

CHAPTER 9: MUNICIPAL CONSUMER DEBT IN SOUTH AFRICA

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9.1 Introduction

Municipalities make an important contribution to poverty alleviation and economic development, through providing free basic services (FBS) to poor households and investing in infrastructure and associated services that are critical for economic activity (National Treasury, 2008). To deliver these services effectively, municipalities rely on two important sources of revenue. One is from the national sphere (local government equitable share allocation (LES) and conditional grants), while the other is the municipality's own revenue, which is composed mainly of property rate taxes and charges for providing water, electricity, refuse removal, sanitation and other services. However, one critical question is what happens when the ability of municipalities to generate adequate levels of own revenue is constrained. To this end, the issue of non-payment, also referred to as municipal consumer debt, poses a serious threat to the financial health of municipalities in South Africa.

9.1.1 Problem statement

In South Africa, municipal consumer debt refers to the non-payment of property rates, fees/charges for services provided by municipalities (for example water, sanitation, electricity and refuse removal) and various other financial obligations to municipalities (which include for example, traffic fines and rental housing payments). Municipal consumer debt encompasses late payments for property rates, service and other municipal charges, as well as amounts that are deemed irrecoverable.

Municipal consumer debt has a number of potential impacts. It can cripple the cash position of municipalities and, therefore, their ability to fulfill constitutionally mandated responsibilities. Municipal consumer debt can also reduce the finance available for the delivery of basic services, infrastructure, maintenance and upgrading. In addition, it can prompt the need for greater cross-subsidisation from richer households/businesses, potentially overburdening the existing tax base. Outstanding payments also represent foregone resources that could be used to improve the living conditions of the poor. Possible reasons as to why this type of debt arises are various. Poor performance by municipalities, such as inaccurate billing, weak credit control measures and customer service mechanisms may serve to reinforce non-payment, as those consumers able to pay become unwilling to pay. On the other hand, consumers may be unable to pay as a result of unemployment and poverty. The causes of non-payment in South African municipalities have been the focus of various studies, including Booysen (2001), Botes and Pelser (2001), Burger (2001) and Fjeldstad (2004). However, as most of the studies were carried out in the early to mid-2000s, changes in the local government sphere warrant a thorough and updated investigation of the factors that drive this kind of debt.

9.1.2 Background to the research

The multiple impacts of municipal consumer debt are a public finance and intergovernmental fiscal concern. Municipalities and local government policy-makers need to understand the extent of this debt and how to manage the related challenges and risks better. This research comes at an opportune time, as the key priorities of the Local Government Turnaround Strategy (LGTAS) and Outcome 9 (the delivery agreement for the local government sphere) centre on optimising revenue collection and halving municipal consumer debt by 2014 (CGTA, 2009a; The Presidency, 2010).

In its Submission on the Division of Revenue 2011/12, the Financial and Fiscal Commission (the Commission) carried out research into the role of local government revenue enhancement strategies in addressing municipal revenue challenges. A number of recommendations were made on ways in which municipalities could improve their revenue enhancement and collection strategies. As part of the broader project, this particular project will delve deeper into the issue of municipal consumer

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debt by understanding who the debtors are and the underlying causes of this debt. This research falls under the theme of accountable institutions, one of the five thematic areas identified in the Commission's five-year research strategy adopted in 2009 (FFC, 2008). Financial viability is a critical ingredient in the legislative-prescribed roles and responsibilities for all three spheres of government aimed at ensuring a viable and sustainable local government sphere. Financial accountability is also about municipalities ensuring that their planning and budgeting processes are based on realistic expectations of revenue collection.

9.1.3 Methodology

To contextualise municipal consumer debt across South African municipalities, secondary data was collected from the National Treasury and analysed at both an aggregate and municipal-specific level. The dataset from the National Treasury covers a six-year period (2004/05 to 2009/10) and reflects the slowly improving data collection and reporting by municipalities. The number and category of municipalities reporting in each year is contained in Table 9.1.

Table 9.1 Municipal reporting on consumer debt, 2004/05 to 2009/10

Municipal category	Count of total					
	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Metropolitan municipalities	6	5	6	6	6	6
Secondary cities	10	11	18	19	19	21
Larger towns	2	9	20	21	25	28
Medium to smaller towns		28	50	73	100	103
Rural municipalities	2	23	15	32	47	58
Districts without major powers	2	5	10	17	20	20
Districts with major powers	1	6	8	13	14	18
Grand Total	23	87	127	181	231	254

National Treasury, 2010

As the reporting is uneven across municipalities, an annual average debt calculation was used to assess the aggregate debt and debt by municipal category. This approach differs from the way that data on consumer debt is usually presented and analysed. In most instances, data is presented in nominal terms and does not factor in differences in reporting, which may unnecessarily inflate the figures so that the consumer debt challenge appears to be growing. As will become evident, the approach taken in this chapter provides a different view.

The purpose of this chapter is to examine changes in, and causes of, consumer debt in the South African local government sphere. Where the majority of research carried out previously focused solely on households, this research also looks at municipal consumer debt emanating from businesses and government departments.

To isolate the factors that drive municipal consumer debt, data from the annually published General Household Survey (GHS) for the period 2004–2008 is used for households. The GHS includes questions about why households do not pay, and places a particular emphasis on non-payment for water services. As no survey data is available regarding reasons for non-payment by government and business, a short questionnaire was developed and sent to provincial treasuries and Business Unity South Africa (BUSA).¹²¹ Finally, regarding legislative provisions to manage debt, various Acts were analysed and, where possible, information on compliance with certain provisions was sourced from the National Treasury.

The overall objective of the chapter is to investigate the characteristics and causes of municipal consumer debt in South Africa, in particular:

- Profile municipal consumer debt by (a) type of municipality, (b) source of the debt (households, government, businesses etc.) and (c) nature of the debt (for example the proportion of the debt that is historical).
- Investigate what drives non-payment.
- Evaluate legislative provisions relating to municipal consumer debt to determine whether or not weaknesses exist.

¹²¹ BUSA is an umbrella body for businesses in South Africa.

- Recommend policy options to assist municipalities in overcoming the challenge of municipal consumer debt.

After a brief literature review on the issue of non-payment, an overview of consumer debt in South Africa is given. The reasons for non-payment by households, government, and businesses are examined, and the government's response to non-payment is reviewed. Five critical aspects that need to be addressed in order to mitigate the challenges caused by municipal consumer debt are discussed, and recommendations are made for specific intergovernmental measures that can be implemented to minimise, and deal with consumer debt.

9.2 Literature Review

At the centre of the municipal consumer debt debate is whether non-payment results from the inability to pay, unwillingness to pay or some other reason. The literature reviewed is aimed at understanding why people do not pay for services and looking at some of the methods employed by governments and other agencies to motivate compliance.

9.2.1 Reasons for non-payment

Inability to pay

The most common reason used to explain non-payment appears to be the inability to pay, as a result of poverty (Booyesen, 2001; Botes and Pelser, 2001; Burger, 2001). The term 'inability to pay' indicates that there is an income level above which people are unable to pay for the delivery of services. This raises the central question of affordability. Milne (2004) suggests using "core affordability indicators", which, if properly monitored, can warn policy-makers of early indications of changes in the affordability of services. A range of possible indicators is proposed (Milne, 2004:5):

- Consumption-related indicators, such as percentage of total household expenditure devoted to a commodity or per capita consumption/expenditure on a commodity.
- Price-related indicators, for example unit prices paid for a commodity.
- Payment-related indicators, which would include the use of arrears statistics, alternative payment schemes and disconnections owing to debt.

The value of using the indicators mentioned above is heightened when they are assessed relative to equivalents for other income groups, the median or some national norm/benchmark. Monitoring trends in affordability indicators represents what can be termed a more ex-post approach. McPhail (1993) suggests incorporating assessments of affordability and willingness to pay at the planning stage of a public good such as water or electricity, especially if the intention is to recover costs. The information from an affordability assessment can provide insight into potential service usage patterns and, therefore, the tariff to be charged in order to maximise cost recovery.

Despite the obvious importance of having an indication of willingness to pay, policy-makers continue to make general assumptions about the population to be served and per capita consumption rates (McPhail, 1993). The end result is that tariff-setting is based on covering operating, maintenance and capital costs, without considering what people are willing to spend, which could even be higher than the rate set. McPhail (1993) conducted a study¹²² of five Moroccan states in a bid to determine whether the price charged for water was correctly set, or whether there was an opportunity to make individual house connections available to some of the indigent households at retail level. The study found that many low-income households, even those with access to free stand-post water service, are willing to pay in excess of 5% of total household expenditures for individual water services (McPhail, 1993:969). The implication of these findings is that South Africa needs to re-examine indigent policies that determine which portions of the population cannot afford to pay for services.

¹²² McPhail's study used the contingent valuation method whereby an interviewer poses questions within the context of a hypothetical market. The study was undertaken on behalf of Morocco's national water company.

Willingness to pay

Non-payment is not a given for those residing in poor areas, as significant variations in payment and non-payment exist across both poor and non-poor areas (Fjeldstad, 2004). These findings are confirmed by Booysen (2001) who analysed the income and expenditure of 1,600 households to determine the root cause of non-payment. The analysis found that not only higher-income households, but also households experiencing relatively high levels of poverty paid for services (Booyesen, 2001). A second reason for non-payment is therefore the willingness (or not) to pay.

In general, willingness or unwillingness to pay can stem from dissatisfaction with services delivered by government, which can lead to a cycle of non-payment. As a result, municipal authorities are unable to leverage financial and other resources in order to improve service delivery adequately, or perhaps certain efficiency aspects that may improve the affordability of services. In South Africa, the phenomenon of being unwilling to pay, or the 'culture of non-payment' refers to people having the same mindset as during apartheid rates boycotts, when rate-payers refused to pay as a protest against the discriminatory policies of the government of the day. The rationale is that people became accustomed to not paying under the apartheid government and have not changed despite the transition to democracy.

Glaser and Hildreth (1999) propose that perceptions of government and willingness to pay are directly linked. In a survey of mid-western United States cities with a population of approximately 300,000, they found that half of the respondents were willing to pay more for improved local government performance (Glaser and Hildreth, 1999). Fjeldstad (2004) concurs with the power of citizen perception, which is implicitly linked to the extent of trust that community members have in local government leadership. He suggests that three dimensions of trust affect citizen compliance. First, trust in local government to act in their (citizens) interest, which refers to whether people believe that government will spend money on the required services, and whether the services provided are of an acceptable quality.

The second dimension relates to whether citizens believe that authorities will establish fair procedures for collecting revenue and distributing services. Effective enforcement to ensure payment is critical, as citizens should believe that non-payment carries a penalty, for example cutting off of services. However, whereas compliance is expected to be positively related to the severity of sanction applied for non-payment, the opposite is true for South Africa (Fjeldstad, 2004). The reason for this perverse relationship could lie within the principle of reciprocity: giving back what you get. In this case, treatment perceived to be unfair or extreme is met with a strong refusal to pay. Finally, the third dimension concerns trust in other citizens to pay their share. Here, the belief about the honesty of others comes into play, which is related to the role of social influences. For example, behaviour may be motivated to change if non-payment is met with certain negative social connotations or stigma. The reverse is also true: if non-payment is considered the norm, people may not consider non-compliance a big issue (Fjeldstad, 2004).

9.2.2 Measures to enforce payment or recover costs

Various attempts have been made to enforce payment for services delivered. For example, in the United States, non-payment of parking tickets, library fines etc. have prompted various local authorities in New York, Miami and Chicago to hand over collection of debts to private collection agencies, which can result in consumers being black-listed. The effects can be far-reaching and even affect the interest rate a consumer can demand when applying for a home-loan or vehicle financing (Spencer, 2006). As the cost of these effects may outweigh non-payment for services, compliance is greater.

Another tool that can be used to encourage payment is the cutting off/disconnecting of services. However, the use of this measure is politically contentious. In addition, total cut-offs are not possible for certain services such as water, which is considered a basic human right (MacDonald, 2002). Responses to service cut-offs also need to be managed, as existing social conditions (including high levels of unemployment and poverty) can lead to, or exacerbate, negative reactions and/or resistance from communities. In 2001, the community responded to Eskom's 'massive' electricity cut-offs by resorting to illegal connections, some of which were effected by former Eskom employees who were unemployed at the time (Khunou, 2002). There were also incidences of violence as a result of the cut-offs (Ibid.). Four types of permanent cut-offs of basic services have been identified: shutting off services through removal of cables and pipes; increasing reconnection fees, which are usually so severe that they effectively limit who can afford to reconnect; requiring residents to pay off outstanding payments before being able to reconnect; self-disconnecting by prepaid meter (Ruiters, 2002:52–53).

One method of cost recovery is to apply the principle of cross-subsidisation, where wealthier households are charged higher tariffs to subsidise services to poorer households. In the solid waste sector, the cost-subsidisation option works

relatively well (Cointreau, 2005), as, for example, access for collection vehicles is better in wealthier areas, and collecting waste from a big commercial establishment is easier than from less affluent areas where settlement patterns and road conditions make collection more difficult. A commonly used strategy for facilitating delivery of services to poorer households is cross-subsidisation using block tariffs. However, policy-makers need to ensure that the extent of cross-subsidisation does not lead to unduly extreme prices for households that pay more. Cost recovery can also come through voluntarism, where consumers who cannot afford the cost of a service, contribute their labour. This approach can bring unforeseen health/social costs and also add gender, race and class dimensions to cost recovery (McDonald, 2002).

Prepaid meters present the ultimate cost-recovery mechanism, as the service is paid for prior to using it; in essence prepaid meters represent an effective means of preventing defaulting on payments (MacDonald, 2002). The use of prepaid meters, which does not require billing or meter reading, can avoid the pitfalls of non-payment due to poor administrative/financial management practices on the part of municipalities.

However, in developing countries where access to basic services for all remains a challenge, the use of prepaid meters may hinder progress, as “whereas municipal disconnection is a visible (and sometimes violent) physical process, self-disconnection is invisible and masks the extent to which people go without water supply” (Ruiters, 2002:53). A case study in Makhaza Section, Khayelitsha, concluded that cost recovery is unsustainable and leads to excessive spending in an attempt to recover costs from low-income households who, because of unemployment and a range of challenges, will not be able to pay (Xali, 2002). A number of impacts can arise from cost recovery (Xali, 2002:114-115):

- Limited access to social services. The consequence of cost recovery implies that those with money will have access to services, thereby limiting or denying access to low-income households/individuals and exacerbating inequalities.
- Increased burden on working class women. Cost recovery programmes increase the weight of social responsibility on working class women, as in most households women have to find access to alternative sources of water, energy etc.
- Health implications. These arise from the lack of access to clean water and exposure to fumes and fires from using alternative forms of energy.
- Undermining constitutional gains. While the Constitution contains clauses (for example the use of the phrase “within available resources”), which aim to exempt government from liability in cases where access to basic services is not realised, this aspect needs to be contested, especially in view of how the state allocates national resources (for example large allocations to defence).

Pape (2002) suggests the prepaid system could be modified by extending the use of pre-paid technology to businesses/bulk consumers. These users would be required to pre-pay for their consumption, generating significant income that could be used for cross-subsidisation. In addition, using this system for bulk users would be more manageable than attempting to extract money which low-income households do not have.

Prior to determining the sanctions to be applied, the root cause of non-payment must be identified. For example, billing and payment methods are important to low-income households. Decision-makers need to ensure that services of a high quality are being delivered, and that proper billing processes and suitable payment options are available.

9.3 Overview of Municipal Consumer Debt in South Africa

This section focuses on who is responsible for the debt and which sectors represent the bulk of the debt. As mentioned in Section 9.1.3 (Methodology), the figures used have been averaged according to the number and category of municipalities reporting in each year as depicted in Table 9.1.

9.3.1 Aggregate municipal consumer debt

An analysis of municipal consumer debt over the period 2004/05–2009/10 reveals that municipalities are making inroads with respect to the challenge of municipal consumer debt. As Table 9.2 shows, consumer debt is generally declining across the majority of municipal categories, with secondary cities and districts with major powers recording real increases between 2008/09 and 2009/10. Real growth was, however, significantly slower in 2009/10 in districts with major powers.

Table 9.2 Real average municipal consumer debt per municipal category, 2004/05– 2009/10 (R'000)

Municipal category	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Metropolitan municipalities	4,423,227	3,431,117	4,187,235	3,772,118	3,826,697	3,715,678
Secondary cities	268,341	499,077	287,915	306,376	352,376	404,590
Larger towns	56,083	1,368,247	106,613	124,428	127,428	111,551
Medium to smaller towns		173,515	38,081	39,739	51,598	42,265
Rural municipalities	10,710	116,798	49,176	21,146	27,023	25,447
Districts without major powers	7,613	37,542	7,502	5,217	17,258	4,306
Districts with major powers	11,164	41,750	63,074	43,228	61,225	70,498
Real year-on-year growth						
Metropolitan municipalities		-22.4%	22.0%	-9.9%	104.0%	-2.9%
Secondary cities		74.3%	-42.3%	6.5%	14.9%	14.8%
Larger towns		2339.7%	-92.2%	16.8%	2.4%	-12.5%
Medium to smaller towns			-78.1%	4.4%	29.8%	-18.1%
Rural municipalities		990.5%	-57.9%	-57.0%	27.8%	-5.8%
Districts without major powers		393.1%	-80.0%	-30.5%	230.8%	-75.0%
Districts with major powers		274.0%	51.1%	-31.5%	41.6%	15.1%

Source: Own calculations based on National Treasury data 2010

This improvement is confirmed when consumer debt is assessed relative to municipal operating revenue. As Table 9.3 shows, consumer debt, as a proportion of municipal operating revenue, is on a downward trend. Districts with major powers show marginal increases from 2007/08 onwards. This issue may be something to monitor, as districts with major powers are one of the two categories that exhibit real increases in municipal consumer debt.

Between 2006/07 and 2009/10, the proportion of consumer debt to operating revenue within secondary cities has remained generally constant. As consumer debt in secondary cities has shown a real increase of about 15% in two consecutive years (2007/08–2008/09 and 2008/09–2009/10), this municipal category should be closely monitored to ensure that consumer debt does not start to affect the financial health of these municipalities.

Table 9.3 Real average municipal consumer debt as a proportion of real average operating revenue, 2004/05–2009/10 (%)

Municipal category	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Metropolitan municipalities	10.9%	26.6%	7.5%	6.1%	5.9%	4.7%
Secondary cities	4.1%	8.1%	1.9%	1.9%	2.0%	1.9%
Larger towns	15.9%	283.3%	2.4%	2.6%	2.0%	1.4%
Medium to smaller towns		6.0%	1.1%	0.7%	0.6%	0.5%
Rural municipalities	12.2%	3.8%	5.5%	1.1%	0.8%	0.6%
Districts without major powers	3.5%	5.6%	0.7%	0.3%	0.7%	0.2%
Districts with major powers	5.7%	40.2%	3.0%	1.1%	1.3%	1.6%

Source: Own calculations based on National Treasury data, 2010 and 2011

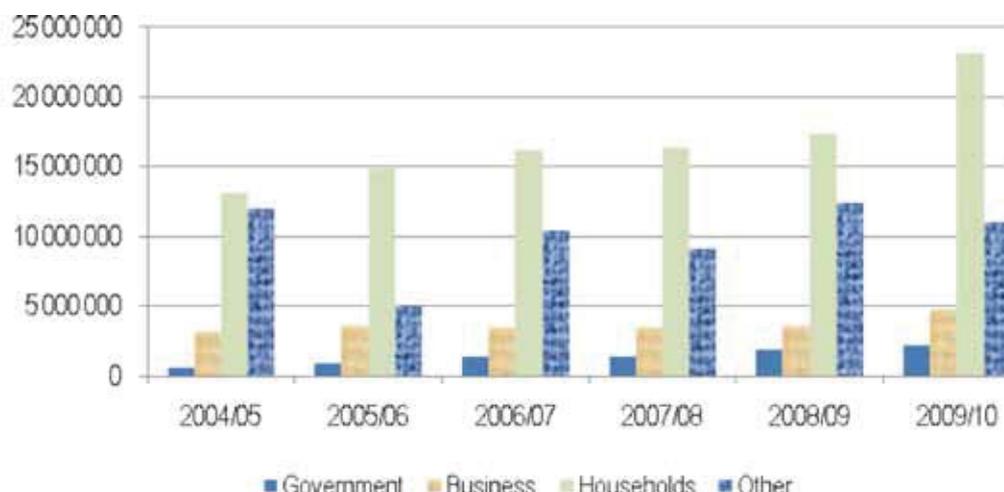
Despite the progress made, consumer debt remains a challenge. For example, metros are still faced with, on average, just under R4 billion worth of consumer debt. However, this analysis indicates that the severity of this challenge is weakening. Policy-makers therefore need to reflect accurately on the consumer debt challenge and acknowledge the progress that has been made.

9.3.2 Disaggregation of municipal consumer debt by customer grouping

Non-payment emanates mainly from households, government, businesses and a category referred to as 'Other'. The manner in which debtor data is reported means that it is not possible to factor out the effects of reporting variances by averaging the amounts recorded across the different types of municipalities. As a result, the data on customer groupings responsible for debt is reported at a real aggregate level. The data shows that households are responsible for the largest share of municipal consumer debt, while non-payment by government departments has grown significantly between 2004 and 2009 (Figure 9.1). Non-payment by the category 'Other' is significant and represents a challenge in terms of transparency. While municipalities may be clear about what this category includes, the use of this term clouds transparency of the municipal budget and spend-

ing plans.¹²³ National Treasury has indicated that the term 'Other' is in the process of being phased out and that municipalities will be required to be explicit about items within this category.

Figure 9.1 Disaggregation of municipal consumer debt by customer grouping (R'000)

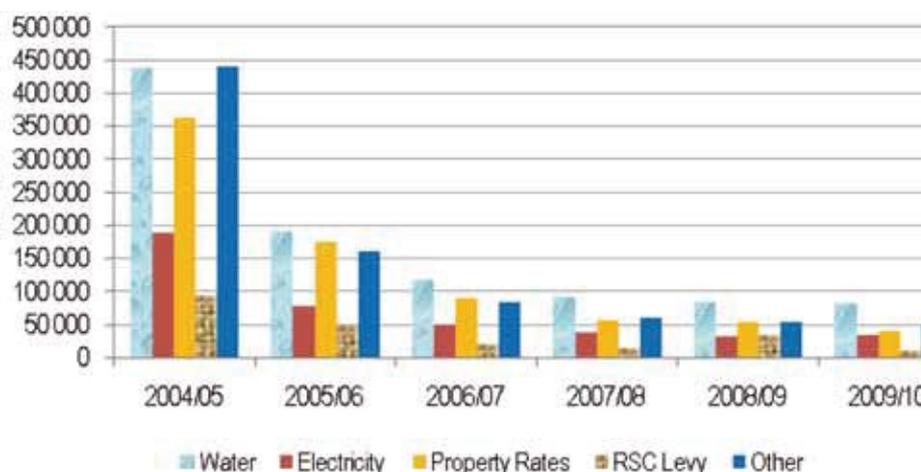


Source: Own calculations based on data from National Treasury 2010

9.3.3 Disaggregation of total municipal consumer debt by income source

Municipal own revenue sources include property rates, service charges (derived largely from electricity, water, sanitation) and various other, smaller sources such as fines. Before being phased out in July 2006, the Regional Services Council (RSC) levies represented a source of income for metropolitan and district municipalities. According to National Treasury, the RSC levy debt represents outstanding amounts payable mostly to district municipalities. As Figure 9.2 shows, outstanding amounts in respect of water, the category 'Other' and property rates dominate over the period.

Figure 9.2 Average municipal consumer debt according to income source (R'000)



Source: Own calculations based on data from National Treasury 2010

Water represents a particular challenge, as it is considered an essential basic service and so cannot be totally cut. This means that non-paying households cannot be completely disconnected from water. The non-payment of electricity may reflect an affordability issue, especially considering recent large increases in electricity prices. Most of the debt arising from non-payment of property rates emanates from government departments, which is the result of government devolving the payment of

123 The contents of this category vary from municipality to municipality. One example of what might be listed in this category is debt emanating from insolvent estates. The practice of using 'Other' is contrary to the reporting format prescribed by National Treasury, whose aims include improving the clarity and accessibility of information.

property rates from the Department of Public Works to provinces. This shift has created a bottleneck in payments, as well as disputes over who is responsible for historical amounts owing to municipalities. Once municipalities start reporting on what 'Other' contains, it will be possible to comment more substantively on this category.

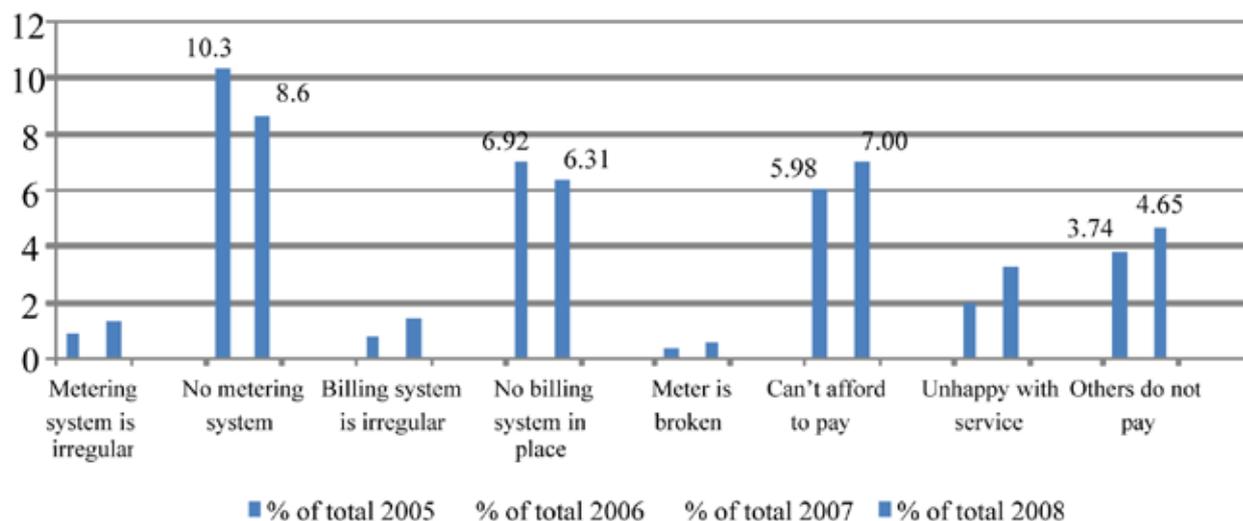
9.4 Reasons for Non-Payment

Households, government and businesses are the main defaulters. This section looks at the possible reasons why these three categories do not pay for services.

9.4.1 Reasons for non-payment by households

Information for this section is sourced from the GHS for the period 2004–2009. The GHS poses specific questions about the non-payment of water and reasons driving defaulters. The GHS was chosen because most non-payment occurs in the water sector. Between 2004 and 2008, eleven reasons were given in the surveys to explain household non-payment. The statistical significance of the reasons was assessed using two F-tests (one to test the equality of the means, and the other to test the equality of the variance). In both instances, the p-value was smaller than 0.05, implying that the reasons provided are different and that some reasons are more dominant than others. Figure 9.3 shows the percentage of households that gave various reasons for non-payment. The absence of a metering system seems to be a strong motivator driving non-payment. The lack of billing systems also features prominently, although appears to be improving. In 2008, the affordability issue emerges strongly, which is probably a result of the slowdown in the economy. In addition, non-payment because other people do not pay seems to be on the increase. However, in general, the reasons driving non-payment tend to stem from municipal performance issues (no metering/billing systems).

Figure 9.3 Reasons for non-payment of water, 2004–2008



Source: StatsSA, 2004–2008

9.4.2 Reasons for non-payment by government

Available data indicates that non-payment by government departments to municipalities has grown rapidly. The information used in this section was sourced from provincial and national treasuries, and data was requested specifically for the six metropolitan municipalities, as municipal consumer debt is concentrated in these six municipalities. As a result, the Gauteng, Western Cape, Eastern Cape and KwaZulu-Natal provincial treasuries were approached for information.

Across the various metropolitan municipalities, the provincial departments of Public Works, Education and Health are responsible for the highest levels of non-payment. The very specific underlying reasons that have led to high levels of non-payment from these particular government departments are:

- **Public Works.** The devolution of assets and payment of property rates from the national Department of Public Works to its provincial counterparts, has created many bottlenecks in payments to municipalities. A conditional grant, the Devolution of the Property Rates Grant to Provinces, was established to assist provinces to pay for this newly acquired function. However, the extent to which this will translate into relief for municipalities is based on the efficacy with which provincial departments transfer funds to municipalities.
- **Education.** The concern here is with Section 21 schools, i.e. schools that have been granted the right to manage their own budgets/financial affairs through their respective governing bodies. In some instances basic services such as water are 'stolen' from these schools by residents, which further results in high bills. These schools have indicated that their budget is insufficient and does not allow them to pay for municipal services. In a bid to address this issue, the City of Cape Town, for example, intends to instal prepaid water and electricity meters at all schools over the next two years.
- **Health.** In this instance, debt is as a result of clinics and hospitals not paying utilities. In addition, in some cases a service level agreement (SLA) exists between provinces and municipalities covering the delivery of certain aspects of primary health care, but either payment is not forthcoming or municipalities have spent more than what was agreed to in the SLA.

In addition to the above, government departments also note the following reasons that contribute to high levels of non-payment: slowness in generating invoices or property rates schedules, inaccurate verification and reconciliation from other municipalities, inappropriate billing systems and unreasonable interest rate charges. Furthermore, the government needs to ensure that reforms, and resulting progress in a particular sector/sphere, do not negatively affect another sphere. To this end, the national departments of Education and Public Works should make a concerted effort to find a speedy solution to these bottlenecks, to ensure that the financial health of municipalities is not unnecessarily jeopardised. While in some instances departments are disputing amounts owed, the increase in government departments owing money to municipalities appears to be partly due to the systemic issues and reforms described above. In view of this situation, calling for punitive action against non-paying departments would not be prudent.

9.4.3 Reasons for non-payment by business

Financial data on non-payment by business is available, but information on the reasons for non-payment is not available. Therefore, BUSA, an umbrella body for business in South Africa was approached to give its views, which are summarised below: (BUSA, 2011)

Reasons for non-payment/late payment

BUSA listed the following factors, in order of importance, as the main reasons driving non-payment/late payment of property rates and/or utility bills:

- Irregular billing
- Incorrect billing
- Unhappiness with service/economic slow-down
- High tariffs
- Others do not pay (this was specifically noted as the most unlikely motive for business non-payment because it would undermine the sustainability of enterprises).

Ways to ensure delivery of high-quality services

The suggestions made by BUSA for ensuring the delivery of high quality services were:

- Increased efficiency (as opposed to increased regulation)
- Qualified people filling key positions/jobs, particularly in the areas of finance, technical and human resources
- Adherence to good governance.

Use of pre-paid meters

The use of pre-paid meters can assist in ensuring that municipalities have access to money, which can be used to cross-subsidise service delivery to poor households. It can also assist in bypassing some of the administrative inefficiencies that numerous municipalities struggle with. The view of BUSA is that, while the use of this type of technology can assist in overcoming certain inefficiencies, it is more suited to private households than to businesses. It was noted that shifting to pre-paid meters was a way to avoid solving the underlying causes of inefficiencies by bypassing them.

Outsourcing municipal billing function

In severe cases, BUSA's view is that this may be a valid option, but in other instances, training and better management may suffice. It was also specifically noted that the effectiveness of outsourcing the billing function would depend on addressing the weaknesses in the current tender system. Based on the reasons driving household, government and business debt, municipalities have much to do in order to convince consumers of the benefit of the services they deliver. Therefore, it may be premature to grant all municipalities punitive collection powers.

9.5 Government's Response to Municipal Consumer Debt

9.5.1 Key legislative provisions

Numerous legislative provisions are intended to guide municipalities in managing their revenue. The Constitution provides broad principles that focus on the role that national and provincial spheres of government should play in municipalities, while the Municipal Finance Management Act (MFMA) and Municipal Systems Act (MSA) provide much more explicit direction on revenue and debt management, including possible recourse mechanisms. Section 64 of the MFMA clearly attributes full responsibility for revenue management to the accounting officer. The accounting officer is expected to ensure that the municipality has an effective revenue-collection system in place, that revenue due to the municipality is calculated on a monthly basis, that interest on arrears are charged and that National Treasury is informed of any cases of non-payment by other organs of state. The MSA dedicates an entire chapter to credit control and debt collection. This chapter details the need for municipalities to set up a customer care management system and provides guidance on the contents of a municipal credit control and debt collection policy, as well as methods that municipalities may employ in trying to recover amounts owed to it (for example, termination/restriction of services, seizure of property or attachment of rent payable on a property).

9.5.2 Other state interventions

In addition to legislative provisions, government has implemented four key interventions in an attempt to motivate greater levels of payment for municipal services by consumers and greater recovery of consumer debt by municipalities (Table 9.4).

Table 9.4 Summary of government-led policy interventions

Intervention	Description
1. Masakhane Campaign	The Masakhane Campaign represents the democratic government's first attempt at implementing a cost-recovery programme. Some commentators indicate that Masakhane was not very successful as a result of slow progress in the delivery of quality services.
2. Project Viability	The initial objective of Project Viability was to monitor the short-term liquidity of municipalities. This encompassed payment levels, arrears and the effectiveness of the credit control or collection function of municipalities. Later, the objective of the intervention was broadened to include support to municipalities experiencing financial problems (DPLG, 1998). According to McDonald (2002:33), the number of municipalities that actually fed the required information to the then Department of Provincial and Local Government (DPLG) was approximately 30%.
3. Project Consolidate	In 2004, the then DPLG launched Project Consolidate, yet another intervention aimed at revitalising the local government sphere. Municipal debt and billing systems were among the specific areas targeted. Relative to previous interventions, Project Consolidate represented a more hands-on approach to addressing municipal challenges, through the deployment of experts and professionals to municipalities. This intervention has shown limited success in the 139 municipalities where experts were deployed.
4. Local Government Turnaround Strategy	The most recent, national attempt to improve the performance of municipalities is the LGTAS, formulated in 2009. In order to achieve its objective of 'turning around' local government, the strategy allocates different roles and responsibilities to the three spheres. The strategy is meant to be holistic and aims to tackle a variety of challenges at the local level, ranging from systemic issues to political and accountability systems, capacity constraints and intergovernmental fiscal issues (CoGTA, 2009:3). Optimising municipal own-revenue collection is a clear goal of this strategy. The performance of this strategy cannot be judged, as it has only been implemented for a short while.

Source: Author

The Commission’s Submission for the Division of Revenue 2011/12 included an assessment of fiscal stress and various local government revenue improvement programmes, which were found to be restricted to revenue management and administration issues. Furthermore while these aspects form part of the broader revenue collection value chain, they do not necessarily improve revenue collection (FFC, 2010). Based on available data on municipal consumer debt, these projects do not appear to have had significant impact. Yet, despite the limited impact, new programmes continue to be established.

In 2009 the LGTAS was introduced with the aim of optimising revenue and reducing debt, among other things. In 2010, before the LGTAS has had time to show results, Outcome 9, whose aim is a responsive, accountable, effective and efficient local government system, has also turned the spotlight on the need to reduce municipal consumer debt (among other things). However, government does not appear to evaluate what went wrong with failed reform attempts before implementing new programmes. In essence, a more holistic approach should be adopted; one that gives attention to the interplay of the various aspects of revenue collection. This would mean that processes, such as ensuring information on indigents is updated, and would run parallel to service delivery and revenue management.

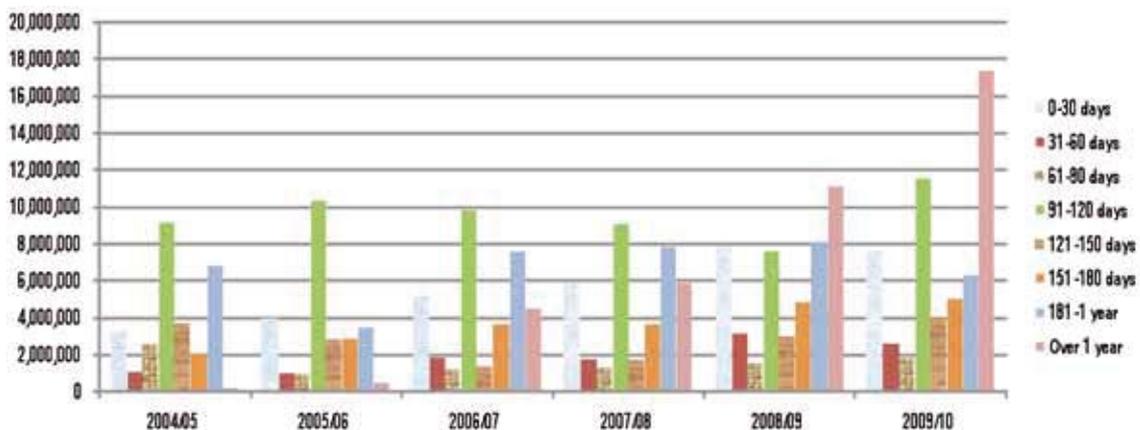
9.6 Key Issues Requiring Attention

The following key issues are considered critical, foundational issues that need to be addressed if the challenge of non-payment is to be further minimised.

9.6.1 Management of debtors

The accounting treatment of debtors varies across municipalities. Issues range from the recognition of revenue¹²⁴ to the inadequate writing-off of irrecoverable debt (this artificially inflates amounts outstanding) and inadequate provision for bad debt. There is also little uniformity on the level of interest charged on outstanding amounts. Figure 9.4 disaggregates total consumer debt in each year by the period for which it was outstanding and provides an indication of just one aspect of poor debt management. Over the six-year period, debt outstanding for 91–120 days is significant, but debt outstanding for over one year has started to dominate in the last two years.

Figure 9.4 Period for which municipal consumer debt was outstanding, 2004/05–2009/10



Source: Own calculations based on data from National Treasury, 2010

With respect to the level of interest charged on outstanding amounts, some municipalities peg the rate to the prevailing prime rate, whereas others charge a rate set at the discretion of the chief financial officer. Although these aspects are at the discretion of municipalities and their councils and should be based on location-specific conditions, formal debt management guidelines for different categories of municipalities could assist government to deal with this challenge. These guidelines could be provided in terms of Section 168 of the MFMA, which allows the minister to establish national regulations or guidelines applicable to municipalities.

124 This refers to some municipalities adhering to Generally Recognized Accounting Practice (GRAP) 9 versus others that comply with International Accounting Standards (IAS) 36 and IAS 39. With GRAP 9 the rendering of a service to an indigent does not increase debtors. The opposite is true for municipalities who adhere to IAS 36 and IAS 39: these municipalities recognise services delivered to indigents, which are then reflected as debtors and provision for bad debts need to be made (see SALGA Input to Budget Forum, 2010 for more information).

When municipalities do not accurately reflect the debtor information and overstate the expected income, they not only provide an unrealistic picture of their financial health, but also place the municipality's financial viability at serious risk. In its submission at Budget Forum in October 2010, the South African Local Government Association (SALGA) raised similar concerns around insufficient and insignificant bad debt write-offs.

9.6.2 Accurate accounting for indigents

Due to unemployment and poverty, certain households/citizens are unable to access or pay for basic services – this grouping is referred to as indigent (DPLG, 2005a). According to the FBS policy of South Africa, indigents are exempt from having to pay for basic services below a certain threshold.¹²⁵ The roll-out of FBS within municipalities is funded via the LES allocation and municipal own-revenue. As a result, the issue of indigents is intricately related to non-payment, as such non-payment constrains the amount of own-revenue at a municipality's disposal and therefore its ability to extend access and deliver FBS to the poorest of the poor.

Municipalities use a variety of ways to target indigents. In the case of water, which is the service where most non-payment accrues, the majority of municipalities use the targeted approach and the indigent register¹²⁶ tool. The problem is that municipalities do not regularly update this information, which means that indigents may be counted as (illegal) defaulters and so falsely inflate the extent of consumer debt. Accurate information, on who is eligible for FBS versus who should pay for services, is essential when devising credible revenue and expenditure estimates. Therefore, regular updating/maintenance of indigent information should be recognised as an integral component of revenue management and be included in Section 64 of the MFMA. More weight should be attached to the quality and accuracy of data and information about indigents, as such information can help to address a range of challenges, from better targeting of the poorest of the poor, to better quantifying of consumer debt and more credible revenue and expenditure estimates.

9.6.3 Monitoring affordability¹²⁷ of basic municipal services

Related to the issue of indigents is the need to monitor the affordability of basic services (water, electricity, sanitation, refuse removal). Although there is a national benchmark for who is eligible for FBS,¹²⁸ municipalities are at liberty to increase this threshold. In times of economic recessions or excessive tariff escalations,¹²⁹ municipalities need to be sensitive to the impact on vulnerable households on the margins that may become eligible for FBS. Affordability indicators need not be complicated. For example, municipal policy-makers can monitor affordability (Milne, 2004:5) through consumption-related indicators (such as percentage of total household expenditure devoted to a commodity or per capita consumption/expenditure on a commodity), price-related indicators (for example unit prices paid for a commodity) or payment-related indicators (such as the use of arrears statistics, use of alternative payment schemes and disconnections owing to debt). These can assist municipalities in becoming more sensitive to potential increases in consumer debt and/or the need to adjust municipal indigent thresholds.

9.6.4 Poor billing and collection activities

Poor billing/collection is not specific to smaller, less resourced municipalities, as recent reports of public discontent with the poor billing practices of the City of Johannesburg prove.¹³⁰ Yet, improvements in billing and collection activities have the potential to bring about immediate enhancements to the revenue bases of municipalities. Instead, as households, business and government confirm, incorrect billing issues continue to negatively affect the integrity of local authorities. Poor performance

125 For example, in the case of electricity the FBS threshold is 50 kilowatt hours per household per month. For water, the FBS amount is 6,000 litres per formal connection per month.

126 See Non-Financial Census, 2008/09.

127 In its October 2011 submission to the Budget Forum, SALGA raised serious concerns around the affordability of municipal services to the average household and in particular the poor.

128 According to the 2005 Guidelines for the Implementation of the National Indigent Policy, R1,600 is cited as the monthly household income threshold for determining indigent status (See DPLG, 2005b).

129 For example according to Eskom's multi-year price determination for the period 2010/11–2012/12, the cost of electricity will increase by just under 26% annually. Municipalities often have little choice but to pass these increases on to consumers.

130 The City of Johannesburg recently spent R580 million on Project Phakama, an upgraded system described on the municipality's website as a system that will, "ensure greater functionality in the areas of metered services, billing, collections, customers' service options and payment process" (Mungoshi, 2010).

can result in paying customers being categorised as defaulters and, in certain instances, can exacerbate an unwillingness to pay. Achieving and maintaining accurate and efficient billing and collection processes depends on a number of factors, including accurate customer databases, effective and regular metering of service consumption, adequate staff capacity and convenient facilities for customer payments (World Bank, 2008). With respect to reasons driving household non-payment, poor/irregular metering systems were particularly emphasised (StatsSA, 2005, 2006, 2007, 2008). In this instance, wider use of prepaid meters may be a possible solution.¹³¹

Nevertheless, some municipalities successfully implement creative measures to improve billing and collection. For example, eThekweni Municipality has developed a geographic information system to facilitate enhanced management of water and sanitation services. The system uses aerial photographic surveys carried out annually to produce maps that indicate (for example) recently constructed properties and can show the precise location of all connected and unconnected properties (World Bank, 2008). The municipality also employs dedicated staff to focus on the recovery of government and top debtors. The City of Cape Town employs a similar strategy, with a dedicated section that focuses on the top 1,000 debtors in the City. Theewaterskloof places particular emphasis on the use of customer profiling and regular updating of its indigent register.

In addressing the billing and collection challenge, municipalities need to determine the root cause of poor performance. In instances where municipalities do not have the financial and human capital resources to upgrade and employ more sophisticated administrative and billing systems, consideration should be given to either outsourcing the function (permissible in terms of Section 76(b) of the Municipal Systems Act) or establishing an internal municipal service district to facilitate improved performance (permissible in terms of Section 85 of the Municipal Systems Act). In less severe cases, municipalities should explore the relatively less complicated solution of leveraging the experience of their counterparts who are capably managing their billing and collection functions. Finally, appropriate weight should be attached to the role of sound and efficient billing and collection processes in municipalities, as part of the specific key performance indicators (KPIs) included in the performance contracts of municipal managers. These KPIs should include, for example, reductions in the average time between meter reading and invoicing, increases in metered consumption (if metering is chosen over the use of prepaid systems) and improvements in the average time between complaints being lodged and (partially or fully) addressed.

9.6.5 Municipal powers to recover unpaid amounts

The government needs to take a differential approach when expanding the powers of municipalities to exercise more punitive recovery measures. This differentiated approach should not be based on municipal category but rather on individual municipal performance with respect to consumer debt, and should consider a range of factors, from general management of debt to regular updates of indigent information.

9.7 Conclusion and Recommendations

Municipal consumer debt is a complex challenge that requires multi-faceted solutions. Addressing the challenge requires not only interventions aimed at promoting greater levels of payment by consumers but also, perhaps more importantly, improvements to municipal service delivery and administrative processes. Based on the key issues discussed, the following recommendations are proposed.

- National guidelines/norms should be established for the management of municipal consumer debt. Such guidelines should cover aspects such as interest charges on outstanding amounts, debt impairment and writing-off of bad debts. The imposition of these guidelines could be an interim measure that can be relaxed once the management of debt improves in the local government sphere.
- Municipalities should continuously track the affordability of basic services, with indigent thresholds being accordingly updated.
- The regular updating and maintenance of data and information on indigents should be included as an integral component of municipal revenue management as specified in Section 64 of the MFMA.

¹³¹ The use of prepaid meters brings certain disadvantages, most notably by providing a false sense of progress with respect to access to basic services as a result of self-disconnection. However, if indigent thresholds are sensitive to changes in affordability and are appropriately adjusted, the advantages of using prepaid meters may outweigh the disadvantages.

- In addressing the billing and collection challenge, municipalities should determine the root cause of poor performance. In instances where municipalities do not have the financial and human capital resources to upgrade and employ more sophisticated administrative and billing systems, consideration should be given to either outsourcing the function (permissible in terms of Section 76(b) of the Municipal Systems Act) or establishing an internal municipal service district to facilitate improved performance (permissible in terms of Section 85 of the Municipal Systems Act). In less severe cases, municipalities should explore the relatively less complicated solution of leveraging the experience of their counterparts who are capably managing their billing and collection functions.
- Specific key performance indicators should be included in the performance contracts of municipal managers. These could include, for example, reductions in the average time between meter reading and invoicing, increases in metered consumption (if metering is chosen over the use of prepaid systems) and improvements in the average time between complaints being lodged and (partially or fully) addressed.
- In terms of expanding the powers of municipalities to exercise more punitive recovery measures, it is recommended that government take a differentiated approach that is not based on municipal category but rather on individual municipal performance with respect to consumer debt, and should consider a range of factors, from general management of debt to regular updates of indigent information.

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