4

Revenue and expenditure trends in local government

Introduction

In 2010/11 municipalities budgeted to spend R191 billion on their operational budgets. This is about one-fifth of overall government spending. In 2010/11 municipalities were also responsible for managing R41 billion in infrastructure spending, which is 15.9 per cent of total public sector infrastructure spending.

This spending is financed from municipal own revenues, transfers from national and provincial government, and borrowing (for capital). Between 2010/11 and 2012/13, direct national transfers to local government grow by R23 billion or by 13.4 per cent annually. Municipalities own revenues are also growing strongly, particularly services charges which are budgeted to increase by 18.6 per cent per year between 2010/11 and 2012/13. Generally, municipal revenues held up well during the recession. Outstanding consumer debts have increased, but at a slower rate than the growth in own revenues. This reflects some positive action with regards to revenue management.

The revenue and expenditure management capacity of a municipality determine its ability to contribute to poverty reduction and economic development. Any weaknesses in these areas are likely to reflect the existence of other governance challenges in the municipality.

This chapter gives an overview of:

- local government in the system of public finance
- trends in intergovernmental transfers to local government
- revenue trends
- expenditure trends
- key issues in municipal budgets.

Local government in the system of public finance

Local government expenditure constitutes one-fifth of total government expenditure

Local government expenditure constitutes one-fifth of total government expenditure. This ratio has remained almost constant since 2006/07. Table 4.1 shows that local government's contribution is set to increase over the medium term. This is driven by rapid increases in the price of electricity, rising municipal wages and the assignment of the housing and public transport functions to the metros.

Table 4.1 Local government revenue and expenditure to GDP, 2006/07 – 2012/13

	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	% Ave annual growth	
		Outcome		Estimate		Medium-term estimates		2006/07 -	2009/10 -
R million								2009/10	2012/13
Expenditure									
National departments	210 172	242 632	289 346	346 103	359 106	370 688	393 757	18.1%	4.4%
Provinces	188 913	216 976	266 591	306 255	328 224	356 567	374 471	17.5%	6.9%
Local government	99 707	114 450	139 337	163 177	191 441	205 084	229 132	17.8%	12.0%
Total expenditure	**498 792**	**574 058**	**695 274**	**815 535**	**878 771**	**932 339**	**997 360**	**17.8%**	**6.9%**
Municipal expenditure as percentage of total government expenditure	*20.0%*	*19.9%*	*20.0%*	*20.0%*	*21.8%*	*22.0%*	*23.0%*		
Municipal expenditure as percentage of GDP	*5.4%*	*5.5%*	*6.0%*	*6.7%*	*7.1%*	*6.9%*	*7.0%*		
Municipal operating revenue	**108 781**	**127 508**	**149 480**	**176 342**	**204 535**	**220 529**	**246 537**		
Municipal revenue as a percentage of GDP	*5.9%*	*6.1%*	*6.4%*	*7.2%*	*7.6%*	*7.4%*	*7.5%*		
Property rates	**18 737**	**21 451**	**22 305**	**26 294**	**31 281**	**33 206**	**35 823**		
Property rates as % of GDP	*1.0%*	*1.0%*	*1.0%*	*1.1%*	*1.2%*	*1.1%*	*1.1%*		
Service charges	**45 553**	**49 968**	**58 286**	**72 255**	**88 735**	**100 310**	**118 345**		
Service charges as % of GDP	*2.5%*	*2.4%*	*2.5%*	*2.9%*	*3.3%*	*3.4%*	*3.6%*		
Gross domestic product	**1 833 191**	**2 081 626**	**2 320 117**	**2 449 858**	**2 699 888**	**2 967 560**	**3 295 749**		

Source: National Treasury 2010 Budget Review

Table 4.1 also shows that municipal operating revenue as a percentage of GDP is growing fairly consistently. It has increased from 5.9 per cent of GDP in 2006/07 to 7.2 per cent in 2009/10. This is primarily due to growth in national transfers, rising electricity revenues (driven by rising electricity prices), as well as above inflation increases in other service tariffs. It is apparent that this increase is not being driven by rising property rates, since rates as a percentage of GDP remain constant at about 1 per cent.

Table 4.2 Public sector infrastructure expenditure and estimates,[1,2] 2006/07 – 2012/13

	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	% Ave annual growth	
		Outcome		Estimate		Medium-term estimates		2006/07 -	2009/10 -
R million								2009/10	2012/13
Expenditure									
National departments	4 631	5 712	6 318	6 382	6 847	7 758	10 703	11.3%	18.8%
Provincial departments	27 112	29 395	36 094	41 185	45 623	49 971	50 786	15.0%	7.2%
Municipalities	21 084	30 736	39 577	37 480	41 305	50 449	56 028	21.1%	14.3%
Extra-budgetary institutions	3 699	3 726	6 194	10 859	11 175	15 083	18 821	43.2%	20.1%
Public-private partnerships[3]	1 343	3 857	4 942	13 751	9 939	11 389	6 109	117.1%	-23.7%
Non-financial public enterprises	25 736	56 765	103 322	125 504	147 025	148 665	157 970	69.6%	8.0%
Total infrastructure expenditure	**83 605**	**130 191**	**196 447**	**235 161**	**261 914**	**283 315**	**300 417**	**41.2%**	**8.5%**
Municipalities as percentage of total infrastructure expenditure	*25.2%*	*23.6%*	*20.1%*	*15.9%*	*15.8%*	*17.8%*	*18.7%*		

Source: National Treasury 2010 Budget Review

1. Transfers between spheres have been netted out.

2. Includes maintenance of infrastructure assets.

3. PPPs reflect private sector contributions and SANRAL toll roads.

4. 2010/11 - 2012/13 are based on National Treasury estimates.

Even though local government infrastructure expenditure shows steady growth, its contribution to total public sector infrastructure spending declines from 25.2 per cent in 2006/07 to 15.8 per cent in 2010/11. This is primarily due to the rapid increase in infrastructure spending by public enterprises, notably Eskom and Transnet.

Trends in intergovernmental transfers to local government

The following table shows the vertical division of revenue raised nationally between the three spheres of government.

Table 4.3 Division of nationally raised revenues, 2006/07 – 2012/13

	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	% Ave annual growth	
		Outcome		Revised Estimate		Medium-term estimates		2006/07 - 2009/10	2009/10 - 2012/13
R million									
Division of available funds									
National departments	**210 172**	**242 632**	**289 346**	**346 103**	**359 106**	**370 688**	**393 757**	18.1%	4.4%
Provinces	**181 328**	**208 666**	**248 286**	**294 968**	**322 858**	**350 547**	**369 348**	17.6%	7.8%
Local government	**26 501**	**37 321**	**44 037**	**50 146**	**58 821**	**66 640**	**73 187**	23.7%	13.4%
Total	**418 001**	**488 619**	**581 669**	**691 217**	**740 785**	**787 875**	**836 292**	**18.3%**	**6.6%**
Percentage of total									
National departments	50.3%	49.7%	49.7%	50.1%	48.5%	47.0%	47.1%		
Provinces	43.4%	42.7%	42.7%	42.7%	43.6%	44.5%	44.2%		
Local government	6.3%	7.6%	7.6%	7.3%	7.9%	8.5%	8.8%		
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**		

Source: National Treasury 2010 Budget Review

1. With effect from 2006/07, the local government equitable share includes compensation for the termination of Regional Services Council (RSC) and Joint Services Board (JSB) levies for metros and district municipalities. From 2009/10 the RSC levies replacement grant is only allocated to district municipalities.

Compared to provinces, the Constitution allocates significant own revenue sources to local government: property rates, surcharges on service charges, other taxes, levies and duties. In addition, unlike provinces, municipalities are expected to charge for most of the services they provide. This explains why local government's share of revenues raised nationally is only about 7.9 per cent in 2010/11.

Compared to provinces, the Constitution allocates significant own revenue sources to local government

However, ever since 1999, when local government was included in the division of revenue process, national transfers to local government have consistently grown faster than total government expenditure. As a result, local government's share has been increasing from year to year. This is again true in the period under review: local government's share of nationally raised revenues increased from 6.3 per cent in 2006/07 to 7.3 per cent in 2009/10, and is projected to reach 8.8 per cent in 2012/13.

With the onset of the economic recession in 2009, government sought to insulate local government from the full impact of the slowdown in national revenues. Between 2010/11 and 2012/13, direct transfers to local government were projected to grow by R14.4 billion, or by 13.4 per cent annually. This is significantly higher than the average annual growth in total government expenditure of 6.9 per cent between 2010/11 and 2012/13.

The growth in grants is intended to assist municipalities in meeting the operating and capital costs of providing basic services to poor households and fulfilling their other functions

The growth in grants is intended to assist municipalities meet the operating and capital costs of providing basic services to poor households and fulfilling their other functions. National transfers are not a substitute for a municipality's own revenues. Non-poor households, businesses and other institutions in all municipalities are expected to pay rates and the full cost of the services they receive. As discussed in *Chapter 3 Intergovernmental relations and the local government fiscal framework*, the Constitution provides that national transfers may not compensate municipalities that fail to collect own revenues in line with their fiscal capacity. All municipalities are expected to show fiscal effort.

National transfers to local government are divided into direct transfers and indirect transfers. The indirect transfers are amounts that national departments spend on behalf of municipalities, so the funds are not actually transferred to municipalities. Table 4.4 shows both direct and indirect transfers to local government.

Table 4.4 Transfers to local government, 2006/07 – 2012/13

	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	% Ave annual growth	
		Outcome		Revised	Medium-term estimates			2006/07 -	2009/10 -
R million				Estimate				2009/10	2012/13
Direct transfers	**26 501**	**37 321**	**44 037**	**50 146**	**58 821**	**66 640**	**73 187**	23.7%	13.4%
Equitable share	**11 058**	**12 631**	**16 515**	**21 050**	**26 676**	**30 268**	**33 370**	23.9%	16.6%
RSC levy replacement grant	**7 000**	**8 045**	**9 045**	**3 306**	**3 492**	**3 672**	**3 864**	-22.1%	5.3%
General fuel levy sharing with metros	**–**	**–**	**–**	**6 800**	**7 542**	**8 531**	**8 958**	-	9.6%
Conditional grants	**8 443**	**16 645**	**18 477**	**18 990**	**21 111**	**24 169**	**26 995**	31.0%	12.4%
Infrastructure	7 447	15 128	17 095	16 910	19 039	22 072	24 793		*13.6%*
Capacity-building and other	996	1 517	1 382	2 080	2 072	2 097	2 202	27.8%	1.9%
Indirect transfers	**1 436**	**1 884**	**2 307**	**3 017**	**3 125**	**4 014**	**4 618**	28.1%	15.2%
Infrastructure	943	1 334	1 928	2 774	2 979	4 014	4 618	43.3%	18.5%
Capacity-building and other	493	550	379	243	146	–	–	-21.0%	-100.0%
Total	**27 937**	**39 205**	**46 344**	**53 163**	**61 946**	**70 654**	**77 805**	**23.9%**	**13.5%**

Source: National Treasury local government database

The direct transfers are divided into unconditional transfers (the local government equitable share and the general fuel levy sharing with metros) and conditional grants. Annexure W1 to the Division of Revenue Act, which is published on the National Treasury website, describes the structure and allocations of all national transfers.

Unconditional transfers

The local government equitable share is intended to balance the unequal distribution of fiscal capacity between spheres of government and across municipalities

The local government equitable share is the main unconditional transfer. Since 2006/07 the Regional Services Council (RSC) levy replacement grant for metros and districts was added, and since 2009/10, the metros' share of the RSC levy replacement grant has been going through a process of conversion to the 'general fuel levy sharing with metros' which is to be completed by 2012/13.

The equitable share grows by an annual average of 16.6 per cent over the medium term, from R21.1 billion in 2009/10 to R33.4 billion in 2012/13.

Table 4.5 shows the equitable share and the RSC replacement grant allocations to municipalities. Between 2009/10 and 2012/13, the growth in the equitable share favours metros at 18.9 per cent per year, compared to 14.9 per cent per year for the mostly rural municipalities. In 2009/10 the metros' share of the RSC levy replacement grant was replaced with the general fuel levy sharing with metros. Prior to this change the metros received two thirds of the RSC levy replacement grant.

Between 2009/10 and 2012/13, the growth in the equitable share favours metros at 18.9 per cent per year, compared to 14.9 per cent per year for the mostly rural municipalities

Table 4.5 Equitable share and RSC levy replacement grant transfers, 2006/07 – 2012/13

R million	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	% Ave annual growth 2006/07 - 2009/10	% Ave annual growth 2009/10 - 2012/13
	Outcome			Estimate	Medium-term estimates				
Equitable share									
Metros	2 648	3 069	4 218	5 147	6 773	7 790	8 644	24.8%	18.9%
Secondary cities	1 864	2 219	2 871	3 611	4 553	5 177	5 711	24.7%	16.5%
Towns	2 472	2 840	3 655	4 723	5 871	6 632	7 297	24.1%	15.6%
Mostly rural	2 391	2 501	3 180	4 264	5 226	5 888	6 477	21.3%	14.9%
Districts	1 683	2 001	2 591	3 304	4 252	4 780	5 241	25.2%	16.6%
Total equitable share	**11 058**	**12 631**	**16 515**	**21 050**	**26 676**	**30 268**	**33 370**	**23.9%**	**16.6%**
Percentage of total									
Metros	*24.0%*	*24.3%*	*25.5%*	*24.5%*	*25.4%*	*25.7%*	*25.9%*		
Secondary cities	*16.9%*	*17.6%*	*17.4%*	*17.2%*	*17.1%*	*17.1%*	*17.1%*		
Towns	*22.4%*	*22.5%*	*22.1%*	*22.4%*	*22.0%*	*21.9%*	*21.9%*		
Mostly rural	*21.6%*	*19.8%*	*19.3%*	*20.3%*	*19.6%*	*19.5%*	*19.4%*		
Districts	*15.2%*	*15.8%*	*15.7%*	*15.7%*	*15.9%*	*15.8%*	*15.7%*		
Total	***100.0%***	***100.0%***	***100.0%***	***100.0%***	***100.0%***	***100.0%***	***100.0%***		
RSC levy replacement grant									
Metros[1]	4 700	5 372	6 043					-	-
Districts	2 300	2 673	3 002	3 306	3 492	3 672	3 864	12.9%	5.3%
Total RSC levy replace	**7 000**	**8 045**	**9 045**	**3 306**	**3 492**	**3 672**	**3 864**	**-22.1%**	**5.3%**
Percentage of total									
Metros[1]	*67.1%*	*66.8%*	*66.8%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*		
Districts	*32.9%*	*33.2%*	*33.2%*	*100.0%*	*100.0%*	*100.0%*	*100.0%*		
Total	***100.0%***	***100.0%***	***100.0%***	***100.0%***	***100.0%***	***100.0%***	***100.0%***		

Source: National Treasury local government database

1. From 2009/10 RSC levy removed as it has been replaced by general fuel levy sharing with metros.

Conditional grants

National government allocates funds to local government through a variety of conditional grant programmes. All conditional grants are regulated by the annual Division of Revenue Act, which requires that each programme conform to a standard set of financial management and reporting rules. The national departments responsible for managing conditional grants are required to make allocations for each municipality over a three-year horizon to enable better planning.

Conditional grants are generally divided into two groups:

Infrastructure grants

Table 4.6 lists all national government's infrastructure related direct and indirect conditional grants to local government. The municipal infrastructure grant (MIG) is by far the largest of the infrastructure grants. It has grown very strongly since 2006/07, and is budgeted to continue growing at 13.5 per cent per year over the medium term. Note that from 2011/12, the urban settlement development grant is separated from the municipal infrastructure grant.

The municipal infrastructure grant is by far the largest of the infrastructure grants

The direct infrastructure grants are intended to supplement municipal capital budgets to accelerate municipalities' capacity to extend access to basic services. In other words, municipalities are still expected to fund infrastructure from their own resources (such as their equitable share, internally generated funds and borrowing).

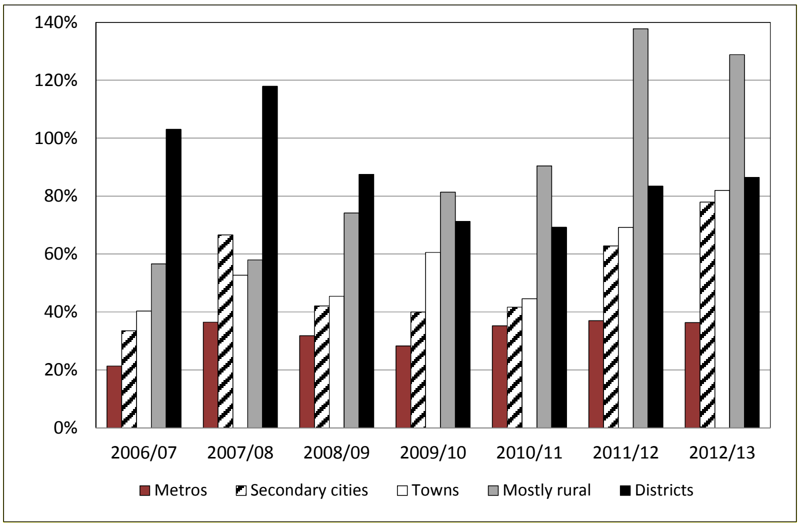
Table 4.6 Infrastructure transfers to local government, 2006/07 – 2012/13

R million	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	% Ave annual growth	
	Outcome			Revised Estimate	Medium-term estimates			2006/07 - 2009/10	2009/10 - 2012/13
Direct transfers	**7 447**	**15 127**	**17 095**	**16 909**	**19 038**	**22 072**	**24 792**	**31.4%**	**9.2%**
Municipal infrastructure grant	5 938	8 754	9 091	11 107	12 529	15 069	18 322	23.2%	13.5%
National electrification programme	391	462	589	933	1 020	1 097	1 151	33.6%	4.1%
Public transport infrastructure and system grant	518	1 174	2 920	2 418	3 699	4 425	4 125	67.1%	3.7%
Neighbourhood development partnership grant	–	41	182	551	1 030	1 190	1 182	-	4.7%
2010 FIFA World Cup stadiums development grant	600	4 605	4 295	1 661	302	–	–	40.4%	-
Rural transport services and infrastructure grant	–	–	9	10	10	11	12	-	6.3%
Electricity demand side management	–	–	–	175	220	280	–	-	-
Municipal drought relief grant	–	91	9	54	228	–	–	-	-
Indirect transfers	**943**	**1 334**	**1 928**	**2 775**	**2 979**	**4 014**	**4 618**	**43.3%**	**15.7%**
National electrification programme	893	973	1 148	1 478	1 752	1 770	1 914	18.3%	3.0%
Neighbourhood development partnership grant	50	61	54	111	125	100	105	30.5%	-5.6%
Regional bulk infrastructure grant	–	300	450	612	893	1 675	1 849	-	27.5%
Backlogs in water and sanitation at clinics and schools	–	–	186	350	–	–	–	-	-
Backlogs in the electrification of clinics and schools	–	–	90	149	–	–	–	-	-
Electricity demand-side management	–	–	–	75	109	119	–	-	-
Rural household infrastructure grant	–	–	–	–	100	350	750	-	-
Total	**8 390**	**16 461**	**19 023**	**19 684**	**22 017**	**26 086**	**29 410**	**32.9%**	**10.1%**

Source: National Treasury 2010 Budget Review

Figure 4.1 shows the percentage contribution that infrastructure grants make to municipalities' capital budgets.

Figure 4.1 Infrastructure grants' contribution to municipal capital budgets



Source: National Treasury local government database

In 2006/07 infrastructure grants contributed 21.4 per cent to metros' capital budgets. This increased to 36.5 per cent in 2007/08, largely due to the grants related to the 2010 FIFA World Cup, before declining to around 28.3 per cent in 2009/10. This is probably a healthy balance in the case of the metros. A similar trend would be expected for the secondary cities, but infrastructure grants' contribution to capital budgets increases to 75.6 per cent in 2012/13. The capital budgets for towns, and mostly rural and district municipalities also reflect that infrastructure grants represent an increasing proportion of their capital budgets over the medium term. Indeed, in the case of mostly rural municipalities, infrastructure grants are shown as being more than 100 per cent of their capital budgets. This indicates serious weaknesses in these municipalities' budgeting for capital – as they are not correctly reflecting the national grants due to them on their capital budgets. There was a similar problem with district municipalities in 2006/07 and 2007/08.

Overall, figure 4.1 shows that all municipalities are becoming increasingly dependent on national infrastructure grants to fund their capital budgets. This is not a sustainable trend, because it means the tariffs for the main municipal services are not covering the infrastructure costs of providing those services.

Capacity-building grants and other transfers

National government uses the capacity-building grants to fund various programmes aimed at supporting municipalities to develop in-house systems and skills for planning, project management and financial management. Water service operating subsidy grants are transitional funding arrangements to facilitate the transfer of the water function from the Department of Water Affairs to municipalities.

Table 4.7 Capacity-building and other current transfers to local government, 2006/07 – 2012/13

R million	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	% Ave annual	
		Outcome		Revised Estimate		Medium-term estimates		2006/07 - 2009/10	2009/10 - 2012/13
Direct transfers	**996**	**1 517**	**1 382**	**2 081**	**2 072**	**2 098**	**2 202**	27.8%	1.9%
Municipal systems improvement grant	200	200	200	200	212	225	236	0.0%	5.7%
Restructuring grant	265	530	–	–	–	–	–	-	-
Financial management grant	145	145	180	300	365	385	404	27.4%	10.4%
2010 FIFA World Cup host city	–	–	–	508	210	–	–		-
Water services operating subsidy grant	386	642	1 002	871	662	380	399	31.2%	-22.9%
Expanded public works programme - Phase 2 incentive grant	–	–	–	202	623	1 108	1 163	-	79.2%
Indirect transfers	**493**	**550**	**379**	**243**	**146**	**–**	**–**	-21.0%	-
Financial management grant: DBSA	53	53	50	–	–	–	–	-	-
Water services operating subsidy grant	440	497	329	243	146	–	–	-18.0%	-
Total	**1 489**	**2 067**	**1 761**	**2 324**	**2 218**	**2 098**	**2 202**	**16.0%**	**-1.8%**

Source: National Treasury 2010 Budget Review

Table 4.7 shows that the largest of these capacity building initiatives is the financial management grant, which funds the appointment of graduate interns in finance related disciplines. The grant is growing rapidly to fund a growing pool of interns.

The financial management grant is the largest capacity building grant

The balance between unconditional transfers and conditional grants

There is concern that the use of conditional grants by national government reduces municipalities' scope to set their own expenditure priorities, and thus weakens their accountability to local communities. The following table shows the proportion of funds flowing to municipalities as unconditional transfers versus conditional grants and indirect transfers.

	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
		Outcome		Revised estimates		Medium-term estimates	
Percentage of local share of nationally collected revenues							
Equitable share	64.6%	52.7%	55.2%	45.8%	48.7%	48.0%	47.9%
RSC levy replacement grant							
General fuel levy sharing with metros	0.0%	0.0%	0.0%	12.8%	12.2%	12.1%	11.5%
Total unconditional transfers	**64.6%**	**52.7%**	**55.2%**	**58.6%**	**60.9%**	**60.1%**	**59.4%**
Conditional grants from national budget	30.2%	42.5%	39.9%	35.7%	34.1%	34.2%	34.7%
Indirect transfers from national budget	5.1%	4.8%	5.0%	5.7%	5.0%	5.7%	5.9%
Total conditional and indirect transfers	**35.4%**	**47.3%**	**44.8%**	**41.4%**	**39.1%**	**39.9%**	**40.6%**

In 2006/07, unconditional transfers were 64.6 per cent of the total transfers to local government. The following year this declined to 52.7 per cent primarily due to the size of the 2010 FIFA World Cup stadiums development grant. Although this grant ended in 2010/11, unconditional transfers only recover to around 60 per cent of total transfers to local government over the medium term. The main reason for this is the ramping up of the regional bulk infrastructure grant and the introduction of a rural household infrastructure grant, both of which are indirect transfers aimed at addressing backlogs in infrastructure for basic services, particularly water.

So although there is a slight increase in conditional and indirect transfers, generally the balance between unconditional and conditional transfers has not changed significantly over the review period.

Provincial transfers

Table 4.8 shows the transfers that provinces make to municipalities. These transfers are primarily related to the housing function, but also include transfers for clinics, emergency health services and libraries.

Table 4.8 Provincial transfers to local government, 2006/07 – 2012/13

	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	% Ave annual growth	
								2006/07 - 2009/10	2009/10 - 2012/13
R thousand		Outcome		Estimate		Medium-term estimates			
Provincial transfers									
Eastern Cape	460 645	470 736	733 245	856 121	561 362	593 509	626 355	22.9%	-9.9%
Free State	100 662	58 322	182 436	446 751	393 813	378 172	353 893	64.3%	-7.5%
Gauteng	405 476	454 504	476 256	622 499	607 163	630 106	663 147	15.4%	2.1%
KwaZulu-Natal	478 394	783 710	1 115 245	1 331 010	728 822	787 321	794 839	40.6%	-15.8%
Limpopo	94 906	23 034	84 272	39 431	135 311	57 334	48 154	-25.4%	6.9%
Mpumalanga	24 207	14 380	100 916	89 682	57 374	65 760	68 888	54.7%	-8.4%
Northern Cape	111 224	89 400	113 925	134 300	141 941	149 853	142 430	6.5%	2.0%
North West	–	–	40 255	222 190	226 770	226 950	1 232 319	-	77.0%
Western Cape	884 544	1 379 595	1 416 736	1 558 963	1 575 760	1 779 694	1 778 731	20.8%	4.5%
Total	**2 560 058**	**3 273 681**	**4 263 286**	**5 300 947**	**4 428 316**	**4 668 699**	**5 708 756**	**27.5%**	**2.5%**
Per category									
Category A	1 043 394	1 779 290	2 233 104	2 555 674	2 263 079	2 483 577	2 529 961	34.8%	-0.3%
Category B	760 905	765 874	1 316 596	1 529 764	1 308 999	1 297 911	2 285 391	26.2%	14.3%
Category C	755 759	728 517	713 586	1 215 509	856 238	887 211	893 405	17.2%	-9.8%
Total	**2 560 058**	**3 273 681**	**4 263 286**	**5 300 947**	**4 428 316**	**4 668 699**	**5 708 756**	**27.5%**	**2.5%**

Source: National Treasury provincial database

Certain provinces are in fact reducing the scope of their delegations to municipalities, particularly the housing function, which is contrary to government's policy

Provincial transfers to local government grew at an average annual rate of 27.5 per cent between 2006/07 and 2009/10. However, the rate of growth declines to just 2.5 per cent per year from 2009/10 to 2012/13. This would suggest that certain provinces are reducing the scope of their delegations to municipalities, particularly the housing function – which is contrary to government's policy to devolve this function to local government. It also suggests that provinces are underfunding certain of the functions they have delegated to municipalities, notably clinics and library services.

Revenue trends

The new budget formats introduced by the Municipal Budget and Reporting Regulations draw a clear distinction between a municipality's operating budget and its capital budget, and between operating revenues and capital revenues. This is to enable the calculation of an operating surplus that reflects whether the municipality is functioning as a 'going concern' or not. Capital transfers are reflected separately, 'below the line' on the operating budget, while capital funding is shown on the capital budget.

The new budget formats draw a clear distinction between a municipality's operating budgets and its capital budget

In addition, only 'realistically anticipated revenues to be collected' may be reflected on a municipality's operating budget (statement of financial performance). This means that revenues that the municipality has 'given away' (so called *revenue foregone*) must not be reflected on the operating budget. It is reported elsewhere in the prescribed budget tables.

Operating revenue

At an aggregate level, the most important sources of municipal revenue are service charges, transfers and property rates. Table 4.9 shows total operating revenue of municipalities in the new budget format prescribed by the Municipal Budget and Reporting Regulations. This format was introduced with municipalities' 2010/11 budget, which means that the information for prior years is not fully aligned.

The most important sources of municipal revenue are service charges, transfers and property rates

Table 4.9 Municipal operating revenue, 2006/07 – 2012/13

	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	% Average annual growth	
	Outcome			Estimate	Medium-term estimates			2006/07 - 2009/10	2009/10 - 2012/13
R million									
Operating Revenue									
Property rates	18 737	21 451	22 305	26 294	30 702	32 599	35 186	12.0%	10.2%
Property rates - penalties & collection charges	–	–	–	–	579	606	637	-	-
Service charges	45 553	49 968	58 286	72 255	91 191	102 703	120 679	16.6%	18.6%
Service charges - electricity revenue					*58 978*	*68 916*	*84 172*	-	-
Service charges - water revenue					*17 676*	*18 633*	*20 223*	-	-
Service charges - sanitation revenue					*7 334*	*7 719*	*8 407*	-	-
Service charges - refuse revenue					*4 747*	*5 042*	*5 542*	-	-
Service charges - other revenue					*2 456*	*2 393*	*2 334*	-	-
Rental of facilities and equipment					1 635	1 443	1 510	-	-
Interest earned - external investments	3 217	3 998	4 504	2 829	1 927	1 927	2 013	-4.2%	-10.7%
Interest earned - outstanding debtors					2 127	2 189	2 362	-	-
Dividends received					3	8	9	-	-
Fines					1 430	1 492	1 675	-	-
Licences and permits					600	536	554	-	-
Agency services					1 327	1 375	1 477	-	-
Transfers recognised - operational	28 970	39 322	49 519	57 474	39 476	39 819	42 845	25.7%	-9.3%
Other revenue	12 303	12 770	14 866	17 490	9 592	9 477	10 091	12.4%	-16.8%
Gains on disposal of PPE					593	278	265	-	-
Total revenue	**108 781**	**127 508**	**149 480**	**176 342**	**181 181**	**194 453**	**219 301**	**17.5%**	**7.5%**
Percentage of total revenue									
Property rates	17.2%	16.8%	14.9%	14.9%	16.9%	16.8%	16.0%		
Service charges	**41.9%**	**39.2%**	**39.0%**	**41.0%**	**50.3%**	**52.8%**	**55.0%**		
Interest earned - external investments	3.0%	3.1%	3.0%	1.6%	1.1%	1.0%	0.9%		
Transfers recognised - operational	26.6%	30.8%	33.1%	32.6%	21.8%	20.5%	19.5%		
Other revenue	11.3%	10.0%	9.9%	9.9%	9.9%	9.0%	8.5%		
Total revenue	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**		

1. RSC levies abolished from 1 July 2006. Interim replacement grant included in Equitable share.

Source: National Treasury local government database

Total operating revenue grew by 17.5 per cent between 2006/07 and 2009/10

The table shows that total operating revenue grew by 17.5 per cent between 2006/07 and 2009/10. This was primarily driven by very rapid growth in 'transfers recognised – operational' (i.e. the equitable share, RSC replacement grant and operating conditional grants), and growth in service charge revenues, particularly related to electricity. Property rates revenue showed steady growth between 2006/07 and 2009/10, which suggests that municipalities weathered the impact of the economic recession relatively well. Between 2009/10 and 2010/11, there is a significant decrease in 'transfers recognised – operational', which is largely due to the conversion of the metros' share of the RSC replacement grant into the general fuel levy sharing with metros, which is captured under other revenue. Many district municipalities also appear to be cutting back on operational transfers to the local municipalities within their areas. It is important to note that many of the revenues previously captured under other revenue are now captured separately – hence the decline between 2009/10 and 2010/11. The rate of growth in service charge revenues increases to 18.6 per cent, reflecting the impact of higher electricity prices and the pressure on municipalities to implement cost reflective tariffs for all trading services.

At 41 per cent in 2009/10, service charges are the largest source of operating revenue for municipalities

Revenues from service charges are the largest source of municipal revenue. However, a very large percentage of this income simply flows through municipal coffers to Eskom or the water boards (depending on the municipality, between 65 and 85 per cent of municipal electricity revenue goes to paying for bulk electricity from Eskom). Historically, many municipalities have been generating a surplus from their trading services (especially electricity) to cross-subsidise other services. However, the rapid increases in bulk tariffs have squeezed these surpluses. This is due to the fact that municipalities have sought to (and, in some instances, been forced to) absorb some of the increases, and because the higher prices are leading to increasing bad debts and inducing customers to consume less. This highlights the need for norms and standards relating to surcharges on these municipal services, so that this 'surplus share' that municipalities rely on to subsidise other services can be made transparent and can be protected. The process of explicitly ring-fencing municipalities' trading services will also help protect this 'surplus share'.

Vulnerable cash position of municipalities

At a very minimum, a municipality should maintain a positive cash position. Section 45 of the Municipal Finance Management Act (2003) provides that municipalities are not allowed to close the financial year with a short-term borrowing or overdraft. At the end of 2009/10 (30 June 2010), there were 63 municipalities that reported negative closing cash positions; 8 were secondary cities. The fact that these municipalities were not able to close the financial year with positive cash positions is a strong indicator that they were experiencing financial distress at that date.

The number of months a municipality has ended with a negative cash balance gives an indication of whether the municipality's cash flow problems are transitory or more persistent in nature. In the last six months of 2009/10, 2 metros had negative end of month cash balances for more than three of the previous six months. There were 6 secondary cities, 77 local municipalities and 11 districts in a similar situation at the end of 2009/10.

Ideally, a municipality needs to have enough cash on hand to meet its monthly payments as and when they fall due. The level of cash coverage is especially important if the municipality is faced with circumstances that threaten revenue. It is generally accepted that a prudent level of cash coverage is three months of average operational expenditure. At 30 June 2010, 98 municipalities reported cash on hand in excess of three months of operational expenditure. However, there were 96 municipalities with a cash coverage ratio of less than one month. This is an improvement from the 140 municipalities that were in this position in 2008/09, it is still a cause for concern.

Any one of the following events could push these vulnerable municipalities into a negative cash position:

- a deterioration in revenue collections due to the impact that rising rates and tariffs have on households' ability to pay
- the need to pay suppliers, especially contractors responsible for capital projects (whose billings are often lumpy and come at year-end)
- the need to finance the cash-flow difference between paying for the increased cost of bulk electricity/water and the collection of revenues from customers
- any major breakdown in service delivery resulting in non-supply (especially water and electricity), and therefore no revenue
- a ratepayer/consumer boycott.

The cash coverage position of the metros and secondary cities has remained fairly constant. There has, however, been significant improvement in the cash coverage position among the local municipalities. The number of local municipalities that reported having cash in excess of three months of operational expenditure increased from 44 in 2008/09 to 77 in 2009/10, an improvement of 75 per cent. Furthermore, the number of municipalities with less than one month of cash coverage decreased from 118 in 2008/09 to 68 in 2009/10. The cash coverage for district municipalities has deteriorated significantly between 2008/09 and 2009/10. In 2008/09, while only 4 districts reported having less than one month of cash on hand, this had increased to 15 districts in 2009/10. This constitutes almost one-third of all district municipalities.

Government transfers are the second largest source of revenue

National transfers are the second largest source of revenue for local government. The very rapid growth in transfers results in this revenue source's share of total revenue increasing from 26.6 per cent in

2006/07 to 32.6 per cent in 2009/10. As a result, other revenue sources' shares of total revenue decline. This trend changes significantly after 2009/10, with the share of revenues from service charges increasing from 41 per cent in 2009/10 to 55 per cent in 2012/13.

Revenue raised through property rates grew by R7.5 billion or 12 per cent between 2006/07 and 2009/10 and is expected to grow further by 10.2 per cent over the medium term. Revenue from property rates held up well during the economic recession.

Municipalities also generate other revenue in the form of traffic fines, business licences, rental fees, entrance fees for use of municipal facilities and fresh produce markets. It is notable that revenue from interest earned on external investments falls significantly in 2010/11, partly as a result of the decline in interest rates, but also because many municipalities have exhausted their historical cash reserves.

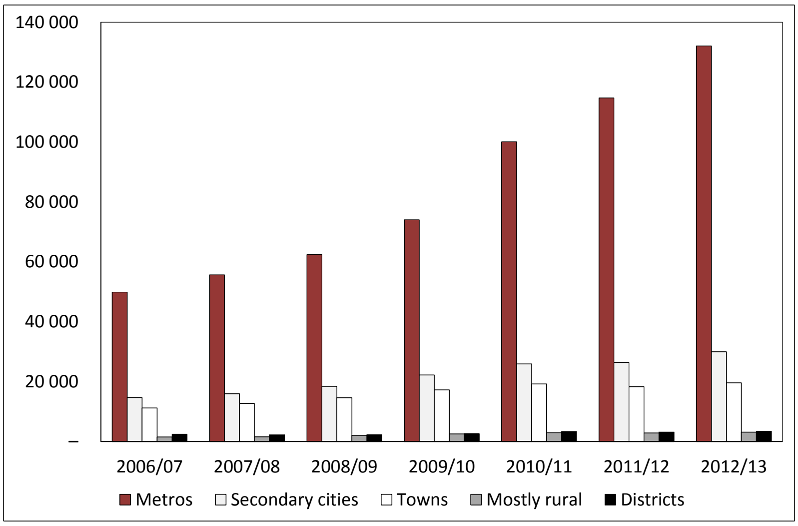
Own revenues

A municipality's scope to raise own revenues depends on its fiscal capacity

All municipalities are expected to raise own revenues in addition to the equitable share transfer they receive from national government. This principle is an important feature of any democratic local government system. It creates a revenue-service link between the municipality and its customers, which empowers customers to hold the municipality directly accountable for the services it provides.

A municipality's scope to raise own revenues depends on its fiscal capacity. The extent to which a municipality does raise own revenues in accordance with its fiscal capacity depends on its fiscal effort; this means the amount of attention it pays to ensuring effective revenue management. Figure 4.2 shows aggregate own revenue for different categories of municipalities and the metros.

Figure 4.2 Aggregated own revenue of municipalities



Source: National Treasury local government database

Outstanding consumer debts

As at 31 December 2010, municipalities were owed a total of R62.3 billion

As at 31 December 2010, municipalities were owed a total of R62.3 billion. This represents an increase of 10.8 per cent from the same month in 2009. However, consumer debts as a percentage of own revenues have been declining. In June 2008, outstanding debtors stood at R37 billion or 39 per cent of own revenue, and in December 2010 outstanding debtors stood at 30 per cent of own revenue. Part of this can be attributed to the rapid increase in own revenues due to the increase in electricity tariffs, as well as to debt write-offs, but there is also evidence that certain municipalities have been paying greater attention to revenue management.

Table 4.10 Debtors age analysis, 31 December 2009 and 31 December 2010

	0 - 30 Days		31 - 60 Days		61 - 90 Days		Over 90 Days		Total	
R thousand	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Debtors analysis as at 31 December 2010										
Category A (Metros)	6 805 163	19.6%	1 639 690	4.7%	1 156 289	3.3%	25 061 754	72.3%	34 662 896	55.6%
Category B (Locals)	2 791 990	10.8%	1 373 927	5.3%	1 369 465	5.3%	20 330 174	78.6%	25 865 554	41.5%
Category C (Districts)	112 929	6.2%	90 373	5.0%	68 311	3.8%	1 538 855	85.0%	1 810 468	2.9%
Total	**9 710 081**	**15.6%**	**3 103 990**	**5.0%**	**2 594 065**	**4.2%**	**46 930 782**	**75.3%**	**62 338 919**	**100.0%**
Debtors analysis as at 31 December 2009										
Category A (Metros)	5 635 881	18.0%	1 603 852	5.1%	1 104 042	3.5%	23 004 527	73.4%	31 348 302	55.7%
Category B (Locals)	2 815 289	12.1%	1 151 620	4.9%	929 843	4.0%	18 462 812	79.0%	23 359 564	41.5%
Category C (Districts)	153 028	9.9%	71 203	4.6%	55 527	3.6%	1 271 167	82.0%	1 550 924	2.8%
Total	**8 604 197**	**15.3%**	**2 826 674**	**5.0%**	**2 089 412**	**3.7%**	**42 738 507**	**76.0%**	**56 258 791**	**100.0%**
Growth rate between 2009 to 2010										
Category A (Metros)	20.7%		2.2%		4.7%		8.9%		10.6%	
Category B (Locals)	-0.8%		19.3%		47.3%		10.1%		10.7%	
Category C (Districts)	-26.2%		26.9%		23.0%		21.1%		16.7%	
Total	**12.9%**		**9.8%**		**24.2%**		**9.8%**		**10.8%**	

Source: National Treasury local government database

Households were responsible for 61.9 per cent or R38.3 billion of consumer debts at 31 December 2010. National and provincial government owed municipalities R3.1 billion or 5.1 per cent of total consumer debts.

Households were responsible for 61.9 per cent of consumer debts at 31 December 2010

Metros were owed a total of R34.6 billion as at 31 December 2010, a 10.6 per cent increase from December 2009. Secondary cities were owed R11.6 billion at 31 December 2010, which is just a 1 per cent increase from the corresponding period last year.

Capital budget funding

Table 4.11 shows that municipalities fund their capital expenditure from four sources.

Table 4.11 Municipal capital funding, 2006/07 – 2012/13

	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	% Average annual growth	
	Outcome			Estimate	Medium-term estimates			2006/07 - 2009/10	2009/10 - 2012/13
R million									
Source of finance									
National Government					*19 793*	*20 939*	*21 543*	-	-
Provincial Government					*1 118*	*1 006*	*1 232*	-	-
District Municipality					*42*	*29*	*29*	-	-
Other Transfers and grants					*49*	*45*	*35*	-	-
Transfers recognised - capital	9 463	13 469	19 917	19 535	21 002	22 019	22 839	27.3%	5.3%
Public contributions and donations	105	175	532	301	1 279	1 153	1 214	19.1%	-48.7%
Borrowing	5 315	7 088	9 935	8 988	8 053	7 297	8 516	42.1%	204.6%
Internally generated funds	6 456	9 232	11 256	12 171	8 559	7 522	6 626	23.5%	-18.3%
Total source of finance	**21 339**	**29 964**	**41 640**	**40 995**	**38 893**	**37 990**	**39 195**	24.3%	-1.5%
Percentage of source of finance									
Transfers recognised - capital	44.3%	45.0%	47.8%	47.7%	54.0%	58.0%	58.3%		
Public contributions and donations	0.5%	0.6%	1.3%	0.7%	3.3%	3.0%	3.1%		
Borrowing	24.9%	23.7%	23.9%	21.9%	20.7%	19.2%	21.7%		
Internally generated funds	30.3%	30.8%	27.0%	29.7%	22.0%	19.8%	16.9%		
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**		

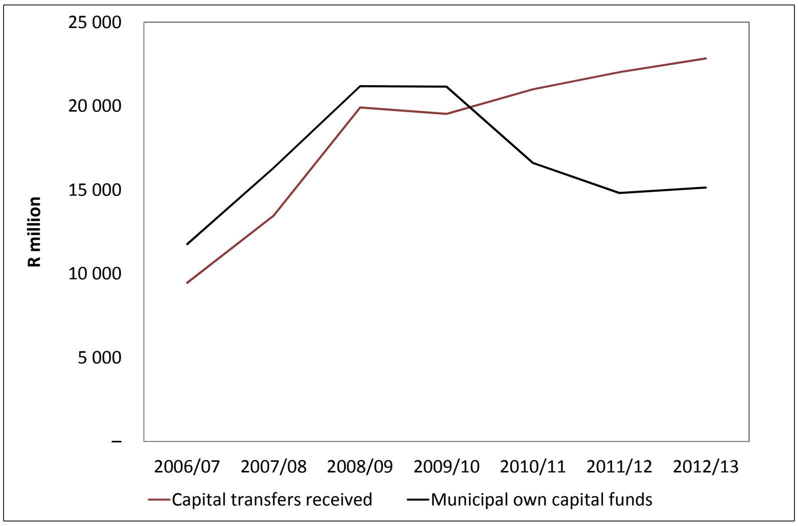
Source: National Treasury local government database

The table shows that transfers recognised – capital, i.e. infrastructure grants from national and provincial government, are the most important source of capital funding for municipalities, and its contribution increases from 44.3 per cent in 2006/07 to 58.3 per cent in 2012/13. The increase between 2007/08 and 2008/09 was driven by the infrastructure grants linked to the preparations for the 2010 FIFA World Cup.

The large decline in municipalities' own contributions to capital expenditure

The decline in municipalities' own contributions to capital expenditure both by way of internally generated funds and funds from borrowing is cause for concern. In 2009/10, municipalities allocated R12.1 billion to their capital budgets from internally generated funds. This source of funding is set to decline to R6.6 billion by 2012/13. In 2010/11, municipalities were also budgeting to reduce their funding of the capital budget from borrowings. This trend is illustrated in figure 4.3.

Figure 4.3 Municipal own contribution to capital expenditure, 2006 to 2012



Source: National Treasury local government database

This decline in municipalities' own contributions to capital expenditure can be attributed to the following: (a) municipalities have largely exhausted their historical cash reserves, (b) they are finding it more difficult to generate surpluses on their operating budgets due to various cost pressures, and (c) they are deliberately substituting own contributions with national transfers, and spending the funds elsewhere on their operating budgets.

Expenditure trends

As noted above, the new budget formats draw a clear distinction between a municipality's operating budget and its capital budget.

Operating expenditure

Municipalities' actual total operating expenditure increased in real terms by 11.8 per cent annually from 2006/07 to 2009/10 and is estimated to grow by 6.4 per cent over the medium term.

Employee costs account for the largest component of operating expenditure, averaging 30 per cent of total operating expenditure. Between 2006/07 and 2009/10, growth in employee costs was 15.4 per cent, primarily driven by high wage increases. (For a detailed discussion see *Chapter 7 Managing municipal personnel*).

Personnel costs account for the largest component of operating expenditure

Table 4.12 Municipal operating expenditure, 2006/07 – 2012/13

R million	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	% Ave annual growth 2006/07 - 2009/10	2009/10 - 2012/13
		Outcome		Estimate	Medium-term estimates				
Operating expenditure									
Employee related costs	29 057	32 672	38 307	44 678	49 843	51 622	55 750	15.4%	7.7%
Remuneration of councillors	1 557	1 671	1 876	2 013	2 146	2 149	2 291	8.9%	4.4%
Debt impairment		–	–	–	7 212	8 572	9 447	-	-
Depreciation and asset impairment	5 365	6 229	10 376	13 233	11 631	12 165	12 890	35.1%	-0.9%
Finance charges	3 503	3 475	4 265	4 882	5 612	6 008	6 364	11.7%	9.2%
Bulk purchases	22 139	23 926	30 182	38 108	48 786	57 714	70 849	19.8%	23.0%
Other Materials		–	–	–	2 376	2 292	2 533	-	-
Contracted services		–	–	–	8 303	8 421	9 142	-	-
Transfers and grants	2 514	3 748	3 297	3 699	3 955	3 331	3 428	13.7%	-2.5%
Other expenditure	35 573	42 730	51 033	56 564	41 600	41 792	44 574	16.7%	-7.6%
Loss on disposal of PPE	–	–	–	–	29	23	24	-	-
Total expenditure	**99 707**	**114 450**	**139 337**	**163 177**	**181 493**	**194 089**	**217 293**	17.8%	10.0%

Source: National Treasury local government database

Bulk purchases constituted 22.2 per cent of municipalities' operating expenditure in 2006/07, and increases to 32.6 per cent in 2012/13. Between 2010/11 and 2012/13, the average annual growth in bulk purchases is anticipated to be 23.0 per cent, driven primarily by the increase in the price of bulk electricity. (See Chapters 8 and 9 for more detailed discussions on water and electricity expenditures).

Expenditure on repairs and maintenance

The *2008 Local Government Budgets and Expenditure Review* highlighted the serious repairs and maintenance and renewal backlogs that exist in relation to municipal infrastructure, particularly municipalities' electricity, water reticulation, sewerage, storm water and roads systems. These backlogs are impacting negatively on the financial sustainability of municipalities and on the reliability and quality of municipal services, as well as municipalities' contribution to supporting economic growth.

Given government's concerns about the low levels of expenditure on repairs and maintenance and the renewal of existing infrastructure in most municipalities, National Treasury's MFMA Circular 55 provides that when a municipality prepares its 2011/12 budget:

- Where the municipality allocates less than 40 per cent of its 2011/12 capital budget to the renewal of existing assets it must provide a detailed explanation and assurance that the budgeted amount is adequate to secure the ongoing health of the municipality's infrastructure supported by reference to its asset management plan.
- Where the budgeted amounts for repairs and maintenance are less than 8 per cent of the asset value (write down value) of the municipality's plant property and equipment (PPE) as reflected in the municipality's 2009/10 annual financial statements, the municipality must provide a detailed explanation and assurance that the budgeted amount is adequate to secure the ongoing health of the municipality's infrastructure supported by reference to its asset management plan.
- In the case of a municipality that received an audit qualification related to its assets register, where the budgeted amounts for repairs and maintenance are less than 10 per cent of the municipality's operating expenditure, the municipality must provide a detailed explanation and assurance that the budgeted amount is adequate to secure the ongoing health of the municipality's infrastructure supported by reference to its asset management plan.
- More generally, all municipalities should provide narrative information in their budget documents on how they are planning, managing and financing repairs and maintenance and asset renewal, with particular reference to what the municipality has done to assess its repairs and maintenance backlog, its estimate of its repairs and maintenance backlog and the strategy it has put in place to progressively deal with the backlog.

Municipalities' provision for 'depreciation and asset impairment' is growing very rapidly as municipalities implement GRAP 17. This accounting standard requires municipalities to bring all assets that have a material value onto their asset registers. The increase in depreciation reflects the fact that municipalities are now having to account for the 'consumption' of these assets. Although depreciation is a 'non-cash' item on the municipal budget, the cost of this 'consumption' needs to be built into municipalities' rates and tariffs so that the refurbishment and replacement of these assets can be funded once they have reached the end of their useful lives. This implies that all municipalities' capital replacement reserve funds should be cash-backed.

Per capita operating expenditure by municipalities

Per capita operating expenditure by each municipality varies greatly

Per capita operating expenditure by each municipality varies greatly. It is mostly determined by the demographics, the socio-economic context and the powers and functions in a particular municipality, as well as by the nature and extent of business activity. It is also influenced by the history of local government in a particular area and consequently the maturity of the municipality.

Table 4.13 shows that municipalities in Gauteng spend the highest amount per capita, at R6 609 for 2009/10, while Western Cape municipalities spend on average R6 167 per capita. This is despite rapid increases in the populations of both these provinces. According to Statistics South Africa's 2007 Community Survey, Gauteng gained 440 411 more households and 1.2 million more people since the 2001 Census. Western Cape gained 195 000 more households and 754 000 more people over the same period. These are also the provinces where most of the national revenue redistributed through the local government equitable share and conditional grants is generated.

Table 4.13 Municipal per capita spending by province, 2006/07 – 2012/13

	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	% Average annual growth	
		Outcome		Estimate		Medium-term estimates		2006/07 - 2009/10	2009/10 - 2012/13
Rand									
Eastern Cape	1 944	2 057	2 544	3 029	3 302	3 485	3 769	15.9%	7.6%
Free State	2 226	2 871	2 885	3 336	4 167	4 499	4 709	14.4%	12.2%
Gauteng	4 080	4 842	6 147	6 609	7 470	8 262	9 352	17.4%	12.3%
KwaZulu-Natal	2 208	2 592	3 335	3 929	4 281	4 491	4 958	21.2%	8.1%
Limpopo	859	1 372	1 757	1 993	2 125	2 156	2 405	32.4%	6.5%
Mpumalanga	1 577	1 761	2 456	2 764	2 589	1 367	1 490	*20.6%*	*-18.6%*
Northern Cape	2 123	2 473	3 135	3 701	3 709	3 334	3 376	*20.4%*	*-3.0%*
North West	1 720	2 006	2 351	2 668	3 141	3 264	3 478	*15.8%*	*9.2%*
Western Cape	3 550	4 364	5 451	6 167	8 100	8 767	9 555	20.2%	15.7%
National	**2 495**	**2 977**	**3 732**	**4 208**	**4 796**	**5 039**	**5 560**	19.0%	9.7%

Source: Stats SA, 2007 Community Survey; National Treasury local government database

Low per capita spending in Limpopo, Mpumalanga and North West points to the historical underdevelopment of local government in these regions

The lowest municipal per capita spending is in Limpopo, where R1 993 was spent in 2009/10. The fact that per capita spending by municipalities is lowest in Limpopo, Mpumalanga and North West indicates that the low level of spending is probably linked to the historical underdevelopment of local government in these regions. It also indicates the importance of efforts to grow the local economies, as well as the fact that a lot of work still needs to be done to address poverty in these provinces.

Table 4.13 shows that per capita spending by municipalities grew at an average annual rate of 19 per cent between 2006/07 and 2009/10. The highest rate of growth was in Limpopo, where municipal per capita spending grew at an average annual rate of 32.4 per cent per year, while the lowest rate of growth was in Free State, at 14.4 per cent per year. These very rapid increases in per capita spending are primarily due to increases in the cost of providing services (driven by rising wages and the increasing cost of electricity and water), and to a lesser extent due to the extension of municipal services to more customers.

The average annual growth in per capita spending between 2009/10 and 2012/13 is projected to be just 9.7 per cent. This is a significant flattening out. In two provinces, per capita spending is budgeted to decline. If these projections are realised, per capita spending by municipalities in Mpumalanga in 2012/13 will be lower than what it was in 2006/07. While municipal spending is under considerable pressure, it would seem that in this instance the decline is largely attributable to poor quality medium term budgeting by municipalities in the province.

Capital expenditure

Table 4.14 shows capital expenditure by standard classification by function in line with the new budget formats.

Table 4.14 Municipal capital expenditure, 2006/07 – 2012/13

R million	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	% Average annual growth 2006/07 - 2009/10	2009/10 - 2012/13
		Outcome		Estimate		Medium-term estimates			
Governance and administration	**–**	**–**	**–**	**–**	**3 572**	**2 838**	**2 901**	**-**	**-**
Executive and council					1 160	752	718	-	-
Budget and treasury office					442	258	350	-	-
Corporate services					1 969	1 828	1 833	-	-
Community and public safety	**979**	**1 866**	**1 526**	**1 438**	**6 864**	**5 368**	**5 768**	**13.7%**	**58.9%**
Community and social services					1 529	910	900	-	-
Sport and recreation					1 240	621	675	-	-
Public safety					656	467	429	-	-
Housing	979	1 866	1 526	1 438	3 208	3 144	3 522	13.7%	34.8%
Health					231	226	242	-	-
Economic and environmental services	**3 178**	**4 017**	**7 335**	**10 548**	**11 857**	**12 141**	**12 340**	**49.2%**	**5.4%**
Planning and development					3 166	2 640	2 915	-	-
Road transport	3 178	4 017	7 335	10 548	8 621	9 452	9 359	49.2%	-3.9%
Environmental protection					70	48	66	-	-
Trading services	**8 907**	**11 230**	**13 863**	**13 750**	**18 768**	**18 881**	**19 453**	**15.6%**	**12.3%**
Electricity	3 093	3 833	4 748	4 784	5 848	5 177	4 912	15.6%	0.9%
Water	5 814	7 398	9 115	8 966	7 472	8 093	8 770	15.5%	-0.7%
Waste water management					4 377	4 610	4 941	-	-
Waste management					1 071	1 000	830	-	-
Other	**8 247**	**12 845**	**18 946**	**15 203**	**131**	**89**	**92**	**22.6%**	**-81.7%**
Total Capital Expenditure	**21 310**	**29 958**	**41 669**	**40 939**	**41 190**	**39 316**	**40 553**	**24.3%**	**-0.3%**

Source: National Treasury local government database

Local government infrastructure expenditure almost doubled between 2006/07 and 2008/09, mainly due to projects related to the 2010 FIFA World Cup

Local government infrastructure expenditure almost doubled between 2006/07 and 2008/09, primarily driven by projects related to the 2010 FIFA World Cup. There was a slight decrease in 2009/10 as a result of the World Cup projects being completed. The fact that capital spending remains at about R40 billion is driven largely by growth in national government transfers to address service delivery backlogs.

Investment in road transport grew at an average rate of 49.2 per cent between 2006/07 and 2009/10, much of which was related to the upgrading of road networks and public transport system in preparation for the World Cup. Following the big drive to build transport infrastructure for the World Cup, spending in this area is budgeted to decline over the medium term.

Infrastructure budgets for electricity have been growing, but probably not as quickly as required

Infrastructure budgets for electricity have been growing, but not as quickly as required given the backlogs. It is important to note that this does not include all spending on backlog eradication funded by national government, as part of this is funded by an indirect conditional grant which is managed by Eskom. Investment in electricity networks remains almost flat over the medium term. It is anticipated that this will change significantly going forward, given national government's decision to abandon the idea of creating REDs (regional electricity distributors) and to leave the electricity distribution function with municipalities. This decision brings certainty about municipal ownership of electricity assets, and creates an incentive for them to invest in those assets.

There are a large number of smaller municipalities whose water and sanitation infrastructure is inadequate or in a very poor state

There has been constant growth in capital expenditure on water and sanitation. However, the Blue Drop Report and Green Drop Report by the Department of Water Affairs indicate that there are a large number of smaller municipalities whose water and sanitation infrastructure is inadequate or in a very poor state. Therefore, these budgets probably need to grow even more strongly.

Even though the housing function is yet to be devolved, municipalities' housing related expenditures have been growing strongly, at an average annual rate of 13.7 per cent between 2006/07 and 2009/10. Over the medium term, municipalities have budgeted to invest R9.9 billion in housing – mostly as agents of provincial housing departments, but also using their own funds.

Most municipalities' capacity to budget reliably for infrastructure spending is weak

Most municipalities' capacity to budget reliably for infrastructure spending is weak. This is reflected by the declining allocations for future years, whereas in practice these will in all probability increase. This is because most municipalities only plan their infrastructure spending within a one-year time horizon. Even then the quality of planning is poor, resulting in significant underspending of capital budgets. In 2009/10 those municipalities' that underspent their capital budgets underspent by R15 billion.

Conditional grant expenditure

Regular concerns are expressed about the level of municipal spending of conditional grants. Table 4.15 shows that to a large extent these concerns have been addressed by the implementation of the 'use it or lose it' principle set out in the Division of Revenue Act (see the following text box).

Returning unspent conditional grants to the National Revenue Fund

In national and provincial government, all departmental budget allocations that remain unspent at the end of the financial year are automatically returned to the relevant revenue fund. The department may then apply for a rollover of such funds, which may or may not be approved. The annual Division of Revenue Act applies the same principles to conditional grants. If a municipality has not spent its grants by the end of the municipal financial year, the municipal manager must apply to National Treasury for the funds to be rolled over. If the municipal manager can prove that the unspent funds are committed to identifiable projects then National Treasury will approve a rollover; if not, then the funds must be returned to the National Revenue Fund.

In 2009/10, National Treasury undertook an extensive exercise to ensure compliance with this aspect of the Division of Revenue Act in respect of the R32.8 billion conditional grants transferred to municipalities between 2005/06 and 2008/09. Working with National Treasury, municipalities had to provide evidence that eligible expenditures against these conditional grants had actually occurred. This verification process was necessary because, first, methods of accounting for grant expenditures in municipalities is different from national government, and, second, there was evidence that many municipalities had chosen to use the grant funding for other purposes, such as paying salaries. National Treasury's initial estimate of the amount of unspent grants was R4.5 billion. Through the verification process this amount came down to R2.5 billion, owed by 213 municipalities. Municipalities were requested to return these unspent funds to the National Revenue Fund in accordance with the Act, to make repayment arrangements with National Treasury. However, very few municipalities did so; the rest simply chose to ignore the instruction. A decision was therefore taken to offset the amount each municipality owed the National Revenue Fund against that municipality's equitable share allocation due to be paid from the National Revenue Fund. This was implemented in November 2009. A total of R1.9 billion was deducted from 178 municipalities' equitable share allocations (35 municipalities were exempted from the first-round off-set process because their cash flows were already negative).

The impact of this action was immediate. No fewer than 151 of the affected municipalities applied to National Treasury for the funds to be rolled over and returned. R1.8 billion was returned to these municipalities between March and June 2010, on the receipt of a written commitment to spend the funds in accordance with the relevant grant conditions before a specified date; for most municipalities this was 30 June 2010. 53 municipalities chose not to meet with National Treasury to request the return of the funds. The R263 million that was off-set against these municipalities' equitable share was therefore retained in the National Revenue Fund.

National Treasury has now developed the systems and capacity to institutionalise the rollover and unspent grants processes at the end of each municipal financial year. The start of the process is determining the quantum of unspent conditional grants as at 30 June. At 30 June 2010, this amount was R3.2 billion. This amount will come down following the verification and rollover processes, but the remainder must be returned to the National Revenue Fund, either as a refund or a deduction against the municipalities' equitable share.

The November 2009 process of offsetting the unspent grants against equitable shares has had a very positive impact on how municipalities manage conditional grants. Previously, many municipalities treated grant funds as another source of own revenue, and made no effort to spend the funds in accordance with the grant conditions or within the required time-period. This has now changed. The application of the 'use-it-or-lose-it' principle creates a clear incentive for municipalities to spend their conditional grants within the financial year and in accordance with grant conditions. This is clearly reflected in the higher levels of spending of the 2009/10 conditional grants.

Table 4.15 Actual spending of national conditional grants to local government, 2006/07 – 2009/10

R million	2006/07	2007/08	2008/09	2009/10	2006/07	2007/08	2008/09	2009/10
	Actual expenditure				Percentage of revised allocation			
Infrastructure	**7 286**	**14 981**	**16 823**	**14 292**	**93.9%**	**97.7%**	**97.7%**	**83.0%**
Direct transfers								
Municipal Infrastructure Grant	5 801	8 238	8 912	9 371	92.8%	99.7%	98.0%	82.0%
Urban Transport Fund Grant	–	–	6	–	-	-	67.3%	-
National Electrification Programme (Municipal) Grant	384	453	534	767	98.1%	96.9%	89.7%	82.2%
Public Transport Infrastructure and Systems Grant	506	1 149	2 873	1 933	97.4%	97.8%	98.4%	80.0%
Neighbourhood Development Partnership Grant	–	41	177	423	92.8%	99.7%	98.0%	82.0%
2010 FIFA World Cup Stadiums Development Grant	596	4 577	4 295	1 649	-	17.8%	61.3%	76.7%
Municipal Drought Relied funds (DWAF)	–	69	9	54	-	69.3%	95.5%	100.0%
Disaster funds (DCOG)	–	454	17	–	-	92.2%	100.0%	-
Electricity Demand Side Management (Municipal) Grant	–	–	–	96	-	-	-	54.8%
Capacity building and other grants	**577**	**863**	**358**	**844**	**73.0%**	**98.6%**	**94.3%**	**83.7%**
Direct transfers								
Municipal Systems Improvement Programme Grant	192	193	188	159	96.2%	96.5%	94.1%	79.5%
Local Government Restructuring Grant	247	530	–	–	55.5%	100.0%	-	-
Local Government Financial Management Grant	138	140	170	219	94.8%	96.5%	94.5%	73.1%
2010 FIFA World Cup Host City Operating Grant	–	–	–	465	-	-	-	91.7%
Total	**7 863**	**15 844**	**17 182**	**15 136**	**91.9%**	**97.8%**	**97.6%**	**83.0%**

Source: National Treasury local government database

Municipalities have spent 91.9 per cent of the conditional grants allocated to them in 2006/07. Similarly high levels of spending are shown for 2007/08 and 2008/09. It must, however, be emphasised that not all this spending would have taken place in the relevant financial year, due to the rolling over of committed funds. Spending for 2009/10 is significantly lower because the process of rolling over committed funds is not reflected. In terms of the annual Division of Revenue Act, conditional grant funds not spent at the end of a financial year and not rolled-over to the following financial year, must be returned to the National Revenue Fund (see textbox above).

Key issues in revenue and expenditure management

It is not enough to simply review the size of municipal revenues or expenditures

Reviewing intergovernmental transfers and the size of municipal budgets does not provide adequate insight into the efficiency or effectiveness of a municipality. Rising expenditures related to the delivery of a particular service may reflect an expansion of services to more citizens or increasingly difficult technical conditions, such as a dispersed population or a municipality reaching a specific stage in the life-cycle of its assets. But it may also reflect higher than average personnel costs or administrative overheads, weak expenditure controls or inappropriate service standards. Inefficiencies in service delivery or corruption might also quickly translate into increased expenditures and reduce the availability of resources to address the core objectives of poverty reduction and economic development.

Key issues in revenue and expenditure management include:

Revenue management: getting the basics right

Much attention has been given to the need for municipalities to collect outstanding debts. This is important, but municipalities need to pay attention to all aspects of the revenue management value chain in order to ensure completeness of revenues:

- *Integrity of billing information:* Are accounts being sent to everyone who should be receiving an account? If accounts are not being sent, then there is no obligation on the ratepayer or customer of a particular service to pay. This requires the municipality to regularly update its information with reference to the property deeds register. Administratively weak systems are open to fraud. For instance, a seemingly 'innocent' misclassification of a residential property as an agricultural property can 'save' the ratepayer 75 per cent on their rates bill.

- *Accuracy of billing systems:* Are all customers being billed accurately according to the market value of their properties and for the services they consume? Or are customers meters not being read, and estimates being used?

- *Ability to collect:* A municipality can send out as many bills as it likes, but unless these are being delivered to the correct address they mean nothing or very little unless it can enforce payment.

Revenue collection needs to be managed holistically, and it must be everyone's business within the municipality. It involves getting the basics right. Failure to get the basics right cannot be made up for by buying a new IT system or appointing debt collectors. A municipality needs to have sound policies, practices and processes in place for managing revenue – none of these are enormously complicated. What is needed are dedicated managers prepared to build administrative implementation systems that integrate each component of the revenue value chain.

Revenue management needs to be managed holistically, and it must be everyone's business within the municipality

Collecting outstanding debts: getting the basics right

The persistently high debtor levels indicate that most municipalities' efforts to collect billed revenues are deficient. In this regard, it should be noted that the growth in consumer debtors pre-dates the slowdown in the economy in 2009. Far more relevant explanations for the growth in debtors include:

- a failure on the part of mayors and municipal councils to provide political backing to revenue enhancement programmes

- a failure on the part of municipal managers to allocate sufficient staff/capacity to the revenue collection function

- council unwillingness to sanction the use of electricity and other service cut-offs as debt management tools (or Eskom not co-operating with municipalities to enable them to use electricity as a debt management tool in the areas it services)

- poorly designed revenue management, indigent and credit control and customer care policies

- the affordability of municipal bills, especially to households where breadwinners lost their jobs in the recession

- resistance among certain communities to paying for certain types of services (or to being billed in a particular way)

- ratepayer boycotts, sparked by deteriorating service delivery, and perceptions that the municipality is unresponsiveness to community concerns.

The scope for improving own revenues by ensuring payment of current bills and collecting outstanding debtors is very large, given that the majority of municipalities have collection rates below 80 per cent. Indeed, there are a number of municipalities that have demonstrated that collection rates can be improved massively by adopting relatively simple, back to basics type debt management processes.

Underpricing of services

Very few municipalities' taxes and tariffs are appropriately structured

Many municipalities' taxes and tariffs are inappropriately structured. The principal problem is that few municipalities understand how their various activities and services are being funded, and therefore what the balance between taxes and tariffs needs to be to ensure financial sustainability. Other problems include:

- a failure to ensure that on average, service tariffs reflect the costs reasonably associated with rendering the service; i.e. that revenues and expenditures for the trading services breakeven
- limited use of inclining block tariffs, particularly for water and electricity, that show cross-subsidies between tariff groups explicitly
- overly generous rates rebates, exemptions and discounts, and a general movement towards the provision of free basic services (which is engendering a culture of dependency rather than adhering to the principle that everyone should make some payment for the municipal services they receive).

As noted in *Chapter 3 Intergovernmental relations and local government fiscal framework*, the principles for rates and tariff setting in legislation are sound. Application of these principles in practice is where the problem lies.

Underspending on repairs and maintenance

The most serious misalignment in municipal budgets probably involves the underfunding of repairs and maintenance

The most serious misalignment in municipal budgets probably involves the underfunding of repairs and maintenance. When a municipality experiences any kind of financial stress, invariably the first category of expenditure to be cut is repairs and maintenance. This is because the impact of not spending on this area is not visible and not obvious in the short term. It is also less politically sensitive than, say, cutting the capital expenditure programme, or reducing the entertainment budget. However, the medium to long term consequences of underspending on repairs and maintenance include:

- deteriorating reliability and quality of services
- move to more expensive crisis maintenance, rather than planned maintenance
- increasing the future cost of maintenance and refurbishment
- shortening the useful life of assets, necessitating earlier replacement

- increased distribution losses of water and electricity
- reduced revenues due to the failure to sell water and electricity, and other services
- Rising tariffs for consumers over the medium term.

Spending on non-priorities

Like national and provincial government, local government will have to redirect spending from non-core items and programmes to frontline services that have a direct impact on communities. The textbox below highlights some areas of municipal spending that needs to be curtailed.

Examples of non-priority spending

The following examples of non-priority expenditure have been observed:

- excessive sponsorships for music festivals, beauty pageants and sporting events, including buying tickets to events for councillors and officials
- public relations projects and activities that are not centred on actual service delivery, for instance celebrations, commemorations, voter education and advertising
- excessive catering for meetings and other events, including the use of public funds to buy liquor
- arranging workshops and events in expensive venues, especially ones outside the municipality
- excessively luxurious office accommodation and office furnishings
- foreign travel by mayors, councillors and officials (especially so-called study tours)
- excessive councillor and staff perks – mayors' cars and houses, cell-phone and telephone allowances, travel and subsistence allowances
- all donations to individuals that are not made in terms of the municipality's indigent policy or a bursary scheme
- costs associated with long-standing staff suspensions and the legal costs associated with not following due process when dismissing staff, as well as the payment of severance packages
- the use of consultants to perform routine management tasks.

The cumulative effect of non-priority expenditures should not be under-estimated. International experience with government cost-saving initiatives indicates that savings of as high as 15 per cent can be realised over time. This suggests that by eliminating non-priority spending, municipalities on aggregate could have saved up to R27 billion on their 2009/10 budgets. This is more than the total equitable share for local government in that year.

Conclusion

Generally, municipal revenues and expenditures have grown quite rapidly over the review period. Capital spending grew very strongly until 2009/10, but spending over the medium term shows little growth.

However, the disparities in per capita expenditure levels between municipalities are still very large. This highlights the importance of national government transfers to local government, particularly to the poorer municipalities. However, it also highlights the need for municipalities to price their services appropriately, so as to ensure they are able to fund their services on a sustainable basis. The importance of getting the basics right with regard to revenue management, debt management and budgeting for repairs and maintenance cannot be over emphasised. Lastly, preventing spending on non-priorities could save municipalities a vast amount, which would be available for improving and extending basic services.