FINANCIAL
AND FISCAL
COMMISSION

Financial and Fiscal Commission
Submission on the 2024 Budget

For an Equitable Sharing of National Revenue

25 February 2024

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Contents

1. Budget 2024 and the State of the Nation Address

1.1. This submission marks the thirtieth anniversary of our nation and the inception of the Financial and Fiscal Commission in the 1994 Interim Constitution of South Africa (1993). Per our Constitution and the relevant legislative prescripts, the submission encompasses the Commission's recommendations to Parliament, provincial legislatures, and other authorities designated by national legislation concerning financial and fiscal affairs, including revenue trends, tax proposals, the Division of Revenue Bill, and the Appropriation Bill. Specific provisions are found in Sections 214, 218, 228, 229, and 230 of the Constitution of the Republic of South Africa (1996), Section 35 of the Intergovernmental Fiscal Relations (IGFR) Act (1998), and S4(4c) of the Money Bills Amendment Procedure and Related Matters Act, also known as MBAPARMA (Act 9 of 2009), as amended.

1.2. This submission represents three decades of South Africa’s accomplishment as a unified democratic nation in the last decade of the 20th century, with strong federal features of intergovernmental fiscal relations (IGFR) system. It underscores the role of the Commission as the sole constitutional entity mandated to advise and oversee the nation's financial and fiscal affairs within the IGFR framework, ensuring the efficient and equitable division of nationally raised revenue.

1.3. During the 2024 State of the Nation Address (SONA) delivered by President Ramaphosa, the message of growth, the advancements in equality, access to basic infrastructure and public services, economic empowerment of the vulnerable, and the promotion of human rights emerged. Most importantly, progress in reducing the poverty rate through the strengthening of social safety nets.

1.4. However, amidst these strides, the President’s address also recognised significant challenges facing our nation, both externally as well as internally. Escalating tensions and conflicts between nations in the northern hemisphere, rising instability in the Middle East, and the trade sanctions in the East. Internally, the sluggish economic growth, elevated levels of youth unemployment, state capture, and gender-based discrimination and violence continue to persist.

State of the Nation Address and the 2024 Budget

1.5. In the State of the Nation Address (SONA) preceding the 2024 General Election, President Ramaphosa issued a series of strategies to address these challenges. These strategies encompass efforts targeted at the development of the youth, broadening the accessibility to basic services, extending the Social Relief of Distress (SRD) grant to alleviate economic hardship, and a resolute pledge to eradicate state capture.

1.6. Since the last election, the current administration has placed a high emphasis on fighting **state capture** and **corruption**. In pursuit of this objective, a specialised directorate has been constituted as a permanent body, endowed with comprehensive investigative authority, capabilities, and power. Efforts are also in progress to enact new legislation aimed at enhancing the nation's capacity to thwart money laundering and fraud, with the ultimate aim of preventing future instances of state capture and facilitating South Africa's removal from the Financial Action Task Force's "grey list." These commitments shall be ear-marked in the 2024 Budget.

1.7. The President accurately noted the substantial **growth** of our economy, which has tripled in size over the past 30 years, accompanied by a rise in employment from 8 million in 1994 to nearly 17 million today. Despite the challenges posed by the Covid-19 pandemic and associated temporary shutdowns, **employment** levels remain higher than before. Further to this, targeted funding initiatives aimed at stimulating economic reforms have been introduced with budget implications, complemented by investment drives and infrastructure-led growth programs, which are expected to boost the economic and fiscal outlook in the long-term.

1.8. The national energy crisis committee has devised a comprehensive plan to address the debilitating effects of **load shedding** and persistent electricity shortages, including leveraging private investments to achieve an optimal energy mix. This plan involves a substantial debt relief package to ensure the long-term sustainability of infrastructure, particularly for Eskom. Additionally, the restructuring of the electricity sector will see the implementation of over 120 new private energy projects and the construction of more than 14,000 kilometres of transmission lines to accommodate renewable energy sources over the next few years over the 2024 Medium-Term Expenditure Framework (MTEF).

1.9. Regarding **climate change** and energy preparations, investments in the just energy transition to reduce carbon emissions and stimulate economic activity through alternative energy generation and innovation have increased from R170 billion in 2023 to R240 billion in 2024. South Africa is also forging partnerships with other nations to champion this energy revolution through international relations and campaigns, with budget implications for the relevant departments.

1.10. In the realm of **transportation** and the **Internet of Things (IoT)**, the government has outlined a clear roadmap to stabilise Transnet's performance and reform the logistics system to revitalise five strategic corridors crucial for export activities. Additionally, data costs have decreased, and internet accessibility has improved following the government's auction of broadband spectrum as own revenue generated from the sale.

1.11. New funding mechanisms will be deployed to boost infrastructure construction and enhance **water** resource management and sanitation. A significant increase in formal dwellings and access to clean water has been achieved, with 9 out of 10 households now living in formal housing and clean water access rising from 6 out of 10 in 1994 to 9 out of 10 presently. Modernisation efforts in the **mining** rights licensing system are also underway, including the launch of an exploration fund to support new miners and exploit untapped mineral deposits in the 2024 Budget.

1.12. Through policy interventions, approximately 25 percent of **farmland** in South Africa is now owned by black South Africans, bringing the nation closer to its target of 30 percent ownership by 2030. Over the past five years, the administration has provided funding and support to around 1,000 black industrialists with budget implications.

1.13. No-fee schools are increasingly contributing to higher bachelor pass rates, with fewer learners dropping out, reflecting the government's commitment to quality **education** and support learning systems, such as early childhood development programs. These initiatives are crucial to enhance human development, reduce **poverty**, and promote inclusivity. Notably, the poverty rate has declined from 71% in 1993 to 55.5% in 2020, with wage increases benefiting over 6 million people and the Social Relief of Distress (SRD) grant assisting 9 million individuals monthly. Efforts to extend and enhance these pro-poor policies and redistributive mechanisms are underway, which are to be detailed in the appropriations to the departments in 2024.

1.14. To address the escalating cost of living, structural **poverty**, and hunger, R36 billion has been allocated to extend the SRD grant for another year. Existing social grants and benefits will also be improved. The National **Health** Insurance (NHI) bill has been passed and will be implemented incrementally, modifying the IGFR system for universal access to healthcare and funding. **Law enforcement services** have undergone substantial expansion, with a focus on economic empowerment for women to combat discriminatory gender-based violence. Around R21 billion will be allocated over the medium term to strengthen the criminal justice system through new legislation. These should find expressions in the 2024 Budget.

Summary of Findings on the 2024 Budget with respect to the SONA

1.15. The Commission appreciates the considerations of its recommendations made in the past 30 years by the legislature and government's implementation. The Commission uplifted the first Budget of the Government of the National Unity and public finance accountability report under the negotiated constitutional order. After a prolonged recession which began in 1989, in 1993, South Africa saw spurts of growth, with 5 to 7 per cent in seasonally adjusted and annualised growth rate in output measured from quarter to quarter.

1.16. At that time, the State Revenue Account recorded total revenues of approximately R89.2 billion, with expenditures reaching R114.7 billion, leading to a budget deficit of R25.4 billion. This necessitated financing of R25.1 billion, equivalent to 28.5% of the revenue budget for the 1994/95 fiscal year. In contrast, contemporary figures show South Africa's main budget revenue exceeding R1.8 trillion and expenditures amounting to R2.1 trillion, resulting in a deficit of R320.9 billion (National Treasury, 1994 & 2024). Additionally, the exchange rate of the South African Rand to the US dollar has shifted from R3.54 to R18.53 in November 2023, as reported by the South African Reserve Bank (SARB) in 2024. When considering the ZAR-USD exchange rate as a benchmark, it is evident that South Africa's fiscal budget has escalated by nearly 250% over the past three decades, from R114.7 billion to R401.2 billion. This raises a critical question: whether the expansion in public expenditure has been matched by corresponding improvements in the quantity, quality, and delivery of public goods and services.

1.17. On the related note of foreign exchange reserves, the purpose of the **Gold and Foreign Exchange Contingency Reserve Account (GFECRA)** is crucial as a buffer to insulate the central bank's profit-and-loss statement from swings in our exchange rate. The gains derived from the account is due to the losses of value and depreciation of the Rand against the US dollar, not a real profit or asset. It would cost South Africa the same exchange rate to regain the foreign reserves unless the Rand appreciates. Hence, the use of GFECRA to the tune or R150 billion over the MTEF is in effect weakening South Africa's strategic position and capability to stabilise our currency value in an increasingly volatile world economy, and South Africa's financial and fiscal integrity. To account for this, the Commission supports the agreement as the **GFECRA Defrayal Amendment Bill** that will ensures retaining sufficient funds to absorb exchange rate swings, with the obligation for the National Treasury to cover exchange rate losses, and calls upon National Treasury to tighten even further the fiscal expenditure and consolidate with a non-diverted purpose to increase economic productivity and growth.

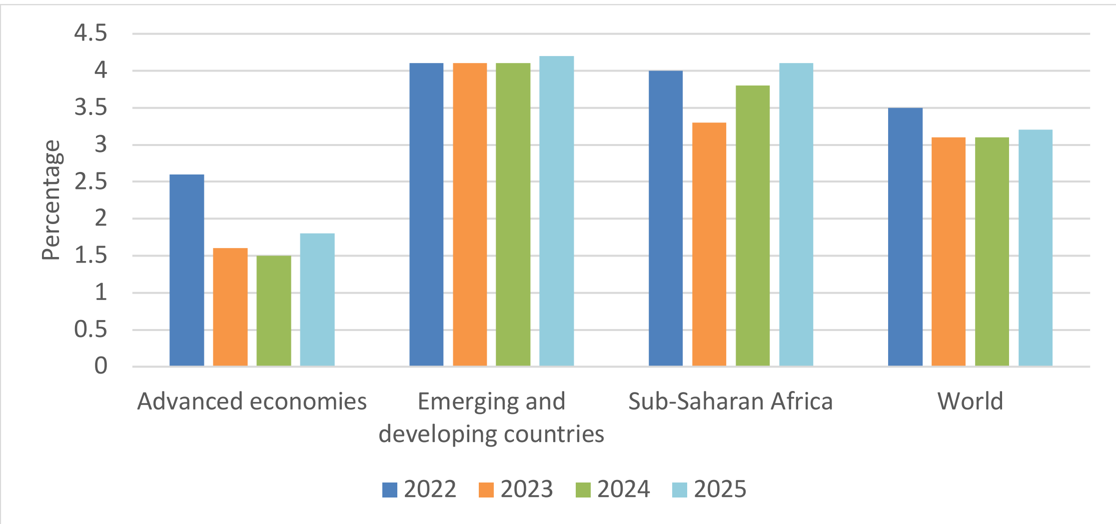
2. Economic Overview and the 2024 Fiscal Framework

Global Economic Growth and Inflation

2.1. The global economic landscape is shaped by a confluence of factors, including rapid technological advancement and pervasive economic uncertainty stemming from the simultaneous occurrence of two critical crises: climate change and widespread conflict. The year 2024 heralds a significant geo-economic transformation, as a series of sixty-four (64) pivotal elections worldwide will reconfigure the global economic landscape for the foreseeable future. These electoral contests, representing the interests of nearly half of the world's population and gross domestic product (GDP), are poised to engender heightened volatility, exerting profound influence on public policy across the tumultuous globe.

2.2. The *January 2024 International Monetary Fund (IMF) World Economic Outlook* projects global growth for 2024 at 3.1 per cent, sustained by the unexpected strength in the United States and a few key emerging market and developing economies and fiscal stimulus, particularly in China. IMF projects global growth to pick up to 3.2 per cent in 2025. Advanced economies are expected to experience a slight slowdown, from 1.6 per cent in 2023 to 1.5 per cent in 2024, followed by a recovery to 1.8 per cent in 2025. These projections reflect stronger-than-expected growth in the United States but slower growth than anticipated in the euro area. Emerging markets and developing economies are expected to reach 4.1 per cent in 2024 before rebounding to 4.2 per cent in 2025 (See Figure 1 below).

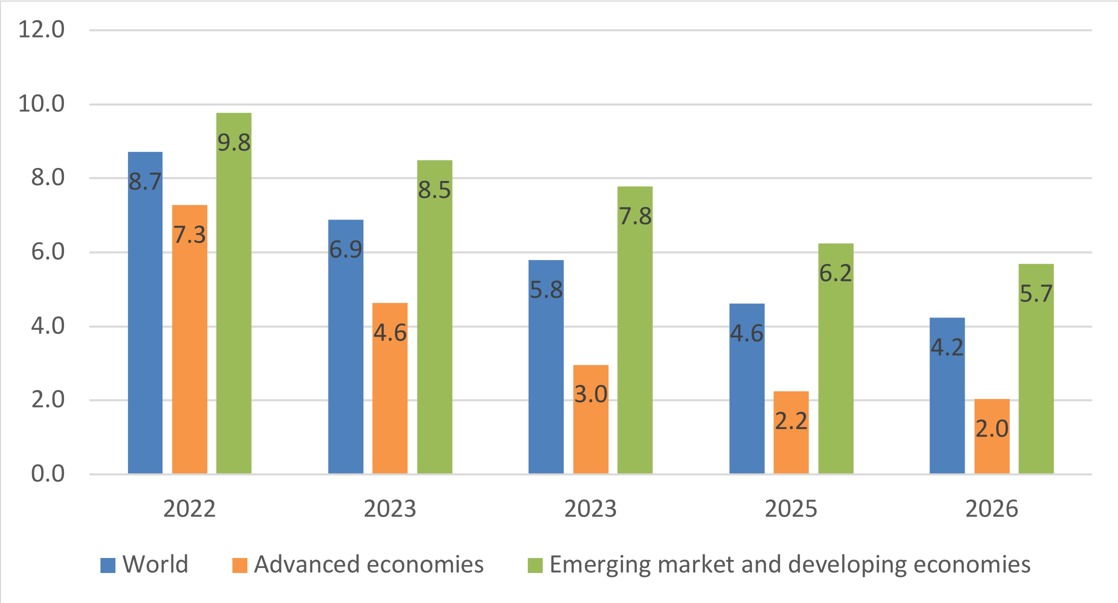
Figure 1: Global economic projections (%)



Source: IMF World Economic Outlook (2024)

2.3. Global headline and core inflation have decelerated sustainably since peaking in 2022, however still above target levels in most advanced economies and nearly half of the inflation-targeting emerging and developing economies (EMDEs). The projected trajectory entails a decrease in global headline inflation from the recorded 6.8 per cent in 2023 (on an annual average basis) to 5.8 per cent in 2024 and further to 4.4 per cent in 2025, as forecasted by the IMF (See Figure 2 below).

Figure 2: Inflation rate, average consumer prices (annual per cent age change)



IMF World Economic Outlook (2024)

South Africa's 30-year Growth Context

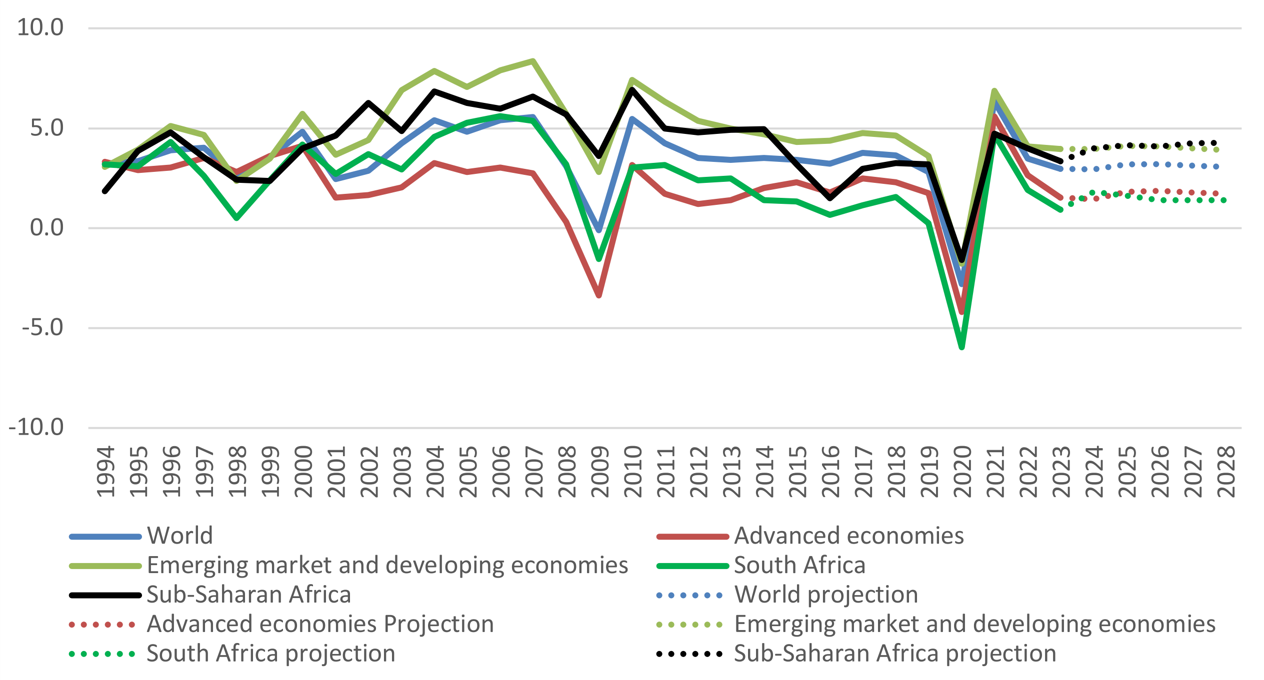
2.4. Following the transition to democracy and the dismantling of the Apartheid system in the early and mid-1990s, South Africa experienced a period of robust economic expansion. Between 1999 and 2008, the country saw an impressive annual GDP growth rate of 4.0 per cent, translating to a 2.6 per cent yearly increase in income per capita. However, it is important to note that this growth rate lagged that of its emerging market and developing country counterparts, which achieved an average annual growth rate of 6.1 per cent during the same period (See Figure 3 below).

2.5. South Africa's economic growth took a significant turn following the Global Financial Crisis and has struggled to recover since then. Between 2010 and 2019, GDP growth slowed to a mere 1.7 per cent per year, resulting in an average annual income per capita growth of only 0.15 per cent. Moreover, from 2015 onward, the country has experienced a structural decline in income per capita. This economic downturn, interfered in part by politics and corruption, has resulted in feeble job creation and decreased labour productivity, in a nation grappling with the highest unemployment rate globally.

2.6. The period after 2007 is pivotal in South Africa's macroeconomic trajectory for two main reasons. Firstly, the GFC triggered a substantial deceleration in growth, from which the economy has yet to recover fully. Secondly, this economic slowdown has profoundly impacted fiscal policy, leading to a more than twofold increase in the country's debt-to-

GDP ratio and a deterioration in its creditworthiness. Consequently, South Africa has been running fiscal deficits for an extended period, exacerbating its economic challenges.

Figure 3: Economic growth trends and projections for South Africa and various regions

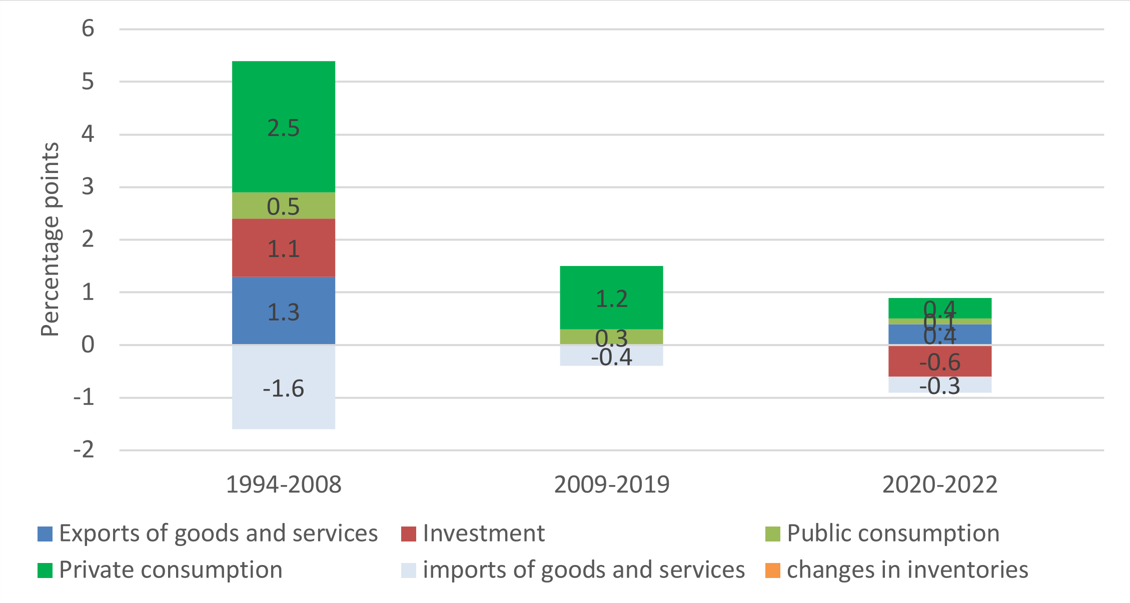


Source: IMF World Economic Outlook (2024)

2.7. South Africa's economic slowdown is attributable primarily to persistent and deepening supply-side constraints, caused by deteriorated public sector productivity and political corruption. Acute deficiencies in critical infrastructure such as the provision of electricity, transportation systems encompassing freight rail, ports, road networks, passenger rail services, water and sanitation facilities, and security services have markedly failed over the past two decades. Because of this degradation, the GDP growth and exports have substantially decelerated. The decline in these factors of productivity is estimated to have accounted for almost 50 per cent of the growth deceleration since the global financial crisis.

2.8. As Figure 4 shows, since 2009, sustainable economic growth drivers have lost steam, and the South African economy is primarily supported by consumption, whereas in between 1994 and 2008, exports and investments played an essential role in driving growth and contributed 1.4 and 1.1 percentage points, respectively. From 2020 to 2022, the contribution of exports dwindled to a mere 0.4 percentage points, while investment subtracted 0.6 age points from growth. Remarkably, from 2009 to 2019, these driver's contribution to growth overall is almost negligible.

Figure 4: Contribution of expenditure components to economic growth



Source: Statistics South Africa and Commission's own calculations

2.9. The changing path of sectoral performance over time reflects the underlying supply-side constraints that have influenced the economic trajectory. The massive deceleration in Utilities, Manufacturing, and Mining explains the economic slowdown. In the earlier period of 1994-2008, the Mining and Manufacturing sectors added 0.6 and 0.5 percentage points to growth, respectively. However, in the more recent 2020-2022 period, these sectors have seen substantial declines in their growth contributions. Mining added just 0.3 points to GDP growth, and manufacturing subtracted 0.3 points.

Recent Domestic Growth Developments

2.10. After witnessing a brief post-pandemic upswing in 2021 and the beginning of 2022, economic activity in South Africa has faded. In the third quarter of 2023, real GDP deflated by 0.2 per cent, following a revised increase of 0.5 per cent in the second quarter. Several economic sectors, encompassing mining, manufacturing, utilities, construction, and trade and tourism, have yet to fully recover to their pre-pandemic levels in real and seasonally adjusted terms. This restrained economic performance can be ascribed to three adverse primary factors: the electricity crisis, transport consequences, and the less favourable global economic environment.

2.11. According to the World Bank, South Africa is likely to experience an acceleration of growth to 1.3 per cent in 2024 and a marginal increase to 1.5 per cent in 2025. The International Monetary Fund (IMF) is less optimistic as they anticipate growth of just one per cent in 2024, followed by a small deceleration to 1.3 per cent in 2025. Domestically, the South African Reserve Bank's GDP forecasts share an even more sanguine view in the two years ahead as they anticipate growth at 1.2 per cent in 2024 and 1.3 per cent in 2025. The 2024 Budget forecasted the economy to grow 1.3 per cent in 2024 and 1.6 per cent in 2025.

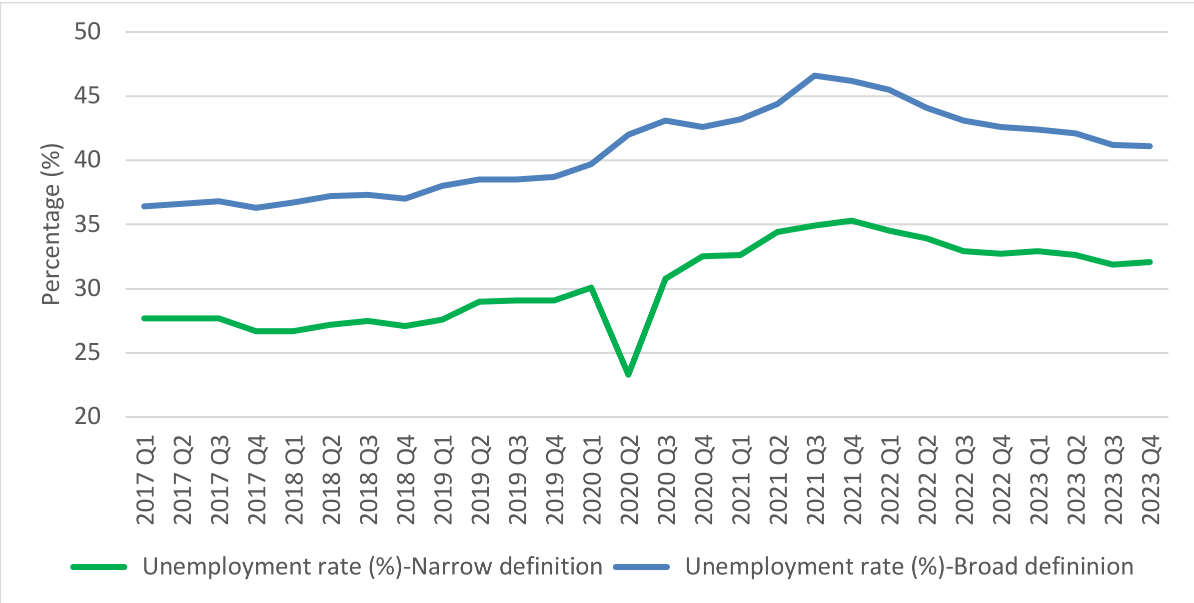
2.12. These muted growth prospects reflect many of the headwinds facing the economy. Consumer sentiment remains fragile and continues to reveal persistent uncertainty at the household level. The FNB/BER's Consumer Confidence Index (CCI) declined to -17 points in Q4 2023 from -16 points in the previous quarter, the worst fourth-quarter reading in 23 years.

2.13. Similarly, the strength of business confidence has been insufficient to attract spending on fixed investment. The RMB/BER business confidence index in SA slipped from 33 in the third quarter of 2023 to 31 in the fourth quarter, signalling a pessimistic economic outlook by businesses. Furthermore, the seasonally adjusted Absa Purchasing Managers' Index decreased from 50.9 in December to 43.6 in January 2024—the lowest in 14 years. This reflects a deep contraction in the country's manufacturing sector, last witnessed during the global financial crisis.

Employment and Investment

2.14. South Africa's unemployment rate increased to 32.1 per cent in the fourth quarter of 2023 from a one-year low of 31.9 per cent in the previous period. The number of unemployed went up by 46 000 to 7.9 million, employment declined by 22 000 to 16.7 million after eight consecutive quarters of increases, and the labour force increased by 25 thousand to 24.6 million (See Figure 5 below).

Figure 5: Unemployment rate (%)



Source: Statistics South (2023)

2.15. The broad unemployment rate, which includes people who have stopped looking for work, fell to 41.1 per cent in the fourth quarter of 2023 from 41.2 per cent in the previous quarter. Compared to the growing working-age population, South Africa has a challenge with job creation, translating into one of the lowest employment ratios globally. A high burden is placed upon the youth population, and they have a very high unemployment rate among 15-24-year-olds, which changed from 58 per cent in the third quarter of 2023 1to 59.4 per cent in the fourth quarter. This underscores the urgent need for targeted interventions and policies to address youth unemployment and foster inclusive economic growth.

2.16. Investment, or Gross Capital formation (GCF) is a fundamental driver of economic growth. In South Africa, the nominal GCF declined substantially by 21.6 per cent in 2020, according to the South African Reserve Bank, due to postponement and cancellation of capital investment projects across various sectors during the COVID-19 pandemic by the general government, public corporations, and private business enterprises at 11.6 per cent. After the contraction in 2020, total capital formation levels recovered and reached R1 trillion in 2022, primarily driven private business enterprises.

Overview of the 2024 fiscal framework

2.17. A recent study on the quantification of multipliers by FFC reveals that government expenditure has a negligible impact on economic growth. In terms of the impact impulse response function, the government expenditure multiplier is 0.01, with the 95% confidence interval includes zero, while the accumulation of the impulse response function shows that the cumulative multiplier from 2001 to 2022 is about 0.04. These results imply that fiscal measures that aimed to stimulate demand have not been impactful, given the binding constraints and lack of productivity within the economy.

2.18. The results derived from FFC's quantitative analysis stress the insignificance of fiscal multipliers and how fiscal multipliers tend to hinder economic growth by escalating the cost of capital and crowding out the private sector. Hence, the current growth challenges faced by South Africa cannot be resolved by expansionary fiscal policy alone, but by fiscal transformation of consolidation and reallocation to yield efficiency.

2.19. Over the last three years, South Africa has embarked on a crucial journey of fiscal consolidation, marked by strategic restructuring efforts aimed at stimulating economic growth. Budget 2024 is, as was stated in the 2023 Medium-Term Budget Policy Statement, designed to implement productive transformation through reallocation and reprioritisation to achieve fiscal consolidation and stimulate the economy. The Commission observes however, that despite the fiscal intentions, South Africa has yet to make tangible progress in reallocating, reprioritising its fiscus while deep inefficiencies in the public sector remain.

2.20. The estimated budget deficit for 2023/24 has been revised upward to 4.9 per cent of GDP compared to the previous estimate of 4 per cent in the 2023 Budget. A consolidated budget deficit of 4.5 per cent is projected for 2024/25, narrowing to 3.3 per cent of GDP by 2026/27. Revenue projections for 2023/24 are R46.5 billion lower compared to 2023 Budget estimates. The 2024 Budget projects a main budget revenue of R1815 billion for 2024/25, which is R53.1 billion less than what was projected in the 2023 Budget.

2.21. Significant shortfalls in revenue projected over the MTEF reflect weak economic conditions and lower consumer demand, resulting in declines in corporate tax and value-added tax. Non-interested expenditure has been revised downward by R6 billion for 2023/24 compared to the 2023 Budget. Over the MTEF, consolidated non-interest expenditure is projected to contract at an average annual rate of 0.5 per cent in real terms.

2.22. The gross borrowing requirement will accelerate from R332 billion in 2024/25 to R424.7 billion in 2025/26, before declining to R279 billion in 2026/27. To offset a portion of the borrowing requirement, the government has introduced the GFECRA settlement, which is projected to reduce the borrowing requirement by a total of R150 billion over the medium. The Commission understands that prudently using resources from the GFECRA can reduce the pressure on public finances and bond markets, giving the investors and financial markets a confident signal.

2.23. While this improves the debt outlook in the short run, it appears to be applying a short-term solution to a structural problem. For the Commission, the focal point, therefore, is the question of ***"whether the cost and the risk of defraying foreign exchange reserves, justify the myopic relief to the current fiscal problem, to address structural fiscal deficits"***. To resolve South Africa's debt crisis, the focus should be placed on tackling the underlying fiscal challenges, and the implementation of structural reforms to achieve greater efficiency and productivity. The Commission asserts that, while drawing on reserves can provide immediate fiscal relief, assessing the short-term returns against the prospective longer-term risks is critical: to ***forgo the assessment is to jeopardise investor confidence, inviting substantial run-ups in borrowing costs, thus ushering in debt distress.***

2.24. Various pressures over the MTEF period will impact the fiscal position. SOEs' poor and inefficient financial performance continues to pressure public expenditure. Government debt is projected to increase due to the Eskom debt-relief arrangement. As a result of the Eskom debt relief and increasing market lending rates, debt-service costs will increase from R356.1 billion in 2023/24 to R440 billion in 2026/27 (see Table 1 below). A narrowing tax base owing to rising unemployment may weigh on public expenditure and increase the budget deficit and borrowing requirements.

2.25. There are several potential threats to the fiscal which could impede economic stability and fiscal prudence. Firstly, economic growth may be less than expected, resulting in lower revenue and a larger budget deficit. Secondly, increased spending may result in borrowing costs escalating, thus putting strain on debt servicing costs. Thirdly, implementing an unaffordable wage increase during the latter part of the medium-term expenditure framework could undermine the fiscal integrity of the budgetary framework. Finally, potential further deterioration of the financial condition of key public sector entities, such as municipalities and state-owned enterprises, could result in bailout requirements, which could strain the fiscus.

Table 1: Consolidated government fiscal framework, 2024 MTEF

	2023/24	2024/25	2025/26	2026/27
R billion/percentage of GDP	**Revised estimate**	**Medium-term estimates**		
Revenue	1 921.4	2 036.6	2 176.4	2 323.6
	27.3%	27.3%	27.5%	27.6%
Expenditure	2 268.9	2 369.0	2 471.4	2 597.8
	32.2%	31.8%	31.2%	30.8%
Budget balance	-347.4	-332.4	-295.0	-274.2
	-4.9%	-4.5%	-3.7%	-3.3%
Debt-service costs	356.1	382.2	414.7	440.2
	5.1%	5.1%	5.2%	5.2%
Gross Domestic Product (current prices)	6 972	7 346	7 801	8 298

Source: National Treasury, 2024

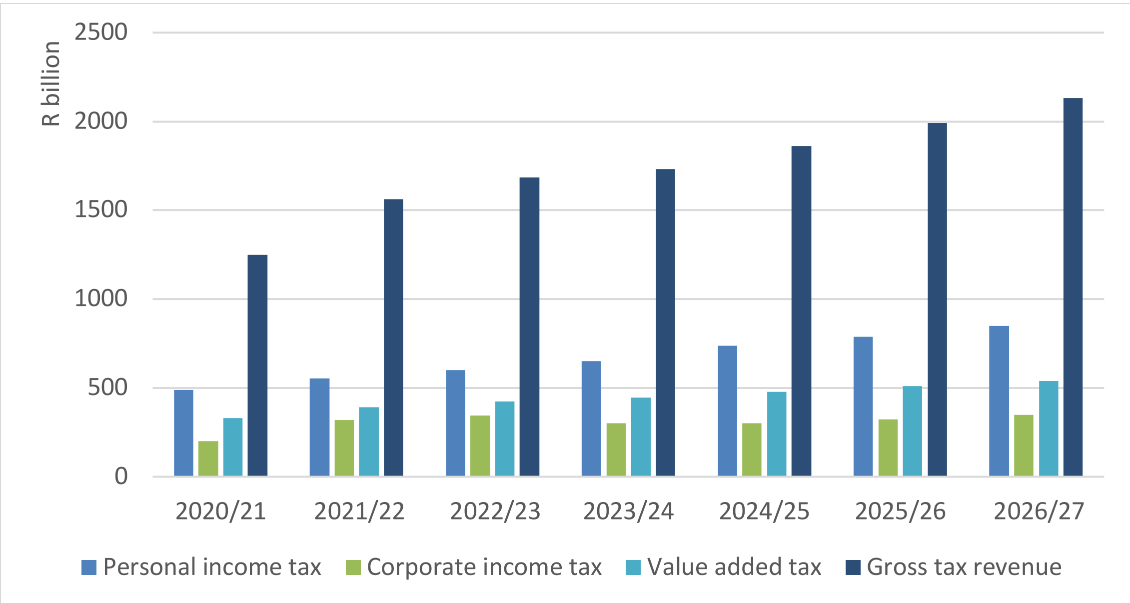
2.26. Notably, over the 2024 MTEF, compensation of employees will grow by an average of 9.05 per cent between 2024/25 to 2026/27, whereas goods and services will grow by an average of 9.83 per cent over the same period. Capital payments will grow by an average of 21.08 per cent over the MTEF period. Compensation of employees makes up the largest component of the current account.

Revenue trends and tax proposals

2.27. The upsurge in commodity prices led to improved tax revenue performance in 2021/22 and 2022/23. Tax revenue for 2023/24 is projected at R1.73 trillion, which is R56.1 billion less than in the 2023 Budget Review, as depicted in Figure 6 below. An average of R1.99 trillion of tax revenue over the medium term is projected, which indicates an expected increase of R45.6 billion in the medium-term relative to the 2023 MTBPS. Corporate income tax collection shrinks by R39.2 billion in the first ten months of 2023/24 relative to the same period in 2022/23. Sluggish global economic growth, lower commodity prices, disruptions in electricity supply, and operational obstacles at South Africa's ports have detrimental effects on the sector. Value-added tax collections have been revised by R26.1 billion compared with 2023 Budget projections.

2.28. Instead of raising income tax rates, the personal tax brackets, medical tax credits, and rebates will not be adjusted for inflation, translating to bracket creep, where taxpayers will be pushed into higher tax brackets and taxed more by inflation increase of the their income, while their real purchasing power may remain the same or deteriorate.

Figure 6: Budget Revenue, 2020/21-2026/27



Source: National Treasury Budget Review, 2024

2.29. The tax to GDP ratio is expected to slump to 24.6 per cent in 2023/24 due to low global economic conditions. Tax revenue for 2023/24 is forecast at R1.73 trillion, an upsurge revision of R0.7 billion from the 2023 from the 2023 MTBPS estimate. The downward forecast in tax revenue is consistent with the downward forecast in corporate tax revenue and the low GDP growth average forecast of 1.6 percent over the years 2024 to 2026.

2.30. Since the COVID-19 pandemic, tax rates have remained stable amidst global and domestic shocks. Two-pot retirement reform and international corporate tax reform are in the final stages of refinement, which is expected to alleviate some revenue pressures once implemented. There will also be no increases in fuel levies.

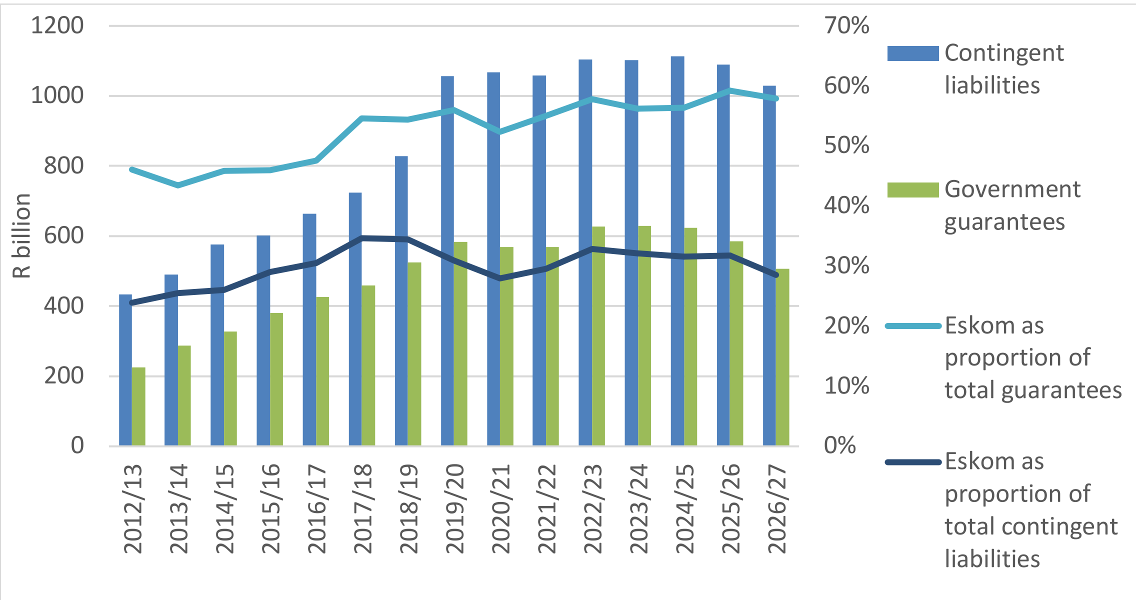
2.31. As a positive incentive for producing and manufacturing electricity vehicles, the global world minimum tax rules, in accordance with the Organisation for Economic Co-operation and Development's (OECD) base erosion of profit-shifting framework, are anticipated to positively improve corporate collection by R8 billion in 2026/27. Electric vehicle producers will also be eligible to claim 150 percent of qualifying investment spending on production capacity in the first year of investment. Lastly, a learnership incentive extension is introduced to foster efficiency in the workplace through training and education over the medium term.

Guarantees to state-owned entities (SOEs)

2.32. Poor governance of SOEs results in wasteful and fruitless exposures in government guarantees and contingent liabilities, thereby negatively impacting service delivery and failing their developmental mandates. The challenges SOEs encounter include a failing of achieving the mandates within their business models e.g. generate and transmit electricity at efficient costs, ill-disciplined, inefficient operations with corruption radiating through governance interference, and weaknesses in oversight.

2.33. Contingent liabilities estimated for 2023/24 have been revised upward to R1.1 trillion over the MTEF, in comparison to R1.02 trillion in the 2023 Budget, as shown in Figure 7. Whereas the 2023 Budget projected contingencies to decrease to R904 billion by 2025/26, the 2024 Budget estimates that contingent liabilities will continue to exceed R1 trillion over the MTEF period.

Figure 7: Contingent Liabilities and Government Guarantees to SOEs, 2012/13-2026/27



Source: National Treasury Budget Review, 2024

2.34. Government guarantees, which make up over 50 per cent of total contingent liabilities for major SOEs in 2023/24 have been revised upward by R88.6 billion compared to the 2023 Budget, from R541 billion to R629.6 billion, signifying the poor financial state of these state-owned company entities. Though government guarantees are budgeted to decrease by

5 per cent annually over the MTEF, the Commission is reminding about the escalating special appropriations, adjustments and defraying of contingency reserves to service these exposures.

2.35. Since 2017/18, over 50 per cent of guarantees to SOEs have been allocated to Eskom. Guarantees to Eskom average 57.4 per cent of total government guarantees to SOEs over the next four years. In terms of Eskom's debt relief arrangement, the government will service R250 billion of the entity's debt – as opposed to R254 billion previously stated – over the next three years. The government will take up R76 billion in 2023/24 and R64 billion in 2024/25, a downward revision of 2 billion in each year compared to the 2023 Budget. This is because Eskom will fail to comply with the condition to dispose of the Eskom Finance Company (EFC) within the agreed timeframe of 31 March 2024. Disposing of non-core assets, such as the EFC, is part of a broader strategy to improve Eskom's financial sustainability. The Commission notes that failing to comply with such conditions raises concerns that Eskom is not making progress on key imperatives to resolve the energy crisis.

2.36. Table 2 shows that total guarantee exposure to public institutions is very high at R433 billion in 2022/23. However, exposure is projected to decrease to R416.3 billion in 2023/24. Government exposure to Eskom remains particularly high at R362 billion in 2022/23 but is expected to decline to R354 billion in 2023/24 due to the debt-relief arrangement.

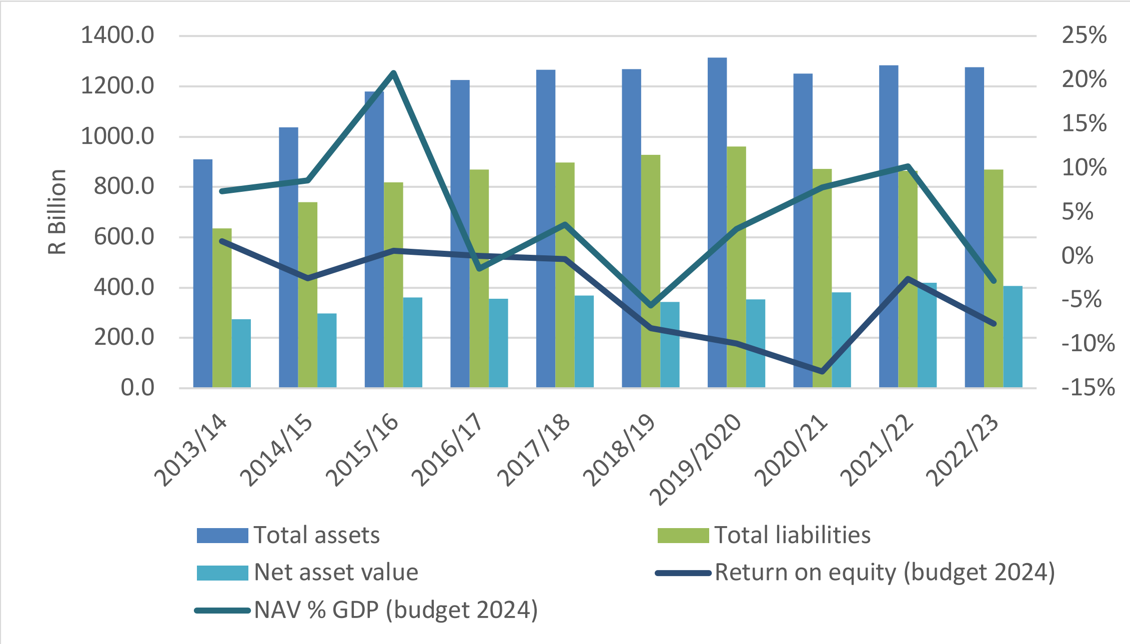
Table 2: Government guarantees and exposure to SOEs, 2021/22-2022/23

R billion	2021/22		2022/23		2023/24	
	Guarantee	Exposure	Guarantee	Exposure	Guarantee	Exposure
Public institutions	559.9	395.3	470.3	433.0	503.3	416.3
Eskom	350.0	313.0	341.6	362.3	326.6	354.0
SANRAL	37.9	42.0	37.9	38.2	37.9	29.5
Trans-Caledon Tunnel Authority	25.0	9.6	25.0	8.7	25.0	8.1
South African Airways	19.1	2.8	19.1	0.2	19.1	0.1
Land and Agricultural Bank of South Africa	9.6	1.9	8.1	0.6	8.0	–
Development Bank of Southern Africa	9.9	5.2	10.1	5.7	10.2	6.1
Transnet	3.5	3.8	3.5	3.8	50.5	9.8
Denel	3.4	3.5	3.4	3.4	–	–
South African Express	0.0	0.0	–	–	–	–
Industrial Development Corporation	0.5	0.1	0.6	0.1	0.6	0.2
South African Reserve Bank	100.0	12.8	20.0	9.3	21.0	8.0

Source: Budget Review 2024

2.37. The SOEs reflect weak financial performance, constituting a significant risk to the fiscus as they require fiscal transfers to cover their losses and recapitalise their balance sheets. Most of the major SOEs experienced sharp declines in the value of their assets, which constitutes a fiscal risk for the government as they require fiscal transfers to cover their losses and recapitalise their balance sheets. The trend in return on equity (ROE), which is a measure of the profitability of an entity, deteriorated from 1.7 per cent in 2013/14 to a low of –13.1 per cent in 2020/21, as shown in Figure 8. ROE since improved to -2.6 per cent in 2021/22 but fell again to -7.7 per cent in 2022/23, reflecting the weak profitability of SOEs on average.

Figure 8: Balance sheet of SOEs, 2013/14-2022/23



Source: National Treasury Budget Review, 2024

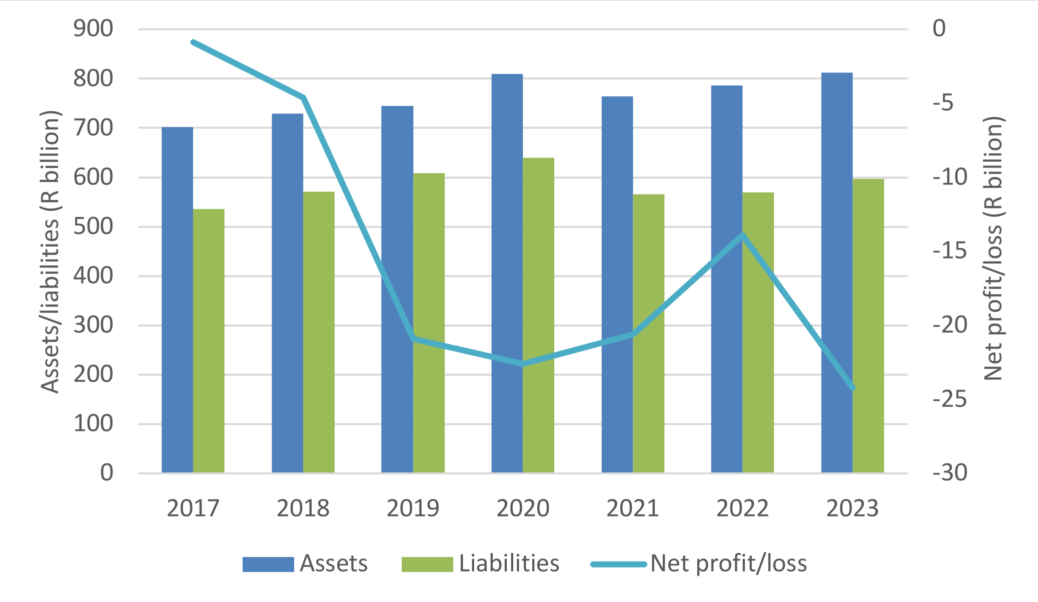
Eskom

2.38. The financial health of Eskom, as measured by key financial ratios, reflects weak economic performance, as shown in Figure 9. The operational performance of Eskom deteriorated significantly in 2023, which is reflected by a low energy availability factor (EAF) and the increase in the number of load shedding days required. Figure 9 shows that Eskom recorded a net loss of R24 billion for the 2023 financial year, compared to R11.9 billion in 2022, reflecting further deterioration in performance of R12 billion. Eskom's sustainability is compromised by poor generating performance, declining sales volumes, increases in primary energy costs, and high debt-service costs as well as municipal arrear debt.

2.39. The earnings before interest, taxes, depreciation, and amortisation (EBIDTA) decreased to R38 billion from R53 billion recorded in the previous year. The EBITDA margin, which measures its operating profit as a percentage of its revenue, declined from 21.4 per cent in 2022 to 14.7 per cent in 2023, indicating that Eskom's operating costs are high compared to its total revenue. The increase in operating costs has largely been driven by a substantial increase in primary energy costs and a decline in sales volume as a result of load shedding.

2.40. The net debt-to-equity ratio for financial solvency which measures the degree to which Eskom finances its operations through debt as opposed to its own funds, has shown some improvement since 2019. However, recent data shows that the ratio deteriorated from 1.64 in 2022 to 1.69 in 2023, indicating a greater degree of reliance on debt than equity to fund its business operations. Net debt increased by R9.7 billion to R398.8 billion in 2023 compared to the previous year. Furthermore, due to Eskom's financial challenges and deteriorating operational performance, liquidity levels remain under severe pressure at the entity, making it heavily reliant on the government for support.

Figure 9: Asset, liabilities and profit/loss for Eskom, 2017-2023



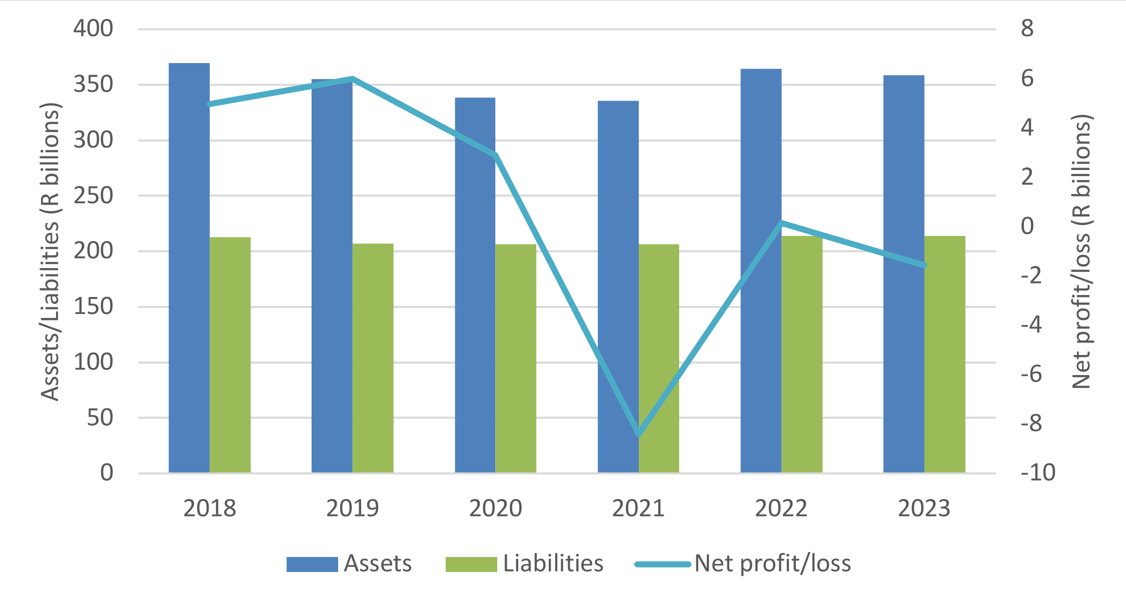
Source: Eskom Annual Reports, various editions

Transnet

2.41. Transnet is a prominent player in the logistics industry and the transportation of goods and commodities to local and international markets. Its core mandate is to provide ports, rail, and pipeline infrastructure operations efficiently. Yet, due to historical and structural challenges, Transnet's performance remains poor, and its operations are consistently constrained by its deteriorating financial position. Some of the key challenges that hinder Transnet's performance include the unavailability of locomotives, theft and vandalism, the impact of the 2022 floods in KZN, the industrial strike action in 2022, derailments and high levels of debt and high debt repayment obligations.

2.42. Transnet has consistently failed to reach its financial performance targets across its operating divisions. The financial health of Transnet also reflects weak economic performance as the profitability and solvency ratios are deteriorating. The EBITA margin decreased from 45.6 per cent in 2019, to 35.9 per cent and 35.3 per cent in 2022 and 2023, respectively. This reflects the declining profitability of the entity. Transnet reported a loss of R1.6 billion at the end of September 2023, compared to an R159 million profit in 2022, as shown in Figure 10. The 2024 Budget highlights a total net loss of R5.7 billion for the 2022/23 financial year, due to its inability to generate sufficient cash flows from its operations. As a result, borrowing has increased from R122.6 billion in 2018 to R131.8 billion by the 2023 year-end, exacerbating liquidity pressures, interest costs on debt and refinancing risk.

Figure 10: Asset, liabilities and profit/loss for Transnet, 2018-September 2023



Source: Transnet Annual Reports, various editions

2.43. The government has provided a R47 billion guarantee to Transnet, however, only R14 billion has been approved to pay off its maturing debt to ensure that the entity implements its recovery plan and adheres to the conditions for freight logistics approved by the Cabinet. In terms of Transnet's recovery plan, the entity is required to, among other conditions, divest non-core assets, reduce its current cost structure and explore alternative funding models for infrastructure and maintenance.

Denel

2.44. Denel is an aerospace and military technology conglomerate and the largest of South Africa's state-owned arms companies. The government provided R3.4 billion to Denel through the Special Appropriation Act (2022) with set conditions relating to the implementation of its turnaround plan to ensure its future sustainability. However, despite government support, Denel remains financially distressed and unable to fulfil its financial obligations.

2.45. The conditions attached to Denel's financial support were intended to enable the disposal of its non-core assets, the finalisation of identified strategic equity partnerships and the overall consolidation of its operations. Denel has utilised R2.2 billion of its debt-relief funds to settle its debt obligations and to fund its working capital requirements, with the remaining balance only being made available once the entity complies with the attached conditions. The inability of Denel to make progress on realising the conditions attached to its financial support raises concerns as to its commitment to implement its turnaround plan and foster sustainability in its operations.

South African Airways

2.46. South African Airways (SAA) is South Africa's flag carrier airline. The government has significantly reduced its contingent liability exposure to SAA, from R200 million to R100 million in 2022/23 and 2023/24, respectively. In terms of the entity's financial performance, the SAA group incurred a total loss of R3.6 billion for the 2021/22 financial year, compared to R7.6 billion in 2020/21. The Auditor-General reported that irregular expenditure at SAA increased from R22 billion in 2017/18 to R44.5 billion in 2021/22. A significant portion of irregular expenditure has been attributed to non-compliance with procurement regulations. Fruitless and wasteful expenditure increased from R24.8 million in 2017/18 to R207.3 million in 2021/22.

2.47. SAA reported on significant deficiencies and weaknesses of internal controls for which the accounting officer and senior management are responsible. Considerations to improve the operational performance and financial viability of the SOE include filling executive vacancies with skilled and experienced individuals, enhancing training of officials and SCM to increase capacity, and implementing strict consequence management to instil a culture of compliance and enhance accountability.

Development Bank of Southern Africa

2.48. The Development Bank of Southern Africa (DBSA) is a development finance institution that promotes economic growth and regional integration through mobilising resources for sustainable development and large-scale infrastructure projects. For the 2022/23 financial year, the DBSA reported a net profit of R5.2 billion, which is an increase from R3.8 billion profit in 2021/2022. Improved profitability is primarily attributed to the increase in net interest income driven upward by higher domestic interest rates. Net interest income increased by 13 per cent to R6.5 billion, compared to R5.8 billion in the previous year. The total equity of the SOE increased by 10.9 per cent from approximately R42.9 billion to R47.6 billion between 2022 and 2023.

2.49. Total liabilities increased by 6.6 per cent from R57.1 billion to R60.9 billion over the same time period. The entity's assets increased from R100 billion in 2021/22 to R108 billion in 2022/23, and net asset value increased from R42.9 billion to R47.6 billion over the same period. The DBSA's debt-to-equity ratio declined from 1.33 in 2022 to 1.27 in 2023, illustrating that the degree to which the institution is financing its operations with debt has declined marginally. Disbursements increased by 3.7 per cent from R13.2 billion in 2021/22 to R13.7 billion in 2022/23. Contrary to the previous year, the bank exceeded its disbursement target of R13.5 billion. In terms of increasing fixed capital formation, the bank exceeded its target of R4.2 billion for the value of infrastructure delivered, attaining R4.8 billion in 2022/2023.

Industrial Development Corporation

2.50. The Industrial Development Corporation (IDC) is a state-owned development finance institution which funds industrial development and enhances economic integration across the continent. It provides funding aimed at the development of enterprises, thereby playing a catalytic role in attracting industry players. The purpose of the IDC is to drive inclusive and sustainable industrialisation in South Africa and the broader region, which creates employment opportunities. The IDC reported two consecutive years of net profits, with an increase in net profit from R6.3 billion in 2021/22 to R10.7 billion in 2022/23. The IDC's total assets decreased between 2021/22 and 2022/23 by R4.7 billion from R164 billion to R159 billion. The entity's net asset value also decreased from R111.1 billion to R108.3 billion over the same period.

2.51. In supporting businesses affected by the outbreak of public violence, the IDC established a recovery fund. The fund has approved 96 transactions worth R2 billion, of which R1.5 billion was disbursed by the end of 2021/22. In addition, the IDC committed R6.6 billion to transformation funding in 2021/22, compared with R3.9 billion in 2020/21. IDC funding disbursed increased by 147 per cent, from R7.2 billion in 2021/22 to R17.8 billion in 2022/23. In 2022/23, the corporation also committed R11.4 billion to transformation funding, an increase of 72.7 per cent from R6.6 billion in 2021/22. However, in terms of development effectiveness, the IDC only achieved 63 per cent of its milestones for the implementation of critical initiatives and projects, including the Township Economy initiative, Covid Industrial production and various agricultural initiatives.

Recommendations

- The Commission recommends a comprehensive economic growth strategy to surmount these obstacles and discover new prospects for growth. The strategy should reorient the industrial policy and align it with shifting global trends and requirements. It should ignite an economically sustainable path by placing more emphasis on sectors that are increasingly in global demand, such as the production of grid-scale storage batteries for electricity and other green economy-related eco-products, and position the country as a prominent figure in the fast-growing green technology market.
- The Commission recommends strengthening SOEs' governance structures, rigorously assessing their business models, and rationalising operations by divesting non-core activities. In addition, the Commission recommends speeding up establishing a centralised holding company as recommended by the Commission in its 2024/25 annual submission. This centralised entity would constitute a well-organised platform to comprehensively tackle obstacles of SOEs, promote strategic decision-making, and ensure unified efforts for operational and financial success.

3. 2024 Appropriation Bill

3.1. The 2024 Appropriation Bill makes provision for the appropriation of funds from the National Revenue Fund for the state's requirements in relation to the 2024/25 financial year and estimates for the outer years. The total appropriation by vote amounts to R1.1 trillion in 2024/25 (or R3.4 trillion over the next three years), which represents an increase of 4.1 per cent when compared to the revised estimate for 2023/24. From an **economic classification** perspective, the following is noted:

3.2. The largest spending item for national government is **transfers and subsidies**, which amount to R1.4 trillion in 2024/25. Just over 62 per cent of transfers and subsidies are comprised of equitable share and conditional grant allocations to provinces and municipalities. In 2024/25, the transfers and subsidies to local government in particular are set to grow by 7.9 per cent. The Commission welcomes the emphasis on transfers to the local government sphere as this is where basic services such as water, sanitation, and electricity, are delivered.

3.3. Assessing the national allocations from an economic classification and growth perspective, current payments and in particular, compensation of employees followed by interest, are the fastest growing items between 2023/24 and 2024/25. These two items are projected to grow by 8.3 and 7.3 per cent respectively in 2024/25.

3.4. In contrast to 2023, payments for capital assets, is projected to decline by 8.9 per cent in 2024/25.

Table 3. Growth in Selected Expenditure Items by Economic Classification, 2023/24-2026/27

R billion	Revised Est.	Medium-Term Expend. Estimates			Year on Year Growth		
	2023/24	2024/25	2025/26	2026/27	2023/24-2024/25	2024/25-2025/26	2025/26-2026/27
Current Payments	**625.8**	**667.8**	**712.0**	**751.5**	**6.7%**	**6.6%**	**5.6%**
Compensation of Employees	190.7	206.5	216.9	226.9	8.3%	5.0%	4.6%
Good and Services	78.8	78.9	80.2	84.1	0.1%	1.6%	4.9%
Interest	356.3	382.4	414.9	440.5	7.3%	8.5%	6.2%
Transfers and Subsidies	**1 399.1**	**1 446.3**	**1 478.6**	**1 537.5**	**3.4%**	**2.2%**	**4.0%**
Provinces	706.4	729.5	760.9	790.8	3.3%	4.3%	3.9%
Municipalities	158.0	170.5	177.8	184.0	7.9%	4.3%	3.5%
Higher Education Institutions	49.4	52.5	53.2	55.6	6.3%	1.4%	4.5%
Households	260.7	275.2	257.8	269.7	5.6%	-6.3%	4.6%
Payments for Capital Assets	**16.7**	**15.2**	**15.4**	**15.3**	**-8.9%**	1.5%	-0.8%

Source: ENE Summary Table No. 3. National Treasury, 2024

Select Votes

3.5. In absolute terms, the largest appropriation at the national sphere is the **Social Development** vote, which will receive R259 billion in 2024/25 – this represents growth of 5.9 per cent relative to 2023/224. The growth in allocation is largely driven by the additional **R33.6 billion addition required to fund the SRD grant**. This grant has been extended numerous times and represents one of the biggest spending pressures facing the government since its inception in 2020. No mention is made of increases in the value of the SRD Grant. While the Commission welcomes the extension of this grant to support those in need, government should finalise with clarity a stance on an impactful and sustainable support structure to relieve socio-economic distress.

3.6. Apart from the SRD grant, allocations for various other social security grants increase from R217.1 billion in 2023/24 to R259.3 billion in 2024/25 for inflation. The Commission notes the administrative challenges that have resulted in non-payment of social security grants and calls on the government to take extra measures to ensure efficient implementation of payments and a smooth transition to better ways of receiving payouts.

3.7. The mandate of the Department of Social Development also encompasses developmental social welfare services. In this regard, the sector is largely dependent on the non-profit sector for implementation. Considering the 2014 NAWONGA[1] court judgement, the Commission is concerned about the continuing decline in the real value of subsidies to non-

[1] Refers to a court case brought by the National Association of Welfare Organisations and Non-Governmental Organisations (NAWONGO) in 2010 against the Free State provincial and national departments of social development wherein the extent of the underfunding of nonprofit organisations was highlighted. The court found that the department's funding policy for NPOs was unreasonable and needed to be revised.

profit organisations, to effectively function to provide access outlined in section 27(1)(c)[2] and various aspects of section 28[3] on social security and social assistance, and the rights of children.

3.8. The allocation to the **Cooperative Governance** vote is projected to increase by 7.3 per cent in 2024/25. Funding is largely directed at the local government equitable share allocation, aimed at covering the operational and maintenance costs associated with the provision of free basic services to indigent households. The commission welcomes the protection of funding for the delivery of basic services which form an integral part of the social wage package provided to indigent households.

3.9. The commission notes the reprioritisation from the direct to indirect components of both the Municipal Infrastructure Grant (MIG) and the Regional Bulk Infrastructure Grant (RBIG). In this regard, the commission reiterates its call for the use of indirect grants to be a measure of last resort for transparency, with a clear timeline for the indirect component of these grants to be phased out set against monitoring and evaluation measures.

3.10. The **Higher Education and Training** vote is allocated R113. billion in 2024/25 and R350 billion over the next three years. For 2024/25 the allocation to this sector, increases by 4.9 per cent. Notwithstanding, the 2024 Budget Review notes that transfers to National Student Financial Aid Scheme (NSFAS) will decline from R58.8 billion to R53.6 billion in 2024/25. While the commission welcomes the announcement of the Comprehensive Student Funding Model which makes provision for supporting students within the missing middle[4] through a loan scheme, it is concerned about the numerous maladministration and spending challenges currently being experienced at the NSFAS. While noting that underspending is inefficient, the commission advises caution in cutting seemingly easy targets, where real needs exist.

3.11. A growth of 7.4 per cent is projected for the allocations to the **Basic Education** vote in 2024/25. The commission expresses concern about the poor quality of basic education in South Africa, reflected across a range of outputs including the alarmingly low level of Grade 4 learners that are unable to read for meaning at 82 per cent as at 2022.

3.12. The Commission views the shifting of the ECD function as an opportunity for greater resources and thus progress to be devoted to early learning interventions. In this regard the significant growth of 34 per cent in this grant in 2024/25, is welcomed.

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[2] Section 27(1)(c) of the South African constitution stipulates that: "Everyone has the right to have access to social security, including, if they are unable to support themselves and their dependents, appropriate social assistance".

[3] Section 28 of the South African constitution requires that: Every child has the right to "…appropriate alternative care when removed from the family environment", "basic nutrition, shelter, basic health care services and social services" and "to be protected from maltreatment, neglect, abuse or degradation".

[4] The missing middle refers to those students from families with an annual income of above R350 000 and below R600 000.

3.13. Over the MTEF period, the baseline of the ECD grant is reduced by R1.1 billion[5]. Annexure W1 notes that the funds have been shifted from the subsidy component of the ECD conditional grant to the National Department of Basic Education which will now undertake the interventions that the funds were intended for, namely a results-based financing initiative and nutrition pilot. While the Commission welcomes government's intention to establish a nutrition pilot and interventions aimed at improving the linkages between funding and outcomes, the shifting of funds in this way, is akin to specifying a portion of the conditional grant as indirect, on behalf of subnational government. The Commission recommends that there be clarity as to the status of the R1.1 billion and whether it becomes an indirect grant.

3.14. Again, the Commission reminds the government to be guided by the experience regarding indirect conditional grants: The Schools Infrastructure Backlogs grant (SIBG) established since 2011/12, whose lifespan has been extended numerous times due to not having met grant targets around school infrastructure backlog eradication.

3.15. The allocation to the **Health** Vote is projected to increase by 6.3 per cent from a revised estimate of R58.6 billion in 2023/24 to R62.2 billion in 2024/25. A major policy development in the sector was the passing of the NHI Bill. The Commission supports the principle of universal health coverage and notes the specification of system-strengthening activities[6] that still need to be undertaken to ensure an improved public health care system.

3.16. From an IGFR perspective, the Commission advises the government, that as part of facilitating a smooth implementation, that the full implications for provinces are considered and that strategies are put in place to support provinces in transitioning to the new system of public health care delivery. This is important given that the implementation of the NHI will affect not only the resource allocation to this sphere but also the constitutionally allocated set of powers and functions that are assigned to provinces in the Constitution.

3.17. National departments are projected to spend R154 billion on infrastructure in 2024/25. From the point of view of the appropriation bill, the national departments driving infrastructure spending in 2024/25 are: Transport (R44 billion), Human Settlements (R31.4 billion) and Water and Sanitation (R19.7 billion).

[5] The R1.1 billion is split across the MTEF as follows: R297 million in 2024/25, R396 million in 2025/26 and R414 million in 2026/27.

[6] In his 2024 Budget Speech the Minister of Finance listed 5 system-strengthening activities that still need to be implemented. These include: (1) building a national health system and digital patient records, (2) upgrading health facilities and improving quality of care (3) improving facility and district management in preparation for contracting, (4) granting semi-autonomous status for central hospitals and (5) developing reference prices and provider payment methods for hospitals.

Table 4. Allocations and growth for selected national votes, 2023/24 to 2026/27

R million	Revised Estimate	Medium-term Expenditure Estimates			Year on Year Growth (%)		
Vote	**2023/24**	**2024/25**	**2025/26**	**2026/27**	**2023/24-2024/25**	**2024/25-2025/26**	**2025/26-2026/27**
Cooperative Governance	116 628.7	125 183.3	131 125.4	136 796.3	7.3	4.7	4.3
Home Affairs	12 380.0	10 495.5	10 738.8	11 227.6	-15.2	2.3	4.6
Public Works and Infrastructure	8 406.0	7 612.1	7 904.6	8 268.5	-9.4	3.8	4.6
Basic Education	30 028.6	32 258.7	34 014.6	35 058.6	7.4	5.4	3.1
Higher Education and Training	107 743.2	113 015.3	116 245.4	121 617.8	4.9	2.9	4.6
Health	58 550.0	62 218.9	63 696.3	66 397.5	6.3	2.4	4.2
Social Development	259 754.9	275 141.1	257 407.6	269 195.7	5.9	-6.4	4.6
Justice and Constitutional Development	20 558.3	21 612.0	22 557.6	23 590.3	5.1	4.4	4.6
Office of the Chief Justice	1 339.5	1 222.4	1 265.5	1 331.0	-8.7	3.5	5.2
Police	105 475.6	113 597.1	119 367.9	124 832.9	7.7	5.1	4.6
Agriculture, Land Reform and Rural Development	16 757.7	16 708.2	17 371.1	18 123.0	-0.3	4.0	4.3
Employment and Labour	3 955.8	3 854.8	3 777.0	3 955.9	-2.6	-2.0	4.7
Forestry, Fisheries and the Environment	9 539.0	8 740.9	8 922.9	9 339.8	-8.4	2.1	4.7
Human Settlements	31 338.0	33 145.6	34 037.8	33 312.4	5.8	2.7	-2.1
Mineral Resources and Energy	10 157.5	8 839.0	8 948.4	9 113.8	-13.0	1.2	1.8
Science and Innovation	10 557.6	9 468.5	9 089.1	9 510.1	-10.3	-4.0	4.6
Small Business Development	2 529.3	2 436.5	2 544.3	2 661.9	-3.7	4.4	4.6
Trade, Industry and Competition	10 709.5	9 600.2	10 023.8	10 487.3	-10.4	4.4	4.6
Transport	78 207.4	80 621.1	86 854.5	88 577.1	3.1	7.7	2.0
Water and Sanitation	21 375.9	24 074.6	25 159.9	23 754.5	12.6	4.5	-5.6
Total appropriation by vote	**1 059 441.6**	**1 102 797.9**	**1 116 981.8**	**1 158 409.6**	**4.1**	**1.3**	**3.7**

Source: ENE Summary Table No. 2. National Treasury, 2024.

3.18. With the tabling of the 2023 budget, the allocation to the **Transport** vote declined from R94.9 billion in 2022/23 to R79.6 billion in 2023/24. For the 2024 MTEF period, we see the following trends: growth of 3.1 per cent in spending in 2024/25 compared to the previous year and average annual growth of 4.9 per cent over the MTEF period. The Commission welcomes the tabling of the Freight Logistics Roadmap and views the three priority areas[7] highlighted in the roadmap as well-placed and at the core of alleviating the country's logistics challenges.

[7] The priority focus areas are: (1) operational and rolling stock improvements, (2) improving the security and safety of the rail network and (3) implementing a capital investment programme.

3.19. The introduction of private sector participation to the freight rail network by May 2024 is also a welcomed development as it has the potential to bring in the much-needed capital and expertise to accelerate infrastructure development, the modernisation of systems, and competition in the freight rail sector (leading to lower costs and improved productivity). The appointment of an international terminal operator to develop and improve operations at the Port of Durban is a positive step toward addressing backlogs and improving volumes. For the Commission, the success of the Freight Logistics Roadmap hinges on efficient and coordinated implementation, which thus makes the oversight role of the National Logistics Crisis Committee (NLCC), critical. The Commission is currently undertaking research on rail transport in South Africa and will table recommendations on options for improving productivity in this sector as part of our 2025/26 Annual Submission.

3.20. The **Water and Sanitation** vote, saw a dramatic increase of 20.8 per cent in 2023/24 – this was driven by planned infrastructure projects relating to water resources and bulk infrastructure. The 2024/25 allocation to the Water and Sanitation vote reflects a significant increase of 12.6 per cent relative to 2023/24. Relative to other departments, infrastructure investment is generally high in the water and sanitation sector. In this regard, the government is prioritising 11 strategic projects. The department has reprioritised R308.9 million from the 2023/24 budget to fund the projects that were awaiting the outcome of a rollover application from National Treasury which was eventually denied as it did not meet the criteria for rollover approval.

3.21. The challenges outlined in the Department of Water and Sanitation's (DWS) recent 2023 Blue Drop and Green Drop reports, paint a worrying picture of the state of water resources and systems in the country. The Blue Drop Report indicates that 23 out of a total of 151 water supply systems (WSS) are in a "poor and critical condition"[8] and further that 46 per cent of WSSs achieved poor or bad microbiological water quality compliance ratings based on quality tests carried out by municipalities during the 2021/2022 financial year. Relative to 2014 when only 5 per cent of WSSs achieved poor or bad microbiological water quality compliance ratings, these recent figures show a marked deterioration in the quality of drinking water.

3.22. Focusing on wastewater treatment works (WWTW), the DWS's 2023 Green Drop Progress Assessment report, found that 64 per cent of WWTWs are at high or critical risk of discharging partially treated or untreated water into rivers and the environment. For the Commission these challenges point to the need to drastically improve access to water and sanitation infrastructure, particularly in rural communities. Against this background, the announcements in the 2024 SoNA with regards to new funding mechanisms, the construction of bulk water projects aimed at improving water supply to the country's population (especially in villages) and enhancing water resource management are thus well-aligned to addressing the current issues related to the country's water resources and systems. The Commission notes that outstanding issues that require further attention is the

[8] The water systems that are in poor and critical condition are located in the Free State, Limpopo, Northern Cape, and the North West provinces.

need to address technical capacity issues at the plant level, infrastructure maintenance backlogs, and implementing climate-resilient water infrastructure.

3.23. With Budget 2023, the **Mineral Resource and Energy** vote increased from R10.4 to R10.7 billion between 2022/23 and 2023/24 with a focus on the regulation of the petroleum sector, improving mine health, safety and equity, rehabilitating mines and the environment, enhancing access to electricity, strengthening energy efficiency and managing nuclear energy in accordance with international commitments. For 2024/25, a significant decline of 13 per cent is projected as a result of Cabinet-approved reductions to the department's budget. Over the MTEF period, expenditure will grow at a muted annual average growth rate of 1.4 per cent. The mining sector in particular is confounded with the challenges of freight rail and port inefficiencies, unreliable power supply, worker health and safety concerns, skills shortages, licences delays and crime and illegal mining actives. The

3.24. The Commission welcomes the move towards modernising the mining rights licensing system as announced in SoNA 2024 as it helps to address one of the major hurdles constraining growth in the local mining industry. This can help unlock an estimated R30 billion in mining investments that have been delayed due to the backlog of more than 3 000 prospecting and mining rights according to Minerals Council South Africa. SoNA 2024 revealed the planned launch of an exploration fund to support emerging miners and exploit new mineral deposits. In this regard, Budget 2024 allocated R80 million in 2024/25 and R120 million in 2025/26 to the Mining, Minerals and Energy Policy Development programme to establish a dedicated exploration fund for mining. The FFC welcomes this as it bodes well for providing opportunities to marginalised groups to enter the mining sector and in turn support mining activity in the country.

3.25. The agricultural sector is well-positioned to drive rural and economic development. This sector is also key in strengthening food security which is a right enshrined in sections 27(1)(b)[9] and 28(1)(c)[10] of the constitution. For this potential to be realised, transformation away from the current dual nature of the sector that sees smallholder farmers contributing on the fringes, is required. The **Agriculture, Land Reform and Rural Development** vote is projected to decrease by 0.3 per cent in 2024/25. While not commenting on the adequacy of allocations via the CASP, Ilima Letsema and Land Care grants, these funding instruments are critical for smallholder farmers. According to Budget 2024, Ilima Letsema is set to decline by 23 per cent (from R585 million in 2023/24 to 448 million in 2024/25). This is concerning given the emphasis of this grant on food production. Technological advancements have permeated most sectors with traditional methods either being relegated to history or significantly modified in order to reap maximum gains for investment. Agriculture is no different. There is a need for assistance provided to smallholder farmers to shift in tandem with these advancements so as to improve the potential for success of smallholder farmers and in so doing, begin to transform the sector away from its current dual nature.

[9] Section 27(1)(b) of the constitution stipulates that "Everyone has the right to have access to sufficient food …".

[10] Section 28(1)(c) of the constitution stipulates that "Every child has the right to basic nutrition…"

3.26. The Commission reiterates its view on the duplication of mandate evident in the role that departments within the economic development space are playing. For example, based on the purpose of the departments of **Trade, Industry and Competition** (which is in part to facilitate access to sustainable economic activity and employment for all South Africans), **Employment and Labour** (to play a significant role in reducing unemployment, poverty and inequality) and **Small Business Development** (to lead and coordinate an integrated approach to the promotion and development of entrepreneurship among SMMEs) these three departments, should be at the centre of developments to reignite growth and drive employment in South Africa. An assessment of the budgets and allocation trends characterising these three departments, raises questions as to whether they are fit for purpose, raising the need for the government to consider options around the national macro-organisation of government (NMoG) to better align departments with similar mandates thereby minimising the extent of duplication and importantly, costs.

3.27. The 2024 SoNA, placed significant emphasis on fighting fraud and corruption in the public sector. Addressing high levels of crime was reiterated as a national priority. To this end, the Commission welcomes the recruitment and deployment of police officers which, according to the SoNA, totalled 20 000 police officers over the period 2022 and 2023 with an additional 10 000 to be recruited in 2024. An assessment of the **Police** vote shows a relatively strong growth of 7.7 per cent in 2024/25, with indications of growth being maintained over the rest of the 2024 MTEF period (growth of 5.1 per cent is projected for 2025/26 and 4.6 per cent for 2026/27).

3.28. While it is anticipated that the increases in financial and human resources will assist in improving safety and security in the country, the Commission raises concern regarding the efficiency of the police department in combating increasing crime rates, especially given that South Africa is ranked 7th on the Global Crime Index.

3.29. The **Justice and Constitutional Development** vote is set to grow by 5.1 per cent in 2024/25, and, like the Police vote, indications of growth are projected to be maintained over the MTEF period. The Commission welcomes the focus of this vote on accelerating the implementation of the recommendations emanating from the Zondo Commission and the Financial Action Task Force and building capacity in the Office of the Legal Services Ombud. In contrast, the **Office of the Chief Justice** is projected to decline by 8.7 per cent in 2024/25. While critical MTEF focus areas such as modernising processes and infrastructure have been identified in this vote, it is unclear to what extent they will be prioritised within the declining resource envelope. From the Commission's perspective, for strategies aimed at combatting crime to yield results, it is imperative that the efforts of the various parts of the criminal justice system including the South African Police (SAPS), the National Prosecuting Agency (NPA) and the courts, are well coordinated and efficient. To this end, the FFC is conducting research to understand and improve the efficient and effective working of the South African criminal justice system.

3.30. A steep 15.2 per cent reduction is projected for the **Home Affairs** vote in 2024/25 which can be attributed to Cabinet-approved budget reductions and one-off allocations in 2023/24 of R839.9 million for the records digitisation project and R200 million for the Represented Political Parties' Fund. The department has stated that it will review its performance targets to accommodate these reductions. The Commission supports the additional allocation provided for the digitisation project recognising its potential to enhance service delivery. That said, given the project's multi-year nature and anticipated completion by 2025/26, careful evaluation of budget reductions needs to be considered to minimise potential adverse impacts on project implementation.

2023 Second Adjustments Appropriation Bill

3.31. The Minister tabled a Second Adjustments Appropriation Bill which aims to effect adjustments to the appropriation of money from the National Revenue Fund for the requirements of the State in respect of the 2023/24 financial year. Total additions outlined in the Bill amount to R470 million. Total reductions also add up to R470 million. Table 5 provides a sense of the adjustments by outlining the vote and programme within which the adjustment occurred.

Table 5. Summary of Second Adjustments Appropriation Bill

Vote	Description	Additions (R'000)	Reductions (R'000)
Presidency	Administration (R54 million) and Executive Support (R16million)	70 000	
Cooperative Governance	Community Works Programme		-400 000
Home Affairs	Represented Political Parties Fund	200 000	
International Relations and Cooperation	Public Diplomacy and Protocol Services	80 000	
Public Service Commission	Administration (R3.1 million), Leadership & Management Practices (R1.8million), Monitoring & Evaluation (R2.5 million) and Integrity & Anti-corruption (R4.7million)	12 000	
Public Works and Infrastructure	Administration (R12 million), EPWP (R8 million) and Property and Construction Industry Policy & Research (R50 million includingR15 million related to PICC)		-70 000
Women, Youth and Persons with Disabilities	Administration (R8million) and Commission for Gender Equity (R5 million)	13 000	
Justice and Constitutional Development	Court Services (R30 million) and National Prosecuting Agency (R20million)	50 000	
Office of the Chief Justice	Administration (R3.1 million), Superior Court Services (R39.8 million) and Judicial Education and Support (R2.1 million)	45 000	
Total		**470 000**	**-470 000**

Source: Second Adjustments Appropriation Bill, 2024.

3.32. The largest addition, amounting to R200 million is in respect of the Home Affairs vote and specifically the Represented Political Parties Fund for political party funding as political parties prepare for the general elections in May 2024.

3.33. The Second Adjustment Appropriation Bill effects reductions to two of South Africa's longstanding public employment programmes (PEPs), namely the Community Works Programme (CWP) and the Expanded Public Works Programme (EPWP). The largest reduction in the Bill, amounting to R400 million is in respect of the Cooperative Governance Vote and the CWP. The EPWP, located under the Public Works and Infrastructure vote is reduced by R8 million. Given the purpose of these PEPs which are focussed on creating income security and work experience for participants, the Commission is hopeful that these adjustments were based on an evaluation of the performance of the two interventions.

3.34. The Second Adjustment Appropriation Bill effects additions to two programmes aimed at improving the efficiency and productivity of judicial and prosecution services. The Office of the Chief Justice will be allocated an additional R45 million, of which close to R40 million will go towards the Superior Court Services Programme. Justice and Constitutional Development is allocated a further R50 million, of which R30 million will go towards the Lower Court Services Programme and R20 million to the National Prosecuting Authority Programme. The Commission expresses its support for initiatives aimed at optimising the efficiency and effectiveness of judicial and prosecutorial services.

Recommendations

- The Commission appreciates the strides that have been made in terms of access to basic services since 1994, however, there is room for further improvement across a range of sectors. For substantive change and transformation to occur, there is a need to complement the hitherto emphasis on quantity of access with a focus on the *quality* of such access.
- The Commission reiterates its previous calls for indirect grants to be used as a measure of last resort. Further, to ensure that the capacity of municipalities are being strengthened to conduct their own affairs, national sector departments implementing indirect grants must devise plans and timelines for building the capacity of the affected subnational department/municipality to take on the implementation responsibility associated with an indirect grant. Timelines for the phasing out of indirect grants is vital. Finally, a stronger monitoring framework should be devised for indirect grants to facilitate improved performance management.
- The Commission welcomes the investigation and efforts at turning around the performance of the NSFAS. However, the Commission recommends that national sector departments strengthen proactive oversight over subnational governments and entities to ensure that early warning systems are developed to identify risks and implement appropriate mitigation strategies.
- The Commission welcomes the approval of the Freight Logistics Roadmap by Cabinet in December 2023 and is of the view that the three areas of intervention outlined in the roadmap are key to alleviating the woes of the country's freight rail and port logistics system. The FFC recommends that the National Logistics Crisis Committee (NLCC) ensure efficient and coordinated implementation of the roadmap with all stakeholders involved. In addition, the roadmap should be enacted in a coordinated manner with Transnet's own recovery plan to ensure alignment in the objectives and timelines of both interventions.
- The Commission notes the Second Adjustment Appropriations Bill and the accompanying reprioritisations.

4. 2024 Division of Revenue Bill – Provinces

4.1. Provinces are responsible for the delivery of social goods and services such as education, health and social welfare services which are not revenue generating, making provinces highly dependent on fiscal transfers. In particular, Compensation of Employees (CoE) accounts for the largest expenditure item on provincial budgets for teachers and doctors' salaries, yet, decisions regarding wage agreements occur outside the budgeting process. Due to this, CoE as a percentage share of provincial budgets has increased from 56 per cent in 2020/21 to 58 per cent in 2024/25 despite efforts by provinces to reduce head count. To absorb these shortfalls, provinces are required to reduce expenditure elsewhere such as infrastructure and goods and services. Critical goods and services which has come under pressure include medicines, medical supplies, learner transport, learner teacher support materials, social development transfers to none-profit institutions and infrastructure spend.

4.2. The Commission notes with concern the trend of increasing CoE expenditure and the impacts of the wage negotiations happen in isolation without taking full cognisance of the fiscal framework and IGFR system. The growth at more than 7 per cent in accruals, which gets rolled over in the new financial year as first charge, is symptomatic of budget desynchronisation. Examples of this include the settlement of medical-legal claims and high value medical equipment purchases. Accruals are estimated at more than 7 per cent of the provincial health budget in 2022/23.

4.3. Population share across provinces are a key determinant of the Provincial Equitable Share (PES). The decision to delay the uptake of the Census 2022 population numbers to 2025/26 is meant to moderate the impact of the significant shifts in provincial population shares with the new Census.

4.4. Table 6 below depicts the trajectory of the provincial fiscal framework from 2020/21 to 2026/27. Over the 2024 MTEF, the total provincial allocation is R2.3 trillion increasing from R2.2 trillion in the 2023 MTEF. This represents a nominal growth of 3.8 per cent, accommodating for both the downward revisions to provincial transfers and additions to cover the carry-through cost of implementing the 2023 public-service wage agreement totalling R105.5 billion over the MTEF.

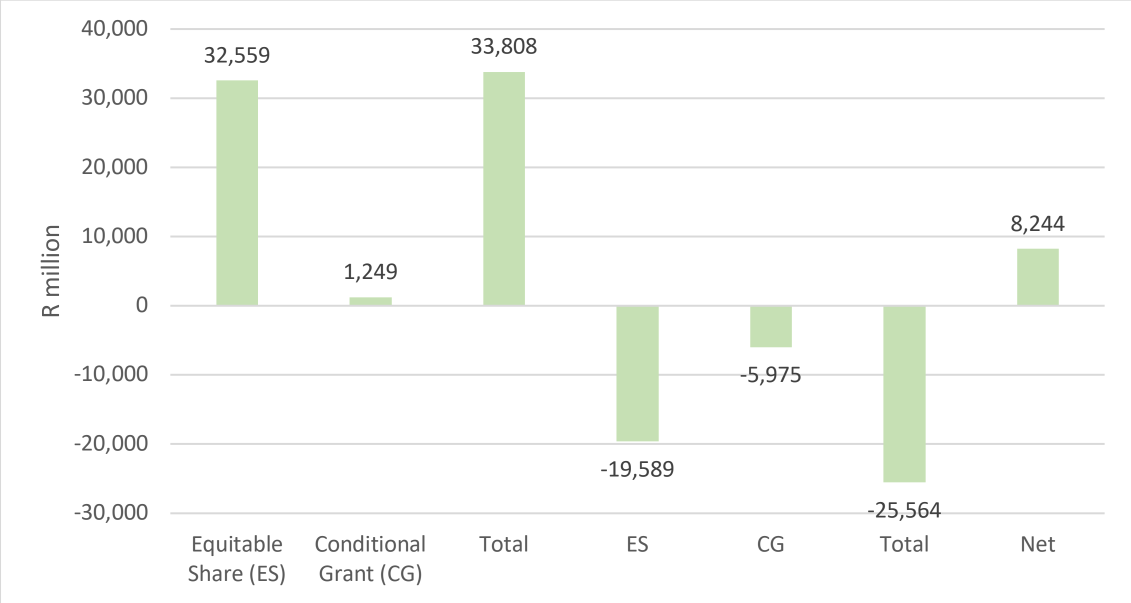
Table 6: Provincial fiscal framework trajectory from 2021/22 to 2026/27

R billion	Outcome			Revised estimate	Medium-term estimates			MTEF Total	Average annual growth 2020/21 - 2023/24	Average annual growth 2023/24 - 2026/27
	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27			
Equitable Share	520.70	544.80	570.90	585.10	600.50	627.40	655.70	1 883.60	4.0%	3.9%
Conditional grants	108.10	116.00	123.30	121.30	129.00	133.40	135.10	397.50	3.9%	3.7%
Total	**628.8**	**660.8**	**694.1**	**706.4**	**729.5**	**760.9**	**790.8**	**2281.1**	**4.0%**	**3.8%**

Source: Budget Review, 2024.

4.5. Figure 11 depicts the additions and reductions made to the equitable share and conditional grants to provinces for 2024/25. Reductions in the PES and conditional grants are due to reprioritisations and spending reductions in the context of fiscal consolidation. Additions provide for the carry-through costs of implementing the 2023 public-service wage agreement with the net effect that funding for provinces increased by R8.2 billion in 2024/25.

Figure 11: Additions and Reductions to provinces for 2024/25



Source: Budget Review, 2024

Conditional grants for provinces

4.6. The total provincial conditional grants allocation for the 2024/25 financial year amount to R129 billion, increasing from R121.3 billion in the 2023/24 financial year representing a nominal increase of 6.3 per cent. Included in the increase to conditional grants is the shifting of R3.9 billion over the MTEF from the PES to health (R3.8 billion) and education (R136 million) conditional grants for the 2023/24 wage implication carry through costs.

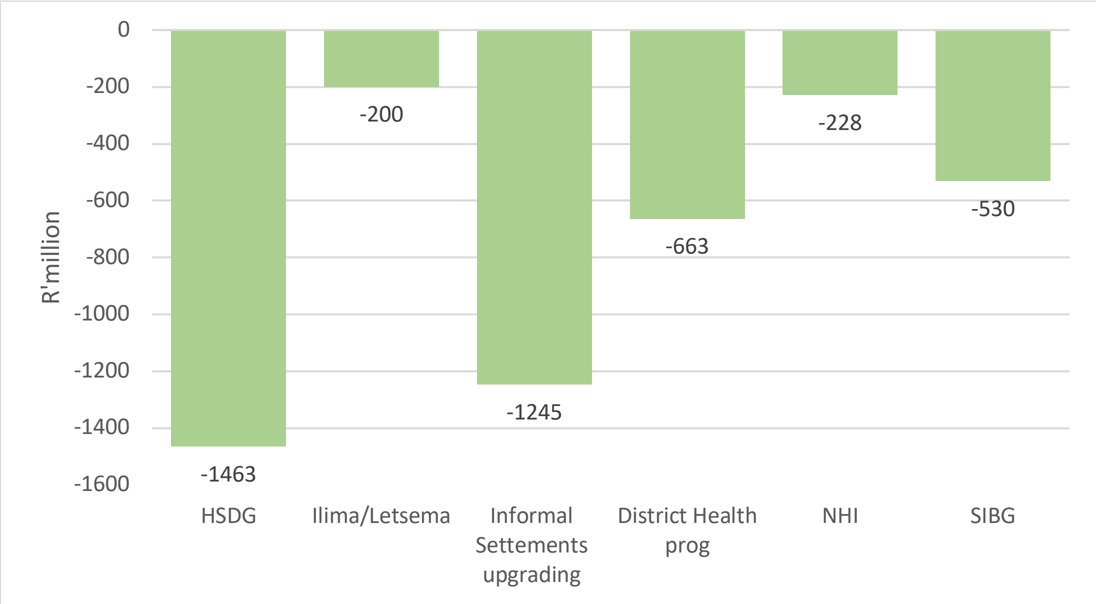
4.7. With respect to reductions in conditional grants for 2024/25, Figure 12 illustrates some of the conditional grants that have been significant revised downwards. **Human Settlements Development grant (HSDG)** and Informal Settlements Upgrading Partnership grants as the most affected grants with reductions amounting to R1.5 billion and R1.2 billion reduction, respectively. It is also key to note that the budget allocation for human settlements development through the HSDG has been significantly reduced, while housing, informal settlements backlogs, and the incidence of poverty remain high.

4.8. Other conditional grants that have been materially reduced include the **District Health Programme**, School Infrastructure Backlogs Grant (SIBG) and the National Health Insurance (indirect component). The Commission notes with concern that these series of reductions may undermine progress and efforts made in district health development and the implementation of national health insurance. More concerning is that the 2022 census showed an increase in the number of people living with HIV/AIDS.

4.9. A shift of R737 million from the National Health Insurance Grant to the National Tertiary Services Grant allows for the funding of oncology services to be consolidated under a single conditional grant.

4.10. Funding for **Ilima/Letsema** has been reduced by R200 million for 2024/25. The Commission notes this with concern given the importance of this programme in helping previously disadvantaged farming communities and the potential to undermine food security.

Figure 12: Reductions to selected Conditional Grants for 2024/25



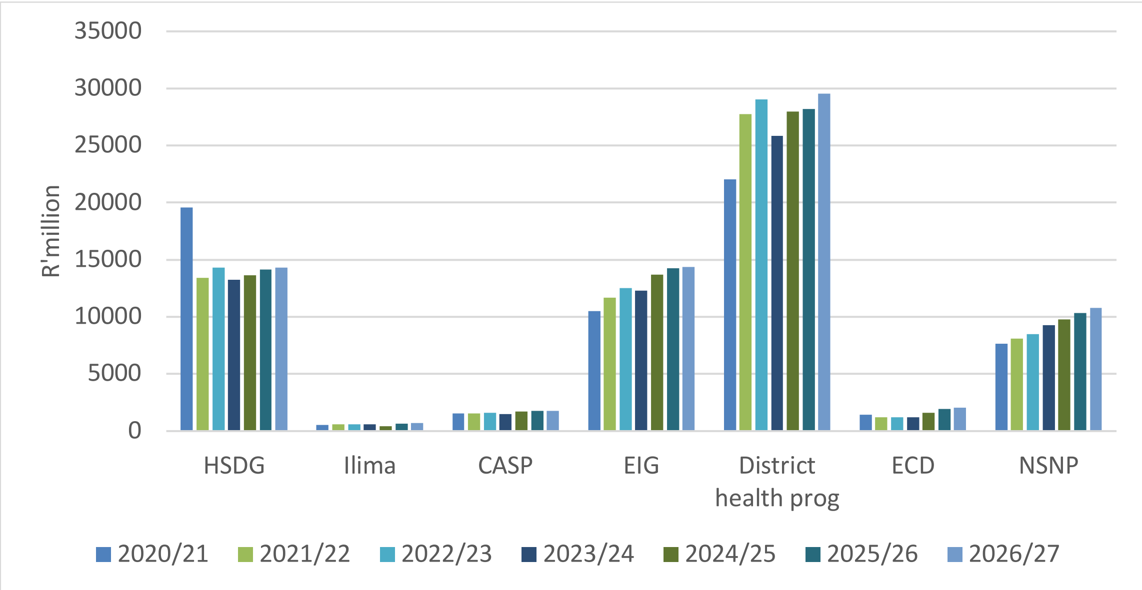
Source: Budget Review 2024

4.11. Figure 13 provides a timeline of allocations made to selected conditional grants. Over the 2024 MTEF R1.1 billion that was previously unallocated has been shifted to the National Department of Education to implement the **Early Childhood Development (ECD) Grant** to pilot a nutrition support programme and a result-based service delivery model on behalf of provinces. The **Education Infrastructure Grant (EIG)** provides supplementary funding for ongoing infrastructure programmes in provinces to be used for maintaining existing infrastructure and building new infrastructure.

4.12. As alluded to earlier, the HSDG continues to experience significant reductions in its allocation from R19.6 billion in 2020/21 to R13.7 billion in 2024/25. From 2021/22, a new stand-alone **Informal Settlements Upgrading Partnership Grant** was created in response to rapid urban migration and an increase in the number of informal settlements across South Africa. The Informal Settlements Upgrading Partnership Grant is designed to upgrade in-situ informal settlement in a targeted manner, in partnership with communities, providing households with tenure and providing municipal engineering services. Allocations for this grant will reduce by R7.2 billion in the baseline over the 2024 MTEF. The Commission is of the view that these reductions to these relatively new grants to be premature, or the grant framework was poorly designed in the first place.

4.13. The **National school nutrition programme grant (NSNP**) aims to improve the nutrition of poor school children, increase their attendance at school and enhance their capacity to learn. The scope of the intervention has expanded over time from initially targeting primary school learners. Following a recommendation made by the Commission, the programme was expanded to include secondary schools between 2009 - 2011. The programme currently provides a free daily meal to primary, secondary and special needs learners in quintile 1 to 3 schools. The reach of the programme has expanded year-on-year. For 2024/25, 10.5 million leaners in 20 661 schools are targeted to benefit from the programme with a budget allocation of R9.8 billion up from 9.7 million learners and a budget of R9.3 billion for 2023/24. Challenges with the roll out of this programme include: some service providers having no experience in food procurement and supply chain, inability to benefit from economies of scale, service providers delivering poor quality food, no tracking system to monitor deliveries and quality, funds not being utilised for intended purposes, learners being fed inferior food and in small portions. The rate of growth in the allocation to the grant of 5.1 per cent over the 2024 MTEF is below the overall food inflation of 7 per cent for the period January 2023 to January 2024 and significantly below that for fruit and vegetables at 10.2 per cent and 12.6 per cent respectively. The Commission supports the annual increase in allocations for this grant and the number of beneficiaries given the positive impact on alleviating hunger, promoting school attendance, concentration and well-being of learners. However, it recommends that consideration should be given to benchmarking the rate of increase to that of CPI food inflation.

Figure 13. Key provincial conditional grant allocations



Source: Budget Review, 2020/21 – 2025/26; FFC Own Calculations

Recommendations

- The Commission welcomes the additional funding allocated to the National Schools Nutrition Program over the 2024 MTEF, however, the Commission recommends the strengthening and improvement of spending to ensure alignment with the grant objectives and consideration be given to linking the rate of increase in this grant to that of food inflation.
- The Commission notes and supports the piloting of a nutrition support programme within ECD to be undertaken by the National Department of Basic Education, however it recommends that once the piloting is completed, the programme should be implemented by provinces. This is in line with the Commission's recommendation that indirect conditional grants be used as a last resort.
- The Commission notes the reductions to the Ilima/Letsema and the District Health Programme grants, the Commission recommends that the Department of Agriculture and Rural Development and the Department of Health elaborate on how these reductions are likely to affect service delivery and plans in place to mitigate the effects thereof.

5. 2024 Division of Revenue Bill – Local Government

Overview of local government allocation

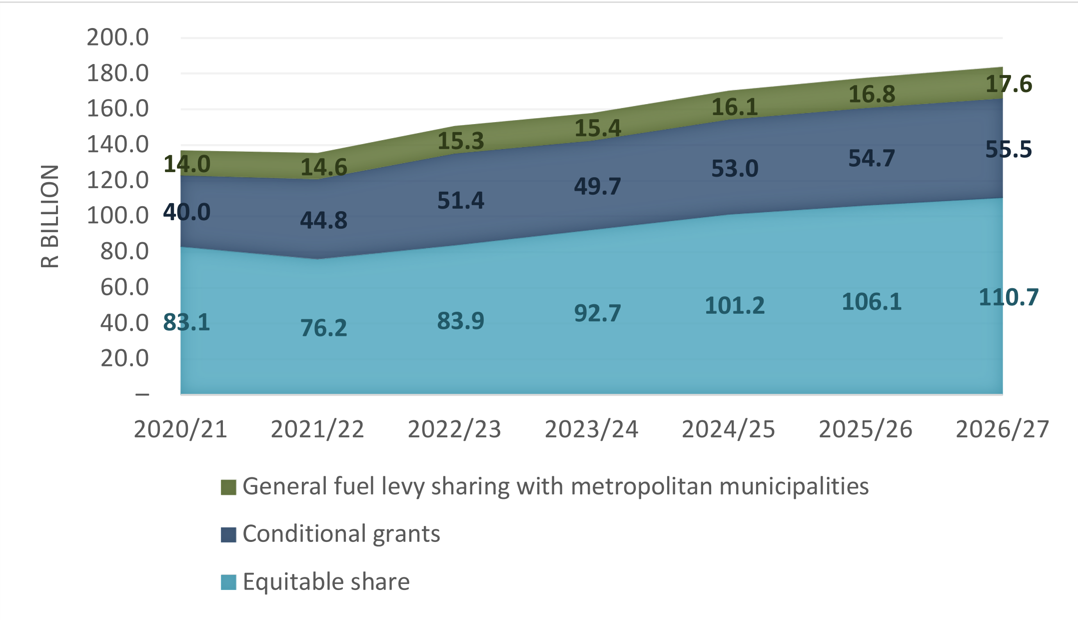
5.1. The South African local government sphere is faced with a myriad of challenges. The challenges faced by the sphere are not new, and many of the challenges were identified in the National Development Plan (NDP), which is still relevant. Aside from the most common challenges, which stems from the political environment, several municipalities are either on the brink of or are in financial distress. In the results of the 2021/22 audit, the Auditor-General identified 66 municipalities as being dysfunctional, coupled with issues relating to a coalition council, has led to many service delivery challenges across the country (FFC Submission for Division of Revenue, 2021/22).

5.2. To aid municipalities in fulfilling their mandate in terms of their development role and improved service delivery, both the national and provincial spheres of government need to assist in strengthening municipal finance and investment, to revitalise local development, create more employment and promote welfare through basic services. The Commission notes with concern the persistent struggles of municipalities due to a deficiency in capacity and its inability to address the obstacles engulfing local government.

Local government equitable share and formula

5.3. Over the 2024 MTEF, the local government sphere is set to receive total transfers amounting to R531.8 billion in direct transfers and R22.7 billion in indirect local government conditional grant transfers. The allocation through the local government equitable share (LGES) is R317.9 billion, R163.2 billion as conditional grants, and R50.5 billion as fuel levies. Figure 14 below illustrates the various allocations to local government. The vertical division of revenue share of local government allocations is expected to increase over the MTEF, from 9.7 per cent in 2024/25 to 9.9 per cent in 2025/26 and 2026/27 respectively.

Figure 14: Allocation to Local Government, 2019/20-2026/27



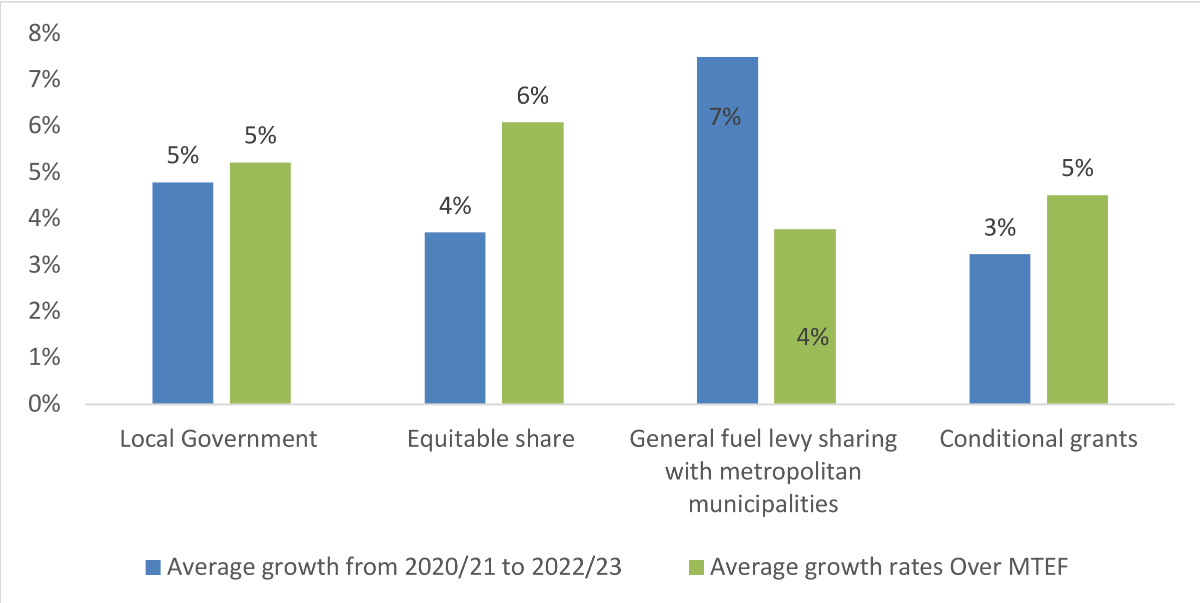
Source: National Treasury Database, 2024

5.4. Since its establishment, the fiscal framework for local government has undergone significant evolution. At the beginning with the 1996 Local Government White Paper, the primary emphasis was placed on the developmental role of municipalities to spur economic development. After the change of the millennium, the IGFR system placed more focus on social requirements and basic services for indigent households.

5.5. Figure 15 below shows that the increase in LGES allocation is the main driver behind the annual average growth rate of 5 per cent over the 2024 MTEF. The Commission welcomes the government's efforts to keep LGES consistent and protect the subsidies to the poor.

5.6. The Commission notes a redistribution of funding within the LGES amongst the different categories of municipalities, noting that the smaller, more rural municipalities are receiving more funding via the formula. The Commission thus notes and welcomes this redistribution of the LGES to fund these municipalities as this will help alleviate some financial pressures that the municipalities face.

Figure 15: Local government average nominal growth rates



Source: National Treasury Data Base; FFC Own Calculations

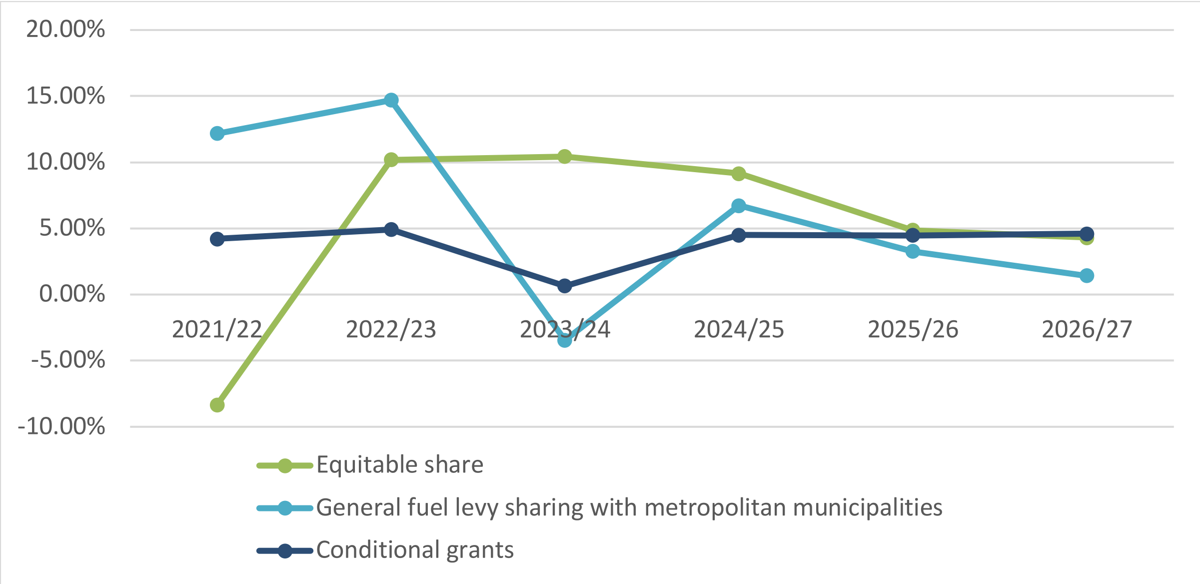
Local government conditional grants

5.7. The evolution of conditional grants over the past three decades saw the transferring department address the issue of the proliferation of grants. In 2004, the grants to municipalities decreased from 10 infrastructure grants to two main capital grants. The reduction of capital grants was achieved by consolidating individual grants into the Municipal Infrastructure Grant (MIG). After the 2014 grant review, grant fragmentation became an issue again. An example is the introduction of the Integrated National Electrification Program (INEP), the continuation of the Water Infrastructure Grant (WIG), etc.

5.8. The Commission cautioned that conditional grants should not continue in to perpetuity beyond their effective lifespan without an exit strategy, which in essence becomes an unconditional transfer similar to an equitable share. For example, MIG funding was supposed to conclude in 2014; however, it is still the largest capital transfer to local government, lacking of non-financial performance information for evaluating the success of interventions and the meeting of grant objectives.

5.9. The local government sector is set to receive R163.2 billion as direct conditional grants and R22.7 billion in indirect grants over the 2024 MTEF, with infrastructure grants accounting for 96.3 per cent of the allocations and capacity grants at 3.7 per cent. Figure 16 below compares the growth rates of infrastructure and capacity grants with the local government equitable share allocations. The results show a steady increase in nominal terms over the 2024 MTEF for municipal condition grants.

Figure 16: Nominal growth rate in the three local government transfer windows



Source: National Treasury Data Base; FFC Own Calculations

5.10. Post the 2023 MTBPS, several more reductions and reprioritisations have affected the local government sphere over the 2024 MTEF. These reductions aim to make funds available for other priorities. The reductions affect the Integrated National Electrification Programme (INEP) municipal grant, the municipal disaster response grant, the Public Transport Network grant (PTNG), the energy efficiency demand-side management grant, and both the direct and indirect components of the Regional Bulk Infrastructure Grant (RBIG). The reprioritisation of funding over the MTEF will decrease the allocations to the local government by R13.5 billion.

5.11. The Commission acknowledges that the grant framework of the Urban Settlements Development Grant has been amended to include spending on new and existing bulk infrastructure. Over the 2024 MTEF, the grant is allocated R27.8 billion, distributed between the eight Metropolitan Municipalities across the country.

5.12. The additional R650 million added to the Neighbourhood development grant for 2024/25, geared is to aid the government's efforts in job creation. The R650 million is to fund the cities' public employment programme. The Commission notes that this is a capital grant with the strategic goal of eradicating spatial inequality towards creating liveable, sustainable, resilient, efficient, and integrated cities and towns. Therefore, the Commission recommends that the transferring department complete a comprehensive review to ensure that the functions and funding align with the strategic objective of the grant.

5.13. Through capacity-building and other current transfers, local government will receive a total of R6.9 billion over the MTEF for this category of grants. The Commission notes a significant decrease of 17.3 per cent year-on-year for this category; this is driven by the reductions in funding of Municipal Disaster Response grant from R745 million in 2023/24 to R378 million and Expanded Public Works Programme from R749 million in 2023/24 to R560 million in 2024/25.

5.14. The Commission welcomes the additional funding of R1.95 billion over the MTEF for the procurement of smart meters. The funding will flow as an indirect grant from the National Treasury, which complements the funding provided via the Eskom Municipal Debt Relief Programme. Currently, the funds will only be available to municipalities on the Eskom Municipal Debt Relief Programme. The Commission further notes the plans to extent funding to other municipalities at a later stage. However, the grant framework states that the projected lifespan is until the 2026/27 financial year.

5.15. The uptake of the FFC's recommendation to fund the District Development Model (DDM) is a step towards the right direction. Over the 2024 MTEF, the National Treasury has prioritised the DDM funding via the Municipal Systems Improvement Grant (MSIG)—the grant allocation is R454 million over the MTEF period, with a year-on-year increase of 2.6 per cent. In 2024/25, the grant will fund the diagnostic assessment of the 21 C2 district municipalities. The proposed evaluation will assess the performance, skills, institutional gaps, systems, and the main challenges hampering their performance. In addition, the grant will also fund the development of institutional improvement and support plans, this will inform future capacity development programmes.

5.16. While the reprioritisation of funding towards local government is supported, the Commission would like to stress the importance of the spending capacity of the receiving municipalities. The allocation of extra funds via conditional grants may lead to a rise in wasteful and inefficient spending as financial performance trends reflect poor spending on conditional grants. Poor grant spending has led to poor service delivery due to municipalities' inability to absorb and utilise money efficiently. Over the 2024 MTEF, national and provincial governments should aid municipalities in fulfilling their constitutional mandate through improved service delivery.

Recommendations

- The Commission notes the proposed increase in the LGES allocation, mainly driven by the increases in the basic component. The Commission would like to emphasise the need for a comprehensive review of the local government fiscal framework to address the systemic challenges facing the sphere.
- The Commission welcomes the reprioritisation and additionality made to conditional grants over the 2024 MTEF; the Commission suggests that value for money should be actively pursued to ensure the efficient utilisation of these funds. For instance, this may be done by calculating the costs of municipal outputs, evaluating performance, and comparing results

while being mindful of innovation to promote continuous development, through the District Development Model principle.

- The Commission recommends that non-financial information be included in the conditional grant reporting framework. The inclusion of non-financial information will facilitate the monitoring and evaluation of grant performance, thereby enhancing and strengthening oversight regarding the success of the interventions.

6. Concluding Remarks and Recommendations

6.1. The Commission appreciates the considerations of its recommendations made in the past 30 years by Parliament the legislature, and government's implementation. The Commission uplifted the first Budget of the Government of the National Unity and public finance accountability report under the negotiated constitutional order. After a prolonged recession which began in 1989, in 1993, South Africa saw spurts of growth, with 5 to 7 per cent in seasonally adjusted and annualised growth rate in output measured from quarter to quarter.

6.2. At that time, the State Revenue Account recorded total revenues of approximately R89.2 billion, with expenditures reaching R114.7 billion. Today, South Africa's main budget revenue exceeds R1.8 trillion and expenditures amounting to R2.1 trillion, resulting in a deficit of R320.9 billion (National Treasury, 1994 & 2024). The question is whether these expansions in public finance has been **matched by corresponding improvements in the quantity, quality, and delivery of public goods and services**?

With respect to the 2024 fiscal framework, Public-sector institutions and investment

6.3. The Commission recommends a comprehensive economic growth strategy to surmount these obstacles and discover new prospects for growth. The strategy should reorient the industrial policy and align it with shifting global trends and requirements. It should ignite an economically sustainable path by placing more emphasis on sectors that are increasingly in global demand, such as the production of grid-scale storage batteries for electricity and other green economy-related eco-products, and position the country as a prominent figure in the fast-growing green technology market.

6.4. The Commission recommends strengthening SOEs' governance structures, rigorously assessing their business models, and rationalising operations by divesting non-core activities. In addition, the Commission recommends speeding up establishing a centralised holding company as recommended by the Commission in its 2024/25 annual submission. This centralised entity would constitute a well-organised platform to comprehensively tackle obstacles of SOEs, promote strategic decision-making, and ensure unified efforts for operational and financial success.

With respect to the 2024 Appropriation Bill

6.5. The Commission appreciates the strides that have been made in terms of access to basic services since 1994, however, there is room for further improvement across a range of sectors. For substantive change and transformation to occur, there is a need to complement the hitherto emphasis on quantity of access with a focus on the quality of such access.

6.6. The Commission reiterates its previous calls for indirect grants to be used as a measure of last resort. Further, to ensure that the capacity of municipalities are being strengthened to conduct their own affairs, national sector departments implementing indirect grants must devise plans and timelines for building the capacity of the affected subnational department/municipality to take on the implementation responsibility associated with an indirect grant. Timelines for the phasing out of indirect grants is vital. Finally, a stronger monitoring framework should be devised for indirect grants to facilitate improved performance management.

6.7. The Commission welcomes the investigation and efforts at turning around the performance of the NSFAS. However, the Commission recommends that national sector departments strengthen proactive oversight over subnational governments and entities to ensure that early warning systems are developed to identify risks and implement appropriate mitigation strategies.

6.8. The Commission welcomes the approval of the Freight Logistics Roadmap by Cabinet in December 2023 and is of the view that the three areas of intervention outlined in the roadmap are key to alleviating the woes of the country's freight rail and port logistics system. The FFC recommends that the National Logistics Crisis Committee (NLCC) ensure efficient and coordinated implementation of the roadmap with all stakeholders involved. In addition, the roadmap should be enacted in a coordinated manner with Transnet's own recovery plan to ensure alignment in the objectives and timelines of both interventions.

6.9. The Commission notes the Second Adjustment Appropriations Bill and the accompanying reprioritisations.

With respect to the 2024 Division of Revenue Bill – Provinces

6.10. The Commission welcomes the additional funding allocated to the National Schools Nutrition Program over the 2024 MTEF, however, the Commission recommends the strengthening and improvement of spending to ensure alignment with the grant objectives and consideration be given to linking the rate of increase in this grant to that of food inflation.

6.11. The Commission notes and supports the piloting of a nutrition support programme within ECD to be undertaken by the National Department of Basic Education, however it recommends that once the piloting is completed, the programme should be implemented by provinces. This is in line with the Commission's recommendation that indirect conditional grants be used as a last resort.

6.12. The Commission notes the reductions to the Ilima/Letsema and the District Health Programme grants, the Commission recommends that the Department of Agriculture and Rural Development and the Department of Health elaborate on how these reductions are likely to affect service delivery and plans in place to mitigate the effects thereof.

With respect to the 2024 Division of Revenue Bill – Local Government:

6.13. The Commission notes the proposed increase in the LGES allocation, mainly driven by the increases in the basic component. The Commission would like to emphasise the need for a comprehensive review of the local government fiscal framework to address the systemic challenges facing the sphere.

6.14. The Commission welcomes the reprioritisation and additionality made to conditional grants over the 2024 MTEF; the Commission suggests that value for money should be actively pursued to ensure the efficient utilisation of these funds. For instance, this may be done by calculating the costs of municipal outputs, evaluating performance, and comparing results while being mindful of innovation to promote continuous development, through the District Development Model principle.

6.15. The Commission recommends that non-financial information be included in the conditional grant reporting framework. The inclusion of non-financial information will facilitate the monitoring and evaluation of grant performance, thereby enhancing and strengthening oversight regarding the success of the interventions.

Approved by:

Dr Patience Nombeko Mbava

Chairperson

Date: 25 February 2024