The Impact of Municipal Capital Spending on Economic Growth

POLICY BRIEF

FINANCIAL AND FISCAL COMMISSION 2/2015

FINANCIAL AND FISCAL COMMISSION

EXECUTIVE SUMMARY

While responsibility for capital spending is shared across all government spheres in South Africa, spending by local government on socio-economic infrastructure is seen as crucial for addressing the apartheid legacy and for boosting economic growth. Municipalities currently account for about 40% of total public infrastructure spending, a share that is likely to grow. However, municipalities are not managing their infrastructure budgets effectively and are under-spending on asset renewals and maintenance. The Financial and Fiscal Commission examined the effects of municipal capital expenditures on growth. The study found that, despite inefficient use and allocation of resources, municipal spending can enhance economic growth. In particular, increasing capital spending on water and sanitation and electricity has a positive impact on growth, whereas spending on housing and road infrastructure has a negative impact. The Commission recommends that the government prioritise investments in infrastructure that will enhance growth and improve municipal management of infrastructure asset management and provision through incentive grants and technical assistance.

BACKGROUND

South Africa's three spheres of government (national, provincial and local) operate within a quasi-federal structure, which is intended to foster a spirit of mutual cooperation and to facilitate the alignment of policy, legislation and overall service delivery programmes.[1] The strong interdependence of the three government spheres implies that policy decisions often involve trade-offs, between having enough resources for each sphere to fulfil its constitutional mandate(s) and allocating scarce resources to the sphere best placed to implement expenditure (and public investment) programmes that will have the strongest impact on growth and development.

>>

[1] The 1996 Constitution of South Africa stipulates a unitary system of governance in which the national and subnational (i.e. provinces and local governments) units operate not along hierarchical lines, but function as distinct, interdependent and interrelated 'spheres'.

Local government in Gauteng is housed in the Civic Centre, Johannesburg.

Infrastructure spending by local government is seen as crucial for boosting economic growth.

The country's strategy to enhance growth is through significant public infrastructure investments. While responsibility for capital spending is shared across all spheres of government, spending by local government on socio-economic infrastructure is seen as crucial for addressing the apartheid legacy and boosting regional economic growth. This corresponds to the constitutional mandate of municipalities to play a 'developmental role' by meeting the 'basic needs' of their constituents. Between 2006 and 2013, municipalities accounted for 30–40% of total public infrastructure spending. This share is likely to grow, given the government's intent to increase public capital expenditure and expand the local government mandate to include responsibility for improving economic growth and development.

The challenge is that municipalities are failing to manage or implement infrastructure budgets effectively, and are significantly under-spending on asset renewals and maintenance. It is therefore questionable whether providing additional funding will have any meaningful impact on growth. In response, the Financial and Fiscal Commission (the Commission) conducted a study into the effects of public capital expenditures on growth using South African municipal data for the period 2003–2012.

RESEARCH FINDINGS

The results suggest that infrastructure investments by local government in South Africa are subject to diminishing returns,[2] indicating inefficiencies in the use and allocation of resources. Across municipalities, capital budgets are characterised by under-spending, which reflects either a failure to align municipal IDPs with budgets or a lack of capacity to properly plan for and implement critical service delivery programmes.[3]

While infrastructure spending by many municipalities may be poorly planned, municipal infrastructure investment remains important. The study found that municipal capital spending can enhance economic growth, depending on the specific function. Spending on housing and road infrastructure has a negative effect, whereas spending on electricity, water and sanitation, and repairs and maintenance has a positive effect on growth. This suggests that increasing capital spending on water and sanitation, and electricity can spur local economic development. In addition, maintaining existing infrastructure (thereby extending its useful life) would benefit long-term economic growth across the country's municipalities.

<<

[2] This refers to a point beyond which the level of profits, production or benefits gained is less than the amount of money or energy invested.

[3] In 2011/12, municipalities under-spent their capital budgets by R14.8-billion (or 32.3% of total capital budgets), compared to R18.9-billion (29.4%) in 2010/11 and R8.5-billion (8.9%) in 2009/10. The 21 secondary cities failed to spend R2.9-billion (44%) of total capital budget between 2009 and 2012. The worst performers were 111 local municipalities that consistently under-spent their capital budgets by more than 30% (National Treasury Budget Review 2012)

CONCLUSION

As the arm of government closest to citizens, municipalities are mandated to provide a range of services critical to improving the social and economic wellbeing of residents within their jurisdictions. As municipal responsibilities for infrastructure investment rise, understanding which aspects of public capital spending (on water and sanitation, roads and storm water, housing and sewerage systems) will have the greatest impact on economic growth is important. In this respect, the Commission recommends the following:

- Grants for infrastructure investment should prioritise growth-enhancing infrastructure (i.e. water and sanitation, and electricity) so that municipalities can play their role in promoting economic development and growth.
- Government should establish an incentive grant or a reserve fund for maintaining and renewing infrastructure, to ensure the long-term sustainability of critical socio-economic infrastructure and enhance local economic growth.
- Government should introduce a transitional capacity-building grant for providing technical assistance to municipalities in preparing infrastructure asset management plans.

Spending on electricity, water and sanitation, and repairs and maintenance has a positive effect on economic growth.

Enquiries: Hammed Amusa (hammeda@ffc.co.za)

Financial and Fiscal Commission
Montrose Place (2nd Floor), Bekker Street,
Waterfall Park, Vorna Valley, Midrand
Private Bag X69, Halfway House, 1685
www.ffc.co.za
Tel: +27 11 207 2300
Fax: +27 86 589 1038

FINANCIAL AND FISCAL COMMISSION