

Municipal Finance

SOUTH AFRICA NATIONAL TREASURY

WINTER SCHOOL

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Threshold questions:

What is a municipality?

What powers and functions do municipalities have?

Municipal Finance

Where do municipalities get money?

- Taxes and fees
- Transfers

What do municipalities spend money on?

- Operations
- Capital investments

Financial management

How do municipalities manage their finances?

- Regulatory framework
- Implementation
- Outcomes

What is a municipality?

What are its powers and functions?






National Government

State, Provincial or Regional government

Local government



Some benchmarks

	 India	 Indonesia	 Saudi Arabia	 South Africa	 USA
Population	1.3 billion	274 million	35 million	58 million	328 million
GDP/capita	\$2,016	\$4,200	\$23,586	\$6,374	\$62,641
Structure	Federal	Unitary	Monarchial	Unitary	Federal
Municipalities	Weak	Strong	Weak	Strong	Strong

Operations vs. infrastructure

1. Operational

- Local revenues
 - Own source
 - Transfers
- Local expenditures
 - Operating
 - Debt service (if any)

2. Infrastructure financing

- Whose responsibility
 - National government?
 - Regional councils?
 - Municipalities?
- Local government financing
 - Pay as you go
 - Use savings
 - Borrow
- PPPs and municipal “entities”

Revenues

Taxes, e.g.

- property taxes
- business taxes
- (sales tax /VAT)

Fees, e.g.

- water / sewer
- solid waste
- connection fees

Transfers in

- conditional
- unconditional

Expenditures

Operational / recurrent

- salaries
- supplies
- O & M
- Debt service

Capital / one time

- buildings
- Vehicles
- Plant, property and equipment

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Capex / one time

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Capex / one time

- Buildings
- Vehicles
- Streets, parks
- Plant, property and equipment



Good local governance / culture

- Is there a shared, coherent paradigm of local governance?
- How is local government understood?
- What are perceived roles and responsibilities?
 - Local vs regional vs national?
 - Politicians vs officials vs citizens?
 - LG vs. other institutions?
 - Executive vs. judiciary
- Legal and financial tools depend on the political culture:
 - Understand why things are as they are
 - Beware of magic bullets



Comparing institutional accountability

Chicago Water:



- Direct accountability
- City employees
- No performance or service delivery agreement
- Consistently very good performance

Joburg Water:



- Drawn-out accountability
- External professional management -> company employees -> city employees
- Service Delivery Agreement
- Performance deteriorating from good to fair

The Role of Borrowing in Municipal Finance

Principles – municipal borrowing

1. Two types of borrowing:
 - Short term borrowing – cash flow
 - Long term borrowing – multi-year, asset finance
2. Borrow to finance capital investment, not to support budget
3. Borrowing term should match asset life
4. Borrowing leverages revenue streams, is **not** an alternative source of funds
5. Municipalities should be creditworthy borrowers
6. Creditworthiness depends on good management, including financial management.
7. Cost of capital should reflect credit quality
8. Laws and regulations are important, should not encourage nor discourage borrowing

Municipal borrowing: why or why not?

PROS:

1. More infrastructure, more quickly:
 - To extend services
 - To rehab / replace aging facilities
 - To support economic development
2. Intergenerational equity
3. Autonomous borrowing supports decentralisation

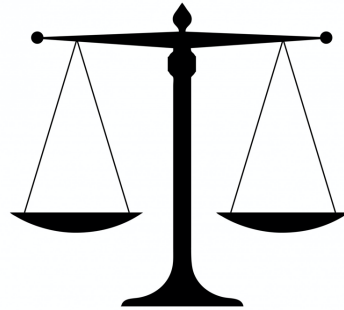
CONS:

1. Borrowing cannot substitute for balanced budgets
2. Limits flexibility of future councils
3. Borrowing can make bad choices worse

Municipal borrowing ecosystem

Creditworthy borrowers

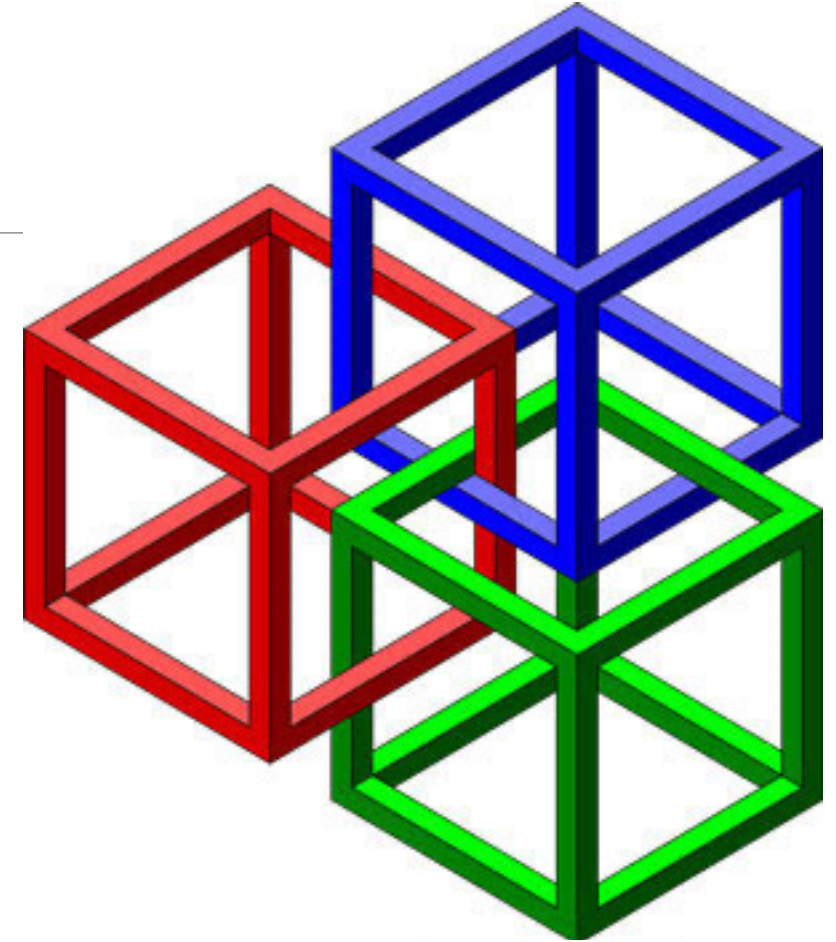
Investors / lenders



Regulatory / legal framework

Regulatory framework

- Revenue authority
- Financial Management
- Borrowing authority
- Pledges, liens, security
 - Remedies for creditors
 - Financial problems in municipalities



Specific types of instruments

- “General obligation” bonds or loans
- Revenue bonds or loans
- Green bonds or loans
- Retail bonds
- Catastrophe bonds

Revenue -> ability to pay -> borrowing capacity

Revenue under municipal control is most credible

- Taxes, especially property taxes
- Fees and charges, e.g., for water, solid waste, electricity
 - Monthly bills
 - Development charges
- Capital revenue (sale or lease of municipal assets)

Any revenue stream can support borrowing

- Transfers must be stable and predictable

Sustainable infrastructure finance

