MINISTRY OF FINANCE
REPUBLIC OF SOUTH AFRICA

MUNICIPAL INNOVATIVE INFRASTRUCTURE FINANCING CONFERENCE
Financing of infrastructure by municipalities

MINISTER OF FINANCE
NHLANHLA NENE
13 June 2018

Honourable Deputy Minister,

Members of Parliament,

President of SALGA,

Honourable Mayors,

Councillors,

Ladies and Gentlemen,

Thank you for the opportunity to address you today on the important topic of infrastructure financing by municipalities.

We all live and work within the boundaries of a municipality. How well a municipality invests and looks after its infrastructure, including roads, electricity, water, and other services, has a huge bearing on our quality of life. Also, since all economic activity takes place within the boundaries of a municipality, the quality of municipal infrastructure matters for the performance of our economy.

But the fact that we are gathered here today in search of innovative ways of financing municipal infrastructure is yet another reminder that all's not well with infrastructure that falls under municipalities. We know only too well of the backlogs in the building of new and maintenance of existing infrastructure. If we are to raise the pace at which our economy grows and eliminate the legacies of apartheid, we must fix municipalities, in particular their ability to build and maintain infrastructure.

National government transfers more than R40 billion annually to municipalities to assist them fund infrastructure investment. This is not enough to meet the infrastructure requirements. So, municipalities must add to this pot of money by increasing the share of resources they generate on their own. I hope that this conference will help municipalities identify ways of sustainably raising finance to invest in much needed new, and the refurbishment of existing, infrastructure.

Investment by municipalities in the building of new and maintenance of existing infrastructure can contribute to faster economic growth. Faster economic growth, on the other hand, will also make it relatively easier for municipalities to fund long-term investments that are required to improve infrastructure networks.

Economic context

Our economy has a potential to growth faster and more sustainably than it has done during the past decade. The rebound in confidence since December 2017 and the potential for increased investment in the replacement of capital equipment and other assets has set the stage for an improvement in growth. In the 2018/19 tabled in parliament in February this year, the economy is projected to grow at 1.5%, and this was mainly on the back of the rebound in investor and consumer confidence.

The contraction in GDP by 2.2% in the first quarter of the year is a reminder that we need to move with a greater sense of urgency in implementing the reforms necessary to raise the pace of economic growth and to ensure that growth is sustained over a longer period. Unless we implement the reform agenda to address the structural challenges that constrain our economy, our economy will remain stuck at low levels of growth.

Government remains committed to implementing the structural reform agenda which includes:

- Creating jobs through faster economic growth;
- Improving the quality of education, skills development and innovation; and
- Improving the capability of the state.

If we implement this core agenda, we can ensure that all South Africans have an opportunity to participate meaningfully in the economy. Youth unemployment in particular remains too high at 55%. Our young people lack the skills that potential employers require to drive their businesses. But we also know that the cost of searching for job opportunities is prohibitively high for young people. Of the young people who have given up on searching for work opportunities, more than 70% said that the distance between where they lived and where potential job opportunities were, was a big constraint on their ability to look for work.

For those who do find jobs, transport costs take up to 40% of the incomes of the lowest wage earners in urban areas. That is why we must redouble our efforts to change the spatial set-up we inherited from apartheid.

The cost structure of our economy also remains too high, making it difficult, for example, for small businesses to be created and sustained. Examples of these costs are broadband, transportation and the high cost of complying with regulation.

To ensure a stable platform for growth, we also need sustainable government finances. This requires difficult trade-offs. If we do not contain expenditure, for example, we are going to spend increasing amounts on paying interest on debt. The Public Finance Management Act (PFMA) demands that interest costs be deducted first before the budget is split among the three spheres of government. this is a prudent way of managing public finances. But it does mean that increased interest payments, which have been the fastest growing expenditure item during the past decade, will result in less money being available to pay for all of other government programmes, and thus threatening service delivery.

Strengthening good governance and acting against corruption is crucial to rebuilding the trust in government. This is as true for municipalities as it is for other spheres of government as well as state owned enterprises. When citizens have trust in their government, they tend to pay their taxes willingly and on time. Trust in local government also results in greater payment for services.

We are keenly aware of the constraints to growth. We are therefore redoubling our efforts to enact reforms that will raise the pace at which our economy can grow, increase its productivity, create more room for competition by, among other things, lowering the cost of doing business. Assuming that the global environment remains supportive, National Treasury estimates that the effective implementation of reforms in areas such as agriculture, competition policy, telecoms, tourism and others could lift the rate of economic growth higher.

Municipalities have a role to play in this reform agenda. The major contribution of municipalities to economic growth is on two fronts. First, is the provision of urban infrastructure services such as water and sanitation, electricity distribution, waste removal and disposal, building and maintenance of roads, and the provision of public transport. Second, municipalities contribute directly to the cost of doing business because they issue construction permits, connect businesses to the electricity network, and play a big role in the transfer of ownership of property. When municipalities carry out this regulatory and administrative function ineffectively and inefficiently, they retard economic growth.

The building of new and the maintenance of infrastructure talks to these two contributions by municipalities to economic growth.

Financing municipal infrastructure

The NDP recognises the role that municipalities can play in creating an enabling environment for investment. This can be done through the provision of strategic infrastructure and land management that supports economic growth.

Municipalities therefore need to mobilise the broadest possible range of resources to fund infrastructure. There are four broad sources of capital finance for municipal infrastructure.

These are:

- Grants from national government;
- Public contributions and donations;
- Internally generated funds; and
- Borrowing

Municipalities must maximise the use of all four. The focus of this gathering is on municipal borrowing. I believe National Treasury officials have already presented here today on the review of the Policy Framework on Municipal Borrowing and conditional grants as well as the reforms to development charges. I will not repeat the detail on these topics, but rather speak to the principles that underpin government's policy on municipal borrowing.

Government policy and legislation supports prudent and long-term borrowing by municipalities. This is an efficient and equitable mechanism for financing capital investment by local governments.

We have a sound legal and regulatory framework for municipal borrowing, which is codified in Chapter 6 of the Municipal Finance Management Act (MFMA). This framework continues to work well for large cities. Last year, two metros issued bonds, and both were over-subscribed, demonstrating once again the appetite of investors for financing local government infrastructure.

However, several factors have changed since the MFMA came into effect more than 15 years ago. Hence, the review of the Municipal Borrowing Policy Framework. Let me discuss some of these factors.

The growth in investment needs. The infrastructure plans of cities are no longer limited to providing basic services to all citizens. Municipalities, especially metros, need to invest also in support of economic growth. There are huge backlogs also for the rehabilitation or replacement of aged infrastructure.

Greater clarity on the role of municipalities in driving spatial transformation. A 2010 Constitutional Court judgment made it clear that municipalities were responsible for spatial transformation of cities. Government policies, including the NDP and the Integrated Urban Development Framework, have emphasised the importance of reversing the apartheid spatial development patterns because they constrain economic growth and perpetuate spatial injustice in our cities and towns.

The maturing of the municipal borrowing market. Metropolitan municipalities in particular can access capital markets to meet a significant portion of their investment needs. Long term lending to municipalities has more than tripled since the MFMA was adopted. However, despite this progress, municipal borrowing remains below the levels projected when the original Municipal Borrowing Policy Framework was adopted in 2000. Part of the reason for this is the surge in grant funding over this period.

When the Policy Framework was adopted, it was expected that creditworthy municipalities would finance most of infrastructure out of own generated or borrowed resources. However, even credit worthy metros have continued to rely on conditional grants as the biggest source of funding infrastructure.

Lastly, the benefits of municipal borrowing have so far been concentrated in the metropolitan municipalities, which account for about 86% of all long-term municipal debt.

The national fiscus is constrained. Creditworthy municipalities must therefore look to debt markets and other revenue sources to fund a greater proportion of capital investment. This will free up a greater proportion of the infrastructure grant to be used to fund municipalities that have less capacity for generating their own revenue.

State of local government finances

Municipalities have to borrow against the strength of their own balance sheets, so I want to also take this opportunity to talk to state of local government finances.

Information on municipal budgets and in-year financial performance is available for scrutiny by the public and investors. We are continually making improvements to the quality of the data on municipal finances, through such initiatives as the new Municipal Standard Chart of Accounts. This commitment to transparency means that investors know they will have reliable information to assess which municipalities are creditworthy. It also means that the public has access to information they can use to hold municipal political office bearers to account. And over time, the greater transparency and scrutiny of municipal finances and other performance information will lead to improved financial management by more municipalities.

Government is also committed to supporting the turnaround of municipalities that are in financial distress. The Minister of Cooperative Governance and Traditional Affairs (COGTA) recently announced that 87 municipalities were deemed dysfunctional. In collaboration with National Treasury, COGTA will support these municipalities to rebuild a foundation for sound financial management.

Conclusion

This conference provides an opportunity for the private sector and government, as well as other stakeholders, to exchange ideas on how we can work together to reform the current system of infrastructure funding. We need to leverage municipal resources to build cities and towns that can put all of our citizens to work, and provide inclusive and dynamic spaces for all of our people. Finally, I hope that government, the private sector and other stakeholders can work together to reposition municipalities as co-drivers of economic development and growth.

Thank you