FINANCIAL SUSTAINABILITY OF LOCAL GOVERNMENT AND FISCAL EQUITY

SALGA INAUGURAL COUNCIL OF MAYORS MEETING

8-9 June 2017
STRUCTURE OF PRESENTATION

- Role of the Financial and Fiscal Commission
- Local government funding
- Risks to the Financial Sustainability of local government
- Debt: Eskom, Bulk Water and PAYE
- Improving financial sustainability of municipalities
- Rethinking the Funding for Municipalities
ROLE OF THE FINANCIAL AND FISCAL COMMISSION

• What is the FFC?
  – Permanent statutory body established in terms of Section 220 of Constitution
  – Independent and subject only to Constitution and the law
  – Must function in terms of an act of Parliament
• The Commission makes recommendations to Parliament on the equitable division of nationally raised revenue and on any other financial and fiscal matter
• FFC in the IGFR system
The Sector received R44 Billion from the fiscus in 2008/9, which has increased to R112 billion in 2017/18. It receives 9.1% of total national acquired revenues. The local government fiscal framework has undergone many major reforms in the past two decades- policy intentions of government has been to use the grant system to promote social justice/spatial equity and erase the apartheid spatial disparities.

Of concern is that grant dependence has increased- fiscal capacity appears to have declined over time. In 2004/5, aggregate municipal own revenues amounted to 90% of aggregate expenditure. In 2014/15, this had declined to about 75% of aggregate municipal expenditure. The revenue base of local government, especially in rural municipalities is on the decline.

FFC research shows that many rural municipalities will continue to be transfer dependent as their revenues bases are fragile and weak. Transfers will remain the main stay of rural local government.
Economy which is in a recession poses a risk to the financial sustainability of LG that is transfer dependent:

- Declining GDP implies amount available for sharing falls
- Declining GDP likely to result in low investment – unemployment - poverty - ratepayers being distressed and eventually municipalities own revenues taking a knock, etc

Unfunded policy mandates (e.g. Library Services, Museums, Health Care Services)

Adequacy of LG Finances

- Reforms on the LGFF have focused on the horizontal distribution of resources. For example, the most review of the LGES formula, focused mainly on the horizontal distribution not the vertical division, i.e the quantum of resources allocated to the LES. The LES is thus under immense pressure and a robust discussion informed by concrete evidence is needed.

Cost of basic services

The adequacy of the LES is also not clear because no one has a good grasp of the cost of basic services in different municipalities. Ideally the LES needs to be based on a sound costing framework for basic goods and services.
Risks to the Financial Sustainably of LG

- **Funding of DMs**
  - The funding for DMs has remained unresolved. We are not absolutely sure what DMs are doing and thus their funding may not be fair. This affects their sustainability.

- **Frequent amalgamations of municipalities**
  - FFC research has shown that amalgamations are costly and will not necessarily result in financially viable municipalities, but in many cases the situation of demarcated municipalities will worsen.

- **Rapid Urbanisation**
  - In 1996 the urbanisation rate was 46% and in 2014 it was about 63%. Rapid urbanisation exerts immense pressure on basic infrastructure.

**Municipal and Consumer Debt**

Municipalities currently owe Eskom over R10 billion and at the same time they are owed R113 billion (as of June 2016) by national and provincial spheres, businesses and households.
The diagram depicts a five year overview of three municipal creditors and the total amounts owed to them by municipalities year on year, from 2011/12 to 2015/16.

- Municipal debt to Eskom shows a serious increase from 2014/15 to 2015/16.
- Debt for bulk water has had a moderate increase, whereas debt to SARS on PAYE deductions shows a steady decline over the years.
THE OTHER SIDE: WHAT MUNICIPALITIES ARE OWED BY ORGANS OF STATE, 2015/16

<table>
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<tr>
<th>Province</th>
<th>Total overall (R million)</th>
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<tr>
<td>EC</td>
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<tr>
<td>FS</td>
<td>603</td>
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<tr>
<td>WC</td>
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Province

Total overall
Improving efficiencies

a) The Commission strongly believes that the area of procurement provides great opportunities to cut costs and saving scarce resources. The Commission is concerned with the proliferation of supply chain management transgressions by all layers of government (as evidenced by annual AG findings), especially the flouting of the provisions of Section 217 of the Constitution, the PFMA and MFMA.

b) Municipalities should always ensure that all their investments reflect good value for money, they minimize costs of service delivery, and tariffs are cost reflective.

c) Among other things, municipalities should endeavour to leverage on modern technologies in the provision of electricity and water, cut energy expenses through energy saving measures; reduce water and electricity loses, improve billing systems and ensure repairs and maintenance of infrastructure are done on a regular basis.

d) Improving the quality of human capital in municipalities.

- This is critical for growing and supporting a capable state as required in terms of South Africa’s 2030 National Development Plan.
IMPROVING FINANCIAL SUSTAINABILITY OF MUNICIPALITIES

a) Improving financial management
   - The quality of internal controls and financial reporting is variable in municipalities
   - Local government needs to improve efficiencies in the collection of revenues and supplying of services.

b) Ensuring greater sustainability of basic services delivery
   - This can be achieved through adequate attention and spending on maintenance and renewal of the infrastructure underpinning the delivery of basic services

c) Need to relook/discuss the vertical division of revenue to ensure that basic services are appropriately financed. We need to factor in the appropriate costs of basic services so that basic services are appropriately financed
Resolving Debt Issues

• The debt issue should be resolved within the IGFR system and not in courts. The IGFR forums should dedicate sufficient time to finding a lasting solutions to debt problems within the Local government sector.

• Approach to debt should be fair and not one sided. Similar pressures should be exerted to all spheres of government to honor their debt. Compliance with the 30 day payment rule should be enforced on municipalities, national and provincial government departments and entities alike.

• A proper diagnostics of the root cause of non-payment be done and if it is due to bad management, there should be appropriate consequences
  – Stricter measures should be imposed on individuals within municipalities that are responsible for continued flouting of MFMA rules.

• Electricity and water undertakings must be ring fenced.

• Section 154 (1) of the Constitution prescribes support should be rendered to municipalities.
INCREASING ALTERNATIVE REVENUES STREAMS

• National Treasury improves access to credit markets for large cities by:
  – Allowing them to use their infrastructure grant funding allocations to leverage private capital
  – Establishing a credit rating mechanism for municipalities.

• The PPP Unit at National Treasury improves the PPP deal flows within municipalities by:
  – Streamlining the PPP approval process by subjecting only high value (above R100 million) and complex projects to rigorous feasibility studies
  – Using the Financial Management grant to build capacity within large cities in specialised skills in PPP development, procurement, negotiating and monitoring.

• National Treasury creates awareness of land value capture fiscal instruments among large cities

• National Treasury should ensure that the Local Government Equitable Share and conditional grants are informed by objectively derived cost estimates, without which the viability of rural municipalities will always be under threat
THANK YOU.

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