FFC SUBMISSION TO THE NATIONAL COUNCIL OF PROVINCES - OVERSIGHT CONFERENCE

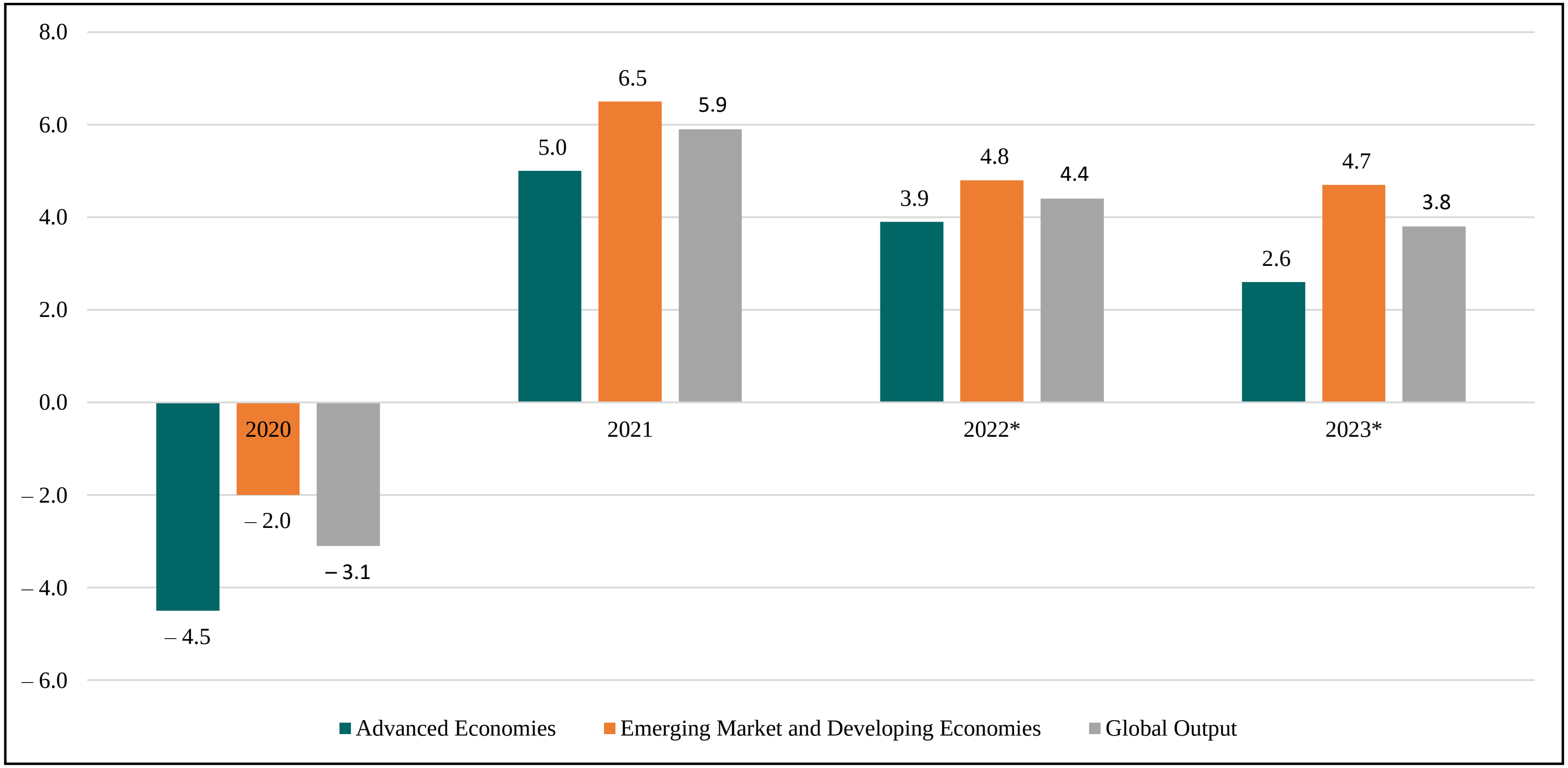
JUNE 2022

FINANCIAL AND FISCAL COMMISSION

Presentation Outline

1. Background: Economic Overview and Prospects
2. Fiscal Allocations towards the implementation of the ERRP
   a. Infrastructure Investment and delivery
   b. Energy security: Eskom
   c. Industrialisation through localisation: Small-Medium Enterprises
   d. Public Employment Interventions
   e. Growth of tourism
   f. Agriculture and Food Security
3. Aligning of the ERRP with the Budget
4. Concluding remarks

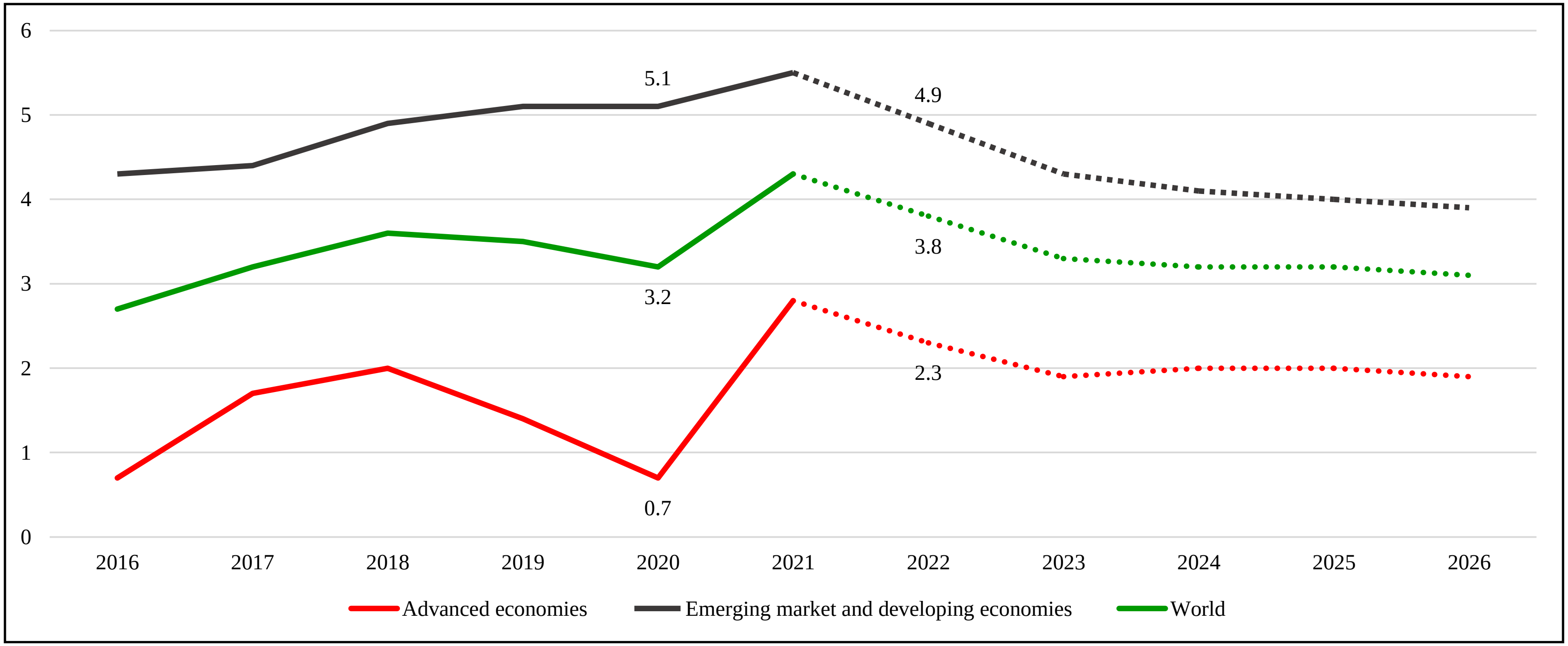
GLOBAL OUTLOOK



- The International Monetary Fund estimated that global output increased by 5.9% but is expected to moderate in 2022 to 4.4%. The first half of 2022 is anticipated to show moderate growth in both emerging and developing economies and advanced economies due to the disruptions brought on by the ever-mutating Covid strains.

FINANCIAL AND FISCAL COMMISSION

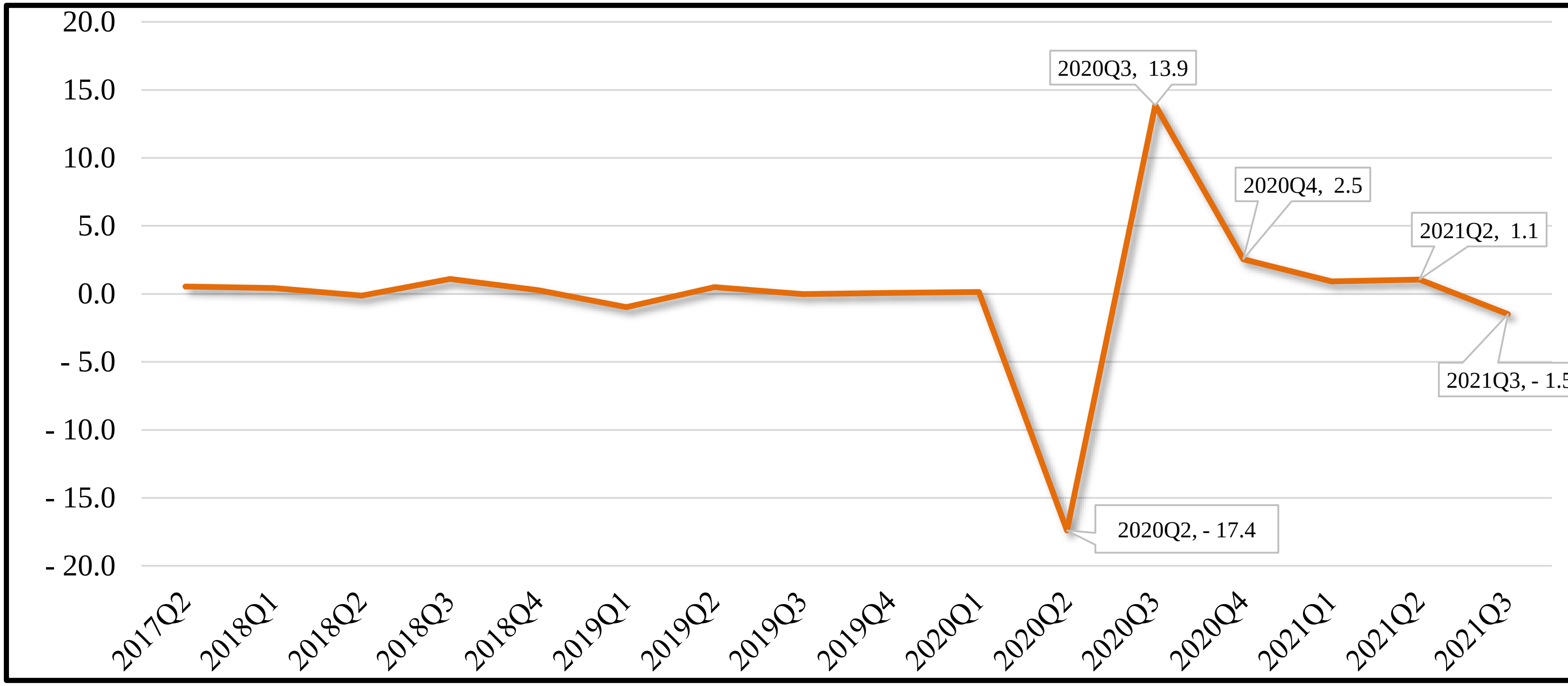
GLOBAL OUTLOOK



- Inflation is expected to continue rising in 2022. Price pressures in 2022 will average about 3.9% in advanced economies and 5.9% in emerging market and developing economies.
- Inflationary pressure seems to be derived mainly from a transitory set of factors, such as the pandemic-related reallocation of spending from services to goods and supply-chain and other disruptions to production

FINANCIAL AND FISCAL COMMISSION

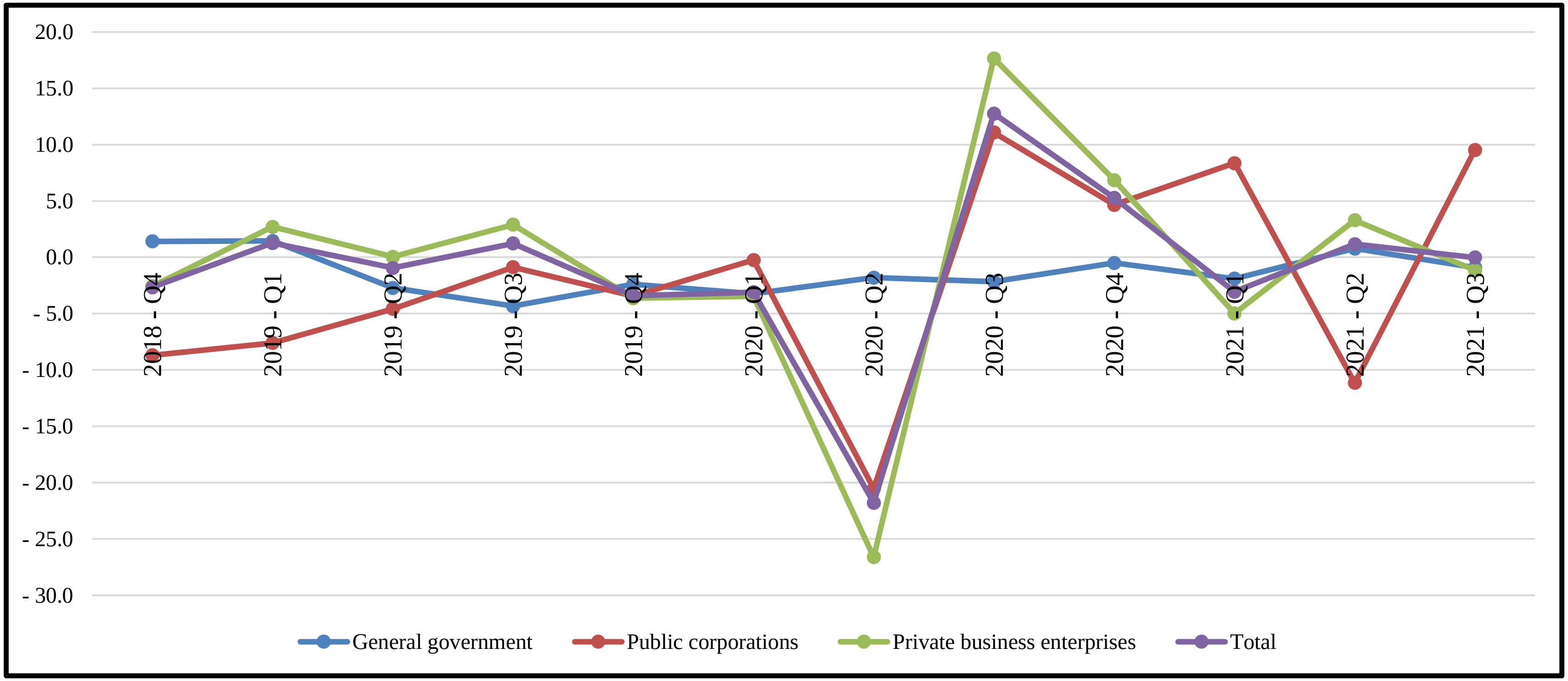
Gross Domestic Product (quarter-quarter changes)



- Signs of a slow economic recovery were starting to emerge, with the economy growing for four consecutive quarters from 2020 quarter 3 to 2021 quarter 2. However, the recovery was disrupted in the third quarter when GDP decreased by -1,5%.
- The Omnicron Covid-19 variant undermined economic recovery progress, and the unrest in KwaZulu-Natal and Gauteng also disrupted the economic recovery.

FINANCIAL AND FISCAL COMMISSION

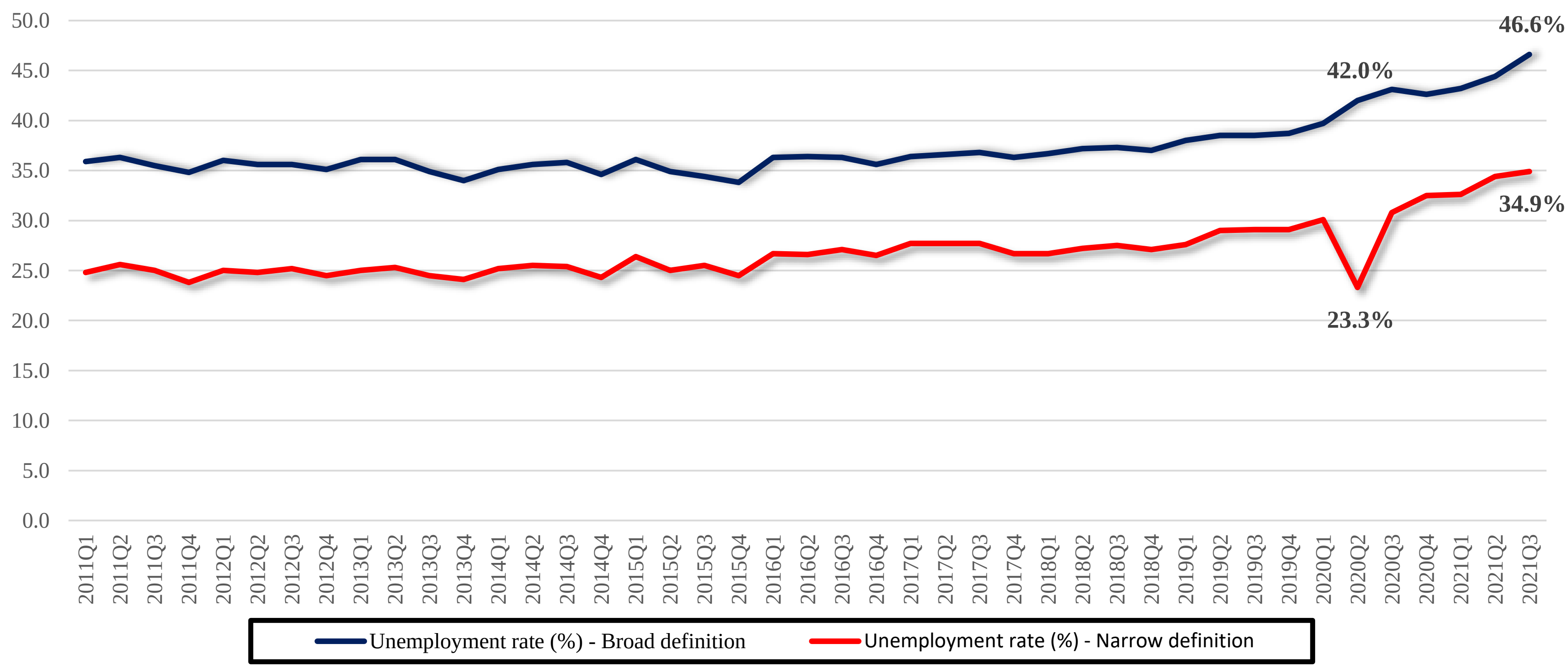
Gross Fixed Capital Formation (Investment)



- Total Gross Fixed Capital Formation (GFCF) improved following a sharp decline due to the impact of Covid-19. Government investment declined by -0.9% in the third quarter of 2021.
- The private fixed capital formation also declined by -1.2%, while public corporations fixed capital formation increased by 9.5%.

FINANCIAL AND FISCAL COMMISSION

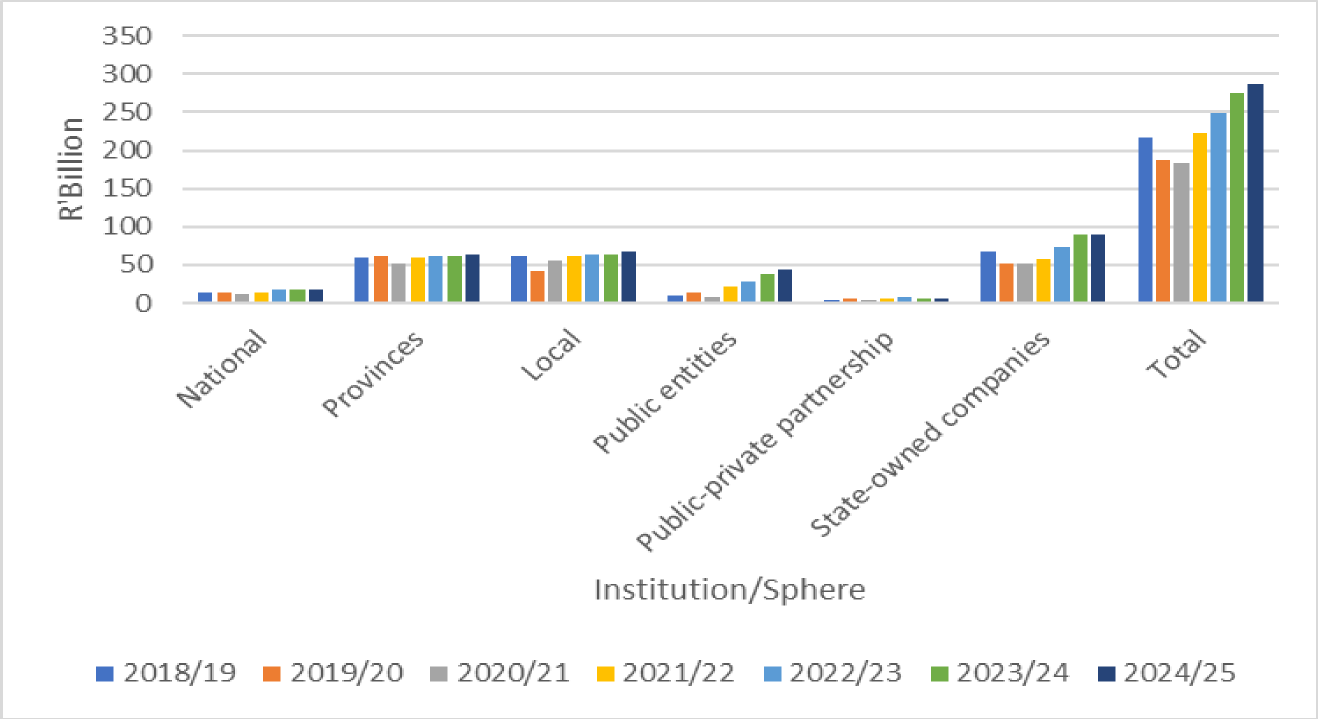
UNEMPLOYMENT RATE



- The employment recovery continues to be sluggish and has not recovered to Pre-Covid-19 levels.
- The official unemployment rate rose by 0.5 of a percentage point from 34,4% in the second quarter of 2021 to 34,9% in the third quarter of 2021 - the highest recorded unemployment rate in South Africa
- According to the expanded definition of unemployment, the unemployment rate increased by 2.2 percentage points to 46,6% in quarter 3 2021 compared to quarter 2 2021.

INFRASTRUCTURE INVESTMENT AND DELIVERY

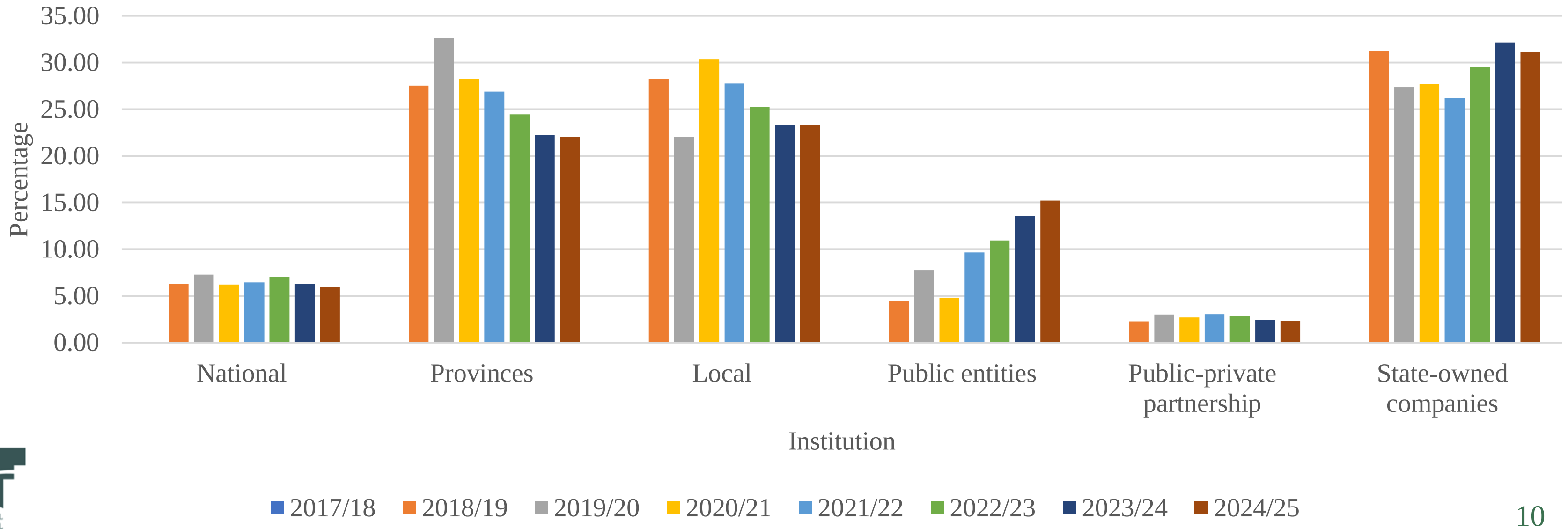
PUBLIC INFRASTRUCTURE INVESTMENT



- Infrastructure is key for national economic growth and development, unlocking of private sector investment and attracting foreign direct investment, and is crucial for households' access to basic services and improvement of socio-economic conditions and job creation
- Total public sector infrastructure investment decreased between 2018/19 and 2019/20 from R216.2 billion to R187.4 billion, and picked up in 2021/22 with an investment of R249.5 billion

Public Infrastructure Investment [cont.]

- With respect to shares of public infrastructure investment – while the share of provinces and municipalities are decreasing, shares of State-owned Companies and public entities are increasing
  - Indicating that the government is increasingly implementing public infrastructure investment through public entities (shares increased from 9.8% in 2021/22 and reached 13.6% in 2022/23 and expected to reach over 15% in 2024/25), the Commission is concerned about this trajectory given poor performance of State-owned Companies and public entities
  - The Commission is concerned with decreasing share of local government given huge infrastructure backlogs in municipalities (both new infrastructure and rehabilitation and maintenance of existing infrastructure)



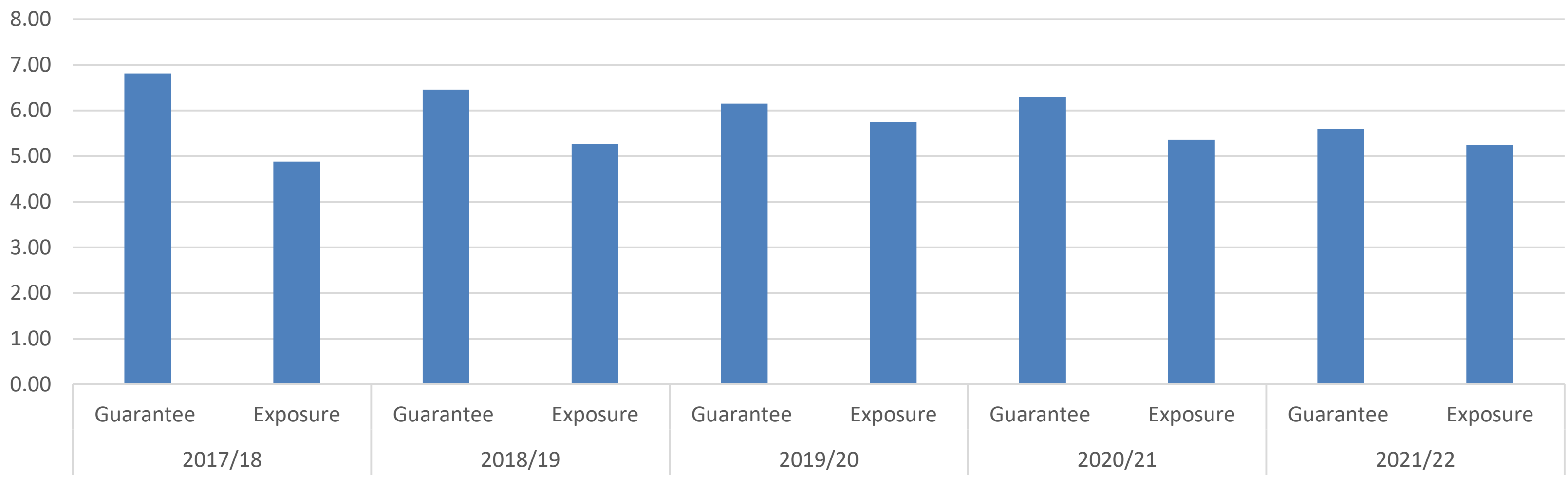
FINANCIAL AND FISCAL COMMISSION

FINANCIAL
AND FISCAL
COMMISSION

ENERGY SECURITY: ESKOM

GUARANTEES TO ESKOM

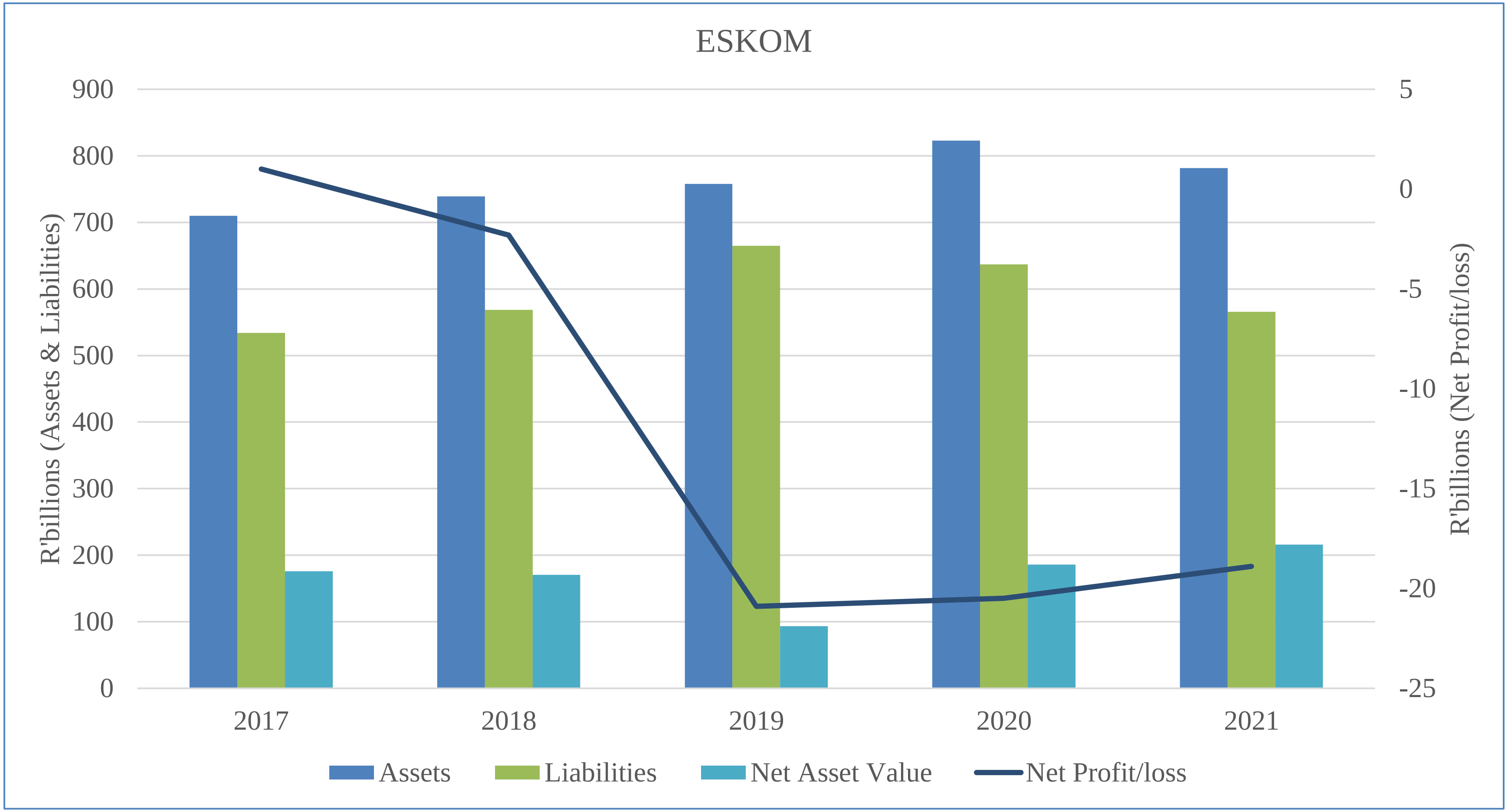
Eskom government guarantee exposure as a % of GDP, 2017/18-2021/22



- Eskom guarantees and exposure as a % of GDP is very high, and represents a risk to debt sustainability and public finances. Eskom's guarantee exposure increased by R29.6 billion to R327.9 billion due to additional drawdowns.
- The fiscus continues to transfer substantial amounts to Eskom. The provisional allocations to Eskom amount to R21 billion in 2023/24 and R22 billion in 2024/25.
- The progress in the required Eskom reforms is slow, thus its contribution to energy security remains constrained.

FINANCIAL AND FISCAL COMMISSION

FINANCIAL PERFORMANCE OF STATE-OWNED COMPANIES



FINANCIAL AND FISCAL COMMISSION

Financial Performance of Eskom

- Eskom plays a very significant role in energy security but its worsening operational and financial performance is placing a heavy burden on the fiscus - underscores the urgency to accelerate the reforms required and address its weak performance.

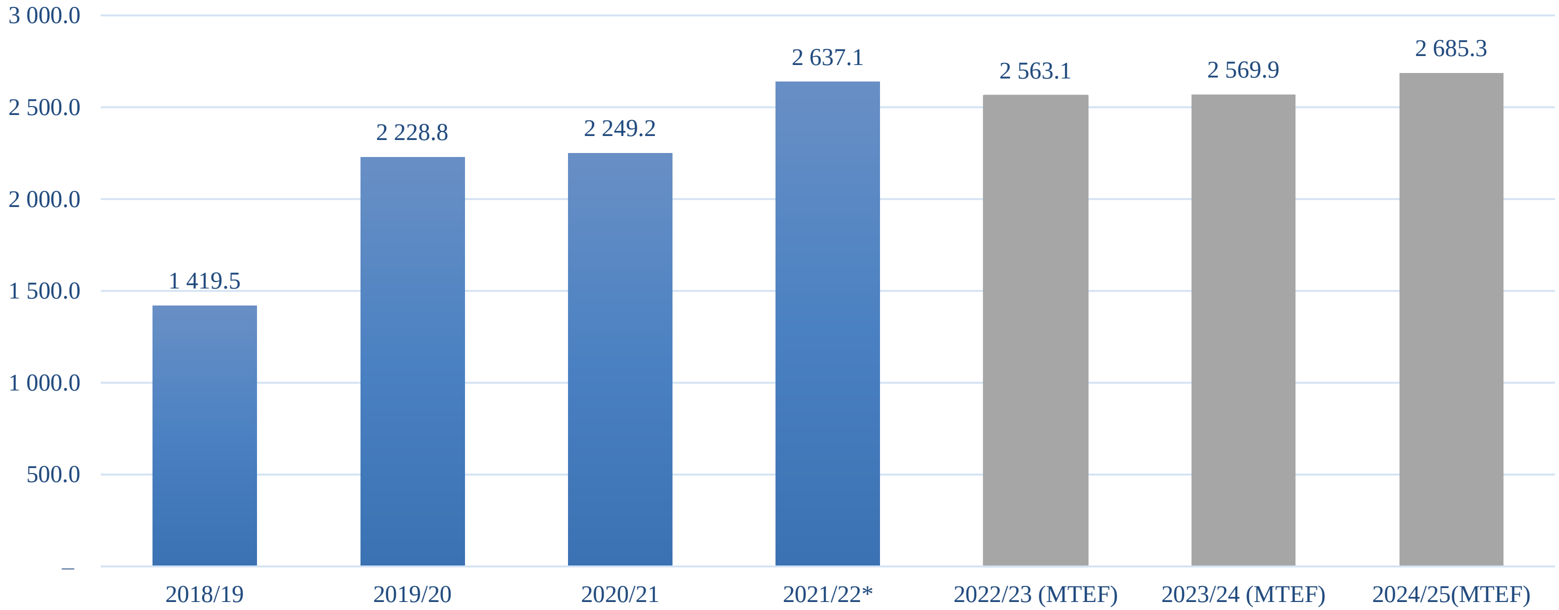
- The financial health of Eskom as measured by key financial ratios further reflects weak financial performance as both the profitability and solvency ratios are deteriorating.

- The Commission supports the proposal for a centralised shareholder model for commercial SOEs as proposed by the PCRSOE as well as the government initiative to publish a framework outlining the criteria for government funding of SOEs because it will support the required reforms at Eskom.

FINANCIAL
AND FISCAL
COMMISSION

INDUSTRIALISATION THROUGH LOCALISATION

INDUSTRIALISATION THROUGH LOCALIZATION: SMALL AND MEDIUM ENTERPRISES (R'MILLIONS)

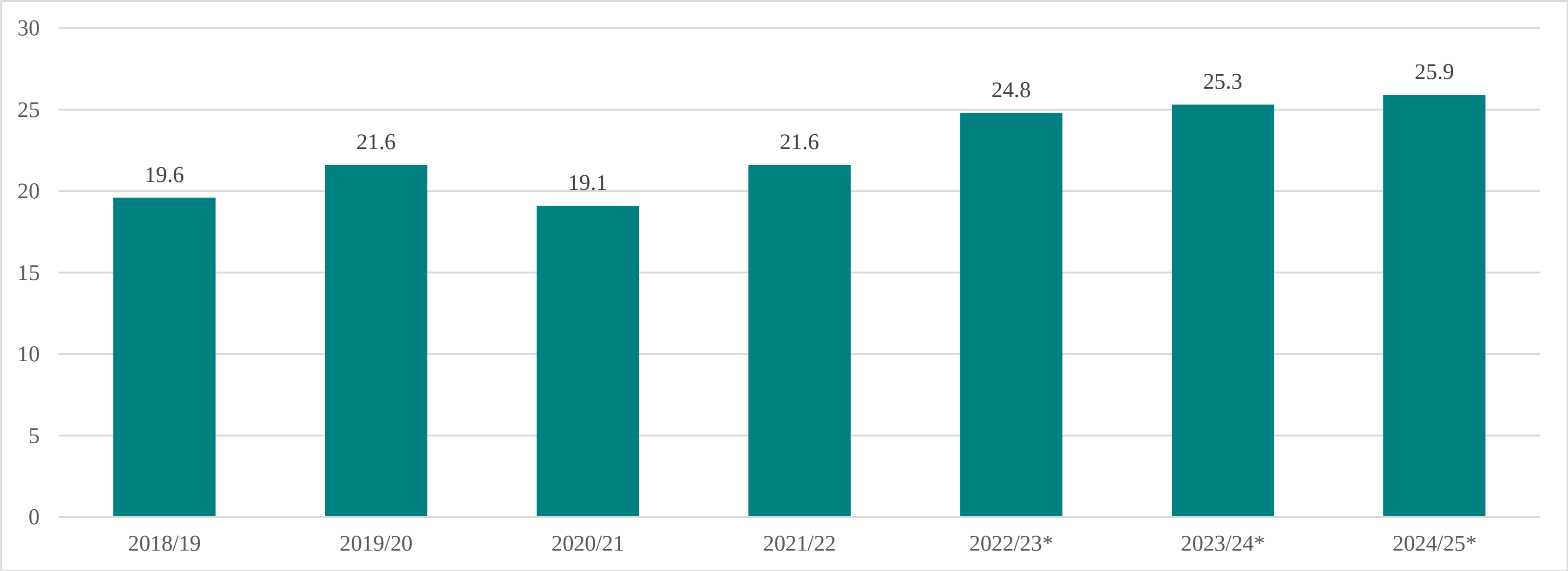


- The Economic Recovery Plan aims to strengthen industrialization and localization by facilitating the participation of Small and Medium Enterprises in key sectors of the economy such as manufacturing.
- The department of small businesses focuses on providing support to SMMEs, including establishing infrastructure to support SMMEs and cooperatives.
- Expenditure is expected to increase at an average annual rate of 0.6%, from R2.6 billion in 2021/22 to R2.7 billion in 2024/25.
- The increase in allocations over the MTEF demonstrates the commitment to accelerating the involvement of SMMEs in local value chains

FINANCIAL AND FISCAL COMMISSION

PUBLIC EMPLOYMENT INTERVENTIONS

PUBLIC EMPLOYMENT INTERVENTIONS (R'BILLIONS)



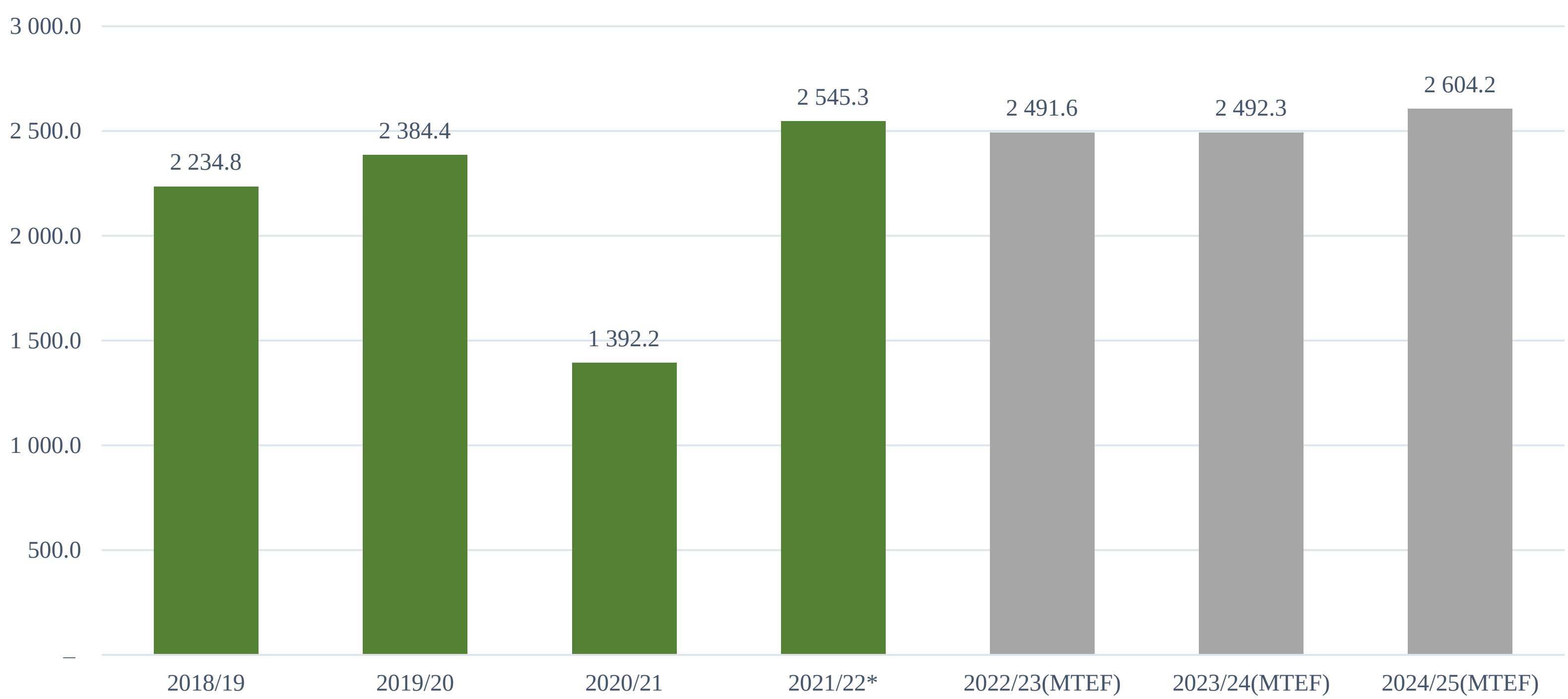
- The Economic Recovery Plan aims to strengthen industrialization and localization by facilitating the participation of Small and Medium Enterprises in key sectors of the economy such as manufacturing.
- The government has committed significant resources to promote the growth and employment needed to build on recovery following a deep contraction due to COVID-19.
- The budget has allocated R24.8 billion for employment programmes for 2022/23. The allocation increased from an estimated expenditure of R21.6 billion in 2021/22. Employment programmes include the EPWP, the Community Works Programme and the Jobs Fund
- have resulted in some economic opportunities at a micro-level for young people, they have no significant impact on reducing the high unemployment rate.

FINANCIAL AND FISCAL COMMISSION

FINANCIAL
AND FISCAL
COMMISSION

GROWTH OF TOURISM

Growth of Tourism Sector interventions (R'millions)



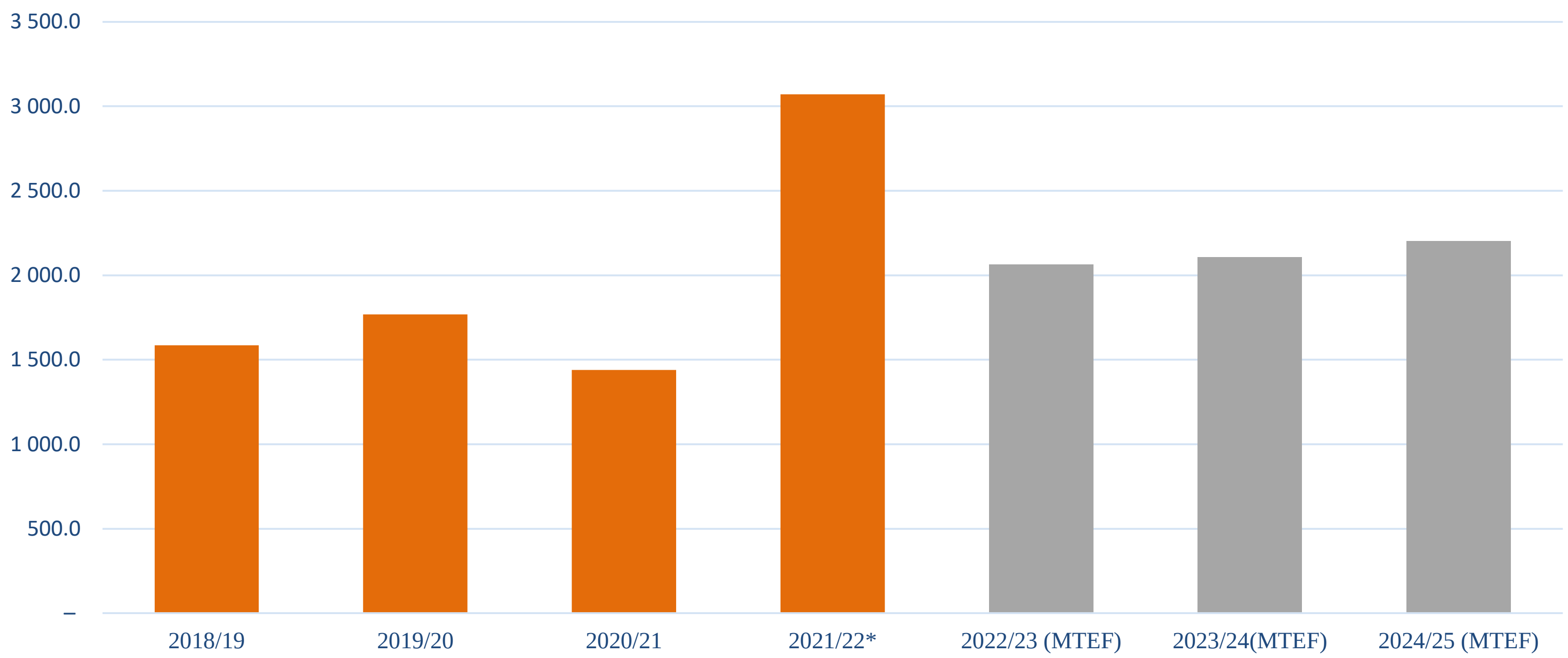
- The Economic Recovery Plan identifies the tourism sector as an integral part of the overall reconstruction and recovery effort. The tourism industry is a growth focal point, able to absorb varying skill levels through employment.
- The department has a total allocation of R7.6 billion over the medium term
- Expenditure is expected to increase at an average annual rate of 0.8%, from R2.5 billion in 2021/22 to R2.6 billion in 2024/25.

FINANCIAL AND FISCAL COMMISSION

FINANCIAL
AND FISCAL
COMMISSION

STRENGTHENING AGRICULTURE AND FOOD SECURITY

FOOD SECURITY AND AGRARIAN REFORM PROGRAM



- The COVID-19 crisis poses and additional threat to the food security of millions of South Africans who were already food insecure before the outbreak of COVID-19.
- Allocation to the food security and agrarian reform program under programme 3 of the Department of Agriculture, Land Reform and Rural Development, declines by 10.5% when compared to 2021/23 appropriation over the MTEF.

FINANCIAL AND FISCAL COMMISSION

FINANCIAL
AND FISCAL
COMMISSION

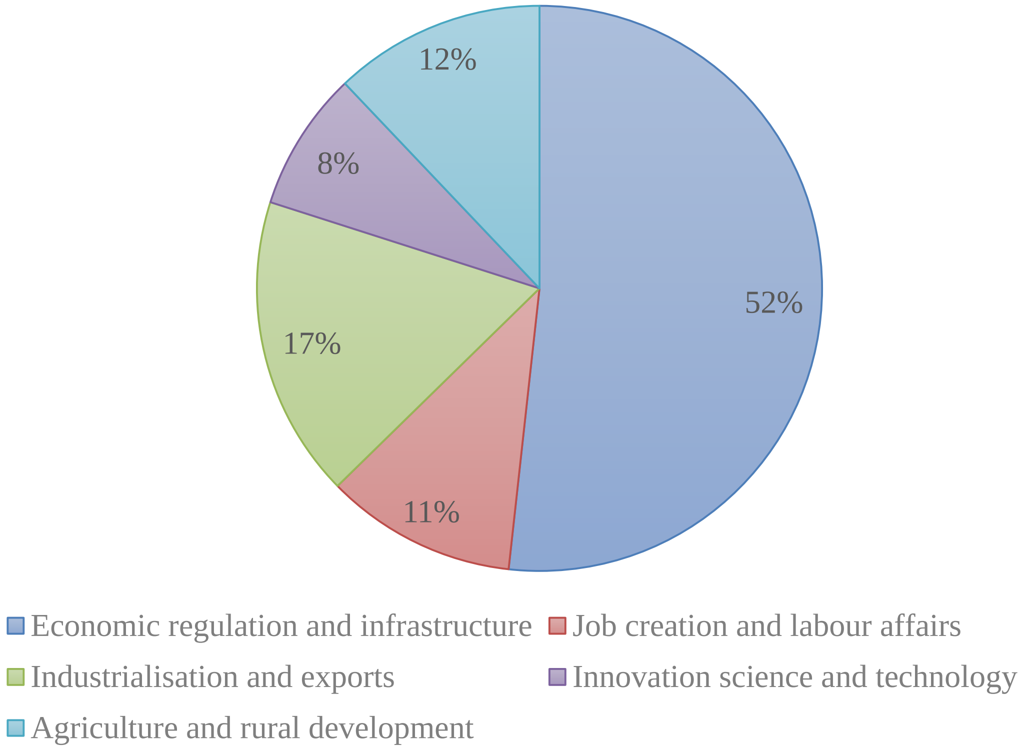
ALIGNMENT OF THE ERRP WITH THE BUDGET

Balancing Recovery and Fiscal Sustainability

- The Commission is of the view that the composition of economic function expenditure is not well aligned to the Economic Reconstruction and Recovery Plan (ERRP)
- Whereas the plan identifies infrastructure roll out, localisation through industrialisation and food security as crucial interventions for job creation – associated allocations are declining
  - Infrastructure spending is marred by delivery and management deficiencies
  - The manufacturing incentives and the product and systems development allocations programmes are projected to decrease by 9% and 6.3% over the MTEF
  - Allocation to the food security and agrarian reform program under programme 3 of the Department of Agriculture, Land Reform and Rural Development, declines by 10.5% when compared to 2021/23 appropriation
- The Infrastructure Fund is one of the ERRP instruments to crowd-in private investments and fast-track approval process for large infrastructure projects
  - The Fund should operate within the confines of IGFR principles in respect of equitable distribution of projects and being assigned to a vote

FINANCIAL AND FISCAL COMMISSION

Balancing Recovery and Fiscal Sustainability [cont.]



- The Commission recommends that the budget process for 2023/24 focus on aligning the allocations to Economic Reconstruction and Recovery Plan – informed by comprehensive budget and expenditure reviews.

Concluding Remarks

The Commission supports government's continued commitment to consolidating public finances while providing support for the pandemic response, job creation and social protection. The Commission further emphasises the following points:

I. In terms of the South Africa's growth prospects, the Commission's view is that it is improbable that the economy will return to pre-pandemic production levels within the year

II. The Commission welcomes government's decision to use a portion of the revenue windfall to lower the gross borrowing requirement and reducing debt issuances. However, the Commission cautions that debt stabilisation risks remain elevated and pose significant challenges to public finances

III. The Commission supports the decision to use the revenue windfall to improve pro-poor and growth inducing allocations in non-interest spending over the MTEF period

- The Commission believes that this is an approach that does not jeopardise the path to deficit reduction and fiscal consolidation
- The Commission notes the misalignment between the prioritisation of spending within the economic function relative to the priorities identified as high impact job creation interventions in the Economic Reconstruction and Recovery Plan, namely, infrastructure roll out, localisation through industrialisation and food security

FINANCIAL AND FISCAL COMMISSION

Concluding Remarks [cont.]

V. The Commission applauds the efforts and outcomes associated with government's attempts to stimulate employment through numerous interventions – however this has not changed the macro-level picture of unemployment. In this regard, more significant structural reforms focused on artisanal skills are required to address unemployment in the long run

VI. The Commission welcomes and awaits the finalisation of processes underway to find a more permanent alternative to the SRD grant so as to support food security. A key consideration for the Commission when evaluating a potential replacement will be the long-run viability and effects that a replacement will have on the fiscus

VII. Fraud, corruption and fiscal mismanagement (in the form of fruitless and wasteful expenditure) remain rampant. The government must take decisive and prompt actions against the perpetrators of these wastages and leakages to send a clear message that the government is serious about addressing this challenge

CONCLUDING REMARKS [CONT.]

VIII. Budget 2022 further provided for expenditure-side economic recovery levers through the economic functions, which is set to receive R227 billion in 2022/23

- Much emphasis on infrastructure – to this end, infrastructure management and delivery flaws are a key factor hampering the potential gains to the economy that can be derived from infrastructure spending