

# The Local Government Fiscal Framework

*FFC Public Hearings*

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**national treasury**

Department:  
National Treasury  
REPUBLIC OF SOUTH AFRICA

# Overview

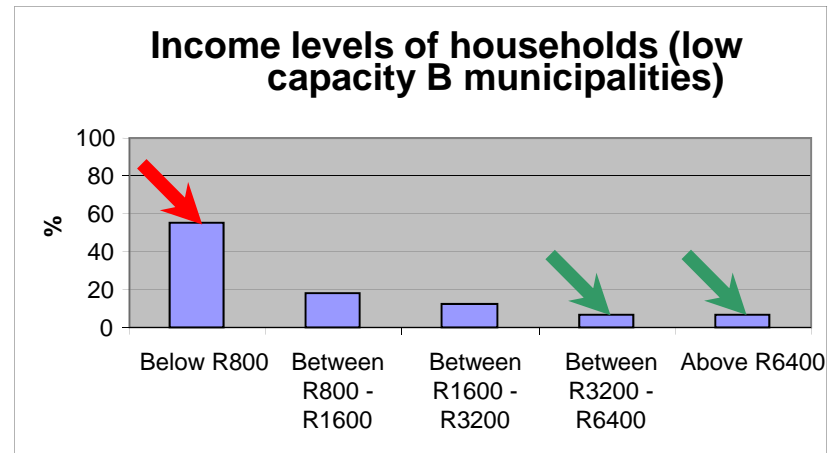
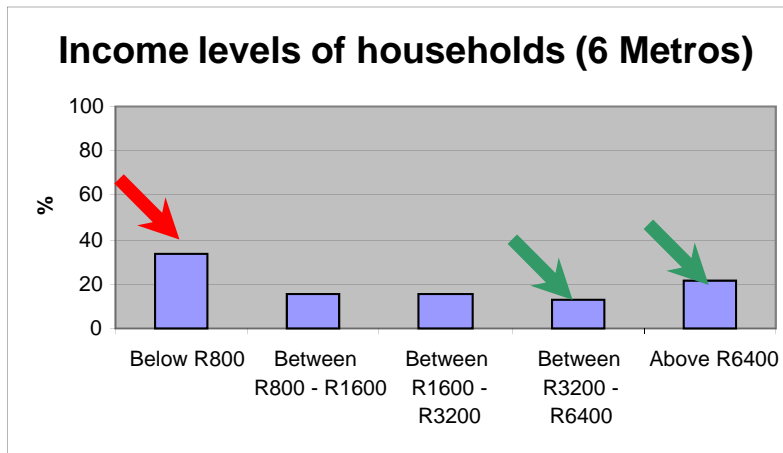
National Treasury welcomes the opportunity to participate in this public hearing and to learn from the experiences of other stakeholders in the Local Government Fiscal Framework

## **Structure of presentation:**

- Context of the Local Government Fiscal Framework
- Transfers
  - Local Government Equitable Share
  - Conditional Grants
- Own revenues
- Performance of LGFF in terms of Local Government White Paper principles
- Possible gaps in problem statement

# The local government fiscal framework

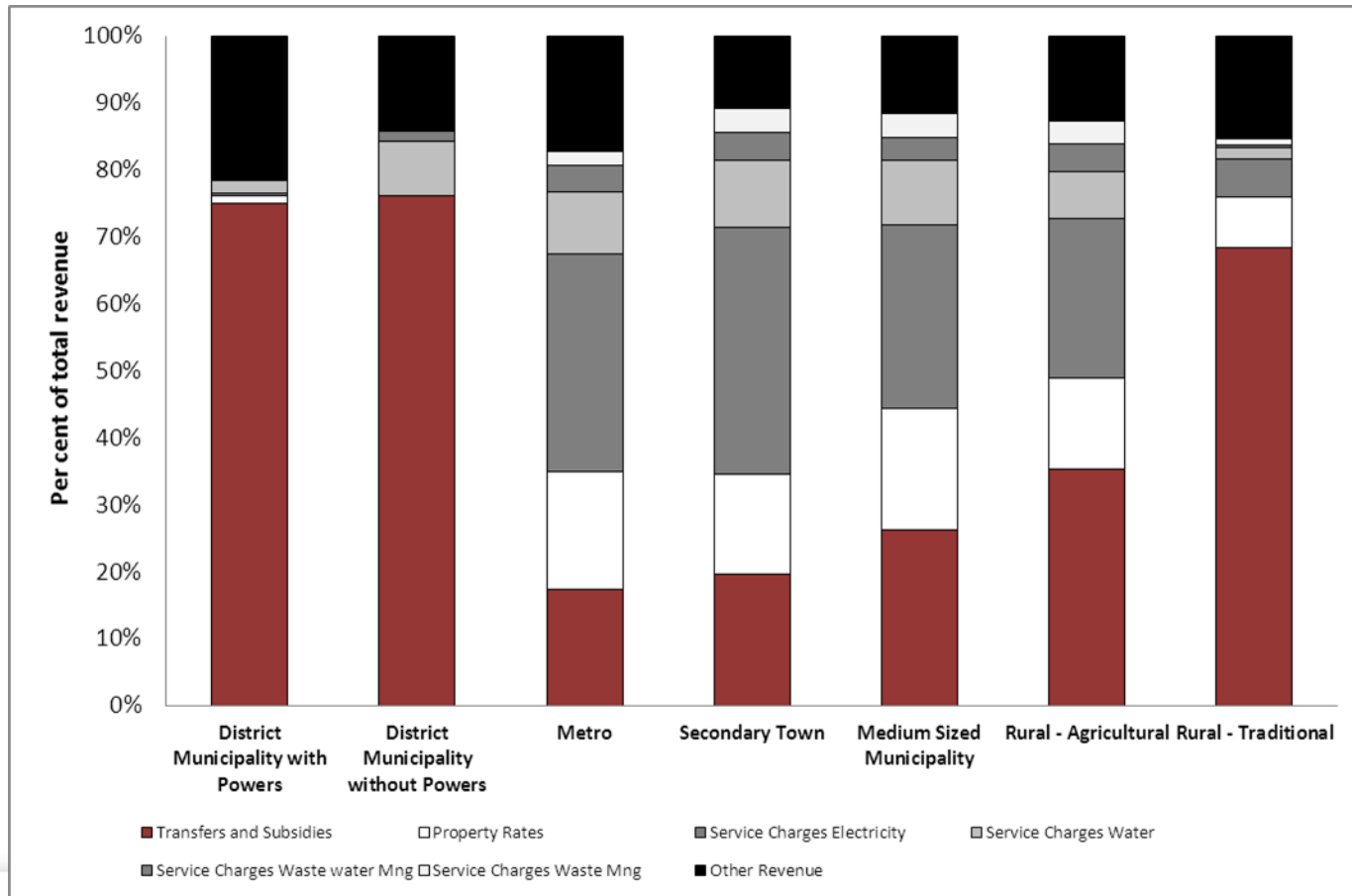
- The local government fiscal framework refers to all the revenues municipalities have at their disposal to meet their expenditure obligations
  - These include own revenues, borrowing and transfers
  - The uneven distribution of economic activity and poverty across South African municipalities means that different municipalities will rely on these sources of revenue in different proportions



- When we consider municipal “viability” we should look at **ALL** of their revenue sources (including transfers) and whether these are sufficient for them to meet their responsibility to provide basic services

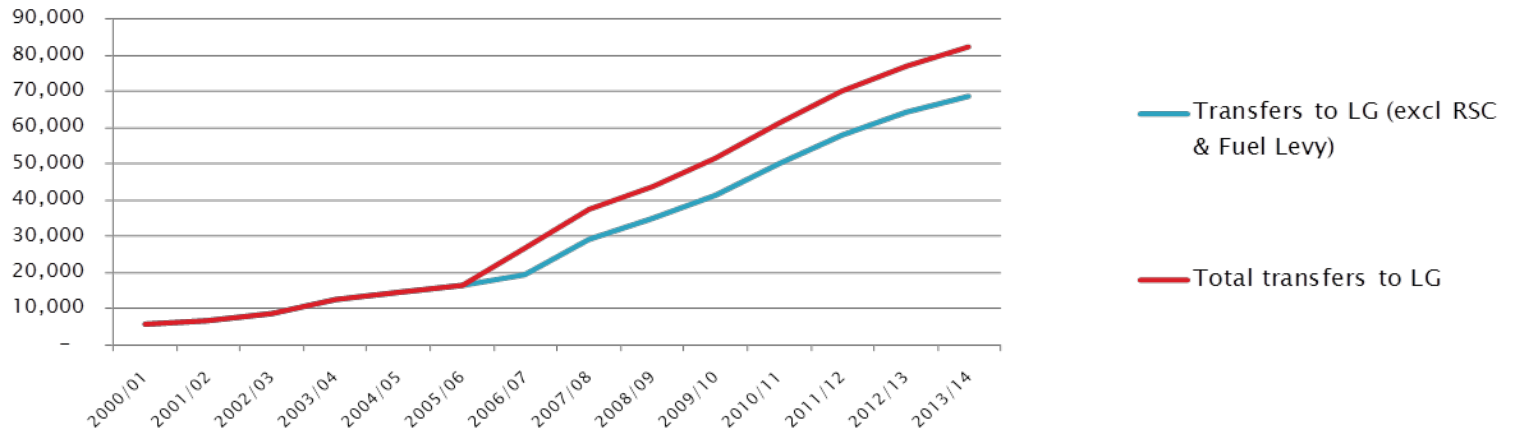
# Importance of different sources of revenue is very different for different types of municipalities:

## Municipal Revenue Sources (percentage) per Type of Municipality, 2010/11

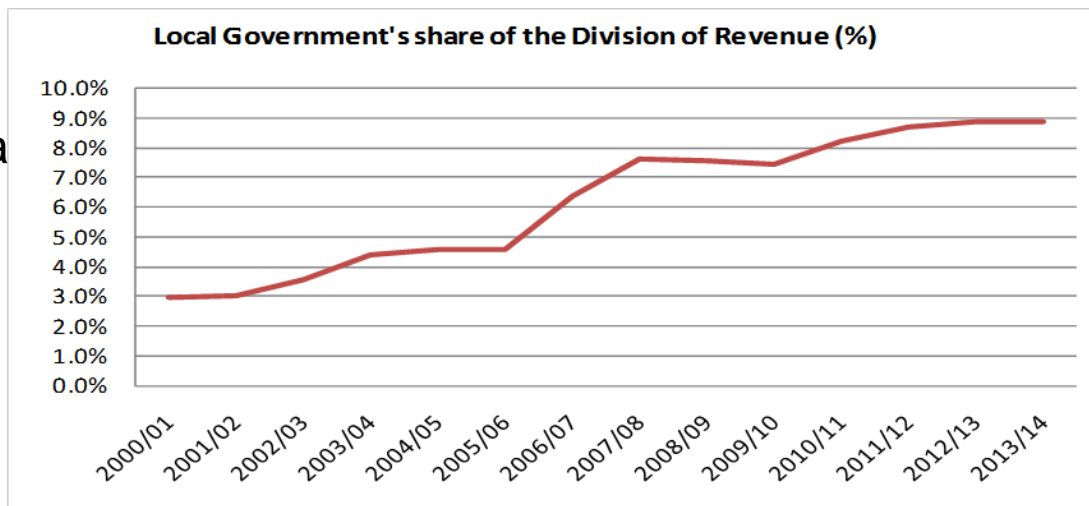


# The role of transfers in the fiscal framework has grown significantly...

...in Rand value (R millions)



...and as a % of the national budget



In the LG White Paper (1998) it was thought that own revenues made up 90% of municipal budgets on average. In 2010/11, transfers accounted for **25%** of municipal budgets (and 75% in B4 municipalities).

# Local Government Equitable Share

- Constitution entitles LG to an “equitable share” of nationally raised revenues
- The equitable share is an **unconditional** transfer
- Two processes:
  - **Vertical division** on overall share of the total
  - **Horizontal division** on allocations to 278 municipalities
    - Is a zero-sum game: for one municipality to gain funds must come from allocations that would have gone to other municipalities
- LGES formula includes three active components:
  - **Basic services** (for water, sanitation, electricity, refuse and environmental health – based on poverty and service access data)
  - **Institutional** (subsidises cost of administration)
  - **Revenue Raising Capacity (RRC) correction**
- The allocations from these components are then adjusted to ensure that all available funds are distributed among municipalities.
  - In effect the formula divides allocations based on a ratio determined by the factors included in each component

# Changes to the formula

## Changes over the last three years:

- In 2009/10 changes were made to the Revenue Raising Capacity correction component which also benefited poor municipalities
- In 2011/12 changes were made to the Basic Services and Institutional components to direct more funds to poor rural municipalities
  - As a result of changes to the formula, each C2 gained **R10.2m** and each B4 gained **R5.3m** in 2011/12

## Longer-term changes:

- LGES formula being reviewed by NT, SALGA and DCoG, with advice from FFC
- Lack of data updates at municipal level are a major constraint (10 year census)
- Will also examine costing of services, range of services funding and institutional costs and how own revenue capacity should be accounted for
- New formula will be introduced together with data from 2011 Census (due to be released in March 2013)

# Conditional Grants

- There is increased differentiation in the transfer system – a trend likely to increase.
  - *Urban Settlements Development Grant* shows move to integrated funding in cities (also a response to devolution of housing function)
  - Approach to infrastructure funding in rural municipalities is being reviewed
- Grant system funds provision of services to poor households
  - it needs to perform better in eradicating persistent backlogs



# Own revenues

- Own revenue sources can create a “virtuous circle” between residents and municipalities
  - municipalities derive more revenue from well-serviced residents and they can use that revenue to further improve services
- Sound regulatory framework for own revenues has been established
  - Includes mechanisms to apply for new revenue sources (for cities and rural areas)
- NT is worried about transfers “crowding out” own revenues
- Revenues must be matched to functions
  - uncertainty surrounding district functions creates difficulty for RSC levy replacement

# How is the LGFF performing against the principles set in the LG White Paper?

Requires reflecting on performance of ALL stakeholders:

Principle	Performance
<b>Revenue adequacy and certainty</b>	<ul style="list-style-type: none"><li>- 3 year budgeting creates certainty</li><li>- Adequacy requires mix of own revenue and transfers (transfers have increased dramatically)</li></ul>
<b>Sustainability</b>	Many municipalities not budgeting sustainably
<b>Effective and efficient resource use</b>	Mixed performance. Community oversight of budgets is institutionalised - is it working?
<b>Accountability, transparency and good governance</b>	<ul style="list-style-type: none"><li>- Publishing budgets increases transparency</li><li>- But audit outcomes reflect poorly on municipalities</li></ul>
<b>Equity and redistribution</b>	<ul style="list-style-type: none"><li>- Principle of cross-subsidisation well established</li><li>- Transfer allocations based on poverty data</li></ul>
<b>Development and investment</b>	Infrastructure rollout has been disappointing
<b>Macroeconomic management</b>	<ul style="list-style-type: none"><li>- Municipalities have acted responsibly</li><li>- Could do more to promote growth</li></ul>

# Possible gaps in the “Problem Statement” for these hearings

- Misalignment between fiscal and functional frameworks
  - For assignments between district and local municipalities and between provinces and municipalities
- Infrastructure rollout has been too slow
  - The fiscal framework needs to take better account of the different challenges facing rural and urban municipalities.
- Municipalities could perform better in supporting economic growth
  - Municipalities are responsible for providing basic services “foundation” for growth
  - this will also support future growth in revenues
- Weak capacity in municipalities is a serious constraint

# Thank you