indicate that the gradual implementation of updated data over the Medium-Term Expenditure Framework (MTEF) period delays the full realisation of provinces' funding needs and may result in persistent underfunding in other provinces, particularly in fast-growing regions.

13. For the provincial equitable share formula to remain objective, transparent, and predictable, and to ensure accountability and improve monitoring, the National Treasury in the Division of Revenue Bill should reduce or eliminate the practice of allocating funds through the Provincial Equitable Share that are not determined by the formula (i.e., outside the formula).

Recently, there has been a significant increase in allocations added to the PES that are not determined by the formula. This undermines the objectivity, transparency, and predictability of the intergovernmental fiscal transfer system. The National Treasury should instead channel such funding through appropriate mechanisms, such as conditional grants or clearly defined programmes, to preserve the integrity of the formula-based allocation system and ensure that deviations are justified and transparent.

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Chapter 5

Strengthening Governance in Intergovernmental Fiscal Transfers for Effective Local Service Delivery



Chapter 5: Strengthening Governance in Intergovernmental Fiscal Transfers for Effective Local Service Delivery

Abstract

The study is grounded in the policy framework of the 1998 White Paper on local government and the constitutional obligation outlined in section 154 of the 1996 Constitution, which emphasises cooperative governance and the need to support municipalities' capacity. A blended approach is employed, combining quantitative and qualitative analysis. The quantitative component uses regression techniques and non-parametric tests to assess the relationships among fiscal transfers, service delivery efficiency and governance outcomes. The findings indicate that the effectiveness of intergovernmental fiscal transfers is not primarily constrained by budget allocation levels but by implementation weaknesses. The research concludes that strengthening governance within the intergovernmental fiscal system is critical to improving the effectiveness of fiscal transfers and translating them into sustainable and equitable local service delivery outcomes.

1 Introduction

The intergovernmental fiscal system in South Africa is based on the principles of equity, predictability and efficiency in allocating resources across the three spheres of government. Municipalities, however, face a critical challenge in achieving developmental outcomes partly due to systemic weaknesses in fiscal governance. Misaligned planning and budgeting cycles affect the timeliness, planning and effectiveness of intergovernmental transfers. Local government often finalise their budgets without clear signals on allocation frameworks, while national and provincial departments struggle to align project timelines and release of funds with municipal capacity.

Audit outcomes from the Auditor General of South Africa (AGSA) and National Treasury 'section 71 reports persistently point to transfer payment delays and disruptions to municipal service

delivery, particularly in infrastructure projects. Although the National Treasury uses budget circulars to mitigate these delays, a research gap remains concerning how fiscal governance issues affect planning cycles, cash flow management and accountability mechanisms at the municipal level.

This study is timely, as the 1998 White Paper on Local Government is under review to address governance challenges, improve fiscal relations and restore the local government's developmental role. It investigates the systemic causes and consequences of fiscal transfer governance and coordination failures and aims to provide to provide recommendations for realigning intergovernmental fiscal relations with cooperative governance principles, focusing on both institutional and fiscal dimensions.

2 Problem Statement and Research Focus

2.1 Research Problem and Questions

Despite robust policy and constitutional provisions, many municipalities continue to face service delivery challenges. The infrastructure backlogs, financial management weaknesses and slow project implementation remain common across municipalities. The monitoring systems, such as the National Treasury's section 71 reports, often reveal challenges, including underspending of conditional grants and delays in infrastructure delivery. These trends often raise worries about whether fiscal transfers are effectively translating into improved service delivery at the municipal level. In many cases, challenges appear to stem not only from funding constraints but from the weaknesses in governance and coordination across the three spheres of government.

Research Questions

1. How governance weaknesses within the fiscal transfer system affect municipal service delivery performance?
2. To what extent do intergovernmental fiscal transfers contribute to improved local service delivery outcomes?
3. What institutional and policy reforms can strengthen governance within the intergovernmental fiscal system to improve the effectiveness of fiscal transfers in supporting local service delivery?

3 Research Methodology

3.1 Research Approach

The study employs a combination of both qualitative and quantitative techniques. This method design first interprets institutional arrangements, then statistically validates observed patterns, yielding a comprehensive understanding of fiscal transfers within the South Africa's cooperative governance system. The combined approach enables a holistic assessment of how these transfers function and identifies potential reform to improve their effectiveness.

3.2 Data

Qualitative data includes the 1998 White Paper on Local Government, National Treasury Section 71 Reports and Section 154 of the Constitution. The dataset integrates variables from different sources, including the National Treasury's 2024 Division of Revenue Bill Annexure W6 Part B and Consolidated statement of financial performance, Annexure A - 2024-2025 data, Auditor General South Africa's Consolidated General Report on Local Government Audit Outcomes 2023-24 data and Statistics South Africa's Non-financial census of municipalities for the year ended 30 June 2025 and 2022 Census.

3.3 Limitations of the Study

While the study aims to provide a comprehensive analysis of governance and coordination in intergovernmental fiscal transfers, it is subject to several limitations. The reliability of municipality financial data poses a constraint, as not all municipalities report timeously or accurately, potentially affecting the accuracy of the quantitative findings.

4 Research Results

4.1 Document and Institutional Analysis Discussion

1998 White Paper on local government

The 1998 White Paper on Local Government introduced the idea of developmental local government, identifying municipalities as the primary level responsible for addressing basic service needs and fostering social and economic growth. The White Paper imagined municipalities as dynamic agents of development functioning within a framework of cooperative governance, supported by national and provincial spheres. This vision depended, in part, on effective coordination of intergovernmental fiscal transfers to ensure municipalities received adequate and reliable resources to fulfil their constitutional duties. However, the analysis reveals that, although the 1998 White Paper presented a compelling developmental vision, it failed to adequately account for disparities in institutional capacity across different

municipalities. The expectation that all municipalities would gradually develop the capacity and capabilities to handle complex fiscal and service-delivery tasks was unrealistic.

It assumed that coordination across spheres would be achieved through cooperation, consultation and shared support rather than through enforceable institutional mechanisms. Strong emphasis is placed on shared objectives and aligned planning, but it provides limited detail on how to address governance failures, misalignment or capacity failures. In the context of intergovernmental fiscal transfers, this resulted in a framework in which responsibilities were decentralised, but accountability and coordination mechanisms remained weakly defined. This dependence on voluntary cooperation has proven insufficient in practise, as evidenced by ongoing challenges in aligning fiscal transfers with municipal priorities and implementation capacity. The lack of clearly articulated coordination instruments has contributed to fragmented planning and budgeting across government spheres.

The policy framework established that municipalities would need sustainable and equitable fiscal support to deliver basic services, particularly through intergovernmental transfers. It recognised the importance of both conditional and unconditional transfers in addressing vertical and horizontal fiscal imbalances. However, the framework provided limited guidance on how to design fiscal transfers to balance national priorities with local flexibility. In practice, this has led to a system in which conditional grants dominate the intergovernmental fiscal framework, often accompanied by complex reporting and compliance requirements. While intended to safeguard accountability, this method has constrained municipal independence and limited municipalities' ability to respond to local service delivery needs, thereby undermining the policy document's developmental intent.

Furthermore, an essential pillar of the White Paper on local government was the alignment of Integrated Development Plans (IDPs) with municipal budgeting and service-delivery processes. The document projected IDPs as the key instruments through which national and provincial priorities would be translated into local action. However, the analysis reveals that the institutional linkages between IDPs and intergovernmental fiscal transfers were not clearly specified. As a result, fiscal transfers have often functioned independently of municipal planning frameworks, leading to misalignment between planned projects and available funding. This disconnect has weakened the effectiveness of intergovernmental fiscal transfers as instruments for coordinated service delivery.

The policy framework envisaged a supportive role for the national and provincial governments in building municipal capacity and facilitating coordination. However, the division of responsibilities between support, oversight and intervention was not clearly defined. This uncertainty has contributed to gaps in institutional support, with municipalities often experiencing fragmented or duplicative interventions. The analysis suggests that the policy document on local government underestimated the long-term nature of capacity constraints and over relied on regulatory compliance as a substitute for sustained institutional development.

Overall, the findings signifies that coordination currently observed in intergovernmental fiscal transfers can be traced back, in part, to the initial assumptions of the policy framework. While the theories of developmental local government and cooperative governance remain relevant, the institutional and fiscal coordination mechanisms imagined by the White Paper were insufficiently specified and operationalised.

Ongoing Review of the 1998 White Paper on Local Government

It is important to recognise that the 1998 White Paper on local government is currently under review, reflecting the government's broader acknowledgement that the local government system has undergone significant changes since its adoption. The discussion document (CoGTA, 2025) guiding this review highlights a range of persistent and emerging challenges, including the service delivery backlogs, financial distress in municipalities, weak institutional capacity and fragmentation in intergovernmental coordination. These challenges mirror the issues identified in this study, particularly the disconnect between fiscal transfers and the service delivery outcomes. The review process explicitly recognises that while the 1998 White Paper provided a strong normative and theoretical framework for developmental local government, it did not fully anticipate the increasing complexity of the intergovernmental fiscal system.

By contrast, the draft ongoing review of the 1998 White Paper on local government by (CoGTA, 2026) introduces important reform directions aimed at strengthening the effectiveness of the local government system. These reforms can be further strengthened by incorporating FFC's recommendations for the Division of Revenue over the years, particularly in addressing implementation gaps, strengthening financial governance, addressing coordination challenges and structural inefficiencies.

An essential reform proposal is the shift towards a differentiated local government model, moving away from a uniform approach. This proposal aligns with the Commission's recommendation, which calls for a review of the local government fiscal framework to better account for the differences in revenue-generating capacity, institutional capability and service demands across municipalities. Given that smaller and rural municipalities remain heavily dependent on the intergovernmental fiscal transfers, a differentiated approach is essential to ensure that the fiscal frameworks are responsive to unpredictable local government conditions, including capacity constraints and persistent spending inefficiencies. The proposed transition towards a single-tier local government system, in which the distinction between district and local municipalities is redesigned, also reflects efforts to address fragmentation and improve coordination. This reform is reinforced by the FFC's recommendation to review and potentially repeal section 84 of the Municipal Structures Act to clarify powers and functions between district and local municipalities. The FFC findings support this position, showing that uncertainty in roles and responsibilities within the two-tier system contributes to weak implementation and limits municipalities' ability to achieve their constitutional mandates.

While these reform directions are progressive and align well with empirical findings and policy recommendations, a key concern is the limited articulation of the implementation strategies. Without a clear execution framework there is a risk that these reforms may replicate the shortcomings of the original 1998 White Paper on local government, strong policy intent without sufficient operational clarity. Furthermore, incorporating FFC recommendations into the White Paper on local government review will strengthen the argument that effective reform requires not only conceptual alignment, but also practical, enforceable and well-coordinated implementation mechanisms. This integration supports the study's fundamental argument that improving local service delivery outcomes depends on addressing both structural design issues, coordination and governance failures within the intergovernmental fiscal system.

National Treasury Section 71 Reports

National Treasury's section 71 reports prepared in terms of the MFMA are significant tools for monitoring municipalities' monthly financial performance. The reports track revenue collection and expenditure trends, cash flow and conditional grant spending and aim to provide early warning signals to enable corrective action. The analysis reveals essential insights into the operation of intergovernmental fiscal transfers and the nature of coordination challenges affecting local service delivery.

A dominant and recurring finding across all reviewed financial years is the systematic underspending of conditional grants, particularly those linked to infrastructure and basic service provision. While section 71 reports often cite immediate causes such as procurement delays, late project implementation, persistent challenges over multiple years suggest deeper institutional and governance failures. Rather than reflecting short-term shocks, the repeated underspending points to misalignment between grant design, municipal capacity and implementation timelines. This indicates that conditional grants are frequently structured without sufficient consideration of local institutions' realities, undermining their effectiveness as instruments for service delivery.

The analysis highlights that the timing and flow of intergovernmental transfers remain a significant coordination challenge. While transfers are scheduled according to the DoRA, section 71 reports reveal uneven expenditure patterns across financial year with spending often accelerating towards the final quarters. Such patterns reduce the effectiveness of fiscal transfers, increase the risk of rushed spending and compromise value for money. They also undermine the intent of in-year monitoring, as early warnings do not consistently translate into timely corrective action by either municipalities or supporting spheres of government.

The review proves that section 71 reporting is heavily compliance-oriented, focusing primarily on financial inputs and expenditure ratios. While this approach strengthens fiscal discipline and transparency, it provides limited insight into whether transferred resources translate into improved service delivery outcomes. This compliance-driven orientation reinforces a misalignment in which national oversight prioritises control and reporting, while municipalities focus on meeting expenditure and reporting requirements rather than achieving developmental outcomes.

The reports repeatedly note capacity-related constraints, particularly in smaller and rural communities. However, the monitoring framework applies largely uniform reporting compliance expectations across municipalities with vastly different institutional capacities. This lack of differentiation exacerbates coordination challenges as municipalities with weaker capacity struggle to meet requirements designed for stronger institutions. The analysis suggests that without differentiated fiscal instruments and targeted support, intergovernmental fiscal transfers risk reinforcing existing inequalities in service delivery performance rather than addressing them.

Section 154 of the 1996 Constitution of the Republic of South Africa

This section of the Constitution requires national and provincial governments to support and strengthen municipalities' capacity to manage their own affairs, exercise their powers and perform their functions. This provision is an important element of the cooperative governance system and recognises that municipalities may face institutional, technical and financial constraints that require assistance from the higher government spheres. It establishes a constitutional obligation to proactive support, rather than reactive oversight. The national and provincial governments are expected to create an enabling environment that allows municipalities to fulfil their development mandate, particularly in relation to the provision of basic needs.

In the context of intergovernmental fiscal relations, section 154 emphasises that fiscal transfers should not be viewed solely as financial allocations; rather, they should be part of a broader support framework aimed at strengthening municipal capacity and service delivery performance. The intergovernmental transfers are designed to address vertical fiscal imbalances and ensure that municipalities have adequate resources to deliver basic services. However, transfers alone may not be sufficient to achieve this objective. Effective service delivery also requires institutional governance, internal coordination, technical expertise and administrative capacity. The evidence from the monitoring systems indicates that municipalities often face challenges in project implementation, financial management and infrastructure delivery. These challenges highlight the need for coordinated support mechanisms that accompany fiscal transfers. Without such support, municipalities may struggle to utilise the allocated resources effectively, leading to delayed projects or persistent underspending.

4.2 Econometric Analysis of Water Services Infrastructure Grant

Service Delivery Efficiency

The regression analysis shows no statistically significant relationship between Water Services Infrastructure Grant (WSIG) allocations and service delivery variables such as the number of water beneficiaries and water losses. The estimated coefficients are statistically insignificant, and the model's explanatory power is very low, indicating that variations in transfer allocations do not meaningfully explain variations in service efficiency. The effectiveness of the transfers depends on complementary functions such as infrastructure maintenance, asset management and technical operation. These functions lie primarily within municipal administrative capacity but require coordination with provincial oversight and national programme design. The absence of the relationship indicates a disconnect between fiscal transfers and operational outcomes.

Infrastructure funding may be provided, but without coordinated planning, maintenance capability and technical support, municipalities may not realise efficiency gains.

Table 20: Regression Models on Water Losses and WSIG Allocations

Model Specification	R-Squared Value
OLS: Water losses- WSIG per indigent	0.04
OLS: Water losses- WSIG per beneficiary	0.08
OLS: Water losses- WSIG per beneficiary	0.22

Source: Financial and Fiscal Commission's calculations

The regression models on Table 20 shows low explanatory power, with r-squared values ranging from 0.04 to 0.22 and no statistically significant predictors. Increasing infrastructure grant per indigent or per beneficiary does not automatically reduce water losses, suggesting that budget allocation levels alone are insufficient to justify service delivery outcomes. This points to coordination, weak municipal technical capacity and governance issues as more decisive factors in successfully managing water systems rather than financing shortages.

Governance Outcome

The multinomial logit results similarly show that WSIG allocations do not significantly influence audit results. Municipalities receiving bigger transfers are not more likely to obtain improved audit outcomes. Since audit outcomes reflect financial management systems and internal controls, this indicates that transfers alone do not strengthen governance capability. This outcome reflects the institutional structure of intergovernmental relations. The national government provides financing, municipalities manage implementation and provinces perform oversight. However, transfers do not automatically improve administrative systems unless accompanied by coordinated capacity support.

Across both service efficiency and governance performance, empirical evidence consistently shows no measurable improvement associated with larger transfers. Instead, it indicates that transfers operate within a system where administrative and operational functions are weakly integrated. Fiscal transfers correct vertical imbalance but do not correct institutional imbalance. Effective service delivery requires alignment between three spheres of government.

Table 21: Regression Models on Audit Outcomes and Fiscal Transfers

Model Specification	Pseudo R-Squared Value
Logistic Regression (Binary: Clean/Unqualified vs. Others)	0.134
Multinomial Logistic Regression (Multiple Audit Categories)	0.32

Source: Financial and Fiscal Commission's calculations

Table 21 shows logistic regression produced an R-squared of 0.134 with no significant predictors, while multinomial logit models yielded a Pseudo-R-squared of approximately 0.32 but again failed to yield statistically significant results. Municipalities with clean audits did not receive different funding than those with qualified or adverse opinions, indicating that institutional compliance and accountability mechanisms are more important drivers of audit performance than fiscal inputs.

Diagnostic Tests

Table 22: Statistical Test Results

Statistical Test	P- value range
Chi-square Test of Independence	0.325
Kruskal–Wallis Test	0.40–0.82

Source: Financial and Fiscal Commission's calculations

Provincial differences were also examined using Chi-squared tests. The results revealed no significant association between province and audit outcomes. This highlights governance challenges across government spheres, where uneven allocation patterns do not translate into measurable differences in outcomes.

Kruskal–Wallis tests confirmed that WSIG allocations did not vary significantly across audit categories, with p-values ranging between 0.40 and 0.82. This demonstrates that funding levels do not distinguish municipalities with clean audits from those with qualified or adverse opinions, supporting the conclusion that governance quality, oversight and coordination mechanisms are the missing links.

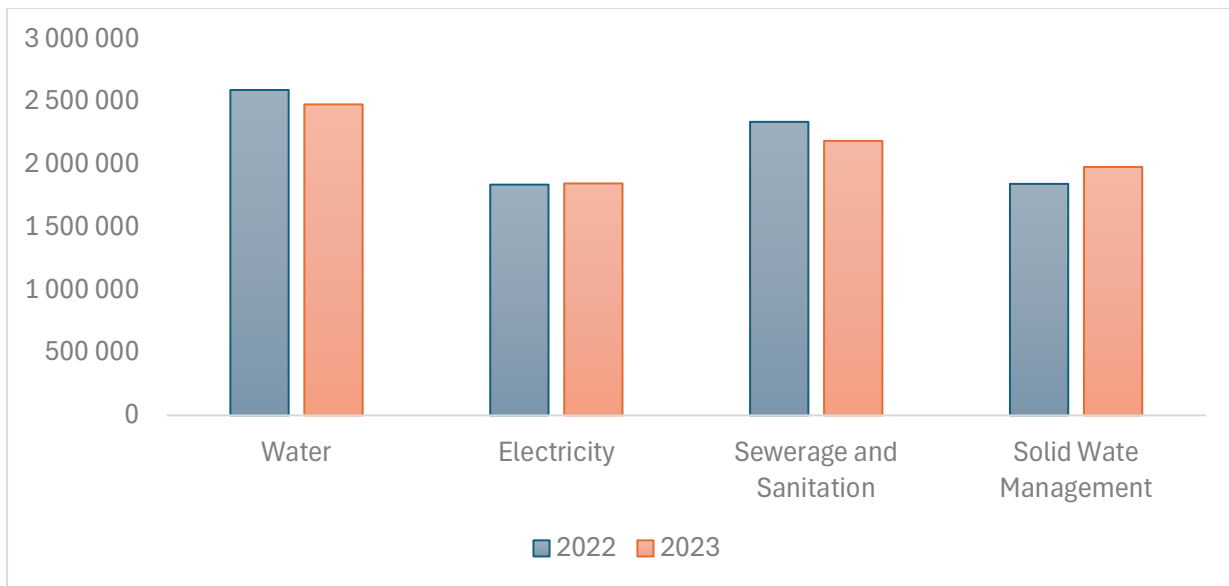
4.3 Trend Analysis

Access to Free Basic Services

This section explores the relationship between intergovernmental fiscal transfers and the actual delivery of basic services at the municipal level, focusing on how effectively conditional grants

translate into expanded access for households. Local government’s mandate is to provide essential services, especially to indigent households. These services are partially funded through conditional grants such as the Municipal Infrastructure Grant (MIG) and WSIG. The effectiveness of these grants depends not only on adequate funding but also on coordination between the three spheres of government. Coordination failures such as poor planning, alignment, fragmented oversight and implementation delays can hamper the service delivery outcomes.

Figure 23: Access to Free Basic Services 2022 -2023



Source: Non-financial census of municipalities, 2023 and the FFCs calculation

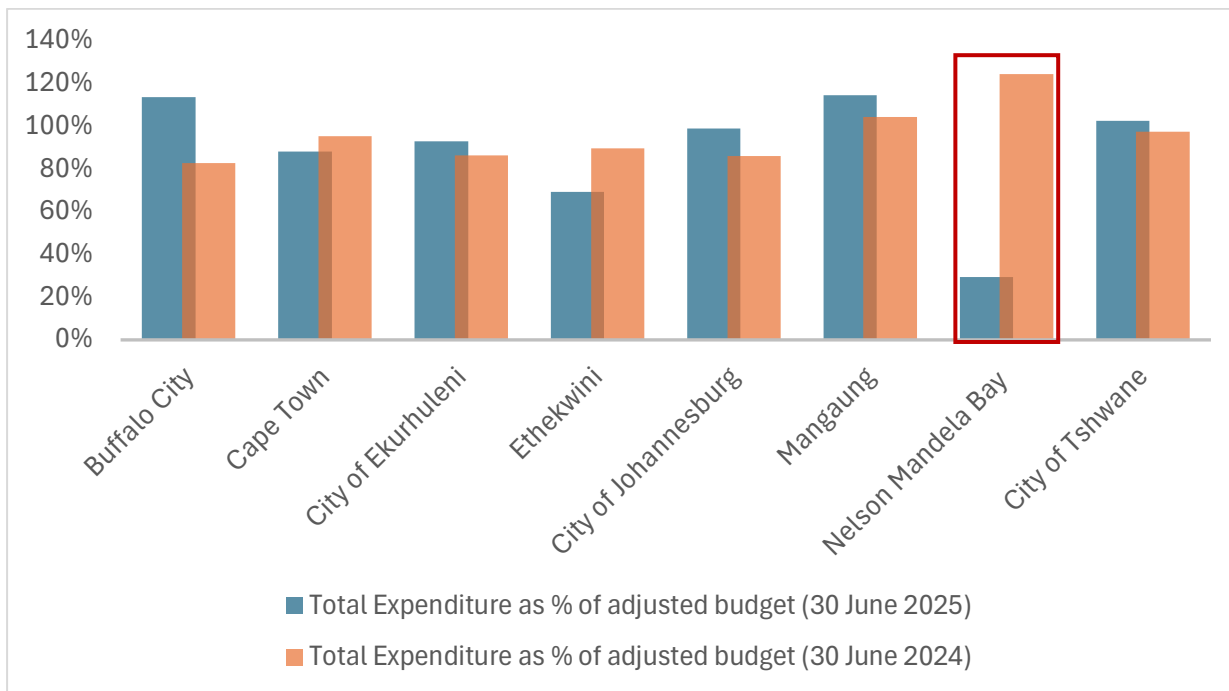
Figure 23 compares the number of households receiving four key free basic services in 2022 and 2023. The graph shows marginal improvements in access to electricity and solid waste management, the latter registering the highest growth of 7.3 per cent despite not being directly tied to a major conditional grant. Water, Sewerage and Sanitation experienced a slight decline, even though these are the focus of significant conditional grant allocations, such as MIG and WSIG. This suggests that high grant spending does not always translate into improved service delivery, particularly where governance and coordination are weak. The decline in sanitation coverage may reflect institutional challenges flagged in the AGSA report, which highlighted poor project execution and misalignment between infrastructure planning and community needs. These findings underscore how governance and coordination failure can weaken the intended impact of fiscal transfers.

Metros Service Delivery Performance and Spending Efficiency

Metros are the engines of public service delivery, responsible for critical services such as water provision, electricity distribution, sewerage systems and solid waste management. The financial

and operational performance of Metros directly impacts the quality of life of millions of South Africans. To assess how metros are effectively managing the delivery of basic services, an analysis of budget expenditure trends across three key service functions such as water management, energy sources and wastewater services, offers insights into both efficiency and areas of concern. Comparing actual spending to adjusted budgets helps to determine whether funds are being used effectively, while changes from the previous year provide context on whether performance is improving or falling.

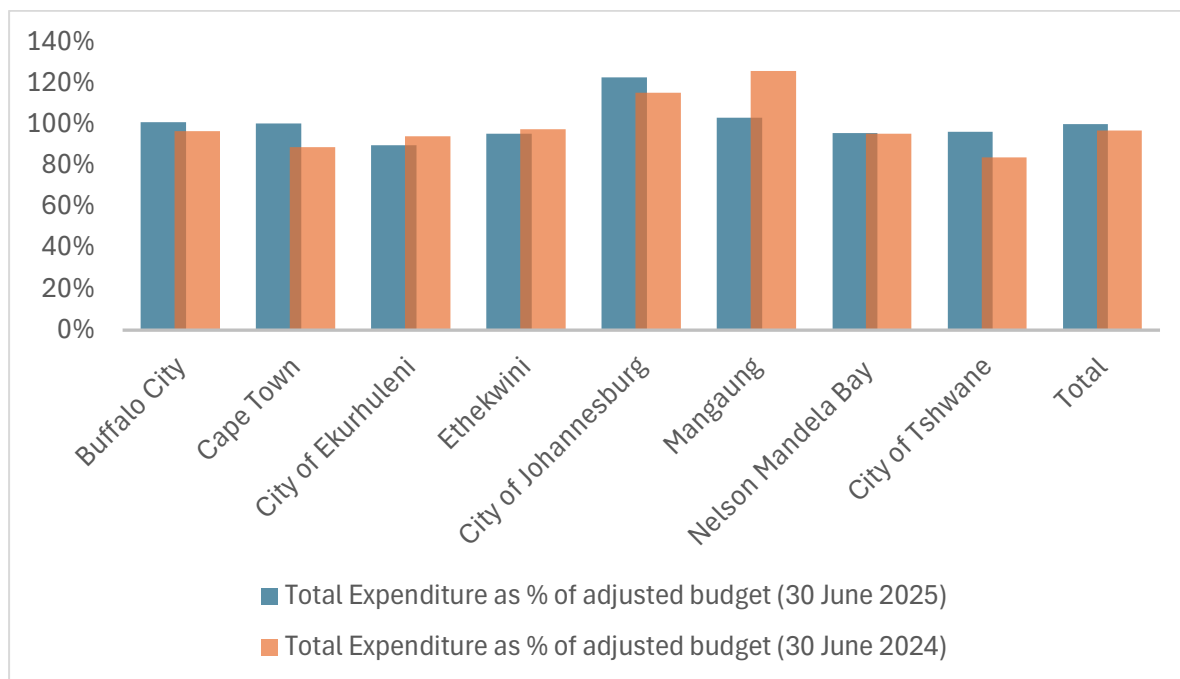
Figure 24: Water Management Expenditure Performance



Source: Consolidated statement of financial performance, 2024-2025 and the FFC’s calculation

Figure 24 reveals persistent underperformance in water management expenditure. Nelson Mandela Bay again lagged, with spending below and 29 per cent of their adjusted budget. These consistent shortfalls raise concerns about systemic challenges in project implementation, such as governance or poor interdepartmental coordination.

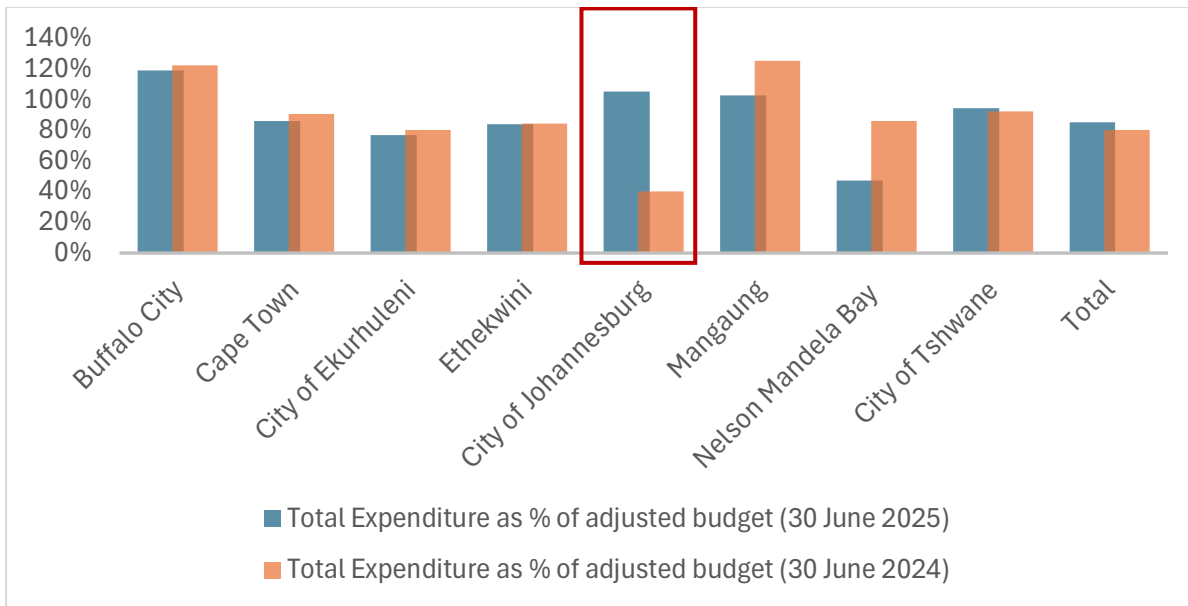
Figure 25: Energy Sources Expenditure Performance



Source: Consolidated statement of financial performance, 2024-2025 and the FFC's calculation

Figure 25 illustrate varying levels of expenditure performance across metropolitan municipalities for energy sources. Large metros such as Johannesburg achieved expenditure exceeding 100 per cent of their adjusted budgets, suggesting full delivery of their planned programmes. In contrast, metros like Ekurhuleni spent below 90 per cent of its budget, highlighting potential procurement delays or project rollout challenges.

Figure 26: Wastewater and Management Expenditure Performance



Source: Consolidated statement of financial performance, 2024-2025 and the FFC's calculation

As demonstrated by the ongoing water crisis in the City of Johannesburg, budget execution does not equate to service delivery reliability. Despite City of Johannesburg expenditure performance appearing stable, residents have experienced prolonged water outages and persistent demand-supply gaps. Buffalo City and Mangaung overspent their adjusted budgets in the last quarter of the 2024/25 financial year, suggesting either under-budgeting or unplanned cost escalations in service delivery. Figure 26 signals inconsistencies in municipal capacity to absorb allocated funds effectively, which may reflect governance, coordination issues and operational inefficiencies in water service delivery.

5 Conclusion

The findings of this study provide a comprehensive understanding of the relationship between policy design, constitutional responsibilities, fiscal monitoring systems and the practical outcomes of intergovernmental fiscal transfers in the local government system. 1998 White Paper on local government established the foundational vision of developmental local government, placing municipalities as fundamental players in promoting socio-economic development and improving service delivery. The policy framework articulated principles of cooperative governance and intergovernmental coordination to guide the progress of the intergovernmental fiscal system. Notably, the 1998 White Paper did not ignore coordination, it set out comprehensive principles and responsibilities while anticipating that the operational mechanisms for coordination would occur progressively as the intergovernmental system matured.

Section 154 of the 1996 Constitution reinforces this policy vision by imposing a clear constitutional obligation on national and provincial governments to support and strengthen municipalities' capacity to manage their own affairs and carry out their functions. This provision establishes support to municipalities as a core feature of the cooperative governance framework and implies the need for well-coordinated institutional arrangements across the three spheres of government. In practise, however, the findings from the Section 71 analysis show ongoing challenges in municipal financial performance, including underspending of conditional grants and weaknesses in expenditure management. These results demonstrate that while monitoring systems are effective at identifying financial concerns, they are less effective at initiating prompt, well-coordinated measures, thereby lessening the impact of fiscal transfers on service delivery.

The empirical findings further confirm the document analysis conclusions and econometric tests reveal that higher grant allocations do not automatically translate into improved operational outcomes, such as reduced water losses and stronger audit outcomes. The lack of a statistically significant correlation between budget allocations, service delivery and governance indicators indicates that fiscal transfers alone are insufficient to ensure effective municipal performance. Instead, the key constraint lies in the governance and the coordination of responsibilities across national, provincial and local governments, particularly the separation between financing, oversight and implementation functions.

These findings highlight the critical importance of strengthening intergovernmental governance mechanisms. Fiscal transfers must be integrated with technical support, capacity building and institutional oversight to function as effective governance tools rather than purely financial instruments. Greater alignment between the national policy design, provincial oversight and municipal implementation capacity is essential to ensure that infrastructure investments translate into service delivery improvements.

6 Recommendations

The Commission makes the following recommendations:

14. *The National Treasury along with the Department of Cooperative Governance and Traditional Affairs should enhance its monitoring tools, particularly Section 71 reports of the Municipal Finance Management Act, into active instruments of governance, coordination and support rather than purely compliance-based reporting mechanisms.*

The findings show that while section 71 reports consistently identify risks such as underspending and delays, these early warnings rarely trigger effective, coordinated interventions during the financial year. As a result, National Treasury and CoGTA should therefore introduce an automatic early-warning intervention system, where identified risks prompt coordinated responses involving national, provincial, and local stakeholders to support implementation and prevent persistent failures. This approach will transform Section 71 reports from a mere compliance tool into an instrument for timely support, enhanced coordination and more effective utilisation of intergovernmental fiscal transfers for service delivery.

15. The National Treasury should embed the institutionalisation of governance, coordinated planning and budgeting across the three spheres of government in the Division of Revenue Bill clauses and the Intergovernmental Fiscal Relations Act, as the findings show that misaligned planning cycles and weak communication between national, provincial, and local government significantly undermine the effectiveness of fiscal transfers.

Municipalities often finalise budgets without clear and timely information on allocations, while national and provincial departments struggle to align project timelines with local planning processes. Treasury should therefore establish synchronised planning frameworks and enforce alignment between national budget cycles, provincial allocations, and municipal IDPs, ensuring that fiscal transfers are both predictable and responsive to local planning needs. This will strengthen the link between fiscal transfers and service delivery outcomes by ensuring that financial resources are rooted within consistent, well-coordinated planning and implementation systems.

16. National Treasury should redesign conditional grants in collaboration with CoGTA and sector departments such as Water and Sanitation to be simpler and flexible in the Division of Revenue Bill clauses and conditions in the grant frameworks, to better reflect and respond to differentials in municipal capacity, governance and coordination requirements.

The analysis reveals persistent underspending and uneven absorption rates, particularly in grants that require complex multi-sphere coordination, such as infrastructure and water-related grants. National Treasury should therefore simplify grant design, improve the predictability of funding flows, and introduce differentiated approaches that consider varying municipal

capacities. This includes providing integrated technical support, multi-year planning stability, and clearer implementation guidelines to ensure that funds translate into actual service delivery.

The empirical results from the WSIG analysis show that there is no statistically significant relationship between grant allocations, service delivery improvements and governance outcomes. This shows the current design of the conditional grants does not adequately account for differences in municipal capacity and the coordination challenges that affect implementation. The analysis of the 1998 White Paper on local government and institutional frameworks highlights that though roles and responsibilities are defined, the system lacks tools to ensure alignment among funding, planning and execution. This results in municipalities with limited capacity struggling to utilise funds allocated effectively, translating to underspending and implementation delays. Redesigning conditional grants to include capacity issues and coordination requirements would enable more realistic planning, fund utilisation, and improve the effectiveness of fiscal transfers.

17. By Section 154 of the Constitution, National Treasury should conditionalise specific national transfers on supports from national and provinces to local government in the Division of Revenue Bill, to strengthen capacity-building and differentiated support incentives. Particularly for weaker and rural municipalities that face structural constraints.

The findings show that uniform compliance and reporting requirements do not account for differences in institutional capacity and may exacerbate existing inequalities. Treasury should therefore adopt a more differentiated approach to fiscal transfers and oversight, combining financial support with targeted technical assistance, institutional development, and coordinated interventions tailored to municipal capacity levels.

The uniform approach to fiscal transfers as envisioned in the 1998 White Paper on local government does not adequately address the disparities in municipalities. Strengthening capacity building and adopting a differentiated approach would ensure that the support is tailored to the specific needs and municipalities' constraints in line with section 154 of the 1996 Constitution.

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