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The socio-economic and fiscal context of local government

■ Introduction

South Africa's municipalities operate in a wide range of geographical, economic and social contexts. This was highlighted in the *2008 Local Government Budgets and Expenditure Review* using mainly information from the 2007 Community Survey undertaken by Statistics South Africa. The national census being planned by Statistics South Africa for October 2011 will provide a valuable update on municipalities' differing contexts – particularly the demographic trends over the last number of years. It is envisaged that this new information will greatly assist the refinement of policies and fiscal arrangements for local government, as well as facilitate better municipal planning.

While the economic recession in 2009 has affected all municipalities, some have been more affected than others due to the particular characteristics of their local economies. Those municipalities whose economies are predominantly trade and manufacturing based tended to be most affected, as job losses were concentrated in these sectors. The decline in employment has placed pressure on households' ability to pay municipal accounts; businesses have also been scaling back on the consumption of municipal services to save costs. Both these factors have placed pressure on municipal own revenues.

The economic recession affected some municipalities more than others due to the particular characteristics of their local economies

While the 2010 FIFA World Cup provided some relief from the recession, it is appropriate to review the lessons learned with a view to strengthening the country's ability to address the key development challenges facing it.

The economy is recovering, but employment growth remains very low. Consequently, municipal own revenues remain under pressure. The national fiscal framework also remains constrained. Despite this,

The local government fiscal framework needs to be progressively reformed to better reflect the different fiscal capacity of municipalities

national government has sought to minimise the impact on national transfers to local government, which have continued to grow more rapidly than general government expenditure.

A key challenge going forward is to ensure that the local government fiscal framework is progressively reformed to better reflect the different fiscal capacities of municipalities. This will entail re-examining the different revenue streams available to municipalities and ensuring that the division of the local government equitable share targets the poorest municipalities. It will also be important to re-examine the design of conditional grants with a view to putting in place appropriate incentives to ensure that they are spent effectively.

However, the greatest challenge facing local government is the decline in public trust in municipalities. This is being reflected in various ways: increased public protests, more militant ratepayer associations, as well as in public opinion surveys. There is growing public frustration with poor governance and corruption, resulting in poor service delivery in many municipalities.

This chapter gives an overview of:

- socio-economic trends and local government
- the economic outlook and local government
- national fiscal policy and local government
- applying the differentiated approach to local government
- governance: the key to effective municipalities.

Socio-economic trends and local government

Since the *2008 Local Government Budgets and Expenditure Review* was released, there have been a number of significant developments in the socio-economic context of local government, such as the economic recession, rising unemployment and the 2010 FIFA World Cup. There is also strong evidence of ongoing rural-urban migration – although the exact extent is unknown.

Demographic trends

It was noted in the *2008 Review* that the prevailing trends of rapid 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.

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. In larger urban areas, the process of rapid population growth and falling household size extend the service delivery challenge facing these municipalities. In addition, HIV and AIDS continues 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.

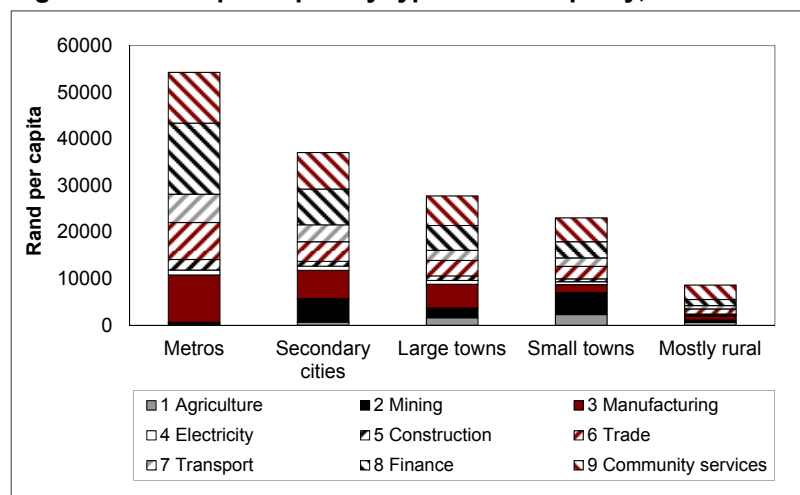
These trends highlight the importance of the national census being planned by Statistics South Africa for October 2011. It is envisaged that by using geographical mapping technologies to plot the dwelling point information gathered through the census, municipalities will have a valuable tool for analysing and understanding their differing contexts – particularly the demographic trends over the last number of years. It is envisaged that this tool will greatly facilitate municipalities' spatial planning – assisting them to deliberately plan to shift the existing apartheid settlement patterns towards more inclusive human settlements.

The national census in October 2011 will provide municipalities with a valuable tool for analysing and understanding their differing contexts

Economic activity

There is significant variation in the level and nature of economic activity across municipalities. The following table shows gross value added (GVA) by type of municipality.

Figure 2.1 GVA per capita by type of municipality, 2009

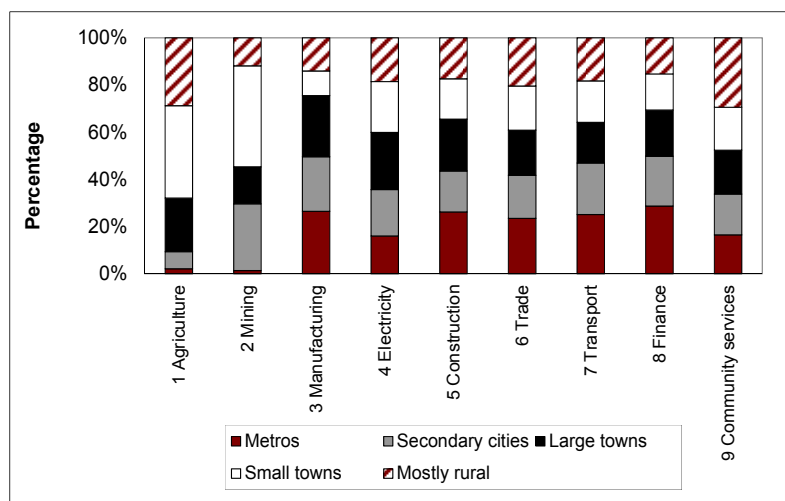


Source: HIS Global Insight, September 2010

Figure 2.1 shows the strong bias in most economic sectors towards larger, more urban municipalities and the contrasting weak economic base of mostly rural municipalities. This highlights the need for the local government fiscal framework to differentiate between urban and rural municipalities in the allocation of taxing powers and the design and targeting of transfers from national government.

Figure 2.2 shows that mostly rural municipalities and small towns are predictably reliant on agriculture, fishing and forestry activities, while the secondary and tertiary 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 development of these regions. These differences underscore the need for individual municipalities to pursue vastly different infrastructure investment and service delivery strategies. Declines in the dominant sectors of a local economy can have knock-on effects for household spending, which ultimately impacts on municipal revenues.

Because of the differences in their local economies, different municipality types need to pursue different infrastructure investment and service delivery strategies

Figure 2.2 Share of economic sector by type of municipality, 2009

Source: HIS Global Insight, September 2010

Trends in unemployment

Total employment declined by more than one million jobs (8 per cent) between the fourth quarter of 2008 and the second quarter of 2010. Job losses were concentrated in the trade, manufacturing and construction sectors. The official unemployment rate at the end of August 2010 reached 25.3 per cent, and labour force participation (the percentage of working age adults with work or actively seeking work) fell sharply, because many people were discouraged and stopped looking for work.

The decline in employment has a direct impact on the affected households' ability to pay municipal bills

The decline in employment has a direct impact on the affected households' ability to pay municipal bills. In June 2008, outstanding debtors stood at R37 billion or 39 per cent of municipal own revenue. In December 2010, outstanding debtors stood at R62 billion or 30 per cent of own revenue. So while there has been an increase in the level of debtors, there has been a decline in debtors as a percentage of own revenues. Part of this can be attributed to the rapid increase in own revenues due to the increase in electricity tariffs, as well as to debt write-offs. In addition, certain municipalities have been paying greater attention to revenue management.

Government's new growth path aims to substantially increase the number of jobs created through economic growth. However, it is likely to take some time before these initiatives begin to bear fruit. In the interim, employment is expected to rise gradually as growth accelerates. As a result, households' ability to pay for municipal services is unlikely to recover at the same rate as the recovery in economic growth – and so municipal own revenues will remain under pressure for some time.

Legacy of the 2010 FIFA World Cup

From the outset, national government viewed the hosting of the 2010 FIFA World Cup as a catalyst for investments in both sport and economic infrastructure, as well as for skills development and employment creation, rather than just a once-off event. To this end, 24 priority initiatives were identified between 2005/06 and 2010/11,

and national government allocated R33.4 billion to these initiatives. Projects included the stadiums and training venues, upgrading of airports and rail-links, rapid bus transit systems, telecommunications and safety and security services.

The plans that the nine host cities developed to host the event included stadium development, transport improvements, electrical reticulation upgrades, health facilities, disaster management, city beautification, marketing and operational plans. National government departments, through a series of bilateral meetings with the host cities and the use of conditional grant instruments, assisted with funds to implement the plans. The host cities funded any shortfall from their own resources.

The World Cup's greatest legacy probably lies in the way it changed the world's perceptions about South Africa, and South Africans' own perceptions of themselves. The impact this will have on future business investment decisions, tourism and how the country manages its development challenges can only be guessed at this point, but it is likely to be significant.

The World Cup's greatest legacy lies in the way it changed the world's perceptions about South Africa

While there are many lessons to be learnt from the hosting of the event, key lessons relevant to addressing the country's development and service delivery challenges include:

The hosting of the event provides municipalities with important lessons to be learnt

- Success depends on hiring the best – people with advanced conceptual, project management and project execution skills are required to increase the pace of service delivery.
- Core 'anchor management tools' are required to focus and instil discipline on the institutions involved in service delivery projects.
- A forward-thinking approach to risk management needs to be adopted so that early remedial action can be taken.
- Ring-fenced bank accounts for managing very large projects to control costs and prevent leakage need to be used.
- Detailed cash-flow planning and complete transparency on all contract payments are essential.
- A specialist oversight team which is capable of making strategic, solution oriented interventions to ensure completion of the project needs to be established.

These lessons apply to all spheres of government. However, they are particularly relevant to municipalities.

The economic outlook and local government

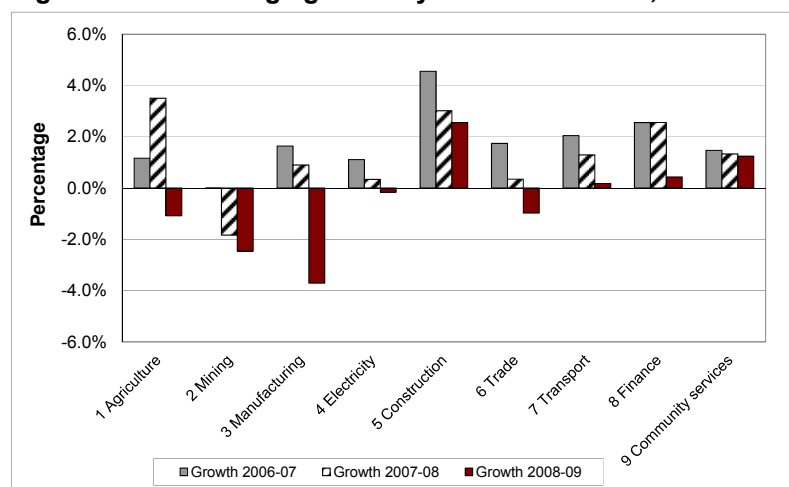
The 2011 Budget Review provides a more detailed analysis of the current economic outlook. It notes that the recovery in global demand has benefited South Africa by supporting higher prices for the country's major commodities. The domestic economy grew by an estimated 2.7 per cent in 2010 as household demand strengthened, supported by expansionary fiscal and monetary policies and lower inflation.

Wide variations in growth trends between different sectors of the economy place different pressures on individual municipalities

Real GDP growth is expected to reach 3.4 per cent in 2011, 4.1 per cent in 2012 and 4.4 per cent in 2013. At these rates, it will take some time before the economy reaches full capacity.

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. The sectors most affected by the economic recession were manufacturing, mining and trade. 2009 and 2010 were also difficult years for the agricultural sector. It follows then that those municipalities whose economies are strongly reliant on these sectors will take longer to recover from the effects of the recession.

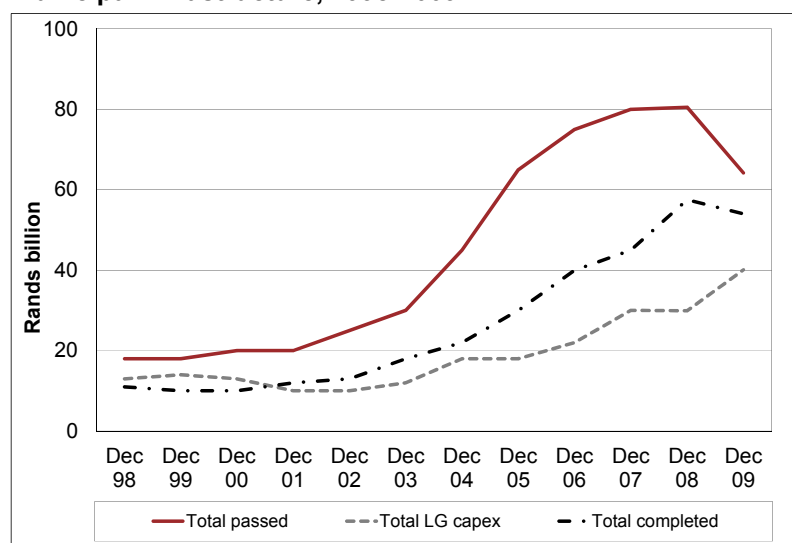
Figure 2.3 Percentage growth by economic sector, 2006-2009



Source: HIS Global Insight, September 2010

On the upside, the economic recession and slower growth prospects gave municipalities an opportunity to gain some ground on the backlogs in the demand for municipal infrastructure and services. This has also been assisted by the acceleration of projects in preparation for the 2010 FIFA World Cup. Figure 2.4 shows the gap between municipal capital expenditure and the value of buildings completed, which serves as a proxy for demand for municipal infrastructure.

Figure 2.4 Buildings plans passed versus investment in municipal infrastructure, 1998-2009



Source: Statistics South Africa. *Selected building statistics of the private sector as reported by local government institutions, 2009*

The trend shown 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 falls from 38.2 per cent in 2007/08 to 33.4 per cent in 2010/11. Capital expenditure continues to fall below budgeted amounts. However, municipal performance has improved from 72 per cent in 2006/07 to 85 per cent in 2008/09, before declining to 80 per cent in 2009/10.

The reasons for municipal underspending on infrastructure are:

- unrealistic budget targets resulting in funding shortfalls, particularly due to low levels of funding from internally generated funds
- inefficient supply-chain management
- lack of capacity to plan and fulfil grant conditions.

Economic developments continue to create pressures on municipalities to expand local infrastructure. Municipalities need to address capacity constraints through increasing the supply of local infrastructure and services, as well as through 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. Infrastructure investment requires additional resources, while increasing the price of municipal services is the most effective way of getting consumers to moderate their use of water and electricity.

The major challenge facing municipalities is to reconcile the need for price increases with the imperative of ensuring that services remain affordable to consumers. Ideally, price increases should be balanced

Most municipalities do not operate their trading services as full cost centres with applied business logic

with efforts to improve internal cost efficiencies. Stepped tariffs (or inclining block tariffs) are also necessary to protect poor households.

As noted in the *2008 Review*, 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.

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

The national fiscal stance for 2011/12 to 2013/14 targets a combination of revenue and expenditure that will enable government to pay for existing programmes, while reinforcing the sustainability of the public finances. The main features include higher GDP growth and reduced inflation, increased tax revenue and a reduction of debt stock as a percentage of GDP over the long term.

The national budget policy framework is informed by the requirements of the new growth path

The national budget policy framework is informed by the requirements of the new growth path, in which six key sectors and activities have been identified for unlocking employment potential. These are:

- infrastructure, through the expansion of transport, energy, water, communications and housing
- agriculture and the agro-processing sector
- mining and mineral beneficiation
- the green economy and associated manufacturing and services
- manufacturing sectors identified in the industrial policy action plan
- tourism and selected services sectors.

Municipal expenditure makes a significant contribution towards alleviating poverty and economic development

National fiscal policy continues to recognise 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; and 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:

First, government has again sought to insulate local government from the ongoing impact of the economic downturn. The increases in government spending favour local government and result in additional resources being made available to municipalities. Due to the tight fiscal circumstances, the pace of increase is slower than in the past.

Nevertheless, local government's share of nationally collected revenues continues to increase relative to the national and provincial spheres. Table 2.1 sets out the division of nationally raised revenue from 2011/12 to 2013/14, which is the most recent information. Table 4.1 in Chapter 4 provides the MTEF information relevant to the period of this *Review*, 2006/07 to 2012/13.

Table 2.1 Division of nationally raised revenue, 2007/08 – 2013/14

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	% Ave annual growth	
	Outcome			Revised Estimate	Medium-term estimates			2007/08 - 2010/11	2010/11 - 2013/14
R million									
National departments	242 580	289 236	345 366	359 120	380 154	408 439	439 049	14.0%	6.9%
Provinces	207 505	246 836	293 164	323 080	357 929	380 449	404 251	15.9%	7.8%
Equitable share	171 054	201 796	236 891	265 139	288 493	305 725	323 604	15.7%	6.9%
Conditional grants	36 451	45 040	52 073	57 941	69 436	74 724	80 647	16.7%	11.7%
Gautrain loan	–	–	4 200	–	–	–	–	–	–
Local government	38 482	45 488	51 537	61 152	70 171	77 029	82 316	16.7%	10.4%
Equitable share	20 676	25 560	23 845	30 559	34 108	37 573	39 960	13.9%	9.4%
Conditional grants	17 806	19 928	20 892	23 051	27 490	30 416	32 743	9.0%	12.4%
General fuel levy sharing with metropolitan municipalities	–	–	6 800	7 542	8 573	9 040	9 613	–	8.4%
Total	488 567	581 560	690 067	743 352	808 254	865 917	925 616	15.0%	7.6%
Percentage share									
<i>National</i>	49.7%	49.7%	50.0%	48.3%	47.0%	47.2%	47.4%		
<i>Provincial</i>	42.5%	42.4%	42.5%	43.5%	44.3%	43.9%	43.7%		
<i>Local</i>	7.9%	7.8%	7.5%	8.2%	8.7%	8.9%	8.9%		

Source: National Treasury Budget Review 2011

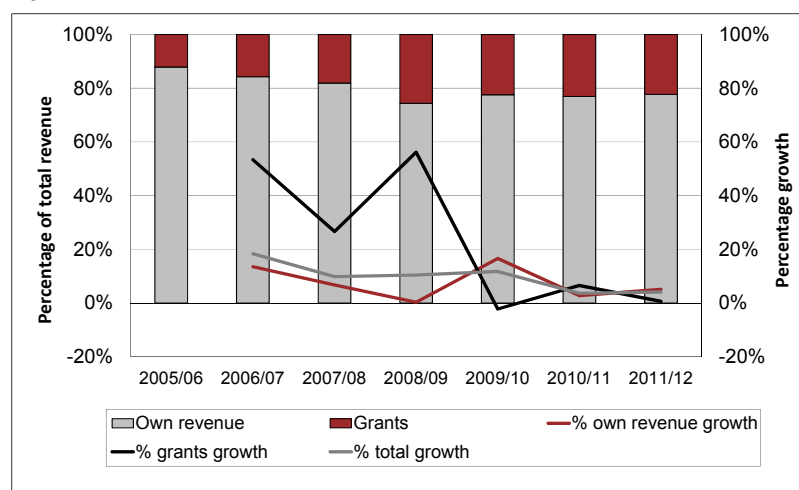
Table 2.1 shows that direct transfers to local government grow by R21 billion over the medium term, of which R5.1 billion is additional to the baseline. National transfers to local government grow by 10.4 per cent between 2010/11 and 2013/14, which is significantly higher than the growth in total government expenditure of 7.6 per cent for the same period. This suggests that fiscal policy recognises the important role of local government and the need to channel more resources to it.

Several amendments have been made to the local government fiscal framework over the last few years to direct more funding towards poor municipalities. A comprehensive review will be undertaken over the medium term that may lead to significant changes in the future configuration of the local government fiscal framework.

Second, transparent and responsible fiscal policy has created a comparatively stable economic and fiscal environment for municipalities to operate in. Figure 2.5 shows that current trends in national transfers to local government are sustainable over the medium term. This is complemented by a provision in the annual Division of Revenue Act that enables municipalities to pledge conditional grant transfers to accelerate capital spending. In addition, this stability enables more accurate planning and better financial management by municipalities. The introduction of the Municipal Budget and Reporting Regulations in July 2009 has placed greater emphasis on ensuring that municipal budgets are funded, and on better management of municipal cash resources.

Fiscal policy recognises the important role of local government and the need to channel more resources to it

One objective of the Municipal Budget and Reporting Regulations is to ensure that municipal budgets are funded, and that there is better management of municipal cash resources

Figure 2.5 Revenue trends per major source, 2005/06 – 2011/12

Source: National Treasury local government database

Third, the prudent fiscal stance of national government provides room for expanded borrowing by municipalities. However, as table 2.2 shows, municipalities generally are not fully utilising the borrowing space available to them. Government has also increased the callable capital of the Development Bank of Southern Africa (DBSA) to R20 billion to facilitate greater scope for lending to municipalities.

Table 2.2 Public sector borrowing requirement¹, 2007/08 – 2013/14

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
	Outcome			Revised Estimate	Medium-term estimates		
R million							
National budget	-19 352	27 158	167 518	143 361	159 066	161 713	148 715
Extraordinary payments	776	4 284	671	802	150	–	–
Extraordinary receipts	-1 850	-8 203	-6 435	-3 148	-1 350	–	–
Borrowing requirements	-20 426	23 238	161 754	141 015	157 866	161 713	148 715
Social security funds	-8 614	-12 362	-10 624	-10 778	-10 388	-11 578	-11 208
Provinces	-1 062	8 927	189	1 587	-1 094	-3 138	-5 973
Extra-budgetary institutions	-6 155	3 802	3 993	8 183	7 215	5 870	3 052
Local authorities	4 571	13 298	16 723	7 470	9 105	8 152	8 641
General government borrowing	-31 686	36 904	172 036	147 478	162 704	161 020	143 227
Percentage of GDP	-1.5%	1.6%	7.0%	5.5%	5.6%	5.0%	4.1%
Non-financial public enterprises	35 503	61 804	45 325	133 731	113 718	99 063	78 733
Percentage of GDP	1.7%	2.7%	1.9%	5.0%	3.9%	3.1%	2.2%
Public sector borrowing requirement	3 817	98 708	217 361	281 209	276 422	260 083	221 959
Percentage of GDP	0.2%	4.3%	8.9%	10.5%	9.5%	8.1%	6.3%
Gross domestic product	2 078 822	2 312 965	2 442 593	2 666 894	2 914 862	3 201 299	3 536 002

1. A negative number reflects a surplus and a positive number a deficit.

2. 2010/11 - 2013/14 are based on National Treasury estimates.

Source: National Treasury Budget Review 2011

Finally, for municipalities, expanded public spending by other public entities places pressure on development planning, zoning and environmental approval processes. 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 coordinate and sequence public investments are thus required.

Local government links to the 12 priority outcomes

In January 2010 government adopted 12 outcomes underpinning its long term development strategy. Each outcome has measurable outputs with targets. Furthermore, each of the 12 outcomes has a delivery agreement, which in most cases involves all spheres of government. When municipalities embark on reviewing their integrated development plans (IDPs) and developing their new budgets, they will need to ensure alignment with these outcomes.

Municipalities need to align their integrated development plans and budgets with government's 12 outcomes

The text box highlights the areas where municipalities will need to contribute to the realisation of each of the 12 outcomes.

Government's 12 priority outcomes and the role of local government	
Cabinet outcome	Role of local government
1 <i>High-quality basic education</i>	<ul style="list-style-type: none"> Facilitate the building of new schools through participating in needs assessments done by provinces, identifying appropriate land and facilitating zoning and planning processes Facilitate the eradication of municipal service backlogs in schools by extending appropriate bulk infrastructure and building connections
2 <i>Improved health and life expectancy</i>	<ul style="list-style-type: none"> Many municipalities perform health functions on behalf of provinces Strengthen effectiveness of health services managed by municipalities by specifically enhancing TB treatments and expanding HIV and AIDS prevention and treatments Municipalities must continue to improve Community Health Service infrastructure, by providing clean water, sanitation and waste removal services
3 <i>All people in South Africa protected and feel safe</i>	<ul style="list-style-type: none"> Facilitate the development of safer communities through better planning and enforcement of municipal by-laws Direct the traffic control function towards policing high risk violations – rather than revenue collection Metro police services should contribute by increasing police personnel, improving collaboration with the South African Police Service (SAPS) and ensuring rapid response to reported crimes
4 <i>Decent employment through inclusive economic growth</i>	<ul style="list-style-type: none"> Create an enabling investment environment by streamlining planning application processes Ensure proper maintenance and rehabilitation of essential services infrastructure Ensure proper implementation of the expanded public works programme (EPWP) at the municipal level Design service delivery processes to be labour intensive Improve procurement systems to eliminate corruption and ensure value for money Utilise community structures to provide services
5 <i>A skilled and capable workforce to support inclusive growth</i>	<ul style="list-style-type: none"> Develop and extend intern and work experience programmes in municipalities Link municipal procurement to skills development initiatives
6 <i>An efficient, competitive and responsive economic infrastructure network</i>	<ul style="list-style-type: none"> Ring-fence water, electricity and sanitation functions so as to facilitate cost-reflective pricing of these services Ensure urban spatial plans provide for commuter rail corridors, as well as other public modes of public transport Maintain and expand water purification works and waste water treatment works in line with growing demand Assign the public transport function to cities Improve maintenance of municipal road networks
7 <i>Vibrant, equitable and sustainable rural communities and food security</i>	<ul style="list-style-type: none"> Facilitate the development of local markets for agricultural produce Improve transport links with urban centres so as to ensure better economic integration Work with provinces to promote home production to enhance food security Ensure effective spending of grants for funding extension of access to basic services
8 <i>Sustainable human settlements and improved quality of household life</i>	<ul style="list-style-type: none"> Cities to work towards fulfilling the requirements to be accredited for the housing function Develop spatial plans to ensure new developments are in line with national policy on integrated human settlement Participate in the identification of suitable land for social housing Ensure capital budgets prioritise maintaining existing services and extending services

Government's 12 priority outcomes and the role of local government <i>continued</i>		
Cabinet outcome	Role of local government	
9 <i>A responsive and, accountable, effective and efficient local government system</i>	<ul style="list-style-type: none"> • Adopt IDP processes appropriate to the capacity and sophistication of the municipality • Implement the community work programme • Ensure ward committees are representative and fully involved in community consultation processes around the integrated development plan (IDP), budget and other strategic service delivery issues • Improve municipal financial and administrative capacity by implementing competency norms and standards and acting against incompetence and corruption 	
10 <i>Protection and enhancement of environmental assets and natural resources</i>	<ul style="list-style-type: none"> • Develop and implement water management plans to prevent water losses • Ensure effective maintenance and rehabilitation of infrastructure • Run water and electricity saving awareness campaigns • Ensure proper management of municipal commonage and urban open spaces • Ensure development does not take place on wetlands and other sensitive areas 	
11 <i>A better South Africa, a better and safer Africa and world</i>	Role of local government is fairly limited in this area. It must concentrate on: <ul style="list-style-type: none"> • Ensuring basic infrastructure is in place and properly maintained • Creating an enabling environment for investment 	
12 <i>A development-orientated public service and inclusive citizenship</i>	<ul style="list-style-type: none"> • Continue to develop performance monitoring and management systems • Comply with legal financial reporting requirements • Review municipal expenditures to eliminate wastage • Continue to implement the municipal turn-around strategies • Ensure councils behave in ways to restore community trust in local government 	

■ Applying the differentiated approach to local government

The Constitution recognises that there will be differences in fiscal capacity among municipalities, and that this should be taken into account in the division of national transfers to local government (see *Chapter 3 Intergovernmental relations and the local government fiscal framework* for further details). There is also a growing sense that current local government funding arrangements may not be addressing the objectives of rural development and redistribution adequately. This has led to calls for a differentiated approach to be implemented for the funding and management of local government.

Dealing with diversity

Municipalities differ in terms of size and structure of population, poverty levels, backlogs in basic services, economic activity, employment, land ownership patterns, spatial characteristics, and other factors

The current legal framework for structuring local government provides for metropolitan, local and district municipalities. These categories (A, B and C) to a large extent determine the powers and functions of the municipality, and so must form the basis of any further differentiation between municipalities. Furthermore, the Municipal Structures Act (1998) provides for functions to be allocated between category B and C municipalities on a differential basis, depending on their capacity – which is assessed by the Municipal Demarcation Board on an annual basis. This allocation of functions must also be taken into account when considering any approach to differentiating between municipalities.

In addition, the preceding sections and other chapters in this *Review* highlight different ways in which municipalities differ from each other. These include: size and structure of population, poverty levels, backlogs in basic services, economic activity, employment, land ownership patterns, spatial characteristics, and a host of other factors. It is also important to take into consideration the institutional capacity of the municipality itself.

What is apparent is that the local government sphere is very diverse and the differences among municipalities are not neatly aligned according to specific groups. This makes categorising municipalities into 'groups' with common characteristics rather difficult – and each classification methodology has its own strengths and weaknesses. National Treasury is of the view that how one classifies municipalities must be specific to the particular purpose of doing so. This means that there cannot be a single approach to classifying municipalities into different groups.

The differentiated approach in current practice

It should be noted that various approaches to differentiating between municipalities are already being implemented in the design and workings of the local government fiscal framework. These include:

- *Differentiation in the local government equitable share formula.* Each element of the formula is designed to target the allocation of equitable share funding to municipalities on a differentiated basis – primarily according to percentage coverage of basic services, but also on the basis of fiscal and institutional capacity.
- *Differentiation in the allocation of conditional grants.* Each conditional grant is allocated according to specific criteria related to the policy purpose of the grant. For instance the integrated national electrification programme is allocated according to electricity backlogs and the readiness of business plans for electrification projects. The recent introduction of the rural households infrastructure grant further highlights the use of different differentiation criteria depending on the purpose of the grant. The appropriateness of the targeting criteria of each grant is being assessed as part of the conditional grants review that National Treasury is undertaking. Generally, the smaller grants are fairly well targeted. Some inadequacies still exist in the formula and the management processes used to allocate and disburse the municipal infrastructure grant (MIG).
- *Urban settlements development grant.* This grant is a further development of the policy initiative that gave rise to the MIG cities grant. It demonstrates how one differentiation approach can be used to allocate funds, and another approach can be used to manage the disbursement and accountability arrangements for those funds. The metros' shares of MIG funds are determined using the same formula applied to the allocation of the MIG grant, but then through the urban settlements development grant 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 in exchange for explicit reporting on development outcomes.
- *Differentiation in the allocation of fiscal powers and functions.* Examples of this are:
 - Only metros and local municipalities may levy property taxes.
 - Only metros have been given a share of the general fuel levy.

- Only municipalities that are responsible for delivering a function may charge for that function.

Greater differentiation in revenue raising powers between metros, local municipalities and district municipalities will be introduced

It can be expected that when National Treasury issues regulations in terms of the Municipal Fiscal Powers and Functions Act (2007), a greater degree of differentiation in revenue raising powers between metros, local municipalities and district municipalities could be introduced.

Taking the differentiated approach further

New municipal level information is required for progress to be made in differentiating between municipalities

Research on ways of differentiating between municipalities on the basis of fiscal capacity is ongoing. However, it has become evident that new municipal level information is required for progress to be made – hence the critical importance of the national census in October 2011, and ongoing improvements in municipal financial reporting processes.

At this stage, this raises a number of challenges when it comes to (a) developing differentiated policies for local government and (b) refining the local government fiscal framework. Essentially, it means that government needs to proceed with extending the differentiated approach with great care in the absence of credible municipal level information.

National policy and transfer mechanisms need to better differentiate between rural, more urban and metropolitan municipalities

Nevertheless, this review seeks to explore key differences between groups of municipalities with a view to informing the debate about how national policy and transfer mechanisms might better differentiate between rural, more urban and metropolitan municipalities, to ensure that they are able to deliver effectively on their functions.

■ Governance: the key to effective municipalities

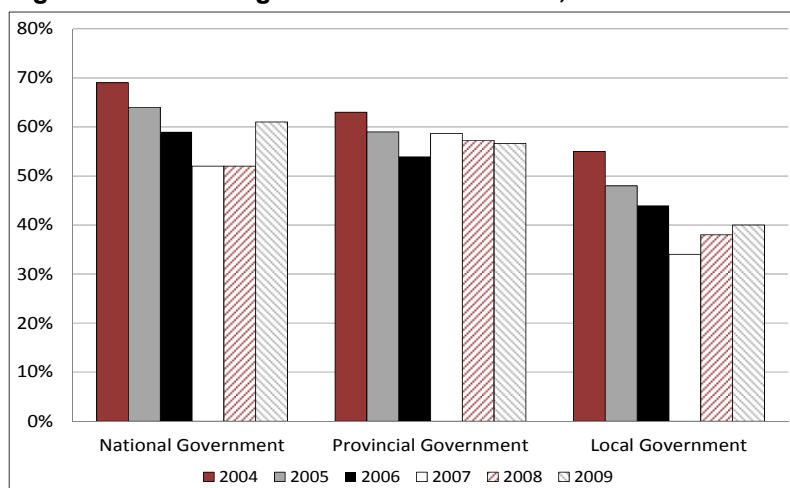
The greatest challenge facing local government is the decline in public trust in municipalities

The greatest challenge facing local government is the decline in public trust in municipalities. This is being reflected in public opinion surveys, increased public protests and more militant ratepayer associations. At the heart of the problem appears to be growing public frustration with poor governance, resulting in poor service delivery in many municipalities.

Crisis in the credibility of local government

Levels of trust in local government have always been lower than national and provincial government

Figure 2.6 shows the level of public trust in the three spheres of government as measured by surveys conducted by the Human Sciences Research Council. Since the inception of these surveys in 2004, levels of trust in local government have always been lower than national and provincial government. From a low of 34 per cent in 2007, trust in local government has gradually increased to 40 per cent in 2009. However, the fact that since 2005, less than 50 per cent of people surveyed expressed trust in local government is cause for concern.

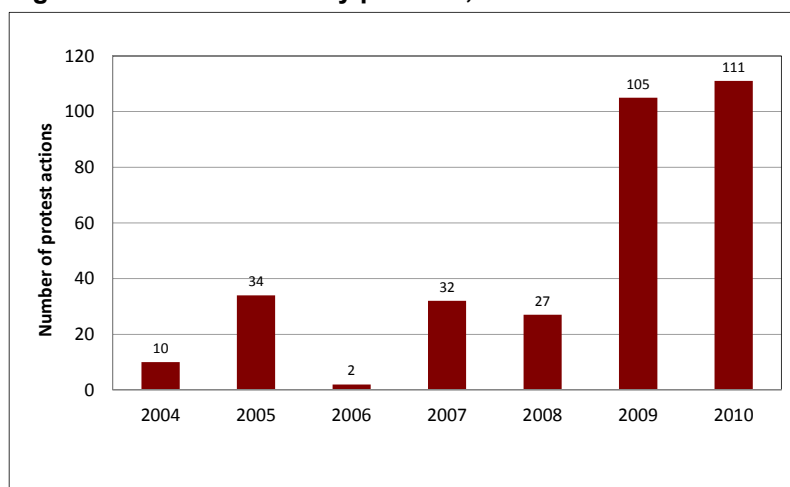
Figure 2.6 Trust in government institutions, 2004 to 2009

Source: HSRC South African Social Attitudes Survey (SASAS) 2003–2009

The high levels of disenchantment with local government finds expression in two main ways: service delivery protests and action taken by the growing number of militant ratepayers associations.

The latest data from Municipal IQ Hotspot Monitor (as at 2 March 2011) indicates that in 2010, there were a record number of 111 protests. The provincial distribution of these protests shows that they were concentrated in Gauteng and Western Cape.

The 111 service delivery protests that took place in 2010 were concentrated in Gauteng and Western Cape

Figure 2.7 Service delivery protests, 2004 to 2010

Source: Municipal IQ – 2 March 2011

While there has been a range of explanations for the growing number of service delivery protests, it would seem that generally poorer communities use these protests to bring their grievances with municipalities to the attention of government.

Poorer communities use protests to bring their grievances with municipalities to the attention of government

By contrast, wealthier communities tend to organise themselves into ratepayer associations and seek to engage with municipalities around particular issues, either directly through meetings, or indirectly through letter writing and petition campaigns. According to the National Taxpayers Union of South Africa, ratepayers in 42 towns are currently engaged in legally declared disputes in terms of section 102 of the Municipal Systems Act (2000), and instead of paying rates and

Wealthier communities tend to organise themselves into ratepayer associations

other service charges over to the municipality, are paying them into trust accounts. In some towns, ratepayer associations have begun to use these funds to do essential maintenance and to pay private companies for the delivery of services.

Both the service delivery protests and actions of ratepayer associations point to the urgent need to improve the service delivery situation in many municipalities.

Getting governance wrong

To date, there has been 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 directly attributed to failures in local political leadership.

Where there are dysfunctional councils and distrust important decisions such as the appointment of senior staff or approvals of plans and budgets get delayed or are not taken. This holds back service delivery.

Provincial governments and national government need to be more proactive in holding municipal councils accountable to the extent provided for in the Constitution. National government has tended to take a lenient approach to applying section 139 of the Constitution. Although this section provides for the dismissal of municipal councils if its financial affairs are in crisis, this has yet to occur. Also, while section 216 enables National Treasury to withhold the transfer of funds to a municipality if it does not comply with prescribed treasury norms and standard (i.e. does not comply with the Municipal Finance Management Act (2003)), this has only ever happened once. Consequently, councils have been allowed to remain in office and have continued to receive transfers from national government despite obvious failures. Generally the interventions that have occurred have been poorly managed and so have not achieved the desired turnarounds.

When governance goes wrong, and concrete steps are not taken to put things right, the municipality's ability to deliver effective services gets undermined. This impacts on all residents.

Getting governance right

There are a number of relatively simple things that need to be done to get governance right: First, 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. Second, there needs to be a clear understanding of and respect for the division of roles and responsibilities between the council, mayor and municipal manager as set out in legislation. Third, all appointments need to be on the basis of competence (and nothing else). Fourth, municipal managers need to ensure that the legally required operating policies and procedures are in place and implemented in the day-to-day running of the municipality. Fifth, councils need to fulfill their oversight functions. The establishment of municipal public accounts committees in the larger municipalities is welcomed in this regard.

However, these committees should not be seen as absolving the rest of councils from exercising rigorous oversight.

In addition, government has introduced a range of initiatives to tackle the problems of poor governance:

- 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. Their aim is to force transparent municipal budgets and so curb malpractices, including corruption.
- The Local Government: Municipal Systems Amendment Act (2011) introduces a range of important reforms. These include barring municipal managers and other managers from holding political office in political parties, regulating the employment of municipal employees who have been dismissed, and prohibiting the employment of a person in a municipality if the post to which he or she is appointed is not provided for in the staff establishment of that municipality.
- National government is currently reorganising the various programmes to provide capacity support to municipalities. The aim is to ensure better overall coordination, improved targeting and closer monitoring of such initiatives.

National Treasury is also working closely with other departments and agencies to improve municipal financial performance and reduce the possibility of fraud and corruption. The approach comprises five broad initiatives, which will include legislative and regulatory reforms:

National Treasury is working closely with other departments and agencies to combat fraud and corruption

- Increasing the monitoring capability of government, aimed at early detection of fraud.
- In line with international best practice, transparent public disclosure will be required at each stage of the supply chain process including reasons for award decisions.
- Government will look holistically at identifying procurement requirements that could be better managed centrally, such as the use of transversal contracts for the acquisition of high value and complex goods and services.
- Stiff penalties are proposed for service providers who obtain government contracts fraudulently. Public officials who assist in tender fraud will also be liable for resultant losses incurred by government.
- Tax compliance measures associated with government procurement will be strengthened.

The importance of the local government elections

The Constitution provides that the first object of local government is to provide democratic and accountable government for local communities. To this end, local government elections are held every five years. The power of the ballot box in addressing failures in local governance should not be underestimated. Elections provide communities with an opportunity to hold their local councillors and

Elections provide communities with an opportunity to hold their local councillors and the different political parties accountable

the different political parties accountable for their governance performance.

Conclusion

This chapter highlights the diverse nature of municipalities, and the fact that they operate in a wide range of social and economic contexts. This has meant that while the economic recession in 2009 affected all municipalities, some were more affected than others. The recovery in employment levels is anticipated to take some time, and so municipal own revenues are likely to remain under pressure. Nevertheless, although the national fiscal framework remains tight, government has sought to minimise the impact on national transfers to local government, which have continued to grow more rapidly than general government expenditure.

The 2010 FIFA World Cup provided some relief from the recession, but its greatest contribution has been the way it has changed perceptions about the country. There are also specific lessons from the World Cup that municipalities need to take on board to strengthen their ability to address the key development challenges they face.

While the local government fiscal framework does contain elements that treat municipalities on a differentiated basis, there is a need to re-examine the different revenue streams available to municipalities and ensure that the division of the local government equitable share and conditional grants targets the poorest municipalities. To move forward with policy on a differentiated approach requires accurate information on municipalities. The national census in October 2011 and financial reporting by municipalities is therefore very important.

As noted, the most pressing challenge facing local government is the decline in public trust in municipalities. This is being reflected in various ways: increased public protests, more militant ratepayer associations, as well as in public opinion surveys. There is growing public frustration with poor governance and corruption, resulting in poor service delivery in many municipalities. In this context, local government elections play a very important role in holding mayors, councillors and political parties accountable. However, there is also a need for stronger provincial and national government monitoring, and greater public participation in council processes.