

Is finance the problem in Local Government?

The role, performance and prospects
for the municipal fiscal framework

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A fiscal framework is a strategy that makes trade-offs in tax & spending decisions to optimise equity & efficiency

Assigns revenue & expenditure responsibilities

- Responds to Constitution, legislation, policy & regs that define powers, norms and standards
- Recognises FM as an input to service delivery process & an indicator of the effectiveness of LG transformation
- Not static - must change with context & other policies,
 - can also lead process of change

Local Govt in SA

- Hold basic service responsibilities, and should be accountable for their performance
- Should be largely self-financing to promote local accountability
- Should be empowered to borrow on basis of own balance sheets (no guarantees)
- Grant framework emphasises transparency & predictability (DoRA), with transfers seeking to:
 - compensate for low fiscal capacity (ES / MIG targeted to poverty and backlogs) and
 - strengthen LG capacity

Policy on municipal finance has evolved quite consistently ...

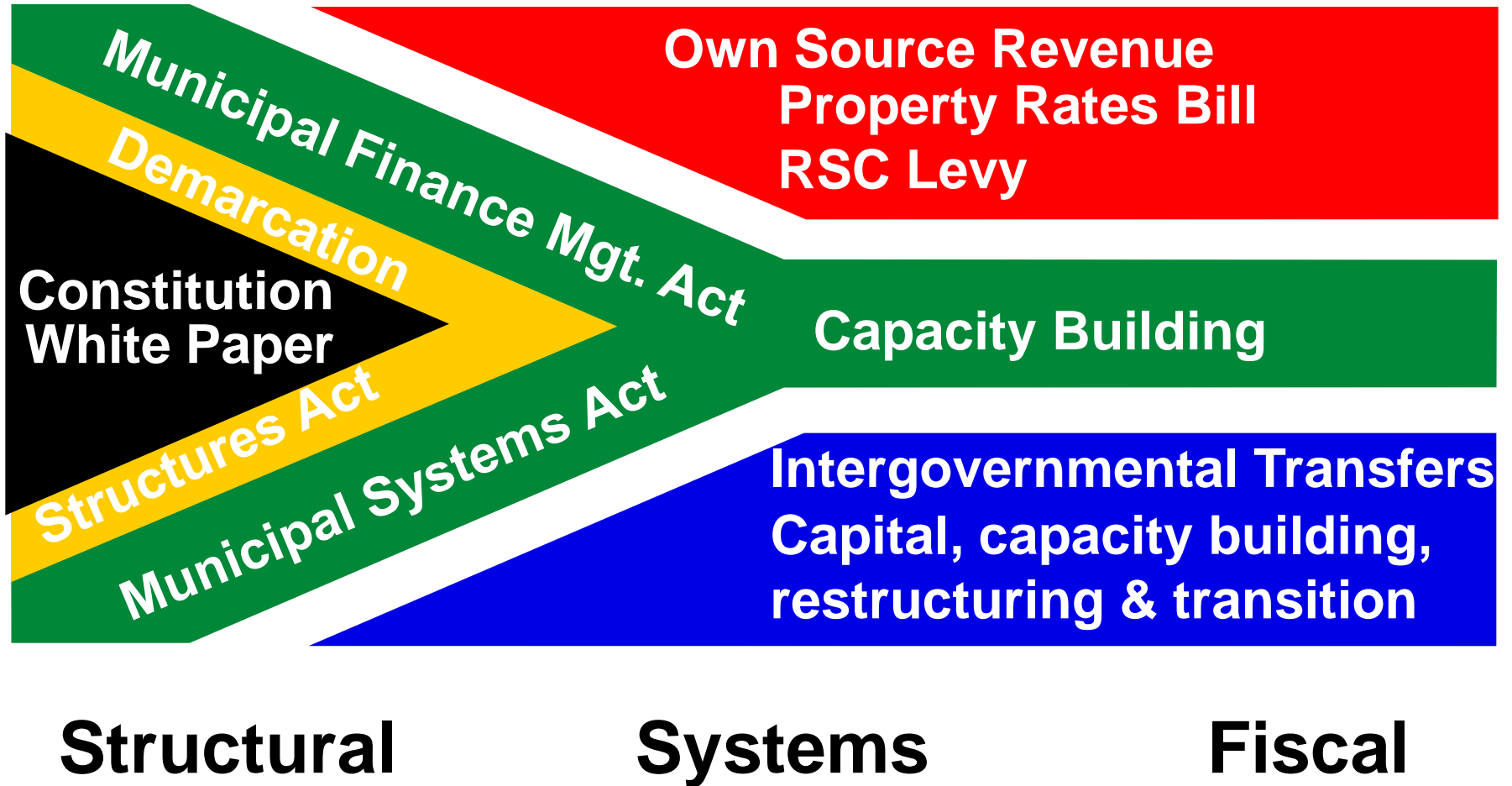
LG White Paper a waypoint, rather than a new direction

- Built on broader PFM reforms, and focussed on regulation of specific financial instruments (taxes, transfers, borrowing, etc)

Policy development constrained by:

- weak data on financial performance; and
- Difficulties in anticipating the financial impacts of LG transformation programme
- Thus largely reflected an instrumentalist perception of LG finance, as the mechanism to “get the job done”

The original LG fiscal framework was part of a comprehensive package



Some trends

Increasing share of national resources

- from 3% to 9% of national revenue;
- Over 20% of total public spending

Increasing discretion in use of resources

- Consolidation and decentralisation of national transfers

Growing equalisation effects

- until recently with 2010 funding, RSC levy withdrawal?

Growing transparency & reporting requirements

- strengthen accountability, increasingly for outcomes

.... But the framework has not resolved three key debates in LG finance

The responsibility for redistribution

- Fiscal redistribution: a national function met through transfers to promote universal service access
- Structures and functions of LG: redeploy management capacity from urban to rural

Resolving fiscal distress

- Difficult to monitor due to unclear indicators and data constraints
- Focus has been on immediate crises and regulatory changes to manage financial emergencies, but:
 - Increased support and resources risk rewarding poor performance through softening the budget constraint
 - Cities have tended to benefit more from increased transfers

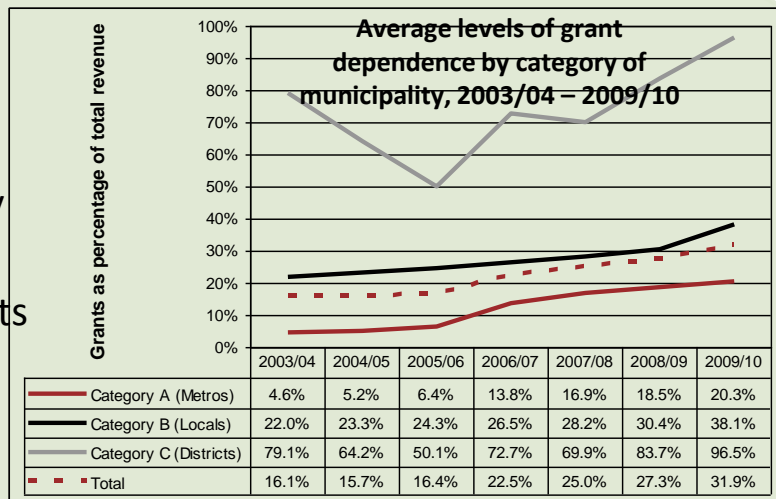
Strengthening accountability

- MFMA has tightened regulatory framework
- Occurred alongside growth in discretionary resources, and improvement in information flows
- BUT -- Has reinforced accountability to national govt, despite constraints to detailed oversight of all LGs
- Less attention paid to citizen accountability, which can powerfully complement national oversight
 - Eg 1: growth in transfers blurs citizen accountability as origin and destination of funds do not match – spending does not need to reflect local preferences
 - Eg 2: Removal of RSC levies undermines connection between business and LG
- Effective mechanisms for citizen oversight have yet to be developed – AG reports show that even accurate financial disclosure is still problematic

Important to note that the strategic intergovernmental issues are not always related to the quantum of resources, which are increasing anyway

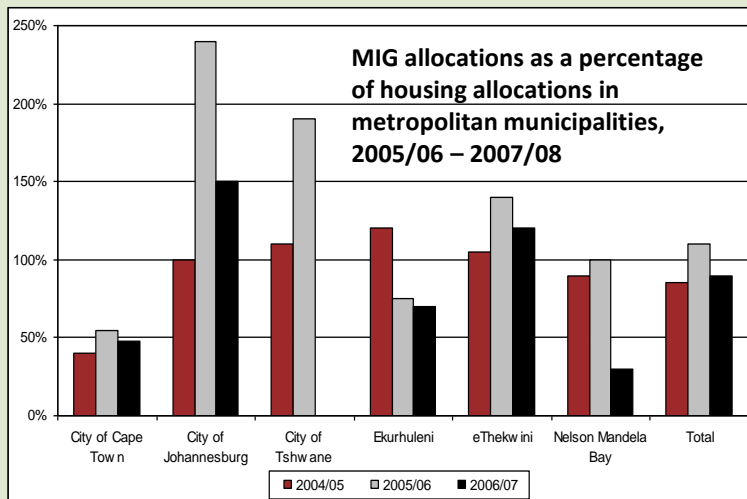
Growing grant dependence

- Long term impact on autonomy
- Grant absorption capacity
- Weak design limits grant impacts



Grant alignment

- Inappropriate “one size fits all” approach assume contexts and capabilities are the same
- Weak alignment causes delays and undermines outcomes, esp in built environment



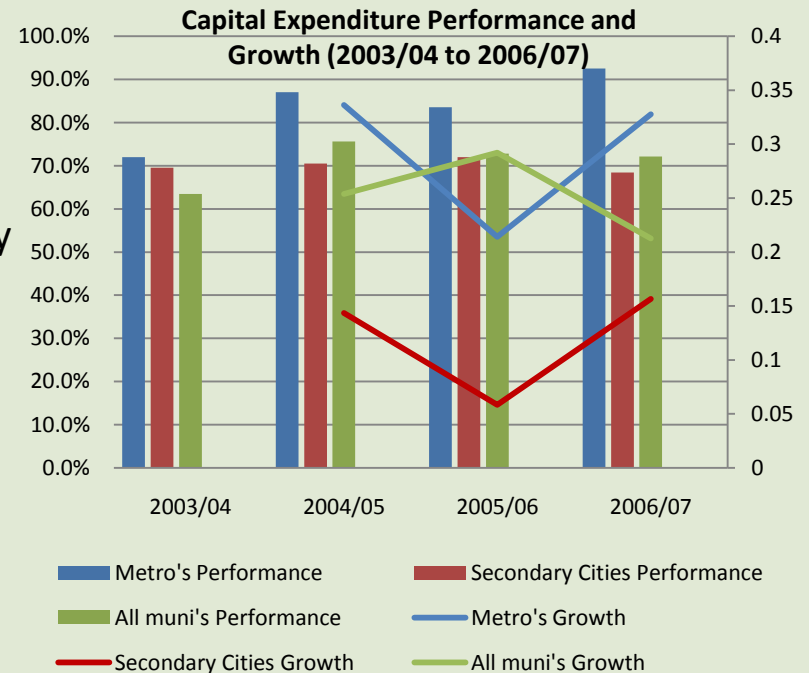
Expenditure issues

Little info available on outputs and outcomes

- Very little information available
- Creates room for criticism of efficiency of LG
- Ultimately restricts options for revenue growth

Confused debate over LG expenditure capacity

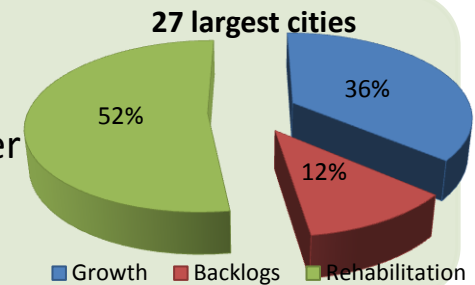
- Capex varies significantly between muni's
- Reflects both internal and intergovt issues



Huge expenditure challenges in transforming the built environment

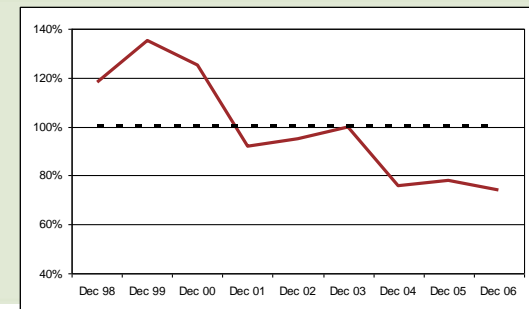
Universalising access to basic services and shelter

- Significant progress, but
 - still 1,8m households without adequate shelter
 - Urbanisation and declining hh sizes



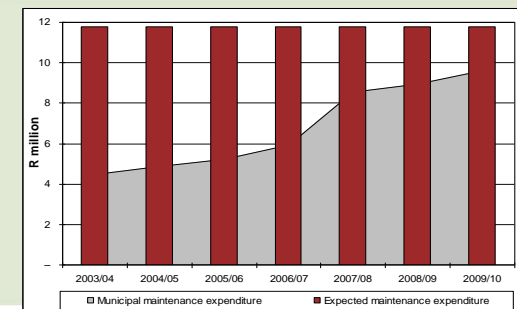
Supporting economic growth

- Declining ratio of pub to pvt investment



Maintaining assets

- Under-investment in existing assets



Easier said than done

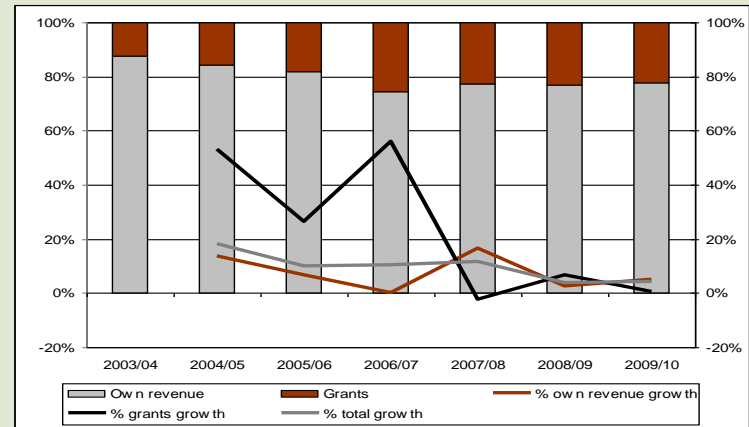
- Resource limitations
- Inefficient land use patterns
- Financing inefficiencies that create opportunities for externalising costs: between public agencies, and by property developers

Revenue issues

Revenue collection / Debtors

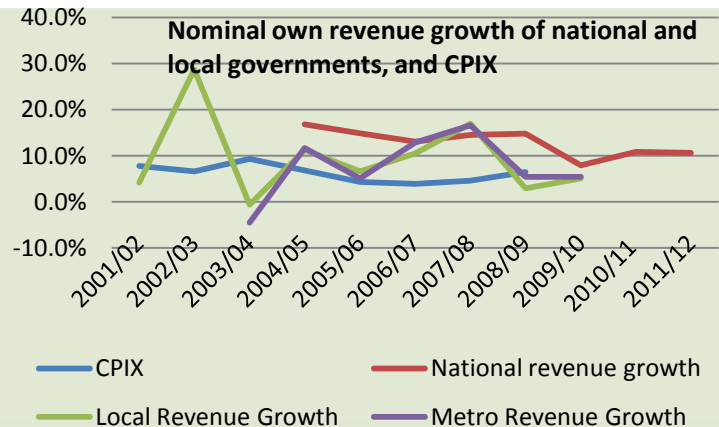
- Long term issue slowly being addressed
- Worrying negative correlation between grant increases and revenue effort

Revenue trends by major source, 2003/04 – 2009/10



Tariff levels

- Underperformance relative to national govt
- Declining role of user charges due to grant increases and electoral pressures?
- But delivery costs have risen dramatically
- Long term impacts on asset maintenance and management



Replacing RSC levies

- Not yet finalised, but must maintain accountability links
- Fuel levy sharing not necessarily a replacement
- Approach to districts

Leveraging private finance

- Scope for additional borrowing to meet investment needs
- Capital finance mix should include equity and development contributions

Financial management issues

Audit outcomes

- IS the AG doing an adequate job? Late, incomplete?
- What happens to repeat municipal offenders? They undermine credibility of all muni's ...

Financial reforms

- Focus needs to shift to smaller muni's
- Requires an integrated approach, not more "coordination"

Resolving debates in fiscal framework will be essential to responding to pressures

Fiscal sustainability

- Infrastructure expansion will have operating cost implications over time, re-opening the debate on the fiscal gap

Capacity constraints at municipal level remain a major challenge and contributor to fiscal distress

- Scope for programs that reward performance rather than failure?
- Ongoing challenge of stimulating effective municipal demand debt
- Sector restructuring may have profound effects on municipal balance sheets

Strengthening real oversight of municipal performance will become increasingly key to the vision of developmental local governance

- Requires more robust efforts to engage communities in the financial management process

Ultimately, it is likely that a more differentiated framework will emerge:

- Account for considerable contextual and performance differences between municipalities

Key elements of a new approach

Accountability for outcomes

- Shift the focus from inputs to development impacts

Differentiation

- One size cannot fit all

Incentives

- Rewards and sanctions
- Transition financing

Smarter national and provincial governments

- Clarifying and enforcing expectations
- Consolidating accountability
- Forming partnerships with LG, not dominating

But LG must change as well

No excuses

- MFMA enables more than it constrains
- Significant resources are given to LG, and all spheres face expenditure pressures
- A hard budget constraint can promote innovation

Expenditure efficiency

- Organisational forms can promote inefficiency

Revenue effort

- Evidence of considerable variation in effort between similar municipalities (FFC Research)

... and so must the DBSA

DBSA competes with subsidised finance for the most creditworthy muni's

- Other have found wealth at the bottom of the pyramid

Proposed DBSA recap should assist it to develop markets and not clients

- Limit head-on competition for the most creditworthy borrowers (focus on secondary market / enhancement activities)
- Encourage market development for borderline muni's

Thank you!