



Media Release

SUSTAINING LOCAL GOVERNMENT FINANCES: REPORT ON THE FINANCIAL AND FISCAL COMMISSION'S REVIEW OF THE LOCAL GOVERNMENT FISCAL FRAMEWORK

22 April 2013

Financial and Fiscal Commission
Montrose Place (2nd Floor), Bekker Street,
Waterfall Park, Vorna Valley, Midrand,
Private Bag X69, Halfway House 1685
www.ffc.co.za
Tel: +27 11 207 2332
Fax: +27 388 3965

For an Equitable Sharing of National Revenue

[22 April 2013, Midrand] Is Local Government Underfunded?

Local government is faced with huge challenges as it moves into the future. Responding to recent calls around the need for a differentiated approach and adequate funding to increase basic service provision, the Local Government Fiscal Framework and related matters such as addressing service backlogs are becoming significant issues for local government. The flow-on impact of the global financial crisis requires a governance response at a local level. Other challenges that need to be met at a local level include coping with an ageing infrastructure and delivering affordable housing. An attempt to quantify the backlogs in the current renewal requirements for local government infrastructure was estimated using current information and several key assumptions and guidelines to range from R20 to R40 billion. This means the performance of local governance is under increasing scrutiny. By the end of the 2010/11 municipal financial year, local government spent approximately R213 billion. Approximately 27% of this was funded from grants while the rest came from municipal own revenue sources. Over the 2013 Medium Term Expenditure Framework, national government is expected to support local government by R277 billion from the national fiscus in the form of conditional and unconditional grants. Despite this, service delivery inefficiencies and resource wastage continue to plague the system. The Auditor General's 2010/11 report finds high levels of irregular and unauthorised expenditure among municipalities of approximately R11 billion.

In light of these inefficiencies on the part of local government, there is the general perception that the local government financing system is inadequately funding municipalities. It is important that municipalities are appropriately funded and spend efficiently and effectively in order to deliver quality services and extend access to basic services to poor households. Furthermore, key developments over the 2013 Medium Term Expenditure Framework, relevant for the Local Government Fiscal Framework, include assignment of the housing function (currently a provincial mandate) to six metros and a greater distribution of resources to rural municipalities following introduction of the new local government equitable share formula. It is important to critically assess these key developments in local government financing.

In 2011, the Financial and Fiscal Commission initiated a comprehensive review of the Local Government Fiscal Framework. One of the key components in this research was the hosting of a set of public hearings aimed at strengthening understanding of the problem and exploring policy options to move towards a more effective Local Government Fiscal Framework. Stakeholders from local government, national government, provincial government, academia, civil society and state owned enterprises attended the public hearings. With technical research strengthened by the inputs from a wide range of stakeholders, the Commission outlined the various challenges inherent in the Local Government Fiscal Framework and proposed recommendations in addressing these concerns.

Identifying the Problems and Options for the Local Government Fiscal Framework Review

The first challenge was the inability of the system to appropriately account for differences across municipalities that resulted in the system being sufficiently sensitive to the different expenditure pressures and revenue raising ability of municipalities. Differentiation in local

government should be based on a municipality's social, economic and demographic context (which lie largely outside its direct control) and internal dimensions of municipal performance such as levels of capacity and efficiency to fulfill its functions.

Secondly, the vertical division of nationally raised revenues was also a concern as it is important that the combination of municipal own revenue sources and grants are sufficient in ensuring that municipalities can deliver on mandated services. Lack of funds flowing from national and provincial government to local government can create a situation of underfunding of municipalities, especially for poor and rural municipalities which do not have significant own revenue bases. In terms of this vertical division of revenue, the quantum of resources allocated to local government for operating expenditure is sufficient but there are inequities in its distribution across municipalities (horizontal division of revenue). The new local government equitable share formula has addressed the concern around the horizontal division of revenue on the operating side. On the other hand, the research also found that total funding from the vertical division of revenue to municipalities is not sufficient to cater for municipal expenditure needs in terms of social and economic infrastructure investments. The Commission therefore calls for a review of the sources of finances for municipal capital expenditure.

Thirdly, a lack of frequently updated and accurate data at the local government level constrains the effectiveness and equity in the design and distribution of grants. The release of the 2011 Census has temporarily solved the issue of out-dated data used in formula distributing funds for local government. However, going forward, the need to update data within formulae to keep pace with the rapidly changing delivery context (e.g. urbanisation) will remain problematic given the current practice of undertaking censuses once every 10 years. In this regard, the Commission calls for the institutionalisation of a 5-year census and the exploration of statistical methods, agreed on and used by all spheres of government and public entities, to fill the data gap between censuses. This can be achieved by strengthening the existing Local Government Data Forum.

Fourthly, there continues to be several constraints inherent in the local government conditional grant framework, including perennial under spending of conditional grants and inefficient and ineffective use of such funds. These factors can undermine the Local Government Fiscal Framework. The Commission will actively engage Government in the review of the conditional grant system and will highlight the findings from this review. This includes: the call for a rationalisation of the local government conditional grant system given the increased proliferation of grants and disjuncture between grant objectives and grant design, refocus monitoring and evaluation to the outcomes of conditional grants and the improved implementation of mechanisms to improve conditional grant expenditure.

Fifthly, municipalities are facing constraints on their own revenue instruments. The issues here include high levels of consumer debt, poor tariff determination and concerns over the replacement of abolished taxes. In this regard, the Commission calls for a combination of punitive and innovative methods to collect revenues from communities and for the appropriate determination of tariffs to ensure costs are recovered and revenues generated. The Commission also calls for an urgent review of the sharing of the general fuel levy with metropolitan municipalities and the permanent replacement for the

abolished Regional Services Levy for district municipalities due to concerns around administration, distribution and buoyancy of these replacement options.

Sixthly, the Local Government Fiscal Framework review highlighted concerns around increasing costs faced by municipalities, such as increases in the administered prices of bulk electricity and water, and the communication breakdown between local government and other spheres of government as well as local government and its local communities. These factors directly impact on the ability of local government to generate revenues and hinder its ability to effectively deliver services to its communities.

Way Forward

The Commission's conclusions and recommendations from this process were officially tabled in Parliament on 19 April 2013. It is now important for all key stakeholders in the Local Government Fiscal Framework to actively engage in the findings and recommendations from the research to improve several aspects of the Local Government Fiscal Framework.

To read the entire report, go to <http://www.ffc.co.za/>

For and on behalf of the Financial and Fiscal Commission



**Bongani Khumalo (Mr.)
Acting Chairperson/CE
Financial and Fiscal Commission
Monday, 22 April 2013**

Contact

Bongani Khumalo (Mr.)
Financial and Fiscal Commission
2ndFloor, Montrose House, Midrand
Phone: 27-11-2072300
Email: bonganik@ffc.co.za