SOUTH AFRICAN LOCAL GOVERNMENT ASSOCIATION

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Inspiring service delivery

CELEBRATING 25 YEARS OF SALGA

Measures to mitigate against the cost and impact of fiscal leakages in the local government sphere

Tuesday, 30 August 2022

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Chairperson: National Working Group on Municipal Finance & Fiscal Policy

www.salga.org.za

Presentation Outline

1. SALGA mandate
2. Policy perspective
3. Operational perspective

Mandate

SALGA MANDATE

Transform local government to enable it to fulfil its developmental mandate.

Lobby, Advocate & Represent

Lobby, advocate, protect and represent the interest of local government at relevant structures and platforms.

Employer Body

Act as an employer body representing all municipal members and, by agreement, associate members.

Capacity Building

Build the capacity of the municipality as an institution as well as leadership and technical capacity of both Councillors and Officials.

Support & Advice

Support and advise our members on a range of issues to assist effective execution of their mandate.

Strategic Profiling

Build the profile and image of local government within South Africa as well as outside the country.

Knowledge & Information Sharing

Serve as the custodian of local government intelligence and the knowledge hub and centre of local government intelligence for the sector.

Introduction

Fiscal leakage

According to Oxford languages ***fiscal*** is defined as relating to government revenue, especially taxes. ***Leakage*** is an economic term that describes capital or income that escapes an economy or system in the context of a circular flow of income model (source: investopedia.com).

Therefore ***fiscal leakage*** refers to government revenue that escapes an economy or a losses of government revenue through the multitude of inefficiencies that riddle the financial system. Fiscal Leakage is the fiscal opportunity lost in a form of rates and taxes were collection was maximized however no investment and development was ventured into or considered.

How does fiscal leakage impact LG?

The occurrence of fiscal leakages impacts LG adversely, because goods and services are not rendered at the right time to the right people with the right quantities and quality. Thereby contributing to unsatisfied communities.

Introduction (continued)

SALGA's approach to the discussion of fiscal leakages is two-pronged as follows:

- Policy / legislative perspective
- Operational perspective

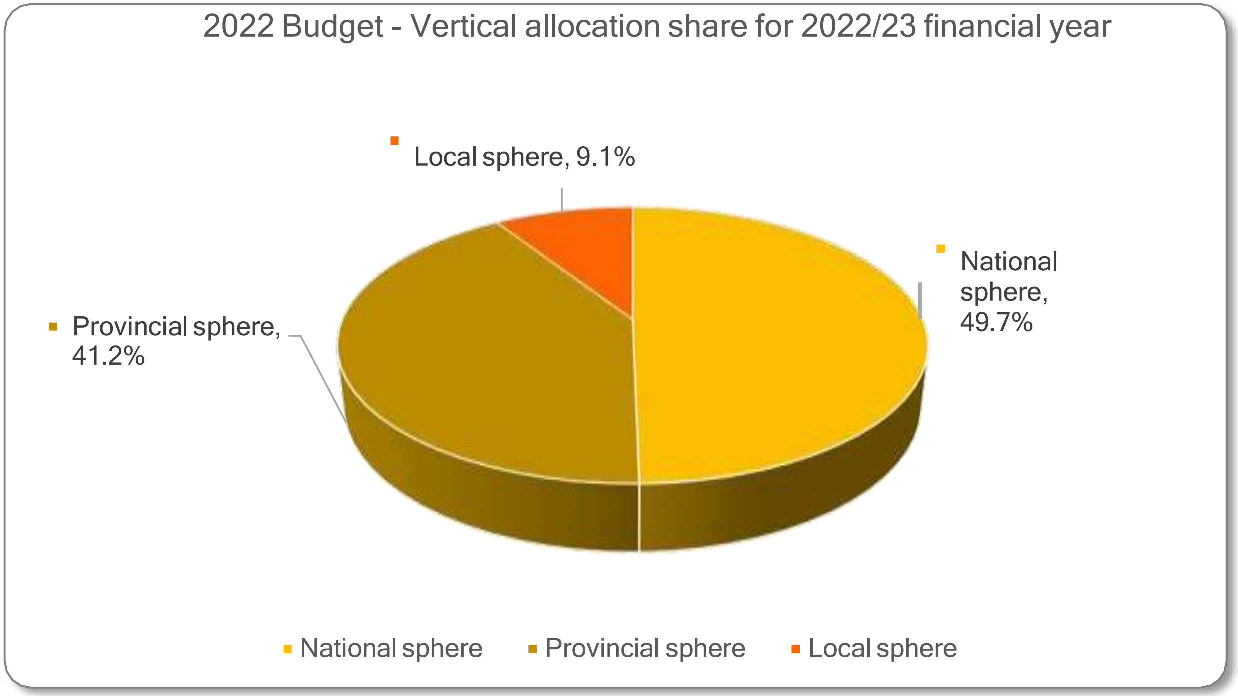
Policy perspective

Fiscal Policy Leakages: Local Government Fiscal Framework

Former President Thabo Mbeki, (ENCA, 2022)

"I think the way we designed the financing of local government wasn't quite right. We made too much assumptions about the capacity of local government to generate funds, and that's restricted only really to the metro, to the metro municipalities the rest don't have the possibility [to generate revenues]. We've got to change the formula, we should have done that earlier, the problem persists. It's not only a matter of bad people being there even the resources are [inadequate]"

Fiscal Policy Leakages: Local Government Fiscal Framework



R billion	2022/23
National sphere	R 824.7
Provincial sphere	R 682.5
Local sphere	R 150.6

The White Paper on Local Government, 1998

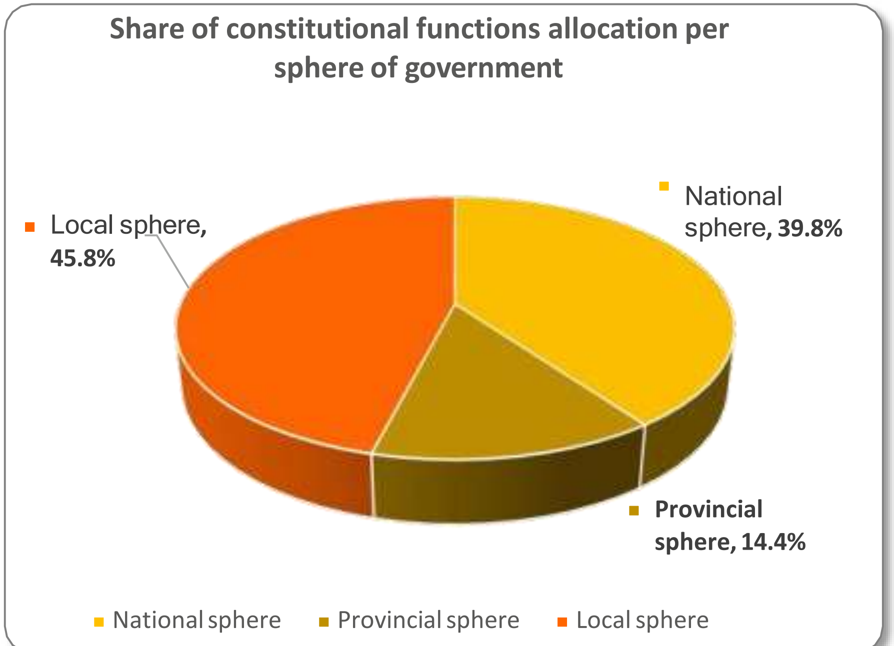
- Local government cannot be solely responsible for redistribution, and national government has a critical role to play in this regard, particularly with respect to subsidising the provision of basic services.

(Source: White Paper on Local Government, 1998: 86)

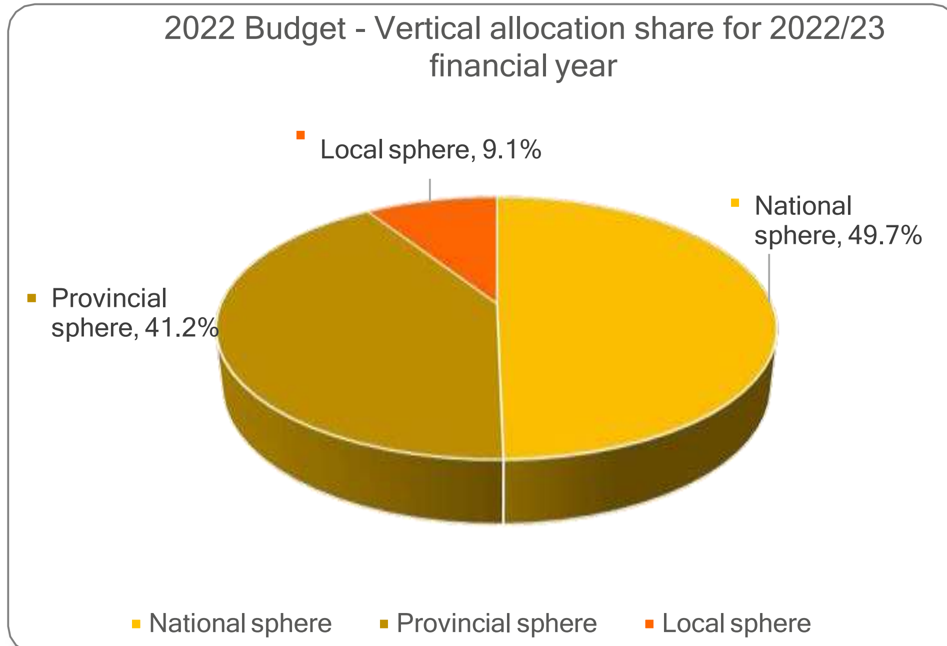
Fiscal Policy Leakages: Local Government Fiscal Framework (cont.)

- s152(2) of the Constitution obligates municipalities to strive to achieve the objects of local government within the financial and administrative capacity that exists. A deeper analysis of these obligations indicates that the functions allocated to local government per the Constitution of the Republic far outweigh functions allocated to the other 2 spheres of government.
- Our analysis has established that local government is responsible for **46 per cent** of the constitutional functions whilst it receives the lowest share of nationally raised revenue. In the 2022/23 financial year the local government share of nationally raised revenue is **9.1 per cent** as reflected in Figure 1 above. The national and provincial sphere of governments are responsible for **40 per cent** and **14 per cent** of constitutional functions, respectively.

(Schedule 4 and 5 of the Constitution of RSA)



versus

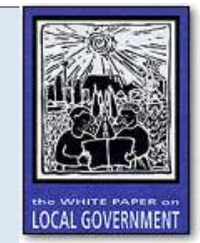


Fiscal Policy Leakages: Local Government Fiscal Framework (cont.)

Provinces have concurrent powers in functional areas listed in Schedule 4 (shared with the national government) and exclusive powers with regard to Schedule 5 matters. Municipalities have powers in respect of the functional areas listed in Schedules 4B and 5B. All residual matters are supposed to fall under the national government’s jurisdiction.

- There is disequilibrium in the **allocation of resources** versus the **allocation of functions**.

The White Paper on Local Government, 1998



- On average, municipalities have sufficient revenue raising powers to fund the bulk of their expenditure, and finance 90% of their recurrent expenditure out of own revenues”..
  (Source: White Paper on Local Government, 1998: 87)

Assumption on the White Paper on LG, 1998 (Assumptions)	Percentage
Property rates revenue as percentage of local government revenue	19.89%
% local government is expected to fund recurrent expenditure out of own revenue	90%
Trading services revenue as percentage of local government revenue	61.42%
% trading service - electricity	41.40%
% trading service - water	11.80%
% Sewage and refuse removal	8.22%

Fiscal Policy Leakages: Local Government Fiscal Framework (cont.)

Testing of assumptions against Water Service Authorities and Licenced Municipal Distributors

Testing of actual operations against assumptions contained on White Paper on Local Government, 1998

Percentage	White Paper on LG 1998	2020/21	White Paper on LG 1998	2019/20	White Paper on LG 1998	2018/19	White Paper on LG 1998	2017/18	White Paper on LG 1998	2016/17
Own revenue:										
Property rates	19.89%	20.24%	19.89%	20.02%	19.89%	18.10%	19.89%	19.95%	19.89%	18.18%
Trading Services	61.42%	52.33%	61.42%	52.70%	61.42%	46.61%	61.42%	53.13%	61.42%	56.00%
- Electricity	41.40%	32.45%	41.40%	32.82%	41.40%	28.87%	41.40%	34.07%	41.40%	36.57%
- Water	11.80%	11.20%	11.80%	11.22%	11.80%	10.10%	11.80%	10.69%	11.80%	11.16%
- Sewage and refuse removal	8.22%	8.67%	8.22%	8.66%	8.22%	7.64%	8.22%	8.37%	8.22%	8.28%

Testing of assumptions against aggregated municipal financial performance

Testing of actual operations against assumptions contained on White Paper on Local Government, 1998

Percentage	White Paper on LG 1998	2020/21	White Paper on LG 1998	2019/20	White Paper on LG 1998	2018/19	White Paper on LG 1998	2017/18	White Paper on LG 1998	2016/17	Average
Own revenue:											
Property rates	19.89%	18.46%	19.89%	18.23%	19.89%	16.48%	19.89%	17.95%	19.89%	16.50%	17.52%
Trading Services	61.42%	47.32%	61.42%	47.39%	61.42%	43.18%	61.42%	46.89%	61.42%	49.28%	46.81%
- Electricity	41.40%	29.12%	41.40%	29.48%	41.40%	26.36%	41.40%	29.63%	41.40%	32.23%	29.36%
- Water	11.80%	10.89%	11.80%	10.55%	11.80%	9.70%	11.80%	9.83%	11.80%	10.04%	10.21%
- Sewage and refuse removal	8.22%	7.31%	8.22%	7.35%	8.22%	7.11%	8.22%	7.43%	8.22%	7.01%	7.24%

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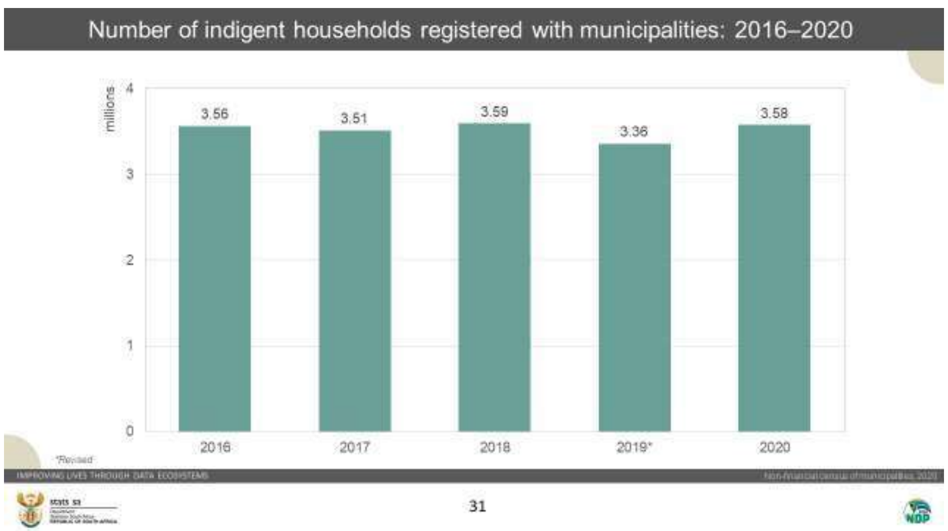
Fiscal Policy Leakages: Local Government Fiscal Framework (cont.)

- The 2020/21 preliminary property rates revenue constitutes 20.2 percent of total operating revenue, the 5-year average of property rates revenue constitutes 19.3 per cent of total operating revenue over 2016/17 to 2020/21 versus the 18.9 per cent envisaged by the WPoLG.
- Preliminary trading services revenue for 2020/21 is 52.3 per cent whilst the 5-year average of trading services revenue constitutes 52.2 per cent of total operating revenue. Trading services revenue is well short of the 61.4 per cent envisaged by the WPoLG.
- The assertion that municipalities are able to fund 90 percent of recurrent expenditure is incorrect. The 2020/21 preliminary results operations indicate that municipalities can generate up to 83.1 per cent of own-revenue to fund recurrent expenditure. The results for the 5-year period results in an average of 84.9 per cent own-revenue generated to fund recurrent expenditure.

- The prominent aspect surfaced by the analysis is that the assumption that trading services can generate up to 61.4 percent of total municipal operating revenue is incorrect. **The result for all municipalities indicate that trading services constitute an average of 46.8 per cent over 5-years**, whilst **the result for WSA and LMD indicates that trading services constitute an average of 52.2 per cent over 5-years**. In both instances, the result is well below the 61.4 per cent envisaged by the White Paper on Local Government.
- The results of testing the assumptions confirm that organised local government is justified in declaring **that the equitable share of nationally raised revenue allocated to municipalities is grossly inadequate and results in a patently inequitable allocation to local government**.

Fiscal Policy Leakages: Funding of FBS from LGES inadequate

The non-financial census of municipalities, 2020 which indicates that **3.58 million households** are registered as indigents which increases the burden of coverage for municipalities on the limited allocation from the national fiscus.



The costing of the REAL cost of providing Free Basic Services (FBS) to communities should also drive or inform the computation of the LGES.

The Non-financial census of municipalities, 2020 provides that:

Key results

Number of consumer units that municipalities service

Variables	2019*	2020	% change
Water	13 587 773	14 117 892	3,9
Free Basic Water	3 433 118	3 377 871	-1,6
Basic Electricity	12 194 165	12 479 998	2,3
Free Basic Electricity	2 367 532	2 373 983	0,3
Basic Sewerage & Sanitation	12 238 384	12 769 267	4,3
Free Basic Sewerage & Sanitation	2 880 093	2 816 134	-2,2
Basic Solid Waste Management	10 291 721	10 525 742	2,3
Free Basic Solid Waste Management	2 790 231	2 733 573	-2,0
Indigents	3 363 990	3 580 006	6,4
Bucket Toilets	42 434	47 130	11,1

Figures for indigents represent number of households *Some 2019 figures were revised*

IMPROVING LIVES THROUGH DATA ECOSYSTEMS — Non-financial census of municipalities 2020 — 8

Reflecting a reduction or stagnation in the number of consumer units in real terms which is incongruent to the economic indicators.

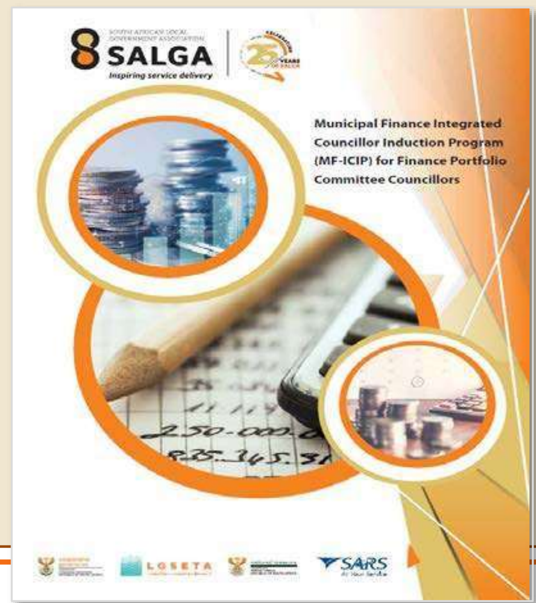
Operational perspective

Operational Fiscal Leakages: Fruitless & Wasteful and Irregular expenditure

According to the Auditor-General's 2020/2021 MFMA General report municipalities incurred irregular expenditure of **R21.95 billion** in the 2020/2021 financial year. This amount represents 5% of the R459 billion expenditure budget managed by municipalities for the same period *(2020-21 MFMA GR p.47)*.

Fruitless and wasteful expenditure of **R1,96 billion** was incurred by 193 municipalities in the 2020/21 financial year *(2020-21 MFMA GR p.23)*.

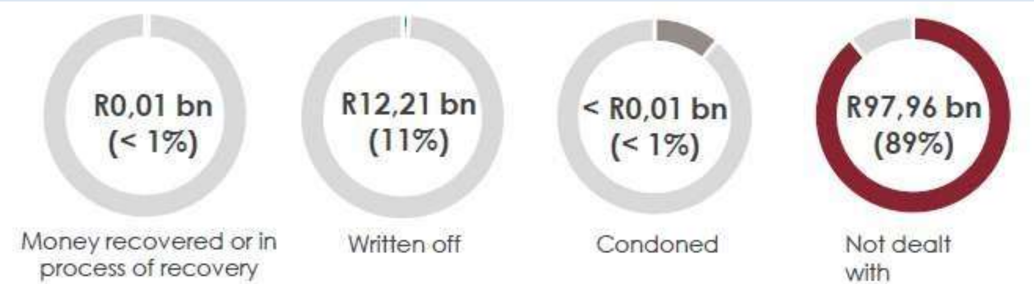
In an effort to mitigate against the incurrence of irregular expenditure SALGA in collaboration with stakeholders developed and rolled-out training for incoming councillors deployed on the Municipal Public Accounts Committees (MPACs) and Finance Portfolio Committees. **A total of 1,186 councillors have been trained and empowered to address the incidence of irregular expenditure**.



Operational Fiscal Leakages: Irregular expenditure (continued)

According to the Auditor-General's 2020/2021 MFMA General report the AG found **significant delays by municipal councils and MPACs in investigating and making decisions on prior years irregular expenditure**.

This means that the municipalities did not take sufficient steps to recover, write off, approve or condone such expenditure.



(2020-21 MFMA GR p.48)

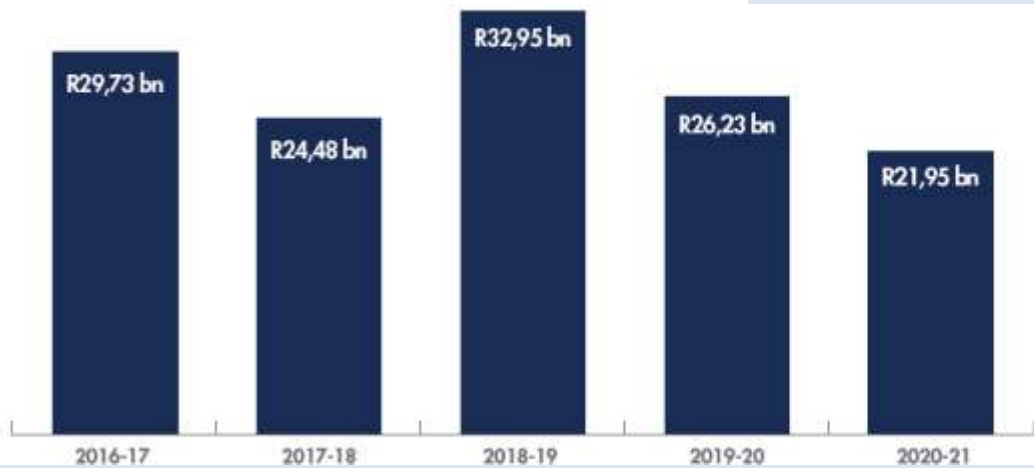
In line with SALGA NEC decision of 18 June 2020 and 24 June 2021 the organisation communicates directly with Mayors and Accounting Officers urging municipalities to **investigate the nature of irregular expenditure** and implement accountability and consequence management, where warranted.

Further, we also support bodies with appropriately legislated powers to extract accountability e.g. the AG by issuing Material Irregularity letters, NT withholds grants as a measure to encourage compliance to legislated prescripts.

Operational Fiscal Leakages: Supply Chain Management (SCM)

According to the Auditor-General's 2020/2021 MFMA General report the AG mentions that non-compliance with supply chain management legislation remained the biggest contributor to the irregular expenditure incurred.

Irregular expenditure over term of previous administration



(2020-21 MFMA GR p.47)

Promote ethics in Supply Chain Management

- Partnered with the Chartered Institute for Procurement and Supply (CIPS) in an effort to professionalise the SCM profession in the LG sector.
- CIPS is the only SAQA recognized Professional Body for Procurement & Supply in South Africa, CIPS PB is an organisation with individual members practicing the procurement & supply profession. CIPS PB maintains an oversight of the knowledge, skills, conduct and practice of the profession

Professionalising the SCM function:

- Encourage municipal employees to belong to CIPS.
- SCM officials to be accountable to a professional body and be subject to its code of ethical conduct.

Operational Fiscal Leakages: Revenue (water losses)

- The AG observes that an acceptable norm for water distribution losses is between 15% and 30%, with anything above 30% indicating that water infrastructure is not being well managed. The average water loss across the country above the 30% norm stood at 50% *(2020-21 MFMA GR p.35)*.
- Apart from scarce water resources potentially being wasted, the water losses add to the significant amounts that are payable to the water boards but that cannot be billed to consumers to earn revenue *(2020-21 MFMA GR p.36)*.
- Municipalities are estimated to lose 1660 million cubic meters per annum. At R6 per cubic meter this comes to R9.9 billion per annum. (DWS National Water & Sanitation Master Plan).

- As part of SALGA participation at the Budget Forum Lekgotla, the Municipal Infrastructure Grant (MIG) has been revised to –
  - ❑ Incentivize continuous non-revenue water (NRW) reduction. NRW is one of the monitored indicators.
  - ❑ Allow municipalities to spend up to 5% of their allocation to develop asset management plans.
  - ❑ Allow municipalities to spend up to 10% of their allocation to undertake emergency repairs & maintenance to restore infrastructure functionality, as part of Covid-19 response provisions.
- SALGA, DWS, DBSA have formed the National Water Partnership Programme (NWPP), with R60m initial funding to accelerate private sector investment in sub-programmes that include Non-revenue water reduction.
- SALGA in partnership with CoGTA, MISA & UCT have:
  - Published the municipal infrastructure unit cost guideline, to assist municipalities to not be over charged and improve cost efficiency.
  - Developing an infrastructure management efficiency index, which has non-revenue water and electricity reduction as indicators, to help municipalities monitor and improve in their efficiencies.
  - Developing targeted training programmes and tools to improve skills at a municipal level.

Support to Municipalities in the Management of Non Revenue Water

Technical (addressing leaking pipes)

- ❑Municipalities have been exposed to funding instruments and project preparations in reducing Non Revenue Water from DBSA

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Social (Awareness)

- ❑Supported Municipalities in creating awareness of water conservation using videos and posters

Institutional Capacity Building

- ❑Trained and continue to train Municipal Officials with the support of Japan International Cooperation Agency (JICA) in the Management of Non Revenue Water

- ❑ Conducted international knowledge sharing session on how other Countries such as Japan, have managed to reduce their NRW to National average of 5%

Operational Fiscal Leakages: Revenue (water & energy losses)

- The National Treasury dictates that municipalities should spend at least 8% of the value of infrastructure assets on the repair and maintenance of those assets. However, the total spending on repairs **and maintenance across all municipalities amounted to R16,82 billion, which is only 3% of the value of infrastructure assets**. It is particularly concerning that nearly half (40%) of all municipalities spent 1% or less on repairing and maintaining their infrastructure assets *(2020-21 MFMA GR p.35).*
- *SALGA has completed electricity and water Councillor inductions. These were aimed at ensuring Cllrs understood the key issues, their roles and what need to be done. This forms part of the SALGA 5-Year Cllr Development Strategies that are run with sector departments.*

- As part of SALGA's participating at the Budget Forum Lekgotla, various proposals to improve municipal infrastructure management have been piloted.
- SALGA, COGTA, MISA & UCT have partnered in a municipal infrastructure Asset Management Improvement Programme which Assists municipalities with:
  - Wastewater management improvement (Green Drop)
  - Drinking water management improvement (Blue Drop)
  - Development of infrastructure asset management plans
  - Asset register credibility analysis
  - DWS non-compliance (pollution) notice responses
- SALGA, CoGTA, MISA, UCT & SEA (Sustainable Energy Africa) are assisting municipalities with cost of supply studies, to ensure municipalities have appropriate tariffs and increase efficiencies.

Operational Fiscal Leakages: Poor project management

- The AG notes that although these grants are sorely needed to finance infrastructure projects, they are often underspent, mostly because of poor project management. For instance, the metros had to return R235,82 million in unspent infrastructure funds to the National Treasury, with funding of a further R70,72 million from the mentioned grants possibly having to be returned if the National Treasury does not approve the rollover of these funds *(2020-21 MFMA GR p.34).*

SALGA developed a project preparation manual and toolkit which is designed to assist municipalities with a framework and easy-to-use reference manual to enable early-stage project preparation in the infrastructure investment cycle.

Further, SALGA has enhanced *'Project preparation training'* to an accredited training that was piloted with 20 Municipalities on 28 March 2022.

Furthermore, SALGA is collaborating with the Infrastructure Fund (DBSA) to improve access to innovative infrastructure financing mechanisms.

Operational Fiscal Leakages: Poor asset management

- According to the AG the value of infrastructure assets that should be maintained and safeguarded totaled R491,70 billion. Further, the AG states that **municipalities did not have credible and reliable data for managing their infrastructure assets** *(2020-21 MFMA GR p.35).*

Operational Fiscal Leakages: Inappropriate use of consultants

- The AG mentions that the salary cost for **finance units totalled R10,41 billion** in 2020-21.
- Financial reporting consultants have become permanent features in municipalities' financial reporting processes, with the **cost of these consultants amounting to R1,26 billion** in 2020-21.
- When combining the money spent on finance units and consultants, it is clear that financial reporting carried a substantial price tag in 2020-21 of just over R11,67 billion *(2020-21 MFMA GR p.16)*.

- In line with SALGA NEC decision of 18 June 2020 and 24 June 2021 the organisation communicates directly with Mayors and Accounting Officers urging municipalities to extract accountability and consequence management.
  - Appoint capable and competent officials are appointed.
  - Conduct an assessment of the capacity of their finance units.
  - Ensure that where consultants are used these are used per the prescripts in that:
    - skills transfer occurs
    - consultancy reduction plans are in place
    - retention amount be withheld
    - contracts to include penalty clauses