FINANCIAL
AND FISCAL
COMMISSION

FINANCIAL AND FISCAL COMMISSION SUBMISSION ON STOPPAGE OF LOCAL GOVERNMENT EQUITABLE SHARE ALLOCATIONS

"For an Equitable Sharing of National Revenue."

24 April 2015

Financial and Fiscal Commission
Montrose Place (2nd Floor), Bekker Street,
Waterfall Park, Vorna Valley, Midrand,
Private Bag X69, Halfway House 1685
www.ffc.co.za

Tel: +27 11 207 2300

Fax: +27 86 589 1038

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1. Context and Purpose of the Submission

This submission is made in terms of Section 3 (1) and (2) b (i) and (ii) of the Financial and Fiscal Commission (FFC) Act of 1997 as amended. The Act provides for the Commission to be consulted by any organ of state, provide advice, and make recommendations to any organ of state on financial and fiscal matters on request or at its own initiative. The Commission is making this submission and recommendations thereof, at its own initiative as well as on the basis of requests by a number of municipalities.

2. Background

On 19 February 2015 a judgment in the Free State High Court delivered a guilty verdict on a Matjhabeng Municipality Manager for persistently non-complying with court orders that compelled the municipality to supply Eskom with information surrounding its debt of almost R 500 million. To avoid such disputes playing out in court, on 6 March 2015, the National Treasury issued a circular on its intentions to stop the LES allocations for Municipalities that are habitually defaulting on Eskom and Water Boards debts. Subsequently National Treasury wrote to municipalities threatening to transfer their LES allocations directly to Water Boards and Eskom in lieu of what these municipalities owe Eskom and Water Boards.

3. The Legal basis for the LES stoppage

Section 216 of the Constitution allows National Treasury to stop transfers to municipalities. This can be done in the event of gross misconduct in the form of serious or persistent non-compliance with measures specified in Section 216 (1) of the Constitution. In this case non-compliance means non-payment of the Eskom debt within 30 days. Section 17 and 18 of the Division of Revenue Act (DoRA) of 2015 and subsequent regulations prescribed in the Municipal Finance Management Act (MFMA), particularly in Section 38-40, allows National Treasury to take punitive measures in the form of stopping allocations if there is persistent non-compliance with the Division of Revenue Act (2015)

Although National Treasury is legally empowered to withdraw allocations to municipalities, there are safeguards within which this should be done. The procedural safeguards as outlined in Steytler and De Visser[1] include:

- National Treasury must allow affected municipalities to make representation with regard to the matter.
- Stoppage of allocations is allowable in situations of persistent non-compliance or otherwise with MFMA regulations and if the municipality is not committed or non-cooperative with respect to resolving the issue of non-compliance

In addition, Steytler and De Visser note that

> "If the stopping affects the provision of basic municipal services, the provincial executive should intervene as per Section 139 of the Constitution to ensure basic services are provided.

At this stage it is important to acknowledge that some municipalities have entered into agreements with Eskom and Water Boards on payment plans but have reneged on their commitments. What is not clear is whether all affected municipalities have reneged on their commitments. It is however, clear that the stopping of the LES will affect service delivery considering that some of the affected municipalities rely on the LES to the tune of over 75%. For example, the LES accounts for 79% of Bushbuckridge Municipality's operational expenditures (see Figure 6 below)

4. The Debt Burden

This section describes the magnitude of the Eskom and Water Boards debt which lies at the heart of the problem. The section relies on figures provided by National Treasury, South African Local Government Association (SALGA) and Department of Water Affairs (DWA).

4.1. Eskom Electricity Debt

Figure 1 (and Figure 8 in the Appendix) shows the total debt owed Eskom by municipalities. As at November 2014, Eskom was owed a total of R 9.49 billion by municipalities; divided

[1] Steytler N and De Visser J. (2012) Local Government Law of South Africa, LexisNexis/Butterworths

into R 4.88 billion as current debt and R 4.61 in arrears. Interestingly, the "current" municipality debt of R 4.88 billion for November was less than bulk electricity sales of R 5 billion for the same period.

Figure 1: Municipality Debt to Eskom (R Billions): November 2014

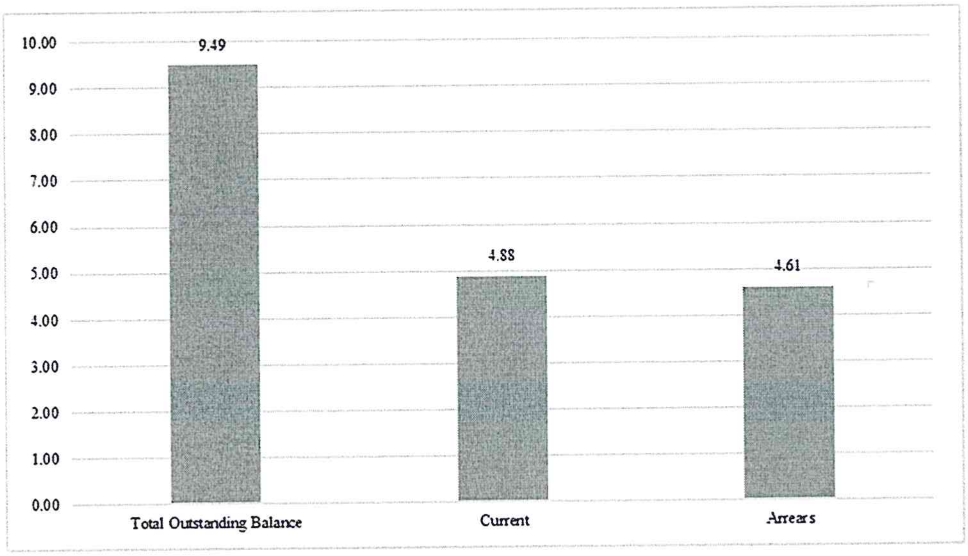


Table 1 provides a provincial distribution of the Eskom debt. The major debtors to Eskom were municipalities in Gauteng, Free State and Mpumalanga provinces. For arrears debt municipalities in Mpumalanga, Free State and North West top the list. Municipalities in these three provinces accounted for 82% of the total arrears.

Table 1: Eskom Municipality Debt: November 2014

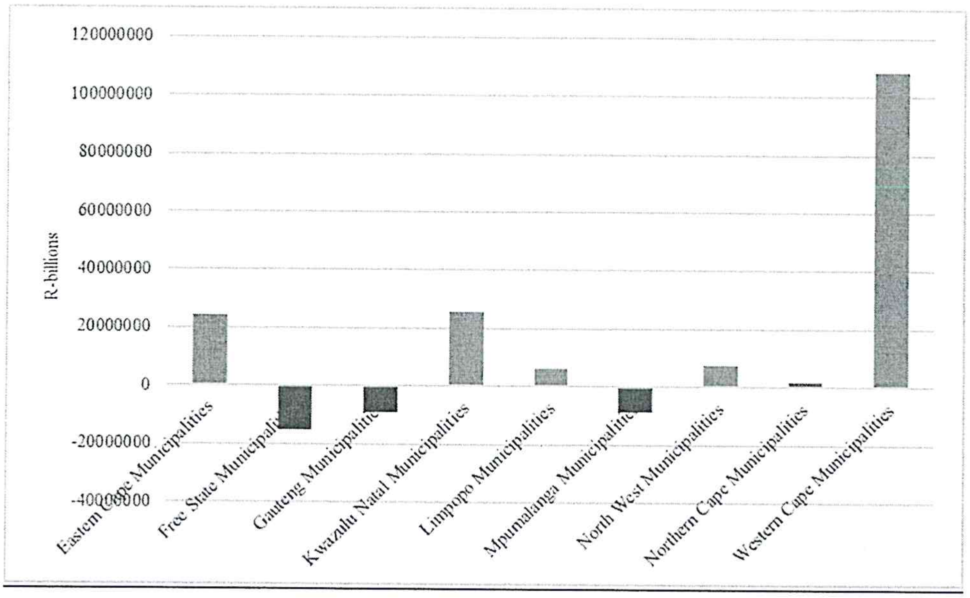
	Current debt (R millions)	% Share of Current Debt	Total Arrears (R millions)	% Share of Total Arrears Debt	Total Outstanding Debt (R millions)	% Share of Outstanding Debt
Eastern Cape Municipalities	350.6	7.2	188.7	4.1	539.3	5.7
Free State Municipalities	242.9	5.0	1606.4	34.9	1849.3	19.5
Gauteng Municipalities	1933.1	39.6	213.8	4.6	2146.9	22.6
KwaZulu Natal Municipalities	875.5	17.9	63.5	1.4	939.0	9.9
Limpopo Municipalities	143.5	2.9	221.7	4.8	365.2	3.8
Mpumalanga Municipalities	249.1	5.1	1478.7	32.1	1727.8	18.2
North West Municipalities	227.2	4.7	671.6	14.6	898.8	9.5
Northern Cape Municipalities	79.5	1.6	142.9	3.1	222.4	2.3

Western Cape Municipalities	783.0	16.0	21.2	0.5	804.2	8.5
Total	4884.4	100.0	4608.5	100.0	9492.8	100.0

Source: National Treasury MFMA Section 41 Report

In Figure 2 we compare total bulk electricity sales (X_1) for November 2014 and current debt (X_2) for the same month. A hypothetical question would be: With total sales for that month, would municipalities in different provinces afford to settle their Eskom debt, other things constant? For Mpumalanga, Gauteng and Free State the negative balances (X_1-X_2) suggest that, given the debt, they would not have covered their current debt. Poor billing systems for municipalities in Mpumalanga, Gauteng and Free State could possibly explain why sales were more than other provinces[2]. For other provinces, their bulk sales were more than the debt owed to Eskom. This may imply that non-payment of Eskom debt was a deliberate choice for such municipalities.

Figure 2: Bulk Electricity sales and Current Debt (November 2014)



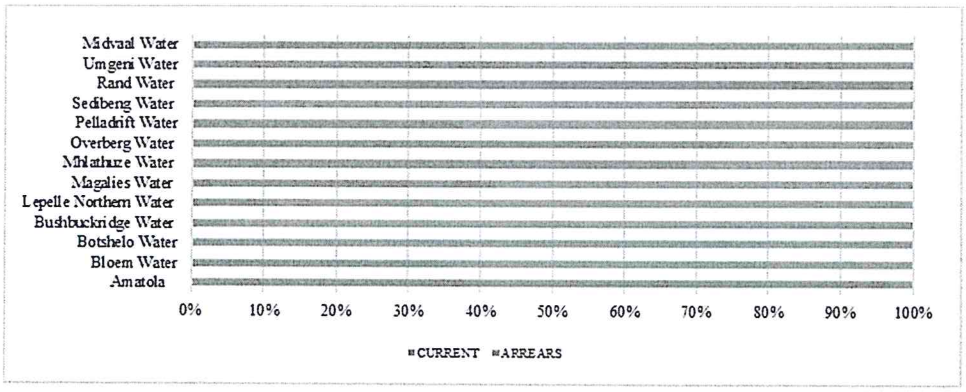
NB: Total Bulk Electricity Sales (for November 2014) Less Total Current Debt (for November 2014)

4.2. WATER BOARDS MUNICIPALITY WATER DEBT

[2] Besides poor billing systems, the inequitable tariff of corporates relative to what households pay has been mentioned in some quarters as the possible reason for non-payment by municipalities. This requires further empirical verification.

As of February 2015 various Water Boards were owed a total of R 3.6 billion by municipalities. Of this debt, R 1.4 billion was current debt and R 2,2 billion was in arrears. The distribution of the debt is shown in Figure 3 which shows that Sedibeng, Bushbuckridge and Botshelo Water boards were owed the largest amounts in terms of arrears debt, while Rand, Umgeni and Amatola Water boards were owed the largest amounts in terms of current debt.

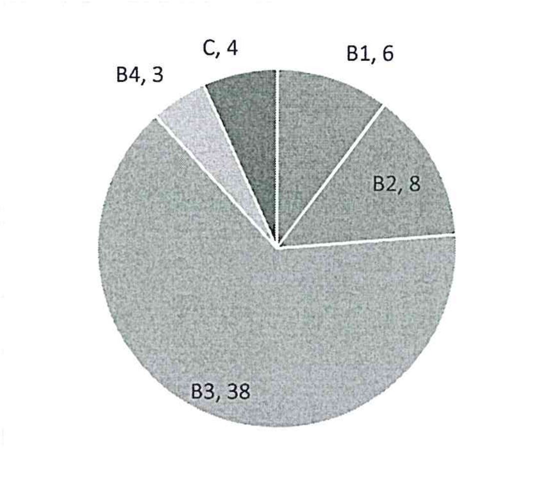
Figure 3 Water Boards Municipality Water Debt



5. THE AFFECTED MUNICIPALITIES

In total 59 municipalities are affected by the National Treasury circular. The majority (38 or 64%) are group B3 municipalities. Typically B3 municipalities consist of one or more small towns, and straddle between commercial farms and rural areas. In terms of the provincial spread, the Free State and North West have the largest numbers of affected municipalities, (22% apiece).

Figure 4 (left). Affected municipalities by category: (Right) Proportion of affected municipality by Province



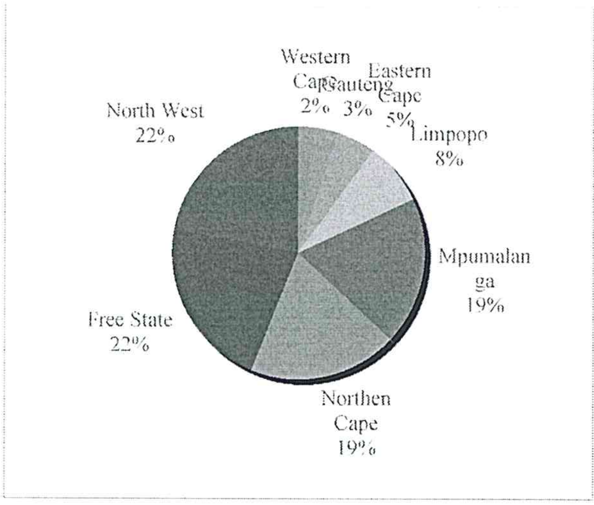
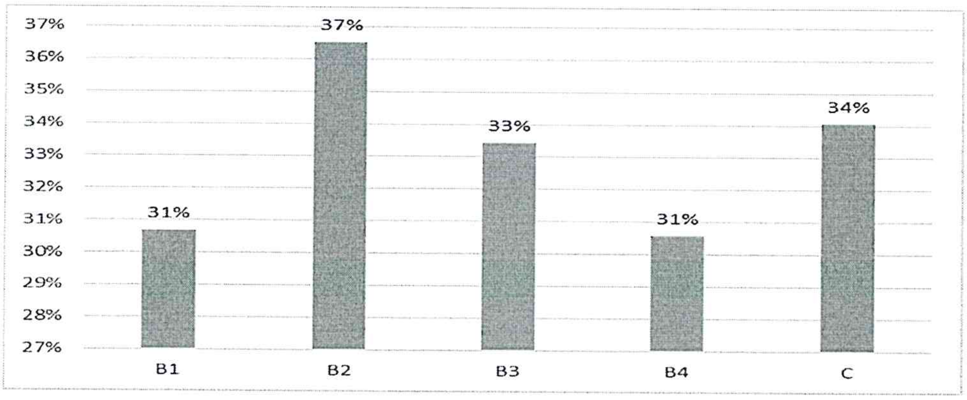


Figure 5 shows the ratio of LES allocations for 2013 for the affected municipalities. Individual ratios for the affected municipalities are in Appendix 1. The aim of Figure 5 is to show the dependency of the affected municipalities on the LES. For the affected municipalities, on average the LES allocations accounts for between 31% and 37% of their total operating revenue. However this range masks extreme rates of LES dependency for some municipalities. For example, the ratio of the LES allocations to total operating revenue was 97% for Mopani District Municipality. This huge LES dependency implies that the LES stoppage would cripple operations and general service delivery in the affected municipalities.

Figure 5: Ratio of LES to Operating expenditure



Source: Own Calculations

6. Issues Of Concern

The Commission is concerned with the amounts owed to Eskom and Water Boards. The Commission is mindful that Eskom and Water Boards are of strategic importance to the country and economy. The monies owed to these institutions risk the operations of these institutions, and overall development of the country. It impairs their future investment plans, and for Eskom in particular, it could contribute to downgrades by international rating agencies, with negative consequences on the country's international rating as well. It has also been confirmed that the municipalities owing the bulk of the debt (80 percent) have been entering into agreements through interventions by the task team (specifically for municipalities in Free State). The municipalities have simply just ignored these agreements resulting in courts judgments in favour of creditors. The situation is spiraling out of hand and in such instances, there is an urgent need for measures taken by National Treasury as the last resort aimed at getting them to take their fiduciary responsibilities seriously.

Having noted the strategic importance of Eskom and Water Boards in the development of the country, the Commission also notes that municipalities have serious constitutional mandates and strategic governance obligations in the country which should be protected. Municipalities need to provide basic services to citizens within an equitable and just costing and pricing framework. There is a need for an equitable and just pricing of electricity and water, where citizens face fair prices/tariffs relative to corporates. Municipalities need protection also on the debt they are owed by government departments, and the entire commercial sector.

Having noted all the above, the Commission has several concerns surrounding the LES stoppage:

(a) Section 216 is a blunt instrument that hits the guilty and the innocent alike. Although the LES stoppage, is a temporary measure as the funds due will have to be paid over at a later date, it has a negative cost to residents. The issue is how are municipalities expected to pay for free basic services during the period of LES stoppage? Should they stop providing free basic services altogether? Whatever the answers to these questions, poor consumers who rely on the LES for free basic services will be affected negatively by the stoppage, yet the source of non-servicing of the debts could be due to bad management. On the other hand, the source of non-payment could be due to some consumers failing to pay their bills on time. The heart of the problem is that some municipalities are not using the money provided for in the LES for Free Basic Electricity to pay for Free Basic Electricity.

(b) The Commission will be concerned if the National Treasury approach to resolving the issue is one sided. The Commission is concerned further at the singling out of Eskom and Water Boards debt to municipalities. In fact municipalities are owed large sums of money by national, provincial, households and commercial entities (see Figure 6). In 2013 municipalities were owed a total of R 100 billion by organs of state, households and commercial entities. Organs of state alone, owed municipalities close to R 4.5 billion, a figure close to what municipalities owe Eskom (See Table 2). Although not empirically verified, it cannot be far-fetched to argue that the huge sums of money owed to municipalities have contributed to their poor payment record to entities, among others, Eskom and Water Boards. Considering the fact that municipalities are facing declining revenues bases, and viability challenges, it is therefore important to balance the pressures on municipalities and those entities owing municipalities. National treasury should exert the same pressure on municipalities to pay what they owe, and those entities owing municipalities. The same pressure of withdrawing the LES should be made to national departments that owe municipalities' unpaid bills. The allocations to national and provincial governments owing municipalities should be withheld and these funds used to offset the debt burden of municipalities. The PFMA rules should apply to all stakeholders in the debt equation. The Commission would encourage an all-inclusive and holistic approach to the debt issue.

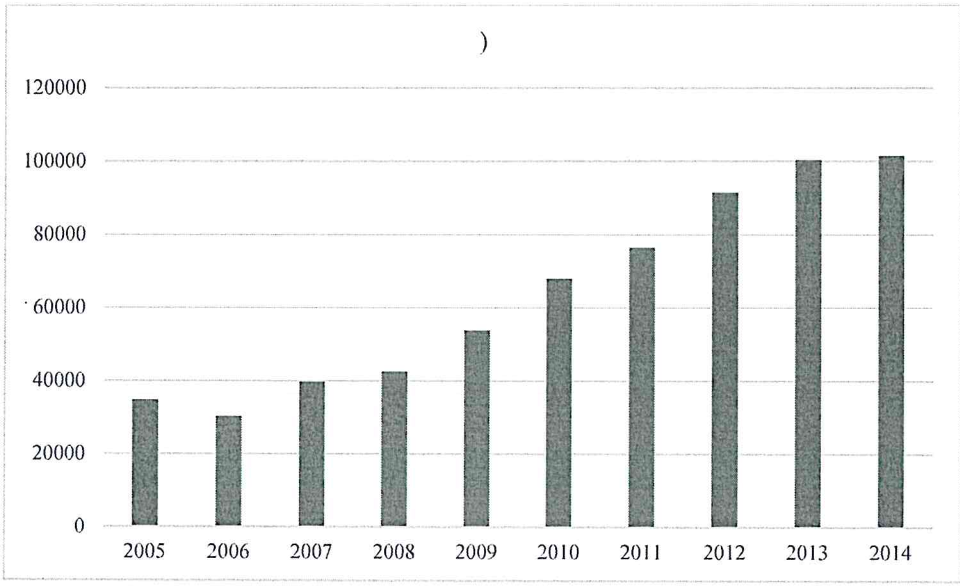
Table 2 Consumer Debt Proportions and Total Consumer Debt

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Government	2%	3%	4%	4%	4%	4%	4%	4%	4%	5%
Business	9%	12%	10%	10%	8%	10%	17%	17%	20%	20%
Households	36%	50%	44%	45%	41%	46%	54%	56%	56%	58%
Other	53%	35%	42%	41%	46%	40%	25%	23%	20%	18%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Total	34796	30353	39796	42540	53820	68013	76486	91503	100403	101565

Source: Author's calculations from National Treasury Section 71 Reports

In consulting stakeholders on this concern, the Commission is encouraged with indications from National Treasury that their approach to resolving the issue is not one sided but they are also dealing with the issue of departmental debt as well. There are also associated problems there with the accuracy of the billing systems which was being resolved by the task team established last year to deal with that issue.

Figure 6: Total Municipality Consumer Debt (R millions



(c) The Commission is further concerned on non-clarity on the assistance/intervention rendered to affected municipalities prior to the LES stoppage. Section 154 (1) of the Constitution prescribes that national government and provincial governments, through legislation or other measures, must support and strengthen the capacity of municipalities to manage their own affairs. It is not clear what support or capacity building measures were undertaken to assist municipalities in this regard. In addition, it is not clear if Treasuries in particular, also exhausted all available instruments and consulted all stakeholders as the MFMA requires. Some municipalities have questioned the accuracy of the billing systems of Water Boards, which makes it imperative that assistances in terms of independent verifications of such bills should have been undertaken prior to the LES stoppage.

(d) The Commission is concerned further that the debt issue, which should be resolved within the IGFR system is playing out in courts. Ideally such an issue should be resolved within the IGFR structures. The Commission would be concerned if the LES stoppage is a first resort instrument.

(e) The Commission notes with concern that some of the municipalities affected by the LES stoppage are also under administration in terms of Section 139 of the Constitution. Section 139 provides for the appointment of an administrator by the provincial government to run the day-to-day activities of the municipality. The list of municipalities under administration as well as being affected by the LES stoppage is presented in Table 3 below.

Table 3: Municipalities under Section 139 Intervention and Affected by LES Stoppage

Name of municipality	Year of Intervention	Type of intervention	Nature of Problem
Ditsobotla LM	April 2013	Section 139(1)(b)	Administration, Governance and Service Delive
Ngaka Modiri Molema DM	September 2014	Section 139(1)(c)	Governance and Service Delivery
Emalahleni LM	April 2013	Section 139(1)(b)	Governance and Financial Administration
Bushbuckridge LM	April 2013	Section 139(1)(b)	Governance and Financial Administration
Makana LM	October 2014	Section 139(1)(b)	Governance, Financial Administration ar Service Delivery

The main concern of the Commission with municipalities under administration being affected by the LES stoppage is: Who is accountable for the LES stoppage? As the administrator is appointed by provincial authorities, it follows that the provincial government is responsible for flouting the MFMA 30 day rule payment rule. The municipality authorities cannot be held accountable for nonpayment but the administrator is accountable and thus consequences/sanctions for such transgressions should fall on the administrator. The Community which ultimately pays the brunt of the LES stoppage is particularly a victim of a blunt instrument, which allows the consequences to fall on wrong parties.

(f) The Commission would also be concerned if National Treasury is misinterpreted as acting on behalf of government and non-government entities to collect their debt. National Treasury also shares the same sentiments and assured the Commission they would not want to be viewed as debt collectors for the entities, hence part of the approach is advising the relevant executives not to interfere with entities when they implement their credit controls in the form of switch off, or slow release of water as part of debt management.

(g) The Commission further notes that compliance with the 30 day payment rule should not be enforced only on municipalities alone, but also national and provincial government departments that owe municipalities, among others, should comply with this rule. In fact Section 38(1) of the PFMA (and Treasury regulations 8.2.3 (2001) and Treasury Instruction note No. 34) requires all accounting officers of national, provincial and local government departments and entities to settle all contractual obligations and pay all monies owing, including intergovernmental claims, within the 30 days from receipt of an invoice.

7. RECOMMENDATIONS

Given the above analysis, the Commission makes the following recommendations:

1. That a proper diagnostics of the root cause of non-payment be done and if it is due to management weaknesses, appropriate consequences should be rendered. As many municipalities are falling into debt problems, it is important that National and Provincial Treasuries play a proactive role in monitoring municipalities by properly diagnosing challenges in municipalities and ensuring remedial measures are implemented accordingly and timeously.

2. Municipalities must produce balanced budgets and in addition the electricity and water undertakings must be ring fenced. In addition, if consumers are not paying they must be disconnected to address the major debt owed.

3. Stricter measures should be imposed on individuals within municipalities that are responsible for continued flouting of MFMA rules. Cases of individual transgressions should be investigated and appropriate sanctions dully imposed against those specific individuals in accordance with the relevant laws. This will hopefully result in greater accountability by public officials. This should apply, not only to municipality officials, but to administrators appointed under Section 139 failing to remit monies owed to Eskom, Water Boards and other government entities; national and provincial officers failing to pay municipality debts timeously.

4. Disputed billing records of Water Boards should be independently verified before measures are taken against the individual municipalities. SALGA, National Treasury and Department of Cooperative Governance should proactively assist this process.

5. That intergovernmental fiscal relations (IGFR) forums dedicate sufficient time to find lasting solutions to the debt problems within the Local government sector.

6. That executives for the relevant entities implement appropriate credit controls as required in law.

7. As the LES stoppage will affect the provision of basic services to poor households, the Commission would encourage that this should be initiated as last resort and when a proper diagnosis of the problem has been undertaken, and when all possible assistance (or intervention) to a municipality has been rendered and exhausted . At this point it is not clear if National Treasury has consulted all stakeholders as the MFMA requires. LES stoppage should only be done when Treasuries have exhausted all available instruments and when stakeholders have been consulted as the MFMA requires.

8. That National Treasury applies the same pressure to all national and provincial departments that are not complying with the 30-day payment rule on municipal bills as per requirement of the PFMA. In addition, the Commission would like to see a speedy conclusion of the work of the task team examining the intergovernmental debt.

For and on behalf of the Financial and Fiscal Commission

Mr. Bongani Khumalo
Acting Chairperson/CEO

24 April 2015

8. APPENDIX

Figure 6 Ratio of LES to Operating Expenditure

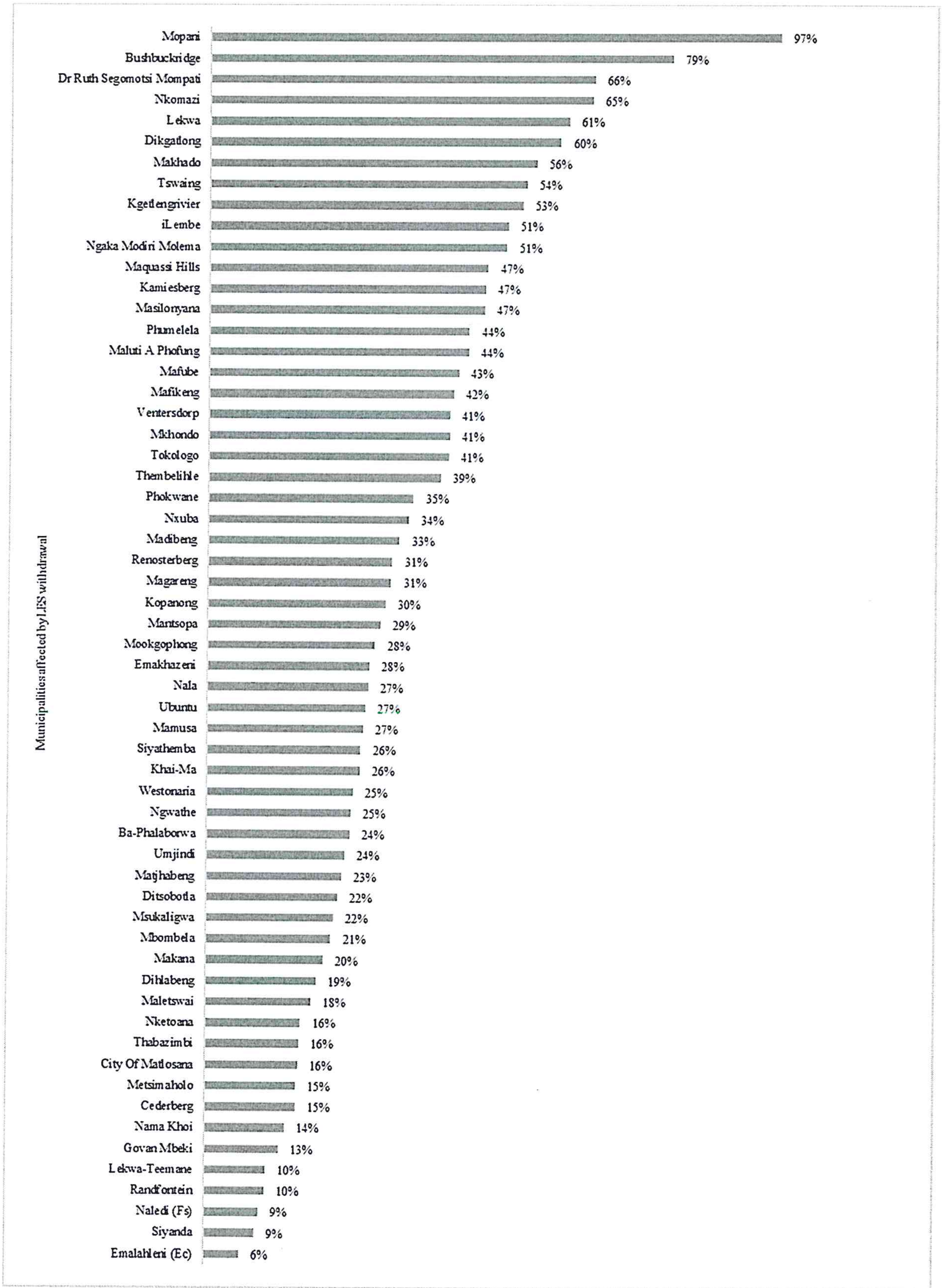


Figure 7 Amounts owed to Water Boards by Affected Municipalities: November 2014. (R- Millions)

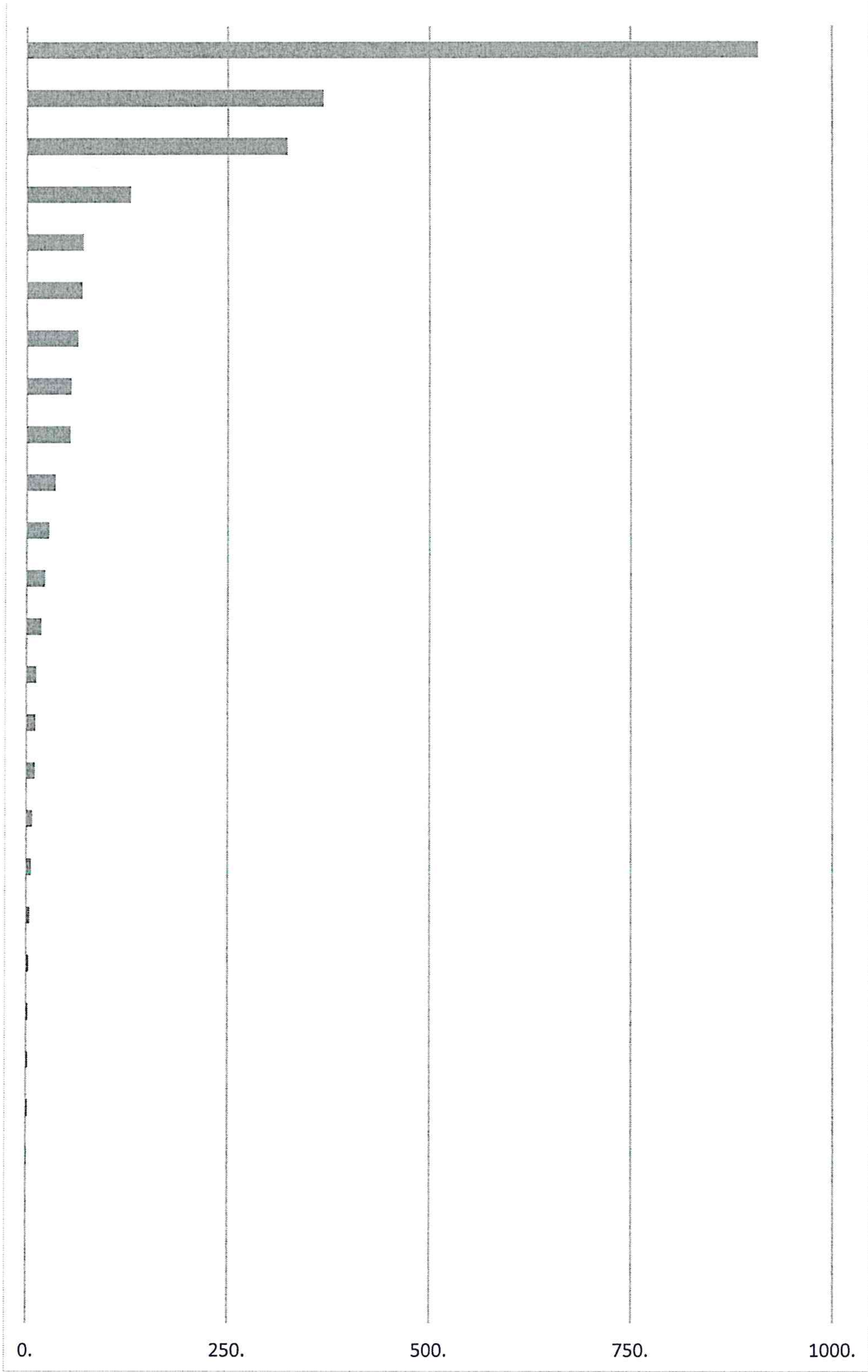


Figure 8 Amounts Owed to Eskom by individual Municipalities