



Financial and Fiscal Commission

Sustaining Local Government Finances

*Final Report on the Financial and Fiscal
Commission's Public Hearings on the
Review of the Local Government Fiscal
Framework*

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Acronyms

CoGTA	Department of Cooperative Governance and Traditional Affairs
DBSA	Development Bank of South Africa
DOR	Division of Revenue
DORA	Division of Revenue Act
DWA	Department of Water Affairs
INEP	Integrated National Electricity Programme
LGES	Local Government Equitable Share
MIG	Municipal Infrastructure Grant
MISA	Municipal Infrastructure Support Agency
MPRA	Municipal Property Rates Act of 2004
MFMA	Municipal Finance Management Act
MFPFA	Municipal Fiscal Powers and Functions Act of 2007
NERSA	National Energy Regulator of South Africa
PRASA	Passenger Rail Agency of South Africa
R&M	repairs and maintenance
SALGA	South African Local Government Association
SASQAF	Statistics South Africa Quality Assessment Framework
StatsSA	Statistics South Africa

Background

This report is presented in terms of the Financial and Fiscal Commission Act 99 of 1997. Section 3 (2)(b)(i) of the Act mandates the Financial and Fiscal Commission (the Commission) to undertake research on its own accord and report to Parliament and Provincial Legislatures. In accordance with its mandate and after extensively engaging with its stakeholders, the Commission recognised the various challenges plaguing the financing of municipalities and subsequently, in 2011, undertook a study on the review of the Local Government Fiscal Framework (LGFF) under the banner of *Sustaining Local Government Finances: Making Local Government Work! The Commission's approach was to review the LGFF holistically, in order to understand all perspectives of the problems reach consensus on solutions and appreciate the repercussions of recommendations to improve the LGFF from all angles.*

The research process included holding public hearings, which provided a basis for the Commission's technical work into the problems inherent in the LGFF and proposed policy options. Through the public hearing process, the Commission was able to canvass inputs from various stakeholders on the nature of the challenges captured in the problem statement.

This submission serves as the final report emanating from the public hearing and research process, and formally outlines the Commission's recommendations to Parliament and Provincial Legislatures on its review of the LGFF.

This report is divided into three chapters:

1. Chapter 1: The Current LGFF. This section introduces the general problem statement of the paper, provides a comprehensive overview of the current LGFF, and describes the public hearing process followed.
2. Chapter 2: Problem Analysis. This section analyses the problem areas in the LGFF and identifies policy options.
3. Chapter 3: Conclusion and Recommendations. This section concludes the report by providing a set of comprehensive recommendations to revise and improve the functioning of the LGFF.

Chapter 1: The Current LGFF

South Africa has a decentralised system of government comprising three spheres: national government, nine provincial governments and 278 municipalities. Its aim is to maximise the political benefits –of representation and democratic participation at community levels– and economic benefits – of efficient and effective service delivery to communities. To achieve these political and economic goals, each sphere is assigned specific expenditure mandates and revenue powers.

The Constitution of the Republic of South Africa (1996) determines the fundamental guiding and enabling principles for the country’s decentralised system of government. It also provides for the establishment, expenditure responsibilities and the funding framework of local government as part of a system of cooperative governance with all other spheres. In accordance with South Africa’s decentralised system of government, local government is assigned an array of service delivery mandates. Municipalities are mandated to provide an array of services, including water, sanitation, electricity, and refuse removal services. To fund these expenditure responsibilities, local government is assigned a range of revenue instruments supplemented with intergovernmental transfers, predominately from national government. Revenue instruments include property rates, user charges for municipal services rendered, surcharges on user charges and other local taxes, while intergovernmental transfers are in the form of unconditional and conditional grants. Subsequent legislation also enables municipalities to leverage private financing via borrowing.

The current local government configuration and system is relatively new, with the financing framework for municipalities first established in 1998, as per the date stipulated in the Constitution. The LGFF refers to this funding arrangement to support local government’s expenditure mandates.

A fiscal framework, as defined formally in the Money Bills Amendment Procedure and Related Matters Act of 2009, is a structure that provides sound fiscal policy objectives and a set of integrated macroeconomic and fiscal targets and projections. It provides an outline on how the government uses public revenues to influence the nation’s economy. *Therefore, the LGFF can be broadly defined as the aggregate revenue arrangement or funding framework of local government relative to its aggregate expenditure mandates and responsibilities.* In essence, the LGFF is the funding arrangement or framework required to ensure that local government and individual municipalities are sufficiently financially resourced to fulfil their constitutional mandates to render services to communities.

1.1 Statement of the Problem

As municipal service delivery challenges become more apparent, protests by communities are plaguing the local government sphere and could threaten the social and political wellbeing of the country. A common perception is that the current structure of the LGFF results in inappropriate funding for certain municipalities.

Under-funding is given as an explanation for municipal service delivery failures and general poor performance, yet little research has been undertaken to justify such a view. Concerns around the LGFF often hide the non-fiscal issues (such as capacity constraints and weak systems of accountability) that result in the failures of municipalities.

The LGFF lies at the heart of the local government sector and needs to be flexible enough to cater for the needs of municipalities and dynamic enough to account for changes within the sector and to meet current challenges and policy priorities. Since becoming operational in 1998, the LGFF has gone through several iterations and reviews. Most of these changes occurred in response to the continuous evolution of the sphere (i.e. changes in the structure of local government) while others were undertaken, in a rather ad hoc basis, in response to certain flaws and/or policy changes. Such ad hoc revisions to the LGFF were undertaken without fully understanding the medium to long-term consequences, which likely resulted in further alterations to the system.¹

A review of the LGFF needs to be comprehensive, involve all decision-makers and cover all aspects of the fiscal framework in order to ensure a holistic and coherent approach to the funding of municipalities. This is what the Commission undertook, using public hearings as the primary methodology for the review. The issue addressed is *how can the current LGFF be configured to appropriately fund the various needs of different types of municipalities in the country, to ensure they are financially and fiscally well capacitated to fulfil their constitutional mandate.*

1.2 The Current LGFF

The Money Bills Amendment Procedure and Related Matters Act of 2009 defines the concept of a fiscal framework as the aggregate revenue arrangement or funding framework of a sphere relative to the aggregate expenditure mandates and responsibilities of the sphere. Thus, the LGFF is the funding arrangement required to ensure that individual municipalities are financed sufficiently to fulfil their constitutional mandates and render adequate services to communities.

Section 155 of the Constitution establishes local government in South Africa by defining three types of municipalities:

- i. Category A: A municipality that has exclusive municipal executive and legislative authority in its area.
- ii. Category B: A municipality that shares municipal executive and legislative authority in its area with a category C municipality within whose area it falls.

¹An example of such is the abolition of the Regional Services Council (RSC) and Joint Service Board (JSB) levies, which, although warranted, were done without an appropriate replacement revenue source at hand. The current measures to replace lost revenues from this tax (i.e. the sharing of the general fuel levy and the RSC levy replacement grant) are plagued with its own design problems and are likely to have longer term consequences.

- iii. Category C: A municipality that has municipal executive and legislative authority in an area that includes more than one municipality.

Schedules 4B and 5B of the Constitution provides a comprehensive list of service delivery responsibilities devolved to the local government sphere, as listed in Table 1.

Table 1 Local Government Service Delivery Mandates

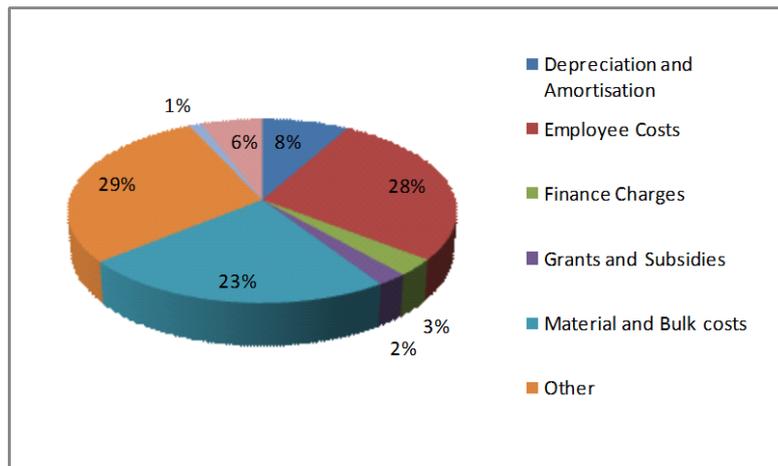
Schedule 4B	Schedule 5B
Air pollution	Beaches and amusement facilities
Building regulations	Billboards and the display of advertisements in public places
Child care facilities	Cemeteries, funeral parlours and crematoria
Electricity and gas reticulation	Cleansing
Fire fighting services	Control of public nuisances
Local tourism	Control of undertakings that sell liquor to the public
Municipal airports	Facilities for the accommodation -are and burial of animals Fencing and fences
Municipal planning	Licensing of dogs
Municipal health services	Licensing and control of undertakings that sell food to the public local amenities

fic and parking

Source: Constitution of South Africa (1996)

Local government expenditure comprises operating and capital expenditure. Operating expenditure funds the on-going operations and maintenance costs of the delivery of a service for immediate consumption by consumers. This type of expenditure usually takes the form of bulk or material purchases, labour costs and depreciation and maintenance of existing infrastructure, all of which support the delivery of the services indicated in Table 1. Figure 1 gives an aggregate breakdown of the components of municipal operating expenditure for the 2009/10 financial year.

Figure 1 Composition of Local Government Operating Expenditures – 2009/10

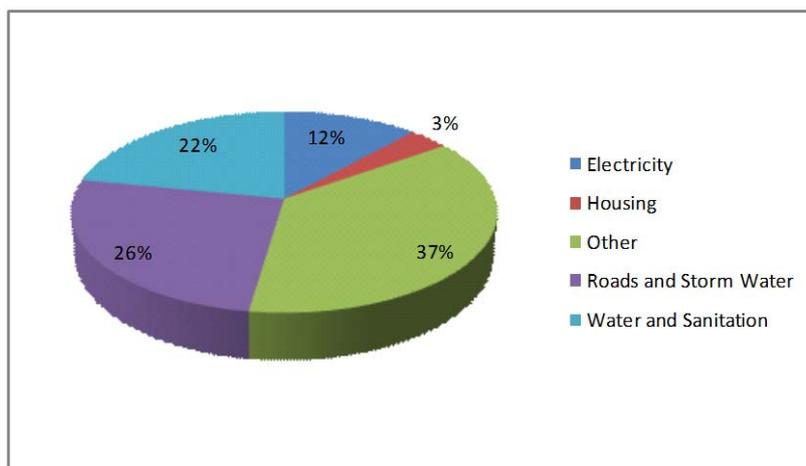


Source: National Treasury Local Government Database (National Treasury, 2011)

As Figure 1 shows, the largest components of municipal operating expenditure are “other” (29%), labour costs (28%) and material and bulk purchases, which include water and electricity (23%).

Municipal capital expenditure comprises municipal investment in economic and social infrastructure, usually intended to extend services to unconnected customers. Figure 2 disaggregates municipal capital expenditure into its various components for 2009/10.

Figure 2 Composition of Local Government Capital Expenditures 2009/10



Source: National Treasury Local Government Database (National Treasury, 2011)

Figure 2 clearly shows that municipalities spend predominantly on water and electricity-related infrastructure used to extend services to communities and households. Other infrastructure investments would include local amenities such as community halls. Although housing is a national and provincial concurrent function, municipalities also invest in housing for the poor (3% of total capital expenditure in

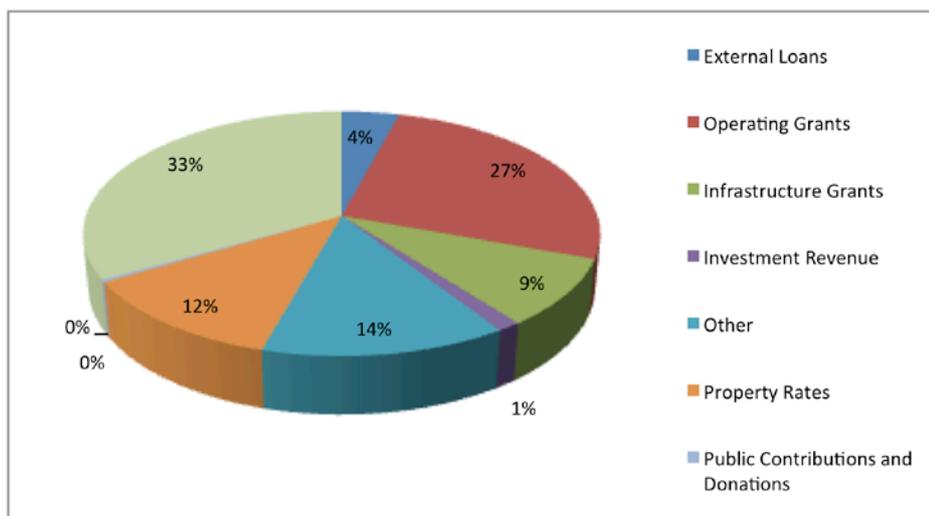
2009/2010). Most of this expenditure is undertaken on behalf of provincial government, but more housing functions are being progressively devolved to local government in recognition of their efficiencies in providing this service.

In addition, municipalities also implement national government’s free basic services (FBS) policy. This policy provides a portion of municipal services (water and sanitation, electricity and refuse removal) free to indigent households. These policies evidently form an integral part of the LGFF. In undertaking their service delivery mandate, municipalities are also constitutionally obliged to ensure that their communities progressively realise their socioeconomic rights as per the country’s Bill of Rights.²

As mentioned earlier, to fund these expenditure responsibilities, municipalities command an array of fiscal instruments. These include own revenue (property rates, user charges for municipal services rendered, surcharges on user charges and other local taxes) and intergovernmental transfers (conditional and unconditional grants) from national government. Conditional grants may only be used for the specific purposes as set out by the transferring department, whereas unconditional grants may be used at the discretion of the recipient municipality. The primary unconditional grant is the Local Government Equitable Share (LGES) grant, which gives a municipality its share of nationally collected revenue. Subsequent legislation that enables municipalities to exercise revenue powers includes the Municipal Property Rates Act (Act 6 of 2004) and the Municipal Fiscal Powers and Functions Act (Act 12 of 2007).

Figure 3 provides an aggregate picture of municipal revenues that form the LGFF³.

Figure 3 Sources of Total Municipal Revenues 2009/10



Source: National Treasury Local Government Database (National Treasury, 2011)

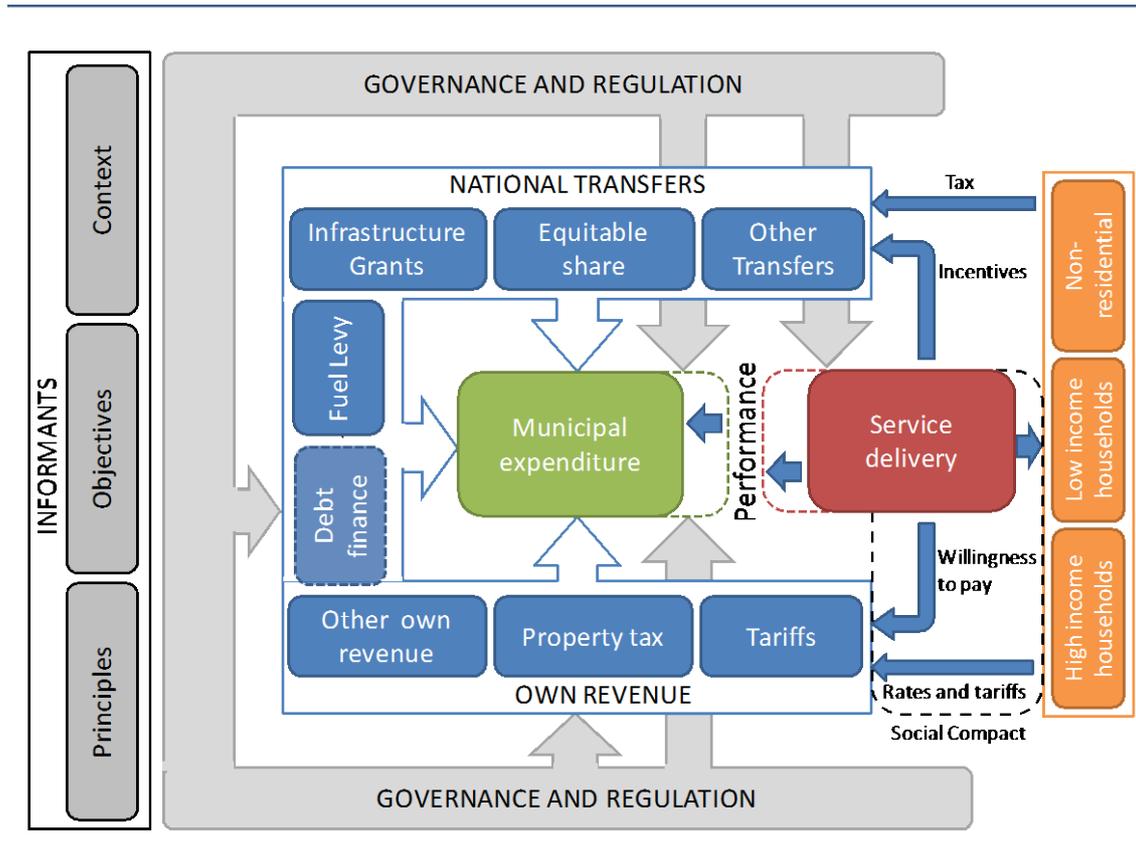
² Chapter 2 of the Constitution of South Africa

³Note that figure 3 includes both revenue used for operating and capital expenditures

1.3 Contextualising the LGFF

The structure of the LGFF is complex and multi-dimensional, comprising successive layers of process and instruments, as well as feedback loops between the various elements. Figure 4 contextualises the various facets of the LGFF and its operational mechanics.

Figure 4 Contextualising the LGFF



Source: FFC Options Analysis (2012)

External to the framework, a number of factors (**informants**) impact on the elements of the LGFF: the principles and objectives of the LGFF and the municipal context, i.e. the general situation in local government and the context of individual municipalities. They inform the design of the fiscal and regulatory instruments within the framework and set up the criteria for evaluating the LGFF.

The primary aim of the LGFF is to ensure service delivery to communities through the appropriate funding of municipalities. In the framework, the recipients of municipal services (i.e. the outputs and outcomes of municipal operations) are **non-residential** recipients (private sector, non-governmental organisations etc.) and **low-income** and **high-income households**. In general, municipalities generate most of their own revenues from non-residential and high-income residential consumers, and use these groups to cross-subsidise services to lower income households (who cannot afford to pay for such services).

Service delivery to communities is achieved with **municipal expenditure**, which takes the form of operating and capital expenditures. Variations in expenditures are dependent on the **performance** of municipalities. The dotted lines in Figure 4 attempt to illustrate the variation in individual (and general) municipal expenditures, which are largely driven by variations in technical efficiency i.e. how efficiently municipalities use their resources.

Various revenue streams support expenditure assigned to local government and decentralised local government in general. These take the form of **own revenues**, which are generated from rates and tariffs, supplemented by intergovernmental fiscal transfers, depicted as **infrastructure grants**, **equitable share (LGES)** and **other transfers**. **Debt finance** and the sharing of the general **fuel levy** are depicted as intermediary revenue sources, since they have characteristics of both grants and own revenues, and debt finance is also enabled by the other sources of revenue (leverage).

The nexus between service delivery, consumers and municipal own revenues takes the form of the principle of a **social contract**, which implicitly states that municipalities are responsible for delivering an agreed level of service, for which consumers must pay an agreed price. Hence the link between good **service delivery** performance and **own revenue** is an increased **willingness to pay** for services. As indicated in Figure 4, the quality of services can differ – poor service delivery may compromise the social contract between the municipality and consumers, thus increasing unwillingness to pay for services and resulting in variations in own revenue generation. This applies to households that can pay for services, as lower income households may also not have the ability to pay for services. While service delivery performance links to municipal own revenue through **rates and tariffs**, the loop to national revenue is closed through the payment of **tax**. Such national taxes make their way back to municipalities in the form of **transfers** from national government.

A comprehensive system of **governance and regulation** informs the operation of the LGFF. This system is intended to ensure minimum levels of performance among municipalities, an effectively functioning LGFF and service delivery. Such governance and regulation occurs as part of the general system of cooperative governance (governance and regulation by national and provincial governments), as well as in the form of internal municipal control mechanisms. The two key national departments are National Treasury, responsible for the design of fiscal instruments and compliance with fiscal legislation, and CoGTA, which is responsible for monitoring service delivery and the functioning of municipal systems, as well as the grants under its control. Other national departments (e.g. Energy, Water Affairs, and Transport) also have a role in the governance and regulation of the framework.

The objective of the framework is to ensure that the revenue available to municipalities is adequate to cover the expenditure that is reasonable to achieve a level of service delivery that is acceptable for the functions for which they are responsible. Hence the proposed framework has municipal expenditure at its core

(outputs), but has the core municipal mandate of service delivery as its ultimate focus (outcomes).

1.4 Principles that Inform the Current LGFF

A guiding set of principles and objectives informs the design of the LGFF. The Commission played a pivotal role in designing these fundamental principles. The Commission's Framework Document of 1996⁴ proposed four key principles to inform the design of an IGFR system and ultimately the LGFF. Essentially, an IGFR system should promote equity, democracy, fiscal accountability and economic efficiency through its process of expenditure and revenue assignment to sub-national governments.

Using the Commission's input as a basis, the White Paper on Local Government (1998) contains a set of principles for municipal finances. These are:

- a) Revenue adequacy and certainty,
- b) Sustainability,
- c) Effective and efficient resource use,
- d) Accountability, transparency and good governance,
- e) Equity and redistribution,
- f) Development and investment,
- g) Macroeconomic management.

The White Paper also specified the following objectives for the design of the LGFF:

- a) Equity,
- b) Efficiency,
- c) Ensuring a basic level of administrative capacity in the most resource-poor municipalities,
- d) Predictability,
- e) Incentives for proper financial management at the local level.

In 1998, the National Treasury (under its previous incarnation of the Department of Finance) articulated a set of principles and objectives for the design of the LGES formula. Although these principles focused specifically on the LGES formula design, such principles can (and are, to a certain extent) be applied to the current LGFF. The policy document *Introduction of an Equitable Share of Nationally Collected Revenue for Local Government* extended on the principles provided for in the White Paper on Local Government (1998) and are highlighted in Table 2:

⁴ Document is available at http://www.ffc.co.za/docs/submissions/dor/1996/submission_1996.pdf

Table 2 Principles and Objectives Informing the LGFF

CENTRAL POLICY OBJECTIVES	
<i>Equity</i> : Intergovernmental transfers should promote the constitutional and governmental goal of ensuring that all South Africans have access to basic services.	In effect, this means the provision of subsidised basic services to the poor. Transfers should also treat jurisdictions fairly and according to a uniform set of criteria.
<i>Efficiency</i> : A new transfer system should promote allocative efficiency by ensuring that inter-jurisdictional fiscal competition is an effective check on fiscal performance.	This in turn requires that, where possible and appropriate, uniform equalisation measures should be introduced to ensure that local tax rates vary because of variations in local service costs rather than because of disparities in tax bases.
<i>Spillover effects</i> : A new transfer system needs to introduce a way of funding projects which have strong spillover effects.	The provision of some public goods generates negative or positive externalities which may spill over into neighbouring jurisdictions. While the costs of providing public services with spillovers accrue to a single jurisdiction, the benefits are enjoyed by other jurisdictions as well. Thus, any local authority could be expected to undersupply such public goods.
<i>Facilitating democracy</i> : A new transfer system needs to enable local authorities to build or acquire a minimum level of institutional and physical infrastructure to discharge their fundamental administrative, functional and political responsibilities to their residents.	However, there is a certain minimum efficient scale for local authorities, and transfers should not be made available to entities falling below this level. In such cases, rationalisation and administrative restructuring are necessary.
ADDITIONAL BASIC PRINCIPLES	
<i>Rationality</i>	The level and distribution of transfers must be grounded in well-articulated arguments showing how they promote goals such as equity, economic growth and efficiency, and so on.
<i>Unintended consequences</i> should be limited.	In particular, the new system of transfers should create no perverse incentives.
Transfers should be <i>predictable</i> .	Without predictability, budgeting and borrowing becomes difficult and expensive.
Transfers should promote <i>accountability</i> .	Without accountability on the part of recipient governments, valuable national resources will be wasted, through inefficiency or corruption.
Transfers need to be <i>politically acceptable</i> .	They should support institution-building at the local level.
Transfers should be as <i>simple</i> and <i>transparent</i> as possible.	
The current system of <i>RSC levies</i> (payroll and turnover taxes) is neither economically efficient nor conducive to labour intensive economic growth.	In the long term consideration should be given to replacing the levies with a more appropriate form of taxation. In the short term, however, the system needs to remain intact.
The bulk of the <i>redistributive</i> effort intrinsic to the equity objective stated above should be funded by the central fiscus.	First, for reasons of economic fairness, economic efficiency and sound fiscal management, national equity standards should be financed by national taxation on all citizens and enforced uniformly across the country. Second, it is not constitutionally possible for central government to reallocate locally raised revenues from one Metropolitan or District Council jurisdiction to another. Third, the potential impact of any alternative needs also to be considered.

Source: Department of Finance (1998)

The principles set out in the White Paper on Local Government (1998) provide a basis for the current design and functioning of the LGFF. Therefore, a review of the LGFF requires a concomitant review of its guiding principles and objectives, assessing their applicability, credibility, effectiveness and success operationally.

1.5 The Instruments of the LGFF

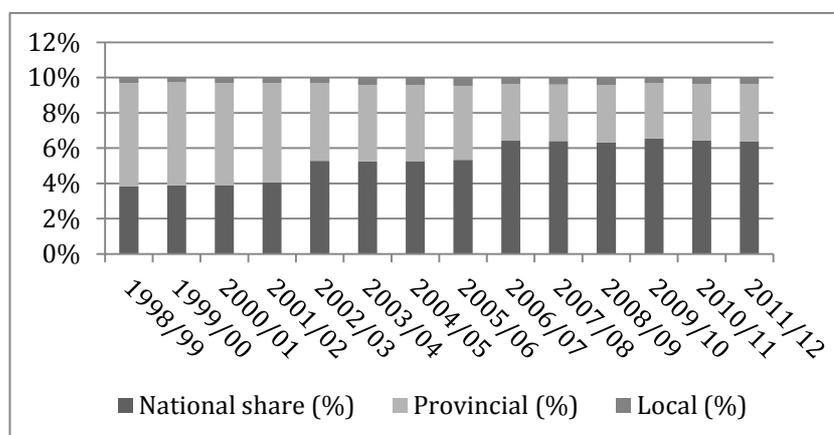
1.5.1 Intergovernmental transfers

Intergovernmental fiscal transfers take the form of unconditional and conditional grants and support both operating and capital expenditures. Conditional grants are further subdivided between grants aimed at supporting municipal infrastructure and grants aimed at building institutional and administrative capacity within municipalities.

The primary unconditional grant to local government is the LGES, which is a constitutional entitlement to municipalities as part of the Division of Revenue (DOR) – the sharing of nationally raised revenues among the three spheres of government. These transfers support municipal own revenues in the provision of services, predominantly on the operating budget. In most fiscally decentralised systems, the expenditure responsibilities devolved to a sphere of government may exceed its revenue powers. This is known as the *fiscal gap* and can exist at the vertical (between spheres) and horizontal (within sphere) levels. In the case of South Africa, the LGES is the primary mechanism aimed at minimising the fiscal gap in South African local government.

Figure 5 traces the share of nationally raised revenue across the three spheres of government since 1995/96. The smallest is the equitable share to local government, which is due partly to the greater fiscal powers decentralised to the sphere. However, this share has been growing faster year on year relative to national and provincial government.

Figure 5 Vertical Division of Revenue 1998/99–2011/12



Source: DOR Bills 1998 - 2011

The LGES

Since 1998, the LGES has been distributed to individual municipalities using a formula-based mechanism. In 2004 Government undertook a review of the formula that had operated since 1998, as it contained several flaws. The 2005/06 financial year saw the introduction of a revised formula. Subsequently, various concerns with this formula led to Government (in collaboration with the Commission and SALGA) introducing a new formula from 2013, which is described in Figure 6.

Figure 6: Structure of the LGES

$$LGES = BS + (I + CS) \times RA \pm C$$

where

- LGES** is the local government equitable share
- BS** is the basic services component
- I** is the institutional component
- CS** is the community services component
- RA** is the revenue adjustment factor
- C** is the correction and stabilisation factor

In 2010/11 the LGES amounted to R25 billion. The full LGES consists of three components (i) the formula-based allocation described above; (ii) funds used to replace revenues lost from the abolition of the Regional Service Council (RSC) levies (discussed later, in section 1.5.4); (iii) additional funding to support the remuneration of councillors allocated with local government's vertical share of revenue in the form of these unconditional transfers.

Conditional Grants

The Constitution allows other spheres of government to provide municipalities with grants that have specific conditions to be used to enhance and promote national policy goals. These conditional grants are usually directed at infrastructure development and capacity building at municipal level. The transfers can either go directly to the municipality or be an in-kind allocation to the municipality that will be spent on their behalf by a third party. Table 3 summarises the transfers to municipalities, including the LGES allocations.

Table 3 Transfers to Local Government – 2011 Division of Revenue

R million	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
	Outcomes			Revised estimate	Medium-term estimates		
Direct Transfers	38 483	45,487	51,538	61,152	70,171	77,029	82,317
Equitable share	20,676	25,568	23,845	30,559	34,108	37,573	39,960
General fuel levy sharing with metros	-	-	6,800	7,542	8,573	9,040	9,613
Conditional grants	17,807	19,927	20,893	23,052	27,490	30,416	32,743
<i>Infrastructure</i>	16,290	18,562	18,812	20,972	25,596	28,642	30,774
<i>Capacity building and other</i>	1,517	1,365	2,081	2,080	1,894	1,774	1,969
Indirect transfers	1,884	2,307	2,997	3,095	3,992	4,445	4,734
<i>Infrastructure</i>	1,334	1,928	2,754	2,947	3,892	4,445	4,734
<i>Capacity building and other</i>	550	379	243	148	100	-	-
Total	40,367	47,794	54,535	64,247	74,164	81,474	87,051

Source: 2011 DOR Bill

The LGFF contains various specific-purpose grants, each with its own objectives. Table 4 disaggregates the infrastructure-related grants to municipalities.

Table 4 Infrastructure Transfers to Local Government – 2011 Division of Revenue

R million	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
	Outcome			Revised estimate	Medium-term estimates		
Direct transfers	16 290	18 562	18 812	20 972	25 596	28 642	30 774
Municipal infrastructure grant	6 967	6 968	8 788	9 515	11 444	13 914	14 679
Urban settlements development grant	2 950	3 590	4 285	4 855	6 267	7 410	8 127
National electrification programme	462	589	914	1 020	1 097	1 151	1 215
Public transport infrastructure and systems grant	1 174	2 920	2 418	3 699	4 803	5 000	5 564
Neighbourhood development partnership grant	41	182	506	1 030	750	800	800
2010 FIFA World Cup stadiums development grant	4 605	4 295	1 661	302	-	-	-
Rural transport services and infrastructure grant	-	9	10	10	35	37	39
Electricity demand side management	-	-	175	220	280	-	-
Municipal disaster grant	-	-	-	-	470	330	350
Municipal drought relief grant	90	9	54	320	450	-	-
Indirect transfers	1 334	1 928	2 754	2 947	3 892	4 445	4 734
National electrification programme	973	1 148	1 478	1 720	1 738	1 882	1 986
Neighbourhood development partnership grant	61	54	90	125	100	80	55
Regional bulk infrastructure grant	300	450	612	893	1 704	2 003	2 176
Backlogs in water and sanitation at clinics and schools	-	186	350	-	-	-	-
Backlogs in the electrification of clinics and schools	-	90	149	-	-	-	-
Electricity demand-side management	-	-	75	109	119	-	-
Rural households infrastructure grant	-	-	-	100	232	480	517
Total	17 624	20 490	21 566	23 919	29 488	33 087	35 508

Source: 2011 DOR Bill

The Municipal Infrastructure Grant (MIG) is the largest infrastructure grant to municipalities, providing capital funding to support the rolling out of water, sanitation, refuse and other public infrastructure. The other major infrastructure grant to municipalities is the Integrated National Electricity Programme (INEP) grant, which supports electricity distribution infrastructure. The MIG and the INEP supports government's national policy to eradicate service delivery backlogs and ensure access to services to all of the country's citizens. Other infrastructure grants fund other national policies and priorities, such as the infrastructure required for hosting the 2010 FIFA Soccer World Cup.

Table 5 illustrates the various capacity-building transfers to local government.

Table 5 Capacity Building Transfers to Local Government – 2011 Division of Revenue

	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
				Revised estimate			
R million							
Direct transfers	1 517	1 365	2 081	2 080	1 894	1 774	1 969
Municipal systems improvement grant	200	200	200	212	219	230	243
Restructuring grant	530	–	–	–	–	–	–
Financial management grant	145	180	300	365	435	479	526
2010 FIFA World Cup host city operating grant	–	–	508	210	–	–	–
Water services operating subsidy grant	642	985	871	670	561	399	421
Expanded public works programme municipal incentive grant	–	–	202	623	680	666	779
Indirect transfers	550	379	243	148	100	–	–
Financial management grant: DBSA	53	50	–	–	–	–	–
Water services operating subsidy grant	497	329	243	148	100	–	–
Total	2 067	1 744	2 324	2 228	1 994	1 774	1 969

Source: 2011 DOR Bill

The conditions, reporting requirements and objectives of all these grants are comprehensively discussed in the annual Division of Revenue (DOR) Bill in the various conditional grant frameworks. The DOR Bill enacts and governs all transfers to local government.

Although most of the transfers to local government are from the national sphere, provinces also allocate grants to municipalities. Table 6 shows the amounts transferred to municipalities from the various provinces between 2006/07 and 2012/13. Most of the transfers support provincial functions being implemented at a municipal level, including housing, primary health care and transportation.

Table 6 Provincial Transfers to Local Government 2006/07–2012/13

R thousand	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	% Ave annual growth	
	Outcome			Estimate	Medium-term estimates			2006/07 - 2009/10	2009/10 - 2012/13
Provincial transfers									
Eastern Cape	460 645	470 736	733 245	856 121	561 362	593 509	626 355	22.9%	-9.9%
Free State	100 662	58 322	182 436	446 751	393 813	378 172	353 893	64.3%	-7.5%
Gauteng	405 476	454 504	476 256	622 499	607 163	630 106	663 147	15.4%	2.1%
KwaZulu-Natal	478 394	783 710	1 115 245	1 331 010	728 622	767 321	794 839	40.6%	-15.8%
Limpopo	94 906	23 034	84 272	39 431	135 311	57 334	48 154	-25.4%	6.9%
Mpumalanga	24 207	14 380	100 916	89 682	57 374	65 760	68 888	54.7%	-8.4%
Northern Cape	111 224	89 400	113 925	134 300	141 941	149 853	142 430	6.5%	2.0%
North West	-	-	40 255	222 190	226 770	226 950	1 232 319	-	77.0%
Western Cape	884 544	1 379 595	1 416 736	1 558 963	1 575 760	1 779 694	1 778 731	20.8%	4.5%
Total	2 560 058	3 273 681	4 263 286	5 300 947	4 428 316	4 668 699	5 708 756	27.5%	2.5%
Per category									
Category A	1 043 394	1 779 290	2 233 104	2 555 674	2 263 079	2 483 577	2 529 961	34.8%	-0.3%
Category B	760 905	765 874	1 316 596	1 529 764	1 308 999	1 297 911	2 285 391	26.2%	14.3%
Category C	755 759	728 517	713 586	1 215 509	856 238	887 211	893 405	17.2%	-9.8%
Total	2 560 058	3 273 681	4 263 286	5 300 947	4 428 316	4 668 699	5 708 756	27.5%	2.5%

Source: *Local Government Budgets and Expenditure Review (National Treasury, 2011)*

1.5.2 Municipal own revenues

Section 229 of the Constitution assigns various taxation powers to local government. These include property rates, user charges and various other local taxes, fees, levies and charges, as shown in Table 7 for the period 2006/07–2012/13.

Table 7 Municipal Own Revenue Sources 2006/07–2012/13

	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	% Average annual growth	
	Outcome			Estimate	Medium-term estimates			2006/07 - 2009/10	2009/10 - 2012/13
R million									
Operating Revenue									
Property rates	18 737	21 451	22 305	26 294	30 702	32 599	35 186	12.0%	10.2%
Property rates - penalties & collection charges	-	-	-	-	579	608	637	-	-
Service charges	45 553	49 968	58 288	72 255	91 191	102 703	120 679	16.6%	18.6%
Service charges - electricity revenue					58 978	68 916	84 172	-	-
Service charges - water revenue					17 676	18 633	20 223	-	-
Service charges - sanitation revenue					7 334	7 719	8 407	-	-
Service charges - refuse revenue					4 747	5 042	5 542	-	-
Service charges - other revenue					2 456	2 393	2 334	-	-
Rental of facilities and equipment					1 635	1 443	1 510	-	-
Interest earned - external investments	3 217	3 998	4 504	2 829	1 927	1 927	2 013	-4.2%	-10.7%
Interest earned - outstanding debtors					2 127	2 189	2 362	-	-
Dividends received					3	8	9	-	-
Fines					1 430	1 492	1 675	-	-
Licences and permits					600	538	554	-	-
Agency services					1 327	1 375	1 477	-	-
Transfers recognised - operational	28 970	39 322	49 519	57 474	39 476	39 819	42 845	25.7%	-9.3%
Other revenue	12 303	12 770	14 888	17 490	9 592	9 477	10 091	12.4%	-16.8%
Gains on disposal of PPE					593	278	265	-	-
Total revenue	108 781	127 508	149 480	176 342	181 181	194 453	219 301	17.5%	7.5%
Percentage of total revenue									
Property rates	17.2%	16.8%	14.9%	14.9%	16.9%	16.8%	16.0%		
Service charges	41.9%	39.2%	39.0%	41.0%	50.3%	52.8%	55.0%		
Interest earned - external investments	3.0%	3.1%	3.0%	1.6%	1.1%	1.0%	0.9%		
Transfers recognised - operational	26.6%	30.8%	33.1%	32.6%	21.8%	20.5%	19.5%		
Other revenue	11.3%	10.0%	9.9%	9.9%	9.9%	9.0%	8.5%		
Total revenue	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%		

Source: Local Government Budgets and Expenditure Review (National Treasury, 2011)

Although property rates and services charges are the most important revenue instruments available to municipalities, other smaller sources of municipal revenues include fines, licences, agency fees and interest on late payments for taxes.

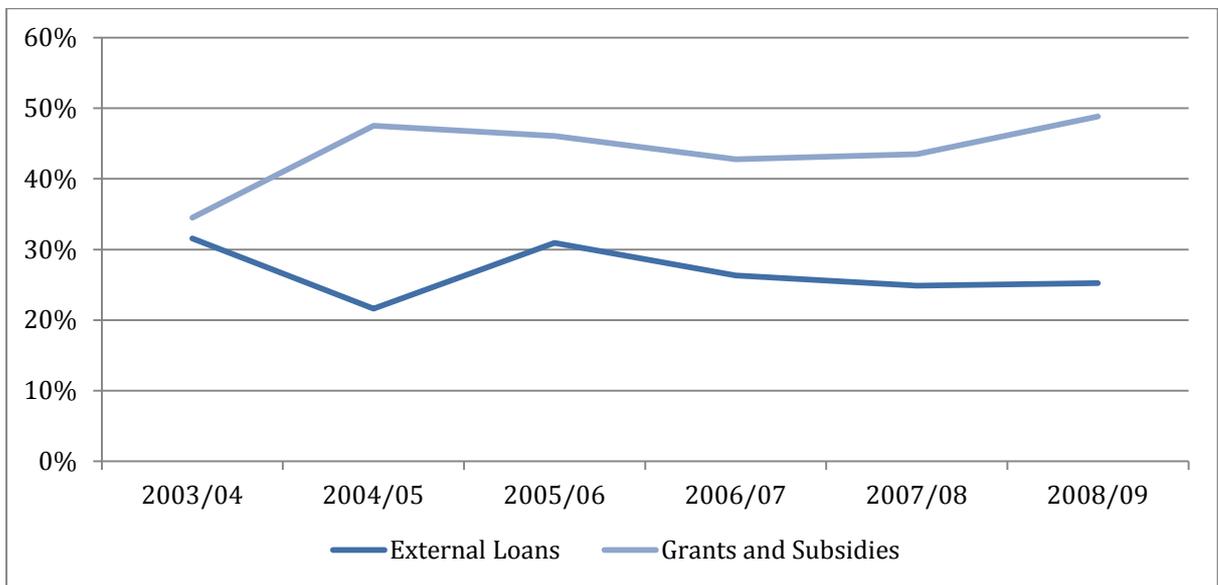
Several pieces of legislation related to municipal own-revenue sources support Section 229 of the Constitution:

- The Municipal Property Rates Act (MPRA) of 2004 regulates local government's ability to impose property rates
- The Electricity Act of 1987 and the National Water Act of 1998 govern service charges and tariffs specific to the sector.
- The Municipal Fiscal Powers and Functions Act (MFPFA) of 2007 regulates all municipal taxes (excluding property rates), including a municipality's ability to apply a surcharge on a tariff and the various "smaller" taxes highlighted in Table 7. Importantly, Section 5 of the Act allows for a municipality, a group of municipalities or organised local government to apply for a new tax.

1.5.3 Municipal borrowing

Although municipalities tend to finance the operating budget mainly from own revenues, local governments are also legally authorised to borrow from credit markets for capital expenditure such as infrastructure. Section 230 of the Constitution empowers municipalities to borrow, while the Municipal Finance Management Act (MFMA) regulates such powers. Section 45 of the MFMA regulates short-term debt, specifying that short-term debt needs to be repaid before the end of the municipal financial year. Section 46 of the MFMA regulates long-term debt, which is incurred to support municipal capital expenditure. Figure 7 illustrates trends in municipal loans used to finance capital expenditures.

Figure 7 Municipal Borrowing as a Contributor to Capital Expenditure 2003/04–2008/09

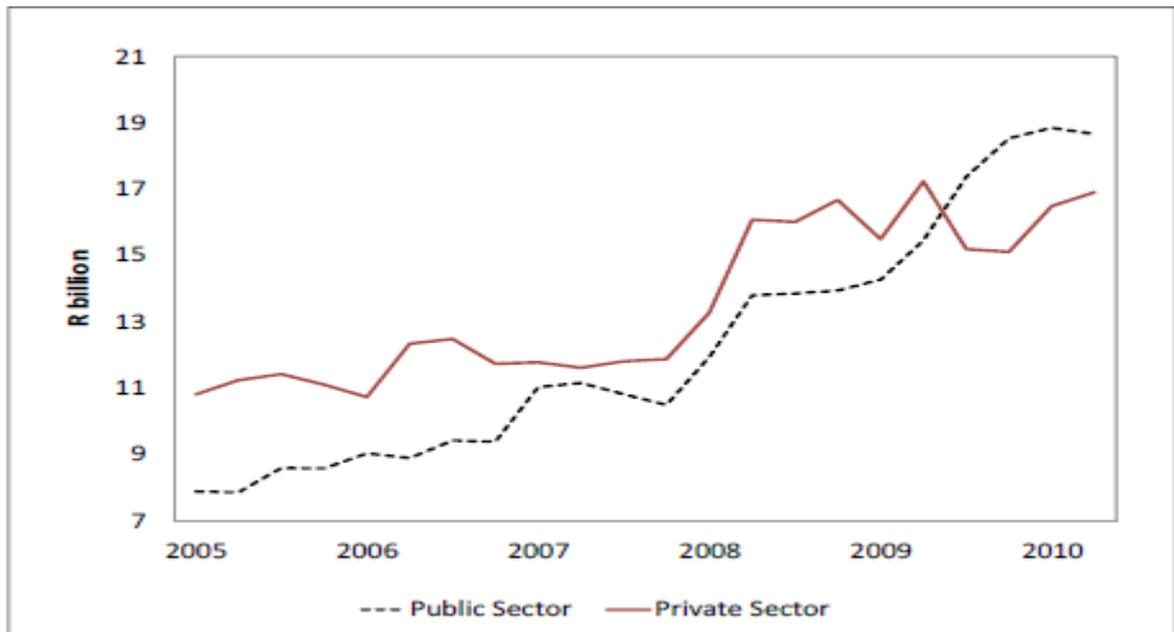


Source: National Treasury Local Government Database (National Treasury, 2011)

For the period 2003/04–2008/09, total municipal borrowing supporting capital expenditure averaged between 20% and 30%. Although most of the capital budget is grant financed, debt-financed expenditure is clearly an important source of revenue. Recently, grant-financed capital expenditure has increased, whereas municipal borrowing has decreased as a proportion of municipal capital budgets.

Figure 8 shows the sources of municipal borrowing, differentiating between public and private sector loans for the period 2005–2010.

Figure 8 Sources of Municipal Debt 2005 - 2010



Source: Local Government Budgets and Expenditure Review (National Treasury, 2011)

At the start of the period, most loans were from the private sector. However, with the financial crisis, municipal credit portfolios shifted to public sector institutes, mainly the Development Bank of South Africa (DBSA). This is possibly due to the favourable interest rates charged by public lending institutes. Another reason is that the current financing structure sees banks as short-term lenders while the DBSA has a longer funding and development outlook.

1.5.4 The Regional Services Council (RSC) levies replacement grant and the sharing of general fuel levy

Until 2006/07, the RSC levy was a major revenue source for local government, accounting for approximately 8% of total municipal operating revenues. A tax levied by metros and district municipalities, the RSC levy was abolished in the 2006/07 municipal financial year because of several economic, legal and administrative deficiencies. To protect municipal budgets from the loss of revenue, national government introduced an RSC levy replacement grant as an interim measure until a suitable replacement for the former tax was identified and implemented. In 2009/10 the sharing of the general fuel level (a national tax) was implemented as the official replacement for the RSC levies for metros (along with the VAT zero rating of municipal property rates). Metros were entitled to an approximate 23% share of the revenues from the general fuel levy, equivalent to the RSC levy replacement grant and shared proportionally among the metros according to total fuel sales within their respective jurisdictions.

1.6 Methodology

To complement the technical research work done by the Commission, public hearings were held in order to:

- i. Improve the Commission's interaction with key stakeholders to ensure that their needs and ideas are being considered.
- ii. Allow for a forum where a variety of ideas and viewpoints could be debated openly and effectively.
- iii. Provide a rare opportunity for stakeholders to reach a consensus on problems and solutions, and to understand and articulate possible tensions and trade-offs.
- iv. Provide a platform to reintroduce previous Commission research and recommendations, where relevant, in a structured and holistic manner.
- v. Ensure that the Commission can extend and improve its scope in the greater policy and intellectual arena while simultaneously ensuring its legal mandate obligations are fulfilled

The methodology can be informally described as a “discussion-driven” or “stakeholder-based” research. In other words, the general problem statement, specific problem areas and associated solutions were generated through intensive interactions with experts and stakeholders in the local government arena. This process consisted of two public hearings, and the rationale, inputs and outcomes of each hearing are described below.

1.6.1 The first public hearing⁵

In October 2011 the first public hearing was held in Limpopo. It provided a platform for all stakeholders to validate and enrich the general problem statements and an initial set of issues, challenges and research questions pertaining to the LGFF, which were captured in a preliminary discussion document released by the Commission. This discussion document together with oral and written submissions from various stakeholders formed the basis of plenary and group discussions.

The Commission used a refined problem statement based on stakeholder feedback on the problem areas identified in the first public hearing to develop an analysis of possible policy options to remedy these problem areas. These policy options formed the basis and rationale for the second public hearing.

⁵This preliminary discussion document, stakeholder presentations, reports and the summary and full report from the outcomes of the first FFC public hearing on the LGFF is available at <http://www.ffc.co.za/index.php/media-a-events-interactive/public-hearings/local-government.html>

1.6.2 The second public hearing⁶

The objective of the second public hearings, which were held in June 2012 in Gauteng, was to provide the space to discuss and reach consensus on policy options. This would ensure the general acceptability, feasibility and appreciation of the potential impacts of the policy options on players in the local government arena. In preparation for the hearings, the Commission analysed each problem area identified in the first hearing and proposed a set of policy options as a point of departure for discussion and debate at the second hearing. The second hearings also provided the platform for stakeholders to propose additional options for consideration.

This final report on the review of the LGFF was prepared after consultations and discussions from the second public hearing.

Chapter 2: Problem Analysis

The public hearing methodology provided a platform for identifying the problem areas, for presenting the Commission's analysis on options to solve these problems, and for discussing such options. At the first public hearing, the FFC presented a set of problems for discussion. The 13 problems identified as critical for transforming the LGFF are described below, the consensus reached by stakeholders is explained, and policy options and proposals to remedy these problems are analysed.

2.1 Differentiation in the Local Government Fiscal Framework

The LGFF needs to be sensitive to the unique characteristics and circumstances faced by every municipality in the country, and be dynamic enough to cater for the evolving nature of the local government sphere. The LGFF needs to cater for a variety of different municipalities. Table 8 highlights some of the distinct differences in terms of economic and demographic indicators for the various types of municipalities in the country.

Table 8 Municipal Economic and Demographic Indicators – 2007

Type of Municipality	Total population	Total gross value added per capita	% of people employed	% of households earning below R3200pm	Average population density	Operating expenditure per capita	Revenues from local taxes per capita
Metropolitan municipalities	16,974,424	75.67	34%	46%	1388	3,789.48	3,279.51
Secondary cities	8,233,208	50.80	29%	59%	221	2,242.55	1,940.00
Larger towns	3,985,216	40.83	27%	62%	87	1,843.08	1,513.82
Smaller towns	6,906,926	29.16	22%	69%	19	1,466.46	988.70
Rural municipalities	12,331,695	9.44	13%	80%	81	370.49	120.77
Total/average	48,431,469	41.18	25%	63%	359	1,942.41	1,568.56

Source: National Treasury Local Government Database and 2007 Community Survey

⁶This preliminary discussion document, stakeholder presentations, reports and the summary and full report from the outcomes of the second FFC public hearing on the LGFF is available at <http://www.ffc.co.za/index.php/media-a-events-interactive/public-hearings/local-government.html>

Urban municipalities (represented by the metros and secondary cities) have greater levels of economic activity, employment and a ‘richer’ demographic profile, which affect expenditure responsibilities, as shown by the higher per capita expenditure. Rural municipalities are characterised by high levels of unemployment and poverty and low levels of economic activities. Urban municipalities have denser settlements, while rural municipalities are relatively more sparsely populated. These differences have an impact on the minimum costs of providing services and suggest that these unique environments require unique planning decisions. The differences also affect the fiscal framework itself, as the ability of municipalities to generate their own revenues varies markedly, and certain municipalities are very dependent on transfers from national government. Table 9 shows the funding mix across the various types of municipalities, highlighting these differences.

Table 9 Municipal Sources of Revenue across Municipal Categories – 2009/10

Type of Municipality	Government Grants	Property Rates	Service Charges	Investment Revenue	Other	Total
Metropolitan Municipalities	25%	18%	45%	3%	9%	100%
Secondary Cities	26%	14%	47%	3%	10%	100%
Larger Towns	27%	21%	40%	2%	10%	100%
Smaller Towns	37%	12%	36%	3%	12%	100%
Rural Municipalities	70%	6%	14%	3%	7%	100%
Districts without P&F	79%	0%	2%	8%	11%	100%
Districts without P&F	80%	0%	8%	4%	8%	100%
Total	34%	15%	39%	3%	9%	100%

Source: National Treasury Local Government Database (National Treasury, 2011)

The greater levels of economic activity and favourable demographic profiles of metros and urban municipalities clearly enhance their ability to generate own revenues. In 2008/09, own revenues funded 75% of the operating budgets of metros and secondary cities, whereas rural municipalities and district municipalities depended heavily on grants. This dependency ranges from 70–80% and suggests that the ability to generate revenues in these areas is minimal.

In addition to revenues, the expenditure functions and powers assigned to different types of municipalities vary. Metros and secondary cities, which operate in the urban space, have greater decision-making powers for planning housing and transport infrastructure, to enhance the development and funding of the built environment.

Stakeholder Consensus

Stakeholders recognised that municipalities have different underlying characteristics, which include spatial factors, population density, topography, level and type of economic activity and historical redress. Stakeholders also agreed that a differentiated approach is needed for municipal funding. However, the basis on which differentiation should occur was contested: should differentiation take place across a

continuum, as is currently the case with the LGES formula, or across groups based on criteria such as capacity, costs or performance.

Some stakeholders argued that the formula basis of LGES means that more differentiation is not required, while others felt that differentiation needs to be further embedded within the LGFF to respond to municipalities with differing capacities. It was argued that different municipalities require different technical and financial capacity-building support. In this case, if formulas were used to distribute funds and include a capacity component, how capacity is defined and measured would need to be clarified.

Another theme in the stakeholder submissions was the need to take into account the different costs of providing services in various contexts. One stakeholder cautioned against generalising urban and rural cost differences and said that, for the same level of service, in certain cases urban costs are higher and in other cases rural costs are higher. It was argued that there is room for an urban/rural differentiation based on the different approaches to service levels in these areas.

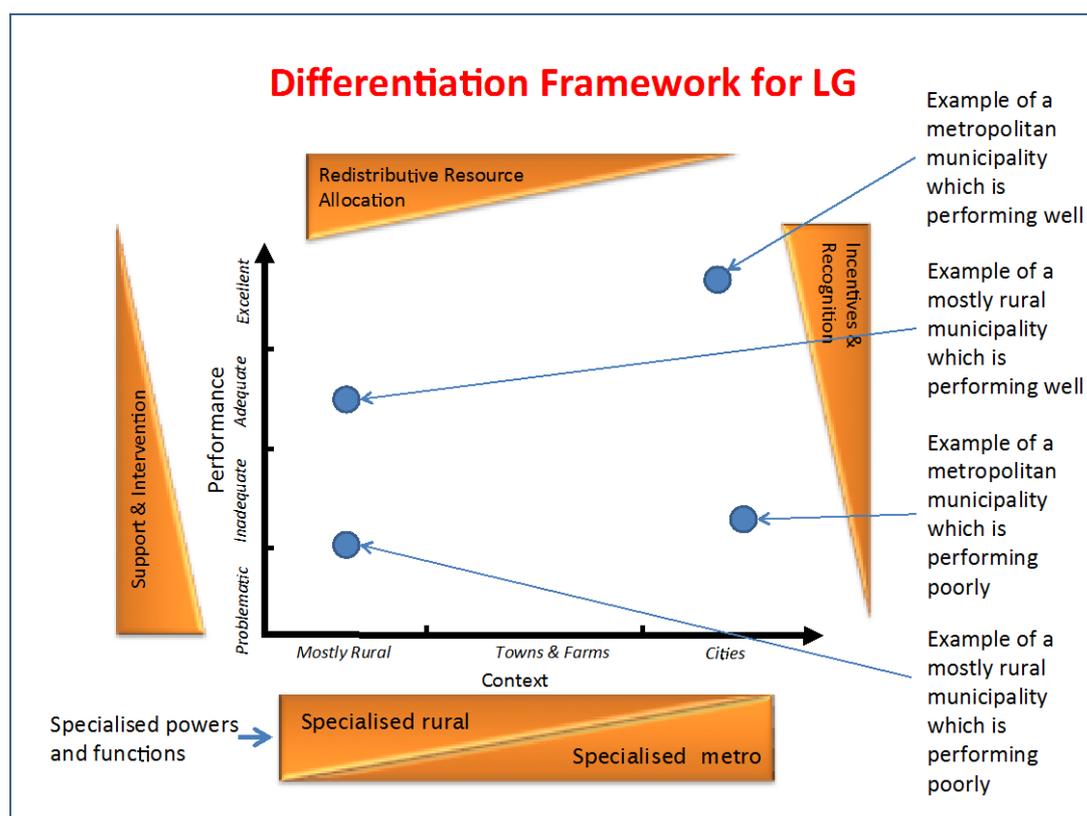
Finally, some stakeholders argued for considering a performance approach to differentiation, which might include once-off performance awards, rewarding compliance, determining fiscal effort and spending efficiency, while ensuring that perverse incentives⁷ are avoided.

Analysis

Over the last year, the CoGTA has developed a framework for differentiation, which is shown in Figure 9 below:

⁷ Perverse incentives refer to the unintended consequences of a particular grant design, where the municipality has more information than the transferring department. For example, linking grant allocations to performance based only on number of houses built could lead to lower quality houses.

Figure 9 Differentiation Framework for Local Government



Source: FFC Options Analysis (2012)

The Framework is based on the following key principles:

- Separation of context-related factors (horizontal axis) from performance-related factors (vertical axis).
- ‘Context’ defines functions profile (specialised powers and functions).
- ‘Context’ defines primary allocation of resources.
- ‘Performance’ defines the support and intervention options.
- ‘Performance’ relates to extent of regulation and application of incentives⁸.

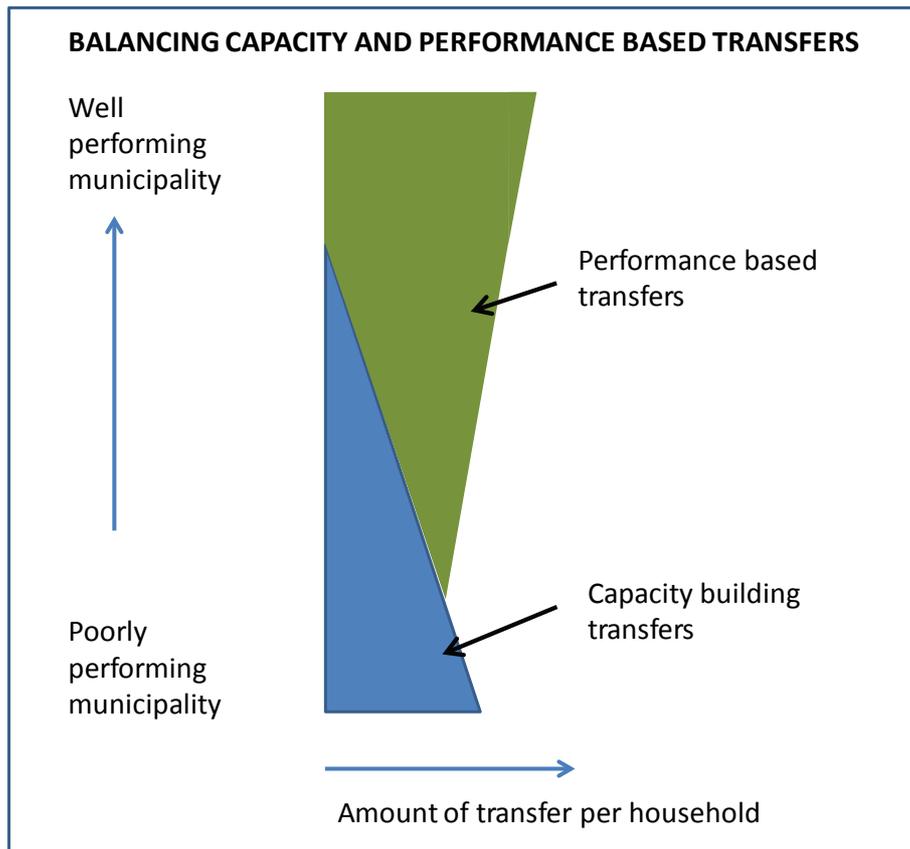
This structure for differentiation has important implications for the design of the LGFF and its associated instruments.

1. **The horizontal distribution of the ‘primary’ transfers aimed at covering operating and capital costs (LGES and MIG) are based on context:** key parameters are access to services and households living in poverty. To some extent the system of transfers also deals with settlement circumstances. For example, the differences in urban and rural service levels or the requirement for public transport infrastructure in larger cities.

⁸The argument is that regulation and incentives are effective only when a municipality is reasonably functional. Until this point is reached the emphasis needs to be placed on capacity building.

2. **The structure allows for differentiation in the way financial resources are allocated with regard to performance.** Capacity-building transfers should relate to performance, with a higher level of allocations for under-performing municipalities. On the other hand, incentive-based transfers imply greater allocations of transfers to higher performing municipalities. The net impact can be illustrated in Figure 10.

Figure 10 Balancing Capacity and Performance Based Transfers



Source: FFC Options Analysis (2012)

This structure has important implications for the LGFF, as a shift towards a greater emphasis on performance is made. Both of the transfers illustrated in Figure 10 are aimed at improving performance. The structure shows the shift in the financial intervention, from externally driven capacity-building initiatives, towards internally driven arrangements to improve performance.

In terms of the differences of service costs across municipalities, various factors can influence these costs:

- a) **Settlement density**, which has two components: the density within a settlement, which drives the cost of internal and connector infrastructure; and the spatial relationship of individual settlements, which need to be linked by

road systems, power supply distribution lines and bulk water supply lines (in the case of larger scale bulk water supply systems).

- b) **Topography:** areas with steeper slopes are typically more costly to serve with roads and, to a lesser extent, water supply and sewerage lines. On the other hand, very flat areas are more costly to serve with sewerage systems (deeper sewer lines and more pumping requirements) and stormwater drainage.
- c) **Soil conditions:** an ideal situation consists of soft cohesive soils, but costs increase with the degree of rock encountered, with clayey soils and loose sandy soils.
- d) **Access to water resources:** a large factor that influences the cost of bulk water supply. At the one extreme, the high cost of water from the Upper Vaal system, which includes charges for the Lesotho Highlands Scheme. At the other extreme, the negligible water costs of simple rural systems, which draw from springs.
- e) **Environmental sensitivity:** particularly with respect to water bodies receiving treated effluent from wastewater treatment works. This also has an impact on solid waste disposal and costs.

All of these factors would be difficult to measure per municipality and even more difficult to incorporate directly into the LGFF.

2.2 The Local Government Equitable Share

2.2.1 The need to review the horizontal and vertical division of revenue

Stakeholder Consensus

The LGES receives the smallest proportion of nationally collected revenue in the vertical division of revenue (see Figure 5), but the proportion has been growing faster year on year relative to national and provincial government. The horizontal and vertical divisions of revenue are both important. The vertical division is critical in the light of declining local government fiscal capacity, as own-revenue instruments have been withdrawn (e.g. the RSC levies) without being replaced by viable alternatives that are true local government taxes under the control of municipalities. In 2003/04 local government financed approximately 90% of its expenditures from own revenues, but this has declined to 67% in 2009/10. Escalations in water and electricity pricing also affect the vertical division.

Examples were given of small rural municipalities that were receiving clean audits (and hence had reliable financial data) and were exerting maximum effort to collect revenues owed to them, but do not have a sustainable revenue base to meet the basic service delivery demands in their jurisdiction. While some municipalities do not collect sufficient revenue from the available tax base (e.g. not metering or billing properly), stakeholders emphasised that small, mainly rural municipalities, which

were optimising revenues at their disposal, are in a precarious financial position. For these cases urgent action was requested.

Analysis

As mentioned, the general aim of both the vertical and horizontal division of revenue is to minimise the potential fiscal gap for both local government, as a sphere, and for each and every municipality respectively. The fiscal gap can be seen both from a ‘structural’ point of view and from an ‘actual’ point of view and can be applied to both the operating and capital account.

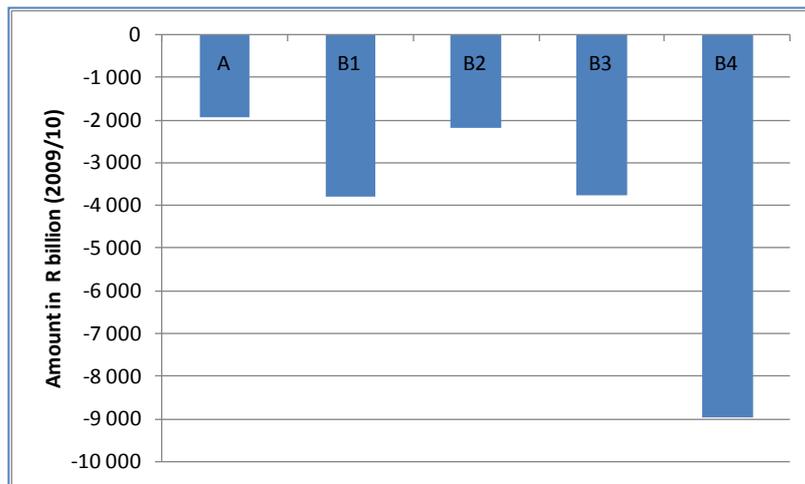
The **structural fiscal gap** is an important concept for the LGFF, as it defines a ‘target’ for applying transfers in an attempt to close this gap. It can be defined as the difference between the costs incurred in providing services at a reasonable level of expenditure (for a properly managed service) less the revenue raised from ‘own sources’, assuming that all the revenue owed to the municipality is raised at appropriate levels from all consumers who are not eligible for FBS. In this case the revenue is referred to as **fiscal capacity**. On the capital account, the structural fiscal gap can be referred to as the difference between the costs of providing an adequate package of services to consumers, taking national standards into consideration, less the finance which the municipality can raise from ‘own sources’ assuming that it makes the best possible effort to raise this finance.

On the other hand, the **actual fiscal gap** is based on whatever the municipality spends less the amount of revenue it actually raises. It is therefore associated with a certain level of **fiscal effort**, which may be less than that associated with the best possible effort.

A quantitative estimate of the structural fiscal gap is a necessary part of the LGFF. This needs to take the differentiated nature of municipalities into account. The Commission’s analysis of options attempted to quantify the structural fiscal gap as defined above. The results for the gap on the operating account are summarised (before any transfers are applied and taking all municipalities in the sub-category into consideration) and shown in Figure 11.⁹

⁹ Labelling: A=metros; B1= secondary cities; B2= large towns; B3=small towns and commercial farms; B4=mostly rural traditional areas. District partners included.

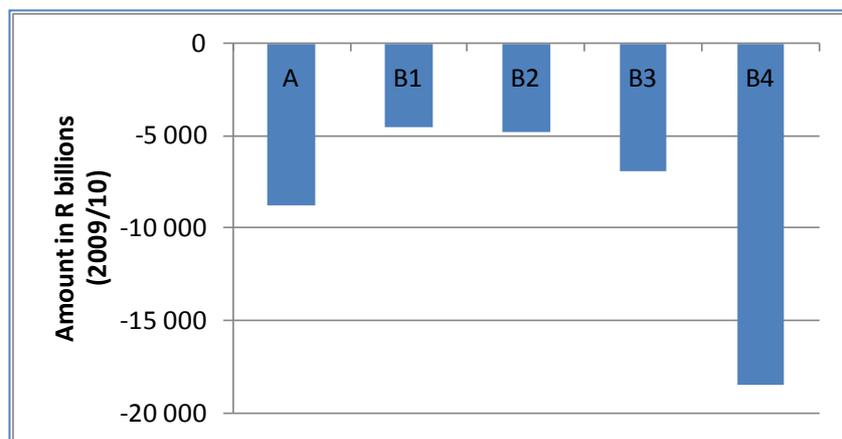
Figure 11 Operating Structural Fiscal Gap before Transfers



Source: FFC Options Analysis (2012)

The expenditure by metros (As) is likely to be underestimated mainly because of the additional costs they are exposed to through unfunded mandates, especially for housing and public transport. Nevertheless this picture provides a basis for understanding the gap and how to fill it. On the capital account the situation is summarised in Figure 12.

Figure 12 Capital Structural Fiscal Gap before Transfers



Source: FFC Options Analysis (2012)

In considering the balance between grant finance and ‘own source’ capital finance, an important principle needs to be addressed in the LGFF. The main capital grants are designed to fund infrastructure for poor households (social infrastructure), implying that economic infrastructure, which serves high-income households, institutions and businesses, will be financed from municipal own revenues on the understanding that sufficient surplus will be generated from these users of infrastructure to provide for this own source capital finance. However, in reality this does not happen, as the

municipality's overall financial position determines the extent to which they can raise their own capital finance. For example, a middle-sized municipality may have only 30% of its infrastructure that serves poor households but cannot generate a good enough credit standing to raise loans to cover the 70% for economic infrastructure.

The degree to which current transfers are closing the gap

On the operating account, the indication is that the fiscal gap can be closed with the current system of transfers aimed at the operating account (the LGES). This implies that the LGES is functioning as a gap-filling measure taking the structural fiscal gap into consideration. In the case of municipalities at the other end of the spectrum: mostly rural municipalities and their district partners, a confirmation of this position is not easy, as nowhere does fiscal effort approach fiscal capacity. However, while anecdotes abound, the evidence based on sound financial modelling does not appear to suggest that the equitable share is not sufficient, with the proviso that there may be some exceptions.

With regard to the capital account, the situation is completely different. The grant arrangements do not close the structural fiscal gap, while all categories of municipality are facing capital shortages, which are hindering the removal of service backlogs and rehabilitation of aging infrastructure.

Despite the lack of proper research on determining the structural fiscal gap at local government level and per municipality, the analysis above reveals that the vertical division of revenue covers the vertical fiscal gap better on the operating budget than on the capital budget. Arguably, the operating fiscal gaps continue to exist across various municipalities. This suggests that, although the vertical division of revenue might be adequate to fill the fiscal gap for local government, the horizontal distribution mechanism (via the LGES) needs to be improved.

On the capital budget, local government appears, in general, to be lacking finances to fund their investment plans.

2.2.3 The need to update demographic data

Stakeholder Consensus

Stakeholders unanimously agreed on the inadequacy of using 2001 census data for calculating the current LGES. They argued that census-quality data was essential for planning and should be updated more frequently than every 10 years, as substantial demographic change takes place within a decade. This view concurs with the concerns raised by the Commission in previous recommendations. In the past it was possible to generalise that rural areas were poor and urban areas were rich, but in recent years urbanisation has led to poverty also becoming concentrated in cities. It was also suggested that the economic linkages between urban and rural areas should be examined, to ascertain whether they were exploitative or mutually beneficial. The development and implementation of a national urbanisation policy need not contradict government's support of rural areas.

Analysis

Currently, grants in the LGFF are based on information provided by Statistics South Africa (StatsSA). The use of such data is mandatory, as it is considered official due to the processes StatsSA follow in terms of collecting the data and validating such data via the Statistics South Africa Quality Assessment Framework (SASQAF). Therefore, the data used to inform the allocations in the LGFF need to be validated via SASQAF.

Currently, allocations formulae such as the LGES and MIG are allocated using data from the 2001 Census. Updates to this underlying data are not possible because StatsSA do not collect demographic, social and economic data that can be disaggregated to a local municipal level frequently enough. Sample surveys, which are undertaken between censuses, cover too small a sample size to be accurately disaggregated at a local municipal level. This creates a huge data gap, resulting in out-dated allocation formulae.

Internationally, various methods are used to update data at a micro level, linking sample surveys to censuses using both as a base to model various economic and demographic data at a municipal level. StatsSA should explore such international best practice and apply these methods so that more data can be made available at municipal level.

Government needs urgently to take a firm stance over the availability and practical use of local government data. If comprehensive data for municipalities is only available every 10 years when a census is carried out, this needs to be officially communicated and accepted. Then, the formulae used to disburse funds can be configured in a way that minimises the effect of such a constraint.. The lack of frequently updated data is one of the fundamental obstacles in the review and subsequent reform of the funding formulae. It results in uncoordinated tinkering of formula parameters to cater for secondary issues such as accounting for migration, changes in household service levels and cost of municipal services. Such tinkering further complicates and distorts the fundamental objectives of these funding mechanisms and can only be solved with accurate and frequent data. The current Statistics Act 6 of 1999 makes provision for a census to be undertaken every five years. Government should again provide a stance on whether such a practice will continue or will the data gap created by 10-year censuses again be filled by a Community Survey. Government needs to ensure that the quality of such a Community Survey is improved substantially from the 2007 initiative, so that it can be used to update local government funding formulae.

In addition, data collection by various players in the local government arena is uncoordinated and undertaken in silos. The result is an administrative burden to the reporting municipalities, as various departments, national and provincial, ask similar questions; the departments themselves do not know what each other collects. Coordination in this regard is critical because such data can possibly feed into the

LGFF if validated through SASQAF. Government has established the Local Government Data Forum with the intention of harmonising data collection and reporting across local government. The mandate of this forum needs to be formalised for it to play an important part in reviewing and solving the data issues at the local government level.

2.3 Conditional Grants

2.3.1 Challenges posed by a plethora of conditional grants

Stakeholder Consensus

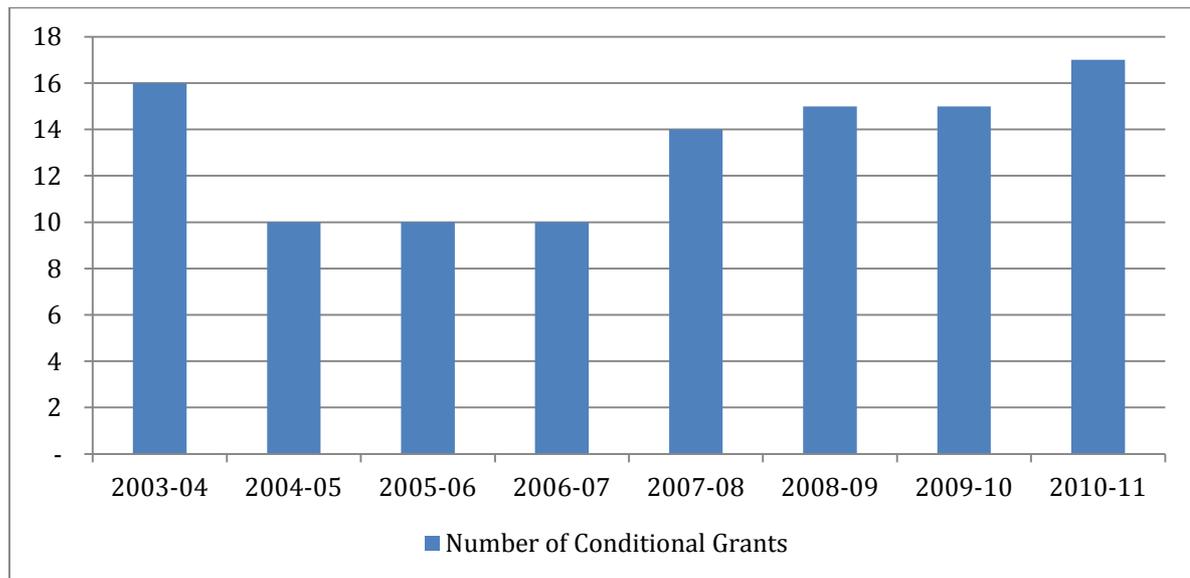
In response to infrastructure backlogs and deterioration in the condition of existing municipal infrastructure, various sector departments issue conditional grants. Stakeholders explained that working with such a plethora of conditional grants is administratively intensive and is contrary to integrated infrastructure planning. In addition, this ad hoc approach prevents municipalities from proper capital budgeting and from pledging capital grants as collateral for borrowing. Stakeholders mentioned that consolidating grants in the form of the MIG could reduce the number of conditions that municipalities need to comply with.

Analysis

Theoretically, conditional grants are aimed at achieving national goals and objectives. These grants are given to municipalities to spend on behalf of other spheres of government. As per the Division of Revenue Act (DORA) and to improve outcome levels, spending on these conditional grants must be reported to the responsible sector departments that distribute these funds. Such a compliance requirement can become an administrative burden to (already capacity-constrained) municipalities, when they are required to report on and administer several grants, and can exacerbate under-spending on such grants.

The recent proliferation of grants complicates the conditional grant framework by duplicating goals and objectives of several grants and not considering the increased administrative burden on municipalities. Figure 13 shows the proliferation of grants in the LGFF since 2004.

Figure 13 Changes in the Number of Municipal Conditional Grants from 2003/04



Source: National Treasury (2011)

In 2003, following recommendations by the Commission, a decision was taken to consolidate grants, especially infrastructure grants into the MIG. As a result, in the subsequent financial year (2004/05), the number of grants decreased, from 16 to 10. However, the system is clearly reverting to a system of unconsolidated grants – in 2010/11 there were 17 municipal conditional grants in 2010/11, even more than in 2003/04.

The proliferation of grants and grant dependency need to be avoided. The MIG should be aligned to other infrastructure grants in order to have a greater impact. For example, MIG allocations could be aligned to housing policy where housing subsidies exclude the funding of internal infrastructure. Some grants may be suitable for integration into the MIG, for example the INEP grant (currently a separate grant), while public transport subsidy grants (for example to the Passenger Rail Agency of South Africa – PRASA) need to be part of the LGFF. Rural road asset management grants should also be factored into the MIG, and the confusion around the classification of roads (provincial versus municipal) sorted out. Spatial development could be promoted through an urban settlement development grant, although the neighbourhood development grant has had a poor uptake, which may be because of the lack of clarity over its purpose and how it fits into the LGFF.

An analysis of recipient municipalities found that capacity grants are not targeting the most appropriate beneficiaries i.e. the least capacitated municipalities. The type of required capacity building, in terms of training, systems, financial capacity, implementation capacity and qualifications specific to local government, needs to be clearly understood.

2.3.2 Insufficient capacity support to accompany conditional grants

Stakeholder Consensus

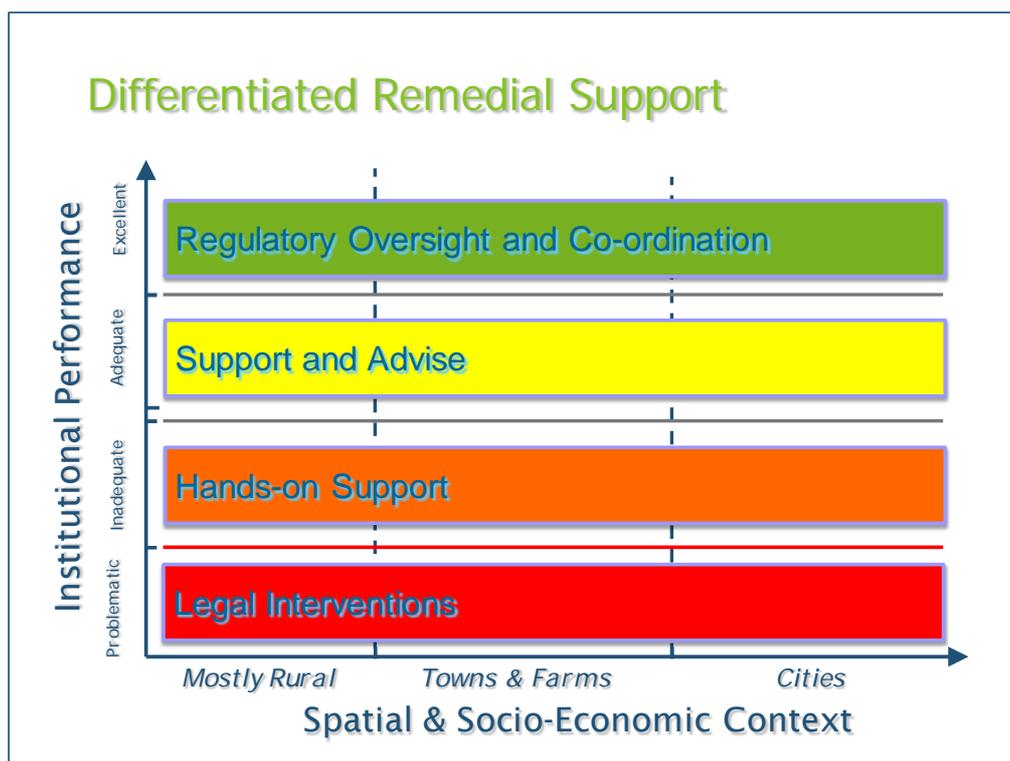
Stakeholders argued that, if necessary, sector departments should provide capacity support as part of the conditional grant allocation. In addition, support for low-capacity municipalities should focus on setting up sound systems and growing management capabilities. For example, before making any major capital investments in water conservation and demand, operations should be funded, to ensure that the management systems are running efficiently. However, other stakeholders were concerned about a “top-down approach”, and felt that local government should be central to setting the agenda for any capacity-building programmes.

Analysis

Capacity-building transfers and initiatives are of a huge concern in the system. In previous research, the Commission has found that such initiatives have very poor outcomes and questioned the amount of resources being pumped into capacity-building programmes. Various programmes have been implemented and subsequently phased out, with poor outcomes being the primary reason for terminating and replacing such programmes. These range from Project Consolidate, Siyenza Manje and currently the establishment of the Municipal Infrastructure Support Agency (MISA). Furthermore, there is no link between capacity-building grants and the performance of general infrastructure grants.

Capacity support can take the direct or indirect route. Indirect interventions are built into the LGFF system in the form of monitoring, evaluation, intergovernmental planning and intergovernmental forums. With such interventions, national and provincial government departments need to ensure that their oversight roles are effective in improving performance in municipalities. It is important to note that such interventions are ultimately based on municipal performance. However, differentiation of municipalities based on performance is not only related to transfers. The proposal made by CoGTA is for a system of interventions, as illustrated in Figure 14.

Figure 14 Differentiated Municipal Support Structure



Source: FFC Options Analysis (2012)

The implications are the following for the fiscal framework:

- a) A municipality's performance that is 'problematic' implies a legal intervention based on Section 139 of the Constitution, where the action maybe to take over the administration of the municipality. There is a strong argument that this also implies the removal of non-conditional transfers, specifically the equitable share.
- b) A municipality in the 'hands-on' support mode can benefit from support through substantial capacity-building transfers, which are indirect and associated with funding a nationally managed capacity-building programme. This may involve direct involvement of externally contracted parties to build systems and management capability within the municipality concerned.
- c) Conditionality of transfers can be lower for the 'support and advice' mode. In this case capacity-building transfers will be significantly lower, possibly involving direct transfers aligned with a moderate support programme. But access to incentive-based funding will increase.
- d) Finally in the 'regulatory oversight and co-ordination' mode, transfers should be less conditional and more incentive based.

The issue of capacity at local level is an important one and must be linked to accountability. While the emphasis is usually on individuals, capacity building should also include strengthening the organisation through improving billing and metering

systems and sharing scarce skills such as engineers. Capacity can be targeted at the individual or systematic level. For instance, a systematic intervention would be the installation of pre-paid meters, which would improve revenue collection and thus cash flow. Stakeholders noted the limited use of internships by municipalities and asked what reasons (cost, incentive or capacity shortcomings?) were inhibiting municipalities from making greater use of internships and developing partnerships for in-service graduate training. Relationships between local government and universities and the private sector should also be strengthened, while communities and social entrepreneurs can be involved in implementation.

3.2.3 Inadequate recognition and rewarding of performance

Stakeholder Consensus

Some stakeholders proposed that the performance of conditional grants should be monitored and results rewarded. This suggests putting in place a performance management system and including incentive-based measures in the LGFF. Suggestions included recognising municipal performance based on the amount of revenue collected relative to potential revenue, and giving once-off rewards. However, other stakeholders argued that conditional grants already pose a significant, costly and time-consuming reporting burden on municipalities.

Analysis

Performance overview

The overall picture that emerges is highly variable performances of both municipalities and the organisations that support and regulate local government. CoGTA stated in 2009 (CoGTA, 2009) that local government was in “distress” and noted the high variation in performance across the spectrum of municipalities. The record number of service delivery protest in 2010¹⁰ are evidence that, while some municipalities are performing well, others are failing to perform their core functions. The Local Government Turnaround Strategy (CoGTA, 2009) sought to address the structural problems that were evident in local government at the time.

At the one extreme metros and secondary cities are relatively functional, with some exceptions¹¹. At the other extreme there are many smaller and more rural municipalities that are performing poorly and not delivering services effectively to the consumers they are supposed to serve. The National Planning Commission (NPC) Diagnostic Overview (NPC, 2011) states that “in many areas service delivery has fallen dramatically short of expectations. This is especially true in some of the poorest parts of the country”.

Here it needs to be acknowledged that the context (in which a municipality functions), such as the extent of economic development in its area and the extent of urbanisation,

¹⁰From the Municipal IG Hotspot Monitor as reported in National Treasury (2011:23)

¹¹The recent ‘Section 139’ intervention in Msunduzi being a case in point

does not imply underperformance. There are both district and local municipalities in rural areas that are performing adequately, as far as can be ascertained from the limited information available. As mentioned above, the performance of local government is difficult to assess without adequate data and a clear set of performance indicators.

Current initiatives to assess performance

A number of initiatives to assess service delivery performance are currently in place, but they suffer from a “disaggregation of effort”, with different methodologies and indicators being used and limited sharing of information. National Treasury uses a range of financial and non-financial information to assess the performance of local government over a six-year period (National Treasury, 2011).

Through the process of the differentiation framework, CoGTA is building on previous capacity and performance indicators to develop a set of indicators that can be consistently applied to all municipalities to measure performance. However, they are facing challenges in obtaining complete datasets.

Performance data in the water sector is improving, but the various initiatives still need to be adopted by all municipalities. Other initiatives to assess performance in the other municipal sectors may exist but are not widely known.

Capacity and ‘professionalisation’

One of the key challenges highlighted is the capacity deficit at local government level. The NPC Diagnostic Report noted (NPC, 2011: 10)

At the local government level, past practices of engaging professional institutes in the training, selection and development of senior managers have diminished, while bodies like the Institute of Municipal Finance Officers and Municipal Engineers have little influence over increasing capacity where it is most needed. The result has been a reduction in the number of professionals available to the state, and a looming crisis in the generational reproduction of professional expertise as the ageing cohorts continue to leave the system.

CoGTA is driving the capacity-building initiatives, with the MISA programme as its flagship project (incorporating the Siyenza Manje programme of DBSA), and the current debate around ‘professionalisation’ of local government administration. However, these initiatives have yet to be implemented, so their impact cannot yet be assessed. Capacity building is also funded through a range of grants described earlier in Table 5.

Current measures to improve performance

The current system of transfers includes relatively underdeveloped measures to incentivise good performance. The LGES is an unconditional transfer and so does not contain an incentive component. Almost all of the other grants have some degree of conditionality, but this is not necessarily associated with improved performance of the municipality in delivering services and containing costs. An exception in this regard is

the MIG grant, which requires municipalities to have the necessary operation and maintenance arrangements in place; however, in reality this is not applied.

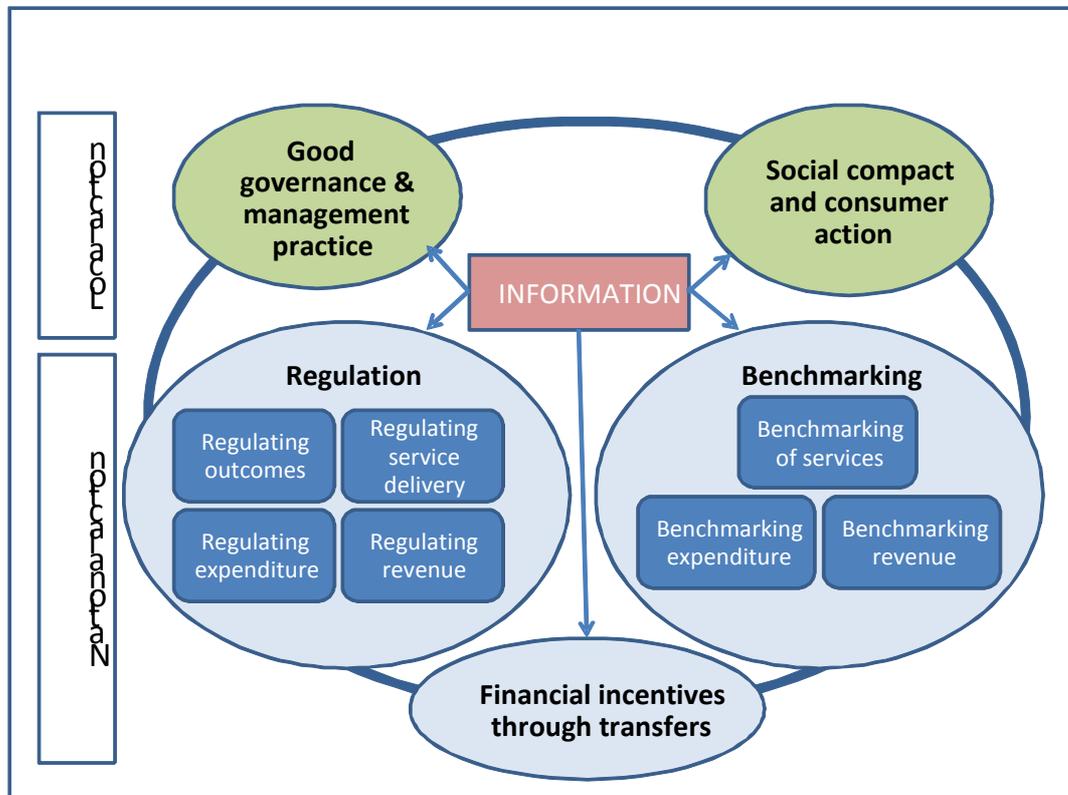
A set of **regulatory measures** is in place to improve performance of the financial administration of municipalities, managed by National Treasury, with the MFMA as a legislative base. This includes a system of reporting to National Treasury on an agreed set of indicators. The Auditor-General also places increasing emphasis on non-accounting indicators. However, the system’s evident shortcoming is that none of the indicators really gets to grips with assessing fiscal effort: the amount of revenue which is actually raised in relation to that which is possible. There is a strong argument for this to be the key indicator.

The use of **benchmarking** techniques to promote improvements in performance is established, in the sense that National Treasury has an effective system for gathering, consolidating and placing in the public domain financial information from municipalities. SALGA has also undertaken an initiative in this regard which includes the use of indicators linking financial measures to non-financial indicators.

A performance-based system

Following from the structure of the LGFF, the key components of a performance-based system are shown in the Figure 15, which expands on the ‘governance and regulation’ ‘social compact’ and incentive elements of the LGFF.

Figure 15 Key Components of a Performance-based LGFF



Source: FFC Options Analysis, 2012

The components, each of which may be made of several instruments, are described briefly below:

Good governance and sound management practice

This is the most important component of any system of local government and its associated financial system. A well-governed and managed municipality will perform well, maximise the available sources of revenue, contain costs to what is necessary to provide a good quality of service and expand services to all its consumers.

This remains the ideal, but most municipalities are far from realising it. Specific national interventions are intended to support municipalities to move towards this ideal through incentive-based and support-based measures.

Social compact and consumer action

Consumers, including property owners, are recipients of the services provided by municipalities and, excluding poor households who receive free services, provide a substantial portion of the revenue required by the municipality to function effectively. This virtuous relationship between consumers and municipality is referred to as the “**social compact**”. While consumers are obliged to pay for services, they also set up an obligation with the municipality to deliver services effectively and at a reasonable cost. Through such ‘**consumer action**’ the performance of the municipality can and should be promoted.

Regulation

As discussions earlier in this document highlight, the importance of regulation on the performance of municipalities is evident. Regulation has different focus areas:

- Ultimately the **regulation of outcomes** is most effective but also the most difficult to achieve. It requires establishing outcome indicators, such as consumer satisfaction and environmental sustainability. While these may represent the highest-level goals, the data for the indicator is typically difficult to obtain and the feedback cycle is long. However, consumer surveys remain an important tool for assessing a municipality’s performance and are not that difficult to do. At a national level, StatsSA does this to some extent, and some municipalities have run their own consumer satisfaction surveys successfully. However, this needs more attention than it gets currently.
- **Regulation of service delivery**, essentially in ‘output’ is more common and easier to set up. Typically this is done using access by households to a specific service level as a measure. However, this may – and typically does – miss the service quality element. In other words, the infrastructure may be in place but is not properly functional. The Department of Water Affairs (DWA) is progressively overcoming this shortcoming through its monitoring systems, with the Blue Drop and Green Drop rating of water quality and wastewater effluent discharge quality having the widest impact. It is essential for a

performance-based system that regulation of other services, particularly municipal roads, is improved substantially, off what is a low base.

- **Regulating expenditure** is input-based regulation and is difficult to achieve for internal expenditure items. However, inputs from other institutions such as Eskom and water boards can and should be regulated by their respective sector departments in order to contain the cost to the municipality. The role of the National Energy Regulator of South Africa (NERSA) in regulating bulk electricity tariffs is important for the LGFF, as is the role of DWA in regulating bulk water tariffs applied by water boards.
- **Regulating revenue** includes the regulation of rates and tariffs, and debt finance. This part of the regulatory structure is essentially aimed at consumer protection but, in the case of debt finance, also protects the municipality. No specific new interventions are needed: currently the property rates are regulated, to an extent, by CoGTA and electricity tariffs by NERSA. While DWA recognises the need to regulate water and sanitation tariffs, this is not done at present. National Treasury regulates access to debt finance by municipalities.

Benchmarking

Current benchmarking initiatives are raised in the context sections above. CoGTA, SALGA, Water Research Commission and the Municipal Demarcation Board are also applying new initiatives and at this stage nothing further seems to be warranted other than to support existing initiatives.¹²

Incentive-based transfers

The proposed performance-based system is obviously an instrument that requires considerable attention, for both operating and capital transfers. Several options exist and are discussed further in Section 3 of the report:

- Add a performance-based component to the LGES.
- Add a performance component to MIG (part of current recommendation on MIG reform).
- Design a new grant with a specific incentive structure.
- Incorporate performance-based criteria into other grants.

Information

Access to data is central to the success of a performance-based system because:

- Internally, information on performance incentivises staff and is key to the success of a performance management system.
- Consumers' information made available by both the municipality and others, through structured benchmarking initiatives or through informal channels

¹² It is acknowledged that further work is needed to develop this aspect in as options in the LGFF.

(including the press), creates an ‘empowered’ community which is able to hold the municipality to account.

- Information is clearly central to a benchmarking system, allowing information to be exchanged in a structured way with useful performance indicators.
- Effective regulation cannot take place without data and a means of collecting it and applying it through meaningful performance indicators.
- Finally, incentive-based transfers are founded on an ability to measure performance in order to assess the level of funding to be applied to particular municipalities.

2.4 Municipal Own Revenues

2.4.1 Understanding the financial constraints in both urban and rural areas

Stakeholder Consensus

There was general agreement by stakeholders on the need to incentivise municipalities to generate their own revenues, and that benchmarks would ensure that transfers do not discourage municipalities from collecting own revenues. However, some stakeholders from the cities pointed out the misconception that urban areas have large untapped sources of revenue. While metros do have a rates base to draw on, large cities experience significant fiscal stress from economic development and infrastructure pressures. These stakeholders mentioned the difficult trade-off between investing in economic and in social infrastructure.

Stakeholders described inadequate property valuations of traditional, non-bondable and rural properties as a challenge for municipal revenue. It was argued that the communal tenure in traditional areas means that municipalities cannot raise revenue based on property rates and should therefore be compensated. However, a counter argument made was that the low sanitation costs in these areas (because of their ‘on-site’ nature) balance the low revenue from property rates.

Analysis

Considering ‘own sources’ of revenue, this is dominantly raised from property rates and tariffs from ‘trading services’: electricity, water supply, sanitation and solid waste removal. In the case of property rates there has been a major effort over the last five years to improve property valuations and implement effective property rates management systems. While this can be assessed as a successful initiative, many smaller municipalities still face problems in this regard. Then there is significant gap in the property rates system in rural areas with communal tenure as property rates do not apply in these situations. This largely explains the low property rates revenue figure for mostly rural municipalities. Looking at trends, property rates can be a buoyant source of revenue, particularly in times of high economic growth. But there is substantial consumer resistance to increases in property rates which dampens the

potential in increase revenue from this source¹³. Further the cut-off for zero rating in order to protect low income households is being increased progressively in many municipalities above the R25 thousand statutory minimum.

With regard to tariffs, larger municipalities have well developed tariff structures, and associated metering and billing systems. These have to be in line with national policy on free basic services¹⁴. Larger municipalities have historically generated surpluses on their electricity, water and sanitation trading accounts which has allowed them to cover some of the 'general' expenditure of the municipality from this source. These surpluses are facing new limitation partly due to regulatory measures (electricity specifically), and partly due to affordability constraints as consumers of electricity and water are having to face high increases in tariffs which have a significant impact on household budgets.

Access to capital finance

As noted above, municipalities finance their capital through transfers (mainly infrastructure grants), use of reserves, debt finance, developer charges and other minor sources. Considering their 'own sources', which excludes transfers, the use of reserves and debt finance are dominant. They are both dependent on the accumulation of cash surpluses on the operating account in order to build reserves and cover the cost of servicing long-term debt. Recent research undertaken by NT¹⁵ indicates that substantial increases in the total amount of debt raised by both metros (9% increase in real terms from 2005 to 2010 to get to total debt of R33 billion) and secondary cities (5% real increase over this period to get to total debt of R4 billion). This research also highlights the borrowing limitation of the middle group of municipalities, those smaller than metros and secondary cities but with a higher level of economic development than rural municipalities which are almost totally reliant on grants.

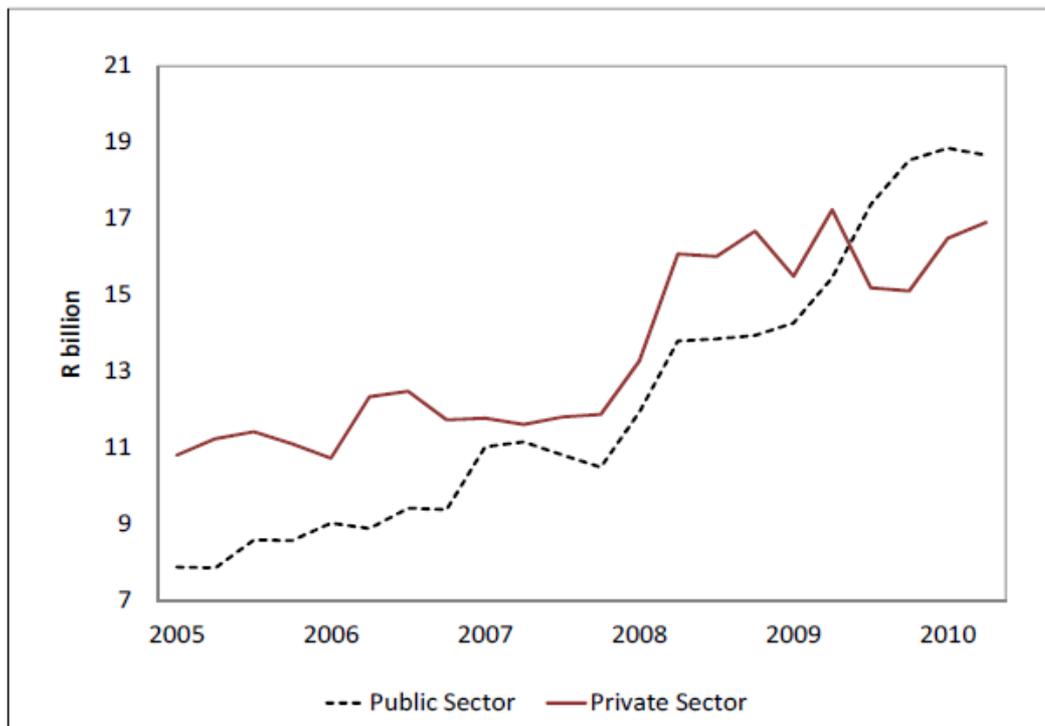
Over the past five years, levels of debt finance for municipalities as a whole have been increasing steadily (Figure 16). The DBSA has been increasing its share while private sector funding has been in decline (in real terms), partly due to the withdrawal of the Infrastructure Finance Corporation Limited from the market.

¹³Rates in larger South African cities for residential properties are typically of the order to 1 cent per Rand of property value (1%). This is not high by international standards but rates increases have been high over recent years as new systems are introduced and this may explain part of the consumer resistance.

¹⁴This is implemented either through an indigent register approach or through consumption-based targeting (based on the assumption that poorer households get a certain amount of the service free).

¹⁵ DNS consultants, 2012, *Building municipal credit markets in South Africa*. Report prepared for National Treasury.

Figure 16 Municipal Borrowing Market Trends



Source: National Treasury local government database (National Treasury, 2011)

In interpreting these trends, it is important to take the state of the economy into consideration. Over the period 2005–2008, the buoyant economy meant improved revenue and cash flows for municipalities, which allowed for higher levels of debt financing. Currently, with the economy having been through difficult times, anecdotal evidence is that levels of borrowing by municipalities have fallen off. However, the perception is that borrowing constraints exist in the municipal market, which is a major challenge because the gap on the capital account is large and cannot be filled only through grants. The outlook for possible improvement is relatively bleak, with the DBSA expressing the view that there is little opportunity for increased lending into the medium-sized municipal sector.

A brief assessment of the legal conditions associated with raising debt finance was undertaken, and the law is clearly not a major constraining factor. Although an important topic for the LGFF, adequate research is not available to draw definitive conclusions. Nevertheless, there is evidence of the following:

- Ultimately, funders use the cash flow position of the municipality to assess debt finance opportunities. Other criteria, such as debt-to-revenue and interest-to-revenue ratios, do not take this into consideration. For example, a municipality's income statement may look good but short-term debtors may be high.
- A strong disincentive is the high level of transaction costs for relatively small loans to non-metro municipalities.

- Municipal treasurers are innately cautious and take a high level of personal responsibility for transactions of this nature.

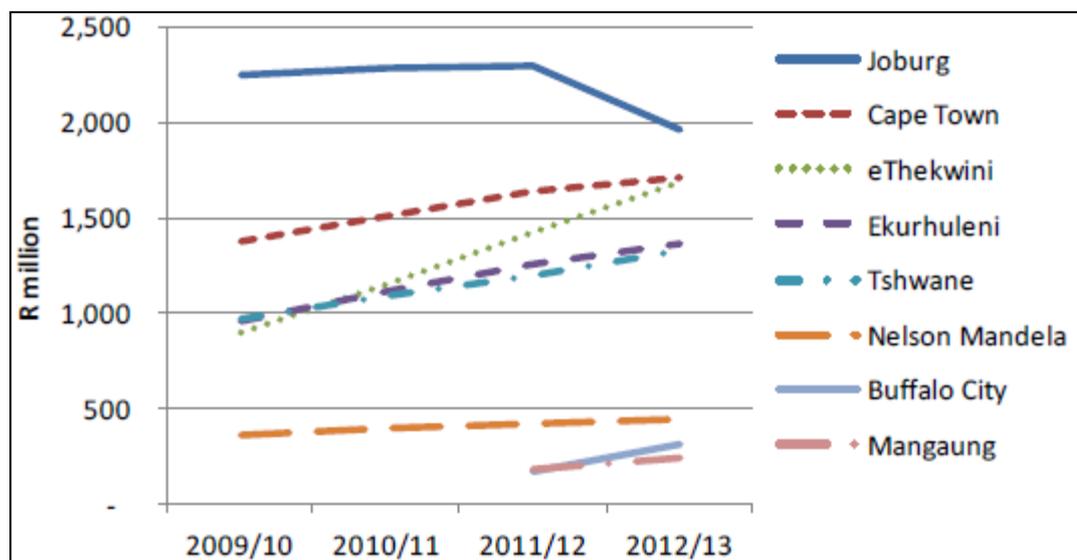
To conclude, while the debt finance trends up to 2010 may be positive, it is not nearly enough to close the capital finance gap, as discussed above.

Fuel levy sharing

The fuel levy directly replaced the RSC levy replacement grant for metropolitan municipalities by taking the same amount from the national fuel levy. This appropriation equalled 23% of the total fuel levy revenues and was intended to be distributed using volumes of fuel sales in litres. However, at the time, the National Treasury faced several challenges in allocating the general fuel levy. Fuel sales data was only available at a magisterial district level, which required a conversion to municipal boundaries. This proved difficult, as the boundaries of magisterial districts overlapped municipal boundaries. Therefore, population was used as a proxy to convert fuel sales from magisterial district boundaries to municipal boundaries.

The introduction of the new distribution methodology (fuel sales) meant that metros (such as the City of Johannesburg), which had benefited proportionately more from the RSC levy replacement grant, would experience a dramatic reduction in revenues. Therefore, National Treasury proposed that the fuel levy allocation methodology be phased in over three years. The allocation was based on a 75:25 split between the RSC levy replacement grant and fuel sales for 2009/10, moving to a 50:50 split in 2010/11 and 25:75 in 2011/12. Complete transition to the new allocation methodology was achieved by 2012/13, and the two new metros were added in 2010/11.

Figure 17 Fuel Levy Allocation to Metros



Source: MFMA Circular No 51

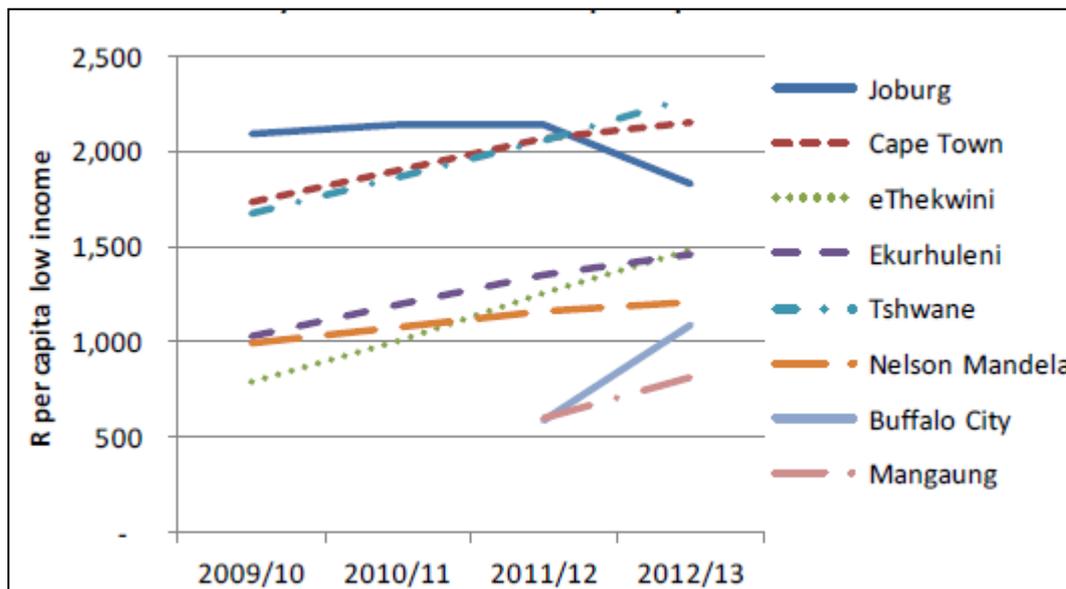
The status and the objectives of the fuel level are explained through excerpts from the DOR Bill and the:

The sharing of the general fuel levy is a source of municipal own revenue for metropolitan municipalities as it involves sharing a revenue source rather than the allocation of funds from national government’s revenue. The sharing of the general fuel levy therefore does not form part of the Division of Revenue Bill. The fuel levy allocations are approved annually by the Minister of Finance and published in the Government Gazette, as prescribed in terms of the Taxation Laws Amendment Act (2009). (DOR Bill, 2012)

Although the sharing of the general fuel levy with metros will be treated as unconditional to enhance fiscal autonomy, municipalities should attempt to direct these resources, similar to that of the former RSC levies, towards basic services and infrastructure development in under-served communities, specifically to roads transport infrastructure given the link between fuel sales and road usage. (MFMA Circular No. 48, National Treasury)

The levy is also termed an unconditional grant but, as the MFMA circular implies, should be used for basic services, in particular for roads and transport. This has caused much confusion and debate, with roads officials believing that the money should be ring-fenced for this activity, which is not in fact the case. If the rationale for the grant was to cover basic services, then the means for division should be based on a quantified need, possibly measured through the proxy of low-income households. Figure 18 provides this analysis and shows that there is no relation between fuel sales and low-income households and, by extension, the need for basic services. The correlation is stronger with total population, but still not significant.

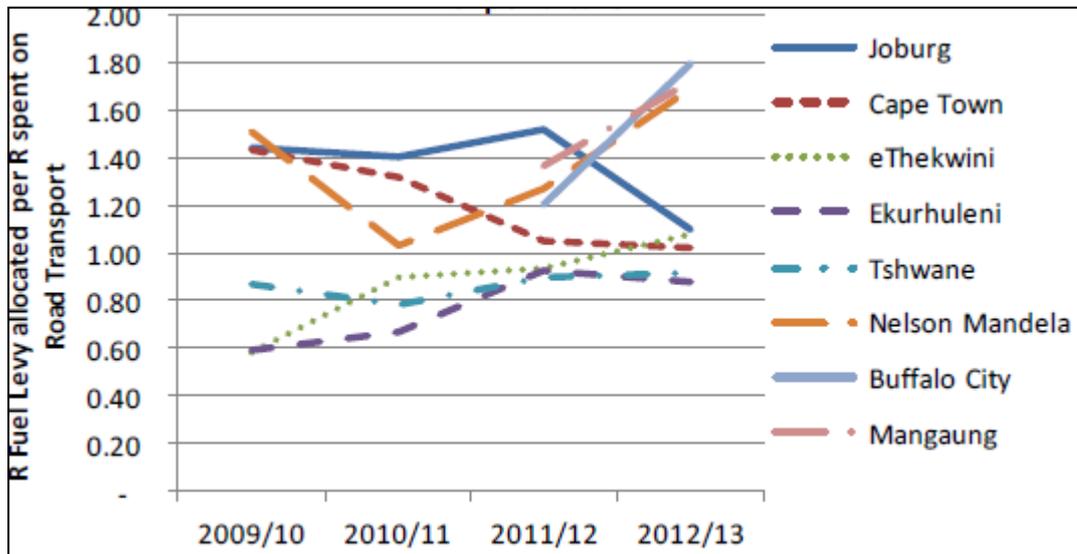
Figure 18 Fuel Levy Allocation to Metros per Capita Low Income



Source: FFC Options Analysis (2012)

Further analysis was done to compare the fuel levy with road transport expenditure (Figure 19). Again there is little correlation: in some cases the levy is in excess of the road and transport expenditure, and in other cases it is insufficient.

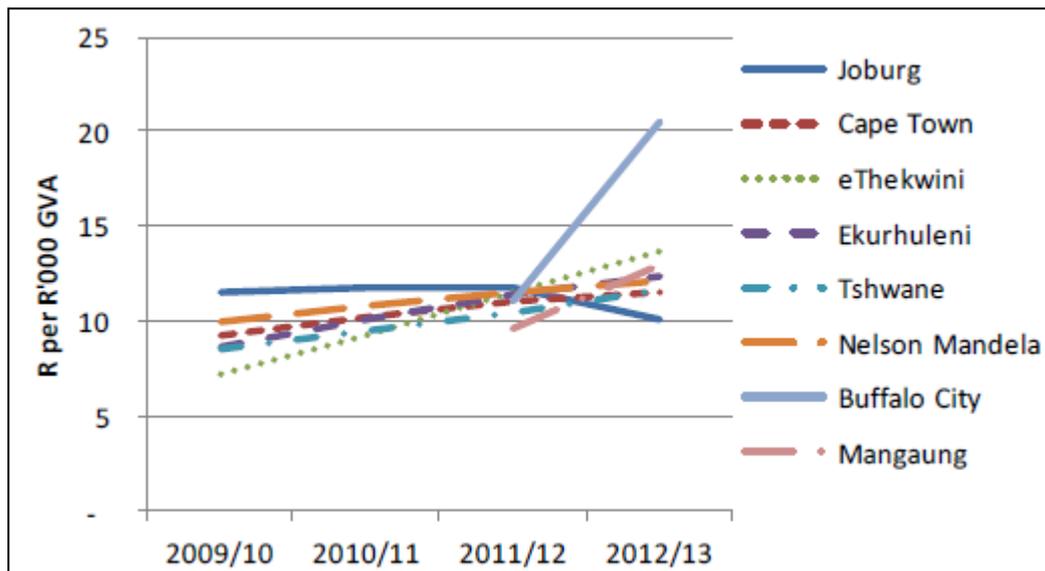
Figure 19 Fuel Levy Allocation to Metros per Road Transport Expenditure



Source: 2010/11 Municipal Budgets and FFC Options Analysis (2012)

The correlation between fuel sales and GVA is much higher, as shown in **Error! Reference source not found.**, which is understandable given that road transport is linked to economic activity. Buffalo City is the one outlier in the series, which implies high fuel sales in relation to its economic activity.

Figure 20 Fuel Levy Allocation to Metros per R'000 GVA



Source: FFC Options Analysis (2012)

The correlation between fuel sales and GVA suggests that the fuel levy allocation is related to economic activity and so could be used by municipalities for economic infrastructure operating costs, including major roads and transport networks. However, if this is the case, then there is a potential conflict with the intentions of the proposed local business tax. It also does not fit with the principle of funding economic infrastructure through ‘own revenue’, unless the fuel tax is genuinely considered an own source of revenue.

Therefore some conceptual work still needs to be done around the nature of the fuel levy and the rationale for using fuel sales as the basis or distributing this general revenue source. Some uncertainty remains over who is responsible for collecting the actual fuel sales data and whether this is still undertaken regularly.

Stakeholder Consensus

One proposal made for improving municipal fiscal effort is through smart and pre-paid metering, which would reduce debt-collection problems. Stakeholders felt that Eskom’s role needs to be reviewed, in particular how the institution prevents municipalities from using electricity as a leverage to regulate non-compliance, and how small municipalities with small load factors are being penalised. Further research is needed to assess the implementation of the Commission’s previous recommendations, such as better reporting on conditional grants, devolution of housing and transport etc. Policies for providing FBS should be able to distinguish between those who can, and those who cannot, pay. Given the huge cost of maintaining indigent registers, the line between affordability and social responsibility also needs to be drawn.

One perspective was that debt finance regulations should allow for foreign investment and strict use of local currency. Municipalities should be encouraged to borrow sustainably for funding capital projects, to generate income and become self-sustaining, and to ensure that funds are used for their intended purpose. Stakeholders suggested ways of encouraging lenders to lend, for example incentivising creditworthiness and providing guarantees from institutions to improve credit rating. The view expressed was that the DBSA’s mandate should be extended so that smaller municipalities can be assisted.

A major issue raised was the insufficient spending by municipalities on repairs and maintenance (R&M). A national infrastructure asset register is the first step, so that the extent, ownership and value of assets can be known. This will enable municipalities to plan their R&M better and national government to know where to allocate grants. Investing in maintenance should be incentivised. To make GRAP 17¹⁶

¹⁶ “GRAP 17 prescribes the accounting treatment for property, plant and equipment so that the users of financial statements can discern information about an entity’s investment in its property, plant and equipment and the changes in such investment. The principal issues in accounting for property, plant and equipment are the recognition of the assets, the determination of their carrying amounts and the depreciation charges and impairment losses to be recognised in relation to them.”
(http://download.asb.co.za/download/GRAP%2017_vs_IAS_16_Sept07.pdf)

a national project would be expensive, and so research is needed to determine what measurement to use and what capacity and capabilities exist within the sphere. Linked to this is the need for sufficiently qualified people and oversight by professional institutions.

The view expressed was that the fuel levy is an unconditional grant and should be spread more broadly, beyond metros, and be spent on transport and roads-related expenditure. However, research is needed to assess the extent to which smaller municipalities can benefit from the fuel levy. Work on development levies and local business tax is currently underway.

2.5 Intergovernmental Fiscal Relations and the Local Government Fiscal Framework

2.5.1 Local government challenges require a whole of government response

Stakeholder Consensus

Local government problems, which are often symptomatic of government-wide issues such as national and provincial policy incoherence, require a whole-of-government response. However, other government spheres often lack the experience required to support municipalities effectively and may have their own capacity problems.

Fragmented funding and a lack of coordination, cooperation and planning among departments, spheres, regulators and state-owned enterprises are frustrating municipal planning, operations and reporting. One of the most significant themes to arise from the public hearings was stakeholders' frustration with the limited municipal control over the setting of electricity and water tariffs. For example, in most municipalities electricity accounts for between 30% and 50% of operating revenue. However, although municipalities provide services in Eskom supply areas, surcharges are not transferred to them, which results in significantly lower collection rates. Also, in Eskom-supplied areas, municipalities cannot disconnect the electricity of households in debt, which has a substantial impact on municipal revenue.

Analysis

Municipal performance in South Africa is highly variable, and municipalities are confronting many challenges. Larger municipalities (that supply electricity) are under pressure from rapidly increasing bulk electricity and water costs, which means that they receive less income (historically municipalities have used surpluses on their electricity and water accounts to cover general expenditure). Furthermore, they are taking more responsibility for public transport and housing services and have to deal with 'unfunded mandates', providing primary health care, libraries and housing-related services. For rural municipalities, their own-revenue sources are limited, as they do not provide electricity (done by Eskom), water or sanitation services (done by the district municipality), while rates are not payable for land under communal tenure. All municipalities are facing escalating capital expenditure costs because of the need

to maintain/build new infrastructure, to reach households in remote areas and to provide higher service levels.

It should be recognised that in less than a decade, municipalities have had to manage the implementation of onerous legislation, including the MFMA, the Municipal Properties Act, the Municipal Systems Act and the DORA. Major changes in budget reforms and accounting standards have added to the burden of municipalities, and the cost of complying with the laws and regulations governing the LGFF has increased substantially.

It needs to be pointed out that the current structure of local government, with two tiers outside the metros, is not yet functioning. Concerns raised included the role of district municipalities (are they providing value for money?) and the role of national departments in supporting local government (e.g. poor intergovernmental coordination and slow progress on various policies, including housing accreditation and transport).

Chapter 3: Conclusion and Recommendations

The review of the LGFF is a continuous process that aims to ensure the appropriate funding of municipalities in a dynamic and continuously evolving sphere. Since 1998 (when the local government and its financing framework came into operation), various changes have been made to the LGFF to accommodate this young and vibrant sphere of government. However, in most cases, the changes were made on an ad hoc, trial-and-error basis and implemented by various players. Most stakeholders have recognised that the time has come to review the LGFF. This review requires a concerted and combined effort by all involved in the financing of municipalities.

The Commission, in its role as an advisory body providing analysis of the country's IGFR system, recognised the need to review the LGFF. The Commission saw that such a review is best undertaken when all stakeholders are jointly involved in identifying the issues and solutions within the LGFF. The Commission undertook discussion-driven or stakeholder-based research, holding public hearings that provided a sounding board for the Commission's technical work into the problems inherent in the LGFF and the proposed policy options. In so doing, the Commission provided a platform for experts and stakeholders at the forefront of decision-making in the LGFF to debate and reach a consensus on the problems and solutions to improving the financing of municipalities in the country.

The stakeholders discussed solutions to a set of identified problem areas. The process showed clearly that a consensus is beginning to emerge among stakeholders over options for improving the effectiveness of the LGFF. Based on the outcomes of both public hearings, the Commission undertook its own analysis around the general problem statement and specific problem areas to inform a set of conclusions and recommendations. In undertaking the review of the LGFF, the following guiding points should be kept in mind:

1. **A better understanding of the dynamic between fiscal capacity and fiscal effort¹⁷ needs to inform any revision of the fiscal framework.** In balancing expenditure needs with revenue sources, a distinction needs to be made between a lack of *fiscal effort* and a lack of *fiscal capacity*— and the policy response needs to be appropriate to the underlying causes. For instance, a Section 139¹⁸ intervention may be appropriate in the case of poor financial management but cannot solve structural fiscal capacity problems that are inherent in the skewed distribution of underlying economic activity.

¹⁷Fiscal capacity is defined as “the amount of revenue a particular municipality can raise using the revenue instruments that it has at its disposal and applying a standard set of rates” (Reschovsky, 2003), while fiscal effort measures the actual performance in collecting revenues billed by a municipality.

2. **A LGFF should ensure that incentives created in the IGFR system are compatible with policy intent.** Performance is inadequately rewarded, whereas non-performance is often perversely rewarded. This emphasis on performance is closely aligned with the principle of accountability, which has been insufficiently embedded in local government financing to date. It includes not only ensuring that actual spending is consistent with planned expenditure, but also that the conditional grant achieves the outcomes delineated in its framework.
3. Mindful of the three re-demarcation stages undertaken by the Municipal Demarcation Board, **the fiscal criteria for re-demarcation should be clarified when demarcating municipalities.** Re-demarcation of municipal boundaries may improve the sustainability of individual municipalities but cannot be a systemic solution because it does not necessarily redistribute fiscal capacity, which ultimately reflects the underlying skewed distribution of economic activity.
4. **The design of a new LGFF must be predicated on a clear understanding of the redistributive and growth-enhancing roles of local government.** This is critical in understanding the vertical division of revenue. Any change in the mandate of municipalities must be accompanied by associated funding (e.g. public transport, housing accreditation) so that “finance follows function”.
5. **Local government is embedded within whole-of-government performance.** Inadequate policy coherence and lack of implementation support from national government have exacerbated dysfunctions within the local sphere. This includes the impact of regulators such as NERSA, state-owned entities such as ESKOM, and ports authority etc. Local government may have an integrated development plan, but efforts by other spheres of government to ensure spatial and financial alignment are often inadequate.
6. Instead of focusing on categorisation into urban and rural municipalities, **the focus should be on the linkages between urban and rural areas within functional economic regions.** This is critical in the light of increased migration and concentrations of poverty and inequality in both rural and urban localities. There needs to be a clearer understanding of how the economies of localities interact with the broader economy.
7. **All elements of the LGFF should be transparent to all stakeholders,** including the elements of the formula and underlying variables for distributing LGES allocations as well as conditional grants. Disturbingly, many IGR practitioners do not understand the division of revenue formula, and the

probability of councillors and communities understanding them is even more remote.

Accordingly, the following conclusions are made and recommendations proposed.

3.1 Problem Area 1: The principle of differentiation

Conclusion

1. Given the substantial variation in economic, social and demographic circumstances across the local government sphere, as well as differences in performance capabilities and institutional capacity, it is paramount that the principle of differentiation be implemented in the functioning and financing of local government
2. In addition to the LGFF, differentiation also needs to be embedded in the functional and capacity support framework to municipalities by national and provincial government
3. Such differentiation should be explicit in the LGFF such that the LGFF should be sensitive to the different funding pressures and fiscal capacities of municipalities in the country, as well as the different abilities of municipalities to spend effectively and efficiently
4. In general, differentiation in the funding methods to local government can be based on the context and performance of individual municipalities. Differentiation may be based on the economic, social and demographic context of a municipality. This would include the exogenous factors (i.e. external to the municipality) that affect its expenditure mandate and revenue potential. Differentiation may also be based on the capacity and performance of a municipality

Recommendations

1. The LGFF should account for the differences in the minimum efficient expenditure needs and fiscal capacities of municipalities in the country. This also includes the endogenous (internal) and exogenous (external) factors that impact on these differences
 - a. It is recommended that government should explicitly adopt a methodology to differentiate municipalities in the LGFF. Ideally, differentiation should be based on *performance* and *context*.
 - b. Such a differentiation methodology would appropriately fund differences between expenditure requirements and revenue potential across municipalities and also form the basis for capacity-building support
 - c. The Commission proposes the following factors that should inform such a differentiation:
 - Context (exogenous variables): poverty; economic activity within a municipality, spatial factors such as topography and

population density; powers and functions assigned; population dynamics (migration).

- Performance (endogenous variables): debt collection, expenditure efficiency, vacancy rates; ability to plan and execute budgets (using past budget surpluses/deficits as an example).

3.2 Problem Area 2: Attaining equity in the vertical and horizontal DOR

Conclusion

1. The quantum of resources allocated to local government for operating expenditure is sufficient but there are inequities in its distribution across municipalities.
2. The Commission notes that the review of the LGES formula has addressed the concern of the horizontal equity on the operating side of municipal budgets.
3. Although the vertical division of revenue appears sufficient on the operating budget, of concern is the possible funding gap on the municipal capital expenditure budget. The Commission is undertaking further research in this regard.

Recommendations

1. The Commission recommends a review of the funding for capital expenditure in local government given the identified vertical fiscal gap on municipal capital budgets, which is driven by increasing infrastructure needs and constraints on municipal capital revenues (operating surpluses and borrowing powers).

3.3 Problem Area 3: Data constraints in the LGFF

Conclusion

1. The current data available at the local government level is not sufficient to support the design of a responsive and accurate LGFF.
2. The lack of frequent and useful data is one of the most fundamental constraints in the LGFF and local government in general. Infrequent data updates and the updating of grant formulae after lengthy periods can result in major shifts in allocations. Although appropriate phasing-in mechanisms can be applied, the inability to track between-census demographic changes results in allocations not going to municipalities where the need is greatest.
3. The Commission notes the burden of several data requests to municipalities but simultaneously recognises the importance of such data in monitoring and supporting municipalities. An appropriate balance is required in this regard. Although a Local Government Data Forum has been established to deal with this issue, of which the Commission is a member, the forum has not made much progress in this regard.

4. The sharing of information among national departments with similar information and data requests should be promoted.

Recommendations

1. The Commission reiterates previous recommendations on the duplication of data requests to local government (2009/10 Annual Submission on the DOR) and for Government to improve the collection and frequency of data at local government level to improve the targeting of funding to municipalities.
2. It is recommended that the role of the *Local Government Data Forum* is strengthened to ensure that its mandate of rationalising data requests to local government is fulfilled. In addition, it is recommended that the mandate of the *Local Government Data Forum* is extended to include:
 - a. Collating and updating local government data collected by departments
 - b. Exploring methods to fill the between-census data gaps.
3. The Commission also recommends that StatsSA conduct a census every five years, in accordance with the Statistics Act of 1999.

3.4 Problem Area 4: Challenges posed by a plethora of conditional grants

Conclusion

1. The continued introduction and fragmentation of new and existing grants increases the compliance and reporting burden on municipalities and creates difficulties in managing and spending such grants. Theoretically, such a practice also diminishes the autonomy of the local sphere by reducing its role in determining expenditure decisions based on local tastes and preferences.
2. The 2004 DOR Bill confirmed that the consolidation of grants was a fiscal framework policy position. However, in recent years, there appears to be a gradual change of direction, with many components of existing grants being fragmented into new or separate components.
3. With that said, the Commission recognises the importance of conditional grants in ensuring national priorities are met and, given the capacity constraints and poor performance inherent across municipalities, municipal expenditure performance and outcomes are improved.
4. The Commission recognises a point where an over-proliferation of grants can result in compromising both of these goals (i.e. municipal autonomy and a limited compliance burden, and the national goal of ensuring national priorities are met and municipalities spend appropriately). Thus an appropriate balance in the conditional grants system is required.

Recommendations

1. Government should generally refrain from introducing or fragmenting new and existing grants unless they have clear objectives and value-add to the LGFF. Consequently, before a specific purpose grant is introduced,

government should use an existing grant mechanism to distribute the funds if possible.

2. Where the introduction of a new grant is necessary, the Commission reiterates its previous recommendation that the grant should have explicit objectives, performance targets, monitoring mechanisms, required capacity building (to ensure expenditure absorption) and criteria for its phasing out and exit strategy.
3. The Commission further recommends that the Commission be consulted directly before a new conditional grant is introduced to local government as per Section 214(2) of the Constitution
4. Government should rationalise the current local government conditional grant system by consolidating grants where possible to minimise the administrative burden placed on municipalities. This would include consolidating the INEP and the MIG, as part of rationalising the local government infrastructure grant system.
5. Government should implement the necessary measures, as stipulated in legislation, to withhold conditional grant funds from municipalities that perennially under-spend such allocations. Furthermore, government should view such situations as a marker for intervention to build the necessary municipal systems so that subsequent conditional grants are easily institutionalised and effectively spent by municipalities. Furthermore, it should not be assumed that merely shifting the grant to another department will automatically solve the underlying barriers to effective and efficient spending, or flaws in the original grant design.
6. The transferring officers (transferring national department) need to ensure that a comprehensive analysis of the outcomes of retrospective and current grant allocations is undertaken, in accordance with the DORA. In addition, accounting and tracking outcomes of conditional grants need to be improved, and appropriate risk mitigation measures put in place to account for potential over or under-spending
7. The Commission reiterates its previous recommendation that a clear appraisal is needed at the start, during and at the end of conditional grant programmes. Such an assessment and monitoring should be conducted independently from government.

3.5 Problem Area 5: Recognise and reward performance

Conclusion

1. In principle, municipalities should not need incentives to perform their constitutional mandates and to perform optimally in delivering services to the poor.
2. With that said, the fact is that the current system is not resulting in optimum performance and quality service delivery and can be improved.

3. In the design of a LGFF, important concepts need to be defined and properly measured to ensure a responsive and accurate system. This includes understanding, distinguishing and measuring municipal fiscal capacity and fiscal effort; technical and allocative efficiency of local government expenditures, and appropriate service delivery norms and standards.
4. The LGFF should not be designed in such a way that it is seen as rewarding poor performance through the creation of perverse incentives. The ‘gap-filling’ nature of the LGFF can unintentionally be construed to reward poor performance, as there is a correlation between resource-constrained municipalities and poor performance.

Recommendations

1. Formula-based grant mechanisms should implicitly or explicitly reward good municipal performance and not reward poor performance. The Commission is undertaking further work to propose the best approach to a performance-based LGFF. The Commission supports measures to reward good performance and to punish poor performance, which need to be strengthened in the current LGFF.
2. When determining current year allocations, all conditional grant allocations should explicitly account for past spending (and outcomes) performance. Conditional grants should not be allocated to municipalities that do not spend such grants.
3. The Commission supports the withholding of unspent grants but notes that such measures are ultimately futile if capacity-building support is not given to the poorly performing municipality. The Commission recommends that the criteria for implementing capacity support to municipalities should include monitoring of unspent conditional grants, so that capacity to spend such grants is built and maintained.

3.6 Problem Area 6: Fairly evaluate financial constraints in urban and rural areas (AND) Review true own-revenue sources and their regulation

Conclusion:

1. Designing a fiscal transfer system to be redistributive and focused towards municipalities with a limited revenue base cannot be appropriately achieved if the constraints on municipal own revenues sources are not remedied. These include:
 - a. The sensitivity of such revenue sources to the global, national and local economic environment.
 - b. Increased urbanisation and growing poverty levels that increase the expenditure requirements but reduce the fiscal capacity of urban municipalities.

- c. Over-regulation of municipal revenue sources. There needs to be a balance between national protection of local constituents and the autonomy of local authorities in protecting their financial sustainability
 - d. Large increases in input costs (administered prices such as water and electricity) combined with the need for municipalities to absorb some of these increases to protect their constituents, slowly erodes the existing revenue surpluses.
2. These pressures on operating revenues limit funding for capital expenditure from internal own revenues (operating surpluses).
 3. Municipal tariffs that are cost reflective and sensitive to the indigent profile of municipalities will ensure municipal consumer debt levels are minimised. This practice will ultimately result in poor households not getting billed for services they cannot afford.
 4. With that said, the general design of the LGFF and the funding mix across municipalities should ideally see more urban municipalities funding more expenditure from own revenues, with the national fiscus providing greater support to revenue-constrained municipalities

Recommendations

1. The Commission recommends that municipalities should explore new and innovative methods to generate revenue and collect outstanding debt, including taking advantage of new technologies. For example, using smart and pre-paid metering for electricity.
2. Municipalities need to ensure that their tariffs are cost reflective and sensitive to the indigent profile of municipalities in order to minimise municipal consumer debt levels. This practice will ultimately result in poor households not getting billed for services they cannot afford.
3. The Commission supports the devolution of additional taxation powers to metros and other urban areas to support their greater economic growth mandate in the urban built environment. However, such powers should not compromise the greater macroeconomic policies and stability of the country. The design of unconditional and conditional grants should explicitly and effectively account for the greater revenue-raising capacity in these municipalities in order to improve the redistributive nature of grant funding.
4. The appropriateness of the sharing of the general fuel levy as a municipal own-revenue source needs to be reviewed. This includes a review of local government's share and the allocation mechanism used to distribute funds to metros.
5. Government needs to urgently find a permanent replacement for the RSC levies for district municipalities.
6. Municipalities are constitutionally assigned the electricity distribution function and are also legislatively entitled to apply a surcharge on the electricity tariff charged. In instances where Eskom is the service provider on behalf of the

municipality, the municipality should be allowed to impose a surcharge on Eskom's tariff.

7. Government should consider allowing municipalities to use conditional grant allocations (specifically MIG allocations) over the medium-term expenditure framework as leverage to support a credit extension

3.7 Problem Area 7 Need for a social compact over service delivery¹⁹

Conclusion

1. The Commission notes that the Constitution and subsequent legislation is well designed to emphasise the need for community consultation and participation in the affairs of local government.
2. The primary concern is the poor implementation of such sound legislation that creates an information gap between the local government and the community. Such an arrangement can disenfranchise communities and create the tensions that culminate in service delivery protests.
3. Service delivery protests and a disgruntled tax base is driven more by miscommunication and community alienations than the actual service delivery failure itself.

Recommendations

1. The implementation of laws and regulations that support and impose the need for community consultation can only be improved by sound political and administrative support from other spheres of government.
2. Municipalities need to ensure community consultation is not undertaken as a matter of legal compliance but that communities are actively involved in the budget process.
3. Ward councillors need to strengthen their roles in the consultation processes.
4. Council needs to improve its oversight role within municipal governance structures.
5. Government needs to review the mechanisms available to promote and strengthen social accountability and, ultimately, the social compact between communities and local government. This can include improved and formal channels for public grievances such as community grievance forums.

3.8 Problem Area 8: Local government challenges require a whole-of-government response

Conclusion

1. The dysfunction of local government is equally the result of the failure of national and provincial spheres of government to monitor effectively, supervise and support municipalities.

¹⁹ In line with the NDP as mentioned in the report

2. It is apparent that certain national and provincial government departments have a severe lack of capacity and have failed to support and monitor local government.
3. In improving the monitoring and evaluation of local government, national and provincial spheres are often not mindful of the financial and administrative burden placed on already stricken municipalities. They also do not sufficiently coordinate their information requests and share information from municipalities in order to minimise the administrative burden.

Recommendations

1. The Commission recommends that Government undertake a review of the capacity and performance of national, provincial departments and provincial treasuries in supporting municipalities as required by the Constitution.
2. The Commission recommends more stringent regulations to establish intergovernmental forums, at both political and administrative level, that ensure support, communication and policy implementation by all parties within a province/district, including improved interactions with national government departments and public entities such as Eskom and water boards.
3. Greater efforts should be made to promote the sharing of information and learning-by-doing across the local government sphere.
4. Recognising the importance of compliance to legislation that ensures sound financial management and best practice, the Commission recommends that national government be mindful of the financial and administrative impact additional legislation will have on poorly capacitated municipalities. The Commission recommends that, in line with Section 105 of the Municipal Systems Act, national and provincial government ensures that a financial impact analysis is undertaken when new laws and regulations are enacted to quantify the impact of such legislation in the function of municipalities.

3.9 Problem Area 9: Municipalities are facing increasing cost pressures

Conclusion

1. The Commission notes the increasing expenditure responsibilities being placed on municipalities, driven by the extension of social programmes by national government and rising costs, and the diminishing tax bases of local government, driven by adverse economic activities, structural shocks and increases in administered prices.
2. Nationally driven policies, such as electricity demand-side management, are also having negative impacts on municipal revenues. Such policies are putting pressure on municipal revenues and expenditures

Recommendations:

1. Regardless of the cost pressures being faced by local government, municipalities should primarily ensure that the poor is protected by such

increases. Municipalities should absorb such increases as much as possible to protect its constituents.

2. With that said, municipalities should be given greater flexibility and autonomy in deciding increases to their tariffs and surcharges. Such flexibility applies to the MFMA budget circular guidelines and the imposition of norms and standards on surcharges as prescribed in the MFPFA.

For and on behalf of the Financial and Fiscal Commission

A handwritten signature in black ink, appearing to be 'BK' followed by a flourish.

Bongani Khumalo (Mr.)

Acting Chairperson/CE

Friday, 19 April 2013

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