



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

CHAPTER SUMMARIES

Chapter 1: Introduction

Overview and background

1. Employment creation is a central focus in South Africa's new growth path and local government has a crucial role to play in supporting economic growth, job creation and the realisation of many of government's recently articulated 12 outcomes.
2. Since the 2008 Local Government Budgets and Expenditure Review, a number of challenges facing local government still remain. These are:
 - a. The increased demand for economic infrastructure;
 - b. Ageing assets that require upgrading, rehabilitation or replacement; and
 - c. Changes in the nature and location of poverty.
3. However, since the previous *Review*, the economic and fiscal context to address these challenges has changed. Owing to the recession, municipal revenues are growing more slowly, making it important to ensure that spending is prioritised appropriately and that the implementation of municipal plans and programmes is effective and efficient.
4. To achieve the above objectives, good governance is critical. However, in a number of municipalities, governance shortcomings remain, placing pressure on procurement, billing and revenue collection, staff appointments and planning and zoning functions.
5. In the period ahead, on-going efforts will be made to ensure that the legislative and fiscal framework is both structured and strengthened to facilitate the effective functioning of municipalities in different contexts.
6. The *2011 Local Government Budgets and Expenditure Review* explores some of the key differences between urban and rural municipalities – highlighting the different kinds of developmental challenges they face and the need for the regulatory and fiscal reforms to respond to these differences. The Review assists in the formation of an aggregate picture of local government and contextualises the developmental role that local government is expected to play.

Data issues

7. The *Review* is based on the best available data on municipal spending and budgets for the period 2006/07 to 2012/13. The introduction of Municipal Budget and Reporting

Regulations have significantly improved the scope and detail of data on local government finances, facilitating a better analysis. However, it will still take some time to produce a consistent multi-year local government financial dataset.

8. National Treasury also routinely publishes on its website adopted budgets, Section 71 quarterly financial information and annual financial statements of municipalities with the intention of improving the quality of local government data and rationalising the number of data requests sent to municipalities by different spheres of government.

Main themes for the 2011 Review

9. The *Review* focuses on the role that municipalities must play in supporting the new growth path and the realisation of government's outcomes through exploring three main themes:
 - a. The performance of local government in supporting economic growth;
 - b. The different challenges facing rural and urban municipalities when it comes to fulfilling their development roles – particularly the provision of basic services; and
 - c. The importance of good governance and accountability in ensuring the effective and efficient stewardship of municipal resources.

Key issues identified

10. The *Review* identifies the following issues that impact on the performance of municipalities in combating poverty and supporting economic growth:
 - a. The quality of leadership and governance is critical to how a municipality performs.
 - b. Municipal budgets must be funded in accordance with the requirements of section 18 of the Municipal Finance Management Act, 2003, to ensure that municipalities remain going concerns capable of providing and extending services.
 - c. Greater attention must be paid to maintaining existing municipal assets.
 - d. Municipalities need to revisit how they fund their capital budgets.
 - e. Current programmes need to be reconceptualised to ensure greater access to basic infrastructure and services.
 - f. More support is required from national government to improve municipal capacity.
 - g. Ways of extending the differentiated approach to the local government fiscal framework need to be pursued.
11. The *Review* also proposes several responses to some of these challenges. These include, but are not limited to:
 - i. Stabilising the senior management cadre in municipalities and ensuring that appropriate technical skills are in place to improve leadership and address governance challenges.

- ii Going back to the basics of cash and revenue management to ensure that municipal budgets are appropriately funded. This involves understanding the relationship between financial planning and effective management of municipal cash resources and the need to undertake regular bank reconciliations of municipal accounts.
- iii Greater attention must be paid to the integrity of billing information, the accuracy of bills and having dedicated managers capable of building administrative implementation systems that integrate each component of the revenue value chain.
- iv Implementing systems of asset management and improving levels of spending on repairs and maintenance. To assist in financing this spending, tariffs for the trading services must be cost reflective, incorporating all input costs associated with the production of those services.
- v The balance between operating budgets and capital budgets must be examined by municipalities. Operating budgets should be structured to generate surpluses required to fund infrastructure. Creditworthy municipalities also need to explore opportunities for leveraging private finance for the expansion and delivery of services, especially those that support local economic development.
- vi There needs to be effective spatial planning and land use regulations governing development. Regulating the use of strategically located land can be used to improve the access of poor households to the urban economy, while municipal infrastructure investment decisions can be used creatively to provide appropriate incentives to the private sector.
- vii Municipalities need to generate more employment through labour intensive programmes and service delivery prospects. Domestic solid waste and public cleansing provide good opportunities for unskilled labour.

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Chapter 2: The socio-economic and fiscal context for local government

Overview and background

1. South Africa's municipalities operate in a wide range of social and economic contexts which have recently been impacted by the global economic recession, rising unemployment and the 2010 FIFA World Cup. In addition, on-going rural-urban migration is redefining the context for municipal service delivery.
2. While the 2009 economic recession affected all municipalities, those with strong trade and manufacturing bases were particularly seriously affected.
3. The local government fiscal framework is in the process of being reformed to better reflect the different fiscal capacities of municipalities. To achieve this, more accurate information on the differing municipal contexts is essential and the national census in October 2011 is therefore very important.
4. One of the most pressing challenges facing local government at the moment is the decline in public trust.

Socio-economic trends and local government

5. Rapid urbanisation and a reduction in the average size of households are redefining the context for service delivery and governance in most municipalities. Falling average household size effectively reduces the number of persons reached by each household service connection.
6. The decline in total employment of more than one million jobs between the last quarter of 2008 and the second quarter of 2010 impacted on the ability of households to pay for municipal services.

The economic outlook and local government

7. Variations in growth trends between economic sectors place different pressures on individual municipalities, depending on the sectoral make-up of their local economies.
8. Economic developments continue to place pressure on municipalities to expand local infrastructure. Municipalities need to address infrastructure capacity constraints, as well as structuring tariffs, to moderate the growth in consumption – particularly of water. Both of these requirements imply that tariffs for municipal services will need to increase.

National Fiscal Policy and Local Government

9. National fiscal policy continues to recognise that municipal expenditure makes a significant contribution towards alleviating poverty and economic development.
10. National government's fiscal policy has four implications for local government:
 - a. Fiscal transfers have been increased so as to insulate municipalities from the impact of the economic downturn;
 - b. National transfers to local government are sustainable over the medium term. The annual Division of Revenue Act enables municipalities to pledge conditional grant transfers to accelerate capital spending;

- c. The prudent fiscal stance of national government provides room for expanded borrowing by municipalities. However, municipalities generally are not fully utilising the borrowing space available to them; and
- d. Expanded public spending by other public entities places pressure on development planning, zoning and environmental approval processes and extends demands for municipal infrastructure. Effective mechanisms to coordinate and sequence public investments are thus required.

Applying the differentiated approach to local government

- 11. There is a growing sense that the current local government funding arrangements may not be addressing the objectives of rural development and redistribution adequately.
- 12. The local government sphere is very diverse and the differences among municipalities cannot be neatly aligned according to specific groups. Therefore, there cannot be a single approach to classifying municipalities into groups.
- 13. Various approaches to differentiation are already being implemented in the design and workings of the local government fiscal framework. These include:
 - a. *Differentiation in the local government equitable share formula* where each element of the formula is designed to target the allocation of funding on a differentiated basis;
 - b. *Differentiation in the allocation of conditional grants* where conditional grants are allocated according to the specific criteria related to the policy purpose of the grant;
 - c. *Urban Settlements Development Grant* where the metros' share of Municipal Infrastructure Grant (MIG) funds are determined using the same formula applied to the allocation of the MIG grant, but a different management framework has been put in place to allow metros to integrate the use of the funds into their overall capital development plans; and
 - d. *Differentiation in the allocation of fiscal powers and functions* where only municipalities responsible for delivering a function may charge for that function.

Governance: the key to effective municipalities

- 14. The greatest challenge facing local government is the decline in public trust in municipalities. Levels of trust in local government have always been lower than national and provincial government.
- 15. There is a tendency to attribute all failings in municipal performance to a lack of capacity – whether it be individual or organisational capacity. However, when evaluating municipal performance failures, the reality is that many municipal failures can be attributed to failures in local leadership.
- 16. There are some simple things that need to be done to get governance right:
 - a. Mayors, councillors and municipal officials need to commit to acting ethically – always seeking the best interests of the municipality and the community as a whole;
 - b. There needs to be a clear understanding of and respect for the separation of roles and responsibilities between the council, mayor and the municipal manager;
 - c. All appointments need to be on the basis of competence;

- d. Municipal managers need to ensure that all operating policies and procedures are in place and implemented in the day-to-day running of the municipality; and
 - e. Councils need to fulfil their oversight functions.
17. In addition, government has introduced a range of initiatives to tackle poor governance:
- a. The Municipal Budget and Reporting Regulations, which came into effect on 1 July 2009, prescribe the format of municipal budgets and in-year financial management reports which aims to enforce transparent municipal budgets; and
 - b. The Local Government: Municipal Systems Amendment Act (2011) introduces a range of important reforms, including barring municipal managers and other managers from holding political office in political parties, and regulating the employment of municipal employees who have been dismissed.

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Chapter 3: Intergovernmental relations and the local government fiscal framework

Overview and background

1. South Africa's intergovernmental system works on the principle of cooperation between the three spheres of government. To achieve this there needs to be a clear understanding of the powers and functions of each sphere to avoid encroaching on the geographical, functional or institutional integrity of government in another sphere.
2. The Constitution envisages that as municipalities develop the necessary capacity, the administration of many functions that are currently the responsibility of national and provincial government will be assigned to municipalities.
3. The assignment of functions to local government will have a direct bearing on the local government fiscal framework. Municipalities need to have access to revenue sources commensurate with the powers and functions that they are responsible for.
4. The revenue-service link between municipalities and residents is critical in fostering greater accountability. Requiring more households to pay even very small amounts for services may deepen local democracy and municipal accountability.

Intergovernmental relations and the role of local government

5. The intergovernmental system depends on well-coordinated policy, planning, budgeting, implementation and reporting within spheres and between spheres. Intergovernmental forums are therefore critical. Municipalities are generally represented on the national intergovernmental structures by 'organised local government' in the form of SALGA.
6. The Constitution differentiates between concurrent functions and exclusive functions. Concurrent functions are shared among the different spheres while exclusive functions are performed by one sphere only. Local government functions are listed in Parts B of Schedules 4 and 5 of the Constitution. They are all concurrent functions because national or provincial government may regulate how municipalities exercise their executive authority in relation to these functions.
7. In terms of the Constitution, municipalities have a responsibility to ensure that they realise the objectives of local government *within their financial and administrative capacity and that the delivery of basic services is prioritised in the way their administrations, planning and budgeting are structured and managed.*
8. Section 156(4) of the Constitution requires that functions are assigned to municipalities that have the capacity to administer them effectively. When assigning functions, care needs to be taken not to create unfunded mandates.
9. The current division of responsibilities between district and local municipalities needs urgent review as it is creating coordination problems and undermining accountability for service delivery. Generally the current agency agreements between district and local municipalities are not accompanied by a flow of funds from the district to the local municipality, undermining service delivery.
10. National and provincial government have a constitutional responsibility to support and strengthen the capacity of municipalities to manage their own affairs. Section 139 of the Constitution provides for intervention in a municipality where it fails to fulfil an executive obligation such as approving a budget or when there is a crisis in its financial affairs.

The local government fiscal framework

11. Constitutionally, local government is entitled to an equitable share of revenue raised nationally and may also receive additional conditional transfers from national and provincial government.
12. However, the Constitution also requires that municipalities raise their own revenues from service fees, property rates, surcharges and other taxes, levies and duties. The Constitution draws a distinction between actual 'revenue raised' and fiscal capacity. Municipal fiscal capacity must be determined independently of municipal fiscal effort, and only fiscal capacity can be considered in the local government equitable share formula.
13. Section 18 of the MFMA requires that municipalities ensure that their budgets are funded. National government does not bail out municipalities that fail to collect own revenues or mismanage their funds.
14. In setting property rates, service charges and other fees, municipalities must consider the two principles of taxation, namely the benefit principle and the ability to pay principle. Section 74(2) of the Municipal Systems Act, 2000 also indicates that all households should always make some payment for the municipal services they receive.
15. Municipalities may borrow funds from financial markets; however, a municipality's capacity to borrow is dependent on sound financial management, ability to repay, sound own revenue management and the choice of infrastructure projects.
16. The local government fiscal framework is deliberately designed to raise the municipalities' level of accountability to residents. The revenue-service link aligns the revenue interests of the municipality and the service delivery interest of the residents that pay for services. The provision of free services to indigent households means that there is no service-revenue link and that the financial interests of municipalities are not aligned with service interests of poor residents.

Services and the local government fiscal framework

17. There are five components in the relationship between municipal finances and service delivery. These are:
 - a. The relationship between the community's demand for services that a municipality is responsible for providing versus the local government fiscal framework;
 - b. The relationship between the local government fiscal framework and the actual revenues collected by a municipality;
 - c. How each municipality chooses to use its available resources;
 - d. The relationship between the municipality's governance and its management systems to implement the budget and manage service delivery; and
 - e. What actually gets delivered by the municipality.

Municipalities' roles in the management of resources

18. Municipal Councils, Mayors and Municipal Managers are responsible for:
 - a. Ensuring that available revenues are collected, that resources are allocated appropriately and that procurement and service delivery processes are economical, efficient, effective and equitable;
 - b. Ensuring that the municipality raises own revenues in line with its fiscal capacity;
 - c. Ensuring that revenues of the municipality are allocated in a manner that prioritises basic needs, and the social and economic development of the community;
 - d. Ensuring that the municipality has sound financial management policies and systems in place; and
 - e. Ensuring that the municipality has sound management in place to ensure that service delivery is economical, efficient, effective and equitable.

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Chapter 4: Revenue and expenditure trends in local government

Overview and background

1. Generally, municipal revenues and expenditures have grown quite rapidly over the review period. Capital spending grew very strongly until 2009/10, but spending over the medium term shows little growth.
2. In 2010/11 municipalities budgeted to spend R191 billion on their operational budgets – this is 20 per cent of overall government spending. In 2010/11 municipalities were responsible for managing R41 billion in infrastructure spending, which is 15.9 per cent of total public sector infrastructure spending.
3. Disparities in per capita expenditure levels between municipalities are still very large, highlighting the importance of national government transfers to local government, particularly to the poorer municipalities.
4. There is an urgent need to get the basics right with regard to revenue management, debt management and budgeting for repairs and maintenance, and to prevent spending on non-priorities.

Local Government in the system of public finance

5. Municipal operating revenue as a percentage of GDP is growing fairly consistently from 5.9 per cent of GDP in 2006/07 to 7.2 per cent in 2009/10, primarily due to growth in national transfers, rising electricity revenues and above-inflation increases in other service tariffs.
6. Even though local government infrastructure expenditure shows steady growth, its contribution to total public sector infrastructure spending declines from 25.2 per cent in 2006/07 to 15.8 per cent in 2010/11, primarily due to the rapid increase in infrastructure spending by public enterprises, notably Eskom and Transnet.

Trends in intergovernmental transfers to local government

7. National transfers to local government have consistently grown faster than total government expenditure, resulting in local government's share of nationally collected revenues increasing. Municipalities are expected to charge for most of the services they provide, and therefore local government's share of revenues raised nationally is only about 7.9 per cent in 2010/11.
8. Between 2010/11 and 2012/13, direct transfers to local government is projected to grow by R23 billion, or by 13.4 per cent annually. This growth in grants is intended to assist municipalities in meeting the capital and operating costs of providing basic services to poor households and fulfilling other functions.
9. The local government equitable share grows by an annual average of 16.6 per cent over the medium term, from R21.1 billion in 2009/10 to R33.4 billion in 2012/13. Most of this growth favours metros at 18.9 per cent per year, compared to 14.9 per cent per year for mostly rural municipalities. This is largely due to the impact of rural-urban migration.
10. The Municipal Infrastructure Grant (MIG) is budgeted to grow at 13.5 per cent per year over the medium term. From 2011/12, the urban settlements development grant is separated from the MIG.

11. Overall municipalities are becoming increasingly dependent on national infrastructure grants to fund their capital budgets. This is not a sustainable trend. It means tariffs for the main services are not covering the infrastructure costs of providing those services.

Revenue trends - operating revenue

12. Total operating revenue grew by 17.5 per cent between 2006/07 and 2009/10, primarily driven by very rapid growth in operational transfers and service charge revenues related to electricity.
13. Between 2009/10 and 2010/11, there is a significant decrease in 'transfers recognised – operational' largely due to conversion of the metros share of the RSC replacement grant into the general fuel levy which is captured under other revenue.
14. Many district municipalities also appear to be cutting back on operational transfers to the local municipalities within their areas.
15. The rapid increases in bulk tariffs have squeezed the ability of municipalities to generate surpluses on their trading services. Many municipalities have sought to or been forced to absorb some of the increases in bulk tariffs because higher prices are leading to increasing bad debt and inducing customers to consume less.
16. Consumer debts as a percentage of own revenues has been declining which is partly attributable to the rapid increase in own revenues (due to electricity tariffs) as well as to debt write-offs and to some extent improved revenue management.

Revenue trends - capital funding

17. Infrastructure grants from national and provincial government are the most important source of capital funding for municipalities, and its contribution increases from 44.3 per cent in 2006/07 to 58.3 per cent in 2012/13.
18. The decline in municipalities' own contributions to capital expenditure, both by way of internally generated funds and funds from borrowing, is cause for concern and can be attributed to historical cash reserves being exhausted, difficulties in generating surpluses on operating budgets due to cost pressures, and deliberately substituting own contributions with national transfers and spending the funds elsewhere.

Expenditure trends - operating expenditure

19. Actual total operating expenditure increased in real terms by 11.8 per cent annually from 2006/07 to 2009/10 and is estimated to grow by 6.4 per cent over the medium term.
20. Employee costs account for the largest component of operating expenditure, averaging 30 per cent of total operating expenditure. Bulk purchases constituted 22.2 per cent of municipalities' operating expenditure in 2006/07 and are expected to increase to 30.6 per cent in 2012/13.
21. Provision for 'depreciation and asset impairment' is growing very rapidly as municipalities implement GRAP 17.
22. Per capita operating expenditure by each municipality varies greatly. Per capita spend is highest in Gauteng at R6 609 in 2009/10 while Western Cape municipalities spent on average R6 167 per capita, despite rapid increases in the population of both these provinces. Per capita spending is lowest in Limpopo, Mpumalanga and North West and is probably linked to the historical underdevelopment of local government in these areas.

Expenditure trends - capital expenditure

23. Local government infrastructure expenditure almost doubled between 2006/07 and 2008/09, primarily driven by projects related to the 2010 FIFA World Cup. The fact that capital spending remains at about R40 billion is driven largely by growth in national government transfers to address service delivery backlogs.
 - a. Investment in road transport grew at an average rate of 49.2 per cent between 2006/07 and 2009/10, much of which was related to the upgrading of road networks and public transport systems in preparation for the World Cup;
 - b. Infrastructure budgets for electricity have been growing, but not as quickly as required given the backlogs;
 - c. There has been constant growth in capital expenditure on water and sanitation but there are a large number of smaller municipalities whose water and sanitation infrastructure is inadequate or in a very poor state; and
 - d. Housing related expenditures have been growing strongly, at an average annual rate of 13.7 per cent between 2006/07 and 2009/10 even though the housing function has not been devolved to local government.

Key issues in revenue and expenditure management

24. *Revenue management: getting the basics right* - Municipalities must pay more attention to all aspects of the revenue management value chain in order to ensure completeness of revenues. These include the integrity of billing information, accuracy of billing systems and the ability to collect revenues.
25. *Collecting outstanding debt: getting the basics right* - Persistently high debtor levels indicate that efforts to collect billed revenues are deficient. This may be due to a lack of political backing, insufficient staff/capacity, unwillingness to sanction electricity and other service cut-offs as debt management tools, poorly designed revenue management and associated policies, and affordability of municipal bills. The majority of municipalities have collection rates below 80 per cent.
26. *Underpricing of services* - Many municipalities' taxes and tariffs are inappropriately structured. Few municipalities understand how their services are being funded and what the balance between taxes and tariffs needs to be to ensure financial sustainability.
27. *Underspensing on repairs and maintenance* - This is probably the most serious misalignment in municipal budgets. Medium to long term consequences of underspensing on repairs and maintenance include deteriorating reliability and quality of services, more expensive crisis maintenance, increased cost of future maintenance, reducing the useful life of the assets, increased distribution losses, reduced revenue and rising tariffs over the medium term.
28. *Spending on non-priorities* - International experience with government cost-saving initiatives indicates that savings of as high as 15 per cent can be realised over time. This suggests that by eliminating non-priority spending, municipalities on aggregate could have saved up to R27 billion on their 2009/10 budgets, which is more than the total equitable share for local government in that year.

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Chapter 5: Financial management and MFMA reforms

Overview and background

1. Sound financial management systems and capacity are key to the successful implementation of infrastructure programmes, service delivery expansion efforts, and improvements in the level, reliability and frequency of services.
2. Significant strides have been made since 2003 with implementing the new financial management arrangements contained in the MFMA and its regulations.

Reforms in municipal finance management

3. The MFMA lays the foundation for reforming municipal financial management. Regulations dealing with supply chain management, public private partnerships, minimum competency requirements of municipal finance officials, and asset transfers are in place. Each reform aims to build on the foundation laid by previous initiatives, taking into account the time needed for municipal systems and practices to change.
4. The MFMA has strengthened accountability in municipalities by:
 - a. separating political and management roles in relation to municipal finance;
 - b. developing a performance orientation; and
 - c. strengthening reporting and disclosure requirements to enable management to proactively identify and solve problems when they arise.
5. The MFMA accountability cycle requires the Integrated Development Plan (IDP), budget, service delivery and budget implementation plan (SDBIP), in-year reporting, annual financial statements, annual report and oversight report to be fully aligned.
6. Recent reforms include the issuing of Municipal Budget and Reporting Regulations in 2009. Future reforms will include:
 - a. introducing a standard chart of accounts;
 - b. strengthening revenue and cash management policies, processes and procedures;
 - c. strengthening non-financial reporting to facilitate “value for money” evaluations; and
 - d. finalising regulations for financial misconduct in terms of Chapter 15 of the MFMA.

Strengthening Planning and Budgeting

7. Improved processes for municipal planning and budgeting allow for more informed decisions and are fundamental to sustainable and efficient service provision.
8. The Municipal Budget and Reporting Regulations prescribe the format of the municipal budget in tables A1 to A10. The tables are designed to ensure that municipalities disclose key information regarding the funding of their budget, the management of assets and the delivery of basic services.
9. The regulations also require the establishment of a budget steering committee, regulate the disclosure of budgets for capital projects, and specify the purposes and amounts that mayors may approve as ‘unforeseen and unavoidable expenditure’.

10. A range of documents have been issued to facilitate the implementation of the regulations, including a Dummy Budget Guide to illustrate the kind of information and analysis municipalities are expected to present in their annual budget documents.
11. Since 2005/06, there has been a steady improvement in municipalities' compliance with the budget tabling deadline of 31 March. In 2010/11 only 31 municipalities failed to meet this deadline. In 2010/11, the number of councils that failed to approve their annual budgets before 1 July was 50 municipalities compared to 110 municipalities that failed to meet this deadline in 2009/10.
12. The funding compliance assessment of municipalities' 2010/11 budgets showed that only 123 municipal budgets (or 43 per cent) were appropriately funded, 90 were unfunded and 70 municipalities did not provide sufficient information to carry out the evaluation.
13. Assessing the credibility of a municipal budget is a complex exercise, but if a municipal budget is unfunded, it is not a credible budget, indicating that the municipality will not be able to implement it.
14. Over and under spending of budgets remains a concern. In 2009/10, 174 municipalities underspent their operating budgets by more than 5 per cent, while 39 overspent operating budgets by more than 5 per cent.
15. In 2009/10, 28 municipalities overspent their capital budgets by more than 10 per cent, while 23 underspent by more than 10 per cent. In the same year, 169 municipalities underspent their capital budgets by between 5 and 10 per cent. Total underspending of the capital budget for 2009/10 was R15 billion.

Strengthening oversight through improved transparency

16. Over the past three years, National Treasury has significantly expanded the range of municipal information published on the MFMA section of its website (www.treasury.gov.za). Through this process, National Treasury aims to increase transparency, support monitoring, analysis and research, and reduce the reporting burden on municipalities.
17. Published information now includes annual budget information, quarterly section 71 finance reports and annual financial statements, as well as municipal IDPs, approved budget documents and annual reports.
18. Municipalities are also required in terms of section 75 of the MFMA to publish key documents and information on their municipal websites.

Institutional strengthening and capacity building

19. The MFMA requires each municipality to establish a budget and treasury office to manage the municipality's finances and oversee that all branches of the municipality comply with finance related legislation. Initiatives to strengthen financial capacity are often hampered by low levels of staff experience, inappropriately qualified staff, high vacancy rates and high staff turnover.
20. Minimum competency requirements for the continued employment of financial officials and supply chain management officials appointed after 1 July 2007 have been implemented. The deadline for compliance is 1 January 2013.
21. The municipal finance management programme has been structured to enable officials to attain the required competency levels.

22. The Siyenza Manje programme was also restructured in 2010, to ensure departments responsible for financial management and infrastructure matters respectively were in a position to direct the deployment of support to where it is most required, and to monitor the effectiveness of the programme.

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Chapter 6: Leveraging private finance

Overview and background

1. Investment in municipal infrastructure is critical for promoting and sustaining economic growth, eradicating service delivery backlogs, responding to demographic changes such as urbanisation, and rehabilitating ageing infrastructure.
2. The economic recovery is putting more pressure on municipalities to provide infrastructure to support growth. Municipalities need to find innovative ways of financing this new infrastructure. Existing sources of capital finance, namely internally generated municipal funds, intergovernmental grants, and borrowing, are insufficient. Other sources of capital finance, such as development charges, land leases and public private partnerships (PPPs), can play an important complementary role.

Municipal Infrastructure Investment Requirements

3. It is estimated that the total municipal infrastructure investment requirement for all municipalities will be some R500 billion over the next 10 years - R421 billion is required to finance new infrastructure to support economic and population growth and the rehabilitation of ageing infrastructure, while R79 billion is required to address backlogs.
 - a. Metros and secondary cities are estimated to need R271 billion over the next 10 years - R26 billion for the eradication of backlogs, and R245 billion to fund new infrastructure;
 - b. Smaller cities and large towns (so-called B2 and B3 municipalities) will need about R98 billion - R52 billion for rehabilitation, R14 billion for addressing backlogs and R32 billion for supporting growth. Accessing capital markets is difficult for these municipalities; and
 - c. The 70 mostly rural municipalities (so-called B4 municipalities) will need about R131 billion over the next 10 years - R40 billion for the eradication of backlogs and R91 billion for infrastructure to support growth and the rehabilitation of existing assets. The borrowing capacity of these municipalities is very limited.

Sources of infrastructure finance

4. Municipalities need to explore ways of leveraging private finance to mobilise additional resources to fund infrastructure investments. Four broad options exist:

Municipal Borrowing:

5. Most municipal borrowing from both private and public sector financial institutions takes the form of long-term loans, accounting for R25.4 billion (64 per cent) of total borrowing. Securities, mainly in the form of municipal bonds, account for R11.8 billion (30 per cent) of total borrowing, while short term debt accounts for 6 per cent, of which R909 million are bank overdrafts and R2.4 billion is commercial paper.
6. The municipal bond market remains small and underdeveloped, accounting for only 2 per cent of total government bonds listed on the Johannesburg Stock Exchange.
7. The development of the municipal debt market is limited by the following factors:
 - a. The lack of a developed secondary bond market to enhance liquidity of bond instruments and enable municipal bondholders to trade the instrument;

- b. Shorter maturities on loans which typically do not match the life-span of the assets. This requires higher tariffs in the medium term to finance debt service costs;
- c. Creditworthiness is impacted by poor financial performance and the use of loans by many municipalities to finance social infrastructure which does not lead to an increased revenue base;
- d. Lack of treasury management capacity and borrowing strategies to support infrastructure investment programmes; and
- e. The need for DBSA to play an active role in crowding-in lending to local government and increasing lending to municipalities at the lower end of the market.

Development charges

- 8. The absence of development charges creates distortions in the economy, particularly through underpricing the cost of development in some municipalities and contributing to the under- provision of municipal infrastructure more generally.
- 9. If used judiciously, development charges can play an important role in accelerating the overall development of municipal infrastructure. Without development charges, infrastructure for new developments would have to be financed from the municipality's capital budget, resulting in reprioritisation of other projects.
- 10. National Treasury is in the process of developing norms and standards to ensure development charges facilitate (and do not stifle) new property developments.

Land Based Finance Strategies

- 11. Apart from selling land, there are a range of other land based strategies that municipalities can explore to raise finance for infrastructure investments, such as using municipal land as security for raising loans, leaseholds on municipal land and land-use exchanges.
- 12. Selling municipal land to fund operating deficits is bad practice. As a principle of good stewardship, municipalities should always use the proceeds of municipal land sales to purchase other land for the municipality in line with its spatial development plan – so as to maintain and grow the value of the municipality's land portfolio, thereby strengthening the municipality's balance sheet – which can then be leveraged to raise the finance required to fund infrastructure.

Public Private Partnerships (PPPs)

- 13. PPPs allow municipalities to take advantage of private sector expertise and experience in the construction of infrastructure.
- 14. Developing 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.

Developing the municipal borrowing market

- 15. The MFMA puts in place a framework to facilitate municipal borrowing. Municipalities are encouraged to access private finance on the strength of their balance sheets and their credit ratings. The development of secondary markets for municipal debt could lower the risk of lenders and therefore lower the cost of borrowing for these municipalities.

16. Measures that are being considered to facilitate municipalities' access to private finance include:
- a. Bond pooling for secondary cities with similar credit qualities will be cost-effective allowing them to pool their financing needs and approach the financial markets as a collective, resulting in longer maturities and lower debt costs associated with bonds;
 - b. The DBSA needs to step up its support for municipalities in line with its developmental mandate and increase lending to those municipalities that currently do not have access to credit markets; and
 - c. National Treasury will explore ways to strengthen municipality's treasury functions to guide municipalities on how to optimise their borrowing strategies.

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CHAPTER 7: Managing municipal personnel

Overview and background

1. The proper management of personnel is critical to the effective and efficient functioning of municipalities. Municipalities in aggregate spend between 25 and 30 per cent of their total operating budgets on the remuneration of personnel.
2. Without proper personnel management, municipalities are likely to experience difficulties. An analysis of municipal finances suggests that personnel issues very often lie at the heart of many municipalities' financial problems.
3. Personnel management in local government has been marred in many instances by poor recruitment practices, political interference in the appointment and dismissal of employees, the inability to attract and retain suitably qualified staff, high vacancy rates and the lack of performance management systems and other related symptoms.
4. The Municipal Systems Amendment Act (2011) which came into effect on 5 July 2011 seeks to address a number of personnel related issues in municipalities.

Trends in local government employment

5. Local Government contributed just over 2 per cent to total employment in the country, with metros employing more than half of the total municipal workforce. Although the trend appears to be stable since 2006, employment related to outsourcing is not reflected as part of municipal employment but is still paid for by the municipality.
6. Employment levels are also expected to increase slightly from 2010 onwards as the general discomfort with labour brokering results in the absorption of temporary workers into permanent positions.
7. Local government employment grew by nearly 11 000 or 4 per cent between 2006 and 2009 with most of this growth concentrated in secondary cities and district municipalities. Employment by metros, towns and rural municipalities fell in this period.
8. There are a number of explanations for the slow growth in municipal employment, including outsourcing activities as a more cost effective method of delivering services, the fact that financial pressures have constrained the ability of municipalities to increase employment, and the difficulty of recruiting suitably qualified staff in towns and rural municipalities.

Building municipal capacity

9. Substantial investments have been made by national and provincial government in building municipal capacity, yet significant challenges still remain.
10. Capacity challenges are not the only cause of poor performance. Reducing all municipal performance problems to a lack of capacity enables institutions and government officials to focus on the softer, easier capacity building type interventions, rather than the complex processes of dealing with poor performance, and a longer-term focus on aligning municipal systems and incentives to ensure sound administration.
11. There is a tendency for municipalities to select training programmes mainly on the basis of cost rather than investing in effective training and development initiatives. There is no reliable, comprehensive data on what municipalities spend on training and the number of staff benefitting.

12. The total vacancy rate in metros has been approximately 25 per cent since 2006 but there are notable differences between the metros.
13. In 2008/09, there were about 144 000 approved positions on district and local municipalities' approved organisational structures. Of these positions, 36 per cent or 51 200 were reported to be vacant, which suggests that municipalities are operating significantly below capacity. Funding is only available for filling less than 50 per cent of these vacant posts.
14. There has not been much improvement in filling senior management vacancies in local municipalities when comparing vacancies in 2006 to those in 2009.

Sector employment trends

15. Employment in the financial administration sector has declined from 14.1 per cent in 2006 to 11.3 per cent in 2009. Overall, employment in the technical sectors has fallen from 29 per cent in 2006 to 23.4 per cent in 2009, while employment in the sector 'other' has increased from 56.9 per cent to 65.3 per cent between 2006 and 2009.
16. Vacancy rates in metros are high – more than 20 per cent among all sectors. Vacancy rates in category B and C municipalities have remained almost unchanged between 2008 and 2009.

Municipal remuneration

17. Total remuneration has increased by 52.5 per cent between 2006/07 and 2009/10, while growth in municipal employment over the same period was only 4 per cent, resulting in a very significant increase in the average per capita cost of employment.
18. The average annual growth rate in personnel remuneration was 15.1 per cent between 2006/07 and 2009/10. Average annual growth in personnel spending is generally consistent amongst the metros and most of the category B municipalities. In rural municipalities, growth in personnel expenditure was above the average growth rate, accompanied by a decline in actual employment. This indicates that salaries in rural areas have grown significantly over the period.
19. Senior management remuneration accounts for only 3.4 per cent of the total municipal wage bill in 2009/10. In metros and secondary cities, salaries for municipal managers and CFO's do not appear to be out of line with experience, expertise and responsibility required. In district municipalities, municipal managers' average salaries appear to be unreasonably high.

Performance Management

20. Public perceptions of municipal service delivery have declined significantly in recent years. In many municipalities, poor performance is compounded by the lack of experienced senior managers in critical positions.
21. Performance management in local government is governed by a legislative framework and performance management regulations but the actual implementation of performance management systems requires significant improvement. The actual translation of organisational objectives into individual performance agreements is often weak.
22. The Municipal Systems Amendment Act now provides that all section 57 managers, other than the municipal manager, be appointed on permanent contracts. This has the potential to greatly enhance the stability of senior management within municipalities, with positive results for performance.

Chapter 8: Water and sanitation

Overview and background

1. South Africa is facing a number of significant challenges in relation to water, both at the level of the resource as well as in the actual provision of water services by municipalities. Recent studies have estimated that by 2025 the demand for water in South Africa will exceed supply if nothing is done to supplement current water resources.
2. The sustainability of the sector as a whole is also at risk due to the poorly maintained and often ill-equipped infrastructure, general under-pricing of water across the value chain and the deteriorating quality of sanitation services in a number of municipalities.
3. The Department of Water Affairs' Blue Drop Report for 2009/10 shows that only 38 water supply systems in 26 municipalities were awarded the highest blue drop status certificate, while about 75 per cent of South Africa's sewerage treatment works are not up to standard.

Water availability and demand

4. South Africa is a semi-arid, water scarce country where only 29 per cent of our total annual surface run-off is available as a reliable yield and only 20 per cent of our ground water can currently be used.
5. Future growth in water requirements is expected to be mainly in metros and large cities. However, the urban demand for water must be balanced with rural water needs, particularly agriculture, to safeguard food security.

Water resource management

6. The management of water resources is an exclusive national competency with the management of water resources being decentralised. South Africa has been divided into 19 water management areas (WMAs) and each WMA has a catchment management agency (CMA) to advise on the protection, development, use and conservation of water in each catchment.
7. The majority of capital investments in water resource infrastructure were made in the 1970s and 1980s. There is a history of underinvestment in maintenance and renewal of assets in the water sector as a whole and it is critical that appropriate investments be made to upgrade existing infrastructure, as many of these assets are approaching the end of their useful lives.
8. The national backlogs in water resource infrastructure is estimated to be approximately R13 billion - R10.1 billion alone relates to dam safety and rehabilitation. Over the next five years, the Department of Water Affairs plans to spend in the region of R15 billion on new capital projects, rehabilitation and maintenance programmes.

The water services sector

9. In its 2009/10 annual report, the Department of Water Affairs reports that overall access to water supply infrastructure has since increased to 97 per cent. The current backlog is therefore estimated at 3.63 million people as at March 2010. This suggests South Africa will come close to its Millennium Development Goals in relation to access to water.

10. The 2009/10 annual report also reported that overall access to sanitation has increased to 79 per cent. It is estimated that approximately 10.6 million people or 2.6 million households still do not have access to basic sanitation services.
11. The total number of households that received basic water increased by 7 per cent or 695 000 between 2008 and 2009, while the number of households that received basic sanitation increased by 7.6 per cent or 657 000.
12. Implementation capacity remains a constraint. Ensuring the sustainability of existing infrastructure requires more funding and the cost of extending the network infrastructure to outlying communities is not cost-effective or sustainable, which points to the need to explore alternative service delivery options.

Funding of basic water and sanitation

13. Municipalities budgeted to spend R32 billion on water and sanitation in 2010/11, compared to the R8.4 billion spent in 2006/07. Most of the operating expenditure associated with the provision of water occurs in metros and large urban municipalities. Operational expenditure on water is expected to increase at an annual average rate of 35 per cent between 2009/10 and 2012/13.
14. Capital spending on water infrastructure among the category B and C municipalities is expected to increase significantly in 2010/11.
15. Overall spending on municipal sanitation is expected to increase at an average annual rate of 31.9 per cent between 2009/10 and 2012/13. Total capital expenditure on sanitation is expected to grow at an annual average rate of 36.3 per cent between 2009/10 and 2012/13, indicating that municipalities are prioritising the rollout of sanitation infrastructure.

Water services pricing and tariffs

16. It is imperative that the costs at each stage in the water value chain are determined as accurately as possible to avoid overall under-pricing of water. The Department of Water Affairs regulates the tariff charged by water boards to municipalities and has issued norms and standards aimed at promoting equitable, financially viable and environmentally sustainable tariffs.
17. The highest average domestic water tariffs are in Gauteng while the lowest average domestic tariffs occur in the Northern Cape.

Factors influencing the efficient provision of water services

18. Non-revenue water (water for which the municipality does not earn any revenue) is estimated to be about 35 per cent of water supplied. This estimate is informed mainly by information from metros and other large municipalities. Non-revenue water may even be higher in rural municipalities due to the maintenance backlogs that exist. Water losses due to poor maintenance, inaccurate or incomplete billing and water theft are a major concern.
19. Most municipalities in South Africa have also not paid sufficient attention to the maintenance of their existing infrastructure. In smaller and more rural municipalities, there is no strategic management of assets. Many of these municipalities are unaware of what assets they have, where those assets are located, how old those assets are and what investments are required to extend the useful life of those assets.
20. The impact of climate change on the provision of water services will complicate planning for future water supplies and investment needs in the sector. However, it is difficult to quantify the cost of climate change on the country's water system.

21. In the 2011 Budget, Cabinet allocated R3.6 billion for water infrastructure and services, part of which is for projects to deal with acid mine drainage following the recommendations of the inter-ministerial task team appointed to determine the risk of acid mine drainage to the environment and water quality.
22. The skills shortage is posing a significant risk to the sector's continued capacity to provide water services effectively. The number of engineers per 100 000 people has decreased from 20 in 1994 to 3 in 2010.

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Chapter 9: Electricity

Overview and background

1. National economic growth has outstripped available electricity generation capacity, while regulatory uncertainty has undermined the effective management of distribution assets at the municipal level.
2. Significant annual tariff increases are set to be a feature of the electricity industry for a few more years as funding for expanding generation capacity is required to meet the demand for electricity from a growing economy.

Overview of the generation and transmission of electricity

3. In June 2006 the country's growing economy began to make full use of the electricity generation capacity that had been built in the 1970s and 1980s, leading to shortages of electricity, resulting in load shedding.
4. In March 2011, Cabinet approved government's integrated resource plan (IRP) for electricity, outlining a strategy for increased generation capacity and committing government to complete the programme of constructing new generation capacity already being implemented, as well as providing options for further capacity that will allow the country's electricity supply to keep pace with the projected future growth in demand.
5. The current electricity generation build programme will add a total of 14 000 MW to the country's generation capacity. From 2013 to 2018, the country will be able to meet the demand for electricity (as well as provide for 15 per cent reserve margin) under current demand forecasts.
6. After 2018 it is envisaged that renewable energy sources will contribute 47.9 per cent of the new build options, fossil fuels will make up 29.5 per cent and nuclear energy 22.6 per cent. This represents a significant shift away from coal-based technology in the country's electricity generation capacity. Government has also decided that Independent Power Producers (IPPs) will play a greater role in electricity generation in South Africa in the period ahead.
7. Reducing demand for electricity plays a key part in government's strategy to make sure that there is sufficient supply of electricity to meet demand. National government committed R978 million to electricity demand side management grants to both Eskom and municipalities over the three years from 2009/10 to 2011/12.

Electricity distribution

8. Responsibility for distributing electricity to end-users is shared between Eskom and municipalities. This creates a complex situation, where different areas are served by different service providers and with different tariff structures for consumers. Furthermore, this arrangement inhibits the ability of these municipalities to raise revenue and manage outstanding debt in the areas serviced by Eskom.
9. The establishment of the Regional Electricity Distributors (REDs) was intended to resolve this problem. However, REDS have been discontinued and the Department of Energy will now undertake a review of the whole electricity value chain and develop a holistic approach to revitalising infrastructure in the sector.
10. The uncertainty created by the proposed restructuring of the electricity sector resulted in serious underinvestment in distribution infrastructure.

Financing electricity distribution

11. Electricity is a major source of revenue and expenditure for municipalities. Revenue from the sale of electricity accounted for over a quarter of total revenue for municipalities before the rapid tariff increases that began in 2009/10.
12. South Africa is currently facing steep annual increases in the tariffs for electricity. NERSA granted Eskom price increases of 24.8 per cent for 2010/11, 25.8 per cent for 2011/12 and 25.9 per cent for 2012/13 for the generation and sale of bulk electricity. If NERSA approves the proposed increases for 2013 and 2014, then by 2014, electricity generation tariffs will be a little over three times higher than at the start of 2009/10 in real terms.
13. Retail tariffs include charges for the generation, transmission and distribution of electricity. NERSA-approved tariffs include provision for the costs of staff and repairs and maintenance for the distribution system. In 2010, NERSA announced a new system of Inclining Block Tariffs (IBTs) which will divide consumers into four groups or blocks based on the amount of electricity they use. Higher-use blocks will pay tariffs that include a surplus to be used to cross-subsidise tariffs in the lower-use blocks.
14. Electricity is generally used by municipalities as a lever for effective credit control. It is the only basic service that municipalities can cut-off to penalise non-paying households. Municipalities that do not supply electricity to households directly have reduced leverage in ensuring that those households pay for the other basic services the municipality provides to them.
15. There is substantial scope for reducing electricity demand and increasing revenue by reducing losses in the distribution of electricity. The internationally acceptable margin for electricity distribution losses is 6.5 per cent but very few cities in South Africa achieve this benchmark. Amongst the metros, eThekweni has the least losses, at around 5 per cent, while Johannesburg loses 12 per cent of the electricity it purchases. Reducing technical losses would mitigate the need to add generation capacity to the system, while reducing electricity theft would raise revenues.
16. The Department of Energy estimated in 2008 a backlog of R27.4 billion in maintenance, refurbishment and short-term strengthening in the electricity distribution industry inclusive of Eskom and municipal backlogs. Capital expenditure grew strongly in 2007/08 and 2008/09, remained flat in 2009/10 and is expected to grow by 20 per cent again in 2010/11.
17. Of great concern is that on average, municipalities are budgeting to decrease their capital spending by 11 per cent in 2011/12 and a further 4 per cent in 2012/13. Given the growth in population, increasing number of households, high levels of historical backlogs and the need for upgrading or replacing aging infrastructure, municipal budgets for capital expenditure should increase over the medium term and not decrease.
18. The discontinuation of REDs means that municipalities now have certainty regarding the future ownership of electricity assets, and must take responsibility for their maintenance. Funding this increased investment in the repair, maintenance and upgrading of infrastructure will require municipalities to either increase tariffs or find the funds from elsewhere in their budgets.

Promoting household access to electricity

19. Between 2006 and 2009, the total number of connections increased by 1.3 million from 7.1 million to 8.4 million. National government funds the rollout of energy distribution infrastructure through the Integrated National Electrification Programme (INEP). Most of the funding is directed towards Eskom, indicating the high levels of backlogs in rural areas where Eskom is the major electricity distributor.
20. Statistics South Africa collects data on the level of access to free basic electricity through its annual non-financial census of municipalities. Figures from both the non-financial census and Eskom are based on consumer units and not households, and are therefore not comparable with household data collected in the census and community survey.

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Chapter 10: Roads

Overview and background

1. Road infrastructure is an effective catalyst for spatial development, and the development of business and residential areas. Roads also facilitate the mobility of goods and people and provide connections to the external world, specifically access to markets and public services, such as ambulances and police services. Social and economic development is constrained where there is a lack of reliable access to services, materials and markets for people and firms. The building of roads creates jobs, especially if labour intensive methods are used, which helps alleviate poverty and unemployment.
2. There is evidence of under-investment in South Africa's road and stormwater infrastructure which is compounded by traffic volumes and heavy rains. Given the enormous value of our country's road assets (estimated to be approximately R1 trillion) it is essential that these assets not be allowed to deteriorate further, as the cost of restoration will be extremely high.

Institutional arrangements for roads

3. Effective institutional arrangements and proper coordination remain a challenge in road infrastructure delivery due to the constitutional assignment of functions for roads.
4. National Government (through the Department of Transport) plays a facilitative and regulatory role and is responsible for the development of policy and the legislative framework to be implemented through provincial departments, local government and public entities.
5. The Constitution makes provincial roads and traffic an exclusive provincial function while municipal roads, traffic and parking are municipal competencies. Municipalities are responsible for investments in local road infrastructure. Municipalities generally tend to outsource large rehabilitation and new infrastructure projects to private sector civil and mechanical engineering firms, while maintenance and light construction activities are done internally.

The state of the country's roads

6. Data on the state of the country's roads and the extent of refurbishment and maintenance backlogs in the road network vary due to the Department of Transport being reliant on provinces and municipalities to supply information. Most municipalities lack road management information and decision support systems to inform construction, maintenance and rehabilitation of their roads.
7. SANRAL (2010) estimates indicate the South African road network comprised 606 978 km of proclaimed national, provincial and municipal roads and approximately 140 000 km of unproclaimed roads predominantly in the rural areas.
8. No authority can spend money on roads that are not proclaimed, meaning that many people living in rural areas do not have access to roads that are maintained by one or other sphere of government. Hence there are no maintenance and rehabilitation programmes in place, undermining prospects for development.
9. It is also estimated that only 37 per cent (222 507 km out of 606 978 km) of the proclaimed roads' condition is known, implying that the condition of the remaining 63 per cent of the proclaimed road network is unknown. This makes it difficult to quantify maintenance backlogs and implies that road authorities are probably not channelling investments in an optimal and cost-effective way.

10. Local government is responsible for 54 per cent of the country's road network. Almost 80 per cent of the paved roads in metros and over 82 per cent in other municipalities are in good and very good condition. The state of gravel roads in metros is generally good, while 30 per cent of gravel roads in other municipalities are in bad condition.
11. The increase in pothole damage is due to reduced preventative maintenance and an increase in the number of heavy vehicles. It is estimated by the South Africa Road Federation that potholes are costing motorists R50 billion in vehicle repairs and injury every year.
12. Challenges faced by municipalities in managing roads and stormwater infrastructure include:
 - a. *Inappropriate prioritisation in allocating budgets*: new infrastructure prioritised over maintenance;
 - b. *Maintenance budgets*: treated as discretionary and first to be cut to realise savings;
 - c. *Non-integrated housing developments*: due to a lack of co-ordination between provinces and municipalities on location of new housing developments;
 - d. *Loss of key technical staff*; and
 - e. *Lack of asset lifecycle planning capability*.

Funding and expenditure on road infrastructure and maintenance

13. For many municipalities, the most significant source of road infrastructure funding is the Municipal Infrastructure Grant (MIG). Another major source of funding road infrastructure at municipal level is the Public Transport Infrastructure and Systems grant (PTIS). Municipalities may also use a portion of the local government equitable share to finance infrastructure road projects or municipal internally generated funding.
14. The expanded public works programme also focuses on the creation of work opportunities by providing resources for labour intensive programmes such as road construction and maintenance. However, many municipalities have not taken advantage of this programme for road infrastructure and maintenance.
15. In 2008/09, total provincial and municipal roads infrastructure expenditure was R20.1 billion. Of this, municipalities spent R7.3 billion or 36 per cent and provinces spent R12.8 billion or 64 per cent. Expenditure on roads and stormwater infrastructure is as low as R200 000 in smaller municipalities indicating that this is not a priority.

Policy and funding developments in the roads sector

16. Key policy developments in the medium term in relation to roads include:
 - a. *Development of an effective and integrated infrastructure network that serves as a catalyst for social and economic development* by ensuring maintenance and expansion of the road network; and
 - b. *Development of road asset management and preservation policy* to begin in 2011/12 to effectively support the road infrastructure strategic framework of South Africa.

17. Government also plans to spend a total of R22.3 billion rand on the S'hamba Sonke project (its road construction and maintenance plan) over the next three years.
18. To support the initiatives of the Department of Transport, the Minister of Public Works launched a R150 million project in March 2011 to address potholes across the country.

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Chapter 11: Solid Waste Services

Overview and background

1. Solid waste management and service delivery systems can make critical contributions to public health by reducing opportunities for disease-spreading vermin to thrive, to environmental sustainability by protecting watercourses and groundwater and preventing illegal dumping and littering, to economic development by supporting higher levels of economic activity, and to poverty reduction by creating job opportunities.
2. The National Environmental Management: Waste Act (2008) uses the waste hierarchy as its overarching principle for waste management, focusing on waste minimisation, re-use, recycling and recovery in preference to waste disposal. Managing waste in line with the waste hierarchy has the potential to provide jobs as recycling requires infrastructure and opens new markets. However, efforts to bring down the unit cost of solid waste services will result in greater mechanisation that may reduce jobs in the sector.

Institutional arrangements for solid waste services

3. Solid waste management in South Africa is primarily a local government function. Municipalities are required to ensure the sustainable delivery of services, subject to national and provincial regulations and standards.
4. Section 44 of the Constitution gives national government the right to legislate on the grounds of the need to maintain essential national standards, establish uniform norms and standards, and to promote and give effect to the right to an environment that is not harmful to health and well-being.
5. Provincial governments are tasked with the implementation of the national waste management strategy and national norms and standards, and may set additional, complementary provincial norms and standards.
6. Government has attached greater importance to the development of integrated waste management plans by all spheres of government which will be seen as the primary tool for strengthening cooperative governance in the sector.
7. A number of weaknesses exist in the current institutional arrangements for solid waste:
 - a. *Division of roles between district and local municipalities:* resulting in vagueness or overlap of responsibilities which undermines accountability for service delivery;
 - b. *Regionalisation of service delivery:* the actual trend has been towards decentralisation. Policy on regionalisation is vague;
 - c. *Ring-fencing of solid waste functions:* important but insufficient to improve efficiencies; and
 - d. *Effective systems of cooperative governance:* inadequate distinction between policy-making, regulatory and service provider roles across spheres of government.

Access to solid waste services

8. Statistics South Africa reports that 64.5 per cent of households had access to some form of solid waste management service in 2007. The number of served consumer units has risen by 6 per cent per year since 2005. Access to services is greatest in

metro areas (92.5 per cent) and small towns (73.5 per cent), while it is lowest in rural municipalities (16 per cent).

9. Levels of service differ markedly by the type of municipality. Most consumers with basic services receive at least a weekly collection service but 19 per cent (or 1.3 million) of households in metros and secondary cities do not receive weekly refuse services. 23 per cent of households in secondary cities make use of their own refuse dumps. Outside of these areas, 13 per cent (or 726 000) of households do not receive any refuse service or make use of on-site disposal.
10. Data from the Community Survey 2007 indicates the backlog in the provision of solid waste services is 2.1 million households while Statistics South Africa in its annual service delivery survey indicates that some 4.1 million households do not have access to solid waste services.
11. Government set a target of providing all households with access to refuse removal services by 2012. Significant progress has been made in expanding access, but significant challenges remain. Lack of access to services remains highest in rural municipalities. The failure to provide services in informal settlements and other underserved areas leads to the unregulated dumping of solid waste, contributing to air and soil pollution.

Financing solid waste services

12. Information on operating revenues and expenditures for the solid waste function is generally weak. Many municipalities have only begun to report on these areas separately as a result of implementing the Municipal Budget and Reporting regulations.
13. Municipal income from solid waste services has grown quite rapidly due to more complete reporting, as municipalities move to identify the streams of revenue associated with trading services.
14. However, for most municipalities', the budgeted revenues for solid waste do not cover budgeted expenditure leading to an under-recovery of costs. This implies municipalities have to subsidise the service from other revenue sources and also sends inappropriate signals to households and other waste generators about the cost of the municipalities' activities, resulting in limited incentives for waste minimisation.
15. Municipal expenditure on solid waste services has been growing very rapidly again due to more complete reporting. Very few municipalities are setting aside funds (in dedicated cash-backed reserve funds) for the rehabilitation and management of their landfill sites once they have reached the end of their useful lives.
16. Capital budgets for the solid waste function grew very rapidly between 2006/07 and 2009/10 – at average annual rates of over 100 per cent. This can largely be attributed to more complete reporting, but municipalities are also expanding access to solid waste services. Over the medium term capital spending on solid waste services grows at a far more moderate pace, and even declines in certain instances.
17. The municipal services financial model used by the Department of Environmental Affairs and Tourism estimates an average annual municipal capital expenditure requirement of between R1.4 billion and R1.6 billion or a total of R14.2 billion or R16.4 billion over a 10 year period. In 2010/11, municipal budgeted capital expenditure levels were about 75 per cent of the lower of these target levels.

Waste minimisation, recycling and energy recovery

18. About 95 per cent of all South Africa's waste is disposed of in landfill sites. This reliance on landfills has limited the incentive to devise alternative methods of dealing with waste.
19. Municipalities and industries currently do not give sufficient attention to waste minimisation, impacting negatively on operating and capital cost structures associated with collection, transport and disposal. It also militates against the achievement of the waste minimisation targets of the Polokwane Declaration on Waste Management (2001). Volumetric user charges offers some prospect of reversing this situation and the move towards producer responsibility seeks to place greater responsibility for promoting recycling on industries, in line with the producer responsibility approach.

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Chapter 12: Delivering municipal services in rural areas

Overview and background

1. Municipalities are not solely responsible for addressing the enormous challenges of rural poverty and rural development, but through providing basic services effectively, leveraging municipal spending to create local jobs, and facilitating local economic development (LED), rural municipalities can play a very important role in alleviating the worst forms of poverty and facilitating development in rural areas.
2. Global Insight's 2009 estimates indicate that 15.9 million South Africans live in poverty. Of these 11 million people, representing 69 per cent of all South Africans that live in poverty, reside in rural areas.

Defining rural areas and municipalities

3. The demarcation of municipal boundaries has removed the administrative distinction between urban and rural areas and complicated the determination of what constitutes a rural area and, by extension, a rural municipality.
4. The rural development framework (1997) defined rural areas as those that are sparsely populated in which people farm or depend on natural resources, and areas that include large settlements in the former homelands, which depend on migratory labour and remittances as well as government social grants for their survival. These areas typically have traditional land tenure systems.
5. In the Review, the definition of rural municipalities is based on the Department of Cooperative Governance methodology, which groups municipalities into seven different categories based on a range of variables. Rural municipalities are those classified as B3 (small towns) and B4 (mostly rural):
 - a. *Small towns (B3)* are municipalities characterised by no large town as a core urban settlement, and a relatively small population which is urban and based in one or more small towns. They are also characterised by local economies that are largely agricultural; and
 - b. *Mostly rural (B4)* are municipalities characterised by the presence of at most one or two small towns, communal land tenure and villages or scattered groups of dwellings – usually located in former homelands.

Demographic, social and economic context of rural municipalities

6. Rural municipalities are home to larger numbers of women than men, and to generally younger populations than urban municipalities. The economically active population (measured as those aged 20 to 64 years) in rural municipalities is considerably smaller than in urban areas. People in rural municipalities are also less likely than their urban counterparts to have school qualifications.
7. Economies of rural areas are less diversified than urban areas. In B4 municipalities, government, community and social services contribute 35 per cent to total Gross Value Added (GVA). Agriculture contributes 20 per cent to GVA in B3 municipalities.
8. Formal employment opportunities in rural areas are limited, often to seasonal employment. Average official unemployment (narrow definition) in the B3 municipalities is 23 per cent and 36 per cent in the B4 municipalities.

Rural development and local government

9. Municipalities have two core responsibilities with respect to rural development: the effective provision of basic services, and associated support to LED. Rural municipalities (both B3 and B4) have the highest backlogs in sanitation, electricity and water.
10. Recent trends in access to basic services in rural municipalities show a slowdown in delivery occurring in 2009 across all services. In small town municipalities, little growth in access was reported in 2009, other than in electricity provision. In mostly rural municipalities, a decline in access to water services was reported.
11. Extending and sustaining access to basic services in rural areas requires the use of appropriate technologies, greater innovation in the development and deployment of these technologies, and new institutional models to leverage local knowledge and skills.

Local economic development activities by municipalities

12. The purpose of LED is to build up the economic capacity of a local area to improve residents' quality of life. It is a collective effort of public, business and social sector partners. Government's new growth strategy highlights the potential of rural development as a driver of job creation.
13. Expenditure directed towards LED initiatives is very limited compared to other service delivery priorities of local government, and on average less than 1 per cent of the operating budgets of municipalities are directed towards LED initiatives.
14. National and provincial governments have introduced a range of specific programmes including the Neighbourhood Development Partnership grant, the EPWP, land reform programmes, agricultural support programmes, tourism support programmes and human capital development programmes.
15. Emerging lessons from municipal LED programmes show that these strategies should aim to support rural people to participate more fully in the market economy by creating an enabling environment for both formal and informal business to operate. This involves:
 - a. The provision of municipal infrastructure, particularly access roads;
 - b. Putting in place a user-friendly regulatory environment that supports new investment; and
 - c. Creating catalytic partnerships between municipalities, public and private agencies.
16. It was also found that initiatives that focus on community-based service provision seem to hold significant potential as they move financial resources into communities that create a basis for increased economic activity.

Financing rural municipalities

17. Given most rural municipalities' weak economic base and high levels of poverty, the fiscal framework is primarily focussed on addressing backlogs in basic infrastructure and subsidising basic service delivery. The local government equitable share subsidises the institutional capacity of rural municipalities, and the provision of basic services. Various conditional grants support the expansion of infrastructure and support capacity development. However, it is important that rural municipalities also show fiscal effort in raising own revenues according to their fiscal capacity.

18. A comparison of municipal own revenues to GVA shows that rural municipalities are collecting less revenue than their fiscal capacity suggests they should. This suggests they need to show more fiscal effort in raising rates from non-poor households and businesses, and from charging for services.
19. The very high level of grant dependence among rural municipalities reflects the unequal distribution of development across the country and these municipalities' relatively limited fiscal capacity. Consequently, rural municipalities' dependence on transfers will be an on-going feature of the local government fiscal framework. However, it needs to be recognised that grant dependence reduces the incentive to collect own revenue and undermines the service-revenue link between municipalities and their consumers.

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Chapter 13: Cities and the management of the built environment

Overview and background

1. South Africa's large urban municipalities are vastly different from their more rural counterparts in terms of demographic, economic and spatial trends. Contexts are rapidly diverging and cities (and rural areas) increasingly require different policies to allow them to focus on their specific challenges, as well as to account for the institutional capacity they have and are capable of developing.
2. Government recognises that large urban municipalities need to play a leading role in the management of the built environment, and so urban municipalities need to be established as the centre of planning and service delivery coordination. Functions that would be more effectively administered locally, including housing and local public transport, need to be assigned to municipalities that have the necessary administrative capacity.

The demographic, economic and spatial context of cities

3. In 2007, at least 52 per cent of the population resided in the 27 largest municipalities in South Africa. It is estimated by the United Nations Development Programme that a further 7.8 million people will live in the country's cities by 2030, followed by an additional 6 million people by 2050.
4. The apartheid spatial patterns persist and poor people continue to be forced to live in dysfunctional and disjointed settlements with limited social and economic infrastructure. International trends suggest that to better manage the urban space, cities need to densify along economic corridors and in areas of economic growth.
5. The demographic, economic and spatial trends have placed increasing pressure on urban municipalities raising four critical challenges that need to be addressed:
 - a. The growth in the number of poor people living in cities is placing pressure on municipalities to provide subsidised housing and free basic services;
 - b. The failure by municipalities to provide sufficient infrastructure and services to support economic growth is constraining private investment;
 - c. An inefficient urban form (physical layout and design of a city) is imposing significant costs on households, firms and public sector; and
 - d. Rising demand for urban services - population growth and declining household size is increasing the number of households requiring municipal services.

Public expenditure on the built environment

6. Public expenditure on *housing* increased from 2005/06 at an annual average rate of 26.6 per cent but the delivery of houses peaked in 2007/08, at 271 219 houses. There were 228 218 houses completed and under construction in 2009/10.
7. Metros' housing expenditure in 2008/09 constituted 22.2 per cent of the total housing allocation to provinces. Expenditure by metros is expected to increase from R1.2 billion in 2009/10 to R2.3 billion in 2012/13 but expenditure by secondary cities shows a declining trend possibly due to the nature of agency agreements with provinces. The provinces' inability to provide funding certainty to municipalities over the MTREF period limits their ability to plan and coordinate development.

8. Total spending on *public transport (excluding roads)*, amounted to R16.6 billion in 2008/09 - R9.85 billion related to capital expenditure and R6.8 billion for subsidies. Significant investments are now under way in rail infrastructure, as well as through the introduction of bus rapid transit systems in major cities. The subsidisation of bus services is currently funded through a provincial conditional grant. In terms of the National Land Transport Act (2009), subsidised bus services that are currently managed by provincial government will be integrated into the municipal based networks.
9. Public transport allocations have increased significantly since the introduction of the public transport infrastructure and systems grant in 2005/06. Between 2006/07 and 2009/10, the average annual increase was 67 per cent.
10. Investment in *passenger rail* has increased significantly in line with the national rail plan. The key areas of investment are in the metropolitan areas. The increased investment in passenger rail has increased the number of coaches in the system, which should lead to increased levels of service.
11. Investments in community assets are volatile and increased significantly between 2006/07 and 2009/10 due to investments in sports facilities linked to the 2010 FIFA World Cup, but decline over MTREF in metros and secondary cities.

Institutional and fiscal arrangements for managing cities

12. The demographic, economic and spatial challenges facing cities have been exacerbated by function and institutional misalignments. Key problems include:
 - a. *Sectoral duplication in the performance of functions*, for example, provinces continue to manage the national housing programme and various public entities hold significant strategically located land. Public transport services are subsidised by national government via a grant to provinces with little role for city administrations;
 - b. *Duplication of land regulation responsibilities* between cities and provinces expand the time required to obtain development approvals and impose deadweight costs on the economy;
 - c. *Failure to adequately exploit existing revenue sources*. Cities need to enhance the revenue management capabilities to fund infrastructure investment; and
 - d. *Weak asset management practices at city level*. The growing outcomes focus on grant programmes will enable national government to monitor municipal prioritisation of new asset creation and asset maintenance, refurbishment and replacement.

Reconsidering the fiscal framework for large cities

13. Government is reviewing the existing institutional arrangements and fiscal framework to strengthen the management of cities. Cities need to play a far larger role in economic growth, dealing with urban poverty and facilitating improved built environment outcomes. Some initiatives include:
 - a. Reviewing land use management legislation to clarify the roles and functions thereby empowering municipalities to fulfil their constitutional mandates;
 - b. The accreditation process associated with the devolution of the housing function to municipalities needs to be speeded up to enable municipalities to structure housing subsidies, facilitate planning and development and improve service delivery;

- c. The devolution of public transport functions to cities will allow for the integration of the planning, regulation and management of public transport services at local level; and
- d. Reviewing the local government fiscal framework will explore whether there is a need to expand own revenue sources for urban municipalities. Cities have significant but underutilised fiscal capacity, and need to focus on sound revenue management.

---Please read the chapter at www.treasury.gov.za---

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