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FINANCIAL AND FISCAL
FACILITATION OF
DEVELOPMENTAL LOCAL
GOVERNMENT IN SOUTH
AFRICA

JANUARY, 2000

*MASTERS DISSERTATION IN THE FULFILLMENT OF M.SOC.SC
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Abbreviations

ANC – African National Congress
BCIG - Bulk and Connector Infrastructure Grants
BLAs – Black Local Authorities
CMIP – Consolidated Municipal Infrastructure Programme
CWSP – Community Water Supply Programme
DBSA - Development Bank of Southern Africa
DCs – District Councils
DCD – Department of Constitutional Development
DFID - Department for International Development
DIMS – Development Indicators Monitoring System
DLG – Developmental Local Government
DWAf – Department of Water Affairs and Forestry
EMIP - Extended Municipal Infrastructure Programme
EU- European Union
FFC - Financial and Fiscal Commission
FRELOGA - Free State Local Government Association
GAMAP – Generally Accepted Municipal Accounting Procedures
GEAR – Growth, employment and redistribution strategy
LDO – Land Development Objectives
LGTA – Local Government Transition Act
IDP – Integrated Development Planning
INCA – Infrastructure Finance Corporation Limited
MCs – Metropolitan Councils
MEC – Member of the (provincial) Executive Committee
MIIF – Municipal Infrastructure Investment Framework
MIIU - Municipal Infrastructure Investment Unit
MIP - Municipal Infrastructure Programme
MLCs – Metropolitan Local Councils
MSPs – Municipal Service Partnerships
NCOP - National Council of Provinces
NER - National Electricity Regulator
NGO – Non-governmental Organisation
NNP – New National Party
NORWELOGA - North West Local Government Association
TLCs – Transitional Local Councils

TRCs – Transitional Rural Councils

TRepCs – Transitional Representative Councils

RDP – Reconstruction and Development Programme

SALGA - South African Local Government Association

SAMWU - South African Municipal Workers Union

SMME – Small, medium and micro sized enterprise

USAID – United States Agency for International Development

UNDP - United Nations Development Programme

VIP – Ventilated improved pit (latrine)

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Abstract

Local government in South Africa is mandated with the delivery of basic services. This responsibility reflects the evolving role and status of subnational governments across the world. In South Africa, local government policy is underpinned by a developmental vision. The vast backlog of infrastructure that apartheid entrenched requires that considerable financial resources facilitate basic service delivery. In many other countries, inter-governmental transfers account for a far larger portion of municipal revenue than in South Africa where financial capacity is broadly assumed to be sufficient for expenditure needs. This is an inequitable assumption - for communities that do not have substantial revenue bases the current fiscal and financial system undermines equalised service delivery. Inter-governmental relations therefore require revision if municipalities are to address socio-economic inequities. Fiscal options to facilitate developmental government include a greater transfer of resources to local government, or, if the constraints of the fiscus inhibit this, transfers that primarily focus on equalisation. If this restructuring does not occur, local government will not have the financial means to ensure that decentralisation implies the optimal mechanism for development – improved financial and fiscal facilitation of developmental local government is therefore imperative.

Introduction and overview

“Even as globalization directs the attention of national governments to events, forces, and ideas outside their borders, localisation highlights the opinions and aspirations of groups and communities at home... The ability of people to participate in making the decisions that affect them is the key ingredient in the process of improving living standards – and thus in effective development. But political responses to localization can be successful or unsuccessful, depending on how they are implemented.” (World Development Report 1999/2000).

An increasingly globalised world has redefined the importance of jurisdictions, and particularly of localities. In order to deal with the increasingly complex networks of economic and social development, governments at subnational, national and international levels have had to begin processes of extensive transformation (Abedian, 1998a). An element of this transformation attempt to draw down governance to the most appropriate jurisdiction – a policy of decentralisation is appropriate in some instances (say, municipal transport), whereas in others, issues like environmental standards extend beyond national boundaries and require alternative (international) arrangements.

South Africa has not been immune from the trend towards decentralisation and is cited by the World Bank in *the 1999/2000 World Development Report* as an important example of the decentralisation of national responsibilities. South African public policies have argued that local government can play a significant role in the reconstruction and development of society - by embedding government that is focussed on delivery at a level that its constituencies can respond to.

“Perhaps the most appropriate understanding of local government is that it should be a dynamic system of governance whereby power resides with the people of that locality and the municipal authorities are themselves the hands and feet of government as a whole.” President Thabo Mbeki (July 1999¹).

The term given used to describe this form of proactive and representative local government in South African literature is *developmental* local government. Developmental local government is described by the *White Paper on Local Government* as “local government committed to working with citizens and groups within the community to find sustainable ways to meet their social, economic and material needs and improve the quality of their lives”. Development local government is

¹ Address to SADC Local Government Conference, 30 July 1999.

therefore of great consequence to most South Africans. An important precondition is that municipalities remain solvent, requiring careful balancing by national policy to ensure delivery and redistribution to poorer constituencies without hampering the development of prosperous localities.

Market forces have not (yet) assisted this process of transformation. During the transition from highly racialised and skewed local authorities to a representative sphere of government responsible for the delivery of considerable levels of social infrastructure, local government has been restricted access to capital markets that are wary of risk implied by uncertainty surrounding municipal boundaries and structures. Intervention and establishing the correct policy environment has become a critical role for national policy makers.

As boundaries and structures are finalised, setting up adequate and appropriate financial arrangements that can underpin sustainable and viable local government has become increasingly important. The legislative process which promulgated the Demarcation and Municipal Structures Acts in 1998 put in place a legal framework with which to realise the constitutional vision of a developmental local government. However, without adequate finances local government will not benefit from structural transformation.

Reports in the South African press describe the financial state of local government as anything from fragile to a crisis. Whilst most of these problems are accentuated by problems with debtors, there are a number of inherent and inter-linked structural, financial and fiscal conditions that contribute to this plight. One such important example is the significance of boundaries that were hastily put together for the first local government elections. If demarcation legislation is correctly adhered to, the second local government elections should see a better set of boundaries put in place from a financial perspective in that they will account for the economic linkages between localities.

The Constitution requires that local government, within its financial and administrative constraints:

- Provide democratic and accountable government,
- Ensure the provision of services to communities in a sustainable manner, and
- Promote social and economic development within a safe and healthy environment.

Despite the significance of this role in the South African context where the needs of a vast number of communities are immense, the prospects for local government depend on a number of factors. Constitutional empowerment and requirements are inadequate to ensure implementation. Clearly a prerequisite for a thriving local government is sound and stable finances, a factor that cannot be assumed of all South African municipalities.

Sound financial positions, in turn, need to be supported by a number of inter-related factors (like appropriate municipal boundaries and structures for these finances to be distributed through). These factors are therefore considered in some detail in order to understand the framework with which local government's financial and fiscal arrangements need to interface. A distinct but critical factor that is not examined in detail is the capacity to deliver, but this is not to underestimate its significance. Even with sufficient financial resources, inadequate human resources constrain local government's potential. Rather, the focus is specifically on direct and indirect financial considerations affecting local government, although structures to put in place financial skills are detailed.

Chapter 1 examines the legal status, its logic and emerging (metropolitan and non-metropolitan) structures of local government and whether this structure is likely to materialise as developmental local government. Without adequate financial powers or entitlement to fiscal resources, developmental local government is doomed to failure. Hence the constitutional entitlements of local government, and why these have arisen out of historical circumstance, are explored in some detail so as to ascertain whether they are appropriate for developmental local government or not. Although only a prerequisite for success, the considerable (financial and functional) powers accorded to local government by the Constitution suggest that developmental local government is feasible within current legislative frameworks (assuming that these are properly applied).

Chapter 2 broadens the concept of decentralisation to a theoretical level and incorporates fiscal dimensions. Principles governing inter-governmental fiscal relations are explored in some detail, looking to practical experience for some examples. The chapter further investigates the limitations of decentralisation within the South African context. Issues raised by the *White Paper on Local Government* are considered, as well as the likely impact of revised boundary demarcations and better planning procedures. The widely publicised problem of non-payment for services is also explored in some detail, in order to appreciate the inherent constraints on decentralisation in South Africa. Whilst decentralisation can occur along a continuum, and is hampered by circumstantial factors that are especially prevalent in developing countries, it is apparent that a significant degree of decentralisation is possible in South Africa.

Chapter 3 focuses in greater detail on local government's financial status. Aggregate balance sheets are assessed in terms of expenditure items and revenue items. Revenue from user charges for electricity and water receive specific attention, as do fuel and RSC/JSB levies. Debates around property tax structures are also highlighted, as are those surrounding municipal borrowing – both significant sources of income for municipalities (see Section 3.1). An understanding of local government's financial position is imperative to assess the opportunities

and constraints of fiscal decentralisation, as well as the requirements of the inter-governmental fiscal system. The findings on local government's balance sheets suggest that local government is under considerable strain. Although local budgets are not inconsiderable, existing revenue sources are unlikely to deliver the capital that the sphere needs to make significant progress in closing the infrastructural backlogs of the past. In addition, a number of these sources are undergoing restructuring and are likely to fluctuate.

Chapter 4 therefore examines the dynamic trends of revenue. Problems highlighted by two key studies on financial stability are assessed, as well as alternative sources of revenue. These problems are numerous and severe and relate to the stresses of institutional as well as financial reform. Essentially local government is faced with a far greater and more expensive mandate than it was in the past when it served white communities, but is equipped with the same level of revenue. This situation requires a reorientation of local government, alternative revenue sources and innovative responses.

The two greatest potential areas for leveraging more income into local government include municipal service partnerships (MSPs) and the development of a municipal bond market. Both the potential and limitations of these revenue sources are considered. Chapter 4 also explores structural responses to local government's financial and transitional difficulties. These include the national strategies of the Local Government Transformation Programme, as well as the metropolitan specific plan for Johannesburg as envisaged by iGoli 2002.

Chapter 5 reviews the system of inter-governmental transfers (IGTs) to local government, taking into consideration the structural and financial challenges facing local government as outlined in preceding chapters. It analyses IGTs in terms of both historical (1995-1998), as well as current policies. These policies are assessed both from the perspective of the allocation of revenue from national to local government (the vertical division), as well as between municipalities (the horizontal division).

Proposals by the Financial and Fiscal Commission (FFC) are compared with actual policy and the implications of varying approaches to IGTs are assessed. The chapter's contents suggest that the current system of IGTs is unlikely to fully deal with the challenges facing local government and that further refinement and revision of policies is necessary to ensure the equitable distribution of revenue within local government, and between local government spheres.

Current fiscal policy argues that local government must take responsibility for its liabilities and that it must make use of its taxation powers to meet expenditure needs (so as to avoid a moral hazard problem). As a result, local government receives less than 2% of nationally collected revenue. Whilst this calculation may be sufficient to meet the policy objective of subsidising

access to municipal service for the indigent, it is unlikely to deal with the problem of backlogs.

Chapter 6 concludes and motivates for a revision of the existing system of inter-governmental transfers to local government. Either a greater quantum of resources should be transferred to local government (the vertical division should increase), and/or the current inter-governmental transfers should have a more redistributive design. Although national government is loath to set the precedence of intervention, there are a number of reasons why the *status quo* should be addressed.

The first is a question of equitable transition – should the localities that apartheid disfavoured continue to suffer under the debt and backlogs of the past? Excessively decentralised financial powers mean that only the localities that apartheid favoured are likely to access adequate resources for capital development. The tenor of the *White Paper on Local Government* suggests that the correction of these imbalances is critical for the advancement of South African society, and for social equity.

The second reason is around cost effectiveness, and the risks of failure. Should developmental government not adequately materialise owing to a lack of resources and therefore fail to deliver an acceptable level of municipal services to all communities, apartheid disparities are likely to deepen, with all their associated inefficiencies. Inadequate levels of sanitation, refuse removal, water supply and other basic services carry large health risks for communities, and costs. In short, an inability to tackle ever-mounting backlogs would undermine attempts to improve the quality of their communities' lives and divert attention to crisis management.

Probably the most important reason for revising the current system is that the hopes and aspirations of the majority South Africans, who voted for a government that promised to reconstruct and develop their society, would be disappointed and their opportunities stunted. Whilst this promise serves the objective of social equity well, it requires careful policy to be implemented, as national governments have limited options with which to exercise fiscal powers:

“[G]lobal integration has had far reaching ramifications for the conduct of policy and the management of the fiscus. It has effectively reduced the state's freedom to exercise conventional fiscal powers.” Abedian, I (1998b).

Decentralisation must be more than a fashionable design of power relations between government spheres; it must imply substantial and cost-effective development for all localities in a world of increasingly scarce public resources.

1. The Structure of local government in South Africa

Local government is one of the three spheres of government created by the Constitution². Contained within the Constitution and subsequent policy work is the concept and definition of *developmental* local government. This concept is of considerable strategic significance for furthering social development programmes at a local level, as well as for the position it affords local government.

As the structures and status around local government continue to be clarified, however, it is not yet apparent whether the vision of developmental local government is feasible or not. One of the key factors of its feasibility surrounds financial arrangements, which is determined, in part, by local government's fiscal relationships with other government spheres.

The *White Paper on Local Government*³ and the Constitution articulated public expectations and perceptions around government's role in the reconstruction and development of South African society. Broadly speaking, local government is expected to ensure the co-ordination and facilitation of all aspects of development affecting communities at a local level.

More specifically, Section 152 of the Constitution requires that local government, within its financial and administrative constraints to provide democratic government and services to communities while furthering social and economic development within a safe and healthy environment.

This broad mandate infers that no one area of local government can be discussed without reference or consideration of others, as objectives and their programmes are necessarily overlapping and intertwined. Consequently, local government's financial arrangements need to be contextualised in order to examine ways in which to facilitate the objectives of developmental local government. In considering local government as a holistic system of which finances are an integral (as opposed to an exogenous) variable, a sketch of the legal framework; practical challenges and policy debates affecting the sphere are outlined in this chapter. This background is necessary to inform an assessment of financial and fiscal arrangements in following chapters.

1.1.1 Developmental local government - the vision for South African local government

“We have to innovate and transform our vision; the transformation has been fundamental. Developmental local government is a new vision; a new paradigm based on our Constitution. Developmental local government must deal with two

² Constitutional Assembly. (1996). *The Constitution of the Republic of South Africa, 1996*. Act 108 of 1996.

elements concurrently. We must address massive poverty; the depth of this poverty cannot be underestimated. At the same time, we must sustain the areas of our country with 'first world' infrastructure and institutions. The challenge is to combine the two – it is a long process. But we now have the instruments: the legislation, the development of new cultures for governments and officials, new skills and new support programmes. Our democracy must be political, social, and economic; it must be transformative." Pravin Gordhan (April 1998⁴).

Local government is widely viewed as a driving force for the transformation of South African society. Unsurprisingly so – activism at the community level and its resistance to apartheid structures during the 1980s were critical levers to the attainment of democracy in the 1990s. This experience supports arguments in favour of decentralisation; that communities have the greatest access to government at the local level and hence the greatest ability to articulate and see the fulfilment of their needs.

This feature of responsiveness is not only applicable to South Africa but has been used to motivate a number of decentralisation policies around the world. Notably, the United Kingdom's 1998⁵ White Paper on Local Government is entitled *Modern Local Government – In Touch with the People* – a theme that resonates strongly with the concept of governance⁶ in the South African Constitution and *White Paper on Local Government* (see Section 2.1 on decentralisation arguments).

Motivated by historical experience and international trends, a strong local government is therefore a key feature of the South African Constitution. According to the *White Paper on Local Government*, local government is mandated by the Constitution to:

“Provide democratic and accountable government for local communities.

“Ensure the provision of services to communities in a sustainable manner.

“Promote social and economic development.

“Promote a safe and healthy environment.

“Encourage the involvement of communities and community organisations in the matters of local government”. (1998: ix).

³ Issued by the Ministry for Provincial Affairs and Constitutional Development, March 1998.

⁴ *White Paper on Local Government* Parliamentary Hearings, quoted in USN (1998).

⁵ Interestingly, published shortly after the South African White Paper on Local Government.

⁶ Essentially implying governing *with* the people rather than *for* the people – a re-orientated “citizen friendly” approach and ethos.

Clearly, local government is intended to optimise its potential as the government “closest to the people”. As argued by the Department of Constitutional Development’s (DCD’s) advocate Paddy Roome⁷ (1998), this position demands that communities are to be seen as partners by local government:

“[The *White Paper on Local Government*] establishes the basis for a system of local government that is centrally concerned with working with local citizens and communities to find a suitable way to meet their needs and improve the quality of their lives.”

Empowered local government cannot, however, emerge without adequate resources – human and/or financial – nor without an ethos of accountability. Fortunately, the Constitution and its reflection in the *White Paper on Local Government* have given a clear articulation of the values and roles that local government is intended to promote and accorded these with significant legal powers, putting in place the framework for a strong local government.

1.1.2 The context of government spheres

Of great significance, local government is awarded the status of a “sphere” by the Constitution. “Spherical” government is intended to represent a distinct juncture from traditional hierarchical versions of government. It also represents a break from the arrangements under the Interim Constitution whereby local government was a functional responsibility of provincial government.

At the same time, however, the Constitution’s Chapter 3 articulates the need for “co-operative governance”. While each sphere is autonomous, its influence and effect is overlapping – they are thus “distinctive, interdependent and interrelated”⁸. In order to compel such inter-governmental relations, Section 41 requires that each sphere “respects the constitutional status, institutions, powers and functions of government in the other sphere”, as well “co-operate with one another in a relationship of mutual trust”.

Hence the concept of co-operative governance allows for the attainment of national priorities via decentralised spheres of government. Bhabha (1997) explains the motivation:

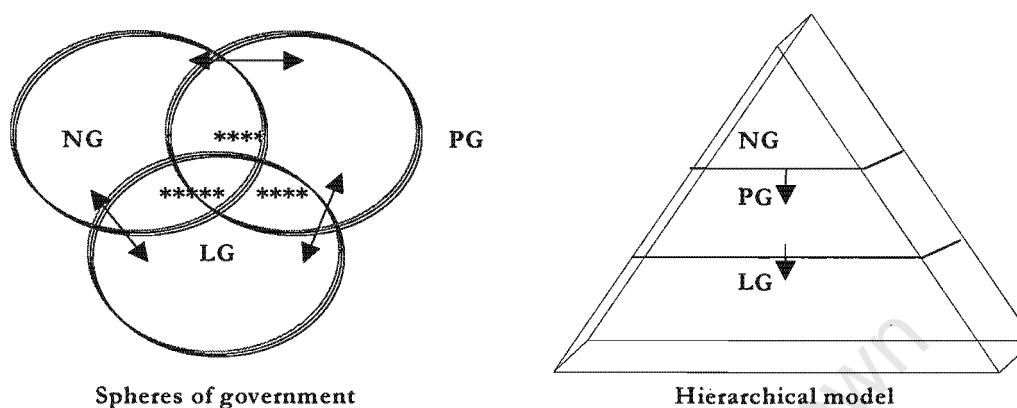
“The African National Congress (ANC) was always firmly of the view that strong central government was an absolute necessity to address the imbalances of the past and to unify a society fragmented by decades of enforced separation. However, it was also equally of the view that there is a need for strong and effective local government to bring government closer to the people”.

⁷ Legal advisor and legislator of local government legislation.

⁸ Section 40 (1) of the Constitution.

The conceptual framework with which to achieve these objectives is represented graphically below:

Figure 1– Spheres of government and inter-governmental relations



NG – National Government PG – Provincial Government LG – Local Government
 *** areas of co-operative governance

1.1.3 Specific powers

According to its Constitutional status, local government is empowered to:

- manage and structure its administration, budgeting and planning to give priority to basic needs (Section 153(a));
- provide basic services and the functions allocated to it by the Constitution using an equitable share of nationally raised revenue specified by an Act of Parliament (Section 214 (1) (a), 227 (1) (a));
- receive other allocations or grants from national government revenue (Section 227 (1) (b));
- and
- impose rates on property, excise taxes and under certain conditions, other taxes, as well as raise loans (Sections 229(1), 230 (1)).

These powers enable local government to be largely autonomous in its operations – entitled to plan autonomously as well as support its strategies with sources of revenue derived from nationally collected revenue, as well as from self-raised revenue. These powers are still to be fully applied by local government structures that are in the process of being redesigned.

1.2 Structures and categories of local government

1.2.1 Transition and the Constitution

Under the interim phase of local government⁹, local government is divided into metropolitan and non-metropolitan structures. Once the *Municipal Structures Act*¹⁰ is effectively implemented¹¹, the Constitutional structures for local government are likely to become reflected more obviously than they are under the interim phase.

The Constitution provides for 3 categories (A, B and C) of local government. Category A municipalities operate as single-tier organisations with exclusive executive and legislative control over their municipal area. Categories B and C form part of a two-tiered system. A category B municipality “shares municipal executive and legislative authority in its area with a category C municipality within which area it falls”¹². Category C municipalities have “municipal executive and legislative authority in an area that includes more than one municipality”¹³ (that is, over Category B municipalities).

Currently municipalities operate as partial two-tier systems as envisaged by the Local Government Transition Act (LGTA)¹⁴. In metropolitan cases, Metropolitan Councils (MCs – Category C types) generally provide bulk services and planning for Metropolitan Local Councils (MLCs – Category B types) - substructures that fall under their jurisdiction.

The non-metropolitan context is less clear under the LGTA. District Councils (DCs) exist in all provinces and have much the same responsibilities as MCs do, although their functions may vary from province to province. DCs tend to play a particularly important role in overseeing the development of infrastructure in non-metropolitan areas (although capacity to do so varies tremendously), whereas MCs co-ordinating and planning roles tend to be of greater importance in metropolitan areas. Transitional Local Councils (TLCs) fall under DCs (as MLCs do under MCs) in urban areas and rural surroundings. TLCs can range from secondary cities such as Port Elizabeth to small towns and act as autonomous units of government. Transitional Rural Councils (TRCs) and Transitional Representative Councils (TrepCs – essentially TRCs without executive status) represent rural areas, with DCs playing the predominant role of service providers. In the North West Province and KwaZulu-Natal, “remaining areas” refer to areas

⁹ Which will end with elections in 2000, heralding the start of the “final stage”.

¹⁰ No. 117 of 1998.

¹¹ In turn requiring the implementation of the Demarcation Act (No. 27 of 1998) in time for ward demarcations for the local government elections to be held after 1 November 2000.

¹² Section 155 (1) (b) of the Constitution.

¹³ Section 155 (1) (a) of the Constitution.

¹⁴ Act 209 of 1993, amended by Act 34 of 1994, which authorises the President to amend the LGTA by proclamation.

where there is no primary rural municipality (Katz Commission, 1998). These exist in all other provinces.

The two final and interim descriptions of local government are represented by the figure below:

Figure 2 – Transitional and final structures

| Metropolitan areas | Non-metropolitan areas |
|---|--|
| Secondary tier | Secondary tier |
| Metropolitan Councils (Category C – could become Category A under a ‘unicity’ model) | District Councils (Category C) |
| Primary tier | Primary tier |
| Metropolitan Local Councils (Category B) | <i>Urban:</i> Transitional Local Councils (TLCs) (Category B) |
| | <i>Rural:</i> Transitional Representative Councils (TRepCs) (Category B) Transitional Rural Councils (TRCs) (Category B) |

[Source: Katz Commission, 1998]

The Municipal Structures Act makes additional provision for sparsely populated areas by creating a separate category for “developing municipalities”. At public hearings held in July 1998, this proposal was criticised for its non-specificity by the South African Local Government Association (SALGA) as well as the Financial and Fiscal Commission (FFC). It was explained by legislators that the intention is that the category apply to vast tracts of land that are underpopulated although this was not explicit in the Bill. Other critics included non-governmental organisations (NGOs). The National Land Committee¹⁵ suggested that a ward system be applied to DCs. The Urban Sector Network¹⁶ felt that there was a risk of insufficient community participation in the establishment of municipalities.

1.2.3 Metropolitan structures, including the ‘Megacity’

At present there are 42 DCs and 6 MCs - 4 in Gauteng, 1 in KwaZulu-Natal and 1 in the Western Cape, all of which cover the surface of South Africa (Katz Commission, 1998). This gives rise to the description “wall-to-wall” municipalities. Under the 6 MCs there are 24 metropolitan local councils - 12 of which are situated in Gauteng, 6 in KwaZulu-Natal and 6 in the Western Cape.

According to the *White Paper on Local Government*, MCs and DCs should act as regional mechanisms for redistribution and provide support to primary councils. This has proven to be difficult where interest groups have contested the outflow of capital from richer to poorer substructures. Although the *White Paper on Local Government* notes that “the mechanisms for intra-

¹⁵ NLC – A network of rural NGOs.

¹⁶ USN – A network of urban NGOs.

metropolitan redistribution are not optimal” (1998: 5), a revision of the existing system presented one of the most contentious proposals put forward by the Municipal Structures Act – giving rise to the “megacity” (or unicity) debate.

The unicity model of single tier metropolitan government falls under category-A type municipalities as defined by the Constitution. The Municipal Structures Bill suggests, within this model, two broad sub-categories (*Financial Mail*, 4/9/98):

- Councils empowered to establish metropolitan executive committees,
- Councils empowered to establish executive mayors.

The reasoning behind a single executive tier structure for metropolitan areas points to the redistributive and planning scope that can accrue to a single locality. This is considered necessary to redress the intra-metropolitan disparities created by apartheid.

There are also service delivery benefits from single metropolitan structures, as argued at the time of the debate by the Deputy Director General of Constitutional Development, Dr. Crispian Olver¹⁷:

“in exercising their prerogative to sign contracts with outside service providers, metropolitan councils must be free to make the decisions on rational, economic grounds, for the whole area under their jurisdiction” (*Financial Mail*, 4/9/98).

According to a report commissioned by the DCD, practitioners are less certain of the value of one structure over another:

“There appeared to be a growing consensus, possibly with the exception of the Western Cape, that metropolitan areas should be Category A municipalities. Greater Johannesburg, Pretoria and Durban appeared to have moved away from the debates around whether or not metropolitan areas should be category A municipalities towards a more detailed discussion on how to ensure the metropolitan system could become more effective, efficient and responsive to local needs and peculiarities. ... At the same time, there were quite strong feelings in these three metropolitan regions [Johannesburg, Pretoria and Durban] that such single-tier governments require the flexibility to develop their own administrative, legal and political mechanisms for ‘getting the job done’. In the case of Greater Johannesburg, there was a strong sense that the provincial Proclamation 42 which should have built on local consensus for strong central powers had set the metropolitan region back quite significantly. It was therefore felt that national and provincial legislation should not

¹⁷ Now the Director General of the Department of Environmental Affairs and Tourism.
January, 2000

be too prescriptive so as to dampen once again local initiative and agreement.”
(Sutcliffe, 1998).

Those opposed to the idea of a unicity cite the argument that an overly bureaucratic system is likely to undermine economies of scale and remove communities from effectively participating in local government. Philip van Ryneveld of the Cape Town City Council is one such detractor:

“While there are economies of scale in providing such services, there are also diseconomies of scale. If the metropolitan boundaries are drawn as widely as they should be to enable effective governance of the truly metropolitan concerns, then the sheer volume of issues dealt with by the single councils is likely to prove overwhelming in many instances”. (Van Ryneveld, 1998).

It should be noted that some of the most vocal of opponents of the unicity are interest groups representing cities’ more affluent groupings. These groups argue that the proposed system of ward committees will not afford them the same representation as MLCs (and thus revenue raised within one area could be more easily channelled to other areas – although this point is rarely made explicit). According to Frances Kendall (a Democratic Party councillor), the unicity proposal is a “blueprint for urban disaster”, and the ward committee system is effectively “toothless” with wards as the “handmaidens of the councils” (*Business Day*, 29/5/98).

Articulating these critiques in the press, the Centre for Development and Enterprise (CDE) called for a presidential commission “to determine the causes of the current crisis in local government”, strongly criticising the contents of the White Paper on Local Government (*The Star*, 3/6/98). As the *White Paper on Local Government* goes to some length to identify the problems facing local government (refer to Section 2.1.1) a question of analysis must lie at the root of the organisation’s objections. At the hearings, Dr. Olver (of the DCD) stressed that the *White Paper* process had been a consultative and iterative one in which CDE had not appropriately engaged.

The *Municipal Structures Act*, after lengthy debates and delays in its promulgation, appears to have accommodated concerns around the unicity by allowing for flexibility from province to province:

“The [Municipal Structures] Bill provides a wider range of options, and greater flexibility for the internal political restructuring or transformation of local government. It will give opportunities to evaluate and adapt different structures to the advantage of local government. In the longer term this must be to the benefit of local government. In the immediate term however, it means further change.”
(Roome, 1998).

As the metropolitan areas in South Africa are faced with varying spatial and financial challenges, it is likely that provincial determination of final structures represents a pragmatic solution, and the most suitable delivery options are likely to differ from city to city.

This flexibility is likely to be particularly important where intergovernmental sensitivities should be incorporated. One option - the executive mayor model, for example, may threaten provincial premiers in terms of financial jurisdiction (*Financial Mail*, 4/9/98). Findings in a study by Sutcliffe (1998) support such a contention:

“The first and most striking point to note is the sheer size of top local government budgets particularly when compared with provincial budgets. While provincial budgets ... include the capital and recurrent transfers from national government and own revenues, the differences between the four largest metropolitan regions and provincial budgets are not that great. In deed, Greater Johannesburg, Cape Metropolitan Area and Durban form the sixth, seventh and ninth provinces if one is simply interested in size of budgets.”

There are, however, critics of the role of provincial government in determining municipal categories. The University of the Western Cape’s Fair Share argues that the provincial role was too great¹⁸, treating local government more as a tier (a subordinate) than a sphere (an equal). A delegation from Langa, similarly, objected to the role given to provincial MECs, as a “small kingdom”¹⁹, and the NLC has expressed concern at the latitude given to provinces in the determination of local government affairs²⁰.

Consequently, a Constitutional debate was engaged in by advocates Gauntlett and Breitenbach, contracted by the Cape Metropolitan Council (CMC), that municipalities have a constitutional entitlement to determine their own internal arrangements (specifically, one- or two-tier metropolitan government)²¹. Advocates Trengrove and Spitz, employed by the DCD, argue that Sections 155, 160 and 164 provide for a national role in determining criteria by creating a framework for national or provincial legislation²².

In response to the comments dealing with other spheres’ role in determining municipal structures, the DCD has argued that the Portfolio Committee, to which submissions are presented, had the right to pass legislation on such matters, especially with respect to Category A

¹⁸ Submission – Municipal Structures Bill, 22 July 1998.

¹⁹ Submission – Municipal Structures Bill, 21 July 1998.

²⁰ Submission – Municipal Structures Bill, 22 July 1998.

²¹ Submission – Municipal Structures Bill, 21 July 1998.

²² Submission – Municipal Structures Bill, 21 July 1998.

municipalities. The DCD has gone further to suggest that powers vested in metropolitan substructures were a “fundamental disaster”²³.

1.2.4 Non-metropolitan structures

The Katz Commission (1998) argues that there is insufficient clarity on the meaning of “rural” in the context of non-metropolitan local government. The *White Paper on Local Government* describes “rural” as referring to a wide range of settlement types, such as:

- Urban fringes,
- Small urban municipalities,
- Dense settlements that tend to be unplanned and ill-serviced,
- Small rural settlements,
- Agri-villages,
- Dispersed settlements, and
- Extensive farming areas.

These areas are represented by 42 DCs, which are summarised by the following table.

Figure 3 - Summary data of DCs by province

| Province | Population | Density/km2 | DCs | TLCs | TRepCs/TRCs | Magisterial Districts |
|-------------------|------------|-------------|-----|------|-------------|-----------------------|
| Eastern Cape | 5 865 000 | 35 | 6 | 94 | 76+7 | 78 |
| Free State | 2 470 000 | 19 | 4 | 80 | 15 | 52 |
| Gauteng | 7 171 000 | 421 | 2 | 14 | 9+10 | 23 |
| KwaZulu-Natal | 7 672 000 | 81 | 7 | 61 | - | 52 |
| Mpumalanga | 2 646 000 | 33 | 3 | 55 | 18 | 23 |
| Northern Cape | 746 000 | 2 | 6 | 64 | 42 | 26 |
| Northern Province | 4 128 000 | 34 | 2 | 13 | 36 | 17 |
| North West | 3 043 000 | 26 | 5 | 30 | 18 | 31 |
| Western Cape | 4 118 000 | 32 | 7 | 95 | 27 | 42 |
| South Africa | 37 859 000 | 31 | 42 | 506 | 265 | 344 |

[Sources: Departments of Provincial Affairs and Constitutional Development and of Justice in Katz Commission, 1998]

In contrast to metropolitan structures, the *White Paper on Local Government* argues for two tiers of rural local government. In particular, DCs should, where appropriate:

- Carry out district-wide integrated development planning,
- Operate as infrastructural agents and bulk service providers using RSC levies (see Section 3.5.2),
- Assist and build capacity in primary municipalities, and
- Provide municipal services in areas where primary municipalities are incapable of doing so themselves.

²³ Response to submissions - Municipal Structures Bill, 21 July 1998.

The *White Paper on Local Government* also argues for the amalgamation of urban-rural by merging the boundaries of existing TRepCs or TRCs with TLCs, forcing small and medium sized urban municipalities to include rural hinterlands with strong functional linkages (Katz Commission, 1998). Towns are generally reluctant to undertake the responsibility for their hinterland areas as these are typically characterised as having poor tax bases and vast infrastructure backlogs. Nonetheless, amalgamation could result in reduced costs of administration at an aggregate level via economies of scale, an extension of the tax base, and wider access to services, promoting integrated development (Katz Commission, 1998).

In some sparsely populated areas, it may not be feasible to have a primary tier of local government at all and the responsibilities of local government will be entirely deferred to DCs (as suggested by *Municipal Structures Act's* "developing municipality" category). Hence, non-metropolitan structures in the final phase are likely to be more varied than their urban counterparts in response to widely differing circumstances.

1.3 Relations with other spheres of government

As a sphere of government, intervention into local government affairs is limited by Section 151(4) of the Constitution:

"the national and provincial government may not compromise or impede a municipality's ability or right to exercise its powers or perform its functions".

While provincial and national government may not undermine local government's autonomy, they have the power to regulate it as well as to ensure sufficient capacity²⁴. This is a critical proviso - it implies that any national or provincial intervention in the short term must be counterbalanced and rectified by ensuring capacity at the local level in the medium term. Bhabha (1997) describes Section 155 (6) - "Each provincial government ... must promote the development of local government capacity to enable their functions and manage their own affairs" - as a *'coup de grace'*:

"This ensures that provincial government cannot refuse to assign functions to a particular municipality simply on the grounds that it does not have the capacity to perform the function, precisely because it is incumbent on provincial government to promote the capacity to perform the function whilst it does nothing to promote that capacity".

²⁴ In terms of Section 154 (1) and 155 (6) of the Constitution.

In order to articulate the interests of local government, SALGA represents the concerns of South Africa's municipalities. The Organised Local Government Act (No. 52 of 1997), empowers the Minister of Constitutional Development and Provincial Affairs to recognise SALGA as the national representative body, and along with provincial MECs, provincial associates (the North West Local Government Association, NORWELOGA, the Free State Local Government Association, FRELOGA, and so forth).

In order to facilitate co-operative governance, SALGA is entitled to represent organised local government at the National Council of Provinces (NCOP), the Budget Forum (see Section 2.2.3), Local Government MINMEC meetings, as well as on the Financial and Fiscal Commission (FFC)²⁵.

According to De Villiers (1997), representation in the NCOP is unique –

“This provision, as well as the provisions requiring the national and provincial governments to consult with organised local government when their interests are affected, provides a very good legal framework.”

As described by Pimstone (1998):

“OLG [organised local government] is a representative mechanism, a means of articulating through representatives the disparate needs and interests of individual local government structures to the local government sphere as a whole. But, more fundamentally, OLG plays an interfacing role, it takes forward those needs and interests to various consultative fora where it argues the local government position on matters affecting the municipal sphere, with national and provincial spheres of government.”

But at the same time he cautions (1998):

“...in reality the bulk of intergovernmental contact takes place in non-statutory fora ... Local government does have a voice, mainly in the Local Government Minmec and in the [Budget] Forum, but it is a very muffled voice indeed ... We must remember that it functions only to consult, recommend and advise. Its word carries out no additional force.”

According to the Constitution, local government should be more than a “muffled voice”. It can be expected that as a relatively new structure, however, it will take some time to enforce its rights

²⁵ In terms of Section 163 of the Constitution.

and to consolidate as an effective lobby group, but once it does, it will have recourse to considerable Constitutional powers.

1.4 Local government's powers

Local government has "the right to govern, on its own initiative, the local government affairs of its own community, subject to national and provincial legislation, as provided by the Constitution"²⁶.

The powers listed in Schedule 4 and 5 Parts B, over which national and provincial governments have concurrent legislative competence²⁷, include:

- air pollution;
- building regulations;
- child care facilities;
- electricity and gas reticulation;
- fire fighting services;
- local tourism;
- municipal airports;
- municipal planning;
- municipal health services;
- municipal public transport;
- municipal public works (only in respect of the needs of municipalities in the discharge of their responsibilities to administer functions specifically assigned to them under the Constitution or any other law);
- pontoons, jetties, piers and harbours (excluding the regulation of international and national shipping and matters related thereto);
- stormwater management systems in built up areas; and
- trading regulations; water and sanitation services (limited to potable water supply systems and domestic waste water and sewage disposal systems).

The powers listed in Schedule 5, over which local government has exclusive legislative competence, include:

- beaches and amusement facilities;
- bill boards and the display of adverts in public places;
- cemeteries,
- funeral parlours and crematoria;

²⁶ Section 151 (3) of the Constitution.

²⁷ National and provincial governments may legislate on these and have executive authority to ensure that

- cleansing;
- control of public nuisances;
- control of undertakings that sell liquor to the public;
- facilities for the accommodation,
- care and burial of animals;
- fencing and fences;
- licensing of dogs;
- licensing and control of undertakings that sell food to the public;
- local amenities;
- local sports facilities;
- markets;
- municipal abattoirs;
- municipal parks and recreation;
- municipal roads;
- noise pollution;
- pounds;
- public places;
- refuse removal;
- refuse dumps and solid waste disposal;
- street trading;
- street lighting; and
- traffic and parking.

Additional powers may be determined by national and provincial legislation. The LGTA, for instance, requires local government to conduct integrated development planning, or IDPs (*White Paper on Local Government*, 1998: 10). In addition, municipalities have potential access to powers and functions that are devolved or delegated to them from provincial and national government.

These national and provincial powers and functions are listed in Parts A of the Constitution's Schedules 4 and 5. In terms of Section 156 (4) these functions may be administered at a local level,

“Consequently, there is a potential for asymmetrical development with one municipality often performing more or fewer functions than another.” (Bhabha, 1997).

This asymmetry is problematic when national legislation attempts to create a uniform framework. An instance is that of municipal health services. Do these represent primary health care (a national government policy objective)? It is certainly unlikely that the existing system of local government could roll out the national intentions of preventative health care, especially when there is no budgetary provision made for this function to be performed by local government.

Acknowledging this, it remains extremely difficult for the national Department of Health to coordinate district and metropolitan health care systems without compelling performance on the part of municipal health authorities to ensure a certain basic level of health provision.

Similarly community policing is seen as a critical measure to curb crime and violence. According to the Constitution, however, local governments should undertake the responsibility only in the event of sufficient funding for the function (that is once basic services have been adequately provided) as policing is a national and not local government function. Alternatively, agency fees could be paid to councils by national or provincial government.

In some cases, neither the surplus funds nor the use of agency fees is an available option, but councils continue to provide services (such as health care), giving rise to “unfunded mandates”, which entail opportunity costs in terms of the basic municipal functions foregone. The term refers to the provision of a service that is only partially or not at all financed by other spheres of government whose responsibility it is. The term is commonly referred to at meetings by local government councillors and officials who argue that they carry out what should be the responsibility of other spheres of government, as they have no choice but to do so to ensure that their communities receive adequate services.

One example of an unfunded mandate that is commonly undertaken by metropolitan local government is that of housing. As a politically popular “product”, a number of local politicians are committed to its provision. In terms of the Constitution, local government is a *facilitator* of housing provision. While national government determines the norms and standards and monitors performance, provincial governments are intended to legislate on the issue and establish provincial housing boards that assess funding requests. Local government should then identify and designate land in order to ensure that residents have access to housing and ensure that the bulk engineering and services needed for housing developments are in place (Smit, 1998).

Although local government’s role should be no more than a facilitator in this process, many municipalities go further to ensure delivery (which is in line with the specifications of the

Development Facilitation Act²⁸) and contribute to housing delivery within (and on occasion, outside of) available resource constraints. This broad reading of local government's role is encouraged by an information pamphlet distributed by the Department of Housing explaining the Housing Act²⁹ (Smit, 1998):

“The [Housing] act stipulates a new and important role for municipalities in the housing process. As the sphere of government closest to the people and being responsible for the social and economic well being of the area within its jurisdiction, it is appropriate that it be in the forefront of housing. Municipalities are now tasked with managing existing stock and front running the provision of new stock.”

In most instances, this provision of housing is simply unaffordable and detracts from local governments' core responsibilities. The Department of Finance has thus strongly urged municipalities to take up such additional tasks when the funds are secured and sustainable³⁰.

The *White Paper on Local Government* (1998: 10) notes that:

“Local government's core function needs to be understood as part of the functioning of the state and its three sphere government system as a whole. The constitutional definition of local government's powers and functions have several components, not all of which are best performed by the same sphere of government. The Constitution makes these distinctions to some extent ... but grey areas remain.”

It is worth noting that despite the depth and breadth of powers assigned to local government, there are some notable omissions – social services relating to welfare, education and health (all provincial functions), which are often assigned to local governments in other countries. Local government's envisaged role as a facilitator of delivery around these social services is, however, still significant (building roads to schools and clinics, putting in place infrastructure that mitigates the spread of disease, and so forth). The difference in countries where additional functions are allocated to local government is that basic infrastructural backlogs (such as water and sanitation) that still exist in South Africa no longer apply. In addition, other regional forms of government (such as South Africa's provinces) do not always exist to deliver social services such as health and education.

²⁸ No. 67 of 1995. Section 2(1) requires that national, provincial and local government ensure the provision of affordable housing.

²⁹ No. 107 of 1997.

³⁰ Mentioned in a number of presentations by and personal communication with T.V. Pillay, Department of Finance.

1.5 Local government's fiscal entitlement

The viability of local government as a developmental and autonomous sphere rests strongly on financial arrangements. This is recognised by the Constitution³¹ – local government is entitled to revenue collected in its own jurisdictions as well as to a portion of nationally-raised revenue.

It is assumed by a number of policy statements that local government is financially self-supporting. This is a curious presumption given the publicity around numerous municipal bankruptcies. The underlying assumption is often that the fundamental problem in individual cases relates to managerial procedures. Whilst this may often be true in many instances, it cannot explain the severe crises in many metropolitan councils where financial skills abound, nor should it be generalised to non-metropolitan cases (Solomon, 1998).

Public finance policy³² has worked on the assumption that, unlike provincial government, local government in South Africa is capable of raising revenue for almost all of its expenditure needs. Maria Ramos³³, for instance, reported at the parliamentary hearings on *the Green Paper on the Local Government* in 1997 that local government collected 95% of its expenditure needs. This estimate was greeted with scepticism on the part of local officials and councillors, but is one that continues to inform policymakers (see Section 4.2.2 – a surplus is projected at an aggregate level in the medium term by some models).

Such estimations may be accurate at an *aggregate* level but this does not necessarily reflect the position of individual municipalities. As councils with larger budgets distort the perception of local government's fiscal capacity (see Section 3.3 detailing metropolitan budgets, which account for a substantial portion of municipal turnover), aggregations can be misleading.

Furthermore current expenditure patterns need not necessarily indicate institutional capacity or ability to deliver basic services or to fulfil the developmental local government mandate. In many instances, they merely reflect slightly revised historical spending patterns that did not take into account the needs of all South Africans. Current expenditure therefore may not reflect the developmental priorities that it should, and cannot be taken as a reflection of what local government requires to fund local government.

Should fiscal policy maintain that local government should remain financially autonomous with only marginal contributions from nationally collected revenue, in order to ensure a developmental focus, there are a number of options to ensure that *all* municipalities remain financially viable (Heese, 1998a):

³¹ As articulated in Sections 214, 227, 229 and 230.

³² Notably by the Financial and Fiscal Commission, as well as by the Department of Finance.

³³ Director General, Department of Finance.

- redistribution must take place between municipalities (which would probably act as a disincentive for more affluent municipalities to run surpluses)³⁴,
- municipal boundaries must encompass both affluent and poorer communities (which may not always be feasible) expanding most localities considerably (decreasing the number of municipalities nationally),
- a lower service standard will have to be accepted by more affluent communities, and,
- national and provincial grants will need to target poorer localities exclusively (that is, the poorest of the poor).

The importance of designing appropriate financial arrangements for local government is not only relevant according to Constitutional provisions, but with respect to the reason for these provisions – to ensure that developmental local government can take effect.

Adequate financial provision is a prerequisite that has been found to be a necessary condition for effective decentralisation in the experience of other countries, as will be discussed in the next chapter. It is however, not a sufficient condition, and other extraneous variables will be looked at with respect to South Africa.

³⁴ The DCD found that a number of metropolitan councils budget for deficits as surplus revenue is expected to be appropriated to poorer substructures (*Business Day*, 28/10/97).

2. Decentralisation, and its constraints in South Africa

“Decentralization itself is neither good nor bad. It is a means to an end, often imposed by political reality. The issue is whether it is successful or not. Successful decentralization improves the efficiency and responsiveness of the public sector while accommodating potentially explosive political forces. Unsuccessful decentralization threatens economic and political stability and disrupts the delivery of public services.” (World Development Report 1999/2000).

The concept of a strong and empowered local government has not only appealed to South Africans but to many governments throughout the world, and increasingly so over recent decades. Bringing government closer to people is an enduring goal. Some themes from comparative experiences are recorded in the next section, including fiscal aspects of this decentralisation³⁵. Once these have been outlined, the remainder of this chapter will assess socio-economic factors inhibiting effective decentralisation in South Africa.

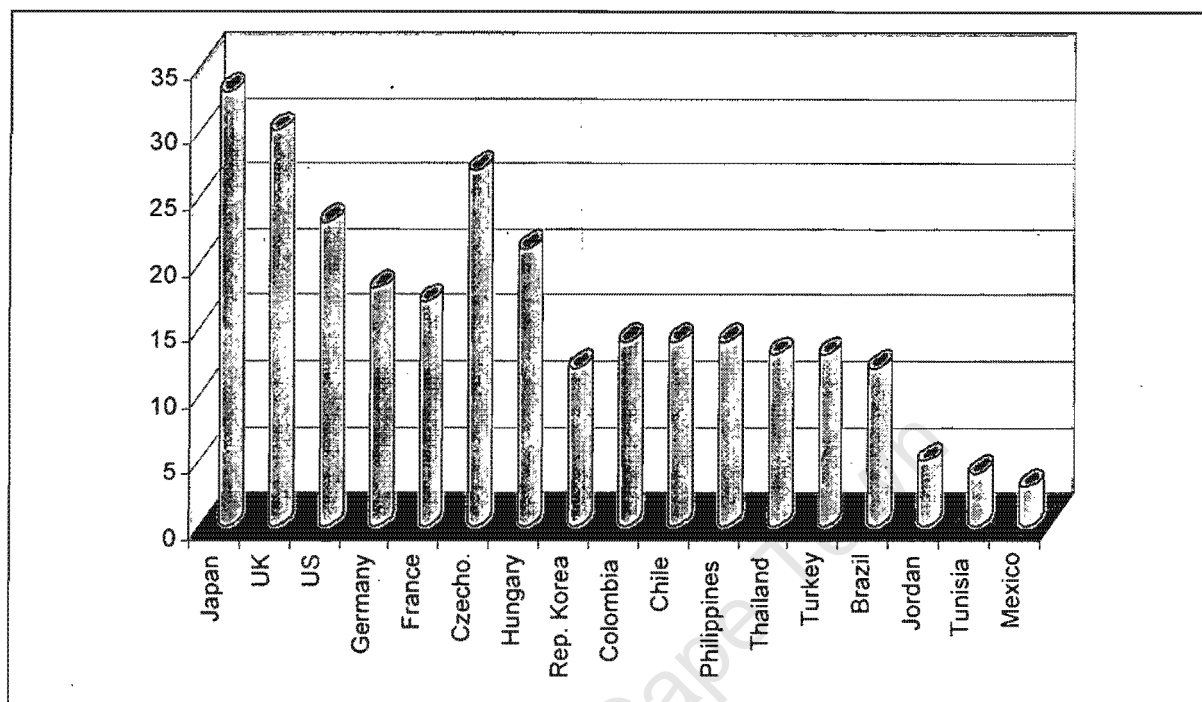
2.1 Decentralisation trends

The efficacy of local government relies not only on the system of inter-governmental relations in which it is to operate, but also on the extent of socio-economic and institutional development. Inter-governmental fiscal transfers, for instance, can only become transparent, predictable and stable – a critical concern for predictable local government revenue streams - once central government budgeting practices are adequately designed and affected. Hence there are issues of synchronicity and interdependence in reforming inter-governmental relations that extend beyond circumstances directly affecting local government (World Bank, 1995).

As a result of varying national circumstances, degrees of local government power vary tremendously. An indicator of these varying inter-governmental systems – based on historical precedent, local politics, fiscal reform, other government tiers and so forth - is the degree to which local government is responsible for public expenditure. The figure overpage details the local share of public expenditure in various countries.

³⁵ The World Development Report (1999/2000) defines decentralisation as “[entailing] the transfer of political, fiscal, and administrative powers to subnational units of government”.

Figure 4– Percentage local share of public expenditure



[Source: World Bank, 1995]

It is notable that of the selection, developed countries tend to have the more decentralised fiscal systems in terms of local government's share of public expenditure. The relationship between fiscal decentralisation and level of development has been supported by work of Bahl and Nath (1986) which looked at World Bank, IMF and UN data, as well as by studies by Wayslenko (1987) (Bahl and Linn, 1992). The former study looked at 23 developed and 34 developing countries and found that the former had 32% of government expenditure accounted for by sub-national government, but only 14.9% in the latter case. Only four developing countries (all Latin American) had expenditure levels that were greater than the developed country sub-national average.

Typically, a certain degree of financial stability is required for central governments to entrust local and regional governments with significant levels of public expenditure. Human resource levels are critical too, as sufficient competence is required at the local level for adequate management systems to be put in place and affected.

A political factor that emerged as being significant is that of the "crisis effect" (Bahl and Linn, 1992). In countries where the risk of social upheaval is great, many governments tend not to favour devolving meaningful functions to the local level of government for fear of losing control. Decentralisation is thus viewed as being related to stages of political as well as social and

economic development. Interestingly, 95% of democracies have elected sub-national governments (World Bank, 1999).

It should be borne in mind that not all countries have allocated the same functions to their regional or local governments and comparisons of public expenditure ratios are necessarily superficial. As functions vary - many countries devolve education to a local level, for instance - fiscal arrangements take on a range of combinations. While other countries' inter-governmental transfers, or IGTs, tend to account for a greater proportion of local government revenue than those in South Africa, taxation powers and yields at a local level may be considerably less and expenditure items vary significantly.

In most G5 countries, for instance, IGTs are commonly used to finance expenditure on primary education and primary health care, as well as direct payments to the indigent (World Bank, 1995). Unfortunately very little current data exists for comparison - the Bahl and Nath (1986) study drew on data between 1960 and 1973. What can be concluded, however, is that developing countries have undoubtedly made great progress in decentralising public expenditure responsibilities over the Bahl and Nath study period, but there are, of course, a number of variations in these patterns.

2.1.1 The theory of decentralisation

Decentralisation is intended to enhance the efficiency and responsiveness of government in service delivery by positioning the provision of services at levels closest to authorities that understand best what their constituents want (World Bank, 1999). This system is intended to make these authorities more accountable owing to physical proximity to "consumers".

Decentralisation encompasses a wide range of systems, an important aspect of which is the fiscal translation between different levels of government. A typology by Rondinelli (1990) identified four categories of decentralisation; all of which represent the transfer of power but varying with respect to which organisation is the recipient:

- Deconcentration – the allocation of responsibilities by national government to regional or "field" offices, but not to locally elected and accountable governments;
- Delegation – the assignment of responsibility and administration of national government role to other levels of government or other organisations such as parastatals;
- Devolution - the assignment of responsibility, finance, management and administration of national government role to sub-national levels of government³⁶;
- Privatisation – transfer of rights and obligations to private sector operations.

³⁶ These need not be simultaneous. In Hungary political autonomy took place before local budgets were separated from the central system, undermining financial stability (Bird and Wallich, 1992). In Brazil, by contrast, increased revenue did not accompany increased political responsibility (Shah, 1991).

Decentralisation thus deals with varying degrees of political, administrative and financial empowerment of sub-national government. The reasons for the outcome are dependent on national and regional political environments, both within particular countries, as well as from international policy advisors. Organisations such as the World Bank tend to favour less centralised forms of government:

“Strategies to stop decentralization are unlikely to succeed, as the pressures to decentralize are beyond government control. The emergence of modern economies, the rise of an urban, literate middle class, and the decline of both external and domestic military threats have created nearly insurmountable pressure for a broader distribution of power ... Rather than attempt to resist it, governments should face decentralization armed with lessons from countries that have gone before them.”
(World Development Report 1999/2000).

Decentralisation is favoured not only for reasons of political accountability, but also as a means to encourage economic outcomes such as more effective urban and environmental management and to facilitate private public partnerships (PPPs). An example of this thinking is illustrated by an address by Ismail Sergeldin (World Bank, 1996):

“In an era of decentralization, intergovernmental finances need to become more transparent, more closely related to the responsibilities placed on local governments, and more closely linked to the financial and managerial performance of local authorities. The resources at hand must be managed more effectively – by pricing urban services better and being responsive to demand, building partnerships with the private sector to manage and finance urban infrastructure and building much stronger local government institutions to operate the nuts and bolts of city management... Issues of poverty and the environment cannot be tackled effectively by local government alone. But mayors should be proactive in setting the central agenda – not bargaining for privileged access to resources, special programs.”

In improving delivery at the local level, three elements have been found to contribute to the efficacy of local government (World Bank, 1995), namely:

- A clear division of functional responsibilities between various levels of government, which is a pre-requisite for accountability to communities and clarity for bureaucrats,
- Revenue sources that correspond to functions (that is, “finance that follows function”),
- Clear accountability, put in place by centralised regulation and by incentives for local responsiveness (which is related to the first concern).

This thinking is not only intuitive but has a long academic history. The publication of Charles Tiebout's seminal article on local government expenditure³⁷ marked the development of the notion that that *fiscal* decentralisation (devolving financial powers to sub-national government) could facilitate more responsive, and therefore more efficient, allocation or assignment of government resources.

John Stuart Mills argued centuries ago that government closer to the people should perform better than more centralised structures. Hirschmann (1970) expanded the idea to the fiscal level. Individuals, as economic agents, will "voice" (vote) and "exit" ("vote with their feet" by leaving a locality) if they are dissatisfied with the package of public goods offered, or by their cost (taxation). In this way, it is argued, local government will need to respond to local preference more efficiently than at a central level (to ensure that their constituency does not relocate), by responding to community needs differently in different "benefit jurisdictions". Hence:

"Responsibility for discrete public services should be assigned to the level of government that whose boundaries incorporate the affected beneficiaries. That level of government should then be assigned a corresponding pricing instrument – a tax with a corresponding incidence- with which to ascertain demand." (World Bank, 1995).

Of course, this mobility and possibility of choice (and information to support choice) cannot be assumed of all countries³⁸. Developing countries are the least likely to display the traits necessary for "voice" and "exit" possibilities as citizens will tend to have less access to resources and information. They also tend to have less decentralised governments (often for other ideological reasons, though). The concept of the efficient assignment of resources is therefore predicated on the assumption of democratic structures that tend to apply to developed, rather than developing countries.

Central governments may, for certain stages of development, be more effective in ensuring the co-ordination of delivery and its equity from a fairly centralised position (depending on country size and population) until adequate conditions are in place for residents to "voice" and "exit" localities. In addition, interest groups in some countries (like the poor, minority groups and labour) are better represented at a national level and disempowered by devolution and "regional elites" may emerge (Ajam, 1998). At a practical level, often the data required to monitor effective implementation, and allocate funds to local government cannot be collated in developing countries.

³⁷ 1956, October. A Pure Theory of Local Government Expenditures. *Journal of the Political Economy*.

³⁸ In countries like South Africa, wealthier citizens may find that there are only a few areas that offer the infrastructure that they demand and have few relocation alternatives, poorer citizens may not have access to this information, or the means to move.

Oates' (1993) decentralisation theorem argues that public services should therefore be provided by the level of government that has the smallest geographic area that "internalises" benefits and costs of provision - that is, by the institution which reaps the benefits from "spillovers"³⁹, whilst still being sensitive to local concerns. An example is building a road in a city. Each neighbourhood would not necessarily appreciate the benefits of linking to other neighbourhoods and may spend on other items, but a metropolitan council would appreciate the value of linking communities (or "spillovers") whilst still being aware of other local priorities and how much should be assigned to the road.

The cost and benefits of decentralisation depend on various functions. A summary of key concerns is illustrated by the following figure:

Figure 5 – Costs and benefits of decentralisation

| Benefits | Costs |
|---|---|
| <u>Efficiency</u> – provision of local services in response to local choice | <u>Decreased central control</u> and co-ordination over macroeconomic environment |
| <u>Resource mobilisation</u> – greater incentive to exploit local tax base if taxation powers are devolved | Investments favour local benefits, and may <u>ignore spillovers</u> at regional and national levels |
| <u>Greater accountability</u> for local service authorities responsible for service delivery (and therefore enhanced democracy) | <u>Assymetrical development</u> likely in areas where capacity constraints (financial or human resources) are greater – widening inequalities |

2.1.2 Issues mitigating or undermining the benefits from decentralisation

Despite theoretical arguments favouring decentralisation, Prud'homme (1994) suggests that retaining centralised control in a less developed country may be desirable:

“Demand for decentralization is strong in most parts of the world. This close look at the negative side of improperly applied decentralization is not an attack on decentralization but an effort to prevent its misapplication – and to promote fuller understanding and wiser use of this potentially desirable policy”.

Some of Prud'homme's (1994) arguments around the “dangers” of decentralization include:

- Uncertain benefits from allocative efficiency may carry a cost in terms of production efficiency,
- Decentralisation hinders interpersonal and/or inter-jurisdictional redistribution and macro-economic stabilisation.

The use of decentralised agents may therefore not be the most efficient in delivering services (costs may vary between regions and be greater than if carried out from a centralised point).

³⁹ The effect of one party's actions (both positive or negative) on a third party.

Decentralisation may be particularly problematic where inequality requires national co-ordination (and control of resources) to ensure an equalisation of benefits to different communities. Redistribution cannot be managed if local units are solely relied on, as they will have neither the ability nor the incentive to transfer resources to each other to ensure equal benefits accrue to all citizens.

These drawbacks infer that functions, sectors and regions are more or less suitable for decentralisation:

“Often, the problem is not so much whether a certain service should be provided by a central, regional, or local government, since the service often has to be provided with the intervention of all three levels of government. The real challenge is how to organize the joint production of the service... What is desirable in a given country at a certain point in time depends on the present state of decentralization and the speed at which it has been reached.” (Prud’homme, 1994).

Prud’homme (1994) discusses decentralisation in terms of tax decentralisation (“subnational government taxes relative to total government taxes”) and expenditure decentralisation (“subnational government expenditures relative to total government expenditures”), as well as the power to spend and to regulate. He (1994) also underlines the importance of discretion to give true meaning to decentralisation, as well as the “localness” of a tax – who chooses the base and the rate, who assesses and collects the tax and who receives the proceeds.

These nuanced considerations make an assessment of decentralisation considerably more complex. Often countries that are viewed as being decentralised may only have a number of features that imply effective decentralisation. Some examples of the matrix of taxation responsibilities and yields are illustrated in the table below:

Figure 6 – Sources of tax revenue in various developing countries

| City | Largest local tax | | | Other major tax | |
|----------------------|-------------------------------|--------------|---------------|-----------------|---------------|
| | Name | Rate control | % Tax revenue | Name | % Tax revenue |
| Bombay, India | Octroi | Local | 66 | Property | 13 |
| Budapest, Hungary | Income | Central | 95 | | |
| Jakarta, Indonesia | Automobile ⁴⁰ | Central | 72 | Property | 11 |
| Lagos, Nigeria | Property | Local | 90 | | |
| Mexico, D.F., Mexico | Payroll | Central | 58 | Property | 21 |
| Sao Paolo, Brazil | Services | Local | 80 | Property | 17 |
| Seoul, Rep. Of Korea | Property | Central | 25 | Tobacco | 21 |
| Shanghai, China | Business profit ⁴¹ | Central | 50 | Industry | 30 |

[Source: World Bank, 1995]

⁴⁰ Separate taxes for ownership and purchase are included.

The table suggests that decentralisation can take numerous forms of financial arrangements – these can be centrally or locally controlled and single sources can yield a relatively small portion of income (as in Korea’s case regarding property tax) or, by contrast, significantly support local government (as Nigeria’s property tax illustrates). It is worth noting that the tabulated taxes controlled locally collect the largest sums, suggesting that there is either a greater incentive for taxpayers to pay local taxes (payments can have apparent benefits) or improved ability by municipalities (given a superior understanding of local dynamics) to do so.

Aside from arguing that decentralisation requires a complex set of arrangements, Prud’homme points to decentralisation features that mitigate the allocative benefits that are expected of decentralisation in developing countries:

“First, the [fiscal federalism] model assumes that the main difference between the various local or regional jurisdictions is in their respective tastes or preferences. In reality, the main difference is in income, either household incomes, which explain differences in tastes, or potential tax incomes. In most developing countries the problem is not to reveal the fine differences in preferences between jurisdictions but to satisfy basic needs, which are, at least in principle, well known and need not be revealed. The potential welfare gains associated with a better match of supply and demand are not large... Second, the model assumes that the taxpayers/voters of each region will express their preference in vote... Local elections, where they exist, are usually decided on the basis of personal loyalties or of political party loyalties... Even if mayors wanted to fulfil it [revealed preferences], they usually could not do it because of a gross mismatch between available resources and promised expenditure... Finally even if mayors wanted to satisfy preferences of the electorate and had enough resources to do so (two heroic assumptions!) it is not sure their local bureaucracies would follow.”

The analysis puts forward a strong case for centralised setting of the local agenda where preferences are clear and need to be pushed through local bureaucracies (such as improved delivery of infrastructure, as articulated by South Africa’s Reconstruction and Development Programme, RDP). These circumstances do not preclude, however, that local government may be a suitable agent for the implementation of a centralised agenda.

With respect to productive efficiency, Prudhomme (1994) highlights a number of additional concerns around decentralisation:

- The loss of efficiency arising from economies of scale,

⁴¹ Amount shared with central government is negotiated.
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- Central bureaucracies may be more efficient than local bureaucracies owing to higher central government salaries and career prospects with greater investment in research and technology,
- Decentralisation may “be accompanied by corruption” (an issue that also has redistributive implications) as local politicians are assumed to have greater discretion in decision-making that can be swayed by local lobby groups than at a national level. It is also assumed that local politicians are presented with fewer obstacles where local officials work more closely with local politicians and have less independence than their national counterparts.

Whilst these arguments suggest that decentralisation may not always be the best arrangement for developing countries, they cannot always be generalised. Local innovation in delivery may enhance efficiency, for instance, and it is difficult to make accurate generalisations about corruption – a factor that is likely to be influenced by a number of incentives and safeguards that are, or are not, in place. Nonetheless, there are circumstances under which decentralisation may not be appropriate. As Ajam (1998) argues:

“The evolving system of intergovernmental fiscal relations ...could realize efficiency objectives without necessarily compromising equity objectives. But increased fiscal decentralization can also magnify pre-existing structural deficiencies within the fiscal structure. Done well, decentralization holds promise of a more responsive public sector. Done badly, it entails a cost to the most vulnerable segments of society.”

Fortunately, decentralisation has various degrees and various options may be adjusted over time according to circumstances. Fiscal decentralisation options are key to this fine-tuning.

2.1.3 Reasons for going about fiscal decentralisation

Fiscal federalism deals with the allocation of services to sub-national tiers that provide benefits for residents in those jurisdictions (World Bank, 1999). In recognising that there are certain services to which all citizens are entitled (as promulgated by the Bill of Rights⁴²), central governments need to ensure sufficient revenue reaches local government in instances where local revenue is insufficient for the provision of decentralised services.

In this way government addresses the paradox that the localities with the greatest backlogs in social and economic infrastructure (the provision of which are local government core functions⁴³) are typically the ones with the fewest resources at their disposal. Grants (or transfers) are therefore a “compromise solution” in the division of revenue debate as they permit central authority over taxation but guarantee local government a source of revenue (Bahl and Linn, 1992).

⁴² Chapter 2 of the Constitution.

⁴³ Refer to the previous chapter.

As discussed, grants are ideally targeted for expenditure for the tier of government that has the greatest spillover benefits. Capital expenditure on the provision of services such as sanitation and water infrastructure is desirable from a public finance perspective as it promotes savings in other areas such as health, by promoting improved living standards, presenting a practical (albeit indirect) opportunity for poverty alleviation. These benefits are usually best interpreted at a sub-national level.

Similarly, infrastructure improvements also have very specific effects - ensuring that women's time for the collection of fuel and water is freed up, and that health, educational and recreational facilities become more accessible, for instance (Bond, 1998). The World Bank's *World Development Report – Infrastructure for Development* (1994) documents environmental, communication and mobility implications of improved infrastructure and how these have considerable effects on poverty alleviation.

At a national policy level, these benefits have been recognised by South African policy frameworks (including the Growth, Employment and Redistribution strategy, GEAR, and the RDP)⁴⁴. This support stems from the ideas that public investments have benefits that “spillover” into the socio-economic fabric of South African society (just as apartheid had negative consequences, RDP goals are intended to mitigate and overcome negative spillovers with the positive).

The idea of spillover effects or externalities gives rise to “public goods” – services or products that have positive socio-economic benefits but would not be generated under normal circumstances (hence, markets “fail”). By considering wider consequences, especially around equity, and longer time frames (implying low interest rates), public agents can motivate for the provision of public goods, such as a minimum level of water provision for all citizens, and their subsidisation. IGTs are one way in which to fund public expenditure.

In addition, Solomon (1998) argues that IGTs to local government in South Africa are warranted over a transitional period for a number of reasons, including:

- Differential costs in the provision of infrastructure between different communities, especially on the basis of urban-rural divide,
- Capacity to collect revenue is often dependent on the infrastructure that municipalities offer, implying that “this responsiveness is lagged for administrative reasons, reacting to

⁴⁴ The RDP acted as a statement of the African National Congress, ANC's, policy commitment to delivering basic social services at the time of South Africa's first democratic elections in 1994 and has guided the ANC government's policy framework subsequently. GEAR is considered a more conservative policy that charted out government's macroeconomic policy position at a time of economic crisis (1996).

infrastructure only 5 - 10 years later. Few local communities have the capability to weather a lag of this length, and require medium term assistance”.

- Newly established institutions, especially in rural areas, merit seed funding or start-up subsidies,
- Changes in operational responsibilities, as inferred by Public Private Partnerships (PPPs) that require managerial restructuring (in procurement, monitoring and supervision of contractors, for instance), and increased technical support and assistance for different forms of planning, management and monitoring.

Fiscal federalists (such as Oates, 1993 and Musgrave, 1959) argue that there are three broad roles for the public sector - macroeconomic stability, income redistribution and resources allocation, and that these should be undertaken by different levels of government to avoid excessive demands of central authorities and to ensure that local service provision responds to local needs, furthering both accountability and efficiency.

Gray and White (1989) use a Canadian health care example of decentralisation to illustrate the potential of better services provision. In this instance, innovative health care systems developed prior to the second world war by some of the country's provinces were extended after the war to a national level once they had proven beneficial.

According to McLure (1994), the principle of subsidiarity assigns services to the lowest level of government that can carry them out most cost-effectively and efficiently. Based on this principle, central government should be assigned the role of stabilisation and income redistribution, while local governments are positioned to allocate resources for services such as health, education, housing and transport (World Bank, 1999).

But as authors such as McLure (1994) and Ter-Minassian (1997) have argued, such neatly defined rules may not always apply. As McLure (1994) notes, the premise of a *tabula rasa* – clean slate – approach neglects a historical perspective that is often critical to understand system's evolutionary phases. Biehl (1994, in Ajam, 1998) highlights the importance of resources required to establish and maintain decision-making institutions, and how these are not accounted for by the traditional decentralisation frameworks. Vaz (1999) argues that differing circumstances, implying varying interjurisdictional externalities, economies of scale and economies of scope.

The key arguments against fiscal decentralisation can be summarised as follows (Ajam, 1998):

1. “Decentralization improves allocative and productive efficiency;
2. “decentralizations can undermine equity and macroeconomic-

stability goals;

3. "and ... hence the need to introduce central grants and controls (over subnational borrowing, for example);
4. "increased allocative-efficiency gains are predicated on the assumption that subnational governments will be able to allocate their own spending and raise their own taxes. But the more central-government intervention there is, the less freedom of choice and tax autonomy there is, and the less potential benefits from fiscal decentralization."

Whatever the theoretical or historical basis of allocation, efficient delivery of public services tend to be dependent on the appropriateness of funding mechanisms, their incentives and controls. There are a number of core traits of funding designs:

- The quantum of transfers,
- The basis of allocations,
- The incentives implied by their conditions.

In considering incentives, a balance between transferring amounts needed by various localities and ensuring that these localities are compelled to raise their own revenue (or maximise their "tax effort") is necessary to mitigate dependence on transfers:

"The ability of subnational authorities to act independently of the central government depends on whether they have access to an independent tax bases and sources of credit. Experience provides two lessons in this area. First, subnational governments need resources commensurate with their responsibilities. Second, subnational authorities must operate under firm budget constraints, so they do not spend or borrow excessively in the expectation of a central government bailout."
(World Development Report 1999/2000).

This firm budgetary constraint is the "flip-side" or obligation of autonomy that needs to be instilled by IGT patterns, whilst maintaining revenue stability from both external and internal sources so that services are not compromised. Locally collected revenue is considered to be important as it ensures accountability to local taxpayers – a premise of many theories promoting fiscal federalism

In order for this accountability to be guaranteed, however:

- Local taxes need to be of a sufficient size for their use to be considered by residents,
- Transparency and accountability in operations is required, and
- Residents need to have a base of understanding as to what can or should be done with revenue, what that revenue is, and participation in budgetary processes to access this information.

Regrettably, South African taxpayers who have the time to unravel municipal budgets and their implementation are unlikely to have a significant proportion of their income spent on local rates. Those members of a community who may pay a high share of their disposable income to rates, by contrast, are the least likely to have access in terms of time and understanding to budgets.

Fortunately, however, South Africa has a strong tradition of community participation and measures to ensure easier access to strategic local plans are likely to contribute greatly to ensuring local government's accountability. It should be recalled, however, that local resource mobilisation is only one component of ensuring effective resource delivery (effective governance and capacity to deliver are other significant considerations) pointing to the significance of broader institutional frameworks (World Bank, 1995).

2.1.3 a Principles of Inter-governmental Fiscal Relations

The starting point of any system of inter-governmental fiscal relations is reaching agreement on the principles that govern a framework. Often these will be conflicting, so a prioritisation is necessary, with adjustments over time. The FFC has set out a number of principles that require such ranking, a number of which have been highlighted by Department of Finance policies, the *White Paper on Local Government* and in its own work. These principles are defined in the table below.

Figure 7 – Principles for determining IGTs

| | |
|--|---|
| Effective resource use | Using scarce resources, allocations must achieve the maximum benefit possible. In order to do so, decision-makers need to be adequately trained. According to Musgrave and Musgrave (1984), the public sector should distribute resources where markets fail to do so. As tastes vary amongst communities, efficiency can often be best accomplished by assigning decision-making to "benefit jurisdictions" to achieve the correct mix of services for individual communities. |
| Accountability | Financial accountability is an extension of the political concept that decision-makers must be able to explain and be held responsible for their decisions. This requires transparency in decision-making and that planning and decisions be made in the interest of the society to which there is accountability. |
| Nation building and fiscal autonomy | While spheres should be seen as autonomous (in decision-making and carrying out their functions), national priorities remain significant. Sufficient funds need to be allocated to each sphere to ensure this autonomy, the accountability for which can be strengthened if these are self collected. Each sphere can then be held accountable for decisions that have been taken by it. |

| | |
|--|---|
| <p>Transparency</p> | <p>Revenue sharing must follow a transparent process – this should enable stability. Reporting, monitoring and auditing need to follow standard and regular procedures to sustain transparency.</p> |
| <p>Certainty of revenue</p> | <p>Financial sustainability is a precondition of autonomy – essentially finance needs to “follow functions”. Revenue needs to be assigned so as to ensure that sub-national government carries out its mandates in a predictable and sustainable manner. It is intuitive, however, that certain taxes (such as income taxes) need to be nationally administered to overcome the incentive for inter-regional migration to more favourable tax regimes. Immobile taxes, such as land, are best suited for local taxation purposes. User charges can be applied at any level but should consider those who cannot afford them.</p> <p>The obligations arising out of certainty of revenue, facilitated by multi-year budgeting, for instance, imply responsible budgeting. Autonomy means that responsibility is located at the sphere of expenditure – a shift of this responsibility to national government would provide for a moral hazard (risking irresponsible behaviour as the consequences are not felt directly at a sub-national level).</p> |
| <p>Equity</p> | <p>Fairness in ensuring access to services for all South African is enshrined constitutionally for sub-national by the description of “equitable” share. Equity aims to redress the social distortions of the past and present in a way that society considers being just. At a fiscal level there are several dimensions:</p> <ul style="list-style-type: none"> • Tax equity considers sharing expenditure requirements between citizens based on their ability to pay both between groups (vertical equity) and within groups or between similar individuals (horizontal equity). • Fiscal fairness refers to equal or similar provision of basic services on the basis of fiscal effort. (<i>Fiscal effort</i> refers to the extent which taxes are collected, that is revenue optimisation). Households should receive equal or similar public services for equivalent contributions of tax or fiscal effort. A poor community making comparable fiscal effort to a more affluent community (where contributions are similar as a proportion of incomes) should not be disadvantaged. This concept applies similarly to municipalities that make comparable fiscal effort relative to fiscal capacity. (<i>Fiscal capacity</i> refers to the full tax yield that is available within a locality and is often measured per capita). A common policy position is that those jurisdictions with high per capita tax capacities should be self-financing and those with low per capita capacities require transfers. Fiscal effort can be included in calculating these transfers (that is, what is being raised relative to what could be raised). • Fiscal need – revenue requirements in order to implement certain performance (such as implementing IDPs). This may incorporate consideration of cost differences between different jurisdictions (such as rural and urban construction costs). |
| <p>Development</p> | <p>Development concepts were articulated by the RDP, advocating an improved quality of life for all. Indicators of development included levels of nutrition, infant morbidity, access to housing, education, electricity, water and refuse removal services, and other indices such as the human development index (HDI). Development needs to be spread geographically so as to ensure certain minimum standards (linked to equity considerations).</p> |
| <p>Administration</p> | <p>The efficiency with which a system can be implemented is of critical importance to its realisation. It is widely conceded that administration of certain roles can be facilitated better by different institutions, such as defence by national government.</p> |
| <p>Macroeconomic management</p> | <p>Autonomous government spheres are expected to behave as responsible fiscal bodies that take budgetary constraints into consideration. If they do so they will not undermine the overall macroeconomic role of government in the efficient management of economic resources.</p> |

| | |
|-----------------------|---|
| Loan financing | Long term projects that contribute to the capital infrastructure of a locality are desirable in that they spread the costs of a roll out over a manageable time period so that the project becomes affordable and the costs are spread between generations. The danger of loan financing is that interest repayments can drastically eat into operating budgets. Collateral is also required in many circumstances. Although the Constitution provides for the raising of capital (Section 230), national regulations still need to be promulgated to ensure appropriate conditions are put in place. |
|-----------------------|---|

[Source: Based on FFC, 1995 and Donian, 1998]

The *White Paper on Local Government* specifies several of these fiscal principles that are required to further the aims of developmental local government. These include the following definitions:

“Revenue certainty and adequacy – sufficient funds to carry out responsibilities and plan appropriately making full use of available funds;

“Sustainability – balanced, realistic budgets and cost recovery;

“Effective and efficient use of resources – best use of available resources;

“Accountability, transparency and good governance – the public’s right to be informed of expenditure decisions via participatory budgeting;

“Equity and redistribution – targeted subsidisation for services by national government and cross subsidisation across municipalities;

“Development and investment – investment in municipal services to meet basic needs;

“Macroeconomic management – integration within the national macroeconomic framework.”

Ultimately these principles are balanced, accentuated or downplayed in practice by shifting political priorities and their articulation is only a manifestation of wider consensus and commitments. They do, however, provide grounds on which to contest, change or advocate certain policies.

2.1.3 b Design parameters

IGTs are used by national government so that they can retain control over revenue collection whilst affording fiscal autonomy to sub-national spheres. A degree of national control over revenue is desirable as national government can plan more strategically from a centralised perspective for some services and can ensure that scarce public resources are put to their optimal use.

By using IGTs, revenue can be collected and expended by the most efficient sphere of government. IGTs need to encompass two considerations:

1. A *vertical* (inter-governmental) division of revenue - the “size of the pie” to be divided, and
2. A *horizontal* (intra-governmental/sphere) division - the cutting up of local government’s pie and the size of “slices” shared between municipalities, (or the provincial slice to be shared between provinces).

Clearly the size of the vertical division will have implications for the horizontal. If the vertical division yields only a relatively small sum, the criteria for its division need to be very clear and of the highest priority as resources for division will be scarce and highly contested. If the sum is large, the revenue can be divided between more tasks and trade-offs are no longer as difficult. As an agent for development, the least capacitated municipalities in the poorest localities are clear favourites for prioritised IGTs.

There are three ways in which revenue can be designed vertically (FFC, 1997):

1. Revenue sharing according to functional responsibilities,
2. On an *ad hoc* basis, or
3. By reimbursing deficits.

Each option has a drawback:

1. Functional responsibilities are often difficult to quantify,
2. *Ad hoc* transfers undermine predictable and stable revenue streams that are required for medium term planning and may cause instability in the short term (until corrected), and
3. Reimbursement of deficits encourages excessive spending as the negative consequences of overspending are removed.

At a horizontal level there are four options (Bahl and Linn, 1992):

1. An *ad hoc* approach,
2. Returning revenue to its source (a derivation principle),
3. Using a formula based on certain factors indicating fiscal need and/or capacity, or
4. By reimbursing deficits.

Difficulties in using these approaches include:

1. Poor predictability and equity when using *ad hoc* options, as in the vertical division case,
2. Exacerbating regional biases by returning revenue to its points of derivation and causing distortions in some cases⁴⁵,
3. Data for formulae are often difficult to collect at a local level (such as poverty indices or other indicators of need and social backlog, tax capacity and tax effort⁴⁶), may cancel each

⁴⁵ In Brazil, the derivation principle is applied to local government’s 25% share of value added taxes with respect to the site of production. This meant that the Volkswagen production plant (located in Sao Bernardo municipio) is cross-subsidised by consumers throughout the country and allows for sufficient

other out (such as population size and “ruralness” or distance considerations)⁴⁷, and require regular updating for accuracy, and

4. As with the vertical division, reimbursements act as a perverse incentive, encouraging over expenditure as negative repercussions are not felt at the local level.

Together these options can form a complex set of alternatives represented by the matrix below:

Figure 8 – IGT options

| Vertical division | Horizontal division | | | |
|----------------------|--|---|--|--|
| | Ad hoc | Derivation | Formula | Reimbursement |
| Shared | Fluctuating inter-governmental grants (IGGs) under apartheid are good examples of this alternative. These are typically inequitable and uncertain. | This option perpetuates income patterns as more affluent localities receive the bulk of income. | The Local Government Equitable Share is an example of this – allowing for some equalisation between localities by considering their income levels (see Section 5.3). | CMIP (refer to Section 5.3) essentially reimburses local governments for expenditure on municipal infrastructure out of revenue that has been split between provinces. This does not encourage equalisation where capacity hinders councils from applying for funding. |
| Ad hoc | - | - | This option is less certain than the formula based alternative and does not strengthen the option of medium term planning. | Transfers of this nature tend to be unreliable and non-transparent. They do not encourage transparency nor sustainable planning. |
| Reimbursement | - | - | - | Agency fees from another sphere are a good example of these typically short-term transfers. If they are applied to all expenditure items, overspending is likely. |

[Source: adapted from Bahl and Linn, 1992]

revenue to fund a municipal symphony orchestra (World Bank, 1995).

⁴⁶ In Nigeria municipal balance sheets were unavailable for years (World Bank, 1995).

⁴⁷ And may carry perverse incentives – a “dearness allowance” in some Indian states fund personnel costs and encourages the creation of more positions than are needed (World Bank, 1995).

Specific features of a grant are dependent on its conditions. Attaching conditions to a grant - making it a *conditional transfer* - allows national government to have greater control over sub-national spending. It can also ensure delivery of a certain service, and hence promote minimum standard specifications, assuming adequate capacity to roll out a programme. Conditions can either apply to performance – are outcome based - or by earmarking funds for specific use – are input specific, such as welfare spending by South African provinces.

National governments can also make use of *matching* grants – by matching equivalent spending by sub-national governments for a specific service or project. Grants will necessarily distort sub-national spending (by lowering the cost of service provision), which may be desirable depending on the benefits a particular service. This is one of the reasons why grants can be *close-ended* - that is, having a ceiling level contribution. Matching grants are not applied in South Africa where, as mentioned, fiscal capacity (and hence ability to raise matching amounts of funding) rarely relates to fiscal need. All grants can be either *open-ended* (such as the Equitable Share) or *capped* (like the Transitional Grant)⁴⁸. These designs depend on the intentions of the grant.

2.1.4 Some experiences of fiscal decentralisation

While decentralisation may prove effective in some countries, it needs to be adapted for the specific needs of individual countries. In less developed countries where there is a need for equalisation and macro-economic stability, decentralisation may need to take different forms from the examples of larger and more developed countries, like Canada, Germany, Australia and (recently) England. Another important consideration is revenue constraints – in developing countries, especially those with relatively small populations such as Botswana, there may simply not be the resources to set up well staffed local institutions and scarce resources may be best used centrally where economies of scale in service delivery are superior.

The 1998 release of the English White Paper on Local Government was influenced by a backlash against the strong centralist control exercised during the Thatcher era, and is reflected in the devolution of power to Scotland and Wales. In England, national budget reform has been underway for the past three years, and in this context, the need to revitalise public interest and participation⁴⁹ in local government informed the drafting of a new White Paper⁵⁰.

Some of the mechanisms intended to stimulate public interest include:

⁴⁸ Refer to Chapter 5.

⁴⁹ Indicated by poor electoral response.

⁵⁰ Presentation given by Sue Charter of Warwick University. Wits School of Public and Development Management, 18 September 1998.

- The use of “beacon”, or exemplary, councils awarded powers for experimentation and innovation in response to outstanding performance, contributing to experiences and practices that can be transferred to other councils⁵¹,
- The implementation of a “best value” principle in service delivery – minimising waste and inefficiency⁵²,
- Increased community planning,
- Instilling the principles of accountability to residents and an ethos of partnership,
- Extending the network of service providers (including private provision).

This approach is similar to that of the South African Local Government Transformation Programme, or LGTP, which intends to draw on innovation and partnerships, without explicit or ring-fenced policies.

In contrast to the South African and English model, the former French colonies of Tunisia and Morocco are illustrations of a more centralised system – and to some extent, reflect the legacy of former French colonial governments. Tunisia, the smaller country, is more centralised than Morocco, and is not fully divided into municipalities (unlike Morocco) as it is easier and probably more efficient to retain central control (Vaillancourt, 1996). Morocco receives three taxes that are collected by central government and thirty-six taxes that are collected at a local level. In addition, local government is entitled to 30% nationally collected VAT revenue, which is divided into current and capital transfers (Vaillancourt, 1996).

The former were based on projected budget deficits – a system that encouraged rising deficit forecasts and was replaced with a formula allocation which is based on fiscal capacity and performance, whilst the latter were based on case-by-case specifics. This instance of deficit based budgeting confirmed Oates’ (1993) contention that a reliance on IGTs can lead to inefficiency - by putting in place the incentive to exaggerate costs and reduce local tax effort. Hence a *moral hazard* arose, with other spheres of government taking on the responsibility for overspending and often, debt servicing.

The Tunisian local government is also the recipient of own tax revenue as well as IGTs based on population and tax effort (Vaillancourt, 1996). By 1993, both Morocco and Tunisia received 35 to 40% of revenue from IGTs, and own revenue was more significant in both cases, fortunately so as the stability of IGTs is weakened by single-year budgeting (Vaillancourt, 1996).

⁵¹ Paralleled to an extent by the prestige awarded by the RDP’s Masakhane (“Let’s Build Together” – a campaign to promote the concept of local governance and increase payment for services) and SALGA merit awards in South Africa, which recognise outstanding performance.

⁵² A theme which is increasingly mentioned by the South African Department of Finance. Quality of services are important where large budgetary allocations (on education, for instance) yield inadequate results.

In a relatively developed country like the United States, equalisation is less of a concern and a number of states allocate income on the basis of population alone. There are, however, two alternative methods of allocation that have been developed by the United States' Advisory Commission on Intergovernmental Relations (Chrihfield, 1994), namely:

1. The Representative Tax System - this is applied in Canada and Germany and attempts to equalise resource bases. In stronger versions, the system taxes wealthier regions. For various categories the average tax rate is worked out as the sum of tax collection relative to the national tax base, multiplied by the representative tax rate of all tax categories added together, divided by state populations. This approach ignores variations in tax effort and the possible disincentive effect of taxing those states that do a better job at collecting taxes disproportionately.
2. The Representative Expenditure Approach - this looks at benchmarking a minimum service standard and working out the cost of provision, directing grants that are spending amounts lower than the average and taxing those that spend larger amounts. The approach advocates fairly centralised control with sub-national government essentially acting as no more than an agent for central government, which determines the quantity and quality of service levels.

In the United States, approximately 30% of local government revenue is received from state governments and an additional 3% from federal government (Chrihfield, 1994).

2.2 Socio-economic constraints on South African decentralisation

Local government is expected to play a largely developmental role in carrying out its Constitutional functions although it is given autonomy in planning for this end. Comparative experience suggests that such a role can only be carried out within the context of a relatively developed socio-economic environment. The *White Paper on Local Government* describes local government's expected developmental contribution as:

“local government committed to working with citizens and groups within the community to find sustainable ways to meet their social, economic and material needs and improve the quality of their lives” (1998: 17).

As a decentralisation strategy, the idea of developmental local government (DLG) has been taken up and advanced by non-governmental organisations. Notably, the Urban Sector Network (1998) views DLG as encompassing principles around:

- Democracy and participation,
- Holism and integration (incorporating social, economic and environmental concerns), and
- Accountability (orientated to redress).

“Building blocks” or principles with which to accomplish these objectives relate to:

- Poverty alleviation,
- Economic growth,
- Governance,
- Democracy,
- Participation,
- Consideration of vulnerable (or marginalised) groups,
- Environmental protection (1998: 4).

Such a broad reading of the role of local government is in keeping with the overall tenor and orientation of the *White Paper on Local Government*. The *White Paper* (1998: 22) sees the outcomes of DLG (in the current context⁵³) as:

- Provision of household infrastructure and services,
- Creation of liveable integrated cities, towns and rural areas,
- Local economic development, and
- Community empowerment and redistribution.

Such aims are, however, extremely ambitious. It would be foolish to assume that once legislation is promulgated that the ethos and ability of the officials operating at a local government level will spontaneously emerge to meet the challenges of DLG. Even if there is sufficient willingness to redress the patterns of local service delivery, other restraints, including inadequate financial resources, hinder the transition to effective decentralisation. These are explored in the next section.

2.2.1 Key challenges identified by the White Paper

“The biggest challenge arises out of the fact that before 1994 you had a local government designed to serve a very small percentage of South Africa’s population. Suddenly, this same administration has to serve a population five times the size it was designed for. That was bound to create problems and we must build capacity to deal with them.” Valli Moosa⁵⁴ (South African Report, 1998)

Local government faces a tremendous task – to address the physical and social backlogs of the past. The *White Paper on Local Government* clearly outlines some of the key obstacles in the way of local government in meeting its developmental expectations. While many of the issues are

⁵³ Priorities are likely to change from one era to the next.

⁵⁴ Minister of Provincial Affairs and Constitutional Development, 1994-1999.

superficially of a non-financial nature, they all have economic implications and are manifested in an inefficient socio-economic system⁵⁵.

The key challenges facing South African local governments are identified by the *White Paper on Local Government* (1998: 15-16) as:

- Skewed and inefficient settlement patterns,
- Concentration of taxable resources in formerly white areas⁵⁶,
- Huge backlogs in service infrastructure,
- Creating viable municipal institutions for dense rural settlements close to the borders of former homeland areas which have large populations without an economic base,
- Spatial separations between towns and townships and urban sprawl,
- Creating municipal institutions which recognise the linkages between urban and rural settlements,
- Entrenched modes of decision making, administration and delivery,
- Inability to leverage private sector resources for development,
- Substantial variations in capacity, and
- The need to rebuild relations between municipalities and local communities.

Apartheid policies, in particular, the Group Areas Act, influx control measures, spatial segregation and “own management for own areas” principles, profoundly influenced the socio-economic prospects for communities falling outside areas designated for white residence and business activities (*White Paper on Local Government*, 1997: 1).

Two pervasive and highly problematic legacies of this system are a culture of non-payment in protest against poor service levels in black areas, and excessively poor levels of economic activity within those areas. The Koornhof Bills established Black Local Authorities (BLAs) in response to these outcomes in the early 1980s in order to raise revenue from black areas. Poor legitimacy and limited internal resources, however, failed to mitigate the effects of economic segregation that had become apparent even then (*White Paper on Local Government*, 1997: 2).

2.2.2 Redrawing boundaries

“The redemarcation of municipal boundaries is the first step in creating areas in which viable and sustainable municipalities can be ensured.” Valli Moosa (February, 1999).

⁵⁵ An example relates to the public and private costs incurred by commuters that are housed in dormitory townships which are a considerable distances from places of work (in terms of congestion, pollution, time and expense).

⁵⁶ These remain mainly white.

The first necessary (but insufficient) step to addressing segregation came about with amalgamation. The LGTA merged 1 300 local councils that were segregated along racial lines into 698 new local authorities (South African Year Book, 1996). This number was been further revised to 841. It was now possible to share revenue between racially segregated communities and planning could work around functional rather than racial units⁵⁷.

Unfortunately the financial benefits of amalgamation may have been overestimated by the popular 1990's *One City, One Tax Base* campaign which called for a redistribution of income from richer (white) to poorer (black) communities. The redistribution of commercial revenue that had been excluded from black areas, as well as higher rates in more affluent suburbs proved to be limited and insufficient to redress the backlogs of the past, especially when non-payment continued⁵⁸.

A re-demarcation process based on more carefully considered criteria than the LGTA process⁵⁹ will certainly take the benefits of amalgamation of councils into functional units even further. It is widely expected that the Demarcation Board will identify about 284⁶⁰ municipal units. Depending on circumstances, individual councils may increase in size, decrease, amalgamate or be disestablished:

“A fundamental intention of the Demarcation Act, and a basic purpose of demarcation, is to create vibrant and financially viable municipal councils. It is not possible to forecast the extent to which municipal boundaries will change during the next year or so, but especially in view of financial instability in many municipalities, there is every prospect that it will be substantial. There will be change.” (Roome, 1998).

Dr. Michael Sutcliffe – an academic and former ANC member and provincial ANC MEC, who has been involved in a number local government processes, chairs the Demarcation Board. The appointment raised queries as to the independence of the board with the KwaZulu-Natal MEC for local government declaring the Board's independence “the joke of the century” (*Business Day*, 3/2/99). Provincial critics are believed to fear that the amalgamation of rural and urban areas will erode the IFP power base in the province despite Sutcliffe's resignation from party positions. It is, however, almost inevitable that these fears would be expressed as most local government

⁵⁷ Although this is not always been the case. Regrettably, in a number of councils there has been reluctance and even resentment on the part of white officials towards redirecting revenue from “white” areas to previously disadvantaged communities.

⁵⁸ The financial difficulties experienced by the Greater Johannesburg Metropolitan Council in recent years have been attributed by some to over-estimating the possibilities of redistribution.

⁵⁹ Which sought to provide units for municipal elections within a short space of time.

⁶⁰ See www.demarcation.org.za for details.

experts who would be suitable for the position are, or have been, in some way aligned to various political parties.

The Board's other ten members were selected by the President from a list of fourteen candidates which was drawn up by the President of the Constitutional Court. They are considered "broadly representative of South Africa's society, reflecting regional diversity and representing a pool of knowledge concerning issues relevant to municipal demarcation in each province" (Moosa, 1999).

These issues, or criteria to be considered by these members in carving up South Africa into councils, are described by the Demarcation Act⁶¹ to include:

- a. the interdependence of people, communities and economics as indicated by-
 - i. existing and expected patterns of human settlement and migration;
 - ii. employment;
 - iii. commuting and dominant transport movements;
 - iv. spending;
 - v. the use of amenities, recreational facilities and infrastructure; and
 - vi. commercial and individual linkages;
- b. the need for cohesive, integrated and unfragmented areas, including metropolitan areas;
- c. the financial viability and administrative capacity of the municipality to perform municipal functions efficiently and effectively;
- d. the need to share and redistribute financial and administrative resources;
- e. provincial and municipal boundaries;
- f. areas of traditional rural communities;
- g. existing and proposed functional boundaries, including magisterial districts, voting districts, health, transport, police and census enumerator boundaries;
- h. existing and expected land use, social, economic and transport planning;
- i. the need for co-ordinated municipal, provincial and national programmes and services, including the needs for the administration of justice and health care;
- j. topographical, environmental and physical characteristics of the area;
- k. the administrative consequences of its boundary determination on -
 - i. municipal creditworthiness;
 - ii. existing municipalities, their council members and staff; and
 - iii. any other relevant matter; and
- l. the need to rationalise the total number of municipalities within different categories and of different types to achieve the objectives of effective and sustainable service delivery, financial viability and macro-economic stability.

⁶¹ No 27 of 1998.

The number of criteria have been criticised as being too numerous and not adequately prioritised. At a roundtable at the Electoral Institute of South Africa (EISA), it was countered by Professor Robert Cameron⁶² that the lack of prioritisation was deliberate so as to ensure that the Board's independence is not weakened by national legislation. Nonetheless, practical issues will place some considerations above others, as Moosa (1999) argues:

“the board will have to pay special attention to two of the many factors to be taken into consideration in the redetermination of boundaries: viability and the rationalisation of the total number of municipalities. Currently there are many municipalities which are not financially viable and creditworthy, and which lack the capacity to provide services in an equitable and sustainable manner. It would be unwise to allow this situation to continue, and the redemarcation of boundaries can make a considerable difference.”

Early in July, the Municipal Demarcation Board released its first official proposals for metropolitan and district councils boundaries. The focus was on metropolitan areas – often the most contentious boundaries, as revenue sources tend to be concentrated in these areas.

According to the Board, “nodal points” which should “definitely be considered” as metropolitan areas include Greater Johannesburg, Cape Town, and Durban; “probably be considered” as metropolitan areas include Greater East Rand and Pretoria; and “possibly be considered” as a metropolitan area is Greater Port Elizabeth⁶³. “Aspirant” metros include Greater Vereeniging, Bloemfontein, East London, Pietermaritzburg and Richard's Bay (Heese, 1999b). The process of demarcation should contain a number of revisions that are to be completed by May 2000, facilitated by a Constitutional Amendment⁶⁴ allowing for elections to take place between October 2000 and January 2001.

Demarcation cannot in itself, however, ensure that segregation is reversed. The tool intended to address the profound dynamics of segregation in all cases is that of *Integrated Development Planning* (IDP).

2.2.3 Reforming planning and budgeting procedures via integrated development planning (IDP)

Integrated Development Planning (IDP) is defined in Section 2 of the *Green Paper on Local Government* (1997) as “a process in which municipalities can establish a development plan for the

⁶² A UCT academic who was involved in the drafting of the legislation, and is now a board member.

⁶³ Port Elizabeth has since been declared a metropolitan area.

⁶⁴ Contained in the 19 June 1998 Government Gazette, Notice 1014 of 1998, allowing for a five-year (in stead of a four-year) term of office, in line with national and provincial terms.

short medium and long term. ... In effect, IDPs are planning and strategic frameworks to help municipalities to fulfil their developmental mandate”.

According to the *White Paper on Local Government* (1998: 28):

“IDPs should empower municipalities to prioritise and strategically focus their activities and resources. ... IDPs should be viewed as incremental plans. In the annual process of review, new or changed priorities can be incorporated.”

IDPs are, as argued by Gugu Moloi (Chief Director of Municipal Infrastructure, the DCD), intended to become the “core business’ of local government”⁶⁵. Aspects of IDPs highlighted by the *White Paper on Local Government* and re-iterated by Colin Matjila (Chairperson of SALGA) as key components of IDPs include:

- Poverty alleviation and targeting,
- Facilitating economic growth and job creation,
- Small, micro and medium size enterprise (SMME) development,
- Infrastructure and service provision, and
- Spatial integration (using land tribunals).⁶⁶

In order to integrate developmental duties, councils are advised to follow “eight logical steps” (Roome, 1998):

1. Prioritise the needs of the municipality in terms of duties and objects,
2. Establish goals that will meet these needs, over a medium term period,
3. Formulate strategies to achieve these goals within short and medium time frames,
4. Identify and allocate financial, institutional and community resources to implement these strategies,
5. Adopt an annual budget that embodies these strategies,
6. Implement the budget,
7. Monitor and evaluate implementation, and
8. Report performance each year to residents.

The *White Paper on Local Government* (1998: 30) represents the planning and budgeting relationship in a matrix form represented overpage.

⁶⁵ Launch of IDP manual, 7 September 1998.

⁶⁶ Ibid.

Figure 9 - Relationship between planning and budgeting

[Source – White Paper on Local Government: 1998: 30]

| | Planning | Budgeting |
|---------------------------------------|--|---|
| Long term (up to 25 years) | Vision | |
| Medium term (up to 5 years) | Integrated Development Plan (including Land Development Objective, LDOs) | Financial Plan (including infrastructure investment plan on capital side) |
| Short term (1 year) | Key Projects (Actual Action Plan) | Annual Budget |

Municipal budgets are intended to become financial representations of IDPs⁶⁷, necessitating medium term budget projections. Such a medium term framework is in line with other governmental budgetary innovation. But this is conceptually difficult and few municipalities have adequately developed this methodology for their localities (and in many cases, not even begun substantial work on IDPs).

In many instances, physical infrastructure and service delivery continue to reflect the patterns of apartheid⁶⁸. In a number of respects, the ability of most local government to affect the integration as defined by national and provincial legislation is not currently feasible, reflected and exacerbated by the outsourcing of this role to consultants⁶⁹.

At the 1998 Institute of Municipal Finance Officers Conference⁷⁰, scant reference was made to linking budgeting to planning over three days of presentations, despite the complexities of such task, and the comment by the keynote speaker Paddy Roome (1998):

“Integrated development planning (or programming) is not something separate from the normal political and administrative functioning of a council. It is not the prerogative of, or something only done by, a special group of professionals. It involves the overall management of a municipality and guides the way in which councillors can make logical decisions.”

⁶⁷ Preferably in consultation with communities – Valli Moosa, former Minister of Constitutional and Provincial Affairs, Launch of IDP manual, 7 September 1998.

⁶⁸ Derek Hanekom, former Minister of Land Affairs, Launch of IDP manual, 7 September 1998.

⁶⁹ Ibid.

⁷⁰ Held in Worcester, October 1998.

Financial officers cannot be held solely responsible for the seeming absence of a link between budgeting and planning processes. Despite detailed emphasis of the significance of IDPs in the *White Paper on Local Government*, the Finance section fails to carry the theme through to a practical level that links with other processes and sections.

Similar concerns apply to the standardisation of accounting procedures. An Accounting Standards Board is to be established to address the current formatting of budgets so as to promote uniformity of accounting procedures (Department of Finance, 1999). These procedures are termed GAMAP – Generally Accepted Municipal Accounting Procedures, but it is of concern that they do not seem to pay attention to the need to interface accounting systems with IDPs. According to Alan Yorke (1998):

“The Terms of Reference relating to the accounting reform project required that the following be undertaken: -

- “Development of a Capital Accounting Model that will be generic to all local authorities, both large and small.
- “The concept of internal loans to be specifically addressed as this aspect of fund accounting is seen as a barrier to the understandability of financial statements.
- “The development of generally accepted municipal accounting statements.’

No consideration of IDPs is apparent in the design of these standards. Standardisation of accounting procedures is nonetheless desirable for a number of reasons relating to risk assessment by:

- government - in being able to standardise calculations of individual municipal finances for comparison and the determination of inter-governmental transfers, assistance and intervention,
- capital markets - for assessment of loan applications,
- partners or potential partners - looking at Municipal Service Partnerships (MSPs), and
- professionals working with and including municipal finance officers.

The technical accounting design of GAMAP may, however, risk removing budgeting too far from other forms of strategic planning at a municipal level. A council resolution for instance does not represent a financial obligation⁷¹ - does this infer that land development objectives (core tools for IDPs) that are identified by councils need not be budgeted for? It is apparent that all planners will have to familiarise themselves with GAMAP in order to ensure that IDPs are reflected in financial plans, and be truly integrated. This will take much training, resource

commitments and incur a time lag. It would certainly have been easier if GAMAP were designed for more integrated municipal use.

2.2.4 Human resource constraints

“Insofar as local government is concerned, there is nothing as urgent and as critical as the training of councillors. Their ability to raise funds and manage them, to play their role in multi-billion Rand housing and infrastructure programmes, to attract investments, to deal with the distortions of the apartheid era and to work with communities in partnership for development are skills that should be built more intensively.” Nelson Mandela (Opening address to Parliament, 7 February 1997).

South Africa’s civil service, like many other South African organisations, is faced with a shortage of skills and capacity. A recent survey by the Human Science Research Council (HSRC, 1999) found that the majority of organisations surveyed lacked adequate levels of skilled personnel, and over a half reported that they required greater numbers of professional staff. Specific to financial skills, nearly a fifth of organisations that employed accountants and related professionals could not fill a sufficient number of posts, and over a fifth reported shortages in managerial categories (HSRC, 1999). Problematically, these skills are classified as high growth occupations and it is likely that shortages will not be eliminated in the near future as demand is likely to continue to outstrip supply (HSRC, 1999). A concern for the civil service is that private sector salaries tend to be greater than those in the public sector, making recruitment of skilled personnel, capable of innovative governance and service delivery, even more difficult.

Local government is faced with this problem, as well as additional human resource problems. In many municipalities, a significant portion of skilled officials is comprised of “old guard” employees who, as a body, are not representative of South Africa’s population. As a result, there is considerable tension between elected politicians and officials. Many officials, politicians feel, carry out their duties reluctantly, fearful that they may lose their jobs, or resentful that they will be undermined by affirmative action policies or made redundant. Often the more skilled officials in this group opt for early retirement or consulting careers. By contrast, newly appointed bureaucrats often lack the experience they require for the administration of localities. This latter problem will, of course, be corrected for over time, but there are costs associated in waiting for experience to be gained.

Poorly equipped bureaucracies undermine the ability of local government to carry out all of its functions, especially the more complex ones such as local economic development. As Lewis and Bloch (1997) discuss:

⁷¹ Presentation by Alan Yorke, Deloitte & Touche, IMFO Conference, October 1998.

“It is all very well for central government and private sector policymakers to encourage officials, businesspeople, unionists and other ‘decision makers’ in the provinces and in cities and towns to formulate localised visions for economic competitiveness, to found public-private-partnerships and/or stakeholder institutions to implement these visions, to develop, as a matter of urgency, “Local Economic Development” (LED) or SMME promotion programmes, in short to get their **own** economies moving in a new era of global competitiveness and transformation. Without experience and human institutional capacity, such exhortations, while not exactly falling on deaf ears, tend to be treated precisely as exhortations, and are often not followed through on to the degree that they could be.”

There are, however, structures in place to transfer the necessary skills to manage local government. The current training system for local government officials is regulated by the Local Government Training Act of 1985 and Manpower Training Act and governed by two training boards: the Training Board for Local Government Bodies and the Local Government Education and Training Board (*Green Paper on Local Government, 1997*).

In addition, the DCD’s Project Viability⁷² intends to extend its role to that of providing support and training. The project will thereby be able to act pre-emptively rather than in response to serious financial problems. The training leg is a Training Board initiative to instil basic treasury control and administrative skills into all municipalities⁷³. This would provide a more proactive approach than the current system of monitoring, auditing and only once cause for intervention is identified, providing managing support.

The support element of the project has to date been more a theoretical than practical element of the programme although R181m was allocated to provinces via the Transitional Grant in 1998/1999, some of which, in turn, allocated a part of their share to facilitate its implementation. Although uptake of this funding was disappointing, the Local Government Support Grant extended the duration of this transfer (despite the use of “Transitional” in its former description), and is to receive R140m for 1999/2000 (Department of Finance, 1999). In addition, local government’s share of nationally collected revenue includes a component for institution building.

⁷² An initiative established to monitor and analyse trends in municipal finance in response to a number of severe financial crises experienced by municipalities – see Section 3.2.

⁷³ Presentation by Dr. C. Olver at Project Viability briefing, 7 July 1998.

A key problem is that funding does not fully dovetail with training initiatives. The Training Board⁷⁴ estimates that R22m will be needed to carry out the two and a half-year financial training programme, but it is uncertain whether a budgetary allocation will be forthcoming. Currently only R4.2m is available for the provision of financial training.

The proposed training cycle is proposed to determine training needs, develop training material, validate the contents and methodology, provide training and monitor outcomes. It is hoped that the training will provide accreditation of attendance and competence, in line with proposals put forward by the Skills Development Bill.

The training model that was developed in 1997 has several significant financial components designed for officials, including:

- Operating budget,
- Capital budget,
- Cash management,
- Debtor's management,
- Debtor's meter reading,
- Managing financial departments.

⁷
Councillors are trained in fewer models dealing with:

- IDPs,
- Budgeting,
- Financial reporting.

It has been suggested that there be a convergence between councillor and official training so that there can be better communication between the two groupings⁷⁵.

In addition, according to its Constitution, one of SALGA's core functions is to transform local government so as to enable it to fulfil its developmental role. This mandate entails training councillors and officials and is undertaken by a Human Resource Development Working Group. A number of NGOs, such as the Urban Sector Network (USN) and the International Republican Institute (IRI), play this role, although there are occasional allegations of political party affiliations, and even with the most "neutral" of intentions, disparate training strategies and inadequate resources leaving a number of regions unattended to.

⁷⁴ Presentation by Sedick Jappie, Local Government Training Board, 7 July 1998

⁷⁵ Ibid.

It is, however, critical to consider that adequate systems for training and recruitment to equip local government with the human resources necessary to efficiently expend local government's revenue, is only one of a number of factors relating to effective governance (see Section 5.4.1).

2.2.5 Non-payment

One of the most publicised problems facing local government is that of non-payment. This has both democratic and financial implications. Financial ramifications are reported by Project Viability (see Section 3.2) and are generally severe, profoundly undermining the assumption that local government can be self-sustaining in a number of communities. The total outstanding debt owing to municipalities responding to the latest Project Viability (June 1998⁷⁶) questionnaire (totalling 633, or 75.99%) is reflected by province in the table below:

Figure 10 – Outstanding debt to local government by province

| Province | Rands |
|-------------------|-----------------------|
| Eastern Cape | 855 097 982 |
| Free State | 626 816 420 |
| Gauteng | 5 224 368 430 |
| KwaZulu-Natal | 1 062 383 724 |
| Mpumalanga | 424 353 174 |
| Northern Cape | 222 558 243 |
| Northern Province | 112 149 237 |
| North West | 438 768 489 |
| Western Cape | 1 320 370 454 |
| Total | 10 286 866 153 |

[Source: Project Viability, 1999]

The implications of this debt are profound for the local government's cash flow status, and thus financial stability, as argued by Project Viability (1999):

“If the level of outstanding debtors were to decrease from the unacceptable level of 33% (17 weeks) of rates and service charges income to the norm of 11% to 15% (6 to 8 weeks), R1,9 billion to R2,3 billion unnecessarily tied up in debtors would be released”.

Hence uncovering the reasons for non-payment are of critical importance if local government is to ensure financial stability. In part, non-payment reflects a failure of local government to be accepted by communities – it is a manifestation of rejection of local government's ability to ensure governance and convince its constituencies that it is acting in their best interests.

Legitimacy is a key concern for local government. As a tactic of resistance, non-payment became entrenched in popular culture during the 1980s, with the intention of making local government

⁷⁶ Only the background report for August 1999 is available. The last full report (published in 1999) details

ungovernable. Consequently, many South Africans are unaccustomed to paying rates and are often critical of services that are delivered.

In instances where services are lower than those of formerly (and typically still) white residential areas – that is, full borne water sewerage, electrification, tarred roads and electrically lit streets – many communities are understandably resentful of lower levels that are viewed as being “sub-standard”. Unfortunately, the full service delivery (“white standard”) option is amongst one of the highest in the world and is simply unaffordable to government and cannot be maintained by consumer user charges⁷⁷. Hence government policy, informed by much work undertaken by the World Bank, has opted for the delivery of *basic* services, which are to be maintained by *affordable* user charges⁷⁸, and in instances of dire poverty, subsidies. As a result, there is a discrepancy between public perception of entitlement and policy decisions, often manifesting in non-payment.

In addition, a survey undertaken by IDASA reveals that coercion of payment should be considered as well as legitimacy in explaining non-payment. The survey, *Public evaluation of and demands on local government* (February 1998), reported that its sample considered local government to be worse than other spheres in terms of public trust, responsiveness and performance. Acceptance of local government’s delivery ethos is revealed by the survey as being poor – “local government is seen as the least responsive level or type of government in the country” (IDASA, 1998).

Perhaps one of the reasons for such a poor rating was the lack of comprehension as to the role of various spheres. Policing and housing (national and provincial functions) were expected of local government, for instance:

“Three of the four most frequently cited demands (job creation, housing and crime control) are areas in which local government may not be authorised to address in terms of constitutional or legislative constraints ... People see local government as much more than a provider of services” (IDASA, 1998).

Another methodological problem in rating local government against other public bodies lies in comparison. Local government is probably dealt with by the public on a more regular basis (in, for example, paying rates and other local taxes) than any other sphere so attitudes at a local level

findings recorded in 1998’s 2nd quarter.

⁷⁷ Government models have suggested that R5bn per annum is required in urban areas to ensure an *intermediate* level of service provision (MIIF, 1996).

⁷⁸ User charges are intended to ensure that delivery is sustainable and that usage is sparing – see the MIIF, FFC (1997), Katz Commission (1998) for discussions around user charges.

will be differently informed to those of, say, the President's office (albeit more accurately). Perceptions are nonetheless important as stated in the IDASA paper's foreword:

"Local government may not be as inept or corrupt as people think it is – but the fact that they think it is, is significant, especially with elections looming over the horizon" (Paul Graham – CEO of IDASA).

Arguably the most important finding, however, was that coercion in payment was considered to be an even greater incentive for payment than that of legitimacy:

"Significant proportions of South Africans are still prepared to tell us that they would avoid paying their financial obligations to local government if they could get away with it⁷⁹." (IDASA, 1998).

The significance of this finding is noted by the *Local Government Transformer* (August/September 1998):

"what is refreshing, is the willingness of the survey to confront the possibility that sanction and coercion may have a role in good governance although in trying to show that legitimacy is not a factor in compliance, the report probably over states the point."

Supporting IDASA's reasoning that legitimacy and payment are poorly correlated is the finding that there are significant racial differences:

"Indian and white communities displayed dismal evaluations of local government, registering much lower levels of trust, responsiveness and job approval. African respondents living in what are undoubtedly the least well resourced areas are relatively more positive." (IDASA, 1998).

Yet it is in the latter communities that non-payment is greatest. So is the expense of services relative to income levels. Perhaps affordability is equally as important an issue as coercion (an issue not explored by the IDASA analysis) - what is interesting is that legitimacy does not appear to be of a similar significance to coercion and affordability.

The survey found that willingness to comply with financial obligation is similar between race groups. This finding strengthens the importance of affordability as an explanation, or coercion

⁷⁹ The survey found that between 8% and 13% would definitely avoid paying, 15% to 24% say that they might and another 6% are unsure. With regard to a rates boycott, 16% would definitely join, another 28% might and 6% are unsure.

would have been raised as a determinant in payment by more black respondents in order to account for higher rates of non-payment in black areas on the basis of coercion alone⁸⁰.

Edward Breslin, the health manager of Mvula Trust, a NGO dealing with water projects, recently told a water conference that:

“Emphasis has been placed on adherence to guidelines rather than on what is practical and affordable to communities. Community involvement in designing the scheme or choosing the technology has been non-existent in the vast majority of cases... Evaluations have consistently shown that systems are over-designed and unaffordable” (Smith, 1999).

In one community Breslin refers to, flush toilets and yard connections were installed at a cost of R90 a month – a third of most household’s income (Smith, 1999). Although the provision of water is laudable – in 1994 it was estimated that 12 million South African lacked adequate access to water, 3 million of whom have been subsequently catered to⁸¹ (Smith, 1999) – consideration as to whether the recipients could always afford the service is critical.

Non-payment, it can be inferred, is not related to legitimacy, but to coercion and affordability. Hence the IDASA conclusion:

“local governments need to eliminate opportunities to evade through better collection, monitoring and enforcement” (1998)

should include the rider “should services be affordable to members of a particular community”. In the absence of affordability, communication campaigns such as Masakhane may be misconceived.

Whatever the solution, appropriate credit control measures are one of the key challenges facing local governance. If members of a community can pay they need to be targeted, and if they cannot, alternative revenue sources must be sought. Arrangements in this regard highlight the significance of realistic budgeting for viable local government - a precondition for the fulfilment of its developmental role given that, as the next chapter will explore, local government is largely responsible for collecting its own revenue.

⁸⁰ But slightly by gender – women seem more compliant although are typically lower income earners.

⁸¹ A recent survey by the Human Sciences Research Council found that more people were satisfied with service delivery than unsatisfied (Smith quoting Michael O’Sullivan, chief HSRC researcher, 1999).

3. Local government's financial status

In addition to own revenue sources, South Africa's local government is constitutionally entitled to a portion of nationally raised revenue. Most of its revenue, however, is self-collected. This fiscal capacity is used as a key reason for considerably smaller fiscal transfers than those received by provincial government⁸², as well as transfers received by local governments in other countries:

“Local government responsibilities include municipal infrastructure and the provision of services such as refuse collection, electricity and water supply. Local government raises the bulk of its revenue on its own through property taxes, regional levies and user charges on water and electricity. Provinces, on the other hand, raise less than 5 per cent of their budgets through own revenue sources”
(Department of Finance, 1999).

In assessing local government's financial ability to sustain development, it is critical to consider own revenue sources, as well as how this revenue is expended. Changes in revenue streams (and hence their sustainability) is the subject of Chapter 4. Broadly speaking, the diversity of South African localities implies that there cannot be a blanket assumption of fiscal capacity (refer to section 3.3).

3.1 Local government's budgetary position

Local government has access to a number of own revenue sources. As discussed in the preceding chapter, this is an important feature of decentralisation that empowers sub-national government in its expenditure decisions whilst making it accountable to its constituencies.

Specifically, Section 229 of the Constitution empowers local government to charge:

- Rates on property,
- Surcharges on services, and
- Other taxes, levies and duties appropriate to local government

These powers, however, are likely to be regulated by national and provincial government (this regulation still has to be finalised) as local taxes may in no way impede national economic policies. Municipalities are prohibited therefore from imposing income tax, value-added tax, general sales tax and customs duties, as these would undermine the national tax base.

Current sources of revenue that are relied upon are represented by the figure overpage:

⁸² For 1998/99, local government received 0.6% of revenue divided between government spheres, whereas

Figure 11 - Current revenue sources for municipalities

| Municipality | Own Revenue Sources |
|---|--|
| Metropolitan Councils (MCs) | <ul style="list-style-type: none"> • Services levy (payroll tax) • Establishment levy (turnover tax) • An equitable portion from all the constituent local councils |
| Metropolitan Local Councils (MLCs) and Transitional Local Councils (TLCs) | <ul style="list-style-type: none"> • Rates on property (property tax) • Income from trading services (water, electricity etc.) • User charges and licences |
| District Councils (DCs) | <ul style="list-style-type: none"> • Services levy (payroll tax) • Establishment levy (turnover tax) |
| Transitional Representative Councils (TrepCs) or Transitional Rural Councils (TRCs) | None |

[Source: Katz Commission, 1998]

Combined, these revenue sources yield considerable sums allowing for local government's aggregate budget to be considerable. The *White Paper on Local Government* (1998: 109) found that municipalities budgeted for R48bn in 1996/97 – accounting for 7.5% of national GDP and 20.7% of the public sector budget. According to the *1998 Budget Review* (Department of Finance, 1998a), local government budgeted for R52,3bn in 1997/98 (an increase of 9% from the previous year) with capital expenditure of R15bn (funded by loans in 54% of cases). In 1998/99 municipal operating budgets decreased to R41,1bn with capital expenditure of R13,7bn (with a smaller proportion, 36%, being financed through loans than the previous year) (Department of Finance, 1999).

These figures are tabulated below:

Figure 12 – Local government's budgeted expenditure: 1996/1997-1998/1999

| | 1996/1997 | 1997/1998 | 1998/1999 |
|----------------------------------|-------------|-----------|-----------|
| Budgeted expenditure (Rbn*) | 48 | 52.3 | 41.1 |
| % Change from previous year | | 9 | -21 |
| % Total government expenditure | 21 | 27 | 20 |
| Capital expenditure (Rbn) | Unavailable | 15 | 13.7 |
| % Capital financed through loans | Unavailable | 54 | 36 |

[Source: adapted from *White Paper on Local Government*, 1998 and 1999 *Budget Reviews*]

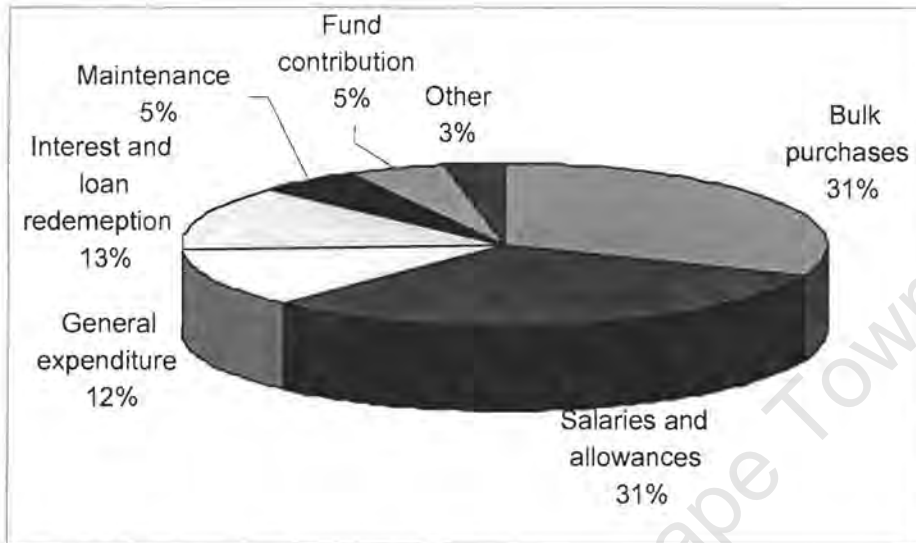
* Rbn = Billions of Rands

For macroeconomic and fiscal reasons, municipalities have to ensure that their budgets fall within limits set by the Minister of Finance (Department of Finance, 1998a). Municipalities are not allowed to run deficits on operational budgets and needed to keep budgets for 1997/1998 below a 6% growth rate - in line with macroeconomic growth targets, excepting capital grants.

For 1999/00, this limit was set at 5.5% but excludes areas where conditional grants fund capital expenditure (Department of Finance, 1999).

Expenditure is broken down by category in the following figure:

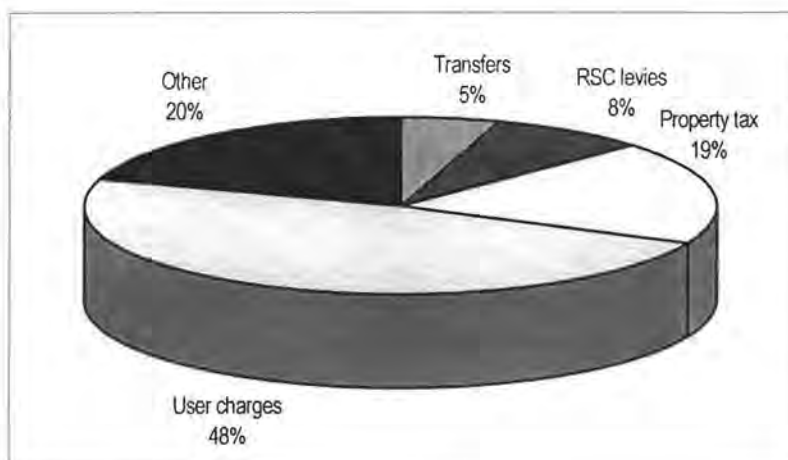
Figure 13– Categories of expenditure: 1998/1999



[Source: Department of Finance, 1999]

In numeric terms, R11.600bn was spent on bulk purchases (making local government a major employer), R12bn on salaries and allowances, R14.9bn on administration and general expenditure and R5.3bn on interest and the loan redemption over 1998/99 (projections by the Department of Finance, 1999). Bulk purchases of R12,7bn were budgeted for in 1998/99 (Department of Finance, 1999). Sources of revenue as described by the 1999 Budget Report are broken down graphically in the following figure:

Figure 14 – Sources of revenue: 1998/1999



[Source: Department of Finance, 1999]

It is apparent that user charges for services rendered account for the bulk of municipal revenue whilst property taxes account for a major source of local tax revenue. In 1998/99, municipalities expected to receive almost R21bn (or 51% of revenue) from electricity, water and sewerage charges, yielding net revenues of R8,3bn, excluding staff and administrative costs (Department of Finance, 1999). This pattern is similar to findings by the *Green Paper on Local Government* (1997) that revenue contributions from user charges in 1996/1997 were:

- electricity 41.4%,
- water 11.8%, and
- refuse removal 8.22%.

It must be noted that this budgeted revenue stream is not necessarily an accurate reflection of reality as it assumes almost full payment for rates and services. Accounting procedures and such static representations are therefore criticised for not reflecting the full extent of non-payment, distorting the apparent level of income available⁸³.

Although finances vary tremendously from municipality to municipality, user charges are generally critical, as revealed by the national survey, Project Viability, which monitors the state of local government's finances.

3.2 Project Viability findings

Project Viability – a study managed by the DCD, tracks the liquidity of South African municipalities. As such, it is a useful source of aggregated data. Project Viability's core group of 272 municipal respondents has operating budgets in the region of R38bn (Project Viability, 1999). It is to be noted that these budgets account for a good portion of local government spending, but are therefore probably not representative of smaller, more vulnerable councils, that do not have the capacity to reply to the survey.

These budgets are broken into the items tabulated overpage.

⁸³ As argued by a number of treasurers and councillors of various municipalities. Phil Sinnet of Wits P & DM argues that the assumption around non-payment being negligible makes municipal balanced budgets a "Department of Finance-approved fiction" (USN Workshop, 23 November 1999).

Figure 15 – Project Viability’s core group’s budgets

| Item of expenditure | Rbn* | % |
|--|------|------|
| Salaries, wages and allowances | 11.6 | 25.5 |
| Bulk purchases (water and electricity) | 10.4 | 22.9 |
| General expenditure | 12.9 | 20.5 |
| Repairs and maintenance | 3.1 | 6.8 |
| Capital costs | 5.2 | 11.5 |
| Contributions to funds | 2.2 | 4.8 |
| Gross expenditure | 45.4 | 100 |
| Less charge outs | 8.1 | |
| Net expenditure | 37.3 | |
| Income | 37.3 | |

[Source: Project Viability, 1999]

* Rbn = Billions of Rands

The operating budgets of these municipalities experienced a R2bn increase in debt from R7,3bn in June 1997 to R9,3bn in June 1998. Contribution to capital funds that could balance the negative cash-flow implications of rising debtors is insufficient, as broken down in the table below:

Figure 16 – Project Viability core group operating budgets (in millions of Rands)

| Operating budgets | Rm |
|-------------------------|---------|
| Capital expenditure | 185.5 |
| Working capital | 820.8 |
| Bad debts | 183.0 |
| Capital development | 369.7 |
| Provisions and reserves | 618.9 |
| Total | 2,177.9 |

[Source: Project Viability, 1999]

Operating budgets for these municipalities are financed from the following sources:

Figure 17 – Project Viability core group’s revenue sources

| | Rbn* | % |
|---------------------------|------|-------|
| Electricity sales | 14,0 | 37,6 |
| Water sales | 5,3 | 14,2 |
| Sewer and sanitation fees | 2,3 | 2,3 |
| Refuse removal fees | 1,1 | 2,9 |
| Subsidies | 1,1 | 2,9 |
| Rates | 7,5 | 20,1 |
| Equitable share | 0,9 | 2,4 |
| Other income | 5,1 | 13,7 |
| Total | 37,3 | 100,0 |

[Source: Project Viability, 1999]

* Rbn = Billions of Rands

Trading services, especially electricity and rates are key sources of income to these municipalities. It is likely that rural municipalities would display a different trend. Capital budgets amounting to R9,3bn are financed from the sources depicted below (notably loans):

Figure 18 – Project Viability’s core group capital financing

| | Rm* |
|------------------|----------------|
| External loans | 980.8 |
| Internal loans | 3,455.7 |
| [C]MIP/RDP funds | 762.3 |
| Housing funds | 894.2 |
| Special funds | 381.0 |
| Subsidies | 1,248.9 |
| Other funds | 1,586.6 |
| Total | 9,309.5 |

[Source: Project Viability, 1999]

* Rbn = Billions of Rands

The survey assumes that there has been an overstatement of internal loans on the basis of provisions made for capital spending in operating budgets and that the capital programmes may therefore be too ambitious in their budgeting (Project Viability, 1999).

3.3 Budget Review findings

The *1999 Budget Review* includes the budget summaries of some of South Africa’s largest local governments. The income, expenditure and capital budgets of these municipalities are detailed in tabular form below:

Figure 19 - Operating income budgets⁸⁴ of selected local governments (in millions of Rands): 1998/99

| | Property Tax | RSC Levies | Bulk Services | Grants and Subsidies | Other | Total |
|------------------|--------------|--------------|---------------|----------------------|--------------|---------------|
| Johannesburg | 1 539 | 645 | 3 959 | 430 | 353 | 6 926 |
| Cape Town | 1 258 | 299 | 2 592 | 157 | 1 264 | 5 570 |
| Durban | 1 013 | 247 | 2 493 | 128 | 1 246 | 5 127 |
| Pretoria | 906 | 266 | 2 978 | 257 | 474 | 4 881 |
| Pietermaritzburg | 151 | | 405 | 87 | 112 | 755 |
| Nelspruit | 35 | | 111 | 7 | 5 | 158 |
| Potchefstroom | 26 | | 121 | 5 | 13 | 165 |
| East London | 102 | | 342 | 67 | 58 | 569 |
| Pietersburg | 49 | | 204 | 8 | 18 | 279 |
| Kimberley | 46 | | 163 | 7 | 63 | 279 |
| Bloemfontein | 103 | | 385 | 29 | 74 | 591 |
| Port Elizabeth | 213 | | 815 | 66 | 139 | 1 233 |
| Germiston | 219 | | 626 | 19 | 48 | 912 |
| Total | 5 660 | 1 457 | 15 194 | 1 267 | 3 867 | 27 445 |

[Source: Department of Finance, 1999]

⁸⁴ Projected but not actual figures.

Figure 20 - Operating expenditure budgets of selected local governments (in millions of Rands): 1998/99

| | Salaries | Bulk Services | General Expenses | Repairs and maintenance | Interest | Contribution to funds | Total |
|------------------|--------------|---------------|------------------|-------------------------|--------------|-----------------------|---------------|
| Johannesburg | 1 664 | 2 382 | 993 | 423 | 898 | 566 | 6,926 |
| Cape Town | 2 199 | 1 389 | 593 | 341 | 842 | 206 | 5,570 |
| Durban | 1 634 | 1 576 | 164 | 597 | 952 | 200 | 5,123 |
| Pretoria | 1 426 | 1 789 | 198 | 600 | 651 | 216 | 4,881 |
| Pietermaritzburg | 244 | 258 | 12 | 56 | 101 | 63 | 734 |
| Nelspruit | 52 | 40 | 9 | 18 | 26 | 11 | 156 |
| Potchefstroom | 61 | 64 | 9 | 11 | 17 | 3 | 165 |
| East London | 180 | 143 | 88 | 51 | 86 | 22 | 570 |
| Pietersburg | 84 | 88 | 7 | 31 | 57 | 11 | 279 |
| Kimberley | 81 | 62 | 67 | 24 | 32 | 13 | 279 |
| Bloemfontein | 184 | 181 | 71 | 56 | 78 | 22 | 591 |
| Port Elizabeth | 446 | 332 | 68 | 133 | 187 | 67 | 1,233 |
| Germiston | 294 | 363 | 24 | 77 | 105 | 47 | 912 |
| Total | 8,549 | 8,667 | 2,303 | 2,418 | 4,032 | 1,447 | 27,421 |

[Source: Department of Finance, 1999, from SSA]

Figure 21 - Capital budgets of selected local governments (in millions of Rands): 1998/99

| | Loans | Contribution from funds | District Council funds | RDP Funds | Grants and subsidies | Total capital projects |
|------------------|--------------|-------------------------|------------------------|------------|----------------------|------------------------|
| Johannesburg | 394 | 14 | 0 | 10 | 59 | 477 |
| Cape Town | 984 | 95 | 50 | 18 | 615 | 1,762 |
| Durban | 887 | 20 | 34 | 34 | 596 | 1,571 |
| Pretoria | 453 | 169 | 173 | 6 | 16 | 817 |
| Pietermaritzburg | 98 | 3 | 27 | 0 | 91 | 219 |
| Nelspruit | 40 | 29 | 4 | 1 | 3 | 77 |
| Potchefstroom | 44 | 1 | 14 | 0 | 24 | 83 |
| East London | 125 | 0 | 48 | 23 | 82 | 278 |
| Pietersburg | 57 | 29 | 0 | 3 | 1 | 90 |
| Kimberley | 30 | 5 | 6 | 7 | 16 | 64 |
| Bloemfontein | 109 | 29 | 0 | 0 | 19 | 157 |
| Port Elizabeth | 123 | 15 | 13 | 4 | 102 | 257 |
| Germiston | 125 | 0 | 37 | 23 | 84 | 269 |
| Total | 3,469 | 409 | 406 | 129 | 1,708 | 6,121 |

[Source: Department of Finance, 1999, from SSA]

Three broad statements can be made about these budgets:

1. Bulk services provide the largest source of operating income,
2. Loans are the most significant funding source for capital infrastructure (although this may not apply to non-metropolitan areas), and
3. Relative income sources vary significantly from one locality to another.

3.4 User charges

Municipalities charge for services rendered. The most important trading services are water, electricity, sewage disposal, and refuse removal. Charges may exceed costs, argues the *White Paper on Local Government* (1998), to cross-subsidise poorer communities. Thus in areas with relatively affluent consumers, municipalities have some leverage in supplementing their income for service provision in poorer areas. To some extent, the role played by local government is complicated in trying to achieve the appropriate balance between efficient and cost effective service delivery (especially when in partnership with the private sector or when attempting to attract commercial residents) and ensuring developmental progress.

3.4.1 Electricity

While the *White Paper on Local Government* (1998: 110) argues that:

“the surplus derived from the sale of electricity (i.e. the difference between revenue and total expenditure) is not large, it remains an important source of income for most municipalities”

it is difficult to get an exact sense of which municipalities the statement refers to. At a workshop on the restructuring of the electricity industry⁸⁵, participants argued that larger municipalities were typically the beneficiaries of electricity surpluses and that smaller municipalities may even lose income in the distribution of electricity. Furthermore, gross income does not reflect the administrative costs of electricity provision (1998 and 1999 *Budget Reviews*).

Although details of profits generated from electricity are unknown and likely to vary between municipalities, the removal of this income will impact on local government's cash flow position. (This as a result of restructuring of the electricity industry that envisages service delivery by competitive regional electricity distributors, REDs – although authority is still to rest with local government, delivery may not). Combined surcharges on water and electricity consistently account for the largest portion of local government's *aggregate* revenue (Heese, 1998). It is, however, difficult to offer specific extrapolations, as revealed by a series of visits to municipalities by the FFC (1997: 55):

“There is no uniformity amongst municipalities in terms of revenues generated, sources of bulk purchase, reticulation, metering systems, size of electricity departments and administrative capacity, tariffs and rebates and the role of utilities in service provision. For this reason cross-jurisdictional comparisons are not only difficult but offer little value...In aggregate, and for most individual municipalities, any loss of revenues from electricity distribution and/or reticulation, without a concomitant alternative source, would cripple the institution of local government.”

⁸⁵ National Electrification Strategy Development Workshop, held at the Development Bank of Southern January, 2000

This contention is substantiated by National Electricity Regulator (NER) studies that reveal that R1,5bn is transferred annually from electricity to other services, although 25% of electricity providers use other revenue to subsidise electricity⁸⁶ (Solomon, 1998).

What is, however, of unambiguous significance is the role of electricity as an effective sanction for the non-payment of rates⁸⁷ (Solomon, 1998). Although illegal reconnection is pervasive, experience has shown, particularly in Gauteng, that the threat of disconnection encourages greater payment of rates. This is significant in light of the IDASA (1998) finding that coercion is as necessary as legitimacy in order to ensure the payment of rates (See Section 2.1.5).

Local government will need to assert its Constitutional (Schedule 4B) authority to regulate the restructuring of the electricity industry. As the industry's "service authority" (which needs not necessarily infer "service provider"), local government is entitled to decide upon the most appropriate way in which to regulate supply⁸⁸. This includes discretion in using appropriate and fair tendering criteria to choose a service provider, the right to planning and develop targets and management of contracts, tariffs and consumer representation. Despite these rights, local government has not been integral in the restructuring of the electricity industry (scant reference is made of local government's role in the *Draft Energy White Paper*, for instance).

If a proportion of the proposed electricity levy goes to local government as compensation for service provision by regional service providers (REDs), the surplus on electricity could become a more transparent and better monitored form of taxation. It could factor in the ability for richer residents to cross subsidise poorer residents, and for commercial areas to subsidise residential areas. Increased competition could also result in greater delivery efficiency and lower prices for consumers. Should REDs roughly coincide with boundaries of MCs and DCs, and be mostly awarded to MCs and DCs, restructuring should not be too disruptive for local government.

3.4.2. Water

Trading surpluses from water provision constitute the fourth largest revenue source for local government (FFC, 1997: 55). According to the *Water Services Act 108 of 1997*, water tariffs may be regulated at a national level. This diminishes municipalities' ability to generate surpluses from the provision of water (although it is questionable whether such a surplus is desirable for a basic

Africa, 27 July 1998.

⁸⁶ The top 25% - 98 of the 400 electricity distributing municipalities - earn R1.43bn annually in surpluses, while the bottom 99 municipalities lose R83m.

⁸⁷ By cutting electricity supply if rates are in arrears. This is a far less drastic measure (in terms of disrupting living arrangements and sanitary conditions) than the cutting of water as has been resorted to in some localities such as Pretoria.

⁸⁸ Presentation made by Dr C. Olyer, DDG (DCD) at the National electrification Strategy Workshop (27 July 1998).

service like water), as well as narrowing the prospects for water concessionaires to cross-subsidise developmental roll out in poorer jurisdictions.

Kasrils (1999) argues that as a “natural monopoly”, the regulation of water services is essential if private providers are to enter provision. A number of international water corporations such as BiWater and Saur have already established a presence in South Africa despite the threat that their profit margins are likely to be curtailed by legislation (which is in the process of being drafted). While regulation to widen affordable access to water furthers local government’s developmental focus, it will mean that some municipalities will have to generate income through other sources.

3.5 Levies

3.5.1 Fuel

Collected at a national level, a portion of the fuel levy (1 cent per litre) was allocated to MCs and DCs until July 1997. This was done on the basis of origin (Katz Commission, 1998). The re-allocation of the fuel levy is supported by *the White Paper on Local Government*. The policy framework proposes that the levy be used to fund municipal roads. In the past, other public transport items (typically bus services) were the largest item of expenditure from this revenue, but in cases of a surplus, roads were funded (Katz Commission, 1998).

Provincial and national government have, however, appropriated the levy. It seems improbable that provinces, with so few alternative sources of revenue, would be likely to forego this levy. Bus subsidies included in the 1999/00 budgets have, to some extent, alleviated the need for the fuel levy (see Section 5.2.3), but exclude the discretionary possibilities of the fuel levy. This is regrettable for local government as roads at a local level are of great significance to marginalised communities that may be overlooked at a regional level in that they provide access to recreational, educational, health and commercial centres (Heese, 1998a).

3.5.2 RSC and JSB levies

DCs and MCs collect regional service council (RSC) levies based on payroll, whereas regional establishment (JSB) levies are based on turnover. These represent the most significant sources of income for second tier local government⁸⁹. The total revenue from RSC and JSB levies accounted for R2,1bn in 1996/97 and R2,9bn in 1997/98 (Department of Finance quoted in Katz Commission, 1998). Evasion, however, is reported to be high as collection is not standardised and not all municipalities have the capacity to manage the function. One controversial example of possible evasion is the allegation that the Strategic Fuel Fund (SFF) owes R1,4bn in levies and unpaid taxes (*Business Day*, 7/10/99).

⁸⁹ In terms of the Regional Services Councils Act 109 of 1985 and the KwaZulu-Natal Joint Services Act 84 of 1990 according to Section 10(3) of the Local Government Transition Act (LGTA).

In rural areas, collection rates are reputedly higher⁹⁰ and represent a critical source of revenue for those areas⁹¹. Information from 28 of the 42 DCs surveyed by Franzen, indicates that only a few have difficulty in registering new levy payers and/or collecting levies from currently registered levy payers, with collection rates, in what is often an expensive outsourced function, in excess of 90% (Katz Commission, 1998). In most cases, levy income was found to be sufficient to fund operations except in the Eastern Cape (the Kei DC and Wild Coast DC, for instance) and KwaZulu-Natal (Ilembe RC, for example), but new DCs require IGTs in the short term (Katz Commission, 1998). The financial status of DCs can be assumed to vary greatly. A few banking institutions have remarked that they have been approached by DCs wishing to invest large cash surpluses.

At a metropolitan level, RSC levies provide a critical revenue source for redistribution. This was their original intention. In terms of the Regional Services Councils Act⁹² -

“in determining the priorities in connection with the appropriation of funds, the council shall give preference to the establishment, improvement and maintenance of infrastructure and infrastructural services and infrastructural facilities in the areas where the greatest needs therefor exist.”⁹³

The latitude in interpreting “preference” has apparently led to a violation of the Act’s intentions with insufficient spending on the least developed areas, and often not on infrastructure.

A recent dispute in Johannesburg highlighted the temptation to use RSC levies for other purposes. A site in Frankenwald, north of the Johannesburg city centre has been earmarked for purchase by the Johannesburg Eastern MLC. The former central Witwatersrand Regional Services Council (RSC) purchased the site for R25m from the University of the Witwatersrand in 1994 to extend the boundaries of low-cost housing around Alexandra, as well as for commercial and industrial use (*Business Day*, 17/11/99).

Kelvin and Buccleuch residents in suburbs adjacent to the site contested the use of the site for anything other than infrastructure as RSC levies had been used to purchase the site. The Johannesburg High Court ruled in the residents’ favour and the University returned the proceeds of the sale to an interest-gathering trust that has amounted to the value of R37m (*Business Day*,

⁹⁰ Discussion and presentations at EISA Local Government Roundtable made by Dr. Hildegard Fast, NLC, and Prof. Riel Franzen, UNISA (24 July, 1998).

⁹¹ Personal communication with Danie de Lange, Chief Financial Officer at Western District Council and consultant to the DCD.

⁹² Number 109 of 1985.

⁹³ Although South Africa’s municipal infrastructural backlog would indicate that this principle was not followed.

17/11/99). Residents have threatened that they will contest the repurchase of the land using the trust monies (*Business Day*, 17/11/99). It is likely that RSC levies have been used in a number of other instances, but have not been similarly detected. What makes the Frankelwald case interesting is that an interest group is using the intentions of the RSC act to pursue other ends (to stop the spread of Alexandra closer to their boundaries). The more worrying scenario is that levies are collecting interest and are not being used for any purpose at all elsewhere in the country.

As RSC levies and JSB levies tax payrolls and turnovers, respectively they should be used sparingly to mitigate any employment disincentives (Heese, 1998a). The long-term future of these levies has been called into question on the basis of their employment disincentives, which are (correctly) viewed as economically inefficient. Furthermore, the Third Interim Report of the Katz Commission suggested that there might be issues around the constitutionality of the levies (Katz Commission, 1998).

The Democratic Party has called for the establishment of a commission to investigate municipal rates and taxes, and specifically the RSC levies:

“The entire issue is complex and sensitive. The government cannot just ignore these issues and continue with the status quo, particularly because further transition is being planned for local government.” Mike Moriarty, DP caucus leader for greater Johannesburg MC (*Business Day* 30/3/98).

The *White Paper on Local Government*, however, recognises the need for the revenue raising potential of the levies in the short term. An even more important source of revenue, however, is property tax.

3.6 Property Tax⁹⁴

According to the Constitution (Sections 228 and 229), rates on property are a constitutionally guaranteed source of local government revenue, and explicitly prohibited from being used by provinces (Katz Commission, 1998).

“The power to tax is essential to sustainable and accountable local government. Municipalities must have access to adequate resources to fulfil their assigned duties and objects. The major source of local taxation is the property tax (rates). On average, rates comprise about 20% of municipal own revenue. Property tax is not the only source of municipal revenue, but it is an important source of discretionary revenue and enables local government to function effectively.” (Roome, 1998)

⁹⁴ Property taxes in most texts refers to taxes on movable property and property transfers, but in South Africa, the term relates to rates on property; either ‘general rates’ or ‘assessment rates’ (Katz Commission, 1998).

Local tax determination however, is likely to be standardised by national and provincial legislation. Currently provincial legislation determines taxation regimes. In the past, rebates were granted to residential ratepayers, with the tax burden weighing heavily upon commercial and industrial rate payers, as well as trading services (Katz Commission, 1998). Typically, shortfalls in revenue were made up by property taxes and thus local rates varied tremendously.

Property tax is currently the largest source of discretionary income for urban local government. Future legislation is likely to determine whether the tax is to be extended to rural areas⁹⁵, a notion that is heavily contested by farmers' unions. The *White Paper on Local Government* suggests that the extension of property tax to rural areas is advisable on the ground of equity. If the option is pursued, there will be a number of important considerations to be made around how tribal land is taxed and whether the recipients of land reclamation are taxed immediately or not, and whether differential rating is used for subsistence farmers.

In practical terms, Van Zyl and Wink (1997) suggest that the marginal contribution of a land tax may not be sufficient to outweigh costs of administration. Data limitations confronting rural local government that were identified by the Katz Commission (1998) include:

- The 1996 population census' use of magisterial districts - these do not or will not necessarily coincide with current or future municipal jurisdictions,
- Areas that have not yet been surveyed by the office of the Surveyor General - especially in former homeland areas,
- Primary municipalities tend to act merely as advisory bodies to the relevant DC with little or no executive powers or functions making DCs the only structures that may be able to manage the introduction of a land tax, and
- Uncertainty and insecurity around land tenure rights is far from being resolved, especially relevant in the context of tribal land.

Even in the event of a theoretically sound framework being developed that addresses the equitable extension of property tax and standardises current systems and assessment techniques, the more critical issue from a practical point of view is that of political acceptance (Heese, 1998a).

The Sandton rate boycott is illustrative of the implications of poor consultation and the absence of a phasing-in period to facilitate resident acceptance of a new rating system. Similarly, owners of property in townships who are unfamiliar with taxation are likely to resist the introduction of property tax unless it is one that has been carefully negotiated.

⁹⁵ Katz Commission findings on the feasibility of introducing a land tax are detailed in Appendix C.

Problems with introducing a revised tax system should, nonetheless, be weighed against gains. Restructuring is required from both an efficiency and equity point of view as fairness and uniformity are still to be introduced into the South African local tax environment. But in order for a smooth transition to occur, a number of careful precautions need to be taken for effective implementation of new policies, requiring extensive consultation to reach consensus with role players in local government and affected communities.

Some of the key decisions that need to be taken include:

- The base of taxation – there are three alternatives:
 1. Site rating – rating unimproved value of the land only,
 2. Flat rating – rating the improved value of the land, and
 3. Composite rating – rating both site and improvements (Franzen, 1997),
- Valuation systems – the sale or capital price can be used; these will be the same if the property is being exploited for its most profitable use; it is important that these are updated regularly (as noted by the *White Paper on Local Government*);
- Tax rates – extent of local discretion in their determination,
- Treatment of the indigent, pensioners and disabled persons – grant in aid⁹⁶ cases may be unaffordable for councils with large numbers of potential beneficiaries,
- Taxation of other spheres of government;
- Payment terms⁹⁷,
- Treatment of environmentally valuable land where higher rates are likely to force owners to sell their properties to developers,
- Revision of land tenure systems – in the former Transkei and Ciskei, for instance, where apartheid policies removed ownership rights by operating on a rental system (such as “permission to occupy”), an understanding and acceptance of property taxation may be difficult to inculcate.

Under the current regime with varying provincial ordinances, few of these issues have been resolved. The Katz Commission summarises features of the current system in the figure overpage.

⁹⁶ Exemptions.

⁹⁷ It has been proposed, for instance, that in some areas of the Cape Metropolitan Area where residents return to families over the December holiday period, taking with them many goods for their family homes, that rate payment not be required for that month. Other localities may have similar concerns around seasonality that require the provision for payment in instalments.

Figure 22 - Synopsis of property tax rates

| | |
|--|--|
| Taxable Object | All land within the municipality (irrespective of zoning) |
| Tax Base | Site rating (i.e. unimproved value); or Flat rating (i.e. improved value); or Composite rating (i.e. land and improvements – but at different tax rates) |
| Taxpayer | The owner |
| Method of assessment (to establish capital value) | Land: Comparable sales method Improvements: Subtracting site value from improved value (except KwaZulu: replacement cost) |
| Assessment | Only registered valuers |
| Objections and Appeal | Elaborate procedures |
| Tax rates | Flat rates (expressed as cents in the Rand) Some provinces set a maximum rate |
| Exemptions | Very few state-owned properties are rateable |
| Rebates | Improved residential properties Sometimes certain hardship cases |
| Collection | Normally monthly or biannual instalments |
| Enforcement | Interest on arrears No transfer unless “clearance certificate” issued In arrears for more than 3 years: seizure and public sale |

[Source: Katz Commission, 1998]

3.7 Municipal borrowing

Although Sections 229 and 230 of the Constitution prohibit deficit budgeting, there is still provision for capital expenditure financing. According to the Department of Finance (1998a), the quarter ending June 1997 saw municipal debt rise to R24.6bn - a 7% increase over the previous quarter. Total exposure of creditors to municipalities declined from the third quarter of 1997 by R8bn to R16bn at the end of the third quarter 1998 (Department of Finance, 1999).

Municipalities are widely regarded as being underexposed in capital markets – the result of poor credit ratings. Understandably so – without the final settlement of structures and boundaries, transaction costs are pushed up by uncertainty. A municipality, even one with good credit rating in 1998, may be amalgamated with another, or parts of another locality in a couple of years, changing its financial profile considerably.

Another hindrance is the emerging clarity that there are unlikely to be any default or guarantee procedures (“gilt edge” loans) underwritten by other spheres of government⁹⁸. There is also a need for standardised accounting procedures – although GAMAP have been drawn up, they have yet to be uniformly applied⁹⁹. Even when accounts are (superficially) in order, there is often

⁹⁸ Sphere is the operative description – as an autonomous sphere, local government is expected to conduct its financial affairs in a responsible and independent fashion (see early drafts of the Treasury Control Bill – now the Public Finances Management Act - that included local government).

⁹⁹ It was reported at the 1998 IMFO Conference by Dion Ramoo of the Eastern Cape Presidential Project, that a number of councils in the former Transkei still draw up financial statements by hand.

no reflection of outstanding debtors – this is clearly problematic when many councils experience significant levels of non-payment (see Section 2.2.1).

The *White Paper on Local Government* refers to the options of bond pooling, bond banking, syndication which are slowly starting to materialise (Solomon, 1998) in the forms of:

- the establishment of INCA¹⁰⁰, which was facilitated by a number of financial institutions, and has within its first year extended an amount in excess of R1bn of loans to municipalities¹⁰¹, using a credit rating model to assess credit-worthiness.
- international development agencies¹⁰² and empowerment groupings which have begun operations in South Africa.

These developments aside, many local governments will, for a long period of time, be of little interest to the private sector, given their inherently weak fiscal capacities. Ironically, it is in such localities where backlogs are greatest and investment most needed. Concessional loan finance is thus of great importance in providing finance for projects with economic returns that would not be calculated by private sector institutions.

The Development Bank of Southern Africa (DBSA) is an instrumental player in concessional finance. According to its 1998 Annual Report, 32% of cumulative loan approvals up to the 31 March 1998 were to local government. During 1997/98, within South African borders, 72% of DBSA clients were local governments. Most of these funds are used to finance the provision of municipal infrastructure. Increased use of loans (in the place of grants) is an approach supported by a number of commentators in order to “both reinforce the technocratic basis for distribution and to provide a future source of funding through the relending of debt service” (World Bank, 1995: 27).

Not all municipalities, however, can qualify for such loans (and loans cannot therefore address redistribution issues¹⁰³). Local government is, as a consequence, seeking innovative ways in which to overcome shortfalls and to leverage finance, including the use of partnerships. Some of the strategies used by local government are explored in Chapter 4. The dynamic nature of municipal finances is critical in assessing the opportunities and constraints facing local government.

¹⁰⁰ Infrastructure Finance Corporation Ltd. is a lending company (which is not technically a bank).

¹⁰¹ By March 1999, INCA had disbursed more than R1.255bn to local governments (presentation by Attie van Wyk, INCA at Local Government Transformation Programme Launch, 29 March 1999).

¹⁰² Such as USAID, which disbursed \$130m in loans during 1998.

¹⁰³ As demonstrated by many of the recent debates around heavily indebted poor countries (HIPC).

4 Local governments financial stability

As detailed in the preceding chapter, on aggregate local government raises almost all of its operating revenue, and it does so through an array of revenue sources, mainly through property tax and user charges for water and electricity. Contrary to some policy assumptions¹⁰⁴, however, this revenue cannot be assumed to be sufficient for local government as a whole, nor for individual municipalities, given the likely changes in these in revenue streams (implied by revised electricity distribution strategies and property rating, for instance).

Intuitively a local tax, an important revenue source in South Africa's case, should be not only easy to administer, but relatively stable. The restructuring of user charges (local government's largest revenue source) and difficulties around non-payment violate these two requirements. Stability is necessary to ensure sustainable service delivery and, in the event of fluctuations, should be facilitated by transfers from other government spheres. These transfers are critical, therefore, to guarantee that local government has sufficient revenue to carry out its constitutional obligations, but at the same time, they must obviate the risk of moral hazard and ensure that they encourage fiscal effort (current IGTs are detailed in Chapter 5).

Trends undermining local government's financial stability, the extent of their threat and likely duration are explored by assessing the arguments of two recent studies on local government finances – those by Project Viability (1999) and Solomon (1998).

4.1 Key trends

4.1.1 Project Viability findings

Project Viability was established by DCD in 1995 in order to assess and monitor the short-term liquidity of municipalities. Reporting by municipalities was voluntary until November 1997 when municipalities became obligated to complete the survey. Yet only a core group of 282 (or 54% of urban) municipalities, completed questionnaires from October 1996 to March 1998 (Project Viability, 1998), decreasing to 272 (or 53%) of urban municipalities in June 1998 (although overall response rates improved somewhat).

Trends are extrapolated from this core group's data on the assumption that "This core group represents and can be used with confidence to determine a trend in respect of all municipalities" (Project Viability, 1999). It is not clear why "The 200 non-responding municipalities ... [that are] mostly rural councils with no or very little capacity to respond to the questionnaires" (Project Viability, 1999) are not considered to be relevant to the trends of "all municipalities".

¹⁰⁴ See Appendix D for a Department of Finance projection (based on the South African Reserve Bank

It is probable that the core group overstates the well-being of municipal finances, as municipalities with sufficient time and skills capacity are the most likely to have responded to questionnaires from the start of the programme. Hence, there is a problem of adverse selection – in trying to identify the nature of financial problems afflicting local government, data received tracks those municipalities that are relatively healthy (in financial terms), thereby possibly highlighting an inappropriate set of issues. Nonetheless, findings by the survey are useful to track the changing status of municipalities' financial well-being.

By June 1998, responses were received from 633 municipalities, an increase from the 69,3% and 46,5% response rate for the two mid-year questionnaires in 1997 and 1996 (Project Viability, 1999). Despite regulations to the contrary, of the 200 municipalities that failed to reply, none applied for exemption (Project Viability, 1999). The response rate of nearly 76% is nevertheless considered to be a positive and pleasing result by government officials (inferring perhaps that about a quarter of municipalities are considered “basket cases” that are unlikely to respond to Project Viability in any event). Anecdotal evidence suggests that there is some suspicion on the part of councils as to the exact intention of questionnaires, and in some non-responding instances, a lack of capacity to deal with questions may not be the key consideration.

One of Project Viability's key focus areas is around credit control. In March 1998, a Project Viability survey estimated that outstanding debtors accounted for 36.5% of income. Only 71% of consumers were regular payers despite the Masakhane campaign. In June 1998, outstanding debtors increased even further (Project Viability). This increase is reflected in the following table as a percentage of rates and service charges (debtors of 11% to 15% of turnover, or six to eight weeks, are accepted as the norm for outstanding debt):

Figure 23- Debtors as a percentage of rates and service charges (turnover)

| | All Provinces (%) | Grades 10-15 (%) | Grades 6-9(%) | Grades 0-5 (%) |
|----------------|-------------------|------------------|----------------|----------------|
| October 1996 | 22 | 22 | 23 | 32 |
| December 1996 | 23 | 22 | 25 | 32 |
| March 1997 | 25 | 24 | 28 | 32 |
| June 1997 | 26 | 25 | 27 | 37 |
| September 1997 | 30 | 30 | 31 | 44 |
| December 1997 | 31 | 30 | 32 | 48 |
| March 1998 | 32 | 31 | 34 | 44 |
| June 1998 | 33 | 33 | 34 | 47 |

[Source: Project Viability, 1999]

De Bruyn (1998) observes that defaulters are often large institutions (including provincial departments) which would explain why targeting of households has had a marginal success:

“And while media reports often blamed apartheid-era township boycotts, the recent cut-offs in Gauteng proved that the private sector and semi-government institutions were often as guilty of non-payment as ordinary citizens. And they usually owed larger amounts.”

An illustration of such non-payment surfaced recently with a dispute between the Eastern Cape provincial government and local municipalities, which are refusing to pay revenue collected on behalf of the provincial government owing to its unpaid debts (*Business Day*, 15/10/98).

Another explanation is that non-paying households can simply afford not to pay for services rendered (see Section 2.2.5). Exact amounts outstanding are reflected below:

Figure 24 - Project Viability core group’s outstanding debtors (for all provinces)

| | Rands |
|----------------|---------------|
| October 1996 | 6,295,132,442 |
| December 1996 | 6,494,540,209 |
| March 1997 | 7,053,399,690 |
| June 1997 | 7,334,618,847 |
| September 1997 | 8,530,957,271 |
| December 1997 | 8,722,995,121 |
| March 1998 | 8,890,241,416 |

[Source – Project Viability, 1998]

Other alarming indicators of an inability to maintain financial stability included:

- The ability to pay creditors, which had fallen to 17.8% from the study’s last quarterly survey completed in March 1998,
- The poor correlation between disconnections and reconnections, suggesting a high rate of illegal connection;
- 87 of the 833 sampled municipalities did not meet criteria indicating sound liquidity levels (a full census would probably exacerbate these figures).

Although the picture sketched by Project Viability is a disturbing one, there have been suggestions that trends are not always structural, but of a temporary, transitional nature. Improvements in the latest survey findings (June 1998) as well as an improvement in Eskom arrears (a proxy of municipal cash flows) have supported this contention.

Bulk debt to Eskom has been reduced from R1.2bn at the end of 1997 to R550m at the end of 1998 (*Business Day*, 23/3/99). After the formation of a bulk debt normalisation committee under the National Energy Regulator in September 1997 and the setting up of repayment arrangements, only three municipalities have failed to sign and undertake repayment agreements (*Business Day*, 23/3/99).

A number of trends around liquidity that Project Viability continues to reveal could be more appropriately broken down by further analysis and improved collection of the survey, including:

- distinctions between metropolitan and non-metropolitan cases,
- analysis of rural versus urban problems, and
- more substantive breakdowns of liquidity problems (to what extent major institutional debtors are a problem, for instance).

4.1.2 Solomon's findings

In a paper commissioned by IDASA's Budget Information Service and Local Government Information Service, Professor David Solomon (1998)¹⁰⁵ argues that local government in South Africa is challenged with transforming its "constitutional arrangements", not with a shortage of resources. He interprets lack of funds to be a symptom, not a cause of distress:

"It is a commonly held perception that local government is in a state of collapse and is in dire need of state sponsored interventions in the form of broadly based subsidies and managerial supervision and expertise. I do not share that view ... If we focus on lack of funds, which is a symptom, not a cause of distress, we will fail to address the key constitutional issues facing us, and to grasp firmly the opportunities offered us by global developments in the infrastructure and service sectors".

To support this thesis, Solomon argues that there are a number of "red herrings" that need to be scrutinised:

- Whilst acknowledging the undermining effects of non-payment, "non-payment is ... a problem that deserves attention, but is, in general, not the cause of short-term financial failure, nor is it caused by incompetence".
- Local government should, according to Solomon, be able to access capital without too much difficulty – "at R31bn per annum, the cash flow to local governments is described as 'strong' by lending institutions (INCA) and is only modestly encumbered by the existing debt burden of R25bn".
- Local government responsibilities are essentially trading services that are able to recover costs and – "local government sector as a whole has limited need therefore of an injection of grant money from central government". He concedes that this may not apply to "individual local governments".
- Cash flow difficulties may underlie what appear to be more structural problems – "Fiscal imbalance is not an automatic case for grant funding. It simply means that local governments are suffering a crisis in their cash flow that will, in time correct itself".

¹⁰⁵ Of the University of the Witwatersrand.

- Redistribution need not be financially crippling – “Local governments are faced with an investment program which is ... focused on formerly black, poorer areas. This constitutes a rational prioritisation of expenditure, ... which is not well served by being termed ‘re-distribution’, a word which is associated with welfare payments, and other interventions aimed at correcting the market-based distribution outcome”.
- Unfunded mandates are a misinterpretation of re-orientation – “There is no new mandate, ... but merely the removal of an explicit exemption from the duty to carry out the functions of local government with respect to people of colour”.
- Inter-jurisdictional competition is a positive feature of local government - “Bad choices, poor prioritisation, over-taxing and providing poor value for money generally will have it’s (*sic*) consequences in diminishing property values and a declining tax base. Not only will residents choose a more suitably managed authority, but the property values in the jurisdictions concerned will reflect this differential in the residential environments, further impacting on the property tax base ... forcing a level of accountability and responsiveness on local governments that is absent from other spheres”.

Instead, Solomon (1998) identifies the following as key challenges:

- The ability to undertake PPPs despite associated problems – “A partnering environment, whether with private or public sector partners represents a new form of local government delivery which has a range of benefits, but is also challenging and difficult to work in. It is, nevertheless an inescapable feature of community service delivery, and must be addressed forthrightly”.
- Electricity restructuring – “Removal of electricity surplus earnings will affect these [metropolitan] areas very severely, but will have less direct impact on other, smaller municipalities. ... Perhaps most importantly, the removal of electricity from the municipal portfolio would deny South African local governments one of their most important tools for revenue collection. ... Removal of electricity from their functions will leave them with a reduced need for capital but also a reduced cash flow to support their independent debt raising capacity. ... Local governments will be left with a very limited capacity to raise debt finance.”
- Unicities – “The major benefit will be the achievement of clarity regarding functional division between metro and substructure and the elimination of existing duplicate rights over cash flows. ... It will also make the process of allocating resources towards the poorly developed former black townships easier, ... removing the necessity to engage in controversial, potentially contestable, inter-authority transfers”.
- Accessing private capital - by clarifying “local government’s rights to its cash flow, its borders, and its duties”, ... “the rights and duties of creditors, and of supervising authorities

... in event of a local government becoming distressed”, ... “a standardised accounting practice”, ... a MSP framework, and a bond rating system.

Respondents (Heese, 1998c and Zziwa, 1998) to Solomon’s paper, however, contested some aspects of this fairly optimistic analysis, arguing that some issues labelled red herrings are in fact dire problems:

- Non payment is indicative of “an important symptom – a breakdown and rejection of local governance. As a matter of process, local government should be advancing towards participatory budget planning, not legislative enforcement” (Heese, 1998c).
- Local government will require IGTs on an on-going basis “for the provision of public goods, especially amongst economically marginalised and commercially unprofitable communities. In some instances, local governments *will* rely on transfers, certainly in the medium term where institutional and socio-economic opportunities are such that it cannot be assumed that ‘a crisis in cash flow will correct itself.’” (Heese, 1998c).

Furthermore Heese (1998c) argued that Constitutional arrangements are not the key area of concern:

“While the Constitution may provide adequately for the arrangement of local government finance, it is the carrying out of constitutional provisions that threatens viability. Constitutional stipulations need not imply that local government is receiving its equitable share. The calculation of sum requires scrutiny in terms of its implementation, not its Constitutional basis” (Heese, 1998c).

Zziwa argued that some of Solomon’s “symptoms” of distress are rather causes, including:

- “the weak transitional institutional base of mainly the newly established local governments and also of the restructured long-established ones;
- “poor fiscal capacities ... most of the priority needs of some communities are not addressed because the budgeting systems and allocations of resources are still a continuation of the old fiscal systems approach and process. The net result of the lack of strategic planning and budgeting gives a lieu way to overspending or misuse of the available public finances and hence financial distress;
- “proliferation of national and provincial mandates to local governments and insufficient intergovernmental transfers” (Zziwa, 1998).

Both Solomon’s paper and the respondents’ views indicate that there are a vast number of challenges facing local government’s financial well being, however prioritised or interpreted.

4.2 Alternative sources of revenue

The Constitution grants local government the right to levy taxes, but this excludes income and general sales taxes, or anything that may “unreasonably prejudice” the policies of other governmental spheres¹⁰⁶. As local government already exploits user charges, property taxes and levies, there is little scope for any additional revenue source that has not already been tapped. As a result, a number of local governments look for ways of mitigating costs. Municipal Service Partnerships (MSPs) are seen as one way of doing so. Junaid Ahmad¹⁰⁷, and other policy makers at the World Bank, have suggested that municipal bonds may also alleviate the pressure on municipal finances.

4.2.1 Partnerships

“The message [of] the Thabo Mbeki government, and indeed of the former government of Nelson Mandela, is one of co-operation, of partnership between all those who, in various ways, seek to influence and change our society for the better. One of the most encouraging things about the post-1994 South Africa has been the degree to which the private sector has shown itself to be prepared to join hands in partnership with government. There have been setbacks, certainly. There have been frustrations on both sides. But I believe that the journey on which we have all embarked has begun. We are on our way.” Ronnie Kasrils¹⁰⁸ (October 1999¹⁰⁹).

Although PPPs in the provision of public goods are inherently restricted by profit motivation (PPPs are likely to overlook external benefits associated with the provision of public goods as they are concerned primarily with private gain), they can offer cost-effective delivery. PPPs also leverage in private capital for public goods on a scale that would not otherwise be possible. As argued by Abedian (1998b), the mix of public and private risk sharing will vary depending on the project:

“Not only with respect to expenditure management, but also on the financing side of the fiscus there have been a number of innovations over the past two decades. Private-sector participation in the financing of public infrastructure has been a critical innovation contributing to the large scale expansion of global economic infrastructure such as telecommunication, power supply, water and transportation...In principle, where projects have cost-recovery potential and provide market-related returns, private sector funding is feasible. In cases where projects offer only partial cost-recovery, the general trend is toward public-private co-funding arrangements.”

¹⁰⁶ Section 229, 230 of the Constitution.

¹⁰⁷ Presentation at the 1999 TIPS Forum, held at Muldersdrift.

¹⁰⁸ Minister of Water Affairs and Forestry.

¹⁰⁹ Speech delivered at the opening of the Standard Corporate and Merchant Bank water concession seminar.

An example of private sector advantages that cannot be harnessed by local government is the ability to use deficit budgeting for long-term projects¹¹⁰ and bringing in flexible and specialised work methods to encourage efficiency. But more than anything else, government policies argue that the major contribution of PPPs is the increased pool of capital that becomes available for investment into social infrastructure when both the private and public sector share risk.

In the South African context, Municipal Service Partnerships, MSPs, encompass a wider range of partnerships than PPPs:

“It’s not only private companies which form partnerships with local authorities, it could be parastatals, or NGOs, or even public companies. We feel the term MSP is more focused on the actual issue, which is the provision of services at a local level.”
Moeketsi Mosola (DCD¹¹¹).

The use of the term MSPs appears a deliberate attempt to distinguish MSPs from PPPs. Valli Moosa suggests this in a press release:

“The local government white paper identifies three primary municipal service partnership categories as flexible and viable options for more effective service delivery. These are, however, not exclusive to the privatisation route as the Congress of SA Trade Unions (Cosatu) seem to suggest. In fact, the white paper proposes a range of partnerships with nongovernmental organisations and communities. It also outlines other options such as public-public partnerships, where two municipalities can jointly provide a better service.” (*Business Day*, 3/9/98).

With regard to preferential treatment between these options, there has been a suggestion that public provision should be favoured as a first option. The *Water Services Act*, in particular, encourages water service boards to find alternatives (such as public-public partnerships) before turning to the private sector. At a briefing of Parliament’s constitutional affairs committee, Zam Titus (Director General of DCD) argued that public sector delivery would remain government’s favoured option (*Business Day*, 6/11/98).

Wariness of outright privatisation is warranted. Asset stripping is an obvious concern. When applying concessions or outsourcing, there are a number of the issues that should be considered to ensure fairness of procurement and sustainability of provision, including:

¹¹⁰ A practice which is prohibited for South African municipalities.

¹¹¹ Quoted in *Partnerships* (1998).

- The consistency and transparency of an approach to PPPs, and the regulatory framework applied,
- Procurement procedures (incorporating appeal mechanisms),
- Responsibility for loans and payment taken out for outsourced, privatised or conceded service,
- Liability of debts arising out of non-payment,
- Measures to deal with non-payment if collection is undertaken by a third party,
- Monitoring rights and capacity of a council,
- Consumer appeal procedures,
- Implications of national tariff setting policies,
- Affordability of tariffs and the implications for service delivery,
- Procedures in the event of a partner's insolvency.

Surrounding these issues is probably the greatest obstacle to successful MSPs – the risk of moral hazard – where “perverse market outcomes arise as a result of information asymmetry between market participants which allows opportunist behaviour on the part of the more informed party” (Ajam, 1998). If a concession is only 10 years long, say, the concessionaire has no incentive to protect the longer-term interests of a community or its council's fiscal position. It bases therefore its decisions on information that is not necessarily available to the public nor to regulators, and thus acts opportunistically in reducing operating costs for short term gain that may adversely affect the community (by increasing rehabilitation costs) over the longer term. A private sector concessionaire's primary concern is necessarily profitability and that operates, in this particular example, within a ten-year time-horizon.

Solomon (1998), however, views the “attention to and careful management of risk” as the “hallmark of PPPs” that have become more sophisticated and had to deal with failings of earlier models. The Institute for Public-Private Partnerships, IP3, a Washington based consultancy, analyses PPP risks as follows:

- Design risk - Overpriced models,
- Technology risk – Obsolete investments,
- Construction or completion risk – Danger of non-completion,
- Market risk – Demand at another price than that asked,
- Operating risk - Outflows exceed inflows,
- Credit risk – Non payment,
- Currency risk - Fluctuations in currency values,
- Political risk - Changes in regulatory frameworks and legislation, and
- Environmental risk – Risk of pollution.

Such rigorous analysis (if data is available) provides some means to mitigate risk although issues and circumstances will necessarily vary from locality to locality. The presence of substantial risk can motivate for public sector service involvement, which is diversified at a national level.

The privatisation option, however, is a popular one in a global context. The International Finance Corporation, IFC, reports that 86 countries have privatised 547 infrastructure companies since 1984 and initiated new projects in infrastructure estimated to be worth \$665bn, or over \$60bn annually (Solomon, 1998). The reasons for such a trend have had much to do with World Bank thinking that advocates privatisation and outsourcing, or, according to Solomon (1998) as a means to:

- mobilise finance and managerial capacity for large scale projects,
- introduce efficiency gains,
- establish a client-vendor relationship between communities and government,
- establish a contract between suppliers and local government,
- ring-fence the contracting environment.

MSPs are not, however, a panacea for public infrastructure financing in South Africa. Broadly speaking, they are likely to be unsuitable for the municipalities that need financial assistance, as municipalities represent typically weak partners (which are often inexperienced in negotiations and can be naïve in their expectations).

To reduce the risk of inappropriate or financially harmful arrangements being drawn up, the Municipal Infrastructure Investment Unit (MIIU) has been established to assist in setting up deals between councils and potential partners in service provision. The MIIU was established as a Section 21 company by national government and has been involved in advising on projects ranging from water and sanitation to airport management, as well as assisting greater Johannesburg with its restructuring (MIIU, 1999).

The Unit's mission statement emphasises the need for carefully planned partnerships and the importance of sustainability is strongly emphasised, presumably in order to distance itself from the criticisms and ideological opposition to outright privatisation of assets. A discrete (five-year) lifespan is also envisaged for the Unit (although it is questionable whether similar assistance will no longer be required after that time¹¹²), hence its mission statement is as follows:

¹¹² The MIIU management feels that in three years' time (the unit has existed for almost two years), sufficient knowledge should exist within consulting firms to assist local governments. This may not be an unaffordable option for many councils and consultants may be less neutral in their recommendations than the MIIU. A privatisation unit is, however, likely to be established in the Department of Finance by that time and this could take over the MIIU's role played to date.

“[The MIIU has been established] to encourage and optimise private sector investment in core local authority services, on a basis that is sustainable for both local authorities and at a national level.

“To assist the development of an established market containing informed local authority clients, private sector advisers, and private sector investors and service providers, so that the MIIU can be wound up no later than five years after the date of its original establishment [in 1998].”

Examples of projects in which the MIIU has assisted fall into three categories of policy objectives:

- Accessing finance, as in Nelspruit for water provision, an energy-from-waste feasibility study in Durban, and a solid waste management study in Tzaneen,
- Improving efficiency by outsourcing, for instance, waste management in Johannesburg’s inner city, and assessing benefits in a feasibility study on outsourcing the operation of Margate airport, and a feasibility study for a lease or management contract for Harrismith’s water and sanitation,
- Investigating the feasibility of selling assets such as Greater Johannesburg’s gas works (see Section 6.1).

A Framework Agreement on the Restructuring of MSPs, released late in 1998 was signed by SALGA and COSATU (DCD, 1998)¹¹³ marking the progress made in the MSP debate. The agreement, although signed by South Africa’s largest trade union federation, specifically required consideration of concerns raised by South African Municipal Workers Union (SAMWU) within COSATU. The framework sets out principles for service delivery, which service providers are required to “strive” to implement (DCD, 1998). “Strive” need not infer compulsion, however.

The principles signed by the two parties include:

- “Universal coverage – all South Africans have access to water, sanitation services, electricity, rubbish removal and other basic services,
- “Services must be delivered in a way that is environmentally sustainable, efficient and effective,
- “All residents should receive a lifeline amount of basic services,
- “Principles of cross-subsidisation to be used to allow for an affordable service,
- “Service standards must be established and monitored for each service so that an effective and efficient service is built,

¹¹³ The framework agreement represented the culmination of lengthy negotiations between the DCD and COSATU.

- “Democratic practices and accountability to residents and users must be established,
- “Resources must be used in an effective and efficient manner,
- “Planning must be done in a sustainable manner, and
- “The Batho Pele principles ... must be observed”, namely: consultation, awareness of service standard, access to services, courtesy in treating citizens, openness and transparency in operations, redressing non-delivery and value for money.

The framework further outlines motivation for public sector delivery. Curiously, there is no reference and little inference to externalities or the incorporation of economic spillovers:

“There will often be time when decisions have to be made about prioritising needs, allocating resources and so on. These are political decisions, which government should be making on the basis of social need. These are not decisions, which should be made on the basis of profit”.

The agreement (DCD, 1998) thus emphasises:

- political commitments - meeting social needs, improving and extending services, accountability and sustainable and “legitimate” planning by democratically elected representatives, and
- operational issues – minimising direct costs to users,
- improving social relations between workers and users, implementing affirmative action and training programmes, protecting the environment and improving the conditions for workers.

It is unclear why operational features of public service provision should be seen as being unique and unlikely to be adequately regulated in the private sector. Further, the issue of moral hazard is not explicitly dealt with. Perhaps the significance of the document is not in its content, but in that agreement was reached on an issue that many union members intuitively resist, as well as the establishment of a Sectoral Forum based on the principles of the National Framework Agreement (NFA). The Forum is to comprise of representatives from Labour, “Government” and SALGA¹¹⁴, to take the local government restructuring process forward.

The Sectoral Forum is intended to:

- win consensus around the “broad objectives, principles and regulatory framework” for MSPs, and
- monitor compliance with agreements.

¹¹⁴ It is interesting to note the distinction between the spheres ‘Government’ (presumably national) and SALGA (organised local government).

Disputes arising in the Forum pertaining specifically to conditions of service are to be referred to the bargaining council, whereas disputes of a broader nature are to be referred to the NFA six-a-side for resolution (DCD, 1998). Measures to be applied to both public and private providers include:

- Provision for a lifeline tariff so that all South Africans have access to basic levels of services (to be determined by inter-governmental forums);
- A progressive tariff structure should be used to implement cross-subsidisation between rich and the poor, between urban and rural areas, between industry and residential areas, between commercial farming and rural communities;
- Limitations to tariff increases;
- The establishment of a minimum standard of services, including the description of work to be done; its method; standard; improvement to be affected over time; cost effectiveness; performance indicators; equipment and materials; facilities to be provided; emergency measures; and special events to be dealt with;
- Definition of key performance indicators (KPIs) such as: number of jobs created; affirmative business enterprises; training provided; monetary returns to communities; use of community labour; SMMEs, plant, and materials; long-term job creation; and performance against RDP objectives;
- Investment requirements, as part of IDPs;
- Environmental standards;
- Employment conditions – recognition of trade unions, engagement in collective bargaining processes, on-going training, appointment procedures, health and safety standards;
- Transparency of financial issues;
- Municipal authority to monitor whether the terms of reference, conditions and stipulations are met; and
- Dispute resolution mechanisms and penalty clauses for non-compliance.

Significantly, the agreement argues that municipalities should retain ownership of infrastructure assets of “core services”, which are to be defined by the Sectoral Forum:

“Measures must be put in place to allow for effective protection against asset stripping. When the service is transferred back to the municipality, it must be transferred as a going concern, with the assets in a state of good repair and maintenance, and at no cost to the municipality” (DCD, 1998).

This infers the moral hazard problem but does not specify that concessionaires should transfer assets at their *best* possible use, rather in an acceptable state. The concessionaire must also

incorporate the costs relating to the monitoring of the contract. The amount of the costs borne by the company will depend on the type, size, and complexity of the contract. In addition, partners could be expected to make social investments. Responsible behaviour is presumed to be ensured by requiring that a performance guarantee be set aside, which is to be forfeited in the event of non-compliance. If this guarantee is too small it may not provide the appropriate incentive, and if it is too large, it may well act as too great a disincentive for investment.

Regulators face a difficult dilemma – if insufficient conditions are put in place the interests of councils and communities may be compromised where partners find loopholes to cut costs, but if too many are put in place, transaction costs may well become too great for any interest in partnerships. In order to meet such a balance, policy makers may have to consider the requirements of different scenarios – for small, medium and large sized localities, for emergency, on-going or discrete services, for various monetary values and different services and regulate specifically in accordance with certain accepted principles. This approach is, of course, only relevant if the fiscus remains unwilling or unable to fund local government's service backlog.

4.2.1 Expanding the municipal bond market

Bonds are an attractive option for local government in trying to leverage private sector for capital for responsibilities that may not be suitable for outsourcing. An important concern is that local governments are associated with an acceptable risk for investors. There has been some improvement in this regard.

Johannesburg has received an improved rating by Fitch IBCA - to A2 in the short term and BBB in the long term in June 1999 (Heese, 1999c). One of the anticipated benefits of the iGoli 2002 strategy – intended to restructure the city into a unicity structure overseeing large utilities (such as water) and corporatised units (such as the zoo)¹¹⁵ - is better customer management leading to improved payment. Johannesburg's ranking is now in a similar category to that of Midrand and Nelspruit (Heese, 1999c).

In the short term, however, uncertainty around boundary demarcations is a major obstacle for all municipalities attempting to establish a good credit rating. To mitigate the effects of this uncertainty and unstable local government finances, it is argued that South Africa's national government should consider insuring a municipal bond market for certain localities or for specific corporatised services (Heese, 1999c).

Generally speaking, however, bonds are neither the cheapest nor the easiest way of accessing capital in South Africa, especially with interest rates fluctuating and reaching high, although a long-term strategy to develop a bond market could release additional capital to local government.

The US bond market offers a tremendously tempting example - about \$200bn is issued for municipal bonds each year, according to James Leigland of the MIIU¹¹⁶. Leigland, however, cautions that this is a result of an anomalous situation where tax exemption on municipal bond interest income facilitated the growth of the municipal bond market (Heese, 1999c).

European models work differently - development finance institutions on-lend capital as loans to local government or local government utilities. The DBSA follow this practice, which could be expanded by issuing bonds for specific sector lending or specially targeted municipalities (Heese, 1999c).

Given its knowledge of local government, the DBSA would be in a good position to provide insurance for bonds. This intervention is under review by the DBSA and would facilitate private sector involvement in (and monitoring of) local government (Heese, 1999c).

The Department of Finance is currently drafting a borrowing framework to deal with these issues, but it will take some time for a secondary bond market to emerge that could make the bond market option a viable one.

4.3 Local government innovation

The Department of Finance has argued in a number of presentations at different fora¹¹⁷ that increased fiscal transfers to local government will not alleviate the financial pressures on municipalities as current income sources are not adequately exploited and that additional income may not be exploited effectively. The premise that current income is not appropriately exploited cannot necessarily be generalised given the poor qualitative knowledge of individual financial capacity within South Africa's municipalities.

Nonetheless, some national programmes and individual local governments are restructuring their approach to delivering services (in response to financial difficulties as well as international benchmarks), and this should impact upon both financial and fiscal arrangements. Although these initiatives have had insufficient time to make their implications apparent, their motivations and processes are outlined below.

¹¹⁵ See Section 4.3.2.

¹¹⁶ Interview.

¹¹⁷ Including a workshop at the launch of the Local Government Transformation Programme, held at Gallagher Estates in March 1999.

4.3.1 The Local Government Transformation Programme (LGTP)

Launched slightly less than a year (in March 1999) after the 1998 *White Paper on Local Government*, the Local Government Transformation Programme (LGTP), housed at DCD, takes forward the suggestions made in the *White Paper* for a support framework for local government. The LGTP has three dimensions:

- Enhancing co-ordination,
- Facilitating information exchange and learning,
- Enabling access to technical assistance, capacity building and institutional support.

The mechanisms whereby these strategies will be realised essentially revolve around the establishment of a database that is to be used as a way in which to communicate information around best practice, evolving, it is hoped, into a “learning network”. This information can be used not only by councillors, but also by donors, universities, community organisations, NGOs and businesses wanting to establish partnerships with municipalities.

A positive financial aspect of the LGTP, however, relates to the role played by donors. Major commitment is mobilised, co-ordinated and focused through the LGTP. Key donors speaking at a March 1999 launch at Gallagher Estates included:

- The United States Agency for International Development, USAID, (which has committed \$18m to a six-year programme, as well as dispersing \$130m in loans),
- The United Nations Development Programme, UNDP (which focuses on poverty alleviation and governance issues),
- The World Bank (which has a relatively small input as a “knowledge bank” contributing expertise only),
- European donors, Germany’s GTZ, the UK’s Department for International Development, DFID and the European Union, EU (the last of which has committed 500 ECU between 1996 and 1999), and
- Scandinavian donor agencies – Norway’s NORAD (one of the largest local government donors which allocated R400m to South Africa between 1994 and 1999, to be extended by another R400m), Sweden’s SIDA and Denmark’s DANIDA.

Most of this donor aid is targeted to specific pilot projects that twin cities, assist local NGOs and build capacity in areas relating to governance and poverty alleviation. A few donors, notably the World Bank and USAID, assist in policy research around finance issues.

Unfortunately, none of these “knowledge banks” has an explicit financial component. Integrating Project Viability and expanding assessments to incorporate information that is useful for both municipalities and for potential financiers would have presented one way in which the LGTP could have facilitated improved financial management at a local government level.

Improved co-ordination and communication between municipalities can only facilitate improved municipal management, including finances. One example of innovation from which lessons may be learnt is that of Greater Johannesburg.

4.3.2 iGoli 2002

Greater Johannesburg is a city that has been beset with financial difficulties. The council’s 1999/2000 R8.2bn budget was criticised for only allocating R400m for maintenance and infrastructure development and R84m for capital expenditure in order to cut a R291m deficit to R141m (Heese, 1999b). Whilst it has undergone massive restructuring to deal with its financial and administrative problems, this has entailed considerable stress on the organisation.

The first step to transformation involved the transfer of all powers and functions, staff, assets and liabilities to the Metropolitan Council (MC) before powers were delegated to seven Metropolitan Local Councils (MLCs)¹¹⁸ - a process which was interrupted by boundary disputes, culminating in the determination of four MLCs (Woolridge, 1999).

But by the time these structures emerged, the state of Johannesburg’s finances had reached crisis point, with the MEC for Local Government in Gauteng setting up a “Committee of Ten” councillors from the MC and four MLCs to address the situation. One of the most critical problems facing Johannesburg is non-payment. Currently, the city is owed R2.1bn (which increases by R33m a month) against a budget of R7bn, half of which is likely to be written off, exacerbating a long-term debt of R2.8bn (Haffajee, 19/3/99, *iGoli News*).

As a result, only R330m is to be spent on maintaining infrastructure when an estimated R660m is required and capital expenditure has been sized down from 1996/97’s R1.7bn to R84m when R800m is what is actually required (*iGoli News*, July 1999). Exacerbating matters, the council’s portion of IGTs decreased to R24m for 1999/2000 from R35m for 1998/1999 (Heese, 1999b). Johannesburg’s city managers argue that it is at a disadvantage with regard to inter-governmental transfers in that it has no former homeland (R293) towns for which it would receive additional monies.

¹¹⁸ Already a number reduced from the original thirteen.
January, 2000

In addition, the council has been struggling with duplicated administrative structures, gaps between administration and implementation, a skills shortage and disincentives arising from the absence of a performance management system (*iGoli News*, July 1999). Expanded to a “Committee of Fifteen”, the task group drew up a plan for restructuring administration and reforming service delivery – *iGoli 2002 – Getting the basics right*.

The iGoli 2002 strategy is different from its predecessors in that it “allows for consultation and recognises the importance of process, process is framed to a means to a (at least partially defined) ends” (Woolridge, 1999). The focus is on implementation and the creation of “mini-businesses” for utilities such as water, electricity, roads, parks, cemeteries, stormwater drains and sanitation provision that are to be controlled by a single political entity. The intention is to retain public control over utilities so that they can focus on profit generation that will be re-directed at (that is, cross subsidise) other council activities with staff working to performance targets (Haffajee, 1999).

Other measures will include the corporatisation of the current loss-making activities of the zoo, civic theatre and bus company with the intention of running these more efficiently, decreasing their subsidies and improving their services over time. It is assumed that the MC will be awarded the right to be a Regional Electricity Distributor (RED) in order for it to generate profits from electricity provision.

Greater Johannesburg’s CEO, Ketso Gordan, has set himself a two-year deadline in managing the process:

“For the next two years, planning is banned from this department. Implementing is what we are doing” (Khumalo, 19/3/99).

Examples of this implementation include declaring areas, like Yeoville, that are battling with inner city decline as “improvement districts” that are to be targeted for regeneration, building a new taxi rank next to Johannesburg train station and off-ramps into the inner city to encourage culturally driven regeneration (Khumalo, 19/3/99).

The South African Municipal and Allied Workers Union (SAMWU) has, however, opposed the plan:

“SAMWU does not believe there is a financial crisis in Johannesburg that could be improved by selling off profit-making [such as the proposed R200m sale of the

Fresh Produce Market] and job creating assets¹¹⁹. Any restructuring plan must first rectify areas where money is being wasted” (*Business Report*, 8/4/99).

During July 1999, SAMWU disputed whether the Transformation Committee is mandated to enact iGoli’s structural transformation and its wary of privatisation (Heese, 1999b). SAMWU’s general secretary (at the time), Roger Ronnie, threatened the Transformation Committee with legal contestation, although the metropolitan council counters that the legality is based on an old Transvaal ordinance which will only be repealed once the Municipal Systems Bill is promulgated (Heese, 1999b).

At the root of its opposition, SAMWU feels that iGoli ignores the 1998 national framework agreement between COSATU and SALGA, and argues that it has been inadequately consulted in terms of the Labour Relations Act¹²⁰ (*Business Report*, 8/4/99). The union has mooted the possibility of calling for a strike or mass action at a community level, arguing that the plan does not take the interests of the city’s poor into account (*The Star*, 8/4/99).

COSATU has not been as dismissive of the strategy, and perhaps as a result of this, the launch of the strategy at the iGoli Summit (held on 13 August 1999) was not disrupted by any major union objections. Despite the absence of this support, in late October 1999, 10,000 SAMWU members went on strike. A violent flare up contributed to a less than sympathetic response from both local and national government (Cargill & Heese, 1999).

In addition to iGoli, the metropolitan council has commissioned a R1m study - *Local Economic Development through Job Creation and Poverty Reduction in the Greater Johannesburg Metropolitan Area* – to be conducted by the World Bank so as to better appreciate the socio-economic status of the metropole. Information from 500 large businesses, 900 small, micro and medium size enterprises (SMMEs) and 2,000 households in townships and the inner city, where information is currently poorest, will be fed into strategies for training, finance and infrastructure (Heese, 1999b).

Over time, Johannesburg could become the most powerful agent of delivery for its residents, making some uneasy about the role it would leave for provinces. It should be recalled that Johannesburg and Gauteng are special cases of highly urban populations and concentrated economic activity that may be best managed at a city-level - a situation which cannot be generalised to other localities and provinces (Heese, 1999b).

¹¹⁹ It should be noted, however, that only 2% of council assets are to be privatised, and all of these non-core assets have been losing money. Their sale is expected to raise R200m and will affect less than 200 employees (*iGoli News*, July 1999).

¹²⁰ Section 64 of the 1995 Labour Relations Act, requiring consultation with unions in event of workplace

Other metropolitan councils are rumoured to have expressed support for the council's strategy but none have formalised anything similar (arguably because they have not yet needed to). This may be a prudent choice - the risk and experience of innovation is one they can watch for a while from a distance given their slightly better financial situations (Heese, 1999b).

4.2.3 Other restructuring programmes

The most conspicuous form of restructuring is in the development of various service delivery partnerships. Various MSP projects underway (listed in *Partnerships*, 1999) throughout South Africa include:

PPP contract negotiations (nearing completion):

- Nelspruit – water and sanitation,
- Dolphin Coast – water and sanitation.

Completed feasibility studies (under evaluation):

- Nkadimeng – rural water supply,
- Plettenberg Bay – water, sanitation and waste disposal,
- Port Elizabeth – water and sanitation,
- Tzaneen – solid waste.

Feasibility studies (underway):

- Stanger – solid waste,
- Johannesburg Metropolitan Council – informal trade,
- Johannesburg Metropolitan Council – solid waste,
- Harrismith – water and sanitation,
- Margate – airport,
- Margate – sanitation,
- Richards Bay – airport,
- Richards Bay – waterworks,
- Richards Bay – waste water.

In many respects, Nelspruit represents the pilot of these projects. After an amalgamation that increased the municipality's population from 24,000 to 240,000 the Nelspruit TLC estimated that the provision of water and sanitation to all residents would cost R212m against a budgeted amount equivalent to 10% of this for all capital expenditure (*Partnerships*, 1999). After proceeding with a competitive bidding process, BiWater-Metsi was identified as the preferred bidder in October 1997. This process received considerable national focus and resistance from not only

COSATU but also a number of NGOs and community organisations that feared that the cost of water, although a basic service, would spiral (although this fear has not yet materialised).

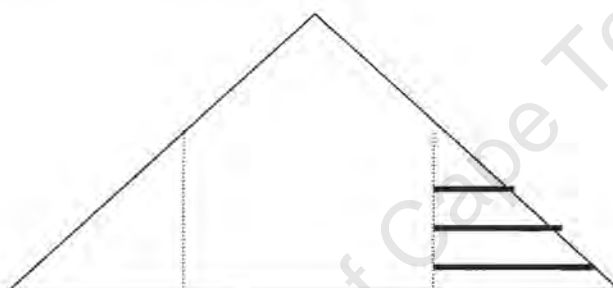
Anecdotal evidence suggests that restructuring has also taken place (especially in rural areas in resource scarce provinces such as the Eastern Cape) where towns and TRCs or TrepCs have effectively amalgamated to jointly provide services to their communities. One reported case is that of the North West towns of Klerksdorp, Orkney, Stilfontein and Hartbeesfontein (to be collectively known as Kosh), that are planning to pool the financial and human resources of the four municipalities. This strategy is intended to develop an economic base that is independent of the area's declining mining industry (*Business Day*, 1/4/99). This strategy has been precipitated by the closure of the Stilfontein gold mine and the sale of a number of Vaal Reefs shafts in the area (*Business Day*, 1/4/99). It is, however, reported that some stakeholders in the North West province feared that the Kosh plan could undermine the authority of the Mafikeng capital.

Unfortunately, cases of innovation are more unusual than those of financial failure, suggesting that inter-governmental assistance is still of the utmost importance to local government. This is the topic of the next chapter.

5 Local Government fiscal position

As revealed by the preceding chapters, not every local government is able to exploit sufficient sources of own revenue to fulfil mandated functions. For this reason, some local governments require additional revenue for operating expenditure. In addition, in order to co-ordinate social expenditure so as to incorporate the implications of spillovers between jurisdictions, capital spending allocations from central or regional governments become necessary to ensure adequate and equitable resource distribution between municipalities. These allocations are channelled through inter-governmental transfers (IGTs).

IGTs have two dimensions – the vertical and horizontal – which will be detailed in this chapter. They are represented conceptually by the figure below:



The dotted lines represent the portions that are allotted to the three spheres of government – the vertical division. The dark short lines represent the division of that revenue within a sphere – the horizontal division. The determination and quantities of these dimensions for South Africa's local government are detailed below.

5.1 Vertical division

The division of revenue amongst the three government spheres, as reported by the 1999 *Budget Review* is reflected in the following overpage:

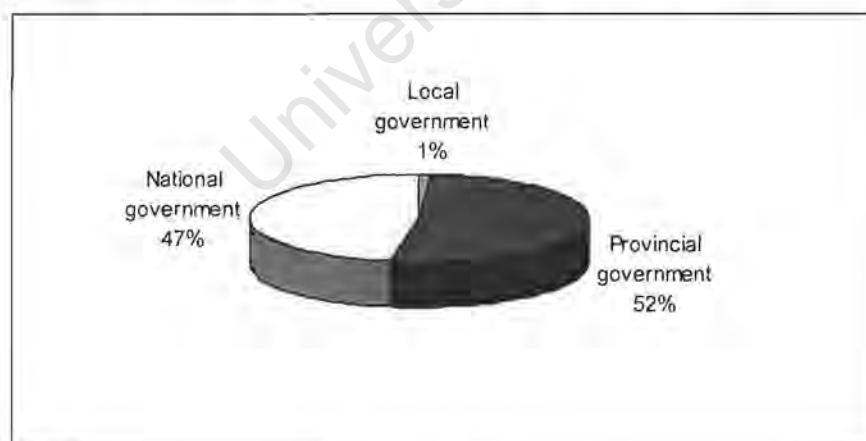
Figure 25 - Division of revenue between the spheres (in millions of rands)

| | 1998/99 ¹²¹ | 1999/00 | 2000/01 | 2001/02 |
|--|------------------------|----------------|----------------|----------------|
| Total budget expenditure | 204 293 | 216 780 | 230 722 | 247 250 |
| Less: | | | | |
| Debt service costs | 43 413 | 48 222 | 49 820 | 52 609 |
| Contingency reserve | - | 1 100 | 3 500 | 8 000 |
| Skills development levy grant scheme | - | - | 1 000 | 2 000 |
| Donor-financed spending | 651 | 750 | 750 | 750 |
| <i>Resources to be divided</i> | <i>160 228</i> | <i>166 708</i> | <i>175 652</i> | <i>183 891</i> |
| National equitable share | 78 273 | 78 733 | 81 100 | 84 489 |
| as a per cent | 48,9% | 47,2% | 46,2% | 45,9% |
| Of which: | | | | |
| National departments | 67 573 | 69 972 | 72 739 | 76 232 |
| Conditional grants to provinces and local government | 10 700 | 8 761 | 8 361 | 8 257 |
| Provincial equitable share | 80 931 | 86 302 | 92 071 | 96 822 |
| as a per cent | 50,5% | 51,8% | 52,4% | 52,7% |
| <i>Local government equitable share¹²²</i> | <i>1 024</i> | <i>1 673</i> | <i>2 480</i> | <i>2 580</i> |
| as a per cent | 0,6% | 1,0% | 1,4% | 1,4% |
| Addendum | | | | |
| Provincial allocations including conditional grants | 90 499 | 94 420 | 100 432 | 105 079 |
| <i>Local government share including conditional grants</i> | <i>2 156</i> | <i>2 316</i> | <i>2 480</i> | <i>2 580</i> |

[Source: Department of Finance, 1999]

Graphically, and perhaps more strikingly, the vertical division of nationally raised revenue for 1999/00 is reflected by the following pie chart:

Figure 26 – Division of revenue between spheres (1999/00)



[Source: adapted from Department of Finance, 1999]

¹²¹ The national and provincial shares of expenditure in 1998/99 are adjusted for the reduction in the employers' contribution to pension funds from 17% to 15%.

¹²² The Equitable Share is an unconditional grant, mainly used as an operating transfer. Conditional grants are intended mainly for capital purposes.

5.1.1 Determination of the vertical division

According to the Constitution, nationally raised revenue must be shared with provincial and local governments on an equitable basis. Accordingly, Section 214(2) specifies that an Act of Parliament is to determine these shares once:

“organised local government and the Financial and Fiscal Commission have been consulted, and any recommendations of the Commission have been considered, and must take into account:

- “the national interest;
- “any provision that must be made in respect of the national debt and other national obligations;
- “the needs and interests of the national government, determined by objective criteria;
- “the need to ensure that the provinces and municipalities are able to provide basic services and perform the functions allocated to them;
- “the fiscal capacity and efficiency of the provinces and municipalities;
- “developmental and other needs of provinces and municipalities in terms of national legislation;
- “economic disparities within and amongst provinces;
- “obligations of the provinces and municipalities in terms of national legislation;
- “the desirability of stable and predictable allocations of revenue shares; and
- “the need for flexibility in responding to emergencies or other temporary needs, and other factors based on similar objective criteria”.

The revenue to be shared among the three spheres excludes a number of items from the total divisible “pot”. Specifically, debt servicing costs and a contingency reserve set aside to cater for unforeseen economic circumstances or natural disasters that may occur during a financial year (referred to as the “top slice”) are deducted from the resources available for distribution. The skills development levy grant and donor-financed expenditure are also not distributed among the spheres (Department of Finance, 1999).

Murphy Morobe, chairperson of the FFC, criticised such “top-slicing”, arguing that there is a tendency in comparative examples for top-slicing to be expanded at the expense of other functions (*Business Day*, 23/2/99).

Wehner (1997a) argues that “no viable principles have been finalised to govern the vertical division of revenue more specifically”. This contention is affirmed by the 1999 *Budget Review*:

“The vertical division of resources is not done by means of a formula. It is a function of the expenditure responsibilities of each sphere and their revenue capacity” (Department of Finance, 1999).

Implicitly contesting this approach, Shoots Naidoo (CEO of SALGA) has called for a study to “quantify the financial implications of the responsibilities allocated to municipalities by the Constitution” (*Business Day*, 29/6/98). He argues that whilst municipalities are capable of raising much revenue on their own, “a study was needed to determine the real financial and ‘hidden’ costs in carrying out local government’s functions” (*Business Day*, 29/6/98). Such a study is certainly desirable to substantiate opinions around local government’s most equitable “equitable share”.

Whilst the Department of Finance is firm that the current inter-governmental fiscal relations provides local government with sufficient revenue to operate, provided that it manage this revenue efficiently and according to sound financial practices, the chairperson of the FFC has argued that the current allocation is wanting:

“If the constitutional principle were followed that finance should be linked to function, then additional revenues would ordinarily need to be made available to local government. Where the local government tax base cannot provide for its constitutional mandate, then national resources should provide the required funding, if resources are available”. Murphy Morobe at the Parliamentary Finance Committee (*Business Day*, 23/2/99).

This quote, forming part of a submission to Parliament’s Finance Committee, deviates from the FFC’s (1997) discussion document on local government. Previously, the FFC had recommended that total transfers should not decline in real terms, and that the benefits of increasing this amount are calculated on the basis of shortening the time in which basic services are delivered. Consideration of these benefits and whether they merit increased expenditure allocations is deemed to be a “political decision” (FFC, 1997), and like the Department of Finance’s arguments, no technical mechanisms were proposed to estimate appropriate equitable shares.

Currently, the division of revenue is based on perceptions around (FFC, 1997):

1. the functions of each sphere,
2. revenue raising potential of each sphere (tax capacity), and
3. fiscal effort (considering efficiency of expenditure).

Revenue allocation has largely concentrated on the operating needs of local government. With respect to *capital* requirements, the closest attempt at quantifying local government's infrastructural functions was undertaken by the Municipal Infrastructure Investment Framework (MIIF). The MIIF modelled the (municipal) infrastructural backlog that needed to be closed in order to ensure that all South Africans receive basic services. In 1996, when the model was completed, it was estimated that 24% of urban South Africans and 75% of rural citizens required greater levels of infrastructure (DCD, 1997) – a mammoth task.

The MIIF suggested that R5bn per annum is required in urban areas to ensure an intermediate level of service provision, defined as the following level of service provision¹²³:

- yard tank water,
- Ventilated Improved Pit Latrine, VIP, sanitation,
- 20 Amp electricity supply,
- 80% graded and 20% gravel roads,
- open side stormwater, and
- kerbside solid waste removal.

The amount for installing intermediate service levels would be R8.5bn if one included asset replacement, rehabilitation and commercial and industrial infrastructure (MIIF, 1996). Rural projections are similar but require considerably greater levels of recurrent expenditure than urban areas (at least 10 times as much), as economics of scale are reduced by smaller, more dispersed communities.

Even when delivering a relatively modest package of goods, the MIIF suggests that local government requires revenue in addition to that which can be raised internally, especially in rural areas. Provinces could, however, present similar calculations for health and education, say, to substantiate that they too require a greater share of nationally raised revenue. Hence, local government needs to prove that its functions receive a disproportional lack of funding to those of other spheres.

¹²³ Basic service provision includes communal water supply, VIP sanitation, 8 Amp electricity supply, gravel roads to with 500m of homestead, open stormwater along distributor roads and communal solid waste. High service provision entails household water connection, full waterborne sewerage, 60 Amp electricity supply, paved roads, piped, underground stormwater and kerbside waste removal.

In considering the vertical division of revenue, local government's lack of capacity to collect user charges needs to be pragmatically factored in over the interim. The Department of Finance has taken a firm line on the issue in oral presentations and argues that until local government demonstrates fiscal responsibility, it does not merit any increases in allocations.

Perhaps a key reason why local government may not receive adequate financial provision lies in its organisational representation. Relatively speaking, provincial governments tend to be far more aware of fiscal debates than organised local government, perhaps because they are more dependent on inter-governmental transfers than local government. In addition, provincial government has had more experience in negotiating with national government than local government as fiscal systems were in place sooner than in local government's case.

5.1.2 The Budget Forum

The Budget Forum, as stipulated by the *Intergovernmental Fiscal Relations Act* (No. 97 of 1997)¹²⁴, comprises the Minister of Finance (the chairperson of the Forum), provincial Finance Members of Executive Committees, MECs, and five national representatives and nine provincial representatives from organised local government. This represents a distinct body from the National Budget Council, which is identical barring the representation of local government¹²⁵. As these two bodies represent the same delegates, there is room to question whether this constitutes inequitable treatment of local government:

“Why should the ‘equitable shares’ of three autonomous spheres of government in a system of cooperative governance be decided in two different places? Why can the equitable share of local government not be determined in the national budget council? ... One must deduce that ‘equitable share’ of local government is only determined after that of provincial and national governments. This is contrary to the notion of autonomous and interdependent ‘spheres’ of government” (USN, 1997: 16).

The Budget Forum, according to the Act, is intended to consult on:

“a. any fiscal, budgetary or financial matter affecting the local sphere of government;

“b. any proposed legislation or policy which has financial implication for local government;

“c. any matter concerning the financial management, or the monitoring of finances, of local government; or

¹²⁴ Which took effect on the 1 January 1998.

¹²⁵ And the DCD, which attends Budget Forums as an observer.

“d. any other matter which the Minister has referred to the Forum.”

It is a curious logic that has provincial representation at the Budget Forum, but not local representation at the Budget Council. SALGA has argued that this imbalance does not adequately reflect the constitutionally envisaged equality among spheres. Despite this contention, no proposals to restructure the system have been made by the Ministry of Finance.

The Budget Council met seven times for the 1999 budget process whereas the Budget Forum met only twice (Department of Finance, 1999). This disparity reflects the provisions of the *Intergovernmental Fiscal Relations Act* that specifies that the Budget Council meets at least twice a year, but the Budget Forum a minimum of once. Furthermore, the Budget Council has support in the form of the Technical Committee on Finance (TCF), comprised of officials from the national Departments of Finance and State Expenditure and provincial treasuries (Department of Finance, 1999); the Budget Forum does not have similar support.

5.2 Horizontal division

5.2.1 Historical transfers to local government (1995 – 1998)

Local government has traditionally received funding from a disparate range of sources. A summary of the multi-channels of inter-governmental transfers to local government are presented in the table overpage.

Figure 27 – Transfers and grants to local government: 1995-1998 (Rands)

| Function | 1995/6 | | 1996/7 | | 1997/8 | |
|---|------------------|----------------|------------------|------------------|------------------|------------------|
| | Operating | Capital | Operating | Capital | Operating | Capital |
| Subsidies to former white municipalities | | | | | | |
| Fire Brigade | 32,997 | 13,444 | 49,348 | 21,896 | 46,214 | 29,316 |
| Library services | 23,478 | 9,287 | 43,137 | 4,235 | 33,725 | 18,365 |
| Disaster Management | 2,590 | 0 | 5,128 | 0 | 4,661 | 0 |
| Subtotal | 59,065 | 22,731 | 97,613 | 26,131 | 84,600 | 47,681 |
| Transfers to municipalities | | | | | | |
| MIP | 0 | 125,800 | 0 | 301,200 | 0 | 450,500 |
| EMIP | 0 | 500 | 0 | 168,600 | 0 | 431,400 |
| CMIP | 0 | 0 | 0 | | 0 | 500,000 |
| BCIG | 0 | 0 | 0 | 70,598 | 0 | 426,273 |
| Intergovernmental grants | 830,220 | 0 | 806,090 | 0 | 903,420 | 0 |
| R293 towns | 559,591 | 85,970 | 863,782 | 79,901 | 882,654 | 68,443 |
| Service of loans | 190,336 | 0 | 214,462 | 0 | 27,689 | 0 |
| Sport & recreation | 747 | 526 | 14,576 | 7,559 | 19,016 | 14,752 |
| Dept redemption | 129,000 | 0 | 129,000 | 0 | 129,000 | 0 |
| Other | 323,389 | 47,402 | 242,154 | 154,122 | 102,410 | 30,652 |
| Subtotal | 2,033,283 | 260,198 | 2,270,064 | 781,980 | 2,064,189 | 1,922,020 |
| Implicit national transfers | | | | | | |
| Department of Water Affairs | 114,489 | 496,289 | 496,969 | 321,288 | 492,525 | 1,429,212 |
| Subtotal | 2,206,837 | 779,218 | 2,864,646 | 1,129,399 | 2,641,314 | 3,398,913 |
| TOTAL | 2986055 | | 3994045 | | 6040227 | |

[Source – Adapted from Department of Finance, 1998b].

As can be gathered from the number of entries in the preceding table, transfers and grants to local government have varied from year to year and source to source. Councils will thus have varying experiences of income flows from one another and from one year to another.

Broadly, however, the various sources of municipal transfers in the past were based on:

- Inter-governmental grants (IGGs) for operating expenditure and bridging finance (managed by provincial governments under the Interim Constitution) – typically to BLAs,
- Agency payments (full or partial) for health services, social services, disaster management and transport (provincial functions),
- “R293 town” (named after the R293 proclamation) subsidies for towns located in former homeland areas, usually with poor administrative capacity and limited tax bases,
- Grants for capital expenditure (see below).

5.2.2 The Equitable Share

Such a plethora of sources is problematic not only because of the instability that it causes at a local level, but from the broader concern of co-ordination. The 1998 system of an “Equitable Share” transfer has rationalised most operating transfers (excluding R293 grants until 2001), or initiated the phasing thereof (the same cannot yet be said of capital transfers).

The Equitable Share formula-based system of allocating operating transfers to municipalities was initiated for the 1998/99 municipal financial year starting on 1 July 1998. The system is to be phased in over a period of five years to allow for adjustments. As a specific earmarking for operating expenditure is intended, and broken down into categories (discussed below), the transfer infers, but cannot enforce, a level of conditionality so that it remains compliant with the concept underlying the equitable division of revenue. The intention is that the transfer will allow for all households to receive a basic and affordable package of services, as well as to facilitate capacity building within local councils as well as to fund infrastructure that has spillover effects for other localities (to be funded by RSC levies).

Key principles for the transfer (Department of Finance, 1998b: 10 -11) are given as:

- “Equity – ensuring ... access to basic services,
- “Efficiency – equalisation ... might entail potentially crippling outflows from richer areas ... total cross equalisation might have a deleterious effect on the country’s ability to attract international investment,
- “Spillover effects – funding projects which have strong spillover effects,
- “Facilitating democracy – to enable local authorities to build up [institutional and physical] infrastructure’.

These principles are to be expressed by the packaging of four transfer programmes (Department of Finance, 1998b):

- the municipal basic services, “S”, transfer – to ensure equity, a per capita services transfer (of R230 per household earning less than R800 per month for 1998/99) is allocated to individual councils on a quarterly basis (once a 10% top slice has been deducted for SALGA¹²⁶), to be phased in,
- tax equalisation, “T”, transfer (not yet implemented) – to affect “efficiency” by transferring income between intra-metropolitan MLCs (but not for substructures of DCs), based on a formula of per capita rates base of a substructure versus an entire metro jurisdiction,

¹²⁶ It is unclear how this portion was arrived at or why a basic service transfer should be the channel for organised local government’s funding.

- municipal institutions, “I”, transfer – for municipalities below a cut off level of normative rates and service charge income (but above a threshold population),
 - matching, “M”, transfer (not yet implemented) – to assist in the provision of “essential infrastructure”¹²⁷ for services that have positive spillover effects (as with RSC levy usage).
- (A critique of the system can be found below in Section 5.3.2).

On the capital transfer side, funds are currently administered by:

- The Department of Housing’s Bulk and Connector Infrastructure Grant (BCIG),
- The Department of Water Affairs and Forestry’s (DWAF) Community Water Supply Programme, (CWSP),
- The Department of Constitutional Development (DCD)’s Consolidated Municipal Infrastructure Programme (CMIP) and Rural Administration.

There has been some rationalisation of capital grants via CMIP (with the exception of grants for rural water infrastructure run by the DWAF), which is administered by the DCD. CMIP is intended to provide grant funding for the installation, upgrading and rehabilitation of municipal internal bulk (water reservoirs, pump stations, purification works, for instance) and connector infrastructure (such as water main connector lines). More simply, it aims to provide access to basic services to all South Africans within the next 8 years.

In aggregate, all IGTs should make up the balance of local government’s expenditure needs, once own revenue sources have been discounted (this may not always apply in South Africa should borrowing become a more affordable and accessible option). Failing this, local government will be responsible for a number of “unfunded mandates”. Unfortunately, scarce resources and a policy environment of scarce resources mean that the optimal outcome is that unfunded mandates are kept to a minimum among spheres and shared equally.

5.2.3 The current system (1998 – 2002)

The 1998 Budget announced a decrease in capital funding for local government owing to high rollovers in 1996/97 into 1997/98, which augmented the 1997/98 figure, in addition to the phasing out of the BCIG and the EMIP (Department of Finance, 1998a). But the 1999 Budget again cut the capital allocation for local government. This cut has been criticised in non-governmental circles. The IDASA Budget Information Service (1999) argues that the 1999/2000 budget is in line with commitment to fiscal discipline, but at the expense of developing social infrastructure:

“the minimal resources available for distribution, are disproportionately skewed to wooing the private sector instead of alleviating poverty. This is not a poverty budget

- it is, in the first instance, an investment budget. The 1999/2000 budget makes provision for R1.1 billion in poverty relief, an increase over the R850 billion allocated last year. ... However, for several reasons we feel that the poor will not benefit significantly from the budget ... spending on social services in provinces will continue to be cut in the face of stagnant provincial allocations and rising unplanned personnel costs. ... Of further concern, ... is the fact that the crowding out of social expenditures is likely to increase in the next two financial years (2000/01 and 2001/02) ... Reduced growth but retained deficit targets, imply reduced social expenditures. Two further factors weight against effective poverty relief in the budget. The decrease in the housing budget (5.8% in nominal terms) is unfortunate given government indications that this is precisely the moment when labour-intensive house building is coming on stream. ... Government has not been able to meet many of the social targets set in the RDP.”

The 1999 Budget Speech (17 February) suggested that social infrastructure, a core function of local government, was a budgetary priority. Superficially, local government is allocated a greater share of nationally raised revenue (in nominal terms) than in 1998. The equitable share for local government is reflected below:

Figure 28 - Local government equitable shares (in millions of Rands): 1998 - 2001

| | 1998/99 | 1999/00 | 2000/01 | 2001/02 |
|-----------------|---------|---------|---------|---------|
| Equitable Share | 1 024 | 1 673 | 2 480 | 2 580 |

[Source: adapted from Department of Finance, 1999a]

The seeming rise in local government’s equitable share over the medium term is distorted by the inclusion of R293 allocations in 2000/01 and 2001/02. R293 towns are to receive separate budgetary provision, as provinces have been unable to transfer all of the provincial staff administering these towns to municipalities (or even account for them in some instances where they are spread among a number of departments). Conditional grants directed to provinces for R293 staff amount to R463m, as well as another R40m for an incentive grant to assist in the transfer of these staff. It is intended that this will be phased out unless the Budget Forum decides otherwise. Factoring the R293 grant into the Equitable Share considerably mitigates the seeming rise in local government transfers, as illustrated by the table overpage.

¹²⁷ Although the programme is purportedly intended to subsidise operating expenditure.

Figure 29- The Equitable Share plus R293 transfer (in millions of Rands)

| | 1998/99 | 1999/00 | 2000/01 | 2001/02 |
|-----------------------|---------|---------|---------|---------|
| R293 staff & services | 951 | 503 | 0 | 0 |
| Equitable share | 1024 | 1673 | 2480 | 2580 |
| Total | 1975 | 2176 | 2480 | 2580 |

[Source: adapted from Department of Finance, 1999a]

Of considerable concern to local government, conditional grants and agency fees decreased by almost 30% since 1998/99. These transfers are critical for funding capital expenditure, which has been declining steadily over the past few years¹²⁸.

Figure 30- Conditional grants and agency payments to local government (in millions of Rands)

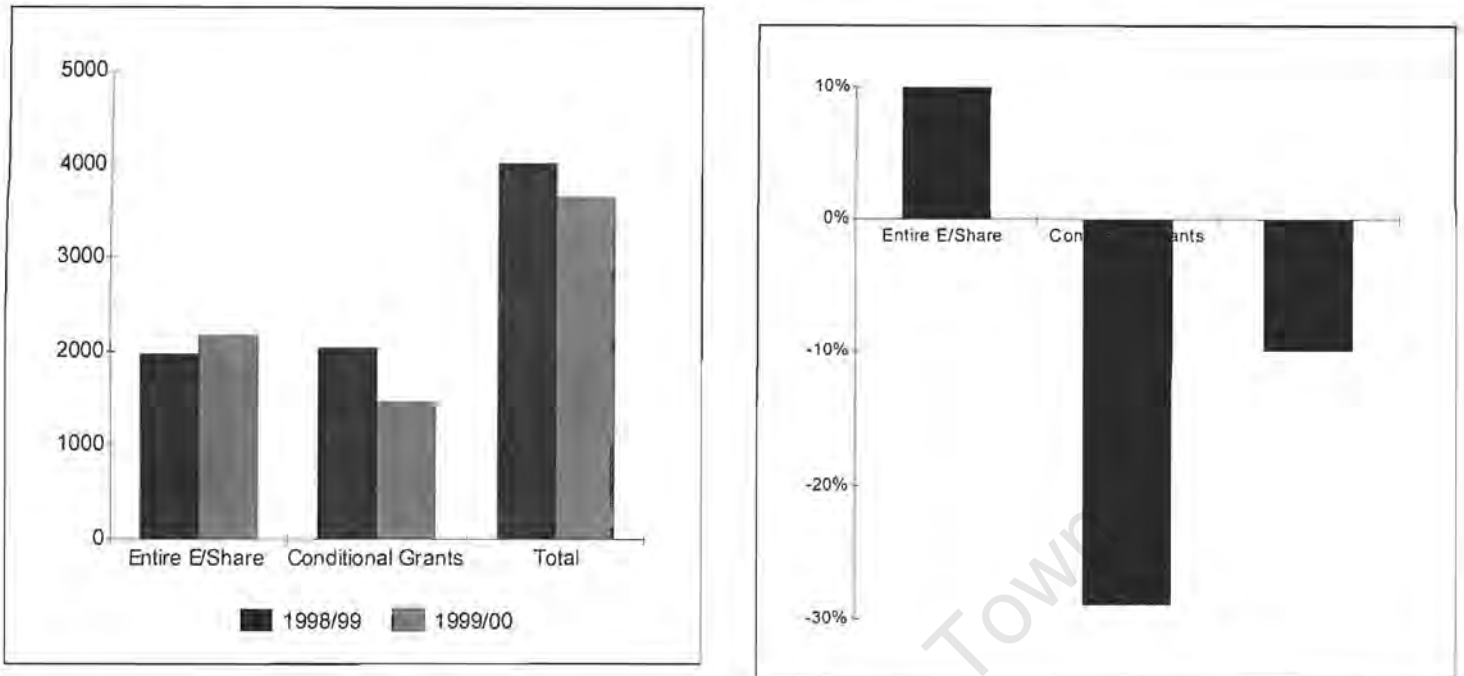
| | 1998/99 | 1999/00 |
|---|------------------------|--------------|
| Constitutional Development | | |
| Consolidated municipal infrastructure programme CMIP | 703, of which R120m | 696 |
| Special presidential projects | R150m | |
| R293 staff | 951 | 463 |
| Assistance in transferring R293 staff | | 40 |
| Local government support grant | 181 | 140 |
| Land affairs | | |
| Land Development objectives | 26 | 38 |
| Housing | | |
| Housing support | 50 | - |
| Special urban renewal projects | 569 | 136 |
| Water affairs | | |
| Government water supply schemes | 25 | - |
| Department of Water Affairs operating subsidies | 494 | 429 |
| Other conditional grants | - | 23 |
| <i>Total</i> | <i>2 729</i> | <i>1 965</i> |

[Source: adapted from Department of Finance, 1999a]

Adding the equitable share to conditional grants, local government is to receive 10% less in 1999/00 than it did in 1989/99, reflected graphically overpage.

¹²⁸ Presentation by Chris Kapp, Project Viability consultant to DCD, at IMFO Conference, October 1998.

Figure 31 - Changes in allocation (millions of Rands and %): 1998/99 – 1999/00



[Heese, 1999a - adapted from Department of Finance, 1999a]

To be particularly noted is the decrease in the allocation to the Consolidated Municipal Infrastructure Programme (CMIP) (Heese, 1999a) despite the 1999 *Budget Review's* contention that “government’s social and development programmes will continue to strengthen, even in the more difficult current economic environment” (Department of Finance, 1999). The decrease may suggest that CMIP is considered to be the incorrect channel for developing infrastructure for social use. Analysis of CMIP is, however, generally lacking in the 1999 Budget and *Budget Review* – there are only static reports of performance and there is no discussion as to whether a decrease in CMIP’s budget has been motivated by a policy shift or whether an alternative is envisaged.

Also noteworthy is the continued use of the Transitional Grant via provinces, now named the Local Government Support Grant (Heese, 1999a). As its predecessor was poorly taken up by provinces, it is unclear why the grant was not directed to local government using the new “I” institution building component of the Equitable Share transfer.

The motivation for decreased transfer to local government in the *Budget Review* is particularly significant. Using South African Reserve Bank data gathered by Statistics SA on 60 municipalities, local government finances are expected to improve with a local government deficit in 1998/99 of about R500m, R300m less than in 1997/1998, even to the extent of a

surplus being projected for 2001/02¹²⁹. This calculation reinforces the widely held view that local government can generate sufficient revenue on its own and hence does not require inter-governmental assistance. This is despite reported Project Viability data that outstanding debt has increased since 1994 and few real signs that this turnaround should materialise.

Perhaps in response to the practical difficulties facing local government, yet out of sync with the prevailing policy position, the 1999 Budget's allocation was increased by an *ad hoc* decision, to R2,800m.

Figure 32 – Changes to the 1999 Budget (in millions of Rands)

| | 1998/99 | 1999/00 | 2000/01 | 2001/02 |
|----------------------------|-------------|-------------|------------------------|-------------|
| R293 staff & services | 951 | 503 | 0 | 0 |
| Equitable share (budgeted) | 1024 | 1673 | 2480 | 2580 |
| <i>Total</i> | <i>1975</i> | <i>2176</i> | <i>revised to 2800</i> | <i>2580</i> |

[Source: adapted from Department of Finance, 1999a, 1999b]

With the adjusted sum of R2,800m in operating transfers, local government still receives (in nominal terms), less than it did in 1998/99. This comparison alters considerably, however, if the bus subsidy for 1999/00 is included (even though the transfer is intended for use in operating budgets, it has been included as a conditional grant, which would usually imply a capital use - see the table below). This transfer is excluded from foregoing calculations as it relates to a non-core municipal service and essentially represents a recent devolution of national responsibility, and owing to its size in relation to other transfers to local government, it distorts previous trends. Furthermore, the transfer is unlikely to affect the financial position of most municipalities, as it will not address the provision of basic municipal services - like the delivery of water and sanitation.

Figure 33 – Local government transfers, including bus subsidies (in millions of Rands)

| | 1998/99 | 1999/00 |
|-------------------------|-------------|-------------|
| Conditional grant total | 2729 | 1965 |
| Bus subsidy | - | 1294 |
| <i>Total</i> | <i>2729</i> | <i>3259</i> |

[Source: adapted from Department of Finance, 1999a, 1999b]

5.3 Assessing the existing system

5.3.1 Department of Constitutional Development's CMIP

Under the Consolidated Municipal Infrastructure Programme (CMIP – the primary capital transfer programme for municipal infrastructure), the application process by municipalities goes through provincial authorities who receive, in turn, sums allocated by the DCD on the basis of need¹³⁰ (but not on performance or capacity to deliver). As a result of poor capacity by provinces

¹²⁹ Although this data set differs from the Department of Finance's records owing to the SARB exclusion of electricity sales, and applies different financial years from those used by local governments.

¹³⁰ Calculated by formulae that take into account poverty levels, water and sanitation backlogs (as a proxy
January, 2000

to assess need and disburse funds, and poor municipal capacity to apply for funds and utilise them effectively, large sums have been rolled over in provinces with great backlogs of infrastructure.

In many instances, the local councils most in need of capital projects are those least capable of compiling business plans to submit to provinces for approval. In addition, there are accusations of political considerations in this decision (a New National Party, NNP, dominated council may, for instance, have its business plan rejected by an ANC province for less than technical reasons). Generally it is the better-equipped and networked urban local governments that have accessed capital through CMIP, although the backlogs exist most pervasively in rural areas¹³¹.

In addition, provincial interests for larger budgets may skew allocation rationale with lobbying. The Northern Cape, for instance, has a relatively small population - a criterion for the allocation of housing funds, amounting to only 1% to 2% in many instances - leading representatives to argue for the consideration of other factors, such as distance¹³².

According to the 1999 *Budget Review*, over 2,000 projects have been approved by CMIP, and 1,650 of these have been completed. The same review reports that 936,754 housing subsidies have been approved since 1994, from which 629,449 houses, which are to be supported by CMIP facilities, have been built. No assessment is made as to whether these are good matches with demand, where shortfalls and problems have been experienced, nor what can be done to make best use of and mitigate roll-overs.

According to the Nedlac, a national tripartite structure, by the end of 1997, R1.3bn had been spent on 1,031 projects targeting 16 million people, *but* of these 16 million, 13.7 million reside in urban areas. This delivery bias is in spite of the rural concentration of infrastructural backlogs. The Projects for Statistics on Living Standards and Development found that only 20% of poor households¹³³ have flush or VIP toilets, and only 9% more of these households have piped water (Nedlac, 1998).

for basic infrastructure) and housing budgets (so that infrastructure delivery complements housing programmes).

¹³¹ According to the Project for Statistics on Living Standards and Development poor access to basic services and adequate transport facilities are closely related to poverty, which is more pronounced in rural areas. Child poverty, for instance, has been found to be more serious in poorer and less urbanised provinces such as Eastern Cape, where as many as 78% of children live in poor households compared to only 20% in Gauteng and 35% in Western Cape (Nedlac, 1998).

¹³² This is not to suggest that the distance of delivery and maintaining services is not important, but that this varies from project to project and should not be highlighted merely because provinces wish to receive a larger slice of the "CMIP pie".

¹³³ Defined according to a World Bank study (1996) that applies a relative definition of poverty - the bottom 20% of all households are regarded as ultra-poor and the bottom 40% as poor (Nedlac, 1998).

The current allocation to CMIP clearly suggests that government is not allocating sufficient revenue to ensure that MIIF objectives are realised. This may be intended to stimulate private sector investment or financing, but if this is the case, it is a risky tactic as only the wealthier and typically more developed councils can access the capital market. Especially so when a framework for partnerships is not yet in place. In addition, the separation of capital expenditure (CMIP, DWAF and so forth) from operating IGTs (in particular, the Equitable Share) is ill-conceived. The two streams should, to some extent inform the other in order for operating revenue to support capital projects, and in order to do so, CMIP should be linked with other capital IGTs under one clear framework.

5.3.2 Department of Finance's "Equitable Share"

The Department of Finance's Equitable Share contains a number of interesting dimensions. As a vehicle to directly fund the poorest councils in as direct and simple a manner as possible (based on the number of indigent households measured by income), its intentions are undermined by a number of features, which are explored below.

It is important to note that the aforementioned definition of "equity" does not imply a redistributive role for financial arrangements. Instead, it is argued that redistribution should be undertaken at a national level. Horizontal division is, therefore, viewed solely from the perspective of need and not fiscal capacity (that is the ability to finance need by using local revenue sources). Public finance theorists such as Musgrave and Musgrave (1984) have argued that this approach is preferable as national bodies can better facilitate co-ordination and that inter-jurisdictional competition is mitigated. As local government is expected to be largely self-sufficient, however, some equalisation is necessary among South African municipalities for redistribution to ensure the mitigation of apartheid's legacy. In the absence of some consideration for local tax capacity, the IGT cannot impact upon the lives of the poor to its fullest.

An exclusively central approach to redistribution is in contrast to the *White Paper on Local Government*, where the role for redistribution at a local level is clearly articulated as a policy objective (1998: 112):

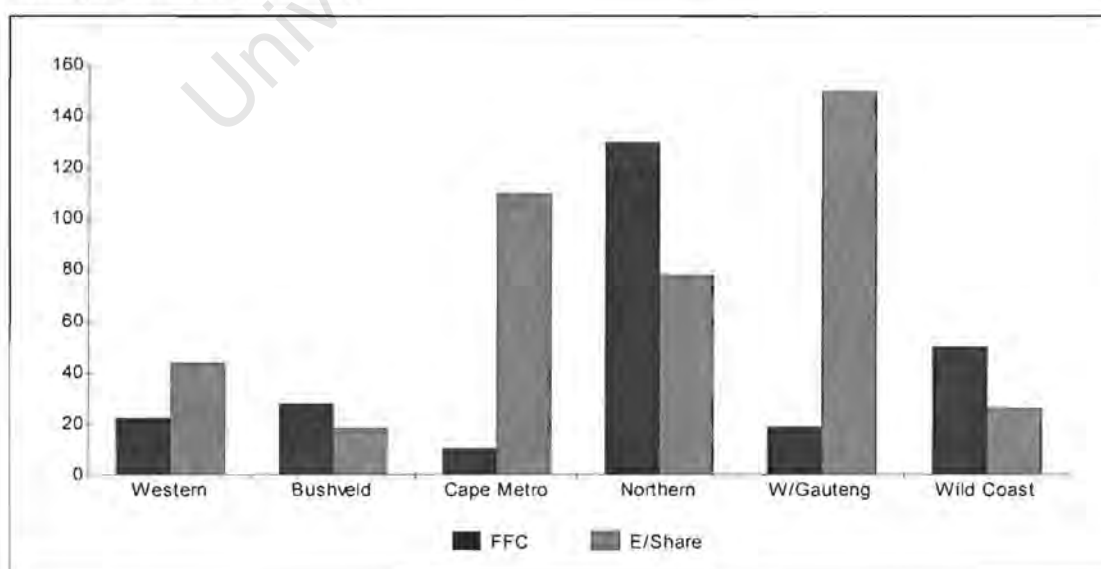
"In addition to targeted subsidies to poor households, funded from the 'equitable share', municipalities can cross-subsidise between high and low-income earners, both within particular services and between services. The extent of this cross-subsidy is a local choice that needs to be exercised carefully, within the framework of the municipal integrated development plan (IDP)."

This principle has been upheld by the Constitutional Court in the Sandton rates case where the Eastern Metropolitan Substructure's proposal to raise rates by 123% and distribute any surplus funds to relatively poorer substructures was challenged by rate payers. The ruling was contentious:

"[Albie] Sachs [a Constitutional Court judge] was reported to have asked in frustration why this decision should not have been taken on the basis of "good neighbourliness – the idea of loving your neighbour." Sach's appeal to religious morality seeks to disguise what he is actually saying. He is not encouraging people to make the decision to love their neighbours; he is suggesting instead that the State is justified in forcing people to love their neighbours, in particular by taking money from them and giving it to others." (Finance Week, 3/9/98)¹³⁴.

The practical implication of excluding fiscal capacity is that localities that have larger tax capacities (and these are predominantly urban with large populations) receive a greater share than they would under a system of equalisation. This implies an urban bias. The following graph demonstrates the implications of including a tax capacity component for selected localities by comparing the Department of Finance Equitable Share allocations for 1998/99 against those proposed by the FFC (which take fiscal capacity into account - refer to the calculation of the latter in the next section). Total transfer amounts are weighed to equal each other and aggregated at the MC or DC level as this is the lowest level of disaggregation for the FFC (which is constrained by insufficient data at TLC and MLC levels at the time of conducting research).

Figure 34 – Considering tax capacities in IGTs (Department of Finance vs. FFC transfers, in millions of Rands)



[Source: adapted from DCD release and FFC, 1997, calculations]

¹³⁴ Interestingly, this view ignores an inter-generational perspective that affluent ratepayers have been

In cases where the MC or DC includes a large urban area – Western DC (Port Elizabeth), Cape MC and Western Gauteng – the Equitable Share allocations are more generous than the FFC's, a situation which is reversed in rural examples – the Bushveld, Northern and Wild Coast. If it is assumed that rural municipalities have the greater backlogs and merit a substantial portion of IGTs, the exclusion of a tax capacity component has extremely negative consequences.

Another feature of the proposals lies in the interpretation of "efficiency". Efficiency conventionally relates to the optimal deployment of resources. The proposals suggest that fiscal equalisation may undermine efficient allocation. This assumes that the benefits of redistribution are outweighed by negative market reactions.

"Full equalisation or equalisation between areas with very uneven tax bases might entail potentially crippling fiscal outflows from richer areas. In addition, because factors of production are mobile not just across municipal borders, but across national ones, total cross country equalisation might have a deleterious effect on the country's ability to attract international investment." (Department of Finance, 1998b: 10).

A partial reworking of this principle, along with the other principles informing the proposals, can be found in the 1998 *Budget Review*:

- "Equity" - Because funds are transferred to municipalities in a uniform, transparent and rational manner according to a formula, all municipalities will be treated equitably, and therefore will be assisted to deliver a package of basic services to all low-income households at affordable cost.
- "Efficiency" - The new transfer system will promote allocative efficiency by promoting competition between municipalities on the basis of their fiscal performance, rather than on their tax bases.
- "Spillover effects" - Services provided by one municipality that produce a positive externality for a neighbouring municipality will be catered for in the new transfer system.
- "Facilitating democracy" - In order for municipalities to fulfil their functional, political and administrative responsibilities towards their residents, they require a minimum level of institutional and administrative infrastructure".

Each of these principles is to be furthered by a particular scheme, although only two are currently operational (to facilitate equity and institutional capacity – the "S" and "I" transfers). This fragmentation is characteristic of the proposals – the starting assumption of which is that

CMIP adequately addresses capital transfers. Whilst this may be true, although there are reasons to doubt the assertion, should this mean that operating transfers do not consider their role in supporting capital infrastructure?

The S transfer (for municipal basic services) is calculated as follows:

$$S_i = \alpha LH_i$$

Where:

- S_i = services transfer to local authority I
- L = annual per capita services transfer (set at R180 pa to be phased to R230)
- H_i = the population living with incomes under R800 per month (1998)
- α = the 'coverage parameter with values between 0 and 1'¹³⁵

Hence, the population of households earning under R800 per month is the key determinant for a municipality's transfer. The much smaller "I" transfer, despite the proposals' view on fiscal equalisation, takes into account the potential revenue collected by a council, which is deducted from a maximum transfer based on population size. The "I" transfer therefore attempts to take into consideration fiscal capacity (using income as a proxy), but will be phased out meaning that fiscal capacity will not be considered over the medium term. Maximum transfers are detailed in the table below:

| Population | Maximum transfer |
|----------------------|------------------|
| 2,000 – 19,999 | R400,000 |
| 20,000 – 99,999 | R800,000 |
| In excess of 100,000 | R1,600,000 |

[Adapted from Department of Constitutional Development, 1998b]

The "T" transfer (which is intended to equalise metropolitan local council's income – again, at odds with the document's criticisms of equalisation) is unlikely to be applied with the re-categorisation of South African cities as category-A councils. It would have been applied as follows:

$$T_i = \theta_t(B^* - B_i)P_i$$

Where:

- T_i = the transfer to sub-structure I
- t = average rate in the R across the MC

¹³⁵ This variable is necessary to ensure scale the transfer amount to the total IGT. Based on the 1998 figure that 11.2 million people are living in poverty in South Africa (Department of Constitutional Development, 1998b), the transfer needed to have been in excess of R2bn to ensure that all of these people received R180 per year, when, in fact, it was only slightly more than half that amount.

- B* = per capita tax rates base across the MC
B_i = per capita rates base in substructure I
θ = the degree of equalisation variable with values between 0 and 1
P_i = population of substructure I.

A formula for allocating matching transfers at the MC or DC level for infrastructure (the “M” transfer) has yet to be released. Problematically, the “M” transfer deals with capital expenditure when the equitable share is intended as an operating transfer.

Aside from the legal difficulty in essentially earmarking a transfer that is constitutionally envisaged as being unconditional, this package of transfers may be too fragmented to deal with the overlapping concerns of local government (although the “S” transfer currently accounts for most of the revenue directed to local government).

5.3.3 Financial and Fiscal Commission’s proposals

The FFC is a product of the Interim and Final Constitution. It is intended to advise Parliament on fiscal arrangements and propose principles for inter-governmental fiscal relations. These recommendations have tended to focus on provincial and national government revenue and expenditure with some involvement in local government marked by the publication of a discussion document in 1997¹³⁶, which contextualises interim local government in the institution’s emerging thinking around a system of fiscal relations (Heese, 1998b).

The Department of Finance adopted these proposals for the Equitable Share transfer to the extent that the focus of the transfer is on the poorest of the poor, in that a formula system is applied, and that local government is the direct beneficiary of the transfer¹³⁷. The two sets of proposals differ, however, in the factors used for calculating the operating transfer and in the Equitable Share’s exclusive focus on operating revenue¹³⁸.

Common principles between the Department of Finance and the FFC include the following arguments:

- Transfers should only be a partial source of revenue,
- Local government should become accountable to constituencies by budgeting appropriately,
- Services must be paid for and therefore used sparingly to implement a “user pays” mentality,
- A package of basic services (defined as access to clean water, basic sanitation and limited access to roads and storm water drainage) should be delivered to all households.

¹³⁶ *Discussion Document on Local Government in a System of Intergovernmental Fiscal Relations in South Africa* (1997, July 27).

¹³⁷ Although at the primary and not secondary level.

¹³⁸ Strictly speaking, however, the Equitable Share may also be used for capital expenditure if a municipality

As stated in the section on the vertical division, benefits from increased expenditure by local government is viewed as a “political decision” (FFC, 1997). While political objectives are certainly of considerable importance in influencing the priorities of government expenditure, this vertical division recommendation is weak from a technical perspective. The document thus investigates the horizontal division in considerably more detail.

The use of formula is similar to methodology used in dividing revenue between provinces by the FFC so as to ensure stability and the pursuit of objectivity (De Bruyn, 1998). The objective considerations in local government’s case are tax capacity for operating transfers and backlogs for capital grants. Total transfers are composed of:

- a conditional capital grant,
- an unconditional operating transfer, and
- a tax capacity component (using RSC levies as a proxy of this capacity).

The operating transfer is intended to subsidise access to basic services for the poor. The costs of water and sanitation services are used as proxies for this need. The transfer (RS_i) is calculated on the cost to the households below the poverty line¹³⁹ for a minimum amount of water and sanitation consumption.

$$RS_i = (a * p_w + b * c_s) * H_{q_i}$$

Where:

- a = minimum household annual water consumption;
- p_w = unit price of water;
- b = minimum level of sanitation;
- c_s = unit cost of sanitation
- H_{q_i} = qualifying population in i^{th} MC or DC

The horizontal inequity between municipalities is dealt with by incorporating a revenue-generating component to weigh up against expenditure needs in the total transfer. Hence, poorer local governments will receive the greatest chunk so as to subsidise access to basic services. As capital grants are calculated according to the extent of infrastructural backlogs, poorer municipalities are also likely to benefit from the transfer more than wealthier, better services localities. In short:

“What the tax capacity component does is to measure the relative ability of the MC or DC to ‘subsidise’ its own ‘poor’” (Donian, 1998).

so wishes.

¹³⁹ As defined in terms of relative poverty, based on an October 1995 RDP report - the poorest 40% of January, 2000

In the absence of other data to indicate relative municipal wealth (such as property values, or personal incomes), RSC levy is used as a proxy for tax capacity, which is then compared to a normative national average to give the *per capita* yield. The tax capacity formula is thus:

$$T_{Li} = a (X_{t-1}^* - X_{t-1}^i) P_i$$

or:

$$T_{Li} = [(X_{t-1}^* / X_{t-1}^i) - 1] (a^* \cdot X_{t-1}^i) P_i$$

Provided that $\sum T_{Li} = 0$ and $(RS_i + T_{Li}) \geq 0$ ¹⁴⁰

Where:

- T_{Li} = the tax capacity transfer to the i^{th} MC or DC
- a^* = the proportion of the tax capacity to be equalised
- X_{t-1}^* = the norm/national average tax capacity *per capita* in year t-1
- X_{t-1}^i = the i^{th} MC or DC's actual tax capacity *per capita* in year t-1
- P_i = the population of the i^{th} MC or DC

The allocation of unconditional transfers (RS_i) is then adjusted for tax capacity to the i^{th} MC or DC is as follows:

$$RST_i = RS_i + T_{Li}$$

Where:

- RS_i = Allocation for Current Expenditure; and
- T_{Li} = Tax Capacity Equalisation Component

The effect of the tax capacity inclusion can be seen in Appendix C.

Further refinements in the capital grant have been suggested by Donian (1998). The FFC (1997) capital allocation (G_i) is based on the cost to provide infrastructure to the qualifying population (households below a defined poverty line) without access to basic services, spread over a period of 10 years.

The allocation of grants for capital expenditure, G_i , to the i^{th} MC or DC is as follows:

$$\text{Capital Grant } (G_i) = \{1 - I_i / \sum(1 - I_i)\} * 1 / n(x^* H_{qi});$$

Where:

households.

¹⁴⁰ The tax capacity component is restricted to a certain level so that it cannot imply a loss of revenue, that is, a negative value for wealthier municipalities.

- I_i = combined index for i^{th} MC or DC
 H_{qi} = qualifying number of households in i^{th} MC or DC
 x = real average cost per household of providing infrastructure for basic services
 n = number of years (phasing)

The weighting is a composite index “I” based on CSIR methodology scaling each variable from 0 (the worst-off) to 1 (the best-off). The real average cost per household of providing basic infrastructure services, “x”, is calculated on the cost of bulk and connector infrastructure installation for basic services. The results of this formula can be found in Appendix C.

The alternative approach determines the *relative* allocations as the aforementioned linear scale ranking between the worst off and least worst off directs the bulk of funding to one particular DC¹⁴¹. This is not a practical outcome as supply constraints within that one particular jurisdiction are likely to leave the bulk of funds unexploited whilst they could be used by some other relatively deserving locality (inferring a high opportunity cost). The results of such a formula are contrasted against those of absolute need in Appendix C.

The combined formula is:

$$IGT_i = G_i + RS_i + T_{Li}$$

Where:

- IGT = Inter-governmental Transfer;
RS + T = RST = Revenue Sharing Transfer;
G = Capital Grants; and
 T_i = Tax Capacity Component.

Wehner (1997b) summarises the FFC proposals as follows:

“the capital and operating components are intended to address the basic needs of the poorest members of society, firstly by eliminating backlogs and secondly by enabling the poor to purchase the minimum quantities of certain essential services”.

The document assumes that “minimum levels of service provision” will benefit recipients directly and members of their wider community indirectly, via “spillover” effects using an example of improved air quality once electrification reduces emissions, encouraging more affluent residents to subsidise the poorer (FFC, 1997). This need not be the case. It cannot be assumed that taxpayers calculate these benefits, which is why the public provision of goods is

¹⁴¹ Northern DC is allocated over 31% of the total amount available.

necessitated (as illustrated by the filing of the Sandton Constitutional Court case). As De Bruyn (1998) observes:

“The discussion document at times also argues the cross-subsidisation point quite narrowly. Instead of focusing on equity, it appeals to self-interest. It talks about the ‘spillover’ effects, that is the bad consequences for wealthier areas if poorer areas are not adequately serviced. It refers, for example, to the spread of infection, or of pollution, from an underserviced area to an adjacent wealthier area. The danger of the focus on self interest is that it does not cover poorer areas that are not adjacent – and thus ‘dangerous’ – to wealthier areas. Most importantly, it does not cover the majority of rural areas. ... The FFC also conceptualises ‘spillover’ only in area terms.”

This criticism can be furthered that the benefits from the spillover are only immediately felt by government (in saving health care costs, for instance) and not by individuals (although tax rates are likely to be affected ultimately).

The second tier of local government is the intended recipient of these transfers in order to balance sensitivity to local conditions against administrative capacity. Primary level local government is considered to be too disparate and not uniformly equipped to manage transfers, nor to have the perspective to understand the spillover benefits, while provincial government involvement is argued to impede local government’s autonomy.

A concern, however, lies with the onus on the primary level of local government to apply for its share of funding, and the discretion it gives to MCs and DCs to determine these allocations (Heese, 1998b). Rather, it is advisable that a formula approach should be applied throughout the transfer procedure to entail a consistency in the allocation of funds according to clearly-defined criteria. The FFC does, however, argue that “stringent criteria need to be applied to ensure that the funds are equitably distributed by the MCs and DCs” (FFC, 1997: 40). As De Bruyn (1998) correctly observes, this is unlikely when there are “weaknesses in data and capacity weaknesses” that would hinder such monitoring.

5.4 Conceptual gaps in the current system of IGTs

Improvements to the existing system of local government financial and fiscal arrangements should be considered in a number of areas. Key considerations should deal not only with the implications of the quantum transferred to local government, but also with better fiscal governance, and the institutional arrangements which would best facilitate these refinements.

3.4.1 Fiscal governance

Abedian (1998b, 1998c) defines fiscal governance as a concept dealing with public expenditure and revenue management, requiring reform of both budgeting systems and public-service delivery to instil good governance - “an appropriate blend of accountability, transparency and efficiency in the use of public money” (1998c: 434) – in financial management of state resources.

Inherently, budgetary systems are critical for three key reasons (Abedian, 1998c):

1. “to maintain overall fiscal discipline; that is, to control aggregate public expenditure;
2. “to align public resources in support of government priorities and plans; that is, to promote allocative efficiency by shifting resources from old priorities to new priorities, or from less to more productive uses consistent with government policy; and
3. “to promote efficient service delivery; that is to enhance delivery efficiency.”

Traditionally, public sector focus was on the first function, but governments under pressure to become more accountable have had to demonstrate and justify budgetary outputs as well as inputs (Abedian, 1998a). In addition, revised management systems in the private sector have had an impact on the public sector in linking strategic planning with budgeting, and inputs with outputs (Abedian, 1998a). Unfortunately, many municipalities have yet to comply adequately with the first function. Nonetheless, the significance of the second and third functions should not be viewed as any less significant. Indeed, a fundamental change in mindset is required to ensure that all three take place through IDPs, and within IDPs, strategic, medium term budget cycles so as to inculcate a culture of accountability and transparency.

“[W]here technically satisfactory provincial development plans exist, they have often not been exposed to in-depth debate in the legislatures or broader civil society. They have missed the fact that planning is not purely an administrative exercise best left to technicians. On the contrary, it is inherently political and hard trade-offs need to be confronted. Unless a common vision for development is developed and consensus created, no development plan, no matter how technically superlative, can be successful.” (Ajam, 1998).

In order for local government to act as a representative of local communities, civil society must have access to budgetary information and processes to ensure accountability and representation in deciding on important budgetary trade-offs. This accessibility, in turn, must feed into management systems that are designed so that delivery reflects consumer (or potential consumer) feedback and consultation. Failing this, the assumptions underpinning the democratic and efficiency benefits from decentralisation are violated.

Hence, attempts to rationalise and standardise municipal reporting procedures should not only be designed for application in, and compatibility with, the private sector, but also for communities, councillors and non-accounting officials who need to understand and participate in financial planning. As municipal finances are often closely guarded by municipal accounting officials (sometimes unwittingly), councillors and community leaders, especially women, feel intellectually marginalised from financial debates and are intimidated by processes in which they should become more active.

Such outcomes are contrary to an increasing trend that attempts to align public service activities with client needs. The *UK Citizen's Charter*, the French *Charte des Services Publics*, the *US National Performance Review*, South Africa's Batho Pele ("people first") principles in the *White Paper on Transforming Public Service Delivery* all argue the importance of improved service delivery that best suits communities' needs (Abedian, 1998b).

At a local level, the IDP process has the potential to become an ideal mechanism for widening access to financial and budgetary decisions, and for better understanding delivery needs. It is regrettable that little policy work has been done in practically linking and obliging treasurers to translate budgets into IDP blueprints. Often policy makers do not have an understanding of the terrain of local government planning, and planners tend to leave financial aspects of processes to specialist financial advisors. A strategy to deal with ensuring better interfacing of these two areas is therefore necessary to allow for improved fiscal governance.

In addition to the participatory implications of reformed budgeting, economic activity can be either beneficially or adversely affected by public budgeting. Abedian (1998b) illustrates:

"[T]he impact of public resource management (budgetary efficiency) goes far beyond its sheer size, because much of private-sector activity depends on the availability or efficient provision of public services. The classic example is the existence of public infrastructure, which is a prerequisite for productive private sector activities."

Reform in budgeting as a reflection of good governance is therefore not only necessary to ensure that public resources are spent efficiently and transparently in attaining people's needs, but also in positively shaping the economic outcomes of public spending (Abedian, 1998c). This broader understanding of financial control should therefore be incorporated into current programmes to improve financial management and strategic planning at the municipal level to ensure the most effective use of scarce economic resources.

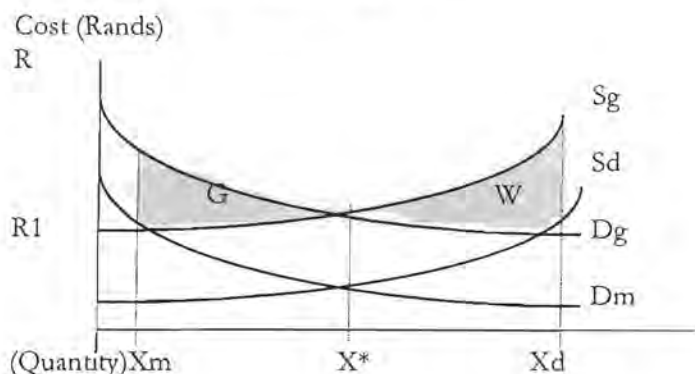
5.4.2 Widening the interpretation of benefits

Local government policy has still to advance to the rather complex level of factoring in inter-governmental benefits for municipal services. Work around the MIIF (see Bond, 1998) sketched

a framework detailing the types of benefits that can be derived from improved infrastructural delivery. These benefits, relating mainly to health and improved living standards, suggest that the public sector is in a position to deliver a greater quantity of services than would be undertaken by the market, and provide a tangible basis on which to begin alleviating poverty.

The figure below graphically demonstrates the role of the public sector:

Figure 35 – Public budgeting



[Adapted from Inman, 1998]

D_m represents the downward sloping demand curve for good X and S_d , the marginal cost of supply of X , say refuse removal, that would occur without government intervention. Including the social benefits or externalities arising out of clean living areas (such as decreased spread of disease), the demand curve shifts to D_g and supply to S_g . Without public intervention, Alexandra residents, say, could not afford the $R1$ fee, and it is unlikely that their Sandton neighbours will voluntarily fit the bill for those who cannot afford the service privately. Relatively wealthier residents in Alexandra who could afford such cross-subsidisation may not undertake it either (even though they would benefit from externalities), as there is no assurance that others in the same position will support poorer residents (that is, ‘free ride’ off other’s investments). At this point, X_m of rubbish is removed in the Eastern Metropolitan substructure. Yet, ideally X^* should be removed, where social demand equals the subsidised cost of supply - $S_g D_g$ (Inman, 1998).

Giving meaning to X^* is extremely difficult, however, and requires a calculation of the Net Present Value (NPV) of spending on refuse removal, which yields a calculation of the gain to society (Triangle G). A danger for those making this decision is the temptation to overspend (providing X_d) where marginal costs (S_d) equal marginal benefits (D_g)⁴². As the marginal cost to the individual is distorted by government subsidies, more is consumed by end users than is efficient as they need not consider the cost of a service (leaving taps running, and so on), wasting

⁴² Although the probability of overspending is unlikely in South Africa where public resources are scarce and demanded for a multitude of services.

government resources (triangle W). Inman (1998) suggests that this incentive can be mitigated by introducing competition by deregulating the provision of a service (that is, allowing privatisation) so that wastage is reduced to reflect true economic costs that would be applied by a competitor in the market.

Although the figure demonstrates the difficulty in deciding the appropriate level of public service provision, it does illustrate the need for intervention and complex analysis. The World Bank World Development Reports, *Development* (1994) and *Poverty* (1990), argue that public infrastructure is as a key tool for poverty alleviation in reducing disease contagion, environmental hazards, improving access to socio-economic opportunities, and decreasing time-consuming activities such as wood collection. This logic provides a motivation for the public provision of goods where spillovers or externalities benefit society at large but would otherwise not be undertaken. What needs to be calculated is to what extent governments should provide these services and in which sectors. It is broadly assumed by both the RDP and GEAR that infrastructural provision needs to be a government priority.

The 1998 Medium Term Budget Policy Statement reports medium term expenditure estimates for infrastructure as reflected in the table below:

Figure 36 - Budgeted expenditure estimates for infrastructure (Rbn)

| Outcome | Revised | Medium term estimates | | | Additional changes since Budget '98 | | |
|---------|---------|-----------------------|-------|-------|-------------------------------------|-------|-------|
| | | 99/00 | 00/01 | 01/02 | 98/99 | 99/00 | 00/01 |
| 23.1 | 22.4 | 23.3 | 24.7 | 26.1 | 0.3 | 0.1 | -0.3 |

[Source: Department of Finance, 1998c]

Local government receives only a small share of this funding. This may be short sighted. The marginal value of a Rand spent at the local level is contended by local government representatives to be likely to ensure greater social spillovers than those spent at the provincial and national level where sensitivity to local needs and easier access to poor communities apply. Unfortunately, this can only be speculated, as national budgeting has not yet incorporated such analysis. Capital transfers to local government must be revisited in this context.

5.4.3 Institutional arrangements

The FFC (1997) argues for IGTs to be directed to the second tier of local government (presupposing the existence of this tier in metropolitan areas), and not primary tiers, nor provincial governments (as under the Interim Constitutional arrangements):

“The degree of aggregation implied by the provincial level would make it too difficult to differentiate between the needs of different municipalities adequately and

necessitate a second level, and thereby effectively 'ring fence' primary municipalities, the opportunities for meaningful redistribution ... would be severely diminished."

The FFC proposals suggest that primary municipalities then receive funding from secondary ones once applications have been put in. Such a system may accord secondary local government with too much fiscal power and undermine primary municipalities incapable or ignorant of application procedures. With the implementation of the Municipal Structures Act (1999), however, enlarged primary structures may provide the appropriately sized institution for transfers, as proposed by the Equitable Share transfers (although in many rural examples, DCs are recipients for TRCs and TrepCs until they are deemed to have sufficient capacity to administer funds). The key problem with this system is accessing data that reflects individual municipal need although Statistics SA has begun collecting figures down to per hundred households.

Once demarcation is complete and final structures have been declared for local government, the inter-governmental transfer system for local government will need to weigh up the administrative, planning and democratic implications of institutional arrangements. These may also need to be revised over time as local government strengthens at a primary level.

6. Conclusion

“The city encompasses all communities which contribute to its growth and to its prosperity... Those people who have, all their lives placed their brains and their brawn at its service, should be the first beneficiaries of its renaissance... Indeed, this renewal should mean that we all begin to own the city ... and the fruits it is going to bear, because the contribution of all of us to in its renewal, its growth, its prosperity is... indispensable.” Thabo Mbeki ¹⁴³.

Local government in South Africa bears the scars of apartheid and its segregation, manifested by ineffective structures, inefficient financial management and inequitable distribution of resources. Its renewal is therefore at the forefront of developmental agendas. Theoretically, aspirations of urban renewal and rural upliftment through empowered municipalities are not misplaced - development via a transformed local government is modelled on examples of successful decentralisation in a number of countries, such as Germany and Canada¹⁴⁴.

Constitutionally, local government is fully empowered to ensure the delivery of basic services. Inter-governmental relations alone, however, are only a legal precondition for tackling backlogs of the past and delivery needs of present and future generations. Like other spheres of government, local government is hindered by poorly structured and demarcated institutions, and is subject to human resource and skills constraints. Specific to the focus of this dissertation, a further area influencing the success of municipalities' operations is that of fiscal arrangements. In their current design, different modelling options suggest they do not adequately take into account the frail and fluctuating state of local government finances by working on the assumption that local government has access to (almost) all the revenue that it requires.

Existing policies emphasise the autonomy of local government in order to obviate the risk of moral hazard and to ensure that municipalities take responsibility for liabilities and make full use of their resources. This is important as a part of government's policy of fiscal restraint - but should not be the core of discussions dealing with local government's fiscal entitlement. The current (and medium term) proposals for local government to receive only a fraction of nationally collected revenue means that individual municipal finances can only partially be equalised by IGTs. This is especially pertinent as transferred revenue makes use of a distribution system (the Equitable Share) that does not adequately factor in individual municipal tax capacities. Furthermore, as self-collected revenue cannot be transferred from one jurisdiction to

¹⁴³ Quoted in USN (1998).

¹⁴⁴ “Highly decentralized fiscal systems with a high degree of autonomy have generated equitable public-service delivery and enviable track records of macroeconomic stability (in Canada and Germany, for instance)” (Ajam, 1998).

another (unless the Municipal Demarcation Board decides to amalgamate them into one body during the process of re-demarcation), equalisation is even less likely.

The message of a hard budget constraint and the need to optimise existing revenue bases needs to be balanced with a better understanding of the cost of *bona fide* developmental expenditure in instances where local governments cannot access additional sources of revenue (especially in impoverished communities). In addition, assuming that the Equitable Share is sufficient to subsidise access to municipal service for the indigent, other transfer systems do not sufficiently address capital backlogs, the elimination of which are a *sine quo non* of development in South Africa.

Similarly, whilst the concern about municipalities' ability to properly manage funds is important to transformation, it is one of several that should be debated in light of a broader framework of fiscal governance. A component of fiscal governance requires adequate resources for efficient delivery. To deal with these two issues, an interim conditional grant that aims to remove backlogs, whilst local governments develop sufficient capacity to deliver services and manage resources, may be warranted.

Over this interim period, local government must be up-skilled (using proposed initiatives) so that municipalities can appropriately respond to local demands and optimise the potential of a decentralised system. Responsible financial officials, councillors and community leaders will also need to be trained further in the complexities of augmenting municipal income via the bond market and service partnerships so that a reliance on IGTs is not inculcated. Measures to ensure participatory budgeting need to be incorporated into reformed budget cycles.

At the same time that these transitional measures are implemented, the existing system of IGTs to local government should be reviewed in light of an assessment of local government's development needs (assuming delivery efficiency). Preliminary evidence suggests that the current financial and fiscal flows are insufficient. If universal delivery requires greater resources, a greater quantum of resources should be transferred to local government (that is, the vertical division should increase), and/or the current IGTs should take on a more redistributive design.

This revision is necessary, as local government with inadequate resources (human and/or financial) will compromise the development of communities that were disadvantaged by apartheid. Overly decentralised financial powers in the absence of fairly equal resource bases mean that only communities with adequate levels of capital (and Project Viability data suggests that these are the exception) are likely to thrive. The *White Paper on Local Government* put in place a framework to correct the spatial imbalances of opportunity, but this framework is impotent without resources. Financial and fiscal policies cannot in their current design adequately facilitate

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effective decentralised delivery.

From the perspective of efficient resource allocation, the fiscus is likely to be affected should developmental local government not adequately emerge. Inadequate social infrastructure hinders development and entails negative externalities (health and productivity costs). Economic development is also likely to be compromised without adequate infrastructure and linkages in place that could be delivered cost-effectively by municipalities.

More importantly, perhaps, is the significance of developmental local government for the majority of South Africans. Without a large number of prosperous localities and a broad base of basic services, socio-economic opportunity will continue to be limited. A deepening of the patterns of inequality would constitute a serious compromise to successful transition towards a more equitable South Africa. Although the challenges facing local government's financial transition and fiscal governance are substantial, with careful consideration of the objectives of developmental local government, they can, with revision, facilitate one of South Africa's most important leverage points in ensuring a more equitable social order.

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Appendix A - Obligations in Local Government Budgeting Process

| According to | Local | Provincial | National |
|---|--|---|---|
| Constitution | 153(a) Structure and manage budget to give priority to community's basic needs 153(b) Participate in National and Provincial Support Programmes | 154(1) Support and strengthen its municipalities' capacity to run their own affairs 155(6)(a) Provide monitoring and support for local government 155(6)(b) Help local government run its own affairs | 154(1) Support and strengthen its municipalities' capacity to run their own affairs |
| LGTA and Amendments | 10(G)(4)(c) Submit budget to Dept. Finance within 14 days of council approval 10(G)(3)(b)(i) Not submit or operate on a deficit budget | 10(G)(4)(c) Must receive a copy of each municipal budget when sent to Dept. Finance for approval and May be delegated by Minister of Finance to approve municipal budgets. | 10(G)(4)(b) Minister of Finance must determine maximum expenditure rates for municipalities 10(G)(4)(c) Minister of Finance must approve each municipal budget |
| 1997/8 Dept. Finance Guidelines (Ref. FS 2/B) | S3 Each municipality (TMC,MLC, TLC, TRC, TrepC) must submit budget before 31 May 1997 S2 Budget based on affordability and sustainability | S4 Must receive copy of budget for information | S1.3 1997/8 Operating and Capital Budgets must not exceed 8% increase of 1996/7 expenditure. |
| HOW REALITY MATCHES UP IN THE WILD Coast DISTRICT* | | | |
| In reference to: | BIZANA TRepC | | WILD Coast DISTRICT COUNCIL |
| Constitution | | | |
| 153(a) | Came up with a draft 1996/7 budget in consultation with community stakeholders | Formulated draft budget | |
| 153(b) | Budgeted for contribution to development programme | Meant to budget for contribution, but unclear from Province and National spheres WHO is responsible for administration of these funds | |
| LGTA and Amendments | | | |
| 10(G)(4)(c) | Council approved ___ Submitted R5,5 million budget to Dept. Finance. | Council approved 14/8/97 Submitted 2/9/97 budget to Dept. Finance. | |
| 10(G)(3)(b)(i) | Only informed 31/7/97 of 1997/8 Provincial IGGs. | Only informed 31/7/97 of 1997/8 Provincial IGGs. | |
| 1997/8 Guidelines | | | |
| S3 | Submitted 3 months past deadline. | Forced to budget utilising roll- over appropriations from 1996/7 | |
| S2 | Total Budget approximately R5,5 million; with an estimated IGG of R2,5 million. | | |
| *Compiled from 21/7/97 interview | | | |

[Source – IDASA, [www.idasa.org.za/logic/log_steps/pullout\(1\).htm](http://www.idasa.org.za/logic/log_steps/pullout(1).htm)]

Appendix B - The introduction of a rural land tax (The Katz Commission)

185. No DC (or any primary rural municipality) is capable of introducing a land tax in the 1998/99 financial year. The Eastern Gauteng Services Council aimed to introduce property rates from 1 July 1998, but due to delays with the establishment of the valuation roll, the introduction has been postponed by at least a year. The majority of DCs will, however, be able, with logistical support (proper land surveys, assessment, etc), to introduce a land tax within 4 to 6 years.

186. It is clear that the introduction of a rural land tax will have cost implications for the implementing authorities, especially in the case where properties are valued according to their market value. Once in place, there will also be costs involved in maintaining a legitimate, accurate and equitable valuation roll.

187. Even if a proper market value-based roll is substituted for a so-called measured roll(8) or a use value-based roll, initial assessments and continuous reassessments will have to be made. The lack of data makes it impossible to estimate the total cost of preparing a valuation roll throughout the country. Only a few DCs have thus far embarked on the estimation of this cost in their area of jurisdiction and/or on an estimation of the cost of doing so.

188. Although it is evident that assessment will be a cost factor to be considered, it is also noteworthy that the information gathered pertaining to land use and land management could become a valuable resource in itself to be used for other purposes, or even to be sold for commercial use.

Capacity to administer a land tax

189. It is clear that primary rural municipalities (where they exist) have no capacity to administer a land tax. However, the capacity to administer such a tax generally exists at the district council tier. Although information was not received from all 42 DCs, and in most instances conclusions had to be drawn from the opinions of or estimates made by individual officials, it can be inferred that it is possible for the majority of DCs to introduce a rural land tax in the not too distant future. A lot will, however, depend on the logistical support provided by the national and provincial spheres of government.

190. In summary, while the DCs in the **Northern Cape** may have the capacity to introduce the tax within the next 2-4 years, the expected low revenue yield may preclude the possibility of doing so. The problem of a low expected revenue yield in the **Eastern Cape** is compounded by the lack of capacity amongst most of the DCs, especially as 5 of the 6 DCs have tribal land within their areas of jurisdiction. It is unlikely that they will be able to introduce the tax within 4 years without support from the provincial and national spheres. The same argument applies to the **Northern Province, Mpumalanga, the North West and KwaZulu-Natal**. The only provinces that are likely to be able to introduce the tax within this period are **Gauteng, the Free State and the Western Cape**. Nevertheless, it should be technically feasible for all DCs to introduce a rural land tax within 5 years, given the required support from the other spheres of government.

3.7 Conclusions

191. This analysis of rural municipalities shows that there are a number of factors that mitigate against the introduction of a rural land tax in the near term:

- Large areas of the country are so sparsely populated that it seems unlikely that a rural land tax will yield a positive net revenue there;
- From the information supplied by half of the DCs (see Table 3.12), it is clear that, by their own estimates, some of the DCs will have to employ additional staff in order to implement a rural land tax successfully;
- Some of the tribally owned land in South Africa (about 15 per cent of the agricultural land in the country) has not yet been surveyed. Experience elsewhere has shown that this is no easy task;
- There are virtually no primary local authorities with the capacity to deliver services of any kind. Therefore, it is evident that DCs will have to be charged with the responsibility to implement the tax, even though the Subcommittee has argued in favour of primary authorities; and
- Few DCs will be able to introduce a rural land tax within 4 years.

192. However, despite these caveats, the research has also shown that most DCs will be able to introduce a rural land tax within the next 4-6 years. Further, most DCs receive very little tax revenue from rural areas, while a large proportion of their spending is in rural areas.

193. Finally, this research has also shown that it is unlikely that RSC levies will be replaced with other revenue sources, if only because of their key importance as an existing source of revenue. Thus, if the principle of maintaining the total tax burden is to be adhered to, and a rural land tax is to be introduced, tax relief measures will have to be implemented or a rural land tax will have to be treated as a provisional tax payment for income tax purposes.

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Appendix C – FFC Allocations

FFC Capital Allocations to each DC & MC, using the DIMS Approach¹⁴⁵

| DC/MC | Prov | % Need | Allocation (R4bn) |
|----------------------------|------|--------|-------------------|
| Algoa (Western) | EC | 0.80 | 32,136,442 |
| Amatola | EC | 10.03 | 401,072,592 |
| Bloem Area | FS | 0.84 | 33,457,532 |
| Bophirima/Garankuwa | NW | 3.02 | 120,927,215 |
| Bree River | WC | 0.03 | 1,137,071 |
| Bushveld | NP | 0.98 | 39,343,038 |
| Cape Metro | WC | 0.08 | 3,132,008 |
| Central/Mmabatho | NW | 1.37 | 54,764,951 |
| Diamantveld | NC | 0.12 | 4,898,523 |
| Drakensberg | EC | 1.73 | 69,144,179 |
| Durban Metro | KZN | 0.57 | 22,626,195 |
| Eastern Free State | FS | 2.28 | 91,276,782 |
| Eastern Gauteng | GP | 0.26 | 10,438,891 |
| Eastern/Huhudi | NW | 1.47 | 58,932,845 |
| Eastvaal | MP | 2.78 | 111,003,122 |
| Goldfields | FS | 1.06 | 42,389,238 |
| Greater Johannesburg Metro | GP | 0.04 | 1,652,425 |
| Highveld | MP | 0.33 | 13,337,259 |
| Ilembe | KZN | 2.75 | 110,140,651 |
| Indhlovu | KZN | 2.43 | 97,012,258 |
| Kalahari | NC | 0.03 | 1,266,822 |
| Kei (Eastern Region) | EC | 7.53 | 301,009,735 |
| Khayalami Metro | GP | 0.01 | 367,308 |
| Klein Karoo | WC | 0.09 | 3,470,451 |
| Lekoa Vaal Metro | GP | 0.02 | 866,392 |
| Lower-Orange | NC | 0.05 | 2,029,190 |
| Lowveld and Escarpment | MP | 1.20 | 47,996,257 |
| Namaqualand | NC | 0.00 | 0 |
| North West/Hantam | NC | 0.13 | 5,094,023 |
| Northern | NP | 31.41 | 1,256,464,347 |
| Northern Free State | FS | 0.51 | 20,257,558 |
| Overberg | WC | 0.02 | 905,804 |
| Pretoria Metro | GP | 0.06 | 2,263,910 |
| Rustenburg-Marico | NW | 1.28 | 51,182,493 |
| Sentrale Karoo | WC | 0.06 | 2,587,344 |
| South Cape | WC | 0.19 | 7,599,811 |
| Southern/Klerksdorp | NW | 0.36 | 14,390,164 |
| Stormberg | EC | 2.72 | 108,813,724 |
| Ugu | KZN | 2.07 | 82,607,763 |
| Umzinyathi | KZN | 2.23 | 89,095,753 |
| Upper-Karoo | NC | 0.26 | 10,359,907 |
| Uthukela | KZN | 1.04 | 41,612,406 |
| Uthungulu | KZN | 6.04 | 241,701,855 |
| West Coast | WC | 0.01 | 429,997 |
| Western Gauteng | GP | 0.02 | 770,639 |
| Wild Coast | EC | 7.74 | 309,400,898 |
| Winelands | WC | 0.14 | 5,619,469 |
| Zululand | KZN | 1.83 | 73,012,764 |
| Total | | 100.00 | 4,000,000,000 |

[Source: Donian, 1998]

¹⁴⁵ The Development Indicators Monitoring System – this calculates the average cost of providing infrastructure in order to close backlogs (an absolute measurement) and does not take into consideration differing regional costs.

FFC Capital Allocations to each DC & MC, using the Relative Needs Approach¹⁴⁶

| DC/MC | Prov | % Need | Allocation (R4bn) |
|----------------------------|------|--------|-------------------|
| Algoa (Western) | EC | 1.81 | 72,251,028 |
| Amatola DC | EC | 7.74 | 309,711,036 |
| Bloem Area | FS | 1.74 | 69,725,548 |
| Bophirima/Gatankuwa | NW | 2.91 | 116,223,998 |
| Bree River | WC | 0.29 | 11,531,679 |
| Bushveld | NP | 1.67 | 66,870,806 |
| Cape Metro | WC | 0.74 | 29,676,869 |
| Central/Mmabatho | NW | 2.38 | 95,320,254 |
| Diamantveld | NC | 0.43 | 17,030,691 |
| Drakensberg | EC | 2.26 | 90,213,987 |
| Durban Metro | KZN | 1.84 | 73,565,628 |
| Eastern Free State | FS | 2.81 | 112,578,803 |
| Eastern Gauteng | GP | 1.66 | 66,279,160 |
| Eastern/Huhudi | NW | 1.93 | 77,278,913 |
| Eastvaal | MP | 3.43 | 137,014,936 |
| Goldfileds | FS | 1.99 | 79,424,158 |
| Greater Johannesburg Metro | GP | 0.66 | 26,318,772 |
| Highveld | MP | 1.17 | 46,725,381 |
| Ilembe | KZN | 2.95 | 118,169,324 |
| Indhlovu | KZN | 3.44 | 137,423,599 |
| Kalahari | NC | 0.13 | 5,313,016 |
| Kei (Eastern Region) | EC | 5.04 | 201,780,769 |
| Khayalami Metro | GP | 0.20 | 7,877,351 |
| Klein Karoo | WC | 0.35 | 13,972,178 |
| Lekoa Vaal Metro | GP | 0.32 | 12,826,099 |
| Lower-Orange | NC | 0.18 | 7,274,637 |
| Lowveld and Escarpment | MP | 1.91 | 76,362,657 |
| Namaqualand | NC | 0.01 | 394,209 |
| North West/Hantam | NC | 0.27 | 10,806,023 |
| Northern | NP | 16.02 | 640,745,807 |
| Northern Free State | FS | 1.16 | 46,485,120 |
| Overberg | WC | 0.23 | 9,273,700 |
| Pretoria Metro | GP | 0.56 | 22,233,997 |
| Rustenburg-Marico | NW | 2.16 | 86,497,747 |
| Sentrale Karoo | WC | 0.27 | 10,782,732 |
| South Cape | WC | 0.75 | 29,934,156 |
| Southern/Klerksdorp | NW | 0.93 | 37,219,600 |
| Stormberg | EC | 3.24 | 129,712,029 |
| Ugu | KZN | 2.61 | 104,579,986 |
| Umzinyathi | KZN | 3.02 | 120,979,208 |
| Upper-Karoo | NC | 0.58 | 23,284,385 |
| Uthukela | KZN | 1.70 | 68,090,081 |
| Uthungulu | KZN | 5.23 | 209,006,530 |
| West Coast | WC | 0.19 | 7,709,607 |
| Western Gauteng | GP | 0.44 | 17,465,287 |
| Wild Coast | EC | 5.51 | 220,352,124 |
| Winelands | WC | 0.69 | 27,743,884 |
| Zululand | KZN | 2.45 | 97,962,512 |
| Total | | 100.00 | 4,000,000,000 |

[Source: Donian, 1998]

¹⁴⁶ The relative needs approach estimates a jurisdiction's needs in proportion to total needs. The result is less redistributive than the DIMS approach.

FFC Operating Transfers per DC/MC: Based on Costs for VIP and 25l Water & HHs Earning <R9 900 per year

| RSC/DC | # of HH (OHS) | # of HH (Income & Exp Survey(IES)) | # HH earning <R9 900(IES) | % earning <R9 900(IES) | HHs earning <R9 900 (OHS) | Operating Transfer (R) |
|------------------------|---------------|------------------------------------|---------------------------|------------------------|---------------------------|------------------------|
| Algoa (Western) | 194,894 | 203,014 | 56,758 | 28% | 54,488 | 8,519,718 |
| Amatola | 364,156 | 410,642 | 217,344 | 53% | 192,740 | 30,136,820 |
| Bloem Area | 183,261 | 207,937 | 97,959 | 47% | 86,334 | 13,499,208 |
| Bophirima/Garankuwa | 124,687 | 139,289 | 46,751 | 34% | 41,850 | 6,543,663 |
| Bree River | 100,151 | 100,897 | 16,406 | 16% | 16,285 | 2,546,276 |
| Bushveld | 128,492 | 160,848 | 78,050 | 49% | 62,350 | 9,748,976 |
| Cape Metro | 332,498 | 334,662 | 23,900 | 7% | 23,745 | 3,712,840 |
| Central/Mmabatho | 203,010 | 211,238 | 79,667 | 38% | 76,564 | 11,971,526 |
| Diamantveld | 56,916 | 60,050 | 27,446 | 46% | 26,014 | 4,067,486 |
| Drakensberg | 133,717 | 146,939 | 70,230 | 48% | 63,910 | 9,993,046 |
| Durban Metro | 321,590 | 276,881 | 25,015 | 9% | 29,054 | 4,542,925 |
| Eastern Free State | 170,455 | 202,336 | 117,675 | 58% | 99,134 | 15,500,527 |
| Eastern Gauteng | 786,516 | 705,280 | 89,077 | 13% | 99,337 | 15,532,352 |
| Eastern/Huhudi | 112,178 | 127,667 | 75,146 | 59% | 66,029 | 10,324,299 |
| Eastvaal | 214,182 | 240,648 | 88,297 | 37% | 78,586 | 12,287,749 |
| Goldfileds | 190,319 | 216,108 | 101,161 | 47% | 89,089 | 13,929,967 |
| Greater JHB Metro | 457,331 | 386,439 | 41,493 | 11% | 49,105 | 7,678,037 |
| Highveld | 181,681 | 205,789 | 45,649 | 22% | 40,301 | 6,301,505 |
| Ilembe | 144,417 | 219,359 | 53,306 | 24% | 35,094 | 5,487,375 |
| Indhlovu | 257,840 | 294,630 | 77,917 | 26% | 68,188 | 10,661,817 |
| Kalahari | 20,229 | 19,899 | 8,046 | 40% | 8,179 | 1,278,936 |
| Kei (Eastern Region) | 161,286 | 187,285 | 124,554 | 67% | 107,263 | 16,771,697 |
| Khayalami Metro | 108,901 | 92,543 | 6,153 | 7% | 7,241 | 1,132,142 |
| Klein Karoo | 53,535 | 55,024 | 14,562 | 26% | 14,168 | 2,215,299 |
| Lekoa Vaal Metro | 166,596 | 198,571 | 25,484 | 13% | 21,380 | 3,343,043 |
| Lower-Orange | 23,230 | 24,859 | 8,010 | 32% | 7,485 | 1,170,371 |
| Lowveld and Escarpment | 139,262 | 160,285 | 33,862 | 21% | 29,421 | 4,600,214 |
| Namaqualand | 10,975 | 10,704 | 1,113 | 10% | 1,141 | 178,435 |
| North West/Hantam | 21,964 | 23,172 | 9,748 | 42% | 9,240 | 1,444,738 |
| Northern | 697,451 | 921,234 | 386,017 | 42% | 292,247 | 45,695,753 |
| Northern Free State | 118,617 | 136,415 | 67,660 | 50% | 58,832 | 9,199,039 |
| Overberg | 81,220 | 80,661 | 12,906 | 16% | 12,995 | 2,031,967 |
| Pretoria Metro | 208,579 | 217,082 | 6,188 | 3% | 5,946 | 929,657 |
| Rustenburg-Marico | 178,252 | 178,163 | 58,890 | 33% | 58,919 | 9,212,640 |
| Sentrale Karoo | 41,419 | 42,877 | 12,819 | 30% | 12,383 | 1,936,221 |
| South Cape | 119,207 | 114,789 | 29,859 | 26% | 31,008 | 4,848,444 |
| Southern/Klerksdorp | 112,520 | 118,880 | 63,010 | 53% | 59,639 | 9,325,155 |
| Stormberg | 196,112 | 221,031 | 103,890 | 47% | 92,177 | 14,412,867 |
| Ugu | 147,412 | 169,541 | 48,571 | 29% | 42,231 | 6,603,297 |
| Umzinyathi | 200,257 | 230,716 | 50,956 | 22% | 44,229 | 6,915,618 |
| Upper-Karoo | 55,469 | 57,160 | 26,995 | 47% | 26,196 | 4,096,068 |
| Uthukela | 117,522 | 128,796 | 34,338 | 27% | 31,332 | 4,899,113 |
| Uthungulu | 235,290 | 277,955 | 85,050 | 31% | 71,995 | 11,257,163 |
| West Coast | 97,494 | 98,288 | 13,651 | 14% | 13,541 | 2,117,227 |
| Western Gauteng | 351,642 | 334,988 | 40,811 | 12% | 42,840 | 6,698,451 |
| Wild Coast | 194,834 | 227,123 | 135,527 | 60% | 116,260 | 18,178,377 |
| Winelands | 134,925 | 134,055 | 11,107 | 8% | 11,179 | 1,747,961 |
| Zululand | 149,851 | 164,290 | 53,543 | 33% | 48,837 | 7,636,193 |
| Total | 8,802,342 | 9,477,039 | 2,902,567 | 31% | 2,695,925 | 402,862,197 |

[Source: Donian, 1998]

FFC Per Capita Tax Capacities: Based on RSC Levies

| MC/DC | Prov | Per Capita Tax Cap. (R) | TC Transfer (R) |
|----------------------------|------|-------------------------|-------------------|
| Algoa (Western) | EC | 141.95 | 141.95-53,645,034 |
| Amatola | EC | 28.52 | 82,382,828 |
| Bloem Area | FS | 58.34 | 9,337,526 |
| Bophirima/Garankuwa | NW | 5.69 | 50,514,318 |
| Bree River | WC | 43.45 | 12,211,235 |
| Bushveld | NP | 39.26 | 20,260,647 |
| Cape Metro | WC | 253.46 | -245,231,942 |
| Central/Mmabatho | NW | 25.55 | 42,210,440 |
| Diamantveld | NC | 87.85 | -3,939,454 |
| Drakensberg | EC | 4.22 | 44,005,825 |
| Durban Metro | KZN | 188.32 | -172,519,406 |
| Eastern Free State | FS | 21.86 | 38,307,612 |
| Eastern Gauteng | GP | 90.00 | -50,151,994 |
| Eastern/Huhudi Region | NW | 63.88 | 4,249,214 |
| Eastvaal | MP | 58.63 | 14,517,882 |
| Goldfields | FS | 62.70 | 6,391,139 |
| Greater Johannesburg Metro | GP | 378.02 | -497,940,464 |
| Highveld | MP | 73.94 | -2,792,519 |
| Ilembe | KZN | 7.61 | 64,333,546 |
| Indhlovu | KZN | 50.86 | 24,417,441 |
| Kalahari | NC | 124.52 | -4,086,516 |
| Kei (Eastern Region) | EC | 5.84 | 63,879,040 |
| Khayalami Metro | GP | 261.03 | -69,824,276 |
| Klein Karoo | WC | 22.30 | 10,746,386 |
| Lekoa Vaal Metro | GP | 1.17 | 41,274,589 |
| Lower-Orange | NC | 61.72 | 982,081 |
| Lowveld and Escarpment | MP | 46.85 | 19,626,674 |
| Namaqualand | NC | 158.86 | -3,120,743 |
| North West/Hantam | NC | 18.47 | 3,622,262 |
| Northern | NP | 10.13 | 301,795,986 |
| Northern Free State | FS | 68.59 | 1,510,318 |
| Overberg | WC | 37.75 | 9,232,491 |
| Pretoria Metro | GP | 354.82 | -207,020,871 |
| Rustenburg-Marico | NW | 61.27 | 7,011,828 |
| Sentrale Karoo | WC | 10.37 | 9,494,159 |
| South Cape | WC | 17.40 | 23,508,775 |
| Southern/Klerksdorp | NW | 122.67 | -19,134,638 |
| Stormberg | EC | 6.32 | 66,384,120 |
| Ugu | KZN | 20.90 | 40,382,562 |
| Umzinyathi | KZN | 15.37 | 66,702,891 |
| Upper-Karoo | NC | 18.90 | 11,482,165 |
| Uthukela | KZN | 23.78 | 29,681,647 |
| Uthungulu | KZN | 41.88 | 46,333,682 |
| West Coast | WC | 65.55 | 1,857,528 |
| Western Gauteng | GP | 57.96 | 14,230,791 |
| Wild Coast | EC | 5.32 | 80,904,616 |
| Winelands | WC | 53.31 | 9,879,636 |
| Zululand | KZN | 9.41 | 55,743,974 |
| | | Average: 71.36 | Total: 0 |

[Source: Donian, 1998]

FFC Full Formula with DIMS Capital Calculation

| RSC/DC | Prov | Capital Grant (R) | Operating Transfer (R) | TxCap Transfer (R) | RS+TxCap (R) | RS+TxCap with constraint (R) | Total IGT (R) |
|------------------------|------|-------------------|------------------------|--------------------|--------------|------------------------------|---------------|
| Algoa (Western) | EC | 32,136,442 | 8,519,718 | -53,645,034 | -45,125,316 | 0 | 32,136,442 |
| Amatola | EC | 401,072,592 | 30,136,820 | 82,382,828 | 112,519,648 | 112,519,648 | 513,592,240 |
| Bloem Area | FS | 33,457,532 | 13,499,208 | 9,337,526 | 22,836,734 | 22,836,734 | 56,294,265 |
| Bophirima/Garankuwa | NW | 120,927,215 | 6,543,663 | 50,514,318 | 57,057,981 | 57,057,981 | 177,985,196 |
| Bree River | WC | 1,137,071 | 2,546,276 | 12,211,235 | 14,757,511 | 14,757,511 | 15,894,581 |
| Bushveld | NP | 39,343,038 | 9,748,976 | 20,260,647 | 30,009,623 | 30,009,623 | 69,352,661 |
| Cape Metro | WC | 3,132,008 | 3,712,840 | -245,231,942 | -241,519,102 | 0 | 3,132,008 |
| Central/Mmabatho | NW | 54,764,951 | 11,971,526 | 42,210,440 | 54,181,966 | 54,181,966 | 108,946,917 |
| Diamantveld | NC | 4,898,523 | 4,067,486 | -3,939,454 | 128,032 | 128,032 | 5,026,555 |
| Drakensberg | EC | 69,144,179 | 9,993,046 | 44,005,825 | 53,998,871 | 53,998,871 | 123,143,050 |
| Durban Metro | KZN | 22,626,195 | 4,542,925 | -172,519,406 | -167,976,481 | 0 | 22,626,195 |
| Eastern Free State | FS | 91,276,782 | 15,500,527 | 38,307,612 | 53,808,138 | 53,808,138 | 145,084,920 |
| Eastern Gauteng | GP | 10,438,891 | 15,532,352 | -50,151,994 | -34,619,641 | 0 | 10,438,891 |
| Eastern/Huhudi | NW | 58,932,845 | 10,324,299 | 4,249,214 | 14,573,513 | 14,573,513 | 73,506,358 |
| Eastvaal | MP | 111,003,122 | 12,287,749 | 14,517,882 | 26,805,630 | 26,805,630 | 137,808,752 |
| Goldfields | FS | 42,389,238 | 13,929,967 | 6,391,139 | 20,321,105 | 20,321,105 | 62,710,344 |
| Greater JHB Metro | GP | 1,652,425 | 7,678,037 | -497,940,464 | -490,262,427 | 0 | 1,652,425 |
| Highveld | MP | 13,337,259 | 6,301,505 | -2,792,519 | 3,508,986 | 3,508,986 | 16,846,245 |
| Ilembe | KZN | 110,140,651 | 5,487,375 | 64,333,546 | 69,820,921 | 69,820,921 | 179,961,571 |
| Indhlovu | KZN | 97,012,258 | 10,661,817 | 24,417,441 | 35,079,257 | 35,079,257 | 132,091,515 |
| Kalahari | NC | 1,266,822 | 1,278,936 | -4,086,516 | -2,807,580 | 0 | 1,266,822 |
| Kei (Eastern Region) | EC | 301,009,735 | 16,771,697 | 63,879,040 | 80,650,738 | 80,650,738 | 381,660,473 |
| Khayalami Metro | GP | 367,308 | 1,132,142 | -69,824,276 | -68,692,134 | 0 | 367,308 |
| Klein Karoo | WC | 3,470,451 | 2,215,299 | 10,746,386 | 12,961,685 | 12,961,685 | 16,432,136 |
| Lekoa Vaal Metro | GP | 866,392 | 3,343,043 | 41,274,589 | 44,617,632 | 44,617,632 | 45,484,024 |
| Lower-Orange | NC | 2,029,190 | 1,170,371 | 982,081 | 2,152,452 | 2,152,452 | 4,181,642 |
| Lowveld and Escarpment | MP | 47,996,257 | 4,600,214 | 19,626,674 | 24,226,888 | 24,226,888 | 72,223,145 |
| Namaqualand DC | NC | 0 | 178,435 | -3,120,743 | -2,942,308 | 0 | 0 |
| North West/Hantam | NC | 5,094,023 | 1,444,738 | 3,622,262 | 5,067,000 | 5,067,000 | 10,161,024 |
| Northern | NP | 1,256,464,347 | 45,695,753 | 301,795,986 | 347,491,739 | 347,491,739 | 1,603,956,086 |
| Northern Free State | FS | 20,257,558 | 9,199,039 | 1,510,318 | 10,709,357 | 10,709,357 | 30,966,915 |
| Overberg | WC | 905,804 | 2,031,967 | 9,232,491 | 11,264,459 | 11,264,459 | 12,170,263 |
| Pretoria Metro | GP | 2,263,910 | 929,657 | -207,020,871 | -206,091,214 | 0 | 2,263,910 |
| Rustenburg-Marico | NW | 51,182,493 | 9,212,640 | 7,011,828 | 16,224,468 | 16,224,468 | 67,406,962 |
| Sentrale Karoo | WC | 2,587,344 | 1,936,221 | 9,494,159 | 11,430,381 | 11,430,381 | 14,017,725 |
| South Cape | WC | 7,599,811 | 4,848,444 | 23,508,775 | 28,357,219 | 28,357,219 | 35,957,031 |
| Southern/Kierksdorp | NW | 14,390,164 | 9,325,155 | -19,134,638 | -9,809,483 | 0 | 14,390,164 |
| Stormberg | EC | 108,813,724 | 14,412,867 | 66,384,120 | 80,796,988 | 80,796,988 | 189,610,711 |
| Ugu | KZN | 82,607,763 | 6,603,297 | 40,382,562 | 46,985,858 | 46,985,858 | 129,593,621 |
| Umzinyathi | KZN | 89,095,753 | 6,915,618 | 66,702,891 | 73,618,509 | 73,618,509 | 162,714,261 |
| Upper-Karoo | NC | 10,359,907 | 4,096,068 | 11,482,165 | 15,578,233 | 15,578,233 | 25,938,140 |
| Uthukela | KZN | 41,612,406 | 4,899,113 | 29,681,647 | 34,580,760 | 34,580,760 | 76,193,166 |
| Uthungulu | KZN | 241,701,855 | 11,257,163 | 46,333,682 | 57,590,846 | 57,590,846 | 299,292,700 |
| West Coast | WC | 429,997 | 2,117,227 | 1,857,528 | 3,974,756 | 3,974,756 | 4,404,752 |
| Western Gauteng | GP | 770,639 | 6,698,451 | 14,230,791 | 20,929,242 | 20,929,242 | 21,699,881 |
| Wild Coast | EC | 309,400,898 | 18,178,377 | 80,904,616 | 99,082,994 | 99,082,994 | 408,483,892 |
| Winelands | WC | 5,619,469 | 1,747,961 | 9,879,636 | 11,627,597 | 11,627,597 | 17,247,066 |
| Zululand | KZN | 73,012,764 | 7,636,193 | 55,743,974 | 63,380,167 | 63,380,167 | 136,392,931 |
| Total | | 4,000,000,000 | 402,862,197 | 0 | | 1,672,707,884 | 5,672,707,884 |

[Source: Donian, 1998]

Appendix D - Budget Review 1999 Projections for Local Government

These project medium-term trends in local government budgets. Improvement in local government finances is assumed to result from financial management reform, with a surplus projected for 2001/02.

Local government revenue and expenditure

| R million | Estimated | | | Projected | | | |
|-----------------------------|-----------|---------|---------|-----------|---------|---------|---------|
| | 1995/96 | 1996/97 | 1997/98 | 1998/99 | 1999/00 | 2000/01 | 2001/02 |
| Tax Revenue | 6 701 | 7 508 | 8 264 | 9 142 | 9 707 | 11 054 | 11 924 |
| Non-tax revenue | 9 385 | 10 136 | 9 394 | 9 954 | 10 891 | 12 092 | 12 961 |
| Capital revenue | 625 | 384 | 434 | 450 | 499 | 539 | 583 |
| Total grants | 4 089 | 6 067 | 6 350 | 5 324 | 6 077 | 6 377 | 6 931 |
| of which equitable share | | | | 1 024 | 1 673 | 2 480 | 2 580 |
| Revenue | 20 800 | 24 095 | 24 442 | 24 870 | 27 174 | 29 062 | 32 399 |
| Current | | | | | | | |
| Goods and services | 14 124 | 17 502 | 17 563 | 16 885 | 17 982 | 18 763 | 20 538 |
| Interest | 1 704 | 1 030 | 1 245 | 1 382 | 1 477 | 1 598 | 1 728 |
| Subsidies and transfers | 314 | 636 | 506 | 440 | 400 | 400 | 450 |
| Capital | | | | | | | |
| Acquisition of fixed assets | 4 105 | 4 547 | 4 742 | 5 197 | 5 934 | 6 467 | 7 043 |
| Capital transfers | 492 | 498 | 454 | 778 | 900 | 1 000 | 1 150 |
| Net lending | 590 | 649 | 714 | 694 | 795 | 860 | 930 |
| Expenditure | 21 329 | 24 862 | 25 233 | 25 376 | 27 488 | 29 088 | 31 839 |
| Deficit (-)/Surplus (+) | -529 | -767 | -791 | -506 | -314 | -26 | 560 |

[Source: SA Reserve Bank, projections by Department of Finance]