PARLIAMENT
OF THE REPUBLIC OF SOUTH AFRICA

Fiscal Brief – June 2023

2022/23 Financial Year Analysis

Parliamentary Budget Office

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Executive Summary

The Auditor General South Africa's (AGSA) 2021/22 PFMA report notes that there have been improvements to both financial and performance outcomes in the fourth year of the sixth administration. Between the 2020/21 and 2021/22, out of the 424 auditees that underwent assessment, the overall outcomes of 65 audits improved, 318 audits remained unchanged, and 41 audits regressed. The AGSA further noted that, between the 2020/21 and 2021/22 financial years, of the 160 (157 in 2020/21) departments considered, the financial health status of 47 (21 in 2020/21) of the departments has improved, 101 (118 in 2020/21) departments remain unchanged and 12 (13 in 2020/21) departments had regressed. AGSA noted that non-compliance with laws and regulations remains a significant concern for oversight. Also, that departments were unable to operate within their budgets, which resulted in unauthorised expenditure, deficits, cash shortfalls and bank overdrafts.

In terms of revenue collection, the 2022/23 revenue collection was R2 067.8 billion compared to R1 884.9 billion in the previous year. The net revenue collection (the gross tax revenue after refunds) was R1 686.7 billion by the end of March 2023 compared to R1 563.8 billion over the same period in the previous financial year. Revenue collection during the 2022/23 financial year was resilience and buoyancy despite economic headwinds such as load shedding. SARS attributes this achievement to continued focus on compliance related activities.

The consolidated government budget expenditure for 2022/23 was revised upwards from R1 965.3 trillion to R2 004.0 billion (30.2% as a share of GDP) compared to R1 895.9 billion (30.3% as a share of GDP) in the previous financial year. The analysis shows that numerous departments (37 departments) struggled to spend all of their allocated budgets by the end of March 2023 despite the needs of importance of services they are mandated to provide to citizens.

Provinces generally spent close to 100 per cent of their budgets by the end of March 2023. However, North West and Gauteng spent just below 97 per cent of their budgets. They are unbudgeted expenditures which may negatively impacts the funding available to provide services. For instance, Claims against the state are still high and in some cases are not provided for.

The number of municipalities in financial distress has risen from 86 in 2013/14 to 175 in 2019/20, and 123 municipalities passed unfunded budgets in 2019/2020. In terms of the 2021/22 MFMA report, only 15 per cent (16% in 2020/21[1]) of South Africa's 257 municipalities have been given a clean audit by the auditor general for the 2021/22 financial year, with the overall standard of financial management having regressed in the past five years[2]. At the 2021/22 year-end, the balance of irregular expenditure that had accumulated over many years and had not been dealt with totalled R136 billion, while unauthorised expenditure stood at R107,38 billion, and fruitless and wasteful expenditure amounted to R14,65 billion.

Concerns over municipal debt owed to Eskom has increased over the last couple of years. In 2014/15, municipalities owed Eskom R4 billion. By May 2018, the total debt owed by municipalities stood at over R13 billion, with the top ten indebted municipalities owing close to R10 billion to Eskom. As of December 2022, municipalities owed Eskom R56.3 billion. In response to the municipal debt to Eskom, the National Treasury introduced a Municipal Debt Relief package, MFMA Circular No. 124. According to the Circular, the package includes 14 conditions for municipalities, relating to sustainable finances, and operational and technical best practices. This relief is – at a high level – a positive development in helping highly indebted municipalities. However, the current debt relief plan does not sufficiently consider the challenges that municipalities are facing.

1. PURPOSE

This fiscal brief aims to provide Members of Parliament (MPs) with the outcomes of t the 2022 national, provincial and municipal budgets. This brief draws on information from the Public Finance Management Act (PFMA) section 32 report for national and provincial departments released on 28 April 2023. Data on municipalities is drawn from Municipal Finance Management Act (MFMA) section 71 quarter three report released on 13 March 2023. The section 32 reports provide preliminary results as at the end of the 2022/23 financial year while the section 71

[1] AGSA, 2022. 2020/21 local government audit outcomes
[2] AGSA, 2023. 2021/22 local government audit outcomes

reports provide data for the first two quarters of the 2022/23 municipal financial year.

2. CONSOLIDATED NATIONAL AND PROVINCIAL FINANCIAL HEALTH STATUS

This section of the brief highlights some of the findings of the Auditor General South Africa (AGSA) outcomes for the 2021/22 financial year. The data provides context to the financial state of departments as at the start of the 2022/23 financial year. Financial and performance audits are critically for oversight and for tracking service delivery. The 2021/22 AGSA report acknowledges that there have been improvements to both financial and performance outcomes in the fourth year of the current administration. Between the 2020/21 and 2021/22, out of the 424 auditees that underwent assessment, the overall outcomes of 65 audits improved, 318 audits remained unchanged, and 41 audits regressed.

The AGSA report noted that the audit outcomes for the key service delivery departments (basic education, health, human settlements, public works, transport, and water and sanitation sectors) were consistently worse than those of other departments. Auditees from these groups account for 58 per cent of the outstanding audits and 31 per cent of the modified audit opinions (qualified, adverse, and disclaimed). When considering the financial health of auditees – this includes indicators such as deficit, and inability to pay creditors and/or paying, an inability to recover debt, or dipping into the next year's budget to cover the current year's expenses - the AGSA concluded that only 30 per cent of the budget was managed by auditees in good financial health. Between the 2020/21 and 2021/22 financial years, of the 160 (157 in 2020/21) departments considered, the financial health status of 47 (21 in 2020/21) of the departments has improved, 101 (118 in 2020/21) departments remain unchanged and 12 (13 in 2020/21) departments had regressed.

Table 1 shows that in 2021/22, unauthorised expenditure was slightly lower at R2.29 billion in 2021/22 compared to R3.21 billion in 2020/21. The AGSA attributed unauthorised expenditure to departments overspending on their budgets. Budget cuts and reprioritisation, along with emergency spending resulted in reduced budgets for operational expenditure for a number of departments. Expenditure by departments exceeded their revenue by R104.69 billion in 2021/22, an increase from R41.74 billion in the previous year. This increase is a worrying and an ongoing concern. More than half (57.7%) of departments had insufficient funds to settle all their liabilities at the end of the 2021/22 financial year. The shortfall means that these departments started the 2022/23 financial year with part of their budget effectively pre-spent. Departments had already spent more than 10 per cent (R29.38 billion) of their 2022/23 operating budgets, excluding employee costs and transfers. These preliminary charges against the 2022/23 budgets have adverse implications for the amounts available for service delivery in 2022/23.

Table 1: Financial health indicators for national and provincial departments, 2021/22

Indicator	2020/21	2021/22
Overspending of budget (unauthorised expenditure)	R3.21 billion	R2.29 billion
Number of department with overspending of budget	10% (15)	9% (14)
Deficit (expenditure exceeded revenue)	R41.74 billion	R104.69 billion
Number of departments with deficit	32% (50)	33.1% (53)
Cash shortfall (bank overdraft less prepaid expenses/advances plus money to be surrendered to treasury)	R33.29 billion	R32.43 billion
Number of departments with cash shortfall	61% (89)	57.5% (92)
>10% of following year's budget (excluding employee cost and transfers) will fund the current year's shortfall	18% (27)	16% (24)
Bank in overdraft	19% (30)	-
Debt Collection period >90 days	22% (35)	28% (44)
More than 10% of debt irrecoverable	21% (33)	23% (37)
Estimated settlement value of claims against the state at year-end	R166.07 billion	R153.64 billion
Number of departments with unsettled claims	94% (138)	-
Claims settlement value >10% of following year's budget (excluding employee cost and transfers)	37% (55)	40% (60)

Source: AGSA, 2022 & 2023

The legal claims settlements against the state remain substantively high. Departments paid out R153.64 billion in claims in 2021/22 and the provincial health departments accounted for the largest portion of this amount (67%). Amendments have been proposed to the State Liability Bill, but these mainly focus on medico-legal claims. The amendments proposed are intended to help government realise the MTSF target to reduce the contingent liability of medico-legal cases by 80 per cent (< R18 billion) in 2024. However, continued efforts are required to remedy the root causes of litigations against the state in the other sectors (for example police and home affairs). Claims against the state negatively impact funding available for departments to cover their operational costs.

Irregular expenditure by provincial and national departments in the 2021/22 financial year amounted to R51.22 billion was less than the R136,67 billion disclosed in the previous year. However, it remains a concern that 25 per cent of the auditees did not report all irregular expenditure that should have been reported in their financial statements. Compliance with laws and regulations also remains a significant concern for oversight. The 2021/22 audit by the AGSA shows that departments were unable to operate within their budgets, which resulted in unauthorised expenditure, deficits, cash shortfalls and bank overdrafts. This context is crucial for our understanding of the preliminary outcomes of expenditure and revenue in the 2022/23 financial year analysis.

3. NATIONAL GOVERNMENT

The national government provides services in terms of Central Government Administration; Justice & Protection Services; Financial & Administration Services; Economic Services & Infrastructure Development; and Social Services. This section provides an analysis of the preliminary expenditure and revenue outcomes against the budget at the national level for 2022/23. This analysis is based on expenditure by national vote.

The South African Revenue Service (SARS) released its preliminary revenue outcomes R2 067.8 billion for 2022/23 in April 2023. This was higher than the previous year's audited outcome of to R1 884.9 billion. Revenue collection during the 2022/23 financial year was resilience and buoyancy as the economy continued to recover from Covid-19 pandemic. However, the pace of economic recovery from the COVID-19 pandemic was disrupted in 2022 by the effects of the devastating floods in KwaZulu-Natal and the Eastern Cape, ongoing war in Ukraine, logistical bottlenecks in the freight industry and persistent electricity supply constraints.

3.1. Revenue Overview

Table 2: Tax revenue collection against budget, April 2022– March 2023

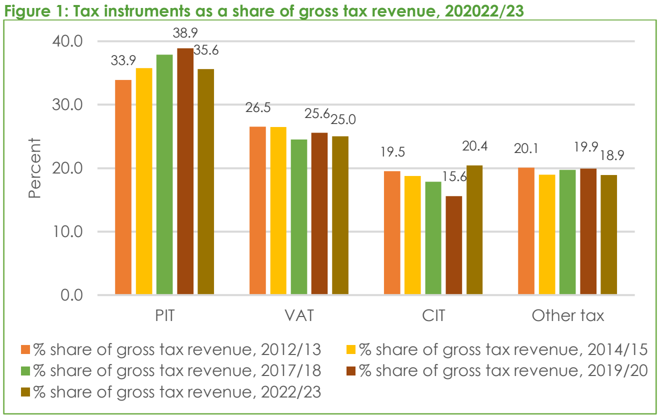
	2022 BR Estimates		2022 Revised estimates		Actual collection as a % of targeted: Apr-Mar 23		Actual collection as a % of targeted: Apr-Mar 22	
R million	**R billion**	**Y-on-Y % change**	**R billion**	**Y-on-Y % change**	**R billion**	**Y-on-Y % change**	**R billion**	**Y-on-Y % change**
Personal Income Tax	587 907	13.9	601 649	11.0	600 367	8.4	553 951	13.7
Value Added Tax	439 681	18.8	426 283	14.1	422 416	8.1	390 847	18.0
Corporate Income Tax	269 931	26.6	344 944	19.5	344 660	7.6	320 447	58.5
Fuel Levy	89 113	7.2	79 131	-11.7	80 473	-9.5	88 884	17.7
Dividend tax	30 325	80.1	38 423	28.7	38 012	14.1	33 308	34.1
Custom Duties	62 505	15.8	76 535	37.3	76 068	27.0	59 913	26.7
Specific Excise Duties	51 864	18.6	55 228	30.6	55 155	11.3	49 567	53.6
Skills Dev Levy	20 619	15.8	21 238	12.2	20 893	8.1	19 336	57.8
Ad-valorem	4 406	24.6	4 461	1.0	5 521	16.8	4 725	39.5
Other	42 097	-12.0	44 283	10.2	43 132	0.8	42 779	26.4
Gross Tax Revenue	**1 598 448**	**17.1**	**1 692 177**	**13.9**	**1 686 697**	**7.9**	**1 563 757**	**25.1**

Source: section 32 reports

During the 2022 MTBPS (Oct 2022), gross tax revenue collection for 2022/23 was revised upwards by R93.7 billion from the R1 598.5 billion budget estimates to R1 692.2 billion. By the end of March 2023, R1 689.7 billion had been collected, representing a 7.9 per cent (R122.9 billion) increase compared to the same period in 2022. SARS attributes this achievement to continued focus on compliance related activities in the midst of economic challenges affecting tax revenue performance. It must also be noted that the tax collection was from the lower base of 2020/21. Corporate income tax contributed to 84.7 per cent (R74.7 billion) of the higher than expected tax collection. Year-on-year, custom duties (27% or R76.1 billion) was the tax instrument with the highest collection rate followed by Ad-valorem (16.8% or R5.5 billion) and Dividends Tax (14.1% or R38 billion).

In contrast, the general fuel levy collection was 9.7 per cent (R8.6 billion) less than the target in the budget 2022 or 9.5 per cent (R8.4) less compared to the same period a year ago. This performance can be attributed to the reduction in the general fuel levy that was implemented from April 2022. The levy was reduced to provide short-term relief to households from rising fuel prices as a result of the Russian/Ukraine conflict. The fuel levy was reduced by R1.50 per litre from 6 April to 6 July 2022. The levy reduction was extended to 2 August 2022 but was revised to R0.75 per litre.

Figure 1: Tax instruments as a share of gross tax revenue, 202022/23



Source: section 32 reports, 2012 - 2023

Figure 1 shows the shift in the composition of the tax base between 2012/13 to 2022/23. The increase in gross tax revenue collection was driven by an increased contribution from PIT in 2017/18, which compensated for the declining CIT and VAT contributions. In contrast, the CIT's contribution to gross tax revenue receded significantly from 22.5 per cent in 2009/10 to 16.4 per cent a decade later in 2020/21 before recovering to breach 20 per cent in 2021/22. PIT remains the largest contributor (35.6%) followed by VAT (25%) and CIT (20.4%). These three instruments contribute more than 80 per cent of gross tax revenue.

Gross tax revenue as a share of the Gross Domestic Product (GDP) increased from 22.3 per cent in 2020/21 to 25.4 per cent in 2022/23. The PIT, VAT and CIT combined was 20.6 per cent of GDP. Following a 2 per cent increase in GDP in 2022, the tax revenue collection was higher than targets, particularly CIT which was boosted by the commodities boom and corporate earnings more broadly. These developments resulted in buoyant tax revenue collections (the percentage change in revenue associated to a one percent change in GDP) for much of the reporting period.

3.2. Expenditure Overview

In the 2022 adjustments budget, the consolidated budget expenditure for 2022/23 was revised upwards from R1 965.3 trillion to R2 004.0 billion (30.2% as a share of GDP) compared to R1 895.9 billion (30.3% as a share of GDP) in the previous financial year.

Table 3: Consolidated government expenditure, 2022/23

	R'000	Revised estimates	Actual Expenditure	% Spent
2022/23	Approrpiation by vote	1 104 035 660	1 087 441 608	98.5
	Direct charges against NRF	919 958 997	920 055 868	100.0
	National government projected underspending	-20 008 372	-	-
	Consolidated Expenditure	**2 003 986 285**	**2 007 497 476**	**100.2**
2021/22	Approrpiation by vote	1 028 457 408	1 013 244 492	98.5
	Direct charges against NRF	875 671 823	873 698 419	99.8
	National government projected underspending	-8 174 793	-	-
	Consolidated Expenditure	**1 895 954 438**	**1 886 942 911**	**99.5**

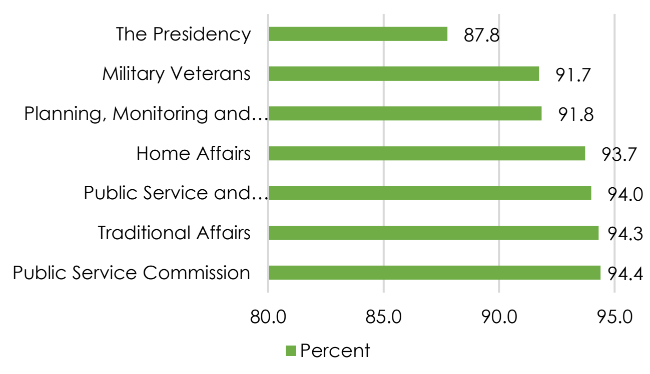
Source: section 32 reports

As shown in table 3, the aggregate actual expenditure for votes was R1 087.4 billion (98.5% of the revised budget) or R16.6 billion in underspending by the end of March 2023. The Direct charges against the National Revenue Fund (NRF) were R920.1 billion (100% of the budget) by the end of March 2023 compared to

R873.7 billion (99.8% of the budget) in the previous financial year.

Figure 2 shows the seven national departments that had spent less than 95 per cent of their revised budget by the end of March 2023. These departments contributed R926.9 million to overall underspending by votes. Six out of the seven departments' budget allocations were less than R1 billion.

Figure 2: Departments that spent less than 95% of budget, 2022/23



Source: section 32 reports

Table 4 shows the departments with the largest contribution to the R16.6 billion unspent budget by the end of March 2023. The total underspending for the departments of social development, cooperative governance, and health, amongst others, was R13.1 billion. It remains concerning that some departments are unable to adequately spend their budgets given the societal needs for service delivery. These departments underspent their budgets amid the backdrop of the overburdened health system, high demand for social grants and more service delivery protests countrywide exacerbated by high costs of living. Conversely, the department of defence, (R2.5 billion or 4.8%), Statistics South Africa (R798.2 million or 26.6%) and Science and Innovation (R127.6 million or 1.4%) spent more than their budget allocations by the end of March 2023.

Table 4: Departments with largest contributors to unspent budget, 2022/23

Vote R'000	Revised estimates	% Spent	Underspending
Social Development	247 854 892	97.4	6 438 853
Cooperative Governance	115 027 438	96.0	4 613 103
Health	64 555 731	96.9	2 016 861
Water and Sanitation	18 555 010	95.4	856 626
Home Affairs	11 096 232	93.7	696 742
Human Settlements	33 478 474	98.2	615 334
Transport	95 134 237	99.4	591 525

Source: section 32 reports

Expenditure by economic classification at a national sphere shows that more than two-thirds (R752 billion or 68.1%) of the expenditure budget is allocated for transfers and subsidies followed by current payments (R267.6 billion or 24.2%). Payment for financial assets was relatively higher than usual due to special appropriations to the department of public enterprise for Eskom, South African Airways (SAA), and Denel. The department of National Treasury, Communications and Digital Technologies, and Transport received appropriation for South African Special Risk Insurance Association (SASRIA), South African Post Office (SAPO) and Transnet, respectively. The departments slightly improved on their capital expenditure outcome by spending 93.8 per cent by the end of March 2023 compared to 83.6 per cent in the previous financial year.

Table 5: Departments' expenditure by economic classification, 2022/23

Expenditure by economic classification R'000 (April - March 2023)			
Economic Classification	**Revised estimates**	**Actual Expenditure**	**% spent**
Current payments	267 619 302	262 765 250	98.2
Transfers and subsidies	751 959 648	742 934 016	98.8
Capital assets	16 869 269	15 829 578	93.8
Financial assets	67 587 441	65 912 764	97.5
TOTAL	**1 104 035 660**	**1 087 441 608**	**98.5**

Source: section 32 reports

3.3. National Government Analysis Summary

The 2022/23 financial year had a relatively low improvement in annual real GDP. GDP increased by 1.3 per cent in 2022 following a 4.9 per cent increase in 2020[3]. The economic activities are affected by the current ongoing energy crisis. Despite the unprecedented levels of power cuts, economic activities improved in some sectors, specifically in the finance, transport, storage and communication, personal services, trade, catering, and accommodation sectors. As a result, government's tax revenue collections have also increased.

However, numerous departments (37 departments) struggled to spend all of their allocated budgets by the end of March 2023 despite the importance of services they are mandated to provide to citizens. For instance, The Department of Social Development and Health combined spent R8.4 billion less than their annual budgets when social grants and primary health services are such critical needs to people.

4. PROVINCIAL GOVERNMENT

Provincial governments play an important role in the provisioning of basic education, health services, roads, housing, and social development. Provincial treasuries play an important role in implementing public financial management in a decentralised fiscal context as delegated by the Public Finance Management Act, 1 of 1999. Similar to the section on the national government, this section provides analysis of expenditure outcomes against the budget at a provincial level for 2022/23 financial year. Unlike the other spheres of government, provincial governments have very limited revenue raising capabilities.

4.1. Provincial receipts

About 97 per cent of the receipts of provincial governments are allocated from the NRF. Provincial government funding consists mainly of a provincial equitable share and conditional grants. The equitable share is determined by an equitable share formula which is updated every year with the relevant provincial socio-economic and demographic data. The formula has six components with education and health being the largest based on demand and the need for education and health services. The remaining four components enable provinces to perform their other functions, taking into consideration the

[3] Statistics South Africa, 2023. Gross Domestic Product (GDP), 4th Quarter 2022

population size of each province, the proportion of poor residents in each province, the level of economic activity and the costs associated with running a provincial administration.

Table 6 shows that provinces had collected 99.2 per cent of the budgeted receipts by the end of March 2023. In terms of own receipts, on aggregate, provinces had over collected by 9.2 per cent (R2.1 billion) of the 2022/23 R22.4 billion estimated budget.

Table 6: Provincial receipts, 2022/23

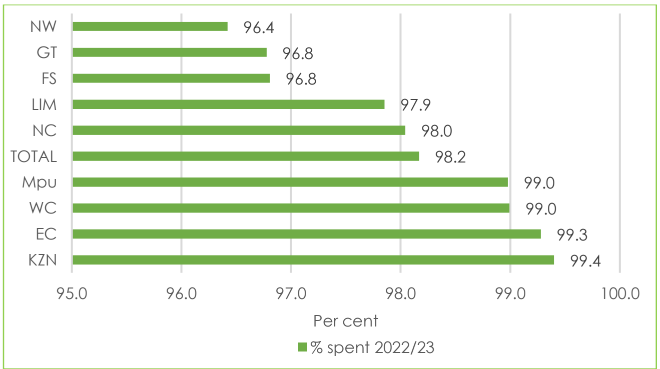
Actual against budget receipts R'000 - March 2023			
Receipts	**Adjusted Appropriaiton**	**Actual collection**	**%**
Equitable Share	570 868 206	567 688 874	99.4
Conditional Grants	123 270 726	121 219 019	98.3
Transfers from NRF	**694 138 932**	**688 907 893**	**99.2**
Tax Receipts	15 741 165	16 006 788	101.7
Sales of Goods and Services other than Capital Assets	3 609 489	3 182 769	88.2
Transfers Received	562 839	569 534	101.2
Fines, Penalties and Forfeits	296 682	281 060	94.7
Interest, Dividends and Rent on land	1 795 319	3 202 539	178.4
Sale of Capital Assets	62 826	158 293	252.0
Financial Transactions in Assets and Liabilities	324 871	1 049 485	323.0
Provincial Own Receipts	**22 393 191**	**24 450 468**	**109.2**
TOTAL: RECEIPTS	**716 532 123**	**713 358 361**	**99.6**

Source: section 32 reports

4.2. Provincial Expenditure

Figure 3 shows expenditure by province. Gauteng, which received the largest budget allocation, had spent 96.7 per cent of their budget by end of March 2023. Other provinces that had spent less than 98 per cent of their budgets were North West (96.4%), Free State (96.8%) and Limpopo (97.9%) over the same period.

Figure 3: Expenditure by province (%), March 2023



Source: section 32 reports

Table 7 shows total provincial expenditure by economic classification. On aggregate, provincial expenditure allocation for the 2022/23 financial year was R719.3 billion. Of the total budget, current payments consist of more than 81 per cent (R588.1 billion) of the budget followed by transfers and subsidies at 13.1 per cent (R94 billion). It is also worth noting that Compensation of Employees (COE) accounts for 73 per cent (R431.6 billion) of current payments or 60 per cent of the total provincial expenditure budget. This high proportion is an indication of the personnel heavily dependent services provided by provincial departments (i.e., health and education). Goods and services accounted for about 26 per cent (R156.4 billion) of the current payments budget and more than 21 per cent of the total provincial expenditure budget.

Table 7: Provincial expenditure by economic classification, 2022/23

Expenditure by economic classification R'000 (April - March 2023)			
Economic class	**Adjusted Budget**	**Actual expenditure**	**% YTD**
Current payments	**588 065 062**	**579 799 837**	**98.6**
COE	*431 604 234*	*428 822 004*	*99.4*
Goods and	*156 423 934*	*150 889 818*	*96.5*
Interest & rent on land	*36 893*	*88 016*	*238.6*
Transfers and subsidies	**93 971 686**	**91 670 026**	**97.6**
Capital assets	**37 224 131**	**34 481 516**	**92.6**
Financial assets	**16 817**	**141 745**	**842.9**
TOTAL	**719 277 696**	**706 093 124**	**98.2**

Source: section 32 reports

Provinces have on aggregate spent 98.6 per cent of their current expenditure budgets by end of March 2023. There was overspending on interest & rent on land as well as financial assets and liabilities. Interest & rent on land was driven by GP (R55.7 million), NW (R50.5 million) and WC (R17.8 million). It is a concern that NW budgeted R104 thousand for interest & rent on land whereas they spent significantly more (R50.5 million). Similarly, in GP and WC, R1.1 million and R7.5 million was budgeted, respectively, but they spent significantly more.

Allocations for provincial payments for capital assets were R37.2 billion for 2022/23 as shown in table 8. Provinces spent 92.6 per cent (R34.5 billion) of their budgets by the end of March 2023. More than 73 per cent (R27.2 billion) of the capital assets budget was allocated for building and other fixed structures. About a quarter (24.5% or R9.1 billion) was allocated for machinery and equipment.

Table 8: Overall provincial payment for capital assets, 2021/22

	Adjusted Appropriation	**Actual expenditure**	**% Spent**
Buildings and other fixed structures	27 242 636	25 469 574	93.5
Machinery and equipment	9 129 355	8 026 811	87.9
Land and sub-soil assets	550 609	754 399	137.0
Software and other intangible assets	281 919	215 304	76.4
Biological assets	9 912	11 009	111.1
Heritage assets	9 700	4 419	45.6
Payments for capital assets	**37 224 131**	**34 481 516**	**92.6**

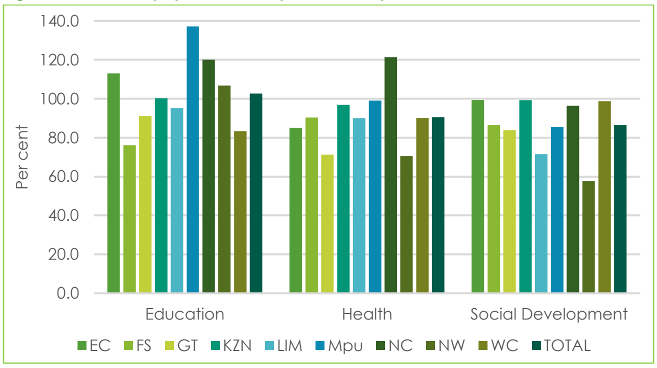
Source: section 32 reports

Overall payment for capital assets by sector shows that for education, provinces were spending almost all their estimated expenditure, except for the Free State (76.1%) and Western Cape (83.2%) that spent below 90 per cent of the budget. There was notable over expenditures in Mpumalanga (137.2%), Northern Cape (120.1%) and Eastern Cape (112.9%).

The health sector in Northern Cape (121.4%) overspent their capital budget. The social development sector in North West

(57.8%) and Limpopo (71.5%) struggled spending their budget while Eastern Cape (99.4%) and KwaZulu Natal (99.2%) spent almost all their capital budgets.

Figure 4: Provincial payments for capital assets by function, 2021/22



Source: section 32 reports

4.3. Provincial Government Analysis Summary

Provinces generally spent close to 100 per cent of their budgets by the end of March 2023. However, North West and Gauteng spent 96.4 per cent and 96.8 per cent respectively. They are unbudgeted expenditure which may negatively impacts the funding available to provide services. For instance, Claims against the state are still high and in some instances not provided for. Nonetheless, spending was overall on track with the budget.

5. LOCAL GOVERNMENT

The core services that local governments are to provide - clean drinking water, sanitation, electricity, shelter, waste removal and roads – these services are basic human rights, essential components of the right to dignity enshrined in our Constitution and Bill of Rights. As per the 1998 Local Government White Paper, municipalities render services at a charge to citizens to generate revenue. Unlike the national and provincial government sections above, this section on local government provides an update for the nine months of the 2022/23 financial year until end December 2022 for expenditure outcomes against the estimated budget at local government levels. The municipal budget starts from 1 July to 30 June of the following year. This section begins by outlining the financial health status of municipalities to contextualise our revenue and expenditure analysis.

5.1. Financial health status of municipalities as of July 2022

AGSA audits have continuously alerted government that local government finances continue to be under severe pressure, which has negative implications for service delivery. Local government finances remain under severe pressure due to non-payment by municipal debtors, poor budgeting practices, and ineffective financial management.

The main source of revenue for most municipalities is the rates and taxes paid by property owners and consumers of municipal services ('own revenue'). The problem with own revenue is that municipal consumers (including government institutions) are not paying what they owe – this has been a trend for many years and has been made even worse by the economic downturn caused by the covid-19 pandemic. This means that while a municipality's revenue might look healthy on paper, the money does not reach the bank.

The number of municipalities in financial distress has risen from 86 in 2013/14 to 175 in 2019/20, and 123 municipalities passed unfunded budgets in 2019/2020. The PBO is concerned about the dipping into future budgets to address current and emerging needs. Only 15 per cent (16% in 2020/21[4]) of South Africa's 257 municipalities have been given a clean audit by the auditor general for the 2021/22 financial year, with the overall standard of financial management having regressed in the past five years[5].

Table 9: An overview of the financial health of municipalities in 2021/22

	2020/21	2021/22
Creditors greater than available cash		
Creditors > available cash at year-end	47% of municipalities	52% of municipalities
Expenditure exceeded their revenue at year-end	R6.63 billion	R1187 billion
Number of municipalities with expenditure exceeding their revenue	26% (55 municipalities)	36% (79 municipalities)
Current liabilities greater than 50%		
Current liabilities > 50% of next year's budget at year-end	29% (52 municipalities)	32%
Unauthorised expenditure		
Unauthorised expenditure	R20.45 billion (64% of municipalities)	R25.47 billion (68% of municipalities)
Unauthorised expenditure incurred by non-cash items	R13.25 billion	R13.03 billion

Source: AGSA, 2022 & 2023
#Excludes 57 outstanding audits
*Excludes 18 municipalities where the financial statements were not reliable enough for financial analysis (i.e., those with adverse or disclaimed audit opinions)

By year-end, just over half of all municipalities (52%) owed their creditors more money than they had available in the bank as they continued to spend money they did not have. The total deficit in local government for the year amounted to R11.87 billion, while 79 municipalities (36%) had spent more money than they had generated. At 32 per cent of municipalities, their current liabilities were more than 50 per cent of their next year's revenue budget. This means that the 2022/23 budget will pay for spending that had already taken place, either in 2021/22 or in prior financial years. This cycle is likely to continue unless municipalities reduce expenditure and generate additional revenue, which is highly doubtful given the prevailing economic conditions and overall economic outlook. In 2021/22, 68% of municipalities incurred a combined R25.47 billion in unauthorized expenditure, with R13.03 billion being for noncash items. This means that municipalities spent money that the council had not provided for in the approved budget, or that the spending did not meet the conditions of a particular grant.

The financial health of metros is particularly concerning, as they serve the largest segment of the population and account for more than half of the local government expenditure budget. Municipalities cannot continue to operate and provide services if financial health concerns remain. Yet local government finances remain under severe pressure due to non-payment by

[4] AGSA, 2022. 2020/21 local government audit outcomes
[5] AGSA, 2023. 2021/22 local government audit outcomes

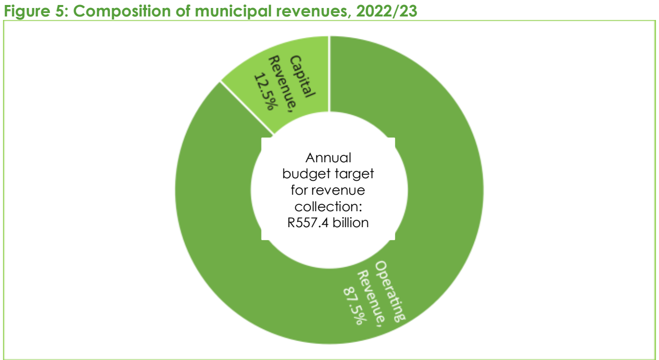
municipal debtors, poor budgeting practices, and ineffective financial management.

For several years, the AGSA has also pointed to the material irregularities that undermine service delivery at the municipal level, namely procurement and payments, interest and penalties, revenue management, and investments and assets. Between 1 April 2019 to 15 January 2023, the total financial loss of these material irregularities was estimated to be R5.19 billion, R1.6 billion of which was money lost by municipalities that had invested in the VBS Mutual Bank. This is an increase from the previous year, where material irregularities amounted to R3.9 billion, with a total of 194 of the material irregularities identified.

5.2. Municipal revenues in 2022/23

Figure 5 shows the municipalities aggregate annual targeted revenue for the 2022/23 financial year was R557.7 billion. This was R 40.7 billion more than the estimates for the 2021/22 financial year. Of the annual estimated revenue, more than 88 per cent (R487.8 billion) is for operating revenue whilst the balance (12%) is capital revenue.

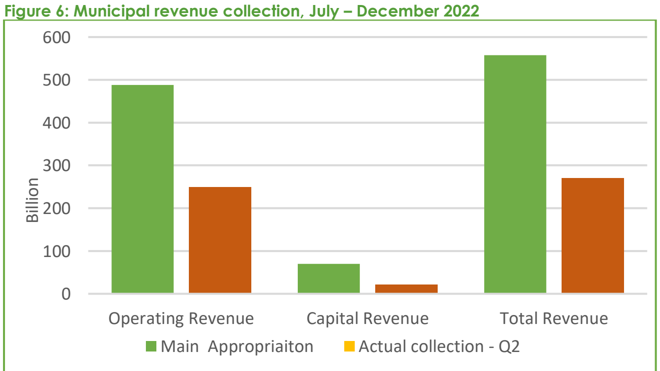
Figure 5: Composition of municipal revenues, 2022/23



Source: Section 71 reports

By the end of December 2022, municipalities had on aggregate collected more than 48.5 per cent (R270.3 billion) of the 2022/23 estimated revenue of which 51.1 per cent (R249.2 billion) was on operating revenue. This means that municipalities were on track to achieve their operating revenue targets by the end of the year. Municipalities had only collected 30.2 per cent (R21.1 billion) of capital revenue by the end of December 2022. This slower than expected collection rate might result in an under collection on capital revenue by the end of the financial year.

Figure 6: Municipal revenue collection, July – December 2022

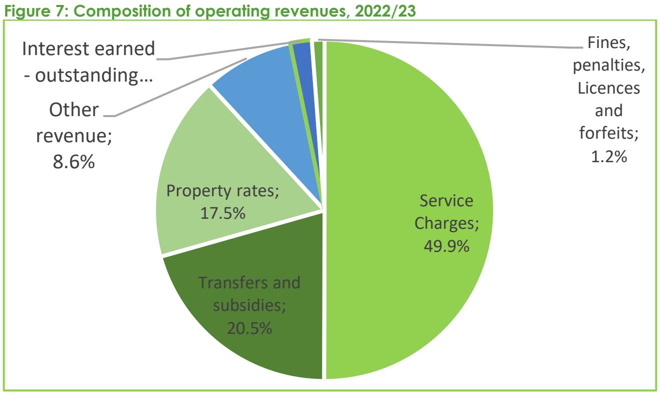


Source: section 32 reports

5.3. Operating revenue

As shown in figure 7, half of the aggregated operating revenues are generated from municipal service charges (50% or R243.5 billion), followed by transfers and subsidies (20.6% or R100.1 billion) and property rates (17.5% or R85.4 billion). These are the three main sources of municipal operating revenue constituting 88.1 per cent of total operating revenue.

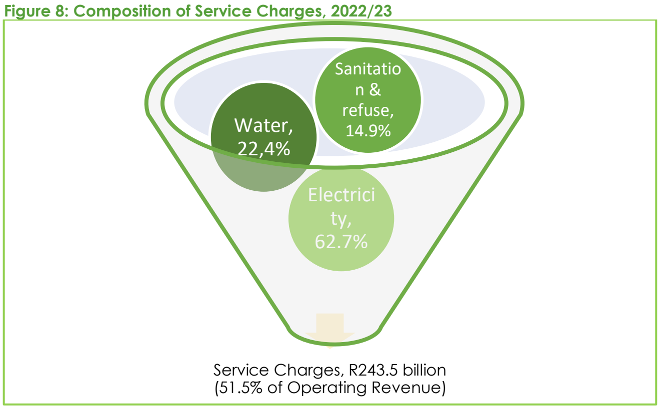
Figure 7: Composition of operating revenues, 2022/23



Source: Section 71 reports

Of the R243.5 billion aggregated service charges, electricity contributed the largest share (62.7%), followed by water provision (22.4%), and sanitation and refuse (14.9%). Despite electricity being the largest share of revenue, as of the end of December 2022, municipalities owed Eskom R56.3 billion.

Figure 8: Composition of Service Charges, 2022/23

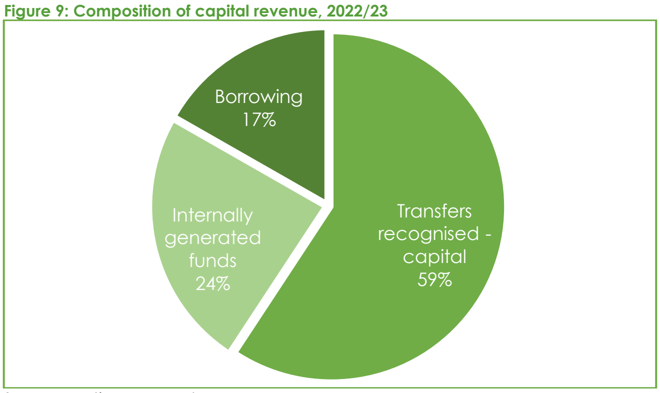


Source: section 71 reports

5.4. Capital revenue

The capital revenue budget consists of government transfers (59%), internally generated funds (24%) and borrowing (17%).

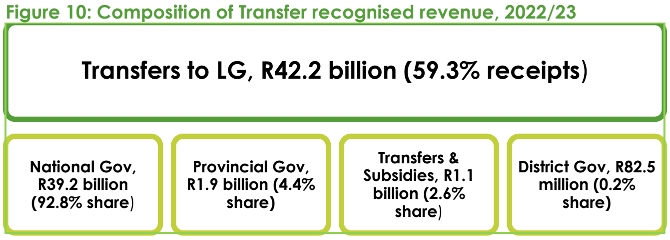
Figure 9: Composition of capital revenue, 2022/23



Source: section 71 reports

On aggregate, municipalities estimated capital transfers amounts to R42.2 billion for the 2022/23 financial year. By end of December 2022, 59.3 per cent was received. The largest proportion is from National government (92.8% or R39.1 billion). Figure 10 shows the proportions of capital revenue per source.

Figure 10: Composition of Transfer recognised revenue, 2022/23

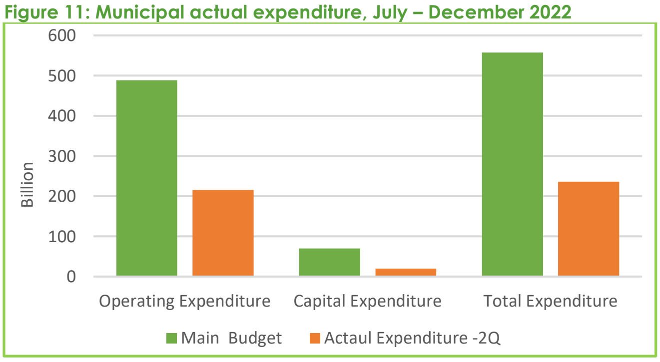


Source: section 71 reports

5.5. Municipal expenditure

By the end of December 2022, municipalities had on aggregate spent 42 per cent (R235.9 billion) of total budgeted expenditure. In the same period, municipalities had spent 44.2 per cent (R215.8 billion) on operating expenditure. Only 28.8 per cent (R20.1 billion) of the capital budget had been spent by the end of December 2022.

Figure 11: Municipal actual expenditure, July – December 2022

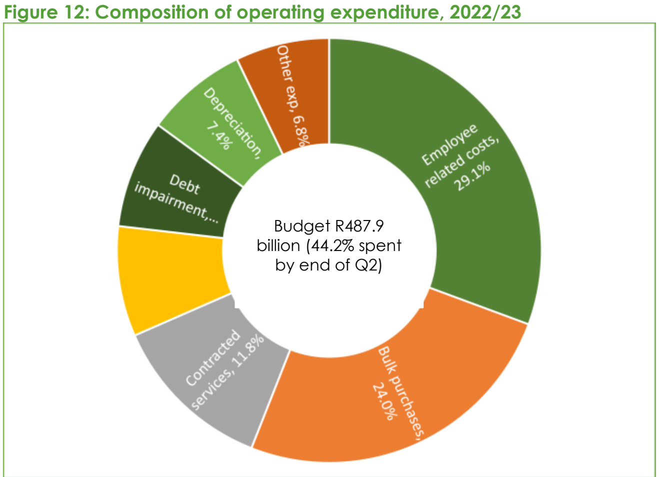


Source: section 71 reports

5.6. Operating expenditure

The drivers of operating expenditure at a municipal level are compensation of employees with the largest budget (29.1% or R141.7 billion), followed by Bulk purchases (24% or R117.1 billion). Contracted services are the third highest (11.8% or R57.6 billion) expenditure item.

Figure 12: Composition of operating expenditure, 2022/23

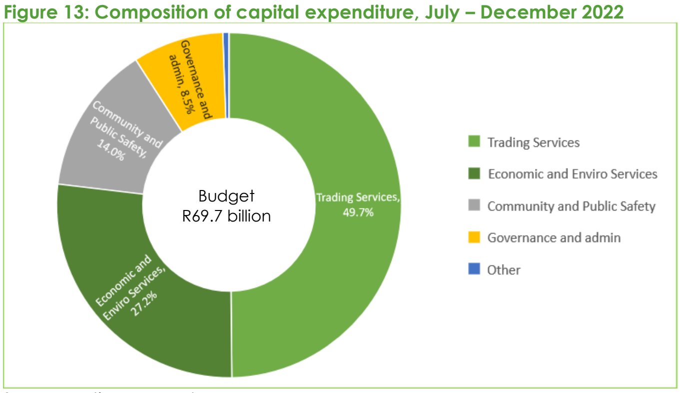


Source: section 71 reports

5.7. Capital expenditure

The capital expenditure budget for 2022/23 is R69.7 billion. The largest share of the capital expenditure budget is allocated to Trading services (50% or R34.6 billion) of which 50 per cent had been spent by end of December 2022. Economic and environmental services budget amounts to 27 per cent or R18.9 billion and 73 per cent had been spent by the end of December 2022.

Figure 13: Composition of capital expenditure, July – December 2022



Source: section 71 reports

5.8. Local government analysis summary

Municipal services are intended to be a tool to address poverty and inequality issues, raise living standards and facilitate economic opportunities. The PBO findings shows that local government requires support in order to increase their revenue collection capabilities and to fulfil its service delivery mandate. Municipalities continue to face financial and operational challenges that hinder local government from delivering basic services. As the AGSA notes, basic discipline and processes should be in place to address these challenges. These measures include procuring at the best price, paying only for what was received, making payments on time, recovering the revenue owed to the state, and safeguarding assets.

The unaffordability of basic services exacerbates the inequalities that exist. Thus, a greater call needs to be made for the review of the local government revenue model as well as the assumptions of revenue generation.

6. MUNICIPAL DEBT TO ESKOM

Concerns over municipal debt owed to Eskom has increased over the last couple of years. In 2014/15, municipalities owed Eskom R4 billion. By 2018, the total debt owed by municipalities in May 2018 stood at over R13 billion, with the top ten indebted municipalities owing close to R10 billion to Eskom. As of December 2022, municipalities owed Eskom R56.3 billion. The top 10 municipalities owe Eskom R38.4 billion. The relatively rapid increase in debt owed to Eskom is reflective of a number of systemic and structural issues being faced by municipalities.

In the National Treasury's Municipal Debt Relief, MFMA Circular No. 124, government introduced a debt relief package. According to the circular, the package includes 14 conditions for municipalities, relating to sustainable finances, and operational- and technical best practices. This relief is – at a high level – a positive development in helping highly indebted municipalities. However, the current debt relief plan fails to sufficiently consider the challenges that municipalities are facing. This section highlights key issues that should remain on the radar when it comes to municipalities.

6.1. The financial health of municipalities continues to deteriorate

The persistent cash flow challenges being faced by municipalities requires government to review the current revenue model for municipalities. The State of Local Government Finances report of 2022 found that 169 municipalities across the country were in financial distress at the end of the 2021/22 financial year. The 2022 AGSA local government audit outcomes report also concludes that the financial statements reveal an increase in the indicators that warn of a collapse in local government finances and continued deterioration. While debt relief will help municipalities in the short term, cash flow problems will persist unless the deeper underlying issues are address. It should be asked how section 6.12 of the Circular will impact municipal finances. Section 6.12 states that:

- 6.12 the municipality for the duration of the Municipal Debt Relief (to ensure proper management of resources):
- 6.12.1 must apportion and ring-fence in a sub-account to its primary bank account –
    - (a) all electricity, water and sanitation revenue the municipality collects in any month; and
    - (b) the component of the Local Government Equitable Share (LGES) the municipality earmarked to provide free basic electricity, water and sanitation.
- 6.12.2 must monthly first apply the revenue in the sub-account (required per paragraph 6.12.1) to pay its current Eskom account and then secondly its bulk water current account before it may apply the revenue in the sub-account for any other purpose.

6.2. Understanding municipalities debtors (owed to municipalities)

Municipal indebtedness has largely been attributed to non-payment to municipalities. While there is a measure of truth to this claim, there are some complexities as to why municipalities were owed R305. 8bn at End-December 2022. The reality is that municipalities are struggling to collect payments for services from consumers and, in turn, battle to pay suppliers, including Eskom. The installation of pre-paid meters has long been punted as a solution to non-payment, however in 2023, SALGA stated that the installation of prepaid electricity meters will not entirely resolve the culture of non-payment. In 2019, Stats SA posited that "possible reasons for the escalating current net debtors are the economic downturn, un-affordability due to low or loss of income, dissatisfaction with service delivery and ineffective municipal billing and credit control systems"[6]. There are questions about the capacity to accurately bill consumers.

Another example is that in the 2021 Section 71 report highlights how "the introduction of wall-to-wall municipalities has left behind a legacy of mandate challenges, with the historic Eskom's mandate to distribute electricity often overlapping with municipal mandates in the same area(s). This, for example, resulted in a disjuncture in electricity prices in the same area to neighbouring consumers". This is not particularly addressed in the Circular.

6.3. Load-shedding and municipal revenue

In their Division of Revenue Bill presentation, SALGA highlighted how load-shedding has had a negative impact on municipalities. SALGA stated that "Load-shedding overall has had a negative impact on the country and municipalities, not only in terms of revenue, but also in terms of additional expenditure, damage and vandalism to infrastructure, theft of electricity, over-time, and so on". They also highlighted how load-shedding is incentivising large energy users to go off the grid, which also negatively impacts revenue. Earlier in the brief, we indicated that 31.4 per cent of local government revenue was collected from electricity.

6.4. The socioeconomic climate

Unemployment, poverty and inequality are underlying issues that must be reckoned with. In 2018, Matjhabeng municipal manager told Scopa that there was a high percentage of unemployment and poverty in that municipality, which has historically had a negative impact on collections.

South Africans have been living in a protracted cost-of-living crisis. The rising costs of basic services have contributed to the strain that households face to secure their means of social reproduction. According to the South African Reserve Bank, there were huge increases in municipal services costs from 2010 to 2020:

- Rates and taxes increased by 118 per cent,
- Electricity tariffs increased by 177 per cent, and
- Water tariffs increased by 213 per cent.

In their Section 71 report, the National Treasury acknowledges that "the high electricity tariff increases by Eskom also impacts on consumer's ability to pay for services giving rise to low collection rates and ultimately, a depletion of the cash flow".

Table 10: The social wage and actual access to services

Service	Households funded for the free service (2019/20)	Households receiving the free service (2019)	Difference (funded – actual recipients	The total value of the difference (R'billions)
Electricity	10 109 607	1 890 691	8 218 916	R8.63
Water	10 109 607	2 163 082	7 946 525	R12.86
Sanitation	10 109 607	1 537 749	8 571 858	R10.42
Refuse	10 109,607	1 991 925	8 117 682	R8.27
TOTAL				R40.18

Source: Tracy Ledger (2021) Access to Basic Services, PARI Working Paper

At the same time, millions of households that are eligible for free services do not get them due to a dysfunctional system for the registration of indigent households. Section 3.6 of the MFMA Circular 124 requires that municipalities include the current number of indigent households registered as such with the

[6] Stats SA. (2019). Debt owed to municipalities reaches R72.4 billion. https://www.statssa.gov.za/?p=12255

municipality. This should be used to ensure that municipalities are provisioning basic services to indigent households.

It is also important that even for those who are registered as indigent, the free utilities available to households are insufficient to meet basic needs. An average household needs around 200 kWh of electricity – the free quota is 50 kWh. The 10 kilolitres of free water are only around two-thirds of what is required by a household. The needs gap requires revision.

6.5. Alignment with the National Development Plan

According to the White Paper on Local Government (1998), municipalities should conform to certain basic principles in terms of the services they deliver. Municipal services should be:

- accessible and communities should have access to at least a minimum level of services as a constitutional obligation;
- easy and convenient to use;
- as affordable as possible; and
- of a predetermined standard, meaning that services should be suitable for their purpose, be timeously provided, be safe and be available continuously.

In 2021 the Public Affairs Research Institute asked, "Is the current model for providing basic services contributing to increased standards of living, reduced household poverty and greater equality?"[7]. This question must be asked of the current conditions for debt relief being imposed on municipalities.

In the Municipal Debt Relief, MFMA Circular No. 124, the Treasury notes that "a critical component of the conditions, therefore, relates to achieving a funded budget. This encompasses cost-reflective tariffs, ensuring a complete revenue base, aligning spending patterns to collection levels, and optimising and enforcing collection by using both electricity and water as collection tools". The PBO notes with concern that the conditionalities linked to water provisioning may lead to violations of the right of access to sufficient water accorded to everyone in S27(1)(b) of the Constitution. This has been emphasised by Tracy Ledger who notes that "the outcome of Treasury's requirement that water disconnection is used as a credit-control tool for all non-indigent-registered households means that millions of poor households will have their water disconnected if they fall into arrears.

7. CONCLUSION

Since the tabling of the 2023 Budget review, GDP growth has been adjusted downwards due to several constraints such as Intensified load-shedding, continued fiscal consolidation, higher interest rates, bottlenecks at Transnet's ports and weakening growth outlook in some of the country's major export markets. Since the GDP forecast informs revenue, expenditure and liabilities projections in the budget, any revisions to GDP also affect public finances, forecasted budget deficit and the debt-to-GDP ratio.

The consolidated budget expenditure for 2022/23 was revised upwards from R1 965.3 trillion to R2 004.0 billion compared to R1 895.9 billion in the previous financial year. However, numerous departments (37 departments) struggled to spend all of their allocated budgets by the end of March 2023. Provinces generally spent close to 100 per cent of their budgets by the end of March 2023. However, they are unbudgeted expenditure which may negatively impacts the funding available to provide services.

Concern over municipal debt owed to Eskom has increased over the last couple of years. As of December 2022, municipalities owed Eskom R56.3 billion. In response to the municipal debt to Eskom, the National Treasury introduced a Municipal Debt Relief package, MFMA Circular No. 124. This relief is a positive development in helping highly indebted municipalities. However, the current debt relief plan does not sufficiently consider the challenges that municipalities are facing.

[7] PARI. (2021). Access to basic services. https://pari.org.za/short-report-access-to-basic-services/