BUREAU FOR ECONOMIC RESEARCH

SA's municipal challenges and their impact on local economic development

Research Note

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Executive summary

The upcoming local elections place municipal performance under the spotlight. Many municipalities in South Africa are characterised by failed service delivery, resulting from poor financial management and a lack of the necessary skills and capacity.

Depending on a municipality's regional and demographic characteristics, it can face a different set of challenges to its neighbour. The service delivery challenge in sparsely populated rural areas, for instance, is different from that in dense metro centres. These variations, as well as the fact that local municipalities form part of the broader sphere of government agents (national and provincial governments, district municipalities, water boards, Eskom, etc.), need to be kept in mind when thinking about South Africa's local government failures.

This research note starts by giving an overview of the factors that inhibit municipal delivery of basic services. These include urbanisation towards metros, low capital spending by municipalities, a debilitating supply chain management (SCM) process, and an auditing environment that focuses more strongly on audit outcomes than on municipal performance.

Poor revenue management and low debtors' collection rates contribute to the problem. In addition, many municipalities appear to be overspending their operational budgets but underspending on capital and infrastructure. Expenditure on repairs and maintenance is also low and increases the need for urgent (and more costly) maintenance when infrastructure breaks down. Spending on contracted services in many instances exceeds the norm, likely resulting from a lack of in-house capacity and skills. High levels of irregular, fruitless and unauthorised expenditure are a concern, caused by fraudulent activity as well as inefficiencies in the SCM process. These issues are exaggerated by a high share of vacancies and an employment process that is characterised by cadre deployment rather than based on merit.

It is crucial that South Africa urgently addresses the problems within local government to broaden economic participation and reverse our unemployment trend. Without the infrastructure and basic services that municipalities should provide – critical for creating a healthy investment climate – local economic development cannot take place.

Acknowledgements:

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Please refer to the glossary on the BER's website for explanations of technical terms.

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Introduction

Municipalities should provide democratic and accountable governance for local communities; ensure the provision of services in a sustainable manner; promote social and economic development as well as a safe and healthy environment; and encourage the involvement of communities in the matters of local government.[1] Current outcomes suggest that South Africa's municipalities are failing in many of these respects.

This Research Note explores the problems and causes of these failures. Economic growth, job creation and local economic development initiatives are dependent on municipal finances and become constrained when local governments do not function well. Households directly suffer the consequences when basic service delivery is poor, but the problems extend beyond the household level and the COVID-19 pandemic and associated lockdown has exacerbated many of these trends. Municipalities need to provide the infrastructure and basic services that support a favourable investment climate[2], without which disinvestment, deepening unemployment and poverty may follow. This has the further effect of eroding the local tax base, increasing municipal dependence on fiscal transfers and worsening South Africa's already constrained fiscal environment.

Two examples illustrate how municipal failure can have a direct negative impact on local economic development. The first is Clover, who in June 2021 announced that it would close its cheese processing facility in Lichtenburg in the North West province and move this to an existing plant outside of Durban.[3] It attributed the decision to ongoing problems with service delivery by the Ditsobotla Local Municipality – specifically water and electricity outages as well as the poor quality of roads. The move is estimated to lead to 330 job losses within the Lichtenburg economy.[4] Another example is Astral foods – one of South Africa's largest poultry producers – who own a processing plant in Standerton in the Lekwa municipality. In 2018, Astral took legal action against the municipality due to severe supply disruptions caused by disintegrating infrastructure. Load-shedding and water shortages reportedly cost the company around R62 million in its latest financial year. Following a court order, the municipality had to submit a long-term plan about how they were going to repair and improve the infrastructure. This did not lead to improved outcomes. Earlier this year,

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[1] Constitution of the Republic of South Africa, 1996 - Chapter 7: Local Government

[2] CoGTA Annual Report 2019-2020 (p. 35)

[3] **https://theconversation.com/small-towns-are-collapsing-across-south-africa-how-its-starting-to-affect-farming-162697?utm_medium=Social&utm_source=Facebook#Echobox=1632471973**

[4] **https://www.news24.com/fin24/companies/clover-closes-sas-biggest-cheese-factory-due-to-municipal-woes-in-the-north-west-20210608**

a new court order was issued requiring national government and Treasury to intervene and prepare a financial recovery plan for the municipality.[5]

Municipal failure not only affects large businesses; it also impacts on households, small, medium and micro-enterprises (SMME), and other investors in local economies. To better understand the degree of municipal failure across different types of municipalities, our note draws a comparison between metros, intermediate city municipalities (ICMs), and other local municipalities. ICMs (previously known as secondary cities) are a subcategory of local municipalities classified by National Treasury. [6] Their population density, potential economic activity, and resource base suggest that good and efficient local government could unlock substantial economic opportunities in these hubs. Creating economic opportunities in ICMs may also reduce some of the service delivery pressure caused by urbanisation toward metros and help to create a less skewed spatial distribution of economic activity and opportunities.

Throughout, it is important to remember that municipalities are characterised by varying blends of service delivery responsibilities across rural and urban zones, and face different opportunities in terms of access to revenue. Hence, not all municipalities face an equal set of challenges. In addition, municipalities form part of the broader architecture of government and are interdependent on national, provincial and district government functions, Eskom, the water boards, etc. They cannot influence local economic development in isolation of these agents. Yet, there are a number of cross-cutting issues that contribute to local government failure in South Africa. We look at service delivery and explain how issues in supply chain management and the audit process can cause poor or non-delivery of basic services. We also highlight some financial performance metrics – like low expenditure on repairs and maintenance and inadequate debt collection rates – that contribute to poor outcomes. Finally, we provide data on high personnel vacancy rates and lack of competencies in municipalities. All of these factors impact on the ability of municipalities to create an enabling environment for private business, local economic development, and better living conditions for South Africans.

Overview of municipalities

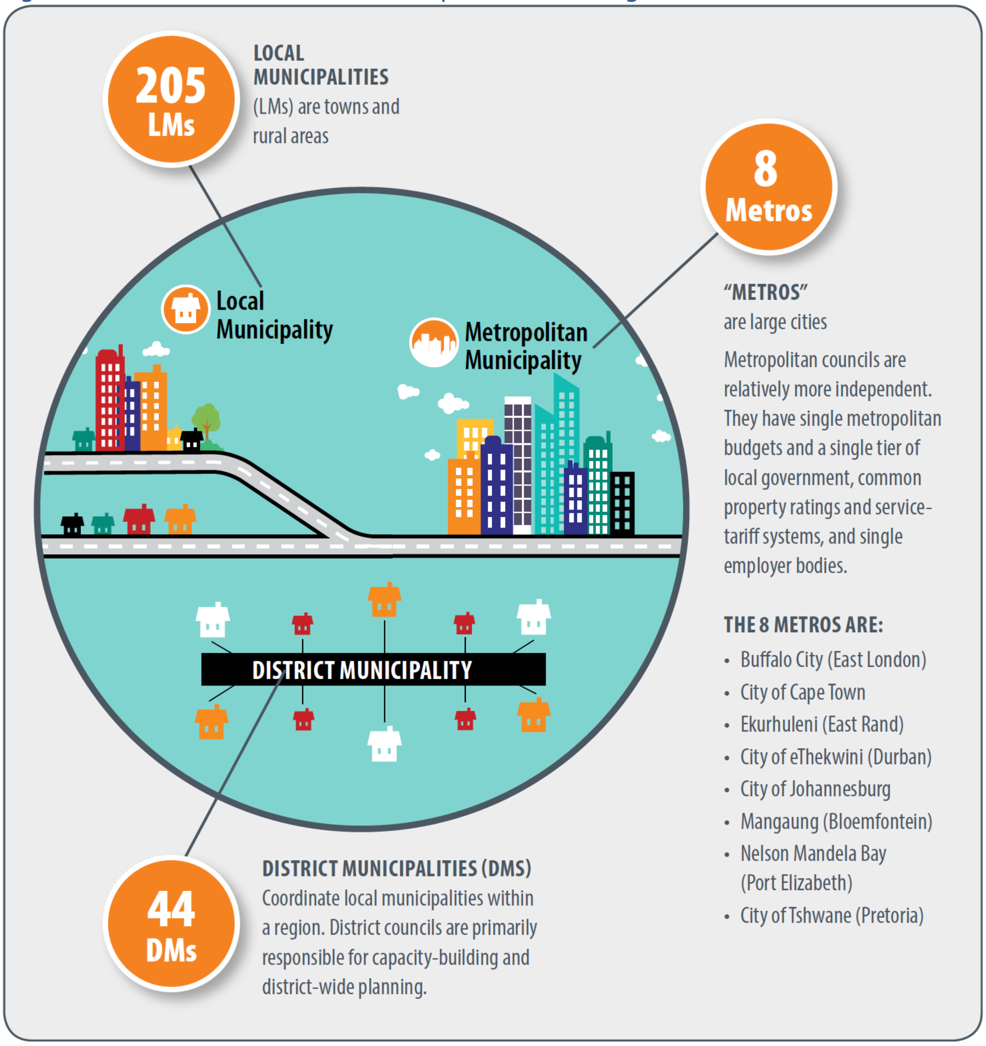
South Africa’s constitution provides for three categories of municipalities: metropolitan municipalities (“metros”), district municipalities and local

[5] **https://www.businesslive.co.za/bd/companies/industrials/2021-04-13-astral-foods-wins-court-order-over-lack-of-service-delivery/**

[6] The rationale for identifying ICMs is that different methods are needed to encourage development in different types of settlements. This approach is also embedded in South Africa’s Integrated Urban Development Framework; ICM Report 2021 (page 10).

municipalities. There are 257 municipalities: 8 metropolitan municipalities, 44 district municipalities, and 205 local municipalities.

Figure 1: Overview of the different spheres of local government



Source: 2016 The State of South African Cities Report

In the context of local government, it is important to understand the respective roles of district and local municipalities, and the overlaps. District municipalities are typically responsible for district-wide integrated planning such as land use, economic planning and development, and transport. Historically, many have played a role as infrastructure development agents and bulk service providers. They have the further role of supporting local municipal capacity through assistance and capacity building, but this often is not borne out.[7]

In instances where local municipalities do not have the necessary administrative capacity to manage specific services, district municipalities can be made responsible for the direct provision of these services (e.g., water and sanitation).

[7] National Treasury (2011). Local Government Budgets and Expenditure Review, Chapter 12. (p. 206).

This is apparently often still the case in the historically "homeland" areas. Local municipalities are, however, intended as the actual locus of service delivery. Where this is taken over by district municipalities, these arrangements are supposed to be transitional while the necessary capacity is established at the local level.

Based on the local government fiscal framework, funding for basic services is paid to the municipality that is legally responsible for providing that function. If another municipality provides the service on its behalf, the money needs to be transferred to that municipality.[8] If a district municipality is the service delivery authority but the function is provided by the local municipality, the district is expected to pass on that funding to the local municipality. In many instances, however, this does not happen.[9]

Government has put forward the District Development model (DDM) to improve the coherence and impact of service delivery. The DDM is seen as "an intergovernmental relations mechanism to enable all three spheres of government to work together, with communities and stakeholders, to plan, budget and implement in unison."[10] One of the facets of the DDM is to implement, through a collaborative process, a plan for each of the 44 district and 8 metropolitan municipalities, which will then be synchronised with municipal Integrated Development Plans.[11] It is beyond the scope of this note to discuss the merits of the DDM but suffice to say that its success will depend greatly on the capabilities and capacity of district municipalities.

39 out of the 205 local municipalities are classified as ICMs

This research note examines the 205 local municipalities and 8 metros as the focus is on the intended level of basic services provision. Of the 205 local municipalities, 39 are classified as intermediate city municipalities (ICMs)[12] (shown in colour on the map, with the eight metros in black).[13]

[8] National Treasury (2016). Budget Review, Explanatory memorandum to the division of revenue (p. 35).

[9] National Treasury (2011). Local Government Budgets and Expenditure Review, Chapter 12. (p. 206).

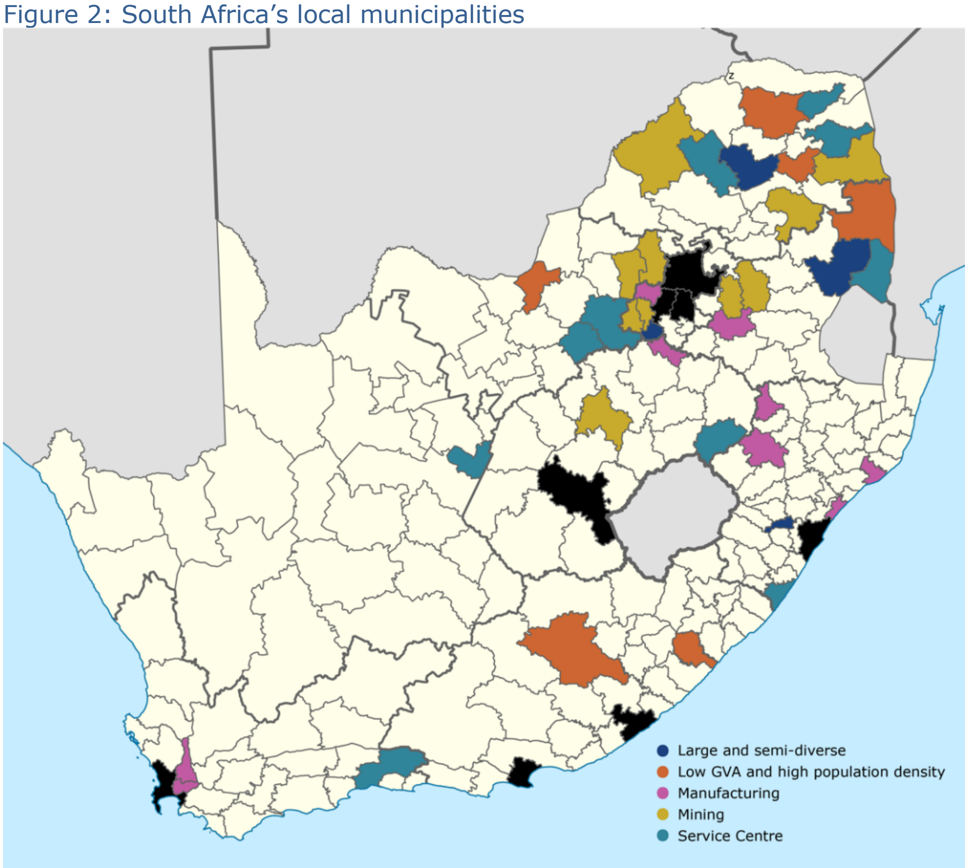
[10] **https://www.cogta.gov.za/ddm/index.php/about-us/**

[11] **https://iudf.co.za/news/what-is-the-district-development-model-and-has-it-replaced-the-iudf/**

[12] Treasury originally identified 21 ICMs, but subsequently expanded it to 39 based on population size. According to the South African Cities Network, this use of a single indicator to identify ICMs is problematic, as it does not take function and location of cities into account.

[13] National Treasury classifies ICMs into five subcategories: large and semi-diverse, manufacturing, mining, service centres, and low GVA and high population density. For the purposes of this note, we group them all together and do not distinguish between the different categories.

Figure 2: South Africa's local municipalities

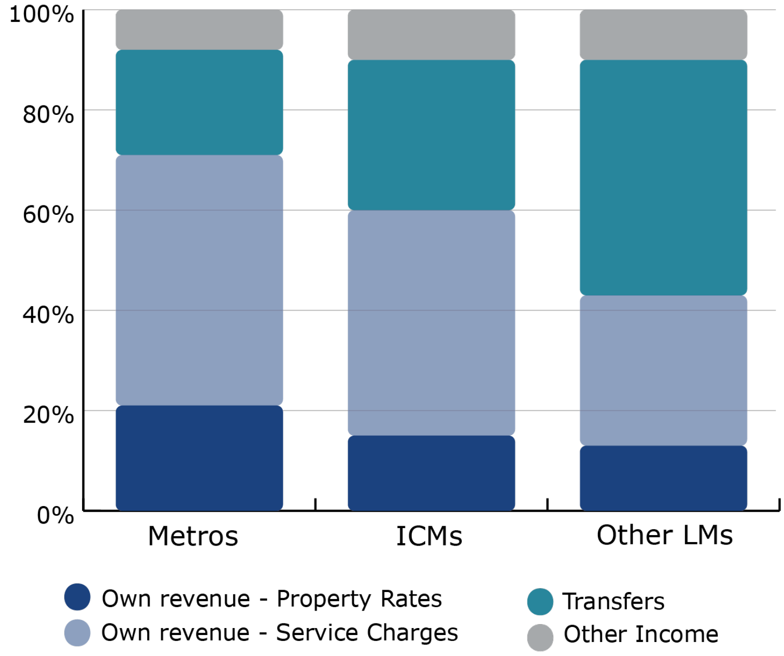


Not all municipalities are equal in the resources that they can access

This Research Note identifies several cross-cutting problems within South Africa's local government sphere, but it is important to remember that (as mentioned before) not all municipalities are equal in the resources that they can access (fiscal, skills, and otherwise) or the developmental challenges that they face. Municipal areas are characterised by urban and rural zones which affect their financial position, revenue streams and cost of service delivery. For example, with more dispersed populations, service delivery poses a different type of challenge in local municipalities than in more densely populated metros.

These differences are seen in municipal income streams, and must be kept in mind when comparing service delivery and financial performance among municipalities.

Figure 3: Split of main municipal revenue sources in 2019



Source: National Treasury (BER calculations based on audited actual statements)

Metros, for example, are on average able to generate a much larger share of their income from own revenue sources (property rates and services charges) due to their larger local revenue base (see Figure 3). ICMs and other local municipalities rely on intergovernmental transfers to a far greater extent.

Municipal service delivery

The activities shown in the diagram below form the core of every metro and local municipality's activities, and underpin the successful functioning of households, businesses, and industries. Municipalities are also responsible for community-oriented services like security & safety, emergency, health, parks & recreation, and environment, but the success of these largely depend on the efficacy with which their core functions are fulfilled.[14] Other support services – like financial, legal, spatial planning and customer relations – should be focused on the proper implementation of the core municipal functions.

[14] Loubser, E. (2021). Paralysis in local government. *Report prepared for the BER.*

To provide water of assured quality for domestic and commercial use and to minimise water losses

To reticulate sewerage without spillage, and to treat and discharge sewerage at acceptable quality back into the natural environment

To provide electricity for domestic and commercial use

To provide roads for private use and public transport

To provide a stormwater system to prevent or mitigate damage to property during exceptional rainfall

To manage and dispose solid waste in an organised and environmentally sustainable manner

Access to basic services

It is well-known that many municipalities in South Africa struggle with service delivery. The General Household Survey (GHS) estimates that in 2019 only 58.8% of households had their refuse removed at least once a week – down from 65.4% in 2016. Eighty-five per cent of households were connected to the mains electricity supply, down from 85.3% in 2015. While 88.2% of households had access to piped or tap water in their dwellings (off-site or on-site), only 44.9% had access inside their dwelling and 28.5% had access to piped (tap) water only inside their yard.

Having access to piped water means little if there are constant supply interruptions or if water quality is poor

Unfortunately, data about access to services do not necessarily reflect the true state of municipal governance. For instance, having access to piped water means little if the quality of water is poor. In addition, the metrics that are used to measure service delivery are often misleading. For instance, while many households may have access to piped water, losses along the water system may lead to inefficiencies and increase municipal costs. Twenty-five per cent of South African households reported some dysfunction with their water supply service in 2019[15], up from 20.3% in 2018.[16]

To better understand how service delivery varies among municipalities, we compare levels of access to basic services between metros, ICMs, and other local

[15] GHS, 2019

[16] GHS, 2018

municipalities in 2000 and 2020.[17] In each of the categories – refuse removal, electricity, and water – metros outperform local municipalities. The share of households with access to refuse removal (once per week) and piped water (inside dwelling or inside yard) is substantially higher in metros than in ICMs or other local municipalities.

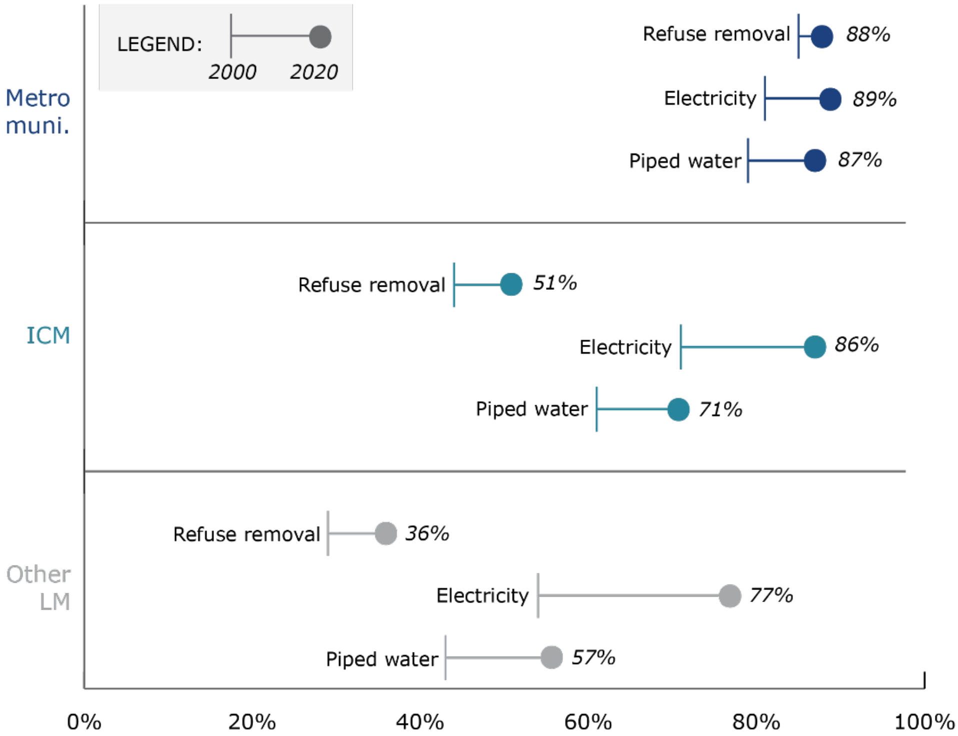
The share of households that use electricity as their main source of energy for lighting lags in local municipalities, but still far outperforms the delivery of other services like refuse removal and piped water. This might be because electricity distribution is often done by Eskom or regional bodies as opposed to being directly provided by municipalities.[18] In the event where a municipality is responsible for electricity provision, it likely still has technical backup from regional bodies. Some water boards similarly provide support to municipalities and can even be contracted to manage or operate municipal water systems on a municipality's behalf.[19] These regional bodies play an important service delivery role, especially in areas where local governments are failing.

[17] Data about the level of service delivery at municipal level is limited. Stats SA's non-financial census of municipalities reports on the number of consumer units receiving services, but this is self-reported by municipalities. It also does not provide the total number of consumer units within the boundaries of the municipality eligible for these services, or the quality or reliability of services. It is therefore impossible to gauge the effectiveness of service delivery. Quantec estimates the number of households receiving services at the level of local municipality.

[18] One example is Centlec, that provides electricity to the Mangaung Municipality (**https://centlec.co.za**)

[19] Water Supply and Sanitation in South Africa: Turning Finance into Services for 2015 and Beyond. Available online: **https://www.wsp.org/sites/wsp/files/publications/CSO-SouthAfrica.pdf**

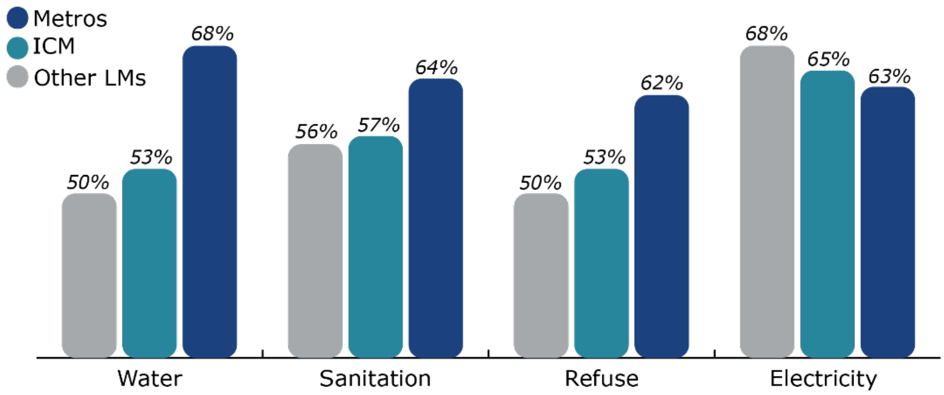
Figure 4: Share of households with access to services, 2000 and 2020



Source: Quantec, BER calculations. Notes: Refuse removal: once per week; Electricity: energy for lighting; Piped water: inside dwelling or inside yard.

The lower levels of access to basic services in ICMs and other local municipalities are also reflected in household perceptions about the quality of basic services. A substantially smaller share of households in ICMs and other metros rated their water, sanitation and refuse services as "good" than was the case in metro municipalities.

Figure 5: Household perception of basic services: % of households rating of services as "good" (2016)



Source: Community Survey, 2016 (BER calculations)

The remainder of this section explores some factors that might help to explain the poor state of service delivery in South Africa.

Factors that impact on service delivery

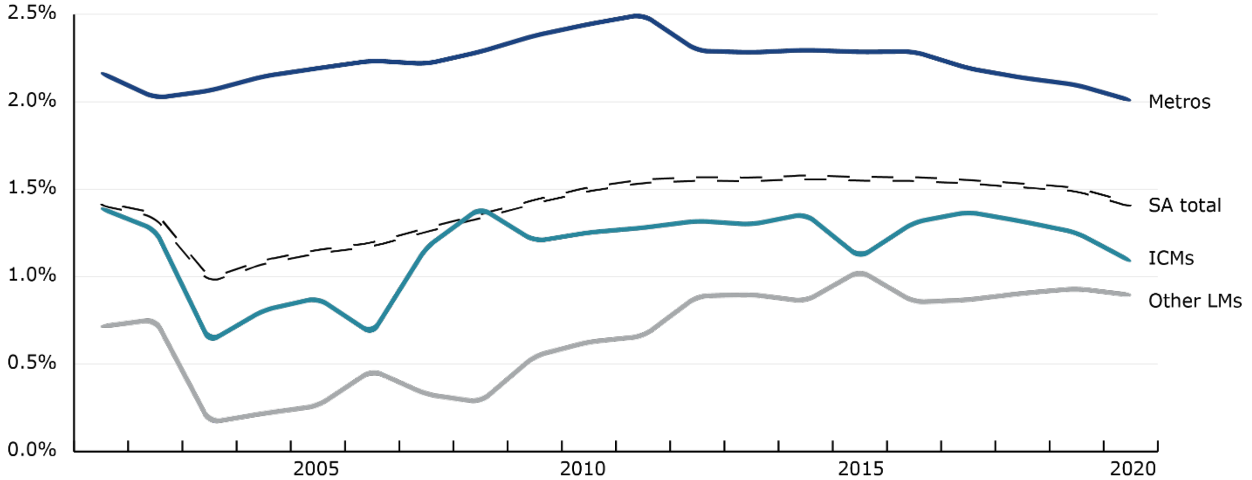
Urbanisation and migration patterns

Migration patterns affect the demand for basic services

Migration patterns can have a large impact on service delivery. While urbanisation gives households greater access to employment and services, it also presents specific challenges to urban development. Rural to urban in-migration means that cities need to acquire new land, build houses, and install services – all of which take time. Out-migration creates a different set of problems for rural municipalities since the people who leave are often those who are more entrepreneurial or economically active in search of better wages, job opportunities, education, or the availability and affordability of housing or food.[20] It can cause rural municipalities to lose an important part of their tax base.

Figure 6 shows the extent of urbanisation towards South Africa's metros – metro population growth exceeds that of ICMs and other local municipalities. On average, the number of people living in metros increased annually by 2% between 2000 and 2020, while ICMs experienced an average annual population increase of only 1.2%. Other local municipalities saw population growth of only 0.6% - far below the national average.

Figure 6: Annual population growth rate (%-change)



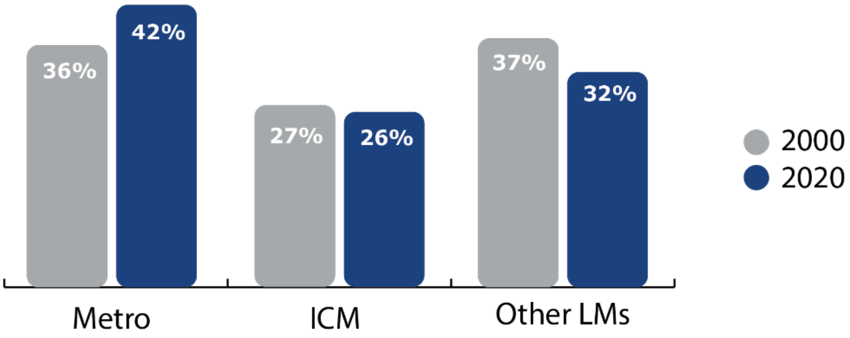
Source: Quantec (BER calculations)

As a result of urbanisation trends, 42% (about 25 million people) of South Africa's population lived in metros and 26% (about 16 million) in ICMs in 2020.[21] Together, these cities and towns account for more than two thirds of South Africa's population.

[20] *Halfacree, K. (2020). Rural populations. In the International Encyclopedia of Human Geography (Second Edition)*

[21] Quantec (BER calculations)

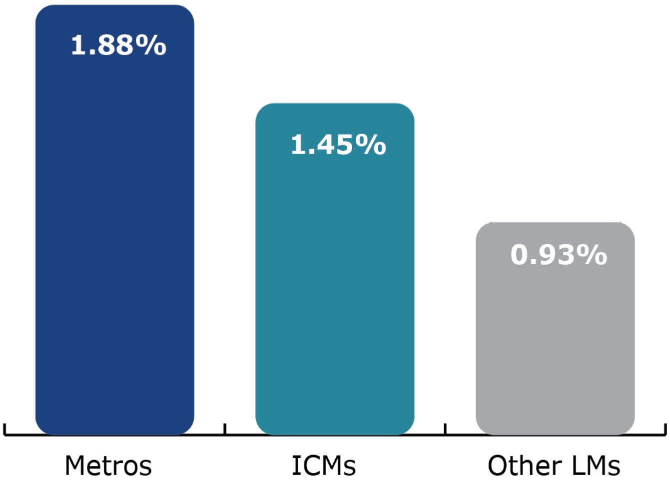
Figure 7: Share of population living in different areas, 2000 vs 2020



Source: Quantec (BER calculations)

Unfortunately, the population trends can in part be ascribed to the slower pace of economic development in local municipalities, creating a "push factor" for out-migration towards metros. Local municipalities (including ICMs) have been slower than metros in creating new employment opportunities (see Figure 8) and are also characterised by higher rates of unemployment.

Figure 8: Annual employment growth (CAGR 2000-2020)



Source: Quantec (BER calculations)

Household growth[22] further contributes to the service delivery challenge, with the number of households growing by 2.4% per year between 2002 and 2018 – this is above the population growth rate.[23] The growing number of households lead to an increased demand for basic services.

[22] In other words, multigenerational families that split up into multiple, single generation units.

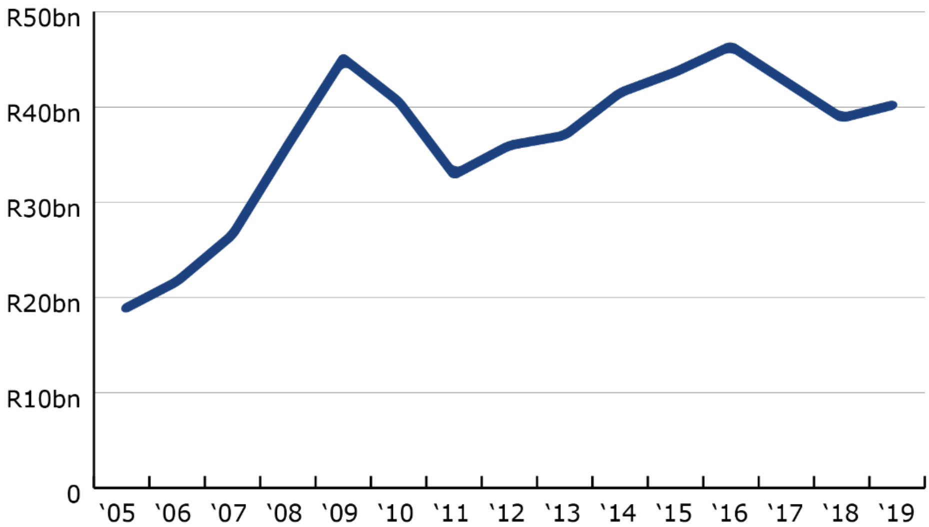
[23] CoGTA Annual Report 2019-2020 (p. 38)

Capital spending

In addition to population trends, low levels of capital spending could perhaps be seen as one of the greatest causes of municipal failure in South Africa. Although there was an encouraging increase in capital spending by municipalities between 2005 and 2009, Figure 9 shows that real total capital expenditure by municipalities in 2019 was no higher than it was in 2010. Sustained levels of low capital spending affect the ability of municipalities to expand access to water, sanitation, electricity and housing.[24] As we discuss later in the note, this trend can in part be attributed to a lack of spending of available funds.

Capital expenditure by municipalities was no higher in 2019 than in 2010

Figure 9: Total capital expenditure by municipalities[25] (constant 2010 prices)



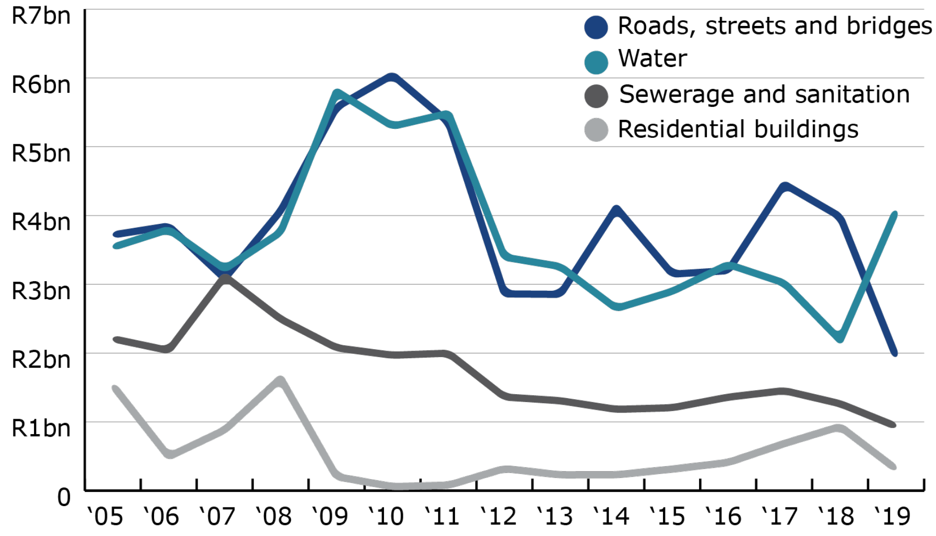
Source: Stats SA Statistical Release P9101

Municipal spending (in real terms) on new construction works for water, roads, streets and bridges, and sewerage and sanitation show a downward trend over the past decade.

[24] **https://www.gov.za/speeches/national-treasury-local-government-revenue-and-expenditure-report-third-quarter-202021**

[25] Includes metro, district, and local municipalities.

Figure 10: Capital expenditure on new construction works by municipalities[26] (constant 2010 prices)



Source: Stats SA Statistical Release P9101

These trends emphasise the importance of South Africa's upcoming local elections. To provide the services that underpin broader economic growth and job creation, municipalities need to increase capital spending. Without stronger public works and improved infrastructure planning, service delivery will continue to deteriorate. It also highlights the importance of shifting the composition of overall government spending away from current expenditure to increased capital expenditure. Between 2010 and 2020, average real general government fixed investment declined by 1.4% per annum. Even if one excludes the impact of COVID in 2020, real government fixed investment outlays saw an average decline of 0.5% per year during the 2010-19 period.

Supply chain management

A paralysing SCM process contributes to poor service delivery

In addition to low levels of capital spending, an inadequate (and in many ways paralysing) supply chain management (SCM) process contributes to the poor state of municipal service delivery. Inefficiencies in the procurement process were already highlighted as problematic in the NDP in 2012 (p. 424), stating that "*procurement systems tend to focus on procedural compliance rather than value for money, and place an excessive burden on weak support functions*". The way in which SCM is implemented severely affects water provision, sewerage systems, electricity provision, roads, and waste management in many municipalities. This impacts on the ability and appetite of businesses to invest in

[26] Includes metro, district and local municipalities, and excludes spending on these services by other spheres of government.

a municipality and prevents new opportunities for economic development from being created.

Some excerpts from responses to the BER's Building surveys illustrate how the COVID-19 pandemic has exacerbated these trends. In our most recent (2021Q3) survey, one respondent observes that "*Project approval processes by local authorities are taking too long, heritage approvals are lengthy and the lack of recourse against project objectors are all issues delaying projects. Plan approval fees are excessive*." Another respondent states that "*Municipal approvals are a bottleneck. We should authorise professionals like architects, civil engineers and town planners to approve plans where the spatial framework is in place, then submit "as-built" plans, this will cut out the delays caused by municipalities*."

The decision-making power throughout the municipal SCM process often lies with managers and staff who do not have the technical insight and competencies, leading to suboptimal outcomes. This contributes to a poor identification of infrastructure or maintenance projects, and long delays in project approvals. The problem is exacerbated by the fact that most of the projects in support of the core services of municipalities require highly technical expertise and proper tender specifications. As we discuss later, municipal technical directors are often not qualified engineers with the necessary practical experience.[27] As a consequence, projects are often inadequately specified, awarded to suboptimal service providers, and eventually poorly or never executed.

Figure 11: The municipal supply chain management process

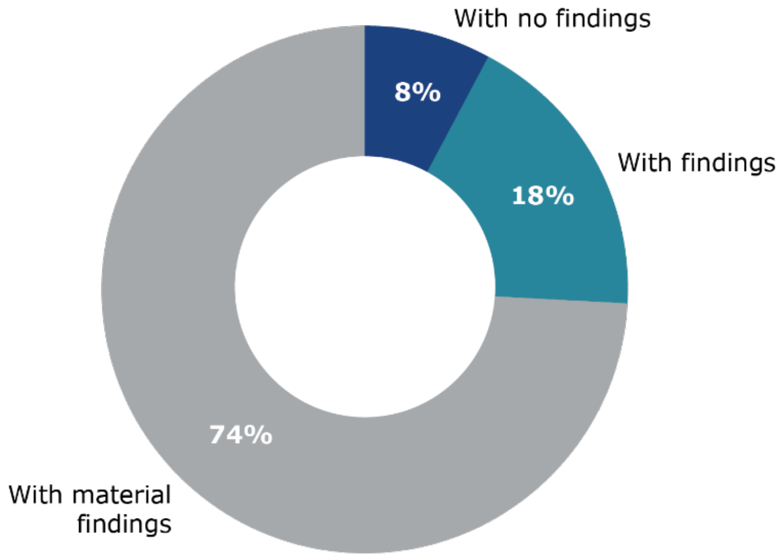
Source: Based on Loubser, E. (2021).

As a result of the inefficient SCM process, municipal compliance with SCM legislation is poor. The Auditor General (AG) found that compliance with SCM

[27] Loubser, E. (2021). Paralysis in local government. *Report prepared for the BER.*

legislation revealed material findings at close to three-quarters of municipalities (74%). Issues include awarding contracts to employees, councillors, close family members and other state officials, false declarations by suppliers and non-disclosure by employees, as well as unfair or uncompetitive procurement processes. However, not all of the irregularities are necessarily fraudulent; it might also result from non-compliance or regulatory issues associated with the complexity of the regulatory framework, inadequate contract management, or the "risk averse" response of officials. The risk of receiving a qualified audit can cause municipal decision-makers to avoid making any spending decisions altogether, resulting in underspending of capital and operational budgets. This contributes to greater backlogs and further deterioration of infrastructure.

Figure 12: Status of complaince with SCM legislation



Sources: AGSA, 2020 (p.36)

Sadly, the SCM process fails to achieve its intended objective. The focus is often more on the cost of a project and who should get the bid (in part a consequence of BEE compliance requirements), than on the 'what', 'how' and 'when' of the project. It results in irregularities like high levels of unauthorised, wasteful and irregular expenditure, misappropriation of state funds, and a disregard for tender documentation.[28] In projects where funding is provided by national sources or via provincial agencies (for example a Department of Public Works), these agencies can also contribute to the dysfunction of the SCM process, contributing to cost inflation or corruption.

[28] Nkwanyana, N.S. & Agbenyegah, A.T., 2020, 'The effect of supply chain management in governance: Public sector perspectives', Journal of Transport and Supply Chain Management 14(0), a493. **https://doi.org/10.4102/jtscm.v14i0.493**

In addition, tender processes are often characterised by long delays. After a successful tender procedure, there are a number of documents that need to be prepared to define the agreement between the municipality and service provider: the tender document (including the Form of Agreement, the Scope of Works, and the Bill of Quantities / Price Schedule), the tender submission by the bidder, the letter of appointment and a letter of acceptance.[29] These four documents fully cover the obligations of the client and the service provider, but legal departments at municipalities have recently started insisting on Service Level Agreements that duplicate much of what is already contained in the tender documents and without which a project may not commence. This results in even longer delays without clear gains, and sometimes require the extension of existing contracts to keep services going. Long delays in municipal planning permissions can also lead to cost increases, for example due to escalating construction costs involved in the planning of new housing developments. Reducing the number of deviations of existing contracts is often a Key Performance Area (KPA), which sometimes leads to departments rather allowing services to be suspended than to apply for a deviation of a contract.

Municipal audits

Municipal audit processes do not necessarily help to improve service delivery. With a total expenditure budget of R719 billion (2019-2020)[30] there is no denying the need for annually auditing municipal finances, but the way the process is managed often hinders rather than improves municipal outcomes.

The focus on audit compliance as opposed to municipal performance creates the wrong incentives for effective service delivery

Like the inefficient SCM process, the focus on audit compliance rather than on municipal performance has unintended consequences. Staff can be held personally liable for material or non-material irregularities and threatened with the recovery of irregular expenditure from their salaries. As a result, a large share of management time is spent on responding to irregularities and dealing with the recovery of these funds. In addition, to avoid the risk of expenditure that might be classified as fruitless and wasteful, managers focus only on clearly defined, narrow mandates as it has become too complex to work with other spheres of government or non-state actors. They become wary of working on complicated, cross-cutting issues that are necessary for dealing with developmental challenges – especially important in large local municipalities.

> "*The current system of regulatory compliance or 'governance for government', and linear 'logical framework' planning, monitoring and evaluation, paralyses service delivery and decision-making, makes it*

[29] Loubser, E. (2021). Paralysis in local government. *Report prepared for the BER.*

[30] Consolidated general report in the local government audit outcomes, MFMA 2019-2020 (p.18)

difficult if not impossible for the state to work with informality, sets government apart from communities, undermines cross-sector partnering, stifles innovation and prevents system change."[31]

Service delivery and compliance with SCM and audit processes cannot be seen in isolation of municipalities' financial performance. The next section presents some financial metrics that may contribute to the poor state of service delivery.

Municipal financial performance

Revenue management

Poor revenue management is one of the biggest causes of financial distress for local governments and affects the financial sustainability of municipalities. The latest CoGTA annual report notes that "*…at an aggregate level, municipalities continue to have insufficient cash coverage to fund their operations. They underspend capital budgets,* [face] *expanded outstanding consumer debtors, their* [outstanding creditors] *remain very high, and their asset management spending remains inadequate*."[32]

Poor revenue management and underspending of capital budgets is illustrative of municipal failure

As a result of these dynamics, many municipalities can't fully finance their operations and maintenance. Only 199 out of 257 municipalities submitted their audits in time to be included in the AG's Consolidated Report 2019-20. Of these, only 38 were deemed to be in good financial health. The financial health of 98 municipalities (excluding the 58 that did not submit their audits on time) was of concern, and intervention was required at a further 63 (32%) municipalities.[33] A total of 53 municipalities (eight of which are classified as ICMs) expressed doubt that they would be able to continue their operations in the near future as a going concern, meaning that they rely on the equitable share[34] grant provided by national government for survival. The equitable share allocation is specifically targeted to allow municipalities to provide basic services to poor households, or to allow municipalities with limited own resources to perform basic administrative and core municipal functions. Indigent households suffer if the money is used for general municipal management, leading to the further deterioration of service delivery in poor areas. South Africa's fiscal constraints and national expenditure

[31] Prof Andrew Boraine (2021) Academy of Science of South Africa (ASSAf), Webinar Three of a Three-part Series: What must be done if the state is to be capable of poverty and inequality reduction? (22 July 2021)

[32] CoGTA Annual Report 2019-2020 (p. 35)

[33] Consolidated general report on the local government audit outcomes, MFMA 2019-2020 (p.18)

[34] AGSA, Consolidated general report on the local government audit outcomes, MFMA 2019-2020, p.20.

priorities following the COVID-19 pandemic will likely increase the financial risk of local municipalities who rely on grants from national government for survival.

Non-payment by municipal debtors contributes to the pressure on municipal finances. Poor economic growth, inability to pay due to loss of income, dissatisfaction with service delivery, and ineffective municipal billing and credit control systems all contribute to rising levels of consumer debt.[35] Household debt represents the largest component of municipal consumer debt and low debt recovery in turn affects municipalities' ability to pay their creditors. This has serious repercussions for Eskom and the water boards who need to continue delivering electricity and water despite non-payment.[36] Interest and penalties charged due to late payments add to financial strain.[37] This emphasises the need to strengthen municipalities' revenue position, without which they won't be able to borrow funds for investing in infrastructure. One way is through higher debtors' collection rates.

The estimates presented in the remainder of this section are measured against Circular 71 of the Municipal Finance Management Act, which provides a set of uniform key financial ratios and norms for municipalities.[38]

Circular 71 sets a debtors collection target of 95%, but in the 2018/19 financial year only metros achieved this goal. Our estimates suggest that ICM's missed the target by close to 15 percentage points. Other local municipalities missed it by an even greater margin.

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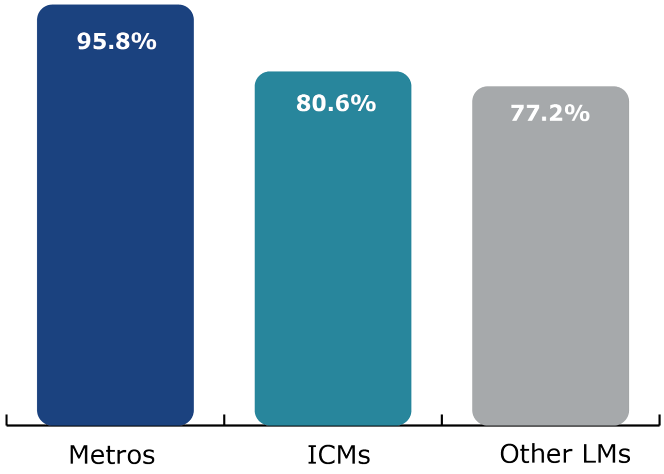
[35] CoGTA Annual Report 2019-2020 (p. 35)

[36] AGSA, Consolidated general report on local government audit outcomes, MFMA 2019-2020, p.21

[37] Some municipalities that have taken hard political decisions have managed to improve their revenue outcomes. One example is the City of Cape Town, which coupled debt forgiveness with the installation of prepaid meters and free water leak repairs to indigent households (South Africa Cities Network, State of City Finances 2020, p.9)

[38] **http://mfma.treasury.gov.za/Circulars/Pages/Circular71.aspx**

Figure 13: Debtors management: collection rate (2018/19) [39]



Source: National Treasury (BER calculations based on audited actual statements)

Cities that are in a stronger revenue position – in part because of their better debtors' collection rates – might benefit by borrowing more so that they are able to finance long-term infrastructure and development plans. It is, however, important that this money is spent on revenue-generating assets. The next section looks at the operational and capital expenditure of municipalities.

Over and underspending of operating and capital budgets

Despite low debt collection rates, many municipalities are not spending their budgets in the correct manner. There appears to be underspending of original capital budgets, and overspending of original operating budgets. In the 2019/20 financial year, municipalities on aggregate only spent 79.9% of their total adjusted expenditure budget.

Capital expenditure

Capital expenditure is typically financed through conditional grants, and although there is a great need for these grants they are often underspent – in part because of poor project management.[40] Low levels of grant spending and delays are often accompanied by service delivery backlogs.[41] The table below illustrates the number of municipalities that did not fully spend infrastructure grant allocations.

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[39] Estimated as collected revenue over billed revenue. Includes property rates, services charges and interest earned on outstanding debtors. Excludes municipalities for which no observations were available.

[40] AGSA, Consolidated general report on the local government audit outcomes, MFMA 2019-2020, p.23

[41] FCC (2020). Technical Report Division of Revenue 2020/21: Repositioning Local Government Public Finances. *31 March 2020.*

Table 1: Underspending of infrastructure grants (2019/20)

Type of infrastructure grant	Underspending by more than 10%
Municipal infrastructure grant	63 out of 168 municipalities
Public transport network grant	5 out of 10 municipalities
Urban settlement development grant	4 out of 7 metros
Regional bulk infrastructure grant	11 out of 26 municipalities
Water services infrastructure grant	31 out of 62 municipalities

Source: Consolidated general report on the local government audit outcomes, MFMA 2019-2020 (p.24)

Municipal capital expenditure data is often delayed to the fourth quarter of the financial year as municipalities try to spend more of their capital budgets. For example, in the 2020/21 financial year, R21bn out of the total year-to-date capital expenditure of R55bn was spent during the fourth quarter of 2020/21, illustrative of project management that is more focused on compliance than on responding to need.

Operating expenditure

Spending on employee-related costs is one of the largest components of operational expenditure.

Circular 71 sets a norm that 95-100% of a municipality's operating budget should be spent. *Underspending* due to improved efficiencies (i.e. savings) is preferable to underspending caused by the non-implementation of necessary projects. It can, however, also be an indicator of cash flow difficulties or capacity challenges. *Overspending* of up to 5% is typically condoned but becomes a sign of high risk if it reaches more than 15%.[42] In these instances it might be indicative of inaccurate budgeting, incomplete initial budgets, poor financial management control,[43] or the reassignment of spending responsibilities. Bulk service costs for water and electricity – which are determined by NERSA and the water boards and are largely outside of the control of local municipalities – also affect overspending of operating budgets.

Spending on employee-related costs is one of the largest components of operational expenditure. Circular 71 stipulates that employee-related costs (including councillors' remuneration) should range between 25-40% of total operating expenditure.[44] If this norm is exceeded, it can indicate inefficiencies or overstaffing.

The figure below plots employee-related costs (y-axis) relative to over- or underspending by ICMs and other local municipalities (x-axis). The size of the

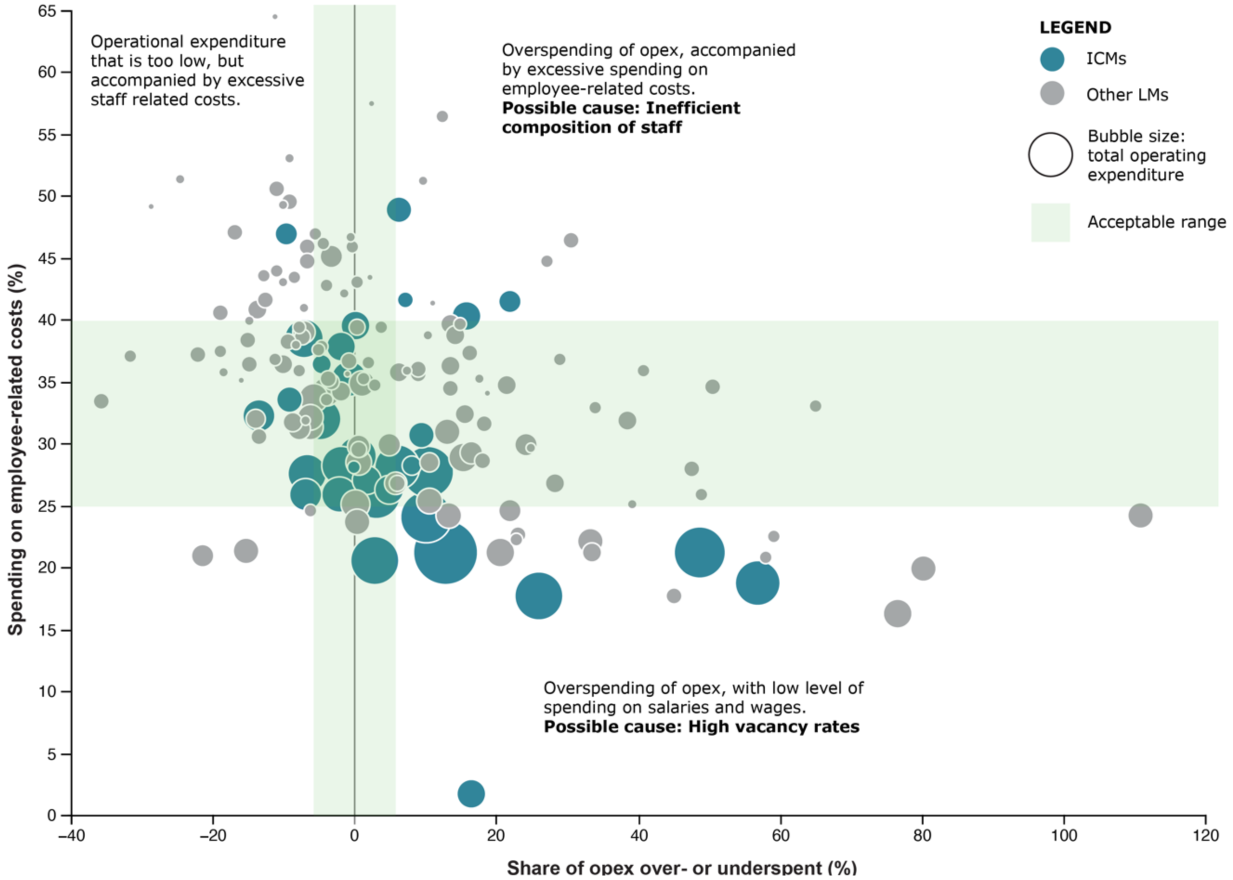
[42] **www.municipalmoney.gov.za**

[43] **http://mfma.treasury.gov.za/Circulars/Pages/Circular71.aspx**

[44] Ibid.

bubbles reflects municipalities' total operating expenditure. Many municipalities suffer from high levels of overspending, although there are also quite a number that underspend their operational budgets. Overspending might also be a sign of reassignment of responsibilities or incomplete initial budgets. Seven out of the 39 ICMs have a level of spending on employee-related costs that is below the prescribed norm – likely due to high vacancy rates (discussed in the following section). The top left quadrant shows that there are also several municipalities that do not manage to spend their operating budgets, but which are characterised by high expenditure on employee-related costs. This might be attributed to an inefficient staff composition.

Figure 14: Spending of operating budget relative to expenditure on employee-related costs (2018/19)[45]



Source: National Treasury, 2019 (BER calculations)

Local government failure cannot

The data illustrate that it is not possible to attribute the failure of local government to only one set of issues. Severe under- as well as overspending of operating budgets is an issue. In addition, while some municipalities struggle to

[45] Calculated as the difference in operating expenditure between actual audited total operating expenditure and operating expenditure in the adjusted budget, as a share of operating expenditure in the adjusted budget. Excludes one outlier municipality that had overspent its budget by more than 1500%. Spending on employee-related costs includes spending on wages and salaries, social contributions, and renumeration of counsellors expressed as a share of total direct operating expenditure.

only be attributed to one set of issues

fill vacancies, others seem to be characterised by inefficient staff composition. In the following section, we elaborate on more financial metrics that may help to explain the poor state of service delivery in South Africa.

Municipal spending priorities and outcomes

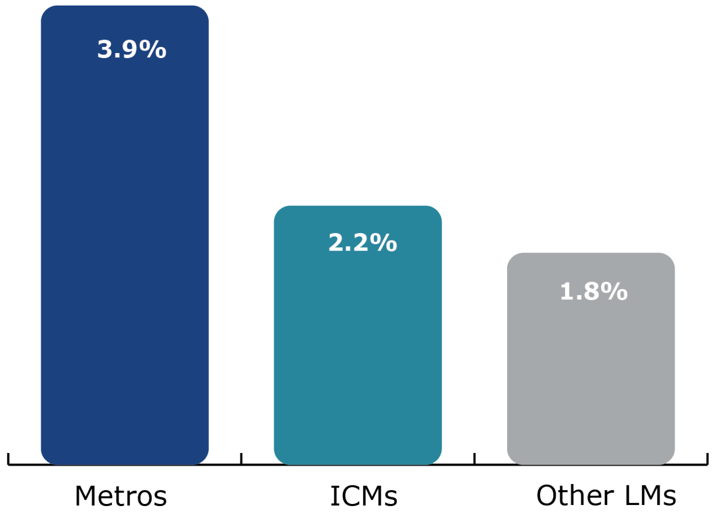
We focus on three specific indicators that may help to explain the poor state of service delivery in municipalities: low expenditure on repairs and maintenance, high expenditure on contracted services, and concerning levels of irregular, fruitless and unauthorised expenditure.

Repairs and maintenance

Most municipalities underspend on repairs and maintenance

Underspending of infrastructure grants (discussed above) is accompanied by a lack of sufficient spending on repairs and maintenance. Repairs and maintenance of municipal assets is crucial to prevent supply interruptions and breakdowns. Circular 71 sets an 8% norm for expenditure on repairs and maintenance as a share of the value of property, plant and equipment and investment property. A ratio of less than 8% increases the likelihood of impairment of assets. Figure 15 suggests severe underspending on repairs and maintenance, especially in ICMs and other local municipalities. This can lead to even greater technical (non-revenue) losses in the delivery of water and electricity services. The deterioration of infrastructure further constrains cash flow and the financial viability of municipalities.

Figure 15: Total repairs and maintenance expenditure as a share of the value of property, plant and equipment[46] (2018/19)



Source: National Treasury, 2019 (BER calculations)

[46] Property, plants and equipment as reflected on a municipality's balance sheet, including investment property.

The Auditor General's Consolidated General Report on local government audit outcomes for 2018-2019 reveals that many municipalities do not have sufficient maintenance plans in place, leading to severe service delivery challenges. Twenty-seven per cent of municipalities did not develop or approve a road maintenance plan; 41% of municipalities had no policy / an approved policy about water maintenance, and 41% of municipalities also had no policy / an approved policy on sanitation maintenance.[47] A factor that may contribute to low spending on repairs and maintenance is that it is often an invisible function that can go unnoticed. In contrast, capital spending can be tied to political gains that attract votes. The way in which municipal service delivery is measured also impacts on these incentives: when municipalities are rated according to the number of households with access to services as opposed to the *quality* of services, the incentive is to expand rather than to maintain infrastructure.

The issue becomes even more complicated when preventative maintenance (like the servicing of water pumps) is neglected. This may lead to an increase in the frequency and cost of urgent issues, such as when the eventual breaking of a water pump causes damage to other infrastructure within the system. Incentives need to be structured in such a way that preventative maintenance does not become second priority while increasing the need for urgent maintenance.

Contracted services

High spending on contracted services reflects the dearth of skills within municipalities

According to the Circular 71 stipulations, expenditure on contracted services should fall between 2-5% of operating expenditure. While outsourcing of municipal services depends on the service delivery model selected by a municipality and needs to be weighed against a municipality's ability to attract skills, excessive expenditure on contracted services can expose municipalities to other types of risks, such as an inability to build capacity.[48] Poor municipal management has a direct cost when consultants need to be appointed, like to assist with financial reporting. The strong focus on getting the annual financial statements to comply takes away from the more important objective of effective day-to-day financial management. Consultant fees accounted for 18% (R1.03 billion) of total financial reporting costs in 2019-2020 and were 21% higher than in the previous financial year.[49] This spending is, however, necessary if the appointed officials do not have the right competencies for the task. In addition, consultants can easily exploit municipalities when senior staff lack the knowledge to evaluate terms of reference, procedures, time frames and budgets.

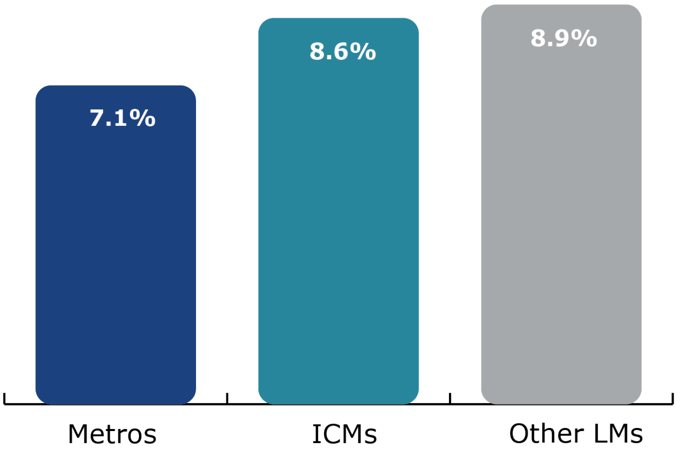
[47] Auditor General's Consolidated General Report on local government audit outcomes for 2018-2019

[48] **http://mfma.treasury.gov.za/Circulars/Pages/Circular71.aspx**

[49] AGSA, Consolidated general report on the local government audit outcomes, MFMA 2019-2020, p.31

Metros, ICMs as well as other local municipalities exceeded the 2-5% norm for spending on contracted services in 2019. This reflects that municipalities often do not have the necessary "in-house" competencies and capacity to fulfil their tasks (we discuss this in the next section), resulting in a need to outsource certain functions.

Figure 16: Expenditure on contracted services as a share of total operating expenditure (2019)



Source: National Treasury, 2019 (BER calculations)

CoGTA reports that the lack of technical skills is particularly severe in finance and engineering services, like wastewater treatment and road transport. For instance, only 55 of South Africa's 257 municipalities reportedly had qualified engineers to assist in the rolling out of infrastructure projects. As a result, many municipalities had to rely on consultants to address these issues.[50] This, however, also creates an opportunity for corruption: in some municipalities we've heard of municipal staff sabotaging infrastructure so that favoured consultants can be appointed to do repairs.

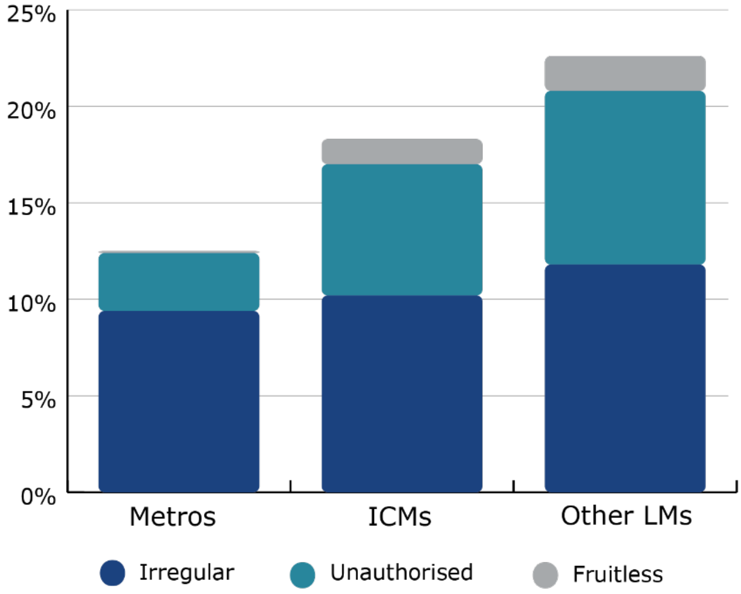
[50] CoGTA Annual Report 2019-2020 (p. 42)

Irregular, fruitless and unauthorised expenditure

Irregular[51], fruitless and wasteful,[52] and unauthorised[53] expenditure is a severe concern and in 2019-2020 totalled R26 billion across all municipalities. Non-compliance with SCM legislation accounted for 97% of irregular expenditure.[54]

Irregular, fruitless and unauthorised expenditure seems to be a particularly large problem in ICMs and other local municipalities. In comparison, metro municipalities appear to be better at limiting fruitless and unauthorised expenditure, but still struggle with high levels of irregular expenditure.

Figure 17: Irregular, fruitless and unauthorised expenditure as a share of total operating expenditure (2018/19)[55]



Source: National Treasury, 2019 (BER calculations)

Poor financial (and ultimately, economic) outcomes might also have to do with a lack of critical skills and capacity in municipal appointments, as explored below.

[51] Irregular expenditure refers to spending that was not incurred in the manner prescribed by legislation. It is an indicator of non-compliance and requires an investigation to determine if it is the result of an unintended error, negligence, or incurred with the intention to work against the requirements of legislation (AGSA, 2020).

[52] Defined as expenditure that was made in vain and which could have been avoided if reasonable care had been taken.

[53] Unauthorised expenditure includes, among other examples, spending of funds that were appropriated for a specific purpose otherwise than for that specific purpose, or overspending of the total amount appropriated in a municipality's approved budget.

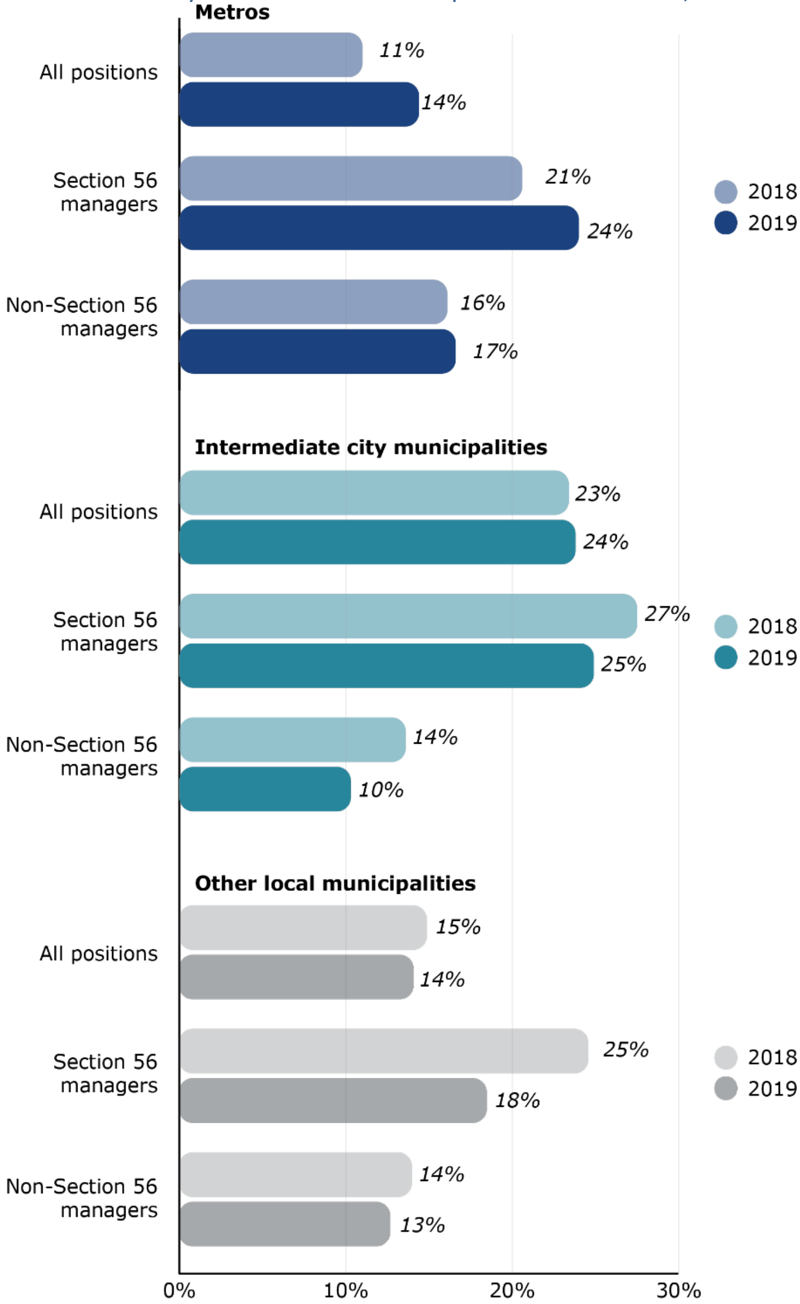
[54] AGSA (2020). Consolidated general report on the local government audit outcomes, MFMA 2019-2020 (p.41)

[55] Excludes municipalities for which no observations were available.

Capacity and skills in municipalities

The dearth of skills (both in terms of capacity and competency)[56] in municipalities is often raised as one of the main reasons for the poor performance of local government.

Figure 18: Vacancy rates in local municipalities and metros, 2018 and 2019



Source: Stats SA Non-financial census of municipalities, 2019; Note: Includes part-time and full-time positions.

[56] Capacity relates to the number of staff per job title and skills to the competencies required to do the work.

Across all local municipalities and metros, 16.4% of positions were vacant in 2019 – 1.5 percentage points more than was the case in 2018. The comparatively high vacancy rate in ICMs is of particular concern: almost one out of every four positions (24%) were vacant in 2019. At the level of Section 56 managers[57], one in every 4 positions were vacant across metros and ICMs, and one in every 5 positions were vacant in other local municipalities. ICMs perform better in terms of Non-Section 56 managerial positions, with one in 10 positions vacant at this level.

Changing how senior appointments are made might help to improve outcomes

In addition to a high proportion of vacancies, many personnel reportedly do not have the right skills for their appointments. Only 1 500 (54%) out of 2 747 senior municipal officials, and 128 out of the country's 248 Chief Financial Officers, meet minimum competency levels.[58]

Political appointments and cadre deployment are large contributory factors to the lack of skills. Twenty years of following this employment strategy has made it very difficult to reverse the problem and has interrupted the pipeline of skilled officials. At the top of the municipal structure is a politically elected council, led by a mayor who is elected by the council. The mayor is given executive powers to choose a mayoral committee, with no guarantee that it consists of individuals with the necessary skills, expertise, and experience to run a municipality. In addition, the municipal council, the mayor, and the mayoral committee influence the appointment of executive managers in the municipality. This typically includes a Municipal Manager (who heads the administrative arm of the municipality and provides a link to the political arm of the municipality) and a deputy Municipal Manager. It also includes other managers who directly report to the municipal manager, such as a Chief Financial Officer, a Technical Director, and general managers for the different departments (collectively known as section 56 managers).[59] These individuals are appointed with specific performance targets, but if they do not have the necessary competencies these targets become meaningless. The extreme centralisation of functions within head office and senior levels of departments can lead to additional dysfunctions and delays. The lack in institutional memory about good governance and the poor quality of management can also have an impact on staff morale, affecting junior and senior staff alike.

[57] Refers to managers who directly report to the municipal manager, such as a Chief Financial Officer, a Technical Director, and general managers for different departments within a municipality.

[58] **https://www.polity.org.za/article/only-53-of-sas-senior-municipal-managers-meet-minimum-competency-levels---khumbudzo-ntshavheni-2021-04-19**

[59] Loubser, E. (2021). Paralysis in local government. *Report prepared for the BER.*

Some changes to the way in which senior appointments are made might help to improve outcomes. Better outcomes would likely also be achieved if it is made imperative that Technical Directors and the General Managers of water and sanitation, roads and stormwater, electricity and solid waste departments should be qualified engineers, at a minimum. Similarly, Municipal Managers should have some managerial qualification (such as an MBA) and Chief Financial Officers should at least be professionally registered chartered accountants. Being part of a professional body provides an extra "check", as these bodies can suspend officials who do not act in accordance with the relevant professional code. Competent professionals in charge of management, finances, and technical execution would provide an additional layer of accountability that would filter down through the rest of the municipal structure.[60]

[60] Ibid.

Conclusion: Is there scope for improved outcomes?

Local economic development and better municipal service delivery are vital if South Africa wants to broaden economic participation and reverse its unemployment trend. To achieve these objectives, it is necessary to strengthen municipal finances and investment, with good municipal governance as a prerequisite. ICMs have an important role to play, as urban development is critical for growth and investment and may help to reduce the pressure caused by urbanisation to metros.

Service delivery is hampered by a lack of capacity and competencies (skills) across municipal management. Political influence and interference in the appointment of managers and other municipal executives contribute to the problem. It is important to ensure that professionals have the necessary qualifications. Requiring registration with professional bodies and ensuring that appointments – especially within the administrative arm of local municipalities – are merit-based and made without undue political influence may help. A mechanism that sanctions or removes municipal officials from their positions if they are consistently underperforming might also contribute to better outcomes.

Supply chain management and audit processes need to prevent fraud and corruption, but should not hamper spending or shift the focus away from core municipal functions. The need to find a less cumbersome SCM process is critical, with a stronger focus on strengthening financial management and responsibility for service delivery, as opposed to the minutiae of compliance and post-facto audit interrogations. The regulatory system whereby municipal finances are managed should enhance rather than paralyse service delivery.

Finally, there is a need for better management of inter-jurisdictional collaboration between different categories of municipalities, water boards, provinces, Eskom and national departments. The complex developmental problems that South Africa faces cannot be solved with local municipalities operating in isolation. Public-private partnerships may also provide valuable opportunities for improving the management, expansion, maintenance, and operation of select revenue-generating components of service delivery, such as water, sewerage and sanitation, and solid waste management. Not all municipalities, however have the skills to manage such projects, and many may need technical support to ensure that risks are managed effectively. These initiatives should be planned well and not be the consequence of inadequate capacity or a lack of skills within municipalities.

These considerations could contribute to better outcomes and improved service delivery at the level of local government. The important developmental role that ICMs can play in creating employment and stimulating economic growth – and the poor performance of these municipalities relative to metros – suggest that these areas in particular should be prioritised.

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