ACCESS TO BASIC SERVICES

ENABLING PROGRESSIVE TRANSFORMATION OR ENTRENCHING POVERTY AND INEQUALITY?

PARI
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LOCAL GOVERNMENT

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This short report investigates the provision of basic municipal services — electricity, water and sanitation — to low-income households, in an attempt to answer one key question: is the current model for providing basic services contributing to increased standards of living, reduced household poverty and greater equality?

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CONTENTS

> *National government has an obligation to intervene on behalf of communities where municipalities, through inefficiency or a lack of commitment to delivery and development goals, fail to provide affordable services.*

White Paper on Local Government (1998)

1
Background

1.1. Municipal services — electricity, water, sanitation and waste removal — were intended to be a tool to reduce poverty and inequality, raise living standards and facilitate economic opportunities

Local government has the primary responsibility for delivering these services (together with Eskom in respect of electricity).1 Providing services to households that were previously denied such access is considered one of the most important roles of local government and its main contribution to reducing poverty and inequality.

> ***South Africa has been given a rare and historic opportunity to transform local government to meet the challenges of the next century. ... the existing local government system will be radically transformed ... (into) a system of local government which is centrally concerned with working with local citizens and communities to find sustainable ways to meet their needs and improve the quality of their lives.***
>
> *White Paper on Local Government (1998)*

National socioeconomic development strategy, as articulated in the National Development Plan,[2] includes an important *social wage* component, as a key tool to raise living standards and reduce poverty and inequality. A social wage comprises both monetary and non-monetary transfers and subsidies for poor households, effectively increasing their disposable income and/or reducing their expenditure requirements. The most visible — and significant in terms of the current budgetary implications — component of the social wage in South Africa is social grants.

Subsidised, including free, services for households — energy, water, sanitation and waste removal — are also intended as an important part of the social wage. The rationale is that (1) access to such services is key to raising living standards and (2) subsidies, including free services, are necessary to compensate for the lack of household income which would otherwise mean that poor households are unable to access these services. In addition, access to quality services facilitates increased opportunities to generate livelihoods,[3] and thereby contributes to national employment and income goals.

1 Eskom directly supplies to just over 50 per cent of all households, and a greater percentage of poor households, due to its historical township electrification programme.

2 NDP 2030 – available at https://www.gov.za/sites/default/files/gcis_document/201409/ndp-2030-our-future-make-it-workr.pdf

3 Many home- and community-based small business opportunities require reliable and affordable access to electricity and water.

Universal access to quality services is thus a critical part of South Africa's long-term goal of reducing poverty and inequality. Effective access comprises both physical access (infrastructure and service delivery that ensures a reliable and quality service) and affordability (services that are unaffordable cannot be accessed).

The 1998 White Paper on Local Government[4] emphasised the importance of ensuring that basic services are affordable to achieve the goal of universal access. When services are unaffordable for poor households, the value of the social wage is eroded, as is its role as a redistributive mechanism. The White Paper was clear that each municipality has a responsibility to ensure that tariffs are set at affordable levels:

> ***Accessibility is closely linked to affordability. Even when service infrastructure is in place, services will remain beyond the reach of many unless they are financially affordable.***
>
> ***The dominant principle underlying this new (local government fiscal) system will be equity — it should enable all municipalities to provide a basic level of services to low-income households in their areas of jurisdiction at affordable cost.***

The White Paper also advocated for affordable services to ensure that municipalities would get paid for those services. That is, affordability was seen as key to effective revenue collection: if households could not afford to pay for services, the financial viability of a municipality would be compromised.

It should be noted, however, that nowhere in the White Paper, or subsequent regulation, is affordability clearly defined — it is unclear at what level services tariffs are, in fact, affordable or unaffordable. There is thus no regulatory benchmark against which affordability can be objectively assessed. The White Paper also recommended that households that are 'unable to pay even a portion of service costs' should still have access to services, and that some form of subsidy mechanism was necessary to ensure this outcome. But, once again, there is no clear definition in any legislation of what exactly qualifies a household as 'unable to pay'.

This is a critical omission, not least because the White Paper also stated that 'national government has an obligation to intervene on behalf of communities where municipalities, through inefficiency or a lack of commitment to delivery and development goals, fail to provide affordable services'. Such an obligation is rendered null and void if there is no clear benchmark against which to assess affordability.

The only policies enacted in response to the White Paper's goal of affordable services are the various free basic services — electricity, water and sanitation. These policies aim to provide a limited amount of each service to qualifying households; 50kWh

4 Available at https://www.cogta.gov.za/cgta_2016/wp-content/uploads/2016/06/whitepaper-on-loca-gov.pdf

of electricity per month, 6KL of water per month, together with communal access points where households do not have individual water connections, and a range of sanitation options.

The implementation of the free-basic-services policy and its contribution to the goal of affordable access is discussed in more detail in Chapter 2.

1.2. Municipal services tariffs are intended to fund the bulk of local government's operating expenditure

In addition to its assumed significance in reducing poverty and inequality, the provision of services fills another critical role in local government: the sale of services, together with property rates and taxes, is intended to be the main source of local government income, the foundation on which municipalities fund their ambitious post-1994 development mandate, with only a relatively small funding top-up from the national fiscus via the equitable share and conditional grants.

The basis of the White Paper's proposed municipal funding model was that *own revenue* would make up most of local government's funding requirements. This assumption was reflected in a key statement: 'Municipalities do generally have sufficient revenue-raising powers to fund most of their expenditure ... On average they finance 90% of their recurrent expenditure (operational or running costs) out of their own revenue, and in particular from property rates and user charges (for services).'

The White Paper assumed that income from property rates and services charges would be **sufficient to finance 73 per cent of all local government aggregate operating expenditure requirements,**[5] as summarised in the table below.

TABLE 1: WHITE PAPER ASSUMPTIONS OF THE CONTRIBUTION OF VARIOUS INCOME SOURCES TO OWN REVENUE AND OPERATING EXPENDITURE*

Income source	Assumed contribution to own revenue (%)	Assumed contribution to total operating expenditure (%)
Property rates and taxes	19.9	17.91
Electricity sales	41.4	37.26
Water	11.8	10.62
Sewerage &refuse removal	8.2	7.38

*Based, in turn, on the assumption that own revenue would make up 90 per cent of total operating expenditure.

5 Operating expenditure includes all staff costs, office accommodation, payments to bulk services provider, all other non-capital costs associated with delivering services and infrastructure maintenance.

The White Paper did not see any conflict between these two goals — services priced at a level that all households could afford, and services priced at a level that would ensure sufficient income for local government. That is, the clear assumption was that there was a point of convergence in tariff setting at which both goals could be achieved — and the current municipal financial system is based on this.

> *Financial sustainability requires that municipalities ensure that their budgets are balanced (income should cover expenditure). Given revenue constraints, this involves ensuring that services are provided at levels which are affordable, and that municipalities are able to recover the costs of service delivery.*
>
> *Municipalities can ensure affordability through ... setting tariffs which balance the economic viability of continued service provision and the ability of the poor to access services.*

The next chapter investigates how well these assumptions have played out since 1998: how affordable are services, particularly for poor households, and are municipalities able to raise enough revenue from such tariffs to be financially sustainable?

2
The current position

How well does the current situation compare to original policy goals? There are three main issues covered in this chapter:[6]

i. The delivery of the free basic services — intended to compensate for services that poor households cannot afford;
ii. The affordability of services for low-income households over and above the free services; and
iii. Municipal financial viability — that is, sufficient municipal income from services tariffs.

2.1. The delivery of free basic services

The only policies enacted in response to the White Paper's goal of affordable services are the various free basic services — electricity, water and sanitation. These aim to provide a limited amount of each service each month to qualifying households; 50kWh of electricity, 6KL of water and a range of basic sanitation options, with the details of the latter to be determined by each municipality.

There is general agreement outside of the state that the amounts of (particularly) free electricity and free water are inadequate to meet the needs of most households: research suggests that the minimum basic requirement for households is approximately four times as much electricity (200kWh per month) and almost twice as much water (10KL). The free basic services therefore represent only a partial subsidy of households' actual needs — and thus only a part of the goal of universal affordable access — but still positively affect standards of living and household disposable income available for other non-services expenditure.

Local government is the gatekeeper of the free-basic-services programme and local municipalities are the final arbiter of who can access these. In general, free services are available only to households that are registered as *indigent* by their municipality.[7]

Each municipality has the responsibility and sole discretion to determine its own criteria for household indigent status. Although the various national policies make suggestions in this regard, the final decision lies with a municipality, and there are significant variations in qualifying criteria and registration processes. A household that is not registered by a municipality cannot obtain any free service, no matter how poor they are. Even where a household receives electricity directly from Eskom, it can

6 Another issue is the quality of services provided, which is generally considered to have declined over the last ten years. This is mainly due to the lack of infrastructure maintenance. Maintenance is one of the expenditure items to be funded out of municipal own revenue, and so an inability to collect revenue directly impedes funding for maintenance.

7 There is still a small number of non-indigent households — fewer than 10 per cent of the total number of beneficiary households — that receive free services due to challenges with updating billing systems.

only access the free basic electricity via registration as an indigent household by the municipality — which municipality should then inform Eskom of that household's indigent status, enabling access to the free electricity. The effective result is that a household's ability to access free basic services is determined significantly by where they live, rather than by their actual poverty.

Most municipalities include an upper limit on household income (commonly around R3,780 per month — double the current older person's grant), together with other qualifying criteria, such as the requirement to be the homeowner (not a tenant). The registration is generally effective for a limited period — usually 12 months — after which the household must reapply. In most municipalities the registration process is onerous, despite original policy intentions that it should not incur unnecessary administrative costs.

There is no appeal process for households who believe that they have been unfairly deprived of access to any free basic services because of the absolute municipal discretion in setting indigent status qualifying criteria.

Municipalities are not required to fund the free basic services out of their own revenue unless they decide to fund a higher level of services[8] or non-indigent households. There is an annual allocation in the national budget to each municipality in respect of these services, which forms part of the local government discretionary equitable share allocation. Each year, the number of qualifying households in each municipality is estimated by National Treasury, with input from StatsSA, using adjusted household income data from the 2011 census and the 2016 community survey. The amount of the subsidy per household is calculated using an estimated average cost of providing each service and contains both an operations and a maintenance component. That amount is multiplied by the number of estimated qualifying households in each municipality[9] to obtain the total equitable share transfer amount that is allocated to each municipality.

Each year the number of households funded for free basic services in the national budget has increased: increasing over the past six years alone from 8.7 million in the 2014/15 financial year, to 10.36 million in 2020/21.

It is important to note that the transfer of funds to municipalities in respect of the free basic services is *not a conditional transfer*: instead, it is part of the discretionary equitable share. This means that a municipality is lawfully entitled to provide fewer households with basic services than it has received funding for. However, national budget documentation is also clear that if municipalities decide to fund fewer households, then 'their budget documentation (should clearly set] out why they have made this choice and how they have consulted with their community during the budget process'.

8 A few municipalities provide free basic electricity in excess of the 50kWh, and a small number also provide more than 6KL of free water.

9 The detailed data per municipality is available in the equitable share summary data on the MFMA web pages. http://mfma.treasury.gov.za/Media_Releases/LGESDiscussions/Pages/default.aspx

If a municipality provides fewer households with the free-basic-service benefit compared to how many are funded in the national budget, the balance of the money allocated to that municipality for free basic services goes into general revenue and can be spent as the municipality wishes.

How does the actual number of households receiving free basic services compare with the number that is funded in the annual budget?

Data on the delivery of free basic services and registered indigent households is captured in the annual Non-financial Census of Municipalities (StatsSA publication, P9115), and the most recent data available is for 2019.[10] P9115 indicates how many households in each municipality are registered as indigent and how many of these are receiving free basic water, electricity, sanitation and solid waste removal. This data can then be compared to how many are funded in the budget each year, as set out in the annual Budget Review Annexures.

The first point to make is that the total number of indigent households registered by local municipalities *declined* by almost 20 per cent from 2015 to 2019, as indicated in the table below. This does not reflect actual poverty trends, and is in sharp contrast to the increase in the number of households funded in the national budget over the same period:

TABLE 2: TOTAL NUMBER OF HOUSEHOLDS REGISTERED AS INDIGENT BY MUNICIPALITIES

Year	Total number of registered indigent households
2019	2,895,124
2018	3,594,058
2017	3,511,741
2016	3,564,866
2015	3,570,602

Source: StatsSA (P9115)

Additionally, the data suggests that not all registered indigent households are actually receiving all of the free basic services:[11] In 2019, there were 2,895,124 registered indigent households, but only:

- 1,890,691 were listed as receiving free basic electricity,
- 2,163,082 were listed as receiving free water,
- 1,537,749 were listed as receiving free sanitation, and
- 1,991,925 were listed as receiving free waste removal.

10 Like many other statistical releases, this one has been delayed due to Covid-19 disruptions.

11 It is far from clear how all of this difference has materialised, but Table SA14 data from Treasury suggests that households registered as indigent are often not charged any property rates, and this may be the only benefit that accrues to those not receiving the other free services. In addition, about 15 per cent of the poorest South African households do not have a formal electricity connection, and thus cannot receive the free basic electricity. However, there is no such explanation for the approximately 700,000 households registered as indigent but not listed as receiving free water.

> *There is no appeal process for households who believe that they have been unfairly deprived of access to any free basic services because of the absolute municipal discretion in setting indigent status qualifying criteria.*

In the same national fiscal year (2019/20) a total of 10.1 million households were funded in the national budget for free basic services. Fewer than one quarter[12] of the households funded in the national budget to receive free basic services actually receive these from their municipality. No more than 1.5 million households — 14.8 per cent of the number funded in the national budget — appear to be receiving all the free basic services.

These are aggregate figures. The data also indicates significant differences across municipalities in respect of the delivery of free services. Some municipalities deliver very close to their funded allowance, while others deliver at a level way below that. Once again, this emphasises the problematic reality that households' ability to access free services is determined to an extraordinary extent by where they live. These variations entrench spatial inequality and poverty: not only are their living standards undermined by not having access to basic services, but households must pay for what they do not receive.

If we compare the actual number of beneficiary households for each service in 2019 against the number funded in the 2019/20 national budget, we can see the shortfall in beneficiary households per service. The table below shows data in respect of households actually receiving the different free basic services compared to the number of households funded in the budget, for the 2019/20 year. The difference indicates the number of households funded in the national budget but not receiving benefits from their municipality.

TABLE 3: HOUSEHOLDS RECEIVING FBS VERSUS HOUSEHOLDS FUNDED FOR FBS (2019)

Service	Households funded for the free service (2019/20)	Households receiving the free service (2019)	Difference (funded – actual recipients)	Total value of difference (R'billions)
Electricity	10,109,607	1,890,691	8,218,916	R8.63
Water	10,109,607	2,163,082	7,946,525	R12.86
Sanitation	10,109,607	1,537,749	8,571,858	R10.42
Refuse	10,109,607	1,991,925	8,117,682	R8.27
TOTAL				**R40.18**

Source: LGES Summary Data and Formula, P9115, own calculations, numbers may not add up due to rounding.

Is there a reasonable explanation for this glaring difference between the number of funded households and those actually receiving the benefits? Mostly not.

- A small number of non-indigent households receive free services due to billing issues. These are funded from the same allocation, thus reducing the funding for genuinely indigent households. But the total number of these

12 Based on the highest number of service beneficiaries, in this case water.

is less than 150,000 across all municipalities, according to P9115; certainly not nearly enough to account for the entire gap (eight million) in delivery to indigent households.

- Approximately 15 per cent of South African households — overwhelmingly the poorest — do not have a formal electricity connection and thus cannot receive the free basic electricity. However, the total number of such households is probably no more than 2.5 million, which does not explain the 8.2 million household gap between the number of households funded for free basic electricity and the number receiving the benefit.
- Approximately two million households access water through a communal standpipe[13] and we could say that they are beneficiaries of the free-basic-water policy since there is no household billing for these services. But adding these households to those formally registered for free basic water, we still only have about 4.2 million households benefitting from the free water allowance, compared to the more than ten million households funded in the national budget.
- Many municipalities maintain that the actual cost of providing these services is higher than the National Treasury estimates and for this reason they cannot afford to deliver services to as many households as indicated in the national budget. There is probably some truth in this, notably in respect of water services in rural areas. But, for this to present a full explanation, the actual costs of providing the free basic services would have to be almost 500 per cent higher than National Treasury estimates. This seems extremely unlikely. No municipality has ever presented empirical data proving that the cost of delivering the free basic services is different from the amount allocated in the national budget.

Since no municipality reports officially on the details of the difference between funded households and beneficiary households or the reasons for funding fewer households, the reasons cannot be determined. However, one clear underlying issue is that millions of households that should be classified as indigent are not being registered by municipalities; no registration equals no possibility of free services.

We can thus conclude that **the free-basic-services policies are, in reality, making little contribution to the White Paper's goal of affordable universal access because so many poor households are effectively excluded**. Millions of poor households are required to pay for all services that they receive from their municipality, the costs of which directly reduce the disposable income that they have for other essential expenditure, such as food.

The exclusionary approach, combined with the fact that free basic services only make up a fraction of actual household requirements, means that there is probably no household in South Africa that receives fully subsidised municipal services.

13 General Household Survey 2019.

2.2. The affordability of services

What are low-income households paying for services against the White Paper's promise of affordability?

Across the board, all municipal services have increased in price well above the rate of consumer price inflation over the last ten years, making it clear that household affordability is *not* the priority in the current system. The South African Reserve Bank reported the following increases in municipal services costs from 2010 to 2020, during which period the increase in headline consumer inflation was 68 per cent:[14]

- Rates and taxes: +118 per cent
- Electricity: +177 per cent
- Water: +213 per cent

But what are poor households actually paying for municipal services each month? This is not easy to answer, partly because of the considerable variations in municipal services pricing among different municipalities and the lack of standardised and accurate data across all municipalities. However, some conclusions can be drawn from existing data in respect of metros and secondary cities, which is where most households are found.

Table SA14 (Household Bills) within National Treasury's municipal MTREF data[15] provides comprehensive information for metros and secondary cities — although not all municipalities submit data and there is no guarantee that submitted data is accurate. Within these limitations, Table SA14 data indicates the average household bills for three categories of household across municipalities, one of which is 'indigent household receiving free basic services'. In most municipalities, an 'indigent household' has a total monthly income of less than R3,780 and thus includes the poorest households.

We have used the most recent data available (June 2020). Some municipalities indicate that they charge property rates and taxes to this category of customer, but most either do not or charge only a small amount. Therefore, most accounts for this group include only services charges — the largest of which is generally electricity usage. **The data indicate that the average monthly municipal account for an indigent household in the year ended June 2020[16] was R865 per month in a metro and R900 in a secondary town.** Within this, there are considerable variations. In secondary towns, accounts range from just under R500 per month to over R1,000. In metros, they range from R660 to R1,200. A poor household's location thus strongly determines how much they pay for services, as well as the quality of those services.

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14 https://www.businessinsider.co.za/water-prices-have-increased-massively-in-south-africa-over-the-last-decade-the-reserve-bank-says-2020-10

15 http://mfma.treasury.gov.za/Media_Releases/mbi/Pages/Municipal%20Budgets%20-%20Main%20Page.aspx

16 http://mfma.treasury.gov.za/Media_Releases/mbi/2020/Documents/Forms/AllItems.aspx?RootFolder=%2FMedia%5FReleases%2Fmbi%2F2020%2FDocuments%2FG%2E%20Non%2Dfinancial%20information%2FSA14%20Household%20bills&FolderCTID=0x0120005868F828F9A47749BB14710173A100EB&View={98485A18-9CBD-42D2-A8F9-F91CC0E4A0E8}

The effective basic-services costs for households are generally higher than these amounts, due to energy requirements. Although 85 per cent of all South African households have an electricity connection, most low-income households with such a connection still use other sources of energy[17] (coal, gas, wood, paraffin, candles etc.) because they cannot afford to purchase the equivalent in electricity.[18] There is limited research available on the details of this expenditure, but a rough conservative estimate from existing data would be R150 per month per household. Since this is correctly a basic-services expenditure, it should be added to the municipal accounts data set out above to generate a more accurate cost of what households are spending. **Thus, the average cost of accessing basic services for an indigent household in 2020 was approximately R1,000 – R1,050 per month.**

What can we say about the larger category of poor (but not registered as indigent) households? The SA Cities Networks' State of Cities Finance Report 2020[19] considers municipal accounts in the eight metros[20] and Msunduzi for four categories of households (A – D). Category A households are low-income (but not indigent) households, with a monthly income of between approximately R4,200 and R8,500 per month (2019 values as estimated in the report). **On average across the metros, category A households were being billed R1,425 per month for municipal services in 2020. The biggest contributors were electricity at R675 per month, and water at R400 per month.**

Given that electricity usage is generally the biggest component of services accounts for low-income households, Eskom should be included as a direct contributor to the affordability issue: more than half of all households access electricity directly from Eskom, often via prepaid meters. In some municipalities, *all* the households access electricity from Eskom. That is, it is not just municipal policies in terms of setting tariffs that impact households, but also Eskom's tariff policies.

How affordable are these bills? In global North studies, a percentage of income allocated is used as the benchmark of affordability: if a household spends less than the target figure, the cost is deemed affordable; if it spends more, then the service is deemed unaffordable. The SA Cities Network utilises this approach, using 10 per cent of household income as the cut-off point. That is, if the municipal account comprises more than 10 per cent of household income it is unaffordable.

This paper proposes that this is not the best approach in South Africa, which has very high levels of household poverty and food insecurity. Instead, a preferred approach is that the cost of basic services be contextualised against the background of food insecurity. We refer to this as a Food First approach; one that takes note of the current dire state (and implications) of household food security:

17 Cooking is the major activity that requires energy.

18 Most poor households have a prepaid electricity meter, which means that there is no 'option' of using the service now and working out how to pay for it later.

19 https://www.sacities.net/wp-content/uploads/2021/03/SOCF-2020-Report.pdf

20 Buffalo City, Cape Town, Ekurhuleni, eThekwini, Johannesburg, Mangaung, Nelson Mandela Bay and Tshwane.

- 27 per cent of South African children under the age of five are so malnourished that they are classified as stunted. Childhood stunting is positively associated with poor cognitive development, significantly increased likelihood of non-communicable diseases such as obesity and diabetes in later life, and an increased propensity for violence in adults.
- At least 30 per cent of South African households regularly experience severe or moderate food insecurity.
- Most South African households purchase all the food that they consume. Household disposable income is thus the single most important factor contributing to food security. Any factor which reduces disposable household income available to purchase food contributes directly to exacerbating food insecurity.

In this context, there is a strong case to be made for a Food First approach towards determining the affordability of services. For a household that does not have enough money to spend on purchasing a basic nutritionally adequate basket of food, every Rand spent on basic services should be considered unaffordable, and the household should be classified as one that is 'unable to pay' in terms of the White Paper's intentions.

The Pietermaritzburg Economic Justice and Dignity organisation (PMBEJD)[21] conducts detailed research into household food expenditure. They calculated the cost of a minimum nutrition basket for a family of four[22] at R2,576.13 in April 2020.[23] This is slightly higher than StatsSA's food poverty line for a family of four — R2,340 per month as at April 2020 — but appears more realistic in terms of basic nutrition requirements since it considers both child and adult requirements.

We can therefore use this (R2,576.13) as the minimum amount of money that an average household requires each month just to pay for food. This is not the only claim on household income — accommodation, transport and municipal services are also required, and it is usually food expenditure that is sacrificed to pay for these items. In comparison, the monthly minimum wage for a full-time worker in April 2020 was R3,155.52. The implication is that a household with one person working at the minimum wage only had R579.39 remaining after purchasing basic food requirements — not enough to cover the indigent household municipal account, never mind any other expenses.

21 https://pmbejd.org.za/

22 Some poor households have considerably more members, but Census 2011 indicates that the majority (43–48 per cent) of households with no or low income had 2–4 members.

23 We have used 2020 data for this data and for the household poverty data, in order to better correspond with the municipal accounts data, which is available as at June 2020. StatsSA updates poverty levels in April each year.

Adopting a Food First approach to basic services pricing implies that:

- For households that live below the food poverty line (R2,340 per month for a family of four at April 2020 prices), **no expenditure on a minimum amount**[24] **of basic services should be considered affordable**, since the household does not have enough money to purchase sufficient food.
- For households that live above the food poverty line, but below the lower bound poverty line (R3,360 per month for a family of four at April 2020 prices), **no expenditure on basic services should be considered affordable** because the household is already sacrificing food expenditure for other essential expenditure items, such as accommodation and transport.
- For households that live above the lower-bound poverty, but below the upper-bound poverty line (R5,072 per month for a family of four at 2020 prices), **expenditure on basic services would have to be no more than a few hundred Rand per month to be considered affordable.**

StatsSA estimates that 25 per cent of all South African households, some 4.3 million, live on less than R2,340 per month. These households do not have enough money to pay for a basic basket of nutritious food: every Rand that they spend on municipal services is taken from their food requirements. Clearly, these 4.3 million households are 'unable to pay' for municipal services as described in the White Paper and should be receiving *all* their municipal services requirements[25] at no charge.

A further 15 per cent, 2.6 million households, live above the food poverty line, but below the lower-bound poverty line and, on a Food First approach, should also be receiving all their municipal services requirements at no charge.

This combined group constitutes almost *seven million households*; seven million households who — in the interests of achieving minimum food security and living standards — should not be diverting any household expenditure towards the payment of municipal services; who are 'unable to pay' against a minimum standard of developmental government and equity.

In sharp contrast to this ideal situation, only about two million South African households receive any of the small amounts of free basic services and it is highly likely that zero households receive all their basic-services requirements for free.

If we consider category A households in the SA Cities report: **these households need an income of R4,000 per month just to pay for food and municipal services** (basic food basket of R2,567.13 plus average municipal account of R1,425). Once again, households in these cities must also find money each month to pay for accommodation and transport.

24 To genuinely support increased standards of living and livelihood opportunities, that minimum level needs to be notably higher than current levels of free services: 200kWh of electricity and 10KL of water per household per month are more reasonable minimums.

25 Realistic services levels that will contribute to meaningful improvements in standards of living and contribute to creating economic opportunities — which are the priority goal of service delivery described in the White Paper — are significantly higher than the current free amounts: 200kWh of electricity and 10KL of water per month are much closer to actual requirements.

Under no circumstances, therefore, should the current cost of basic services be considered affordable for the poorest 8.6 million households in South Africa; the number of households that live below the upper-bound poverty line. It appears very likely that most of these households are being forced to sacrifice food expenditure to pay these accounts and/or are failing to pay them because the choice they face is food for their children or pay the account. Far from being the tool of progressive pro-poor development, municipal services have become an instrument of impoverishing even further the poorest South African households, and entrenching inequality.[26] In addition to exacerbating household food security, the current unaffordability of municipal services — particularly electricity — greatly reduces opportunities for poor households to engage in a wide range of livelihood activities, thereby effectively trapping them in poverty.

The current focus on cost recovery as the basis of municipal tariff-setting may sound like a perfectly reasonable operating strategy, but in its current form and within the context of household poverty, it is diametrically opposed to the goal of universal affordable access, mostly because that goal seems to have disappeared. **That is, the goal of affordable access to services is not placed where it should be — at the very centre of the local government budgeting system. Ideally, costs should be controlled to ensure affordable tariffs. But under the current system there are few controls over costs and the assumption is that households must simply pay.**

The current inter-governmental framework allows enormous discretion to municipalities in terms of operational expenditure. Since income from property taxes and services is intended to cover 73 per cent of total operating costs of a municipality, increases to the overall operating cost base —whether through inflated salary dispensations for senior managers, or the excessive and increasing regulatory burden on local government, or poor financial management, or above-inflation price increases from bulk providers[27], or corruption — are simply passed on to the users of services. National government has never intervened to ensure that municipalities deliver affordable services, as envisaged in the White Paper, because the truth is that affordable services are not a national priority.

But what about the other side of the assumed win-win fiscal outcome depicted in the White Paper; that tariffs could be set at levels that were simultaneously affordable for households and sufficient to ensure municipal financial viability?

26 This effect is exacerbated by poor quality and unreliable services in many municipalities, despite the high cost of such services. There is no correlation between the cost of services and their quality.

27 Eskom and the various water boards

2.3. Municipal financial viability

Many municipal officials are aware that numerous households cannot afford to pay their bills. But municipalities are locked into a fiscal framework, with corresponding pressure from national government to set tariffs that are based on cost-recovery and to not have unfunded budgets. The only place to match ever-increasing municipal expenditure is municipal services.

If these rapidly increasing municipal accounts were matched by strong municipal finances, quality services and the maintenance of basic infrastructure, then a case could be made that at least part of the White Paper's vision of effective and developmental local government had been attained, even though a strong argument could still be made that the associated cost is too high. But it is clear that — even while setting municipal tariffs at a rate that is impoverishing households and exacerbating food insecurity and child malnutrition — the financial state of municipalities is deteriorating. That is, neither side of the supposed win-win situation has been achieved. Instead, there is an increasing slide into a lose-lose quagmire.

The Auditor-General (AGSA)[28] found that in the 2018/19 financial year:

- 79 per cent of municipalities had a financial health status that was 'either concerning or requiring urgent intervention';
- 31 per cent of municipalities were in a 'particularly vulnerable' financial position; and
- 34 per cent of municipalities ended the year with a deficit, involving an aggregate amount of R6.3 billion of unfunded expenditure.

At the beginning of the 2019/2020 financial year, 126 municipalities (49 per cent of the total) adopted unfunded budgets — that is, a budget where 'realistically anticipated revenue is insufficient to meet planned spending'. This was a significant increase from the 74 municipalities that adopted unfunded budgets at the beginning of the 2016/17 financial year. After an intervention by National Treasury, the number was reduced to 66. The fact remains, however, that almost half of all municipalities were planning to spend money they could not reasonably expect to collect and almost a quarter still had unfunded budgets *after* Treasury's intervention.

The situation declined further in the 2019/20 financial year, although even that was before the main impact of Covid-19 would be felt on municipal finances. The AGSA summarised the situation as follows[29]:

This deteriorating state of municipal finances creates the environment that incentivises many municipalities to divert free-basic-services funding to general revenue.

28 https://www.agsa.co.za/Portals/0/Reports/MFMA/201819/Media%20Release/2020%20MFMA%20Media%20Release%20Final.pdf

29 https://www.agsa.co.za/Portals/0/Reports/MFMA/201920/Section%2001%20Executive%20Summary.pdf

> *Local government finances continue to be under severe pressure as a result of non-payment by municipal debtors, poor budgeting practices, and ineffective financial management. The financial position of just over a quarter of municipalities is so dire that there is significant doubt that they will be able to continue operating as a going concern in the near future.*

The unaffordability of municipal services means that account payments levels are low, and the low collection rate is one of the key factors behind deteriorating financial viability. The White Paper was clear that if tariffs were unaffordable, municipal customers would not be able to pay.

- Outstanding debt owed to local government has risen steadily over the last few years, from just under R130 billion at the end of the 2016/17, to just over R230 billion at the end of December 2020 (which, in turn, was almost R50 billion higher than in March 2020).
- Most of this debt (R192 billion) has been owed for more than 90 days, and 72 per cent is owed by households.
- The Auditor-General estimates that no more than 60 per cent of that debt can ever be recovered, given the assessed ability of households to pay.

There are clear limits to how much more revenue municipalities can collect because there is a limit to how much households can pay — despite the apparent assumption by many officials that the only impediment is willingness to pay. And within the current economic context, households cannot keep paying increased services charges. Although there are other debtors (such as the other parts of the state that collectively owe local municipalities R14 billion in debt that has been outstanding for more than 90 days)[30] to which more pressure to pay could be applied, households are still the single biggest group that owe money to municipalities.

The move to more and more prepaid services is seen by some as the solution to the problem, but in the current context of household poverty prepaid services will ensure even less access to services by poor households. This will not only further entrench poverty but may also effectively result in *lower* services revenue for local municipalities.

Declining municipal finances are reflected in collapsing municipal infrastructure, since maintenance is one of the expenditure items that municipalities are supposed to self-fund out of services revenue. In turn, the quality of municipal services is declining in many locations[31] due, in part, to a lack of maintenance expenditure by local government. The South African Institution of Civil Engineering (SAICE) rated South Africa's public infrastructure at a D (at risk of failure) in 2017, with sanitation outside of major urban areas graded with an E (unfit for purpose). Surveys (such as StatsSA) indicate high levels of dissatisfaction among households with the quality of municipal services. And so poor households are receiving a double blow: unaffordable tariffs combined with poor levels of service delivery. In reality, there is little that remains of the White Paper's vision of developmental local government.

Municipalities' ability to collect revenue is unlikely to improve significantly in future; employment and household income growth prospects are subdued and there is

30 As at 31 July 2021.

31 https://www.nationalplanningcommission.org.za/assets/Documents/NPC%20background%20paper%20-%20Infrastructure%20delivery%20Watermeyer%20Phillips%206%20March%202020%20FINAL.pdf

a physiological limit to how much food a household can sacrifice to pay services charges that consistently increase above the rate of increase in the minimum wage or social grants — the main source of income for poor households.

Some commentators, including parts of national government, insist that if households are forced to pay their accounts, there will be significantly fewer municipalities in financial distress. But **do we seriously believe that a legitimate local government fiscal framework is one that can only be viable if it further impoverishes low-income households?**

The main counterargument is that if municipalities made better expenditure choices — reduced their cost base — then their financial situation would improve to such an extent that they would be financially viable, and they could reduce tariffs to affordable levels. Undoubtedly, there is room in many municipalities to reduce non-essential expenditure and to improve efficiencies, but is this the magic silver bullet that will solve everything?

We certainly don't think so for, at least, the following reasons:

- An important contributor to the local government cost base is created by the regulatory and compliance burden on municipalities. As just one example, the AGSA has estimated that municipalities spend R5 billion a year just on internal financial reporting requirements. There are no indications that this burden will decrease.
- Even well-managed and -governed municipalities with clean audits are under financial pressure. We should not assume that good governance will automatically make all municipalities financially viable while simultaneously resulting in genuinely affordable services.
- For local government to be financially viable and to meet all its constitutional obligations, it must not simply reduce expenditure. Instead, municipalities need to refocus expenditure, not least to address the estimated R200 billion water and sanitation infrastructure maintenance backlog, and the estimated R250 billion electricity distribution infrastructure maintenance backlog.[32] That is, even if municipalities reduce non-essential expenditure, there are other essential items on which those savings need to be spent. There is thus no guarantee that the result of an efficiency exercise will be lower aggregate expenditure — although it would be better services outcomes.
- The single biggest reason for our skepticism is, however, the challenges imposed by the other side of the equation: for tariffs to be affordable and to be a genuine instrument of poverty reduction and economic opportunity, half of all South African households would have to receive a minimum amount[33] of all the basic services at no charge. Under the current fiscal framework and

32 These amounts can be compared to total local government operating expenditure of around R450 billion a year.

33 Considerably higher amounts than the current free-basic-services allowances.

> functions that must be delivered by local municipalities, including catching up the infrastructure maintenance backlog, we do not believe that any municipality could deliver this quantum of free services and remain financially viable.

The bottom line is that the convergence point assumed in the White Paper — at which tariffs will be low enough to ensure universal affordable access to quality services, and high enough to ensure local government financial viability — does not exist. Our local government fiscal framework represents a policy choice that should never have been made, because it wasn't ever a choice that existed in the real world.

3
Implications of findings

This PARI short report aims to answer a key question: is the current model for providing basic services — built on cost-recovery — contributing to increased standards of living, reduced household poverty and greater equality? The clear answer is no. Nor is the current local government fiscal framework ever likely to result in all municipalities having sufficient own revenue to cover the required share of operating expenses, including the full infrastructure maintenance requirements, since households will only find it more and more difficult to pay. The assumed win-win tariff setting framework anticipated in the White Paper on Local Government has materialised as a dismal lose-lose.

The overarching problem in the current system is that services are seen primarily as a source of revenue and not as a tool for socioeconomic development. Given the historical lack of access to services by poor households and current levels of poverty and patterns of inequality, this approach essentially guarantees that poor households will remain poor, that their quality of life will remain low, that they will continue to struggle to feed their families and that their economic opportunities will remain limited. Additionally, this approach entrenches spatial inequality, ensuring that municipalities with high percentages of poor households will remain underdeveloped simply because they cannot raise sufficient revenue from the sale of services to change this situation. All these outcomes are completely at odds with the original developmental vision of local government, the progressive aims of the constitution and the goals of all national socioeconomic development policies.

What are the implications of these findings?

(i) The current model of services delivery is unlikely ever to deliver its developmental goals, which goals are the main reason for the existence of local municipalities

It is useful to remember the original intention of municipal services as a key tool to reduce poverty and inequality, raise living standards and create economic opportunities. The original policy intention was never that the sole purpose of these services was to generate income for municipalities, no matter the implications for poverty and inequality. Unfortunately, the latter approach has become the *de facto* policy, and in the process, the local government fiscal framework has become an effective tool for entrenching poverty and inequality.

The current model — which prioritises cost recovery and the need for municipalities to treat basic services first and foremost as their main source of revenue and not as a tool of socioeconomic development — will never deliver the developmental potential of basic services because it can never deliver universal affordable access.

Impoverishing millions of households through the local government fiscal framework while simultaneously spending hundreds of billions of Rands to try and compensate for that poverty represents a policy own goal.

(ii) This is not just a service delivery or a local government problem: the failure of the municipal services delivery model is undermining all South Africa's other efforts to reduce poverty and inequality

This paper has demonstrated that the current local government fiscal framework is effectively impoverishing millions of households by requiring them to divert money from necessities — most notably food — to pay for services. This outcome dominoes onto all other government efforts to reduce poverty, and particularly to address food insecurity through income transfers. Thus, the current orientation of basic-services provision in South Africa is effectively undermining all other state programmes (and the hundreds of billions of Rands spent in this regard) that are attempting to reduce poverty and inequality. South Africa's high levels of food insecurity and child malnutrition—almost entirely the result of insufficient household income to purchase food — are exacerbated by unaffordable services accounts. The socioeconomic impacts are considerable and expensive: an increased public health burden and unacceptable levels of domestic violence are just two of these outcomes.

How effective are cash transfers to poor households from one part of the state if they (households) must then use those funds to pay another part of the state for basic services? This is an accounting transaction between two spheres of the state to try and balance the books, not a genuine attempt to address poverty and inequality.

Additionally, the inability of poor households to access sufficient basic services greatly undermines efforts to create employment and livelihood opportunities through small enterprise development and similar economic initiatives. Almost all home- and community-based small business opportunities require access to reliable and affordable electricity and water. Depriving the poorest households of these services, in addition to the regular outages in supply and the often poor quality and low reliability of services, creates a significant barrier to economic opportunity. What exactly is the point of the state allocating billions of Rands to creating small-scale economic opportunities while effectively ensuring that poor households cannot take advantage of these opportunities because they cannot access quality and affordable services?

Impoverishing millions of households through the local government fiscal framework while simultaneously spending hundreds of billions of Rands to try and compensate for that poverty represents a policy own goal.

Conversely, affordable access to meaningful levels of basic services for all low-income households could represent the single most effective policy to:

- Reduce food insecurity and child malnutrition;
- Increase household disposable income for other basic expenses; and
- Support households in creating new livelihood and economic opportunities.

In addition, these benefits could be obtained in a relatively cost-effective manner — subject to appropriate institutional arrangements for delivery as discussed below — compared to other household support mechanisms, since the state provides the services at cost while households realise an effective income benefit at the retail price.

(iii) Within the constraints imposed by the current legislative and fiscal framework, the goal of genuinely affordable access to services cannot be achieved by most individual municipalities.

As discussed above, there are real constraints to most municipalities' ability to reduce their cost base to the extent necessary to facilitate meaningful levels of access to free services, although there are probably opportunities to reduce the current cost base in many places: municipalities are not permitted to have an unfunded budget, that is, to plan to spend more money than they plan to collect. Providing universal affordable services to all households that fall below the upper-bound poverty line would probably put even well-managed municipalities into a budget deficit that they are not permitted.

The implication is that it is the overarching legislative and fiscal framework (including the oversight mechanisms to ensure quality and reliable services) that must change for affordable universal access to materialise.

(iv) Any sustainable solution must clearly prioritise universal access to quality and genuinely affordable basic services, over all other outcomes, and create an enabling regulatory and institutional environment to achieve that priority

Under the current framework of services provision and tariff setting, the critical developmental goal of universal access to affordable services cannot be achieved. It should also be obvious that achieving that goal will reduce poverty and inequality in a far more effective manner than many other policy initiatives undertaken to date:

- Genuinely affordable access — which for the poorest households means free services at meaningful levels — will significantly increase disposable income available for the purchase of food and other essential items, thereby reducing the negative outcomes of food insecurity; and
- Affordable access to a realistic basic minimum[34] of services will significantly increase living standards and create a strong foundation for multiple livelihood opportunities.

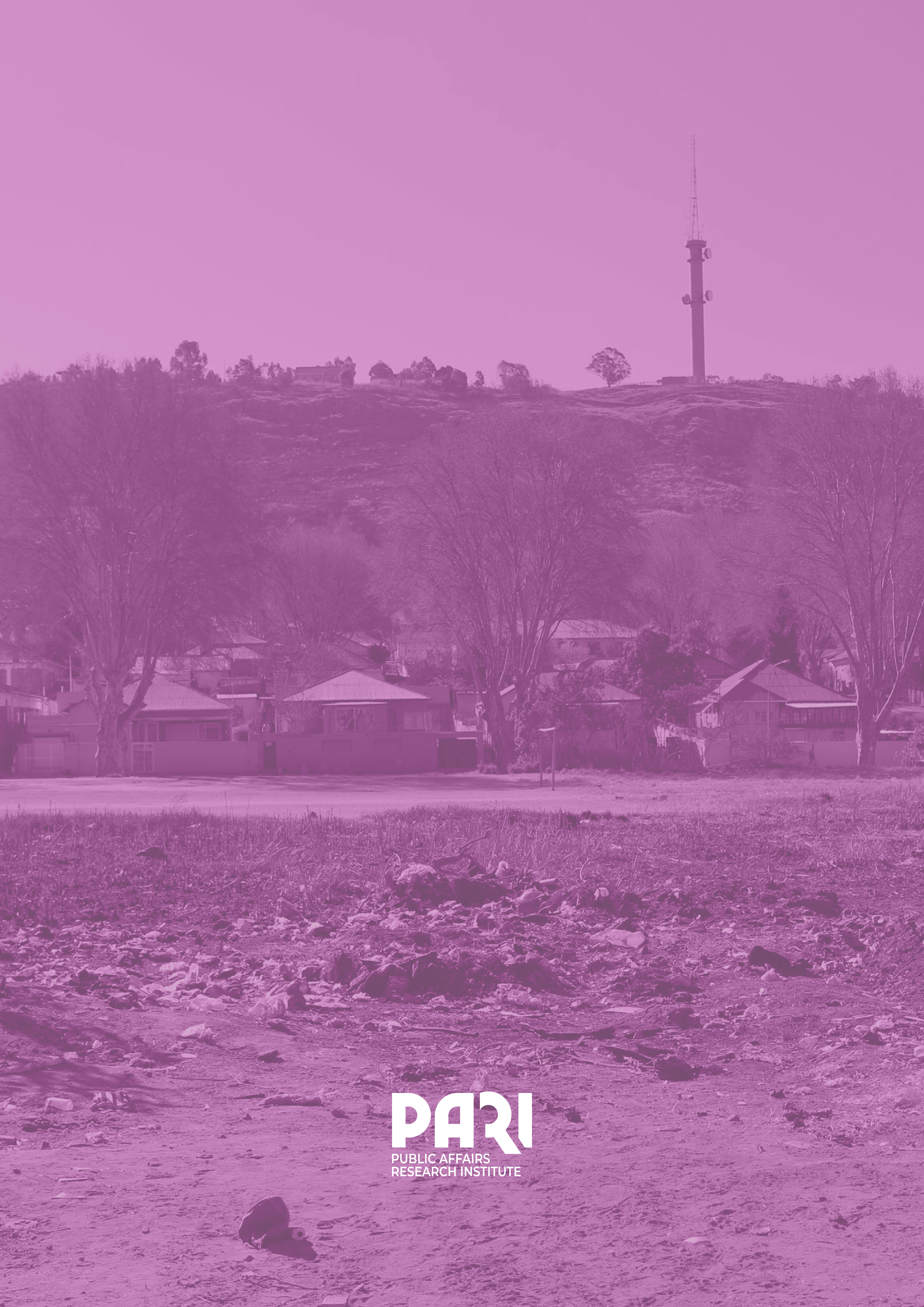
34 The report recommends that this minimum is set at 200kWh of electricity and 10KL of water per household per month.

But none of these outcomes can be achieved until there is a clear policy decision that the non-negotiable priority for local government, and Eskom, is delivering universal and genuinely affordable access to quality services. That policy decision must be accompanied by clear and empirical benchmarks for determining 'affordability', so that the current ambiguity is addressed. Our recommendation is that the Food First approach to affordability outlined in this report is adopted.

Once that policy goal is clearly established, it will be necessary to **rethink the entire model of service delivery to create an institutional structure that is fit for purpose; that has the greatest likelihood of delivering universal access to affordable and quality services and can do so at the least cost to the state**. Services are currently delivered across multiple institutional arrangements, which differ between electricity, water and sanitation:

- Electricity is provided to households by both local municipalities and Eskom, with very different market shares in different places.
- Water services are provided by designated entities, some of which are district municipalities and some of which are local municipalities.
- There are enormous variations in the institutional arrangements for sanitation.

Under a new policy, at least seven million households will require free access to a reasonable level of quality services. The institutional challenge for the state is how to deliver these in the most-cost-effective and highest quality manner possible.



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