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For an Equitable Sharing of National Revenue

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ACRONYMS

ADS	Agency Development and Support (IDC)
AGOA	African Growth and Opportunity Act
AGSA	Auditor-General of South Africa
ALHA	Agricultural Land Holding Account
ANC	African National Congress
ANOVA	Analysis of Variance
APAP	Agricultural Policy Action Plan
apw	Agricultural Value Added per Worker
AsgiSA	Accelerated and Shared Growth Initiative for South Africa
ASIDI	Accelerated Schools Infrastructure Delivery Initiative
B&CB	Business and Corporate Banking (Land Bank)
BFAP	Bureau for Food and Agricultural Policy
BLA	Black Local Authority
BRICS	Brazil, Russia, India, China and South Africa
BVT	Business Value Tax
CAADP	Comprehensive African Agriculture Development Programme
CASP	Comprehensive Agricultural Support Programme
CGE	Computable General Equilibrium
CLC	Community Law Centre
COGTA	Cooperative Government and Traditional Affairs
CPI	Consumer Price Index
CRDP	Comprehensive Rural Development Programme
CRS	Constant Returns to Scale
CWP	Community Works Programme
DAFF	Department of Agriculture, Forestry and Fisheries
DARD	Department of Agriculture and Rural Development
DBE	Department of Basic Education
DBSA	Development Bank of Southern Africa
DEA	Data Envelope Analysis
DFI	Development Finance Institutions
DHS	Department of Human Settlements
DLA	Department of Land Affairs
DM	District Municipality
DMA	District Management Areas
DME	Department of Minerals and Energy
DOE	Department of Energy
DOH	Department of Health
DORA	Division of Revenue Act
DPE	Department of Public Enterprises
DPME	Department of Planning, Monitoring and Evaluation
DPW	Department of Public Works
DRDA	District Rural Development Authorities
DRDLR	Department of Rural Development and Land Reform
DSBD	Department of Small Business Development
DSD	Department of Social Development
dti	Department of Trade and Industry
DWS	Department of Water and Sanitation
ECA	Economic Commission for Africa
ECD	Early Childhood Development
EcoSan	Ecological Sanitation
EDD	Economic Development Department
EPWP	Expanded Public Works Programme
ESTA	Extension of Security of Tenure Act
EU	European Union
FBS	Free Basic Services
FDH	Free Disposal Hull
FEVD	Forecast Error Variance Decompositions
FFC	Financial and Fiscal Commission
FICA	Financial Intelligence Centre Act
FTE	Full-Time Equivalent
GDP	Gross Domestic Product
GEAR	Growth Employment and Redistribution
GHS	General Household Survey
GMM	Generalised Method of Moments
GPP	Gross Provincial Product

GRP	Gross Regional Product
GSM	Government Shareholder Management
GVA	Gross Value Added
HDA	Housing Development Agency
HDDS	Household Dietary Diversity Score
HFSIAS	Household food insecurity access score
HST	Health Systems Trust
ICASA	Independent Communications Authority of South Africa
ICT	Information and Communication Technology
ID	Identity Document
IDC	Industrial Development Corporation
IDP	Integrated Development Plan
IDT	Independent Development Trust
IFAD	International Fund for Agriculture Development
IGFR	Intergovernmental Fiscal Relations
IGR	Intergovernmental Relations
ILO	International Labour Organisation
IMF	International Monetary Fund
INEP	Integrated National Electrification Program
IRF	Impulse-Response Function
ISRDP	Integrated Sustainable Rural Development Programme
ISRDS	Integrated Sustainable Rural Development Strategy
KwH	Kilowatt Hours
KZN	KwaZulu-Natal
LASS	Land Acquisition for Sustainable Development
LBIS	Land Bank Insurance Services (Land Bank)
LED	Local Economic Development
LGES	Local Government Equitable Share
LGFF	Local Government Fiscal Framework
LGNF	Local Government Negotiating Forum
LGTA	Local Government Transition Act
LM	Local Municipality
LRAD	Land Redistribution for Agricultural Development
MDB	Municipal Demarcation Board
MFMA	Municipal Finance Management Act
MIG	Municipal Infrastructure Grant
MISA	Municipal Infrastructure Support Agency
MPF	Municipal Participation Fund
MSA	Municipal Structures Act
MTEF	Medium Term Expenditure Framework
MTSF	Medium Term Strategic Framework
MWIG	Municipal Water Infrastructure Grant
NAMC	National Agricultural Marketing Council
NDP	National Development Plan
NEF	National Empowerment Fund
NGO	Non-Governmental Organisation
NGP	New Growth Path
NPC	National Planning Commission
NPO	Non-Profit Organisation
OECD	Organisation for Economic Cooperation and Development
OLS	Ordinary List Squares
P&F	Powers and Functions
PCC	Presidential Coordinating Commission
pci	Per Capita Income
PDARD	Provincial Department of Agriculture and Rural Development
PEP	Public Employment Programme
PES	Provincial Equitable Share
PFMA	Public Finance Management Act
PICC	Presidential Infrastructure Coordinating Commission
PIE	Prevention of Illegal Eviction
PIT	Personal Income Tax
PLAAS	Institute for Land and Agrarian Studies
PLAS	Proactive Land Acquisition Strategy
PRC	Presidential Review Commission
PSC	Public Service Commission
PSM	Propensity Score Matching
RADP	Recapitalisation and Development Programme
RBIG	Regional Bulk Infrastructure Grant
RCB	Retail Commercial Banking (Land Bank)
RCDF	Rural and Community Development Fund
RDP	Reconstruction and Development Programme
REM	Retail Emerging Markets (Land Bank)
RHIG	Rural Household Infrastructure Grant
RHIP	Rural Household Infrastructure Programme
RICA	Regulation of Interception of Communications and Provision of Communication-Related Information Act
ROA	Return on Average Assets

ROE	Return on Assets
SAHRC	South African Human Rights Commission
SALGA	South African Local Government Association
SAM	Social Accounting Matrix
SAPO	South African Post Office
SARB	South African Reserve Bank
SARS	South African Revenue Services
SIBG	School Infrastructure Backlogs Grant
SIP	Strategic Integrated Project
SLA	Service Level Agreement
SLAG	Settlement Land Acquisition Grant
SOC	State-Owned Company
SOE	State-Owned Enterprise
Stats SA	Statistics South Africa
TDCA	Trade, Development and Cooperation Agreement
TMC	Transitional Rural Council
UCLG	United Cities and Local Governments
UN	United Nations
UNDP	United Nations Development Programme
UNICEF	United Nations Children's Fund
USA	United States of America
USDG	Urban Settlement Development Grant
VAT	Value Added Tax
VECM	Vector Error Correction Model
VIP	Ventilated Improved Pits
VRS	Variable Returns to Scale
WHO	World Health Organization
WLA	White Local Authority
WSA	Water Service Authority
WSP	Water Service Providers
WTA	World Trade Atlas

FOREWORD AND EDITORIAL

The Financial and Fiscal Commission (the Commission) tables at Parliament its Annual Submission for the Division of Revenue every year. The Submission is made in terms of Section 214(1) of the Constitution of the Republic of South Africa (1996), Section 9 of the Intergovernmental Fiscal Relations Act (No. 97 of 1997) and Section 4(4c) of the Money Bills Amendment Procedure and Related Matters Act (No. 9 of 2009).

This Submission is part of the Commission's constitutionally defined processes, to advise Parliament and state organs on how the money collected by national government should be allocated fairly and equitably among the three spheres of government, to enable them to carry out their constitutional and other legal mandates. Intergovernmental fiscal transfers are a dominant feature in South Africa, as the bulk of government revenue is raised at national level and then allocated to subnational government (municipalities and provinces) through the equitable share and other grants. On 27 May 2016, the Commission tabled at Parliament its Annual Submission for the 2017/18 Division of Revenue. This volume of technical chapters is published as a companion document to the Annual Submission.

The theme of this year's Submission is the Intergovernmental Fiscal Relations System and Rural Development in South Africa. Rural areas cover 80% of South Africa's land and are home to almost 40% of the population. Although poverty and economic deprivation have declined significantly since 1994, rural areas lag behind the country as a whole. Despite increased funding, rural regions are not performing as well as urban areas, and the unemployment rate, particularly among the youth, in rural areas is much higher than the national unemployment rate. Poverty is a manifestation of under-development emanating from a range of factors, including historical legacies, under-investment and structural issues. As a result of historical social engineering policies and weak regional economies, rural areas carry the highest burden of poverty. This burden imposes additional demands for services and funding on rural provinces and municipalities.

Government has recognised the need for integrated rural development – one of the key objectives of the National Development Plan (NDP) is an "Integrated and Inclusive Rural Economy" by 2030, while rural development is one of the priority areas identified in the Medium Term Strategic Frameworks (MTSF) of 2009–2014 and 2014–2019. However, this new approach has not yet been accompanied by a substantial reallocation of resources. Part of the problem is that, like many other countries, South Africa does not have a government-wide, officially agreed and accepted definition of "rural". This lack of a common definition has led to a plethora of rural development programmes across government departments.

To date, the fiscal framework has not had a significant impact on rural development for various reasons, including (a) the transfer system from national government; (b) uncollected property rates and/or service charges that are not cost-reflective; (c) leakages, including bad management, inefficient procurement, under-spending and institutional challenges. The Submission provides evidence on how improving the efficiency of intergovernmental fiscal relations can assist national government, public entities, provinces and municipalities to stimulate rural development through prioritising public investments and interventions.

Rural development is a complex process and is not just about agricultural development, as agriculture contributes less than 3% to South Africa's economy. Indeed farm families increasingly rely on off-farm employment and social grants. Therefore, land reform needs to go beyond agriculture and farm-based activities. Rural areas require new economic engines and initiatives that seek to expand industrial activities, enhance agricultural productivity, and foster greater production linkages within agro-processing industries.

Given this complexity, rural development requires proper coordination among the institutions and departments involved. Coordination is needed at both local level and between national and subnational governments, in order to integrate sectoral approaches, to involve private partners and to achieve the appropriate geographic scale. Public

entities, such as state-owned companies (e.g. Eskom, Telkom) and development finance institutions (e.g. Land Bank, Industrial Development Corporation) also have a responsibility to support rural development. However, they invest modestly in rural areas and do little to crowd in the private sector.

Perhaps the most challenging aspect of rural development is ensuring that provinces and municipalities are well funded, through own-revenues and transfers from nationally collected revenue. Rural provinces have limited economic activity and a narrow tax base, which means that they rely heavily on central government for funding. As a result, they have little spending discretion (i.e. ability to direct resources towards province-specific needs). While the principle of supporting the poorer regions or provinces through grants or special projects is generally well-supported, there is no agreed method for determining poverty levels and related needs among regions. In addition, government's current rural strategies are often sector-based and do not allow for the different developmental needs of rural regions, many of which depend on exploiting special local resources. For example, policies to encourage rain-fed activities, such as livestock and cropping, are clearly not suitable for all areas. This sector-based approach, coupled with the lack of intergovernmental coordination, has led to the two main rural grants servicing the same target audience and funding the same activities. Greater alignment is needed between the land reform programme and other rural development policies.

Like rural provinces, the majority of municipalities in rural areas depend heavily on transfers to fulfil their mandate. This is in part because they have limited scope for economic diversification, exhibit deficient services and infrastructure and revenue bases are declining because of high unemployment and population losses through migration. In addition, rural municipalities face the dilemma of expanding expenditure requirements, including caring for the farm workers and dwellers who are evicted from farms – these evictions are the unintended consequences of laws introduced since 1994 to regulate the rights of farm workers. Municipalities have to use their own funds because currently the intergovernmental fiscal instruments do not cater for evictions.

The main purpose of this Technical Report is to explore how improving the efficiency of intergovernmental fiscal relations (IGFR) can assist national government, provinces and municipalities to stimulate rural development through prioritising public investments and interventions. If managed properly, fiscal reforms for rural development can bring about greater inter-regional equity and potential economic growth. While the focus is on rural areas, the debate should not be an "either-or" choice between urban and rural development, as both exist in parallel throughout South Africa. The Commission is also interested in urban development, as both rural and urban regions can contribute to national growth and poverty alleviation.

A vexing methodological question confronting practitioners is whether these IGFR instruments for rural policies work. Despite growing interest among policy-makers, very little research has documented the results of place-based rural development policies[1], and what determines success or failure. This is because isolating the impact of cross-sectoral policies is difficult, especially in quantitative terms.

Two pillars dominate the conceptual framework underpinning the work in this volume:

1. Weak and ineffective IGFR instruments, which are a major constraint for planning, implementing, operating and maintaining rural development interventions.

2. Institutional failures and deficiencies, which account for a large part of this state of affairs, in particular weak governance and technical and administrative capabilities.

At the broadest level, this Technical Report will enhance our understanding of emerging trends in rural-urban development and their theoretical and practical implications for South Africa. Reflecting the diversity of systems and practices, the Report adopts a multi-layered and multi-levelled approach, covering local, regional and provincial aspects, and encompassing many actors, institutions, enterprises, state enterprises and social movements. While these multiple dimensions are modelled here as distinguishable from one another, in reality they cannot be separated, as they are intertwined in various ways. For example, public investment in urban areas can affect poverty directly or indirectly, and at different levels (i.e. household, municipal, provincial or national), while the magnitude and direction of impacts will depend on the type of investment. Therefore, the impacts of investments must be assessed holistically. In essence, this is the concept of a general equilibrium, in that the inter-relations, interactions, exchanges and positive externalities are expressed simultaneously across all dimensions. Similarly, the general equilibrium concept is not limited to urban areas but captures all possible elements that share the same geographical space on both the consumption and production side. The notion of general equilibrium only becomes meaningful when this wider set of interdependencies, interactions, and the implied synergies and externalities are taken into account. In assessing the impact of public investments in urban areas, the importance of institutional arrangements needs to be highlighted. Institutional arrangements are structures and mechanisms of social configuration and cooperation and can be formal and/or informal.

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[1] Place-based policies refer to government efforts to enhance the economic performance of an area within its jurisdiction (in this case a rural area), typically in the form of transfers to facilitate more job opportunities, higher wages or basic consumption. Perhaps the best known place-based policies are those that target underperforming areas, such as deteriorating rural areas or relatively disadvantaged areas eligible for regional development aid such as former Bantustans.

Reflecting the ambitions of this volume, each of the chapters takes the form of a structured narrative, which (unlike descriptive accounts) maps the interaction between multiple variables that the literature suggests may contribute to institutional change. In line with this approach, a mix of econometric and simulation/modelling methods and tools are used to assess the impacts of IGFR instruments in rural areas. To attach numbers to relationships requires quantification and modelling. However, identifying the types of socio-economic models that can be used to analyse rural policy issues is fraught with difficulty. The model types used take into account the different policy measures corresponding to each generic policy issue and thus the "compatibility" of each measure with types of socio-economic models that are able to carry out the analysis.

Defining the policy effects that models can capture is complicated. A policy-impact analysis can be directed towards more than one type of effect, and different "perspectives" can drive the definition of the effects to be measured (as relevant). These include policy-eligibility criteria (e.g. low agricultural incomes, high share of agricultural employment, etc.), micro-level direct variables (e.g. new economic activities generated, or new quality products produced), economy-wide impacts of policy measures (e.g. on employment, income, structures) and "meta" issues such as regional economic growth and convergence or residual choice (to which rural development policies seem to contribute). The approach adopted here draws on the literature, as well as the researchers' relevant experience in research and policy analysis, and concentrates on modelling approaches judged to be suitable on the evaluation of "most important" effects.

Another important issue, which influences not the choice of model but the choice of scale, is related to the issue of spill-overs. Ideally (i.e. to serve a comprehensive policy-evaluation exercise), every model type could be used at the lowest possible sectoral level. However, spill-over effects and the rather wide scale of the socio-economic process do not allow such an approach.

Finally, another issue taken into account is the difficulty that several model types have in distinguishing the effects induced by the (specific) policy alone. This is a major/traditional methodological problem, and its solution is included here. However, where appropriate, there is a hint that a model might be more useful for assessing the likely impacts in the absence of policy intervention.

It is difficult to isolate the impact of a particular external (exogenous) shock from underlying trends and from other internal and external factors that influence economic performance. These factors include price movements of major imports and exports, changes in government economic policy, booms and slumps in the world economy, or the effects of civil or international conflict. Therefore, an eclectic approach is adopted, using a mixture of quantitative and qualitative analysis. The quantitative analysis combines regression analysis and an examination of movements around trends, "before-and-after" impacts of instrument changes, and forecasts versus actual performance of key economic indicators. Other relevant approaches are drawn upon, including those used in constructing computable general equilibrium (CGE) models, input-output tables and social accounting matrices (SAMs). Furthermore, a number of the drought impacts are qualitative and not easily captured within the framework of a formal model. Therefore, qualitative approaches included stakeholder interviews and perception surveys. In addition, desk-based statistical studies of the relationships between economic performance and IGFR instruments were undertaken. Finally, case studies examine the interlinking issues of farm evictions and municipal finances in selected municipalities that have experienced actual farm expulsions.

The Technical Report consists of 15 chapters that are organised into four parts:

1. Macro-Micro and Fiscal Context of Rural Development
2. National Government and Rural Development
3. Provincial Government and Rural Development
4. Rural Municipalities and Rural Development

Part I presents the methods and tools applied in the analysis of the many different topics, as well as an overview of the definitions of rural development. Rural areas account for four-fifths of the land and are home to about two-fifths of the population in South Africa. Although poverty and economic deprivation have reduced substantially since the advent of democracy, greater poverty is found in provinces that contain former homelands (only the Western Cape and Gauteng did not "inherit" former homeland territory). Like many other countries, South Africa does not have a government-wide, officially agreed and accepted definition of "rural". Understanding what "rural" means is particularly important when assessing programmes aimed at stimulating rural development. This lack of a common definition may explain the plethora of rural development programmes that are found in virtually every corner of the government. Furthermore, measurement issues remain unresolved, and so the relationship between rural development, intergovernmental fiscal relations instruments and related aspects (such as land reform, food security or infrastructure) is not always clearly defined and understood. Thus, the effectiveness of spending on rural development is unclear. This section sets the context for the rest of the Technical Report, by looking at these issues and offering the lens through which the Commission will approach the contestable areas. It examines the socio-economic profile and characteristics of rural areas, as well as how to define rural areas, and assesses how rural regions are coping with

economic change, and the weight of agriculture and agricultural spending in rural economies. It also explores the evolution of rural policy, including who is implementing policy for rural areas and whether integrated rural policies work, and presents the rural development model underlying the Commission's recommendations.

Part II presents chapters focusing on national government and rural development. Over the past decade, South Africa has implemented many rural development strategies focused on mostly land reform and restructuring the country's agrarian economy, as a catalyst for poverty reduction and wider societal transformation. In recent years, conditional grants have been used to fund the flagship policy programmes. However, agriculture's declining share (in terms of employment and gross value added) has raised concerns about the efficacy of directed public investments in agriculture for achieving growth, reducing rural poverty and creating a vibrant and inclusive rural economy. Three aspects are examined in this section. The first seeks to show that agriculture and non-agricultural linkages can play an important economic development role and, if well managed, the interactions between the two can be the basis for economically, socially and environmentally balanced regional development. The second argues that land reform is essential because for many poor rural households, land is the main source of livelihood and means for investing, accumulating and transferring wealth. Providing secure rights in land they already possess can significantly increase the net wealth of rural households. Finally the third deals with state entities and their critical developmental role in the economy, looking at what state-owned companies (SOCs) and development finance institutions (DFIs) do in rural spaces and what they need to do in order to be drivers of rural growth.

In **Part III,** the primary focus is on provincial government and rural development. Like many other developing countries, South Africa is characterised by disparities across provincial jurisdictions. The distribution of poverty is highly skewed, with the rural provinces carrying the highest burden due to historical social engineering policies and weak regional economies. The higher poverty burden imposes additional demands for services and funding on rural provinces, but the funding framework for provinces is not adequately sensitive to the different developmental needs. Poverty is a manifestation of under-development emanating from a range of factors including historical legacies, under-investment and structural issues. Limited economic activity and a narrow tax base impede the ability of rural areas to mobilise sufficient resources to finance their own development programmes, leaving them dependent on the centre for both transfers and interventions. As a result, their spending discretion (i.e. directing resources towards province-specific needs) is limited – the provincial equitable share, which accounts for 80% of revenue, is normally tied to national priorities and statutory responsibilities. Similarly, spending on the remainder of the funding from conditional transfers is restricted to specific sector and expenditure activities. The inability of the rural provinces to intervene in their spaces through the powers and functions assigned to them by the Constitution is evident from their consistent maladministration practices and fiscal management failures. Whereas such failures reflect poor fiscal choices, the lack of appropriate skills in the rural areas may also exacerbate management inadequacies and thus reinforce rural under-development.

Part IV addresses rural municipalities and rural development. Poor access to adequate levels and standards of basic services compound the challenges of poverty and unemployment in rural areas. Dealing with these challenges requires not only a strong national government but also a capable and capacitated local government – the sphere of government closest to the people. However, despite increased funding and interventions over the years, this has not translated into commensurate service delivery improvements in the majority of rural municipalities. Initiatives underway include the recent review of the local government equitable share formula introduced in 2013, the ongoing "Back to Basics" initiative, as well as the infrastructure grant reviews. In addition, amalgamations of municipalities are being experimented with in order to turn around the fortunes of this sphere of government. Yet many municipalities continue to under-spend their budgets, and suffer from inefficient procurement and irregular and wasteful spending, bad management and outright corruption. For many rural municipalities, their dilemma is one of expanding expenditure requirements and shrinking fiscal space. This part of the Technical Report looks first and foremost at whether the resources transferred to the sector are adequate and used efficiently and effectively. It then considers the extent and costs of farm displacements, and how rural local municipalities can deal with this problem and the associated costs. Furthermore, the section evaluates the role of district municipalities in rural development. Lastly, the focus turns to finding innovative ways of tapping into economic activity in rural areas, and developing new sources of municipal income while arresting the decline in existing sources.

The chapters that make up the four parts of this Technical Report are briefly described below.

In Chapter 1, Ramos Mabugu outlines and addresses IGFR problems associated with rural development. After describing the main rural development issues (i.e. rural development, classification and spatial characteristics, economic activities and the impact on growth and jobs, the role of migration and declining agricultural jobs in rural areas), the macroeconomic issues influencing rural development are summarised. Next, the conceptual framework underlying the Technical Report is developed, taking into account the strong interdependence of national, provincial and local government and differences across municipalities. The rest of the chapter looks at the evolution of rural policy, the main rural development actors, and the flagship rural policies and interventions. The final

section gives recommendations that set the context underlying the more detailed recommendations in the rest of the report.

The aim of **Chapter 2**, by Hammed Amusa, is to examine the role of targeted intergovernmental transfers in reducing rural poverty. This chapter looks at the contribution of the agricultural and non-agricultural sectors to poverty reduction and local/regional economic growth. The study found that agricultural activities represent an important driver of incomes and local economic growth in rural municipalities because of their positive effect on non-agricultural sectors. However, growth within the non-agricultural sector can lead to resources leaving the agriculture sector, causing a slow-down in productivity growth or a decline in overall value-added output. Growth within the agriculture sector exerts significant poverty-reducing effects and can be a powerful tool for lifting people out of poverty. However, this comparative edge over growth in the non-agricultural sector declines in the presence of a large public sector and deep poverty. In such instances, growth in non-agriculture per-capita value added is a more powerful tool for reducing poverty. The chapter recommends reviewing the agricultural grants targeted at small-scale farmers and creating linkages between the agriculture and non-agricultural sectors.

Ghalieb Dawood evaluates the national land reform programme's impacts on rural development in **Chapter 3**. A field-based approach across three selected provinces is used to investigate the impact of land reform on food and nutrition security, job creation and agricultural output. Then ways of improving the intergovernmental implementation of land reform are explored. The study found that land reform beneficiaries are worse off than those who did not benefit, and that land reform has had a negative effect on job creation and farm productivity. Clear duplication and overlaps exist between the Recapitalisation and Development Programme (RADP) and the Comprehensive Agricultural Support Programme (CASP) grants, while major gaps include the lack of affordable loans for land reform beneficiaries and planning for land reform. The findings reveal that weak administration and implementation have compounded poor outcomes of land reform. The chapter recommends consolidating the RADP and CASP grants into one funding programme and clarifying the role of municipalities in providing support to land reform. It also notes the need for a wider perspective to land reform that goes beyond agriculture and farm-based activities.

Chapter 4 by Sasha Peters, Poppie Ntaka and Thembie Ntshakala analyses ways of enhancing the role of state-owned companies (SOCs) in rural development. SOCs have a responsibility to align to the country's national goals and support government's initiatives aimed at addressing the socio-economic legacy of the past. This chapter's overarching objective is to assess the role of SOCs in rural development. The study found that the studied SOCs (Eskom, Telkom, Transnet and the South African Post Office or SAPO) do not have a specific rural focus. The chapter recommends reconfiguring and modernising the South African Post Office (SAPO) to broaden its focus, improving Transnet's contribution to regional economic growth and expanding Telkom's network infrastructure in rural areas.

Chapter 5 by Thando Ngozo analyses ways of enhancing the role of development finance institutions (DFIs) in rural development. DFIs are expected to play an instrumental role in the implementation of developmental policies and act as catalysts for accelerated industrialisation, economic growth and human resource development. The chapter examines the role of four DFIs – the Land Bank, Development Bank of Southern Africa (DBSA), Industrial Development Corporation (IDC) and the National Empowerment Fund (NEF) – in enhancing rural economic development, and how they can support rural development. The study found that investments by DFIs in rural areas are minimal and declining. The chapter recommends designating a single champion and coordinating entity for rural finance and development to guide investment by DFIs in rural areas.

In Chapter 6, Thando Ngozo evaluates the extent to which provincial own-revenues respond to rural development needs. The fiscal decentralisation and IGFR systems entrenched by the Constitution assign to provinces narrow-based taxes, which means that they have lower fiscal autonomy and tax-raising powers than other government spheres. This constitutional constraint means that all provinces – and especially rural provinces – have a limited ability to generate own-revenues. This chapter explores the scope for increasing provincial own-revenues and examines the shared tax base model as a viable alternative. The study found that, with the exception of KwaZulu-Natal, rural provinces have low own revenues (because of narrow tax bases) and high levels of poverty – poverty constrains the ability of provinces to generate own revenues. The chapter recommends investing in infrastructure and quality education and training in order to enhance economic growth and employment, and thereby grow the tax base.

Chapter 7 by Eddie Rakabe evaluates the extent to which provincial fiscal transfers (provincial equitable share and conditional grants) respond to rural development needs. Rural provinces in South Africa have the heaviest burden of under-development, and are characterised by weak economic activity, poor socio-economic conditions and high infrastructure backlogs. The chapter assesses the responsiveness of the fiscal transfers to the needs of rural provinces and the extent to which rural provinces prioritise development. The study found that provincial fiscal transfers show mixed results. The equitable share makes no visible distinction in the allocations to various provinces (to address disparities), while infrastructure conditional grants allocations seem to favour the rural provinces. The grants supporting agrarian development and the eradication of other rural-specific in-

frastructure backlogs have design, targeting and spending deficiencies. The chapter recommends that the allocation framework for rural development grants be aligned to the national rural development policy imperatives.

In Chapter 8, Poppie Ntaka, Ghalieb Dawood and Sasha Peters assess government's fiscal instruments to fund job creation in rural areas, and in particular public employment programmes (PEPs). This chapter assesses the targeting and benefits of PEPs to households in rural areas. The outcomes of the Expanded Public Works Programme (EPWP) and the Community Works Programme (CWP) in rural areas are compared using a mixture of quantitative and qualitative methods. Specific focus areas include job opportunities created, the intergovernmental implementation model and cost effectiveness. The CWP was found to be more effective than the EPWP at creating employment opportunities in rural areas. In addition, the CWP's design and implementation is better able to meet the needs of rural communities and to foster social cohesion. In order to achieve the NDP target of two million full-time recipients by 2020, the chapter recommends that the training component of PEPs be strengthened and that PEP spending be restructured, so that more resources can be directed at the CWP and the non-profit and social sectors of the EPWP, which are labour-intensive and more cost-effective, and have activities that are easily implementable in rural areas.

Chapter 9, by Zanele Tullock, is about developing rural local municipalities' own-revenue sources. Municipalities require diverse and "non-traditional" revenue sources to address their growing responsibilities and pay for their operations, infrastructure and maintenance. This chapter examines the potential for additional own-revenue taxes that could benefit rural municipalities and explores constraints to the property revenue base. The study found that, despite property taxes being generally deemed to be a reliable source for local governments, this is not the case in rural municipalities because of deficient property tax administration. Other possible additional revenue sources (outside of property taxes and electricity service charges) include "user fees" for social amenities and "restaurant/hotel fees" in areas with a vibrant tourism industry. The chapter recommends that rural municipalities ensure their property registers and valuation rolls are up to date and be capacitated to collect such taxes.

Chapter 10, by Mkhululi Ncube and Jabulile Monnakgotla, is about financing rural local municipalities for rural development needs. Government is seeking to make rural municipalities self-sufficient and less dependent on transfers, through amalgamating municipalities. This chapter examines whether the model (whereby all municipalities are financially viable) is appropriate for rural municipalities, considering their weak and fragile revenue bases. The study found that amalgamations are a weak instrument for pursuing financial viability of rural municipalities and the wrong one for improving the functionality of municipalities. The chapter recommends that the transfer system be sensitive to financially unviable municipalities, and that financial viability be achieved through economic development and functionality through legislative, policy and capacity-building measures.

Chapter 11, by Mkhululi Ncube and Jabulile Monnakgotla, is about the adequacy of the local government equitable share (LGES) and conditional grants for rural development needs. This chapter investigates whether the LGES and conditional grants compensate municipalities sufficiently for their lack of own revenues, and whether the new LGES has had the desired outcomes. The study found that transfers adequately compensate rural local municipalities for the lack of own revenues in some services and not in others. Viewing a grant in isolation, rather than taking a holistic view of all grants, may give the impression that a service is underfunded, when this is not the case. The chapter recommends that grants continue to be consolidated and reviewed regularly to ensure needs and resources are aligned, and (along with the LGES) that they are informed by objective cost estimates.

Chapter 12 by Nomfundo Vacu is about the effectiveness of transfers to local municipalities for rural development needs. The main objective of this chapter is to assess the effectiveness and efficient use of intergovernmental transfers in South African rural municipalities. The study found that conditional grants are under-spent, and yet these municipalities have significant backlogs in almost all services. Rural municipalities are not prioritising their spending, as shown by the resources spent on employee costs compared to vital expenditure needs such as repairs and maintenance of existing infrastructure. It also found that the performance of rural municipalities can be improved without necessarily increasing the amount of resources. The provision of FBS and the lack of institutional capacity are the major causes of technical inefficiencies in rural municipalities, whereas economic performance, municipal size and grant reliance have positive effects on municipal efficiency. The chapter recommends more stringent expenditure supervision of rural local municipalities by national and provincial governments.

Chapter 13, by Mkhululi Ncube and Nomfundo Vacu, evaluates the effectiveness of district municipalities (DMs) for rural development. DMs have an important role to play in rural development and in assisting local municipalities to fulfil their mandate. This chapter assesses the effectiveness and efficient use of intergovernmental transfers in the South African rural local government space and evaluates the role of DMs in rural development. The study found that DMs under-spend on conditional grants and on infrastructure repairs and maintenance, and that many DMs are not performing their core legislative functions, which is compromising local economic development. The chapter recommends that DMs should be retained in rural (not urban) areas and be tasked with more complex tasks, in particular water and electricity infrastructure, in addition to strategic regional planning and coordination. The

chapter recommends strengthening the capacity of DMs so that they can support weaker municipalities, and making DMs more accountable to citizens.

Chapter 14, by Thembie Ntshakala, analyses the extent of farm evictions and the increasing responsibilities of rural local municipalities. Since 1994, government has introduced numerous laws, policies and initiatives to regulate and improve the situation and rights of farm dwellers and farm workers. However, unintended consequences have been a climate of uncertainty in the agriculture sector and the eviction of farm workers and dwellers from farms. The chapter examines the extent of the burden caused by farm evictions and explores how fiscal instruments can respond to this widespread situation. According to legislation and court rulings, the responsibility of caring for the vulnerable evictees increasingly falls on municipalities, thereby creating an unfunded mandate. The study found that municipalities have to use their own funds because currently the intergovernmental fiscal instruments do not cater for evictions. The chapter recommends that the current disaster grant should be allowed to include (or cater for) eviction-related emergencies. Furthermore, government should strengthen the coordination and implementation of the existing programmes targeting the increasing number of displaced farm workers and dwellers.

In Chapter 15, Sabelo Mtantato reviews the effectiveness of fiscal instruments and governance in enhancing sanitation in rural areas. Improving sanitation infrastructure reduces the risk of infection from excreta-related diseases, particularly for children under the age of five years. Since 1994, the government has introduced programmes to reduce sanitation backlogs. The chapter reviews funding and institutional constraints that are undermining government's efforts to address sanitation backlogs in rural areas, where backlogs remain high. The study found that the high backlogs are because of limited revenue sources, the poor performance of the Rural Household Infrastructure Grant (in part as a result of municipalities failing to submit business plans on time), the lack of prioritising sanitation infrastructure (not included in IDPs) and a failure to plan, budget and undertake maintenance. The chapter recommends that rural municipalities should include sanitation in their IDPs and develop a complete sanitation infrastructure plan that includes relevant technologies, and scheduled and costed periodical maintenance.

Ramos Mabugu, Research and Recommendations Programme Director

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Ramos Mabugu is Head of the Research and Recommendations Division at the Commission and a Fellow at the University of Stellenbosch, South Africa. He has published on topics related to applied economics, public finance, tax policy, and intergovernmental fiscal relations. Most of his economic modelling work is on the application of computable general equilibrium (CGE) models, social accounting matrix (SAM) methods, input-output methods, and macroeconomic models. In collaboration with colleagues, Ramos has pioneered the first applications of CGE microsimulation (static and dynamic) in two Southern African countries. He has taught and supervised at postgraduate level at the University of Zimbabwe and the University of Pretoria, South Africa. While at the University of Pretoria, Ramos was instrumental in setting up a collaborative environmental economics MSc and PhD training programme. He has served as a consultant for many organisations and was an external examiner for several universities. Ramos has also taught economic modelling courses at the Ecological and Environmental Economics Programme at the Abdus Salam International Centre for Theoretical Physics (ICTP) in Italy. In 2003/04, Ramos gave technical advice at the Centre for International Forestry Research (CIFOR), Indonesia, and Sida, Sweden. In 2006 he was awarded the visiting fellowship award from Curtin University in Australia, in recognition of his contributions to intergovernmental fiscal relations modelling. He earned his PhD in economics from the University of Gothenburg, Sweden.

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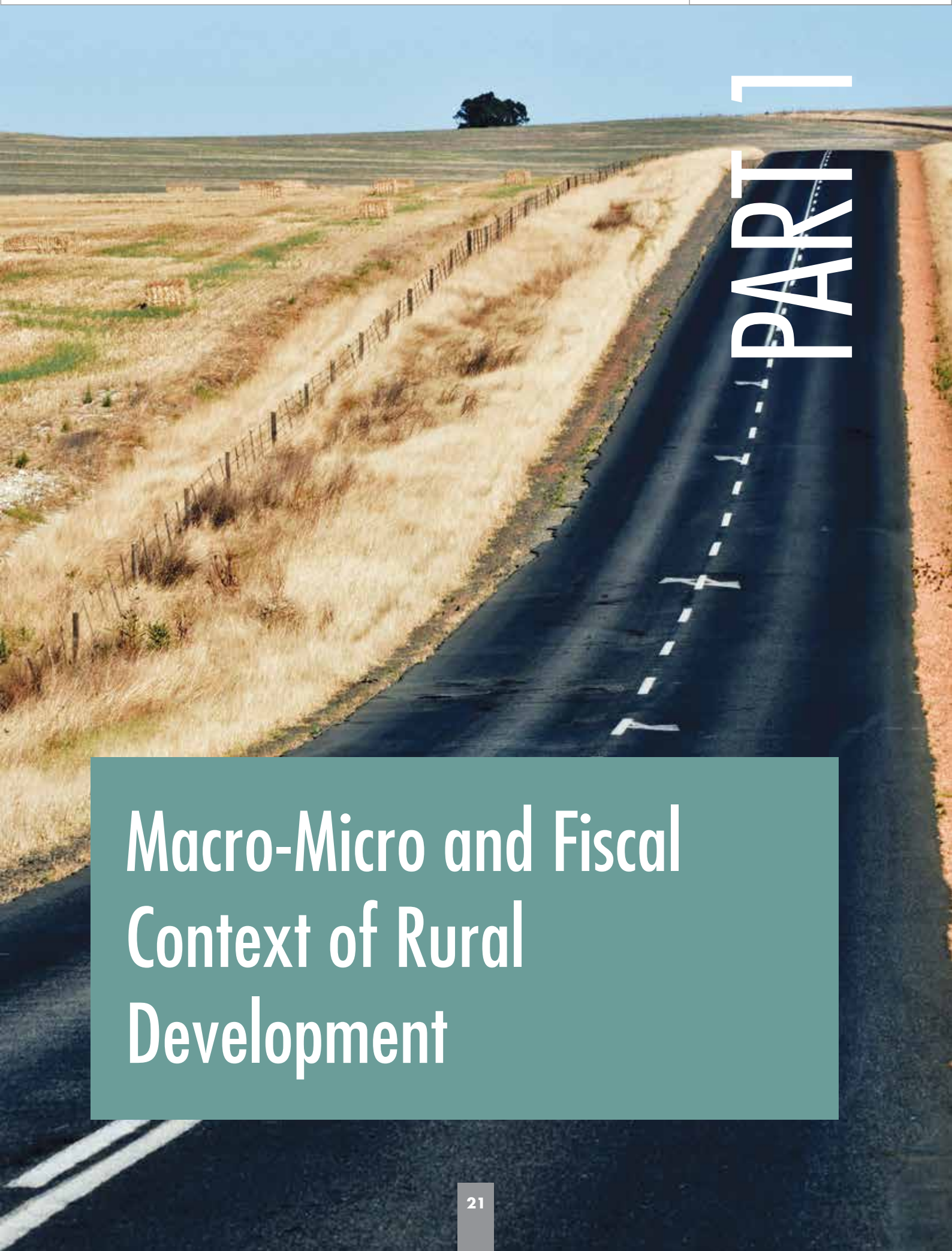

PART 1

Macro-Micro and Fiscal Context of Rural Development

CHAPTER 1

Introduction to Rural Development and Intergovernmental Fiscal Relations

Ramos Mabugu

Introduction to Rural Development and Intergovernmental Fiscal Relations

1.1 Rural Development: Why it Matters

Rural areas account for about 80% of the land and are important demographically, economically and politically in South Africa. They are home to 38% of the population, or about 20.5 million people, compared to 43.4% in 2001 and 81.8% in 1911 (Vacchiani-Marcuzzo, 2005). This figure is projected to fall to 30% by 2030 (NPC, 2011: 84). Despite the decline, South Africa's rural population is still large and, although government has had some impressive achievements since 1994, poverty, inequality and unemployment remain the main rural challenges. The majority of the poor live in rural areas (Stats SA, 2014b: 33):

> In 2006, eight out of ten (80,8%) people living in rural areas were poor, which was double that in urban areas (40,7%). By 2009, the proportion of poor people had increased to 83,0% in rural areas compared to 41,0% in urban areas. In 2011, more than two-thirds (68,8%) of rural dwellers were still living in poverty as compared with less than a third (30,9%) of residents in urban areas. The rate of reduction between the two settlement types from 2006 to 2011 was also different – there was a 15% reduction in poverty levels in rural areas, which was much lower than the 24% reduction in urban areas.

Rural areas lag behind the country as a whole on economic performance indicators, such as economic growth, labour force participation rates, unemployment, education attainment and life expectancy at birth. Challenges include insufficient skills and educational performance, socio-spatial inequalities, infrastructure deficits, housing backlogs, environmental issues, an ageing population and health disparities. In addition, rapid changes in the economy affect these regions differently from cities and towns, offering different challenges as well as opportunities.

Government has recognised that policy reforms, especially in agricultural and rural policy, play vital roles in the success of sustained development. Rural development was one of the priority areas identified in the Medium Term Strategic Framework (MTSF) of 2009–2014 and 2014–2019. Indeed, in 2009, the Department of Rural Development and Land Reform (DRDLR) was established to bring rural development to the forefront, through its Comprehensive Rural Development Programme (CRDP), which identifies 27 rural district municipalities with significant infrastructure backlogs and low human development indicators. One of the key objectives of the National Development Plan (NDP) is an "Integrated and Inclusive Rural Economy" by 2030, to be achieved through successful land reform, infrastructure development, job creation and poverty alleviation.

The question is how to adapt current rural strategies, which are often sector-based, to allow for the different development needs of rural regions, many of which depend on exploiting specific local resources. For example, policies that encourage rain-fed activities, such as livestock and cropping, are clearly not suitable for all areas. Moreover, no substantial reallocation of resources has accompanied these new approaches to rural development. An integrated rural policy requires coordination across sectors, across levels of government, and between public and private actors. Furthermore, rural areas face both challenges and opportunities, as a result of globalisation, the information and communications technology (ICT) revolution, reduced transportation costs, changing trade patterns and the emergence of important non-farm activities. Government is increasingly recognising that traditional sectoral policies need to be upgraded and, in some cases, phased out and replaced with more appropriate instruments. As implementers of national policy, provinces and municipalities deliver significant services in the rural areas and consequently influence rural development. However, national, provincial, and local government interventions have not fully achieved their objectives. In particular, agricultural subsidies have had only a modest impact on general economic performance, even in the most farming-dependent communities. Indeed, with farm families relying increasingly on off-farm employment and social grants, the economic success of rural communities will depend on the development of new economic engines. And in some provinces and many municipalities, state failure (lack of capacity, maladministration and corruption) prevents development.

Government is searching for new ways to unlock the economy's growth potential. Both rural and urban regions are key contributors to national growth and places where citizens and firms create and reap economic benefits. Although this Submission focuses on rural areas because (as mentioned earlier) a significant proportion of the poor are still located in these areas, the Commission is also interested in urban development. The debate should not be an "either-or" choice between urban and rural development. In most of South Africa, the two exist in parallel, and both are failing to achieve positive structural transformation. The objective here is to make a practical contribution on how interventions and recommendations can contribute most to poverty alleviation in rural areas.

This chapter begins by clarifying what is meant by the concept of rural development and discusses the evolution of literature on the mechanics of development. This is

followed by the development of the conceptual model that underlies the Technical Report and, after defining rural areas, municipalities and provinces, the chapter examines the socio-economic characteristics and the state of service delivery in rural areas. It then looks at how rural regions are coping with major economic changes and the performance of recent rural and agricultural policies and programmes, and concludes with recommendations.

1.2 Rurality and Rural Development

Rural development is distinct from rural growth. Growth usually means "more of everything": more population, more resource use and more total income without a significant change in industry mix, technology, productivity or income per capita. Traditionally, the economic definition of development referred to the ability of a country to generate and sustain GDP growth. However, since World War II, the definition has increasingly become concerned with reducing/eliminating poverty, inequality and unemployment, and growing the economy. Development is perceived as a multi-dimensional process that involves reorganising and reorienting entire economic and social systems. The aims of development must include (a) increasing living standards, and having a positive impact on quality of life, (b) expanding the economic and social choices available to individuals, and (c) reducing inequality and exclusion.

Observation #1: Rural development is distinct from rural growth.

"Rural development"[1] is essentially about revitalising and strengthening the rural, and thus includes non-farm rural industries and land uses, and new rural occupations that result in higher per capita income. This involves repositioning the rural, making it more attractive, more accessible, more valuable and more useful for society as a whole (including rural dwellers). The World Bank (1975: 3) defines rural development as:

> A strategy designed to improve the economic and social life of a specific group of people – the rural poor. It involves extending the benefits of development to the poorest among those who seek a livelihood in the rural areas. The group includes small-scale farmers, tenants and the landless.

Yet this definition does not mention the most disadvantaged groups of rural people – women and children. Therefore, a complementary definition of rural development could be (Chambers, 1983: 147):

> A strategy to enable a specific group of people, poor rural women and men, to gain for themselves and their children more of what they want and need. It involves helping the poorest among those who seek a livelihood in the rural areas to demand and control more of the benefits of development. The group includes small-scale farmers, tenants, and the landless.

Sustainable rural development can make a powerful contribution to three critical goals of poverty reduction: (i) wider shared growth; (ii) global, national and household food security; and (iii) sustainable natural resource management (World Bank, 2006). Agriculture and rural development, and their interaction with industry and regional development, have long received special attention from scholars and analysts who are of the view that land and agrarian reforms have an important role to play in resolving rural poverty and under-development.

Observation #2: The rural economy is no longer just a farm economy.

If the rural economy is no longer just a farm economy, the concern is the effectiveness of agricultural policy as the main component of public policy for rural regions. Agricultural development focuses on a small segment of the rural population – farmers and others involved in agricultural enterprises – rather than on rural places or areas. Challenges facing the rural poor go beyond agriculture and agrarian reforms to include education, health care, social and economic infrastructure, the creation of employment opportunities, as well as changing the economic structure of rural areas. Therefore, rural development is a complex process requiring proper coordination among the institutions and departments involved. The performance of non-agricultural sectors affects rural households, and so any analysis of rural development must include urban-rural links (through the relationship between agricultural and non-agricultural sectors) and mobility among sectors.

The concept of rural development has evolved over time, responding to changes in the nature of rural economies and in rural policy approaches. The main change has been from focusing on the agricultural sector to focusing on rural territories and more diversified economic activity (Van der Ploeg et al., 2000; Léon, 2005; OECD, 2006). Until the 1970s, rural development was synonymous with agricultural development, as industrial development was seen as the focus of development efforts, with agriculture playing the (secondary) role of providing capital, food and labour for industrial development.

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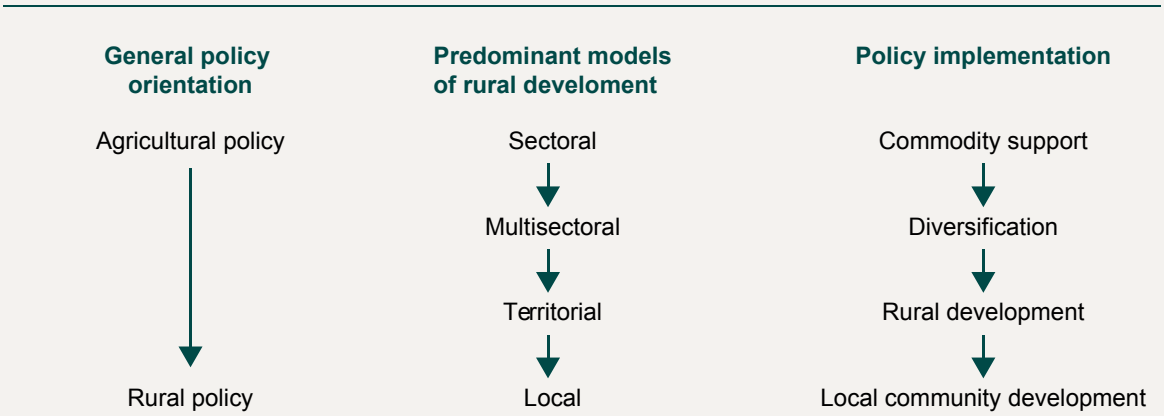
[1] The concept of rural development is both ambiguous and contested. This ambiguity is not intrinsic to the concept but due to the many social struggles (including classification struggles) at the many interfaces within the agricultural sector, between agriculture and wider society, within society, and within policy.

Figure 1 illustrates the four predominant models of rural development. Immediately after World War II, the priority was increasing food production, and so the focus was on the agricultural sector, with rural employment and services seen as following directly from the production support given to the agricultural sector. Since then, the approach has shifted to multi-sectoral, territorial and local approaches. The multi-sectoral policy recognises agriculture as one of several economic sectors through which development objectives can be attained. While the focus is still on farming, agricultural diversification is encouraged. The territorial approach recognises the importance of social, environmental and economic issues within the rural areas. Lastly, the local approach differentiates among rural areas and seeks solutions that are specific to individual circumstances. These changes in approach have major implications for the methodologies used to analyse rural problems and evaluate policies.

Figure 1. Evolution of rural development policies



Source: Hodge (1997)

The fundamental logic of rural development is beginning to be questioned at two levels: (i) policies or central intervention, and (ii) local aspirations aimed at improving everyday rural life (Nemes, 2005). Land and agrarian reforms on their own have had limited success in reducing poverty, underdevelopment and inequalities in rural areas (Hemson et al., 2004). Therefore, perhaps constructing a comprehensive and generally accepted policy guideline or strategy of rural development is not possible (Van der Ploeg et al., 2000).

Conceptual definitions, policies and strategies of rural development remain contested. Shifts in rural employment and population reflect larger shifts in the national economy, including the expansion of employment in the services sector and a decline in the relative size of the manufacturing sector. In fact, many rural areas benefited from technological change and the relocation of manufacturing into rural areas, while other areas benefited from reduced transportation and communication costs. These shifts have made rural places with high-valued natural amenities more accessible and desirable destinations for retirees, tourism-related businesses, and services sector firms. Rural areas are also home to people attracted by a rural lifestyle and lower land and housing prices, and willing to commute to cities for employment and for cultural reasons. Rural economies are becoming more diverse, while rural places are increasingly accessible, adjacent to expanding urban areas, and have rising incomes and preferred amenities.

Observation #3: "Rural" vs. "urban" is more than a simple dichotomy. There is a strong interdependence that produces a continuum from dense urban places to remote rural places.

The growing consensus is that rural development is more than just agriculture, land reform and food security. Therefore, agrarian reform is only a part of the rural development programme, which needs to address other aspects of societal development, including universal access to water, electricity, roads, schools and health in rural areas. These are constitutionally mandated services and essential for the livelihoods of rural communities. The relevance of multiple sectors and multiple factors, the interplay of demand and supply, and the need to understand household and producer responses to market signals and policies are obvious in this setting.

Observation #4: Rural development requires general equilibrium tools, as these and other quantitative tools provide a necessary foundation for community economic analysis.

Rural development policy has evolved, from the social and political goals implicit in the RDP era, to the spatial concepts of nodes, corridors and infrastructure strategies contained in the Integrated Sustainable Rural Development Strategy (ISRDS) of 2000, to the extension of quality government services to rural areas in the Comprehensive Rural Development Programme (CRDP) of 2009. Rural development has consistently been among the priority areas identified in the Medium Term Strategic Framework (MTSF) of 2009–2014 and 2014–2019. Between 1996 and 2012, government's strategies and growth plans supporting rural development included the Growth, Employment and Redistribution (GEAR) programme, the Accelerated and Shared Growth Initiative (AsgiSA) framework, the New Growth Path (NGP) and both the National Development Plan (NDP) and the Strategic Infrastructure Projects (SIP) in 2012. Rural development is Outcome 7 (Vibrant, equitable and sustainable rural communities and food security for all) of the 12 delivery outcomes, and the service delivery agreement is between the President and the Minister of Rural Development and Land Reform.

The Reconstruction and Development Programme (RDP) emphasised people-centred development, democratic participation, social goals, investment strategies and infrastructural objectives. It was comprehensive, covering areas such as agriculture, education, health, public works and social welfare. The ISRDS focused on poverty eradication by ensuring effective implementation (of rural development programmes) through better coordination and cooperation among the different spheres of government. It emphasised greater effectiveness in service delivery without additional funding (resources). The ISRDS, which was later launched as the Integrated Sustainable Rural Development Programme (ISRDP), has been criticised for relying too much on integrated development plans (IDPs) and for "not setting out clear priorities and sequences that would make change possible" (Hemson et al., 2004: 13). An assessment of the ISRDP found that, although poverty steadily declined in the rural nodes and literacy rates showed signs of improvement, unemployment remained critically high (Everatt et al. 2006). The programme was found to be fraught with coordination problems and mixed results, with low levels of community awareness of associated projects, suggesting a lack of community participation (ibid). Therefore, in 2009, the Department of Rural Development and Land Reform (DRDLR) was established to bring "comprehensive" rural development to the forefront, through the CRDP, which identifies 27 rural district municipalities with significant infrastructure backlogs and low levels of human development indicators. The intention is to address rural development through a cross-sectoral and multi-occupational diversity of programmes, and to build "vibrant and sustainable communities", through a coordinated and integrated broad-based agrarian transformation, rural development infrastructure, and an improved land reform programme.

1.3 Explaining Change in Rural Development

The Technical Report documents and analyses broad trends in rural development and intergovernmental fiscal relations (IGFR) instruments, with a view to providing new insights into sustainable national development. Rural development is inextricably linked to industrialisation and modernisation, both historically and among rapidly growing developing countries today. The good economic reasons for this relation are supported by both theoretical and empirical work. The literature covers inter-related topics of (a) structural transformation, and (b) surplus labour, migration and growth.

1.3.1 Structural transformation literature

Economic transformation is a long process, from agriculture to manufacture, and then to services. Its anchors are the classic papers by Rostow (1960) and Kuznets (1966), and the modern literature can be partitioned into three blocks: transition to modern economy and industrial transformation; activation of the industrial transformation process; and recent quantitative analysis that uses dynamic general equilibrium models.

Transition to modern economy and industrial transformation

Long-term economic development is a four-stage model driven by increasing returns to specialisation, which lead to the transition from household to market production, knowledge and human-capital accumulation and then industrialisation (Goodfriend and McDermott, 1995). The increasing returns to specialisation are made possible by a growing population and ultimately trigger a learning technology that activates industrial growth, which in turn moves the economy to a balanced, fully market-based growth path (ibid).

The movement of labour force from a more land-intensive to a less land-intensive technology drives the transition process from stagnation to growth (Hansen and Prescott, 2002). Over time, the share of land in production should decline endogenously, enabling an escape from Malthusian stagnation towards the modern Solow type of growth – this transition (from Malthus to Solow) denotes the diminishing importance of land as a factor of production (ibid). Given the decline in the importance of agriculture, as labour shifts from agriculture to manufacturing and services, the balanced macroeconomic growth models need to be questioned (Kongsamut et al., 2001). While widely used in macroeconomics because of their consistency with the famous

Kaldor facts of economic growth, these growth models are inconsistent with the equally important massive structural change, as labour moves away from agriculture in "one of the most striking regularities of the growth process" (ibid, 2001: 869).

Gollin et al. (2002a) also emphasise the importance of agriculture's declining share to development – development is associated with a relative decline in the weight of the agricultural sector in the economy, in terms of its share of employment and per capita output. Thus advances in agricultural productivity are essential for providing the means to allow labour to be reallocated to the modern sector (ibid). Agricultural productivity is negatively related to the share of employment in agriculture, and a negative relationship exists between the productivity of agriculture and the productivity of non-agriculture. Thus the growth in a country's agricultural productivity (as measured by food output per capita) is positively related to the movement of labour out of agriculture, whereby a shift of labour from agriculture to non-agriculture raises average productivity (Gollin et al 2002b).

The factors of production are important in determining the transition process, while growth is influenced by the interaction between capital deepening and differential capital shares across sectors (Acemoglu and Guerrieri, 2008). Differences in capital intensity across sectors bring about a faster growth of output and employment in sectors with relatively lower capital shares. Differential sectoral capital intensities generate both relative price changes across sectors and sectoral shifts, resulting in more capital-intensive sectors (because of capital deepening) and, at the same time, capital and labour being reallocated away from those capital-intensive sectors (ibid). However, in the industrial transformation process, job losses may exceed job creation immediately following the establishment of a modern industry, while income distribution may worsen (Wang and Xie, 2004). If implemented inappropriately, development policy programmes could fail, resulting in a poor country.

The transition to a "new economy" is characterised by faster manufacturing productivity growth, in terms of output per hour, and driven by an increasing pace of technical change (Atkeson and Kehoe, 2007). The three main aspects of such a transition are productivity paradox (a remarkably lagged response of the productivity growth rate to the increased rate of technological change), slow diffusion of new technologies and significant ongoing investment in old technologies (ibid). While this model may not fit all transitions, a transition to a "new economy" following prolonged increases in the rate of technological change is not always slow, as the speed of an existing technological change will determine the speed of the transition. Thus, the type of the transition following any technical revolution depends very much on its historical context (ibid).

Activation of the industrial transformation process

Increases in per capita income lead to a changing structure of demand, which consequently drives the economy's structural changes, in particular the rise of a mass consumption society (Matsuyama, 2002). The distribution of income across households is critical in determining whether a productivity improvement two-way causality produces expanding markets and virtuous cycles of productivity gains. Income distribution should not be too equal or too unequal: if it is too equal the process does not take off, and if it is too unequal, the process will stop prematurely (ibid). As productivity improves in the industries affected by the increase in consumption, consumer goods prices decline, enabling more and more households to afford increasingly large numbers of consumer goods. Thus larger markets for consumer goods are generated, further improving productivity – the development process is characterised by a series of sectors that take off one after another (ibid).

As discussed in the previous section, a diminishing agriculture sector is important. Subsistence consumption of agricultural goods can lead to a downward trend in agricultural employment and, as per capita income rises, the consumption share of expenditure on agricultural products declines while the share of services rises (Kongsamut et al, 2001). Growth in per capita income is also associated with a decline in the share of agriculture and an increase in the share of services, not only in employment but also in gross domestic product (GDP).

Buera and Kaboski (2012) postulate a theoretical framework for understanding how the disproportionate service sector growth is influenced by specialised high-skilled labour. They argue that the movement of consumption into more skill-intensive outputs drives the growth in services. As demand shifts to more skill-intensive outputs, payment for high-skilled labour rises, ultimately pushing up the relative price of services associated with that level of skill. Empirical evidence highlights the rise in the importance of skill-intensive services, which increase as relative wages and the number of high-skilled labour increase (ibid). This theory is based on the increase in the quantity and price of skilled labour rather than the generic skill-biased technical change.

General equilibrium models

Analysing the structural change of an economy is crucial for informed policy-making, and such analysis is best undertaken using computable general equilibrium (CGE) analysis (Buetre and Ahmadi-Esfahani, 1996).

In Sri Lanka, Gunawardena (2012) found that rising agricultural productivity has a positive impact on the economy. However, improved agricultural productivity could result in reduced agricultural employment, with relatively lower short-run real household income in agricultural provinces

(ibid). Salami et al. (1998) used a four-sector model to study how the Iranian economy is affected in the short run by several types of technical change in the agricultural sector. They found that self-sufficiency in agricultural commodities is supported by capital-saving and labour-using technical change with a general growth in productivity, and such a technical change leads to an increase in the country's overall employment. However, if the capital-saving and labour-using technical change is not accompanied by increased productivity, the result is a reduced agricultural sector, a decrease in employment, dampened economic growth and, consequently, reduction in overall welfare (ibid).

Agricultural policy reforms can have complex impacts on diversified economies, particularly in developing countries (Taylor et al., 1999). When the support price of staples is decreased, and the decrease in price is compensated by a lump-sum income transfer to staple producers, households shift their resources out of staple production to other competing activities, and migration effects are minimal (ibid).

Using CGE-microsimulation analysis, Otchia (2014) compared agriculture modernisation models in the Democratic Republic of the Congo to see which contribute more (or less) to growth and poverty. The results suggest that labour-intensive technological change creates relative and absolute pro-poor effects, while capital-intensive technological change generates immiserising growth. What is important for pro-poor agricultural modernisation is "developing input supply networks, securing tenure among smallholders, and improving access to land for women" (Otchia, 2014: 1).

Dynamic CGE models

Using a dynamic CGE model that takes into account technical and institutional rigidities in the economy, Storm (1994) assessed the macroeconomic impact of various agricultural policies between 1985 and 1990 on growth, income distribution, and balance of payments, inflation and government budget. The simulation found that public investment in irrigation is more effective at achieving growth than fertiliser subsidisation and procurement pricing.

Bussolo et al. (2014) used a dynamic CGE-microsimulation analysis to assess medium to long-term poverty and distribution impacts of different growth patterns, in support of their argument that a massive reduction in employment in the agricultural sector in Brazil in recent years could have contributed to poverty reduction in the country. The simulations included: changes in the agricultural and non-agricultural labour income of unskilled labour, changes in the labour income of skilled labour and changes in the sectoral (agriculture vs. non-agriculture) composition of the unskilled labour (Bussolo et al., 2014: 13). The results indicate that the rural poor in Brazil benefit relatively more than the average population, driven by growing labour demand and related higher wages in agriculture.

1.3.2 Surplus labour, migration and growth literature

The pioneering work on surplus labour economies is by Lewis[2] (1954), Fei and Ranis (1961, 1964) and Sen (1966) who analysed implications of surplus labour economies for labour-market performance and economic development. The term "dual economy" refers to the existence of traditional and modern sectors within one economy (Lewis, 1954). The traditional sector typically uses traditional technology with low capital intensity and features low productive and paid labour. In contrast, the modern sector uses advanced technology and is relatively capital intensive, with high productive and paid labour. In the Lewis model, agriculture supplies labour and food to industry: labour migrates from agriculture to industry until the surplus of labour is exhausted, i.e. convergence in urban and rural wages (Harris-Todaro equilibrium conditions discussed below).

Following these seminal works, there has been an explosion of work focusing on the implications of rural surplus labour in a dual economy. Perhaps the most influential papers are by Todaro (1969) and Harris and Todaro (1970), (hereinafter referred to as HT). In the HT papers, urban unemployment and labour policies are examined under an institutionally fixed minimum wage (above its equilibrium level) in the urban areas. Extensions of HT include Khan (1980) who re-examined generalised HT models through a trade theory lens (Heckscher-Ohlin). The findings are that a uniform subsidy to labour with a differential subsidy to capital is optimal (in the sense of second-best).

A number of studies look at the growth debate from a trade viewpoint. Batra and Naqvi (1987) evaluate gains from trade in an urban unemployment setup, with the optimal policy being a uniform subsidy to labour together with free trade (no tax levied on goods). Beladi and Marjit (1996) feature a rural sector that employs labour and an intermediate good (no capital), while in the urban area, both the intermediate good and final good employ capital and labour. A tariff on the final good in urban areas lowers capital rental and raises urban employment, provided the urban final good sector is capital intensive. Chang et al. (2009) argue that a tariff reduction improves production efficiency but distorts labour markets in a simple HT setting.

Another strand of the literature brings dynamics into the analysis, with two variants. One is by Drazen and Eckstein

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[1] Lewis's two-sector model assumptions are that (a) the traditional sector is agriculture and (b) the modern sector is industry.

(1988) who construct a two-period overlapping generations framework. Land is a specific factor in the rural sector and capital is a specific factor in the urban sector. The decentralised equilibrium in this setup is suboptimal. The other variant is by Glomm (1992) who proposes an infinite lifetime model that allows for rural-urban migration. Higher urban productivity is explained by lower costs of communication with higher population density. Unlike in the Overlapping Generations Model, the decentralised equilibrium is found to be Pareto optimal.

A final strand of the literature worth mentioning uses rural-urban migration to explain equilibrium low-growth traps under informational asymmetries. For instance Bencivenga and Smith (1997) argue that adverse selection of workers into urban areas perpetuates low growth, and that rural-urban migration as well as underemployment can cause development traps. They observe that two important features of economic development are usually omitted from conventional neoclassical growth models: (a) pronounced migration from rural to urban employment sectors has consistently accompanied modern economic development, and (b) some level of unemployment is present in all economies.

For Banerjee and Newman (1998), the modern urban sector has imperfect credit markets and associated higher agency costs, and migration is a very important channel through which modernisation takes place. They model a general equilibrium modernising economy with an urban sector characterised by high productivity and large information asymmetries, and a rural sector that has low productivity and small information asymmetries. The trade-off between productivity and credit availability due to agency costs in the urban sector implies that not everyone will be able to move to the urban sector (ibid).

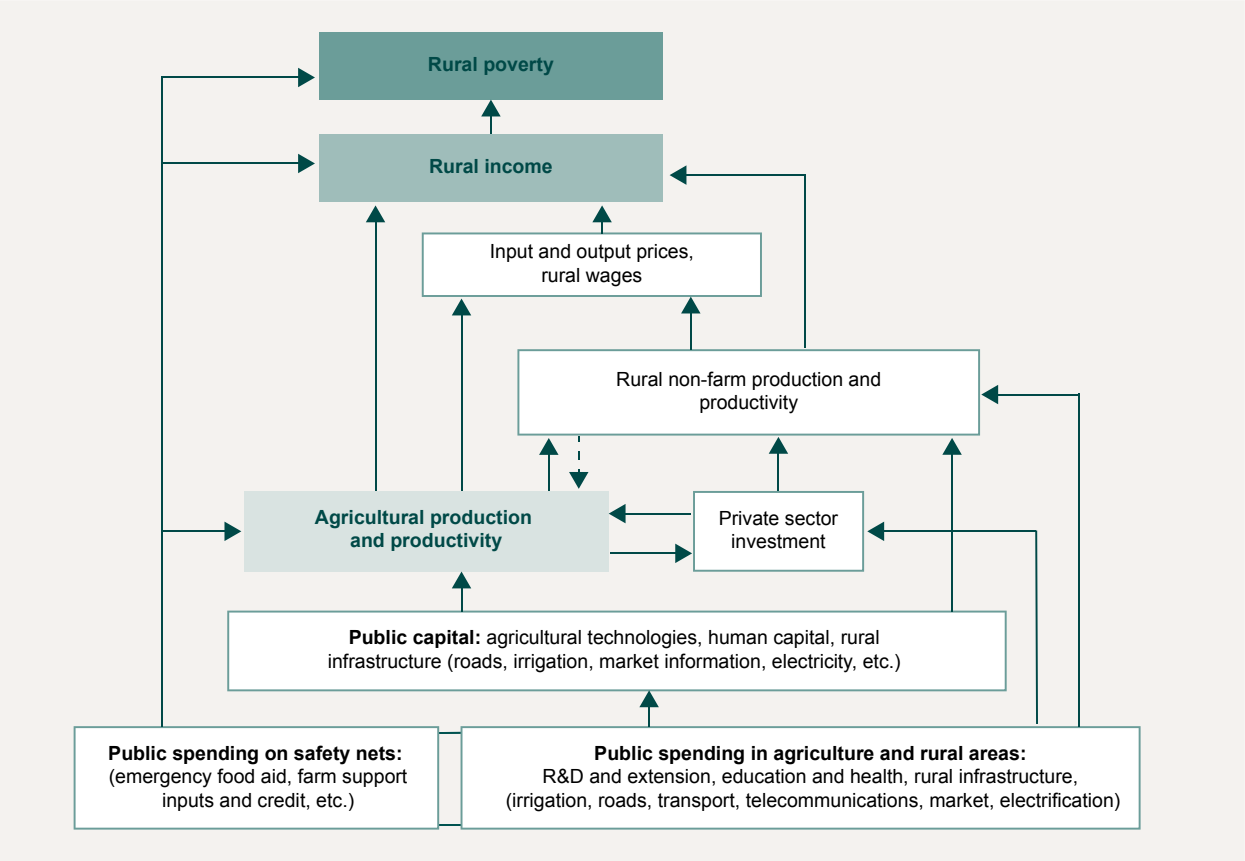
Lucas (2004) offers a variant to the HT model, whereby rural-urban migration is modelled as a "transition from a no-growth agricultural sector using traditional technology to an urban sector where there is persistent growth due to human capital accumulation". Urban sector workers choose to allocate their time between accumulating human capital and working. There is a persistent wage differential between the urban and rural sectors, which in essence reflects the return to human capital accumulation that workers must engage in when they migrate to the city. Other causes of rural-urban migration include the loss of income-earning opportunities because of gains in agricultural productivity and extensive uses of capital (Barkley, 1990); the differential urban/ rural wage (Dennis and Iscan, 2007); higher levels of rural unemployment or better prospects of getting employment in urban areas (Gebremariamet al., 2011); declining farming programmes and the transfer of manufacturing plants to suburbs and metro areas (Goetz and Debertin, 1996); diversification, as a household responds to the gains from an expansion of economic choices and opportunities (Arzaghi and Rupasingha, 2013); and the need for social and natural amenities (Deller et al., 2001).

1.4 The Conceptual Framework Underpinning the Technical Volume

The model underpinning the volume is multi-layered and multi-levelled, covering local, regional and provincial and encompassing many actors, institutions, enterprises, state enterprises and social movements. While these various dimensions are modelled here as distinguishable from one another, in reality they cannot be separated, as they are intertwined in various ways. For example, public investment in agriculture and rural areas can affect rural poverty directly or indirectly and at different levels (i.e. household, municipal, provincial or national), and the magnitude and direction of impacts will depend on the type of investment. Therefore, the impacts of investments must be assessed holistically (Figure 2).

The framework's premise is that when governments invest in agriculture and rural areas, government-owned assets (i.e. public capital) are created or increased, which are then used as a vehicle for increased agricultural production and productivity. Improvements in agricultural production and productivity then affect rural incomes either directly or through its impacts on input and output prices, rural wages, rural non-farm production and productivity. As rural incomes improve, rural poverty is expected to decline. The framework in Figure 2 highlights the complementarities between the two interventions proxied by public capital (IGFR instruments) and productivity (institutions): public capital stock affects the productivity of private capital (along with other factors of production) and its contribution to farm wages and incomes and poverty reduction (Anderson et al., 2006).

Figure 2. Growth and poverty-reduction pathways of rural policies



Source: Benin et al. (2008)

Figure 2 also captures the direct and indirect (via agricultural production and productivity, and rural incomes) impacts on rural poverty of public spending on safety nets. Safety nets increase the productivity of target groups by, for example, investing in their human capital through education, skills, health, and nutrition (Schultz, 1982), thereby contributing to poverty reduction. However, safety nets might also induce recipients to no longer work on farms, which could reduce agriculture production.

The essence of a general equilibrium is that the interrelations, interactions, exchanges and positive externalities are expressed simultaneously across all dimensions. Similarly, the general equilibrium concept is not limited to the agricultural sector but captures all possible elements that share the same geographical space on both the consumption and production side. The notion of general equilibrium only becomes meaningful when this wider set of interdependencies and interactions, and the implied synergies and externalities, are taken into account.

In assessing the impact of public investments in agriculture and rural areas, the importance of institutional arrangements needs to be highlighted. Institutional arrangements are formal and/or informal structures and mechanisms of social configuration and cooperation. The starting point for this model is the Constitution. South Africa is a unitary decentralised country with a three-sphere government structure, divided into 278[4] municipalities, nine provinces and one national government. Schedule 4 Part A of the Constitution assigns rural development as a concurrent area of responsibility among national government, provinces and municipalities. This makes rural development policy complex and traversal, involving different state institutions and agencies that are assigned different aspects of rural development. National and provincial governments, rural municipalities, state-owned enterprises (SOEs) and the private sector are all involved in rural development initiatives. Others involved include professional interests and communities, which are to some extent dominated by the agricultural profession and its representatives, and an expanding civil society represented by local and national non-governmental organisations (NGOs), particularly in the environmental domain. Non-agricultural professional interests constitute a third component of the non-state, non-local government actors in rural development.

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[3] Also referred to as "general equilibrium" effects when combined.

[4] The 2015 boundary redeterminations will result in a reduction of local government structures by 21 municipalities, from 278 to 257.

Table 1. Mandate and funding of three government spheres

Government sphere	Constitutional mandate for rural growth and development	Funding
National	• Overall coordination of rural development, land and agrarian reforms. • Agricultural development.	Taxes and duties
Provincial	• Economic: rural development, regional planning and development, agriculture, industrial promotion, etc. • Social: education, health, social welfare. • Oversight over sub-provincial governance structures: municipalities, traditional authorities.	Own revenue Provincial equitable share Grants (conditional, indirect and other) No borrowing
Local	• Economic: local planning, infrastructure and services for economic activities: electricity, water, roads, markets, abattoirs, etc. • Social: early childhood development (ECD).	Own revenue Local government equitable share Grants (conditional, indirect and other) Borrowing

Source: Author's computations

At national government level, rural development programmes are mostly located within the DRDLR and the Department of Agriculture, Forestry and Fisheries (DAFF), which each have a dedicated programme for delivering services to rural people. As rural development is multi-faceted, government has adopted a joint implementation approach, which among other things addresses coordination failures. This joint approach is outlined in the MTSF implementation plan. Table 2 shows the various outputs, policy targets and responsible government ministries for each NDP rural development outcome. The government departments responsible for the different activities cut across the spectrum of provincial mandates. It can thus be concluded that national policy acknowledges the role of provinces in implementing various aspects of rural development. The main provincial responsibilities of expenditure for local governments are: administrative costs; provision of the basic services (electricity, water, sanitation and refuse removal); building and maintaining of municipal roads; local social and economic development; community services, such as parks, sports, recreation etc.; and disaster management and fire services.

Table 2. Selected rural development outputs and departmental responsibilities

Outcomes	Activity/output	Responsible Minister	Target
1	Develop and implement spatial development plans	DRDLR, Department of Cooperative Governance and Traditional Affairs (COGTA), Department of Human Settlements (DHS), Department of Public Works (DPW)	March 2016
2	Acquire and allocate strategically located land	DRDLR	2 million hectares (ha) by March 2019
3	Implement the comprehensive food security and nutrition programme	DRDLR, Department of Agriculture, Forestry and Fisheries (DAFF), Department of Social Development (DSD), Department of Basic Education (DBE), Department of Health (DOH)	1.6 million households benefiting by March 2019
4	Expand land under irrigation	DAFF, DRDLR, Department of Water & Sanitation (DWS), Department of Energy (DOE)	Additional 1250 ha under irrigation by 2019
5	Eradicate infrastructure backlogs in rural schools	DBE, DRDLR, DPW	100% by March 2019
6	Promote rural enterprises and industries	Department of Small Business Development (DSBD), Department of Trade and Industry (dti), Economic Development Department (EDD), Department of Tourism, DRDLR and DAFF	Additional 60 formal enterprises per district municipality

Source: Author's computations

Provinces and national government have similar rural development approaches and sub-programmes. The provincial departments of agriculture and rural development carry out many of the programmes, which are overwhelmingly dominated by agrarian activities, project oriented and supply driven, unsystematic and spread thinly across rural villages. These departments are involved in delivering programmes, such as the revitalisation of irrigation schemes, livestock improvement, milling plants and silos on CRDP sites, food nutrition, and the provision of boreholes and agriculture inputs to communities. Unlike their national counterparts, some of the provincial agriculture and rural development departments include the services delivered by other departments within the rural space. For instance, Mpumalanga's Annual Report 2014 shows the contribution made by the departments of social development, education and economic development in providing youth centres, training ECD professionals and establishing a bakery, among other things.

Overall, rural areas are receiving considerable attention from provincial governments, especially agriculture, but it is unclear whether the programmes are delivering the full complement of services required for rural development. Although the CRDP provides government with an opportunity to coordinate interventions towards areas with the greatest needs, the programme is likely to be undermined by isolated departmental planning processes – sector departments plan separately from municipalities (the custodians of rural spaces), which leads to duplication.

Municipalities have two core responsibilities with respect to rural development: the effective provision of basic services, and associated support to local economic development (LED).[5] The purpose of LED is to build up the economic capacity of a local area to improve residents' quality of life. It is a process whereby the public, business and social sectors work collectively to create better conditions for economic growth and employment generation. Since 1995, considerable energy and resources have gone into enabling municipalities to play a meaningful role in LED. However, the resources are not sufficient for implementing large-scale projects outside of strong partnerships with other public and private agencies. Expenditure is also very limited compared to local government's other service delivery priorities, with on average less than 1% of municipal operating budgets going towards LED initiatives, either directly or through municipal entities (development agencies). Initiatives include the tourism and agricultural sector, and depend on the geographical location and comparative advantages of each municipality. For instance, in most coastal municipalities, LED initiatives are focused on tourism development and urban regeneration initiatives that will further attract investment and tourism.

In addition to national, provincial and local government, a range of public entities and SOEs are responsible for various rural development initiatives. In certain instances, these initiatives are part of the entities' corporate responsibility programme; in others, specific programmes have been established to offer technical support to municipalities and to provide financial support for the implementation of projects. The three main initiatives in this regard are:

- The Agency Development and Support Programme, which is an initiative of the Industrial Development Corporation (IDC) and supports the establishment of municipal LED agencies. Currently, 32 such agencies are being established or are operational. However, the concern is that using the agency route creates another level of governance and bureaucracy, which is costly to manage and dilutes the developmental impact.
- Electricity reticulation by Eskom and district municipalities. Most rural municipalities have very limited functions because of the asymmetric division of functions between municipalities and historical legacies of poor capacity. As a result, Eskom and district municipalities play a crucial role in the reticulation of electricity and water respectively in rural areas.
- The Rural Economic Development Initiative, which is a DBSA project currently being piloted in three municipalities. Its aim is to explore ways of implementing seven common development principles for effective LED: plotting the path; shifting stakeholder focus from the consumption economy to the productive economy; acknowledging the importance of a large, diversified economic development portfolio; identifying bold projects; promoting and facilitating partnerships; improving municipal performance; and developing strategic policies to promote sound economic development.

Private sector LED initiatives range from projects by individual firms, farmers and churches, to interventions by research institutions and non-profit organisations that focus on particular aspects of development, such as micro-finance, subsistence gardening, skills development etc. Examples of micro-finance assistance include the Women's Development Bank and the Old Mutual Group's Project Imbizo. International donors also play a valuable role in funding and facilitating LED. For example, the European Union (EU) provides financial and technical support for municipal LED programmes in the Eastern Cape, KwaZulu-Natal and Limpopo.

To ensure robust analysis and findings, a mix of econometric and simulation/modelling methods and tools are used to assess the impacts of IGFR instruments in agriculture and rural areas (Byerlee et al., 2009). Figure 3 demonstrates how the effects of IGFR instruments (e.g. public investments) filter through the entire economy in the proposed framework.

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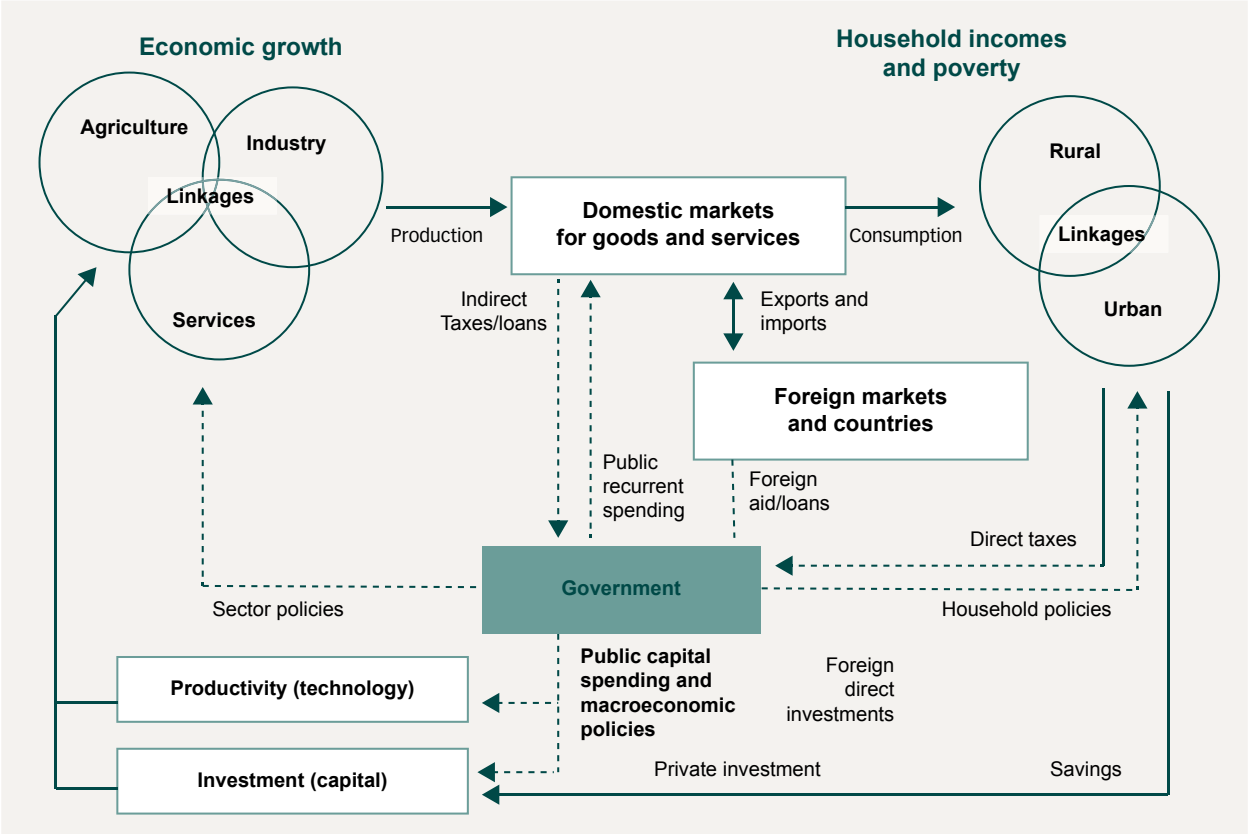
[5] According to Sections 152(1) (c) and 153 of the Constitution, one of local government's objectives is to promote social and economic development. These objectives are further articulated in the Municipal Systems Act (No. 32 of 2000).

Figure 3. Economy-wide linkages of rural policy in a general equilibrium model



Source: Benin et al. (2008)

Quantification and modelling is required in order to attach numbers to these relationships. Identifying the types of socio-economic models that can be used to analyse rural policy issues is fraught with difficulty. The model types used in this Technical Report take into account different policy measures corresponding to each generic policy issue and hence, the "compatibility" of each measure with types of socio-economic models that are able to carry out the analysis. The various methodological approaches used are described below:

Econometric analysis

- A systems approach and, more specifically, a simultaneous-equations method that takes into account different rural poverty and investment decisions. Failure to take these decisions into account leads to biased estimates of the effects or net benefits of public investments (Greene, 1993).
- A reduced-form, single equation of rural poverty in which instruments are used for the potentially endogenous explanatory variables or estimating a reduced-form model. The major shortcoming of this approach is that the different intermediate effects of public investments cannot be quantified.

Estimations are also done at three levels: micro-, meso-, and national level.

- Micro-level analyses focus on the impacts of public investments on farms and/or households. Possible data sources include nationally representative household surveys, such as General Household Surveys (GHS). Since the level of public investments does not vary by household or farm, the effect of public investments will be captured by including variables that capture the household's access to particular public goods and services.
- Meso-level analyses at municipal and/or provincial level make it possible to assess the effects of inter- and intra-sectoral public expenditure allocation. Further, this approach allows the spatial distribution of public investments and poverty-reduction to be analysed.
- Macro-level analyses are common in literature, as different types of public investments and related data are often available at this level. However, estimation at this level requires a relatively long-time series data.

Qualitative and case study approaches

- In some instances there is also reliance on case studies and desktop research to address the issues.

Simulation modelling approaches: CGE models

- CGE models that use SAMs to analyse economy-wide impacts of public investments (see e.g. Jung and Thorbecke, 2003; Lofgren and Robinson, 2008) are also used. They have also been combined with household surveys for micro-simulation where issues of poverty are discussed.

1.5 Defining Rural

South Africa does not have an officially agreed and accepted definition of "rural". Efforts to classify territories according to their degree of rurality – for policy purposes – have not been entirely successful.[6] Further complicating the situation is the large-scale re-demarcation of provincial and municipal boundaries that accompanied the transformation of provincial and local government after apartheid. This process removed the administrative distinction between urban and rural areas, in recognition of the strong linkages between towns and the countryside. Although a largely positive development, it has made determining what constitutes a rural area (and by extension a rural province or municipality) more complicated.

Although the importance of rural development for reducing poverty is recognised, the meaning of the concept is sometimes not clearly understood. The relationship between rural development and related aspects, such as land reform, food security, infrastructure, institutions etc., is also not always clearly defined. These terms are often used very casually when discussing public policy, without describing explicitly the places where rural programmes are intended, or having precise eligibility requirements, so the programmes can be delivered "without expensive leakages to other, unintended beneficiaries" (Isserman, 2007: 73). The effectiveness and appropriateness of rural development policies depend on how places are selected, while the understanding of rural conditions and the policy context depend on the definitions used.

As there is no common understanding of what constitutes a rural area or rural municipality, a hybrid of administrative, historic and literature-based approaches is used to establish a definition. Consistent with the Rural Development Framework of 1997, rural areas are defined as having at least the following two characteristics:

- Sparsely populated areas in which people farm or depend on natural resources, including villages and small towns that are dispersed through these areas.
- Areas that include large settlements in the former homelands, which depend on migratory labour and remittances, as well as government social grants for their survival, and typically have traditional land tenure systems.

The definition takes into account spaces and population densities, as well as relevant history (the "homelands"). The DRDLR defines as "rural", areas outside urban settlements where population densities are less than one dwelling unit per hectare, and describes rural development as generally including primary economic activities: agriculture, agro-processing, mining, tourism, resource extraction, water, energy. The Department of Cooperative Governance and Traditional Affairs (COGTA) has developed an analytical tool to help classify municipalities based on their spatial characteristics. Category B municipalities are classified into categories B1, B2, B3 and B4.[7] Both B3 and B4 municipalities (and C2 district municipalities) are classified as rural. The advantage of this rural/urban classification is its general acceptance and use, at least within the local government sphere. However, the disadvantage is the classification may be somewhat outdated, having remained largely static over the years, with the only real changes being the "upgrading" of two secondary cities to metropolitan status.

To be in sync with these administrative definitions at the broadest level, the methodology used is as follows:

- Spatial (urban/rural divide) and sectoral (agriculture and traditional activities) factors plus population size and density: sparsely populated areas in which people depend largely on agriculture or natural resources, including villages and small towns that serve as rural centres.
- History and/or rural idyll: large or "closer" settlements created by the dumping of populations in the former homelands during apartheid.
- Administrative: categorisation methodology developed by the COGTA and DRDLR.

Municipalities are grouped into seven different categories using variables that include the number of poor households, the proportion of households with access to services (water, sanitation and electricity), and capital and operating budgets. Accordingly, rural municipalities are those classified as B3 (small towns) and B4 (mostly rural) municipalities in the typology outlined in Table 3.

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[6] Stats SA has discontinued the publication of spatially disaggregated (urban and rural) official statistics. Note the new Stats SA definition now has small areas as opposed to enumeration areas and the following three classifications: urban, tribal areas and farms.

[7] The B1 to B4 classification system was developed by the Palmer Development Group. The definition can be found in Chapter 12 of National Treasury (2011). Although not an official definition, it is used very widely for analytical purposes and helps to make a case for the differentiated approach to municipalities

Table 3. Classification of municipalities in 2015

Class	Characteristics	Number
Metros	Category A municipalities	8
Secondary cities (B1)	All local municipalities referred to as secondary cities	19
Large towns (B2)	All local municipalities with an urban core. These municipalities have large urban dwelling populations, but the size of their populations vary hugely.	26
Small towns (B3)	Municipalities without a large town as a core urban settlement. Typically they have relatively small populations, of which a significant proportion is urban and based in one or small towns. Rural areas in this category are characterised by the presence of commercial farms because these local economies are largely agriculture-based. The existence of such important rural areas and agriculture sector explains why they are included the analysis of rural municipalities.	113
Mostly rural (B4)	Municipalities that contain no more than one or two small towns and are characterised by communal land tenure and villages or scattered groups of dwellings, and are typically located in former homelands.	68
Districts (C1 and non-rural)	District municipalities.	9
Districts (rural)	District municipalities that are rural.	35

Source: Author's computations based on Global Insight data and National Treasury (2011) definitions

The analysis identified 68 local municipalities that are mainly rural with at most one or two small towns in their areas. For district municipalities, the usual classification of C1 and C2, indicating rural and non-rural, is not very helpful because the provincial government decides whether or not to give water authority to a district municipality. Therefore, the same basis was used as for local municipalities, i.e. B3 and B4s. The number of rural municipalities was calculated as a share of total number of local municipalities in a particular district municipality. A district municipality is classified as "rural" if two-thirds or more of its local municipalities are B3 or B4. Applying this criterion, 80% of district municipalities are "rural" and 20% are non-rural. All non-rural municipalities are C1, while all C2 municipalities and some C1 fall in the rural category.

Distinguishing rural and urban provinces is equally as complicated. The Constitution does not classify provinces as urban or rural, and there is no common understanding of what constitutes a rural province. As a consequence, policy-makers and the general public tend to describe the provinces that historically formed part of the homelands and Bantustans as rural (in particular Eastern Cape, KwaZulu-Natal and Limpopo). These provinces are perceived to be highly under-developed and contain vast spaces of sparse settlements and land under traditional authority. In addition, traditional assumptions of "rural" persist, but these assumptions are often ungrounded and at best ignore the diversity inherent in areas typically grouped together as "rural" or "non-urban" provinces. For instance, a commonly held belief is that farming is a mainstay of rural provinces, which also have an ageing population and high poverty levels. In fact, provinces traditionally regarded as rural have relatively good access to amenities and connectivity.

Table 4 provides a breakdown of provinces ranked according to the level of "ruralness", as derived from a composite index that takes into account the share of B3 and B4 municipalities in each province. Provinces with higher composite indexes are more rural in nature than provinces with lower indexes. Using this definition, the three most rural provinces are Limpopo, KwaZulu-Natal, and Eastern Cape, while the Western Cape and Gauteng are the least rural provinces.

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[8] District municipalities which are water services providers (C2s) are typically located in "deep rural" or "traditional" areas, consisting of traditional villages and communal land ownership (these were the erstwhile "homelands"). In the past, these areas did not have conventional municipalities, and their current local municipalities are still extremely weak. Therefore the district municipalities took on the role of water services providers. Conversely, the district municipalities which are not water services providers are typically located in more western-type areas, consisting of large towns, small towns and commercial farmland (the erstwhile "white South Africa"). In these areas, the towns have had many decades (often over a century) of municipal governance, so the current local municipalities are fairly competent to manage water services provision. Therefore, the district municipalities do not have to execute this function.

[9] Homeland territories strictly set aside for black people under apartheid South Africa.

Table 4: Provincial ranking according to composite rural index (2015)

	Percentage share of B3 and B4 municipalities in each province (A)	Percentage share of B4 municipalities in each province (B)	Composite average of (A) and (B)	Rural ranking
Eastern Cape	87%	38%	63%	3
Free State	75%	0%	38%	7
Gauteng	8%	0%	4%	9
KwaZulu-Natal	79%	54%	66%	2
Limpopo	92%	64%	78%	1
Mpumalanga	67%	28%	47%	6
Northern Cape	92%	4%	48%	5
North West	74%	26%	50%	4
Western Cape	60%	0%	30%	8

Source: Author's computations based on Global Insight data

The robustness of this approach was checked by using the variable of whether the province (as currently configured) historically formed part of the Bantustans. This choice is driven by pragmatic policy considerations, as homelands remain an important policy issue and sentiment towards "rural". Based on these criteria, the most rural provinces are the Eastern Cape, KwaZulu-Natal, North West and Limpopo followed by Mpumalanga, Free State and Northern Cape. Table 5 locates the rural municipalities across the nine provinces based on the pre-2016 demarcations. Their ranking is similar to that in Table 4. Most of the rural municipalities (84%) are in the provinces that are predominantly former homeland areas i.e. the Eastern Cape, Limpopo and KwaZulu-Natal.

Table 5. Categories of municipalities per province

Province	Metros (A)	Secondary cities (B1)	Large towns (B2)	Small towns (B3)	Mostly rural (B4)	Districts (C1)	Districts (C2)	South Africa
Eastern Cape	2		3	19	15	1	5	45
Free State	1	1	3	15		4		24
Gauteng	3	2	3	1		2		11
KwaZulu-Natal	1	3	6	14	27	0	10	61
Limpopo	0	1	1	7	16	1	4	30
Mpumalanga		4	2	8	4	3		21
Northern Cape		1		25	1	6		33
North West		4	2	9	5	2	2	24
Western Cape	1	3	6	15		4		29
Total	8	19	26	113	68	23	21	278

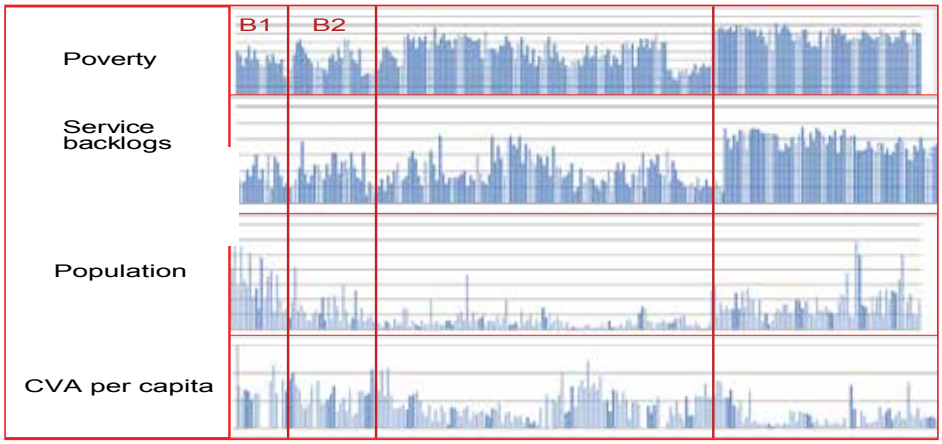
Source: Author's computations based on Global Insight data

1.6 Socio-Economic Characteristics of Rural Areas

Figure 4 illustrates that many municipalities have relatively high levels of poverty and service delivery backlogs, especially in rural municipalities (B3s and B4s) where gross value added (GVA) per capita is only R9 (compared to R76 in metros). This low economic activity translates into lower employment levels (13% on average in rural municipalities compared to 34% in metros and 29% in secondary cities) and points to rural municipalities having a limited own-revenue base.

Table 6 compares the population, economy and service backlogs in urban and rural municipalities.

Figure 4. Characteristics of municipalities



Source: Author's computations based on Global Insight data

Table 6. Comparison of urban and rural municipalities

	Metros	Secondary Cities (B1)	Large Towns (B2)	Small Towns (B3)	Mostly Rural (B4)	Districts (C1)	Districts (C2)	South Africa
Population (%SA)								
Male	41%	14%	8%	15%	22%	28%	31%	100%
Female	39%	14%	8%	15%	24%	27%	33%	100%
Aged 0–19 years	34%	13%	8%	16%	28%	27%	39%	100%
Aged 20–64 years	44%	15%	8%	14%	19%	28%	28%	100%
Aged 65+ years	37%	12%	9%	16%	26%	28%	35%	100%
Aged 20+ years with matric	53%	16%	8%	11%	13%	26%	21%	100%
Unemployment	23.65%	26.60%	26.60%	25.20%	33.60%	27.20%	28.40%	25.3%
GVA per Capita	R68 307	R57 493	R49 943	R40 180	R19 422	R49 037	R24 311	R50 748
Poverty	27.50%	27%	27%	26%	29%	26%	29%	28.0%
Service backlogs								
Electricity	11%	10%	14%	14%	28%	10%	25%	15%
Water	7%	9%	17%	17%	52%	11%	44%	19%
Sanitation	13%	18%	24%	23%	48%	20%	43%	25%
Housing	20%	17%	21%	18%	36%	16%	32%	22%

Source: Author's computations based on Global Insight data

The economically active population (measured as the population aged 20–64 years) is considerably smaller in rural municipalities than in urban areas, accounting for 19% of people in B4 municipalities and 14% in B3 municipalities, compared to 67% of the population in urban areas.[10] Young people under the age of 20 make up 28% of the population in B4 municipalities and 16% in B3 municipalities, in contrast to 55% in urban municipalities. People in rural municipalities are less likely to have school qualifications than their urban counterparts: only 13% of the population over the age of 20 years in B4 municipalities, and 11% in B3 municipalities, have matric qualifications, compared to 77% in urban areas.

As formal employment opportunities in rural areas are limited and often seasonal, unsurprisingly unemployment averages 25.2% in the B3 and 33.6% in the B4 municipalities, using the official (or narrow) definition of unemployment.

Table 7 shows the economic profile of urban and rural municipalities.

Table 7. Share of GVA by sector in rural and urban areas

	Metros (A)	Secondary cities (B1)	Large towns (B2)	Small towns (B3)	Mostly rural (B4)	Districts (C1)	Districts (C2)	South Africa
Agriculture and hunting	0.6%	2.2%	5.2%	10.7	5.1%	6.9%	5.1%	2.1%
Air transport and transport supporting activities	1.8%	0.8%	1.0%	0.6%	0.4%	0.7%	0.5%	1.4%
Collection, purification and distribution of water	0.3%	0.9%	1.2%	1.3%	2.2%	1.0%	1.7%	0.8%
Construction	4.1%	3.8%	5.0%	4.8%	3.9%	4.3%	4.0%	4.0%
Education	7.0%	7.3%	7.8%	9.6%	16.5%	7.0%	14.1%	7.5%
Electrical machinery and apparatus	0.3%	0.2%	0.2%	0.1%	0.1%	0.1%	0.1%	0.2%
Electricity, gas, steam and hot water supply	1.9%	3.6%	3.5%	3.9%	3.7%	3.6%	3.6%	2.9%
Electronic, sound/vision, medical & other appliances	0.3%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.2%
Finance and insurance	12.6%	6.9%	6.2%	5.3%	4.2%	5.5%	6.0%	10.0%
Fishing, operation of fish farms	0.1%	0.1%	0.6%	0.2%	0.1%	0.3%	0.1%	0.1%
Food, beverages and tobacco products	3.0%	3.9%	5.5%	3.9%	2.9%	3.7%	3.5%	3.2%
Forestry and logging	0.0%	0.2%	0.5%	0.8%	1.5%	0.3%	1.1%	0.3%
Fuel, petroleum, chemical and rubber products	2.9%	3.0%	3.1%	0.6%	0.7%	2.6%	1.0%	2.9%
Furniture/other items not else classified (NEC) and recycling	1.1%	0.8%	1.1%	0.6%	0.6%	0.6%	0.7%	1.0%
Health and social work	7.3%	5.3%	4.7%	4.3%	5.8%	4.3%	5.9%	5.8%
Hotels and restaurants	0.8%	1.0%	1.4%	1.2%	1.6%	1.1%	1.5%	0.9%
Land and water transport	7.7%	5.7%	6.5%	6.4%	5.6%	6.0%	6.4%	6.6%
Metal products, machinery and household appliances	2.1%	4.0%	1.7%	0.6%	0.9%	1.8%	1.6%	2.4%
Mining of coal and lignite	0.1%	5.8%	1.3%	0.9%	1.5%	2.7%	1.3%	1.9%
Mining of gold and uranium ore	0.3%	4.1%	4.8%	0.5%	0.7%	3.9%	0.1%	1.4%
Mining of metal ores	0.2%	4.8%	1.7%	4.8%	4.4%	7.4%	3.6%	3.7%
Other business activities	4.7%	2.9%	2.9%	2.0%	2.1%	2.3%	2.5%	4.2%
Other mining and quarrying	0.5%	2.1%	1.4%	4.7%	1.8%	4.6%	1.5%	1.4%

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[10] Note that "urban areas" includes metros, large towns and small towns using the conventions in Table 1.

	Metros (A)	Secondary cities (B1)	Large towns (B2)	Small towns (B3)	Mostly rural (B4)	Districts (C1)	Districts (C2)	South Africa
Other non-metallic mineral products	0.5%	0.6%	0.6%	0.6%	0.3%	0.6%	0.5%	0.5%
Other service activities	3.8%	2.7%	2.8%	2.8%	2.0%	2.7%	2.4%	3.6%
Post and telecommunication	2.6%	1.6%	1.5%	2.2%	1.0%	1.9%	1.4%	2.1%
Public administration and defence activities	7.0%	5.4%	6.1%	7.0%	5.9%	6.3%	6.6%	5.8%
Real estate activities	7.2%	5.0%	4.7%	3.8%	7.5%	4.2%	5.0%	6.3%
Retail trade and repairs of goods	7.1%	5.6%	6.1%	6.6%	7.6%	5.5%	7.4%	6.5%
Sale and repairs of motor vehicles, sale of fuel	2.9%	2.6%	3.0%	2.7%	2.0%	2.5%	2.5%	2.5%
Textiles, clothing and leather goods	0.6%	0.3%	0.5%	0.3%	0.4%	0.2%	0.5%	0.4%
Transport equipment	1.9%	0.4%	0.5%	0.5%	0.3%	0.3%	0.4%	0.9%
Wholesale and commission trade	5.4%	4.6%	4.5%	4.8%	5.5%	4.1%	5.7%	5.0%
Wood and wood products	1.4%	1.6%	2.2%	1.0%	1.6%	0.9%	1.7%	1.5%
Total industries	100	100	100	100	100	100	100	100

Source: Author's computations based on Global Insight data

As Table 7 shows, economic activities are less diversified and lower in rural areas than in urban areas, which partly explains the high unemployment rate in rural areas. Interestingly, agriculture plays a less significant role in rural municipalities than is generally perceived: it contributes 10.7% to GVA in B3 municipalities (reflecting the presence of commercial farming in these areas) but only 5.1% in B4 municipalities. Wholesale and trade, infrastructure and manufacturing are also significant contributors to GVA in all rural (B3 and B4) municipalities.

Access to infrastructure affects the ability of municipalities to carry out their functions and deliver services to their communities. Figures 5 and 6 shows access to water, sanitation and electricity services in urban and rural municipalities respectively.

Figure 5: Access to services in urban municipalities (1996–2014)

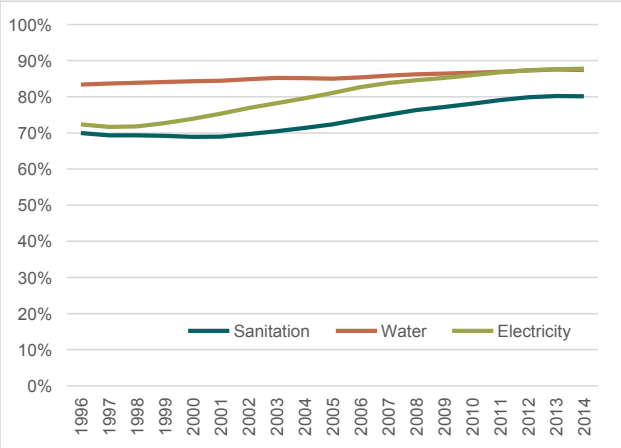
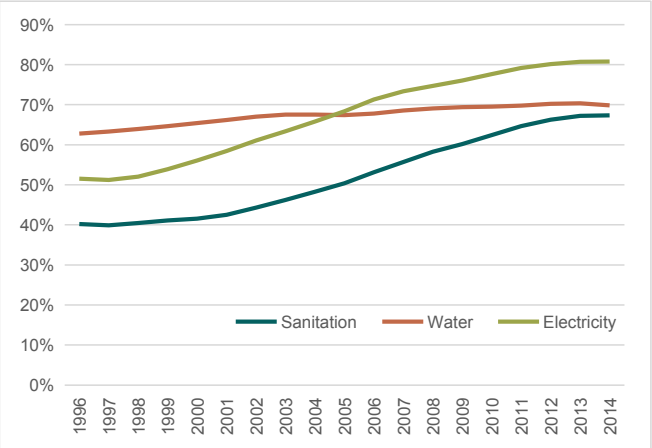


Figure 6: Access to services in rural municipalities (1996–2014)

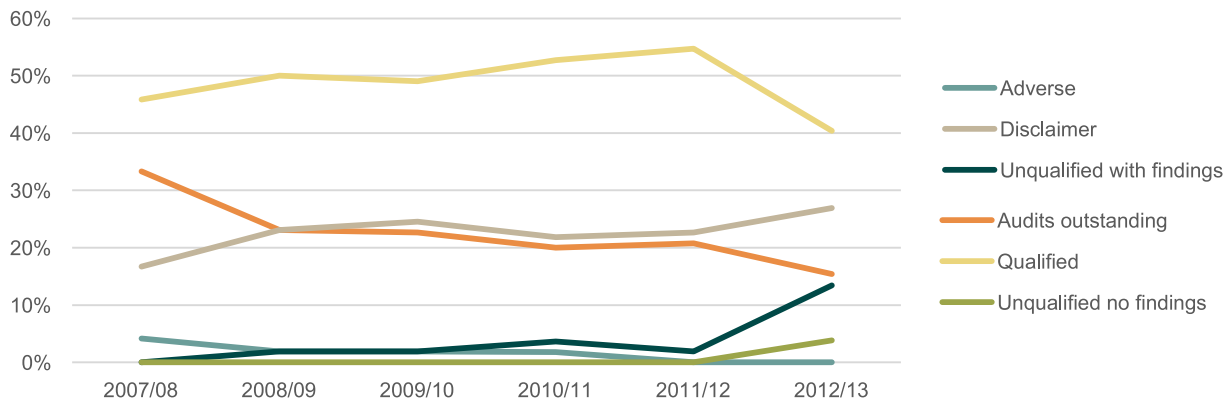


Source: Commission's computations based on Global Insight data

In urban areas, the average overall access has not changed significantly and remains below 90%, whereas access to electricity connections has steadily increased, from 73% in 1996 to 88% in 2013/14. Access to sanitation has improved but still has the highest backlog. In comparison, rural municipalities have seen a substantial improvement in access to sanitation, from 41% in 1996 to 69% in 2014 (Figure 6). Electricity connections to households have also improved hugely in rural municipalities, increasing from 52% in 1996 to 81% in 2014. Access to water, although at a higher level than sanitation, has not improved much over the years. This is because the spatial setting of households in some rural municipalities makes delivering services difficult.

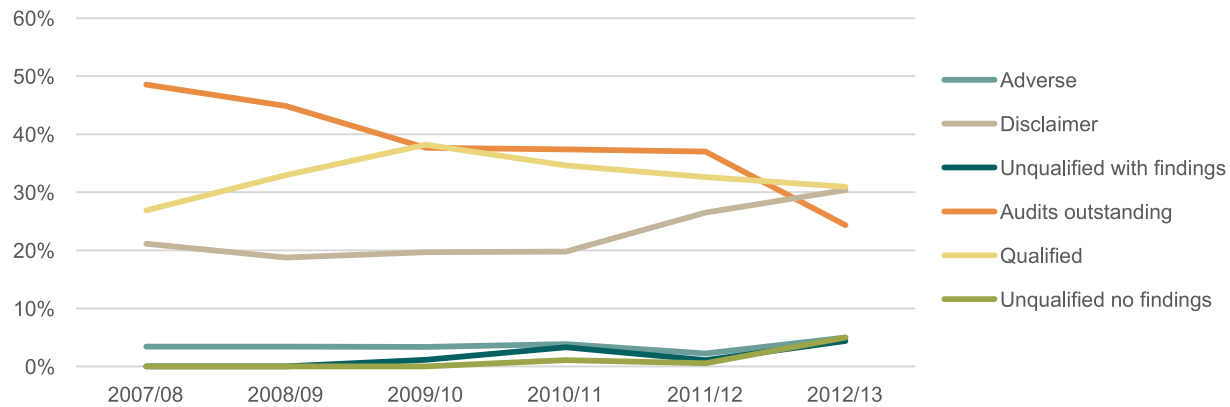
The majority of those being connected to municipal services are poor and unemployed, which poses a challenge for local economic development and the viability of municipalities. State (municipal) capacity may be compromised when residents are too poor to pay for the services necessary for development. However, in practice, this might not be true, as rural municipalities often have high repayment levels because pre-paid electricity and water is the norm. For example, in the case of municipal debt owed to Eskom, the culprits are from the Free State and Mpumalanga rather than from the more rural provinces of KwaZulu-Natal, Eastern Cape and Limpopo. This is collaborated by audit outcomes, which show that the number of municipalities with outstanding audits across both urban and rural areas have declined over the years (Figures 7 and 8).

Figure 7. Audit outcomes for urban municipalities (2007/08–2012/13)



Source: Commission's computations based on Global Insight data

Figure 8. Audit outcomes for rural municipalities (2007/08–2012/13)

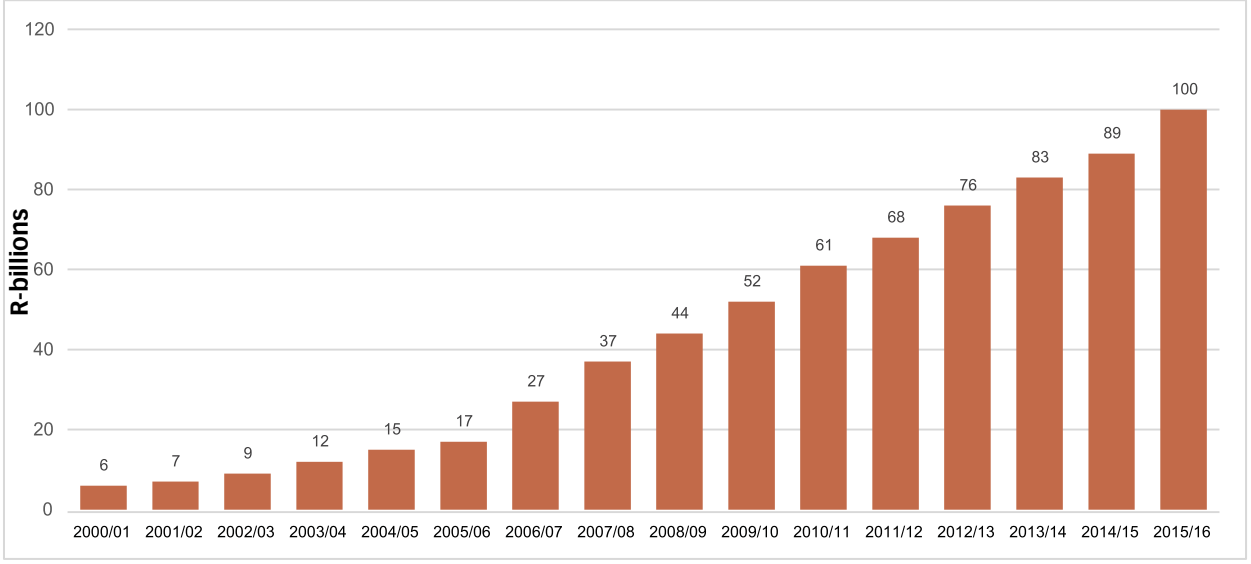


Source: Commission's computations based on Global Insight data

Over the past 15 years, transfers allocated to the local government have increased at a phenomenal rate, from R6-billion in 2000/to R100-billion in 2015/16 (Figure 9). Yet the increased resources have not led to an equivalent improvement in service delivery.

As Figure 10 shows, between 2003/04 and 2012/13, intergovernmental transfers were the dominant source of revenue in the smaller towns and mostly rural municipalities, whereas own revenue represented a greater share of revenue for metros, secondary cities, and large and small towns.

Figure 9. Value of transfers to local government (2000/01–2015/16)



Source: Commission's computations based on National Treasury data

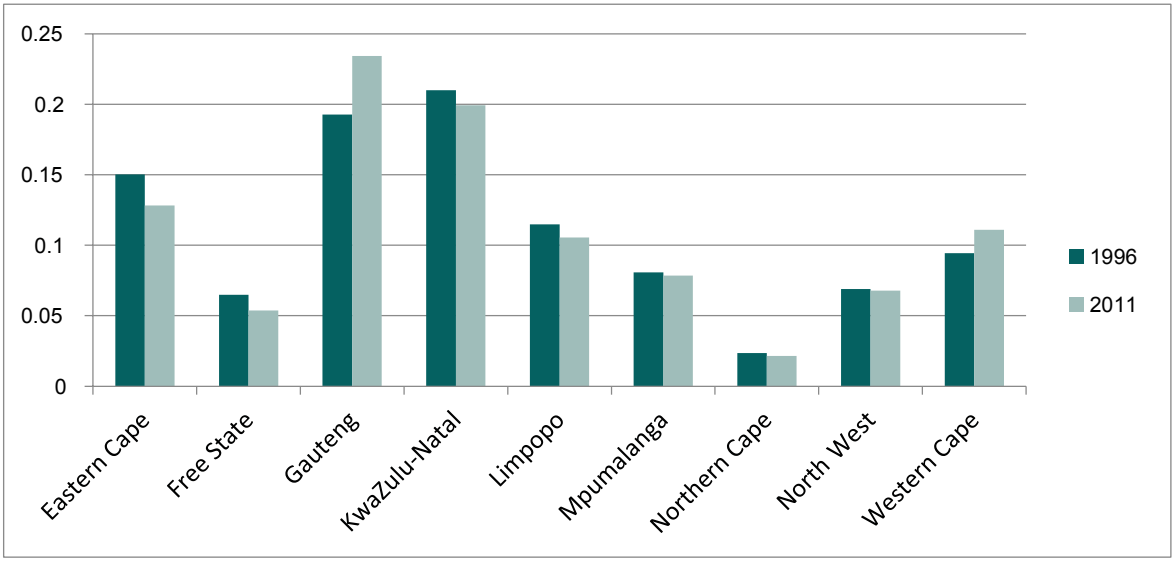
Figure 10. Average revenue split per source by municipal category (2003/04–3012/13)

Source: Commission's computations based on National Treasury data

As illustrated in Figure 11, between 1996 and 2001, the two most urbanised provinces (Gauteng and Western Cape) showed the highest increase in population, as a result of in-migration. Census 2011 found that only 56% of the people counted in Gauteng were born in the province.

When selected development indicators are evaluated, the results are mixed (Table 8). For instance the per capita gross provincial product (GPP) for Gauteng is almost twice that of rural provinces. Similarly, compared to other provinces, poverty levels are higher in the three most rural provinces (Eastern Cape, KwaZulu-Natal and Limpopo). However, the disparities across provinces dissipate when observed over a long period, implying some level of convergence in their development trajectory. This convergence is also evident in the provincial per capita expenditure. Overall Table 8 shows that, despite government's substantial transfers to provinces and expenditure on public services, disparities remain a major issue.

Figure 11. Shifts in distribution of population among provinces



Source: Commission's computations based on National Treasury data

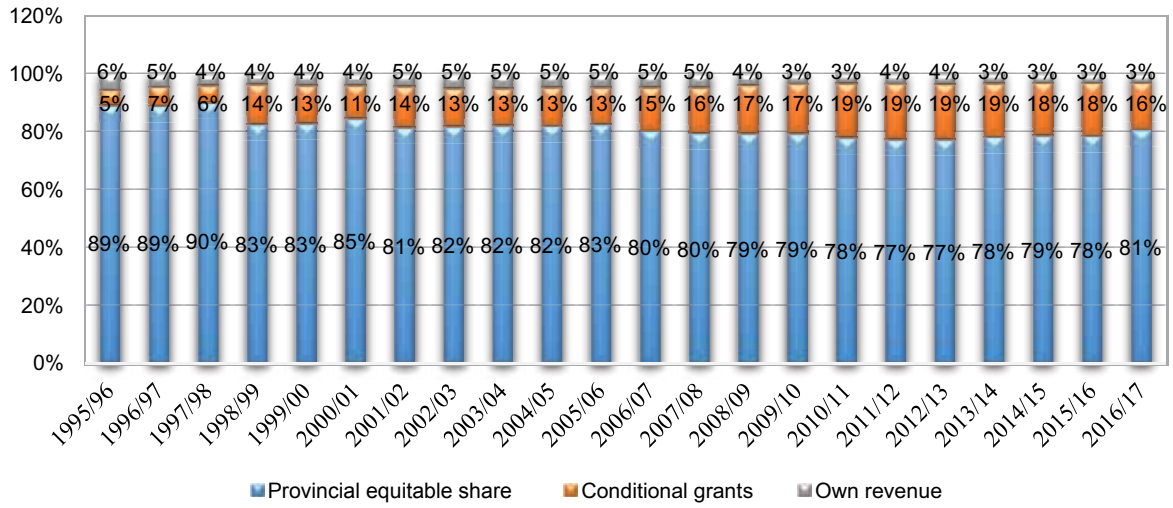
Table 8. Provincial development disparities

Province	GPP per capita (Rands)	Percentage of population below food poverty line	Population aged 15+ years and completed Grade 7	Expenditure per capita (Rands)
Eastern Cape	34 140	29.1%	76.9%	9 157
Free State	56 869	22.3%	82.1%	10 279
Gauteng	80 534	16.2%	91.1%	6 539
KwaZulu-Natal	45 513	28.9%	80.4%	9 267
Limpopo	39 274	29.1%	77.8%	9 251
Mpumalanga	51 395	24.4%	80.3%	8 542
Northern Cape	56 213	18.4%	76.7%	11 509
North West	46 362	22.7%	76.9%	8 673
Western Cape	68 727	13.7%	89.5%	7 996

Source: Commission's computations based on Global Insight data

Between 1995/96 and 2013/14, total provincial revenues increased over six-fold, from roughly R60-billion to just under R400-billion. In general, own revenue represents a small share of total provincial revenue and decreased from 6% in 1995/6 to 3% in 2013/14. Gauteng, KwaZulu-Natal and Western Cape have consistently generated more own revenues than the other six provinces. In 2010/11, Gauteng generated the highest amount of own revenues (R2.8-billion or 28% of the total provincial own revenues), followed by Western Cape (R2-billion or 20% of total provincial own revenues) and KwaZulu-Natal (R1.9 billion or 19% of total provincial own revenues). Northern Cape, Mpumalanga and Limpopo generated the least own revenues compared to the other six provinces, i.e. 2%, 5.1% and 5.4% of total provincial own revenues. These trends remained largely unchanged between 2010/11 and 2013/14 (Figure 12).

Figure 12. Provincial revenue by source



Source: Commission's computations based on National Treasury data

The inability of provinces to increase own revenues has created a heavy reliance on intergovernmental transfers and a widening vertical fiscal imbalance (i.e. the difference between provincial own revenues and expenditure needs). The provincial equitable share (PES) as a proportion of total provincial revenue has declined gradually, from 89% in 1995/96 to 78% in 2013/14, while conditional grants increased from 5% in 1995/96 to 19% in 2013/14.

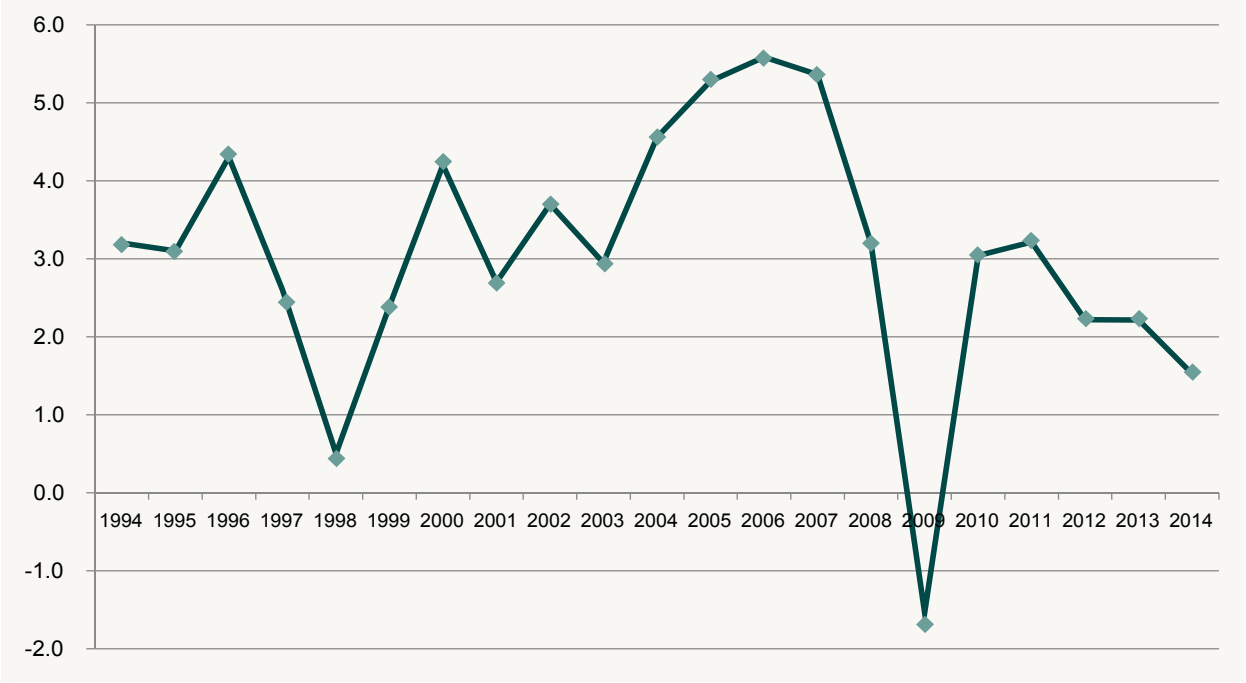
For rural provinces, with their weak economic base and high levels of poverty, the largest share of funding comes from intergovernmental transfers, which comprise the PES and conditional grants. The PES subsidises basic service delivery (education and health), while the various conditional grants support the expansion of infrastructure and capacity development. However, rural provinces also need to show fiscal effort in raising own revenues according to their fiscal capacity.

1.7 How are Rural Regions Coping with Major Economic Changes?

Prior to the democratic elections in 1994, the incumbent National Party was responsible for the country's economic management and was fiscally supporting four nominally independent homeland states and six self-governing areas, which had high and increasing fiscal requirements. At the same time, severe international sanctions restricted economic progress. After 1994, the economy at large, and rural and agricultural sectors in particular, have been subjected to fundamental policy reforms, some of which persist today. Far-reaching macroeconomic reforms have been undertaken in order to redress past injustices, particularly in terms of access to basic services (e.g. electricity, water and sanitation, housing, health and education), and income and employment opportunities. From 1994, the RDP became the official macroeconomic policy of the new democratic government, and was followed by the GEAR programme in 1996, the AsgiSA framework in 2006, the New Growth Path (NGP) in 2010 and the NDP in 2012. These major public policy shifts and investment priorities have had major implications for rural development.

Figure 13 shows economic growth since the democratic election of 1994. The country had four years of 3–4% growth until 1998, when the economy grew by only 0.5% because of the international Asian financial crisis and high domestic interest rates that were instituted to combat exchange rate speculation. However, over the next decade, economic growth was robust: above 4.5% from 2004 to 2007 and reaching 5.6% in 2006 and 2007. Then, like almost all other countries, the financial crisis of 2008 led to significant declines in asset values, company closures, rising unemployment and a sharp slowing of economic growth – South Africa plunged into a recession in 2009 and substantially revised its macroeconomic forecasts downwards.

Figure 13. GDP growth (annual %)

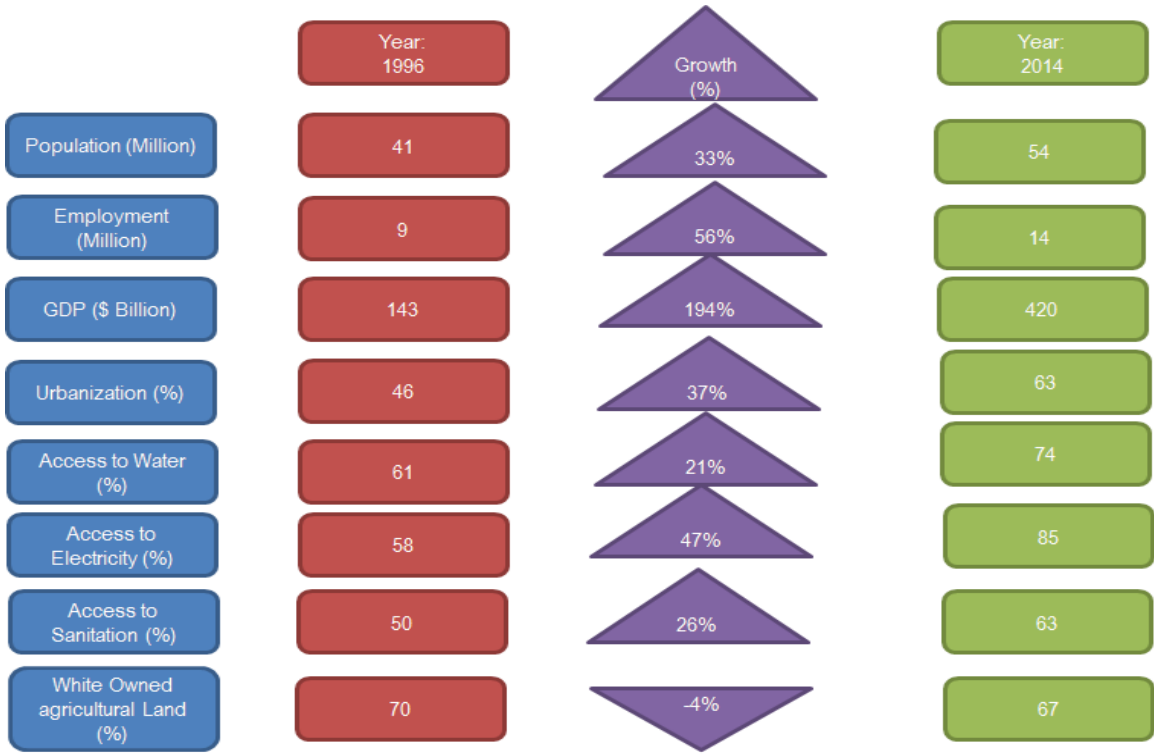


Source: Commission's computations based on SARB data

Since 2009, the uncertain global economic climate has had a negative impact on South Africa's economy because of the country's exposure to Eurozone economies through trade and financial markets, and the recent decline in resource and commodity prices. Domestically, the economy has been affected by South Africa's worst drought in 35 years, increased uncertainty over the country's credit rating and plans to reform laws governing investments in property and mineral exploration, and existing supply-side constraints in power and bulk transport infrastructure. Coupled with the structural misalignments and the infrastructural challenges facing the economy, it is unlikely that South Africa will reach pre-2008 growth rates of 4–5% before 2018. The sluggish economy has meant that unemployment rates have remained elevated, with most recent figures reflecting 24.3%.

The present environment of fragile growth is making it difficult to tackle the challenges of high unemployment, and fiscal and external imbalances. The lower-than-forecast economic growth further represents significant obstacles to achieving the targets set in the NDP and the CRDP. The economy needs to achieve higher growth rates in order to generate jobs for young workers, tackle the growing social tensions, and reduce poverty and inequality. These dire economic consequences, coupled with impatience with service delivery and social outcomes two decades after freedom (Inman and Rubinfeld, 2013), appear to be a significant threat to future prioritisation of rural development initiatives. This in turn may lead to increasingly tense intergovernmental relations.

Figure 14. South African developmental indicators (1996–2014)



Source: Commission's computations based on Stats SA (2014, 2015), National Treasury (2014) and DPME (2014)

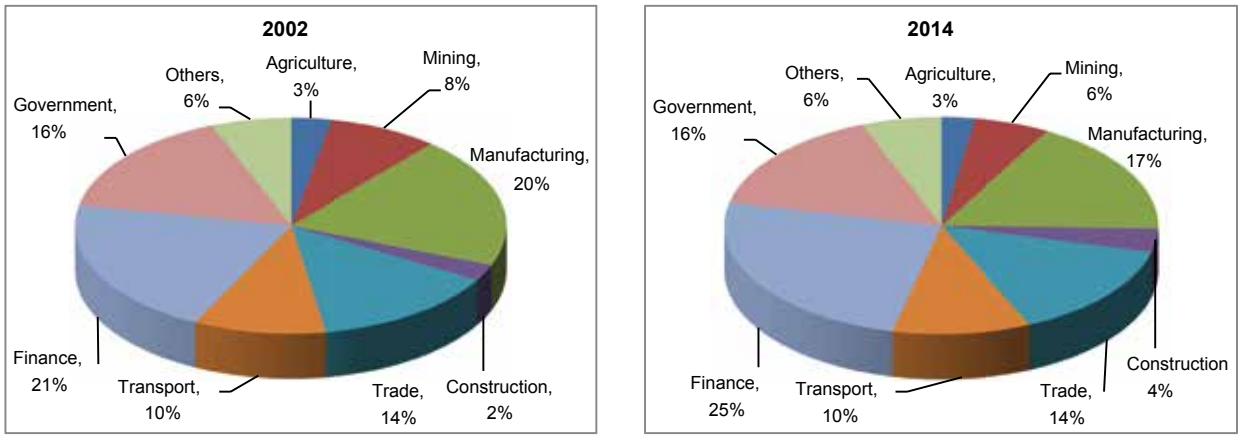
Figure 14 shows a few selected macroeconomic and developmental indicators between 1996 and 2014.

Between 1996 and 2014, South Africa's population grew by 33%, from 41 to 54 million people (DPME, 2014) and the economy created 14 million jobs (despite the recent turmoil in the macro-economy). GDP grew cumulatively by 194%, driving the increased delivery of water, electricity and sanitation services witnessed. Access to these basic services has significantly improved living conditions.

However, although significant growth has been achieved in many developmental areas, stubborn challenges remain, including poverty, inequality and lack of transformation (Goldman Sachs, 2014). One indicator of the slow transformation progress is the redistribution of land from white to black ownership (just 4% change).

Over the past 22 years, the economy has seen a shift away from the primary sector towards the secondary sector, as Figure 15 illustrates.

Figure 15. Main economic sectors and contribution to GDP

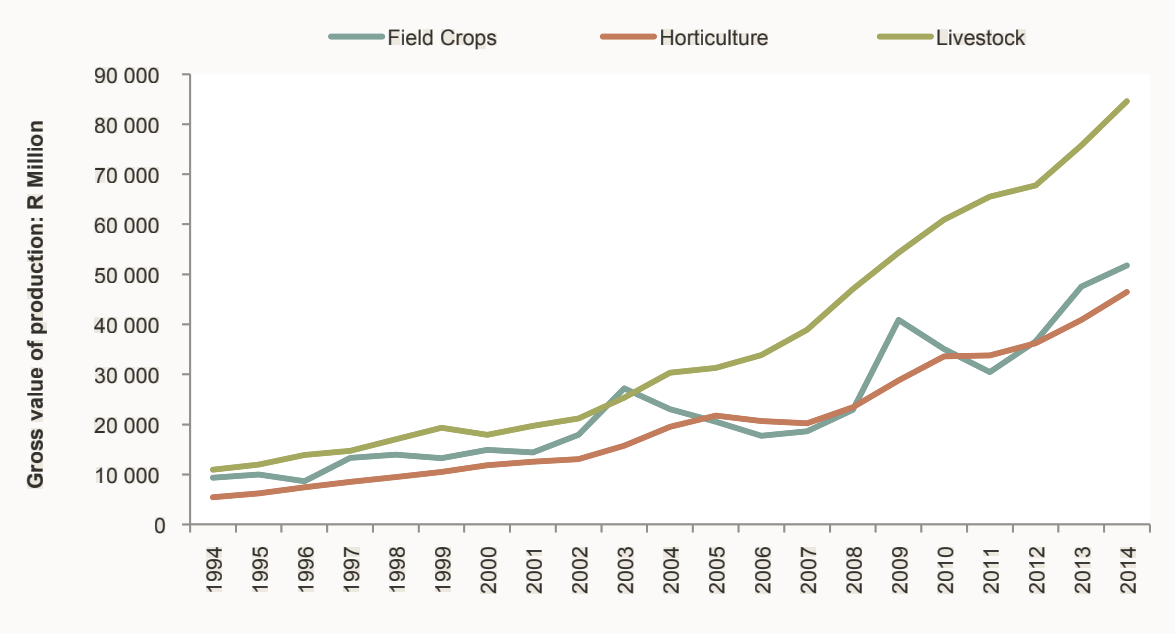


Source: Commission's computations based on Stats SA data
Note: Both 2002 and 2014 charts are generated from data published in Stats SA (2014)

Between 2002 and 2014, the financial sector grew the fastest, at an average rate of 5.13% per annum, and its share of GDP increased from 21% to 25%. Agriculture, which is the hoped-for main economic activity in rural areas, grew by a modest rate of 1.88%, and its share of GDP remained the same at around 2.5% (having declined from about 3% in 1994). This transition is typical of countries that have successfully diversified their economy, away from primary production (resource extraction and farming) toward manufacturing and services (see for example Byerlee et al., 2009; Timmer, 1988). The mining and manufacturing sectors declined from 8% to 6% and 20% to 17% respectively.

The country's diverse weather conditions allow a variety of agricultural commodities to be grown, ranging from field crops (e.g. maize, sorghum, sugar, soybean, wheat) to livestock (e.g. beef, lamb, game and poultry) and horticulture (e.g. deciduous, subtropical and citrus). Figure 16 provides a breakdown of growth in value for these agricultural commodities produced in the country over 20 years.

Figure 16. South Africa gross value of main agricultural commodities (1994–2014)



Source: Commission's computations based on DAFF (2014)

As Figure 16 shows clearly, the value of animal products increased faster than that of field crops and horticultural products. This can be attributed to growing export markets, increasing animal feed costs and tightening consumer standards (NAMC, 2014). Horticultural production has also grown steadily, with spikes during periods of exchange rate volatility, such as 2002–2005 and 2008–2010. This is because the bulk of horticultural products are exported and thus generate foreign earnings.

The agricultural sector is dualistic in structure, comprising commercial and emerging farmers. Prior to 1994, over 60 000 white commercial farmers occupied 70% of the country's land, and over two decades later nearly 67% of land remains in their hands (PLAAS, 2012; DPME, 2014). In 2014, this land was owned by approximately 37 000 commercial farmers and produced nearly 95% of agricultural output (DAFF, 2014; NAMC, 2014). It should be noted that the number of white farmers significantly declined in the early 2000s, when farm units were consolidated to gain economies of scale and to cope with increasing costs of farm inputs (NAMC, 2014).

Over one million emerging farmers are scattered throughout rural areas, mainly in the former homelands. They produce just 5% of agricultural output because of low adoption of technology, limited skills and training, and a lack of infrastructure investments and market access (NAMC, 2014). Emerging farmers are found in rural areas within the 27 poorest districts (Figure 17). These 27 districts are home to nearly 17 million people and have a much higher unemployment rate (particularly youth unemployment) than the national unemployment rate (DPME, 2014). Therefore, government has committed to develop policies and programmes that will channel investments into these rural areas in order to alleviate poverty, create jobs and fast-track service delivery.

Figure 17. Location of the 27 priority districts

Note: The 27 priority districts include: Alfred Nzo; Amajuba; Amathole; Bojanala; Capricorn; Chris Hani; Dr Ruth Segomotsi Mompati; Ehlanzeni; iLembe; Joe Gqabi; John Taolo Gaetsewe; Mopani; Ngaka Modiri Molema; OR Tambo; Sekhukhune; Sisonke; Ugu; uMgungundlovu; Umkhanyakude; Umzinyathi; Uthukela; Uthungulu; Vhembe; Waterberg; West Rand; Xhariep; and Zululand

1.8 Performance of Recent Rural Development Policies and Programmes

Various rural development policies have been attempted but have generally been poor, while cities have shown a much greater degree of developmental momentum, driven by better capacitated and fairly effective metropolitan governments. The result has been declining fortunes in the rural areas and migration en masse from rural areas to the towns and cities.

Like other economic sectors, agriculture has undergone many policy reforms over the past 22 years. Since 1994, rural and agricultural development have been shaped by reforms in four main areas: (a) land reform policy to address the land ownership imbalances caused by the Natives Land Act (No. 27 of 1913); (b) the deregulation of agricultural markets to demolish control boards created by Marketing of Agricultural Products Act of 1936; (c) labour reform, which introduced minimum wages in the agricultural sector; and (d) infrastructure development polices and plans to promote investment in the rural economy and agro-processing space.

1.8.1 Land reform and rural development

Land reform is essential in many developing countries because of its significance for development. The importance of secure land rights for (rural) development has been highlighted in numerous studies (Place et al., 1994; Feder et al., 1998), and "secure and well-defined land rights are key for households' asset ownership, productive development, and factor market functioning" (Deininger, 2003: xix). Secure property rights and economic growth are positively

correlated, as such rights (a) promote economic growth by providing incentives for households to invest in land and enabling them to access credit, and (b) may facilitate the equal distribution of land and thus promote productivity.

In developing countries, secure property rights play a significant role in poverty reduction because, for many poor rural households, land is the main source of livelihood and means for investing, accumulating and transferring generational wealth. As land represents a large part of their asset portfolios, providing secure rights to land that these households already possess can significantly increase their net wealth (Deininger, 2003). Indeed, giving poor people "access to land and improving their ability to make effective use of the land they occupy is central to reducing poverty and empowering poor people and communities" (Deininger, 2003: xx).

Colonialism and the implementation of apartheid policies, especially the Natives Land Act in 1913, led to large-scale, racially based dispossessions of land ownership rights, which resulted in whites owning about 87% and blacks only 13% of the land (Jacobs et al., 2002). The democratic government adopted a land reform policy in its White Paper of 1997, which was derived from Section 25(5) of South Africa's Constitution: "the state must take reasonable legislative and other measures, within its available resources, to foster conditions which enable citizens to gain access to land on an equitable basis". The land reform policy has three pillars:

(i) Land restitution, which aims to give people back (compensate for) the land they were unfairly dispossessed of after the Natives Land Act of 1913.
(ii) Land redistribution, which aims to provide the poor with access to land for residential and productive uses in order to improve their income and quality of life.
(iii) Land tenure, which targets mainly poor people, especially women and youth, so that they have a reasonable opportunity to gain access to land with secure rights, in order to fulfil their basic needs for housing and productive livelihoods.

The land reform policy has not achieved its goal of redistributing 30% of land to black people by 2014 (DPME, 2014). By 2012, only 7% of all land (urban and rural) had been redistributed through the land reform programme, up from 5% in 2009 (PLAAS, 2012). The land reform programme has also not changed the lives of people living in rural areas: production conditions in the communal farming areas have remained largely unchanged (or may have worsened), and tenure forms have hardly changed, despite attempts to provide greater tenure security (Vink and Van Rooyen, 2009). There is also no evidence that the supposed beneficiaries of land reform are better off as a result of their participation in the land reform programme.

Recognising the difficulties faced by the land reform programme, over the past 12 years government has introduced various programmes to promote land and agrarian reforms, including four initiatives:

(i) In 2001, the Land Redistribution Programme, which is meant to enable emerging farmers and interested groups to obtain a grant for the purchase of land from willing sellers, to be used for both residential and agricultural purposes.
(ii) In 2004, the Comprehensive Agricultural Support Programme (CASP), which is aimed at improving the productivity of emerging farmers by providing them with agricultural inputs, infrastructure and technical training.
(iii) In 2009, the Proactive Land Acquisition Strategy (PLAS), which is intended to accelerate the pace of land reform.
(iv) In 2010, the Recapitalisation and Development Programme (RADP), which is meant to help land reform beneficiaries to access infrastructure, inputs and technical support in order to use their acquired land productively.

These four initiatives have had limited success because of a lack of technical support from established commercial farmers coupled with increasing costs of agricultural inputs, limited investment in infrastructure and the lack of market access for land reform beneficiaries (Ngqangweni, 2010). In addition, the lack of coordination and weak intergovernmental relations result in duplication across departments and spheres of government and, consequently, scarce resources are misallocated and allocated inefficiently.

1.8.2 Market deregulation and trade policy reforms

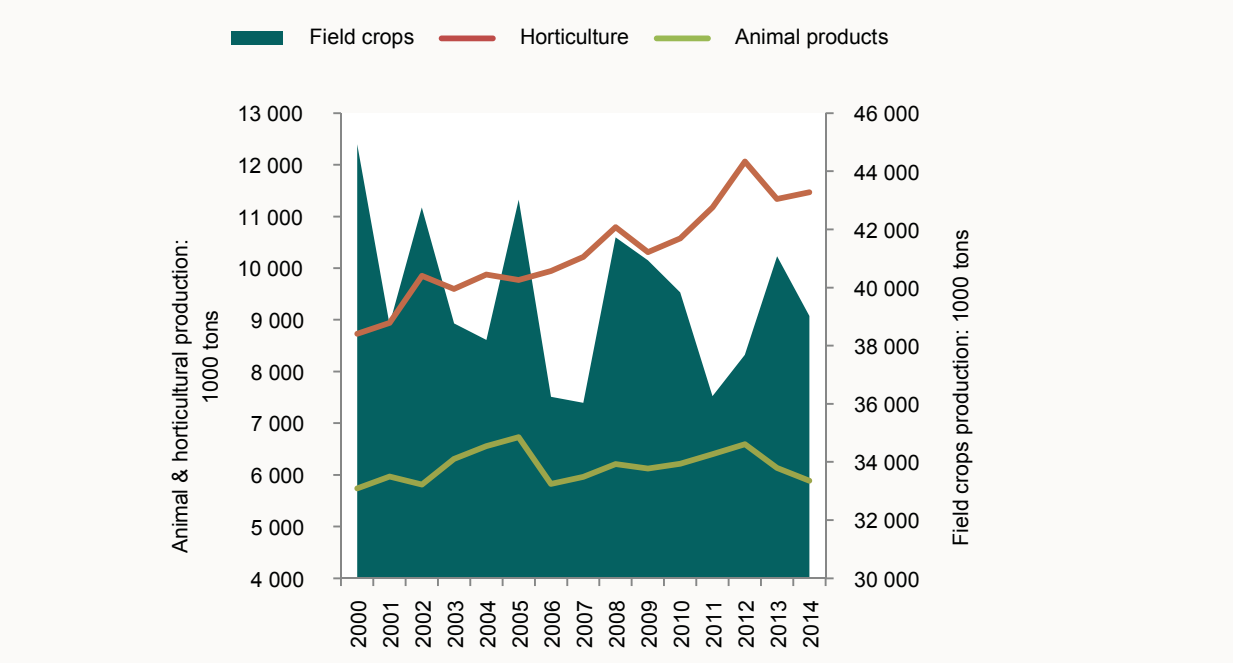
A key feature of post-1994 agricultural trade policy in South Africa has been tariffs replacing direct controls over imports and exports (as per the Marketing Act of 1936 amended in 1968), and the lowering of those tariffs below the bound rates agreed to in the Marrakech Agreement of 1994 (Ngqangweni, 2010; Vink and Van Rooyen, 2009). As a result of the Marrakech Agreement, South African agricultural tariffs cascaded from a relatively high rate on consumer goods to a moderate rate on intermediate goods and a low rate on capital goods. From the late 1990s, support programmes to farmers decreased significantly, leading to an open trading system in the country. For example the Producer Support Estimate declined from an average 11% in 1995–1997 to 3% in 2012–2014, well below the Organisation for Economic Cooperation and Development (OECD) average of 30% for that period (OECD, 2015).

Pre-1994, the marketing of agricultural products was strongly regulated. All commodities were exported through a single channel system, i.e. control boards: 22 marketing boards regulated the domestic sale and export of

agricultural commodities (Vink and Van Rooyen, 2009). The democratic government introduced the new Marketing of Agricultural Products Act (No. 47 of 1996), which demolished the marketing boards (subsequently deregulating the agricultural marketing systems) and created access to new markets outside the traditional EU market (NAMC, 2014).

As Figure 18 shows, horticultural commodities, in particular deciduous and citrus fruits, have largely benefitted from the deregulation of markets, from a single channel into multiple market systems – the lifting of the export quotas triggered strong production of horticultural commodities. The production of animal products has grown minimally, largely in the white meat (poultry) segment (NAMC, 2014). Since the demise of the grain marketing boards, production of field crops has been very volatile, although weather variability in the last decade has also contributed to this fluctuation, as the bulk of grain production is rain-fed.

Figure 18. South African agricultural production



Source: Commission's computations based on DAFF (2014)

The positive growth in the horticultural subsector can also be attributed to foreign exchange volatility in the early 2000s and the opening up of new export markets that created more demand for South African products. The global recession in 2008 also contributed to the growth in export-oriented products, such as fruits, wine, maize, sugar and nuts (NAMC, 2014).

The South African agricultural sector (including forestry and fisheries) generates income mainly from export markets. In 2014, exports by the agricultural sector amounted to R134-billion, driven mainly by citrus fruit, wine, maize, fish and wood pulp commodities (DAFF, 2014). South Africa exports unprocessed agricultural products and imports processed agricultural products, such as soybean oilcake, prepared foods, palm oil and animal feed.

Over the last two decades, two of the key trade agreements concluded by South Africa are the Trade, Development and Co-operation Agreement (TDCA), and the African Growth and Opportunity Act (AGOA).

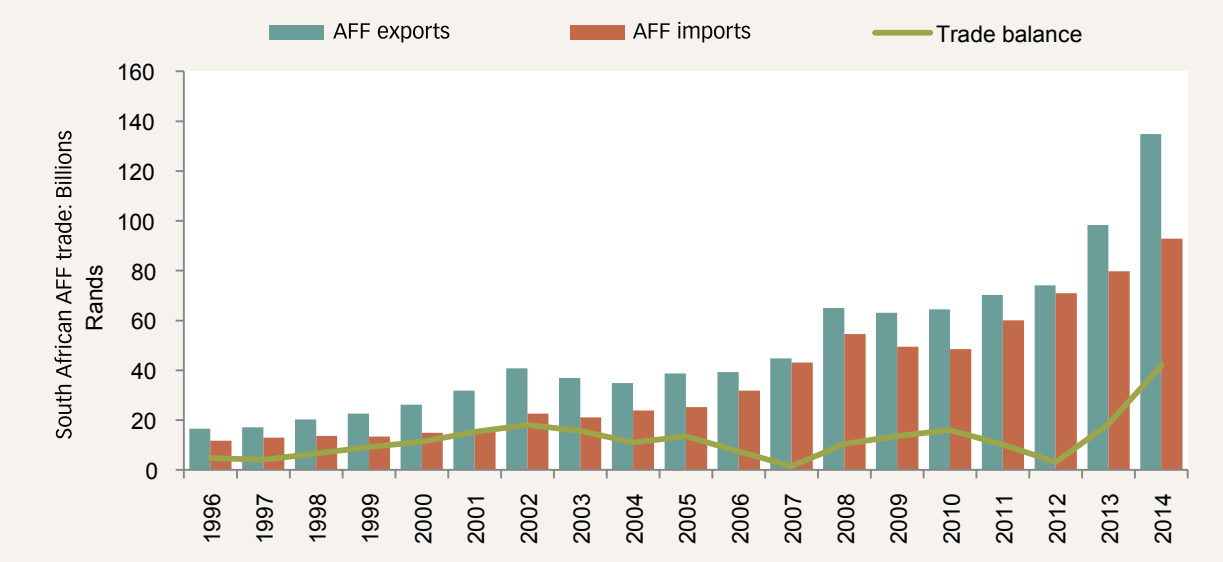
The **TDCA** is an agreement that regulates trade between South Africa and EU member states, covering approximately 90% of bilateral trade, and grants South African agricultural commodities preferential access to the EU market. South Africa agreed to remove duties on approximately 81% of its imports of agricultural products from EU member countries, while the European Commission agreed to remove duties on 61% of agricultural imports from South Africa (DAFF, 2012). Between 2003 and 2013, South Africa's agricultural exports to the EU grew by 108%, from R10.2-billion to R21.3-billion (Table 7).

Promulgated in 2000, the **AGOA** gives sub-Saharan countries (including South Africa) preferential access to the USA market for a wide range of products. Three sectors benefit the most: agro-processing, textile and apparel, and automotive sectors (TIPS, 2015). South African agricultural products covered under AGOA include citrus, wine, essential oils and other fruits (ibid). Although South Africa and USA reached an agreement allowing the USA to export 65 000 tons of chicken into the South African market

(Erasmus, 2016), sanitary and phytosanitary issues (e.g. avian influenza) led to South Africa banning chicken imports from the USA. In 2014/15, the USA threatened to remove South Africa from AGOA if the ban on their chicken imports was not lifted. Following a series of bilateral negotiations, South Africa lifted the ban in March 2016 (AGOA.Info, 2016). In the spirit of reciprocity, USA will support the poultry sector through skills and technology dissemination targeting previously disadvantaged groups in South Africa (Erasmus, 2016).

Table 7 shows the main markets for South African agricultural exports in 2003 and in 2013.

Figure 19. Agriculture, forestry and fisheries (AFF) trade



Source: Commission's computations based on WTA (2014)

Table 9. South Africa's agricultural export destinations

Markets	Export value R-million (2003)	Export value R-millions (2013)	10-year growth (%)	Share of SA exports (2003)	Share of SA exports (2013)
World	**23 534**	**66 686**	**183%**	**100%**	**100%**
EU 28	10 243	21 291	108%	44%	32%
Africa	6 489	20 919	222%	28%	31%
Asia (excl. China and India)	3 865	13 041	237%	16%	20%
BRIC	661	5 417	719%	3%	8%
CAMANZ	233	1 851	694%	1%	3%
USA	1 011	1 763	74%	4%	3%

Source: Commission's computations based on WTA (2014)
Notes: BRIC = Brazil, Russia, India and China; CAMANZ = Chile, Argentina, Mexico, Australia, New Zealand

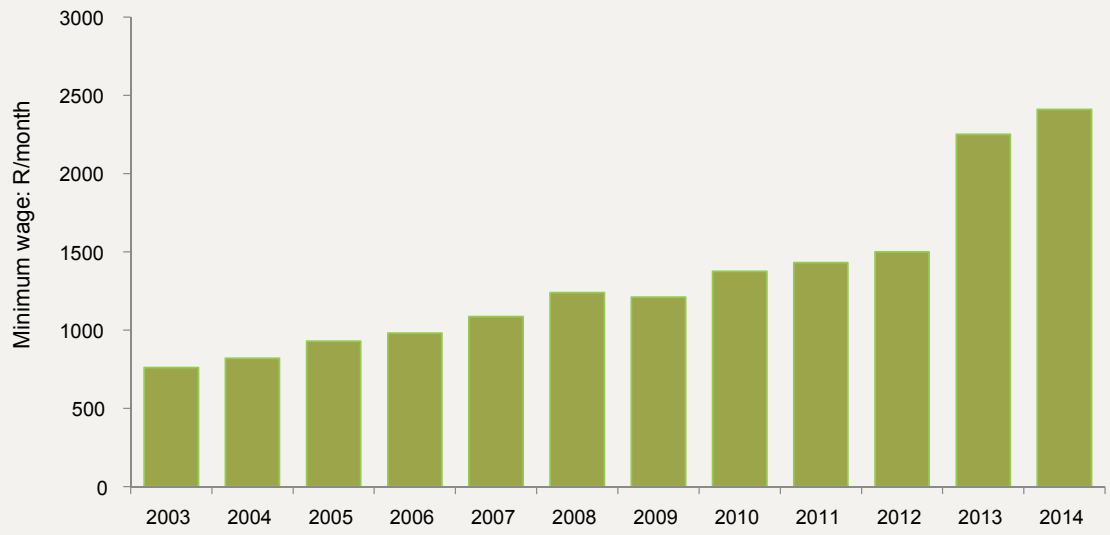
Over the 10-year period, agricultural exports grew by 183%, increasing from R23.5-billion to R66.7-billion. The main export markets, accounting for 83% of total exports, were the EU, Africa and Asia. However, exports are slowly shifting away from Europe to Asia and Africa: the EU's share declined by 12%, whereas Africa's and Asia's shares increased by 3% and 4% respectively.

1.8.3 Labour policy reforms

Before 1994, South African farm workers were not protected by any labour legislation. With the advent of democracy, farm workers received basic employment rights under the Agricultural Labour Act (No. 147 of 1993) and were included in the provisions of the Unemployment Insurance Act (No. 63 of 2001). The Basic Conditions of Employment Act (No. 75 of 1997) stipulates minimum labour standards for farm workers, as well as maximum working hours and payment for overtime. The Extension of Security of Tenure Act (No. 62 of 1997) ensures security of tenure for occupiers of rural and farm land who earn less than R5000 per month. In 2003, the Department of Labour introduced minimum wages for the agricultural sector (BFAP, 2015). Between 2003 and 2012, the farm minimum wage increased on average by 8% annually, and then increased by nearly 50% in 2013, as a result of the farm workers' strike in the Western Cape. However, by 2014 the increase was back to inflation growth of 7% (Figure 20)

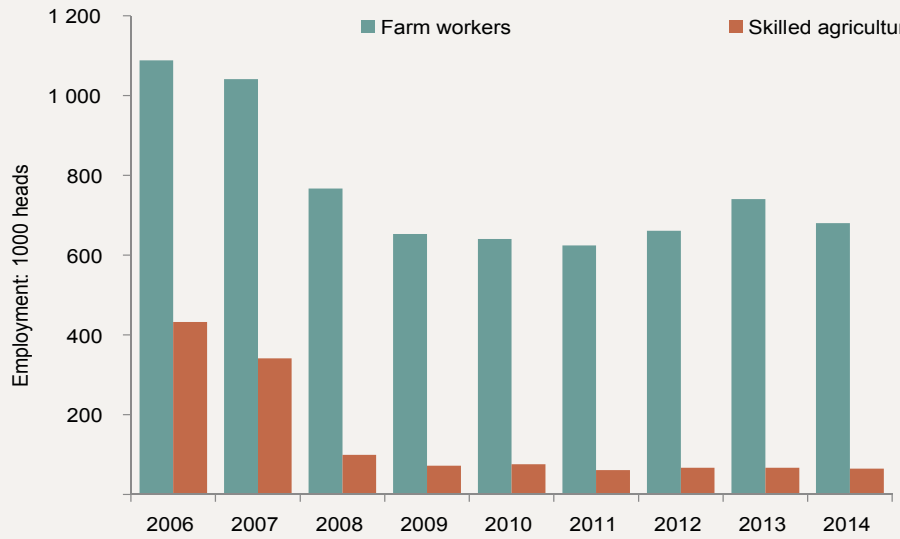
Over the past decade, agricultural employment has been gradually declining, from 1.5 million agricultural workers in 2006 to 800 000 workers in 2013 (Figure 21). Low-skilled farm workers have been the biggest losers. The labour policy reforms, especially the minimum wage policy, led to the casualisation of farm workers and the consequent decline in farm worker numbers (BFAP, 2015; PLAAS, 2012; Dinkelman and Ranchhod, 2012).

Figure 20. Trends in farm minimum wages (2003–2015)



Source: Commission's computations adapted from DoL (2014)

Figure 21. South African agricultural labour trends (2006–2014)



Source: Commission's computations adapted from DAFF (2014)

1.8.4 Food security and rural development

Food insecurity is largely the result of a household's or an individual's inability to purchase food because of a limited or lack of purchasing power, which is the case for many poor rural households and individuals. Rural development is about reducing poverty and thus automatically increases food security.

The Comprehensive African Agriculture Development Programme (CAADP) is Africa's policy framework for agricultural transformation, wealth creation, food security and nutrition, and rural economic development for all African states. Its aim is to invest 10% of the state's GDP into the agricultural sector. South Africa is in the process of implementing the CAADP in order to ensure food security in the country. The country is food secure at national level, but very high levels of food insecurity are found at household level in rural areas, especially in KwaZulu-Natal, the Eastern Cape and Limpopo (FANRPAN, 2014). South Africa's Integrated Food Security Strategy adopted in 2002 covers five areas of food insecurity:

(i) inadequate safety nets, especially for poor households in rural areas;
(ii) disaster management systems, which aim to create a structured system of dealing with food security disasters;
(iii) unstable household food production, which deals with hunger and malnutrition;
(iv) lack of purchasing power, promoting agricultural and other economic activities in order to enhance household purchasing power; and
(v) poor nutrition status, with the aim of improving the nutritional status of households.

In 2009, approximately 11.9 million children were living in poverty-stricken households, i.e. below the poverty line. According to UNICEF (2012), the highest percentages of children living below the poverty line are found in Limpopo (83%), the Eastern Cape (72%), KwaZulu-Natal (71%) and North West (70%).

1.8.5 Infrastructure development policies and rural development

It is a well-known fact that poor physical infrastructure inhibits rural development in developing countries. In most low-income countries, agricultural growth and poverty reduction are severely limited by "poor physical infrastructure for transport, power, communications, irrigation, water, and sanitation" (World Bank, 2006). Poor physical infrastructure in rural areas means high transaction costs, which prevent rural households from reaching their productivity and growth potential, and result in markets not functioning effectively. Poorly maintained rural roads makes distributing products difficult. Therefore, in most developing countries, one of the preconditions for rural development is to provide physical infrastructure and thus lower transaction costs. However, over the years, investment in agriculture has been declining, as other economic sectors (such as manufacturing) are emphasised. The low and variable investment in the agriculture sector is a concern because of the link between agricultural production, food security and poverty.

Government has introduced a number of policies aimed at encouraging the participation of previously disadvantaged individuals in the commercial agricultural value chains. One key policy is the AgriBEE, which is part of a broader government process related to the Broad-Based Black Economic Empowerment Act (No. 53 of 2003). The Act makes provisions for codes of good practices that spell out the rules of the transformation agenda and developmental mandate. Parallel to AgriBEE policy, the Agricultural Policy Action Plan (APAP), which was introduced in 2014, identifies key agricultural commodities and areas where they will be grown, with a strong bias towards the 27 poorest districts (DRDLR, 2015). The APAP has three pillars: AgriParks, Strategic Integrated Projects (SIP 11) and commodity value-chain development. The aim of AgriParks is to create rural infrastructure and to build one AgriPark facility per district. SIP 11 is part of the National Infrastructure Plan (which is administered by the Presidential Infrastructure Coordination Commission) and intends establishing agro-processing and rural logistics infrastructure and encouraging import substitution of processed agricultural products. Through these three pillars, the APAP aims to create over one million rural and agricultural jobs and 300 000 emerging farmers by 2019. It also plans to increase the contribution of agriculture to GDP, from the current 2.5% to over 3%, through agro-processed commodities exports.

Another government programme is the Integrated Strategy on the Development and Promotion of Co-operatives, which is driven by the Department of Trade and Industry (the dti) in partnership with the DRDLR and DAFF. It promotes co-operatives, mainly for emerging farmers, in an effort to promote strong viable and self-reliant agricultural businesses. Government has also introduced the Expanded Public Works Programme (EPWP), as a means of generating employment and alleviating poverty in the short to medium term. EPWP brings more people into the economy and gives them opportunities or skills to effectively participate and earn a living. Sectors targeted by EPWP include infrastructure development by municipalities (e.g. upgrading of rural and municipal roads); environmental and cultural programmes (e.g. fire programmes and wetlands); the agricultural sector (e.g. land-care programmes) and the social sector (e.g. home-based care).

1.9 Concluding Remarks

As South Africa faces the challenge of reducing rural poverty, it is worth looking at lessons from other countries and from South Africa's own experiences with rural development since the mid-1990s. Rural development efforts should continue to focus on improving the incomes of the poor and ensuring a fair distribution thereof. However, challenges facing the rural poor are not just the need for agriculture and agrarian reforms, but also include education, health care, social and economic infrastructure, the creation of employment opportunities as well as changing the economic geography of rural areas. Thus, rural development is a complex process that requires proper coordination among the ministries involved. Therefore, adequate fiscal frameworks can only be designed once there is clarity and a common understanding of the role of all spheres of government in rural development.

The highest per capita expenditure levels are found, unsurprisingly, in provinces with the strongest revenue performance, which happen to be non-rural. Out-migration from rural towards urban regions is growing, no doubt as a result of the democracy dividend that brought freedom of movement to all. As shown in this chapter, large economic disparities exist across provinces, for instance in terms of GDP per capita, unemployment and average household income.[11] Given this situation, policies aimed at improving human capital in disadvantaged regions make sense from both an equity and efficiency perspective. The key drivers of growth vary according to a region's level of development, but education and training, above all, are critical for the growth of all regions (Petchey et al., 2007).

Institutional and fiscal reforms are needed to overcome these bottlenecks and to enable all spheres of government to deliver on their rural development mandate. The main objectives of fiscal reforms should be to bring about greater inter-regional equity and discourage migration in response to regional economic differentials. Nevertheless, the sustainability of rural development initiatives depends greatly on the capacities, accountability and inter-relationships of the institutions involved.

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[11] This is especially the case for African and coloured populations who are characterised by worse health and education outcomes (NPC, 2011)

1.10 Recommendations

With respect to creating conditions for the future prosperity of rural areas, the Commission recommends that Government:

1. Develops a comprehensive definition of "rural areas" and "rural development" to be applied across the three spheres of government. The Department of Rural Development and Land Reform and the Department of Planning, Monitoring and Evaluation must convene a task team with other relevant government departments to develop a definition of "rural, remote and rural development" that is clear and simple to categorise and measure. This definition should be:
    - multi-sectoral and place-based, aimed at identifying and exploiting the different development potential of rural areas, with a focus on places not just sectors.
    - measurable, to enable Stats SA to report on "rural" versus "urban" development and to provide credible and accessible data on rural development.

2. Deals with disparities between and within regions by harnessing the growth potential of rural areas.
    - Inter-regional and inter-provincial migration is already underway following freedom of movement brought about by democracy. Government should further strengthen the equity focus of intergovernmental transfers, in particular in the health and education sectors targeted at rural areas, as this facilitates efficient reallocations.
    - Policy efforts should complement these reallocation-enhancing processes in order to sustain productivity growth within rural areas. Government should actively and specifically include conditions in rural grants aimed at increasing productivity and employment whenever significant capital investment in rural public infrastructure occurs.

3. Strengthens intergovernmental relations by:
    - Boosting incentives for performance (own-revenue raising, policy and administrative capacity for service delivery, etc.), especially in provinces and municipalities with large disparities within them.
    - Addressing the identified weaknesses (coordination failures, governance complexity, etc.). Coordination is needed between the national government and subnational governments and authorities. Developing a true partnership implies participating in decision-making and implementing rural development policies that the regional or local government helps to design. This requires a high level of commitment, effective knowledge sharing and competence on the part of national, provincial and local representatives. In this respect, government should design a mechanism to ensure that proper incentives are provided to make rural communities act dynamically and in a way that rewards initiative and experimentation, but that also promotes consistency in public policy across sectors and regions.

4. The Department of Rural Development and Land Reform together with the Department of Planning, Monitoring and Evaluation convene a task team with other relevant government departments to develop a new rural development research agenda with three key objectives:
    - Develop a comprehensive analytical framework for rural development policy that includes appropriate qualitative and quantitative indicators to allow different policies to be evaluated and compared across municipalities and across regions within provinces.
    - Undertake a systematic review of rural development strategies and make the results available to policy-makers across municipalities and provinces.
    - Encourage the various institutional and managerial systems charged with formulating and implementing rural policy to work together to ensure that individual policies are consistent and converge in a coherent strategy. This can be achieved through special high-level joint inter-departmental coordination via working groups, formal contracts and policy proofing by, for example, benchmarking among peers.

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CHAPTER 2

The Role of Targeted Intergovernmental Transfers in Rural Poverty Reduction

Hammed Amusa

The Role of Targeted Intergovernmental Transfers in Rural Poverty Reduction

2.1 Introduction

Over the last 60 years, the question of which sectors can serve as engines of growth, stimulate development and reduce poverty across rural communities has received significant attention, particularly in economic transformation strategies pursued by developing countries in Africa, Asia and Latin America. The dual economy model, which was developed by Lewis (1954) and dominated development theory in the 1960s and 1970s, viewed agriculture as a backward and relatively unproductive sector, characterised by low wages and a surplus of labour. This view informed the economic transformation agenda adopted by many developing countries that emphasised accelerating the industrialisation process by heavily taxing agriculture (Krueger et al., 1988; Schiff and Valdez, 1992).

The experience of the Green Revolution provided an alternative view: that agriculture could serve as an active engine of growth and development. The Green Revolution used modern science and technology to address a widening food crisis across Asian countries during the 1960s. Its dynamism and contribution to reducing poverty inspired confidence in the potential of agriculture to launch broader economic growth. However, confidence around the potential of the sector was tempered by the poor performance of many agricultural development projects, especially in sub-Saharan Africa, and the shift to export-led manufacturing growth in the economies of East Asian countries (World Bank, 2007).

Despite pessimism over the role of agriculture in economic growth, the UN's Sustainable Development Goals (or the Global Goals) shifted the focus from the growth–agricultural productivity nexus, to reforming the agricultural sector with the objective of enhancing job creation and food (as well as nutritional security), thereby reducing high levels of poverty in developing countries. This approach is based on the premise that agricultural activities form the main source of income and economic livelihoods for the majority of poor people in developing countries. Thus strategies to achieve "pro-poor" or "shared growth" would be more effective if policies and investments targeted growing labour-intensive sectors such as agriculture, in which the poor are active participants and important stakeholders (Christiansen et al., 2011).

In South Africa, a renewed focus is on the potential of the agricultural sector to be an engine for rural development and support the creation of economically vibrant and sustainable rural communities. For much of the first decade of democracy, the country's agricultural policy focused on the historical inequities of apartheid-era discriminatory practices that skewed the racial (and gender) participation in agricultural activities and access to land.[12] Included within this focus was the objective of addressing rural development through a cross-sectoral and multi-occupational diversity of programmes (ANC, 1994). The initial policies relating to rural development evolved around the social and political goals of the Reconstruction and Development Programme (RDP) in 1994 and the spatial concepts of nodes, corridors and infrastructure strategies contained in the Integrated Sustainable Rural Development Strategy of 2000.

By 2004, government concerns over the structural nature of rural poverty and the limited impact of land reform on reducing inequality and poverty prompted a shift in government's views of rural development. Between 1994 and 2003, South Africa's economy grew by an average of 3.2%, the longest period of steady economic growth since World War II, but at the same time poverty continued and inequality rose.[13] Concerns over the continued co-existence of relatively strong economic growth and structural poverty led the then State President, Thabo Mbeki, to describe South Africa's main development challenge as the need to create sustainable linkages between "two economies" – a first or modern economy (dominated by industrial, mining, financial and services sectors) that was well integrated with global markets and generated the bulk of South Africa's wealth, and the second or marginalised economy that was under-development, contained the vast majority of rural and urban poor and structurally disconnected from the first economy (Mbeki, 2003). Integrating both economies would require sustained agrarian reform and integrated rural development programmes that could transfer resources and infuse much needed capital into growing agricultural and agro-processing activities in order to address growth and development challenges of the second/marginalised economy.

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[12] The first set of post-1994 strategies to address the question of rural and agrarian development in South Africa was embodied in a number of key legislations enacted between 1994 and 1996. These included: Restitution of Land Rights Act (No. 22 of 1994); Provision of Land and Assistance Act (No. 126 of 1993, amended in 1994); Extension of Security of Tenure Act (No. 62 of 1997); Land Reform (Labour Tenants) Act (No. 3 of 1996); and the Communal Property Associations Act (No. 28 of 1996) (Twala and Selesho, 2013).

[13] The country's Gini coefficient had decreased slightly from 0.66 in 1993 to 0.63 by 2001. South Africa also experienced a steady increase in unemployment in the decade following the 1994 transition and the unemployment rate peaked in early 2003 at 31.2%, using the narrow or strict definition that includes only active job-seekers, and 42.5%, based on the broad or expanded definition, which includes people who want employment but were not actively looking for work (Seekings, 2007).

2.2 Problem Statement and Rationale for the Research

Since 2009, government's strategy seeks to fast-track rural development and land reform, and radically restructure the country's agrarian economy as a catalyst for poverty reduction and wider societal transformation (Nzimande, 2014). A stand-alone ministry – the Department of Rural Development and Land Reform (DRDLR) – was established, dedicated to the socio-economic development of rural South Africa. The department's flagship policy is the Comprehensive Rural Development Programme (CRDP), which consists of three phases[14] and has two focus areas: (i) an integrated programme of land reform and agrarian change aimed at fostering social cohesion and development, and (ii) a rural development strategy aimed at improving economic, cultural and social infrastructure, public amenities and facilities, and information and communications technology (ICT) infrastructure.

Complementing the focus on rural development are programmes aimed at integrating land reform and agricultural development. Government has two main initiatives in this regard: the Comprehensive Agricultural Support Programme (CASP) and the Land Redistribution for Agricultural Development (LRAD) programme. Following the 2003 intergovernmental fiscal review of agriculture, which found that agriculture was under-funded, especially capital funding, CASP was launched in 2004, with the aim of expanding the provision of support services in order to promote and facilitate agricultural development programmes targeting beneficiaries of land and other agrarian reform strategies (Hall and Aliber, 2010). Established in 2008, as a joint programme of the Department of Agriculture, Fisheries and Forestry (DAFF), the Department of Land Affairs (which was the forerunner of the DRDLR) and provincial departments of agriculture, the LRAD is designed to address imbalances created by apartheid-era land distribution through providing black South African citizens with grants to access agricultural land.

Despite these laudable initiatives, agriculture's contribution to rural development and poverty reduction has been called into question. The scope for agriculture to be an engine for economic growth and job creation is limited because of poor coordination, implementation and administration of (and access to) key support programmes (Grewell et al., 2012). Although government has increased capital funding to small-scale farmers, only about 13% of eligible black farmers benefitted from the range of support services offered by CASP (Hall and Aliber, 2010). A recent study found that the CASP programme had little to no impact because the grant services were thinly spread across a large number of beneficiaries (Business Enterprises at UP, 2015).

The limited impact of agricultural support programmes has raised concerns about the efficacy of public investments in agriculture. Policy-makers argue that, although agricultural support programmes are needed, intergovernmental transfers could be used more effectively if directed at improving farm infrastructure and inputs, community level infrastructure, market development and institutional re-engineering (Hall and Aliber, 2010). More effective use of intergovernmental institutional and fiscal instruments could spur rural development and aid poverty reduction efforts. Furthermore, the potential role of the non-agricultural sector should not be ignored, as shown in a number of recent studies. For example, Hasan and Quibria (2004) found that, although agricultural activities were the most effective driver for reducing poverty in South Asia and sub-Saharan Africa, in Latin America and East Asia, growth in the services and industrial sectors respectively had the greatest impact on poverty reduction. Based on the analysis of a sample of 25 countries, Cervantes-Godoy and Dewbre (2010) found that while growth in agricultural productivity was the main driver in reducing extreme poverty reduction (denoted as income ≤ US$1.25 per day), support to the non-agricultural sector was more effective at reducing poverty among the relatively poor population (i.e. those classified as living on US$2.00 per day).

The lack of South African empirical research is a major drawback in the current policy debates and recommendations around the effectiveness (or efficacy) of agricultural support in rural development and poverty reduction strategies. In particular, whether (i) the inter-sectoral linkages/value chains needed for a pro-agricultural strategy are present in a world of increasingly interconnected markets, and (ii) the potential pro-agricultural support-driven growth will facilitate the participation of the majority of poor people living in rural areas (Anriquez and Lopez, 2007).

When assessing the growth and participation effects of pro-agriculture strategies, four questions need to be answered (Christiansen et.al., 2011):

(i) Do agriculture-focused investments enhance overall growth more than similar investments in non-agricultural sectors?
(ii) Do more poor households benefit from agricultural growth than from non-agricultural growth, and if so, which groups are able to participate in such growth and under which conditions?

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[14] Phase one of the framework is driven by programmes aimed at meeting basic human needs of citizens located in rural areas; the second phase will focus on the delivery of large-scale infrastructure development to support the transformation of rural economies; the final phase will focus on facilitating the emergence of rural industrial and credit financial sectors through the creation of small, micro and medium enterprises and village markets (South African Yearbook: 2010/2011, 20110)

(iii) If agricultural growth results in slower overall growth but greater participation by the poor (compared to non-agricultural growth), then which (agricultural or non-agricultural) growth strategy will reduce poverty the most and under which circumstances?
(iv) Will the results of (agricultural or non-agricultural) growth on poverty reduction be different if different measures are used to classify the poor?

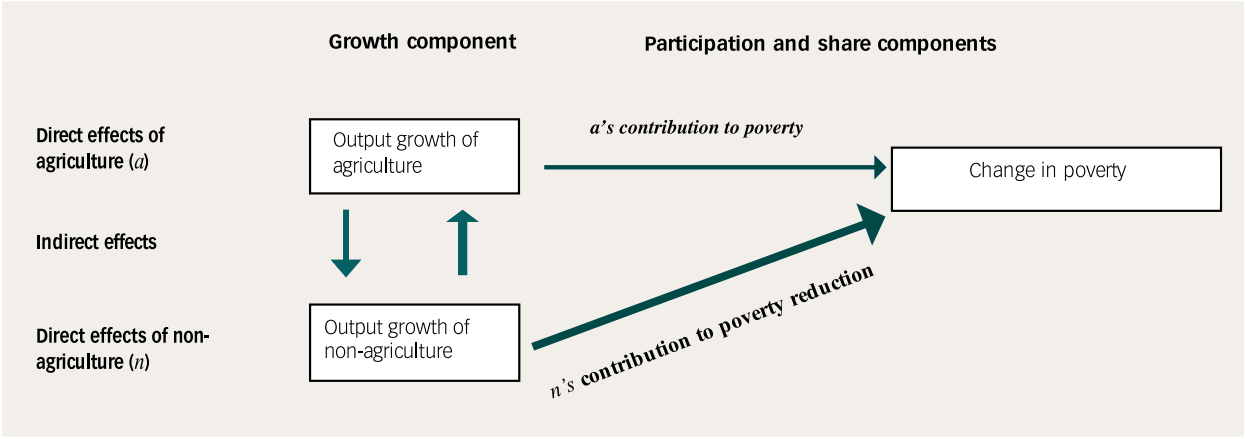
Empirical research addressing these four questions should provide a more nuanced and qualified framework in which the impacts of the productivity of agriculture and non-agriculture on poverty can be decomposed into three main sources: a growth, participation and a size effect. Knowledge of such decompositions should provide policymakers with an important starting point in formulating effective poverty reduction strategies that capture the relative levels of poverty across regions. To the best of the author's knowledge, no such study exists for South Africa. Thus, the paucity in extant literature is addressed by focusing on the role of both agriculture and non-agriculture in reducing poverty levels across South Africa's rural municipalities.

2.3 Conceptual Framework

An economic sector's impact on poverty reduction depends on the interaction of four components: (a) the *direct effect* that captures a specific sector's capacity to increase the income levels of those employed in that sector; (b) the *indirect component* that stems from spill-over effects of growth in one economic sector on other economic sectors and helps to reduce poverty; (c) the *participation component* that captures the extent to which poor people benefit from a particular sector's growth and depends on the type and location of a sector's productive processes;[15] (d) the *total contribution* of a sector to poverty reduction, which depends on the relative size of that sector in total economic activity.

The framework in Figure 22 highlights the interaction of these four components in terms of the relative role of agriculture and non-agriculture in reducing poverty.

Figure 22. The relative role of agriculture and non-agriculture growth in reducing poverty



Source: Christiansen et al. (2011)

The formal representation of Figure 22 is as follows. Let P_i denote the measure of poverty and Y_i be gross domestic product (GDP) per capita in region i. The proportionate change in poverty in a region can be viewed as being equal to the GDP elasticity of poverty (≈ the proportionate change in poverty divided by the proportionate change in GDP per capita) multiplied by per capita GDP. Mathematically, this is equivalent to:

$$\frac{dP_i}{P_i} = \left(\frac{dP_i}{P_i} \bullet \frac{Y_i}{dY_i} \right) \frac{dY_i}{Y_i} \qquad (1)$$

Approximating for small changes, Eq. (1) can be rewritten as:

$$d \ln P_i = \varepsilon \; d \ln Y_i \qquad (2)$$

where ε_i, the GDP elasticity of poverty captures the participation component and measures the growth component of poverty change in region i. Given heterogeneity in the growth processes across different sectors, the growth in Y_i can be approximated as the sum of the share weighted growth rates of economic sectors.

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[15] For example, capital-intensive agricultural activities in Region A is likely to result in minimal participation of poor and unskilled persons living in that area. However, a higher intensity of labour-intensive subsistence agriculture in Region B may result in a high participation rate by the poor.

Agriculture (***a***) and non-agriculture (***n***) in Figure 22, Eq. (1) can be rewritten as a share weighted sum of the contributions to poverty reduction by these two sectors:

$$d\ln P_i = \varepsilon_{ia} s_{ia} d\ln Y_i + \varepsilon_{in} s_{in} d\ln Y_i \quad (3)$$

where s_{ij} denotes the share of the j^{th} sector ($j=a,n$) in total GDP of the i^{th} region. From Eq. (3), the two sector-economy yields two elasticity terms ($\varepsilon_{ia}s_{ia}$ and $\varepsilon_{in}s_{in}$) that each have two elements: a share component (s_{ij}) and a sector's participation component (ε_{ij}). The sectoral participation components measure the responsiveness of overall poverty to aggregate growth originating from a particular sector ($\approx s_{ij}dY_{ij}/Y_{ij}=dY_{ij}/Y_i$). This responsiveness measure can be seen as an indicator of the extent to which all persons classified as poor participate in overall growth generated by the j^{th} sector.

A two-step econometric approach is used to derive the parameter estimates of Eq.(3). For the first step of the empirical analysis, rural municipalities are the preferred unit of analysis, following Christiansen et al. (2011) in estimating non-agricultural output growth per capita ($y^n_{it} \approx$ per capita growth in non-agriculture gross value added [GVA]/GDP) in a region/municipality i at time t as a linear function of both lagged levels of per capita non-agricultural sector growth and lagged levels of agricultural sectoral growth (y^a_{it-p}) and a vector X_{it} of region specific explanatory factors. Mathematically, this can be expressed as:

$$y^n_{it} = \chi_0 + \sum_{j=1}^{k} \beta_j X_{it} + \gamma_1 y^n_{it-p} + \gamma_2 y^a_{it-p} + h_i + \upsilon_{it} \quad (4)$$

where h_i represents unobserved municipal specific characteristics and υ_{it} is an idiosyncratic error term. Similarly, agricultural GDP growth per capita (y^a_{it}) is expressed as a function of lagged levels of per capita non-agricultural and agricultural sector growth as well as unobserved region-specific exogenous variables. The linear functions for each of y^n_{it} and y^a_{it} are estimated separately, with a statistically significant coefficient on lagged agricultural growth (in the non-agricultural growth equation) indicating Granger causality from agriculture to non-agriculture (and vice-versa in the agricultural growth equation).

Empirical estimations of versions of Eq.(4) for both the non-agricultural and agricultural sectors will help in evaluating the extent to which linkages exist, and show that such linkages encourage mutually beneficial growth. While linkages within the dual economy provide the extent of direct and indirect growth, how citizens benefit from such growth – the participation effect – becomes important for assessing the impact of sectoral growth on poverty. The literature offers three main propositions on why the effect of growth on poverty differs across economic sectors:

- The majority of rural poor stand to benefit more from agricultural growth than from non-agricultural growth because of their location in rural areas where agriculture is the main economic activity (Byerlee et al., 2005).
- The major asset of the majority of the poor is their (unskilled) labour, and so differences in (unskilled) labour intensity might result in sectoral differences in poverty reduction on growth (Christiansen et al., 2011).[16]
- Differences in asset inequality, such as the distribution of land, are likely to lead to growth having different poverty-reducing effects across sectors. When small and medium-scale farmers cultivate a larger share of land, lower income inequality occurs and (by extension) growth has a greater impact on poverty (Bourguignon and Morrisson, 1998). [17]

To test these three propositions, and examine which source of (sectoral) growth matters for poverty, a modified version of Eq.(3) is estimated:

$$\Delta\ln P_{it} = \delta_a s_{iat-1}\Delta\ln Y_{ait} + \delta_n s_{\text{int}-1}\Delta\ln Y_{nit} + c_i + u_{it} \quad (5)$$

where P_{it} is the measure of poverty derived from nationally representative household surveys, and ΔY_{ait} ($j=a,n \approx$ where a denotes the agricultural sector and n is non-agricultural sector) denotes economic growth of a sector in a region/municipality, i at time period t. δ_j ($j\approx a,n$) represents parameter coefficients that capture sectoral participation effects i.e. the impact of growth in a particular sector on growth. Finally, c_i are time-invariant municipal-specific characteristics, while u_{it} represents the white-noise error term.

It is important to ensure that the estimation of Eq.(5) controls for possible bias that may arise if unobserved municipal characteristics are correlated with sectoral growth rates, while simultaneously influencing the rate-dependent variable – the poverty rate, independently. For example, if a municipality with a large mining industry experiences a positive exogenous shock (such as an increase in demand or rise in relative prices), such a shock will serve to boost the growth of the non-agricultural sector relative to the agricultural sector, while also reducing the rate of poverty reduction. Such an outcome would cause the effect of the

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[16] In a study on cross-country heterogeneity of the poverty response to changes in economic growth, Loayza and Raddatz (2010) find evidence that growth in the highly labour-intensive agricultural sector has the greatest impact on reducing poverty. On the other hand, growth in the relatively skilled and less labour-intensive services, mining and utilities sector had the least impact on poverty reduction.

[17] A number of country study reports support this argument. Ravallion and Chen (2007) found that in China, where land is relatively equally distributed, the poverty-reducing effects of growth in agriculture is four times that of growth in the services sector. In contrast, in India where land inequality and landlessness is more widespread, Ravallion and Datt (1996) found that growth in the agriculture sector and the services sector had a similar impact on poverty reduction.

non-agricultural sector to be underestimated (and that of the agricultural sector to be overestimated), resulting in a misleading importance being attached to growth in the agricultural sector relative to the non-agricultural sector. To address this potential bias, Eq.(5) is estimated using the fixed-effects approach.

While the fixed-effects estimation helps mitigate against potential omitted variable bias, the effects of different economic activities/sectors may also depend on municipal-specific characteristics ($\boldsymbol{X_{it}}$). To examine how such characteristics affect sectoral participation effects, the approach of Christiansen et al. (2011) is used and interaction terms – the Gini coefficient of income/consumption inequality ($\boldsymbol{GN_{it-1}}$) and the share of the mining (or manufacturing) sector in GDP ($\boldsymbol{M_{it-1}}$), – are included in the empirical model. The size of the sectoral participation effects ($\boldsymbol{\delta_a}$ and $\boldsymbol{\delta_n}$, respectively) are also dependent on the position of the poverty line relative to the mean, as well as the shape of income distribution within a particular municipality. Given that both the mean and shape of income distribution evolve over time and critically depend on the level of development, it becomes important to quantify how sectoral growth affects income across different segments of the population within each municipality. Drawing upon the approach of Christiansen and Demery (2007), Eq.(5) is further augmented with interaction terms between sectoral GDP growth variables and the ratio of the poverty line ($\boldsymbol{z}$) to each municipality's average household income ($\tilde{\boldsymbol{e}}_{\boldsymbol{it-1}}$). Eq.(5) then becomes:

$$\Delta \ln P_{it} = \delta_0 + [\delta_a + \delta_{ax} X_{it'-1}] s_{iat-1} \Delta \ln Y_{ait} + [\delta_n + \delta_{nx} X_{it-1}] s_{int-1} \Delta \ln Y_{nit} + c_i + u_{it} \quad (6)$$

where $X_{it-1} = GN_{it-1}, M_{it-1}$ and $\frac{z}{e_{it-1}}$, i.e. the interactive terms of the Gini coefficient, sectoral GDP growth and poverty-to-household income ratio.

Given the unit of analysis, the regression analysis is carried out by applying dynamic panel data techniques to a panel of municipalities classified as rural in South Africa.[18] A unique feature of the estimations, especially of Eq.(6), is that effects of sectoral growth on poverty reduction are carried out using poverty measures that that take into account the position of the poverty line with respect to the mean of income distribution (in each region/municipality), as well as the shape of this poverty distribution. In this regard, Stats SA's measure of a set of three national poverty lines – the food poverty line, lower-bound poverty line and upper-bound poverty line – will be employed as measures of poverty in this study.

2.4. Empirical Analysis and Results

2.4.1 Agriculture as engine of growth

In many developing countries, the argument for policies aimed at agricultural growth and development is that economic growth results from the export of surplus resources. The opposite has also been suggested, that increased wages in the non-agricultural sectors result in resources leaving and productivity increasing in the agricultural sector (Tiffin and Irz, 2006).

The issue of whether agriculture growth drives economic growth or economic growth drives agricultural growth is of vital importance to policy-makers. If the former is true, then it validates current efforts to bolster rural economies through policies that enhance agricultural investments and productivity. If the latter is the case, then a more appropriate policy could be one that targets growth in key non-agricultural sectors and encourages more linkages between such sectors and agriculture. Therefore, the first part of the analysis examines the links between agriculture and regional economic growth across municipalities.

Very little is known about the relationship between agriculture and economic growth in the context of sub-national settings such as South Africa's. Therefore, the first part of the empirical analysis presents the first detailed attempt to examine the relationship between agriculture and regional economic growth in a local government setting, following the works of Zapata and Rambaldi (1997) and Tiffin and Irz (2006). An econometric model is estimated that allows for an analysis of Granger causality between agricultural value-added per worker and regional GDP per capita in constant prices.

First, the unit root properties are tested for the two variables (agriculture value added per worker and regional GDP per capita) using the standard tests of integration such as Dickey-Fuller (DF) and the Augmented Dickey-Fuller (ADF). More formally, the test for unit root in the agricultural value-added series for the $\boldsymbol{i^{th}}$ municipality is obtained by estimating the following regression:

$$\Delta v_{it} = \mu_i + \delta_i v_{it-1} + \gamma_i t + \varepsilon_{it} \quad (7)$$

where $\boldsymbol{v}$ is agriculture value added, $\boldsymbol{\mu}$ is a constant and $\boldsymbol{t}$ is a trend term. The subscripts $\boldsymbol{i}$ and $\boldsymbol{t}$ denote the $\boldsymbol{i^{th}}$ municipality and time period, respectively. The relevant test statistic obtained as a $\boldsymbol{t}$- statistic on the coefficient $\boldsymbol{\delta}$.

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[18] In 2006, measures developed by the Department of Cooperative Governance classified South Africa's municipalities into five sub-categories. Of relevance to this study, rural municipalities are those classified as B3 (small towns) and B4 (mostly rural) municipalities. B3 municipalities are defined as lacking a large town as a core urban settlement, with a relatively small population largely based in one or several small towns. B4 municipalities are characterised by the presence of at most one or two small towns in their areas, communal land tenure and villages or scattered groups of dwellings, and typically located in former homelands. Based on this classification, 111 municipalities are in category B3, and 70 in category B4.

On the basis of these test statistics, three different cases can be distinguished: (i) the series are all stationary in levels; (ii) the series are all non-stationary in levels and stationary in first differences, and (iii) some of the series are stationary in levels and others are stationary in first differences. In the first case, the VAR is the standard formulation with variables entering in all levels, as it is for the third case but with the variables entering in levels if stationary and in differences if non-stationary. In the second case, it is necessary to check for cointegration between variables. If cointegration is not present, then the VAR is still the reference formulation, but the variables are entered after first differencing. The approach of Pedroni (1999) is used to test for cointegration, estimating for each series in a panel data set of 234 municipalities over the period 1996 to 2014, the following model:

$$y_{it} = \beta_i \nu_{it} + \gamma_i t + \varepsilon_{it} \quad i = 1,\ldots\ldots\ldots N \tag{8}$$

where y is regional GDP per capita and the other variables are as described in Eq.(7). The residuals obtained from Eq.(8) are checked for unit roots by estimating the following model:

$$\hat{\varepsilon}_{it} = \varphi_i \hat{\varepsilon}_{it-1} + \nu_{it} \tag{9}$$

with the relevant test statistic computed as the arithmetic mean of the t- statistics on φ_i across the cross-sectional units (Tiffin and Irz, 2006). If there is cointegration, then the appropriate formulation is the vector error correction model (VECM) estimated under dual restrictions required for Granger non-causality and cointegration, where the first differenced variables are entered jointly with the vector of deviations from long-run equilibrium.

Following Tiffin and Irz (2006), panel data is used on agricultural value-added per worker (in the agricultural sector) and income per capita in constant 2010 Rands for the 234 municipalities in South Africa over the period 1996–2014. Table 10 reports the findings of the regressions for the full sample of 234 municipalities as well as sub-samples of urban and rural municipalities.[19]

Table 10. Panel – VAR Granger causality wald test

Regression (1)	Equation Variable	Excluded	Prob > Chi² (3)
Full sample (all 234 municipalities)	APW	PCI	5.311 (0.150)
		ALL	5.311(0.150)
	PCI	APW	168.221 (0.000)***
		ALL	168.221 (0.000)***
Sub-sample 1 (urban municipalities)	APW	PCI	11.472 (0.003)***
		ALL	11.472 (0.003) ***
	PCI	APW	19.289 (0.000) ***
		ALL	19.289 (0.000) ***
Sub-sample 2 (rural municipalities)	APW	PCI	12.796 (0.002) ***
		ALL	12.796 (0.002) ***
	PCI	APW	276.796 (0.000) ***
		ALL	276.796 (0.000) ***

Notes: The terms APW and PCI denote agricultural value added per worker and per-capita income, respectively. (***) denotes statistical significance at the 1% level. The Prob > Chi2 gives the causality test, where the test is:
H_{01}: PCI does not cause APW;
H_{02}: APW does not cause PCI

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[19] These sub-samples are based on the 2010 classification/categorisation of municipalities within the local government sphere by the Department of Cooperative Governance and Traditional Affairs (COGTA). According to this classification, South Africa's 234 municipalities can be defined into two broad categories: A and B. Category A includes 8 metropolitan municipalities described as having large urban complexes with populations of over one million and accounting for over 50% of all local government spending. Category B municipalities include four main types: (a) 19 B1 municipalities that have secondary cities with large urban spatial patterns and responsibilities for relatively higher operating budgets; (b) 25 B2 municipalities that have large town(s) as their urban core; (c) 113 B3 municipalities that are local municipalities with small towns, and a relatively small percentage of its population residing in smaller urban settlements, but with no large town as a core, and (d) 69 B4 municipalities that cover mainly rural areas characterised by the presence of no more than two small towns in their areas, communal land tenure and villages or scattered groups of dwellings, and typically located in former homelands. Based on this classification, the 52 Category A, B1 and B2 municipalities are urban municipalities, and the 182 Category B3 and B4 municipalities are rural municipalities.

In Table 10, column (3) gives the Wald test-statistic for the hypothesis that per-capita income (agricultural value added) is non-causal of agricultural value added (per-capita income). For the full sample of municipalities, the hypothesis that per-capita income causes agricultural value added cannot be rejected, i.e. per-capita income does not Granger cause agricultural value added across all municipalities. However, the results indicate that for the whole sample, agricultural value added exerts a causal influence on per-capita income. In terms of the two sub-samples of municipalities, the evidence points to bi-directional causality where for both urban and rural municipalities, agriculture value added and per-capita income exert causal influence on one another.

While knowledge about the direction of causality is valuable, Granger-causality does not often provide a complete picture of the interactions among the variables. Applied work and policy analysis require an understanding of the response of one variable to an impulse or shock in another variable. To gain insight into such a phenomenon, this kind of causality is examined by tracing the effect of an exogenous shock or innovation in agriculture value added on per-capita income (and vice versa). This kind of analysis is carried out using *impulse-response functions* (IRF), which describe the evolution of the variable of interest along a specified time horizon following a shock at a given moment. The impulse response analysis is supplemented with estimations of *forecast error variance decompositions* (FEVD), which measures the percentage of the variance of the error made in forecasting a variable (e.g. agriculture value added) due to a specific shock (e.g. the error term in the per-capita income equation) at a given horizon (e.g. 10 years).

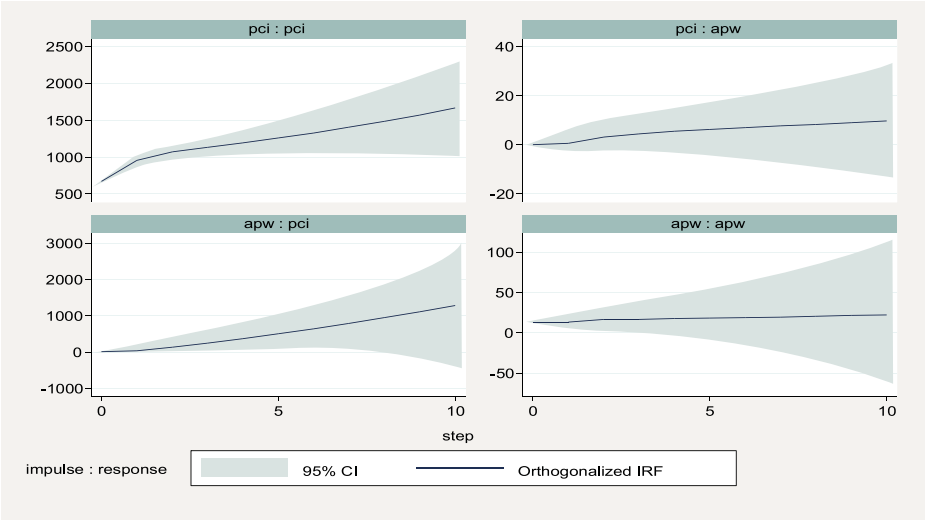
Table 11. Forecast-error variance decomposition

Response variable and forecast horizon			Impulse variable	
			APW	PCI
Full sample (all municipalities)	APW	5	.9536	.0463
		7	.9283	.0716
		10	.8991	.1008
	PCI	5	.0410	.9589
		7	.0950	.9049
		10		.8050
Sub-sample 1 (urban municipalities)	APW	5	.985	.014
		7	.988	.011
		10	.994	.005
	PCI	5	.066	.933
		7	.074	.925
		10	.072	.927
Sub-sample 2 (rural municipalities)	APW	5	.975	.024
		7	.968	.031
		10	.965	.034
	PCI	5	.163	.836
		7	.184	.815
		10	.197	.802

Table 11 provides the forecast decompositions. Generally, for the full sample of municipalities, about 10% of the variation in agricultural value added can be explained by per-capita income, while about 19% of variation in per capita-income (*pci*) can be explained by agricultural value added per worker (*apw*). For both sub-samples of rural and urban municipalities, per capita-income accounts for relatively little (3.4% and 0.5%, respectively) of the variation in agricultural value added. However, the agricultural sector is clearly important to incomes within rural municipalities in particular, as agricultural income here accounts for almost one-fifth of the variation in per-capita income.

The dynamic adjustment patterns are traced out in the IRFs provided in Figures 23–25. The IRF plot displayed in Figure 23 depicts the response of agriculture value added (per-capita income) to an innovation in per-capita income (agriculture value add).

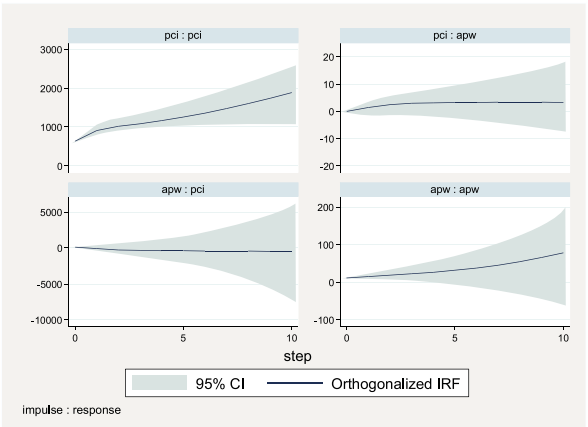
Figure 23. Responses to innovations in apw and pci – full sample



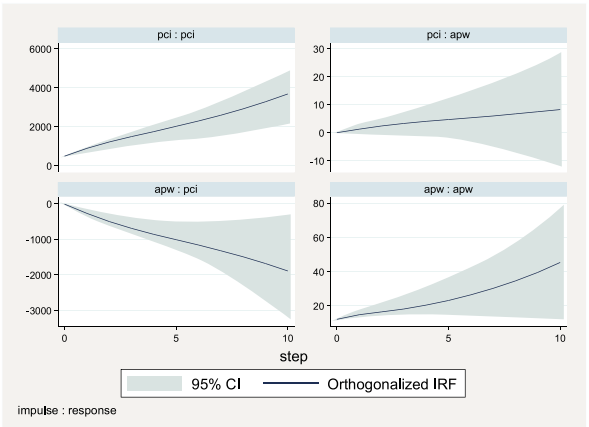
The bottom left quadrant of Figure 23 shows that a positive shock to agriculture value-added leads to an increase in per-capita income. Similarly, the top right quadrant shows that a shock to per-capita income has a positive effect on agriculture value-added. In both cases, these effects persist over a 10-year forecast horizon.

Figures 24 and 25. Responses to innovations in apw and pci

Sub-sample: urban municipalities



Sub-sample: rural municipalities



Figures 24 and 25 show that, for large/urban municipalities, innovations in agriculture value-added (per-capita income) has no impact on per-capita income (agriculture value-added). However, in rural municipalities, innovations cause negative shocks to agriculture value-added and have a persistent negative impact on per-capita income, while positive shocks in per-capita income have a positive impact on future agriculture value-added.

2.4.2 Indirect growth effects

In addition to contributing directly to overall economic growth, the development of the agricultural sector has indirect economic growth effects (see Schultz, 1964; Johnston and Mellor, 1961). These indirect effects occur through three main channels: (a) the *production* channel, through which the agriculture sector forms forward linkages with other economic sectors via agro-processing activities, and backward links via its demand from input supply sectors, (b) the *consumption* channel, which occurs when people within the agriculture sector consume locally produced non-tradable goods, and (c) the *income effects* channel through which increased agricultural productivity serves to lower food prices. Reduced food prices lower the real product wages in the non-agricultural sector, providing a boost to levels of profitability and investment in other non-agricultural sectors. Similarly, reduced food prices would cause real consumption wages to rise, thus providing a direct benefit to poor wage earners in both urban and rural settings.

To gain insights into these channels, the relationship between agricultural and non-agricultural output is explored by applying dynamic panel data techniques to the estimation of Eq.(4). Following Christiansen et al. (2011), separate regressions/estimations of Eq.(4) are carried out for agricultural and non-agricultural per-capita growth using the generalised method of moments (GMM) estimator developed by Arellano and Bond (1991). Both regressions include dummy variables to capture period-specific shocks relating to the effects of the 2008 global financial crises as well as the sudden change in agricultural terms of trade arising from the 2007/08 global food crisis.

To capture the effects of the increased developmental role of the public sector in South Africa's sub-national economies, the lagged share of community services is included in total non-agricultural value added, as an additional exogenous variable in the estimation of the non-agricultural version of Eq.(4). The regressions also include a rural municipality indicator variable to examine whether linkages in municipalities with relatively low per-capita incomes differ from those observed in urban municipalities. Table 12 provides the regression results for the full sample of 234 municipalities as well as the sub-samples of urban and rural municipalities.

Table 12. Sectoral growth linkages. Forecast-error variance decomposition

Panel A: Agricultural per-capita growth	Full Sample (1)	Rural Municipalities (2)	Urban Municipalities (3)
Non-agricultural growth$_{t-1}$	0.0277 (0.114)	**-0.026** (.005) ***	-0.004 (0.014)
Non-agricultural growth$_{t-1}$ *RuralMun	-0.042 (0.124)	---	---
Agricultural growth$_{t-1}$	**-0.221** (0.016)***	**-0.288** (0.15) ***	**-0.187** (0.033) ***
Dummy1 (global financial crisis)	**-3.941** (.441) ***	-0.642 (0.677)	-0.325 (1.469)
Dummy2 (world food crisis)	**9.789** (0.525) ***	**9.643** (0.669) ***	**11.181** (1.52) ***
Panel B Non-agricultural per capita growth			
	(1)	(2)	(3)
Non-agricultural growth$_{t-1}$	**0.242** (0.021) ***	**-0.756** (0.012) ***	**-0.531** (0.087) ***
Agricultural growth$_{t-1}$	**-0.077** (0.016) ***	**0.071** (0.027) ***	-0.001 (0.038)
Agricultural growth$_{t-1}$*RuralMun	-0.001 (0.018)	-----	-------
Dummy1	**3.051** (0.205) ***	**13.226** (1.74) ***	**8.067** (2.89) ***
Dummy 2	-0.304 (.233)	**3.95** (1.83) ***	3.372 (3.037)
Community services share$_{t-1}$	**-63.02** (11.28) ***	44.59 (74.10)	**-114.83** (66.93) *

Note: Panel A shows estimation results using agricultural per-capita growth as the dependent variable, while Panel B depicts the results using non-agricultural per-capita growth as the dependent variable. (*) and (***) denote statistical significance at the 10% and 1% levels, respectively.

Results for the full sample of municipalities indicate that a 1% growth in the non-agricultural sector raises the per-capita growth rate of the agricultural sectors by 0.03 percentage points. Although this effect is not statistically significant, it suggests that the non-agricultural sector creates growth-enhancing linkages with the agricultural sector. In the case of rural municipalities, growth in the non-agricultural sector does not create growth-enhancing linkages but has a negative and statistically significant impact on per-capita agriculture value-added. This finding is consistent with the argument that, as a country's economy expands, growth in the non-agricultural sector leads to resources leaving the agricultural sector, which causes a slow-down in productivity or a decline in overall output.

Similarly, as Table 12 indicates, agriculture has a negative and statistically significant impact on non-agriculture. This result is not surprising given the declining share of agriculture in South Africa's economy, and the increasing linkages within the country's non-agricultural sectors because of the adoption of technology and structural transformations. It mirrors results of similar studies, such as Bravo-Ortega and Lederman (2005) and Tiffin and Irz (2006). The sub-sample of municipalities revealed a more interesting result: a positive (and strongly significant) reverse effect from agriculture to non-agriculture in rural municipalities: a 1% increase in annual per capita growth in the agricultural sector raises the per capita growth rate outside the agricultural sector by 0.07 percentage points.

2.4.3 Participation effects – the impact of sectoral growth on poverty reduction

As explained in Section 2.3 about the Conceptual Framework, the literature provides three main explanations of why the impact of growth on poverty differs across economic sectors.

- People are better able to participate or benefit from growth that occurs in areas where poor people are located. Therefore, agricultural growth will have a larger impact on poverty alleviation than non-agricultural growth because the poor are mainly concentrated in rural areas where their main income source comes from agriculture and related activities (Byerlee et al., 2005; Christiansen et al., 2011).
- Labour intensity is a key factor in determining a particular sector's impact on poverty (e.g. Loayza and Raddatz, 2006; 2010). In rural areas, most poor people's major asset is their unskilled labour, and so growth in the agricultural sector (which in developing countries is mainly labour-intensive) would result in greater poverty reduction than, for example, growth in the less-labour intensive and technology-driven services sector. [20]
- Differences in asset inequality, in particular land ownership, can explain why growth has different poverty-reducing effects across sectors. In countries that have favourable land distribution, income inequality is lower because small and medium farmers are able to cultivate a large share of available land (Bourguignon and Morrisson, 1998). Similarly, in China (where land distribution is relatively equitable) agricultural growth contributed up to four times more to poverty reduction than growth from industry and services (Ravallion and Chen, 2007). In contrast, in countries with high levels of land inequality – India (Ravallion and Datt, 1996) and Pakistan (Dorosh and Haggblade, 2003) – agricultural growth either had the same poverty-reducing effect as the services sector (India) or contributed very little to poverty reduction in rural areas (Pakistan).

To assess whether or not the source of growth matters for poverty reduction, an empirical model is estimated in which different measures of poverty are expressed as linear functions of lagged agriculture and non-agriculture per capita growth as well as interaction terms of the variables that capture the impact of the structure of the non-agricultural sector and the effects of the levels and depth of poverty, respectively. The literature on economic development posits that the presence of a large, non-agricultural sector such as mining/extractive industries can create a "Dutch disease" phenomenon, whereby the real exchange rate appreciates because of increased exports from the non-agriculture sector, which results in reduced growth of the agricultural sector and increased growth of the expanding non-agricultural sector. Failure to account for this could result in an estimation bias, where the effect of the non-agricultural (agricultural) sector is underestimated (overestimated);, a result that could lead to a potentially misleading conclusion: that the agricultural sector, not the non-agricultural sector, has greater poverty-reducing effects. To account for the share of the non-agricultural sector, the share of community services in municipal GVA is used.[21] Following Christiansen et al. (2011), an indicator variable is used, taking a value of 1 if the share is greater than or equal to 25% and zero otherwise.

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[20] Thorbecke and Jung (1996) find that the agricultural sector contributes the most to overall poverty reduction, followed by the services and informal sectors. They also find that, despite the manufacturing sector having the least impact on poverty reduction, the (unskilled) labour-intensive food processing and textiles sub-sectors within manufacturing made relatively large contributions to poverty reduction. Loayza and Raddatz (2010) report similar findings, with growth in the relatively labour-intensive sectors of agriculture, manufacturing and construction having the most poverty-reducing impact, and the capital-intensive mining, utilities and services sectors having the least poverty-reducing effects.

[21] Community services captures economic activities run by the Government and related public-sector institutions.

Three national poverty lines (Stats SA, 2014) were used: (a) the food poverty line, which is the level of consumption below which individuals are unable to purchase sufficient food needed for an adequate diet (those below this line are either consuming insufficient calories or must change their consumption patterns); (b) the lower-bound poverty line, which includes non-food items that individuals obtain by foregoing food; and (c) the upper-bound poverty line, which is defined as the level of consumption at which individuals can purchase adequate food and non-food items. The Rand value of each line is updated annually using CPI prices data (Stats SA, 2014).

Tables 13 to 15 provide the results obtained from applying fixed effects estimation technique to the preferred empirical model in which the three poverty measures are alternated as dependent variables.

Table 13. Impact of sectoral growth on food poverty

Food Poverty Line (Headcount)	All Municipalities		Rural Municipalities		
Country fixed-effects estimate	(1)	(2)	(3)	(4)	(5)
	Coefficient /p-value	Coefficient /p-value	Coefficient/p-value	Coefficient/p-value	Coefficient/p-value
Agriculture growth	-1901 (0.001)***	-2474 (0.000) ***	-2555 (0.000) ***	-2254 (0.000)***	-2920 (0.000)***
Agriculture growth* $Gini_{t-1}$	3215 (0.001)***	3895 (0.000)***	4051 (0.000)***	3835 (0.00) ***	4583 (0.000)***
Agriculture growth* $(poverty/income\ per\ capita)_{t-1}$	--	11797 (0.000) ***	7679 (0.230)	--	14534 (0.000)***
Agriculture growth* (poverty/income per capita)* rural	--	--	3922 (0.473)	--	---
Non-agricultural growth	-1370 (0.460)	-5535 (0.006) **	-5383 (0.008) **	-2430 (0.234)	-6744 (0.003)***
Non-agriculture growth* $Gini_{t-1}$	2411 (0.427)	7786 (0.016)**	7438 (0.019)**	4318 (0.191)	9765 (0.006)***
Non-agriculture growth* 25% community services share	-5 (0.972)	-405 (0.02)**	-396 (0.022)**	-48 (0.735)	-491 (0.009)***
Non-agriculture growth* *$(poverty/income\ per\ capita)_{t-1}$	--	84244 (0.000) ***	103884 (0.003) **	--	89030 (0.000)***
Non-agriculture growth* (poverty/income per capita)* rural	--	--	-18305 (0.497)	--	--

Note: (*), (**) and (***) denote statistical significance at the 10%, 5% and 1% levels, respectively.

Table 13 shows that agriculture has a statistically significant effect on poverty, irrespective of the poverty line used (columns **(1)** and **(4)**, respectively). A 1% increase in agricultural growth per capita leads to the food poverty headcount reducing by about 1900 persons across all municipal types, and by about 2300 people across rural municipalities. However, when the depth of poverty and the presence of a large public sector are taken into account, this significant poverty-reducing effect is dampened. While both agricultural and non-agricultural growth has statistically significant (food) poverty-reducing effects, the effect of non-agricultural growth is on average 2.24 times (-5535/-2474) greater than agricultural growth for all municipal types, i.e. urban and rural – see column **(2)**, and on average 2.3 times higher for rural municipalities – see column **(5)**.

Tables 14 and 15 present the estimation results that serve to assess whether the reported findings detailed in Table 11 are consistent with other measures of poverty.

Table 14. Impact of sectoral growth on lower-bound poverty (LBP)

Lower-Bound Poverty Line (Headcount)	All Municipalities			Rural Municipalities	
Country fixed-effects estimate	(1)	(2)	(3)	(4)	(5)
	Coefficient /p-value	Coefficient /p-value	Coefficient/p-value	Coefficient/p-value	Coefficient/p-value
Agriculture growth	-1988 (0.001)***	-2670 (0.000) ***	-2764 (0.000) ***	-2301 (0.000)***	-3039 (0.000)***
Agriculture growth* $Gini_{t-1}$	3371 (0.001)***	4185 (0.000)***	4361 (0.000)***	3908 (0.00)***	4757 (0.000)***
Agriculture growth* (poverty/income per capita)$_{t-1}$	--	13047 (0.000) ***	8891 (0.173)	--	15421 (0.000)***
Agriculture growth* (poverty/ income per capita)* rural	--	--	4025 (0.485)	--	---
Non-agricultural growth	-795 (0.665)	-4707 (0.018) **	-4506 (0.022)**	-1822 (0.363)	-5893 (0.007)**
Non-agriculture growth* $Gini_{t-1}$	1457 (0.628)	6499 (0.04)**	6029 (0.053)**	3297 (0.308)	8432
(0.014)***	-5 (0.972)	-405 (0.02)**	-396 (0.022)**	-48 (0.735)	-491 (0.009)***
Non-agriculture growth* 25% community services share	27 (0.850)	-354 (0.04)**	-341 (0.05)**	-24 (0.861)	-446 (0.016)***
Non-agriculture growth* *(poverty/income per capita)$_{t-1}$	--	79611 (0.000) ***	107508 (0.003)**	--	84393 (0.000)***
Non-agriculture growth* (poverty/income per capita)* rural	--	--	-25959 (0.360)	--	--

Note: (*), (**) and (***) denote statistical significance at the 10%, 5% and 1% levels, respectively

Table 14. Impact of sectoral growth on lower-bound poverty (LBP)

Lower-Bound Poverty Line (Headcount)	All Municipalities			Rural Municipalities	
Country fixed-effects estimate	(1)	(2)	(3)	(4)	(5)
	Coefficient /p-value	Coefficient /p-value	Coefficient/p-value	Coefficient/p-value	Coefficient/p-value
Agriculture growth	-1759 (0.001)***	-2370 (0.000) ***	-2448 (0.000)***	-1963 (0.000)***	-2617 (0.000)***
Agriculture growth* $Gini_{t-1}$	2964 (0.001)***	3712 (0.000)***	3855 (0.000)***	3329 (0.00)***	4084 (0.000)***
Agriculture growth* (poverty/income per capita)$_{t-1}$	--	11510 (0.000) ***	8486 (0.123)	--	13395 (0.000)***
Agriculture growth* (poverty/ income per capita)* rural	--	--	2984 (0.553)	--	---
Non-agricultural growth	-142 (0.929)	-3271 (0.06)*	-3085 (0.072)*	-1190 (0.488)	-4528 (0.015)**
Non-agriculture growth* $Gini_{t-1}$	338 (0.897)	4368 (0.112)	3926 (0.148)	2220 (0.422)	6429
(0.014)***	(0.027)**	-405 (0.02)**	-396 (0.022)**	-48 (0.735)	-491 (0.009)***
Non-agriculture growth* 25% community services share	54 (0.683)	-253 (0.108)	-240 (0.126)	-19 (0.878)	-366 (0.021)**
Non-agriculture growth* *(poverty/income per capita)$_{t-1}$	--	63956 (0.000) ***	91089 (0.004)**	--	69370 (0.000)***
Non-agriculture growth* (poverty/income per capita)* rural	--	--	-25223 (0.312)	--	--

Note: (*), (**) and (***) denote statistical significance at the 10%, 5% and 1% levels, respectively

The coefficient estimates listed in Tables 14 and 15 mirror the reported findings in Table 13. Growth within the agriculture sector has significant poverty-reducing effects and can be a powerful tool for raising households above the three poverty lines. However, when a large public sector is present and the depth of poverty is accounted for, growth in non-agriculture per-capita value added is a more powerful tool for reducing the headcount of persons living below all three poverty measures.

2.5 Concluding Remarks

Despite almost two decades of efforts aimed at restructuring the county's agrarian economy, most of South Africa's rural areas remain characterised by high levels of poverty and inequality. This raises concerns about the efficacy of agricultural support programmes in achieving growth and reducing rural poverty in line with the government's stated objective of creating a vibrant and inclusive rural economy. While agriculture remains an important source of sustenance in rural areas with weak economic bases, its contribution to overall economic activity in rural areas is less significant than is generally perceived: agriculture accounts for 30% or more of total gross value added (GVA) in only 48 municipalities, or about 21% of all municipalities, of which 43 are classified as rural (i.e. category B3 and B4 municipalities). The relatively small share of agriculture in economic output/activities of rural municipalities has called into question government's emphasis on agriculture-led rural development strategy, and whether it is the most viable policy to generate growth required for development and poverty reduction, and facilitate the participation of the majority of poor people in economic activities within rural spaces.

The argument for policies aimed at agricultural growth and development within rural economies is that economic growth in the agriculture sector results from the export of surplus resources. The empirical evidence indicates that agricultural activities represent an important driver of incomes and local economic growth in rural municipalities because of its positive effect on non-agricultural sectors. In contrast, growth within the non-agricultural sector can lead to resources leaving the agricultural sector, causing a slow-down in productivity growth or a decline in overall value added output. Growth within the agriculture sector exerts significant poverty-reducing effects and can be a powerful tool for lifting people above the three poverty levels. However, this comparative edge over growth in the non-agricultural sector declines in the presence of a large public sector and deep poverty. In such instances, growth in non-agriculture per-capita value added is a more powerful tool in reducing the headcount of persons living below all three poverty levels.

2.6 Recommendations

With respect to creating conditions for rural development from agriculture-led growth, the Commission recommends that:

1. The Department of Agriculture, Forestry and Fisheries enhances agricultural productivity by establishing a framework for implementing, evaluating and monitoring key agricultural grants targeted at subsistence and small-scale farmers.
2. Agriculture-related intergovernmental transfers are distributed across recipient provinces in a manner that promotes equity and ensures access for targeted groups, especially emerging and subsistence farmers located within rural provinces and municipalities. This can be achieved through expanding the current disbursement criteria to incorporate weights for a province's share of national rural population, the proportion of a province's rural population with incomes below official poverty levels/measures, and the extent to which the rural population in a province participates in subsistence and smallholder farming.
3. A framework is established to supplement rural development initiatives. The framework would facilitate greater coordination and communication among departments and public entities tasked with driving rural development through entrepreneurial programmes, which create linkages between agriculture and non-agricultural sectors.

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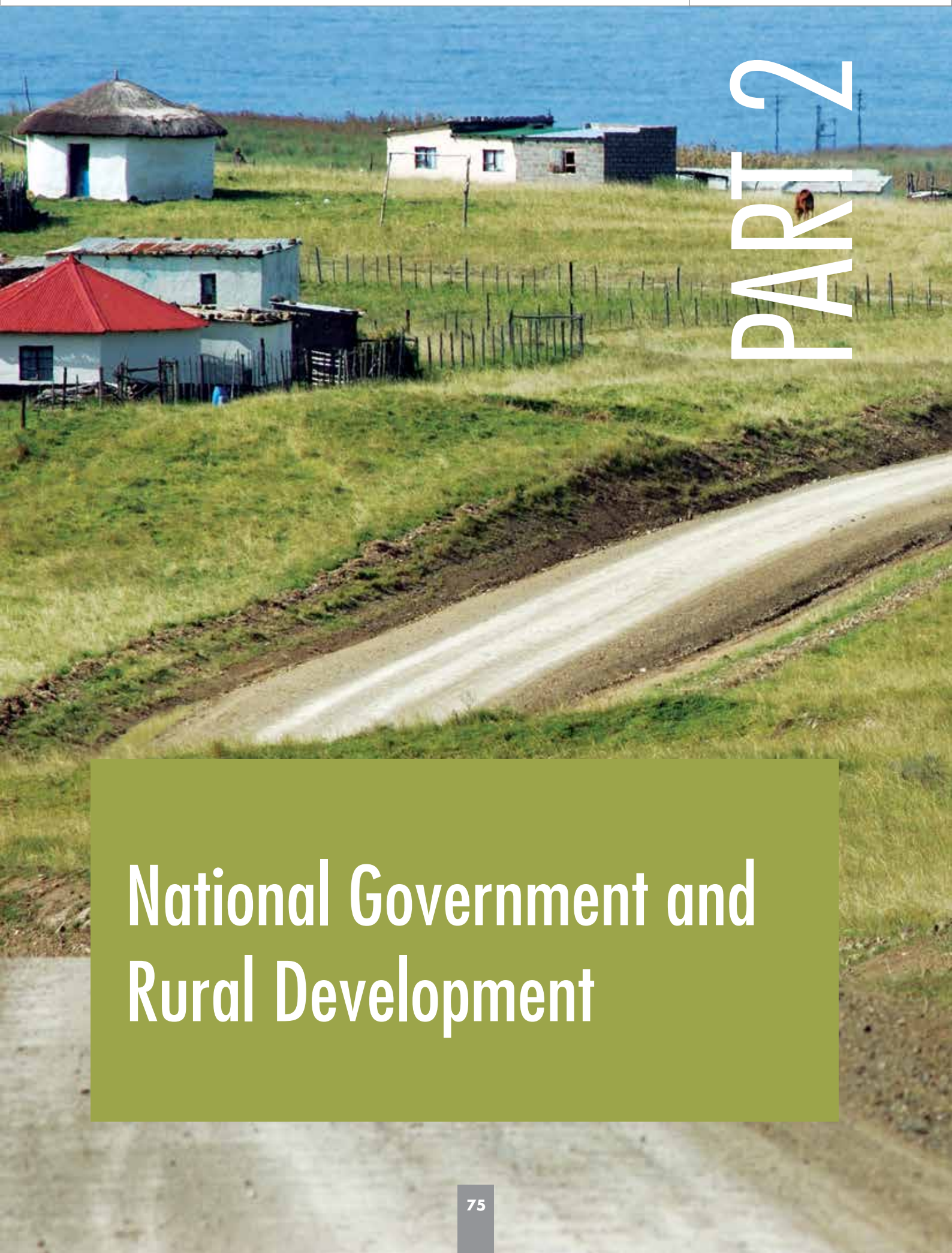

PART 2

National Government and Rural Development

CHAPTER 3

The National Land Reform Programme and Rural Development

Ghalieb Dawood

The National Land Reform Programme and Rural Development

3.1 Introduction

In South Africa, challenges of unemployment and poverty are largely concentrated in rural areas, especially among households residing in the previous homelands. In response to historical practices of economic exclusion, government has pursued redistributive policies, such as land reform, to broaden access to land, especially in rural areas where land access is seen as a vital source of livelihood support. Much of the development literature supports the view that asset inequality undermines economic growth, while well-targeted asset transfer (provided the beneficiaries use the land productively) enhances economic development (Stewart, 1965; Obeng-Odoom, 2012).

Introduced in 1994, South Africa's land reform programme is based on both equity and economic grounds, and originates from Section 25 of the Constitution. It consists of three main pillars: land restitution, land redistribution and land-tenure reform. Since 1996, government has transferred a considerable amount of land and settled nearly all restitution claims lodged prior to the 1998 cut-off date (DRDLR, 2015). Yet, despite these achievements, the land reform programme has failed to achieve its policy objectives.[22] The programme has been criticised for the slow pace of land transfers relative to the goal of transferring 30% of agricultural land to the previously disadvantaged by 2014 (Kariuki, 2009; Lahiff and Cousins, 2005). Most of the transferred land has either remained fallow or been used for productive activity that has not been profitable (Lahiff, 2007). Therefore, much of the potential of land reform, especially as a mechanism for agrarian change and rural development, has gone unrealised (Deininger and May, 2000; Lahiff and Cousins, 2005). In the case of land restitution and redistribution programmes, significant amounts of public funds have been spent, but the quality of spending remains a concern.

The study assesses how the intergovernmental implementation of the land reform programme can be strengthened in order to play the catalytic role envisioned in policy. The specific objectives are:

- To examine the impact of the land reform programme on critical policy outcomes in rural areas, such as food security, job creation and agricultural productivity.
- To assess whether provincial and local governments are adequately supporting land reform projects in rural areas in order to achieve policy outcomes.
- To determine whether provincial and local governments have access to the necessary financial instruments to achieve the policy outcomes.

The assessment is only of the land reform programme, which encompasses land redistribution, funding instruments and services offered to restitution projects, and does not include land tenure reform and basic infrastructure. Tenure reform has the potential to unlock significant investment and production in rural areas and, consequently, stimulate rural development. Individuals and households are generally less inclined to invest in agricultural production and other forms of enterprise if the land tenure is insecure. Policy measures to reform land tenure in rural areas are currently underway, but the new policy framework (the Communal Land Tenure Policy) is being contested because it seeks to turn traditional leaders into the owners of communal land. This could increase the level of conflict in communal areas by enforcing an inappropriate level of individual entitlement on tenure systems premised on jointly managed land (Du Toit, 2014).

The National Development Plan (NDP) includes the goal of increasing employment in agriculture by 643 000 direct jobs and 326 000 indirect jobs by 2030, as well as increasing export of agricultural products (NPC, 2011). A well-designed land-reform programme is critical for revitalising the agricultural sector, leading to employment and output growth that would improve food security, and poverty and inequality levels in rural areas (Lahiff and Cousins, 2005). While many studies have focused on land reform, very little work has been done on the impact of land reform on rural development, especially in relation to food security and job creation. Furthermore, the Constitution calls for historical redress of land by enabling citizens to obtain land on an equitable basis, and an effective land-reform programme should give effect to this key constitutional provision.[23] Implementation of the land reform programme involves stakeholders across all three spheres of government, and any recommendations emanating from the research are subject to South Africa's intergovernmental relations framework, thus warranting the involvement of the Financial and Fiscal Commission (the Commission).

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[22] Approximately 97% of all the land claims lodged before the December 1998 cut-off date were finalised by 30 March 2014 (Mail and Guardian, 2014).

[23] This provision is contained in Section 25(5) of the Constitution. The Land Reform programme also addresses – more broadly – some of the other provisions in Section 25.

3.2 Background

The Natives Land Act (1913) and subsequent discriminatory land policies relocated Africans from fertile rural areas and confined them to reserves where land was least arable, and environmentally degraded (Du Toit, 2014). The land reform programme introduced in post-apartheid South Africa is an attempt to reverse this historical de-agrarianisation process, which resulted in skewed ownership patterns and social exclusion of Africans from the rural economy. The land reform programme, especially the redistribution policy, is closely tied to revitalising smallholder agriculture in rural areas. Land is a principal source of wealth in rural areas, and transferring land assets to the poor provides security, while using the land productively can reduce unemployment, improve food security and increase economic growth (Stewart, 1965; Lahiff and Cousins, 2005).

According to economic theory, as a country modernises, the agricultural sector declines over the long-term and greater dependence grows on secondary and tertiary industries. In South Africa, the long-term decline of the agricultural sector has been quite noticeable. The gross domestic product (GDP) of agriculture fell from 9.1% in 1965 to 2.3% in 2013 (Greyling, 2012; Stats SA, 2014). Employment in the agricultural sector also declined, from 1.8 million in 1962 to 742 000 in 2014 (Stats SA, 2015). The long-term downward decline of agriculture is structural in nature, and yet land reform policy continues to be formulated almost exclusively around agriculture as a mechanism for rural development. However, there are arguments for continuing to invest in the agricultural sector. Agriculture is labour-intensive and so could be leveraged to create much needed employment, especially given the high unemployment levels in rural areas. The sector is also an important earner of foreign exchange, contributing 8% of South Africa's total exports. Lastly, the agricultural sector's strong production and consumption linkages makes its overall contribution to the economy even more significant (Greyling, 2012).

Despite the strong agricultural bias in policy, land reform beneficiaries have struggled to convert the acquired land into productive use. This is because they often have insufficient access to credit, equipment and technical assistance, and only a small percentage of the land owned is irrigated – irrigated farmland is far more productive than non-irrigated land. In addition, agriculture depends on good infrastructure, but rural areas are still characterised by significant backlogs, despite progress made since 1994. These are some of the reasons why the land reform programme has not achieved its initial policy goals.

In recent years, government has introduced various new policies designed to address some of the previous shortcomings in the land reform programme. These include the Recapitalisation and Development Programme (RADP) which is aimed at turning around unproductive land reform projects, and the reopening of the land claims process while some old claims are still outstanding. A concern is whether this new policy proposal is affordable and whether appropriate funding has been identified (SAHRC, 2013). In addition, the Proactive Land Acquisition Strategy (PLAS) allows land reform beneficiaries to lease land from the state under stringent conditions, which means that it is unlikely that the land will be transferred to beneficiaries anytime soon – instead the land will remain in the ownership of the state.

At present, what is not known is the number of land reform projects that have failed and the proportion of these failed projects that were recapitalised under the RADP. It is likely that the vast majority of farms acquired through Settlement Land Acquisition Grant (SLAG) and Land Redistribution and Agricultural Development (LRAD) grants are no longer functional or are struggling to survive (Lahiff and Cousins, 2005). And, as the RADP funds farms over an initial five-year period, the chances are that only a small percentage of failed land reform farms would be part of the RADP programme. Therefore, it is unclear on what basis participating farms are selected and, more importantly, what is going to happen to the remaining land reform farms that did not succeed under previous funding regimes.

The DRDLR is the main driver of the land reform programme but has overlapping duties with the Department of Agriculture, Forestry and Fisheries (DAFF) and the Department of Human Settlements (DHS), among others. Municipalities are also expected to provide basic services to land reform beneficiaries, although infrastructure planning to support land reform beneficiaries may be lacking in municipal integrated development plans, and rural municipalities are constrained by capacity challenges that hamper effective infrastructure roll-out in rural areas.

3.3 Literature review

3.3.1 Benefits of land reform in rural areas

The rationale for land reform in rural areas often goes beyond equity considerations. Benefits of land reform include outcomes that are crucial for rural development, i.e. poverty reduction, food security, employment and agricultural productivity. The question is whether or not land reform can in fact achieve these outcomes.

Poverty and food security

Land policy in South Africa makes a strong claim that land reform can decrease poverty levels and improve food security in rural areas. Making land available allows family units to grow crops and support livestock, which results in a more continuous flow of food to households, as well as potential cash income for the purchase of other necessary consumables. This decreases the overall level of poverty and allows for enhanced nutrition and human development (DLA, 1997).

A study in India found that land reform was associated with lower rural poverty, which benefitted the landless, as agricultural wages increased (Besley and Burgess, 2000). These results suggest that reforms aimed at production relations in agriculture can play a significant role in reducing poverty. In West Bengal, the Nijo Griha Nijo Bhumi land-allocation programme improved the food security of rural households (Santos et al., 2013), and these households were also more likely to access credit and invest in agriculture. Women reported significantly improved tenure security, as a result of being granted land titles, which is likely to lead to long-term food security, even though food security itself was not initially realised. The programme's weakness was that financial constraints meant that many families did not move to the larger plots provided, which prevented the full benefits of the allocated land from being realised.

In South Africa, only a handful of studies have examined the impact of land reform on food security and poverty. A survey carried out in 1999 concluded that 80% of land-reform beneficiaries expected to plant crops, although only 22% actually did. It found that land reform households had not used or had under-used labour, suggesting significant potential for improving household nutrition and welfare from own production (Deininger and May, 2000). A review of the LRAD programme, which makes land-purchase grants to landless farm workers and labour tenants,[24] found that living standards initially dipped with land transfers but improved by 50% over the medium term (Keswell and Carter, 2014). Kepe and Tessaro (2014) investigated what happened when households in two rural villages in the Eastern Cape participated in government-led food security programmes being implemented by quasi-private agencies. They found that a significant number of households preferred to leave the land fallow rather than participate in the food-security project, while households that did participate in the programme soon lost interest. Villagers feared losing control of the management of the land, suggesting a lack of compatibility between land-tenure reform programmes and food-security strategies. In a study of households receiving grants, Valente (2009) found that beneficiaries receiving land grants were more likely to report difficulties in satisfying food needs than non-land grantees by between 2.1% and 2.2%. Households receiving grants were also more likely to report children or adults in the household having gone hungry at least some times in the 12 months preceding the survey compared with non-land grantees with similar socio-economic backgrounds.

Employment

Another proposed benefit of land reform is increased employment in rural areas, especially with the development of smallholder agriculture, which has a high elasticity of employment. As more smallholder farms become productive and profitable, agricultural employment will increase. This argument also applies to large commercial farming operations, which also display a high elasticity of employment. An employment multiplier effect will also occur, as an increase in agricultural activity will result in a higher demand for inputs and support services.

In Mexico, land reform beneficiaries were found to use less fertiliser and more manpower to achieve the same overall crop yields as private-sector farms, suggesting that land reform has a positive impact on employment, as beneficiaries use more labour-intensive production methods (Nguyen and Saldivar, 1979). A study of land reform in Taiwan found that land reform policies led to a reduction in unemployment in agriculture and other industries, and increased profitability in the manufacturing sector, while farmer associations were important institutional partners in providing critical services to land reform beneficiaries (Dorner and Thiesenhusen, 1990).

Surprisingly, no published study into the impact of land reform on employment in South Africa could be found. This may be because of a lack of data on land reform projects and household employment.

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[24] In order to accelerate land redistribution, government introduced the proactive land acquisition strategy (PLAS) which aims to acquire high potential agricultural land and ensure maximum productive use of the land acquired (PLAAS, 2011).

Agricultural productivity

Land reform is often based on the assumption that small-scale farms are more productive than large-scale farms. This is because small-scale operations are generally owner-operated rather than managed by wage labour, resulting in lower supervision and management costs, and more productive labour (Adams, 2000). Another reason for small-scale farms being more productive is that they tend to have greater application of productive inputs such as fertiliser and seed, and use the land more intensively (Fan and Chan-Kang, 2005). Overall, land reform policies in Asian economies have resulted in increased productivity and profitability for small-scale farmers, but this is contingent on the type of farm production as well as the associated security of property rights and institutional support.

However, the traditional view of an inverse relationship between farm size and productivity has been challenged. The traditional view has been found to be true only for certain types of farming operations (Fan and Chan-Kang, 2005). The Green Revolution resulted in increasing economies of scale for some types of agricultural production, with a greater reliance on capital inputs and sophisticated production procedures (Adams, 2000). In addition, small-scale farmers face significant barriers to entry, particularly in high-value export products, which require large inputs, such as herbicides, fertilisers and chemical pest control. These costs, together with the high costs of credit and substantial production risks, present difficulties to new entrants in agriculture, particularly the small-scale producer. Such costs can be mitigated by state institutions employing reforms to assist small-scale farmers with access to credit, technology and market linkages (Fan and Chan-Kang, 2005). In some instances, agricultural production remained the same after implementing land reform, such as in Peru and Japan. In Japan, this was partly a result of investment in infrastructure and the provision of support services to land-reform beneficiaries (Weideman, 2004).

In South Africa, Lyn and Ortmann (1996) found that livelihoods increased moderately when redistribution occurred from large to small farms, with no change in the quantity and extent of crop production in KwaZulu-Natal (KZN).

The varied empirical results from the literature demonstrate the nature of the land reform policy, and that the economic and social contexts are critical factors determining the effect of a land-reform programme on agricultural production (Weideman, 2004).

3.3.2 Constraints on effective land reform

Various critical factors lead to the failure of land reform. In India, land reform post-independence achieved limited success (other than in Kerala and West Bengal) largely as a result of loopholes in legislation, lack of political will, delays in implementation, and poor execution of plans (Ghosh, 2007). In Botswana, land reform was implemented to achieve agricultural productivity, to conserve range resources and to establish social equity. While the country managed to attain moderate success in the first two objectives, social equity was severely compromised, as land ended up being sold to a limited number of individuals with access to capital. The poor lost out and did not benefit because of constraints such as high development costs, lack of cattle ownership, insufficient human capital and an absence of any loan and grant-funding programme from government (Malope and Batisani, 2008).

In South Africa, several barriers to land reform exist, including limited fiscal allocations and institutional capacity, and bureaucratised state machinery (Kariuki, 2009). In addition, the land acquired is often a long distance from the place of residence of beneficiaries, resulting in the land not being put to productive use (Valente, 2009). The grants issued to beneficiaries are small, and so beneficiaries can only purchase land as a collective, which leads to the formation of dysfunctional groups that are driven by the need to make up the numbers rather than to bring together individuals with the know-how, complementary resources and similar objectives. In addition, policy emphasises support for emerging farmers with their own resources and access to credit, while the lack of post-transfer support and the failure to integrate land reform into broader rural development is limiting the impact of policy on the rural economy (Lahiff and Cousins, 2005). Other weaknesses that need to be addressed include the many commercially unviable projects, high transaction costs, scattered projects that do not meet people's needs, and inadequate infrastructure provision by provincial governments and municipalities (Deininger and May, 2000).

In addition, the conceptual divide between land reform and agricultural policies has encouraged the lack of integration on the ground. This conceptual divide arises from the separation of land reform and agriculture functions at a national level, resulting in poor coordination and creating additional layers of bureaucracy in an already fragmented rural space (Du Toit, 2014).

Water is a limited resource in South Africa and one of the major constraints to successful land reform. Furthermore, the pace of establishing water-users' associations has been very slow, which has essentially maintained the status quo in water allocation for agriculture (Lahiff and Cousins, 2005).

3.3.3 Enabling factors for land reform to succeed

International studies have identified various factors that enable successful land reform. In Mexico, income transfer can only take place with financial support from government (Nguyen and Saldivar, 1979). In India, success depends on political factors, for example in West Bengal where a left-wing government was in power, there was a strong correlation with successful land-reform implementation, although this was largely tenancy-related (Ghatak and Roy, 2007). In Taiwan, policy measures that aid agricultural performance include decentralising industrial development, choosing appropriate factors of production, promotion of research, extension services, credit, input and product marketing (Dorner and Thiesenhusen, 1990).

Based on evidence in 19 countries, including South Africa, Weideman (2004) confirms that land reform through small-scale farming can succeed if supported by a package of appropriately coordinated support and enabling conditions. The package of support includes state investment in appropriate technology, agricultural research, social services in rural areas, infrastructure, education and training, extension services, cheap credit, transport, and water. Land reform farmers also require access to quality land, the necessary management and entrepreneurial skills, and agricultural equipment and supplies such as seeds, fertiliser, fencing materials and insecticides. In addition to state support, land reform is also more likely to succeed in a politically stable environment and where favourable economic conditions prevail, such as good prices for agricultural produce and well-functioning and accessible markets.

3.3.4 Measuring the impact of land reform

Studies investigating the impact of land reform include various potential outcomes. At a macro level, developmental outcomes of land reform include food security (Ghosh, 2007; Santos et al., 2013; Valente, 2009), agricultural output and productivity (Deininger et al., 2014; Grega et al., 2015; Nguyen and Saldivar, 1979), and growth (Besley and Burgess, 2000). Studies have also sought to measure the socio-economic effects, particularly related to poverty and inequality (Aliber and Cousins, 2013; Chitiga and Mabugu, 2008; Nene et al, 2014;), while other studies have looked at the general equilibrium impacts (Juana, 2006). The South African literature on the developmental impacts of land is surprisingly limited. Most studies are focused at a micro-level (Aliber and Cousins, 2013; Anseeuw and Mathebula, 2008), with only a few at a macro level (Keswell and Carter, 2014; Valente, 2009). No study could be found on the effects of land reform on job creation, although policy in South Africa emphasises economic development as a key outcome of land reform.

The approaches used to measure the impact of land reform on developmental outcomes are selected based largely on data availability. For example, some studies adopted econometric models, using a panel dataset to compare the impact of land reform pre-implementation and post-implementation (Besley and Burgess, 2000; Deininger et al., 2009; Deininger et al., 2014; Nguyen, 2012). Santos et al. (2013) used an inverse-propensity score-weighted regression to assess beneficiaries of a land-reform programme in West Bengal (Santos et al., 2013), while Grega et al. (2015) used chi-square tests in Ghana – both studies were cross-sectional surveys. In South Africa, national survey data on land reform is generally unavailable, and so most studies adopted a case study approach (Aliber and Cousins, 2013) or conducted micro surveys (Anseeuw and Mathebula, 2008; Hart, 2012; Kepe and Tessaro, 2014). The present study conducted a micro survey administered in three provinces with a significant rural population.

3.4 Methodology

The study used a combination of methodological tools to measure the impacts of land reform. A field-based, area-specific participant approach was adopted at sites in three provinces, focusing particularly on low-income rural households. In addition, interviews were held with national, provincial and local government officials, as well as with support institutions.

3.4.1 Field survey

Each site evaluated was a land reform area that was compared to a commercial area. This fieldwork provided an accurate estimation of current poverty, employment and food-security issues within these communities. The sites that were compared had similar climatic, physical and commodity characteristics. Overall, 850 interviews were conducted across the three sites, which fell slightly short of the target of 900 individuals because of complications in the enumeration process, particularly in the Eastern Cape. The propensity score matching (PSM) technique was used to identify appropriate counterfactuals to land reform beneficiaries in the community where beneficiaries were based.

Both farm-level data and household-level data were collected. The three provinces selected – KZN, Eastern Cape and Mpumalanga – have large land reform areas, a significant rural population and labour-intensive crop types.

Study variables

The impact of the policy on set objective outcomes is measured at a household level and assessed using the "general treatment model" by instrument variables (Khandker et al., 2010) as required. The key variables identified to form the matching criteria to matching treated (land

reform beneficiaries) and control (non-land reform beneficiaries) sampling units (individual households) with limited effect on the probability of all sampling units to benefit from land reform policy are age, gender, highest level of qualification, and occupation type before occurrence of land reform in their space.

The dependent variables that were identified in line with the study objectives, to show the impact of land reform on household livelihoods, were household total income, household dietary diversity scores (HDDS) and household food insecurity access scale (HFIAS). The HDDS measures the diversity of basic food items consumed by the household in the last 24 hours before enumeration, while HFIAS measures household inaccessibility/accessibility of food in the past 30 days.

Given that land reform and social security are both policies meant to influence income, not household income and welfare, the social security income component is removed from household total income because it would distort the estimated average treatments during application of matching methods. Hence, the average treatment effect of land reform policy on household income is estimated using total household income and total household income excluding social security income, to justify the latter argument.

The univariate t-tests for equality of means across the treatment and control groups are computed to identify statistically significant differences in the variables measuring the impact of the policy in line with study objectives.

Model specification

Following Khandker et al. (2010), the impact of land reform on household Income, HDDS and HFIAS change can be measured by estimating the general treatment model:

$$Yj = \beta 0 + \beta 1 Tij + \beta 2 Xj + \varepsilon j \quad (1)$$

Where Yj (dependent variable) is the expected change in the dependant variable observed for the i^{th} beneficiary, T is the treatment variable measuring the effect of the policy, X (independent variable) is a vector of observed attributes that affect observed outcome of the policy, and ε accounts for the random error and unobserved attributes influencing expected outcomes of the policy.

3.4.2 Qualitative method

Interviews were conducted with senior officials at national, provincial and local government levels, as well as with land reform specialists in the private and non-government organisation (NGO) sectors to assess the current implementation of land reform at sub-national level. The purpose of this assessment was to isolate efficiency and funding gaps in the system that could be weakening implementation of the land-reform programme.

3.5 Findings

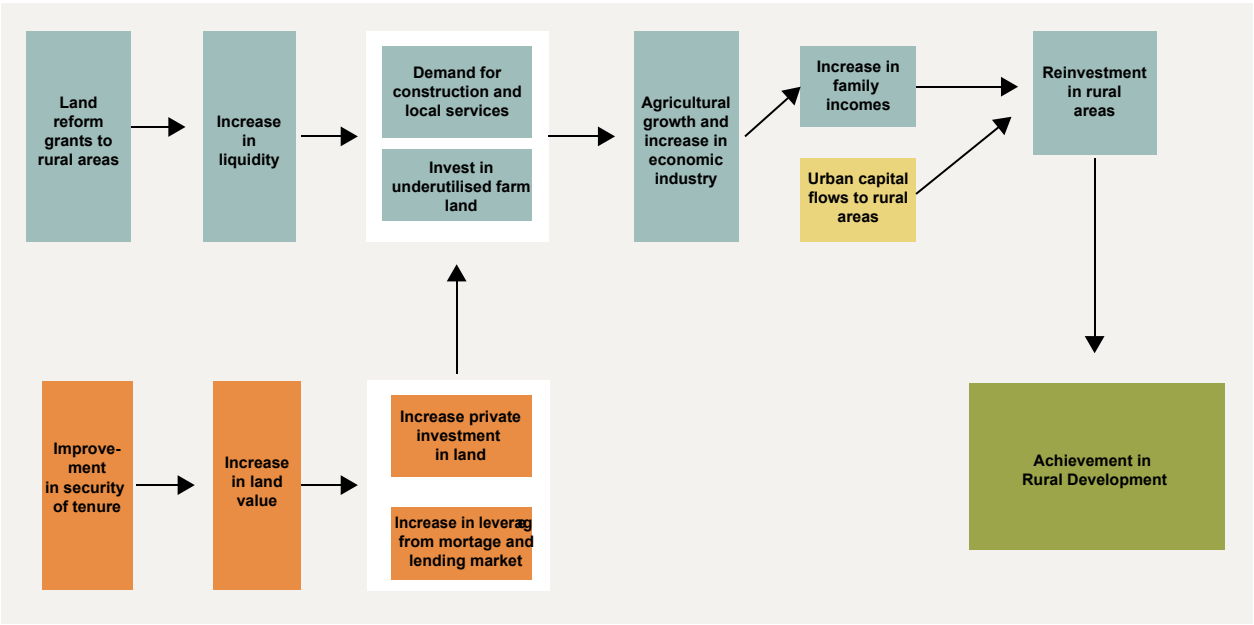
3.5.1 Land reform policy assessment

The land reform programme in South Africa was initiated soon after the 1994 democratic elections. The programme's objective is to address the historical imbalance in the ownership of land, specifically agricultural land, and to provide redress to individuals and groups previously dispossessed of their land as a result of racial or prejudicial policies. South Africa's land reform programme is legally supported by Section 25 of the Constitution and has three components: land restitution, land redistribution and land tenure reform. Land restitution seeks to return land to individuals or groups who unjustly lost their land rights since 19 June 1913 (although some landless groups are contesting this cut-off date). The goal of the redistribution policy is to rebalance land ownership patterns, by making funding available for mostly rural poor, farm workers and emerging farmers to acquire land for residential or productive purposes. Land tenure has two components: providing farm workers with tenure security in the face of uncertainty over evictions from commercial farmland; and improving tenure security of rural dwellers residing in communal areas. These three components of land reform have remained relatively unchanged since 1994, although tenure reform has received the least amount of attention and funding, despite various legislation that has since been passed.

The White Paper on Land Reform (1997) envisions land reform as a critical component of rural development and poverty reduction. This link, of land reform and rural development, has remained a consistent theme in various rural development strategies. The policy depicts two main pathways by which land reform facilitates rural development. The first pathway (Figure 26) is the disbursement of land reform grants to land-needy households in rural areas. The second pathway is through tenure reform aimed at improving the security of tenure of rural households, especially those living on commercial farms and communal areas.

Land reform is legislatively a national function. Up until 2008, the Department of Land Affairs was responsible for implementing land policy. Its name then changed to the Department of Rural Development and Land Reform, to strengthen land reform's linkage with rural development as emphasised in land policy. However, despite the name change, very little progress has been made to integrate land reform into the national rural development strategy (DPME, 2013).

Figure 26. Land reform and rural development linkages



Source: Author's compilation

Part of the problem may be the way in which land reform is conceptualised in policy. The Comprehensive Rural Development Programme (CRDP), which is the overarching rural development strategy, depicts land reform as a stand-alone component. Conspicuous by their absence are the linkages with rural development and agrarian reform, the other two components of the strategy. This disjuncture between land reform, rural development and agrarian reform also manifests itself at an implementation level: rural development and land reform are two separate programme structures in the DRDLR's organogram, and very little synergy is found between these two programmes at a design and implementation level.[25]

Land reform policy has also encouraged the view that land reform's role in rural development is largely about agriculture. This view was reinforced by the target of transferring 30% of white-owned commercial farmland in rural areas through mostly land reform, although government has now done away with aiming to achieve this target by a specific deadline. Agriculture is a concurrent function shared between national and provincial government. At national level, the Department of Agriculture, Forestry and Fisheries (DAFF) is responsible for overseeing the sector as a whole and so is legally responsible for post-settlement support to land reform beneficiaries, not the DRDLR. This separation of land reform and agriculture functions, and coordination weaknesses at national level, are two of the reasons for the failure of many land reform projects. Other reasons include inadequate post-settlement support to land reform beneficiaries, which for some (e.g. Chitonge and Ntsebeza, 2012) is the biggest failure of the land programme. Yet this failure may be because land reform has been framed within the narrow confines of agriculture. This means that success and failure are defined based on whether or not farms remain a going concern in spite of the inherent sectoral challenges. While agriculture is a crucial sector for stimulating rural employment, the absence of a stronger focus on non-farm sectors could explain why the land policy has moved away from distributing land to land-needy individuals towards a "use-it-or-lose-it" approach.

3.5.2 The funding instruments of land reform

Table 16 (page 87) illustrates the list of funding and grant instruments available to land reform since 1994. The SLAG was the first funding instrument introduced soon after 1994 and was disbursed to poor households earning less than R1500 per month. Despite the pro-poor nature of the grant, the grant size was too small for households to purchase farmland on their own. In 2001 a land reform review by the then Department of Land Affairs found that beneficiary households had to combine grants in order to purchase agricultural land. These projects eventually failed, as groups lacked cohesion, which led to conflict and dissolution. In 2001, the SLAG was replaced by the LRAD grant, which entitled beneficiaries to larger grants based on a sliding scale determined by an individual's own contribution. The grant targeted any previously disadvantaged individual,

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[25] An evaluation conducted on the Integrated Rural Development Programme found that there were poor linkages with land reform projects, despite the programme achieving enhanced infrastructure in rural areas (DPME, 2013).

although those interested in commercial agriculture were encouraged to apply. Despite LRAD grants being much larger than SLAG grants, purchasing land for farming remained unaffordable for most beneficiaries unless households pooled grants in order increase their "own contribution" portion. In 2006, the introduction of the PLAS marked a clear break from the previous system of disbursing grants to beneficiaries. Instead, the state purchased strategically located commercial farms, which were rented to beneficiaries for an initial three-year period. However, PLAS suffered from the same land tenancy challenges, including financial institutions being reluctant to issue any loans and tenants being reluctant to invest in the land because of their insecure tenure.

In 2009, the DRDLR introduced the RADP, as a response to the collapse of many land reform projects. The RADP provided funding over an initial five-year period to failed land reform and some land restitution projects. An evaluation of the programme in 2013 (DPME, 2013) revealed widespread shortcomings, in particular, the lack of technical knowledge transfer from the strategic partner to the beneficiary, and unclear selection criteria used to identify beneficiary farms. While the RADP provided comprehensive post-settlement support (which is believed to be the biggest failure of the land reform programme), in so doing it overlapped with the Comprehensive Agricultural Support Programme (CASP) grant that is managed by the DAFF. This clear overlap between the RADP and CASP grants means that much-needed resources could have been better used or combined to enhance the overall impact of the function.

The changing nature of land reform funding suggests that the state is paralysed between equity and economic development considerations, resulting in an underlying tension between promoting pro-poor land reform and encouraging larger scale commercial agriculture. What is missing from the overall funding design are incentives for alternative land uses and the acknowledgement of a possible trade-off between equity and economic development. If the objective is simply to provide the land-needy with access to land, the land reform programme's success should be measured by the amount of land transferred, irrespective of how households chose to use the land. However, these equity considerations may have to be foregone if the objective is economic development. By ignoring the fact that it may not be possible to achieve both objectives simultaneously, both goals could end up being compromised in the process. For example, current land reform policy only allows land to be leased to tenants who could continue leasing indefinitely while the RADP only benefits a small proportion of land reform farms, making post-settlement support inaccessible to other – possibly most – land reform projects.

Another concern is the complete lack of transparency about how land reform grants are managed. The budget lumps together all the grants as a single line item and gives no breakdown of the grants, how many beneficiaries qualified for each grant, grant criteria, what was spent on each grant and how these grants are being monitored. The RADP evaluation expressed a similar concern about transparency, especially in the way projects were selected (DPME, 2013).

Table 16. Funding and grant framework of land reform

Grants	Period	Description	Weaknesses
Settlement/Land Acquisition Grant (SLAG)	1995–2000	A maximum of R15,000 (raised to R16,000 later) was allocated to each household to purchase land in urban or rural areas for agriculture or residential purposes. The intention was to develop occupancy and expand land ownership of poor and previously disadvantaged South Africans earning less than R1500 per month (Mearns, 2011). Although inadequate, SLAG approved 599 projects, transferred 358 201 hectares and benefitted 95 871 beneficiaries.	• The grant was insufficient for households to purchase land and farm equipment. • Groups of households, which formed to purchase land because of small grant size, achieved little success and led to conflicts among beneficiary households. • The Department of Agriculture provided limited support to agricultural development of purchased farms. • Cost to poor people of relocating to the acquired land was unaffordable (Mearns, 2011).
Land Redistribution for Agricultural Development (LRAD)	2001–2010	In 2002, LRAD replaced SLAG and aimed to assist previously disadvantaged people to purchase land primarily for commercial farming (Mearns, 2011). LRAD allowed any black individual (no minimum income required) to apply for a land purchase grant that increased with personal contribution. The grant gave individuals between R20,000 and R100,000 depending on their personal contribution. The grant was designed to achieve the goal of transferring 30% of agricultural land to black South Africans by 2014. In 2008, the grant was increased to a maximum of R431,000 because previous amounts were still inadequate to purchase commercial farms (Aliber and Cousins, 2013). Unlike SLAG, the implementation of LRAD projects was decentralised to provincial level (Mearns, 2011). LRAD has been more successful than SLAG, as grants are larger and paid to individuals or groups rather than per household.	• Since LRAD's focus was on commercial farming, most of the grant funding went to better-off applicants. • The grants did not adequately address poverty and food security needs of poor rural households. • Given the willing-buyer willing-seller principle, commercial farms were still too expensive for individuals to purchase farms with the grant, which led to groups being formed in order to increase 'own contribution' (Mears, 2011).
Proactive Land Acquisition Strategy (PLAS)	Since 2006	PLAS is supply driven, whereby the state purchases strategically located farmland directly, as opposed to dispensing grants to beneficiaries. Land is given to beneficiaries on a loan basis for a three-year period and then disposed of beneficiaries if land was used productively. PLAS replaced LRAD as the main form of land acquisition in 2012 (Hall et al, 2014).	• The criteria for identifying beneficiaries is unclear. • There is widespread non-payment of rentals. • Beneficiaries are unable to secure loans on the basis of 3-year leasehold agreements, and this insecure tenure makes them less willing to invest. • Farms purchased could be far away from the beneficiary' residence and social networks. • No review of PLAS farms has been done since 2006 to inform policy (Hall, 2014)
Land Acquisition for Sustainable Development (LASS)	Since 2008	The LASS grant is made available to municipalities in need of land for settlement purposes and also to create a commonage for urban agriculture (Veda Associates, 2009)	
Municipal Commonage Grant		The grant's aim is to allow municipalities to acquire land for commonages, with the intention of establishing agricultural or productive schemes for underprivileged and disadvantaged residents. Beneficiaries must be South Africans and earn less than R1500 per month (Moroaswi, 2013).	The commonage programme has underperformed, has weak post-transfer management and no clear evidence of outcomes (Moroaswi, 2013).
Recapitalisation and Development (RADP) Grant	Since 2009	RADP grants aim to revitalise unproductive land reform projects. The DRDLR closely supervises farms funded through the programme, and each farm is assigned a strategic partner with experience in industry. The grant is guided by a business plan, and all projects are funded 100% on a five-year funding model. Grant beneficiaries who qualify are those who received land under land reform and the farm failed (unsustainable or about to be re-possessed), and emerging farmers who purchased land with loan funding but experienced challenges as land reform beneficiaries. Most of the RDP projects were previously PLAS or LRAD farms (DPME, 2013).	• Beneficiaries may not be encouraged to use the land acquired according to their own need, and this should not be the case (SAHRC, 2013) • No clear selection criteria for projects, beneficiaries and strategic partners. • Strategic partners are failing to transfer technical skills to beneficiaries. • Some farmers who are financially strong enough to sustain their operations benefitted from RADP funds. • RADP is duplicating agricultural support efforts by DAFF, which has failed to provide adequate post-settlement support to land reform beneficiaries (DPME, 2013)
Comprehensive Agriculture Support Programme (CASP)	Since 2004	Established in 2004, the CASP's target was to assist land reform beneficiaries, producers of agricultural products who obtain land via private means and agri-business (Moroaswi, 2013).	Co-ordination between the DAFF and DRDLR is weak, and quality of spending quality and planning of the grant has been suboptimal (Moroaswi, 2013).
Post-settlement financing opportunities		Financial opportunities are also available to beneficiaries from various private and public financial organisations prepared to provide financial assistance to land reform beneficiaries and emerging farmers (e.g. MAFISA, Land Bank, etc.).	These financing agencies may not be in a position to assist poor farmers who do not have the collateral to take out loans.

Source: Commission's computations based on Global Insight data and National Treasury (2012) definitions

As Table 17 shows, of the R76-billion spent by DRDLR between 1997/8 and 2014/15, about two-thirds was spent on the land restitution programme (34%) and on the land reform programme (32%).

Table 17. Public spending on land reform by DRDLR

	1997/8 - 2014/15 (R'000)	% Share of departmental expenditure	% Share of land reform expenditure
Department expenditure	76 207 031		
Land restitution programme	30 976 487	41%	
Land reform programme	25 487 582	33%	
Land reform grants	8 339 857		33%
Agricultural land holding account	12 810 712		50%

Source: National Treasury's estimates of national expenditure (various)

The land reform programme consists of a sub-programme containing various land reform grants and the agricultural land holding account (ALHA) which is the budget for PLAS. Total spending on PLAS has far outstripped land reform grants, even though PLAS only started in 2006, whereas land reform grants go back as far as 1995. ALHA accounts for half (50%) of land reform expenditure compared to land reform grants that make up only a third (33%). These percentages show the dominance of government's new approach to land reform, which is to acquire land and then lease it to tenants rather than to disburse grants to beneficiaries. A key concern is whether government has deviated from the goal of providing secure tenure to poor rural households by entering into lease agreements with a small group of emerging farmers without any clear indication of the selection criteria for these beneficiaries.

3.5.3 Impact of land reform

Most land reform beneficiaries were previously farm labourers or unemployed. For both land reform beneficiaries and the counterfactuals, their income included a lease, wage, social security and family remittances components, but the spread of incomes was quite different.

Table 18. Proportion of sample by land reform treatment and employment type

Employment type	Count of land reform	Count of counterfactuals	Proportion of land reform (%)	Proportion of counterfactuals (%)
Farm labour	70	61	71	29
Temporary farm labour	5	53	4	14
Driver	2	2	2	1
Employed off farm	5	12	4	4
Unemployed	17	86	15	29
Total	99	214	100	100

Land reform impact on household income

Regression analyses were run for each of the provinces, to examine the effect of various factors (excluding social security) on household income. All of the models were statistically significant at the 1% level and explained 32%, 56% and 22% of the total variation the dependent variable in KZN, Mpumalanga and the Eastern Cape, respectively (Table 19).

The models were run with the constant representing any omitted employment category and non-beneficiary group, which were unemployed individuals in KZN and Mpumalanga and pensioners in the Eastern Cape. None of the coefficients were statistically significant, indicating that the income of unemployed and pensioner households (excluding social security) is not significantly different from 0, which is consistent with expectations.

The regressions for the different provinces were consistent, finding that land reform had a negative effect on household income, but this was only statistically significant at 10% level in the Eastern Cape. The household head's gender appears to play a defining role in KZN but makes no significant difference in the other provinces. Highest qualification aligns well with expectations that higher qualified individuals earn higher incomes. Age plays no significant impact on land reform, except in the Eastern Cape, where older individuals are expected to earn less. This is in line with expectations given that the bulk of employment is regarded as 'blue collar' labour, which can only grow to a certain extent and would be expected to drop off with age.

Various types of employment are generally in line with expectations, since they seem to earn significantly more than unemployed/pensioners across the provinces. Interestingly, the off-farm employees in Mpumalanga earn on average more than those in KZN or the Eastern Cape.

These results are consistent with observations from the field, where most farms showed little or no agricultural activity, with on-farm beneficiaries earning little-to-no income, and the bulk of working beneficiaries being employed on surrounding commercial farms. Therefore, there appears to be a more consistent benefit associated with employment than being a land reform beneficiary.

Table 19. Regression analysis of factors affecting household income excluding social security

Variable	Coefficient		
	KZN	**MP**	**EC**
Land reform	-781***	-751***	-449*
Age	3	-4	-18**
Gender	598***	-348	-132
Highest qualification	77**	93***	53**
Farm labourer	1758***	2980***	1992***
Employee off farm	4340***	10892***	3360***
Temporary labourer	1261***	1255***	331
Driver	5466***	-	2401***
Pensioner	-	680	-
Manager on farm	-	12773***	-
Domestic worker	-	-	798
Constant	Unemployed	Unemployed	Pensioner
	-350	-128	1213

*Note: where: *** is statistical significance at the 1% level, ** is statistical significance at the 5% level, and * is statistical significance at the 10% level.*

Land reform impact on household food security and dietary diversity

Regressions were carried out on the impact of land reform on household dietary diversity score (HDDS) and food insecurity. The impact on dietary diversity in Mpumalanga and KZN is insignificant. However, when the restitution sample is excluded, a slight improvement in dietary diversity scores is noticeable in the Eastern Cape and KZN and was statistically significant at the 1% and 10% level, respectively.

Compared to the control group, the household food insecurity of land reform beneficiaries is statistically significant at the 1% level in KZN but insignificant for the other provinces.

In KZN, land reform farms are largely non-operational or operate at a very low level, whereas in the Eastern Cape and Mpumalanga they are operating but significantly below their full commercial potential, with a strong bias towards subsistence agriculture.

Household food insecurity is strongly linked to the level of operations of land reform farms. Food security is higher in operational projects than in failed or non-operational projects. The overall implications are that maintaining operational projects plays an important role in maintaining food security for beneficiaries in South Africa.

Table 20. Impact of land reform on household dietary diversity and food insecurity

Province	Treatment	Sample	Impact on household dietary diversity	Impact on household food security
KwaZulu-Natal	97	55	-0.1	3.8***
Eastern Cape	68	44	1.375***	1.29
Mpumalanga excluding large scale restitution	54	36	0.88	0.63
Mpumalanga	54	36	1.27*	-2.49

*Note: where: *** is statistical significance at the 1% level, ** is statistical significance at the 5% level, and * is statistical significance at the 10% level.*

Table 21. Impact of land reform on HFAIS index for farm labour beneficiaries

Analysis type	Treated	Control	Average treatment Effect	Standard error	t-statistic
Nearest neighbour matching	200	122	2.05**	0.927	2.209
Kernel matching	200	351	1.80**	0.728	2.47
Stratification matching	200	351	1.79**	7741	2.407

*Note: where: *** is statistical significance at the 1% level, ** is statistical significance at the 5% level, and * is statistical significance at the 10% level.*

Farm labour does not result in any statistically significant change in household dietary diversity after receipts of their farms, but household food insecurity increases.

3.5.4 Productivity and employment on land reform farms

Table 22 illustrates the total land reform area transferred in each province, the total area under cropping and irrigation at the time of transfer and current area under cropping and irrigation. In all three provinces, productivity drastically declined after the land reform transfer. However, these figures are largely skewed by two very large restitution projects in Mpumalanga.

Table 22. Land area sampled including comparisons of the area transferred to the beneficiaries

Province	Total area represented	Crop production area (ha)		Irrigation production area (ha)	
		At Transfer	Current	At Transfer	Current
KwaZulu-Natal	2718	509	27	313	19
Mpumalanga	9926	1892.4	2474.8	1892.4	1170.8
Eastern Cape	4731	540	226	275	20
Total	17375	2941.4	2727.8	2480.4	1209.8

Mpumalanga represents a questionably biased sample, as researchers were guided to the projects by the DRDLR. When the two large restitution projects (making up approximately 75% of the sample) are removed, a more realistic perspective of redistribution projects within the province emerges (Table 23).

Table 23. Land area sampled excluding two large joint venture restitution projects (outliers)

Province	Total area represented	Crop production area (ha)		Irrigation production area (ha)	
		At Transfer	Current	At Transfer	Current
KwaZulu-Natal	2718	509	27	313	19
Mpumalanga	2326	779.4	135.8	779.4	127.8
Eastern Cape	4731	540	226	275	20
Total	9775	1828.4	388.8	1367.4	166.8

Across the three provinces, the area used for crop production has decreased by 79%, of which the bulk is irrigated land, which decreased by 88%. This has drastic implications for jobs, especially as the production areas lost were for labour- and skill-intensive crops, such as vegetables, citrus and tobacco.

As most beneficiaries had worked for the previous farmer, it was possible to compare the production pre- and post-transfer employment, using approximate industry labour estimations per hectare (BFAP, 2011). Table 24 shows the estimated job losses as a result of decreased production area within the sample.

Table 24. Estimated job losses on land reform farms within the sample

Province	Total area represented	Jobs on farm		
		At transfer	Current	Percentage change
KwaZulu-Natal	490	30	-94%	313
Mpumalanga	878.6	99.3	-89%	779.4
Eastern Cape	93.35	27.8	-70%	275
Total	1461.95	157.1	-84%	1367.4

KwaZulu-Natal farms are the most hard-hit by job losses. This is because most crops grown are cash crops such as vegetables, which are highly labour intensive and require extensive experience, as the production environment is especially competitive. Although the Eastern Cape sample appears to perform better, the reality is the "jobs" are of very low value. Many farmers have attempted to move to higher value, labour-intensive products (e.g. vegetables), but their ability to capitalise in this market is limited by their location and the small size of the market. In addition, beef enterprises have suffered from decreased supplementary feeding, which used to be the bulk of agricultural production in those areas. Therefore, this has most likely resulted in additional job losses that are unrecorded in these figures.

Based on the sample, production has decreased by more than 80% on land reform farms since transfer. However, despite the overwhelming evidence of decreased productivity and employment, there are pockets of success nationally. The negative picture improves when very large restitution projects are included, such as the outliers in this sample.

3.5.5 Land reform implementation by provincial and local governments

This section is based on interviews conducted with key officials from the provincial offices of land reform, the departments of agriculture and rural development, and municipalities, as well as feedback received from the fieldwork.

The land redistribution component of the land reform programme consists of two main pillars: land acquisition and land recapitalisation. The land acquisition (or PLAS) is a supply-led approach where government purchases farms upfront and then transfers the land to the selected beneficiary. Beneficiaries can only lease the land from the state, an arrangement which may carry on indefinitely. Those who qualify for RADP funding purchased farms under previous land reform regimes and are struggling to survive because of insufficient funds.

Provincial offices of land reform are largely in control of implementing land reform, with the actual implementation taking place at a district level. Each district keeps its own database of potential beneficiaries looking for land and a list of farms available for purchase. In most provinces, selection criteria ensure suitable beneficiaries are selected for the farms. Recently, district land committees were established, so that the nomination of beneficiaries takes place in a transparent and objective manner. Officials from line departments and non-governmental members sit on these district committees. The details of the nominated beneficiary, purchase price and the farm available for purchase are submitted to the provincial land committee, which then sends it to the national land control and allocation committee. Once the national department has signed the memo, the province starts a process of transferring the ownership of the farm to the state. A lease is then signed with the beneficiary for an initial five-year probation period, extended to 30 years if performance is acceptable.

Even though independent valuers carry out the valuation, the price of farms is still significantly higher than what the state can afford. As a result, beneficiaries far exceed the number of farms available. In addition, the available funding in the RADP is insufficient for the number of distressed farms. A major gap in the funding model is the lack of affordable loan funding to support land reform beneficiaries. At present, many beneficiaries do not qualify for loan funding, as they are regarded as risky. As both the RADP from DRDLR and the CASP from DAFF fund post-settlement support, nothing prevents a beneficiary from double-dipping by applying to both DRDLR and provincial Department of Agriculture and Rural Development (DARD) for funding support. At present, provinces do not have systems in place to prevent this type of inefficiency.

Another critical gap is funding for planning. Grant funding is available for inputs and infrastructure but not to assist with planning – and if any funding is available, it is difficult to access. The result is a disjuncture between planning and implementation. The lack of proper planning has also resulted in a gap between human settlements and land reform at local government level. Although they do not have a significant role in land reform, municipalities could provide rebates to emerging farmers who are unable to pay for electricity, especially in the first three years of operation when farmers rarely make any profit from their operations. Some municipalities lease available municipal land to emerging smallholders, but these smallholders often end up sub-letting the land to other tenants. In some instances, municipalities provide land reform beneficiaries with input support, such as seeds and fertiliser, and in most cases, municipalities play a liaising role between the various stakeholders of land reform and land restitution.

Table 25. Intergovernmental implementation of land reform

Implementation phases	Description	Intergovernmental implementation	Weaknesses
Identification of land	In many instances, the farmer approaches the district land office with an offer to sell their farm. Sometimes state agencies identify farms, and beneficiaries can also approach the district land office to request a farm on the market. Before purchasing the farm, the district land committee consults with the provincial department of agriculture to assess agricultural potential and economic viability of the farm, and conduct an independent valuation of the land. It then gets approvals from the provincial and national land reform committees.	DRDLR, PDARD	Despite the use of independent valuers and the establishment of the Valuer-General, the cost of purchasing farms remains high, and there are not enough farms to purchase to match the applicants who require access to land.
Identification of beneficiaries	Potential beneficiaries send their applications to the district office to be captured on the database. In some instances, beneficiaries are identified in the commodity committees (where they exist). Although this may be inconsistent across provinces, there is a definite shift towards prioritising emerging farmers with the required experience.	DRDLR, PDARD	Most of the beneficiaries are in their 50s. Not many youth are interested in farming.
Selection of beneficiaries	The process of selecting beneficiaries is similar in most provinces. The district land committee interviews potential beneficiaries selected from the district database according to suitability. Each candidate must present a business plan and motivation to the committee, and then committee makes a decision. A memo containing details of the farm, evaluation price and recommended applicant is sent to the provincial land committee who then sends it to the national land control and allocation committee (NLAC), after which it goes to the minister's coordinating committee, and then the DDG signs off. The provincial office then facilitates the transfer of the land into the name of the state.	Various line departments and independent members sits on the district land committees.	The process of approval can take 3–6 months. By the time all the approvals are granted, the farmer may have sold the farm on the market or may no longer be interested in selling the farm. The farmer may also decline the recommended purchase price offered by the state.
Contracting and leasing	A lease is drawn up between the beneficiary and the state. The lease agreement is for 30 years, of which the first five years is a probation period. The lease amount is 5% of annual nett income.	DRDLR	The state can lease land indefinitely without the beneficiary getting the opportunity to own the farm.
Post-settlement support	Funding for post-settlement support is consolidated under the RDP. The RDP cuts across all programmes. Land reform beneficiaries can also apply to DARD for post-settlement support, especially in relation to infrastructure, extension services, drafting a business plan and market access. A strategic partner/mentor is selected for the project, and funds are disbursed on the approval of the business and production plans.	DRDLR, DARD	RDP initially funded farmers over a five-year period, but financial constraints mean that funding is now only given for one year. RDP is also incapable of funding all beneficiaries.
Funding	National government gives each provincial office an allocation, although actual control of the budget sits with the national government.	Provincial and national Department of Land Reform and Rural Development	Funding is insufficient to cater for all beneficiaries. Many emerging farmers are also not creditworthy, and so banks are unlikely to offer loan funding. Beneficiaries have therefore become dependent on grant funding.

Source: Author's compilation

3.5.6 The role of development finance institutions in land reform

If land reform is to succeed, development finance institutions (DFIs) should be actively involved in land reform projects, as they traditionally fill the void between commercial banking and state development aid, by providing loans at affordable rates to small and medium enterprises. However, current investment and financial support by DFIs to rural areas is very modest and does little to crowd in the private sector.

The Land Bank is a DFI with a long history in land, farming and agricultural finance. It is therefore strategically placed to enhance the land reform programme through government support. DFIs can participate in land reform through the following key avenues:

- DFIs that concentrate on land and agriculture should focus fully on development funding. This will allow them to assist emerging farmers, which has been a key challenge in the past.
- The lending criteria of DFIs should be aligned to the economic needs of land reform farmers, while government provides guarantees in case of default.
- DFIs should be allowed to approach investors to invest in farming to maintain land reform projects.
- The institutional alignment between the DRDLR and DFIs operating in the land reform space should be examined, so that DFIs are able to discharge their land reform mandate with support from government.

3.5.7 Critique of land reform in South Africa

The survey and interviews highlighted a number of challenges with respect to the land reform programme. The sector has a structural failure that does not adequately take into consideration the risky and unstable nature of agriculture. In the past, production boards guaranteed the purchase of a certain level of production, offering South African commercial agriculture a secure market space. This security net no longer exists, and so risks are higher. Attempts by government to cover the input costs and infrastructure (through CASP and RADP) and to decrease risk have resulted in farmers having no incentive to invest their personal funds, as government is regarded as an investment safety net. Furthermore, additional costs after planting/investing with "donated" money have lower returns, and since this is not safeguarding prior investment, there is reluctance to invest. In addition, subsidising at the start (not the end) of the process prevents beneficiaries from learning most of the business and production skills required to farm on their own.

A further concern is the poorly timed support, as a result of non-agricultural officials who manage RADP and other programmes being far from the farmer's decision-making position. This distance between investors (i.e. government) and the locus of decision-making (i.e. farmers) results in large production and timing inefficiencies that are almost impossible to overcome. This is partly the result of "forced" and "limited" spending within a financial year, which means that non-project decisions, instead of long-term planning decisions, affect the funding.

DRDLR has also not managed land reform farms effectively largely because of centralised decision-making and responsibility, which has led to many loopholes and omissions at lower levels. Managing such a large volume of farms needs to be done by someone who knows the farm and the farmer. For example, in the Eastern Cape, only one out of 240 farmers has signed long-term lease agreements. This severely hampers any ability of a farmer to obtain credit even if their farm is viable. Given that a lease is one of the less complicated and more administrative support roles required for successful land reform, this observation highlights the challenges of departments administering every farm's private partnerships, mentorships and/or recapitalisation plans. Further, there is a lack of pre- and post-transfer support, particularly with relation to institutional arrangements which are essential for the success of group owned production.

Farmers also lack access to credit for production loans and on-farm costs, which results in under-investment. Non-bankable operational institutional structures result in banks being reluctant to finance land reform projects. A range of perverse incentives also occurs when beneficiaries hold equal ownership (and benefit) rights, as these do not confer appropriate responsibility and benefits are insufficient to dissuade freeriding.

Finally, state purchase and ownership of complete farms has a number of inherent challenges. These include inter alia: (a) the state carries the full cost of transfer; (b) administrative red tape means that decision-making takes time, resulting in farmers selling farms privately, as the state is too slow to take up a transaction; (c) administration and support of farms is too centralised with the state – i.e. other stakeholders carry little or no responsibility; and (d) the high cost as the state replicating all private institutions (e.g. banks, by re-designing a valuation and transfer process.)

3.6 Conclusion

Since the 1990s, government has spent a significant amount of resources on land reform, but land reform has had little impact on rural development. Policy has evolved in an attempt to address both equity and developmental objectives, but these objectives imply difficult trade-offs that government has not yet acknowledged. Currently, the approach adopted by the state is to lease land to beneficiaries indefinitely, irrespective of the aspirations of emerging farmers to own their own land.

The analysis conclusively shows that land reform beneficiaries are worse off than those who did not benefit from land reform, especially when household income is considered. Only a minority of household incomes improved as a result of successful projects. Beneficiary households have not seen improved dietary diversity or food security. The loss of jobs is the key cause of decreased incomes to beneficiary households.

In terms of post-settlement support, there is clear duplication in funding, with an overlap between the RADP and the CASP grant. The RADP was introduced to address the failure of post-settlement support to land reform beneficiaries, but timing remains a problem. Both instruments currently service the same target audience and fund the same activities.

Gaps in the funding model include a lack of affordable loan funding to support land reform beneficiaries. At present, many beneficiaries are considered too risky to qualify for such funding. The lack of proper planning has also resulted in a gap between human settlements and land reform at local government level. In addition, despite land reform projects being implemented within municipal jurisdictions, municipalities play hardly any role in land reform. Yet municipalities could assist by providing rebates for municipal services for emerging farmers whose farms will only be profitable after at least three years of operations.

A further concern is the complete lack of transparent reporting on the land reform grants. The DRDLR budget lumps together grants as a single line item and provides little information about the grants, what has been spent and on what, and how these grants are being monitored. A similar concern around transparency was expressed in the evaluation of the RADP programme, especially in the way projects were selected.

3.7 Recommendations

With respect to measures to improve land reform impacts on rural development, the Commission recommends that:

1. CASP and RADP are consolidated into one funding programme for post-settlement support to emerging and land reform farmers under DAFF, which has more expertise in the area of agriculture. The consolidated fund should provide timeous support to land reform beneficiaries and be complemented by affordable loan funding. DFIs should explore possible funding models, so that the funding framework can reach more land reform beneficiaries.

    a. For individual farm transfers, the LRAD model should be emulated, as it provides the necessary incentives to access credit, own an asset and enter into productive activity on the land.

    b. For group-owned projects, models should be explored in partnership with commodity organisations and land reform specialists.

2. Coordination and alignment between DRDLR and DAFF is strengthened at both policy and implementation levels. To enhance coordination, the recently established district land reform committees should include officials from all relevant sector departments, including agriculture. This multi-stakeholder arrangement should be replicated in the provincial and national land reform committees.

3. Implementation gaps in the land reform programme are addressed through reprioritised funding. Gaps include providing resources for planning and aligning land reform with human settlements, agriculture and infrastructure; training land reform farmers in technical and business skills (with a mechanism to assess skills of mentors); and establishing selection criteria for land reform beneficiaries that are applied uniformly across all the provinces. An important criterion for transfer should be maintaining agricultural production.

4. The role of municipalities in supporting land reform beneficiaries is clarified. Areas of support that municipalities could provide include offering land reform beneficiaries discounts or exemptions from municipal tariffs for the first three years and liaising with DRDLR to resettle farm evictees on land assigned for land reform. Ways in which municipalities can access national funding to support the land reform programme, should be worked out with the DRDLR.

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CHAPTER 4

State-owned Companies and Rural Development

Sasha Peters, Poppie Ntaka and Thembie Ntshakala

State-owned Companies and Rural Development

4.1 Background and Problem Statement

State-owned companies (SOCs) are commonly established for natural monopolies and infrastructure, or where government has strategic interest in a sector, such as railways and telecommunications, strategic goods and services (mail, weapons), natural resources and energy, politically sensitive business, broadcasting, demerit goods (alcohol) and merit goods (healthcare) (Dewenter and Malatesta, 1997). The National Development Plan (NDP) identifies infrastructure development as being central to attaining South Africa's economic and social goals. In 2012, the Presidential Infrastructure Coordinating Commission (PICC) was established, as well as the first National Infrastructure Plan, in order to address South Africa's poor track record in developing efficient and effective infrastructure. To drive and prioritise infrastructure development, 18 strategic infrastructure projects (SIPs) were devised. The SIPs are clusters of infrastructure projects that are considered crucial for economic growth and service delivery and for unlocking development. SOCs are the primary implementing agents that will be used for rolling out the SIPs.

SOCs have a dual mandate to fulfil, which causes tensions. SOCs need to meet their developmental (or non-commercial) mandates, while remaining financially viable and sustainable through commercial activities. The non-commercial mandates of the SOCs include anything that an entity does or is expected to do that would not be expected from a private company in the same industry or situation. For instance, expanding access to services, providing affordable services, investing in infrastructure that has wider social and economic benefits, and providing or generating employment. These non-commercial mandates have negatively affected the performance of various SOCs.

The financial health of SOCs has a bearing on the country's finances, as continuously injecting cash into ailing SOCs not only places undue stress on the fiscal framework but also takes funding away from core service delivery areas. It also brings into question the ability of SOCs to effectively drive South Africa's infrastructure-led growth. Persistent weaknesses in the balance sheets of several SOCs could trigger calls for additional government support, especially as, since 2008, borrowing by SOCs has constituted a significant part of South Africa's public sector borrowing requirement[26] and gross domestic product (GDP). On average, SOCs account for 45% of South Africa's infrastructure development over the 2015 Medium Term Expenditure Framework period. The Department of Public Enterprise's (DPE)[27] Strategic Plan to 2018/19 includes the aim that activities by SOCs are directed to serve government's strategic objectives as outlined in the NDP (DPE, 2014).

The aim of this research is to ascertain the extent to which SOCs currently contribute to the NDP's overall goal of alleviating the triple challenge of poverty, unemployment and inequality. SOCs operate across different spaces and spheres of government. The research seeks to understand whether SOCs play a complementary or competing role in relation to traditional fiscal instruments (e.g. spending by a government department) used to facilitate rural development. The Presidential Review Committee's report on SOEs (PRC, 2013) is an important point of reference for this research. The report focused on how SOEs in South Africa can optimally contribute to growth, development, social and economic transformation in South Africa, while remaining financially viable and competitive, and contained some valuable recommendations. This research supplements the report and has a narrower focus: the contribution of selected SOCs to rural development.

The research's overarching objective is to assess the role of SOCs in rural development. It aims to answer two questions:

- Do SOCs in South Africa have a rural focus?
- For those SOCs that have a specific rural focus, what kind of activities are they involved in and how effectively are the activities carried out?

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[26] The public sector borrowing requirement refers to funds needed by the public sector to cover any deficit incurred in the financing of its activities.

[27] Specific reference is being made to the strategic plan of the DPE, since it has been mandated to oversee some of South Africa's larger and most important SOCs, for example, Eskom and Transnet.

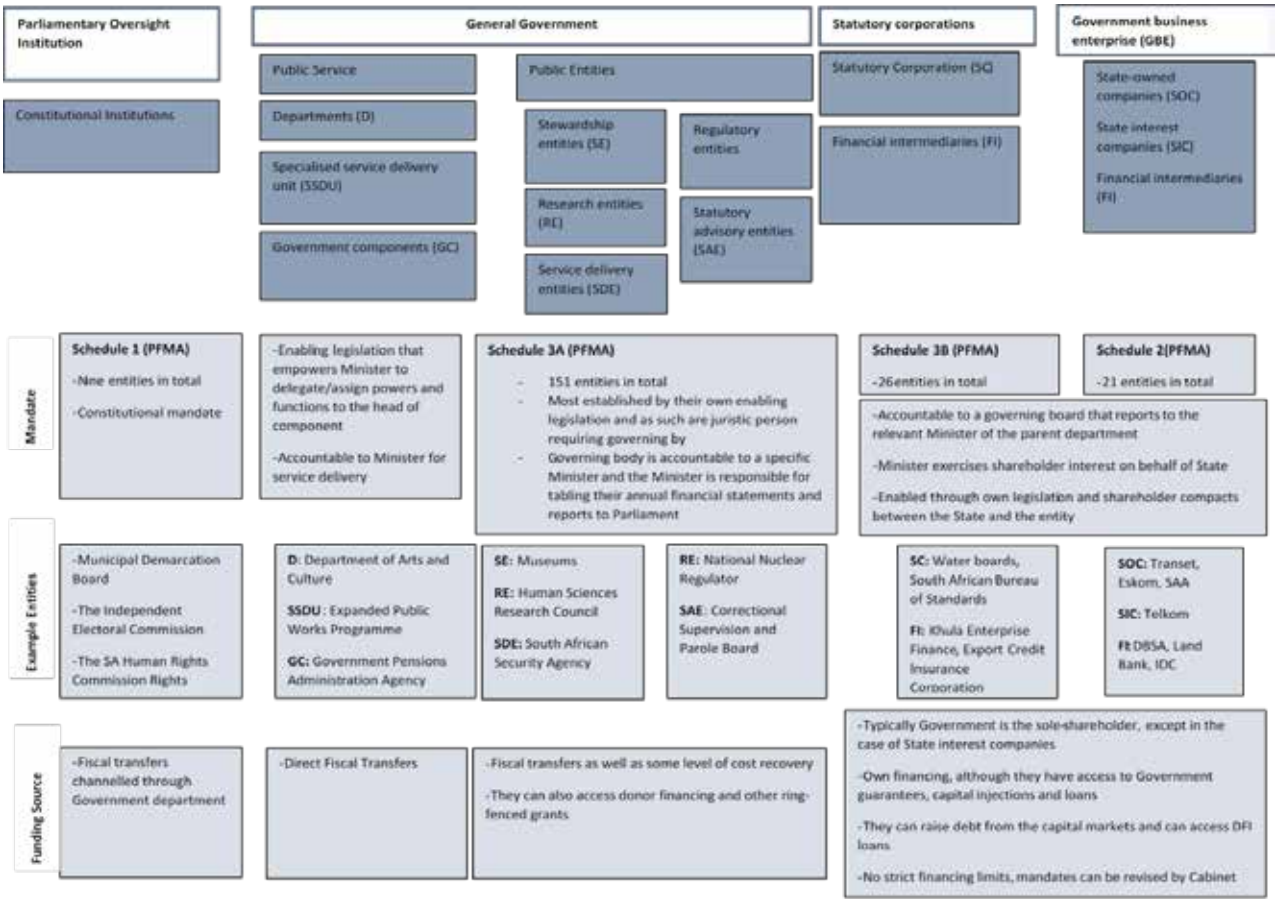
4.2 Literature Review

4.2.1. Definitional issues

The term SOCs is often used interchangeably with state-owned entities (SOEs). National Treasury and the Department of Public Service and Administration developed a categorisation framework in which SOE is used as a broad, umbrella term, with SOCs being a subcategory of a particular type of SOE. As Figure 27 shows, a SOC is a type of government business enterprise that meets three main requirements:

- The SOC has a governing board that reports to the accounting officer of a designated parent department.
- The Minister of the designated parent department represents the government's shareholder interest in that particular SOC.
- The above arrangement is codified in the founding legislation of the entity, and government and the specific entity enter into a shareholder compact.

Figure 27. SOE categorisation framework



Source: PRC (2013: 48)

4.2.2 Rationale for state involvement in specific markets

The state's involvement in the economy, or in specific markets, generally relates to the need for "market failures" to be corrected (Radygin et al., 2015: 57). The rationale for the state maintaining involvement in the economy can be categorised according to the following groups: (a) primarily economic motives; (b) primarily socio-political motives; (c) mixed motives, where these groups are closely inter-related with each other (Gillis, 1980). Each of these groups is explained below:

Economic motives
Savings mobilisation is one of the economic motives, particularly in less developed countries where low levels of income per capita and a weak tax base makes it difficult to finance public sector capital formation through raising taxes (ibid). SOEs are seen as a way of generating investment finance that can be used for the formation of physical and human capital.

Another economic reason, which is often aligned with a country's developmental objectives relates to employment, with SOEs expected to stimulate economic activities and create work opportunities as the economy grows (ibid).

State involvement in commercial activities is seen as a way to address market failures or exercise control over any abuse that may arise from natural monopolies (Forfás, 2010). Natural monopolies occur in some industries where the technological conditions dictate that only one supplier can profitably exist, and the problem arises when the monopoly supplier produces at a level that is not socially optimal and is able to appropriate high profits by charging high prices (Forfás, 2010; PRC, 2013).

Another reason for state involvement is capital failure, when investors in the private sector are unable or unwilling to fund capital-intensive projects, especially projects that have high risks in the short term and only accrue high returns in the long run (Forfás, 2010; Gillis, 1980). SOEs are expected to overcome such capital failures, particularly in many developing countries where only the state or foreign enterprises would have sufficient capital to fund capital-intensive projects, for example in energy or transport.

Externalities also justify the existence of SOEs in respect of commercial activities where private sector investors are dis-incentivised to invest in certain industries that give rise to benefits for other industries and sectors as they will be not paid for that service (Forfás, 2010).

Socio-political motives
Equity is one socio-political motive for state involvement, as the private sector may not be willing to cater for certain types of customers (e.g. customers living in rural and remote areas), meaning that customers from a specific socio-economic background are effectively excluded from these goods and services (Forfás, 2010; Gillis, 1980). SOEs are expected to provide goods and services that will support and contribute to achieving the social and equity goals of a country. These include: income redistribution, reducing unemployment, regional growth and the correction of imbalances (ibid).

Mixed motives
Donor preference is one of the mixed motives that justify the establishment of SOEs, especially in African and Latin American countries that largely depend on foreign aid. SOEs are seen as a way to channel large amounts of funding from donors and provide technical assistance in the case where the private sector lacks the capacity to undertake large projects (Gillis, 1980).

4.2.3 Limitations of SOCs

Governance is one of the major limitations, linked to accountability challenges that negatively affect their performance. This is because the non-commercial objectives of SOCs are often not aligned to their governance structures, and are not defined or monitored in a transparent manner (Forfás, 2010; Mistra, 2014). Related to governance is the issue of the "soft-budget constraint"[28]. SOCs are provided with a safety net if, for example, they require financial assistance because of an inability to service their debt and/or poor operational performance. SOCs are also protected from the adverse competitive forces that would ordinarily affect private entities, such as insolvency or the risk of a takeover by a rival firm (Forfas, 2010). A soft-budget constraint not only weakens incentives for SOCs to perform better but also may contribute negatively to management practices, which could influence the ability of SOCs to deliver on their mandates (Deviatov and Ickes, 2005; Forfás, 2010).

When identifying governance challenges, the "principal-agent" problem cannot be ignored (Forfás, 2010). The "principal-agent" problem suggests that managers may not be incentivised to align their interests with those of the owners by maximising the efficiency of the entity. This is because SOCs are not managed by their owners, who also have no way of telling whether the poor performance of SOCs is the result of management failure or of external

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[28] "Soft-budget constraints are as a result of borrowers knowing or expecting that they will be bailed out or provided with a safety net in the event of adverse outcomes" (Deviatov and Ickes, 2005: 2).

factors (ibid). Conversely, where government interferes excessively, the lack of a clear distinction between ownership and management can lead to SOCs becoming bureaucratised, which can influence the decision-making process in an unfavourable manner (Mistra, 2014).

Other limitations of SOCs, which are not necessarily specific to governance-related issues, include poor project planning, over-capitalisation, under-utilisation of capacity and lack of coordination (ibid). Poor planning is reflected in investment decisions that are not informed by appropriate technical feasibility and cost and benefit analyses, which results in unnecessary project delays and excessive costs. Over-capitalisation is related to poor planning and results from, for example, poor financial planning coupled with the soft-budget constraint that leads to the inefficient use of scarce capital resources (ibid). Compounding these challenges is the under-utilisation of capacity, which results mainly from the failure to use fixed assets and from poor planning, management and control in producing goods. In most instances this leads to lower productivity (ibid).

Another challenge is the lack of coordination, as various SOCs are generally dependent on each other, with the output of one SOC being the input of another (ibid). For example, a SOC that uses electricity to produce goods and services will rely on another SOC that generates electricity. A persistent lack of coordination contributes to wastage and excess stock, as well as the shortage of key inputs (ibid).

4.2.4. Factors affecting the performance of SOCs

The factors that influence the performance of SOCs are explained through the resource-based theory, the stewardship theory, the agency theory, the stakeholder theory and the public choice theory (Mbo and Adjasi, 2013).

The resource-based theory says that SOCs with more resources perform better than those with fewer resources. In particular, SOCs will have performed better if they have higher liquidity levels and a higher gearing ratio (the proportion of debt to the total capital employed), as well as an efficient and larger workforce (ibid).

According to the stewardship theory, SOCs with managers who are good stewards (i.e. they always act in the best interest of the entity) can be expected to perform better than those with weak stewards. In particular, the stewardship theory recognises that the extent to which government is involved in pricing decisions and the existence of competition are factors that influence performance (ibid).

The agency theory refers to the principal-agent problem, where the agent's goals are not aligned to those of the principal, and suggests that SOCs perform better if they have a strong board of directors (ibid).

According to the stakeholder theory, the performance of SOCs is influenced by the extent of stakeholder representation on the board and stakeholder reporting. SOEs whose interests are aligned with those of their stakeholders tend to perform better than those that do not capture the interests of all their stakeholders (ibid).

The public choice theory can be proxied by the extent of financial dependency on the government and the existence of an independent regulator. It argues that SOCs will perform better in an environment where there is less political influence (ibid).

4.2.5 Privatisation in the SOC context

In many developing countries, privatisation[29] as an economic reform strategy has been seen as a way to address the issue of the poor performance of SOCs. One of the main reasons for privatisation is to transform SOCs in order to achieve wealth creation, economic efficiency and growth (Marcelin and Mathur, 2015). According to the property rights theory, SOCs can be expected to perform less efficiently and even less profitability than private enterprises, which seems to suggest that ownership determines performance. However, the existing empirical evidence presents mixed results.

A study by Boardman and Vining (1989) found that private enterprises do not necessarily perform better than SOCs, particularly because performance varied across sectors. For example, in sectors where competition is limited or where private companies would be subject to strict regulation measures, such as the electricity and water sector, SOCs are more efficient (ibid). However private enterprises tend to be more efficient than SOCs in delivering services, such as health care, refuse collection and fire protection. Mixed enterprises, which are partially unregulated companies, were found to have similar efficiency levels to SOCs and to perform better than SOCs in some instances, but their profitability is lower than SOCs.

In Ghana, private enterprises were established to address inadequate managerial and technical competence, conflicting social and commercial objectives, poor incentives, indebtedness, corruption and political interference, which resulted in the poor financial performance of its SOCs (Appiah-Kubi, 2001). Nearly 70% of all SOCs were divested,

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[29] The various forms of privatisation include "divestment or the transfer of SOEs' assets to private sector operators through assets sales or auctions, spin-offs, liquidations and reinstatement of formerly nationalised SOEs into private domain" (Marcelin and Mathur, 2015: 529).

resulting in a positive impact on government revenue: the privatisation programme contributed about 14% of the mean GDP of 1988/98 (ibid). This enabled Ghana to achieve its fiscal adjustment goal: the fiscal deficit reduced from 4.2% of GDP in 1981–1983 to an annual average surplus of 0.8% in 1986–1991, which increased to an annual average of 2.6 % in 1995–98. However, despite these positive outcomes, the major drawback of the Ghanaian privatisation programme was the failure to meet many of the other objectives, particularly those related to socio-political and regulatory issues (ibid).

In South Africa, the adoption of privatisation has been "slow". In the 1990s, shortly before the political transition, privatisation was difficult because the international sanctions meant that multinational enterprises were not eager to invest in South African enterprises. The current opposition to complete privatisation reflects Congress of South African Trade Unions' view that privatisation will lead to job losses and compromise the delivery of basic social needs (Jerome, 2006).

In 1997, instead of adopting full privatisation, South Africa embarked on the restructuring of state-owned assets, informed by the macroeconomic strategy Growth Employment and Redistribution (GEAR). The South African Broadcasting Corporation sold six of its radio stations; the Airports Company of South Africa sold a 20% share to Aeroporti Di Roma (an Italian enterprise); and Transnet's production house, chemical services and Transwerk Perway were sold (ibid).

In 1996, the fixed line component within Telkom was partially (30%) privatised, with the intention of providing Telkom with an alternative source of revenue, in order to invest in the doubling of the size of the fixed-line network (Gillwald, 2005). Telkom has gained economically, with South Africa's telecommunications sector growing from R7-billion in 1992 to around R43-billion in 2001, but has failed to achieve its dual objectives of contributing to the sector's development and ensuring affordable access to telecommunication services for the society at large. The reform has had unintended consequences, including a poor internet take-up and usage because of high prices, as a result of other value-added service operators being expected to pay to use Telkom's network, delays in the provision of facilities and anti-competitive behaviour by Telkom; all of these have contribute negatively to South Africa's participation in the global network economy (ibid).

In general, South Africa's restructuring of state-owned enterprises reflects a weak adoption of privatisation, and the intended objectives have not been met for the cases of privatisation. The poor outcomes of the restructuring process can be explained by the lack of clearly defined roles of various departments, the government, SOEs and other related stakeholders, and weak intergovernmental coordination (Gillwald, 2005; Jerome, 2006). Other reasons include institutional incapacity and design, skills shortage in the various departments and the regulatory agencies, as well as the funding regulator (Gillwald, 2005).

4.4 Research Methodology

The study focuses on four national SOCs: Transnet (transport sector); Telkom and the South African Post Office (SAPO) (information and communication technology sector); and Eskom (energy sector)

These SOCS were selected based on their critical role in rolling out government's infrastructure-led growth strategy and on the 18 SIPs prioritised by the PICC. Table 26 outlines the 18 SIPs. The strengthening and accelerated expansion of rail, electricity and information and communication technology (ICT), particularly in rural areas cuts across SIPs 1, 2, 3, 4, 5, 7, 8, 10, 11 and 15. In addition, transport, energy and ICT are key enablers of both rural and urban development.

Table 26. Government's 18 Strategic Infrastructure Projects

Type of infrastructure	Focus areas of SIPs
Geographic	SIP 1: Unlocking the northern mineral belt, with Waterberg as the catalyst
	SIP 2: Durban–Free State–Gauteng logistics and industrial corridor
	SIP 3: South-eastern node and corridor development
	SIP 4: Unlocking economic opportunities in the North West province
	SIP 5: Saldanha–Northern Cape development corridor
Spatial	SIP 6: Integrated municipal infrastructure project
	SIP 7: Integrated urban space and public transport programme
	SIP 8: Agri-logistics and rural infrastructure
Energy	SIP 9: Green energy in support of SA economy
	SIP 10: Electricity generation to support socio-economic development
	SIP 11: Electricity transmission and distribution for all
Social infrastructure	SIP 12: Revitalisation of public hospitals and other public health facilities
	SIP 13: National school-build programme
	SIP 14: Higher education infrastructure
Knowledge	SIP 15: Expanding access to communication technology
	SIP 16: Square Kilometre Array and Meerkat projects
Regional integration	SIP 17: Regional integration for African cooperation and development
Water and sanitation	SIP 18: Water and sanitation infrastructure

Source: PICC (2014)

Using a case-study approach, the four SOCs are evaluated to determine the extent to which their service delivery activities take place in rural areas, and the type of investments that are made. Qualitative and quantitative data is collected through interviews with the four SOCs and from annual reports and presentations to parliamentary committees. Specifically, budget analysis and descriptive statistics are used to determine the spending and locational focus of SOCs.

In addition to service delivery, data on rural access to the infrastructure provided by the identified SOCs is analysed using data from the following sources:

a) The General Household Survey (GHS) is used for the period 2010 to 2014 to understand the rural focus of Telkom, SAPO and Eskom (Stats SA, 2011; 2012; 2013; 2014; 2015). The GHS provides information on:

- The number of households per province with a functioning telephone landline (for the period 2010 to 2014). However, the GHS does not identify the provider of the landline (i.e. Telkom or others), and so this data is acquired directly from Telkom.
- The number of households that do not receive mail and the percentage of households that have post delivered to their dwelling/post box or private bag. In all instances, this data is provided at a provincial level.
- Access to electricity per province and supplier of electricity. The data is cross-checked with service delivery data from Eskom. Focus will be specifically on electricity distribution, which focuses on delivery to the end user and from a spatial perspective (rural/urban).

b) The information on rail activity was sourced from Transnet's Integrated Reports for the years 2011–2015.

4.5 Key Issues Concerning SOCs in South Africa

The Public Finance Management Act (PFMA) classifies the four case study SOCs (Eskom, Transnet, SAPO and Telkom) as Schedule 2 "major entities", which have to abide by specific rules. For example, in terms of Section 52 of the PFMA, Schedule 2 entities must submit to their parent department and to National Treasury, projected revenue, expenditure and borrowings for the financial year, as well as a detailed three-year corporate plan. The parent department is the department responsible for acting on behalf of government as the shareholder representative to the specific SOC. Table 27 details the parent departments of the four SOCs.

Table 27. Parent departments of selected SOCs

Entity	Parent department	PFMA schedule
Eskom	Department of Public Enterprises	2
Transnet	Department of Public Enterprises	2
Telkom	Department of Telecommunications and Postal Services	2
Post Office	Department of Telecommunications and Postal Services	2

Source: National Treasury (2015a)

It should be noted that, unlike with Eskom, Transnet and the SAPO, government is not the sole shareholder of Telkom. Telkom is listed on the Johannesburg Stock Exchange, and government owns a 52% share in the company, of which 13% is held by the Public Investment Corporation, an entity under the National Treasury (Telkom, 2015).

In addition to the PFMA, which pertains to national and provincial government, other pieces of legislation that govern SOCs include:

- The Municipal Finance Management Act (MFMA), which is specific to local government
- The founding legislation of respective SOCs
- The Companies Act.

A single framework is needed to underpin the establishment, activities and performance principles of SOCs in order to ensure a uniform approach and an overarching understanding of SOCs. Currently SOCs operate in silos and do not coordinate their actions. The burden of this lack of coordination falls on the end users (households), especially the poor, when (for example) transport, electricity, water, etc. tariffs increase or there are continued delays in the completion of power stations). For SOCs to play a real developmental role in South Africa, such considerations will have to be factored into their operations and decision-making processes. The pending Government Shareholder Management (GSM) Bill, which will take the role of an overarching piece of legislation, should assist in establishing some uniformity in how government interfaces with SOCs. However, it is unclear when the GSM Bill will be finalised. According to the DPE, the Bill was meant to be finalised during the 2014/15 financial year but was not – Cabinet decided to hold back the finalisation of the Bill in order to review the project plan and ensure that the required elements are in place to pass the Bill (DPE, 2015).

4.5.1 Financial health of the SOCs

Grant guarantees

The SOCs do not rely solely on fiscal transfers for their survival but also receive government guarantees, which appear as contingent liabilities on government's books. Given these government guarantees, the financial health of SOCs has an important bearing on the country's broader public finances. Table 28 outlines the guarantees provided to selected SOCs between 2004/05 and 2014/15. Over this period, the size of guarantees provided to Eskom grew markedly, whereas those provided to Transnet and the Trans Caledon Tunnel Authority declined.

Table 28. Guarantees to selected SOCs (2006/07–2014/15)

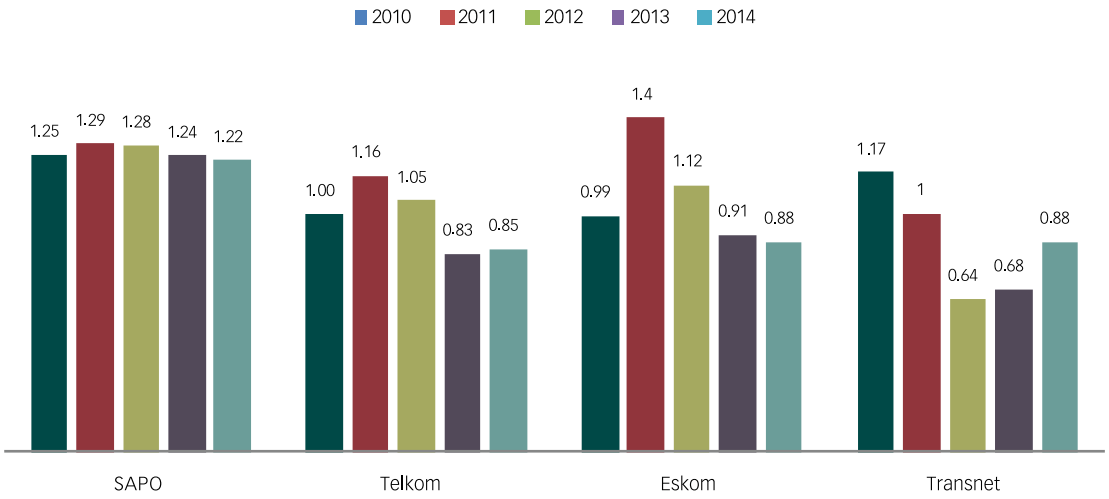
R'million	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Eskom	133			46 678	67 057	77 230	103 523	125 125	144 546
Transnet	18 420	14 716	12 895	11 620	9 887	3 975	3 757	3 757	3 757
Post Office									120
Telkom	4 785	140	138	108	90	85	90	111	107
SA National Roads Authority	5 885	6 441	6 708	12 287	18 605	19 426	19 482	23 866	30 174
Trans Caledon Tunnel Authority	17 690	19 271	19 588	20 721	18 489	19 886	20 460	20 516	20 747
Total guarantees	**67 783**	**64 485**	**63 038**	**129 099**	**149 600**	**153 924**	**180 240**	**209 569**	**224 935**
Guarantees to selected SOCs as a % of total guarantees									
Eskom	0.20%	0.00%	0.00%	36.16%	44.82%	50.17%	57.44%	59.71%	64.26%
Transnet	27.17%	22.82%	20.46%	9.00%	6.61%	2.58%	2.08%	1.79%	1.67%
Post Office	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.05%
Telkom	7.06%	0.22%	0.22%	0.08%	0.06%	0.06%	0.05%	0.05%	0.05%
SA National Roads Authority	8.68%	9.99%	10.64%	9.52%	12.44%	12.62%	10.81%	11.39%	13.41%
Trans Caledon Tunnel Authority	26.10%	29.88%	31.07%	16.05%	12.36%	12.92%	11.35%	9.79%	9.22%

Source: National Treasury, 2015(b)

Solvency and liquidity of the SOCs

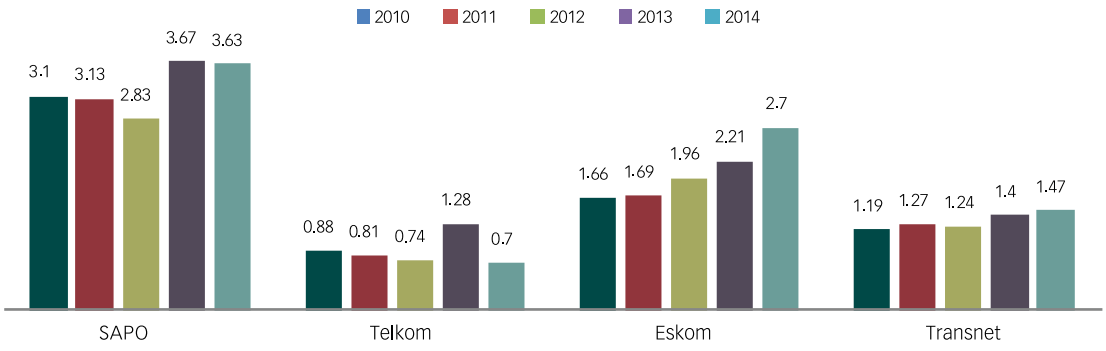
Figures 28 and 29 illustrate the financial health of the SOCs, as measured by the solvency (current ratio) and liquidity (debt-to-equity ratio) ratios. Between 2010 and 2014, the current ratios for all four SOCs fell moderately: for every rand of current liabilities SAPO had R1.22 (down from R1.25), Telkom had 85 cents (down from R1), Eskom had 88 cents (down from 99 cents) and Transnet had 88 cents (down from R1.77) of current assets. During the same period, SAPO's debt exceeded its equity by more than three times, while Eskom and Transnet saw their debt-to-equity ratio increase from 1.66 to 2.7 and from 1.19 to 1.47 respectively. In contrast, Telkom's debt-to-equity ratio improved from 0.88 to 0.7.

Figure 28. Current ratio (2010–2014)



Source: Authors' calculations using SAPO, Telkom, Eskom and Transnet annual/integrated reports (2010–2014)

Figure 29. Debt-to-equity ratio (2010–2014)



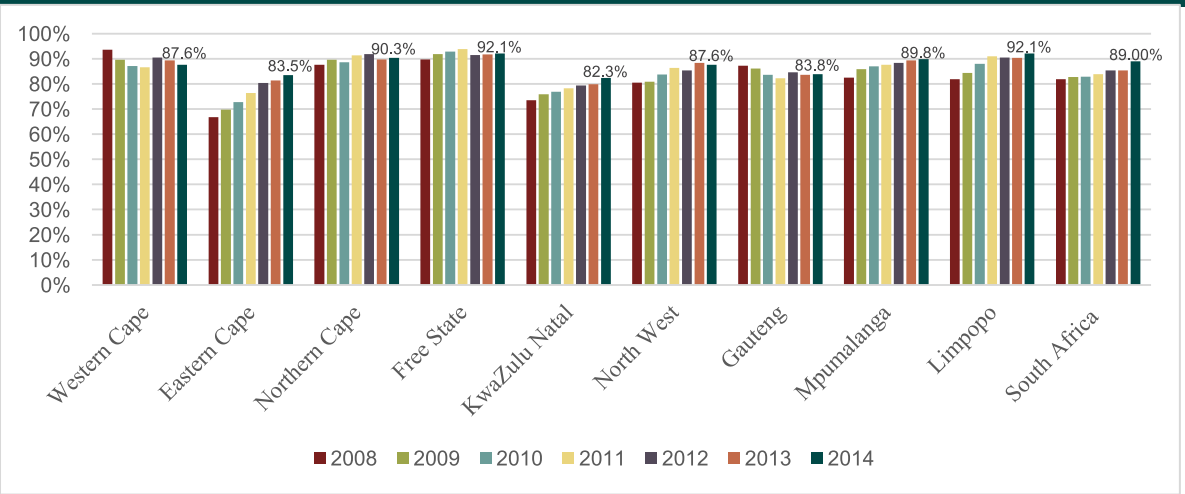
Source: SAPO and Eskom annual/integrated reports; authors' calculations using Telkom and Transnet annual/integrated reports (2010–2014)

4.6 Rural Focus of SOCs: Case Studies of Selected SOCs

4.6.1 Eskom

The provision of electricity (along with water and sanitation), is considered a basic service in South Africa, with the security of electricity supply being a central socio-economic goal for government. As shown by Figure 30, between 2008 and 2014 access to electricity improved from 81.9% to 86% of all households. The three provinces with the highest percentage of households with access to electricity are Limpopo (92.1%), Free State (92.1%) and Northern Cape (90.3%), while the lowest percentage of households with access are found in KwaZulu-Natal (82.3%), Eastern Cape (83.5%) and Gauteng (83.8%). The decline in the percentage of households with access (in the Western Cape and Gauteng) indicates an increased influx of migrants and creation of informal settlements (Stats SA, 2014).

Figure 30. Households connected to mains electricity (2008–2014)



Source: Stats SA (2014)

Established in 1923, in 2002 Eskom was converted into a public company that operates in accordance with the Public Finance Management Act (No. 1 of 1999), the Eskom Conversion Act (No. 13 of 2001) and the Companies Act (No. 71 of 2008). Eskom's core business is the generation (production), transmission (conveyance) and distribution of electricity.[30] Through this SOC, government controls 96% of electricity generation and 100% of electricity transmission. Schedule 4b of the Constitution assigns responsibility for electricity distribution to municipalities, and municipalities are allowed to delegate distribution to an entity. As a result, in practice, electricity is distributed by Eskom and licensed municipal distributors, and, where distribution is delegated to Eskom, the municipality pays Eskom directly for undertaking the responsibility.

As mentioned, Eskom plays an integral role in expanding access to free basic electricity, which is considered a basic service in South Africa. The law provides all indigent households with a certain level of basic services free of charge – under the Free Basic Electricity Policy, all indigent households receive 50 kilowatt hours (kWh) of electricity free per month (DME, 2003). Municipalities can provide more, but not less, than 50 kWh free of charge. Government is addressing the electrification backlog and meeting the challenge of providing free basic electricity to all indigent households through the Integrated National Electrification Programme (INEP), which is funded through a local equitable share allocation and a conditional grant (the INEP grant). According to the 2015 Division of Revenue Act, the INEP grant must be spent in areas that are predominantly rural and have high backlogs.

The largest increase in indigent households receiving free basic electricity was in the metropolitan municipalities (Figure 31). Access to free basic electricity remains unacceptably low in rural (B4) municipalities, where only 53.8% and 56.7% of indigent households received this service in 2013 and 2014 respectively.

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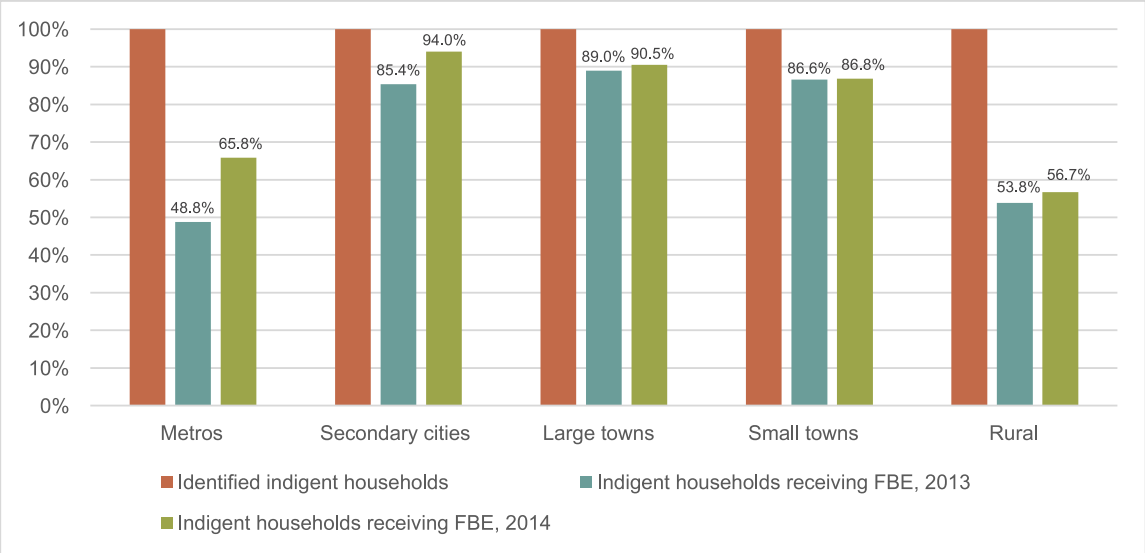
[30] As explained in the 'Research Methodology' section of the paper, the focus insofar as Eskom is concerned will be electricity distribution.

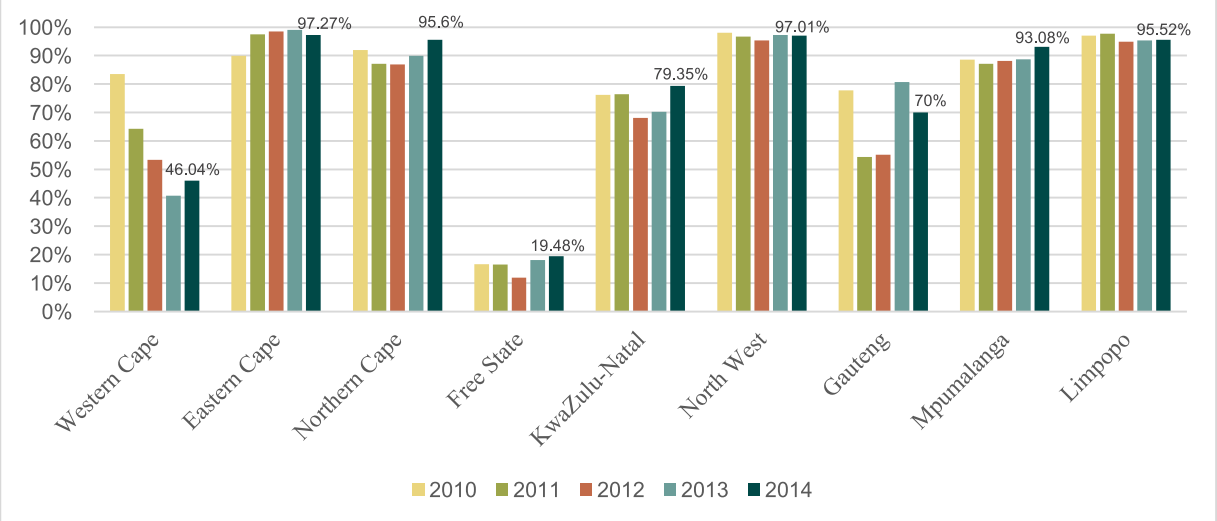
Figure 31. Percentage of indigent households that receive free basic electricity (2013–2014)



Source: Stats SA (2015)

Figure 32 shows that Eskom's electricity distribution is significant in rural areas of South Africa. The SOC is relatively more active in the Eastern Cape (97.27%), North West (97.01%), Northern Cape (95.6%) and Limpopo (95.52%), and provided electricity to just less than 80% of rural households in KwaZulu-Natal.

Figure 32. Rural households where Eskom distributes electricity (2010–2014)



Source: Stats SA (2011; 2012; 2013; 2014; 2015)

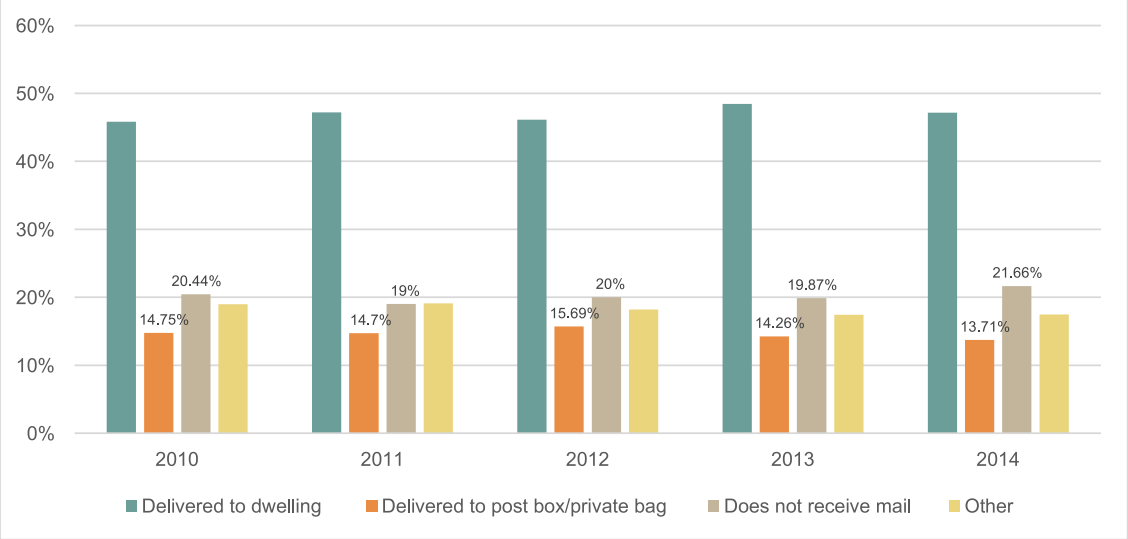
Eskom's reports do not provide details on the spatial location of electricity distribution in rural areas (Eskom, 2015), but the following information was provided through interactions with Eskom and the Department of Energy (DoE):

- Provision of electricity in rural areas has been fast-tracked through the INEP. Municipalities with licences do their own installations into the households, while municipalities without licences enter into a service level agreement with Eskom. The municipality's integrated development plan informs the projects that are identified and prioritised in the INEP.
- Eskom does not allocate a percentage of its distribution budget to rural development, but receives capital funding from the DoE for electrification connections. One million new connections are planned over the next five years, and the electrification programme is aiming for universal access by 2025.

4.6.2 South African Post Office (SAPO)

One of SAPO's roles is to contribute to socio-economic development by increasing access to equitable and efficient postal services. Figure 33 presents the national picture of how households access postal services.

Figure 33. Households with access to postal services (2010–2014)

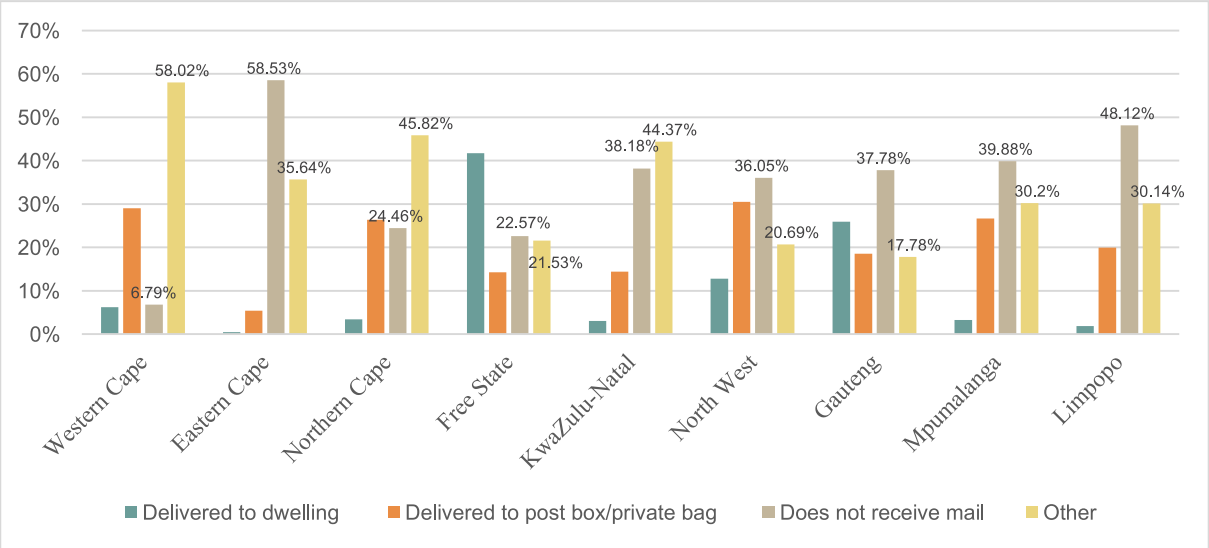


Source: Authors' calculations using data from Stats SA (2010; 2011; 2012; 2013; 2014)

Nearly half of all households have their post delivered to their dwelling as opposed to a post-box or "other", which includes to the workplace, to the house of a relative, neighbour or friend and to a shop. Between 2010 and 2014, the proportion of households that had their post delivered to their dwelling increased slightly, from 45.82% to 47.17%. The same period saw a corresponding decline in the percentage of households that receive their post via the post-box (from 14.75% to 13.71%) or other means (from 18.99% to 17.46%). The percentage of households that do not receive mail, i.e. have no access to postal services, grew from 20.44% in 2010 to 21.66% in 2014.

However the picture is somewhat different at the provincial level (Figure 34).

Figure 34. Rural households with access to postal services (2014)



Source: Authors' calculations using data from Stats SA (2014)

The highest proportion of rural households with no access to postal services is found in the Eastern Cape (58.53%), Limpopo (48.12%), Mpumalanga (39.88%) and KwaZulu-Natal (38.18%). In contrast, in the Western Cape, only 6.79% of households have no access to postal services, and over half (58.02%) receive mail through "other" means. In most provinces, less than 10% of households have postal services delivered to their dwelling. The exceptions are the Free State (41.67%), Gauteng (25.93%) and North West (12.79%).

The following information was provided through interactions with the SAPO:

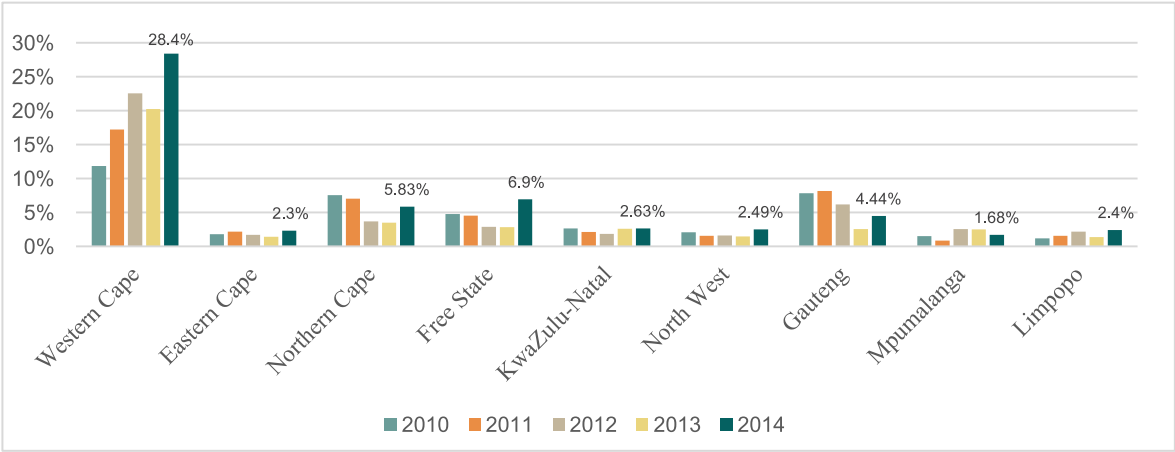
- The SAPO implements some specific programmes that relate to rural development (other than corporate social investment), including rolling out addresses and retail branches, and converting off-line retail postal agencies to fully fledged outlets.
- The SOC considers a rural area to be land under tribal authority, i.e. the traditional settlement where land allocation and planning falls outside the municipality's town planning department.
- The process for identifying and prioritising rural development programmes includes conducting a demand study, so as to ascertain the maximum social impact; using targets provided by the SAPO regulator, Independent Communications Authority of South Africa (ICASA) based on Stats SA data (e.g. census); and spreading programmes evenly or according to the population distribution as reported by Stats SA.
- Rural development programmes entail access to the economy and compliance with the Regulation of Interception of Communications and Provision of Communication-Related Information Act (RICA) and Financial Intelligence Centre Act (FICA); access to basic rights of postal services, which include sending or receiving money and goods; and greater access to government service delivery (ambulance, police or other emergency services).

4.6.3. Telkom

In post-apartheid South Africa, access to telecommunications reflects the extent to which the country's social development goals are being met. In other words, it reflects the extent to which the telecommunications sector is contributing to social, economic and political inclusion and equality that favours previously marginalised communities, or previously under-serviced areas. Figure 35 illustrates the percentage of rural households with access to a functional landline telephone. Between 2010 and 2014, access to landline telephones increased in the Western Cape and the Free State, declined in the Northern Cape and Gauteng, and remained fairly constant in the other provinces.

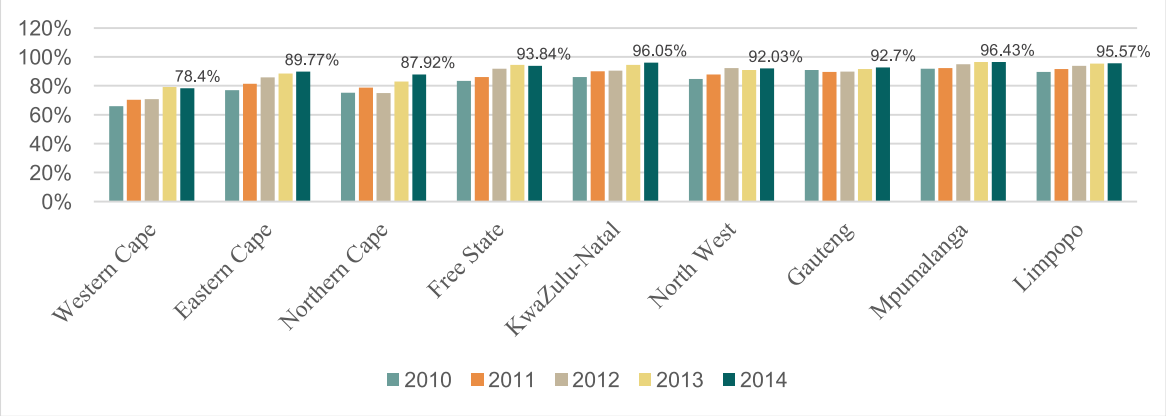
In contrast, between 2010 and 2014, the percentage of rural households with access to a functional cell phone grew significantly (Figure 36).

Figure 35. Rural households with access to functional landline telephones (2010–2014)



Source: Authors' calculations using data from Stats SA (2010; 2011; 2012; 2013; 2014)

Figure 36. Rural households with access to functional cell phones (2010–2014)

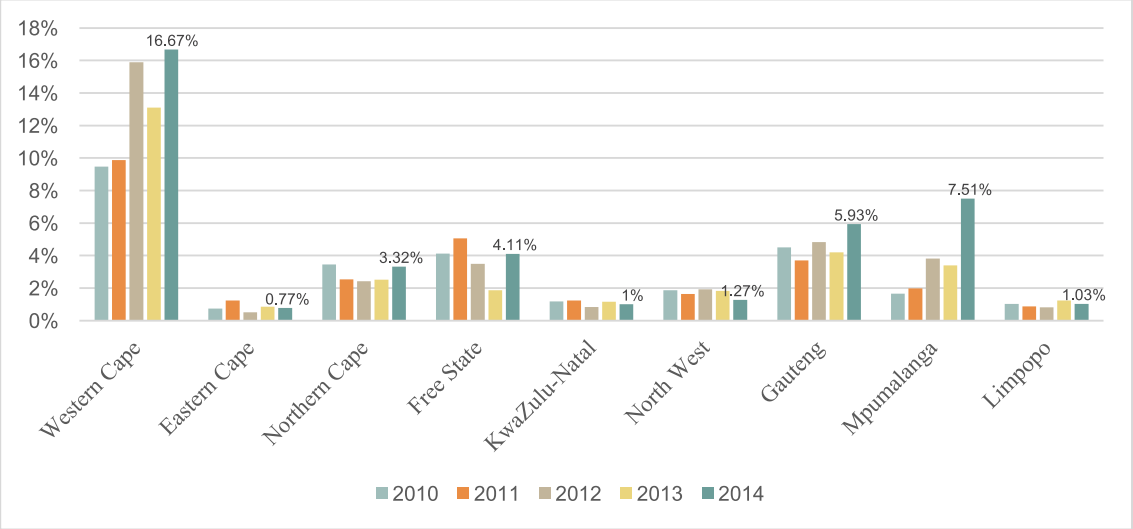


Source: Authors' calculations using data from Stats SA (2010; 2011; 2012; 2013; 2014)

In 2014, the three provinces with the highest proportion of households that had access to functional cell phones were Mpumalanga (96.43%), KwaZulu-Natal (96.05%) and Limpopo (95.57%). The three provinces with the lowest access to cell phones (the Western Cape, Northern Cape and Eastern Cape) had a faster growth rate, of more than 10% between 2010 and 2014. The proportion of rural households with access to cell phones grew from 65.88% to 78.4% in the Western Cape, from 75.14% to 87.92% in the Northern Cape and from 77.08%to 89.77% in the Eastern Cape.

Figure 37 shows the access to the internet at home among rural households over the period 2010–2014.

Figure 37. Rural households with access to the internet at home (2010–2014)



Source: Authors' calculations using data from Stats SA (2010; 2011; 2012; 2013; 2014)

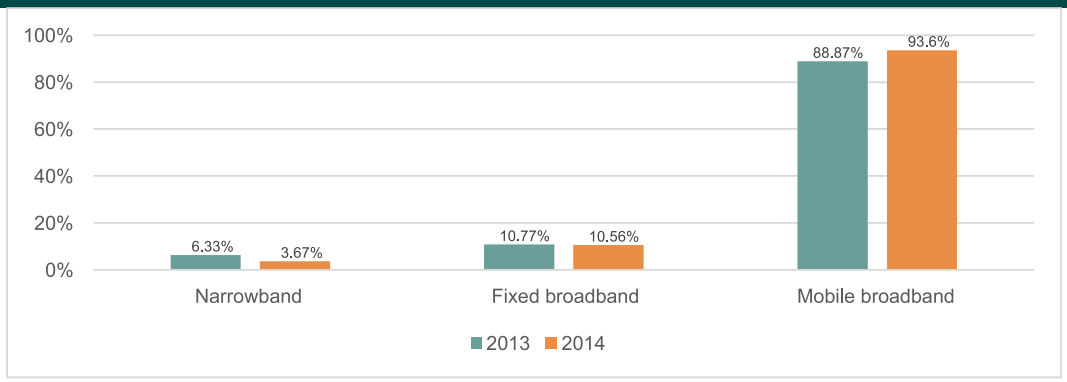
With the exception of the Western Cape, the proportion of rural households with access to internet connections remains low in all provinces, particularly in the Eastern Cape (0.77%), KwaZulu-Natal (1%) and Limpopo (1.03%). This suggests that comparatively more urbanised and economically developed provinces have higher access to computers, hence the need/demand for internet connections. The increase or availability of broadband and affordability are contributing factors to the growth in internet access.

Since 2010, rural households are increasingly accessing the internet via their cell phones rather than via narrowband, fixed broadband and mobile broadband (Figures 38 and 39).

In 2014, the majority (93.6%) of rural households used mobile broadband to access the internet, compared to 88.87% in 2013. Between 2013 and 2014, households using narrowband and fixed broadband declined, from 6.33% to 3.67% and from 10.77% to 10.56% respectively.

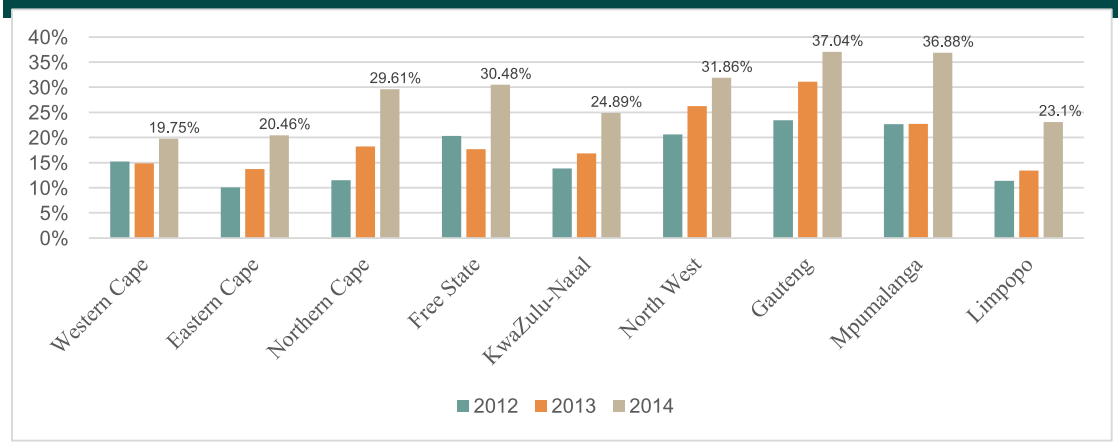
About a third of households access the internet via cell phone or other mobile services in Gauteng (37.04%), Mpumalanga (36.88%), North West (31.86%) and Free State (30.48%). The lowest proportion is found in the Western Cape (19.75%).

Figure 38. Services used to access internet at home (2013–2014)



Source: Authors' calculations using Stats SA (2013; 2014)

Figure 39. Households that access the internet via cell phone or other mobile services (2012–2014)



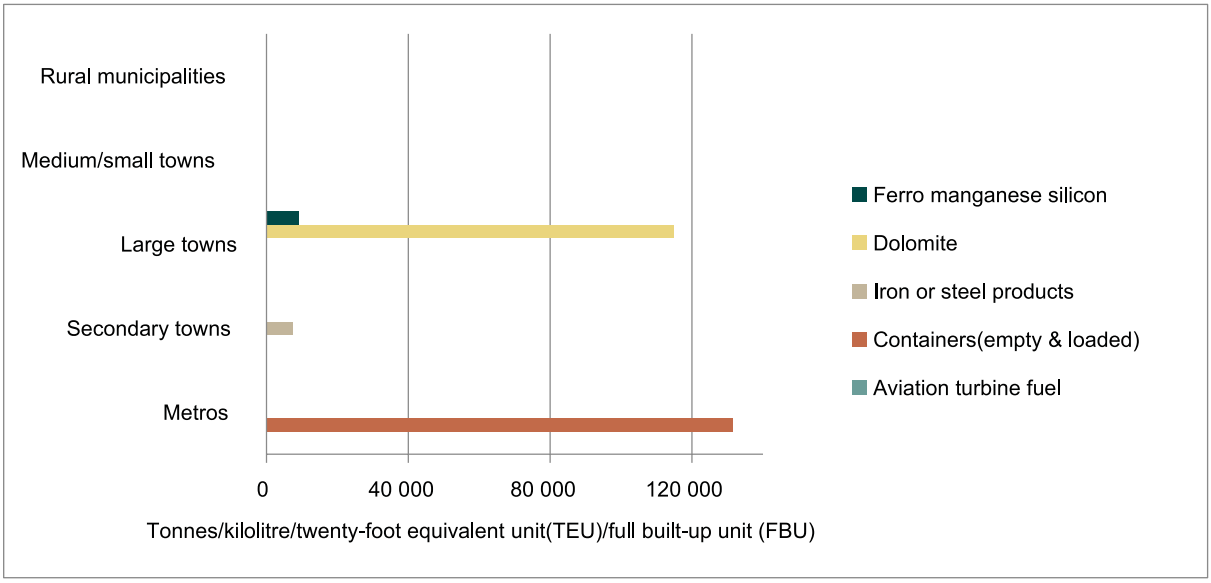
Source: Authors' calculations using data from Stats SA (2012; 2013; 2014)

4.6.4. Transnet

Transnet plays a strategic role in the transport sector, by contributing to competitiveness, growth and the development of the economy through delivering reliable freight transport and providing rail and port infrastructure.

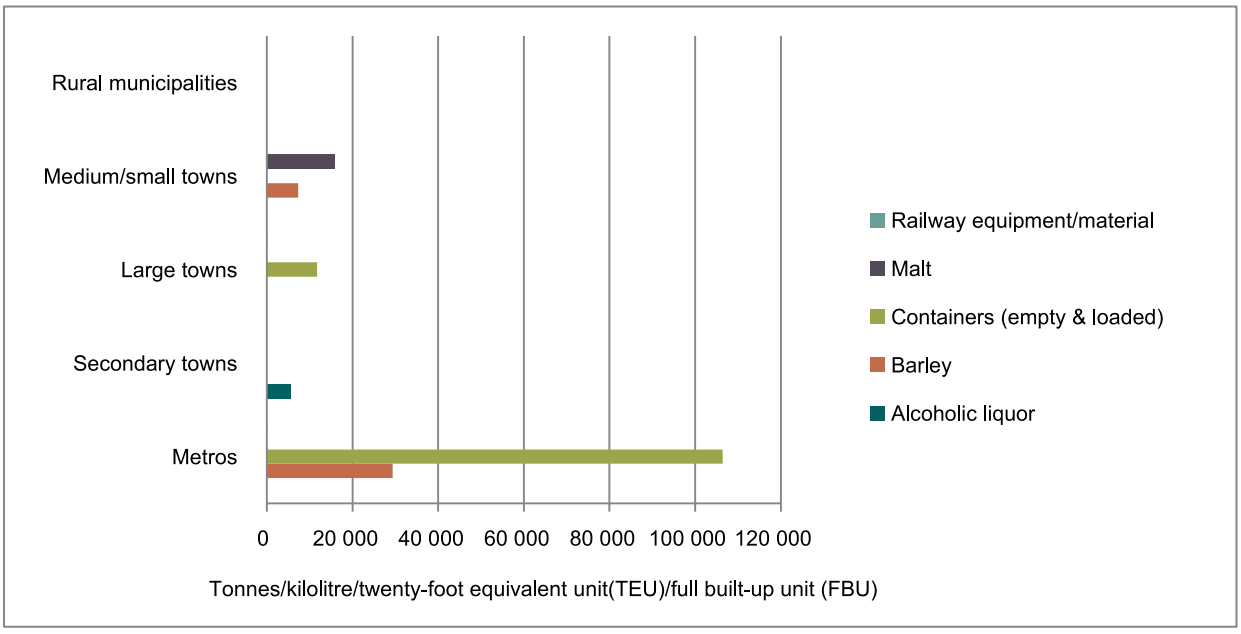
Figures 40–42 illustrate freight commodities transported along the three main corridors: Gauteng–Natal, Cape–Gauteng and Natal–Gauteng. The freight flow type is for domestic, imports and exports. Freight commodities are largely transported from metros, secondary towns, large towns and medium or small towns and are less likely to be transported from rural areas. These findings highlight the importance of transport infrastructure and investment. The findings suggest that rural areas are excluded from transport and economic activity as well as from the benefits that accrue from such activities, which has implications for rural development. The very nature of the commodities being transported show clearly the lack of rural focus.

Figure 40. Freight commodities Gauteng–Natal Corridor (2015/16)



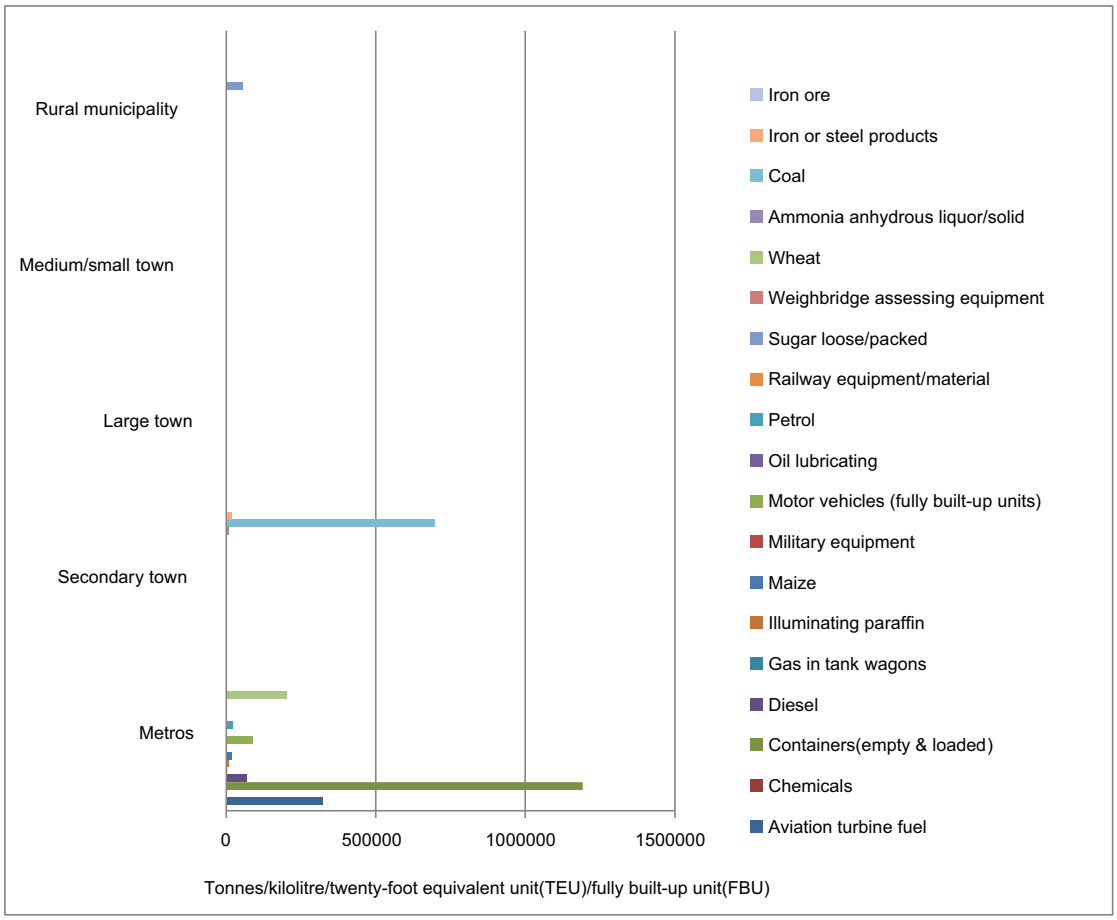
Source: Transnet (2015)

Figure 41. Freight commodities Cape–Gauteng corridor (2015/16)



Source: Transnet (2015)

Figure 42. Freight commodities Natal–Gauteng corridor (2015/16)



Source: Transnet (2015)

4.7 Conclusion and Recommendations

Rural areas in South Africa are particularly vulnerable in terms of access to services, infrastructure and economic opportunities. SOCs have a responsibility to align to the country's national goals and support government's initiatives aimed at addressing the socio-economic legacy of the past. The four SOCs (Eskom, Telkom, Transnet and SAPO) do not have a specific rural focus, unless such a focus is being driven by the parent/sector department responsible for the SOC (e.g. Eskom). It is also not clear whether SOCs are actually required to have an explicit rural focus/dimension to their activities. SOCs would benefit from clear guidelines on what their roles are in terms of furthering South Africa's developmental agenda.

With respect to creating conditions for rural development from infrastructure-led growth by SOCs, the Commission recommends that:

- The Department of Telecommunications and Postal Services ensures that SAPO modernises and broadens focus towards becoming a one-stop shop in rural areas, where communities/customers can renew (car, driver's) licences and access financial products such as banking (ATM, etc.).
- The Department of Public Enterprises ensures that Transnet contributes to regional economic growth and development by connecting business to customers, goods to markets. Transnet should also transport agricultural goods, so as to include rural communities from rural areas where they produced to urban areas where they are consumed, processed, or sent out of the country.
- The Department of Telecommunications and Postal Services puts measures in place to improve Telkom's network infrastructure in rural areas, so as to improve cellular network coverage. Telkom and SAPO, under the guidance of the Department of Telecommunications and Postal Services, should forge a partnership to develop the mobile market.

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CHAPTER 5

The Role of National and Provincial DFIs in Rural Development

Thando Ngozo

The Role of National and Provincial DFIs in Rural Development

5.1 Introduction

Development Finance Institutions (DFIs) operate in the intermediary space between public aid and private investment. They provide finance to the private sector for investments that promote development. In South Africa, DFIs are expected to play an instrumental role in the implementation of developmental policies and act as catalysts for accelerated industrialisation, economic growth and human resource development. South Africa urgently needs to accelerate economic growth and expand human capital resources capabilities in order to get to grips with the crippling economic and social challenges of high unemployment, income inequality and poverty.

In developing countries, DFIs provide a broad range of financial services, such as loans or guarantees to investors and entrepreneurs, equity participation in firms or investment funds, and financing for public infrastructure projects. They also initiate or develop projects in industrial fields or in countries where commercial banks are reticent about investing without some form of official collateral. This approach benefits DFIs because they often find themselves with first-mover advantage in markets with strong growth potential. DFIs depend on profits from their investments to ensure resources for further engagements. However, pursuing a double bottom line of both profit and development can prove difficult, as the two can be contradictory. Nevertheless, DFIs have the capacity to make long-term investments at attractive rates in markets that are too risky for the private sector. They have a higher tolerance to risk and longer investment horizon, benefit from government guarantees and are free from the short-term constraints of private investors.

South African DFIs support agriculture and rural development activities, but their products do not appear to be tailor-made for rural communities. Instead of servicing rural areas and promoting rural development, they are having little impact on rural development and appear to serve the interests of the commercial and well-established wealthy clientele who can afford the high interest rate they charge, thereby reproducing patterns of uneven development.

The objective of this paper is to examine the role of four DFIs – the Land Bank, Development Bank of Southern Africa (DBSA), the Industrial Development Corporation (IDC) and the National Empowerment Fund (NEF) – in enhancing rural economic development, and to investigate how DFIs can support rural development.

5.1.1 Problem statement

Since 1994, the development finance system has been restructured to reflect government's developmental policy priorities, which include rural development. DFIs provide government with an alternative instrument for investing money in the poorest sectors in rural areas, thus accelerating rural development. The private sector tends to avoid investing in socio-economic development that would benefit the poor because the poor are viewed as high risk and unable to afford the high interest rates of commercial loans. Using concessional funding from DFIs to target rural development could extend public resources beyond relying exclusively on grants. Therefore, the role of DFIs as an alternative instrument to rural development needs to be investigated.

5.2 Development Finance Institutions

DFIs have rapidly expanded their lending in line with NDP objectives. In 2014/15, the three largest DFIs (IDC, Land Bank and DBSA) had a combined asset value of R233.8-billion and a combined loan book value of R117.2-billion. By 2017/18, their loan portfolios are forecast to grow by 3%, while their total asset base is projected to increase to R324.7-billion. In 2014/15, the combined borrowing of the three DFIs reached R52-billion against a budget of R70-billion, reflecting the impact of weak economic conditions and falling commodity prices. Borrowing budgeted for 2015/16 is dominated by the Land Bank at R45-billion, followed by the DBSA (R18.2-billion) and the IDC (R12-billion). Their combined medium-term borrowing is estimated at R275-billion.

The DFIs will need to manage prudently their expanding loan books, which are inherently risky because of new exposures. They will also have to pursue carefully the double bottom line of profit and development, and crowd in more private investment in order to finance rural development. The weak economic outlook could complicate this undertaking.

5.2.1 The Development Bank of Southern Africa (DBSA)

DBSA business model

The DBSA secures funding from various sources including reserves, capital markets, other DFIs and government. It then uses this funding to prepare, fund and deliver infrastructure projects. Some of this funding is provided on concessionary terms and conditions. These funds are also used to augment development impact in specific areas and to accrue interest and non-interest income (DBSA, 2014). It is worth noting that the cost of funding from capital markets is directly affected by the domestic and international interest rate policies. The equity investments are affected by movements in stocks in various stocks exchanges.

DBSA financial health

Profit and loss margins

In 2009/10, the DBSA posted a profit of R518-million, which declined to R29.4-million in 2010/11 and then a net loss of R370.8-million in 2011/12. The loss was attributed to investments in equities that were affected by the decline in the platinum price and increased platinum mining costs. In 2012/13, the DBSA reported a further net loss of R825.9-million, which was due to impairment losses and revaluation losses on financial instruments. Recovery began in 2013/14, when the DBSA recorded a profit of R787-million and R1.214-billion in 2014/15. The DBSA's profit grew negatively, by -1379% between 2010/11 and 2011/12 and -269% between 2009/10 and 2014/15.

Between 2009/10 and 2012/13, the return on assets (ROE) ratio decreased from 3% to -4.8% before recovering to 5.7% in 2014/15, while the return on average assets (ROA) ratio decreased from 1.2% to -1.6% before recovering to 1.8% in 2014/15. In the five years (2009/10–2014/15), the average ROA for the DBSA was 0.18%, which is very weak compared to benchmarks. ROA ratios greater than 5% are considered very good, ratios from 1–5% are average, and ratios of less than 1% are very weak.

Solvency analysis

Over the past six years, the DBSA has been carrying unacceptably high levels of debt, as reflected in the debt-to-asset and debt-to-equity ratios, which have worsened over the period. This also means that the already high debt levels are not improving. The high debt levels prevent the DBSA from generating additional resources for rural development. The equity-to-asset ratio was average but deteriorating, which will also have negative ramifications. In brief, the DBSA's role in rural development is hamstrung by its business model and weak profits.

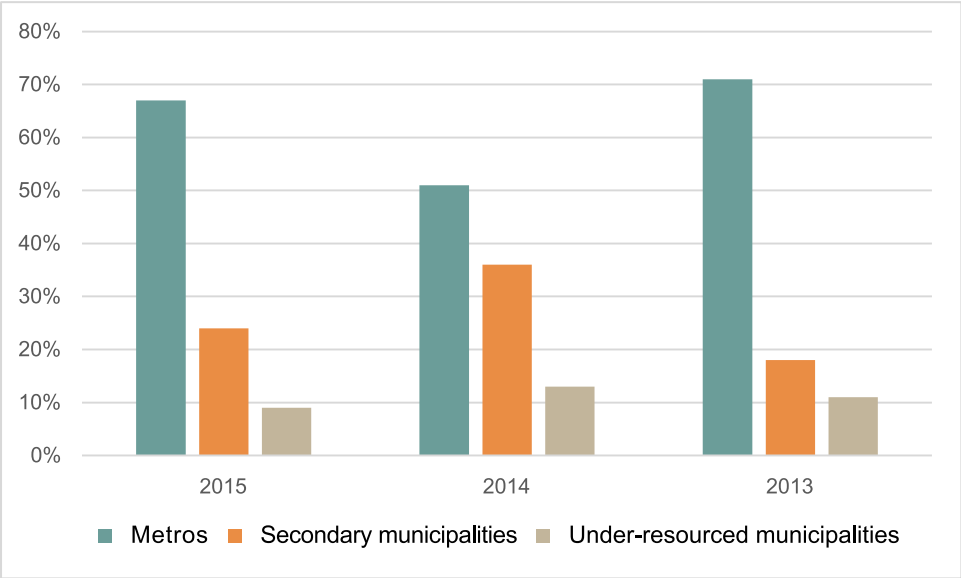
DBSA rural development programmes

Within the municipal space, the DBSA focuses on improving social infrastructure (water and sanitation, electricity, community facilities, roads and transportation) and economic infrastructure support (energy generation, bulk water supply, industrial transport and telecommunication services). The DBSA works with various national and provincial departments, including National Treasury, the Department of Energy (DOE) and the Department of Cooperative Government and Traditional Affairs (COGTA) to accelerate service delivery by providing bridging finance to municipalities for projects that will be funded by National Treasury through the Municipal Infrastructure Grant and the Integrated National Electrification (INEP) grant.

The DBSA provides funding to metros, secondary and under-resourced municipalities. It also offers technical support to under-resourced municipalities to strengthen their ability to plan and implement capital projects, thereby increasing efficient infrastructure delivery. The emphasis is not only on under-resourced municipalities that receive funding from the DBSA, but also other under-resourced municipalities with substantial service delivery backlogs and potential for accelerated infrastructure investment. For instance, the DBSA has agreements with five municipalities (Uthukela district and the Emnambithi, Elundini, Emfuleni and Theewaterskloof local municipalities) to provide support for planning infrastructure, based on infrastructure assessment outcomes. The DBSA approved nine water and sanitation projects valued at R224-million for the Emfuleni Municipality, as part of the bank's assistance to the agricultural sector.

However, the DBSA invests heavily in metros compared to secondary and under-resourced municipalities. In 2015, over two-thirds (67%) of DBSA disbursements went to metros (compared to 71% in 2013 and 51% in 2014), while just 9% went to under-resourced municipalities (Figure 43).

Figure 43. DBSA disbursements to municipalities (2013–2015)



Sources: Various DBSA annual reports

The DBSA used to have a rural development programme whose purpose was to identify, prepare and implement catalytic socio-economic infrastructure and to formulate tailor-made rural development solutions. The programme was housed under the Development Fund which was the capacity building arm of the DBSA. However, when the DBSA was restructured, the Development Fund was scaled down and the programme was discontinued.

The DBSA continues to be indirectly involved in rural development. In 2011, it established the National Rural Youth Service Corps programme, with the aim of creating economic opportunities for the rural youth, including skills training. The DBSA hosts the programme's technical support unit, and provides monitoring and quality assurance support to the Department of Rural Development and Land Reform (DRDLR). In 2015, the programme placed 850 learners in infrastructure employment opportunities, a substantial decline compared to 2014 when 2057 learners were placed. The DBSA also helped with the registration of eight youth enterprises by learners who are leaving the programme.

5.2.2 Land Bank

Business model

The business model for the Land Bank has three core income generating business areas to sustain the Retail Emerging Markets (REM) division: Retail Commercial Banking (RCB), Business & Corporate Banking (B&CB), and Land Bank Insurance Services (LBIS).

The Land Bank generates its income by extending agricultural loans to emerging and commercial farmers and large agribusinesses. It also earns interest on cash invested and generates significant income from its insurance portfolio investments. The Bank's lending activities are funded by participating in the open market through issuances of instruments such as promissory notes, call bonds, bills, floating rate notes and debentures. It is worth noting that the cost of funding from open markets is directly affected by the domestic and international interest rate policies, and equity investments are affected by movements in stocks in various stock exchanges.

Financial health

Profitability

The profitability of the Land Bank has generally declined in the past seven years. Between 2008/09 and 2009/10, the profit increased by 144%, from R145.4-million to R354.4-million, but decelerated by 25% (to R286.1-million) in 2010/11. Over the next two years, the profit declined further by 39.1% to R161.4-million (2011/12) and then to R154.3-million (2012/13). In 2013/14, profit increased by 29.4% (to R394.3-million) but declined again in 2014/15 by 25.8%, to R292.4-million. Between 2011 and 2015, the Land Bank's profits have seen a negative average annual growth rate.

Solvency analysis

Over the past five years, the three debt ratios (debt-to-asset, debt-to-equity and equity-to-asset) for the Land Bank have been in the red zone and deteriorated. The Land Bank is burdened by a high level of debt that is worsening and seriously constrains the Land Bank from generating additional resources for rural development.

Divisional performance and rural development programmes

As stated, the Land Bank has three divisions: B&CB, RCB and REM.

- The RCB provides farmers with secured long-term (5–15 years), medium-term (3–8 years), and short-term (up to 18 months) loans in excess of R3-million. The four main products are mortgages (for land), production finance, instalment sale finance (for moveable assets) and medium-term loans for infrastructure (e.g. for pack houses).
- The REM caters for emerging farmers who would ordinarily not be able to secure funds from conventional financial markets. It offers loans of less than R3-million with concessionary interest rates to emerging commercial farmers (not subsistence farmers) who can be individuals or corporations. Loans are specifically for black farmers with no or low assets but who have access to land through a lease, a Permission to Occupy (PTO) certificate or through traditional rights of tenure. Loans are for primary production only. REM also provides wholesale loans to intermediaries for on-lending to farmers as well as for lending directly to farmers. Wholesale loans are provided to, among others, cooperatives and former cooperatives, now operating as private companies, and commodity associations. These intermediaries are familiar with the needs of emerging farmers, provide support to such farmers and have the ability to reach farmers relatively easily.
- The B&CB offers insurance to farmers and the overall agricultural sector, while the LBI short-term insurance offering includes assets, crop and legal solutions.

The B&CB accounts for the largest share of the Land Bank performing loan book, followed by the RCB and the REM. The B&CB loan book decreased from R11.38-million in 2007 to R8.65-million in 2009 and then increased to R30.79-million in 2015. Its annual average growth was 17% between 2007 and 2015. The RCB loan book decreased from R3.64-million in 2007 to R2.21-million in 2010, and then increased to R5.11-million in 2015. Its annual average growth was 6% between 2007 and 2015. The REM performing loan book, which only came into existence in 2012, increased from R0.1-million in 2012 to R0.24-million in 2013 before declining to R0.77-million in 2015. Its annual average growth was 133% between 2012 and 2015, but this growth is from a very low base.

The Land Bank also administers some rural development funds on behalf of government departments:

- The Agri-BEE fund: The Land Bank administers this fund on behalf of the Department of Agriculture, Forestry and Fisheries (DAFF). The fund allocates grants to promote rural community-based empowerment groups. Between 2014 and 2015, disbursements increased to R5.89-million from R5.5 million, from an injection of R36.2-million (in 2014) and R33.3-million (in 2015) by DAFF.

- Emerging Farmers Support Facility: In 2011, the Land Bank received R208-million from the DRDLR to use as a guarantee for identified deserving emerging farmers who require rescue packages. The identified farmers all have mortgage loans with the Bank and can only access the guarantee after complying with conditions as set by DRDLR. This facility has not yet been used.

5.2.3 The Industrial Development Corporation (IDC)

Business model

The IDC uses its balance sheet, retained earnings and borrowings to provide funding. Capital and interest repayments from loans provided to businesses are used to cover obligations to lenders. Dividend payments from equity investments are translated to an annuity income, and exits from mature equity investments results in capital for new equity investments (IDC, 2014). The IDC business model is premised on soliciting funding from capital markets, which is directly affected by the domestic and international interest rate policies. The equity investments are affected by movements in stocks in various stock exchanges. For instance, the IDC equity-accounted investments suffered a total loss of R778-million between 2012 and 2014, but showed a significant improvement in performance in 2015, recording a profit of R656-million. The borrowing from capital markets is also subject to domestic and international interest rate policies.

Financial health

Profit and loss margins

Between 2010 and 2014, the IDC posted successive profits, peaking at R3412-million in 2012 before declining to R2447-million in 2014. The profits then recovered slightly to R2513-million in 2015. Between 2014 and 2015, the annual percentage growth in profit for the IDC was -60% and -9% between 2011 and 2015, meaning that the IDC's profit has grown at a negative rate over the period under review.

Solvency analysis

The three debt ratios for the IDC have mostly been strong for the past six years, i.e. the IDC had low debt levels, which have allowed it to generate additional resources for rural development. However, it should be noted that these ratios have deteriorated over the period reviewed. Compared with the other DFIs, the IDC has invested more in rural areas. The IDC is playing an increasingly important role in rural development, helped by its business model and its diversified portfolio in other investments (other than interest from loans).

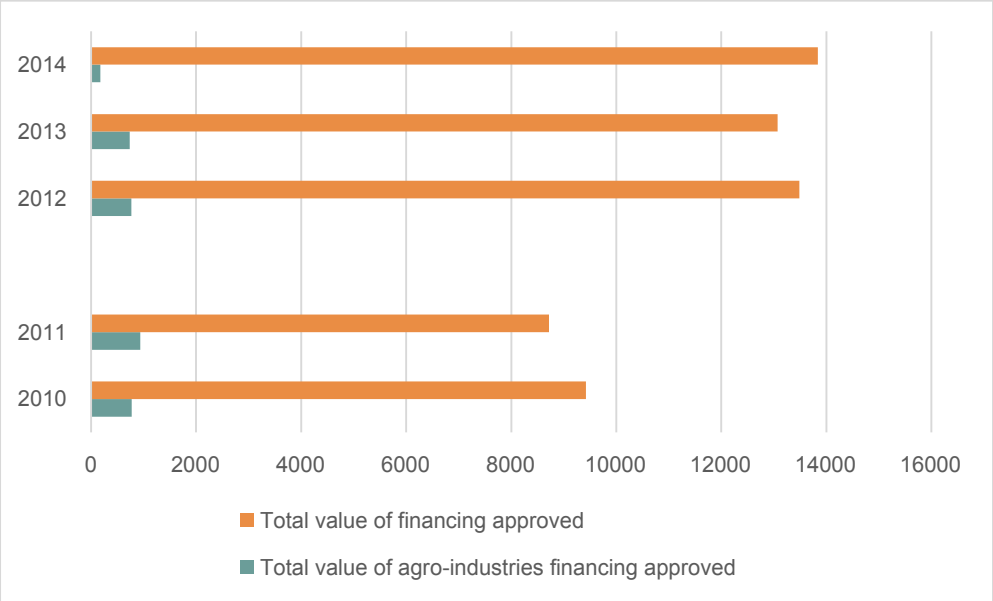
Divisions and rural development activities

The IDC has three business units/divisions:

- Agro and New Industries, consisting of Agro-Industries, Green Industries, Strategic High-Impact Projects and Venture Capital.
- Mining and Manufacturing Industries, consisting of Chemicals and Allied Industries, Forestry and Wood Products, Metals, Transport and Machinery Products, Mining and Minerals Beneficiation, as well as Textiles and Clothing.
- Services Industries, consisting of Information and Communications Technology, Healthcare, Media and Motion Pictures as well as Tourism.

The Agro and New Industries is the most relevant division to rural development. It focuses on agro-processing (food and non-food), beverages (alcoholic and non-alcoholic) and aquaculture. The IDC does not fund pure primary agricultural projects. As Figure 44 shows, between 2011 and 2014, the total value of financing approved by the IDC increased from R8.7-billion to R13.8-billion. Of this, agro-industries made up just 1.25% (R175-million) in 2014, compared to 8.17% (R770-million) in 2010.

Figure 44. IDC total value and agro-industries financing approved (2010–2014)



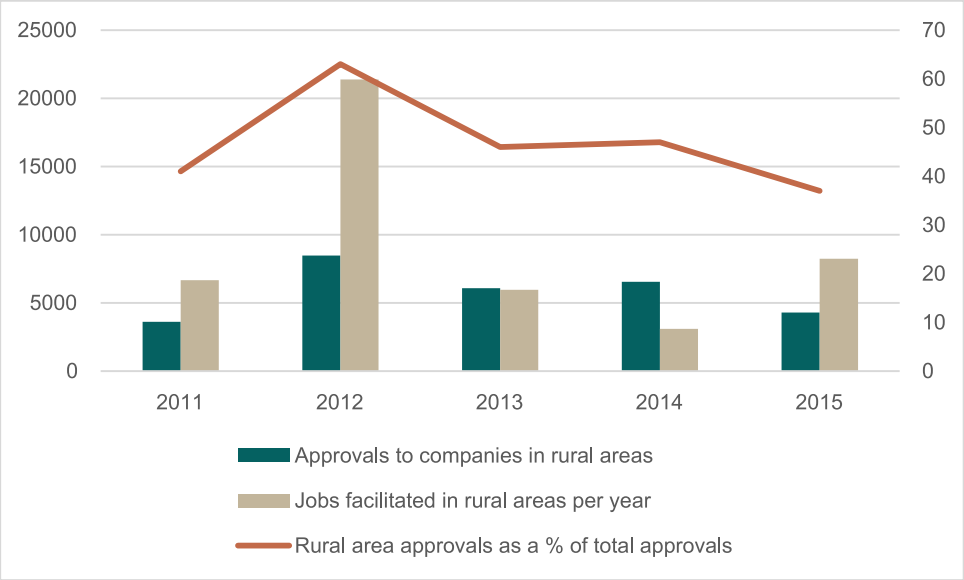
Source: Various IDC Annual Reports

Approvals to companies in rural areas almost doubled between 2010 and 2012, from R4.6-billion to R8.46-billion, before declining to R4.28-billion in 2015. The total value of financing approved by the IDC increased from R8.7-billion in 2011 to R13.8-billion in 2015. Out of the total approved financing, companies in rural areas received 49% in 2010, 63% in 2012 and 37% in 2015 (Figure 45). This resulted in thousands of jobs being facilitated: 6664 jobs in 2011, 21 382 jobs in 2012 and 8223 jobs in 2015.

Provincial investment by the IDC

The IDC mostly invests in rural provinces, but Gauteng (an urban province) also benefits from IDC investments. Between 2010 and 2014, the Northern Cape received 30% (R16.2-billion) of total financing approved by the IDC, while Gauteng received 26%, North West and Limpopo received 9% and the Free State just 1%.

Figure 45. IDC approvals to companies and jobs facilitated in rural areas (2010–2014)



Source: Various IDC Annual Reports

In 2002, the IDC launched the Agency Development and Support (ADS) Department to support the establishment of local economic development agencies at a municipal level. Through the ADS, 34 municipal agencies have been established with the aim of improving socio-economic development and leveraging job creation potential in marginalised communities. In 2013/14, funding of R38.5-million was approved to assist six of these agencies to expand their work in developing, packaging and implementing projects in their areas of operation. These agencies are mainly located in rural areas and play a critical role in facilitating projects that support local economic development in specific municipalities.

5.2.4 The National Empowerment Fund (NEF)

Business model

The NEF generates revenue from interest on development activities and investments, as well as dividends from development activities and financial market assets. Its lending activities are funded by participating financial markets. Its cost of funding from capital markets is directly affected by the domestic and international interest rate policies. The equity investments from financial markets are also affected by movements in stocks in various stock exchanges.

Financial health

Surplus and loss margins

Between 2010/11 and 2011/12, the NEF's profit dropped from R103-million to R28-million. In 2012/13, the NEF posted a loss of R138-million before recovering to a profit of R53-million and R38-million in 2013/14 and 2014/15 respectively. The annual percentage growth of profits was -593% between 2011/12 and 2012/13, and -208% between 2010/11 and 2014/15, implying a negative profit growth over the period.

Solvency analysis

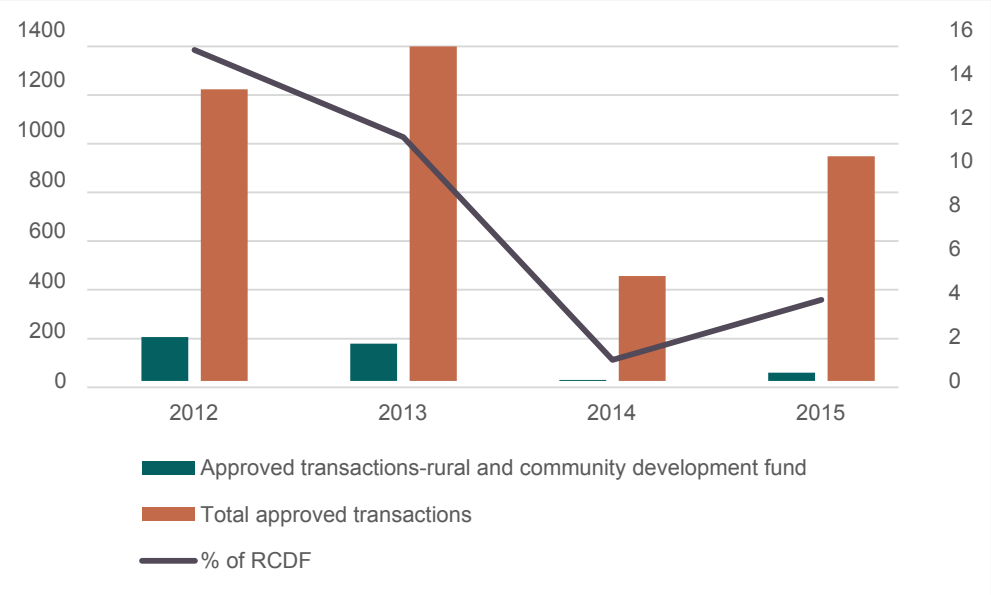
The NEF has a very low level of liabilities, which means it is not possible to calculate the debt-to-asset and the debt-to-equity ratios. The equity-to-asset ratio reveals that the NEF pays a lower interest rate and so has more free cash on hand for future expansions, growth and dividends. Therefore, the NEF has more funds available for further investments and growth.

Divisions and rural development programmes

The NEF has a fund specifically for rural and community development: the Rural and Community Development Fund (RCDF). The fund promotes sustainable change in social and economic relations and supports growth and development in the rural economy through financing sustainable enterprises. Rural communities are mobilised to form legal entities or cooperatives, in order to participate in the broader economic activities. The fund provides capital for project finance, business acquisition and expansion, and start-ups/greenfield enterprises. Funding ranges from R1-million to R50-million. The NEF is also involved in agro-processing investments.

Between 2012 and 2014, the value of approved transactions for the RCDF declined from R175-million to R4-million, reflecting the decrease in total NEF approved transactions, which declined from R1.16-billion to R895-million over the same period. The RCDF's share of total transactions also decreased, from 15.1% in 2012 to 3.7% in 2015. This decline is because other NEF programmes have increased their share of funding. For instance, between 2012 and 2013, the Imbewu Fund increased by 117% compared to 37% for the RCDF (Figure 46).

Figure 46. RCDF vs. total approved transactions (2012–2015)



Source: Various NEF Annual Reports

Provincial investment by the NEF

The NEF invests mostly in urban provinces, with Gauteng receiving over half (51.1%) of NEF financing between 2010 and 2015. Over the same period, KwaZulu-Natal received 18.7% of total NEF financing, followed by Western Cape, Eastern Cape, Limpopo, Free State and North West.

5.3 Conclusion and Recommendations

Within the municipal space, the DBSA improves social infrastructure (water and sanitation, electricity, community facilities, roads and transportation) and enhances economic infrastructure (for energy generation, bulk water supply, industrial transport and telecommunication services). The DBSA invests heavily in metros compared to secondary and under-resourced municipalities, and plays an indirect role in rural development through the National Rural Youth Service Corps programme, which creates economic opportunities for the rural youth, including skills training.

The Land Bank's divisions are designed to cater for agricultural commercial businesses. The RCB and REM are the closest mechanisms through which the Land Bank could contribute to rural development. However, these divisions receive less funding, which suggests that the Land Bank is biased towards agricultural commercial business, as opposed to rural development. The Land Bank allocates most of its resources to its B&CB division, implying that it is more biased to funding agricultural cooperatives and businesses than emerging farmers in rural areas.

The IDC's agro-industries business unit is the closest mechanism that can be used to finance rural development. However, its share of the total financing approved by the IDC is minimal. Nevertheless, the IDC approvals to companies in rural areas is significant, reaching 63% of all financing approved by the IDC in 2012. Moreover, in 2012 the IDC facilitated 21 382 jobs in rural areas. The IDC also supports development agencies through the Municipal Agency Programme, which aims to improve social and economic development and leverage development and job creation potential in marginalised communities.

The NEF contribution, through the Rural and Community Development Fund, is very small and is declining.

What is clear is that there is no single champion and coordinating entity for rural finance and development guiding investment by DFIs in rural areas. The investment and financial support they offer to rural areas is very modest and does little to crowd in the private sector.

With respect to creating conditions for rural development from infrastructure-led growth by DFIs, the Commission recommends that:

1. The Economic Development Department, in collaboration with the departments of agriculture, forestry and fisheries, rural development and land reform, and public enterprises, designates a single champion for rural finance and development. This champion should guide and coordinate investment by DFIs in rural areas, and encourage crowding-in by the private sector.

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Appendix: Results for debt ratios and benchmarks and interpretation

Table 29. Debt ratio formulas, benchmarks and interpretations

Solvency analysis	Calculation	Green	Yellow	Red
Debt-to-asset ratio	Total liabilities/total assets	<30%	30% to 55%	>55%
Equity-to-asset ratio	Total equity/total assets	>55%	30% to 55%	<30%
Debt-to-equity ratios	Total liabilities/total equity	<42%	42% to 122%	>122%

Source: Adapted from Northwest Credit Services

Table 30. DBSA debt ratios

	2010	2011	2012	2013	2014	2015
Debt-to-asset ratio	60%	62%	67%	69%	69%	67%
Equity-to-asset ratio	40%	38%	33%	31%	31%	33%
Debt-to-equity ratio	152%	166%	199%	223%	221%	200%

Table 31. IDC debt ratios

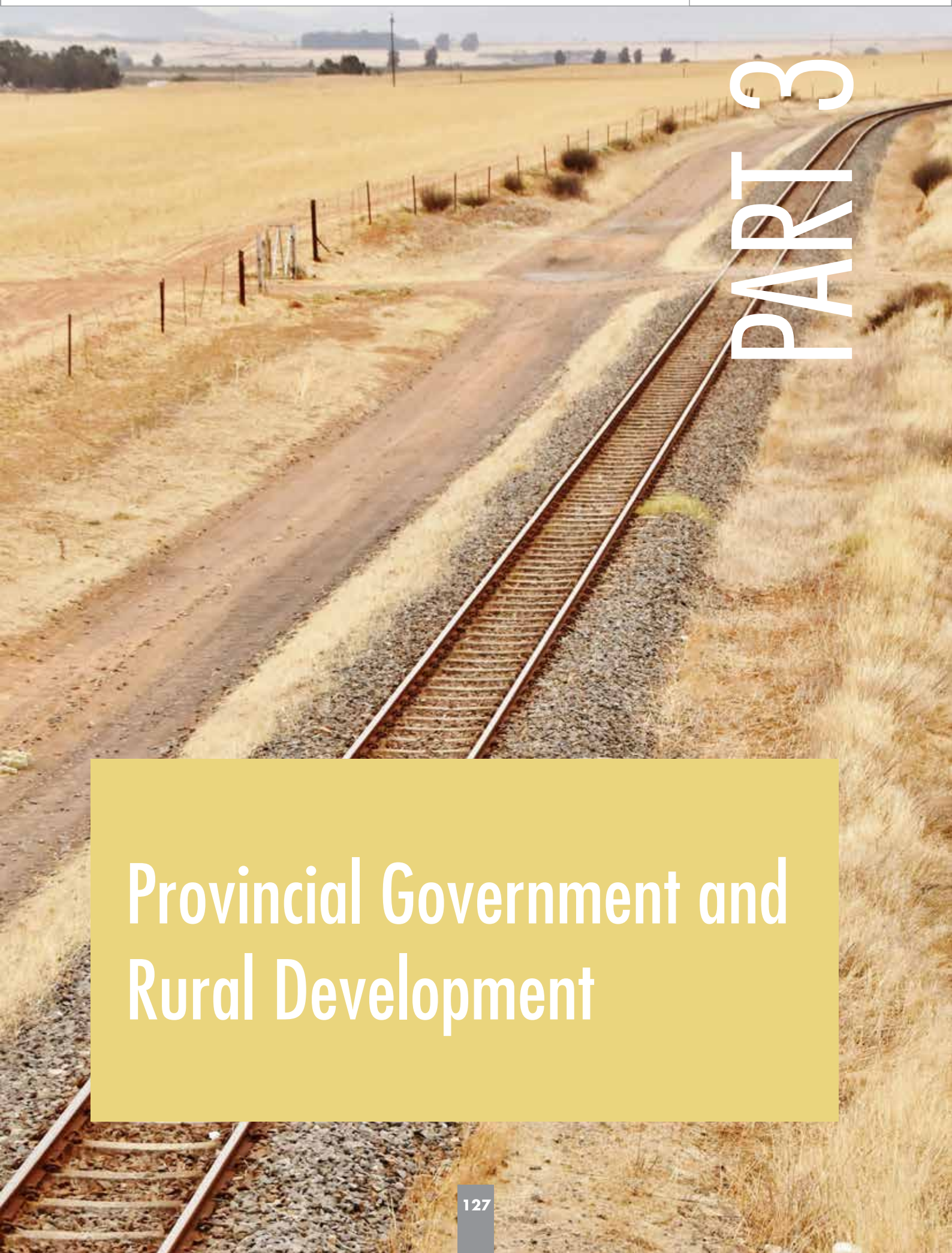
	2010	2011	2012	2013	2014	2015
Debt-to-asset ratio	18%	20%	23%	28%	25%	32%
Equity-to-asset ratio	82%	80%	77%	72%	73%	68%
Debt-to-equity ratio	22%	24%	30%	38%	35%	47%

Table 32. Land Bank debt ratios

	2010	2011	2012	2013	2014	2015
Debt-to-asset ratio	81%	77%	80%	83%	84%	83%
Equity-to-asset ratio	19%	23%	20%	17%	16%	17%
Debt-to-equity ratio	415%	343%	401%	473%	520%	492%

Table 33. NEF debt ratios

	2010	2011	2012	2013	2014	2015
Equity-to-asset ratio	99.16%	99.34%	99.15%	99.08%	99.07%	98.93%



PART 3

Provincial Government and Rural Development

CHAPTER 6

Assessing Government's Fiscal Instruments to Fund Job Creation Strategies in Rural Areas: The Case of Public Employment Programmes

Sasha Peters, Poppie Ntaka and Ghalieb Dawood

Assessing Government's Fiscal Instruments to Fund Job Creation Strategies in Rural Areas: The Case of Public Employment Programmes

6.1 Introduction to the Problem

For the past 20 years, unemployment has remained stubbornly above 20% because of sluggish economic growth combined with structural weaknesses in the South African economy. Rural areas are worst affected, particularly in former homeland areas, where unemployment rates are among some of the highest in the world (Klasen and Woolard, 2008). Unemployment imposes huge social and economic costs on society (Philip, 2013). Long-term unemployment erodes human capital and contributes to upward pressure on wages, as the unemployed disengage from the labour market. The structural nature of unemployment combined with the inflexibility of the labour market to absorb the unemployed poor, created the need for a policy response to address a burgeoning crisis.

In response to this unemployment challenge, government initiated a multi-pronged strategy, which includes a large-scale public employment programme (PEP) called the Extended Public Works Programme (EPWP). Introduced in 2004, the EPWP provides short-term temporary "work opportunities" for the unemployed poor. In early 2009, government implemented a second PEP, the Community Works Project (CWP), which provides a minimum employment guarantee and has a different implementation model to that of the EPWP. Proposals are underway to extend the CWP's current minimum employment guarantee from 100 to 180 days, which would then bring into question whether the CWP would still qualify as a PEP that creates short-term work opportunities[31].

In times of economic downturn, PEPs play a critical role in protecting the poor and vulnerable from the adverse impacts of a slow recovery in the labour market (Brodsky, 2000). If designed properly, PEPs also provide participants with job training and "real world" experience that can help their chances of being absorbed into the formal labour market. In addition, PEPs can be used as a mechanism to deliver essential social and economic services to the public, especially in rural areas where the greatest needs exist.

During the first phase of the EPWP, government spent R50-billion, of which only R6.7-billion (13.5%) went on wages (DPW, 2009b). The largest share of grant funding went to infrastructure-related projects because of this sector's job creation potential. However, there was very little compliance with the Division of Revenue Act (DORA) requirements, which called for the use of labour-intensive construction methods and skills training for participants. This lack of labour-intensity meant a significant amount of the income did not end up in the pockets of the poor (McCutcheon and Taylor Parkins, 2012).

Other criticisms of the EPWP include insufficient attention on rural areas where infrastructure backlogs exist, and an emphasis on employment targets at the expense of providing longer duration employment opportunities (ibid). Another major challenge is the integrated delivery of PEP projects, as the management and implementation of PEPs span all three spheres of the government and various government sectors. An important policy question is whether PEPs lead to a reduction in long-run unemployment.

Despite these concerns, funding to PEPs is growing faster than most budget programmes. The 2016 Medium Term Expenditure Framework (MTEF) allows for significant increases in PEPs: conditional grants are expected to grow by an annual average of 6% for the EPWP and by 14% for the CWP, despite other counter-cyclical measures resulting in total government expenditure growing at 0% over the 2016 MTEF period. This increased funding comes on top of significant funding in previous years and in the context of a fiscally constrained environment. Therefore, it is imperative to assess whether government is getting value for money from these programmes and whether PEPs are an effective livelihood mechanism to support poor households that experience the brunt of the economic slowdown. It is also important to examine whether the programme design encourages the attainment of project outcomes, especially job creation, and whether the incentives in place result in absorption into the formal labour market.

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[31] Short-term work opportunities are defined as temporary or ongoing work provided by contractors, NGOs or government according to the Ministerial Conditions of Employment for EPWP and CWP. In the case of CWP, beneficiaries work for a maximum of 2 days per week on an ongoing basis.

PEPs are implemented in all three spheres of government and therefore have important intergovernmental implications that merit the investigation by the Financial and Fiscal Commission. The specific objectives of this research are:

- To measure the effectiveness of fiscal instruments of PEPs in relation to intended outcomes in rural areas.
- To evaluate access/targeting of PEPs in terms of spatial location.
- To comment on the effectiveness of the intergovernmental delivery models of PEPs to deliver services in rural areas.
- To make recommendations that can enhance the performance of PEPs in rural areas, especially with respect to EPWP and CWP.

6.2 Background

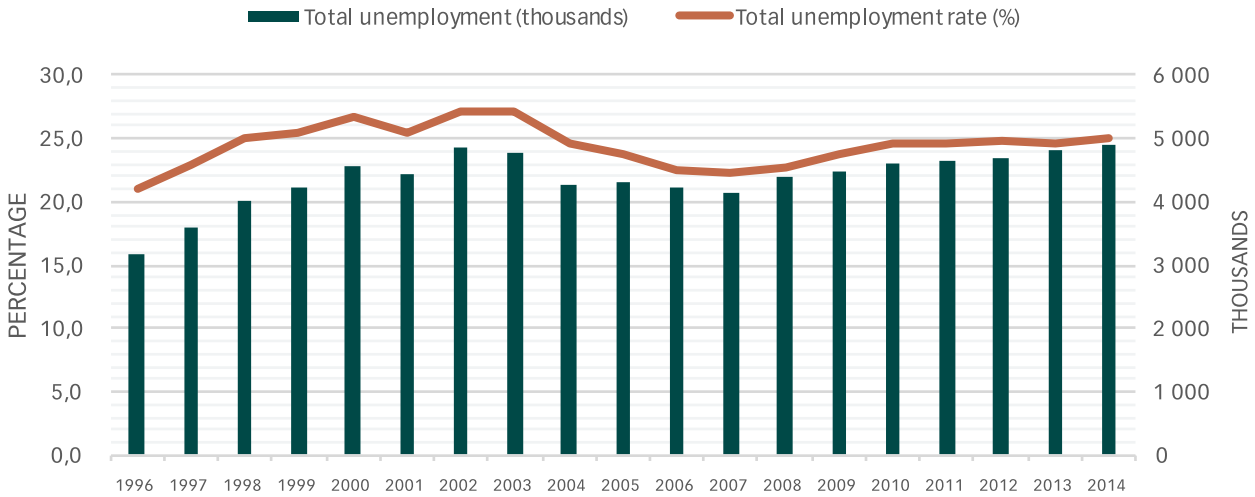
The National Development Plan (NDP) identifies job creation as one of the major policy goals over the next 15 years and sets an ambitious target of creating five million new jobs by 2020 and 11 million new jobs by 2030 (NPC, 2011). This implies reducing unemployment to around 14% by 2020 and 6% by 2030 (FFC, 2014). The assumption is that the South African labour market is incapable of correcting the imbalance between labour supply and demand, and so government has a crucial role to play in implementing active labour market policies to address the unemployment problem. Keynesian economic theory supports this position, although the view that governments should actively correct labour market disequilibrium fell out of favour internationally in the 1970s. With the onset of the global economic recession in 2007, huge job losses globally have resurrected this Keynesian perspective and created a dynamic for government to intervene more actively in the labour market and to move the economy towards full employment.

6.2.1 Unemployment and poverty

In the case of South Africa, the persistently high unemployment[32] rate as reflected in Figure 47 suggests the problem is structural because of historical reasons, compounded in rural areas by the lack of essential skills and labour market experience, and the remoteness of rural location from major labour markets (McCord, 2002).

South Africa also has one of the highest youth unemployment rates, at around 50% over the past 10 years, significantly above sub-Saharan Africa and BRICS average (Figure 48).

Figure 47. Unemployment trends in South Africa



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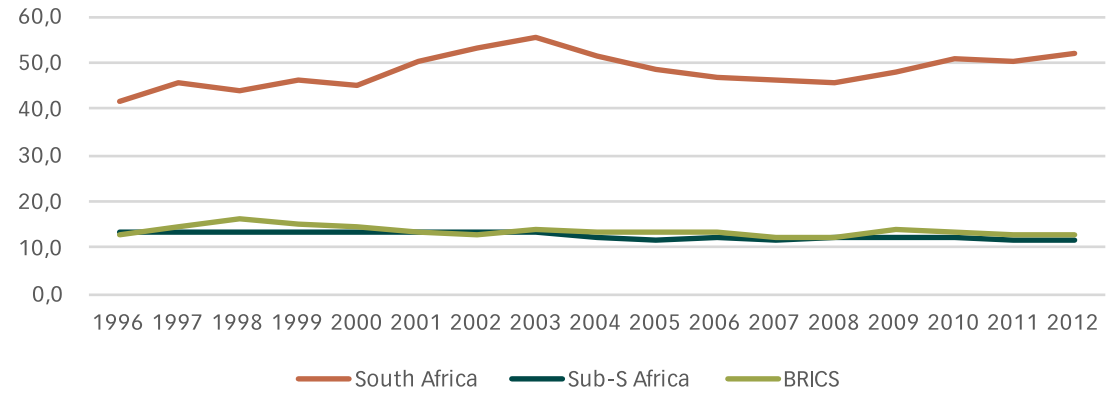
[32] The narrow definition of unemployment rate is referred to here.

[33] Stats SA defines headcount as the share of the total population below the upper bound poverty line. The poverty gap measures the intensity of poverty, while severity is the percentage of the population living below the inflation-adjusted food poverty line.

Figure 48. Youth unemployment trends in South Africa, sub-Saharan Africa and BRICS*



Measured against various poverty measures, the economic recession in 2008 had a negative impact on household poverty, as illustrated in Table 34. Despite a strong recovery, poverty's spatial nature is clear – the headcount ratio in rural areas is more than twice that of urban areas and extreme poverty (severity) is more than three times that of urban areas.[33]

Source: ILO (2014); Commission's calculations.
**The average youth unemployment rates for BRICS exclude South Africa*

Table 34. Poverty measures by settlement type

Percentage (%)	Headcount Ratio			Poverty Gap			Severity		
	2006	2009	2011	2006	2009	2011	2006	2009	2011
Total	57.2	56.8	45.5	26.7	27.9	19.6	15.4	16.7	10.8
Urban	40.7	41	30.9	s16.1	17.6	12	8.3	9.7	6.2
Rural	80.8	83	68.8	41.9	45	31.8	25.6	28.3	18.1

Source: Stats SA (2014)

Poverty is closely associated with unemployment, and most poor households are poor because of the absence of wage income. In addition, shocks to wage income accounts for more than 80% of household mobility into poverty (McCord, 2002). These findings suggest that job creation strategies by government are crucial to improve the overall wellbeing of the rural poor.

6.3 Literature Review

6.3.1 Definition of public employment programmes

The literature uses the terms public works programmes and PEPs interchangeably. This report uses the term public employment programme or PEP. These programmes are defined as (McCord, 2008:1):

> all activities which entail the payment of a wage (in cash or in kind) by the state or by an agent acting on behalf of the state, in return for the provision of labour, in order to (i) enhance employment and (ii) produce an asset (either physical or social), with the overall objective of promoting social protection.

Generally, PEPs have three potential welfare effects: a direct effect for those who are employed in a PEP; a labour-market effect, which results from a shift in the demand for labour; and a productivity effect that arises from the investment in public goods (Berg et al., 2015). The size of these effects varies according to the country or project context. Whether these effects are evident in the South African scenario will become clear through the findings of this study.

PEPs are implemented for different and numerous reasons, and come in various time-frames, sizes, targets and implementation models. McCord (2008) provides a useful four-pronged typology of PEPs that emphasises their core features (Table 35).

Table 35. Typology of PEPs

Typology	*Explanation*
Type A: Short-term employment	Implemented in response to temporary disruptions in the labour market or economic shocks; generally implemented in the infrastructure sector.
Type B: Employment guarantee scheme	Often implemented in response to chronic unemployment, with the objective of offering repeated access to employment; implemented either directly by governments or indirectly through the private sector or civil society.
Type C: Labour intensification	Usually implemented in the public infrastructure sector, with the objective of heightening the labour-intensity of public infrastructure development and thereby providing employment opportunities.
Type D: Promotion of employability	Addresses supply-side issues through providing skills and workplace training to improve the employability of workers.

Source: McCord (2008)

Given the different types of PEPs, it is not surprising that these programmes often fulfil multiple objectives. Table 36 illustrates the multiple dimensions within which PEPs operate, ranging from social protection to the delivery of public (mostly infrastructure) services.

Table 36. Multiple dimensions within which PEPs operate

	Social protection	**Employment**	**Delivery of infrastructure services**
Macro objective	Provide security and protect vulnerable groups against shocks.	Reduce un- and underemployment/full employment.	Contribute to national/ local growth.
Intermediate objective	Provide a minimum transfer or income security to those defined as in need.	Mobilise surplus labour for productive activities.	Public investment in infrastructure or delivery of services.
Mechanism	Provide a minimum level of income.	Create employment as required.	Improve connectivity and access through infrastructure or services through labour-intensive methods.
Operational focus	Guarantee income.	Create work.	Create assets and services.

Source: Tsukamoto (n.d.)

6.3.2 Brief overview of benefits and challenges of PEPs

The challenges associated with PEPs are directly linked to the multiple roles that PEPs play. As alluded to above, they are often required to meet social protection, employment and public service provision objectives. This multiplicity of objectives can serve to dilute the impact of the intervention (Tsukamoto, n.d.). A related challenge is the issue of poor intergovernmental coordination, particularly when it comes to the management of PEPs, which can have a negative impact on the outcomes and effectiveness of the interventions, especially where one government sphere finances and another (subnational) sphere implements the PEP.

6.3.3 Key factors to consider in the design of PEPs

Targeting

Effective targeting is critical to ensure that PEPs create jobs for the unemployed and the poor. To effectively reach the poor, such interventions or schemes must be designed in a way that incentivises participants to self-select into the schemes (Ravallion, 1991). This is because incentivising self-selection will encourage the poor to participate and deter the non-poor if, for example, the wage rate is low enough for poor individuals to accept but not high enough for the non-poor individuals. PEPs are by design self-targeting schemes because, even if their intention is not to target the poor, they end up reaching the poor, especially

through contributing to poverty alleviation (Antonopoulos, 2007). In contrast, schemes that have poverty as an explicit objective or target certain demographic groups do not always reach the poor or the targeted groups (Teklu and Asefa, 1997). In other words, targeting may serve to exclude many needy individuals, especially if the targeting objectives are too restrictive when selecting people into the programme.

Arguably, the type of targeting used influences the composition of participants, which may also depend on the geographical location and functional focus of PEPs. For instance, urban projects tend to be male-dominated because of the nature of the employment, while in rural areas females may dominate participation in public works projects because of men migrating to work elsewhere (Webb, 1995; von Braun et al, 1992).

6.3.4 Delivery models of PEPs

The management of PEPs varies across countries, particularly by region. In most OECD countries, the central government manages PEPs but in countries such as Australia, the Netherlands and Switzerland, quasi-competitive mechanisms[34] are increasingly taking over the management of such schemes (Martin and Grubb, 2001). In Africa, central government usually guides the management of PEPs, in close collaboration with non-governmental organisations (Webb, 1995).

6.3.5 A note on South African studies on PEPs

A review of all South African research on PEPs was conducted as background to this research (see Appendix A for a detailed list and summary of the papers reviewed). The studies range from questioning the rationale and overall effectiveness of PEPs (Philip, 2012 McCord, 2003), to examining the specific effects that PEPs have on the poor (McCord and Van Seventer, 2004; Adoto and Haddad, 2002; Haddad and Adoto, 2001; Khosa, 1998). While these studies resonate with the objectives of this research, in terms of focusing on a category of people (i.e. the poor), their analyses have no locational/spatial slant. For example, Haddad and Adoto (2001) focus on the poor within the Western Cape, which is a province that is better resourced and more urban. In contrast, this study prefers to emphasise the poorer, more rural spaces in South Africa. In addition, the studies that focus on targeting and benefits to the poor date from over a decade ago, whereas this study presents an updated assessment of the manner in which PEPs target beneficiaries.

6.4 Research Methodology

Both qualitative and quantitative methods were used. Budget analysis was used to determine the allocations and growth rates of the EPWP and CWP, while descriptive statistics were used to evaluate the access of PEPs in relation to spatial location (that is, rural relative to urban). The outputs and outcomes were assessed against the programme targets in order to comment on the relative effectiveness of the EPWP and CWP delivery models. The data underpinning the analysis was obtained from various sources, notably annual Labour Force Surveys, Estimates of National Expenditure, and CWP and EPWP evaluation reports.

To complement the findings emerging from the quantitative analysis, targeted interviews were held with relevant stakeholders including the Department of Public Works (which administers the EPWP programme), the Department of Cooperative Governance and Traditional Affairs (which administers the CWP programme) and the National Treasury.

Distinguishing rural from urban can be complicated. However, in South Africa, the classification of municipalities includes B3s (small towns) and B4s (rural municipalities) categories that encompass the more rural municipalities. Fortunately, the data on work opportunities created is disaggregated to municipal level, and so it is possible to evaluate the EPWP and CWP in rural municipalities (i.e. B3s and B4s). The advantage of this rural/urban classification is its general acceptance and use, at least within the local government sphere. However, the disadvantage is that the classification may be somewhat outdated, having remained largely static over the years, with the only real change being the "upgrading" of two secondary cities to metropolitan status. A composite index was developed to rank provinces from rural and urban (see Appendix A). The index takes into account the number of B3 and B4 municipalities in each province. Provinces with higher composite indexes are more rural in nature than provinces with lower indexes.

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[34] Quasi-competitive mechanisms refer to the creation of a market-type mechanism through tendering, whereby private players (commercial and non-commercial) take over the role of government in providing service delivery.

6.5 Job Creation in Rural Areas

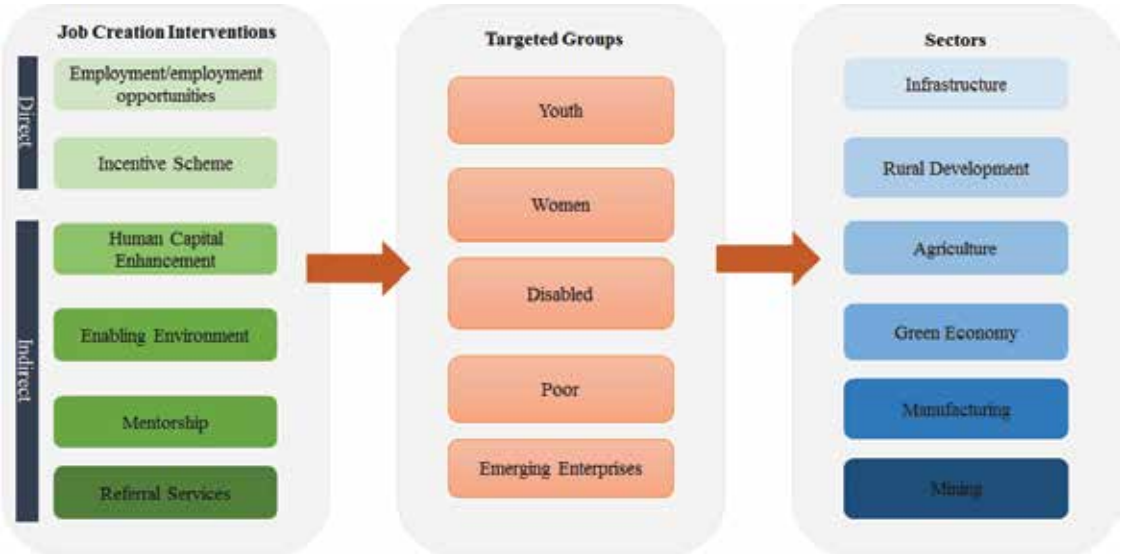
The job creation strategy in South Africa is multifaceted and covers a range of sectors, target beneficiaries and intervention modalities (Figure 49). Three important policy documents underpin the strategy: the New Growth Plan, the Industrial Policy Action Plan and the National Infrastructure Plan. The strategy balances the need to stimulate investment in key sectors with the need to tackle structural factors that are impeding inclusive growth, such as inequality, regulatory compliance costs and economic exclusion. Therefore, the strategy puts a strong emphasis on addressing the historical legacy of unequal economic opportunities, which manifests starkly throughout South Africa, especially in rural areas located in the old Bantustans.

The strategy's implementation contains interventions for creating both direct and indirect jobs. Direct interventions are spending programmes that lead directly to the creation of jobs through (for example) public employment schemes or financial incentives that support enterprises to create employment in targeted sectors. Indirect interventions are programmes that do not translate immediately into jobs but rather seek to create the necessary conditions for employment creation to occur. Moreover, it is not a given that employment will follow indirect interventions. Skills development programmes or bursary schemes are common indirect government-funded interventions, and yet the outcomes may not always justify the expenditure. For example, an unemployed individual may have successfully completed a government-funded skills programme but not find a job. This could be because of a range of factors, including a mismatch between the skills acquired and the labour market, the oversupply of candidates in a particular field, a lack of incentive to recruit, the need for prior experience and structural issues, such as labour market regulations.

The Department of Trade and Industry (the dti) coordinates the job creation strategy, supported by a core group of government departments, such as the Department of Agriculture, Forestry and Fisheries (DAFF) and the Department of Rural Development and Land Reform (DRDLR). The task of the dti and these core departments is to implement, monitor and report against the stated objectives of the strategy, while also responding to unanticipated risks that may arise. The strategy's rural indicators are to boost adult employment from 20% in 2012 to 30% in 2019, and ultimately to 40% by 2030. As an initiative to drive job creation in rural areas, the DAFF and DRDLR developed the Agriculture Policy Action Plan to provide for a specific policy response.

Table 37 illustrates job creation schemes that are being implemented across a range of government departments and agencies. Apart from the Employment Creation Fund and PEPs, most other initiatives do not have an explicit rural bias. The schemes are also not necessarily designed to absorb large numbers of unemployed individuals and have quite onerous and time-consuming compliance requirements. For instance, intensive data collection is necessary to comply with the tax incentive grant. This suggests that high compliance costs work against the intended benefits of some job creation schemes. Another concern is the funding shortages in some programmes, such as the clothing and textile programme, where competition from cheap imports makes it difficult for companies to remain competitive. With respect to PEPs, such as EPWP and CWP, the available funding is also insufficient to cover every citizen that qualifies for the programme.

Figure 49. Job creation strategy of government



Source: Authors (2016)

Table 37. Selected job creation programmes

Programme name	Description	IGFR implementation modality	Rural focus	Challenges	Allocation (2014/15) R-million
Employment Creation Fund	Set up to fund innovative and relatively higher risk projects, which are unlikely to be funded through government's normal budget processes and/or the commercial financial sector. Government agencies, NGOs and private sector within South Africa qualify under the programme criteria.	The Department of Trade and Industry (the dti) implements the programme; specialists and experts are used for project design and implementation.	Strong bias towards rural and peri-urban areas	The programme lacks capacity where those who are hired cannot fulfil the job specification. There are also bureaucracy and procurement-related challenges.	Unavailable
Clothing and Textiles Development Programme	Aims to encourage manufacturers to become (and remain) competitive against, for example, cheap imports or low-cost producing countries. Thus, the programme seeks to create new jobs and to preserve existing jobs in the sector. The programme has two strands: (i) Customised sector programme (ii) Clothing and textile production incentive	The dti is the parent department, and IDC is the implementing agent.	No rural dimension, although some companies that employ low-skilled individuals who have benefitted from the programme are situated in rural areas.	The programme has been well received, although the shortage of funding is a major challenge.	(i) 163.9 (ii) 723.4
Employment Tax Incentive	Aims to encourage employers to hire young and less experienced work-seekers. The incentive is meant as a temporary programme to stimulate demand for young workers.	SARS implements the programme.	The programme is available in all sectors (apart from the public sector) across the country.	Long data-gathering process (including tax filing, database management, verification and auditing). As this is the first time that government attempts a programme of this nature, some of these issues could be teething problems. The tax incentive may not be creating "new" jobs but rather going to jobs that would have been created in the absence of the incentive.	Unavailable
Jobs Fund	The programme creates jobs by supporting initiatives that generate employment in innovative ways. Grant funding is made available on a matched basis.	National Treasury has taken over as implementing agent from the Development Bank of Southern Africa (DBSA).	Most of the jobs created are in urban and peri-urban areas, as creating jobs in rural areas takes longer.	To get assistance, beneficiaries must have some available seed capital and capacity must be in place. Another challenge is meeting the funding criteria. For example, to qualify for funding, a farming project cannot have an outstanding Environmental Impact Assessment. In addition, some agricultural projects seem viable but cannot be funded because the project does not have any water rights.	1 338 913
EPWP	Aims to provide poverty and income relief for the unemployed through temporary work on socially useful projects. In addition, the programme provides some basic training and work experience for participants, to empower them to earn a living on an ongoing basis.	The programme is cross-cutting and implemented by all spheres of government and state-owned enterprises (SOEs). The DPW is responsible for overall monitoring and evaluation and submitting progress reports to Cabinet.	Both urban and rural	The funding for the programme is not sufficient to accommodate every citizen who qualifies for the programme. Training can be improved to offer better skills and better knowledge	
CWP	Similar to EPWP, the programme provides temporary work opportunities to unemployed and provides basic training and work experience. It falls under the non-state sector.	The programme is coordinated by COGTA, while NGOs implement the programme in municipal areas.	Both urban and rural	Challenges include institutionalising the CWP, getting framework agreements in place, and building the capacity for a much wider roll-out.	2 257.8

Source: Commission's compilation

6.6 Overview and Spending Trends of PEPs in South Africa

The persistent and structural nature of unemployment created the impetus for government to introduce a wage income safety net for the unemployed poor. At the Growth and Employment Summit in 2003, the introduction of a public works programme was seen as a critical priority. The objective was to provide wage income to large numbers of unemployed individuals through temporary work opportunities and socially useful work. In April 2004, the first phase of the EPWP was officially launched and targeted four sectors: infrastructure, environmental and culture, social and economic. In the second phase (2010–2014), the non-state sector was added, while the economic sector was largely subsumed under infrastructure. Unlike the other sectors, the CWP is located in the Department of Cooperative Governance and Traditional Affairs (COGTA), not in the Department of Public Works. As Table 38 shows, the focus of the EPWP was creating work opportunities in the infrastructure sector, but in Phase 2 the social and non-state sector absorbed a larger proportion of participants.

The EPWP is designed to be implemented across all three spheres of government. The bulk of its funding comes from the baseline budgets of government departments and municipalities. During Phase 1, a total of R49.6-billion was spent, doubling to R111-billion in Phase 2 (Table 39). Phase 2 saw the introduction of conditional grants to fund EPWP activities. These conditional grants are designed to complement departmental and municipal budgets and make up only a small share of total EPWP funding, amounting to R4.6-billion between 2009/10 and 2013/14.

Table 38. Number of participants per sector

	Phase 1 2004–2009	Phase 2 2010–2014
Infrastructure	312 227	418 006
Environment and culture	114 228	191 900
Social	119 717	272 565
Economic	4 745	0
Non-state sector		
Non-profit organisations		27 124
CWP		200 822

Source: DPW (2005; 2006; 2007; 2008; 2009a; 2010; 2011; 2012; 2013; 2014; 2015)

Table 39. Spending on PEPs

	Phase 1 2004/5–2008/9	Phase 2 2009/10–2013/14	Average annual real growth rate	
	R'million		2004/5–2008/9	2009/10–2013/14
Total government spending (non-interest expenditure)	2 243 764	4 359 817	7%	7%
EPWP (total spending)	49 686	111 227	75%	-9%
EPWP (conditional grants)	-	4 563	0%	70%
CWP	-	4 238	0%	89%

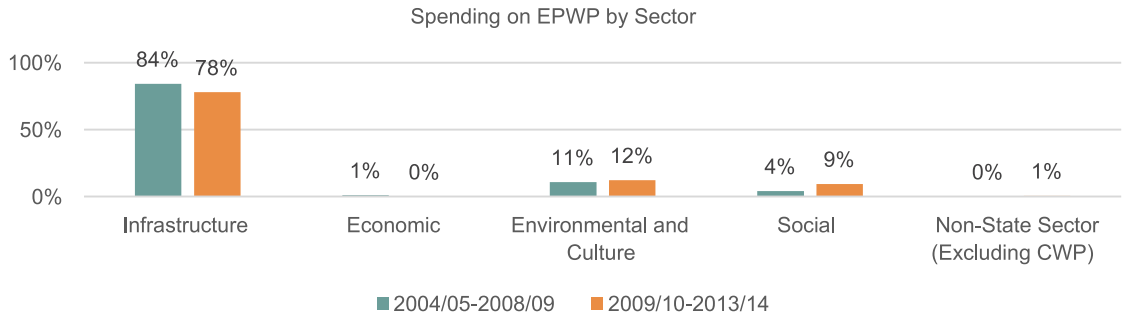
Source: National Treasury (2004-2014a, b, c)

Between 2009/10 and 2013/14, the CWP received funding of R4.2-billion, which is marginally less than the EPWP grant allocations for the same period. The fiscal pressure arising from the global crisis in 2009 has led to departments and municipalities moving away from funding EPWP out of baseline budgets to using more conditional grants, which increased on average, by 70% per annum in real terms over this period. Between 2009/10 and 2013/14, CWP grew on average by 89% per annum. Spending on CWP has grown strongly because of the scaling-up of the programme's implementation in order to cushion the poor against the negative fallout of the domestic economy. CWP is growing faster than the EPWP conditional grants, suggesting that government is prioritising CWP as a vehicle for creating temporary jobs for the unemployed.

Disaggregating the EPWP by sector reveals huge variations in spending. Although the infrastructure sector remains the most significant cost driver of EPWP, its share of total spending has declined marginally, from 84% in Phase 1 (2003/4 to 2009/10) to 78% in Phase 2 (2009/10 to 2013/14). A major weakness of the EPWP remains the short-term nature of jobs, particularly in the infrastructure sector. This means that beneficiaries often find themselves unemployed again at the end of the contract period of an infrastructure project (Philip, 2013). To remedy the situation, Phase 2 of the EPWP started targeting sectors where the jobs created could be of longer duration and more sustainable. As a result, the social sector has gained traction (Figure 50).

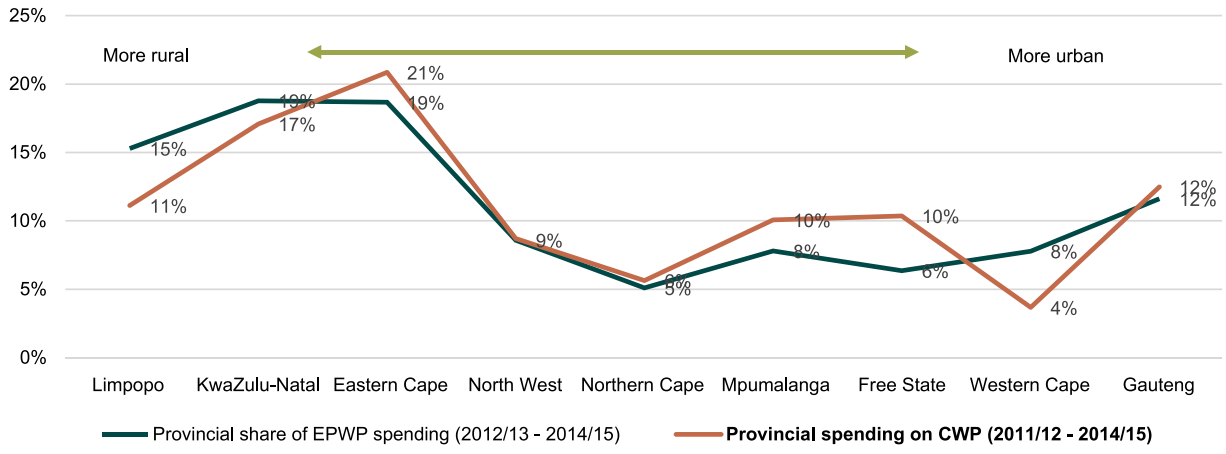
Figure 51 provides a breakdown of provincial spending on EPWP and CWP as a proportion of total spending. The provinces are arranged according to the level of "ruralness" derived from a composite index discussed in Appendix A.

Figure 50. Spending on EPWP by sector



Source: DPW (2010; 2014):

Figure 51. Breakdown of provincial spending on EPWP and CWP



Source: DPW (2015); CWP Financial Report (2012)

During the period 2011/12–2013/14, over half (53%) of EPWP spending and almost half (49%) of CWP spending occurred in the three most rural provinces (Limpopo, KwaZulu-Natal and Eastern Cape). Just over a quarter of EPWP (26%) and CWP (27%) funding was spent in the three most urban provinces (Free State, Western Cape and Gauteng). This suggests spending on the EPWP targets rural provinces more than the CWP, although the real difference is marginal. The results show that the bulk of the resources for both programmes are allocated to more rural provinces where the greater share of unemployed and poor households live.

Spending on PEPs is growing much faster than total government spending, which declined by 2% in 2016/17, as a result of the poor economic growth (Table 40). Allocations are expected to grow in real terms by 53% for the EPWP social sector grant and by 30% for CWP. This is a clear indication that government is targeting PEPs as a soft landing for the unemployed poor who are likely to face the brunt of the economic slowdown.

Table 40. Annual growth in PEPs over the MTEF (2015/16–2018/19)

Percentage	2015/16	2016/17	2017/18	2018/19	Average annual growth (2016/17 –2018/19)
Total government spending	5%	-2%	1%	2%	0%
CWP	40%	30%	13%	-1%	14%
EPWP integrated provincial	-12%	17%	-1%	0%	5%
EPWP social provincial	-18%	53%	1%	0%	18%
EPWP integrated municipal	-7%	6%	2%	0%	3%

Source: National Treasury (2016a; 2016b)

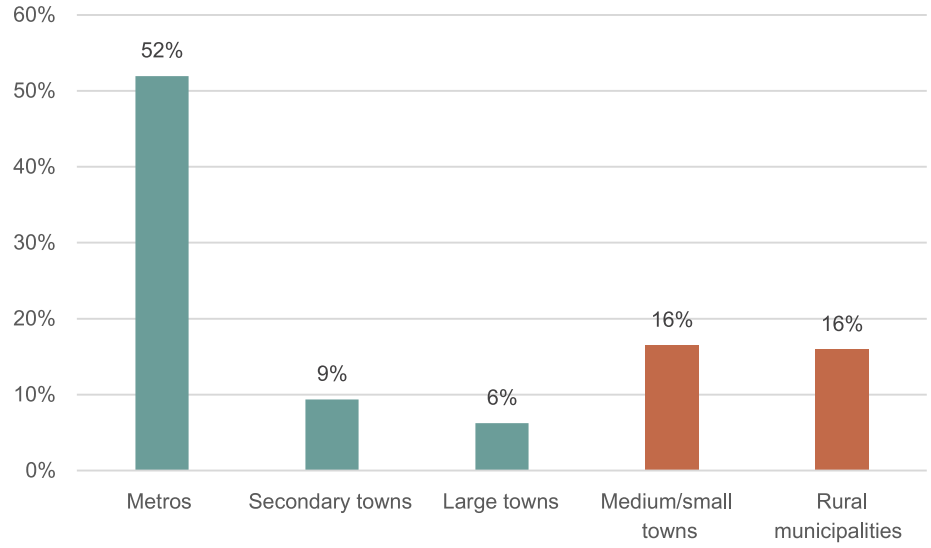
6.7 Access to PEPs

To gain insight into the issue of access, the location of EPWP and CWP-related work opportunities was explored. The actual number of work opportunities created according to the type of PEP (i.e. EPWP or CWP) was disaggregated by province and type of municipality over seven years, from 2008/09 to 2014/15.

6.7.1 Overview of work opportunities created across EPWP and CWP

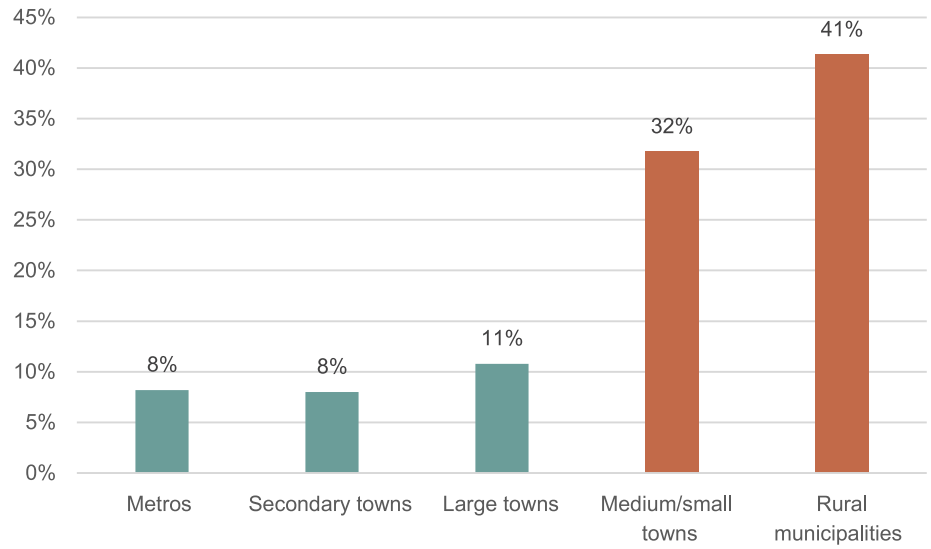
Figures 52 and 53 show the share of work opportunities created through the EPWP and CWP by type of municipal category. While most EPWP work opportunities are in metropolitan areas, CWP has a much stronger rural focus, with a significant share of its opportunities being created in more rural (B4 and B3) municipalities.

Figure 52. Work opportunities created through EPWP (2008/09–2014/15)



Source: DPW (2015)

Figure 53. Job opportunities created through CWP (2012/13–2014/15)

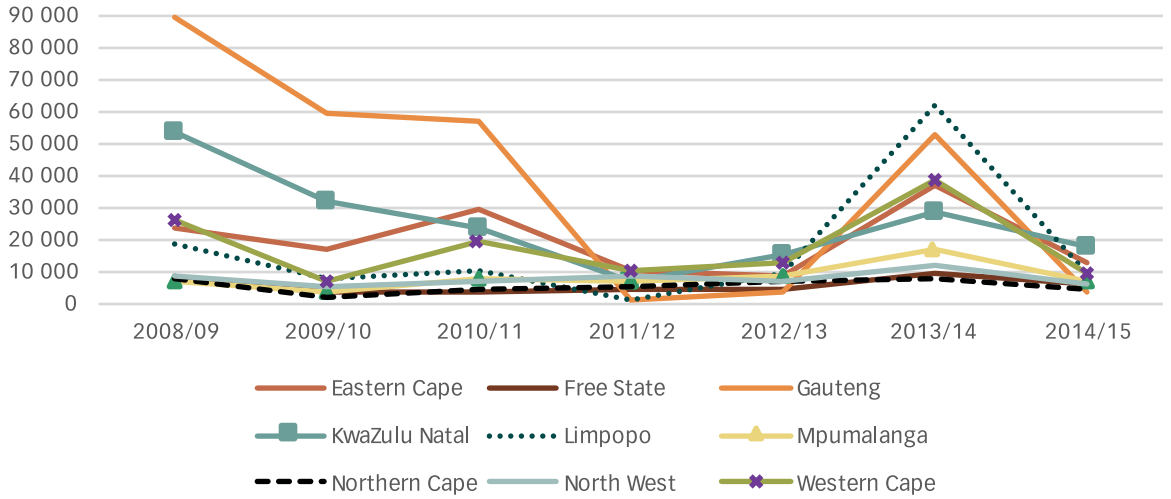


Source: COGTA (2015)

6.7.2 Work opportunities created via the EPWP

Figure 54 shows that the number of work opportunities created via the EPWP declined between 2008/09 (the onset of the global financial crisis) and 2012/13, with 2011/12 and 2012/13 showing particularly flat or stagnant growth. An explanation for the upswing after 2012/13 could be government's adoption of an infrastructure-led approach to growth. However, after peaking in 2013/14, the number of work opportunities created again declined.

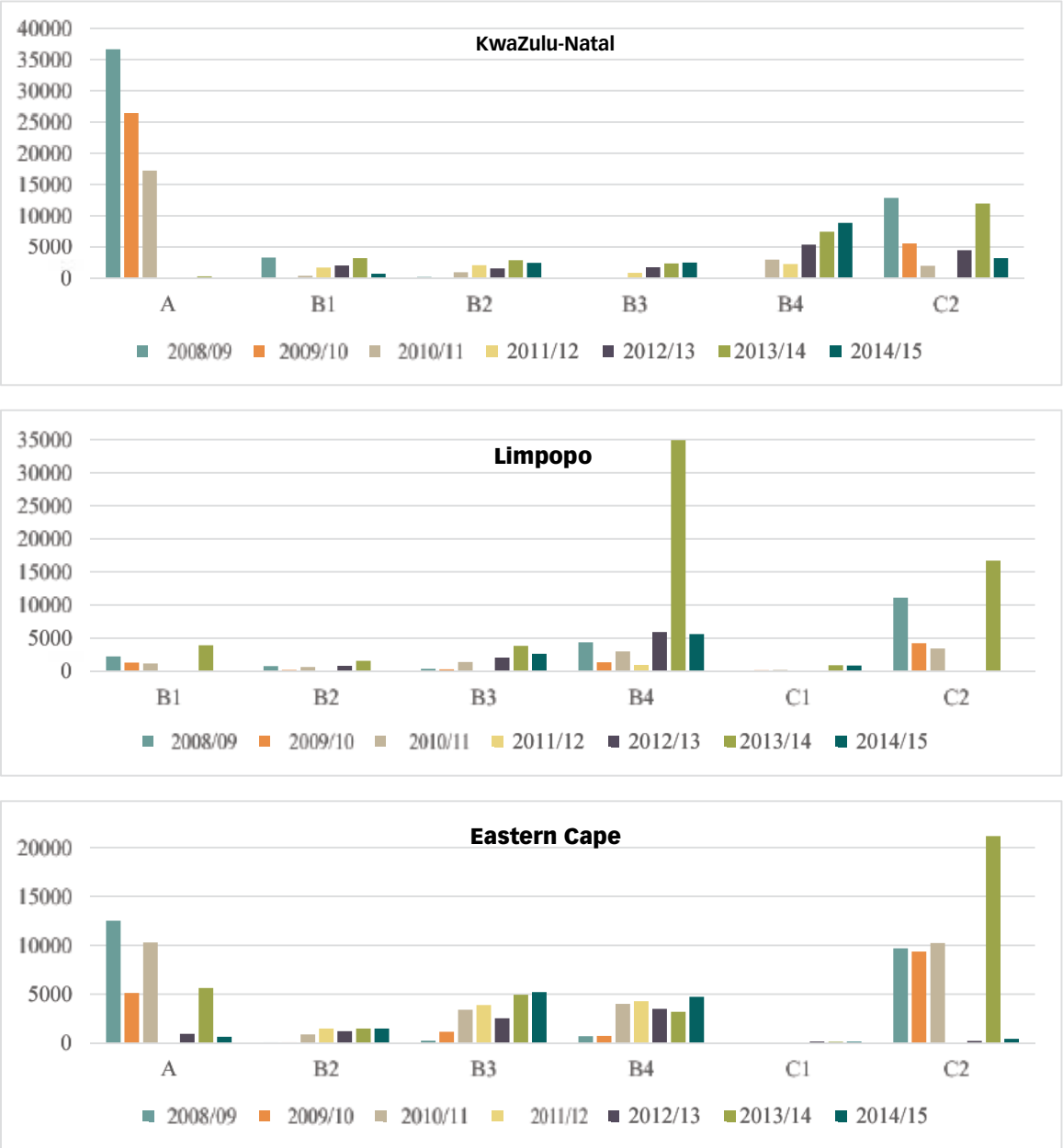
Figure 54. EPWP work opportunities created across the nine provinces (2008/09–2014/15)



Source: DPW (2015)

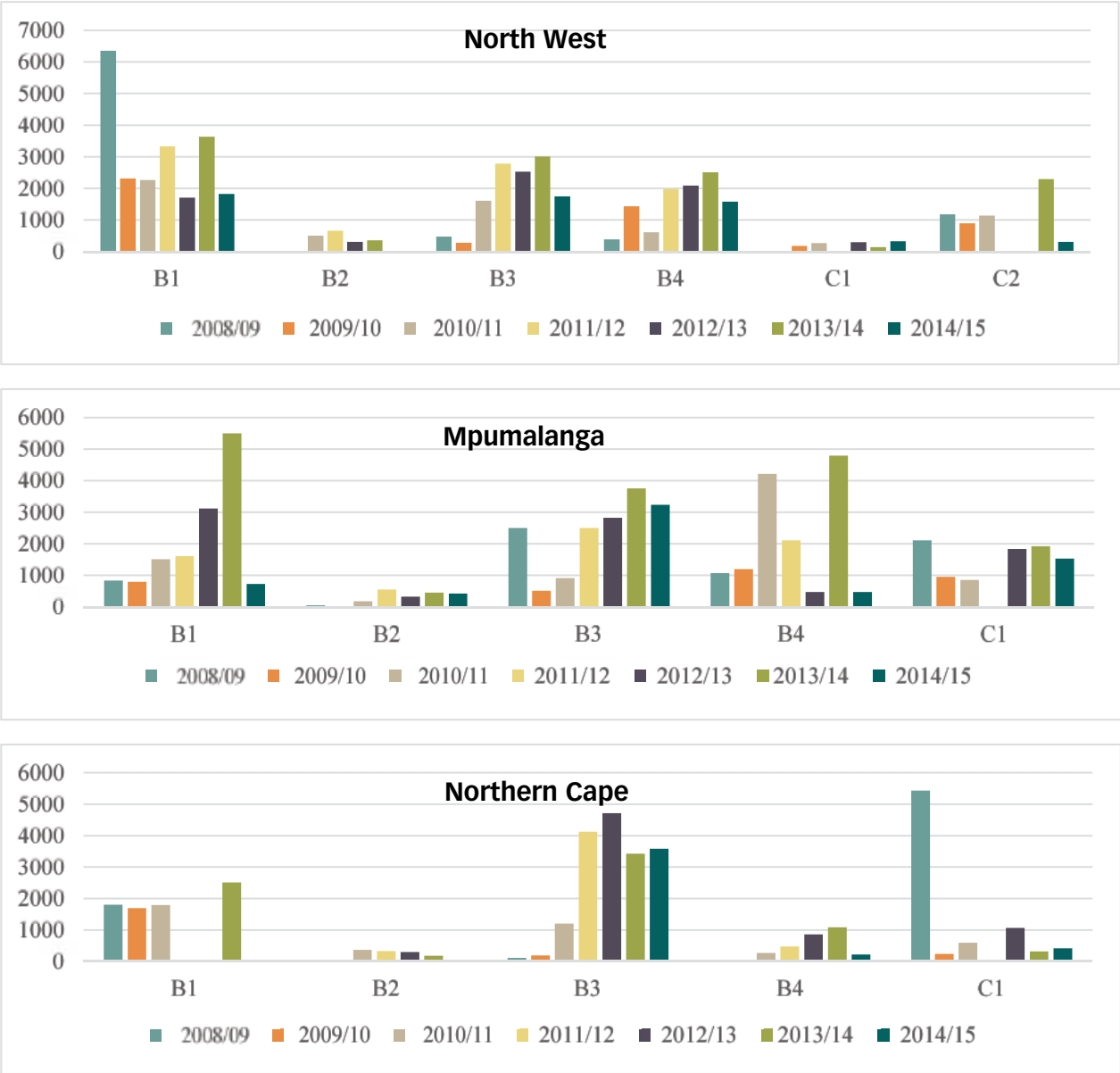
Disaggregating the work opportunities created in each province to the different municipal categories provides a more nuanced picture. Figure 69 shows the work opportunities created in the three provinces that contain the highest number of rural (B4) municipalities. In KwaZulu-Natal, initially most work opportunities were created in the metropolitan areas (category A municipalities), but from 2010/11 this trend starts to shift to rural (B4) municipalities, and by 2014/15, most work opportunities are found in the relatively more rural areas of KwaZulu-Natal. In Limpopo, work opportunities were concentrated in rural municipalities between 2008/09 and 2014/15, and especially so in 2013/14 when the number of work opportunities created were significantly higher in B4 municipalities than in other municipal categories. In the Eastern Cape, most work opportunities were created in the district municipalities, specifically the C2 municipalities (municipalities that are assigned the water function).

Figure 55. EPWP work opportunities created across three provinces with the highest number of rural (B4 and B3) municipalities (2008/09–2014/15)



Source: DPW (2015)

Figure 56. EPWP work opportunities created across three provinces with thesecond highest number of rural (B4 and B3) municipalities (2008/09–2014/15)



Source: DPW (2015)

Figure 56 illustrates the number of work opportunities created in the three provinces with the second highest number of rural municipalities. Between 2008/09 and 2014/15, work opportunities in the North West were concentrated in secondary cities (B1s), followed by small towns (B3s) and rural municipalities (B4s). In Mpumalanga, work opportunities were located in the small towns and rural municipalities, while in the Northern Cape they were mostly concentrated in the small towns and (to a lesser extent) secondary cities.

Figure 57. EPWP work opportunities created across three provinces with the least number of rural (B4 and B3) municipalities (2008/09–2014/15)

Source: DPW (2015)

Figure 57 shows the number of work opportunities created in the three provinces with the least number of B3 and B4 municipalities. In the Free State, the greatest number of work opportunities was in the small towns (B3s), whereas in the Western Cape and Gauteng, work opportunities were almost exclusively created in the metropolitan (category A) municipalities.

6.7.3 Work opportunities created within CWP

Between 2012/13 and 2014/15, the most work opportunities were created in the Eastern Cape, KwaZulu-Natal and Limpopo (Figure 58). Across the nine provinces, the number of work opportunities created increased between 2012/13 and 2013/14, but declined thereafter. This pattern is similar to that of the EPWP.

Figure 58. CWP job opportunities created across the nine provinces (2012/13–2014/15)

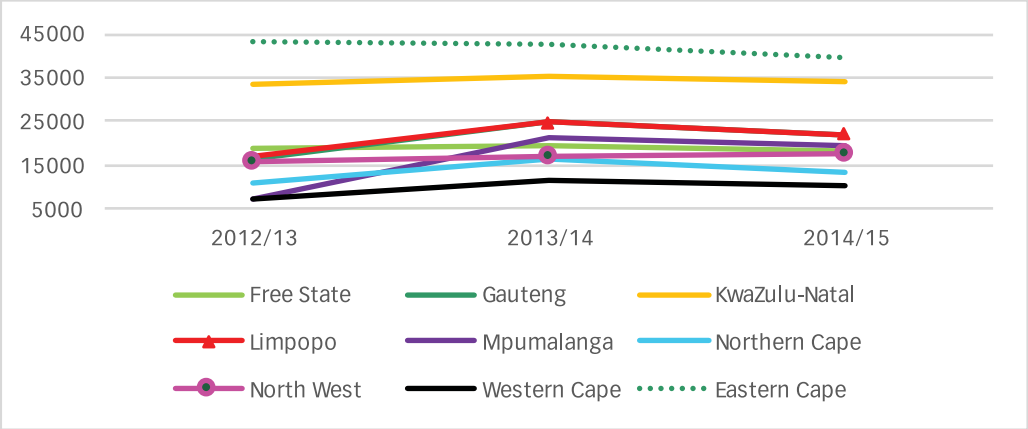


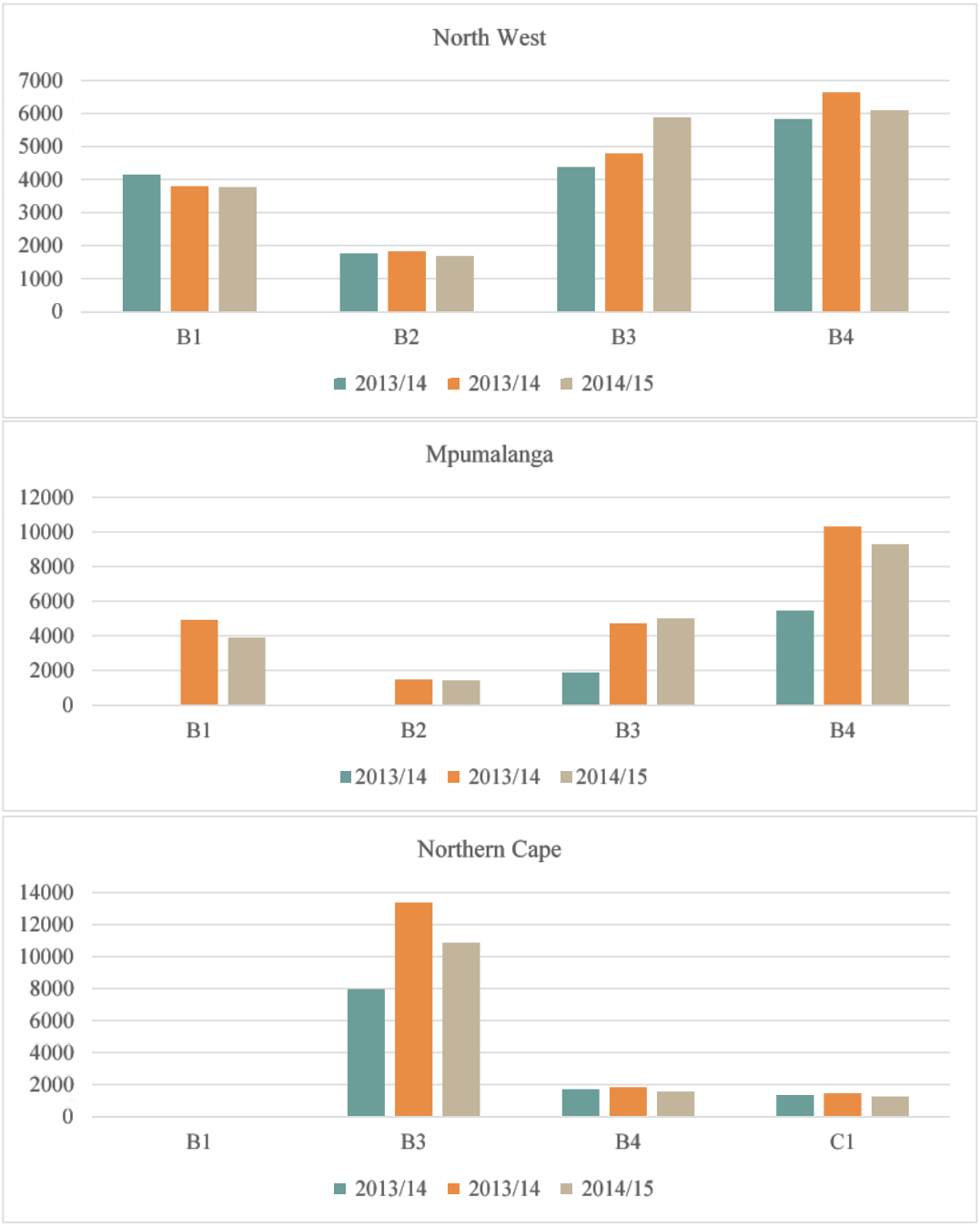
Figure 59 shows the work opportunities created through the CWP in the three provinces that contain the highest number of rural (B3 and B4) municipalities. Between 2012/13 and 2014/15, the majority of work opportunities were created in B3 and B4 municipalities.

Figure 59. CWP work opportunities created across the three provinces with the highest number of rural (B4 and B3) municipalities (2012/13–2014/15)

Source: COGTA (2015)

Figure 60 illustrates the number of work opportunities created in the three provinces with the second highest number of rural municipalities. Again, these opportunities were concentrated in the more rural (B3 and B4) municipalities.

Figure 60. CWP work opportunities created across the three provinces with the second highest number of rural (B4 and B3) municipalities (2012/13–2014/15)



Source: COGTA (2015)

Figure 61 shows work opportunities created in the three provinces that contain no B4 municipalities. Over the three-year period, most work opportunities in the Free State were created in small towns (B3s) and in metropolitan municipalities (in 2014/15), and in small towns (B3s) in the Western Cape. In Gauteng, most work opportunities were created in large towns (B2s) and metropolitan (A) municipalities.

Figure 61. CWP work opportunities created across the three provinces with the least number of rural (B4 and B3) municipalities (2012/13–2014/15)

Source: COGTA (2015)

Table 41 outlines the design and implementation features of the EPWP and CWP, and highlights key weaknesses per programme.

Table 41. Design and intergovernmental implementation of PEPs

Key Dimensions of the Implementation Model	EPWP	CWP
Target recipients	Across all sectors, the average age of participants is 36.4 years, and on average 1% of participants are persons living with disabilities, 58% of participants are female and come from households consisting of about 5.49 people (DPW, 2009a). Participants are employed in the social sector (45.8%) the environment and culture sector (30.6%) and in the infrastructure sector (23.6%)	The CWP targets areas with high levels of unemployment and, by design, focuses largely in rural areas. CWP local reference committees establish the mechanisms for selection and the recruitment of participants. These committees comprise representatives from local government, the local community and local civic society organisations. The CWP reaches the most vulnerable members of society (DPME, 2015: 22).
Identification of projects and targeting	Projects are identified according to specific sectors: infrastructure, environment and culture, and social sectors. At the planning and beginning of the identification process, municipalities are offered assistance, support and workshops that help them identify projects and ways to create work opportunities. Furthermore, public bodies are expected to develop a business plan that outlines how the grant will be used towards the projects and how many work opportunities the projects are intended to create. The major weakness in the identification process of rural projects is the influence of local elites and traditional leaders who may want to fast-track projects that serve their personal interests and may not benefit the community as a whole. Other weaknesses relate to the fact that projects are limited to certain sectors, which limits job creation, as more jobs could be created if the sectors were expanded.	The CWP is an area-based programme with project sites comprising various wards in a municipal area and located in areas of high unemployment and poverty levels. The programme prioritises labour-intensive activities (COGTA, 2011). The CWP local reference committee advises on the identification of community needs, work priorities and type of projects to implement. Political interference poses a major challenge in the selection of project sites and the identification of projects.
Employment conditions (e.g. stipend paid, number of work days, training)	Participants are paid a wage, which is set at a level that incentivises participation but not too high in order to avoid attracting individuals who are already employed. The duration of the work opportunity is linked to the duration of the project. Furthermore, the duration of work opportunity varies across the different sectors and spheres of government. On average, employment is six months in the environment and culture sector and four months in the infrastructure sector (DPW, 2009a). Participants receive accredited and non-accredited training, and the participants gain sector-specific skills. One of the weaknesses of these employment conditions is that participants are paid according to attendance and not necessarily according to the level of output/work for a day's work.	The programme offers participants a minimum number of regular days of work, typically two eight-hour days per week, eight days a month or 100 days a year. Although a part-time arrangement, the CWP is an on-going programme and therefore has no specific contract expiry date. Training is available to the programme participants and covers a wide range of skills in various industries. A widely reported weaknesses in the programme's employment conditions is the issue of non-payment by implementing agents. This could be due to the lack of banking services in rural areas.
Programme implementation and intergovernmental coordination	The EPWP is implemented by various public bodies, which include government departments, municipalities and service providers (e.g. subcontractors who only implement the labour-intensive component). Provincial steering committees, sector committees, district coordination forums and political forums in certain provinces facilitate intergovernmental engagements and coordination of the programme itself and all interactions between the departments and stakeholders or other public bodies. One issue is that participants do not always wanting to exit the programme at the end of the contract, which leads to labour unrest. Other implementation weaknesses are: stakeholders under-reporting work opportunities created, the money spent not equating to the reported work opportunities, full-time equivalent (FTE) targets not being met, and the incentive grant being underspent.	An implementing agent is appointed to develop a CWP project site, and provide financial, logistics and project management. Within each province, provincial departments in charge of local government are responsible for the planning, coordination and oversight of the programme. COGTA undertakes the overall management of the programme. Intergovernmental coordination is through local and provincial reference committees, and the CWP national steering committee. In certain municipalities, the CWP local reference committee structure is a duplication of existing structures and therefore could not be established. Implementation weaknesses relate to political interference and lack of good service delivery by the implementing agent in certain areas. Furthermore, it can sometimes take up to three months to authorise participants, which delays the implementation of the programme
Reporting	The DPW is responsible for reporting to Cabinet on the programme's progress, while provincial departments report to the national EPWP database. A major weakness in the reporting system is that work opportunities are under-reported. For example, participants require an identity document (ID) in order to be correctly captured on the system, and so for those who are part of the programme but have lost their IDs end up not being captured, which leads to the under-reporting of work opportunities. In addition, what is reported does not include the physical output, and the data reported is inconsistent. For instance the data reported by the EPWP unit differs from that reported by Stats SA.	Implementing agents are required to submit monthly financial and output reports, as well as EPWP monthly reports to COGTA. COGTA is responsible for reporting to Cabinet on the programme's progress. A weakness is that CWP data is not publicly available.

6.8 Intergovernmental Delivery Models of PEPs

Stakeholder interviews were conducted with various national and provincial officials, and evidence was obtained from external reports in order to shed light on the effectiveness of intergovernmental delivery models in rural targeting.

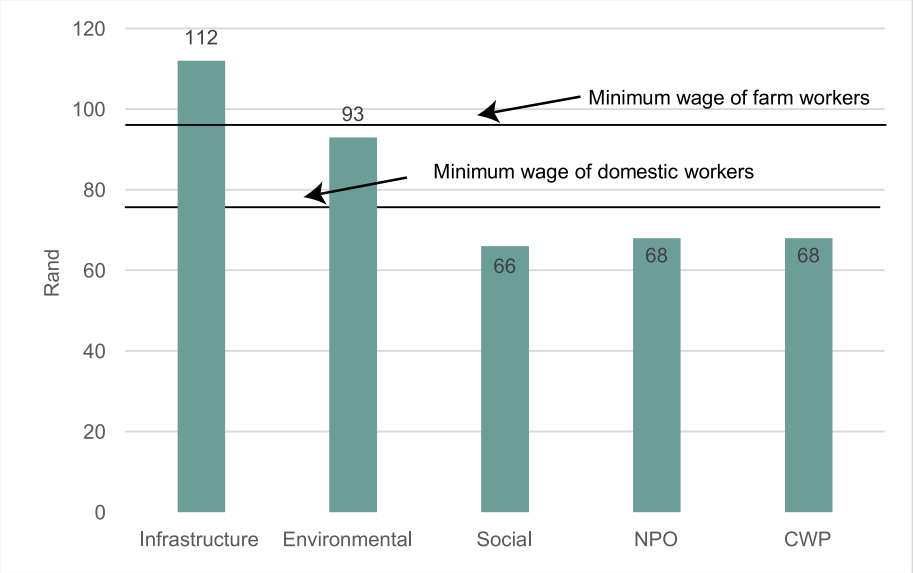
Suitable projects for the EPWP and CWP are identified in different ways. EPWP projects are sector-specific (infrastructure, environment and culture as well as social sectors), while CWP projects are area-based, with sites covering several wards in the municipal area. The CWP is a more effective programme because it is designed to suit the communities where the projects are implemented. It uses community participation to identify "useful work" and priorities. This means that the communities themselves own the assets created and the service delivered, and thus assets (such as roads, schools, libraries and clinics) would be maintained satisfactorily.

Unlike the EPWP, where the duration of employment is on average between four and six months, the CWP is a part-time arrangement but is ongoing: participants can remain on the programme for as long as they need to. This also makes the CWP less prone to labour unrest. In this regard, CWP is more effective at combating poverty – despite EPWP participants receiving training, only 25% of the participants who exit the programme get absorbed in the formal labour market, while 75% remain unemployed (Philip, 2013).

The two programmes are implemented differently. Various sector departments, municipalities and service providers implement the EPWP, whereas an implementing agent contracted by COGTA implements the CWP. The lack of technical capacity of municipalities is likely to affect the effectiveness of the EPWP. With respect to programme reporting, both programmes have weaknesses but, unlike the EPWP, CWP annual reports are not available in the public domain. Figure 62 shows the average daily rates for EPWP sectors and CWP compared to two minimum wage rates for domestic and farm workers.

In 2013/14, the daily minimum wage rate was R93 for farm workers and R77 for domestic workers. The average daily rates paid in the social and non-profit organisation (NPO) sectors of EPWP and CWP are below both minimum wage levels, although very close to the minimum wage of domestic workers. In the infrastructure sector, the daily rates are higher than both minimum wage levels, while the environmental sector's daily rates are on par with the minimum wage level for farm workers. This suggests that some employed individuals, particularly domestic workers, could be incentivised to switch from their current employment to an EPWP work opportunity, particularly in the infrastructure and environmental sectors. The lack of resources in some sectors, such as the social and NPO sectors, means that beneficiaries are sometimes paid below the minimum rate prescribed by the ministerial determination.

Figure 62. EPWP and CWP daily rates compared to domestic and farm workers (2013/14)



Source: DoL (2013)

6.9 Effectiveness of PEPs

Table 42 compares the effectiveness of EPWP and CWP (the EPWP is disaggregated by sector in order to present a nuanced analysis). Over the three-year period, the cost of creating one full-time equivalent (FTE) is significantly lower in the CWP than in the EPWP, with the exception of the NPO sector. In addition, costs vary considerably within the EPWP. For example, in 2013/14, one FTE in the infrastructure sector cost R119,387 compared to R17,370 in the NPO sector. In other words, to create seven FTEs in the NPO sector costs the same as one FTE in the infrastructure sector. The reason for the infrastructure sector's poor performance is partly because of its low labour-intensity rate, which in 2013/14 was only 16% compared to 59% for the CWP and 89% for the NPO sector.

The results from Table 42 clearly demonstrate that, despite pumping significant resources into the infrastructure sector over the past 10 years, government has received very little value for money. In comparison, government is achieving greater value for money in the CWP and the NPO and social sectors of the EPWP. Thus, the nature of the PEP activity being funded has a critical bearing on the impact of expenditure. Activities that are more labour-intensive, such as in the NPO sector, will naturally be more cost-effective in creating jobs. However, of note is the rising cost of creating one FTE in both the NPO sector and the CWP, although the cost escalation is much higher in the CWP. These increases are a result of higher management costs and better conditions of service attached to employment.

In 2013/14, a total of just over R18-billion was spent on creating 305 000 FTE jobs through PEPs. This is significantly below the one million jobs projected for 2015 in the National Development Plan (NDP). Interestingly, if government had spent all the PEPs funds exclusively in the NPO sector, it would have achieved its target of one million jobs. Moreover, if the funds had been spent exclusively on the CWP, a total of 685 000 FTE jobs would have been created in 2013/14. Therefore, if government wants to achieve the NDP target of two million FTE jobs by 2020, the nature of spending on PEPs would need to change, especially given the weaker economy, which is unlikely to be able to maintain continued growth in allocations to PEPs.

6.10 Conclusions and Recommendations

Government invests large sums of funding in indirect interventions, such as training programmes and bursary schemes, but it is difficult to gauge the success of these initiatives in transitioning unemployed individuals into full-time jobs. Other than PEPs, many job creation initiatives do not have an express rural focus and are not designed to absorb large numbers of unemployed individuals into any gainful employment. This suggests that PEPs are well-designed as an employment and social safety net, targeting the unemployed poor who are unlikely to find employment, even if conditions in the economy were to improve.

Although PEPs were not established with the express intent of addressing unemployment in rural areas, the CWP appears to be more effective than EPWP at creating employment opportunities in rural areas. This suggests that attributes of the CWP could be insightful in conceptualising and implementing other government initiatives aimed specifically at the rural space.

Allocations to PEPs are insufficient to fund all qualifying beneficiaries who want to participate. Therefore, PEPs need to prioritise the most needy, especially recipients who are unemployed and without access to any type of state grant. This implies giving special priority to rural areas through the various funding instruments, as urban municipalities have a larger tax base that enables them to complement targeted transfers with own revenue to support PEPs. Rural municipalities have much smaller tax bases and are largely dependent on transfers to create jobs through PEPs.

The daily rates and work duration currently offered by the PEPs are unlikely to lift a person out of poverty. Therefore, the critical policy issue is whether PEPs are intended to be a mechanism for poverty alleviation or merely an additional source of livelihood support. If policy-makers view PEPs as a poverty-alleviation mechanism, any push to alter the conditions of services significantly could blur the distinction between job opportunities created through PEPs and employment offered through the formal labour market. However, this may be less significant in rural areas, where economic activity is low and formal sector jobs are scarce. Instead, ways of reducing the costs of rural participation should be investigated, especially in relation to access to banking facilities and re-registration processes.

Table 42. Effectiveness of EPWP and CWP (2011/12–2013/14)

		2011/12	2012/13	2013/14
Expenditure (R'million)				
	Infrastructure	16 461.3	9 598.4	12 398.0
	Environmental and culture	2 038.6	217.0	2 103.2
	Social	1850.1	662.0	1 932.3
	NPOs	135.6	177.3	191.1
	CWP	623.5	1 289.9	1 721.7
Job opportunities				
	Infrastructure	374 591	N/A	391 555
	Environmental and culture	164 475	N/A	205 870
	Social	164 662	N/A	191 516
	NPOs	39 552	N/A	51 645
	CWP	105 218	205 494	172 000
Full-time equivalents (FTE)				
	Infrastructure	107 491	N/A	103 847
	Environmental and culture	52 203	N/A	59 076
	Social	67 297	N/A	67 447
	NPOs	9 974	N/A	11 003
	CWP	33 167	52 714	64 313
Cost per FTE (Rand)				
EPWP				
	Infrastructure	153 141	N/A	119 387
	Environmental and culture	39 051	N/A	35 602
	Social	27 491	N/A	28 649
	NPOs	13 591	N/A	17 370
	CWP	18 799	24 470	26 771
Labour intensity				
	Infrastructure	12%	N/A	16%
	Environmental and culture	40%	N/A	53%
	Social	37%	N/A	58%
	NPOs	70%	N/A	89%
	CWP	59%	59%	59%

Source: ENE (2016), Public Works (2015), Presidency, 2015; Commission Calculations[35],[36]

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[35] The estimate for labour intensity was derived by dividing the expenditure on recipient wages by the total expenditure.

[36] To estimate FTEs, the duration of work opportunities was divided by 230 days (FTE), and then that total was multiplied by the number of work opportunities.

From a policy perspective, an important consideration for allocating resources is the potential trade-off between improved service conditions and expanding the programme. Increasing daily rates or average work durations may come at the cost of slower expansion of the programme, unless budgets are increased proportionately.

Clearly the nature of PEP spending needs to change if government is going to come close to reaching the NDP target of creating two million FTE jobs by 2020. The cost of creating job opportunities through infrastructure is unaffordable, even though government's growth strategy is infrastructure-led. More jobs can be created with fewer resources, if more funds are directed to CWP and social and NPO sectors of the EPWP, which are more labour-intensive and have activities that are easily implementable in rural areas.

A critical weakness in both the EPWP and CWP is the lack of training opportunities afforded to participants. If PEPs are going to be a vehicle for transitioning individuals into full-time employment, recipients should be provided with appropriate training, especially in entrepreneurship and business skills. These skills are more likely to encourage individuals to create their own enterprises, if the formal labour market remains rigid and is incapable of absorbing the unemployed poor.

With respect to creating conditions for rural job creation from PEPs, the Commission recommends that:

1. Government, through the dti, National Treasury, the Department of Social Development and the Department of Public Works, considers narrowing the focus of PEPs and using the CWP and the social and NPO sectors of the EPWP, as an explicit strategy for addressing rural poverty. Work opportunities created in these sectors are the most cost-effective and labour-intensive, and easily implementable in rural areas.

    - Ways of reducing the costs of rural participation in PEPs should be explored, including easier accessibility to services such as banks and re-registration processes.

2. Priority is given to unemployed individuals without access to a grant, as PEP funding is insufficient to cover all unemployed. At present, many participants either receive a social grant or are employed elsewhere. Government should also carefully balance the need to improve the conditions of employment and the need to expand PEPs.

3. The Department of Public Works and National Treasury ensure that EPWP grant frameworks in the Division of Revenue Act include an explicit condition that appropriate training of recipients (especially in skills that promote self-employment) is mandatory, given that only a small portion of EPWP beneficiaries transition into formal sector jobs. An assessment of microenterprises in rural areas that are viable self-employment options should be conducted and inform the roll-out of training programmes to EPWP beneficiaries.

4. Funding of job creation initiatives is viewed in an integrated way, with priority given to programmes that absorb unemployed poor individuals, especially if they are targeting high unemployment nodes in B3 and B4 municipalities.

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Appendix

Provincial ranking according to composite rural index

	% Share of B3 and B4 municipalities in each Province (A)	% Share of B4 municipalities in each Province (B)	Composite average of (A) and (B)	Rural ranking
EASTERN CAPE	87%	38%	63%	3
FREE STATE	75%	0%	38%	7
GAUTENG	8%	0%	4%	9
KWAZULU-NATAL	79%	54%	66%	2
LIMPOPO	92%	64%	78%	1
MPUMALANGA	67%	28%	47%	6
NORTHERN CAPE	92%	4%	48%	5
NORTH WEST	74%	26%	50%	4
WESTERN CAPE	60%	0%	30%	8

Paper/Authors	Research Question	Methodology	Data Sources (e.g. case studies/datasets used)
Antonopoulos and Kim (2011)	Analysing the direct and indirect job creation and the distributional impacts of social care expansion through employment, or rather, through public job creation programmes	• Social Accounting Matrix (SAM)-based multiplier analysis • Input-output analysis at the macro level • Use of the microsimulation model at the micro level	Case studies: South Africa and the USA • The original South African SAM includes 26 productive sectors and 20 different household types decomposed by location, residence type, race and three-tiered income level • The employment multiplier matrix is computed from the US input-output table, which includes 201 detailed industries
Dicks et al. (2011)	Investigating the relationship between social security interventions and public employment programmes: • Identify the interaction and possible synergies between EPWP and social security transfers and explore how one or a combination of these initiatives impacts on households • Investigate what changes could improve the manner in which these initiatives complement each other and increase their impact on reducing poverty and promoting decent work Review the existing social security interventions and how these may be structured to support an employment growing economy through the Decent Work Agenda (DWA) lens	Descriptive analysis	• Survey data: - the EPWP longitudinal survey conducted by the Department of Public Works (DPW) and the Community Works Programme(CWP) site survey by the Right to Work Programme • Informant interviews and two focus group discussions conducted by the National Labour and Economic Development Institute (NALEDI)
Haddad and Adato (2001)	How efficiently do public works programmes transfer benefits to the poor? Put differently, how many rands of public funds does it take to transfer one rand to a poor worker?	Cost-benefit analysis; an extension of Ravallion's (1999) analytical framework which is largely based on rapid appraisal methods	Project-level data collected by the authors in the Western Cape. In particular, information on 101 public works projects conducted in the province between 1995–1997 is merged with the October household survey data from the 25 magisterial districts in which the projects were based.

Paper/Authors	Research Question	Methodology	Data Sources (e.g. case studies/datasets used)
Hoddinott et al. (2001)	The relationship between community participation and the efficacy of public works interventions, or rather, the impact of participation on the efficacy of public works interventions	Multivariate analysis	The data is derived from a study of public works programmes in the Western Cape, conducted between 1996 and 1998 by the International Food Policy Research Institute (IFPRI) and the Southern Africa Labour and Development Research Unit (SALDRU) at the University of Cape Town Project-quantitative and qualitative data on: • Institutional arrangements between government, communities, and the private sector; types of community participation; project outcomes
Hough and Prozesky (2012)	Investigating beneficiaries' desire for permanent employment in the Working for Water (WfW) programme. In particular: • Why did beneficiaries enter the WfW? • Do beneficiaries engage in other employment in between contracts? • What are the beneficiaries' aspirations for long-term WfW employment?	Multi-site case study in the Western Cape	Sampling of four WfW projects: • Hottentots Holland (HH) NR Project; • Riviersonderend (RSE) Mountain Catchment Area Project; • Marloth NR WfW project; and • De Hoop NR Project Stratified systematic sampling was used to select a random sample of 214 beneficiaries and then face-to-face interviews were conducted
Khosa (1998)	• What is the relationship between the geographical distribution of the projects in various magisterial districts with the highest rate of unemployment and poverty? • Do the Community Empowerment Programme (CEP) funded projects reduce unemployment by creating job opportunities for both unemployed men and women? • Do projects result in the transfer of skills and training? • Do projects give rise to the creation and maintenance of physical assets in order to improve the quality of life of poor communities?	Descriptive analysis: evaluation of 120 community-based public works projects in KwaZulu-Natal	• The Independent Development Trust (IDT) database • Information from the regional office of the Department of Public Works in KwaZulu-Natal • Geographical Information System (GIS) Unit of the Human Sciences Research Council for information on poverty, unemployment and employment, water and sanitation, infrastructure existing in various magisterial districts.
McCord and Van Seventer (2004)	The performance of public works programmes in addressing both micro-economic and macroeconomic policy objectives relating to employment, growth and poverty reduction	Microeconomic analysis and a macroeconomic analysis using the SAM model	Survey and budget data from the Gundo Lashu public works programme in the Limpopo Province collected in collaboration with the Limpopo Roads Authority. Microeconomic analysis: Random one-stage survey administered to 263 households within the district of Capricorn. Macroeconomic analysis - using SAM: Budgetary information derived from the Gundo Lashu public works programme.
Philip (2012)	The paper makes the case for an employment guarantee in South Africa whereby the unemployed would have a right to a minimum level of work.	A case study relating to the Indian employment guarantee system espoused under the banner of the Mahatma Gandhi National Rural Guarantee Act is used as a point of reference.	Qualitative analysis underpinned by extensive literature review and case study.

CHAPTER 7

Enhancing Domestic Resource Mobilisation for Effective Rural Development and Growth: The Role of Provinces Taxation

Thando Ngozo

Enhancing Domestic Resource Mobilisation for Effective Rural Development and Growth: The Role of Provinces Taxation

7.1 Introduction

The New Growth Path and the National Development Plan outline programmes to overcome income and asset poverty, chronic unemployment and food insecurity in rural areas. These policy documents state clearly that multiple interventions are needed over the next two decades in order to place rural areas on more sustainable development paths. They advocate for both farm and non-farm rural employment, the creation of a broad suite of green economy initiatives in rural areas and the delivery of rural services.

The meaning of rural development varies but, essentially, it is about addressing poverty and improving the quality of life for people living in rural areas. The democratic government that came to power in 1994 inherited poverty-stricken rural areas characterised by overcrowding and underdevelopment (May, 2000). Therefore, the agenda of the new government included redressing the past to improve the living standards of the majority who were living in poverty and who mostly resided in rural areas (Kole, 2005). This was reflected in various government development policy documents, programmes and strategies that have been developed since 1994 (Gwanya, 2010; Kole, 2005).

The funding of rural development is intertwined with fiscal design. Theoretically, subnational governments should provide constituents with services whose cost is equal to the benefit (i.e. the value of the services). This can only happen if subnational governments have the authority and are in a financial position to raise their own taxes. This means decentralised revenue policy, which relates to three dimensions: the assignment of revenue sources to government spheres, the degree of autonomy with which subnational governments can exercise their assigned authority, and the efficiency of the revenue administration system.

In South Africa, the intergovernmental system is sound, but concurrent functions occasionally present particular challenges and test the system's robustness. The sometimes imperfect alignment between policy-making and resource allocation results in a divergence between policy intentions and actual outcomes. Therefore, budgets provide an important connection between policy objectives and policy outcomes. Policies that are not funded or are inadequately funded are hardly implemented, and their objectives are therefore not properly realised.

The performance of the intergovernmental system in general, and provinces in particular, is important in improving the quality of life of South Africans. According to Schedule 4 (Part A) of the Constitution, rural development is a concurrent responsibility of national and provincial governments. Therefore, provinces should play a crucial role in rural development. National transfers (the provincial equitable share (PES) and conditional grants) comprise the largest share of funding for services delivered by provinces, while provincial own revenue remains a small portion of total provincial revenue.

The main objectives of this chapter are

- To explore the scope for increasing provincial own-revenue streams.
- To investigate the drivers behind the decline of own revenue in rural provinces and the necessary remedial actions needed to stem the tide.
- To determine whether the lack of accountability for spending provincial fiscal transfers represents a moral hazard problem, and if yes, how it can be rectified.
- To examine the shared tax base model as a viable alternative for provinces.

7.1.1 Overview and problem statement

Provinces receive three forms of revenue: the PES, provincial conditional grants and own revenue. They have limited revenue-raising powers and so collect insignificant own revenues. In 2014/15, own revenues accounted for just 3% of provincial budgets and are projected to decline to 2.9% in 2016/17. National transfers are also likely to remain stagnant or decline because of fiscal constraints, and so transfers to provinces will grow more slowly in the future. It is worth noting that own income is healthy in urban provinces but declining in rural provinces. For instance, between 2013/14 and 2016/17, the annual average growth rate of own revenue was -7.2% in the Eastern Cape compared to 3.4% in Gauteng. Therefore, the potential of increasing provincial own revenues (particulary in rural provinces) needs to be explored.

7.1.2 Cogent reasons for assessing provincial own revenue

The literature (and indeed practice) is filled with studies and experiences that point to some obvious drawbacks of taxes in general (Stiglitz, 1999) and a lack of interest on the part of authorities in raising taxes. It is well known that most forms of taxation impose economic costs by distorting decisions on such matters as whether to incorporate (or become informal), the debt-equity ratio, dividend policy, and where and how much to invest. The economic case against taxes seems even stronger at the subnational level than at the national level. Some of the reasons identified include:

- Resource mobility is higher across provincial and regional boundaries than national boundaries.
- Provincial budgeting is difficult because of the unpredictability of the tax yield.
- The national government's scope for increasing national tax rates is restricted if provincial tax rates combined with local and national taxes exceed a certain desirable magnitude.
- Cross-border shopping poses problems, as it weakens accountability (since some provincial taxes would be paid by non-residents) and potentially result in suboptimal tax rates ("race to the bottom" hypothesis).
- Agents have to carry a compliance burden, especially where frequent changes require stock repricing or where businesses supply customers who are located in many different areas.

The Commission argues that own revenue is important for funding rural development, in particular because of two reasons.

- It reduces dependence on grants and fosters accountability. The overall system of provincial government finance is generally unsatisfactory. Subnational governments that rely on own-revenue sources (rather than grants) are more responsive to the needs of residents and businesses, and to the overall long-term needs of the province. Provincial own revenue removes the negative implications inherent in grant financing, which places substantial power in the hands of individual national officials able to influence the continuing grant flow and removes responsibility from provincial governments since they can legitimately argue that the feasibility of delivering services is dependent on national government rather than the province itself. Additional own tax is attractive for two reasons: (a) The burden of paying for additional local spending is spread across more than one tax base, and so the provincial tax burden is distributed more fairly, across taxpayers and (b) a reduction in gearing might help to reduce the influence of central government over provincial government, by reducing the percentage increase in own taxes following any given percentage change in budget or grant.
- It fosters efficiency. Provincial taxation will incentivise the rural province to act in ways which expand the local economy. In so doing, the tax base will be expanded and thus the revenues of the province will grow, offering scope for further improvements and further growth. Implicitly the argument here is that "nationalising" parts of provincial own revenue has left provincial governments with little incentive to attract province-specific economic activity; reintroducing some form of provincial taxation might help restore a better mutual awareness between business and provincial government. The counter argument is that this premise is false because provincial government has not sought to attract business using existing instruments, such as charges/surcharges on services, development and tourism. Nevertheless, in the current context, what is needed is careful consideration of whether a rural tax would be a better way of fostering the relationship between provincial government and business than the alternative handles that are already available.

7.1.3 Constitutional revenue-raising powers for provinces

The revenue system in South Africa is based on the principles of uniformity, harmony, and efficiency, although the assignment of revenue functions involves lower fiscal autonomy for subnational governments. All broad-based taxes are assigned to the national government, while narrow-based taxes are assigned to provincial authorities (Khumalo and Rao, 2004).

According to Section 228(1) of the Constitution, provinces have the right to levy certain taxes and surcharges, i.e. flat-rate surcharges on any tax, levy or duty that is imposed by national legislation, except for corporate income tax, value-added tax (VAT), excise levies or property taxes (Mabugu et al., 2009). Provinces may impose these taxes provided they do not prejudice national economic policies, economic activities across provincial boundaries and national goods and services or factor mobility (Ajam, 2006). No province has exercised its taxation or surcharge powers. The Constitution gives provinces some leeway to augment own revenues but fails to provide specific details of other tax bases on which provinces could impose levies or surcharges.

7.2 Literature Review on Subnational Taxes Applicable to Provinces

The literature suggests that the following sources of own revenues are available to provinces: automotive and fuel taxation, surcharges on a nationally uniform personal income tax (PIT), a provincial value added tax (VAT) and a business value tax (BVT).

7.2.1 Vehicle-related taxes

The potential of vehicle-related taxes at subnational level could be exploited more fully (Bahl and Linn, 1992). From a revenue perspective, the fuel tax is the most important tax and the simplest and cheapest form of vehicle tax to administer. Provinces could choose to impose different taxes, but the constraint would be the inability to differentiate much from the rates imposed by neighbouring provinces owing to the mobility of the tax base (ibid).

The subnational taxation of motor vehicles is often designed and implemented poorly, but it remains a fundamentally good tax for provinces. The design of any vehicle taxation system needs to be carefully considered (Smith, 1991), particularly in developing countries, to avoid repeating the mistakes of most developed countries and to achieve more revenue and better economic effects. Provincial revenues could be increased by allowing provincial governments some access to the fuel tax and allowing them to impose variable provincial surcharges. Vehicle and fuel taxation seems to be the only universally available subnational revenue source that exhibits more than unitary income-elasticity, thereby matching this aspect of some of the key services (such as education and health) for which provincial governments are responsible.

7.2.2 Personal income taxes

Canada and Scandinavia provide evidence of supplementary subnational PITs that can increase provincial own revenues, so that provinces can expand their activities or become more self-reliant. A subnational PIT is visible and so enhances greater political responsibility and accountability. The Nordic countries (Denmark, Finland, Norway, Sweden), where subnational governments have large expenditure roles and are mostly fiscally autonomous, offer the best-known examples of subnational income taxes. These subnational income taxes are basically levied at a flat, subnationally determined rate on the same tax base as the national income tax and collected by the central government (Soderstrom, 1991).

In most developing countries, subnational income taxation does not exist because (in most instances) of the rationale that central governments prefer to collect income tax themselves. And yet the reality is that even central governments appear to find it difficult to collect much from income tax (Bird and Zolt, 2005).

In practice, a subnational PIT could reach the same tax base as a subnational payroll tax. However, subnational PITs have to be linked to specific employees and so would be more costly to administer. Although a provincial payroll tax should be considered as a possible revenue source in large emerging countries, surcharges on a nationally uniform PIT base are in principle a more appropriate way for subnational governments to tax wages.

7.2.3 General consumption taxes (VAT)

A subnational revenue source, which is economically respectable, administratively viable and broad based with reasonable elasticity, is a general sales tax, which in most countries takes the form of VAT.

The dominance of VAT poses a serious problem for the finances of subnational governments (Keen and Lockwood, 2006). The conventional consensus is that a central VAT is the only good VAT and subnational VATs are either unfeasible or undesirable for a variety of reasons, such as high administrative and compliance costs, the possible loss of macroeconomic control, the general reluctance of central governments to share VAT room, and the problems arising from cross-border and inter-provincial trade (ibid). However, a well-functioning, destination-based, subnational VAT is now in existence in Canada (Bird et al., 2006). The Canadian experience shows that with good tax administration, a destination-based, subnational VAT at provincial level is perfectly feasible. However, a common base is highly desirable and a single administration is clearly more efficient, while a high degree of intergovernmental trust is required if the system is to work efficiently.

In terms of accountability, a subnational PIT appears preferable to a subnational VAT in most respects. However, in most countries, enforcing effective PITs is a challenge, and so an effective VAT could be an important additional way to strengthen regional tax revenues, especially when provincial governments have large spending responsibilities that require them to have control of, and responsibility for, some major revenue sources.

7.2.4 Business taxes (BVT)

Another important source of subnational tax is business taxes, which include corporate income taxes, capital taxes, non-residential property taxes, as well as ancient levies and various forms of industry and commerce taxes. Subnational business taxes often produce substantial revenue and are more elastic than property taxes.

Experience in both developed and developing countries suggests that some form of business taxation is generally

the most elastic source of revenue at subnational level. However, estimating the incidence of such taxes is difficult because of the assumption that they are paid by someone other than local residents. Where possible, subnational governments are inevitably tempted to impose taxes on someone else, rather than to increase the home, income or consumption taxes of their citizen-voters.

Tax experts are not enthusiastic about subnational business taxes because their impact is not well understood, and the evidence in most countries appears to be that business taxes usually exceed business benefits (McLure, 1994). Therefore, the main question is how subnational governments can realise the potential virtues of subnational business taxation (an essentially elastic revenue source that provides increased autonomy), while minimising problems, such as economic distortions, high administrative costs and exporting benefit taxes to non-residents. One answer is to impose a BVT. Businesses add value by combining labour and capital with other purchased inputs. The value added by labour is the cost of labour (wages and salaries), while the value added by capital is the cost of capital (both debt and equity). The tax base would consist of revenues less purchases of inputs (except labour).

Compared to a conventional value-added tax (VAT), a BVT has three important distinguishing features:

- It is a tax on income, not consumption, and so is imposed on profits as well as wages, i.e. on both investment and consumption.
- It is a tax on production, not consumption, and so is imposed on an origin rather than a destination basis, i.e. in effect it taxes exports, not imports.
- It would be assessed on the basis of accounting records (or equivalent estimates) rather than on a transaction basis and collected annually (or by periodic payments) based on an annual assessment.

Studies have highlighted that badly designed and implemented local business taxation systems can be a barrier to the growth of micro and small enterprises (World Bank, 2007). The BVT offers a potential solution to this problem and to local government revenue problems, particularly in large and expanding urban areas, and so deserves more detailed examination in many emerging countries.

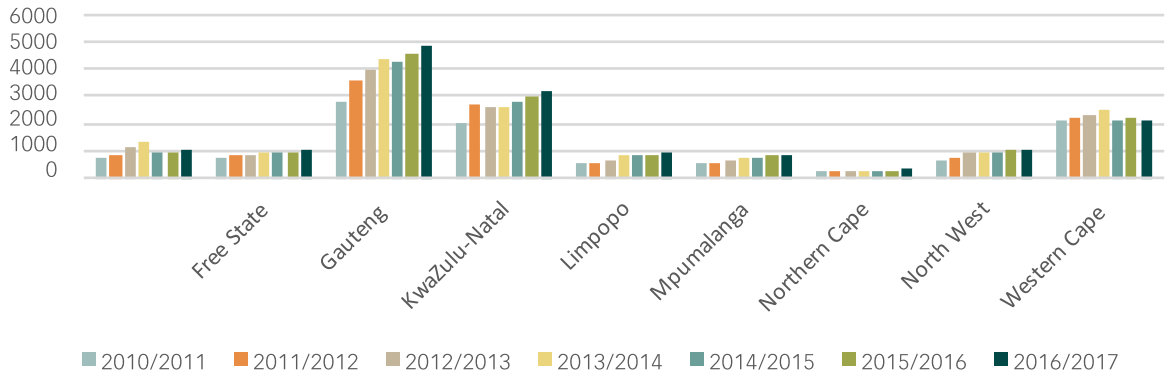
7.3 Provincial Own-Revenue Analysis[37]

7.3.1 Provincial own revenues by province

Between 2010/11 and 2016/17, Gauteng, KwaZulu-Natal and Western Cape consistently generated more own revenues than the other six provinces (Figure 63). In 2010/11, Gauteng generated R2.8-billion in own revenues, or 28% of total provincial own revenues, followed by Western Cape (R2-billion or 20%) and KwaZulu-Natal (R1.9-billion or 19%). The provinces that generated the least own revenues were the Northern Cape (R213-million or 2%), Mpumalanga (R528-million or 5.1%) and Limpopo (R551-million or 5.4%).

Medium-term projections show that, in 2016/17, Gauteng will continue to generate the highest amount of own revenue (R4.8-billion, or 32% of total provincial own revenues), followed by KwaZulu-Natal (R3.1-billion or 21%) and the Western Cape (R2.1-billion or 14%). The projections also show that the Northern Cape will continue to generate the least own revenue (R313-million or 2%) followed by Mpumalanga (R838-million or 5%) and Limpopo (R919-million or 6%).

Figure 63. Provincial own revenue (2010/11–2016/17)



Source: National Treasury

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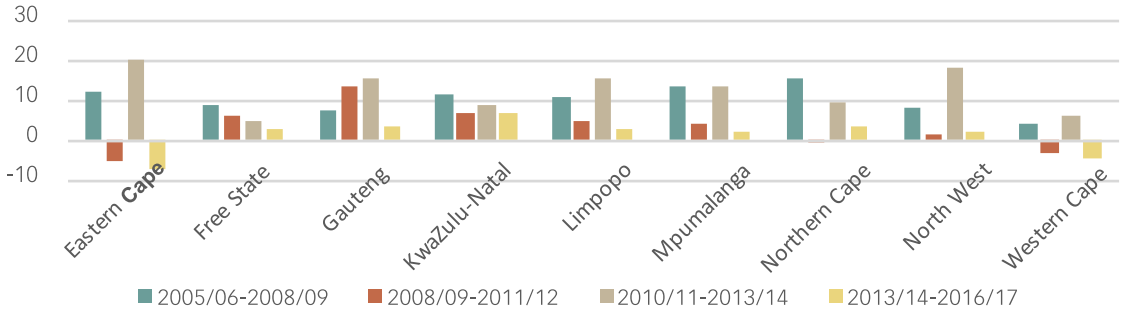
[37] All the data in this section has been sourced from National Treasury's provincial database

7.3.2 Growth in provincial own revenues

The growth in own revenue shows a mixed picture across provinces (Figure 64).

Figure 64. Growth in own revenue (2005/06–2016/17)



Source: National Treasury

The analysis of annual percentage growth in provincial own revenues show that own revenues have generally been declining and the projections show a further decline for the medium term. Between 2005/06 and 2008/09, percentage growth in provincial own revenue was 8.6%, it decelerated to 4.9% between 2008/09 and 2011/12 before increasing to 12.5% between 2010/11 and 2013/14. Between 2013/14 and 2016/17 the percentage growth in provincial own revenue is projected to decrease substantially to a mere 1.8%. This is mainly attributed to the fact that while provinces are responsible for functions that account for a large share of government spending, they have limited revenue-raising opportunities. The decline may also be attributed to strong growth in national transfers to provinces. Provinces also prefer not to commit their projected own revenues in their budgets and like to use over-collections as in-year discretionary funding.

The differential analysis of annual percentage growth by provinces shows a mixed picture. The analysis show that for some periods, rural provinces were able to record higher annual percentage growth in own-revenues than urban provinces reflecting higher efficiencies in their own-revenue collection mechanisms. While the Northern Cape and Mpumalanga generated the least own revenues between 2005/06 and 2008/09, they recorded the highest percentage growth in own revenues over the same period. This could potentially suggest their higher efficiency in own revenue collections when compared with the other provinces, notwithstanding their rurality. However, the picture changed between 2008/09 and 2011/12, as Gauteng and KwaZulu-Natal, predominantly urban provinces, recorded the highest percentage growth in own revenues over this period. This suggests that not only did these provinces generate more own revenues but they were also more efficient in doing so when compared with other provinces over this period. Between 2010/11 and 2013/14, the Eastern Cape and North West, largely rural provinces, recorded the highest percentage growth in provincial own revenues even though they generated the least revenue compared with the urban provinces. This suggests that over this period these provinces were more efficient in own revenue collection when compared with other provinces. Between 2013/14 and 2016/17, KwaZulu-Natal and Gauteng, effectively urban provinces, are projected to record the highest percentage growth in provincial own revenues, suggesting more efficiency in their own revenue collection than the other provinces.

7.3.3 Composition of provincial own revenues

Provinces generate their own revenues from tax receipts (casino taxes, horse racing taxes, liquor licences and motor vehicle licences). In 2016/17, tax receipts are expected to account for 70.1% of provincial own revenue, having increased from 49.5% to 64.5% between 2001/02 and 2013/14. Motor vehicle licence fees are the most significant source of own revenues for provinces, followed by casino tax, horse racing tax and liquor licence taxes (Figure 65).

Figure 65. Provincial own revenue by category (2001/02–2016/17)

Source: National Treasury

Motor vehicle taxes

Historically motor vehicle licences have been the major source of provincial own tax revenue in South Africa. As Figure 65 shows, motor vehicle licences represented over half total provincial own revenue in 2015/16, but the growth has remained fairly stagnant over the past 15 years, growing by an average 2.5% per year. Thus the most important source of provincial own revenue records only moderate growth.

Between 2005/06 and 2014/15, motor vehicle licences represented 89% of the provincial own revenue in the Free State, 86% in the Northern Cape, 85% in Limpopo and 83% in Mpumalanga, compared to 73% in the Western Cape and 74% in Gauteng and KwaZulu-Natal.

Casino tax

Tax from casinos is the second most important source of own revenues for provinces, representing 13.1% of total own revenue in 2014/15. This share is expected to rise to 13.9% by 2016/17. The average annual percentage growth of casino tax was 8.61% between 2001/02 and 2007/08, but decelerated significantly to -0.31% between 2008/09 and 2013/14 before recovering marginally to 2.01% between 2014/15 and 2016/17. This means that the second major source of provincial own revenue is mostly experiencing negative growth.

Between 2005/06 and 2014/15, casino licence taxes made up 24.3% of Gauteng's own revenues, the highest share of all provinces, followed closely by the Western Cape (24%), the North West (21.9%) and KwaZulu-Natal (21.5%). In contrast, casino licence taxes contributed just 8% of provincial own revenue in the Free State, 10% in Limpopo and 12% in the Northern Cape.

Horse racing tax

Horse racing tax, the third major source of provincial own tax revenue, contributes less than 2% to total provincial own revenue, having decreased from 3.1% in 2001/02. However, in terms of average annual percentage growth, horse racing taxes increased by 0.57% between 2008/09 and 2013/14 and 14.67% between 2014/15 and 2016/17. This means that the third major source of provincial own revenues has, on the main, been marginally increasing.

Between 2005/06 and 2014/15, horse racing taxes represented an average of 6% of the North West's total own revenue, followed by KwaZulu-Natal (4%), Limpopo (3%) and the Western Cape (2%). In the Northern Cape, the horse racing tax contributed an average of 0.61% to provincial own revenue, compared to 1.59% in Gauteng and 1.76% in the Eastern Cape.

Liquor licences tax

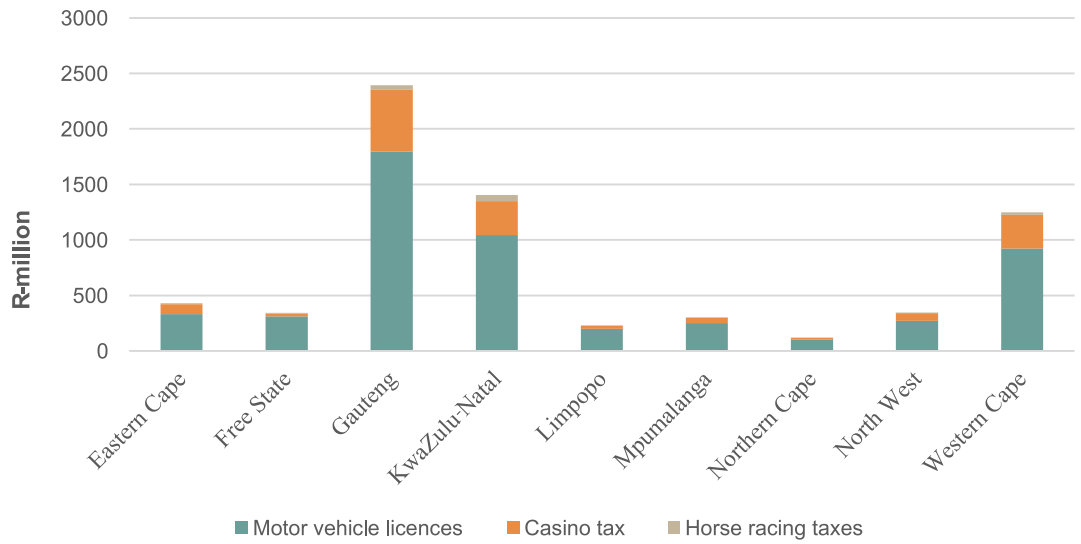
The fourth major source of provincial own tax revenue is the liquor licensing tax, which represents 1% of total provincial own revenues. It has remained stagnant over the past 15 years and did not grow (growth of 0%) between 2014/15 and 2016/17. The differential analysis of liquor licences tax by province could not be carried out due to lack of data.

7.3.4 Differential analysis of the composition of own revenues by province

As Figure 66 shows, Gauteng, KwaZulu-Natal and the Western Cape collect more motor vehicle licensing and casino taxes than the Northern Cape, Limpopo and Mpumalanga. Between 2005/06 and 2014/15, Gauteng collected R17.9-billion in motor vehicles licence taxes and R5-billion in casino taxes, followed by KwaZulu-Natal (R10.4-billion and R3.05-billion) and the Western Cape (R9.2-billion and R3.02-billion), whereas the Northern Cape collected R1.04-billion and R142-million in motor vehicle licence and casino taxes respectively.

A slightly different picture emerges for horse racing taxes, with KwaZulu-Natal collecting R5.4-billion, Gautent R3.76-billion and the Western Cape R2.45-billion.

Figure 66. Own-revenue composition (2005/06–2014/15)



Source: National Treasury (2015a)

7.3.5 Poverty levels and own revenues

The highest poverty levels are in Limpopo, where in 2011 almost two-thirds (63.8%) of all residents were poor, followed by the Eastern Cape (60.8%) and KwaZulu-Natal (56.2%). These three provinces are also home to the largest share of South Africa's poor people: in 2011, more than a quarter (26.3%) of all poor people lived in KwaZulu-Natal, followed by Eastern Cape (18.3%) and Limpopo (16.1%). Their share of the poor has been increasing since 2006, by 4% in KwaZulu-Natal and Eastern Cape and 9% in Limpopo.

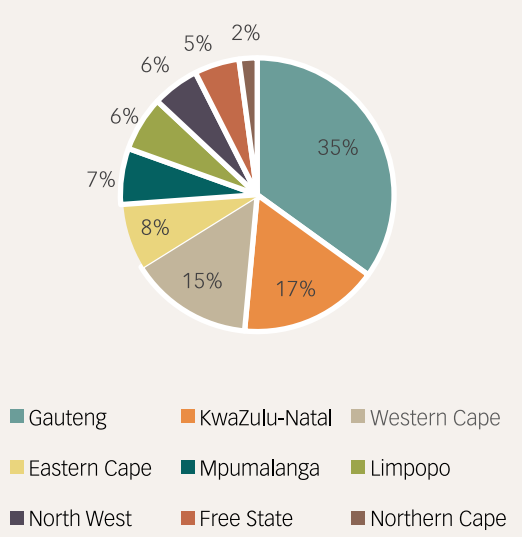
In 2011, Gauteng had the lowest number of individuals living below the poverty line but was home to the fourth highest percentage (11%) of poor people in South Africa. The Northern Cape had a poverty headcount of 46.8%, but the province's small population meant that only 1.8% of the country's poor lived there. Between 2006 and 2011, the number of individuals living below the poverty line reduced the most in the Western Cape and Gauteng, by 33% and 29% respectively, and the least in the Eastern Cape (13%) and Limpopo (14%).

Limpopo and the Eastern Cape have high levels of poverty and generate very low own revenues when compared with the other six provinces, implying that high poverty levels are associated with low own revenues. However, KwaZulu-Natal is an exception to this trend, as the province experiences high levels of poverty but generates more own revenues than most provinces.

7.3.6 Provincial economic activity and own revenues

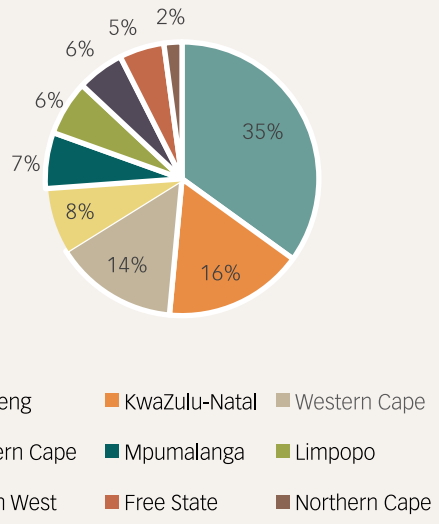
Economic activity in South Africa remains highly concentrated in a few provinces. Between 2004 and 2014, Gauteng, KwaZulu-Natal and the Western Cape accounted for more than 64% of national GDP. As Figures 67 and 68 show, the GDP share by provinces changed little during this period, with Gauteng consistently contributing 35%, followed by KwaZulu-Natal (17% in 2004 and 16% in 2014) and the Western Cape (15% in 2004 and 14% in 2014). These three provinces also generate more own revenues than the other provinces, suggesting a strong relationship between economic activity and own-revenue generation.

Figure 67. GDP share by province (2004)



Source: IHS Global Insight Regional (2015)

Figure 68. GDP share by province (2014)



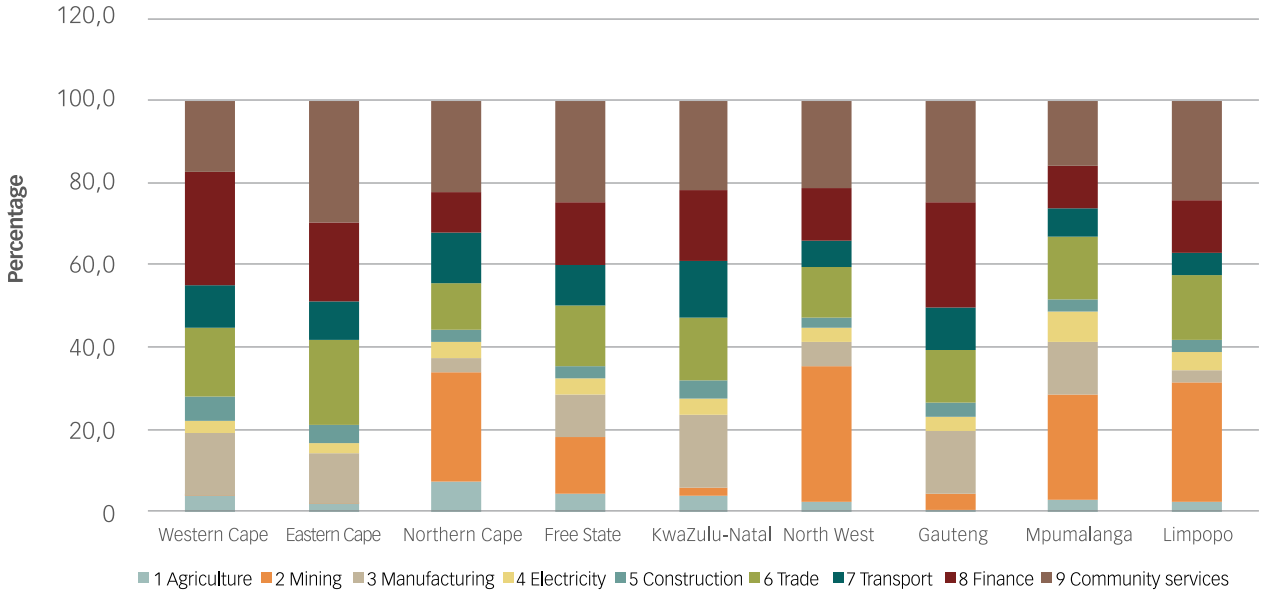
Source: IHS Global Insight Regional (2015)

7.3.7 Provincial sectoral analysis and own revenues

As Figure 69 shows, in provinces, the largest sectors are community services, finance, trade, mining and manufacturing, which together account for 79% of South Africa's GDP. Community services represent at least 20% of provincial GDP except for in the Western Cape and Mpumalanga, while finance is important for the Western Cape and Gauteng. Trade occupies a larger share of the Eastern Cape's GDP than in any other province, mining makes up between 25% and 33% of GDP in four provinces – the Northern Cape, North West, Mpumalanga and Limpopo – while manufacturing represents over 15% of the GDP in the Western Cape, KwaZulu-Natal and Gauteng.

The finance sector is highly concentrated in the Western Cape, Gauteng, the Eastern Cape and KwaZulu-Natal while manufacturing is moderately concentrated in the same provinces. The analysis shows that these provinces generate more own revenues than the other six provinces with the exception of Eastern Cape. This means that the finance and manufacturing sectors are important sectors for the generation of provincial own revenues.

Figure 69. Sector share of GDP by province (2014)



Source: IHS Global Insight Regional (2015)

7.3.8 Conditional grants vs. own revenues

Conditional grants have consistently grown more than own revenues: between 2001/02 and 2004/05, conditional grants grew at an average annual growth rate of 24% compared to only 8.7% in own revenue. Between 2005/06 and 2008/09, conditional grants grew at an average annual growth rate of 30% compared to only 8.9% in own revenue. Between 2009/10 and 2012/13, conditional grants grew at an average annual growth rate of 15% compared to 11.8% in own revenue. Between 2013/14 and 2016/17, conditional grants are projected to increase at an average annual growth rate of 8% compared to 4.5% in own revenue. This inverse relationship between the growth of conditional grants and own revenues suggests a lack of fiscal effort by provinces to generate own revenues.

Between 2001/02 and 2014/15, conditional grants to Gauteng grew by an average annual rate of 48%, much higher than the growth found in other provinces, i.e. the Free State (31%), Mpumalanga (27%), the Northern Cape (22%), KwaZulu-Natal (18%), the Eastern Cape (16%), the Western Cape (14%) and the North West (12%). The variations in annual percentage growth of conditional grants could be attributed to different frameworks for the different grants as well as the different needs of grant-specific programmes in each province. While Gauteng generated a higher percentage of own revenue (28% of total provincial own revenues), Mpumalanga (5.1%) and the Northern Cape (2%), generated the least. This suggests that in Mpumalanga and the Northern Cape, the high annual percentage growth in conditional grants is associated with low generation of own revenue.

The concentration of economic activity and sectoral analysis reveals that urban provinces with high economic activity also collect more own revenues. The finance and manufacturing sectors are important sectors for the generation of provincial own revenues. Therefore, the lack of concentrated economic activity and the underdevelopment of the finance and manufacturing sectors constitute a third constraint for rural provinces in the generation of own revenues. However, the Eastern Cape is an outlier with regards to the finance sector.

7.4 Methodology

7.4.1 Background to the methodological approach

As stated earlier, provincial governments rely heavily on national transfers because they have very limited revenue sources, as most tax bases are delegated to the national government. At the same time, provincial governments are responsible for promoting rural development and meeting the population's demand for quality public services. These responsibilities will increase in tandem with education levels. Therefore, this mismatch between limited revenue and increasing expenditures for rural development will eventually translate into a widening deficit in the provincial governments' fiscal balance.

Two plausible solutions are available to meet this challenge: either devolve more tax revenues to provincial governments or increase the amount of central government transfers. However, an in-depth analysis is first needed into how well provincial governments are using their tax bases. The fiscal effort exerted by the provincial governments is analysed using the representative tax system (RTS) approach. The objective of comparing the fiscal effort of different provinces is to establish what limits the provincial revenue collection: the tax base or the reluctance of provinces to optimise revenue collection.

7.4.2 The representative tax system methodology

The RTS approach quantifies the disparities across provinces. It measures the revenue-raising ability of each province by applying a standard tax rate on available tax bases. Comparing actual revenue collections to potential revenue collections, and indexing these to the national average, creates the fiscal effort index. This shows the extent to which provinces are maximising their potential revenue from current revenue sources – their "tax effort", which measures the amount of revenue collected by a province relative to what could reasonably be collected given the tax base. The ratio of actual to potential tax revenue serves as an index for fiscal effort (Bahl, 1972; Tait and Echingreen, 1978; Tanzi (1981).

The methodological approach consists of five steps:

Step 1:

The major provincial tax revenue sources used are own revenue and their respective tax bases. [38]

Step 2:

An average tax rate is estimated:

$$tjy = \frac{\sum_{i=1}^{4} Tijy}{\sum_{i=1}^{4} TBijy} \quad (1)$$

Where tjy = national average tax rate source j $(j=1 \text{ to } n)$ in year y

$\sum_{(i=1)}^{4} Tijy$ = Sum of tax revenue of all provinces from source j in year y

$\sum_{(i=1)}^{4} TBijy$ = Sum of tax base of all provinces for revenue source j in year y

Step 3:

The average tax rate is applied to respective tax bases to calculate provincial potential tax revenue for each source j:

$$PTR_{ijy} = t_{jy} \; x \; TB_{ijy} \quad (2)$$

Where

PTR_{ijy} = potential tax revenue of province i from resource j in year y

TB_{ijy} = tax base of province i for source j in year y

Step 4:

An index for fiscal effort (IFE_{IJY}) is constructed, for tax revenue of province i from source j in year y:

$$IFE_{ijy} = \frac{Tijy}{PTRijy} \quad (3)$$

Step 5:

An overall index for fiscal effort $(OIFE_{iy})$ is constructed for province i

$$OIFE = \frac{\sum_{j=1}^{n} Tijy}{\sum_{j=1}^{n} PTRij} \quad (4)$$

Where

$\sum_{j=1}^{n} Tijy$ = Sum of tax revenues of a province i from all sources $(j=1 \text{ to } n)$ in year y

$\sum_{j=1}^{n} PTRijy$ = Sum of potential revenues of province i from all sources in year y.

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[38] See Appendix for the specific tax revenue sources and their respective tax bases.

7.4.3 Data analysis and construction of indices for fiscal effort

The above methodology is used to construct the following indices:

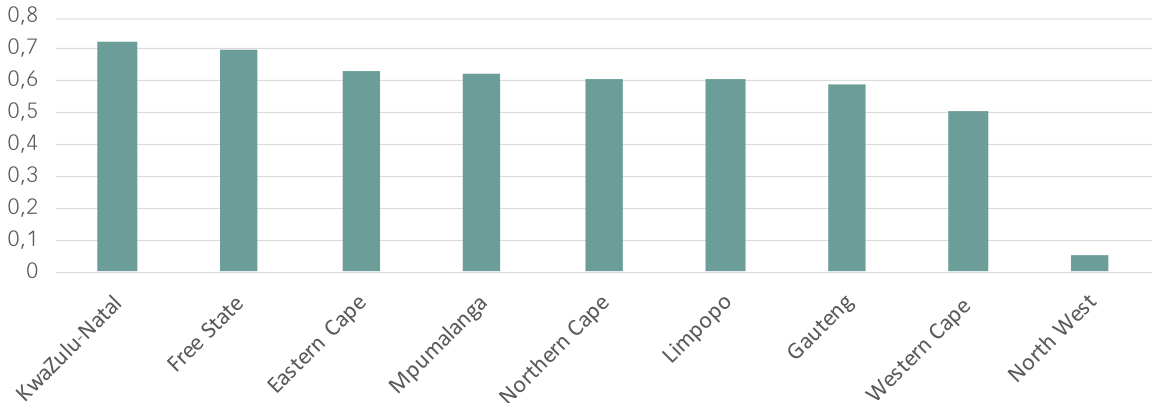
- Provincial fiscal effort indices for individual taxes
- Overall indices for fiscal effort for all provinces

The benchmarks used in these indices are merely national averages, and so are not necessarily proven optimal levels nor necessarily desirable. Therefore, it would be distorting to interpret that above one or above-average reflect disproportionately more fiscal effort, or those less than one or below-average reflect an unacceptably low fiscal effort.

7.4.4 Results and discussion

Figure 70 shows the results for fiscal effort in 2005. KwaZulu-Natal had the highest fiscal effort (0.7268), followed by Free State (0.7028), Eastern Cape (0.6347) and Mpumalanga (0.6212). North West, Western Cape and Gauteng had the lowest fiscal effort, at 0.0538, 0.5085 and 0.5919 respectively.

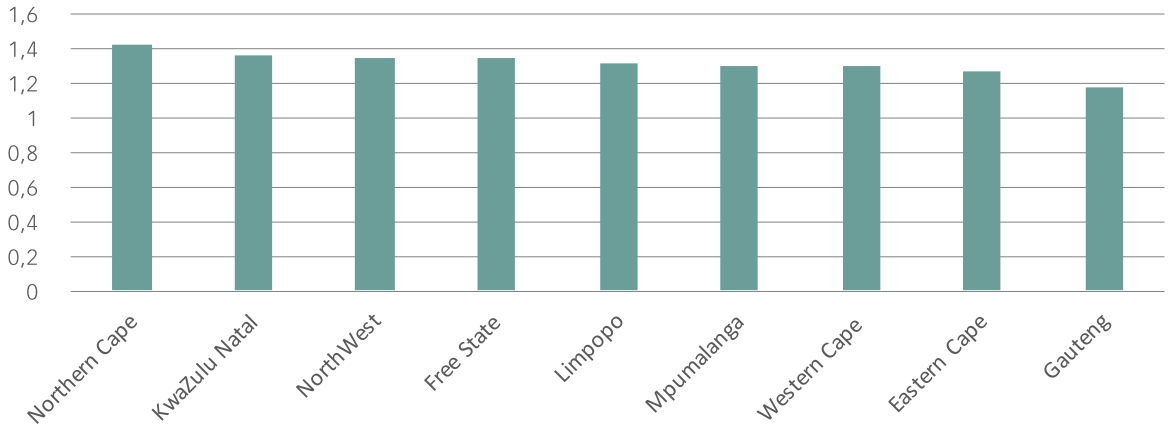
Figure 70. Overall index for fiscal effort (2005)



Source: Author's calculations

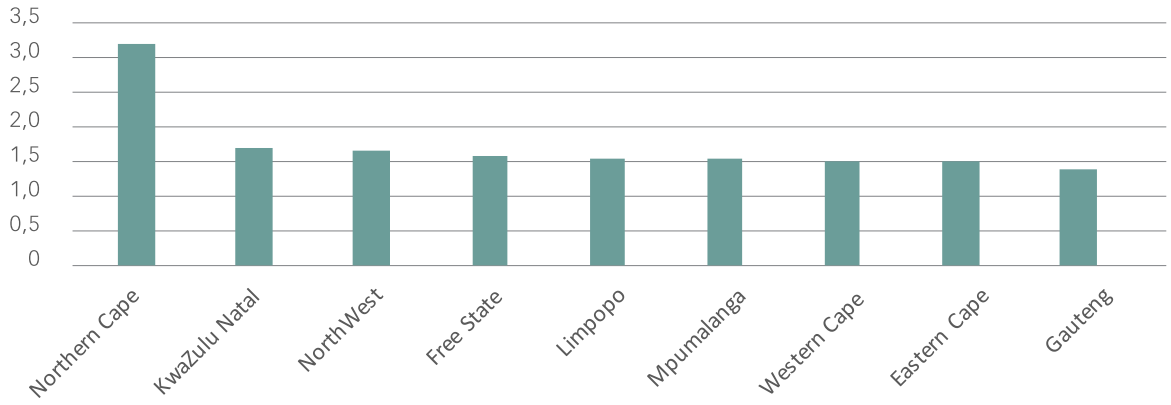
Figure 71 provides the results for 2010. The Northern Cape had the highest fiscal effort (1.4102), followed by KwaZulu-Natal (1.3477), North West (1.3459) and Free State (1.3402). The three provinces with the lowest fiscal effort were Gauteng, Eastern Cape and Western Cape with indexes of 1.1738, 1.2640 and 1.2866 respectively.

Figure 71. Overall index for fiscal effort (2010)



Source: Author's calculations

Figure 72. Overall index for fiscal effort (2014)



Source: Author's calculations

Figure 72 presents the results for 2014. The Eastern Cape had the highest fiscal effort with an index of 2.9244, followed by Northern Cape (1.5393), North West (1.4923) and Limpopo (1.4392). Gauteng, Western Cape and Free State had the lowest fiscal effort, with indexes of 1.2508, 1.3612 and 1.3767 respectively.

The main objective of this quantitative analysis was to establish the extent to which provinces are maximising their own-revenue collection from current sources, by calculating the tax effort using the RTS approach. The results revealed that provinces have very different levels of tax effort. Generally, the North West and Eastern Cape have the highest and the Western Cape and Gauteng have the lowest level of tax effort. The results also show that the effort exerted in collecting own-tax revenue is greater in rural provinces than in urban provinces. This can be explained by the composition of own-tax revenue: the amount of tax collected is largely a function of the concentration of economic activity. The noticeable discrepancies in fiscal effort among rural and urban provinces also imply different tax bases. Across all provinces, the tax effort increased drastically between 2005 and 2014. The differences between potential and actual tax revenues suggest that provinces are relatively optimising their collection of own revenues and in some instances "overtaxing" their tax bases.

7.5 Conclusions and Recommendations

7.5.1 Conclusions

The fiscal decentralisation and IGFR systems entrenched by the Constitution assign provinces narrow-based taxes, which means that they have low fiscal autonomy and tax-raising powers. This constitutional constraint means that all provinces – and especially rural provinces – have a limited ability to generate own revenues.

Provinces in South Africa levy only a few of the taxes identified in the literature as appropriate sources of own revenues for subnational governments, including automotive and fuel taxation, surcharges on a nationally uniform PIT, a provincial VAT and business value tax. This is in line with the Financial and Fiscal Commission's Framework Document for Intergovernmental Fiscal Relations (FFC, 1995) which recommended personal income tax, excise duty and fuel levies as provincial taxes for South Africa.

Urban provinces generate more own revenues than rural provinces. Rural provinces' own revenues have grown at a higher annual rate than urban provinces, albeit from a very low base. With the exception of KwaZulu-Natal, rural provinces have low own revenues and high levels of poverty – poverty also contrains the ability of rural provinces to generate own revenues. Urban provinces generate more own revenues across all major sources, i.e. motor vehicle licensing taxes, casino taxes and horse racing taxes. Motor vehicle licensing is the most important source of own revenues for provinces. These main sources of own revenues for provinces are primarily price-elastic goods and services that make the tax bases sensitive to price increases, especially in rural areas.

Conditional grants to provinces have consistently grown faster than own revenues, which implies a lack of fiscal effort by provinces to generate own revenues. The analysis found that the North West and the Eastern Cape have the highest and the Western Cape and Gauteng have the lowest levels of tax effort, suggesting that rural provinces exert more effort than urban provinces in the collecting own tax revenue. Some provinces were found to be relatively optimising their collection of own revenues to such an extent that in some instances they are "overtaxing" their tax bases.

7.5.2 Recommendations

South Africa's constitutional arrangements have deliberately centralised the collection of revenue at national level. Provinces collect a very small fraction in own revenues. The urban provinces collect more own revenues because they contain economic activities, which also means broader tax bases. Rural provinces collect less own revenues because their tax bases are narrow, and the fiscal effort is relatively optimal across all provinces. The following is recommended:

- Enhanced inclusive economic growth and employment in order to grow tax bases for rural provinces, and thereby mobilise more resources for rural development at provincial level.

- Investment in enabling infrastructure that will boost exports through de-monopolising and increasing competition in the energy, transport and telecommunication sectors, thereby enhancing growth and employment.

- Investment in quality education and training to address skills mismatches between the education system and the labour market, thereby reducing unemployment and boosting growth.

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Appendix: Selected Provincial Tax Revenue Sources and Tax Bases

Tax Revenue	Tax Bases
Liquor licences	Retail trade in beverages
Motor vehicle licences	Maintenance of motor vehicles
Casino taxes	Hotels, camping sites and other accommodation
Horse racing taxes	Recreational, cultural and sporting activities

Statistical Appendix

Table 43. Tax revenue receipts by province

Province	Year	Revenue Sources			Total
		Motor vehicle licences	Casino taxes	Horse racing taxes	
Western Cape	2005/06	0.758594	0.205318	0.01665	0.984864
	2010/11	0.901651	0.296313	0.02633	1.230722
	2014/15	1.143991	0.299335	0.02	1.488326
Eastern Cape	2005/06	0.303589	0.055733	0.00262	0.367907
	2010/11	0.331964	0.085533	0.00656	0.428859
	2014/15	0.459368	0.124631	0.00661	0.599217
Northern Cape	2005/06	0.059068	0.011798	0.00039	0.072131
	2010/11	0.115246	0.013706	0.00062	0.130638
	2014/15	0.146842	0.017597	0.00147	0.169564
Free State	2005/06	0.179036	0.011243	0.00509	0.197789
	2010/11	0.300907	0.025739	0.00543	0.337697
	2014/15	0.486598	0.036864	0.00906	0.539209
KwaZulu-Natal	2005/06	0.624302	0.162073	0.03198	0.822356
	2010/11	1.083507	0.305583	0.04586	1.43997
	2014/15	1.452633	0.457046	0.07456	2.00585
North West	2005/06	0.143205	0.050787	0.00276	0.196754
	2010/11	0.198624	0.060638	0.00419	0.265763
	2014/15	0.372149	0.100679	0.00582	0.482399
Gauteng	2005/06	0.959577	0.388748	0.02597	1.374291
	2010/11	1.705814	0.58598	0.03066	2.32245
	2014/15	1.705814	0.58598	0.03066	2.32245
Mpumalanga	2005/06	0.149918	0.022444	0.0035	0.177206
	2010/11	0.238951	0.043961	0.00426	0.289534
	2014/15	0.371302	0.072006	0.00794	0.453462
Limpopo	2005/06	0.127946	0.00824	0.0033	0.143786
	2010/11	0.194721	0.02093	0.00866	0.227015
	2014/15	0.307034	0.050807	0.01056	0.37196
Totals	2005/2006	3.305235	0.916384	0.09227	4.337084
	2010/2011	5.071385	1.438383	0.13256	6.672648
	2014/2015	6.445731	1.744945	0.16668	8.432437

Table 44. Selected provincial tax bases

Province	Year	Tax Base			Total
		Maintenance of motor vehicles	Hotels, camping sites and other accommodation	Recreational, cultural and sporting activities	
Western Cape	2005	0.153362	0.11255	0.029168	0.295083
	2010	0.3554688	0.3089	0.219472	0.883844
	2014	0.4938523	0.28672	0.3631	1.143668
Eastern Cape	2005	0.0930466	0.06059	0.043352	0.19699
	2010	0.3591844	0.33191	0.197984	0.889074
	2014	0.5020227	0.46028	0.235157	1.19746
Northern Cape	2005	0.1112318	0.06941	0.055011	0.23565
	2010	0.3083105	0.27321	0.265534	0.847057
	2014	0.395668	0.31563	0.399402	1.110704
Free State	2005	0.0724514	0.02691	0.031897	0.131258
	2010	0.2915509	0.23983	0.202614	0.733999
	2014	0.4642232	0.37465	0.322241	1.161111
KwaZulu-Natal	2005	0.0731063	0.03597	0.046181	0.155255
	2010	0.357142	0.21223	0.296676	0.866047
	2014	0.5079958	0.226	0.434399	1.168394
North West	2005	0.1171575	0.05527	0.034665	0.207094
	2010	0.3215043	0.25949	0.238789	0.819786
	2014	0.45842	0.42482	0.418452	1.30169
Gauteng	2005	0.104805	0.03739	0.033669	0.175867
	2010	0.431708	0.22426	0.228983	0.884956
	2014	0.5835273	0.24194	0.3514	1.17687
Mpumalanga	2005	0.0934467	0.04259	0.03381	0.169846
	2010	0.3727338	0.33771	0.232232	0.942674
	2014	0.4844507	0.41808	0.373195	1.275727
Limpopo	2005	0.1071854	0.06348	0.046633	0.2173
	2010	0.3863577	0.33955	0.270145	0.99605
	2014	0.4994547	0.451	0.408182	1.358639
Totals	2005	0.9257927	0.50416	0.354386	1.784342
	2010	3.1839604	2.5271	2.152428	7.863486
	2014	4.3896147	3.19912	3.305528	10.89426

Table 45. National average tax rates

Revenue Source	2005	2010	2014	2005	2010	2014
Motor Vehicle	3.57	1.59279	1.4684047	0.0357	0.015928	0.014684
Casino Taxes	1.818	0.56918	0.5454453	0.01818	0.005692	0.005454
Horse Racing	0.26	0.06159	0.0504234	0.0026	0.000616	0.000504

Table 46. Potential tax revenues (R-billions)

Province	Year	Source of Revenue			Total
		Motor vehicle licences	Casino taxes	Horse racing taxes	
Western Cape	2005	0.54753	0.20458	0.00759	0.759702
	2010	0.56619	0.1758227	0.01352	0.755527
	2014	0.72517	0.1563877	0.01831	0.899871
Eastern Cape	2005	0.33219	0.1101342	0.01129	0.453613
	2010	0.57211	0.1889152	0.01219	0.773214
	2014	0.36405	0.0719822	0.00431	0.440342
Northern Cape	2005	0.39712	0.1261559	0.01432	0.537595
	2010	0.49107	0.1555082	0.01635	0.662936
	2014	0.581	0.1721611	0.02014	0.773301
Free State	2005	0.25866	0.048913	0.0083	0.315881
	2010	0.46438	0.13651	0.01248	0.613368
	2014	0.68167	0.204349	0.01625	0.902265
KwaZulu-Natal	2005	0.261	0.0653751	0.01202	0.3384
	2010	0.56885	0.1207973	0.01827	0.707921
	2014	0.74594	0.1232702	0.0219	0.891118
North West	2005	3.57017	1.8176327	0.26035	5.648155
	2010	0.51209	0.1476987	0.01471	0.674494
	2014	0.67315	0.2317149	0.0211	0.925961
Gauteng	2005	0.37417	0.0679657	0.00877	0.450903
	2010	0.68762	0.1276479	0.0141	0.829371
	2014	0.85685	0.1319665	0.01772	1.00654
Mpumalanga	2005	0.33362	0.0774107	0.0088	0.419834
	2010	0.59369	0.1922177	0.0143	0.800207
	2014	0.71137	0.2280406	0.01882	0.958228
Limpopo	2005	0.38267	0.115386	0.01214	0.510197
	2010	0.61539	0.1932653	0.01664	0.82529
	2014	0.7334	0.2459971	0.02058	0.999981
Totals	2005	3.30524	0.916384	0.09227	4.313885
	2010	5.07139	1.438383	0.13256	6.642329
	2014	6.44573	1.744945	0.16668	8.357352

Table 47. Index for fiscal effort

Province	Year	Source of Revenue			Total
		Motor vehicle licences	Casino taxes	Horse racing taxes	
Western Cape	2005	0.28	0.55017	3.8409179	0.38842
	2010	0.628	1.7569	16.237263	1.16984
	2014	0.681	1.83336	19.832057	1.27092
Eastern Cape	2005	0.28	0.55017	3.8409179	0.43427
	2010	0.628	1.7569	16.237263	1.14984
	2014	1.379	6.39436	54.61877	2.71939
Northern Cape	2005	0.28	0.55017	3.8409179	0.43834
	2010	0.628	1.7569	16.237263	1.27774
	2014	0.681	1.83336	19.832057	1.43631
Free State	2005	0.28	0.55017	3.8409179	0.41553
	2010	0.628	1.7569	16.237263	1.19667
	2014	0.681	1.83336	19.832057	1.28688
KwaZulu-Natal	2005	0.28	0.55017	3.8409179	0.45879
	2010	0.628	1.7569	16.237263	1.22337
	2014	0.681	1.83336	19.832057	1.31116
North West	2005	0.033	0.03041	0.1331438	0.03667
	2010	0.628	1.7569	16.237263	1.21541
	2014	0.681	1.83336	19.832057	1.40577
Gauteng	2005	0.28	0.55017	3.8409179	0.39003
	2010	0.628	1.7569	16.237263	1.06702
	2014	0.681	1.83336	19.832057	1.16922
Mpumalanga	2005	0.28	0.55017	3.8409179	0.40455
	2010	0.628	1.7569	16.237263	1.17804
	2014	0.681	1.83336	19.832057	1.33134
Limpopo	2005	0.28	0.55017	3.8409179	0.42591
	2010	0.628	1.7569	16.237263	1.20691
	2014	0.681	1.83336	19.832057	1.35867
Totals	2005	0.28	0.55017	3.8409179	0.41363
	2010	0.628	1.7569	16.237263	1.18384
	2014	0.681	1.83336	19.832057	1.30355

Table 48. Overall fiscal effort by province

Province	Year	Total
Western Cape	2005	0.509
	2010	1.287
	2014	1.361
Eastern Cape	2005	0.635
	2010	1.264
	2014	2.924
Northern Cape	2005	0.608
	2010	1.41
	2014	1.539
Free State	2005	0.703
	2010	1.34
	2014	1.377
KwaZulu-Natal	2005	0.727
	2010	1.348
	2014	1.402
North West	2005	0.053
	2010	1.346
	2014	1.492
Gauteng	2005	0.592
	2010	1.174
	2014	1.251
Mpumalanga	2005	0.621
	2010	1.288
	2014	1.416
Limpopo	2005	0.604
	2010	1.314
	2014	1.439
Totals	2005	0.603
	2010	1.303
	2014	1.391

CHAPTER 8

The Role of PES and Conditional Grants in Funding Provincial Rural Development Mandates

Eddie Rakabe

The Role of PES and Conditional Grants in Funding Provincial Rural Development Mandates

8.1 Introduction

Throughout developing nations, intergovernmental fiscal transfers are the focus of much attention because of growing concerns over deeply entrenched regional development inequities. Historical and market-led patterns of development, resulting in the skewed distribution of economic activity, cause regional disparities that often require equalisation through fiscal transfers to offset the developmental gap. Regional disparities manifest in a number of ways and have a number of policy implications (Blochliger and Charbit, 2008). This chapter examines rural under-development, which is one of the key manifestation of disparities in South Africa.

South Africa is characterised by disparities across provincial jurisdictions. About a fifth of South Africans live in rural areas where population sizes and income levels are low and the unemployment rate is high (NPC, 2011). Rural populations are spatially dispersed, which increases the cost and difficulty of providing rural services effectively, resulting in extensive service backlogs. Similarly, rural areas have limited economic activities and a narrow tax base, which prevents them from mobilising sufficient resources to finance their own development programmes. This leaves them dependent on national government for both fiscal transfers and interventions. A number of policy documents have identified rural development as a crucial remedy for regional disparities, ranging from the spatial approach of investing in rural nodes contained in the Integrated Sustainable Rural Development Strategy (ISRDS) of 2000 to a service-delivery oriented Comprehensive Rural Development Programme (CRDP[39]) of 2009 (Mabugu, 2015).

The intergovernmental fiscal relations (IGFR) system is also designed to address regional disparities and in particular rural development. The Constitution assigns the multi-faceted rural development function across the three spheres of government. The responsibility for rural development permeates through the different spheres and sectors of government. Traditionally, provincial rural development responsibilities included regional planning, schooling and health facilities, housing, roads and agriculture. However, the Constitution makes no spatial distinction when assigning or classifying functions. It requires (in Section 214(2)) for economic disparities between and within provinces to be taken into account when determining their respective equitable share entitlements. Accordingly, the provincial equitable share (PES) and various conditional transfers allow for different aspects of rural development in both their allocation formulae and spending activities. For instance, the poverty component of the PES is intended to provide a rural bias in the allocation framework in the same way as grants do, e.g. the Rural Household Infrastructure Grant (RHIG) prioritises the provision of sanitation within rural communities.

The renewed emphasis on rural development, within the context of regional disparities, raises questions about the sources, composition and effectiveness of funding for rural development. Without a clear framework of provincial rural development functions and coordinated spending, the transformation of the rural landscape will remain an elusive ideal. Against this background, this chapter looks at how responsive the PES and conditional grants are to the needs of rural provinces, by assessing the extent to which the fiscal transfers respond to rural challenges. It examines the sensitivity of these transfers to the needs of the rural provinces, the effectiveness of the backlogs component of the infrastructure conditional grants in channelling resources towards rural provinces, and the rural development programmes funded through the PES and conditional grants.

The research objectives are:

- To assess the responsiveness of the provincial horizontal transfers (equitable share formula and selected provincial conditional grants) to the needs of rural provinces.
- To examine whether rural provinces experience peculiar developmental needs or challenges associated with their rural conditions.
- To assess the extent to which rural provinces prioritise rural development through discretionary and conditional allocations and identify constraints hampering the prioritisation of rural development.
- To make recommendations for the Commission's 2016/17 Annual Submission to the Division of Revenue

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[39] The CRDP is the Department of Rural Development and Land Reform's flagship policy that has two focus areas: (i) an integrated programme of land reform and agrarian change, and (ii) a rural development strategy, and is targeted at 27 districts. (See Chapter 3 for more details.)

8.1.1 Problem statement

In South Africa, rural provinces carry the highest poverty burden because of historical social engineering policies, weak regional economies, and the inability of provinces to effect change through development interventions and allocated resources. The higher poverty burden imposes additional demands for services and funding on the rural provinces. However, the funding framework for provinces is not sensitive enough to the different developmental needs and the inherent cost disabilities of rural provinces.

Maladministration practices and fiscal management failures provide evidence of the inability of the rural provinces to intervene in their spaces through the powers and functions assigned to them by the Constitution. Whereas such failures reflect poor fiscal choices, the lack of appropriate skills in the rural areas may exacerbate management inadequacies and thus reinforce rural under-development.

As provinces rely almost entirely on national transfers for revenue, their spending discretion (i.e. their ability to direct resources towards province-specific needs) is limited. The PES, which accounted for 78% of total provincial revenue in 2013/14, is normally tied to national priorities and statutory responsibilities. Similarly, conditional grants can only be spent on specific sector and expenditure activities. Of course, assuming national priorities match local preferences, provinces can invest within their space where the needs are greatest.

8.1.2 Methodology

The study employs a multi-pronged methodological approach. Firstly, a qualitative comparative analysis of the fiscal transfers is carried out, focused on the design and mechanism for addressing spatial disabilities. Secondly, a quantitative analysis of the PES formula and allocation is undertaken that looks specifically at the composition of components and need indicators, and per capita allocation per province. A panel data analysis is used to assess the degree of variance in per capita allocation per province. The results are corroborated by an in-depth budget review of the two biggest provincial conditional grants and selected conditional grants with a rural focus, to help establish the extent of rural development prioritisation within the different provinces.

8.1.3 Linkages to the Division of Revenue theme

The Division of Revenue is underpinned by the principles of equitable distribution of resources to minimise the fiscal gap across jurisdictions. The allocation criteria for both the PES and conditional grants include the principles of equitable distribution of resources. However, the extent of the equity is a subject of ongoing debates, as the IGFR system evolves and the different interests advocate for a fair share. South Africa has a unique duo spatial characteristic, where under-developed rural regions coexist alongside affluent urban centres, and so the varying needs of these two spaces have to be reflected in the allocation framework. The consensus among policy-makers is that rural spaces have structural inabilities that require a separate funding instrument or approach. This study seeks to provide answers to the ongoing impasse regarding the effectiveness of fiscal transfers in addressing rural development.

8.2 Addressing Regional Disparities through Fiscal Transfers

Development disparities between and within regions are a global phenomenon, found mostly in low-to-middle income countries, and emanate from skewed factor endowment and economic activity distribution, and deliberate government policies to promote one region ahead of the others. To reduce regional economic and social disparities, countries have adopted regional policies to develop activities in the rural sector. They include policies that emphasise economic growth as a remedy to reducing inequities, direct national government interventions through social services and infrastructure, and the decentralisation of expenditure responsibilities to subnational governments (Kirori, 2015 and Fan et al., 2009).

Many countries have embraced fiscal decentralisation as a fundamental policy for rural development, despite concerns of adverse redistributive effects. For instance, Kenya has created a number of decentralised structures (local authorities and regional development authorities) and institutional interventions for developing rural areas, such as the Special Rural Development Programme and the District Focus Strategy for Rural Development. Districts or regional development authorities are responsible for planning, financing and implementing rural development initiatives. These development programmes cover rural access roads, basic education, water, agriculture support, employment and development finance. However, the regional development authorities lack independent budgets to drive development and the powers to coordinate plans and budgets of national ministries on a district-by-district basis, and rely on budgetary allocations and appropriated aid for revenue (Kirori, 2015).

Kenya's approach to rural development resembles that of India where District Rural Development Agencies (DRDAs) are responsible for coordinating, supporting and facilitating rural development programmes designed by the Ministry of Rural Development. Like Kenya, India's programmes are multi-dimensional, entailing poverty reduction, rural

employment, housing, roads and improving agricultural productivity, etc. The DRDAs implement central and state government schemes because they lack the legal status of a government tier. Similarly, municipalities are not autonomous institutions of local self-government but are mostly assigned the responsibility to implement national or state (provincial) projects.

Between the early 1990s and the mid-2000s, Brazil's rural development model evolved immensely, from an agrarian focus to a welfare orientation, to the current integrated approach aimed at ending poverty and inequality through intergovernmental interventions. Much of Brazil's success in addressing rural under-development is attributable to the two national welfare-type programmes that have since been decentralised to local municipalities: the Bolsa Familia – a conditional cash transfer scheme – and the School Meals Programme (Schneider et al., 2010). In Brazil, municipalities are also responsible for health and education, which constitute an important part of development. Each municipality receives the Municipal Participation Fund (MPF) whose allocation criteria take into account population size and production capacity. This means that, generally, municipalities with smaller populations receive higher per capita allocations. The transfer allocation framework does not distinguish between rural and non-rural municipalities. A recent study showed that socio-demographic characteristics, such as the human development index and Gini coefficient, "do not help to understand most of the fiscal inequality found across municipalities". Therefore, they are unlikely to bring about fiscal equalisation when incorporated into the transfer system (Politi and Mattos, 2013: 15).

8.3 Rurality and Provinces

Efforts to classify territories according to their degree of rurality – for policy purposes – have not been entirely successful. The anomalies that characterise rural spaces are acknowledged, but the factors that cause such anomalies cannot conclusively determine whether or not a space is rural. Some factors may be inherent to rural space, while others are only associated with the space. In the absence of a universal definition of rurality, policy-makers need to adopt a working definition of rurality suited to the policy goals being pursued (Du Plessis et al., 2002). This is because different definitions generate different outcomes (see Table 49).

Rurality's distinctive characteristics include a small population size, sparse settlements (low densities), distance from large population concentration areas and reliance on agriculture for economic activity (Monk, 2007). Other attributes, which are not limited to but are generally closely associated with rural spaces, include higher levels of poverty and aging and unemployed people, low transportation connectivity and lack of access to basic amenities (i.e. education and health facilities, water, electricity and sanitation). Chapter 11 provides a detailed discussion on rural sanitation.

This study explores three methods of categorising provinces as rural:

- Provinces that include former Bantustans – territories set aside for black people under apartheid in South Africa – and characterised by sparse settlements, extensive land under traditional leadership and high levels of under-development (Khunou, 2009). Bantustans were mainly concentrated in KwaZulu-Natal, the Eastern Cape, Limpopo, North West and parts of the Free State. To this day, provinces into which Bantustans were assimilated continue to be associated with poor socio-economic conditions and high levels of rurality (UNDP, 2014).
- Provinces that have the most B3 and B4 municipalities based on a composite index (see Chapter 1 for a description of this method). According to this index the three most rural provinces are Limpopo, KwaZulu-Natal, and the Eastern Cape.
- Provinces that have certain rural attributes. This chapter categorises provinces using a combination of factors that are inherently and indirectly associated with rural spaces. They include sparsity, demographics, socio-economic attributes, access to services and connectivity using proxy variables. Provinces are assigned a score of one to nine for each variable, where one represents a low and nine a high degree of rurality.

Table 49 show the results of this third classification. Gauteng and North West have the lowest, and the Northern Cape and Western Cape the highest rurality score. However, these results are inconsistent with the other two methods of classifying provinces by rurality. What Table 49 shows is that rurality is dynamic. No specific rural characteristics are peculiar to a provincial territory. For instance, of all nine provinces, Gauteng has the highest degree of rurality for aging and reliance on agriculture, whereas provinces traditionally regarded as rural (former Bantustans) fare relatively better in terms of access to amenities and connectivity. These results may have implications for the design and division of the fiscal transfer system across provinces and the prioritisation of funding to address different rural development needs.

Table 49. Classification of provinces by rural attributes

	Density	Rank score	Population >60yrs	Rank score	Poverty headcount	Rank score	Number of clinics/ 1600 m^2	Rank score	Number of schools/ 1600 m^2	Rank score	Agriculture output/ 5000 m^2	Rank score	Road KM/200 m^2	Rank score	Total rank score
Eastern Cape	40	6	772 787	7	2051837	7	7	3	53	3	138 584	2	38,11361337	5	33
Free State	22	8	279 496	2	665691	2	3	7	16	8	318 542	5	42,51765281	3	35
Gauteng	720	1	1 116 021	9	2238403	8	28	1	181	1	1 465 196	9	58,6847966	1	30
KwaZulu-Natal	113	2	933 083	8	3179382	9	10	2	102	2	1 185 957	8	45,37697953	2	33
Limpopo	44	5	516 596	5	1676781	6	6	4	50	4	256 345	3	34,96444051	7	34
Mpumalanga	56	3	344 977	3	1088648	5	5	5	37	5	522 449	6	36,11345905	6	33
North West	35	7	119 501	1	222647	1	1	9	2	9	72 690	1	39,04205353	4	32
Nothern Cape	3	9	349 547	4	881407	4	4	6	24	6	261 835	4	13,79078074	9	42
Western Cape	47	4	590 971	6	861974	3	3	8	18	7	726 314	7	25,17869079	8	43
															35

Sources: Regional Explorer, Department of Education 2013; HST, 2013

8.3.1 Provincial disparities in South Africa

The disparities across the nine provinces of South Africa are examined through the per capita gross regional product (GRP), the percentage of population living below the poverty line and the per capita expenditure. Table 50 shows significant variations in the per capita GRP and poverty. For instance, Gauteng's per capita GRP is almost twice that of rural provinces. Similarly, compared to other provinces, poverty levels are higher in the three most rural provinces (the Eastern Cape, KwaZulu-Natal and Limpopo). However, when observed over a long period, these disparities across provinces dissipate, implying some level of convergence in their development trajectory. This convergence is also evident through provincial per capita expenditure. Overall, these results suggest that there is little evidence to corroborate the existence of disparities between provinces in South Africa, which makes the targeting of resources to selected provinces for rural development unjustifiable.

Table 50. Provincial development disparities

Province	GRP per capita Rands	% population below food poverty line	Population aged 15+, completed grade 7	Expenditure per capita Rands
Eastern Cape	34 140	29.1%	76.9%	9 157
Free State	56 869	22.3%	82.1%	10 279
Gauteng	80 534	16.2%	91.1%	6 539
KwaZulu-Natal	45 513	28.9%	80.4%	9 267
Limpopo	39 274	29.1%	77.8%	9 251
Mpumalanga	51 395	24.4%	80.3%	8 542
Northern Cape	56 213	18.4%	76.7%	11 509
North West	46 362	22.7%	76.9%	8 673
Western Cape	68 727	13.7%	89.5%	7 996

8.4 Design of the IGFR System and Implications for Rural Development

Decentralisation is a fundamental principle of South Africa's IGFR system, calling for community-centred responsibilities to be devolved to the lower levels of government, and participatory governance at institutional and community levels to facilitate development. In the Constitution, Section 40 establishes three distinctive, interrelated and inter-dependent spheres of government, while Section 152 requires government to involve the community in the processes of local decision-making. In the context of rural development, decentralisation enables people, especially the poor and marginalised, to determine their own development trajectory, to control the fiscal resources for implementing local rural development programmes and to hold authorities accountable (UNDP, 2004).

The link between rural development and decentralisation is clear, but rural development – conceptually and practically – is inherently fluid. This often means that in the process of participation and negotiation (between and within government and the community) consensus cannot be reached on what rural development should entail. As the previous chapters have indicated, rural development is not only vague but also multi-dimensional. It includes wide-ranging imperatives, such as improving the quality of life of the rural poor, reducing poverty and sharing growth, ensuring food security and managing natural resources sustainably (Phuhlisani, 2009). In recent years, rural policy has taken a more integrated paradigm, promoting joint action among rural agents and coordination of different government levels and sectors in addressing rural development challenges, including (but not limited to) agriculture, education, health, infrastructure and employment (Albala and Bastiaensen, 2010).

In a decentralisation process, local communities should ideally engage and agree on rural development priorities and use available resources to address their specific regional inequalities. However, decentralisation does not always leads to local governance that in turn leads to local development and to poverty reduction. The relationship between decentralisation and rural development is not linear and is affected by the contestations inherent within the design and functioning of the IGFR system (UNDP, 2004). The IGFR system often lacks mechanisms that allow local demands to be integrated within a framework of national goals and strategies, while subnational governments do not always have the necessary resources to address local specific rural development needs, including delegated responsibilities (Wong and Guggenheim n.d.). Overlapping responsibilities between subnational and national government also creates intergovernmental and fiscal tensions, which undermine or duplicate rural development efforts. These tensions manifest in national government dominating the rural development agenda, which contributes to the disconnection with locally driven rural development. Most national rural development policies are region- and sector-neutral and fail to take into account the heterogeneity of rural spaces (Schejtman and Berdegue, 2008).

Decentralised rural development requires a number of fundamentals to be in place (World Bank, 1998). National government must provide institutional capacity to enable rural development programmes to be implemented, help subnational governments to identify local needs and encourage resources to be used where the needs are greatest. To minimise costs, the community should as far as possible be directly involved in implementing rural development projects. This requires strong political commitment to transferring appropriate powers and responsibilities to the subnational governments, sufficient funding to enable the subnational governments to carry out the prescribed mandates, and capacitated community institutions able to implement the relevant elements of rural development.

Decentralisation is a necessary condition for rural development, which should be carried out by the level of government closest to the community. The key question is whether the functions allocated to provinces constitute rural development and whether the responsibilities are amenable to participatory governance.

8.5 Provincial Rural Development Mandates

According to Schedule 4(A) of the Constitution, urban and rural development is a concurrent responsibility of national and provincial governments. The Constitution does not explicitly indicate how the various activities should be shared between the two spheres. This lack of specificity lies at the centre of uncertainties over how different spheres perceive their respective roles in (and contributions to) rural development. Complexities ingrained in the definition of rural development further reinforce these uncertainties.

Before outlining the specific provincial rural development mandates, the concept of rural development needs to be unpacked. Rural development is widely accepted as being concerned with poverty reduction and improvements in general standards of living (World Bank, 1998). The provincial functions of education, health, welfare services, housing, public transport, roads and agriculture potentially constitute rural development, as they reduce poverty and improve living standards. Agricultural growth has been a major driver of poverty reduction in developing economies: a 1% increase in agricultural productivity is associated with a 0.6–1.2% reduction in the number of people living on less than a dollar a day (Thirtle et al., 2001). Access to assets such as land, housing and livestock is also a crucial strategy for addressing rural poverty (IFAD, 2011). The impact of roads on rural poverty is mixed: investment in roads is found to be poverty neutral because rural populations travel infrequently, and yet roads provide increased mobility and accessibility to services, so long as motorised transport is available (Bryceson and Bradbury, 2006). Education and health expenditure has a significantly positive impact on poverty (Gounder, 2012). Yet provinces do not always perceive their education and health spending as rural development, partly because sector policies are mostly driven from the centre, and partly because sectoral allocations and investments are not space-based, and the outcomes are not physically confined to a rural space (as in the case of investments in roads and agriculture).

8.5.1 Community participation and provincial rural development

As previously indicated, in a decentralised government system, rural development needs to embrace community participation, as communities are better able to identify specific rural development needs. However, the way in which the delivery of provincial functions is structured does not provide sufficient room for optimum community participation. For instance, in the case of education, the law makes no provision for a local council or committee to oversee the education needs of the entire community, but instead relies on school governing bodies, which typically focus on individual schools. District and circuit offices are the provincial structures that are closest to the community. However, they are located far away from rural villages and have no decision-making powers. Similarly, the disconnect between schools and communities means that schools rarely draw on the various sources of expertise (such as unemployed graduates and retired professionals) and support structures available in their surrounding communities. The Department of Education (DOE, 2005) recommends that community structures be involved in school decision-making processes at district, local and national government level. These recommendations were implemented in an experimental study, which found that schools in communities where Community Education Forums were established had better attendance by parents at school meetings, more information-sharing about children between parents and teachers, and greater use of community expertise and skills. Bringing schools and communities together is difficult and challenging, but necessary in order to stimulate functional linkages between education and development (Gardiner, 2008).

The importance of community participation in primary health care and rural health services development is uncontested (Preston et al., 2010). Provinces have district health authorities (which coincide with municipal boundaries) to facilitate interaction between health-care providers and the community in order to improve community health. Section 42 of the National Health Act (No. 61 of 2003, amended 2013) provides for clinic and community health centre committees, which must include local councillors, community members and the head of the health centre. These structures are meant to enable local communities to identify their own health-care needs and to have a say in how the budget is allocated and how health services are planned and delivered. As is the case in education, community participation within health-care services is absent or ineffective (HST, 2008). Resources, especially budgets and staff, are still managed centrally, limiting the ability of districts and communities to channel resources towards local priorities. Community involvement is carried out only for the purpose of legitimising programmes, while clinic committees are not fully functional[40] and their role is limited to conflict resolution, health education and facilitating voluntary services (ibid).

Other provincial rural development mandates make no provision for regular interface other than through ward committees, whose role is limited to local government issues and beleaguered by structural limits to power and party political tensions (Smith, 2008). For instance, development planning of housing and roads in South Africa is top-down (Xala, 2005). The only community participation for built environment functions occurs through the local

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[40] Local councillors' representation is very small, and they are not allocated resources to carry out their duties.

government integrated development plan (IDP) processes, which lack provincial participation. Similarly, community participation in agriculture is scant. Community participation during land reform tends to decline after land transfer (Jacobs and Price, 2003), and the failure of community agriculture projects funded by provinces may be because of the lack of community participation (Mwale et al., 2012).

Legislation provides for sufficient decentralised structures for provinces to fulfill their rural development community participatory requirements. However, provinces do not appear to regard community participation as a critical component of their rural development mandates.

8.6 Provincial Rural Development Programmes

Provinces and national government have similar rural development approaches and sub-programmes. The provincial departments of agriculture and rural development carry out many of the programmes, which are overwhelmingly dominated by agrarian activities, project-oriented and supply-driven, unsystematic and spread thinly across rural villages. These departments are involved in delivering agriculture-related programmes, such as the revitalisation of irrigation schemes, livestock improvement, milling plants and silos in CRDP sites, food nutrition and provision of boreholes and agriculture inputs to communities. Unlike their national counterparts, some provincial agriculture and rural development departments include the services delivered by other departments within the rural space. For instance, the Mpumalanga annual report for 2014 shows the contribution made by the departments of social development, education and economic development in providing youth centres, training ECD professionals and establishing a bakery, among other things.

Overall, rural areas are receiving considerable attention from provincial governments, especially agriculture, but it is unclear whether the programmes are delivering the full complement of services required for rural development. Although the CRDP provides government with an opportunity to coordinate interventions towards areas with the greatest needs, the programme is likely to be undermined by isolated departmental planning processes – sector departments plan separately from municipalities (the custodians of rural spaces) which leads to duplication (PSC, 2009).

When the CRDP was introduced in 2009, most provincial departments of agriculture were already implementing aspects of the programme but had to establish a new "rural development" sub-programme in order to conform to national government requirements. These sub-programmes are meant to coordinate rural development programmes, but placing the coordination role within the provincial department of agriculture constitutes unnecessary duplication, as the Offices of Premiers are mandated to play a coordination role. The Offices of the Premier are also best placed to provide central and strategic coordination from a multi-sectoral rather than an agricultural perspective (The Presidency, 2008).

8.7 Funding Instruments for Rural Development

Provinces rely for their funding mostly on transfers (up to 97%) from national government. comprising the PES[41] and a number of conditional grants. The PES, which represents 81% of national transfers to provinces, is a general purpose grant that provinces can spend at their discretion. Conditional grants, which make up 19% of transfers to provinces, are intended to fund national priorities across a range of mandates. These intergovernmental transfers must be equitable, and their allocation and spending must take into account the interjurisdictional fiscal and development disparities. Therefore, the PES allocation framework and selected provincial conditional grants include variables that directly and indirectly compensate for "ruralness".

In existence for over 18 years, the PES formula has undergone several reforms, including the introduction of components aimed at explicitly addressing rurality. The most notable are the backlogs component (introduced in 2000) and the poverty component[42] (introduced in 2005), which replaced the social welfare component in the PES formula. The aim of the backlogs component was to fund the capital needs of historically neglected provinces or former Bantustans, which included the Eastern Cape, KwaZulu-Natal and Limpopo. The three provinces accounted for 65% of the education backlog factor and 70% of the rural factor within the backlogs component. Similarly, the poverty component was intended to reward provinces with the highest incidence of poor people – generally presumed to be concentrated in the rural areas. The backlogs and poverty components both have a weighting of 3% in the overall PES formula (National Treasury, 2000; 2005).

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[41] The provincial equitable share is distributed across the nine provinces through a deterministic model or formula made up of components and variables which proxies provincial expenditure mandates and needs.

[42] The poverty component was a compromise following the removal of the social welfare component and the shifting of a social security function from provinces to national government. The 2005 reforms revealed distortions between the weights assigned to components in the formula and expenditure levels, which resulted in some provinces (mostly rural) being short-changed by the shifting of social security funds. The poverty component was introduced to compensate provinces that were spending far beyond the social welfare weighting.

The backlogs component has since been removed from the PES and replaced by a myriad of infrastructure conditional grants, which are considered more suited to addressing specific regional development disparities, such as rural under-development. Notwithstanding these grants, the PES formula continues to be criticised for perpetuating regional imbalances. Its poverty component, which is largely regarded as being pro-rural, is small and uses a variable that is not necessarily peculiar to rural areas as a measure of need. As discussed earlier, poverty is increasingly becoming urban. Other important (and larger) PES components, such as education and health, are seen as insensitive to rurality because their underlying indicators of need do not specifically distinguish between rural and other developed areas.

Overall the PES formula is perceived as unresponsive to rural development, which is confirmed by a simple ANOVA[43] test. Table 51 compares the variation in provincial PES per capita allocations between 2000 and 2013. When the backlogs component was active (between 2000 and 2005), no discernible variation is found in the per capita PES allocations to rural and non-rural provinces. Only from 2006, following the wholesale PES reforms, do the allocations show statistically significant variations across provinces. However, the variations only appear when Gauteng is included in the analysis, suggesting that the PES is not responsive to rurality. Even when the ANOVA test is applied over a long period, from 2000 to 2013, the results show no material difference in the allocations for all provinces. Overall the results overwhelmingly suggest that the PES formula is not sensitive to rurality and imply a need to redesign the PES formula.

Table 51. Variation in per capita provincial allocations

Until 2005	*SS*	*df*	*MS*	*F*	*P-value*	*F crit*
Between groups	4187334,711	8	523416,8389	1,540963125	0,177767769	2,208518074
Within groups	12228070,8	36	339668,6335			
Until 2006	*SS*	*df*	*MS*	*F*	*P-value*	*F crit*
Between groups	5212226,918	8	651528,3647	2,35345129	0,033064753	2,152132879
Within groups	12457779,15	45	276839,5367			
2006 onwards	*SS*	*df*	*MS*	*F*	*P-value*	*F crit*
Between groups	29238931,44	8	3654866,43	2,7096799	0,013855733	2,115223279
Within groups	72836200,03	54	1348818,519			
From 2000 - 2013	*SS*	*df*	*MS*	*F*	*P-value*	*F crit*
Between groups	28044927,47	8	3505615,933	1,839764043	0,077334919	2,025247482
Within groups	205790803,5	108	1905470,403			

Source: Author's estimates

8.7.1 Rural responsiveness of the backlogs component replacement grants

After the backlogs component was removed from the PES in 2005, conditional grants were introduced within the broader provincial fiscal framework to address (among other things) historical infrastructure backlogs in the rural provinces (National Treasury, 2005). Conditional grants are appropriate instruments for funding specific regional expenditures needs that cannot be accommodated by general transfers. Grants include the Health Facility Revitalisation Grant and the Provincial Infrastructure Grant, which were discontinued in 2011 and disaggregated into the Education Infrastructure Grant and the Provincial Roads Maintenance Grant.

Unlike the PES, infrastructural conditional grants are not formula-driven and do not derive each province's share from expenditure indicators, despite being introduced to remedy historical infrastructure backlogs largely in the rural hinterlands. The allocations for infrastructure grants to provinces are based on the number of projects approved and were recently linked to a two-year planning and approval process to minimise under-spending. In this allocation model, the responsibility for addressing rural development challenges falls on provinces rather than the grant design.

As Table 52 shows, South Africa's three most rural provinces (the Eastern Cape, KwaZulu-Natal and Limpopo) combined were allowed over half (52%) of the Provincial Infrastruc-

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[43] ANOVA is a statistical tool used to evaluate whether there is any significant difference in the means of three or more independent data groups.

ture Grant and just under half (46%) of the Health Facility Revitalisation Grant (although over 15 years, Gauteng received the largest share, i.e. 25%). These three provinces also accounted for nearly two-thirds (63%) of the relatively newer Education Infrastructure Grant. Between 2000 and 2015, most of the allocations went to the rural provinces, which indicates that infrastructure conditional grants are responsive to rural needs. However, whether such infrastructure allocations are of value to rural provinces is a matter that requires further research. For instance, research needs to establish the specific types of infrastructure needed in each region and whether a province should invest in deep remote areas (where the marginal returns to infrastructure decrease rapidly due to high costs and low usage levels) – or whether a more feasible rural development remedy for these remote areas would be to move people out of the fragile lands into areas with more jobs (Fan and Zhang, 2004).

Table 52. Average provincial share of the infrastructure allocations (2000–2015)

Province	Provincial Infrastructure Grant (10-year average)	Health Facility Revitalisation Grant (15-year average)	Education Infrastructure Grant (4-year average)
Eastern Cape	17%	16%	21%
Free State	8%	5%	4%
Gauteng	14%	25%	17%
KwaZulu-Natal	20%	16%	22%
Limpopo	15%	14%	20%
Mpumalanga	7%	5%	5%
Northern Cape	5%	6%	3%
North-West	8%	6%	4%
Western Cape	6%	7%	5%

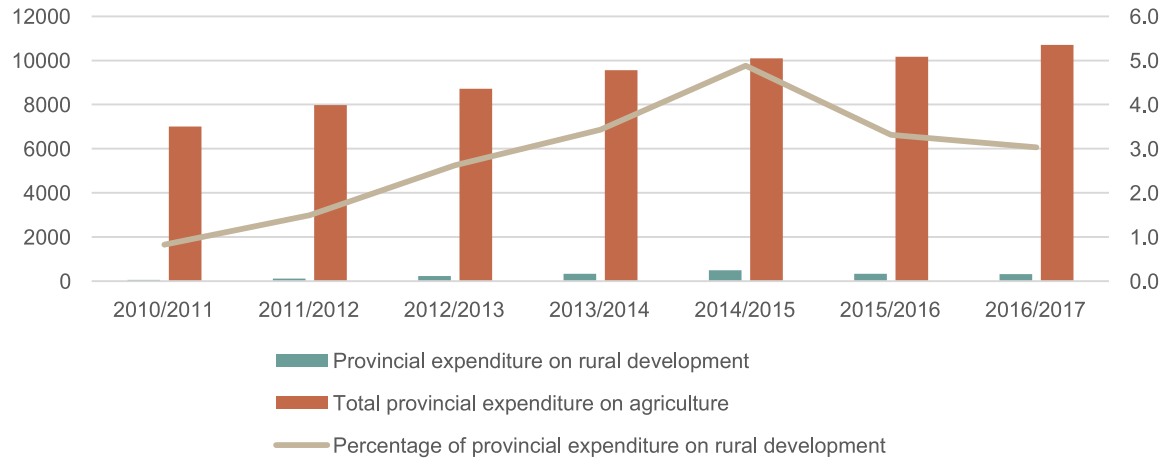
Source: Author's compilation

8.7.2 PES expenditure on rural development

The task of channelling PES towards priority areas rests entirely with the provincial legislatures and executives, albeit within the bounds of national policies and national norms and standards. Funding allocated to rural development depends on the importance attached to it by the respective provinces. As most provincial rural development activities are focused on agriculture, the allocations to the sector provide an indication as to what extent agriculture is prioritised.

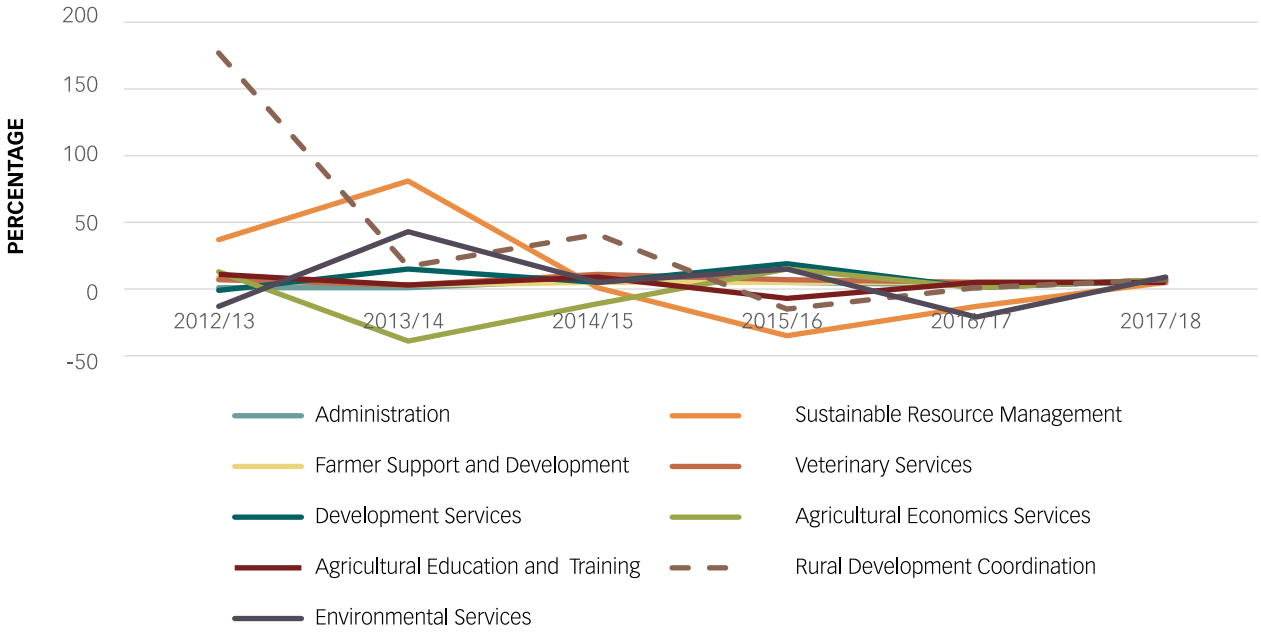
Provinces spend on average approximately 3% (or R10-billion) of their PES allocation on agriculture (Figure 73). Unsurprisingly, the three rural provinces (the Eastern Cape, KwaZulu-Natal and Limpopo) allocate the most (4%), while Gauteng allocates the least (1%). In 2016/17, rural development programmes received just under 3% of the total agriculture budget, compared to 0.08% in 2010/11 and 5% in 2014/15. The growth, albeit from a low base, of the provincial rural development budget coincided with the reintroduction and re-emphasis on rural development through the CRDP in 2009. Allocations to the CRDP are notably small because it is new and because provinces locate many activities that are associated with it under different programmes. For instance, food security initiatives, which generally sit under rural development, are part of the provincial farmer support and development programme. The rural development programme within the provincial department of agriculture is largely limited to consultation with the community (National Treasury, 2015).

Figure 73. Provincial agriculture and rural development expenditure (2010–2017)



Source: National Treasury (2015)

Figure 74. Agriculture expenditure growth rates by programme (2012/13–2017/18)

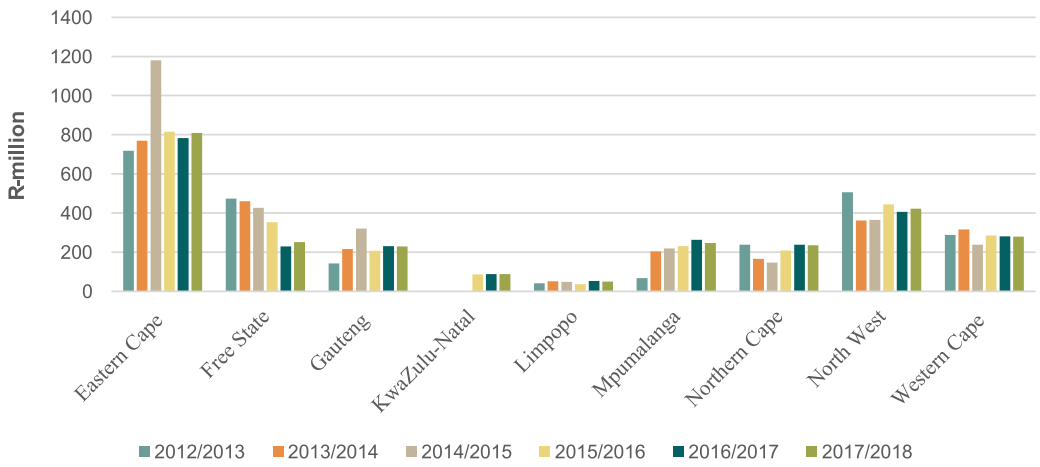


Source: National Treasury (2015)

As seen in Figures 73 and 74, rural development expenditure grew fast at the beginning of the period, presumably driven by the attention from the Presidency, but then tapered off. The decline in rural development programme allocations from 2014/15 coincided with the overall national expenditure slowdown but also reflects some de-prioritisation of rural development. National priority programmes are usually allocated bigger allocations at inception in response to policy "hype". However, as implementation challenges become apparent, allocation declines, resulting in devastating consequences for delivery goals. The RHIG, which is discussed later, is a typical example

A comparison of rural development expenditure (Figure 75) found that the Eastern Cape allocates the highest budget for rural development, while Limpopo spends the least, despite being a rural province. However, the data provides no conclusive indication of whether or not provinces are prioritising rural development. This is because (a) the extent of rural development needs in each province is unknown; (b) provincial expenditure reports do not give any spatial indication of where funds are spent – expenditure on other functions, such as education, are standardised across beneficiaries irrespective of space, while access to health-care facilities or spending per patient is not determined by a person's place of origin (HST, 2015).

Figure 75. Rural development expenditure trend by province (2012/13–2017/18)



Source: National Treasury (2015)

This expenditure review shows that provinces perceived generally as rural (with the exception of the Eastern Cape) allocate very little of their own discretionary funding to rural development, which is defined in the narrow sense as part of the agriculture department's sub-programmes. Admittedly the size of the provincial agriculture and rural development budgets are an insufficient measure to determine provincial prioritisation of rural areas.

8.7.3 Conditional grant expenditure on rural development

Conditional grants are another important source of finance for rural development, albeit driven from the centre. The current provincial fiscal framework consists of many conditional grants specifically targeted at various aspects of rural needs. The main ones are three agricultural grants: the Land Care grant, the Comprehensive Agricultural Support Programme (CASP, including Fetsa Tlala) grant, which have been in existence since 2000 and 2005 respectively, and the Ilima/Letsema project, which commenced in 2008. The 2014/15 budget allocated a total of R2.4-billion to the three grants: 78% to CASP, 19% to Ilima 19% and 3% to Land Care. These grants have overlapping objectives, which include increasing agricultural productivity, poverty relief and sustainable resource management. Their allocation framework is neither rural nor agriculture biased, whereas these grants are focused on agriculture, which has been shown not to be a dominant economic activity in rural provinces. For instance, the Northern Cape receives the largest share of CASP (34%) and Ilima (19%) grants despite contributing the least to total national agricultural output (Table 53). Conversely, the Western Cape, which is commonly regarded as an urban province, has the second highest agricultural output after KwaZulu-Natal, ahead of provinces perceived as rural. These findings dispel the view that rural areas have a strong agricultural base, and hence rural development strategies should be agrarian in focus.

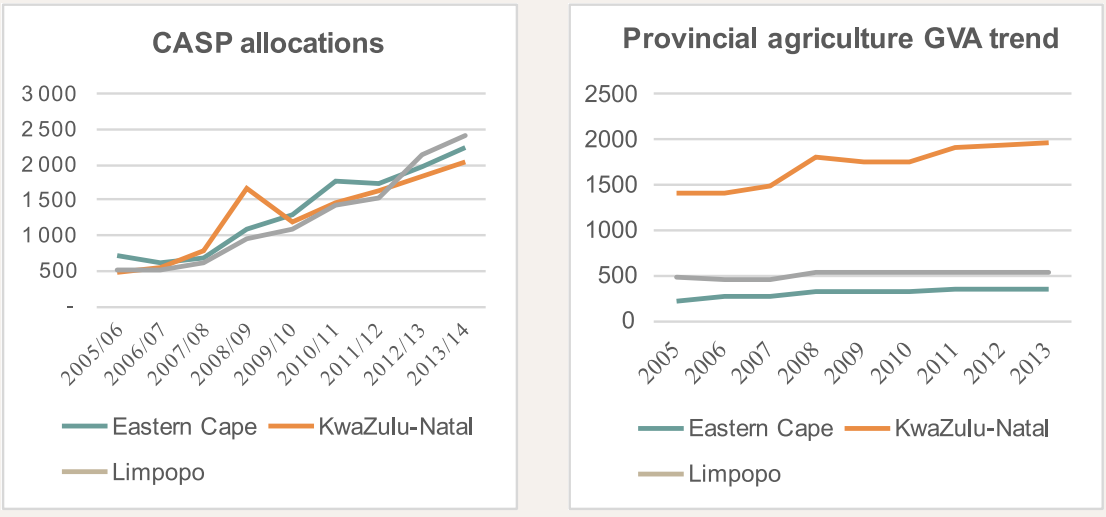
Table 53. Comparison of provincial agriculture conditional grant allocation and agriculture output

Province (R'000)	2013/14 CASP allocation	% share of CASP allocations	2013/14 Illema allocations	% share of Illema allocations	% Share of agriculture output
Eastern Cape	223 626	12%	45 567	10%	6%
Free State	140 274	7%	57 999	13%	10%
Gauteng	55 880	3%	17 538	4%	6%
KwaZulu-Natal	202 522	11%	65 768	14%	26%
Limpopo	239 978	13%	43 845	10%	8%
Mpumalanga	130 986	7%	43 845	10%	9%
Northern Cape	641 306	34%	84 393	19%	6%
North-West	170 714	9%	43 845	10%	6%
Western Cape	106 376	6%	51 737	11%	22%

Source: National Treasury database.

The skewed distribution of the allocations stems from the land area/mass being considered as a more important variable that the other factors that account for rurality, such as households involved in agriculture, restituted land, food insecurity, deprived areas and land degradation (National Treasury, 2015). The CASP allocation criteria appear to be entirely driven by land size, as the allocations reflect the province's respective land area. This is totally inconsistent with the grant objectives, especially that of increasing productivity. A simple comparison of provincial CASP allocations and agriculture GVA for the three rural provinces shows an unrelated growth pattern, with GVA growing at a flat rate and CASP at a steeper rate. Agriculture transfers do not appear to have any effect on provincial GVA (Figure 76).

Figure 76. CASP allocations and agriculture GVA in rural provinces (2005/6–2013/14)



In addition to the traditional agriculture-focused conditional grants, the current provincial fiscal framework provides for sectoral grants to finance specific rural infrastructure challenges. In 2009, the government adopted the Medium Term Strategic Framework (MTSF) in response to which (in particular Outcome 7), several departments introduced new conditional grants to fund priority rural infrastructure needs, including sanitation and school infrastructure. The Department of Water and Sanitation has taken over from the Department of Human Settlements the oversight of the indirect conditional RHIG that funds sanitation infrastructure, while the Department of Education established the Accelerated School Infrastructure Delivery Initiative (ASIDI) to address school infrastructure in the rural areas. The ASIDI is also funded through an indirect conditional grant called the School Infrastructure Backlogs Grant (SIBG).

The RHIG was introduced 2009/10, with an MTEF allocation of R1.2-billion, while the SIBG was introduced in 2011/12 with an initial MTEF allocation of R8-billion. The SIBG delivery targets are to replace 496 mud schools and provide water to 1307 schools, sanitation to 536 schools and electricity to 1434 schools within a three-year period. The Eastern Cape receives the largest share (more than 90%) of the SIBG and the second largest share (29%) of the RHIG (KwaZulu-Natal receives 34% of the RHIG). Both grants are allocated on the basis of backlogs, but the RHIG is restricted to the 27 CRDP districts. Since inception, the two grants have been characterised by significant under-spending (Table 54) and implementation challenges, and have failed to meet the government target of eradicating rural infrastructure backlogs by 2014 (FFC, 2015; AGSA, 2015).

Many of the conditional grants aimed at addressing rural development challenges are profoundly controlled by national government, either through stringent, nationally determined conditions or outright central management of the grants. For instance, in 2013, part of the CASP allocation was diverted into the national Fetsa Tlala (End Hunger) Food Production Initiative, with national government directing provinces to allocate 70% of the CASP to Fetsa Tlala. In the case of the SIBG, the allocation criteria are subjective, as the grant is mainly allocated to the Eastern Cape, over and above the School Infrastructure Grant allocated to all provinces. Lastly, control of the RHIG has been at the centre of controversy and contestation between national departments and across spheres, presumably because national government wants to control and direct where resources are allocated.

Table 54. Special rural development conditional grants (R-million)

Year	SBIG		RHIG	
	Aggregate allocation (R-millions)	% spent	Aggregate allocation (R-millions)	% spent
2010/11			R100	62%
2011/12	R700	10.9	R258	31
2012/13	R2 065	42%	R340	60%
2013/14	R1 960	70%	R106 (direct) R100 (indirect)	100% 75%

Source: National Treasury– (2010; 2011; 2012; 2013; 2014)

8.8 Main Findings and Conclusion

Internationally, no blueprint exists for designing institutional and funding arrangements for rural development. Each country organises its fiscal arrangements in accordance with the ideological orientation of its IGFR. There are visible attempts to devolve rural development responsibilities to subnational structures, in particular the districts, but in most cases rural development projects are strongly influenced and controlled by central government.

Provincial developmental trajectories are clearly converging, which counters the need for a special funding dispensation to address rural development or prioritise rural development.

Citizen participation is an important aspect of rural development because it enables the active involvement of the community in identifying their developmental needs and channelling resources towards immediate needs. However, structures created to facilitate interface between provinces and communities are ineffective and dysfunctional.

Provincial rural development mandates straddle many concurrent functions, creating fiscal tensions and duplications but also causing misperceptions of whether the responsibilities undertaken by provinces in education and health constitute rural development or not.

The PES is a key funding instrument for provinces but appears less responsive to rural challenges, as the per capita PES allocations do not differ across provinces (with the exception of Gauteng). PES allocations are primarily driven by population distribution rather than rural need indicators. Incorporating the rural indicators of needs (and the ability to collect own revenue) in the fiscal transfer frameworks may disadvantage the rural provinces because characteristics such as poverty are peculiar to both rural and urban provinces.

Notwithstanding the unresponsiveness of the PES, rural provinces allocate a small portion of this discretionary funding instrument to agriculture. The education and health budgetary allocations from the PES are found to be rural-neutral, partly because expenditure levels at schools and health-care centres are standardised across beneficiaries and not dependent on a person's place of origin. The rural provinces account for a larger share of the infrastructure conditional grants allocations, but questions remain regarding the extent to which these funds have been used to address rural infrastructure backlogs, and how infrastructure investments contribute to better expenditure outcomes.

Misalignment is evident between the allocation formulae of agriculture grants and the policy objectives for promoting agriculture output and food security. The other non-infrastructure conditional grants for promoting rural development are generally managed and implemented centrally and dominated by national policy imperatives. However, centrally controlled grants are associated with poor spending performance and insufficient reporting on expenditure outcomes.

8.9 Recommendations

Related to the Division of Revenue

1. The Provincial Offices of the Premier, in consultation with the provincial departments of basic education, health, agriculture and rural development and roads, should identify the rural development needs in the province and set annual delivery targets against which PES allocations will be assessed by oversight bodies. Departmental budgets and expenditure reports should be disaggregated in accordance with municipal boundaries to help ascertain the extent to which PES allocations are targeted to rural areas' needs.

2. The National Treasury, in collaboration with the departments of basic education, health and those responsible for provincial roads, should ensure that the criteria for allocating infrastructure conditional grants take into account spending efficiency, delivery targets and performance, as well as the applicable national norms and standards. This should assist with the monitoring of provinces in meeting their developmental goals and facilitate targeted intervention where a province consistently fails to meet delivery targets.

3. The Department of Agriculture, Fisheries and Forestry and National Treasury should review the framework for allocating agricultural conditional grants, to reduce the weighting of agricultural land size and poverty relief, and to incorporate factors that are closely aligned to the objectives of the grant, in particular the promotion of emerging farmers or agriculture production in the rural areas, as stipulated in the Agriculture Policy Action Plan.

4. The Department of Planning, Monitoring and Evaluation should conduct a comprehensive review of expenditure outcomes associated with infrastructure conditional grants targeted at the rural provinces, to ascertain the extent to which infrastructure backlogs have been reduced and the efficacy of the spend. The outcome of the review should be used to form the basis of any adjustments to infrastructure grants earmarked for rural development.

Related to coordination, community participation and prioritisation

1. In order to ensure active community participation in setting rural development priorities, the provincial Department of Health must ensure that clinic committees are functional, while the provincial Department of Education must institutionalise community participation processes between school governing bodies and the education circuit and district offices during the planning and budgeting phase.

    - Provinces must shift the role of coordinating rural development programmes from the provincial Department of Agriculture to the Office of the Premier to ensure that all aspects of rural development are taken into account during planning. The Office of the Premier must ensure that rural redevelopment projects or initiatives carried by the national Department of Rural Development and Land Reform or any other department are subjected to the relevant community participation processes – to avoid duplications.

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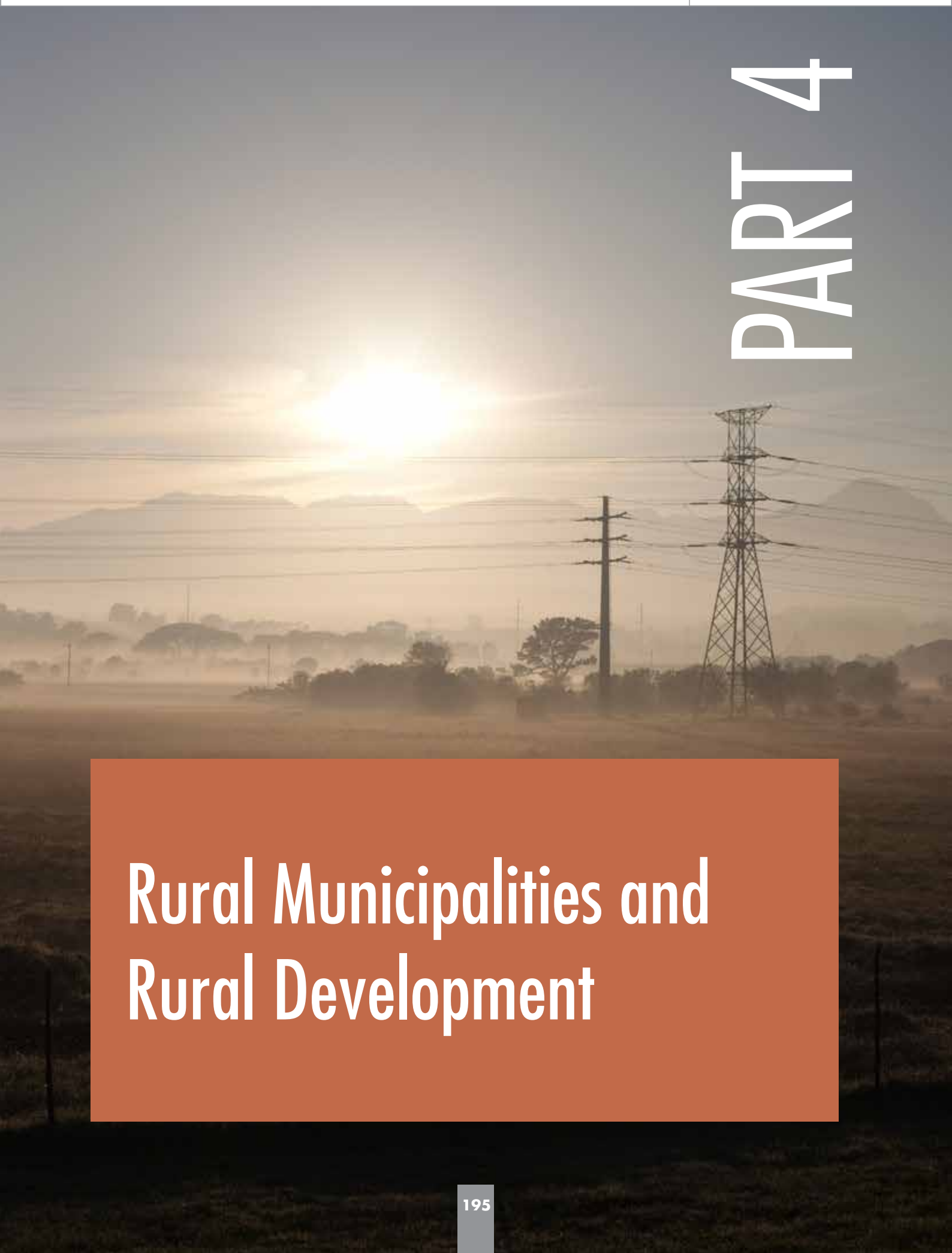


PART 4

Rural Municipalities and Rural Development

CHAPTER 9

Developing Rural Municipalities' Own-Revenue Sources

Zanele Tullock

Developing Rural Municipalities' Own-Revenue Sources

9.1 Introduction

Local governments play a pivotal developmental role throughout the world, and local government finance is vital to the improvement of living standards. Local government finance is based on two main pillars: the efficient use of public resources in order to satisfy the needs of citizens, and the potential role of local government in addressing the challenges that affect almost all countries (Martinez-Vázques and Smoke, 2010). In South Africa, local governments, unlike provincial governments, have a number of relatively broad revenue sources, including property rates and user fees on water, electricity and sanitation services (Amusa and Mathane, 2007).

Local municipalities have different expenditures and revenue bases, but all fund their expenditures from transfers, own revenues and borrowing. However, urban and rural municipalities have very different levels of revenue collection, with rural municipalities generating and collecting low levels of revenue. Metros, secondary cities and larger towns get much of their income from own-revenue sources, while intergovernmental transfers are the main source of revenues for rural municipalities (B3s and B4s) – although local governments that depend heavily on grants might not be eager to exploit their own-revenue sources (Schoeman, 2011). Increasing own revenues, which should go hand in hand with improving efficiencies, would enhance local government finances (Comrie, 2013).

Urban municipalities use own revenues to cover on average 75% of their operating expenditures, compared to 25% for rural municipalities. However, these averages mask disparities because some rural municipalities receive over 95% of their income from transfers. The rural tax base is highly constrained, despite rural municipalities being endowed with land and mineral resources. This is because rural municipalities have a limited tax base, high levels of poverty, low levels of employment and limited business activities (Mahabir and Vacu, 2013). Ideally, a significant proportion of own revenues in rural areas should be from property taxes on vast tracts of land and service charges on mining giants and other rural-based conglomerates. Therefore, a key issue is to examine what obstacles are preventing the exploitation of these rural revenue bases.

Anecdotal evidence suggests that the inability of municipalities to generate these much-needed revenues is less about billing systems and more about the low tariffs levied to corporations and business institutions; the dominance of reticulating electricity to mines and communities by Eskom, the state-owned utility, to the exclusion of municipalities; and disparities in tariff adjustments granted by the National Energy Regulator of South Africa (Nersa) between Eskom and municipalities. Another stream of anecdotal evidence suggests that rural municipalities are denied property rates revenues because agricultural and communal lands are rated differently. Against this background of eroded revenue bases, this study investigates the constraints to own-revenue generation in rural municipalities. Unlike previous studies, such as Mahabir and Vacu (2013) that focused on borrowing and the fiscal capacity and effort of rural municipalities, the present study looks at rural municipalities (B3s and B4s) and the bottlenecks relating to rating and levying agricultural and communal land, tariff levels and tariff adjustments.

The Constitution provides for three types of municipalities: category A municipalities (only in metropolitan areas), category C (district) municipalities that contain and share jurisdiction with a number of category B (local) municipalities. This study uses the methodology adopted by the Department of Cooperative Governance as the primary mechanism to define rural municipalities (the unit of analysis). Municipalities are grouped into seven different categories using variables that include the number of poor households, the proportion of households with access to services (water, sanitation and electricity), and capital and operating budgets. Accordingly, rural municipalities are those classified as B3 (small towns) and B4 (mostly rural) in the typology outlined in Table 55.

Table 55. Classification of municipalities in 2015

Class	Characteristics	Number
Metros	Category A municipalities	8
Secondary cities (B1)	All local municipalities referred to as secondary cities	19
Large towns (B2)	All local municipalities with an urban core. These municipalities have large urban dwelling populations, but the size of their populations vary hugely.	26
Small towns (B3)	Municipalities without a large town as a core urban settlement. Typically they have relatively small populations, of which a significant proportion is urban and based in one or small towns. Rural areas in this category are characterised by the presence of commercial farms because these local economies are largely agriculture-based. The existence of such important rural areas and agriculture sector explains why they are included the analysis of rural municipalities.	113
Mostly rural (B4)	Municipalities that contain no more than one or two small towns and are characterised by communal land tenure and villages or scattered groups of dwellings, and are typically located in former homelands.	68
Districts (C1 and non-rural)	District municipalities.	9
Districts (rural)	District municipalities that are rural.	35

Source: National Treasury (2012)

9.2 Objectives of the Study

This study has three objectives: to ascertain whether potential additional own-revenue sources exist that could benefit rural municipalities; to explore the constraints to the property revenue base; and to investigate the reticulation of electricity mainly between Eskom, mines and local communities. The research seeks to:

- Examine the constraints to rating and levying agricultural land.
- Investigate the inequitable electricity tariff structures, and why businesses and households have different tariff structures.
- Explore different and innovative ways of tapping into economic activity in rural areas, such as benefiting from mining activities and taxing communal land.
- Make recommendations on how obstacles identified can be overcome.

9.3 Background

Local government in South Africa has been plagued by challenges that signify the sector's inability to perform its constitutionally mandated functions efficiently (Benz and Fetzer, 2006). The myriad of challenges have put in the spotlight various aspects of the intergovernmental fiscal relations (IGFR) system, including the fiscal unsustainability of municipalities. A number of municipalities have been subjected to Section 139 interventions, which are often a sign of poor fiscal performance. Although audit outcomes have improved slightly, with unqualified (without findings) audits increasing over time, qualified audits (which demonstrate poor financial health) have also increased

The contribution of own revenues to total municipal revenue varies considerably among municipalities. As Figure 77 shows, between 2003/04 and 2012/13, own revenue represented a greater share of revenue for metros, secondary cities, and large and small towns, whereas intergovernmental transfers were the dominant source of revenue in the smaller towns and mostly rural municipalities.

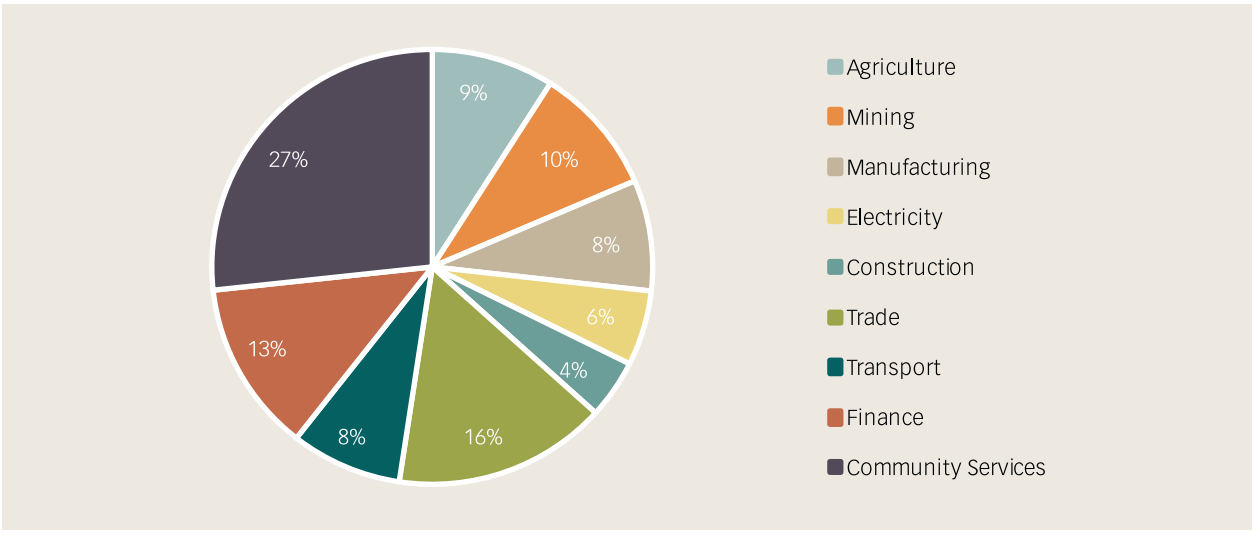
Poverty and the poor delivery of basic services are much more accentuated in rural areas (Jacobs, 2012) because of the inherent characteristics of the sector. These include spatially dispersed populations, the legacy of the former homeland system, limited opportunities for resource mobilisation, a limited tax base and political marginalisation. B3 and B4 municipalities are concentrated in KwaZulu-Natal, Eastern Cape, Northern Cape and Limpopo, Free State, North West and Mpumalanga, with some (mostly B3) in the Western Cape.

The dominant economic activities in rural municipalities are trade, finance and community services. In contrast, A and B1 municipalities have robust financial and manufacturing industries, and this economic activity translates into increased use of municipal services, which in turn results in increased municipal revenues. Figure 78 depicts the contribution of each sector to the general economy of rural areas.

Figure 77. Average revenue split per source by municipal category (2003/04–3012/13)

Source: Author's calculations using data from National Treasury (2012)

Figure 78. Economic activities in B3 and B4 municipalities (2014)



Source: Author's calculations using data from National Treasury (2012)

Like most developing countries, South Africa is becoming urbanised. Between 2001 and 2011, the country's rural population declined, from 42.5% to 37%, while the urban population increased from 57% to 60% (Stats SA, 2002; 2013), making South Africa slightly more urbanised than the international average. The urban population is projected to grow to 70% by 2030 (NPC, 2011). Table 56 provides an overview of South African population distribution. The large proportion of people still living in traditional rural areas creates great developmental challenges in a rapidly modernising economy. Of the estimated 15.9 million people living in poverty, 69% reside in rural areas (National Treasury, 2014).

Table 56. The geographical distribution of the South African population (2011)

Class	Geography type			Total
	Urban area (%)	Tribal or traditional area (%)	Farm (%)	
Formal residential	87	03	01	56
Informal residential	09	0.1	1.7	06
Traditional residential	-	96	13	31
Farms	-	-	76	4
Parks and recreation	0.03	0.005	0.9	0.07
Collective living quarters	1.7	0.2	1.2	1.1
Industrial	0.4	0.02	0.6	0.3
Smallholdings	0.9	0.06	5.8	0.9
Vacant	0.08	0.2	-	0.1
Commercial	0.9	0.01	0.05	0.55
Total	100	100	100	100

Source: Stats SA (2013)

Rural development is not simply about alleviating poverty but is a multi-faceted phenomenon. Its key focus is on empowering disenfranchised people to earn more, advance themselves and their communities, and contribute to the upkeep of crucial infrastructure. The rural economy is not sustainable enough to provide the rural poor with meaningful self-employment opportunities, which constrains their earning capabilities. The rural poor also experience high living costs because they spend comparatively more on basic social services. Social grants, subsistence agriculture and remittances serve as sustenance for poor households in rural areas, and yet rural municipalities could be a conduit for alleviating poverty through sustainable rural development. By providing basic services effectively and ensuring municipal fiscal sustainability, rural municipalities can play a pivotal role in the fight against poverty. Currently, the rural sector depends heavily on grants from provincial and national government, so much so that if the grants were withdrawn, most municipalities would stumble and ultimately crumble (Kanyane, 2011).

9.4 Brief Overview of the Municipal Revenue System in South Africa

Municipalities get their own revenue from taxes charged on immovable property, such as land and buildings, and the tariffs charged for services such as refuse removal, water and electricity, as well as other taxes. In addition, South African legislation provides for municipalities to receive resources proportionate to their responsibilities through transfers, in the form of either the "equitable share allocation" or grants. One of the most important conditional grants from national government is the Municipal Infrastructure Grant (MIG), which is intended for the extension and/or maintenance of infrastructure necessary to provide basic services such as water, electricity and sanitation. Table 57 sets out the main sources of local government funding.

Table 57. Sources of local government funding

Source of Local Government Funding	Characteristics	Number
Municipal own-revenue sources		
Rates on property	Section 229 and 227(2)	Municipal Property Rates Act
Surcharges on fees for services provided by, or on behalf of, the municipality	Section 229 and 227(2)	Municipal Fiscal Powers and Functions Act
Service charges/fees	Section 229 and 227(2)	Municipal Systems Act Municipal Finance Management Act Electricity Act and Electricity Regulation Act National Water Act Provincial Land Use Planning Ordinances
Other taxes, levies or duties	Section 229 and 227(2)	Municipal Fiscal Powers and Functions Act
Administrative fees		Municipal Systems Act
Fines		National Road Traffic Act
Borrowing	Section 230A	Municipal Finance Management Act
Credit control and debt control		Municipal Systems Act
Transfers from national and provincial government		
Local government equitable share of nationally collected revenues	Section 214 and 227	Intergovernmental Fiscal Relations Act The Annual Division of Revenue Act
Fuel levy sharing with metropolitan municipalities	Section 229(1)(b)	The Annual Taxation Laws Amendment Act
Conditional grants from national government	Section 214(c), 226(3) and 227(1)(c)	Intergovernmental Fiscal Relations Act The Annual Division of Revenue Act The Annual National Appropriation Act
Conditional grants from provincial government	Section 226	The Annual Division of Revenue Act The Annual National Appropriation Act of the relevant province

Source: Author's calculations using data from National Treasury (2012)

In 2014/15, the 70 most rural local municipalities had a combined total projected budget of R17.1-billion, of which 73% was funded by national transfers. In contrast, eight metropolitan municipalities had projected budgets totalling R196.9-billion, of which 17% was funded through nationally raised revenue (National Treasury, 2014). One of the constraints that undermines the finances of rural municipalities is the fact that property rates and service charges are not levied on non-poor households and businesses in rural municipalities, even though these households and businesses can afford to pay for services (National Treasury, 2011). Improving own revenues is crucial in re-establishing the link between user charges for services and the value of the service delivered.

9.5 Literature Review

9.5.1 Fiscal federalism and autonomy in sub-national resource mobilisation

Most governments in developing countries strive to use internal resources for economic and social development. An effective tax policy is one of the most important instruments for organising resources (Karagöz, 2013). "Good" local taxes have the following characteristics: (a) they are easy to administer locally, (b) they are obligatory for local residents, and (c) they do not raise competition among the various tiers of government (Bird and Slack, 2013).

Participation and accountability at the local level are greater when decision-making is distributed and not localised (Shah, 1994). Subnational governments also tend to be more responsive to residents when they depend on own revenues (Pöschl and Weingast, 2013) to provide market-enhancing public goods and are less corrupt (Singh and Srinivasan, 2006). In contrast, reliance on grants can make local governments less accountable for their fiscal decisions.

According to Dirie (2005: 260), "[t]here are two basic principles for assigning revenues to local government":

- Own-source revenues, which should be adequate enough to finance services that benefit local residents.
- Local government revenues that should be collected only from local residents, businesses and service users.

Local autonomy or accountability is meaningless if local government does not have the freedom to set the level and composition of its revenues. The lack of taxing powers at local level reduces accountability and does not provide sufficient revenue for the supply of adequate services (Brosio, 2000; Fjeldstad and Heggstad, 2000) At the same time, there must be a link between the taxes collected and services delivered by the municipality (Bahiigwa et al., 2004), as dissatisfaction with service delivery can lead to non-payment of taxes (Fjeldstad and Semboja, 2001). However, the reality is that most local governments in Africa do not have sufficient local revenues and so will continue to depend on national transfers.

9.5.3 Local government "own-revenue" instruments

Property taxes

Very few taxes are as important to the local government as property tax, which meets the characteristic of a "good" local tax (Bird and Slack, 2013). A property tax is in principle difficult to avoid because "real property is visible, immobile, and a clear indicator of one form of wealth" and, if well administered, it can be "a non-distortional and highly efficient fiscal tool" (Fjeldstad and Heggstad, 2012: 10). Yet in Africa, property tax is not an important revenue source for various reasons (ibid: 12):

> (a) with the exceptions of Botswana, Namibia and South Africa, property markets are not well developed; (b) property registers and valuation rolls are often outdated or not in place; (c) administrative capacity and equipment are often limited; (d) the tax base is generally narrowed by extensive legal exemptions; and (e) lack of political support to enforce the property tax and political interference in revenue collection.

To address the problem of outdated valuation rolls, some countries (e.g. South Africa and Uganda) have "introduced 'mass valuation' as an alternative to discrete valuations of individual properties or are considering this (e.g. Kenya)" (ibid: 13). However, this is constrained by the lack of external quality control of valuation rolls; only South Africa has legislation that "provides for ministerial oversight regarding the effectiveness, consistency, uniformity, and application of municipal valuations" (ibid).

User charges for "trading services"

For urban municipalities in South Africa, an important source of own revenue is user charges for basic services, especially surcharges on water and electricity (Fjeldstad and Heggstad, 2012). A large share of surpluses from these charges is used to fund other local government services (including wages) rather than being reinvested in the electricity sector (Peters, 2014). What this means is that "the tax component of the user fee is hidden for ratepayers", i.e. the "true level of local government taxation is not transparent". As a result, the accountability of the local revenue system is undermined because the price the consumer pays for the service includes this implicit tax (Fjeldstad and Heggstad, 2012).

9.6 Methodology

To ascertain the potential for additional own-revenue taxes in rural areas, case study information from six rural municipalities was used, supplemented by focus group interviews with chief financial officers (CFOs) and senior managers responsible for planning and electricity reticulation in the selected municipalities. Six rural municipalities with agricultural and mining activities were identified through purposive sampling. These municipalities were: Abaqulusi (KwaZulu-Natal), Dihlabeng (Free State), Emakhazeni (Mpumalanga), Endumeni (KwaZulu-Natal), Maluti-a-Phofung (Free State) and Ikwezi (Eastern Cape). A total of 21 officials were interviewed in these six municipalities, using a semi-structured questionnaire. Secondary data from municipal records was also used to supplement information collected from personal interviews and focus group discussions.

The questionnaire was constructed around the following themes:

(i) Revenue sources from communal/agricultural land and property on this land: to establish how communal or agricultural land is rated and levied, how land taxation is administered and how often valuations are undertaken. This theme also seeks to determine revenue collected from property e.g. buildings and other immovable assets on communal land.

(ii) Revenue sources from mining activities: taxes (e.g. business tax and real property tax), royalties or other fees (e.g. registration and occupation fees) levied by the municipality on mining companies in its jurisdiction. Is taxation and/or the payment of other fees dependant on the type of mineral mined, the mine's life cycle or the economic scope of the mine (large-scale vs small-scale)?

(iii) Revenue sources from electricity reticulation: the possible existence of disparities in electricity tariffs levied to business institutions compared to households, and the municipality's revenue management capabilities in this regard.

(iv) Other revenue sources: the respondents were asked to suggest any other alternative sources that municipalities can pursue.

9.7 Findings

9.7.1 Property taxes from communal/ agricultural land

In rural municipalities, collecting property taxes faces the triple challenge of unemployment, property valuation difficulties and tax administration challenges. Further compounding the challenges of assessing, billing and collecting property taxes are the unclear division of powers, and sometimes the acrimonious relationship, between the municipality and traditional leaders (in the form of chiefs). Households also prefer to pay flat levies rather than taxes based on the value of the property because municipalities have not adequately communicated the role of value-based property taxes to residents. Most municipalities interviewed do not know what the role of chiefs is in the rating of communal land and property in their areas, and agree that more could be done to exploit property tax as an own-revenue source.

Even though property taxation is being extended to rural properties in South Africa under the terms of the Local Government: Municipal Property Rates Act 6 of 2004 (Franzsen, 2007: 12), the study indicated that among other things, property registers and valuation rolls are often outdated or not in place; administrative capacity to manage such a tax is often limited; and there is both a lack of political support to enforce the property tax and political interference in revenue collection.

9.7.2 Electricity provision as source of revenue

Electricity user charges are an important source of revenue, accounting for more than half of municipal own revenues in certain jurisdictions. However, in some municipalities, one area gets electricity from the municipality, while another area gets it directly from Eskom. For instance, in Dihlabeng Local Municipality, the commercial and some residential areas of Bethlehem buy electricity from the municipality, while Bohlokong Township receives electricity directly from Eskom. Eskom has a service level agreement with the municipality to provide electricity to Bohlokong. Electricity prices are regulated by the National Energy Regulator of South Africa (Nersa), which limits the extent to which municipalities can increase own revenue by passing increased costs onto end users. Given the developmental role that local government must play, this limitation has consequences that are more far-reaching than simply foregone revenue. Some municipalities charge different end-user tariffs (e.g. Abaqulusi, Ikwezi and Endumeni) in order to increase the municipal revenue base. Other factors that contribute to diminished revenue from electricity include the theft and loss of electricity through illegal connections and tampering with conventional meters.

9.7.3 Mining levies/fees as a source of revenue

Mining levies/fees were found not to be a viable sources of revenue for municipalities. Two local municipalities (Endumeni and Maluti-a-Phofung) have little knowledge of the exact mining activities taking place within their respective jurisdictions, other than knowing that a mine exists. The officials interviewed felt that municipalities do not have any constitutional or legal mandate to levy fees related to mining. Furthermore, they do not know whether the mines are paying taxes to the province or to central government, and in what form the taxes are paid.

9.7.4 Other sources of own revenue

Other possible own-revenue sources, outside of property taxes, mining levies and electricity service charges, include charging "user fees" for social amenities (such as parks and community halls) and "restaurant/hotel fees" in areas with viable and vibrant tourism industries. Most of the municipalities interviewed conceded that their biggest constraint is the inadequate capacity to administer such fees, and the unwillingness of communities to pay for facilities that they feel entitled to freely use and enjoy. Blouberg and Endumeni municipalities suggested a surcharge[44] as an added source of revenue but conceded that, if residents feel no value has been added to a particular service, they are unlikely to pay an "extra fee". If properly captured, these additional revenue sources could enable rural development to become a reality. However, in exploring additional revenue sources, the buy-in of traditional leadership must be prioritised.

9.8 Conclusion

Government seeks to make rural municipalities self-sufficient and less dependent on transfers, and so municipalities need to generate their own-revenues and not rely completely on transfers. It has emerged from the study that the collection of property taxes from rural municipalities faces a number of challenges, including outdated property valuation rolls, political interference and the unwillingness of residents to pay rates commensurate to the value of the property. The regulation of electricity prices by Nersa also limits own revenue collection, resulting in revenue losses for these municipalities. Given these limitations, it is therefore necessary for municipalities to seek diverse and "non-traditional" revenue sources to address their growing responsibilities and pay for their operations, infrastructure and maintenance. Despite property taxes being generally deemed a reliable source for local governments, this is not the case in rural municipalities due to deficient property tax administration.

9.9 Recommendations

With respect to financing rural local municipalities for rural development, the Commission recommends that:

1. With assistance from the national and provincial Departments of Cooperative Governance and Traditional Affairs, rural municipalities ensure that:

    - Property registers and valuation rolls in rural areas are in place and up-to-date.
    - Rural municipalities are adequately capacitated to collect and administer such a tax.

>>

[44] A surcharge is a fee or other charge that is added to the cost of a good or service. It is typically added to an existing tax, and may be temporary (e.g. fuel surcharge) or permanent in nature.

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CHAPTER 10

The Funding Model for Local Rural Municipalities

Mkhululi Ncube and Jabulile Monnakgotla

The Funding Model for Local Rural Municipalities

10.1 Introduction

Local government is facing a myriad of challenges that include poor economic growth, and high levels of unemployment and poverty. According to the Department of Cooperative Governance and Traditional Affairs (COGTA), a third of municipalities are dysfunctional and unviable (whatever the definition), while another third are at risk, and the remaining third are functional and viable. The majority of unviable municipalities are in rural areas and depend significantly on grants to fulfil their mandates. The government is aiming to minimise this dependency, as evidenced by the recent proposal by COGTA to amalgamate many municipalities to make them self-reliant.

The COGTA proposal suggests that a third of municipalities are dysfunctional and non-viable. Therefore, to correct for dysfunctionality and financial viability, the Minister of Cooperative Governance and Traditional Affairs proposed the redrawing of some municipal boundaries or the simple amalgamation of some municipalities. COGTA requested the Municipal Demarcation Board (MDB) to consider reviewing the boundaries of 34 municipalities in a proposal that affected 90 municipalities. The recent demarcations were motivated by a desire to eliminate dependency and improve municipal functionality. They provide an interesting case study because, for the first time in South Africa's history, demarcations were motivated by the desire to optimise the financial viability of municipalities. In the COGTA proposal, financial viability equates with self-reliance or self-sufficiency. Dependency on grants is considered an indicator of financial unviability and a problem that can be addressed through the demarcation instrument, i.e. dividing the country into spaces that have roughly even revenue bases. The assumption is that amalgamating municipalities will bring economies of scale and create functional municipalities that are large enough to deliver financially and technically on their mandates.

The COGTA request raises various research questions related to municipal viability and municipal functionality. In particular, what constitutes a viable municipality, and will the mergers proposed by COGTA create financially viable or self-reliant rural municipalities? If not, are there alternative funding models that could enhance the viability of the amalgamated rural municipalities? Furthermore, is there a link between functionality and boundary changes, and can a boundary change or amalgamation solve a municipality's managerial and delivery challenges?

10.1.1 Objectives

The main objective is to evaluate the funding model implied by the motivation underpinning the COGTA proposal for demarcations, using the recent wave of boundary changes as a case study. Other objectives include:

- To evaluate the implications of implementing the COGTA demarcation proposals.
- To examine whether current amalgamations will create "viable" or self-sufficient/self-reliant or functional rural municipalities.
- To recommend an appropriate funding model for amalgamated rural municipalities that are not financially self-sustaining.

10.2 Background

10.2.1 Historical context of municipal demarcation in South Africa

Demarcations and amalgamations in the local government sphere are not a new phenomenon in South Africa. Between 1948 and 1994, the country's decentralisation experience demarcated jurisdictions and organised governance on the basis of race, rather than on the basis of functional linkages or similar criteria (Van Ryneveld, 1996). The racially driven, decentralised governance system consisted of two main categories – white local authorities (WLAs) and black local authorities (BLAs). [45]

WLAs represented the earliest example of fiscal decentralisation in South Africa. Established in the early 1900s, they covered most of the country's urban areas, and were primarily responsible for providing services to urban white, coloured and Indian citizens living in areas outside of the homelands. Access to relatively wealthy sections of society meant that WLAs enjoyed a high degree of fiscal autonomy. In fact the notion of a viable municipality comes from the era of WLAs. WLAs were "viable" in the sense that they were self-sufficient. They had all the tax bases (property taxes and fees) and so relied entirely on own revenues but served only a small section of the population. In contrast, post-1994 municipalities have a fundamentally different mandate, do not have all the tax bases, rely significantly on transfers and cover entire populations, including rural areas. Therefore, it is difficult to subscribe to the same notion of viability.

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[45] The development of segregated local government bodies for coloureds and Indians followed a separate path from that for Africans. Under the Group Areas Amendment Act of 1962, provincial administrators constituted "Local Affairs Committees" or "Management Committees" in designated coloured and Indian areas. In their initial phases, these committees were intended to act in a purely consultative capacity in relation to WLAs, which retained administrative control over their areas. These committees would subsequently be granted full local authority status in terms of the criteria set out by provincial administrators in relation to a prescribed range of local issues. Despite their transformation into wholly elected entities, very few attained full local authority, as the status of the majority of the committees remained that of mere advisory bodies with few powers beyond granting trading licenses (Lemon, 1992).

Initially administered by adjacent WLAs, the BLAs evolved from the community councils that were introduced in response to the uprisings of June 1976. The BLAs enjoyed very little political legitimacy, as they were regarded as a facade set up by the apartheid regime to give some form of democracy to blacks, while entrenching segregation (Bahl and Smoke, 2003). The BLAs were unable to develop productive tax bases because of apartheid restrictions on economic development in black areas, insufficient socio-economic infrastructure that could generate service fees, and a lack of access to property, quality education and formal employment among black South Africans. As a result, BLAs generated very little own revenue, operated inefficient fiscal systems, and lacked the capacity to provide the necessary socio-economic services.

For much of the late 1980s and early 1990s, public anger over appalling service levels and attempts to impose rents and service charges in the BLAs led to violent rent boycotts, and fuelled the drive by civic organisations and activists to link local grievances to internal efforts to overthrow apartheid. As part of political efforts to end apartheid, a Local Government Negotiating Forum (LGNF) was established in 1992, and tasked with negotiating local settlements to rent and service boycotts, and amalgamating racially divided local authorities into a new local government system that would be more widely accepted. By 1993, negotiations at the LGNF resulted in the enactment of the Local Government Transition Act (LGTA) which outlined three phases – the pre-interim, interim and final phases as steps towards completing the formal role of local governments under a democratic dispensation (Smoke 2001; Powell 2012).

The pre-interim phase covered the period between the democratic election of 1994 and the first local government democratic elections held in 1995/96. In terms of the LGTA, local government was organised through locally negotiated transitional councils that were established via "negotiating transitional forums" within each municipal area. Representation on these transitional councils took the form of members being appointed in equal proportions from statutory institutions (such as the WLAs, BLAs and designated Indian and coloured local governments), and non-statutory bodies (mainly civic organisations, trade unions and previously unrepresented political parties). This phase concluded with the 1995/96 local government elections which ushered in the interim phase. A major prerequisite for the 1995/96 local government elections was to amalgamate the inherited apartheid-era local government structures. To facilitate this, the LGTA provided for the establishment of a Local Government Demarcation Board in each of the nine provinces, and granted these boards mainly advisory powers to make recommendations on matters relating to boundary and ward delimitations to their respective provincial Ministers of Local Government.

The process of boundary and ward delimitations for the interim phase led to the creation of three types of municipalities: metropolitan, urban and rural. The six large urbanised areas of the country (four in the Johannesburg–Pretoria area plus one each in Durban and Cape Town) were administered within a two-tier system consisting of transitional metropolitan councils (TMCs) and transitional metropolitan substructures, while transitional local councils (TLCs) were established to govern urban areas. For rural areas not included within TLCs, local governance structures took one of three forms: transitional representative councils, transitional rural councils (TRCs) and district councils (Cameron 2006; Schroeder 2003).

Chapter 7 of the 1996 Constitution made provision for three categories of municipalities: **Category A** municipalities (metropolitan councils) that exclusively covered large urban areas; **Category B** municipalities (local councils) that administer non-metropolitan areas, which vary in size and extent of urbanisation, and **Category C** municipalities (district councils).[46] The Local Government Demarcation Act (No. 27 of 1998) became the major policy instrument for dismantling locally segregated local government and ushering in the final phase of the local government transformation process. In line with Constitution, which stipulates that municipal boundaries are demarcated by an independent body, the Act merged the nine provincial demarcation boards into a single entity: the Municipal Demarcation Board (MDB). Unlike provincial boards, which had played a largely advisory role, the MDB was granted the status of the final decision-making body over matters of municipal demarcation and delimitation of municipal borders. [47]

In preparation for the 2000 local elections, which commenced the final phase of transforming the local government sphere, the MDB initiated two important changes to the composition of local governments. First, it established "wall-to-wall" municipalities, in accordance with the Constitution (1996) that called for municipalities to "be established for the whole of the territory of the Republic". Second, the MDB consolidated the former TLCs into a single local jurisdiction, which meant that a number of former TLCs would be included within the boundaries of Category B municipalities. As a result of the MDB's demarcation process, by the 2000 local elections, the complex system of 843 transitional municipalities had been consolidated into 284 municipalities. The country's six largest urbanised and industrialised centres made up the Category A municipalities. Outside the metropolitan areas, a two-tier structure was established with 231 Category B

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[46] These district councils succeeded joint structures between local authorities that had been established via the Regional Services Council Act of 1985 and named "Regional Services Councils (RSCs)" and "Joint Services Boards" (JSBs). The main function of the RSCs and JSBs was to operate a regional system for providing "bulk" infrastructure services in larger urban areas, especially poor black areas, as well as some rural areas.

[47] Where applicable, these powers were subject to a process that afforded any aggrieved parties or stakeholders the right to appeal decisions by the MDB, and for the MDB to consider such appeals.

municipalities falling under 47 Category C district councils. Then, in preparation for the 2006 local elections, the MDB consolidated the number of municipalities to 283. This reconfiguration resulted in the disappearance of cross-boundary municipalities. Ahead of the 2011 local elections, the number of municipalities was further reduced to 278: Category A municipalities increased from 6 to 8, while the number of local and district municipalities decreased to 226 and 44, respectively.

The motive underpinning the demarcations in the 1990s was to de-racialise municipalities that were segregated along apartheid spatial lines and, to an extent, redistribute resources from affluent municipalities to poor municipalities. White municipalities had clear tax bases, capacity and other resources but were only serving very small populations, whereas the black authorities consisted of mainly townships, tended not to have strong tax bases, and were characterised by a culture of non-payment for services and poor services. For example, in Cape Town, the main rationale for amalgamation in 1996 was to redistribute from rich municipalities to poor municipalities. The Western Cape Demarcation Board deliberately drew the boundaries of Cape Town to merge the former black and white municipalities. This resulted in a one-tier municipality with geographic boundaries that cover the economic region. However, amalgamating the previously black and white local authorities created problems, such as collapsing infrastructure (e.g. water and sewerage systems) because of the increasing number of people that now had to be serviced. Other challenges included financial stress due to increasing salaries, limited experience and lack of capacity.

In 2002, financial viability became a demarcation issue after The Presidential Coordinating Council (PPC) passed a number of resolutions on local government, mostly stemming from the need to build financially viable municipalities. The issue of municipal financial viability is not new but has still not been resolved 16 years after developing local government.

10.2.2 Demarcations in 2015

In 2015 the Minister of COGTA proposed further boundary changes that would see more municipalities becoming even larger. As noted above, the principal motivation for these changes was to ensure that municipalities are financially viable and functional. This study addresses the question of whether these amalgamations will result in viable (self-sufficient/self-reliant) or functional municipalities.

The 2015 boundary redeterminations reduced the number of municipalities by 21, from 278 to 257. Table 58 shows the distribution of municipalities affected by demarcations in 2016.

Table 58. Municipalities affected by boundary re-determinations in 2016

New Municipality	Affected municipalities (Amalgamations)
Eastern Cape	
EC101	Camdeboo LM, Baviaans LM and Ikwezi LM
EC129	Nxuba LM and Nkonkobe LM
EC139	Inkwanca LM, Tsolwana LM and Lukanji LM
EC145	Gariep LM and Maletswai LM
KwaZulu-Natal	
KZN212	Vulamehlo LM and Umdoni LM
KZN216	Ezinqoleni LM and Hibiscus Coast LM
KZN237	Umtshezi LM and Imbabazane LM
KZN238	Emnambithi/ Ladysmith LM and Indaka LM
KZN276	Hlabisa LM and The Big Five False Bay LM
KZN282	uMhlathuze LM and Ntambanana LM
KZN285	Mthonjaneni LM and Ntambanana LM
KZN436	KwaSani LM and Ingwe LM
Free State	
MAN	Mangaung Metro and Naledi LM
Limpopo	
LIM341	Musina LM and Mutale LM
LIM343	Thulamela LM and Mutale LM
LIM345	Makhado LM and Thulamela LM
LIM351	Blouberg LM and Aganang LM
LIM353	Molemole LM and Aganang LM
LIM354	Polokwane LM and Aganang LM
LIM368	Modimolle LM and Mookgopong LM
LIM476	Fetagomo LM and Gretaer Tubatse LM
Mpumalanga	
MP326	Umjindi LM and Mbombela LM
Northern Cape	
NC087	Mier LM and //Khara Hais LM
North West	
NW405	Tlokwe LM and Venterdorp LM

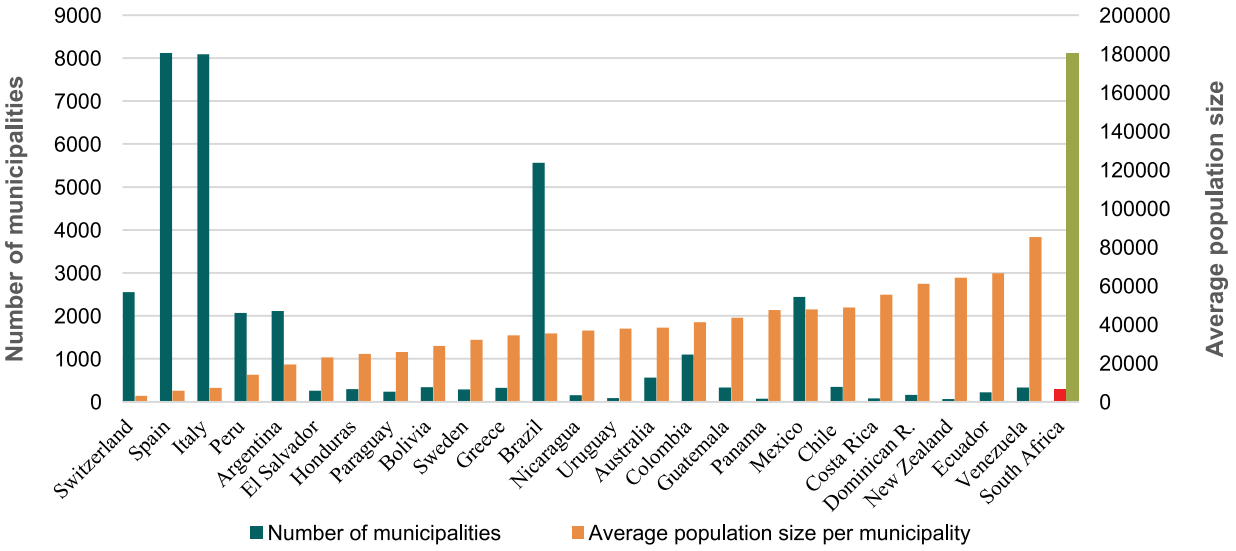
Source: MDB (2015)

10.3 Literature Review

10.3.1 South Africa's local government sector within a global context

With the reduction in the number of municipalities, from 278 to 257, a comparison with other countries is pertinent. International literature is clear that no standard size for a municipality exists, whether by geographical space, population size or political representation. However, compared to other countries, South Africa is at the extreme end of the spectrum for three characteristics: number of municipalities, average population size per municipality and number of citizens per local councillor. South Africa has one of the lowest number of municipalities and one of the highest average population sizes per municipality (Figure 79), as well as one of the highest number of citizens per councillor (Table 59). This has far-reaching implications for political representation, and democratic and governance accountability. When a local government structure is large, access to authority through public hearings, meetings, elections or direct contact is difficult; political representatives are far removed from the electorate; and citizen participation is weaker.

Figure 79. Number of municipalities and average municipal population sizes



Source: IMF (2010); World Bank (2014); Federation of Canadian Municipalities (2015)

Table 59. Number of citizens per councillor

	Number of councillors	Number of citizens per councillor
Republic of Ireland (2014)	949	4861
New Zealand (2000)	1892	2039
Philippines (2000)	2102	37075
Malaysia (2000)	2921	7654
Nepal (2000)	3344	7099
Australia (2000)	6637	2886
South Africa (2011)	9090	5671
Canada (2014)	19534	1819
Japan (2000)	62452	2031
China (2000)	653244	1933

Source: Drage (2001); IMF (2010); World Bank (2014); Morna and Mbadlanyana (2011); Federation of Canadian Municipalities (2015)

10.3.2 Why amalgamate municipalities?

Literature cites a number of reasons for amalgamations, including economies of scale, through, for instance, reducing the number of politicians and bureaucrats. Bigger municipalities are viewed as able to deliver services more effectively than smaller, fragmented municipalities. Larger municipalities result in improved productivity, cost savings, enhanced quality and mix of public goods, greater administrative and technical capacity and more effective lobbying with other spheres of government (Dollery and Robotti, 2008). They are able to provide a more extensive array of services than small, fragmented municipalities (Dollery et al., 2007; Slack and Bird, 2013).

The literature also has some strong arguments against amalgamations. When municipalities with different service levels and wage scales are amalgamated, operating costs may increase if the employees of the smaller municipality demand wage parity with their counterparts in the larger municipality. Salaries and benefits tend to equalise to the higher scale, thereby offsetting any cost savings (Slack and Bird, 2013). The advantage of having many smaller municipalities is that this can stimulate competition and be an incentive to be efficient, responsive and accountable to community needs (Faguet, 2004; 2011).

However, despite all the strong arguments for and against consolidation, empirical evidence is at best mixed (Lago-Penas and Martinez-Vazquez, 2013) and shows that there is no optimal municipal size (Bish 2000; Boyne, 1998; Dollery et al., 2012; Oakerson, 1999;). A review of research in the UK and USA found that "[o]verall, 29 percent of the empirical papers find evidence of U-shaped cost curves, 39 percent find no statistical relationship between per capita expenditure and size, 8 percent find evidence of economies of scale, and 24 percent find diseconomies of scale" (Byrnes and Dollery, 2002: 3). Cowley (2009) argues that high-density developments result in service delivery and administrative efficiencies, whereas spread-out, low-density developments are more costly to serve. Therefore, amalgamation may not achieve the hoped-for economies of scale but rather spread the operating costs of the insolvent municipality over a wider tax base (ibid).

Table 60 summarises this literature. The main message from this literature is that boundary changes can have either positive or negative fiscal consequences on municipalities as well as on their fiscal/financial viability.

Table 60. Summary of literature on the impact of municipal boundary changes

Author	Country	Findings
Dollery et al. (2007)	Australia	The study looked at the impact of municipal amalgamation on the financial viability of the South Australian Local Government, focusing on whether the size of a municipality improves its viability. The results indicate that there is no correlation between the municipal size and its viability. The study suggests that alternative methods to improve viability and effectiveness of local authority should be pursued.
Forsynth (2010)	America	This study asked the question: "Is a country's post consolidation (boundary change) economic development significantly better than reconsolidation development?" The study found that consolidations have a significant impact on the distribution of economic burdens within a county, but the impact on economic development is not significant and limited to social development. The study concludes that consolidating counties does not result in any efficiency gains.
Savitch and Vogel (2004)	America	The study tested the hypothesis that city-county consolidation promotes efficiency, equity and accountability. The study found that mergers reduce efficiency, but costs associated with transition and harmonising employment and wages increase, and inequities continue. They also result in minimal cost savings and make accountability problems worse.
Fleischmann (1986)	America	The study looked at the benefits and costs of local boundary changes and who the winners or losers were. Gains include new revenues sources (increased tax base), while areas that were poor before boundary changes benefited in the form of improved service delivery. The study also highlighted political and social costs/benefits, but found that the winners were largely the private actors.
Reingewertz (2012)	Israel	The study assessed the fiscal outcomes of municipal amalgamation using the "difference in differences" method. The results indicate that amalgamation leads to a decrease in municipal expenditures but, at the same time, causes no decrease in the quality of services provided. Based on this, the study concludes that amalgamation may have a positive impact on municipal viability.
Fritz (2011)	Germany	The study examined whether large-scale municipal amalgamations had an impact on the fiscal outcomes of municipalities in Germany, using the "difference in differences" approach. The results suggest that the effect is significant, with municipal amalgamation having a positive impact on debt per capita and expenditure per capita, but a negative impact on expenditure on administrative staff.

10.4 Methodology

According to COGTA, a third of municipalities are dysfunctional and unviable (whatever the definition) while another third are at risk, and the remaining third are functional and viable. The motivation underpinning the COGTA proposal is the elimination of dysfunctional and non-viable municipalities. This section explains how viability, functionality and revenue-raising capacity are evaluated.

10.4.1 Functionality

Functionality refers to how badly or how well a municipality operates, delivers services and accounts for the money it spends. The functionality of rural municipalities due for amalgamation in 2016 will be assessed by looking at the functionality indicators of management stability, fiscal stress levels and audit profiles.

10.4.2 Viability

The self-sufficiency or self-reliance (viability) of a municipality can be measured by its ability to raise own revenues to pay for basic public services (as per its constitutional mandate). One way of assessing the ability of demarcated municipalities to fulfil their constitutional mandate is to compare the gap between expenditure needs and revenue-raising capacity (Bandyopadhyay, 2013). This gap is often referred to as the need-capacity gap or fiscal gap. Expenditure needs refer to the amount of money needed to provide minimum acceptable levels of public goods (water, electricity, refuse removal, roads, etc.), while revenue-raising capacity refers to revenues that the municipality can raise from own sources (own revenues) when exerting a standard amount of effort.

A municipality's revenue-raising capacity depends on its fiscal capacity, which can be measured using many variables. These variables range from a municipality's tax and revenue base, to its socio-economic framework and all other political and legal constraints that may prevent its full revenue potential being realised. The most important component of a municipality's fiscal capacity is its economic base. Fiscal capacity will be assessed using the following measures:

- Per capita income (the wealth or income of a municipality divided by its population) captures a municipality's ability to handle a tax burden, or ability of individuals within a municipality to meet the financial needs of the community. The measure is simple and easy to understand.
- Per capita gross value added (GVA) captures the value of goods and services produced by a municipality over a given period. A higher per capita GVA value signifies a larger revenue base and greater ability to pay taxes.
- Employment (and unemployment) rates are indicators of a municipality's fiscal capacity. A higher employment rate implies a bigger tax base, as employed people pay taxes and fees, whereas a high unemployment rate means a smaller revenue base for a municipality.
- Property rates per capita are an important measure of fiscal capacity for local governments. These taxes are significant in many municipal governments. A municipality with many properties/estates is likely to raise more revenues. Similarly when property values increase, revenue yields are likely to increase.

10.4.3 Data

The data used in this paper is mainly secondary, and was sourced from National Treasury and Financial and Fiscal Commission databases.

10.5 Results

The purpose of this case study is to assess whether municipalities that were demarcated for the 2016 local government elections will be viable and functional, at least as per the COGTA definition of viability and functionality.

10.5.1 Amalgamation and municipal viability

In the COGTA proposal, viability refers to the ability of municipalities to fulfil their constitutional mandates using their own resources. In other words, demarcations will result in municipalities that are self-reliant and self-sufficient, have a strong fiscal base to support their constitutional mandates and minimum dependency on intergovernmental transfers. Fiscal capacity is crucial for a municipality to be viable/self-sufficient or self-reliant, and so the fiscal capacities of the demarcated municipalities was evaluated using a number of indicators, including revenue-raising capacity. As with other studies (Bandyopadhyay 2013; City of Fort Lauderdale, 2013; Yilmaz et al., 2007), all measures of fiscal capacity were indexed to the average, i.e. the average figure for South Africa was equated to 100 and used as a base against which to compare individual municipality indicators. These indicators are not measures of the fiscal health of a municipality but simply a relative gauge of whether or not a particular municipality can sustain all the assigned mandates using its own resources without intervention from national and provincial governments. Furthermore, the South African average is not necessarily the optimum but, in the absence of norms or standards, gives an indication of where an average municipality is operating in South Africa. The reader is also reminded that these measures evaluate a municipality's fiscal capacities relative to the national average, not their absolute fiscal capacities.

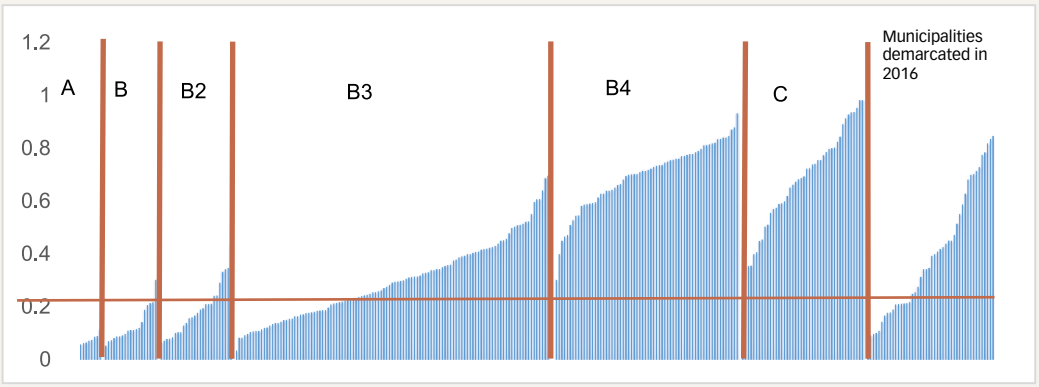
10.5.2 Dependency on transfers

Self-sufficient municipalities do not need to depend on transfers for their basic needs and are capable of delivering a range of services using own revenues. A simple dependency ratio (transfers/operating revenues) can reveal whether municipalities can sustain their mandates without significant assistance from national and provincial governments. The ratios used are: the local government equitable share (LGES) as a share of total municipal operating revenue and transfer capital funding as a percentage of total capital funding.

As Figure 80 shows, the dependency ratios vary widely, from metros (A municipalities) that derive less than 10% of their revenues from transfers, to district municipalities (C municipalities) that rely on transfers for almost 90% of their total revenues. The majority of rural municipalities (B3s and B4s) depend on transfers for more than 20% of their revenues, with most B4s relying on transfers for more than 50% of revenue. These municipalities are unlikely to be self-reliant and will always be dependent on transfers. In the case of the newly demarcated municipalities, the majority of them depend for more than 50% of their operational revenues on the LGES. A similar picture emerges for capital funding (Figure 81).

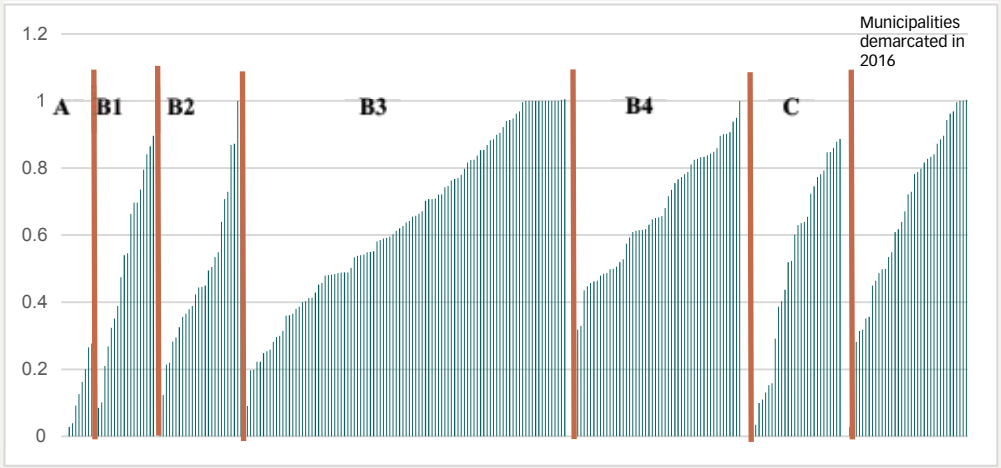
What Figure 80 and 81 show is that, given the present configurations, rural municipalities and the newly demarcated municipalities will never sustain their activities without transfers. Therefore, amalgamation will not make them self-reliant because of their limited revenue base and high levels of dependency. This implies that the funding model for rural municipalities and the newly demarcated municipalities should always consist of transfers.

Figure 80. LGES as a percentage of operating revenue



Source: Commission's calculations

Figure 81. Total transfer capital funding as a percentage of total capital funding



Source: Commission's calculations

10.5.3 Own-revenue index

The own-revenue index is generated from a ratio of own revenues to total revenues. According to the index, own revenue is the main source of income for over 70% of newly demarcated municipalities (they lie above the South African average).

The foregoing brief analysis on the degree of grant dependency of rural municipalities, and in particular the newly demarcated municipalities, shows that a significant number of individual municipalities and clusters will continue to be reliant on transfers. The amalgamations will not have an impact on the many municipalities that already have a high dependency on grants, while for some clusters, their dependency is likely to intensify. This means that transfers will continue to be the main funding window for rural and amalgamated rural municipalities.

Figure 82. Own-revenue index

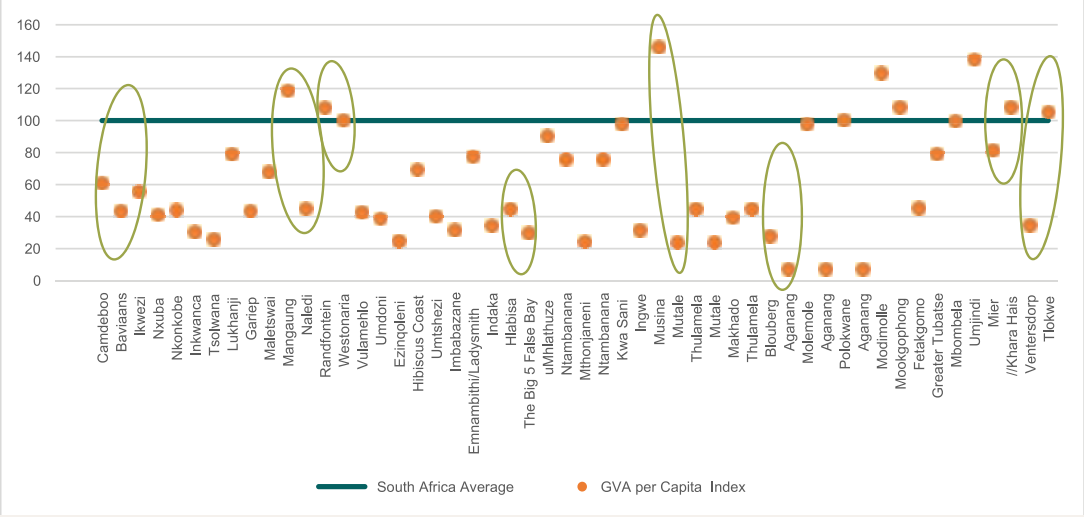
Source: Authors' calculations

10.5.4 Per capita GVA index

This indicator measures the value of goods and services produced by a municipality over a given period. A municipality with a higher per capita GVA value has a potentially larger revenue base and greater ability to pay taxes. All newly demarcated municipalities were compared to the average for all municipalities (Figure 83).

It is quite clear that the majority of municipalities demarcated in 2016 are below the South African average, and over 80% of them have a weak potential revenue base. Examples of amalgamations that consist of municipalities with GVA per capita indices below average include Camdeboo, Baviaans and Ikwezi; Hlabisa and The Big Five False Bay; and Blouberg and Aganang. This suggests that some of the proposed amalgamations will not necessarily result in municipalities with a better revenue base.

Figure 83. GVA Index



Source: Authors' calculations

10.5.5 Per capita income

Another well-known indicator of fiscal capacity is per capita income (Bandyopadhyay 2013; Tannenwald 1999; Yilmaz et al., 2006). Like per capita GVA, the per capita income measure captures the wealth or income potential of a municipality through a community's ability to meet its financial needs. As Figure 84 shows, around 70% of the municipalities demarcated in 2016 fall below the South African average for per capita income. This is a further indication that, other things being constant, the communities of such municipalities (e.g. the Hlabisa and Big Five False Bay amalgamation) would be hard pressed to meet their financial needs.

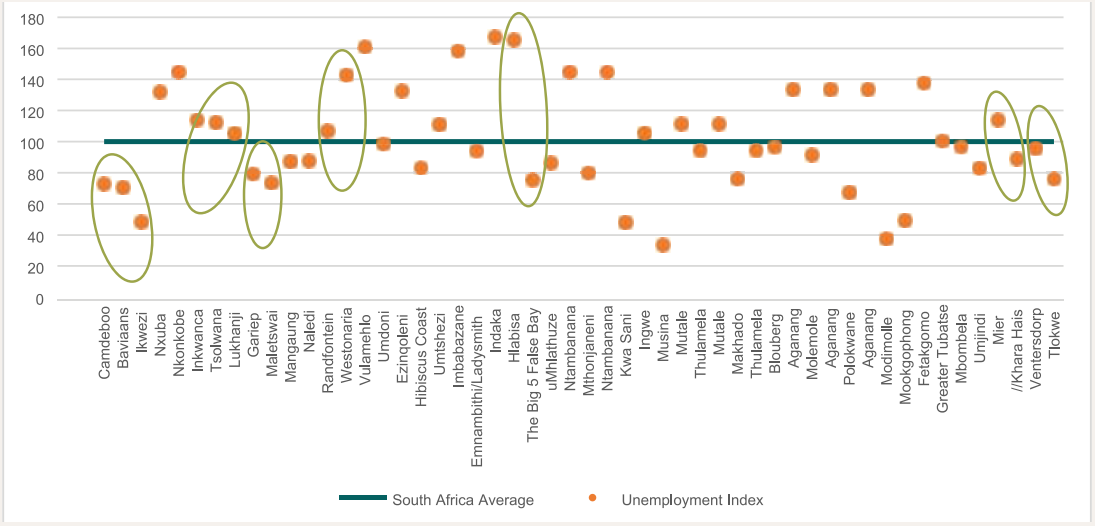
Figure 84. Per capita income index

Source: Commission's calculations

10.5.6 Employment

A municipality's revenue base also depends on the employed population within its jurisdiction. The likelihood of a municipality generating a steady stream of revenues is high when a significant proportion of its population is employed. Conversely, the tax base is constrained when the unemployment rate is high. Figure 85 shows that almost half of the municipalities amalgamated in 2016 have below-average unemployment rates, indicating a weak revenue base. Clusters with above average unemployment rates include Camdeboo, Baviaans and Ikwezi; Inkwanca, Tsolwana and Lukhanji; and Ventersdorp and Tlokwe.

Figure 85. Unemployment index

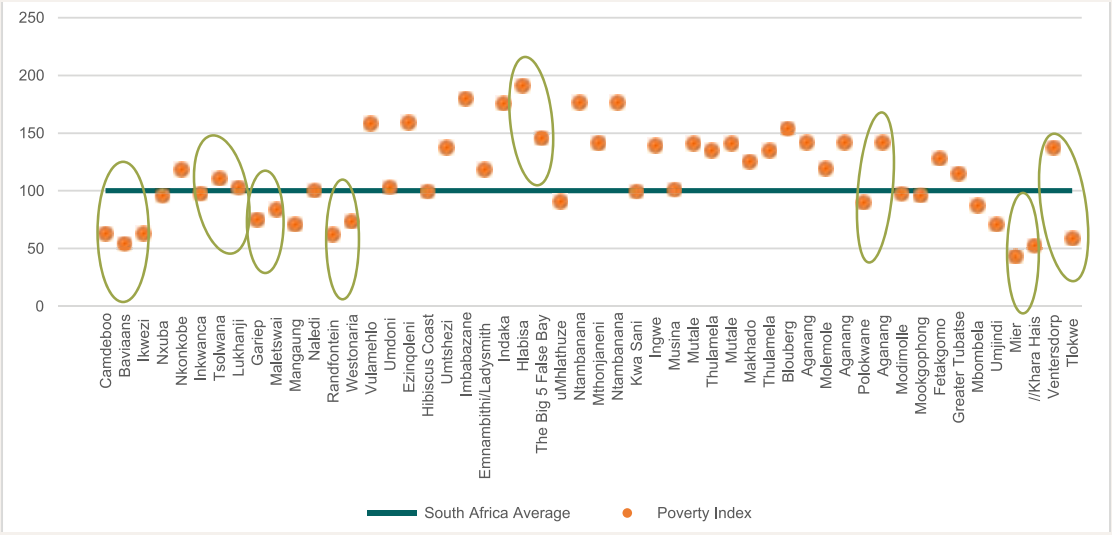


Source: Commission's calculations

10.5.7 Poverty index

Poverty is another variable that explains a municipality's fiscal incapacity, with high levels of poverty implying a weak revenue capacity. Poverty levels for all the newly demarcated municipalities were compared with the average poverty level for all South African municipalities. Figure 86 indicates that over 60% of municipalities fall below the average poverty level. This suggests that for many municipalities (e.g. Hlabisa and The Big Five False Bay), the mergers will not improve their poverty levels nor their revenue base.

Figure 86. Poverty index



Source: Commission's calculations

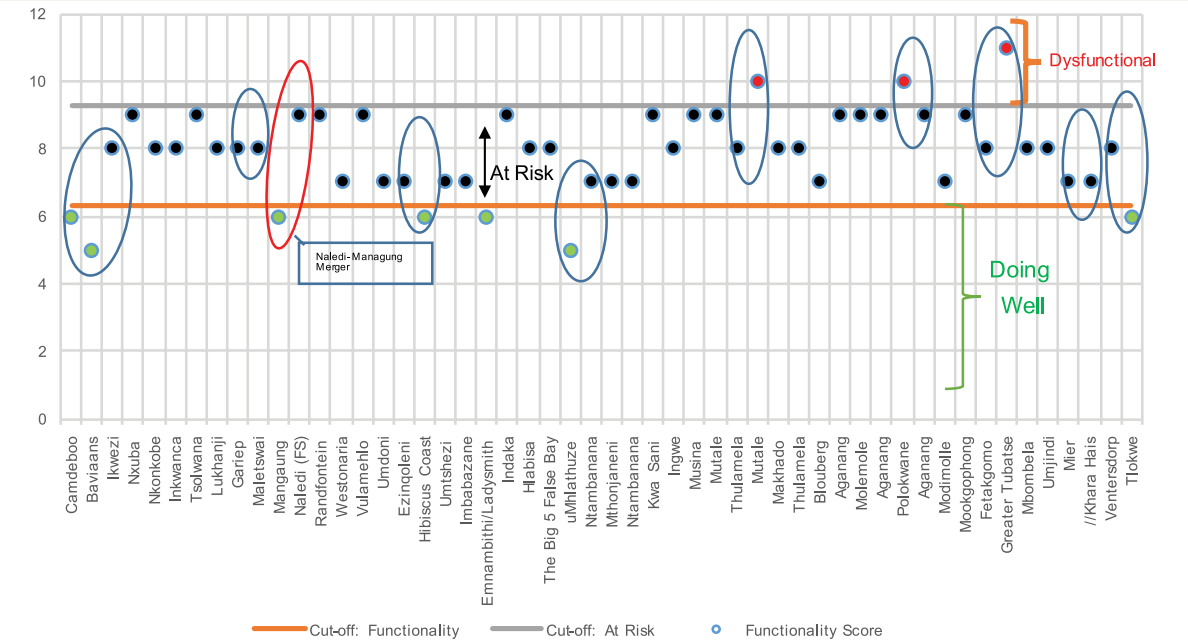
The above analysis suggests that a significant number of municipalities amalgamated in 2016 have weak revenue-raising capacities. This implies that amalgamations will not make many municipalities viable or self-sufficient or self-reliant. With weak revenue bases, most of the municipalities will continue to depend on transfers. Besides transfers, alternative revenue sources are required for such municipalities. The focus should be on increasing or developing tax bases through economic development rather than amalgamating municipalities.

10.6 Viability and Demarcation

10.6.1 Can amalgamations correct for municipal dysfunctionality?

The functionality of a municipality is a function of many factors, within and outside a municipality's control. The functionality of the municipalities amalgamated in 2016 were assessed using four factors: (a) institutional management, (b) financial management, (c) governance and (d) service delivery. Figure 87 shows that most municipalities (80%) are at risk of being dysfunctional and 6% are dysfunctional. Amalgamating municipalities that are at risk of being dysfunctional may actually worsen the problem. An interesting result concerns the amalgamation of a functional metro (Mangaung) and a dysfunctional rural area (Naledi). While this merger may achieve financial viability/self-reliance, two important elements of municipal viability – governance and democracy – may be compromised. With the amalgamation, political representation for marginalised communities in Naledi virtually disappear, and in many ways rural governance of these communities becomes less functional, as an urban core governs and administers rural areas. Although Naledi may not be able to be financially viable, it could serve a critical constitutional and democratic role.

Figure 87. Municipal functionality



Source: Commission's calculations

Given that many of the newly demarcated municipalities are not functioning well, the question is whether demarcation is the appropriate instrument for addressing their challenges and whether functionality can be a criterion for demarcating municipalities. In reality, many factors can cause a municipality to be dysfunctional. They include service delivery, institutional management, financial management, community satisfaction, and governance or political stability. Furthermore, such factors do not have a direct bearing on (or can be influenced by) boundary changes. For example, using demarcation to correct for financial mismanagement is akin to providing a patient with an incorrect pill, which may do more harm than good. The MDB's primary mandate is to demarcate municipal boundaries, delimit wards and carry out municipal capacity assessments, as spelt out in the Local Government: Municipal Demarcation Act (No. 27 of 1998). Correcting for dysfunctionality in municipalities is clearly not part of the MDB mandate, but that of national and provincial governments, which have a range of monitoring, support, regulatory and intervening powers at their disposal. As there are no apparent connections between municipal boundaries and municipal functionality, elevating the issue of functionality to a demarcation criterion may simply raise expectations that will never be fulfilled by demarcation. Furthermore, problems of dysfunctionality are often temporary and transient, and cannot be solved by a long-term drastic measure such as demarcation.

10.7 Conclusion and Recommendations

Government seeks to make rural municipalities self-sufficient and less dependent on transfers. In 2015, it proposed using demarcations to achieve financial viability or self-sufficiency, and to improve functionality among rural municipalities. However, an analysis of municipalities demarcated in 2016 found that amalgamations will not necessarily result in financially viable municipalities and may worsen the situation of some of the demarcated municipalities. The dependency ratio of many demarcated rural municipalities is too high to be reversed by amalgamations. Many rural municipalities will continue to be dependent on transfers, as their revenue bases are fragile and weak. Transfers will remain the mainstay of rural local government. The transfer system must also cater for the Constitution's acknowledgement of transfer-dependent municipalities (the Constitution sets no financial viability requirement for all municipalities but makes provision for some to be transfer-dependent). Some municipalities should exist to serve other equally important roles, such as ensuring that communities are politically and democratically represented. Amalgamations should carefully be studied, and benefits of amalgamations should be based on sound empirical evidence.

The study noted that elevating functionality to a demarcation criteria is problematic, as there is no direct or indirect link between functionality and municipal boundaries. Municipalities can be dysfunctional for a variety of reasons that have no relationship with boundary demarcation. Amalgamations are a long-term measure that cannot correct for short-term operational problems associated with municipal dysfunctionality.

The foregoing analysis has demonstrated that many rural municipalities will continue to depend on transfers. The analysis also suggests that demarcations are a weak instrument for pursuing the financial viability of rural municipalities and an incorrect one for improving the functionality of municipalities.

In light of the observations and findings above, it is recommended that:

- Rural municipalities with a low revenue base should be allowed to exist and be funded through the transfer system and not forced to amalgamate, as such municipalities could be serving other crucial constitutional imperatives such as democratic representation and community participation. The funding model should differentiate between rural municipalities, in terms of their revenue base.

- To achieve financial viability, government should focus on increasing or developing tax bases through economic development rather than amalgamating municipalities.

- Functionality should not be elevated to a demarcation criterion, as it has no direct or indirect link with boundary changes. Functionality should be corrected through legislative, policy and capacity-building measures rather than through amalgamations.

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CHAPTER 11

The Adequacy of Local Equitable Share and Conditional Grants for Rural Development

Mkhululi Ncube and Jabulile Monnakgotla

The Adequacy of Local Equitable Share and Conditional Grants for Rural Development

11.1 Introduction

South Africa requires a strong economy in order to tackle the triple challenges of poverty, inequality and unemployment. Nearly half (45%) of the population is poor, about a fifth live in extreme poverty and the Gini coefficient (a measure of inequality that reflects the income distribution in a country) was 0.69 in 2011. Underpinning a strong national economy is a strong local government with the resources to deliver the public services that communities need. The local government, as the sphere closest to people, plays a key role in facilitating development and improving living standards. Over the past two decades, transfers from national and provincial government to local government have increased steadily, in a bid to ensure that municipalities fulfil their constitutionally assigned mandate. Between 2000/01 and 2015/16, local government's share of the Division of Revenue allocations tripled, from R6-billion (3%) to about R100-billion (9%). However, the increase in resources has not translated into commensurate service-delivery improvements in the majority of municipalities. Many municipalities face the dilemma of expanding expenditure requirements and a shrinking fiscal space.

The Constitution and other legislation assign a range of functions to local government. Local government's mandate includes providing infrastructure and services (e.g. electricity, water and sanitation, refuse removal, roads) to local communities and developing local economic activities. To execute these functions, local governments rely on their own revenues, which are supplemented by transfers. Although own revenues fund on average 73% of municipal budgets overall, they constitute a small proportion of budgets of some (in particular rural) municipalities who depend on transfers for over 80% of their budgets.

To improve service delivery and the performance of rural municipalities, a number of interventions have been initiated, including the recent review of the local government equitable share (LGES) formula. The new formula, which was introduced in 2013 and is expected to be fully phased in by 2017, seeks to address rural-urban imbalances by shifting allocations towards rural municipalities. However, despite this deliberate effort to shift resources, many rural municipalities continue to face poverty, deficient services and infrastructure, lending credence to claims that the funds directed to rural municipalities are insufficient to fulfil their constitutionally assigned mandate. The perception in many cases is that the challenges faced by many rural municipalities are a consequence of insufficient LGES and conditional grant funding.

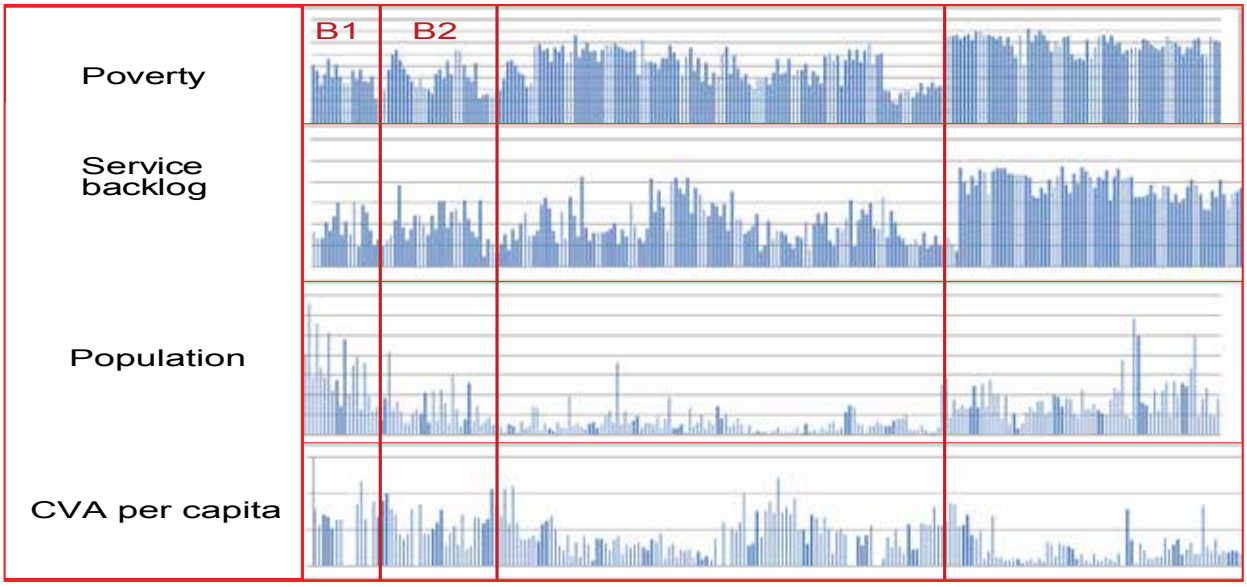
To date no independent empirical work has been carried out to investigate whether rural municipalities are sufficiently compensated for their lack of own revenues. Therefore, the main objective is to investigate whether the LGES and conditional grants compensate rural municipalities sufficiently (relative to their mandate) for their lack of own revenues. In addition, the study will investigate whether the new LGES formula has had the desired outcomes to date, and if not, why not, and how this can be remedied.

11.2 Background

Figure 88 shows that many municipalities have relatively high levels of poverty and service backlogs, especially in rural municipalities (B3s and B4s) where the GVA per capita is only R9 (compared to R76 in metros). This low economic activity translates into lower employment levels (13% on average in rural municipalities compared to 34% in metros and 29% in secondary cities), and points to rural municipalities having a limited own-revenue base.

Table 61 also shows the limited own-revenue base of rural municipalities, which rely on government grants for 70% of their funding and raise only 6% and 11% of their revenue from property rates and service charges, respectively. As these municipalities have such a limited revenue base, grants to them should be adequate to enable them to fulfil their mandate.

Figure 88. Characteristics of municipalities



Source: Commission's computations based on Global Insight data

Table 61. Funding profiles of municipalities

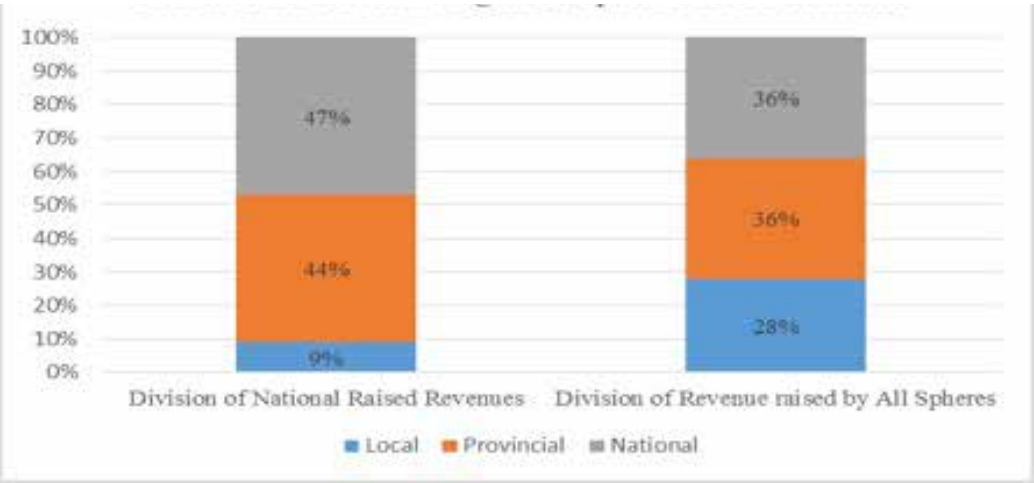
Type of municipality	Government grants	Investment revenue	Other	Property rates	Public contributions	Service charges
Metro	24%	2%	9%	18%	0%	48%
Secondary cities	25%	1%	14%	14%	0%	46%
Larger towns	28%	1%	9%	19%	0%	42%
Smaller towns	40%	1%	10%	11%	0%	37%
Rural municipalities	70%	1%	12%	6%	0%	11%

Source: Authors' calculations

Figure 89 shows the revenue allocations among the three spheres. The local sphere receives 9% of national raised revenues, compared to 44% and 47% for provincial and national spheres, respectively. When revenues raised by all spheres are considered, the local sphere receives 28%, compared to 36% apiece for national and provincial spheres. This imbalance has led to claims that the local sphere is unable to deliver on their mandate because it is not adequately compensated for the lack of own revenues.

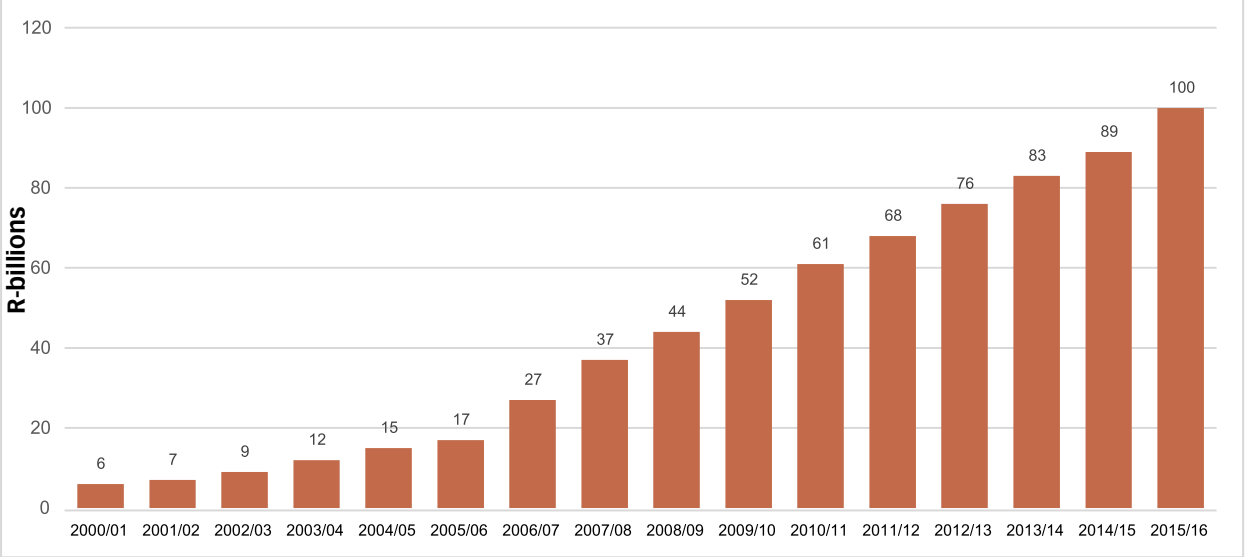
As Figure 90 shows, transfers allocated to the local government have increased at a phenomenal rate, from R6-million in 2000/01 to R100-billion in 2015/16. Yet the increased resources have not led to an equivalent improvement in service delivery.

Figure 89. Division of Revenue among the three spheres of government



Source: Authors' calculations

Figure 90. Value of transfers to local government (2000/01–2015/16)



Source: Commission's computations based on National Treasury data

11.3 Related Literature: Adequacy of Funding

Despite various municipalities saying that resources are inadequate, the issue of adequate funding has not been scrutinised locally. The issue has also received little attention in international literature, with only a few international studies looking at the adequacy of funding of the local government sector in general. For example, Hancock (2002), found that funding for local government in Australia was adequate, despite continuous upward pressures on local government spending. Table 62 provides a summary of the findings from international literature concerning the adequacy (or otherwise) of funding for local government across both developing and developed countries. Local governments appear to be adequately funded in developed countries but not in developing countries, implying that funding adequacy is probably linked to a country's level of development and affluence. This mixed evidence suggests that the issue depends on each country's context and circumstances, and needs to be evaluated through empirical evidence.

Table 62. Summary of literature on the adequacy of local government funding

India	Large urban local governments have adequate resources, but small urban and rural local governments are severely resource-constrained
Pakistan	Most local governments suffer harsh resource constraints
Australia	Local governments have sufficient resources for their responsibilities
Bangladesh	Resources of local governments are severely constrained
Nepal	Resources of local governments are severely constrained
Japan	Local government's current and capital resources are adequate
China	Local government resources are constrained, especially at the lowest level of government
Korea	Local government's current and capital resources are adequate
Thailand	Local governments have sufficient resources for their responsibilities

Source: UCLG (2010)

11.4 Methodology

The question of whether the LGES and conditional grants sufficiently compensate the lack of municipal own revenues is essentially about whether the funds allocated are enough to cover the cost of a municipality's mandated services. In other words, whether the operational and capital funding allocations are sufficient. To establish whether funding for municipalities is sufficient, the cost of basic services were estimated using an Excel-based model developed by I@Consult on behalf of the Commission. A full description of the model can be found in FFC and SALGA (2015). Unlike the current Division of Revenue cost estimates of basic services, this robust model takes into account an elaborate array of cost-influencing factors, e.g.

- Topography (flat, rolling or mountainous terrain)
- Location (coastal or inland)
- Distance from economic centres
- Development status (number of settlements and densities)

The estimated costs of basic services were then compared with the LGES and conditional grants allocated to rural municipalities. Capital costs were determined through costing backlogs and new investments, while operational costs included: bulk purchases, contractual services, employee-related costs (salaries and wages), insurance, other materials, rent of facilities and equipment, repairs and maintenance and transport costs. Service access backlogs were based on the 2011 Census data, adjusted to 2015.

Additional key features of the model include:

- The municipal-specific factors are comprehensively profiled.
- The costs of municipal basic services are moderated individually, per category or in total, based on exogenous cost-influencing factors such as spatial characteristics, topography and geology.
- The model allows for temporal adjustments to variable base datasets (e.g. population size and number of households).
- Municipal inefficiencies are discouraged by establishing loss-limiting factors through a combination of quantification of demand based on national policy allowance and the setting of limits for unaccounted water and electricity.

11.4.1 Data

The costs of municipal services were based on actual costs, benchmark actual costs, average costs and a combination of the three mechanisms. Primary unit cost and benchmark data were sourced from a sample of 32 municipalities, i.e. 12% of the total 278 municipalities in South Africa. The sample cuts across all municipality categories: from metros to B4s, and includes municipalities in seven of South Africa's provinces. Secondary data, especially on municipalities, was sourced from the National Treasury, sector departments, Stats SA, the Municipal Demarcation Board, the Agricultural Research Council, audited municipal annual financial statements and budgets, Quantec, and the South African Local Government Association (SALGA).

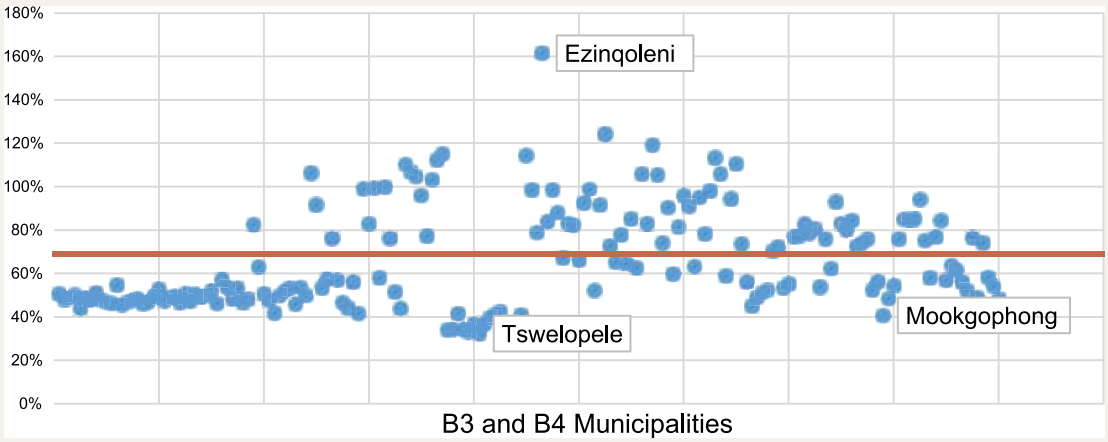
11.5 Results

11.5.1 Does the LGES sufficiently compensate rural municipalities?

The Constitution is clear on the purpose of the LGES, stating in Section 227(a): "Local Government and each province is entitled to an equitable share of revenue raised nationally to enable it to provide basic services and perform the functions allocated to it". In addition, Section 214(2)(e) says that the LGES has to achieve equity in the provision of basic services and must take into account the different levels of fiscal capacity of municipalities. This implies that the LGES is a useful instrument for compensating municipalities that lack fiscal capacity. Therefore, the effectiveness of the LGES in compensating rural municipalities for lack of own revenue was tested, by comparing the operational costs calculated from the model with the LGES allocations for rural municipalities (Figure 91).

Given that own revenues account for almost 30% of rural municipalities' budgets, the LGES would be expected to cover about 70% of their operational expenses. Using this rough guide, the LGES fully compensates about 40% of rural municipalities for their estimated operational expenses, and covers between 40% and 70% of operational expenses for the other 60% (Figure 91).

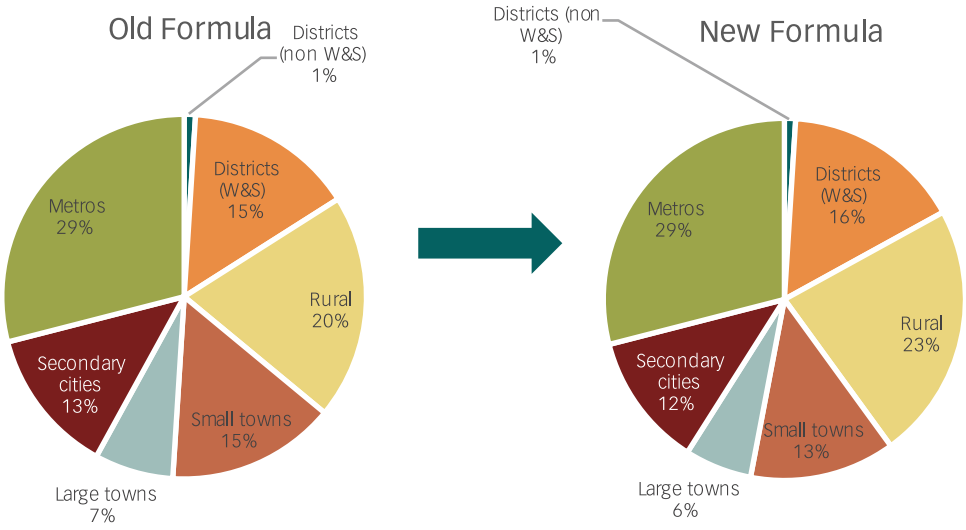
Figure 91. LGES vs. actual operational costs



Source: Commission's calculations

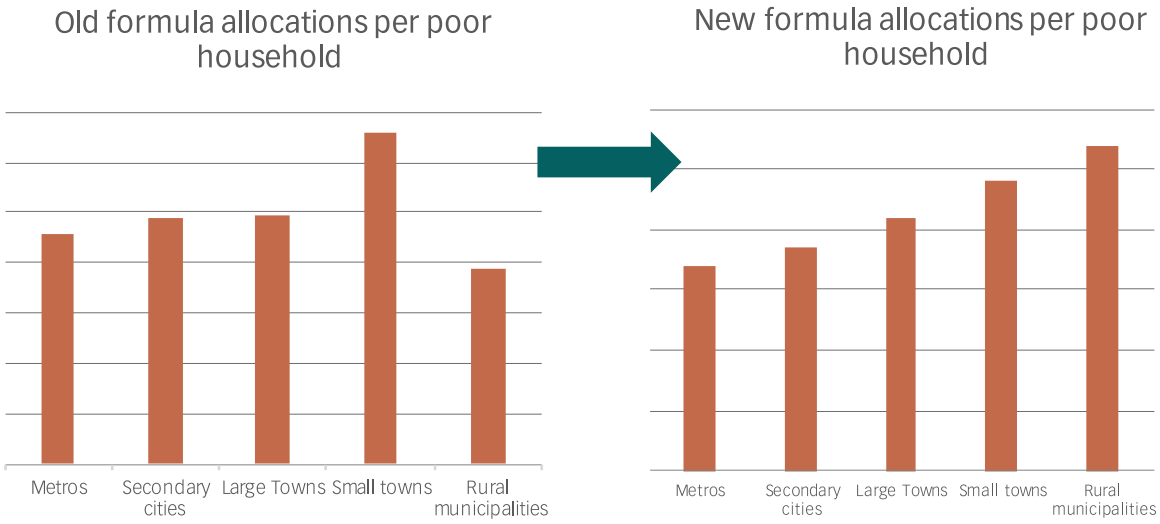
The next step was to look at whether the LGES is achieving the desired outcomes since its review. In 2011, the review focused on redistributing LGES funding towards municipalities that lack own revenues. Figures 92 and 93 suggest that rural municipalities benefit more from the LGES, as they receive more allocations per poor household. Poor households in rural municipalities are now receiving more through the LGES than households in metros, secondary cities, and large and small towns.

Figure 92. Impact of LGES



Source: Commission's calculations

Figure 93. Redistributive impact of LGES



Source: Authors' calculations

11.5.2 Do conditional capital grants sufficiently compensate rural local municipalities?

To determine whether conditional capital grants sufficiently compensate rural local municipalities, the capital grants for electricity, solid waste, roads and storm water, and water and sanitation were compared to the amount of investment required for each service. The costs of backlogs were estimated based on the assumption that municipalities are able to service 15% of the existing backlogs per annum. So for 2015, the costs of the backlogs will be equal to 15% of the existing backlogs.

Adequacy of funding for electricity

The assumption made is that all municipalities buy bulk electricity from Eskom, and so the extent of off-grid supply is not material. Hence generation infrastructure is excluded from the scope of infrastructure to be funded. The estimated capital investments required for electricity in 2015 by province are shown in Table 63.

Table 63. Estimated capital investments required for electricity per province (2015)

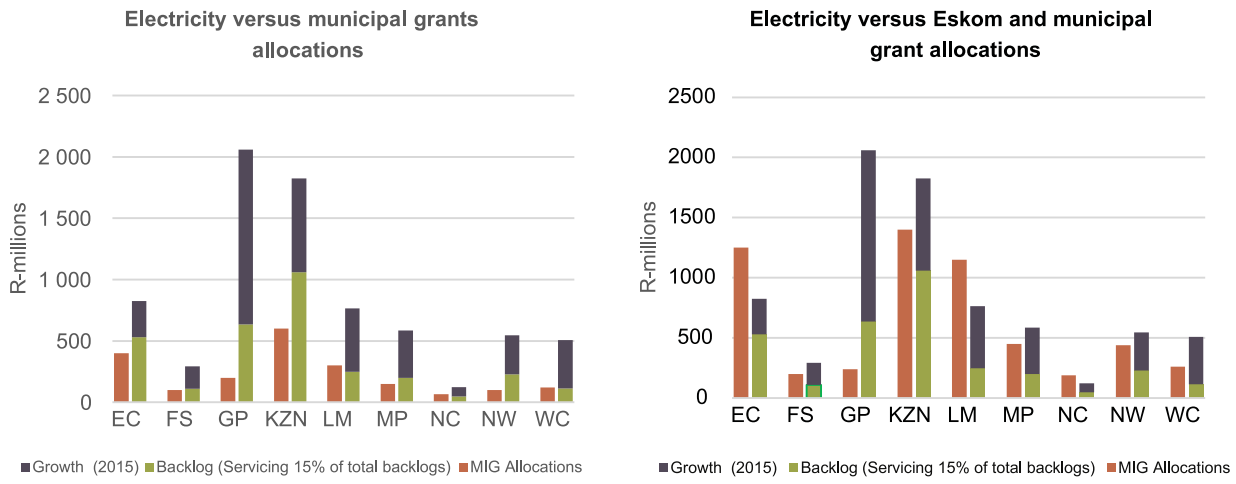
Electricity	1	2	3	4
	Growth 2015	Backlog – 15% of total backlog	Total need (1+2)	Growth in poor households
Eastern Cape	294 310 549	530 441 215	824 751 764	17 746
Free State	184 984 515	108 562 323	293 546 838	11 154
Gauteng	1 424 322 370	636 193 213	2 060 515 583	85 883
KwaZulu-Natal	767 689 091	1 058 842 304	1 826 531 395	46 290
Limpopo	516 472 892	248 804 607	765 277 499	31 142
Mpumalanga	386 219 374	200 604 221	586 823 595	23 288
Northern Cape	74 088 534	48 222 920	122 311 455	4 467
North West	316 562 139	228 124 857	544 686 997	19 088
Western Cape	393 772 403	113 890 031	507 662 433	23 743
Total	**4 358 421 867**	**3 173 685 691**	**7 532 107 559**	**262 801**

Source: Authors' calculations

Table 63 suggests that the capital investment required for electricity currently stands at R7.5-billion: R4.3-billion for new investment to cater for growth in poor households, and R3.1-billion to deal with 15% of the backlogs. The question is whether the grants are adequate to deal with this need.

Figure 94 compares the capital investments required for electricity and the grant allocations for electricity per province. The left graph shows clearly that in every province the Municipal Infrastructure Grants (MIG) allocations are far lower than the capital investments required. The largest shortfall is in Gauteng, where the MIG covers just 10% of the required electricity capital investment. As the Integrated National Electrification Programme (INEP) is channelled via Eskom, the graph on the right compares the sum of municipal and Eskom grants with the need on the ground. Together, the municipal and Eskom grants are adequate to service 15% of the backlogs and new infrastructure in the Eastern Cape, Limpopo and Northern Cape. Again, Gauteng has the largest shortfall, which is too wide to be closed by own revenues.

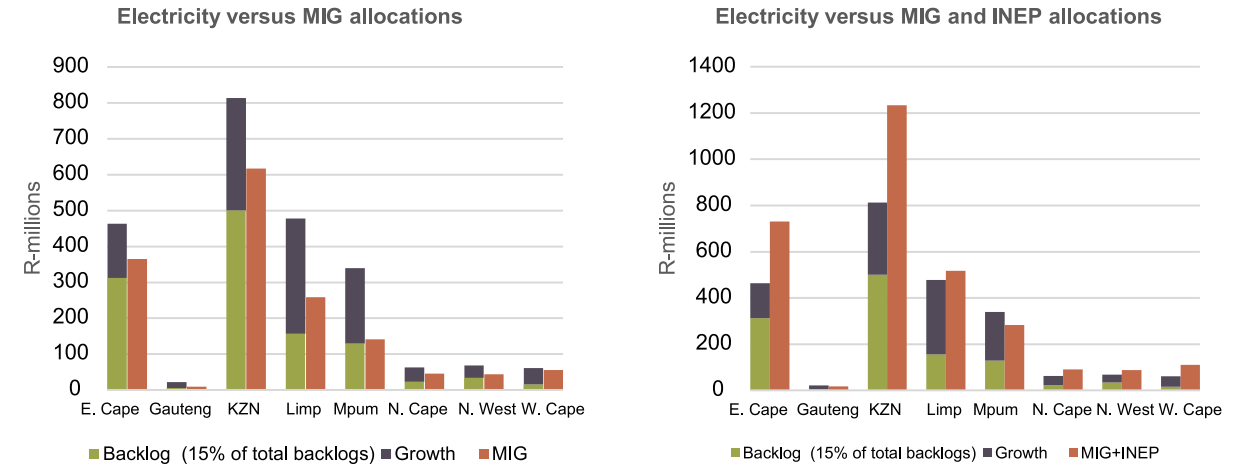
Figure 94. Estimated capital requirements



Source: Commission's calculations

The same comparison is done for rural municipalities only (Figure 95). As the left graph shows, MIG allocations are not enough to cover electricity costs. However, what is clear from the right graph is that when two funding streams (MIG and, INEP) are combined, electricity is over-funded in all provinces, especially KwaZulu-Natal, Eastern Cape and Western Cape.

Figure 95. Capital investments required for electricity (2015)



Source: Commission's calculations

Solid waste

The main cost drivers of solid waste are garden refuse, land fill sites and transfer stations. The estimated total capital required to cover the need (backlogs plus growth) is about R659-million (Table 64).

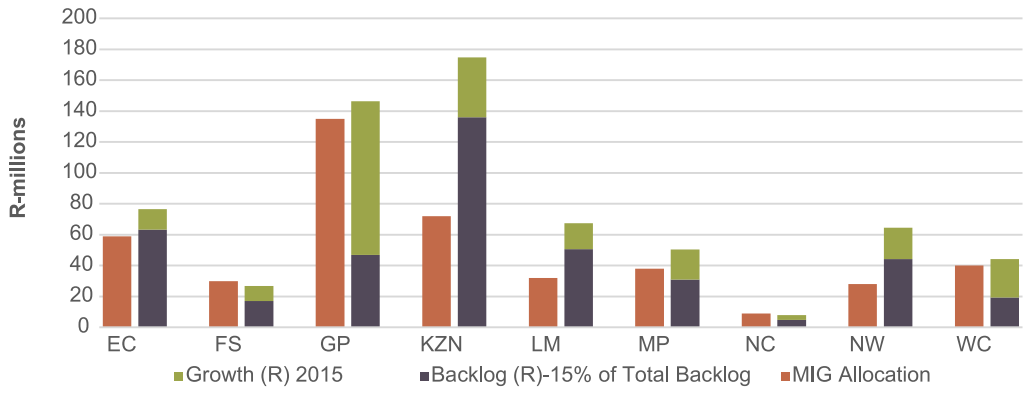
Table 64. Estimated capital investments required for solid waste (2015)

Solid Waste	1	2	3	4
	Growth 2015	Backlog – 15% of total backlog	Total need (1+2)	Growth in poor house-holds
Eastern Cape	13 357 549	63 163 156	76 520 706	17 746
Free State	9 802 596	17 065 325	26 867 921	11 154
Gauteng	99 431 932	46 971 158	14 6403 090	85 883
KwaZulu-Natal	38 820 478	136 008 071	17 4828 549	46 290
Limpopo	16 835 861	50 650 857	67 486 719	31 142
Mpumalanga	19 474 437	30 974 776	50 449 213	23 288
Northern Cape	3 147 238	4 873 209	8 020 447	4 467
North West	20 307 331	44 144 162	64 451 494	19 088
Western Cape	24 814 050	19 335 415	44 149 465	23 743
Total	**245 991 472**	**413 186 129**	**659 177 604**	**262 801**

Source: Authors' calculations

Figure 96 compares the infrastructure needs for solid waste to the relevant part of the MIG allocated to municipalities. The MIG here represents 86% of the "Other" component in MIG, as case studies show that municipalities use on average 86% of the "Other" component of MIG for refuse removal. The figure shows that the grants are insufficient to address needs in all provinces, except for the Northern Cape and Free State. The shortfall is largest (over 50%) in KwaZulu-Natal, Limpopo and North West.

Figure 96. Capital investments required for solid waste vs MIG allocations (2015)



Source: Commission's calculations

Roads and storm water

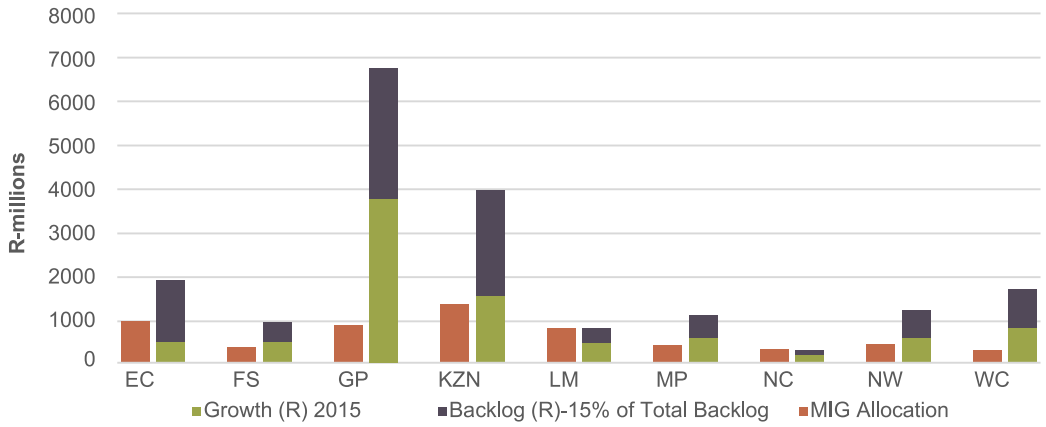
The main roads and storm-water capital spending include pavements, storm-water systems, public utilities, road furniture and public utilities. The estimated requirement for new infrastructure and servicing backlogs is R18.5-billion (see Table 65). The greatest needs are municipalities in Gauteng followed by KZN. Figure 97 shows that the MIG will be insufficient to address all the needs (growth infrastructure plus 15% of the backlogs). The shortfall in funding is greatest in Gauteng and smallest in Limpopo.

Table 65. Estimated capital investments required for roads and storm water (2015)

Roads Stormwater	1	2	3	4
	Growth 2015	Backlog – 15% of total backlog	Total need (1+2)	Growth in poor households
Eastern Cape	498 784 906	1 435 916 414	1 934 701 320	17 746
Free State	360 012 925	458 104 691	818 117 616	11 154
Gauteng	3 706 480 965	3 112 891 631	6 819 372 595	85 883
KwaZulu-Natal	1 395 909 926	2 626 505 694	4 022 415 620	46 290
Limpopo	573 908 683	269 656 473	843 565 156	31 142
Mpumalanga	632 243 030	475 053 104	1 107 296 134	23 288
Northern Cape	110 930 086	92 592 451	203 495 536	4 467
North West	644 419 353	563 762 812	1 208 182 165	19 088
Western Cape	914 526 109	637 975 833	1 552 501 942	23 743
Total	**8 837 215 983**	**9 672 459 103**	**18 509 648 084**	**262 801**

Source: Authors' calculations

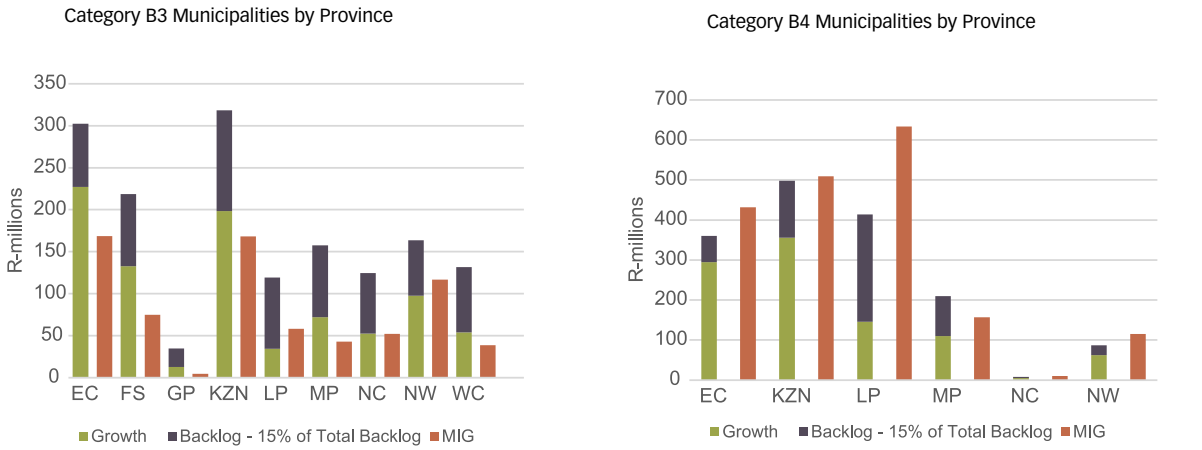
Figure 97. Capital investments required for roads and storm water vs MIG allocations (2015)



Source: Commission's calculations

Figure 98 compares roads and storm-water capital requirements with the MIG allocations for B3 municipalities (left graph) and for B4 municipalities (right graph). The MIG allocations alone are inadequate to cover roads and storm water requirements in B3 municipalities but adequate for B4 municipalities in the Eastern Cape, Limpopo and North West.

Figure 98. Estimated capital requirements for roads and storm water



Source: Commission's calculations

Water

Water is examined separately from sanitation. The main components of water capital budgets are dams and boreholes, bulk mains, distribution, reservoirs, connections, pump stations and water treatment centres. The estimated capital investment requirements for water amounted to R7.7-billion in 2015, with growth infrastructure accounting for R4.7-billion of this amount. The need for new infrastructure is greatest in Gauteng municipalities, while the need for servicing backlogs is largest in KwaZulu-Natal municipalities.

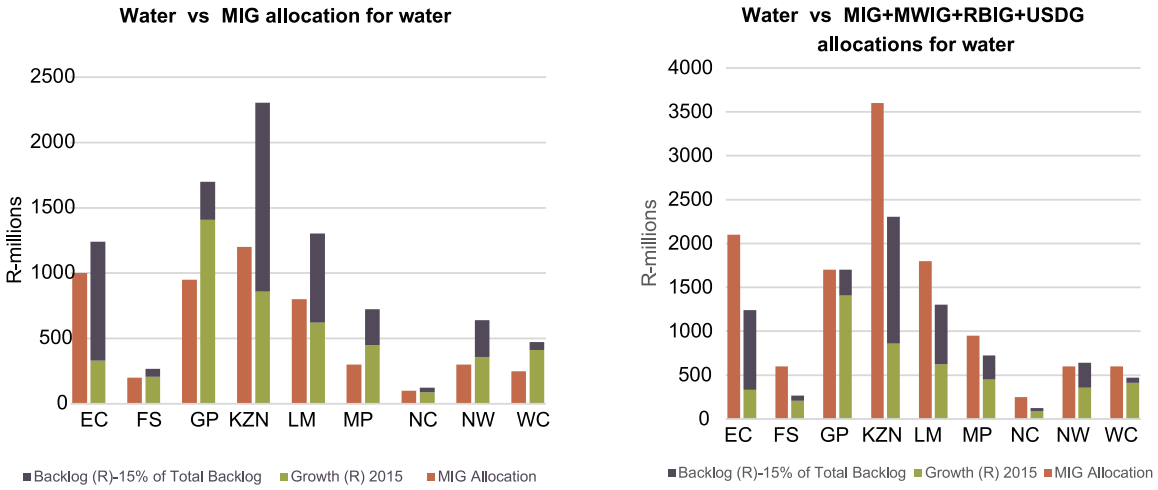
Table 66. Estimated capital investments required for water per province (2015)

Water	1	2	3	4
	Growth 2015	Backlog – 15% of total backlog	Total need (1+2)	Growth in poor households
Eastern Cape	331 555 107	909 780 946	121 336 054	17 746
Free State	206 835 698	61 429 072	268 264 769	11 154
Gauteng	1 408 278 658	291 655 224	1 699 933 882	85 883
KwaZulu-Natal	858 357 297	1 446 612 926	2 304 970 223	46 290
Limpopo	622 504 299	680 988 239	1 303 492 539	31 142
Mpumalanga	449 530 147	273 886 610	723 416 757	23 288
Northern Cape	89 293 550	34 524 436	123 817 986	4 467
North West	357 891 624	282 934 412	640 826 037	19 088
Western Cape	411 783 839	60 403 076	472 186 915	23 743
Total	**4 736 030 219**	**4 042 214 941**	**7 658 245 162**	**262 801**

Source: Authors' calculations

In Figure 99, the infrastructure needs (that are identified in Table 66) are compared with the basic MIG grant to municipalities (left graph) and (right graph) with 50% of the total infrastructure grants, i.e. MIG + Municipal Water Infrastructure Grant (MWIG) + Regional Bulk Infrastructure Grant (RBIG) + Urban Settlements Development Grant (USDG), as these grants are assumed to be split equally between water and sanitation. The basic MIG underfunds water infrastructure, whereas when all relevant grants are considered, water appears to be overfunded in all provinces except for the North West and (to a lesser extent) Gauteng.

Figure 99. Capital investments required for water vs MIG allocations (2015)



Source: Commission's calculations

Sanitation

The main components of sanitation budgets are outfall sewers, reticulation, connections, pump stations, waste water treatment works and VIP toilets. The estimated infrastructure needs for sanitation in 2015 stand at R10.5-billion (Table 67), which is what the country requires to cover 15% of the existing backlogs and new sanitation infrastructure for 262 000 additional poor households.

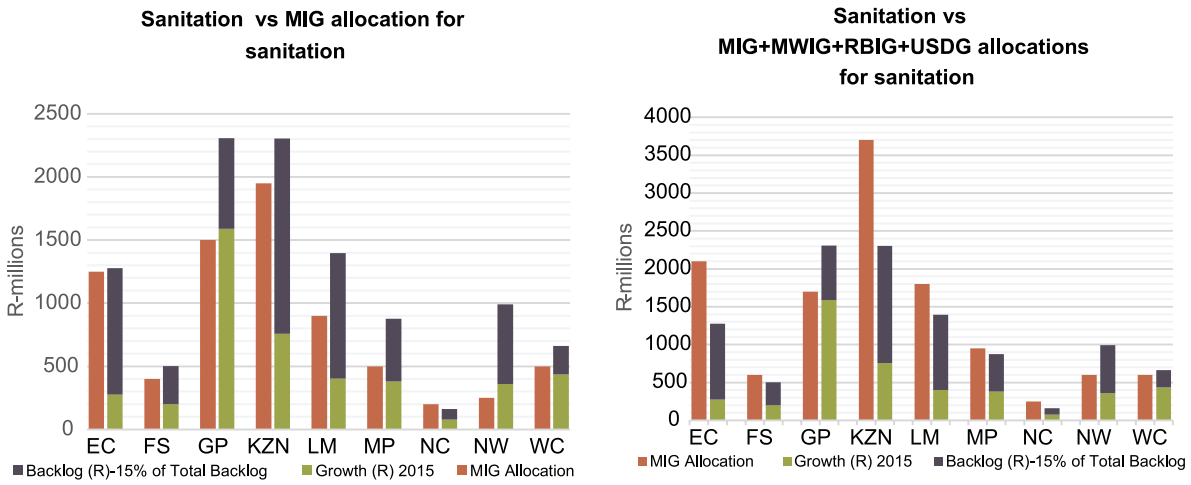
Table 67. Estimated capital investments required for sanitation per province (2015)

Sanitation	1	2	3	4
	Growth 2015	Backlog – 15% of total backlog	Total need (1+2)	Growth in poor households
Eastern Cape	276 564 413	1 001 645 912	1 278 210 324	17 746
Free State	200 071 658	301 685 328	501 756 986	11 154
Gauteng	1 588 905 275	716 580 803	2 305 486 078	85 883
KwaZulu-Natal	757 530 895	1 545 710 449	2 303 241 394	46 290
Limpopo	401 298 802	994 077 845	1 395 376 647	31 142
Mpumalanga	380 078 374	496 891 038	876 969 412	23 288
Northern Cape	77 603 659	83 464 939	161 068 599	4 467
North West	358 765 553	633 123 976	991 889 529	19 088
Western Cape	435 058 295	2 270 03 481	662 061 776	23 743
Total	**4 475 876 924**	**5 773 180 290**	**10 476 060 745**	**26 2801**

Source: Authors' calculations

Figure 100 compares the infrastructure needs for sanitation with the MIG allocations (graph on the left) and with the 50% of the total infrastructure grants (MIG+MWIG+RBIG+USDG), as these grants are assumed to be split equally between water and sanitation (except for specific grants such as the bucket eradication). It shows clearly that the grants are insufficient to cover the required new infrastructure and the eradication of 15% of the sanitation service backlogs. The gap is very small in municipalities in the Eastern Cape and widest in municipalities in the North West, Mpumalanga and Gauteng. When all capital grants for sanitation are taken into account, it should be possible to eradicate the backlogs at a higher rate than the assumed 15% per annum.

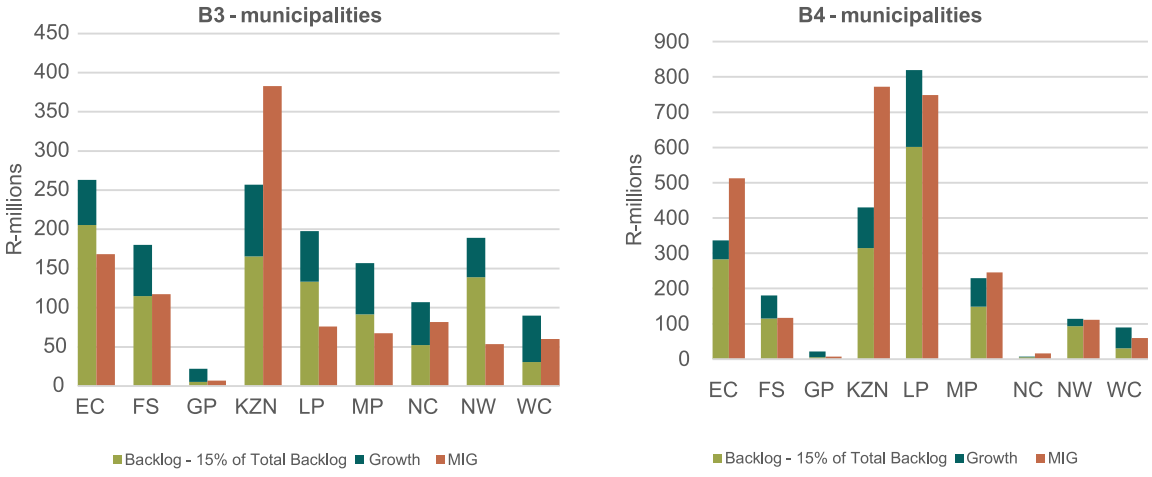
Figure 100. Capital investments required for sanitation vs MIG allocations (2015)



Source: Commission's calculations

Figure 101 shows the sanitation capital requirements for B3 and B4 municipalities separately. Apart from in KwaZulu-Natal, B3 municipalities are not adequately funded, whereas B4 municipalities are adequately funded in all provinces.

Figure 101. Estimated capital requirements for sanitation



Source: Commission's calculations

11.6 Conclusion and Recommendations

The assessment shows that transfers adequately compensate rural local municipalities for the lack of own revenues in some services and not in others. This result implies that it is crucial to regularly review every transfer stream, so that needs and resources are always aligned, and it is important that objective cost estimates inform the allocations. The result also suggests that viewing a grant in isolation may lead to the impression that a service is being underfunded. However, when a holistic view of all grants is taken, a service may be fully funded. This suggests consolidating grants that are designed to achieve the same outcome. Therefore, the allocation of resources needs to be reviewed on a regular basis to avoid a situation where some services are over-compensated while others are not.

The following recommendations are in order:

- National Treasury should continue to consolidate grants (as previously recommended by the Commission) because viewing grants in isolation gives the impression that some services are underfunded, whereas services may be fully funded or overfunded when the grants are viewed holistically.
- National Treasury should ensure that the local government equitable share and conditional grants are informed by objectively derived cost estimates, without which the viability of rural municipalities will always be under threat.

11.7 References

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CHAPTER 12

The Effectiveness of Transfers to Local Municipalities for Rural Development

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The Effectiveness of Transfers to Local Municipalities for Rural Development

12.1 Introduction

The Constitution entrenches the developmental role of local government, which is further underscored in the National Development Plan (NDP). Section 152 of the Constitution mandates municipalities, among other things:

a. to provide democratic and accountable government for local communities;
b. to ensure the provision of services to communities in a sustainable manner;
c. to promote social and economic development;
d. to promote a safe and healthy environment; and
e. to encourage the involvement of communities and community organisations in the matters of local government.

According to Section 153 of the Constitution, each municipality is expected to:

a. structure and manage its administration, and budgeting and planning processes to give priority to the basic needs of the community, and to promote the social and economic development of the community; and
b. participate in national and provincial development programmes.

In the NDP, rural local government in particular has a pivotal role to play in reducing poverty and inequalities through providing basic services and infrastructure. The Constitution provides for a Local Government Fiscal Framework (LGFF) that includes own revenue, borrowing and intergovernmental transfers as revenue instruments.

Ideally, increased resources to municipalities translate into improved delivery of basic services and thus development. However, this has not been the case, especially within rural municipalities that have difficulties in executing their constitutional obligations. Difficulties include limited revenue capacities, poor audit results and maladministration, under-spending on capital budgets, service delivery protests and backlogs in virtually all basic services. In addition, rural municipalities are failing to service their debt (to Eskom for bulk electricity and to water services boards for water services) and have been unable to attract and retain skilled managers, professionals, and technicians (COGTA, 2009). Given the persistence of these challenges, this chapter looks at how intergovernmental transfers can enable rural municipalities to drive rural development more efficiently and effectively.

The main aim of this study is to examine the effectiveness and efficient use of intergovernmental transfers in rural municipalities. To be specific, the study seeks:

- To assess the efficient use of local government equitable share (LGES) allocations and conditional grants in rural local municipalities
- To evaluate the effectiveness of intergovernmental transfers in rural municipalities
- To identify strategies through which the impact and utilisation of these grants can be improved.

The two main research questions that form the basis of this study are:

- Is the use of LGES (as block grant) optimal, and if not, should the emphasis shift to conditional grants?
- Where conditional grants are not sufficiently absorbed, should the emphasis shift to indirect grants?

12.2 Rural Municipalities within the Local Government Structure

12.2.1 Municipal structure

The Constitution of South Africa provides for three types of municipalities: Category A (have exclusive municipal executive and legislative powers in their jurisdictions); Category B (share executive and legislative authority in an area with a Category C under which they fall), and Category C (have executive and legislative authorities in an area that includes more than one municipality). As the Constitution does not distinguish between municipalities in urban and rural areas, the Department of Cooperative Governance has developed a methodology to classify municipalities (National Treasury, 2011: 192). This classification groups municipalities into seven categories using variables such as poverty levels and access to basic services, among others (Table 68).

Table 68. Municipal categories in South Africa

Class	Characteristics	Number
Metros	Category A municipalities	8
Secondary cities (B1)	All local municipalities referred to as secondary cities	19
Large towns (B2)	All local municipalities with an urban core. These municipalities have large urban dwelling populations, but the size of their populations vary hugely.	26
Small towns (B3)	Municipalities without a large town as a core urban settlement. Typically they have relatively small populations, of which a significant proportion is urban and based in one or several towns. Rural areas in this category are characterised by the presence of commercial farms because these local economies are largely agriculture-based. The existence of such important rural areas and agriculture sector explains why they are included the analysis of rural municipalities.	113
Mostly rural (B4)	Municipalities that contain no more than one or two small towns and are characterised by communal land tenure and villages or scattered groups of dwellings, and are typically located in former homelands.	68
Districts (C1 and non-rural)	District municipalities that are not water services providers.	9
Districts (rural C2 and some C1)	District municipalities that are water services providers.	35

Source: Author's compilation

In the Rural Development Framework of 1997 (DLA, 1997), rural areas are defined as the sparsely populated areas in which people farm or depend on natural resources, including the villages and small towns that are dispersed through these areas. These areas include large settlements in the former homelands, which depend on migratory labour and remittances as well as government social grants for their survival, and typically have traditional land tenure systems. Based on the characteristics indicated in Table 68, B3 and B4 are classified as rural municipalities.

12.2.2 Powers and functions

According to Section 156 of South Africa's Constitution, the local government sphere has executive authority, and the right to administer the provision, of social and basic services[48]. As provided for in the Municipal Structures Act (2009), these functions are divided between the three types of municipalities. Depending on the capacity to provide a particular service, Category B municipalities share the four major services[49] with category C (district) municipalities. Metropolitan municipalities on the other hand are responsible for all the services. In the case of rural local municipalities, the four basic services are shared between local and districts municipalities.

12.3 Intergovernmental Transfers and Expenditure in Rural Municipalities

12.3.1 Intergovernmental transfers

Compared to other types of municipalities, rural municipalities receive a larger share of their revenue from government transfers. Between 2008/09 and 2010/11, transfers accounted for more than 40% and more than 60% of the total revenue for B3 and B4 municipalities respectively.

Local governments receive two types of transfers: conditional grants and unconditional grants. Conditional grants are earmarked for specific types of expenditures and must be spent in accordance with prescribed processes. Unconditional grants have no such conditions attached but must be spent according to existing public expenditure standards and requirements (National Treasury, 2008). The primary unconditional grant is the local government equitable share (LGES), which is a constitutional entitlement to municipalities, as their share of national revenue. The LGES is transferred through an equitable formula that is designed to allocate funds according to expenditure needs. The formula comprises five components: the basic services component, institutional component, community services component, the revenue adjustment factor, and

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[48] Some of these services are concurrent, as local government shares with provincial and national government the responsibility of making policy, legislating, administrating and monitoring the performance of these functions.

[49] Water, electricity, refuse removal and sanitation.

the correction and stabilisation factor. Conditional grants can be direct or indirect. Direct grants are transferred directly to municipalities in the form of cash, while indirect grants are transferred in the form of assets or support services.

Conditional grants are used to finance capital projects, while unconditional grants are used for operational spending. Total allocations to local government have been increasing over the years, from R18.2-billion in 2006/7 to R101.3-billion in 2015/16 and are projected to increase to R128.4-billion in 2018/19. During this period, the unconditional portion of the total allocations has been higher than the conditional component. The share of local government allocations to the total nationally raised revenue has also increased, from 6.3% in 2006/7 to 9.0% in 2015/16, and is projected to reach 9.4% in 2018/19 (Table 69).

Table 69. Conditional and unconditional allocations to municipalities (2006/07–2018/19)

Financial year	Uncon-ditional allocations (R-billions)	Conditional allocations (R-billions)	General fuel levy sharing with metropol-itan (R-billions)	Total local government allocations (R-billions)	Local govern-ment's share of nationally raised revenue
2006/7	9.6	8.6	-	18.2	6.3%
2007/8	18.1	9.9	-	28.0	7.6%
2008/9	20.7	18.2	-	38.9	7.6%
2009/10	25.6	20.0	-	45.5	7.5%
2010/11	24.4	21.4	6.8	52.6	8.2%
2011/12	30.5	22.8	7.5	60.9	8.4%
2012/13	33.2	26.5	9.0	68.7	8.7%
2013/14	37.1	30.3	9.6	77.0	8.8%
2014/15	40.6	34.3	10.2	85.0	8.6%
2015/16	51.7	38.9	10.7	101.3	9.0%
2016/17	52.9	42.9	11.2	107.0	9.2%
2017/18	57.5	46.0	11.8	115.3	9.1%
2018/19	62.7	53.2	12.5	128.4	9.4%

Source; National Treasury (2013; 2014; 2015)

Between 2005/06 and 2012/13, rural municipalities[50] received 35% of the total unconditional allocations to local government. The new LGES formula, which came into effect in 2013/14, channels more funds to rural municipalities. Rural municipalities are currently receiving 36% of the unconditional grants allocated to municipalities. Figure 102 presents the adjustments from the old formula to the new formula.

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[50] Small towns and mostly rural municipalities

Figure 102. Implications of the new LGES formula on rural municipalities

Source; SALGA, Author & National Treasury, 2012

As indicated earlier, municipalities receive both conditional and unconditional grants. Over the past five years, the amount and number of conditional allocations to rural municipalities have increased (Table 70).

Table 70. Conditional allocations to municipalities (2008/09–2015/16)

	Allocated amount to rural municipalities				
Grants to Municipalities	2008-9	2009-10	2010-11	2011-12	2012-13
Equitable share and related	5 686 146	12 098 762	14 669 333	16 363 239	11 415 253
Equitable Share	5 616 053	7 434 153	9 165 183	10 331 555	11 365 010
Water Services Operating and Transfer Subsidy Grant (Augmentation to the Water Trading Account)		20.0	-	45.5	7.5%
70 093		21.4	6.8	52.6	8.2%
224 093		22.8	7.5	60.9	8.4%
151 958		26.5	9.0	68.7	8.7%
80 976		30.3	9.6	77.0	8.8%
50 243	40.6	34.3	10.2	85.0	8.6%
Infrastructure	3 649 860	5 331 584	6 244 496	7 955 952	8 864 073
Direct transfers			1 662 650	1 999 677	
Municipal Infrastructure Grant	2 355 497	3 239 286	1 934 450	2 326 573	5 260 324
Building for Sports and Recreation Programme Grant	-	-	232 471	245 803	-
National Electrification Programme (Municipal) Grant	149 527	487 207	387 837	453 400	722 953
Public Transport Infrastructure and Systems Grant	-	-	73 000	81 076	-
Neighbourhood Development Partnership Grant	31 500	100 598	154 500	196 092	279 692
2010 FIFA World Cup Stadiums Development Grant	-	-	48 600	-	-
Municipal Drought Relied funds (DWAF)	5 000	-	-	-	-
Disaster funds: dplg	-	-	-	470 000	-
Rural Transport Services and Infrastructure Grant	-	-	18 000	72 000	11 655
Electricity Demand Side Management (Municipal) Grant	-	12 000	-	-	-
Implementation of Water Services Projects (Capital)	-	-	-	-	-
Indirect transfers			168	-	-
Water Services Operating Subsidy Grant		42 065	32 247	-	270 870
Community Based Public Works Programme Grant (indirect grant)	-	-	193 400	176 601	164 800
Integrated National Electrification Programme (Eskom) Grant	888 054	1 096 238	1 248 834	1 287 229	1 156 541
Regional Bulk Infrastructure Grant	88 600	160 087	84 000	253 440	321 207
Backlogs in Water and Sanitation at Clinics and Schools Grant	11 752	16 793	-	-	5 371
Backlogs in the Electrification of Clinics and Schools Grant	87 600	148 950	10 690	8 050	-
Neighbourhood Development Partnership Grant (Technical assistance)	32 330	28 360	76 650	29 610	149 660
Electricity Demand Side Management (Eskom) Grant	-	-	-	54 400	-
Rural Households Infrastructure Grant (Schedule 7)	-	-	87 000	302 000	521 000
Capacity building	256 860	363 261	478 802	1 511 180	1 578 000
Direct transfers			86 550	91 300	
Municipal Systems Improvement Programme Grant	134 110	132 980	54 250	57 830	148 100
Local Government Restructuring Grant	-	-	160 700	154 350	161 250
Local Government Financial Management Grant	122 750	213 490	93 700	99 700	105 250
Expanded Pubic Works Programme Incentive Grant for Municipalities	-	16 791	83 602	1 108 000	1 163 400
Total conditional transfers	15 626 880	22 779 379	26 893 190	37 868 527	41 768 292

Source: National Treasury (2013)

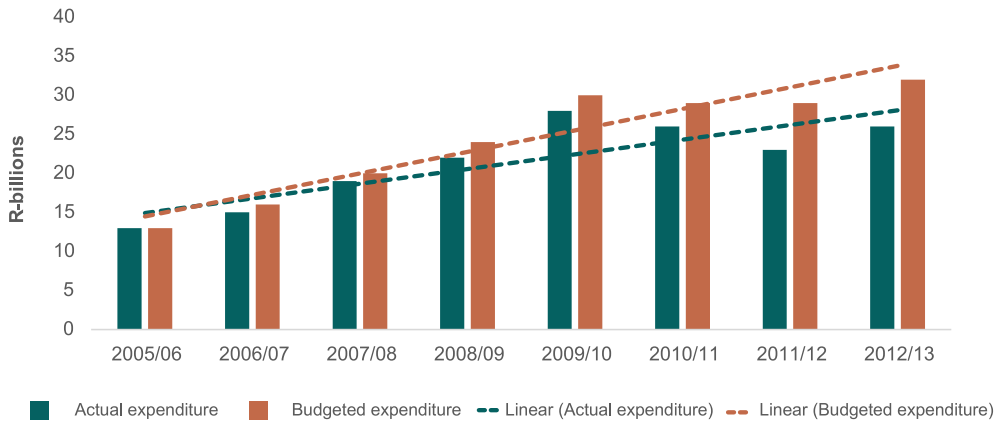
Between 2008/09 and 2012/13, the total amount of conditional allocations to municipalities increased from R15.6-billion to R41.7-billion, with grants for infrastructure accounting for a larger share.

12.3.2 Expenditure performance of rural municipalities

Rural municipalities are known for their lack of capacity to use funds allocated to them, which manifests in the under-spending of especially conditional grants.

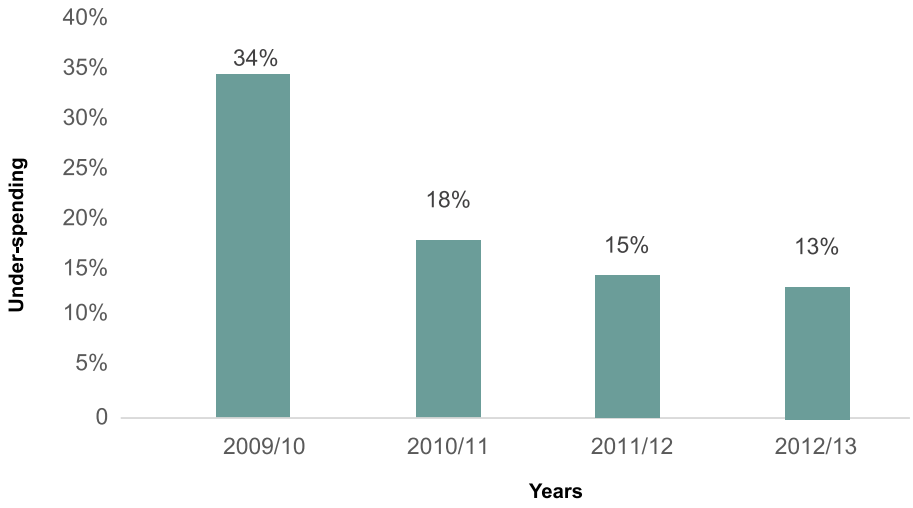
As Figure 103 shows, between 2005/06 and 2012/13, rural municipalities spent less than their budgeted amounts, especially since 2009/10. Municipal spending consists of operating expenditure and capital expenditure. Operating expenditure refers to the day-to-day costs for municipal operations and service delivery, and includes employee-related costs, and the repairs and maintenance of existing infrastructure. Capital expenditure includes spending on large municipal social and economic infrastructure projects, such as electricity connections, and water and sanitation infrastructure. In rural municipalities, capital budgets account for a larger portion of the under-spending (National Treasury, 2012). Capital projects in rural municipalities are largely financed through conditional grants, and so significant under-spending on capital budgets implies the low absorption of conditional grants. Figure 104 shows the magnitude of under-spending on conditional grants in rural municipalities.

Figure 103. Actual vs. budgeted expenditure in rural local municipalities (2005/06–2012/13)



Source; National Treasury (2012)

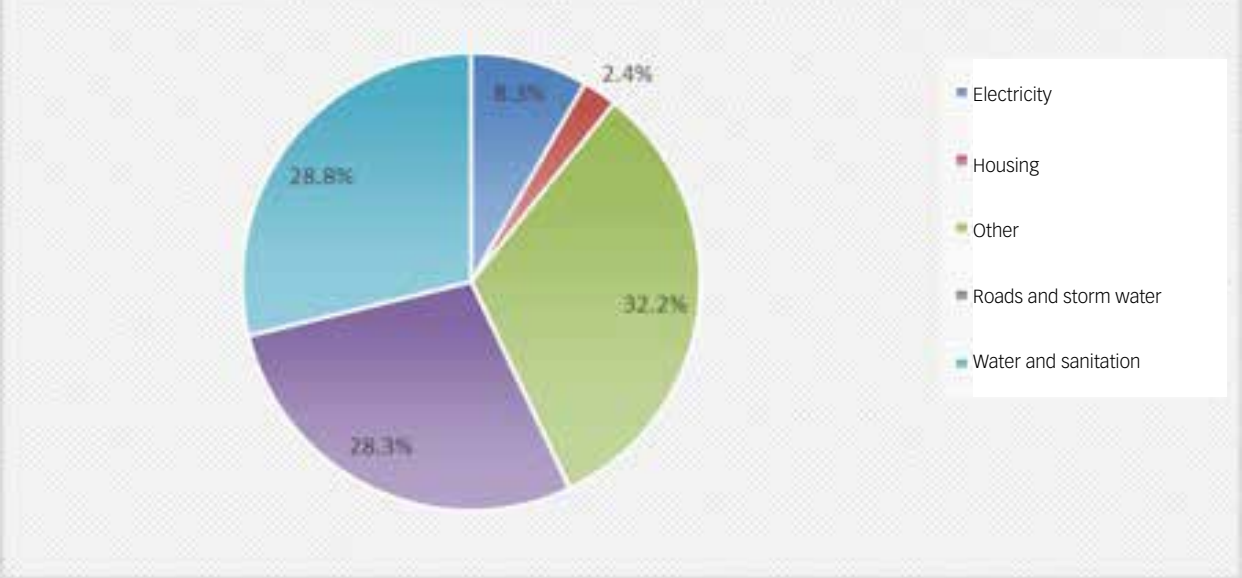
Figure 104. Under-spending on capital grants in rural municipalities (2008/09–2012/13)



Source: National Treasury (2012)

A worrying trend is the under-spending of capital budgets, given the infrastructure backlogs of about 30%. Although it has improved from 34% in 2009/10, under-spending in 2012/13 still amounted to 13%, which is significant for poor communities. Figure 105 shows capital spending by service for rural municipalities over the period 2005/6–2012/13.

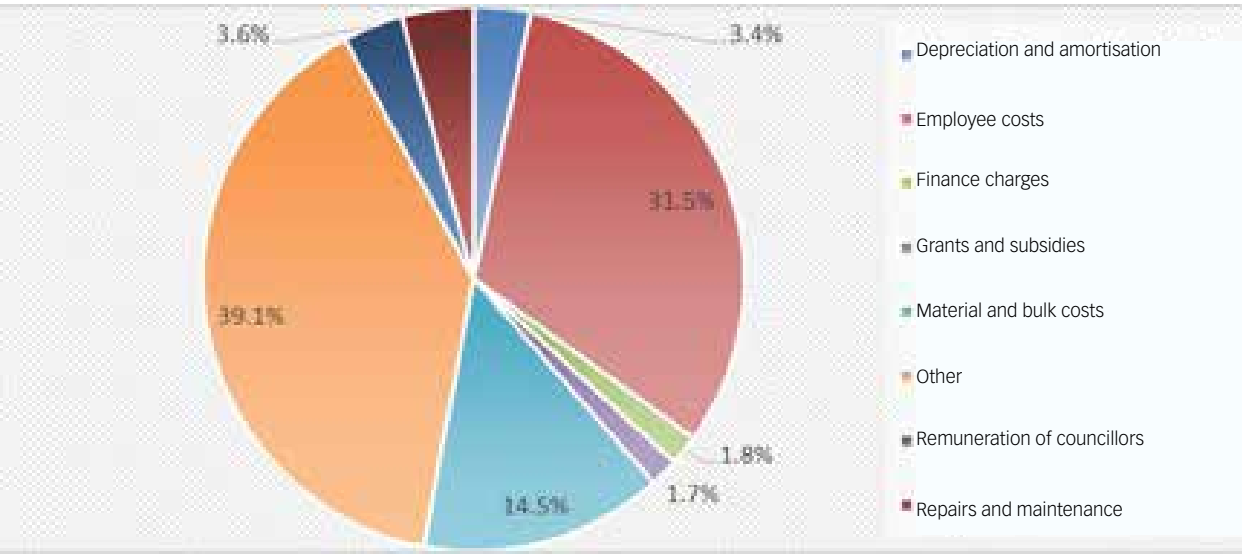
Figure 105. Capital spending in rural municipalities by service (2005/6–2012/13)



Source; National Treasury (2012)

Over the seven-year period, most capital expenditure was on "other" (32%), water and sanitation (28.8%), and roads and storm water (28.3%). The rural municipalities spent relatively little on electricity (8.2%), regardless of the increasing need for electricity infrastructure signified by the significant backlogs (more than 30%) in rural municipalities. Figure 106 shows operational spending in rural municipalities.

Figure 106. Operational spending in rural municipalities by expenditure item (2005/6–2011/12)

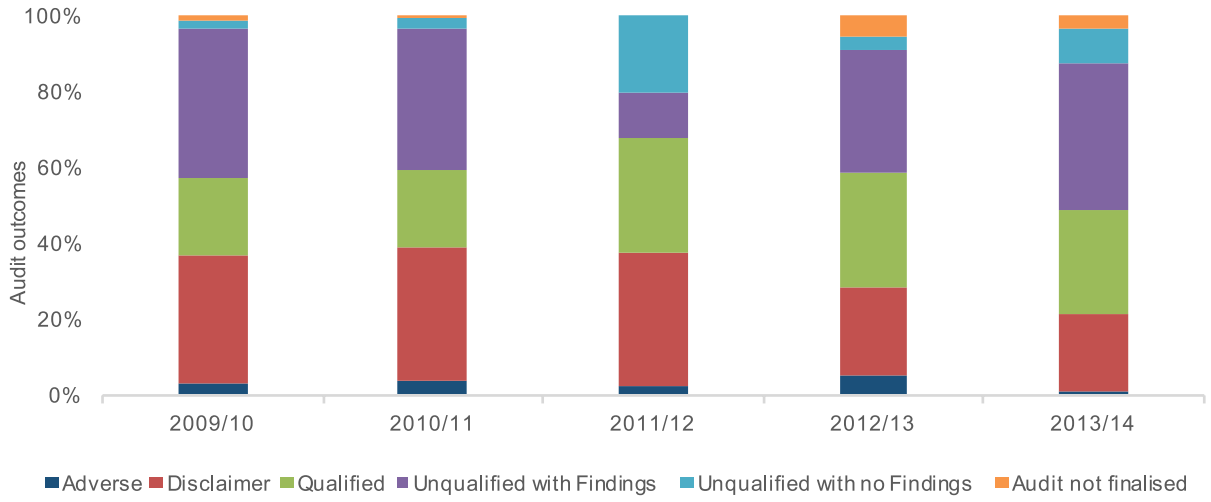


Source; National Treasury (2012)

Almost two-fifths (39.1%) of municipal operational spending is on "other", which is not disaggregated. However, the most notable issue is the employee-related costs. Although the National Treasury norm for salaries is between 25% and 40%, spending 31.5% of the operational budget on salaries is still a cause for concern, as items such as repairs and maintenance are not being prioritised, despite their importance for sustainable social and economic infrastructure. Rural municipalities spend only 4.3% of their operational budgets on repairs and maintenance, which is far below the national norm of 8%–10%.

Audit outcomes are another important indicator, as they measure the overall performance of municipalities in terms of operating and capital expenditure, unauthorised, irregular and fruitless expenditure, supply chain compliance and governance deficits, among other things. Figure 107 shows the audit outcomes for rural municipalities.

Figure 107. Audit findings for rural municipalities (2009/10–2013/14)



Source: AGSA (2009/10–2013/14)

Although audit outcomes have improved slightly, with unqualified audits increasing from 39% to 39.9% between 2009/10 and 2013/14, the majority of rural municipalities continue to receive poor audit results. In 2013/14, nearly half (49%) received adverse, disclaimer and qualified opinions. The Auditor-General (AGSA, 2013) attributes the persistence of poor audit results to the high levels of unauthorised, irregular, fruitless and wasteful expenditure. These findings confirm that rural municipalities are not using resources effectively and efficiently.

12.4 Review of Literature

This section presents a review of the literature on the effectiveness of intergovernmental transfers and spending efficiency in rural municipalities.

Numerous studies have looked at different types of efficiency at different levels of government, using parametric and non-parametric approaches. Findings reveal that a municipality's spending efficiency depends on a number of factors, and the size of a municipality is one of the key determinants. Table 71 summarises a few studies on this subject.

Table 71. Summary of empirical studies on spending efficiency in local government

Author	Description and findings
Afonso and Fernandes (2003)	The spending efficiency of a sample of 51 Portuguese municipalities in 2001 was assessed using a non-parametric free disposal hull (FDH) methodology. Input and output was measured by municipal per capita spending and total performance index respectively. The study found that, on average, Portuguese municipalities are inefficient, and that spending inefficiencies are more evident in non-metropolitan municipalities.
Geys and Moeson (2008)	The sources of government spending inefficiencies for 300 Flemish municipal governments in 2000 were assessed using the non-parametric approach. The study found that grants, historical debt and fiscal surplus, population size and density were the main determinants of spending efficiencies.
Sousa and Stosic (2005)	The study measured spending efficiency for 4796 Brazilian municipalities using non-parametric efficiency methods: data envelope analysis (DEA) and FDH efficiency measurements. Input and output were measured using municipal spending and municipal performance respectively. The study found that smaller municipalities in Brazil are less efficient than bigger municipalities.
Afonso and Scaglioni (2005)	The study assessed expenditure efficiency of a sample of 20 Italian municipalities for the year 2001 using the non-parametric approach called the DEA approach. To measure municipal performance, the study used general administration, access to energy, water, sewerage, solid waste collection, and transport services. Findings from this study revealed that inefficiencies are significant in Italian municipalities and improvements are possible across the municipalities in question.

12.5 Methodology

This section presents the methodology that the study uses to evaluate the spending efficiency and effectiveness of intergovernmental transfers in rural municipalities.

12.5.1 Techniques of measuring spending efficiency in rural municipalities

Efficiency[51] can be measured using parametric and non-parametric approaches, depending on the type of efficiency being measured. Parametric approaches measure economic efficiency, and methods include the stochastic frontier, thick frontier and distribution free approaches (Vincova, 2005). Non-parametric approaches are commonly used to measure technical efficiency in a decision-making unit and include two methods: data envelopment analysis (DEA) and free disposal hull (FDH).

This study uses DEA because this method (a) does not require any assumptions about the functional form of the regression function (Diggle et al., 2000); (b) allows the use of more than one input to produce a number of outputs (see Chovanec, 2005); and (c) requires the assumptions of convexity and does not require the price of inputs and outputs used.

A brief description of data envelopment analysis

DEA is a linear programming approach that involves enveloping the observed set of input/output vectors with a convex structure around a set of variables (Afonso and Fernandes, 2007; Kneip et al., 2015). Farrell (1957) introduced this approach, proposing a linear convex structure method to estimate the production frontier and assuming constant returns to scale. Charnes et al. (1981) suggested the assumption of variable returns to scale and an input-oriented approach with constant returns to scale. This method measures technical efficiency in a decision-making unit by calculating maximum efficiency scores for that particular unit and comparing with the performance of other similar units. In addition, it treats all observations as non-stochastic.

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[51] Technical (spending) efficiency can be defined as the effectiveness with which a given set of inputs is used to produce an output http://www.economicshelp.org/blog/glossary/technical-efficiency/

DEA can measure technical efficiency with output-oriented and input-oriented models. In the output model, inputs are kept constant but outputs change, while in the input model, inputs reduce and output levels remain the same. DEA can be carried out with the assumption of constant returns to scale (CRS) or variable returns to scale (VRS). With CRS, the relevant units are assumed to be scale-efficient, while with VTR they are assumed to be not operating at optimal scale. As it is not known whether or not rural municipalities in South Africa are operating at optimal scale, technical efficiency is estimated through VRS, which allows technical efficiency to be calculated without the effects of scale efficiency. The limitations of the DEA method include its sensitivity to measurement error, input and output specification and sample size (Haikos et al., 2005).

The output-oriented DEA model is applicable in South Africa because municipalities do not have much control over the amount of resources that are channelled to them, but do have control over the amount and quality of output produced with those resources.

The VRS output-oriented efficiency model is expressed as follows:

Max $n, m\ (n'x_j/m'y_j)$

S.T.

$$n'x_j/m'y_j \geq 1,\ j=1,2,3\ldots,\ldots\ldots\ldots L$$
$$m,n \geq 0$$
$$m'y_j = 1$$

Where:

X_j = output measure for municipality j
Y_j = input measures and
j = municipality in question
'n' = weight for the output measure for municipality j
'm' = weight for the input measure for municipality j
L = the number of municipalities in question

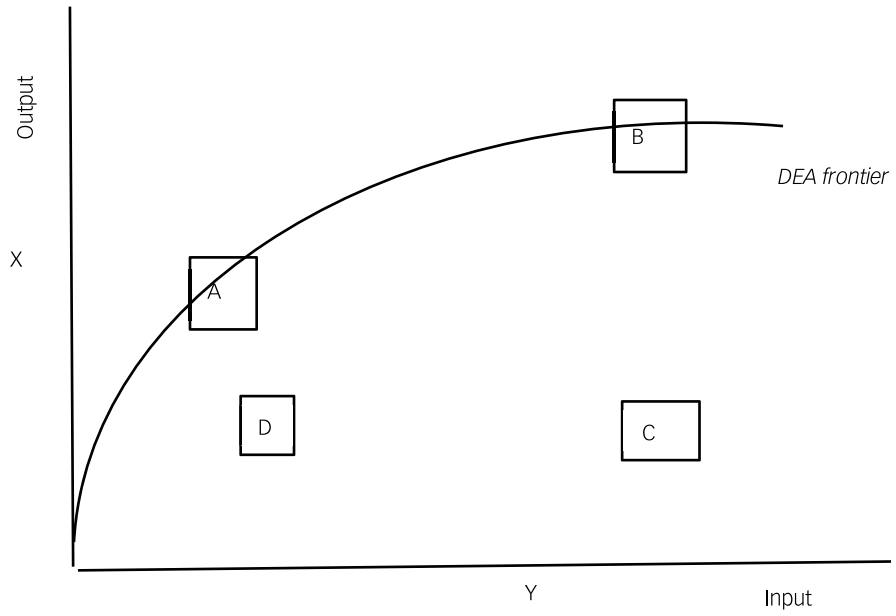
The model specifies three conditions: the first one is that the ratio of output to inputs is equal to one, the second is that the weights of each of these variables are not less than zero, and the third one is ensuring the efficiency scores are not more than one.

The linkage that the study attempts to test can be expressed as the following function:

$$Xj = f(Yj) \qquad (1)$$

Figure 108 expresses this graphically.

Figure 108. DEA frontier



In Figure 108, different units (municipalities A, B, C and D) are assumed to have the same amount of resources and expected to produce a certain level of output. The frontier line traces the maximum level of output that each municipality is expected to produce for a given amount of resources (input). For the municipalities on the frontier line, the ratio of output to input (efficiency score) is equal to 1, which is viewed as the best practice. Municipalities that fall below the frontier line have an output/input ratio of below 1 and are considered inefficient compared to the municipalities on the frontier line. Thus municipalities D and C are inefficient compared to municipalities A and B.

12.5.2 Definition of variables

Input and output variables are needed to measure spending efficiency in an organisation. Inputs measure the amount of resources used to produce a given amount of output. The type of variables used have a great influence on the type of results produced through DEA. The main limitation for studies looking at spending efficiency is the lack of standard and direct variables that can be used for efficiency estimation (see Ngomuo and Kipesha, 2015).

Input and output variables

The study used two input variables: per capita capital spending and operational spending (following Afonso and Fernandes, 2003; Sousa and Stosic, 2005). Capital spending refers to spending on long-term projects, such as infrastructure for basic services, while operational spending includes employee costs, maintenance of the existing infrastructure, material and bulk costs, remuneration of councillors and depreciation. As mandated by the Constitution, South African local municipalities spend the largest share of their resources providing four major basic services: water, electricity, sanitation and refuse removal. For this reason, access to these four services is used as an output measure in this study. Municipalities also provide general administrative services and other small services to their communities, but no direct measure exists for these services. Therefore, the study uses total population per municipality as a surrogate for the demand for these services. One major weakness of this proxy is that it does not provide information on whether the service was actually rendered but only gives an ideal picture of the services that a municipality should be providing.

In this study the access to the four basic services is defined as follows:

- Number of households with access to water (communal piped water: less than 200m from dwelling at RDP-level)
- Number of households with access to electricity (for lighting and other purposes)
- Number of households with access to sanitation (ventilation improved pits)
- Number of households with access to refuse removal (removed weekly by authority)

12.5.3 Determinants of technical efficiency

The different spending efficiency levels of municipalities could be attributed to their different characteristics. Therefore, the second stage of the analysis examines the factors that are likely to affect the technical efficiency of each municipality. To estimate the effect of these factors, most previous studies (e.g. Loikkanen and Susiluoto, 2005; Balaguer-Coll et al., 2002) used the censored Tobit regression analysis and ordinary list squares (OLS) approach. However, a criticism of these methods is the serial correlation that exists between the inputs and outputs used in the DEA and the potential explanatory variables, which results in invalid and biased conclusions (Simar and Wilson, 2007). The truncated regression approach eludes these problems and is based on a double bootstrap procedure (ibid). Therefore, the truncated regression approach is used to assess the determinant of the DEA efficiency scores in South African rural municipalities. This approach is also more applicable for this study, as the sample is selected systematically and does not include all rural local municipalities in South Africa. The truncated regression model is specified as follows:

$$\Pi j = \beta Xj + \varepsilon j \ldots \quad (2)$$

Where Π is a technical efficiency score for municipality j, and X is the potential determinant of technical efficiency in municipality j. β is the coefficient of X.

Potential explanatory variables

In selecting the potential determinants of technical efficiency, the study takes into account the characteristics of rural municipalities in South Africa and adopts some of the factors suggested in the reviewed literature. Fiscal, demographic and socio-economic factors are the major factors affecting spending efficiency in municipalities. Indicators for each of these categories are used and include: grant dependency; population size; poverty levels; share of vacant managerial posts in the organogram and indigents as a percentage of number of households (as an indicator for fiscal, demographic, socio-economic and institutional capacity and provision of free basic services respectively).

12.5.4 Data period and sources

The study measures spending efficiency in rural South African municipalities between 2008/9 and 2012/13. The choice of the study period is informed by the availability of municipal financial data. Data on municipal spending and other municipal budget variables was sourced from the National Treasury local government database. Non-financial data, such as access to basic services, was sourced from Stats SA and Global Insight databases. The study covers a sample of 87 local rural (B3 and B4) municipalities that provide all four municipal basic services.

12.6 Results

12.6.1 Output-oriented DEA efficiency results

Table 72 provides technical efficiency scores obtained from the DEA analysis of 87 local municipalities. These scores measure the ability of a municipality to achieve the maximum output given the set of resources at its disposal. A municipality with a score of 1 is regarded as efficient, while those with less than 1 are regarded as inefficient.

Table 72. Output-oriented DEA (VRS) efficiency results

Years	2008/9	2009/10	2010/11	2011/12	2012/13
Number of municipalities	87	87	87	87	87
Number of efficient municipalities	2	1	6	8	11
Share of the total sample	2%	1%	7%	9%	13%
Number of inefficient municipalities	85	86	81	79	76
Mean efficiency	0.31	0.32	0.40	0.37	0.38
Minimum efficiency	0.04	0.04	0.04	0.04	0.04
Maximum efficiency	1	1	1	1	1

Source: Author's computations

The number of efficient municipalities is low but increased between 2008/09 and 2012/13, from 2 (2%) to 11 (13%). Over this period, the mean efficiency scores for local municipalities ranged between 0.31 and 0.38. This implies that the municipalities could produce, on average, more than 60% additional output with the same resources. The minimum average efficiency score was 0.04 throughout the period. This implies that certain municipalities have high technical inefficiencies and could produce about 90% additional output if they used their resources properly. Furthermore, most of these rural municipalities produce less than 50% of their expected output, for example, on average 76% of the municipalities had efficiency scores below 50%. Table 73 shows the municipalities that were 100% efficient in each year.

Table 73. 100% efficient municipalities

Years	2008/9	2009/10	2010/11	2011/12	2012/13
Municipalities	Matzikama	Mohokare	Bushbuckridge	Albert Luthuli	Bushbuckridge
	Mohokare		Emthanjeni	Bushbuckridge	Dr JS Moroka
			Kou-Kamma	Hantam	Emalahleni
			Lephalale	Laingsburg	Hantam
			Mkhondo	Matzikama	Laingsburg
			Nkomazi	Mohokare	Mafube
				Ngwathe	Matzikama
				Thembisile	Mohokare
					Moretele
					Ngwathe
					Thembisile

Source: Author's computations

Matzikama, Mohokare and Bushbuckridge appear to have been efficient in most of the years. Mohokare was the most consistently efficient municipality (except in 2010/11 when its efficiency score was less than 1). Table 74 presents a list of the 10 most relatively efficient municipalities for each year in the period under review.

Table 74. Ten most efficient municipalities

Municipality	2008/9	Municipality	2009/10	Municipality	2010/11	Municipality	2011/12	Municipality	2012/13
Bushbuckridge	0.97	Albert Luthuli	0.69	Albert Luthuli	0.81	Dr JS Moroka	0.90	Albert Luthuli	0.94
Dr JS Moroka	0.70	Bushbuckridge	0.98	Emalahleni	0.92	Emalahleni	0.96	Emthanjeni	0.75
Emalahleni	0.90	Emalahleni	0.90	Hantam	0.89	Emthanjeni	0.74	Kamiesberg	0.63
Hantam	0.82	Hantam	0.85	Kamiesberg	0.81	Joe Morolong	0.72	Lephalale	0.76
Laingsburg	0.83	Laingsburg	0.88	Laingsburg	0.93	Mafube	0.95	Maluti a Pho-fung	0.65
Mafube	0.89	Mafube	0.87	Mafube	0.96	Maluti a Pho-fung	0.65	Modimolle	0.67
Maluti a Pho-fung	0.65	Matzikama	0.99	Matzikama	0.98	Moretele	0.79	Moses Kotane	0.95
Moretele	0.70	Moretele	0.71	Mohokare	0.89	Moses Kotane	0.81	Nala	0.78
Nkomazi	0.82	Nkomazi	0.81	Nala	0.74	Nkomazi	0.84	Nkomazi	0.87
Thembisile	0.92	Thembisile	0.87	Thembisile	0.87	Thabazimbi	0.71	Umjindi	0.60

Source: Author's computations

Between 2008/09 and 2012/13, Bushbuckridge, Matzikama, Mohokare and Mafube were the most efficient municipalities, with scores ranging from 0.97 to 1. This suggests that they can produce between 0% and 10% additional output with their existing resources. The performance of most of the top ten municipalities has been improving. For example, Emalahleni and Laingsburg had an efficiency score of 1 in 2012/13 compared to 0.90 and 0.83 in 2008/9 respectively. Table 75 presents a list of the ten least efficient municipalities for each year.

Table 75. Ten least efficient municipalities

Municipality	2008/9	Municipality	2009/10	Municipality	2010/11	Municipality	2011/12	Municipality	2012/13
Baviaans	0.06	Baviaans	0.06	Kannaland	0.07	Baviaans	0.07	Baviaans	0.06
Kareeberg	0.06	Kareeberg	0.06	Kareeberg	0.06	Kannaland	0.07	Kannaland	0.08
Karoo Hoogland	0.04	Karoo Hoogland	0.04	Kgatelopele	0.06	Karoo Hoogland	0.04	Kareeberg	0.06
Kgatelopele	0.05	Kgatelopele	0.05	Khâi-Ma	0.10	Prince Albert	0.04	Karoo Hoogland	0.04
Prince Albert	0.04	Prince Albert	0.04	Prince Albert	0.04	Renosterberg	0.11	Kgatelopele	0.08
Renosterberg	0.04	Renosterberg	0.04	Renosterberg	0.11	Richtersveld	0.05	Prince Albert	0.05
Richtersveld	0.04	Richtersveld	0.04	Richtersveld	0.04	Siyathemba	0.08	Richtersveld	0.05
Siyathemba	0.07	Siyathemba	0.07	Thembelihle	0.05	Thembelihle	0.05	Siyathemba	0.08
Thembelihle	0.05	Thembelihle	0.05	Tsantsabane	0.11	Ubuntu	0.06	Thembelihle	0.08
Ubuntu	0.06	Ubuntu	0.06	Umsobomvu	0.09	Umsobomvu	0.09	Ubuntu	0.06

Source: Author's computations

Most of these municipalities are consistently highly inefficient over the reviewed period. Prince Albert, Kareeberg and Richtersveld municipalities were relatively the worst performing municipalities, with efficiency scores ranging between 0.04 and 0.06. This means that, if resources were used properly, these municipalities could produce approximately 96% additional output without increasing the amount of resources. The performance of some municipalities has improved over the years. For example, Renosterberg municipality's efficiency score increased from 0.04 in 2008/9 to 0.11 in 2011/12.

12.6.2 Factors affecting spending efficiency in rural municipalities

The determinants of municipal efficiency used are the provision of free basic services (FBS), the vacancy rate for senior management, reliance on intergovernmental transfers, municipal size and municipal economic performance.

Table 76. Results from the truncated regression analysis

Independent variable	Coefficient	Standard-error	t-value
Water (FBS)	-7.9854	7.6169	0.9731
Electricity (FBS)	-1.2895	4.8399	6.2348
Refuse (FBS)	-3.8686	1.1599	-3.3353
Sanitation (FBS)	-3.7053	5.3851	-6881
Vacancy rate	-9.444	1.2041	-0.0784
Grant reliance	3.0733	8.269	0.3717
Population	2.5181	2.1086	11.9423
GVA	6.4299	2.70728	2.3789
Sigma	3.1037	2.0275	15.3081
Intercept	7.4123	7.6169	0.9731

Source: Author's computations

As Table 76 shows, the provision of FBS has a negative effect on municipal efficiency. This is because a municipality is unable to recover the cost of providing services to indigent households that receive FBS. High vacancy rates also result in municipal inefficiency, which concurs with the Auditor-General's report that highlights the lack of institutional capacity as a major cause of poor municipal performance (AGSA, 2014). Grant reliance, economic performance and the size of the municipality have a positive impact on municipal efficiency.

12.7 Conclusion and Recommendations

The main objective of this study was to assess the effectiveness and efficient use of intergovernmental transfers in South African rural municipalities. The study found that conditional grants are under-spent, and yet these municipalities have significant backlogs in almost all services. Rural municipalities are not prioritising their spending, as shown by the resources spent on employee costs compared to vital expenditure needs such as repairs and maintenance of existing infrastructure.

The analysis found that South African rural municipalities are least efficient at providing water, electricity, sanitation and refuse removal, with efficiency levels ranging from between 0.31 and 0.38. These levels imply that the municipalities are providing 31% to 38% of what they could provide given their resources. Therefore, the performance of rural municipalities can be improved without necessarily increasing the amount of resources, as they could provide over 60% additional services on average, with the same resources.

The provision of FBS and the lack of institutional capacity are the major causes of technical inefficiencies in rural municipalities, whereas economic performance, municipal size and grant reliance have positive effects on municipal efficiency.

In light of the observations and findings above, it is recommended that;

- National Treasury includes, as part of the principles underlying grants to rural municipalities, more stringent expenditure supervision, in order to minimise wastage and improve efficiency. The national and provincial governments should evaluate the effectiveness of existing supervision methods with a view to strengthening them.

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Appendix: Efficiency Scores

Municipalities	2008/9	2009/10	2010/11	2011/12	2012/13	Annual average
!Kai !Garib	0.14	0.14	0.14	0.14	0.14	0.14
!Kheis	0.16	0.14	0.18	0.16	0.16	0.16
Albert Luthuli	0.62	0.69	0.81	1.00	0.94	0.81
Baviaans	0.06	0.06	0.16	0.07	0.06	0.08
Beaufort West	0.17	0.17	0.17	0.17	0.18	0.17
Bela-Bela	0.20	0.20	0.21	0.23	0.22	0.21
Bergrivier	0.19	0.20	0.20	0.20	0.20	0.20
Bitou	0.17	0.18	0.19	0.19	0.20	0.19
Blue Crane Route	0.12	0.12	0.12	0.12	0.13	0.12
Bushbuckridge	0.97	0.98	1.00	1.00	1.00	0.99
Camdeboo	0.17	0.17	0.17	0.18	0.17	0.17
Cape Agulhas	0.12	0.12	0.12	0.12	0.12	0.12
Cederberg	0.15	0.15	0.15	0.15	0.16	0.15
Dikgatlong	0.12	0.12	0.35	0.12	0.13	0.17
Dipaleseng	0.15	0.44	0.45	0.16	0.16	0.27
Dr JS Moroka	0.70	0.63	0.68	0.90	1.00	0.78
Emalahleni	0.90	0.90	0.92	0.96	1.00	0.94
Emthanjeni	0.61	0.55	1.00	0.74	0.75	0.73
Gamagara	0.21	0.22	0.24	0.27	0.30	0.25
Ga-Segonyana	0.24	0.24	0.26	0.24	0.24	0.24
Hantam	0.82	0.85	0.89	1.00	1.00	0.91
Hessequa	0.13	0.13	0.27	0.13	0.13	0.16
Ikwezi	0.10	0.10	0.56	0.21	0.22	0.24
Joe Morolong	0.33	0.32	0.71	0.72	0.44	0.50
Kamiesberg	0.51	0.53	0.81	0.57	0.63	0.61
Kannaland	0.07	0.07	0.07	0.07	0.08	0.07
Kareeberg	0.06	0.06	0.06	0.21	0.06	0.09
Karoo Hoogland	0.04	0.04	0.12	0.04	0.04	0.06
Kgatelopele	0.05	0.05	0.06	0.15	0.08	0.08
Kgetlengrivier	0.13	0.12	0.13	0.13	0.13	0.13
Khâi-Ma	0.09	0.11	0.10	0.12	0.14	0.11
Kopanong	0.24	0.24	0.24	0.24	0.24	0.24
Kouga	0.27	0.27	0.27	0.27	0.28	0.27
Kou-Kamma	0.28	0.30	1.00	0.37	0.38	0.47
Laingsburg	0.83	0.88	0.93	1.00	1.00	0.93
Langeberg	0.17	0.18	0.18	0.18	0.18	0.18
Lekwa	0.34	0.34	0.34	0.35	0.36	0.35
Lephalale	0.56	0.58	1.00	0.62	0.76	0.70
Lesedi	0.30	0.31	0.34	0.40	0.49	0.37
Letsemeng	0.26	0.27	0.26	0.32	0.35	0.29
Mafube	0.89	0.87	0.96	0.95	1.00	0.93
Magareng	0.14	0.14	0.14	0.15	0.15	0.15
Maluti a Phofung	0.65	0.65	0.65	0.65	0.65	0.65
Mantsopa	0.32	0.36	0.36	0.39	0.41	0.37

Municipalities	2008/9	2009/10	2010/11	2011/12	2012/13	Annual average
Maquassi Hills	0.15	0.23	0.20	0.22	0.24	0.21
Masilonyana	0.27	0.30	0.33	0.38	0.45	0.34
Matzikama	1.00	0.99	0.98	1.00	1.00	0.99
Mier	0.22	0.24	0.25	0.26	0.28	0.25
Mkhondo	0.31	0.32	1.00	0.36	0.44	0.49
Modimolle	0.42	0.47	0.52	0.57	0.67	0.53
Mohokare	1.00	1.00	0.89	1.00	1.00	0.98
Mookgopong	0.21	0.23	0.25	0.31	0.36	0.27
Moretele	0.70	0.71	0.69	0.79	1.00	0.78
Moses Kotane	0.58	0.65	0.71	0.81	0.95	0.74
Nala	0.42	0.48	0.74	0.63	0.78	0.61
Naledi	0.21	0.19	0.19	0.18	0.18	0.19
Nama Khoi	0.19	0.18	0.18	0.18	0.18	0.18
Ndlambe	0.23	0.21	0.21	0.21	0.21	0.21
Ngwathe	0.51	0.61	0.67	1.00	1.00	0.76
Nketoana	0.14	0.15	0.17	0.19	0.20	0.17
Nkomazi	0.82	0.81	1.00	0.84	0.87	0.87
Phokwane	0.32	0.33	0.29	0.54	0.51	0.40
Phumelela	0.17	0.16	0.41	0.17	0.17	0.22
Pixley Ka Seme	0.24	0.23	0.47	0.22	0.22	0.27
Prince Albert	0.04	0.04	0.04	0.04	0.05	0.04
Renosterberg	0.04	0.04	0.11	0.11	0.11	0.08
Richtersveld	0.04	0.04	0.04	0.05	0.05	0.04
Setsoto	0.37	0.36	0.35	0.35	0.35	0.36
Siyancuma	0.13	0.12	0.26	0.12	0.12	0.15
Siyathemba	0.07	0.07	0.19	0.08	0.08	0.10
Sundays River Valley	0.20	0.16	0.16	0.19	0.22	0.19
Swartland	0.34	0.35	0.38	0.39	0.39	0.37
Swellendam	0.12	0.12	0.12	0.12	0.13	0.12
Thaba Chweu	0.32	0.31	0.31	0.33	0.32	0.32
Thabazimbi	0.25	0.26	0.70	0.71	0.46	0.48
Theewaterskloof	0.42	0.37	0.40	0.37	0.41	0.39
Thembelihle	0.05	0.05	0.05	0.05	0.08	0.06
Thembisile	0.92	0.87	0.87	1.00	1.00	0.93
Tokologo	0.13	0.13	0.13	0.14	0.15	0.13
Tsantsabane	0.11	0.10	0.11	0.17	0.11	0.12
Tswelopele	0.18	0.16	0.16	0.17	0.17	0.17
Ubuntu	0.06	0.06	0.13	0.06	0.06	0.08
Umjindi	0.23	0.22	0.58	0.60	0.60	0.44
Umsobomvu	0.09	0.09	0.09	0.09	0.10	0.09
Ventersdorp	0.24	0.25	0.25	0.27	0.29	0.26
Victor Khanye	0.23	0.24	0.57	0.25	0.26	0.31
Witzenberg	0.32	0.33	0.34	0.35	0.36	0.34
Average	0.31	0.32	0.40	0.37	0.38	0.35

CHAPTER 13

District Municipalities and Rural Development

Mkhululi Ncube and Nomfundo Vacu

District Municipalities and Rural Development

13.1 Introduction

The role of local government is set out in legislation. Section 156 of the Constitution outlines the powers and functions of the local government. Municipalities have "executive authority in respect of, and has the right to administer" the provision of basic services. The Municipal Structures Act (MSA) (No. 117 of 2009) clearly delineates the roles and responsibilities of each local government tier. Category B local municipalities (LMs) share the provision of four major services (water, electricity, refuse removal and sanitation) with Category C district municipalities (DMs), whereas metropolitan municipalities (metros) are mandated to provide all the services under their jurisdiction. Rural LMs form part of category B municipalities.

The Constitution recognises local government's developmental role, which is further entrenched in the National Development Plan (NDP). One of the NDP's key objectives is an "Integrated and Inclusive Rural Economy" by 2030, to be achieved through successful land reform, infrastructure development, job creation and poverty alleviation (NPC, 2011).

Poor access to adequate levels and standards of basic services compounds the challenges of poverty and unemployment in rural areas. Dealing with these challenges requires not only a strong national government but also a capable and capacitated local government – the sphere of government closest to the people. However, despite increased funding and interventions over the years (in 2015/16, the sector received over R100-billion in transfers, a huge leap from the R6-billion in 2000/01), this has not translated into commensurate service delivery improvements in the majority of rural municipalities. Initiatives meant to improve the performance of the local government include the recent review of the local government equitable share formula introduced in 2013, the ongoing "Back to Basics" initiative, as well as the infrastructure grant reviews. In addition, amalgamations of municipalities are being experimented with in order to turn around the fortunes of this sphere of government. Many rural municipalities face the dilemma of expanding expenditure requirements and shrinking fiscal space. They have limited scope for economic diversification, as well as deficient services and infrastructure, making it difficult for them to arrest the process of social and economic decline within their jurisdiction.

District municipalities are supposed to play a key role in rural development and in assisting local municipalities to fulfil their mandate. The roles of DMs are spelt out in the 1998 White Paper on Local Government, Section 83 of the Local Government: Municipal Structures Act of 1998, and the IGFR Act of 2005.

Following these legislative and policy provisions, the roles of DMs can best be summarised as:

- Provision of services (health, sewage disposal, domestic wastewater and potable water supply) to end user
- Redistribution of resources within their jurisdiction
- District-wide services, such as district roads, airports, solid waste disposal sites, firefighting services, abattoirs, markets, local tourism
- Coordination and district-wide planning
- Technical assistance and capacity-building for LMs in their jurisdiction
- Direct governance of district management areas (DMAs)
- Coordination of intergovernmental relations and link between provincial and local governments.

Based on these roles, DMs could potentially turn around the fortunes of rural local government. However, the effectiveness of DMs has been compromised by the lack of clarity in the division of powers and functions, and "unproductive and often unsatisfactory relations between LMs and DMs" (Joseph, 2012: 28). Debates about the effectiveness and relevance of DMs have been divided between either scrapping DMs (i.e. change to a single-tier LM system) or strengthening DMs (i.e. retaining a two-tier LM system). Some have advocated for something in between, through redefining the role and mandate of DMs, which would be confined to non-urban areas (Steytler, 2007). A review of the DMs' role is necessary in order to eliminate turf battles in the local government sector, reduce transaction costs and duplication, ensure accountability and streamline decision-making and funding flows. The ANC advocated for the creation of standalone strong urban municipalities (i.e. remove strong B1 LMs from DMs) and the maintenance of rural DMs. The ANC 4th National Policy Conference resolution proposed that DMs "should focus on coordinating, planning and support of local municipalities functions' and that DMs 'should exist only in areas where there are weak local municipalities" (ANC, 2012).

As DMs consume large chunks of fiscal resources, their relevance and effectiveness in rural development must be scrutinised. This chapter's objectives are to:

- Assess the effectiveness DMs in rural development.
- Examine the allocation of powers and functions of DMs and LMs with a view to recommending divisions of powers and functions that would catalyse rural development.

13.2 Background: DMs in the Local Government Sector

The Constitution of South Africa introduced a three-tier system of local government: metropolitan municipalities (metros), DMs and LMs. However, the Constitution was silent on the role of DMs, which was only clarified in the 1998 White Paper on Local Government. The White Paper conceded that a variable system of district governance was the way to go and envisioned four distinct roles for DMs:

i. Integrated district-wide planning
ii. Planning and development of bulk infrastructure in non-metropolitan areas
iii. Provision of direct services to consumers in areas where municipalities are not established
iv. Provision of technical assistance and capacity building in LMs.

The mandate of DMs contained in the White Paper found legal meaning in Section 83 of the Local Government: Municipal Structures Act (MSA) (No. 117 of 1998). The Act provided the legal framework for a single-tier metropolitan government system and a two-tier local government system. Section 84(1) (a) to (p) defines the roles of DMs, and any residual powers not contained in this section were vested in LMs.

Two subsequent Acts amended the role of DMs in a fundamental departure from the White Paper, which had limited the role of DMs.

- The Local Government: Municipal Structures Amendment Act (No. 33 of 2000) made DMs direct service providers of electricity, sanitation, water and health services.
- The Intergovernmental Relations Framework (IGR) Act (No. 13 of 2005) added the role of IGR coordinator and channel of communication between the province and LMs.

The powers and functions of DMs listed in the MSA are not absolute and can, under certain circumstances, be altered. Section 85 of the MSA allows the MEC for local government in a province to:

> adjust the division of functions and powers between a district and a local municipality as set out in section 84(1) or (2), by allocating, within a prescribed policy framework, any of those functions or powers vested –
>
> (a) in the local municipality, to the district municipality; or
> (b) in the district municipality (excluding a function or power referred to in section 84 (1) (a), (b), (c), (d), (i), (o) or (p), to the local municipality.

The MEC can re-allocate powers or functions if "the municipality in which the function or power is vested lacks the capacity to perform that function or exercise that power", provided a consultative process is followed. Then, in 2003, the Minister for Provincial and Local Government issued new directives on the powers and functions of LMs and DMs. LMs were to provide bulk electricity until the restructuring of the industry was completed, DMs were vested with powers to provide municipal health services, while water and sanitation functions were to be determined on a provincial case-by-case basis. In the end, municipalities were authorised to continue providing water and sanitation in 22 of the 46 districts.

This has resulted in a highly variable system of district governance, costly overlaps and duplications, and real risks of confusion, contestations and even conflict in the IGR system, as well as possible further distortions in accountability lines. Furthermore, MECs often alter the powers and functions of DMs and LMs following Municipal Demarcation Board (MDB) capacity assessments, resulting in much uncertainty in the local government space and the potential to compromise development.

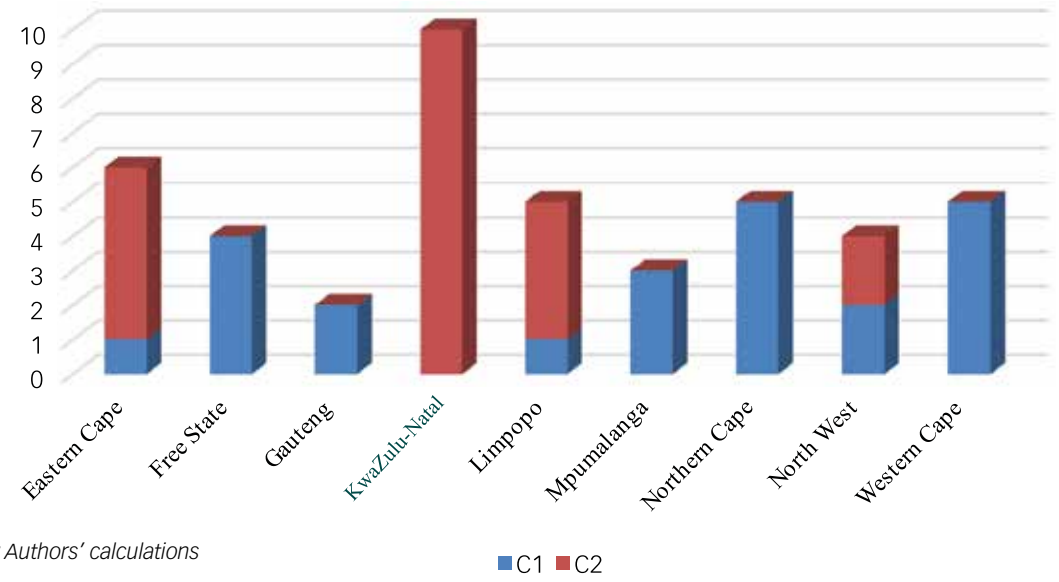
Following the legislative and policy changes, the roles of DMs can best be summarised as:

- Provision of services (health, sewage disposal, domestic wastewater and potable water supply) to end user
- Redistribution of resources within their jurisdiction
- District-wide services, such as district roads, airports, solid waste disposal sites, firefighting services, abattoirs, markets, local tourism
- Coordination and district-wide planning
- Technical assistance and capacity-building for LMs in their jurisdiction
- Direct governance of DMAs
- GR coordinator and link provincial and local government systems.

However, in reality many DMs are not performing these core functions in areas where LMs are strong.

DMs are further divided into C1 and C2 categories: C1 are DMs that have no water service functions and C2 are DMs that do have water service functions. Of the 44 DMs, 15 are both Water Service Authorities (WSA) and Water Service Providers (WSPs), while 21 are Water Service Authorities (WSAs). Figure 109 shows the distribution of DMs across the provinces. Five provinces (Free State, Gauteng, Mpumalanga, Northern Cape and Western Cape) have no C2 DMs, whereas three provinces (KwaZulu-Natal, the Eastern Cape and North West) have a mix of C1 and C2 DMs.

Figure 109. Provincial distribution of DMs



Source: Authors' calculations

13.2.1 Performance of DMs

In general, DMs have a thin own-revenue base, and most of their funding is allocated through a "temporary" revenue replacement grant. As Table 77 shows, they rely on transfers for 75–85% of their revenue, while revenues from property rates are virtual non-existent in DMs with water provision powers and functions (P&F).

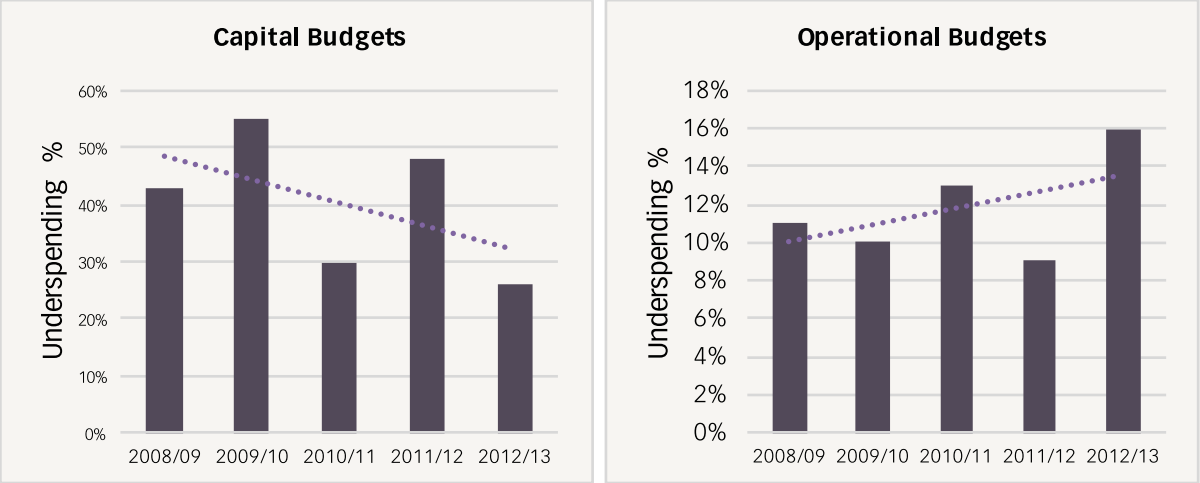
Table 77. Revenue sources for DMs

Type of municipality	Government grants	Investment revenue	Other	Property rates	Public contributions	Service charges
DM without P&F	75%	5%	16%	1%	1%	2%
DM with P&F	85%	2%	5%	0%	0%	8%

Source: Authors' calculations

The performance of DMs is similar to that of LMs, as Figure 110 illustrates. All DMs under-spend, especially their capital budgets. Their spending on capital budgets shows signs of improving but is worsening on operational budgets. Under-spending on any budget is worrying given the high levels of backlogs in the country, as it implies ineffective and inefficient use of resources and, importantly, forgone or postponed investments.

Figure 110. DMs and under-spending



Source: Authors' calculations

13.3 Literature Review

The debate over whether DMs add value, in particular rural local development, has been raging for some time. Some argue that DMs have no role to play, while others advocate for the role of DMs to be strengthened. The answer may be found between these two extremes.

Reasons for pushing for the scrapping of DMs include their failure to redistribute resources, in particular since the abolishment of the RSC levies[52], the cost of maintaining a two-tier system of local government, especially as DMs and LMs have overlapping and duplicated functions; their lack of presence in urban areas; and an unviable two-tier system when there are too few LMs to a DM (CLC, 2007).

Atkinson et al. (2003) are in favour of scrapping DMs and converting them into administrative arms or field offices of provinces. Giving their functions to provinces would strengthen the effect of provincial governments; promote inter-sectoral collaboration; remove political jockeying and remove expenditure on councillors.

Completely scrapping the DMs – or maintaining the status quo – would be unwise because of the huge financial and human investments made in DMs (CLC, 2007). Not only would removing DMs be a waste of time, but it would also disrupt service delivery (Joseph, 2012). The two-tier system should not be abolished entirely, as DMs have made a big difference in some (rural) areas, and so should be strengthened in DMAs and in areas where the LMs are weak, but scrapped in urban areas (CLC, 2007).

Baatjies (2008) argues for the scrapping of LMs and instead having a single tier, with DMs providing all services and LMs acting as sub-councils of DMs. However, this option is only feasible if institutional and human capacity to deliver basic services is strengthened within DMs. The other challenge is that this option will increase the distance between the representatives and the represented and will be costly, requiring boundaries to be redrawn and capacity to be built (Joseph, 2012).

The ANC has also weighed in on the debate about the need for DMs. The ANC 2010 Summit on Provincial and Local Government Reform emphasised the need for local government reform. Four reform proposals were put on the table (Joseph, 2012):

- Scrapping of the two-tier system
- Incorporating DMs into provinces, and thereby remaining with a single tier
- Retaining DMs as shared administrative and service centres for LMs
- Retaining DMs only in certain areas.

In 2012, the ANC policy document listed three proposals (Joseph 2012; ANC, 2012):

- Maintain status quo with DMs and strengthen their planning, coordination and supporting functions.
- Incorporate DMs into national or provincial administrative structures and leave LMs to be stand-alone municipalities.
- Remove strong LMs from DMs.

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[52] Regional Services Council (RSC) levies, which were basically two levies applicable to employers: the Regional Services Levy, based on gross remuneration of employees, and the Regional Establishment Levy, based on the turnover of each business.

The last option, of removing strong (urban) LMs from DMs, has gained more traction than the first two. The question is whether evidence on the ground supports this or any of the options.

13.4 Methodology

The effectiveness of DMs in rural development is assessed by evaluating the effectiveness (or the efficiency) of their spending. This is done using the data envelopment approach (DEA) model. The DEA model allows the use of multiple inputs and outputs, and does not require assumptions about the functional form of the regression model and the price of inputs and outputs used (Ngomuo and Kapesha, 2015). DEA measures technical efficiency with output-oriented and input-oriented models. In the output model, inputs are kept constant but outputs change, while in the input model, inputs reduce and output levels remain the same. DEA can be carried out with the assumption of constant returns to scale (CRS) or variable returns to scale (VRS). With CRS, the relevant units are assumed to be scale-efficient, while with VTR they are assumed to be not operating at optimal scale. As it is not known whether rural municipalities in South Africa are operating at an optimal scale, technical efficiency is estimated through VRS, which allows technical efficiency to be calculated without the effects of scale efficiency. The output-oriented DEA model is more applicable in South Africa because municipalities do not have much control over the amount of resources that are channelled to them, but do have control over the amount and quality of output produced with those resources.

13.5 Findings

13.5.1 Efficiency of rural DMs

As noted above, DMs rely heavily on transfers from national and provincial governments. These resources are transferred to DMs so that they are able to fulfil their mandate as set out in the 1998 Local Government White Paper and the Municipal Structures Act. The DEA is used to assess the efficiency of their spending. As Table 78 shows, the average level of efficiency ranges between 0.8246 and 0.8693, suggesting that DMs produce between 82% and 86% of what is expected, given their resources.

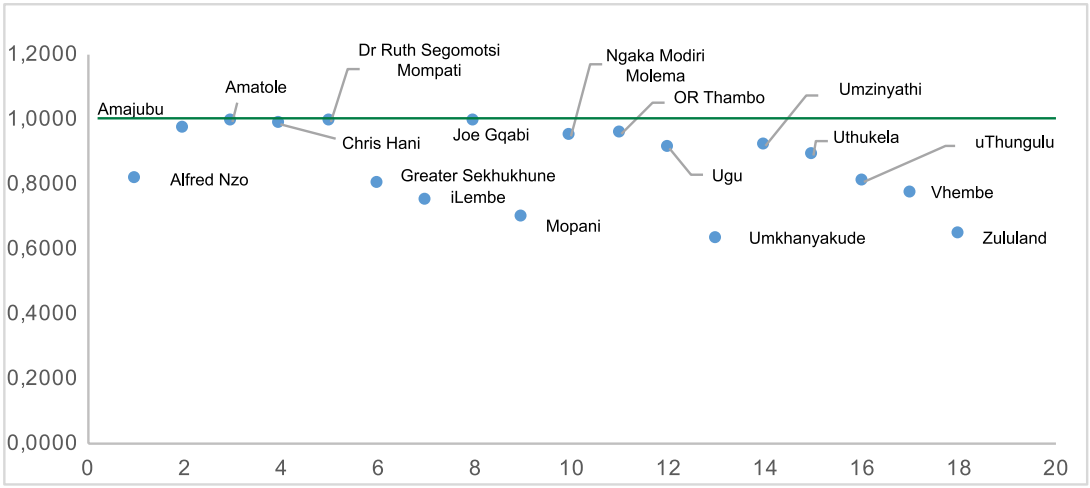
Table 78. Average efficiency scores for district municipalities

Years	2008/9	2009/10	2010/11	2011/12	2012/13
Sample size	18	18	18	18	18
Efficient municipalities	0	0	0	7	3
Inefficient municipalities	18	18	18	11	15
Mean efficiency	0.8246	0.8396	0.8649	0.8870	0.8693
Minimum efficiency	0.5640	0.5967	0.6325	0.6553	0.6807
Maximum efficiency	0.9891	0.9891	0.9930	1	1

Source: Authors' calculations

Figure 111 gives the annual average efficiency scores for each rural DM between 2008 and 2013. All rural DMs fall just on or below the frontier line, implying that they are not as efficient as they could be in using funds at their disposal. The most inefficient DMs are uMkhanyakude and Zululand, while Amatole and Dr Ruth Segomotsi Mompati DM are relatively more efficient.

Figure 111. Annual average efficiency scores by municipality



Source: Commission's calculations

The high levels of inefficiency and under-spending compromise the developmental role of DMs. If DMs used the resources at their disposal more efficiently and effectively, they could add more value to rural development.

13.5.2 The role and responsibilities of DMs: a critical analysis

Districts and service provision

As noted earlier, the MSA mandates DMs to provide services to end users, e.g. health services, sewage disposal systems, domestic wastewater and potable water supply systems, and bulk electricity. However, DMs are not performing their core service functions as envisaged in the MSA (Wahid and Steytler, n.d.). According to the MDB capacity assessment report of 2009, 76% of DMs are performing less than 50% of their statutory functions and only two DMs are performing more than 75% of their functions (Steytler, 2010). Money to spend on core services is crowded out by expenditure on non-core activities, with half of the expenditure by DMs going to governance, administration and planning (Wahid and Steytler, n.d.). From as early as 2007, the MDB's capacity assessments showed that services were increasingly being shifted from DMs to LMs (CLC, 2007), in particular refuse removal, roads, firefighting and cemeteries (MDB, 2011). In 2014, only 45% of DMs were providing water and sanitation services (compared to 61% in 1008), and only 2% were providing refuse removal services (down from 23% in 2008).

The reduction in water, sanitation and refuse removal services provided by DMs is more pronounced in urban areas than in rural areas. Between 2008 and 2014, the proportion of urban DMs providing water and sanitation services halved, from 22% to 11%, whereas in rural areas, 54% of DMs provided these services in 2014, down from 71% in 2008 (a decline of 24%). Similarly, in the case of refuse removal services, urban DMs providing these services have declined by 100% compared to 90% for rural DMs. This analysis shows that urban DMs are not providing many services to consumers, whereas rural DMs still play a significant role in rural development. The implication, therefore, is that rural DMs should be strengthened, while the role of urban DMs needs to be reviewed.

In many countries with a two-tier system of local government, large urban municipalities are often left out of the system. In South Africa, strong secondary cities dominate urban DMs in every aspect, e.g. budgets, population size, economic GVA and capacity (Table 79), rendering DMs ineffective in fulfilling their mandated functions.

Table 79. Urban LMs by indicators showing relations to DMs

DM	DM pop in Thousands	DM budget in R'000	DM GVA in R' Mil	LMs	B1	B1 POP in Thousands	%B1 POP/ DM	B1 Budget In R'Mil	B1GVA in R' Mil	%B1 GVA/ DM	%B1 Own Revenue
Lejweleput-swa	686	106 251	15 295	5	Matjhabeng	426	62%	1 579	12 482	82%	75%
Sedibeng	947	325 263	20 242	4	Emfuleni	784	83%	3 555	14 740	73%	84%
West Rand	888	251 977	21 710	3	Mogale City	352	40%	1 472	9 915	46%	85%
Amajuba	520	193 514	9 146	3	Newcastle	614	71%	2 684	7 393	81%	83%
uMgungun-dlovu	1035	456 546	22 968	7	Msunduzi	370	59%	1 235	17 026	74%	83%
uThungulu	984	574 227	22 954	6	Umhlathuze	350	36%	2 019	9 352	41%	87%
Capricorn	1268	571 812	26 442	5	Polokwane	555	44%	2 064	17 788	67%	78%
Ehlanzeni	1556	192 290	31 171	5	Mbombela	513	33%	1 804	20 560	66%	73%
Gert Sibande	967	257 677	34 337	7	Govan Mbeki	238	25%	1 076	19 949	58%	79%
Nkangala	1095	317 768	42 818	6	Emalahleni	297	27%	1 227	19 556	46%	84%
					Steve Tshwete	153	14%	1 110	16 204	38%	88%
Frances Baard	360	104 183	12 814	4	Sol Plaatje	225	63%	1 323	11 155	87%	86%
Siyanda	225	95 744	8 546	6	//Khara Hais	87	39%	401	2 334	27%	83%
Bojanala	1276	488 633	53 951	5	Rustenburg	415	33%	2 331	32 793	61%	89%
					Madibeng	373	29%	984	11 541	21%	79%
Kenneth Kaunda	643	168 938	16 976	4	City of Matlosana	385	60%	1 740	10 591	62%	80%
					Tlokwe	138	21%	767	5 730	34%	100%
Ngaka Modiri Molema	820	531 287	14 188	5	Mafikeng	278	34%	462	8 110	57%	72%
Cape Wine-lands	728	470 063	23 864	5	Drakensburg	224	31%	1 396	7 368	31%	85%
					Stellenbosch	137	19%	904	5 791	24%	86%
Eden	525	243 277	18 554	7	George	173	33%	1 184	5 814	31%	75%

Sources: Wahid and Steytler (n.d.)

One solution is to establish a single-tier system in urban areas and to maintain a two-tier system in rural areas. India and Germany have such local government systems. In the case of two tiers, the upper tier does not normally supply services directly to households unless the lower tier lacks capacity or the services are bulk services.

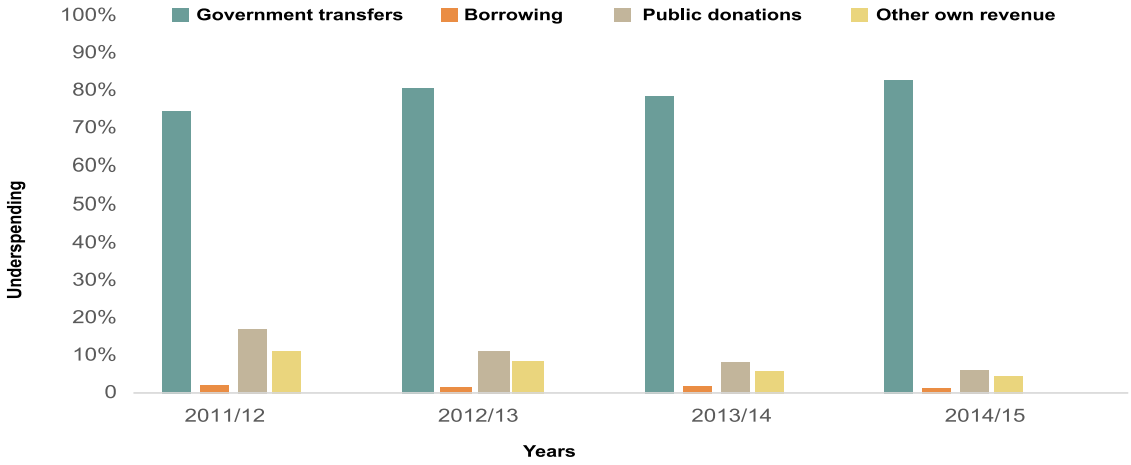
Social participation and social accountability are weak in the current model of DMs, which is why some believe that DMs should not provide services such as water directly to consumers – such services require effective participation by citizens and accountability to society. Only 40% of district councillors are directly elected by voters in the DM – the other 60% are appointed by the constituent municipalities and so are not directly accountable to the electorate.

Despite the weaknesses described above, DMs in rural areas are visible and have a history of providing services directly to consumers. Moreover, some rural LMs have weak capacity and need the support of DMs, while some DMs provide services in DMAs where no direct services exist. This should continue unless nearby LMs have the capacity and could provide services to the DMAs through a service level agreement.

District municipalities and redistribution

As cross-municipality authorities, the assumption is that DMs will facilitate the redistribution of resources from rich municipalities to poorer municipalities. This may not be possible for rural DMs, as many rural municipalities do not contain a large anchor town whose wealth could be used to subsidise rural areas. The cross-subsidisation argument also presupposes that districts have abundant own revenues to use in order to distribute wealth fairly and equitably. However, since the scrapping of the RSC levies[53] in 2006, DMs have no substantial own-revenue sources and remain grant dependent (Figure 112). As a result, DMs have no muscle to influence municipal spending and thus the overall distribution of wealth (Mlokoti, 2007). Therefore, redistribution should be left to national government because, as the Commission has noted before (in 2001), the Constitution provides the national sphere with expenditure (e.g. transfers) and tax levers to redistribute wealth across municipalities (CLC, 2007). National Treasury has also argued that DMs are not the suitable institution to tackle the issue of income redistribution (ibid). Furthermore, achieving equity within a district will not necessary result in an equal South Africa.

Figure 112. Composition of total revenue for DMs



Source; Authors' compilation

District municipalities and services with spill-over effects

The central argument for establishing DMs was that they can provide services that transcend many municipal jurisdictions more cost effectively. Such district-wide services include roads, airports, solid waste disposal sites, firefighting services, abattoirs, markets and local tourism. A cross-municipality structure can also benefit from economies of scale in the case of services with high fixed investment costs, such as bulk infrastructure (e.g. water). While this economy-of-scale argument may be true in theory, it is not in practice because of South Africa's model of local government. A two-tier system of local government is common in countries with many smaller municipalities (e.g. Germany, Spain, and India), whereas a single-tier local government system is found in countries with a few large municipalities (e.g. Canada, Australia and Nigeria). However, South Africa appears to be the exception, as it has a two-tier system of local government but only a few, very large (in terms of population) LMs.

- Average population: an average South African local municipality is home to 200 000 people, whereas in Germany 40% of municipalities (*kreise*) have populations of less than 1000, and in Spain 80% of municipalities have populations of less than 5000.
- District size: some of the DMs in South Africa are larger than many countries in the world. For instance, Switzerland is smaller than some of the districts in South Africa but is divided into 26 cantons, each with its own parliament, that are divided into 2700 communes (equivalent to LMs).

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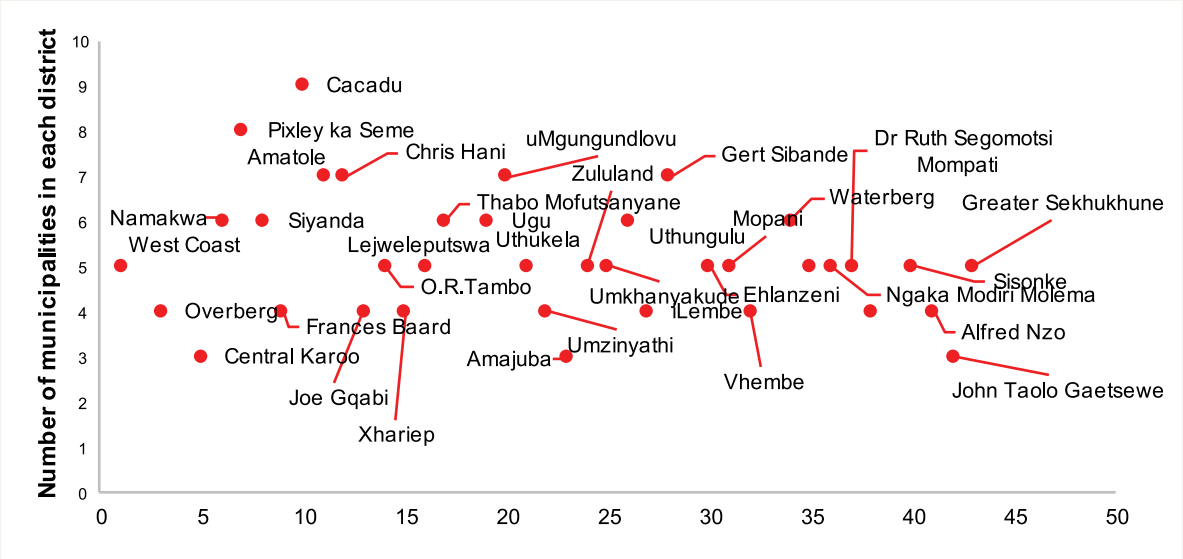
[53] Regional Services Council (RSC) levies, which were basically two levies applicable to employers: the Regional Services Levy, based on gross remuneration of employees, and the Regional Establishment Levy, based on the turnover of each business.

Thus the economy-of-scale argument is more applicable to the German, Swiss and Spanish models than to the South African model. In South Africa, an average DM covers 4–5 municipalities, and some DMs have even fewer municipalities (Figure 113). For example, Amajuba DM contains three municipalities and is dominated by the Newcastle municipality, which is home to 66% of the district's population. Newcastle is a large town and a B1 municipality with the capacity to provide its own bulk infrastructure. Therefore, the Amajuba DM focuses only on the two smaller LMs: Emadlangeni and Dannhauser, and so no economies of scale are achieved. Economies of scale can be a factor for DMs with six or more municipalities, such as Sarah Baartman DM and Gert Sibande DM.

Figure 113. Number of municipalities in each district



Source: Global Insight (2014)

District-wide planning and coordination

Regional planning and coordination of regional development plans are best suited to a cross-municipality authority. Over the years, all DMs have coordinated district-wide planning through developing frameworks for integrated planning within District Information Forums. These forums are composed of representatives of constituency municipalities and the DM, and are chaired by the district mayor. The district planning frameworks form the basis for local municipal integrated development plans (IDPs). However, many municipalities resent this top-bottom approach to planning and feel that IDPs should inform the district planning frameworks, not the other way around. Anecdotal evidence also suggests that district-wide planning has not been effective in districts containing one or more of the municipalities with a large dominant secondary city. As these municipalities often have better capacity to plan and coordinate their activities than the DM, the DM is left to facilitate the planning and cooperation among smaller municipalities.

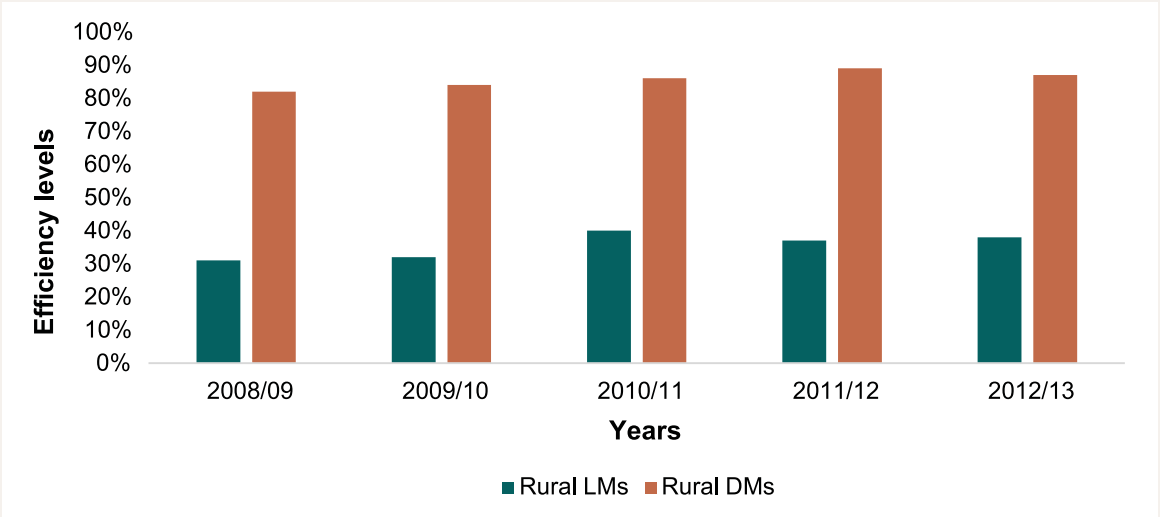
Therefore, as suggested earlier, urban areas should be left out of the two-tier system of local government, while a two-tier system would continue in rural areas, where DMs would continue to play a coordination and planning role. This arrangement seems to be the trend elsewhere in the world, i.e. where there is a large number of LMs, a few overarching institutions coordinate the planning process. For example, Spain has 50 provincial governments that coordinate the regional planning for about 8000 municipalities, of which nearly 80% have a population of less than 5000 (CLC, 2007). This proposal also aligns with the ANC 4th National Policy Conference resolution that DMs "should focus on coordinating, planning and support of local municipalities functions" and that DMs 'should exists only in areas where there are weak local municipalities" (ANC, 2012).

DMs are also required to coordinate IGR issues in their jurisdiction and to provide communication platforms for provinces and LMs. Again, this makes sense when the DM is speaking for many LMs. However, anecdotal evidence indicates that many MECs and provincial premiers ignore DMs and deal directly with municipalities on IGR issues, especially in urban areas. Nevertheless, if appropriately resourced and capacitated, DMs are best placed to co-ordinate IGR policy issues in the rural local government space, and to act as a communication platform for national and provincial governments on one hand, and rural LMs on the other.

District municipalities and technical assistance to LMs

DMs are supposed to build capacity of LMs where necessary and to provide services directly to consumers if the LMs have weak capacity. The question is whether districts have better human and institutional capacities than the LMs within their jurisdictions. Capacity is evaluated by looking at the vacancy rates and efficiency scores of DMs. High vacancy rates signify weak institutional and human capacity, while efficient decision-making units are often better capacitated units. The efficiency scores in Figure 114 reflect whether the DMs and LMs are spending their resources optimally.

Figure 114. Average efficiency levels: rural LMs vs. DMs (2008/09–2014/15)



Source: Global Insight (2014)

Figure 114 shows clearly that, on average, rural DMs are better capacitated than rural LMs. In 2012/13, DMs produced 87% of what they could produce given resources at their disposal, whereas LMs produced just 38%. Over the five years, these scores have remained fairly constant (i.e. above 80% for DMs and below 40% for LMs). The results suggest that there is merit in the argument for using DMs to provide complex cross-municipality services (e.g. bulk water) in rural areas where capacity deficits are more pronounced.

DMs are also better capacitated than LMs based on average senior management vacancy rates. In 2014/15, the average vacancy rate was 2% for DMs compared to 8% for B3s and 9% for B4s (Stats SA, 2014). Therefore, rural DMs should be capacitated to render quality assistance to rural municipalities and, in this regard, government agencies such as the Municipal Infrastructure Support Agency (MISA), COGTA and National Treasury could assist.

13.6 Conclusion and Recommendations

This chapter assessed the effectiveness and efficient use of intergovernmental transfers in South African rural local government space and evaluated the role of DMs in rural development. The budget analysis showed under-spending on conditional grants and on infrastructure repairs and maintenance, which does not augur well for rural development. The study found that many DMs are not performing their core legislative functions, which compromises local economic development. Reasons for the poor performance of DMs include:

- DMs have no significant own-revenue sources and are grant dependent, and so do not have the muscle to influence the redistribution of income by LMs.
- Half of their expenditure is on governance, administration and planning, with little going to their legislated mandates.
- The powers and functions of DMs changed following MDB capacity assessments and various policy shifts, resulting in uncertainty and confusion in the local government space.
- DMs have weak accountability because they have no wards and PR councillors and so do not account to any constituencies, which makes it difficult to provide services that require citizen participation.
- Clarity on powers and functions in the local government space is lacking, which results in wasteful duplication, tension and sometimes competition between DMs and LMs.

As a structure established through the Constitution, the role of DMs needs to be carefully framed and differentiated from that of LMs. The analysis suggests that a two-tier form of local government should be strengthened in rural areas. In urban areas, DMs are a pale shadow of their former self, and their existence should be reviewed in the long run. Disestablishing urban DMs may be a good idea, as their powers and functions have systematically shifted to secondary cities. This shift is not by design but because secondary cities dominate DMs in many respects and so should be able to champion their own development, with provinces as the immediate overarching authority. Like elsewhere in the world, DMs should be empowered to handle complex and strategic local government issues (e.g. regional planning and coordinating district development strategies), IGR issues (i.e. act as a communication platform for national and provincial government, government agencies and LMs). Ideally, DMs should not be concerned with operational issues that require close accountability to the electorate. As cross-municipality authorities, DMs should be empowered to provide complex infrastructure projects that cover many municipalities, such as in the areas of bulk water, sanitation, waste disposal and many spill-over services. Rural DMs are already playing a significant role in the provision of many services in rural areas and should ideally cover many small LMs, to enable economies of scale.

Some of the policy options that government could pursue in order to optimise the role of DMs in rural development are:

- Adopt a single-tier local government system in urban areas, and a two-tier system in rural areas. This is because DMs in urban areas are no longer playing their role as envisaged in the MSA. MECs are systematically adjusting powers and functions of DMs in favour of LMs, especially in urban areas. DMs could then focus more on under-capacitated municipalities in rural areas.
- Strengthen the capacity of DMs in rural areas, to enable them to effectively coordinate development planning, support weaker municipalities and provide services to end-users in LMs that lack capacity.
- Strengthen the capacity of DMs in rural areas, to enable them to provide bulk water, sanitation, refuse removal and district-wide services.

In order to make DMs useful vehicles for rural development, the Department of Cooperative Governance and Traditional Affairs should:

- Pronounce on the role that urban district municipalities ought to be playing, with a view to introducing a single-tier local government system in urban areas and to strengthen a two-tier local government system in rural areas.
- Review the accountability mechanisms of district municipalities in order to make them more accountable to citizens.
- Provide clarity, as a matter of urgency, on the functions and powers of district municipalities. In line with the White Paper on Local Government, their powers and functions should encompass district-wide planning, coordination of strategic development and intergovernmental relations policy issues, provision of technical assistance to local municipalities, provision of district-wide services, and provision of bulk water, sanitation, refuse removal, and services to District Management Areas.
- Ensure that MISA prioritises the capacity-building of rural district municipalities in the areas of coordination and planning, so that they in turn provide quality technical support to local municipalities.

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CHAPTER 14

Farm Evictions and Increasing Rural Local Municipal Responsibilities

Thembie Ntshakala

Farm Evictions and Increasing Rural Local Municipal Responsibilities

14.1 Introduction and Problem Statement

Since the inception of democracy in 1994, government has introduced numerous laws, policy and initiatives to regulate and improve the situation and rights of farm dwellers[54] and farm workers. The land reform policy programmes fall under three pillars: land restitution, land redistribution and land tenure. The aim was to redress imbalances in land ownership and to protect the land rights of previously marginalised people (many of whom are still living in poverty) and the rights of the vulnerable. However, an unintended consequence of the land reform programmes is the creation of a climate of uncertainty in the sector, which has resulted in disinvestment from the sector (ILO, 2005) and illegal farm occupations, and has prompted farmers to evict farm dwellers and workers.

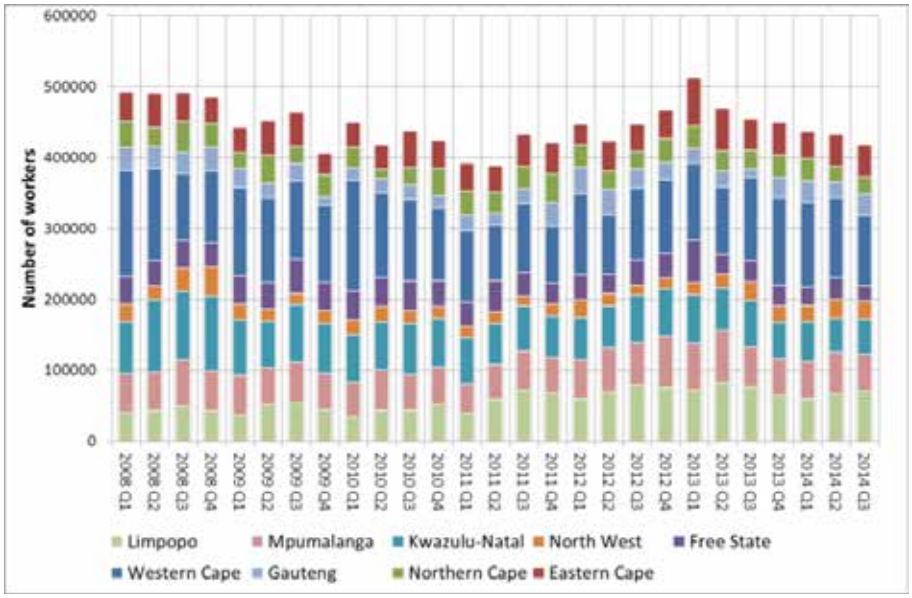
Despite the Extension of Security of Tenure Act (ESTA) (No. 62 of 1997), farm dwellers and workers remain among the most vulnerable people in society and at risk of being evicted from farms. The direct effects of the evictions are devastating: evictees are forced to relocate to another physical environment, are deprived of work, forfeit income, and lose access to homes and fertile land for own production. Other undesirable effects include the breakdown of families and social structures, and disruptions to children's education. Where evictees move to informs the livelihood options available for them (including access to physical capital), and farmers may specifically relocate their workers to rural towns in order to avoid possible land reform measures.

Local municipalities increasingly have to deal with the ramification of this influx into rural towns in terms of shelter, services and consequences of unemployment. In a recent ruling, the Constitutional Court placed the challenge of these migrations firmly at the door of local municipalities. It ruled that, although the housing function is shared between the national and provincial government, local government is responsible for providing shelter and other services to the evictees from municipal budgets.

Therefore, when workers are evicted from farms, rural municipalities are responsible for providing services and caring for the destitute, despite being ill-equipped and having no budget. This constitutes an unfunded mandate. This chapter looks at the extent of the burden caused by farm evictions and explores how fiscal instruments can respond to this widespread situation.

Between 2008 and 2014, the number of farm workers and labourers declined throughout South Africa (Figure 115).

Figure 115. Formally employed farm workers and labourers in the agriculture sector (2008–2014)



Source: ILO (2015: 19)

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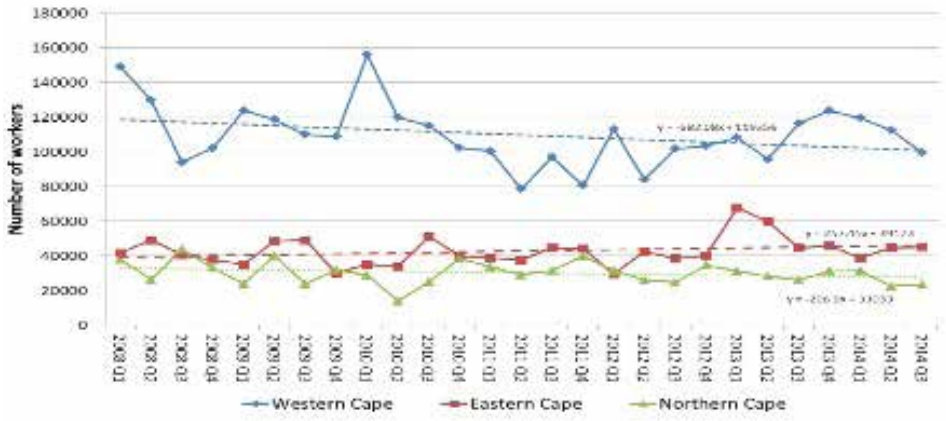
[54] Farm dwellers is defined in this section as people living on farms in Farm areas of South Africa (ILO, 2015: 8).

The nature of farming is changing (ILO, 2015: 1), as "feudal relationships between farmers and farm workers are increasingly breaking down through movement off farms (for various reasons, including, but not only, evictions) and a shift away from use of permanent workers towards the use of indirect labour and short-term employment contracts".

Figure 116 shows that the formally employed farm workers and labourers in the agriculture sector is fluctuating but comparatively is declining in the Eastern Cape and Northern Cape.

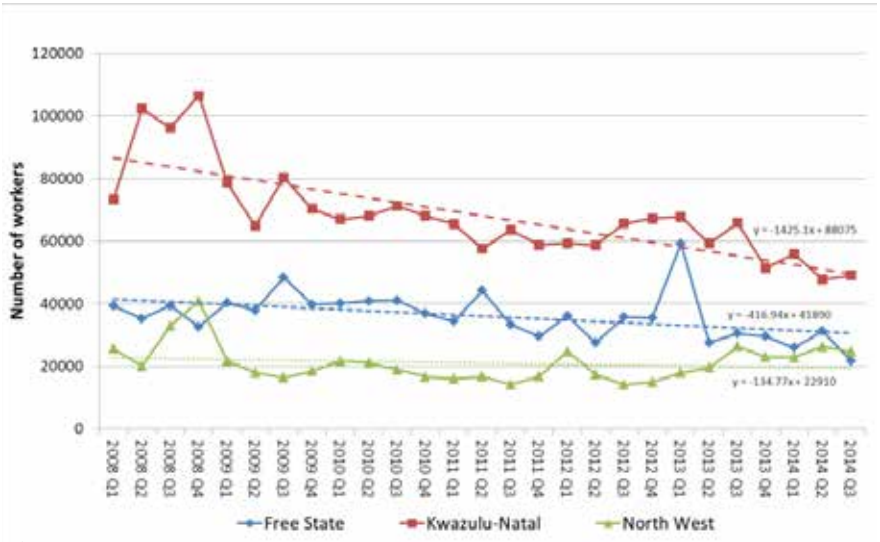
Figure 117 shows that, although numbers fluctuate, the number of farm workers and labourers shows a persistent decline in three provinces: Free State, KwaZulu-Natal and North West.

Figure 116. Formally employed farm workers and labourers in the agriculture sector in Free State, KwaZulu-Natal and North West (2008–2014)



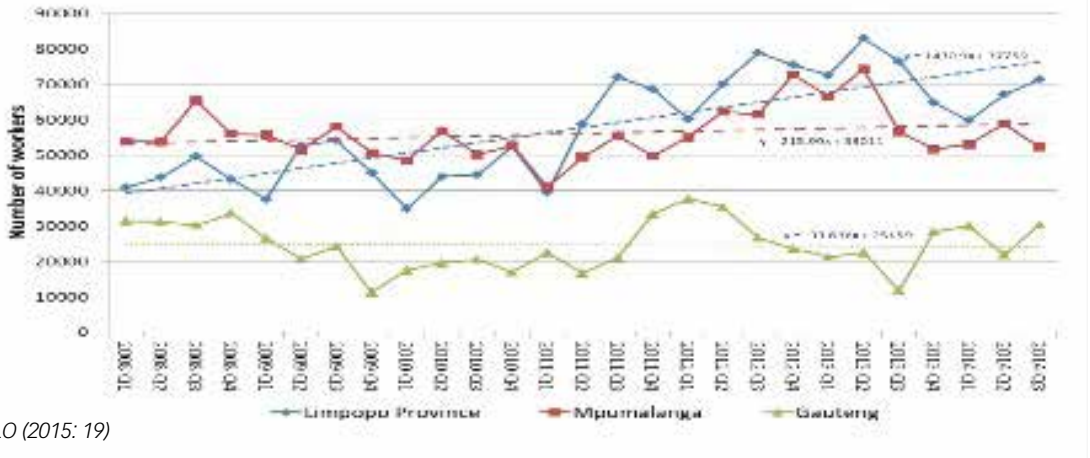
Source: ILO (2015: 19)

Figure 117. Formally employed farm workers and labourers in the agriculture sector in Free State, KwaZulu-Natal and North West (2008–2014)



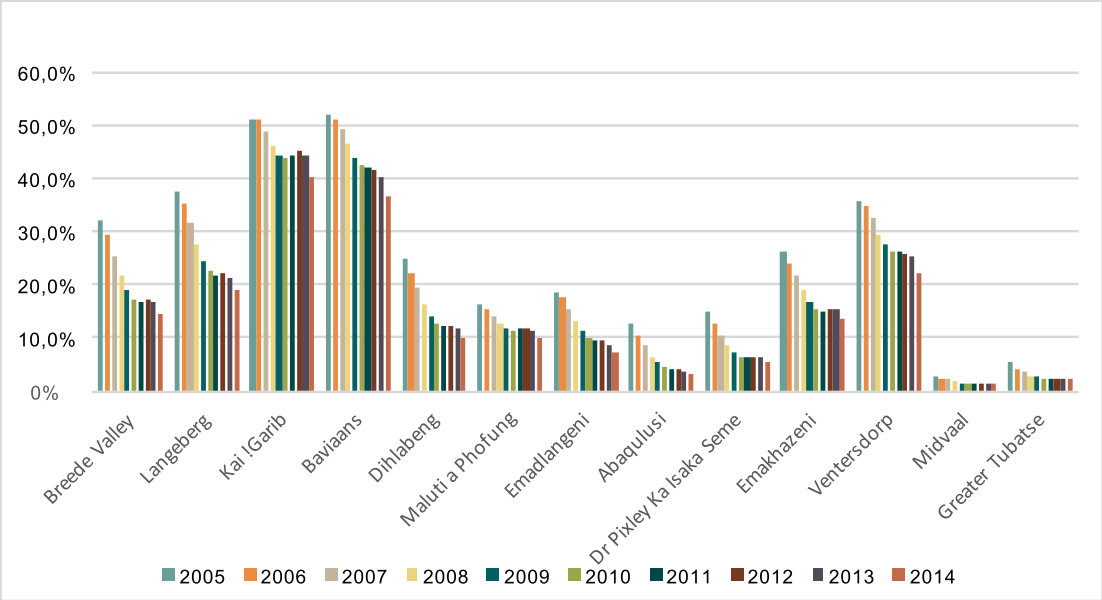
Source: ILO (2015: 19)

Figure 118. Formally employed farm workers and labourers in the agriculture sector in Limpopo, Mpumalanga and Gauteng (2008–2014)



Source: ILO (2015: 19)

Figure 119. Employment in the agriculture sector for the 13 municipalities (2005–2014)



Source: Global Insight (2015)

Figure 118 shows that in 2014 the formally employed farm workers and labourers in the agriculture sector declined in all three provinces: Limpopo, Mpumalanga and Gauteng.

Thirteen (13) case study municipalities were selected, based on whether the municipality was (i) located in the rural provinces, and (ii) experiencing farm evictions (and thus was classified by the Department of Rural Development and Land Reform (DRDLR) as a "hot spot" for land tenure disputes).

Within all the case study municipalities, employment in the agriculture sector has declined continuously since 2005. This decline concurs with Figure 115, which shows a decline in the number of farm workers in most provinces in the country. Agricultural employment continues to decline at an alarming rate, which signifies a serious problem of rural unemployment because farm employment is among the most important sources of work in rural areas. Agriculture has in the past played a major role in providing formal employment, although at very low wages.

14.1.1 Objectives

The study aims to answer the following research questions:

- How many people have been evicted, and what is the rate of evictions?
- Can the cost impact on rural local municipalities be measured? What budgetary pressures does it exert on rural local municipalities?
- How do rural local municipalities deal with the problem and the costs?
- How have/can the intergovernmental fiscal relations (IGFR) instruments deal with the problem?
- How could the issue be better addressed?

14.2 Legal Precedent Relevant to Human Rights and Farm Evictions

14.2.1 The Grootboom case (2000)[55]

In this case, the applicants (who included a number of children) were evicted from the private land that they were unlawfully occupying. Following the eviction, they camped on a sports field in the area. The Constitutional Court held that the state had an obligation to ensure, at the very least, that the eviction was executed humanely. It stated that "[t]he respondents were evicted a day early and to make matters worse, their possessions and building materials were not merely removed, but destroyed and burnt". The Court found that the manner in which the eviction was carried out amounted to a breach of the obligation embodied in the right of access to adequate housing recognised under Section 26(1) of the Constitution (Grootboom [88]).

Housing entails more than bricks and mortar. For a person to have access to adequate housing, there must be land, services and a dwelling. Therefore, available land, appropriate services such as provision of water and sewage removal, and a house are needed, and these have to be financed. A right of access to adequate housing also suggests that the state is not the only party responsible for providing housing, but that other role-players (including individuals) must be enabled to provide housing. The state's duty is to "create the conditions for access to adequate housing for people at all economic levels of our society" (ibid [35]) and to "take reasonable legislative and other measures, within its available resources, to achieve the progressive realisation of this right" (ibid [19]).

The Constitutional Court found the state to be in violation of Section 26(2) of the Constitution, which "requires the state to devise and implement within its available resources a comprehensive and coordinated programme progressively to realise the right of access to adequate housing" (ibid [99]). Although the state housing programme satisfied all the other requirements of the reasonableness test, the state was unreasonable in that "no provision was made for relief to the categories of people in desperate need" (ibid [69]). Accordingly, a declaratory order was made requiring the government to meet the obligations of Section 26(2), which included devising, funding, implementing and supervising measures aimed at providing relief to those in desperate need.

14.2.2 Blue Moonlight case (2011)[56]

In this case, the owner of property in the inner city of Johannesburg sued the occupiers for eviction in the South Gauteng High Court (High Court) under the Prevention of Illegal Eviction (PIE) Act (No. 19 of 1998). The occupiers (poor people who had lived on the property for many years) claimed that the eviction would render them homeless. They joined the City of Johannesburg (the City) in the case, maintaining that the City was obliged to provide them with emergency housing. They contended that the City's housing policy was unconstitutional because it did not oblige the City to furnish them with emergency housing.

The City appealed to the Constitutional Court, saying that it was not obliged to provide emergency housing, its housing policy was good and that it had no resources to provide the housing in any event. The Court found that the City was obliged to provide temporary emergency accommodation for the occupiers. The Court was not persuaded that the City did not have sufficient resources to provide this accommodation, holding that the City had wrongly budgeted on the basis that it was not obliged to provide them with emergency housing.

14.3 Literature Review

14.3.1. The concept of farm evictions

This study uses the United Nations' definition of eviction, i.e. "the permanent or temporary removal against their will of individuals, families and/or communities from the homes and/or land which they occupy, without the provision of, and access to, appropriate forms of legal or other protection" (UN, 2014). Evictions, or movement from farms to alternative areas, is another form of migration. They are "distinct from other forms of displacement, as they are involuntary, permanent and involve some element of coercion or force" (Wegerif et al., 2005: 91). Pull factors, or motives for choosing to relocate to a specific type of settlement, include personal preference and affordability; those who move to rural areas select rural townships that have better access to housing and infrastructure, and clearer tenure rights (ibid). There are also push factors, which are the undesirable factors that cause people to leave a settlement or are reasons for migrating.

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[55] Government of the Republic of South Africa and Others v Grootboom and Others (CCT11/00) [2000] ZACC 19; 2001 (1) SA 46; 2000 (11) BCLR 1169 (4 October 2000)

[56] City of Johannesburg Metropolitan Municipality v Blue Moonlight Properties 39 (Pty) Ltd and Another (CC) [2011] ZACC 33; 2012 (2) BCLR 150 (CC); 2012 (2) SA 104 (CC) (1 December 2011)

14.3.2 Causes of Evictions

Some of the main causes of evictions (and job losses) are:

- Changes in land uses, in particular when a farm is converted from agricultural production to game farming and tourism ventures (Wegerif et al., 2005).
- New labour legislation and policies, such as the proclaimed minimum wage, which many farm owners blame for increased retrenchments and evictions of farm workers.
- Overcrowding, or people who live but do not work on the farm, is an issue for most producers. Common complaints from producers are that these people cause overcrowding of houses and consequently put a lot of stress on existing infrastructure, especially on sewage systems (ILO, 2015).
- Vulnerability to land claims, such as when farmers evict women and children upon the deaths of their husbands who used to work on the farm, to avoid potential land claims (Wegerif et al., 2005).
- Epidemic of criminal farm attacks, which adds to anxiety in the sector and negative attitudes towards government's new policies (Mntungwa, 2014).

Indeed, non-economic considerations mostly drive the collective decision to shed permanent workers in the farming section. These considerations include above all: the fear of losing control of one's land to resident farm workers due to new (and possible future) legislations; and a sense that farm workers are more difficult to manage than they were prior to 1994 because of democracy and a commitment by the state to safeguard human rights (Mntungwa, 2014).

14.3.3. The extent of evictions

Agriculture has in the past played a major role in providing formal employment, although at very low wages. However, the new minimum wage for farm workers (introduced in December 2012) and strikes by farm workers have led to a harsh backlash against farm workers and their organisations, "including a spate of dismissals and retrenchments, and of farm evictions and lockouts" (ILO, 2015: 83).

According to the 2011 Census, 759 127 households (or 2 732 605 people, equal to 5.28% of the national population) live in farm areas. Of these, 592 298 households (or 2 078 723 people) live on farms (ILO, 2015). Excluding employed people who earn no income (typically business owners and family members working in those businesses) and those who did not specify their incomes, in 2011 over 80% (82.3%) of employed farm dwellers earned less than R3,200 per month: 65.1% earned less than R1,600 and 17.2% earned between R1,601 and R3,200. However, 2.5% earned more than R25,600 per month (Stats SA, 2013b) cited in (ILO, 2015:10).

14.3.4. Effects of evictions

When evictions occur, religious and cultural strings are disturbed, such as when graveyards of the evictees' ancestors and families who were buried at the farm are suddenly abandoned when the evictees relocate to other areas. Evictees have to leave arable land, which they used for cultivating their own food, and so have to adopt new food security approaches. The manner in which some evictions are carried out can have negative psychological effects on evictees, as they have to adjust to a different way of life from the one they have known for a long period of time. Evictions result in large numbers of ex-farm dwellers having no access to decent housing and services, and for many, inadequate means of support (ILO, 2015).

Those evicted include children of various ages, and so school-going children have their education distributed. The depopulation of farms that results from evictions means that many government social services (such as farm schools and clinics) decline or disappear, prompting a further migration from the farms.

14.3.5 Post evictions dilemmas

Case law has ruled that, in an attempt to find suitable alternative accommodation for the potential evictee, the relevant municipality, the land owner and the occupier are supposed to have a "meaningful engagement" (ILO, 2015: 192). However, these have become mere procedural formalities. Although the evictees are supposed to contact the DRDLR for help, they often end up on the doorstep of the municipalities. And municipalities are "generally unsure of how to implement the emergency housing policy" (ILO, 2015: 193).

The National Housing Code provides for an Emergency Housing Programme, and the national Department of Human Settlements allocates funds for emergency housing to provincial departments of human settlements. Municipalities are considered "the first party responsible for responding to emergencies" and can therefore obtain funding for such emergency housing from provincial government (HDA, 2012: 20). The Emergency Housing Programme is designed to offer temporary relief, through providing secure access to land, engineering services and shelter. It stipulates that "emergency housing should be limited to absolute essentials" (ibid: 16). This means that emergency housing is unlikely to meet the requirements of "suitable, alternative accommodation" as defined by ESTA (ILO, 2015: 194).

Rural local municipalities have a mandate to deliver services to citizens, (including the farm evictees) living within their area of jurisdiction. Yet the same municipalities face many challenges. On the one hand, they have to deal with the

perception that democracy means basic services will be provided for free (Breier and Visser, 2006), and on the other hand, they are often financially unviable because they have minimal own-revenue sources, when the "collection of own revenue is a critical determinant of the financial viability of municipalities" (Manyaka, 2014: 127). As a result, municipal managers are overwhelmed, clearly frustrated and unsure of what they should do (ILO, 2015: 192), especially given the long waiting lists, lack of available funding for housing and existing settlements that are bursting at their seams.

14.3.6 International perspective

Migration in rural areas is not peculiar to South Africa. Migration in industrialised countries includes not only rural to urban, but also urban to rural and rural to rural (Human and Feridhanusetyawan (2007) cited in Henning et al., 2011). The migration of people to other areas takes two forms: "voluntary"[57] or "involuntary"[58]. Evictions are non-voluntary migration, whereas voluntary migration involves an economic decision, such as moving to places for better employment and earnings possibilities. This type of migration is also described as "voting with the feet", which "implies that migration decisions correspond to choices between regionally provided bundles of quality-of-life factors including local wage levels, employment opportunities and local amenities and disamenities" (Henning et al., 2011: 97).

In China, migration is seen as correlated with better chances of entrepreneurial success in origin communities when people return home (Hu and Wu, 2012). This is because human capital accumulated during the past migration periods enhanced the entrepreneurial activities of the returnees, and returned migrants are more likely to invest in productive farm assets than their non-migrant counterparts (ibid). A study conducted among Mexican rural households revealed that rural migration may have a positive effect on the rural sector itself, and remittances open up a possibility for poor households to accelerate productive asset accumulation (Chiodi et al. 2012).

14.4 Research Methodology

The analysis used secondary and primary data. The secondary data entailed desktop research to review existing legislation, reports and literature (both local and international) on the impact of farm evictions, rural migration and effects of rural population growth on the responsibilities and capabilities of rural local municipalities. Primary data was gathered using the case study approach.

Thirteen (13) municipalities were selected from all nine (9) provinces in South Africa. Officials and councillors in the case study municipalities were asked for information about the pressures caused by farm evictions and migration in the various municipalities.

One municipality was selected from each province, plus an additional municipality from the four provinces where most of the hot spots are located, i.e. the Western Cape, KwaZulu-Natal, Mpumalanga and Free State. The 13 case study municipalities are:

- KwaZulu-Natal; AbaQulusi Local Municipality and eMadlangeni Local Municipality
- North West: Ventersdorp Local Municipality
- Limpopo: Greater Tubatse Local Municipality
- Eastern Cape: Baviaans Local Municipality
- Free State: Maluti-A-Phofung Local Municipality and Dihlabeng Local Municipality
- Gauteng: Midvaal Local Municipality
- Mpumalanga: Dr Pixley Ka Isaka Seme Local Municipality and Emakhazeni Local Municipality
- Northern Cape: Kai !Garib Local Municipality
- Western Cape: Breede Valley Local Municipality and Langeberg Local Municipality [59]

The 13 case study municipalities were selected in order to provide a representative spread of all nine provinces in South Africa, and certain municipalities were selected based on agriculture being one of their main economic sectors (with reported land tenure disputes in their area of jurisdiction), increase in population and service delivery backlogs (water, sanitation and electricity).

The senior officials who participated in the research, work within the areas of basic services (water, sanitation etc.), infrastructure, town or development planning, finance, integrated planning, community services, economic development and emergency services. Councillors (Mayor and Exco/Mayoral Committee) also participated in the research because they are the elected community representatives and the link between local municipalities and communities. Interviews with evictees (both farm workers and dwellers) were not part of this research because the study's focus is on increased responsibilities for local municipalities as a result of farm evictions.

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[57] Voluntary migration is where individuals or households choose to migrate.

[58] Involuntary migration is where individuals or households are forced to move.

[59] The Langeberg Municipality was formed by the merger of Robertson, Ashton, Bonnievale, McGregor and Montagu.

14.5 Findings

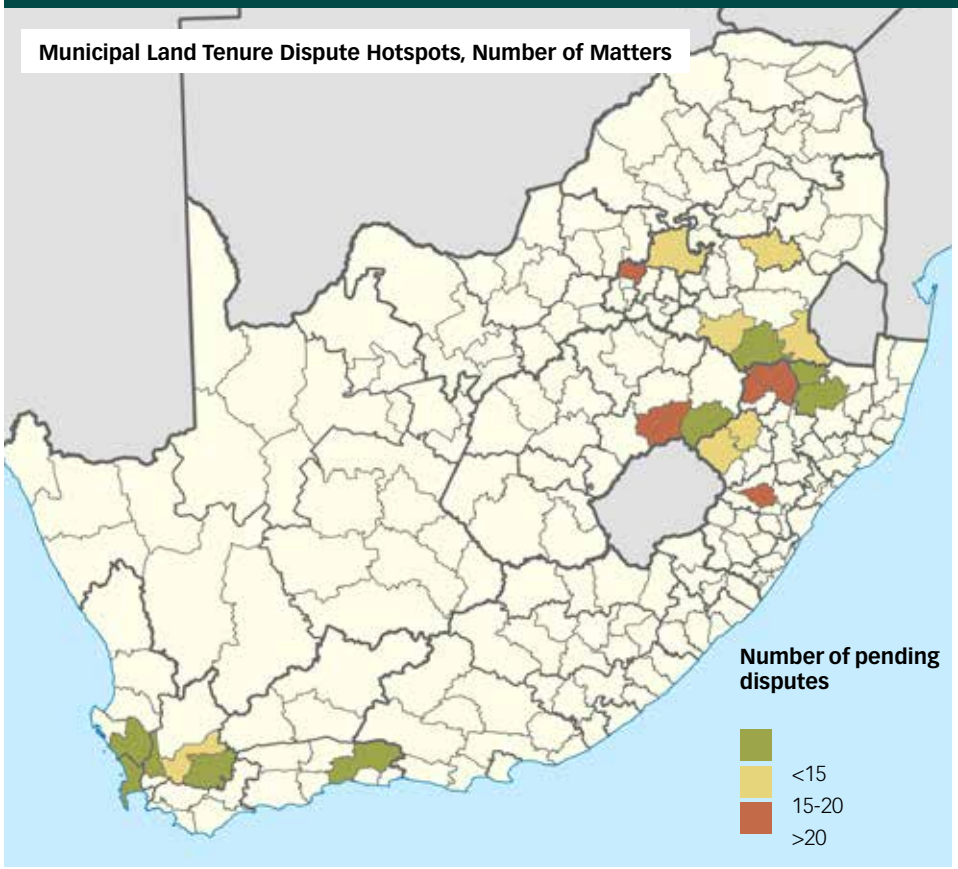
14.5.1 The scale of the farm evictions problem

The maps in Figures 120 and 121 show the municipal hotspots and the distribution of municipalities with at least 10 pending tenure security disputes for 2014 and 2015. Those with more than 20 disputes are shaded in red, those with 15–20 disputes are shaded in yellow, and those with fewer than 15 disputes are shaded in green. The country as a whole has 21 municipal hotspots.

In 2014 and 2015, municipal hotspots were found in KwaZulu-Natal, Mpumalanga, Western Cape, Free State and Gauteng. The provinces that contained municipal hotspots with more than 20 disputes pending (i.e. shaded in red) were KwaZulu-Natal, Mpumalanga and the Free State.

As Figure 122 shows, in 2015, over half (52%) of all tenure security cases in South Africa concerned evictions, and of these, 48% were evictions and 4% illegal evictions.[60] A third (32%) of all cases were threatened evictions, which might lead to either legal or illegal evictions.

Figure 120. Municipal hotspots in South Africa (2014)



Prov	LM	Matters
FS	Maluti a Phofung	12
FS	Dihlabeng	53
GT	City of Tshwane	15
GT	Mogale City	15
KZN	eDumbe	11
KZN	Abaqulusi	12
KZN	Okhahlamba	16
KZN	Emnambithi/Ladysmith	20
KZN	uMngeni	25
KZN	Emadlangeni	38
KZN	Newcastle	59
MP	Pixley Ka seme	14
MP	Lekwa	15
MP	Emakhazeni	16
MP	Mkhondo	17
WC	Swartland	10
WC	City of Cape Town	11
WC	George	11
WC	Langeberg	14
WC	Drakenstein	14
WC	Breede Valley	20

Source: DRDLR (2014)

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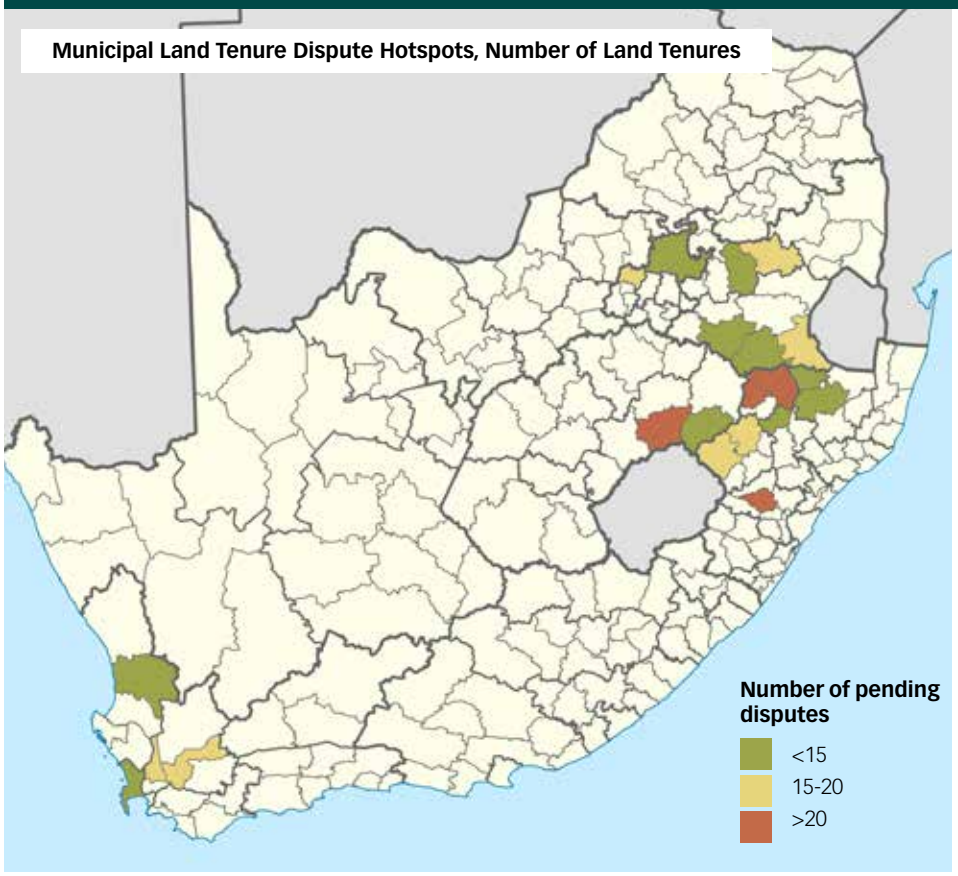
[60] Illegal evictions include all situations in which ESTA occupiers have moved off farms against their will and in the absence of a court order for their eviction (Hall, 2003: 8).

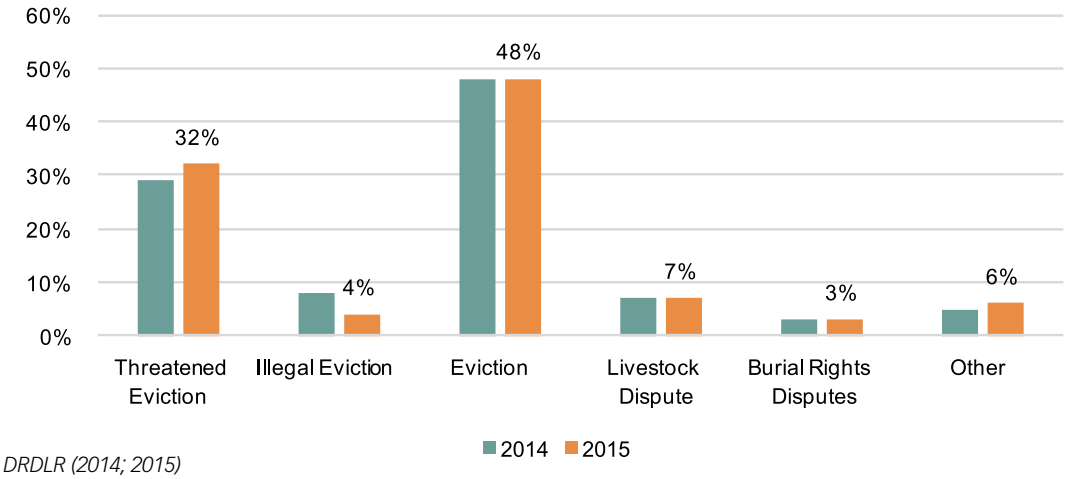
Figure 121. Municipal hotspots in South Africa (2015)



Prov	LM	Land Tenure
FS	Maluti a Phofung	10
FS	Dihlabeng	53
GT	City of Tshwane	11
GT	Mogale City	16
KZN	eDumbe	11
KZN	Endumeni	10
KZN	Abaqulusi	13
KZN	Okhahlamba	19
KZN	Emnambithi/Ladysmith	20
KZN	uMngeni	27
KZN	Emadlangeni	37
KZN	Newcastle	55
MP	Pixley Ka seme	11
MP	Lekwa	11
MP	Steve Tshewte	13
MP	Emakhazeni	17
MP	Mkhondo	20
WC	City of Cape Town	11
WC	Cederberg	10
WC	Drakenstein	17
WC	Breede Valley	20

Source: DRDLR (2015)

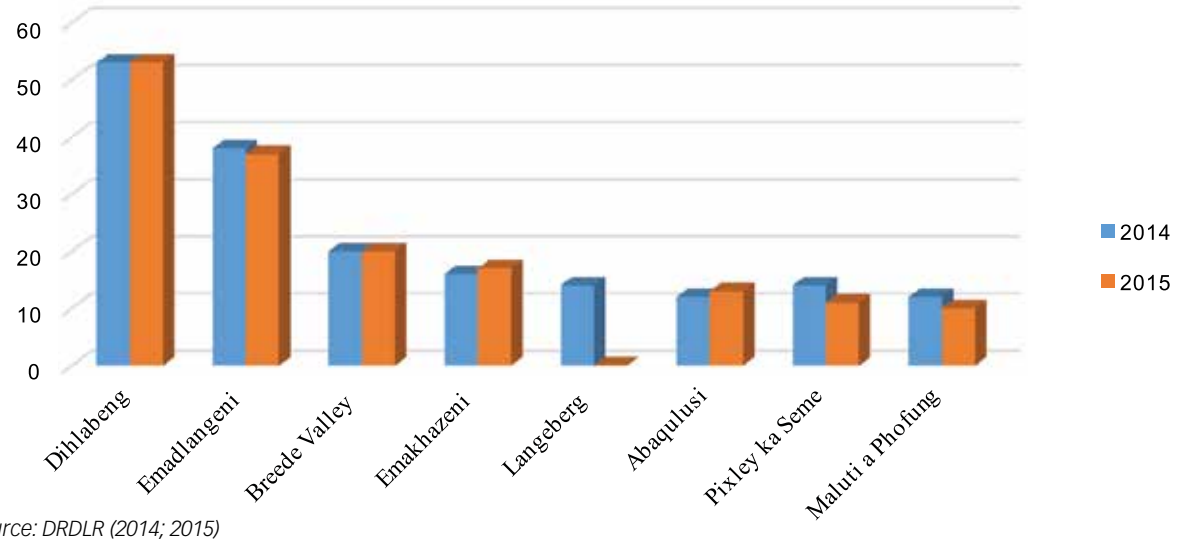
Figure 122. Tenure security cases in South Africa (2014 and 2015)



Source: DRDLR (2014; 2015)

When the number of land tenure disputes for 2014 and 2015 is compared (Figure 123), two of the municipalities (Emakhazeni and Abaqulusi) experienced an increase in the number of disputes (from 16 to 17 and from 12 to 13 respectively), while three municipalities (Emadlangeni, Pixley ka Seme and Maluti a Phofung) saw a decrease.

Figure 123. Land tenure disputes in municipal hotspots (2014 and 2015)



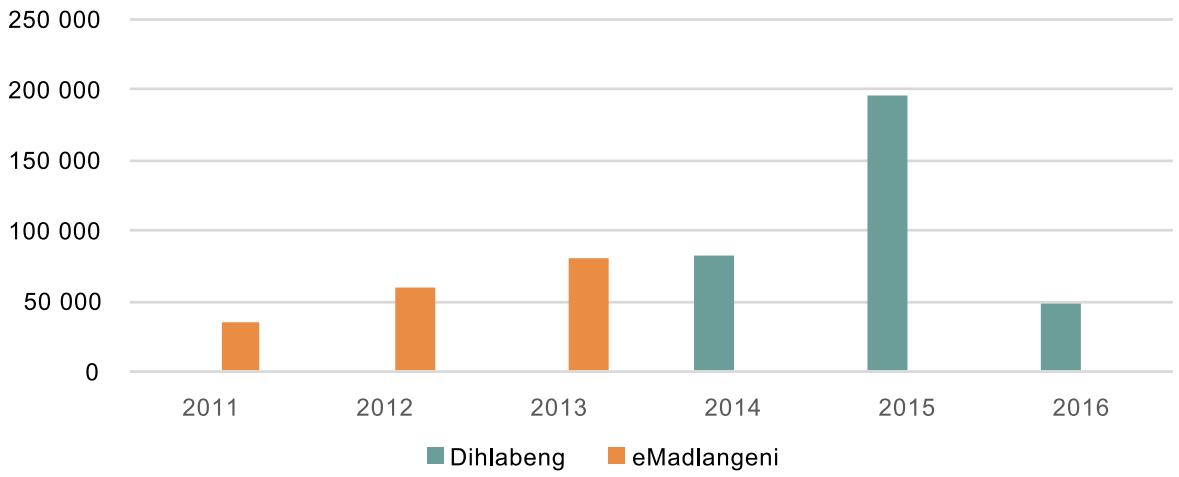
Source: DRDLR (2014; 2015)

14.5.2. Cost implications of the farm evictions

Farm evictions result in costs that are carried by local municipalities. Between 2011/12 and 2015/16, Dihlabeng municipality had 21 reported farm eviction incidences, affecting 126 people, and Emakhazeni had 65 incidences. In a three-year period (2011–2013), six incidences were reported to the Emadlangeni municipality. However, the actual number of incidences are likely to be much higher, as many evictions go unreported.

Figure 124 shows the direct costs for the two municipalities with the highest farm evictions: Emadlangeni in 2011–13 and Dihlabeng in 2014–16.

Figure 124. Expenditure related to farm eviction incidents in Dihlabeng and Emadlangeni



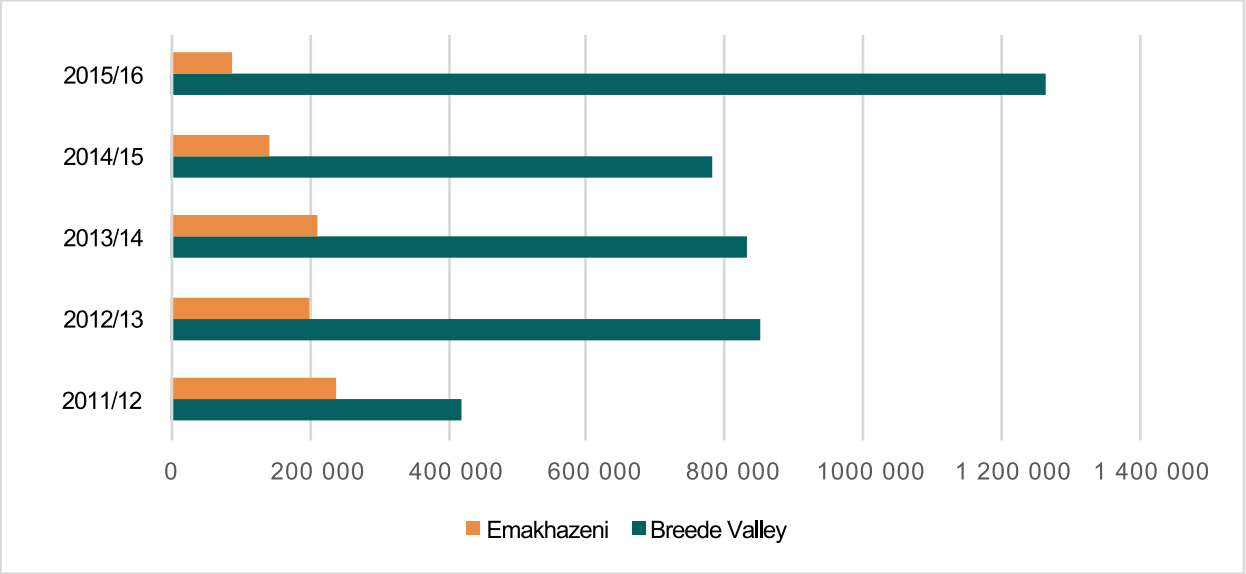
Source: Commission's calculations based on municipal data 2016

This expenditure represented 0.1% of Dihlabeng's local government equitable share (LGES) in 2014 and 0.2% of its LGES in 2015. Over the three-year period, Dihlabeng has spent about R326,000 in total, including nearly R50,000 (R49,095.70) during the first two months of 2016, and the final costs for 2016 are likely to be far higher than in 2015 if the trend of previous years continues. Emadlangeni spent a total of about R175,000 over a three-year period, or the equivalent of 0.4% of its LGES in 2011, 0.5% in 2012 and 0.6% in 2013 respectively.

The expenditure includes only the direct costs incurred for providing temporary and indefinite accommodation (renting flats at municipal costs, erecting shacks on municipal property, buying tents) and providing food parcels and blankets. Other indirect costs carried by the municipalities are not specified. For example, the cost of providing temporary water and sanitation facilities for the destitute families. As Figure 124 illustrates, expenditure related to farm evictions in both Dihlabeng and Emadlangeni has increased over the years, and yet no intergovernmental fiscal (IGFR) instruments are in place to support this type of expenditure.

Figure 125 shows the expenditure for Emakhazeni (in Mpumalanga) and Breede Valley (in the Western Cape). The Breede Valley municipality spent (in direct costs) the equivalent of 1% of its LGES every year over a three-year period (2012/13–2014/15). Over five years (2011/12–2015/16), the municipality spent over four million rand (R4.146,164) on emergency/housing, squatter/informal settlement control and legal services related to farm evictions. Emakhazeni also spent the equivalent of 1% of its LGES in 2012/13 and in 2013/14. Over five years (2011/12–2015/16), Emakhazeni spent R875,000.

Figure 125. Expenditure related to farm eviction incidences in Emakhazeni and Breede Valley



Source: Commission's calculations based on municipal data 2016

14.6 Conclusion and Recommendations

According to the legislation and recent court rulings, municipalities are responsible for caring for vulnerable evictees. This creates an unfunded mandate, as providing shelter and other services for the evictees must come out of the municipal budget. Such an unfunded mandate has a far greater impact on the finances of rural local municipalities, given their financial situation that cannot be equated to metropolitan municipalities (e.g. City of Johannesburg). Metros are financially better off than rural local municipalities, which collect less (sometimes no) revenue and depend on grants for funding. The IGR instruments currently do not cater for evictions, and so municipalities have to use their own funds.

With respect to addressing the negative impact of farm evictions on rural municipalities' finances, the Commission recommends that:

1. The current Municipal Disaster Grant is allowed to cater for eviction-related emergencies. The same approach of accessing the portion of the Disaster Grant should be applicable to farm eviction incidences. This approach is aligned with the findings from previous research by the Commission that provinces and municipalities, rather than national government, appear better at ensuring grant funding is spent.
2. Government strengthens the coordination and implementation of existing programmes targeted at displaced farm workers and dwellers, through:
    - Including farm evictees among the beneficiaries for housing in rural towns, access to land for own production and the agri-villages programme.
    - Centralising the reporting of evictions and improving data collection.
3. The following government departments should be involved in coordinating and implementing programmes: DRDLR, the departments of agriculture, fisheries and forestry, home affairs, human settlements, cooperative governance and traditional affairs, social development, SAPS and municipalities.

14.7 References

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CHAPTER 15

Reviewing Effectiveness of Sanitation Fiscal Instruments and Governance in Enhancing Rural Development

Sabelo Mtantato

Reviewing Effectiveness of Sanitation Fiscal Instruments and Governance in Enhancing Rural Development

15.1 Introduction

Adequate sanitation[61] infrastructure and services are important for the health and dignity of people. Improving sanitation infrastructure and services, and educating households on the importance of good sanitation practices, reduces the risk of infection from excreta-related diseases (including diarrhoea). Diarrhoea is the second leading cause of death globally (after pneumonia) and the biggest cause of death in children under the age of five years in sub-Saharan Africa (Liu et al., 2012). In South Africa, about 21% of children under the age of five years die as a result of diseases related to poor sanitation, including diarrhoea.

Since 1994, government has introduced specific programmes aimed at reducing the high sanitation infrastructure and maintenance backlogs. These backlogs are a nationwide challenge but are more serious in rural than in urban residential areas. The Bucket Eradication Programme and the Rural Household Infrastructure Programme (RHIP) are two of the programmes introduced to address sanitation backlogs in rural areas. Bucket toilets are found in both formal and informal settlements. The government had not achieved its objective of eradicating the bucket system in the established formal settlements by the end of 2007, and the end date has now shifted to 2019. In 2010, the RHIP was introduced specifically to reduce sanitation backlogs in rural areas but has seriously underperformed. Other funding sources for sanitation infrastructure and services include the Municipal Infrastructure Grant (MIG), the local government equitable share (LGES), conditional grants and municipal own revenue. However, as sanitation backlogs remain a challenge, particularly in rural areas, the adequacy and effectiveness of these funding instruments are questionable. Understanding the other, non-financial challenges affecting the effectiveness of planned infrastructure and service delivery programmes is also important.

Municipalities in South Africa are classified into six categories: A (metropolitan municipalities), B1 (secondary cities), B2 (large towns), B3 (small towns), B4 (mostly rural municipalities) and C (district municipalities). District municipalities are further divided into C1 (district municipalities that are not water services providers) and C2 (district municipalities that are water services providers) (National Treasury, 2011).

With respect to the provision of water and sanitation, local municipalities are either water services authorities (WSA) or not. Local municipalities that are WSA are responsible for implementing and managing water and sanitation services/projects within their jurisdications, while local municipalities that are not WSA rely on district municipalities (C2) to implement and manage water and sanitation services/projects. For the purposes of this study, rural municipalities are either B3 or B4 municipalities that depend on district municipalities (C2) for their water and sanitation projects.

Sanitation backlogs are a national phenomenon but remain a major challenge in rural areas. The sanitation backlog overall has decreased since 1996, but B4 municipalities and district municipalities still had high backlogs, of 47% and 31% respectively, in 2014. Furthermore, the sanitation sector is characterised by poor governance, fragmentation and the lack of a single department or institution taking the lead (between 1994 and 2014, the sanitation function has shifted between departments). As a result, there have been challenges in the coordination and upholding of norms and standards. In addition, intergovernmental fiscal (IGF) instruments have not provided adequate funding for the provision and maintenance of sanitation infrastructure. Therefore, to achieve rural development through improving access to sanitation requires a review of the IGF instruments and associated challenges.

This chapter looks at constraints in the current intergovernment fiscal relations (IGFR) system and the institutional arrangements that are undermining government's efforts to address sanitation backlogs in rural areas. The three main objectives are:

- To analyse the reduction in sanitation backlogs between 1996 and 2015 in the different municipal categories.
- To evaluate and analyse the effectiveness of the current sanitation funding arrangements with respect to rural municipalities.
- To evaluate governance and institutional issues relating to the provision of sanitation focusing on rural municipalities

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[61] Sanitation covers a wide range of activities including the collection, transporting, treatment and disposal of waste (including human waste) and associated hygiene promotion.

15.2 Literature on Sanitation

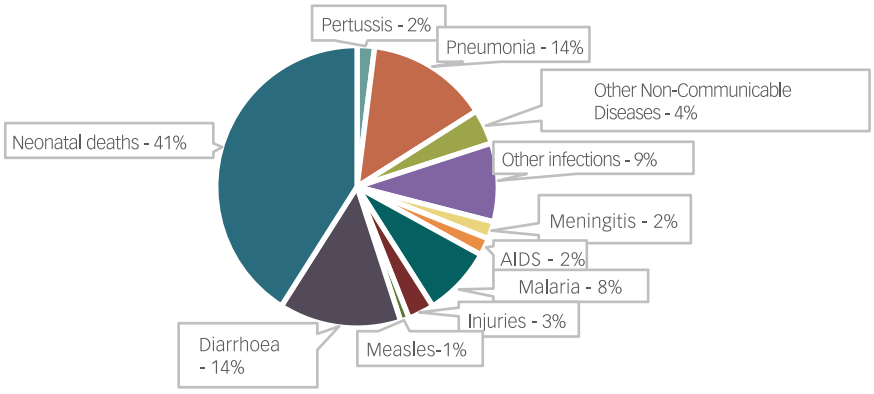
15.2.1 Sanitation and rural development

Infrastructure is one of the pillars of economic transformation and economic development. Sustainable economic growth often occurs in an environment where there is a meaningful infrastructure, and there is evidence that it reduces inequality in society (ECA, 2013). According to the literature, improving, delivering and maintaining infrastructure, which includes water and sanitation infrastructure, generally contributes significantly to rural development – countries that invest in the development of such infrastructure have a higher and better quality of rural development (ibid). Globally, compared to urban areas, rural areas are deprived of adequate sanitation infrastructure, which limits the potential for rural development.

15.2.2 The role of sanitation in health

One of the main basic services is sanitation, which refers to the collection, transport, treatment and disposal or re-use of waste. It includes human excreta, domestic wastewater and solid waste, as well as associated hygiene promotion. Diseases related to unsafe sanitation (diarrhoea) are projected to reach 7% of the total global years of life lost (due to premature mortality) in the year 2030 (WHO, 2008a). Improved sanitation reduces the risk of infection from excreta-related diseases, especially for children under the age of five years who are most susceptible to diarrhoeal diseases (Figure 126).

Figure 126. Global causes of child death under the age of five years



Source: WaterAid (2011b)

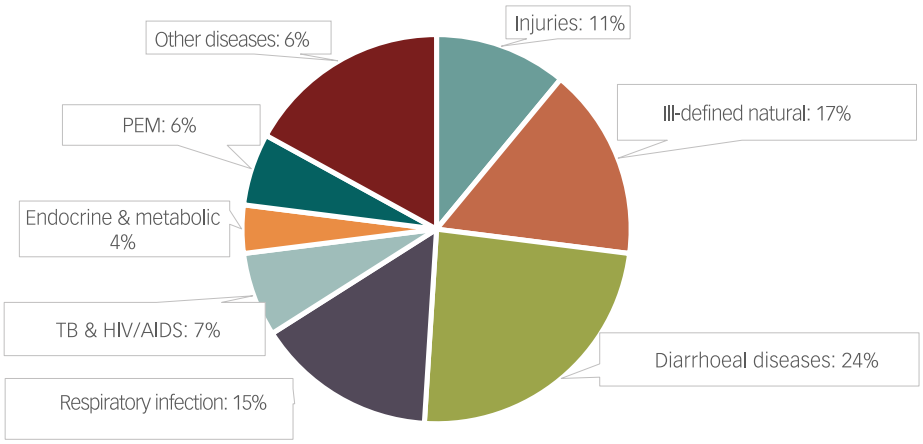
As Figure 126 shows, the biggest cause is neonatal death, which includes tetanus, sepsis, birth asphyxia and preterm birth complications. The second cause is diarrhoea, which is responsible for more deaths in children under the age of five years than Aids, malaria, measles and pertussis combined. An estimated 88% of diarrhoea in the world is the result of inadequate sanitation and hygiene (WHO, 2008b). A survey of 172 countries revealed a robust association between access to sanitation and reduced child mortality and morbidity, where improved sanitation lowered the rate of children suffering from diarrhoea by 7%–17% and by 5%–20% for children under the age of five (Gunther and Fink, 2010).

Sanitation also has a direct impact on health, and so investing in sanitation can result in economic returns for the nation. Returns on investment in sanitation include savings on health care, increased productive days and school attendance, and the value of deaths averted (Hutton and Haller, 2004). Good sanitation systems also benefit the health system and budget, as in developing countries occupants of hospital beds often suffer from diseases related to poor sanitation, which overstretches an already burdened health system.

In South Africa, children (especially those under the age of five) are also most affected and die from diseases related to poor sanitation, including diarrhoea. In 2007, a total of 14 782 young children died, and a quarter (24%) of those deaths were from diarrhoeal diseases (Figure 127).

Between 1997 and 2007, diarrhoeal diseases were the top cause of death in children (Table 80).

Figure 127. Causes of child deaths (aged 1–5 years) in South Africa (2007)



Source: WaterAid (2011b)

Table 80. Causes of child deaths (aged 1–4 years) in South Africa (1997, 2001, 2005 and 2007)

	1997: 7 751 deaths	2001: 11 252 deaths	2005: 15 596 deaths	2007: 14 782 deaths
1	Diarrhoeal diseases 20.8%	Diarrhoeal diseases 20.6%	Diarrhoeal diseases 23.5%	Diarrhoeal diseases 24.0%
2	Undetermined injuries 16.6%	Respiratory infection 13.9%	Ill-defined nature 17.1%	Ill-defined nature 16.1%
3	Ill-defined nature 14.2%	Ill-defined nature 12.8%	Respiratory infection 14.0%	Respiratory infection 15.1%
4	Protein-energy malnutrition 9.5%	Undetermined injuries 8.1%	Protein-energy malnutrition 6.3%	Protein-energy malnutrition 6.0%
5	Respiratory infection 8.7%	Protein-energy malnutrition 8.1%	Undetermined injuries 5.7%	Tuberculosis 5.4%
6	Tuberculosis 3.8%	Tuberculosis 5.8%	Tuberculosis 5.6%	Other endocrine & metabolic 4.3%
7	Other endocrine & metabolic 3.0%	Other endocrine & metabolic 5.4%	Other endocrine & metabolic 4.6%	Undetermined injuries 4.0%
8	HIV/Aids 2.9%	Other infectious & parasitic 3.1%	Other infectious & parasitic 3.0%	Other infectious & parasitic 2.6%
9	Ill-defined cardiovascular 1.8%	HIV/Aids 3.0%	HIV/Aids 2.4%	Bacterial meningitis 2.0%
10	Bacterial meningitis 1.5%	Bacterial meningitis 1.5%	Other respiratory diseases 1.7%	HIV/Aids 1.70%

Intestinal infectious diseases, which include diarrhoeal diseases, were the leading cause of death for children aged 1–4 years (Table 81).

Table 81. Causes of death for children aged 1–4 years (2012)

Rank	Cause of death	Number of deaths	Percentage
1	Intestinal infectious diseases	1 506	14.6%
2	Influenza & pneumonia	1 021	9.9%
3	Malnutrition	692	6.7%
4	Tuberculosis	349	3.4%
5	Other forms of heart disease	204	2.0%
6	Other low respiratory infections	195	1.9%
7	Other viral diseases	184	1.8%
8	Inflammatory diseases of the central nervous system	158	1.5%
9	HIV	142	1.4%
10	Other bacterial diseases	139	1.4%

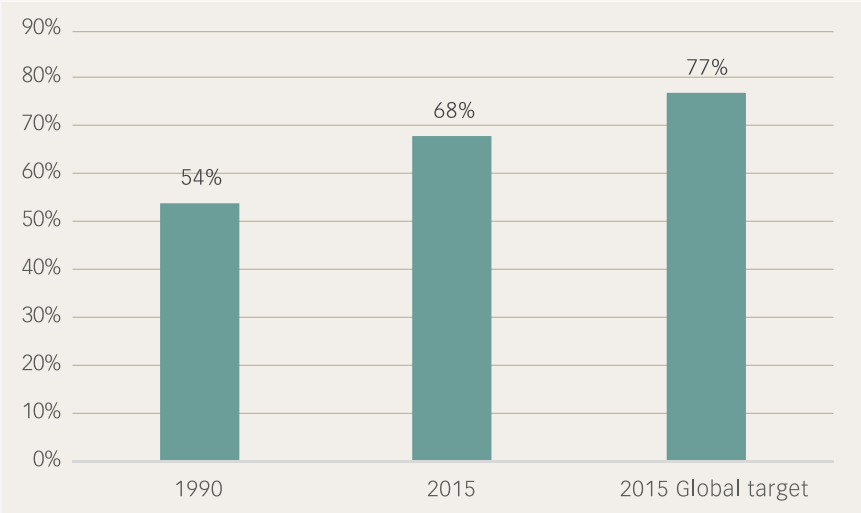
Source: Stats SA (2012)

15.3 Access to Sanitation Internationally and in South Africa

In 1990, about 54% of the global population had access to improved sanitation and in 2015, the percentage of the world's population with access to improved sanitation was estimated at 68% (Figure 128). This represents an improvement of about 9% with respect to improved sanitation, however falls short of the 2015 global target to improved sanitation of 77%.

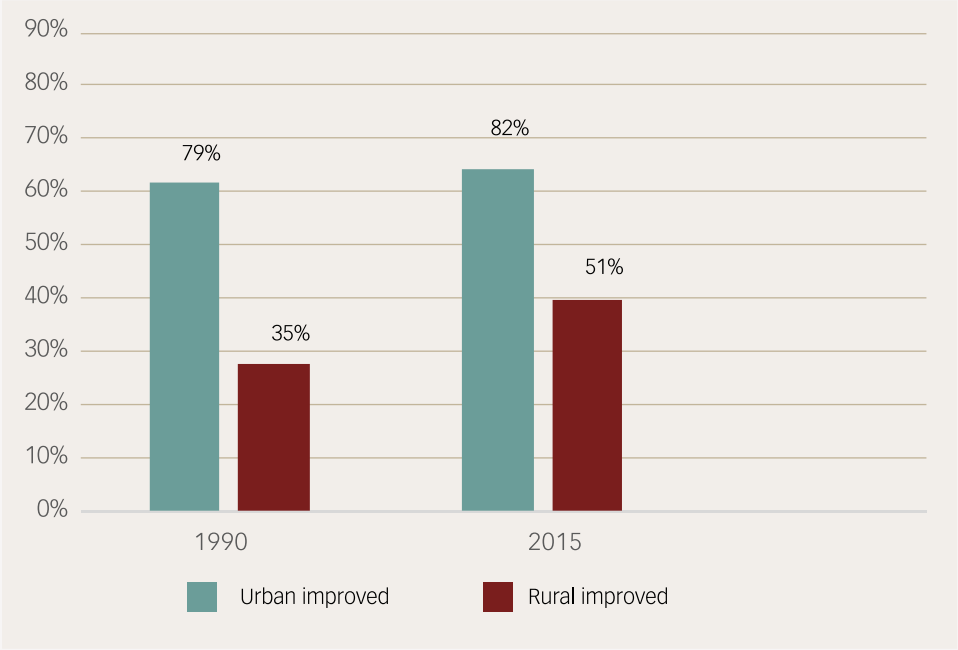
As Figure 129 illustrates, despite progress made between 1990 and 2015 with respect to access to improved sanitation, rural coverage continues to lag that of urban areas.

Figure 128. Global use of improved sanitation between 1990 and 2015 (%)



Source: WHO (2015)

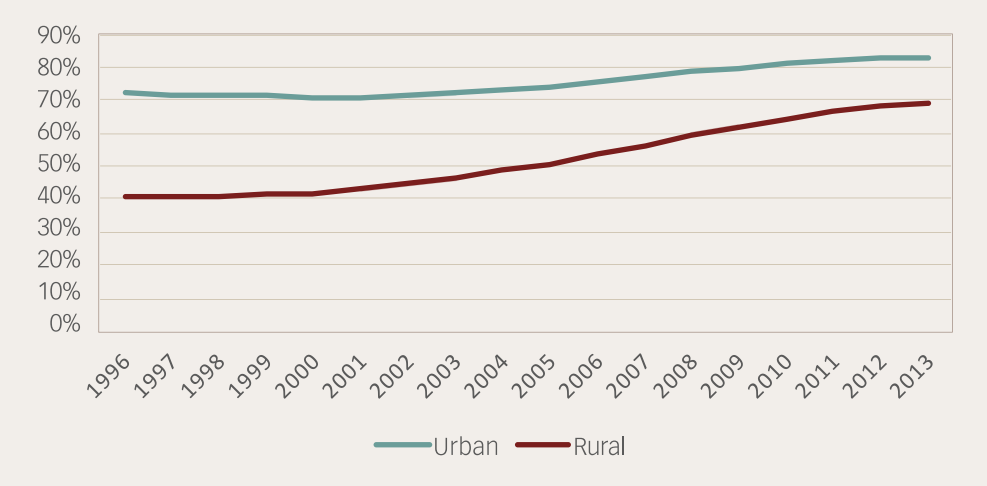
Figure 129. Urban and rural trends in sanitation coverage (%)



Source: WHO (2015)

In South Africa, the access to sanitation in rural and urban areas follows exactly the international trend. Between 1996 and 2013, rural dwellers with access to adequate sanitation[62] rose from 40% to 68% (Figure 130). Although the gap between urban and rural narrowed over this period, rural access remains low.

Figure 130. Urban and rural access to adequate sanitation in South Africa (1996–2013)



Source: Author's computations based on data from IHS Global Insight (2015)

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[62] The provision and ongoing operation and maintenance of systems of disposing of human excreta, waste water and household refuse, which is acceptable and affordable to the users.

15.4 Methodology

The different sources of funding for sanitation infrastructure were analysed, including part of the MIG and conditional grants, and the Rural Household Infrastructure Grant (RHIG) that specifically focuses on rural areas. A mixture of qualitative and quantitative analyses was used to look at design issues, performance and challenges for these IGFR instruments.

The effect of the RHIG on reducing sanitation backlogs in different municipal categories between 2013 and 2014 was assessed using a sampling method to select municipalities that had received the RHIG in 2012. One of the key assumptions is that the level of sanitation infrastructure backlog should decrease following an implementation of RHIP as an intervention.

The sanitation backlog was measured before and after the introduction and implementation of the RHIP through RHIG, i.e. 2012 and 2013, in order to identify whether the sanitation backlog declined a year after the implementation of the RHIG.

In 2012, a total of 52 municipalities benefited from RHIG. After calculating the change in sanitation backlogs between 2012 and 2013, municipalities were divided into three categories based on the level of improvement in sanitation backlogs: less than 2%, between 2% and 3%, and between 4% and 5% (Table 82)

Table 82. Municipal ranking based on improvement in sanitation backlog (2012)

Ranking	Number of municipalities	Percentage of municipalities	2010/11
4–5%	8	15.4%	87
2–3%	21	40.4%	6
Less than 2%	23	44.2%	7%

Source: Commission's computations

Table 83. Randomly selected municipalities based on improvement ranking

Improvement		
Between 4-5%	**2-3%**	**Less than 2%**
Engcobo	Maluti-a-Phofung	Umzumbe
Umzimvubu	Thulamela	Umzimkhulu
Mbizana	Greater Giyani	Dannhauser
Nyandeni	Amahlathi	Phumelela
Matatiele	Ratlou	Ramotshere Moilao

Source: Commission's computations

From the ranking, five municipalities were chosen from each category using a random sampling. A total of 15 (29%) out of 52 municipalities were chosen (Table 83).

Data for the selected rural municipalities was sourced from Global Insight, while data on the general performance of RHIG was sourced from the National Treasury and Department of Human Settlements (DHS) publications. Other data and information for secondary analysis were sourced from other studies undertaken on sanitation and RHIP, including a study undertaken by the Auditor-General and by the DHS (AGSA, 2015; DHS, 2012).

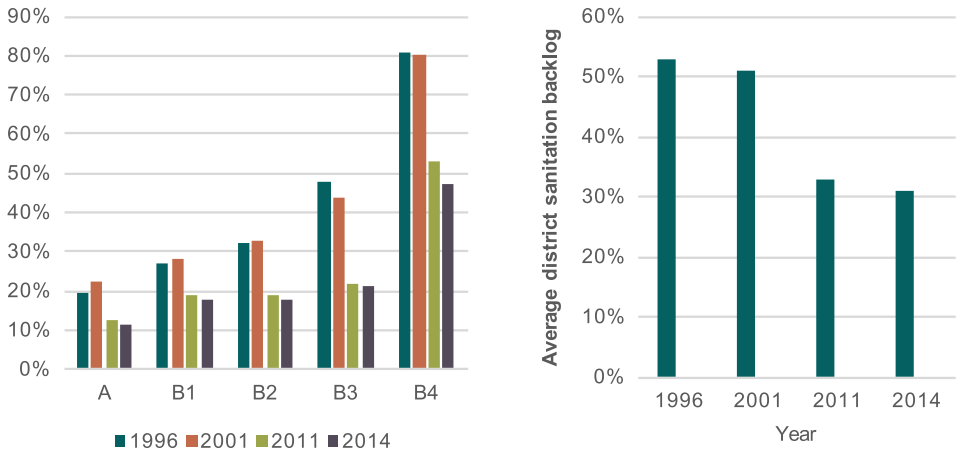
To confirm the analysis and understand institutional challenges, meetings with key stakeholders were held, including with the Independent Development Trust (IDT), one of the key stakeholders contracted by DHS to implement RHIP over the past few years. Meetings were also held with the South African Local Government Association (SALGA) and the Department of Water and Sanitation (DWS).

15.5 Findings

15.5.1 Progress on sanitation backlogs

As Figure 131 illustrates, the sanitation backlog overall has decreased since 1996, but B4 municipalities and district municipalities still had high backlogs (of 47% and 31% respectively) in 2014. The backlogs in the other categories were considerably lower, at 11% for A municipalities, 18% for B1s and B2s and 21% for B3s.

Figure 131. Sanitation backlog by municipal category between 1996 and 2014



Source: Author's computations based on data from IHS Global Insight, 2015

15.5.2 Intergovernmental instruments

Sanitation infrastructure and services are funded in a very unsystematic manner, and "sanitation in particular has up to now been mainly funded on an ad-hoc basis, while water has enjoyed the benefit of a more matured ring-fenced funding regime".[63] The effectiveness of the various funding instruments (which include MIG, LGES, RHIG and municipal own revenue) is discussed in the following sections.

Municipal Infrastructure Grant

The MIG consolidates all existing capital grants for municipal infrastructure and is supposed to be the main funding source for sanitation. Table 84 describes the MIG's different components:

Table 84. Municipal Infrastructure Grant components

Component	Purpose
B	To fund basic residential infrastructure, which includes water and sanitation, electricity, roads and other (street lighting and solid waste removal).
P	To fund public municipal services infrastructure
E	To fund social institutions and micro-enterprises and (the N-Component) nodal municipalities

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[63] Speech made by the Minister of Water and Sanitation, Nomvula Mokonyane (26 August 2014) in response to a debate on "Moving with utmost speed to provide water and sanitation to our people to eliminate the bucket system".

According to the MIG conditions, 75% of MIG allocations should be used to fund the B component, of which 72% should be for water and sanitation – the other 25% is split between components P and E. A formula determines the share received by each municipality, and then the municipality can decide which type of infrastructure to prioritise and fund through the MIG. Based on the proportion going towards sanitation services, MIG funding is inadequate to address the extent of sanitation needs. While a quota of 6000 litres of water has been determined for water beyond which people start to pay, there is no similar quota for sanitation; hence it does not receive adequate resources.

Local Government Equitable Share

The LGES is a formula-based allocation to municipalities, as stipulated by Section 214 of the Constitution. It is designed to enable municipalities to have the resources to deliver basic services to low income or poor households and to build administrative infrastructure. It also provides municipalities with funds to cover operational costs associated with providing free basic services to indigent households. Rural municipalities rely heavily on the LGES as their primary revenue source because their revenue base is low.[64] They use LGES funding to finance their operations, which leaves few or no resources to fund basic infrastructure needs, including sanitation. This implies that LGES funding to rural municipalities is not necessarily an effective instrument for providing and maintaining sanitation infrastructure and services.

Rural Household Infrastructure Grant

In 2010/11, the RHIG was introduced as an indirect conditional grant through which national government provides sanitation infrastructure for rural households where connector-services would be inappropriate. As an indirect grant, national government (or its agent) spends all funds on behalf of municipalities, and so no funds are transferred to municipalities (unless a municipality is acting as an implementation agent). Then, in 2013/14, a direct component of the RHIG was introduced. However, since being established, the RHIG has performed very poorly (Table 85). In its Submission for 2016/17 Division of Revenue, the Commission recommended that National Treasury and line departments consider using indirect grants as a measure of last resort, based on an analysis of performance of some grants including the RHIG.

Table 85. RHIG budget and expenditure

Year	Allocation (R-million)	Expenditure (R-million)	Percentage spent
2014/15	113.1 65.6 (direct) 47.5 (indirect)	22.6	34.45%
2013/14	240.4	215.3	89.56%
2012/13	340.6	205.6	60.36%
2011/12	258	187.3	72.60%
2010/11	100	62	62.00%

Source: Commission's computations

One of the biggest challenges with respect to the RHIG is under-spending, which is mainly as a result of business plans from municipalities being received very late or not being detailed enough to comply with Division of Revenue requirements.

Although sanitation backlogs decreased on average between 2009 and 2014, they remain high, at 50% (Figure 132). The sanitation backlog in some municipalities remains above 60% in 2014 (Umzumbe 68%, Dannhauser 64%, Ramotshere Moiloa 62% and Umzimkhulu 61%). For some municipalities (e.g. Umzumbe, Umzimkhulu and Dannhauser), sanitation backlogs are on the increase.

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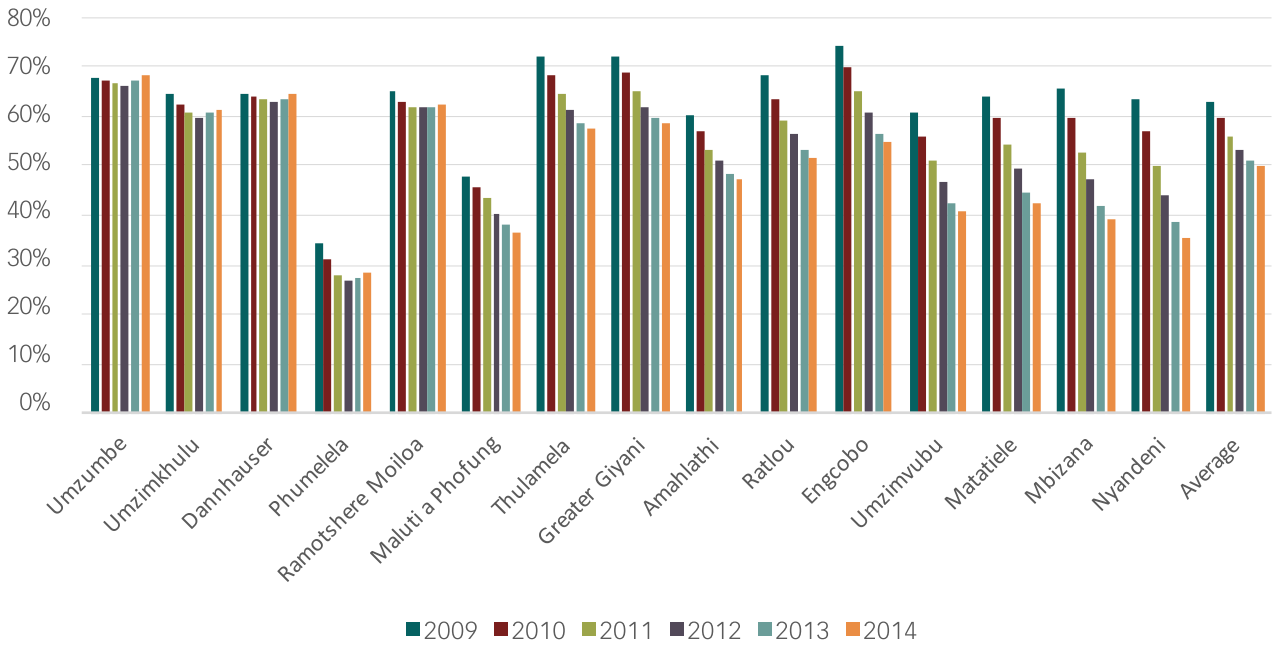
[64] Chapter 8 of this Submission gives a clear breakdown of transfer shares for rural municipalities compared to other municipal categories

Figure 132. Municipal sanitation backlog as a percentage (2009–2014)

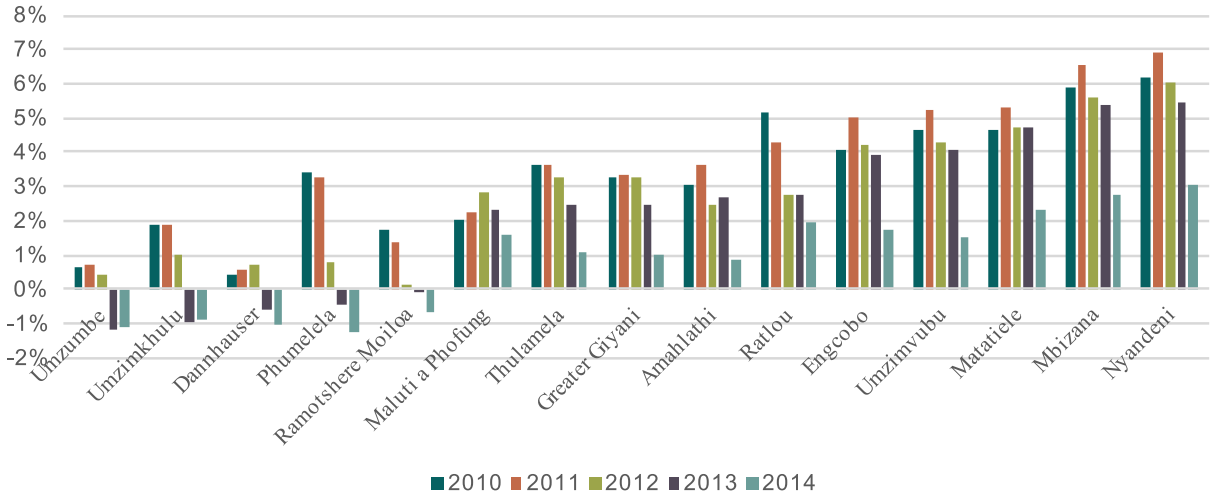


Source: Author's computations based on data from IHS Global Insight (2015)

Although the unavailability of data makes it difficult to single out the impact of a particular grant (MIG vs. RHIG), Figure 133 shows the year-on-year change in sanitation backlogs across the rural municipalities that were part of the RHIP.

- In some municipalities (Matatiele, Ratio, Engcobo and Umzimvubu), sanitation backlogs remained the same before and after the RHIP was implemented.
- Some municipalities (Nyandeni, Mbizana, Thulamela, Maluti a Phofong and Greater Giyani) saw a marginal reduction of about 1% in their backlogs between 2012/13 and 2013/14.
- Some municipalities (Umzumbe, Umzimkhulu, Dannhauser, Phumelea and Ramotshere Moiloa) had an increase in sanitation backlogs.

Figure 133. Year-on-year percentage change in sanitation backlogs



Source: Commission's computations based on data from IHS Global Insight (2015)

Unlike other grants, which are spread over a number of years, the RHIG is funded on an annual basis. Some municipalities receive funding for only one financial year, while others are funded for more than a year. What is not clear is why the RHIG funding to a municipality is terminated when the sanitation backlog is still high, i.e. the grant has not achieved its objectives. As Table 86 illustrates, some municipalities received funding for only 2012/13, despite their increasing backlogs (i.e. Umzimkhulu, Umzimvubu and Phumelela), whereas other municipalities received it for only 2013/14 or for both 2013/14 and 2014/15.

Table 86. RHIG recipients (2012/13–2014/15)

2013/14 and 2014/15	2013/14 only	No RHIG received after 2012/13
Umzumbe	Matatiele	Engcobo
Ratio	Mbizana	Umzimvubu
Dannhauser	Nyandeni	Umzimkhulu
Maluti a Phofung	Amahlathi	Phumelela
Thulamela	Ramotshere Moiloa	
Greater Giyani		

There is some duplication in the sanitation objectives of the RHIG and MIG, showing a lack of alignment between these grants. The MIG provides capital finance for basic municipal infrastructure backlogs for poor households, micro enterprises and social institutions servicing the poor, while the RHIG provides capital funding for the eradication of rural water and sanitation backlogs.

Municipal own revenue

Municipal own revenue includes funds from the municipality's tax base (e.g. funds collected for municipal services, property taxes, various consumer tariffs levied, etc.). These funding sources are very limited in rural municipalities because of their weak tax bases. As a result, rural municipalities are limited in their ability to raise sufficient revenue to cover both their operating costs and infrastructural needs. Therefore, the funding of basic services for poor households is mostly addressed through other capital grants and equitable share transfers, and own revenue is not a source of funding for sanitation infrastructural needs in rural municipalities.

15.5.3 Green technology and waterless toilets

Various technologies can be used to improve sanitation, particularly in rural areas. In South Africa, ventilated improved pits[65] (VIPs) are commonly used to improve sanitation, whereas other countries have moved towards ecological sanitation (EcoSan) or waterless toilet technologies. EcoSan is an environmentally friendly, sustainable waterless sanitation system that regards human waste as a resource for agricultural purposes rather than something to be disposed of (WaterAid, 2011a). It is environmentally sound, as it does not contaminate ground water and other freshwater sources, and reduces waste by 5–10% of its original mass, to be then used as compost. Furthermore, EcoSan technologies do not need expensive vehicles, such as vacuum trucks or tankers ("honey suckers") to remove the waste. In South Africa, EcoSan is currently not considered an option for dry sanitation, despite the presence of EcoSan toilet manufacturers in the country.

15.5.4 Institutional arrangements

The three spheres of government have different roles and responsibilities with respect to sanitation. According to the Constitution, municipalities are generally responsible for ensuring a safe and healthy environment and providing communities with services in a sustainable manner. The role of national and provincial governments is to support and strengthen municipal capacity and to enable municipalities to exercise their powers and perform their functions However, a number of challenges relating to institutional arrangements emerged from interviews with stakeholders.

Poor coordination of plans by various relevant departments

Programmes are not aligned among the different levels of government (e.g. between a national/provincial department and a municipality), resulting in inefficiencies and a lack of service delivery. For instance, the DHS provides housing with full waterborne sanitation technologies, but municipalities have not planned for bulk water infrastructure in the area. In these cases, beneficiaries find themselves living in housing units with no working toilet facilities (i.e. cannot be flushed).[66]

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[65] A VIP is a "dry" toilet facility that is an improvement on standard pit latrines, eliminating flies and odour.

[66] Presentation by Department of Human Settlements to the Select Committee on Public Services on 25 October 2011.

Poor communication between local and district municipalities

Poor communication is found within single government levels, not only among different spheres. For example, their district municipalities did not consult Ditsobotla and Butterworth municipalities about the sanitation projects being implemented in their municipalities. The two local municipalities only knew about the sanitation projects when they were interviewed by the Ministerial Sanitation Task Team (DHS, 2012).

RHIG and MIG duplication and underfunding

As RHIG funding is available, some rural municipalities do not allocate or reduce their MIG allocation. As a result, they rely heavily or only on RHIG funding, which compromises service delivery. The two grants also have common objectives, resulting in duplication. Although sanitation appears to be under-funded by these grants, it is difficult to make a strong case for additional funding when rural municipalities fail to spend the allocated funding. According to a DWS official, National Treasury is willing to increase funding for rural sanitation provided spending and infrastructure delivery improve.

Shifting of the function from one department to the other

The shifting of the sanitation function from one department to the other affects the continuity of planning and implementation of sanitation projects, which has an impact on delivery outcomes.

Funding operations and maintenance

Major challenges occur after the infrastructure has been delivered. Most rural municipalities do not include sanitation plans in their IDPs or have operation and maintenance plans in place, and so allocate little or no funding to sanitation infrastructure. A study undertaken by the DHS (2012) found that sanitation facilities developed through the RHIP are not sustainable because of poor operation and maintenance. However, the study was unable to determine how much is allocated to operating and maintaining VIPS because of limited data.

15.6 Conclusion and Recommendations

Improving sanitation infrastructure is key for a number of reasons, including reducing the risk of infection from excreta-related diseases, and thereby saving lives, particularly those of children under the age of five. Since 1994, sanitation backlogs have decreased but remain high in rural areas, despite government intervention through the Bucket Eradication Programme and the RHIP. Rural municipalities can use a number of funding instruments to provide and maintain sanitation infrastructure, including the MIG, LGES and RHIG. The RHIG has not achieved its expected outcomes for various reasons. These include the grant's design (as an indirect grant), discontinued funding in some municipalities despite high backlogs remaining, and under-spending because of the late transfer of funding, as a result of poor quality and late submission of business plans. Furthermore, in some municipalities sanitation is not included in their IDPs and so is not prioritised. Another challenge is the lack of operations and maintenance plans, and funding. These challenges must be overcome in order to reduce the sanitation backlogs and to ensure the health and dignity of South Africans.

With respect to intergovernmental instruments and institutional issues pertaining to the provision and maintenance of sanitation infrastructure in rural municipalities, the Commission recommends that:

1. Rural municipalities that are Water Services Authorities prioritise the delivery of sanitation infrastructure, which must be reflected in municipal IDPs. SALGA should play an oversight role in ensuring compliance with this recommendation.
2. Rural municipalities that are Water Services Authorities explore and prioritise EcoSan waterless technologies (where feasible) and develop a complete municipal sanitation infrastructure project delivery plan, which includes the following:

    - Technologies to be used for emptying toilet latrine pits (VIPs), taking into account community dynamics.
    - Scheduled periodical maintenance of sanitation infrastructure.
    - Full costs of maintenance and sources of funding.

    SALGA and the national and provincial departments of water and sanitation develop and implement monitoring tools for this recommendation.
3. The Department of Planning, Monitoring and Evaluation, National Treasury and the Department of Water and Sanitation undertake a comprehensive evaluation of the impact of sanitation grants on rural municipalities before discontinuing the grants.
4. District and rural municipalities that are Water Services Authorities submit compliant business plans timeously to the national Department of Water and Sanitation. Should they fail, executives should be held accountable. In cases where Water Services Authorities lack capacity, the national and provincial departments of water and sanitation should intervene and provide the required capacity.

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