# National Council of Provinces
# 2022 Strategic Review & Planning Session

Dr. Dumisani Jantjies –
Director
Parliamentary Budget Office-

March 2022

Parliamentary Budget Office

PARLIAMENT
OF THE REPUBLIC OF SOUTH AFRICA

# Outline

- Introduction
- Background
- 2022 Provincial and Local government fiscal framework
- Issues impacting on municipalities equitable share
- Understanding the sources of municipal revenue

# Introduction

- The Parliamentary Budget Office is a juristic entity of South African Parliament, established by sec 15 of the Money Bills and Related Matters Act 2009, as amended in 2018
- Established to support the implementation of the Money Bills and Related Matters Act; in particular support to Finance and Appropriations Committees in both Houses of South African Parliament; but other Committees and Members of Parliament (MPs) subject to the availability of capacity
- The Money Bills and Related Matters Act of 2009 provide procedures to amend or approve the National Budget and related instruments, fiscal framework, Appropriations Bill
- The Parliamentary Budget Office offers independent and objective analysis and advice to Parliament on money bills and other bills presented by the Executive; and any other documentation or reports with fiscal implications

# Background

In South Africa and in other countries we have seen an increase demand for a rigorous legislative oversight and need for better governance mechanisms over government service delivery and development indicators

The form of governance or oversight system (2 or 3-tier spheres) inherently affects or determine state service delivery capabilities and related oversight (National, Provincial and Local Spheres)

Some key leanings related to three-tier system from the international experiences;

- There are currently fewer countries that have three-tier government spheres, e.g. Argentina, Brazil, South Africa and Switzerland
- National developed policy priorities are not always implemented by other spheres of government; due to in part the contestations around fiscal powers and weaker coordination between the three spheres
- Capable Local government sphere is prerequisite and necessary to realising service delivery goals and objectives set out at National sphere. Therefore, it is necessary that local government has sufficient technical and administrative competence
- Three-tier governance system requires a great cooperation between the provincial and local government spheres in relation to fiscal powers. This approach is able to reduces service delivery complexity and governance measures
- Provincial and local government often accounts for significant public expenditure and are major public employers, and grants and subsidies are their (for it is own revenue) key revenue sources

# 2022 Provincial and Local government Fiscal Framework

- 2022 Budget states that over the MTEF, the provincial and local spheres of government will focus on improving service delivery
- Provincial and local government allocations accounts for 51.2%
- Provincial allocation increased by R58.4 billion to R682.5 (41.4% of DORA) while local government increased by R30.7 billion to R150.6 billion(9.8% of DORA)
- 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.
- Shortage of skills capacity in municipalities is often raised as one of sources of poor service delivery
- Per capita allocations to rural and low-income provinces and municipalities has increased relative to more urbanized counterparts. However, patterns of migration have significant impact on service delivery
- Poor revenue management and inability to raise own revenue is one of the biggest causes of financial distress to local government
- Underspending of infrastructure grants and lack of sufficient spending on repairs and maintenance leads to greater technical losses
- Greater spending efficiency and fiscal discipline are required in provinces and municipalities

# Local Government Equitable Share (LGES)

- Allocation is derived from Section 214 of the Constitution, which requires an Act of Parliament to provide for "*the equitable division of revenue raised nationally among the national, provincial and local spheres of Government*"
- The share of nationally raised revenue allocated to the Local Government sphere through the equitable share is based on:
  - The functions assigned to each government sphere emanating from the Constitution;
  - Revenue-raising powers and abilities; and
  - The total national revenue available (tax receipts and borrowing)
- Section 214 of the Constitution further provides a list of criteria to be considered when deciding on the equitable share allocation to each Government sphere, and these are:
  - National interest, national debt and other national obligations, fiscal capacity and efficiency of the Provinces and Municipalities,
- Significant part of the equitable share or success therefore, is reliance on the local government sector capabilities raise own revenue

# Local Government Equitable Share (LGES)

- Local government is entitled to an equitable share of nationally raised revenue to enable it to provide basic services and perform its allocated functions
- The LGES is an unconditional transfer that supplements the revenue that municipalities can raise themselves
- The LGES provides funding for municipalities to deliver free basic services to poor households and subsidizes the cost of administration and other core services for those municipalities with the least potential to cover these costs from their own revenues
- The LGES formula
  - Designed to enable municipalities to provide basic services and perform the functions allocated to them taking into account the fiscal capacity and efficiency and developmental and other needs of municipalities
  - Uses demographic and other data to determine each municipality's portion of the local government equitable share
  - Components, Basic Services Component, Institutional Component, Community Services Component, Revenue Adjustment Factor

# Some of the issues impacting on municipalities equitable share

# Issues impacting on municipalities equitable share

- Weak institutional arrangements between district and local municipalities
- High levels of water and electricity losses lead to unaccounted and reduced municipalities revenues
- High operating costs and in particular, above normal COE
- Municipalities are over stating the debtors figures and under stating their creditors figures. This exercise also revealed that the creditors amounts far exceed the equitable tranche due
- Incompetent leadership and weak financial management lead to mismanagement of finances and lead to debt escalation
- Weak tariff setting ability contribute to tariffs are not fully cost reflective
- Poor revenue management led to payments due to creditors far exceeding revenue collected
- Setting unaffordable and unrealistic repayment arrangement, and in many cases are concluded merely for compliance
- The lack of credible Service Level Agreements between municipalities and their bulk services providers (Eskom and Water boards)

# Other key issues related to service charge- Eskom in particular

- Tariffs charged are not always the same across the different municipalities whereas all licensed municipalities are being charged the same tariff by Eskom
- Charging a lower tariff for the supply of electricity than tariff charged by Eskom thereby leading to accruing of debt
- Inefficient billing systems where in some instances billing is based on an average rate of consumption of electricity
- Electricity supply infrastructure such as transformers and meters in some of the municipalities are so old that they need to be replaced
- Submission of unreliable information by municipalities affect their proper assessment by NERSA for tariff approval
- Municipalities resort to the use of equitable share transfers to pay for electricity bulk purchases to Eskom. This is problematic since equitable share is meant to deal with poor households while other households should be paying for the services
- Municipalities that implemented untampered prepaid meters are able to collect steady revenue as compared to conventional meters
- There are consumers that are paying for electricity regularly at the tariff being charged. However, due to the fact that municipalities were not passing the payment to Eskom, these consumers may be unfairly affected when Eskom cuts off the electricity supply to municipalities that do not pay their debt

# 2021Understanding the sources of municipal revenue

# 2021 Understanding the sources of municipal revenue

- An overview of the main sources of local government revenue and main operating expenditure
- Shows historic trends and estimated collection rates hampered by slow economic growth, Covid-19 and others
- Further shows that Metros rely on service charges to households and businesses to fund current expenditure
- The reduction in government transfers due to fiscal consolidations is likely to negatively affecting municipal revenue sources over the medium term
- The declining budgets due to the declining revenue collection rates and transfers from other spheres of government to municipalities are concerns that might adversely affect the implementation of the District Development Model

# Funding structure of local government expenditure

- Main sources of local government revenue is property rates and service charges, which on aggregate amounted to 62.5% of the total operating budget
  - Biggest proportion of the 62.5% which is 29.5 % come from electricity service charges.
  - Income from transfers and subsidies amounted to 23.8 % of the total operating revenue budget
- Main local government operating expenditure item is employee related costs, which on aggregate amounted to 29.4% of the total local government operating expenditure
  - The aggregate bulk purchases amounted to 21.6% of the total local government operating expenditure
- Main source of capital revenue that funds capital expenditure is transfers from the national government around 53.9 % of the total capital revenue budget
  - Other main local government capital sources are internally generated and from borrowing, 27.8% and 13.6% respectively of the total capital revenue budget
- Capital expenditure is mainly for road transport and water management, which amounted to 20% and 26% respectively of the total spending on capital

# Revenue sources for Metros

- Total income of Metros has increased from approximately R50 billion to R56 billion between 2017/18 and 2020/21
  - The increase in revenue collection is mainly due to increases in service charges and transfers received in the form of grants
- Smallest proportion of total revenue in metros is from grants
  - The proportion of income from grants has also decreased from contributing 5.9% to total revenue to 3.1%
  - The proportion of income from service charges, the main source of income, has dropped in Buffalo City, Cape Town, eThekwini, City of Johannesburg and Mangaung from 2018 to 2021, while other resources increased
- Annual average growth on total revenue sources for Metros between 2017/18 and 2020/21 amounted to 3.3%
  - In total, Metros has, on average, received 16.8 % less from grants between the 2017/18 and 2020/21
- Income from property rates has grown on average by between 4.9% and 14.6% in Metros
  - Income from Service charges has increased, on average, between 3.5% and 15.9% in Metros
  - Income from other sources has increased, on average, between 1.7% and 21.5% in Metros

# Change in the proportion of revenue

- Municipalities have collected between 74.8% and 77.6% of their operating revenue between 2017/18 and 2020/21
- Operating expenditure was between 64.2% and 68.0% during the same period
  - This slower expenditure than revenue collections resulted in surpluses between 2017/18 to 2020/21
- In total the operating revenue collection rate, per source, range between 69.6% and 77.6%
  - The slowest collection rates were recorded for fines (between 50.9% and 59.1%) and the highest rates are from transfers recognised (between 81.8% and 89.0%)
- The annual average growth rates of the main operating revenue sources, in municipalities, between 2017/18 and 2020/21 ranged between 5.5% and 38.4%
  - Interest earned on outstanding debt grew by 15.8% while sanitation revenue grew by 14.8%
  - The slowest annual average growth rates over the period was on electricity and water revenue at 5.8% and 5.5% respectively
- The main sources of capital expenditure are transfers received from national and provincial governments
  - The transfer rates in three of the financial years were below 50% except for 2019/20 when the transfers peaked at 71.1%
  - This high capital revenue collection rate in 2019/20 can be attributed to the higher internally generated funds when compared to the other years
- The expenditure rates were below 50% in three of the financial years except for 2019/20 when expenditure peaked at 67.0 per cent in the third quarter
  - The highest proportion of the capital budget was spent on road transport, water, electricity, waste water management and housing

# Change in transfers from nationally raised revenue 2021 MTEF

- 2021 MTEF reductions to the public-service wage bill affected national and provincial government only, resulting in local government's share of revenue to rise in relative terms
- At the same period, transfers to local government were reduced by R20.2 billion, including R15.5 billion from the local government equitable share, R2.7 billion from the general fuel levy and R2 billion in direct conditional grants since the previous MTEF
- The reduction to direct local government conditional grants includes R329 million from the municipal infrastructure grant and R21 million from the integrated urban development grant.
    - These amounts were reprioritised from underspending grants to fund a once-off councillor gratuity for non- returning councillors.
- The largest proportional reduction of R1.3 billion to local government grants were made in the public transport network grant.
    - The reason for this reduction was that only six of the thirteen cities receiving the grant have successfully launched public transport systems.
    - Indirect conditional grants are reduced by R286 million over the period
- Metropolitan municipalities receive 31% of the total transfers to municipalities, while between 20% and 21% are transferred to district and local municipalities.
- The annual average growth of transfers to metros are 3% over the 2021 MTREF, 5% for district municipalities

# Implications for the District Development Model

- The District Development Model is a practical Intergovernmental Relations (IGR) mechanism to enable all three spheres of government to work together, with communities and other stakeholders, to plan, budget and implement together
- Declining budgets due to the declining revenue collection rates and transfers from other spheres of government to municipalities are concerns that will adversely affect the implementation of the District Development Model
- The success of the implementation of the DDM is largely linked and dependent on certain government sectors policy and budgets, these departments include; Public Enterprises; Mineral Resources and Energy; Tourism; Trade, Industry and Competition; and Water and Sanitation
- All these government departments' appropriations were reduced from the 2020/21 appropriations. The highest increases of between R1.7 billion and R7.5 billion are reflected in Cooperative Governance, Basic Education, Health, Social Development and Transport

# Enkosi, Ndiyabulela!

Dr Dumisani Jantjies
Director, PBO
djantjies@parliament.gov.za,

4th Floor, Parliament Towers 103-107 Plein Street, Cape Town, 8000
**http://www.parliament.gov.za/live/content.php?Item_ID=7207**