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Policy Brief 1

Supplementary revenue sources for local government

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Executive summary

This policy brief provides a summary of the supplementary revenues for municipalities as identified by the Financial and Fiscal Commission (the Commission). The Commission isolated development charges, tourism and fire levies, and amusement and advertisement taxes as viable revenue options for local government (LG). These revenue sources rank highly in terms of the five important criteria for a “good” tax handle, i.e. efficiency, accountability, transparency, fairness, and ease of administration. Many municipalities own massive tracts of land. As the most important asset of municipalities, land should provide a steady flow of income for many local authorities. There are various value capture mechanisms that municipalities can assess and consider adopting.

Background

The LG sector plays a crucial role in the delivery of basic public services and the provision of fundamental public infrastructure. Since the White Paper on Local Government (1998), the roles and responsibilities of LG have expanded, albeit against a backdrop of limited finances (Department of Constitutional Development, 1998). The stunted growth that has characterised the South African economy since the 2008 financial crisis has intensified the financial challenges of the sector. The fundamental problem confronting most municipalities is the widening gap between the available financial resources and the delivery of service needs. Demand for the sector’s services has increased exponentially, thanks to a plethora of factors, including acute levels of unemployment and poverty, rapid and unplanned urbanisation, growing backlogs of infrastructure needs and poor maintenance of existing infrastructure. Given the limited resource pool, many municipalities are hamstrung to fulfil their constitutional mandate. Municipalities cannot count on transfers to plug the resource gap, as this revenue window is heavily constrained due to, among other things, under collection of revenues and fiscal consolidation measures. Given the muted growth of the economy, local government cannot count on conventional revenue sources either as many municipalities have limited space to optimise conventional revenue sources.

In order to fulfil their mandate, municipalities should have adequate own sources of both tax and non-tax revenues. This then begs the following question: What are the alternative revenue sources for different tiers of South African local government? This policy brief provides a summary of the supplementary revenues for the local government as identified by the Commission.

Research findings

Based on the results a survey of 257 South African municipal managers (MMs), and content analysis of both modern public finance theory and empirical studies, a list of potential revenue sources for LG was drawn up and subjected to a rigorous evaluation process. The evaluation process involved testing the potential of each revenue source against a number of public finance principles for a "good" LG revenue source. The Commission identified development charges[1], tax sharing and weigh in bridges in mining areas, as viable revenue sources that can be exploited by local government.

These revenue sources rank highly in satisfying the five important criteria listed above for a "good" tax handle. Tax sharing in particular is gaining traction as the first stage instrument of closing the vertical gap left by insufficient revenue assignments. A number of levies, including fire levies, amusement and advertisement taxes, could be added to the list of supplementary revenue options.

Conclusion and recommendations

LG is a critical sphere in the country's growth and development process. Given that it accounts for almost 40 per cent of the country's GDP, LG requires adequate revenue sources to fulfil its constitutional mandate. In the current economic climate, the sector cannot count on transfers to close its fiscal gaps on either the capital or operational accounts. The ever-increasing expenditure demands facing LG against a backdrop of very constrained revenue streams requires a review of the LG fiscal framework to introduce additional new revenue streams.

Besides internal revenues, the Commission reviewed the potential of external financing arrangements. The Commission underscores the importance of developing LG credit markets through, among other things, incentivising financial intermediaries to serve LG or incentivising financial intermediaries that will package financial instruments in a way that is accessible to

[1] A development charge is a "once-off capital charge to recover the actual cost of external infrastructure required to accommodate the additional impact of a new development on engineering services". Weigh in bridge tolls, in this case are tolls imposed on trucks (based on their loads) entering or leaving mining areas with the purpose of recovering the costs associated with repairs and maintenance of such roads. Tax sharing refers to the sharing of tax revenues in a multi government system.

municipalities. It is also important to improve municipal creditworthiness by promoting transparency in budgeting and accounting. The Commission also noted that many municipalities own massive tracts of land. As the most important asset of municipalities, land should provide a steady flow of income for many local authorities. There are various value capture mechanisms which municipalities should assess and, if possible, adopt.

With respect to supplementary revenue sources for LG, the Commission recommends that:

(a) The Minister of Finance should take steps (including piloting) to add the following supplementary revenue sources to the list of allowable taxes for different types of municipalities in a differentiated manner that could include, the development charges, tourism levies, land value capture mechanisms, tourism levies and fire levies. Fire service levies in particular should be considered for the municipalities that are to be authorised for this function. The greater potential for expansion of own revenue sources in urban areas should be compensated for by changes to the division of revenue to increase transfers to rural areas.

(b) The Minister of Finance proactively inform municipalities about various land value capture mechanisms, that municipalities can take advantage of in order to supplement their current own revenue sources.

References

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