2008

Local Government Budgets and

Expenditure Review:

2003/04 – 2009/10

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National Treasury

Republic of South Africa

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To obtain copies please contact:

Communications Directorate
National Treasury
Private Bag X115
Pretoria
0001
South Africa
Tel: +27 12 315 5518
Fax: +27 12 315 5126

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Foreword

The *Local Government Budgets and Expenditure Review* is a valuable resource that assists analysts, policy makers, elected representatives, citizens, academics and practitioners in assessing the impact of government policies and the resources allocated to implement them. It supports Parliament, provincial legislatures and municipal councils in assessing progress made in implementing government programmes funded through the equitable share and conditional grants allocated to municipalities, as well as municipal own revenue raised from local communities. The Review will also assist political office bearers and all South Africans in evaluating future plans for critical municipal services such as water, sanitation, electricity, refuse removal, municipal transport, roads and community and recreational facilities. In this way, the Review serves as both an accountability and future planning document.

This Review contains both financial and non-financial information relating to key municipal functions. While it is evident that the ability of municipalities and municipal entities to collect financial data has improved, it must be acknowledged that a lot still needs to be done to improve local government non-financial data. Only when this is done will it be possible to evaluate the efficiency of spending with greater accuracy. Steps are already being taken in this regard.

The set of 72 indicators published by the Presidency in July 2007, and the collaborative effort among key government stakeholders to co-ordinate data collection across all spheres of government, in accordance with Cabinet Resolution of 2003, should contribute towards improving government's ability to collect, use and publish non-financial information for local government.

Revenue and expenditure trends in this Review show that local government expenditure is growing strongly in real terms. Service delivery is accordingly improving, particularly in the metropolitan municipalities and other big cities, and so is access and equity to municipal services. All this contributes significantly to supporting economic growth, delivering basic municipal services and creating jobs. The Review also identifies a range of challenges that will need to be addressed to ensure faster service delivery in the period ahead.

The compilation of this Review is a collaborative effort among officials of government. I wish to thank all of them for their contributions.

Lesetja Kganyago
Director-General: National Treasury

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Technical notes

The notes set out below are intended to assist readers, analysts and users by giving context to the information in the Review.

General notes on numbers

Although the financial data in the Review covers a seven year horizon (i.e. 2003/04 to 2009/10), the data may not always be strictly comparable. The key reasons for this are as follows:

- Before 2005, municipalities were gradually changing from fund accounting to Generally Accepted Municipal Accounting Practice (so called old GAMAP). Thereafter, some municipalities have been implementing revised GAMAP, with the highly capacitated municipalities implementing at least eleven standards of Generally Recognised Accounting Practice (GRAP). The basis of accounting prior to and after 2005 has, therefore been significantly different. Moreover, some municipalities adopted the new basis of accounting earlier than others, thus affecting the comparability of data over the seven-year horizon in the Review.
- As a result of the changes in the basis of accounting, some amounts recorded under certain items changed due to a change in accounting practice rather than real change in the substance of the transactions and the financial circumstances. This means that amounts were reclassified rather than changed due to the nature of the transactions. This exercise was undertaken by National Treasury and, in our opinion, this is the best set of financial information available given the circumstances. The aim was to prepare a set of numbers that will provide a high level comparison across all the 283 municipalities.
- With the phased implementation of the MFMA, the clause relating to preparation of consolidated financial statements was delayed for all municipalities, but the municipalities and entities were encouraged to adopt it early. This means that in some instances the data of municipal entities may be included in the consolidated numbers and in other instances this may not be the case.
- Since the abolishment of the RSC levies in 2006, the equitable share calculation includes the RSC replacement grant for metros and district municipalities. Equitable share figures may therefore seem inflated from 2006/07 onwards.

Data sources and reliability

The main sources of data for the Review, and the extent of their reliability, are as follows:

- The 2003/04 to 2005/06 numbers were obtained from the audited annual financial statements and, where applicable, the consolidated annual financial statements of the municipalities and municipal entities. Where available, the previous years' restated numbers from the annual financial statements were used as these take into account the adjustments required by the auditors. However, such restated numbers were not available in all instances, in which case the numbers applicable for that financial year were used. Every effort has been made to compile a reliable set of numbers, but there may still be some shortcomings in the dataset.
- 2006/07 numbers were obtained from two sources, namely (1) the audited annual financial statements of municipalities where they were available at the time of capturing and drafting of the publication and (2) the pre-audit in-year results submitted to councils and National Treasury as part of the monitoring on budget implementation where the annual financial statements have not been finalised. Whereas the reliability of the audited financial statements is high as mentioned above, the reliability of the in-year reports is fairly low. This is expected to significantly improve

with the new budget and in-year reporting formats and regulations and as the coverage is extended to all 283 municipalities.

- The Medium Term Revenue and Expenditure Framework (MTREF) estimates are based on the budget and related documents of municipalities and their entities as approved by respective municipal Councils and municipal entities' Boards. The quality of this data is not of the desired standard as the multi-year planning and budgeting reforms are not yet sufficiently institutionalised in all municipalities. The budget reform programme and continued efforts to strengthen MFMA implementation are designed to address this deficiency.
- Data from official publications of other government departments and state owned enterprises have been used. Key sources are the Budget Review (2007), Stats SA Census 2001 and the 2007 Community Survey, the national spatial development strategy, latest Auditor–General reports, the provincial budget statements; South African Reserve Bank Quarterly Bulletins, the Department of water Affairs and Forestry's water resource strategy; Eskom's annual report; the National Energy Regulator of South Africa (NERSA); EDI Holdings; the national Department of Transport; and the Council for Scientific and Industrial Research. These data sources are generally very reliable.
- Non-government sources such as reports from the South African Cities' Network and the Bond Exchange of South Africa have also been used. These sources are usually secondary and reliability depends to some extent on the interpretations and judgements of the writers of these reports.

Because of the re-demarcated processes since 2005 and the abolition of the cross-boundary municipalities, the municipal specific data used in the Review are not comparable over the whole seven-year period for the municipalities affected by redemarcation. The data for the period 2003/04 to 2005/06 are based on the old municipal boundaries, while the data for the 2006/07 to 2009/10 period are based on the new municipal boundaries. However, the redemarcation does not impact on the comparability of aggregated data.

Service delivery information is based on the old municipal boundaries, as reporting on the financial and non-financial performance of municipalities goes up to the period ending 30 June 2007.

Financial years

A financial year for the municipalities and municipal entities starts from 1 July and ends on 30 June of the following year.

Per capita estimates

Except for instances where it is stated otherwise, estimates of per capita spending are based on Census 2001 and 2007 Community Survey results. Such estimates will be different from those that are calculated using data from other sources.

Real growth rates

When comparing monetary values from one year to another, it is common to adjust the growth rates for inflation. Real growth rates in this publication are calculated using the CPIX.

Rounding of numbers

Appropriation of funds and reporting of expenditure is done in terms of Rand thousands. The majority of the tables in this publication are in Rand millions. As a result of rounding off, some minor deviations may occur.

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Introduction

Introduction

Local government has emerged from a prolonged transition to face a second generation of challenges. A growing economy and urbanisation have resulted in increased demand for economic infrastructure, ageing assets are increasingly requiring upgrading, rehabilitation or replacement and the location and nature of poverty are changing. Yet the context and pressures of individual municipalities differ widely. Levels of economic activity and poverty are markedly different: large urban municipalities are coping with rapid demographic and economic growth, while more rural municipalities face huge challenges in addressing backlogs in basic services.

Local government has emerged from a prolonged transition to face a second generation of challenges

Municipalities are the custodians of public funds, whether raised from their own revenues or received through intergovernmental grants. They are tasked with using these resources to respond to the needs of their communities for infrastructure, local services such as water, electricity and refuse removal and enabling and guiding the spatial development of their localities.

While there are many examples of exceptional efforts and remarkable successes by individual municipalities, the local government system does not, at present, appear to be responding to these challenges very effectively. The evidence suggests that, in aggregate, the demands of a growing economy are no longer being met by the levels of municipal investment. Asset maintenance and life-cycle management are very weak as the low levels of maintenance expenditure reflect. Governance and spatial planning responses tend to be both fragmented and delayed. While they were successful in the past, the strategies to address service backlogs for previously ignored communities are coming up against significant cost pressures that partially result from

The demands of a growing economy are no longer being met by the levels of municipal investment

inappropriate decisions by municipalities on the level of service to be provided. Balancing the tough choices of investing in social infrastructure to meet the targets of the Millennium Development Goals with investing in infrastructure that would stimulate and support local economic development is becoming increasingly harder. The result of these trends is that the limited provision of strategic infrastructure and a declining quality of service are growing constraints to economic growth and poverty reduction. If this trend is not arrested it might undermine the future sustainability of everything.

Municipal revenue collection has begun to fall as greater reliance is placed on transfers as a revenue source

A shortage of national funding is an inadequate explanation for these trends. Significant real increases in resources have been transferred to local government and proportionate to the location of poverty. This has resulted in growing under-spending and unclear value for money in outputs. Municipal revenue collection has begun to fall as greater reliance is placed on transfers as a revenue source. Indeed, the growth in transfers may impact on the ability of municipalities to respond to local contexts, as local needs may increasingly diverge from the requirements that other spheres of government impose through the grant conditions.

Government has introduced a range of reforms to support municipalities in addressing the challenges they face. To encourage better planning, government has legislated that municipalities must produce integrated development plans (IDPs). These plans are supposed to interface with the provincial growth and development plans and the national spatial development perspective to provide an overarching plan of how infrastructure services are to be provided within the local geographic area. However, this is only true in theory. While some municipalities have come a long way, integrated planning in the true sense is not sufficiently recognised by the existing institutional and financing arrangements.

Financial management reforms have begun to improve the transparency, credibility, timeliness and usefulness of municipal financial information. This process began in 2004 in larger municipalities and is now being rolled out to smaller municipalities. The reforms are intended to empower both municipalities and citizens. Municipalities are more able to respond to local demands for infrastructure, services and the facilitation of spatial development through allocating available public resources in an effective and sustainable way. Communities are increasingly able to hold their municipalities to account for their expenditure choices and performance. Collectively, this helps municipalities to realise value for money in the use of public resources.

Uses of this publication

The main target audiences for this Review are people in local government: councillors, practitioners and citizens. The Review should help them form an aggregate picture of local government and to situate them in the context of the developmental role that this sphere of government is expected to play. However, policy-makers in other spheres of government will also find the information and analysis to be extremely valuable. Provincial and national legislatures

will find useful information for strengthening their oversight of government at all levels, through the comparative and historical data on financial performance and, where possible, associated outputs. National and provincial departments sharing functional concurrency with the local government sphere could enjoy similar benefits. Researchers, analysts and investors will find a wealth of information on individual municipalities, categories of municipalities and the sphere as a whole.

Objectives of this publication

The Review focuses on the impact of municipalities on their socio-economic environments

The 2008 Local Government Budget and Expenditure Review is National Treasury's second publication dedicated to local government financial and fiscal issues. The 2006 Review described the basic fiscal and financial position of the local government system, based on the limited data that were available at the time. This Review marks a shift in National Treasury's analysis of local government from focusing largely on the finances and financial management of local government, to a focus on the impact of municipalities on their socio-economic environments. After all, municipalities are institutions of democratic local governance that exist to provide basic services to the communities that are living and working in these environments.

Data issues

Data limitations continue to restrict the scope and depth of the focus on the developmental outcomes of local government, but it is anticipated that the analysis begun in this Review can be deepened and broadened in the future. For example, information on what municipalities actually produce is not adequate, which limits the evaluation of municipal performance. Services such as solid waste management are not covered, despite being an important function that can have important environmental, social and employment effects. Analytical and policy research on the role of development charges in financing infrastructure investment is only beginning now.

National Treasury intends to complement the information presented here with increasingly greater public access to its own databases. This will be rolled out as part of a broader exercise to rationalise and improve the quality of data available on local government. Hopefully, this will encourage empirically driven public interest analysis and debate on issues in local governance and basic service delivery.

For more information on the different data sources used and their reliability, please refer to the Technical Notes at the beginning of this Review.

Main themes for the 2008 Review

This Review focuses on the impact of municipalities on their environment through exploring three main themes:

The Review investigates the performance of local government in supporting economic growth

First, the Review investigates the performance of local government in supporting economic growth. It collates available and often new, information on the growth in demand for municipal infrastructure. It assesses the extent to which municipal expenditures have kept pace with these demands and whether the quality of services provided is adequate to meet the needs of a growing economy. It investigates trends in municipal capital spending relative to these priorities and provides an initial assessment of the performance of regulatory and development planning functions by municipalities.

The Review assesses the performance of local government in combating poverty

Second, the Review assesses the performance of local government in combating poverty through investigating progress towards meeting targets for the elimination of basic service backlogs. It introduces an analysis of the employment effects of municipal service delivery programmes that will be expanded on in later publications.

The Review assesses the financial management capacity of municipalities

Third, it reviews the progress that has been made in strengthening the financial management capacity of municipalities, which must lie at the centre of any programme to improve their overall operational capacities. It identifies the significant challenges that remain, particularly in stabilising the senior management cadre in municipalities that is responsible for implementing these reforms.

Key issues identified

The Review identifies at least two related trends that are impacting on the performance of municipalities in combating poverty, supporting economic growth and in strengthening their own governance and service delivery capacity.

Municipalities have been wary of actively leveraging private sector finance

First, municipal responses to demands for additional or improved infrastructure and services resulting from sustained economic growth have been constrained in a number of ways. There is growing evidence that municipal services are under-priced relative to the cost of production and this may be exacerbated by current inflationary pressures. Municipalities have also been wary of actively leveraging private sector finance, through debt, PPPs and development charges (that are paid by property developers for obtaining connections to infrastructure networks), despite a conducive economic and regulatory environment. This suggests that municipalities continue to face capacity constraints in conceptualising and implementing developmental spending programmes.

Municipalities have become more reliant on transfers from national government

Second, the increasing reliance of municipalities on transfers from national government to fund their activities has grown markedly, particularly in larger urban municipalities. This partially reflects the priority accorded to combating poverty through providing universal access to basic services. However, it also reflects limited own revenue effort and a lack of commitment to leverage private finance. This undermines the effectiveness of government's poverty alleviation efforts as these revenue sources are not being optimally utilised. Ultimately, this trend may reduce the autonomy of municipalities as they become increasingly dependent on national transfers.

The Review proposes several appropriate responses by all spheres of government. These span the three dimensions of supporting growth, combating poverty and strengthening municipal capacity.

Municipalities need to free up additional local resources

First, in order to better support economic growth, municipalities need to free up additional local resources to invest in infrastructure provision and service delivery. A careful balance will need to be struck between a structural adjustment to taxes and tariffs to cover the full, long term costs of service delivery and improved expenditure efficiencies. Managing necessary price increases will require a long term view (based on new tariff setting models) and sensitivity to growing pressures on household budgets. Price increases will thus need to be substantially offset by improved expenditure efficiencies that increase productivity in the major trading services. Most municipal expenditure is in major utility trading services such as water, electricity and refuse collection, that need to be managed efficiently and according to sound business principles. The institutional form of these local utilities needs to be clarified as a precursor to improved asset management and the pursuit of lower unit costs. Also, creditworthy municipalities need to explore opportunities for leveraging private finance for the expansion and delivery of services, especially those that support local economic development. Levels of borrowing are relatively low, while the use of PPPs for the development of infrastructure has been very limited. There is considerable scope for expanding the use of development charges to finance infrastructure investment, based on the principle that direct beneficiaries of services should shoulder the largest burden of the associated costs.

Municipalities need to reconceptualise their current programmes for combating poverty

Second, in order to combat poverty more effectively, municipalities need to reconceptualise their current programmes to ensure that there is more universal access to basic infrastructure and services. Here, effective spatial planning and land use regulations governing development are crucial. While improving the access of poor households to the urban economy requires better use of strategically located urban land, municipal infrastructure investment decisions can be used creatively to guide private sector responses. For example, the location of bulk infrastructure obviously influences the private sector's decisions about where to invest and set up their businesses within a municipal jurisdiction. However, municipalities will only be able to guide private sector investments towards efficient and pro-poor development outcomes if they are able to spatially co-ordinate public investments across housing and infrastructure sectors. This needs to be done in ways that improve the access of poor households to economic opportunities as well as public services.

Municipalities need to generate more employment

There is also considerable scope for municipalities to generate more employment through their activities. A range of opportunities for labour intensive capital programmes and service delivery practices have not been adequately explored. Domestic solid waste and public cleansing activities, in particular, seem to provide good opportunities for using comparatively unskilled labour. This could contribute significantly to government's job creation objectives without undermining the financial position of municipalities.

Municipalities need to stabilise their senior management cadre

Third, to improve the capacity of municipalities to perform their functions, municipalities urgently need to stabilise their senior management cadre. Appropriate technical skills need to be in place. Evidence suggests that, in some instances, senior management positions have become tools in local political power plays, with unacceptably high turnover and vacancy levels, particularly around election times. This seriously disrupts the implementation of critical reform programmes and destabilises municipal administration.

More inputs are required from national government to improve municipal capacity

More inputs are also required from national government to contribute to the improvement of municipal capacity. The following technical functions require particular attention: sewerage and water treatment plant operators, road maintenance supervisors, health inspectors and planning and project managers. In particular, there needs to be better co-ordination between policy instruments. For example, grants may be squeezing out borrowing and community/user contributions and undermining sound asset management practices. Greater emphasis needs to be placed on the self-financing of services, the transparent operation of subsidies and clear incentives for municipal performance. Capacity support programmes have been fragmented and often un-strategic in their orientation and may have undermined municipal accountability for performance.

Finally, there should be space for greater asymmetry in the fiscal regime for different types of municipalities, where the more capable municipalities are able to exercise more discretion in the way they pursue their developmental mandates.

A summary of the chapters

The 2008 Review is made up of twelve chapters that are divided into four parts. The first part of the Review looks at the context for local governance, the second part considers the financing of local government, the third part investigates trends within the major services provided by municipalities and the final part discusses some key themes in managing local development.

The first part consists of just one chapter. *Chapter 2: The socio-economic and fiscal context for local government*, highlights the wide variation in social and economic contexts among South Africa's 283 municipalities. It outlines the key components of national government's fiscal policy stance that address the major social and economic trends and highlights important opportunities for municipalities that arise from these policy choices.

The second part looks at the key issues in financing local government. *Chapter 3: Revenue and expenditure trends in local government* provides a broad overview of the financial performance of municipalities. It highlights four issues - the under-pricing of services, growing reliance on national transfers, inadequate maintenance expenditures by municipalities and the high level of consumer debtors. *Chapter 4: Metropolitan finance* focuses specifically on the financial performance of South Africa's six metropolitan municipalities. In addition to the points raised in Chapter 3, it notes the effects on municipal budgets of expenditure related to the 2010 FIFA World Cup

and the specific challenges associated with coping with high levels of urbanisation. *Chapter 5: Intergovernmental transfers* tracks the reforms introduced in the system of transfers to municipalities and begins to evaluate the performance of transfer programmes. It identifies problems in the design of programmes and co-ordination between transfer programmes. It also raises concerns about the potentially negative effects of growing municipal reliance on grants for municipal accountability to communities. *Chapter 6: Leveraging private finance,* notes the huge demands placed on municipalities for responding to local social and economic needs. It highlights the limited use of partnerships with the private sector in financing infrastructure, relative to the potential that exists.

The third part investigates municipal performance in the delivery of major services. *Chapter 7: Water and sanitation* highlights emerging challenges in the water and sanitation sector, specifically those related to system losses arising from inadequate maintenance. Importantly, it highlights emerging problems in the pricing of water services. *Chapter 8: Electricity* outlines the structure of the electricity sector in South Africa and some of the challenges it is facing. Again, issues of asset maintenance and pricing are highlighted as key challenges facing the electricity distribution industry if it is to continue to contribute to growth and development. Ongoing uncertainty about the pace and direction of reforms to the electricity distribution industry continues to disrupt efforts to reverse the declines in the sector. *Chapter 9: Roads and public transportation*, considers the current demand for municipal investment in roads and public transport in the context of limited public expenditure on the sector and an environment of institutional overlap and uncertainty.

The final part considers three cross-cutting issues in municipal finance that are critical to the ability of municipalities to manage the local development processes. *Chapter 10: Managing the built environment*, describes the rapid growth in demand for public investment in the built environment and analyses trends in investment responses by municipalities, in the context of overall public investment in the built environment. It notes that while municipalities have made significant progress in addressing historical backlogs in basic infrastructure, shifting patterns of demand – to urban areas and to support economic growth – are currently outstripping the investment capacity of municipalities. Municipal approaches to asset management are increasingly being exposed as inadequate. Underlying this problem are concerns about the current framework for spatial planning and weaknesses in mechanisms for the co-ordination of public investments. Considerable work is still required to refine policy and implementation frameworks for both spatial planning and public sector co-ordination. Without this, the efficiency and developmental effectiveness of public investments will continue to be undermined. *Chapter 11: Financial management and MFMA implementation*, reviews progress made with the implementation of financial management reforms in municipalities over the last four years. These reforms underpin the process of democratic accountability. It notes that while a firm foundation of financial management systems and capacity has been laid down, considerable work remains. Key issues include improving audit outcomes and stabilising senior municipal

management positions. *Chapter 12: Managing municipal personnel* considers trends in municipal employment. It highlights the modest contribution that municipalities make to overall employment and notes that between 2005 and 2006, the number of municipal employees declined, despite an increase in the number of available positions. Together, these factors have contributed to rising vacancy rates. Personnel expenditure has been growing strongly. However, the average cost of employment and the average minimum wage have grown even faster. In effect these gains are being "paid for" by the shedding of low level jobs – facilitated by mechanisation and outsourcing. Indeed many of the trends point to a bias in favour of mechanisation. This needs to be reversed if municipalities are to make a meaningful contribution to job creation and combating poverty.

Conclusion

The environments in which South Africa's 283 municipalities operate differ considerably. The varied demographic and social trends and the varying spatial implications of national fiscal policy will all require vastly different policy responses from individual municipalities.

All municipalities must reconcile the need to fund service improvements, through price increases, with the imperative of ensuring that household bills remain affordable. Short term price increases seem to be unavoidable for the major municipal services. Over the medium term, however, municipalities will need to consider mechanisms to improve the efficiency of their expenditures. This will not only support local economic development, but also provide scope for more aggressive programmes to combat poverty.

National fiscal policy gives municipalities the space to respond appropriately to this challenge. Increased grant resources can fund the cost of necessary institutional reforms to improve expenditure efficiencies of municipal trading services. The scope for more municipal borrowing will allow municipalities to fund investments up front, while spreading their financing over the life of these assets.

The ability of municipalities to rise to these challenges will ultimately be determined by the quality of their governance and administrative practices. Stronger, more participatory governance practices will, however, only have a meaningful effect if municipalities provide stable and attractive work environments. Ultimately, councils must ensure that they have the right people in the right places to lead their municipal administrations and provide the technical expertise required to deliver services.

2

The socio-economic and fiscal context for local government

Introduction

South Africa's municipalities operate in a wide range of social and economic contexts

South Africa's 283 municipalities operate in a wide range of social and economic contexts. The priorities of fiscal policy, such as poverty alleviation or job creation, present them with different challenges and opportunities. Demographic trends vary significantly between large urban municipalities and their smaller rural counterparts, making very different demands on municipal budgets. Economic activity in some municipal areas is predominantly agricultural, while in others it is more concentrated on manufacturing or financial services. Different sectors have different requirements from local government. National government policy attempts to address structural disparities between municipalities, through distributing nationally raised resources to areas of greatest need, while other aspects of fiscal policy create opportunities for some municipalities to leverage private sector finance or facilitate economic development.

All municipalities must play a central role in supporting economic development and alleviating poverty

Regardless of their specific contexts, all municipalities must play a central role in supporting economic development and alleviating poverty. The services they provide, such as water, sanitation, refuse removal and electricity, are critical inputs to social wellbeing and economic activity. The availability, price and reliability of these services impact on local economic performance and can significantly affect the quality of life of poor households. Municipalities can also guide private investment decisions through the spatial location of their own infrastructure investments and their powers to regulate spatial development. The location of major roads, for example, can determine which areas become preferred locations for private investment. These spatial choices can also significantly influence the accessibility of

poor households to economic opportunities and thus to productive livelihoods.

Municipalities must remain responsive to challenges and opportunities presented by social and economic trends and by fiscal policy. A key justification for a system of local governance is that it is better able, than national or provincial governments to respond to local trends, needs and priorities.

This chapter gives an overview of:

- local government and the national economy
- variations between municipalities
- economic outlook and local government
- national fiscal policy and local government.

Local government and the national economy

Between 2003/04 and 2007/08 the actual contribution of municipalities to GDP was relatively low

Between 2003/04 and 2007/08, expenditure by the local government sphere amounted to an average of 6.9 per cent of South Africa's gross domestic product (GDP). The infrastructure and services provided by municipalities are essential ingredients to the functioning and growth of other economic sectors. Municipal services are delivered predominantly to households, which provide the labour force for the economy. Water, electricity and refuse collection are critical inputs into all productive processes, while local road networks are essential to the delivery of goods and services to consumers. On average, local government accounted for 24 per cent of total public sector infrastructure expenditure between 2004/05 and 2007/08. The share of local government is, however, set to decline in response to more rapid growth in infrastructure expenditure by provincial government and public enterprises.

Variations between municipalities

There is considerable variation in the social and economic contexts and trends between municipalities. Trends in the social and economic contexts, the scale of service backlogs and the rate at which they are being addressed vary markedly.

Demographic trends

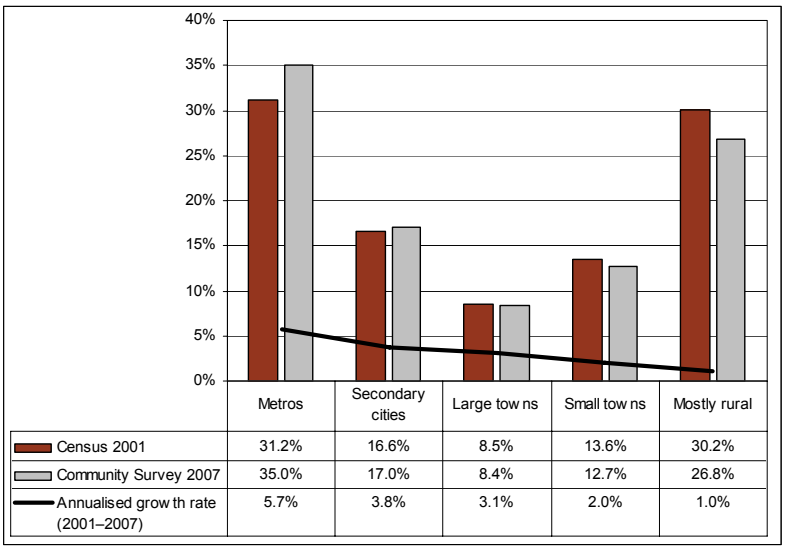
The current demographic trends of urbanisation and a reduction in the average size of households impact differently on individual municipalities

The current demographic trends of urbanisation and a reduction in the average size of households are reshaping the contexts for service delivery and governance in most municipalities in strikingly different ways[1]. The Community Survey 2007 reports that 52 per cent of South Africans live in metropolitan areas and secondary cities. The proportion of the population in mostly rural municipalities has

[1] The reduction in household size is known as "household decompression" and appears to have been driven by out-migration from rural areas and the greater availability of urban housing and basic services.

declined since the Census 2001. This reflects the strong growth in the population of the metros, which rose by 5.7 per cent per year between 2001 and 2007.

Figure 2.1 Share of population and annual growth rate by category of municipality, 2001 – 2007

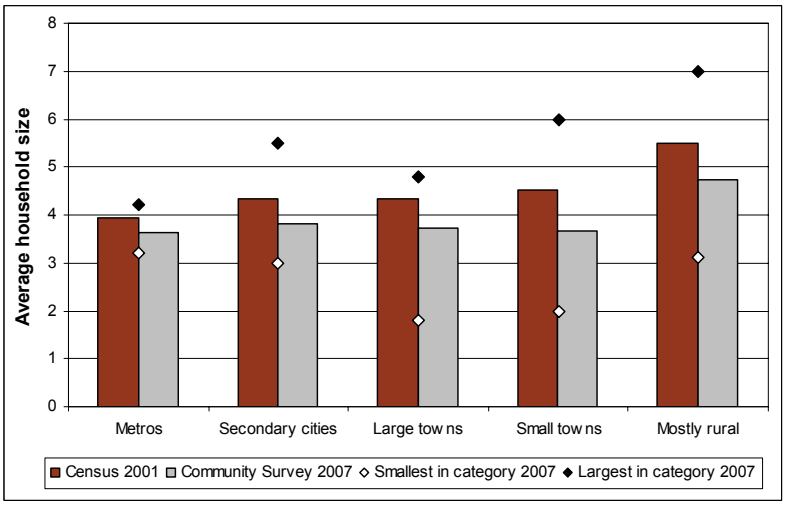


	Metros	Secondary cities	Large towns	Small towns	Mostly rural
Census 2001	31.2%	16.6%	8.5%	13.6%	30.2%
Community Survey 2007	35.0%	17.0%	8.4%	12.7%	26.8%
Annualised growth rate (2001–2007)	5.7%	3.8%	3.1%	2.0%	1.0%

Source: Stats SA, Census 2001 and Community Survey 2007

The drop in the average size of households is a common trend across all categories of municipalities. In larger urban areas this is associated with an increase in the absolute number of households. But, due to out-migration, this process of household decompression is most marked in small towns and mostly rural municipalities, where the variation in average household sizes between individual municipalities is also greatest.

Figure 2.2 Average household size by municipality, 2001 – 2007



Source: Stats SA, Census 2001 and Community Survey 2007

Urban population growth and smaller households are creating significant fiscal challenges for all municipalities

The processes of urban population growth and the reduction in the average size of households create significant fiscal challenges for all municipalities. In more rural jurisdictions the out-migration of individuals to urban areas has been accompanied by falling average household sizes. This reduces the number of persons reached by each household service connection while simultaneously adding to backlogs in the urban centres. Also, while it is likely that new household formation has been limited, significant backlogs in access to basic infrastructure persist.

In larger urban areas, the process of rapid population growth and falling household size combine to extend the service delivery challenge facing these municipalities. In essence, each infrastructure connection installed and operated serves fewer people in a household, but the absolute number of connections required increases as the number of households rises.

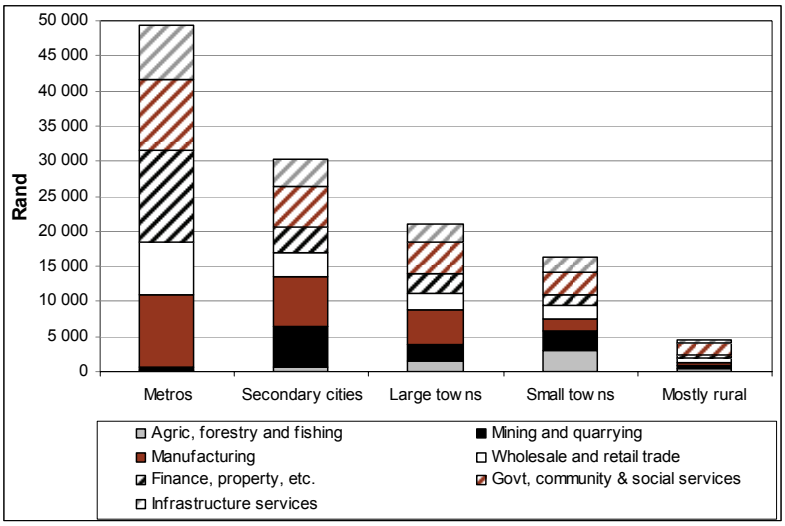
In addition, the HIV and AIDS pandemic has begun to fundamentally alter the definition of household units, with an increased prevalence of child-headed and multi-family units that have lost their primary income earners to illness or death. Most directly, this presents municipalities with more of a challenge when it comes to implementing their indigent policies and generating revenue.

Economic activity

There is also significant variation in the level and nature of economic activity across different municipal contexts.

Figure 2.3 demonstrates the strong bias in most economic sectors towards larger, more urban municipalities and the contrasting weak economic base of mostly rural municipalities. This results in the revenue base of rural municipalities being constrained and the need for high levels of grant support from national government.

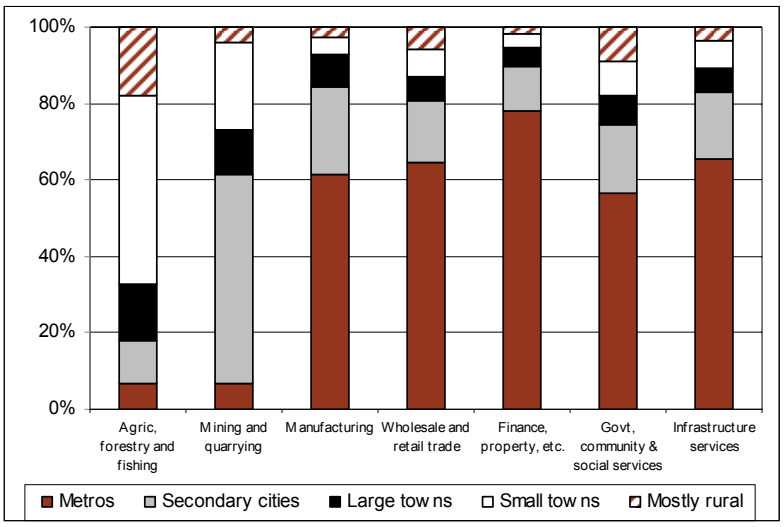
Figure 2.3 Gross value added (GVA) per capita by type of municipality, 2004



Source: National spatial development strategy

Figure 2.4 shows that mostly rural municipalities and small towns are predictably reliant on agriculture, fishing and forestry activities, while other economic sectors are more dominant in metropolitan areas. The mining and quarrying sector is most dominant in secondary cities, reflecting both the location of these activities and their significant contribution to the national economy. These differences underscore the need for individual municipalities to pursue vastly different infrastructure investment and service delivery strategies.

Figure 2.4 Municipal types and share of GVA by economic sector, 2004



Source: National spatial development strategy

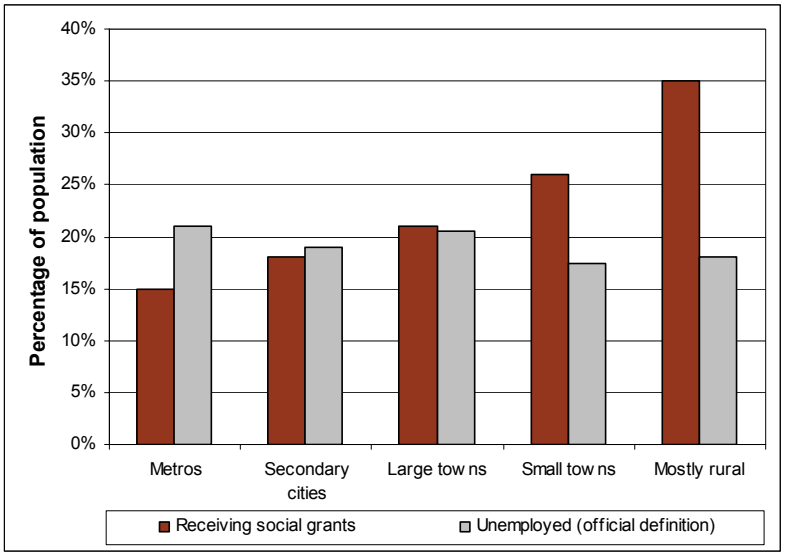
Poverty levels and access to services

There are wide variations in levels of poverty and access to services

There are wide variations in levels of poverty and access to services between the different categories of municipalities and individual municipalities within the same category. Reliance on social grants is highest in mostly rural municipalities, reflecting the weak economic base of these areas. Unemployment is highest in metropolitan areas. Both these factors constrain the own revenue potential of municipalities. High levels of poverty limit the ability of residents in more rural municipalities to pay for even basic services and constrain the ability of these municipalities to introduce significant cross-subsidies between richer and poorer consumers. Although metros do have the capacity to generate consumer cross-subsidies, they must ensure resources are effectively targeted to those in need in order to limit the overall size of the subsidies that are required.

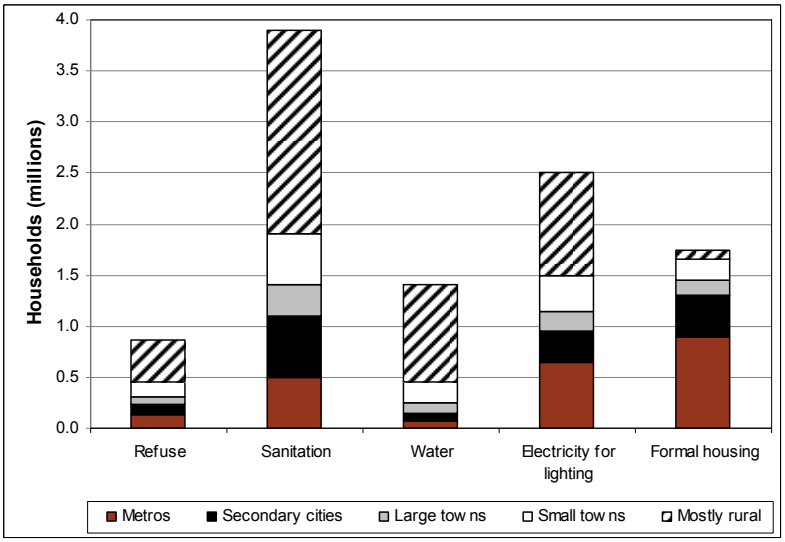
Backlogs in access to basic levels of services are most significant in the sanitation sector. Again, the mostly rural municipalities face the most significant absolute backlogs in access to services, while metros report high levels of backlogs in access to electricity for lighting and formal housing.

Figure 2.5 Proxies of poverty by municipal location, 2007



Source: Stats SA, Community Survey 2007

Figure 2.6 Households without access to basic services and housing by municipal location, 2007



Source: Stats SA, Community Survey 2007

Other chapters in this publication explore these issues in greater depth. At a broad level it is important to note the variations in contexts between municipalities and consider the implications of how municipalities respond. In particular, the high residual backlogs in the mostly rural municipalities continue to pose a serious institutional challenge. Despite significant increases in transfers to these municipalities and a declining share of population, they have been unable to make a significant dent in backlogs. Metros, on the other hand, face significant population growth. As they have addressed existing backlogs, new demand has emerged. This volatility in demand requires municipalities to improve their long-term planning.

The economic outlook and local government

The 2008 Budget Review provides a more detailed analysis of the current economic outlook. It notes that the economic advances of the past five years have benefited all South Africans through higher employment, rising public spending, strong welfare gains and substantive investments in productive capacity.

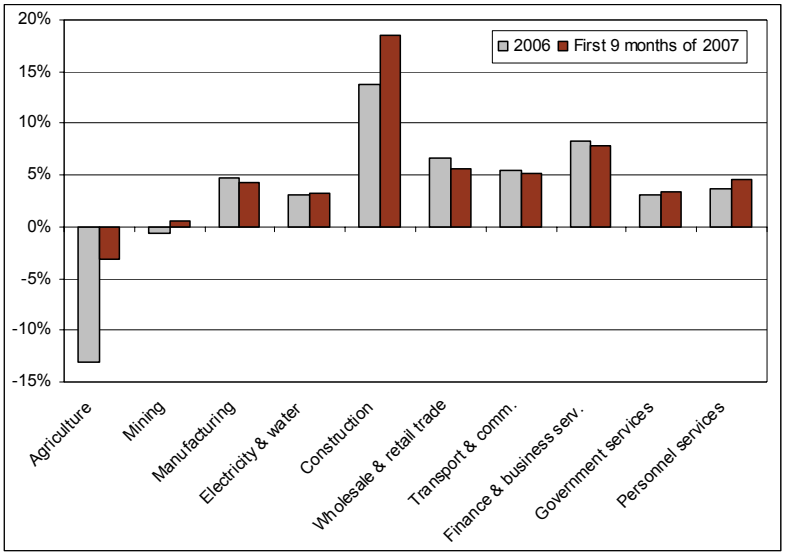
The short term economic outlook is clouded by a deteriorating global economy, rising inflation and supply constraints

The economic outlook in the short term, however, is clouded by a deteriorating global economy, rising inflation and supply constraints. Economic growth is projected to slow from 5 per cent to 4 per cent in 2008, rising to about 4.6 per cent by 2010. Gross fixed capital formation reached 21 per cent of GDP in 2007 and the pace of investment is expected to remain robust. Public sector infrastructure spending is increasing rapidly to alleviate capacity constraints and congestion in various network industries.

Two specific factors are of relevance to local government. First, wide variations in growth trends between different sectors of the economy place different pressures on individual municipalities, depending on the sectoral make-up of their local economies.

Construction, financial services, transport and communication and wholesale and retail trade continued to grow at rates above 5 per cent, while the agriculture, forestry and fishing sector contracted by 3.1 per cent in the first nine months of 2007 compared with the same period in 2006. The mining sector grew at a sluggish pace in the first three quarters of 2007, with gross value added rising by only 0.5 per cent compared to the same period in 2006.

Figure 2.7 Sectoral growth, 2006 and 2007

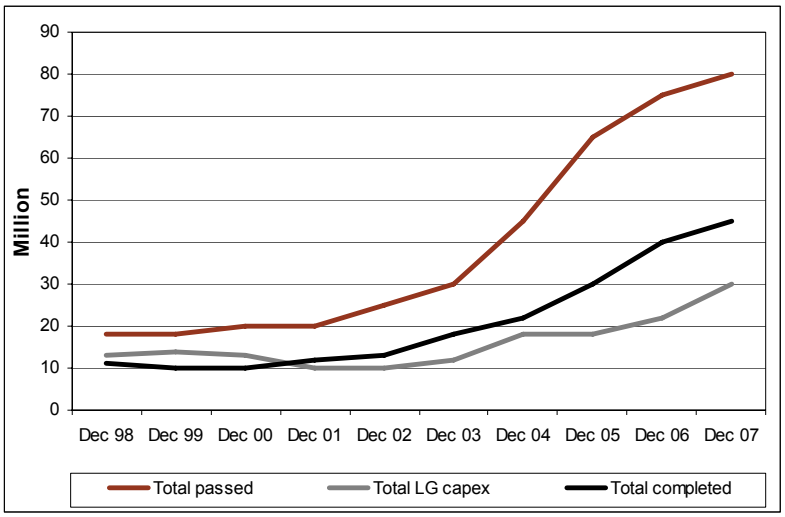


Source: 2008 Budget Review

Mostly rural municipalities tend to have a greater reliance on agriculture and related sectors, while secondary cities are largely reliant on the mining sector. Growth in these sectors can have knock-on effects for local economies and particularly for household spending, which ultimately impacts on municipal revenues.

In municipalities with economies based in higher growth sectors, growth has led to an expansion in demand for municipal infrastructure and services. Figure 2.8 shows the widening gap between municipal capital expenditure and the value of buildings completed, which serves as a proxy for demand for municipal infrastructure.

Figure 2.8 Nominal value of building plans passed and buildings completed and local government capital expenditure, 1998 – 2007



Source: Stats SA and National Treasury local government database

As reported in the 2008 Budget Review, this trend mirrors the declining share of gross fixed capital formation by general government between 2000/01 and 2006/07 (of which municipalities contributed approximately 36 per cent). This was due to the rapid expansion in investment by the private sector and public corporations. The municipal share of public infrastructure expenditure by general government is projected to fall from 38.2 per cent in 2007/08 to 33.4 per cent in 2010/11.

Economic developments are creating pressures for an increase in municipal taxes and user charges

Economic developments are creating pressures for an increase in municipal taxes and user charges, even as growth in some sectors is showing signs of slowing due to capacity constraints, rising interest rates and more moderate household spending. Municipalities need to address capacity constraints through increasing the supply of local infrastructure and services (through infrastructure investment and refurbishment), as well as through measures to moderate the growth in consumption. Both of these requirements have significant price implications for local services. Infrastructure investment requires additional resources, while demand management is most effective when transmitted through pricing signals to consumers.

Municipalities need to manage price increases while ensuring that services remain affordable to consumers

The major challenge facing municipalities is to reconcile the need for price increases with the imperative of ensuring that services remain affordable to consumers, in an environment where household budgets are tightening. In this environment, price increases will need to be balanced with efforts to improve internal cost efficiencies.

Expenditure side productivity improvements remain largely unexplored in municipalities. Most municipalities do not operate their trading services as full cost centres with applied business logic. Few municipalities operate coherent or effective public works programmes.

Ancillary measures by municipalities to reduce the costs of doing business in their jurisdictions, through streamlining by-laws and development approvals, may provide some scope for offsetting the negative effects of price increases without expenditure side reforms, but this cannot be the only solution.

National fiscal policy and local government

In the face of economic developments, the core priorities of public policy and the 2008 Budget are focused on investment in sustainable long-term growth and progressively raising living standards. The fiscal stance enables government to raise public spending in key areas – increasing fixed investment, creating jobs, boosting export capacity, fighting poverty and improving public services – while providing a cushion against global volatility. Rising fixed investment, together with further microeconomic reforms, will raise the competitiveness of the economy, while reducing constraints in key areas, such as electricity.

National fiscal policy recognises that municipal expenditure contributes to poverty alleviation and economic development

National fiscal policy has long recognised that municipal expenditure makes a significant contribution towards alleviating poverty and economic development. Municipalities contribute to providing a social wage through providing free basic services to poor households. Municipal infrastructure investment contributes to total fixed capital formation by the public sector and the provision of associated services is critical for economic activity and household welfare.

National government's fiscal policy has four implications for local government:

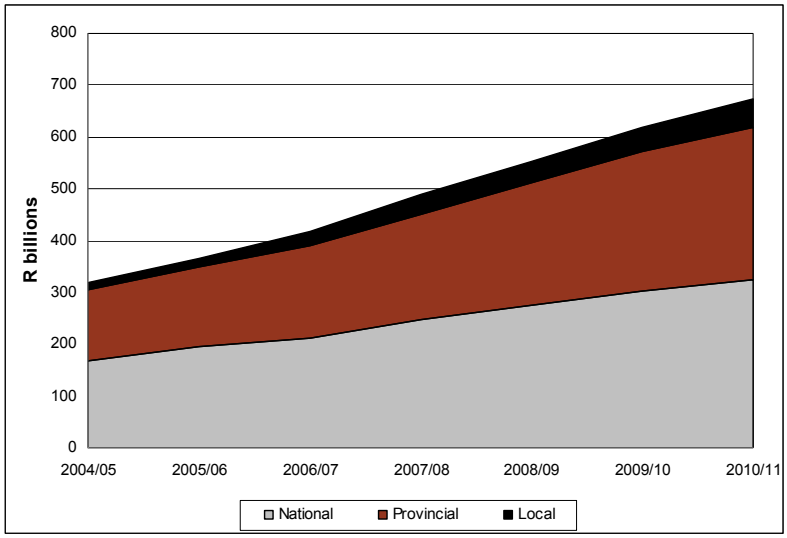
Local government's share of nationally collected revenues increases relative to the national and provincial spheres

First, the growth in government spending and its bias towards increased transfers to local government will result in additional resources being made available to municipalities. The broadly equitable nature of the distribution of these resources ensures that all municipalities benefit fairly and will experience significant real growth in national financial support over the medium-term. Local government's share of nationally collected revenues increases relative to the national and provincial spheres. This suggests that fiscal policy recognises the important role of local government and the need to channel more resources to it.

However, these resources are intended to contribute to the capital and operating costs of providing basic services to poor households, rather than as a general subsidy to municipal operations. The costs of providing infrastructure and services to non-poor households and firms must continue to be fully financed from local taxes and service charges. But municipal own revenue collection has declined as a portion of total revenue, with service charges in particular having grown at the slowest pace of all revenue sources. As a result, municipalities have become increasingly reliant on grants, indicating

that there may be significant leakage of national resources to non-poor households.

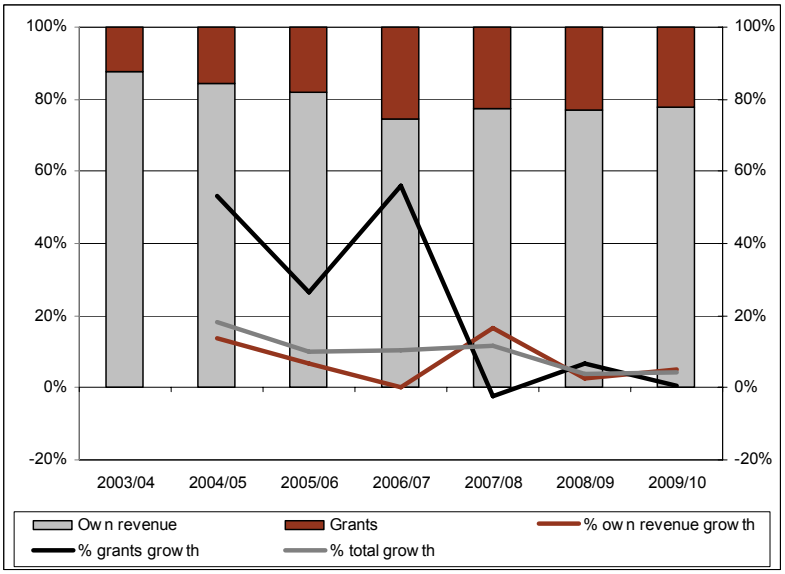
Figure 2.9 Historical nominal vertical division of revenue, 2004/05 – 2010/11



Source: 2008 Budget Review, National Treasury database

Second, transparent and responsible fiscal policy has created a comparatively stable economic and fiscal environment for municipalities to operate in. Current trends in national transfers to local government are sustainable over the medium-term. In turn, this stability enables more accurate planning and financial management by municipalities. Regulatory reforms to planning and budgeting processes have provided the legal basis on which municipalities can take advantage of this trend.

Figure 2.10 Revenue trends by major source, 2003/04 – 2009/10

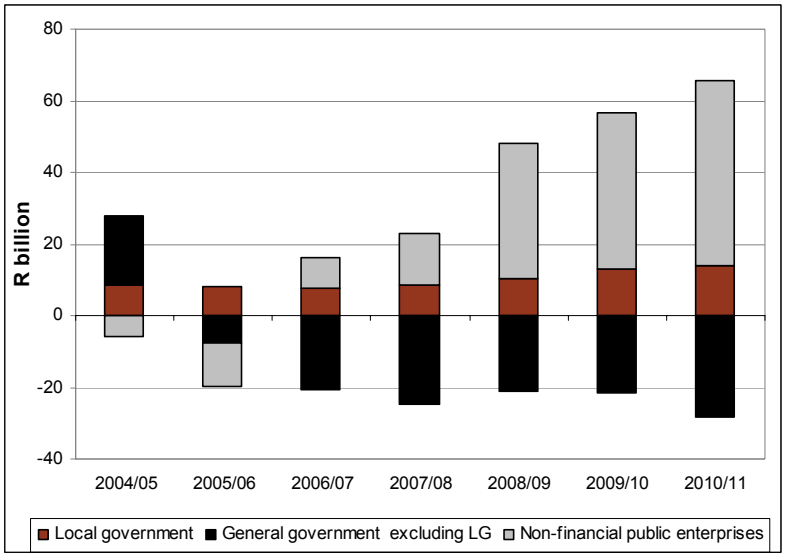


Source: National Treasury local government database

Third, the prudent fiscal stance of national government provides room for increased borrowing by sub-national entities, including municipalities. However, although not all municipalities are able to access private capital markets, those that can have not shown much initiative.

National government's prudent fiscal stance provides room for increased borrowing

Figure 2.11 Public sector borrowing requirement, 2004/05 – 2010/11



Source: 2008 Budget Review

Finally, the rapid real growth in capital spending by public corporations and, to a lesser extent, by other spheres of government poses severe co-ordination challenges for public investment in the built environment. For municipalities, expanded public spending by other public entities places pressure on development planning and control systems. In addition, it extends demands for municipal infrastructure. For example, a new school or a shopping mall will require infrastructure such as local roads, water, electricity and sanitation. Effective mechanisms to co-ordinate and sequence public investments are thus required. These issues are considered in more detail in the next chapters of this Review.

Conclusion

Considerable variation exists between municipalities across South Africa. The impact of the differing demographic and social trends and fiscal policy will require vastly different policy responses from individual municipalities.

All municipalities must reconcile the need to fund service improvements, through price increases, with the imperative of ensuring that household bills remain affordable and their jurisdictions remain competitive investment destinations. Short-term price increases appear unavoidable for the major municipal services. Over the medium-term, however, municipalities will need to increasingly consider mechanisms to improve the efficiency of their expenditures.

National fiscal policy provides important breathing space for municipalities to address this challenge. Increased grant resources can fund the cost of the required institutional transition, which is already supported strongly by legislation. The scope for increased municipal borrowing will allow municipalities to fund investments up front, while spreading their financing burden over the life of these assets.

3

Revenue and expenditure trends in local government

Introduction

The revenues and expenditures of municipalities determine their ability to deliver services. Weaknesses in revenue and expenditure management could constrain the ability of a municipality to contribute to poverty reduction and economic development. They are also likely to reflect the existence of other governance challenges.

This chapter reviews key trends in the revenues and expenditures of all 283 municipalities from 2003/04 to 2006/07 and future budget trends over the medium-term. Other chapters in this Review provide a more detailed analysis of specific expenditure functions.

It is not enough to simply review the size of municipal revenues or expenditures

Simply reviewing the size of municipal revenues or expenditures provides little insight into the challenges that face municipalities, nor does it reveal much about the efficiency or effectiveness of a municipality. Rising expenditures related to the delivery of a particular service may reflect an expansion of services to more citizens or increasingly difficult technical conditions, such as a dispersed population or a municipality reaching a specific stage in the life-cycle of its assets. But it may also reflect higher than average personnel costs or administrative overheads, weak expenditure control systems or inappropriate service standards. Inefficiencies in service delivery might also quickly translate into increased expenditures and perhaps even reduce the availability of resources to address the core objectives of poverty reduction and economic development.

This chapter gives an overview of:

- local government in the system of public finance

- revenue trends
- expenditure trends
- key issues in municipal budgets.

Local government in the system of public finance

Table 3.1 shows that the ratio of municipal expenditure to total government expenditure increases from 20.8 per cent in 2003/04 to 23.4 per cent in 2007/08. This reflects the strong growth in national transfers to local government, particularly associated with the 2010 FIFA World Cup. Over the medium-term the share of local government spending declines to 19.6 per cent in 2009/10. This is due to the ending of the 2010 FIFA World Cup transfers and slower municipal infrastructure spending.

Table 3.1 also shows that municipal operating revenue as a percentage of GDP was fairly stable between 2003/04 and 2007/08, but is set to decrease quite rapidly over the medium-term. It is apparent that this is not being driven by changes in property rates, since rates as a percentage of GDP remain constant at about 1 per cent. Rather most of this trend can be attributed to the fact that national transfers remain largely constant in the medium-term.

Table 3.1 Local government expenditure to GDP, 2003/04 – 2009/10

R million	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
	Outcome			Estimate	Medium-term estimates		
Expenditure							
National departments	194 515	216 140	245 635	264 821	299 766	331 165	365 797
Provinces	131 858	142 629	161 764	186 561	214 571	247 860	274 712
Local government	85 850	97 162	112 882	128 106	157 294	160 620	156 514
Total expenditure	**412 222**	**455 931**	**520 281**	**579 488**	**671 631**	**739 645**	**797 023**
Municipal expenditure as percentage of total government expenditure	*20.8%*	*21.3%*	*21.7%*	*22.1%*	*23.4%*	*21.7%*	*19.6%*
Municipal expenditure as percentage of GDP	*6.7%*	*6.8%*	*7.1%*	*7.1%*	*7.7%*	*7.0%*	*6.2%*
Total operating revenue	**73 832**	**87 369**	**96 000**	**106 056**	**118 405**	**122 710**	**127 705**
Municipal revenue as a percentage of GDP	*5.7%*	*6.1%*	*6.1%*	*5.9%*	*5.8%*	*5.4%*	*5.1%*
Property rates	13 980	16 396	17 401	18 521	21 486	22 770	24 136
Property rates as percentage of GDP	*1.1%*	*1.1%*	*1.1%*	*1.0%*	*1.1%*	*1.0%*	*1.0%*
GDP	1 288 979	1 427 445	1 584 743	1 807 316	2 045 533	2 286 906	2 506 870

Source: 2007 and 2008 Budget Review

Revenue trends

Municipalities are largely self-financing

Municipalities are largely self-financing. This means that the bulk of their resources are raised from own revenue sources such as taxes and service charges. This principle is an important feature of any democratic local government system. It ensures that municipalities are directly accountable to local residents for the functions they perform

and the services they provide. It empowers residents to play an important role in deciding on the services they prefer and are willing to pay for and ensures that municipalities remain responsive to the needs of their residents.

However, in South Africa there are two important dimensions to this basic principle. First, there is a structural imbalance between available local revenue sources and the expenditure functions that are assigned to local government. Second, not all municipalities have the same capacity to raise revenues, as levels of poverty vary considerably and are particularly high in mostly rural municipalities. In practice, this means that while national government must provide financial support to all municipalities, such support needs to be directed to ensuring all citizens have access to basic services.

Table 3.2 shows that total operating revenue of municipalities (including government grants) grew by 7 per cent annually for the period between 2003/04 and 2006/07 and is projected to further increase by 1.1 per cent per year over the medium-term. This growth is driven largely by increases in national transfers targeted at stepping up funding access to pro-poor basic services, increased funding for 2010 FIFA World Cup commitments and the replacement grant for the Regional Services Levies (RSC) which was abolished in 2006/07.

Table 3.2 Municipal operating revenue, 2003/04 – 2009/10

R million	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
		Outcome		Estimate	Medium-term estimates		
Operating Revenue							
Property rates	13 980	16 396	17 401	18 521	21 486	22 770	24 136
Service charges	36 146	38 735	40 201	44 498	49 223	51 549	54 777
Regional Service Levies[1]	4 983	7 009	7 604	386	95	2	0
Investment revenue	1 673	2 115	2 357	2 970	3 845	3 818	4 133
Government grants	8 980	13 742	17 398	27 223	26 571	28 311	28 491
Public contributions and donations	44	588	664	695	–	–	–
Other own revenue	8 025	8 784	10 375	11 763	17 184	16 260	16 167
Total revenue	**73 832**	**87 369**	**96 000**	**106 056**	**118 405**	**122 710**	**127 705**
Percentage of total revenue							
Property rates	18.9%	18.8%	18.1%	17.5%	18.1%	18.6%	18.9%
Service charges	49.0%	44.3%	41.9%	42.0%	41.6%	42.0%	42.9%
Regional Service Levies	6.7%	8.0%	7.9%	0.4%	0.1%	0.0%	0.0%
Investment revenue	2.3%	2.4%	2.5%	2.8%	3.2%	3.1%	3.2%
Government grants	12.2%	15.7%	18.1%	25.7%	22.4%	23.1%	22.3%
Public contributions and donations	0.1%	0.7%	0.7%	0.7%	0.0%	0.0%	0.0%
Other own revenue	10.9%	10.1%	10.8%	11.1%	14.5%	13.3%	12.7%
Total revenue	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

1. RSC levies abolished from 1 July 2006. Interim replacement grant included in Equitable share.
Source: National Treasury local government database

Service charges' share in total operating revenue declines from 49 per cent in 2003/04 to 42.9 per cent in 2009/10 mainly due to the sharp increase in national transfers. Despite this decreasing share, revenue raised from service charges is budgeted to grow by 1.9 per cent per year over the medium-term in real terms.

At 42 per cent in 2006/07, service charges are the largest source of operating revenue for municipalities

Government grants are the second largest source of revenue

At 22.4 per cent of total operating revenue in 2007/08, government grants are the second largest source of revenue. Table 3.2 also shows that for 2006/07 and over the medium-term, the increase to transfers averages 7.3 per cent, which is mainly attributable to the additional grants given to the host cities of the 2010 FIFA World Cup.

Revenue raised through property rates grew by R4.5 billion or 4.2 per cent in real terms between 2003/04 and 2006/07 and is expected to grow further by 3.8 per cent over the medium term. This is largely due to the implementation of the new rating system, where municipalities will charge households according to the market value of both the land and any improvements to it.

Progress report on the implementation of the Municipal Property Rates Act

Although the Municipal Property Rates Act (2004) took effect from 2 July 2005, the new property rating and valuation system only takes effect when a council has adopted its rates policy and has prepared the first valuation roll in terms of the Act. Municipalities are required to bring their valuation records up to date within four years of the effective date of the legislation, i.e. between 1 July 2006 and 1 July 2009. As municipalities require between 6 to 18 months to put in place a new municipal valuation roll, only a limited number of municipalities implemented their first valuation in terms of the Act on 1 July 2006 and 1 July 2007. The majority of municipalities (approximately 90 per cent) are therefore targeting either 1 July 2008 or 1 July 2009 as the implementation date, as indicated in the table below (based on 266 municipal reports):

2006/07 implementation date	=	4 municipalities
2007/08 implementation date	=	23 municipalities
2008/09 implementation date	=	77 municipalities
2009/10 implementation date	=	162 municipalities

Although national and provincial governments are responsible for monitoring and assisting municipalities with the implementation of the new property valuation and rating system, municipalities are primarily responsible for ensuring that property rates bills remain affordable. Municipalities have been advised that when they implement new valuation rolls in terms of the act and their base increases (due to higher property values), appropriate reductions need to be made to the tax rate. In terms of current practice, the following trends have been observed in a selection of municipalities that implemented the Act from 1 July 2007:

Municipality	2006/07 Prior to implementation	2007/08 Implementation	% increase
Bela Bela	16 707	21 950	31.4%
Blue Crane Route	3 269	3 538	8.2%
Breede River Winelands	20 215	42 443	110.0%
Cape Town	2 674 117	3 496 600	30.8%
Greater Tubatse	13 614	27 350	100.9%
Ikwezi	1 020	1 550	52.0%
Inkwanca	2 396	3 533	47.5%
KwaDukuza	83 936	290 083	245.6%
Maruleng	2 400	8 000	233.3%
Matzikama	11 513	13 500	17.3%
Mbonambi	–	3 716	–
Midvaal	43 000	55 527	29.1%
Msukaligwa	27 138	37 408	37.8%
Mthonjaneni	3 220	3 300	2.5%
Musina	8 555	11 513	34.6%
Nkandla	560	712	27.1%
Ntambanana	–	215	–
Sol Plaatje	98 553	105 572	7.1%
Umlalazi	20 111	33 065	64.4%
uMngeni	44 527	61 911	39.0%
uMshwathi	3 270	21 889	569.4%

Source: Department of Provincial and Local Government and National Treasury local government database

Municipalities also generate other revenue in the form of traffic fines, business licences, rental fees, entrance fees for use of municipal facilities and fresh produce markets. Revenue from these sources increases from R8 billion to R17.2 billion between 2003/04 and 2007/08 and is anticipated to decrease slightly to R16.2 billion by 2009/10.

Revenue from traffic fines, business licences, rental fees and other fees make up 14.5 per cent of total revenue in 2007/08

Table 3.3 shows that the equitable share grant is the largest national transfer to municipalities. The total equitable share grant for municipalities has grown by R11.7 billion between 2003/04 and 2006/07 and is set to increase by another R12.1 billion over the medium-term. The rapid growth in local government's equitable share is largely due to increases in the allocations for indigent households.

Table 3.3 Division of nationally collected revenues, 2003/04 – 2009/10

R million	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
	Outcome			Estimate	Medium-term estimates		
Division of available funds							
National departments	**148 201**	**167 289**	**194 723**	**212 629**	**246 937**	**273 929**	**302 672**
Provinces	**122 673**	**138 512**	**154 368**	**178 871**	**205 224**	**238 076**	**268 158**
Equitable share	107 538	120 885	135 292	150 753	172 862	199 377	225 466
Conditional grants	15 135	17 627	19 076	28 118	32 362	38 699	42 692
Local government	**11 521**	**13 808**	**16 681**	**26 501**	**37 127**	**41 855**	**47 651**
Equitable share1	6 350	7 678	9 643	18 058	20 676	24 889	30 156
Conditional grants	5 171	6 130	7 038	8 443	16 451	16 966	17 495
Total	**282 395**	**319 609**	**365 772**	**418 001**	**489 288**	**553 860**	**618 481**
Percentage of total							
National departments	52.5%	52.3%	53.2%	50.9%	50.5%	49.5%	48.9%
Provinces	43.4%	43.3%	42.2%	42.8%	41.9%	43.0%	43.4%
Local government	4.1%	4.3%	4.6%	6.3%	7.6%	7.6%	7.7%
Total	***100.0%***	***100.0%***	***100.0%***	***100.0%***	***100.0%***	***100.0%***	***100.0%***

1. RSC levies abolished from 1 July 2006. Interim replacement grant included in Equitable share.
Source: National Treasury local government database

Table 3.4 shows that equitable share allocations to the metros grew most rapidly. It increased by 70.1 per cent in real terms from 2003/04 to 2006/07. The equitable share grant to district municipalities increased by 50.3 per cent in real terms; and local municipalities saw their equitable share grow by 12.1 per cent in real terms.

Table 3.4 Equitable share transfers, 2003/04 – 2009/10

R million	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
	Outcome			Estimate	Medium-term estimates		
Category A (Metros)[1]	1 273	1 657	2 300	7 348	8 441	10 015	11 983
Category B (Locals)	4 077	4 847	5 873	6 727	7 560	9 281	11 609
Category C (Districts)[1]	1 001	1 174	1 471	3 983	4 674	5 593	6 564
Total	**6 350**	**7 678**	**9 643**	**18 058**	**20 676**	**24 889**	**30 156**
Percentage of total							
Category A (Metros)	*20.0%*	*21.6%*	*23.8%*	*40.7%*	*40.8%*	*40.2%*	*39.7%*
Category B (Locals)	*64.2%*	*63.1%*	*60.9%*	*37.3%*	*36.6%*	*37.3%*	*38.5%*
Category C (Districts)	*15.8%*	*15.3%*	*15.3%*	*22.1%*	*22.6%*	*22.5%*	*21.8%*
Total	***100.0%***	***100.0%***	***100.0%***	***100.0%***	***100.0%***	***100.0%***	***100.0%***

1. RSC levies abolished from 1 July 2006. Interim replacement grant included in Equitable share.
Source: National Treasury local government database

The distribution of the equitable share has increasingly favoured metros over local municipalities. In 2003/04, metros received only 20 per cent of the equitable share, while local municipalities received 64.2 per cent and district municipalities the remainder. In 2006/07, 40.7 per cent of the total grant went to metros, 37.3 per cent to local municipalities and 22.1 per cent to the district municipalities. The bias towards the metros is a result of both their large and growing poor populations and the introduction of the RSC levy replacement grant, which is transferred through the equitable share mechanism. This replacement grant was also allocated to district municipalities. The trend in 2009/10 shows metros and local municipalities receiving almost the same proportion of the equitable share, at 39.7 per cent and 38.5 per cent respectively.

The growth in grants for all categories of municipalities is intended to assist them in meeting the capital and operating costs of providing basic services to poor households and is not intended to be a substitute for municipalities' own revenue. Non-poor households and firms should still pay the full cost of services they receive and municipalities need to continue their efforts to collect these revenues.

Just as there is an increase in transfers to meet the developmental objectives of local government, there should also be a concerted effort to improve the accountability of the application and performance of these transfers. This should not only be in terms of reporting for compliance purposes, but more in terms of the outcomes of these transfers in reducing poverty and enhancing economic growth. The performance of these transfers should also not only be measured in terms of quantities, such as the number of water connections made but the performance measures should in future graduate to the quality of the service, such as the quality of water provided.

Capital funding

Municipalities fund their capital expenditure in various ways such as external loans, own revenue and grants

Municipalities fund their capital expenditure in various ways such as external loans, own revenue and grants. Table 3.5 shows that grants and subsidies are still the preferred source of finance for the acquisition of fixed assets by municipalities.

Grants for municipal infrastructure averaged about 45.1 per cent of the capital funding of municipalities for the period 2003/04 to 2006/07, with real annual growth averaging 16.8 per cent. The upswing in the grants between 2007/08 and 2008/09 is because of additional grants allocated to municipalities hosting the 2010 FIFA World Cup. Another reason for the increase in grants over the medium-term is the R1.8 billion set aside for the development of regional bulk water services.

Municipalities are increasingly using external loans to fund their infrastructure programmes. This can be seen in the real growth of 40.5 per cent for the period 2003/04 to 2006/07. However, only 26 out of 283 municipalities use external loans to fund capital expenditure and there is, as yet, little indication that the numbers will increase. (For a detailed discussion on municipal borrowings, see Chapter 6 of this Review).

Table 3.5 Municipal capital funding, 2003/04 – 2009/10

R million	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
	Outcome			Estimate	Medium-term estimates		
Source of finance							
External loans	2 011	3 315	5 278	6 543	7 621	6 678	5 909
Public contributions and donations	371	248	301	287	838	786	701
Grants and subsidies	4 775	6 058	8 186	8 909	20 813	22 118	14 960
Other	3 539	3 702	3 467	5 153	10 464	9 670	8 767
Total source of finance	**10 696**	**13 323**	**17 232**	**20 891**	**39 736**	**39 252**	**30 337**
Percentage of source of finance							
External loans	*18.8%*	*24.9%*	*30.6%*	*31.3%*	*19.2%*	*17.0%*	*19.5%*
Public contributions and donations	*3.5%*	*1.9%*	*1.7%*	*1.4%*	*2.1%*	*2.0%*	*2.3%*
Grants and subsidies	*44.6%*	*45.5%*	*47.5%*	*42.6%*	*52.4%*	*56.3%*	*49.3%*
Other	*33.1%*	*27.8%*	*20.1%*	*24.7%*	*26.3%*	*24.6%*	*28.9%*
Total	***100.0%***	***100.0%***	***100.0%***	***100.0%***	***100.0%***	***100.0%***	***100.0%***

Source: National Treasury local government database

Municipalities also fund their capital expenditure from surpluses generated from their trading activities or from rates. This form of funding has been decreasing over the years, from 33.1 per cent of total funding in 2003/04 to 24.7 per cent in 2006/07 and is set to increase to 28.9 per cent over the medium-term. The real growth rate in this form of funding was 7.5 per cent for the period 2003/04 to 2006/07 and is set to increase to 13.5 per cent over the medium term. This is attributable to municipalities recognising the importance of using their own revenues to finance capital projects.

Outstanding consumer debts

As at December 2007, municipalities were owed a total of R44.2 billion. This represents an increase of 0.3 per cent from the same month in 2006.

Metros are owed the biggest portion of the debt, amounting to R25.4 billion. While this is high, it does represent a decrease of about R2.8 billion from December 2006. This is mainly due to debt write offs by municipalities like Ekurhuleni, the City of Tshwane and the City of Johannesburg, as part of debt management strategies, rather than this revenue actually being collected. These strategies include data cleansing, updating the indigent register and effective implementation of credit control policies.

However, outstanding consumer debts owed to local municipalities have increased by nearly R3 billion between December 2006 and December 2007 as most of them have not yet instituted the same debt management strategies as the metros.

The debts owed to district municipalities are mainly outstanding RSC levies, which are still on the books of the municipalities as they were collectable until June 2008.

Closer scrutiny shows that as at December 2007, metros were owed almost 35 per cent of their total annual budgets, local municipalities 39 per cent and district municipalities 11 per cent. A further breakdown shows that residents owe almost 60 per cent of the total

amount, while national and provincial government owes 20 per cent with businesses owing the remaining 20 per cent for all categories of municipalities.

Table 3.6 Debtors age analysis, 31 December 2006 and 31 December 2007

	0 - 30 Days		31 - 60 Days		61 - 90 Days		Over 90 Days		Total	
R thousand	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Debtors analysis as at 31 December 2007										
Category A (Metros)	3 719 555	14.7%	1 300 603	5.1%	868 440	3.4%	19 493 137	76.8%	25 381 736	57.4%
Category B (Locals)	1 996 506	11.2%	818 689	4.6%	792 657	4.4%	14 261 829	79.8%	17 869 682	40.4%
Category C (Districts)	96 463	10.3%	32 842	3.5%	47 240	5.1%	758 865	81.1%	935 409	2.1%
Total	**5 812 524**	**13.2%**	**2 152 134**	**4.9%**	**1 708 337**	**3.9%**	**34 513 831**	**78.1%**	**44 186 827**	**100.0%**
Debtors analysis as at 31 December 2006										
Category A (Metros)	3 339 731	11.8%	1 130 074	4.0%	739 697	2.6%	22 990 769	81.5%	28 200 271	64.0%
Category B (Locals)	1 557 068	10.4%	650 283	4.4%	755 874	5.1%	11 939 153	80.1%	14 902 377	33.8%
Category C (Districts)	80 010	8.5%	29 786	3.2%	52 010	5.5%	783 487	82.9%	945 293	2.1%
Total	**4 976 809**	**11.3%**	**1 810 143**	**4.1%**	**1 547 581**	**3.5%**	**35 713 409**	**81.1%**	**44 047 941**	**100.0%**
Movement between 2006 and 2007										
Category A (Metros)	379 824		170 529		128 743		-3 497 632		-2 818 535	
Category B (Locals)	439 438		168 406		36 783		2 322 676		2 967 305	
Category C (Districts)	16 453		3 056		-4 770		-24 622		-9 884	
Total	**835 715**		**341 991**		**160 756**		**-1 199 578**		**138 886**	
Growth rate between 2006 to 2007										
Category A (Metros)	11.4%		15.1%		17.4%		-15.2%		-10.0%	
Category B (Locals)	28.2%		25.9%		4.9%		19.5%		19.9%	
Category C (Districts)	20.6%		10.3%		-9.2%		-3.1%		-1.0%	
Total	**16.8%**		**18.9%**		**10.4%**		**-3.4%**		**0.3%**	

Source: National Treasury local government database

Expenditure trends

Table 3.7 shows that actual expenditure by all categories of municipalities has been increasing annually by 14.3 per cent from R85.9 billion in 2003/04 to R128.1 billion in 2006/07 and is set to increase by 6.9 per cent to R156.5 billion over the medium-term. Spending is set to increase by 22.8 per cent between 2006/07 and 2007/08 and then decline over the medium-term. This is driven primarily by the increase in capital expenditure associated, in large part, with the 2010 FIFA World Cup.

The slight dip in the outer year reflects two things. First, the phasing out of 2010 FIFA World Cup related spending. Second, the fact that multi-year budgeting is not yet sufficiently robust amongst municipalities.

Table 3.7 also shows the expenditure split between the different categories of municipalities. Metros account for 59 per cent of total local government expenditure. By virtue of their size, powers and functions and comparatively well established asset bases, metros have seen their spending rise at a comparatively stable real growth rate of 9.2 per cent and 9.8 per cent in 2004/05 and 2005/06 respectively, with an average annual growth rate of 7.5 per cent between 2003/04 and 2006/07. (For a more detailed analysis of spending patterns and other matters relating to metros, see Chapter 4 of this Review).

Table 3.7 Municipal budgets by category, 2003/04 – 2009/10

R million	2003/04	2004/05 Outcome	2005/06	2006/07 Estimate	2007/08 Medium-term estimates	2008/09	2009/10
Category A (Metros)	50 565	57 526	66 232	73 544	90 519	94 478	92 464
Category B (Locals)	29 820	33 727	39 332	45 994	54 533	54 832	52 828
Category C (Districts)	5 464	5 908	7 318	8 569	12 243	11 311	11 222
Total	**85 850**	**97 162**	**112 882**	**128 106**	**157 294**	**160 620**	**156 514**
Percentage growth							
Category A (Metros)		13.8%	15.1%	11.0%	23.1%	4.4%	-2.1%
Category B (Locals)		13.1%	16.6%	16.9%	18.6%	0.5%	-3.7%
Category C (Districts)		8.1%	23.9%	17.1%	42.9%	-7.6%	-0.8%
Total		**13.2%**	**16.2%**	**13.5%**	**22.8%**	**2.1%**	**-2.6%**

Source: National Treasury local government database

The 231 local (category B) municipalities account for the second biggest portion of local government expenditure, at 35 per cent. These municipalities vary widely, from rural towns like Ulundi in KwaZulu-Natal or Makhuduthamaga in Limpopo to big cities that are the economic hubs in their regions like Emfuleni, Mangaung, Mbombela, Polokwane, Buffalo City and Rustenburg.

Per capita spending by municipalities

Per capita spending by each municipality varies greatly

Per capita spending by each municipality varies greatly. It is mostly determined by the demographics, the socio-economic context and the powers and functions in a particular municipality. It is also influenced by the history of local government in a particular area and consequently the maturity of the municipality.

Table 3.8 Municipal per capita spending by secondary city, 2003/04 – 2009/10

Rand	Population 2005	2003/04	2004/05 Outcome	2005/06	2006/07 Estimate	2007/08 Medium-term estimates	2008/09	2009/10
Buffalo City	695 278	2 078	2 239	2 386	3 372	3 063	3 059	3 157
City of Matlosana	359 202	1 413	1 959	2 223	2 430	3 154	2 845	3 167
Drakenstein	194 417	2 410	2 637	3 118	3 357	4 190	4 495	4 813
Emalahleni	276 413	2 443	2 337	2 646	2 902	3 162	2 883	3 056
Emfuleni	658 420	2 034	2 426	2 229	2 877	2 800	2 534	2 629
George	135 409	2 954	3 797	4 681	5 271	6 632	6 482	6 935
Govan Mbeki	221 747	1 737	2 047	2 990	3 536	3 234	3 313	3 414
Madibeng	346 675	983	1 154	1 440	1 934	1 830	1 944	2 360
Mangaung	645 440	2 258	2 459	1 911	2 156	3 569	3 836	3 515
Matjhabeng	408 170	1 734	2 860	1 691	2 177	2 511	2 628	2 847
Mbombela	476 593	982	1 123	1 376	2 457	3 363	3 661	2 112
Mogale City	289 835	2 321	2 126	2 130	2 250	2 805	2 844	2 966
Msunduzi	552 837	2 340	2 523	2 933	2 761	3 549	3 759	3 967
Newcastle	332 981	1 262	1 138	1 360	1 874	2 047	–	–
Polokwane	508 277	1 298	1 553	1 755	1 157	4 719	4 471	2 515
Rustenburg	387 096	1 934	2 464	3 098	3 216	4 429	4 906	4 431
Sol Plaatje	201 465	2 470	2 396	2 753	2 843	3 652	3 775	3 860
Stellenbosch	118 709	2 906	3 374	4 123	4 248	5 544	5 784	6 149
Steve Tshwete	142 772	2 148	2 772	3 112	3 092	4 283	4 069	3 977
Tlokwe	128 353	2 488	2 828	2 799	2 977	3 516	3 752	3 963
uMhlathuze	289 190	2 387	2 579	2 850	3 664	4 571	4 671	4 522
Total	**7 369 279**	**1 920**	**2 198**	**2 320**	**2 684**	**3 436**	**3 393**	**3 221**

Source: Stats SA, Census 2005 and National Treasury local government database

Table 3.8 shows the population for 2005 and the per capita spending for the 21 secondary cities. The highest per capita spending in 2007/08 is in George at R6 632 per person, while the lowest is Madibeng (Brits: North West) at R1 830 per person.

Table 3.9 shows that municipalities in Western Cape spend the highest amount per capita, at R6 334 for 2007/08, while Gauteng municipalities spend on average R5 665 per capita. This is despite rapid increases in the populations of both these provinces. According to the Community Survey 2007, Gauteng gained 440 411 more households and 1.2 million more people. Western Cape gained 195 000 more households and 754 000 more people over the same period.

Table 3.9 Municipal per capita spending by province, 2003/04 – 2009/10

	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Rand		Outcome		Estimate		Medium-term estimates	
Eastern Cape	1 367	1 507	1 608	1 836	2 545	2 355	2 204
Free State	1 782	1 790	1 900	2 249	2 583	2 594	2 542
Gauteng	3 293	3 674	4 233	4 769	5 665	6 016	6 029
KwaZulu-Natal	1 678	1 883	2 104	2 353	2 814	2 847	2 882
Limpopo	674	759	975	1 129	1 903	1 836	1 492
Mpumalanga	973	1 058	1 362	1 708	2 130	2 149	1 980
Northern Cape	1 663	1 952	2 184	2 427	2 842	2 832	2 668
North West	1 132	1 326	1 837	2 113	2 477	2 816	2 640
Western Cape	3 201	3 946	4 755	5 316	6 334	6 363	6 235
Total	**1 931**	**2 185**	**2 539**	**2 881**	**3 538**	**3 613**	**3 520**

Source: Stats SA, Census 2005 and National Treasury local government database

The lowest municipal per capita spending is in Limpopo, where R1 903 was spent in 2007/08. Indeed the fact that per capita spending by municipalities is lowest in Limpopo, Mpumalanga and North West indicates that the low level of spending is probably linked to the historical under-development of local government in these regions. It also indicates the importance of efforts to grow the local economies, as well as the fact that a lot of work still needs to be done to address poverty in these provinces.

Operating expenditure

Municipalities' actual operating expenditure increased in real terms by 4.6 per cent annually from 2003/04 to 2006/07 and is estimated to grow by 4.1 per cent in the medium-term.

Personnel costs account for the largest component of operating expenditure

Personnel costs account for the largest component of operating expenditure, averaging 29.4 per cent of total operating expenditure. Between 2003/04 and 2006/07, real growth in personnel expenditure is 3.3 per cent and is set to increase by 5.8 per cent over the medium-term. The higher nominal year-on-year increase in personnel expenditure of 8.9 per cent for the period 2003/04 to 2006/07 does not include amounts spent on private contractors and consultants working for municipalities. (For a detailed discussion on personnel trends in local government, refer to Chapter 12 of this Review).

Table 3.10 Municipal operating expenditure, 2003/04 – 2009/10

R million	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
	Outcome			Estimate	Medium-term estimates		
Operating expenditure							
Employee costs	21 577	23 433	25 015	27 895	34 820	36 354	38 433
Remuneration of councillors	596	787	955	1 417	–	–	–
Repairs and maintenance	4 459	4 868	5 245	5 925	8 532	8 943	9 587
Depreciation and amortisation	2 505	3 945	4 253	4 980	–	–	–
Finance charges	4 216	3 409	3 123	3 180	7 483	8 029	8 759
Materials and bulk purchases	17 198	18 243	19 480	21 481	23 827	25 027	26 715
Grants and subsidies	1 435	2 021	2 141	2 339	–	–	–
Other expenditure	19 742	25 557	27 604	28 884	42 897	43 016	42 683
Total expenditure	**71 729**	**82 264**	**87 815**	**96 100**	**117 558**	**121 368**	**126 176**

Source: National Treasury local government database

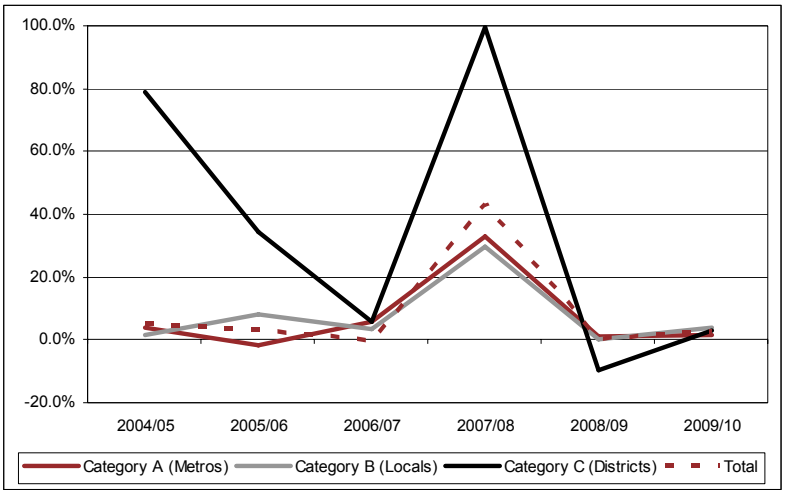
Bulk purchases take up almost 21.8 per cent of municipalities' operating expenditure and have remained stable over the seven-year period. The cost of bulk purchases of electricity and water have increased from R17.2 billion in 2003/04 to R21.5 billion 2006/07. Real growth in expenditure on bulk services has been minimal, amounting to an average of 2.1 per cent for the period 2003/04 to 2006/07. This reflects the below inflation increases in the price of bulk services for the period up until 2007/08. Current data indicates that municipal expenditure on bulk services is set to increase by 2.2 per cent between 2006/07 and 2010/11. However, given expected increases in the bulk prices of both electricity and water, expenditure on this item is likely to grow more rapidly than currently estimated by municipalities. (See chapters 7 and 8 for more detailed discussions on water and electricity expenditures).

Infrastructure has to be maintained to keep it in good working order

The growth in capital expenditure on new infrastructure assets in previously under-serviced areas means that over time, this infrastructure has to be maintained to keep it in good working order. In historically serviced areas, the continued maintenance of existing infrastructure also requires the same attention. Expenditure on repairs and maintenance has grown from R4.5 billion in 2003/04 to R8.5 billion in 2007/08 and will be increasing by R1 billion over the medium-term. In real terms this represents an average annual increase of 4.3 per cent between 2003/04 and 2006/07 and is set to increase further by 11.6 per cent in the medium-term. Yet maintenance expenditure remains low, constituting only 6.6 per cent of total expenditure since 2003/04. It is projected to remain at this level over the medium-term while the asset base of municipalities continues to grow. Ideally allocations to repairs and maintenance should be directly linked to the life-cycle management of municipal assets. However, in most municipalities expenditure on maintenance tends to be reactive, rather than proactively determined as part of a routine and periodic maintenance programme linked to managing municipal assets. What a municipality should be spending on maintenance will depend on how effectively it has maintained its assets in the past, the age of its assets and the extent of utilisation of its assets. However, given existing backlogs, most municipalities should probably be budgeting between 10 per cent and 15 per cent of operating expenditure for repairs and maintenance.

Figure 3.1 shows that growth trend for repairs and maintenance was low between 2003/04 and 2006/07, picks up in 2007/08 and then dips over the medium-term. As mentioned above, the medium term trend suggests a lack of multi-year budgeting skills and proper asset management processes in some municipalities. It is anticipated that with increased emphasis being placed on better asset management, the budget for repairs and maintenance will be revised upward in future years.

Figure 3.1 Repairs and maintenance real expenditure growth, 2004/05 – 2009/10



Source: National Treasury local government database

Capital expenditure

Spending on municipal infrastructure has increased from R10.7 billion in 2003/04 to R20.9 billion 2006/07 and is set to increase by nearly R10 billion over the medium-term. In real terms this amounted to an average annual growth of 18.5 per cent between 2003/04 and 2006/07. However, the real growth rate is set to decline to 7.6 per cent over the medium-term.

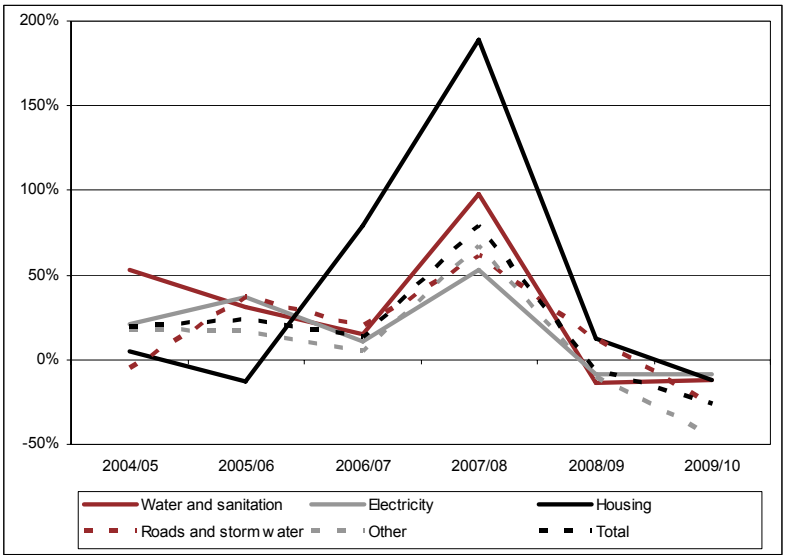
Table 3.11 Municipal capital expenditure, 2003/04 – 2009/10

	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
R million		Outcome		Estimate	Medium-term estimates		
Water and sanitation	1 839	2 925	4 014	4 957	10 397	9 434	8 664
Electricity	1 267	1 599	2 295	2 725	4 426	4 255	4 063
Housing	658	718	658	1 269	3 893	4 586	4 221
Roads and storm water	1 775	1 751	2 517	3 222	5 536	6 466	5 013
Other	5 157	6 329	7 747	8 718	15 484	14 510	8 376
Total	**10 696**	**13 323**	**17 232**	**20 891**	**39 736**	**39 252**	**30 337**

Source: National Treasury local government database

Figure 3.2 shows that the real growth in capital spending between 2003/04 and 2006/07 was most significant in water and sanitation, at 32 per cent, followed by spending on electricity infrastructure, at 22.4 per cent. Growth in housing expenditure, though not a major function of municipalities, also showed an upswing at 18 per cent.

Figure 3.2 Real growth in capital expenditure, 2004/05 – 2009/10



Source: National Treasury local government database

Growth in expenditure on roads and storm water also increased significantly, at 15.7 per cent in real terms between 2003/04 to 2006/07. Other capital expenditure forms a significant portion of total capital expenditure (averaging 43.1 per cent) and comprises of land and buildings, fleet vehicles, specialised vehicles like ambulances, computers and so on. Spending on this item has grown at a real average annual rate of 13 per cent between 2003/04 and 2006/07, but growth is set to decline to a negative 6.2 per cent. This is also attributable to the lack of planning that underpins the outer years' projections.

Key issues in municipal budgets

Growing grant dependence

The growth in government transfers has occurred at a faster pace than the increase in own revenue generated by municipalities. This has created a situation where municipalities are increasingly dependent on grants to fund their operating costs. This is creating a dependency syndrome, which in future might be unsustainable. The equitable share constituted 8.6 per cent of the total operating revenue in 2003/04. This has risen to an estimated 17.5 per cent in 2007/08.

Inadequate maintenance expenditure

Among the reasons for the low expenditure on repairs and maintenance is the ease with which these expenditures can be deferred in favour of new capital projects or other operating costs. This results in the degradation of the value of assets and the need for their replacement earlier than might otherwise be the case. Two factors appear to underlie this problem. First, the under-pricing of municipal services relative to their true cost of delivery, including maintenance costs. Second, poor management practices in municipalities,

particularly the absence of up to date asset registers, often result in maintenance schedules either not being set or being ignored.

Outstanding consumer debts

Most municipalities have failed to overcome the challenge posed by outstanding consumer debts

Most municipalities have, as yet, failed to overcome the challenge posed by outstanding consumer debts. If municipalities had collected half of these debts, they would have had about 18 per cent more revenue with which to fund delivery of services. This would have added substantially to their ability to address service delivery backlogs.

The increase in outstanding consumer debts also highlights possible governance problems. Good governance includes the ability of an organisation to implement adopted policies. Unfortunately, many municipalities pay lip-service to the implementation of their credit control policies.

The amount of debts that municipalities choose to write off as uncollectable impacts on the amount of debt older than 90 days in the debtors' age analysis. Municipalities appear to be resistant to write-off debt because there is a perception that this will send a negative signal to communities regarding the consequences for non-payment. This is despite the fact that all avenues may have been exhausted to collect the debt. Municipalities should ensure that arrear debtors are not inflated by the ongoing inclusion of debtors that are not collectable. This will require council to approve policies to at least annually review and address this issue.

Under-pricing of services

The over reliance by municipalities on national grants points to the possibility of under-pricing of services. This is more so even in services that have the potential to finance themselves. This practice has the potential to negatively affect investments in repairs and maintenance of existing municipal infrastructure.

Conclusion

Slow but steady progress is being made by local government since the introduction of new legislation to govern municipalities. This is evidenced by a healthy growth in municipal revenues and expenditure.

However, the disparities between the per capita expenditure levels between municipalities are still very large. This highlights the importance of national government transfers to local government, particularly to the poorer municipalities. However, it also highlights the need for municipalities to price their services correctly, so as to ensure they are able to fund their services on a sustainable basis. Lastly, the importance of having sound indigent policies, linked to robust debt collection strategies cannot be over emphasised.

4

Metropolitan finance

Introduction

South Africa's six metropolitan municipalities (metros) namely, the City of Cape Town, City of Johannesburg, City of Tshwane, Ekurhuleni, eThekwini and Nelson Mandela Bay are playing an important role in supporting economic growth and combating poverty. First, they provide public infrastructure and services to households and firms that enable economic activity to occur. Second, they guide and regulate spatial development in their jurisdictions that can significantly enhance the equity and efficiency of development.

The six metros play an important role in supporting economic growth and combating poverty

The combined budgeted expenditures of the metros comprise 57.5 per cent of all municipal budgets for 2007/08. This is expected to increase to 59.1 per cent in 2009/10. Census 2001 shows that 36.8 per cent of the country's households resided in the metros and according to the Community Survey 2007, this increased to 37.8 per cent. The share of the metros' population in the country has increased from 32.7 per cent in 2001 to 35 per cent in 2007. Furthermore, the Statistics South Africa 2007 Non-financial census shows that metros employ 49.2 per cent of all municipal personnel. The spatial profiles[1] of the municipalities show that the six metros contribute 58.6 per cent to the national economy in terms of value of goods and services produced, the gross value added (GVA). These statistics point to the significant role that metros play, not only in the local government sphere, but also in the country as a whole.

Despite their many similarities, there are also important differences among metros. The economies of the areas governed by metros differ markedly and are subject to different pressures. Social pressures and poverty levels are changing at different rates and from differing

Despite their many similarities, there are also important differences among metros

[1] NSDP Spatial Profiles, May 2006: GVA (2004 at 2006 prices).

starting points. Service delivery mechanisms vary between metros as do their sources of revenue.

Strategies to address the pressures of social and economic change must be developed within the specific socio-economic context of each metro. Metros cannot be conceived of as a homogenous block. Each one requires the institutional capacity unique to its developmental objectives and priorities.

Despite large investments by metros, certain developmental challenges remain. These include, among others, greater demand for basic services due to inward migration and declining household size, high levels of poverty and unemployment and unsustainable developmental practices.

Nevertheless, a comparative analysis of the socio-economic profiles and financial position of the six metros is useful in identifying these differences, highlighting variations in performance and identifying common issues that they must all address.

The chapter gives an overview of:

- the regulatory environment and functions
- the social and economic context
- a detailed financial analysis and overview of trends.

Regulatory environment and functions

The Constitution and the Municipal Structures Act assign specific powers and functions to metros

Municipalities have been established in terms of Section 155 of the Constitution of South Africa. Section 155(1)(a) classifies metros as category A and assigns them the exclusive executive and legislative authority within their areas of jurisdiction. Parts B of schedules 4 and 5 of the Constitution specify the functional competencies of municipalities. Moreover, the final authorisations made in 2002 by the Minister of Provincial and Local Government, in terms of the Municipal Structures Act (1998) as amended, assign metros full water, sanitation, refuse and electricity functions. Other than the Constitution and the Municipal Structures Act, the metros are regulated by the same legislative framework as all other categories of municipalities.

The functions, referred to above, are essentially service utilities that enable municipalities to raise a significant portion of revenue to support local economic development, combat poverty and improve institutional capacity to improve performance. The revenues enable metros to cover capital and operating costs and use any surpluses to subsidise other municipal activities that, by their nature, do not raise sufficient revenue to cover their costs.

Operating service utilities as "businesses" requires cost-benefit evaluation

A key challenge for municipalities has been to model and operate the service utilities functions as separate and identifiable "businesses". It is difficult for municipalities to apportion revenues, expenses, assets, liabilities and personnel directly to activities associated with these service utilities. The cost of performing the exercise should be weighed against the benefits to be derived. The benefit of operating the service utilities as businesses is that it becomes less cumbersome

to plan and manage the infrastructure investments and related maintenance. Better still, tariffs could be set so that both the capital and operating expenditure associated with the functions could be recouped and adjusted over the economic lives of the infrastructure assets. The associated costs of this approach include organisational restructuring to reflect the business model (this includes designing appropriate organisational structure and setting up reporting relationships and responsibilities) and designing budgeting, accounting and financial reporting systems to support the structure.

The financial performance of the service utilities is examined in the financial analysis section below and in chapters 7 and 8 of this Review which deal with water and electricity respectively. Caution when interpreting the revenues and costs associated with the service utilities is advised, as they are not based on a robust ring-fencing exercise.

Social and economic context

Metros are well positioned to play a major role in fulfilling government's objective of combating poverty

A key focus of developmental local government is the provision of basic municipal services to local communities and industries, other spheres of government, private firms and public facilities such as schools, hospitals and churches. Due to the high concentration of individuals and households in their jurisdictions, metros are well positioned to play a major role in fulfilling government's objective of combating poverty.

Table 4.1 shows that the number of households in the six metros have increased by 593 000 or 14.4 per cent between the Census 2001 data and the results of the Community Survey 2007. This growth is primarily driven by inward population migration, decreasing household size and faster household formation. This has implications for service delivery and the sustainability of these municipalities.

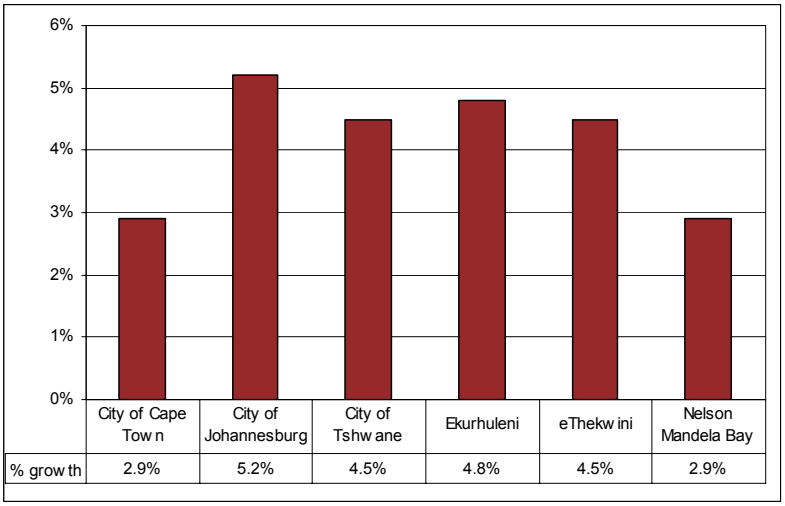
Table 4.1 Number of households per metro, 2003/04 – 2009/10

Number of households	Census 2001	Community Survey 2007
City of Cape Town	759 485	902 278
City of Johannesburg	1 006 742	1 164 014
City of Tshwane	561 772	686 640
Ekurhuleni	744 479	849 349
eThekwini	786 746	833 859
Nelson Mandela Bay	260 799	276 881
Total	**4 120 023**	**4 713 021**
Percentage growth		
City of Cape Town		18.8%
City of Johannesburg		15.6%
City of Tshwane		22.2%
Ekurhuleni		14.1%
eThekwini		6.0%
Nelson Mandela Bay		6.2%
Total		**14.4%**

Source: Stats SA, Census 2001 and Community Survey 2007

The 2006 Spatial Profile report shows that the metros' GVA (a measure of municipal economic activity at the local level) is 58.6 per cent of the national GVA. Within the metros, the City of Johannesburg has the highest GVA of 18.1 per cent, followed by the City of Cape Town (11.2 per cent), eThekwini (10 per cent), City of Tshwane (9.2 per cent), Ekurhuleni (7.1 per cent). The lowest is Nelson Mandela Bay, at 2.9 per cent. Figure 4.1 shows average GVA growth per metro. The City of Johannesburg shows the highest growth of 5.2 per cent.

Figure 4.1 Average GVA growth, 2001 – 2004



Source: Adapted from South African Cities Network, State of the Cities Report, 2006

There is a need for strategies to sustain the growth while developing new industries

It is imperative for each metro to critically analyse and understand the industries and factors that drive growth in its areas. Each metro needs to implement strategies to sustain growth in existing industries, while at the same time pursue opportunities to develop new industries. This strategic approach is central to municipalities successfully performing their role of supporting economic development.

Financial analysis and trends

Total metro budgets and expenditure outcomes

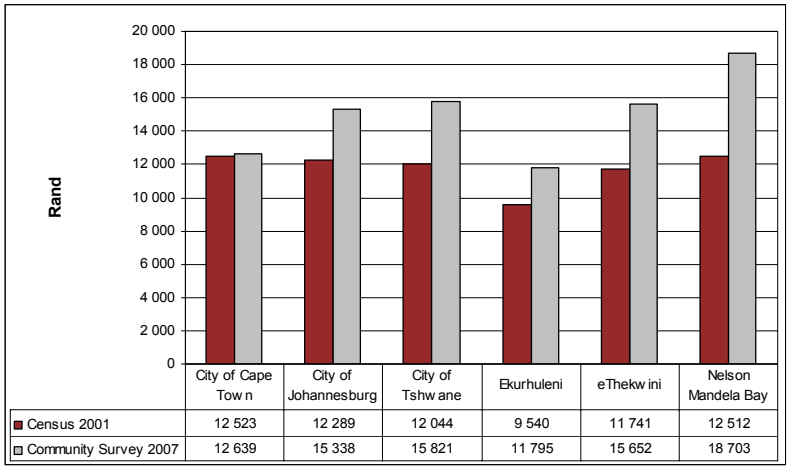
Collectively, the metros' budgets made-up 57.5 per cent of local government budgets in 2007/08. Table 4.2 shows that, in fulfilling their service delivery responsibilities, metros' actual expenditure increased from R48.3 billion in 2003/04 to R68.4 billion in 2006/07, an increase of 6.5 per cent in real terms. Given the large increase in national transfers to municipalities to roll out basic services to the poor and to meet the 2010 FIFA World Cup commitments, spending is budgeted to increase to R92.5 billion by 2009/10, a real annual increase of 5.1 per cent.

Table 4.2 Metros' outcomes and budgets, 2003/04 – 2009/10

R million	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
		Outcome		Estimate	Medium-term estimates		
Capital expenditure							
City of Cape Town	910	951	1 521	1 969	4 073	3 523	2 655
City of Johannesburg	1 296	1 954	2 722	3 284	4 761	5 112	3 658
City of Tshwane	887	1 273	1 550	2 316	2 316	2 795	2 598
Ekurhuleni	742	918	766	1 191	1 852	1 847	1 564
eThekwini	1 465	2 014	2 087	2 551	4 199	4 794	3 512
Nelson Mandela Bay	363	456	544	888	2 129	1 627	1 069
Total capital	**5 663**	**7 568**	**9 189**	**12 200**	**19 330**	**19 698**	**15 056**
Operating expenditure							
City of Cape Town	8 601	8 329	9 492	9 435	16 626	17 297	17 157
City of Johannesburg	11 076	12 048	13 379	14 569	18 262	19 461	20 224
City of Tshwane	5 879	7 733	7 822	8 547	9 408	10 058	10 880
Ekurhuleni	6 361	7 964	7 540	8 827	10 594	11 214	11 583
eThekwini	7 773	9 283	9 243	10 500	11 155	11 828	13 245
Nelson Mandela Bay	2 900	3 000	3 024	4 291	5 145	4 921	4 319
Total operating	**42 589**	**48 357**	**50 501**	**56 169**	**71 189**	**74 780**	**77 408**
Total							
City of Cape Town	9 511	9 281	11 012	11 404	20 698	20 820	19 812
City of Johannesburg	12 372	14 002	16 101	17 853	23 023	24 574	23 882
City of Tshwane	6 766	9 007	9 372	10 863	11 724	12 853	13 478
Ekurhuleni	7 103	8 883	8 306	10 018	12 445	13 062	13 146
eThekwini	9 237	11 297	11 330	13 051	15 354	16 622	16 757
Nelson Mandela Bay	3 263	3 456	3 568	5 179	7 274	6 548	5 388
Total	**48 252**	**55 925**	**59 689**	**68 369**	**90 519**	**94 478**	**92 464**
Percentage growth							
City of Cape Town		-2.4%	18.7%	3.6%	81.5%	0.6%	-4.8%
City of Johannesburg		13.2%	15.0%	10.9%	29.0%	6.7%	-2.8%
City of Tshwane		33.1%	4.1%	15.9%	7.9%	9.6%	4.9%
Ekurhuleni		25.1%	-6.5%	20.6%	24.2%	5.0%	0.6%
eThekwini		22.3%	0.3%	15.2%	17.6%	8.3%	0.8%
Nelson Mandela Bay		5.9%	3.3%	45.1%	40.5%	-10.0%	-17.7%
Total		**15.9%**	**6.7%**	**14.5%**	**32.4%**	**4.4%**	**-2.1%**

Source: National Treasury local government database

Figure 4.2 Metros' expenditure per household, 2001 – 2007



Source: Stats SA, Census 2001 and Community Survey 2007; National Treasury local government database

Figure 4.2 shows that spending per household remains static in the City of Cape Town, while the rest of the metros experienced large spending growth. This is mainly due to a faster rate of growth in revenue in the other metros and rapid inward migration into the City of Cape Town. The rest of the metros' budgets grew faster than household growth.

Capital budgets and outcomes

Investment in urban infrastructure is important for the development of local economies, combating poverty and the provision of universal access to municipal services. Of equal importance is the institutional capacity to develop and maintain the infrastructure.

Table 4.3 Metros' capital budgets, 2003/04 – 2009/10

R million	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
	Outcome			Estimate	Medium-term estimates		
Source of finance							
External loans	1 475	2 668	4 015	5 671	5 081	5 012	4 438
Public contributions and donations	347	96	122	218	574	487	507
Grants and subsidies	2 063	3 150	3 569	4 471	8 037	9 228	5 438
Other	1 778	1 653	1 483	1 840	5 637	4 971	4 673
Total funding	**5 663**	**7 568**	**9 189**	**12 200**	**19 330**	**19 698**	**15 056**
Percentage of revenue							
External loans	*26.0%*	*35.3%*	*43.7%*	*46.5%*	*26.3%*	*25.4%*	*29.5%*
Public contributions and donations	*6.1%*	*1.3%*	*1.3%*	*1.8%*	*3.0%*	*2.5%*	*3.4%*
Grants and subsidies	*36.4%*	*41.6%*	*38.8%*	*36.7%*	*41.6%*	*46.9%*	*36.1%*
Other	*31.4%*	*21.8%*	*16.1%*	*15.1%*	*29.2%*	*25.2%*	*31.0%*
Capital expenditure							
Water and sanitation	609	1 292	1 611	1 965	3 247	3 085	2 805
Electricity	831	1 177	1 660	2 022	2 527	2 557	2 468
Housing	480	516	343	1 052	2 170	2 405	2 435
Roads and storm w ater	1 048	918	1 403	1 950	2 749	3 195	2 634
Other	2 696	3 665	4 172	5 211	8 636	8 456	4 715
Total expenditure	**5 663**	**7 568**	**9 189**	**12 200**	**19 330**	**19 698**	**15 056**
Percentage of expenditure							
Water and sanitation	*10.7%*	*17.1%*	*17.5%*	*16.1%*	*16.8%*	*15.7%*	*18.6%*
Electricity	*14.7%*	*15.5%*	*18.1%*	*16.6%*	*13.1%*	*13.0%*	*16.4%*
Housing	*8.5%*	*6.8%*	*3.7%*	*8.6%*	*11.2%*	*12.2%*	*16.2%*
Roads and storm w ater	*18.5%*	*12.1%*	*15.3%*	*16.0%*	*14.2%*	*16.2%*	*17.5%*
Other	*47.6%*	*48.4%*	*45.4%*	*42.7%*	*44.7%*	*42.9%*	*31.3%*

Source: National Treasury local government database

Rapid inward population migration, declining household sizes and greater economic activity are placing pressure on existing municipal infrastructure and require larger investment in the period ahead. To meet the greater demand for infrastructure, table 4.3 shows that capital budgets of metros have more than doubled from R5.7 billion to R12.2 billion between 2003/04 and 2006/07, a real increase of 48.6 per cent per year. Between 2006/07 and 2008/09, capital spending is projected to increase by R7.5 billion to R19.7 billion mainly due to the large infrastructure investment related to the 2010 FIFA World Cup. The decline to R15.1 billion in 2009/10 is due to the 2010 FIFA World Cup projects coming to an end. The "other"

component in capital expenditure includes projected infrastructure spending on projects related to the 2010 FIFA World Cup, which are not covered in water and sanitation, electricity, roads and storm water and housing functions.

Operating budgets and outcomes

Table 4.4 shows that operating revenue increased from R43.7 billion in 2003/04 to R61.8 billion in 2006/07. Service charges on water, sanitation, electricity and refuse removal consistently constitute a significant portion of metro revenues (around 44 per cent). Revenue from service charges grows slowly (1.2 per cent per year in real terms) between 2006/07 and 2009/10, mainly due to growing outstanding consumer accounts, increases in water and electricity losses and the under-pricing of utility services. All these factors affect the ability to recover the full cost of providing the services, which in turn affects the maintenance and sustainability of those services.

Table 4.4 Metros' operating revenue, 2003/04 – 2009/10

R million	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
	Outcome			Estimate	Medium-term estimates		
Property rates	9 967	11 531	12 157	12 725	14 844	15 832	16 744
Service charges	23 268	24 477	25 456	28 506	30 522	32 311	34 432
Regional Service Levies1	3 341	5 031	5 401	115	20	–	–
Investment revenue	1 081	1 388	1 558	1 940	2 703	2 735	3 046
Government grants	2 371	4 513	5 019	11 425	12 487	13 004	12 286
Public contributions and donations	33	474	495	598	–	–	–
Other own revenue	3 603	4 511	4 875	6 496	10 539	10 920	10 948
Total revenue	**43 665**	**51 926**	**54 961**	**61 804**	**71 115**	**74 802**	**77 457**
Percentage of revenue							
Property rates	*22.8%*	*22.2%*	*22.1%*	*20.6%*	*20.9%*	*21.2%*	*21.6%*
Service charges	*53.3%*	*47.1%*	*46.3%*	*46.1%*	*42.9%*	*43.2%*	*44.5%*
Regional Service Levie	*7.7%*	*9.7%*	*9.8%*	*0.2%*	*0.0%*	*0.0%*	*0.0%*
Investment revenue	*2.5%*	*2.7%*	*2.8%*	*3.1%*	*3.8%*	*3.7%*	*3.9%*
Government grants	*5.4%*	*8.7%*	*9.1%*	*18.5%*	*17.6%*	*17.4%*	*15.9%*
Public contributions and donations	*0.1%*	*0.9%*	*0.9%*	*1.0%*	*0.0%*	*0.0%*	*0.0%*
Other own revenue	*8.3%*	*8.7%*	*8.9%*	*10.5%*	*14.8%*	*14.6%*	*14.1%*

1. RSC levies abolished from 1 July 2006. Interim replacement grant included in Equitable share.
Source: National Treasury local government database

From 2006/07, Regional Services/Joint Services Board levies were abolished and replaced with income derived from VAT zero rating on property rates and a transfer from national government, which explains part of the growth in national transfers from 2006/07 onwards. National government is exploring creating tax room by earmarking part of the general fuel levy for municipalities. The projected growth in property rates revenue is due to an increase in the rates base due to the expansion of cities and the gradual implementation of the Municipal Property Rates Act (2004).

Operating budgets of metros account for 83.3 per cent of their total budgets. Operating expenditure increased in real terms by 4 per cent annually between 2003/04 and 2006/07 and is budgeted to increase annually by 5.8 per cent in real terms between 2006/07 and 2009/10. The share of personnel in the total operational budget is around 27 per cent. The metros have successfully contained personnel spending without compromising service delivery. This approach has ensured that important resources are released to improve service delivery in a sustainable way. This is evident in the growth of non-personnel operating and capital spending.

Table 4.5 Metros' operating expenditure, 2003/04 – 2009/10

	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
R million	Outcome			Estimate	Medium-term estimates		
Employee costs	12 827	13 438	14 011	15 902	18 416	19 590	20 637
Remuneration of councillors	184	235	256	317	–	–	–
Repairs and maintenance	2 928	3 162	3 254	3 703	5 231	5 548	5 902
Depreciation and amortisation	1 673	3 050	2 845	3 480	–	–	–
Finance charges	3 062	2 279	2 196	2 267	5 231	5 694	6 249
Materials and bulk purchases	11 342	12 034	12 858	14 461	15 579	16 520	17 717
Grants and subsidies	135	385	387	879	–	–	–
Other expenditure	10 438	13 775	14 693	15 161	26 731	27 428	26 902
Total expenditure	**42 589**	**48 357**	**50 501**	**56 169**	**71 189**	**74 780**	**77 408**
Percentage of expenditure							
Employee costs	*30.1%*	*27.8%*	*27.7%*	*31.5%*	*25.9%*	*26.2%*	*26.7%*
Remuneration of councillors	*0.4%*	*0.5%*	*0.5%*	*0.6%*	*0.0%*	*0.0%*	*0.0%*
Repairs and maintenance	*6.9%*	*6.5%*	*6.4%*	*7.3%*	*7.3%*	*7.4%*	*7.6%*
Depreciation and amortisatior	*3.9%*	*6.3%*	*5.6%*	*6.9%*	*0.0%*	*0.0%*	*0.0%*
Finance charges	*7.2%*	*4.7%*	*4.3%*	*4.5%*	*7.3%*	*7.6%*	*8.1%*
Materials and bulk purchases	*26.6%*	*24.9%*	*25.5%*	*28.6%*	*21.9%*	*22.1%*	*22.9%*
Grants and subsidies	*0.3%*	*0.8%*	*0.8%*	*1.7%*	*0.0%*	*0.0%*	*0.0%*
Other expenditure	*24.5%*	*28.5%*	*29.1%*	*30.0%*	*37.5%*	*36.7%*	*34.8%*

Source: National Treasury local government database

Maintenance should be planned and not deferred as it affects the productivity of assets

Metros are gradually prioritising repairs and maintenance. Table 4.6 shows that spending on repairs and maintenance nearly doubled from R2.9 billion in 2003/04 to R5.2 billion in 2007/08 and is set to grow further over the medium-term. Table 4.6 also shows that, given the large capital stock of roads, electricity and water, the share of spending on repairs and maintenance remains low at around 6 per cent of total metro budgets. Spending on repairs and maintenance is particularly low in the City of Johannesburg.

To ensure sustainable uninterrupted delivery of municipal services and certainty in own revenue streams, municipalities will have to increase their investment in repairs and maintenance. This is even more important for these large cities given the growing demand for services due to rapid inward migration and the demands to support an expanding economy. Further, it is important for municipalities to put in place sound asset management practices.

Table 4.6 Repairs and maintenance expenditure by metro, 2003/04 – 2009/10

R million	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
	Outcome			Estimate	Medium-term estimates		
City of Cape Town	561	680	804	964	1 148	1 197	1 251
City of Johannesburg	152	206	240	256	299	312	330
City of Tshwane	861	863	677	731	1 097	1 199	1 300
Ekurhuleni	367	398	445	566	1 077	1 147	1 223
eThekwini	788	798	830	879	1 309	1 373	1 460
Nelson Mandela Bay	199	218	258	307	302	319	338
Total	**2 928**	**3 162**	**3 254**	**3 703**	**5 231**	**5 548**	**5 902**
Percentage expenditure of total expenditure							
City of Cape Town	6.5%	8.2%	8.4%	10.2%	9.3%	9.3%	9.3%
City of Johannesburg	1.3%	1.5%	1.8%	1.8%	1.8%	1.8%	1.8%
City of Tshwane	14.7%	10.2%	9.3%	8.6%	12.1%	12.5%	12.6%
Ekurhuleni	6.0%	5.0%	5.8%	6.4%	8.5%	8.6%	8.8%
eThekwini	9.1%	9.0%	8.6%	8.0%	11.8%	11.6%	11.3%
Nelson Mandela Bay	6.9%	7.3%	8.5%	7.4%	8.3%	6.5%	7.8%
Total	**6.6%**	**6.2%**	**6.5%**	**6.5%**	**7.9%**	**7.9%**	**8.0%**
Percentage expenditure of property, plant and equipment written down value							
City of Cape Town	7.6%	9.0%	9.4%	9.8%	8.7%	7.4%	7.0%
City of Johannesburg	2.1%	1.5%	1.4%	1.3%	1.4%	1.2%	1.2%
City of Tshwane	15.0%	10.0%	9.5%	8.6%	9.7%	8.6%	7.7%
Ekurhuleni	10.7%	11.1%	11.1%	11.7%	11.9%	10.7%	10.1%
eThekwini	15.4%	7.9%	7.3%	6.9%	8.8%	7.0%	6.7%
Nelson Mandela Bay	7.8%	7.7%	8.1%	7.8%	5.8%	6.6%	6.7%
Total	**9.3%**	**6.7%**	**6.4%**	**6.2%**	**6.7%**	**5.9%**	**5.7%**

Source: National Treasury local government database

Consumer debtors[2]

Increasing outstanding consumer debtors negatively affect municipal revenue and their cash position

Increasing outstanding consumer debtors negatively affect municipal revenue and, therefore, their cash position. Table 4.7 shows that while still high, at R25.4 billion at the end of December 2007, debt owed by consumers declined by just under R3 billion compared to the previous year. This is mainly due to credit control policies and limited write-offs instituted by metros. Further, more attention has been given to indigent policies and their alignment to budgets. Measures have been put in place to collect information on the identity of the debtors (government, business or households). Knowledge of the debtors will assist the metros and other municipalities, to implement appropriate strategies for debt recovery. Ekurhuleni and the City of Cape Town have shown the highest decreases of R1.6 billion and R1 billion for the period, respectively.

The table also shows that a significant portion of the debt is older than 90 days: 76.8 per cent of the debt as at 31 December 2007 and 81.5 per cent as at 31 December 2006[3].

[2] Consumer debtors reflect the amount owed to municipalities by consumers / customers due to the non-payment for services rendered.

[3] The gross debtors' amounts exclude provisions for debt impairment, which amounted to R13 billion for metros in the 2006/07 financial statements.

Table 4.7 Outstanding debtors by metro, as at 31 December 2006 and 31 December 2007

	0 - 30 Days		31 - 60 Days		61 - 90 Days		Over 90 Days		Total	
R thousand	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Metros debtors analysis as at 31 December 2007										
City of Cape Town	588 106	18.0%	193 263	5.9%	126 641	3.9%	2 363 921	72.2%	3 271 931	12.9%
City of Johannesburg	913 533	9.5%	424 643	4.4%	339 240	3.5%	7 939 518	82.6%	9 616 934	37.9%
City of Tshwane	240 642	12.5%	117 674	6.1%	58 998	3.1%	1 501 010	78.2%	1 918 324	7.6%
Ekurhuleni	871 179	13.9%	307 875	4.9%	249 044	4.0%	4 843 578	77.2%	6 271 676	24.7%
eThekwini	670 280	22.5%	201 906	6.8%	78 967	2.7%	2 024 680	68.0%	2 975 833	11.7%
Nelson Mandela Bay	435 816	32.8%	55 242	4.2%	15 550	1.2%	820 430	61.8%	1 327 038	5.2%
Total	**3 719 556**	**14.7%**	**1 300 603**	**5.1%**	**868 440**	**3.4%**	**19 493 137**	**76.8%**	**25 381 736**	**100.0%**
Metros debtors analysis as at 31 December 2006										
City of Cape Town	449 911	10.4%	93 297	2.2%	127 610	3.0%	3 646 910	84.5%	4 317 728	15.3%
City of Johannesburg	756 018	8.3%	369 423	4.1%	292 257	3.2%	7 701 853	84.5%	9 119 550	32.3%
City of Tshwane	366 114	16.2%	147 931	6.5%	35 242	1.6%	1 717 151	75.8%	2 266 438	8.0%
Ekurhuleni	828 251	10.5%	324 020	4.1%	210 697	2.7%	6 512 429	82.7%	7 875 397	27.9%
eThekwini	517 137	15.5%	144 398	4.3%	61 765	1.9%	2 608 040	78.3%	3 331 339	11.8%
Nelson Mandela Bay	422 300	32.7%	51 005	4.0%	12 127	0.9%	804 385	62.4%	1 289 817	4.6%
Total	**3 339 731**	**11.8%**	**1 130 074**	**4.0%**	**739 698**	**2.6%**	**22 990 768**	**81.5%**	**28 200 269**	**100.0%**
Movement between 31 December 2006 and 31 December 2007										
City of Cape Town	138 195		99 966		-969		-1 282 989		-1 045 797	
City of Johannesburg	157 515		55 220		46 983		237 665		497 384	
City of Tshwane	-125 472		-30 257		23 756		-216 141		-348 114	
Ekurhuleni	42 928		-16 145		38 347		-1 668 851		-1 603 721	
eThekwini	153 143		57 508		17 202		-583 360		-355 506	
Nelson Mandela Bay	13 516		4 237		3 423		16 045		37 221	
Total	**379 825**		**170 529**		**128 742**		**-3 497 631**		**-2 818 533**	
Growth rate 2006 vs. 2007										
City of Cape Town	30.7%		107.1%		-0.8%		-35.2%		-24.2%	
City of Johannesburg	20.8%		14.9%		16.1%		3.1%		5.5%	
City of Tshwane	-34.3%		-20.5%		67.4%		-12.6%		-15.4%	
Ekurhuleni	5.2%		-5.0%		18.2%		-25.6%		-20.4%	
eThekwini	29.6%		39.8%		27.9%		-22.4%		-10.7%	
Nelson Mandela Bay	3.2%		8.3%		28.2%		2.0%		2.9%	
Total	**11.4%**		**15.1%**		**17.4%**		**-15.2%**		**-10.0%**	

Source: National Treasury local government database

Cash flows

The major sources of cash for the metros are consistently from operating activities

The way in which a municipality generates and manages its cash flows determines the extent to which it can provide required levels of municipal services and meet its commitments. Table 4.8 shows the sources and application of cash by the metros over the period. The major sources of cash for the metros are consistently from operating activities. Between 2003/04 and 2006/07, metros mainly financed their investments in infrastructure and property, plant and equipment from cash generated by operations. Cash from operations includes government transfers and subsidies.

There is a shift in the cash generated to finance infrastructure investments. Whereas the cash from operations continues to fund infrastructure assets, there is significant growth in other forms of financing, such as external loans. Cash from financing activities increases from R1 billion to R3.7 billion between 2006/07 and 2007/08 and declines to R1.7 billion in 2009/10. This reflects the tapering off in 2010 FIFA World Cup capital spending.

Table 4.8 Cash flow by metro, 2003/04 – 2009/10

R million	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
	Outcome			Estimate	Medium-term estimates		
City of Cape Town							
Net cash from (used) operating	960	1 298	1 964	2 559	2 818	2 738	1 932
Net cash from (used) investing	-818	-712	-1 494	-2 005	-4 187	-3 482	-2 612
Net cash from (used) financing	566	-114	-128	-69	1 140	757	770
Cash/cash equivalents at the year end	1 240	1 712	2 054	2 625	2 302	2 315	2 405
City of Johannesburg							
Net cash from (used) operating	566	2 249	2 347	3 392	2 124	3 996	3 368
Net cash from (used) investing	-1 589	-2 672	-2 918	-3 726	-3 519	-5 403	-3 439
Net cash from (used) financing	899	346	524	367	1 454	1 452	142
Cash/cash equivalents at the year end	135	58	12	44	103	148	219
City of Tshwane							
Net cash from (used) operating	1 095	1 087	1 121	880	1 714	2 186	2 196
Net cash from (used) investing	-891	-1 516	-1 707	-1 289	-1 899	-2 306	-2 210
Net cash from (used) financing	10	519	476	653	188	227	184
Cash/cash equivalents at the year end	614	696	586	830	154	261	430
Ekurhuleni							
Net cash from (used) operating	280	238	1 272	1 052	1 243	1 487	1 782
Net cash from (used) investing	-83	-44	-700	-763	-1 994	-1 887	-1 614
Net cash from (used) financing	370	358	-163	-95	475	367	339
Cash/cash equivalents at the year end	2 302	2 244	2 652	2 847	2 896	2 863	3 371
eThekwini							
Net cash from (used) operating	883	887	1 694	2 944	2 912	4 034	3 199
Net cash from (used) investing	-27	-2 459	-1 613	-3 652	-3 568	-4 466	-3 601
Net cash from (used) financing	184	650	671	350	263	186	290
Cash/cash equivalents at the year end	861	27	779	421	4 945	4 699	4 587
Nelson Mandela Bay							
Net cash from (used) operating	532	502	668	995	1 800	820	1 163
Net cash from (used) investing	-344	-564	-662	-638	-2 043	-1 871	-1 164
Net cash from (used) financing	28	-8	-25	-193	264	80	–
Cash/cash equivalents at the year end	206	137	108	271	292	-678	-679
Total							
Net cash from (used) operating	**4 315**	**6 261**	**9 067**	**11 822**	**12 611**	**15 262**	**13 640**
Net cash from (used) investing	**-3 753**	**-7 967**	**-9 093**	**-12 074**	**-17 210**	**-19 414**	**-14 639**
Net cash from (used) financing	**2 059**	**1 751**	**1 354**	**1 013**	**3 783**	**3 070**	**1 724**
Cash/cash equivalents at the year end	**5 357**	**4 874**	**6 192**	**7 038**	**10 691**	**9 609**	**10 333**

Note: (-) is cash outflow / cash used.

Source: National Treasury local government database

Indicators of financial performance

Table 4.9 presents a selection of key indicators of financial performance for the metros. These indicators are of particular interest to institutions that either lend or are contemplating lending to municipalities.

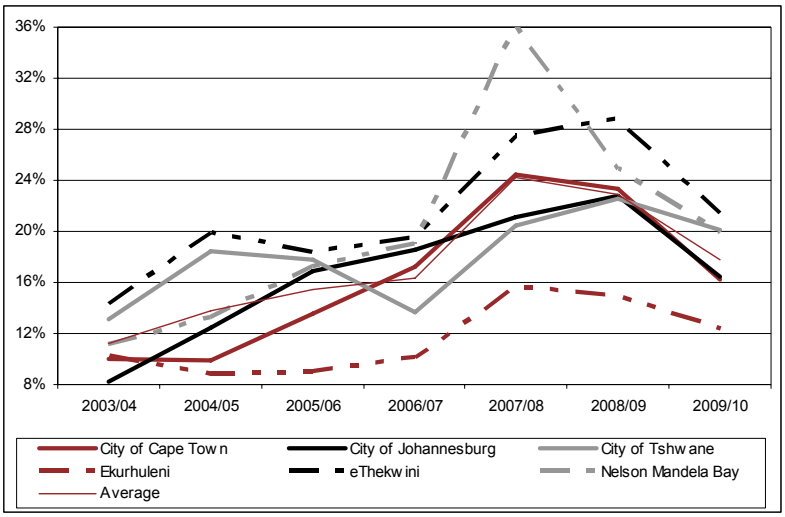
The ***capital benefit ratio*** is an approximate effectiveness measure indicating the proportion of metro capital expenditure to total expenditure. Generally, it is considered that communities will have a greater preference for a higher proportion of available resources to be deployed as capital, especially during times of high demand for new infrastructure to provide basic services such as electricity, sanitation, water and roads. This ratio is affected by increased external funding for capital projects.

Table 4.9 Summary of metros, 2003/04 – 2009/10

	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Percentage		**Outcome**		**Estimate**	**Medium-term estimates**		
Capital benefit ratio							
City of Cape Town	10.0%	9.8%	13.6%	17.2%	24.4%	23.4%	16.2%
City of Johannesburg	8.2%	12.4%	16.9%	18.5%	21.1%	22.7%	16.4%
City of Tshwane	13.1%	18.4%	17.7%	13.6%	20.4%	22.5%	20.2%
Ekurhuleni	10.2%	8.8%	9.0%	10.1%	15.6%	14.9%	12.4%
eThekwini	14.4%	19.9%	18.3%	19.5%	27.5%	28.8%	21.4%
Nelson Mandela Bay	11.1%	13.2%	17.3%	19.0%	36.2%	24.8%	19.8%
Total non-current liabilities to revenue							
City of Cape Town	38.1%	35.2%	39.8%	37.6%	38.6%	42.9%	51.0%
City of Johannesburg	60.6%	47.8%	54.4%	51.2%	50.7%	50.1%	54.3%
City of Tshwane	27.7%	28.7%	31.8%	35.7%	28.0%	27.7%	34.9%
Ekurhuleni	17.1%	18.2%	15.5%	14.7%	22.1%	22.6%	21.6%
eThekwini	40.5%	41.4%	45.2%	46.5%	51.9%	51.6%	56.3%
Nelson Mandela Bay	24.2%	24.7%	23.3%	23.7%	26.4%	22.0%	25.6%
Rates and service charges as a percentage of total revenue							
City of Cape Town	72.8%	70.6%	70.8%	70.3%	64.9%	64.2%	70.1%
City of Johannesburg	72.1%	66.8%	63.0%	64.8%	62.4%	62.3%	65.4%
City of Tshwane	77.9%	70.9%	66.1%	68.1%	66.3%	65.2%	66.5%
Ekurhuleni	75.8%	71.6%	72.1%	70.9%	72.3%	71.0%	70.3%
eThekwini	77.8%	72.0%	69.4%	63.7%	71.2%	67.1%	70.4%
Nelson Mandela Bay	65.0%	66.6%	66.1%	56.1%	46.8%	51.9%	63.4%
Rates as a percentage of property rates and service charges							
City of Cape Town	33.8%	33.1%	33.8%	32.9%	38.7%	38.7%	38.7%
City of Johannesburg	30.2%	30.0%	30.7%	29.3%	29.5%	31.3%	30.9%
City of Tshwane	29.6%	28.4%	29.1%	28.7%	29.0%	29.0%	29.0%
Ekurhuleni	26.4%	28.6%	28.0%	24.4%	22.5%	22.3%	22.1%
eThekwini	39.0%	40.5%	40.5%	40.5%	39.0%	39.6%	39.7%
Nelson Mandela Bay	23.4%	23.9%	24.1%	24.4%	25.5%	25.0%	24.5%
Collection rate							
City of Cape Town	100.6%	97.6%	98.1%	100.6%	89.5%	92.7%	100.9%
City of Johannesburg	88.2%	99.2%	102.8%	99.1%	96.2%	99.0%	95.7%
City of Tshwane	106.3%	95.9%	101.3%	101.0%	98.5%	98.2%	99.9%
Ekurhuleni	88.1%	78.2%	94.6%	94.7%	93.3%	93.1%	93.1%
eThekwini	91.4%	92.2%	89.8%	90.1%	84.8%	74.6%	93.0%
Nelson Mandela Bay	129.8%	136.7%	105.8%	105.9%	95.4%	151.3%	128.9%
Expenditure per household (Rand)							
City of Cape Town	12 329	11 849	14 019	14 096	19 581	19 741	18 495
City of Johannesburg	12 926	14 818	15 353	16 759	20 113	20 382	19 822
City of Tshwane	11 783	14 060	16 131	16 505	18 618	20 017	20 434
Ekurhuleni	9 937	11 497	10 966	12 999	14 800	15 268	15 242
eThekwini	12 633	13 845	14 704	16 805	18 492	19 924	19 486
Nelson Mandela Bay	11 675	12 113	12 777	17 948	20 511	22 769	18 704
Average rates and service revenue as a percentage of average household income (AHI)							
City of Cape Town	7.9%	7.4%	7.4%	7.4%	8.2%	7.9%	7.7%
City of Johannesburg	7.9%	8.2%	8.1%	8.2%	8.3%	8.2%	8.2%
City of Tshwane	7.4%	7.9%	8.0%	7.8%	7.9%	7.9%	7.9%
Ekurhuleni	9.7%	9.6%	9.6%	9.6%	9.8%	9.6%	9.4%
eThekwini	11.4%	11.8%	11.7%	11.6%	11.8%	11.9%	12.0%
Nelson Mandela Bay	10.2%	10.4%	10.5%	10.2%	10.3%	10.4%	10.6%

Source: National Treasury local government database

Figure 4.3 Capital benefit ratio, 2003/04 – 2009/10



Source: National Treasury local government database

In 2005/06 and 2006/07 there is general consistency in the weighted average of 15 per cent and 16 per cent among all metros, except for Ekurhuleni (only 9 per cent and 10 per cent). The ratio moved generally upwards from 2003/04, with the weighted average increasing from 11 per cent to 17 per cent in 2006/07. There is a noticeable decline budgeted in 2009/10, directly related to reductions in national funding of the 2010 FIFA World Cup.

There are significant differences in metros' appetite for borrowing risk

The ***total non-current liabilities to revenue ratio*** is mainly influenced by long term borrowing and revenue size, although other long term provisions have an influence. The ratio can be seen as a measure of risk (high levels of debt increase the risk of repayment default) and also a measure of each individual metro's appetite for risk. The variation between metros is significant (in 2006/07 Ekurhuleni was only 15 per cent and the City of Johannesburg was the highest at 51 per cent). Generally, metros are budgeting to take on more long term liabilities, with the City of Cape Town and eThekwini showing the greatest changes after 2006/07. There appears to be a correlation between this measure and the capital benefit ratio, for example, in 2006/07 Ekurhuleni had the lowest outcomes under both measures, suggesting their borrowing policy is constraining capital expenditure.

The ***rates and services charges as a percentage of total revenue*** indicates the level of reliance on own "billed" revenue to support the expenditure budget. The weighted average declined from 74 per cent in 2003/04 to 67 per cent in 2006/07, probably as a result of increased reliance on transfers and subsidy funding, particularly grants associated with the 2010 FIFA World Cup and the abolition of Regional Service Council (RSC) levies. However, the decline could also be due to the under-pricing of utility services. Motivating evidence will become available when municipalities ring-fence their budget.

The ***collection rate*** measure is based on total cash collections (excluding external funding) relative to billed and other revenue, but adjusting for changes in consumer debtors. The measure is used due to the difficulty in obtaining reliable and consistent measures of

consumer debtor collection rates and is preferred as it can be obtained from audited and budgeted financial statements. However, the ratio is influenced by the proportion of revenue collected by individual metros as "cash" (fines, licences and permits) rather than 'billed' revenue. A measure can be greater than 100 per cent if there has been a collection of arrears from a previous year, but it is improbable that this would be sustained for a long period of time. The results for Nelson Mandela Bay are probably affected by issues relating to changes in accounting standards and need further clarification.

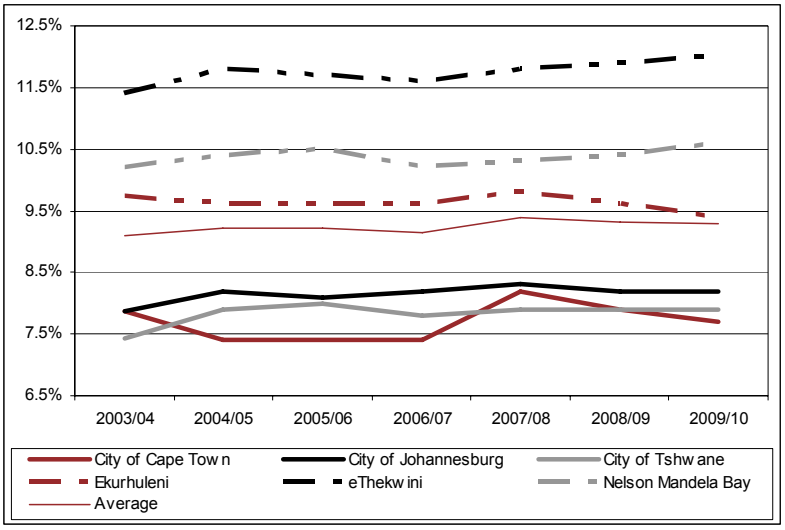
There appears to be conservative projections for collection rates in the 2007/08 budget and this may be related to predictions of greater economic uncertainty and difficulties in 2007/08.

Ekurhuleni is consistently the lowest spender

The ***expenditure per household*** can be influenced by "once-off" changes in the capital programme as discussed in relation to the capital benefit ratio, as well as by growth in the number of households. Ekurhuleni is consistently the lowest spender per household.

Average rates and service revenue as percentage of average household income is a measure of the affordability of property tax and service charges. It calculates the average total bill per household relative to average household income. The weighted average is relatively stable, staying at 9 per cent in 2003/04 and 2006/07. This measure means that households spend 9 per cent on average of their household incomes on paying for "billed" municipal services (property tax, electricity, water and sanitation). Differences in the pricing of electricity services between metros would influence this outcome and could partially explain the variability between metros. eThekwini consistently shows the highest percentage and was 11.6 per cent in 2006/07. The City of Cape Town (7.4 per cent in 2006/07) and the City of Tshwane (7.9 per cent in 2007/08) are the lowest, probably as a result of their higher average incomes (suggesting a higher ability to pay in their communities).

Figure 4.4 Average rates and service revenue as percentage of average household income, 2003/04 – 2009/10



Source: National Treasury local government database

Financial position

This section focuses on two key measures relating to the financial position of the metro, namely the change in current assets and the liquidity ratio. The aspect of "debt" (borrowing) is dealt with by the non-current liabilities as a percentage of total revenue measure discussed in the previous section. Table 4.10 shows the changes in current assets and liquidity ratios of the metros.

Table 4.10 Metros' financial position summary, 2003/04 – 2009/10

	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Percentage		Outcome		Estimate	Medium-term estimates		
Current assets change from previous year							
City of Cape Town		17%	4%	11%	1%	-14%	-4%
City of Johannesburg		22%	-1%	-5%	-16%	11%	15%
City of Tshwane		19%	2%	9%	-50%	-2%	7%
Ekurhuleni		39%	15%	11%	-2%	-4%	12%
eThekwini		15%	105%	6%	0%	-24%	-11%
Nelson Mandela Bay		-3%	19%	25%	1%	-18%	6%
Liquidity ratio							
City of Cape Town	1.3	1.2	1.2	1.2	1.1	1.0	1.0
City of Johannesburg	1.0	1.1	1.1	0.8	0.7	0.7	0.9
City of Tshwane	1.4	1.3	1.3	1.3	0.7	0.7	0.6
Ekurhuleni	1.4	2.2	2.2	2.2	1.8	1.7	1.6
eThekwini	1.2	1.3	1.3	1.4	1.3	1.0	0.9
Nelson Mandela Bay	1.3	0.8	0.8	0.7	0.6	1.2	1.2

Source: National Treasury local government database

Resources of metros are tied up in current assets and short term investments

The top part of table 4.10 shows the "current assets change" ratio. Except for the City of Johannesburg, the ratio indicates a trend of increasing current assets for reported audited amounts, but decreasing budgets. This suggests that, when preparing budgets, metros are confident about achieving budgeted expenditure plans (and therefore reducing cash and short-term investment levels), improved collection of outstanding debtors and more efficient use of inventory. However, past trends appear not to support this confidence. For example, the average increase in current assets for 2006/07 was 10 per cent, yet the 2007/08 budget was prepared on the basis of an average 11 per cent reduction.

The liquidity ratio (current assets/current liabilities), shown on the lower part of table 4.10, is a standard measure of an ability to meet short-term obligations. The budgeted decline in the ratio from an audited actual average of 1.3 in 2006/07 to 1 in 2007/08 is partially caused by predicted reductions in current assets. However, of some concern is that the liquidity ratio of the City of Johannesburg, Nelson Mandela Bay and the City of Tshwane were budgeted to be less than 1 in 2007/08, generally considered to indicate an inability to meet short-term obligations. Well managed municipalities can possibly manage this situation and would contend that maintaining higher levels of current assets is an inappropriate use of community funds.

Four-year trend on audit outcomes

Table 4.11 shows the audited outcomes of the six metros for the period 2003/04 to 2006/07. The table shows that the City of Cape Town and eThekwini had unqualified audit outcomes over the four-year period. The City of Johannesburg has gradually improved from disclaimers (inability of the Auditor-General to make an opinion) in 2003/04 and 2004/05 to an unqualified opinion in 2006/07. This shows the significant impact of adopting a project approach to addressing significant challenges as the City of Johannesburg has done. Ekurhuleni, City of Tshwane and Nelson Mandela Bay have not shown any improvements over the period under review.

Table 4.11 Audited outcomes by metro, 2003/04 – 2006/07

	2003/04	2004/05	2005/06	2006/07
Audit outcome				
City of Cape Town	Unqualified	Unqualified	Unqualified	Unqualified
City of Johannesburg	Disclaimer	Disclaimer	Qualified	Unqualified
City of Tshwane	Qualified	Qualified	Qualified	Qualified
Ekurhuleni	Qualified	Qualified	–	Qualified
eThekwini	Unqualified	Unqualified	Unqualified	Unqualified
Nelson Mandela Bay	–	Qualified	Qualified	Qualified

Source: Auditor-General report

The main issues identified by the Auditor-General include long outstanding consumer debtors, water and electricity losses, employee benefit schemes, not meeting deadlines in terms of accounting standards reforms, for example, standards on property, plant and equipment and non-compliance with legislative requirements, such as the Municipal Systems Act with regards to performance management. Detailed information is contained in the audit reports of the relevant financial years.

Conclusion

The capital budgets of the metros have benefited hugely from national transfers related to the 2010 FIFA World Cup. Despite this the metros face the following challenges:

- The share of revenues from service charges is declining and there is a growing reliance on operating grants and subsidies. It appears that the metros are under-pricing on their utility services.
- The extent of arrear consumer debt distorts the true value of current assets on the metros' statements of financial position.

Metros need to invest in productive economic infrastructure and price services in a way that makes them affordable, but that also earns a modest rate of return for reinvestment in order to ensure the sustainability of services and revenue streams.

5

Intergovernmental transfers

Introduction

The system of transfers to municipalities is intended to assist them in combating poverty and strengthening their own capacity to provide services. Municipal expenditures that directly support economic growth are intended to be largely self-funding through service charges and subsidised through local taxes, although a new generation of national transfers is beginning to support municipalities in this process. In addition, transfers support economic growth indirectly through releasing municipal resources for this purpose.

The system of transfers is to assist municipalities in combating poverty and strengthening their capacity to provide services

In general, transfer programmes play three roles:

- addressing the structural imbalance between revenues available to municipalities and the expenditure responsibilities assigned to them
- supporting national priorities as outlined through different sectoral policies, in particular those focused on providing universal and sustainable access to services
- establishing incentives for good governance and building local government capacity within a sound fiscal framework.

In practice, transfers from national and provincial government are made through a range of different mechanisms and instruments. The most basic distinction is between those that are directly transferred to municipalities as cash, either on a conditional or unconditional basis, those that are transferred indirectly in the form of assets or in instances where other spheres of government perform functions or services on behalf of a municipality and those transfers that are made as agency payments to reimburse municipalities for expenditures incurred on behalf of other spheres of government.

There are different types of national and provincial transfers

While some transfer programmes explicitly focus on strengthening municipal capacity and providing incentives for good governance, it is important that the overall system of transfers is designed to support these objectives. This will assist in the national and provincial spheres presenting a coherent stance to individual municipalities. For example, the overall system of transfers should not reduce the incentives for municipalities to remain accountable to their citizens or to abandon fiscal discipline. Individual programmes must therefore avoid undermining these incentives by imposing particularly stringent conditions that are focused on the needs of other spheres rather than local citizens, inadvertently encouraging inappropriate or unsustainable expenditures at the municipal level or rescuing municipalities from the consequences of poorly conceived expenditure commitments that they have made.

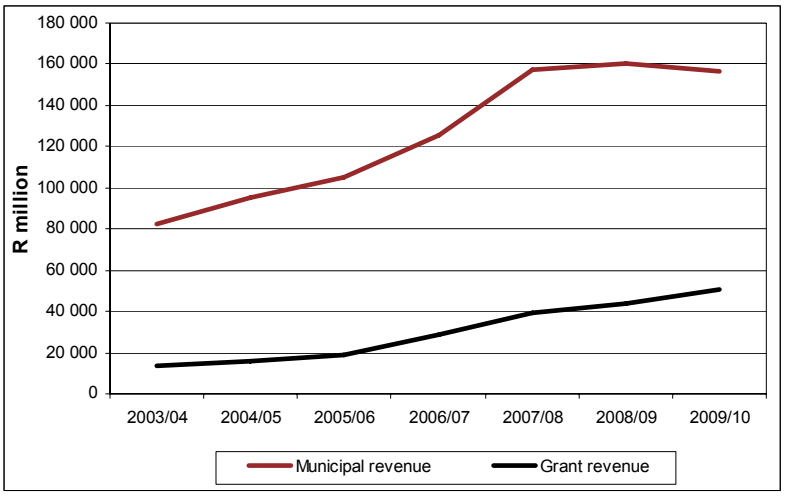
The major transfer programmes contribute significantly to the fight against poverty

National government transfers to local government have continued to grow strongly in real terms since 2003/04. This has led to a structural adjustment in the vertical division of resources between the spheres of government. These new resources and improvements to the mechanisms through which funds are transferred, have allowed the major transfer programmes to contribute significantly to the fight against poverty. Transfers are also increasingly effective in targeting priority geographical areas of poverty. A new generation of programmes is beginning to help municipalities meet the challenges of economic growth at the local level, through encouraging infrastructure investment.

Municipal dependence on grants as a source of revenue has risen dramatically

Yet the rapid growth in transfers and the reforms to transfer mechanisms have also exposed a new set of challenges. Municipal dependence on grants as a source of revenue has risen dramatically. Figure 5.1 shows this increase. The figure includes the metros, which contribute significantly to the municipal revenue trend and which are less dependent on grant income.

Figure 5.1 Municipal revenue and grant revenue, 2003/04 – 2009/10



Source: National Treasury local government database

Metros generated more than 50 per cent of total own revenue between 2003/04 and 2006/07

Between 2003/04 and 2006/07, municipalities generated own revenue of R408.2 billion, of which metros generated 52 per cent and the 21 secondary cities 15 per cent. This means that the remaining 256 municipalities are largely dependent on national transfers, which were R76.3 billion for the same period. It must be noted that this amount is spread across all municipalities. Figure 5.1 also shows that municipal own revenue is expected to grow by a slow rate of 2.3 per cent, while grants to municipalities are expected to grow by 14.9 per cent over the medium-term in real terms.

This reflects both the expansion of the expenditure responsibilities of municipalities as well as a decline in own revenue collection efforts. Co-ordination between transfer programmes with locally funded municipal expenditures remains problematic. Some conditional grants are allocated in a formulaic way, without taking into account the particular dynamics or requirements of an area. For example, experience with the special allocation for the eradication of the bucket sanitation system showed wide variations in the unit cost of toilet units due to varied geological conditions. Furthermore, the continuous introduction of indirect transfers that are managed at the national level for municipal functions undermines efforts to strengthen municipal capacity and the introduction of sustainable improvements to service delivery.

This chapter gives an overview of:

- the vertical division of revenue
- the horizontal division of revenue
- the division of revenue process
- grant performance.

Vertical division of revenue

The Constitution guarantees the provincial and local government spheres an "equitable share of nationally-raised revenues". This recognises that a fundamental imbalance exists between the expenditure functions assigned to them and the instruments they have available to generate their own revenues. The main purpose of the equitable share is to close this fiscal gap, as there are few additional revenue instruments that would be appropriate at the sub-national level.

Nationally raised revenues, less debt repayment liabilities, are divided between the three spheres of government based on their expenditure responsibilities and the other revenue sources available to them. Thus provincial governments, which have far fewer revenue sources than local governments, receive a commensurately larger portion of their resources from national transfers.

In practice, the vertical division of revenue is an outcome of government's deliberations on policy and associated expenditure priorities. It reflects government's balanced approach to meeting policy priorities over the medium-term, considering the responsibilities, expenditure pressures, capacity and performance of

each sphere of government. Inevitably, this involves difficult trade-offs between functions and spheres of government over time.

The vertical division of revenue has favoured national and provincial government as local government can draw on other sources

The size and nominal value of increases in the vertical division of revenue have typically benefited national and provincial governments. This reflects their reliance on the vertical division of revenue to secure resources, whereas local government can draw on more sources of own revenue. In addition, it reflects the significant expenditure allocations and the priority attached to programmes such as safety and security, education, social development and health, in the national and provincial spheres.

However, the local government share has risen at the fastest rate, averaging 21.3 per cent annually since 1995/96, compared to the other spheres of government. This is well above the rate of increase in available national revenue, which averages 12.3 per cent over the same period. This means that local government is getting a rapidly rising proportion of nationally raised revenue, although it is starting from a low base. This realignment shows that the provision of basic services like water, sanitation and electricity is becoming more of a government priority.

Table 5.1 summarises these trends in the vertical division of revenue. The local government sphere received approximately R11.6 billion in 2003/04 and is projected to grow to R47.7 billion by 2009/10.

Table 5.1 Vertical division of revenue, 2003/04 – 2009/10

R million	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
		Outcome		Estimate	Medium-term estimates		
National government	148 142	167 289	194 723	212 629	246 937	273 929	302 672
Provincial government	122 673	138 511	154 368	178 871	205 224	238 076	268 158
Local government[1]	11 581	13 808	16 682	26 501	37 127	47 651	47 651
Total	**282 396**	**319 608**	**365 773**	**418 001**	**489 288**	**559 656**	**618 481**
Percentage share							
National government	52.5%	52.3%	53.2%	50.9%	50.5%	48.9%	48.9%
Provincial government	43.4%	43.3%	42.2%	42.8%	41.9%	42.5%	43.4%
Local government	4.1%	4.3%	4.6%	6.3%	7.6%	8.5%	7.7%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

1. RSC levies abolished from 1 July 2006. Interim replacement grant included in Equitable share.

Source: National Treasury local government database

The increases to the local government share result from growth in three programmes areas. First, the allocation to the local government equitable share grows due to the abolition of the Regional Services Council levies and the introduction of a temporary replacement grant and the special contribution towards the councillor remuneration grant. Second, the municipal infrastructure grant grows rapidly to support municipal expenditures on infrastructure. Finally, a new set of grants has been introduced to support the 2010 FIFA World Cup and encourage township development, as well as scale-up spending on regional bulk infrastructure.

Provisional transfers are made at the discretion of provinces

These figures exclude provincial transfers to local government. These transfers are made at the discretion of provinces and focus on supporting any additional provincial development priorities or making agency payments to local governments for services delivered on

behalf of the province. (They exclude payments for services rendered to provinces by municipalities, such as service charges for water and sanitation services). Provincial transfers do not assist in addressing any structural imbalance between the revenues and expenditures of local government.

Table 5.2 highlights the generally poor quality of data on provincial transfers to local government. Some provinces are not consistently gazetting their municipal allocations and it is safe to assume that they transfer larger amounts than what they are publishing. Provincial transfers to municipalities have not been consistent, evident in the 11.3 per cent decline between 2003/04 and 2006/07 in real terms. The transferred amount decreased in 2004/05 and started to increase from 2005/06 onwards. This is a clear indication of uncertainty on the part of provinces in relation to their planning, which in turn makes it difficult for municipalities to plan for this funding.

Table 5.2 Provincial transfers to local government, 2003/04 – 2009/10

	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	% average annual	
		Outcome		Estimate	Medium-term estimates			2003/04 –	2006/07 –
R thousand								2006/07	2009/10
Provincial transfers									
Eastern Cape	410 140	401 377	512 188	498 517	365 444	639 532	531 002	1.2%	-2.9%
Free State	316 820	183 290	99 175	80 616	42 137	210 043	162 025	-39.9%	20.0%
Gauteng	697 758	597 171	496 324	427 533	451 780	506 476	534 077	-19.4%	2.4%
KwaZulu-Natal	482 964	258 572	340 102	478 763	742 938	944 853	997 826	-5.4%	21.4%
Limpopo	318	252	543	10 331	10 590	82 562	17 200	202.6%	12.7%
Mpumalanga	47 948	53 756	36 980	34 962	18 012	52 518	60 094	-14.6%	13.9%
Northern Cape	204 044	164 087	148 198	119 392	96 253	116 728	122 683	-20.7%	-4.1%
North West	126 436	71 693	96 447	125 391	129 268	80 600	81 100	-5.4%	-17.8%
Western Cape	1 202 352	812 104	958 551	1 079 599	1 528 970	1 709 118	1 748 457	-8.5%	11.6%
Total	**3 488 780**	**2 542 302**	**2 688 508**	**2 855 104**	**3 385 392**	**4 342 430**	**4 254 464**	**-11.3%**	**8.6%**
Per category									
Category A	1 235 941	1 018 719	1 126 754	1 143 453	1 481 637	2 270 002	2 159 970	-7.6%	17.5%
Category B	641 045	746 718	825 434	814 582	798 599	1 037 324	831 707	2.7%	-4.3%
Category C	1 611 794	776 865	736 320	897 069	1 105 156	1 035 104	1 262 787	-22.0%	6.5%
Total	**3 488 780**	**2 542 302**	**2 688 508**	**2 855 104**	**3 385 392**	**4 342 430**	**4 254 464**	**-11.3%**	**8.6%**

Source: National Treasury provincial database

Horizontal division of revenue

The horizontal division of revenue gives concrete expression to government's policy priorities

The vertical division of revenue determines only the quantum of nationally raised resources that are available to the local government sphere. These resources must be divided into transfer programmes and allocated between municipalities. Individual municipalities will thus experience higher or lower increases as a result of the mechanisms used to allocate funds between them. This process is known as the horizontal division of revenue. It gives expression to the policy priorities of government, as this is where specific instruments are introduced to pursue the objectives that underlie the outcomes of the vertical division of revenue. National Treasury continues to play an important role in reconciling the design and inter-relationships of individual transfer programmes with the overall fiscal stance of government towards the local sphere, as reflected in the vertical division of revenue. This oversight role is important for ensuring that

municipalities are able to pursue national priorities, while remaining subject to mechanisms of local democratic accountability.

Table 5.3 summarises the allocation of national resources between specific transfer programmes between 2003/04 and 2009/10.

Table 5.3 Transfers to local government, 2003/04 – 2009/10

	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
R million		Outcome		Estimate	Medium-term estimates		
Equitable share and related	**6 624**	**7 811**	**9 808**	**18 421**	**21 297**	**25 750**	**31 011**
Equitable share[1]	6 350	7 678	9 643	18 058	20 676	24 889	30 156
Water services operating subsidy grant	273	133	165	363	622	861	855
Infrastructure: MIG	**2 323**	**4 481**	**5 436**	**5 809**	**8 262**	**8 657**	**10 330**
Municipal infrastructure grant	2 323	4 481	5 436	5 809	8 262	8 657	10 330
Other direct transfers	**364**	**330**	**539**	**909**	**1 758**	**4 173**	**3 922**
Integrated national electrification programme (municipal) grant	245	196	297	391	468	596	897
Public transport infrastructure and systems grant	–	–	242	518	1 174	3 170	2 325
Neighbourhood development partnership grant	–	–	–	–	116	407	700
Building for sports and recreation programme grant	119	134	–	–	–	–	–
2010 FIFA World Cup stadiums development grant	**–**	**–**	**–**	**600**	**4 605**	**2 895**	**1 400**
Infrastructure: Indirect transfers	**2 727**	**2 126**	**1 939**	**1 333**	**2 576**	**2 293**	**2 741**
Water services operating subsidy grant	817	819	626	440	497	269	–
Community based public works programme grant	12	–	–	–	–	–	–
Implementation of water services projects (capital)	1 102	208	139	–	–	–	–
Disaster relief grant (DWAF)	–	–	–	–	100	–	–
Disaster funds (DPLG)	–	280	311	–	492	–	–
Integrated national electrification programme (Eskom) grant	796	819	863	893	973	1 151	1 421
Regional bulk infrastructure grant	–	–	–	–	300	450	650
Backlogs in water and sanitation at clinics and schools grant	–	–	–	–	105	210	350
Backlogs in the electrification of clinics and schools grant	–	–	–	–	45	90	150
Neighbourhood development partnership grant (technical assistance)	–	–	–	–	64	123	170
Capacity building	**998**	**768**	**655**	**664**	**929**	**430**	**500**
Municipal systems improvement programme grant	150	182	200	200	200	200	200
Local government restructuring grant	539	388	256	265	530	–	–
Local government financial management grant	280	137	132	145	145	180	300
Financial management (DBSA) grant	29	61	66	53	53	50	–
Other recurrent transfers	**–**	**–**	**–**	**–**	**–**	**–**	**488**
2010 FIFA World Cup host city operating grant	–	–	–	–	–	–	488
Total	**12 672**	**15 186**	**17 838**	**26 827**	**37 669**	**40 025**	**46 470**

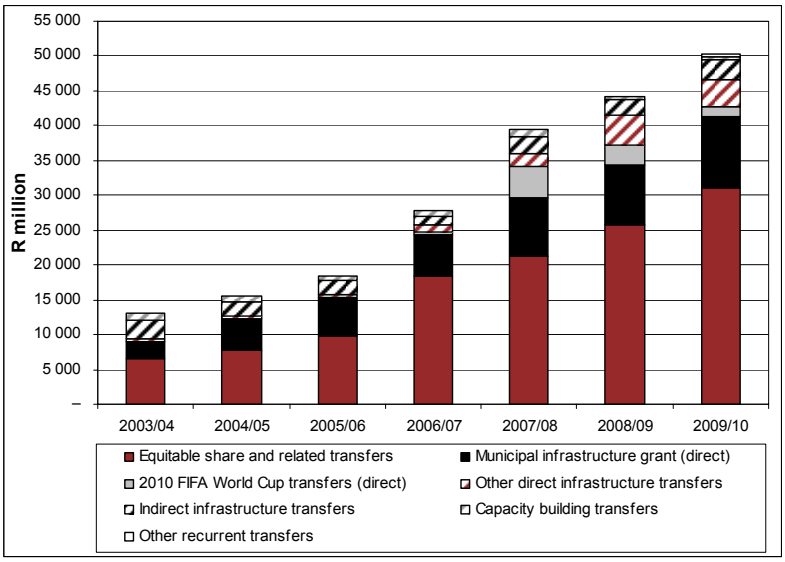
1. RSC levies abolished from 1 July 2006. Interim replacement grant included in Equitable share.

Source: National Treasury local government database

Transfer instruments

The most basic distinction between types of transfers is between conditional and unconditional funding instruments. A conditional transfer is earmarked for specific types of expenditures by municipalities and must be spent in accordance with prescribed processes. An unconditional transfer has no such conditions attached, although it must be spent in accordance with existing standards and requirements for all public expenditure.

Figure 5.2 Transfers by type, 2003/04 – 2009/10



Source: National Treasury local government database

Unconditional transfers

The local government equitable share is the only unconditional transfer in South Africa

The only unconditional transfer in South Africa is the local government equitable share which is a constitutional entitlement. Municipalities are largely free to allocate the equitable share as they see fit after taking account of national priorities that underpin the vertical division of revenue. It was first introduced in 1998/99. The main purpose of this programme is to address the gap between the revenues and expenditures of municipalities. In the South African context, the main cause of this gap is high levels of poverty. The equitable share thus allocates resources between municipalities largely on the basis of the proportion of poor households in their jurisdiction. The formula does, however, have five variable components: basic services (BS); development (D), institutional (I); revenue-raising capacity (RRC); and correction and stabilisation (R) components. Further details on the formula can be found in National Treasury's annual Budget Review and the Division of Revenue Act.

Municipalities can exercise discretion in how to channel the equitable share to beneficiaries

The equitable share is intended to fund a range of municipal activities, although national free service levels are the main purpose. Most importantly, government uses this mechanism to support municipalities in providing free basic services to poor households. Municipalities have discretion in designing the actual subsidy mechanism that channels these resources to intended beneficiaries, as

there is no single subsidy mechanism that is appropriate across all services and municipalities in South Africa. The equitable share also supports the general expenditures of municipalities, including specific items such as councillor remuneration. Many smaller municipalities use their equitable share to pay basic operating expenditures such as salaries, due to their limited capacity to raise their own revenue.

Since 2006/07, part of the equitable share has been used to temporarily channel funding to replace revenues lost to municipalities as a result of the withdrawal of RSC levies on the payroll and turnover of businesses. This accounts for the large rise in the transfer in this year.

The equitable share is the largest single transfer programme

The equitable share is the largest single transfer programme, accounting for an average of 56.7 per cent of all transfers between 2003/04 and 2009/10. It has also experienced strong real growth of 31.4 per cent between 2003/04 and 2005/06. Real growth of 12.8 per cent is projected over the medium-term as government continues to prioritise universal access to basic municipal services.

The equitable share is generally classified together with the direct transfer component of the water service operating subsidy, managed by the Department of Water Affairs and Forestry. This grant funds the operating costs of water services schemes that have been transferred to municipalities. It is complemented by an indirect transfer, through an augmentation to the water services trading account on the Department of Water Affairs and Forestry's budget vote. This funds the costs of schemes that have not yet been transferred to municipalities. The direct transfer component of this programme is thus projected to rise over time, as more scheme transfers take place. Ultimately, these resources will be consolidated into the equitable share once the transfer of schemes has been accomplished. This programme makes up a small and declining proportion of total transfers to local government, although it has shown real growth as the costs of operating these water services schemes have increased.

Conditional transfers

Conditional transfers support municipal infrastructure investment and strengthen municipal capacity

Conditional transfers make up the remainder of the resources transferred by national government to municipalities. These transfers are provided to support municipal infrastructure investment and to strengthen municipal capacity. In both cases, transfers are made directly, in the form of cash and indirectly, in the form of assets or support services provided to a municipality. The specific conditions and procedures associated with individual programmes are provided in annexures to the annual Division of Revenue Act.

Infrastructure transfers collectively make up an average of 40.2 per cent of all conditional transfers to municipalities between 2003/04 and 2009/10. Infrastructure transfers have also experienced strong real growth, averaging 17.8 per cent over the period. Government has a distinct policy preference for direct (cash) transfers. These make up an average of 81 per cent of all infrastructure transfers and are projected to constitute an ever larger share of infrastructure transfers over the period.

The municipal infrastructure grant is the largest infrastructure transfer programme

The largest infrastructure transfer programme is the municipal infrastructure grant (MIG), currently administered by the Department of Provincial and Local Government. It accounts for an average of 54.1 per cent of all infrastructure transfers between 2003/04 and 2009/10. The MIG has shown strong real growth over the period, averaging 6.4 per cent between 2004/05 and 2006/07. Real growth is projected to accelerate to an average of 21.4 per cent over the medium-term.

The MIG was introduced in 2004/05 through consolidating various sector infrastructure grants, each administered by different departments, into a single programme. This was intended to make the system of transfers to municipalities simpler, more certain and more supportive of municipal infrastructure priorities. The programme is designed to supplement the capital budgets of municipalities, with a focus on providing basic infrastructure services to the poor, while stimulating local economic development and job creation over the medium-term. Funding for electrification has not yet been incorporated into the MIG, due to uncertainties associated with the restructuring of the electricity distribution industry. MIG funds are distributed to all municipalities based on a formula that accounts for existing backlogs in service delivery as well as the functions assigned to individual municipalities. In some instances, portions of MIG allocations are earmarked for specific expenditures by municipalities, although on the whole they have the flexibility to determine their own expenditure priorities.

The remaining direct transfers account for an average of 24.8 per cent of all infrastructure transfers between 2003/04 and 2009/10. The significant growth in these transfers from 2007/08 is related to the development of stadiums and public transport systems in preparation for the 2010 FIFA World Cup. These expenditures benefit only the host cities and will peak at R6 billion, or 33.7 per cent of all infrastructure transfers in 2008/09. Other direct infrastructure transfers support electrification programmes of municipalities and township development initiatives through the recently introduced neighbourhood development partnership grant.

Indirect infrastructure transfers focus mainly on electrification and water services

Indirect infrastructure transfers make up an average of 24 per cent of infrastructure transfers between 2003/04 and 2009/10. This declines rapidly from 57.2 per cent of infrastructure transfers in 2003/04 to a projected 14.9 per cent in 2009/10. The declining trends of the indirect grants are because the implementation of the water services projects was phased out from 2004/05. The trend starts to rise again from 2007/08 due to the introduction of more indirect grants in the local government sphere. The major programmes here focus on electrification and water services. Electrification transfers are made to Eskom through the Department of Minerals and Energy, which accounts for an average of 71.6 per cent of electrification transfers over the period. However, Eskom's share of these transfers is declining, due to more rapid growth in direct transfers to municipalities. Additional transfers are also made to support electrification in clinics and schools. Indirect transfers for water services focus on the construction of regional bulk water assets by the

Department of Water Affairs and Forestry and water services in clinics and schools.

The neighbourhood development partnership programme

The neighbourhood development partnership grant (NDPG) and the Neighbourhood Development Programme (NDP) Unit were established by National Treasury in 2006. The NDPG is a new hybrid grant (combining technical assistance for project planning and a capital grant).

Its goals are to support "neighbourhood development projects that provide community infrastructure and create the platform for private sector development and that improve the quality of life of residents in targeted areas".

The NDP unit delivers on its mandate through supporting the creation of plans that mainstream future-oriented township development to support neighbourhood development. Capital injections for kick-starting township regeneration projects are also available for initiatives such as:

- the creation of a critical mass of commercial and community facilities (such as nodes and precincts) and/or
- the creation of internal and external linkages within townships and/or between townships and main economic centres and/or
- the provision of general environmental improvements in townships.

An example of the application of the NDPG is the Bridge City project, undertaken by the eThekwini metropolitan municipality. (Bridge City is a large scale project that aims to build a new mixed-use town centre within the Inanda-Ntuzuma-KwaMashu area in KwaZulu-Natal). Critical fast-tracked transportation linkages are enhancing the feasibility and attractiveness of the development. The NDPG's key role here is to address constraints to investments in the Inanda, KwaMashu and Ntuzuma townships by establishing certainty about infrastructure investments.

NDPG investment into the CBD of Khayelitsha, a township located 35km from the heart of Cape Town, will support its growth as a regional commercial centre, with anticipated outlays for the public environment, social infrastructure and urban management.

Capacity building transfers account for only an average of 2 per cent of all transfers to municipalities between 2003/04 and 2009/10. This share declines over the medium term due to the ending of some programmes and strong growth in other categories of transfers. These transfers support municipalities in introducing reforms to management practices associated with the Municipal Systems Act (2000) and the Municipal Finance Management Act (2003). The financial management grant (FMG) has replaced the restructuring grant as the largest single transfer to municipalities in this category. The restructuring grant supported large cities with the transition costs of adjusting their fiscal positions to better support growth and poverty alleviation and has been phased out.

Municipalities receive different kinds of capacity building support

Different kinds of capacity building support are also provided to municipalities, most often through direct hands on assistance (such as the deployment of technical advisors). The Siyenza Manje programme, managed by the DBSA, is one such example. The lack of standardised information on these indirect transfers prevents accurate analysis of their contribution to the overall system of transfers. This matter is being addressed by National Treasury, with the intention of introducing more rigorous monitoring and evaluation of expenditure and output performance of all capacity building programmes.

Furthermore, the municipalities are receiving transfers from provinces in the form of a direct transfer. This is mainly from programmes that are administered at the provincial level, but have local government related programmes. Programmes such as ambulance services and

primary health clinics are administered at the local level, though they are partly funded by the provincial departments of health.

Municipalities are required to provide a service on behalf of the province for these programmes. Provinces should therefore provide municipalities with a clear indication of the exact amounts to be transferred to them during the course of the financial year. This will assist municipalities in planning.

Issues in horizontal division of revenue for local government

There are four issues that emerge from this analysis of the horizontal division of revenue for local government:

- the consolidation of transfers into the equitable share and the MIG
- increasingly equitable distribution of grants between municipalities
- the increase in levels of grant dependence
- the prevalence of indirect transfers.

First, the consolidation of transfers into the equitable share and MIG is increasingly being counterposed by the expansion in the number of specific purpose conditional transfers. Consolidation was a strong feature in recent years as government sought to strengthen the accountability of municipalities for spending outcomes, give greater policy direction to transfers and improve co-ordination between spending programmes at the municipal level. Much of this was achieved through strengthening regulatory controls in the annual Division of Revenue Act.

Consolidation created scope for a step increase in the quantum of transfers to local government, as reflected in the structural shift in the vertical division of revenue. However, it brought with it two challenges.

National departments are now engaging with municipalities on sectoral priorities to influence local decision-making processes

On the one hand, national departments have found it considerably more challenging to engage with municipalities on their sectoral spending priorities. In the past, grants were earmarked for specific sectors and specific amounts allocated to municipalities, but with only limited information on their relative needs and priorities. Now national departments must engage with municipalities on sectoral priorities to influence local decision-making processes. This requires significantly more information and a different approach to co-ordination with municipalities.

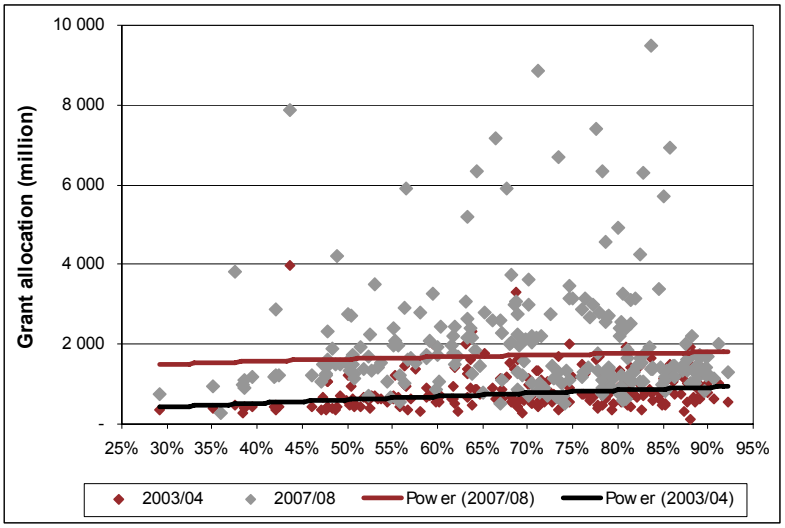
On the other hand, the consolidation was intended to improve co-ordination between remaining programmes, specifically between the equitable share and MIG and with the national housing subsidy transfers that are made to provinces. In the past, the plethora of grant programmes made co-ordination difficult. Yet while internal co-ordination within municipalities has improved, co-ordination between municipal infrastructure and housing programmes remains highly problematic and dysfunctional. (These problems are discussed in more detail in Chapter 10 on the built environment.)

The consolidation exercise has created space for a new generation of transfer programmes to emerge

Nonetheless, a positive result of the consolidation exercise has been the space that has been created for the emergence of a new generation of transfer programmes. These programmes have emerged to address newly identified gaps and opportunities in the transfer system, such as funding for the 2010 FIFA World Cup and the neighbourhood partnership development programme. These programmes have adopted innovative approaches in grant design that could be more widely adopted by other transfer programmes.

Second, the distribution of grants between municipalities has become increasingly equitable over time. This means that municipalities with larger proportions of poor people have received an increasingly larger allocation of available resources. As poverty in South Africa is increasingly located in large urban areas, these municipalities have benefited from this trend. However, the benefits to large urban municipalities have been reinforced by the introduction of additional transfers, such as the RSC levy replacement grant that is included within the equitable share and the 2010 FIFA World Cup transfers to host cities. This has tended to skew the distribution of transfers and reduce the overall equalisation effects in the system.

Figure 5.3 Total grant allocations per household as a percentage of the population in poverty, 2003/04 and 2007/08



Source: Stats SA and National Treasury database

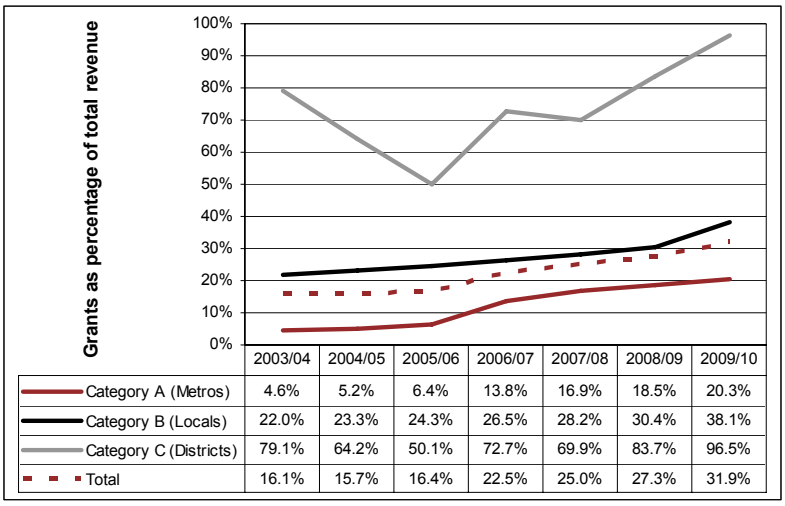
The levels of municipalities' dependence on grants have increased for all categories

Third, the significant real increase in transfers has resulted in an increase in levels of grant dependence across all categories of municipalities. Average levels of grant dependence are projected to rise to 31.9 per cent by 2009/10. Metros, in particular, have become increasingly dependent on grants as a result of the removal of RSC levies and funding for the 2010 FIFA World Cup. But district municipalities are mostly dependent on grants, given the absence of other revenue instruments at this level of local government.

Rising levels of grant dependence can become problematic if they are associated with a decline in revenue collection efforts by municipalities. An increase in municipal dependence on conditional

grants can be problematic if this diffuses direct municipal accountability to citizens and replaces it with reporting to national government. This emphasises the importance of retaining the decentralised nature of funding instruments such as the MIG and preserving their importance in the system of transfers.

Figure 5.4 Average levels of grant dependence by category of municipality, 2003/04 – 2009/10



	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Category A (Metros)	4.6%	5.2%	6.4%	13.8%	16.9%	18.5%	20.3%
Category B (Locals)	22.0%	23.3%	24.3%	26.5%	28.2%	30.4%	38.1%
Category C (Districts)	79.1%	64.2%	50.1%	72.7%	69.9%	83.7%	96.5%
Total	16.1%	15.7%	16.4%	22.5%	25.0%	27.3%	31.9%

Source: National Treasury local government database

The ongoing prevalence of indirect transfers remains an ongoing challenge to the fiscal stance of national government in relation to the local sphere

Fourth, the ongoing prevalence of indirect transfers remains an ongoing challenge to the fiscal stance of national government in relation to the local sphere. The construction of infrastructure assets by national administering departments on behalf of municipalities can limit their commitment to associated maintenance and replacement responsibilities, even if these assets are formally included in municipal asset registers. If other spheres assume a direct responsibility for municipal operating expenditures this allows municipalities to expand expenditures elsewhere. This may ultimately create an unsustainable local fiscal position for that municipality. The provision of non-cash operating support to municipalities, such as the deployment of technical advisors, can limit municipal commitment to the outcomes of these advisory programmes unless these relationships are clearly contracted. Also, the limited information on resources spent per municipality, particularly when indirect transfers are not captured within the division of revenue process, limits the extent of oversight and performance evaluation of these programmes.

Division of revenue process and administration of grants

The horizontal division of revenue is mediated by a formal process to divide available revenues. This process has been developed and institutionalised over a number of years and continues to evolve as government seeks to ensure closer alignment between policy priorities and funding programmes and seeks mechanisms to improve value-for-money in spending outcomes.

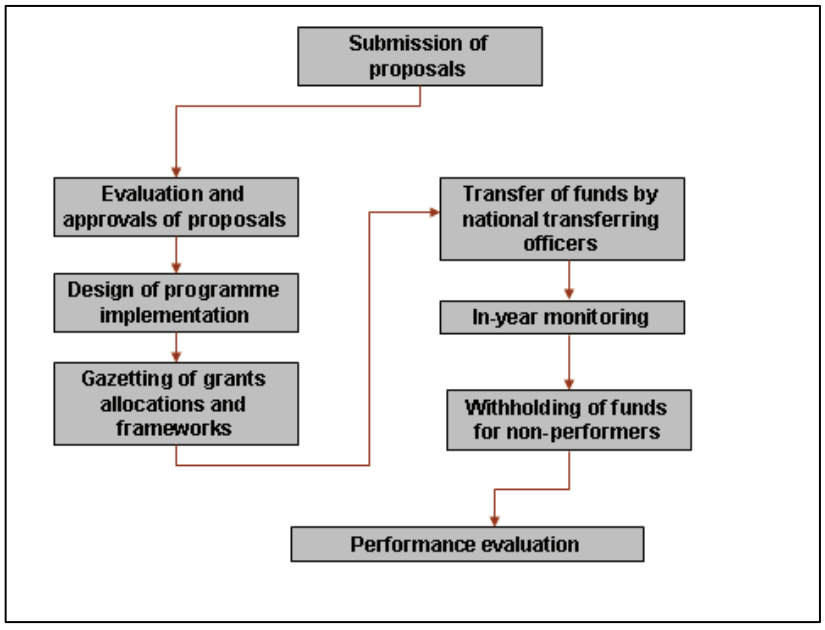
The division of revenue process involves eight generic steps

Following the determination of policy priorities and the vertical division of revenue, the horizontal division of revenue process involves eight generic steps.

Step 1 – Submission of spending proposals: Following the determination of the vertical division of revenue, National Treasury engages sector departments on priority areas for additional funding to local government. Departments then submit proposals for new or expanded grant programmes as part of their individual budget proposals.

Step 2 – Evaluation and approval of proposals: An evaluation committee comprising National Treasury, the transferring national officer and other sector departments evaluate new programme applications and in the case of large infrastructure projects, specific municipal project proposals. Emphasis is placed on ensuring a robust design to ensure overall readiness to transfer and spend grant resources. For a new grant programme to be included in the following year's budget, the project evaluation process must be concluded before the tabling of the annual Medium Term Budget Policy Statement (MTBPS).

Figure 5.5 Main steps in budget process



Step 3 – Detailed design of programme implementation procedures: After the tabling of the MTBPS, three-year indicative allocations for each programme are issued to national departments through the standard budget allocation letters. Successful programmes must then begin detailed planning for programme implementation. The period between October and January before the beginning of each national financial year is used to engage all stakeholders to finalise the allocations and to determine the extent of readiness by the department and municipalities to implement the programme.

Step 4 – Gazetting of programme framework and allocations to municipalities: The Division of Revenue Act (DoRA) requires transferring national departments to submit a payment schedule that outlines how they intend to transfer funds to different municipalities to National Treasury before the tabling of the April DoRA gazette. National transferring officers are required, in consultation with the municipalities, to determine a schedule on how and when they would like to receive the grant funding. The final payment schedule must be communicated to all municipalities before the first transfer is made. This assists municipalities in planning expenditures, tabling their budgets and is also used for their internal reporting purposes.

Infrastructure-related grants may, at this stage, require submission of projects plans by municipalities to the relevant national department. These projects should meet the requirements of the relevant grant programme.

Step 5 – Transfer of funds: National Treasury periodically transfers funds to national departments in accordance with the agreed payment schedule. These funds are then transferred to municipalities, provided they have met the conditions of the relevant grant programme.

Step 6 – In-year monitoring: The Act requires national departments to monitor grants that are transferred to municipalities. The Act requires the transferring national officer to report to National Treasury on a monthly basis on information on grant amounts transferred, actual expenditure and any material differences with regard to transfers that are not in line with the payment schedule. The payment schedule is used by National Treasury to monitor spending on grants and on service delivery by checking whether the amounts scheduled were indeed spent within that period. This monitoring process assists in averting problems with fiscal dumping by transferring national officers.

Step 7 – Withholding of funds in cases of non-performance: In instances where municipalities are not adhering to the provision of the Act, or specific grant conditions, the Act allows for the allocation to be withheld, stopped or re-allocated to other municipalities:

- *Withholding transfers:* Funds may be withheld if municipalities show significant under-spending or in instances where the municipalities are in contravention of any provision of the Act. Withholding can be for a period of not more than 30 days, but if contravention of the Act persists, the transferring national officer can request National Treasury to withhold transfers for more than 30 days.
- *Stopping transfers:* If municipalities continue contravening the provisions of the Act, National Treasury may stop the transfer of the grant to municipalities at its discretion or at the request of the transferring national officer.
- *Re-allocation of transfers:* National Treasury may, when it stops the transfers to municipalities and after consultations with the transferring officer, determine that a portion or the entire transfer be re-allocated to one or more municipalities.

Step 8 – Performance evaluation: The final stage in the process is to evaluate the performance of grant programmes, both to determine spending pressures facing local government that require redress in the budget for the following year and to identify steps to improve the design and operation of programmes. Evaluations of grant programmes are particularly important when they are wound up, as this provides insights into the design of new programmes.

Concerns about the division of revenue process

The design and procedures of individual grant programmes have improved

The division of revenue process has evolved considerably since it was introduced. Its evolution has assisted in improving the design and procedures of individual grant programmes. Despite the progress that has been made, there are still a number of concerns about the current operation of grant programmes.

First, programme designs concentrate on specifying inputs to be made by municipalities, rather than establishing and monitoring desired outcomes. This selection of monitoring indicators tends to emphasise expenditure *per se* rather than the developmental outcomes expenditures are intended to achieve.

Second, national departments have not been effective in applying procedures for withholding, stopping or reallocating funds. (The most advanced programme in this respect is the MIG, which stopped allocations twice in both 2006/07 and 2007/08). This reflects weaknesses in the monitoring systems of departments and limited commitment to effective oversight of municipal performance. National Treasury intends to tighten its monitoring of grant programmes from 2008/09 in terms of applicable sections of the Division of Revenue Act.

Finally, to date there have been few rigorous evaluations of grant programmes. This shortcoming is now being addressed by government and will become an increasingly important component of the transfer system in future.

Grant performance

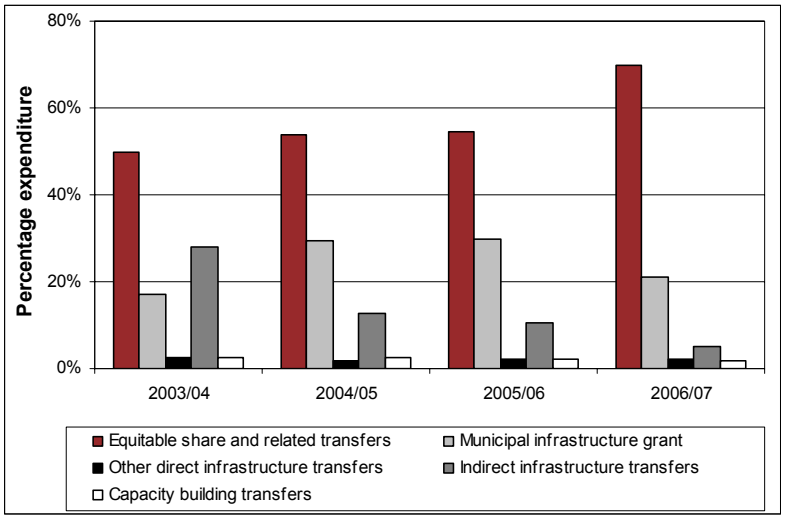
Performance monitoring and evaluation are important tools in strengthening the outcome and impacts of individual programmes

Grant programmes are intended to impact positively on the lives of citizens, particularly the poor. Merely allocating and transferring funds to municipalities does not guarantee these impacts. Municipalities must spend funds appropriately and in terms of individual programme objectives, while transferring national departments need to continually monitor and engage with municipalities to address emerging problems and seek new ways to improve programme performance. Performance monitoring and evaluation are important tools in strengthening the outcome and impacts of individual programmes through, for example, focusing on the value for money of outputs. Recent improvements in monitoring systems have begun to allow a tentative evaluation of the performance of grant programmes to be conducted for the first time.

Five key issues emerge in the discussion of a review of the performance of grant programmes:

First, levels of expenditure relative to allocations vary considerably between categories of programmes and individual programmes. Figure 5.6 demonstrates the excellent spending performance of the equitable share and MIG. This indicates the efficacy of formula based and outcomes focused programmes in ensuring funds are transferred to municipalities. In comparison, other direct infrastructure programmes reported far lower expenditure levels in 2003/04 (before the introduction of the MIG). Indirect infrastructure transfers report a very volatile expenditure pattern, with overspending of allocations by almost 40 per cent in 2003/04, but under-spending by 14 per cent the following year. This reflects poor planning by national spending agencies.

Figure 5.6 Expenditure performance of selected grant programmes by category, 2003/04 – 2006/07



Source: National Treasury local government database
Note: Figure excludes 2010 FIFA World Cup programmes and the Neighbourhood development partnership grant

Capacity building programmes report the lowest spending levels. Collectively, they spent only 38.7 per cent of their allocations in 2003/04, although this has now risen to almost 54.5 per cent for the capacity building category in 2006/07. The growth in spending levels counteracts arguments that spending is disrupted by weak municipal capacity and compliance. The worst performer in this category was the municipal systems improvement grant managed by the Department of Provincial and Local Government, one of government's flagship capacity building programmes that receives over R200 million per year. An average of 33.9 per cent of this allocation was spent between 2003/04 and 2006/07, though spending levels have risen from 6.5 per cent in 2003/04 to 58.1 per cent in 2006/07.

Infrastructure programmes contribute to combating poverty through expanding access to basic services

Second, infrastructure programmes have made a significant contribution to combating poverty through expanding access to basic services. Table 5.4 summarises progress made in servicing households through the MIG. As at March 2007, nearly 2.9 million households

had been serviced through completed MIG projects since the inception of programme in April 2004. In addition, the MIG had funded the eradication of 121 228 bucket toilets by the end of 2006/07.

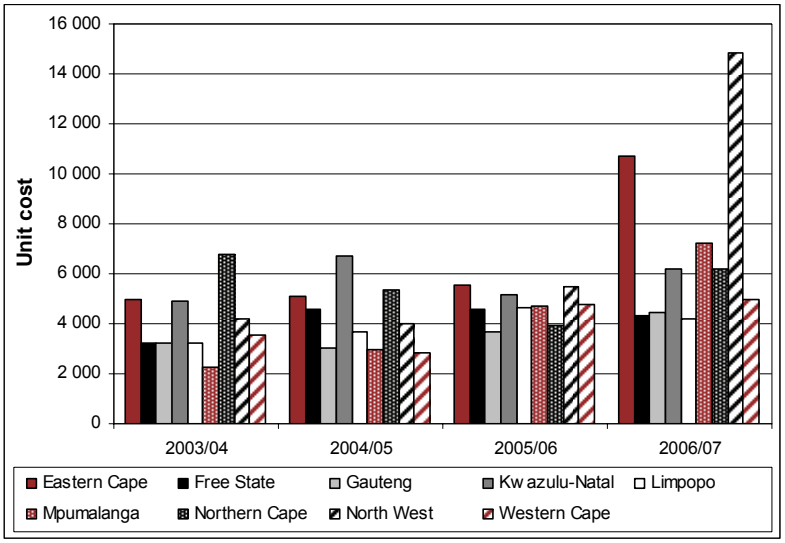
Table 5.4 Impact on the Municipal Infrastructure Grant, 2006/07

MIG formula	2006/07 Estimate
Number of households serviced on MIG projects	**Up to March 2007**
B-Component	1 980 301
P-Component	874 652
E-Component	3 872
Total	**2 858 825**
Households serviced on Basic Infrastructure Projects	**Up to March 2007**
Water	610 293
Sanitation	324 071
Roads	520 119
Stormwater	89 411
Street / Community Lighting	204 147
Solid Waste Removal	232 260
Total	**1 980 301**

Source: Department of Provincial and Local Government

The integrated national electrification programme (INEP) is managed by the Department of Minerals and Energy and implemented by municipalities (as a direct transfer) and Eskom (as an indirect transfer). The intention of this programme is to achieve universal household access to basic electricity by 2014.

Figure 5.7 Average cost of electrification per household by province, 2003/04 – 2006/07



Source: National Treasury local government database

The cost of electrification per household has risen considerably

An average of almost 200 000 connections has been made every year over the last four years, predominantly in more rural provinces where the backlogs are greatest. The average cost of a single connection over the period has been R5 006, but this has begun to rise dramatically. In 2006/07, the average cost of connections was R7 014, due to both significant growth in the cost of materials and the costs associated with servicing outlying areas. As the connection costs of the decreasing number of connections completed has increased, the

number of connections made has declined by an average of almost 19.6 per cent per year since 2003/04, despite a decrease in the total allocation for electrification by 2.6 per cent. A further factor influencing the rate of progress has been the unavailability of houses for electrification, due to delays in the implementation of housing projects and the inability to service informal settlements.

MIG funded projects are specifically intended to be labour intensive

Combating poverty involves more than providing basic infrastructure to poor households. Labour intensive construction methods can provide poor households with job opportunities, supporting livelihoods and reducing poverty. MIG funded projects are specifically intended to be labour intensive. Up to the end of March 2007, more than 28.3 million person-days' employment opportunities had been created through MIG projects. Women (including female youth and disabled persons) benefited from 38 per cent of the total employment opportunities, while the youth benefited from 40 per cent. The community at large has also benefited from the MIG programme because it uses local contractors and suppliers when implementing projects.

2010 FIFA World Cup related programmes are intended to have direct and indirect effects on economic activity

Third, there has been early progress in programmes supporting municipalities' economic development activities. These programmes are generally part of the new generation of transfers described earlier in this chapter. The 2010 FIFA World Cup related programmes for stadium development and public transport improvements are intended to have both direct effects on economic activity through the construction process and indirect effects through improving urban infrastructure to support local economic development. R8.4 billion has been allocated to host cities for stadium development.

Table 5.5 2010 FIFA World Cup stadium development grant allocations, 2006/07 – 2009/10

R million	2006/07 Estimate	2007/08 Medium-term estimates	2008/09 Medium-term estimates	2009/10 Medium-term estimates
City of Cape Town	98 256	842 248	686 000	776 022
City of Johannesburg	101 476	1 079 265	634 000	60 770
City of Tshwane	4 000	52 778	46 000	1 166
eThekwini	108 977	811 871	690 000	299 432
Mangaung	4 000	110 213	117 800	3 563
Mbombela	88 052	469 916	255 500	96 208
Nelson Mandela Bay	110 087	552 896	296 000	51 135
Polokwane	81 152	613 599	91 000	110 527
Rustenburg	4 000	72 215	78 700	1 177
Total	**195 239**	**1 238 710**	**465 700**	**162 839**

Source: Division of Revenue Act (2008)

Stadium construction is advanced for most cities and it is expected that all cities will meet the completion target date. According to the project register, most cities are slightly behind schedule as a result of technical issues such as rain, late delivery of materials from suppliers and labour conflicts in Mbombela, City of Cape Town and eThekwini. But this is not expected to affect completion dates. Indeed, funding schedules have had to be accelerated in the case of seven fast moving projects, with R1.9 billion being brought forward from the 2008/09 allocation.

Related expenditure on the public transport infrastructure and systems grant (PTIS) is also accelerating, given its slow take-off in 2005/06, when the grant was established. Many cities are investigating the development of innovative mass transportation systems that promise to alter mobility patterns in South African cities over the long term. (These issues are addressed in Chapter 9 on roads and public transportation).

The grant was established in 2005/06 with an allocation of R241 million, which grew to R519 million in 2006/07. The grant is expected to grow by 56.7 per cent in real terms between 2006/07 and 2009/10.

Performance on the PTIS grant has not been satisfactory. The PTIS allocation process was done in such a way that the cities received the bulk of the allocation in the first year, when in reality, they needed 10 per cent in the first year, for the preliminary project stages. This therefore means that the 2005/06 allocation was largely unspent, as they still had to finalise the requisite environmental impact assessments, land acquisition and preliminary and detailed designs. A delay in the signing of the memorandum of understanding (MOU) between the national Department of Transport and municipalities has been the major cause for under expenditure by municipalities. Transfers are made only to municipalities that have signed the MOUs.

The proposed budget for the neighbourhood development partnership grant (NDPG) is some R10 billion over 10 years at current values (2007). To date, awards have been made for 72 projects, covering 46 municipalities in all 9 provinces. By the end of 2008, the targeted number of projects under management by the NDP Unit is 100.

Spending on the neighbourhood development partnership grant is picking up

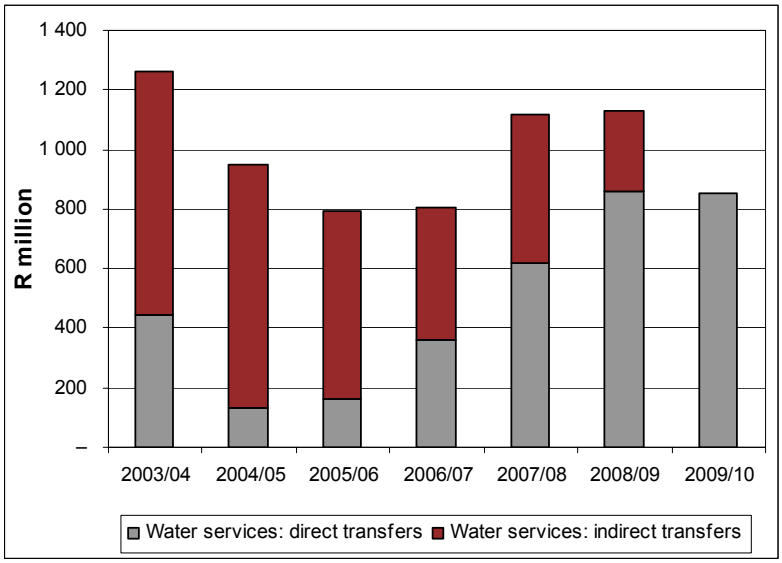
Funding agreements are being concluded with municipalities as the award status of projects is confirmed. While expenditure on the NDPG has been initially slow, this is now improving as the programme becomes established. A significant challenge is to shift the municipal mindset from coping with backlogs to long-term, area-based, economic development planning for townships. In addition, dealing with the demand for building the capacity for such strategic planning in municipalities is taking longer than envisaged. Nonetheless, over the past nine months there has been an increase in programme expenditure as municipalities start take-up of the available funding for technical assistance and capital investments. The estimated contribution of the NDPG to the costs of regeneration projects is currently 30 per cent of an anticipated R26.2 billion investment into townships across South Africa.

The lowest levels of spending are on programmes for supporting municipal capacity development

Fourth, there has been only limited progress in programmes supporting municipal capacity development. As already discussed, expenditure levels are the lowest in this category of programmes, while severe problems with municipal capacity persist. Assessing the efficacy of these programmes is made more difficult by the expansion of indirect transfers and incomplete information on progress towards identified outcomes. Weak co-ordination may be resulting in duplicated expenditures.

However, some programmes are demonstrating significant progress. The local government financial management grant (FMG), administered by National Treasury, aims to promote and support financial management reforms in building capacity in municipalities for the implementation of the MFMA (2003). Some reforms achieved by the FMG programme include support to municipalities for the MFMA reforms; all 283 municipalities are now participating and over 450 graduate finance interns have been appointed by municipalities using the FMG programme; and five advisors are currently placed in Eastern Cape, Free State, Limpopo, Mpumalanga and North West to assist in the implementation of the MFMA reforms.

Figure 5.8 Direct and indirect transfers in the water services operating and transfer subsidy programme, 2003/04 – 2009/10



Source: National Treasury local government database

The remaining transition process involves the transfer of water services infrastructure from the Department of Water Affairs and Forestry to municipalities

Fifth, a further aspect of enhancing municipal capacity is the completion of the process of restructuring local government. This has been a long and difficult process that has sought to align municipal assets, staff and finances with the constitutional assignment of functions. Past grant programmes, such as the R293 towns transition grant and the local government transition grant have already successfully run their course, with funds consolidated into the equitable share. The remaining transition process involves the transfer of water services infrastructure from the Department of Water Affairs and Forestry to municipalities. The water service operation subsidy and transfer grant was established in 2003 to support this process. It provides for the refurbishment, operation and maintenance of the department's water schemes prior to their transfer to municipalities and also for the costs of transferring assets and staff to municipalities. Funds are converted from an indirect transfer (through an augmentation to the water services trading account on the Department of Water Affairs and Forestry's budget vote) into a direct transfer to the relevant municipality once the transfer of assets and staff has been formalised through a transfer agreement. Figure 5.8 shows actual and

projected progress with the conversion of funds from an indirect transfer to a direct transfer to municipalities.

Conclusion

The system of national transfers to local government has adapted well to rapid real increases in resources being transferred from national government. This is largely due to the establishment of two flagship grant instruments, the equitable share and the MIG and the emergence of a new generation of grant programmes supporting economic development. Ongoing progress is evident in the contribution of these programmes to supporting the objectives of economic growth, combating poverty and strengthening municipal capacity.

However, a number of issues are beginning to emerge and will have to be addressed within the system of transfers over time.

First, co-ordination between programmes remains weak. The overall implication is that transfers are not yet reaching their potential in terms of comprehensively supporting economic growth and poverty alleviation. Delays in housing implementation which is not a municipal function, for example, can slow down the rate of infrastructure investment by municipalities. The proliferation of indirect infrastructure transfers further complicates co-ordination arrangements.

Second, transfers continue to weaken local democratic accountability. The growth in grant dependence and the prevalence of indirect transfers obscure the accountability of municipalities. The grant conditions often replace local oversight of municipal performance with complicated reporting requirements to national departments.

Third, weak programme design, implementation and evaluation procedures limit the impact of grants on the development outcomes sought by government. Smaller grant programmes, in particular, continue to underspend relative to their allocations and produce sub-standard information on their impacts. Few evaluations of programme performance are available to contribute to the ongoing refinement of the transfer system. Although a number of grant programmes have been phased out on completion of their design lives, this has not been accompanied by exit evaluations. Many others continue regardless of their performance.

Finally, programmes to strengthen the capacity of municipalities remain fragmented and are difficult to evaluate. This is a significant problem, given concerns over capacity constraints in municipalities.

The system of transfers to local government has evolved considerably since the advent of democracy in 1994. Significant restructuring of transfers has had significant positive impacts, but has also presented a range of second generation challenges. The emerging challenges identified in this chapter will continue to inform the ongoing evolution of the transfer system, as government seeks to assist municipalities in responding to the challenges of economic growth, poverty alleviation and local governance in accordance with national policy.

6

Leveraging private finance

Introduction

Municipalities are not using favourable macroeconomic conditions to increase borrowing

Local government legislation is designed to regulate, reform and stabilise municipal finances in a macroeconomic environment that is more enabling for private investment. Despite this, municipalities have not yet used the opportunity to borrow more creatively from capital markets, thereby expanding the potential financing instruments and sources of financing for major programmes.

It is estimated that for the three years to the end of 2009/10, an average of only 18.5 per cent of the value of all capital budgets will be financed from external loans, compared to 27.6 per cent over the four years up to the end of 2006/07.

On average 57 per cent of external loans of municipalities are with private sector institutions, while the rest are with the public sector through the Development Bank of Southern Africa (DBSA). The annualised average growth of outstanding capital balances of loans with the private sector has increased at a slower pace of 3.3 per cent, compared to 5.1 per cent with the public sector, in real terms between 2003/04 and 2006/07.

Effective leveraging of private finance releases municipal resources for poverty alleviation

Effective leveraging of private finance through the optimal use of borrowing and public private partnerships (PPPs), supports economic growth through ensuring the timely provision of infrastructure. It also releases municipal resources for poverty alleviation as well as encouraging improved governance practices by municipalities.

This chapter gives an overview of:

- the financing needs of municipalities
- sources of infrastructure financing

- borrowing instruments
- lending institutions
- managing credit risk
- the regulatory framework impacting on municipal borrowing
- constraints to leveraging private finance.

Financing needs of municipalities

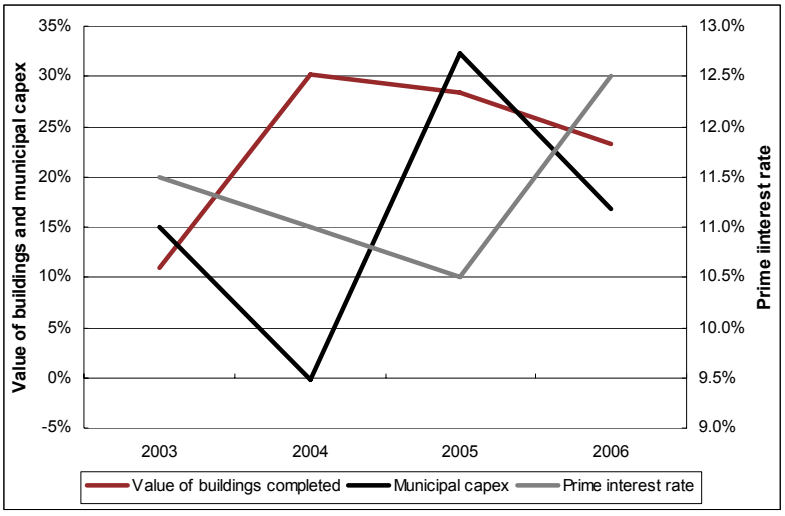
Municipal investment needs arise from spending pressures associated with growth in the economy, the replacement of assets and combating of poverty.

Impact of economic growth

Municipalities are key role-players in creating favourable conditions for economic development. The robust performance of the South African economy over the last four years was fuelled by unprecedented growth in construction, financial services, transport and communication and wholesale and retail trade. These sectors operate and trade within the boundaries of municipalities.

Figure 6.1 shows that the average annual growth in the real value of residential and non-residential buildings was 27.2 per cent between 2003 and 2006, compared to 15.6 per cent for municipal capital expenditure over the same period.

Figure 6.1 Growth in value of buildings completed and municipal capital expenditure and prime interest rates, 2003 – 2007



Source: StatsSA and South African Reserve Bank

Municipal capital expenditure is lagging behind construction activity

These trends suggest that municipal capital expenditure is lagging behind construction activity. Figure 6.1 further illustrates a more stable trend in construction activity over the prime interest rate cycle, compared to the relatively more erratic trend in municipal capital expenditure.

The rejuvenation of city precincts, expansion of suburbs and connections of townships to central business districts will continue to support construction activity. This will require greater municipal investment in bulk and reticulation infrastructure for electricity, water and sanitation, waste management systems, roads, storm water drainage systems and so on. All revenue sources therefore, will have to be optimally leveraged to meet the increased demand for services.

Replacement of assets

The management and maintenance of existing infrastructure is lagging behind and could become a binding constraint to future local economic development. Municipalities need to put measures in place to avoid system failures such as water leakages, pollution, power failures and damaged road surfaces.

Municipalities also need to focus on infrastructure management and maintenance

Renewed focus on infrastructure management and maintenance will improve the reliability of municipal services and enhance their potential for sustained local and national economic growth. Municipalities have budgeted to spend R7.3 billion on the maintenance of existing infrastructure in 2009/10. This is already R2 billion more than what was spent in 2006/07 and it is estimated that approximately R7 billion per year will be needed to address the full maintenance costs of municipalities.

The challenges that backlogs present

During 2007/08, municipalities experienced a huge financial challenge in the run up to the December 2007 deadline for the eradication of the bucket sanitation system. In some municipalities in the Free State, national government had to provide an extra R147 million through the municipal infrastructure grant to finance the increased costs associated with unforeseen geological obstacles.

A further challenge is responding to the demand for higher standards of sanitation services expressed by certain communities. These communities have indicated that they would rather wait for waterborne sanitation than accept a more basic service, such as ventilated pit latrines. This means that these municipalities are not able to meet the targets set by national government.

Combating poverty

The total cost of eradicating all backlogs in access to basic services is estimated to be around R70 billion. To improve their viability and sustainability, municipalities need to have a sustainable indigent policy to meet the demand for pro-poor social development within their jurisdictions. Eradicating backlogs in water and sanitation, electricity and waste management in established and developing low income areas is therefore a major priority. This needs to be a central component of a municipality's overall financing strategy.

Some municipalities will remain dependent on fiscal transfers over the medium to long-term

It is widely recognised that municipalities differ in terms of their fiscal capacity and that some municipalities will remain dependent on fiscal transfers over the medium to long-term. This is because of their low revenue base, demographic structure and the generally low level of economic activity in some areas. The latter group needs appropriate capacity building initiatives to help them achieve financial sustainability.

Metros and larger local municipalities

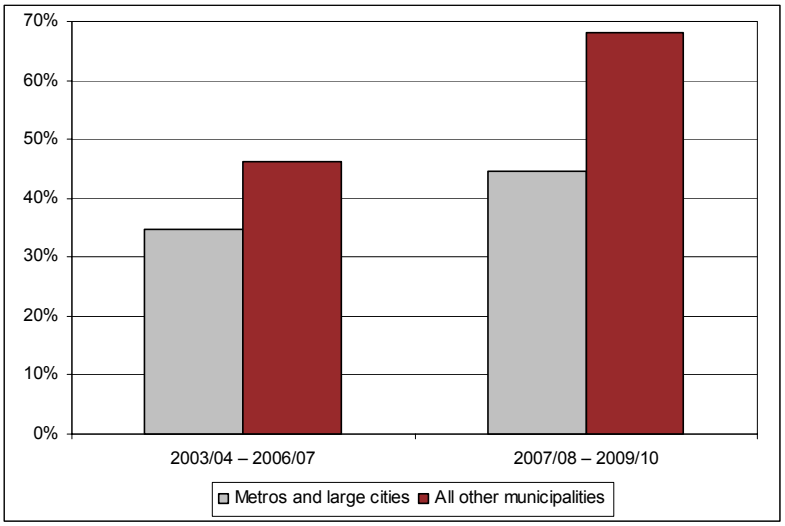
More than 25 per cent of urban dwellers live in formal areas, of which 40 per cent are regarded as poor. Approximately 38 per cent of the poor live in South Africa's nine largest cities[1].

Potential exists for metros to tap into external municipal financing sources to support critically needed investment in infrastructure to fully realise the potential of their integrated development plans.

Over-reliance on national transfers for future municipal capital investment

Figure 6.2 shows the reliance on national transfers as a financing source for future municipal capital investment. Development plans, based on sound partnerships with national and provincial government, the private sector and the electorate, have now become obligatory and should help to reduce this over-reliance.

Figure 6.2 Grants and subsidies as a percentage of municipal capital expenditure, 2003/04 – 2009/10



Source: National Treasury local government database

Sources of infrastructure financing

It is crucial for municipalities to develop a financing strategy that optimises the leveraging of grant funding, own and external sources of finance and off and on-balance sheet funding.

Current fiscal policy developments have become favourable as national government is not planning to introduce any domestic financing instruments over the medium-term. Instead, it projects to reduce its debt stock of R449.6 billion to R438 billion by 2010/11.

Financially sound municipalities need to enter the market and diversify their sources of finance

The decreasing borrowing requirement of national government has created liquidity in the domestic capital market and a unique opportunity for other players, including financially sound municipalities to enter the market and diversify their sources of finance.

[1] Stats SA, Census 2001 and Community Survey 2007.

Scope for more borrowing

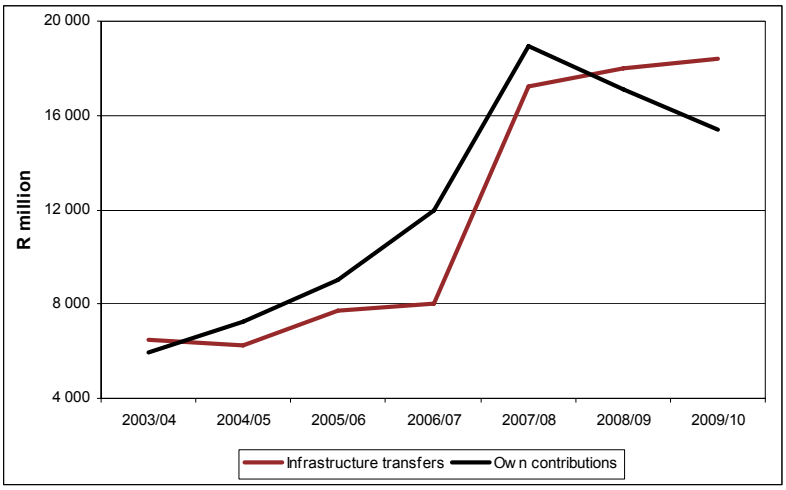
Approximately 80 per cent of the country's GDP is generated in 27 of the country's largest cities. (This includes the six metros and the 21 secondary cities). However, capital investment as a percentage of GDP by these municipalities remains low, at around 0.8 per cent. Municipalities' debt as a percentage of revenue is also low, at approximately 1 per cent. Taking the current credit rating of municipalities into account, there is scope to borrow a further R30 billion over the next three years to boost municipal infrastructure investment.

The additional funds could be raised through long term municipal bonds and bank loans and would allow creditworthy municipalities to address backlogs and invest in bulk projects needed for service delivery.

National transfers

Over the past 14 years, the rollout of pro-poor municipal infrastructure has been funded mainly through national transfers. Excluding transfers for the 2010 FIFA World Cup, infrastructure transfers increase by an average annual 13.3 per cent in real terms, between 2003/04 and 2009/10. Figure 6.3 shows that transfers for infrastructure are projected to exceed municipal own contributions, including external loans as a financing source for municipal capital expenditure.

Figure 6.3 Growth in capital transfers relative to own contributions, 2003/04 – 2009/10



Source: National Treasury local government database

If metros and larger municipalities were to borrow more from financial markets, this would release more funds from the national fiscus to benefit smaller municipalities.

Current revenues

Current revenues are income derived mainly from rates and service charges. Surpluses generated from these sources can be used to finance assets. However, increasing property rates and service charges may not be the only answer to finance infrastructure. This is because it would place an immediate burden on current residents who may not be there to enjoy the benefits of the completed infrastructure in the future.

Development charges

South Africa has experienced unprecedented growth in residential and non-residential property developments over recent years. As the trend in property development is expected to continue in the future, albeit at a pace related to the prevailing economic conditions, municipalities will have to form strong partnerships with developers. These partnerships could unlock potential revenue sources through development charges.

Development charges are an off-balance sheet source of finance for capital projects as they relate to residential and non-residential developments of land and buildings. A municipality would typically enter into an agreement with property owners or developers that allows it to recoup some of the cost of infrastructure development from the individual property owners who will benefit directly from the infrastructure. Municipalities will need to become more proactive partners in property developments in their areas.

The benefit of this source of finance is that development charges are equitable in the sense that the infrastructure costs are not covered by a general increase in local taxes, but are recovered from residents who will benefit directly from the developments.

Public private partnerships

Public private partnerships (PPPs) are important service delivery mechanisms that facilitate rapid infrastructure development. There are different types of PPPs that involve models for risk sharing between the municipality and its partners. In many cases the private party is in a better position to raise debt and equity to finance the project[2].

PPPs allow municipalities to take advantage of private sector expertise and experience

Municipalities can take advantage of private sector expertise and experience in the construction of the infrastructure. Furthermore, the development of PPPs for economically justifiable projects eases the pressure on the municipality's budget and allows for better allocation of funds towards addressing social needs of the community.

Public private partnerships

PPPs are a good way to generate more revenues from municipalities' existing assets. The Johannesburg Water Management contract for example, turned around the operational and financial performance of the utility. Revenue increased by 46 per cent in four years and power and chemical consumption decreased by 9 and 57 per cent respectively.

Before it was turned into a PPP, Cape Town's Epping Fresh Produce Market generated R3.5 million per annum. Its revenue has since grown to R6 million per annum, in addition to the sale of the ongoing operations of R16 million and R22 million owed to the City by the traders.

Borrowing instruments

Borrowing carries an intrinsically higher risk as a financing option

Borrowing as a financing option carries an intrinsically higher risk compared to financing from own resources and national transfers. The risk of procuring infrastructure through PPPs is essentially the same as borrowing. With borrowing, there are different financing options

[2] Introducing Public Private Partnerships in South Africa.

available to municipalities - the public sector through the Development Bank of Southern Africa (DBSA) and the private sector through banks, Infrastructure Finance Corporation (INCA) and other financial institutions.

Among lenders, different forms of instruments are offered, such as notes (short and long-term loans and other structured debts) or direct loan placements and bond issues.

A municipality will identify projects that have the potential to generate income and those that only offer public services. The financing approach for income-generating and public services projects will differ. Projects that offer public services such as libraries can be financed from rates income, cross-subsidising or even issuing general obligation debt. Cross-subsidisation for the benefit of poor households is feasible in most urban areas as there are large concentrations of high income households that are likely to be both able and willing to pay more for services, as well as demand higher levels of service.

Projects with the potential to generate revenue have the ability to attract private sector investment

Projects with the potential to generate revenue have the ability to attract private sector investment because financial institutions would have assurance about where the money to repay the loan originates. The choice of selecting an appropriate debt instrument involves looking at the tenure of the instrument, how the capital and interest are to be financed (for example, using an amortising or bullet profile) and any credit enhancement required.

Long-term loans

Over the years, municipalities have preferred long-term loans over bonds. This is partly because loans are less complicated to administer and only a few municipalities can absorb the high initial transaction costs associated with bond issues. Municipalities also may not have the technical capacity to issue bonds. Long-term loans amount to approximately 73 per cent of total local government debt.

Long-term loans may be offered at floating rates to the benefit of a municipality when its financial position improves and interest rates drop. The municipality will benefit from refinancing its debt, resulting in borrowing costs being lower than at the time when the loan was concluded. Despite the benefits of floating rates, their disadvantage is that the debt service costs can go up unexpectedly and the municipality's revenues may not increase in-line with the interest costs. Floating rates are largely in favour of the lender and the cost of financing debt at fixed rates is predictable.

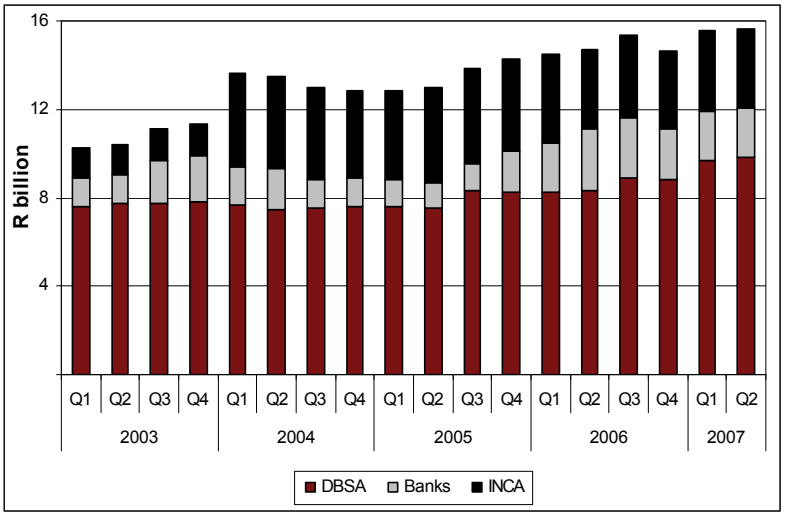
The disadvantage of financing infrastructure from long-term loans is that banks may not be able to match the tenure of loans with the life-span of some of the assets that the municipality wants to build. Some municipal assets have very long life-spans, such as bridges.

South African banks usually price loans using an amortising profile, rather than a bullet profile. With amortised loans, monthly repayments incorporate capital and interest until the redemption of the loan. The bulk of initial repayments will comprise mostly of interest and the capital (principal) will be evenly spread during the tenure of loan. For

a loan with a bullet profile, the capital is only paid by the municipality when the loan is redeemed and interest will be paid during the tenure of the loan.

Amortised loans result in a higher cost of borrowing compared to a bond issue. This is because the interest is based on what the bank's risk perception is of the municipality rather than the perception of a multitude of lenders in a functioning market. Outstanding long-term loans amounted to R15.6 billion as at June 2007.

Figure 6.4 Outstanding long term loans (supply side), 2003 – 2007



Source: National Treasury borrowing monitoring analysis

Short-term loans

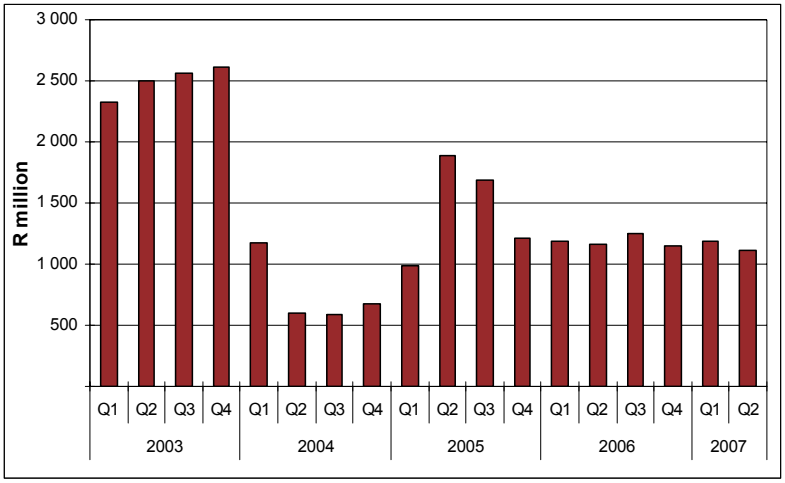
Short-term debt is permitted in terms of section 45 of the Municipal Finance Management Act (2003) (MFMA). The Act makes provision for short-term debt to be incurred for bridging finance for operational purposes only and to be redeemed within the current financial year in which the debt was incurred.

The risk of allowing short-term debt to accumulate is that cost of servicing the debt can quickly become unaffordable. This may result in the need to finance old debt with new loans. Figure 6.5 shows that this was the case before the budget reforms that came about with the implementation of the MFMA.

Ideally a balanced budget should limit the risk of a municipality being over-exposed to short-term debt, which may result in the rolling-over of debts.

According to the Quarterly Bulletin of the South African Reserve Bank, outstanding short-term loans amounted to R2.6 billion in the fourth quarter of 2003. As part of the budget reforms, municipalities were required to reduce their short-term debts incurred before 2003/04 by end of June 2008.

Figure 6.5 Quarterly outstanding short-term debt, 2003 – 2007



Source: SARB Quarterly Bulletins

Overdrafts are the largest contributor to short-term debt instruments, and they have shown a significant decline, from R2.2 billion to R1 billion between 2003/04 and 2007/08. Short-term loans amounted to R23 million and the remaining R92 million are tax-structured loans. Short-term debt accounted for 5 per cent of total municipal debt in the second quarter of 2007.

Municipal bonds

Municipal bonds are an ideal instrument for financing large capital projects

Municipal bonds are an ideal instrument for financing large capital projects. They address the shortcomings of loans as the period of tenure of bonds can go up to more than 30 years and the issuer (municipality) is able to negotiate the interest rate payments and the repayment period to meet its own and investors' needs. With bonds, there is a diverse pool of investors involved, whereas only two parties are involved in bank loans.

As bond issues involve underwriters, credit rating agencies, trustees and the general public, they create an obligation for greater accountability and transparency on the part of the municipality. All stakeholders and investors demand up to date knowledge of the financial affairs of the municipality and the issuer is required by the debt disclosure regulations of the MFMA to obtain an annually renewable credit rating.

The regulations are aimed at improving transparency to protect investors. For example, investors will know the extent to which changes in local taxes and service charges will affect the servicing of the bond repayments.

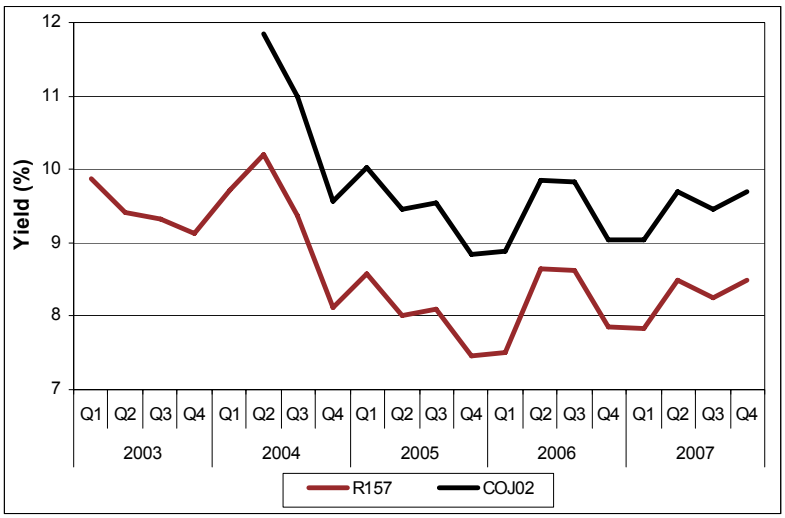
For a successful bond issue, a municipality must have a good revenue collection and revenue growth rate, as this serves as an indicator of the ability of a municipality to meet its bond repayment obligation.

The City of Johannesburg and the City of Cape Town are the only municipalities that have recently issued bonds

The City of Johannesburg and the City of Cape Town are the only municipalities to have recently issued bonds. The benefit of issuing municipal bonds is that they are priced against government bonds, which are a true reflection of the pricing in the market. This can potentially reduce the cost of borrowing for a well run municipality.

The COJ2, the City of Johannesburg's second bond, was priced at 11.9 per cent at the time of issue in June 2004. It further improved to a yield of 9.7 per cent in December 2007. Since municipal bonds are priced against government bonds, which are very low risk, it is worth noting that the COJ2 is moving in sync with the R157 government bond. As the spread narrows or comes closer to the government bond, it indicates that the risk profile of the municipality has improved and the market is gaining confidence, which is then reflected in the price.

Figure 6.6 COJ2 and R157 spread, 2003 – 2007



Source: Bond Exchange of South Africa

The City of Johannesburg and the City of Cape Town have successfully launched bonds totalling R5.7 billion and R1 billion respectively. The City of Johannesburg's first issue, COJ1, launched at a coupon rate of 11.95 per cent in 2004 and the City of Cape Town's at a rate of 12.57 per cent in 2008. The premium in the coupon rate, above the yield of the R157 government bond, was a reflection of the relatively low credit rating based on an unfavourable audit report on the financial state of the municipality at the time. Moreover, the municipal bond market was not yet established at the time of the initial issue.

Lending institutions

There are a number of public and private institutions active in the long-term municipal debt market. The private sector's share of this market has remained stable at around 57 per cent since 2003/04.

The Development Bank of Southern Africa

DBSA is the largest public lender to municipalities

The Development Bank of Southern Africa (DBSA) is the largest public lender to municipalities, with a 46 per cent share of total municipal debt in June 2007. Providing financing to all categories of municipalities, DBSA's share of the total municipal debt market has increased by an annualised growth of 6 per cent since 2003.

Although DBSA is lending to all municipalities, its bias in favour of the metros might be justified by the fact that the bank is fulfilling its mandate to fund social projects and projects that contribute to the broader transformation agenda. However, this bias is seen as potentially limiting for metros entering the bond market, as annuity loans are considered to be cheaper, when taking into account the initial fixed costs of bonds.

The DBSA therefore needs to provide more assistance to municipalities that are not creditworthy so that they reach the stage where commercial banks develop an interest in funding them. Such interventions would ensure that the DBSA crowds in private sector finance in the local government environment.

Infrastructure Finance Corporation

INCA is a significant private lender to municipalities

The Infrastructure Finance Corporation (INCA) is a significant private lender in the market. It was established to support the country's stalled municipal bond market by issuing bonds to raise funds. It acts as a bond bank that issues debt in the financial markets against its portfolio of municipal loans and also buys outstanding debt, thus providing liquidity in the municipal bond market.

INCA accounted for R3.6 billion or 23 per cent of municipalities' outstanding long-term loans as at 30 June 2007. Loans are not extended to municipalities that cannot demonstrate adequate financial management capacity.

Banks and other financial institutions

Banks provide both short and long-term debt to municipalities

Banks and other financial institutions play an important intermediary role of linking the supply of capital with demand. They provide both short and long-term debt to municipalities. They accounted for R2.2 billion of outstanding long-term loans in June 2007.

Their approach to the long-term municipal borrowing market is that they would normally require municipalities to securitise their assets before they can lend to them. Securitisation is the process where a municipality moves some of its assets to a low risk vehicle (normally called a special purpose vehicle).

With securitisation, a pre-defined set of assets cannot be seized by a third party when a municipality becomes bankrupt, the financial institution's risk exposure is thus lessened. This is then reflected in the pricing of the loan.

Pension and insurance funds are very inactive in the market, only accounting for R22 million (0.2 per cent) as at 30 June 2007. It appears that these players have withdrawn from the market and that the outstanding debt may be debt that was issued in the past and has not been redeemed. The lack of suitable municipal debt finance products, such as bonds with longer repayment cycles, could be an explanation for the low involvement in the market.

Managing credit risk

Leveraging municipal revenue with private capital carries risks

Leveraging municipal revenue with private capital carries risks. Large infrastructure projects tend to take more than a year to build. The cost of material, labour and other overheads tends to escalate during the construction phase of the asset. An example of this is the cost of building and rehabilitating stadiums for the 2010 FIFA World Cup, where medium-term allocations had to be brought forward to cover unexpected cost escalations.

A recessionary cycle can result in a downward revision of municipal allocations over the medium-term. A recession will result in interest rate fluctuations. The cost of financing infrastructure through debt can increase substantially if interest rates increase, which in turn may lead to defaults. Options available to mitigate risks to provide comfort to investors include credit enhancements and improved credit ratings.

Credit enhancements

Credit enhancements are designed to reduce risk exposure

Credit enhancements are programmes that are designed to reduce risk exposure both for the investor and the municipality.

Municipalities would be required to apply credit enhancement procedures when applying for debt in order to reduce the risk that the potential lender may be exposed to. Credit enhancement is a process of reducing risk by providing collateral, insurance or other agreements to assure the potential lender that the lender will be compensated if the municipality defaults on its loan.

Credit enhancement may be in the form of partial guarantees, where the guarantor covers a portion of the debt service costs, or comprehensive guarantees, which involve guaranteeing the debt entirely, irrespective of the cause of default.

City of Johannesburg bond benefits from credit enhancement

The R1 billion bond matures in 2018. It amortises over the last three years (principal is paid in three instalments). The International Finance Corporation (IFC) and the DBSA assisted in structuring the transaction and together provided a partial credit guarantee for up to 40 per cent of the principal amount outstanding. This amount can be used to repay up to the full amount and principal and the amount falling due to bondholders on any given payment date, subject to guarantee limits.

The enhanced bond was rated AA- by Fitch Ratings. The issue was oversubscribed 2.3 times, reflecting a strong endorsement by the market of the issue and the credit enhancement structure.

Source: The Municipal Fund: Global Financing for Local Needs, IFC

Credit ratings

Municipalities need a credit rating to access capital markets

As an indicator of risk, a credit rating is essential for municipalities to access capital markets. A good rating reduces the cost of financing while a bad rating will result in a premium being demanded to offset the increased risk.

Another benefit of a credit rating would be that it increases the marketability of the borrower and its debt instruments. It opens up more financing options and enhances the municipality's ability to choose the most efficient and cost effective source of finance.

A rating methodology will look at the economic base of a municipality. The economic base will ultimately generate resources to pay the debt, which include the strength and diversity of its large taxpayers, unemployment rates and debt burden ratios per capita, as it demonstrates the ability of its residents to absorb the debt, amongst other things.

Table 6.1 Credit ratings from Moodys

Municipality	Long term	Short term
Amathole District municipality	BBB	A2
Breede Valley municipality	BBB-	A3
Buffalo City	A-	A2
City of Cape Town	A+	A1
City of Johannesburg	A+	A1
City of Matlosana	BBB	A2
City of Tshwane	A+	A1
Ekurhukeni metro	AA-	A1+
Emnambithi / Ladysmith municipality	BB+	B
George municipality	A-	A2
Greater Tzaneen municipality	BBB-	A3
Lephalale municipality	BB+	B
Makana municipality	BB-	B
Mbombela municipality	A-	A2
Mogalakwena municipality	BBB-	A3
Nelson Mandela Bay metro	A	A1
Polokwane municipality	BBB+	A2
Tlokwe municipality	A-	A2
uMngeni municipality	BB-	B
West Coast district municipality	BBB+	A2
Westonaria municipality	BB	B

Source: Moodys Investors Service

Regulatory framework impacting on municipal borrowing

South Africa's well developed capital markets need to be supported by national government regulations and procedures that set out the rules for both municipalities and investors in terms of disclosure requirements and procedures governing defaults.

The White Paper on Local Government (1998) recognises the need for municipalities to source alternative financing to address infrastructure backlogs. It also acknowledges the role that the private and public sector can play in terms of mobilising funds and additional infrastructure investment from the private sector.

National government does not stand surety for municipal debt

National government does not stand surety for municipal debt and there are no regulations limiting the supply and demand for borrowing by municipalities and investors. However, the Regulatory Framework for Municipal Borrowing (1999) recommends that every municipality should adopt a written debt policy when planning to issue debt.

This policy will assist in determining borrowing limits that a municipality can cope with. The debt policy will also provide comfort for credit rating agencies and potential lenders that the municipality is committed to being responsible and prudent when borrowing.

In 2002, national government made a constitutional amendment[3] that allowed municipal councils to make firm financial commitments to investors regarding future budgets and revenue streams. Previously, there had been a line of legal precedent that could have allowed a council to repudiate the debts of a predecessor council. It also allowed the pledging of various types of security and created specific remedies in the event of financial emergencies.

The MFMA is the overarching legal framework giving all municipalities equal borrowing powers

The MFMA is the overarching legal framework giving all municipalities equal borrowing powers. Section 46 of the MFMA limits long term borrowing to financing capital investments in property, plant and equipment through a council resolution signed by the mayor to approve the debt agreement.

Before a municipality issues debt, the purpose of the loan in relation to infrastructure financing must be aligned with the municipality's integrated development plan. In addition to this, a municipality invites National Treasury, the relevant provincial treasury and the public to submit written comments to council.

Municipal borrowing and pro-poor policies

The most critical issue for municipal borrowing regarding the development of pro-poor policies is that indigents who do not have the ability to pay are able to access services.

A clear indigent policy will not only benefit the poor but will have a positive impact on municipal credit ratings. The risk related to lending to municipalities is related to the stability of revenue flows and a clear indigent policy enables accurate calculation of revenue flows.

Source: Report from Urban Policy Lekgotla

Since municipalities table multi-year budgets, the projections of anticipated revenue and expenditure for the medium term assist lenders when making risk assessments on a municipality's credit applications. Multi-year budgeting should be simplified by the fact that local government allocations are also published over the three years in terms of the Medium Term Expenditure Framework (MTEF) and updated annually to improve predictability and transparency.

The recently gazetted debt disclosure regulations set out clear guidelines on the disclosure requirements needed when incurring debt. The regulations enforce section 49 of the MFMA and do not introduce additional disclosure requirements. Municipalities are required to disclose details on current and defaulted loans, debt repayment plans and the revenue for the three preceding financial years. In addition, it is mandatory for the municipality to obtain a credit rating (reviewed annually after the issue), if it intends incurring debt using alternative instruments other than loans.

[3] Amendment of section 156 of the Constitution.

With legislation designed to improve regulations on borrowing by local government, the policy framework for municipal borrowing and financial emergencies, is also crucial as it sets out remedies and financial recovery plans when a municipality defaults on its debt obligation.

The framework, together with chapter 13 of the MFMA, provides for a designated person that will prepare the financial recovery plan in consultation with the relevant MECs of local government and finance and the Municipal Financial Recovery Service (MFRS). The MFRS will facilitate necessary recovery plans to assist municipalities that are in need of financial recovery assistance.

Constraints to leveraging private finance

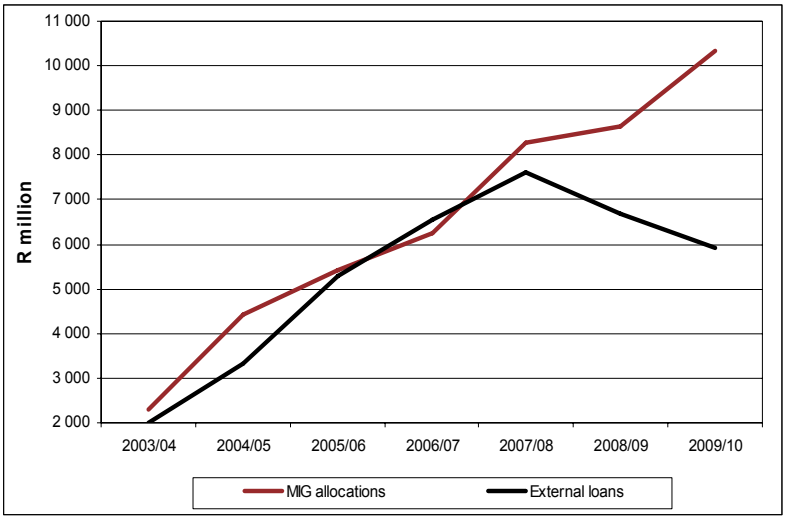
Any form of leveraging of finance for infrastructure purposes must be aligned with a municipality's IDP. Not only is it a challenge for municipalities to align their IDPs with their budgets, but the variance between the actual versus budgeted expenditure is also a concern.

Municipalities are still underspending national transfers

Despite the efforts of various capacity-building programmes, municipalities are still underspending national transfers. Some of this may be attributable to the misalignment of national and municipal financial years and the tendency to plan more for the short-term than the long-term. Municipalities tend to report improved expenditure levels towards the end of their financial year. This is an indication of the lack of planning for the execution of their capital spending programmes.

The municipal infrastructure grant (MIG) has grown by an annualised rate of 24 per cent between 2003/04 and 2009/10, external loans grew by 16 per cent for the same period and are set to decline from 2007/08.

Figure 6.7 Growth in MIG and external loans, 2003/04 – 2009/10



Source: National Treasury local government database

It is evident that the growth in the MIG provides an incentive for municipalities not to borrow. Figure 6.7 suggests that councillors prioritise grant funded capital projects compared to those that will require external finance.

Some financial institutions believe that the lack of borrowing may be due to a very complicated and highly regulated municipal environment. Another observation is that municipalities generally take a short-term view of their capital projects and they would rather implement a series of small projects that will exhaust capital grants by the year end.

Conclusion

Municipalities' capital expenditure is not keeping pace with the growing economy and an expanding population. Capital investment strategies need to be well designed and include provisions for new infrastructure and for the replacement of deteriorating infrastructure.

Carefully designed finance strategies to suit the financial situation and potential of each locality will have to bring in a more focused role for private finance.

Private finance is available and is currently utilised to finance a number of infrastructure projects around the country. However, analysis of the financing of municipal capital budgets reveals that there is potential for municipalities and private financiers to draw on established relationships and broaden the scope of their transactions.

Municipalities that are well positioned for more investment by the private sector, such as metros and the large secondary cities, should diversify their finance mix into bonds and PPPs. This will free-up significant resources that national government can use to assist struggling municipalities that will always be grant dependent.

7

Water and sanitation

Introduction

Water is fundamental to life, the environment, food production, hygiene and power generation

Water is probably the most fundamental and indispensable of natural resources – fundamental to life, the environment, food production, hygiene and power generation. Prosperity for South Africa depends on the sound management and use of many resources, of which water is a crucial one.

The nation gains directly from improved access to basic water and sanitation services through improved health, averted health care costs and time saved. Poverty reduction and improved water management are inextricably linked.

Water-related diseases are among the most common causes of illness and death among children below the age of five, affecting mainly the poor in developing countries. In South Africa, the recent outbreaks of cholera and typhoid in Eastern Cape, Gauteng and KwaZulu-Natal due to water contamination have emphasised the need for prioritising sanitation, which falls under the municipal water services function.

This chapter gives an overview of:

- the composition of the water sector in South Africa
- the management of water resources
- the institutional arrangements in the water services sector
- access to water and sanitation
- municipal and municipal entity budgets
- factors influencing the efficient provision of the water services function.

Composition of the water sector

There are three fundamental objectives for managing South Africa's water that are firmly grounded in the provisions of the Bill of Rights of the Constitution. These are, to achieve:

- equitable access to water and to the benefits from the use of water resources
- sustainable use of water by making progressive adjustments to water use with the objective of striking a balance between water availability and legitimate water requirements and by implementing measures to protect water resources
- efficient and effective water use for optimum social and economic benefit.

The water sector in South Africa is classified into two main sub-sectors - water resources management and water provision. Water resources management focuses on the protection, optimal utilisation, development, conservation, management and control of the country's water resources in a sustainable and equitable manner for the benefit of all people. Water services management focuses on the provision of adequate, sustainable, viable, safe, appropriate and affordable water and sanitation services to all people in South Africa. Water services include education on the wise use of water and the safe practice of sanitation.

Management of water resources

The management of water resources is an exclusive national competency

In terms of the Constitution of the Republic of South Africa, the management of water resources is an exclusive national competency and in terms of the National Water Act (1998) it falls within the portfolio of the Minister of Water Affairs and Forestry.

Although renewable, water is also a finite resource. Water sources include rivers, streams, groundwater and rainfall. These water sources are captured or contained into dams (South Africa has 358 state dams and many thousands of smaller farm and private dams) and from there the water is taken to water treatment plants for purification.

South Africa is a semi-arid country with only around half the average rainfall of other countries

South Africa is a semi-arid country that receives an average rainfall of 450 mm per annum, which is well below the world average of 860 mm per annum. Rainfall is also not evenly distributed across the country, with some regions in the west receiving less than 100 mm per annum of rainfall while some regions in the east receive over 1 000 mm per annum. In global terms, South Africa's water resources are scarce and extremely limited. The country does not have any truly large rivers and the combined flow of all the rivers amounts to approximately 49 000 million m^3 per annum, less than half of that of the Zambezi River, by world standards the closest large river to South Africa. Four of South Africa's main rivers are shared with other countries. These are the Limpopo, Inkomati, Pongola (Maputo) and Orange (Senqu) rivers.

Due to the uneven distribution of rainfall, the natural availability of water across the country is also highly uneven and further compounded by the strongly seasonal and erratic nature of rainfall. In areas where the average rainfall is low, dry periods with no rainfall at all can last up to eight months, which means that there will be no open flow in the rivers and streams for many months. Groundwater therefore plays a pivotal role in water supplies, especially in rural areas. Because of the predominantly hard rock nature of the South African geology, however, only about 20 per cent of groundwater can be used on a large scale.

South Arica has been divided into 19 catchment-based water management areas

To facilitate the management of water resources, the country has been divided into 19 catchment-based water management areas. The interlinking of catchments gives effect to one of the main principles of the National Water Act (1998) which designates water as a national resource. This act makes provision for the progressive establishment of the catchment management agencies for delegating water resource management to regional or catchment level agencies and for involving local communities in decision-making. Five catchment areas have already been established: the Inkomati (Mpumalanga), Thukela and Usutu-Mhlathuze (KwaZulu-Natal), Gouritz (Western Cape) and Olifants-Doorn (Western Cape). Work is currently being undertaken by the Department of Water Affairs and Forestry to oversee the progressive rollout of the remainder of the catchment areas, which will include a review of the appropriate number of catchment areas to be established. The role of the catchment management agencies includes the equitable allocation of water resources to prospective water users, including domestic users, agriculture, commerce and industry and the environment.

Table 7.1 Reconciliation of requirements for and availability of water for the year 2025

Water management area m^3/annum	Reliable local yield	Transfers in	Local requirements	Transfers out	Balance
Limpopo	281	18	347	–	-48
Luvuvhu/Letaba	404	–	349	13	42
Crocodile West & Marico	846	727	1 438	10	125
Olifants	630	210	1 075	7	-242
Inkomati	1 028	–	914	311	-197
Usutu to Mhlathuze	1 113	40	728	114	311
Thukela	742	–	347	506	-111
Upper Vaal	1 229	1 630	1 269	1 632	-42
Middle Vaal	55	838	381	503	9
Lower Vaal	127	571	641	–	57
Mvoti to Umzimkulu	555	34	1 012	–	-423
Mzimvubu to Keiskamma	872	–	413	–	459
Upper Orange	4 734	2	1 059	3 589	88
Lower Orange	-956	2 082	1 079	54	-7
Fish to Tsitsikamma	456	603	988	–	71
Gouritz	278	–	353	1	-76
Olifants/Doring	335	3	370	–	-32
Breede	869	1	638	196	36
Berg	568	194	829	–	-67

Source: Department of Water Affairs and Forestry, National Water Resource Strategy, First Edition, September 2004

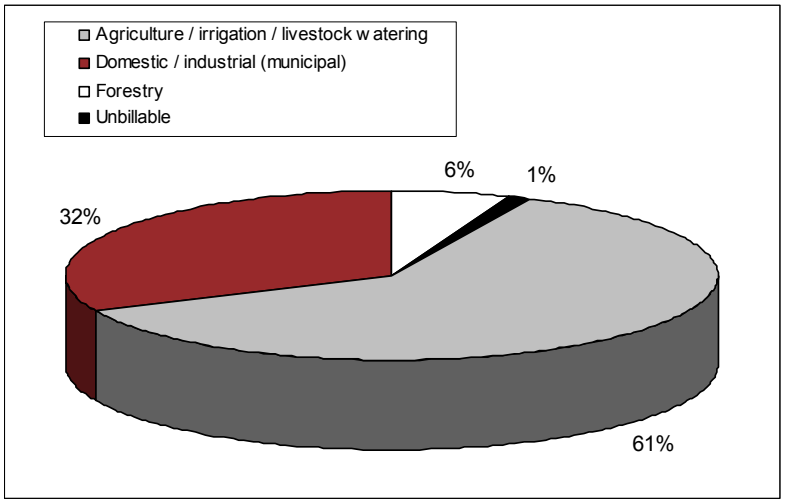
Trends in demand for water

Like electricity, water plays an important role in supporting economic growth in the country. Statistics South Africa reported that the water industry, made up predominantly by the water boards and other national agencies, contributed about R6.4 billion to the country's annual gross domestic product (GDP) in 2006. This accounted for an average of 0.4 per cent of GDP.

Table 7.1 gives a perspective on the possible future requirements for water for the year 2025 and the water that will potentially be available. It also highlights the regional differences in terms of water resources in the country, with more than half the water management areas showing a deficit in terms of water requirements.

Demand for water is dominated by agriculture, specifically irrigation and livestock watering, which in 2006/07 used 10.6 billion m^3 (61 per cent) of the total of 17.2 billion m^3 water used by all users in the country. Agriculture was followed by domestic and industrial customers (32 per cent), forestry (6 per cent) and 206.4 million m^3 (or 1 per cent) is unbillable as illustrated in figure 7.1.

Figure 7.1 Total use of water by sector, 2006/07



Source: Department of Water Affairs and Forestry

There needs to be a balance between water requirements in urban and rural areas

It is expected that future growth in water requirements will largely be in the metros. However, this needs to be balanced with rural water needs, particularly agriculture. Specific attention will therefore need to be given to ensuring adequate future water supplies to urban growth areas as well as ensuring equitable access to the existing supplies.

Spending on infrastructure development and rehabilitation in water resources management is expected to increase from R1.3 billion in 2007/08 to R2.6 billion in 2010/11, driven by the additional allocations for the Olifants River water resources development project (De Hoop Dam), related bulk distribution infrastructure and the dam safety rehabilitation programme.

The implementation phase of the De Hoop Dam project will be partly funded from the budget vote of the Department of Water Affairs and Forestry. For subsequent phases, a portion of the funding will be provided from the financial markets, which will be determined together with commercial user charges. A similar arrangement will be applied to the Mokolo River water resources augmentation project, for which an estimated 75 per cent of the estimated total cost of R1.9 billion will be attributable to commercial users. Funding for new dams, such as the Nwamitwa Dam, the Mzimkulu Off-Channel Storage Dam and the Zalu Dam is fully provided for in existing baseline allocations. Funding for rehabilitating dams to ensure safety will continue throughout the MTEF period.

As part of the institutional framework for managing water resources, it is proposed that a National Water Resources Infrastructure Agency be established through the South African National Water Resources Infrastructure Agency Limited Bill, which is currently under debate. The agency, which will be wholly owned by the state, will be responsible for operating national water resource infrastructure that will ensure the efficient and effective water supply to all water users.

Water quality

In addition to appropriate quantities of water being made available for use, it is also essential for water to be of a suitable quality for a particular use, either for human and economic purposes or for the maintenance of ecosystems. Water use thus has an economic value and the use of water should reflect this value.

The WSSD recognised the importance of adequate and clean water supplies

Recognising the importance of adequate and clean water supplies throughout the world, participating countries at the World Summit on Sustainable Development (WSSD) held in Johannesburg in 2002, agreed to:

- intensify water pollution prevention to reduce health hazards and protect ecosystems by introducing technologies for affordable sanitation and industrial and domestic wastewater treatment, by mitigating the effects of groundwater contamination and by establishing, at the national level, monitoring systems and effective legal frameworks
- adopt prevention and protection measures to promote sustainable water use and to address water shortages.

Historically, South Africa's tap water has been of very high quality by international standards, but due to problems in some areas, quality can no longer be guaranteed. The Department of Water Affairs and Forestry is implementing appropriate clean-up programmes and municipalities have been instructed to provide communities affected by contaminated water with safe drinking water.

Investigations have revealed that not all water purification works are functioning according to the required specifications, resulting in a risk of contaminated water being distributed to users in certain areas. Therefore, investments in storage, transfer and distribution infrastructure need to be complemented by ongoing investments in

refurbishing, replacing and/or maintaining existing infrastructure and the training of staff.

Global climate change will lead to an increased incidence of both drought and floods

Global climate change is likely to worsen many existing environmental trends such as water stress. It is predicted that global climate change will cause mean temperatures to rise, accompanied by an increased incidence of both drought and floods, where prolonged dry spells will be followed by intense storms. As agriculture makes up a large component of the South African economy, this kind of climate change could have adverse implications for the country in terms of the economy, food production and employment.

There are also important interrelated effects between environmental issues. For example, inadequate waste management practices can contribute to water pollution problems.

The Department of Water Affairs and Forestry is currently in the process of developing a wastewater discharge charge system (WDCS). The aim is to recover the costs associated with different wastewater treatment and water quality management programmes and to provide incentives for water users to treat their waste in-house rather than discharging it untreated into a water resource. The major sources of direct pollution include industrial effluent, domestic and commercial sewerage, acid mine drainage, agricultural runoff and litter. The WDCS will be payable by polluters who exceed certain resource objectives and the charge rate will be determined per sub-catchment. Piloting of the WDCS will start in 2009.

Examples of recent water service delivery failures

Below are examples of recent water service delivery failures that have affected the quality of life of citizens and the environment:

- During December 2007, thousands of fish, eels and other marine life washed up dead in and around the Durban port estuary due to the build up of organic matter in the water.
- A number of participants in this year's 58th Dusi Marathon, held in KwaZulu-Natal, went down with chronic diarrhoea and/or vomiting after the race. According to international standards, for water to be drinkable, an acceptable count of the human intestinal bacteria, E. Coli, is 150 to 100 ml of water. But tests done along the Umsundusi River, just nine days before the race, showed E Coli levels were measuring up to 115 000 per 100 ml.
- On 16 April 2008, the Gauteng Department of Health confirmed the outbreak of two cholera cases at the Chicken Farm informal settlement in Kliptown, Soweto and indicated that an urgent investigation is under way to confirm the source of the infections. Soweto residents pointed to deep-seated problems related to poor sanitation facilities and the lack of access to potable water. The local utility, Johannesburg Water, however, has subsequently indicated that Kliptown's water was cholera-free and safe to drink.
- The Eastern Cape's Daily Dispatch reported on 22 April 2008 that nearly 80 children had died in the Eastern Cape district over the last three months from diarrhoea and other complications. A health department official in Bisho confirmed that "these babies are dying because of the dirty water that they drink".
- During May 2008, people suffering symptoms of typhoid fever have been urged to seek medical assistance after an outbreak in Delmas, Mpumalanga. It is reported that at least 18 people have been hospitalised and a further 380 could be infected. The outbreak is suspected to have originated in Delmas's water supply.

Institutional arrangements in the water services sector

Water services refer to water supply and sanitation services and include regional water schemes, local water schemes, on-site sanitation and the collection and treatment of wastewater. The Department of Water Affairs and Forestry, water boards and municipalities are the primary players in water services sector.

The Department of Water Affairs and Forestry, water boards and municipalities are the primary players in water services sector

National government

The Department of Water Affairs and Forestry has repositioned itself as sector leader responsible for policy development, regulation and support functions. As part of this process, the department is phasing-out its role as implementing agent by transferring water schemes to the relevant municipalities.

Progress with the transfer of water schemes to municipalities

The Department of Water Affairs and Forestry administered a number of water services schemes in poor areas before 1994. The transferring of water schemes to municipalities is to be finalised over the next three years and funding is to be phased into the local government equitable share from 2009/10. All funds for this programme will subsequently be transferred directly to municipalities in terms of the provisions of the transfer agreements. The operating grant amounts to R1.1 billion in 2008/09, R0.9 billion in 2009/10 and R0.6 billion in 2010/11, or a total of R2.3 billion over the MTEF period.

The transfer of water schemes involves the transfer of assets and staff and the resulting operating costs of salaries and free basic services. The 321 schemes employ 8 094 staff and supply water to 53 municipalities. So far, 56 out of 60 transfer agreements have been signed, 3 157 staff have been transferred to local authorities while 3 500 staff have been seconded. A total of 1 701 schemes with a total asset value of approximately R6.0 billion have been transferred. Full costs for the operations of the schemes are being finalised. R554 million (44 per cent) of funds set aside for the refurbishment of assets has been transferred.

Water boards

Water boards are established in terms of the Water Services Act (1997) as national government business enterprises, in terms of schedule 3B of the Public Finance Management Act (1999) (PFMA). There are currently 15 water boards that employ over 6 000 staff.

Water boards are intermediaries between the raw water supply and reticulation functions under contract to water services authorities (municipalities). Traditionally, water boards provide bulk water to a number of municipalities in a defined geographic area, but some water boards also provide a limited retail or reticulation function. Through their role in the operation of dams, they also play an important role in water resources management.

Water boards provide bulk water to a number of municipalities in a defined geographic area

Table 7.2 provides a summary of the budgets for the 15 existing water boards for the period between 2004/05 and 2005/06.

The two largest water boards are Rand Water and Umgeni Water, not only in terms of budget size but also people served (Rand Water in Gauteng serves 11 million people and Umgeni Water in KwaZulu-Natal serves 4.8 million). Rand Water's budget accounted for 62 per cent of the total revenue and 64 per cent of total operating expenditure for all water boards, followed by Umgeni Water, which accounted for 18.1 per cent of the total revenue and 13.4 per cent of total operating expenditure. Although Rand Water services a relatively

Rand Water accounts for most revenue and operating expenditure

small area compared to other water boards, it serves the most customers and has the largest number of staff, which reflects the high density of Gauteng's population. Ikangala Water Board (falling within portions of both the Limpopo and Mpumalanga provinces) is the smallest water board with respect to budget size. It also has the least number of staff of all water boards, with just four staff members.

Table 7.2 Income and expenditure of water boards, 2004/05 and 2005/06

	2005/06			2004/05	2005/06	2004/05	2005/06	2004/05	2005/06
	Population served (thousands)	Service area (sq km)	Number of staff	Revenue		Capital expenditure		Operating expenditure	
R thousands				Actual	Estimated actual	Actual	Estimated actual	Actual	Estimated actual
Albany Coast	10	20	5	2 584	2 807	113 821	98 706	1 884	1 539
Amatola	1 300	43 400	230	80 071	88 035	12 987	11 076	84 271	94 711
Bloem	900	35 150	192	146 697	158 604	6 463	985	104 074	141 093
Botshelo	900	49 858	305	54 577	52 045	605	3 175	95 405	125 615
Bushbuckridge	1 600	12 320	167	37 716	44 563	790	527	47 515	27 476
Ikangala	1 600	4 008	4	1 175	1 383	–	60 530	3 009	1 459
Lepelle	1 000	82 000	272	159 761	179 656	2 226	14 464	90 203	115 069
Magalies	800	35 000	395	175 589	140 108	28 552	42 005	236 390	160 852
Mhlathuze	400	37 000	143	143 710	166 437	14 507	7 942	102 856	109 845
Namakwa	40	1 487	31	7 489	8 986	–	–	8 615	14 904
Overberg	70	6 700	70	15 546	20 053	376	825	15 353	16 397
Pelladrift	7	9 531	–	5 711	5 664	–	–	5 455	5 745
Rand Water	11 000	18 001	3 006	3 460 099	3 672 119	385 486	339 137	2 990 992	3 087 775
Sedibeng	1 600	86 000	600	274 896	278 388	14 182	5 066	275 674	266 764
Umgeni	4 800	32 000	789	1 008 352	1 084 544	20 353	79 376	627 237	688 657
Total	**26 027**	**452 475**	**6 209**	**5 573 973**	**5 903 392**	**600 348**	**663 814**	**4 688 933**	**4 857 901**

Source: Department of Water Affairs and Forestry

According to the Department of Water Affairs and Forestry's 2006/07 annual report, most of the water boards managed to remain financially viable as they were able to accumulate surpluses (which are, among others, necessary for infrastructure rollout) and repay their debts. Some of the notable successes include:

- The overall financial position of Mhlathuze Water improved considerably and the net operating surplus increased at an average of 9.1 per cent over the past five years.
- Overberg Water improved its financial viability and is on a steady path to sustainable service delivery and expansion of its services.
- Umgeni Water overcame its liquidity and solvency problems of the past five years.

Water boards do, however, face a number of challenges. These include concluding long-term bulk water supply agreements with municipalities, which means they are not able to make long-term infrastructure capital projections, they also experience problems in the recovery of costs for services rendered to municipalities, especially in the rural areas that were previously unserviced and there does appear to be weaknesses in their systems relating to internal control and accountability. In addition, 3 of the 15 water boards (Botshelo in North West and Bushbuckridge and Ikangala in Mpumalanga) are not financially viable and are dependent on subsidies to cover their operating expenses.

Local government

Water and sanitation systems is a local government function

Section 4B of the Constitution lists water and sanitation services limited to potable water supply systems and domestic wastewater and sewage disposal systems as a local government function.

The two-tiered local government system requires that powers and functions be divided between category B and C municipalities to avoid duplication and co-ordination problems. An asymmetric approach has been followed in relation to water and sanitation, where all category A (metros) municipalities are authorised, category B (locals) municipalities are authorised in certain instances and category C (district) municipalities in others. There are currently 22 district municipalities and 123 local municipalities authorised for the water services function. An authorised municipality may, however, appoint another organisation (including another municipality) to provide the water services function on its behalf (referred to as the water services provider).

The sharing of the water services function between category B and C municipalities may have contributed to some of the difficulties currently being experienced in providing the service, including problems in the allocation of resources through the intergovernmental fiscal system. The current practice is that the only recipients of the national grant for water and sanitation are the authorised municipalities. This becomes a problem in cases where authorised district municipalities delegate the responsibility for service provision to local municipalities without the (adequate) necessary resources/funds.

The Department of Provincial and Local Government will as part of its review of the White Paper on Local Government (1998), among others, also deal with a number of issues related to the two-tier local government system.

Access to water and sanitation

Government's objective is to ensure that all South Africans have access to basic water supply and sanitation services

Government's objective is to ensure that all South Africans have access to basic water supply and sanitation services. Government has prioritised not only the rollout of infrastructure necessary for the rendering of services but also the provision of free basic services to the poor.

A basic water supply facility refers to the infrastructure necessary to supply 25 litres of potable water per person per day supplied within 200m of a household and with a minimum flow of 10 litres per minute (in the case of communal water points) or 6 000 litres of potable water supplied per formal connection per month (in the case of house connections).

A basic sanitation service refers to the provision of a basic sanitation facility which is easily accessible to a household and the sustainable operation of the facility. This includes the safe removal of human waste and wastewater from the premises where this is appropriate and necessary and the communication of good sanitation, hygiene and related practices.

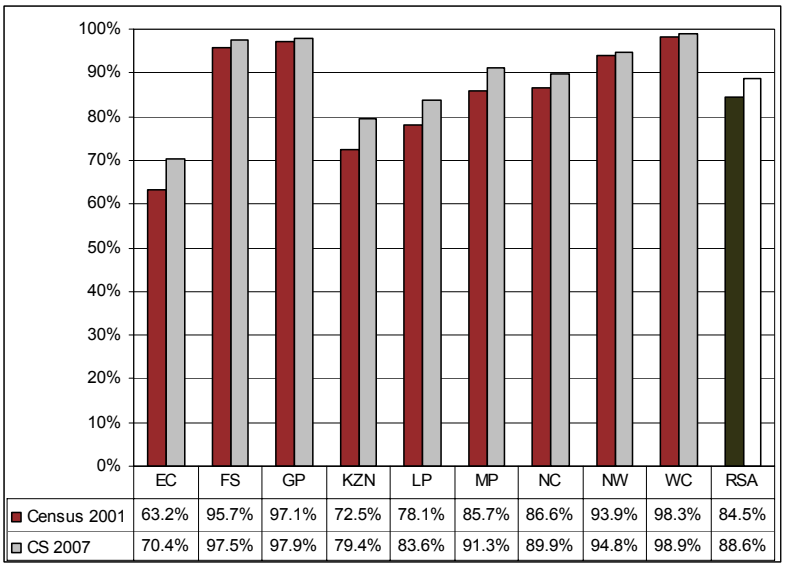
While there has been substantial improvements in the rollout of water services infrastructure and the rendering of free basic water and sanitation, the sector does face some challenges in the period ahead as implementation capacity remains a constraint. Furthermore, the sustainability of existing infrastructure cannot be neglected and is requiring more and more funding as infrastructure ages, making bigger demands on the available funds for the provision of new infrastructure to communities.

Progress with basic water infrastructure rollout

Between 2001 and 2007, access to piped water increased in all provinces

Figure 7.2 shows that the percentage of households with access to piped water has increased in all nine provinces when comparing the Census 2001 and the Community Survey 2007 results. The province with the lowest percentage of access is Eastern Cape (70.4 per cent), followed by KwaZulu-Natal (79.4 per cent) and Limpopo (83.6 per cent). However, these three provinces made the most progress in percentage terms from 2001 to 2007, where access percentage in the Eastern Cape increased by 7.2 per cent, KwaZulu-Natal by 6.9 per cent and Limpopo by 5.5 per cent, compared to Western Cape which increased by 0.6 per cent and Gauteng by 0.8 per cent.

Figure 7.2 Percentage of households with access to piped water by province, 2001 – 2007



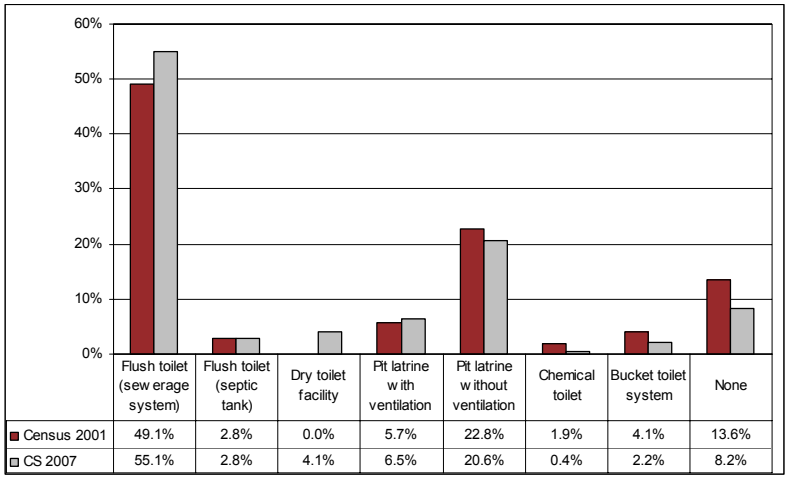
	EC	FS	GP	KZN	LP	MP	NC	NW	WC	RSA
Census 2001	63.2%	95.7%	97.1%	72.5%	78.1%	85.7%	86.6%	93.9%	98.3%	84.5%
CS 2007	70.4%	97.5%	97.9%	79.4%	83.6%	91.3%	89.9%	94.8%	98.9%	88.6%

Source: Stats SA, Census 2001 and Community Survey 2007

Progress with basic sanitation infrastructure rollout

Many different types of sanitation technology are currently used in South Africa, including buckets (priority has been given to eradicating this system), pit latrines (with or without ventilation), chemical toilets (also to be replaced with more appropriate technology types), flush toilets with on-site septic tanks and disposal and flush toilets with waterborne and central treatment works. Figure 7.3 shows the percentage of households by type of toilet facility in 2001 and 2007.

Figure 7.3 Percentage of households with access to flush toilets, 2001 – 2007



	Flush toilet (sewerage system)	Flush toilet (septic tank)	Dry toilet facility	Pit latrine with ventilation	Pit latrine without ventilation	Chemical toilet	Bucket toilet system	None
Census 2001	49.1%	2.8%	0.0%	5.7%	22.8%	1.9%	4.1%	13.6%
CS 2007	55.1%	2.8%	4.1%	6.5%	20.6%	0.4%	2.2%	8.2%

Source: Stats SA, Census 2001 and Community Survey 2007

Although progress had been made with the eradication of the bucket toilet system backlogs remain

The figure shows that the percentage of households in the country with access to flush toilets has increased from 49.1 per cent in 2001 to 55.1 per cent in 2007, while households with no toilet at all decreased from 13.6 per cent in 2001 to 8.2 per cent in 2007. Gauteng, Free State, Northern Cape and Western Cape were the only provinces that had more than 50 per cent of households using flush toilets. Although progress had been made with the eradication of the bucket toilet system (from 4.1 per cent in 2001 to 2.2 per cent in 2007), backlogs remain. Free State had the highest number of households still using the bucket system in 2007. But government has been committed to fast-tracking the completion of the bucket eradication programme.

Funding of basic water and sanitation infrastructure

As they can cross-subsidise more easily, metros are less reliant on transfers

Table 7.3 shows the per capita operating and capital expenditure on the water and sanitation service and the per capita operating and infrastructure grants allocated for the service. Capital expenditure is investment in new and existing infrastructure and operational expenditure is mainly bulk water purchases. The water and sanitation services are financed through the water and sanitation components in the local government equitable share (LGES) and capital spending on water and sanitation assets are financed through the basic services component of the municipal infrastructure grant (MIG). Metros contribute substantial own revenues towards supplying water and sanitation services to complement the LGES, while other categories of municipalities do not do so (this is indicated by the 'Difference' columns in table 7.3). This could be because metros serve a larger variety of customers, including businesses and industries, compared to smaller municipalities that largely serve a residential customer base. Metros are accordingly more able to cross-subsidise between and within different types of customers and services so that they are much less reliant on transfers to fund their basic operations than smaller municipalities. Infrastructure grant funding is supplemented by internal sources and external borrowing for all types of municipalities, with the exception of district municipalities where less is spent on

water and sanitation infrastructure than what is allocated through the water and sanitation component of the MIG, which could be indicative that infrastructure expenditure is being redirected to other municipal services or a lack of capacity to spend.

Table 7.3 Water and sanitation expenditure and grants per capita

R thousands	Bulk purchases per capita	LGES per capita	Difference	Capital expenditure per capita	Water and sanitation component of MIG per capita	Difference
Category A (Metros)	238	166	72	111	29	82
Category B (Locals)	54	216	-162	56	30	26
Category C (Districts)	5	57	-52	47	53	-6

Source: National Treasury local government database

Although contributions by metros and larger urban municipalities are larger, there is probably more scope for increased borrowing by larger municipalities. Funding from external sources will enable these municipalities to accelerate the rollout of both social and economic water infrastructure.

Free basic water and sanitation

Free basic water

Table 7.4 shows the number of households that benefited from free basic water services.

There has been an increase in the number of households receiving free basic water and sanitation

The total number of households that received basic water increased by 10.4 per cent between 2005 and 2006, while the number of households that received free basic water increased by 10.2 per cent over the same period. In 2005, Gauteng municipalities registered the best performance, providing free basic water to 99.2 per cent of all households with access to basic water. In contrast, Limpopo municipalities provided free basic water to only 43.6 per cent of households with access to basic water infrastructure.

Table 7.4 Number of households receiving free basic water, 2004 – 2006

Province	2004	2005	2006	2004	2005	2006
	Basic water services			Free basic water		
Eastern Cape	985 873	1 163 962	1 231 817	688 452	547 892	620 664
Free State	692 038	500 087	560 341	500 899	406 474	493 458
Gauteng	2 144 620	2 113 866	2 258 846	2 083 478	2 066 391	2 240 085
KwaZulu-Natal	1 540 245	1 705 659	1 999 834	938 634	1 120 091	1 248 565
Limpopo	917 324	1 151 289	1 310 883	539 640	565 811	571 470
Mpumalanga	510 455	587 492	684 837	367 984	429 132	512 385
Northern Cape	190 374	200 831	211 886	104 522	101 683	109 856
North West	585 654	670 697	742 743	391 391	393 541	460 885
Western Cape	1 066 982	845 012	869 066	977 455	764 273	788 336
Total	**8 633 565**	**8 938 895**	**9 870 253**	**6 592 455**	**6 395 288**	**7 045 704**

Source: Stats SA, Non-financial census of municipalities for the year ended 30 June 2006

Free basic sewerage and sanitation

Table 7.5 shows the number of households receiving free basic sewerage and sanitation. The total number of households receiving basic sewerage and sanitation increased by 6.8 per cent between 2005 and 2006, while the number of households receiving free basic sewerage and sanitation increased by 7.4 per cent of households over the same period. Of the 7.7 million households receiving basic sewerage and sanitation from municipalities, 3.8 million (49.7 per cent) had access to free basic sewerage and sanitation. Municipalities with a high percentage of rural population will not be in a position to provide free basic sanitation as they still lack the necessary equipment and other resources to empty ventilated pit latrines (the sanitation service provided to most rural communities).

Table 7.5 Households receiving free basic sewerage and sanitation, 2004 – 2006

Province	2004		2005		2006	
Consumer units	Basic sewerage and sanitation	Free basic sewerage and sanitation	Basic sewerage and sanitation	Free basic sewerage and sanitation	Basic sewerage and sanitation	Free basic sewerage and sanitation
Eastern Cape	871 702	363 961	905 339	396 294	918 496	411 691
Free State	611 652	272 923	534 817	192 891	608 725	402 069
Gauteng	2 122 600	1 282 276	2 101 101	1 846 790	2 171 581	1 427 019
KwaZulu-Natal	1 110 071	213 511	1 165 379	214 381	1 329 021	546 724
Limpopo	444 602	116 353	605 013	148 503	642 099	109 973
Mpumalanga	436 528	149 845	372 009	84 597	407 676	161 561
Northern Cape	176 372	63 293	186 916	66 571	202 376	77 848
North West	362 314	79 782	517 274	63 228	557 601	106 472
Western Cape	1 009 849	815 326	846 719	565 151	887 814	599 853
Total	**7 145 690**	**3 357 270**	**7 234 567**	**3 578 406**	**7 725 389**	**3 843 210**

Source: Stats SA, Non-financial census of municipalities for the year ended 30 June 2006

Municipal and municipal entity budgets

The water services function is an important municipal function, which comprised 11 per cent of total municipal budgets in 2007/08. Municipalities are intending to spend R16.6 billion on water and sanitation in the 2009/10 municipal financial year compared to the R8.5 billion spent in 2003/04. This represents a real annual growth in expenditure of 5.7 per cent between 2003/04 and 2009/10.

A progressive shift towards increasing expenditure in sanitation is evident

Although the majority of water services expenditure is directed towards water, a progressive shift towards increasing expenditure in sanitation is evident. In 2003/04, water expenditure amounted to 80 per cent (R6.9 billion) and sanitation to 20 per cent (R1.6 billion) while in 2006/07, water expenditure amounted to 75 per cent (R10.3 billion) and sanitation to 25 per cent (R3.4 billion).

Municipal water budgets

Table 7.6 indicates that most of the water expenditure (both operating and capital) occurs in metros and large urban municipalities. In 2006/07, over 69 per cent of water expenditure took place in the 27 municipalities with the largest budgets.

Table 7.6 Budgeted water expenditure by category of municipality, 2003/04 – 2009/10

R million	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
	Outcome			Estimate	Medium-term estimates		
Operating expenditure							
Category A (Metros)	3 034	3 459	3 683	4 032	4 255	4 436	4 724
Category B (Locals)	1 178	1 457	1 550	1 695	1 985	2 080	2 199
Secondary cities	*739*	*978*	*1 049*	*1 162*	*1 274*	*1 350*	*1 420*
Remainder	*439*	*478*	*501*	*533*	*711*	*730*	*778*
Category C (Districts)	112	265	190	152	242	251	280
Subtotal operating	**4 324**	**5 180**	**5 423**	**5 879**	**6 482**	**6 767**	**7 202**
Capital expenditure							
Category A (Metros)	820	1 146	1 350	1 307	2 185	2 023	1 851
Category B (Locals)	907	1 027	1 341	1 624	1 826	1 872	1 799
Secondary cities	*308*	*370*	*564*	*587*	*698*	*658*	*719*
Remainder	*598*	*657*	*777*	*1 037*	*1 128*	*1 214*	*1 080*
Category C (Districts)	801	542	1 159	1 446	2 529	2 230	2 265
Subtotal capital	**2 527**	**2 715**	**3 849**	**4 377**	**6 540**	**6 125**	**5 914**
Total							
Category A (Metros)	3 853	4 605	5 032	5 339	6 439	6 459	6 574
Category B (Locals)	2 085	2 483	2 891	3 319	3 812	3 951	3 997
Secondary cities	*1 048*	*1 348*	*1 612*	*1 749*	*1 973*	*2 007*	*2 139*
Remainder	*1 037*	*1 135*	*1 278*	*1 570*	*1 839*	*1 944*	*1 859*
Category C (Districts)	913	807	1 349	1 599	2 771	2 481	2 545
Total	**6 851**	**7 895**	**9 272**	**10 257**	**13 022**	**12 892**	**13 116**

Source: National Treasury local government database

Metros show a progressive shift towards increased spending on water infrastructure. The significant cost drivers for operating expenditure are bulk water purchases, employee costs and repairs and maintenance.

Local municipalities also show a progressive shift to increased spending on water infrastructure.

The district municipalities, authorised for water and sanitation, direct most of their water expenditure towards infrastructure. This could also be an indication that most of the districts authorised for the water services function do not provide the retail function (actual delivery of water to customers) at this stage. In a number of instances, this function is still performed by the non-authorised local municipality.

Municipal sanitation budgets

Municipalities are prioritising the rollout of sanitation infrastructure

Table 7.7 shows that municipal sanitation expenditure more than doubled between 2003/04 and 2006/07. Most of the sanitation budget is directed towards infrastructure expenditure: 72 per cent for metros (R996 million), 91 per cent for local municipalities (R1.6 billion) and 95 per cent for district municipalities (R322 million) for 2006/07. Municipalities are therefore prioritising the rollout of sanitation infrastructure. But good sanitation includes acceptable, affordable and sustainable sanitation services and appropriate health and hygiene awareness and behaviour. It is therefore important that municipalities complement any sanitation infrastructure investment with initiatives focused on behaviour change.

Table 7.7 Budgeted sanitation expenditure by category of municipality, 2003/04 – 2009/10

R million	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
	Outcome			Estimate	Medium-term estimates		
Operating expenditure							
Category A (Metros)	226	415	360	379	441	470	509
Category B (Locals)	116	173	174	145	131	141	151
Secondary cities	*61*	*126*	*131*	*57*	*65*	*68*	*71*
Remainder	*55*	*47*	*44*	*88*	*67*	*74*	*80*
Category C (Districts)	27	24	16	17	4	2	2
Subtotal operating	**369**	**613**	**551**	**540**	**576**	**614**	**662**
Capital expenditure							
Category A (Metros)	364	522	639	996	1 063	1 062	954
Category B (Locals)	668	688	1 333	1 551	2 165	1 457	1 211
Secondary cities	*215*	*308*	*585*	*647*	*849*	*571*	*536*
Remainder	*453*	*380*	*747*	*904*	*1 316*	*885*	*675*
Category C (Districts)	225	159	291	322	632	617	639
Subtotal capital	**1 257**	**1 370**	**2 262**	**2 869**	**3 859**	**3 135**	**2 803**
Total							
Category A (Metros)	590	937	999	1 375	1 503	1 532	1 462
Category B (Locals)	784	861	1 507	1 696	2 296	1 598	1 361
Secondary cities	*275*	*434*	*716*	*704*	*913*	*639*	*607*
Remainder	*508*	*427*	*791*	*992*	*1 383*	*959*	*754*
Category C (Districts)	252	184	307	339	636	619	641
Total	**1 626**	**1 982**	**2 813**	**3 410**	**4 436**	**3 749**	**3 465**

Source: National Treasury local government database

Progress in water and sanitation rollout by Joburg Water as at March 2008

Joburg Water introduced a number of large projects in 2006/07, which focused on extending water and sanitation services to the poor. Major projects include:

- Thonifho, a project to provide basic water to indigent communities. This project has extended basic water provision to an additional 17 332 households and extended basic sanitation provision to a further 12 427 households.
- Water provision to the Diepsloot area and supply of and the sewer system in Cosmo City have been improved.

Joburg Water will invest over R5 billion in the coming five years on eradicating the backlog and upgrading and rehabilitating water and sanitation infrastructure.

Source: Statement by Ms Ros Greeff, Member of the Johannesburg Mayoral Committee for Infrastructure and Services at a media briefing by Johannesburg Water

Water services budget of two municipal entities

Municipal entities are responsible for water provision in municipalities. A prominent feature of the two municipal entities, Joburg Water in Gauteng and Maluti-A-Phofung in Free State, is the difference in the size of their budgets. According to the Community Survey 2007, Joburg Water serves about 3.9 million people (compared to 3.2 million in 2001) while Maluti-A-Phofung serves about 385 000 people (compared to 361 000 in 2001). This highlights the difference in size between several municipal distributors. The variations between the two municipal entities are clearly linked to the size of the populations served by the municipalities, but could also be attributed to per capita expenditure, the extent to which a municipality purchases bulk services and the level of service offered in a municipality, among others.

Table 7.8 indicates that Joburg Water collected R3.3 billion in water services revenue in 2006/07 and Maluti-A-Phufong Water collected R76 million. This total is projected to increase to R3.5 billion and R92 million for the two entities respectively in 2009/10. This represents a real decline of 3 per cent between 2006/07 and 2009/10, which is more likely to be attributed to conservative multi-year budgeting rather than actual declines in the funding of the service.

Table 7.8 Budgets of two municipal entities focused on water and sanitation provision, 2006/07 – 2009/10

R million	2006/07	2007/08	2008/09	2009/10	2006/07	2007/08	2008/09	2009/10
	Joburg Water				Maluti-A-Phufong Water			
Income	3 302	3 254	3 304	3 512	76	83	93	92
Expenditure	3 177	3 225	3 215	3 398	71	82	92	99
Income:								
User charges for services	3 070	3 165	3 225	3 416	34	41	47	49
Other income	232	90	79	95	43	41	46	42
Total operating income	**3 302**	**3 254**	**3 304**	**3 512**	**76**	**83**	**93**	**92**
Expenditure:								
Employee costs: wages and salaries	444	528	559	584	33	37	39	41
Employee costs: social contributions	–	–	–	–	–	–	–	–
Bad debts	397	347	253	248	–	–	–	–
Depreciation	218	122	141	157	–	–	–	–
Repairs and maintenance	9	12	13	13	14	16	19	22
Interest expense: external borrowings	25	36	35	32	–	–	–	–
Bulk purchases	1 395	1 441	1 431	1 524	6	6	6	6
Contracted services	183	247	258	269	–	–	–	–
General expenses: other	234	270	282	295	18	23	28	29
Direct operating expenditure	**2 904**	**3 002**	**2 972**	**3 122**	**71**	**82**	**92**	**99**
Internal transfers	273	222	243	276	–	–	–	–
Contributions to municipality	–	–	–	–	–	–	–	–
Internal charges	–	–	–	–	–	–	–	–
Total operating expenditure	**3 177**	**3 225**	**3 215**	**3 398**	**71**	**82**	**92**	**99**
Surplus/(Deficit)	**125**	**30**	**89**	**114**	**5**	**0**	**0**	**-7**

Source: Municipal budgets documentation

The scale at which Maluti-A-Phufong Water invests in repairs and maintenance is substantially higher than that of Joburg Water. This could be because of a number of factors, including possible under-investment in repairs and maintenance by Joburg Water and older water services infrastructure in the Maluti-A-Phufong area, which requires more maintenance and refurbishment.

Only Joburg Water is running at a surplus over the four-year period, while Maluti-A-Phufong Water runs at a surplus only in the first year, breaks-even in 2007/08 and 2008/09 and runs at a loss in 2009/10. Although Joburg Water makes a surplus, these surpluses are much lower than in the electricity sector (see discussion on City Power in chapter 8 of this Review). The water services function provided by Maluti-A-Phufong Water is therefore not run as a profit-making entity but rather to break-even.

The trends reflected in these two water entities are also reflected in other municipalities, where some make marginal profits, others break-even and others are rendering water services at a loss. The more rural municipalities with high levels of poverty (where poor households are entitled to free basic services), struggle particularly to run this service profitably.

Factors influencing the efficient provision of the water services function

A range of external and internal factors impact on the ability of municipalities to provide the water services function. These issues are discussed below.

Total losses in municipal water reticulation systems

Total losses from municipal water reticulation systems for the whole of South Africa in 2005 were in the order of 1 150 million m^3 per annum, which is equivalent to 28.8 per cent of the approximately 4 000 million m^3 of total municipal system water input at that time.

The total municipal non-revenue water (NRW) for the whole country was estimated to be 1 430 million m^3 per annum, excluding the free basic water allocation, which is considered to be revenue water which is billed at a zero rate. This NRW figure was equal to 35.8 per cent of total municipal system input. Table 7.9 illustrates water losses per income area.

Table 7.9 Water losses per income area, 2005

Non-revenue water categories	Water losses due to	Medium-to-high income areas	Low income areas
Non-recoverable revenue	Billed consumption that is not paid	3%	10%
	Unbilled metered consumption	2%	55%
	Unbilled unmetered consumption	2%	–
Apparent losses	Unauthorised consumption	1%	11%
	Customer meter inaccuracies	5%	1%
Real losses	Leakage on service connections up to point of customer meter	70%	18%
	Leakage on transmission and distribution mains	16%	3%
	Leakage on overflows at storage	1%	2%
Total		**100%**	**100%**

Source: Department of Water Affairs and Forestry

Most difficulties with revenue collecting are experienced in low income areas

Most difficulties with revenue collection are experienced in low income areas, which is probably due to the lack of administrative capacity that is often evident in rural municipalities. Even poorer areas within richer urban municipalities are difficult to monitor in terms of illegal consumption.

The majority of water losses are real losses, occurring due to infrastructure and transmission leakages. Recorded water losses occur mainly in the medium income to richer areas. This could be due to the

complexities of networks and the cost of repairing and refurbishing current infrastructure. Losses in the smaller municipalities are often not measured and hence not reported.

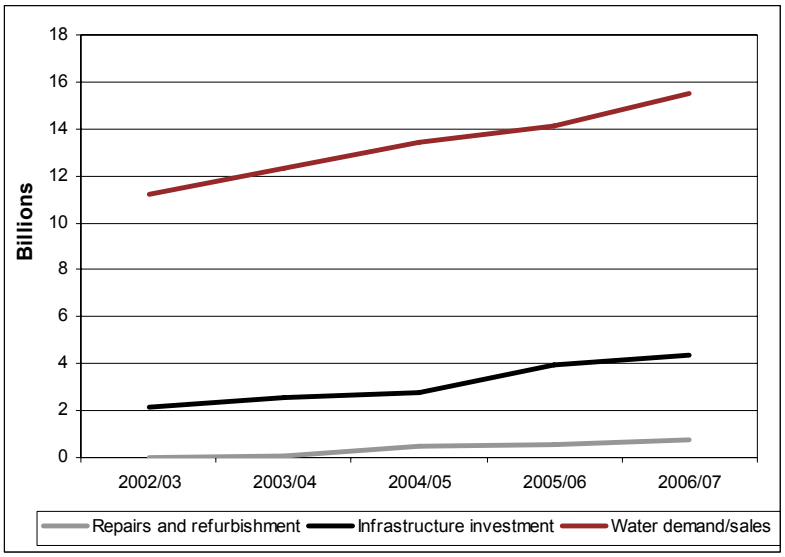
Maintenance of existing infrastructure

Water losses could also be due to insufficient investment in repairs and refurbishment. Municipalities spent 18 per cent of their annual operating budget on repairs and maintenance in 2006/07, with water maintenance making up 6.2 per cent (2 per cent for metros, 2.7 per cent for local municipalities and 1.5 per cent for district municipalities).

Increased service requirements are placing more strain on the existing infrastructure

Figure 7.4 shows the growth in water sales (a proxy for demand), infrastructure investment spending as well as spending on repairs and maintenance of existing infrastructure. Investment in new and existing water services infrastructure could be lagging behind as it does not correspond to the growth in water sales. This places strain on existing infrastructure assets to cope with these increased service requirements.

Figure 7.4 Water demand and investment, 2002/03 – 2006/07



Source: National Treasury local government database

Municipalities can exercise a number of measures to reduce water losses, wastage and inefficient use for both distribution system and consumer demand management. These include leak detection and repair, pressure management, effective zoning of the distribution system, repair of visible and reported leaks, pipe replacement/ management programme, cathodic protection of pipelines, meter management programme, unauthorised connection management programme, effective tariff setting and billing and awareness and education on the importance of water conservation.

Water pricing and tariffs

There are six stages of water tariffs and charges in the water cycle:

- raw water tariff (water resources development charge)

- bulk water tariff
- retail water tariff
- sanitation charge
- bulk waste-water tariff
- waste water discharge.

This charging system is complemented by nationally-funded subsidies for infrastructure and ongoing services to poor households. The municipal infrastructure grant and equitable share to local government are meant to complement municipal resources to enable municipalities to provide access to water and sanitation services.

Most major dams in South Africa are owned by the national government through the Department of Water Affairs and Forestry. The department sells raw water to either a water board or to the water service authority, i.e. the municipality. Certain municipalities, such as the City of Cape Town, operate their own dams. Municipalities that purchase raw water directly from the department need to carry out the purification process of the water internally. In most cases, water boards purchase raw water from the department, purify and refine it and sell the purified water to municipalities.

The Department of Water Affairs and Forestry regulates the tariff charged by water boards to municipalities

The tariff charged by water boards to municipalities is regulated by the department. Several factors influence the tariffs that each water board charges. These include the actual purchase price of the raw water, cost and methods used in the purification of water and financial viability and capital investment requirements to be addressed by the water board. The average bulk price charged by water boards was R4.06 per kℓ in 2006/07, with the highest bulk tariff charged by Mhlathuze Water Board in KwaZulu-Natal (R7.13 per kℓ) and the lowest bulk tariff charged by Magalies Water Board, which supplies potable water to parts of the Northwest, Gauteng, Limpopo and Mpumalanga (R2.09 per kℓ). This suggests that there is considerable variance in the price of treated bulk water from water boards, which has implications for municipalities' retail water price setting as bulk forms a large proportion of the overall retail tariff.

The Department of Water Affairs and Forestry prescribes norms and standards for water services tariffs as provided for under section 10 of the Water Services Act (1997). These are aimed at promoting socially equitable, financially viable and environmentally sustainable tariffs. Although the water services authority will either be setting tariffs or deciding the parameters within which tariffs are set, water services providers may in some circumstances also set tariffs within the prescribed parameters. The regulations, however, apply to all water services institutions and no water services institution may use a tariff which is substantially different from any prescribed norms and standards.

Municipalities need to take a number of issues into account when setting appropriate tariffs for sanitation. The servicing of on-site sanitation systems is not a monthly activity and is also highly dependent on the type of sanitation system installed, the role of the household maintaining the system and the accepted final disposal

method of the wastes. An investigation of the emptying of pit latrines, for example, has indicated that these should be scheduled for emptying once every 5 to 8 years and will cost between R600 and R1 200 to empty (2007 prices). The approach to collecting tariffs for providing such a service may either be built into the water bill, to charge a fee for emptying at the time of emptying, or a number of other alternatives.

Appropriate investments need to be made to ensure the sustainable delivery of water

It is important that appropriate investments be made to ensure the sustainable delivery of water (resources and services), otherwise there will be significant price increases in the future. These include appropriate investment in maintaining water quality and regular refurbishment and replacement of the water sector infrastructure.

Possible reforms to South Africa's water services sector

The problems that the water services sector face are similar in many ways to those currently being experienced in the electricity distribution sector. Many smaller municipalities do not have the necessary economies of scale, skills and specialisation to provide a water services function efficiently and effectively. The Department of Water Affairs and Forestry is currently supporting a number of institutional reform investigations that are aimed at advising water services authorities (municipalities) on the most appropriate institutional options applicable for that service provision area. Three areas in which reform investigations are currently taking place, are Central Eastern Cape, Western Highveld (Mpumalanga) and Southern Free State.

Conclusion

The quality and availability of the water and sanitation services are of extreme importance to the quality of human life and living standards. The Community Survey 2007 confirms that strides have been made in increasing access to this service to all members of the community. Several reforms and measures are being implemented to improve the quality and efficiency of the water sector as well as measures to improve sanitation and prevent outbreaks of related diseases. A concerted effort is required from all stakeholders in the water sector to address challenges, such as deterioration in the water services infrastructure, which impact on the quality and reliability of service and ultimately the quality of water itself.

8

Electricity

Introduction

Electricity plays a significant role in the betterment of human life. Apart from its social benefits, electricity is also a driving factor in the economy. Its usage ranges from communication and transportation to production.

Electricity plays a significant role in the betterment of human life

Local government plays an important role in the electricity industry in South Africa. Schedule 4B of the Constitution lists electricity and gas reticulation as a local government responsibility. Section 153 of the Constitution places the responsibility on municipalities to ensure the provision of services (which includes electricity reticulation) to communities in a sustainable manner as well as promote economic and social development. Electricity is an important funding source for local government, particularly for larger urban municipalities.

Municipalities are required to provide electricity reticulation services to their communities in a sustainable manner

Substantial investments are currently being made in the South African electricity industry, together with the restructuring programme which is addressing the current emergency in electricity supply.

This chapter gives an overview of:

- current and future developments in the electricity supply industry
- the current composition of the electricity distribution sector
- electrification and free basic electricity
- municipal and municipal entity electricity budgets
- factors influencing the efficient provision of the electricity distribution function.

Current and future developments in the electricity supply industry

Electricity provision consists of three phases namely, generation, transmission and distribution. Generation is the process by which electricity is produced; transmission is the transportation of electricity that has been generated in power stations to local networks for distribution via high voltage, long distance power lines to the load centres and distribution is the actual delivery of electricity to end consumers. Electricity generation and transmission together constitute electricity supply and in South Africa this is largely the function of Eskom (in some cases, municipalities have their own generation capacity, but this is on a limited scale). The distribution function is shared between municipalities and Eskom.

Current and future developments in generation

Coal remains the biggest source for electricity generation in South Africa

Africa only produces a small percentage (3 per cent) of total world electricity generated. South Africa generates around two-thirds of this amount, making it the largest supplier of electricity on the African continent. South Africa is particularly reliant on coal for electricity generation, where close to 90 per cent of all electricity in South Africa is generated using fossil energy/coal. This is because of South Africa's large deposits of coal, which provide a comparative advantage in coal production. And it is the main reason that the average selling price of electricity has been one of the lowest in the world. Nevertheless, Eskom is currently exploring alternatives to the heavy reliance on coal for generating electricity, including hydro power and nuclear energy.

Of all the energy sources available for electricity generation, burning coal is one of the most hazardous to the environment. It is estimated that coal-based electricity generation accounts for 40 per cent of carbon dioxide emissions into the atmosphere. In most countries, environmental taxes are usually applied directly on electricity generation and to a lesser extent electricity consumption and emissions. Several countries have implemented environmental taxes on electricity, including several EU countries, India and Zambia.

Government has proposed a 2 cent/kWh tax on the sale of electricity from non-renewable sources

An electricity levy to support energy efficiency was announced in the 2008 Budget Review. Government proposes to impose a 2 cent/kWh (kilowatt-hour) tax on the sale of electricity generated from non-renewable sources by the producers/generators of electricity, to be collected at source. This measure will serve the dual purpose of helping to manage the current supply shortages and protecting the environment. It is expected to raise about R4 billion annually. The introduction of this tax will be complemented by incentives that encourage firms to behave in a more environmentally responsible way. Tax incentives to encourage the uptake and development of renewable energy, such as accelerated depreciation allowances, are already in place and could be developed further.

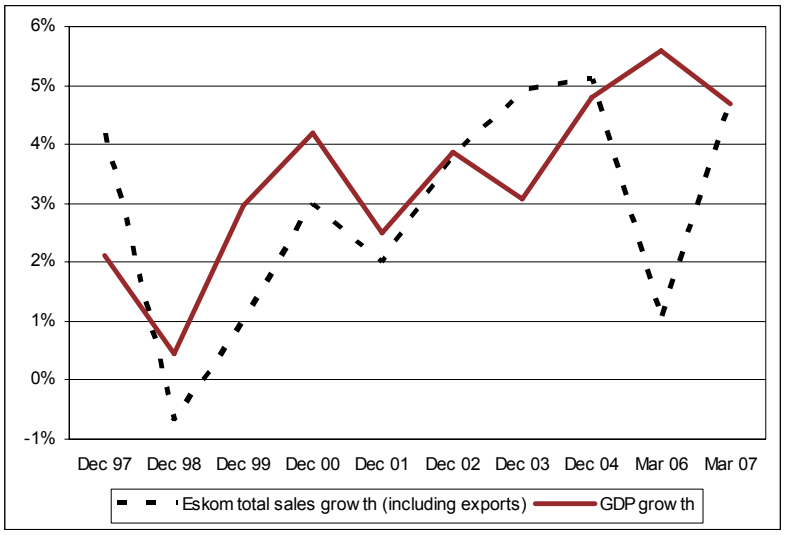
Trends in demand for electricity

Between 1970 and 2000, electricity supply in South Africa exceeded electricity demand, which led to the mothballing of several power stations in the late 1980s and early 1990s. These included three stations in Mpumalanga - Komati in Middelburg, Camden in Ermelo and Grootvlei in Balfour. They are currently being re-commissioned to meet the country's energy demands, which have been growing since 2000.

Electricity demand/usage increases with economic activity

In the last few years the demand for electricity has increased significantly. The positive economic growth that South Africa has experienced is undoubtedly one of the factors contributing to this increased demand. Figure 8.1 compares the growth rate of South Africa's gross domestic product (GDP) with the growth in Eskom's sales (which is a good proxy for electricity demand). There is a close correlation between overall growth in the economy and Eskom's total sales.

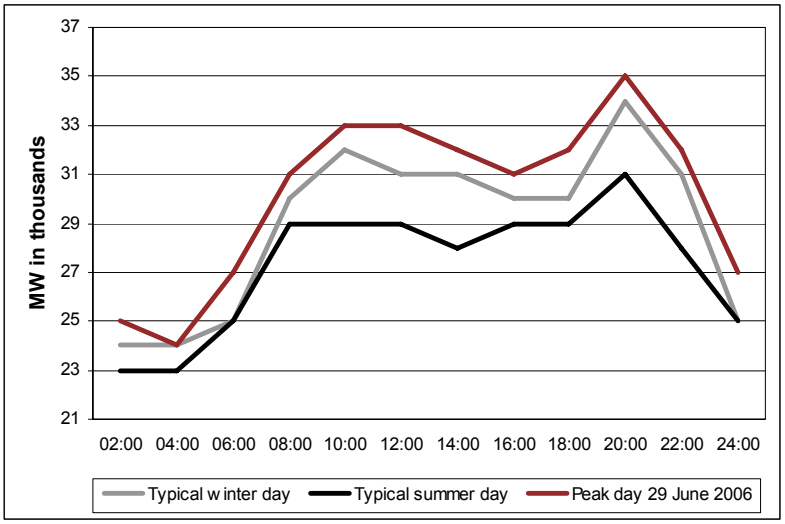
Figure 8.1 Real GDP growth versus Eskom sales (GWh) growth, December 1997 – March 2007



Source: Eskom, Annual Report, 2007

In determining energy demands/requirements, seasonal differences and daily peaks in electricity usage need to be taken into account. Figure 8.2 shows that electricity demand in South Africa varies over a 24-hour day, as well as in summer and winter. Between 7am and 5pm there is a constant demand for electricity. The small dip at around 12pm to 1pm is probably due to the decreased use of equipment during lunchtime. Demand peaks at the end of the working day, between 6pm and 9pm, when electricity consumption is at its maximum in the form of lighting, stoves and television. In terms of seasons, there is an approximate increase of 2000MW in usage in the winter months between June and August.

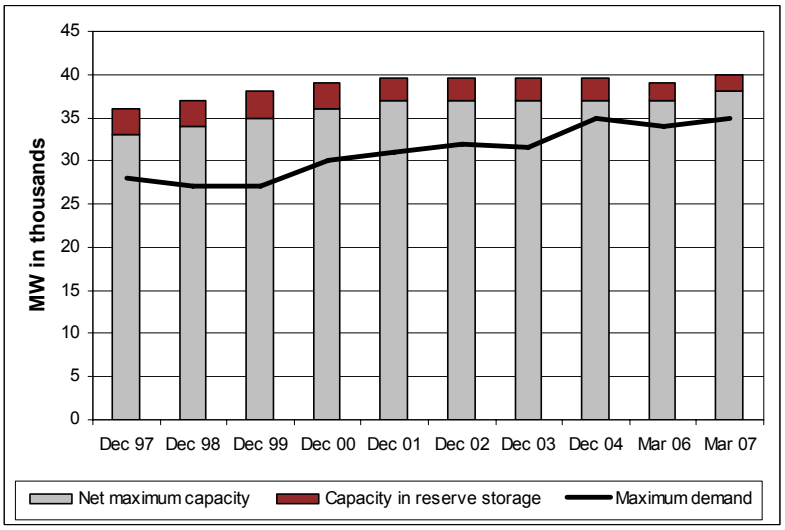
Figure 8.2 Electricity demand patterns



Source: Eskom, Annual Report, 2007

South Africa's estimated existing capacity is around 43 000MW, with maximum demand peaking at 38 000MW. In the last few years, maximum demand for electricity has tended to be just below maximum capacity, which led to the supply constraints experienced in 2007 and a critical shortage of supply in 2008. Figure 8.3 illustrates Eskom's generation plant capacity and maximum demand over the last decade.

Figure 8.3 Generation plant capacity and maximum demand, December 1997 – March 2007



Source: Eskom, Annual Report, 2007

When it comes to managing electricity capacity challenges, South Africa can learn from experiences elsewhere. For example, Brazil presents a major success story of controlling electricity demand. When the country suffered serious droughts in 2001, hydropower generation capacity fell. The Brazilian government initiated demand management strategies, which included a successful electricity rationing programme that was driven by incentives for electricity saving and

penalties for excessive use. This system, implemented in conjunction with a number of other structural and legal reforms, facilitated a positive response from consumers, resulting in a decrease in electricity demand. Since the proposed reforms, Brazilian electricity demand has remained constant at a lower level.

Government's response to the current situation

Government has recognised that a multi-pronged approach is required to address the current situation. Priority will be given not only to the building of new power generation capacity (through Eskom and independent power producers (IPPs)), but also to finding effective demand side management strategies.

Government has urged all South Africans to save more energy

At a joint sitting of Parliament in January 2008, the Minister of Minerals and Energy made a plea to all South Africans to support government in dealing with the problem. Government has since put together a national electricity emergency programme, which deals with the management of the situation on both the supply and demand side. Demand side strategies include the use of energy efficiency technologies (such as solar heating panels), voluntary reduction of electricity consumption (with government having set a target of a 10 per cent reduction in electricity usage for the residential sector) and load shedding. At times when use is dangerously high, Eskom transmits messages on evening television to warn users to cut down on their usage, to avoid load shedding. Load shedding is applied as a last resort to prevent a collapse of the national electricity supply system. Electricity efficiency regulations will be introduced by national government during 2008.

Implementing demand side management strategies in the local government sphere

The City of Johannesburg has plans to make some 745MW of electricity available to the national grid over the next 18 months through supply side and demand side interventions at a cost of around R617 million. The City of Johannesburg's rollout plan includes:

- Supplying 300 000 households with energy efficient light bulbs over a six-month period at a cost of R15 million. The light bulb initiative would offer up to 45MW in electricity savings.
- Installing remote geyser controls at a cost of R270 million, to be implemented at 200 000 households over 18 months, offering a power saving from 150MW to 300MW during peak times.
- Using solar power for traffic lights that will cost from R100 million to R280 million to install and which could take 100MW off the grid in a year.
- Installing some 10 000 solar water heating units. The metro is looking to partner with Eskom and the Development Bank of Southern Africa for this initiative, which would save about 30MW, at a cost of R12 million to the municipality.

In addition to initiatives centred around curbing demand, the metro has also been working to boost power supplies by recommissioning old gas turbines that have been lying idle at sites in Fordsburg, Kaserne and Cottesloe. This project will cost R40 million and would add up to 120MW to the national power grid. Either City Power or Eskom would also enter into a new power purchase agreement with the private owners of Kelvin power station, near Sebenza. The plan is to boost Kelvin's generation output to 500MW by 2013, which would be significantly greater than the current output of 120MW to 150MW.

Source: Extracts from an article by Matthew Hill that appeared in Engineering News – 28 February 2008

Municipalities are to play a crucial role in government's demand-side management initiative

Municipalities are required to participate in the electricity demand-side management initiative by ensuring that there is more efficient (reduced) electricity consumption within their jurisdictions. Meeting the nationally defined target of 10 per cent decrease in electricity usage would result in a fall in electricity sales and hence revenue for local government, as municipalities derive surcharges on electricity sales. Also, additional costs would be incurred in implementing energy saving initiatives, such as implementing the use of energy saving light bulbs (CFLs), solar geysers and smart meters with ripple control features. Municipalities will also be required to make various adjustments and improvements to existing electricity distribution systems to cope with switching-off systems (partially or fully) where scheduled load shedding is being carried out. In order to implement this initiative, municipalities could be required to make appropriate adjustments to their budgets to cater for these costs.

The 2008 Budget Review announced an electricity levy to support improved energy efficiency

R2 billion will be set aside through the fiscus over the next three years to support programmes aimed at encouraging the more efficient use of electricity, generation from renewable sources, installation of electricity-saving devices and co-generation projects. To give content to these proposals, allocations for this year will be included in the adjustments budget.

Funding the generation investment programme

Electricity users and not the fiscus, should fund the costs of electricity supply

Government policy has always been that electricity users should bear the costs of its supply, with capital financed through retained earnings and debt on market-related terms. Public expenditure on electrification has been explicitly targeted at subsidising the extension of supply to low-income consumers and not at providing finance for the utility itself. Eskom's tariffs are subject to an independent regulator, the National Energy Regulator of South Africa (NERSA).

Eskom will direct substantial investments towards the build programme over the next few years. In addition to the R17 billion that it invested in infrastructure in 2007, the utility will accelerate its investment plan to ease the current capacity constraints. This is set to run from 2009 until 2013 and will cost an estimated R343 billion.

Eskom will direct nearly three-quarters of the R343 billion investment programme towards building generation capacity. This will involve not only building new coal-fired power stations, but also exploring hydroelectric, gas and, in particular, nuclear options. It is estimated that close to 20 000MW will be generated by new nuclear plants. Eskom forecasts that by 2014, South Africa will have enough electricity generation capacity to meet its reserve capacity targets.

The 2008 Budget provides for R60 billion over the next three years to support the financing of Eskom's investment programme

Eskom's balance sheet is expected to come under some pressure due to the utility's build programme. The 2008 Budget provides for a R60 billion loan over the next three years to support the financing of Eskom's capital investment programme on terms structured to meet its cash flow requirements. Currently, the release of funds to Eskom is structured as follows: R10 billion in 2008/09, R20 billion in 2009/10 and the remaining R30 billion in 2010/11. These amounts could be supplemented either by guarantees or other assistance should the need arise.

In addition to the build programme, a number of factors will impact on electricity prices in future. These include increases in the price of materials used in the production process of electricity, necessary reforms for making the price of electricity to the consumer more cost-effective and factoring in environmental taxes intended to introduce more efficient electricity use.

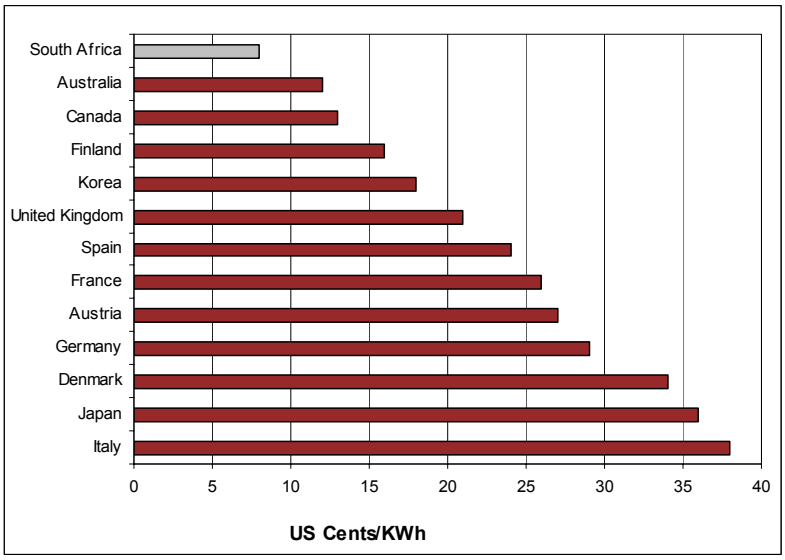
Current and future developments in tariffs/pricing of electricity generation

Reforms to the current generation tariff are therefore required which will facilitate the entry of new participants in the generation sector

During the 1980s and 1990s, Eskom's tariff was steadily reduced in real terms, which means that electricity prices in South Africa are now far lower than in any other comparable countries and well below full economic cost. Reforms to the current generation tariff are therefore required so that electricity prices are based on marginal costs rather than historical costs, which will facilitate the entry of new participants in the generation sector.

Figure 8.4 illustrates the difference in prices for electricity between South Africa and a sample of developed countries. For 1999, South Africa has the cheapest electricity, at around 8 cents (US) per kWH.

Figure 8.4 Comparison of prices from a sample of countries



Source: Energy Supply Association of Australia, 1999

To cater for the additional revenue requirement, NERSA approved a 14.2 per cent tariff increase for 2008/09

NERSA considered Eskom's application for a rule change to the multi-year price determination for 2008/09. In December 2007 the regulator agreed that, based on Eskom's capital financing needs, the utility be allowed to recover the following additional revenue during 2008/09. Based on tariff sales of 201 503GWh, the average tariff would be 22.61 cents per kWh, which is a 14.2 per cent increase on the expected average tariff per kWh for 2008/09.

Eskom has made a follow-up application to NERSA for a further electricity price increase in 2008/09, to take into account full primary energy pass through and recovery of demand-side management costs over the period. Given that the additional approved revenues will be

recovered in the period 1 July 2008 to 31 March 2009, the regulator made the following ruling on this matter on 18 June 2008:

- an average additional increase of 20 per cent for Eskom's non-municipal customers as the "original" 14.2 per cent increase had already been implemented (or a total increase of 34.2 per cent)
- an average increase of 35.9 per cent for licensed distributors at municipal level
- increases to poor residential customers be limited to 14.2 per cent.

Any amendment to Eskom's tariff will have implications for municipalities as their bulk price will need to be readjusted accordingly. Following the tabling of Eskom's additional price increase for 2008/09 in Parliament, the Minister of Finance, given the nature of the current crisis in electricity supply, exempted municipalities, municipal entities and Eskom from the provisions of the Municipal Finance Management Act (2003) (MFMA) that prohibit mid-year tariff adjustments by municipalities to enable them to factor this additional electricity bulk price increase into their 2008/09 budgets. To further facilitate the process, NERSA has allowed municipalities who have had tariff approval from the Regulator prior to end of June 2008 for the 2008/09 financial year and who have then applied the calculated municipal guideline of 20.6 per cent to these approved tariffs (i.e. treated this additional increase as a pass through), will not be required to re-apply to NERSA for a further approval of tariffs.

Developments in electricity transmission

Eskom owns the South African transmission network system

Electricity transmission is the transportation of electricity that has been generated in power stations to local networks for distribution via high voltage (above 132kV), long distance power lines. The South African transmission network/system is owned by Eskom and consists of transmission lines and wires that extend throughout the country as well as neighbouring countries in Southern Africa.

Although transmission networks usually sell electricity to distribution systems, certain customers that require large amounts of electricity are connected directly to transmission lines. Most of the power for transmission lines is generated in and around the Mpumalanga province. This is due to large deposits of coal in this area. Electricity therefore needs to travel long distances via transmission grids to reach customers in coastal regions such as KwaZulu-Natal, Western Cape and Eastern Cape. Municipalities that are further from the grid will be more exposed to electricity outages due to transmission failures. Upgrading transmission grids and networks is an urgent part of Eskom's investment initiatives.

Current composition of the electricity distribution sector

The current arrangements in the electricity distribution industry are the result of its historical development. Before 1994, municipalities

distributed electricity in historically white areas, while Eskom covered historically black townships and some of the former so-called homelands.

Electricity reticulation means the trading or distribution of electricity and services associated with it

The Electricity Regulation Amendment Act (2007), which was enacted in January 2008, has clarified the role of local government in relation to electricity reticulation. Electricity reticulation means the trading or distribution of electricity and includes all associated services. An electricity distribution system means a power system that operates at or below 132kV.

The constitutionally mandated responsibility in relation to electricity reticulation has therefore been clarified as "providing electricity to all electricity customers served on a power system of 132kV". A large range of customers are served on a 132kV power system, including poor households that receive free basic electricity as well as large industrial customers where electricity is used as part of their production processes.

Table 8.1 shows that the mining and manufacturing sectors have the fewest customers (less than 0.5 per cent) yet combined they use over half of the country's electricity. Although the domestic sector makes up the majority of electricity customers (just below 95 per cent), it uses only 16.8 per cent of electricity.

Table 8.1 Electricity sales by category for Eskom and municipalities, 2004

Category	Average sales price (c/kWh)	Number of customers	% of total	MWh sales	% of total
Domestic	28.82	7 196 667	94.3%	35 081 031	16.8%
Agriculture	31.13	102 811	1.3%	4 996 532	2.4%
Mining	15.37	1 944	0.0%	33 321 422	16.0%
Manufacturing	18.31	31 373	0.4%	79 299 454	38.0%
Commercial	28.45	256 111	3.4%	23 634 351	11.3%
Transport	22.13	1 059	0.0%	5 576 224	2.7%
General	23.45	42 101	0.6%	26 701 791	12.8%
Total	**21.82**	**7 632 066**	**100.0%**	**208 610 805**	**100.0%**

Source: National Electricity Regulator of South Africa, Electricity supply statistics for South Africa, 2004

Municipalities have more customers but more sales are attributed to Eskom

Table 8.2 shows the breakdown of total sales and total customers of Eskom and municipalities. Although municipalities have more customers, more sales are attributed to Eskom. This is indicative of the fact that they serve different electricity customers - Eskom sells approximately 35MWh per customer compared to municipalities, which sell an average of 21MWh per customer. Although municipalities have just below 90 per cent of industrial (manufacturing and mining) customers, Eskom derives more sales from this sector, i.e. 71 per cent. This suggests that Eskom's industrial customers are larger and use more electricity than the smaller businesses that get their electricity from municipalities. Conversely, although Eskom and municipalities have a similar number of residential customers, municipalities sell much more electricity to this sector, suggesting that municipalities provide electricity to both low use (generally poor) and high use (generally non-poor) residential customers, while Eskom has more customers in the low use category. This is partially explained by the fact that Eskom has had to undertake electrification of many of the more sparsely situated electrification

customers in rural areas, whereas most urban residential customers are situated in areas falling under municipal provision.

Table 8.2 Electricity customers and sales for Eskom and municipalities, 2004

Category	Estimated number of customers				Estimated sales per category (MWh)			
	Eskom	Municipalities and other	%	Total	Eskom	Municipalities and other	%	Total
Domestic	3 475 330	3 721 337	92.4%	**7 196 667**	8 099 000	26 982 031	32.6%	**35 081 031**
Agriculture	80 131	22 680	0.6%	**102 811**	4 426 000	570 532	0.7%	**4 996 532**
Mining	1 124	820	0.0%	**1 944**	33 042 000	279 422	0.3%	**33 321 422**
Manufacturing	3 019	28 354	0.7%	**31 373**	56 698 000	22 601 454	27.3%	**79 299 454**
Commercial	42 620	213 491	5.3%	**256 111**	7 162 000	16 472 351	19.9%	**23 634 351**
Transport	511	548	0.0%	**1 059**	3 188 000	2 388 224	2.9%	**5 576 224**
General	1 208	40 893	1.0%	**42 101**	13 211 200	13 490 591	16.3%	**26 701 791**
Total	**3 603 943**	**4 028 123**	**100.0%**	**7 632 066**	**125 826 200**	**82 784 605**	**100.0%**	**208 610 805**

Source: National Electricity Regulator of South Africa, Electricity supply statistics for South Africa, 2004

Electrification and free basic electricity

Progress with the rollout of electrification

Government has prioritised both the provision of infrastructure and free basic electricity to the poor

The electricity distribution sector is still faced with service delivery challenges despite the significant progress made in the rolling out of services since 1994. Government has prioritised not only the rollout of infrastructure necessary for providing services but also providing free basic services to the poor. Government is committed to eliminating electrification backlogs by 2012.

Government currently funds electrification through:

- grants to municipalities and Eskom, to help them tackle electrification backlogs of permanently occupied residential dwellings
- the installation of bulk infrastructure
- the rehabilitation and refurbishment of electricity infrastructure to improve the quality of supply.

Through the integrated national electrification programme (INEP), capital grants amounting to R595.6 million will be made available to municipalities in 2008/09 (compared to R467.8 million in 2007/08) and will increase to R897 million in 2009/10 and R950.8 million in 2010/11. Capital grants amounting to R1.1 billion will be made available to Eskom in 2008/09, which will increase to R1.4 billion in 2009/10 and R1.6 billion in 2010/11. The larger proportion of the grant is allocated to Eskom due to its focus in the more rural sparsely populated areas of the country, where the average cost per connection is higher. Therefore, a total amount of R1.7 billion will be allocated to municipalities and Eskom during 2008/09 which will increase to R2.3 billion in 2009/10. This amounts to a real growth rate of 26 per cent over the period.

Table 8.3 illustrates the per capita municipal electricity operating and capital expenditure and per capita operating and infrastructure grants received for electricity spending from the fiscus. Electricity

expenditure by municipalities includes the purchase of bulk electricity and investment in electricity assets while grants for electricity flow through the electricity component of the local government equitable share (LGES) as well as the integrated national electricity programme (INEP) infrastructure grant. Operating and capital expenditure per capita considerably exceeds the grants received for the service in metros and the 21 secondary cities. These municipalities have a greater potential to cross-subsidise households due to the larger income they receive from providing the electricity service and they have more borrowing capacity to fund infrastructure investments compared to the rest of municipalities. Smaller municipalities are more reliant on transfers for providing the electricity service as these municipalities have a smaller income base and thus less scope for cross-subsidising.

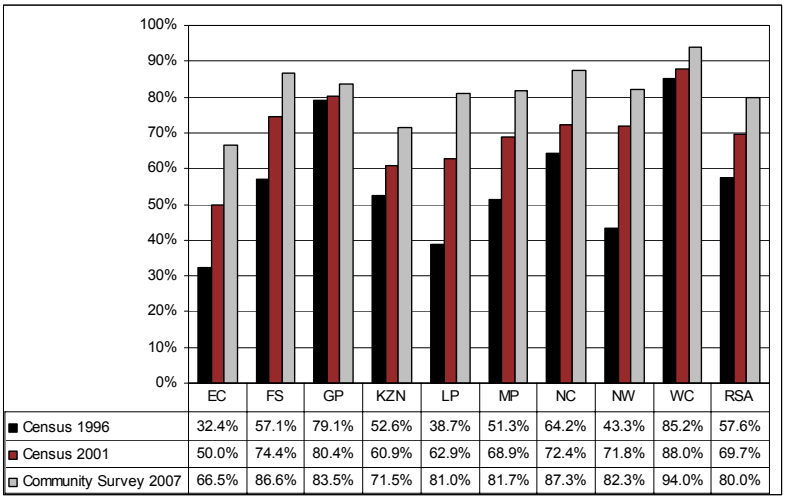
Table 8.3 Electricity expenditure and grants per capita

	Bulk purchases per capita	LGES per capita	Difference	Capital expenditure per capita	INEP per capita	Difference
Category A (Metros)	571	166	405	166	9	157
Category B (Locals)	172	216	-44	48	8	40
Category C (Districts)	1	–	1	1	–	1

Source: National Treasury local government database

Figure 8.5 illustrates the increased levels of access to electricity used for lighting per household between 1996 and 2007.

Figure 8.5 Percentage of households using electricity for lighting by province, 1996 – 2007



	EC	FS	GP	KZN	LP	MP	NC	NW	WC	RSA
Census 1996	32.4%	57.1%	79.1%	52.6%	38.7%	51.3%	64.2%	43.3%	85.2%	57.6%
Census 2001	50.0%	74.4%	80.4%	60.9%	62.9%	68.9%	72.4%	71.8%	88.0%	69.7%
Community Survey 2007	66.5%	86.6%	83.5%	71.5%	81.0%	81.7%	87.3%	82.3%	94.0%	80.0%

Source: Stats SA, Census 1996, Census 2001 and Community Survey 2007

Access to electricity has increased

It is evident that access to electricity has increased over the 11-year period. Although progress varies per province, it is evident that the country as a whole has been extremely successful in increasing and improving service delivery in relation to electricity. Factors impeding the rollout of the electrification programme include increased costs of raw materials, scarcity of engineering skills and the higher costs of rolling out infrastructure in rural areas due to longer distances.

Progress with the rollout of free basic electricity

50kWh per month per household is sufficient for basic domestic functions

The electrification programme is supported by government's programme to provide free basic electricity/energy to poor households. The free basic electricity allocation of 50kWh per month per household is sufficient for basic functions, such as basic cooking, lighting and ironing.

Municipalities have applied different free basic electricity/energy approaches. One is a blanket approach, which involves providing the stated amount of free basic electricity to all households having access to infrastructure, the other is a targeted approach, which involves distinguishing between different types of households and providing free basic electricity to the identified poor only (applied in the City of Cape Town and the City of Tshwane (from July 2007)). Municipalities develop indigent registers to assist them in applying the targeted approach.

Eskom is largely responsible for providing electricity in rural areas

Table 8.4 compares consumers receiving free basic electricity from municipalities per province for 2005 and 2006. Predominantly rural provinces, such as Eastern Cape, KwaZulu-Natal and Limpopo, may have underestimated figures as Eskom is largely responsible for providing electricity in rural areas. By 2006 Eskom had provided free basic electricity to 1 254 199 households. Eskom's ability to roll out free basic electricity is based on the funding it receives from municipalities to carry out this process on the municipalities' behalf.

Table 8.4 Consumer units receiving free basic electricity services from municipalities, 2005 and 2006

	2005			2006		
	Number of consumer units receiving basic electricity services	Free basic electricity services		Number of consumer units receiving basic electricity services	Free basic electricity services	
Province		Number of consumer units	%		Number of consumer units	%
Eastern Cape	682 105	251 946	36.9%	780 208	305 245	39.1%
Free State	528 110	361 306	68.4%	559 492	396 086	70.8%
Gauteng	1 403 713	1 239 487	88.3%	1 674 008	1 398 011	83.5%
KwaZulu-Natal	1 086 056	135 883	12.5%	1 155 798	137 371	11.9%
Limpopo	670 111	113 674	17.0%	706 359	155 853	22.1%
Mpumalanga	498 901	149 215	29.9%	545 829	215 123	39.4%
Northern Cape	155 140	58 936	38.0%	168 432	67 040	39.8%
North West	459 128	100 748	21.9%	516 002	112 733	21.8%
Western Cape	1 063 861	587 350	55.2%	1 112 570	569 973	51.2%
Total	**6 547 125**	**2 998 545**	**45.8%**	**7 218 698**	**3 357 435**	**46.5%**

Source: Stats SA, Non-financial census of municipalities for the year ended 30 June 2006

In 2006, about 360 000 more households had access to free basic electricity from municipalities than in 2005. However, in three provinces (Western Cape, Gauteng and North West) access to free basic electricity decreased in percentage terms. This is most likely due to municipalities changing their existing free basic electricity policies from the blanket approach to the targeted approach.

Funding for free basic electricity is supported by allocations from the local government equitable share. As the local government equitable share is an unconditional grant and intended to supplement own

resources of municipalities (i.e. property rates, user charges/tariffs and surpluses), there are no conditions placed on municipalities with regard to allocating specific portions of the allocation towards the funding of free basic services, including free basic electricity. Municipalities accordingly fund their free basic services/electricity programmes in terms of priorities (as stated in their integrated development plans) and available resources (own resources and equitable share).

Other approaches that municipalities apply for funding free basic electricity include cross-subsidies between customers (where some customer groups subsidise poorer households), most often through block tariffs (where a prescribed amount is provided for free and these costs are recouped in tariffs that are applicable when use exceeds this amount).

The free basic electricity programme caters for alternative sources of energy

The Department of Minerals and Energy has recently extended its free basic electricity programme to include alternative sources such as paraffin, coal, liquefied petroleum gas (LPG) and bio-ethanol gel. Free basic alternative energy is intended to provide indigent households with alternative energy where electricity is not available.

Municipal and municipal entity electricity budgets

Overall municipal electricity budgets

Table 8.5 Electricity expenditure by category of municipality, 2003/04 – 2009/10

R million	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
	Outcome			Outcome	Medium-term estimates		
Operating expenditure							
Category A (Metros)	7 970	8 608	9 425	9 695	10 884	11 614	12 485
Category B (Locals)	4 440	4 725	5 065	5 414	5 855	6 002	6 333
Secondary cities	*2 616*	*2 827*	*2 991*	*3 171*	*3 426*	*3 495*	*3 679*
Remainder	*1 824*	*1 899*	*2 075*	*2 244*	*2 430*	*2 507*	*2 653*
Category C (Districts)	4	5	10	20	29	31	33
Subtotal operating	**12 414**	**13 338**	**14 501**	**15 129**	**16 769**	**17 647**	**18 851**
Capital expenditure							
Category A (Metros)	1 179	1 167	1 680	1 914	2 385	2 391	2 303
Category B (Locals)	569	673	817	1 217	1 600	1 565	1 484
Secondary cities	*263*	*342*	*402*	*505*	*722*	*732*	*725*
Remainder	*307*	*331*	*415*	*712*	*878*	*832*	*759*
Category C (Districts)	54	12	28	22	113	19	14
Subtotal capital	**1 802**	**1 853**	**2 526**	**3 153**	**4 099**	**3 975**	**3 801**
Total							
Category A (Metros)	9 148	9 775	11 106	11 609	13 269	14 005	14 788
Category B (Locals)	5 009	5 399	5 882	6 632	7 455	7 567	7 817
Secondary cities	2 879	3 169	3 393	3 676	4 148	4 228	4 404
Remainder	2 131	2 230	2 490	2 956	3 308	3 339	3 412
Category C (Districts)	58	17	38	42	143	50	47
Total	**14 216**	**15 191**	**17 026**	**18 282**	**20 867**	**21 621**	**22 652**

Source: National Treasury local government database

Electricity is an important municipal function that makes up 20 per cent of total municipal revenue budgets in 2007/08. Table 8.5 shows that most electricity expenditure (both operating and capital) takes place in metros and large urban municipalities. In 2006/07, over four-fifths of electricity expenditure took place in the 27 municipalities with the largest budgets.

An appropriate balance be struck between investing in new versus old infrastructure

In 2006/07, electricity operating expenditure made up 83 per cent of total electricity budgets and electricity infrastructure expenditure, 17 per cent. Current trends in municipalities indicate that most municipalities primarily focus on investing in new electrification infrastructure to extend the provision of the service and make only limited contributions towards the repair, replacement and upgrading of existing infrastructure. As the lack of proper and timeous maintenance of infrastructure could impact on the reliability of supply, it is accordingly important that an appropriate balance be struck between investing in new versus old infrastructure.

The operating expenditure is primarily the cost of bulk electricity purchase and does not necessarily include staff and other costs associated with this service. It is therefore difficult to assess the extent to which municipalities profit from their electricity function.

Electricity budget of two municipal entities

Most municipalities are still to introduce ring-fenced electricity budgets

The recently enacted Electricity Regulation Amendment Act (2007) will require municipalities to prepare ring-fenced electricity budgets in future. Most municipalities have, however, not yet fully ring-fenced their electricity operations to generate separate budgets, this means they have not incorporated the electricity related departments into one entity/company with its own administration and functions (such as City Power and Centlec, which are discussed below). Nevertheless, municipalities are intending to spend R21.6 billion on electricity in 2008/09 compared to the R14.2 billion spent in 2003/04. Making electricity a ring-fenced service will bring about institutional efficiencies that will yield many benefits, including a more correctly costed service and tariff setting that is more appropriately aligned with the actual cost of providing the service.

Table 8.6 provides an analysis of current practices in City Power and Centlec, illustrating some of the current electricity tariff and surcharge practices in municipalities. The City of Johannesburg established the Johannesburg City Power municipal entity in 2001 and the Mangaung municipality established the Centlec municipal entity in 2002.

The table clearly shows the difference in size of the two entities. City Power's income and expenditure is almost nine times that of Centlec, which points to the range in different municipal distributors. The Community Survey 2007 results show that 3 888 180 people reside in the City of Johannesburg and 752 906 people in Mangaung municipality. City Power provides electricity to approximately 300 000 customers in its area of provision (which makes up only a proportion of overall electricity provided in Johannesburg as Eskom also provides electricity to large numbers of customers in certain areas of Johannesburg), while Centlec provides to 159 000 customers, of which 4 400 are business customers.

Table 8.6 Budgets of two municipal entities focused on electricity provision, 2006/07 – 2009/10

R million	2006/07	2007/08	2008/09	2009/10	2006/07	2007/08	2008/09	2009/10
	City Power (Johannesburg)				Centlec (Mangaung)			
Income	4 100	4 519	4 936	5 379	558	628	662	699
Expenditure	4 035	4 374	4 718	5 042	461	511	525	558
Income:								
User charges for services	3 898	4 312	4 706	5 126	514	552	580	606
Other income	202	207	230	253	44	76	82	93
Total operating income	**4 100**	**4 519**	**4 936**	**5 379**	**558**	**628**	**662**	**699**
Expenditure:								
Employee Costs - wages and salaries	328	355	379	396	67	64	67	70
Employee Costs - social contributions	76	88	94	98	11	12	12	13
Bad debts	152	152	166	181	1	1	1	1
Depreciation	225	212	249	179	28	44	45	48
Repairs and maintenance	122	129	136	145	9	17	18	18
Interest expense - external borrowings	–	–	–	–	–	–	–	–
Bulk purchases	2 418	2 678	2 891	3 207	306	331	346	362
Own generation	–	–	–	–	–	–	–	–
Contracted services	225	265	278	290	12	10	1	11
General expenses - other	110	151	158	165	27	33	35	36
Direct operating expenditure	**3 657**	**4 030**	**4 352**	**4 662**	**461**	**511**	**525**	**558**
Internal transfers	378	344	365	379	–	–	–	–
Contributions to municipality	–	–	–	–	–	–	–	–
Internal charges	–	–	–	–	–	–	–	–
Total operating expenditure	**4 035**	**4 374**	**4 718**	**5 042**	**461**	**511**	**525**	**558**
Surplus / deficit (-)	**65**	**145**	**218**	**337**	**96**	**116**	**137**	**140**

Source: Municipal budgets documentation

Between 2006/07 and 2009/10, total electricity expenditure for City Power is projected to increase from R4 billion to R5 billion for City Power and from R461 million to R558 million for Centlec. As bulk electricity purchases make up a large proportion of this expenditure (70 per cent), the price changes from Eskom would need to be factored into these entities' budget projections.

Both entities are expected to run at a surplus over the four year period, on average R191.1 million for City Power and R122.5 million for Centlec. The surplus suggests that these funds could be and probably are used to fund other municipal activities or functions. The future sustainability of these surplus levels could, however, be influenced by increased costs to purchase bulk electricity (making electricity tariffs affordable to customers could mean that municipalities have to absorb some of these increases). Another factor affecting future sustainability of surplus levels is the reforms to surcharges on municipal services, where certain municipalities will be required to reduce electricity surcharges to affordable levels when the norms and standards on surcharges on municipal services are introduced in terms of the Municipal Fiscal Powers and Functions Act (2007).

Centlec's achievements

Ever since its establishment as a corporate entity of Mangaung local municipality, Centlec has grown from power to power as an electricity distributing entity in Free State. Centlec is assisting smaller local municipalities in building capacity, including Naledi, Mohokare and Kopanong. Eskom employees are also offered training at Centlec.

In 2006, Business Initiative Development (BID), a world recognised company for the provision of quality services, awarded Centlec a golden award for their progress and quality of service delivery in electricity distribution. Centlec was rewarded again by BID when it received a platinum award for customer service in October 2007.

Source: Extracts from The Weekly (Free State newspaper): 31 October 2007 – 7 November 2007

Factors influencing the efficient provision of the electricity distribution function

Various factors impact on the ability of municipalities to render the electricity distribution function

A range of external and internal factors impact on the ability of municipalities to render the electricity distribution function. In relation to the internal factors, if municipalities are proactive there can be substantial spinoffs. These include investing appropriately in the maintenance of existing electricity infrastructure (in addition to rolling out new infrastructure) and setting electricity tariffs to appropriately cater for all related costs. These issues are discussed below.

Maintenance of existing infrastructure

In addition to appropriately investing in new electricity infrastructure, municipalities should also make appropriate funds available for the maintenance and refurbishment of existing assets in order to ensure reliable service provision.

Technical problems and power outages are mostly due to failures in existing distribution lines and networks

In recent years, some municipalities have experienced technical problems and power outages due to failures in existing distribution lines and networks, rather than a failure in Eskom supply. Older networks are being increasingly damaged by supply disruptions, leading to more frequent distribution failures.

Factors contributing to the current state of municipal infrastructure

EDI Holdings Company, which was established by the national Department of Minerals and Energy to facilitate the restructuring of the electricity distribution industry in South Africa, has indicated that, according to its research findings, a backlog of approximately R5 billion in infrastructure investment has developed over the last 10 years.

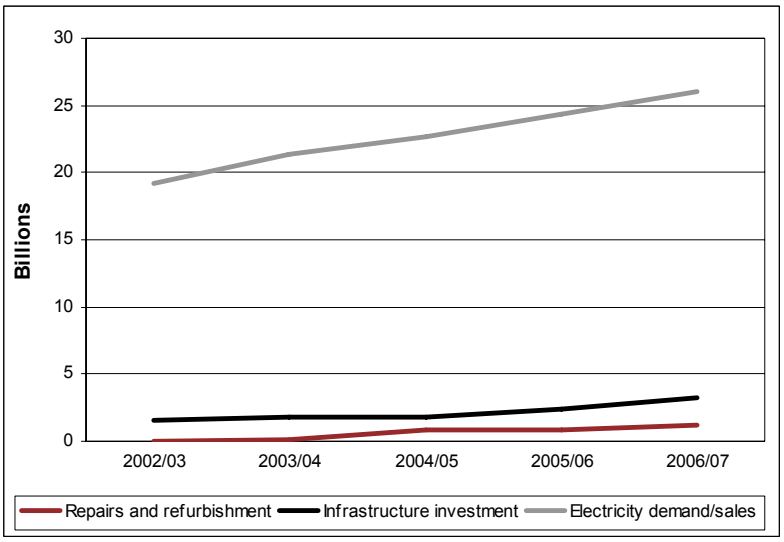
NERSA has indicated that some of the reasons for the current state of municipal distribution infrastructure are:

- Most equipment is ageing, its unreliability is increasing as is the cost of repair and it needs to be replaced.
- Most equipment is overloaded, due to unplanned-for development in its area.
- Few municipalities have adequate planned or preventative maintenance programmes.
- Few municipalities have infrastructure asset databases, many rely on their corporate memory for their maintenance strategy, few have contingency arrangements and many lack adequate stocks of suitable spare parts.
- Insufficient provision has been made for refurbishment of networks. Practice has in many cases been to rely on the overdesign of the past, but that capacity has now been eroded.

Growth in electrification does not correspond with the growth in electricity demand

Figure 8.6 shows the growth trends in municipal electricity sales (which is a good proxy for demand in electricity), total investment in electricity and spending on repairs and maintenance of existing electricity infrastructure. Investment in new and existing electricity infrastructure could be lagging behind as growth in electrification does not correspond with the growth in electricity demand. The trends in investment are becoming flatter, while demand is steadily increasing.

Figure 8.6 Electricity demand and investment, 2002/03 – 2006/07



Source: National Treasury local government database

NERSA has recommended that when municipalities determine their electricity tariffs for 2008/09, the revenue requirement should be inclusive of a 5 per cent provision for maintenance, refurbishment and recapitalisation and a 7 per cent provision towards capital charges. In 2006/07, metros spent close to 7 per cent of their total capital budget on repairs and refurbishments on existing electricity infrastructure. The City of Johannesburg and the City of Cape Town, combined, spent approximately R1.6 billion on repairs and refurbishment to existing electricity infrastructure between 2004/05 and 2006/07. This investment will have long-term benefits as well maintained systems will ensure more reliable electricity supply. Outages resulting from insufficient maintenance will be less frequent.

Addressing non-technical electricity losses

Another way for municipalities to ensure that electricity services are provided more efficiently is taking appropriate measures to counter electricity losses. The process of distribution from municipalities to customers results in several technical and non-technical losses. The national average of electricity losses is 15 per cent for municipal distributors. This amounts to roughly R4 billion in electricity losses from total municipal electricity sales in the country.

While technical losses are largely unavoidable, non-technical losses are more of a concern

Certain technical losses are inevitable during the transmission process. Technical losses should ideally not exceed an average 3.5 per cent for the transmission networks and 6.5 per cent for distribution networks. This figure varies, depending on the circumstances, such as the distance the electricity needs to be transported and the extent to which the electricity needs to be converted from higher to lower voltages and *vice versa*, in order to adapt to the specific lines. Electricity losses give an indication of the need to repair and refurbish existing lines in order to make them more efficient.

Non-technical losses are more of a concern - these losses can be attributed to illegal connections, tampering and incorrect billing. According to NERSAs pricing guidelines, electricity losses in excess of the 6.5 per cent allowed for technical reasons are excessive and need to be addressed as a matter of urgency by municipal distributors.

Improved regulation of the electricity reticulation function

The Electricity Regulation Amendment Act places certain responsibilities on municipalities in relation to electricity reticulation

The Electricity Regulation Act (2006) deals with the regulation of the whole electricity chain, excepting electricity reticulation. But the recently enacted Electricity Regulation Amendment Act (2007) fills this gap by addressing the regulation of electricity reticulation services. The act places certain responsibilities on municipalities in executing their executive authority in relation to the provision of the electricity reticulation service. In terms of the Act, a municipality must:

- comply with all technical and operational requirements for electricity networks determined by the regulator
- progressively ensure access to at least basic reticulation services through appropriate investments in its electricity infrastructure
- provide basic reticulation services free of charge or at a minimum cost to certain classes of end-users within its available resources
- ensure sustainable reticulation services through effective and efficient management and adherence to national norms and standards
- execute its reticulation function in accordance with national energy policies
- keep separate financial statements, including a balance sheet of the reticulation business.

Section 160(2)(c) of the Constitution stipulates that it is the responsibility of the municipal council to impose rates and tariffs (including electricity reticulation tariffs) and that this cannot be delegated to any other body or institution. Although the important role of the regulator (NERSA) is acknowledged, it is important that its activities do not infringe on the constitutional mandate of local government in relation to electricity reticulation services.

Further legislative reforms are under way to make electricity tariff and surcharge setting processes more efficient and transparent. The Municipal Fiscal Powers and Functions Act (2007) makes provision for the introduction of compulsory norms and standards on municipal surcharges, including electricity reticulation. The Act defines a base tariff as "the fees necessary to cover the actual cost associated with rendering a municipal service" and a surcharge as "a charge in excess of the municipal base tariff that a municipality may impose on fees for a municipal service provided by or on behalf of a municipality, in terms of section 229(1)(a) of the Constitution".

Further legislative reforms are under way to make electricity tariff and surcharge setting processes more efficient and transparent

National Treasury aims to introduce regulations on electricity surcharges from 2010/11. When these are in place, NERSA will be responsible for regulating the base tariff and National Treasury will regulate the electricity surcharge. In the interim, the regulator will still prescribe electricity tariffs inclusive of the surcharge.

In addition, the Department of Minerals and Energy has initiated a process for developing a pricing policy framework for the electricity industry. The policy is intended to:

- introduce transparency in pricing and tariffs (including making existing cross-subsidies more transparent)
- define accurately and distinctively the roles of the several stakeholders consequently introducing efficiency in the pricing procedures and to prevent duplication of tasks
- introduce norms and standards in pricing principles
- resolve any current or apparent conflicts.

Progress in the reform of South Africa's electricity distribution industry

As discussed earlier, the current electricity distribution industry is not uniform and is characterised by a small number of very large distributors (Eskom Distribution and the 12 largest municipalities) and a large number of very small distributors. This has led to various problems in the industry, including the inability of the smaller distributors to achieve economies of scale, skills and specialisation.

The restructuring of the electricity distribution industry has been the subject of considerable debate since at least 1988. More recently EDI Holdings Company has been established to facilitate the restructuring process. The challenge is to merge the distribution structures of Eskom and municipalities into the REDs without compromising the provision of electricity or adversely affecting municipal finances. The restructuring also needs to avoid introducing undue risks for Eskom, so that it is able to maintain its current credit profile, which is needed to facilitate the required capital investment in additional generation capacity.

The six RED boundaries were drawn to provide for a balance of customers in terms of the type (domestic/industrial) and location (rural/urban/metro). Each of the six REDs is to be anchored around one of the metros, which would then be required to subsidise

Each of the six REDs is to be anchored around one of the metros

electricity provision in the surrounding poorer municipalities. RED1 will be anchored in the City of Cape Town (although RED1 was established as a pilot in 1 July 2005, it has since been disbanded), RED2 in the Ekurhuleni municipality, RED3 in Nelson Mandela Bay municipality, RED4 in the City of Johannesburg, RED5 in eThekwini municipality and RED6 in the City of Tshwane.

Concerns have been raised that the pace of the EDI restructuring process is too slow and that it has resulted in some operational practices being applied by electricity distributors which have led to inefficiencies in the sector, as their future role in the electricity distribution function has not yet been clarified. This could be one of the reasons that municipalities have been reluctant to invest in the maintenance and refurbishment of electricity infrastructure.

National government has acknowledged this concern and is currently dealing with some of the outstanding EDI policy and legislative issues, including:

- an asset transfer framework for transferring Eskom's and municipal assets to the REDs
- a compensation framework (compensation does not refer to cash but the number of shares to be allocated to Eskom and each municipality in a RED)
- dealing with key industrial customers
- format of a service delivery agreement between municipalities and a RED
- addressing any possible financial and other risks for Eskom and municipalities.

Conclusion

The correlation between electricity and economic growth is apparent and electricity's importance in the growth process and its ability to better the lives of people cannot be denied.

The South African electricity industry is going through a very important phase in its development. Although South Africa is currently facing a number of challenges with regard to security of supply, government is committed towards making substantial investments over the next few years to enable the building of appropriate generation capacity for future years. This will be complemented by initiatives on the demand-side to bring down existing energy consumption levels (and maintaining long-term sustainable levels of consumption). Alternative sources of energy, such as solar panels, are also an important development.

Despite current problems facing the sector, the Community Survey 2007 does show that great strides have been made in providing basic electricity services to the majority of South Africans and making a better life for all.

9

Roads and public transportation

Introduction

Transport is at the centre of an efficient and equitable urban system

Political and economic developments in South Africa have created rapidly evolving markets for labour, capital, goods and services. As a result, spatial and industrial structures are changing and transport infrastructure needs to respond accordingly. Indeed, transport remains at the centre of an efficient and equitable urban system.

Municipalities need to enhance their capacity to effectively perform their role within the transport sector. Municipalities' integrated transport plans should provide a long term vision of local mobility, as a guide to the investment in and maintenance of road infrastructure as well as the regulation of public transport networks. Currently the supply of appropriate transport infrastructure, particularly in the big cities, is not keeping pace with the growth in demand. This has resulted in the emergence of serious urban transport bottlenecks and increasing congestion.

The 2010 FIFA World Cup provides a catalyst for developing transport infrastructure and systems

Recent changes, however, are beginning to address these problems. Funding for public transport is increasing. The 2010 FIFA World Cup also provides a catalyst for developing transport infrastructure and systems that promote public over private transport in host cities. The focus is also not just on transport within the host cities, but also on systems for travelling across the country.

This chapter gives an overview of:

- the institutional arrangements for transport
- municipal road infrastructure
- expenditure on roads infrastructure and maintenance
- developments in the public transport systems.

Institutional arrangements for transport

The national Department of Transport is responsible for the policy and legislation governing roads and public transport. This is implemented through provincial departments, local government and public entities.

In terms of Schedule 5 of the Constitution, provincial roads and traffic are an exclusive provincial function, while municipal roads, traffic and parking are exclusive Schedule 5B municipal functions. Public transport is a concurrent Schedule 4A function of both national and provincial government. While municipal public transport is a Schedule 4B concurrent municipal function.

The functional assignment of roads and public transport functions between spheres of government is confusing and fragmented

Partly because of these rather opaque constitutional assignments, the *de facto* functional assignment of roads and public transport functions between spheres of government is confusing and fragmented. For example, rail commuter services are a national government function and buses are the responsibility of provincial government, while taxis are regulated in part by local government and in part by provincial government. And yet the minibus taxi re-capitalisation process is being driven at national level.

Poor co-ordination between transport and other sectors undermines the efficiency and effectiveness of the roads and public transport functions

Poor co-ordination between transport and other sectors, such as housing, also undermines the efficiency and effectiveness of the roads and public transport functions. In some instances, there is no synergy in planning, budgeting and implementation of infrastructure services within the same jurisdiction. Municipalities are responsible for investments in local infrastructure, including roads, while provinces are responsible for low income housing development and bus subsidies. Yet, the location of new housing developments impacts on the road infrastructure and public transport needs of the community that is to live there. Low density housing developments located on the periphery of cities mean that the future residents will need to travel long distances to work and to access public services. Thus transport costs will be high and may require ongoing subsidies to keep public transport affordable. Developing synergy between line functions means understanding how they relate to each other, money saved on cheap land is lost to transport subsidies.

Municipal road infrastructure

As at 2007, the South African road network comprised some 741 100 km of proclaimed roads and streets. However, the national public road inventory is out of date according to the national Department of Transport, which is responsible for compiling it. The department attributes this to the fact that it is reliant on provinces and municipalities to supply information based on their monitoring of roads. According to the department, provincial road authorities and municipalities used to carry out annual "visual condition index" studies, but that in the 10 years before 2002 more than half of them stopped doing these surveys, primarily due to a lack of technical capacity and budgets. As a result, some municipalities have very little quality information on which to base their evaluation of roads within their jurisdiction. To remedy the situation, the national Department of

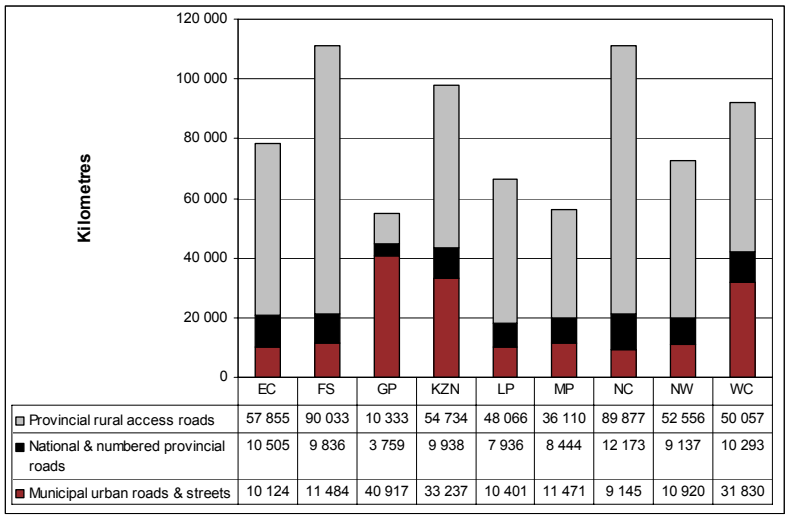
Transport is currently undertaking studies aimed at reclassifying the entire road network in South Africa and clarifying responsibilities for individual roads.

The absence of accurate data on roads hinders analysis of the state of the country's roads and the extent of refurbishment and maintenance backlogs. It also hinders local level budgeting for roads infrastructure and maintenance.

Gauteng reflects the smallest share of the total road network but is responsible for the greatest proportion of the roads

Figure 9.1 gives a breakdown of the road network according to type and the sphere of government responsible, based on the data that is available. While Gauteng reflects the smallest share of the total road network in South Africa, the municipalities in the province are responsible for the greatest proportion of the roads.

Figure 9.1 Estimated length of road network by category per province



	EC	FS	GP	KZN	LP	MP	NC	NW	WC
Provincial rural access roads	57 855	90 033	10 333	54 734	48 066	36 110	89 877	52 556	50 057
National & numbered provincial roads	10 505	9 836	3 759	9 938	7 936	8 444	12 173	9 137	10 293
Municipal urban roads & streets	10 124	11 484	40 917	33 237	10 401	11 471	9 145	10 920	31 830

Source: National Department of Transport, SANRAL, RTMC

Nearly, all municipalities that are designated roads authorities have transport departments as an integral part of their organisational structure. Generally, municipal roads departments have the capacity to do routine maintenance. Some municipalities have the capacity to also handle light construction activities. However, large rehabilitation and new infrastructure projects generally get outsourced.

A few municipalities have established municipal entities to deliver the public transport and roads functions. For example, the City of Johannesburg has established the Johannesburg Roads Agency. The relationship between the council and the agency is based on a performance contract which is governed by the city's contracting unit.

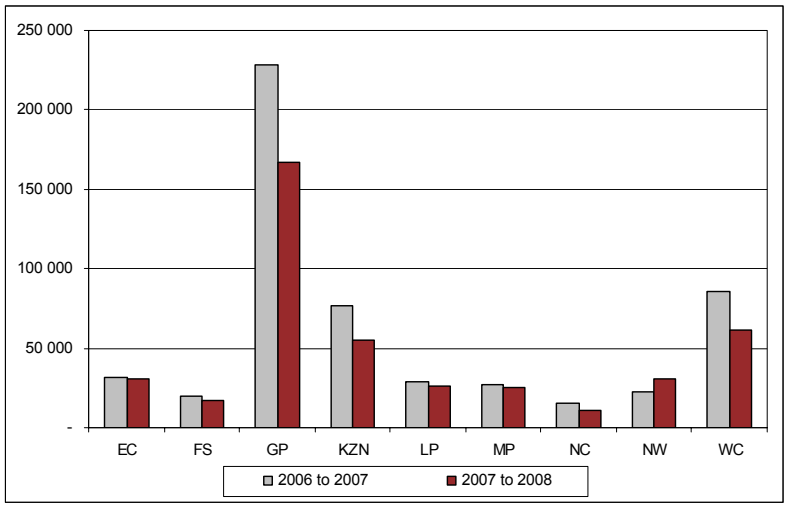
Motor vehicle registration and the impact on roads

One effect of economic growth has been an increasing number of vehicles on the roads

One effect of economic growth has been an increasing number of vehicles on the roads. Between 2004 and 2007, nearly 2.5 million new vehicles were sold in South Africa. This is on top of the 1.5 million vehicles sold between 2000 and 2003. Currently, South Africa's vehicle population is over 8.2 million.

Figure 9.2 shows the number of new vehicle registrations per province as at February for 2007 and 2008. At least 83 per cent of these new registrations are of light vehicles, which are generally privately owned. This rapid growth in the number of vehicles has resulted in increasing congestion problems.

Figure 9.2 Number of new vehicle registrations per province, February 2007 – February 2008



Source: Road Traffic Management Corporation

Traffic between Johannesburg and Pretoria is much heavier than the roads were originally designed for. It is reported that the N1 between Johannesburg and Pretoria now carries 220 000 vehicles a day. Traffic congestion is also a growing problem in Cape Town and eThekwini.

Another problem is the impact that these utilisation rates have on the need for maintenance. Important in this regard, is the rapid growth in road freight transport. Between February 2007 and February 2008 the number of registered heavy vehicles grew by nearly 22 per cent or some 62 780 units. Given that the heavy vehicles' wear and tear impact on roads is far greater than that of light vehicles, this very rapid growth has serious implications for future maintenance needs.

There are essentially three ways in which municipalities (and government) can begin to mitigate the costs associated with rising private vehicle usage. First, in the short term it can extend, enhance and maintain the existing road network. Second, it can encourage a shift away from private vehicle usage to public transport. Third, over the medium term it can encourage more integrated and sustainable human settlement patterns that encourage people to live closer to their places of employment and where land uses are mixed. Addressing these issues remains a significant challenge for municipalities.

Generally, the motor vehicle using public in South Africa is very unwilling to switch to public transport. This is primarily because existing public transport modes are inconvenient and have a poor safety record.

Vehicle overloading and breaches of road safety regulations continue to be major problems

The challenges of increasing congestion are compounded by problems associated with the behaviour of road users. Vehicle overloading and breaches of road safety regulations continue to be major problems despite enforcement efforts. Overloading causes premature road deterioration and, together with speeding, inadequate vehicle maintenance and driver fatigue, all contribute to South Africa's poor road safety record. The country has very high accident rates, with approximately 498 000 traffic accidents, 46 500 serious injuries and 13 000 traffic fatalities annually. About 5 300 of the fatalities are pedestrians. The need to improve road safety is recognised as a top priority, not least due to the economic costs it imposes on individuals and the economy.

Expenditure on roads infrastructure and maintenance

Maintaining the municipal roads infrastructure includes routine maintenance, upgrading and rehabilitation activities; all of which require planning and adequate budgets.

It is difficult to get a clear picture of consolidated municipal expenditure on roads infrastructure and maintenance

It is difficult to get a clear picture of consolidated municipal expenditure on roads infrastructure and maintenance. In 2005/06, total provincial and municipal roads infrastructure expenditure was R11.1 billion. Of this, municipalities spent R3.5 billion or 31.9 per cent and provinces spent R7.6 billion or 68.9 per cent. Metros account for 60 per cent of the aggregated municipal roads infrastructure budgets and the 21 secondary cities account for 30 per cent. Small municipalities account for 10 per cent of the total roads infrastructure budgets; some of them have roads infrastructure budgets as small as R200 000.

Metros' expenditure on roads infrastructure and maintenance

Table 9.1 shows that metros' roads infrastructure budgets increased from R1.4 billion in 2003/04 to R1.6 billion in 2006/07 and are set to increase to R2.3 billion by 2009/10. Adjusted for inflation, the metros' aggregated roads infrastructure budgets grew by 2.1 per cent in real terms between 2003/04 and 2006/07. This means budgets have not kept pace with the escalating costs in the construction industry and growth in vehicle registrations.

Over the medium-term, only the cities of Cape Town and Johannesburg are growing their budgets faster than 5 per cent per year. In the other metros, roads infrastructure budgets are projected to decrease. This shows that there is no alignment between budgeting and life-cycle costing for roads. Funding should include allocations for the provision of new roads and lanes to address traffic growth, refurbishment of roads that have reached the end of their useful life and routine maintenance. Decreasing budgets will inevitably result in greater backlogs in roads infrastructure.

Table 9.1 Metro roads infrastructure expenditure, 2003/04 – 2009/10

R thousands	2003/04	2004/05 Outcome	2005/06	2006/07 Estimate	2007/08	2008/09 Medium-term estimates	2009/10
City of Cape Town	154 178	109 439	213 589	193 251	550 039	608 872	658 644
City of Johannesburg	349 300	342 303	276 901	298 033	285 862	314 000	317 000
City of Tshwane	166 294	177 087	228 273	234 192	605 913	780 910	574 372
Ekurhuleni	178 273	303 884	319 010	397 391	323 016	346 350	266 430
eThekwini	367 774	466 655	254 859	154 580	211 712	240 403	203 300
Nelson Mandela Bay	156 223	226 801	148 023	294 301	526 025	599 921	326 110
Total	**1 372 042**	**1 626 169**	**1 440 655**	**1 571 748**	**2 502 567**	**2 890 456**	**2 345 856**
Percentage growth (average annual)		**2003/04 – 2006/07**				**2007/08 – 2009/10**	
City of Cape Town		7.8%				9.4%	
City of Johannesburg		-5.2%				5.3%	
City of Tshwane		12.1%				-2.6%	
Ekurhuleni		30.6%				-9.2%	
eThekwini		0.0%				-2.0%	
Nelson Mandela Bay		23.5%				-21.3%	
Total		**4.6%**				**-3.2%**	

Source: National Treasury local government database

Table 9.2 shows that metros' roads maintenance budgets increased by 6.2 per cent per year between 2003/04 and 2006/07 and are set to grow by 13.3 per cent per year to 2009/10. Maintenance budgets average 35 per cent of the total roads infrastructure budgets and remain at this level over the medium term.

Table 9.2 Metro roads maintenance expenditure, 2003/04 – 2009/10

R thousands	2003/04	2004/05 Outcome	2005/06	2006/07 Estimate	2007/08	2008/09 Medium-term estimates	2009/10
City of Cape Town	83 298	181 550	220 675	241 536	303 902	316 970	331 234
City of Johannesburg	–	5 104	7 310	6 812	6 407	6 727	7 064
City of Tshwane	166 585	187 215	273 531	283 680	220 614	243 030	263 468
Ekurhuleni	90 224	91 587	126 073	123 096	186 449	298 066	316 455
eThekwini	367 774	466 655	254 859	181 535	313 327	334 327	422 125
Nelson Mandela Bay	67 846	72 304	76 323	92 865	99 684	104 606	109 820
Total	**775 727**	**1 004 415**	**958 771**	**929 524**	**1 130 383**	**1 303 726**	**1 450 166**
Percentage growth (average annual)		**2003/04 – 2006/07**				**2007/08 – 2009/10**	
City of Cape Town		42.6%				4.4%	
City of Johannesburg		0.0%				5.0%	
City of Tshwane		19.4%				9.3%	
Ekurhuleni		10.9%				30.3%	
eThekwini		-21.0%				16.1%	
Nelson Mandela Bay		11.0%				5.0%	
Total		**6.2%**				**13.3%**	

Source: National Treasury local government database

Secondary cities' expenditure on roads infrastructure and maintenance

Secondary cities' roads infrastructure budgets are set to decrease

Table 9.3 shows that the roads infrastructure budgets for the 21 secondary cities increased by 32.4 per cent annually between 2003/04 and 2006/07, but set to decrease by 4.6 per cent per year to 2009/10. While most of the secondary cities' integrated development

plans (IDPs) list roads and stormwater upgrading as an important priority, roads infrastructure budgets over the MTEF period are actually decreasing. This reflects a serious misalignment between planning and budgeting.

Table 9.3 Secondary cities roads infrastructure expenditure, 2003/04 – 2009/10

	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
R thousands		Outcome		Estimate	Medium-term estimates		
Buffalo City	34 278	27 297	33 016	42 405	55 773	54 166	39 300
City of Matlosana	6 282	13 967	22 170	18 055	52 120	49 180	49 180
Drakenstein	4 005	6 674	16 319	7 010	12 985	11 455	10 821
Emalahleni	5 061	20 921	12 513	12 059	46 116	33 332	36 665
Emfuleni	3 012	27 960	13 130	55 542	17 817	55 800	63 000
George	7 812	37 158	40 098	79 042	93 032	88 668	62 950
Govan Mbeki	–	7 647	17 126	7 782	4 500	1 565	1 635
Madibeng	876	9 030	18 943	24 410	29 400	29 500	27 656
Mangaung	57 388	69 937	96 089	77 271	140 149	165 929	133 758
Matjhabeng	–	–	–	3 892	29 099	33 044	40 000
Mbombela	27 359	32 178	19 121	25 994	31 000	31 000	31 000
Mogale City	579	4 740	4 208	479	6 652	8 334	6 888
Msunduzi	26 958	22 898	19 150	25 327	52 124	37 965	30 021
Newcastle	3 453	19 042	11 352	25 486	10 780	34 230	–
Polokwane	29 676	17 680	40 323	66 615	102 303	204 100	87 600
Rustenburg	12 840	14 420	34 965	49 676	68 888	60 619	58 142
Sol Plaatje	11 553	29 158	48 521	17 331	40 172	13 000	15 592
Stellenbosch	2 198	6 776	2 353	12 687	26 183	32 400	31 950
Steve Tshwete	14 295	53 884	31 186	21 703	45 262	33 911	34 676
Tlokwe	10 191	21 410	6 030	19 210	11 027	39 498	19 487
uMhlathuze	23 015	26 295	47 773	59 432	86 922	103 697	96 024
Total	**280 831**	**469 072**	**534 386**	**651 408**	**962 303**	**1 121 392**	**876 346**
Percentage growth (average annual)		**2003/04 – 2006/07**				**2007/08 – 2009/10**	
		32.4%				*-4.6%*	

Source: National Treasury local government database

Table 9.4 shows that the secondary cities' roads maintenance budgets increased by 16.8 per cent per year between 2003/04 and 2006/07 and grow by 3.1 per cent annually to 2009/10. A concerted effort is clearly needed to reverse the trend. Roads infrastructure budgets should be earmarked to both deliver new infrastructure and properly maintain existing infrastructure.

Developments in the public transport system

The rail and bus services are subsidised but the mini-bus taxi service is not

The South African public transport system consists predominantly of rail and bus services that are subsidised by government and the mini-bus taxi service, which is not subsidised. These three modes do not work in an integrated way and usually compete with one another for commuters.

The public transport system needs to be more convenient and affordable than private vehicle use in order to attract commuters away from their own motor vehicles. However, the majority of users of public transport in South Africa have no choice but to use it despite its shortcomings. This places a greater responsibility on national,

provincial and local government to ensure that public transport systems meet the needs of the communities they serve.

Table 9.4 Secondary cities maintenance expenditure, 2003/04 – 2009/10

R thousands	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
		Outcome		Estimate		Medium-term estimates	
Buffalo City	12 742	18 363	13 012	13 556	13 962	14 800	15 688
City of Matlosana	3 846	2 030	1 989	2 832	3 215	3 375	3 595
Drakenstein	7 982	10 796	8 716	12 900	13 369	14 372	15 450
Emalahleni	7 282	11 489	9 520	10 489	14 564	12 961	14 257
Emfuleni	8 810	9 006	14 870	34 659	43 080	49 959	54 397
George	26 251	32 536	36 180	55 764	56	41	47
Govan Mbeki	2 221	12 174	11 305	8 653	9 851	10 275	10 737
Madibeng	3 420	2 914	3 128	5 125	5 924	6 095	4 974
Mangaung	10 597	17 106	13 645	32 444	41 688	42 181	45 546
Matjhabeng	–	2 246	636	636	8 531	9 213	9 951
Mbombela	8 358	13 524	24 757	19 206	23 167	–	–
Mogale City	–	3 680	1 385	–	–	–	–
Msunduzi	70 479	51 896	69 304	83 466	83 942	88 979	94 317
Newcastle	7 139	9 150	8 983	9 049	8 849	9 482	18 316
Polokwane	4 866	7 216	5 344	6 300	6 500	6 955	7 442
Rustenburg	5 195	6 671	6 344	5 563	6 630	7 465	7 764
Sol Plaatje	13 013	5 784	6 744	6 841	9 099	13 522	13 954
Stellenbosch	2 208	2 628	2 103	2 067	4 408	5 316	2 750
Steve Tshwete	2 542	1 879	2 208	2 198	2 404	2 581	2 759
Tlokwe	1 399	2 178	1 614	2 204	1 899	1 981	2 070
uMhlathuze	14 303	17 011	18 767	24 704	62 565	59 906	62 376
Total	**212 653**	**240 277**	**260 554**	**338 656**	**363 703**	**359 459**	**386 390**
Percentage growth (average annual)		**2003/04 – 2006/07**				**2007/08 – 2009/10**	
		16.8%				*3.1%*	

Source: National Treasury local government database

Taxi recapitalisation

Minibus taxi commuters account for over 63 per cent of public transport users for work, school and other purposes. Bus services account for another 22 per cent of public transport commuters. The remainder of commuters use trains.

Many taxis are old, un-roadworthy and in bad condition, resulting in frequent accidents

The pressing challenge in the taxi industry is that many taxis are old, un-roadworthy and in bad condition, resulting in frequent accidents. Since 2001, there has been an ongoing initiative driven by the national Department of Transport to formalise and regulate the industry. In rolling out the taxi recapitalisation plan (TRP), government recognises that the plan's sustainability does not only lie in the scrapping of old taxi vehicles, which remains the primary and immediate goal. Also key to the success of the plan is effective regulation, its integration into the public transport system, effective law enforcement and putting the safety of commuters first. The TRP has progressed significantly since its implementation in October 2006. To date, a total of 13 415 old and un-roadworthy minibus taxis have been scrapped. Of the R1 billion requested by the department from National Treasury for scrapping, only R470 million was made available during 2007/08. Subsequently, a total of R668 million was paid out to individual operators as a scrapping allowance.

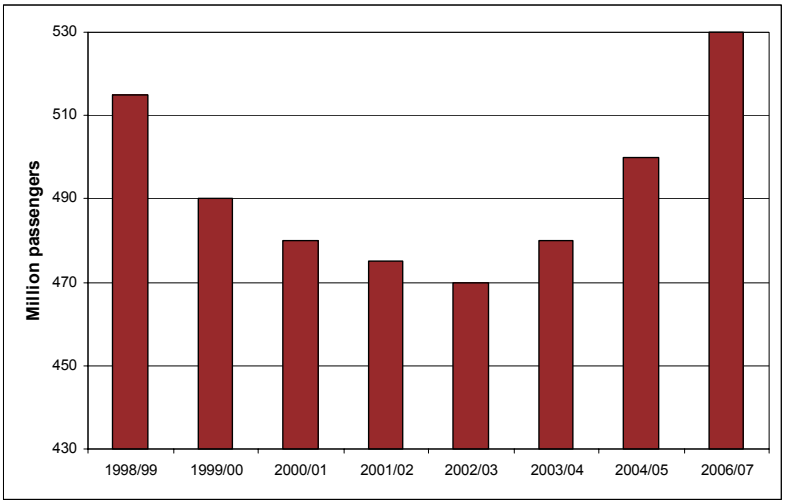
The taxi recapitalisation plan has not been universally welcomed. Some taxi operators are resistant to it because they believe the scrapping allowance is too low, they are unable to afford the recommended replacement vehicles, they have difficulty accessing credit because of the stringent criteria imposed by the National Credit Act (2007) and access to new operating licences is difficult.

Metrorail

About 1.3 million South Africans use trains daily

About 1.3 million South Africans use trains daily. Figure 9.3 shows that since about 2002/03 there has been a turnaround in the number of commuters travelling by train. This is encouraging as it indicates that Metrorail's initiatives to improve services are bearing fruit.

Figure 9.3 Metrorail's passenger trips per year, 1998/99 – 2006/07



Source: Metrorail

However, there is still a lot of work. Metrorail has 4 600 coaches, of which only about 3 000 are operational. In order to further improve services, Metrorail has approved a capital plan of R23 billion for the current MTEF, including meeting the requirements of the 2010 FIFA World Cup. The first phase in the current MTEF is a recapitalisation plan of R18 billion. The emphasis in the second phase, between 2011 and 2014, will be on recovering customers. The third, from 2015 to 2030, is aimed at business growth. This phase will include the acquisition of new rolling stock as the existing equipment will have reached the end of its useful life.

Metrorail's strategy includes upgrading the rail infrastructure; ensuring train frequencies of between 5 and 10 minutes during peak hours, extending daily operating hours to 18 from the current 10 and addressing commuter confidence.

Metrorail intends opening new lines in the next two years while improving the service of existing ones

Metrorail intends opening new lines in the next two years, while improving the service of existing ones, especially those dealing with high passenger volumes. These include the Soweto-Johannesburg, Mabopane-Tshwane and Khayelitsha-Cape Town lines. New lines are also being built in order to service the various soccer stadiums which will host the 2010 FIFA World Cup.

Joburg's rapid bus transport system

The City of Johannesburg has unveiled a bus rapid transport (BRT) system. The plan is to have hundreds of new 160-seater buses transporting commuters on dedicated lanes on routes linking townships in the south to northern suburbs and the city centre. The buses will run from 5am to midnight. During peak times there will be buses every 1 to 3 minutes. In off-peak times there will be buses every 10 minutes. A pre-boarding ticketing system will save time. The aim is to complete construction of the R2 billion project before April 2009, so that it will have been operating for a year before the 2010 FIFA World Cup. It will be operated by Metrobus and other contracted operators.

Public transport developments in Cape Town

Priority is being given to public transport on Symphony Way (linking Philippi and the south east part of Cape Town with Bellville), the N1 and the R27/Koeberg Road. These schemes provide for dedicated public transport lanes, that the City of Cape Town intends will form part of an integrated rapid public transport network (IRPTN) covering rail, BRT and taxi feeder systems. It is likely that Cape Town will upgrade the current bus lanes into a full BRT system – similar to the Rea Vaya plan in Johannesburg. There will also be significant improvements for pedestrians in the city centre and around the Greenpoint stadium precinct.

Durban's People Mover

In 2007 Durban's People Mover began transporting passengers in the inner city and to the city's beaches. The service comprises 10 hi-tech buses and forms part of a redesign process that the city is undergoing ahead of the 2010 FIFA World Cup. The buses, each costing R1.3 million, can accommodate wheelchairs and prams. Security is also part of the system with closed circuit surveillance cameras in each bus and wardens at each of the service's 16 bus stops to help tourists and passengers. The buses cover the beachfront and inner city routes from 6am to 11:30pm daily.

Developing more integrated human settlements

Planning for land use and transport should be integrated processes

For municipalities committed to the creation of integrated human settlements, tackling the transport problems becomes a key policy objective. Planning for land use and transport should be integrated processes, with the overall goal being to create the necessary transport and socio-economic infrastructural conditions that allow people to actively participate in the economy. The provision of an affordable and efficient transport system that reduces overall household expenditure on travel costs and decreases actual time spent on travelling is critical to achieving this goal. Communities should be integrated with mixed-use land development taking place around transport interchanges. This will minimise transport infrastructure having to respond to the effects of the social engineering of the past, which located poor people far from social and economic infrastructure.

Two initiatives that will contribute to this goal are under way within the transport sector. First, the establishment of transport authorities will encourage greater co-ordination within the transport sector and with other sectors and second, the public transport initiatives associated with the 2010 FIFA World Cup will fast-track the introduction of new approaches and systems.

The establishment of transport authorities

Provincial and local governments are required to establish a public transport authority in terms of the National Land Transportation Transitional Act (2000). Transport authorities will help to overcome the problems inherent in the currently fragmented transport system, with the three levels of government and with a range of public entities

and private organisations responsible for different sections of transport.

This marks a paradigm shift in the provision of transport services. Concrete developments include the City of Tshwane, where the Tshwane Transport Authority is in place. The business plan has been drawn up and the Gauteng MEC for transport has approved the establishment of the authority and the plan. In Ekurhuleni, the feasibility study has been completed and the council has approved the study. Ekurhuleni is ready to establish a transport authority.

For the City of Johannesburg, an agreement with the Gauteng provincial transport department is in place to set up the transport authority as well. Progress is also being made by Nelson Mandela Bay, Mangaung and Welkom municipalities.

Preparations for the 2010 FIFA World Cup

One of the developmental aims of the 2010 FIFA World Cup is that it should leave a legacy of more efficient and integrated public transport system. Table 9.5 shows that since 2005/06 the department has transferred more than R2 billion to host cities, feeder municipalities, the South African Rail Commuter Corporation (SARCC) and the Cross-Border Road Transport Agency (CBRTA) for public transport infrastructure between 2005/06 and 2008/09. The PTIS has been allocated R1.8 billion in 2007/08, R3.5 billion in 2008/09 and R2.8 billion in 2009/10.

The 2010 FIFA World Cup is intended to leave a lasting legacy of a more efficient and integrated public transport system

Table 9.5 Public transport infrastructure and systems grant allocation, 2005/06 – 2010/11

R million	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	Total
Municipalities	241 710	519 000	1 174 000	3 170 000	2 325 000	–	**7 429 710**
CBRTA	–	1 000	–	–	–	–	**1 000**
SARCC	–	180 000	476 000	210 000	200 000	–	**1 066 000**
SANRAL	–	–	130 000	100 000	200 000	–	**430 000**
Total	**241 710**	**700 000**	**1 780 000**	**3 480 000**	**2 725 000**	**–**	**8 926 710**
Unallocated	**–**	**–**	**28 000**	**500 000**	**1 816 500**	**4 464 500**	**6 809 000**

CBRTA: Cross Border Road Transport Agency
SARCC: South African Commuter Corporation
SANRAL: South African National Roads Agency Limited

The funding is aligned with the 2007 public transport strategy. Critical components for achieving an integrated multi-modal metropolitan rapid transit include developing local government network control and managing and transforming bus and taxi services into scheduled trunk, feeder and distribution services.

A fast, comfortable and low cost urban transport system, called the bus rapid transit (BRT) system, is being planned for the host cities of the 2010 FIFA World Cup during the tournament. This has been the most cost-effective and flexible mass mover in developing countries. The City of Cape Town, City of Johannesburg, City of Tshwane, eThekwini and Nelson Mandela Bay have made significant progress in having designs for these systems approved. The integrated transport plan for host cities Cape Town, Tshwane, Durban and Bloemfontein, among several others, will include a BRT transport system that will

The BRT will operate in the central business districts and also in townships

promote the use of public transport ahead of the 2010 FIFA World Cup. The BRT will be made available not only for the central business districts but also in townships. This involves the construction of bus way corridors on segregated lanes as well as using modernised integrated transport systems. The transport upgrade will provide for parking, pedestrian bridges and walkways, hawker facilities, clear signage and improved interchanges.

In November 2006, the City of Johannesburg launched 'Rea Vaya' (We are Going)

In November 2006, the City of Johannesburg launched 'Rea Vaya' (We are Going), the new system will have 325 km of special public transport lanes and intersections and 40 transport interchange nodes, where commuters can switch from one form of transport to another. They will be able to buy a single ticket, making travel via the different means of transport a seamless journey. The Rea Vaya brand will appear on taxis, buses and trains and on the new bus and taxi stops. The special lanes and intersections will be created on existing road networks, excluding freeways. Major facilities such as schools, community centres, libraries, clinics and railway stations will all be within one kilometre of the routes. The Soweto Business Express train, which is an upmarket train service running between Soweto and Johannesburg, is intended to encourage affluent groups to use public transport.

These investments are supported through the public transport infrastructure and systems grant (PTIS). The PTIS is administered by the national Department of Transport. Through the PTIS, the department is executing its responsibility for the national transport plan for the 2010 FIFA World Cup. The department has to co-ordinate focal points for transport information exchange, provide technical support, evaluate priority statements and manage and administer the grant.

Provinces are responsible for provincial-wide co-ordination, linking host cities to non-host cities, preparing provincial priority statements and providing technical support.

Conclusion

If improvements to existing roads infrastructure and public transport challenges are not tackled in a robust way, municipalities will find that the growth in private motor vehicle usage will increasingly become a problem. Developing an integrated, safe, customer-oriented public transport system supported by a good roads infrastructure is essential. In terms of public transport, the immediate focus by all spheres of government is to manage current bus contracts, develop appropriate institutional structures and formalise the taxi industry. The long-term goal involves restructuring the entire public transport system, including commuter rail.

The solution to the transport challenges at the municipal level is a complicated and multi-faceted one. It involves increased spending to improve the rail network, a much improved public transport network and improving and expanding the road network. Investment policies are needed to improve the whole transportation system and in particular public transport.

10

Managing the built environment

Introduction

Public investment in the built environment occurs across a number of sectors

Public investment in the built environment occurs across a number of sectors. National and provincial governments make extensive investments in transportation networks, health, educational and recreation facilities, housing low income families and water resource facilities. Public entities, such as Eskom and the water boards, invest in and provide electricity and water services respectively.

Municipalities invest in infrastructure relating to water, sanitation, electricity, solid waste and transportation. These investments are intended to address basic community needs and support economic activity. Public investment that is targeted to meet these objectives can take a number of forms, depending on the needs of a particular locality or function. It may involve the construction of new assets, extension, replacement, refurbishment or maintenance.

Co-ordination is key to achieving positive developmental outcomes

Co-ordinating the sectors and forms of these investment programmes is necessary to achieve positive developmental outcomes. This is a complex and difficult task. Priorities and investment needs vary by area and sector, reflecting different economic and social trends and the age and coverage of existing infrastructure assets.

The effectiveness of public sector infrastructure investments in supporting and guiding growth and combating poverty, depends on first, the effectiveness with which infrastructure assets are managed, second, the capacity of public institutions to plan and guide the process of spatial development and third, the ability of the public sector to co-ordinate its investments to deliver positive developmental outcomes and guide future fixed investments across the public and private sectors.

This chapter gives an overview of:

- demands for municipal investment in the built environment
- municipal performance in infrastructure investment and asset management
- spatial planning
- co-ordination of public investments in the built environment.

Demands for municipal investment in the built environment

Demand is influenced by backlogs, economic growth and refurbishment and/or replacement of existing infrastructure

Municipalities face significant demand for investments in infrastructure from at least three sources. First, they must address backlogs in poor households' access to basic municipal services. Second, they must address the infrastructure needs of a growing economy, where firms and households are seeking additional infrastructure services. Finally, they must refurbish or replace infrastructure that has outlived its design life.

After 1994, infrastructure investment strategies initially focused on increasing access to new services. More recently, however, a second generation of challenges has begun to emerge, that is related to the need to expand or replace economic infrastructure.

Addressing basic municipal service backlogs

Apartheid left a legacy of inequitable access to basic services

Apartheid left a legacy of inequitable access to basic services, along racial lines. These distortions are still reflected both within and between municipalities. Residents in wealthier areas typically have easy access to services, with infrastructure standards of a very high quality. Poorer townships and informal settlements within the same municipality have far lower levels of access to services and infrastructure is of a significantly lower quality. Municipalities in former homeland areas generally have far lower levels of access to services than other municipalities.

Demographic, economic and social trends have begun to alter the distribution of basic infrastructure backlogs

More recent post-apartheid demographic, economic and social trends have begun to alter the distribution of basic infrastructure backlogs. Urban growth, attempts to change and enhance dysfunctional urban areas, household decompression and even the impact of HIV and AIDS, have increased the demand for services in the larger urban centres. The migration of people to cities shifts the location of infrastructure needs. As infrastructure is not mobile, this creates new demand for investment, even as government successfully reduces existing backlogs. In some cases it may result in the under-utilisation of newly installed infrastructure in rural areas.

Assessing the cost of addressing backlogs in basic services has usually involved estimating the number of poor households requiring services, the rate of household growth and the average costs of providing a basic level of access by service function. This can be done at the national, municipal or even settlement level. In reality, this just identifies the costs associated with addressing backlogs. Actual

physical investment programmes are more typically a direct response to subsidised housing investments. In many instances a decision to invest in a housing project will require commitments by municipalities to install electricity, water, sanitation and roads infrastructure, as well as provide related urban services such as refuse removal. In addition, housing developments should leverage community infrastructure investments, such as schools and clinics from provincial governments.

Nonetheless, it is possible to estimate the total infrastructure investment required to address backlogs in access to basic services.

Table 10.1 Estimate of required municipal infrastructure investment to meet remaining backlogs in access to basic services

	Number of households (millions)	Estimated cost (R billion)	Cost per capita (Rand)
Water	2.1	12.8	R1 470 / person
Sanitation	3.5	18.4	R8 000 / person
Electricity	3.3	10.2	R3 100 / household
Solid waste	4.5	68.5	R15 / household

Source: Department of Water Affairs and Forestry, 2005

Expanding economic infrastructure

Sustained economic growth has also created a demand for the extension of municipal infrastructure services

Sustained economic growth has also created a demand for the extension of municipal infrastructure services. The formation of new enterprises or the expansion of the productive capacity of existing firms creates additional demand for municipal infrastructure services. In some cases, this may require the extension of infrastructure to new industrial or commercial areas, while in others it may require increased infrastructure service and road network capacity. Roads may need widening to accommodate additional traffic, while water networks may need to be expanded to meet a level of demand that is beyond their existing design capacity.

Since 1994, economic growth has also resulted in the rapid growth of higher income housing developments that are now a feature of all South African cities. These developments create additional demand for roads, electricity, water services and solid waste infrastructure, regardless of whether they are located on the periphery of cities or are part of existing re-developed and dense urban areas.

Failure to keep pace with demand leads to congestion and over-utilisation of existing infrastructure assets

It is important to note the compound effect of demand for municipal infrastructure to support economic growth. Average annual GDP growth of 5 per cent implies an annual increase in the size of the economy. The failure of municipalities to keep pace with demand in one year does not dissipate, it is rolled over and quickly magnified in succeeding years. It also leads to congestion and over-utilisation of existing infrastructure assets. This accelerates the deterioration in the condition of these assets, which may now require more rapid replacement. Therefore, municipalities may find their infrastructure asset base overwhelmed and a critical constraining factor to continued economic growth.

Maintaining infrastructure assets

The need for maintenance of infrastructure differs markedly between sectors

The need for maintenance of infrastructure differs markedly between sectors and depends on the initial quality of infrastructure that has been installed. As a general rule, the higher the quality of the initial investment, the longer the period before significant maintenance is required. However, this is not always the case as maintenance needs will also vary with how intensely the infrastructure is used.

Table 10.2 summarises data from various sources that suggest that the national total replacement value of municipal assets in water, sanitation, roads and electricity amounts to some R295 billion. Assuming that annual maintenance expenditure should amount to approximately 4 per cent of replacement value, municipalities should be spending around R11.8 billion annually on maintenance activities.

Table 10.2 Estimated total municipal asset replacement values and annual maintenance expenditure requirements

R million	Estimated total replacement value of assets	Estimated annual maintenance expenditure requirement
Water and sanitation	180 000	7 200
Roads	60 000	2 400
Electricity	55 000	2 200
Total	**295 000**	**11 800**

Source: CSIR, 2007 and Construction Industry Development Board (CIDB), 2007

Key challenges arising from demands for infrastructure

The resources required to finance infrastructure demands far outstrip the actual availability of resources at the municipal level

Collectively, the resources required to finance these infrastructure demands far outstrip the actual availability of resources at the municipal level. This has been evident for some time now and government has introduced a variety of policies to support municipalities. These include a rapid real increase in national grants, policy frameworks to assist municipalities to leverage private finance through increased borrowing or public private partnerships (PPPs) and planning and financial management reforms that help municipalities to more clearly identify, prioritise and respond to needs. Infrastructure investments also generate long-term operating cost implications associated with the delivery of services and ongoing maintenance. Again, the policy framework emphasises the importance of own revenue generation, complemented by transfers from national government, in meeting these costs. These issues are addressed in other chapters of this Review.

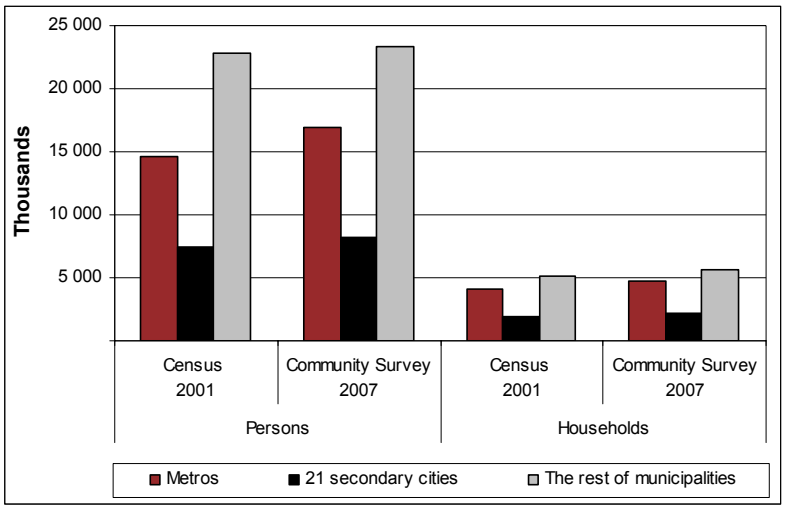
However, in addition to these financing challenges three additional challenges are also evident. These challenges add to the complexity of municipal investments in the built environment and in many instances may undermine the realisation of targeted developmental outcomes.

Demand for municipal investment in the built environment is shifting towards large urban centres

First, the demand for municipal investment in the built environment is shifting towards large urban centres. This shift is a function of both demographic change and the location of economic growth centres.

Figure 10.1 shows that the population in metros has increased by 16 per cent between 2001 and 2007 and by 12 per cent in the 21 secondary cities. The number of households increased by 14 per cent for both metros and the 21 secondary cities. Much of this new demand is from poorer households, which are less able to pay for services. Yet, as large urban municipalities address this challenge they must also ensure that infrastructure is available to support economic growth, both through new investments and the replacement of ageing infrastructure. Although insufficient data is available on the age and condition of existing assets in large urban municipalities, anecdotal evidence suggests that they are increasingly due for replacement. This implies that these municipalities may be approaching a comparatively higher cost stage in their asset life cycles.

Figure 10.1 Population statistics for metros and 21 secondary cities, 2001 – 2007



Source: Stats SA, Census 2001 and Community Survey 2007

Effective spatial planning systems guide all fixed investments in the built environment

Second, the growth in private demand for municipal infrastructure has emphasised the importance of effective and efficient spatial planning systems to ensure appropriately located and leveraged investments. Effective spatial planning systems guide all fixed investments in the built environment. An efficient system ensures that the process of development approval is not subject to unnecessarily lengthy delays that raise the overall cost of all investments.

Effective co-ordination of multi-sectoral investments is essential for achieving positive developmental outcomes

Third, the growth in both demand for and allocations to public infrastructure programmes has emphasised the importance of co-ordinating public investment. All public sector fixed investment occurs within municipal jurisdictions. Effective co-ordination of these investments is essential to achieving developmental outcomes of safe, habitable and dynamic community settlements and to providing a consistent guide to fixed investments by households and firms.

Specifically, investments in housing for low income communities require careful co-ordination with municipal infrastructure investment programmes. Municipal investments must not only connect these houses to infrastructure networks, but also ensure that adequate bulk infrastructure capacity exists to provide associated services. The

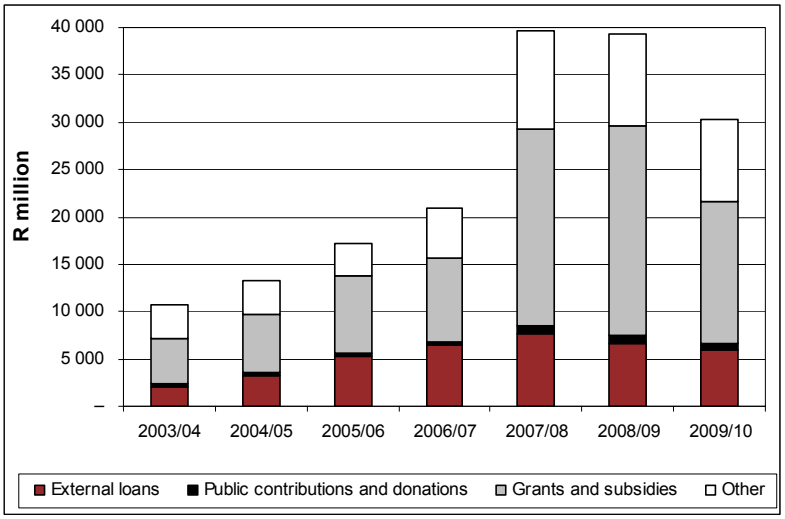
location and density of housing developments has a profound impact on the cost of municipal infrastructure investments and can have long-term implications for the costs of providing basic services. For example, a low density housing development for poor households that is located on the periphery of a city may require new bulk infrastructure assets and extended reticulation networks, both of which increase the ongoing operating costs that must be borne by residents or subsidised by a municipality. Residents may also require transport subsidies to travel to places of economic opportunity. Thus, while the cost of providing housing may be lower, the collective cost over the long-term could be unaffordable.

Municipal performance in infrastructure investment and asset management

Sources of infrastructure finance for municipalities

Various sources of finance are available to municipalities to assist them in meeting demands for infrastructure investment. These include private financing, transfers from national government and municipal own revenues, these are discussed in some detail in other chapters of this Review.

Figure 10.2 Sources of capital finance for municipalities, 2003/04 – 2009/10



Source: National Treasury local government database

The municipal infrastructure grant (MIG) is the single largest external contributor of finance for municipal infrastructure investment

The municipal infrastructure grant (MIG) is the single largest external contributor of finance for municipal infrastructure investment. This grant is intended to supplement municipal budgets for infrastructure and ensure a focus on the provision of basic infrastructure for poor households. To maximise its benefit, the MIG programme must be aligned with other programmes funded by national government and by municipalities themselves. In particular, the alignment of the housing and MIG grants is critical. There are also grants that complement MIG such as the bulk infrastructure grant funding cross-boundary water schemes, the public transport infrastructure systems grant, the national

electrification grant and the neighbourhood development partnership grant.

Trends in municipal infrastructure expenditure

Capital expenditure by municipalities grows at an average annual rate of 26.9 per cent between 2003/04 and 2009/10. This is high, despite budgeted reductions in capital expenditure from 2008/09. An increase in capital expenditure of 90.2 per cent was projected in municipal budgets for 2007/08, although it remains to be seen whether this will materialise. This rapid increase in capital expenditure reflects the extent of the pressures facing municipalities to expand and replace infrastructure, as well as spending on the 2010 FIFA World Cup.

Table 10.3 Municipal capital budgets by category, 2003/04 – 2009/10

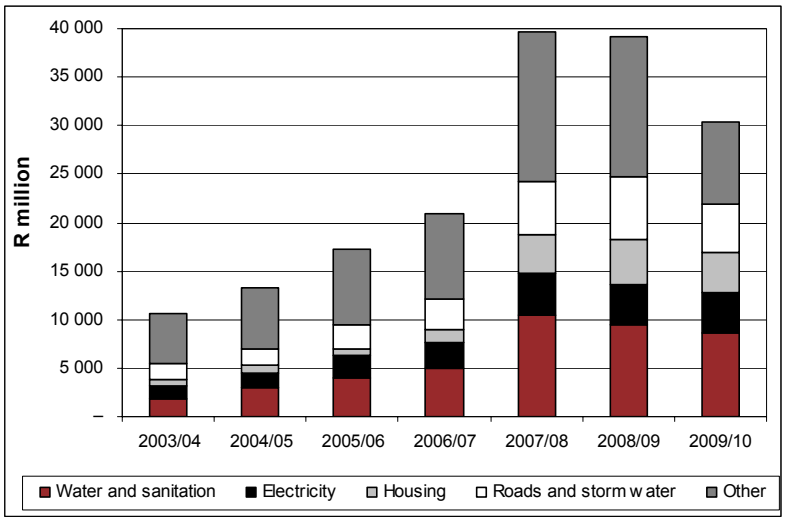
	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
R million		**Outcome**		**Estimate**	**Medium-term estimates**		
Category A (Metros)	5 663	7 568	9 189	12 200	19 330	19 698	15 056
Category B (Locals)	4 001	4 723	6 183	7 100	15 329	15 136	11 041
Category C (Districts)	1 033	1 032	1 860	1 591	5 077	4 418	4 240
Total	**10 696**	**13 323**	**17 232**	**20 891**	**39 736**	**39 252**	**30 337**
Percentage growth							
Category A (Metros)		*33.6%*	*21.4%*	*32.8%*	*58.4%*	*1.9%*	*-23.6%*
Category B (Locals)		*18.0%*	*30.9%*	*14.8%*	*115.9%*	*-1.3%*	*-27.1%*
Category C (Districts)		*-0.0%*	*80.2%*	*-14.5%*	*219.1%*	*-13.0%*	*-4.0%*
Total		***24.6%***	***29.3%***	***21.2%***	***90.2%***	***-1.2%***	***-22.7%***

Source: National Treasury local government database

Growth in the metros' capital spending has been consistent

The bulk of municipal infrastructure investment occurs in metros, which accounted for an average of 47 per cent of all municipal capital expenditure over the period. These municipalities have also experienced consistent growth in capital spending over the period.

Figure 10.3 Municipal infrastructure expenditure by sector, 2003/04 – 2009/10



Source: National Treasury local government database

Figure 10.3 shows that over the past four years, the water sector has been the largest beneficiary of the increase in municipal capital spending, followed by the roads sector. Water services received an average of 29 per cent of the total capital budgets of municipalities between 2003/04 and 2007/08.

Progress in addressing backlogs

Considerable work is required to meet targets

Despite significant progress being made in the eradication of backlogs, considerable work to meet targets remains. Although the population has increased by 8.2 per cent from 2000/01 to 2006/07, backlogs have been reduced by 56 per cent in the water sector from 1994/95 to 2006//07 and sanitation backlogs have decreased by 32 per cent between 1994 and 2007. Table 10.4 reflects that 14.4 per cent of the population still require access to water and 29.50 per cent of the population do not have sanitation services. In addition, an estimated 4.5 million households do not have access to adequate solid waste services.

Table 10.4 Estimated backlogs in infrastructure, 1994 – 2007

	1994 (RDP)		1997		2001		2004		2007	
R million	Un-served population	%	Un-served population	%	Un-served population	%	Un-served population	%	Un-served population	%
Total population	40 400		41 141		44 820		47 845		48 502	
Water	15 890	39.3%	15 782	38.4%	13 103	29.2%	9 431	19.7%	6 969	14.4%
Sanitation	21 000	52.0%	20 329	49.4%	19 595	43.7%	16 278	34.0%	14 330	29.5%
Electricity	13 500	33.4%			13 464	30.0%	13 406	28.0%		
Housing (units)	1 200	13.0%					1 800	14.0%		

Sources: RDP, 1994; PDG estimates based on Stats SA census and survey data, National Department of Housing, Department of Water Affairs and Forestry, Department of Minerals and Energy

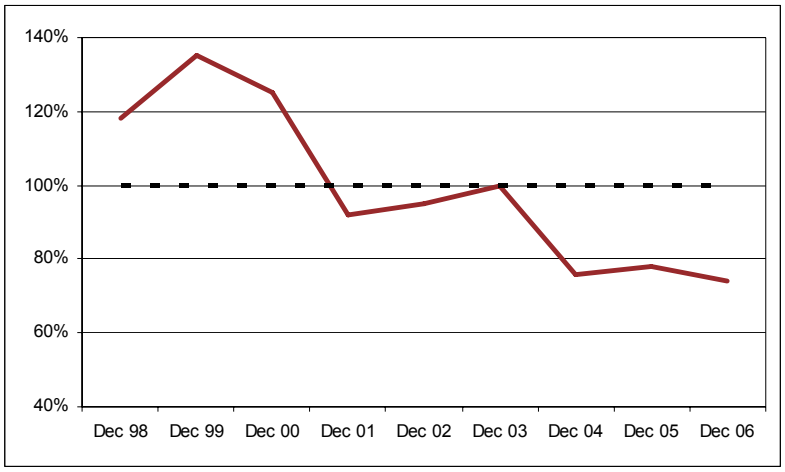
Sector departments are in the process of finalising their sector master plans to guide municipalities' implementation plans. It is the view of the sector departments that their respective sector targets are not likely to be met in all municipalities due to the diverse and numerous challenges such as inadequate capacity, maintenance and modification of systems and inadequate bulk infrastructure. Most progress is happening in big cities where there is more capacity. The biggest ongoing backlogs are in rural areas.

Providing economic infrastructure to support growth

Municipal capital expenditure has fallen below the value of buildings completed from 2003. Since then, the gap has widened, despite increases in municipal spending.

Figure 10.4 shows that municipal capital expenditure has now fallen to less than 75 per cent of the value of buildings completed. The effects of this under-spending are cumulative. Backlogs in demand are experienced in the greater congestion and over-use of existing assets. In extreme circumstances they may lead to firms deferring decisions to expand their productive capacity.

Figure 10.4 Municipal capital expenditure as a percentage of the total value of buildings completed, December 1998 – December 2006



Source: Stats SA, Community Survey 2007 and National Treasury local government database

Maintenance expenditure

A municipality with a comparatively new infrastructure network will require less maintenance expenditure

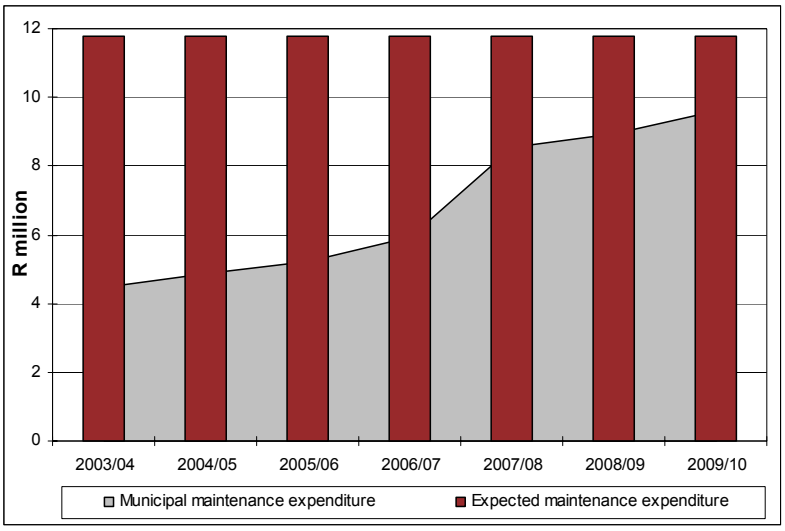
A failure to adequately maintain assets can lead to service delivery disruptions and the need to replace assets before the end of their design lives. The need for expenditure on asset maintenance depends on where a municipality is in its asset management life cycle. A municipality with a comparatively new infrastructure network will require less maintenance expenditure. Detailed information on the age, value and condition of municipal assets is unfortunately not available. This shortcoming is currently being addressed through the introduction of municipal asset management regulations and is being closely monitored by the Auditor-General. For example, a 2007 audit by the National Electricity Regulator of South Africa (NERSA) of 11 electricity distributors reported the standard of data collection on infrastructure maintenance as "well below international standards".

Sustained under-investment in asset maintenance is having a negative impact on the quality of service

The limited sectoral information that is available does indicate that sustained under-investment in asset maintenance is having a negative impact on the quality of service. In 2004, in the water services sector, 37 per cent of households had water distribution interrupted mainly for technical reasons, while 28 per cent of households experienced failures in their sanitation systems. Over 50 per cent of a sample of 30 municipalities reported leakages at levels above international norms. In 2005, 63 per cent of municipalities could not confirm that they met water quality standards, although by 2007 it was estimated that 72 per cent were compliant.

Figure 10.5 presents estimates of the total replacement cost of municipal assets at approximately R295 billion. It suggests that an annual maintenance expenditure of R11.8 billion would be required to ensure that these assets were adequately maintained.

Figure 10.5 Municipal maintenance expenditure by year against expected expenditure, 2003/04 – 2009/10



Source: National Treasury local government database

Spatial planning

Spatial planning mechanisms are an important tool for government to guide public and private investment for the public good

Spatial planning mechanisms are an important tool for government to guide public and private investment for the public good. The spatial component is an important element of national strategy. The introduction of the national spatial development perspective in 2003 and its revision in 2006 has not adequately addressed and emphasised where development should take place. The current democratic government inherited many planning and property development approval regulations in 1994. These regulations differ from province to province and are based on apartheid spatial planning models. Since 1994, government has been grappling with the fragmented, incoherent and constraining regulatory framework for planning. This has a direct impact on the country's ability to facilitate economic investments. It also fails to redress the unequal and dysfunctional spatial patterns inherited from apartheid and it does not yet reconcile the country's socio-economic needs with those of the environment.

The continued applicability of the apartheid era legislation renders the entire development planning system inefficient, costly and confusing and consequently does not support a number of government's current objectives.

Rethinking the spatial project to realise developmental growth objectives must take cognisance of new challenges and realities.

The planning and regulatory environment

Impact of current planning and approval processes

Overall, the planning and property development approval processes have had the effect of both increasing the cost of investment and enabling lobbies opposed to investment to delay and prevent new

property development projects. This regulatory environment has a negative impact in the following ways:

- *Economically:* it impedes investment in land development and fails to establish sufficient certainty in the land market.
- *Spatially:* it fails to address the segregated and unequal spatial patterns inherited from apartheid.
- *Environmentally:* it does not balance the country's socio-economic needs with those of environmental conservation and sustainability.
- *Procedurally:* the planning regulatory system has not only added to bureaucracy, but also increased the incentives for corruption of officials vested with the power of approving applications. Further, it has allowed scope for developers to by-pass one set of authorities (municipality) for another (province), leading to fragmentation in the planning process.

The reasons for the regulatory framework having this effect include:

- The fragmented nature and definition of planning functions means that the concept of planning is understood differently in different sectors and between spheres of government.
- There is little co-ordination of forward planning between sectors and uncertainty as to the manner in which forward planning should relate to the day-to-day management of land development.
- There are no procedures to review planning decisions every 10 years, to ensure that previous decisions are updated to take into account new realities.
- Administrative mechanisms to deal with objections and appeals are weak or non-existent, leaving judicial processes to deal with objections, often resulting in lengthy delays.
- Preventative and management mechanisms to minimise risk of corruption and delay in approving planning applications are weak.

The current situation puts considerable strain on the processes and instruments of co-operative governance in an area in which co-operation is especially important. The various government actors are unsure of each other's roles and the private and community sectors are, unsurprisingly, confused and frustrated. This is not a situation that is conducive either to promoting appropriate investment in land development or to effective efforts to redress the spatial legacy left by apartheid.

Conflicts also can arise with other sector planning and approval legislation

Further conflicts also arise with other sector planning and approval legislation, like the legislation in the transport sector for road planning, modes of transport and for public transport licences. Obviously such planning and approval processes should be part of the spatial planning processes.

Planning regulations

Currently, most land development applications are submitted via the procedures set out in the four "old order" town planning ordinances:

- the Natal Town Planning Ordinance, 27 of 1949 (in KwaZulu-Natal)
- the Orange Free State Townships Ordinance, 9 of 1969 (in Free State)
- the Cape Province's Land Use Planning Ordinance, 15 of 1985 (in Western Cape, Eastern Cape, Northern Cape and some parts of North-West)
- the Transvaal Town Planning and Townships Ordinance, 15 of 1986 (in Gauteng, Limpopo, Mpumalanga and most of North West).

These inherited laws do not apply to those parts of the country that previously fell within the former bantustan boundaries. Nor do they apply to most of the townships. In these areas land development is either governed by old order bantustan legislation (for example, the KwaNdebele Town Planning Act (1992), the Bophutatswana Township Regulation Amendment Acts, the Venda Land Affairs Proclamation 45 (1990) and the Ciskei Land Use Regulations Act (1987) or, more commonly, regulations issued under the Black Administration Act (1927) and the Black Communities Development Act (1984).

In addition, there is the Less Formal Township Establishment Act (1991), which provides a special, fast-track procedure for applications for low income housing, as well as the Development Facilitation Act (1995), which gives development tribunals considerable powers to expedite various land development applications.

In addition to the legislation described above, which relates directly to traditional town planning and township establishment approvals, there is also a parallel set of environmental regulations issued in terms of the National Environmental Management Act (1998). For a large number of development applications and especially large-scale, mega-projects, the applicant has to comply with (at least) two development approval processes - planning approval and environmental authorisation. In some instances this translates into a scenario in which the planning concerns are not tackled very rigorously as there is a sense that the environmental authorisation will determine the outcome anyway.

National and international policy objectives are increasingly moving away from the compartmentalisation of planning and environmental concerns. As the range of environmental concerns widens to include social and economic impacts and the planning agenda integrates environmental impacts more and more, so it becomes less and less defensible to have separate and often unrelated, misaligned legal approval procedures.

Intergovernmental co-ordination

Uncertainty about which sphere of government is responsible for what element of planning results in contradictions such as the disjuncture

between provincial approvals for environmental impact assessments and municipal approvals for land development applications.

Difficulty in identifying an effective way to link plans for the future with day-to-day development management decisions

Closely linked to the assignment of the planning function, is the practical difficulty faced by all three spheres of government in identifying an effective way to link their plans for the future with day-to-day development management decisions. How can a municipality ensure that a decision in support of a specific rezoning or township development application reflects the intention of its integrated development plan? How does it do this in a way that effectively balances the need for predictability with the need for flexibility? In answering these questions it is important also to remember that issues of co-operative governance inevitably arise - a project may well comply with all the policy objectives and delivery targets of one sphere of government, but not fit very well with those of the decision-making body charged with approving or rejecting the application.

As a further complicating factor, decisions relating to building plan approvals (governed by the National Building Regulations and Building Standards Act (1977)) have clearly been made on the basis of inconsistent interpretations and have been legally challenged by individuals who are adversely affected by certain decisions.

Intergovernmental arrangements are confusing

In larger infrastructure projects (particularly the development of network infrastructure like roads and railways that cut across geographic regions), the fragmentation and confusion relating to planning approvals is magnified. In the transport sector, the intergovernmental arrangements are confusing. For example, approvals for taxi licences are often vested with the province rather than the municipality. Similarly, some roads (like the N1 and M1 between Mid-Rand and Rosebank) fall under three different spheres of government, greatly complicating the planning and maintenance processes.

Recent initiatives and the need for a common approach

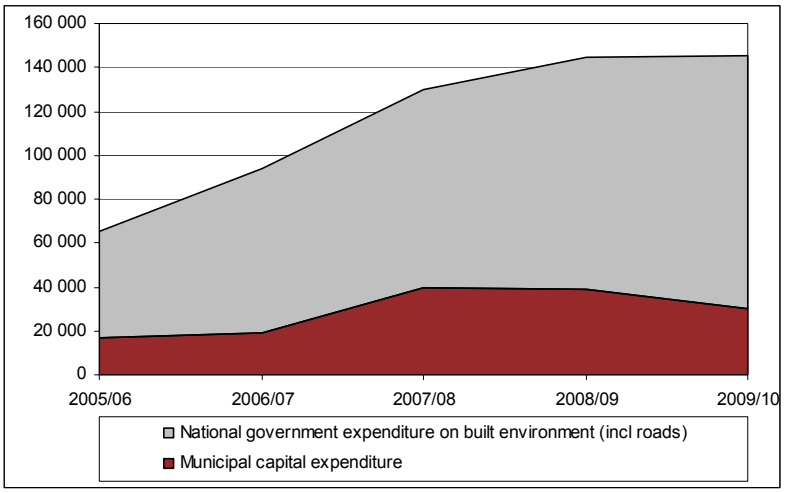
Despite the pervasive uncertainty and disagreement as to the way forward there has been considerable activity in all three spheres of government to reform planning laws. The problem, however, is that the various legislative initiatives are not in terms of a common framework or even an agreed interpretation of constitutional provisions. This activity thus raises the spectre of yet more layers of planning and land development regulation being added. It also reflects a range of different approaches and lays the foundation for many years of uncertainty and litigation in the future. There is an urgent need for consistency in land use planning across the country.

Co-ordination of public investments in the built environment

The public sector makes significant investments in the built environment.

National government sets out policies that play a regulatory role in municipal infrastructure functions and provide significant grant financing for housing and municipal infrastructure. Some national departments, such as the Department of Water Affairs and Forestry, invest directly in bulk and in some instances, local infrastructure. National public entities such as Eskom, Transnet and the South African National Roads Agency (SANRAL) invest directly in electrical and transport infrastructure. Provincial governments invest directly in housing, health, education and related community infrastructure such as libraries and roads. In addition, they monitor municipal infrastructure and services. Municipalities and municipal entities invest directly in water services and electricity, solid waste, transport and community infrastructure. Figure 10.6 summarises national and local expenditure on the built environment.

Figure 10.6 National and municipal capital expenditure in the built environment, 2005/06 – 2009/10



Source: National Treasury local government database

Community and household infrastructure investment needs to be properly co-ordinated and carefully sequenced

To fulfil their infrastructure obligations, municipalities must maintain a large variety of relationships involving the co-ordination of built environment functions. To achieve positive developmental outcomes requires community and household infrastructure investment to be properly co-ordinated and carefully sequenced. For example, a new clinic or school will require roads, water services and electricity. New housing developments may require clinics and schools and other community facilities.

Evaluating the extent of co-ordination in public investment is methodologically challenging, particularly at an aggregate (national) level. Methodological refinements to improve this are currently being developed.

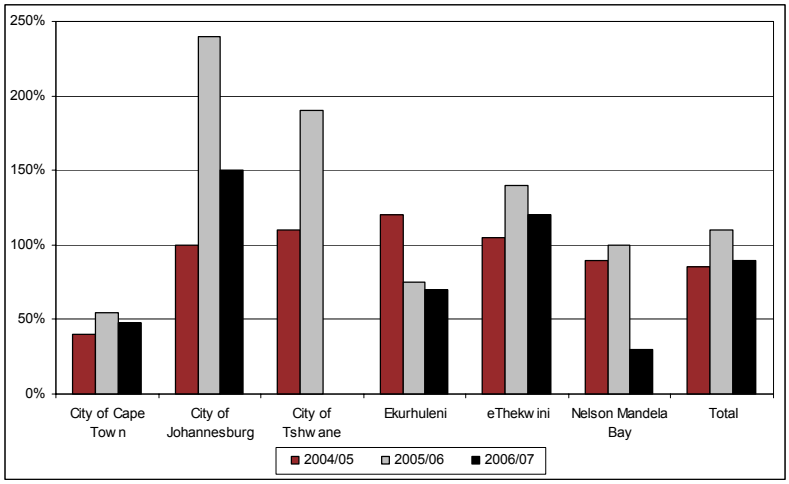
Nevertheless, it is clear that municipalities face three specific challenges in co-ordinating investment in the built environment.

First, the current assignment of functions and financing arrangements for built environment investments creates potentially excessive demands for intergovernmental co-ordination. This is most evident between provincial and local governments with respect to housing and

related infrastructure investments. In general, a lack of synergy prevails between provincial housing department funding for subsidised housing developments and IDP-based municipal development targets.

The misalignment of housing and infrastructure grants is symptomatic of this challenge. Figure 10.7 shows the wide range in the relationship between housing and MIG transfers to metros. Although MIG transfers have on average amounted to 93 per cent of housing transfers over the period, there are wide variations both within individual cities and between them.

Figure 10.7 MIG allocations as a percentage of housing allocations in the metros, 2005/06 – 2007/08



Source: National Treasury local government database

The volatile and unpredictable nature of provincial housing expenditure undermines the ability of municipalities to adequately plan for infrastructure investments and can lead to delays in both housing and infrastructure projects.

Some metros have begun to undertake the housing function on behalf of their provincial counterparts. In such cases municipalities will prepare plans and submit them to their provinces for approval and release of funding. However, better alignment is required between housing and infrastructure conditional grants, which could potentially include the gradual re-assignment of the housing function to the municipal level.

Alignment of the fiscal instruments supporting the development of the built environment, will improve local government's ability to deliver on its service delivery mandates

In the short term, the alignment of the fiscal instruments supporting the development of the built environment will go a long way to improving local government's ability to deliver on its service delivery mandates. Associated with this alignment is the need to improve the predictability and certainty of grant allocations over a three-year horizon. This will assist municipalities in integrating their planning and budgeting processes. To this effect, the national Department of Housing has begun to facilitate the determination of housing allocations by provincial housing departments to ensure that these are gazetted in the Division of Revenue Act. This will contribute to forward planning and align their planning processes with the

infrastructure grants for inclusionary housing and other Breaking New Ground programmes.

Co-ordination within the local government sphere is another dimension of the co-ordination challenge. The internal organisational arrangements of municipalities often reinforce fragmentation between service delivery units, such as roads and water departments, or between municipal public entities where these exist. In addition, non-metros must co-ordinate investment programmes between district and local municipalities, as the actual functional assignments between these tiers differs and is often opaque across the country.

Second, the system of functional and fiscal assignments may exacerbate principal-agent problems, leading to confusion about accountability for achieving developmental outcomes. In cases where provincial governments are performing a direct housing implementation role, they are poorly suited to also oversee municipal investment performance in the built environment. In essence, this dual mandate weakens the ability of municipalities to co-ordinate built environment investments, despite them being relatively better suited to judging local needs and priorities.

Weak information flows compound co-ordination problems

Third, weak information flows compound co-ordination problems. Reporting by municipalities tends to be done within the silos of departmental functions. This can result in a lack of coherence between different silo-based inputs and undermine the reliability and utility of the information itself. Sectoral reports fail to provide an indication of the extent to which integrated development outcomes are being addressed in the planning and budgeting process as well as integrated outcomes achieved. Most reporting is focused purely on expenditure performance, without providing information on medium-term targets. Consequently, it is impossible to gauge the extent to which the municipality is ‘on track’ with investment programmes.

Conclusion

The demand for municipal investment in the built environment has grown strongly over the past few years. While municipalities have made significant progress in addressing historical backlogs in basic infrastructure, shifting patterns of demand, to urban areas and to support economic growth, are currently outstripping the investment capacity of municipalities. Municipal approaches to asset management are increasingly being exposed as inadequate to meet these challenges, not least due to the absence of high quality data. Underlying this problem are concerns over the current framework for spatial planning and weaknesses in mechanisms for the co-ordination of public investments. Considerable further work is required to refine policy and implementation frameworks for both spatial planning and public sector co-ordination, without which the efficiency and developmental effectiveness of public investments will continue to be undermined.

11

Financial management and MFMA implementation

Introduction

Sound financial management practices underpin the process of democratic accountability

Sound financial management practices are essential to the long-term sustainability of municipalities. They underpin the process of democratic accountability. Weak or opaque financial management results in the misdirection and under-utilisation of resources and increases the risk of corruption. The key objective of the Municipal Finance Management Act (2003) (MFMA) is to modernise municipal financial management.

Municipal financial management has four interrelated components: planning and budgeting, revenue and expenditure management, reporting and oversight. Each component contributes to ensuring that expenditure is developmental, effective and efficient and that municipalities are held accountable.

The reforms introduced by the MFMA are the cornerstone of the broader reform package for local government outlined in the 1998 White Paper on Local Government. The MFMA, together with the Municipal Structures Act (1998), the Municipal Systems Act (2000) and the Municipal Property Rates Act (2004), sets-out the procedures and processes for municipal operations, planning, governance and accountability.

This chapter gives an overview of:

- the municipal finance reform programme
- the management of the reform programme in municipalities
- how the budgeting and planning processes are being strengthened

- the strengthening of oversight through improved transparency and reporting practices
- the strengthening of the regulatory environment for municipal financial management
- institutional strengthening and capacity building.

Reforms in municipal financial management

The municipal financial management reforms aim to support a coherent institutional and procedural approach to financial management that assists in improving service delivery.

The MFMA replaced an antiquated system of local government finance that focussed on compliance with rules and procedures. Practices, such as one-year, line-item budgeting, did not support long-term strategic planning nor match resources with needs over the medium-term. This generally resulted in councils allocating resources based on historical commitments rather than looking at current priorities and the future needs of communities.

Municipal practices were not rooted in a culture of performance and regular reporting

Municipal practices were also not rooted in a culture of performance and regular reporting. Reports were often irregular or inaccurate, or contained too much data and too little useful information. Often municipalities did not publish annual reports and did not submit their financial statements for audit on time or in some cases at all. The lack of effective monitoring and reporting systems often resulted in councils finding out too late about any financial problems that had arisen.

The MFMA and its regulations seek to address these historical weaknesses in budgeting, accounting, reporting and provide tools for improving efficiency in the use of public funds.

The municipal financial management and accountability cycle

The municipal financial management and accountability cycle consists of:

- ***Integrated development plan (IDP):*** Sets out the municipality's goals and development plans. Council adopts the IDP and undertakes an annual review and assessment of performance.
- ***Budget:*** The IDP informs the budget. The budget sets out the revenue raising and expenditure plan of the municipality for approval by council. It is linked to the service delivery and budget implementation plan (SDBIP). The budget and the SDBIP lay the basis for the performance agreements of the municipal manager and senior management.
- ***In-year reports:*** Council monitors financial and non-financial performance through quarterly and mid-year reports produced by the administration and tabled in Council.
- ***Annual financial statements:*** These are submitted to the Auditor-General who issues an audit report on financial and non-financial audits undertaken simultaneously.
- ***Annual report:*** Reports on implementation performance in relation to the budget and the SDBIP.
- ***Oversight report:*** Council adopts an oversight report based on outcomes highlighted in the annual report and actual performance.
- ***Audit committee:*** Provides independent specialist advice on financial and non-financial performance and governance.

Key mechanisms for strengthening accountability

The first mechanism involves separating and clarifying roles and responsibilities of executive councillors, non-executive councillors and officials. This is important for good governance.

The municipal manager holds the primary legal accountability for financial management in terms of the MFMA

The municipal manager holds the primary legal accountability for financial management in terms of the MFMA and, together with other senior managers, is responsible for implementation and outputs. The aim is to allow managers to manage, but to also make them more accountable.

The executive mayor and executive committee are expected to provide the municipality with political leadership, by proposing policies, budgets and performance targets for the municipality and oversee their implementation by monitoring performance through monthly progress reports.

Non-executive councillors, as elected representatives of the community, debate and approve the proposed policies and budgets and also oversee the performance of the municipality. They hold both the executive mayor or committee and the officials accountable for performance on the basis of quarterly and annual reports.

The second mechanism involves developing a performance orientation. The legal framework introduces requirements and processes for establishing service delivery priorities and plans. As noted the SDBIP sets out performance targets and provides a link between the IDP plans and the budget.

The third mechanism involves strengthening reporting and disclosure requirements. High quality and timely management information allows management to be proactive, identifying and solving problems as they arise. It also strengthens the separation of roles and supports a performance orientation in local government.

Two-phased approach to implementing MFMA reform

Implementation of the MFMA reforms has been phased in two ways:

- First, implementation has been phased to accommodate the diverse capacity of municipalities. Municipalities with low capacity were given extra time to comply with certain aspects of the MFMA, while municipalities with high capacity were required to implement the Act more rapidly.
- Second, the implementation programme has focused on priority issues in municipal financial management irrespective of municipal capacity. During the initial period attention was given to: the preparation of implementation plans, assigning responsibility to the accounting officer for all funds of the municipality, establishing a senior management team with delegated authorities, implementing cash management and control over bank accounts, introducing monthly reporting on revenue and spending; implementing procurement reforms, identifying all municipal entities and completing all outstanding financial statements for audit.

An MFMA co-ordination structure was established to monitor the implementation of the reforms

An MFMA co-ordination structure consisting of national and provincial departments and the South African Local Government Association (SALGA) was established to monitor the implementation of the reforms. To facilitate this, municipalities submit quarterly implementation priority reports (refer to MFMA Circular 38). This chapter presents information drawn primarily from these reports. Further information is available on National Treasury's website.

Management of the reform programme in municipalities

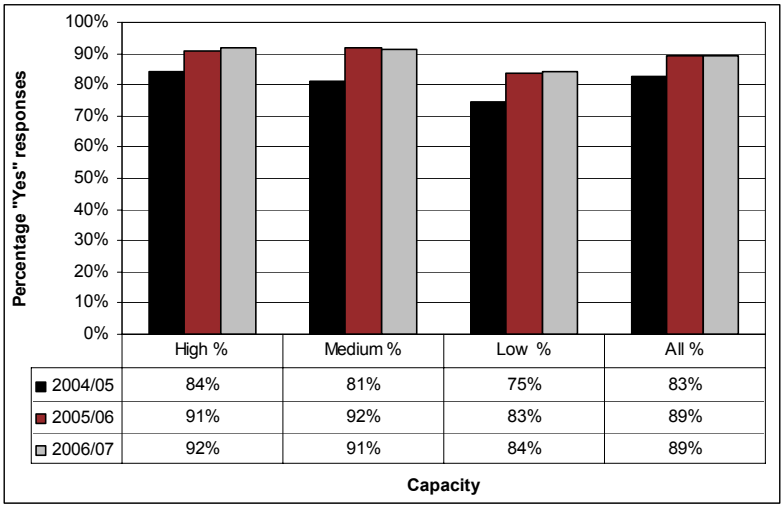
Effective implementation of the MFMA depends on good management arrangements being in place

Where a municipality has well developed management arrangements in place, it is generally easier to implement the MFMA and to maintain sustainable financial management practices. Conversely, where these management arrangements are lacking, implementing financial management reforms will be much harder.

Assessing management arrangements is a complex task. Two proxy indicators are used. The first measures a municipality's own assessment of its management arrangements and the second, monitors the vacancy rates for municipal managers and chief financial officers.

Figure 11.1 shows a noticeable improvement in municipalities own assessment of their management arrangements between 2004/05 and 2005/06, while between 2005/06 and 2006/07 there is a levelling-off.

Figure 11.1 Municipalities' own assessment of management arrangements, 2004/05 – 2006/07



	High %	Medium %	Low %	All %
2004/05	84%	81%	75%	83%
2005/06	91%	92%	83%	89%
2006/07	92%	91%	84%	89%

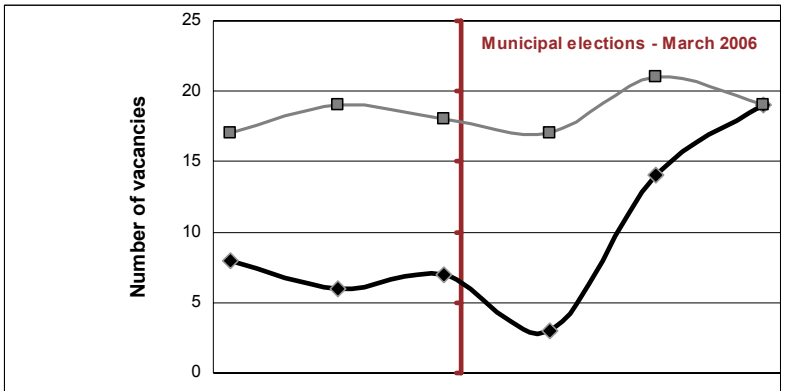
Source: National Treasury local government database
Note: The municipal capacity categories differentiate between 50 high, 106 medium and 127 low capacity municipalities.

Despite this largely positive self-assessment, the number of municipalities reporting vacancies in the key positions of municipal manager and chief financial officer (CFO) increased over the period, as shown in Figure 11.2. Moreover, in some of the larger municipalities, the position of CFO remained vacant for long periods. It is likely that the higher vacancy rates resulted in the flattening out of perceptions of management arrangements between 2005/06 and

2006/07. This period also coincides with the March 2006 local government elections.

The relationship between the 2006 elections and the increase in vacant positions for municipal managers and CFOs is illustrated in Figure 11.2. The vertical line represents the date of the local government elections in March 2006.

Figure 11.2 Vacancies for municipal managers and chief financial officers at the time of municipal elections, March 2006 (shown as red line) per quarter



	30-Sep-05	31-Dec-05	31-Mar-06	30-Jun-06	30-Sep-06	31-Dec-06
Municipal managers	8	6	7	3	14	19
CFOs	17	19	18	17	21	19

Source: National Treasury local government database
Note: The results show responses from 221 municipalities for Sept 2005 and 243 responses for December 2006, covering a 15 month period.

The negative impact of the 2006 elections is evidenced by the loss of senior managers in the 6 months following the elections

The negative impact of the 2006 local government elections is evidenced by the loss of senior managers in the six months following the elections. Further research on the impact of elections on the implementation of financial reforms and delivery of municipal services is required. This would enable government to prepare appropriate contingency strategies and support, including the need to stagger performance contracts between senior managers.

Strengthening planning and budgeting

Improved processes for municipal planning and budgeting empower a council to make better informed decisions and is fundamental to sustainable and efficient service provision.

The generic municipal budget cycle

The generic municipal budget cycle has been communicated to municipalities in MFMA Circular 19. The cycle involves:

- *A planning phase* that starts with the mayor tabling, in council, a budget process schedule by August. This schedule sets key target dates for the budget process. The planning phase involves the strategic review of the IDP, setting service delivery objectives for

the next three years, consultation on tariffs, indigency, credit control and free basic services and reviewing the previous year's performance and current economic and demographic trends;

- *A preparation phase* which involves the analysis of revenue and expenditure projections, drafting budget related policies and considering local, provincial and national priorities;
- *Tabling* a complete proposed budget, IDP revisions and budget policies in council by March and consulting on and considering local, provincial and national inputs during April and May;
- *Approval* of the budget by council before 1 July; and
- *Publishing* the budget, the SDBIP and annual performance agreements on the municipal website and elsewhere.

The following three indicators seek to measure the effectiveness of municipalities in managing the budget cycle:

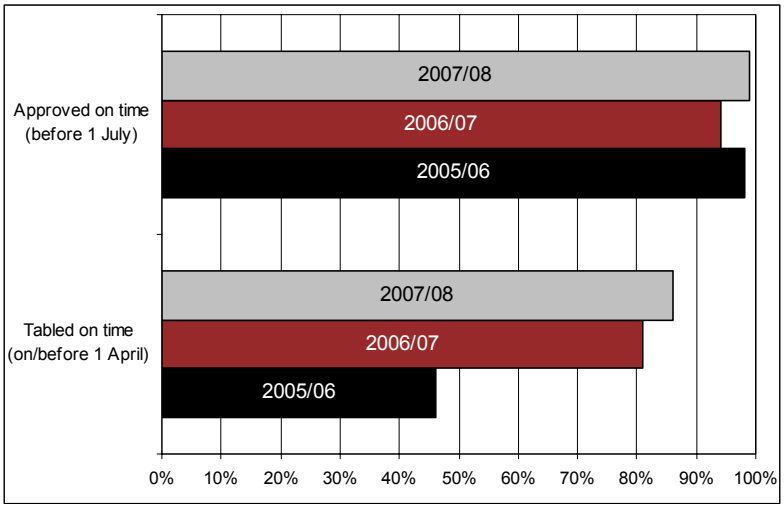
- meeting deadlines for tabling and approving budgets
- establishing a strategic orientation in budgeting
- the credibility of approved budgets relative to actual expenditures.

Meeting deadlines for tabling and approving budgets

The deadlines set out in the MFMA for tabling and approving budgets are minimum requirements

The deadlines set out in the MFMA for tabling and approving budgets are minimum requirements designed to improve planning and consultation processes. The budget must be tabled for consultation at least 90 days (31 March) before the start of the financial year (1 July). It must be considered for approval at least 30 days (31 May) before the start of that year. Finally, it must be approved before the start of the financial year (1 July).

Figure 11.3 Municipalities that tabled and approved budgets on time, 2005/06 – 2007/08



Source: MFMA Research Unit – annual submission of budget survey

Figure 11.3 shows that since 2005/06 there has been a steady improvement in municipalities tabling and approving budgets on time. Despite this, in 2007/08 there were still 40 municipalities that were unable to meet the budget tabling deadlines, resulting in shortened community consultation processes.

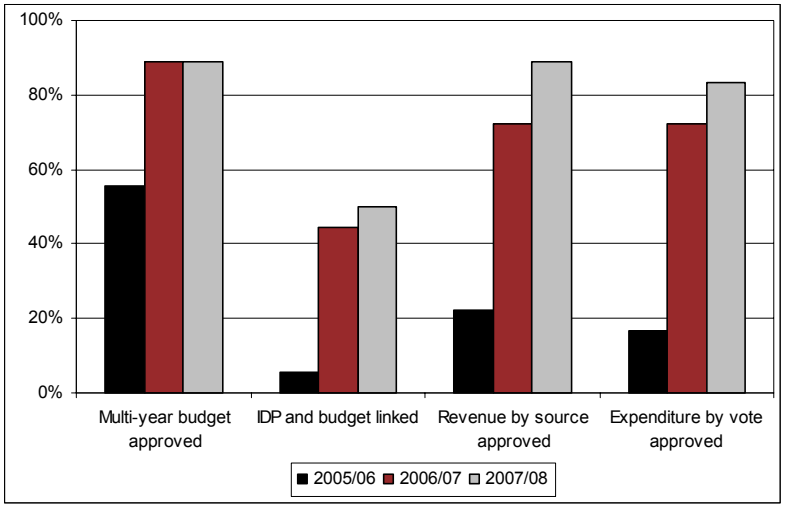
In 2007/08 there were still 40 municipalities that were unable to meet budget tabling deadlines

Establishing a strategic orientation in budgeting

The MFMA requires that municipalities produce multi-year budgets so as to facilitate the consideration of the medium-term implications of expenditure decisions, respond to community needs over time and integrate financial planning with their integrated development planning activities. New budget formats assist this process by requiring that budget information be presented by revenue source and by functional area (or vote). Figure 11.4 shows that there have been significant improvements in the strategic orientation of municipal budgeting in the largest 17 municipalities since the introduction of the MFMA.

The MFMA requires that municipalities produce multi-year budgets

Figure 11.4 Percentage of 17 non-delegated municipalities complying with key budget reforms, 2005/06 – 2007/08



Source: MFMA Research Unit – annual submission of budget survey

Provincial treasuries are currently ascertaining the extent of progress in establishing a strategic orientation to budgeting beyond these 17 municipalities. This work should also include a detailed independent assessment of municipal budgets.

The credibility of budgets relative to actual expenditures

Judging whether a budget is credible is a complex task. A simple but conservative measure has been used here. It compares the original budget to the estimated actual outcomes reported at the end of the financial year for capital and operating expenditures and operating revenues. If the variance is greater than 20 per cent, the original budget is deemed not to have been credible.

A large percentage of municipal budgets tabled are not credible

Based on this analysis, a large percentage of municipal budgets tabled on or before 1 April each year are not credible. Most often they are not properly funded and are treated as unbalanced drafts requiring the council to make decisions to "balance the budget". The MFMA requires that a tabled budget must be capable of being implemented without alteration so to ensure that proper consultation can take place.

Table 11.1 shows that the primary area of weakness is in municipalities' capital budgets. This indicates that municipalities are failing to honour most of their capital investment commitments. Internal factors contributing to this problem include poor project planning for financing capital/infrastructure and slow progress with implementing supply chain reforms at the municipal level. It is clear that many municipalities lack capital budget forecasting capacity and single-year appropriations for capital expenditure projects are still commonplace. External factors include delayed notification of grants from national and provincial departments. The annual Division of Revenue Act has introduced measures to improve the predictability of transfers, particularly the requirement that each transferring department publish a multi-year schedule of transfers for each municipality. However, similar reforms in provinces and district municipalities have not yet been adequately implemented.

Table 11.1 also shows that the credibility of budgeted operating expenditures and revenues is considerably higher than for capital expenditure. However, it is clear that there still needs to be a significant focus on assisting municipalities to develop credible budgets. Further reforms to municipal budget formats and contents are intended to assist in this regard. These reforms are at an advanced stage and are being piloted in selected municipalities.

Table 11.1 Credibility of municipal budgets, 2005/06 – 2007/08

Capacity	2005/06	2006/07	2007/08
Credibility of budgets for capital expenditure[1]			
High	54%	52%	66%
Medium	27%	37%	36%
Low	21%	33%	45%
Total	29%	38%	45%
Credibility of budgets for operating expenditure[2]			
High	84%	86%	84%
Medium	66%	69%	72%
Low	63%	58%	63%
Total	68%	67%	70%
Credibility of budgets for operating revenue[3]			
High	84%	86%	88%
Medium	70%	73%	73%
Low	68%	69%	68%
Total	72%	73%	73%

1. Based on responses from 83 municipalities in 2005/06, 107 municipalities in 2006/07 and 128 municipalities in 2007/08
2. Based on responses from 192 municipalities in 2005/06, 190 municipalities in 2006/07 and 199 municipalities in 2007/08
3. Based on responses from 203 municipalities in 2005/06, 208 municipalities in 2006/07 and 208 municipalities in 2007/08.
Source: MFMA Research Unit - survey

Strengthening oversight through improved transparency and reporting practices

The MFMA requires municipalities to report regularly on performance

The system of reporting in the MFMA assists in making available useful and regular internal and external information on municipal financial performance. Provided the information is accurate and reliable, this strengthens decision-making processes and improves oversight by managers and council.

The reports on the implementation of the budget and the SDBIP required by the MFMA include monthly and quarterly budget statements, half-yearly performance assessment, annual financial statements, annual reports and oversight reports.

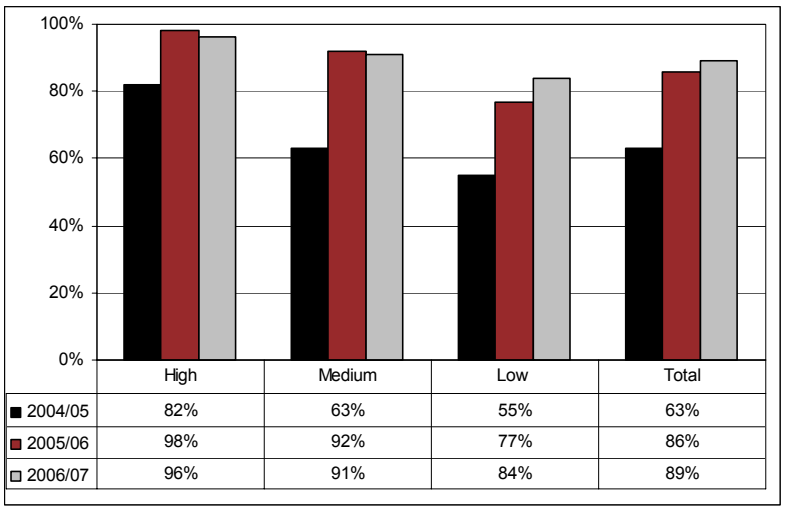
As noted, the implementation of the MFMA was a phased process, so for instance, municipalities with low capacity were not required to produce annual reports until the 2006/07 financial year and in 2004 these municipalities were given an additional month to submit their annual financial statements to the Auditor-General.

In-year monitoring and reporting

The mayor must table monthly budget statements to the council on a quarterly basis

Section 71 of the MFMA requires the accounting officer to submit monthly budget statements to the mayor, who must table these in council on a quarterly basis. Monitoring the implementation of the budget is a key responsibility of the mayor and should ensure that financial problems that a municipality may face are identified early. The council exercises oversight over budget implementation through the quarterly statements tabled by the mayor.

Figure 11.5 In-year reporting by municipalities in terms of section 71 of the MFMA, 2004/05 – 2006/07



	High	Medium	Low	Total
2004/05	82%	63%	55%	63%
2005/06	98%	92%	77%	86%
2006/07	96%	91%	84%	89%

Source: National Treasury local government database

While the timely submission of section 71 reports by accounting officers to the mayor shows an upward trend overall, most of this occurred between 2004/05 and 2005/06, as Figure 11.5 shows. An analysis based on municipality capacity shows that high and medium capacity municipalities experienced a decline in section 71 reporting

between 2005/06 and 2006/07. This decline coincides with the 2006 elections period and so could be linked to the instability in management arrangements at the time.

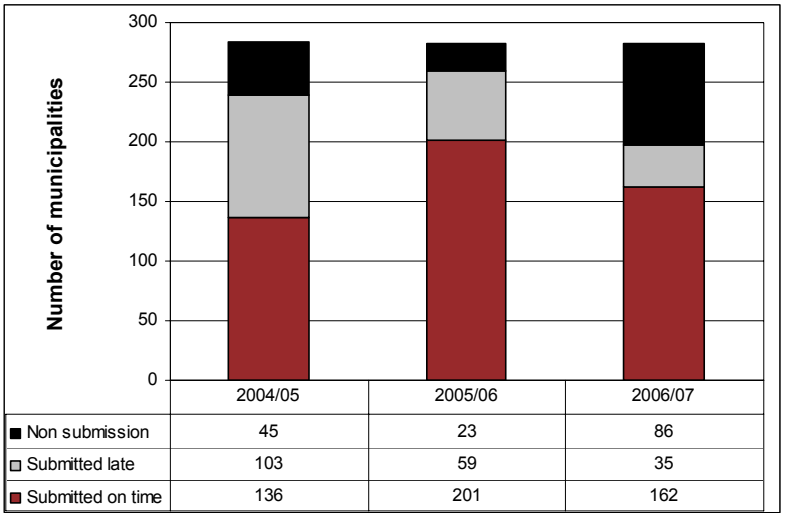
Annual financial statements

The annual financial statements are the most important record of the financial status of a municipality and municipal entity

The annual financial statements are the most important record of the financial status of a municipality and municipal entity. Every municipality and municipal entity must prepare annual financial statements for each financial year and submit it to the Auditor-General for auditing no later than 31 August of each year. In the case of a municipality with municipal entities, the municipality is also required to submit consolidated annual financial statements to the Auditor-General no later than 30 September of each year.

Figure 11.6 shows the extent of compliance with the timeliness for submissions six months after the close of the financial year. The figure shows that the number of municipalities that have not submitted their annual financial statements by January 2008 increased, relative to past years. This reflects a concerning decline in performance.

Figure 11.6 Timely submission of annual financial statements to the Auditor-General by 31 December of each year, 2004/05 – 2006/07



	2004/05	2005/06	2006/07
Non submission	45	23	86
Submitted late	103	59	35
Submitted on time	136	201	162

Source: Report of the Auditor-General on submission of AFS by municipalities, Status of audit reports as at 31 December 2005 for 30 June 2005 and Report on 2004/05 and 2005/06 AFS and Consolidated AFS for municipalities to the Auditor-General as at 31 December 2006 and 2006/07 research undertaken by MFMA Implementation Unit

The MFMA requires high capacity municipalities consolidate their annual financial statements submission with those of municipal entities

The MFMA also requires that, from 2005/06 onwards, high capacity municipalities consolidate their annual financial statements submission with those of their municipal entities. According to information provided by municipalities, of the 35 municipalities with entities, only 8 submitted their consolidated annual financial statements on time, 1 submitted late and the other 26 municipalities did not address the question at all. These discrepancies have been communicated to the Auditor-General, as they paint a worrying

picture of financial management practices in relation to municipal entities in particular.

Continued pressure needs to be placed on municipalities that fail, or whose municipal entities fail, to submit their annual financial statements on time. Municipal councils should take action against managers who persistently do not comply with the legal requirements.

Annual reporting

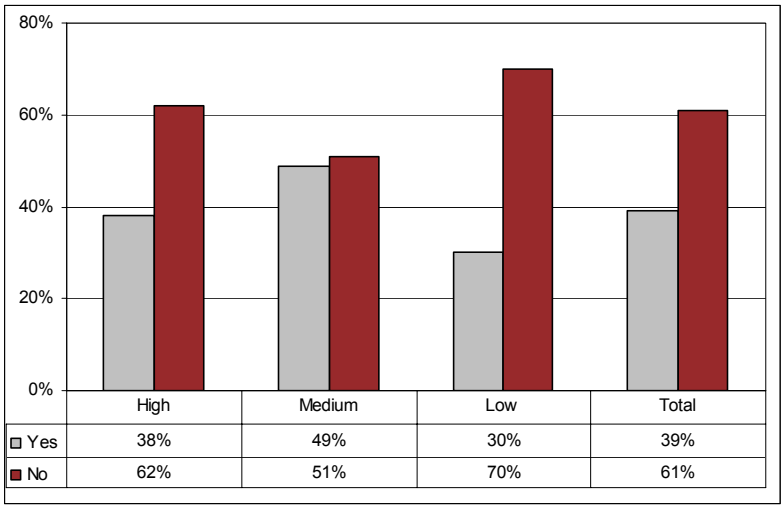
The MFMA requires that every municipality and municipal entity must prepare an annual report for each financial year.

The annual report is the key instrument of transparent governance and accountability

The annual report is the key instrument of transparent governance and accountability and must be used to measure performance for the year. The early completion and submission of annual reports, together with the annual financial statements will facilitate timely and improved information for oversight bodies. Oversight of the annual report represents the final stage in the accountability cycle.

Once approved by the council, the annual report must be placed on the municipal website, made available to the wider community and copies must be sent to various authorities. Figure 11.7 shows municipalities' compliance in tabling annual reports for 2005/06 on time.

Figure 11.7 Tabling of 2005/06 municipal annual reports to council by 31 January 2007



	High	Medium	Low	Total
Yes	38%	49%	30%	39%
No	62%	51%	70%	61%

Source: National Treasury local government database

There was a poor outcome in meeting timelines for tabling the 2005/06 annual report

The poor outcome in meeting timelines for tabling the 2005/06 annual report by municipalities and their entities is disappointing. The general explanation provided by municipalities for non-compliance with tabling annual reports by 31 January, was that audit opinions had not been received from the Auditor-General. Municipalities have been advised to submit their annual reports on time, accompanied by the annual financial statements submitted for audit, pending the audit outcome.

Types of audit opinions expressed by the Auditor-General

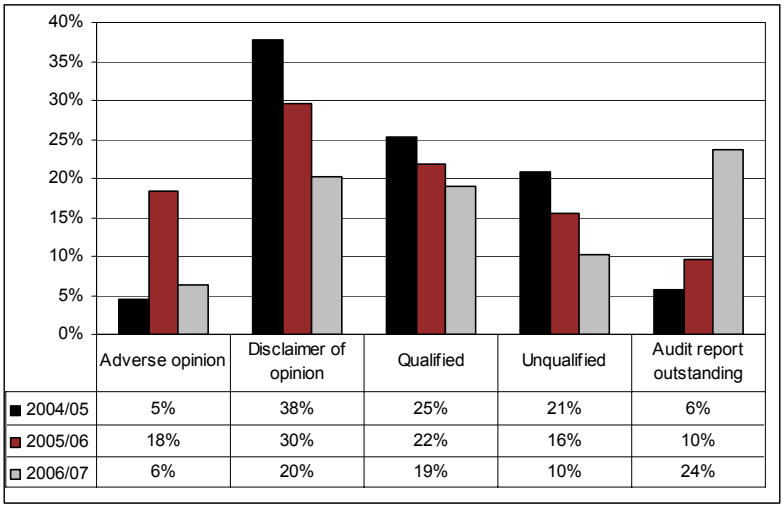
The Auditor-General may express one of four opinions in relation to the annual financial statements, namely unqualified, qualified, disclaimed or adverse. The definitions of the four opinions are:

- ***Unqualified opinion:*** This opinion represents a "clean bill of health" where the annual financial statements are regarded by the Auditor-General as fairly representing the financial status of the municipality or its entity and may include minor issues to be addressed by the accounting officer. This is the best outcome.
- ***Qualified opinion:*** The Auditor-General will issue this type of report when faced with material exceptions to any of the conditions required for issuance of an unqualified report. A qualified opinion is basically a negative opinion. This opinion asserts that the annual financial statements, viewed as a whole, are not misleading. Thus the problems, while material, must not overshadow the overall fairness of the statement.
- ***Disclaimer opinion:*** A disclaimer of opinion means that due to significant scope restrictions (or to major uncertainties) the Auditor-General was unable to form an opinion on the fairness of the financial statements. It means that the Auditor-General does not have an adequate basis for expressing an opinion. This constitutes evidence of financial problems that may require intervention in terms of the MFMA.
- ***Adverse opinion:*** This is a negative opinion, asserting that the annual financial statements are not a fair presentation. Auditors will issue an adverse opinion when the deficiencies in the financial statements are so significant that a qualified opinion would be inappropriate. This also constitutes evidence of financial problems that may require intervention in terms of the MFMA.

Audit opinions issued by the Auditor-General

The Auditor-General's opinion is the most important part of the auditor's report provided to the municipality. The audit opinion results from an independent and often extensive verification process of the annual financial statements and information supporting the annual financial statements.

Figure 11.8 Audit opinions for all provinces, 2004/05 – 2006/07 (expressed as an average)



	Adverse opinion	Disclaimer of opinion	Qualified	Unqualified	Audit report outstanding
2004/05	5%	38%	25%	21%	6%
2005/06	18%	30%	22%	16%	10%
2006/07	6%	20%	19%	10%	24%

Source: MFMA Research Unit
Note: The information on audit outcomes for municipalities is being regularly updated, since the Auditor-General has prioritised the finalisation of outstanding municipal audits. Therefore, information for all 283 municipalities is not used in this analysis. The graph shows a cross-section of municipalities from the nine provinces, covering 269 municipalities for 2004/05, 272 for 2005/06 and 224 for 2006/07.

The extent of the audit qualifications should serve as a reminder of the challenges ahead. On average, 44 per cent of municipalities received an adverse or disclaimed audit opinion for 2004/05, 2005/06 and 2006/07 for those that have received an outcome.

These poor audit outcomes indicate that fundamental principles of good governance, transparency, the accountable use of public resources and ongoing performance improvements, are being severely compromised.

The most common weaknesses requiring attention are in management and accounting skills, shortcomings in operational financial management, lack of internal controls and collection of revenue. For example, during 2006/07, municipalities were requested to indicate whether consultants had been engaged to prepare annual financial statements, either entirely or jointly with municipal officials. Of the 164 municipalities that responded, over one third indicated that they had engaged consultants to prepare the entire annual financial statements for 2006/07.

Internal audit and audit committees

The municipality and each of its municipal entities must have an internal audit unit and an audit committee

In terms of the MFMA, the municipality and each of its municipal entities must have an internal audit unit and an audit committee which must prepare a risk-based audit plan and internal audit programme for each financial year.

The establishment of internal audit units and audit committees are issues that National Treasury is currently monitoring. By 2006/07, 204 municipalities had established an internal audit unit and 172 had established audit committees.

More municipalities are able to comply with establishing an internal audit unit than an audit committee. This can partly be ascribed to the unavailability of appropriately skilled members to serve on the audit committees of the more remote municipalities. Where municipalities are experiencing scarce skills, they have been advised to share the committee structures within a district, if possible.

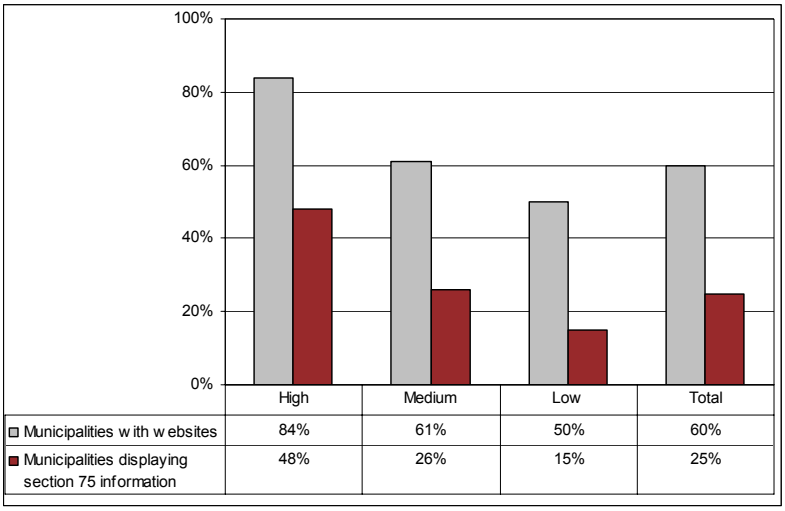
Information for public participation and disclosure on municipal performance

A municipal website should be an integral part of a municipality's communication infrastructure and strategy

A municipal website should be an integral part of a municipality's communication infrastructure and strategy. If managed effectively, it allows easy access to relevant information, serves as a tool for community participation, improves stakeholder involvement and facilitates stakeholder monitoring and evaluation of municipal performance. Section 75 of the MFMA requires that the municipalities place key documents and information on their website, including the IDP, the annual budget, adjustments budgets and budget related documents and policies.

Figure 11.9 shows that 60 per cent of municipalities have established websites, but that only 25 per cent of them actually show all the information on their websites required in terms of section 75. Municipalities have been encouraged to utilise the funding support for the financial reforms to fund these facilities.

Figure 11.9 Municipalities with websites, 2006/07



	High	Medium	Low	Total
Municipalities with websites	84%	61%	50%	60%
Municipalities displaying section 75 information	48%	26%	15%	25%

Source: National Treasury local government database

A broad-based strategy to encourage all municipalities to establish websites is necessary, as this is one of the most powerful tools they can use to facilitate investments, assist in community participation, offer easy access to information and improve transparency.

Strengthening the regulatory environment for municipal financial management

The key reforms focussed on strengthening the regulatory environment for municipal financial management deal with:

- supply chain management
- oversight of municipal entities
- interventions in municipalities

Supply chain management

Municipalities need to have well run supply chain management operations that widen the supplier base, improve local economic development and provide scope for equitable resource allocations.

A new supply chain management system was introduced for municipalities and municipal entities during 2005 and 2006

A new supply chain management system was introduced for municipalities and municipal entities during 2005 and 2006. They were assisted with the development of appropriate policies, plans and processes; setting up structures for clear roles and responsibilities; and key threshold values. This was supported by sample bid documentation, a procurement manual and training for bid committee members.

Table 11.2 shows the extent to which the supply chain management reforms are being implemented. Note that this table only covers 111 (or 39 per cent) of municipalities. The remaining ones did not respond to National Treasury's research survey.

Table 11.2 Responses to key SCM implementation indicators

	High capacity				Medium capacity				Low capacity			
Question asked	Yes	%	No	%	Yes	%	No	%	Yes	%	No	%
Adoption of SCM policy by the Council	21	*91%*	2	*9%*	34	*85%*	6	*15%*	47	*98%*	1	*2%*
Delegation of SCM roles and responsibilities (in writing)	18	*78%*	5	*22%*	21	*53%*	19	*47%*	29	*60%*	19	*40%*
Development of a SCM procedure manual	15	*65%*	8	*35%*	18	*45%*	22	*55%*	20	*42%*	28	*58%*
Bid Committee membership	21	*91%*	2	*9%*	31	*78%*	9	*22%*	40	*83%*	8	*17%*
Training of SCM practitioners	11	*48%*	12	*52%*	34	*85%*	6	*15%*	34	*71%*	14	*29%*

Source: National Treasury SCM Unit

The relatively high level of compliance probably reflects the fact that only those municipalities that have made progress with the supply chain management reforms responded to the questionnaire. Nevertheless, it is evidence that the model supply chain management policy issued in support of the framework, assisted in the implementation of the policy.

However, challenges remain in practitioners' understanding and capacity to effectively plan their internal processes to expedite supply chain outcomes. A concerted effort to train supply chain management practitioners started during 2006 and 2007, when over 4 500 officials were trained. Furthermore, a formal qualification supporting supply chain management is being prepared for rollout during 2008.

Oversight of municipal entities

Municipalities are required to report to National Treasury on all municipal entities, including those in existence before the new regulatory framework provided by the MFMA and the Municipal Systems Act (2000) (MSA) came into effect.

In February 2007, a total of 95 municipal entities were reported on

In February 2007, a total of 95 municipal entities were reported on, of which 45 were in Gauteng, 16 in the Eastern Cape and 15 in KwaZulu-Natal.

The effect of the change in the legal framework in 2003 has resulted in an extensive review of existing entities by most municipalities and it is envisaged that in the reporting periods that follow the total numbers will fall.

Intervention in municipalities

The MFMA provides for intervention in municipalities that are experiencing persistent financial problems

The MFMA provides for intervention by national and provincial departments in municipalities that are experiencing persistent financial problems. These problems are often manifested as financial emergencies and result from weak financial management and poor practices.

The municipal finance recovery service was established in National Treasury in August 2007. Its function is to:

- provide guidance to other departments
- prepare the financial recovery plan on request by municipalities and government departments
- monitor the implementation of the recovery plans
- assist in identifying the causes and provide potential solutions to the financial problems, in co-ordination with any other provincial or national efforts
- collect information on municipal financial problems
- give guidance on the best approaches to address these challenges.

Research into recent interventions shows that for the period 2004 to 2007, there have been 34 interventions in municipalities, of which 13 show early signs of good progress. Results were mixed for the remaining 21 municipalities receiving attention, for a variety of reasons. Interventions tend to focus on budgets, revenue collection, cash flow management, internal controls, improvement to internal reporting and timely decision-making, strengthening governance and oversight and developing operational skills to execute daily tasks. Informed by the research and the outcomes of visits to municipalities, a guide in support of future interventions is being prepared.

Institutional strengthening and capacity building

There is a general lack of the technical skills and knowledge necessary for performing key duties in financial management from an operational perspective. This is seen as a major constraint and one of the biggest challenges facing municipalities. These technical skills include planning, engineering, project management and plant operating. Inadequate capacity at the senior management level and a lack of appropriate financial management skills in municipalities results in poor service delivery. Furthermore, a high turnover of senior management in municipalities is a major issue affecting municipalities' ability to expand and improve service delivery.

The financial management support programme has been providing support to municipalities since 2003

The financial management support programme for municipalities has been providing support for local government financial management reforms since 2003. It was targeted at the larger municipalities, which had greater capacity to implement the reforms as they were phased in.

The programme operates through the provision of grants and technical advisors to municipalities to assist in implementing the MFMA. A quarterly MFMA co-ordination committee, representing national and provincial departments and SALGA, was established in 2004, to receive updates on progress in implementing the financial reforms and assist in addressing challenges in a coherent and sustainable way.

Specific programmes to build financial management capacity include:

- the finance management grant (FMG)

- financial advisors through the municipal financial management technical assistance programme (MFMTAP)
- the municipal finance management intern programme (MFMIP).

Finance management grant

Direct financial assistance has been provided to municipalities in the form of the finance management grant (FMG). The main objective is to assist in the rollout of financial management reforms embodied in the MFMA through building capacity in financial management.

Initially the primary focus of the programme was the metros and the 21 secondary cities. Support was also provided to smaller municipalities and districts to ensure a cross-section of types of issues and capacities and to cover all provinces.

Since 2005, greater attention has been paid to expanding the reform programme to smaller municipalities

Since 2005, greater attention has been paid to expanding the reform programme to smaller municipalities and specifically those municipalities in areas of extreme poverty and where institutional capacity is lowest. From July 2006, all 283 municipalities received funding to support the implementation of basic aspects of the MFMA and to employ graduate financial management interns with the view to offering them permanent opportunities once their internship has been completed.

Finance management technical assistance programme

The finance management technical assistance programme, which ran from 2003 to 2008, helped to accelerate the implementation of reforms by placing international municipal finance experts in selected municipalities, in some cases for up to five years. Programme advisors have worked hand-in-hand with councillors, municipal managers, chief financial officers and financial management staff to progressively implement the priority reforms in the MFMA. Under this programme 41 municipalities were provided with technical assistance in implementing reforms. This programme closed in May 2008.

Municipal finance management internship programme

The municipal finance management internship programme (MFMIP) started in 2005. It is designed to provide graduates in the fields of accounting, economics and finance with well structured training and work experience in all aspects of municipal financial management. The average cost per intern, for the two-year period, amounts to around R215 000.

The goal is for each municipality to appoint a minimum of 2 interns. Table 11.3 shows the current participation rate split per capacity of municipality.

Table 11.3 Municipal participation in the internship programme

Capacity	Number of municipalities	Municipalities with one intern		Municipalities with two or more interns		Average interns per municipality
		Number	%	Number	%	
High	50	7	14.0%	37	74.0%	2.5
Medium	107	16	15.0%	71	66.4%	1.3
Low	126	26	20.6%	65	51.6%	1.7
All	**283**	**49**	**17.3%**	**173**	**61.1%**	**2.0**

Source: MFMA Research Unit - survey

Once interns have completed their internships, it is hoped that most of them will be employed by municipalities

Once interns have completed their internships, it is hoped that most of them will be employed by municipalities thus improving financial management capacity in local government. To review the retention of interns in the local government a survey was conducted to trace the movement of interns whose contracts had ended. A total of 94 internships have ended so far. Of these, 54 were employed on a permanent basis either by their municipality or another municipality. This number could be higher as some of the 22 interns could not be traced. Of the remaining 15 interns, 3 remained in the public sector, while 12 were employed in the private sector.

A review of the financial management support programme for municipalities is currently under way and preliminary findings suggest that more of this kind of assistance would be useful.

The scaling-up of support for weaker municipalities will be very closely linked to ensuring capacity grows as support resources are increased. For example, key finance positions needed to implement the reforms under the MFMA must be filled before additional support is initiated. This is to ensure that resources are available to undertake effective learning and skills development.

Conclusion

A firm foundation of financial management systems and capacity is key to the successful implementation of infrastructure programmes, service delivery expansion efforts, improvements in the level, reliability and frequency of services. It is therefore absolutely critical that the correct skills, mindset and expertise are located at the right place to implement the duties required for the modernisation of the local government sphere. If this is not in place, then there are likely to be more interventions in municipalities to address such weaknesses, before any changes for the better become evident.

Further measures will have to be considered as to how best to enforce compliance with the legal framework and to build on the key principles espoused to promote good governance, public accountability and transparency in the use of public resources. A combination of measures, such as withholding transfers, implementation of the code of conduct for municipal councillors and officials, withholding performance bonuses when service delivery fails will need to be introduced.

12

Managing municipal personnel

Introduction

Municipal expenditure on personnel comprises 30 per cent of operating expenditure

Municipal expenditure on personnel comprises 30 per cent of aggregated operational expenditure by municipalities. Levels of municipal employment have declined, while vacancy rates and the average cost of employment have risen. However, there exist divergent employment and personnel expenditure trends within and between the different categories of municipalities that are masked by the aggregate figures.

Municipal employees and the skills they bring to the workplace are a critical input in the delivery of all services a municipality delivers. The objective of managing municipal personnel is therefore not necessarily to minimise the "wage bill", but rather to ensure that people with the required skills are recruited, retained and appropriately deployed.

Generally, expenditure on personnel is notoriously difficult to restructure, even over the medium-term. Therefore any interventions aimed at changing the way a municipality manages its employees and allocates its personnel budget, need to be thoroughly thought through, as such interventions typically have long-term impacts on municipal finances, delivery and the livelihoods of individuals and households.

A key issue that this chapter explores is the link between the observed trends in employment, personnel expenditure numbers and the choices municipal managers are making in relation to the adoption of labour intensive versus capital intensive approaches to delivering services.

It is common knowledge that municipal services differ widely in terms of their skills and labour intensity. Some, by nature, require high-level skills, such as planning, others are skills and capital intensive, such as

electricity and water distribution and others are labour intensive such as waste removal. However, in many instances municipalities can choose whether to use more capital intensive or more labour intensive technologies to perform a particular activity or deliver a particular service. It is important to know which way these decisions are going and why.

Municipalities contribute directly to economic growth by providing a range of essential services

Municipalities contribute directly to economic growth by providing a range of essential services to households, commercial enterprises, industries and institutions, such as schools and hospitals. Municipalities can increase their contribution to economic growth by improving the reliability, quality and efficiency of these services. This involves getting the overall mix between expenditure on personnel and other inputs right. It also means getting the skills mix right – an appropriate balance between managers, technical personnel and others, with vacancies kept to a minimum. Finally, it involves increasing productivity to reduce the unit cost of municipal services.

By providing indigent households with access to free or subsidised services, municipalities contribute directly to alleviating poverty. However, where municipalities choose to use labour intensive approaches their contribution to combating poverty is even greater. By extending formal and temporary employment opportunities, particularly to those with limited skills, municipalities are, in essence, providing people with fishing rods and not just fish.

This chapter gives an overview of:

- the various trends local government employment
- the implications for local government's role in fostering economic growth and combating poverty and efforts to strengthen financial management capacity
- employment data and personnel expenditure trends across municipalities and their various functions
- the factors that influence the contribution of municipalities to job creation.
- the progress towards the establishment of a single public service.

Trends in local government employment

In 2006, overall, municipalities employed some 200 000 people and contributed 1.6 per cent to employment (official definition). In the 70 mostly rural municipalities, municipal employment contributed only 0.7 per cent to employment. This is substantially less than in the metros, secondary cities and towns.

Overall municipalities' contribution to employment is relatively modest

Overall, it is evident that municipalities' contribution to employment is relatively modest and is significantly greater in the metros than in rural areas. This would seem to contradict the received wisdom that in small towns and rural areas municipalities are the primary employers. These trends are shown in table 12.1.

Table 12.1 Local government's contribution to employment in South Africa by category of municipality, 2006

Category	Employment (official definition)	Local government employment (2006)	Percentage of total employment
Number			
Category A (Metros)	5 764 855	100 203	*1.7%*
Category B (Locals)	6 573 875	93 305	*1.4%*
Secondary cities - 21	*2 372 824*	*35 309*	*1.5%*
Towns - 140	*2 530 086*	*46 113*	*1.8%*
Mostly rural - 70	*1 670 965*	*11 883*	*0.7%*
Category C (Districts)	25 536	10 226	
Category B + C	*6 599 411*	*103 531*	*1.6%*

Source: Stats SA, Non-financial census of municipalities for the year ended 30 June 2006, (P9115 - 2007)

The provincial data shows significant disparities

The provincial data shows significant disparities. In Limpopo there is only one municipal job for every hundred formal sector jobs. By contrast there are two and a half times more municipal jobs per hundred formal sector jobs in Northern Cape. Municipal jobs are also twice as prevalent in Eastern Cape and Western Cape, compared to Limpopo.

Table 12.2 Local government's contribution to employment in South Africa by province, 2006

Province	Employment (official definition)	Local government employment (2006)	Percentage of total employment
Number			
Eastern Cape	1 108 460	23 624	*2.1%*
Free State	710 963	12 039	*1.7%*
Gauteng	3 691 722	61 064	*1.7%*
KwaZulu-Natal	2 185 477	33 486	*1.5%*
Limpopo	818 818	8 237	*1.0%*
Mpumalanga	886 506	10 678	*1.2%*
Northern Cape	269 000	6 779	*2.5%*
North West	783 596	10 898	*1.4%*
Western Cape	1 909 724	36 929	*1.9%*
Total	**12 364 266**	**203 734**	***1.6%***

Source: Stats SA, Non-financial census of municipalities for the year ended 30 June 2006, (P9115 - 2007)

Indeed, municipalities' contribution to formal employment is far more limited in Limpopo, Mpumalanga and North West than in other parts of the country. It would seem that these trends reflect the historical under-development of local government in the former Transvaal and to a lesser extent the rural areas of KwaZulu-Natal. It is anticipated that as municipalities in these areas mature, the number of people they employ will need to increase substantially.

Growth in local government employment

Previous chapters have indicated that spending by municipalities has increased significantly over the past five years. To what extent has this translated into municipalities expanding their operations? Has there

been commensurate growth in municipal employment? Or is the increased expenditure being used to increase salaries of existing staff, rather than expand employment? Unfortunately, a consistent dataset tracking municipal employment over the last five years is not available. Nevertheless, table 12.3 shows changes in municipal employment numbers between 2005 and 2006. Over this period, the increases in municipal spending have not translated into increased employment. Table 12.3 shows that employment has decreased, while the average cost of employment is in fact increasing.

Table 12.3 Total employment in local government by category and by metro, 2005 and 2006

Number	2005 Total employment	2006 Total employment	Jobs gained (+) and lost (-)
By category of municipality			
Category A (Metros)	101 774	100 203	-1 571
Category B (Locals)	95 474	93 305	-2 169
Secondary cities - 21	*34 765*	*35 309*	*544*
Towns - 140	*44 455*	*46 113*	*1 658*
Mostly rural - 70	*16 254*	*11 883*	*-4 371*
Category C (Districts)	9 018	10 226	1 208
Category B + C	*104 492*	*103 531*	*-961*
Total	**206 266**	**203 734**	**-2 532**
By metro			
City of Cape Town	23 605	22 322	-1 283
City of Johannesburg	25 340	26 274	934
City of Tshwane	13 643	12 297	-1 346
Ekurhuleni	14 065	14 688	623
eThekwini[1]	18 067	18 067	–
Nelson Mandela Bay	7 054	6 555	-499
Total	**78 169**	**77 881**	**-288**

1. The 2005 data for eThekwini was incomplete and so has been replaced with the 2006 data.

Source: Stats SA, Non-financial census of municipalities for the year ended 30 June 2006, (P9115 - 2007)

Some job losses can be attributed to increasing mechanisation of service delivery systems

Overall, 2 532 fewer people were employed by municipalities in 2006 than in 2005. This is a decrease of some 1.2 per cent, which is somewhat surprising since it would have been expected that municipal employment should increase in response to the demand for services. Some of the job losses can probably be attributed to increasing mechanisation of service delivery systems – a trend which is discussed in greater detail below.

Employment by category B municipalities shows a decline of 2 169 employees or 2.3 per cent between 2005 and 2006, while in the 70 mostly rural municipalities there is a decline in employment of 4 371 or nearly 27 per cent. In the case of the mostly rural municipalities, part of the decline can probably be attributed to incomplete reporting. Nevertheless, the sheer magnitude is indicative of the fact that these municipalities are experiencing serious difficulties in retaining personnel.

The number of employees employed by the City of Tshwane declined by 1 346 or nearly 10 per cent between 2005 and 2006. Nelson Mandela Bay's workforce declined by 7.1 per cent and the City of

Cape Town's by 5.4 per cent between 2005 and 2006. It is possible that part of these reductions in employment among the metros can be attributed to ongoing programmes to rationalise organisational structures following the amalgamation of municipalities in the demarcation process in 2000. However, it is more likely that what appears as a reduction in employment among metros reflects a shift of employment from municipalities to contractors as a consequence of outsourcing. This issue needs to be addressed when collecting data on municipal employment in future.

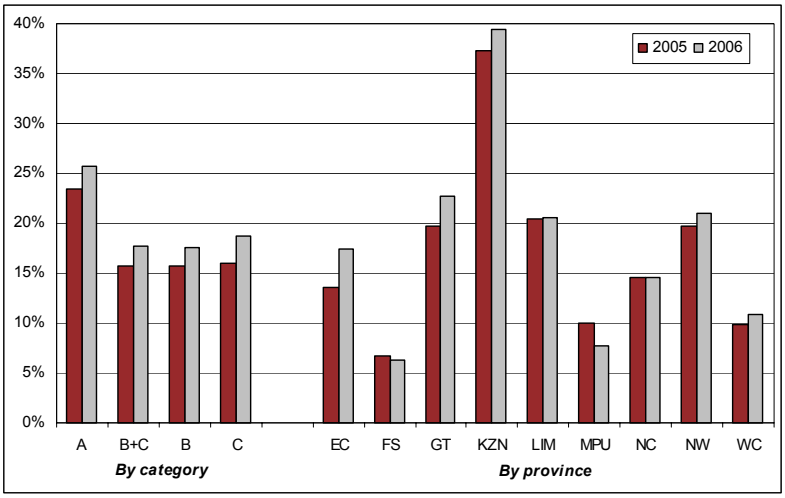
Vacancies in local government

Very high vacancy rates in local government

"Lack of capacity" is one of the perennial explanations for shortcomings in municipal service delivery. Core to this capacity problem are the very high vacancy rates in local government, which are aggravated by the job losses noted above.

Unsurprisingly therefore, figure 12.1 shows that the percentage of vacancies in local government increased virtually across the board between 2005 and 2006.

Figure 12.1 Vacant local government positions, 2005 and 2006



Source: Stats SA, Non-financial census of municipalities for the year ended 30 June 2006, (P9115 - 2007)

In 2005, there were 256 885 positions in local government, of which 50 619 or 19.1 per cent were vacant. In 2006, the number of positions increased to 260 744, of which 57 010 or 21.9 per cent were vacant.

In 2006, the vacancy rate among the metros was above 25 per cent. By contrast, the vacancy rate among category B and C municipalities was 17.7 per cent and among the 70 mostly rural municipalities it was 16.6 per cent. These differences seem to contradict the general view that the smaller municipalities are finding it more difficult to fill vacant positions than the large metros, although this probably still applies to vacancies for skilled personnel.

Figure 12.1 also shows that in 2006, vacancy rates were highest in KwaZulu-Natal at 39.4 per cent, followed by Gauteng at 22.7 per cent, North West at 20.9 per cent and Limpopo at 20.6 per cent. The lowest vacancy rates are in Free State at 6.3 per cent, followed by Mpumalanga and Western Cape. It is not clear what is driving these differences among municipalities located in different provinces. Why, for instance, are vacancy rates among municipalities in Limpopo twice as high as those located in Mpumalanga?

Evaluating vacancy rates in municipalities is a complex task

While the information in figure 12.1 seems to be fairly clear cut, evaluating vacancy rates in municipalities is not that simple. The following table presents employment information for category B and C municipalities, collected by the Municipal Demarcation Board, which highlights some of the difficulties.

First, a vacancy only has meaning in the context of an up-to-date organisational structure that has been approved by its council. Such an organisational structure reflects the number of approved positions that the council deems necessary to deliver the services for which it is responsible. However, in most instances the organisational structures are dated or inadequate. So in 2006,the actual staff requirements of category B and C municipalities may in fact have been far greater than the 134 643 approved positions reflected in table 12.4.

Table 12.4 Vacancies in category B and C municipalities, 2006/07

	2006/07				
Number	Currently employed	Approved positions	Funded vacancies	Unfunded vacancies	Appointments to non-existent positions[1]
By category of municipality					
Category B (Locals)	108 575	120 567	16 875	26 286	31 169
Secondary cities - 21	*52 321*	*51 585*	*7 471*	*15 743*	*23 950*
Towns - 140	*45 212*	*53 021*	*7 602*	*6 898*	*6 691*
Mostly rural - 70	*11 042*	*15 961*	*1 802*	*3 645*	*528*
Category C (Districts)	11 585	14 076	2 920	1 536	1 965
Category B + C	**120 160**	**134 643**	**19 795**	**27 822**	**33 134**
By province					
Eastern Cape	15 158	19 295	2 511	7 531	5 905
Free State	14 244	17 780	3 037	3 766	3 267
Gauteng	7 856	10 317	600	2 213	352
KwaZulu-Natal	17 063	21 236	4 921	4 218	4 966
Limpopo	8 683	12 697	1 373	2 855	214
Mpumalanga	25 820	13 646	2 590	1 813	16 577
Northern Cape	6 106	7 364	864	790	396
North West	10 574	14 666	1 932	2 157	-3
Western Cape	14 656	17 642	1 967	2 479	1 460
Total	**120 160**	**134 643**	**19 795**	**27 822**	**33 134**

1. Calculated as follows: (currently employed + funded vacancies + unfunded vacancies) - approved positions
Source: Municipal Demarcation Board, Capacity assessment report, 2006/07

A municipal council may approve an organisational structure, but invariably may only be able to fund a certain percentage of the positions

Second, a municipal council may approve an organisational structure, but invariably may only be able to fund a certain percentage of the positions. Those positions that are funded but not filled are referred to as funded vacancies, while the remainder are unfunded vacancies. Table 12.4 shows that in aggregate just over 20 per cent of the approved positions in municipalities are unfunded. In Eastern Cape

nearly 40 per cent of approved positions are unfunded, while in Northern Cape about 11 per cent of approved positions are unfunded. The proportion of unfunded positions may indicate either the extent of the resource shortfall faced by a municipality in meeting its service delivery obligations, or that the municipality's organisational structure is too ambitious.

Lastly, table 12.4 indicates that about 28 per cent of municipal employees are appointed to non-existent positions, i.e. positions not reflected on the municipality's organisational structure. The practice appears to be very widespread among municipalities in Mpumalanga, where more than 60 per cent of municipal employees are appointed to positions not reflected on municipal organisational structures. This may explain the relatively low vacancy rate in this province. The practice is also prevalent among municipalities in the Eastern Cape (39 per cent), KwaZulu-Natal (29 per cent) and Free State (23 per cent). This practice may point to problems with municipalities' organisational structures in that they are not aligned to what the municipalities do in practice because they are either out of date, or poorly designed. However, it also reflects non-compliance with the legislation governing the updating of organisational structures and the procedures for making municipal appointments.

When analysing vacancies, one also needs to pay attention to vacancies in key positions within the management structure of a municipality, in positions requiring critical technical skills and other vacancies. This aspect is addressed below.

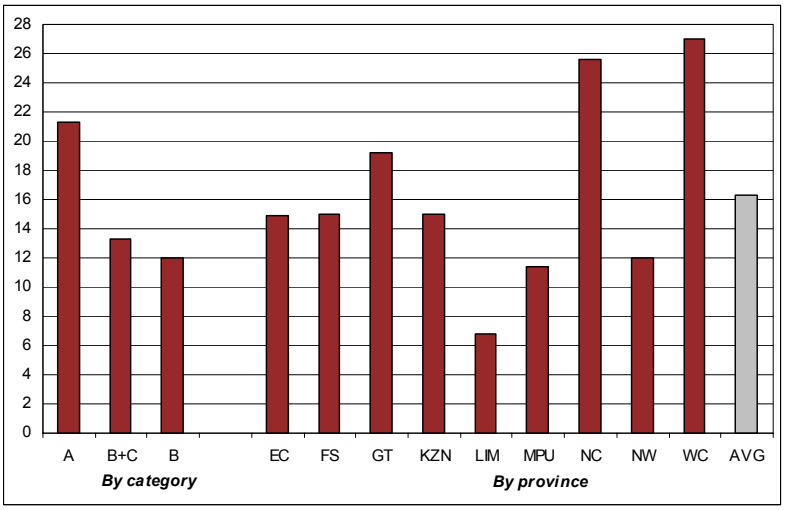
Getting the personnel mix right

A municipality needs sufficient workers and the right skills mix to deliver services effectively

A municipality needs sufficient workers and the right skills mix to deliver services effectively. On the issue of sufficient workers the following figure compares the number of municipal workers per 1 000 households by category of municipality and by province.

Figure 12.2 shows that in the metros there were on average about 21 municipal workers per 1 000 households in 2006, compared to 13 municipal workers per 1 000 households for category B and C municipalities added together. This large difference can probably be attributed to three factors, first, the metros are responsible for a wider range of functions than are the category B and C municipalities combined. For instance, the metros have significant policing responsibilities. Second, managing service delivery in a metro environment is more complicated and therefore requires a wider range of skills and thus more employees. Third and probably most significantly, households are only one of the categories of clients that municipalities serve. Municipalities also deliver services to commercial enterprises, industries and institutions. In the metros these latter clients represent a higher proportion of the client base than in most category B municipalities. The additional personnel required to serve these other clients artificially raise the average number of workers per 1 000 households for the metros.

Figure 12.2 Number of municipal workers per 1 000 households, 2006



Source: Stats SA, Non-financial census of municipalities for the year ended 30 June 2006 (P9115 - 2007)

It would therefore be more useful to compare staffing levels in this way across municipalities with similar functions and similar client profiles. For instance, the City of Cape Town employs nearly 25 workers per 1 000 households, while Ekurhuleni and the City of Tshwane employ just more than 17 workers per 1 000 households. It would require a more detailed analysis than is possible here to understand these differences.

Despite the above caveats, the fact that there are on average only about 7 municipal workers per 1 000 households in Limpopo and about 11 and 12 in Mpumalanga and North West respectively, does suggest that staffing levels among the municipalities in these provinces may be inadequate. This seems to be true, especially, when compared to the 26 and 27 municipal workers per 1 000 households in Northern Cape and Western Cape respectively. The differences between provinces can probably be attributed to the historic under-development of local government structures in the former Transvaal (excluding Gauteng). It also confirms that municipalities in Limpopo, Mpumalanga and North West can be expected to increase the number of staff they employ.

Employment trends in key sectors

Getting the right mix of skills means striking an appropriate balance between managers, technical personnel and others

Getting the right mix of skills means striking an appropriate balance between managers, technical personnel and others, particularly in the key sectors. National Treasury is in the process of gathering municipal employment data to complement the financial information now available. This information will facilitate an analysis of the mix of personnel employed by municipalities. In the meantime the data currently available only allows for an analysis of the distribution of staff and personnel expenditure between sectors.

Table 12.5 shows the percentage of staff employed in key sectors by category of municipality, by metro and by province in 2006.

Table 12.5 Percentage of municipal workers employed in key sectors, 2006

Number	Headcount of municipal workers	Financial adminis-tration	Electricity	Water	Sewerage/ Sanitation	Refuse removal	Other
By category of municipality							
Category A (Metros)	100 203	11.6%	9.1%	8.5%	1.0%	8.7%	61.1%
Category B (Locals)	93 305	15.7%	6.4%	6.2%	6.3%	12.6%	52.9%
Secondary cities - 21	35 309	13.3%	8.0%	6.9%	6.7%	13.1%	52.0%
Towns - 140	46 113	16.7%	6.0%	5.6%	6.6%	12.7%	52.4%
Mostly rural - 70	11 883	18.4%	3.1%	6.6%	3.8%	10.6%	57.4%
Category C (Districts)	*10 226*	25.5%	0.1%	19.6%	1.4%	0.7%	52.7%
Category B + C	*103 531*	*16.6%*	*5.8%*	*7.5%*	*5.8%*	*11.4%*	*52.9%*
Total	**203 734**	**14.1%**	**7.4%**	**8.0%**	**3.5%**	**10.1%**	**56.9%**
By metro							
City of Cape Town	22 322	15.6%	9.1%	9.0%	2.1%	9.8%	54.3%
City of Johannesburg	26 274	7.8%	7.4%	10.1%	0.0%	14.8%	59.9%
City of Tshwane	12 297	17.6%	15.2%	6.4%	0.0%	0.0%	60.9%
Ekurhuleni	14 688	6.5%	6.1%	6.2%	0.8%	6.1%	74.3%
eThekwini	18 067	9.1%	9.5%	9.4%	0.0%	6.9%	65.0%
Nelson Mandela Bay	6 555	19.8%	9.9%	6.3%	6.7%	7.6%	49.6%

Source: Stats SA, Non-financial census of municipalities for the year ended 30 June 2006, (P9115 - 2007) and Community Survey 2007

Nationally, about 32 per cent of municipal staff are directly involved in delivering the key services of electricity, water and sanitation and waste removal

Nationally, about 32 per cent of municipal staff are directly involved in delivering the key services of electricity, water and sanitation and waste removal. A further 14 per cent are involved in financial administration, much of which is closely linked to the effective delivery of these key services. What is interesting is that despite the metros being responsible for a wider range of functions, the percentage of metro staff in these four areas is not significantly lower than among the category B and C municipalities combined. It is, however, notable that among category B municipalities the percentage of staff working on financial administration increases as the size of the municipality decreases. This points to the fact that there are economies of scale in financial administration.

Probably the most noteworthy point emerging from the table 12.5 is the fact that over 25 per cent of the 10 226 staff employed by district municipalities are in financial administration, which at the time would have involved the administration associated with the regional services council levies. It would be important to track what has happened to this staff component since the scrapping of these levies. More broadly, it must certainly raise questions about the institutional efficiency and even the continued relevance of category C municipalities.

Comparing the information on the metros raises interesting questions about their relative efficiency:

- Is Ekurhuleni inherently more efficient than the other metros given that only 26.2 per cent of its staff are involved in delivering the five key functions noted in the table, whereas for the other metros it is between 35 and 50 per cent?
- Why does Nelson Mandela Bay require 19.8 per cent of its staff to perform financial administration while just 7.8 per cent is sufficient for the City of Johannesburg?

- Is outsourcing more efficient than keeping the function in-house? For instance, the City of Tshwane reports that none of its staff are involved in waste removal. Has outsourcing brought substantial job creation and efficiency benefits for the ratepayers of the City of Tshwane relative to say the City of Johannesburg, where nearly 15 per cent of staff work in the refuse removal function?

Answering these types of questions would require a detailed study of the functions and service delivery arrangements across municipalities. Such comparative analysis would certainly be very useful.

It is important to determine whether key functions are adequately staffed

However, given existing service delivery pressures it is probably more important at this stage to determine whether these key functions are adequately staffed. The existing data may point to municipalities where there may be inadequate staffing levels, but to answer the issue definitively requires clear staffing benchmarks for each of the functions, information on the distribution of functions and a detailed analysis of each municipality. Getting clear information on this aspect of capacity needs to be given far more attention than it has received to date.

Filling key positions

The positions of municipal manager and chief financial officer are critical to sound corporate governance and effective management

The positions of municipal manager and chief financial officer are critical to sound corporate governance and the effective management of the municipality. The first priority of every mayor and municipal council should be to ensure that these two critical positions are filled by appropriately qualified officials, who are able to lead the administrative side of the municipality effectively. Chapter 11 discusses trends in the filling of these critical positions.

Section 57 of the Municipal Systems Act (2000) specifies that all managers who report directly to the municipal manager must be subject to an annual performance agreement. These managers are directly responsible for the different service delivery units/ departments within a municipality. Table 12.6 shows information on section 57 manager posts by province.

Table 12.6 Filled and vacant posts for section 57 managers, 2006 and 2007

	September 2006			September 2007		
Section 57 posts	Total posts	Total posts filled	% Vacant posts	Total posts	Total posts filled	% Vacant posts
Eastern Cape	194	173	10.8%	232	205	11.6%
Free State	140	126	10.0%	174	117	32.8%
Gauteng	187	153	18.2%	193	170	11.9%
KwaZulu-Natal	235	197	16.2%	324	293	9.6%
Limpopo	183	175	4.4%	190	145	23.7%
Mpumalanga	121	94	22.3%	121	110	9.1%
Northern Cape	143	105	26.6%	143	105	26.6%
North West	172	144	16.3%	152	125	17.8%
Western Cape	171	151	11.7%	139	117	15.8%
Total	**1 546**	**1 318**	**14.7%**	**1 668**	**1 387**	**16.8%**

Source: Department of Provincial and Local Government, 5YLGSA Provincial Progress Report, October 2007

Between 2006 and 2007 the total number of section 57 manager posts increased from 1 546 to 1 668 posts or by 8 per cent. This is despite the fact that municipalities in Western Cape and North West shed 52 posts between them. Despite their being 122 more posts available, the number of officials appointed to these positions only increased by 69. Consequently the vacancy rate increased from 14.7 per cent in 2006 to 16.8 per cent in 2007. In September 2007 the vacancy rates in these posts were highest in Free State (32.8 per cent), Northern Cape (26.6 per cent) and Limpopo (23.7 per cent). In both Free State and Limpopo new posts were created between 2006 and 2007, but the number of filled posts declined. It is not clear why this happened.

The fact that a position is filled does not necessarily mean the incumbent has the requisite skills

Unfortunately, the fact that a position is filled does not necessarily mean the incumbent has the requisite skills to carry out the responsibilities of the position. The Municipal Demarcation Board conducts detailed capacity assessments of category B and C municipalities on an ongoing basis[1].

On the issue of filling key positions it would be useful to have detailed information on the number of posts on municipal organisational structures requiring specific professional or technical qualifications and how many of these critical posts are vacant.

In the absence of this detailed information, table 12.7 presents information on the total number of positions filled in key sectors and the vacancy rates in these sectors. This information covers professional, technical and ordinary positions.

Table 12.7 Filling positions in key sectors, 2005 and 2006

	2005			2006		
Number	Total positions	Positions filled	Percentage positions vacant	Total positions	Positions filled	Percentage positions vacant
By category of municipality						
Category A (Metros)	132 952	101 774	23.5%	134 948	100 203	25.7%
Financial administration	*13 261*	*11 518*	*13.1%*	*13 858*	*11 617*	*16.2%*
Electricity	*11 272*	*9 310*	*17.4%*	*12 787*	*9 116*	*28.7%*
Water	*8 829*	*6 404*	*27.5%*	*12 992*	*8 471*	*34.8%*
Sewerage/Sanitation	*2 711*	*2 565*	*5.4%*	*1 155*	*1 031*	*10.7%*
Refuse removal	*11 073*	*9 454*	*14.6%*	*10 491*	*8 708*	*17.0%*
Other	*85 806*	*62 523*	*27.1%*	*83 665*	*61 260*	*26.8%*
Category B + C	123 933	104 492	15.7%	125 796	103 531	17.7%
Financial administration	*19 194*	*16 259*	*15.3%*	*19 986*	*17 208*	*13.9%*
Electricity	*7 457*	*6 287*	*15.7%*	*7 286*	*5 974*	*18.0%*
Water	*9 416*	*7 856*	*16.6%*	*9 416*	*7 856*	*16.6%*
Sewerage/Sanitation	*7 972*	*6 722*	*15.7%*	*7 972*	*6 583*	*17.4%*
Refuse removal	*13 514*	*12 106*	*10.4%*	*13 439*	*11 797*	*12.2%*
Other	*66 380*	*55 262*	*16.7%*	*67 697*	*54 113*	*20.1%*
Total	**256 885**	**206 266**	**19.7%**	**260 744**	**203 734**	**21.9%**

Source: Stats SA, Non-financial census of municipalities for the year ended 30 June 2006, (P9115 - 2007)

[1] For further details, readers are referred to the National report on local government capacity: District and local municipalities: 2006/07 which is available on the Municipal Demarcation Board's website, www.demarcation.org.za.

While the vacancy rates in these key sectors are uniformly high, they tend to be lower than the vacancy rates of the "other" category. This suggests municipalities are giving priority to filling positions in the key sectors, as indeed they should. Among the metros, the vacancy rates for 2006 are highest for electricity and water, which points to a severe shortage of workers with skills relevant to these sectors.

Trends in personnel expenditure

Total municipal expenditure on personnel increased from R22.2 billion in 2003/04 to R29.3 billion in 2006/07 and is projected to increase to R38.4 billion by 2009/10. In other words, personnel expenditure increased at an annual rate of 9.8 per cent between 2003/04 and 2006/07 and is set to increase by an average annual 9.5 per cent over the MTEF period. This is consistent with the growth in total expenditure by municipalities.

Table 12.8 Municipal personnel expenditure by category, 2003/04 – 2009/10

	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	% average annual growth	
	Outcome			Estimate	Medium-term estimates				
R million								2003/04 – 2006/07	2006/07 – 2009/10
Category A (Metros)	13 011	13 673	14 267	16 219	18 416	19 590	20 637	7.6%	8.4%
Category B (Locals)	8 044	9 124	10 060	11 293	13 634	14 110	15 002	12.0%	9.9%
Secondary cities - 21	3 567	4 053	4 347	5 036	5 640	5 821	6 220	12.2%	7.3%
Towns - 140	3 469	3 861	4 283	4 551	5 712	5 978	6 344	9.5%	11.7%
Mostly rural - 70	1 008	1 209	1 430	1 706	2 281	2 312	2 437	19.2%	12.6%
Category C (Districts)	1 117	1 424	1 642	1 800	2 770	2 654	2 794	17.2%	15.8%
Category B + C	*9 162*	*10 548*	*11 703*	*13 093*	*16 404*	*16 765*	*17 795*	12.6%	10.8%
Total	**22 173**	**24 221**	**25 970**	**29 311**	**34 820**	**36 354**	**38 433**	**9.8%**	**9.5%**

Source: National Treasury local government database

There are disparities in the growth of personnel expenditure across the municipalities

There are, however, significant disparities in the growth of personnel expenditure across the municipalities. Personnel expenditure is growing fastest in category C municipalities: between 2003/04 and 2006/07 it grew by an average annual 17.2 per cent and is set to increase by a further average annual 15.8 per cent over the MTEF period. This compares to category B municipalities, where personnel expenditure grew by an average annual 12 per cent between 2003/04 and 2006/07 and is planned to increase by an average annual 9.9 per cent between 2006/07 and 2009/10. There are even lower growth rates for the metros, where personnel expenditure grew by an average annual rate of 7.6 per cent between 2003/04 and 2006/07 and is set to increase by an average annual 8.4 per cent over the MTEF period. If the rapid growth in personnel expenditure among category C municipalities was commensurate with the increase in their overall expenditure, there would be little reason for concern, however, this is not the case.

As the rural and district municipalities mature they will need to employ more staff

Among category B municipalities, personnel expenditure is growing most rapidly in the 70 mostly rural municipalities. Between 2003/04 and 2006/07 it grew at an average annual rate of 19.2 per cent and is set to increase by an average annual 12.6 per cent over the MTEF period. The anticipated growth in personnel expenditure among both the rural municipalities and the district municipalities supports the

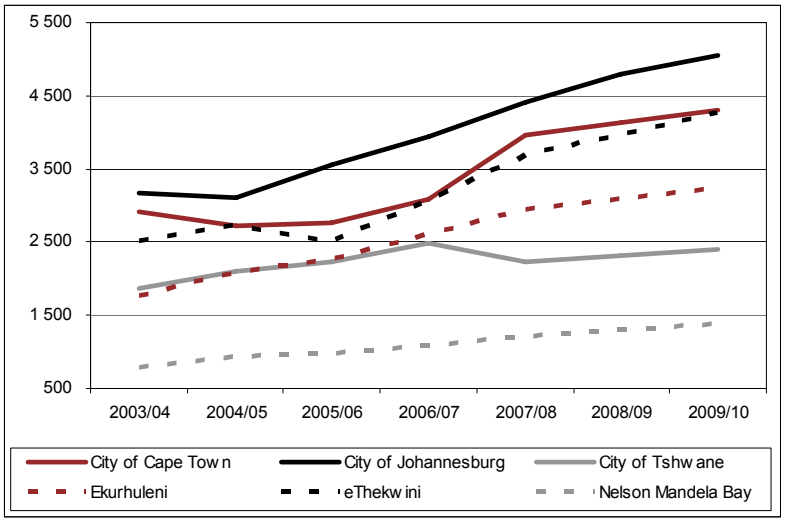
view that as these municipalities mature they will need to employ more staff, especially those municipalities that have been assigned key functions such as water and sanitation.

Figure 12.3 shows personnel expenditure by metro for the period 2003/04 to 2009/10. In this figure, the trend lines for Nelson Mandela Bay and Ekurhuleni show fairly uniform growth in personnel expenditure over the period. Those for the other metros show uneven trends, in some instances even declines in personnel expenditure between years. The three most significant instances of this nature are:

- a R255 million decline between 2006/07 and 2007/08 in the City of Tshwane. (This represents a 10 per cent decline in personnel expenditure by this metro).
- a R219 million or 8 per cent decline between 2004/05 and 2005/06 in eThekweni.
- a R192 million or 6 per cent decline between 2003/04 and 2004/05 in the City of Cape Town.

Such declines usually reflect either the impact of a retrenchment programme or the outsourcing of functions.

Figure 12.3 Personnel expenditure by metro, 2003/04 – 2009/10



Source: National Treasury local government database

Personnel expenditure versus other inputs

Aggregate municipal expenditure on personnel as a percentage of operating expenditure has remained almost constant around 30 per cent since 2003/04.

For the metros, the ratio of personnel expenditure to operating expenditure is below the national average and is set to decline to a level around 26 per cent over the MTEF period. By contrast, for category B municipalities this ratio has been increasing consistently from 32.8 per cent in 2004/05 and is set to reach 35.9 per cent in 2009/10. It is difficult to reconcile this trend with the decline in

employment numbers for category B municipalities. What it points to is that higher wages appear to correlate directly with a decline in the number of jobs, rather than attracting more people to work for municipalities. Or stated differently, average wages are increasing at the expense of jobs.

The ratio of personnel expenditure to operating expenditure among the 21 secondary cities is slightly higher than for the metros. It increases to around 38 per cent in the case of the 170 municipalities that make up the towns sub-group and among the 70 mostly rural municipalities is set to reach 45 per cent over the MTEF period. The two factors most likely to be underpinning this trend are:

Metros and larger municipalities have lower personnel to operating expenditure ratios

First, the metros and larger municipalities are better placed to take advantage of the economies of scale associated with mechanisation and have indeed been doing so for a long time. They are also more able to negotiate the intricacies of outsourcing labour intensive functions. Together these result in metros and larger municipalities having lower personnel to operating expenditure ratios.

Second, as municipalities become smaller in terms of budget size, the more top heavy their governance and management structures become relative to their overall staffing profile, as well as their budget. The problem is particularly acute among small municipalities where the revenue bases are so limited that they do not allow for much more than the employment of core staff. This translates into the very high ratios of personnel expenditure to operating expenditure shown among the 70 mostly rural municipalities.

Understanding the ratio of personnel expenditure to operating expenditure

The ratio of personnel expenditure to operating expenditure is widely used as an indicator of the sustainability of municipal budgets and expenditures. This raises important questions of exactly how the ratio should be interpreted and whether National Treasury should set a benchmark for purposes of assessing the sustainability of municipal finances.

First, on the issue of interpreting the ratio, one needs to be aware of the factors that can influence it. These include:

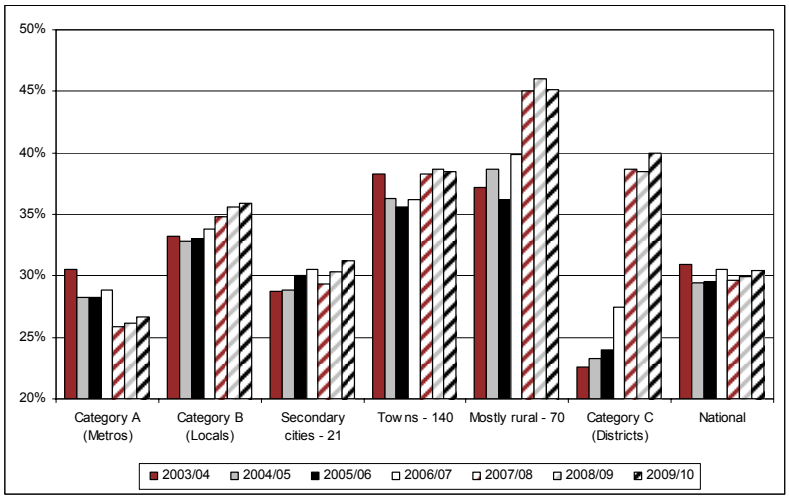
- the nature of the functions allocated to the municipality and types and extent of services it delivers
- the municipality's organisational structure, particularly the ratio of management to technical and unskilled employees
- the labour intensity of the municipality's operations versus the extent of mechanisation
- the extent to which the municipality has outsourced the more labour intensive components of its operations
- the composition of the non-personnel components of operating expenditure, particularly trends in expenditure on maintenance and payments for bulk water and electricity services.

Second, on the issue of setting a benchmark, it is clear that the interpretation of the ratio is specific to the context of each municipality. It would therefore be inappropriate for National Treasury to set a specific benchmark. Nevertheless, should the ratio for a municipality be significantly above or below the average ratio for its peers it should be treated as a warning signal and should trigger an enquiry into the factors that are driving the ratio in a particular direction. It is after all these underlying factors that may be threatening the financial sustainability of the municipality and not the ratio itself.

There has been very rapid growth in personnel expenditure among category C municipalities

The picture that figure 12.4 gives of what is happening among category C municipalities is cause for concern. Personnel expenditure as a percentage of operating expenditure increases from 22.5 per cent in 2003/04 to an expected 40 per cent in 2009/10. This indicates a radical shift in the composition of expenditure by district municipalities. Part of this shift can be attributed to declining operating expenditure, but a greater part is due to the very rapid growth in personnel expenditure among category C municipalities.

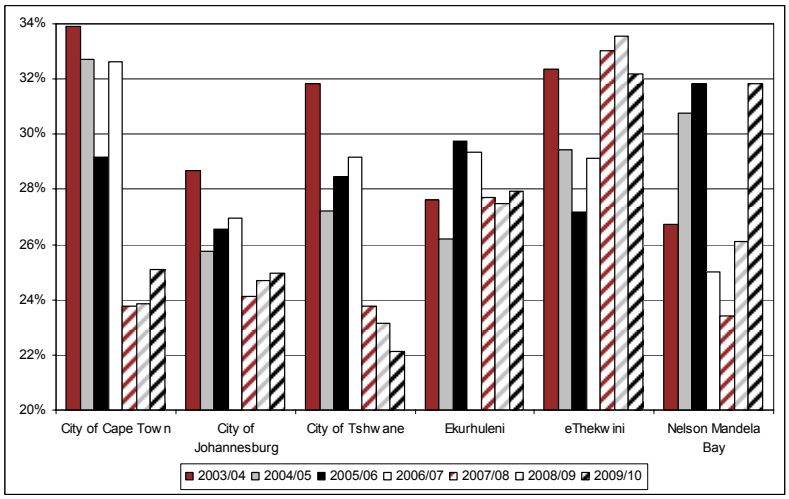
Figure 12.4 Municipal personnel expenditure versus operating expenditure by category of municipality, 2003/04 – 2009/10



Source: National Treasury local government database

Figure 12.5 shows personnel expenditure as a percentage of operating expenditure for the metros.

Figure 12.5 Municipal personnel expenditure versus operating expenditure for the metros, 2003/04 – 2009/10



Source: National Treasury local government database

Even though the data for the individual metros appears highly variable the following three trends are worth noting. First, of the six metros, the City of Johannesburg has, on average, maintained the lowest personnel to operating expenditure ratio between 2003/04 and 2006/07. This would suggest the City of Johannesburg's budget and operations are in some respects structurally different from the other metros, more highly mechanised for instance.

Second, the City of Cape Town is projecting to reduce its personnel to operating expenditure ratio from over 32 per cent in 2006/07 to under 25 per cent in 2007/08. This is driven by a 43 per cent increase in the operating budget between 2006/07 and 2007/08, most of which is allocated to non-personnel items, particularly maintenance. The City of Tshwane is projecting a similar drop, eventually reaching just more than 22 per cent by the end of the MTEF period. However, in the City of Tshwane's case the decline in the ratio is being driven primarily by the R255 million drop in personnel expenditure between 2006/07 and 2007/08.

Third, eThekwini is projecting that its personnel to operating expenditure ratio will increase to around 32 per cent in 2007/08. It is likely that the metro's plans to establish a metro police force is driving this increase – given that this is a relatively labour intensive function.

Table 12.9 shows the five category B municipalities that for the period 2003/04 to 2009/10 have on average the highest and the lowest ratios of personnel expenditure to operating expenditure. It is noticeable that the five municipalities with the highest personnel to operating expenditure ratios are all located in KwaZulu-Natal and the Eastern Cape, while four of the five municipalities with the lowest ratio of personnel expenditure to operating expenditure are located in the northern and north-western regions of the country.

Table 12.9 Personnel expenditure as percentage of operating expenditure for the top 5 and bottom 5 category B municipalities, 2003/04 – 2009/10

	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Percentage		Outcome		Estimate	Medium-term estimates		
By top five category B municipalities							
Nongoma - KZ265	91.0%	80.1%	57.8%	60.5%	52.2%	52.9%	56.9%
Ndwedwe - KZ293	80.9%	62.7%	52.4%	60.5%	56.5%	62.9%	63.0%
Mnquma - EC122	27.0%	54.4%	64.4%	68.7%	68.2%	69.7%	70.2%
Inxuba Yethemba - EC131	53.2%	54.5%	59.3%	58.7%	63.9%	63.9%	63.9%
Tsolwana - EC132	53.3%	58.7%	41.5%	45.3%	71.8%	71.8%	71.9%
By bottom five category B municipalities							
Polokwane - NP 354	25.4%	24.4%	24.2%	35.3%	16.5%	20.5%	30.2%
Moshaweng - NC041	24.9%	16.1%	24.7%	16.5%	29.3%	30.3%	34.2%
Greater Tzaneen - NP 333	27.9%	25.6%	23.8%	28.9%	21.6%	21.6%	21.6%
Emfuleni - GT421	21.7%	19.7%	23.6%	21.2%	26.1%	28.1%	28.9%
Rustenburg - NW373	19.0%	17.9%	17.7%	17.0%	14.9%	13.1%	14.6%

Source: National Treasury local government database

There have to be serious doubts about the financial viability of municipalities with personnel to operating expenditure ratios in excess of 60 per cent, especially if there is little prospect of them being able to increase their budgets with internally generated revenues. The challenges faced by the municipalities at the lower end of the spectrum relate primarily to persistently high vacancy rates, which are greatly aggravated by poor management and poor governance.

Municipalities with high personnel to operating expenditure ratios and those with persistently high vacancy rates are problematic

Average cost of employment

Table 12.10 shows the average cost of employment in most instances increasing at rates well above inflation. Indeed the growth in average wage costs for the City of Tshwane, eThekweni and Nelson Mandela Bay are all above 20 per cent. This points to the possibility that many of the jobs shed between 2005 and 2006 were lower income jobs, which suggests that municipalities are either adopting less labour intensive approaches to deliver services, or they are outsourcing labour intensive services to the private sector. Either way municipalities are employing fewer low skilled workers directly.

Municipalities are employing fewer low skilled workers directly

Table 12.10 Average cost per employee, 2005 and 2006

Rand	2005	2006	% growth
By category of municipality			
Category A (Metros)	140 187	161 861	15.5%
Category B (Locals)	105 370	121 029	14.9%
Secondary cities - 21	*125 051*	*142 631*	*14.1%*
Towns - 140	*96 346*	*98 686*	*2.4%*
Mostly rural - 70	*87 961*	*143 550*	*63.2%*
Category C (Districts)	182 124	176 012	-3.4%
Category B + C	111 995	126 460	*12.9%*
By metro			
City of Cape Town	117 356	137 828	17.4%
City of Johannesburg	140 278	149 558	6.6%
City of Tshwane	163 189	202 626	24.2%
Ekurhuleni	159 427	176 450	10.7%
eThekwini	139 020	169 230	21.7%
Nelson Mandela Bay	136 397	163 538	19.9%
By top five category B municipalities			
Fetakgomo - NP03a3	234 000	396 926	69.6%
Moshaweng - NC451	115 509	301 667	161.2%
Aganang - NP352	231 425	300 421	29.8%
Bela Bela - NP366	83 251	293 734	252.8%
Maphumulo - KZ294	73 494	290 543	295.3%
By bottom five category B municipalities			
Maletswai - EC143	44 264	51 793	17.0%
Emakhazeni - MP314	46 731	48 421	3.6%
Nxuba - EC128	66 744	43 234	-35.2%
Nquthu - KZ242	431 308	40 920	-90.5%
Elias Motsoaledi - NP03a5	132 219	21 524	-83.7%

Source: National Treasury local government database

The table also shows some very interesting differences between municipalities. Among the metros, the City of Cape Town has an average cost of employment that is well below the national average and in 2006 was nearly R65 000 less than the City of Tshwane. This may be partly explained by the fact that professional salaries are generally lower in Cape Town than in Gauteng. However, it would be interesting to explore the extent to which these differences are due to differences in the labour intensity of their operations and approaches to outsourcing.

There could be a sub-optimal duplication of management structures between district municipalities and category B municipalities

On aggregate, the average cost of employment is highest in category C municipalities – nearly R33 000 more than the national average. This suggests that these municipalities have top heavy management structures and employ relatively few low skilled workers. It could be argued that this is inherent to the role assigned to the district municipalities, but it may also point to a sub-optimal duplication of management structures between district municipalities and category B municipalities.

Among the category B municipalities, the 21 secondary cities have average wages similar to those for certain of the metros, whereas average wages are lowest among the 170 municipalities that make up the towns subgroup, probably due to the fact that they generally use more labour intensive approaches to deliver services and so the ratio of management to unskilled workers is low.

In 2006, average wages in the 70 mostly rural municipalities were higher than in the secondary cities. This further confirms the point made above about top heavy management and governance structures, which is emphasised by the five municipalities that paid the highest average wages in 2006.

Are municipalities supporting job creation?

As indicated in the introduction, municipalities have a crucial role to play in job creation. This is an integral part of their contribution to combating poverty.

Many activities performed by municipalities lend themselves to providing job opportunities for low and unskilled labour

Many activities performed by municipalities lend themselves to providing job opportunities for low and unskilled labour. As indicated, municipalities face critical choices in this regard, whether to adopt capital intensive approaches or labour intensive approaches. Even when outsourcing, the municipality should specify the technology it expects the private company to use. The aim should be to ensure that outsourcing contributes to job creation, rather than job shedding as a consequence of more capital intensive approaches. Indeed, "number of jobs created" should be a standard performance indicator on all outsourcing contracts and PPP arrangements.

Municipalities are generally inclined to adopt capital intensive approaches

The data currently available does not enable the labour intensiveness of different municipal activities to be assessed and compared at an aggregate level. Anecdotal information suggests that generally municipalities are inclined to adopt capital intensive approaches. The mechanisation of grass cutting, street sweeping, ditch digging, road maintenance and a host of other activities points in this direction. Of

course there is a balance between job creation, efficiency and cost. This needs to be managed and in each instance the appropriate technology for the task needs to be decided upon, with a bias towards labour intensive approaches.

In this regard, a large number of projects falling under the umbrella of the extended public works programme (EPWP) provide examples of labour intensive approaches to delivering services.

Municipalities' contribution to the expanded public works programme

Municipalities' involvement in the EPWP is very limited

Municipalities' involvement in the EPWP is very limited. Only 20 of the 283 municipalities participated in the programme in 2005. This increased to 33 in 2006 and 2007. Table 12.11 highlights the extent of these municipalities' contribution to the overall EPWP outcomes in 2005 and 2006.

Table 12.11 Municipalities' contribution to the EPWP, 2005 and 2006

	2005			2006		
Province	Number of projects	Expenditure (including professional fees) (R million)	Gross number of work opportunities created	Number of projects	Expenditure (including professional fees) (R million)	Gross number of work opportunities created
Eastern Cape	1	1	171	92	324	12 283
Free State	45	89	21 152	31	29	1 055
Gauteng	28	54	1 634	82	456	12 377
KwaZulu-Natal	48	85	9 470	93	343	27 003
Limpopo	6	2	273	39	31	1 360
Mpumalanga	69	44	2 017	107	139	4 345
Northern Cape	4	36	1 608	6	4	327
North West	44	48	1 584	43	170	1 171
Western Cape	68	14	5 779	141	312	5 284
Total	**313**	**372**	**43 688**	**634**	**1 808**	**65 205**
Percentage of national EPWP	*7.2%*	*15.0%*	*20.6%*	*9.0%*	*25.1%*	*20.3%*

Source: Department of Public Works

Table 12.11 emphasises the potential that exists at the local government level to implement labour intensive approaches to delivering services. Although less than 10 per cent of the total number of EPWP projects have been run by municipalities over the last three years, these projects have created over 20 per cent of the work opportunities. This indicates that EPWP projects run by municipalities are on average larger than those located in the national and provincial spheres of government.

The challenge is to mainstream the labour intensive approaches that are being used in the EPWP projects into the normal way municipalities go about their business of delivering services. Currently, municipalities are required to adopt labour intensive approaches in order to access the municipal infrastructure grant (MIG). However, the MIG only constitutes 7 per cent of total expenditure by municipalities. If municipalities adopted similar labour intensive approaches in other areas of expenditure, their contribution

to job creation and therefore poverty alleviation could be increased very significantly.

Impact of municipal wage settlements

Why do municipalities appear to be becoming more capital intensive in their approach to service delivery?

A municipality's primary aim is to maximise the output of services to communities given available resources

A standard economic answer to this question is that the cost of labour has increased relative to the cost of capital within the municipal sphere of activity. And so municipalities are behaving rationally (economically speaking) when they replace labour with machines – labourers digging ditches with ditch diggers. After all, a municipality's primary aim is to maximise the output of services to communities given available resources. Hence, if a capital intensive approach is more cost effective than a labour intensive approach it is incumbent on a municipality to mechanise. Or is it?

Table 12.12 indicates that municipal wage settlements in 2005 to 2007 have been slightly below the average level of settlement for all sectors.

Table 12.12 Municipal wage settlements and minimum wages, 2005 – 2007

	2005	2006	2007
Average level of settlements			
All sectors	6.3%	6.5%	7.3%
Municipalities	6.2%	5.6%	7.0%
Average minimum wage			
All sectors	R 3 057	R 3 065	R 3 609
Municipalities/utilities	R 3 425	R 3 613	R 5 100

Source: Andrew Levy Group, The Wage Settlement Survey, 2005, 2006, 2007

However, the table also shows that the average minimum wage for municipalities and utilities has increased from 12 per cent above the national average for all sectors in 2005 to 41 per cent above the national average in 2007. Given the relatively modest wage settlements in these years, this points to a reduction in the proportion of jobs at the lower end of the wage spectrum within municipalities. The optimistic view is that these lower level jobs are being re-graded upwards. However, jobs are being lost, the average cost per employee is increasing and the higher minimum wage noted above are being "paid for" by the shedding of low level jobs – facilitated by mechanisation and outsourcing.

Labour relations challenges seem to be driving the bias in favour of mechanisation over labour intensive production approaches

It is likely that municipal managements' views of the cost of labour are strongly influenced by the "hassle factor" of managing a highly unionised and relatively militant workforce. In 2005 and 2007 strikes in the municipal sector ranked among the top six strikes nationally in terms of workdays lost. Unfortunately, these labour relations challenges seem to be driving the bias in favour of mechanisation over labour intensive production approaches.

Indeed there seems to be a catch-22 situation in the local government sector, outsourcing and the shedding of jobs lead to a militant response from the unions and municipal managers respond by seeking

to outsource and mechanise further. It is a downward spiral that requires a collective response. All parties need to give priority to protecting and expanding jobs in a way that promotes efficient and cost effective services.

Shifting to a single public service

The Department of Public Service and Administration is currently driving an initiative to establish a single public service. The initiative seeks to facilitate the co-ordinated management of personnel across the three spheres of government and in so doing facilitate:

- a deepening of integrated service delivery
- the strategic alignment of government institutions in the three spheres of government
- enabling the mobility of staff between the three spheres of government.

The department completed an initial draft of the Public Administration Management Bill in June 2007. In July 2007, Cabinet approved a process of consultation on the draft bill. This was followed by information sharing and engagements with provincial intergovernmental relations forums, municipalities through the South African Local Government Association (SALGA), trade unions, that National Economic Development and Labour Council (NEDLAC) and the Public Services Commission. This first bill has since been redrafted to include the inputs from the above-mentioned stakeholders as well as legal advice. A redrafted Public Administration Management Bill was introduced in Parliament on 8 June 2008.

Greatest challenge involves aligning the human resource management practices between the public service and municipalities

Getting the necessary legislation in place is a necessary step, but the greatest challenge involves aligning the human resource management practices between the public service and municipalities. This involves aligning the current remuneration grading and conditions of service dispensations (including pension and medical aid dispensations).

A project team comprising of representatives of the departments of public service and administration and provincial and local government, National Treasury and SALGA has been appointed to work out possible transition scenarios and the cost of the different options. This work is currently under way.

Conclusion

The above analysis highlights the relatively modest contribution that municipalities make to overall employment. It shows that between 2005 and 2006 the number of municipal employees declined, despite an increase in the number of available positions. Together, these factors have contributed to rising vacancy rates. Although the aggregate vacancy rates are on average lower in the key sectors of electricity, water and sanitation and waste removal than in other areas of service delivery, they are worryingly high among the metros.

Dealing with municipal pension funds

The transformation of municipal pension funds is a key outstanding challenge in the local government sector. There are 104 registered retirement funds available to employers in local government. Although these represent a small portion (less than 5 per cent) of the total retirement savings in South Africa, they nevertheless constitute around R60 billion in assets and cover some 220 000 members and 62 000 pensioners. The ten largest municipal pension funds by value of assets are shown below.

Ten largest municipal pension funds by assets, 2008

Name of fund	Total assets (R million)	Contributing members	Non-contributing	UB members
Caper Municipal Pension Fund	8 525 884	8 132	5 798	335
Municipal Gratuity fund	8 198 399	26 903	–	2 285
Municipal Employees Pension Fund	4 943 843	14 331	7 584	–
Johannesburg Municipal Pension Fund	4 388 819	1 939	4 716	–
Natal Joint Municipal Pension Fund (superannuation)	3 380 800	6 877	3 568	193 296
National Fund for Municipal Workers	3 015 254	26 163	–	–
KZN Municipal Pension Fund	2 661 661	5 983	–	–
City of Johannesburg Pension Fund	2 346 481	5 660	4 868	–
Southern African Municipal Workers' Union National Provident Fund	2 213 269	25 224	–	–
Joint Municipal Pension Fund	2 157 218	765	3 139	123

In transforming municipal pension funds the following outstanding issues need addressing:

- There are 18 remaining defined benefit funds of which only 2 are open to new members and even these appear to be *de facto* closed due to a directive issued by the employer body (SALGA) to municipalities.
- The funds offered by municipalities are overly-generous when compared to both the private sector and the rest of the pubic sector. What is particularly concerning is that the municipal defined contribution funds appear to have been established using the existing (or similar) contribution rates payable in the defined benefit funds. The average contribution rate in the municipal defined contribution funds is 27.3 per cent, compared to 21.0 per cent in the Government Employees Pension Fund (GEPF) and 15.9 per cent in the private sector. The result of this is that these funds are in effect virtually as costly as their defined benefit counterparts.

Finally, any shift to a single public service will probably involve amalgamating the municipal pension funds with the GEPF. This, however, is potentially a very costly exercise. Aligning the municipal funds with the GEPF will bring an annual saving of R610 million to the municipalities, whilst moving all GEPF members to the average municipal defined contribution fund will cost government an extra R6.3 billion per year.

Personnel expenditure has been growing strongly. However, the average cost of employment and the average minimum wage have grown even faster. In effect these gains are being "paid for" by the shedding of low level jobs – facilitated by mechanisation and outsourcing.

Indeed many of the trends point to a bias in favour of mechanisation and against labour intensive approaches to delivering services. This needs to be reversed if municipalities are to make a meaningful contribution to job creation and to combating poverty.

Lastly, there is an urgent need to improve the scope and quality of information pertaining to municipal personnel so that it can be used to analyse the nature of the problems facing local government and so assist developing interventions that go to the core of the capacity challenges faced by the sector.

A

Summary data of all municipalities

Over the past two years, National Treasury has greatly improved the scope and coverage of the local government budget and expenditure information it now collects. To publish this information exclusively in a paper based format would be very costly. It would also reduce the usefulness of the information, since anyone wanting to analyse it would have to do so manually, or would have to retype or scan it onto a suitable computer programme.

Therefore Table A1 of this annexure only presents the summary of all the municipalities' operating revenue, operating expenditure, sources of finance and capital expenditure. More detailed summary information on all 283 municipalities budgets and expenditures for the period 2003/04 to 2009/10, as well as the detailed results of a headcount survey of municipal personnel, is published on National Treasury's website - **www.treasury.gov.za**.

It should be noted that the information on the headcount survey is incomplete and will be updated from time-to-time as municipalities supply the necessary information.

Structure of information on National Treasury's website (www.treasury.gov.za)

Overall summary information

Table 1	Summary – All municipalities, 2003/04 – 2009/10	(Table A1)

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Summaries by metros and 21 secondary cities

Table 8 Summary – per metro, 2003/04 – 2009/10
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Summaries of other relevant municipal budget related information

Table 10 Summary – conditional grants to municipalities, 2003/04 – 2009/10
Table 11 GVA indicators per province, 2004
Table 11.1 GVA indicators per municipality, 2004

Budget and expenditure information per municipality organised by province

There are nine workbooks that presenting each municipalities' budget and expenditure data on a separate worksheet.

Staff head-count information per municipality by province

There are nine workbooks that presenting each municipalities' personnel head-count data on a separate worksheet.

TABLE A1: SUMMARY – ALL MUNICIPALITIES, 2003/04 – 2009/10

	2003/04			2004/05			2005/06			2006/07			2007/08	2008/09	2009/10
R thousands	Original budget	Revised budget	Outcome	Original budget	Revised budget	Outcome	Original budget	Revised budget	Outcome	Original budget	Revised budget	Outcome	Medium-term estimates		
Operating revenue and expenditure															
Operating revenue	**72 947 909**	**73 273 992**	**73 831 794**	**84 020 969**	**84 181 661**	**87 369 451**	**93 530 241**	**89 865 735**	**95 999 610**	**107 370 496**	**101 592 030**	**106 056 393**	**118 404 568**	**122 709 731**	**127 704 524**
Property rates	14 343 399	14 396 590	13 980 250	15 653 352	15 782 807	16 395 974	17 035 028	16 793 204	17 400 994	18 631 341	18 615 638	18 521 438	21 486 120	22 770 062	24 136 304
Service charges	36 184 345	36 442 902	36 145 855	38 850 542	39 596 752	38 734 881	41 497 872	41 634 933	40 200 699	44 798 419	45 546 655	44 497 830	49 223 014	51 548 643	54 777 338
Regional Service Levies	5 227 048	5 249 577	4 983 299	5 718 065	5 999 473	7 008 755	6 508 520	6 681 518	7 603 925	649 269	649 869	385 709	95 188	1 556	15
Investment revenue	2 344 249	1 844 626	1 672 858	1 596 579	1 829 875	2 115 382	2 409 691	2 086 122	2 356 697	3 351 597	2 281 156	2 970 052	3 845 404	3 818 195	4 133 494
Government grants	8 258 610	8 635 746	8 980 383	11 867 644	12 484 743	13 741 891	13 084 063	14 144 663	17 397 501	26 451 537	25 896 611	27 222 719	26 570 567	28 310 782	28 490 501
Public contributions and donations	-	-	44 489	-	8 027	588 340	-	8 707	664 331	-	146 888	695 340	-	-	-
Other own revenue	6 590 258	6 704 550	8 024 660	10 334 786	8 479 984	8 784 228	12 995 067	8 516 588	10 375 464	13 488 334	8 455 213	11 763 305	17 184 275	16 260 493	16 166 871
Operating expenditure	**69 301 101**	**69 485 458**	**71 728 766**	**80 114 392**	**78 032 240**	**82 263 988**	**87 131 726**	**85 244 671**	**87 814 936**	**99 018 901**	**96 520 258**	**96 100 368**	**117 558 371**	**121 368 468**	**126 176 461**
Employee costs	22 855 671	22 638 984	21 576 629	25 458 582	25 156 156	23 433 315	27 523 316	27 188 896	25 015 008	30 816 405	30 600 266	27 894 731	34 819 800	36 354 370	38 432 589
Remuneration of councillors	-	110 064	596 029	-	131 464	787 419	-	152 271	954 929	-	200 572	1 416 742	-	-	-
Repairs and maintenance	5 029 678	5 032 207	4 459 461	5 860 642	5 868 999	4 867 650	6 516 103	6 479 312	5 244 694	7 190 324	7 170 502	5 924 907	8 532 097	8 942 540	9 587 354
Depreciation and amortisation	-	1 344 299	2 504 967	-	1 675 103	3 945 215	-	1 785 553	4 253 438	-	1 798 620	4 979 849	-	-	-
Finance charges	6 144 635	5 530 273	4 216 296	5 791 585	5 125 772	3 409 236	6 539 426	4 701 388	3 122 602	6 709 941	4 740 578	3 180 224	7 482 518	8 028 661	8 758 836
Materials and bulk purchases	17 103 246	17 106 156	17 198 222	19 126 193	19 062 945	18 242 704	20 466 699	20 283 115	19 479 785	21 544 703	21 719 604	21 481 103	23 826 939	25 027 259	26 714 637
Grants and subsidies	-	74 188	1 435 221	-	263 263	2 021 303	-	307 376	2 140 876	-	1 117 395	2 339 109	-	-	-
Other expenditure	18 167 871	17 649 286	19 741 941	23 877 390	20 748 538	25 557 147	26 086 182	24 346 760	27 603 605	32 757 528	29 172 720	28 883 703	42 897 016	43 015 638	42 683 045
Surplus/(Deficit)	**3 646 808**	**3 788 534**	**2 103 028**	**3 906 576**	**6 149 421**	**5 105 463**	**6 398 515**	**4 621 064**	**8 184 674**	**8 351 595**	**5 071 772**	**9 956 026**	**846 197**	**1 341 263**	**1 528 063**

	2003/04			2004/05			2005/06			2006/07			2007/08	2008/09	2009/10
R thousands	Original budget	Revised budget	Outcome	Original budget	Revised budget	Outcome	Original budget	Revised budget	Outcome	Original budget	Revised budget	Outcome	Medium-term estimates		
Capital revenue and expenditure															
Source of finance	**16 548 407**	**16 762 333**	**10 696 150**	**17 047 112**	**17 291 192**	**13 322 730**	**25 750 410**	**23 638 071**	**17 231 783**	**29 087 422**	**28 986 273**	**20 891 196**	**39 735 966**	**39 251 993**	**30 337 375**
External loans	1 689 864	2 514 586	2 011 082	3 378 878	4 025 135	3 314 936	4 434 768	5 346 160	5 277 967	5 286 629	7 498 952	6 542 592	7 620 976	6 677 767	5 909 158
Public contributions and donations	845 564	301 045	371 359	218 190	259 572	247 928	342 793	375 853	301 125	1 210 581	437 871	286 697	838 083	786 157	701 270
Grants and subsidies	7 381 914	8 286 944	4 775 012	7 376 062	7 703 278	6 057 711	13 297 918	12 000 375	8 185 757	14 651 300	14 708 750	8 908 954	20 813 028	22 118 109	14 960 343
Other	6 631 065	5 659 758	3 538 697	6 073 981	5 303 206	3 702 155	7 674 931	5 915 683	3 466 933	7 938 912	6 340 700	5 152 952	10 463 879	9 669 960	8 766 605
Capital expenditure	**16 548 407**	**16 762 332**	**10 696 150**	**17 047 112**	**17 291 192**	**13 322 729**	**25 750 410**	**23 638 071**	**17 231 783**	**29 087 422**	**28 983 272**	**20 891 196**	**39 735 966**	**39 251 993**	**30 337 376**
Water and sanitation	3 671 405	3 749 637	1 839 377	4 071 416	4 210 196	2 925 391	6 026 107	5 965 941	4 014 330	7 273 319	7 130 910	4 957 067	10 397 049	9 434 457	8 664 349
Electricity	1 940 468	1 881 481	1 267 114	2 071 018	2 011 574	1 599 473	2 782 083	2 714 047	2 295 125	3 333 347	3 502 593	2 724 927	4 426 212	4 255 156	4 063 457
Housing	2 791 809	2 770 846	658 414	2 273 937	2 263 736	718 197	5 284 098	3 791 941	658 199	4 038 712	3 805 960	1 269 266	3 892 607	4 586 310	4 220 797
Roads and storm water	2 921 172	3 017 865	1 774 573	2 804 986	2 806 791	1 750 705	4 172 610	3 752 929	2 516 879	4 465 212	4 313 538	3 221 543	5 535 950	6 466 011	5 012 873
Other	5 223 553	5 342 503	5 156 671	5 825 754	5 998 895	6 328 963	7 485 513	7 413 213	7 747 250	9 976 832	10 230 272	8 718 394	15 484 148	14 510 060	8 375 899

	2003/04			2004/05			2005/06			2006/07			2007/08	2008/09	2009/10
R thousands	Original budget	Revised budget	Outcome	Original budget	Revised budget	Outcome	Original budget	Revised budget	Outcome	Original budget	Revised budget	Outcome	Medium-term estimates		
Capital and operating expenditure															
Operating expenditure	69 301 101	69 485 458	71 728 766	80 114 392	78 032 240	82 263 988	87 131 726	85 244 671	87 814 936	99 018 901	96 520 258	96 100 368	117 558 371	121 368 468	126 176 461
Capital expenditure	16 548 407	16 762 332	10 696 150	17 047 112	17 291 192	13 322 729	25 750 410	23 638 071	17 231 783	29 087 422	28 983 272	20 891 196	39 735 966	39 251 993	30 337 376
Total	**85 849 508**	**86 247 790**	**82 424 916**	**97 161 504**	**95 323 432**	**95 586 717**	**112 882 136**	**108 882 742**	**105 046 719**	**128 106 323**	**125 503 530**	**116 991 563**	**157 294 337**	**160 620 460**	**156 513 837**

Notes:

- The 2003/04 to 2005/06 numbers were obtained from the audited annual financial statements and, where applicable, the consolidated annual financial statements of the municipalities and municipal entities.

- The 2006/07 numbers were obtained from two sources, namely (i) the audited annual financial statements of municipalities and (ii) the pre-audit in-year results submitted to Councils and National Treasury as part of the monitoring on budget implementation where the annual financial statements have not been finalised.

- The Medium Term Revenue and Expenditure Framework (MTREF) estimates are based on the budget and related documents of municipalities and their entities as approved by respective municipal Councils and municipal entities Boards.

Source: National Treasury local government database