ANNEXURES

Two annexures are available on the National Treasury website (www.treasury.gov.za):

- Annexure W1: *Explanatory memorandum to the division of revenue*
- Annexure W2: *Structure of the government accounts*

A

Report of the Minister of Finance to Parliament

Introduction

This annexure fulfils the requirement of section 7(4) of the Money Bills Amendment Procedure and Related Matters Act (2009), which prescribes that the Minister of Finance submit a report to Parliament at the time of the budget explaining how the Division of Revenue Bill and the national budget give effect to, or the reasons for not taking into account, the recommendations contained in:

- Budgetary review and recommendation reports submitted by committees of the National Assembly in terms of section 5 of the act.
- Reports on the fiscal framework proposed in the *Medium Term Budget Policy Statement* (MTBPS) submitted by the finance committees in terms of section 6 of the act.
- Reports on the proposed division of revenue and the conditional grant allocations to provinces and local governments set out in the MTBPS submitted by the appropriations committees in terms of section 6 of the act.

Budgetary review and recommendation reports

Section 5 of the act sets out the procedure that the National Assembly committees must follow when assessing the performance of each national department before the budget is introduced. This procedure provides for committees to prepare budgetary review and recommendation reports, which:

- Must provide an assessment of the department's service delivery performance given available resources.
- Must provide an assessment of the effectiveness and efficiency of the department's use of available resources.
- May include recommendations on the future use of resources.

This annexure provides responses to the portfolio committees' recommendations where they relate to the National Treasury.

A number of committees recommended making additional budget allocations available for certain programmes, sub-programmes or other budget items. Due to the constrained fiscal outlook, there is limited scope to do so. Departments, public entities and constitutional institutions are required to reprioritise existing funds for emerging priorities. Should the fiscal outlook improve, recommendations for additional funding may be considered in future budget processes.

Portfolio Committee on Basic Education

Together with relevant authorities, the department should fast-track the implementation of plans to allocate ring-fenced funds for learner transport.

The committee made a similar recommendation in the 2019 Budget. The National Treasury is part of the task team on this issue. Funds can only be ring-fenced after government decides whether the function lies with the Department of Basic Education or the Department of Transport.

Consideration should be made to increase the budget of Umalusi due to its expanded mandate.

As noted at the beginning of this section, there is little scope to provide additional funding at this time.

Portfolio Committee on Employment and Labour

The committee recommends that the Minister of Finance take steps to ensure that the budget allocation of the Department of Employment and Labour is adjusted to accommodate its expanded mandate, thus enabling the capacitation of its inspectorate.

The National Treasury recognises the Department of Employment and Labour's contribution to creating jobs. The department has a budget allocation of R3.6 billion in 2020/21, R3.9 billion in 2021/22 and R4 billion in 2022/23. As noted at the beginning of this section, there is little scope to provide additional funding at this time.

Portfolio Committee on Higher Education, Science and Technology

The committee recommends that the Minister of Higher Education, Science and Technology and the Minister of Finance consider the following:

The Ministry should expedite the process of filling the three Deputy Director-General positions in the Planning, Policy and Strategy; Technical and Vocational Education and Training (TVET); and Community Education and Training (CET) programmes as the process started in November 2017 for the Deputy Director-General of CET and June 2018 for both the Deputy Director-General of Planning, Policy and Strategy and TVET.

The National Treasury has previously raised the issue of filling these posts with the department.

The committee notes that notwithstanding the significant progress made by the department in securing additional funding to expand student accommodation in higher education, the private sector should be pursued to invest more resources towards the expansion of student housing in higher education.

Since 2018, the Student Housing Infrastructure Programme has received additional funding through the Budget Facility on Infrastructure. The programme is estimated to cost R96 billion over the next 10 years to build about 300 000 beds. Construction of residences is under way at Fort Hare and Nelson Mandela University, funded by government, development finance institutions and private finance. The Development Bank of Southern Africa, together with the Department of Higher Education and Training, is facilitating the programme. Moreover, the current public-private partnership (PPP) regulations are being reviewed to address the shortcomings of the current framework and increase the PPP pipeline. Most universities continue to establish partnerships and elicit sponsorships to fund infrastructure projects.

The committee notes that notwithstanding the current fiscal constraints, the National Treasury should increase the baseline funding for the CET sector so that the mandate of the sector and its policy priorities can be realised.

The Department of Higher Education and Training should investigate whether funds from its baseline can be redirected to this sector. In the 2019 *Adjusted Estimates of National Expenditure*, the department declared underspending of R129.6 million for compensation of employees due to vacant posts. The ability to spend additional allocations is relevant in determining whether to provide more funding.

The committee recommends that the filling of vacant funded posts by the Quality Council for Trades and Occupations (QCTO) should be prioritised as a matter of urgency to improve the overall performance of the entity, which was at 59 per cent during the year under review.

The National Treasury agrees with the recommendation. The QCTO has underspent on the compensation of employees budget by an average of R16.5 million over the past three financial years, indicating that it has funds to fill critical posts. The entity is in the process of filling the posts.

The committee recommends that the QCTO expedite the process of purchasing its own premises given the high rental fee amounting to R8 million per annum.

The National Treasury agrees with the committee's recommendation that the QCTO should expedite the purchase of its own premises. It should be noted that R12 million from the reserve fund was approved and earmarked to procure the QCTO's premises in 2018/19.

The committee recommends that mechanisms to increase the budget allocation to the Department of Science and Innovation be explored and pursued by the Minister of Higher Education, Science and Technology. The committee will support all efforts to secure additional funding for the science and innovation portfolio.

There is little scope to provide additional funding at this time. The National Treasury will continue to work closely with the Department of Science and Innovation on developing and strengthening existing mechanisms to better account for public-led research and development spending to support the policy priorities outlined in the 2019 White Paper, and the draft Science and Innovation Decadal Plan.

Portfolio Committee on Health

The National Treasury and the Department of Health should allocate part of the 2018/19 Medium Term Expenditure Framework (MTEF) health infrastructure allocations to gradually offset expenditure accruals that have arisen from unavoidable demands for which allocated budgets were depleted. The National Treasury should ensure that the framework for health infrastructure conditional grants accommodates flexibility during periods of protracted fiscal constraint so that provinces can be allowed to re-orientate their package of available capital allocations towards maintenance.

Accruals incurred by provincial health departments have increased significantly in recent years, exceeding R13.3 billion as at 31 March 2019. Of this, R6.7 billion is older than 30 days. This partly reflects financial pressures in provinces, but it also reflects weak financial management. Provincial departments require a more systematic and sustainable way of addressing rising accruals. The National Treasury, together with the national Department of Health, has developed a Health Action Plan that includes developing accruals intervention strategies and aligning procurement and cash-flow plans.

Infrastructure is partly funded through the provincial equitable share, which provinces use at their discretion. The conditional grant framework does not limit redirecting capital allocations to maintenance. Provinces will, however, need to resubmit annual implementation plans showing changes to the infrastructure project list for approval by the national Department of Health. When redirecting funds to maintenance, it is important to consider the stages and cash flows of currently funded projects to ensure there are funds for contractually committed infrastructure projects.

The national Department of Health and the National Treasury should provide adequate funding to the Office of the Health Ombud in line with the recently approved structure for better reporting and functionality.

The National Treasury will support reprioritisation requests from areas that will not negatively affect service delivery.

Portfolio Committee on Women, Youth and Persons with Disabilities

The Commission for Gender Equality's funding model should be aligned with the rest of the Chapter 9 institutions, in particular the Public Protector, to enable it to optimally give effect to its mandate.

The National Treasury has taken note of this recommendation. The commission's funding model is similar to that of the Public Protector of South Africa: both are funded through transfer payments in the votes of the Department of Women, Youth and Persons with Disabilities and the Department of Justice and Constitutional Development, respectively.

The Commission for Gender Equality should be provided with additional funds in order to retain existing staff and attract new staff. Specific emphasis should be placed on the funding of staff for legal clinics, public education and information, communication and legal support. To this end, provinces with the largest case load should be prioritised where offices require additional support.

Departments, public entities and constitutional institutions are encouraged to reprioritise existing funds for emerging priorities. The National Treasury will continue to engage the Commission for Gender Equality as part of the budget process, specifically in relation to the issues highlighted by the committee.

Portfolio Committee on Agriculture, Land Reform and Rural Development

Agriculture has been highlighted by the President in his economic stimulus package, including the National Treasury's discussion paper entitled "Economic Transformation, Inclusive Growth, and Competitiveness: Towards an Economic Strategy for South Africa", as one of the sectors with massive job creation potential. However, the sector is constrained by challenges which include climate change in the form of frequent and prolonged droughts, floods and veld fires; disease outbreaks; technological advances; and international trade standards and regulations. To give effect to the department's mandate and some of the proposals in the Treasury discussion document, including the plans to reprioritise funding towards investments in agriculture, a significant increase in the budget allocation to the Department of Agriculture, Land Reform and Rural Development for the medium term is proposed.

The National Treasury agrees with the committee's recommendation. Over the 2020 MTEF period, an allocation of R495.1 million has been reprioritised within the existing budget baseline to boost agriculture production; improve health and food safety programmes; develop capacity to respond to biosecurity threats; revitalise laboratories; revitalise quarantine stations and strengthen inspection services at ports of entry; and strengthen animal and plant health, inspection and laboratory services. Over the medium term, a further R500 million will be allocated to the sector to fast-track the process of restoring land rights, supporting inclusive economic transformation as envisaged in the National Treasury's discussion paper.

Onderstepoort Biological Products (OBP) plays a vital role in the prevention and management of livestock diseases and, therefore, food and human safety. Notwithstanding the once-off allocation of R492 million that was made to OBP in 2012/13 for the refurbishment and modernisation of the vaccine manufacturing facility, and that over the years, the entity managed to raise additional funding to continue with the refurbishment project, which cost an estimated R1.2 billion, an additional funding allocation for operational activities is proposed from 2020/21 onwards. The funds will be used to establish a vaccine reserve to ensure that vaccines are available in sufficient quantities to address animal disease outbreaks (e.g. Anthrax, African Horse Sickness, Rift Valley Fever, Brucellosis, etc.), and to manufacture public good vaccines (orphan vaccines), which are unprofitable for OBP to produce but are of national importance in animal disease prevention and management. While the modernisation project is in progress, the aging infrastructure that does not meet good manufacturing practice standards is limiting OBP's production efficiency and competitiveness.

The National Treasury agrees with the committee's recommendation. Over the medium term, the reprioritised allocation of R495.1 million to the Department of Agriculture, Land Reform and Rural Development for the Agricultural Production, Health, Food Safety, Natural Resources and Disaster Management Programme will indirectly reduce OBP's burden of producing and distributing vaccines. The budget allocated to the department includes a component for preventing and managing animal and livestock disease. There is little scope for additional allocations. The department will have to collaborate with OBP to prevent and manage livestock diseases. The National Treasury will continue to engage with the department and OBP to ensure that funding is available.

Portfolio Committee on Mineral Resources and Energy

The National Treasury should restore MTEF funding of the Council for Geoscience in the short term, while securing R300 million baseline funding for the medium to long term in order to ensure that the entity is able to meet its mandate, which is long term in nature and scope, including the funding model that accommodates the National Key Point designation of the entity, in order to ensure compliance.

The National Treasury agrees with the committee's recommendation. Over the 2020 MTEF period, an additional allocation of R345.8 million has been reprioritised within the existing budget baselines for geological mapping to assess on-shore and off-shore mineral, agricultural, energy and groundwater resources to catalyse their exploration.

Portfolio Committee on Small Business Development

The committee should be updated on the Small Business Innovation Fund after commitments by the National Treasury have been formalised.

The Department of Small Business Development has already begun to operationalise the fund through the Small Enterprise Agency. Over the 2020 MTEF period, the fund has been allocated R2.8 billion.

Portfolio Committee on Tourism

The committee recommends that the Minister of Finance work with the Department of Tourism to reprioritise budget for the Tourism vote in line with the committee's new oversight approach with a focus on villages, townships and small towns.

The National Treasury and the Department of Tourism will hold further discussions to realign budget and spending priorities over the medium term.

The committee recommends that the Minister of Finance, notwithstanding the constrained national fiscus, consider the contribution of the tourism sector to the gross domestic product (GDP) of the country and the labour-intensive nature of the tourism sector and find innovative ways of increasing the budget appropriated for the Tourism vote.

The National Treasury recognises tourism's important contribution to GDP growth, but there is little scope to provide additional funding at this time. The National Treasury discussion paper, *Economic Transformation, Inclusive Growth, and Competitiveness: Towards an Economic Strategy for South Africa*, identifies the tourism sector as one of the labour-intensive sectors that could create jobs for semi-skilled and unskilled workers in the short to long term. The National Treasury supports the implementation of microeconomic reforms in the paper that could stimulate growth, investment and job creation in tourism.

Portfolio Committee on Defence and Military Veterans

The committee recommends that the National Treasury should not lower the Department of Defence's baseline budget allocation in nominal terms over the MTEF period. This relates to all outlying years of the MTEF and specifically to 2021/22 where the budget is set to decrease from R52.5 billion in 2020/21 to R50.9 billion in 2021/22.

The Department of Defence has an allocation of R52.4 billion in 2020/21, R50.8 billion in 2021/22 and R53 billion in 2022/23. In nominal terms, the 2020 MTEF allocations of the department are comparable to the 2019 MTEF allocations.

The committee urges the National Treasury to provide additional funds specifically for the purpose of border safeguarding. The committee recommends that the number of sub-units be increased incrementally over the MTEF period with the aim of having 22 sub-units deployed for landward borderline duties by the end of the MTEF period. Additional funds should also include an allocation for the use of technology as a force multiplier for border safeguarding purposes.

Border security remains a priority for government. The National Treasury has allocated an additional R225 million to the Department of Defence over the medium term to procure equipment and technology to support military units deployed to safeguard our borders.

The committee urges immediate engagement between the Minister of Defence, the Minister of Finance and the Commander in Chief of the South African National Defence Force, to finalise a funding plan that will arrest the current decline of the military. This recommendation is derived from the dire financial and resource situation shared with the committee by especially the South African Army, the South African Air Force and the South African Navy during its recent oversight engagements. The finalised plan should be presented to the committee no later than the end of the first quarter of 2020/21.

The National Treasury agrees that the funding challenges of the Department of Defence should be discussed. The department is arranging a meeting with the President, the Minister of Finance, the Minister of Public Service and Administration, and the Minister of Defence and Military Veterans to address the funding challenges.

The committee noted comments by the Department of Defence that savings to compensation of employees can be made through a process of force rejuvenation. The committee therefore recommends a joint approach to force rejuvenation that would see the Department of Defence develop and roll out a rejuvenation plan and the National Treasury provide funding for an exit mechanism to speed up rejuvenation. The National Treasury should, as soon as possible, release funds to facilitate an interim exit mechanism for the remainder of 2019/20. The Department of Defence should finalise rejuvenation plans for full implementation from 2020/21.

The National Treasury agrees that the Department of Defence should develop a rejuvenation strategy. At a ministerial meeting, it was resolved that the department would develop and submit a rejuvenation strategy to the National Treasury by May 2019. The department has not yet submitted the strategy, but is engaging with the National Treasury on a draft. The Department of Defence has yet to implement early retirement without penalties, which was introduced in the 2019 *Budget Review* as one of the measures to reduce spending on compensation of employees.

Portfolio Committee on Justice and Correctional Services

In addition to recommending that zero budget reductions be applied in the case of the South African Human Rights Commission and the Public Protector of South Africa, the committee recommends that additional funding be provided to:

- *The National Prosecuting Authority to address the shortfall in its compensation of employees budget; fill critical post vacancies; create capacity in the asset forfeiture, specialised commercial crimes, and witness protection units; and resume its aspirant prosecutor programme.*
- *Legal Aid South Africa to prevent it from having to cut posts with adverse consequences for service delivery, and to ensure that it is able to maintain its civil work and assist in land claims matters.*
- *The South African Human Rights Commission to fulfil its coordinating role in respect of the National Preventative Mechanism established in terms of the Optional Protocol to the Convention Against Torture and Other Cruel, Inhumane or Degrading Treatment or Punishment.*
- *The Public Protector of South Africa to fill vacancies, employ professional services, and improve security.*

The 2020 Budget provides additional funding of R1.2 billion to the National Prosecuting Authority to improve prosecutorial capacity, rejuvenate the aspirant prosecutor programme and operationalise the new Investigative Directorate. Over the medium term, Legal Aid South Africa will receive additional funding of R75 million for increased capacity. The National Treasury has not reduced the baselines of the South African Human Rights Commission or the Public Protector of South Africa over the medium term.

Portfolio Committee on International Relations and Cooperation

The committee recommends to the Minister of Finance that investigations be undertaken, and a report submitted, around the role played by the National Treasury in the procurement processes of the New York Pilot project. Consequence management should be undertaken where wrongdoing has been established.

The National Treasury is assisting the Department of International Relations and Cooperation with its investigation into the New York Pilot project, which aims to develop a multi-use area of offices and residential accommodation for diplomats and foreign-service staff in New York. It has given the department information pertaining to the procurement of a building through the PPP process, and will continue to provide any assistance required for the department to complete its investigation.

Portfolio Committee on Public Service and Administration

The Minister in the Presidency for Planning, Monitoring and Evaluation and the Minister of Finance should urgently resolve the budget shortfall on compensation of employees and critical surveys at Statistics South Africa (Stats SA) so that crucial and quality statistics get generated to the country and government's benefit; if an ideal resolution cannot be found, the Minister for Planning, Monitoring and Evaluation is requested to escalate the matter to the Presidency.

The department has been allocated R154.4 million over the MTEF period to address funding shortfalls in employee compensation and R150 million in 2020/21 to conduct the Income and Expenditure Survey. There is little scope for additional funding. The National Treasury will continue to engage with Statistics South Africa to find solutions for the funding shortfall on compensation of employees, and has asked the department to present the following information to justify its budget programme structure:

- Explain the structure of its provincial and regional offices, considering the staff complement and budget allocation of these offices as a proportion of the department's total staff complement and budget.
- Calculate how much the department will save by transitioning from paper-assisted personal interviewing to computer-assisted personal interviewing. The savings could be reprioritised or used to reskill staff for other critical areas in the department.

Recommendations of the Standing Committee on Appropriations on the 2019 MTBPS

The National Treasury and the Department of Employment and Labour should conduct a comprehensive study on the public-sector wage bill at all levels of government, including state-owned companies and municipalities, in order to determine the exact impact of aggregate wages in government. This assessment should also consider the wider implication of reducing the public service on tax revenue, unemployment, service delivery and skills leakages within the public sector. The National Treasury should report to the committee before the tabling of the 2020 MTBPS.

The National Treasury welcomes the committee's recommendation. The National Treasury and the Department of Public Service and Administration have undertaken an extensive review of remuneration trends in the public sector over the past decade. Some of this work is reflected in Annexure B of the 2019 MTBPS. This collaboration will be extended to include the Department of Employment and Labour and the increased scope recommended by the committee will be factored into future work. Findings will be reported in the 2020 MTBPS.

The National Treasury, in consultation with relevant stakeholders, should develop more effective supply chain management and procurement mechanisms to ensure value for money is obtained, especially regarding the overpricing of goods and services.

The National Treasury has finalised a revised supply chain management regulatory framework. Compliance monitoring has been strengthened to maximise value for money, eliminate waste and prevent abuse of the procurement system.

Other steps to improve procurement capacity and service delivery include reducing fragmentation and strengthening the national procurement architecture; strengthening the tax clearance system to ensure that those who have defrauded the state cannot do business with it; and introducing measures to improve institutions' ability to set up bid committee structures for the invitation, evaluation and adjudication of tenders.

To intensify compliance monitoring and expenditure containment, institutions are required to submit tender programmes to relevant treasuries. Demand-management procurement plans are scrutinised against the tender programmes.

In addition to the focus on reducing the public-sector wage bill, the National Treasury should focus on other measures that will boost the performance of the South African economy.

The National Treasury supports this recommendation. It has released a discussion paper, *Economic Transformation, Inclusive Growth, and Competitiveness: Towards an Economic Strategy for South Africa*. In it, government has outlined short- and medium-term reforms that can boost economic growth, many of which do not require significant state resources. Interventions to improve the quality of infrastructure planning, including the Budget Facility for Infrastructure, are beginning to show results. Government continues to work with the private sector through the Infrastructure Fund and other initiatives.

Report of the Standing and Select Committees on Finance on the 2019 Revised Fiscal Framework

The committee appreciates the global and domestic economic and political uncertainties and volatilities that make it difficult to accurately forecast GDP growth figures but recommends that the National Treasury draw in more independent expertise in its forecasting process to improve the credibility of the fiscal framework and better manage the economic and fiscal risks associated with its forecasts.

The National Treasury uses various models to generate economic forecasts, including inflation, terms of trade, sector and business cycle models. They supplement the main macroeconomic forecast model, which is a large semi-structural econometric model similar to those used by the Reserve Bank and the Bureau for Economic Research. The assumptions that are used in the main model are sourced from global institutions or determined internally through a rigorous assumptions process. The model is regularly updated to capture changes in the South African and global economy. The Economic Policy division is engaging with the Bureau for Economic Research to assess and improve the model. Other models that are used for policy analysis and research are also maintained and updated. These are less appropriate for forecasting, but are still used to analyse trade-offs of policy and other shocks to the economy to better inform the forecast process.

Since 2014, forecast errors from the National Treasury and market analysts have been decreasing. Independent studies show that National Treasury forecasts are on par with, or better than, market projections. It should also be noted that no institution has had consistently accurate forecasts over time.[1]

The Minister of Finance agreed that high debt now will burden future generations if it is not managed properly and the situation is unsustainable. We therefore require the National Treasury to report quarterly on the effectiveness of its debt management strategies, that would ensure that the level of debt stabilises over the medium term as the current situation is not sustainable.

Rising fiscal deficits over the past decade have increased government's borrowing requirements and debt-to-GDP ratio. Accordingly, the only way to lower the debt-to-GDP ratio is through consistently higher economic growth or lower spending. Government's prudent debt management strategy enables it to manage the risks associated with elevated borrowing. Debt management is guided by strategic risk benchmarks for refinancing, interest, inflation and currency risks.

[1] See for example: Bhoola, F., Rossouw, J. and Giannaros, M. 2018. Comparing Macroeconomic Forecasts for South Africa from 2001 to 2017: Do We Need Official Forecasts? *Studies in Economics and Econometrics, 42(3): 35-69.*

The committee supports the new approach to project planning, budgeting, preparation and implementation and welcomes the progress of the Budget Facility for Infrastructure technical team. It believes that government needs to do much more to reduce corruption and wasteful and unnecessary expenditure and significantly improve the efficiency and quality of spending also in light of the Auditor-General's announcement of continued increases in wasteful, fruitless and irregular expenditure, which stood at a total of R63.4 billion in 2018/19. Irregular expenditure increased from R52.7 billion in 2017/18 to R61.4 billion in 2018/19. The National Treasury should report progress made to the Committees on Appropriations in both the Houses of Parliament.

Reducing corruption and wasteful, fruitless and irregular expenditure is the responsibility of every government department and entity, all of which have their own accounting officers. The National Treasury provides support to departments and entities in line with its mandate.

Under the Public Finance Management Act (1999), the accounting officer and authorities of departments and public entities must:

- Report irregular expenditure and fruitless and wasteful expenditure to the relevant treasury.
- Take disciplinary steps against officials who make or permit irregular expenditure and fruitless and wasteful expenditure.

In 2018, the National Treasury issued an irregular expenditure framework as an instruction, which was revised in May 2019. It sets out procedures for disciplining officials accused of financial misconduct and, where applicable, recovering funds and laying criminal charges. These disciplinary steps are required before such expenditure may be condoned.

Amendments to the Public Audit Act (2004), which took effect on 1 April 2019, empower the Auditor-General to refer any suspected material irregularities for investigation. They also empower the Auditor-General to take appropriate remedial action and to issue a certificate of debt where an accounting officer or accounting authority has failed to comply with remedial action.

The South African Revenue Service (SARS) needs to develop its policies and capacity to tax the digital economy more effectively and is required to report on this to the committee at the first quarterly briefing of 2020.

The National Treasury agrees with the recommendation and will report as requested. Officials from both the National Treasury and SARS have been engaging with other countries to find global consensus on how to ensure that profit from digitised business models is taxed appropriately. The aim of the Organisation for Economic Co-operation and Development committee responsible for making recommendations in this area is to reach consensus on a new international tax architecture in 2020. South Africa is represented on the committee.

SARS needs to work together with the relevant stakeholders to address the root causes of fiscal leakages emanating from, but not limited to, Road Accident Fund claims, medico legal claims and police litigations, particularly those resulting mainly from negligence.

SARS will continue to engage with stakeholders on limiting the fiscal leakages cited by the committee. For example, SARS participates in an inter-agency working group with the Department of Trade and Industry and the National Treasury that focuses on tackling illicit trade, particularly in the clothing and textile industry.

The committee notes with concern the direct impacts of incorrect economic growth forecasts on tax revenue collection by SARS. We are concerned that the revenue shortfall increases from a projected R14.5 billion in 2018/19 to R52.5 billion in 2019/20 and R84 billion in 2020/21 and that the scope for further tax increases has also narrowed. The National Treasury should support SARS more actively, *including financially and in rebuilding the organisation without interfering in its operational matters. SARS, the National Treasury and law enforcement agencies need to work far more effectively in processing cases against any staff members legitimately accused of financial misconduct and corruption.*

The final revenue shortfall for 2018/19 was R57.3 billion compared to 2018 Budget estimates, and based on the audited revenue outcomes for 2018/19. The significant downward revisions to the economic and revenue outlook since the 2019 Budget are mainly the result of weaker economic performance. Tax revenue collection estimates published in the *Budget Review* and MTBPS are projections, rather than targets. If assumptions are not realised or economic performance is different than projected, these revenue estimates are subsequently revised.

In the 2019 MTBPS, the National Treasury proposed additional allocations of R1 billion over three years for SARS to rebuild capacity, improve operations, and implement critical projects and recommendations from the Nugent Commission. Investigations into financial misconduct and corruption are ongoing. The National Treasury and SARS presented a progress report to the Standing Committee on Finance about implementing the recommendations of the Commission of Inquiry into Tax Administration and Governance by SARS.

The committee is concerned about a constantly increasing gross debt-to-GDP ratio, a projected increase from R3.2 trillion in 2019/20 reaching R4.5 trillion in 2022/23 (71 per cent by 2023) as this is likely to burden future generations if concerted efforts are not made to sustainably reduce it. The persistently widening budget deficit, expected to peak at 6.5 per cent in 2019/20, a level last experienced during the 2009 recession, is a cause for concern, since there does not appear to be a point of stabilisation over the medium term. The committee also notes that debt service costs have become the fastest-growing expenditure item, costing the national fiscus R203.7 billion per annum (13.7 per cent) in 2019/20 and are expected to reach almost R300 billion in 2022/23. These funds could be utilised for other competing economic and social needs. The committee recommends that the National Treasury do far more to incrementally reduce the debt-to-GDP ratio and report on progress on this at its quarterly briefings.

In the 2019 MTBPS, government proposed achieving a main budget primary balance by 2022/23. Achieving the fiscal target requires making large additional adjustments to the fiscal framework exceeding R150 billion in total over the medium term. These adjustments would need to address growth in the public-service wage bill and include a sustainable plan for state-owned companies in order to reduce future transfers. Given the size of the required adjustment, additional tax measures were considered. These measures require making difficult decisions that will affect the economy and the distribution of public resources.

The committee notes that the 2019 MTBPS budgeted contingency reserves amount to R18 billion over the medium term, or R6 billion each year. These amounts are not adequate and are likely to leave South Africa susceptible to external and internal shocks in an event of unforeseen circumstances such as imminent dangers of food insecurity and water scarcity, including through potential floods and drought. The committee urges the National Treasury to quantify and factor in these potential risks in the economic growth forecasts and the overall fiscal framework.

The National Treasury assesses fiscal risks to identify and plan for unexpected and uncertain events. This process informs the formulation of the fiscal framework and culminates in the publication of an annual fiscal risk statement. The contingency reserve is part of the expenditure ceiling and is determined within this overall limit. Its size depends on available resources and the level of uncertainty and is revised during the budget process. Analysis in the 2013 *Budget Review* showed that unforeseen and unavoidable expenditure adjustments, for which the contingency reserve was budgeted, averaged R4 billion per year over five years. This was much lower than the contingency reserve amounts, which were then lowered. In addition to the contingency reserve, there are disaster relief grants for local and provincial government. In the past, the combination of the contingency reserve, the disaster relief grants and other ring-fenced funds within infrastructure grants has proven sufficient to meet the costs associated with natural disasters.

Recommendations of the Standing Committee on Appropriations on the Adjustments Appropriation Bill

The Minister of Finance should ensure that the National Treasury carefully scrutinises government departments' ability to spend allocated funds before submitting budget proposals to Parliament in order to prevent continued underspending on allocated funds as it has implications for government debt and the interest payments.

Over the past 25 years the National Treasury has developed a rigorous budget process that imposes the highest level of scrutiny to ensure that departments have the ability to spend allocated funds. The Constitution mandates the National Treasury to manage public finances, and the Public Finance Management Act makes the National Treasury responsible for managing the budget preparation process. To support this, the National Treasury provides an overall fiscal framework based on the macroeconomic forecast. It also proposes the division of revenue between the three spheres of government and provides technical guidelines for budget submissions to ensure that they reflect the priorities set out by the President. These processes are subject to a lengthy period of consultation and modification throughout government, including the Ministers' Committee on the Budget, before they are considered by Cabinet and ultimately Parliament. The National Treasury recognises that ultimate authority for the nation's finances rests with Parliament, which debates and votes on the Budget in a range of public forums. The Money Bills Amendment Procedure and Related Matters Act also gives Parliament the opportunity to amend the Budget. The National Treasury conducts a wide range of stakeholder engagements, and encourages all South Africans to comment on the allocation of public funds.

The Minister of Finance should, within 60 days after the adoption of this report by the House, submit to Parliament a report on all outstanding conditions attached to the bailouts of state-owned entities; while conditions for the 2020/21 Budget allocation to Eskom should be included in the primary legislation, to improve oversight and accountability.

Eskom met conditions for the initial transfer of funds in December 2019 and continues to meet conditions for the remaining tranches of the Special Appropriation in 2019/20. Denel, South African Airways, South African Express and the South African Broadcasting Corporation have partially complied with the conditions attached for drawdowns in 2019/20 from the contingency reserve. These entities are being monitored to ensure compliance is achieved by the end of 2019/20. The National Treasury will separately provide a comprehensive analysis of the status of the conditions for all five entities to the committee.

All departments that requested virements from compensation of employees to other economic classifications due to unfilled vacancies should, together with the National Treasury, and within 60 days after the adoption of this report by the House, provide a report detailing why budgeted vacancies were not filled on time, particularly the critical ones and those on the frontline service delivery points.

The National Treasury will investigate the causes of these vacancies with the Department of Public Service and Administration, and provide a detailed report to Parliament within the 60 days.

With regards to the R157 million declared unspent allocation for the Jobs Fund by the National Treasury, the committee recommends that the Minister of Finance should, within 60 days after the adoption of this report by the House, submit to Parliament a report on the reasons for this underspending and how it will be avoided in future. The National Treasury should also brief the committee on how the Jobs Fund is being administered in order to broaden its understanding.

The National Treasury has briefed the committee. As outlined in the report, the funds have already been committed to projects and have not been declared unspent.

Approved projects are funded through the budget processes, with the Jobs Fund's allocations being ring-fenced or earmarked. Projects are required to provide budgets over three years even though their expenditure is projected to go beyond the MTEF period. This usually results in benchmarking rather than bottom-up budgeting or rescheduling.

External factors affecting projects include the following:

- The Jobs Fund only releases grant funding when projects reach contracted milestones, and the weak economy has negatively affected these plans.
- Before the Jobs Fund releases grant funding, project partners are required to contribute funding. Where project funds have not been provided timeously, grant funding has been delayed.
- A significant portion of the Jobs Fund portfolio consists of projects in the agricultural sector. Severe drought has delayed planned activities such as planting, with consequences for the release of grant funding.

These factors have resulted in revised project implementation plans and related annual budgets. The Jobs Fund requested that the R157 million be released at a later stage when funds are required by implementing projects in order to roll out project activities and achieve the planned job creation targets.

The Jobs Fund will continue to implement prudent fiscal discipline. Although funds have been committed to projects, grant funding will not be released unless performance and matched funding targets have been met.

Recommendations of the Standing Committee on Appropriations on the Division of Revenue Amendment Bill (2019)

The Minister of Finance should ensure that the National Treasury gazettes the following corrections to the Conditional Grant Frameworks as well as the New Conditional Grant Frameworks as set out in annexures 2 and 3 of the bill, in accordance with section 16(4) of the Division of Revenue Act (2019):

Corrections to Conditional Grant Frameworks:

- *Ilima/Letsema grant framework*
- *School infrastructure backlogs grant*
- *National health insurance direct grant*
- *Human papillomavirus vaccine grant*
- *Human resources capacitation grant*
- *National health insurance indirect grant: Health facility revitalisation component*
- *Provincial roads maintenance grant*
- *Integrated urban development grant.*

The corrected frameworks have been gazetted together with the details of the revised allocations, which were provided through the Division of Revenue Amendment Act (2019).

The Minister of Finance should ensure that there is a consequence management framework and that actions are taken against government institutions that continuously underspend on their appropriated budgets.

The National Treasury agrees that there should be consequences for institutions that underspend or underperform.

Provinces and municipalities that underspend face consequences set out in the Division of Revenue Act. In terms of sections 18 to 20, if a recipient is anticipated to underspend, further transfers can be withheld, stopped or reallocated to another institution. If transferred funds are not spent by the end of the financial year, and no rollover is approved, provinces and municipalities must transfer the remaining funds back to the National Revenue Fund, or the funds owed will be offset against future transfers. Additional discussion is provided in Chapter 6 of the *Budget Review*.

Recommendations of the Select Committee on Appropriations on the Division of Revenue Amendment Bill (2019)

The Minister of Finance must ensure that the National Treasury gazettes the corrections to the Conditional Grant Frameworks as well as the New Conditional Grant Frameworks as set out in annexures 2 and 3 of the bill, in accordance with section 16(4) of the Division of Revenue Act (2019) as soon as possible. The following are the affected grants:

- *Ilima/Letsema grant*
- *School infrastructure backlogs grant*
- *National health insurance direct grant*
- *Human papillomavirus vaccine grant*
- *Human resources capacitation grant*
- *National health insurance indirect grant: Health facility revitalisation component*
- *Provincial roads maintenance grant*
- *Integrated urban development grant*
- *Municipal disaster recovery grant*
- *Municipal infrastructure grant.*

The corrected frameworks have been gazetted together with the details of the revised allocations, which were provided through the Division of Revenue Amendment Act.

While the committee notes the technical issues behind the school infrastructure backlogs grant adjustment and adjustments to infrastructure grants as a whole, the committee recommends that all procedural and technical issues be swiftly and effectively dealt with to ensure that the financial support for the removal of these backlogs is given, and that government does everything in its power to ensure the speedy completion of these projects.

The National Treasury agrees that all procedural and technical issues need to be dealt with swiftly and effectively and has engaged the Department of Basic Education on these issues. The National Treasury can also confirm that provinces that had their allocations reduced in the 2019 adjustment budget due to technical challenges have received their full allocation in the 2020 Budget.

In order to prevent fiscal dumping and fruitless and wasteful expenditure, the Minister of Finance, together with the Ministers of Agriculture, Health and Basic Education and the affected provincial treasuries, should ensure that concrete steps are taken to build and demonstrate capacity to spend, including developing clear plans to monitor expenditure for proposed additional allocations. Further, the ministers need to ensure that the proposed additional allocations are effectively and efficiently spent according to the approved plans before the end of this financial year, and provide a progress report to the committee in the first quarter of the 2020/21 financial year. The proposed additional allocations include the following conditional grants:

- *The ring-fenced R60.7 million, which was shifted to the Eastern Cape Provincial Department of Transport for roads damaged by floods.*
- *The new indirect component of the Ilima/Letsema grant, amounting to R45.3 million, to fund the National Food and Nutrition Survey.*

- *The human resources capacitation grant, amounting to R300 million, which is allocated to cater for the shortage of funding towards the carry-through costs of filling vacancies in the health sector.*
- *The direct component of the national health insurance grant, which will allow provinces to make payments directly to contracted health professionals.*
- *Additional funding of R700 million to the school infrastructure backlogs grant, which was added to the 2019/20 allocation.*
- *The municipal disaster recovery grant amount of R133.2 million, earmarked for eThekwini Metropolitan Municipality and Ugu District Municipality.*

The National Treasury agrees with this recommendation and will monitor the spending of all transferred funds and provide the progress report as requested.

The Minister of Finance should ensure that the National Treasury timeously approves the roll-overs contained in the bill for all projects near completion for the receiving municipalities (for regional bulk infrastructure to be used for emergency Vaal River pollution remediation) and provinces (for medical equipment in Limpopo hospital), and provides a progress report to the committee in the first quarter of 2020/21.

The roll-overs have been approved and the funds are available to be spent. The National Treasury will provide the progress report as requested.

The committee appeals to the National Treasury, the Department of Cooperative Governance and Traditional Affairs and the South African Local Government Association (SALGA) to continue to support municipalities until the Eskom and water boards' debt issues are resolved; and to ensure that the issues around provincial and national departments owing municipalities are also expeditiously addressed to bolster municipal finances. They must further ensure that municipalities create credible credit control measures, debt management policies and effective revenue collection strategies; and provide a progress report in this regard to the committee in the first quarter of 2020/21.

The National Treasury agrees with this recommendation and continues to work with the Department of Cooperative Governance and SALGA to support municipalities. The revised municipal budgets, described in Chapter 6 of the *Budget Review*, take account of the need to make payments to Eskom and water boards. The smart meter pilot, also described in Chapter 6, could make revenue collection and payments more sustainable.

The National Treasury will provide the progress report as requested.

The committee requests that the National Treasury consider allocating a budget for the development of the Moloto Rail Corridor even if it is spread over a period of five years. The argument that a feasibility study found the project to be too expensive was not accepted by the committee, which argued that high cost of a project cannot be elevated above the lives of voters who had been promised a better service.

The Minister of Finance agrees that the loss of life on this road, and all roads in the country, is unacceptable. Improving safety on this route is a priority and work is already under way to improve road capacity and safety through infrastructure upgrades. This will be complemented by improving the safety of government-subsidised buses operating along the Moloto Corridor and running road safety campaigns. The option of building a new railway line along the Moloto Corridor was explored in a feasibility study undertaken by the Department of Transport in 2015. The National Treasury's evaluation of this study concluded that it did not justify investment in a new railway link through the Moloto Corridor route, but that it does provide good grounds for improvements to the road infrastructure and transport services along the route. These upgrades will be carried out by the South African National Roads Agency Limited (SANRAL).

SANRAL is upgrading roads across five municipalities in three provinces to accommodate the large volumes of daily traffic along this route. SANRAL is allocated R4.2 billion to upgrade these roads between 2019/20 and 2022/23.

The buses that operate along the Moloto Corridor are subsidised by the Gauteng Provincial Government, including through funds transferred to the province in the *public transport operations grant*. The grant rules provide for the possibility that the national Department of Transport could take over responsibility for managing the contract for this route. This would allow the national department to issue a new contract for the route to improve the service. The bus operator on this route has recently implemented additional safety measures, including providing advanced driving courses for bus drivers and introducing new buses with cameras and GPS systems.

Human settlement and economic development options for this region also need to be considered. A large number of residents in this region commute long distances daily to work in Tshwane – a legacy of apartheid spatial development policies. The National Development Plan calls for reducing the commuting burden and developing in ways that account for the unique needs and potential of different urban and rural areas. Future economic development in the Moloto region could alter commuting patterns, as would the decision by some households to take advantage of new housing opportunities closer to their places of work. All of these options must be kept open. A bus transport system will be much more flexible than a rail-based system to meet future changes in commuting patterns.

The Minister of Finance and the Minister of Transport should report progress to Parliament, within three months after the adoption of this report, on what has been done since the pronouncement by President Jacob Zuma – in September 2017 – that the Moloto Rail Development Corridor was a government priority and one of the infrastructure development initiatives.

An update is provided in the response to the previous recommendation.

Recommendations of the Select Committee on Appropriations on the proposed division of revenue and the conditional grant allocations to provincial and local spheres of government

Given the current state of the country's fiscus presented in the 2019 MTPBS, including proposed budget reductions at provincial and local governments levels, which are at the coalface of service delivery, the committee recommends that the National Treasury, together with the Department of Cooperative Governance and Traditional Affairs, alongside provincial treasuries and provincial cooperative governance departments, ensure that provinces and municipalities use all the available resources in line with the public financial management prescripts in a manner that reduces waste, eradicates opportunities for corruption, and promotes quality service delivery as envisaged in the National Development Plan.

The Minister of Finance agrees with this recommendation and appreciates the call to action for all parts of government to redouble their efforts to ensure sound management of public funds.

Given the levels of under-investment in infrastructure projects by larger urban municipalities, the committee recommends that the National Treasury and the Department of Cooperative Governance fast-track the following initiatives and provide a progress report to the committee in the first quarter of the 2020/21 financial year:

- *Table the Municipal Fiscal Powers and Functions Amendment Bill to standardise the regulation of development charges in order for municipalities to recover their capital costs of connecting new developments to infrastructure.*

- *Introduce the dedicated grant funding for large urban municipalities, whereby eligible municipalities will receive co-financing on a declining basis over three years.*
- *Ensure that capacity-building and improvement of municipal systems allocations, such as the local government financial management grant and the municipal systems improvement grant, are effectively and efficiently utilised for their intended purposes.*

The National Treasury agrees with the recommendations and can report the following updates on each item:

- The draft Municipal Fiscal Powers and Functions Amendment Bill was published for public comment in January 2020. Comments are invited until the end of March, after which they will be processed before the revised draft will go to Cabinet before being tabled in Parliament.
- The grant funding for project preparation recommended by the committee is being provided through the *integrated city development grant*, which forms part of the Division of Revenue Bill (2020).
- Grants like the *financial management grant* and the *municipal systems improvement grant* must be used for their intended purpose, as required by the Division of Revenue Act. The effectiveness of the capacity-building system for local government is also being reviewed by the National Treasury, with initial results likely to influence improvements to the system from 2021.

While the committee understands the need to restructure certain conditional grants, it is of the view that grant restructuring, termination or merging must not affect service delivery objectives and proper assessment or analysis of grant performance ought to be conducted before any restructuring can happen. These include the following affected conditional grants: the human papillomavirus vaccination grant, which will be merged with the HIV, TB, malaria and community outreach grant; and the fact that from 2021/22, two new components, mental health and oncology, will be added to the HIV, TB, malaria and community outreach grant.

The National Treasury agrees that grant restructuring should not harm but improve service delivery. Only small changes are being made to the structure of conditional grants in 2020/21. The Department of Health and the National Treasury will work together to develop a broader strategy that will inform future changes to health grants and ensure their alignment to national health insurance reforms.

With regards to the Moloto Corridor, the committee believes that the loss of many lives in that area must come to an end. The committee recommends that the National Treasury consider allocating resources for the development of a Moloto Corridor Rail Project over the 2020/21 MTEF period and make use of all revenue-sourcing avenues at its disposal. The argument that a feasibility study found the project to be too expensive is not acceptable given the high levels of road fatalities there, affecting not only the Department of Transport, but also the Department of Health, due to the overcrowding in the hospital near the high accident zone. The National Treasury should provide a progress report on this during the tabling of the 2020 Budget.

This issue has been responded to under an earlier recommendation of the Select Committee on Appropriations, recommendations on the Division of Revenue Amendment Bill.

With regards to the municipalities adopting unfunded budgets, the committee recommends that the National Treasury, together with the Department of Cooperative Governance and Traditional Affairs, as well as the affected provincial treasuries, expedite the implementation of the revised strategy to address municipal financial performance failures, which has been endorsed by the Budget Council and Budget Forum, the respective intergovernmental forums for provincial and local government finances. A progress report hereon should be submitted to the committee in the first quarter of the 2020/21 financial year.

The National Treasury agrees with this recommendation and is already implementing the strategy. Chapter 6 of the *Budget Review* reports on the results of efforts to get municipalities with unfunded budgets to revise their spending plans in line with credible revenue expectations. The National Treasury will provide further reports to the committee as requested.

The committee recommends that the National Treasury, together with the Department of Cooperative Governance and Traditional Affairs and affected treasuries, expedite the pilot project of the district models, which will be implemented in Oliver Reginald Tambo District Municipality and eThekwini Metropolitan Municipality, and ensure that resources allocated to this project are effectively and efficiently utilised and value for money is achieved. On completion of the pilot project, the committee expects a report identifying lessons learnt during the pilot phase, how resources allocated have been utilised and clear recommendations to improve the programme before it is implemented.

The National Treasury agrees with this recommendation. The national Department of Cooperative Governance is coordinating the implementation of the pilots of the district development model. The National Treasury will support the department in identifying lessons learnt for the report requested.

The National Treasury should review the vertical division of nationally raised revenue, in order to ascertain whether the 9 per cent allocation to local government is sufficient for the sector to perform its mandate.

The Minister of Finance has proposed holding a special local government Budget Forum lekgotla to discuss the structure of the local government fiscal framework, including the size and structure of transfers.

The National Treasury should engage more extensively with the Financial and Fiscal Commission (FFC) and respond more comprehensively to its recommendations, as a constitutional body. Government, and specifically the Department of Planning, Monitoring and Evaluation, should provide detailed implementation plans, including deadlines, for the recommendations that it does agree with.

Section 214 of the Constitution requires that the FFC's recommendations be considered before tabling the division of revenue. Government's responses to the FFC's recommendations related to the division of revenue are provided in part 3 of Annexure W1 of the *Budget Review*. Other FFC recommendations have been referred to the relevant ministers, who will respond directly to the FFC. The Minister of Finance and the Chairperson of the FFC have corresponded to clarify how interactions between the staff of the commission and the National Treasury should be structured to facilitate a productive working relationship.

In order to have more effective consultation on budgetary matters, the National Treasury and SALGA should engage more extensively during the budget planning cycle and not only at the Budget Forum meetings.

The National Treasury agrees that ongoing engagements with stakeholders, including SALGA, are important to resolving problems in the intergovernmental system. SALGA officials are invited to participate in a range of meetings and processes with the National Treasury and others, such as the local government equitable share working group and conditional grant framework meetings. The National Treasury has proposed collaborating with SALGA and the Department of Cooperative Governance to produce papers and presentations for the local government Budget Forum lekgotla in 2020.