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# LOCAL GOVERNMENT FINANCES

Finances lie at the core of effective and autonomous local government. If denied sufficient funding, local authorities cannot perform their functions. Local finances typically centre around four main matters: (1) the revenue of local authorities; (2) the budget; (3) expenditure; and (4) internal and external controls to prevent and correct poor financial management, including corruption.



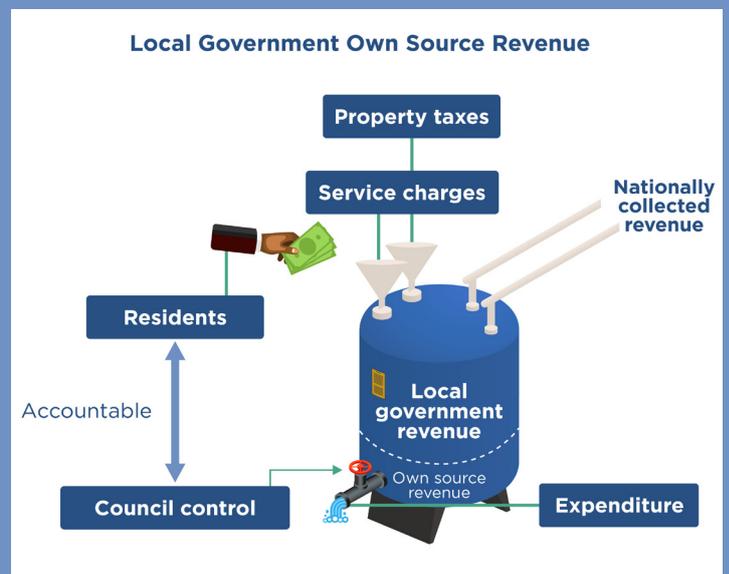
## The Revenue of Local Authorities

In the light of the responsibilities allocated to local government (see Fact Sheet #4), the basic principle is that 'funds follow functions'. Local authorities collect taxes and service charges, and also receive transfers from the central government. Ideally, local authorities should as far as is possible raise, by themselves, the necessary revenue to finance its functions. This promotes self-reliance, which in turn is essential for accountability and good financial management. However, all local authorities do not have access to the same economic resources from which they can raise tax revenue. At the same time, all citizens of a country are entitled to a similar level of services, or at least a similar 'minimum floor'. Revenues raised nationally should then also be shared among local authorities according to their respective needs.

## Raising own revenue

As local democracy is aimed at allowing local citizens to express their preferences with regard to the services they receive, they will hold the politicians and administrators accountable for the taxes they pay and the services they demanded and received. But when a local authority receives the bulk of its revenue from the central government, there is no accountability to the local community, and wastage occurs and resources squandered. In Nigeria, for example, local authorities, which receive almost all their revenue through federal transfers, have often been accused of reckless and corrupt spending.

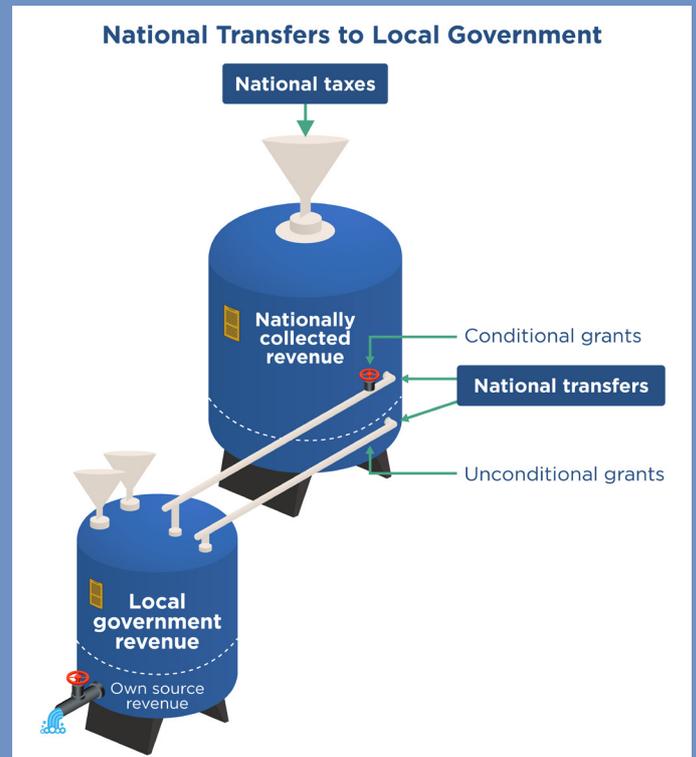
Property taxes are the primary local tax used across Africa. Other taxes include entertainment taxes (on movie or sports tickets, for instance), while further revenue is earned on the issue of various licences, such as vehicle licenses. Where a local authority provides electricity, water, sanitation and refuse removal, the user charges for these services can bring in substantial revenues. In South Africa, most municipalities raise the bulk of their income through user charges on electricity and water.



## Transfers from central government

The revenue that local governments can raise is usually too little to cover all the expenditure for the services and functions they must provide. There is thus a big funding gap between own revenue and expenditure obligations, the size of which depends on the amount of revenue that each local authority can raise from its economic base. The central government thus fills the funding gap, ensuring that there is a minimum floor of services that all local authorities must deliver. The central government may also give conditional grants with the aim of implementing national programmes, such as road construction.

The decision as to the amount of money that should be transferred to all local governments, and how that amount of money divided between the different local governments, is often difficult to make. In Zimbabwe, a minimum of 5 per cent of the national budget must be transferred to all the provinces, metropolitan councils and local authorities. The usual approach is that the central government determines the amount, often with some input about their needs from the local government. The fairest method of distributing transfers among local governments uses a number of factors, captured in a formula. This ensures that the amount each local authority receives is not subject to political manipulation, but determined according to their needs.

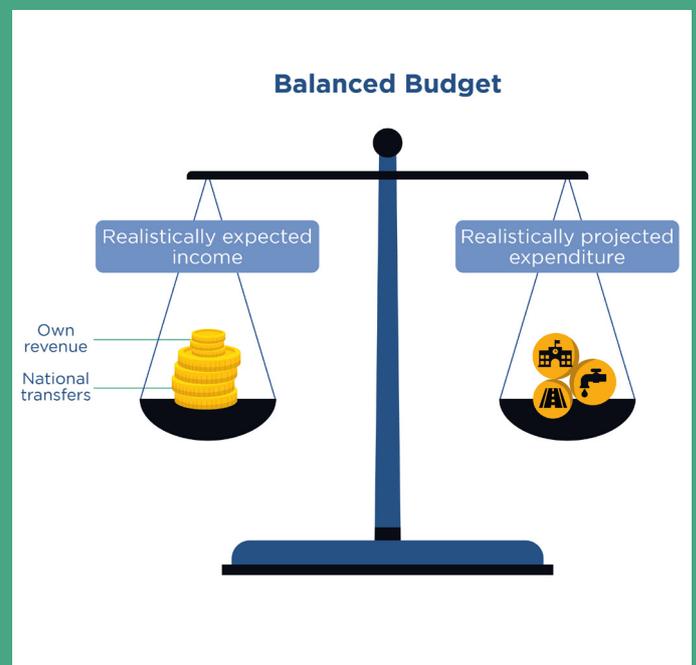


## Budget

The adoption of the annual budget is the most important decision that the elected council of a local authority makes every year. It sets out its spending priorities (which services and at what level they will be delivered), and how they will be funded.

In countries like South Africa, where local authorities enjoy a measure of autonomy, the council makes the final decision. In others, such as Botswana, the budget must be approved by the Ministry responsible for local government, a process that undercuts local accountability.

As a general rule, local authorities may not run deficit budgets, meaning that they must be balanced and that their realistically expected income must match their foreseen and planned expenditures. But this raises the question of a council's borrowing powers: can they borrow money to balance the budget? In this regard a distinction is often made: money may not be borrowed to cover current expenditures, but loans can be made to pay for long-term infrastructure projects. In most countries very strict conditions are set by the central government about when a local authority may borrow.





## Expenditure

In most African countries, the scourge of mismanagement of finances and corruption is ever present, and it mostly revolves around expenditure decisions. How is this problem addressed? Governments' hard earned revenue must be spent according to following principles:

- Expenditure must implement the budget. Expenditures may not be incurred for purposes other than that specified in the budget, and only for those amounts allocated in the budget.
- Expenditure decisions must follow the correct process, and must comply with the prescribed rules and regulations relating to procurement of goods and services in particular. Expenditures may thus not be irregular.
- Expenditure must be used for productive ends; hence the rule against fruitless and wasteful expenditure.

Where local government has a measure of autonomy, the council makes the final decisions about expenditure. In some countries, local governments are not trusted to make these decisions, requiring that the central government must approve large-item expenditures.



## Controls over expenditure

The democratically elected council is the primary body mandated to ensure that a local authority's finances are properly managed. They must ensure that all the taxes and fees due, are collected; that expenditure is carried out according to general rules on procurement; and that the basic rules of balanced budgets are followed. However, this body could fail to execute this task properly because officials lack the necessary skills and capacity, or municipal revenues are misspent because of corruption. This can be remedied in the following ways:

- The finances of a local authority must be transparent, so that civil society may question and hold the council accountable.
- An important institution that has been put in place to ensure transparency and accountability is the Auditor-General. This office checks whether revenue was collected according to the law, and how it was spent. It reports to both the council and the central government, both of which should act upon its recommendations.
- The central government may take supervisory action, as outlined in Fact Sheet #7.
- There may also be other constitutional bodies, such as an ombudsman or an anti-corruption commission, that can investigate complaints of maladministration and corruption.

