

**PANEL:  
THE EVOLVING ROLE OF LOCAL GOVERNMENT  
IN THE IGFR SYSTEM**

**Local Government Asymmetry and the  
Intergovernmental Fiscal System in South Africa**

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## **Abstract**

This paper describes the historical processes that resulted in the considerable socio-economic disparities that are found in South Africa. Owing to the spatial orientation of much of apartheid policy, these disparities have a distinctive geographic form, with significant socio-economic contrasts within rural and urban areas and between urban and rural areas more broadly. It was inevitable that these disparities would find expression in asymmetrical circumstances in municipalities, particularly the contrasting conditions of municipalities located in the former “white” South Africa on the one hand and the former bantustans on the other.

It is the purpose of this paper to understand the various facets of this asymmetry and the challenges it poses for the system of local public finance. The paper first explains how the asymmetry developed over time and describes its specific ramifications with respect to systems of local governance and finance. The paper then summarises the various local government reform initiatives and assesses their success in addressing the issue of asymmetry, and finally it outlines some challenges that remain.

## **1. Introduction**

The historical processes that shaped South Africa have left their deep imprint on the physical landscape. This is no more apparent than when one travels across the country: from urban to rural areas, from commercial farmland to ex-bantustan areas, from affluent suburbs to sprawling shacklands. This is the essence of South Africa, past and present.

These disparities are characterised by significant differences in levels of economic activity and poverty, access to capital and social infrastructure, and patterns of land settlement and ownership. A term that captures these differences is “asymmetrical development”, which denotes that different regions of South Africa are at different levels of development, owing largely to deliberate government policy under apartheid.

It is the purpose of this paper to understand the various facets of this asymmetry and the challenges it poses for the system of local public finance. The paper first explains how the asymmetry developed over time and describes its specific ramifications with respect to systems of local governance and finance. The paper then summarises the various local government reform initiatives and assesses their success in addressing the issue of asymmetry, and finally it outlines some challenges that remain.

## **2. Differential development in South Africa**

### **2.1 Laying the founding: History to 1948**

There were significant movements of peoples throughout the Southern African region in the centuries leading up to the establishment of the first permanent European settlement at the Cape in 1652. The Europeans were another group vying for resources, but their military technology enabled them to dominate with respect to access to land and resources. By the early 1800s, most of the original inhabitants of the Cape – who had relied primarily on pastoral activities – had been subsumed into the economy of the Europeans.

As European settlers continued their expansion into the interior of South Africa and the mining industry began to develop, more and more black South Africans<sup>1</sup> were drawn into the colonial economy. Mining in particular encouraged the migration of rural dwellers to the cities hoping to find employment. This migration was reinforced by various colonial policies in the countryside. For example, many African households were required to pay an annual hut tax, and the money to pay the tax could only be earned if one earned wages within the white-controlled<sup>2</sup> economy.

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<sup>1</sup> In this paper, the terms “black South Africans” and “blacks” refer to people who were historically disenfranchised until 1994 (with the exception of a period in the old Cape Colony), and includes people classified under apartheid as African (or “Bantu”), Coloured, and Asian (usually Indian). The term “white” refers to people of European background who settled in what is now South Africa, and who were classified as “white” under apartheid.

<sup>2</sup> See footnote 1 above.

By 1910, white people dominated the indigenous inhabitants of South Africa. Coloured people, whose ancestors included the indigenous hunting and herding inhabitants of the western part of Southern Africa, owned little land compared to many Bantu-speaking African farmers, who were still able to practice subsistence farming in reserves proclaimed by the colonial governments or on land bought from whites.

In subsequent years, however, the government applied a comprehensive programme of racial segregation and discrimination and gained control over the African peasantry. The government enforced laws that limited land ownership by Africans to demarcated reserves, transformed blacks who lived in rural areas outside the African reserves into tenant labourers for white farmers, and ensured white dominance in the industrial cities and rural townships.

A significant turning point in the history of South Africa was the enactment of the Natives Land Act in 1913. The Act stipulated that seven percent of the area of the Union of South Africa constituted the "Native Reserves," and it prohibited Africans from purchasing land outside the reserves from people who were not Africans. In 1936, new legislation created the South African Native Trust, managed by whites, which allowed for more land to be bought for Africans from funds provided by Parliament. By 1939, the trust purchases had brought the augmented African reserves to 11.7 percent of the area of South Africa.

These African reserves were scattered throughout the eastern half of the country. The Transkei was the only substantial block of African territory in South Africa. Elsewhere, even in Zululand, whites had acquired legal title for much of the best land, whereas the Republican governments of the Orange Free State and the Transvaal had set aside relatively little land for the exclusive use of Africans.

In the ensuing years, the African reserves declined as a result of the huge concentration of people and livestock. The original vegetation deteriorated, streams and waterholes dried up, and soil erosion spread. The state network of railways and roads served the white farmers but neglected the reserves, and the government provided massive assistance to white farmers but scarcely any to Africans.<sup>3</sup>

The government left African education to the missionary societies, whose resources were very limited. The reserves were essentially being transformed into pools of low-cost, unskilled labour for white farmers and industrialists.

Besides dividing the country into white-owned and African-owned land, the Natives Land Act contained clauses designed to reduce all Africans in white-owned rural areas into tenant and wage labourers. The Act prohibited Africans from paying rent to absentee landlords or from having the use of part of a white farm and sharing the produce with the owner. The most hardship was experienced in the Orange Free State, where many farmers evicted Africans from their land immediately after the Act was passed. The South African rural economy thus developed unique characteristics as the government imposed a policy of racial segregation.

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<sup>3</sup> L. Thompson (2001). *A History of South Africa*. Third Edition. London: Yale University Press, pages 164 – 165.

South Africans increasingly moved to the cities after 1910, especially Johannesburg, Cape Town, Durban, Pretoria and Port Elizabeth. They included whites who lost their land in the South African (Anglo-Boer) War or could not cope with the increasing commercialisation of agriculture, and Africans who were unable to survive in the reserves. According to the official census of 1936, the urban population numbered more than 3 million and comprised 31 percent of the total population. Of this, about 1.3 million were classified as White, 1.1 million as African, 400,000 as Coloured, and 200,000 as Asian.<sup>4</sup>

The government tried to control the flow of Africans into the cities with a complex system of pass laws. Certain pass laws were crafted to ensure that white farmers should not lose their African labourers. Other laws were designed to prevent Africans from living in towns, except as labourers for whites.

The government tried to segregate Africans within the urban areas. By 1910, there were laws in the Cape Colony, Natal, and the Transvaal authorising the colonial governments to create and control urban “locations” for Africans. However, many townships, particularly in the larger cities, had areas where white and black lived next to each other.

The concentration of people in the urban areas led to slums, increased crime, and disease. In 1923, the Smuts government enacted the Natives (Urban Areas) Act, which empowered an urban authority to establish an African location. The government could then order all Africans in that town, except domestic servants, to reside in the location.

Over the years, South African towns acquired a characteristic dual form. The largest and most conspicuous part was a spacious modern town, consisting of a business sector where people of all races worked during the day and suburbs of detached houses, ranging from opulent to mediocre, owned by white families and served by black domestic workers. Separated from the modern town was a black location, where mud, clapboard, or corrugated iron buildings, with earth latrines, stood on tiny plots of land and were served by water from infrequent taps along unpaved paths and roads.

### 2.1.1 Impact of Segregation Policies on Local Government

It is evident that the events of the segregation era began to divide South Africa into distinct racial, class, geographic, and other lines. The white population was economically affluent. Most of the economy’s income accrued to them as they were allowed the best employment opportunities and received support from the government. As a result, they lived in well-developed and serviced areas, maintained by their privileged revenue base.

In contrast, blacks were discriminated against and were subject to laws that preserved their subordinate living standards. Consequently, the areas in which they resided were underdeveloped with little service provision.

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<sup>4</sup> *Report of the Native Laws Commission, 1946 – 1948*. U.G: Pretoria (known as the Fagan Report).

Due to population growth, there was extreme overcrowding in the designated African locations, and this resulted in a number of informal settlements being established on the fringes of cities. The following section describes how the apartheid government sought to address this problem and further implement and enforce laws that contributed to the current asymmetry in local government.

## 2.2 The Apartheid Era

After 1948, when the National Party was elected to power, it used its dominance in the governmental system to fulfil Afrikaner ethnic goals as well as white racial goals. Simultaneously, it systemically abolished every trace of black participation in the central political system.

Much of the National Party's initial legislation coordinated and extended the racial laws of the segregation era and strengthened the administration of those laws. The term *apartheid* soon developed from a political slogan into a harsh, systematic programme of social engineering.

The National Party government applied apartheid in a number of laws and executive actions. The apartheid system was based on four central ideas:<sup>5</sup>

1. The population of South Africa comprised four racial groups – White, Coloured, Indian, and African – each with its own inherent culture.
2. Whites were entitled to have absolute control over the country.
3. White interests should prevail over black interests.
4. The white racial group formed a single nation, with Afrikaans- and English-speaking components, while Africans belonged to several distinct nations. This formula made the white nation the largest in the country.

The following is a selection of apartheid laws enacted by the government:

- Group Areas Act of 1950: Forced physical separation between races by creating different residential areas for different races. Led to forced removals of people living in "wrong" areas, for example Coloureds living in District Six in Cape Town.
- Prevention of Illegal Squatting Act of 1951: Gave the Minister of Native Affairs the power to remove blacks from public or privately owned land and to establish resettlement camps to house these displaced people.
- Bantu Authorities Act of 1951: Provided for the establishment of black "homelands" and regional authorities and abolished the Native Representative Council.
- Natives Laws Amendment Act of 1952: Narrowed the definition of the category of blacks who had the right of permanent residence in towns.
- Natives (Abolition of Passes and Co-ordination of Documents) Act of 1952: Commonly known as the Pass Laws, this ironically named Act forced black people to carry identification with them at all times. No black person could leave a rural area for an urban one without a permit from the local authorities.
- Bantu Education Act of 1953: Mandated the development of a curriculum that suited the "nature and requirements of the black people". Africans were to receive

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<sup>5</sup> As outlined in Thompson, *A History of South Africa*, page 190.

an education designed to provide them with skills to serve their own people in the bantustans or to work in labouring jobs under whites.

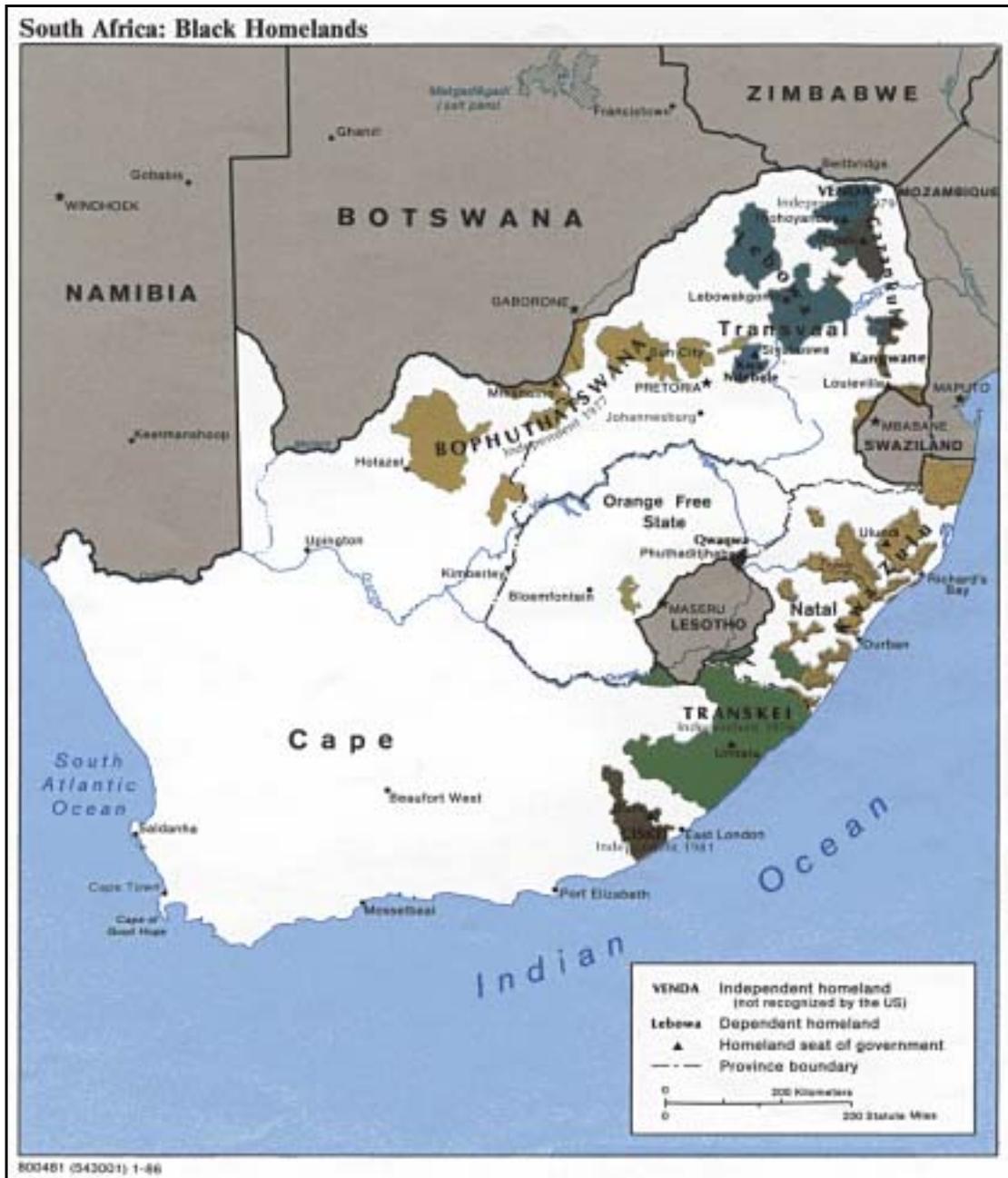
- Promotion of Bantu Self-Government Act, Act No 46 of 1959: Classified black people into eight ethnic groups. Each group had a Commissioner-General who was tasked to develop a bantustan for each ethnic group, which would be allowed to govern itself independently.
- Bantu Homelands Citizens Act of 1970: Compelled all black people to become a citizen of the “homeland” that corresponded to their ethnic group, regardless of whether they had ever lived there, and removed their South African citizenship.

Apartheid incorporated rigid controls over all black South Africans, who were forced into the bantustans, apart from those needed by the white employers as labourers. The government removed African squatters from illegal camps near the cities, placing those who were employed in segregated townships, and sending the rest either to the bantustans or to the farms where the white owners required their labour.

The map below shows the location of the bantustans.<sup>6</sup>

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<sup>6</sup> Available online: <http://1uptravel.co.m/worldmaps/south-africa10.html> (June 2004).



The Transkei was the first to become “independent” in 1976, followed by Boputhatswana (1977), Venda (1979), and Ciskei (1981). Virtually every bantustan was made up of several pieces of land, separated by white-owned farms. For example, Boputhatswana had nineteen fragments, with some being many kilometres apart, and KwaZulu comprised twenty-nine major and forty-one minor fragments.

The forced removals caused an overpopulation problem in the bantustans. The 1950 census indicated that 39.7 percent of the African population lived in the bantustans, and in 1980 this figure rose to 52.7 percent.<sup>7</sup> While the South African economy prospered in the 1950s and 1960s, the bantustans remained economically stagnant.

<sup>7</sup> L. Thompson, *A History of South Africa*, pages 194–195.

Investing in the bantustans was forbidden and the governments of the bantustans depended on subsidies from the central government.

Despite all the removals to the bantustans, the African, Coloured and Asian population of the towns continued to increase under apartheid, and they were not allowed to own or occupy land in the white areas. Dormitory townships outside white towns were built for Coloured and Asian people (such as Atlantis in Cape Town and Phoenix in Durban), and African townships were generally located even further away. The apartheid government declined to build sufficient houses to accommodate the growing numbers, especially in African townships.

Apartheid planning distorted urban areas through separating black townships from the city centre, industrial areas, and wealthy suburbs. These townships hardly had any social amenities or places to work. As a result, township residents had to travel long distances to access their amenities or their workplaces. Black townships within the city were further characterised by insufficient land, overcrowded housing, minimal service delivery or investment in infrastructure, lack of access to social services and facilities, and lack of formal economic activity.

Historically, most local government revenue in urban South Africa was self-generated, largely through property taxes and the delivery of services to residents and businesses. White municipalities benefited from this as they had small populations to serve and large concentrations of economic resources to tax. Apartheid regulations banned most retail and industrial developments in black areas. This limited the revenue base and forced residents and retailers to spend most of their money in white areas.

The 1980s gave rise to growth in the manufacturing sector, which began to progressively challenge the mining sector for superiority. As opposed to the mining sector, the manufacturing sector demanded a more sophisticated workforce. These developments compelled the apartheid government to adopt a policy of “orderly urbanisation” in 1986. This policy allowed for expanded but controlled African migration into the cities.

Together with its new urban policy, the government followed international privatisation trends and abandoned its previous role of direct housing provider in townships. The result was further expansion of shack settlements around South African cities, with peri-urban settlements growing rapidly.

During the 1980s, African townships within the city were governed by Black Local Authorities established by the apartheid government. However, the revenue base within townships was limited because property ownership and economic activity had been prohibited by apartheid legislation. Without recourse to traditional sources of municipal finance, Black Local Authorities were compelled to raise revenue through increasing rent, transport, and service charges. This resulted in extensive rent boycotts and other forms of civil disobedience in the townships. Concurrently, investment in infrastructure and service delivery in the townships remained negligible.

### **2.3 The legacy: impact of segregation and apartheid on local governance and finance**

On a practical level, the following were the consequences of colonial, segregation, and apartheid policies:

- Blacks were deprived of a wide range of employment and education opportunities, thus relegating the majority of them to relatively low-paid wage labour.
- By restricting urban black people to residential areas that were expected to be largely self-financing, black residential areas were characterised by poor infrastructure and limited tax bases owing to the low incomes of residents.
- The increasing concentration of people in the bantustans led to significant environmental degradation, making subsistence agriculture difficult. The new bantustans effectively became reservoirs of labour for white South Africa.
  - As with black urban areas, the social and capital infrastructure of bantustan areas was generally very poor and significantly inferior to that of “white” South Africa. Electricity, running water and sanitation, public telephones, and parks were rare.
  - By contrast, white South Africans were provided with excellent public services such as schools, hospitals, parks, public transport, roads, water and sanitation, electricity, and telephones.
- In terms of local governance, each bantustan was administered by black authorities (mainly hereditary chiefs), who governed under the ultimate authority of the central white government. In urban areas, the government established local councils whose effectiveness was compromised by association with the white government. There were thus no legitimate institutions able to organise the financing of service provision and maintenance of urban facilities.

### **2.4 Challenges for systems of local governance and finance**

The asymmetry with respect to different settlement patterns and levels of development has posed particular challenges in the area of local government finance and public finance more generally. These challenges are as follows:

- The significant distances between black residential areas and the areas in which black people work and shop require substantial, on-going transport subsidies. These distances are a feature of both urban and rural areas: in urban areas, the (relatively impoverished) African, Coloured, and Indian townships are far from city centres, and in rural or semi-rural areas, “dormitory townships” (usually located in the former bantustans) are far from the urban centres to which residents must commute on a daily or weekly basis.
- The various influx control measures applied to the black population of South Africa slowed down the rate of urbanisation that would otherwise have occurred. With the significant increase in people resident in urban areas, significant

pressure on urban townships has resulted in vast shack settlements and their attendant problems (e.g. on health).

- Furthermore, the forcible removal of black people to bantustan areas meant that where housing and other infrastructure was installed (albeit of a low quality), it was far from economic centres.
- Taxable economic resources are concentrated in the formerly white areas, requiring redistribution between and within local areas. As noted above, commercial and industrial infrastructure was located in formerly white areas, while black areas suffered from deliberate under-investment owing to apartheid legislation. In addition, black people were in most cases prevented from owning land, such that the rates base in black urban areas was significantly under-developed. The main consequence was that the ability of residents in black residential areas to pay for services and pay (property) tax to support the general development of their communities was compromised owing to their limited economic and land ownership opportunities under apartheid.
- Similarly, the local tax base in rural areas has been significantly under-developed owing to the lack of economic activity in the bantustan areas. In addition, freehold title of land was limited to some bantustan towns, with rural land either falling under the jurisdiction of traditional authority or being subject to complicated land holding arrangements in “betterment” areas.

This is vividly demonstrated by the revenue per capita of a major local government revenue source, namely regional levies. These are levies on the total wage bill and turnover of business enterprises, and as such they are a good reflection of economic activity in a region. The table below provides a list of the metro / district municipalities with the ten highest and five lowest per capita levy income in South Africa:

Rank	Municipality	Province	Per Capita RSC Income (Rands) 2002/03
1	Johannesburg Metro	Gauteng	325
2	Cape Town Metro	Western Cape	226
3	Tshwane Metro	Gauteng	205
4	Ekurhuleni Metro	Gauteng	169
5	Nelson Mandela Metro	Eastern Cape	148
6	Nkangala District	Mpumalanga	127
7	Boland District	Western Cape	124
8	Sedibeng District	Gauteng	114
9	Ethekwini Metro	KwaZulu-Natal	104
10	West Rand District	North West	99
49	OR Tambo District	Eastern Cape	13
50	Chris Hani District	Eastern Cape	13
51	Zululand District	KwaZulu-Natal	13
52	Greater Sekhukhune District	Limpopo	10
53	Umkhanyakude District	KwaZulu-Natal	4

As the table demonstrates, the per capita regional levy income is highest in the metros and in districts situated in the former “white” South Africa. Significantly, the districts with the lowest per capita levy income are those incorporating

substantial portions of ex-bantustans: OR Tambo district municipality includes large parts of the old Transkei, Chris Hani includes parts of the former Ciskei and Transkei, Zululand and Umkhanyakude district municipalities include large sections of the former KwaZulu, and Greater Sekhukhune includes much of the former Lebowa.

- It follows that the level of infrastructure – both the quality and quantity – varies considerably between areas that were formerly demarcated as “white” or “black” areas (whether urban or rural). This applies to both capital infrastructure, such as roads and buildings, and social infrastructure, such as equipment and human resources required to deliver quality health and education services. This has had three major effects:
  - Backlogs in service infrastructure in the historically underdeveloped areas require municipal expenditure far in excess of the revenue currently available within the local government system;
  - The human, institutional, and capital infrastructure backlogs are significant, especially in ex-bantustan areas. There are substantial variations in capacity, with some municipalities having little or no pre-existing institutional foundations to build on. This poses considerable challenges for the eradication of these backlogs. It also raises the question as to the optimal investment plan for eliminating the backlogs, given the location of economic activity;
  - On the other hand, the significantly better-quality social and other infrastructure in urban areas has encouraged people living in rural areas to spend much of their time in urban areas.

The following section will outline the various local government reform initiatives and will assess the extent to which they have been able to address these challenges.

### **3. Addressing the asymmetry: ten years of local government reform**

Since the end of the apartheid era, South Africa has been reforming its local government system – like the rest of its governance policy – along non-racial lines. This process involved reforms such as the abolition of racially demarcated local authorities, South Africa's first democratic local elections in 1995, and the publication of a White Paper on Local Government in 1998. An underlying aim of the reform process was to address the inequities perpetuated under apartheid. As noted in the White Paper of 1998,

Local government has been given a new constitutional mandate to create and sustain humane, equitable and viable human settlements. It is doubtful whether local government – as presently designed – is adequately equipped to fulfil this developmental mandate. Local government has been democratised, but the local government system is still structured to meet the demands of the previous era. A fundamental transformation is required.<sup>8</sup>

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<sup>8</sup> The White Paper on Local Government, 9 March 1998.

This section of the paper assesses how the reforms have addressed the issue of asymmetry. In doing so, the paper evaluates the main reform initiatives implemented in the transformation of local government.

### **3.1 The transition process**

The local government transformation process took place in three stages:

The Pre-interim Phase (1993 – 1995): Pre-interim councils were established and took decisions necessary to sustain governance and service delivery during that period of transition. This phase focused more on the democratisation of local government than on its transformation.

The Interim Phase (December 1995 - December 2000): In the interim phase three important developments shaped the transformation of local government:

- First, the form and structure of the new system of democratically elected transitional councils was tested in practice.
- Second, a new policy framework for local government was designed. This was reflected in the Constitution (1996) and the White Paper on Local Government (1998).
- Third, new laws were enacted to implement the Local Government White Paper and re-demarcate local government boundaries. The legislation included the Local Government Municipal Structures Act of 1998, the Local Government Municipal Systems Act of 2000, and the Local Government Municipal Demarcation Act of 1998, all of which are discussed below.

The Final Phase (December 2000 – onwards): In the final phase of the transition, Government has sought to strengthen policy frameworks necessary for service delivery. During this consolidation phase, the systems and practices of developmental local government are being consolidated in municipalities.

### **3.2 The vision for a new system of local government**

The local government reform process set about to address comprehensively the inequities perpetuated under apartheid. The two most significant documents in this regard are the Constitution and the Local Government White Paper.

#### **3.2.1 The Constitution**

The drafters of the Constitution took the view that local government in South Africa should be regarded not as a “third tier” of government established by statute, but rather as a sphere of government that receives its mandate, powers and functions directly from the Constitution. As a sphere of government, local government is distinctive from, yet interdependent and inter-related with, provincial and national government.

Section 152 of the Constitution of 1996 mandates local government to:

- Provide democratic and accountable government for local communities;
- Ensure the provision of services to communities in a sustainable manner;
- Promote social and economic development;

- Promote a safe and healthy environment; and
- Encourage the involvement of communities and community organisations in the matters of local government.

Section 155 of the Constitution classifies municipalities into three categories, namely Category A (metros), Category B (local municipalities falling within Category C / district boundaries), and Category C (a district including more than one local municipality).

The Constitution thus provided the foundation for addressing the extreme spatial inequalities that characterised South Africa. It did so in the following ways:

- Municipal councils are democratically elected, thus representing all the residents in their jurisdiction rather than a privileged minority; and
- All municipalities have a developmental mandate, which requires them to actively address the socio-economic disparities within their boundaries.

### 3.2.2 Local Government White Paper

The White Paper on Local Government of 1998 gave content to the constitutional vision of development local government. It included the following:

- An outline of the challenges facing municipalities, such as skewed settlement patterns, concentration of taxable resources in formerly white areas, infrastructure backlogs, spatial separation, lack of urban and rural linkages, and variations in capacity;
- A detailed vision for addressing these challenges, namely democratising, redistributing resources, promoting social development and economic growth, developing mechanisms for integrated planning, and investing in infrastructure;
- A vision for the institutional and administrative systems required to realise the vision (such as service delivery approaches and performance management systems);
- Proposals for new municipal structures that would combine previously (racially) separated jurisdictions (“one-tier” metropolitan local government, urban areas that included their informal fringe settlements, and amalgamated urban and rural areas); and
- Proposals for an intergovernmental fiscal system that would be based upon the principles of equity and redistribution (building on the concept of “one city, one tax base”).

The White Paper marked a significant milestone in the development of local government in South Africa as it made provision for “wall-to-wall” municipalities across South Africa. In effect, this meant that municipalities would encompass the former “white” South Africa as well as the bantustan areas, and that the integration of the rural and urban economies would be facilitated.

### 3.3 Implementing the vision

The vision outlined in the Constitution and the Local Government White Paper was given effect through a number of key pieces of legislation and through the intergovernmental transfer system. These are outlined and assessed below.

### 3.3.1 Municipal Demarcation Act

The Municipal Demarcation Act of 1998 was the first piece of legislation to give effect to the proposals outlined in the Local Government White Paper. It provided for the establishment of the Municipal Demarcation Board and specified a wide range of criteria to be taken into account by the Board in its determination of municipal boundaries. Among others, these criteria include:

- Patterns of human settlement, and existing and expected land use;
- The mobility of people in an area, i.e. their employment, commuting and transport movements;
- Facilities and infrastructure;
- Factors related to the promotion of integrated areas and avoiding sprawls and fragmentation;
- Financial and administrative viability; and
- Areas of traditional authority.

The Board was also tasked with reducing the overall number of local authorities in South Africa. The number of local government bodies in South Africa was reduced from 1200 to 843 in 1993, and during the demarcation process in 2000 the 843 municipalities were further reduced to 284 municipalities (6 metropolitan, 231 local, and 47 district municipalities).<sup>9</sup> Many existing municipal authorities were amalgamated (on average, between 3-5 municipalities), and urban boundaries were expanded to include their rural hinterland.

Although a range of criteria was taken into account in determining the boundaries, the overall impetus was to ensure that there was a redistribution of resources. These resources were taken to include human resources, institutional capacity, infrastructure, and revenue base. In this way, the significant socio-economic and development disparities outlined in section 2 above were quite comprehensively addressed in one stroke, with each new municipal entity typically comprising rural and urban, rich and poor, and economically well-developed and under-developed areas.

However, the actual demarcation of municipalities was based upon the assumption that redistribution should be effected through all-encompassing boundaries, rather than through the transfer system. If two municipalities have significantly differing proportions of low-income residents, then the intergovernmental fiscal system should assess the differences in expenditure need and revenue-raising capacity and allocate resources accordingly. While it is too soon to evaluate the efficacy of current boundaries, it may well be that the significantly enlarged municipalities will struggle to cope with the widely divergent circumstances of the vast areas under their jurisdiction.

### 3.3.2 The Municipal Structures Act and amendments

The Municipal Structures Act of 1998 clarified the status of municipalities and determined the appropriate division of powers and functions between local (Category B) and district (Category C) municipalities. The role of district municipalities was to

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<sup>9</sup> There are sparsely populated areas within a district municipality that do not fall within the area of a local municipality. These areas are referred to as District Management Areas (DMAs).

facilitate co-ordinated planning in the district and to deliver services that were district-wide (such as district roads). Local municipalities were tasked with basic service delivery (such as water, sanitation, refuse removal, electricity distribution, and municipal health services), although the district was required to deliver these if a local municipality lacked the capacity.

The Structures Act was amended in 2001, transferring four key service functions to district municipalities (namely water and sanitation services, electricity distribution, and municipal health services). While the status quo for electricity was subsequently retained (that is, local municipalities have continued to be the service authorities), a process was embarked upon to assess the capacity of each district and local municipality to determine where the three functions should lie.

The results are quite striking, for with some exceptions, the division of functions between district and local municipalities – and hence their service delivery role – mirrors the historical legacy. Generally, local municipalities located primarily in the old “white” South Africa are better-capacitated and thus able to fulfil their service delivery functions, and the districts in which they are located play a co-ordinating role. On the other hand, areas comprising significant sections of former bantustans lack capacity at local level, and much of the responsibility for basic service delivery on the ground lies with district municipalities.

A positive feature of this system is that it has shown that South Africa’s new legislative framework is flexible enough to accommodate significant differences in capacity. On the other hand, the key criterion used to decide whether a function should be located with a district or local municipality was existing capacity, and there has been no indication that these functions would shift if capacity were developed over time.

The difficulty with present arrangements is that it takes insufficient account of settlement patterns. The Local Government White Paper provided a broad typology of settlement types, and suggested that the new local government system should take account of these. It could be argued that the present system does not do so.

For example, there are rural (local) municipalities within which there are no towns of significant size and infrastructure, and the question arises as to whether one chooses one small town in which to build the necessary institutional and administrative capacity to facilitate service delivery throughout the entire local municipal area, or whether one continues with the status quo, whereby the capacity remains focused on the district municipality.

There is therefore potential for a debate on the development of different models for governance and service delivery outside the metropolitan areas and secondary cities, a debate that looks beyond issues of capacity and takes account of issues likely to be relatively permanent in nature, such as settlement patterns.

### 3.3.3 Property Rates Act

The Property Rates Act of 2004 regulates the levying of property rates by all municipalities. In the past, municipalities differed in their methods of assessing

property tax liability, with some assessing the value of land only, others assessing land value as well as improvements, but at different rates (called composite rating), or others assessing land and improvements at one rate (called uniform rating).

The difference in assessment methods, and the lack of transparency in providing “rates relief” to some categories of property and not others, meant that municipalities could shift the burden of financing service delivery to other users of services. For example, property rates could be kept artificially low by increasing electricity or water tariffs. Also, if market value was not regularly updated, owners of low-value properties could end up subsidising owners of properties that had significantly increased in value, as happened in Cape Town.

The Property Rates Act provides for one method of assessment – namely uniform rating based on market value – which ensures that property taxes are based upon the value of the property.

#### 3.3.4 Other institutional mechanisms

Other legislation has been enacted to give effect to the proposals contained in the Local Government White Paper. These include:

- The Municipal Systems Act, which outlines municipal administrative mechanisms in detail (such as integrated development planning processes, performance management systems, and the development of tariff and credit control policies); and
- The Municipal Finance Management Act, which makes provision for efficient systems of finance and budgeting.

#### 3.3.5 Intergovernmental transfers

The Local Government White Paper outlined the principles that should characterise the system of intergovernmental transfers to local government, such as revenue adequacy and certainty. It emphasised the role of central government in redistribution, and noted that the equitable share for local government (already provided for in the Constitution) should ensure that all residents had access to basic municipal services. The current system broadly supports these principles, as outlined below.

##### Equitable share transfers

Up to 1998, the system of recurrent transfers to local government was ad hoc and incoherent. In 1998, the (then) Department of Finance introduced a new equitable share formula, which was based upon the following:

- A notional allocation for the provision of four services considered to be basic, namely water, sanitation, refuse removal, and electricity;
- An element that ensures that funds are distributed according to the number of households living in poverty in each jurisdiction.

The FFC has indicated from 2001 onwards that the equitable share formula suffers from three major shortcomings:

- There is a lack of clarity on what services are considered to be basic. If the purpose of the transfer system is to ensure that all low-income residents have access to a basket of basic services, then these services need to be specified.
- There is no revenue-raising capacity element in the current formula. Municipalities located in the former white South Africa generally have well-developed revenue bases and are better able to draw on their resources to deliver services, as opposed to municipalities that are located in primarily rural, ex-bantustan areas.
- The formula does not reflect variations in expenditure need among municipalities. Expenditure need may vary owing to circumstances beyond the control of municipalities (such as population density) and to differing levels of infrastructure for delivering basic services (such as bulk water and sewerage systems).

These issues are receiving attention as the local government equitable share formula is reviewed in the coming year.

In general, however, it should be noted that the current local government formula has a strong redistributive thrust by targeting resources according to the concentration of low-income residents. Nevertheless, the inequities of the past cannot be fully addressed unless municipal revenue-raising capacity is taken into account.

### Infrastructure transfers

Until recently, there has been a system of infrastructure transfers called the Consolidated Municipal Infrastructure Programme (CMIP). The aim of the programme was to channel infrastructure funding to areas where backlogs were greatest. The infrastructure funding was provided to provincial governments, which evaluated applications for funding from municipalities and monitored their expenditure. The programme specified that a minimum proportion of funding was spent on rural infrastructure.

On the positive side, the programme has ensured that infrastructure has been installed in many areas severely prejudiced by apartheid planning and investment policies. However, CMIP has also had its shortcomings:

- Municipalities with the capacity to complete the application process were able to access funds, and these were not necessarily the municipalities where backlogs are greatest;
- Infrastructure backlogs had not been sufficiently calculated for each municipal jurisdiction owing to data collection problems, and this further complicated the targeting process.

To remedy these shortcomings, the Municipal Infrastructure Grant (MIG) has been introduced, which has been piloted since 2003/04. The MIG is not application-based, as with CMIP: municipalities are allocated funds according to a formula, which takes account of infrastructure backlogs (mostly calculated through Census 2001). The formula allocates 75% of funding to household infrastructure, and the remainder to public infrastructure (such as community halls) and business infrastructure.

In theory, then, the MIG programme has comprehensively addressed the need to ensure that areas that were neglected with respect to infrastructure receive the necessary funding. By making funds available for businesses, the MIG programme recognises that it is important to make provision for economic opportunities as well as household infrastructure.

### **3.4 Summary: Assessment of Local Government Reforms**

It is appropriate at this point to return to the historical legacy that the new system of local government had to address, as outlined in sections 2.3 above, with a view to assessing the extent to which these challenges have been addressed through policy instruments.

During the segregation and (especially) apartheid eras, black people were deprived of access to education and employment opportunities. They were restricted to living in demarcated “group areas”, where there were limited business opportunities. The result was a very skewed pattern of commercial and business development, with almost all development in the formerly white areas.

The reform process has addressed this in a number of ways:

- The new municipal boundaries include both developed and under-developed areas. Indeed, one of the key considerations in the demarcation process was the need to create one tax base out of such disparate areas;
- The Property Rates Act provides for one uniform (market-value) basis for rating properties, thereby ensuring that a significant proportion of local tax resources are drawn from areas that benefited under the previous dispensation;
- The intergovernmental transfer system is structured in a way that ensures that national tax resources are distributed to municipalities in accordance with the principle of redistribution. This includes significant allocations for municipal infrastructure, which are targeted at areas where backlogs are greatest;
- A wide range of institutional and administrative mechanisms has been put in place to ensure that municipalities are required to prioritise under-developed areas for investment and to promote efficient and accountable service delivery to all residents.

In summary, the policy and legislative process has been quite successful in structurally addressing the fundamental inequities bequeathed by the past. Yet there remain some challenges, which are outlined below.

## **4. Remaining challenges**

### **4.1 Redistribution within municipal boundaries**

As noted in section 3 above, the intergovernmental transfer system and new property rates dispensation ensure that taxable resources are made available to municipalities to address the socio-economic disparities within their jurisdictions. However, it remains for the municipal councils and their administrations to ensure that resources are, in fact, distributed in a manner that takes account of these disparities.

One example of a resource (namely land) that is not being appropriately allocated is with respect to the planning of new settlements. Apartheid planning was characterised by significant distances between black and white areas; in many cases, this has been exacerbated by the placement of new housing developments in existing black settlements, rather than in areas that would facilitate the integration of once-divided communities.

In addition, many municipalities have taken their existing expenditure allocations as the basis for their budgets, rather than going through a re-prioritisation exercise. There are, however, limits to redistributing existing resources within municipalities, as it may involve the reduction of existing public services and may lead to the deterioration of infrastructure that underpins economic activity in the municipality.

Thus, while some funding could be freed up by some trimming of municipal services to “rich” parts of municipalities and by finding new operational efficiencies, it is doubtful whether substantial resources could be freed up through the process of reallocation. New resources will have to be found for municipalities, whether through the development of new revenue sources, larger equitable share allocations, or economic development strategies that grow the tax base of municipalities.

#### **4.2 Investment in rural areas**

As demonstrated in the table in section 2.4, economic activity in the ex-bantustans is very limited. There is little commercial agricultural activity, and even subsistence farming is difficult given the environmental degradation.

While there has been considerable infrastructure investment in urban areas over the past ten years, rural areas have lagged behind. This is owing to a number of factors: urbanisation has increased, causing the proportion of people living in rural areas to decline (between 1996 and 2001 alone, the rural population of South Africa declined from 46% to 42%).<sup>10</sup> Related to this, the economies of many rural towns and hinterland are declining.

This is a challenge to policy-makers, for the majority of South Africa’s poor live in the rural areas. Attempts to channel funds and attract investment to such areas has not shown the desired rate of success, as evidenced in the 13 rural development nodes identified by Government. An on-going policy debate in South Africa relates to the extent to which (scarce) resources should be used to promote economic activity in historically under-developed regions where population is declining and significant economic growth is not expected in future, but where poverty is concentrated and basic service provision is very limited.

#### **4.3 Regional levy reform**

As the table in section 2.3 demonstrated, the fiscal capacity of metro / district municipalities varies considerably with respect to regional levy income (between

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<sup>10</sup> Statistics South Africa, *Census 2001*. For the reasons outlined in this paper, settlements in South Africa cannot be easily classified into “urban” and “rural” categories. The methodology used to determine the proportion of urban and rural dwellers is described in Statistics South Africa, *Discussion of Rural Definitions* (2003).

R225 per capita in Ekurhuleni metro and R4 per capita in Umkhanyakude district municipality). Regional levies are the only own revenue source of district municipalities, and there is no equalisation system to address these vast differences in fiscal capacity.

There is currently a policy process to review regional levies as a revenue source, and it is likely that major reform will take place (either changing the nature of the levies or replacing them with intergovernmental transfers). This reform process should take account of both the differences in fiscal capacity and the role the regional levies may be playing in addressing spillovers.

#### **4.4 Transport subsidies**

As noted in 2.3 above, the significant distances between formerly black areas and the areas in which black people work and shop require substantial, on-going transport subsidies. At present, these subsidies are administered by national government, amounting in the fiscal year 2004/05 to R1.8 billion for commuter rail subsidies and R2.1 billion for bus subsidies.

Yet the onus for addressing the spatial legacy of apartheid lies primarily with municipal planners, who must integrate landscapes that were (and continue to be) characterised by former racial divisions.

One way to address this is to prioritise underdeveloped areas for infrastructure development. Indeed, the nodes prioritised for urban development recognise the need to invest in areas in which minimal commercial and other infrastructure was installed, rather than to merely upgrade and subsidise transport infrastructure.

A further strategy is to ensure that the location of new settlements makes sense with respect to distances and transport linkages. However, if municipalities can rely on transport subsidies to continue into the future, they have less incentive to make appropriate planning decisions and promote densification, which cuts down on recurrent transport costs.

If municipalities were to receive these subsidies directly, they would be able to use the funds to support their long-term spatial plan, while at the same time the gradual phasing out of some portion of the subsidies would provide them with the incentives to plan appropriately.

#### **4.5 Overall approach to asymmetrical development**

In addition to the specific intergovernmental fiscal mechanisms that are influenced by the local asymmetry in South Africa, it is important to develop a flexible approach to the application of local government policies so as to ensure that the different circumstances on the ground are taken into account.

The Financial and Fiscal Commission has proposed that the local government system recognises these differences.<sup>11</sup> In particular, an asymmetrical approach could be applied to:

- Local government borrowing: municipalities could be classified according to their ability to raise loan finance and to provide effective financial management. This classification would assist Government to target their support to municipalities for the development of debt management capacity and could also provide the basis for concessionary loans to municipalities with limited or no access to loan finance.
- Municipal service partnerships (MSPs): There are many kinds of MSPs, such as service contracts and concessions, and as they increase in complexity, so does the required financial and management capacity to implement them. As with municipal borrowing, municipalities could be classified in terms of their ability to engage in such partnerships, and this would assist in developing capacity-building programmes and in discouraging municipalities from entering into certain types of partnership until the minimum institutional capacity is in place.
- Local government revenue sources: many municipalities have insufficient capacity to develop their local fiscal instruments and to collect revenue. There should be scope for varying the mix and nature of revenue sources, which could change over time. Such a “graduated approach” has been suggested with respect to regional levies (e.g. some municipalities collect the levies, while others receive a grant from Government until such time that they are able to effectively manage their own revenue source).

## 5. Conclusions

This paper has described the historical processes that resulted in the considerable socio-economic disparities that are found in South Africa. Owing to the spatial orientation of much of apartheid policy, these disparities have a distinctive geographic form, with significant socio-economic contrasts within rural areas and within urban areas, and also between urban and rural areas more generally. It was inevitable that these disparities would find expression in asymmetrical circumstances in municipalities, particularly in the differing circumstances of municipalities located in the former “white” South Africa and the former bantustans.

For the most part, the local government reform process has been successful in addressing this asymmetry. It has been very effective in ensuring, through the re-drawing of municipal boundaries, that proximate developed and under-developed areas are encompassed by one boundary, thereby creating one tax base. The intergovernmental transfer system has directed recurrent funding according to the distribution of poverty, and infrastructure transfers are targeted at municipalities with the greatest infrastructure backlogs.

Challenges remain, and the intergovernmental fiscal system can play a key role in addressing them. First, the local government equitable share requires revision so that it ensures that the varying fiscal capacity of municipalities is adequately taken into

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<sup>11</sup> Financial and Fiscal Commission, *Submission: Medium-Term Expenditure Framework 2004-2007* (April 2003). Pages 107-114.

account, including the fiscal capacity of regional levies. The transfer system should also be assessed with respect to the need to address significant spillovers in the provision of some social and economic services. Secondly, the system of transport subsidies should be re-examined with a view to ensuring that municipalities have the resources and incentives to transform the apartheid landscape. Thirdly, incentives should be put into place to ensure that municipalities redistribute resources within their jurisdictions. And finally, a differentiated approach should be adopted with respect to other areas of local government, such as borrowing and municipal service partnerships.

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