

Central–Local Financial Relations in South Africa

ROBERT CAMERON

The Republic of South Africa Constitution of 1996 vested local government with substantial powers. It uplifted local government from a subordinate level of government to a significant sphere within its own right with constitutionally entrenched functions, powers and finance. In a general overview of the South African local government reforms, it was suggested that the results of this decentralisation experiment are at best mixed, with increasing centralisation measures being undertaken by the national government (Cameron, 2001).

This article focuses specifically on local government finance, which is undoubtedly the weak link in the new local government system. Prior to 1994, most local governments were elected by and served a small – predominantly white – base. There has been the transition to municipalities with many poor residents without any concomitant increase in the tax base.

The first part of the article looks at a framework for decentralisation. It traces the evolution of local government finance in South Africa from the days of segregation and apartheid up to the current democratic era. The article examines the current local government finance system, with a focus on two different views in this regard. The one argument is that local government is inherently inefficient and poor financial management is the primary reason for financial problems. The other view is that the tax base of local government is too small for it to fulfil its constitutional service provision and development functions. An analysis is then undertaken of two recent local government financing controversies, namely, the local government boundary demarcation process and the Department of Finance-driven constitutional amendment.

A FRAMEWORK FOR DECENTRALISATION

There is little conformity amongst various authors on the meaning of the term 'decentralisation'. One of the most commonly accepted distinctions is

Robert Cameron, University of Cape Town

to regard decentralisation as a blanket term encompassing a number of sub-categories: devolution (or democratic decentralisation), deconcentration and delegation.

Devolution (democratic decentralisation) is the most extensive form of decentralisation. It is the 'conferment of rule-making and executive powers of a specified or residual nature on formally constituted sub-national units' (Vosloo *et al.*, 1974: 10). Manor's definition (1999: 6) is slightly different in that he argues that decentralisation powers can be conferred on bodies that are democratic in some way and to some degree.

Devolution/democratic decentralisation generally has the following characteristics (adapted from Mawhood, 1993: 9–10).

- Local government should be separate constitutionally from central government. It should be responsible for a significant range of services.
- Local authorities should have their own treasury, a separate budget and accounts, and their own taxes to produce a significant part of their revenue.
- Local authorities should have the right to allocate substantial resources, including the power to decide over expenditure, and vary revenue and to appoint and promote staff.
- Policy should be decided by local councils, consisting predominantly of elected representatives.
- Central government administrators should play an indirect, advisory and inspection role only.

Deconcentration is usually the least extensive form of decentralisation. It often involves the transfer of workload from the central government head offices to regional branches. It may involve limited discretion for field staff to perform functions within the constraints of central government policy. Effective control over major policy decisions resides at central level (Rondinelli, 1981: 137).

Delegation entails the transfer of broad authority to plan and implement decisions concerning specific activities to organisations such as local government which are technically and administratively capable of exercising them (Rondinelli, 1981: 138). Although delegated power is usually controlled by the attachment of conditions by the delegating body, this form of delegation can lead to the exercise of a certain amount of judgement and discretion on the part of the local authorities.

A comprehensive discussion of all the features of devolution is beyond the scope of this article, which is a specific examination of central–local financial relations. However, it will focus on some of the criteria for devolution, most notably the right of local government to make policy and to allocate financial resources.

The right of local representatives to make local policy is the bedrock of local democracy. Councillors are elected by local citizens and should ultimately be accountable to local voters. In practice, there is a whole range of mechanisms through which the higher tier exercises control over local authorities. This includes policy only coming into effect after approval by the higher authority and the right of the higher-tier authority to reject or modify policy.

In democratic decentralisation central government should play an indirect, advisory, supportive and monitoring role in respect of local government. It should not attempt to substitute local decisions with national priorities, even where it disagrees with local policy, except in cases where local policy is in conflict with national legislation. Decentralisation is, however, meaningless unless local governments have sufficient financial resources to exercise their functions. As Manor (1999: 7) points out, democratic decentralisation will flounder if there are not concomitant financial resources.

As a general rule, it can be suggested that the most autonomous of local revenue is when local government has a substantial tax base and has wide discretion to vary the rate of the tax collected. Grants from central government are less conducive to local autonomy because local government is dependent on another body for its revenue and is accordingly unable to vary the rate allocated. Grants can be divided into specific and general grants. General grants are more conducive to local autonomy in that while local authorities cannot determine the amount of revenue raised, they can determine how it is spent. Specific grants, on the other hand, mean that central government money is earmarked for specific programmes and local governments have little say in how the money is spent (Mawhood, 1993: 14).

A problem with grants generally, even where there are formulae calculating the degree of subsidisation to local government, is that central government often reduces the anticipated amount for a particular financial year arbitrarily. This makes balancing expenditure and income very difficult for local authorities.

The conventional view of the relationship between central government grants and local government autonomy is that the greater the degree of central government subsidisation of local authorities, the greater the degree of control (Davey, 1971: 45; Byrne, 1996: 202; Wilson and Game, 1998: 171-5). However, matters are sometimes more complex than this simple equation suggests. Smith (1979: 22) proposes that there is no consistent relationship between central control and financial independence. For example, in a centralised local government system in France (until the reforms of the 1980s), the current revenue of communes and departments in 1948 was subsidised only to the extent of 12 per cent and 34 per cent, respectively, by the central state. In Japan, local authorities raised 69 per

cent of their revenue from direct taxation yet were controlled tightly by central government (Davey, 1971: 48). Conversely, grants from central government do not necessarily mean central control (Manor, 1999: 70–71).

THE HISTORY OF LOCAL GOVERNMENT IN SOUTH AFRICA

Segregation and Apartheid

South Africa became a unitary system in terms of the South African Act of 1909, which created a three-tier unitary system of government, namely central, provincial and local government. Local authorities were created by provincial authorities, which defined the scope of their local jurisdiction.

The South African local government system approximated to the British model in terms of structure. However, unlike the British system, South African local government did not provide large-scale social services such as education and social welfare. Trading services such as electricity and water were major local government functions. The major sources of revenue for local authorities were rates on fixed property and income derived from trading services such as electricity, water and gas supply services. The principle of financial self-sufficiency applied to local government with grants only providing around four per cent of total expenditure (Solomon, 1983).

Until the 1980s, with the exception of limited coloured and Asian representation in the Cape Province, only whites could vote for and stand for election at local government level. With the partial exception of the Cape Province, there was no formal rural local government in the system, even for whites.¹

White local authorities (WLAs)² were required to establish separate locations for black areas and to establish advisory bodies for such nominated areas. They were also required to establish local government advisory boards, called black advisory boards³ (Welsh, 1982: 101–3). The principle of financial self-sufficiency also applied to black townships. WLAs were required to keep a special account, called the Native Revenue Account, for black townships under their control. The major sources of revenue for this account were sorghum beer production and retailing, liquor sales in the townships, levies on white employers of black labour in certain areas and the payment by township residents to local authorities for various services rendered, mainly rentals and fees (Bekker and Humphries, 1985: 119).

The amount of finance these sources of revenues raised was minimal. A fundamental problem was the 'dormitory town' status of black urban areas. Because of a lack of freehold (blacks were not allowed to own land in 'white' South Africa), there could consequently be no tax on property. Furthermore, most of the rented housing was low income, owing to the

large-scale poverty among black people. There were also minimal rate-generating industrial and commercial activities in black areas. These were overwhelmingly located in WLAs. The situation was exacerbated by the fact that the government regulated the ability of black business to trade in black areas. The government's policy was that black entrepreneurs with sufficient capital to establish large businesses should move to the homelands⁴ (Welsh, 1971: 195).

In 1971, central government legislation divested WLAs of their responsibility for urban black areas. Control of this function was vested in central government appendages called Administration Boards. This was a political attempt to bring urban blacks under closer central government control (Bekker and Humphries, 1985: 119).

These limited financial sources of revenue managed to sustain urban black townships when they were kept in a deliberate state of underdevelopment. After the 1976 riots in urban black townships, when the government decided to improve facilities and services in these areas, these sources of revenue proved to be hopelessly inadequate.

In addition to centralisation for political reasons, there were also specific financial controls over WLAs. For example, the provincial administrators placed limits on the rates which local authorities were allowed to levy. Furthermore, local authorities were not allowed to budget for deficits on the operating account and, if the budget showed a deficit, the administrator had the power to force the local authority to levy an extraordinary rate. Local authorities could not exceed the estimated expenditure without the approval of the administrator. All capital expenditure over a certain amount had to be approved by the Department of Finance. The administrator also had control over local authorities' ability to borrow money. Money could only be borrowed for prescribed purposes and there were ceilings on the amount that could be borrowed. These financial controls can be partly ascribed to the centralist imperatives of the unitary South African state. There was the viewpoint that local government was inherently inefficient, which was expressed forcefully by the Browne Committee (Republic of South Africa, 1980: 24, 27, 35; Cameron, 1995).

The 1980s – Limited Reform

In the 1980s, the National Party (NP) government retreated from strict apartheid and introduced constitutional changes at all levels of government. Limited power sharing was introduced for Coloureds and Asians at national level. To compensate partially for their exclusion from this tricameral arrangement, urban blacks were given Black Local Authorities (BLAs) with extensive powers. However, no extra sources of revenue were provided for the financing of those new structures. The government was not prepared to

depart from its principle that local governments should primarily be self-financing. As pointed out, the sources of revenue for black townships were inadequate. The introduction of BLAs with more extensive functions involved increases in expenditure. The state was not prepared to offset the subsidisation. Thus, to finance township services BLA councils were forced to increase rent and service charges significantly. Protests against rent increases mounted and this escalated into violence in many areas, often in the form of physical attacks on black councillors. This led to the resignation of many councillors and the collapse of many BLAs. There was also a boycott of rent and service charges because of the increases. The central government, through the various provincial administrations, had to introduce bridging finance to meet the shortfall of BLAs. Non-payment was partly because most people could not afford the rent and service charges. It was also used as a political protest against apartheid structures (Swilling, 1987: 13–16; Seekings, 1998: 202–5, 211–16).

The crisis of local government finance continued unabated into the 1990s. Political opposition and capacity frailties weakened BLAs fundamentally, while rent and service arrears mounted. By 1992, BLAs had run up deficits of R1,586 billion. Some were on the point of collapse owing to their inability to provide services. Furthermore, of the 264 BLAs countrywide, 125 were inoperative (South African Institute of Race Relations, 1991/92: 469–70).

During the 1991/92 financial year, bridging finance and intergovernmental grants paid by BLAs amounted to R903,7 million (Technical Committee, 1994: 20). Grants from central government accounted for over 60 per cent of the revenue of BLAs across the country. These grants were classified initially as bridging loans and were intended to finance capital expenditure in black communities. Central government, however, converted the flows to explicit grants for the financing of current expenditure (World Bank, 1994: 7)

There was a major structural reason underpinning this lack of finance. Citizens from black areas contributed heavily to the growth of commercial and industrial areas in many WLAs in their capacity as workers and consumers, yet they did not receive concomitant financial benefits. For example, Planact (1989) estimates that in 1987 Sowetans spent about R1 billion in Johannesburg's central business district. However, because Soweto was a BLA and segregated from the Johannesburg WLA, Sowetans did not benefit from the economic tax base of Johannesburg.

Regional Services Councils

Regional Services Councils (RSCs) were one of the flagship reforms the government introduced in the mid-1980s. RSCs were quasi-metropolitan structures consisting of indirectly elected representatives of racially based local authorities. Their major function was to redistribute resources from the

well-off white areas to poorer black townships in cities and towns. RSCs were introduced by the state as an attempt to defuse township unrest (which was at a high level in the mid-1980s) by uplifting the quality of life in such underdeveloped areas. Two new taxes on businesses were provided for this purpose – an establishment levy on turnover and a service levy on wages and levies.

While RSCs generally facilitated the redistribution of resources to historically disadvantaged areas, they failed to establish financial viability in BLAs. Although RSCs were supposed to be for capital expenditure only, many RSCs spent their money on BLAs' operating expenditure. For example, in 1991, the Central Witwatersrand Regional Services Council (CWRSC), the biggest RSC in the country, spent more than half of its income on subsidising BLAs' operating expenditure (Humphries, 1991; Cameron, 1993).

A major problem with RSCs was that they failed to transcend the parameters of the apartheid city. RSCs could not deal with the structural weakness of racially divided cities, with BLAs being deprived of the benefits of industrial and commercial property rates.

An analysis of the local government reforms in the 1980s concludes that delegation and deconcentration were the most prominent forms of decentralisation and there were only limited manifestations of devolution present (Cameron, 1995). There was increased centralisation of local government financial powers by the Department of Finance. This included macro-economic controls over local authorities' permissible expenditure. In the 1980s, the Treasury supplanted the provinces as the regulators of local government finance. This was not only at the expense of local government powers, but also to the detriment of provincial administrations, which had historically supervised local government finance. The viewpoint of the Department of Finance was that local government expenditure, if left unchecked, can lead to excessive inflation and may break the back of the South African economy. Part of the motivation for this stance was that local government is inefficient (Cameron, 1995).

The Local Government Transformation Process

South Africa's constitution-makers in the 1992/93 negotiations decided to divide the local government democratisation process into three phases. The pre-interim phase (1994–96) was basically a holding phase until the first local government elections and did not really change the system. The interim phase (1995/96–2000) introduced a quasi-federal system in the country. The new local government system was characterised by a number of power-sharing consociational measures. It also entailed the rationalisation of local government structures to 843, the amalgamation of

many (but not all) black areas with surrounding white cities and towns, the creation of metropolitan government in the larger cities and the introduction of democratic two-tier local government in some (although not all) rural areas in the country.⁵ The hierarchical three-tier system of local government remained. However, local government was, subject to limitations, given the constitutional right to levy property rates, fees, taxes and tariffs (Cloete, 1995; Cameron, 1996).

However, on the ground, local government finance was deteriorating. At the end of 1993, rent and services charges owed by BLA residents amounted to R1.8 billion. A report, *State of Local Government Finance*, was drawn up by a technical committee set up by the government in 1994. It stated that BLAs had all but collapsed. Some BLAs were operating on monthly cash budgets, unable to plan and barely surviving. It warned that if the instability of local governments in the townships spread to white areas, it could lead to deterioration in basic services in such areas with devastating consequences (Technical Committee, 1994).

The Final Constitution

The final constitution was certified in December 1996, and, with the exception of power-sharing mechanisms negotiated for the interim phase, came into effect in February 1997 (Republic of South Africa, 1996). It became fully effective after the 2000 local government elections.

The constitution is the supreme law of the republic and any law inconsistent with it is invalid. A highly advanced Bill of Rights forms the cornerstone of the constitution. Provision is made for a three-sphere government, namely, national, provincial and local spheres, which are distinctive, interdependent and interrelated (Section 40).

The principle of co-operative governance underpins intergovernmental relations. Section 41 states, *inter alia*, that all spheres of government must:

- respect the constitutional status, institutions, powers and functions of government in these spheres;
- not assume any power or function except those conferred on them in terms of the constitution;
- exercise their powers and perform their functions in a manner that does not encroach on the geographical, functional or institutional integrity of government in another sphere;
- co-operate with one another in mutual trust and good faith; and
- avoid legal proceedings against one another.

Theoretically, this has uplifted local government from a subordinate level of government to a significant sphere in its own right. Local government was also given important new development functions, including the

promotion of social and economic development and meeting the basic needs of the community.

The Constitution made provision for three different categories of local government. Category A municipalities are the metropolitan single-tier authorities, while category B and C municipalities are the lower- and upper-tier models, respectively, of the non-metropolitan local government system.

The functions of local government are entrenched in the constitution. The most important services include the provision of water, sanitation (and sewage disposal systems), roads, storm water drainage, refuse removal (including solid waste removal) and electricity reticulation. In practice, different types of local governments have different responsibilities. In larger urban areas, municipalities are often responsible for a range of functions and services, while rural local governments generally provide fewer services. Prior to the 2000 amalgamations, rural councils had little or no fiscal capacity, and a limited economic and tax base. The district council usually performed all the fiscal functions assigned to its rural municipalities (National Treasury, 2000a: 100). This weakness of rural local government can also be ascribed partly to the fact that there was no tradition of rural local government in South Africa, even amongst whites.

Local Government Finance

The final constitution gave local government the right to impose rates on property and surcharges on fees for services provided. Although other sources may be assigned in national legislation, local government may not impose income tax, value-added tax, general sales tax or custom duties (National Treasury, 2000a: 100). The constitution also gave local government the right to a division of the equitable share of revenue raised nationally to enable it to provide services and perform the constitutional functions allocated to it. However, there is no obligation on the national government to compensate provinces or municipalities that do not raise revenue commensurate with their fiscal capacity and tax base. Allocations to local government are considerably smaller than allocations to provinces, because municipalities have considerable own sources of revenue and provinces do not.

Municipal own revenue is obtained through property taxes, regional levies, and service charges and fees. Own revenue covers more than 90 per cent of the operating income of local government as a whole. Total central transfers to local government in 2000/2001 amounted to R6.7 billion. R1.867 billion of this was in its portion of the equitable share, and the rest was in the form of conditional and unconditional grants. The largest conditional grant is the consolidated Municipal Infrastructure Programme, which is for major infrastructure. Grants (including the equitable share) from national government comprised about seven per cent of the projected

R58 billion local government budgets in the 1999–2000 municipal financial year (National Treasury, 2000: 164–165).

Municipalities can also raise loans for capital and operating expenditure (for bridging purposes only) in accordance with reasonable conditions determined by national legislation (Section 230(1)). This provision is intended to enhance local government access to the capital market.

These financial sections must also be seen in the context of socio-economic rights enshrined in the Bill of Rights, which give citizens the right to access to services such as housing, health care, food, water and social security. They are intended to promote local government's capacity to provide such services. However, as pointed out later, these rights have not led to significant increases in local government revenue.

THE SOUTH AFRICAN LOCAL GOVERNMENT FINANCE DEBATE

After the 1994 elections, the African National Congress (ANC)-led Government of National Unity (GNU) adopted the Reconstruction and Development Programme (RDP). It was a Marshall plan-type approach to development and was the prevailing development model from 1994 to 1996. Since 1996, the GEAR (Growth, Employment and Redistribution) strategy has been the macro-economic framework of the ANC government. It is a neo-liberal approach with a strong emphasis on financial and fiscal austerity. Cutting government expenditure in order to reduce the budget deficit is a major aim of GEAR. Left-wing critics accuse the government of abandoning the more state interventionist RDP, but the government's official position is that GEAR is a continuation of the RDP (Le Roux, 1997).

One of the consequences of the GEAR policy has been the view that local government should remain largely self-sufficient. GEAR involves the cutting of government expenditure in order to reduce the budget deficit, which came down from over five per cent in 1995/96 to two per cent in 1999/2000 (National Treasury 2000c: 34).

There are two broad views on how to finance local government in South Africa. The one viewpoint is that local government should primarily be self-financing and the other position is that local government requires substantial extra sources to fulfil its constitutional mandate. The former view is that local government generally has sufficient resources at its disposal to undertake its constitutional responsibilities and any future functions that may be delegated from national and provincial government. However, the inherent inefficiency of local authorities, in particular in the field of financial management, is a major impediment to their proper functioning. There needs to be stronger financial control and guidance over local authorities. This latter view is that local government decentralisation

is only meaningful if there are sufficient financial resources for local authorities to undertake their functions. Many local governments do not have sufficient resources and should get a substantially increased portion of the equitable share (which is an unconditional grant). This will enhance decentralisation.

The Department of Finance⁶ is the major exponent of the viewpoint that local government should remain largely self-financing. The White Paper on Local Government (Provincial Affairs and Constitutional Development, 1998) confirmed that own revenue is the primary source of income for municipalities. The Department of Finance reiterated that government is committed to this position. The motivation given by the department was that in many other countries municipalities are responsible for major social services such as health, education, welfare and security. In South Africa, most of these functions are the responsibility of national or provincial government, and thus there is less need for extensive transfers to municipalities. In addition, for municipalities to obtain more support from the national fiscus, other national budgetary priorities and allocations would have to be scaled down (National Treasury, 2000a: 102).

The Department of Finance's view is that many of the financial problems of local authorities are owing to their inefficiency. Throwing more money at local government will not necessarily solve their financial problems. The department's view is that the problems of local government finance are primarily managerial rather than systemic (SALGA, 1998:4). The Deputy Director-General in the Department of Finance called local government budgetary systems 'archaic and based on unrealistic planning and inefficient revenue collection' (*Cape Times*, 19 March 2000). The department focuses on capacity building with a view to improving financial and managerial systems and capacity (SALGA, 1998: 4).

As pointed out, this perception that South African local government is inefficient is not new: it resonates through South Africa's history (see the Borkenhagen Commission, Republic of South Africa, 1960, and the Browne Committee, Republic of South Africa, 1980). The department's view is that the lack of finance is sometimes overplayed. Often the problem is that municipalities cannot manage funds or utilise them properly. Many municipalities do not have the capacity to perform their functions, including basic treasury functions such as billing ratepayers and keeping a proper credit control system. A study found that the lack of financial management skills is the biggest capacity problem facing municipalities (Municipal Demarcation Board, 2000a).

According to the Department of Finance, municipal financial management is weak and apparently deteriorating amid increased demands for services and development. Project Viability was a government initiative

TABLE 1
 PERCENTAGE OF HOUSEHOLDS WITHOUT SERVICES AS A PERCENTAGE OF
 OVERALL HOUSEHOLDS

Backlog	Percentage of households without services as a percentage of overall households	
	Urban areas	Rural areas
Water services	10.0	39.2
Sanitation services	25.8	75.8
Refuse removal services	18.3	53.3
Development of acceptable roads	16.0	42.7

consisting of a combination of strategic and operational measures aimed at restoring the financial health of municipalities. It included measures to improve municipalities' financial management and accounting and to improve credit control. While there has been some improvement in better financial management, local authority debt has increased owing to the unaffordability of rent and service charges for poorer residents, the culture of non-payment and inadequate revenue collection systems (National Treasury, 2000c: 101, 103). Capital expenditure has actually fallen as a result of deficits and liquidity problems in many municipalities (National Treasury, 2000b: 88). This is a reflection of the department's position that municipalities should first put their house in order before coming to the Treasury for more money.

The Auditor-General in his March 2000 year-end report to parliament's public accounts committee said that the financial position of many municipalities had worsened further (*Business Day*, 20 June 2001).

Those who reject the viewpoint that local government should primarily be self-financing would argue that central government is not providing local government, faced with apartheid development backlogs, with sufficient revenue sources to execute its constitutional functions. Decentralisation, in the case of many poor municipalities, would be pseudo-decentralisation because of the lack of finance. According to the Municipal Infrastructure Investment Framework, there were service backlogs in 2000 as represented in Table 1 (Mufamadi, 2000):

There have been constant complaints from the South African Local Government Association (SALGA), the voice of organised local government, that national government has delegated some functions to local government without supplying commensurate finance. They accuse the centre of 'unfunded' mandates, which is the delegation of functions to local authorities without the commensurate finance needed to perform them, or 'underfunded' mandates, which is the delegation of functions to local authorities with insufficient finance. The opposition, the Democratic

Alliance (DA), estimates that the cost of unfunded mandates in Johannesburg alone is between R50 and R150 million (Democratic Alliance, 2000: 10–11). There are, however, no reliable state figures for unfunded mandates. SALGA argues that policies, norms and standards are often set at national level without prior consultation with regard to their budgetary implications. There often is not the funding for provinces to exercise their constitutional responsibility to monitor and support local government (Matjila, 1999). SALGA also argues that the formula for the allocation of the equitable share is flawed, as it does not take into account development aspects of local government.

SALGA has raised concerns that the 'equitable share' determined by the Department of Finance does not clearly outline the process through which the total amount that is assigned to local government is determined. It raised the point that local government's 'equitable share' in the constitution should be determined in relation to its ability to 'provide basic services and perform the functions allocated to it'. It is not clear to SALGA whether the department undertook sufficient research to enable it to ascertain whether the equitable share is determined in relation to local government's ability to provide services. In fact, SALGA suggests that the determination of local governments' 'equitable share' is simply a more rational way of distributing funds which have historically gone to local government (SALGA, 1998: 2–3).

SALGA's view is that while there is clearly room for improvement in financial management, there also may be more systemic problems in the local government finance system. They are concerned that the department's assumptions about financial management capacity overshadow other issues which are equally relevant to building viable local government (SALGA, 1998: 4–5). This view is also shared by the South African Municipal Workers Union (SAMWU), which argues that the assumption that local government is self-supporting and therefore gets a small portion of the equitable share is misleading. There are many municipalities without any tax base at all (*Business Day*, 25 Feb. 2000). In the metropolitan areas, the average municipal expenditure per person per annum (2000/2001) was R2,525, while in weaker B municipalities with disproportionately rural African poor, the equivalent amount was R82 per person (Municipal Demarcation Board, 2002). The Financial and Fiscal Commission (a constitutionally established advisory body on intergovernmental fiscal relations) agrees that the current equitable share does not adequately address the obligations of local government to provide constitutionally mandated services. It has recommended an alternative framework for local government finances (Financial and Fiscal Commission, 2001). If government accepted such a financing framework, it would lead to a

substantial increase in the equitable grant to local government. Indications are that the Treasury will not accept the new framework.

It is argued that the infrastructural backlog owing to apartheid spatial planning is too great to be left primarily to local government to sort out. In 1998, the government's Investment Review Team estimated the cost of total infrastructure service backlog to be R47–53 billion (Financial and Fiscal Commission, 2001: 58), an amount which is almost as much as total local government budgetary expenditure of R58 billion in 1999/2000.

It could also be argued that non-payment for services is much more an issue of an ability to pay than it was 5–10 years ago when there were political campaigns against payment. A study has found that poverty is the main cause of non-payment and services (Sutcliffe and Allen, 2001).

There are also concerns that new water and electricity legislation will lead to local government losing these functions, along with sources of revenue, to envisaged statutory single-purpose bodies for electricity and water.

THE DEMARCATION DISPUTE: 1999–2000

This tension around local government finance manifested itself in a major conflict around the demarcation of local government boundaries in 1999/2000. An independent Demarcation Board with final decision-making powers rationalised municipalities from 843 to 284. As the basis of its demarcation, the Board primarily used functional interdependence of communities and minimum sizes to achieve economies of scale. The aim was to create bigger municipalities with larger tax bases that would be able to promote services and development in a sustainable manner. In order to achieve this aim, urban and rural local authorities were combined into single municipalities (Municipal Demarcation Board, 1999a; Cameron, 2000).

The board primarily used the socio-geographic approach to demarcation, which attempts to create coterminous political and economic boundaries. At a theoretical level, this is based on, firstly, the principle of 'fiscal equivalence', namely that the consumers of services should be the same people who pay for them (Sharpe, 1988: 104–5; Paddison, 1983: 22). The board tried to create municipalities with significant internal functional linkages, as is evident in shopping and work travel patterns, patterns of social interaction, economic interdependencies and shared transportation networks. Secondly, it is based on the view that consolidation into larger units will lead to jurisdictions having richer and poorer areas, which could facilitate a more equitable distribution of services and taxes (see Cameron, 1999).

Apartheid planning had reallocated black communities to areas outside cities and towns, often at considerable distance from their work place. The

board believed that the preservation of islands of privilege abutted by under-serviced areas would be inequitable and not contribute towards a rational settlement landscape (Municipal Demarcation Board, 1999b).

The board's preliminary proposals were virulently opposed by the Department of Finance. A memorandum by the Director-General of Finance to the board argued that the board's proposed boundaries would weaken the fiscal position of non-metropolitan cities and towns structurally and as a consequence constrain rather than enhance their ability to raise capital and develop infrastructure (water, power, and so on) which is their key responsibility. Already prior to demarcation, the long-term debt market had largely dried up (Department of Finance, 2000: 106). The concern was that the resultant diminished creditworthiness would mean that the only source of capital available to some municipalities would be government transfers.

The department made an analysis of three existing towns in which it was shown that non-metropolitan towns (B municipalities) generally would face a marked structural decline in their fiscal position as a result of the inclusion of considerably more black areas into their jurisdictions (which in some cases were seriously disadvantaged). It found that in the case of Welkom the inclusion of additional territory with large amounts of poor rural households would lead to a 25 per cent decline in total income per capita, a 23 per cent decline in rates and general income per capita and a 34 per cent decline in trading service income per capita, and as a corollary a 29 per cent rise in dependence on equitable share grant allocations. A similar scenario in East London would lead to a 36 per cent decline in total income per capita, a 35 per cent decline in rates and general income per capita, a 37 per cent decline in trading service income per capita and a consequential rise in dependence on equitable share allocations. The board was asked to revisit its demarcation of non-metropolitan towns and cities (Department of Finance, 2000).

The board responded by disputing the methodology used by the department. It argued that the Department of Finance's report gave no indication of what powers and functions were being analysed against available income; ignored the fact that the smaller the boundaries the greater would be the spatial inequalities and the greater the correlation to the old apartheid order; and incorrectly presumed that boundary demarcation would affect financial viability and creditworthiness. The board accused the department of boundary determinism because of the latter's inference that boundaries are the prime determinant of creditworthiness and financial viability. The board did not change its boundary proposals, which were used for the December 2000 local government elections (unlike many other countries, the board's recommendations are binding) (Municipal Demarcation Board, 2000b).

The board also responded to the department by emphasising that it had never stated that all its municipalities would be financially viable. Its own research showed that 102 new municipalities – mostly B categories in the former independent and self-governing territories – are weak and have limited financial resources. Given spatial inequalities arising from apartheid underdevelopment, making all municipalities viable was always going to be a near impossible task. This was exacerbated by lack of finality on national financial policy for local government. The board made a number of recommendations for extra sources of revenue, including a surcharge on personal income tax and a substantial increase in the equitable share (Municipal Demarcation Board, 2000b). This was not accepted by national government.

THE CONSTITUTIONAL AMENDMENT

In late 2000, a Department of Finance-driven constitutional amendment led to a major clash between central and local government. This amendment would have allowed direct intervention by national government in local governments that fail to manage their finances properly (Republic of South Africa, 2001a).

As mentioned, the constitution had given municipalities the right to raise loans for both capital and current expenditure. The Department of Finance accordingly published a policy framework for Municipal Borrowing and Financial Emergencies. The problem was, however, that the municipal debt market had stagnated due to the perception that local government was a bad risk. In particular, the long-term debt market, which was especially critical for providing financial resources for municipalities in investment in infrastructure, had largely dried up.

The Department of Finance argued that big municipalities should be borrowing at least R5 billion per annum and this in turn could reduce the grants that the central fiscus was providing to local government. The banks would not lend cheaply if they perceived the risks of non-payment. One default or delay in payment created the view that all municipalities are risky (Department of Finance, 2001).

The problem for the Department of Finance was that the authority to make decisions, including for financial allocations, was an exclusive local government responsibility. If local government decided not to pay a creditor, there was little the department could do about it.

The department introduced draft legislation to deal with debt issues in the form of the Municipal Finance Management Bill (RSA, 2001b). What was particularly controversial was Section 11 of the Bill, which made provision for a declaration of a Municipal Financial Emergency Authority. The Emergency Authority had to oversee the administration of

municipalities which were declared a financial emergency with a view to normalising their financial affairs.

An application could be made to a court for the declaration of a financial emergency if one or more of the following conditions existed:

- The municipality had defaulted on the payment of the amount due.
- The municipality had defaulted on an agreement providing security for any debt of the municipality.
- The municipality's current expenditure had exceeded actual current revenue for at least the three preceding financial years.
- The municipality had an operating deficit in excess of a prescribed percentage of actual operating revenues in terms of the latest financial statements.

If the court declares that a municipality is in a financial emergency it must order the Emergency Authority to appoint an administrator. The administrator would be given any of the municipality's executive or legislature power that it required to restore the municipality to a sound financial and fiscal position. This would include temporary powers to increase taxes or charges or to cut expenditure. This provision could also be used where a local government had failed to pass its budget (which was not an uncommon occurrence!).

The Department of Finance's problem was that there was a good chance that the bill was unconstitutional in that these provisions provided for the exercise of not only executive but also legislative authority on behalf of the municipality. It accordingly attempted to drive through the constitutional amendment.

There was unprecedented opposition from organised local government and provinces to this constitutional amendment bill during the parliamentary hearings. It was argued that the bill would diminish fundamentally the powers of local government (University of Western Cape, 2001), would reduce the status of local government from being a district sphere of governance to being a stepchild of national treasury (Municipal Demarcation Board, 2001), would encroach onto the sovereignty of local government (SALGA, 2001) and would lead to a municipality's status as a repository of legislature authority being eroded by the hierarchical approach adopted in the proposed amendments (WECLOGO), 2001).

The Department of Finance eventually withdrew this amendment, not on substantial grounds but on procedural grounds, namely that there had not been sufficient consultation with stakeholders. While the first step to centralise local government finance failed, this must be seen as a tactical retreat. Indeed, the Department of Finance presented the Municipal Finance Management Bill to Parliament in 2002 with Section 11 virtually

unchanged. It is amended as an annexure with the proviso saying that 'its section will be inserted upon the approval of the constitutional amendments' (Republic of South Africa, 2002). Although the department justified its motivation at the 2001 public hearings in terms of the need for a borrowing policy, in reality many of the interventionist provisions relate to the inability of local governments to pass budgets. Arguably, the department did not use the latter reason in its line of argument during the hearings because it would have inflamed local government even more. It could be suggested that the amendment was motivated as much as by concerns about local government's inability to pass budgets as it was by the borrowing policy. As pointed out in the framework, the ability of a local government to pass its budget goes to the core of local government sovereignty. Attempts to diminish such autonomy signals a retreat from democratic decentralisation.

The Municipal Finance Management Bill, 2002 is aimed at making local government financial management more effective and efficient. It is intended to modernise the budgeting, financial reporting and financial management systems of local government as well as to provide a framework for municipal borrowing. Besides the criticism of Section 11 there are concerns that the bill as a whole authorises the National Treasury to prescribe to municipalities through regulation, guidelines and instructions. This would include the powers to prescribe uniform treasury norms and standards and to review any system of financial management and internal control in any municipality, to withhold funds to municipalities that breach the provisions of the bill, to intervene in the bank affairs of a municipality in a detailed fashion and the powers to force municipalities to appoint certain financial officers. One of the criticisms of the bill is that it is primarily about the regulation of local government, with very little emphasis on building the capacity of this sphere of government. It is argued that the provisions would weaken the powers of elected local governments (Municipal Demarcation Board, 2002).

AN EVALUATION OF THE INTERGOVERNMENTAL FINANCIAL SYSTEM

This article has traced the evolution of local government in South Africa from a subordinate tier of government to an independent sphere within its own right. Theoretically, the constitutional entrenchment of local government functions and powers has led to local government becoming more autonomous. It is able to exercise considerable discretion in how it allocates its budget from its own sources and the equitable share, with the conditional share only forming a small portion of its revenue.

However, many municipalities, in particular poorer rural municipalities, do not have sufficient finance to exercise their constitutional functions. The rationalisation of local government boundaries will not solve this fundamental problem of lack of finance in such municipalities, given that in some cases consolidation of poorer authorities has led to a magnification of poverty. Such poorer, larger rural local governments have very little own sources of revenue and rely primarily on the equitable share and intergovernmental grants. While it is true that the equitable share is weighted in the favour of rural municipalities, the amounts received are still not sufficient to install the major infrastructure needed for the delivery of services as indicated in the backlogs and spending pattern described in this article. Such municipalities tend to spend a disproportionate amount of their income on operating expenditure, most notably on staff salaries and councillors' allowances. For such local governments, democratic decentralisation without financial resources is illusory.

The second issue is the issue of the Department of Finance exercising greater financial control over all local authorities, both better-off metropolitan and urban poor municipalities. Poor financial management is not only a problem of poorly capacitated rural municipalities. Indeed, the Greater Johannesburg Metropolitan Authority, the best resourced municipality in South Africa was rescued from bankruptcy by the Department of Finance in 1997. Prolific spending, poor management and inadequate financial controls had contributed to this crisis (Cameron, 1999).

The Department of Finance's historically centralised view towards local government is based on the belief that it (local government) is inefficient. The department has persisted in this view despite the greater constitutional status of local government. The proposed constitutional and legislative amendments will lead to greater control over local government's finances. If the constitutional amendment allowing national government to intervene directly in local government finance is passed, it could lead to significantly more central intervention in local government affairs. Even some of the ordinary provisions of the Municipal Finance Management Bill (if passed) give the department interventionist powers in municipalities far exceeding an indirect advisory and monitoring role.

The department would argue that such steps are being introduced to enhance local government autonomy in that it would give municipalities access to the capital market and reduce their reliance on central government for revenue. As this article has shown, most local government stakeholders would disagree. Such legislation, if implemented, can be construed as a form of delegation replacing devolved responsibility. In conclusion, it can be suggested that this growing financial centralisation is slowly eroding the much-vaunted autonomy of South African municipalities.

NOTES

1. Apartheid policy divided South Africans into different racial categories. There were different forms of local government structures for white, black, coloured and Asians. Historically (until 1983) only white local authorities were vested with formal legal authority and decision-making powers.
2. This is not a formal term. It is used as a matter of convenience.
3. Most advisory bodies were appointed rather than elected.
4. Nominally independent and self-government territories called homelands were created for blacks as part of the National Party's apartheid policy. Virtually all of these areas were poor with limited or non-existent local government. The intention was that the political aspirations of blacks would be channelled through this homelands policy.
5. In some provinces, most notably KwaZulu-Natal and North-West, no primary tier of rural local government was introduced. Such areas were serviced directly by district/regional councils.
6. The Treasury is a major directorate of the Department of Finance. In practice, the Treasury and Department of Finance are referred to interchangeably.

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