



# Financial and Fiscal Commission: Submission on the 2017 Fiscal Framework and Revenue Proposals

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*For an Equitable Sharing of National Revenue*

28 February 2017

Financial and Fiscal Commission  
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## List of Acronyms

CIT	Corporate Income Tax
DM	District Municipality
EU	European Union
FFC	Financial and Fiscal Commission
GDP	Gross domestic product
HFRG	Health Facility Revitalisation Grant
IMF	International Monetary Fund
LES	Local Equitable Share
LGFF	Local Government Fiscal Framework
MFMA	Municipal Finance Management Act
MIG	Municipal Infrastructure Grant
MTBPS	Medium Term Budget Policy Statement
MTEF	Medium Term Expenditure Framework
NDP	National Development Plan
NGP	New Growth Path
NHI	National Health Insurance
NSFAS	National Student Financial Aid Scheme
PFMA	Public Finance Management Act
PIT	Personal Income Tax
RAF	Road Accident Fund
RSC	Regional Services Council
SAHPEA	South African Health Products Regulatory Authority
SALGA	South African Local Government Association
SARB	South African Reserve Bank
SME	Small Medium Enterprise
SOEs	State Owned Enterprises
UK	United Kingdom
USDG	Urban Settlements Development Grant
VAT	Value-Added Tax
WEO	World Economic Outlook

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## **1. Background**

- 1.1. The submission is made in terms of Section 4 (4c) of the Money Bills Amendment Procedure and Related Matters Act (Act 9 of 2009) which requires Parliamentary Committees to consider any recommendations of the Financial and Fiscal Commission (FFC) (hereafter the Commission) when considering Money Bills. It is also made in terms of the FFC Act (1997) as amended which requires the Commission to respond to any requests for recommendations by any organ of state on any financial and fiscal matter.
- 1.2. The submission consists of seven sections which cover the following areas:
  - Section 2: Brief Review of the 2017 Fiscal Framework
  - Section 3: Overview of Public Finances
  - Section 4: Fiscal Framework and Revenue Proposals
  - Section 5: Local Government Financing Issues
  - Section 6: Financing South Africa's Social Programmes: Focus on Health and Education
  - Section 7: Concluding Remarks

## **2. Brief Overview of the 2017 Fiscal Framework**

- 2.1. The 2017 Fiscal Framework is enacted in an environment in which South Africa needs to balance the prospects of moderate pickup in economic activity with potential adverse effects stemming from downside risks. Even though South Africa succeeded in avoiding a downgrade in 2016, nevertheless, going forward investors and rating agencies expect concrete results. Economic growth forecasts (i.e. 1.3 per cent in 2017) have not been revised downwards for the first time in several years. As a result, it has not been necessary to change budgeted growth in tax revenue downwards. South Africa's Gross Domestic Product (GDP) growth is forecasted to continue to be sluggish albeit gradually picking up. The 2016 Medium Term Budget Policy Statement (MTBPS) lowered the growth projections for 2016 and 2017 from 0.9 percent to 0.5 percent and from 1.7 percent to 1.3 percent respectively. The South African Reserve Bank forecasts are slightly lower at 0.4 percent for 2016 and 1.1 percent for 2017, while the International Monetary Fund (IMF) in its January 2017 World Economic



Outlook (WEO) update is more pessimistic estimating economic GDP growth of 0.3 percent for 2016 and 0.8 percent for 2017.

- 2.2. The tax proposals are heavily reliant on personal income tax, across board but more harshly on upper income groups; substantial increase in taxation of dividends; minor changes to fuel levy, sin taxes.
- 2.3. The prospects for economic growth are now positive, as the country has addressed the electricity shortage issue which was disabling the economy. Electricity demand has been relatively lower which assisted with making more electricity available. On the supply side, there have been notable successes in bringing some new units to coal-fired power station generating electricity. The improvement in electricity production removes bottlenecks and should boost confidence and therefore investment. Furthermore, infrastructure investment in expanding electricity generation capacity is important for growth and competitiveness.
- 2.4. Continuous infrastructure investment done by government, specifically the major infrastructure expenditure by State Owned Enterprises (SOEs), Provinces and local government, is welcomed. The Commission notes the incidents of roads being flooded that occurred in 2016 which caused the death of people, lots of vehicles swept away and damaged dwellings. These incidents highlight, amongst others, the importance of maintenance to avoid blocking of storm water pipes, culverts, bridges etc. The Commission reiterates the point it raised in its 2016 MTBPS submission, that regular road maintenance and a well-maintained road network are key to economic development and growth.
- 2.5. As part of the reforms aimed at improving the country's medium-term growth outlook, there are several specific imperatives that government has announced, to boost investment in the short term, safeguard South Africa's investment-grade credit rating and measures to stabilize government debt. Government debt will stabilise at about 48 per cent of GDP over the next three years.

### **3. Overview of the Economy and Public Finances**

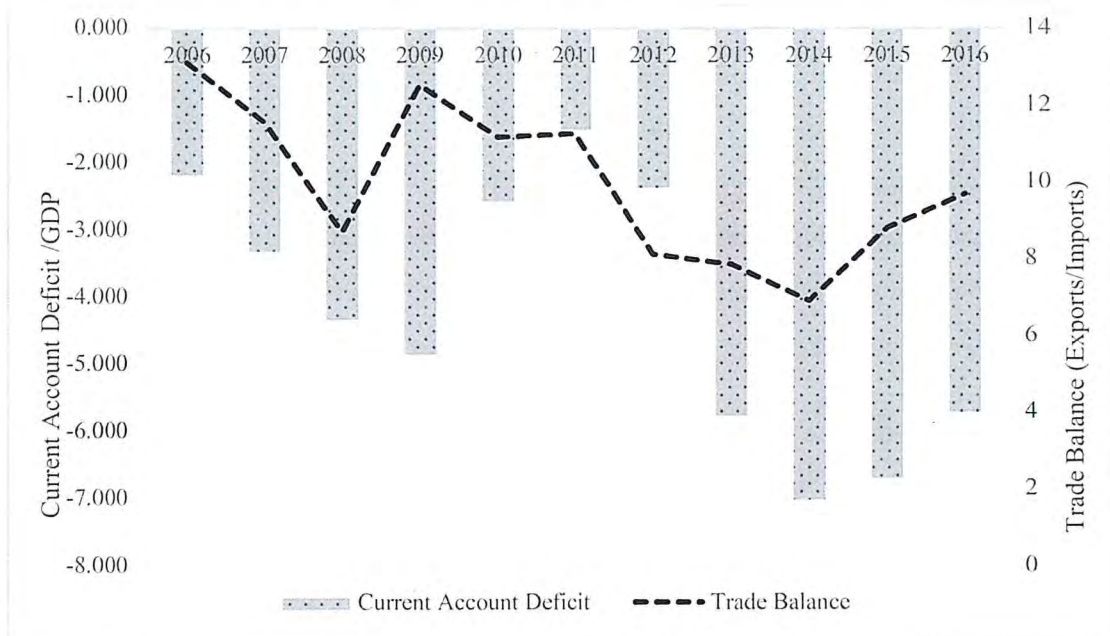
#### **Economic Outlook**

- 3.1. The expectations of moderate recovery are based on stronger than expected pickup in economic activity within advanced countries. Expectations that the US will pursue a

more expansionary fiscal policy and adopt less gradual normalization of monetary policy to combat inflationary pressures stemming from future increases in aggregate demand, coupled with increased infrastructure investment in the Chinese economy, has strengthened both the demand and prices of base metals. Along with global economic growth projected at 3.4 percent and 3.6 percent in 2017 and 2018, respectively, rebound in economic activity across advanced economies in Europe, Asia and the United States (US) could provide impetus to Government's objective of enhancing terms of trade and reducing the current account deficit via increased export volumes.

- 3.2. Trends in global outlook have a strong impact on the level and growth of economic activity in South Africa. Through its interlinkages with the global economy, a significant proportion of domestic production (about 30 percent) is exported to the rest of the world. In the aftermath of the 2008 global financial crises, marked slump in global commodity prices, subdued economic performance across major industrialized nations, and the deceleration in the growth trajectory of the Chinese economy had an adverse impact on South Africa's terms of trade and current account deficit (see Figure 1). Between 2006 and 2016, trade balance (the ratio of exports to imports) declined at an average rate of 0.8 percent. In the latter half of 2016, the moderate increases in commodity prices and the performance of the Rand contributed to improvements in the terms of trade. While these factors are expected to reduce the current account deficit, it still remains wide. Relative to the less than 3 percent levels pre-2010, the current account deficit as a share of GDP has averaged more than 5 percent since 2010.



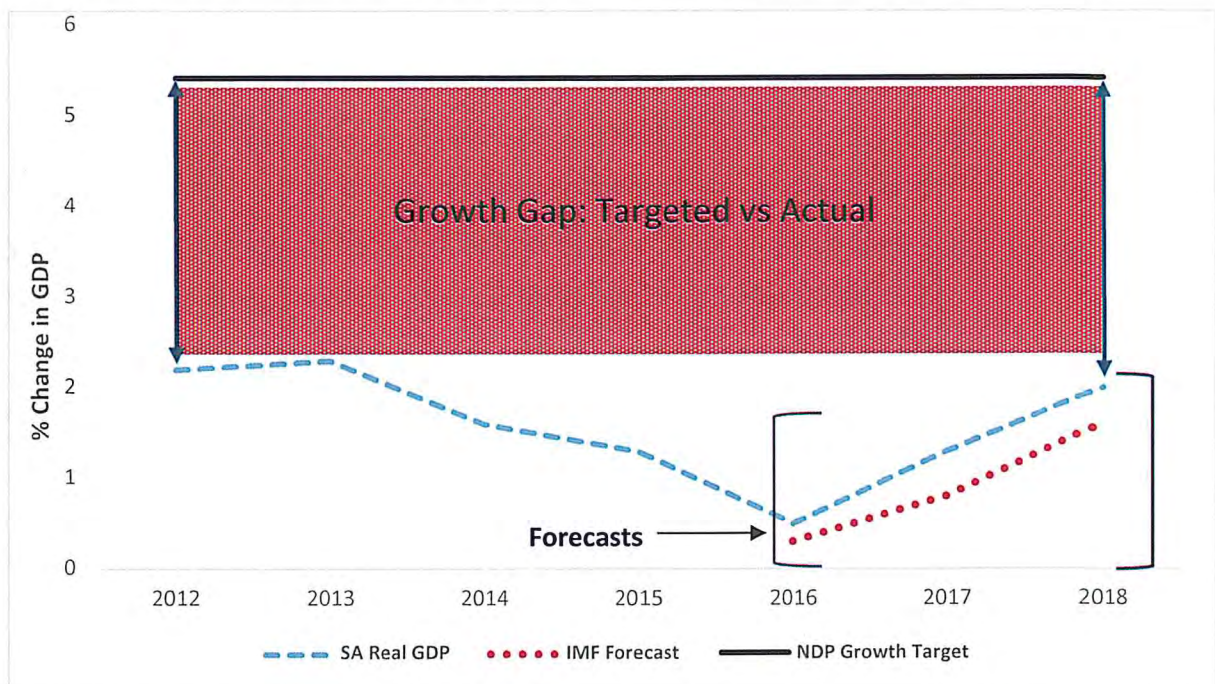
**Figure 1: South Africa's Trade Balance and Current Account Deficit, 2006 - 2016**

Source: SARB Statistical Database and Commission Calculations

- 3.3. Potential downside risks remain for the current account deficit and the potential for exports to provide impetus to economic recovery. Following the recent presidential elections in the US, significant uncertainty remains around the sustainability of strong recovery in the US economy. Any ramping up of protectionist measures by the new administration could adversely affect global trade and undermine growth within emerging and developing market economies.
- a. Uncertainty also persists regarding the prospects for the United Kingdom (UK) economy following the decision of its citizens to vote in favour of leaving the European Union (EU). The impact on mutual trade and financial flows of the UK's exit decision will only be clear once the process of the UK's exit from the Eurozone is finalized. With the exit process likely to require an intense round of negotiations and take several years to complete, significant uncertainty remains around the long-term economic prospects of EU nations as well as the UK in the post-Brexit era. While the latter half of 2016 has seen recovery in the Eurozone boosted by stronger-than expected performance in Germany, Spain and Italy, rising sentiment against cross-border economic integration in other EU states could intensify calls for implementation of populist, inward-looking policies that pose a risk to continued slow growth recovery across the EU.



- b. In addition, underlying vulnerabilities remain in the Chinese economy where capacity reductions and rising demand for commodities have caused producer price inflation to rise for the first time since 2012. The 2017 growth forecast for the Chinese economy has been revised upwards (from 6.2 to 6.5 percent). While upward revisions a welcome development, especially for commodity exporting countries, it is mainly driven by expectations of continued implementation of policy stimulus measures. However, rapid credit-driven nature of and slow progress in stabilizing the debt and budgets of state-owned enterprises raises the risk of an unsustainable credit bubble which require adjustments that create financial sector vulnerabilities, and undermine the growth outlook.
- 3.4. Despite the improved global economic outlook and its potential to generate positive benefits, aggregate growth estimates and projections for 2017-18 remain muted for South Africa. The relatively weak economic performance reflects an economy still dealing with the lingering effects of China's reduced reliance on import-and resource-intensive investment, the impact of the worst drought in three decades that occurred in 2015 and impact of political risks on policy certainty. South Africa's economy is expected to grow by 1.3 percent and 2 percent in 2017 and 2018, respectively. While these projections represent a slight improvement on the 0.5 percent growth recorded in 2016, it remains lower than the 5.4 percent annual growth envisaged by the National Development Plan (NDP) as necessary in efforts to eliminate income inequality and achieve a 50 percent reduction in unemployment levels by 2030 (see Figure 2).

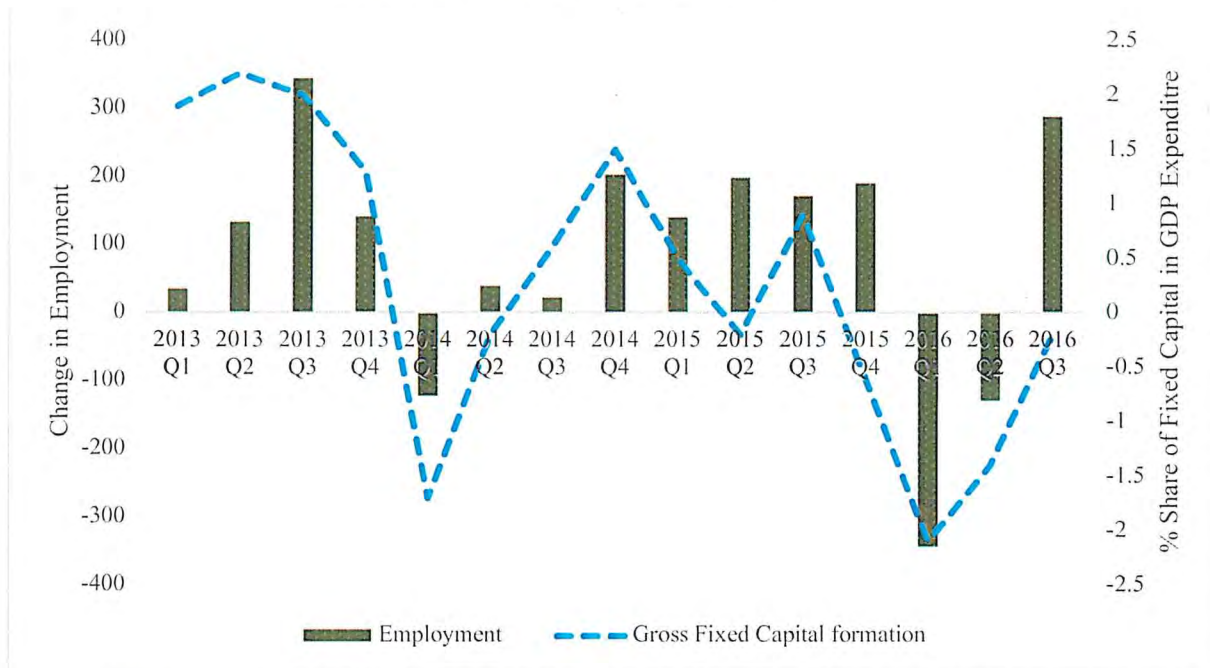
**Figure 2. South Africa's GDP Growth: Projections and Revised Forecasts, 2014-2018**

Source: October MTBPS (2013, 2014, 2015), WEO of the IMF (January 2016) and Commission Calculations.

- 3.5. Data from the 2016 Quarterly Labour Survey shows that a below target growth rate has had severe implications for the labour market. The number of employed individuals decreased by 473 000 in the first two quarters of 2016. While the number of people employed in the last two quarters increased by 523 000, the combined effect of these outcomes translates to a 50 000-net increase in the number of people employed in 2016. Similarly, the number of unemployed people increased by 530 000 and 239 000 in the first and third quarters of 2016 respectively while the second and fourth quarters were characterised by a reduction in unemployment by 90 000 and 92 000 people, respectively. These changes translated into a 587 000-net increase of the number of people unemployed in 2016. Increased jobs are thus indicative that subdued growth and low investments continue to act as a binding constraint on the economy's capacity to make a meaningful impact on levels of employment and unemployment figures.
- 3.6. Accelerating existing levels of investment is vital to Government's job-creation initiatives. However, a worrisome trend of weakening investment growth in tandem with low employment levels has become an associated feature of South Africa's low growth environment (see Figure 3)



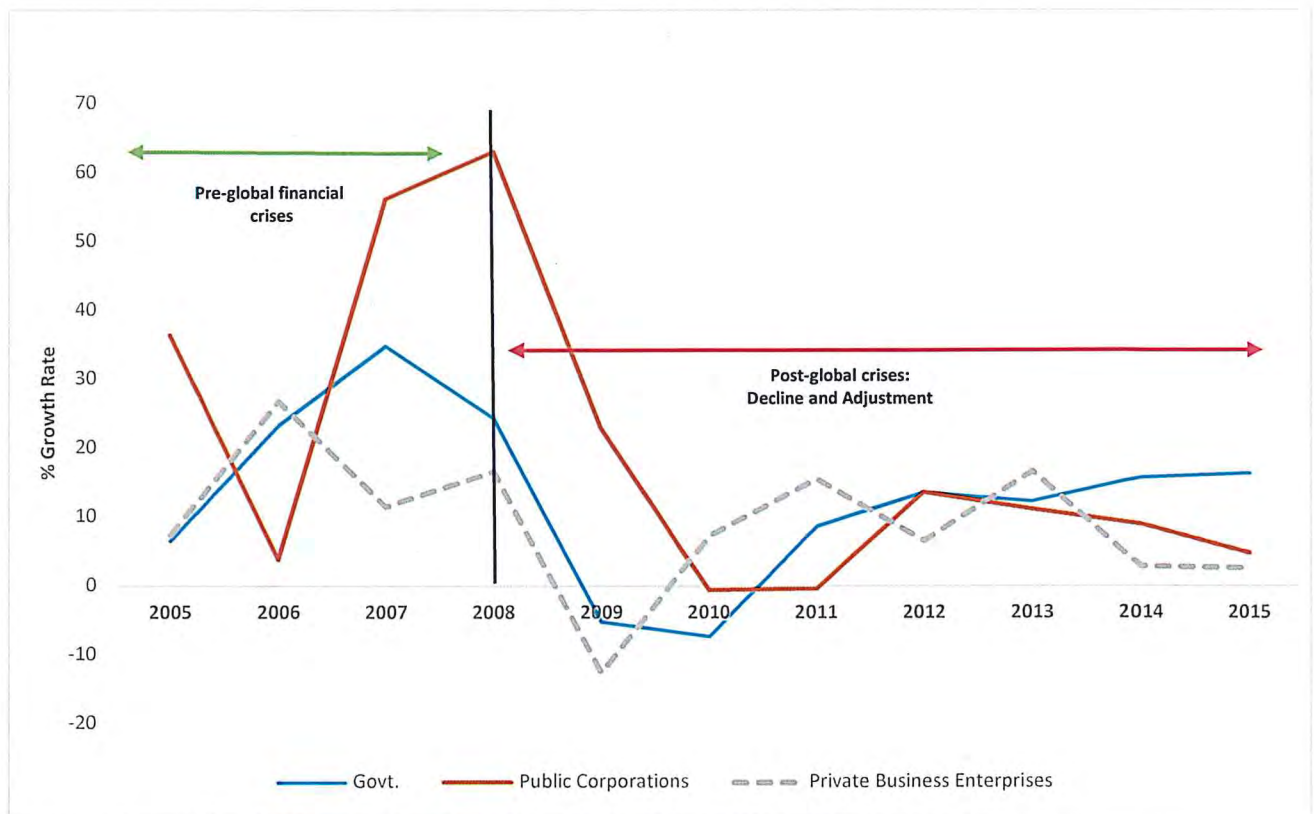
**Figure 3. Gross Fixed Capital Contributions to Growth in Expenditure on GDP and Quarter Changes in Employment, 2013-2015**



Source: Statistics South Africa, Gross Domestic Product-third quarter, 2016 and Quarterly Labour Force Survey-fourth quarter, 2016.

- 3.7. Weakness in investment growth has been particularly acute within private business enterprises where relative to its peak of over 26 percent in 2006, expansions in investment grew by a modest 2.6 percent in 2015. At an aggregate level, investment growth averaged over 16 percent between 2000 and 2008. In the post-global crises period, this growth has declined to 8.5 percent on average between 2008 and 2015. As a result of Government's stated commitment to addressing infrastructure bottlenecks and enhancing socio-economic investments, much of the investment growth has been driven by the public sector (see Figure 4). While slowing investment growth within the private sector is partly a correction from relatively high pre-crisis levels, it also reflects obstacles faced from declining commodity prices and stagnant global economic growth, and more broadly, investors' concerns over uncertainty generated by political risks.

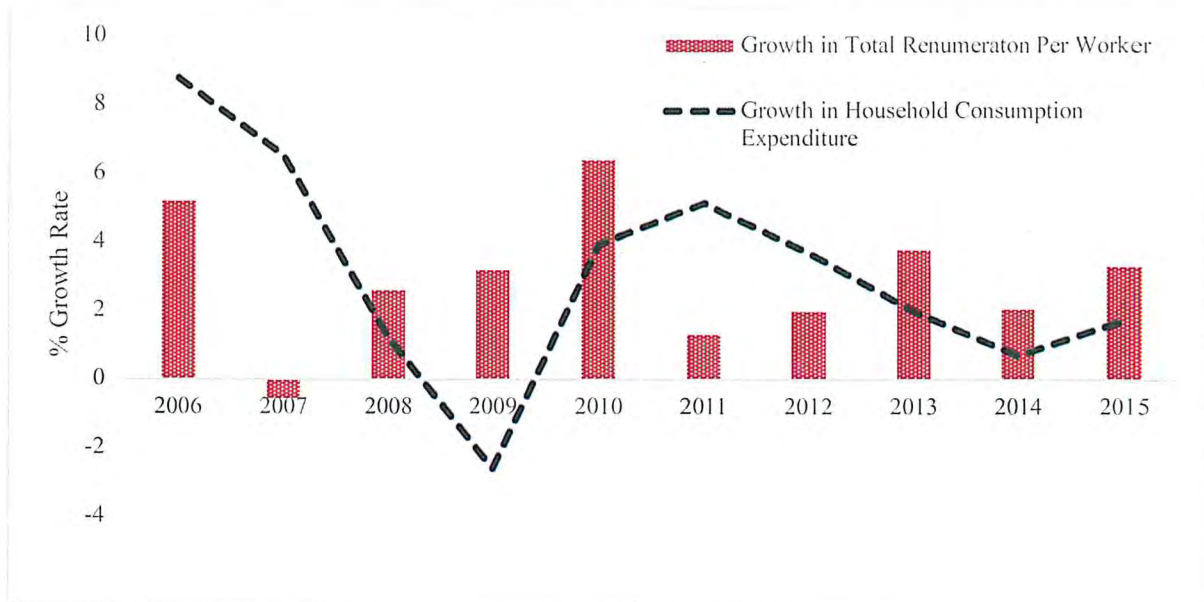
Figure 4. Gross Fixed Capital Formation by Organisation, 2005-2015



Source: South African Reserve Bank (SARB) Statistical Bulletin (Various Years).

- 3.8. The weak labour market environment has impacted on growth in wages per worker and by extension, household consumption expenditure (see Figure 5). For the fifth consecutive quarter, year-on-year nominal wage growth per worker in the third quarter of 2016 declined to 5.8 percent. Household consumption expenditure accounts for close to 60 percent of national GDP and is thus a major driver of economic activity. Stagnant wage growth along with slower wage growth have placed significant constraints on household spending. In the post-2008 dispensation, growth in total household spending has averaged a modest 2 percent. Exacerbating weakness in household expenditure growth is persistence in low levels of consumer confidence and pressures on disposable incomes stemming from high levels of household indebtedness.



**Figure 5. Growth in Remuneration Per Worker and Household Consumption Expenditure, 2006 - 2015**

Source: SARB Statistical Bulletin (Various Years)

3.9. On the demand side of the economy, GDP-third quarter 2016 publication from Statistics South Africa shows that private consumption grew at 0.9 percent year-on-year in the first three quarters of 2016, reflecting a weak trend when compared with the first three quarters in 2015. The ongoing fiscal consolidation saw public consumption decelerating from 2.1 percent in the first quarter of 2016 to 1.5 and 1.1 percent year-on-year, respectively, in the subsequent two quarters. Overall, final consumption expenditure was the main driver of economic growth at an average of 1.1 percent year-on-year in the first three quarters of 2016, adding 0.8 percentage points to overall GDP growth as shown in Figure 6 below.

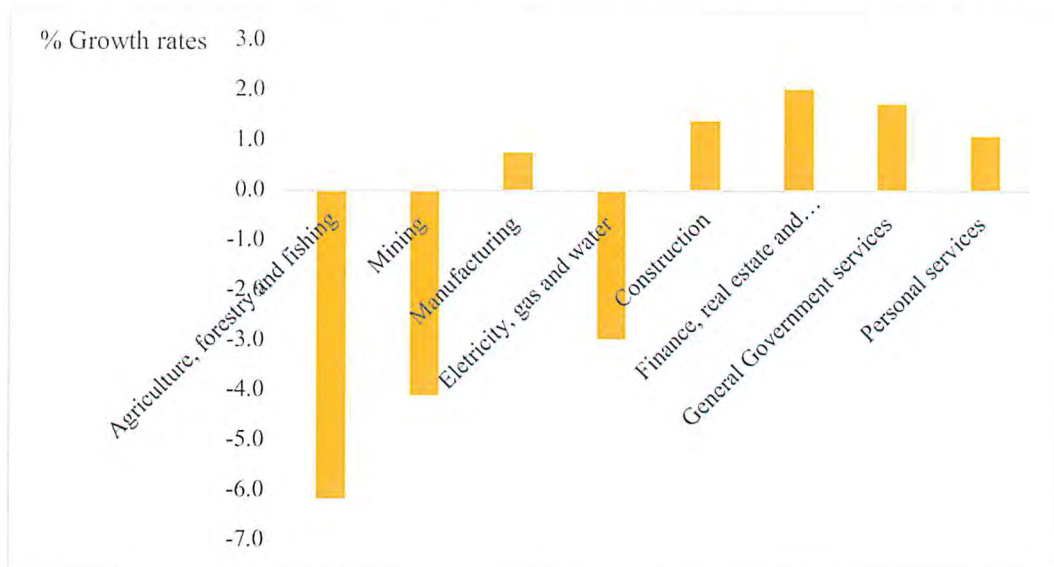
Figure 6. Average Growth Rates in Expenditure on GDP, 2016Q1-2016Q3



Source: Statistics South Africa, Gross Domestic Product-third quarter 2016

- 3.10. On the production side of the economy, available GDP data from Statistics South Africa shows that the agriculture sector contracted sharply by 6.2 percent year-on-year in the first three quarters of 2016. The sharp deceleration is closely associated with effect of the severe drought caused by the El Niño weather phenomenon. The return of relatively good rainfall in the third quarter of 2016 has ensured that the rate of the deceleration in agricultural output has slowed down. This has raised expectations of a rebound in agricultural activity. However, as agricultural output has fallen back to 2012 levels, regaining lost production will take some time to materialize. The drought also adversely affected the electricity and water sector which also contracted markedly by 3.0 percent year-on-year in the first three quarter of 2016 as shown in Figure 7 below.



**Figure 7. Average Growth Rates in Industry Value Added and GDP, 2016Q1-2016Q3**

Source: Statistics South Africa, Gross Domestic Product-third quarter 2016

- a. The mining and manufacturing sectors have been purported as strategic drivers of growth and job creation as envisaged in the various versions of the Industrial Policy Action Plans, National Growth Path and NDP. However, these sectors have had mixed fortunes in terms of growth performance and significance. Together, these sectors account for about one-fifth of GDP, even though their share has been falling because they have been outperformed by the finance, real estate, and business services sectors. The mining sector contracted significantly by 4.1 percent year-on-year in the first three quarter of 2016. The manufacturing sector grew marginally at 0.8 percent year-on-year in the first three quarter of 2016. Their mixed fortunes in growth performance calls into question their ability to become sustainable drivers of growth. The fortunes of the mining sector will continue to hinge on the commodity price cycle which fluctuates unpredictably. The increased volatility of the rand will continue to weigh heavily on the manufacturing sector.
- b. The financial, real estate and business services sectors have now been the main drivers of economic growth. While jointly they account for just over a fifth of GDP, their share is increasing in line with ongoing structural transformation of the economy. These sectors grew by 2.1 percent year-on-year in the first three quarters of 2016 thus maintaining their role as the engine of growth. The feeble



domestic economy, slowing consumer credit and a weakening real estate market are all contributing to slowing down this main engine of growth from previous levels.

- 3.11. Government's commitment to short-term stabilisation measures and long-term efforts to strengthen governance framework of SOEs is beginning to yield some gains. For the first time in recent years, liabilities of SOEs have declined as a percentage of assets, while the return on equity has risen from heavily negative to slightly positive following the combined 0.8 percent return on equity recorded by the 16 largest SOEs in 2015/16. The borrowing requirement of the six largest state-owned companies as a share of GDP is expected to average 1.6 percent between 2017/18 and 2019/20, a 1.4 percent decline from its 2015/16 levels. The Commission welcomes the declining levels of contingent liabilities of SOEs as this will enhance ongoing efforts to avoid fiscal slippage and ensure the reigning in of public debt.
- a. Investors will continue to assess Government's long-term efforts to limit further capitalizations and reform those SOEs where operational inefficiencies, poor procurement practices, weak corporate governance continues to cause financial difficulties. In this regard, the Commission welcomes Cabinet's November 2016 decisions around endorsing a framework to guide public-private partnerships on infrastructure projects and process for establishing overarching legislation related to shareholder policy for SOEs
- 3.12. In order to stimulate inclusive growth and create more jobs, structural reforms are imperative and vital. Given that the fiscal space is virtually exhausted, the priority now must be to increase private sector employment inclusive of provisional and informal jobs. A comprehensive package of structural reforms encompasses promoting competition, labour market reforms to make it inclusive, transforming the training and education system, and improved governance. The starting point should be concentrated endeavours aimed at lowering policy uncertainty and improving investor confidence. In this regard, clarifying the regulatory environment in mining would go a long way in minimising policy uncertainty. Agricultural investment is largely depended on the nature and details of land reform and the settlement of restitution claims on land. This is key in promoting agriculture which could be instrumental in alleviating youth employment. The reduction of business costs such as port tariffs and spectrum



allocation for broadband as well as trade liberalization to promote regional integration would galvanise the Small and Medium Enterprises (SMEs) sector, reducing transportation costs could enhance unemployed in their endeavour find jobs. The introduction of the proposed national minimum wage in conjunction with wage flexibility reforms encompassing exempting SMEs from collective bargaining outcomes, and the introduction of contracts where workers gradually accumulate benefits and job security could help in stabilising the labour market. Similarly, the lowering of fees in telecommunications and transport sectors could have large positive multiplier effects on other sectors.

## 4. Fiscal Framework and Revenue Proposals

### Fiscal Framework

4.1. Table 1 shows the consolidated government fiscal framework. It indicates that a consolidated revenue target of R1.41 trillion is estimated for 2017/18 (or 29.8 percent of GDP). Expenditure is projected at R 1.56 trillion, leaving a budget deficit of R 149 billion, or 3.1 percent of GDP. The deficit is estimated to decline from 3.1 percent in 2017/18 to 2.6 percent in 2019/20.

**Table 1. Consolidated Fiscal Framework, 2013/14-2019/20**

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
<b>R billion/percentage of GDP</b>	<b>Outcome</b>			<b>Revised estimate</b>	<b>Medium-term estimates</b>		
<b>Revenue</b>	<b>1,008.1</b>	<b>1,098.9</b>	<b>1,222.0</b>	<b>1,297.3</b>	<b>1,414.1</b>	<b>1,535.2</b>	<b>1,668.5</b>
	27.8%	28.4%	29.9%	29.4%	29.8%	29.9%	30.1%
<b>Expenditure</b>	<b>1,143.4</b>	<b>1,233.5</b>	<b>1,364.2</b>	<b>1,445.2</b>	<b>1,563.1</b>	<b>1,677.1</b>	<b>1,814.3</b>
	31.5%	31.9%	33.4%	32.8%	33.0%	32.7%	32.7%
<b>Non-interest expenditure</b>	<b>1,033.8</b>	<b>1,112.1</b>	<b>1,227.9</b>	<b>1,291.8</b>	<b>1,393.8</b>	<b>1,489.5</b>	<b>1,608.0</b>
	28.5%	28.8%	30.0%	29.3%	29.4%	29.0%	29.0%
<b>Interest payments</b>	<b>109.6</b>	<b>121.4</b>	<b>136.3</b>	<b>153.4</b>	<b>169.3</b>	<b>187.6</b>	<b>206.4</b>
	3.0%	3.1%	3.3%	3.5%	3.6%	3.7%	3.7%
<b>Budget balance</b>	<b>-135.4</b>	<b>-134.6</b>	<b>-142.2</b>	<b>-147.9</b>	<b>-149.0</b>	<b>-141.9</b>	<b>-145.8</b>
	-3.7%	-3.5%	-3.5%	-3.4%	-3.1%	-2.8%	-2.6%
<b>Primary balance</b>	<b>-25.8</b>	<b>-13.2</b>	<b>-5.9</b>	<b>5.5</b>	<b>20.3</b>	<b>45.7</b>	<b>60.6</b>
	-0.7%	-0.3%	-0.1%	0.1%	0.4%	0.9%	1.1%

Source: 2017 Budget Review, National Treasury.



### Non-Interest Allocations: Division of Revenue

4.2. Table 2 summarises the division of non-interest allocations amongst the three spheres of government by comparing allocations at the time of 2016 MTBPS and in the 2017 budget. The 2017 MTEF division of revenue amongst the three spheres is identical to what was projected at the time of the 2016 MTBPS. After accounting for national debt, there are estimated receipts of R 4.007 trillion to share amongst the three spheres over the 2017 medium term expenditure framework (MTEF) period.

**Table 2. Medium Term Expenditure Framework (MTEF): Division of Revenue (R' billion)**

Division of Revenue	Total 2017/18 - 2019/20 (R' billion)		Real Annual Average Growth Rate	
	2016 MTBPS	2017 Budget	2016 MTBPS	2017 Budget
<b>National allocations</b>	<b>1.903</b>	<b>1.903</b>	<b>0.8</b>	<b>0.9</b>
<b>Provincial allocations</b>	<b>1.738</b>	<b>1.738</b>	<b>1.4</b>	<b>1.4</b>
<i>Equitable share</i>	1.419	1.419	1.2	1.2
<i>Conditional grants</i>	319	319	2.5	2.5
<b>Local government allocations</b>	<b>366</b>	<b>366</b>	<b>2.0</b>	<b>2.5</b>
<i>Equitable share</i>	189	189	3.5	4.4
<i>General fuel levy sharing with metropolitan municipalities</i>	38	37	-0.4	-0.4
<i>Conditional grants</i>	140	140	0.6	0.9
<b>Total</b>	<b>4.007</b>	<b>4.007</b>	<b>1.2</b>	<b>1.3</b>

Source: 2016 MTBPS; 2017 Budget Review. Commission Calculations

4.3. Despite the strained fiscal environment, the Commission notes that Government has managed to maintain real growth in the resources allocated to the three spheres. On the whole, there has been a clear prioritisation of funding to municipalities. On aggregate, allocations to the local government sphere grow by a real annual average of 2.5 percent over the 2017 MTEF period whilst slower growth is projected in the cases of the national and provincial spheres of government which are projected to grow by a real annual average of 0.9 percent and 1.4 percent respectively

4.4. The Commission particularly welcomes the real growth in the equitable share allocations to provinces and municipalities over the 2017 MTEF period. It is anticipated that these increases will enable provinces and municipalities to deliver a marginally



expanded basket of constitutionally mandated basic services. Nevertheless, the Commission would like to emphasize the need for provinces to evaluate each aspect of their spending plans to ensure any inefficiencies in provincial service delivery systems are eliminated. National departments should also carefully monitor and support provinces in this regard, especially around planning for service delivery in big spending areas such as health and education, so that spending programmes are effectively implemented

- 4.5. With respect to provinces, the Commission notes that unlike previous years, government has made no baseline adjustments to the provincial fiscal framework over the 2017 MTEF period. The Commission welcomes this decision as it brings stability to the finances and planning decisions of provincial governments. By keeping provincial baselines unchanged, government may be signalling that reducing the provincial fiscal framework further to fund reprioritisation may have reached its threshold and any further reductions could have an adverse impact on service delivery at provincial level, especially in health and education services
- 4.6. Regarding the components of provincial transfers, conditional grants are projected to grow by a real annual average of 2.5 percent over the 2017 MTEF period relative to a 1.2 percent real annual average growth projected for the provincial equitable share (PES) allocation over the same period. This trend is influenced by the introduction of three grants in 2017/18 namely: a new early childhood development grant, a grant to fund the education of learners with intellectual disabilities and a social development grant aimed at funding the employment of additional social workers
- 4.7. In terms of the PES formula, new data is being phased-in over a three-year period. The Commission agrees with the principle that any effects on updates to the PES is phased in as this provides for stability of the intergovernmental fiscal relations system and smoothing of expenditure over time. Government has also announced a review of the provincial equitable share formula. The review is expected to cover the funding burden of poorer schools, the cost of service provision and assessment of data reliability. The Commission welcomes this review and calls on government to provide clear milestones on the review process.
- 4.8. Government has previously always maintained real growth in local government allocations - this is again maintained in the 2017 Budget allocations. The Commission welcomes this relative prioritisation especially in respect of the local equitable share (LES) allocation which is projected to grow by a healthy real annual average of 4.4



percent over the 2017 MTEF period. Given that funding to municipalities is aimed at supporting the rollout of basic services to indigent households, the Commission notes that the effective spending of these resources can have a significant redistributive impact in terms of expanding access to basic services to the poorest of the poor.

- 4.9. Table 3 provides detail regarding the extent of indirect transfers by the national sphere to provinces and local government. Indirect transfers to municipalities are generally twice as large as those to provinces. By the end of the medium term indirect transfers to provinces are projected to decline to R1.9 billion – reflecting a significant real annual average decline of 17.1 percent per annum. In contrast, indirect transfers to municipalities are set to decline by a real annual average of 4.7 percent per annum. By the end of the 2017 MTEF period indirect transfers are projected to amount to R8 billion. As in previous submissions, the Commission reiterates its caution around the use of indirect grants and the negative incentives it gives rise to, especially in relation to the dilution of accountability and upkeep of infrastructure developed through the use of indirect grants. As recommended in its Submission for the 2016/17 Division of Revenue, the Commission is of the view that the use of indirect grants should be a measure of last resort whilst continuing to build capacity in provinces and especially, municipalities, to undertake their functions.

**Table 3: Overview of Revenue Allocations within National Departments, 2014/15 to 2019/20**

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	Real Annual Average Growth over the 2017 MTEF
R billion	Outcome			Revised estimate	Medium-term estimates			
<b>National departments</b>	<b>453.4</b>	<b>490.0</b>	<b>546.1</b>	<b>557.5</b>	<b>590.2</b>	<b>631.4</b>	<b>681.6</b>	<b>0.9%</b>
<i>of which:</i>								
Indirect transfers to provinces	2.7	5.8	3.5	3.7	4.3	1.8	1.9	-17.1%
Indirect transfers to local government	5.9	8.3	10.4	7.8	7.3	7.6	8.0	-4.7%

*Source: Commission compilations based on Budget Review 2016 and 2017.*

### Revenue and Tax Proposals

- 4.10. The 2016 Budget estimated government tax revenue at R1.175 trillion in 2016/17. However, the MTBPS projected that tax revenue will fall below estimates. The MTBPS forecasted revenue shortfall of R22.8 billion, which has now been revised upwards to



R30.4 billion, implying that an estimated R1.144 trillion will now be collected. This is the largest tax revenue shortfall relative to budgeted estimates since 2009/10. The 2017 tax proposals are projected to raise R28 billion. There is a heavy reliance on income tax to plug the gap in tax revenue at the expense of growth imperatives. The new top marginal income tax bracket for individuals and partial relief for bracket creep will contribute more than half of the required tax revenue at R16.5 billion. The increase in dividend tax will contribute R6.8 billion while indirect taxes will contribute R5.1 billion.

- a. Government has proposed a new top personal income tax bracket of 45 percent for taxable incomes above R1.5 million per year. This represents an increase of the top personal income bracket from 41 to 45 percent. The new top personal income tax bracket is applicable to 103 000 or 4.1 percent of taxpayers. It will raise an additional R4.4 billion in tax revenue. Given that high earners are also skilled and mobile, caution should be exercised in ensuring that the marginal tax rate is not punitive so as to trigger aggressive tax planning or provide incentives for higher earners to relocate to lower tax rates jurisdictions. Since income and wealth must first be produced before it is consumed, an increase in taxes on one of the factors of production-labour, is particularly disruptive for wealth creation. Progressive income taxes, where higher income is taxed at higher rates, can also reduce the returns to education because high incomes are associated with high levels of education and thus reducing the incentive to build human capital which is vital for growth. It also reduces investment, risk taking, and entrepreneurial activity since a disproportionately large share of these activities is done by high income earners. Moreover, since high income earners save most of their income, increasing their tax rate is essentially a higher tax on savings. This proposal is therefore likely to impact negatively on long term economic growth and hence should not become a trend. In the short term, however, it is likely that the growth effects of the higher tax are not as severe given that high income earners have relatively lower consumption propensities.
- b. Government is considering expanding the value-added tax (VAT) base in 2018/19. The proposal is that zero-rating on fuel be removed. The effect of this proposal on transport costs, will be mitigated by freezing or decreasing the fuel levy. In addition, businesses providing foreign electronic services to South



African consumers have been required to register for VAT and regulations are being updated to broaden the scope of electronic services that are subject to VAT. These measures to broaden VAT coverage are supported. Given that consumption taxes are one of the more growth-friendly forms of taxation (tax savings more lightly) and that the current VAT rate is relatively low, there is scope to raise additional revenue using the VAT. As a consumption tax, VAT is also considered growth friendly thus more appropriate for the current economic circumstances. In this regard, the concerns raised by the Davies Tax Commission First Interim report that an increase in VAT will have a negative impact on inequality, real GDP growth and inflation is worth noting. Moreover, VAT increases are likely to be fiercely opposed by organized labour movements. Having said that, it is worth recalling in the final analysis that "...it is not whether the VAT itself is regressive or not, but whether the entire tax and expenditure system is achieving the pattern of household income net of taxes and gross of transfers and government expenditures that society desires. The case for VAT does not fall on its regressiveness. The case for VAT is that it is an efficient way of collecting a large and buoyant revenue for government; other parts of the budget should take care of progressiveness, and the VAT should be kept as simple and efficient as it is intended to be – for that is its justification" (Tait: 1988).

- c. The 2017 Budget propose excise duty rate increases of between 6.1 percent and 9 percent. This will lead to excise tax burdens that are slightly higher than the targets for beer and spirits. Government will be able to raise R1.9 billion in additional tax revenue through higher than inflation adjustments in sin taxes. However, caution should be exercised to ensure that the increases are not disproportionate such that they encourage black market consumption.
- d. Government proposes to implement a tax on sugary beverages, as soon as the necessary legislation is approved by Parliament and signed by the President. The design of the tax has been revised to incorporate the broader World Health Organisation definition to cover both intrinsic and added sugars in sugary beverages. The sugar content will remain the base on which the tax is applied because it is well suited to public health goals. The proposed tax rate will be 2.1c/gram for sugar content in excess of 4g/100ml. The sugar tax has potential



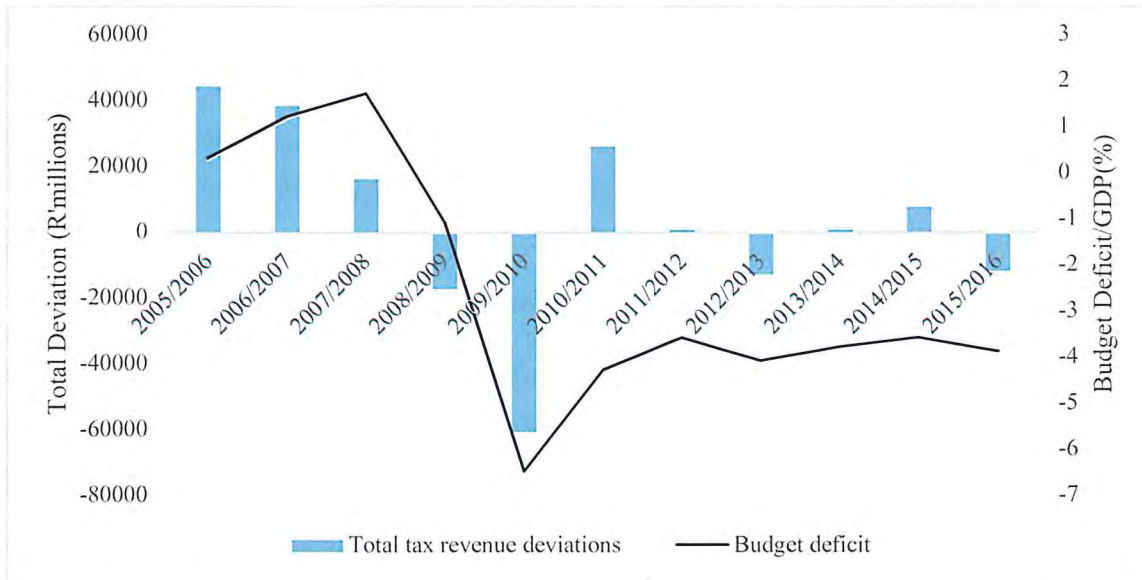
to induce behavioural change. However, its effective tax rate should not be higher than most countries that have a comparable tax so that it does not negatively affect competitiveness.

- e. Government proposes to increase the general fuel levy and the Road Accident Fund (RAF) levy. The general fuel levy will increase by 30c/litre. The RAF levy will be increased by 9c/litre. The increase in general fuel levy will raise an additional R3.2 billion in tax revenue. There is potential to raise significant additional revenue through fuel taxes. However, given that crude oil prices are likely to increase, the scope to increase this source of revenue could be limited. Government could also consider increasing wealth-related taxes such as property taxes which have the attractive feature that they are immobile.
  - f. Government is proposing increasing the dividend withholding tax rate from 15 percent to 20 percent. The increase in dividend withholding tax will raise an additional R6.8 billion in additional tax revenue. Given that the dividend withholding tax is essentially a cost to the shareholder, caution should be exercised to ensure that its increase tax does not impact negatively on investment portfolios and savings mechanisms of investors.
- 4.11. Actual revenue has historically exceeded budget estimates by very high margins resulting in reduced actual budget deficit outcomes. This trend seems to be reversing recently. The analysis of deviations between budget estimates and actual outcomes as captured in the various editions of the National Treasury Budget Reviews show that total tax revenue in 2005/06 exceeded the 2005 Budget estimate by as much as R44.56 billion. In 2006/07 the overestimation marginally decelerated to R38.7 billion and in 2007/08 it further declined to R16.41 billion as shown in Figure 8. However, in 2008/2009 and 2009/2010 tax revenue was underestimated by R16.98 and R60.59 billion respectively. This period coincides with the global financial crisis which might partly explain the underestimations. The period between 2010/2011 and 2011/12 saw the resumption of tax revenue overestimates even though they were considerably lower than the pre-crisis levels. There was a very sharp underestimation of R12.57 billion in 2012/2013 that was followed closely by another one in 2015/16 amounting to R11.57 billion. The analysis shows that the massive overestimation that were recorded in the



period preceding the global financial crisis have since been reduced substantially in the period after the crisis with marked underestimations also occurring twice over this period. These massive overestimates of total tax revenue have now been significantly reduced and underestimations are beginning to show up and now more pronounced.

**Figure 8. Total Tax Revenue Deviations between Budget and Outcomes, 2005/06-2015/16**



Source: National Treasury, Budget Review (Various years)

### Unallocated Resources and Economic Classification

4.12. Unallocated reserves (see Table 4) are meant to serve as a fiscal buffer for Government in times of unplanned emergencies. In previous submissions, the Commission raised concerns around the danger of excessive drawdowns on these resources, and in so doing, creating a risk of having low reserves should an emergency arise.

- a. The contingency reserve for 2017/18, has remained the same at R 6 billion in the 2017 Budget compared to the 2016 MTBPS. The contingency reserve for the outer years have also remained more or less unchanged. The amounts being put aside for the contingency reserve is still far from adequate (R6 billion in 2017/18 increasing to R20 billion in 2019/20) compared to previous years even though risks today appear greater than ever before. Nevertheless the Commission welcomes the new policy approach of maintaining consistency in the contingency reserve as it provides the fiscus with at least some room to manage ongoing fiscal pressures.



**Table 4. Adjustments to Unallocated Reserves (2013/14-2018/19)**

R'billion	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
Budget 2014	3	6	18			
MTBPS 2014		5	15	45		
Budget 2015		5	15	45		
MTBPS 2015			2.5	9	15	
Budget 2016			6	10	15	
MTBPS 2016				6	10	20
Budget 2017				6	10	20

Source: Budget Review (2014, 2015, 2016, 2017); MTBPS (2014, 2015, 2016).

4.13. Table 5 provides details of the economic classification of consolidated government expenditure. Allocations in respect of transfers and subsidies show the strongest real annual average growth over the MTEF compared to other categories of expenditure. The growth of transfers and subsidies is largely driven by transfers to higher education institutions and households to account for social grant increases. It is noteworthy that in previous budgets, compensation was the fastest growing line item. In contrast, the 2017 budget managed for the first time since the economic recession to bring the growth of compensation in line with most other spending categories. Between 2008/09 and 2015/16, the national and provincial compensation budgets rose by 1.8 percent in real terms while over the 2017 MTEF period, compensation of employees grow by 1.3 percent. Prudent increases in compensation is necessary especially since it's the largest expenditure category in the government's budget and therefore has a disproportionately larger impact on government's overall fiscal framework. As in previous years, allocations to capital assets takes a knock with a 0.8 percent decline in real annual average growth rate over the 2017 MTEF period. This decline is of concern especially since government's growth path is dependent on an infrastructure-led strategy.

**Table 5. Real Growth of Consolidated Expenditure by Economic Classification**

R'billion	2016/17	2017/18	2018/19	2019/20	Real Annual Average Growth Rate
Compensation of employees	512.2	550.4	588.7	631.1	1.31%



Goods and services	208.3	221.7	237.5	253.6	0.9%
Transfers and subsidies	471.9	508.8	543.7	590.2	1.84%
Payments capital assets	93	101.4	104.6	107.8	-0.8%
<b>Real Year on Year Growth (%)</b>		<b>2016/17-2017/18</b>	<b>2017/18 - 2018/19</b>	<b>2018/19-2019/20</b>	
Compensation of employees		1.1%	1.3%	1.6%	
Goods and services		0.03%	1.43%	1.18%	
Transfers and subsidies		1.4%	1.2%	3.0%	
Payments capital assets		2.63%	-2.54%	-2.54%	

Source: Budget Review (2017)

#### 4.14. Disaggregating the data by year, the following trends are noticeable

- a. Compensation of employees increases from R512 billion in 2016/17 to R631 billion in 2019/20. The three-year wage bargaining agreement signed with the unions in 2015 is still in effect and government is locked into above inflation increases to public sector salaries. However, the Commission welcomes steps taken by government to reign-in the growth of compensation expenditure. Some of these measures include removing funding for vacant posts, freezing appointments to non-critical posts, encouraging voluntary severance packages and managing headcounts through human resource budget plans prepared by departments. New wage negotiations commence in 2017. The Commission welcomes the decision taken that the new wage settlement agreement due to begin during 2017 will take account of fiscal constraints. This will allow government to direct a larger portion of its expenditure into infrastructure-related expenditure. The Commission made a recommendation in its submission on the 2016/17 Division of Revenue Bill that a framework on public productivity should be developed. Such a framework is critical to ensure cost reduction initiatives are mainstreamed into the workflow processes of government. The Commission therefore proposes a task team be established, headed by National Treasury, Public Service Commission, Department of Public Service and Administration and the South African Local Government Association (SALGA) to draft the framework on public productivity for approval at Budget Council and Budget Forum.
- b. In line with a push to limit spending on goods and services, there is growth in goods and services close to 0 percent in 2017/18. Government's focus since



2014/15 has been on reducing spending on non-core goods and services, such as travel, subsistence and catering. The Commission welcomes efforts by the Office of the Chief Procurement Officer to expand centralised procurement for common goods and services which aims to save R25 billion over the MTEF period by renegotiating contracts with government's 100 suppliers. Savings from non-core goods and services is intended to be redirected to frontline services. Despite these cost saving initiatives, goods and services increases by 1.4 percent in 2018/19 and 1.1 percent in 2019/20. The 2017 budget does not specify the key drivers of this increase, but the likely reason could be the increased costs of medicines and other imported items. The Commission would like to reiterate the need to monitor cost reductions from government cost containment initiatives so that savings in one area is not outweighed by increased costs in another.

- c. Allocations to payments of capital assets increase in real terms by 2.6 percent in 2017/18 but takes a significant knock in the outer years, with real growth in allocations expected to decline by 2.5 percent in 2018/19 and 2019/20 respectively. The reduction in allocations are as a result of underspending capital grants which are reprioritised elsewhere. The Commission is of the view that instead of simply cutting these grants, government should also address the root cause of underspending as capital-related spending programs are key in the delivering of important social services and boosting economic growth.

## **5. Local Government Financing Issues**

### **Local Government Equitable Share (LES)**

- 5.1. Over the 2017 MTEF, additions to the LES amount to R3.3 billion, excluding R1.5 billion that was added in the current year and the R3 billion that will be added in 2018/19 from the 2016 MTEF. The Commission welcomes the addition of resources to the LES to offset the ever-increasing costs of basic services. This will also enable the sector to fulfil its constitutional mandate of providing basic services to poor households. The Commission is of the view that municipalities can be realistically compensated for the rising costs of basic services only if the true cost of providing municipal basic services are known. To assist in determining the true costs of basic services, the



Commission and SALGA developed (and still being refined) a model that accounts for different cost influencing factors.

- 5.2. The Commission welcomes the realisation that there are inconsistencies in the funding of district municipalities. A number of district municipalities (DMs) were receiving very low allocations from the Regional Services Council (RSC) levy replacement grant, that is, less than R40 million per annum. The Commission welcomes the interim measures taken to alleviate the funding gap faced by the 13 DMs that have been receiving the lowest RSC levy grant allocation. However, the Commission strongly feels that a long term sustainable funding model for DMs should be found. The Commission is of the view that this model should be based on a clear understanding of the powers and functions of DMs.
- 5.3. The Commission welcomes the updating of the LES with the 2016 Community Survey data. This will ensure that the formula is responsive to new household changes. The Commission also welcomes the three-year phase in period as this will minimise shocks in the local government fiscal framework that may accompany the introduction of new data.

### **Conditional Grant Allocation**

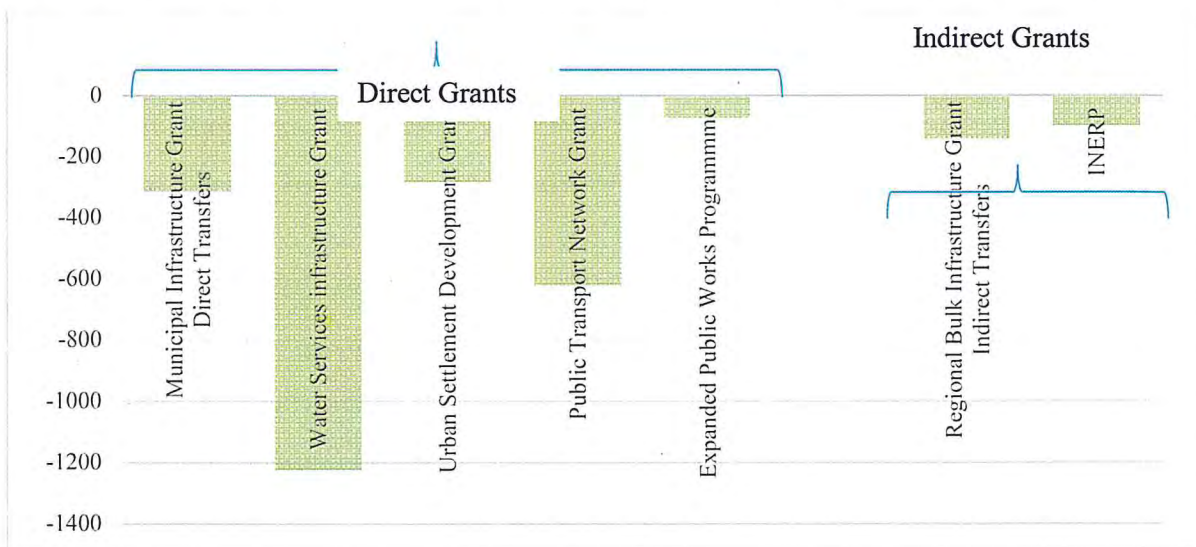
- 5.4. National government will transfer R156.4 billion (both direct and indirect) to local government for infrastructure development and R7.2 billion for local government capacity building initiatives during the 2017 MTEF.
- 5.5. Many local government conditional grants will see their baselines reduced over the 2017 MTEF. While R4.3 billion will be added to the baselines of local government grants (mainly on the LES and INEP grants), R2.8 billion will be deducted from a number of grant baselines. Figure 9 shows the spread in the reductions to both direct and indirect grant baselines. The worst affected grants (in terms of reductions) are the Municipal Infrastructure Grants (MIG), Water Services Infrastructure grant, Urban Settlement Development Grant (USDG) and the Public Transport Network Grant. Although the addition of resources to the sector is commendable as it will go a long way in supporting the 'Back to Basics' plan and the NDP, the Commission wishes to reiterate its long-standing position that reductions should prioritise underperforming grants. Table 6, which provides information on the performance of the four affected grants (using spending patterns as a proxy), shows that the cuts affected even the best



performing grants for example the MIG and USDG are among the best performing grants.

- a. The Commission is also concerned that these reductions affect key municipal deliverables: infrastructure, water, human settlements and transport services. Furthermore, the Commission is concerned that cuts to baseline disproportionately affect direct grants. Two years ago, the Commission noted that direct grants generally outperform indirect grants. Thus, the Commission would expect more reductions to be incident on indirect grants. With respect to the Water Services Infrastructure grant, the Commission is further concerned that this grant is affected more than any other grant despite the fact that its scope has been increased to include sanitation. In its 2017/18 Annual Submission, the Commission noted that sanitation backlogs remain high, particularly in rural areas and a government set target of achieving universal access to sanitation by 2014 has remained elusive.

**Figure 9: Total Baseline Reductions to Local Government Grants over 2017 MTEF (R-Millions)**



Source: National Treasury.

**Table 6: Conditional Grant Spending**

	2013/14	2014/15	2015/16
Municipal Infrastructure Grant	96%	92%	93%
Urban Settlement Development Grant	94%	95%	96%
Public Transport Network Operations Grant	62%	78%	84%
Water Services infrastructure grant*	66%	81%	85%

Source: National Treasury.

\*Consolidation of the Water Services Operating Subsidy, Water Infrastructure and Rural Household Infrastructure Grant

- 5.5. The Commission is particularly concerned with the ever-escalating consumer and municipal debt. The increase in consumer debt has continued to affect the fiscal viability and financial health of municipalities. Similarly, the operations of public entities owed large sums by municipalities have been adversely affected. Municipalities currently owe Eskom over R10 billion and at the same time they are owed R113 billion (as of June 2016) by national and provincial spheres, businesses and households (i.e. 5.4 percent by national and provincial governments; 23 percent by business and 65 percent by households). The Commission reiterates its previous recommendations that, in case of ESKOM debt (or other entities), stricter measures should be imposed on individuals within municipalities that are responsible for continuous flouting of Municipal Finance Management Act (MFMA) rules. Section 216(2) and Section 19 of the Division of Revenue Bill of the Constitution allows National Treasury to apply pressure to municipalities that persistently continue to flout provisions of Section of the Constitution and Section 38(1)(b) (i) of the Municipal Finance Management Act, in particular the 30-day payment rule. The Commission is of the view that Section 19 of the Division of Revenue Bill should also apply to intergovernmental debt. In other words, National Treasury should apply the same pressure to all national and provincial departments that are not complying with the 30-day payment rule on municipal bills as per requirement of the Public Finance Management Act (PFMA). Furthermore, the Commission would like to see a speedy conclusion of the work of the task team examining the intergovernmental debt.
- 5.6. The 2017 budget was also presented against a backdrop of a restructured local government. Through mergers, the number of municipalities were reduced from 278 to 257 in August 2016. The 2016 amalgamations were partly motivated by the desire to improve municipal financial viability and functionality. Although the Commission has



reservations on the veracity of reasons behind the 2016 amalgamations, it nonetheless supports the allocation of funds through the Municipal Demarcation Transition grant to support this process. In 2017/18 amalgamated municipalities, will be allocated a total of R112 million through this grant.

## **6. Financing South Africa's Social Programmes: The Case of Health and Education**

### **Health**

- 6.1. Health care is one of the priorities of government in line with NDP goals of increased life expectancy and reduced burden of disease. The budget for this sector is divided between funding for the personnel, primary health care and hospitals including priorities such as the HIV/AIDS TB programme. Accordingly, in the year 2017/18, R187.5 billion will be allocated to the sector and it accounts for about 12 percent of government expenditure. Of this amount, R17.6 billion would be spent on the HIV/AIDS and TB programme, in line with the expansion on antiretroviral treatment which includes a TB component a commitment by government towards the reduction of the burden of disease in the country. The Commission welcomes the establishment of the South African Health Products Regulatory Authority (SAHPEA) as a public entity in 2017/18 with a total budget of R211.3 million. The Commission is of the view that the SAHPRA has the potential to play a vital role in regulating prices and maximising efficiency gains in the process.
- 6.2. The Budget Review (2017) notes the closure to the National Health Insurance (NHI) pilot allocation which were meant to test the readiness of NHI and state that new initiatives will be built on the progress made to date. The Commission notes the closure of the national health insurance grant (NHI) in 2016/17 due to it reaching its final year, more so about its poor performance. The Commission would like to highlight the urgency towards addressing issues of poor performance to the grant so as to be able to realise the benefits of the NHI before its full roll out takes into effect as its vision would be carried over by the NHI (indirect grant). The Commission welcomes the establishment of a national health insurance fund during the 2017/18 financial year as per the Budget Review (2017). It is stated that the fund would be established through a combination of reorganisation and legislative amendments and it would offer packages



such as the maternal care, improved psychiatric care as well as care to the elderly and people with disabilities. The Commission would like highlight that as the NHI fund is to be established, clarity about its powers and functions need to be clearly defined so as to ensure that there is accountability and once that is done sources of funding can be identified.

- 6.3. In terms of funding for the NHI and the flow of funds from national government, FFC ‘on the colloquium on NHI report’ (2016) recommended the need for simple, predictable and need to promote revenue adequacy and efficiency through giving transfer recipient autonomy. More so, as the implementation of the NHI during its first phase will happen in a tight fiscal space therefore clarity and simplicity will play a significant role.
- 6.4. In line with recent deaths of psychiatric patients in Gauteng, the Commission would like to highlight the need of the setting of norms and standards for care, treatment and rehabilitation of mental health care users by the Minister of Health in line with S (66) of the Mental Health Act (2002), more so in line with the NHI reforms currently in place. World Health Organisation (WHO, 2003) proposes a mental health policy and service guidance package that can assist countries on improving mental health of their citizens. WHO (2003) proposes the following; mental health context, mental health policy plans and programmes, mental health financing, mental health legislation and human rights, advocacy for mental health, organisation of services for mental health, quality improvement for mental health, planning and budgeting to deliver services for mental health, improving access, mental health information systems, human resources and training for mental health and research and evaluation of mental health policy and services. The Commission proposes the use of these policy and guidance package in a phased approach manner towards realising inclusive health care for all as per the NDP objectives.

## **Education**

- 6.5. In the provision of basic schooling, funding is largely driven by personnel through public sector wage agreements accounting for about 80 percent of the budget with the rest allocated for non-personnel non-capital expenditure (NPNC) programmes such as the National School Nutrition Programme (NSNP), expanding access through expansion of grade R, provision of learner teacher support material, improvement on



infrastructure as well as on improvements on annual assessments (literacy and numeracy outcomes). In line with meeting NDP goals of improved access and improved learner outcomes, expenditure in the sector for 2017/18 is about R232.6 billion and this accounts for about 15 percent of government expenditure. According to the NDP, basic education loses half of every cohort learner that enters the schooling system by the end of the 12-year period with about 70 percent completion at secondary education. Therefore, improved learner outcomes in the sector both on the annual assessment of learners (grade 3, 6 and 9) and matric performance plays a critical role in raising skills needed by the country on technicians and professionals which in turn can be achieved through access and funding by institutions of higher learning.

- 6.6. The Commission welcomes the R12.7 billion that would be allocated to learner teacher support materials over the 2017 MTEF. This is in line with the findings by the Commission on the study carried on financing of learner support material that highlighted the inadequate and erratic expenditure on learner support material. One of the major changes to the funding of basic education is the introduction of the new grant on learners with profound intellectual disabilities of the 2017 MTEF with allocations of R72 million in 2017/18, R185.5 million in 2018/19 and R220.8 million in 2019/20 respectively. The Commission welcomes this approach to expanding access to education for learners with intellectual disabilities as it is in line with meeting international and local obligations of an inclusive society for all persons. Further, this approach is in line with previous Commission recommendations in 2012/13 that government must, through input and output norms and standards, take reasonable measures to give effect to the inclusive education of intellectually disabled children. These norms should indicate human, physical, administrative and regulatory resources provided by government dedicated to achieving targets for inclusive education.

## **7. Concluding Remarks**

- 7.1. The 2017 Budget has been crafted in a severely constrained environment characterised exceptionally difficult global and domestic economic conditions over the next several years. These include growing concerns about slow economic growth, the unequal distribution of wealth and a widening budget deficit.

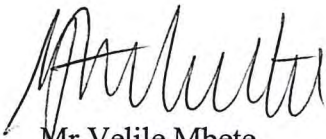


- 7.2. Overall, the 2017 Budget re-affirms and still reflects the major thrust and spirit of the recommendations that the Commission has been making since the onset of the global economic crisis: that growth and employment in South Africa can only be achieved by combining gradual fiscal consolidation and investment into future growth given the prevailing economic climate coupled with undertaking requisite structural reforms.
- 7.2.1. Given the current economic outlook, the Commission fully supports the government's new position on 'gradual' fiscal consolidation which is in line with previous Commission recommendations and tightening measures to maintain expenditure sustainability.
- 7.2.2. Given the tight fiscal framework, the 2017 Budget proposals will return the public finances to a sustainable path. The Budget sets out tax increases and spending reductions to narrow the fiscal deficit and stabilise growth of public debt, while protecting core social and economic programmes. The Commission commends efforts by Government to protect social expenditures, which are fundamental in maintaining and improving wellbeing of vulnerable communities.
- 7.2.3. Real growth of compensation of employees is projected to slow down over the MTEF period. The Commission welcomes measures being taken to reign in the wage bill but notes that for the compensation projections to be realistic a wage bargaining agreement where salaries are pegged close to the inflation rate, will be required. This will enhance the credibility and likely sustainability of the fiscal framework.
- 7.3. The revenue proposals are supported subject to matters raised by the Commission in this Submission.
- 7.4. Yet fiscal measures alone are not enough. To expand the social wage in a sustainable manner, create jobs and reduce poverty, South Africa needs much faster rates of inclusive economic growth. In today's conditions, doing so requires a sense of common purpose. The Commission has made various suggestions for strengthening the fiscal framework and ensuring that it re-ignites economic growth which include:
- 7.4.1. Putting in place measures to encourage savings.
- 7.4.2. Emphasising structural economic reforms in the product and service markets, particularly where the state has a strong presence such as the transport and electricity service sectors.



- 7.4.3. Addressing rigidities in the labour market, with a huge focus on productivity. These will require companies to invest in skills, training and knowledge.
- 7.4.4. Improving basic education to enhance the likelihood of school leavers finding employment.
- 7.4.5. Revitalising and reinvigorating agriculture and rural development to enhance the likelihood of school leavers finding employment in the rural economy

**For and on behalf of the Financial and Fiscal Commission**



Mr Velile Mbete

Acting Chief Executive Officer

