Financial Mail

Down the broken drain

Municipal funding

Troye Lund | 09 May 2013

The weakest, most cash-strapped local authorities get extra to prevent services from collapsing. But they don't have the capacity to manage and use these funds.

The funding model also discourages municipalities from improving and expanding their revenue collection. Unless this changes, local government will collapse, the Finance & Fiscal Commission (FFC) has warned after an investigation into whether local government failure is due to insufficient funding.

"It's as simple as that," says FFC acting chairman Bongani Khumalo. The key weakness lies in the system of unconditional and conditional grants that national government uses to allocate money to municipalities. Conditional grants have to be used for a specific purpose.

They are offered and monitored by different national departments and are mainly aimed at extending and maintaining municipal infrastructure, especially water and sanitation. The unconditional grant, however, can be spent at a municipality's discretion. This grant is called the local government equitable share, and gives municipalities a share of national revenue.

In total, municipalities will receive R227bn in conditional and unconditional grants over the next four years. This is just less than a third (about 30%) of the total expenditure that SA's 278 municipalities will need over this period.

The less of its own revenue a municipality is able to raise and the bigger its financial shortfalls, the more grant money it will get relative to other municipalities. This is done to help municipalities, especially those in rural areas, that don't have a big enough tax base from which to collect revenue. The constitution makes national government responsible for ensuring municipalities have the funds needed to provide a specific list of services.

But the danger is that the system doesn't differentiate between municipalities that truly don't have a tax base and those that don't "make enough effort" to generate revenue, as the FFC puts it. The commission says grant money should rather be based on the revenue that a municipality raises in relation to what it could generate.

The other problem in the way grant money is shared between municipalities is that the weaker municipalities, which benefit most, don't have the capacity and skill required to manage and spend money efficiently. Last year, according to national treasury figures, Buffalo City in the Eastern Cape spent only 13% of its conditional grants. This kind of underspending undermines any attempt to ramp up SA's infrastructure.

The municipal infrastructure grant (MIG) is the biggest of the conditional grants to municipalities. Finance minister Pravin Gordhan allocated R85bn to this grant for this financial year and has budgeted for it to increase to R101bn by 2015. But six months into the year, the Greater Giyani Municipality in Limpopo had managed to spend only R1,1m of its R36m MIG grant.

While municipalities in the North West province had spent only 23% of their total infrastructure budget, the Eastern Cape municipalities had, according to the department of co-operative government & traditional affairs, spent the most (51%).

"There's no point pumping money into a system that can't absorb money," says Khumalo. Treasury agrees and says a redesign of the system has started. While that happens, a "use it or lose it" policy for conditional grants has been put in place, which means municipalities have to give back unspent conditional grant money.

They can apply to have these funds again but meanwhile the projects they were supposed to pay for are delayed and existing infrastructure isn't being maintained. The FFC estimates the municipal infrastructure maintenance backlog is now between R20bn and R40bn.

Tracking the conditional grant spending is one thing but it's harder to monitor how unconditional grant money is spent because municipalities can spend it on anything.

Getting hold of reliable and up-to-date data will be one of treasury's biggest obstacles as it redesigns the grant allocation system and assesses which municipalities should get more and which are able to spend money. While treasury has been trying to get municipalities to submit regular data, government relies on the census data to make allocations. This is collected every 10 years, which means allocations don't match reality.

This is a serious problem when it comes to shifting funds to compensate for rapid urbanisation. The FFC has found that some municipalities should actually be getting about 80% less than they are in grants and others should be getting twice the amount.

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