LOCAL GOVERNMENT

BULLETIN

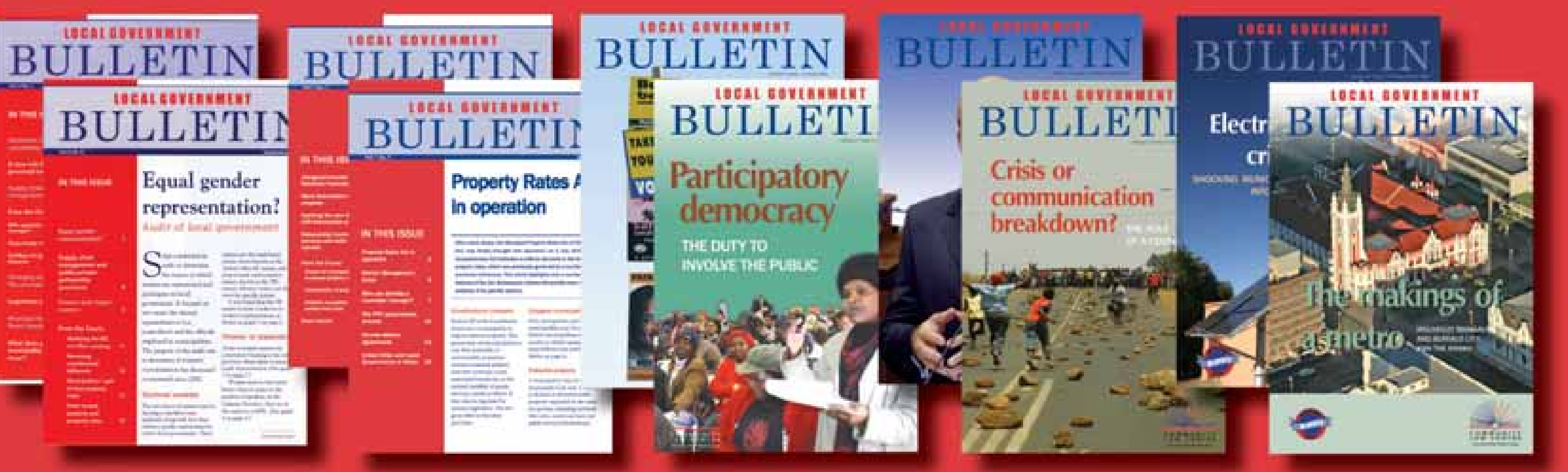
Volume 11 • Issue 3• August 2009

Local Government 10 years Bulletin

research advocacy education human rights democracy

COMMUNITY LAW CENTRE

1999-2008



COPING WITH Crunch time

WHAT THE RECESSION MEANS FOR LOCAL GOVERNMENT

Municipalities have already passed their budgets for the 2009/10 municipal financial year, and are beginning to finalise financial statements for 2008/09. Both of these processes are driving home to managers and councillors the impact of the global economic crisis on their own operations.

According to the International Monetary Fund, 'the global economy is in a severe recession inflicted by a massive financial crisis and an acute loss of confidence. … [W]orld output is projected to decline by 1.3 percent in 2009 and to recover only gradually in 2010, growing by 1.9 percent.'

South Africa has not escaped the effects of the global recession. The direct effects of the crisis have been felt predominantly in the financial sector, facilitated by our strong integration into the global financial system. For example, the average stock index in South Africa fell by 23%, while stocks in the US, England and Japan fell by 12% to 19%. There have been other less direct but more tangible effects as well. Since the last quarter of 2008 our economy has been in decline, export earnings have fallen and jobs have been lost. The demand for mining products reduced overnight and manufacturing activity has declined significantly. Job losses are expected to be high in these sectors. Manufacturing alone accounts for 16% of gross domestic product (GDP) and employs 14% of workers. These job losses will have a negative impact on the demand for goods and services. Banks are experiencing a huge increase in bad debts resulting from massive lending prior to the introduction of the National Credit Act and the effect of the credit crunch. They are now unwilling to grant new loans. South Africa is also facing a recession in gross domestic fixed investment, judged by the decline in the number of building plans passed. Stats SA data showed that the real value of recorded building plans passed by larger municipalities (at constant prices) from January to September 2008 decreased by 14.9%, or R5.4 billion, compared with the same period for 2007.

Many analysts think that the economy will continue to shrink for the rest of 2009. This means that job losses are likely to continue and salary increases will probably be smaller than anticipated, while food prices stay high, despite the decline in fuel prices. House prices are also likely to continue to decline.

However, some analysts also detect positive signs in the economy. Interest rates have come down and, some predict, will fall by a further 1% to 1.5% by the end of 2009. This is helping not only households and businesses, but also the government, as it pays less interest on its domestic debt. Inflation is expected to return to the Reserve Bank's target band of between 3% and 6%, which should reduce the need for price increases. The 2010 soccer world cup will result in an influx of tourists and foreign capital, and the government's ongoing infrastructure investment programme will continue to support GDP, particularly in the local construction industry.

Impacts on municipalities

Despite these 'green shoots', municipalities have not been immune to the trends. Households are under severe financial strain, with breadwinners losing their jobs and many families forced to cut back their expenditures to make ends meet. Businesses face similar pressures, with declining demand for their goods and services forcing production cutbacks. Many families and some businesses are thus also struggling to pay their municipal accounts. Third-quarter financial results for municipalities released recently by the National Treasury confirm that, as at March 2009, debt owed to municipalities has increased by 13.8% year on year (or R3.7 billion) in the metros and 12.5% (or R1.2 billion) in secondary cities. Total outstanding debt in these 27 municipalities alone now amounts to R41 billion. Most of this debt is more than 90 days overdue: in other words, it should have been paid in 2008.

So far the actual revenues of municipalities have kept pace with both budget projections and municipal expenditures. However, it is likely that the situation has continued to deteriorate after March. This means that municipalities may increasingly face cash flow problems as their income declines while expenditures proceed. Already, some signs of weakening cash flow are evident, particularly in non-metropolitan provinces. The Treasury's municipal creditor age analysis (the time it takes for a municipality to pay its own bills to suppliers) shows that Mpumalanga has the highest percentage of creditors outstanding for more than 90 days, at 64.5%, followed by the Northern Cape at 42.5%. Percentages for the Eastern Cape, Free State and North West range from 20% to 30%.

Where will the shoe pinch?

Households, and particularly poor households, are likely to feel the pinch of the recession the hardest. Four out of ten South

Africans exist on less than R3 000 per annum. For a quarter of households, the main source of income is the state. Unemployment is hovering at around 25%. Among young black South Africans the problem is particularly acute. Despite service delivery successes, a significant proportion of households still do not have access to a formal house with running water and electricity. And now, as tax revenues decline, the government may have to reconsider the speed at which it can achieve its goals of universal access to basic services.

Households are likely to feel the impacts in very different ways, depending on their location, employment status, expenses and adaption strategies. Urban dwellers will be more exposed to the crisis than those in rural areas due to their stronger linkages with internal and external markets, and some poor households may be cushioned by their lack of substantial relations with the markets. Job losses may result in a slowing or reversal of urbanisation trends, and a reduction in the transfer of money from urban to rural areas. At the same time, lower prices for non-food-related goods and services may assist urban residents in particular.

Like households, municipalities are likely to feel the effects of the recession in different ways, depending on both the economic and social characteristics of their area and their current financial status. Those municipalities whose local economies are exposed to foreign trade, such as through mining (excluding gold), petrol, steel, motor vehicle manufacturing and electronics, are likely to feel the pinch first. The effects will also reach those local economies linked to but not heavily dependent on foreign trade, as consumption of, investment in and demand for intermediate goods all decline. These include construction, electricity production, hotels and restaurants, transport services, communications and real estate. Local economies based on gold, agriculture, food production, textiles, footwear and water are likely to be less effected by declines in foreign trade. But similarly, those municipalities that have not managed their financial positions effectively in the past are likely to find their deepest weaknesses exposed as the impacts of the recession reach their local areas. Most directly, municipal revenues, expenditures and debt profiles are all likely to feel the consequences of the recession.

Depending on where municipalities fall in this broad categorisation, their revenues are likely to come under pressure from rising job losses that reduce the ability of consumers to pay for services. Already, data shows an increase in consumer debtors. Although many households will not be able to reduce their consumption (and thus the cost) of services such as water and electricity, some businesses will do so, further eroding municipal revenues.

Other revenue sources are likely to come under pressure too. Interest received on municipal bank balances has already plunged in response to falling interest rates, harming those municipalities with large investment portfolios. The collapse of the property market is not only likely to bring reductions in fees from property developers and planning applications, but will probably also undermine the accuracy of recent property valuations on which municipal rates are based. In particular, if

the decline in house prices continues and is felt differentially across different segments of the property market, this will lead to an unfair distribution of the rates burden among property owners.

Municipalities will find it difficult to respond to declining revenues by merely hiking tariffs and rates. Household budgets are already under stress, and large rate increases are likely to result in higher levels of non-payment and increased bad debts.

Similarly, applying firm credit control measures is likely to be politically challenging. Already, proposals have been made that for the duration of the current economic crisis there should be no cut-offs of water and basic services due to debt or if the households concerned are affected directly by the consequences of the crisis. It has been argued that firms in distress should also be spared and not face cut-offs for at least six months while attempts are made to save jobs.

To some extent, the decline in municipal own revenue will continue to be offset by ongoing increases in grant funding from national government. However, already the pace of increases in the local government share of national revenues has slowed (after a prolonged period of rapid growth). National grants to municipalities will climb just 7.7%, compared to 10% for national and provincial government. This reflects the limitations faced by national government, which faces other large revenue and expenditure pressures. Should national revenues underperform, even in the context of current expectations, there is a very real possibility that transfers may actually decline. In April 2009, for example, year-on-year growth in government revenue was heavily negative at –10.6%, while, conversely, growth in government expenditure soared to 50.2%! Increasingly, municipalities will need to demonstrate the higher relative returns of their expenditures in comparison with those of other spheres, as well as strong spending capacity, if they are to motivate for revenue shortfalls to be made up by national transfers.

As revenues come under pressure, municipalities will need to review their expenditure priorities. Rising consumer debt will require increased provision to be made for the non-payment of residents' accounts. This will reduce the resources available for other priorities. The growth in unemployment is likely to increase the number of households on municipal indigent registers and cause a spike in subsidy applications.

Municipalities will need to carefully balance these forms of relief to households with the longer-term strategic priorities of their areas. Infrastructure networks in particular came under considerable pressure during the previous period of growth, leading to extensive road congestion and other service delivery failures. The maintenance and rehabilitation of infrastructure have historically been ignored by municipalities, and the risk remains that they will continue to be ignored as resources are pushed elsewhere.

New infrastructure to support future economic growth also remains a priority. Although demand may well be reduced now, it is likely to return as the recession ends. Large infrastructure projects have long lead times before networks are installed and available for use. Delayed implementation now can lead to delays in the positive effects of an economic recovery being felt in a municipal area. Similarly, careless human resource policies that result in a freeze in employment can undermine the ability of a municipality to respond to both recession and recovery.

As revenues shrink, the management of these competing expenditure priorities will be a difficult challenge for all municipalities. Failure to develop realistic plans and budgets for both recession and recovery will result in de facto choices being made. Continuing to provide unaffordable levels of service, for example, will lead to an implicit rationing of access between households, as those in the front of the queue are serviced first and others not at all.

There have been some immediate effects of the recession on the ability of municipalities to borrow in order to finance their capital programmes. In particular, banks have been cautious about issuing new loans, and when they have done so this has typically been at higher rates than would have been obtainable before the crisis began. This means that municipalities will have to direct more of their resources to servicing loans, as opposed to building infrastructure. Similarly, the length of loans is likely to be reduced, meaning that municipalities will have to pay back their debts faster than would have otherwise been the case. Again, this reduces the resources available for infrastructure investment.

What can municipalities do?

Despite the grim global picture, South Africa is currently better off than many other countries. The current state of the global economy presents us with an opportunity to transform and restructure our economy so that we can take full advantage when the tide turns. The well-timed infrastructure investment programme of national government is intended to contribute to this, particularly through helping to generate income for individuals and households in difficulty while laying the foundations for a resumption in growth.

But, unlike the national fiscus, individual municipalities have little if any capacity to try to address the economic crisis head-on. Indeed, national government explicitly prevents municipalities from trying to borrow money to fund their operating expenditures. However, national government has attempted to significantly boost the infrastructure spending of municipalities through providing grants, in part to insulate them from the full impact of the reduction in their own revenues. Municipalities need to ensure that their financial position remains sustainable over the medium term, even in the face of the current economic crisis.

Municipalities themselves will need to take some very tough decisions in the coming year. The National Treasury has already requested them to give priority to managing all revenue streams, especially debtors; protecting the poor from the worst impacts of the economic downturn; supporting meaningful local economic development initiatives; securing the health of their revenue-generating asset base by increasing spending on repairs and maintenance; and expediting spending on capital projects that are funded by conditional grants. The latter is particularly important, as national government has announced a significant step-up in spending on the Expanded Public Works Programme, which is partly implemented by local government. This is a critical measure necessary to protect poor households from the crisis.

But municipalities must also focus on ensuring that they obtain value for money in their expenditures. This means not only seeking better, smarter partnerships with the public and private sectors to improve service delivery, but also real efforts to reduce leakage through fraud, corruption and wasteful or unnecessary expenditure. The former Minister of Finance, in his budget speech in February this year, highlighted the insufficient control of foreign travel, advertising and public relations activities, as well as the use of consultancy services. The new Minister has also made it clear that fraud and corruption can no longer be tolerated

Finally, SALGA has noted the critical role municipalities have to play in identifying the local impacts of the recession and communicating to residents about them, to explain how municipal strategies are addressing the crisis and positioning the municipal area for the future.

David Savage is a specialist in municipal finance and local service delivery and serves as a national appointee on the Financial and Fiscal Commission