

## DISCUSSION NOTES ON FINANCING DECENTRALIZATION, PUBLIC SERVICE DELIVERY AND LOCAL DEVELOPMENT IN AFRICA

### - SOME OBSERVATIONS FROM THE SOUTH AFRICAN EXPERIENCE -

#### 1. INTRODUCTION

Decentralization in Africa has evolved through at least three broad distinctive phases over the last three decades<sup>1</sup>:

- Structural adjustment influenced administrative decentralization in the 1980s;
- Widespread efforts to entrench decentralization in the legal frameworks of African countries as part of the period democratic renewal in the 1990s; and
- A decisive policy shift and preference for decentralization by devolution post-2000 in many African countries.

It is against this context that fiscal decentralization and financing local government must be assessed and debated. Fiscal decentralization essentially refers to the transfer of fiscal resources and revenue-generating powers from the central level to sub-national levels of government<sup>2</sup>. There is an inextricable relationship between decentralization in general and fiscal decentralization in particular. For most policy makers and studies, fiscal decentralization is both a key pillar and an enabler for decentralization. Put differently an inappropriate fiscal decentralization regime can undermine the general decentralization policy and strategy for a country.

There is general consensus on the principles and key elements of fiscal decentralization and consequently how local governments should be financed<sup>3</sup>. These include:

- i) An Adequate Enabling Environment
- ii) Assignment of Appropriate Functions to Sub-national Governments
- iii) Assignment of Appropriate Revenues to Sub-national Governments
- iv) Developing an Appropriate Intergovernmental Transfer System
- v) Developing Adequate Local Access to Investment Capital

The interpretation and application of these principles is the real issue for discussion going forward in Africa.

#### 2. FISCAL DECENTRALIZATION IN AFRICA

One of the most significant continental-wide assessments of decentralization in Africa in the last decade was a 2002 World Bank study that focused on 30 African countries. It measured

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<sup>1</sup> Africa, E (2012) on *African Local Government Timeline: Post-1980*; for GFA Consulting as part of larger AMCOD / GIZ study on ALGOT, 2012

<sup>2</sup> Ribot, JC (2002), "African Decentralization - Local Actors, Powers and Accountability", *UNRISD Programme on Democracy*, Paper No. 8

<sup>3</sup> Smoke, P (2000), "Fiscal Decentralization in East and Southern Africa: A Selective Review of Experience and Thoughts on Moving Forward", Prepared for: Conference on Fiscal Decentralization International Monetary Fund Washington, DC, November 20-21, 2000

the extent of decentralization in three areas, namely the political, administrative, and fiscal dimensions<sup>4</sup>.

Political decentralization was measured against the indicators of the number of directly elected levels of sub-national government, the regularity of elections at these sub-national levels, and the extent to which these elections are free and fair. A total of 8 countries scored high in the area of political decentralization (South Africa, Uganda, Namibia, Kenya, Ghana, Senegal, Ethiopia, and Ivory Coast)

Fiscal decentralization was assessed against the indicators of arrangements for fiscal transfers from the central government to localities, and the proportion of public expenditure controlled by localities. Therefore according to this study a country with an established and often-used formula for fiscal transfers and in which locally-controlled expenditures account for a high proportion of overall public expenditures would have scored high. The findings were that South Africa was the only country to score “very high”; while 3 fell into the high category (Nigeria, Uganda, Zimbabwe) and 7 were in the moderate category (Kenya, Rwanda, Ghana, Senegal, Burundi, Congo Brazzaville, DRC).

The study issued caution with these findings: firstly the proportion of public expenditures controlled by the local authorities is very small such that even the ‘high performers’ are marginal in their performance compared to the global trends; secondly, in a number of instances it was difficult to disentangle the proportion disbursed by local authorities but actually allocated and earmarked by central ministries; lastly, some of the figures for fiscal decentralization may also reflect certain inaccuracies as no hard figures were found or those found to be quite dated.

An important general finding in 2002 was that political decentralization in Africa made the most progress. Administrative and fiscal decentralization were lagging behind respectively.

The relevance of the findings of study published 10 years ago, is that it calls for a similar continental-wide *evidence-based assessment* both of the nature and extent of all of the dimensions and indicators of decentralization.

In 2010, USAID<sup>5</sup> undertook a comparative assessment of decentralization in Africa, focusing on 10 countries. An overall summary of this study found that,

*“Decentralization of responsibilities in the 10 African cases has been consistent with the principles of fiscal federalism, which suggest that monetary policy and national defense must be the responsibility of the central government, but many social services can be usefully devolved. The most commonly devolved areas in Africa have been the major public services of health, education, water and sanitation, and basic infrastructure, along with responsibilities for civil services and registries, and some responsibilities in local economic development.”*

Key findings on the legal and political dimensions of decentralization were that,

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<sup>4</sup> Ndegwa, SN (2002), “Decentralization in Africa: A Stocktaking Survey”, *World Bank: Africa Region Working Paper Series No. 40 - November 2002*

<sup>5</sup> USAID (2010), *Comparative Assessment Of Decentralization In Africa: Final Report And Summary Of Findings*, USAID, ARD, Inc., Vermont

- i) All African countries in the sample have passed framework laws for decentralization;
- ii) All countries feature some degree of devolution to elected sub-national government (SNG) officials;
- iii) Decentralization in Africa combines devolution with deconcentration;
- iv) Legal authority does not itself give SNGs significant autonomy from central governments;
- v) All countries in the sample now have elections for SNGs, some at multiple levels;
- vi) Political decentralization has not been reversed, and recentralization has been limited; and
- vii) Political autonomy of SNGs is constrained by dominant political parties and other factors.

On fiscal decentralization the USAID study found that,

- i) African countries have small local tax bases and SNGs have limited own-source revenues
- ii) SNGs rely heavily on inter-governmental transfers from the centre for their revenues. IGT are based on formulas in many cases, and not on the discretion of central governments.
- iii) Central governments sometimes offload responsibilities to SNGs without adequate finances.
- iv) It is unclear what level of government is responsible for which services in many instances.
- v) Central governments can control fiscal decentralization by monitoring expenditures and setting standards and guidelines for SNGs to follow.

On a positive note this study pointed out that, *"on the fiscal side, decentralization gave sub-national-governments important expenditure responsibilities in public services, and guaranteed access to some of the revenue resources needed to meet these responsibilities. A major achievement here is the creation of regularized, formula-based revenue transfers from the centre, though these are relatively small in several cases."*

One of the first main lessons from this brief examination of the World Bank and USAID studies is that there is a need to define a set of common indicators on all the dimensions of decentralization *and* of fiscal decentralization in particular as it applies to Africa. Both these studies have used varied indicators with some degree of overlap. This needs thorough discussion and a shared consensus.

### **3. OBSERVATIONS ON FINANCING LOCAL GOVERNMENT FROM THE SOUTH AFRICA EXPERIENCE**

#### ***Background to Local Government in South Africa***

Both studies above have recognized the South African experience on decentralization generally, and on fiscal decentralization in particular as an exemplary one. What are some of the key features and lessons from South Africa ?

Politically, South Africa emerged from the apartheid colonial regime into a democratic country in 1994 with a system of government comprising of three spheres: national, provincial and local. The 1996 Constitution entrenches and promotes local government as an

*inter-dependent, inter-related and distinct* sphere, together with the other two spheres into a system of cooperative governance or inter-governmental relations. The Constitution makes provision for concurrent and exclusive functions by the three spheres.

Over 800 apartheid local authorities were rationalized to 284 fully democratic and de-racialized local governments with the first democratic municipal elections in 2000.

Key enablers and success factors for the decentralization and local government programme in South Africa include the,

- Constitutional entrenchment of local government and cooperative governance;
- Critical powers, functions and responsibilities of all three spheres of government are outlined in Schedules attached to the Constitution of the country;
- Legislation on Inter-governmental Relations (2005);
- A suite of local government legislation addressing the core functions, systems and structures of municipalities;
- Specific legislation dealing with Municipal Finance Management (2003); and
- Periodic and improved centrally driven local government support programmes.

### **Key Elements of the South African Inter-Governmental Fiscal Regime**

The intergovernmental system informs the inter-governmental fiscal regime in South Africa. In other words, the assignment of functions to local government has a direct bearing on the local government fiscal framework<sup>6</sup>.

The distribution of powers and functions across the three spheres is summarised as follows:<sup>7</sup>

- i) *National government has responsibility for security (army and police) and national economic policy as well as for overall direction of the social service departments*
- ii) *Provincial government administers the major social services: education, health, transfer payments (e.g. social pensions and child care grants)*
- iii) *District councils in some cases organise water and sewerage reticulation and other bulk infrastructure, while in other cases they do not have a clear rationale. They act as municipal service providers of last resort.*
- iv) *Municipalities have a key role in the provision of basic services, in particular water, sanitation, refuse removal, electricity, town planning and so on.*

The Intergovernmental Fiscal Relations Act was passed in 1997, which in turn lays the basis for the annual enactment of the Division of Revenue Act. The latter legislation details the vertical split of funds between the three spheres and horizontal split between sector Departments at a national and provincial level, and also between municipalities in the local government sphere.

Together with the Municipal Finance Management Act (MFMA), the above legislation constitutes the regulatory bedrock for the fiscal decentralization regime in South Africa. The primary purpose of the MFMA is to "*secure sound and sustainable management of the financial affairs of municipalities and other institutions in the local sphere of government ...*"

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<sup>6</sup> National Treasury (2011), *2011 Local Government Budgets and Expenditure Review*, Pretoria, South Africa

<sup>7</sup>Wittenberg, M (2003), "Decentralization in South Africa", School of Economic and Business Sciences and ERSA, University of the Witwatersrand Johannesburg, South Africa

Financing of local government is enabled via three streams:

- Unconditional grants from the central government;
- Conditional grants from the national and provincial government;
- Own revenue sources, which comprise of both limited local taxes and user charges for services.

### **Key Achievements**

How has South Africa's inter-governmental fiscal system evolved and what have some of the key achievements been?

- i) Firstly there has been a steady increase of resources and funding set aside for the local government sphere under the post-apartheid democratic regime. Between 1999/2000 and 2005/6, local government's share from the national fiscus rose from 2.7% to 4.4%<sup>8</sup>. Between 2006/7 and 2012/12 this same division of funds increased from 6.3% to 8.8%<sup>9</sup>.
- ii) Secondly, the unconditional grant component to local government is known as the equitable share; this has a strong redistributive purpose and is informed by a predictable formula comprising of various components. This formula has been constantly under review with the aim of sharpening its impact and effectiveness. Between 2009/10 and 2012/13 the unconditional transfer to local government grew by an annual average of 16.6% per annum.<sup>10</sup>
- iii) Thirdly, there are number of conditional grants to local government. All of these grants are closely monitored by national and/or provincial government. The largest is the Municipal Infrastructure Grant (MIG). Since 2006/7, this grant has grown by 13.5% per annum. Some of the other grants include the National Electrification Programme, Public Transport Infrastructure and Systems Grant, Neighbourhood Development Partnership Grant, Municipal Systems Improvement Grant, Community Work Programme, Financial Management Grant, Restructuring Grant, Water Services Operating Grant etc.
- iv) Fourthly, property taxes and user service charges are significant sources of own revenue especially for urban-based municipalities in South Africa. However, the local tax instruments for municipalities are very limited, i.e. mainly property rates. In 1996/97 property rates was the single most important local tax accounting for 20.34 percent of local revenues.
- v) On the expenditure side local government's total operating expenditure increased in real terms by 11.8% between 2006/7 and 2009/10. Local government infrastructure expenditure almost doubled between 2006/7 and 2008/9, mainly due to the FIFA World Cup projects. When compared to the national and provincial spheres, it has been noted that local government expenditure constitutes almost one fifth (23%) of total government expenditure in 2012/13.
- vi) Next planning systems for fiscal decentralization and funding of local government are very transparent and predictable. At a national level, a Medium Term

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<sup>8</sup> Wittenberg: *ibid*

<sup>9</sup> National Treasury (*ibid*)

<sup>10</sup> <sup>10</sup> National Treasury: *ibid*

Expenditure Framework (MTEF) is published annually. This provides all spheres of government, including local government with a clear sense of what they can expect over a three year period from the national fiscus. This is translated into the into the Division of Revenue Act on an annual basis. At a local level, the Integrated Development Plans (IDPs) of municipalities are prepared for a 5 year electoral term. This is updated annually and informs the preparation of 3 year budgets and an annual Service Delivery and Budget Implementation Plan (SDBIP).

- vii) There are robust procedures and mechanisms for accountability built into the fiscal decentralization system. Four key elements of this includes in-year reporting by municipalities of conditional funds allocated by national government, the preparation of annual financial statements, the preparation of annual reports, and the independent auditing of the municipalities financial affairs by the Auditor General. Politicians across all spheres hold regular public meetings (Imbizo) to assess public service delivery with local communities.
- viii) Finally, there is a very robust support institutional environment that complements the inter-governmental fiscal regime. National Treasury has a structured process of consulting all relevant stakeholders in the preparation of the annual division of revenue. In-year accountability takes place through key bodies such as the President' Coordinating Council (made up of key national Ministries, provincial Premiers and the South African Local Government Association), Premiers Coordinating Forums, and District Coordinating Forums. In addition, the Constitution has provided for the establishment of the Financial and Fiscal Commission (FFC) which is an independent, objective advisory institution. It has the responsibility of making recommendations to parliament, provincial legislatures and organized local government on financial and fiscal matters.

### **Key Challenges**

A number of studies have summarized the main challenges that characterize the South African inter-governmental fiscal system as it pertains to local government<sup>11</sup>. These challenges include:

- a. In general, there is an increasing grant dependency by non-metropolitan municipalities on the national fiscus. National transfers are the second largest source of revenue for local government in general. In 2009/10 national transfer constituted 32.6% of the total revenue of local governments.
- b. Municipalities do not spend all the conditional funds transferred to them. In 2006/7, they spent 91.9% of their allocated conditional grants.
- c. All municipalities are becoming increasingly dependent national infrastructure grants to fund their capital budgets.
- d. Revenue management is a critical challenge for many municipalities. In particular many municipal billing systems have lots of problems. Huge amounts of monies are owed to local governments by consumers. By the end of 2010, municipalities were owed about R62.3 billion (ZAR).
- e. Resource allocation does not sufficiently take spatial differences & realities into account.

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<sup>11</sup> For example: Wittenburg (ibid); Smoke (ibid); National Treasury (ibid); Department of Cooperative Governance and Traditional Affairs (2009), *State of Local Government in South Africa in 2009*, Pretoria, South Africa

- f. Regarding the vertical allocation, there has been a steady increase, but it is still a limited slice of the national fiscus to local government.
- g. There is misaligned budgeting and planning across the three spheres of government.
- h. The equitable share and its formula does not address the real needs of small, rural municipalities with a limited revenue base.
- i. Grants coordination, management and compliance is weak. There is a limited provincial role.
- j. Employee costs account for the largest component of operating expenditure, averaging about 30%. This is informed by the growth of municipal employee costs by 15.5% between 2006/7 and 2009/10.
- k. Per capita operating expenditure by each municipality varies greatly. The two extremes are in the province of Gauteng (R6609 per capita) and the Limpopo province (R1993 per capita).
- l. There are a number of smaller municipalities whose water and sanitation infrastructure is in a very poor state and these budgets need to grow strongly.
- m. The under-funding of repairs and maintenance in municipal budgets is serious challenge.
- n. Funding of some local government mandates and responsibilities are very poorly supported by the national fiscus, e.g. local democracy and community participatory mechanisms.
- o. The audit findings of the Auditor -General have pointed to many weaknesses in municipal financial management and the relevant oversight systems.

### **Key Way Forward Priorities**

In 2009, South Africa adopted a Local Government Turn Around Strategy<sup>12</sup>. Specific priorities were to,

- a) Ensure that municipalities meet the **basic service needs** of communities;
- b) Build clean, effective, efficient, **responsive and accountable** local government;
- c) Improve performance and **professionalism** in municipalities;
- d) Improve **national and provincial policy, oversight and support**; and
- e) Strengthen **partnerships** between local government, communities and civil society.

This was complemented by the adoption of a 10 Point Plan for Local Government:

1. Improve the **quantity and quality of municipal basic services** to the people in the areas of access to water, sanitation, electricity, waste management, roads and disaster management;
2. Enhance the municipal contribution to job creation and sustainable livelihoods through **Local Economic Development (LED)**;
3. Ensure the development & adoption of **reliable and credible Integrated Development Plans (IDPs)**;
4. Deepen democracy through a **refined Ward Committee model**;
5. Build and **strengthen the administrative, institutional and financial capabilities** of municipalities;
6. Create a **single window of coordination** for the support, monitoring and intervention in municipalities;

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<sup>12</sup> Department of Cooperative Governance and Traditional Affairs (2009), *Local Government Turn Around Strategy*, Pretoria, South Africa

7. **Uproot fraud, corruption**, nepotism and all forms of maladministration affecting local government;
8. Develop a coherent and **cohesive system of governance** and a **more equitable intergovernmental fiscal system**;
9. Develop and strengthen a **politically and administratively stable system** of municipalities; and
10. Restore the **institutional integrity** of municipalities.

Within the context of the Local Government Turn Around Strategy and 10 Point Plan, key reforms of the inter-governmental fiscal system have been proposed:

- Consider long term fiscal planning (5-15 years) to be balanced with the current skills base; this will give even greater predictability to local government;
- Address key challenges facing the implementation of the Division of Revenue Act: Address non-compliance; review grant conditionalities & improve coordination;
- Explore specific target financial instruments to support (smaller rural) municipalities with a limited revenue base.

The refinement and improvement of the inter-governmental fiscal regime in South Africa has been given impetus by an additional process. Presently the country is undertaking a Local Government functional *and* fiscal review process jointly lead by National Treasury and the Department of Cooperative Governance. Various preparatory meetings have been held already.

A number of principles are presently under discussion that should inform the review:

1. There must be a long-term developmental approach embedded in the framework for functional and fiscal assignment.
2. Funding follows functions—any transfer or own revenue source must be allocated to the municipality (or other sphere of government) that has been formally assigned the function that that revenue or transfer is intended to fund.
3. The assignment of functions must follow a thorough understanding of the diverse circumstances in municipalities.
4. Differentiated approaches should be followed, with awareness of their limitations.
5. Policy implementation must take account of the realities of the varying municipal contexts.
6. Any reform proposals emanating from this process should not unnecessarily disrupt but further contribute to the stability of the still young South African local government system. The reform proposals should build on those good practices.
7. The Department of Cooperative Governance and National Treasury are the regulators for local government; a specialist governance framework is required that empowers national government to provide for oversight or veto powers within concurrent arrangements and over specific assignments provided for through legislation.

#### 4. CONCLUSION

Options, principles and guidelines for financing decentralization, public service delivery and local development must be considered in the overall context of the decentralization regime and decentralization strategy for a country.

A number of studies, resolutions and documents have already provided a foundation for this debate, for example:

- CLGF (2005) *Aberdeen Agenda: Time for Local Democracy*, CLGF, London
- CLGF (2011) *Municipal Finance for Inclusive Development: Innovative Models for funding infrastructure and services for state and local self-governments*, by GHK Consulting for CLGF, London
- UCLGA (2010) *Local Government Finance: The Challenges of the 21st century*, UCLGA, Barcelona
- UN-Habitat (2009) *International Guidelines on Decentralization and Access to Basic Services for All*, UN-Habitat, Nairobi, Kenya
- UN-Habitat & MDP (2008) *Participatory Budgeting in Africa: A Training Companion – with cases from eastern and southern Africa*, UN-Habitat, Nairobi, Kenya
- World Bank (2011) *Accountability in Public Services in South Africa*, World Bank, Washington DC

Two starting points to assess our varied continental experiences could be the *Aberdeen Agenda* and the *UN Habitat International Guidelines on Decentralization and Access to Basic Services for All* (see Annexure). Some of the key principles include<sup>13</sup>:

***"Adequate and equitable resource allocation: in order to respond to the needs of the local community.***

- *Local government must have adequate financial resources to fulfil its mandate and ensure significant autonomy in resource allocation.*
- *An independent and secure revenue base is key to sound management of resources, and included in this is the predictability and adequacy of financial transfers from central to local government in terms of timeliness and amounts. Such transfers must be free of political bias, and a local government agreement or legal framework to govern such transfers is often of critical importance.*
- *In the distribution of resources, local government must be seen as an integral part of the overall public sector involved in delivering key public services.*

***Equitable service delivery: the distribution of services should reflect the diverse needs of the local community.***

- *Services provided by local government should be accessible to all.*
- *The poor and marginalised, may in certain circumstances, require local government to adopt proactive policies to address their particular needs.*
- *There is a balance to be struck between nationally set standards and locally set priorities. Local government should have the space to respond to the needs of its local area."*

There is no doubt that Africa's commitment to political decentralization must be complemented and significantly strengthened by more robust policies and greater resourced systems of fiscal decentralization to accelerate the realisation of a better life for our people.

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<sup>13</sup> CLGF (ibid)

## **Annexure:**

(Extract from the *UN Habitat International Guidelines on Decentralization, 2009*)

### **"FINANCIAL RESOURCES AND CAPACITIES OF LOCAL AUTHORITIES**

#### **Capacities and human resources of local Authorities**

42. Local authorities should be supported by other spheres of government in the development of their administrative, technical and managerial capacities, and of structures, which are responsive, transparent and accountable.

43. Local authorities should be allowed to determine as far as possible their own internal administrative structures, to adapt them to local needs and to ensure effective management.

44. Local authorities should have full responsibility for their own personnel. There should be common standards of qualification and status in the management of such personnel.

45. The service conditions of local government employees, as defined by national legislation, should be such as to permit the recruitment and retention of high-quality staff on the basis of best performance, professional competence and experience and of gender equality, and should exclude any type of discrimination based on religion, language or ethnicity.

46. Adequate training opportunities, remuneration and career prospects should be provided to local government employees in order to enable local authorities to reach a high quality performance in the provision of services to the citizens.

47. Training opportunities should be provided or supported by governments, in collaboration with local authorities and their associations.

#### **Financial resources of local authorities**

48. Effective decentralization and local autonomy require appropriate financial autonomy.

49. Local authorities' financial resources should be commensurate with their tasks and responsibilities and ensure financial sustainability and self reliance. Any transfer or delegation of tasks or responsibilities by the state shall be accompanied by corresponding and adequate financial resources, preferably guaranteed by the constitution or national legislation, and decided upon after consultations between concerned spheres of government on the basis of objective cost assessments.

50. Where central or regional governments delegate powers to them, local authorities should be guaranteed the adequate resources necessary to exercise these powers as well as discretion in adapting the execution of their tasks to local conditions and priorities.

51. Local authorities should have access to a broad variety of financial resources to carry out their tasks and responsibilities. They should be entitled, preferably on the basis of

constitutional and/ or national legislative guarantees, to adequate resources or transfers, which they may freely use within the framework of their powers.

52. A significant proportion of the financial resources of local authorities should derive from local taxes, fees and charges to cover the costs of services provided by them and for which they have the power to determine the rate, notwithstanding their possible framing (tax brackets) or co-ordination by legislation.

53. Taxes which local authorities should be entitled to levy, or of which they receive a guaranteed share, should be proportional to their tasks and needs and of a sufficiently general, dynamic and flexible nature to enable them to keep pace with their responsibilities. International Guidelines on Decentralisation and Access to Basic Services for all

54. Local taxes, such as land-based taxes, should preferably be collected by local authorities themselves, provided that they have appropriate capacities and oversight mechanisms in place.

55. Financial sustainability should be ensured through a system of financial equalization, both vertical (between state and local authorities) and horizontal (among local authorities). This should happen especially where the local tax-base is weak or non-existent.

56. Legislation should guarantee the participation of local authorities in framing the rules governing the general apportionment of redistributed resources, including both vertical and horizontal equalizations.

57. As far as possible, financial allocations to local authorities from governments should respect their priorities and shall not be earmarked for specific projects. The provision of grants shall not remove the basic freedom of local authorities to exercise policy discretion within their own jurisdiction.

58. Earmarked allocations shall be restricted to cases where there is a need to stimulate the local implementation of national policies, in areas such as environmental protection, social development, health and education.

59. For the purpose of borrowing for capital investment, local authorities should, within guidelines and rules established by governments and the legislation, have access to national and international capital markets. State supervision and monitoring may however be necessary in countries affected by volatile macro-economic situations.

60. Local authority borrowing should not endanger the fiscal policies designed to ensure financial stability of national governments."

End, 4 August 2012