Submission for Division of Revenue

2010/11

FINANCIAL
AND FISCAL
COMMISSION

For an Equitable Sharing of National Revenue

Financial and Fiscal Commission

Submission for the Division of Revenue 2010/11

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For an Equitable Sharing of National Revenue

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FINANCIAL AND FISCAL COMMISSION

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Acronyms

ABET	Adult Basic Education and Training
AFDC	Aid to Families with Dependent Children
AFS	Annual Financial Statements
AMPS	All Media and Products Survey
ASGISA	Accelerated and Shared Growth Initiative for South Africa
AusAid	Australian Aid
Capex	Capital Expenditure
CCT	Conditional Cash Transfer
CGE	Computable General Equilibrium Model
CMA	Catchment Management Agency
CMTP	Consolidated Municipal Transformation program
CPI	Consumer Price Index
CRUs	Community Rental Units
CSG	Child Support Grant
CWSS	Community Water and Sanitation Services
DBSA	Development Bank of Southern Africa
DFID	Department of International Development
DG	Disability Grant
DMTN	Domestic Medium Term Note
DoE	Department of Education
DoT	Department of Transport
DPLG	Department of Provincial and Local Government
DPW	Department of Public Works
DRZ	Designated Restructuring Zones
DSD	Department of Social Development
DWAF	Department of Water Affairs and Forestry
EITC	Earned Income Tax Credit
EMS	Emergency Medical Services
ENERGYS	Engineers Now to Ensure Roll-out by Growing Young Skills
EPWP	Expanded Public Works Programme
EU	European Union
FCG	Foster Care Grant
FIFA	Fédération Internationale de Football Association
FFC	Financial and Fiscal Commission
FMG	Financial Management Grant
GDP	Gross Domestic Product
GHS	General Household Survey
GSDM	Greater Sekhukhune District Municipality
HAART	Highly Active Antiretroviral Treatment
IDP	Integrated Development Plan
IES	Incomes and Expenditure Survey
IHHSD	Integrated Housing and Human Settlement Development Grant
IGP	Infrastructure Grant for Provinces
ISRDP	Integrated Sustainable Rural Development Program
IWRM	Integrated Water Resources Management
LED	Local Economic Development
LES	Local Government Equitable Share
LGTP	Local Government Transformation Programme
LGNET	Local Government Network

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LGRC	Local Government Resource Centre
LGSETA	Local Government Sector Education and Training Authority
LGSP	Local Governance Support Programme
MDGs	Millennium Development Goals
MFMTAP	Municipal Finance Management Technical Assistance Programme
MIG	Municipal Infrastructure Grant
MSIG	Municipal Systems Improvement Grant
MSP	Municipal Support Program
MTEF	Medium-Term Expenditure Framework
MTBPS	Medium-Term Budget Policy Statement
NALEDI	National Labour and Economic Development Institute
NCBF	National Capacity-Building Framework
nDoH	National Department of Housing
NDoH	National Department of Health
nDoT	National Department of Transport
NERSA	National Energy Regulator of South Africa
NGO	Non Governmental Organisation
NRB	National Roads Board
NRF	National Road Fund
NSDP	National Spatial Development Plan
NTC	National Transport Commission
OECD	Organisation for Economic Cooperation and Development
PALAMA	Public Administration Leadership and Management Academy
PES	Provincial Equitable Share
PFMA	Public Finance Management Act
PHC	Primary Health Care
PIG	Provincial Infrastructure Grant
PLTF	Provincial Land Transport Framework
PPP	Public Private Partnerships
PRWORA	Personal Responsibility and Work Opportunity Act
PTIS	Public Transport Infrastructure and Systems Grant
RDP	Reconstruction and Development Programme
RHA	Rental Housing Act
SAICE	South African Institute of Civil Engineers
SALGA	South African Local Government Association
SANRAL	South African National Road Agency Ltd
SARCC	South African Rail Commuter Corporation
SASSA	South African Social Security Agency
SDA	Service Delivery Agreement
SDF	Service Delivery Facilitator
SETA	Sector Education and Training Authority
SH	Social Housing
SHA	Social Housing Act
SHF	Social Housing Foundation
SHIs	Social Housing Institutions
SHRA	Social Housing Regulatory Authority
SHRCG	Social Housing Restructuring Capital Grant
SOCPEN	Social Pension System
SSP	Sector Skills Plan
StatsSA	Statistics South Africa
TANF	Temporary Assistance to Needy Families
UIF	Unemployment Insurance Fund
URP	Urban Renewal Programme
USAID	United States Agency for International Development
WHO	World Health Organisation
WISA	Water Institute of South Africa
WMA	Water Management Areas
WMI	Water Management Institutions
WSSCU	Water Sector Support Coordinating Unit

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Foreword

This Submission for the Division of Revenue 2010/11 covers many topical issues confronting the South African intergovernmental fiscal relations system. Over the past 14 years of the evolution of the system, a key issue has been the tension between national and provincial government regarding the funding of priorities in the realm of concurrent functions. In the Submission for the 2009 Division of Revenue, the Commission indicated that it was conducting a comprehensive review of the provincial equitable share (PES) formula in collaboration with the provincial and national treasuries. This submission addresses this matter from the Commission's independent perspective and makes recommendations on the system of equitable sharing of revenue, institutional arrangements with regard to the equitable division of revenue, and also recommendations on the technical configuration of the formula itself. Other key issues covered in the submission include public infrastructure, social grants, health, rental housing, water, and municipal capacity building. The issues covered in each of these topics are relevant for all three spheres of government. The analysis is both retrospective and forward looking, seeking to propose ways of managing change within the system in a consistent, logical fashion.

As part of its response to the 2009 Division of Revenue, the Commission identified the following strategic issues as areas requiring a significant amount of focus from the government in the short to medium term:

1. The Commission notes with concern that there is an increased proliferation of conditional grants. This concern was initially raised by the Commission in its 2006 Division of Revenue, especially with reference to a need to reduce the introduction of very small grants. At the time, the government agreed that most of the grants were being reviewed with a view to consolidating and incorporating them into the equitable share. For the 2009 Medium-Term Expenditure Framework (MTEF), it is the Commission's observation that a number of the conditional grants introduced are small in value and are mainly once-off. The Commission recognises this as a proliferation and may be signalling some tension between competing objectives of the national and sub-national governments in the areas of concurrent functions, especially non-social services.

2. The Commission is concerned about the number of instances where policy implementation stalls, resulting in negative impacts on the intergovernmental fiscal system. These need to be finalised as they tend to create tension and may lead to delays in implementing agreed policy positions, uncertainty and poor service delivery. Areas where policy has stalled include the Regional Electricity Distributors, primary health care and the process on formulation of a White Paper for Provincial government and the review of the White Paper on Local government by the Department of Provincial and Local Government.

The challenges facing South Africa and the world are increasingly complex and interrelated. There has been an overwhelming need for a focus on outcomes and impact of government action. Coupled with this has been an unprecedented demand for transparency and accountability across the public and private sectors. New and emerging global standards and best practices to promote financial and budgetary transparency have also informed thinking around the Commission's research thrust, as has been the observation that successive 'new' governments in South Africa following democratic elections

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are changing the relationship between the spheres of government every five years. Keeping abreast with such complex and fluid developments requires creative, rigorous and pragmatic research. As part of its regular strategic self-evaluation exercise, the Commission has developed a new research strategy to inform its recommendations. While in the past, the research emphasised first-generation issues of equitable revenue allocation across the spheres, expenditure assignments and development of models, the focus of this new research strategy is on second-generation issues of how much the quantum of public funds and their allocation can be translated into service delivery outputs and outcomes which actually have a positive impact on communities. The primary focus will be on outcomes and impact of government interventions within and across the various spheres of government.

As has always been the tradition with the Commission's work, this year's submission has relied on collaborative input from various partnerships. There have been rigorous consultations with the Commission's primary stakeholders from the provincial and national legislatures, expressed through the finance committees, to government, primarily through the Budget Council and Budget Forum, and local government, through the South African Local Government Association. The technical reports that support this year's recommendations have relied on collaborative research with our technical advisors and members of the Commission's Secretariat. Their contributions are greatly appreciated.

The Financial and Fiscal Commission remains committed to assisting the government and the legislatures with evidence-based recommendations and this submission is a reflection of that commitment, and of the Commission's mission to combine research excellence with genuine impact.

We, the undersigned, hereby submit the recommendations for the 2010 Division of Revenue in accordance with the obligations placed upon us by the Constitution of the Republic of South Africa.

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For and on behalf of the Commission

Chairperson Dr Bethuel P Setai

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Executive Summary

This Submission is made in terms of Section 214(2), Section 229(5) of the Constitution, and Section 9 of the Intergovernmental Fiscal Relations Act of 1999. These require the Financial and Fiscal Commission (FFC) to make recommendations on the division of revenue among the three spheres of government, and also recommendations to support government's policy-making on intergovernmental fiscal relations. The recommendations informed by our rigorous research comprise a wide range of policy areas of both national and international significance.

The submission starts off by making recommendations on reforms to the provincial equitable share (PES). This is followed by further recommendations on public infrastructure scale up, social grants, health, rental housing and roads. The focus then turns to local government issues of water and sanitation and capacity building. These issues cut across all three spheres of government and are both reactive and prospective with respect to pressing policy challenges.

The section below presents the recommendations of the Commission for the 2010/11 Division of Revenue.

With respect to the provincial equitable share (PES), the Commission recommends that:

On principles

a. Expenditure assignments between provinces and national government should be clarified beyond what is covered under Schedule 4 of the Constitution: A concerted effort is required to make a distinction between delegated responsibilities (for which the national government still retains a strong interest in performance) and own or devolved responsibilities of the provincial governments. There is also a need to emphasise exclusive assignments, as opposed to concurrent assignments to increase accountability.

b. There should be a clear separation of instruments in the transfer system. The following principles should be observed:

    i. The equalisation grant should equalise on the basis of differences between expenditure needs.

    ii. There is a need to establish a system of conditional grants, which has performance aspects, and that clearly support the delivery of delegated responsibilities by sub-national governments.

    iii. There is a need for other transfers for regional development, including capital grants that need not be conditional.

c. Provincial governments should be encouraged to exercise the revenue powers conferred to them through Section 228 of the Constitution and the Provincial Tax Regulation Process Act of 2003.

d. The ability of provinces to borrow should be carefully facilitated and linked to their revenue-raising capacity as a way to close the infrastructure gap in a responsible and incentive-compatible fashion.

On reform options for the PES and formula

Option 1: The short-term solution

In the short term, the Commission recommends that the reform of the PES formula stay within the confines of the current constitutional dispensation. The Commission further recommends that:

a. The PES formula should retain for the most part its current structure, and only be reformed to bring it closer to a conventional equalisation grant which equalises both expenditure and revenue.

   i. Both the expenditure needs and the fiscal capacity of each province should be defined by means of objective criteria that properly represent the objectives of horizontal equalisation.

   ii. Expenditure needs should be derived on all expenditure responsibilities of the provinces. Expenditure can be quantified on the basis of an explicit per client financial norms, determined in the annual budget cycle for the national government, or the costed norms approach.

   iii. The computation of the fiscal capacity must take into account the direct forecast receipts from revenue sharing for each province and the estimated potential revenues from own revenues, including the piggyback personal income tax and fuel levy if they were introduced.

b. The PES formula should be divided into a number of components, in pursuit of clear and separate objectives.

   i. The 'economic activity' component of the PES formula should be removed to become a straightforward conventional form of revenue sharing, allocated either on a derivation basis or according to some other criterion such as the share of gross domestic product.

   ii. Another part would be allocated for a system of conditional capital grants, mainly targeting backlogs in capital infrastructure and capital investment needs of provinces, especially for those that are not expected to be financed through borrowing, and should build on the current infrastructure grant for provinces.

   iii. Most importantly, another component would be dedicated to implementing a system of unconditional equalisation grants that takes into account differences in expenditure needs and differences in fiscal capacity. The latter assumes that none of the expenditure assignments to the provincial governments (in particular education, health, and social welfare) are delegated. This would allow provinces complete autonomy to set priorities within the parameters of the Constitution, i.e. respecting the role of national government. An incentive system of matching grants should be developed to support the implementation of national priorities.

c. That institutional weakness in the budget process should be addressed as a matter of urgency to enhance cooperation between the two spheres, improve enforcement of norms and standards, and increase the capacity of national departments to monitor and build capacity of provincial counterparts. The role of the FFC, as defined in the Constitution, should be strengthened within the institutions dealing with division of revenue matters.

Option 2: Medium- to long-term solution

In the medium to long term the Commission recommends that the reforms should depart from the realisation that fixing the PES as a pool requires the fixing of other aspects of the current fiscal decentralisation system. Specifically, the reform of the PES will require the reform of current expenditure and revenue assignments between the national and provincial governments. The implementation of this option will require significant changes in the current legislation and amendments to schedules 4 and 5 of the Constitution in order to enable the conversion of several functions into delegated functions.

The Commission further recommends that this option should be considered with utmost caution owing to the inherent risks, relating to transition costs and the potential to compromise service delivery. It will be necessary to have a dedicated intergovernmental committee that will oversee and manage the transition process as well as identify potential risks.

a. Taking the education and health services out of the PES, and converting those components into separate block, conditional grants from the national government to the provinces. Under a block grant, the provincial governments will have the obligation to spend the grant in the particular expenditure area (for example, primary education), but they will also be free to determine how the funds are used within that area. Education and health services will remain concurrent responsibilities of the national government and the provinces. In the reformed expenditure assignment system, these services will be explicitly recognised as 'delegated' responsibilities from the national government to provinces (as opposed to provincial government's own responsibilities and concurrent functions but not delegated responsibilities). Under this redefinition, the national government will have explicit responsibility for securing adequate funding on behalf of the provinces for the provision of these services. Provincial governments will use their discretion to add their own funds for improved financing and speed up service delivery. The national government will also have responsibility for establishing performance standards for the delegated services. The necessary level of funding for the delegated responsibilities in education and health will be determined in the annual budget of the national government by using financial per client norms or any other expenditure quantification criteria. The quantification of expenditure needs can be improved by adjusting the norms for differences in the costs of provision across jurisdictions.

b. Removing the 'economic activity' component from the PES formula and converting it into a revenue-sharing pool. Because provincial governments will have added expenditure responsibilities, the current levels of revenue sharing will be maintained. This will be a mechanism to close the vertical gap between expenditure needs and financing ability of the provinces. Revenue sharing on a stable basis will increase the fiscal stability of provincial governments and will also be a way to let less poor, sub-national governments receive their share in the wealth/revenues collected within their boundaries.

c. Increasing the revenue autonomy of provincial governments by fully implementing the provisions of section 228 of the Constitution and the Provincial Tax Regulation Process Act of 2003.

d. Introducing an equalisation grant with the following features:

    i. A predetermined fixed funding rule, which allows beneficiary provinces to anticipate and plan, based on the funding that will be available from this grant from year to year; and

    ii. A distribution formula for the available funds, proportionate to the fiscal gap computed for each province, on the basis of the difference between allowable expenditure needs and fiscal capacity. Unlike the first option, expenditure needs will be a derivative of all expenditure responsibilities for provinces other than the delegated responsibilities (education and health), which are already minimally financed by the block grants.

With respect to public infrastructure investment, the Commission recommends that:

1. The government should review upwards the departmental baselines and increase the quantum of appropriate investment in public infrastructure (national, provincial and municipal): Macro-micro modelling done by the Commission, as well as international experience, has shown that investment in appropriate infrastructure leads to reduced unemployment and poverty. The Commission recommends that increased funding be directed towards infrastructure programmes that are linked to basic services including water, health, electricity, roads, transport and communication.

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2. For funds already in the system, the Commission recommends that the government should improve the quality of targeted outcomes of infrastructure investment towards employment creation and poverty reduction. Leveraging from efficiency gains throughout all baselines of departments should be made an ongoing exercise, as it strengthens the link between planning and spending, especially within the provincial sphere of government.

3. The Commission recommends that the government should implement a fully comprehensive national infrastructure maintenance strategy, especially for those infrastructure classes with a high impact on unemployment and poverty, with dedicated maintenance objectives. To achieve sustainable outcomes, the government must improve management of infrastructure investment by building in/safeguarding adequate future lifecycle replacement and maintenance provision of the infrastructure.

4. The Commission recommends that government develops appropriate funding mechanisms through intergovernmental coordination to facilitate, integrate and sequence infrastructure planning and delivery. Such planning should:

    a. Support stronger municipal management, especially for capital expenditure and maintenance programmes, and resolve lingering policy uncertainty. A case in point relates to the Regional Electricity Distribution reforms which have stalled and, as a consequence, are currently undermining municipal investment in infrastructure and maintenance.

    b. Improve long-term planning for state investments:

        i. Use best practice from effective state owned agencies for infrastructure planning, management, spending and maintenance.

        ii. Complete comprehensive infrastructure monitoring and evaluation system.

        iii. Use common methodologies for calculating costs and benefits for project appraisal.

With respect to social assistance grants, the Commission recommends that:

1. The government should increase the rollout of social grants to cushion poor people from the effects of the economic downturn. However, there are risks and opportunities associated with the scaling up of social grants. The government needs to make trade-offs between coverage and grant amounts, taking into consideration affordability, incentive effects and the net effect across all grants. There is an inherent trade-off within programmes in attempts to scale up social grants, as the resource envelope is not without limits. Past experience at provincial level has illustrated that increases in social grants may 'crowd out' other forms of social expenditure, leading to the rationing of other non-cash social services (such as increased waiting times in health clinics, reduced welfare services etc.).

2. Social assistance should be managed in such a way as to eventually reduce dependency on the social grants. The issue of fiscal risk is linked to issues of fiscal sustainability of scaling up conditional cash transfers (CCTs). Fiscal risk arises when such CCTs give the receiver an impression of entitlement, which will be hard or impossible to reverse in the future. In the presence of revenue decline or volatility, the fiscal rigidities of entitlement spending may exacerbate fiscal risk. As a starting point, social grants on the demand side appear to be working well and can be scaled up in the short term but those on the supply side are not working well and will need to be shrunk.

3. The government should use infrastructure expansion to provide opportunity for workfare programmes as well as activities identified in the Expanded Public Works Programme (EPWP). The government should consider the EPWP to pilot workfare immediately.

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With respect to the performance of public hospitals, the Commission recommends as follows:

1. Whilst recognising the provisions of the National Health Act (2004) and current norms guiding the primary health care (PHC) system, there is a policy gap in respect of legislative provisions and norms and standards for a well-functioning public hospital system. In addressing the identified gap, the government must develop norms and standards that should address the following issues in relation to the public hospital system:
    a. The specification of minimum service requirements;
    b. The establishment of minimum input norms;
    c. The establishment of a workable quality assurance framework;
    d. The establishment of a transparent reporting system focusing on:
        i. Inputs
        ii. Processes
        iii. Outputs, and
        iv. Outcomes;
    e. The identification of governance requirements;
    f. The establishment of governance norms and standards;
    g. A strategic planning framework which outlines the medium-/long-term vision of the hospital system, expressed in terms that are implementable and auditable.
    h. A need exists for a mix of hard (codified by legislation) and soft norms (guidelines to aid departments) and standards. Hard norms and standards should be set by national government, codified by statute and be enforceable in relation to allocations set to achieve this objective. Soft norms and standards can be expressed as guidelines to assist delivery agencies in motivating for resources. Provinces should be allowed to contextualise soft norms and standards which suit their needs/socio-economic circumstances.
2. It is recommended that the government needs to standardise and institutionalise budget formats processes across all hospitals. In effecting these considerations, the following issues are pertinent:
    a. Setting individual hospital budgets:
        i. In relation to an agreed set of services with due consideration to the unit cost per service and needed activities;
        ii. Subjected to a substantial and informed negotiation process between the province and the hospital;
        iii. Which include agreements on how to deal with unforeseen and unavoidable expenses so that services are not disrupted; and
        iv. That ultimately address how case mix-based budgets can be deployed (that are consistent with international best practice). By defining the cost-drivers within a case mix, it is possible to mitigate against avoidable variances that currently occur between hospitals.
    b. Consistent with hard norms and standards, allocations should be determined by differentiating by hospital type i.e. central, regional and district hospitals; acute psychiatric and chronic hospitals; and infectious disease hospitals.

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With respect to rental housing, the Commission recommends that:

1. There should be relaxation and flexibility on the:

    a. eligibility criteria for accessing the Social Housing Capital Restructuring Grant to allow projects falling outside the Designated Restructuring Zones to access funding;

    b. number of Designated Restructuring Zones to respond to excess demand for rental housing;

    c. minimum unit size for redevelopments of existing buildings.

2. The process of disbursing funds for rental housing within the housing sector should be made shorter to minimise time lags following the submission of approved project plans.

3. The Social Housing Regulatory Authority should improve the inter-sectoral coordination between various government departments responsible for integrated human settlement.

4. The qualifying income bands should be reviewed to ensure that individuals are not unfairly excluded from benefiting from the subsidy (due, for example, to increases in the cost of living).

With respect to the management and financing of road infrastructure, the Commission recommends that:

1. There should be an increased and stable flow of funds for maintenance, rehabilitation and addressing backlogs in the long-term. Potential policy proposals to ensure that this is achieved can include:

    a. Formulating pricing and cost-recovery policy for roads that generate sufficient revenues for authorities to maintain and operate their road infrastructure network on a sustainable basis;

    b. Earmarking a portion of road-related user charges and taxes;

    c. Explicitly including a road infrastructure component within the provincial and local government equitable share formulae;

    d. Expanding the role of development institutions and capital market in funding road infrastructure investment especially at sub-national spheres.

2. There should be greater coordination of road management functions across the three spheres of government. In this regard, the revision and modification of the inter-road authority coordinating model proposed by the National Department of Transport [see Appendix A] should be carried out with a view for possible future implementation.

3. Priority should be given to addressing the lack of technical skills in the road management sector of sub-national governments. Attaining this objective can be done through the introduction of a separate conditional grant, specifically targeted at building technical capacity within the road management sector of sub-national governments.

With respect to water and sanitation, the Commission makes the following recommendations:

1. The Commission recommends that there must be a review of the free basic water and sanitation subsidy as well as a review of water tariff structures, to ensure that the shortcomings implicit in the current subsidy system do not outweigh the benefits. At present, there is no coherent framework of oversight for how water service authorities manage trade-offs in the design and determination of their water tariffs. The tariff structures (that is, the number of customer classes or consumption blocks

and the level of tariffs for each of the classes or blocks), which are different in various municipalities, have a substantial impact on the pricing of water. Principles and practices guiding both tariff and subsidy structures and price levels should be made clear and routinely monitored.

2. In order to sharpen the focus of public expenditures on expanding access to sanitation services and improving sanitary outcomes, the Commission recommends that:

   a. The sanitation strategy should target behavioural change in relation to sanitation practices by households, rather than the provision of infrastructure alone, premised on attaining certain health outcomes. This can generally be achieved through establishing targets and providing funding in a manner that creates incentives for community-level behavioural changes, while providing households with greater discretion on selecting sanitation technologies that meet their needs.

   b. Greater consideration should be given to household affordability constraints that may affect the long-term sustainability of sanitation investments. High service levels (such as in-house flush toilets) put significant ongoing pressure on household and municipal budgets, without a significant proportional improvement in public health outcomes. This limits the pace at which sanitation backlogs can be addressed, and may create significant fiscal risk for service providers over the longer term, as assets must be maintained and replaced.

3. The Commission recommends that there be a separation of policy function from the regulatory function within the water services sector. This should help to improve institutional accountability for performance and the achievement of policy goals. The current overlapping of capacity support, oversight and policy-making functions within the Department of Water Affairs and Forestry (DWAF) has led to a situation where policy targets are inadequately monitored, and simply shifted in the case of under-performance. Following on this recommendation, the Commission would like to propose that the government consider establishing an independent National Water Regulator that would report to Parliament. Its functions, amongst others, will be to:

   a. Regulate the entire water supply industry.

   b. Issue licences, regulate tariffs, and monitor Water Integrated Resource Plans for infrastructure investments.

   c. Regulate compliance to industry norms and standards.

   d. Regulate the supply of water and sanitation services and their compliance to quality standards.

   e. Regulate water efficiency and demand-side management

   f. Develop regulatory frameworks for Public Private Partnerships and alternative service delivery models in the water sector.

   g. Ensure regulatory instruments support the achievement of universal access to water and sanitation services.

   h. Monitor supply and demand trends in the water supply industry.

With respect to local government capacity building, the Commission recommends that:

1. For their own improvement, local government should be central to setting the agenda for capacity-building programmes. This recognises the fact that municipalities remain accountable for their own performance until such time as section 139 of the Constitution is invoked. To achieve this, the Commission further recommends that:

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a. Capacity programmes should be informed by a local government performance management system which is driven by their Key Performance Indicators.

b. Prior to capacity programmes being developed and implemented at local government level, a comprehensive assessment and design process should be undertaken.

c. Capacity-development programmes should be aligned to each stage of the developmental transition of municipalities. There should be a differentiated approach in building capacity.

d. Capacity-development programmes should be comprehensive and not only focus on training of personnel and deployment of experts within municipalities. They must also focus on other organisational, fiscal and institutional constraints that impact on the overall performance of municipalities.

2. The government must establish an intergovernmental-wide framework for understanding what constitutes a lack of capacity within the context of local government.

3. When capacity-building interventions are undertaken with respect to different functional areas, there should be a clear separation of responsibilities, as well as coherent interface, between service authority and the service providers.

4. It is also recommended that replication of poorly defined roles and responsibilities between national, provincial and district municipalities in the policy framework should be eliminated. This is necessary to create clear lines of responsibility and accountability for spheres of government or sector departments over their capacity-building roles in local government.

5. Each capacity-building programme must have a clear outline of measurable objectives, targets and timelines. These must detail conditions under which a programme can be withdrawn from a respective municipality and following a detailed monitoring and evaluation of success factors, failures with possible suggestions for sustaining the programme. The method of implementing capacity programmes should be changed from a standard stop-gap package to a more unique incremental solution, focusing on the identified problems within the municipality and identifying key leverage points where capacity programmes can make a difference

6. A variety of grant instruments should be used for addressing different capacity challenges within different functional areas. Such grants should only be devolved to sector departments once they have demonstrated the capacity to manage such grants and capacity programmes in an Intergovernmental Relations (IGR) system effectively. The Commission further recommends that appropriations for Siyenza Manje should be allocated through the Division of Revenue as done for other capacity grants. This will promote order, transparency and accountability.

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Chapter 1

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Chapter 1 Review of the Provincial Equitable Share Formula

1.1 Background

The South African Intergovernmental System configuration is such that provincial governments are funded from nationally collected revenue through the provincial equitable share (PES) and conditional grants. The Constitution established the PES as a discretionary funding or grant instrument which enables provinces to deliver constitutionally mandated services or functions. Provinces are entitled to a share of the nationally raised revenue in the form of the PES. The PES constitutes around 83% of provincial revenue from national government.

The PES formula, on the other hand, is an objective-transfer mechanism that distributes the grants among the nine provinces on the basis of demographic and economic profile, while at the same time addressing vertical[1] and horizontal[2] imbalances. The current design and structure of the formula was initially proposed by the Financial and Fiscal Commission (FFC) in 1996[3]. Its design and application has critical implications for the delivery of social services and other functions allocated to provinces in South Africa. At its inception the formula comprised three major elements:

i. The basic grant (B), to enable provinces to provide public services in the fulfilment of their constitutional obligations according to their own priorities.

ii. The national standards grant (S), to enable the provinces to provide primary and secondary education and primary health care to their residents.

i. The tax capacity equalisation grant (T), to encourage provinces to take responsibility for raising their own revenue.

In addition, recognising the national role of the academic hospitals, the FFC recommended separate conditional grants (m) to those provinces having such institutions. Thus the total transfers (G) to be received by the provinces were expressed as:

G = B + S + T + m

In its Submission for the Division of Revenue 1998/99, the FFC proposed that the total provincial allocation formula should be extended to incorporate an institutional grant (I) such that the formula becomes:

G = B + S + T + m + I

While it accepted the principles as per the FFC's recommendations on the nature of the formula, the government opted for a formula that is less driven by inputs, but is rather a proportional approach driven by need, approximated primarily by the demographic and economic profile of provinces. Over the years since inception, the formula has been subjected to several reviews in response to the evolving nature of the intergovernmental fiscal system. The most notable reviews include the costed norms approach by the FFC in 2000 and the review done by the Budget Council in 2004, which resulted in the removal of the backlog and the social development components following the devolution of the social security function to the South African Social Security Agency (SASSA). These were replaced by the poverty component and a separate conditional grant to deal with infrastructure backlogs. Other minor reviews include updating of data resulting from exogenous policies (outside the fiscal framework), such as the re-demarcation of provincial boundaries. In all these instances, there have been pressing issues that have been raised by

[1] Vertical imbalance is a term used to refer to the mismatch between revenue and expenditure responsibilities across different levels or spheres of government.
[2] Horizontal imbalance refers to the situation in which different regions within a sphere of government have different abilities to provide services, due to differing ability to raise revenue or costs of providing services.
[3] See Framework Document for Intergovernmental Fiscal Relations (IGFR) in South Africa, 1996.

all key stakeholders with respect to what can be achieved by the formula against the criteria that the horizontal division of revenue must satisfy, as outlined in section 214(2) a-j of the Constitution.

The 2004 changes raised more fundamental issues related to the redistributive powers of the formula, which necessitated a full review of the PES formula. In the main, there were issues of divergence between provincial expenditure trends and the indicative weight assigned to the social welfare component in the formula. This discrepancy was raised starkly when social assistance grants were removed from the formula. While the indicative weight for social development was at 18%, provinces on aggregate were spending around 28%, with some spending as high as 34% on social security grants alone.

Considering the fact that social security grants constituted a larger part of provincial shares, poorer provinces contended that the formula was losing its redistributive thrust with the shifting of this function. These concerns were resolved by adjusting the economic activity component downwards and by introducing a new component referred to as the poverty component, with a bias to poorer provinces. The relatively wealthier provinces raised issues around the fact that their discretion on functions other than social services was being eroded as a result of the formula's strong focus on redistribution, which negated the fact that these wealthier provinces were massive recipients of in-migration from the poorer provinces.

Subsequent to the 2004 review, the Budget Council agreed that the FFC and the Technical Committee on Finance (TCF) should carry out a comprehensive review of the PES formula, taking into account concerns from provinces related to, among others, the formula's ability/inability to redirect resources to poorer provinces, appropriateness of indicators (measurement) and the relevant weights assigned to formula components, reliance on demographic variables as well as response to demographic changes due to migration patterns.

1.2 Purpose

This chapter presents the Commission's findings and independent recommendations emanating from the review of the PES that was conducted by its Secretariat and the TCF. The Commission highlights some of the shortcomings and lack of clarity in the design and implementation of intergovernmental fiscal system as a whole, and how other funding instruments, such as conditional grants and possibly borrowing negatively affect the performance of the PES both as a grant and as a formula. The chapter argues that the weaknesses and ambiguities in the design and implementation of the main pillars of the system, such as expenditure assignments and revenue assignments, negatively affect the performance of the PES. The important corollary to this analysis is that, in order to fix the PES, it will be necessary to remedy some other fundamental aspects of South Africa's system of fiscal decentralisation.

Even though the South African intergovernmental fiscal relations system has an explicit assignment of functions between the national and provincial governments, the current arrangements with respect to concurrent functions (i.e. education, health and to some extent social development) and responsibilities have some defects. These are outside the mechanics of the PES formula but directly affect its performance.

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1.3 Fundamental challenges to the current design of the intergovernmental fiscal system

1.3.1 Expenditure assignment

A critical challenge affecting the working of the PES mechanism is that there is no clear separation of concurrent responsibilities with respect to 'own' responsibilities, for which provincial governments can make decisions with substantial autonomy, and 'delegated' responsibilities, for which provincial governments have to comply with standards of provision dictated by the national sphere. Currently, for example, there is no clarity regarding whether general education and health services constitute 'own responsibilities' or 'delegated responsibilities', and the system continues to debate the desirability of both.

Even though the Constitution may be clear on functional assignments across spheres, the prevalent overlap of responsibilities between national and provincial government creates distortions in funding and accountability. For instance, the National Departments of Education and Health are always discontent with deviations between the 'agreed' funded priorities and the provincial budget outcomes. In other instances national departments argue that they are held accountable for policy outcomes over which they have little control on the required funding. These are the results of an incomplete system where expenditure responsibilities are neither clarified nor defined, and quantification of expenditure needs to be funded through the PES are not carried out.

Furthermore, there are inadequate norms and standards or principles in legislation to inform provincial expenditure and to derive funding needs of provinces. Currently, the spending of provinces on new programmes is driven mainly by the departmental bidding process. This process is normally driven by a national agenda, which some provinces perceive as undermining provincial-specific needs. As a result, there is always tension between the two spheres of government with respect to the funding of competing priorities.

1.3.2 Lack of exercise of revenue powers

With respect to revenue assignments, South Africa currently has what can be considered as a weak assignment of revenue sources to provincial governments. The lack of both significant revenue sources and effective use of such sources raises an important question. The key question relates to the overall discretion that provinces can exercise over national transfers and provincial allocative efficiency. International experience suggests that greater levels of revenue autonomy tend to bring significantly higher benefits than costs (Martinez and Alm, 2008). Therefore, providing greater revenue autonomy to provinces becomes a viable route to take. The contrary view in South Africa's case is that revenue autonomy is not important because the assigned functions to provinces are mainly basic social services. By their nature, these functions are conveniently funded when financed through transfers from the centre.

Regardless of the appropriateness of the level of revenue autonomy and its use by the provincial governments, currently the formula used to determine the PES is perceived to be biased against fiscal (revenue) capacity. In South Africa the economic activity component only accounts for 1% of the equitable share to provinces. Although there are other countries that disregard revenue-capacity issues in their transfer systems, many other decentralised systems, in which provincial governments have their own-revenue sources, do equalise not only expenditure needs but also differences in fiscal capacity. So these systems are able to equalise more intensively across sub-national jurisdictions.

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1.3.3 Conditional grants

Conditional grants are another element of a well-designed decentralisation system, particularly in funding policies of national importance. Overall, the current system of conditional grants still faces important challenges. Among other reasons, the lack of clear expenditure responsibilities has resulted in a proliferation of conditional grants in recent times. It is of concern to the Commission that increasingly more funds are being channelled through conditional grants to overcome structural problems related to assignments of expenditure responsibilities. Although the constitution does not prescribe the balance between conditional and unconditional, the general practice has been biased against the former. There has also been, through precedent, an impression created that infrastructure should be primarily funded through conditional grants. This also implies that the equitable share is only meant to fund operational expenditure. The Commission is of the view that this should not be the case. In the past, the Commission has recommended that only backlogs in infrastructure should be funded through conditional grants.

1.3.4 Borrowing

Where there is an infrastructure backlog and low credit capacity, borrowing, in combination with conditional capital transfers, is an important element for addressing infrastructure needs of sub-national governments. A well-developed and mature decentralised system of finance requires the development of credit institutions to finance capital investment projects. Of course, borrowing has to be exercised under strict rules and financial discipline. In the case of South Africa, the Provincial Borrowing Powers Act makes provision for provinces to borrow. But the incompleteness of the decentralisation system, among other things, makes it difficult for borrowing to be pursued in a rigorous manner. A need for, and the usefulness of, borrowing will become more apparent as expenditure assignments (including those for capital infrastructure) are clarified for the provincial governments. At the same time, the creditworthiness of the provinces will be increased with their increased revenue autonomy

1.3.5 Institutional failures of the intergovernmental fiscal relations system

The weaknesses of the intergovernmental fiscal system are further embedded in the institutions set up primarily to promote cooperation between national and provincial government, as well as to facilitate alignment of policy and budgets on concurrent functions during the budget process. These institutions include statutory bodies such as the FFC and the Budget Council as well as intergovernmental forums such as Budget Forums, MinMecs, MinComBud and Presidential Coordinating Committee (PCC)[4]. While the national and provincial governments are represented within these bodies and in the budget process, there is a tendency for national government to dominate the proceedings and sometimes impose on the provinces. Equally the provinces' representation and participation in the process is at times perceived as inadequate given their capacity and inability to influence decisions at this level. Of particular importance is that the FFC's participation in this process has been non-existent (it is supposed to play a referee function), or, where it exists, is very low key given its observer status in most of these forums. As a result, intergovernmental fiscal disputes are elevated to institutions that operate outside of the budget process.

[4] MinMecs are sectoral committees comprising a minister and nine provincial members of executive councils that identify trends in the sector, set priorities, and discuss budgetary implications of national policies for provincial service delivery. MinComBud is a smaller technical subcommittee of the cabinet led by the Minister of Finance that is involved in the oversight of developing budget and its compliance with government goals. The PCC comprises the President and nine provincial Premiers and discusses budgetary issues and alignment of the budget with national policy.

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1.4 Issues in the design of the formula

1.4.1 Addressing the problem of multiple objectives

A common problem with the design of transfers, as in the case of equalisation grants, is that in many countries they get overloaded with many policy objectives. Eventually it becomes unclear what has been pursued or achieved with the transfer system. A very important general rule of policy design, and in particular for the design of transfers, is that a separate instrument must be used for each objective.

The PES formula attempts to achieve too many objectives and, as a result, it often does not achieve any one of them in a clear manner. Currently there are too many objectives other than equity/equalisation, such as revenue sharing, redistribution, being pursued with the PES transfer. For example, the 'economic activity' component of the formula can be interpreted as a form of revenue sharing on a derivation basis. It therefore needs to be treated separately from the formula, given its different objective to the rest of the formula. Revenue sharing is a form of transfer used in many countries as a solution to closing vertical fiscal imbalances (national governments collect much more than their expenditure responsibilities) and it may also be a way to let richer sub-national governments get their share in the wealth/revenues collected back to their territories.

An important objective of the national government is to ensure a minimum level of service for education, health, and (some aspects of) social welfare no matter in which province the citizens reside. The other objective is equity in the distribution of the resources. The problem is that neither of these two objectives are clearly defined and identified in the current system. What is a minimum level of service? How do we ensure that it is provided? What is the equity standard to be achieved? Does it imply, for example, that the relatively poorer get relatively more (in per capita terms) and if that is the case, how much more should they be receiving? These questions can only be answered by setting clearly defined norms for funding and spending, and standards for service delivery.

There is a need to re-interpret how to implement the constitutional mandate for the distribution of the equitable share. The direction set in the 2001 FFC proposal on costed norms was attempting to do exactly that. The 'equitable share' must be seen as a minimum pool of funds arrived at as a share in the annual tax collections of the national government. But, instead of distributing this pool through an all-comprehensive formula, it may be more transparent and effective to divide the pool into a number of sub-pools, in pursuit of clear and separate objectives enriched under every one of the formula's subcomponents.

1.4.2 Grant nature of the PES

The question to ask is should the PES transfer continue to be an unconditional, general-purpose funding grant for provincial governments, or should it be a conditional transfer with funds earmarked for expenditure priorities established by the national government? In terms of sections 227(1) and 214(1) of the Constitution, the equitable share is meant to be unconditional while 'other allocations' may be conditional. However, there remain debates regarding the autonomy that provincial governments should exercise over the PES to pursue their own priorities, against the provision of constitutionally defined and mandated basic services. As such the equitable share is often viewed by some provinces as a de facto block grant.

To proceed with the agenda of reforming the PES, further clarity is required on the nature of grant that the PES should be. If the PES is unconditional in nature, then the direction for the reform is to transform it into an equalisation transfer that provides general revenue funding to sub-national jurisdictions. Provision of such a grant is premised on the understanding that provinces have the autonomy in setting priorities for use of the transfer, subject to adhering to nationally set norms and standards. However, if the main purpose of the PES is to provide a set, minimum level of services to all citizens, then the PES should be

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transformed into an outright conditional transfer, with full accountability by the provinces to the national authorities on how the funds are being used.

The South African system has relied on dialogue, consensus, and persuasion between national government and the provinces to resolve this issue. These processes of dialogue between the two different levels of governments are very important and cannot be played down. However, it may be naïve to think that coordination and dialogue alone will give satisfactory answers to the question of who sets the priorities for the use of funds if there is disagreement between the two spheres of government. A different approach may thus be needed.

In conclusion, there are a few options available to choose from if we are to reform and improve the current architecture and performance of the PES. But all of them will require the goals of government to be made much more explicit than they currently are.

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1.5 Recommendations

With respect to the PES, the Commission recommends that:

On principles

a. Expenditure assignments between provinces and national government should be clarified beyond what is covered under Schedule 4 of the Constitution: A concerted effort is required to make a distinction between delegated responsibilities (for which the national government still retains a strong interest in performance) and own or devolved responsibilities of the provincial governments. There is also a need to emphasise exclusive assignments, as opposed to concurrent assignments, to increase accountability.

b. There should be a clear separation of instruments in the transfer system. The following principles should be observed:

   i. The equalisation grant should equalise on the basis of differences between expenditure needs.

   ii. There is a need to establish a system of conditional grants, which has performance aspects, and that clearly support the delivery of delegated responsibilities by sub-national governments.

   iii. There is a need for other transfers for regional development, including capital grants that need not be conditional.

c. Provincial governments should be encouraged to exercise the revenue powers conferred on them through section 228 of the Constitution and the Provincial Tax Regulation Process Act of 2003.

d. The ability of provinces to borrow should be carefully facilitated and linked to their revenue-raising capacity, as a way to close the infrastructure gap in a responsible and incentive-compatible fashion.

On reform options for the PES and formula

Option 1: The short-term solution

In the short term, the Commission recommends that the reform of the PES formula stays within the confines of the current constitutional dispensation. The Commission further recommends that:

a. The PES formula should retain for the most part its current structure, and only be reformed to bring it closer to a conventional equalisation grant, which equalises both expenditure and revenue.

   i. Both the expenditure needs and the fiscal capacity of each province should be defined by means of objective criteria that properly represent the objectives of horizontal equalisation.

   ii. Expenditure needs should be derived from all expenditure responsibilities of the provinces. Expenditure can be quantified on the basis of an explicit per client financial norms, determined in the annual budget cycle for the national government, or the costed norms approach.

   iii. The computation of the fiscal capacity must take into account the direct forecast receipts from revenue sharing for each province and the estimated potential revenues from own revenues, including the piggyback personal income tax and fuel levy if they were introduced.

b. The PES formula should be divided into a number of components in pursuit of clear and separate objectives.

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i. The 'economic activity' component of the PES formula should be removed to become a straightforward conventional form of revenue sharing, allocated either on a derivation basis or according to some other criterion such as the share of gross domestic product.

ii. Another part would be allocated for a system of conditional capital grants, mainly targeting backlogs in capital infrastructure and capital investment needs of provinces, especially for those that are not expected to be financed through borrowing, and should build on the current infrastructure grant for provinces.

iii. Most importantly, another component would be dedicated to implementing a system of unconditional equalisation grants that takes into account differences in expenditure needs and differences in fiscal capacity. The latter assumes that none of the expenditure assignments to the provincial governments (and in particular, education, health, and social welfare) are delegated. This would allow provinces complete autonomy to set priorities within the parameters of the Constitution, i.e. respecting the role of national government. An incentive system of matching grants should be developed to support the implementation of national priorities.

c. That institutional weakness in the budget process should be addressed as a matter of urgency to enhance cooperation between the two spheres, improve the enforcement of norms and standards and increase the capacity of national departments to monitor and build capacity of provincial counterparts. The role of the FFC as defined in the Constitution should be strengthened within the institutions dealing with division of revenue matters.

Option 2: Medium- to long-term solution

In the medium to long term the Commission recommends that the reforms should depart from the realisation that fixing the PES as a pool requires the fixing of other aspects of the current fiscal decentralisation system. Specifically, the reform of the PES will require the reform of current expenditure and revenue assignments between the national and provincial governments. The implementation of this option will require significant changes in the current legislation and amendments to schedules 4 and 5 of the Constitution in order to enable the conversion of several functions into delegated functions.

The Commission further recommends that this option should be considered with utmost caution owing to the inherent risks related to transition costs and the potential to compromise service delivery. It will be necessary to have a dedicated intergovernmental committee that will oversee and manage the transition process as well as identify potential risks.

a. Taking the education and health services out of the PES, and converting those components into separate block, conditional grants from the national government to the provinces. Under a block grant, the provincial governments will have the obligation to spend the grant in the particular expenditure area (for example, primary education) but they will also be free to determine how the funds are used within that area. Education and health services will remain concurrent responsibilities of the national government and the provinces. In the reformed expenditure assignment system, these services will be explicitly recognised as 'delegated' responsibilities from the national government to provinces (as opposed to provincial government's own responsibilities and concurrent functions but not delegated responsibilities). Under this redefinition, the national government will have explicit responsibility for securing adequate funding on behalf of the provinces for the provision of these services. Provincial governments will use their discretion to add their own funds for improved financing and speeding up service delivery. The national government will also have responsibility for establishing performance standards for the delegated services. The necessary level of funding for the delegated responsibilities in education and health will be determined in the annual budget of the national government, by using financial per client norms or any other expenditure quantification criteria. The quantification of expenditure needs can be improved by adjusting the norms for differences in the costs of provision across jurisdictions.

b. Removing the 'economic activity' component from the PES formula and converting it into a revenue-sharing pool. Because provincial governments will have added expenditure responsibilities, the current levels of revenue sharing will be maintained. This will be a mechanism to close the vertical gap between expenditure needs and financing ability of the provinces. Revenue sharing on a stable basis will increase the fiscal stability of provincial governments and will also be a way to let less poor, sub-national governments receive their share in the wealth/revenues collected within their boundaries.

c. Increasing the revenue autonomy of provincial governments by fully implementing the provisions of section 228 of the Constitution and the Provincial Tax Regulation Process Act of 2003.

d. Introducing an equalisation grant with the following features:

    i. A predetermined fixed funding rule, which allows beneficiary provinces to anticipate and plan, based on the funding that will be available from this grant from year to year; and

    ii. A distribution formula for the available funds, proportionate to the fiscal gap computed for each province, on the basis of the difference between allowable expenditure needs and fiscal capacity. Unlike the first option, expenditure needs will be a derivative of all expenditure responsibilities for provinces other than the delegated responsibilities (education and health) which are already minimally financed by the block grants.

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Chapter 2

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Chapter 2 Public Infrastructure Investment

2.1 Introduction

South Africa's pressing macroeconomic challenge is that of insufficient economic growth required to reduce high levels of unemployment and poverty. Recent empirical studies suggest that countries facing high unemployment and poverty, and lagging behind the technological frontier, need to invest significantly in infrastructure in order to enhance productivity and economic growth (Aghion et al., 2005; Vandenbussche et al., 2006). This chapter provides a measure of the impact that an expansion of public infrastructure spending above the baseline would have on economic growth, poverty and unemployment in South Africa.

A computable general equilibrium (CGE) model of the economy was developed and used to run and quantify the effects of a series of simulations focusing on water, health, roads and transport, electricity and communication infrastructure spending above those indicated in the baseline. It is contended that major investment to expand and upgrade existing infrastructure is necessary in order to address imbalances, backlogs and support developmental efforts particularly in areas that are struggling to come out of abject poverty. The increased estimates of infrastructure backlogs are an indication that the government has not put enough funding towards infrastructure. It can also be argued that maintenance spending is below where it should be. The only dedicated source of infrastructure funding for the provinces is the Schedule 4 Infrastructure Grant for Provinces, to which provinces are barely contributing from their own revenue. The grant in itself has performed well since inception (around 95%) which indicates a capacity to absorb extra money. The recent capacity deployed for the construction of the 2010 Fédération Internationale de Football Association (FIFA) World Cup Stadia and related infrastructure is further testimony that South Africa has reasonable capacity to absorb new and big cash injections of the magnitude envisaged in the simulations proposed in this chapter. This capacity will be idle and waste away if not deployed elsewhere, and infrastructure expansion offers part of the solution to this.

2.2 Constitutional and institutional framework supporting infrastructure[5]

2.2.1 The Constitutional Framework

The South African Constitution establishes the rights of citizens to have access to basic public services. In particular, section 27(1) of the Bill of Rights states that all citizens have the right to access to health care service, sufficient food and water, and social security. The Bill of Rights also makes special mention of education in section 29(1) by noting that all citizens have the right to basic and further education.

The Constitution also explicitly recognises that these rights can only be realised progressively because of limited resources. For example, section 27(2) of the Bill of Rights notes that: "The state must take reasonable legislative and other measures, within its available resources, to achieve the progressive realisation of each of these rights". Similar wording can be found in section 29 of the Constitution dealing with education where it is stated in part (b) that the state should make further education "progressively available and accessible". Interestingly, the Constitution leaves open the question of the standard of service provision that should eventually be provided.

Infrastructure provision to provinces and municipalities is one of the responsibilities of national government, especially through the provision of sufficient transfers for the purpose of their financing. Indeed, the

[5] The first two subsections of this section are an extract from the work we did recently reported in Petchey et al. (2007)

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Constitution makes special reference to these transfers. Section 214 Part (1) notes that "An Act of Parliament must provide for:

a. the equitable division of revenue raised nationally among the national, provincial and local spheres of government;

b. the determination of each province's equitable share of the provincial share of that revenue; and

c. any other allocations to provinces, local government or municipalities from the national government's share of that revenue, and any conditions on which those allocations may be made."

Section (214) Part (2) states that "The Act referred to in subsection (1) may be enacted only after the provincial governments, organised local government and the Financial and Fiscal Commission have been consulted, and any recommendations of the Commission have been considered".

This process has to take into account the following:

- the national interest;
- any provision that must be made in respect of the national debt and other national obligations;
- the needs and interest of the national government, determined by objective criteria;
- the needs and interests so that provinces and municipalities are able to provide basic services and perform the functions allocated to them;
- the fiscal capacity and efficiency of the provinces and municipalities;
- economic disparities within and amongst the provinces;
- obligations of the provinces and municipalities in terms of national legislation;
- the desirability of stable and predictable allocations of revenue shares; and
- the need for flexibility in responding to emergencies or other temporary needs, and other factors based on similar objective criteria.

Not only does the Constitution stipulate that decisions over the equitable shares must take account the matters listed above, it also says, in section 220 Part 3, that the Financial and Fiscal Commission must take these issues into account when making its recommendations to the national government on the equitable sharing of revenue between the spheres of government.

Thus, there is a constitutional case for the national government to use the existing intergovernmental grant system to provide progressively all citizens with uniform access to basic public services, which one might reasonably think of, at the very least, as including health, education, social security, transport, housing, water, sanitation and electricity.

2.2.2 The economic case for public infrastructure

Apart from the constitutional case for public infrastructure provision, the economics literature provides additional arguments for national governments to make transfers to other spheres of government, to ensure that uniform minimum standards of basic public services are provided to all citizens by making the requisite infrastructure. These arguments are now examined.

[6] See Aghion and Howitt (2000).

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a. Dynamic efficiency gains, human capital and economic growth

The literature on the causes of economic growth[6] presents evidence that education and health are important determinants of human capital formation. In turn, human capital formation is important for economic growth and rising per capita incomes over time. This is a lesson that has been well learned and applied in Asian economies over the past few decades, where large public investments in education and health have contributed to high economic growth. Since governments are major providers of these public services, they have a role to play in ensuring that such services are provided to increasing standards over time (to expand the formation of human capital and future economic growth). Hence, regional uniformity of provision of such services is important for maximising the gains from trade and ensuring the efficiency of internal common factor markets, but the level of the standard, and changes in that standard over time, are important for the rate of human capital formation and future economic growth. This is particularly important in South Africa where unemployment is high and there is a need for higher job growth.

Although it can be argued that higher public spending on human capital formation can have positive effects, there are also potentially negative consequences. Public capital expenditure has to be financed and could lead to the 'crowding out' of private sector investment. For example, government borrowing to fund the expenditure could raise interest rates and crowd out (potentially more efficient) private sector investment. Higher taxes will have a negative impact on private consumption and hence the demand for private goods. There is no clear-cut answer from theory as to whether the net effects of public spending on human capital formation are positive or negative, and the empirical evidence has yielded mixed results.

The question of whether there are economic gains from the provision of higher levels of public spending on human capital is more fundamental[7]. If a higher level of human capital raises the growth path of the economy, then it is justifiable on both equity and efficiency grounds. While no one will argue about the equity issues involved, some will no doubt argue that additional public spending on basic services in South Africa will create efficiency costs. There are a number of possible reasons for this. Firstly, whilst public capital is productive, this is by no means the consensus view empirically, and the literature contains a wide variety of estimates of the size of the marginal product of public capital ranging from positive to negative. Even if it is assumed that the additional output derived from additional public spending in South Africa is positive, critics might presumably ask further questions. Is the effect of such spending permanent or temporary, and, if temporary, of what magnitude and after what period of time can one expect positive effects? Government spending on public sector capital may have positive multiplier effects and may, therefore, raise economic activity and thus economic growth[8]. However, once installed will these effects drop to zero? The answer here is not clear; in a neoclassical growth model the effects on growth would be expected to be transitory, positive initially, but zero in the new steady state with a higher level of output. However, if public capital raises education and innovation, which might be expected in South Africa, the effects could be permanent and indeed much of the gains could come from spill-over effects raising the productivity of private sector capital and labour.

Secondly, critics of public spending would presumably argue that even if public capital were to have a positive effect, its magnitude would need to be compared to the productivity of private sector capital. However, if inefficient public capital spending is crowding out efficient private sector capital, the effects on the economy could be negative. Thirdly, consideration would have to be given to how the public spending is financed. Raising taxes or borrowing could both have negative effects on economic activity which might offset the gains of public sector capital spending.

[7] For a detailed discussion of relevant papers in this field see Aghion and Howitt (2000).

[8] These are often referred to as Solow-type growth models. In neoclassical growth models, the long-run rate of growth is exogenously determined – in other words, it is determined outside of the model. A common prediction of these models is that an economy will always converge towards a steady state rate of growth, which depends only on the rate of technological progress and the rate of labour force growth.

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b. Static efficiency and equity gains

There are also 'static efficiency'[9] and equity[10] arguments for having uniform minimum standards of public services in a decentralised economy. One is that they facilitate the free mobility of capital, labour, goods and services between regions, increasing the economic efficiency gains from having common goods and factor markets within a given country. This applies in particular to major public services such as health, education and transportation infrastructure. This argument for uniform minimum standards is well known and summarised in Boadway et al. (1994) and more recently in Boadway and Shah (2007) and is indeed recognised in section 146 of the Constitution as well.

Second, it is well known that if provincial tax and expenditure policies generate differential 'net fiscal benefits' across provinces (see Boadway, 2004), this may lead to fiscally induced migration of mobile factors of production, principally private sector capital and mobile labour, and hence inefficient location decisions. Essentially, net fiscal benefits are the differences between the benefit received from locating in a particular region and the tax contribution made. There may be a difference between the two for many reasons, including the public character of local services (e.g. education and health), subsidies built in to the pricing policies for locally provided services (e.g. water or housing) and differences in the concentration of inequality and poverty across regions. Inefficiency in the location decisions made by mobile factors of production results in lower national and regional output and, potentially, lower rates of economic growth since factors such as capital and labour are not being used where their marginal product is at its highest.

The most often argued solution to this problem is to have a system of fiscal equalisation among the provinces and local governments, which corrects for the differential net fiscal benefits and ensures that mobile factors of production migrate only in response to genuine economic factors, such as differences in marginal products (see Boadway, 2004). However, in the absence of such a system, uniformly provided public services can at least remove the incentive for factors of production, particularly labour, to make migration decisions based on differential access to public services. In this sense, uniform provision across provinces and local governments can reduce fiscally induced migration and hence may be efficiency enhancing.

Third, the presence of differential net fiscal benefits also implies that the well-known public finance principle of 'equal treatment of equals' may also be violated (Buchanan, 1951). This is because individuals who are otherwise identical will not be treated equally by the various systems of local public finance. Once again, the preferred solution is to have a system of fiscal equalisation across regions, and indeed one can show that the equalisation system that corrects for location inefficiencies also establishes horizontal equity (Boadway, 2004). As a second-best policy, uniform provision of public services across regions may also contribute to the goal of horizontal equity.

2.2.3 The institutional and funding framework

Responsibilities for capital investment within government are located across a number of government spheres and agencies. Strategic planning functions are typically coordinated by the Presidency at national level through the Accelerated and Shared Growth Initiative for South Africa (ASGISA). At provincial level, planning is undertaken by the Office of the Provincial Premier through Provincial Growth Development Plans whereas the Office of the Mayor at local level coordinates infrastructure plans through Integrated Development Plans (IDPs). Line departments are responsible for budgeting and expenditure on specific or sectoral infrastructure projects, coordinated at national and provincial level by the relevant treasuries. This is, however, not always the case where public entities have been established. Project implementation functions are located either with sector departments or special purposes departments, most notably the provincial Departments of Public Works (DPW) where Service Delivery Agreements (SDAs) have been entered into. Monitoring functions are less clear, with national and provincial treasuries playing a

[9] Static efficiency exists at a point in time and focuses on how much output can be produced now from a given stock of resources and whether producers are charging a price to consumers that fairly reflects the cost of the factors of production used to produce a good or a service.

[10] Equity concerns the distribution of resources and is inevitably linked with the concepts of fairness and social justice. A market may have achieved maximum efficiency but we may be concerned that the 'benefits' from market activity are unfairly shared out.

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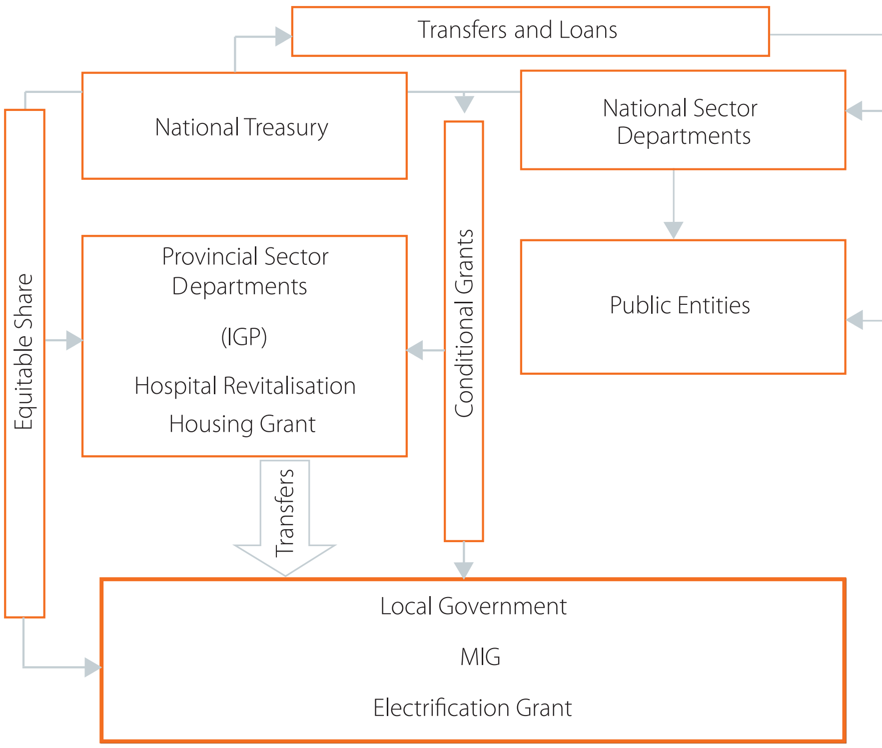
dominant role. The nature of this inter or intra governmental functional assignment requires extreme levels of coordination and cooperation between sector departments at all levels of the infrastructure development process.

Intergovernmental infrastructure financing evolved from sector-focused and project-based programmes that effectively earmarked resources for particular sectors, and required national approval of specific projects in each sector. These programmes were poorly designed and highly bureaucratic, leading to extensive delays in project approvals and very limited oversight of expenditure. They also displaced accountability for investment decisions from sub-national to national government departments (who in some cases were audited for individual project expenditures) (Savage, 2008). In 2002, the government introduced the provincial infrastructure grant (PIG), now the infrastructure grant for provinces (IGP) and the municipal infrastructure grant (MIG) as flagship, sub-national, infrastructure programmes. During the same year, the backlogs component within the provincial equitable share formula was removed due to the introduction of the IGP.

Public infrastructure is financed from various sources including government transfers, own revenue in the case of municipalities, private and public loans and to a limited extent Public Private Partnerships (PPPs) and concessions. The importance of these sources of infrastructure finance varies widely between and within various spheres of government and entities. Generally, provinces and municipalities rely heavily on government grants while entities are mainly financed through their own balance sheets (loans, sales of assets, dividends and so on).

Figure 1: Flow of intergovernmental infrastructure transfers



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The equitable share, which represents the provinces' vertical share of nationally raised revenue, forms an important cornerstone of unconditional infrastructure finance between the three spheres. However, most provinces and municipalities tend to use their equitable share for funding operational or current expenditure. For that reason, a plethora of conditional infrastructure grants to provinces and municipalities have been introduced to circumvent under-utilisation of equitable share on infrastructure. Traditionally, conditional grants are meant to fund programmes of national importance such as housing (e.g. housing for the poor), health (e.g. spill-overs in health) etc., or supplement programmes that are partly funded by sub-national governments. There are two types of infrastructure conditional grants in the South African system, namely Schedule 4 or specific purpose grants (such as in health revitalisation) and Schedule 5 (such as the MIG) (see Josie et al., 2006, for a comprehensive discussion of conditional grants in South Africa).

The largest contributor of conditional infrastructure finance to provinces is the IGP, which is mainly used for all infrastructure functions of provinces. In addition to the IGP, provinces have several key specific-purpose infrastructure grants, namely the hospital revitalisation grant, the integrated housing and human settlement development grant (IHHSDG) and the further education and training college sector recapitalisation grant. Due to insufficient revenue-raising powers and concerns over debt-service costs, provinces are unable to source private funding to finance their infrastructure projects (Savage, 2008). However, legislations such as the Public Finance Management Act of 1999 and Provincial Borrowing Powers Act of 1996 make provision for intergovernmental lending, where the National Treasury borrows on behalf of provinces.[11]

The largest conditional infrastructure transfers for municipalities are the MIG, public transport infrastructure and systems (PTIS) grant and the 2010 FIFA World Cup stadium development grant. Municipalities further use own revenue from user charges and property taxes, equitable share and loans to supplement their infrastructure budget. Many local governments, with the exception of category C[12] municipalities, have the ability to raise a substantial amount of revenue. Category A[13] and B[14] municipalities have access to the property tax and all local governments can charge user fees for the provision of services.[15] Fees for potable water and for the distribution of electricity are widespread. Among local governments, the actual capacity to raise revenue differs substantially. In the country's six metropolitan areas, locally-raised revenues account for over 95% of total revenue, while in many rural areas the local contributions fund only 10-25% of local spending (National Treasury, 2008).

Table 1 below shows the overall infrastructure expenditure estimates from the Medium-Term Expenditure Framework (MTEF) by sphere and selected major government entities. At an intergovernmental level, it is clear that provincial government accounts for a bigger share of infrastructure spending followed by municipalities. These two spheres are predominately responsible for social infrastructure financed mainly from grants.

[11] The Gauteng Loan Agreement is a case in point. Similarly the Municipal Finance Management Act of 2003 provides the legislative framework for municipal borrowing.
[12] A municipality that has municipal executive and legislative authority in an area that includes more than one municipality.
[13] A municipality that has exclusive municipal executive and legislative authority in its area.
[14] A municipality that has exclusive municipal executive and legislative authority in its area.
[15] Although the recently enacted Property Tax Rates Bill authorised all municipal governments in South Africa to levy a property tax, revenue from the property tax is relatively modest in many, especially rural, municipalities. The new property rates legislation provides the legal framework for municipal governments to tax agricultural land and public service infrastructure. The absence of administrative capacity in many municipalities suggests that expansions of the property tax base will occur only slowly.

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Table 1: 2008 MTEF: infrastructure expenditure estimates

	2006/07	2007/08	2008/09	2009/10	2010/11
R Million		**Estimate**	**Medium Term**		
National Departments	4 626	4 810	5 601	6 367	8 899
Provincial Departments	26 731	32 709	34 432	42 481	44 502
Municipalities	21 441	28 768	30 663	33 871	36 773
Public Private Partnerships of which	2 443	4 050	7 886	9 288	11 367
South African National Road Agency (SANRAL)		797	1 429	1 807	2 732
Extra budgetary public entities	3 999	4 747	4 950	5 323	7 814
Non financial public enterprises, of which	37 176	53 165	64 570	63 956	63 687
Eskom		23 803	25 010	34 010	31 578
Transnet		16 935	21 481	17 480	12 714
Infraco	627		1 131	872	92
South African Rail Commuter Corporation (SARCC/Metrorail) rolling stock, signalling, buildings, tracks and equipment	688	1 029	1 696	2 267	3 484
SARCC PTIS and grant		180	476	210	450
SANRAL PTIS grant			130	100	200
Total	**96 416**	**128 249**	**148 102**	**161 286**	**173 042**
Percentage Gross Domestic Product (GDP)	5.4	6.4	6.6	6.6	6.4
GDP	**178 731**	**2 019 148**	**2 230 281**	**2 458 882**	**2 723 837**

Public entities on the other hand account for a bigger share of the total spending on economic infrastructure. Both Eskom and Transnet play an integral role in this respect (see Table 2).

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Table 2: National consolidated infrastructure budgets and expenditure as at March 2007

	2006/07	2007/08	2008/09	2009/10	2011/12
R Million		**Estimate**	**Medium Term**		
Transnet capital expenditure (Capex)					
Transnet Freight Rail		7 878	8 869	7 210	5 603
Transnet National Port Authority		3 949	5 691	4 631	2 452
Transnet Port Terminals		3 136	2 642	1 343	1 338
Pipelines		900	3 282	3 289	2 302
Rail Engineering		699	774	796	866
Other continuing business		373	223	211	153
Total		**16 935**	**21 481**	**17 480**	**12 714**
Eskom Capex					
Generation		15 837	20 057	23 802	23 200
Transmission		3 739	6 393	4 831	3 637
Distribution		3 797	4 327	4 569	4 113
Corporate		430	693	808	628
New Business					
Total Funded By Eskom		**23 803**	**31 470**	**34 010**	**31 578**

The distinction between funding for social and economic infrastructure follows conventional practices, where social infrastructure is financed by grants and economic infrastructure is financed in part by private funding.

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2.3 The CGE model and simulations

This analysis aims at providing an economy-wide impact analysis of public infrastructure. The analysis makes use of a CGE model designed for the South African economy. While these models are not the only tools available for economic impact analysis, they represent the type of tools that are most frequently used within the public sector. The CGE model used is the one recently developed in Fofana et al. (2007; 2008) for the Financial and Fiscal Commission.

The following simulations were performed using the CGE model:

- *Simulation 1*: The impact of a 10% increase in water infrastructure above the baseline.
- *Simulation 2*: The impact of a 10% increase in health infrastructure above the baseline.
- *Simulation 3*: The impact of a 10% increase in electricity infrastructure above the baseline.
- *Simulation 4*: The impact of a 10% increase in roads and transport infrastructure above the baseline.
- *Simulation 5*: The impact of a 10% increase in communications infrastructure above the baseline.

The simulated amounts are the benefits to different sectors as a result of the infrastructure initiative. Results on economic growth, exports, investment, sectoral performance, labour demand, and income distribution between households among others are discussed.

2.3.1 A 10% increase in water infrastructure above baseline

This simulation takes into account all infrastructure investment in water. The macroeconomic impact of the full simulation is given in Table 3. A 10% increase in capital in the water sector leads to an increase in the output of the water sector and related sectors. This increase leads to a slight increase in GDP of 0.02%. Because of increased output, consumer prices fall slightly, by 0.04%.

The increase in capital means that labour becomes more expensive and its wage goes up by 0.01%. The urban high-skilled workers (who are closer substitutes to capital compared to unskilled workers and who are used the most in the water sector) contribute to most of this increase. Employment generally falls in the economy due to the reduction in the overall price of capital.

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Table 3: Macroeconomic effects of a 10% increase in water infrastructure

Variable	Variation (%)
Price index	-0.02
Import	0.01
Export	0.00
Unemployment rate*	0.01
Wage	0.01
Rent	-0.06
Consumer Price Index (CPI)	-0.04
Consumption	0.03
Saving	-0.19
Investment price	0.15
Investment	0.02
GDP	0.02
Employment	-0.01
Employment urban	0.00
Employment rural	-0.10
Gross wage high skilled	0.05
Gross wage low skilled	-0.03
Gross wage high skilled urban	0.05
Gross wage low skilled urban	-0.02
Gross wage high skilled rural	-0.01
Gross wage low skilled rural	-0.15
Gross wage urban	0.01
Gross wage rural	-0.12

Note: Variations computed as per cent changes; *except for unemployment rate expressed as percentage point changes.

Source: Compilation from water infrastructure shock using the CGE model for South Africa

A sectoral breakdown showing which sectors gain from this infrastructure programme is discussed next. Water consumes a lot of light manufacturing products, (such as chemicals, pumps etc.) and services (such as electricity, insurance etc.). As water supply increases, this induces an increase in the demand for these products, leading to price increases for the product. This demand induces price increases in light manufacturing and services sectors. At the same time those sectors that use a lot of water, such as food manufacturing and mining, benefit from the reduced prices and increase their output. The increased supply in these sectors leads to reduced prices in the affected sectors.

The policy is neutral on household welfare as Table 4 shows. Changes in the cost of living are exactly offset by changes in the disposable income, leaving the equivalent variation unaffected.

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Table 4: Welfare effects of a 10% increase in water infrastructure (per cent)

	Disposable income	CPI	Equivalent variation
Urban households	0	-0.1	0
Rural households	-0.1	0	0
ALL	0	0	0

Note: Equivalent variation of gross income

Source: Compilation from water infrastructure shock using the CGE model for South Africa

2.3.2 A 10% increase in health infrastructure above baseline

This simulation involves a 10% increase in health infrastructure. In this experiment GDP goes up by 0.13%, driven mainly by consumption that is increasing substantially by 0.24% (see Table 5). The health sector tends to be more labour intensive than the other five sectors. Thus all skill types of labour experience an increase in demand and unemployment falls.

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Table 5: Macroeconomic effects of a 10% increase in health infrastructure

Variable	Variation (%)
Price index	-0.19
Import	0.06
Export	0.06
Unemployment rate*	-0.10
Wage	0.06
Rent	-0.54
CPI	-0.20
Consumption	0.24
Saving	-0.21
Investment price	-0.03
Investment	-0.03
GDP	0.13
Employment	0.12
Employment urban	0.12
Employment rural	0.15
Gross wage high skilled	0.44
Gross wage low skilled	0.01
Gross wage high skilled urban	0.26
Gross wage low skilled urban	0.01
Gross wage high skilled rural	4.29
Gross wage low skilled rural	0.00
Gross wage urban	0.11
Gross wage rural	0.89

Note: Variations computed as per cent changes; *except for unemployment rate expressed as percentage point changes.

Source: Compilation from health infrastructure shock using the CGE model for South Africa

As services prices fall, those in the rest of the economy also fall and the overall CPI falls. The falling input prices in the economy induce an increase in output in most sectors. The sectors that benefit the most are, once again, services sectors that have strong linkages with this sector. The sectors that benefit the most use unskilled labour relatively intensively and, as a result, there are benefits to this type of labour. This is reflected in the incomes of the households, which increase in rural areas. The advantage of falling prices means that both rural and urban households see an increase in their welfare.

2.3.3 A 10% increase in electricity infrastructure above baseline

A 10% increase in capital infrastructure in the electricity sector leads to the macroeconomic effects displayed in Table 6. The simulation leads to an increase in GDP of 0.19%. Private consumption rises as incomes have gone up. With a given current account balance, the increase in output induces a real exchange rate depreciation, which leads to an increase in exports and consequently imports. The increase in investment, consumption and exports all contribute to the increase in GDP.

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Table 6: Macroeconomic effects of a 10% increase in electricity infrastructure

Variable	Variation (%)
Real Exchange Rate	-0.24
Imports	0.18
Exports	0.22
Unemployment rate*	-0.17
Wage	-0.04
Rent	-0.28
Consumer Price Index	-0.12
Consumption	0.16
Saving	0.50
Investment Price	0.02
Investment	0.43
GDP	0.19
Employment	0.20

Note: Variations computed as per cent changes; *except for unemployment rate expressed as percentage point changes.

Source: Compilation from electricity infrastructure shock using the CGE model for South Africa

The main mechanism behind the mesoeconomic/sectoral production effects comes from the investment closure. As demand for investment products increases in line with increased infrastructure demand, industries, whose products are used intensively in investment, experience substantial increases in their demand and consequently their output. Coal is heavily utilised in electricity production and experiences the highest increase in output. Heavy manufacturing, light manufacturing and mining have among the highest shares of their product in total investment demand and hence experience higher than the economy-wide average increase.

Consumption prices in real terms decrease for all households. In contrast, disposable income increases for urban households while it falls for rural households. However, the price reductions in real terms are more important so that the welfare effect, as measured by the equivalent variation, is positive for all households.

2.3.4 A 10% increase in roads and transport infrastructure above baseline

The fourth simulation mimics an increase in transport infrastructure by simulating a 10% increase in capital used in the transport sector. Table 7 reports on the macroeconomic results of this simulation. This increase leads to an increase in GDP of 0.44%. This is afforded by the increase in investment, consumption and government consumption that all go up. The unemployment rate falls while the price index increases marginally by 0.04%. As savings are investment driven, the increase in investment requires an increase in savings. This comes from increasing incomes of households, government and firms.

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Table 7: Macroeconomic effects of a 10% increase in roads and transport infrastructure

Variable	Variation (%)
Price index	0.04
Import	0.30
Export	0.52
Unemployment rate*	-0.14
Wage	0.61
Rent	-0.64
CPI	0.19
Consumption	0.41
Saving	0.82
Investment price	0.12
Investment	0.51
GDP	0.44
Employment	0.16
Employment urban	0.14
Employment rural	0.46
Gross wage high skilled	1.46
Gross wage low skilled	0.32
Gross wage high skilled urban	1.13
Gross wage low skilled urban	0.28
Gross wage high skilled rural	8.31
Gross wage low skilled rural	0.62
Gross wage urban	0.64
Gross wage rural	2.22

Note: Variations computed as per cent changes; *except for unemployment rate expressed as percentage point changes.

Source: Compilation from roads and transport infrastructure shock using the CGE model for South Africa

The services sectors, which have the larger backward linkages with transport, benefit from increased demand for inputs. This allows them to produce more output. The sectors with large forward linkages with transport, such as mining, are able to increase output at lower prices, as transport inputs become cheaper.

Table 8 shows that household welfare increases as indicated by the positive equivalent variation. Welfare increases more for rural households than for urban households. This is because they receive a higher boost to their disposable income compared to urban households from the simulation.

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Table 8: Welfare effect of a 10% increase in roads and transport infrastructure (per cent)

	Disposable Income	CPI	Equivalent Variation
Urban households	0.4	0.2	0.2
Rural households	0.8	0.2	0.5
ALL	0.5	0.2	0.3

Note: Equivalent variation of gross income

Source: Compilation from roads and transport infrastructure shock using the CGE model for South Africa

2.3.5 A 10% increase in communications infrastructure above baseline

The results of a 10% increase in capital used in the communications sector show similar patterns to those of the previous simulations. GDP goes up by 0.34%. The growth of communications induces increases in investment, consumption and exports, leading to an increase in GDP. As savings are investment driven, the increase in investment requires an increase in savings. As will be seen later, this comes from increasing incomes of households and firms. Government dis-saving also falls by 1.3%, as a result of indirect product and direct taxes that go up while import taxes fall. The overall effect is an increase in government revenue leading to a reduction in government dis-saving.

The communications sector has strong backward and forward linkages with the services industry. Hence, as its output increases, the output of services also increases with the result that prices fall in the services sector. Other sectors that use services sector inputs intensively, especially services themselves, benefit further from the reduced prices. Petroleum, which is a main input in communication, responds by increasing output.

As demand for labour falls, especially in the rural areas, rural households see a 0.4% fall in their income while urban households' income increases by 0.3%. The CPI decreases in the urban areas and remains the same in the rural areas, with the result that the equivalent variation increases for urban households and falls for rural households. Overall, welfare increases following an increase in capital in the communications sector as shown in Table 9.

Table 9: Welfare effect of a 10% increase in communications infrastructure (per cent)

	Disposable income	CPI	Equivalent Variation
Urban households	0.3	-0.1	0.3
Rural households	-0.4	0.0	-0.3
ALL	0.2	-0.1	0.2

Note: Equivalent variation of gross income

Source: Compilation from ccommunications infrastructure shock using the CGE model for South Africa

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2.4 Conclusion and recommendations

This chapter confirms that increases in public spending, above those budgeted for, on infrastructure in the medium term expenditure framework, have beneficial effects on the economy. Gross domestic product increases as consumption and investment increase. On sectoral effects, output of the affected sectors increases as capital increases and the sectors with strong backward and forward linkages are also affected. Furthermore, analysis of the economic and welfare effects shows that the impact depends on the nature of factor markets. As capital increases, labour becomes relatively scarce and its value increases in the capital-intensive sectors. In the labour-intensive sectors, the type of labour that is used intensively sees a fall in its wages when there is an injection of capital. These differential effects mean that household effects also differ between rural and urban areas. Generally though, overall household welfare improves with these policies.

The Commission finds that maintaining, expanding, and modernising South Africa's infrastructure is beneficial for the country's continued economic wellbeing and in raising the quality of life for households. The Commission acknowledges, based on these results and experience, that fiscal stresses in national, provincial and local budgets, along with growing competition from the rest of the world and other domestic competing uses of limited resources, demand urgent efforts to improve investment efficiency, programme coordination, and economic productivity in the nation's infrastructure programmes.

The Commission makes the following recommendations:

1. The government should review upwards the departmental baselines and increase the quantum of appropriate investment in public infrastructure (national, provincial and municipal): Macro-micro modelling done by the Commission, as well as international experience, has shown that investment in appropriate infrastructure leads to reduced unemployment and poverty. The Commission recommends that increased funding be directed towards infrastructure programmes that are linked to basic services including water, health, electricity, roads, transport and communication.

2. For funds already in the system, the Commission recommends that the government should improve the quality of targeted outcomes of infrastructure investment towards employment creation and poverty reduction. Leveraging from efficiency gains throughout all baselines of departments should be made an ongoing exercise, as it strengthens the link between planning and spending, especially within the provincial sphere of government.

3. The Commission recommends that the government should implement a fully comprehensive national infrastructure maintenance strategy, especially for those infrastructure classes with a high impact on unemployment and poverty, with dedicated maintenance objectives. To achieve sustainable outcomes, the government must improve management of infrastructure investment by building in/safeguarding adequate future lifecycle replacement and maintenance provision of the infrastructure.

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4. The Commission recommends that government develops appropriate funding mechanisms through intergovernmental coordination to facilitate, integrate and sequence infrastructure planning and delivery. Such planning should:

   a Support stronger municipal management, especially for capital expenditure and maintenance programmes, and resolve lingering policy uncertainty. A case in point relates to the Regional Electricity Distribution reforms which have stalled and, as a consequence, are currently undermining municipal investment in infrastructure and maintenance.

   b Improve long-term planning for state investments:

      i. Use best practice from effective state owned agencies for infrastructure planning, management, spending and maintenance.

      ii. Complete comprehensive infrastructure monitoring and evaluation system.

      iii. Use common methodologies for calculating costs and benefits for project appraisal.

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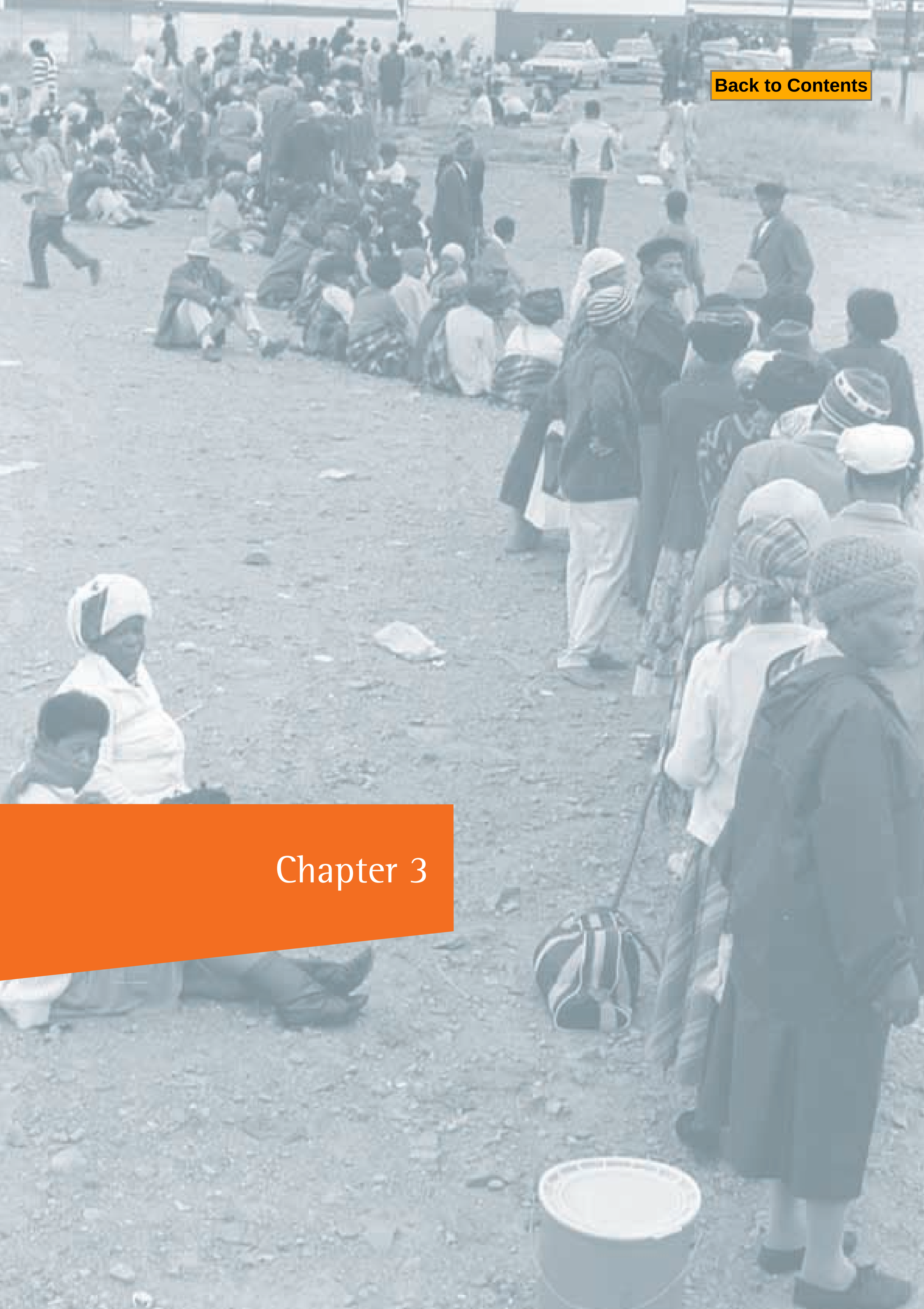

Chapter 3

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Chapter 3 Efficiency and Equity Effects of Social Grants

3.1 Introduction

Social security systems provide protection against the risk of income loss due to contingencies such as old age, unemployment, disability, or injuries sustained at work. As such, they play an important role in smoothing consumption by redistributing income across time, between generations and amongst the insured, according to risk and vulnerability. Social security systems typically consist of three parts:[16]

- Social insurance: benefits organised by the state and funded by means of specified contributions by employers and employees;
- Social assistance (grants): non-contributory cash or in-kind grants to provide protection to the most needy;
- Informal insurance: cash or in-kind assistance from the extended family and other social networks.

Despite being a middle-income country, South Africa has an extensive formal social security system with many of the trappings of a modern welfare state. This chapter focuses on the social assistance part of the system, which is particularly well developed by international standards.

3.2 South Africa's social security framework

3.2.1 The Constitutional framework

Section 27(1)(c) of the Constitution of the Republic of South Africa (No. 108 of 1996) stipulates that everyone has the right to have access to social security, including appropriate social assistance for those unable to support themselves. As is the case with various other social rights conferred by the Bill of Rights (Chapter 2 of the Constitution), it is stated further that the state should take reasonable legislative and other measures, within its available resources, to achieve the progressive realisation of this right. Hence, the South African Constitution is transformative in nature: "... it does not simply place limits on the exercise of collective power ... but requires collective power to be used to advance ideals of freedom, equality, dignity and social justice" (Brand, 2005: 1).

For the governments of middle-income countries such as South Africa, giving effect to such constitutional social rights represents a major challenge. The post-apartheid government has managed to maintain fiscal discipline while significantly expanding the coverage and poverty-alleviating impact of the social assistance system. However, whether or not enough has been done to satisfy the constitutional imperative is obviously difficult to establish, and some human-rights advocates have argued that a more aggressive approach was required in view of the extent and persistence of poverty in South Africa (e.g. South African Human Rights Commission, 2006: 65-66).

The Constitutional Court has approached its role as the custodian of the constitutional socio-economic rights with circumspection, and has been reluctant to impose additional policy burdens on the executive (Davis, 2006: 304). On the whole, the Court has rejected the notion that the South African government has a minimum core obligation to the people of the country as far as realising socio-economic rights is concerned; instead, its jurisprudence has reflected a reasonableness approach that emphasises

[16] Social security systems are often complemented by other social programmes such as education and training programmes, health insurance schemes, specialised care facilities and protective labour-market policies. These programmes fall outside the scope of this report.

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"… rationality (non-arbitrariness); a demand for reasons backed up by evidence (justification); and proportionality between means and ends, between advantages and disadvantages" (Pillay, 2007: 4).[17]

The Constitutional Court nonetheless has not shied away from making judgments with significant budgetary implications.[18] This was affirmed in a case heard on 13 and 30 May 2003 and decided on 4 March 2004: Khosa and others versus Minister of Social Development, no 2004(6) SA 505(CC), that dealt with sections of the Social Assistance Act (No. 59 of 1992), which disqualified persons who were not South African citizens from receiving social assistance grants. The Court ruled that the citizenship requirement infringed the constitutional right to equality of citizens of other countries living in South Africa as permanent residents, and that permanent residents were bearers of the right to social security that the Constitution vested in 'everyone'. Accordingly, the Social Assistance Act (No. 13 of 2004) expanded the eligibility for social assistance to include South African citizens and persons resident in the Republic.

3.2.2 Social security administration

The social security funds (the Compensation Fund, the Road Accident Fund and the Unemployment Insurance Fund) are section 3A public entities, that is, extensions of government departments with mandates to fulfil specific economic or social responsibilities of the government. Legislation governs the management, operations and reporting obligations of these funds. The commissioners of the Compensation Fund and the Unemployment Insurance Fund report to the Minister of Labour, while the chief executive of the Road Accident Fund reports to the Minister of Transport.

Schedule 4 of the Constitution of the Republic of South Africa (No. 108 of 1996) lists welfare services as a functional area of concurrent national and provincial legislative competence. The White Paper for Social Welfare (Department of Welfare, 1997) proposed the following division of labour:

- National government is responsible for developing generic norms and standards for providing services, and for ensuring that uniformity in the performance of particular functions is maintained.
- Provinces are responsible, concurrently with the national department, for planning, developing and providing services. However, where mutual cooperation between national and provincial departments is essential, powers are allocated concurrently.

In practice, this has boiled down to a separation between the administrative and delivery aspects of the social assistance system: overall responsibility for policy and administration is vested in the national Department of Social Development (DSD), while provincial departments manage the payment of social grants. In 2004, the administration and disbursement of social grants were unified when the South African Social Security Agency Act (No. 9 of 2004) established the South African Social Security Agency (SASSA). Its mandate is regulated by the Social Assistance Act (No. 13 of 2004). Following the transfer of the social assistance administration and payment service functions to SASSA in 2006 and 2007, the national DSD now focuses on the development and review of social policy and the monitoring of service delivery. The delivery of social welfare services is now the main activity of the provincial departments of social development.

SASSA was created to promote efficiency and improve service delivery in the social assistance system, mainly by improving coordination and raising administrative standards. It is envisaged, for example, that consolidation and standardisation of contracts with grant payment contractors (which account for 76% of total payments to beneficiaries) would reduce the administrative costs of providing social grants (National Treasury, 2008: 330). SASSA has also made a concerted effort to combat fraud by cleaning up its records of recipients. Among other initiatives, regular audits of the social pension system (SOCPEN) were introduced in conjunction with the DSD and the Special Investigations Unit. In 2008 it was reported that these audits have yielded the following results (National Treasury, 2008: 329):

[17] The notion of a minimum core obligation was introduced by the United Nations' Committee on Economic, Social and Cultural Rights in its General Comment 3 (released in 1990).
[18] In the judgment in the case of the Minister of Health versus Treatment Action Campaign, no 2002(5) SA 721(CC), the Court distinguished between scrutiny of budgetary issues directed at 'rearranging budgets' and scrutiny of budgetary issues with 'budgetary implications', indicating that the first type is not its domain.

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- 21 588 government employees who were on the system illegally have been removed and subjected to disciplinary actions.
- Apart from these government employees, the removal from the system of an additional 143 485 people has been recommended as well.
- The annual value of the 165 073 grants that have been suspended totalled R424 million.
- 6 693 people have been arrested and taken to court, where a conviction rate of more than 80% was achieved.
- Acknowledgements of debts amounting to R77.5 million have been signed, and R16.6 million has been recovered from un-entitled beneficiaries.
- The payment of grants to 123 610 beneficiaries has been cancelled because of non-collection or direct requests from beneficiaries.

The Social Assistance Act (No. 13 of 2004) established an independent Inspectorate for Social Assistance, funded by money appropriated by Parliament to combat abuse of the social assistance system and to audit compliance by SASSA with regulatory and policy measures and instruments.

3.2.3 The budgeting framework

Currently the budget for social assistance transfers falls under the programme entitled the Comprehensive Social Security Framework, part of the DSD's budget, from where it is transferred to SASSA for disbursement. The provincial equitable share (PES) formula does not cater directly for social assistance since the social development component was replaced with the poverty component.

Two broader sets of reforms during the recent past have also affected the budgetary framework governing the social assistance system. In November 1997, South Africa entered a new phase of fiscal planning with the publication of the first Medium-Term Budget Policy Statement (MTBPS). Subsequent budgets have been presented in the context of a medium-term policy framework consisting of three-year rolling expenditure and revenue projections for the national and provincial governments compiled against the backdrop of economic and fiscal goals and prospects for the economy.

The promulgation of the Public Finance Management Act (PFMA) of 1999 was a major step towards increasing the transparency and accountability of fiscal policy-making in South Africa. The Act emphasises regular financial reporting, sound internal expenditure controls, independent audit and supervision of control systems, improved accounting standards and training of financial managers, and greater emphasis on outputs and performance monitoring. Furthermore, it compels the South African fiscal authorities to disclose annually their longer-term objectives and views about future trends in fiscal policy, along the lines of the existing medium-term budgeting framework.

3.3 International perspective on social grants

Social insurance programmes absorb about 85% of total social security expenditure in Organisation for Economic Cooperation and Development (OECD) countries and social assistance schemes the remaining 15% (World Bank, 2006: 1).[19] The overall coverage of social assistance schemes remains low despite significant increases in the number of recipients of grants since 1980: in 1999, only 3% of the working-age populations of continental European countries and 9% of that of the United Kingdom received targeted social assistance benefits (De Neubourg et al., 2007: 17-18).[20] Social assistance schemes therefore play a

[19] These averages mask considerable variation. Anglo-Saxon countries generally devote larger chunks of their social security outlays to social assistance schemes and correspondingly smaller portions to social insurance programmes than the countries of continental Europe (International Labour Organisation, 2000: 181; World Bank, 2006: 2).

[20] The International Labour Organisation (2000: 180) ascribed this increase in the number of social assistance beneficiaries to growing unemployment, changes in employment patterns that have prevented growing numbers of workers from accumulating adequate entitlements for full income protection, the proliferation of single-parent families, and reductions in the levels of social insurance benefits.

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residual role in the social security systems of most industrialised countries and their impact on poverty and inequality tends to be marginal. Such schemes nonetheless are very effective at, as De Neubourg et al. (2007: 13) put it, "weaving the safety net tightly" for those needy people who receive inadequate or no benefits from contributory programmes and other forms of social protection (cf. also International Labour Organisation, 2000: 179). In a number of these countries, social assistance programmes function as income-guarantee schemes that complement contributory schemes by providing tax-financed, minimum incomes on a means-tested basis. Other common types of social transfers in OECD countries include cash and in-kind housing benefits, universal or means-tested family benefits, cash benefits for lone parents, employment-conditional benefits for able-bodied individuals, and child-care benefits (World Bank, 2006: 3).

In recent decades, a number of trends in OECD countries have caused concern about the long-term financial viability of social protection systems, including rising long-term unemployment, globalisation-induced pressure on tax bases and tax rates, population ageing, and changes in family structures such as growing numbers of one-parent families (World Bank, 2006: 5). Along with mounting unwillingness among taxpayers to pay for social protection, caused in part by perceptions of growing welfare dependence among the recipients of grants (cf. De Neubourg et al., 2007: 30), these trends have stimulated widespread reform of social assistance and other components of social security systems. The remainder of this subsection discusses the nature of these reforms in broad terms and provides a more detailed review of one of its most prominent examples, namely workfare programmes.

Debates about the reform of social assistance schemes in OECD countries have revolved around links between the nature of such schemes, work incentives, and social exclusion.[21] To discourage dependence on social grants, many OECD countries have reduced the amounts and duration of benefits and tightened the requirement that beneficiaries should actively seek work (World Bank, 2006: 7). Such reforms have often been accompanied by the following measures to encourage working and social inclusion: terminating the practice of cancelling benefits when recipients obtain part-time work; changing the delivery of benefits from the household to individuals so that individuals do not jeopardise the household's access to benefits when they find jobs; providing benefits conditional on finding employment (e.g. cash bonuses, wage supplements and tax credits); and offering more assistance to job seekers (labour-market information, training programmes, etc.) (World Bank, 2006: 7). This has been described as a shift from protective to productive modes of providing social assistance (and social protection more generally) (Hudson and Kühner, 2009).[22]

The United States (US) pioneered modern welfare reforms aimed at integrating recipients of social benefits into the formal labour market. The approach, which has become known as workfare[23], can be traced back to experimental programmes introduced by the Reagan Administration in 1981, but which reached maturity under the Clinton Administration with the implementation of the Personal Responsibility and Work Opportunity Act (PRWORA) of 1996 and other welfare reforms. Ochel (2005: 78) defined workfare as "programmes or schemes that require people to work in return for social assistance benefits" and stressed three aspects of this definition:

- Participation in workfare programmes is compulsory for unemployed people deemed physically and mentally able to work, and non-compliance with programme requirements could jeopardise recipients' benefits.
- The primary focus of workfare programmes is work, while training and other mechanisms to achieve reintegration into the labour market are of secondary importance.
- Workfare programmes are linked with policies tied to the lowest tier of public income support.

[21] Social exclusion is defined as "... a multi-dimensional socio-economic conception of deprivation" that often involves "... the development of an 'underclass' mentality, with little emphasis on the per¬sonal responsibility to find work." (World Bank, 2006: 7).
[22] There is some debate about the actual extent of this shift in focus. Hudson and Kühner (2009), for example, compared the welfare states of 23 OECD countries in 1994, 1998 and 2003 and found that a shift towards the productive model of social protection occurred in some but by no means all of them.
[23] According to Kildal (2001: 3), the term 'workfare' is derived from 'work-for-your-welfare' or 'welfare-for-work'.

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The major elements of US workfare programmes are as follows (cf. Blank, 2004: 4-8). First, PRWORA abolished the matching-grant aid to families with dependent children (AFDC) programme and replaced it with temporary assistance to needy families (TANF), which it provided to states in the form of a block grant. The introduction of TANF allowed the states more discretion over programme design than the AFDC had. Such a block grant needs to be carefully designed because the full financial risk of cycles in assistance needs is transferred to the states. The PRWORA legislation also made access to federal funds conditional on states placing larger numbers of their active welfare recipients in jobs, limited TANF-funded assistance to 60 months over the full lifetimes of individuals, and limited access to income assistance programmes among targeted groups (e.g. immigrants and certain categories of disabled persons).

The states responded to the PRWORA legislation by:

- markedly expanding their welfare-to-work programmes;
- reducing the earnings disregard (i.e. the rate at which cash benefits decrease as earnings increase) to encourage working;
- enforcing benefit losses on assistance recipients who did not participate in work programmes;
- enforcing the federal 60-month limit on eligibility for TANF-funded assistance and, in some cases, setting and implementing even tighter limits.

Other policy changes strengthened state-level efforts to get welfare recipients in jobs. These included the expansion of in-kind assistance to needy families by means of child-care subsidies, food stamps and Medicaid services, as well as minimum wage increases and expanded refundable tax credits under the earned income tax credit (EITC) system (Blank, 2004: 9-12). In a careful review of the empirical evidence, Blank (2004: 14-18) highlighted three major results of this gamut of changes:

- Welfare caseloads dropped by 42% from 1994 to 2001, and did not rebound significantly during the 2000-2001 recession.
- Employment increased sharply during the late 1990s, especially among less-skilled, single mothers. Data from 2002 showed that the majority of women who had left welfare in the 1990s remained employed, although a significant minority were jobless.
- The incomes of single mothers (the group most heavily affected by the changes) rose during the second half of the 1990s, despite the fact that many of them lost cash benefits as a result of the introduction of workfare.

These developments suggest that workfare programmes have succeeded in their primary aims of reducing welfare caseloads and moving welfare recipients into jobs. However, Blank (2004: 37-40) added that it is particularly difficult to separate the effects of such programmes from concurrent labour-market developments, such as the rapid growth in job opportunities and earnings in the US during the second half of the 1990s. Furthermore, it is too soon to ascertain some of the longer-term effects of the welfare reforms on the livelihoods and social choices of needy families.

Welfare reforms with workfare elements were also implemented in the United Kingdom (UK) by the Labour government of Tony Blair, as well as in the Scandinavian countries. The UK reforms, known as the New Deal, offer assistance to four groups of welfare recipients: young unemployed persons aged 18 to 24, long-term unemployed aged 25 and above, lone parents and disabled people (cf. Kildal, 2001: 4; Ochel, 2006: 80-81). Younger unemployed persons first enter a period of intensive job search (the 'Gateway'), after which they have to choose from four six-month options, namely subsidised employment, full-time education and training, voluntary service, and the Environmental Task Force (Ochel, 2006: 80). This is followed by another period of intensive job search (known as the 'follow-through'). Unemployed persons aged 25 and above who have received the Jobseeker's Allowance continuously for 12 to 18 months

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undergo a 13-week Gateway period, followed by an Intensive Activity Period that lasts another 13 weeks and provides subsidised employment or education and training opportunities (Ochel, 2006: 81). Several studies reviewed by Ochel (2006: 80-81) found that the New Deal programmes successfully promoted the employment of younger and long-term unemployed people.

The Scandinavian countries have long combined a commitment to the maintenance of full employment (pursued by means of active labour-market policies, inter alia) with the belief that generous social benefits for the unemployed are basic social rights regardless of achievements and financial means (cf. Kildal, 2001: 5-6). During the second half of the 1990s, however, the forces listed earlier also led the governments of these countries to introduce workfare-like welfare reforms, with Denmark leading the way. Prior to a series of labour-market reforms introduced from 1993 until 1998, the jobless in Denmark could indefinitely access unemployment benefits, provided that they participated in work programmes for six months during each three-year benefit cycle (Kildal, 2001: 7-9). The first wave of reforms abolished the right to earn new benefits through participating in work programmes by limiting the period of entitlement to seven years, of which the last three years involved compulsory 'activation initiatives' aimed at reintegration into the labour market. The limits were subsequently tightened and by 1998 the maximum unemployment period was four years, including three years of activation activities. In 1996, these steps were complemented by special measures for low-skilled individuals under 25 years of age who, after six months of unemployment, were compelled to enter education or work-training programmes and accept sharply reduced benefits. Ochel (2006: 81) reported positive employment effects for these Danish workfare programmes, but Kildal (2001) was more circumspect and expressed concern about the implications of such programmes for norms of fairness and justice that have long underpinned the Scandinavian welfare regimes.

The available evidence therefore indicates that workfare programmes can be effective mechanisms for returning welfare recipients to work, especially in rapidly growing economies where sufficient numbers of jobs are created to absorb programme participants in the regular labour market. The importance of the availability of jobs is magnified by the reality that workfare programmes affect the low-skilled labour market by assisting unemployed people to get regular public or private sector employment. In contrast to public works programmes, which provide government-created temporary jobs, workfare therefore causes competition between social security recipients and regular workers for low-skilled work in the formal labour market (e.g. sweeping streets, cleaning parks, and basic clerical tasks). In some US cities, such as Baltimore, regular low-skilled workers were displaced by workfare workers, who were not unionised and were paid less than the minimum wage (Samson et al., 2001: 4). The perverse result was that people who were in regular paying work ended up on welfare because their jobs were taken by workfare participants. Hence, inadequate availability of jobs may well be the most serious barrier to the successful implementation of workfare programmes. Furthermore, the US experience showed that workfare programmes can be time-consuming and financially expensive: the costs to be taken into consideration are the work-related and child-care expenses of recipients as well as supervisory and administrative costs (Samson et al, 2001: 12). In discussing the Scandinavian experience, Kildal (2001: 14) also warned that workfare-type programmes could easily lead to two-tiered labour markets in which poor labourers are compelled to work on 'second-rate terms', lacking labour rights and sickness, vacation and unemployment benefits.

3.3.1 Developing countries

The colonial authorities introduced rudimentary social security systems in most African, Asian and Latin American countries. Such systems offered health care, maternity leave, disability allowances and pensions for small sections of the population – mainly civil servants and employees of large enterprises – but bypassed the numerically dominant poor, especially those living in rural areas (Townsend, 2007: 32). After obtaining independence, a considerable number of developing countries introduced or expanded social assistance programmes to assist households not covered by social insurance schemes. However, such schemes were usually afforded a relatively low priority compared to social services such as education

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and health care, and funding was restricted further by limited tax resources. To this day, the benefits provided by most developing countries have remained modest. Furthermore, in most countries coverage has remained low and restricted to the victims of particular contingencies (e.g. widows, orphans and elderly people without income and family support). International Labour Organisation (ILO) data reported by Townsend (2007: 179-180, 181) suggest that approximately 90% of the inhabitants of South Asia and sub-Saharan Africa and 20-60% of the populations of middle-income countries lack any form of statutory social protection. The bleak picture extends to the formerly socialist countries of Central and Eastern Europe. Prior to 1989, these socialist countries did not provide unemployment insurance, and devoted limited resources to social assistance schemes. Even by the turn of the century, the share of social security expenditure they devoted to social assistance and unemployment benefits remained marginal (ILO, 2000: 56).

Several developing countries, apart from South Africa, maintain substantial social assistance systems, including Brazil, Mexico, Botswana, Namibia and India (cf. Townsend, 2007: 32-34). Possibly the most thoroughly studied reform initiative in recent years has been the introduction of conditional cash transfers (CCTs) in several Latin American and Central American countries. The remainder of this section provides a brief review of the Latin American experience with CCTs.

Latin America's inequality and poverty problems were exacerbated by the debt crisis of 1980 and the contagion effects of the Mexican and Asian crises of 1995 and 1997-98, which reversed the economic recovery of the early 1990s. Amid this turbulent economic environment, within which social spending levels often came under severe pressure, Latin American countries started to introduce CCTs to overcome the most common shortcomings of traditional social assistance programmes, including poor targeting of the needy, high administrative costs, fragmentation of projects and programmes, accusations of paternalism and clientelism, and an overemphasis on short-term relief of poverty with inadequate attention to longer-term poverty of a structural nature (Rawlings and Rubio, 2005: 30, 33). Britto (2005: 2-3) summarises the essence of CCTs as follows: "The operation of conditional cash transfers (CCTs) consists in the provision of money subsidies to targeted households, provided they assure school attendance of their school-aged children and, in some cases, make periodic visits to health centres and attend other health-related activities." Hence, CCTs combat current poverty (by providing income support that enables consumption smoothing) as well as future poverty (by encouraging human capital accumulation among the young in an attempt to break the intergenerational poverty cycle) (Rawlings and Rubio, 2005: 33). According to Britto (2005: 3), other objectives of CCTs are to overcome the failure of universal social policies to reach the poor – especially in the areas of education and health – and the failure of existing systems to provide adequate social protection during times of crisis.

CCTs were initiated by Mexico to replace the highly regressive and urban-biased general food subsidy scheme (Britto, 2005: 7-8), but soon spread to other countries in Latin America and the Caribbean. The Mexican scheme, Progresa, was introduced by President Ernesto Zedillo and consisted of cash and in-kind transfers to households whose children regularly attended school and whose members all visited health centres regularly. The education component of Progresa targeted poor households with children in primary and secondary school, and provided educational grants and support for school materials. The programme also included supply-side benefits: teachers, for example, received bonuses for every pupil who was on the programme. The health component focused on poor households with pregnant and lactating women, children under two years of age, and malnourished children between the ages of two and five; the benefits included cash grants for food consumption, basic health care services, nutrition and health education, and nutrition supplements (Rawlings and Rubio, 2005: Table 1). Furthermore, Progresa has a positive gender bias: benefits are disbursed to the female heads of participating households, and participating secondary school girls receive higher cash grants than boys, because the former face higher risks of dropping out of school and their educational attainment brings positive externalities (Britto, 2005: 8). In 2002, Progresa was renamed Oportunidades and its scope was expanded to include income generation for poor households by means of preferential access to microcredit, housing improvements, and adult education (Rawlings and Rubio, 2005: 32).

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President Fernando Henrique Cardoso introduced the Bolsa Escola CCT programme in Brazil in 2001. This programme granted monthly cash transfers to poor households with children aged six to fifteen enrolled in grades one to eight, provided that they maintain school attendance rates of 85% or higher (Britto, 2005: 10-11). Bolsa Escola benefits are also disbursed to female heads of households. The benefits provided by the national governments were significantly lower than those of Progresa, but richer states and municipalities were allowed to raise the transfers or expand coverage. The details of the targeting of beneficiaries were also left to municipalities (Britto, 2005: 11). In 2003, Bolsa Escola was unified with other federal CCTs, creating a programme known as Bolsa Família. Apart from better coordination with other social spending initiatives, Bolsa Família added health-related conditionalities to Bolsa Escola's education-related ones and markedly extended the coverage and size of transfers. It soon became Brazil's largest CCT in terms of coverage and financing (Britto, 2005: 12).

Very similar CCT programmes exist in a number of other Latin and Central American countries, including Colombia, Jamaica, Nicaragua and Honduras (cf. Rawlings and Rubio, 2005: 31-32). In Honduras, for example, pupils receive education vouchers and supply-side incentives encourage schools to participate. The health and nutrition grants are targeted at newborn babies until the age of three years or pregnant mothers in Honduras and Jamaica. Honduras also gives health and nutrition vouchers, nutrition training for mothers and provides health centres with incentives to participate.

CCT programmes use a variety of targeting mechanisms. Honduras uses the Height Census of First Grade School children to provide data on the levels of malnutrition.[24] In Mexico, the qualifying communities in rural areas are selected using a marginality index, based on census data. Nicaragua compares the results of household-level proxy means test to results from geographic targeting. Furthermore, in Jamaica, the eligibility of beneficiaries is continuously reviewed. This happens every three years in Mexico as well. In Nicaragua the programme only lasts three years in a community and is then phased out within two years; hence, inhabitants know that it is only a temporary measure (Rawlings and Rubio, 2005: 38).

The evidence suggests that CCT programmes are effective mechanisms for alleviating poverty, and this is reflected in increases in budgets and the number of recipients. When the Mexican Progresa began it covered 300 000 people compared to more than 4 million people – or 20% of the population – in 2002 (Rawlings and Rubio, 2005: 38). The same trend is observed in Brazil, where the coverage of Bolsa Escola reached some 5 million people in 2002 (Britto, 2005: 7). Rawlings and Rubio (2005:48) reported that CCTs have had positive effects on school enrolment among boys and girls, child health and nutrition, and consumption levels. Brazil's 2000 census show that school attendance rates among poor children had increased by 4%, while that of Argentina rose by 9% between 2005 and early 2007 for beneficiaries between the ages of six and 17. However, this does not necessarily imply that child labour has declined because school attendance can be combined with work (Britto, 2005: 13). Britto (2005: 25) also pointed out that the effectiveness of CCTs is influenced markedly by the environment within which they are implemented. In the Latin American context, for example, sustainable poverty reduction is likely to require appropriate macroeconomic policy, various redistributive policies and initiatives to enable the poor to accumulate more assets, in addition to CCT programmes.

3.4 Effects of social security in South Africa

3.4.1 Social security and poverty

Recent research has confirmed that the various social grants are well targeted at the poor and that they have a significant mitigating impact on poverty (cf. Van der Berg, Yu and Louw, 2008). Fully 76% of government spending on social grants accrues to the poorest two-fifths of households; moreover, grants raise the income share of the poorest 40% of households from 4.7% of pre-transfer income to 7.8% of post-transfer income.

[24] Duflo (2003) used a similar methodology in a study to determine the nutritional status of South African children staying with an old-age pension recipient.

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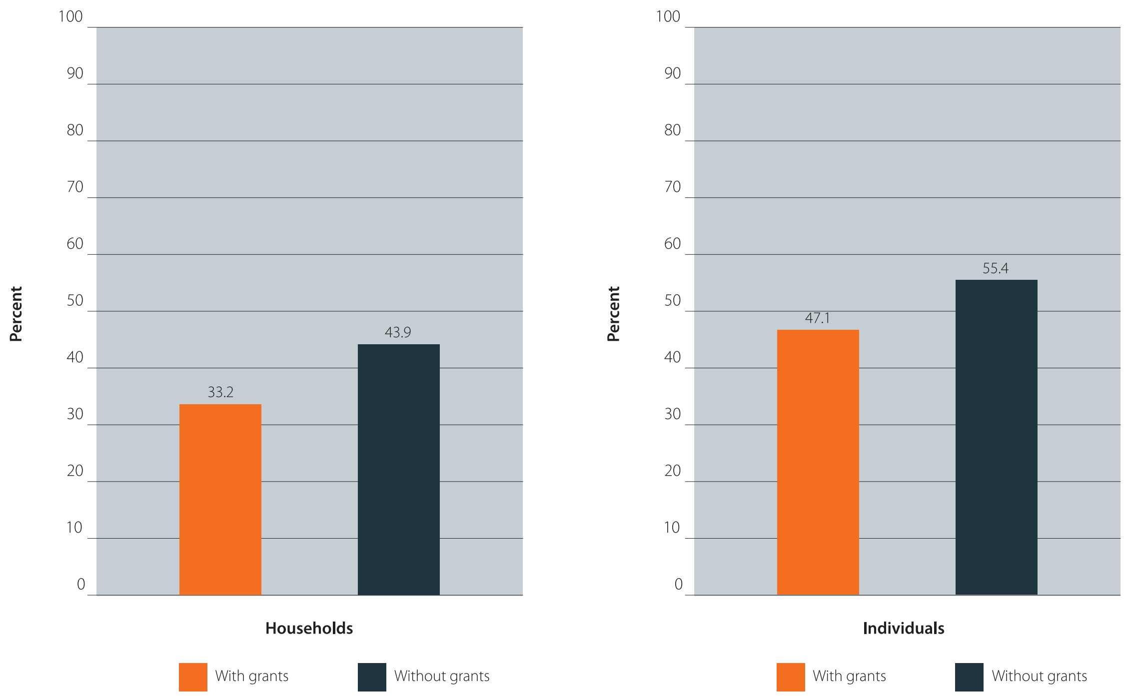
Figure 2 gives a rough indication of the effect of social grants on the extent of poverty in 2005 (see Armstrong et al., 2008: 21-22). It compares the actual incidence of poverty among households and individuals at the time of Statistics South Africa's incomes and expenditure survey (IES) 2005 to the incidence that would have been obtained if all respondents had reported zero income from social grants. The actual and hypothetical poverty rates for households were 33.2% and 43.9% respectively. Hence, if nothing else were different, the incidence of poverty among households would have been 32.2% higher in 2005 had the various types of social grants not existed.

Similarly, social grants reduced the incidence of poverty among individuals from a hypothetical 55.4% to 47.1% (i.e. by 15%). These numbers are indicative only – they rest on the very strong assumption that the availability or otherwise of social grants has no impact whatsoever on the behaviour of households in terms of labour supply, household formation patterns, etc. – but nonetheless suggest that social grants markedly reduce poverty by augmenting the income of poor households.

Figure 2: Poverty rates for households and individuals (2005)



Source: Calculated from data in Statistics South Africa (2008a)

Other evidence also suggests that the recent expansion of the South African social assistance system has markedly reduced the incidence of poverty. Figure 3, which depicts poverty headcount rates based on data from the All Media and Products Survey (AMPS), shows that poverty decreased by seven percentage points from 2001 until 2006. Moreover the portion of children whose parents reported that they had gone hungry in the previous year declined from 31% in 2002 to 23% in 2005.

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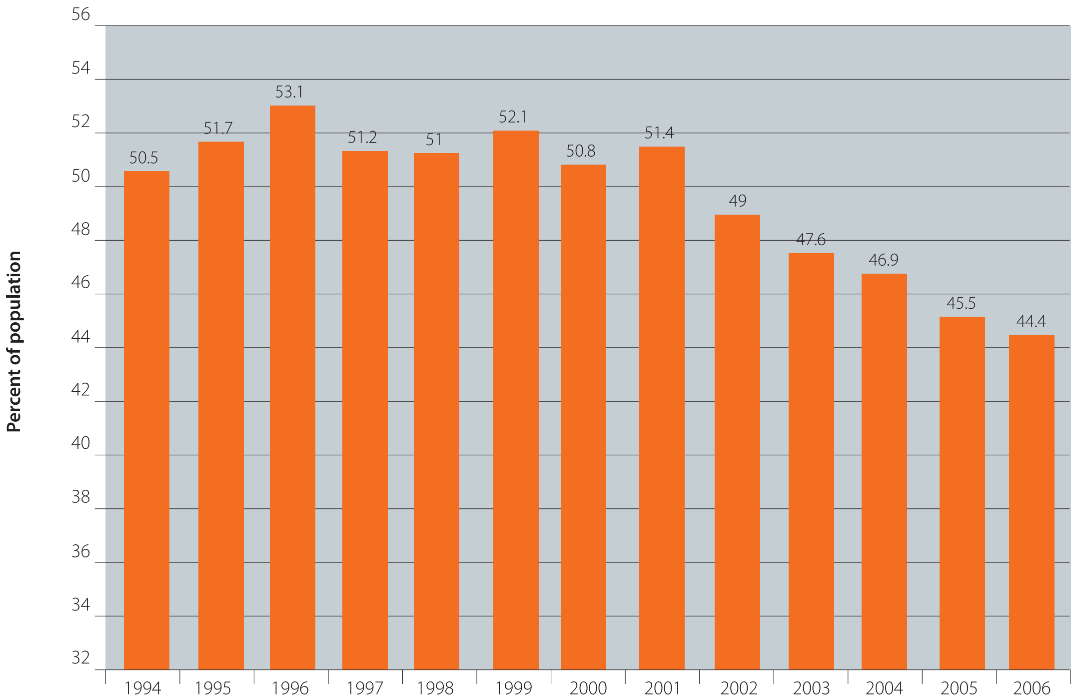
Figure 3: Poverty headcount rates based on AMPS data (1994-2006)



Source: Van der Berg, Louw and Du Toit (2007)
Note: Poverty line: R3 000 per capita per annum in 2000 Rand values

The social grant is an important type of income for poor households, especially those in rural areas. It makes up to 50% of income in households headed by the elderly; preventing these households from falling into poverty traps (Leibbrandt et al., 2004: 13). Social grants are well targeted in South Africa because they reach most of the poor. The target groups include children, the aged, the physical and mental disabled and caretakers. The old-age pension is received by more than 80% of the aged, most of whom are black women (Case and Deaton, 1998; Van der Berg 1999; Lund, 2006). The old-age pension and the child support grant programmes are effective in transferring money to predominantly poor families, especially households with children (Case and Deaton, 1998). Social assistance to the poor in the form of grants is used like normal income would be used by the family to buy clothing, food and education (CASE, 2000: 43). It has sharply reduced the incidence of poverty (Van der Berg et al., 2008).

The gender of the pension recipient in the case of the old-age pension is important. Literature shows that women allocate their spending of the grant more efficiently than men (Duflo, 2003; Lund, 2006). Lund (2006) shows the relative improvement in the family's health status and nutritional status when the recipient is a woman. Duflo (2003) compared the weight-for-height ratio of children living in households where the pension recipient is a male versus households where the recipient is female. The weight for height is a good indicator of nutrition as it responds quickly to the change in environment (Duflo, 2003: 3). Her results were that the weight for height for girls increased while that of boys did not change significantly in households that had a female pensioner. In households where the pensioner was male, there was no improvement in the health status of either boy or girl.

The objectives of the child support grant (CSG) are to support poorer households with the cost of raising a child, to redistribute income, influence birth rates and relieve child poverty (Triegaardt, 2005: 252). Despite administrative challenges within government, research has found that the grant is effective in

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reaching children in poor households (CASE, 2000: 43). Triegaardt (2005) also notes that the CGS has been the main source of income for many poor households, making it essential for survival. The unintended consequences of this may be higher rates of household formation as a means of attaining the CSG. There is a positive relationship between children receiving grants and school enrolment. Lund (2006) found this to be noteworthy given the fact that some of the parents did not have a formal education and the household was poor. Despite the contribution that the CSG makes to poverty stricken households, the grant is not reaching all impoverished children. This may be because some households do not have the means to produce the proof required to establish need.

South Africa is a developing country that does not have social security for unemployed individuals who have not entered the labour market. The Unemployment Insurance Fund (UIF) is contributory and is not long lasting. The old-age pension has been found to be the main source of support for unemployed individuals in the rural areas (Case and Deaton, 1998). Unemployment persists because individuals attach themselves to households that have at least one pension recipient. Klasen and Woolard (2009) take the labour market as given, and evaluate how household formation responds to unemployment. They find that the unemployed have a low propensity to set up their own households and tend to live with pensioners to get access to resources. The adverse effect of this coping mechanism is that when resources are stretched too far, some households are plunged into poverty due to the pressure on resources (Klasen and Woolard, 2009: 32-34). People are crowded into households; it is common for three generations to live in the same household. Because there is no social policy that directly targets these individuals, their attachment to poor households adversely affects all individuals living in that household.

The impact and incentives of the foster care grant (FCG) are worth noting. Families foster children mainly because they themselves are poor and need the additional income. These children are usually above the CSG age. The FCG is three times the CSG and lasts longer; therefore people have an incentive to foster children to receive this grant. A positive effect of the FCG is that poor households release their children to go and live with other families, changing the formation of the household, where they would be better cared for (Vorster et al., 2000). Social workers have observed that the grants are used as measures of poverty alleviation rather than being primarily to protect a child, and household members do not direct the spending of income towards the child (Naicker, 2005). Whether these grants are well targeted or not still needs to be further investigated.

3.4.2 Social security and the labour market

A household may decide to insure itself against risk by diversifying its sources of income by sending out members of the household to look for work (often away from home). Bertrand et al. (2003: 30) found that social pensions reduce willingness to participate in the labour force. They found a large drop in the labour force participation of prime-aged males, especially in households where there is a female pensioner.

a. The old-age pension and the labour market

The research of Klasen and Woolard (2005) yielded results that support the thesis that unemployment persists because individuals who should be actively looking for work move into households that receive a pension. The pension acts as a safety net for people who are unemployed; however the negative effect is that this coping strategy negatively influences job search prospects because the location of the household supporting them is often far from potential labour market opportunities (Klasen and Woolard, 2009). They also observe that these individuals put a strain on the household resources, pulling everyone into poverty. Both Klasen and Woolard (2009) and Bertrand et al. (2003) argue that the social grant ends up supporting people whom it was not intended to support; however, Klasen and Woolard (2009) do acknowledge that it is the lack of economic support that reduces a person's employment prospects, as they cannot work away from home due to the additional costs of migration and job search.

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A different view is held by Posel et al. (2003), who investigated the relationship between migrant labour and the household; and, in particular, how social pensions affect the labour supply. Posel et al. (2003: 837) argue that if migrant labourers are included as part of the household, the results are different. Indeed, they show that a pension has a positive effect on labour supply. They found that the social grant facilitated the ability of household members to look for employment away from home. These results were more prominent among women, who left home to look for work away from the rural areas, even though it was temporary employment. The additional funds freed up female labour by contributing toward child care and giving women the financial support needed to migrate to places where there are employment opportunities (Lund, 2006). This is a profoundly different conclusion from that reached by Bertrand et al. (2003), who only surveyed resident household members and did not take into account the fluidity of South African household composition due especially to migration.

The reservation wage of individuals who are not employed but who live in households with a grant recipient may be higher. Kingdon and Knight (2000: 2) warn that higher household income, which leads to intra-household transfers to an unemployed person, may lower that individual's search efforts because the income effect allows them more leisure (i.e. the taste for unemployment hypothesis). Empirically Bertrand et al. (2003) and Dinkelman (2004) find support for this. Klasen and Woolard (2009) find little evidence of disincentives. Furthermore, Posel et al. (2003) found no convincing evidence that prime-aged males do not actively seek employment. Black (2004: 419) argues that it is not rational to look for employment if the probability of finding it is too low compared to the effort and the costs involved in the search. For Lund (2006), these findings, which suppose that prime-aged males were the main beneficiaries of the pension, did not make economic sense given the current environment in South Africa "of high unemployment and high search for jobs so desperate that it seems less credible that these men would voluntarily leave the job market" (Lund, 2006: 172).

What can be concluded in respect of the effects of social pensions on the labour supply might depend on how the household is conceptualised in a model. When it is exogenous to the model, the effects are negative; but if migrant labour is included, the pension is found to enable women to look for work, where they would previously have been bound by the lack of financial support and child-care responsibilities. There is no conclusive evidence on the deterrent effect of the pension on prime-aged males.

b. Effects of the disability grant on the labour market

The impact of HIV/Aids on prime-aged individuals would usually mean that a household would forgo the income of the affected member. The disability grant (DG) is offered to people who are mentally and physically unable to take part effectively in the workforce. Provinces use different criteria for assessing eligibility. One of the most common methods uses a panel of social workers, nurses, social services officers and community members to assess each case (Nattrass, 2006a). The other method is for the district medical practitioner to examine the applicant for eligibility. In the Western Cape, it is only individuals who have a CD4 cell count of less than 200 or who are in clinical stage 4 of AIDS that qualify (Nattrass, 2006a: 7). The DG is offered on condition that when individuals are restored back to health, they lose the grant. Herein lies a possible policy conflict between social welfare and the policy of the Department of Health (NDoH) in rolling out antiretroviral treatment.

In order to improve the health of those infected by HIV/Aids, the government is rolling out a programme of providing Highly Active Antiretroviral Treatment (HAART), which boosts an infected person's immune system so that they can take up formal employment. However, due to high unemployment, some recipients of the temporary disability grant may be incentivised to discontinue their treatment to remain eligible for the grant, thereby compromising their health (Nattrass, 2006a). One of the dangers of discontinued treatment is the emergence of multi-drug resistant strains of the virus, which can then spread through the population (Nattrass, 2006b). Some people regard the DG as a lifeline and would rather contract HIV than remain poor. There is a perception that if people are unemployed, they can apply for the DG (CASE, 2005: 92).

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There has been an observable increase in the uptake of the temporary disability grant between 1995 and 2005. This might be attributed to an increase in HIV-related illnesses such as tuberculosis (Department of Social Development, 2007). Vorster et al. (2004) have also noticed that the demographics of individuals receiving the DG are increasingly becoming younger and largely female.

c. The CSG and the labour market

Low levels of employment characterise the target group of childminders (mostly women) who received the CSG: 18% of CSG recipients are employed compared to 33% of economically active women. (Department of Social Development, 2007). Those with jobs are generally poorly paid or employed for short periods. There is little evidence to suggest that this grant is a deterrent to attaining employment.

3.4.3 Other incentive effects of the social security system

a. The CSG

There is evidence of an increase in teenage births between 1995 and 2005. Fertility increased amongst girls in their late teens or early twenties (Department of Social Development, 2006). Young mothers may use this grant to gain financial independence from the household. Mothers receive the grant on behalf of their children, even if they are not the primary caregivers. However, there is counter-evidence that should also be considered. Only 5.3% of CSG recipients are young mothers in the age group 15-19 years, while the 2001 Census results suggest that 18% of all mothers would be eligible to receive the grant. This implies an under-representation of young mothers as subsidy recipients and does not support the thesis that teenagers fall pregnant with a view to achieving the grant (Department of Social Development, 2006). The increased uptake is likely to be due to increased awareness of its availability.

b. The FCG

One possible perverse effect is foster families using the FCG for their own purposes rather than that of the foster child. Due to case overload in the children courts, social workers may opt to register families for the FCG and forgo long court proceedings (Vorster et al., 2000: 130). Under-capacity is more evident in the poor provinces where courts are reported to be overcrowded by claims and social workers swamped by their caseloads (Nattrass, 2006a).The increase in the uptake of the FCG observed is also because many children are being orphaned due to the death of their parents from HIV/Aids.

c. The means test for the old-age pension and child support grant

Depending on the design of the means test for and value of the social old-age pension scheme, there may be incentive effects:

- on retirement age, as lower-income earners may not find it worthwhile to remain in the labour force beyond the inception age for the pension;
- on own provision for retirement (e.g. private pensions), as an incentive may be created to under-provide for own retirement, if the net result is that less is received from state benefits;
- on pension preservation when people leave their jobs; and on their choice between pension and provident funds;
- on household formation, where unemployed adults attach themselves to households in receipt of a pension.

The initial means test for the CSG was characterised by a bias towards rural and informal settlements by establishing a household income ceiling of R1 100 per month; higher than in urban areas where the ceiling was limited to R 800 per month.

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This design bias was eliminated when the means test was changed in 2008. Nonetheless, the mere availability of CSGs may still influence where and with whom children reside. Prior to the introduction of the grants, many children were left with grandmothers or relations in rural areas while mothers searched for jobs in urban areas. The availability of grants in the urban areas has enabled more mothers to keep their children with them. This may have stimulated the migration of children to the urban areas. Whether such migration improves or worsens the welfare of children is debatable. They may be better off with their mothers than remaining with a grandmother or relatives in rural areas, but if the mothers do not have the time to give children the care they need, this may be to their detriment.

3.4.4 Incentive effects of the CSG

Thus far, little research has been conducted into the impact of the CSG on both poverty and sexual behaviour, yet the latter aspect in particular has generated heated public debate, with some people arguing that the CSG increases fertility. It is not possible to draw strong conclusions on this, yet a descriptive analysis of potential behavioural effects can perhaps be useful. These effects can be categorised into impact on fertility, household composition or formation, and migration.

The potential impact on fertility receives the most public attention. However, little evidence, other than anecdotal, has been presented to support such a view.

Economists would argue that incentives matter, and that the CSG changes incentives for having children. Yet, at the same time, as supporters of the CSG often argue, R230 per month (the present value of the grant) is a rather small benefit to be gained for having a child, compared to the additional costs that a child brings. It is likely that there are some people for whom the additional benefits of having a child may make it more attractive than it may otherwise have been. To use some anecdotal examples, for a teenage girl in poor circumstances in rural areas, the fact that such a grant exists may have an influence on how careful she is to avoid pregnancy. This alteration in incentives is thus likely to have some positive impact on fertility, as critics argue. But how large would such an effect be, and how widespread?

It is likely that only a relatively small number of people would be in a situation where such a small grant would alter their behaviour in such a manner. Were the grant large (say ten times as large), a different scenario might have arisen. Yet examples of where governments have tried to stimulate fertility in some developed countries have shown that it is very difficult to do so by offering even large incentives. There has been no clear evidence of fertility increases, or a reduction in the age of first conception, to support the view that the CSG has increased fertility; it may at most have succeeded in slightly slowing the rate of decline of fertility compared to what it would have been.

It is well established that, in South African circumstances, households form around the income earner. The large old-age pension has had a particularly strong effect in this regard in rural areas. Many studies indicate that household formation and composition are endogenous, i.e. that the social grant system affects the formation and composition of households (see e.g. Klasen and Woolard, 2009). Little of this research has yet been conducted on the impact of the CSG, but it is likely to have had some effect on household structure, even though the individual benefit is less than a quarter of that of the social pension.

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3.5 Conclusion and recommendations

This chapter confirms that South Africa has a well-developed social assistance system that is exceptionally large by middle-income country standards. South Africa's social grants are very well targeted and have a significant mitigating impact on poverty. Considerable uncertainty remains about some of the incentive effects of these grants, but it is becoming increasingly clear that they influence the behaviour of recipients and potential recipients in a variety of ways, not all of which are necessarily benign. Firm evidence, or even sufficiently strong perceptions, of widespread perverse incentives resulting from social assistance schemes may make workfare and conditional cash transfers more attractive to South African policy-makers.

In other countries, such programmes have shown promising signs of being able simultaneously to alleviate poverty and incentivise desired behaviour. However, important aspects of their longer-term impacts remain unclear, and their applicability in South Africa would depend crucially on contextual factors such as the availability of work opportunities for workfare participants and the ability of educational and health care institutions to participate effectively in CCT programmes. There is much scope for further research on the potential of these and other innovative social assistance schemes in the South African context.

With respect to social assistance grants, the Commission recommends that:

1. The government should increase the rollout of social grants to cushion poor people from the effects of the economic downturn. However, there are risks and opportunities associated with the scaling up of social grants. The government needs to make trade-offs between coverage and grant amounts, taking into consideration affordability, incentive effects and the net effect across all grants. There is an inherent trade-off within programmes in attempts to scale up social grants, as the resource envelope is not without limits. Past experience at provincial level has illustrated that increases in social grants may 'crowd out' other forms of social expenditure, leading to the rationing of other non-cash social services (such as increased waiting times in health clinics, reduced welfare services etc.).

2. Social assistance should be managed in such a way as to eventually reduce dependency on the social grants. The issue of fiscal risk is linked to issues of fiscal sustainability of scaling up conditional cash transfers (CCTs). Fiscal risk arises when such CCTs give the receiver an impression of entitlement, which will be hard or impossible to reverse in the future. In the presence of revenue decline or volatility, the fiscal rigidities of entitlement spending may exacerbate fiscal risk. As a starting point, social grants on the demand side appear to be working well and can be scaled up in the short term but those on the supply side are not working well and will need to be shrunk.

3. The government should use infrastructure expansion to provide opportunity for workfare programmes as well as activities identified in the Expanded Public Works Programme (EPWP). The government should consider the EPWP to pilot workfare immediately.

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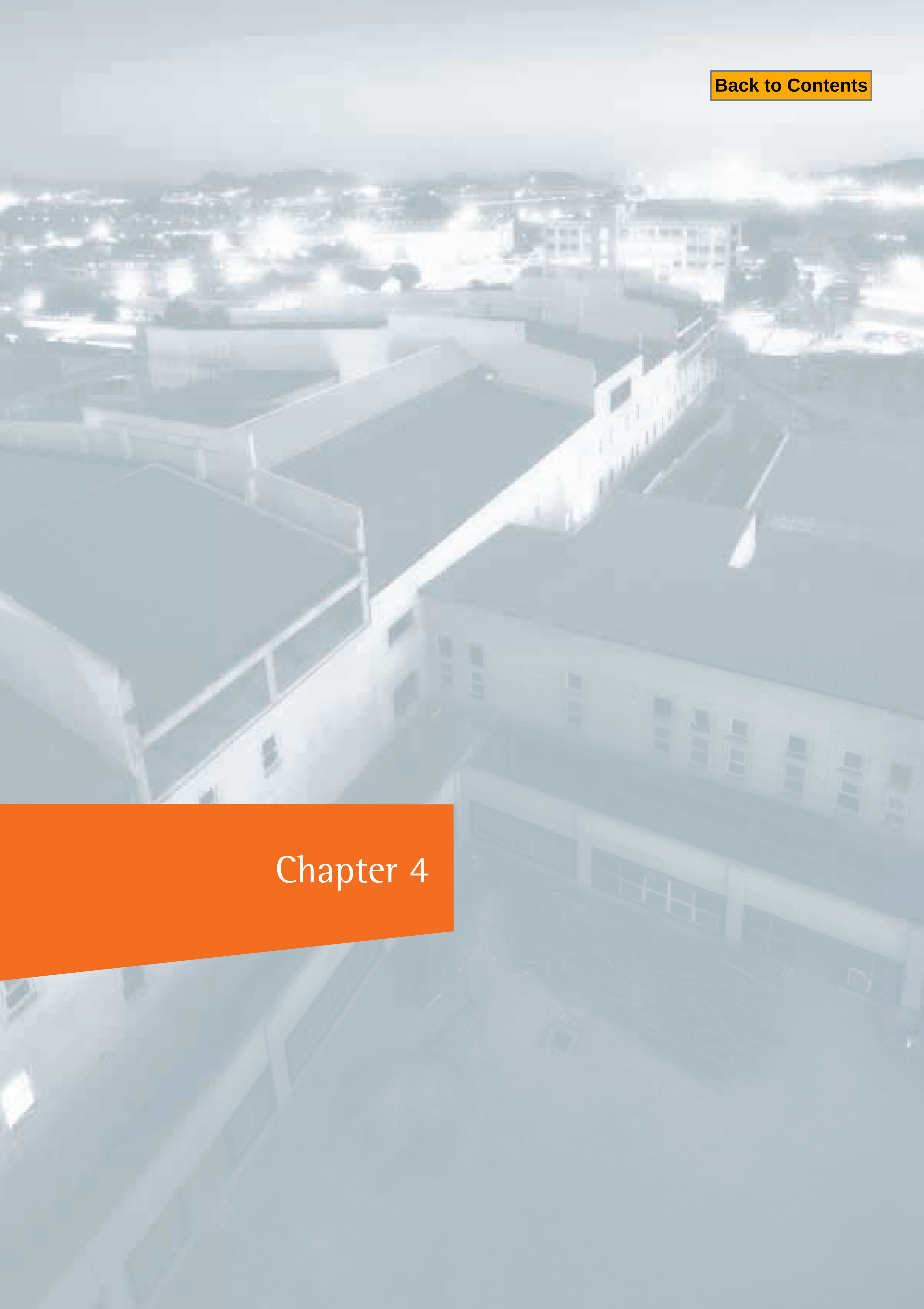

Chapter 4

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Chapter 4 Performance of Public Hospitals

4.1 Introduction

Public hospitals are an integral part of the public health system. Not only do they provide more specialised levels of care, but the academic hospitals also provide a platform for the training of health professionals. Notwithstanding the importance of these institutions, recent budget and spending trends suggest that in the process of scaling up primary health care (PHC) programmes, public hospitals are not given sufficient funding and are therefore neglected. For those that receive funding, growth in such funding is inconsistent and unstable. This is amidst an aggregate decline in the proportion of provincial health budgets allocated to hospitals (district, provincial and central hospitals) between the financial years 2003 and 2009.

Between 2003 and 2006, district, provincial and central hospitals recorded marginal yet persistent overspending across the majority of provinces. This may be a reflection of under-budgeting for these functions. Related performance outputs such as variations in the cost per patient day equivalent across similar types of hospitals is also a sign that there are no norms and standards in place which are applied uniformly across hospitals. The current legislative framework relating to public hospitals also lacks proper integration and coordination. These are elements that are essential if we wish to achieve a well-functioning hospital system.

The ultimate purpose of the chapter is to assess the dominant factors affecting the performance of public hospitals in South Africa. The analysis should contribute to the development of a comprehensive framework for measuring the performance of public hospitals in South Africa.

4.2 The Constitutional framework and public hospitals administration

Guided by the Constitution of South Africa, Chapter 2 deals with the Bill of Rights, in particular section 27(1)(a) stipulates that everyone has the right to have access to health care services, including reproductive health care. Section 27(2) provides for these rights to be met by the state within reasonable legislative and other measures within its available resources. The Constitution, under schedule 4, provides a clear assignment list of functions to be either exclusively or concurrently performed by any of the three spheres of government.

The National Health Act (2004) provides a regulatory framework and defines the roles of the national and provincial health authorities. The White Paper of 1997 on the Transformation of the Health Systems provides policy direction to unify the fragmented health services into a comprehensive and integrated national health service, promote equity, accessibility and utilisation of health services. It recognises that the PHC system cannot work effectively on its own without proper support of hospitals, if it is to ensure the delivery of an integrated package of service delivery.

In providing this health service, legislation and policy define the roles and responsibilities of both the national and provincial health departments. National government is largely responsible for formulating policy, determining the regulatory framework and monitoring the overall implementation by the provincial health departments in line with a nationally determined framework.

The provision of provincial health services is split into three levels, namely primary, secondary and tertiary health care. The primary health (clinics) or level one care is provided by district hospitals; secondary health, or level two care, is provided by regional hospitals; and tertiary health, or level three care, is provided by

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central academic hospitals. Each level of health care is meant to be a more specialised level than the one below it. The standard criteria are that patients ought to enter the health care system at the clinic level for examination before they are referred to the next and higher level.

A number of policy documents exist that govern the provision of health care services. These are, however, not coordinated and integrated. For example, the White Paper (for the Transformation of the Health System) notes that the PHC system will not function efficiently on its own without proper support of the hospitals to which they refer patients, such that substantial improvements to the PHC need to be intimately connected with the functional efficiency of hospitals. Existing gaps in the various roles of the spheres of government in terms of fulfilling those responsibilities can be interpreted as a lack of adherence to the legislation by the spheres of government.

Broad policies in support of the health care services exist (which makes reference to hospitals) but they are not effectively implemented because, among other things, there is no specific national hospital policy or Act guiding the operations of these public institutions. While there are norms and standards for PHC (clinics and community services), there is currently a lack of norms and standards for hospitals to guide the delivery of services. Therefore, by setting norms and standards, there will be some indications of what quality is expected on the hospital care levels. The latter makes it possible to assess the level of quality of services that are offered.

Some of the reviewed South African literature on hospital management has indicated the need for a reform of the public hospitals (van Holdt and Murphy, 2006; NALEDI, 2005). In its 2001 submission (as part of the establishment of a framework for local government finance proposals), the FFC highlighted that there was confusion around the allocation of functions and funding between spheres of government with respect to heath. Current literature also points out that, at present, the location of functions and responsibilities between provincial health departments and public hospitals is vague. For instance, there is no clear point of decision-making between these institutions. It is not clear where head office control ends and institutional responsibilities begin. Even if decisions take place, they involve significant bureaucratic processes.

International literature shows that organisational reform of hospitals is an important determinant of performance. Reforms aimed at granting hospitals more independence may lead to greater efficiency gains and better performance. The rationale behind the reform is that greater independence can mitigate disadvantages commonly associated with publicly provided services (for example inefficiency, low productivity, fraud and corruption), while entrenching a culture of good governance in ensuring the independence of hospitals.

Entrenching a culture of good governance is essential to ensuring that autonomous hospitals are successful. According to Jakab et al. (2002: 51), three things are essential for good governance, namely:

- The objectives of government need to be narrow, clear and non-conflicting. These then need to be translated into clear and measurable criteria for management performance.
- The responsibility for supervising management should be vested in an effective, professional body or board of directors that abides by a clear set of responsibilities and accountabilities.
- There should be consistent monitoring and motivation of hospital management. Good performance should be rewarded, while poor performance should be met with penalties/consequences.

It is thus clear that transforming from purely public to more autonomous hospitals requires adequate segregation of roles and responsibilities. Important in this transition is the entrenchment of good corporate governance, which places emphasis on respecting authority and responsibility allocated to various role-players. Therefore, organisational structure is considered a strong determinant of good performance. Autonomy-enhancing reforms are a prerequisite for addressing a broad range of performance issues unique to hospitals (La Forgia and Couttolenc, 2008; WHO, 2003).

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4.3 The budget framework and financial resources for the provision of public health care

4.3.1 The budget framework

In the case of health care services, funds flow through the provincial equitable share (PES) formula. The health component (based on the share of the province's population with medical aid and weighted population without medical aid coverage) constitutes 26% of the PES. To fund health services, provinces receive a portion of the PES. In addition, there are five major conditional grants, namely the comprehensive HIV and Aids, forensic pathology services, health professions training and development, hospital revitalisation and national tertiary services. According to the national Department of Health (2008) South Africa has 427 public hospitals, whose funding is provided through three broad programmes, namely district, provincial and central hospitals.

Three provincial health programmes exist within provinces: the central hospitals programme, the provincial hospitals programme and the district hospitals programme. Within the provincial health budget structure, provincial and central hospitals are stand-alone programmes. District hospitals are a sub-programme within the district services programme. It should be noted that as a result of the current structure of provincial health budgets and the classification of district hospitals as a sub-programme, it is not possible to determine the portion of personnel, goods and services and capital attributable to this type of hospital. This is because these items are provided at a programme level; thus in the case of the district hospitals sub-programme, it is provided for the district health services programme, and not the district hospitals sub-programme itself; while in the case of provincial and central hospitals, this type of analysis becomes possible.

4.3.2 Financial resources in the provision of public health care

At present there is no standardised national approach used to determine the structure of hospital budgets. Different formats are applied by provinces, which makes it difficult to assess implementation challenges at a delivery level. An incremental approach that uses the previous year's allocation as a basis for allocations is employed in all provinces (Okorafor, 2005). This is backed by the National Treasury's provincial programme structure database. The ideal course would be to link allocations more closely to workload and other service delivery outputs.

Since 2004, there has been a decline in the real growth of funding allocated to the implementers of public health. This is projected to stabilise at 6.6% by 2010. This level of growth is informed by the annual average growth rate as recorded in this sector over the entire seven-year period (2004 to 2010) under review, as Figure 4 below illustrates.

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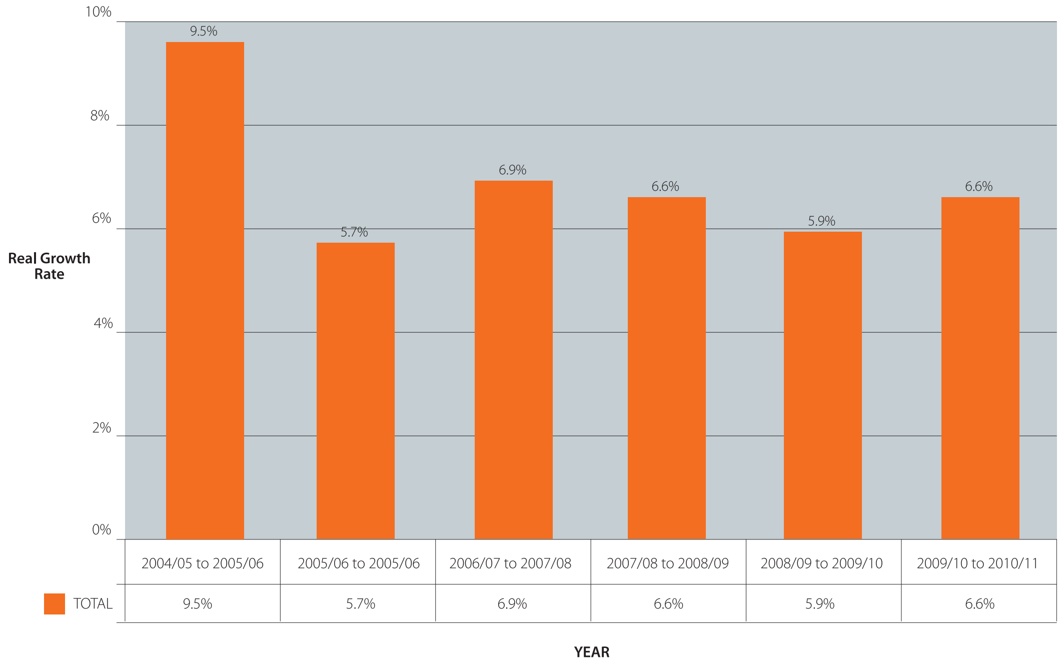
Figure 4: Real growth in allocations to public health care



Source: Own calculations based on data from National Treasury (2008a).

From a provincial health programme perspective, over the entire period, and most certainly as of 2007/08, capital investment was and will continue to be the fastest growing expenditure item on provincial health budgets. This is evident from Table 10. Over the medium-term period, and indeed over the entire seven years under review, growth in allocations to capital has exceeded growth in goods and services, personnel, and transfers and subsidies. Within the various provincial health programmes, this is reflected in the strong growth characterising the health facilities management programme between 2004 and 2010.

With respect to core public health care service delivery interventions, Table 10 indicates that emergency medical services (EMS) have been strongly prioritised. This prioritisation can be seen as a reflection of both the need to fulfil the constitutional imperative with respect to EMS as well as the need to facilitate the sector's readiness for the 2010 FIFA World Cup. The position that growth in the EMS programme is being driven predominantly by the need to ensure readiness for the 2010 FIFA World Cup is reinforced by the shift in the driver of growth in the sector in 2010/11, from EMS to central hospitals. Central hospitals show the strongest real growth in 2010/11 although, if one considers growth over the entire seven-year period, this programme has recorded the least growth of 2.7%.

Investment in the training of health professionals reflects an unstable growth path over the entire review period, ranging from 18.9% in 2005/06 to -3% in 2009/10 before reaching 2.7% in 2010/11. Given the labour-intensive nature of the provision of health care, the apparent lack of stability in budget allocations is a cause for concern.

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Table 10: Budget and spending trends of programmes on provincial health budgets

	Real Growth Rates				Under / Spending	Medium - Term Budget			Real Growth Rates	
Programme	**2004/05 to 2005/06**	**2005/06 to 2006/07**	**2006/07 to 2007/08**	**2007/08 to 2008/09**	**2007/08**	**2008/09**	**2009/10**	**2010/11**	**2008/09 to 2010/11**	**2004/05 to 2010/11**
Administration	-9.80%	9.40%	-2.40%	18.40%	-1.70%	2,374,793	2,308,087	2,365,252	-0.20%	1.90%
District Health Services	8.40%	6.00%	11.90%	5.50%	-2.50%	26,368,594	27,931,592	29,809,836	6.30%	7.00%
Emergency Medical Services	23.70%	8.50%	12.40%	10.00%	-1.50%	2,725,867	2,972,759	3,140,014	7.30%	11.10%
Provincial Hospital Services	5.90%	3.40%	3.50%	1.80%	-1.30%	14,751,466	15,698,712	16,592,240	6.10%	4.20%
Central Hospital Services	9.80%	-0.60%	-1.10%	-0.70%	-3.80%	8,962,338	9,533,782	10,233,000	6.80%	2.70%
Health Science and Training	18.90%	5.90%	8.10%	23.80%	-3.60%	2,401,233	2,328,951	2,392,822	-0.20%	8.40%
Health Care and Support Services	28.80%	-1.00%	12.00%	11.40%	-16.80%	1,066,216	1,053,812	1,154,096	4.00%	6.70%
HealthFacilities Management	30.10%	26.90%	8.10%	25.30%	-0.20%	6,239,722	6,907,075	7,573,676	10.20%	18,00%
Total	**9.50%**	**5.70%**	**6.90%**	**6.60%**	**-2.40%**	**64,836,512**	**68,683,117**	**73,199,504**	**6.30%**	**6.40%**

Source: Own calculations based on data from National Treasury (2008a).

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Similar to other countries, hospitals in South Africa constitute the largest expenditure item on health budgets. As illustrated in Table 11, the proportion of the provincial health budget allocated to hospitals has been diminishing. Based on National Treasury provincial financial data, the proportion has declined from 61.6% in 2004/05 to a projected 52.2% in 2010/11, almost outside the range of the 50-70% international norm.

Table 11: Proportion of total provincial health budgets allocated to public hospitals

R'000	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/2011
	Audited			Revised Estimate	Medium-Term estimates		
Total hospital allocation at the provincial level	31,021,354	32,996,796	33,581,137	34,629,196	33,987,709	35,935,265	38,216,769
Total Provincial health allocation	50,353,362	55,146,085	58,278,282	62,273,689	64,836,512	68,683,117	73,199,504
Provincial health budgets allocated to	61.60%	59.80%	57.60%	55.60%	52.40%	52.30%	52.20%

Source: Own calculations based on data from National Treasury (2008a).

Coupled with the declining shares of allocation, Figure 5 shows that real growth in hospital allocations has not kept pace with general growth in provincial health budgets between 2004/05 and 2008/09. For example, in 2007/08 the total allocation to public hospitals declined to just below 2%. This pattern reverses somewhat towards the outer years of the current Medium-Term Expenditure Framework (MTEF) period, where the average growth in the allocations to hospitals comes closer to the average growth in provincial health budgets.

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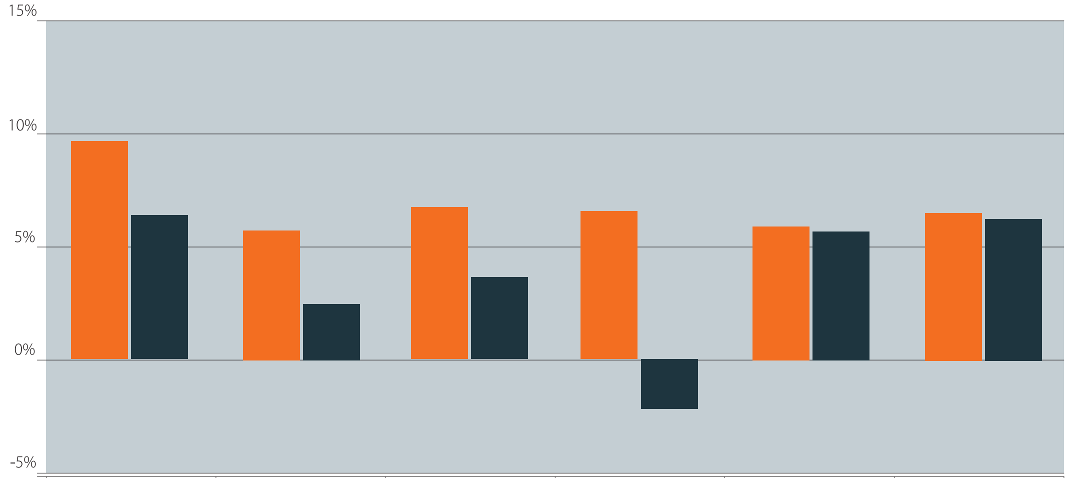
Figure 5: Real growth in allocations to public health care



	2004/05 to 2005/06	2005/06 to 2006/07	2006/07 to 2007/08	2007/08 to 2008/09	2008/09 to 2009/10	2009/10 to 2010/11
Real Annual Growth in Total Provincial Health Allocation	9.5%	5.7%	6.9%	6.6%	5.9%	6.6%
Real Annual Growth in Total Allocation to All Public Hospitals	6.4%	1.8%	3.1%	-1.9%	5.7%	6.3%

Source: Own calculations based on data from National Treasury (2008a).

Figure 6 examines the financial trends for hospitals according to programme type, that is, district, provincial and central. The main findings are as follows:

- Over the entire seven-year review period, all hospital types reflect an unstable growth path that is increasing one year and declining in the other.
- For all hospital types, there is sufficient growth of 5-7% in real terms in the outer years of the 2009 MTEF period.
- Central hospitals illustrate the strongest growth over the 2009 MTEF. This is however on the back of a very marginal to slow growth of just above 2% over the period 2004/05 and 2010/11.

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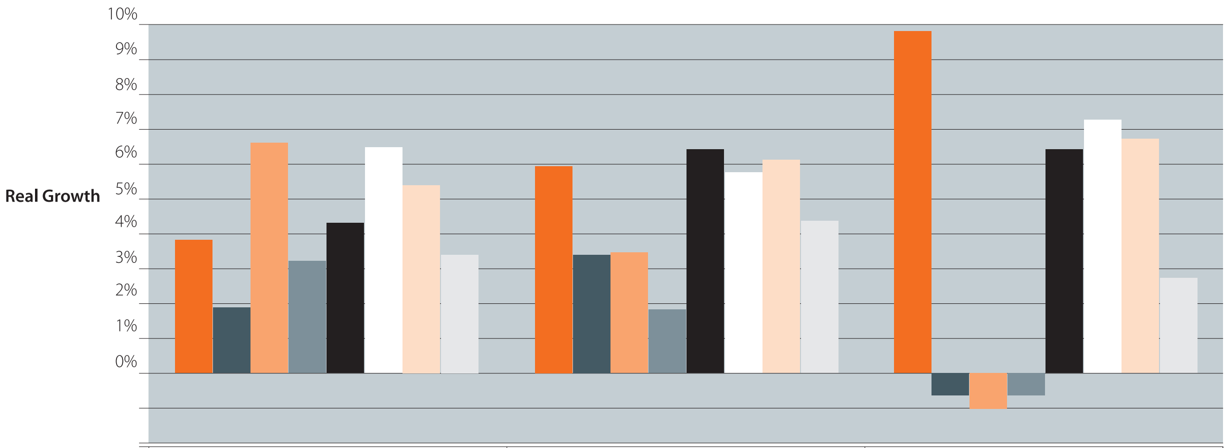
Figure 6: Real growth within the various types of public hospital programmes



	District Sub-programme	Provincial Programme	Central Programme
2004/05 to	3.8	5.9	9.8
2005/06 to	1.9	3.4	-
2006/07 to	6.6	3.5	-
2007/08 to	3.1	1.8	-
2008/09 to	4.2	6.4	6.4
2009/10 to	6.5	5.7	7.2
Real Growth over the Year	5.3	6.1	6.8
Real 7 Yr Growth	3.3	4.2	2.7

Source: Own calculations based on data from National Treasury (2008a)

It should be noted that as a result of the current provincial health budgets structure and the classification of district hospitals as a sub-programme, it is not possible to determine the portion of personnel, capital, goods and services attributable by type of hospital. This is mainly due to the inconsistent way in which these programme-level items are classified. For instance, the district hospitals sub-programme is classified as a programme provided for the District Health Services and not as a sub-programme. It is however possible to analyse the budgets for provincial and central hospitals for personnel, capital, goods and services, as these are consistently captured across the programmes and sub-programmes.

The two major conditional grants, namely the national tertiary services grant and the hospital revitalisation grant were analysed. The hospital revitalisation grant is a non-discretionary schedule five grant that provides an exclusive funding stream for capital expenditure on health infrastructure outside of the PES. An analysis of the spending during the review period shows that this grant has experienced significant under-spending. Part of the challenge with this grant is that allocations do not occur within the context of a broader, strategic framework for hospital infrastructure and as such misallocations are possible (see Table 12).

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Table 12: Hospital revitalisation conditional grant to provincial health departments

Name of Conditional grant	Real growth rates				Under / (over) - spending 2007/08	Medium term estimates (R'000)			Real growth over the medium term
	2004/05 to 2005/06	2005/06 to 2006/07	2006/07 to 2007/08	2007/08 to 2008/09		2008/09	2009/10	2010/11	
Hospital Revitalisation Grant	27.20%	30.40%	23.50%	23.90%	8.90%	2,691,562	2,743,083	3,091,693	7.20%

Source: Own calculations based on data from National Treasury (2008a)

The national tertiary services grant is allocated to provincial health departments to plan, modernise, rationalise and transform the tertiary hospital service delivery platform in line with national policy (Division of Revenue Bill, 2009). The grant compensates provinces for any supra-provincial services, that is, services for patients that extend beyond the provincial boundaries with spill-over effects. The funding is further geared at enabling provinces to transform and modernise tertiary services in line with principles of equity and access (National Treasury, 2008b). This grant is a significant source of funding within the central hospitals programme (see Table 13).

Table 13: National tertiary services conditional grant to provincial health departments

Name of Conditional grant	Real growth rates				Under / (over) - spending 2007/08	Medium term estimates (R'000)			Real growth over the medium term
	2004/05 to 2005/06	2005/06 to 2006/07	2006/07 to 2007/08	2007/08 to 2008/09		2008/09	2009/10	2010/11	
Hospital Revitalisation Grant	27.20%	30.40%	23.50%	23.90%	8.90%	2,691,562	2,743,083	3,091,693	7.20%

Source: Own calculations based on data from National Treasury (2008a)

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4.5 Summary and recommendations

The primary purpose of this chapter was to assess factors affecting the performance of public hospitals in South Africa. In assessing public hospital performance, the chapter analysed and reviewed domestic and international literature on the subject matter. The chapter recognises that public hospitals in South Africa often operate under challenging circumstances. The government has initiated legislative, policy and budget reforms to increase the administrative and financial performance of the public health services. The recommendations below are a contribution to the development of a comprehensive framework for measuring and improving the performance of public hospitals in South Africa.

The findings indicate that while the rights to have access to health care are stated in the Constitution and enabled frameworks, bottlenecks hamper the realisation of these rights in practice. The current legislative framework relating to public hospitals lacks proper integration and coordination. These are elements that are essential if we wish to achieve a well-functioning hospital system. There is therefore a need to improve coordination and integration. Minimum norms and standards are required to guide the delivery of hospital services with respect to staffing, facilities, equipment and other aspects that affect the provision of quality care. Norms and standards exist for PHC (clinics and community services), but not for hospitals offering more specialised levels of care.

Public hospitals consume approximately half the total provincial allocation for health services. However, there is very little confirmatory evidence of the impact of these allocations. At present, hospital budgets are determined according to different methodologies across the various provinces. Budget allocations for public hospitals need to be set and overseen in a consistent manner across all provinces.

Lastly, the international review of hospital management practices suggests that the organisational form of hospitals is an important determinant of performance. In addition, evidence suggests that reforms aimed at granting hospitals more independence may lead to greater efficiency gains and better performance. South African literature points out that the present location of functions and responsibilities between provincial health departments and public hospitals is not clear, thus negatively impacting service delivery.

To conclude, with respect to hospital management, the Commission observed that there is a need to investigate whether authority for rendering hospital services should be devolved entirely to autonomous institutions. The establishment of autonomous hospitals might need to be combined with the implementation of a governance configuration and the requirements of good corporate governance. Devolution of authority would need to be phased in along with enhanced mechanisms for managerial accountability, such as performance management systems and monitoring and reporting systems. Further work needs to be done to review international best practice and its relevance to the South African context.

With respect to the performance of public hospitals, the Commission recommends as follows:

1. While recognising the provisions of the National Health Act (2004) and current norms guiding the PHC system, there is a policy gap in respect of legislative provisions and norms and standards for a well-functioning public hospital system. In addressing the identified gap, the government must develop norms and standards that should address the following issues in relation to the public hospital system:

    a. The specification of minimum service requirements.

    b. The establishment of minimum input norms.

    c. The establishment of a workable quality assurance framework.

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d. The establishment of a transparent reporting system focusing on:

   i. Inputs,

   ii. Processes,

   iii. Outputs, and

   iv. Outcomes.

e. The identification of governance requirements.

f. The establishment of governance norms and standards.

g. A strategic planning framework which outlines the medium-/long-term vision of the hospital system, expressed in terms that are implementable and auditable.

h. A need exists for a mix of hard (codified by legislation) and soft (guidelines to aid departments) norms and standards. Hard norms and standards should be set by national government, codified by statute and be enforceable in relation to allocations set to achieve this objective. Soft norms and standards can be expressed as guidelines to assist delivery agencies in motivating for resources. Provinces should be allowed to contextualise soft norms and standards which suit their needs/socio-economic circumstances.

2. It is recommended that the government needs to standardise and institutionalise budget formats processes across all hospitals. In effecting these considerations, the following issues are pertinent:

   a. Setting individual hospital budgets:

      i. in relation to an agreed set of services with due consideration to the unit cost per service and needed activities;

      ii. subjected to a substantial and informed negotiation process between the province and the hospital;

      iii. which include agreements on how to deal with unforeseen and unavoidable expenses so that services are not disrupted; and

      iv. that ultimately address how case mix-based budgets can be deployed (that are consistent with international best practice). By defining the cost-drivers within a case mix, it is possible to mitigate against avoidable variances that currently occur between hospitals.

   b. Consistent with hard norms and standards, allocations should be determined by differentiating by hospital type i.e. central, regional and district hospitals; acute psychiatric and chronic hospitals and infectious disease hospitals.

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Chapter 5

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Chapter 5 Rental Housing

5.1 Background

Access to housing is an essential and basic right. Provision of housing as shelter is fundamental to human dignity as it usually brings along with it other basic services. According to Kissick et al. (2006), the world is facing a global housing crisis with almost one billion people in cities around the world living in sub-standard housing without clean water and adequate sanitation. Apart from the people living in sub-standard houses, homelessness and displaced people are still challenges that need to be addressed by public housing systems.

In South Africa, the right to housing is enshrined in section 26 of the Bill of Rights, which states that "everyone has the right to have access to adequate housing…" and "The state must take reasonable legislative and other measures, within its available resources to achieve the progressive realisation of this right" (the Constitution of the Republic of South Africa, 1996). One of the government's key objectives is to eradicate informal settlements. Since 1994, the government has made remarkable progress in this regard. It has reportedly managed to provide 2.6 million subsidised houses. However, the housing backlog persists and, by 2008, was estimated at 2.1 million units (Mbola, 2008). In addition to the legacy of apartheid, the housing backlog is exacerbated by a combination of factors such as a rising population, migration, unemployment and declining household sizes.

Developing a policy framework and funding instruments to assist in the provision of rental housing opportunities represents a key government intervention aimed at assisting those individuals who are not opting for ownership but require short-term accommodation. Rental housing represents a central component of the plan aimed at speeding up housing delivery and thereby assisting in the eradication of informal settlements. The rental housing market is important as it provides adequate accommodation for the poor, offering choice and mobility, and opportunities for those who do not qualify for ownership subsidies.

There is general consensus that a well-functioning housing system needs to have a good balance between ownership and rental opportunities. Presently, this is not the case in South Africa (Department of Housing, 2005). The 2005 Social Housing Policy for South Africa highlighted an imbalance between ownership and rental in the housing sector. The challenge is that, relative to international standards, people in South Africa prefer to own houses as opposed to renting. This highlights the importance and the need for accelerated rental housing delivery in the context of the government's intention to promote generally the scale of housing delivery. The skewed preference in the delivery, ownership and occupation of houses needs to be addressed.

This chapter identifies challenges that are hampering the delivery and development of the rental sector and makes recommendations to resolve such challenges. The objectives of the chapter are to:

- assess the current funding framework for rental housing and policy;
- assess bottlenecks and limitations hampering the delivery and development of the rental market;
- assess the extent to which proposed policy and funding reforms will adequately address the aforementioned bottlenecks and limitations; and
- recommend interventions aimed at improving the delivery, monitoring and evaluation of social housing.

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To attain these objectives, an analysis of legislation and policy on rental housing was carried out. Interviews were held with the national Department of Housing (nDoH) as well as with some social housing institutions (SHIs).

5.2 Rental housing in South Africa

5.2.1 Demand for rental housing

To understand the demand for rental housing, it is important to understand the characteristics of the different groups of people that need this type of housing. According to the nDoH (2005), groups that require rental housing include:

- people who have invested in the rural areas but are currently working and earning an income in the city;
- contract workers who follow work to different locations;
- vendors who cannot afford to return nightly to their permanent residences;
- people who cannot afford inner city residential property prices;
- individuals excluded from subsidy assistance;
- people renting in the informal settlements, as this is the only rental option available and affordable to them.

To cater for these different groups, a wide product range is needed. In 2008, the Social Housing Foundation (SHF) published findings of a study on the supply and demand of rental accommodation in South Africa (SHF, 2008). It revealed that there is a significant shortage of rental accommodation country-wide, especially in large urban areas.

The SHF report estimates that rental market accommodates about 20% of households in South Africa. Of those that are renting, approximately 43% of households could be considered to be living in slum[26] conditions (SHF, 2008). The report notes that data collected from various providers in inner city dwellings in Johannesburg, Pretoria, Durban, East London and Port Elizabeth indicate high levels of demand. The demand for rental housing is driven by approximately 51% of individuals who earn between R1,500 and R7,500 per month and 27% by those who earn below R1,500 per month. These income categories fall within the social target market of the state's rental housing interventions (SHF, 2008).

Data from the general household survey (GHS) indicates that, between 2001 and 2006, there has been a continuous increase in the number of households that are renting (SHF, 2008). This is depicted in Figure 7 below, where the number of households renting has increased by approximately 5% between 2001 and 2006.

[26] A slum household is defined as a group of individuals living under the same roof and lacking one or more of: access to improved water, access to improved sanitation, sufficient living area, durability of housing and security of tenure (SHF, 2008).

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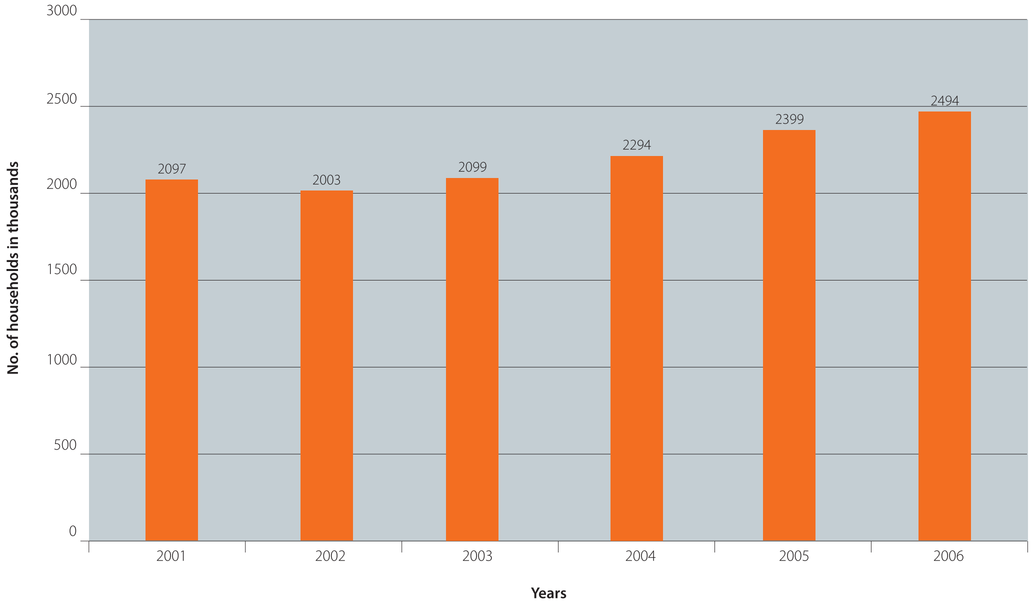
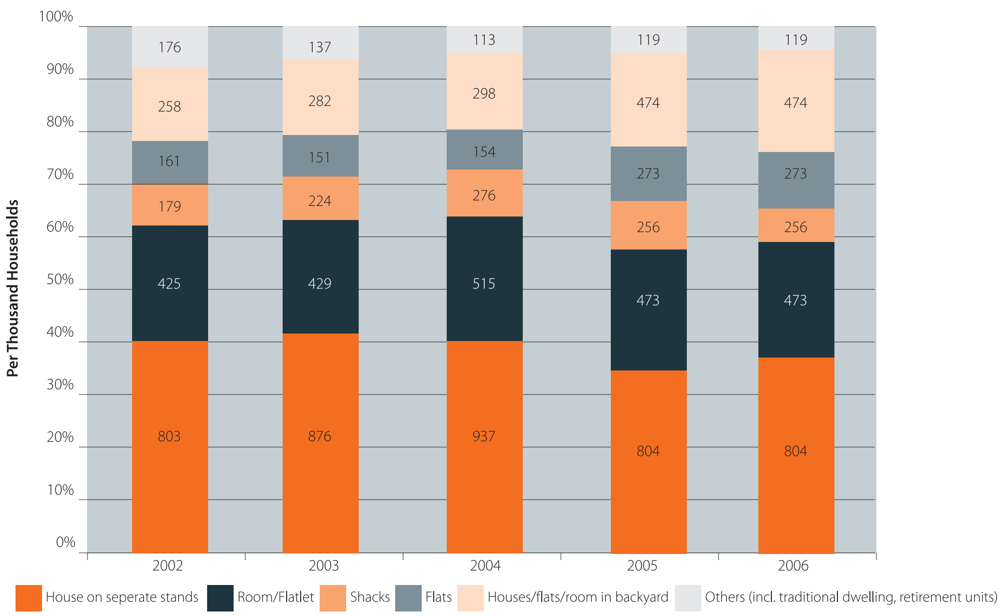
Figure 7: Households renting over time



Source: Source: Social Housing Foundation (2008) – figures extracted from the Statistics South Africa General Household Surveys 2002, 2003, 2004, 2005 and 2006.

The data presented in Figure 8 shows that the percentage of households with single houses on single stands has been declining since 2004. This trend has been associated with an increase in backyard dwellings. This could be an indication that the formal rental sector has not kept up with increased demand for rental housing and, as a result, most households opt for shacks and backyard dwellings.

Figure 8: Rental dwelling type over time



Source: Social Housing Foundation (2008) – figures extracted from the Statistics South Africa General Household Surveys 2002, 2003, 2004, 2005 and 2006.

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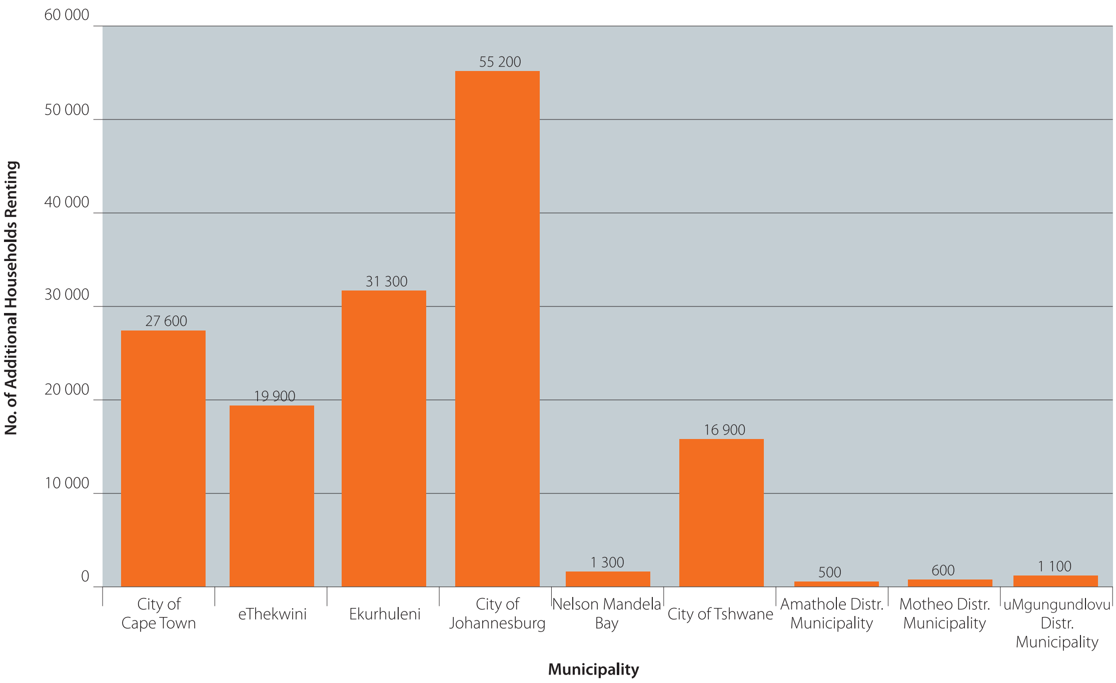
The GHS provides projections of additional households renting in bigger cities over the period 2005-2012. This is depicted in Figure 9.

Figure 9: Projected additional households renting: 2005-2012



Source: Social Housing Foundation (2008).

The projections above indicate that the demand for rental accommodation is likely to increase across municipalities, although the extent differs from municipality to municipality. Ekurhuleni and City of Johannesburg have the highest growth projections of demand for rental accommodation.

5.2.2 Supply of rental housing

According to the GHS data in Figure 8, the growing demand for rental housing is primarily addressed through shack and backyard dwelling-type opportunities. This is likely to be an indication that the demand for formal rental housing outstrips its supply. Responding to this challenge the nDoH has devised the community residential units (CRU) programme and the social housing (SH) programme as key mechanisms to address the supply of rental housing. Characteristics of these programmes are summarised in Table 14. Essentially, the CRU programme is a pure public sector intervention that is totally state-funded, while the SH programme represents a public-private partnership approach between government and other non-government organisations.[27]

[27] Non-government organisations include SHIs which are organisations for non-profit, profit-making organisations as well as commercial banks.

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Table 14: Key attributes of the CRU and SH programmes

CRU programme	SH programme
• correcting historical problems with public housing and hostels	• private sector for profit and non-profit sectors mobilised to supply affordable rental
• coherent framework for public housing and hostels	• cross-subsidisation
• indigent groups and low income groups	• mobilising private funders
• stabilising market and housing environments	• restructuring objectives
• addressing slum landlords	• lower and middle income target market
• affordable formal rental housing option for informal tenants	• object subsidy
• object subsidy	

Source: Department of Housing, undated.

It is important to note that the CRU programme targets individuals earning between R800–R3,500 per month and the SH programme targets individuals earning between R1,500-R7,500, with quotas for households earning between R1,500-R3,500. The nDoH's proposed National Housing Rental Strategy states that the objective is to deliver 100 000 rental housing units over the next five years commencing from 2007/08. The five-year rental housing target according to delivery mechanism is shown in Table 15.

Table 15: National targets for CRU and SH programmes

Total Rental Units and Investment			
Units	2007-2012	2007-2015	2007-2021
Social Housing	75,000	149,792	299,377
CRUs	25,000	56,690	120,070
Total Rental Units	100,000	206,482	419,447

Source: Department of Housing, undated.

The 100 000 rental housing units target is distributed across all provinces with the Gauteng province having the biggest share, based on the projections of future demand for rental accommodation shown in Figure 9.

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5.3 Policy developments and legislation

5.3.1 Policy

Social housing is one of the key thrusts of the overall housing strategy in South Africa. The South African Social Housing Policy was formulated:

- To contribute to the national priority of restructuring South African society so as to address structural, economic, social and spatial dysfunctionalities. It also intends to contribute to the government's vision of an economically empowered, non-racial and integrated society living in sustainable human settlements.
- To improve and contribute to the functioning of the housing sector and widening the range of housing options available to the poor.
- The policy also intends to address some key challenges identified in the sector, namely that:
- The funding framework and institutional subsidy have not been designed to promote the production of medium to higher density housing and have made inadequate provision for operating and management costs.
- The parameters of the housing approach were too tight to allow for the provision of social housing to poorer recipients.
- Capacity building focused largely on educational and training initiatives and the pre-establishment phase of SHIs, instead of on project packaging and implementation, and the operation skills needed to run rental housing institutions.
- There is no agency to address governance and management capacity issues that were evident in some SHIs.
- Due to financial pressures and subsidy constraints, there has been a movement away from the low-income market into the middle-income markets, thereby distorting the market by competing with private sector players, who do not receive state subsidies.

5.3.2 Legislative and regulatory environment for rental housing

Until recently, the social housing sector was guided and governed by a range of policies and legislation, including the Companies Act no. 61 of 1973 (section 21), the Public Finance Management Act of 1999 , the White Paper on Housing of 1996, and the Rental Act 50 of 1999. The absence of legislation specific to social housing has complicated matters such that legislation is applied by borrowing from related legislation on a case-by-case basis. The Social Housing Act (SHA) (No. 16 of 2008) enacted in November 2008 is a new development and its central aim is to address the gap in legislation on social housing by providing a legal framework for the regulation of the social housing sector (Department of Housing, 2007).

The SHA seeks to define the roles and responsibilities of the different spheres of government and other key role-players, establish a Social Housing Regulatory Authority (SHRA), address issues around the process of accreditation, and give clarity about the functioning and management of SHIs. Apart from the SHRA, other stakeholders include SHF, rental housing tribunals, municipalities, provinces, national government and SHIs.[28]

[28] The SHRA will take over the functions of the Social Housing Foundation and will accredit SHIs, ensure compliance, maintain a register of accredited SHIs, coordinate training and capacity-building programmes, ensure good governance and sustainability of the SHIs, and advise the Minister of Housing on developments in the sector. Rental tribunals provide dispute resolution to tenants and landlords. Municipalities facilitate the delivery of social housing in the areas of their jurisdiction; encourage the development of new social housing stock; upgrade existing social housing stock; provide access to land and buildings, and municipal infrastructure; and identify restructuring zones, etc. Provinces ensure fairness, equity and compliance with national and provincial norms and standards, protection of consumers; mediate when conflict arises between SHIs and municipalities; monitor social housing projects; and develop capacity within municipalities. National government creates and upholds an enabling environment for social housing; ensures compliance with its constitutional responsibilities; addresses issues affecting growth and development of social housing; funds the social housing programme; determines norms and standards, etc. SHIs acquire, develop and manage approved projects for low-income residents; re-invest operational surpluses in further approved projects; inform residents of their rights and responsibilities; consult municipalities to develop social housing stock; seek permission for any merger or separation of social institutions and any changes in lease agreements.

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Apart from the SHA that was enacted recently, the Rental Housing Act No. 50 of 1999 (RHA) is in place. The RHA however is silent on a number of issues pertaining to the development of rental housing; for example, the establishment and accreditation of SHIs and an agency to regulate and overlook the sector. These have been addressed by the SHA.

5.4 Funding rental housing

As mentioned previously, the CRU and the SH programmes are two key interventions to deliver rental housing in South Africa. Table 16 details the planned number of units and funding for the CRU and SH programmes over the period 2007 to 2021.

Table 16: Rental housing target by programme type and funding

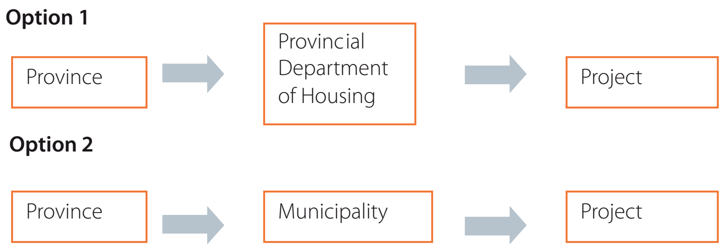
Total units and investment			
Units	**2007-2012**	**2007-2015**	**2007-2021**
Social Housing	75 000	149 792	299 377
CRUs	25 000	56 690	120 070
Total rental units	**100 000**	**206 482**	**419 447**
Funding and investments	**2007-2012 R' Million**	**2007-2015 R' Million**	**2007-2021 R' Million**
Capital Restructuring Grant	6,479	15,221	43,525
Provincial Top Up	3,667	8,062	19,531
CRU Subsidy	4,587	11,425	28,356
CRU Maintenance	-	-	-
Total Government Grants & Subsidy	14,734	34,708	91,412
Social Housing Equity Fund	3,134	8,771	31,317
Social Housing Senior Debt	2,998	7,116	17,862
Private Sector Debt and Equity	5,177	11,230	31,888
Total Funding and Investments	**40,776**	**96,533**	**263,891**

5.4.1 Funding for CRU programme

The CRU programme replaces the hostel redevelopment programme and places emphasis on lower-income persons. Presently it is funded by provincial governments through the CRU capital subsidy. The CRU capital subsidy covers the capital cost of the project and future long-term maintenance costs. The stock used under the auspices of the CRU programme must be owned either by a provincial housing department or a municipality.

Funding for the CRU programme flows to provincial housing departments through the housing equitable share component. Depending on the ownership, funding then either stays with the province or is allocated to the relevant municipality. From this point, funding flows directly to the project. This is depicted in Figure 10. This intervention is new and is still gaining momentum. Furthermore, the structure of most provincial housing budgets (which do not disaggregate down to sub-programme level) do not allow for a proper budget analysis of this programme.

Figure 10: Flow of funding between key role-players within CRU programme



There are three ways in which management of CRU projects can occur: the province or municipality can manage the project, the function can be outsourced to a provincial/municipal entity, or through an agency such as an SHI.

5.4.2 Funding for SH programmes

One of the core objectives of recent developments in the rental housing market, crystallised in the social housing policy, is to reach effectively the poor. The terminology used to describe this objective is referred to as 'deep, downmarket reach'. In the rental market, the type of project is defined as one that charges a rental fee falling within the R500 to R1,166.66 per month range (implying a monthly income of between R1,500 and R3,500 if one third of income is used for rent). Another objective is to ensure the development of balanced communities in socio-economic terms (Department of Housing, 2005: 34).

This signals a shift away from the view that people falling in similar socio-economic circumstances should live in the same area, towards a more integrated approach. In order to achieve its objectives, the nDoH has adopted a mixed-income rental housing approach which entails attracting people from both ends of the income spectrum (high and low). The intention is that a significant portion of rentals will be taken up by beneficiaries falling within the deep, downmarket reach range, combined with beneficiaries able to pay higher rentals. This strategy makes provision of housing opportunities for the poor while also ensuring an aspect of continuity and sustainability in that higher rentals will also be charged for those who can afford to – all within a single project.

Originally, social housing for rent was financed primarily through the institutional subsidy, which was the only subsidy available for financing SH projects. The process of restructuring has necessitated the creation of additional financing mechanisms aimed at entrenching the principles underpinning the reform process. As a result, the social housing restructuring capital grant (SHRCG) was established. This grant provides funding to approved social housing projects within Designated Restructuring Zones (DRZs).[29] It is also envisaged that the following grants will be established to assist SHIs in becoming viable institutions that manage viable projects:

- Staff gear-up grant: This grant is intended to assist SHIs in capacitating themselves prior to the commencement of projects. This grant can therefore not be used to assist ailing institutions. The point at which this grant can be applied for is once an institution has been approved to receive SHRCG and is about to commence its first project. The grant may not exceed 33.3% of staff operating costs.
- Project acquisition and feasibility grant: A key consideration put forward in the social housing policy is the need to ensure viable projects – that is, projects that have the potential to become self-sustaining. This grant is aimed at ensuring that projects identified and submitted for consideration for the SHRCG

[29] Designated Restructuring Zones: Buffalo City Municipality, Ekhurhuleni Metropolitan Municipality, Ethekwini Municipal Authority, Cape Town Metropolitan Municipality, City of Johannesburg Metropolitan Municipality, Mangaung Local Municipality, Msunduzi Local Municipality, Nelson Mandela Metropolitan Municipality and City of Tshwane Metropolitan Municipality.

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are properly investigated and designed. This grant provides support for conducting a feasibility analysis.

- Pre-accreditation grant: This grant is aimed at assisting SHIs and cooperatives in setting up a governance structure, establishing capacity to apply for accreditation and managing a project. It can also be used to aid the setting up of an office and drawing up a business plan. The grant amount may not exceed R25,000.
- General capacity-building grant: There are two components to this grant, namely, ad hoc grants and programme-related grants. They are aimed mainly at building professional knowledge and innovative development of the sector.

The institutional subsidy was previously used to finance all social housing projects and this has changed since the introduction of the SHRCG. Currently; the institutional subsidy finances those projects falling outside of the DRZs. A key challenge with respect to this grant is the lack of assessment of a project's viability. The SHRCG on the other hand finances projects that fall within DRZs. The SHRCG however is not intended to cover all costs associated with a social rental development but rather to cover a proportion of the capital costs of the project. The balance of funding required to complete the project is to be sourced from other avenues of funding such as, for example, debt (given that commercial debt funding is allowed) (Department of Housing, 2005:36).

There are two key considerations when determining eligibility for accessing the grant. The one is whether or not a social rental development is located within a designated restructuring area. The other consideration is the extent to which the development is mixed income and achieves 'deep, downmarket reach'.

A further dimension of the SHRCG is that it consists of a standard component[30] and a top-up (variable)[31] component. In determining eligibility for the grant, three assessment tools have been established, namely quick scan A, B and C. Quick scan A assesses governance and financial performance of the SHI. Quick scan B assesses project readiness to proceed on-site. Quick scan C assesses the project's financial sustainability. It appears then that there are more processes in place to ensure the viability of projects under the social housing restructuring capital grant compared to the institutional subsidy.

5.5 Factors hampering delivery and development of rental housing in South Africa

The SHIs have highlighted a number of factors that impact on the delivery and development of the rental market in South Africa. These factors pertain to the policy and regulatory environment, funding and institutional factors. A number of the limitations and challenges mentioned below have been corroborated by the SHIs themselves. The severity and negative impact of some of these challenges have informed the recommendations made later on.

5.5.1 Policy and legislation

a. Restructuring zones

Currently only those SH projects that fall within the DRZs are eligible to receive SHRCG. During the first phase of rolling out/piloting the newly established SHRCG, the nDoH together with some cities and provincial administrations identified nine municipalities that are to be included in the first phase. Limiting access to SHRCG to social housing projects within the DRZ has the effect of limiting the delivery of social housing to within these zones, even if SHIs have identified viable projects outside these zones.

[30] The standard component is the portion that will be sourced from the nDoH and administered provincially and it varies depending on the extent of deep down-market reach but has a limit of 70%.

[31] The top-up component forms part of the equitable share allocated to provinces and may not exceed more than an amount equivalent to the institutional subsidy amount.

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b. Requirements for a social housing project to qualify for the SHRCG

One of the requirements for the project to qualify for the SHRCG is that the unit size should be at least 30m2. While this requirement is suited to ensuring that SHIs deliver rental units of adequate quality and size, especially for greenfield projects, the guidelines fails to make suitable provisions for non-greenfield (brownfield) projects. In some cases, SHIs buy old and derelict buildings where existing units are below this minimum size. These buildings require funding for upgrading and the SHIs would struggle to raise their own without assistance from the government funding.

5.5.2 Funding

a. Disbursement of funds

A number of SHIs complain of the slow process involved in obtaining funding from provincial housing departments. Some attribute the lag between project approval and disbursement of funding to a lack of capacity within provincial housing departments. In a project undertaken by the Financial and Fiscal Commission (FFC) during 2007/08 regarding bottlenecks in the delivery of houses, the slow and overly bureaucratic manner in which resources flow between provinces and municipalities was highlighted as a key concern (Financial and Fiscal Commission, 2008).

b. Income targeting

The concern is that the income bands linked to the institutional subsidy were developed for a pilot programme some years ago and have not been adjusted, despite increases in construction costs, as well as the cost of living resulting from inflation. In other words, the income bands have not been adjusted to increasing costs of living over the past years and, by so doing, exclude some individuals who should qualify for a subsidy. In essence, in order to achieve policy goals and objectives, policies need to be adaptable. In this case, in order to reach the target market, the income eligibility criteria of funding instruments should be reviewed.

5.5.3 Institutional

In light of the establishment of DRZs, social housing projects can be an important driver of urban renewal. A critical consideration is the location of a housing project: if projects are located in the middle of derelict neighbourhoods that are far from social and economic opportunities, the tenants (who will in all probability be low income) will be disadvantaged. Furthermore it is a concern that greater effort is not being put into improving intergovernmental coordination to ensure that various forms of complementary funding opportunities for social housing are leveraged so that holistic development occurs. This will ensure that housing initiatives do not occur in isolation to other important social and economic necessities that allow for the development of a strong and sustainable community. Streams of funding that could be more attuned to rental housing initiatives include for example, the neighbourhood partnership development grant and other urban renewal-type grants.

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5.6 Conclusion and recommendations

State provision of rental housing represents an intervention aimed at the provision of adequate housing especially for lower- and middle-income groups who cannot afford to buy homes. One of the most important characteristics of rental housing, which makes it distinct from other forms of public housing programmes, is that in order to be eligible to rent, potential tenants must have an income that enables them to sustain their rental payments.

The policy and regulatory environment, funding and institutional factors that are hampering the speed and further development of the rental housing sector have been discussed. The policy in its current form enables only those social housing projects that fall within the DRZs to benefit from the SHCRG. The fact that any project outside the DRZs is unable to attract funds from the SHCRG, even if it targets the 'deep, down market', limits the delivery of rental housing especially where SHIs have identified viable projects that are ready to be implemented. Furthermore, one of the requirements for the project to qualify for the SHCRG is that the unit should be at least 30m2. While this requirement is appropriate in ensuring that SHIs deliver rental units of decent quality and size especially for greenfield projects, the guidelines fail to make provisions for brownfield projects.

With respect to rental housing, the Commission recommends:

1. Relaxation and flexibility on the:
    a. eligibility criteria for accessing the SHCRG to allow projects falling outside the DRZs to access funding;
    b. number of DRZs to respond to excess demand for rental housing;
    c. minimum unit size for redevelopments of existing buildings.
2. The process of disbursing funds for rental housing within the housing sector should be made shorter, to minimise time lags following the submission of approved project plans.
3. The Social Housing Regulatory Authority should improve inter-sectoral coordination between various government departments responsible for integrated human settlement.
4. The qualifying income bands should be reviewed to ensure that individuals are not unfairly excluded from benefiting from the subsidy (due, for example, to increases in the cost of living).

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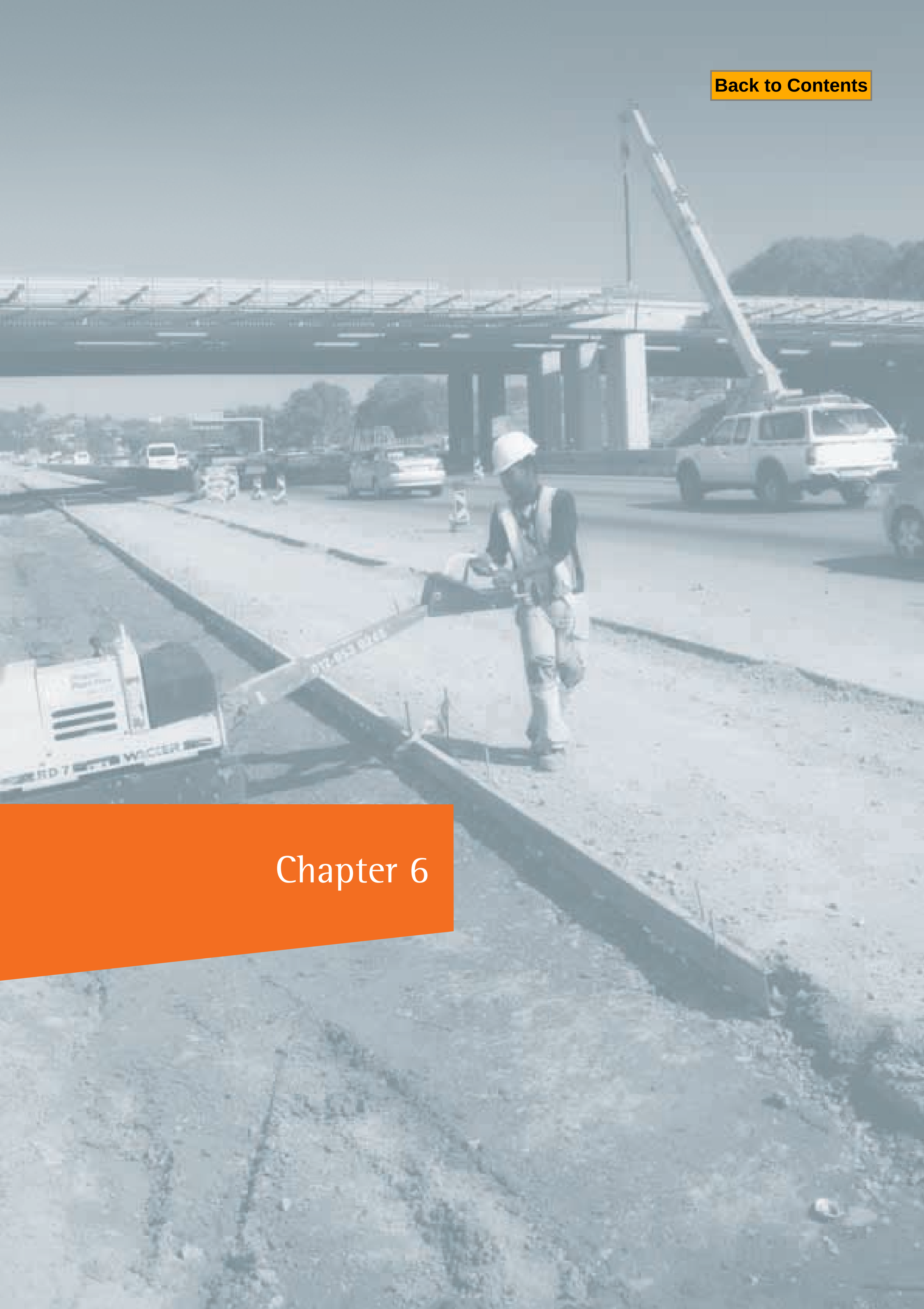

Chapter 6

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Chapter 6 Management and Financing of Road Infrastructure

6.1 Introduction

An important aspect of investments in public socio-economic infrastructure includes the financing and development of a nation's transport infrastructure and network. A well-developed and modernised transport network is necessary for the efficient functioning of any economy, as it creates economic opportunities and facilitates the movement of people, resources, and outputs to industries and markets and enables people to access social services (Solomon, 1983).

Decades of under-investment in road maintenance and management, relatively inappropriate user costs, significant capacity constraints, and considerable increase in the volume of road transport usage has resulted in an estimated 35% of South Africa's total road network being rated as in a 'poor' or 'very poor' condition. In a 2006 study assessing the built environment infrastructure in South Africa, the South African Institution of Civil Engineering (SAICE) scored the national road infrastructure at C, meaning most of the road infrastructure is in a fair to good state, while provincial and municipal road infrastructure were scored at D which means that many of their road infrastructures are in a poor condition.

The under-investment in maintenance and the deteriorating condition of many of the country's provincial and municipal road networks have significant economic and social costs. According to the South African National Roads Agency Limited (SANRAL), a delay in road maintenance of three to five years increases the required repair costs by between six and 18 times. Subsequent decreases in road quality also have adverse effects on road users. The South African Roads Federation (SARF) estimates that the failure of the road network, both in condition and its ability to cope with increased demand, imposes an estimated additional R20 billion per year in excess road user costs (fuel consumption, tyre wear, vehicle maintenance), and up to ten times more in congestion costs (SARF, 2009). In the major urban centres, competition (between industrial, public and private road users) has resulted in increased traffic congestion, contributing to the relocation of business activities from inner cities to the outskirts, further increasing the cost of fuel and transportation for many South Africans. For rural communities, the very poor state of many municipal access roads (including un-proclaimed roads) have contributed to soaring vehicle operation costs and, more significantly, hampered the ability of communities to access services in key health and education sectors (Financial and Fiscal Commission, 2007).

6.2 History and evolution of road administration and financing

6.2.1 The pre-1994 dispensation

In the first decade following the formation of the Union of South Africa in 1910, road developments remained a responsibility entrusted to the four provincial authorities of the Cape, Natal, Transvaal and the Orange Free State. Road infrastructure development was heavily localised, as construction was carried out by district/municipal councils/authorities using funds derived mainly from local taxes (such as property taxes) and matching grants/subsidies provided by provincial authorities. While there was an extensive use of loans, most of the loan amounts were utilised for the construction of bridges. Despite their best efforts, much of this funding proved inadequate and, with limited taxing powers, provincial authorities struggled to meet the rising demand for roads that were more suitable to increased motorised traffic.

Concerns over the slow pace of road infrastructure development and the need for formal road management structures resulted in the enactment of the National Roads Act of 1935. This legislation formally classified

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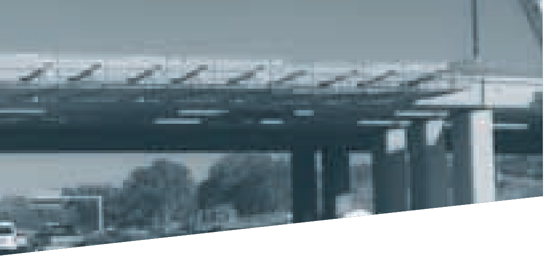
South Africa's road infrastructure into three types (national, provincial and municipal) and established the National Roads Board (NRB) to develop a road grid connecting the country's major commercial regions and centres. The Act also created the National Roads Fund (NRF), which derived its primary income from a share of customs duty levied on every gallon of petrol imported into the Union (Solomon, 1983). As the Act was not enacted to encroach on the jurisdiction of the provinces, the NRB was granted no powers to proclaim roads or amend provincial road ordinances. Instead, the NRB functioned as an oversight body tasked with making decisions on which roads NRF funds would be spent, while the actual construction, repair and maintenance of roads remained a provincial function. .

Although the gold boom of the 1930s had fostered considerable improvements in the quality of road construction, the onset of the Second World War impacted negatively on the gains made in road construction during the 1930s. By the end of the war in 1945, less than half of the targeted asphalt roads had been completed, with most of these located within the jurisdiction of national government. In addition, a shortage of funds within sub-national administrations, and tensions between the NRB and provincial authorities (mainly over the oversight and road classification functions of the board), had exacerbated backlogs in the development of targeted road infrastructure at sub-national level. In a bid to address these issues, the Transport (Coordinating) Act of 1948 was passed into law and the NRB was replaced by the National Transport Commission (NTC). Though the NTC's powers mirrored those of the NRB, one major distinction was that the Transport (Coordinating) Act afforded provinces a greater role in the formulation and implementation of policies related to road infrastructure development.

By 1961, the NRF had been relieved of any obligations to repay loans incurred by provincial administrations in the construction of roads prior to 1935. In addition, the NRF's primary source of funding was expanded to include a tax on all motor vehicle fuels (i.e. both imported and locally produced petroleum products), furnace oil and paraffin. Freed of debt obligations and boosted by substantial revenue flows, the NTC managed to complete over 90% of the original road scheme conceived in 1935, expand rural road infrastructure and construct a network of urban freeways in the country's major cities (notably Johannesburg, Cape Town, Durban and Port-Elizabeth). By the end of the 1960s, strong economic growth had resulted in a phenomenal increase in the demand for motorised transport, creating a need for significant upgrades and reconstruction to meet the standards required by modern traffic. In the NTC's view, this outcome could only be attained if provinces had limited influence in the planning of national roads and there was a reduction in its obligations to construct local and special roads. Legislative backing for this vision led to the enactment of the National Roads Act of 1971, which effectively ended the partnership of the central and provincial authorities in the sphere of road development and maintenance (Floor, 1984).

With enabling legislation and finance streams, the NTC focused on developing a road infrastructure programme aimed at providing South Africa with a well-developed national roads network and its first system of dual carriageway freeways. However, the fuel crises of 1973-1974 and 1978-1979 created significant uncertainty around incomes accruing to the NRF, negatively impacting on the NTC's commitment to undertake modern road infrastructure projects. By the mid 1980s, the country's international isolation, and prioritisation of programmes related to national defence and alleviating the effects of economic embargoes, further deepened the funding constraints faced by the NTC. As funding difficulties intensified, arguments were made for the share of the fuel tax allocated to the NRF to be substantially increased. However, the central government's unwillingness to part with a relatively important revenue source, and concerns about the inflationary effects of increased fuel taxes, prompted investigations by the NTC into the introduction of alternative funding sources. Consequently, the Second National Roads Amendment Act of 1983 was enacted, granting the NTC powers to introduce toll financing on selected roads.

By July 1987, the central government terminated the use of earmarked funding, effectively ending the existence of the NRF. In its place, funding for road building and maintenance would only be allocated from the central fiscus (Stander and Pienaar, 2002). Despite these measures, the years leading up to the democratic transition of 1994 were characterised by severe economic recession that virtually diminished the resources available for funding any new investments in road infrastructure. Instead, road authorities



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placed more emphasis on the development of export-related freight movements, increasing mobility in metropolitan areas, and maintaining efficient and safe linkages between the major population centres of the country (Mitchell, 2002).

6.2.2 The post 1994 dispensation

The democratic transition of 1994 ushered in a phase of significant reforms and encompassed the political and socio-economic system under which South Africa would operate. The Constitution of the Republic of South Africa (1996) assigned public transport, road traffic regulation, and vehicle licensing as concurrent, Schedule 4A functions of the national and provincial spheres. Provincial roads and traffic is an exclusive Schedule 5A provincial function, while municipalities are responsible for municipal airports (where relevant), municipal public transport, and municipal roads (Schedules 4B and 5B). In terms of assigned concurrent functions, the national Department of Transport (nDoT) plays mainly a facilitative and regulatory role that includes the development of policy and legislative framework implemented through provincial departments, local government and public entities. Table 17 gives a breakdown of the assigned responsibilities for the 754 600 kilometres of roads and streets in South Africa, the bulk of which are administered by sub-national authorities.

Table 17: Total length of road infrastructure network in South Africa

Type	Length in km
Surfaced national toll and non-toll roads	15 600[32]
Surfaced provincial roads	348 100
Un-proclaimed rural roads	222 900
Metropolitan, municipal and other	168 000
Total	**754 600**

Source: National Treasury – Provincial Budgets and Expenditure Reviews: 2002/03 – 2008/09

Compared to the pre-1994 dispensation, where the provision of road infrastructure was generally handled by a national agency in conjunction with provincial authorities, the current institutional arrangements has created different methods for delivering road infrastructure across the three spheres of government. At national level, the development, maintenance and management of roads are carried out on an agency basis by the SANRAL, while the traditional public service delivery model dominates the delivery of road infrastructure at provincial level.[33] Under this arrangement, a specific provincial roads department is wholly responsible for routine and special maintenance of the road system. Most provincial roads departments have the internal capacity to design roads but outsource the actual construction, as does SANRAL. The traditional roads authority structure is used to provide and maintain road infrastructure at municipal level, with oversight activities usually provided by transport advisory boards or roads authorities administered by respective councils.

The funding arrangements related to the construction and maintenance of the country's road infrastructure network has changed significantly since the formalisation of the current system of intergovernmental fiscal relations in 1996. At the national level, funding arrangements are made on the basis of transfers from the national fiscus, tolling and debt finance. Non-toll roads which make up 85% of the total national road network are funded via transfers from the national fiscus (see Figure 11). The remainder of national roads

[32] It is important to note that this figure has increased to 16 150km currently due to the incorporation of other provincial roads into the national road network.
[33] Of the nine provinces, only the Limpopo province utilises a combination of traditional public service and road agency models.

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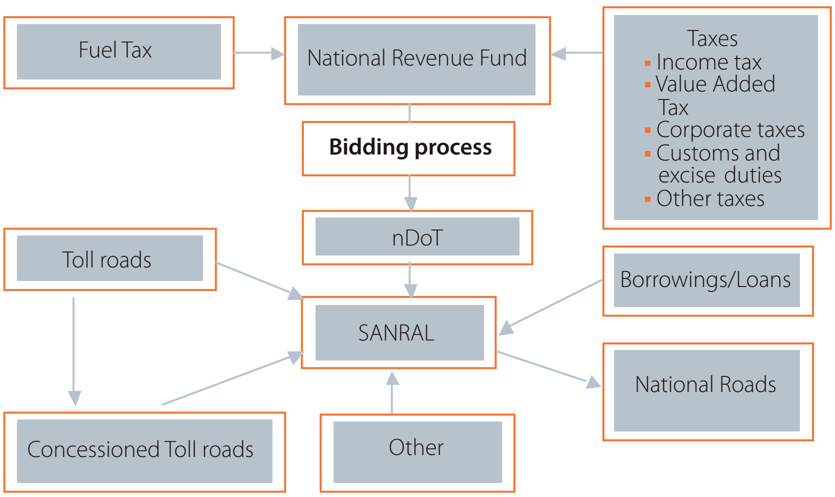
(15%) consists of approximately 1 500km of infrastructure managed by SANRAL and 1 300km granted as concessions to private investors. Toll roads administered by SANRAL are self-financing as they are financed through revenues generated from user fee charges, while concessioned toll roads are managed through thirty-year agreements signed between SANRAL and concessionaires. In this regard, national toll roads are self-financing. In recent years, the need to alleviate enormous financial pressures, resulting from having to improve and expand an aging national roads network, has prompted SANRAL to seek additional funding from the capital market.

Figure 11: Sources of funds for the national (non-toll) road network



Source: National Department of Transport (2002).

For sub-national governments, there is no dedicated, explicit source for funding the delivery of road infrastructure. Instead, the provision of road infrastructure is part of the overall expenditure functions of sub-national governments, funded mainly via intergovernmental fiscal transfers (see Figures 12 and 13).

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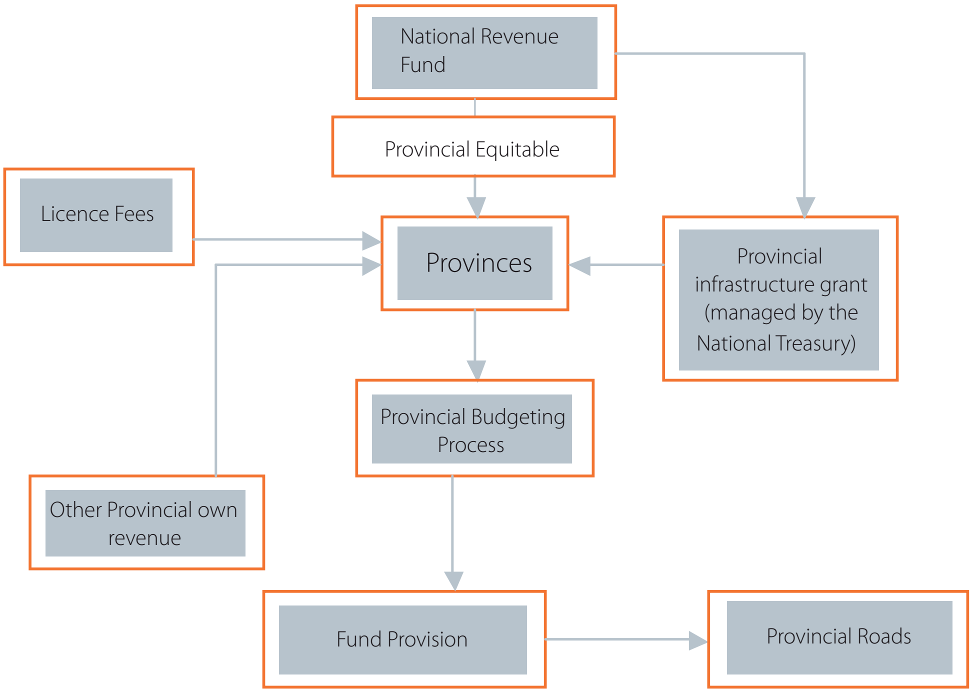
Figure 12: Sources of funds for the provincial road network



Source: National Department of Transport: Road Infrastructure Strategic Framework for South Africa (2006)

For provinces, non-conditional transfers in the form of equitable share allocations represent on average 95% of total revenues while income derived from narrow-based tax sources (including motor vehicle licenses) make up less than 5% of total revenues. Based on specific priorities and budgetary imperatives, provinces have discretion in determining the amount of resources to be allocated from their total revenue pool towards operating and maintaining their road networks. A portion of the infrastructure grant for provinces (33%) should supplement the provincial equitable share (PES) for roads construction and maintenance as stipulated by the Division of Revenue Act grant framework. The challenge is that this generates perverse incentives because provinces end up using PES to fund other provincial functions.

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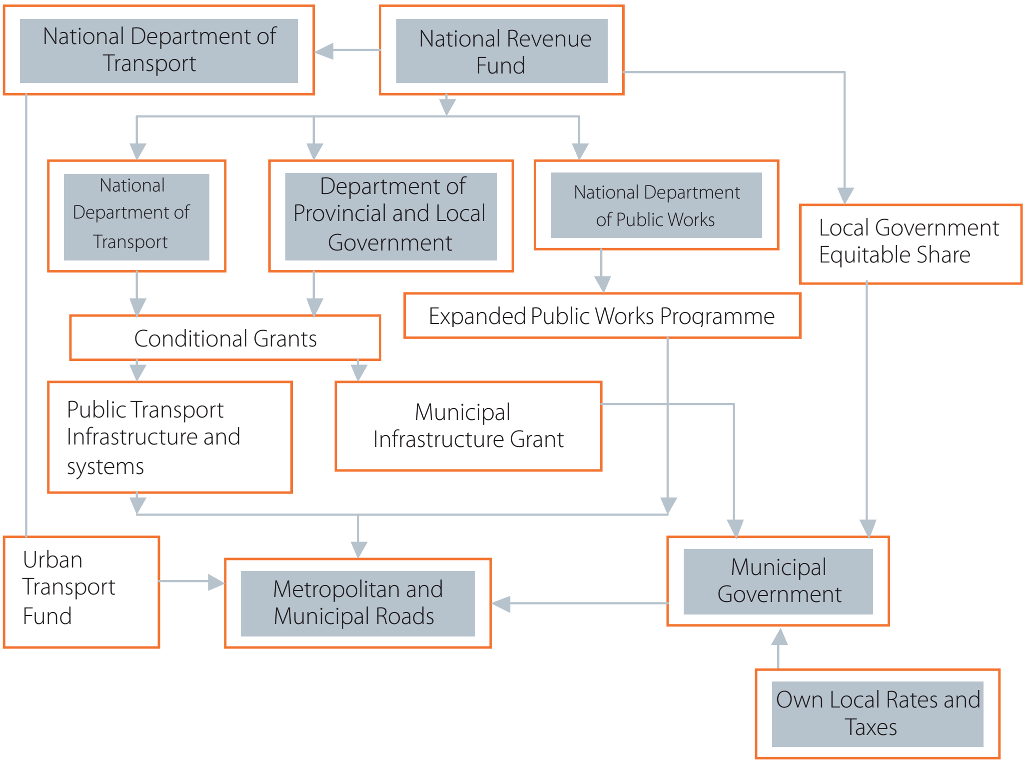
Figure 13: Funding streams for municipal provincial road network



Source: National Department of Transport: Road Infrastructure Strategic Framework for South Africa (2002).

Like the provincial sphere, equitable share allocations and own revenues constitute a pool of funds from which municipalities are able to finance their road infrastructure operations. While a number of metropolitan and district municipalities utilise own-revenues to finance the delivery of road infrastructure, the majority of the country's 284 municipalities rely on three major conditional grant transfer programmes, namely: the public transport infrastructure and systems grant (PTIS); the municipal infrastructure grant (MIG); and the expanded public works programme (EPWP).

6.3 Key challenges in the current system of road financing and administration

While the prudent economic policies implemented in the country's first decade of democracy led to relatively strong economic growth, significant infrastructure backlogs in the key economic infrastructures (particularly in the electricity sector and the country's rail and road networks) had become 'binding constraints' to government's stated goal of growing the economy at a rate that enhanced job creation and reduced high levels of poverty. In a bid to address the country's infrastructure bottlenecks, a comprehensive programme of expanding public-sector capital investments was initiated in 2005, under the auspices of the Accelerated and Shared Growth Initiative for South Africa (ASGISA). The high levels of capital investment have boosted spending on the country's road infrastructure. Since 2005, annual growth in road expenditure by the three spheres has averaged 24%. In absolute terms, investment in road infrastructure has more than doubled since 2000 and is expected to be almost 2% of GDP by 2010 (see Figure 14).

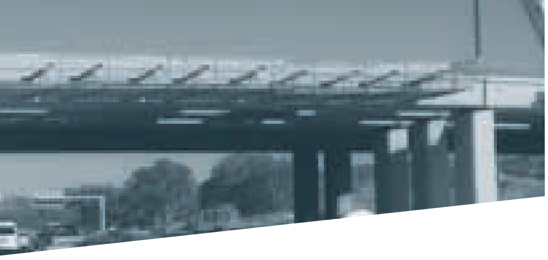


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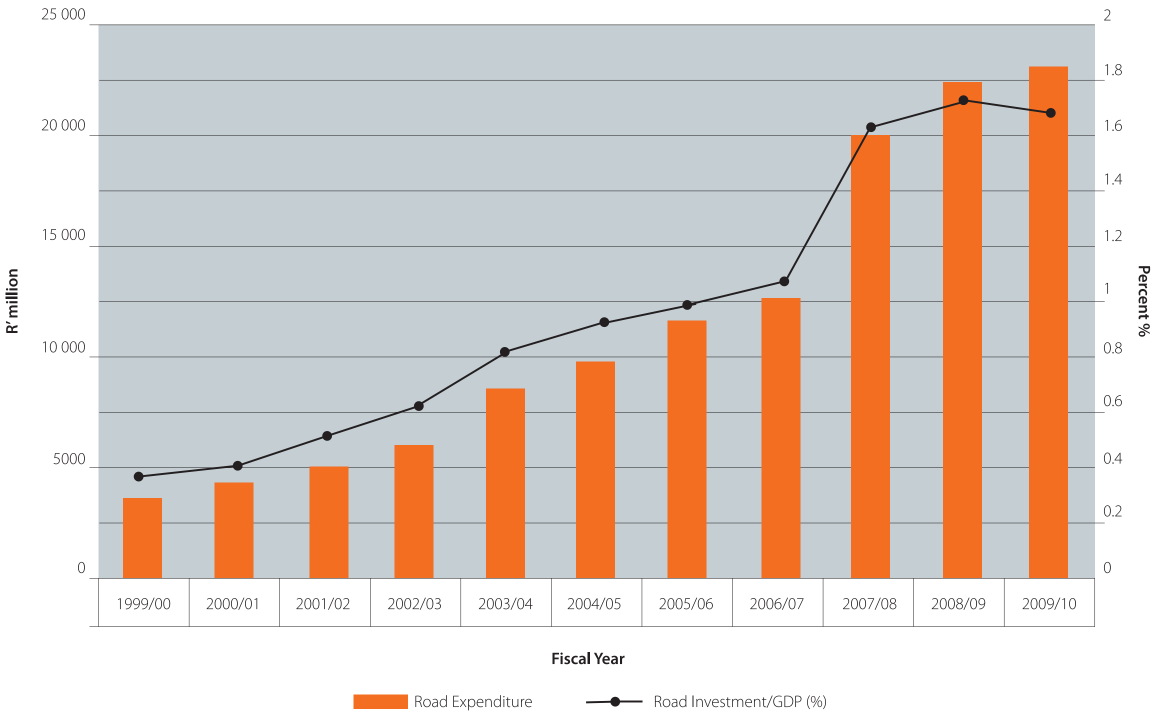
Figure 14: Road investment indicators, 1999/00 – 2009/10



Source: National Treasury Budget Review (various years); Reserve Bank Statistical Bulletin. Note: Road expenditure figures include all road expenditures by national, provincial and metropolitan governments as well as authorities in secondary cities.

Despite the scaling up of investments, a general decline in the condition of the country's roads has continued. In a recent report on road conditions, it was noted that the number of roads categorised as 'poor and very poor' doubled between 1998 and 2008, while the number of roads categorised in 2008 as 'good and very good' was only a third of what was obtained a decade earlier (see Figure 15). In addition, the 60% of national and provincial roads in 'poor' and 'very poor' condition contrasts sharply with the international benchmark, which stipulates that only a maximum of 10% of total road network can be permitted to be in such conditions (Automobile Association South Africa, 2008).

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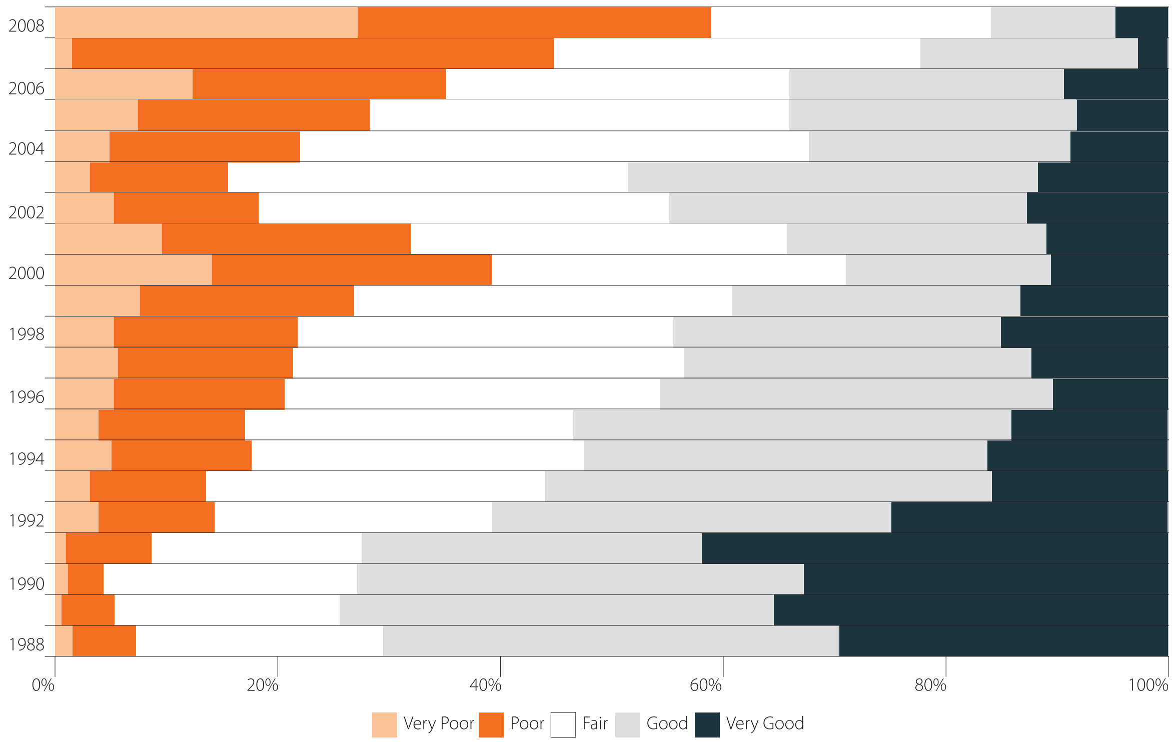
Figure 15: Condition of surfaced roads in South Africa, 1998 – 2008



Source: Automobile Association South Africa (AASA, 2008)

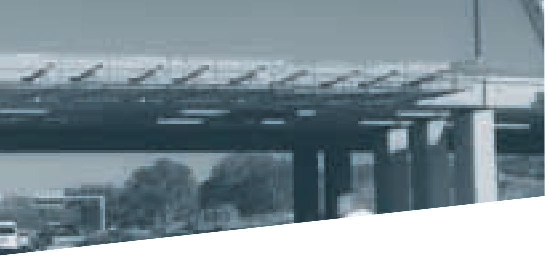
Two key challenges face the delivery of road infrastructure in South Africa, namely inadequate financing arrangements (especially at sub-national spheres), and institutional arrangements set up to deliver and manage road infrastructure.

6.3.1 Road financing arrangement

Funding arrangements are critical for the effective provision of roads. Where adequate and stable flows of funds are lacking, then road maintenance policies will not be sustainable (Heggie, 1995). The national road infrastructure under the administration of SANRAL is funded from two primary sources: revenues from non-tax revenues (mainly from user-charge fees imposed on tolled roads), and direct transfers from the nDoT. In addition, SANRAL is allowed to supplement its funding via loans secured in the capital market. Although SANRAL's initial participation in the capital market was limited by the National Treasury's principle decision to limit guarantees for SANRAL's loans to R6 billion, the granting of an independent credit rating in 2007 has enabled SANRAL to secure relatively significant funding, albeit at higher loan premiums.[34] The granting of a credit rating has also allowed SANRAL to move from being a mere agency that structures public-private partnerships, to a roads utility capable of constructing, owning and operating road infrastructure in a sustainable manner.

In sub-national spheres, funding arrangements for roads are markedly different. At provincial level, funds for road maintenance are allocated as part of the budgetary process. Under this arrangement, each provincial department competes for funds during the annual budgetary process. In the absence of norms and standards for roads maintenance budgeting, provinces use their own discretion to allocate funds

[34] As part of a programme aimed at providing SANRAL with flexible funding options in the debt capital markets, the road agency in 2008 established a R10 billion Domestic Medium-Term Note (DMTN) programme. This programme forms part of a larger programme of placements aimed at raising about R44 billion by 2012.



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for this item. In the years following the post-democratic transition of 1994, the major part of allocations from PES revenues continued to be channelled towards reducing poverty and historical inequities. This resulted in a significant share of available funds directed at services with strong redistribution and spill-over effects – education, health services, social welfare, and housing. Between the 2003/04 and 2007/08 financial years, provincial spending on social services made up 76% of total provincial expenditures; the remainder (24%) was allocated to other provincial functions that included agricultural support to farmers, construction and maintenance of provincial roads, and the financing of provincial administrations (see Table 18).

Table 18: Comparison of roads expenditure against priorities

Local Government expenditure								
	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	**TOTAL**
R million	Outcome	Outcome	Outcome	Outcome	Medium-term estimates			
Capital expenditure	10,629	13,326	17,219	20,878	39,735	39,065	30,377	**171,232**
Water and sanitation	1,839	2,925	4,014	4,957	10,397	9,260	8,717	**42,111**
Electricity	1,267	1,599	2,295	2,724	4,426	4,255	4,063	**20,631**
Housing	658	718	658	1,269	3,892	4,586	4,220	**16,003**
Roads and storm water	1,774	1,750	2,516	3,221	5,535	6,466	5,012	**26,278**
Other	5,089	6,332	7,734	8,705	15,484	14,497	8,362	**66,207**
Metro roads infrastructure	1,372	1,626	1,440	1,571	2,502	2,890	2,345	**13,749**
Secondary city roads infrastructure	280	469	534	651	962	1,121	876	**4,895**
Metro roads maintenance	775	1,004	958	929	1,130	1,303	1,450	**7,552**
Secondary city roads maintenance	212	240	260	338	363	359	386	**2,161**
Provincial expenditure								
Roads infrastructure	5,761	6,340	7,553	8,795	10,382	11,814	13,400	**64,045**
Roads maintenance	2,386	2,617	3,115	3,550	4,066	4,884	5,416	**26,034**
Health	36,987	40,599	47,116	53,648	59,252	64,939	71,182	**373,723**
Social development	3,209	3,650	4,220	5,173	6,550	7,875	8,735	**39,412**
Education	60,255	64,670	71,981	78,963	88,719	98,505	107,327	**570,420**
Housing	4,563	4,629	5,067	6,549	8,238	9,853	11,531	**50,430**
National expenditure								
Roads infrastructure	1,293	1,450	1,783	2,382	3,498	4,175	5,630	**20,211**

Source: National Treasury: Provincial Budgets and Expenditure Review: 2003/04-2009/10, and Local Government Budgets and Expenditure Review: 2003/04 – 2009/10.

In 2001, the social sector bias of provincial budgets, coupled with a need to assist provinces in dealing with infrastructure backlogs in education, health, and roads and agriculture, prompted the National Treasury to introduce the infrastructure grant for provinces (IGP). Although guidelines related to the disbursement of IGP funds stipulate that 33% of available funds should assist in funding construction, maintenance, upgrading and rehabilitation of new and existing road infrastructure, provinces do not generally comply, spending far lower percentages on road infrastructure and prioritising other sectors.

Section 153a of the Constitution mandates local government to give priority to fulfilling the 'basic needs' of their communities. Like provinces, this legislative imperative has resulted in most municipalities focusing their budgetary allocations on providing social services linked to water, electricity, sanitation, refuse removal and environmental health care. Between the 2003/04 and 2007/08 financial years, average spending on road infrastructure amounted to less than 8% of total municipal spending, with most of the spending undertaken by authorities in the major metropolitan areas and secondary cities (these accounted for 60% and 30% of the aggregated municipal road infrastructure budgets respectively). The paucity of resources for road infrastructure is even more telling for small municipalities; while small municipalities account for 10% of the total road infrastructure budget in the municipal sphere, many have road infrastructure budgets that are less than R500,000.

6.3.2 Institutional arrangements for road infrastructure delivery

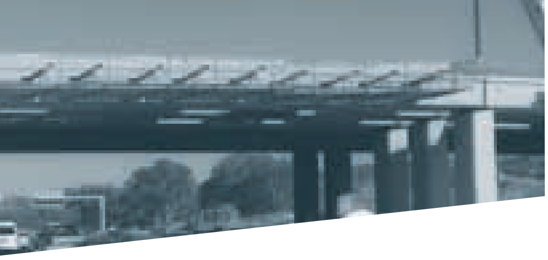
Globally, two key methods dominate the approaches to delivering road infrastructure. With the first approach, the traditional or departmental approach, road transport infrastructure is provided by a government department or agency (in most cases a public sector roads agency). Given that such a department/agency is largely or totally funded from the fiscus and is subject to ministerial directions, it is often the case that the autonomy of road agencies or departments in undertaking construction and maintenance projects is limited by the governance arrangements decided by the minister. The second approach, the output-based management approach, involves funding service providers on the basis of agreed specific outputs. In this model, government decides on desired outcomes and then purchases specific outputs from competing providers in a competitive environment. Linked to the output-based management are performance-based contracts, which put more emphasis on contracting out road maintenance to reduce costs and improving road conditions so as to meet the challenges of financial constraints faced by authorities.

South Africa operates a mix of these two models. At national level, the main roads development and management organisation, SANRAL, is a dedicated road development agency with expertise and capacity in the management of road infrastructure. SANRAL's capacity ranges from an independent board of directors, dedicated specialist personnel, cash flow streams, planning, project management, and asset management systems. This capability affords SANRAL the ability to manage efficiently the national road network and continuously conduct research on new technologies that can be used to improve management of the national road infrastructure. In this regard, road delivery functions by SANRAL can be described as excellent (nDoT, 2002).

For sub-national authorities, the favoured public service delivery approach made the delivery of roads extremely variable. Eight of the nine provinces operate on a traditional road authority structure. The exception to this is the Limpopo province which switched to a combination of the traditional road authority structure for its maintenance arm, and a roads agency structure for the remainder of its functions. For the remaining provinces, road infrastructure operations are handled by:

(i) Department of Public Works, Transport and Roads in the provinces of the Free State, Gauteng and Western Cape;

(ii) Department of Transport and Roads in the provinces of the Eastern Cape, Limpopo, Mpumalanga and North West, and



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(iii) A Transport Department in the case of Kwazulu-Natal.

While the more narrowly focused functions of roads in provincial administrations helps overcome potential problems of cumbersome and ineffective management of roads, the major problem facing road management institutions is a shortage of professional managerial and technical skills (see Table 19).

Table 19: Summary of technical skills in provincial roads sector

Technical staff employed in roads and transport departments

There is a severe shortage of technical skills, especially civil engineering skills in provincial departments of roads and transport.

The results of a survey undertaken by National Treasury in 2006 in five provincial departments of transport (Eastern Cape, Free State, Gauteng, Limpopo and Northern Cape) show that:

- the technical sectors of provincial departments of transport are under-staffed;
- the average age of engineers is 50, so most senior engineers will be retiring in the next few years;
- the few remaining senior engineers available play a more managerial role, so the departments do not really benefit from their technical skills;
- in some cases senior engineers have to do junior level work because of the shortage of available young engineers.

Posts	8 or more years experience after university degree	Engineers 4-7 years experience after university degree	0-3 years experience after university degree	More than 8 years experience after qualifications	Technicians 5-8 years experience after qualifications	0-4 years experience after qualifications
Filled	55	18	9	93	89	89
Vacant	58	68	21	134	102	167
Total	**113**	**86**	**30**	**227**	**191**	**256**
%Filled	48.70%	20.90%	30.00%	41.00%	46.60%	34.80%

The situation is even more acute within municipal jurisdictions. According to the National Land Transport Transition Act (Act No. 22 of 2000), each municipality is a planning authority tasked with ensuring that road delivery operations are carried out in an effective and efficient manner. However, very few municipalities have dedicated road authorities and lack capacity to carry out road management functions.[35] According to research undertaken by the SAICE in May 2005, of the total of 283 municipalities, 78 did not have civil engineers and 49 had only one civil technician. Although municipalities account for about a third of road sector employees, approximately 70% of these employees fall into the 'elementary' or 'semi-skilled' category (mainly labourers) while skilled personnel (mainly engineers) make up less than 9% of personnel (see Table 20).

[35] To the best of the authors' knowledge, the only significant dedicated roads entity at municipal level is the Johannesburg Road Agency.

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Table 20: Estimated skill profile of municipal road-related human capital

Skill category	Split (%)
Legislators, senior officials and managers	0.3
Professionals	1.2
Technicians and associate professionals	7.0
Clerks	14.1
Semi-skilled workers	22.8
Elementary occupations	54.6
Total	**100.0**

Source: National Department of Transport: Road Infrastructure Strategic Framework for South Africa (nDoT, 2002).

The discussion above indicates that the lack of critical technical skills has major implications for road management functions of sub-national authorities. Very few sub-national authorities have well-developed road management information systems while little or no studies exist on assessment of road conditions.[36] Without such key inputs, many sub-national road authorities have very little quality information on which to base managerial performance evaluation and needs identification processes, further exacerbating the poor condition of available road network infrastructure. Furthermore, it also limits the ability of road authorities to generate and evaluate alternative ways of operating, improving, and extending the road network.

6.4 Addressing key challenges in administration and financing of road infrastructure

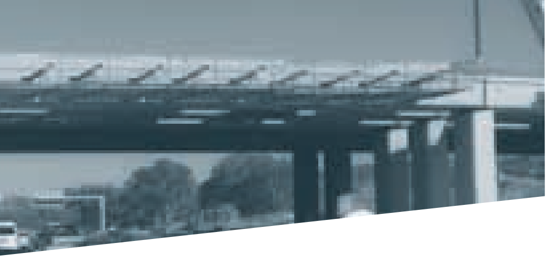
South Africa's road infrastructure remains the most developed on the African continent. However, years of under-investment in maintenance and rehabilitation have led to significant deterioration in the road network, particularly at sub-national levels. Current resource flows and funding arrangements are inadequate and insufficient to tackle an ever-increasing backlog problem and the increased demands placed on the country's roads. Further compounding the issue is the institutional arrangements relating to road service provision. A well-resourced and technically capable agency has ensured that the national road network remains in good condition, while the focus on social service delivery and lack of dedicated roads bodies at sub-national level has lowered the quality of road infrastructure within provinces and municipalities.

From the discussion outlined in the previous section, the main problems affecting South Africa's road infrastructure are financial and institutional. Solving these problems will require that policy-makers focus on two key issues: (i) boosting road finances by providing an adequate and stable flow of funds for road infrastructure; and (ii) improving the capacity of institutions tasked with managing the country's road infrastructure. The discussion that follows outlines these two issues in greater detail.

6.4.1 Adequate and stable flow of funds

Dealing with the roads challenge will require an increase in the amount of funds dedicated to funding of road infrastructure, particularly at sub-national level. The government needs to formulate pricing and

[36] According to the nDoT, all provincial authorities used to carry out annual 'visual inspection index' studies but, in the decade prior to 2002, more than half had curbed or stopped such surveys. The same document noted that almost half of the municipal road authorities had non-existent road network information systems.



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cost recovery policy for roads that generate sufficient revenues for authorities to maintain and operate their road infrastructure network on a sustainable basis. A number of options exist in this regard. The use of charging instruments that are related to road use, easily recognisable, and separate from indirect and other service fees provide a potential revenue source. The use of such instruments already exists in South Africa in the form of the fuel levy and motor vehicle licenses.

Earmarking a portion of road-related user charges and taxes paid into special road funds has been widely used in developed countries, such as the United States, New Zealand and Japan, to fund the construction and maintenance of road infrastructure. Over the last decade, countries such as China and India have introduced road-related charges that have provided a reliable stream of funds for road construction and maintenance (Postigo, 2008). Historically, the utilisation of a dedicated road fund and the earmarking of a share of taxes on fuel proved pivotal in modernising the country's road infrastructure and laying down the current system of roads in South Africa. The South African National Treasury has previously opposed the setting up of a roads fund and earmarking road-related user charges on the basis that earmarking imposes undesirable rigidity on government expenditure decisions and should be discouraged. Given the magnitude of the road problem and the massive deterioration anticipated if current funding levels are not increased, the government should re-examine the possibility of setting aside portions of road-related revenues and pooling such shares into a road fund dedicated to financing road infrastructure backlogs, especially at sub-national levels. The allocation of resources in the road fund can then be allocated between different road authorities at provincial and municipal level based on (i) a simple allocation formula, (ii) an indirect assessment of needs, or (iii) a direct assessment of needs to ensure that resources are allocated according to a thorough and objective assessment of road needs across the three spheres of government. It could well be argued that such a proposal should take into account the fact that not all fuel consumption is related to road use and, given the current backlog levels, required expenditures for road infrastructure are generally likely to be larger than the earmarked amounts. In this case, the government should give consideration to including explicitly a road infrastructure component within the provincial and local government equitable share formulae.

Beyond the two policy proposals outlined above, other avenues for increasing the funding of road infrastructure exist. As South Africa seeks to expand the arterial road network in its major urban centres, attention needs to be given to examining the amenability of high traffic volume routes to toll exploitation. Additional funding can also be obtained through expanding the role of lending institutions specialising in infrastructure development and enhancing the capacity for sub-national governments to access capital from domestic financial markets. The poor financial state of many sub-national governments and the risks of borrowing for profligate spending have often been cited as factors that have impacted on the capacity of many sub-national authorities to tap into capital markets. However, the increasing role of provincial and local governments in infrastructure development, continued strengthening of regulatory accounting and management standards as well as careful oversight by National Treasury and specialised financial institutions such as the Development Bank of Southern Africa offer a beneficial means for reconsidering restrictions on the ability of sub-national entities to source the funds for infrastructure investment in the capital market.

6.4.2 Institutional arrangement

Increased funding of South Africa's road infrastructure network cannot be effective without the inputs of well-capacitated road authorities across the three spheres of government. Road bodies/agencies with prerequisite management and technical skills are vital to the management and sustainability of South Africa's road network.

It is acknowledged that the roads sector faces severe challenges with engineering skills, from professionals through to technicians and artisans, in short supply. If additional funding is to be allocated to infrastructure maintenance and rehabilitation, to ensure that the road network fulfils its socio-economic objectives,

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short-term strategies should be put into place to ensure that the roads sector will be able to operate at its best and that the development and maintenance of South Africa's road infrastructure will be able to keep up with the growing demand. This will require greater coordination of road management functions across the three spheres of government. To this end, the inter-road authority coordinating model proposed by the nDoT needs to be reviewed and modified for possible implementation (see Appendix A for details of the model). Unlike an intra-authority system set up to enhance the effectiveness of a particular road authority's management of roads within its area of jurisdiction, this inter-authority system coordinates activities between various road authorities at a strategic level. In this particular case, the coordinating body (consisting of the nDoT and extant road authorities in the nine provinces and municipalities) should be responsible for:

- developing a roads policy on norms and standards, including guidelines on classification;
- implementing a needs assessment framework to assist National Treasury in its allocations of road-related funding for road funding;
- developing an integrated management information system in line with section 6(1) of the National Land Transport Transition Act of 2000.
- developing a standardised monitoring and evaluation framework for road infrastructure; and
- formalising arrangements for technical and professional collaborations between SANRAL and sub-national entities lacking in technical and managerial aspects of road infrastructure management and development.[37]

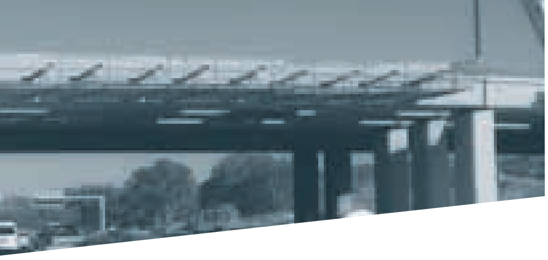
Finally, with the full realisation of the potential benefits of improved funding for road infrastructure, maintenance and rehabilitation likely to be hampered by the lack of technical skills in the road sector, allocating conditional grants for building road management capacity can help assist in addressing the most urgent skills deficit in sub-national road management sectors, and also maintain or broaden skills base.[38]

6.5 Conclusion and recommendations

This chapter provides an assessment of the administrative and funding arrangements for road transport infrastructure in South Africa. Years of under-investment in maintenance and rehabilitation has led to significant deterioration in the country's road network, particularly at sub-national levels. Current resource flows and funding arrangements appear inadequate and insufficient to tackle an ever-increasing backlog problem and increased demands placed on the country's roads. Further compounding the issue is the institutional arrangements relating to road service provision. A well-resourced and technically capable agency has ensured that the national road network remains in good condition, while the focus on social service delivery and lack of dedicated roads bodies at sub-national level has lowered the quality of road infrastructure within provinces and municipalities.

Given the finite quantum of funds, developmental and social programmes have often received greater priority in budgetary allocations across the three spheres of government. For roads to be financed more efficiently, it is important that innovative funding mechanisms be developed. Dedicated roads funding and allocating available funds based on a careful and rigorous assessment of roads needs across the three spheres of government will be crucial in alleviating future pressures on road network. In addition, ensuring that sub-national entities are able to access capital financing and also apply some form of road-user charges can assist in dealing with backlogs.

[37] This is often termed 'twinning'. Twinning programmes have linked a wide variety of institutions in the past, including utility companies, city administrations and development banks, as well as road agencies.
[38] The use of conditional grants to improve capacity is not new. In the first few years following the establishment of the nine provincial and 284 municipal authorities, substantial conditional grants were allocated towards addressing critical constraints in financial and accounting management systems.



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In the past decade, South Africa has devoted considerable funding to developing and implementing (with minimal fiscal burden on the public,) a transport policy that is both efficient and sustainable. The present government's position[39] has translated into key policy frameworks underpinned by a growing recognition that the country's road network is an essential component of the overall transport infrastructure. The current road transport infrastructure strategy highlights the need to address three key issues: (a) an emerging sustainability crisis and deterioration of the road network; (b) ensuring that the road infrastructure is able to cope with increased demand driven by larger volumes of both passenger and freight commuting; and (c) the institutional coordination implications of addressing backlogs and under-spending in the road infrastructure

With respect to the management and financing of road infrastructure, the Commission recommends that:

1. There should be an increased and stable flow of funds for maintenance, rehabilitation and addressing backlogs in the long term. Potential policy proposals to ensure that this is achieved can include:
    a. Formulating pricing and cost recovery policy for roads that generate sufficient revenues for authorities to maintain and operate their road infrastructure network on a sustainable basis.
    b. Earmarking a portion of road-related user charges and taxes.
    c. Explicitly including a road infrastructure component within the provincial and local government equitable share formulae.
    d. Expanding the role of development institutions and capital market in funding road infrastructure investment especially within sub-national spheres.
2. There should be greater coordination of road management functions across the three spheres of government. In this regard, the revision and modification of the inter-road authority coordinating model proposed by the nDoT (see Appendix A) should be carried out with a view to possible future implementation.
3. Priority should be given to addressing the lack of technical skills in the road management sector of sub-national governments. Attaining this objective can be done via the introduction of a separate conditional grant specifically targeted at building technical capacity within the road management sector of sub-national governments.

[39] As articulated in two White Papers: (i) National Transport Policy (Department of Transport, 1996), and (ii) Moving South Africa (Department of Transport, 1998); and a strategic policy document: (iii) Financing of Land Transport (Department of Transport, 1998).

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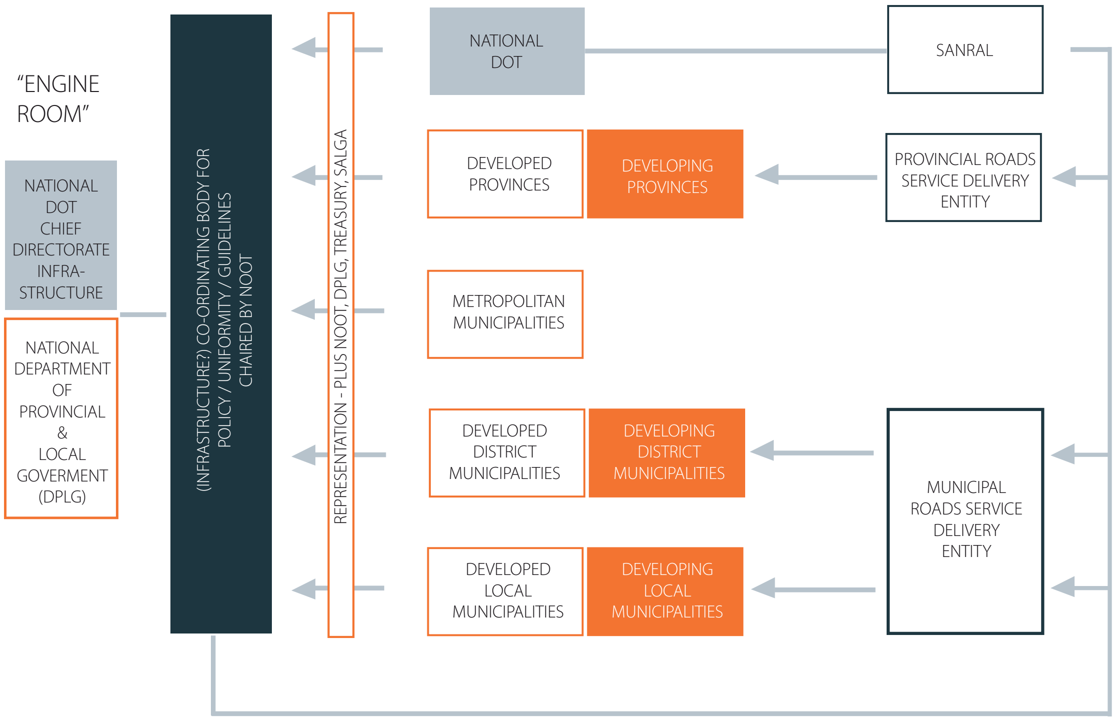
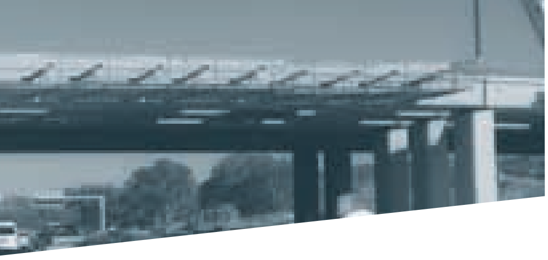
APPENDIX A:
Roads Coordinating Model of the National Department of Transport

In a discussion document entitled Road Infrastructure Strategic Framework for South Africa, the National Department of Transport (nDoT) proposed a roads coordinating body comprised of metropolitan municipalities, district municipalities, local municipalities and the South African Local Government Association (SALGA). According to the nDoT, the coordinating body will be structured in terms of the diagram below:

Figure A1: Roads Coordinating body





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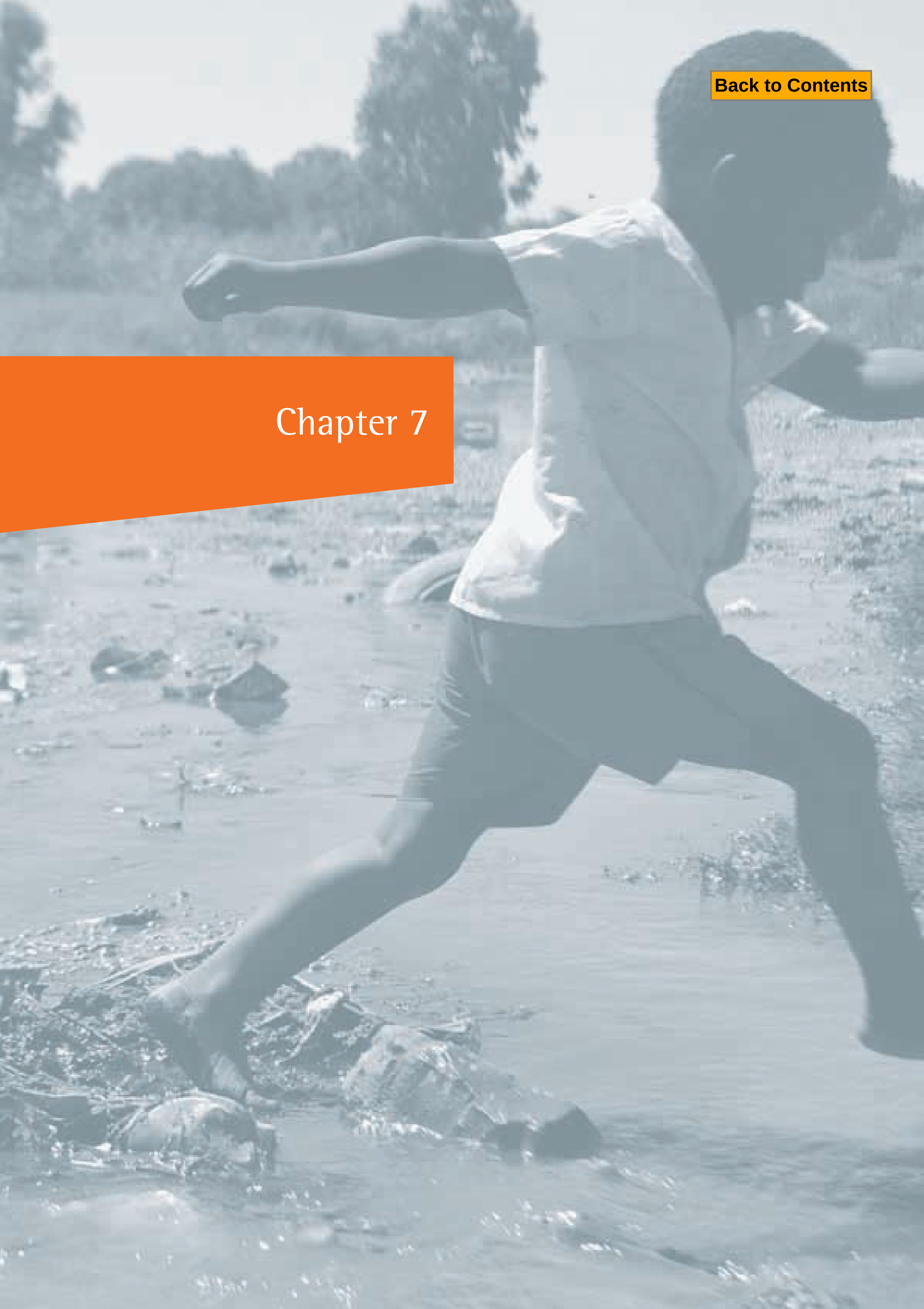
The functions of the body will include:

- Development of roads policy, standards and guidelines – including classification
- Review and normalisation of road proposals in developing provincial land transport frameworks (PLTFs) and municipal IDPs, and
- Allocation of road funding, including conditions for MIG funding relating to roads. The resources required to undertake the work of the roads coordinating body should come from the nDoT and the Department of Provincial and Local Government (DPLG), and a combined 'engine room', comprising officials from these two departments is recommended. The nDoT's part of the 'engine room' would effectively be the new transport infrastructure division within the department.

Roads service delivery would be affected by roads service delivery entities consisting of:

- SANRAL at national level
- A provincial roads service delivery entity at provincial level, and
- Municipal roads service delivery entity at municipal level.



Chapter 7

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Chapter 7 Assessment of Universal Access to Water and Sanitation Services

7.1 Introduction

Before the advent of democracy in 1994, water supply was inadequately and inequitably supplied to the South African population. Many people in rural areas and in some of the townships did not have access to safe and reliable water services. The sparsely populated nature of rural areas made them expensive for municipalities to reticulate infrastructure networks.

Water problems in South Africa are symptomatic of an emerging gap between national policies and implementation of such policies. For instance, recently the reliability and quality of water supply by municipalities has been receiving attention, with some experts warning that South Africa has serious water challenges (Abrams, 1996; Muller, 2007; Eales et al., 2009). Some of these challenges include a lack of qualified staff and insufficient investments in water infrastructure for both capital and maintenance. The drive to achieve universal access for water and sanitation is compounding the challenge. Most of the intended beneficiaries cannot afford to pay for services beyond the stipulated amount of free basic water services (Metcalf-Wallach, 2007).

7.2 South Africa's water supply framework

7.2.1 The constitutional and legislative process

The Constitution of the Republic of South Africa (No. 108 of 1998 as amended), the Water Services Act (No. 108 of 1997) and the National Water Act (No. 36 of 1998) emphasise the government's responsibility of ensuring that citizens have access to basic water and sanitation services. Muller (2007) argues that the Constitution underpins the right to water and sanitation "…since it is difficult to maintain minimum standards of dignity in the absence of water required for health and cleanliness and sanitation facilities which provide a modicum of privacy, convenience and comfort." However, he does acknowledge that social rights cannot be absolute and mandatory but their achievement is a long-term process. Section 27(2) of the Constitution provides that "… the state must take reasonable legislative and other measures within its available resources, to achieve the progressive realisation of each of these rights."

According to Abrams (1996), prior to the 1994 elections, the policy and functions of the Department of Water Affairs and Forestry (DWAF) were limited mainly to water resource management. This included the management of the larger water catchment areas; the supply of bulk untreated water to water boards (bulk treated water supply utilities), water quality management and the administration of the Water Act. Currently, DWAF is in the process of restructuring itself to be more responsible for policy development, regulation and support functions related to water and sanitation distribution services. The National Water Act divides the country into 19 water management areas (WMAs) based on river catchments, each to be managed by a Catchment Management Agency (CMA).

According to the Constitution, the Water Services Act of 1997 and the Municipal Structures Act of 1998, the responsibility for the provision of water and sanitation services lies with the municipalities. The water services function is shared between category B and C municipalities. Overall, there are 169 water service authorities in South Africa, including water boards, district municipalities, local municipalities and municipal water utilities. Even though the Constitution assigns the responsibility for ensuring the provision of water and sanitation services to municipalities, the function is concurrent between spheres of government in South Africa.

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The National Treasury (2008) in the Local Governments Budget and Expenditure Review (2003/04-2009/10) notes that the sharing of the water services function between category B and C municipalities is contributing to some of the difficulties currently being experienced in providing the service. These include:

- Confusion over responsibilities and accountability for the service in the community; and
- Confusion over funding and allocations of resources through the intergovernmental fiscal system.

The current practice is that the only recipients of the national grant for water and sanitation are the authorised municipalities. This becomes a problem in cases where authorised district municipalities delegate the responsibility for service provision to local municipalities without the (adequate) necessary resources/funds.

DWAF administered a number of water services schemes in poor areas before 1994. These were predominantly schemes in the former homelands areas that were created by those governments. There were 321 schemes which employed 8 094 staff and supplied water to 53 municipalities. The department has ended its role as water services provider and is transferring water schemes to the relevant municipalities. As at 2007/08 financial year there 317 water schemes and 57 transferring agreements signed (DWAF, 2007). This is to be finalised over the next three years and funding is to be phased into the local government equitable share from 2009/10. The transfer of water schemes involves the transfer of assets and staff, and the resulting operating costs of salaries and free basic services.

The effectiveness of the function and cooperative government does, at times, become compromised when responsibilities are not fulfilled because of a lack of resources. The capability of municipalities to carry out water service provision is uneven across the country. Where municipalities are incapable of performing their tasks, DWAF is empowered to intervene by strengthening the capacity of those municipalities.

Abrams (1996) notes that the role of water boards in providing treated water to municipalities and other large consumers mainly in urban areas has been a long standing institutional mechanism in the water sector. Water boards are regulated in terms of the Public Finance Management Act of 1999. The Water Services Act of 1997 has modified the role of bulk treated water supply utilities, or water boards, by defining their functions and those of municipalities. According to DWAF, the Water Services Act now allows municipalities to develop their own bulk water supply infrastructure or to buy bulk water from service providers other than water boards. A simplified institutional framework of the water sector is shown in Table 21.

Table 21: The institutional framework of the water sector in South Africa

First Tier	National Government (DWAF)	Water resource management support to municipalities,
Second Tier	Water Boards	Supply of bulk treated water on a commercial basis
Third Tier	Local Government	Supply of water and sanitation services to consumers

Source: DWAF, 2005

There are currently 15 water boards that employ over 6 000 staff. Their function, where they exist, is to provide bulk water services to local government in a defined geographic area. Municipalities provide

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reticulation services and manage the interface with water and sewerage customers, consistent with regulatory, norms and standards. Service standards for wholesale water, sewerage and recycled water services are set out in supply agreements that are commercially negotiated between water boards and municipalities. In other areas (e.g. Cape Town), DWAF plays the role of a bulk service provider or municipalities perform this function directly.

According to the Local Governments Budget and Expenditure Review (2003/04-2009/10), the estimated revenue of all water boards amounted to R5.9 billion in 2005/06. In terms of budget size and people served, the two largest water boards are Rand Water and Umgeni Water.

7.2.2 Review of water supply policy issues

Water supply policy reforms in South Africa, which started in 1994, form part of the government's overall programme of redressing past discriminatory legislation and practices. Referring to the White Paper on a National Water Policy for South Africa, DWAF (1997) states that

… the new water policy embodies the national values of reconciliation, reconstruction and development so that water is shared on an equitable basis, so that the needs of those without access to water in their daily lives are met, so that the productive use of water in the economy is encouraged, and so that the environment which provides South Africa with water and which sustains life and economy is protected.

Abrams (1996: 2) argues that South Africa will have some difficulties in reaching its stated policy objective because the country has a semi-arid climate with unevenly distributed rainfall (43% of the rain falls on 13% of the land) with high annual variability and unpredictability.

What underpin the analysis of the South African water supply are access, affordability, reliability and quality of water services. According to Jackson (1998), out of a population of 43.8 million in 1995, about 52% of the population was urban, and 18% of urban dwellers (4 million) had only a minimal water supply or none at all. The equivalent figure for lack of urban sanitation was 22%. In rural areas, Jackson (2003) estimated that 40-60% of the population (8-12 million) did not have an adequate water supply service.

At the United Nations Millennium Summit in 2000, countries adopted the challenge of attaining the eight Millennium Development Goals (MDGs) by pledging to meet specific targets aimed at eradicating extreme poverty by 2015. Central to all eight goals is water. The central role of water in human and physical development was formally recognised in target ten that aims at halving by 2015 the proportion of people without sustainable access to safe drinking water and basic sanitation. In responding to the Millennium Summit pledge, South Africa made its own specific targets that all people of South Africa will have access to:

- safe drinking water by 2008; and
- basic sanitation by 2010.

7.2.3 Skills challenges in the water sector

South Africa has placed itself at the forefront of water resources management through the development of remarkable policy and legislation. However, the shortage of skills, especially technical skills, is a challenge for the implementation of the water policies and legislation. In this respect, DWAF (2005) notes that the recruitment and education of technical people has become a 'critical bottleneck' that seriously affects the department, water boards, municipalities, the South African Institution of Civil Engineering (SAICE) and the Water Institute of South Africa (WISA) in fulfilling constitutional obligations to provide reliable water and sanitation services.

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The shortage of technical skills is severe in South Africa. According to Lawless (2007), the ratio of civil engineers to total population in South Africa is 1:3170, while in Europe the ratio is 1:400-500. A survey undertaken by SAICE in 2004 revealed that local authorities have experienced a severe loss of engineers and technologists over the past 14 years, leading to the collapse of infrastructure and maintenance programmes, widespread demand failures and water treatment failure (SAICE, 2004).

The survey also found that there are proportionately more unfilled posts at the senior professional and technical level than in any other category of positions in local government. The survey indicates that of the 278 local and district municipalities, 83 have no civil engineers, technologists or technicians, and 44 have only one civil engineering technician. Specific issues identified during the survey by SAICE are:

- The high turnover of staff;
- The loss of skills and institutional memory following the departure of experienced staff;
- Little or no career-path planning and succession planning; and
- Loss of mentors following the departure of experienced staff.

SAICE (2008) also notes that a large proportion of the best qualified and most experienced technical staff in municipalities will be retiring in the next 10 years, taking with them much of the institutions' skill, experience and institutional memories.

A number of skills development initiatives aimed at training in scarce skills are being put in place in the water sector. A water sector support coordinating unit (WSSCU) was established within DWAF in 2007 to focus on the acceleration of basic water services delivery, by identifying and addressing project implementation bottlenecks in DWAF and municipalities. Hands-on engineering and technical support is provided through the Development Bank of Southern Africa's (DBSA) Siyenza Manje programme, the SAICE deployment programme known as ENERGYS (engineers now to ensure rollout by growing young skills), and the Masenzani management support contract. More creativity is needed to circumvent skills challenge in the sector, especially at local government level. This relates to partnerships, training, joint ventures and retention strategies.

This shortage of skills in the industry necessitates urgent recruitment, training, mentoring and retention of critical skills across all institutions responsible for water and sanitation services. Water institutions should use a variety of instruments to circumvent capacity challenges. Some of the options to consider are:

- Issuing of bursaries for scarce skills;
- Developing mentorship programmes;
- Developing and implementing retention strategies to deal with staff turnover;
- Establishing Water Shared Services Centres with roving teams to assist municipalities;
- Embarking on joint ventures with engineering companies.

7.3 Balancing government control and independence of the water regulator

The comprehensiveness of the water industry makes the subject of water economics complex and evolving. The consequence of the political importance of water is that governments attach considerable priority to retaining the ability to maintain control over decisions that will affect its development (Griffin, 2006). The importance of maintaining policy control over the water sector is also complicated by the

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ability to balance contestations between policy implementation and trade-offs in certain circumstances. The industry structure, conduct and performance indicate that issues of economic regulation in the sector will become prominent and will attract a lot of public and political interest. There has to be a robust discussion on the various aspects of regulation. This relates to the creation of an autonomous regulatory authority with enough powers to achieve water policy objectives.

It is crucial that regulators should be clearly independent from the businesses that they are charged with regulating. A key role of regulators is to maintain the right balance between the interests of consumers and the interests of service providers. It is logical, therefore, that regulators should not come under the control of government or consumer representatives but report to Parliament.

Economic regulation through the use of a variety of instruments can play a role in ensuring that universal access targets are met, the environment is protected, quality water is provided, and that the industry is sustainable. Joskow (2005) points out that economic regulation covers both the regulation of price and non-price economic activities. Price issues in the context of regulation generally include, among other things, determining the rate of return, price-cap regulation and benchmarking. Non-price regulation on the other hand includes service provision in relation to security of supply, quality of supply, environmental, health and safety regulation, and responsiveness to complaints. Regulation is only feasible in uncompetitive markets and should assist in maximising marginal social benefits over marginal social costs.

Security of water supply, deteriorating infrastructure and alternative service delivery methods are driving legislative, policy and regulatory changes in water provision. The primary economic and regulatory concerns are to achieve efficiencies in the industry subject to political choices. The water sector is changing, and emerging policy issues span from the role of the state in the water sector, funding and infrastructure support to environmental regulation. The main thrust here is how to implement policies, strategies, programmes and projects, bringing in and using market-type mechanisms so that the institutions of the state can better manage the trade-offs.

The South African water supply industry is plagued by a number of structural deficiencies, and the government has embarked on a reform agenda to address them. The government must make a choice on the structure of the regulator and regulatory instruments to be used in the sector. The question is whether DWAF should be responsible for both policy development and regulatory oversight or should an independent regulator be established? Of critical importance for the establishment of the regulator is to deal with the industry structure and market design, including the extent of both vertical and horizontal integration. Regulatory provisions should be made to enable and/or encourage efficiencies within the entire supply chain in the sector.

In his State of the Nation address in 2006, the then President Thabo Mbeki indicated that the South African government's stance is that strong and proper regulation in the key sectors of the economy, such as energy, telecommunications and transportation, will contribute to better, predictable and informed decision-making. This should be extended to the water sector.

7.4 Water pricing and fiscal instruments

7.4.1 Water pricing

Water pricing affects the provisioning of water and sanitation services in South Africa. According to Eales et al. (2009), water tariffs and the free basic water subsidy programme coupled with transfers (equitable share and conditional grants) are instruments used for financing water services. These instruments are yielding differentiated service levels measured in terms of efficiency, affordability and willingness to pay.

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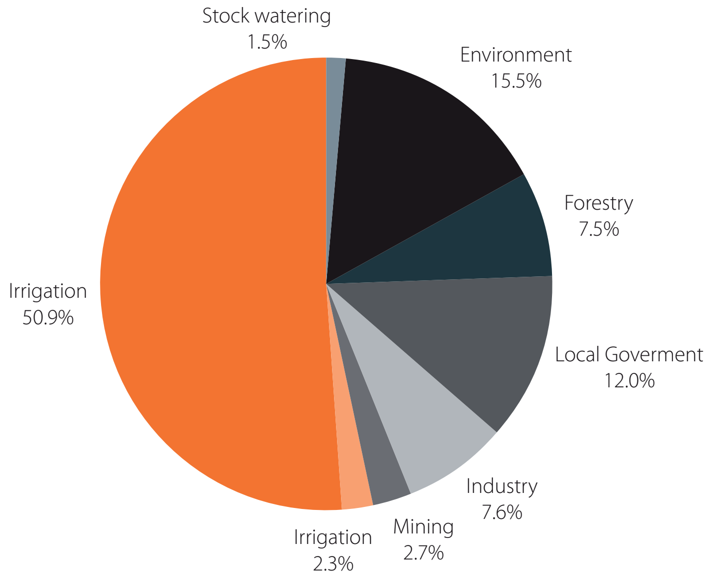
According to the DWAF (2005), water pricing policy is structured into three tiers:

- First tier: raw water tariffs administered by DWAF for the sale of water to water boards.
- Second tier: water boards set the wholesale price of water to bulk water users, such as municipalities, and industries, such as Eskom and Sasol.
- Third tier: municipalities determine the price of water to charge end users such as households and industries.

MacKay (2003:64) argues that "… historically, pricing of water in South Africa did not generally take into account the real cost of managing water, the cost of water supply and the scarcity value of water." MacKay further notes that the government financed the capital costs of water schemes supplying agricultural water users, some urban bulk water suppliers and industrial users. In addition, operation and maintenance costs were often not fully recovered from these water users.

Water pricing can be an instrument to foster efficiency and demand-side management. South Africa needs to implement its integrated water resources management (IWRM) strategy because it has a "semi-arid climate with unevenly distributed rainfall and differentiated utilisation rates" (Abrams, 2006). Figure 16 shows the demand for water per sector. Data presented in Figure 16 shows that irrigation within farming consumes more than 50% of water in South Africa. Local government consumes more than 12% of available water. There is a need for the country to manage its demand for water services carefully.

Figure 16: Demand for water for various water user sectors in South Africa



Source: DWAF, 2007

Proper implementation of water resource management is crucial. The policy is in place but plans are needed on a variety of issues pertaining to actual implementation. These relate to equitable allocation and usage of water, tariff and levies, water quality, standardised water supply regulations, loss management policy, related land-use policy, the impact of alien plant species in catchments and water-using appliance

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labelling policy. Coupled to pricing is a need for better coordination by WMAs and Water Management Institutions (WMIs) on functions and accountability

Pricing issues, no matter how contestable they may be; cannot be viewed in isolation from policies, governance and institutional structures. These issues affect the performance of the water supply industry. They are all important and interlinked. Any comprehensive review or analysis of the industry must touch on them.

7.4.2 Fiscal instruments

a. Local government revenue

Municipalities are responsible for funding most of their activities from own-revenue sources. Own-revenue sources on average make up 96% of their budgets (National Treasury, 2008). They have discretion in deciding on the composition of the service delivery packages, the levels of service and the manner in which services are funded. The challenge is that the local government system is currently characterised by huge disparities in terms of individual municipalities' local economies, revenue-raising capacity, and capacity (both infrastructural and human) to deliver basic municipal services. Poor and rural municipalities have difficulties providing basic services in general (Eales at al., 2009).

Municipalities use their own revenue to cross-subsidise services and between 'rich' and 'poor' households. A broad assessment of municipal revenues in poor and mostly rural municipalities, (the areas with the greatest service delivery needs), indicates that currently the direct cost recovery mechanism is not economical to cover the real cost of providing services (National Treasury, 2008). Thus, domestic water pricing is combined with a subsidy programme to achieve the goals of the National Water Act. It should be noted that it is difficult to cross-subsidise when everyone is poor. Shortfalls in revenue are either carried by the service provider or financed by intergovernmental transfers.

b. Water pricing as a source of local government revenue

The Constitution and the Local Government Municipals Systems Act of 2000 require that local government ensure that the services it provides are sustainable. The Department of Provincial and Local Government (DPLG) (2007) noted that the main gap in basic and infrastructure services delivery is the lack of sustainable financing. Municipalities must endeavour to provide infrastructure and deliver services within a financially and administratively sustainable framework. In respect of local government, there is a need for a trade-off between sustainability and the affordability level that must be achieved in the pricing of a basic service.

In South Africa, municipalities are using block tariffs to charge users for water consumption beyond the free basic water subsidy (Metcalf-Wallach, 2007). The common characteristic of block tariffs is that the first block price is free for all; the second block is sometimes set below the marginal cost price in certain municipalities. For blocks beyond, and for luxury uses such as filling swimming pools, extremely high prices are charged with the idea that the wealthy cross-subsidise the poor. This assumes that (a) the rich are sufficient high consumption users to cross-subsidise the first block; (b) the average cost of water remains transparent, with incentives for providers to set it at an efficient level; and (c) that punitive charges for high consumption do not result in a radical reduction in use and thus of revenues needed for the cross-subsidy.

Because all South Africans receive the same level of service, there is a contestation around the amount of water allotted as free basic water in terms of pricing and equity. Critics of block tariffs say the system is discriminatory towards the poor and makes a mockery of the notion of 'free basic water', as the poor cannot afford beyond the allocated amount. This compounds and exacerbates the already existing culture of non-payment for services. There is a need to review the pricing of water in order to limit errors of exclusion and inclusion amongst beneficiaries.

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c. The equitable share

Part of the local government equitable share (LES) is the provision of free basic services. Therefore, as part of the constitutionally mandated basic services, water becomes one of the first services for which the equitable share is charged. However because LES is an unconditional transfer, municipalities tend to use it to supplement operating costs of service delivery. Therefore this instrument, as a way of financing water and sanitation, is not ring fenced.

Other funding instruments that the government has in place include specific purpose grants, such as the municipal infrastructure grant (MIG) whose purpose is to fund the provision of supporting infrastructure and services, which are lacking, poor or inadequate.

d. Conditional grant funding for water

Prior to the MIG, there was a water grant funding known as the community water and sanitation services (CWSS), which was managed by DWAF. The grant formula was determined by the Reconstruction and Development Programme (RDP) and the associated policy on free basic water policy. CWSS won the Water Globe Award in 2000 as the most innovative programme in the world.

Third parties, such as local committees, NGOs or private companies that the Water Services Act (No. 108 of 1997) allowed to be made responsible for service provision at village level, benefitted from the CWSS. At one stage, the Mvula Trust (the largest NGO supporting water and sanitation development in South Africa) received 10% of funds allocated to CWSS. It is now heavily dependent on donor funds from the European Union (EU), Australian Aid (AusAid) and Irish Aid (Venter-Hildebrand et al., 2000).

After the promulgation of the Municipal Structures Act (No. 117 of 1998) as amended, the responsibility and authority to be water service authorities was transferred to local government. There was also a need for a multi-sectoral approach to fund municipal infrastructure. In this regard, the MIG replaced the CWSS.

MIG is a conditional grant for infrastructure investments transferred to municipalities. The grant is administered by the DPLG. Its goal is to eradicate municipal infrastructure backlogs by expanding access to basic municipal services. Municipalities in the urban renewal and rural development programmes are prioritised for support. Social institutions and micro-enterprises infrastructure are beneficiaries as well. The intention is to maximise opportunities for employment creation and enterprise development.

Sectors targeted by MIG are on-site services, internal reticulation, internal bulk such as local water resources, local water treatment, local supply and village reservoirs. Allocations to municipalities are made in terms of the formula that takes into account the backlogs, powers and functions and also poverty levels. The weights are allocated to the different components and sectors depend on the policy priorities of the government. Water and sanitation receives the bulk of MIG funds (see Figure 17).

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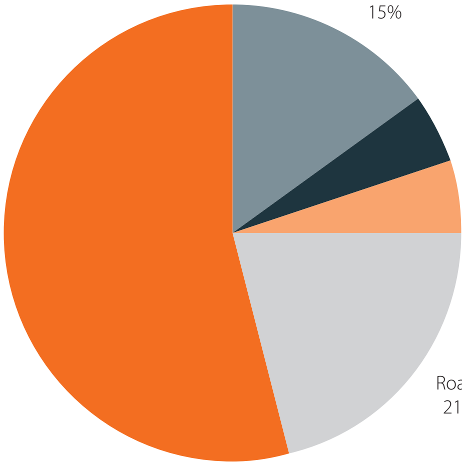
Figure 17: Municipal infrastructure grant components



Source: DPLG, 2007

The Division of Revenue Act requires that MIG allocations to all municipalities be fully spent in the year of allocation and failure to do so would result in funds being reimbursed back to National Treasury (i.e. no rollovers are allowed). The other grant earmarked for the water sector is the regional bulk infrastructure grant. According to the Division of Revenue Bill (2007), the application of this grant is specifically for:

- Water supply and sanitation regional bulk infrastructure, with the focus on 'regional' characteristic and the 'infrastructure' element.
- Macro and regional 'bulk' infrastructure (schemes). 'Macro' is defined as infrastructure serving extensive areas across multi-municipal boundaries.
- Internal bulk infrastructure is to be funded under alternative funding mechanisms (for example, the MIG for the basic services component).
- The 'capital' component of the scheme. This includes all aspects relating to the implementation of the infrastructure, planning, design, procurement and implementation, as well as setting-up the institutional arrangements. Funding for operations and maintenance must be obtained from alternative funding mechanisms and must be addressed as part of the grant funding application.

DWAF argues that this grant is required to connect the water resources, on a macro or sub-regional scale (over vast distances), with internal bulk and reticulation systems. Its performance in the 2007/08 financial year was that the programme consisted of 44 implementation readiness studies and 30 infrastructure projects (12 in construction phase and 18 in design and tender phase).

Alternative service delivery models should augment funding instruments. For instance, in rural areas where municipalities are struggling to provide adequate water and sanitation services, it is important to give assistance to organisations such as the Mvula Trust, community cooperatives or farmer groups who obtain the permission of their local government to identify and develop a water supply. Eales et al. (2009) propose that the reconsideration of Public Private Partnerships (PPPs) can improve efficiencies in the water sector. This must be linked to changes in the formulation of fiscal transfers, improvements in the design of tariff structures to permit the systems to meet demand, and better-targeted subsidies.

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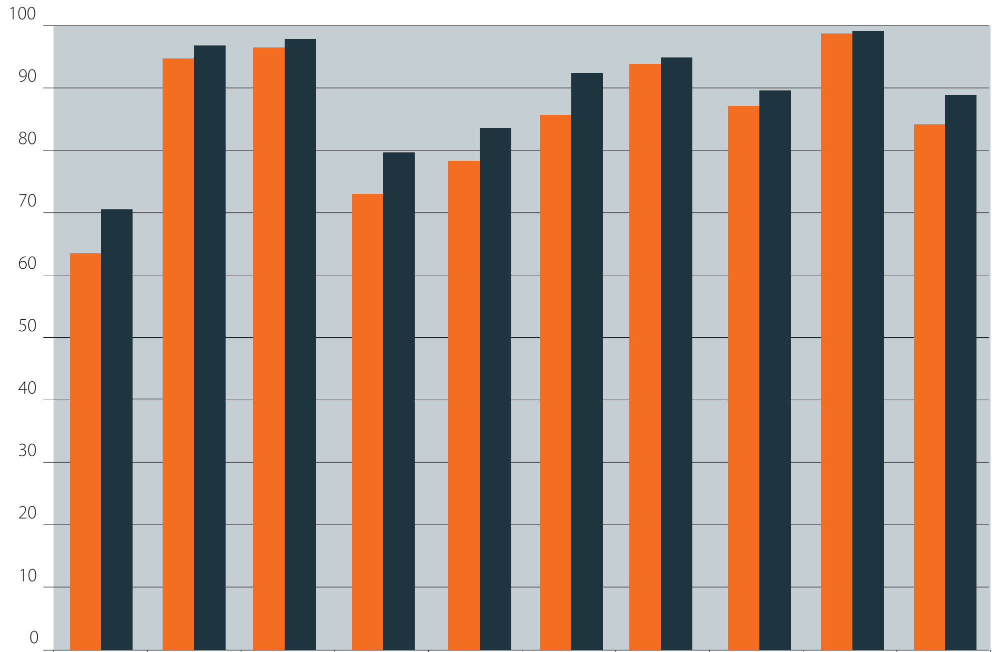
7.5 Analysis of free basic water policy

In response to the process of 'progressive realisation' of social rights, national government introduced a free basic water subsidy policy in 2000. In terms of this policy, all municipalities are required to provide a basic minimum quantity of water (6 000 litres per household per month) free of charge to all people in their areas (Kasrils, 2000). According to Muller (2007), the amount of water provided free is based on the 25 litres per person per day calculated for a family of eight members. For the poorest households not connected to a water network, the National Water Act stipulates that community pumps be installed within 200 meters of all houses. Muller notes that this is in line with the World Health Organisation's (WHO) recommendations which suggest that the priority should be to ensure that all people have access to this basic level of service before upgrading to household connections.

In assessing the government's achievement on this score, the 2007 community survey by Statistics South Africa (StatsSA) estimated that 88.6% of the population in South Africa had access to piped water in 2007 (see Figure 18). All provinces showed an increase in the percentage of households that had access to piped water. The percentage of households with access to piped water in Eastern Cape, KwaZulu-Natal and Limpopo is below the national average. Though access to piped water is increasing, South Africa has missed its target of making safe drinking water accessible to all by 2008. Policy issues pertaining to access, reliability, quality water, levels of service and pricing require a comprehensive review and considered attention.

Figure 18: Percentage of households with access to piped water by province



	Eastern Cape	Free State	Gauteng	KwaZulu Natal	Limpopo	Mpumalanga	Northern Cape	North West	Western Cape	South Africa
Census 2001	63.2	95.7	97.1	72.5	78.1	85.7	93.9	86.6	98.3	84.5
Community Survey 2007	70.4	97.5	97.9	79.4	83.6	91.3	94.8	89.9	98.9	88.6

Source: Statistics South Africa: Community Survey, 2007

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The 2007 StatsSA's community survey further highlights two critical demographic trends affecting the water services sector: urban migration and a rapid decline in the average size of households (from 4.5 to 3.9 between 1996 and 2007). These have created a large number of new urban households that require access to water services, therefore increasing the backlog. In addition, installed water services infrastructure requires expansion, rehabilitation and replacement to keep up with the demand as a result of economic growth. Collectively, this creates a significant financing challenge for water service authorities.

This challenge is compounded by the need to ensure that all South Africans are able to obtain access to water on a sustained basis, regardless of their ability to pay. Thus, financing strategies must balance the affordability of services with the significant investment needs of the sector. The water financing challenge needs to be resolved through a water pricing and subsidy strategy for the sector, as implemented by individual water services authorities. Ultimately, the final cost of water to consumers must be reflective of both the financial and environmental sustainability. Such sustenance should be premised from critical social policy concerns such as equitable access to services, affordability, ability and willingness to pay.

Currently national government has encouraged municipalities to provide free basic services subsidies through the tariff system. Within this system the subsidy is passed on to water account holders through consumption, as opposed to direct transfers. This leads to errors of exclusion and inclusion wherein large consumer units (households) sharing a single connection receive smaller per capita subsidies, while small-sized households receive larger subsidies. This is regardless of their ability to pay for services. Because it is consumption based the error that exists is that even the well-off households are not excluded by the subsidy, especially in areas where a mix of varied income-earning households exists.

Another challenge with the current subsidy is that people who do not have access to piped water are not beneficiaries of the policy. Therefore unless the government achieves universal access to this service, it becomes difficult to attain its objectives. Furthermore, tenants, particularly in high-density dwellings such as flats or compounds, are excluded from receiving the subsidy altogether.

Lack of transparency in the system between the service provider and the consumer further complicates the water subsidy system. As such, a tariff-based subsidy may discourage efficiency savings by service providers, as the average cost of water is hidden from the consumer and water services authorities. This has a potential to reduce the net benefit of the subsidy over time.

With respect to sanitation, the 2007 community survey estimated that by 2007 just above 60% of households had access to flush toilets. Free State, Gauteng, North West and Western Cape were the only provinces with more than 50% of households owning flush toilets. However, even though Free State had the highest number of households with access to flush toilets, they also had a high number using the bucket system. More than half of households in Limpopo (56.3%) used a pit latrine without ventilation, and 25.2% of households in Eastern Cape had no toilet at all.

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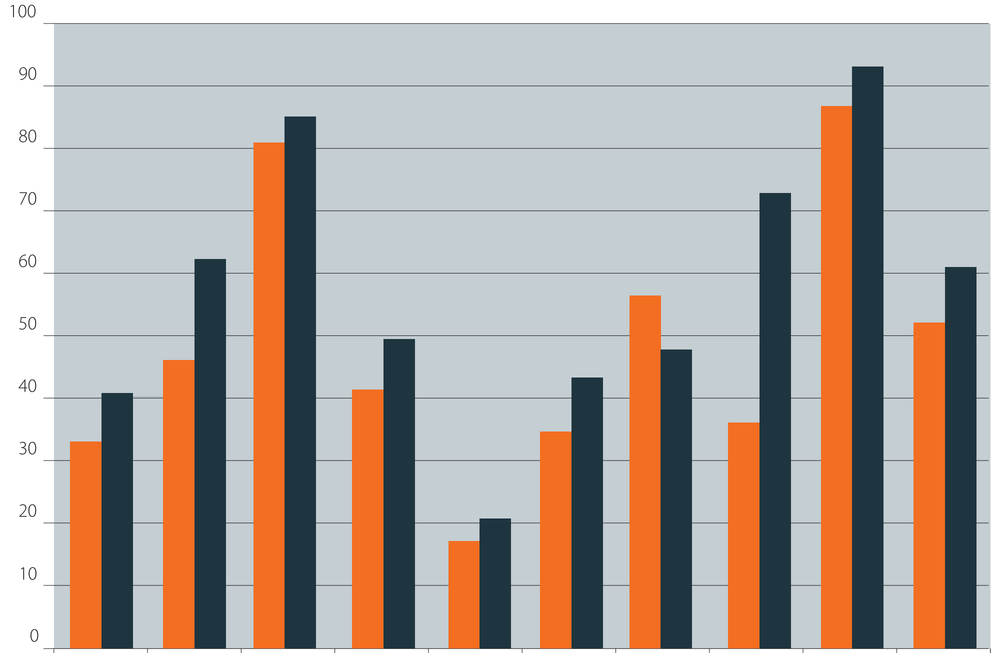
Figure 19: Percentage of households with access to a flush toilet by province



	Eastern Cape	Free State	Gauteng	KwaZulu Natal	Limpopo	Mpumalanga	Northern Cape	North West	Western Cape	South Africa
Census 2001	33.7	46.3	80.2	40.8	16.8	35.4	57.8	36.7	86.2	51.9
Community Survey 2007	40.2	61.4	85.2	49.9	20.2	42.6	48.2	73.2	92.9	60.4

Source: Statistics South Africa: Community Survey, 2007

The number of people without a flush toilet remains high at almost 40% of the population in 2007. Muller (2007) notes that the most severe challenge South Africa is facing is in the provision of sanitation services. He argues that the definition of 'basic sanitation' requires that the target be shifted, to focus on the individual households units within each dwelling site. Rapid migration to urban areas and decreasing household sizes are adding to the challenge of achieving universal access to piped water and basic sanitation services.

The potential conflict between the classification of sanitation as a basic service and the expectation by recipients of a full water-borne sanitation has the potential to hamper equal progress across provinces similar to that achieved in water supply. Muller (2006: 6) notes that "… poor communities, particularly in smaller urban areas, often refuse to accept on-site sanitation solutions that meet government's definition of a 'basic service' and demand full water-borne sanitation."

7.6 Policy options, recommendations and conclusion

Several systemic issues contribute to the provision of water and sanitation services in South Africa. These range from best practice through to the unacceptable. In many municipalities, budget and staffing challenges inhibit the supply of safe and reliable water and sanitation services. It is in this context that this chapter asserts that a divergence is beginning to emerge between policy objectives and practical provision and financing of water and sanitation services.

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With respect to water and sanitation, the Commission makes the following recommendations:

1. There must be a review of the free basic water and sanitation subsidy, as well as a review of water tariff structures, to ensure that the shortcomings implicit in the current subsidy system do not outweigh the benefits. At present, there is no coherent oversight framework for how water service authorities manage trade-offs in the design and determination of their water tariffs. The tariff structures (that is, the number of customer classes or consumption blocks and the level of tariffs for each of the classes or blocks), which are different in various municipalities, have a substantial impact on the pricing of water. Principles and practices guiding both tariff and subsidy structures and price levels should be made clear and routinely monitored.

2. In order to sharpen the focus of public expenditures on expanding access to sanitation services and improving sanitary outcomes, the Commission recommends that:

   a. The sanitation strategy should target behavioural change in relation to sanitation practices by households, rather than the provision of infrastructure alone, premised on attaining certain health outcomes. This can generally be achieved through establishing targets and providing funding in a manner that creates incentives for community-level behavioural changes, while providing households with greater discretion to select sanitation technologies that meet their needs.

   b. Greater consideration should be given to household affordability constraints that may affect the long-term sustainability of sanitation investments. High service levels (such as in-house flush toilets) put significant ongoing pressure on household and municipal budgets, without a significant proportional improvement in public health outcomes. This limits the pace at which sanitation backlogs can be addressed, and may create significant fiscal risk for service providers over the longer term as assets must be maintained and replaced.

3. There is a separation of policy function from the regulatory function within the water services sector. This should help to improved institutional accountability for performance and the achievement of policy goals. The current overlapping of capacity support, oversight and policy-making functions within DWAF has led to a situation where policy targets are inadequately monitored, and simply shifted in the case of under-performance. Following on this recommendation, the Commission would like to propose that the government consider establishing an independent National Water Regulator that would report to Parliament. Its functions, amongst others, will be to:

   a. Regulate the entire water supply industry.

   b. Issue licences, regulate tariffs, and monitor water integrated resource plans for infrastructure investments.

   c. Regulate compliance to industry norms and standards.

   d. Regulate the supply of water and sanitation services and their compliance to quality standards.

   e. Regulate water efficiency and demand-side management

   f. Develop regulatory frameworks for PPPs and alternative service delivery models in the water sector.

   g. Ensure regulatory instruments support the achievement of universal access to water and sanitation services.

   h. Monitor supply and demand trends in the water supply industry

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Chapter 8

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Chapter 8 Assessment of the Institutional and Fiscal Capacity Support Mechanisms of Local Government

8.1 Introduction

The South African Constitution envisions a developmental local government sphere whose objective, among others, is to ensure the provision of services to communities in a sustainable manner, as well as promoting social and economic development. This vision is further articulated by the White Paper on Local Government of 1998 which identifies the provision of infrastructure and services, integration of cities and rural towns, promotion of Local Economic Development (LED), community empowerment and redistribution as key to reaching developmental outcomes. The critical role of local government is to ensure sustainable delivery of basic services such as water, sanitation, housing and electricity in an integrated manner.

Over the 10-year period since the beginning of the local government transition, substantial progress has been made with respect to increasing service delivery. Since 1994, the number of people with access to potable water increased from 59% to 86%. Electricity access increased from 36% to 79%, while sanitation increased by 25% to 73%. The number of people using the bucket system in 2006 was estimated at 67 000, compared to 250 000 in 1994 (National Treasury, 2008). These improvements were made possible by substantial increases in both the operational and infrastructure transfers of local government from the national government.

Recent evidence shows that there is a growing perception among the stakeholders that local government is unable to manage its own affairs as well as perform its powers and functions, particularly with respect to delivering good quality services. Central to these perceptions is a general assumption about the profound lack of capacity to perform critical functions necessary to facilitate service delivery. In his Budget Speech of 21 June 2004, the national minister responsible for provincial and local government acknowledged that limited capacity and resources within certain municipalities is a clear cause of poor service delivery. The minister acknowledged that without capacity and resources to implement its assigned functions, local government cannot reach the goals envisaged in the White Paper. However it is worth noting that an inability to deliver services in itself does not necessarily reflect a capacity challenge, but could be a manifestation of the failure of local government procedure and systems.

The persistent inability of municipalities to deliver services, caused by the absence or lack of adequate capacity within local government, has attracted numerous support interventions from the national government, provincial governments, district municipalities, state and private entities, as well as international development agencies. National and provincial governments are legislatively bound to assist local municipalities with capacity in order to fulfil the service delivery mandate. Such a responsibility is vested in the national and provincial department responsible for local government as well as the national and provincial treasuries. The support programmes have in the main focused on addressing symptoms of lack of capacity (as opposed to underlying causes), through various initiatives such as universal and targeted grant funding as well as hands-on technical support to a selected number of municipalities (mainly rural municipalities).

Against this background, this chapter seeks to evaluate the performance of capacity-building programmes to municipalities. The main purpose is to assess the effectiveness of local government capacity-building programmes and gain a deeper understanding of the causes of poor capacity, and highlight key reforms necessary to improve the effectiveness of current public expenditure in this area.

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8.2 Conceptual framework for capacity building

The concept of capacity development/building has numerous definitions and understandings. Each definition reflects a particular bias towards specific focus areas. It is used in many different ways and these are susceptible to contradiction and confusion (Lusthaus et al., 1999). At times, it is simply equated to the provision of basic equipment, training, institutional strengthening, development support and other miscellaneous aspects. It is also sometimes seen as an approach or process (e.g. towards reduction of poverty or a development objective) targeting development of individual and organisational capacity. In essence, there is no consensus on the definition or understanding of what exactly constitutes capacity development. However there is widespread consensus that capacity development entails various approaches, strategies and methodologies aimed at improving the overall performance of an institution or organisation (Gesellschaft für Technische Zusammenarbeit, 2003).

Capacity building can take many forms including people, organisational, institutional and fiscal aspects, contrary to the common misconception of limiting capacity to training, workshops and seminars to build staff skills.

- Fiscal capacity simply refers to the ability of local government to generate revenue. The adequacy of this revenue is central to local government ability to perform its functions.
- Individual capacity focuses on improving the skills base of municipal personnel. It comprises the transfer of knowledge, experience, skills and values, behavioural changes, development of cooperation and communication systems. To achieve this, the organisational environment must be dynamic and responsive.
- Organisational capacity on the other hand relates to planned attempts to establish, develop or improve the ability of organisations to carry out effectively and efficiently assigned functions on a sustained basis with minimal external assistance.
- Institutional capacity refers to the legal and regulatory changes that have to be made in order to enable organisations and agencies at all levels and in all sectors to enhance their capacities. Institutional issues generally require political and legislative intervention of national government to bring about effective change.

To proceed with the agenda of building capacity requires a capacity-building framework. This framework identifies the required capacity needs of individual municipalities. Once the needs analysis is completed, it is necessary to determine the nature of capacity-building programmes suitable for each municipality. The capacity-building strategy must also define the roles and responsibilities of various stakeholders in terms of providing support, oversight, monitoring, evaluation and coordination. The strategy must provide a predictable and coherent financing plan that supports complex, lengthy processes of enhancing municipal capacity over the medium to long term. Objectives and timeframes of capacity-building programmes should be spelt out. Agreeing on the desired outcomes of capacity development is fundamental for focusing interventions and setting benchmarks for assessing progress along the way.

8.3 Government financing of municipal capacity building

The three main sources of financing capacity building are grants, including the financial management grant (FMG), municipal systems improvement grant (MSIG) and restructuring grant (see Table 22), skills levy and donor funds. The restructuring grant was phased into the local government equitable share in the 2007/08 financial year. For the 2007/08 financial year, the three grants were allocated a total of R875 million.

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Significant amounts (approximately R190 million in 2006/07) of funding for capacity building are also derived from the skills levy contributed by municipalities to the Local Government Sector Education and Training Authority (LGSETA) for the training and development of municipal officials (LGSETA, 2007).

A proportion of additional funds come from donor-funded programmes such the United States Agency for International Development's (USAID) local governance support programme (LGSP) and the Development Bank of Southern Africa's (DBSA) Siyenza Manje.

Table 22: Capacity-building transfers to local government 2004/05-2010/11

	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11
R million	**Outcome**			**Revised estimate**	**Medium-term estimates**		
Direct transfers	**699**	**588**	**610**	**875**	**380**	**500**	**577**
Municipal systems improvement grant	182	200	200	200	200	200	212
Restructuring grant	388	255	265	530	–	–	–
Financial management grant: Municipalities	129	133	145	145	180	300	365
Indirect transfers	**69**	**66**	**53**	**53**	**50**	**–**	**–**
Financial management grant: DBSA	69	66	53	53	50	–	–
Total	**768**	**654**	**663**	**928**	**430**	**500**	**577**

Source: National Treasury, 2008

Part of the problem with capacity grants has been the persistent under-spending by municipalities. For the 2007/08 financial year, the FMG was under-spent by 15% whereas MSIG was under-spent by 34%. The persistent under-spending of these grants shows that municipalities are sometimes unaware of what should be done with the funds, which is perhaps due to a lack of proper planning. The most disturbing feature of these grants, with specific reference to the MSIG, is the lack of clearly defined objectives and targets. The grant has been in existence for more than seven years, and there is no concrete evidence to support its impact and or indication of when it will be terminated. Part of the FMG, the municipal finance management technical assistance programme (MFMTAP) which was financed through donor funds, was withdrawn in 2008 even though the problem that it sought to resolve still remains. This is also true for the restructuring grant.

The problem with the skills levy is that municipalities have limited control over the training areas for which the levy can be utilised. It is also not clear whether the levy should be used exclusively for skill development programmes or other non-skills-related capacity-building projects. Donor-funded programmes are specifically problematic in that they are driven by the respective agenda or objectives of donors, which may not be in sync with the priorities of local government. A key example is the consolidated municipal transformation programme (CMTP) funded by the United Kingdom's Department of International Development (DFID), which among other things sought to improve municipal journalism. The single biggest challenge with respect to funding for Siyenza Manje is that it bypasses the Division of Revenue processes and therefore is not accounted for in the total local government receipts for capacity building.

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8.4 Capacity-building environment

8.4.1 Causes of poor capacity

a. Assignment of powers and functions

The division of fiscal powers and functions between the three spheres plays a critical role in explaining the extent to which municipalities are able to perform their functions. Currently there are observable asymmetries in the division of powers and functions between categories B (or local) and C (or district) municipalities. Due to these asymmetries, municipal expenditure responsibilities are not aligned to revenue source and service delivery needs, thus resulting in distortions of revenue allocation and local accountability.

b. Local economy

The size of the local economy impacts on the ability of a municipality to raise revenue and deliver services. Given the established relationship between low economic activity and lower revenue-raising potential it can be argued that the performance of rural municipalities with regard to improving access to services is partly caused directly by the inability to generate additional sources of revenue.

c. Skilled personnel

There is a general lack of technically skilled and experienced personnel to perform key municipal duties. This has an impact on the ability of municipalities to develop credible budgets, financial statements, Integrated Development Plans (IDPs) and most importantly deliver services. The skills shortages are profound in financial management, municipal planning, engineering, property valuation, project management as well as artisanship.

d. Governance

Despite the local government transition and progress made with respect to delivery of service, municipalities still face formidable challenges relating to good governance. The biggest concern relating to local governance includes poor political leadership and the interface between political, technical and administrative domains, community participation and legislative compliance.

8.4.2 Symptoms of poor capacity

a. Service delivery

There is compelling evidence to suggest that the pursuit of local government service delivery is improving. Nevertheless, there remain huge disparities in access to services across different categories of municipalities. These differences manifest widely on a number of aspects such as access to services, provision of free basic services, infrastructure delivery and so on. Metropolitan municipalities have generally high service levels than their rural counterparts. However, it remains unclear whether low levels of service delivery within small and rural municipalities are a function of challenges immediately related to capacity or not.

While service coverage has increased over time, the quality of services has decreased. In a 2006 survey of water services, authorities revealed that only 72% were compliant with drinking water quality regulations such as SABS 241-2001 (South African Institute of Civil Engineers, 2006).

b. Infrastructure backlogs

Lack of capacity also manifests itself in the form of the growing challenge to eliminate infrastructure and maintenance backlogs (The Presidency, 2008). The SAICE survey (2006) estimates that the current

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infrastructure backlog (replacement) of the water services infrastructure, which is the responsibility of the 170 water services authorities, is at least R120 billion, while the replacement cost of backlogs of electricity distribution infrastructure in 2004 was estimated by the National Energy Regulator of South Africa (NERSA) to be about R84 billion.

c. Spending capacity

Over a six-year period since the 2003/04 financial year, local government expenditure increased annually by 14% to R128.1 billion (2008/09) (National Treasury, 2008). Whereas local government expenditure continues to rise, in many cases it does not immediately translate into increased and good quality services due to inefficiency and ineffectiveness of spending.

d. Planning, budgeting and financial management

Starting with planning, linkages between planning and budgets as well as the credibility of budgets remain key areas of concern. The most important concern relates to the synchronisation or coordination of IDPs with municipal finance, planning timeframes, other municipal operations and intergovernmental plans such as national and provincial priorities as well as growth and spatial development plans.

With respect to budgeting, the number of municipalities with IDPs that are linked to budgets is significantly small. Out of the 17 large municipalities complying with key budget reforms only 40% are able to link budgets with IDPs (National Treasury, 2008).

The ability or inability of municipalities to develop credible budgets and carry out prudent fiscal and financial management practices reflects in the Auditor General's audit report. A 2006/07 report by the Auditor General shows that the proportion of municipalities receiving negative audit opinion is extremely high. For this financial year, a total of 247 municipal audits were completed, of which 9% received adverse opinion, 41% received disclaimer of opinion, 28% were qualified while 22% received unqualified opinion.

Financial management and budgeting deficiencies indicate the lack of availability of appropriately qualified personnel. While poorly constructed IDPs may be a reflection of financial limitation for some municipalities, they are also a clear manifestation of strategic planning and business management capacity constraints.

8.4.3 Approaches to capacity building in South Africa

a. Legislative framework

The legal framework places an obligation on district municipalities, national and provincial government to support and strengthen the capacity of local municipalities in managing their own affairs, exercising and performing their powers and functions. The consolidated legal framework comprises of the following legislation:

- The Constitution (No. 108 of 1996),
- Municipal Systems Act (No. 32 of 2000) ,
- Municipal Finance Management Act (No. 56 of 2003), and
- Sector legislations such as Water Services Act (No. 108 of 1997) and Electricity Regulation Act (No. 4 of 2006) etc.

It should be noted that some of these legislations are not directly concerned with capacity building, but only intended to facilitate the smooth functioning of the local government system, particularly the organisational, institutional and fiscal environment. As such the entire legislative framework is inadequate because:

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- The different pieces of legislation establish overlapping and poorly defined roles and responsibilities of national, provincial and district government to assist municipalities in executing their mandates. There is also a combination and overlap of authority and provider functions placed on each sphere with regard to supporting local municipalities. This is exacerbated by the fact that several national and provincial sector departments are responsible for functions that fall within the Constitution's definition of municipal functions.
- National and provincial governments do not always provide the necessary direction in a number of areas such as the definition of norms, standards and targets, and ideal structures to be modified based on nuanced contextualisation.
- Legislation requires municipalities to build their own capacity, without defining the level or type of capacity at which municipalities must provide for themselves and the conditions under which municipalities fail to build the requisite capacity. These loopholes create negative incentives and will most likely be exploited by municipalities who, with the expectation that national and provincial government will intervene, make limited efforts to build their own capacity.

b. Policy framework

The framework setting the parameters for provision of support to local government consists of two overarching policy documents; (a) the 5-year strategic agenda for local government and (b) the national capacity-building framework (NCBF). The five-year strategic agenda for local government outlines three key priority areas for government spheres and departments to emphasise in assisting municipalities to improve their performance. Such priorities include:

- mainstreaming hands-on support to local government to improve municipal governance, performance and accountability;
- addressing the structure and governance arrangements of the state in order to better strengthen, support and monitor local government;
- refining and strengthening the policy, regulatory and fiscal environment for local government; and
- giving greater attention to enforcement measures (South African Local Government Association, 2007).

Within this framework, each national and provincial sector department should develop its own five-year local government support plan or master plan. Each department must assess the local government capacity needs relevant to its functions, define the capacity support required, identify and structure the resources required, coordinate the rollout of support programmes in consultation with the Department of Provincial and Local Government (DPLG) and, lastly, monitor and evaluate the programmes.

The NCBF provides a set of overarching goals, builds on the foundation of ongoing capacity building, provides a framework for packaged support in line with government priorities set out in the 5-year strategic agenda for local government, and ensures an enabling environment for capacity support. The primary aim of the NCBF is to maximise the impact of capacity-building programmes on municipalities by 2011, define roles and responsibilities, guide stakeholders towards integrated and targeted capacity-building support for municipalities and develop implementation strategy (DPLG, 2008). Through the NCBF, the DDPLG has identified five programme areas to support the implementation of the five-year local government strategic agenda. These programme areas include strengthening leadership and professionalisation of municipalities, hands-on support, non-office based support, strengthening the environment for municipalities to deliver, and strengthening capacity to coordinate and deliver capacity for municipalities intended to assist in prioritising different types of capacity-building interventions and mobilising resources.

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The local government capacity-building policy framework gives a clear picture of the intentions of national government in building local government capacity. It is also a clear manifestation that national government acknowledges the challenges currently experienced by local government.

Whereas the policy provides a logical framework and process for building local government capacity, several weaknesses are clear. Firstly, there is no mention of what happens to current capacity programmes that have been introduced under a policy vacuum. Secondly, policies are driven mainly from national government, which often result in institutional 'turf' battles about who is in charge rather than what they should be doing. This requires clarity of who should be doing what. In particular, provinces were identified as needing to play a stronger coordinating role. Provinces need to have some authority in terms of setting minimum standards and broad targets. Lastly, the framework does not emphasise the need to deal with different categories or types of municipalities differently in line with the varying nature of capacity needs.

c. Institutional framework

In terms of the NCBF, each stakeholder is assigned a responsibility for a specific activity. Stakeholders are separated into two: those responsible for managing the capacity-building environment, and those concerned with the provision of capacity building. Both the national and provincial departments of local government, as well as district municipalities and the South African Local Government Association (SALGA) are described as the key stakeholders responsible for managing the capacity-building environment. National sector departments, non-governmental organisations such as SALGA, the DBSA and professional bodies associations are responsible for providing capacity. According to the NCBF, those responsible for managing the environment will, among other things, coordinate a process of defining the enabling conditions of the environment, establish priority capacity-building needs, define key strategies, mobilise resources, regulate the quality and use of capacity, as well as monitoring and evaluation. On the other hand, capacity-building providers are responsible for identifying key capacity needs, selecting appropriate modes of intervention, managing the implementation of intervention, as well as monitoring and evaluation of outputs.

8.5 Capacity-building assessment

8.5.1 Overview of capacity building

Table 23 below suggests that capacity building has been on the agenda of both the national and provincial government since the early years of local government transition. Over a 13-year period starting in 1996, a total of 15 local government capacity-building programmes and a few capacity grants have been introduced. Examples of these programmes include Project Viability introduced in 1998 to discourage the culture of non-payment of services among communities. More recently programmes, such as Project Consolidate operated by DPLG to support distressed municipalities and Siyenza Manje overseen by the DBSA focusing on the infrastructure expenditure capabilities of municipalities, have been initiated.

There are also a number of national and sector initiatives such as the Joint Initiative on Priority Skill Acquisition (JIPSA), training and information sessions on national policies and acts, implementation of the municipal revenue enhancement programme, deployment of community development workers as well as the Presidency's National Spatial Development Plan (NSDP). The district application project is intended to improve various aspects of capacity shortages within municipalities. Initiatives such as the Local Government Resource Centre (LGRC) and Local Government Network (LGNET) under the ambit of DBSA further aim to intensify support to municipalities through interconnecting all local government stakeholders into an e-community, which is able to share knowledge and information, and to provide vertical connectivity between the local and the other two spheres of government.

Table 23: Past and recent capacity-building programmes by duration

	Interim phase					Final phase									
Capacity programs	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Masakhane Campaign	■	■	■	■											
Project Viability				■	■	■									
MSP				■	■	■									
LGTP				■	■	■	■	■	■						
PIMSS							■	■	■	■	■	■			
ISRDP					■	■	■	■	■	■	■	■	■	■	■
URP					■	■	■	■	■	■	■	■	■	■	■
Provincial government						■	■	■	■	■	■	■	■	■	■
Districts						■	■	■	■	■	■	■	■	■	■
CMTP								■	■	■	■	■	■		
MFMTAP								■	■	■	■	■	■		
Project consolidate									■	■	■				
LGSP									■	■	■	■	■		
AFS										■	■				
ERNEGYS											■	■	■		
SAACE											■	■	■		
LOGOLA												■	■	■	■
PALAMA															
Siyenza manje												■	■	■	■
Capacity grants															
FMG							■	■	■	■	■	■	■	■	■
MSIG							■	■	■	■	■	■	■	■	■

Source: Own compilation

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There are also a number of training institutions, such as the Local Government Sector Education and Training Authority (LGSETA), Public Administration Leadership and Management Academy (PALAMA) formerly SAMDI, Vulindlela Academy run by the DBSA and other private training providers, directly involved in the training of municipal officials and councillors on an ongoing basis. Training programmes are provided in the form of learnerships, short courses, bursaries and apprenticeship in areas such as Adult Basic Education and Training (ABET), LED, leadership and management as well as administration and finance.

In addition to the programmes outlined above, the local government fiscal framework consisting of the local government equitable share and conditional grants plays an integral role in boosting the overall fiscal capacity. For the 2007/08 financial year, local government's share of nationally raised revenue amounted to R37 billion with a 41%, 37% and 22% split among metros, local and district municipalities respectively (National Treasury, 2008).

8.5.2 Performance assessment of local government capacity-building programmes and grants

Measuring performance support in capacity building is not a straightforward exercise, as it is beset with conceptual and methodological difficulties. One difficulty in measuring performance is that the benefits often associated with capacity building are not easily quantifiable and, consequently, there is an inordinate preoccupation with impact in the measurement of how capacity-building programmes perform. Ogiogio (2004) argues that impact measures on their own are meaningless when assessing the success of a capacity-building intervention until, for instance, the issue of the ownership of the skills and institutions that generate the impact and the sustainability of such impacts have been addressed. According to Ogiogio, there are three levels of measurement at which capacity should be assessed, namely, the agency level, project level as well as macro level.

a. Agency level measurement

Measurement first takes place at the agency level. The agency must have a capacity-development mandate and sufficient resources to support the capacity-building process. Assessment areas at this level should include programme development, appraisal, approval, implementation, monitoring and supervision and evaluation.

According to the policy framework set out above, the institutional framework emphasises a clear separation of responsibilities between those responsible for managing and those providing capacity. In this way, those responsible for managing capacity will be able to assess, monitor and evaluate the performance of capacity-building providers. The current approach to capacity building is such that programme development, appraisal, implementation and monitoring are fragmented and uncoordinated across various institutions including DPLG, SALGA, National Treasury, sector departments, donor agencies, private training providers and DBSA.

Weak coordination between a large and growing number of programmes at the individual and organisational levels remains a major problem in building capacity. One of the major reasons why coordination has been difficult is the lack of, or failure to implement, an overall policy framework into which different providers fit in. Coordination is best undertaken within the context of a framework with clear targets. In the absence of this, coordination can become an end in itself, and hence be ineffective. Unfortunately the recently developed NCBF is silent on targets.

Lack of coordination has tended to create a fragmented and incomplete environment for strengthening municipal capacity and has led to sub-optimal outcomes relative to the level of support that has been provided. An underlying problem is the fragmentation of accountability, financing, policy monitoring and evaluation for specific programmes and municipal capacity as a whole. In many instances this resulted in overlapping operations in a specific municipality. An example of this is the Greater Sekhukhune District

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Municipality (GSDM), which at a certain point during 2006 was the recipient of more than five capacity-building programmes.

In the absence of streamlined coordination structures, each programme tends to establish their own structures, which results in duplication. Although their intent is similar, various capacity programmes have different monitoring and evaluation arrangements and reporting requirements. This creates an administrative burden for municipalities, which may have to complete several, similar monthly quantitative and narrative reports for different donors. A further challenge is that most programmes are not independently evaluated and linked and they are not evaluated against the financial and non-financial objectives of municipal performance. Such criteria should be used in motivating for the continued existence of the programme and to stimulate analysis of why some municipalities continue to experience distress.

b. Project level measurement

Measurement next takes place at a project level where indicators such as adequacy, effectiveness and efficiency of inputs are considered. Indicators for measuring effectiveness and efficiency of inputs include the quality of consultation during the project's development, funding, quality of capacity needs assessments, phase of project life cycle, timelines, and extent of compliance with the grant agreement, and so on.

Current evidence points to significant difficulties in respect of project level measurement indicators. There are clear weaknesses in the consultation process and poor assessment of the other indicators. A DPLG-commissioned study found that municipalities are disturbed by what they consider to be a top-down approach, which often treats them as passive recipients (DPLG, 2006). For example, with the integrated sustainable rural development programme (ISRDP) national government has commissioned economic assessments for the rural nodes,[40] even though some of the municipalities such as Sekhukhune had already commissioned their own. The municipalities concerned were not consulted and believe that such practices create unnecessary duplication and confusion. Capacity assessments should be more responsive to the unique needs of a municipality and be endorsed, or agreed to, by municipalities to avoid rejection or the perception that programmes are being imposed. Voluntary participation by municipalities is more effective than imposed programmes by higher levels of government.

There are a number of tools used to assess the capacity needs of municipalities and/or to classify them into different categories for targeting purposes. Such tools include Project Consolidate assessments and evaluations, budget sizes, under-spending on the municipal infrastructure grant (MIG), IDP credibility assessments, municipal demarcation board assessments, workplace skills plans and LGSETA sector skill plans. In terms of the Skills Development Act, each Sector Education and Training Authority (SETA) is obliged to prepare a capacity assessment or sector skills plan (SSP), updated annually for submission to both DPLG and the Department of Labour. These tools are further used for determining a municipality's eligibility for a particular programme. However, certain programmes such as Siyenza Manje have their own pre-deployment assessment tools, while others are ad hoc interventions simply responding to a crisis. The Institute of Municipal Financial Officers' annual financial statements (AFS) programme would be a case in point.

Due to the duplication of assessment criteria, the findings are also replicated and, when combined, do not provide an integrated understanding of municipal capacity constraints and the specific interventions required. There also tends to be a misalignment between assessment criteria and the objectives of capacity-building programmes, particularly when selecting municipalities. For example, some of the profiling indicators used for selecting Project Consolidate municipalities include, among other things, unemployment rate and poverty levels whereas the main aim of the programme was to unblock service delivery through short-term deployment of experts. Siyenza Manje used under-spending on the MIG allocations (less than 30% by December 2007) for selecting municipalities. Selection of municipalities

[40] The 13 most severely impoverished municipalities in South Africa declared in 2001, as part of the Presidential initiative to push back the frontiers of poverty and under-development in rural areas.

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should be based on a set of relevant indicators that define whether a municipality requires support or not. These indicators should be linked to overall municipal key performance indicators to ascertain the stage at which a municipality finds itself, in terms of capacity needs and ability to deliver on its mandate. The effectiveness of this approach will depend on the functioning of the performance management system. Without adequate data on municipal performance, it is very difficult to develop a relevant municipal support and intervention programme.

The upshot of this analysis is an observed tendency by government departments to ignore existing and official capacity assessments such as the LGSETA, opting to perform their own independent annual assessments. The DPLG is currently conducting a skills audit of all municipalities, which essentially constitutes duplication.

c. Macro level measurement

Measurement also needs to take place at a broader macro level, in addition to the agency and project levels. Macro-level measurement relates to the transformation of inputs through projects and programmes into outputs and outcomes. The relevant indicators at this level will consist of the relevance/appropriateness, effectiveness, efficiency, ownership, impact and sustainability of the intervention.

The question of whether existing capacity-building programmes are well suited to reducing or eliminating the capacity constraints currently experienced by local government is critical. This question is particularly important in that many programmes have generally been focused on the supply side (in other words, what the support provider identifies the problems being faced by municipalities, often in the context of urgency for delivery) with little consideration of the demand side (i.e. identified capacity needs of municipalities). This has tended to result in quick wins that are often in contradiction with the principles of capacity building, which encourages sustainable solutions through a focus on all aspects of capacity including institutional, fiscal, individual and organisational.

The matrix in Table 24 plots capacity-building programmes against municipal capacity constraints and shows that most programmes are geared towards service and infrastructure delivery, financial management as well as skills transfer. While it may be concluded that many of these programmes are suited to the capacity constraints facing municipalities, it is a concern that they do not deal holistically with the challenges due to weaknesses in assessing capacity, defining timelines, coordinating and selecting municipalities. Municipal capacity constraints have an inherent chain of causation suggesting that dealing with one problem while neglecting the source can be futile. This requires that programmes need not only be appropriate but properly sequenced as well.

The extracts provided in Table 25 suggest that the impact of capacity programmes is effective in enhancing service delivery within local government. However the contrary view is that progress has only been made on mobilising various role-players to provide hands-on support, but it remains too early to evaluate the overall effectiveness of these programmes. It should also be noted that these programmes are not independently evaluated and therefore run the risk of being over-rated. The other challenge is that the success of these programmes is mostly dependent on the skills of deployed experts or service delivery facilitators (SDFs). In many cases municipalities fail to sustain the success factors introduced by SDFs at the end of their deployment terms. In fact one of the perspectives held by municipalities on SDFs is that 'they fix the problems for few months, only to return to the same problems once they leave'.

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Table 24: Capacity-building programmes against municipal capacity constraints

Capacity constraint/ capacity programme	Masakhane Campaign	Project Viability	MSP	LGTP	PIMSS	ISRDP	URP	Districts	CMTP	MFMTAP	Project consolidate	LGSP	AFS	ERNEGYS	SAACE	LOGOLA	PALAMA	Siyenza manje	MIIU	TAU	FMG	MSIG
Service delivery						√	√		√		√							√				
Local economy and demography						√	√															
Infrastructure delivery and challenges									√		√	√		√	√			√	√	√		
Powers and functions											√											
Spending capacity																						
Expenditure coordination and prioritisation					√							√										
Financial management and budgeting			√			√			√	√			√								√	
Availability of skilled personnel											√			√	√	√	√	√			√	
Governance issues	√			√												√	√					√
Pricing of services																						
Non payment of service		√																				
Borrowing																						
No of munics	**all**	**all**							**8**	**42**	**134**							**179**				

Source: Own compilation

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Table 25: Impact of capacity-building programmes (narrative reports)

Siyenza Manje	CMTP	Project Consolidate
The Siyenza Manje programme deployed experts in eight provinces at provincial, district and local municipal level. A total of 97 experts were deployed, of which 16 were young professionals thus extending the coverage of the programme to 86 municipalities. In the targeted municipalities, 471 projects are in the process of being implemented and 97 projects were completed. Siyenza Manje interventions augmented municipal and other government efforts and nearly 178 000 households were provided with access to water and about 126 000 with access to sanitation. Nearly 70 000 bucket toilets were replaced.	Initially, the municipality did not have a good understanding of the IDP and LED; key positions were lacking capacity and most community projects were in shambles; management procedures, key policies and integration between planning and execution also had significant room for improvement. Over the past few years, there has been a clear improvement in the understanding of the IDP, planning, project prioritisation and budgeting, as well as overall project management. A higher priority is being given to the local economy, especially around integration with the district municipality and private sector, and this results in much better planning. One of the latest initiatives at the municipality was the development of the GIS to help manage municipal affairs.	Some 281 experts and professionals had been deployed to 85 out of 139 Project Consolidate municipalities. Much progress has been reported in the areas of technical, financial, planning, project management, accelerating service delivery through the unblocking of blocked projects, the establishment of financial systems, addressing audit queries and improving revenue income.

Source: DBSA, 2008; CMTP, 2008; DPlG, 2008

As was mentioned elsewhere, the ownership of capacity-building programmes is fragmented across various national departments and agencies. This is contrary to one of the principles of capacity building, which advocates local ownership of capacity building. Sustainability of capacity programmes is also questionable given that many programmes are introduced and discontinued within a short period of time. Capacity building should be a long-term adaptation process with sustainable outcomes that is not rushed, but at the same time shows visible, quick wins that deepens commitment for change early in the process.

8.5.3 Timelines

The average time frame for a capacity-building programme is between one and three years. This period is considered to be too short for programmes to make a meaningful impact. "Programmes that are shorter than two years and implemented in the context of rapid delivery requirements result in a focus on gap-filling rather than capacity building. This results in a perpetual cycle of new programmes redoing the same

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things and never quite solving the problems they set out to" (DPLG, 2006). Other programmes such as the ISRDP and Urban Renewal Programme (URP) have been in existence for indefinite periods, to the extent that they are currently seen as permanent feature of the system; yet their impact is minimal as they are confined to a specific area within a municipality or are even non-existent.

This practice is also evident in more recent programmes, such as Siyenza Manje, which have been introduced without any specific timeline. The danger of this approach is that it creates an expectation of long-term support or assistance on the part of municipality. Second, it exposes certain municipalities to the risk of being overly dependent on grant support. Since the eligibility criteria of such grants require a lack of capacity, a perverse incentive to remain under-capacitated may be established. Programmes that are introduced without pre-determined timeframes and that have unclear problem statements or objectives are unable to have long-term impacts and are difficult to evaluate and hence terminate. An 'exit strategy' needs to be included in the initial plan and not at the end as an after-thought. In addition, an 'after-care' phase needs to be included to ensure that the municipality maintains its improved capabilities. In essence, exit should only be considered once an evaluation indicates that the issues have been resolved

Certain programmes are also merged or collapsed into other programmes (for example, the local government transformation programme (LGTP), CMTP and Project Consolidate into Siyenza Manje) making it difficult to ascertain both the timeframe and the impact. While merging programmes reduces the administrative burden on municipalities being supported, a concern is that capacity programmes continue for long periods under different banners but all claiming credit for the same outcomes. The upshot of this analysis is that care should be taken when integrating different programmes, and the timeframes for support should depend on 'the type of disease being treated' and not only be time bound.

8.6 Conclusion and recommendations

The nature of capacity constraints experienced by municipalities requires various forms of intervention. Various challenges faced by local government are directly linked to the different aspects of capacity but it remains unclear whether these challenges, such as availability of skilled personnel and high staff turnover, are self-induced or genuinely related to the functioning of local government. On the one hand there are institutional challenges related to policy and governance, while on the other, there are organisational challenges related to effective management and availability of skilled personnel.

The legislative, policy and institutional prescripts provide a framework within which capacity building is undertaken. However, there are various gaps within these frameworks that affect the manner in which capacity programmes are carried out. The legislation assigns shared, but undefined, roles and responsibilities in other spheres of government to assist in building the capacity of local government. There is also no practical separation of responsibilities between capacity-building authority and capacity-building providers as envisaged in the policy. The result is a capacity-building process which is fragmented and uncoordinated across numerous relevant stakeholders.

Coordination, or lack thereof, is clearly visible during programme development and design, financing, monitoring and evaluation as well as capacity needs assessment stages. This leads to the introduction of various intervention measures which are less responsive to the nature of challenges being experienced by different categories and types of municipalities. Most programmes focus directly on facilitating service delivery and project implementation, and not on the underlying causes of the capacity. The current practice tends to emphasise the performance of functions on behalf of municipalities rather than providing strategic direction on how municipalities should go about performing their functions. A singular focus on implementing sophisticated programmes or interventions on a weak institutional, economic and managerial base almost invariably leads to a return to original problems. This highlights the need to focus on the basics.

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With respect to local government capacity building, the Commission recommends that:

1. For their own improvement, local government should be central to setting the agenda for capacity-building programmes. This recognises the fact that municipalities remain accountable for their own performance until such time as section 139 of the Constitution is invoked. To achieve this, the Commission further recommends that:

    a. Capacity programmes should be informed by a local government performance management system which is driven by their Key Performance Indicators.

    b. Prior to capacity programmes being developed and implemented at a local government level, a comprehensive assessment and design process should be undertaken.

    c. Capacity-development programmes should be aligned to each stage of the developmental transition of municipalities. There should be differentiated approaches in building capacity.

    d. Capacity-development programmes should be comprehensive and not only focus on training of personnel and deployment of experts within municipalities. They must also focus on other organisational, fiscal and institutional constraints that impact on the overall performance of municipalities.

2. The government must establish an intergovernmental wide framework for understanding what constitutes a lack of capacity within the context of local government.

3. When capacity-building interventions are undertaken with respect to different functional areas, there should be a clear separation of responsibilities, as well as coherent interface, between the service authority and the service providers.

4. It is also recommended that replication of poorly defined roles and responsibilities between national, provincial and district municipalities in the policy framework should be eliminated. This is necessary to create clear lines of responsibility and accountability for spheres of government or sector departments over their capacity-building roles for local government.

5. Each capacity-building programme must have a clear outline of measurable objectives, targets and timelines. These must detail conditions under which a programme can be withdrawn from a respective municipality and, following a detailed monitoring and evaluation of success factors and failures, with possible suggestions for sustaining the programme. The method of implementing capacity programmes should be changed from a standard stop-gap package to a more unique incremental solution focusing on the identified problems within the municipality and identifying key leverage points where capacity programmes can make a difference.

6. A variety of grant instruments should be used to address different capacity challenges within different functional areas. Such grants should only be devolved to sector departments once they have demonstrated capacity to manage effectively such grants and capacity programmes in an IGR system. The Commission further recommends that appropriations for Siyenza Manje should be allocated through the Division of Revenue like other capacity grants. This will promote order, transparency and accountability.

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