

UPDATING THE LOCAL GOVERNMENT FISCAL FRAMEWORK IN SOUTH AFRICA

This fact sheet is based on a research study on the impact of the Covid-19 pandemic on municipal fiscal sustainability in the Western Cape (WC). The study was commissioned by the WC Department of Local Government, and was conducted by the School for Public Leadership at the Stellenbosch University, with the support of the Hanns Seidel Foundation.

What is the local government fiscal framework (LGFF)?

The local government fiscal framework refers to the projections of aggregate revenue, expenditure, borrowing and debt of all municipalities over three years.

Crafting a coherent local government fiscal framework is contingent on a coherent local government functional framework so that 'finance can follow function'.

What is the local government functional framework?

The functional framework outlines the powers and functions of district and local municipalities, which translates into their expenditure responsibilities.

Example: Local municipalities deliver a minimum lifeline amount water and electricity for free to indigent consumers, and therefore receive intergovernmental grants from national government for free basic service provision (Local Government Equitable Share Grant.) By contrast, district municipalities which do not provide free basic services, do not receive this grant.

Why does the LGFF need to be updated?

- The LGFF depends on a well-defined functional framework. Uncertainty relating to powers and functions, and the role of the three categories of municipalities (particularly district municipalities) have remained unresolved for more than a decade.
- Decisions on the shifting of functions across spheres have largely occurred on an incremental sectoral basis, without sufficient consideration on their collective impact on the local government functional framework as a whole.
- Since 1998 a number of critical shifts in the municipal operating environment have occurred which the present LGFF does not take into account. These include long term shifts in water consumption patterns in the wake of the drought, higher water pricing for water demand management, and increasing bulk electricity prices (which reduce municipal surpluses available to fund infrastructure investment and cross-subsidisation in service provision).
- The transition to renewable energy to combat climate change, Eskom's load shedding and the long-deferred restructuring of the electricity industry will also fundamentally alter the premises on which the LGFF is based.

- Not only has the pandemic placed municipal revenue sources under pressure, but new national government legislation (like the Administrative Adjudication of Traffic Offices Act of 1998 which came into effect in July 2021) is reducing municipal revenue sources.

Attempts to update the LGFF to date:

In 2008 the former national Department of Provincial and Local Government (currently the Department of Cooperative Government and Traditional Affairs) had unsuccessfully initiated a policy process on the system of provincial and local government, to update the 1998 White Paper on Local Government.

In December 2020, a special lekgotla of the Budget Forum (the intergovernmental structure established to facilitate formal consultation on local government finances) resolved that National Treasury, the national Department of Cooperative Governance and the South African Local Government Association (SALGA) should review the local government fiscal framework.

In the past, incremental reviews have been done predicated largely on the current functional framework configuration, and typically focused on the technical details of the Local Government Equitable Share formula and capital grant frameworks, whereas the vertical division of revenues across national, provincial and local spheres is also crucial, but it is regarded as a political decision.

Recommendations for updating the LGFF:

- Thorough review based on a streamlined, differentiated and clearly defined long term functional framework and an associated change management plan is called for.
- Alignment of the vertical division of revenue with the local government functional framework.
- Unlike the 1998 White Paper on Local Government which relied on assumptions in lieu of credible empirical data (which was then not available), this review should be based on twenty years of evidence relating to the fiscal effort gap, the expenditure inefficiency gap, the transfer gap and the unfunded or underfunded mandate gaps.
- The local government functional framework should be reviewed in the light of 25 years of local government experience and the implementation of far-reaching reforms in electricity and water industries.
- The revised functional framework should inform a fundamental review of the local government fiscal framework.
- A process of this magnitude should not just involve SALGA, provincial departments of local government and provincial treasuries but also consultation with individual municipalities, so that the differentiated impacts can be understood, and diverse municipal voices can be heard.