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# Assessment of the Financial Resources of Municipalities

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## ABSTRACT

The challenges with which municipalities are currently faced, include the fulfilment of the expectations of many new communities to whom they must render services, while they must simultaneously improve the quality of existing services and eliminate backlogs. The sources from which local authorities generate their revenue at present do not appear to be adequate for the increased need for funds.

This paper provides an overview of the issues that have led to the current state of municipal finances and the factors that influence the revenue and expenditure of municipalities. In the light of the lack of sources of income for municipalities, particular attention is given to issues which could have an effect on the improvement of administration in municipalities.

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## INTRODUCTION

The restructuring of municipalities in South Africa has been the cause of a variety of serious difficulties experienced by the newly formed municipalities. These difficulties include a dramatic increase in their responsibility for the rendering of services while certain sections of the community default in respect of the payment of service charges, increased administrative and personnel costs, a relative decrease in intergovernmental grants and a decline in the number of personnel who are experienced in financial matters.

The short-term effects of these difficulties are that significant pressure is exerted on municipalities' cash flow and that their financial resources diminish. To date, municipalities have coped with these pressures by spending their accumulated reserves; reducing expenditure on maintenance and capital projects; deferring payments to creditors, in particular bulk service suppliers such as Eskom; utilising

bridging finance and extending long-term debt. Municipalities in South Africa are therefore facing a complex new political, social and financial environment. It is particularly the financial capability of municipalities that will determine the success of service delivery at municipal level.

The primary objective of this paper is to provide background information on the development of municipalities, especially in respect of their financial viability and the current state of municipal finance. A secondary objective is to present an innovative perspective on alternatives to higher taxation.

## MUNICIPAL DEVELOPMENTS

Until the 1990s, municipalities were racially segregated and directly and indirectly geared towards political control. Like most state institutions, this was an object of political conflict. For the current purpose it is not necessary to record the entire constitutional history of municipalities. It is, however, necessary to identify the cardinal factors and dynamics in order to understand the financial difficulties with which municipalities are faced.

Whites traditionally elected municipal councillors, the elections usually being associated with fairly high-priced real estate, industrial areas and commercial centres in urban areas. This base gave the municipality an adequate source of revenue. On the other hand, the Coloured and Indian communities had management and local affairs committees, but these committees tended to be underfunded and rarely engendered much enthusiasm (Botes *et al.*, 1996: 212-214).

In view of the guiding ideology of the government, Africans were not considered to be permanent residents of "white" South Africa, but rather as citizens or future citizens of "independent" homelands. Nevertheless, local structures were designed to provide assistance in the management of the problems experienced in urban African communities. In order to improve local service delivery, the Black Local Authorities Act, 1982 (Act 102 of 1982), was introduced. This Act devolved on the black municipalities powers in respect of matters such as electrification, waste disposal, and the construction and maintenance of roads, but the Minister of Co-operation and Development retained a large measure of control over the activities of these authorities. Because they did not have commercial or industrial property from which they could obtain revenue in the form of rates, and due to service backlogs, the black municipalities began to accumulate financial deficits.

In the 1980s, the central government attempted to manage the situation by extending credit to municipalities whose financial situation was in a particularly parlous state. The legislative steps taken, were designed to provide a long-term solution to the financial and developmental problems facing the black municipalities. The Regional Services Councils Act, 1985 (Act 109 of 1985), is an example of such legislation. This Act provided for the joint provision of bulk services by white, coloured, Indian and black municipalities as well as for the collection of levies from the commercial sector to contribute to the costs incurred by municipalities.

With the introduction of reform initiatives in the early 1990s, the concept “own affairs” was abandoned by the government of the day. In March 1993 the Local Government Negotiating Forum was established for the purpose of negotiating the formation of a democratic, non-racial, non-sexist and financially viable municipal system (SAIRR, 1993/94:564). The process of restructuring involved the establishment of negotiating forums throughout the country in order to pair areas which were previously governed by racially defined bodies. It was intended that this measure might satisfy the requirement of non-racism and, hopefully, also improve financial viability, as inferred in the slogan “one city, one tax-base”.

The democratisation process at the municipal level created 835 municipal structures of which only 35 percent are viable, 35 per cent marginally viable and 28 per cent not viable. It has become apparent that many of these municipalities do not have the required financial resources to deliver services at a level acceptable to the community they serve. The needs of townships mainly occupied by people previously classified as blacks, in particular, are very real. According to Kruger (1996: 3) their needs are as follows:

- Four million people have access to untreated water only;
- Eight million people have minimal sanitation only;
- Seventeen million people have no electricity; and
- Eight million people have no formal road access to residential areas.

Municipalities, as the sphere of government closest to the citizenry, is expected to take a leading role in addressing the above-mentioned problems.

The current system of municipalities, which is regulated by the Local Government Transition Act 1993 as amended by the Local Government Transition Act, Second Amendment Act, 1995 (Act 89 of 1995), is a transitional one. The South African Constitution, 1996 (Act 108 of 1996), specifically includes municipalities.

Constitutionally, municipalities are enjoined to carry out two main tasks: ensure the delivery of services to the communities under its jurisdiction, and promote economic development. A new system is due to be implemented in 1999. However, the current financial position of municipalities will most certainly continue into a new constitutional dispensation.

## **THE STATE OF MUNICIPAL FINANCES**

One of the most important factors contributing to the present highly unsatisfactory state of municipal finances is the non-payment of municipal service charges by a substantial percentage of the communities newly incorporated into the transitional municipal structures. In addition, there is an inability, and seeming unwillingness, on the part of the central government to compensate municipalities for these losses to the extent that they were expected to do so.

The Minister of Finance, in presenting his budget to Parliament on 12 March 1997, acknowledged that there were problems in respect of municipal finances which required attention, and singled out non-payment as the most important of these. Furthermore, the Minister pointed out that the amount owing to municipalities at the end of October 1996 represented 25 percent of the total annual rates and service charges payable. In monetary terms the municipal debt is at least R26 billion (see Table 1). This amount includes loans of R964 million owing to the Local Authorities Loans Fund Board which makes loans to municipalities for the financing of capital projects (Budget Review, 1997: 4.8).

The Minister stated clearly that it is unsustainable and unacceptable, and neither right nor fair, that on average only 69 percent (see Table 2) of residents pay for municipal services on a regular basis, and that a democratic South Africa cannot afford a culture of non-payment (Budget Review, 1997: 4.9). It is, however, equally important that municipalities should also manage their finances better by improved administration, including the implementation of proper credit control. See Table 3 in this regard.

**Table 1: Municipal Debt**

<b>TYPE OF DEBT</b>	<b>R m</b>
Stock issues	7 070
Government loans (housing and other)	2 779
Loans from DBSA	707
Loans from the Local Authorities' Loans Fund Board	964
Other annuity loans	200
Overdrafts and loans from commercial banks	2 714
Bills issued by local authorities and held by banks	605
Leases and instalment credit from banks	70
Loans from insurers and pension funds	140
Other loans	700
<b>Total</b>	<b>25 949</b>

Source: Budget Review, 1997: 4.8

**Table 2: Percentage of Regular Payers. October 1995 - October 1996.**

	<b>All Provinces</b>	<b>Grades 10-15</b>	<b>Grades 6-9</b>	<b>Grades 0-5</b>
	%	%	%	%
October 1995	68	70	67	57
March 1996	69	71	64	59
June 1996	69	71	65	60
August 1996	69	69	71	60
October 1996	68	69	70	60

Source: Project Liquidity Surveys, 1997

**Table 3: Ability to Render Accounts to all Areas. September 1995 - October 1996**

	All Provinces	Grades 10-15	Grades 6-9	Grades 0-5
	%	%	%	%
September 1995	88	62	95	90
March 1996	88	76	94	90
June 1996	91	74	92	90
August 1996	90	76	95	91
October 1996	95	91	99	94

Source: Project Liquidity Surveys, 1997.

Although the non-payment of municipal charges has been largely politically motivated and exacerbated by socio-economic conditions, other reasons also come into play: inadequate services, inability of the municipality to effectively meter and charge for service usage, and weak internal capacity to exercise credit control and manage debt collection effectively.

The levying of rates on property (real estate) is still the main source of revenue, supplemented by revenue from the sale of services (Bahl & Linn, 1992: 79). Over the years, a number of investigations were undertaken and recommendations made in respect of additional sources of revenue for municipalities. The net result of these investigations and recommendations was the decision by government in the 1970s to pay rates on its properties to municipalities, and to subsidise services such as preventative health care and ambulance and emergency services.

In the absence of an alternative source of revenue to supplement their revenue from rates in order to finance non-revenue yielding services, municipalities came to rely rather heavily on the profit they make on the sale of services. However, uncertainty has since arisen regarding this source of revenue, because the National Electricity Working Group has decided to support a model of regional electricity distribution which will bring about the establishment of regional and subregional electricity distributors and operators, while Eskom and municipalities discontinue their electricity distribution activities (*Argus*, October 9 1996). This decision was followed by an announcement by the Director-General of Mineral and Energy Affairs on 10 February 1997 concerning a proposed rationalisation and

restructuring programme, which would result in only 20 to 30 institutions being permitted to distribute electricity while municipalities forfeit the right to do so. According to the Director-General, consideration was also being given to the introduction of uniform electricity tariffs, especially in respect of households. This measure could also have a detrimental effect on the finances of municipalities (*Die Burger*, February 2 1997).

### **The “tax revolt” in Sandton: A new culture of non-payment?**

The “tax-revolt” which began in 1996 in Sandton, in the eastern metropolitan substructure of Johannesburg, is still in progress. An increase in the property rates together with the revaluation of property resulted in rates increasing by as much as 300% (Franzsen, 1997:12). The funds collected were to be incorporated into the budgets of the metropolitan council and the southern and western substructures. The Gauteng’s Development Planning and Local Government Department argues that this approach is tantamount to taxing the rich in order to subsidise the poor. This argument may well be true and there is probably also validity in the view that the rates increase was exceptionally high and bound to elicit a reaction.

The lessons to be learnt from the “tax-revolt” should be noted. The first lesson is in respect of the legal issues that were raised when ten firms based in the eastern metropolitan substructure attempted to have the increases and levy nullified. This experience was repeated in Pretoria. In March 1997 the Supreme Court in Pretoria refused the Pretoria City Council leave to appeal against a decision that differentiated rates - *de facto* along racial lines - were discriminatory and therefore unconstitutional. This dispute had started when a resident of “old” Pretoria had refused to pay more than the “flat rate” applied in areas which were formerly under the control of BLAs. The residents were initially ordered by a magistrate to pay the outstanding amount, but this ruling was reversed on appeal. The legal arguments were based on the principle of “equitable shares” as well as the relationship between primary and secondary tiers of municipalities. The aforementioned issues should be clarified when a new, permanent system is developed and introduced.

The second lesson to be learnt from the Sandton “tax revolt” is that the boycotting of rates and service payments has become a feature of South Africa’s culture and it cannot be considered to be merely part of the particular experience of the “struggle”. It also points to the manner in which such boycotts are likely to recur in future: this time the white taxpayers in Sandton, next time perhaps the black residents in another town e.g. Soweto?

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### **The impact of non-payment**

According to Kapp (1995:6), for every R1m lost by a municipality as a result of the non-payment of service charges, the capital budget decreases by about R5m. This decrease is essentially due to the adverse impact that lost revenue has on the ability of a municipality to raise loans and to finance their repayment. It should be borne in mind that the capital budget is the only instrument that political leaders have to make a meaningful difference to the quality of life of their followers and fellow-citizens.

If non-payment is not addressed, it will continue to create serious problems for municipalities. In the short term, it will put pressure on the liquidity of local authorities and retard the development of projects. Municipalities would be unable to finance capital projects, because a greater proportion of their budget would have to be utilised for their operating expenses. The long-term implications of persistent non-payment should be regarded as speculative, since it is unclear how central, provincial and local governments would respond to it over a long period. As already mentioned, there are indications that all levels of government do not intend permitting this to continue.

### **IMPROVING MUNICIPAL FINANCES**

The total municipal budgets for 1996/1997 exceeded R47 billion, or about 7½ per cent of GDP, including capital expenditure of R11,5 billion (Budget Review 1997: 4.7). With the aforementioned in mind, an extension of the power to impose taxes is commonly regarded as the logical solution to the problem of local finances. The simplest way to improve revenue would be to increase the percentage of revenue received from current sources. This could, however, have a negative effect, for example, some residents would be taxed out of their homes, unpaid bills would escalate, more enforcement would be required and municipalities would therefore require more officials.

The extension of tax powers does, however, entail increased political responsibility which, although it may be desirable, will nevertheless not meet with approval at the central government level (Evans, 1992: 298; Cf. also Section 229 of the Constitution, Act 108 of 1996). Solutions related to new resources of local revenue may be easy to suggest, but it is highly unlikely that the higher levels of government would hand over many sources of revenue to local bodies. With the aforementioned in mind the question which immediately arises, is: Are there other



sources of revenue available to municipalities? Investigations into the finances of municipalities are not new; good examples in this context are the Borckenhagen Commission (1965 - 66), the Browne Report (1980), the Croeser Working Group (1982) and the Malan Committee (1990 - 92). Croeser (1992: 282 - 9) also paid attention to vertical and horizontal disparities, and suggestions were made regarding the improvement of the financial capabilities of municipalities. These suggestions include a local revenue or sales tax, a tourism tax and a road or tax, but such suggestions are regularly turned down. It should be borne in mind that the central government is unlikely to release its hold on taxation of income in order to allow municipalities to build up and strengthen their own capacities (Craythorne, 1994: 361; Cf. also Evans, 1992: 300 - 302) and that central government demonstrates a tendency to centralise rather than to decentralise. Furthermore, central government tends to delegate more and more functions to municipalities, often without the necessary financial powers or grants. In the Budget Review (1997: 4.7) it is stated that municipalities already have a substantial tax base; own resources account for over 90% of their budgets. Therefore municipalities are said to have a significant capacity to support the services they provide. The inference of this statement is that a municipality must find its own way of balancing its books, because a dramatic increase in the transfers received from national government or the provinces is unlikely.

In the light of these circumstances, it is important that municipalities should take cognisance of and consider innovatively the issues discussed in the rest of the paper, in order to strengthen their financial capabilities.

### **The Masakhane Campaign**

The Masakhane campaign is part of the broad national strategy intended to create the necessary conditions for the success of the Reconstruction and Development Programme (RDP). It is aimed at mobilising all sectors of society to become actively involved in redressing the imbalances of the past and creating a society characterised by new values and norms. This aim should also include a sense of responsibility by all citizens to build and sustain democratic municipal structures (Sono, 1995: 78-9). Integral to this responsibility is the payment of rates and service charges. In many areas the effort has not been particularly successful, but there have also been some reasonable successes, such as the informal settlement of Ivory Park, Midrand and areas of the North West Province. It should be borne in mind that municipalities are ultimately responsible for their own financial affairs, which includes securing sources of revenue and balancing the budget.

### **Considering priorities**

One of the important duties of municipalities is to reconsider their priorities on a regular basis. They should ask: What are our priorities? What must we do first? And: What must be postponed because we do not have the necessary resources at present. One of the main pitfalls that a public authority should avoid is the force of habit to regard the matter currently being considered as having the highest priority. However, no one issue should be considered in isolation, but be assessed against the background of all the other issues to be considered, and thus determine its position in the order of priorities thus be determined (Abernethy, 1974: 70). In this regard it is important that municipalities should do an infrastructure audit in selected areas to determine precisely what the existing needs are, and – if necessary – to reprioritise capital budgets so that precedence can be given to the provision of really basic, essential services. They need to develop the necessary capacity to be able to render the services with which they are charged. Furthermore, it is important that the communities should be involved in the process of deciding precisely what services residents require, as well as in the provision of the required services (Kruger, 1996: 5).

### **Assessing the internal capacity of the administration**

If a municipality is to be people-centred and people-driven, then it should address current challenges and opportunities. In order to enable the administration to do this, functions and activities that hamper the effective rendering of services and thus waste scarce financial resources, should be identified. In the process, attention could also be given to the elimination of duplication of work, identification of the areas in which officials need better administrative skills, functions that should be restructured and the development of business plans (Pallot, Undated: 18 – 9).

### **Economic promotion**

Areas of municipal jurisdiction are generally “open” economies, in the sense that there is constant movement of people and goods across their boundaries (Browning & Browning, 1994: 504). The basic economic objective is to create and maintain conditions that are conducive to the development of a city or town. It is essential for the successful promotion of local economic promotion activities that they should respond to the special conditions and needs of the local economy and are implemented in close co-operation with decision-makers in both public and private sectors. The main thrust of economic policy should be to identify the strengths, weaknesses, opportunities and pitfalls of economic development, in order

to work out strategies for short-term and long-term development. A co-operative policy of this nature will create a suitable climate for attracting new enterprises. Attention should also be given to existing industries and their growth, in order to create new jobs and income for the population, which will in due course broaden the tax base too (Honert, 1992: 118).

It should be noted that economic promotion does not necessarily involve money and public expenditure. What is required, is initiative and flexibility on the part of the municipality and local entrepreneurs. A system of communication and co-ordination between local actors should be established, and necessary information on infrastructural conditions should be timeously available.

### **Simplification of rules and regulations**

There is no specific legislation covering financial policy at local level. It is, however, the duty of municipalities to observe the laws and ordinances of the government and the provinces. Extremely rigid legislation together with very detailed regulations and procedures which demand very high standards, could strangle the independence of municipalities. Municipalities not only have to deal with the issue of funding (Honert, Undated: 8), but it is generally accepted that an increasing number of laws are setting excessively stringent requirements for local authorities. Consequently, it is generally proposed that the large number of laws and regulations, guidelines and administrative controls should be reduced as soon as possible. Discussions should be held to devise programmes for the reduction and simplification of legislation affecting local administrations in order to relieve them of some of their current burden.

### **Political responsibility**

With the introduction of the new municipal system, cognisance should be taken of the fact that any new system will have to be based on “existing” realities. It therefore cannot be assumed that there is a clean slate to work on. The legacies of the past will have to be acknowledged. For example, the backlog in respect of infrastructure in some municipal areas still exists and will continue to exist for some time (Thornhill, 1993: 1 - 2). A lack of funds will continue to be a limiting factor in the reconstruction process. Councillors should support officials in the decisions they have to take, for example, to apply strict credit control measures (Kruger, 1996: 4). Furthermore, councillors should play an active role in their areas by informing the members of the community about the implications of non-payment for services.

According to Craythorne (1994 : 10 - 1), councillors play a decisive role in financial management. Furthermore, Section 160(3)(b) of the Constitution determines that the budget of a municipality shall be decided by a majority of all its members. Therefore, if councillors are to govern effectively, they should successively comply with the task of allocating resources and determining priorities in respect of their approved budget. However, the functioning of any budgetary system is very complicated, and training in and exposure to budgetary, priority determination and decision-making would improve the skills of councillors in carrying out their responsibilities.

### **Improvement in the ability to collect and administer revenue**

A sustainable system of financing municipal infrastructure and services requires stable and predictable sources of revenue and, in particular, revenue which is under the direct control of municipalities. Although the present sources are stable, the actual amount of revenue collected from these sources is very unpredictable, and adversely affects the ability of municipalities to access finance in capital markets. To ensure that revenue is collected, it is important that the revenue collection system is operating optimally. A municipality should, among other things, have adequate records of the households in its area of jurisdiction, the metering and billing systems should be functional, accurate accounts should be compiled, and adequate and safe payment points should be accessible within the area (Kruger, 1996 : 5-6). The involvement of partners (Heymans, 1993: 21) in the field of revenue collection may also be helpful, and in this regard banks, post offices and private organisations can play an important role. The services of a revenue manager, as in the Ivory Coast, could also be considered there, taxes are collected in the communes under the auspices of a revenue manager. The latter hands his "tickets" to local revenue collectors who in turn deposit the revenue received on a daily basis. If a revenue manager succeeds in collecting all the tax revenue within his area, he receives a bonus. The bonus system also applies to individual collectors (Thornhill, 1993: 130). It should, however, be borne in mind that this system might give rise to corruption, and measures should therefore be introduced to prevent this from occurring.

In attempting to improve the collection and administration of revenue, qualified and trained financial personnel should send out accounts on a regular basis and apply strict credit control measures (Kruger, 1996: 4).

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**Training to build local capacity**

Some of the above proposals assume increased competence on the part of municipalities to plan and manage the services for which they are responsible. Clearly there is still much that needs to be done in this area. Some municipalities remain woefully inadequate in terms of financial, technical and managerial capacity, and find it difficult to recruit and train staff of a high calibre. In expressing concern about auditing, the Auditor-General reported that a month after the closing date for the submissions of their 1995/1996 annual financial statements, 184 municipalities had yet to submit their statements for the previous financial year (Kluever, 1997).

Furthermore, the concept of pairing could also be utilised in training. This means that an experienced and capable municipality is paired with an inexperienced one in order to exchange ideas and to provide instruction, especially in respect of financial administration.

**Privatisation or outsourcing of services**

With budgets being cut and the demand for more and better services increasing, privatisation or outsourcing could be considered. Privatisation is based on the neo-classical hypothesis that private ownership means greater efficiency and more rapid growth, that should curb the growth of expenditure, raise money to reduce internal and external public debt, and promote individual initiative. Avenues that might be explored are those that lower cost to consumers, while minimising the negative impact on the employees concerned. The Benoni fire department may serve as an example in this regard (Barber, 1997:4). If managed correctly, the privatisation of services has the potential to become a source of job creation and thus provide a broader revenue base for local authorities. In addition to privatisation is the possibility of partnerships between the public and private sectors, that could be utilised to develop managerial and financial skills and to provide access to private capital with a view to the improvement of service delivery.

Against this background, it is imperative for municipalities to take an objective and innovative look at their problems, in order to strengthen their financial capabilities. In focusing upon its internal functioning, successful management will to a large extent depend on the degree to which it exercises control over its own activities.

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## CONCLUSION

South Africans have some very fundamental problems to address, as they seek to move their local communities through a process of transition. These problems transcend the immediate issues which typically tend to be the target area of finance. This article presents a perspective on an inherently complex problem, namely, an overview of the financial problems facing municipalities in South Africa. In particular, the article attempts to show that there are no simple solutions to difficult problems. The notion of "financial problems" should not be accepted at face value, but be qualified in respect of specific cases and the economic, political and constitutional environment within which they operate.

Attention should be given to the system of local taxation. The purpose of local taxation is to obtain revenue to finance expenditure at municipal level. Whatever the prevailing political or economic ideology of a country, its economic and social progress depends largely on its government's ability to generate sufficient revenue to finance an expanding programme of essential, non-revenue yielding services, like health, transport and other components of the socio-economic infrastructure.

In order to develop an economic and social infrastructure, municipalities need funds. It is therefore essential to promote a culture of payment for services received, and to combat non-payment of rates and service charges. In this respect, municipalities should, wherever possible, take creative measures to make payment acceptable, enjoin their administration to eliminate unnecessary procedures and regulations, and take a fresh look at their own priorities.

Finally, in order to utilise existing sources of revenue effectively, it is important that central and provincial government should assist municipalities to determine which taxes they may levy and successfully collect, and give them the necessary authority and technical assistance to implement programmes to mobilise resources.

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