The state of municipal budgets

Intergovernmental Fiscal Review for 2003

The Minister of Finance released the 2003 Intergovernmental Fiscal Review on 8 April. It provides a wealth of information on municipal budgets for the 2002/03 financial year.

These were the first consolidated and integrated budgets since the establishment of the new municipalities. The Review provides an important picture of trends in municipal expenditure and revenue as well as the place and role of local government in the overall government of the country.

Overall budgets

Municipal budgets for 2002/03, including capital and operating budgets, total an estimated R74.5 billion, an increase of 15.7% over the previous year. In comparison, the overall 2002/03 provincial budgets were R147.5 billion and the national budget was R99 billion (excluding debt repayment). The significant difference between local government and provincial budgets is attributable to provinces dependency on national grants for 96% of their activities while local government receives only 17% of its revenue from national and provincial governments.

Metros

The six metropolitan municipalities' combined 2002/03 budgets of R46.7 billion represent 62.7% of all municipal budgets. Their budgets are as follows:

Johannesburg	R11.0 billion
Cape Town	R9.8 billion
eThekwini (Durban)	R9.3 billion
Ekurhuleni (East Rand)	R8.1 billion
Tshwane (Pretoria)	R6.1 billion
Nelson Mandela (Port Elizabeth)	R2.4 billion

The size of these budgets becomes evident when compared with the 2002/03 provincial budgets:

KwaZulu-Natal	R28.9 billion
Eastern Cape	R24.6 billion
Gauteng	R24.3 billion
Limpopo	R19.1 billion
Western Cape	R14.9 billion
North West	R11.5 billion
Free State	R10.4 billion
Mpumalanga	R10.0 billion
Northern Cape	R 3.4 billion

The budgets of the large metros are thus equal to, or larger than, those of the smaller provinces. The combined budgets of the three metros in Gauteng are larger than that province's budget.

Local municipalities

The local municipalities are responsible for around R22.3 billion or 30% of the total local government budget. The largest local municipality budgets are the following:

Buffalo City (East London)	R1.3 billion
Mangaung (Bloemfontein)	R1.3 billion
Msunduzi (Pietermaritzburg)	R1.1 billion
Polokwane	R718 million
Rustenburg	R699 million
UMhlathuze (Richards Bay)	R616 million

District municipalities

District municipalities' budgets are difficult to compare because in many cases the bulk of their operating budgets consists of transfers of national grants to local municipalities. With actual spending budgets of R3.2 billion, districts are responsible for 4% of total local government budgets. Shifts in water and sanitation, refuse-removal and health services between local and district municipalities from 1 July 2003 (see *LG Bulletin* 2003, 5:1) mean the 2003/04 budgets will be affected significantly.

Expenditure

Operating expenditures consume the bulk of the budgets (82.4%) with the remaining 17.6% devoted to capital budgets.

Salaries

Salaries of the 210 000 employees use the largest share (32.2%) of the operating budgets. If the purchase of bulk water and electricity is deducted, the percentage is around 45%. Expenditure on salaries has increased rapidly over the last two years – by 15.2% in 2000/01, 12.6% in 2001/02 and 10.6% for 2003, although the number of employees has not increased. The Review suggests this is probably due to the costs of amalgamation, which pushed wages and salaries up to the highest levels without improvements in productivity or expansion in service delivery. It comments that the share of operating budgets allocated to personnel spending is of concern and needs intensive scrutiny and more transparency.

Revenue

Municipalities raise the bulk of their revenue overall. However, there has been a sharp increase in national transfers over the past two years and it is estimated that they now comprise 17% of local government revenue. Some municipalities collect 95% of their own revenue while poorer ones rely on transfers for up to 60% of their revenue. For capital expenditure budgets of R13.1 billion, 39% of the revenue will come from national and provincial transfers. Operating income budgets (82.4% of the total), are based on the following revenue sources:

1. User charges (mainly electricity and water): R28.0 billion (45.5%)
2. Rates: R12.5 billion (20.3%)
3. Other (tariffs, fines, subsidies): R10.0 billion (16.2%)
4. Intergovernmental grants: R6.7 billion (10.8%)
5. RSC levies: R4.4 billion (7.2%)

Rates and user fees

The Review argues that increases in rates and user charges over the last year (8.6% and 12%) fuel inflation and have dampened economic growth and local sustainability. It notes that user fees charged for trading services generate surpluses that are used to fund or subsidise other municipal activities. It points out that municipalities have accumulated R24.3 billion in unpaid consumer bills, which increases by about R1.8 billion per year. The bulk (63.5%) is owed to the metros. It notes that many municipalities budgeted for 100% payment on all billings, which is over-optimistic about poor households' ability to pay for basic services. To improve their revenue, municipalities need to reduce technical and other losses in their water and electricity distribution functions.

key points

- Municipal budgets for 2002/03 total R74.5 billion, representing approximately 23% of overall government spending.
- The six metros are responsible for nearly 63% of all municipal budgets.
- Local municipalities are responsible for 30% of total municipal budgets.
- The actual spending budgets of district municipalities are 4% of all municipal budgets.
- Salaries take up the largest share of municipal budgets – 32% of operating expenditure.
- National and provincial transfers comprise 17% of local government revenue.

Intergovernmental transfers

Intergovernmental transfers have increased significantly over the past four years, doubling to R8.8 billion in 2002/03. Transfers in the 2003/04 national budget amount to R12 billion. This trend is projected to continue over the next three years. The strongest growth will be in the equitable share of local government. This is set to increase from R3.9 billion in 2002/03 to R7.7 billion in 2005/06. Equally important, the portion of the equitable share will be 53% of all transfers, reflecting the move towards greater discretion for local government.

Borrowing

The Review notes that the municipal borrowing market has remained stagnant since 1994. The total outstanding was R20.2 billion at the end of 2002. The main public sector lender is the Development Bank of South Africa, with credit of R7 billion. Commercial banks and the Infrastructure Finance Corporation are the main lenders of the remaining R12 billion. Metros do the bulk of borrowing (93%).

The Review argues there is a strong economic reason for financing capital expenditure through long-term borrowing, as a large portion of municipal infrastructure can generate income. Financing expensive and bulky assets can then be spread over the life of the asset. As the benefits of such assets straddle generations, the financial burden should too. The Review further outlines the steps the government has taken to reduce uncertainties that inhibited the growth of a strong municipal borrowing market, such as constitutional amendments and finalising the Municipal Finance Management Bill.

Audits

A critical problem is the failure of numerous municipalities to submit their financial statements to the Auditor-General on time and the high number of qualified opinions expressed by the Auditor-General. The Review questions whether provincial governments and legislatures are performing their oversight function, as it is not clear what action is taken when municipalities fail to meet the deadline or fail to take corrective steps after receiving a qualified opinion from the Auditor-General.

Future budgets

The imminent restructuring of electricity distribution will change the budgets of municipalities significantly. As electricity comprises around 33% of their budgets, the restructuring will cut budgets accordingly. A possible outcome is that municipalities may shift R20 billion of their budgets, at least 25 000 personnel and a substantial portion of their liabilities, to the regional electricity distributors.

Review of local government fiscal system

The Review states that the national Government intends to undertake a comprehensive review of the local government fiscal system. This is prompted by the restructuring of the electricity sector, the finalisation of functions between districts and local municipalities and the census results of 2001. Such a review will include proposals for the future of RSC levies and new formulae for national grants to municipalities.

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