



Summary of Local Government Fiscal Framework Public Hearings

For an Equitable Sharing of National Revenue

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1.1 Introduction

On 3 and 4 October 2011, the Financial and Fiscal Commission (FFC) hosted public hearings at the Protea Hotel Ranch Resort, Polokwane, Limpopo Province, on the financing of municipalities and requirements of the Local Government Fiscal Framework (LGFF). A problem statement document¹ was released by the FFC research team for stakeholder discussion at the hearings in order to strengthen analysis of the challenges relating to the LGFF. This discussion, complemented by the FFC's international and national research, will be extended into a draft technical report, with an initial set of recommendations and policy options which will be considered at a second public hearing. Thereafter, the FFC will finalise the technical report. This will inform a structured research agenda going forward and will provide policy options to the issues raised via sound research, thereby making a contribution to the policy debate on reviewing the LGFF.

This document is a summary of some of the key emergent themes arising from submissions and group discussions of 75 stakeholders represented at the first public hearing, and not those of the FFC. It includes consolidated views on the problem statement, separating the symptoms of perceived problem areas relating to the current LGFF from their underlying causes, identifying principles that could drive solutions and knowledge gaps that exist in four areas, namely Local Government Equitable Share and Conditional Grants, Municipal Revenue Sources and Municipal Borrowing, Intergovernmental Fiscal Coordination and Interface with Municipalities, and a Differentiated Approach to the Funding of Municipalities. The Commission will in due course release a more comprehensive document outlining in more detail stakeholder perspectives articulated at the hearings.

1.2 The Local Government Equitable Share (LES) and Conditional Grants

Stakeholders discussed the principle of the LES and challenged the formula as a technical instrument. Outdated data, an inadequate definition of poverty, allocation of LES funding on the basis of financial rather than technical service level equity, and the exclusion of backlogs from the formula were described as problematic. In terms of conditional grants, poor design and operation thereof were mentioned as challenges along with the lack of human resources required for technical implementation. Many local government practitioners did not understand the basis of the formula and expressed the view that access to the underlying data was non-transparent.

Stakeholders pointed out that not only the horizontal division of revenue through the LES formula is important, but also the basis of the vertical division of revenue itself. This is critical in the light of declining fiscal capacity of local governments as own revenue instruments have been withdrawn (e.g. the RSC levies) without being replaced by viable alternatives which are true local government taxes under the control of municipalities. In 2003/4 local government financed in aggregate 90% of its expenditures from own revenues, this has declined to 75%. Escalations in water and electricity pricing also impact the vertical division.

¹ The LGFF problem statement and policy options document, along with stakeholder submissions and group feedback presentations, can be found on <http://www.ffc.co.za/index.php/media-a-events-interactive/public-hearings.html>, as well as on Facebook and Twitter.



Examples were given of small rural municipalities which were receiving clean audits (and hence had reliable financial data) , which were exerting maximum effort to collect revenues due to them, but despite the fiscal effort did not have the revenue base to be sustainable in the light of basic service delivery demands they face. While some municipalities do not exert sufficient fiscal effort to utilise the tax base available (e.g. not metering or billing properly), stakeholders emphasised that small, mainly rural municipalities, which were optimising whatever revenues at their disposal, are in a precarious financial position. For these cases urgent action was requested.

Stakeholder perceptions of principles that should drive the review of the LES include: a clear understanding of what the constitution envisages for the LES as well as transparent and well communicated adjustments to the variables in the formula. With respect to conditional grants, it was recommended that performance be monitored and rewarded and, where necessary, capacity support should be provided by sector departments as part of the allocation. In addition, infrastructure projects should be costed on a lifecycle basis, such that the maintenance costs are included.

Areas for future research include better understanding of allocative and technical efficiency at a local government level, consistent and predictable reviews of the data informing the LES, understanding of costs and cost disabilities, defining fiscal capacity and fiscal effort, the role of the LGFF in economic growth, and how the fuel levy could be designed and allocated.

1.3 Municipal Revenue Sources and Municipal Borrowing

Stakeholders described a number of challenges regarding raising municipal revenue. These include little municipal control over electricity and water tariff setting; underdeveloped local economic development methodologies; inadequate property valuations of traditional, non-bondable and rural properties; lack of a social compact over service delivery, and limited fiscal space for further metro taxes. In addition, many municipalities do not have the required alienable collateral for borrowing.

Some stakeholders from cities pointed out that it was a misconception that urban areas had large untapped sources of revenue. While in the past it could be generalised that rural areas were poor and urban areas were rich, in recent years with urbanisation, poverty has become concentrated in cities as well.

Stakeholders suggested that solutions for municipal revenue sources should be driven by the following principles: true own revenue sources for local government; affordability and a greater degree of consultation and participation by residents; and linking title deed registration processes to untracked and unrecorded market values. Municipalities must aim to be viable and borrowing should be sustainable and only occur for assets that will yield a stream of revenue to enable repayment and continuous maintenance and operations.

Research should be conducted to examine how rural properties can be valued; how relationships between traditional and municipal councils function in practice; what levels of cross-subsidisation of property, electricity and water rates are feasible; credible levels of consultation to preserve the social contract; quantifying infrastructure backlogs for determination of grant funding; and whether removal of the RSC levy exacerbated a pre-

existing fiscal gap. A review should also be conducted of the regulatory framework for borrowing mechanisms.

1.4 Intergovernmental Fiscal Coordination and Interface with Municipalities

Local government problems, often symptomatic of government-wide issues such as national and provincial policy incoherence, require a whole of government response. However, there can be limited engagement from other spheres which often lack the experience required to support municipalities and may have their own capacity problems. Functions and assets get devolved from provinces to municipalities without understanding cost implications. Stakeholders described fragmented funding and a lack of coordination and cooperation between departments and spheres as a frustration for municipal planning, operations and reporting. In addition, state owned enterprises (SOEs) often do not cooperate with municipalities in long term planning, impacting their role in local economic development.

Stakeholders suggested that solutions to these problems should be driven by the following principles: recognition of the role and mandate of local government; funding following function (institutional arrangements are currently under review) based on proper costing of municipal services; and effort should be exerted to make existing structures work rather than duplicating efforts and resources.

Further research should be conducted on how intergovernmental relations, SOEs and regulators impact local government; government-wide planning processes and systems; funding infrastructure projects; and costing legislation, regulations and implementation plans.

1.5 A Differentiated Approach to the funding of Municipalities

All municipalities are currently facing infrastructure cost pressures and an increased demand for service delivery. Many factors driving up the costs in municipalities are out of their control e.g. in-migration, compliance requirements, unfunded mandates, escalating fuel prices, as well as the failure of government departments to pay municipal debts. However, underlying characteristics of municipalities such as spatial factors, population density, topography, level and type of economic activity and historical redress require a differentiated approach in terms of funding.

Stakeholders debated on what basis municipalities could be differentiated. Principles included recognising and rewarding performance; differentiation not discouraging fiscal effort and efficient spending; funding depending on functions and cost of services; and development and capacity building funds incentivising improved performance.

Future research should be conducted on: criteria used to define a “viable municipality” and municipal demarcations; the performance approach to differentiation (once-off performance rewards, determination of fiscal effort etc.); and what data would still be required in order to implement a differentiated approach.

1.6 Conclusion

While the vertical split of national revenue has tilted in favour of local government in recent years, it is clear from stakeholder input that the local government fiscal framework must be reviewed, using updated data, in line with changes to the local

government operating context. The Financial and Fiscal Commission will explore this further in the full workshop report, as well as in its further engagements with stakeholders. A draft technical report, with an initial set of recommendations and policy options, will be released for further consideration by stakeholders at a second public hearing.
