# POLICY BRIEF

FINANCIAL AND FISCAL COMMISSION (2023)

# The Impact of Municipal Spending on Local Unemployment and Development

## EXECUTIVE SUMMARY


Infrastructure can drive the economy and offers numerous positive economic benefits, i.e. increased and more sustainable economic growth, as well as improved productivity. These infrastructure projects will also have several positive indirect spin-offs, such as reducing poverty, higher levels of employment and citizens will also have an improved standard of living through access to better services (Pereira and Pereira, 2018)[1].

Municipal performance of infrastructure-related conditional grants is crucial to boost local economic development and, in turn, employment in South Africa. As the sphere of government closest to the people, municipalities are mandated to provide basic essential services to the people as enshrined in the constitution.

Several grants, conditional and unconditional, are allocated to municipalities to enable them to deliver these services. However, municipalities need to manage their capital budgets effectively and are under-spending on the critical infrastructure needed to drive the economy. The Financial and Fiscal Commission examined the impact of municipal grant spending on local economic development and employment and the study found that municipalities are spending less than 60 per cent of the allocated infrastructure grants for various reasons that include, among others, the need for more skills and capacity. This indicates that local economic development and employment need to be improved.


FINANCIAL AND FISCAL COMMISSION

### THE FINANCIAL AND FISCAL COMMISSION

The Financial and Fiscal Commission is a body that makes recommendations and gives advice to organs of state on financial and fiscal matters. As an institution created in the Constitution of the Republic of South Africa, it is an independent juristic person subject only to the Constitution itself, the Financial and Fiscal Commission Act, 1997 (Act No. 99 of 1997) (as amended) and relevant legislative prescripts. It may perform its functions on its own initiative or at the request of an organ of state.

The vision of the Commission is to provide influential advice for equitable, efficient and sustainable intergovernmental fiscal relations between national, provincial and local spheres of government. This relates to the equitable division of government revenue among three spheres of government and to the related service delivery of public services to South Africans.

Through focused research, the Commission aims to provide proactive, expert and independent advice on promoting the intergovernmental fiscal relations system using evidence-based policy analysis to ensure the realisation of constitutional values. The Commission reports directly to both Parliament and the provincial legislatures, who hold government institutions to account. Government must respond to the Commission's recommendations and the extent to which they will be implemented at the tabling of the annual national budget in February each year.

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

[1] Pereira AM and Pereira RM (2018). On the effects of infrastructure investment on economic performance in Ontario. Journal of Infrastructure, Policy and Development, 2(2): 286–300.

## BACKGROUND

South Africa's three spheres of government are intended to foster a spirit of cooperation and facilitate the alignment of policy, legislation, and overall service delivery programmes. The District Development Model (DDM) reemphasises this coordination. The strong interdependence of the three government spheres implies that policy decisions often involve trade-offs between having enough resources for each sphere to fulfil its constitutional mandate(s) and allocating scarce resources to the sphere best placed to implement expenditure programmes that will have the most substantial impact on growth and development.

The country's strategy to enhance growth is through significant public infrastructure investments. While responsibility for capital spending is shared across all spheres of government, spending by local government on socio-economic infrastructure is seen as crucial for addressing the apartheid legacy and boosting regional economic growth and employment. This corresponds to the constitutional mandate of municipalities to play a developmental role by meeting the basic needs of their constituents.

The challenge is that municipalities must manage or implement their infrastructure budgets effectively, yet many have been significantly under-spending on these grants annually. It is questionable whether providing additional funding will have any meaningful impact on growth and employment. In response, the Financial and Fiscal Commission conducted a study into the effects of the performance of infrastructure-related grants on local economic development and employment for 2018-2021.

## RESEARCH FINDINGS

For this study, category C municipalities were excluded from the analysis as this category of municipalities are exempt from conditional grant allocations, especially districts that are not water services providers. The study completed an expenditure review of municipal infrastructure grants. Given that not all municipalities receive all conditional grants, the analysis was based on metropolitan and local municipalities and excluded District municipalities.

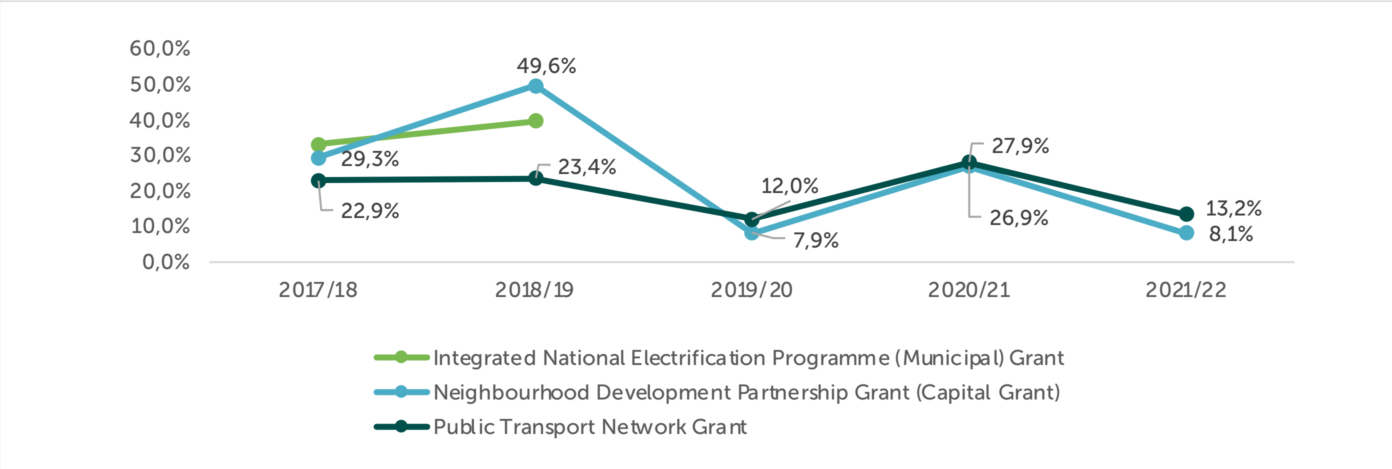
## METROPOLITAN MUNICIPALITIES

Metropolitan municipalities receive several grants, and of these, the integrated national electrification (municipal) programme (INEP) grant; the neighbourhood development partnership grant; and the public transport network grant have been included in the study. The Municipal Disaster Recovery Grant and Municipal Emergency Housing Grant are not included as this funding is in response to a disaster.

The Urban Settlements Development Grant is not part of this review as this grant's information is not published as part of the section 71 reports.

Figure 1 illustrates Metros' performance on the three grants over five years; however, funding via INEP was only for the first two years of the review period.

*Figure 1: Grant Performance of Metro Municipalities*

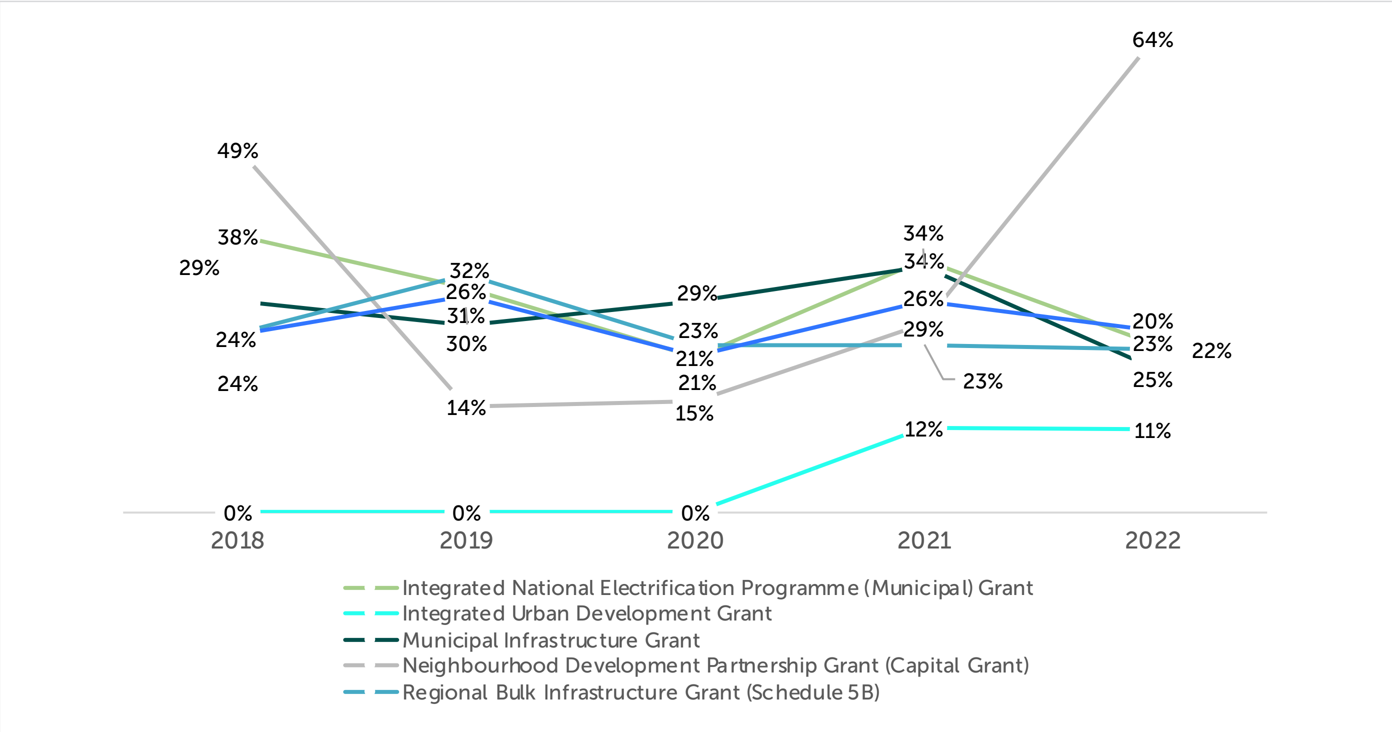



*Source: Section 71 reports.*

## LOCAL MUNICIPALITIES

Category B, or local municipalities, receive six direct infrastructure-related conditional grants. The largest allocation to local municipalities flows via the municipal infrastructure grant. Figure 2 illustrates the expenditure performance of these grants. The Municipal Infrastructure Grant (MIG) is the only direct infrastructure grant to many local municipalities, especially B3 and B4 municipalities.

*Figure 2: Local municipalities infrastructure grant performance*




*Source: Section 71 reports.*

For the economy to flourish and promote economic activity, the country will require a consistent water and electricity supply. The funding allocation to water and electricity has remained constant and marginally increased over the review period. However, municipalities have been unable to perform in these two areas financially. The findings from the expenditure review and the regression show that lack of spending on infrastructure is still a prominent factor in the local government sphere, with significant underspending occurring annually over the review period.

## REGRESSION ANALYSIS

The quantitative analysis uses two models to evaluate the impact of underspending on the economy. The first model analyses the relationship between Local Economic Development (LED) and the selected conditional grants. The second model will then relate LED and employment.

The results suggest that infrastructure investments by local government in South Africa are subject to diminishing returns, indicating inefficiencies in the use and allocation of resources. Across municipalities, infrastructure grants are characterised by under-spending, which reflects either a failure to align municipal integrated development plans (IDPs) with budgets or a lack of capacity to plan for and implement critical service delivery programmes properly. While infrastructure spending by many municipalities may need to be better designed, municipal infrastructure investment remains essential.

The study found that infrastructure grants can enhance local economic development, and this can then spill over to creating employment for the citizenry. However, such impact is marginal since municipalities generally underspend on conditional grants.

## CONCLUSION

The research provides an overview of the policies and framework regarding economic development in South Africa and the role that municipalities are envisaged to fulfil. This shows that the country, through its transfers to local government through conditional grants, is aimed at unlocking its growth potential through infrastructure investment.

The findings from the expenditure review and the regression show that lack of spending on infrastructure is still a prominent factor in the local government sphere, with significant underspending occurring annually over the review period.

Several legislations, policies, and frameworks relate to LED in the local government sphere, and the findings from the report indicate that a few challenges exist that hamper policy implementation. One of the main reasons for the failure of LED is that LED is not embedded in municipalities. The literature review showed a lack of LED units in municipalities, and if municipalities had units, they had limited funding available to allocate to LED. As such, cities do not have sufficient economic strategies to address the issues of inequality, poverty, and unemployment (SACN, 2004)[2].

## RECOMMENDATIONS

The Commission makes the following recommendations:

1. *Cooperative Governance and Traditional Affairs (COGTA) to include skills development through the revitalisation of mentorship/apprenticeship programs as part of future LED Frameworks.*

2. *COGTA and Treasury must develop an appropriate funding mechanism or funding plan in a targeted and phased approach that considers the spatial inequalities across local government. The Commission further believes the District Development Model (DDM) must be strengthened and financed for local government to fulfil its developmental role.*

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[2] South African Cities Network (SACN). (2004). State of the Cities Report 2004. Johannesburg. SACN.