Metropolitan Financing and Development In South Africa: *Quo Vadis*?

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ABSTRACT

Metropolitan municipalities are largely regarded as the catalysts of economic development. The main finding of the paper globally. Eight metropolitan municipalities were introduced in the then new democratic South African state, post 1994. The article only reviewed the primary and secondary literature impacting on metropolitan financing and development, drawn from the desktop literature review and documentary analysis in the larger study. This article focussed on the three largest metropolitan municipalities, namely eThekwini; Cape Town and Tshwane City Councils. Increasing urbanisation and infrastructural decay has placed considerable pressure on these municipalities to deliver on their service delivery mandate, in the broader context of redistribution/equity. The accumulated developmental backlogs pre and post 1994 in South Africa are interrogated and the required funding for additional growth/development in metropolitan municipalities are explored. Public-private partnerships and alternative service delivery models are also examined as an option for enhancing service delivery. The issue of unfunded mandates has to be given serious consideration as they are currently impacting negatively on the finances of local government. The notion of a "smart city" and public private partnerships in the broader context of local economic development and financial sustainability has to be prioritised in terms of the overall socio – economic impact on local communities. A main finding of the paper was a funding gap in local government South Africa and the development of a model to address such a funding gap.

Keywords: Development, Financing, Income, Metropolitan, Municipalities, South Africa

INTRODUCTION

Increasing pressure is being exerted on municipal finances in South Africa due to the historical backlogs, deteriorating infrastructure and service delivery challenges. The White Paper on Local Government (Republic of South Africa, 1998) has detailed a local government framework that acknowledges that substantial capital investment is required for municipal providing services.

Despite the progress made with basic service delivery, there are currently immense backlogs particularly in the major metropolitan municipalities that are further exacerbated by rapidly increasing urban migration. The SA Cities Network (2013) has pointed out that the adequacy of funding for the repair, maintenance and rehabilitation of public infrastructure requires urgent attention. Metropolitan municipalities are the key facilitators of the gross domestic product (GDP) nationally, presently generating more than 80 per cent of it, and consequently this a matter of concern (FFC, 2013a). There has to be massive investment in metropolitan municipalities to facilitate growth, presently just above 2 percent (SARB, 2014) to ensure that progress is made in addressing development bottlenecks.

Globally, modern towns and cities have to facilitate smart growth if they are desirous of being both successful and prosperous (McKinsey & Company, 2013). A strategic metropolitan funding model will seek to facilitate a smart development strategy by guaranteeing that economic development, asset maintenance and developmental backlogs are adequately addressed. Becoming a smart city is the national metropolitan vision. It goes beyond becoming a digital city with the emphasis being placed on achieving "value for money" through efficiency and effectiveness. A balance has to be maintained between social expenditure, economic development and growth. Consequently, metropolitan municipalities have to critically review their *modus operandi*, specifically, the effectiveness of their development strategy adopted post-1994 and accordingly map a way forward. This article critiques metropolitan financing with particular emphasis on the sources of income, and the adequacy thereof; the additional challenge of unfunded mandates, and the development of "smart cities" and public private partnerships.

BASIS OF LOCAL GOVERNMENT FUNDING

Certain distinct principles detailed below are essential for local government funding (De Villiers, 2008; UNDP, 2012a and UNDP, 2012b):

- Effective decentralisation and local independence require appropriate fiscal autonomy.

- Funding must be in accordance with municipal roles/responsibilities to ensure financial sustainability, viability, and ability to generate own funding. All functions delegated/assigned by other spheres has to be fully funded.
- Power delegated by national/provincial government to a municipality has to be accompanied by the requisite funding/resources to exercise such power, or delegations to adapt execution to local conditions.
- Municipalities have divergent funding sources and this should be constitutionally entrenched/legislatively guaranteed. Grants/transfers have to be adequate and accessible to municipalities.
- Funding should largely be from local taxes/fees/charges for cost recovery purposes and to determine the tariff/rate.
- Taxes that municipalities have the power to levy (property tax) or receive a set percentage (fuel levy), should be flexible and in line with their responsibilities.
- Local taxes should ideally be collected by municipalities, subject to the required monitoring tools and capacity.
- Financial equalisation vertically (between spheres) and horizontally (among municipalities) should ensure financial sustainability.
- Power/rights to participate in funds apportionment/redistribution vertically/horizontally should be legislated for.
- Grants/transfers from the national sphere must be unconditional and not aimed at particular projects and municipal policy discretion should not be impeded.
- Conditional grants/transfers must be limited to national policies execution on health, education, environmental protection and social development.
- Municipalities should have access to national/international capital markets for borrowing subject to legislation/rules/guidelines and monitoring is imperative to prevent major socio-economic upheavals.
- Municipal borrowings should not threaten national financial stability.

Some of these principles have not been adhered to as local government is not receiving a rightful portion of state income equal to their functions. A number of the grants are conditional and consequently the adequacy of metropolitan funding is a concern. Matabane (2017) has also pointed out that infrastructural financing is a problem, especially if municipalities are responsible for infrastructural provision for service delivery. Municipalities were committed to addressing backlogs in service delivery up to 2014 by Government and this was imposed with no consultation with local government. There was no funding from Government and, consequently, the deadline was not met. Infrastructural development for power, water and transport is a priority and there has to be a balance between socio – economic and rehabilitative expenditure. Modelling and technical preparation is a priority, with considerable emphasis being placed on affordability and sustainability.

Demonstrable progress has been made in addressing service delivery backlogs nationally; however, many households continue to experience limited or no access to services, particularly refuse removal and sanitation (FFC, 2013a). Local and national economic needs of cities continue to place a greater demand for supporting infrastructure and services from municipalities. Municipal infrastructural demands is substantial and continually escalating.

A wide – ranging review of the fiscal framework for local government was completed in 2011 by the FFC to calculate local government funding constraints (FFC, 2013a). An important finding was that the capital expenditure of municipalities was characterised by a possible vertical funding gap. It seems that municipal infrastructure grants are inadequate in terms of bridging the gap that exists between own income sources of municipalities and current capital spending costs. In totality, own revenue sources, grants and borrowings are inadequate in terms of funding the required local infrastructure (FFC, 2013a). This vertical fiscal gap in municipal capital budgets is progressively widening due to local infrastructural investments and this tends to exert pressure on revenue tools funding capital expenses. The 2008 global financial crisis has impacted negatively on the South African economy and more particularly on municipalities' own revenues sources for capital expenditure.

Increasing government expenditure which is debt-funded or the debt standing of the state also impacts on the capacity of sub-national governments to generate funds, despite the national government implementing a fiscal policy which is stimulatory to counter the impact of the economic recession. Furthermore, constant downgrading of the state's credit rating due to recent socio-political and economic factors also impacts on the credit rating of the sub-national governments (FFC, 2013a). The downgrading of some metropolitan municipalities can be attributed to the recent international downgrading of the Government. These factors are increasing the cost of local government to borrow, thus hindering one of its revenue mechanisms to fund capital expenditures.

CORE REVENUE SOURCES OF MUNICIPALITIES

The most daunting task in municipal budgetary preparation is calculating the funding available. Financial sustainability challenges emanates from estimates that are too high and it is essential to budget prudently for revenues. Municipal revenues can be categorised into different groupings, for purposes of financial planning and analysis. The defining features of a principled local tax, namely equity, local control, predictability and buoyancy has to be heeded by municipal finance functionaries. Municipal revenues should preferably be controlled locally to ensure that proceeds are equitable, predictable, stable, buoyant and usable without restrictions (Farvacque-Vitkovic & Kopanyi, 2014).

Municipal revenues in some cases are predictable and constant (property taxes), while others show divergence (sale taxes). Others are reserved for certain activities (road costs), and there are no limitations. Internationally, municipalities can determine some of their own local revenue sources, but in the majority of cases they are beyond local control, for example, the Province of Wyoming's Constitution makes provision for very limited decision-making authority relative to fees and taxes (Wyoming, 2011). Mexico and other developing countries have similar challenges.

Municipal revenue can be divided into capital and current and further categorised into transfers, own and additional revenues. Taxes collected nationally and shared with the sub-national structures as in Serbia, Argentina and Turkey border on being self – initiated revenues/transfers as they generally provide a significant percentage of revenues deemed local (Farvaque-Vitkovic & Kopanyi, 2014).

Revenues deemed recurrent should be adequate to fund current (or operational) expenditures and generate an operational surplus, the proceeds of which could be used to finance capital investments directly or leverage debt. The incapacity to generate adequate revenues implies that the municipality is not viable resulting in arrears, sale of assets and use of its own resources (some United States cities have done it temporarily, following a tax revenue reduction post 2008), or being assisted financially through discretionary grants awarded by the national government (Jordan) (Farvaque-Vitkovic & Kopanyi, 2014).

Own Revenues Sources Internationally

The funds generated by municipalities are Own-source revenues (OSR's), as opposed to grants and transfers expected from the higher governmental spheres. Measuring and making a distinction is imperative to determine municipal creditworthiness, capacity and autonomy to generate revenues (Garrett & Leatherman, 2010). OSR's are also significant relative to revenue incentives and it is funding that can be projected, increased and controlled through local policymaking. Transfers and donations from the national government is important but local government does not exercise control over them and has no influence to increase them (Mahabir & Mabena, 2015).

Taxes are imposed to finance expenses generally whilst fees cover the direct expenses of a particular function or service, including *inter alia* issuing business licenses or building permits. Own-source revenues used by municipalities to fund expenditure include: general consumption/sales tax, motor vehicle tax; property tax; surcharges on utilities (water/electricity); local business tax; local personal income tax; penalties/fines; current revenue from assets, user charges, fees, permits, licences, capital revenue, and other recurrent revenues.

South African Municipal Funding Sources

The DORA (Division of Revenue Act) process is not open, despite the participation by municipalities in the equitable share process. The process is unlike municipal budgeting process, particularly in relation to participation and consultation with key stakeholders. A similar open and transparent process would be a positive development in enhancing the involvement of taxpayers and consulting them on matters of the national budget to deepen democracy (Mahabir, 2013).

The national fiscus through the Division of Revenue Act (DORA) support municipalities financially and empowers them to discharge their mandate constitutionally. Other grants are conditional while the equitable share is an unconditional grant allocated from the national government. Khumalo, Dawood and Mahabir (2013) point out that the DORA processes are regulated constitutionally in terms of Sections 214 and 227 and this acknowledges that municipalities are constrained by their taxation powers, and consequently they have to be subsidised by the national fiscus to ensure basic services provision.

The division of revenue between the three governmental spheres in 2013/14 was as follows:

Table 1: Revenue allocations to the governmental spheres in 2013/14 was as follows

R Billion	Revenue allocation	Percentage of Total
National Allocations	**452.5**	**48%**
Provincial	**414.2**	**43%**
Equitable share	337.6	35%
Conditional grants	76.6	8%
Local	**84.7**	**9%**
Equitable share	50.2	5%
Conditional grants	34.5	4%

Total	R951.4bn	100%

Source: Khumalo, Dawood, Mahabir in Kumar and Reddy (2016)

As depicted, National Government received 48%, Provinces 43% and municipalities only 9% of the total national revenue.

The sources of local government funding in South Africa are reflected in Table 2.

Table 2: Municipal funding sources

Own revenue sources	Constitutional Provision	Applicable Legislation
Rates on Property	Section 229 and 227 (2)	Local Government Municipal Property Rates Act
Surcharge on fees for services provided by or on behalf of the municipality	Section 229 and 227 (2)	Local Government Municipal Fiscal Powers and Function Act
Service charges/fees	Section 229 and 227 (2)	Local Government Municipal Systems Act; Local Government Municipal Finance Management Act; Electricity Act and Electricity Regulations Act; National Water Act; and Provincial land use planning ordinances
Other taxes, levies or duties	Section 229 and 227(2)	Local Government Municipal Fiscal Powers and Function Act
Administrative fees		Local Government Municipal Systems Act
Fines		National Road Traffic Act.
Borrowing	Section 230A	Local Government Municipal Finance Management Act
Credit control and debt collection	Section 230A	Local Government Municipal Systems Act
Transfer from national and provincial government		
Local government equitable share of nationally collected revenues	Section 214 and 227	Intergovernmental Fiscal Relations Act; and Annual Division of Revenue Act
Fuel levy sharing with metropolitan	Section 229 (1) (b)	Annual Taxation Laws Amendment Act
Conditional grants from national	Section 214 (c), 226(3) and 227(1) (c)	Intergovernmental Fiscal Relations Act; Annual Division of Revenue Act; and Annual Appropriation Act of the relevant province

Source: National Treasury in Kumar and Reddy (2016)

According to the "Review of Municipality's Own Revenue Sources" by National Treasury (2013), the principal revenue sources of metropolitan municipalities nationally are services charges/fees (66.6%); property tax (19.6%) and grants

(12.18%). Comparatively, Canadian income is derived from property tax (54.3%), user charges (16.4%) and grants (25.7%). In the case of Germany's property tax (24.1%) income is much lower than Canada, but however, close to South Africa. German local authorities are allowed to levy a trade tax and this constitutes 73.7% of their revenue (Kumar, 2016).

Swiss and American local authorities receive a share of national income tax, are allowed to levy sales tax and also derive income from property tax service charges and entertainment tax (Steytler, 2005). Most of the prospective revenue sources/ taxes are situated in South Africa, as highlighted below as the taxes have not been devolved to municipalities, implying that they are not collected and used as own sources of income:

i. Taxation on motor vehicles (provincial).

ii. Local sales tax (VAT equivalent tax levied by National Government).

iii. Local taxation on service/business (National Treasury approval for levying this tax was sought by eThekwini Municipality).

iv. Tourism/entertainment, hotel, restaurants (provincial).

Steytler (2005) has demonstrated that if the local sphere is independent, the current funding framework should be reviewed to grant municipalities power to levy entertainment and a value added tax thereby ensuring total fiscal economy and increasing their financial sustainability

Financing Gaps/ Constraints

Limited funding for local capital investment and the likelihood of such cracks widening has been an international trend in accordance with expected GDP growth rates in developing countries (McKinsey and Company, 2013). Alam (2012) adds that Asian municipalities have a projected $250 billion capital financial gap per annum over a 25 year period. An estimated $123 billion financing gap for Canadian municipalities, consisting of existing and new infrastructural investment backlogs was highlighted by Mirza (2007). This shows that funding constraints of municipalities have not been prioritised despite the growing existing and new quantum of infrastructural gaps (Kumar & Reddy, 2016).

The municipal infrastructure financing constraints evident in four countries (Uganda, Tanzania, Bangladesh and Pakistan) was qualitatively researched by Alam (2012), who also sought to identify proven alternative financing options through the use of a case study. In this context, Alam (2012:13) explained that "....limited municipal revenue-raising autonomy; inability of municipalities to fully realise the potential of own-source revenues; inadequate government transfers; limited resources for capital expenditure as a result of large operational expenses; poor municipal financial management mostly due to lack of technical expertise within municipalities and recent development of financial markets" are the limitations impacting negatively on optimal infrastructure delivery in the countries sampled.

Bagchi (in Kumar, 2014) also conducted a case study implicitly aimed at analysing challenges in funding capital expenses for basic services provision by Indian local governments. More specifically, the author qualitatively reviewed the "traditional capital financing approach" (central government allocations and the "alternative approach" (capital markets borrowing).) Bagchi (Kumar, 2014) adds that the poor financial standing of municipalities (restricted tax bases, increasing administrative/operational costs; limited use of user charges for services; fiscal powers/responsibilities limited/not autonomous; fiscal discipline lacking; capital markets underdeveloped; lengthy/complex processes in accessing capital markets requiring expertise usually not available; and undue political influences) are all constraining factors to accessing capital markets for infrastructure finance (Kumar, 2014:78).

Diagnosing the causes of the declining performance standards of the municipal bonds markets while also pinpointing constraints embedded in the financing of municipal services was researched by Banerji et al. (2013). They also indicate in their findings that autonomy; disjointed coordination in service delivery; transfer systems inappropriately structured that caused perverse incentives; poor tax collection and financial management, are constraints hindering the full realisation of own revenue generation potential by Indian local government.

The United Cities and Local Governments (UCLG, 2010) in a report mainly commissioned to identify and analyse key constraining factors on delivering equitable and efficient local government public services, also used a case study in analysing the sampled regions (Africa, Asia Pacific, Middle East and West Asia, and North America). The study identified a wide range of expenditure and financing constraints (summarised below) that were not necessarily relevant to all sampled countries concurrently, but in some, worse than others, due to uniquely differentiating factors in each of the sampled countries.

Table 3: Summary of identified local government financing constraints

Minimal Revenue Generation	Minimal revenue generation autonomy characterised by vertical fiscal imbalances (i.e. devolution of expenditure responsibilities which do not correspond with revenue sources or autonomy); unrealised revenue potential especially in the case of property taxes due to the complex and expensive nature of properly tax administration which tends to be burdensome to municipalities from developing countries with minimal capacity to properly execute the function; undiversified local tax bases (inelastic and narrow); the inability of local governments to establish fees and user charges that feasibly recover incurred costs; political influences on local revenue generation; and delayed transfers of centrally collected local revenues.
Inappropriately Structured Intergovernmental Transfer system	Inappropriately structured intergovernmental transfer (revenue sharing) system which unintentionally strengthens horizontal imbalances across municipalities; lack of transparency causing volatile municipal revenue which affect municipal long-term plans; extensive transfers which tend to disincentives municipal own-revenue generation which in essence undermines autonomy and accountability; where equalisation schemes are incorporated in the transfer system, improperly balanced transfers in terms of fiscal capacity and expenditure needs, and in some cases equalisation systems embed rigid conditions; conditional grant design tending to be complex and excessive in number, lack of transparency, unstable, vulnerable to political manipulation and tend to deviate municipalities from initial priorities.
Non–Optimal Use of Borrowings	Non-optimal use of borrowings as a financing alternative by local governments due to weakly developed and implemented borrowing frameworks (i.e. some frameworks are restrictive and disincentivising, for example, Denmark and Chile, while others are too lax thus creating perverse incentives (Argentina and Brazil); underdeveloped financial markets; underperforming specialised institutions which are dependent on government; specialised institutions improperly vetting local governments in appraisals for loan qualifications (another form of bailout) which in essence disrupts the development of credit markets and disincentivises local government's gradual reliance on private capital for financing; and, curtailed borrowing capacity as a result of uncertain, opaque central government transfer and improper financial management practices.

Source: Adapted from FFC, 2013a

The studies discussed above begin to unravel what should be part of policy discussions. However, in truly stimulating a process that enables policy implementation, a thorough understanding of the actual scope of the problem (municipal capital financing constraints) that is established through both qualitative and quantitative analysis techniques is a necessity. Minimal work has been done in quantitatively working out the extent of these capital financing constraints. National Treasury (2010) used a number of qualitative measures to assess the borrowing capacity of the six metropolitan councils in South Africa which was a methodology adapted from the World Bank approach. The approach assumes that there are two ways to estimating borrowing capital, namely the gearing factor and critical limits such as prudential limits on borrowing and debt service. Using this methodology, the study found that even with escalating debt servicing among these councils, they had low gearing ratios and acceptable debt-to-current revenue ratios on average. This implies that borrowing by metropolitan councils is a feasible financing instrument that can be utilised. However, what was neglected in this approach was the impact of the cost of borrowings on tariffs.

ADDITIONAL CAPITAL FINANCING INSTRUMENTS: SOME INTERNATIONAL EXPERIENCES

This article seeks to identify additional revenue sources that could support the financing of municipal capital expenditure for metropolitan councils. The section above explicitly indicates that capital expenditure gaps are apparent internationally and these countries are also experiencing similar constraints relative to municipal capital financing, which hinder growth prospects longitudinally. Consequently, partnerships need to be developed between sub-national and national governments to be innovative in terms of creatively developing other funding sources thereby ensuring that the potential for revenue generation is fully exploited. Table 4 summarises the municipal capital financing instruments explored in different countries (developed, less developed and developing) in addition to traditional financing approaches, such as transfers from central government, which, with specific reference to cases of success and/or distinct financing options that could possibly apply to South Africa in 2014 (Kumar, 2014).

Table 4: Alternative approaches to financing municipal capital expenditure, international experiences.

Country	Capital Financing approach (Including brief discussion)
Indonesia & Kenya	Informal taxation schemes The construction/maintenance of public services is also paid for by local residents outside the formal system. Public officials co-ordinate payments made, enforced primarily through local customs/norms. Individuals in developing countries contribute substantially to inter alia, water and roads in money/labour, with complex arrangements in determining payment and penalties for those not paying (referred to by many different names: Gotongroyong (Indonesia) and Harambee (Kenya). Informal payments can be substantial, often regressive and there is considerable diversity among countries (Alam cited by Olken and Signhal (2009).

Country	Capital Financing approach (Including brief discussion)
Applicability to South Africa	An informal arrangement of this sort will not work as the taxation systems are highly regulated and the constitutional requirements of fairness, equity and transparency will also be impeded.
India	Developing banks and financial institutions Accordingly to Alam (2010), developing banks and financial institutions are primarily established to offer long-term credit and other financing services for infrastructure projects even with the existence of municipal borrowing constraining factors such as inflated interest rates which municipalities of these banks use to evaluate borrowing risks. An example is the IDFC in India created by the government and financing institutions (foreign and domestic institution) in 1997, with the purpose of attracting private capital for infrastructure projects. It is currently offering a wide range of financing and advisory services pertaining to infrastructure projects such as debt financing; project loans; take out financing; guarantees for payment obligations and project performances; and advisory and capacity building services to both government and non-government organizations (NGOs) (through its foundation, on a not-for-profit basis).
Applicability to South Africa	The DBSA (Development Bank of South Africa) plays this role nationally and has been very successful in providing financing for capital infrastructure at rates lower than the market. Accordingly, there have been complaints from the commercial banks, resulting in the DBSA focusing on lending to the smaller municipalities over the past 3-4 years. However, in 2013-2014 DBSA indicated that they would be lending once again to the metropolitan councils and high capacity municipalities and would also be facilitating joint funding arrangements with other development banks and development agencies (e.g. AFD – French Development Bank, European Union and the World Bank.)
Municipal pooled financing	Most applicable to municipalities that are in need of capital financing from the capital market individually due to constraining factors such as poor credit ratings. This financing approach, according to Alam (2010), groups municipalities/projects with a view to attracting favourable capital financing terms from the markets, whilst reducing costs and risks. The Karnataka Water and Sanitation pooled fund in India is one such successful project managed by the Karnataka Urban Infrastructure Development and Finance Corporation (KUIDFC).
Applicability to South Africa	This has not been applied primarily due to each city having different credit ratings and the differential interest rates that would be applicable. It is certainly worthy of merit particularly for the issue of bonds and should be further explored. The DBSA could also assist in facilitating the pooling arrangements.

Country	Capital Financing approach (Including brief discussion)
Canada	Development Charges Defined according to Kitchen (2006) as charges imposed on developers to finance infrastructure projects such as local roads, street lighting and sewers as one of the municipal conditions for approval of land development. Canadian municipalities charge a fixed rate for all properties regardless of differentiating factors such as the location of property, all in an attempt to reduce administrative complexities. Kitchen (2006) indicates that this approach is not without imperfections as it has led to allocative inefficiencies. He urges that in employing development charges for capital financing, a proper capital provision pricing should be carried out as and when new development area(s) are identified, to ensure close true costs of capital projects.
Applicability to South Africa	Development charges as a funding source has great potential. Cape Town generates R147 million from this source whilst Tshwane and eThekwini Municipalities are awaiting the enabling legislation that National Treasury are developing in terms of the M.F.P.F.A. (Municipal Fiscal Powers and Function Act). eThekwini Municipality, in 2012, attempted to introduce development charges. However, the legal basis was challenged by developers and it had to be withdrawn.
United States	Municipal Bond Market It was developed in the late 1820' and categorised as one of the largest municipal bond markets globally. "The market is largely self-regulatory with market participants developing rules that govern the markets through assigning rights and responsibilities to participants as well as providing credible information to investors and the public at large. Certain bond issuances qualify for tax exemptions but discretion lies with the US Internal Revenue Service" (Blaauw and Mantso, 2009:46)
Applicability to South Africa	The bond market is developing at a very slow rate primarily due to the costs and technical expertise required in setting up the framework for a bond issue.
Brazil	Fully Privatised Function This relates to a function being fully privatised (Fox 1994) and Guthrie (2006) as cited by Alam (2010). An attempt has been made to induce competitive market forces to lower capital service provision costs while enhancing the quality of the service. Solid waste disposal and collection in Brazil is cited as an example of successful implementation of privatisation. Alam (2010) argues that key to successful privatisation are functional competitive market forces, thus implicitly arguing for government being more active in facilitating non-restrictive entry and exit conditions into markets that are privatised.

Country	Capital Financing approach (Including brief discussion)
Applicability to South Africa	The legislative framework exists for full privatisation. However, this needs to be carefully packaged as labour unions are very sensitive to privatisation. The Local Government Municipal Systems Act is very clear that local government must provide services in the most cost effective manner. Accordingly, if privatisation does not impact on jobs (staff are guaranteed redeployment) it should be pursued with a proper business case/plan, whilst taking due cognisance of the long-term impact of providing the service.
Colombia	Public Private Partnership (PPP) PPP' s can be regarded as the public sector partnering with the private sector in an attempt to mitigate the fiscal burden already borne by the government, without compromising on adequate delivery of the service. Kitchen (2006:7) indicates that in PPP's "both parties contribute funds or services in exchange for certain future rights". He further indicates that effective and ineffective PPP agreements are based on a mutual understanding of the risks and costs that are borne by both parties. The relationship is contractual and can be once-off or on going. Alam (2010) uses the Colombian Bogota TransMilenio bus system concession contract as an example of a continual PPP which was implemented in an attempt to reduce traffic congestion. It was funded by the Colombian government, the World Bank and respective transport sector stakeholders jointly and has yielded great success.
Applicability to South Africa	As with privatisation, the legislation for PPP's exists; however, it is very onerous. National Treasury has set up a help desk which has been very helpful, nevertheless, the number of PPP's being created is still too low. The Chief Procurement Office in National Treasury will possibly look at further refinement to the regulations that will hopefully streamline the process and enable easier application.

Source: Adapted from FFC (2013a)

UNFUNDED MANDATES

A contentious issue that has a significant impact on municipal financing are unfunded mandates. Co-operative governance which is distinctive, interrelated and interdependent, is a basic principle enshrined in the Constitution (Chapter 3) seeks to promote a harmonious relationship the three governmental spheres. Ensuring efficient and effective service delivery within the confines of fiscal decentralisation is an overarching goal.

The Constitution, together with secondary legislation, the Local Government Municipal Systems Act (MSA) 32 of 2000, in the spirit of cooperative governance facilitates the transfer of national and provincial functions to municipalities (SALGA in Kumar and Reddy, 2016). This arrangement is stipulated in section 156(4) and section 126 of the Constitution (1996) and emphasises that such assignments should be undertaken: (1) with the agreement of local government, (2) if such a function is delivered more efficiently in the locality, and; (3) that the municipality is capacitated to discharge the service (SALGA in Kumar, 2014). In terms of this arrangement, or otherwise, key provincial competencies presently being discharged by some municipalities are libraries, museums and primary health care. Certain services, notably roads, transport and public housing are by nature concurrent, while some are jointly discharged by all three governmental spheres. This is done in the spirit of cooperative governance, where the provision of the service is shared; however, at times the politicisation of the services results in it gravitating beyond municipal control (SALGA in Kumar and Reddy, 2016).

Whilst promoting decentralisation of powers/functions relative to service delivery, the Constitution also ensures that each sphere has revenue instruments (a combination of own revenue and grants) to fund such service delivery, under the principle of funding the devolution function. However, in cases where provinces have assigned specific provincial functions (e.g. housing) to local government as part of the legislation described above, municipalities deliver the service to communities, hence incurring the expenditure responsibility, while the revenue instrument stays with the province. The issue of the risk and additional costs associated with, for example, housing delivery is a key cause for concern relative to the effect on the financial viability of metropolitan councils (SALGA in Kumar, 2014).

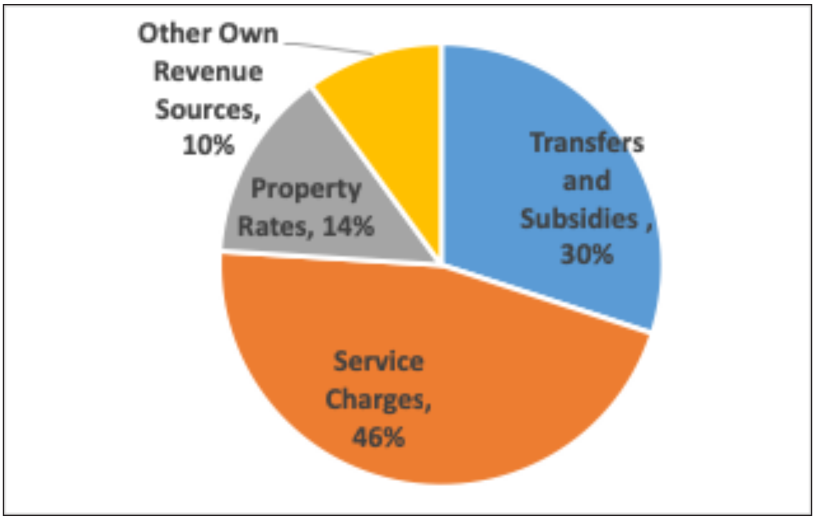
Municipalities have been allocated limited or no funding for supporting the delivery of assigned provincial functions, in some cases. This then becomes an underfunded or an unfunded mandate. Both unfunded/ underfunded mandates have compromised efficient service delivery whilst exerting unnecessary pressure on the funds of local government, as municipalities are expected to use their own funds to finance provincial functions (SALGA in Kumar, 2014). Whilst there is a comprehensive legislative framework that governs the transfer of functions to the local sphere by the national and provincial government, it is not fully or properly adhered to. This would suggest a potential challenge in the cooperative governance system envisaged in the Constitution (FFC, 2013b).

This study focused on constitutional functional assignments undertaken relative to Sections 99,126,156 and 238, pertaining to the transfer of exclusive national/ provincial functions to the local level (notably museums, libraries and primary health care). However, it is necessary to also highlight the issue of potential unfunded mandates arising through functions undertaken concurrently across the spheres. This would include the delivery of housing, public transport and roads. With greater aspects of these functions being devolved to local government through other supporting legislation, it is important that the finances to support these additional expenditure pressures are also afforded to municipalities.

AN ANALYSIS OF INCOME AND EXPENDITURE

It should be noted that expenditure and revenue vary considerably amongst the metropolitan councils given their size and cannot be compared on a like-for-like basis. This relates to the 2015/2016 financial year.

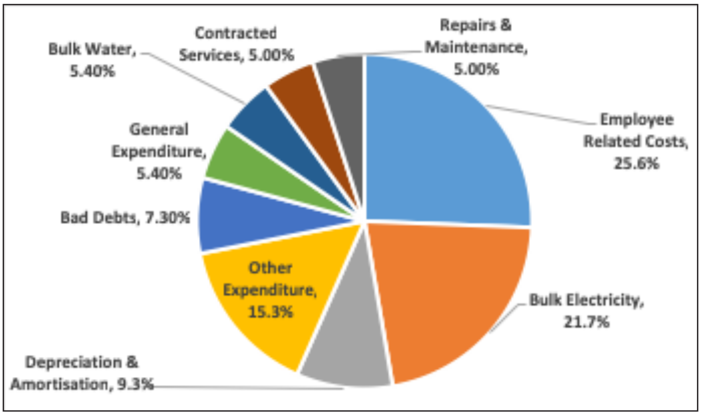
Figure 1: Major income for 2015/16 and audited outcome



Source: ESI-Africa (2018)

In 2015/2016, the main sources of revenue for municipalities in South Africa were service charges (46.1%), transfers and subsidies (30%), property rates (14%) and other own revenue sources (9.9%). Seventy percent of revenue of municipalities is self-generated. In metropolitan municipalities, it is much higher at 80% of revenue being self-generated (National Treasury, 2017).

Figure 2: Operating expenditure audited outcome for 2012/13



Source: Statistics South Africa (2016)

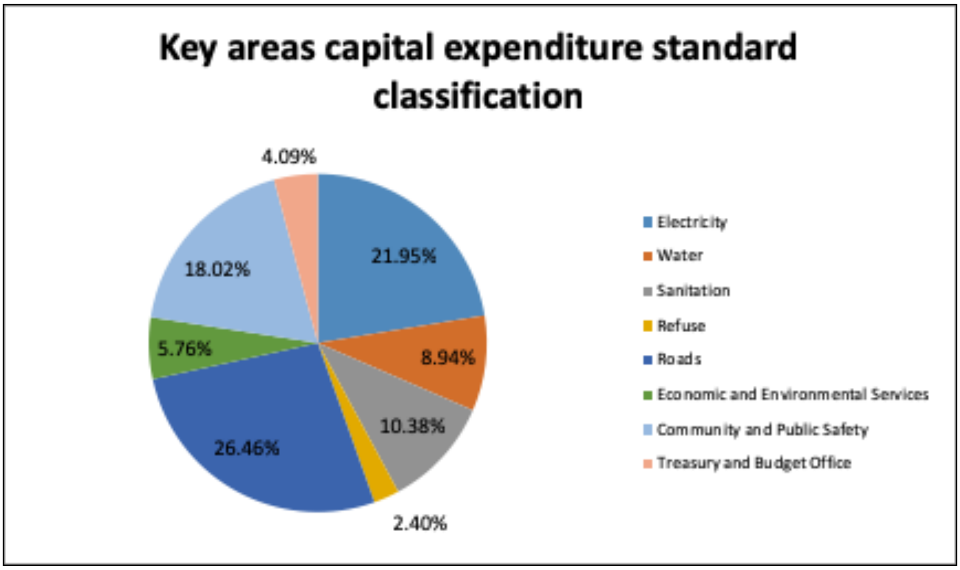
It has been demonstrated that a total of R289.3 billion was spent by municipalities in 2015/2016. The major contributor to total operational spending of municipalities was employee-related costs (25.6%), trailed by purchases on electricity (21.7%), depreciation/amortisation (9.3%), other expenses (15.3%) (includes loss on disposal of property, plant and equipment, collection costs, impairment loss, interest paid, grants & subsidies paid and remuneration to councillors), bad debts (7.3%), general expenses (5.4%) (includes inter alia, travel and subsistence costs, accommodation, bank charges, audit fees, professional/consultancy fees, fuel/oil, equipment hire, subscriptions and membership fees, insurance costs and costs of telecommunication), water purchases (5.4%), contracted services (5.0%), and repairs and maintenance (5.0%).

Table 7: Key areas capital expenditure standard classification 2012/13 audited outcome

METROPOLITAN COUNCIL	ETHEKWINI	CAPE TOWN	JOHANNESBURG	EKURHULENI	MANGAUNG	NELSON MANDELA BAY	TSHWANE	BUFFALO	TOTAL	%
	2012/13	**2012/13**	**2012/13**	**2012/13**	**2012/13**	**2012/13**	**2012/13**	**2012/13**		
R thousands	Unaudited outcome	Unaudited outcome	Unaudited outcome	Unaudited outcome	Unaudited outcome	Unaudited outcome	Unaudited outcome	Unaudited outcome		
Electricity	606,097	1,118,172	1,268,807	283,957	161,601	100,873	700,031	76,686	4,316,224	21.95%
Water		278,099	655,890	142,967	154,698	256,397	203,484	66,924	1,758,459	8.94%
Sanitation	669,317	272,043		77,359	109,958	152,639	662,084	98,613	2,042,013	10.38%
Refuse	139,732	199,201	22,277	40,478	13,438	1,106	41,383	15,147	472,762	2.40%
Roads	208,276	2,244,607	379,176	535,608	188,348	216,960	1,309,060	121,817	5,203,852	26.46%
Treasury & Budget Office	657,819	9,762	3,469	125,518	2,781	2,032		2,035	803,416	4.09%
Community and Public Safety	398,074	891,466	737,328	339,225	41,071	151,669	942,754	42,662	3,544,249	18.02%
Economic and Environmental Services	691,331	50,500	83,249	38,525	42,647	129,873	31,761	64,941	1,132,827	5.77%
Other	124,070	5,408	-5,594	16,633	697	7,350	242,167	1,338	392,069	1.99%
Total	**3,494,716**	**5,069,258**	**3,144,602**	**1,600,270**	**715,239**	**1,018,899**	**4,132,724**	**490,163**	**19,665,871**	100%

Source: National Treasury, 2013a.

Figure 3: Key areas capital expenditure standard classification audited outcome 2012/13



Source: National Treasury (2013b)

Figure 3 indicates that 70.13% of capital expenditure is spent on basic infrastructure for electricity, water, sanitation and roads and refuse removal. Expenditure on community and public safety amounts to 18.02% and comprises expenditure relative to housing, health, public safety, social/community services, sport and recreation. It should be noted that R1.9billion was spent on housing whilst R206 million was spent on primary health care notwithstanding that these are not municipal functions and as such are unfunded mandates. The high spend on basic infrastructure is a clear indication of the commitment by metropolitan councils to eradicate the service delivery backlogs.

SMART CITIES

The global population (3.6 billion people) living in cities is increasing alarmingly and it is anticipated that more than 60% of the global population (5 billion people) will be residents of cities by 2030. In South Africa the projection as indicated earlier, is that it will be 70% (Kumar, 2014). Accordingly, the strategy of government and cities to address growing urbanisation is vital to all stakeholders, especially citizens (McKinsey & Company, 2013).This is clearly a global issue and applies equally to South Africa.

The increase from 3.6 billion to 5 billion people living in the cities will increase the world's economic growth very rapidly. Even cities in developed countries grapple with issues of ageing infrastructure and budgets are under pressure as their growth prospects are poor. This highlights the challenges faced by South African metropolitan municipalities as they try to be competitive and cost effective as possible, but at the same time endeavouring to enhance living standards of their citizenry (McKinsey & Company, 2013). Moreover, there is some understanding of the environmental impact of expanding their economies in ways that are unsustainable and not resource-efficient.

The performance of a city has to be measured relative to environmental/socio-economic impact. However, cities can change. For example, Singapore changed from a colonial harbour to a world-class city in just a few decades, as well as New York's rise to a world-class city following the economic recessions of the late 1960s and 1970s. Three common drivers of change can be identified, namely, achieving smart growth, becoming more efficient, effective and economical and change management (Future Cities Catapult, 2017).

Cities generally would like to grow their economies, however; this does not necessarily result in a better quality of life for citizens as there are environmental impacts. Not all growth can be deemed good. Consequently, there is a need to determine what smart growth is all about. This is clearly evident in a number of examples amongst South African cities. When the eThekwini Municipality declared it wanted to be the eventing capital nationally, as this would impact on growth and more specifically tourism and job creation, this was opposed by the local residents who felt that it would impact on their quality of life with the inconveniences of traffic congestion and road closure. Construction of the ICC (International Convention Centre) Moses Mabhida Stadium and Ushaka Marine Theme Park were also not viewed positively in terms of their multiplier effects on the economy, but rather the deficits that they incur. The ICC has of late after ten years of operation made a profit over the past two financial years.

To achieve smart growth, a city needs to develop a strategy that facilitates an integrated and co-ordinated approach to developing growth opportunities identified. This requires good planning. Initially, the city competitive advantage must be identified in terms of sectors that can stimulate growth.

PUBLIC–PRIVATE PARTNERSHIPS IN URBAN AREAS

Agreements between municipalities and businesses or other private entities to provide infrastructure, facilities and other services are generally referred to as public–private partnerships. This partnership includes costs sharing, risks/duties and rewards. There are a number of reasons for establishing these relationships. The White Paper on Municipal Service Partnerships (2000) accepts the failure of local government sometimes to deliver effective and efficient services, thus there is a need for partnerships between municipalities and the private sector to deliver the services concerned more efficiently, effectively, and economically (Bruchez, 2014). The main benefit of such a partnership is that municipalities and the private sector have different strengths and weaknesses and hence they are able to complement one another very well (Van Der Walt, 2014). For the partnership to be successful, both the municipality and the private entity must complement one another, so that the weaknesses of the one are complemented by the strengths of the other. Both the public sector (metropolitan councils) and the private sector have weaknesses and strengths, and a complementary relationship can only benefit local communities. When entering into partnerships, specific roles and responsibilities are created, and these vary from project to project. But despite this, the basic roles and responsibilities of metropolitan councils do not change (Van Der Walt, 2014).

Metropolitan councils have not maximised the use of public-private partnerships (PPPs) primarily due to the cumbersome legislative requirements. However, National Treasury has introduced technical support that may assist in improving the number of projects that could be funded by PPP's (Van Der Walt, 2014). A similar apathy is evident for the African continent with telecommunications (70%), energy (18%) and transportation (11%) being the key sectors, and regrettably water and sanitation only comprising 2%. There are only 40 PPP projects to date in South Africa (Van Der Walt, 2014).

CONCLUSION

A significant portion of the financial resources of metropolitan councils nationally are derived from service charges, property taxes and other own revenue generated, whilst grants only account for 12% of total income. Whilst substantial strides have been made in eradicating service delivery backlogs, there is still no or limited access to basic services in many municipal jurisdictions. Capital financing instruments based on international experiences need to be further explored to accelerate service delivery. However, this must not impact on sustainability of local authorities as well as affordability of tariffs and taxes.

Unfunded mandates, whilst reducing, are still a cause for concern. In addition, the impact of urbanisation is causing a further strain on local government. A system of financial equalisation, both vertically to municipalities and horizontally (between municipalities) will ensure greater financial sustainability. There is a need to target smart growth that balances economic development and the impact on the environment and communities. Public-private partnerships also must be explored in terms of an alternate service delivery mechanism that reduces the financial burden on metropolitan councils.

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