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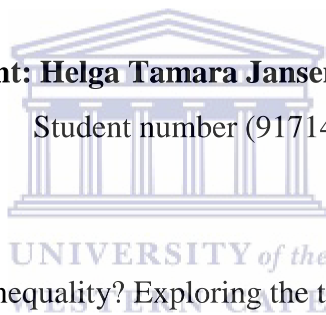

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Diminishing or perpetuating inequality? Exploring the terms and conditions of Development Bank of Southern Africa infrastructure loans to Theewaterskloof Municipality: A case study.

A mini-thesis submitted in fulfilment of the requirements for the degree of Magister Artium, in the Institute for Development Studies, University of the Western Cape.

Supervisor: Dr Leon Pretorius

January, 2018

KEYWORDS AND PHRASES

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- Bulk services
- Development Bank of Southern Africa
- Development finance loans
- Loan terms and conditions
- Municipal infrastructure loans
- National Development Plan
- Socio-economic inequality
- State-owned banks
- World Systems Theory

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DECLARATION

I declare that …**Diminishing or perpetuating inequality? Exploring terms and conditional of Development Bank of Southern Africa (DBSA) infrastructure municipal loans**… is my own work, that it has not been submitted for any degree or examination in any other university, and that all the sources I have used or quoted have been indicated and acknowledged by complete references.

Full Name: **Helga Tamara Jansen**

Date: **January 2018**

Signed: ……………………………….

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I wish to acknowledge the support and love of my family. My father Donald Jansen believed in me when I refused to believe in my own ability. My mother Beverley Jansen held on to the belief that it is always darkest before the light, and it is that belief that served as a shining beacon of hope for me during the past three years. My sisters' Liezl Jansen and Inge Jansen and my brother Sven Jansen, for keeping me grounded and reminding me of the sacrifices made to get me to the point of post-graduate study. My partner and husband Henrik Daugbjerg and daughter Mika Beverley, for knowing that I could do it. No matter how long it took. My supervisor, Dr Leon Pretorius for his infinite patience and wisdom. And lastly I dedicate this MA Degree to the memory of my maternal grand-father, Louis Edwards, son to farm labourers who ran away from the rural country-side of the Southern Cape to find an education in the city. For that single act of defiance, I would not be here.

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ABSTRACT

The South African government has earmarked infrastructure development as a key driver of the economy. The infrastructure sectors of energy, water and transport have received large Development Bank of Southern Africa (DBSA) loans to fund new projects, repairs and maintenance. The DBSA loan approvals to municipalities for the period 2012-2013 was R2.3 billion. Loans to 'under-resourced' municipalities totalled R927 million for the same period. Key infrastructure sectors included electricity (R466 million), roads and drainage (R678 million), community facilities (R735 million) and water and sanitation (R1.2 billion). The DBSA is owned by the South African state and its relationship with municipalities is legislated and regulated through the Constitution and an Act of Parliament.

One of the post-apartheid roles of the DBSA is to support the infrastructure development agenda of the State through a complexed network of infrastructure projects in the key infrastructure sectors of water and sanitation, education, housing, health and housing. It does so through project, technical and development finance support to municipalities. The underlying rationale for the relationship between municipalities and the DBSA is to forward the States' agenda of providing equal access to basic services and develop infrastructure to support its social and economic development agenda.

While the DBSA does provide infrastructure grants and facilitates intergovernmental transfers to municipalities, it also provides infrastructure loans to municipalities for both capital expenditure and large-scale infrastructure projects. The premise of development banks is to provide development finance for infrastructure projects at low interest. The DBSA specifically as a state-owned bank has an overall agenda to develop the infrastructure of poorer municipalities whose credit-worthiness will not allow it to qualify for commercial loans.

The focus of this research project is to explore the lending and borrowing conditionalities of DBSA infrastructure loans to municipalities and to ask the

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question: do DBSA loans to municipalities diminish or perpetuate inequality? The relationship between municipalities, and the DBSA, through the lens of the Banks' lending and borrowing conditionalities, is employed in this study, as an analytical tool. The analysis was conducted using the loan agreements, the rate of interest, the type of interest applied (i.e. floating or fixed), the loan conditionalities, the time-frame for loan repayments and the general socio-economic context of the municipality as a basis of the research. The data was gleaned from the municipal loan repositories and based on these and an extensive review of literature, conclusions and recommendations have been put forth for a people-centre role and not a market orientated role for the DBSA.

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LIST OF ABBREVIATIONS

ABSA	Amalgamated Banks of South Africa
ADB	African Development Bank
ADB	Asian Development Bank
ANC	African National Congress
BankRural	Mexican Banco Nacionalde Credito Rural
CDB	Caribbean Development Bank
CIS	Commonwealth of Independent States
DBSA	Development Bank of Southern Africa
DFI	Development Finance Institutions
EID	European Investment Bank
GDP	Gross Domestic Product
IDP	Integrated Development Plan
IMF	International Monetary Fund
LED	Local Economic Development
MFMA	Municipal Finance Management Act
STD Bank	Standard Bank
WST	World Systems Theory

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CHAPTER 1: INTRODUCTION, BACKGROUND AND CONTEXT

1.1 INTRODUCTION

The Development Bank of Southern Africa (DBSA) provides infrastructure grants and facilitates intergovernmental transfers to municipalities. It also provides infrastructure loans to municipalities for both capital expenditure and large-scale infrastructure projects.

The DBSA, as a state-owned bank, has an overall agenda to develop the infrastructure of poorer municipalities whose credit-worthiness will not allow it to qualify for commercial loans.

The focus of this research project is to explore the lending and borrowing modalities of DBSA infrastructure loans to municipalities and to ask the question: does DBSA loans to municipalities diminish or perpetuate inequality? The research will critically review these loans through the rate of interest, the type of interest applied (i.e. floating or fixed), the loan conditionalities, the time-frame for loan repayments and the general socio-economic context of the municipality.

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1.2. BACKGROUND AND HISTORICAL CONTEXT

The historical contexualisation of South Africa's economic and social infrastructural development is one steeped in the apartheid ideology and legacy. This system divided the country along race lines and controlled every facet of social and economic development of its citizens. What remains since the dismantling of Apartheid can still be felt in the democratic national project in which the spatial geography of rural towns and urban centres is still delineated by under-development for poor people and the municipalities meant to deliver services and infrastructure.

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1.2.1. Apartheid's two worlds

An example of this delineation between rural and urban centres can be seen in the Gross Domestic Product (GDP) contributions of the Western Cape and Eastern Cape. In 2010 the Western Cape construction sector contributed 17.6% to the national GDP, while the Eastern Cape contributed just 6.0% from its construction sectors. In the transport, storage and communication sectors, the Western Cape contributed 15.0% to national GDP, while the Eastern Cape just 7.0% (www.statssa.co.za, online).

A further illustration of the high levels of inequality between metropolitan municipalities can be seen between Buffalo City in the Eastern Cape, and The City of Cape Town, in the Western Cape. Buffalo City has a population of 755 200, an unemployment rate of 35%, a social welfare dependency rate of 47% and a youth unemployment rate of 45%. It has an expected economic growth rate of just 0.6% (www.statssa.co.za). Conversely Cape Town has a population of 4.4 million, an unemployment rate of 23%, a youth unemployment rate of 31%, a social welfare dependency rate of 43% and an expected economic growth rate of 2.57% (capetown.gov.za).

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The disparities between these two provinces, based just on these indicators, confirm the dualities of apartheid race-based economies. Buffalo City is the provincial capital of the Eastern Cape, a former Bantustan province. Cape Town is the provincial capital of the Western Cape, whose GDP contributions (as noted above) is far higher than its Eastern Cape counterpart.

However, within the City of Cape Town, racial and economic disparities abound. The Cape Flats township of Nyanga has a population of 55 996 (capetown.gov.za). The percentage of people with no income is 17,8%. Its neighbouring coastal suburb of The Strand has a population of 55 558 and a no-income population of just 11, 5%. Those earning between R1 – R1 400 is 1%, while in Nyanga that figure is 5, 9%.

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Apartheid's race-based social and economic development gives credence to former President Thabo Mbeki's description of 'two-worlds' existing in South Africa. One wealthy and prosperous, the other poor and without hope (Mbeki, 1998). Without a more mutually beneficial development relationship between the two, growth and development cannot build a sustainable present or future. Key to this is investment in local infrastructural development.

1.2.2. Infrastructure and the Development Bank of Southern Africa

Social and economic infrastructure plays a supporting and foundational role in the development of any country. In the South African context, the mutually beneficial development relationships between these two development elements will play its part in delivering on national growth imperatives.

The National Development Plan (NDP) notes the differences between rural and urban areas in its access to infrastructure services. These discrepancies inhibit not only the delivery of quality services, but also the economic and social development of under-resources municipalities (NPC 2011:44). South African urban areas are generally well-serviced in terms of electricity; water and sanitation; information and communication (ICT); and transportation, while their rural counterparts fall significantly short in these respects (Bogetic and Fedderke, 2005).

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The success of delivering services and development equitably will concretise the vision of the NDP to ' build a more inclusive society'. To do so 'South Africa must translate political emancipation into economic wellbeing for all' (www.npconline.co.za). Municipalities are at the coal-face of infrastructure development, and service delivery. The relationship between infrastructure development at municipal level, and the States' mandate to delivery, is concretised through the DBSA's funding framework, The Municipal Infrastructure Investment Framework and its targeted funding schemes to municipalities (DBSA, 2017).

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1.2.3. Development Banks as a tool for economic growth

Development banks are an important tool of governments in supporting economic growth (de Luna-Martinez & Vincente, 2012). They do so through the provision of financing, credit facilities and acting in advisory capacities, particularly where private commercial banks are unable, or unwilling to provide services.

The DBSA is the state-owned development finance institution (DFI) and has been mandated to support South African municipalities in the delivery of infrastructure. The DBSA is regulated through the DBSA Act of 1997 and its primary purpose is to promote economic development (DBSA website, 2017). The Bank, as noted above, also has municipal infrastructure investment programmes to assist municipalities' infrastructure project development.

1.2.4. Towards a definition of Development Banks

'Development banks are government-sponsored financial institutions concerned with the provision of long-term capital to industry' (de Aghion (1983, in Lazzarini 2011). This definition supports an important element of development banks: that they are state-owned and therefore are called on to advance the states' economic and development project. Infrastructure development and its development finance loans are a large part of the mandate of State-owned banks such as the Development Bank of Southern Africa (DBSA, 2012).

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1.2.5. The DBSA

The DBSA is a state owned bank established in 1983 (DBSA, 2012). The bank is governed by the DBSA Act of 1997, with further regulation guided by the Public Finance Management Act of 1999. Its mandate is to provide 'financial, technical and other assistance' to an investment focus on infrastructure financing. In its role as financier the bank is constitutionally mandated to support the delivery of basic services and economic growth through funding infrastructure in the form of loans,

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equity investments, co-funding, grants and development expenditure (DBSA, 2012).

For the purposes of this research project, emphasis will be placed on the role of the DBSA in South African municipal infrastructure. The objective of the bank, in the context of municipal infrastructure of municipalities, is focus on large infrastructure projects (DBSA, 2017) in the specific sectors of water, energy, transport and Information Communications Technology (ICT).

1.2.6. Towards a critical lens of the DBSA?

In the preparation for this research project it was discovered that there is a shortage of academic work on the impact of development finance loans by the DBSA to municipalities. There are however examples of a strong policy and legislative framework in which the DBSA operates, and this can be seen to confirm the states' commitment to its constitutional mandate to provide for socio-economic rights, which includes basic services of water and sanitation (Josie, 2011. Leibig, 2008).

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The DBSA lending practices to local government is regulated through a raft of Constitutional and legislative frameworks, namely the DBSA Act of 1997, The Infrastructure Development Act of 2014, The Municipal Finance Management Act of 2003, the Local Government Act of 2002, and the National Development Plan 2030.

In addition, policy and legislated frameworks guide the work of local government in the development agenda of the National State. These include, but not limited to, The Constitution of the Republic of South Africa 1996, The Municipal Structures Act of 1998, The Municipal Finance Management Act of 2003, The Municipal Systems Act of 2000, The National Spatial Development Perspectives, Broad Based Black Economic Empowerment Act of 2003, Framework for Economic Development: Integrated Sustainable Rural Development Strategy and the Industrial Policy Action Plan.

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1.2.7. Municipal Mandates for Infrastructure Development

Liebig (2008) and Josie (2011) have both shown that local governments are responsible for delivering infrastructure development. The centrality of DBSA in furthering the infrastructure development agenda of the state is of importance and this study will expand on this through the lens of the what Ferguson (1994) terms the 'political character' of the state, and in the context of this study, its infrastructure development agenda in the articulation of that character.

To characterize the political nature of the South African state in this context will be to view it from the new vision statement of the DBSA which is to 'play a pivotal role in delivering developmental infrastructure in South Africa and the rest of the African continent' (DBSA, 2012).

However, the lack of scholarly interrogation of this vision and its link to infrastructure loan contracts between DBSA and municipalities, will not allow for a more in-depth analyses, or critical engagement with the modalities of lending practices. Despite the limitations of the study, it can however contribute through the research and data gleaned from available information, to a broader discussion of lending modalities, and its impact on continued social and economic inequality in poor municipalities. The mini-thesis framework can set the foundations for a larger study.

It is the intention of this study to problematise the terms and conditions of DBSA loans to municipalities to ascertain if these loans are more punitive for development, or if they serve its constitutional and state mandated purpose. This project will focus on the loans agreements made between DBSA and Theewaterskloof municipality in the Western Cape.

The study will focus on 11 DBSA loan agreements signed-off between 2006 and 2012. The study will focus on Theewaterskloof municipality and its infrastructure

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loan agreements with two commercial banks: Standard Bank (3 loan agreements) and Amalgamated Banks of South Africa (ABSA) (9 loan agreements). The commercial bank loans were also signed-off between 2006 and 2012.

1.3. DELINEATION OF STUDY

The study is focused on the Theewaterskloof Municipality, located in the Overberg District of the Western Cape Province.

Figure 1: Geographical location of Theewaterskloof municipality

Source: www.municipalities.co.za

Theewaterskloof Municipality is the largest local authority in the Overberg District with an area of approximately 3231km² and houses 13 wards, embracing the City of Cape Town on its western boundary and sharing the eastern coastline with the Overstrand Municipality (Theewaterskloof IDP, 2015).

It is the most populous municipality in the Overberg district with 42% of the total district population. Theewaterskloof Municipality can be categorised as a rural area with open spaces and farming activities as it is clear from the land and areas occupied by agriculture, small holdings and other land uses. Towns of

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Theewaterskloof include Grabouw, Caledon, Villiersdorp, Riviersonderend, Botrivier, Greyton and Genadendal.

The towns represent 8 wards, and the overall population is 121 000. Theewaterskloof has the lowest GDP of all towns in the province of equal size and profile, at R25 182 per capita, compared to the regional average of R31 159. The municipality has the largest economy in the region, but has experienced the slowest growth between 2005-2013 (Theewaterskloof IDP, 2015). The largest sector is finance, insurance, real estate and business services (32%) followed by agriculture, fishing and forestry (21%) and manufacturing (14%). The smallest sectors include mining and quarrying (0%) and electricity and water (1%) (Theewaterskloof IDP, 2015).

1.4. PROBLEM STATEMENT

The terms and conditions of DBSA infrastructure loans to rural, under-resourced municipalities such as Theewaterskloof presents a problem given the unequal levels of socio-economic development between the urban and rural areas, as noted previously. In 2012 the Bank disbursed R43 billion to infrastructure projects (DBSA, 2012). However, Bond (2013) holds the view that the DBSA, through its loan practices to municipalities, and even within the Southern African Development Community region, furthers an anti-development agenda of the South African state.

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Theewaterskloof Loan agreements reviewed from the period 2006-2012 display an inordinate amount of penalty clauses as it relates to pre-payments, late payments, commitment fees, a mix of interest rates formulas such as fixed, nominal and floating, all contained in the same agreement. In comparison, commercial loan agreements, would seem to be far less penalty-driven with a fixed interest rate and far less onerous terms and conditions and punitive financial derivative instruments.

An example is the 2011 ABSA loan agreement with Theewaterskloof (Theewaterskloof, 2017). The loan amount is R3 million over 8 years. Interest is

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fixed with any default interest calculated at the prime lending rate, plus 3%. A DBSA loan (Theewaterskloof website, 2017) taken over 10 years and valued at R1 million has a ten year Amortising Swap Rate (ASR) plus 1.68%. The contract includes a 0.5% commitment fee on deviation from the disbursement schedule and a late penalty interest of the fixed interest rate as agree upon, plus an additional 2%. While this agreement does stipulate a one-year grace period for capital repayment, default clauses and the commitment fee clause will ensure that the assets of the Bank are protected through these allocations.

These examples may bear out the assertion that the DBSA utilises a range of different financial instruments in a single agreement which makes such agreements onerous and punitive in comparison to the commercial bank entities.

It must be noted that the State has numerous inter-governmental funding and grant mechanisms aimed at infrastructure development at local and provincial level. The Municipal Infrastructure Grant funding instrument is one such instrument. This scheme is perceived as re-inforcing historical inequalities through the 'undifferentiated approach to costing the provision of infrastructural services resulting in an inequitable allocation of municipal infrastructure grants' as noted by Josie (2008, 2011). The reason for this inequitable allocation is a result of 'varying degrees of historical disadvantage, socio-economic inequalities and geo-spatial disparities (in municipalities)'.

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Only when historical disparities and socio-economic inequalities are taken into account in infrastructure funding models will the true cost of services be realised (Josie, 2011). However, the lack of technical capacity and skills at local government level and the lack of equitable and stable allocations mechanisms means that infrastructure grants and funding, and I would add, the loans on offer by DFIs and commercial entities, mire rural municipalities in further poverty.

In this scenario it is under-capacitated and under-resourced municipalities, and their poverty-stricken communities, who pay the price through generational debt. The

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unknown in this problem are the consequences of a negative generational burden of debt which under-resourced municipalities have when saddled with a 20-year loan repayment schemes.

1.5. AIM AND PURPOSE OF STUDY

This research exploration will critically examine the lending and borrowing modalities of the DBSA loans to the Theewaterskloof municipality in the Western Cape Province of South Africa. Theewaterskloof is classified as a Category B municipality and is one of four Municipalities located in the Overberg District Municipality (Western Cape Government website, 2016).

Section 155(1) of the Constitution of South Africa, guides that a Category B Municipality is an entity which shares Municipal executive authority in its area with a Category C Municipality within the area in which it falls. Therefore, a Category B Municipality is commonly referred to as a "Local Municipality". A Local Municipality is defined as a municipality that shares municipal executive and legislative authority in its area with a district municipality (Municipal Structures Act, 1998).

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Theewaterskloof was identified as a case study because it has a complete repository of all DBSA and commercial bank loans on its website. This made researching the topic more accessible as information was readily available. However, it must noted that accessing information from the DBSA was challenging. The reliance on desktop sources, while it may be perceived as a weakness of this study, is an indication of the lack of transparency and access to information by the DBSA, in comparison to its global counterparts in the development banking arena. The DBSA has no loan repository on its website, while the World Bank (www.worldbank.org) and the Asian Development Bank (www.adb.org) have complete loan repositories, loan conditions and terms on its websites.

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The research exploration will be accomplished through an analyses and data-gathering process of the loan agreements between the DBSA and Theewaterskloof municipality. The specific aims of the study will be to:

- Explore the modalities of lending with respect to loan amount, interest rates, loan terms, loan conditions and financial derivatives (if any);
- Explore the modalities of lending between commercial banks of ABSA and STD Bank with respect to loan amounts, interest rates, loan terms, loan conditions and financial derivatives;
- Provide recommendations to be considered for further study;

The terms and conditions of DBSA infrastructure loans to municipalities' present an opportunity to explore infrastructure loans in the context of socio-economic development at a local government level. Through this mini-research project, it will be explored if the DBSA progresses the States' infrastructure development agenda entrenches an anti-development agenda through its infrastructure borrowing and lending practices at the local level.

The following infrastructure profile underscores Theewaterskloof's reliance, on inter-government transfers, development finance and commercial bank loans to fund capital projects:

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15.1. Infrastructure

Infrastructure backlog is estimated at R473 969 409. Existing infrastructure and bulk services are not responding to the growing demands due to population growth, and the changing needs of the communities in the municipality (Theewaterkloof, IDP, 2016).

1.5.2. Housing

The biggest challenge to Theewatersklood, is addressing the housing backlog and ensuring the necessary bulk infrastructure is in place (Theewaterkloof, IDP, 2016).

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1.5.3. Water

Eighteen percent (18%) of the water supply infrastructure in Theewaterskloof, and 26% of sanitation infrastructure is in very poor condition. Estimated cost values of the municipalities water and sewer Master Plans is between R205 million and R113 million respectively (Theewaterkloof, IDP, 2016).

1.5.4. Energy

Eskom is the main energy provider in the municipality. The municipality does however provide electricity supply for 4 of the 8 towns in its jurisdiction. There are no other energy sources available or supplied (Theewaterkloof, IDP, 2016).

1.5.5. Roads

Theewaterskloof acts as a road agency for the Overberg District Municipality. Neither public transport systems or non-motorised infrastructure is of a good quality and requires upgrading (Theewaterkloof, IDP, 2016).

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1.5.6. Telecommunications

There is no provision for telecommunications infrastructure development cited in the Theewaterskloof Integrated Development Plans 2016-2017. Telecommunications is not a local government function (Theewaterkloof, IDP, 2016).

1.5.7. Local Economic Development

Economic growth in Theewaterskloof has been relatively small, and slow in comparison to the population growth. A knock-on result of this is a considerable

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decline in municipal revenue collection. The overall consequences are smaller resources available in the local economy (Theewaterklood IDP, 2016).

1.5.8. Overall socio-economic inequality

Theewaterskloof has high levels of inequality with a large social and economic divide between white farmers who have historical ownership of agricultural lands, and the unskilled migrant agricultural workers. In addition, the patterns of economic migrancy from other provinces have also impacted on the demand for infrastructure and bulk services. This, in turn, have placed a burden on the municipal revenue collections for services (Theewaterkloof, IDP, 2016).

1.5.9. Narrow Revenue Collection Rates

Theewaterskloof has a narrow rates base. As the municipality is not the main electricity provider, it cannot secure this as a source of income. The influx of indigent communities in search of work, the high dependency of seasonal work in the agricultural sector, high unemployment and the overall poor economic climate have all contributed to the already narrow tax base (Theewaterkloof, IDP, 2016).

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The infrastructure and resource landscape as outlined above profiles a municipality which has aging infrastructure, high levels of inequality, an influx of indigent people and a narrow rates collection base.

The choice to locate this case study in the Theewaterskloof municipality of the Western Cape province is to explore if the development mandates of the DBSA through its infrastructure loans focus on 'economic infrastructure integration and development' (DBSA, 2012) or if its municipal loans to Theewaterskloof merely serve to maintain the spatial and infrastructure inequality still prevalent in much of the province.

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1.6. RESEARCH QUESTION

The research question which will be explored is does the terms and conditions of DBSA infrastructure loans to municipalities diminish or perpetuate inequality. This is a desk-top study that makes use of secondary data. The focus is on the lending and borrowing modalities of the DBSA infrastructure loans to the Theewaterskloof municipality in the Western Cape Province.

1.7. RESEARCH METHODOLOGY

This research study is situated within a qualitative paradigm and makes use of secondary sources as an avenue of enquiry. Creswell (2003) describes a qualitative research study as an 'inquiry process of understanding a social or human problem based on building a complex, holistic picture formed with words'. An important element of this methodology is the aspect of the 'value-laden' nature of the study. Creswell notes that in a qualitative study the researcher 'actively reports his or her values and biases, as well as the value nature of information gathered'.

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The analyses of the data will rely on drawing value-laden conclusions about the rationale and strategy employed by the DBSA in lending financial support to local municipalities.

1.7.1. Data Collection

The collection of data for this research study was gathered from electronic archives on the website of the Theewaterskloof municipality. The main source documents were long-term loan contracts and the Integrated Development Plans (IDP) sourced from the Theewaterskloof municipal website (Theewaterskloof website, 2017).

The agreements are a matter of public record and were sourced online from the websites of the sample municipalities. This data is classed as secondary data. Secondary data, as defined by Hox (2005) is data collected by other researchers or

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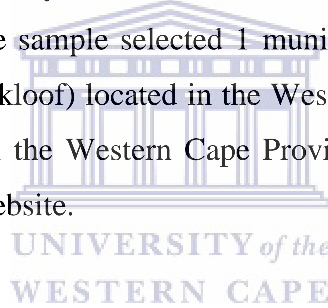
for others purposes such as official statistics or administrative records. Because this data is archived and accessible any type of primary data can be used as secondary data.

1.7.2. Sampling

A non-random sampling technique was used to select the municipal loan agreements with the DBSA and commercial banks. This technique can be defined as selecting units based on 'specific purposes associated with answering a research question' (Teddlie and Yu, 2007).

Maxwell (1997) also defines purposive sampling as elements (i.e. people, events or settings) as being deliberately selected for the information which they can provide. In this study a purposive sample selected 1 municipality from category B (local municipality Theewaterskloof) located in the Western Cape Province. The reason for locating the study in the Western Cape Province is the accessibility of data through the municipal website.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1.7.3. Research method

According to Singh (2006) the case study is both a tool and method of research. According to Stake (1995 in Creswell, 2003) the case study approach allows the research to make an in-depth exploration of an event, an activity, or a process. Case studies are time-bound and activity bound. It also provides detailed knowledge disallowing generalizations beyond the knowledge contained in the case study.

This research study is situated within is a qualitative framework utilising document analysis as a method. Organisational and institutional documents are an important tool of research and analysis for the qualitative research study (Bowen, 2009). For this study the organisational documents analysed are the Infrastructure Development Plans of Theewaterskloof (2014, 2016). The institutional documents

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analysed are the loan agreements of the commercial banks (Standard Bank Limited and Amalgamated Banks of South Africa) and the DBSA.

These documents, accessed electronic, provided a desk top study of the borrowing and lending conditions of Theewaterskloof in its loan agreements with commercial banks and the DBSA. While there are various qualitative methods available for a study such as this (e.g. combination of methods in a single study as a means of triangulation, (Denzin, 1970 in Bowen, 2009), this desktop qualitative method utilising the organisational and institutional documents as documents of analyses, did so due to the limitations of financial resources and time.

The research design will incorporate a case study approach to explore the loan agreements so as to draw conclusions on the lending and borrowing modalities of the DBSA to municipalities. The Case Study method will focus on Theewaterskloof municipality. While several other methods of data collection are available, the purpose of the research was to look at what was currently available at the time of the study, within the limitations of resources and time.

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The case study will consider the following aspects:

- 23 loan agreements which the Theewaterskloof municipality has with the DBSA, and its commercial counterparts, Amalgamated Banks of South Africa (ABSA) and Standard (STD) Bank;
- the socio-economic profile of the municipality;
- the rate of loan interest;
- the type of interest rate applied (i.e. floating or fixed, nominal, swap);
- the term of the loan;
- MFMA compliance
- Loan conditionalities

1.7.4. Data-analysis

According to Tesch (1990, in Creswell, 2003; 153) data analyses is eclectic. Kawaulich (2004) explains data analyses as immersing oneself in the data to

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become familiar with it, looking for patterns and themes and the relationship between them. This study will analyse the data gleaned from loan agreements signed by Theewaterskloof with the DBSA and commercial banks to make comparisons between the various terms and conditions of the loans. The data analyses method in this study will utilise typology, constant comparison and content analysis (Ratcliff, undated). The data will be compared loan agreements between the period 2006 – 2012, and its terms and conditions to ascertain patterns of relationships between the data.

1.8. LIMITATIONS OF THE STUDY

The limitations of the study relied on secondary data and empirical reports. This provided a limited understanding of the power relations between bank and local government officials. A second limitation of the study is that due to time and financial considerations face-to-face in-depth interviews could not be conducted with DBSA and municipal officials to broaden the scope of the research.

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A third limitation was that the information sourced had the potential to be dated as the research relied on electronic data, journals, loan agreements, development plans and financial and municipal policy documents. A final limitation is that the DBSA website does not offer any information regarding loan agreements and their terms and conditions. This does raise a question about the levels of transparency and accountability to the South African public.

This limitation did not however constrain the research as Theewaterskloof has a complete repository of loan and policy documents. However, it must be noted that the municipality did not have a copy of its Borrowing Policy on its website. This made it difficult to ascertain its borrowing policies. However, all local government transactions and borrowings are regulated by the Municipal Finance Management Act 2003 and other related government policies and legislation.

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1.9. ETHICAL CONSIDERATIONS

The highest ethical considerations were used in the study. The data-collection and data-analyses methods used protected the integrity of the information. In this the researcher was guided by Section 9.9.2 of the University of the Western Cape's Research Policy (2009) which states that 'researchers are expected to maintain the highest standards of honesty and integrity'. The researcher ensured that all data and its analyses, and research material was obtained in a truthful manner.

In this context all materials are referenced according to academic protocols. Furthermore, regular engagements with the dissertation supervisor ensured that ethical considerations were maintained. It is not the intention of this research study to harm, discredit or shame any person or institution.

1.10. CHAPTER PROGRESSION

The mini-thesis is organised in 5 chapters and is presented as follows:

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Chapter One provides an introduction and describes the aims and objectives of the study; this section also provides the background and significance of the study; and describes the research tools and methods.

Chapter Two provides a review of related literature, key definitions and concepts such as critiques and discussions of development banking, development finance and the approaches of the development banks in particular to infrastructure project finance. This chapter also situates the study in its theoretical and conceptual framework.

Chapter Three presents the data and analysis, as well as a discussion the findings of the research.

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Chapter Four describes and discusses recommendations flowing from the research.

Chapter Five concludes the study.

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CHAPTER 2: THEORETICAL AND CONCEPTUAL FRAMEWORK

2.1. INTRODUCTION

This will discuss the theoretical frame-work in which this research is situated. The second section of this chapter will review literature aligned to the study.

2.2 THEORETICAL FRAMEWORK

This research project is held in frame by the World Systems Theory (WST). WST provides a theoretical basis on which to investigate the development of capitalism and its impact on nation states and their inter-relationships with the world (Chase-Dunn, 1999). The theoretical discussion will also explain theoretical assertions linked to the WST such as Dependency Theory.

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The WST is the intellectual and theoretical contribution of Immanuel Wallerstein, Andre Gunder Frank and Samir Amin (Chase-Dunn, 1999). 'A world-system is a social system, one that has boundaries, structures, member groups, rules of legitimation, and coherence. Its life is made up of the conflicting forces which hold it together by tension and tear it apart as each group seeks eternally to remold it to its advantage' (Wallerstein, 1976).

According to Petras (1981) 'the real innovation of the world systems approach lies in the choice of the primary unit of analysis - the capitalist world economy'. All phenomena are to be explained in terms of their consequence for both the whole of the system and its parts. The parts of the world system are articulated the as a Core, Peripheral, Semi-Peripheral state or areas (Wallerstein, 1976; Grundy, 1976; Cantori and Spiegel, 1970;).

2.1.2 World System Theory and Modernisation

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‘World-system theory is a macrosociological perspective that seeks to explain the dynamics of the “capitalist world economy” as a “total social system” (Martínez-Vela, 2001)’.

The World Systems Theory (WST) is a conceptual break with the theories of modernisation and provides an alternative lens through which to investigate the development of capitalism and its effects on countries. It is important to view the WST in opposition to the criticism of modernisation theory (Chase-Dunn, 2015).

Modernisation theory sees the nation-state as an isolated unit of analyses and that in order to achieve modernisation a country must follow a linear path of development (Tadaro, 2012). The State is seen as a homogeneous unit, autonomous from other agents with political and economic power able to put in place techno-industrial plans (Gurrieri, 1987 in Hettne 1990).

In the ‘modernisation paradigm’ (Hettne, 1990) development is seen as evolutionary and that any gaps in development could be filled through an imitative process. Less-developed states could, in this paradigm, achieve the state of development of their wealthier counterparts through imitation.

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Within the Marxist articulation of modernisation transition to stages of development is defined through progress (Hettne, 1990). A society is forced to make ‘qualitative leaps’ because of the contradictions expressed through class-struggle.

Conversely the WST views the whole, the global historical development of the capitalist world structure as the unit of analyses. The main insight of WST is the interaction between trade, information flows and alliances, and how they are woven with politics and culture since the evolution of human-kind.

2.1.3. World Systems Theory and its units of analyses

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A crucial element of World Systems Theory is the unit of analyses. For the purposes of this discussion Core, Periphery and Semi-Periphery will be focused on. The relationship between the Core and Periphery are interdependent (Martinez Vela, 2001) and while culturally different, the relationship is structural with one focused on labour - intensive activities and the other on capital intensive activities.

Within these, are Semi-Peripheral states which act as a buffer zone (Skocpol 1977, in Martinez Vela, 2001). The states, despite their weaker position in relation to the Core, experience a development that reproduces their subordinate status. The semi-periphery societies act as a bridge between the Core and the Periphery. The semi-periphery is necessary to ensure that the capitalist system runs smoothly (Wallerstein, 1974). The smooth functioning of the system is juxtaposed by a highly unequal system of rewards.

The varying strengths, and power relations between multiple states is what maintains the capitalist system. This is what Wallerstein calls 'unequal exchange' and what leads to capital accumulation at a global scale. Some Periphery and Semi-periphery regions have strengthened their positions in the Periphery hierarchy through the dominance of global capitalism and its systems. The dominance of global capitalism is through the expansion of foreign trade, financial flows and the international banking system. The section which follows will discuss the theoretical articulations of the WST and its related theoretical component of Dependency in greater detail.

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2.1.3(a) Core

The Core-state is what Wallerstein (1976) calls the 'advantaged areas of the world-economy'. They occupy dominant positions in the global economic systems, possess dominant or near dominant military structures global in scope, and boast commanding technological and cultural structure (Grundy, 1976). These elements serve as a mechanism to protect disparities within the world-system. Strong state

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machinery and national culture are an ideological mask which maintains the disparities.

2.1.3(b) Periphery

Within the Peripheral area the indigenous state is weak, ranging from its nonexistence to one with a low degree of autonomy (Wallerstein, 1976). The Periphery states must adjust and adapt to decisions and structures controlled by the Core. In economic terms they tend to produce raw materials for export and its economic institutions strongly influenced from the Core. Each state is like-wise made up of a center (the power wielders) and a fringe (the objects of power) (Grundy, 1976).

2.1.3(c) Semi-periphery

Semi Periphery areas are in between the Core and the periphery (Wallerstein, 1976). These areas operate on dimensions such as the complexity of economic activities, the strength of the state machinery and cultural integrity. The Semi Periphery is a structural element in a world economy. They are collection points of vital skills that are often at odds with the general society. Within the DBSA these 'vital skills' may be the ability to foreground the profit-seeking agenda of the State under guise of its development agenda.

For the purposes of this study it is crucial to note the articulation of Petras (1981) on the Core, Periphery and Semi-Periphery; and the dependency model of international relations of Grundy (1976). Collaborator classes within the Peripheral, and it may be added, Semi-peripheral areas, organise the state and the economy aligned to the Core. As Petras notes: 'the creation of an international political economic order based on the inequalities of nations is rooted in the existence of an expanding center of capitalism and a set of classes within the periphery whose own expansion and position is enhanced in the process'.

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The combination of social formations within the global system of capitalism and the division of labour into classes serve to exploit *within* the society, and exchange *outside* the society. The dual nature of this process leads to the expansion of production and tension-filled class relations in the Peripheral area while exchange relations and competition grows within the Core.

In the Petras articulation of the inter-relationship between Core and periphery we can extrapolate the following: 1) the DBSA as an institution and extension of the ruling economic and political class can be viewed as part of the collaborator class within the Peripheral area, (South Africa) and 2) the political economy of South Africa can be viewed as aligned to the Core, given the relationships which the DBSA, as will be illustrated further in this research, has with regional and global capital.

The Grundy dependency model (1976) of international relations has at its theoretical base the link between 'the distribution of power and wealth internationally and similar distributions within states'. This is thus a core-periphery model that notes center- fringe relationships in intrastate and interstate terms. Within this are intermediary actors that serve as agents of the Core states at the same time that they seek to inflate their own influence within the system.

The intermediary status could provide a center of a periphery state with the maneuverability to assert its power. According to Grundy the competitive and symbiotic relationship between South Africa and the capitalist Core is the product of 'conscious governmental policy'. This assertion was made in 1976, more than 5 years before the DBSA and its developmental post-apartheid articulation. The research may well show that while South Africa's journey to democracy and development is under-scored by its liberal Constitution, its institutions and government policies continue its historical relationships with the Core.

The facet of the Grundy dependency model of international relations between industrial states and the less-developed countries (1976) which bears relevance to

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this research project are the assertion of the: 1) dominance of relations of the Core and the distribution of its power and wealth; 2) the inequality which this distributes; and 3) the intermediary actors, both within and between states which solidifies the power and centrality of the systems of the Core. The power of the Core is solidified through the 'divisions and competition among groups within the "have" and "have-not" elements of a state, alliances between actors in different states, and international organizations that, by and large, are creatures of combinations of governments and elements within various states'.

The DBSA is an 'intermediary' of the global capitalist system in the manner its relationships with municipalities are structured. An example of this relationship is its infrastructure development offerings to municipalities such as project finance, project management services, and 'slicing' fees from government transfers. It may be posited that this system will work to further entrench the capitalist orientation of the the DBSA, in contrast to the many premises of its world-economy counterparts.

2.1.4 Inter-generational debt

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During the 1940s and 1950s the economic view grew to build a narrative that internal debt should not burden future generations (Black, Calitz and Steenekamp, 2011). This is the view of American economist, Abba Lerner (n.d.) who progressed the argument that 'members of future generations will inherit a debt repayment or debt-servicing obligation, but other members of the same generation will be the recipients of these payments'.

When internal debt is repaid, income is thus transferred from one group who holds the bonds to another group who do not hold bonds. The view holds that future generations are not penalised, theoretically, since they are able to aggregate the same level of consumption. This is called an inter-generational redistribution of resources.

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In the case of external debt, generational debt burden is dependent on 3 things: 1) the manner in which the funds are used; 2) interest payments constitute a net transfer of funds to an external entity and 3) bond holders are now external to the economy (Black, Calitz and Steenekamp, p. 329-330, 2011). If funds borrowed from an external entity is used to finance capital projects such as rail-networks or roads the productivity of the project is crucial that the combination of debt and the performing asset is of benefit to future generations.

The burden of generational debt, be it internal or external debt, will only be of benefit to future generations if consumption levels of a population grow with employment, health, education, and a growth in the sub-national and national economy. Where socio-economic inequality, extreme poverty and unemployment exists, a generational burden of debt, such as long-term development finance loans, can only serve to mire future communities in cycles of continued inequality.

2.1.5 Capitalism and how it thrives

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Wallerstein (1976) views capitalism as the constant 'absorption of economic loss by political entities while economic gain is distributed to "private" hands'. Capitalism, and its success is 1) reliant on the structure of the area in which it operates and 2) its economic factors operate in a space larger than any single political entity and can therefore not be controlled.

According to Petras (1981) the phenomena of the WST can be explained by how the various political and economic structures and actors within a country or region play specific roles within the overall system of capitalism. WST also explains the structural power relations in the world and how it replicates inequality through those relations.

Capitalism has flourished because of the multiplicity of political systems. There are many political units inside the world-economy, loosely tied together in our modern world-system in an interstate system (Wallerstein, 2004). According to Wallerstein,

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the world-economy contains many cultures differing in their everyday patterns. While common cultural patterns do emerge, it does not mean that neither political nor cultural homogeneity is to be expected or found in a world-economy. Central to 'cultural homogeneity' is the continued project of capitalism.

Capitalism is 'endless accumulation' and means the accumulation of capital to acquire ever more capital (Wallerstein, 2004). Capitalism is a continual and endless process. If the system "gives priority" to such accumulation, it would mean that structural mechanisms exist to penalize any alternatives to the system. Systems and processes which act to continue the 'endless process' are rewarded and enriched.

Apartheid-capitalism, as a part of the global capitalist system and its accumalatory practices and motivations, was established through the DBSA (Feinstein, 2005). It is thus within the world system of capitalism in which the DBSA proliferated. For the purposes of this research agenda the relationship between the units of analyses, and the power relations between them is relevant to explore the terms and conditions of DBSA municipal loans. Within the context of the WST, the DBSA can be viewed as a proxy representative of the Core, reproducing a development agenda which entrenches the subordinate status of Peripheral states, or in this case municipalities. The DBSA and its relationships with municipalities is an illustration of the national, represented by the DBSA and the sub-national institutions, represented by the municipalities.

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2.1.6 The DBSA

The DBSA is a development finance institution (DBSA, 2012) and is regulated by the DBSA Act of 1997. The Bank was established in 1983 to perform an economic development function within the apartheid-era constitutional dispensation. The roles and functions of the Bank have since been transformed, in line with the democratic constitutional and economic dispensation to promote socio-economic development and growth both nationally and within the Southern Africa region. It

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is one of the leading infrastructure development finance institutions in the region (DBSA, 2012).

The strategy of the Bank is underpinned by two major themes: 1) generating investment in assets that serve the poor, directly and indirectly, and that support broad-based wealth creation; 2) mobilising, developing, applying and sharing knowledge in support of greater development effectiveness, innovation and an enabling development environment (DBSA, 2012).

'...municipal infrastructure delivery…is critical to the Bank's core mandate' (Dlamini, DBSA, 2013). Within the municipal market, the Bank provide is a conduit for inter-government grant transfers, loans and technical support to infrastructure development. The conduits include the Municipal Capacity Support and Implementation Programme, the Municipal Infrastructure Grant programme and the DBSA Development Fund.

The section which follows within the context of the theoretical framework is a description and discussion of the key concepts within the borrowing and lending context. These are also contained in the borrowing agreements between the municipality Theewaterskloof, which forms the focus of this research, and its lenders.

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2.1.7 Municipal borrowing

Long term borrowing is one major instrument for financing infrastructure development. Responsible borrowing by municipalities is strongly supported in government policy and legislation as an efficient and equitable mechanism to finance municipal capital investment needs (Municipal Borrowing Bulletin, 2016). Capital market loans are the largest source of capital for local governments (Gildenhuys, 1997). Long-term loans are defined as longer than five years and primarily for infrastructure financing. Short-term loans are shorter than five years (Gildenhuys, 1997).

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Long term loans may be fixed term and are a result between direct negotiations between the local government entity and the finance institution. The loan contract signed between the two entities determines the interest rates and the means of repayment (Gildenhuys, 1997).

South African municipalities rely on the following sources of borrowing: external loans, grants and subsidies (i.e. intergovernmental transfers), other sources, and public contributions and donations (Mahibir and Mabena, 2015). Internal revenue generation from taxes and tariffs for services represent the second largest contributor to municipal treasurery while municipal borrowing or external loans are only the third largest source of revenue. This source of funds is also the most prone to political and economic changes. Mahibir and Mabena (2015) note the downward influence of the 2008 global financial crises on municipal revenue collection for tariffs and external loan borrowings.

Figure 2: Capital expenditure, new borrowing and outstanding debt

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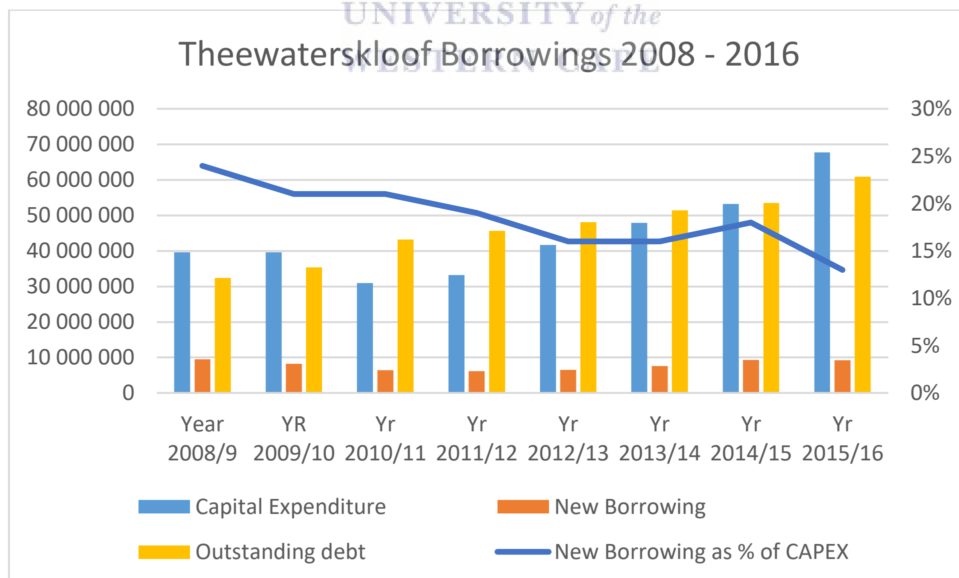

Source: Municipal Borrowing Issue 2, September 2016

Figure 2 above shows an overview of debt levels in municipalities as at 2016. Metropolitan municipalities, as a group, are significantly more leveraged than either local municipalities or district municipalities (Municipal Borrowing, Issue 2, 2016).

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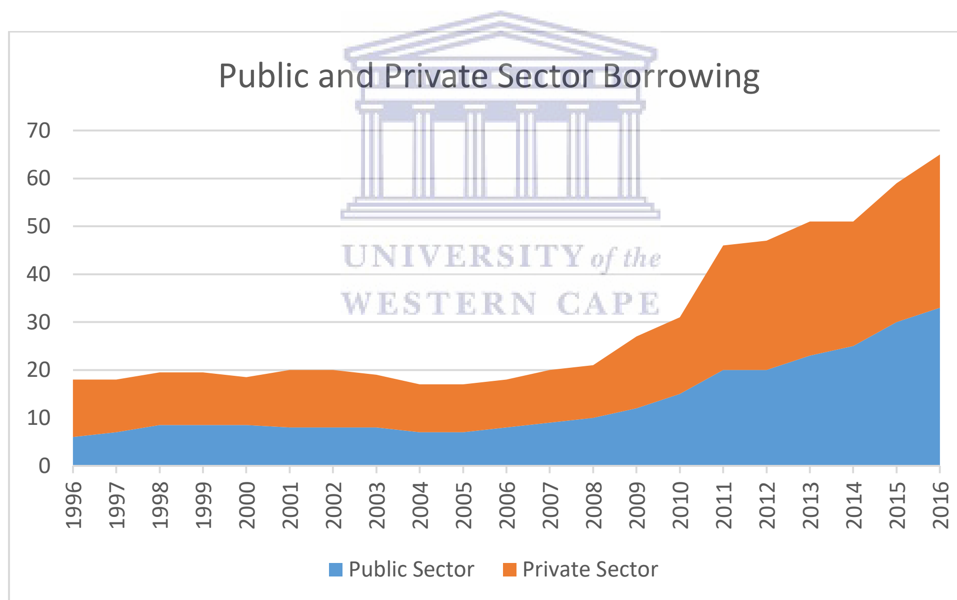
This data fact substantiates the view that metropolitan municipalities are more resourced than local and district municipalities. This also reinforces the idea that rural and urban areas are still affected by apartheid under-development.

Between 2005 and 2010 total municipal borrowing grew from R18.7-billion to R38.1-billion in 2010, representing a 15% growth rate (National Treasury, 2011) During this period, the private sector dominated the municipal credit market until late 2009, when the public sector surpassed the private sector. Metropolitan and secondary cities (cities governed by Category B municipalities sought DBSA loans substantially between 2005 and 2010 (Mahabir and Mabena, 2015).

Figure 3: Public and private sector lending to municipalities



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Source: Municipal Borrowing, Issue 2, Sept. 2016

Figure 3 above shows the distribution of municipal borrowing between public and private lenders. The DBSA has remained the largest lender to the municipal market since 1999 (Municipal Borrowing, 2016). The private commercial sector, notablty increased their investment to municipalities by 445% between 1996/7 and 2015/2016 (Municipal Borrowing, 2016).

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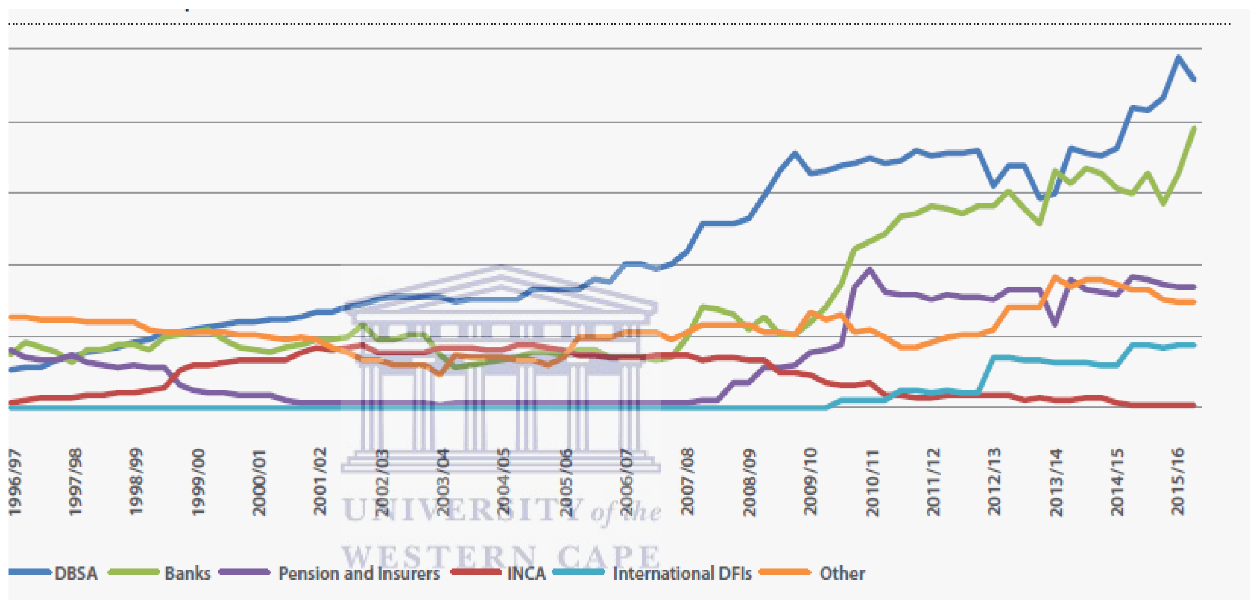
The DBSA is seen as part of the State and as such enjoys much lower borrowing costs. This immediately puts it at a competitive advantage compared to commercial lenders. However, despite this it is still metropolitan and secondary or Category B municipalities, with greater fiscal capacity and financial resources who are deemed less credit risky and who can access loans.

Figure 4: Largest Lenders to municipalities



Source: Municipal Borrowing Bulletin, Issue 1, June 2016

As *Figure 4* above confirms the DBSA is the largest lender to municipalities. The line graph shows a steady growth in DBSA municipal lending from the 1999 with a spike in 2010 and again in 2013-2014. Most borrowing at the state level, is regulated, and legislated by the Municipal Finance Management Act of 2003 (Municipal Borrowing Bulleting, 2016). All contracts signed by municipalities must comply with borrowing frameworks contained in the Act.

2.1.8. Borrowing policy

There are two approaches to borrowing (Gildenhuys, 1997). The first approach holds the view that government expenditure should be financed from current

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revenue and that governments should never borrow money. In this approach all operational expenses should be financed from current revenue and loan-money should only be used to finance capital projects which generate more money. The second approach is an integrative approach where current and borrowed money is pooled to pay all expenditure without differentiation between operational costs and capital expenditure (Gildenhuys, 1997).

The National Treasury favours an integrative approach (Municipal Borrowing, 2016). Municipalities have access to a variety of revenue sources and financing instruments to address these needs.

Responsible borrowing by municipalities is strongly supported in government policy and legislation as an efficient and equitable mechanism to finance municipal capital investment needs (Municipal Borrowing Issue, 2016). Having legislative and statutory control over borrowing money by local governments is a general practice globally (Gildenhuys, 1997). Regulatory practices serve as a protection for the public purse. In South Africa, local government can raise loans through borrowing powers (Gildenhuys, 1997) but are restricting from using bank overdrafts for bridging finance purposes.

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These tenets can be found in the borrowing policies of local governments' as regulated by the MFMA of 2003. Two examples can be found: the first in Section 3 (1) (a) of the Ethekwini Municipality (2014) which states: 'The Municipality may only borrow funds, in terms of the Municipal Finance Management Act, for the purpose of acquiring assets, improving facilities or infrastructure to provide service delivery'; the second can be found in Section 10 (10.2.1) the Borrowing Policy Guidelines of the Breede Valley Municipality (2016) which states: '…long-term debt may be incurred only for purposes of…capital expenditure on property, plant or equipment to be used for the purpose of achieving the objects of local government, as set out in Section 152 of the Constitution;'

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2.1.9. Credit worthiness

A municipal loan or municipal bond is "creditworthy" when it meets the risk standards of the lender (Peterson, 1998). According to Scott (2011) the method of evaluating the "creditworthiness" of municipalities in South Africa is to inquire into their history of loan repayments. Where a municipality defaults on loan repayments, the default influences its creditworthiness and even where its repayment record is positive, the municipality may continue to be seen as a credit unworthy.

2.1.10 Credit rating

Credit rating, in the context of municipalities, is defined as the external assessment of a municipality's ability to comply to risk standards (Mahibir and Mabena, 2015). It is this assessment which affects the municipality's ability to borrow. Metropolitan municipalities are often deemed to have greater credit worthiness due to their greater financial and fiscal capacity. This is particularly evident in the development challenges faced by rural and urban municipalities, the availability of human resource capacity, the degree of economic activity and overall institutional strength. Some administrations are relatively stable and well-resourced, whilst others face huge infrastructure backlogs, the negative impacts of demographic change and prevailing apartheid-based socio-economic legacies (The State of Local Government Report, 2009).

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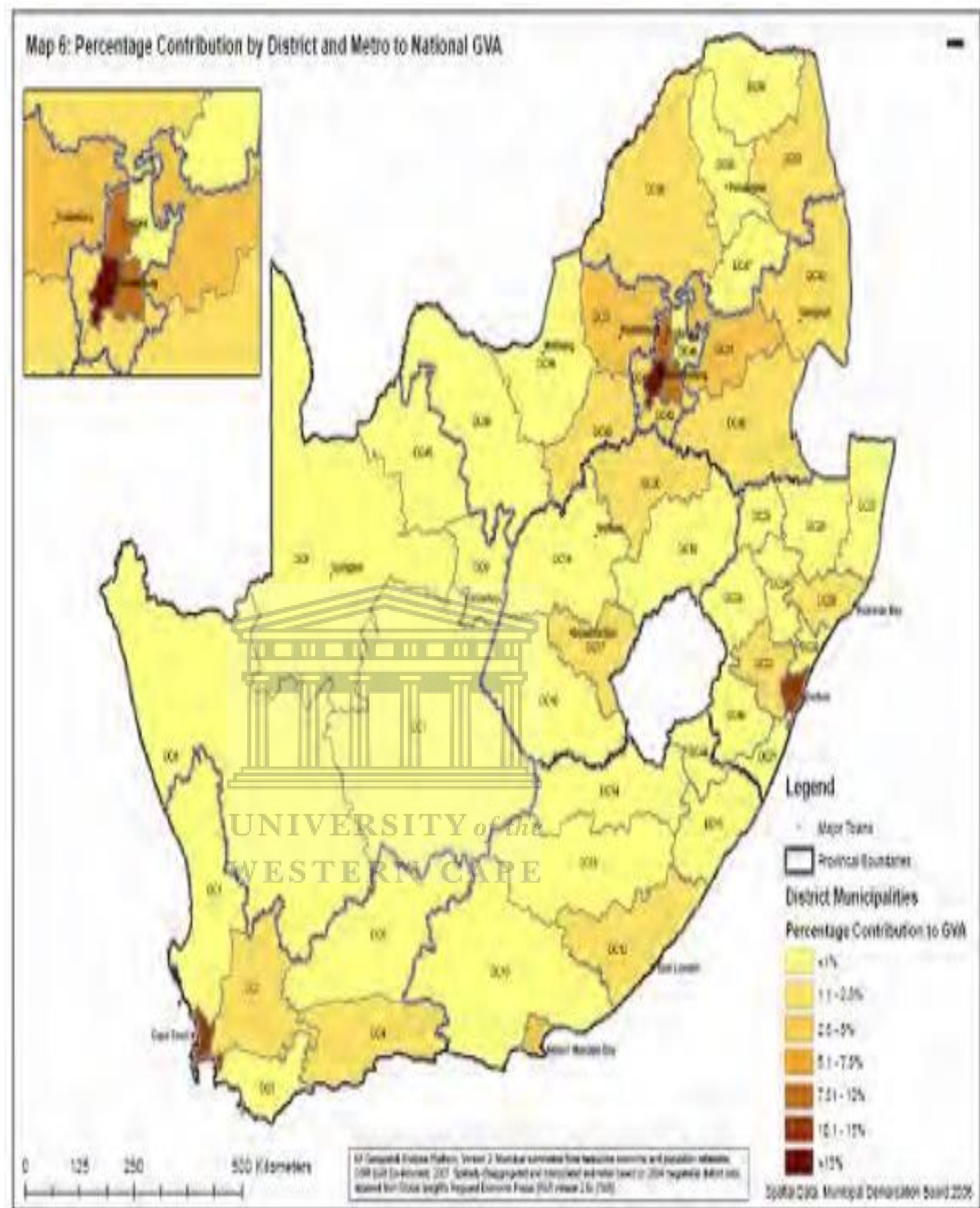
Figure 5: Spatial location of Gross Value Added



Source: Theewaterskloof IDP, 2015

Figure 5 above shows the spatial distribution of Gross Value Added (GVA) across the map of South Africa. Twenty municipalities in South Africa accounted for 82.8 per cent of total GVA to the national economy in 2004 (State of Local Government Report, 2009). Of these municipalities all of them contain major metropolitan areas,

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secondary and port cities or large towns. Johannesburg contributes more than 15% to national GVA, Cape Town 12% and eThekwini 10%; Tshwane and Ekurhuleni contribute 9.2% and 8.9% respectively; district municipal areas with large urban areas generally contribute more than 1% to the total GVA; and districts which are the lowest performers tend to be found in the desert and semi desert areas and or in the municipalities which fall within the former homeland areas of South Africa (The State of Local Government Report, 2009).

In the context of credit-risk the scenario described above confirms the view of Nyalunga (2006) that local government was structured to facilitate and regulate an agenda of racial segregation and exclusion. This has translated to the ability of urban metropolitan local government to raise funds. South African municipalities however face constraints in raising funds based on credit-worthiness (Horn, 2003).

According to Horn (2003) South African municipalities do not have adequate revenue to support borrowing. This is mainly the result of outstanding debt and revenue collection problems. Financial disclosure to the public is usually absent, late or unreliable. Finally, less than 6 municipalities in South Africa currently reported having credit. The creditworthiness of most municipalities in South Africa seems to be the greatest obstacle in the way of municipal bond market development.

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The City of Cape Town is an example of a credit-worthy municipality who has the ability to raise capital through municipal bonds. The metro of the City of Cape Town is able to raise finance through the issuing of municipal bonds, and appoint financial services providers for exclusive finance servicing (City of Cape Town Borrowing Policy, 2013). In contrast, the District Municipality of the Overberg, of which Theewaterskloof is a category B municipality) is not permitted to borrow for the purposes of investment, nor can is it able to issue municipal bonds (Overberg Borrowing Policy, 2017) due to the constraints as noted by Horn (2003).

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2.1.11. Municipal Bonds

Bonds are financial instruments in which the borrower promises to regularly pay the holder, and repay the capital amount at an agreed upon date (Mohr, Fourie and Associates, 2008, p. 326). Its three features are 1) the principal which is the amount that the issuer will repay to the bond holder upon expiration of the bond; 2) the maturity date on which on the bond will expire, and 3) the coupon rate. This is the interest promised by the issuer to the bond holder upon the maturity date. Johannesburg issued Africa's first municipal bond in 2004 while Lagos sold $533 million worth of 7-year debt in 2013 (Halimi, 2016).

Currently, municipal bond issuers in South Africa are City of Johannesburg,City of Cape Town, City of Tshwane and Ekurhuleni (National Treasurery website). It is note-worthy that urban-based cities, who benefited from apartheid-capitalism are positioned to continue to grow its historical wealth through the issuing of bonds. Poorer metros such as Nelson Mandela Bay had an outstanding debt of R1.4 million in the financial year 2016 (Municipal Borrowing Bulletin, 2016) and would therefore not be eligible to issue bonds or be classed as credit-worthy.

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2.1.12. Financial instruments and derivatives

In the loan agreements reviewed for this project a wide variety of interest rate instruments were found in loan agreements between Theewaterskloof, the DBSA, ABSA and Standard Bank (www.theewaterskloof.co.za). Examples include fixed interest rates, floating interest rates, and amortising swap rates (ABSA, 2006, DBSA, 2009). There are however a range of interest rates aligned to different financial instruments (Mohr, Fourie and Associates, 2008).

The rates differ as a result of a verity of factors which may include differences in risk, maturity, the structure of the financial market and the size of the loan. In the case of loan agreements between Theewaterskloof and lenders, the underlying

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financial instruments include flat interest rates, floating interest rates, compound interest, interest rates, nominal fixed interest rates, amortising swap rates include, indicative rates.

2.1.13. Interest rates

An interest rate is a financial instrument and can be defined as the cost of hiring money or credit (Mohr, Fourie and Associates, 2008). The Keynesian theory of interest rate is defined as the rate which governs 'the terms on which funds are supplied; is dependent on the demand and supply of money and is the reward for parting with liquidity for a special period of time' (Keynes, 1960, p.165 in Appelt, 2016). There are many interest rates associated with various borrowing or lending funds. Examples include the Repo Rate, The Interbank Lending Rates, the Prime Rate of Banks, various rates on deposits of money, and the rate on government stock (Mohr, Fourie and Associates, 2008).

Changes in interest rates can reflect the basic situation of the operation of the macro economy; it also affects the level of employment (and) the rate of economic growth (Khurshid and Suyuan, 2015). The interest rate is usually calculated by dividing the amount of interest by the principal amount or loan.

The calculation of interest rates is determined by the risk profile. The higher the risk profile, the higher the interest rate. I would offer that the poorer and less resourced the municipality is, the higher the risk profile, and are therefore charged higher interest rates. Interest rates cover a range of rates for different types of financial instruments (Mohr, Fourie and Associates, 2008).

Interest rates will differ due to a range of factors such as differences in risk, maturity, market liquidity, size of the loan and the structure of the market. For the purposes of this study, long term borrowing is one major instrument for financing infrastructure development in the municipal sector.

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2.1.14. Financial derivatives

In the loan agreements reviewed for this project a wide variety of interest rate and financial derivative instruments were found in loan agreements between Theewaterskloof, the DBSA, ABSA and Standard Bank. The underlying financial instruments include fixed interest rates, floating interest rates, compound interest, interest rates, nominal fixed interest rates, amortising swap rates include, and indicative rates.

2.1.14(a) Derivatives

The use of derivatives in municipal bond or loan markets has gain traction in the years leading to the 2008 global financial crises (Luby, 2012). In the US the supply of municipal derivatives increased to over $500 billion in the years leading up to the financial crisis (Lucchetti, 2010 in Luby, 2012).

A derivative is a contract between two or more parties whose value is based on an agreed-upon underlying financial asset, index, or security. Derivative markets can facilitate the management of financial risk exposure, since they allow investors to unbundle and transfer financial risk (Olatundun, 2009).

South Africa's derivatives market was established to further develop the financial system, enhance liquidity, manage risk, and meet the challenges of globalization. In the context of the municipal bond market, a financial derivative instrument offers the possibility of significantly lower interest costs (especially in the short-term) (Olatundun, 2009).

2.1.14(b) Amortized Swap Rate

The Amortized Swap Rate is a contract between two entities who agree to exchange future interest rate payments they make on loans or bonds (Gay and Venkateswaran, undated).

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The swap rate is an instrument used exclusively for the exchange of interest cash payment exchanges. Examples of swap rates include plain-vanilla fixed for floating interest rates swaps where one party pays a series of fixed payment based on fixed rate interest applied to a specified principal amount. A second example is the commodity swap where one party agrees to make a series of fixed payments in a commodity while the second party makes floating payments based on commodity price index from a specific geographical region (Gay and Venkateswaran, undated).

An example of a fixed swap rate can be found in the 2008 DBSA loan agreement with Theewaterskloof. The loan is taken over 20 years at a nominal fixed rate.

2.1.14(c) Default interest

The default interest instrument is usually applied to mitigate the risk exposure of the bank (Chernenko, 2011). In the 2010 DBSA agreement with Theewaterskloof, default interest is paid on demand by the borrower, and used to offset risk exposure. In this agreement the DBSA will determine the default interest rate. Default interest rates can be best described as ‘penal interest rates’ (Motari, 2013).

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While default rates are a measure of protection for the Bank, the higher the interest rates the greater the risk of default on loan repayments (Motari, 2013). I would offer that in the case of DBSA and its loan arrangements with Theewaterskloof, the risk of default is greater, not only because of the punitive default interest rate clause, but also because of the highly unequal levels of revenue collection in the municipality.

2.1.15. Loans

Investment loans have a long-term focus (5 to 10 years); they finance goods, works, and services in support of economic and social development projects in a broad range of sectors (World Bank, 2005). As can be seen from the figure below (*Figure*

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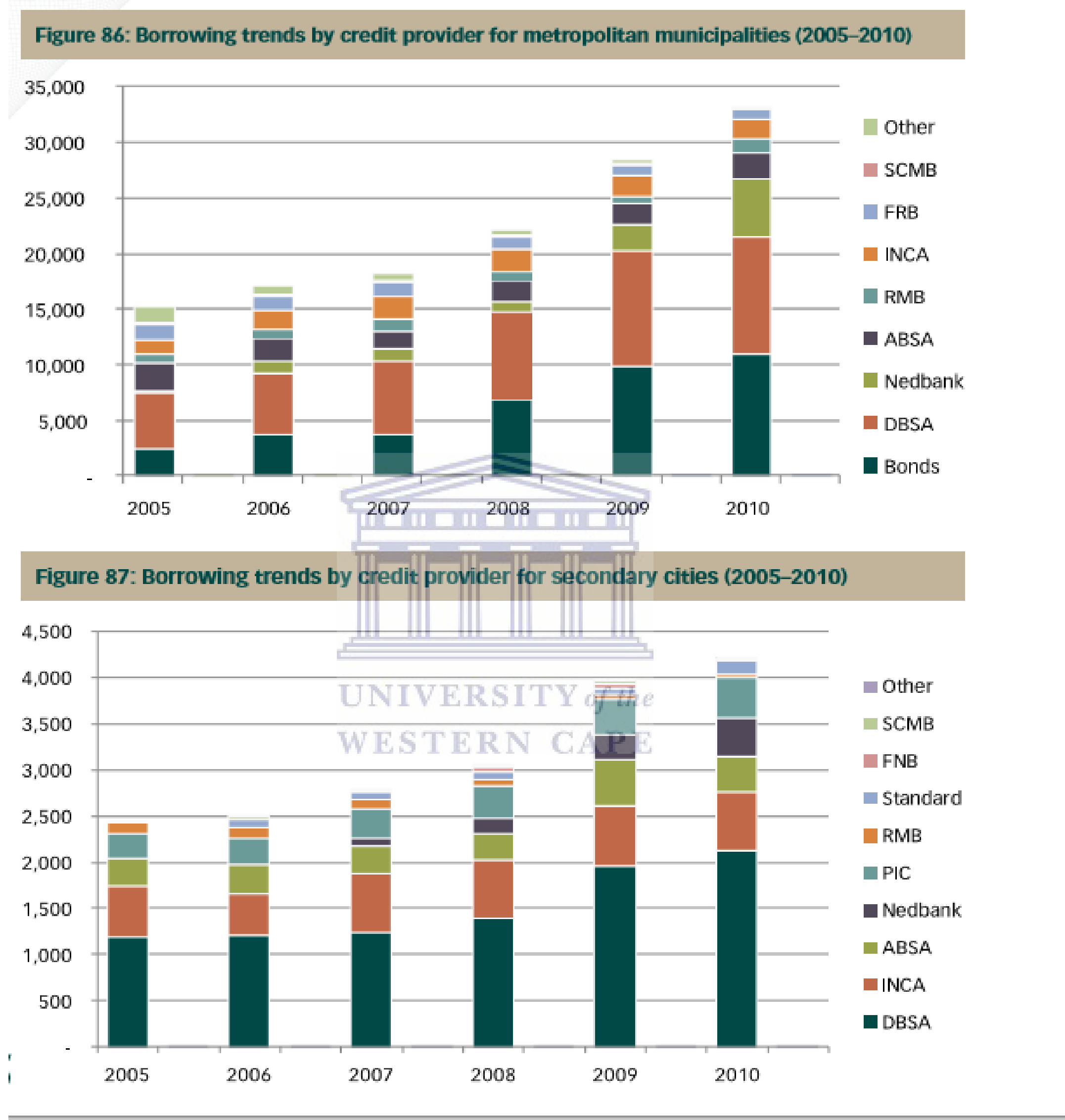
6), the loan trends in the metropolitan municipal market shows the greatest lender as the DBSA through 2005 to 2010.

Figure 6: Borrowing Trends in Metropolitan Municipalities



Source: Mahabir and Mabena, 2016.

Metropolitan municipalities and Category B cities depend substantially on funds from the DBSA (Mahabir and Mabena, 2016). The DBSA enjoys lower borrowing costs from capital markets than do private banks because of it is part of the State. Examples of capital markets include the derivatives market, the currency market and the bond market (Hassan, 2013). South Africa’s capital markets are larger than

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Turkey, Mexico and Indonesia (Hassan, 2013). The DBSA thus has a 'competitive advantage' and is able to lend to municipalities at lower rates. This creates a disincentive for the private sector to participate in the market. This has been argued to crowd out private financing (National Treasury, 2010).

2.1.16. Loan Conditions

Conditionality of development finance loans is central to policy based lending, linking financial support to policy reforms considered critical for a country's economic and social development (Koeberle, undated). In the context of the South African governments' infrastructure policy and development agenda, DBSA loans are mandated to promote infrastructure policy and infrastructure development (DBSA website).

The conditions under which a municipality can incur long term debt are prescribed in the Municipal Finance Management Act of 2003. The prescripts as guided in the MFMA of 2003 forms the legislative framework of municipal borrowing policies. The Breedevallei Municipal Borrowing policy denotes the following as the legislative framework of its policy: 'Municipal Finance Act, 2003 ('the MFMA') and the Municipal Regulations on Debt Disclosure ('the Disclosure Regulations') made thereunder and published under GN R 492 in Government Gazette 29966 of 15 June 2007 (Breedevallei Borrowing Policy, 2015).

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The rationale for quoting the Breedevallei Borrowing policy is that the Theewaterskloof repository, upon which all loan and borrowing related data was gleaned, did not have a Borrowing Policy on its online repository. However, a desktop scan confirmed that all Borrowing policies of local government must be underscored by the prescripts contained in the MFMA of 2003. These guidelines quoted below are thus universal to the local government borrowing space.:

Risk Management: The need to manage interest rate risk, credit risk exposure and to maintain debt within specified limits is the foremost objective of the borrowing

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policy. To attain this objective, diversification is required to ensure that the Chief Financial Officer prudently manages interest rate and credit risk exposure;

Cost of Borrowings: The borrowings should be structured to obtain the lowest possible interest rate, on the most advantageous terms and conditions, taking cognizance of borrowing risk constraints, infrastructure needs and the borrowing limits determined by Legislation;

Prudence: Borrowings shall be made with care, skill, prudence and diligence. To this end, officials of the Municipality are required to: 1) adhere to this policy, and other procedures and guidelines; 2) exercise due diligence; 3) prepares all reports in a timely fashion; and 4) ensure strict compliance with all Legislation and Council policy.

In summary this first section gave a theoretical discussion on the World Systems Theory, capitalism and how it manifests in the world economy. It also discussed municipal structure and its borrowing regulatory frameworks. The section which follows will review the literature associated with development banking, development banks and the DBSA in relation to the development agenda of the state.

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2.2. LITERATURE REVIEW

The review which follows will incorporate literature focusing on both the South African development finance landscape and the global perspective. The first section will reflect on the concept of development as transformation and then the role of development in development banking.

2.2.1. Development as transformation

Development is the overarching goal of the South African state. Development represents a *transformation* of society (Stiglitz, 998). However, in the view of

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Stiglitz, development is much more than just resource allocation, as was previously thought by traditional economists. Development, in the 1970s came to be redefined as a reduction in poverty, inequality and unemployment (Todaro, 2012).

The period of redefining the development agenda in this period was about questioning a country's overall growth. In this period the slogan 'redistribution from growth' became very popular with political economists of this generation. Financing for growth has become an important tool in development. Here the role of development banks, and more specifically, State-owned Financial Institutions (SFIs) such the DBSA plays its role in municipal lending and infrastructure development.

2.2.2. The role of development banks in development

Development banks provide medium to long-term financing to large entities such as governments (Tadaro, 2012). Historically, governments established development banks to provide credit and other financial services to individuals, firms and strategic sectors of the economy that private financial institutions were unable or unwilling to serve (de Luna-Martínez and Vicente, 2012). The role of a development bank is to lend and invest. Within in this context they determine the scale of investment.

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They are a crucial component of the financial structure of a society and often ensure that lending can lead to productive investments and increase economic growth and social development (Chandrasekhar, undated). Development banks obtain funding from various sources including from other financial institutions and receiving budget allocations from the state. Some critics (Rudolph in de Luna-Martinez, 2012) argue that taking money from the public is unwise.

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2.2.3. Historical context of Development Banks

2.2.3(a) Pre-20th century history of development banks

The history of development banking and public finance for development can be traced to 2400 BC (Marois, 2013). In ancient Babylon and Sumer temples functioned as credit-granting, interest charging public lending institutions. In medieval times Italian bankers brought in the scheme where people could purchase now and pay later. In the 14th century the first state-owned bank emerged from this medieval tradition and survived for 450 years until it merged with the Bank of Spain.

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In the 15th century, the Genoese state opened its first state-owned bank and operated for almost two centuries. In the 1700s the American colonies operated a Land Bank which ensured that profits were channelled into public projects. In the 20th century state-owned banks were viewed as countering the restrictive and imperial power of private banks. An example given by Marois (2013) is of the Ottoman Empire which in 1863 created an agricultural fund to stave off the yoke of European debt dependency.

2.2.3(b) Development Finance in the 20th Century

Probably the greatest example of investment in public infrastructure in the 20th century is the Marshall Plan. In *The Marshall Plan: History's Most Successful Structural Adjustment Programme*, De Long and Eichengreen (1991) the Marshall Plan was established by the United States and was valued at USD13 billion. Its loans and aid packages assisted Western Europe in its reconstruction and development after the Second World War. It allowed Western European countries to finance investment and public expenditure.

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Bruck (1998) in *Role of Development Banks in the 20th Century*, describes the Marshall Plan as having been set up to finance the reconstruction of Western Europe post the Second World War. While De Long and Eichengreen critique the premise of the Marshall Plan and unpack the realities of the Plan as securing a conduit for US capital flows and determining the post-war economic trajectories to favour capital, the point in this context is that the Marshall Plan is an example of investment in the public sector for the development of infrastructure via the state.

Bruck (1998) explains that the discipline of development banking can be found in the work of development economists such as Rostow, Prebisch, Harrod and Domar who saw the concept of capital growth as a means to achieve economic growth. Capital investment thus came to be viewed as essential for long term economic growth. This could be made possible by the provision of long-term financing. The creation of development banks was seen as alleviating the problem of short-term finance.

But what of the role of Development Banks in the 21st century? The section which follows will define the meaning and role of development banks in the context of public sector investment and development finance.

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2.2.3(c) Defining the role of Development Banks in the 21st Century

I would offer the view of Bruck (1998) that in the 21st century the role of Development Banks is determined by the social and economic environment in which they operate. They achieve the developmental goals of the State through 'principle instruments' of funds, planning, monitoring and developing projects. However, the dominant trends of the final three decades of the 20th century, specifically financial liberalisation, privatisation of public owned enterprises, and the globalisation of the world trade finance, have impacted on the evolution and premise of development banks.

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Development banks have a ‘hybrid’ financial character (Bruck, 1998) and its scope often goes beyond traditional development banking. As we see in the focus of this research, the DBSA covers relations with both national and sub-national organs such as provincial and local governments and within the Southern Africa region and the continent of Africa.

In *Global Survey of Development Banks* (World Bank, 2012), a development bank (DB) is defined as a bank or financial institution where at least 30% of its equity is owned by the state. In addition, its mandate has an explicit socio-economic goal in a region, sector or particular segment of the market.

In *Should the Government be in the Business of banking? The Role of State-Owned and Development Banks* (Yeyati, Alejandor and Panizza, 2004) state-owned banks are defined as financial institutions concerned with offering long-term capital finance for projects, and I would offer development programmes, that have a positive impact on society, or as the authors state, ‘generate positive externalities and are tied to the economic development of a country or sector (e.g. agriculture or infrastructure development).

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Bruck (1998) defines a development bank as a ‘specialised financial institution’ which are ‘institutional instruments of public policy’. Its performance is measured in terms of their social benefits. The scope of the development bank is linked to industry, rural development, infrastructural development, government, social and institutional processes.

2.2.3(d) Differences between commercial banks and development banks

There are significant differences between private sector commercial banks and public state-owned banks. Bruck (1998) notes that private banks have a banking licence and are legal entities incorporated through articles of association. Public banks are constituted through law and are often regulated through an Act of government.

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Examples of this include the Development Bank of Southern Africa Act 1997 (DBSA website), the Brazilian Economic Development Bank established in 1971 under Law 5662 (www.bndes.gov.br) and the Caribbean Development Bank, a regional development signed into being through an agreement between the Commonwealth of Caribbean States in 1971 (www.caribank.org)

2.2.3(e) Differences in functions of private and public banks

Distinct differences between commercial and public banks are that commercial banks make short-term loans and buy and sell foreign currencies. Private investment banks raise long-term finance on the financial markets with the express aim of profit making over the long term. While development or public banks also deal in long-term project financing, they do so within the frame-work of social and economic development.

It is of significance that during the 1980s and 1990s the development banks sector included some private bank functions such as the financing of capital ventures, providing advisory and consulting services and programmes for entrepreneurial development (Bruck, 1998).

The significance of this expansion of services can be seen in the New Strategy (www.dbsa.org) announced by the DBSA in which it seeks to increase its support for the private sector through capital expansion programmes and to increase its role in project preparation activities which includes advisory and consulting services to large scale projects. In light of this evidence it becomes clear that the purpose of state-owned banks is aligning itself to the vagaries of the global capital as will be explored below.

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2.2.4. Refocusing the development bank premise

This World Bank *Global Survey of Development Banks (2012)*, commissioned so soon after the global economic crises of 2008, serves to provide evidence for a refocus on the potential of state-owned development banks as conduits for financial flows from global financial institutions.

The study focuses, among other elements, on the growth rates, or increase in lending of development banks (e.g. the Bulgarian Development Bank is reflected as having a growth rate of 275% and regionally, the loan portfolios of the DBs in Asia experienced the highest growth rate (72%) in this period, followed by Americas (70%), Africa (60%), and Europe (12%). In this study growth rate is defined as the loan portfolios, or the size of the loans granted.

The study noted that between 2007 and 2009 the combined loan portfolios of Development Banks who formed part of the study increased by US $1.16 trillion to US $1.58 trillion dollars. In the period of the study these Development Banks provided more credit than private bank credit providers during the same period. It can thus be concluded that in this study Development Banks provided more and larger loans and credit than their private sector counterparts.

Significantly the study notes that Development Banks increased their short and long term lending to existing and new clients, including multinationals such as auto-manufacturer Chrysler who benefited from loans from middle-income country Development Banks. Given the convergence of the interests of private capital and state-owned banks to adhere to the strictures of the capitalist markets, are there alternatives to the current spaces which development banks occupy? This question will be explored below.

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2.2.4(a) Alternative Development Banks within the neo-liberalism context

Given the World Bank's neoliberal predilection, as noted by Marois (2013) in *State-owned banks and development: Dispelling mainstream myths,* many state-owned banks have restructured along commercial lines. They have adopted a neo-liberal philosophical approach which emphasises marketization and corporatisation.

This position is also confirmed above by Bruck (1998) who notes the dominant trends in global capitalism which have infiltrated the development premise of Development Banks. This is a relevant point and confirms the Wallerstein (1976) position as noted above, that the capitalist system is structured in a way that is punitive to systems and processes which threaten it pathways to accumulation.

Yeyati, Micco and Panizza (2004) note that during the 1980s and 1990s the role of the state in the economy was at the centre of the neo-liberal policies. According to Thorsen and Lie (2009: 6), neo-liberalism is a revival of liberalism, and most particularly a revival of economic liberalism in which the state does not intervene in the economy and leaves the individual to participate in free and self-regulating markets.

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In *Noam Chomsky and the Struggle Against Neoliberalism* (McChesney, 1999) the author 'refers to the policies and processes whereby a relative handful of private interests are permitted to control as much as possible of social life in order to maximize their personal profit'. Chomsky views neo-liberalism as the 'dominant global political economy trend' assimilated by right and left political parties acting in the interest of wealthy individuals and corporations.

Key elements of neo-liberalism, according to Stieglitz (2008) are the idea that markets will correct itself and that allocating resources through privatization could serve the public well. In this the privatization of welfare services (hospitals, education) and state-owned entities such as banks is a feature.

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Between 1987 and 2003, 250 state-owned banks were privatised, raising USD 143 billion (Yeyati, Micco and Panizza, 2004). Despite the pervasive privatisation policies of the neo-liberalism of the 1980s and 1990s the authors note that state-owned banks survived. By the mid-1990s a quarter of the assets of large banks in industrialised countries and 50% of assets in developing countries were under state control. This view may conclude that state-owned banks remain relevant in national economies for economic and social infrastructure development.

2.2.4(b) Rise of development banks post-2008

In the context of rise and proliferation of development banks it must be acknowledged that the post-2008 economic crises have seen the decline of the 'alleged waning geopolitical influence of the United States' (Desierto, 2015) and the rise of China's global financial influence.

Desierto notes the 2015 launch of the Chinese-led Asian Infrastructure Development Bank. Already France, Italy, Germany and Australia have indicated their willingness to join, with South Korea expressing an interest. The bank has been capitalized to the tune of USD 50 billion.

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2.2.4(c) BRICS Bank

A second example of the rise of alternatives to the current global development bank landscape is the BRICS Bank. BRICS is the acronym designating Brazil, Russia, India, China and South Africa. In *The Rise of Development Finance Institutions: South Africa, BRICS and Regional Strategy* (Qobo and Soko, 2015) BRICS is defined as a social, (Qobo and Soko, 2015) trade and economic group in answer to the powerful G7 nations established in the 1970s and led by the US.

BRICS Bank is anticipated to be capitalized to the tune of USD 50 billion and USD100 million in Contingency Reserve (Bond: 2013). The BRICS Bank, in

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making an impression on the developing world (Qobo and Soko: 2015) has the aim of making interventions in infrastructure development across the developing world.

Crucially the BRICS nations represent approximately 40 per cent of the world population. They generate approximately 20 per cent of world output and have accounted for 50 per cent of global growth since the end of 2009 (East Asia Forum, 2016). It is their industries who play a crucial role in developing industries dominated by global value chains. The role of BRICS as 'emerging protagonists' in the global arena is significant, particularly in the arena of international co-operation and development (Morazan, Knoke, Knoblauch and Schafer, 2012).

While the BRICS countries have been treated as 'junior partners' by the major emerged economies represented in the IMF-Washington consensus (Lavelle, 2012) the challenge by BRICS to the consensus, has been the establishment of New Development Bank (ChinaDaily, 2015).

The increasing relevance of BRICS boils down to three key points: 1) the size of their economies, 2) the increasing economic growth rates, and 3) their demand for greater political voice on the global stage in relation to their economic status (O'Neill 2001, in Morazan, Knoke, Knoblauch and Schafer, 2012).

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2.2.4(d) The View of the World Bank

The World Bank view of finding a development finance approach which combines the demands of capital markets with development finds traction in the *DBSA Annual Report 2013.* In reflecting on the 2008 global financial crises, the then Board Chair of the DBSA, Jabu Moleketi notes that South Africa and the continent (a nod to the Banks' regional mandate) can capitalise on infrastructure development and facilitate continental trade to develop ever higher levels of industrialisation and economic growth.

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This means that infrastructure investments must be leveraged to improve connectivity within the region and on the continent to boost trade flows, develop local industries, local markets and skills and integrate infrastructure in the region.

Qobo and Soko (2015) support this view when they note that a New Development Bank (in the form of a BRICS Bank) could be beneficial for South Africa as it could play a role in financing infrastructure projects on the continent and thus help reshape the structural transformation in resource-dependent economies in Africa and stimulating regional integration and act as a bulwark against globalization. The BRICS Development Bank is seen as a challenge to Western economic hegemony, and sees the alliance between the BRICS nations as a rejection of western neoliberalism (Desai, 2011). The section which follows will discuss global examples and perspectives on development banks.

2.2.4(e) The DBSA in relation to BRICS

In 2013 the DBSA's regional portfolio covered all 15 states in the Southern African Development Community. Qobo and Soko (2015) note the position of South Africa, in relation to furthering the BRICS and its Development Bank project and could help South Africa 'leverage development finance institutions under its ownership that have a continental reach'. The DBSA is cited as being positioned to benefit from the BRICS Development Bank in Africa. The New Development Bank of Brics is expected to blend its financing modalities to bring together private and public sources of funding, including development finance (Bertelsmann-Scott, Prinsloo, Sidiropoulos, Wentworth and Wood,2013). In addition, New Development Bank loans to the DBSA will 'help expand the scope of DBSA disbursements in line with its objectives…' (Mazenda and Ncwadi, 2013).

Bond (2013) provides a counter to this position when he notes that this strategy (of leveraging the BRICS Development Bank with South Africa's own continental ambitions) is 'sub-imperialism', i.e. dominating continental economic relationships in Africa. According to Bond by 2012 South Africa's leading objective of foreign

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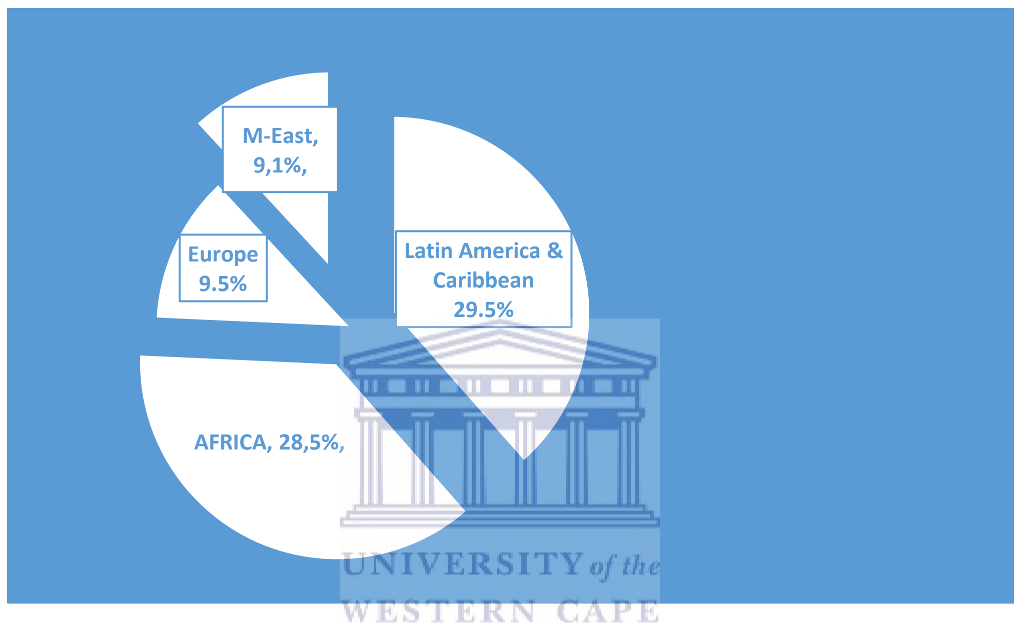
policy was to rationalize and facilitate 'tighter continental economic relationships' with the aim of exploiting the continents' USD 40 billion infrastructure needs spearheaded by it DBSA.

2.2.5. Development Banks: Global Scope

Figure 7: Global number of development banks per region



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Source: Authors' chart

Globally there are 550 development banks in all regions of the world (Bruck, 1998). Of this number 32 are international, regional and sub-regional banks and 520 are development banks representing 185 countries of whom all are members of the United Nations.

As can be viewed in *Figure6* the largest number of development banks is in the Western Hemisphere with 152 or 29.5% in Latin America and the Caribbean. Second is Africa with 147 development banks of 28.5%. Third is Asia and the Pacific with 121 development banks, or 23.4% followed by Europe with 49 development banks or 9.5%. The Middle East has 47 development banks or 9.5%. In terms of assets, Asia, the Americas, Europe and the Middle East rank ahead of Africa.

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2.2.5(a) Europe and Japan

In Europe and Japan, development banks played its part in the industrialisation of those regions after World War 2 (Cameron, 1961, and Armendáriz de Aghion, 1999 in Yayati et al). In Germany and Japan development banks helped to reconstruct those countries post the War, and in Europe, Credit Mobilier helped to finance the European railway system through partnerships with other banks. Furthermore, European regional integration offers examples of the creation of financial mechanisms.

These include the European Investment Bank (EIB) and European Investment Fund which aided greater regionalism between European member states and acted as the precursor to the European integration process (Enhancing the Role of Regional Development Banks Stephany Griffith-Jones with David Griffith-Jones and Dagmar Hertova No. 50, July 2000).

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The EIB aided in reducing the gulf between wealthy and poorer European nations, support for modernisation of industries which stagnated after World War 2 and finally to boost infrastructure development which assisted cross-border trade and investment.

2.2.5(b) Latin America

In Latin America there are many institutions that define themselves as development banks and form part of a continental association made up of 21 banks (Yeyati, Micco and Panizza, 2004). The Asociación Latinoamericana de Instituciones Financieras para el Desarrollo have 121 members and according to Yayati, Micco and Panizza (2004) the banks maintain their mandate of focusing on disadvantaged sectors such as agriculture(20% of its focus) and rural development.

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The authors note the example of the Mexican Banco Nacional de Crédito Rural (BANRURAL) which has a mandate to finance agricultural activities but has a large share of its branches in urban areas.

2.2.5(c) Eastern Europe

In the 1990s the transitional economies of the post-socialist countries of Central and Eastern Europe slowly introduced a two-tier system to its mono-banking system. In *State-owned Banks in the Transition: Origins, Evolution, and Policy Responses,* Sherif, Borish and Gross (2003) posit that Central Banks became responsible for the transition to a two-tier banking system which opened the way for commercial banking practices.

In this period of transition in the former republics of the Union of Soviet Socialist Republics (USSR), the state-owned banks of the Commonwealth of Independent States (CIS) continued to serve as the primary banking vehicle for directed lending and budget purposes, usually for loss-making state-owned enterprises and collective farms. Sherif, Borish and Gross (2003) provide the case of Armenia which after the collapse Soviet Union, inherited all five state-owned banks. Among these were Ardshinbank, Promstroybank, and Agrobank. In 1993 the banks accounted for more than 70% of the Armenian banking systems balance sheet. However, the banks were weak and unprofitable.

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In this example it can be seen how state-owned banking systems was at the mercy of external political forces. And while the political transition in the CIS is not the focus of this study, it must be noted, that like the DBSA, the state-owned banks also underwent a political and economic redirection after the transition from Apartheid.

Sherif *et al* (2003), provide a case for the commercialisation of banks, and advocate less state involvement in the banking system. Chief among their recommendations are restructuring and improving the business environment to allow for a more favourable investment for the private sector.

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2.2.5(d) Global: International Monetary Fund

The International Monetary Fund was set up in 1944 after the Second World War (Lessambo, 2013). *The International Banking System: Capital Adequacy, Core Business, and Risk Mangement* (Hampshire: Palgrave Macmillan), p. 79 (). Led by British economist John Keynes and American Secretary of State Harry Dexter, the global institution was set up to assist member states tasked with rebuilding nations after the War. It was essentially to facilitate international trade and control foreign exchange.

By 2013 the initial number of IMF Member States had grown from 44 to 187. Stieglitz (Governance: An International Journal of Policy, Administration, and Institutions, Vol. 16, No. 1, January 2003 (pp. 111–139) 2003) posits that by 1997 the IMF went contrary to its financial development principals by making 'capital market liberalisation' part of its mandate.

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So instead of promoting global economic stability the IMF, through its Structural Adjustment Programmes (SAPs), in-fact destabilised the global economy (Easterly, 2005. Journal of Development Economics, pg. 1-22). The SAPs enforced strict privatisation conditionalities to sovereign state loans. Between 1980 and 1988 Ghana had 26 IMG SAP loans, while Uganda, 20 lMF SAP loans at interest rates of 16% and 18% respectively. During the same period both these countries experienced negative trade growth (-0.6% and -2.3% respectively).

2.2.5(e) Asian Development Bank

The Asian Development Bank (ADB) was founded in 1966 (The Asian Development Bank and Developmental Regionalism in East Asia, Christopher M Dent, Third World Quarterly_Vol. 29 , Iss. 4,2008 Kilby, 2006). The organisation of the Bank is loosely based on the World Bank configuration and this speaks to the role the US has played in the Banks' development.

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The Bank however has increased its East Asian regionalist focus in recent years linking development, regionalism and capacity building among its members. The lending and borrowing modalities of the Bank which seeks to minimise the risk to the Bank, while offering a range of flexible lending instruments to sovereign states which include: flexible lending rates terms based on the London Interbank

2.2.6. Deriving capital for development banks

As its name suggests, and as the definitions and case studies note above, development banks are in the business of developing economic or social benefit sectors for the betterment of public good. This view is articulated by Marois and Güngen (2013) in *Reclaiming Turkey's state-owned banks* when they note that state-owned banks are 'institutions of social power and provide funding for the provision of essential services such as electricity, water and health-care'.

How that social power is articulated and expressed, as we see from the Commonwealth of Independent State case studies noted above, the policy direction of a state-owned bank is influenced by the external political and economic forces. Where banks derive their capital is also a highly contested arena and is reliant on the development agenda objectives of the state.

In *Global Survey of Development Banks*, Luna-Martinez and Vicente (2012) note the various models of funding for development banks. These include taking savings from the public, borrowing from other financial institutions, raising money in capital markets, using their own equity and receiving allocations from the state. Many development banks use a combination of all of these.

Rudolph (2007) in Luna-Martinez and Vicente is of the view that not taking deposits from the public allows development banks to focus on their lending operations while avoiding competition with private banks. The Luna-Martinez and

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Vicente study claims that not much is known about development banks, what their policies are, how they function and what their business models are.

This claim is countered by Marois and Güngen (2013: 4) in *Reclaiming Turkey's State-owned Banks* when the authors note the role which Turkish State-owned banks have played: *'State-owned banks have been at the centre of Turkey's national developmental and public infrastructure building strategies from the early 20th century. For decades, the state banks have worked sustainably toward achieving their institutionalized developmental mandates, funding industrialization, public infrastructure, other state-owned enterprises, agriculture, small trades, co-operatives, and so on'.* The advantage of indigenising revenue gathering safe-guards against stringent or punitive loan conditionalities from foreign capital markets.

Marois, in his paper *State-owned banks and development: Dispelling mainstream myths* (2013), is of the view that development banks and its potential for alternative ways of financing development have been side-lined by neo-liberal restructuring of financial systems. Marois notes that 'neoliberal restructuring brought significant market-oriented changes, such as marketization and corporatization'.

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Sherif (2003) advocates a more neo-liberal privatisation of state-owned banks and asserts that state interference in development finance are bad for development. Historically there has always been a relationship between public institutions and lending for development of public goods (Marois 2013; Marois and Güngen, 2013). Public finance mechanisms have also mitigated the excesses of lending in the private sector.

The neo-liberal agenda painted a picture of development banks as bad for development. In response they were restructured along pure business lines. Marois (2013) asserts that despite this development banks can provide lessons for alternatives to public financing against neoliberal strictures. In *State-owned banks*

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and development: Dispelling mainstream myths (Marois, 2013) states that 22% of development bank assets remain in state control in emerging economies.

Marois points to the 2008 economic crises where trillions of dollars of public finances provided bailouts for private banks. He views this as underscoring the necessity of situating ‘progressive public banking alternatives’. A progressive alternative points to the tension between private development finance and public development finance.

As Marois states (2013: 4) ‘Rather than being driven exclusively by profit imperatives, state bank ownership and control can enable the extra-market and political coordination of financing for public infrastructure… This is because state ownership entails a different reproductive basis than that of private banks. Whereas private banks must compete for profit to survive, SOBs can exist without having to turn a surplus’.

2.2.7. Towards an alternative model of development banks

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In *Should the Government be in the business of banking? The Role of State-owned and Development Banks*, Yeyati, Micco and Panizza (2004), and in concurrence with Marois (2013), present evidence that the state-owned banking sector in Latin America, most notably Brazil, Columbia and Argentina, increased their share of loans to the public sector. In addition, while the profitability of banks in Honduras and Columbia is relatively low, Brazil and Honduras charge the lowest interest rates.

While the low interest rates can be ascribed to high levels of state subsidies, the authors acknowledge that ‘state-owned banks may not maximise profits but social welfare’. Further stated while a state-owned bank may lose money, it increases the ‘positive externalities’ of society.

2.2.7(a) Alternatives: Turkey

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In *Reclaiming Turkey's State-owned Banks*, Marois (2013) gives the example of the Turkish development banks which overturned the neoliberal damage done to its development premise. Turkey's three large state-owned commercial banks and three smaller development banks continued to offer alternative sources of financing for development.

Collectively they control 30% of the banking sectors' assets (nearly USD193 billion) and work in a sustainable manner to achieve its public infrastructure goals, industrialisation and developing smaller trades and cooperatives. Marois (2013) does provide an indication that providing for infrastructure and general development does not have to come at the price of a people-centred approach to public financing.

It is however necessary to reflect on indicators of a 'people-centred' approach to public financing by state-owned banks and multi-lateral organisations: the rate of interest; period of loan and terms and conditions of financing. Lloan conditions can be a contributor to long term prosperity for an area, or mire generations of residents with loan repayments which they may not be able to honour because of structural poverty linked to under-development.

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2.2.7(b) Alternatives: Caribbean Development Bank

An example of loan conditions which can contribute more positively to development is the Caribbean Development Bank (2008). This development finance bank has a lending rate to public sector borrowers of 6.03% per annum with interest rates reviewed on a 6-monthly basis. The Bank also offers a grace period determined by the states' ability of to repay which may not exceed ten years.

As the bank has a Caribbean regional scope countries wishing to borrow are classed in Groups from one to four. Countries in Group 1 have an interest rate of 5% per annum, a grace period of repayment of 5 years and maximum loan period of 10

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years. Those countries classed in Group 4 have an interest rate of 2%, a grace period of repayments of 10 years and a loan maturity period 30 inclusive of the grace period. The CDB offers both private and public lending services in the region of the Caribbean.

Its procurement policy stipulates that borrowers must procure goods and services for projects from Member Countries of the Banks' region. In addition, the bank offers a 'retroactive financing scheme' which serves as an incentive for good repayment records. On this scheme, borrowers are able to claim back repayments to expenses incurred within 12 months of the approval of the loan.

2.2.8. African Development Bank

The Resolution to establish the African Development Bank (ADB) was passed in 1963 at a Conference of African Ministers of Finance and formally came into being in 1966 (Giuseppe Schiavone, 2005, International Organisations, A Dictionary and Directory). Like its counterparts in the other regions, membership is restricted to member African states but in 1979 membership was opened to non-African state actors, with a specific focus of retaining the African character of the Bank.

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The capital stock of the bank was valued at $29 billion in 2002 and its 2015 Financial Statements (www.adfb.org) is reported at UA 4.69 billion. The bank offers a range of borrowing and lending instruments commensurate with the sectoral specificities of its member clients. Like the IMF the ADB has a series of Structural Adjustment Programmes and Sectoral Adjustment Loans as part of its basket of lending and technical assistance instruments.

South Africa has a series of ADB loans for infrastructure which have been approved (www.afdb.org). These include USD 2,147,483,647 for the Eskom Power Project, (currency not indicated) 950,000,000 for the Medupi Power Project Supplementary Loan, (currency not indicated) and 600 000 000 (currency not indicated) for Eskom Transmission Improvement Project

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2.2.9. The Development Bank of Southern Africa (DBSA)

The section which follows will give a broad review of the literature dealing with the DBSA. This will include a discussion on its historical beginnings, its relationship with municipalities, and the regulatory framework which governs it.

2.2.9(a) DBSA: development premise

The DBSA was established in 1983 with the specific intention to advance apartheid capitalism in the home-lands. According to Lipton (1985; p30) the need for African labour meant that only political and not economic segregation was envisaged. It was Prime Minister Malan who saw the whole Apartheid National Party economic edifice built on native labour. Apartheid architect, Hendrik Verwoed, went further to cement this idea by stressing that it was the aim to not 'stop economic growth, but to control it and make it compatible with apartheid and white security'.

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Dr Ian Golding, who served as DBSA Chief Executive in 1996, noted in his submission to the Truth and Reconciliation Commission in 1997 (TRC, Business Sector Hearing) that the Bank was established to 'promote an investment of public and private capital for development purposes' and to mobilise funds to prop up the collapsing economic edifice of the apartheid structure.

2.2.9(b) DBSA: historical context

The historical purpose of the establishment of the DBSA remains intact: to promote investment for development purposes. The thesis remains to prove: do the terms and conditions of lending and borrowing diminish or perpetuate inequality at the municipal level?

There is evidence of a clear alliance between the then capitalist apartheid-era government and white capital. This is particularly evidence by O'Meara (1975;

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1977; 1997) in his seminal work on the rise of Afrikaner capitalism and Afrikaner nationalism.

The rise of industrialisation and the growth of war-time industries in South Africa saw the South African economy expand during the years 1939 and 1946. Manufacturing establishments grew by more than 950 in the decade between 1935 and 1946. The historical role of the Afrikaner *Broederbond* (Brother-hood) in directing and influencing the trajectory of Afrikaner capitalism cannot be under-stated (O'Meara).

The establishment of media group *Nationale Pers* (National Media), and financial institutions such as Sanlam and Santam, founded in the first decade of the 20th century, has its roots firmly in the Afrikaner *Broederbond.* By 1948, the influence of powerful corporate, mining and agricultural business interests, rooted in the Afrikaner *Broederbond*, established its powerful impact on the political, economic and cultural landscape of South Africa (O'Meara).

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The section which follows will develop the conceptualisation of the lending and borrowing framework of the DBSA loans to municipalities.

2.2.9(c) Institutional framework for DBSA lending and borrowing modalities

The exploration into the lending and borrowing modalities of the DBSA to South African municipalities takes its mandate directly from the post-apartheid development agenda of the South African state. The institutional framework and policy objectives for the deracialising of development at local government are set out in a series of institutional and legislative instruments. These include Chapter 7 Section 152 (b, c) and 153 (a) of The Constitution which describe the objectives and development agenda of municipalities and sets out the Constitutional requirements for the delivery of services to communities.

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In addition, infrastructure development is set out in a range of institutional, policy and development frameworks which include the Municipal Systems Act 2000 which enables municipalities to move towards a progressive realisation of 'social and economic upliftment of communities'; and the Municipal Finance Management Act No. 56 of 2003 which oversees the financial management of municipal finance systems including the transfer of intergovernmental grants and funding.

In 2014 the DBSA launched the Infrastructure Investment Programme for South Africa (IIPSA) (DBSA website) **to** provide grant funding in support of loans for essential infrastructure projects in South Africa and the region. The fund is worth R1.5 billion.

Evidence of the DBSA's strategy to provide loans for infrastructure is found in the 2014 loan agreement signed with the City of Tshwane, a metropolitan municipality. The loan is worth R1, 6 billion, will be taken over a 20-year period and is for the exclusive purpose of capital expenditure projects to support infrastructure development in water, sanitation and electricity.

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2.2.9(d) DBSA and the States' Infrastructure Development Agenda

Providing infrastructure is a key driver of local government. According to Perkins (n.d.) the development of South Africa's 'economic and social infrastructure has a long and troubled history'. In his view the legacy of apartheid infrastructure are under-developed and unequal communities. A further testimony to the inequality entrenched by apartheid remains in the 'hopelessly inadequate' social and economic infrastructure which is unequally distributed and still impacts negatively on social and economic growth and development'.

This provides evidence of the States' rationale for developing infrastructure. Municipalities at local level are mostly responsible for the development of physical infrastructure to deliver basic services. An intricate system of municipal funding

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mechanisms exists through intergovernmental transfers, commercial loans and development bank loans.

The DBSA describes itself as playing a pivotal role in the delivering infrastructure to South African and the rest of the continent (DBSA website). The Banks' vision, mission, and strategic objectives mirror the broad development objectives of the South African state.

Legislatively the Bank is regulated through the Development Bank of Southern Africa Act of 1997, and performs an economic development function within the context of the South African constitution. The Banks' key strategic objectives are sustained growth in in developmental impact and financial sustainability.

2.2.9(e) DBSA Strategic Development Goals

These strategic goals are an abstraction of the developmental state ideology as premised in the numerous growth plans delivered by the ruling African National Congress over the past decade and a half. Evans (1995:29), in Gumede (2011), offers that the construction of a developmental state requires specific historical endowments and characteristics. South Africa's record levels of inequality, with its racial under and overtones remain a potential source of instability and hindrance to economic development.

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In addition, the task for building the developmental state remains the simultaneous projects of building a unified nation which share universal aspirations out of the scarred ashes of apartheid, while strengthening the democratic project and its institutions. The DBSA situates an abstract notion of its mandates in the developmental state ideology. In practice, as the research may very well show, its operations mirror private sector commercial practices.

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2.2.9(f) DBSA: Borrowing and Lending

The Banks' lending and borrowing is premised on infrastructure development and commercial viability (DBSA website), yet its client-base, predominantly local and provincial government entities, are already mired in deep structural social and economic dysfunction. Secondly, the DBSA through its Accelerated Infrastructure Delivery Programme aims to deliver infrastructure, not through bricks and mortar projects, but through Project Management Units (PMU) for the health and education sectors.

The DBSA will be paid for these services through inter-state grant transfers. In other words, 'the top-line slicing of sectoral conditional grants' (DBSA website) transferred from National Treasurery to the government departments, and then deposited in tranches to the DBSA as a project management fee are established.

These purely commercial bank practices such as offering project management services to provinces, and 'slicing' fees from government transfers, will not build a developmental state, but further entrench a capitalist orientation to a development bank institution.

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2.2.9(g) Public/private Partnerships: The New Strategy of the DBSA

In the DBSA's *Launch of New Strategy (2012)* the bank also notes Private-Public Partnership (PPP) deals have historically been driven by the state with a limited space for the DBSA. It aims to alter this by strengthening its networks in the public and private sector and working to 'unblock the PPP pipeline' and increase its lending in the PPP market to R3.5 billion. PPPs have been held as the panacea for reforming 'the high cost of government' intervention (Kessides, 2004). According to the author 'rebalancing the roles of the private and public sector has been an integral part of infrastructure reform'.

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In *Launch of New Strategy* (2012) the DBSA acknowledges that it will partner with the private sector using the banks own debt and equity to invest via third party intermediaries. The DBSA Act of 1997 Section 3 (1a) says that the bank will mobilise 'financial and other resources from the private and public sectors, national or international'. This would suggest that the Bank sees itself as a public sector entity operating within the domain and rules of engagement of the private sector.

This view is reinforced by Liebig (2008) in *Municipal Borrowing for Infrastructure Service Delivery*. This work notes the tension between public borrowers such as the DBSA and private borrowers. The author notes that (at the time of publishing) the DBSA held half of all outstanding municipal debt while both public and private borrowers targeted the same municipalities. In its investigation this study used a qualitative and quantitative study to collect data from a sample of 29 municipalities and conducted 66 interviews. The question they asked was if municipal borrowing improved infrastructure delivery.

The overall answer to this question is that municipal borrowing did in fact strengthen service delivery. However, in the context of the fact that a public borrower such as the DBSA held most of the debt of municipalities, and competed with private borrowers for the same municipal bond market, growing evidence in the literature would suggest that these motivations pull the DBSA closer to a market-driven neo-liberal approach and further from its stated mandate to support the infrastructure development in the municipal market.

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2.2.9(h) DBSA: Private Sector cites unfair competition from DBSA

More evidence of the DBSA's market driven approach is offered by Liebig (2008). The author notes that private lenders report 'unfair' price competition by the DBSA in the municipal market segment winning most of the tenders. Sixty-four percent of its portfolio, at the time of the study, was in the Metro municipal market (urban centres such as Johannesburg, Cape Town and Durban) which offered greater returns on borrowed capital and a more reliable institutional capacity to manage

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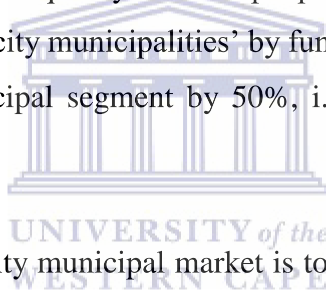
expenditure (Liebig, 2008). Greater effort should in fact go into targeting municipalities that have lesser prospect of attracting private capital.

2.2.9(i) DBSA: a refocused approach to support the development agenda

In 2012 The Development Bank of Southern Africa underwent restructuring and identified a new strategy (*DBSA Annual Report, 2012*). The DBSA is entirely state-owned as set out by the Development Bank of Southern African Act of 1997. Key among goals in its 2012 vision was to double its loan book to R91 billion by 2017, and increase its presence in the municipal market.

Despite its development speak of 'accelerating sustainable socio-economic development to improve the quality of life of people' its goal is to 'increase its asset base in the medium capacity municipalities' by funding infrastructure and increase its lending to this municipal segment by 50%, i.e. from R200 million to R400 million per annum.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Its goal in the low capacity municipal market is to lend less for development, and to act more as a catalyst for development. To this end the Bank will play a management role in the delivery of infrastructure to low capacity municipalities in the national Integrated Municipal Infrastructure Programme. It also sees a stronger role in Public-Private Partnership deals and will use its extensive networks in the public and private sector to tender for deals (DBSA website, 2012).

Bond (2013), in his paper *Frustrated global governance reform, sub-imperial geopolitical-economy and BRICS banking: A view from South Africa* questions the banks' commitment to its public sector development finance imperatives, when in the same period the bank announced its new vision, it loaned R3.2 billion to finance the development of a hotel in the centre of Cape Town.

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This loan represents 7% of its investment portfolio. There are some critics who hold the view that this investment could better serve the much needed development of roads, sanitation, water and electricity provision in poor communities.

The refocusing of the DBSA in its 2012 vision in the context of the states' infrastructure development agenda has been much encouraged, particularly by the amendment to the DBSA Act to increase the banks' capitalisation from US$480 million to US$2 billion (Qobo, undated power point presentation) particularly to support the capacitation of low functioning municipalities.

2.2.9(j) Shortage of critical analyses of DBSA

However, there has been a shortage of critical academic analysis, barring the work of Patrick Bond and Richard Kamidza, of the new vision for the DBSA and its less than sterling performance during the period. Given the state-owned status of the bank, Bond and Kamidza (2014) critique the banks' growing bias towards privatisation in its regional finance development mandates. In Lesotho, the DBSA disbursed about R740 million to Tsepong, a public–private partnership (PPP) consortium led by South African private hospital and healthcare group Netcare, to construct, upgrade and operate a new public hospital at Bots'abelo in Maseru.

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Similar PPP financing of R1.4 billion was provided to Infralink Pty Ltd – a joint venture between the Zimbabwe National Road Administration and Group Five Limited of South Africa – to rehabilitate roads and implement tolling of existing national routes, covering 801.5 kilometres on an east-west axis from Plumtree through Bulawayo to Harare and then Mutare (Bond and Kamidza, 2014).

2.2.9(k) DBSA Loans and conditionalities

The issue of transparency and open-ness in the research became apparent when trying to compare and investigate the terms of conditions of borrowing by the DBSA. Details of every sovereign loan issued to country borrowers since 1947 can

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be found on the World Bank website (http://data.worldbank.org/data-catalog/projects-portfolio). The Caribbean Development has a list of all approved loans, including loan periods and interest rates on its website (http://www.caribank.org/projects/loan-grant-project-summaries).

In comparison, the DBSA website, nor in its repository of publications found on its website, has any evidence of its loan conditions to municipalities or regional borrowers. Nor does it have any information on its interest rates, grace periods, financial covenant policies or retro-active financing schemes. The Development Bank of Southern Africa Act (1997) is silent on the Banks' responsibility to transparency to South African public.

The DBSA Amendment Bill (2014) authorises an increase in share capital and a host of amendments which increases the Banks' ability to leverage profits. Share capital is defined as the 'maximum capital the bank may raise' (DBSA Amendment Bill Standing Committee on Finance, 2014). The share capital of the bank was moved from R5 billion to R20.2 billion (Peoples Assembly Blog, 2014).

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Within the context of a legislated profit motive via the DBSA Amendment Bill (2014) which gives the Minister far-reaching powers to increase the share capital a critical question which must be asked is: what is the influence of the profit motive on the Banks' mandate to provide infrastructure financing to municipalities? This critical question must be prefaced with a perspective on the current economic circumstances of post-apartheid municipalities. The section which follows will review the literature dealing with local government municipalities.

2.2.10. Municipalities: at the coal-face of infrastructure delivery

In *The Revitalisation of Local Government in South Africa* (Nyalunga, 2006), governments and municipalities are 'defined as political units' and have substantial control over local affairs. The apartheid-era of local government system was designed to regulate the States' agenda of 'racial segregation and exclusion'.

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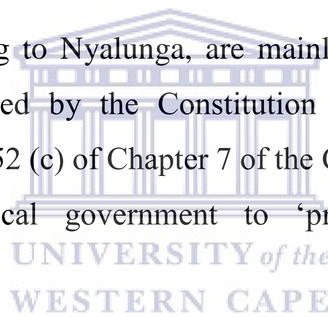
Chapter 7 Section 151 of the Constitution of South Africa describes and regulates the powers and mandates of local government. Since 2000, 47 new municipalities have been created outside urban metropolitan areas (Steytler, 2009). The process of local government transformation took place between 1995 and 2000.

Nyalunga (2006) notes the 'building blocks' of legislation which ensured a shared power of authority and responsibility between national, provincial and local government. The Local Government Transition Act (1993), the Development Facilitation Act (1995) and the Constitution (1996) has paved the way for co-operative governance which ensures that the state takes legislative responsibility for eradicating poverty and deracialising the delivery of basic services and public goods.

Municipalities, according to Nyalunga, are mainly responsible for delivering of services and is mandated by the Constitution to 'work towards sustainable development'. Section 152 (c) of Chapter 7 of the Constitution and Section 153 (a) specifically charges local government to 'promote social and economic development'.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2.2.11. Structure of Municipalities

The structure of municipalities is legislated through the Municipal Structure Act (117 of 1998), and has been amended between the years 2000 and 2003 through the Local Government Municipal Structures Amendment Acts 1, 20 and 33. The Act and its Amendments sets out categories of municipalities, its powers and functions. There are 278 municipalities in South Africa and they are broken down into three categories. There are 8 metropolitan municipalities, 44 district municipalities, and 226 local municipalities (Institute for Race Relations Local Government Report, 2014). This is a single tier municipality and has exclusive legislative authority vested in a metropolitan council.

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The second delineation is Category B Municipalities. These are areas that fall outside of the eight metropolitan municipal areas and are divided into local municipalities. This category of municipality shares municipal executive and legislative authority in its area with a category C (district) municipality within whose area it falls. Theewaterskloof, the focus of this research project, is classified as Category B.

Category C District municipalities are made up of a number of local municipalities that fall in one district. There are usually between four and six local municipalities that come together in a district council.

The category of municipality is significant and can be described as an indicator of the legacy of apartheid-era separate development policies, and a failure of the past 20 years of democratic dispensation to equalise development. In a study on indicators of poverty conducted by the Institute of Race Relations (IRR) (2014) revealed that the Alfred Nzo district municipality in the Eastern Cape has the highest poverty rate, at 79%.

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2.2.12. Apartheid-era poverty in municipalities persists in the 21st century

The lowest rate among all the district municipalities is that of the Cape Winelands district municipality in the Western Cape, at 48%. The metropolitan municipality (metro) with the highest poverty rate is Buffalo City (East London), at 60%. Cape Town has the lowest, at 44%. The local municipality with the highest poverty rate is Matatiele in the Eastern Cape, at 98%. The lowest poverty rate is in the Overstrand local municipality in the Western Cape, at 11%.

It is important to note that Alfred Nzo, Buffalo City and Matatiele municipalities are located in the former Bantu-Stan province of the Eastern Cape, a structural apartheid-era reservation. The district municipalities with the lowest levels of poverty are found in the Western Cape, a historically wealthy urban city.

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Ninety percent (90%) of households in the Alfred Nzo municipality have no access to flushable toilets. It is also the municipality with the lowest percentage of population (13%) aged 20 and older who do not have Grade 12. In comparison the Metro of Cape Town has the lowest percentage of poverty (44%), the Cape Winelands has the lowest percentage of unemployment (44%) and the West Coast District Municipality has the lowest youth unemployment percentage at 20%, compared to Sekhukhune district municipality in Limpopo at 61%.

These percentages are significant in that they confirm the inequality between provinces and municipalities. The Alfred Nzo district municipality does not only have the highest rate of poverty in the country, but in 2006 signed a DBSA loan agreement of R25 million over 20 years with a 5% annual interest rate.

In the work of Nyalunga and Steyler (2006) the following conclusions can be drawn: 1) local government has been overhauled through various legislative building blocks; 2) resource distribution at the local level was devised on an apartheid-era race discrimination; 3) the backlog in infrastructure development today can be traced to the apartheid-era distribution. It is within this context that municipalities are constitutionally tasked with the responsibility of 'local infrastructure and basic services (Josie, 2008).

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2.2.13. Infrastructure financing to municipalities

In the financial year 2012-2013 municipalities spent R19.4 billion or 84.6 per cent, of their infrastructure grants. Of the R104.6 billion allocated to municipal infrastructure grants over the MTEF 2014 period, 44.4 per cent is allocated to metropolitan municipalities and 32.1 per cent to the 70 most rural local municipalities and the district municipalities that provide services in these rural areas.

The State thus allocates large budgets to the development of infrastructure through transfers and grants to provincial and local government. In the context which has

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been described above the role of the DBSA becomes significant and necessitates a critical national conversation to engage with the States' mandate on encouraging external local government loans for infrastructure development.

In a 2008 Treasury review (2008) the review notes 'municipalities have not yet used the opportunity to borrow more creatively from capital markets'. The review further notes that local government is not using the design of its structure to 'stabilise municipal finances in a macroeconomic environment that is more enabling for private investment'.

In the 2011 Treasury Review it is noted that 'borrowing to finance their (municipalities) infrastructure needs is not an option, unless provided on special terms by development finance institutions'. Between 2005 and 2010 the growth of private and public sector borrowing grew from R18.7 billion in 2005 to R38.1 billion in 2010. This represents an average annual growth of 15 per cent.

The review also notes that the significance of public sector borrowing as lenders in the private sector had become more 'risk averse' during the global economic recession. The public sector lending during this period was 'almost entirely' from the DBSA and exceeded private sector lending in the municipal borrowing market for the first time.

This is significant as it points to a strategic shift in the borrowing practices of municipalities in favour of the DBSA. DBSA municipal funding programmes such as the Accelerated Schools Programme which supports the building of schools, the Programmatic Carbon Credit Facility which aims to reduce carbon emissions through state housing design and the Infrastructure Delivery Division which assists the State to implement its infrastructure programmes (DBSA website) have all been established to facilitate infrastructure project implementation and financing.

Despite the honouring of the mandates to progress infrastructure development through the DBSA's legislated grants and loan schemes to municipalities, the

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question which must be addressed is whether municipalities with low revenue bases (such as the Alfred Nzo municipality), low levels of skilled and educated labour (such as the Alfred Nzo municipality) and still large infrastructure backlogs (as evidenced again in the Alfred Nzo municipality) can honour loan repayments of R25million.

This concludes Chapter 2. The Chapter which follows will present the findings of DBSA and commercial bank loan agreements with the Theewaterskloof municipality.

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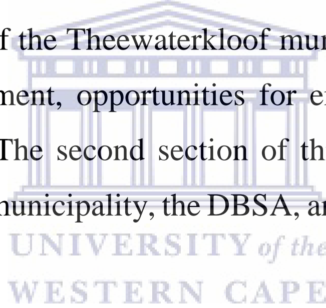
CHAPTER 3: PRESENTATION OF DATA AND FINDINGS

3.1 INTRODUCTION

The Theewaterskloof Local Municipality is situated in the Overberg District in the Western Cape Province. It is one of four municipalities in the district, making up a third of its geographical area. The towns in the Local Municipality include: Botrivier, Caledon, Genadendaal, Greyton, Riviersonderend, Tesselaarsdal and Villiersdorp. It is the largest Local Municipality in the Overberg District, and demarcates 13 municipal wards. It is a rural municipality (Theewaterskloof, IDP, 2016) with predominantly farming and agricultural activities.

This chapter provides a presentation of the research findings and research analyses. It will present a profile of the Theewaterkloof municipality with specific focus on local economic development, opportunities for employment, population profile, and household income. The second section of this chapter will review the loan agreements between the municipality, the DBSA, and commercial banks ABSA and STD Bank.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3.2. INFRASTRUCTURE PROFILE

Theewaterskloof has historical backlogs in infrastructure and bulk service provision. Infrastructure backlog is estimated at R473 969 409 (Theewaters IDP, 2016). Existing infrastructure and bulk services are not responding to the growing demands due to population growth, and the changing needs of the communities in the municipality.

3.2.1. Housing

The biggest challenge to Theewatersklood, in terms of infrastructure is addressing the housing backlog and to ensure that the necessary bulk infrastructure is in place in order to meet the future demands.

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3.2.2. Water

Eighteen percent (18%) of the water supply infrastructure in Theewaterskloof, and 26% of sanitation infrastructure is in very poor condition. The municipality estimates that significant resources are requires to address refurbishment or replacement. The estimated cost values of the municipalities water and sewer Master Plans is between R205 million and R113 million respectively.

There is also the challenge of allocating finance resources to essential rehabilitation and maintenance of the existing infrastructure in addition to expanding services to poor communities within the Municipality. Due to the lack of adequate funds, such maintenance is however in competition with the need to extend services to the poor communities. The lack of maintenance of existing assets could result in the total collapse of such service with enormous economic consequences (Theewaterskloof IDP 2016).

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3.2.3. Energy

Eskom is the main energy provider in the municipality. The municipality does however provide electricity supply for 4 of the 8 towns in its jurisdiction. These are Caledon, Greyton, Villiersdorp and Riviersonderend. A total number of 5260 households are supplied. There are no other energy sources available or supplied.

3.2.4. Roads

Theewaterskloof acts as a road agency for the Overberg District Municipality. The quality of roads is fair to good. There is a limited public transport system, with mini bus taxis being the main provider. Neither public transport systems or non-motorised infrastructure is of a good quality and requires upgrading.

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3.2.5. Telecommunications

There is no provision for telecommunications infrastructure development cited in the Theewaterskloof Integrated Development Plans 2016-2017. Telecommunications is not a local government function.

3.2.6. Local Economic Development

Economic growth in Theewaterskloof has been relatively small, and slow in comparison to the population growth. As a result, per capita income has consequently declined which has impacted on household income. A knock-on result of this is a considerable decline in municipal revenue collection. The overall consequences are smaller resources available in the local economy (Theewaterklood IDP, 2016).

3.3. OPPORTUNITY FOR INCREASED EMPLOYMENT

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The number of unemployed people has grown. In Theewaterskloof. Despite the agricultural sector the largest site of work opportunities, the sector is likely to continue to shed jobs with estimates of a possible further 3 000 jobs lost. The IDP forecast that this is a direct result of global competition, climate change and the rising costs of inputs into production.

While alternative growth sectors in construction, tourism and agro-processing do exist, its potential to employee large numbers are not positive and are likely to replace only about a third of the jobs lost in agriculture. Unemployment in Theewaterskloof is therefore likely to keep growing, reaching 44% of the working age population by 2030. The current dependency ratio is also likely to increase peaking at 4.32 in 2030.

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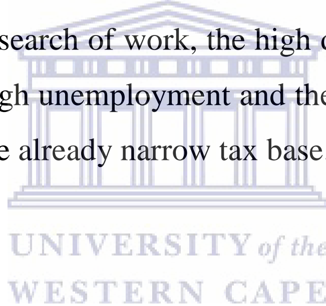
3.4. OVERALL SOCIO-ECONOMIC INEQUALITY

Theewaterskloof has high levels of inequality with a large social and economic divide between white farmers who have historical ownership of agricultural lands, and the unskilled migrant agricultural workers. In addition, the patterns of economic migrancy from other provinces have also impacted on the demand for infrastructure and bulk services. This, in turn, have placed a burden on the municipal revenue collections for services.

3.5 NARROW REVENUE COLLECTION RATES

Theewaterskloof has a narrow rates base. As the municipality is not the main electricity provider, it cannot secure this as a source of income. The influx of indigent communities in search of work, the high dependency of seasonal work in the agricultural sector, high unemployment and the overall poor economic climate have all contributed to the already narrow tax base.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3.6 POPULATION

The overall population of Theewaterskloof is 121 739, with an annual estimated increase of 1.5%. The most notable areas on this table is the age profile and the dependency ratios. Twenty-five percent (25%) of the population is under 14 years old, while 69% is between 15-64. A smaller percentage is over 65 years. The largest segment of the population (69%) is of economically viable age.

Yet, Theewaterskloof has a high dependency ratio. This means that the difference between those of working age (15-64 age bracket) and those of non-working age (0-14 and 65+) is very high (http://geographyfieldwork.com/PopulationDependency.htm). While there are advantages to this situation such as providing a large workforce and providing a market for goods, the disadvantages are that a larger population will put strain on services, education, food supplies and employment.

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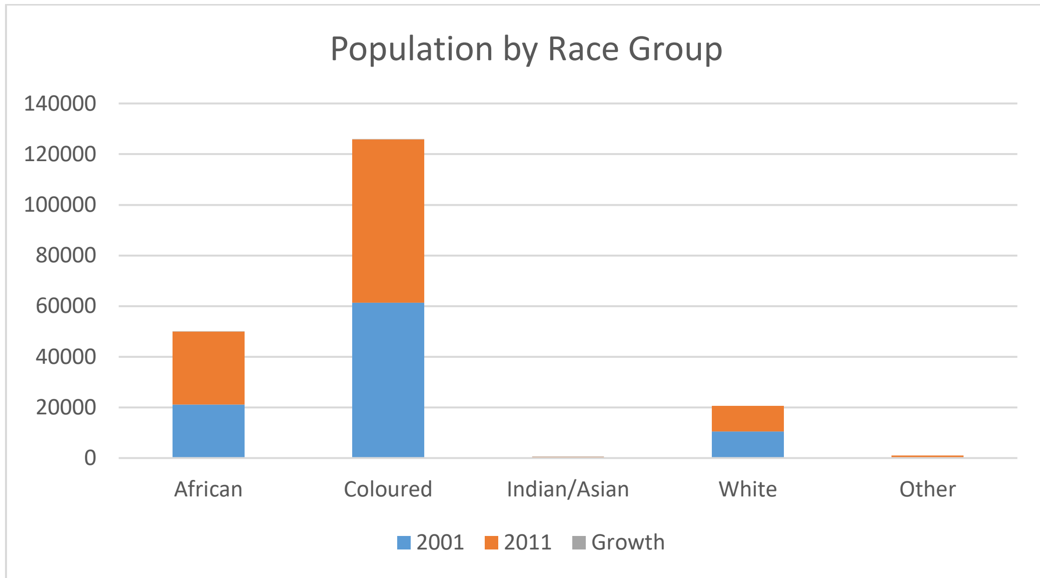

Figure 8: Population overview of Theewaterskloof municipality

Source: Theewaterskloof, IDP 2016-2017

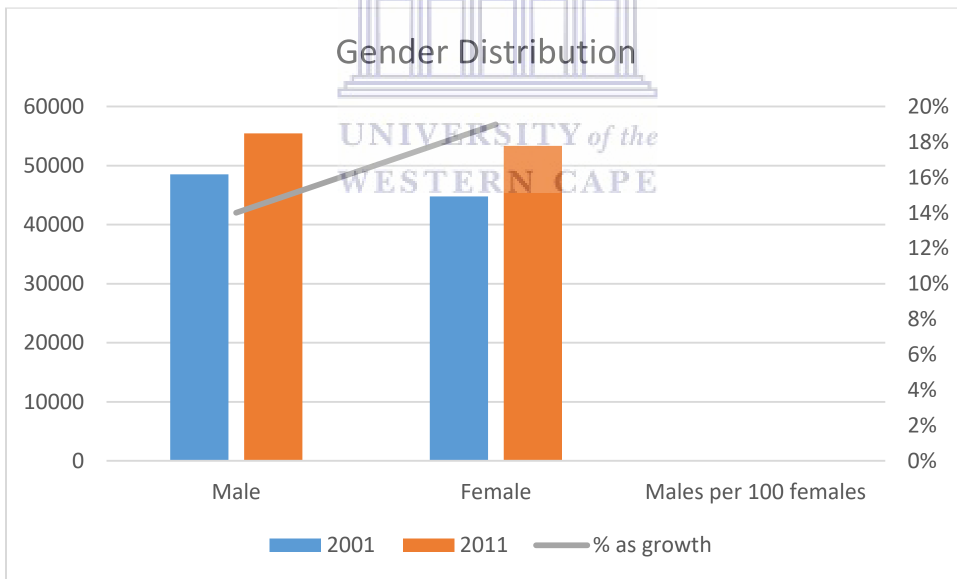

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Figure 9: Gender Distribution of Theewaterskloof municipality

Source: Theewaterskloof, IDP 2016-2017

The coloured racial group was the largest in the municipality in both 2001 (61 370) and 2011 (68 478). This shows a growth of 11.58%. The white racial group share of the total population increased from 21 204 in 2001 to 28 757 in 2011. The Indian/Asian racial group is relatively small comparatively but does show a steady

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growth. These patterns of population growth continue the racial demographics of the rural countryside as a legacy of Apartheid.

The gender distribution in the municipality, according to the 2001 and 2011 Census estimates, shows that males are the majority, although females show bigger growth in 2011.

3.7 HOUSE-HOLD INCOME

In 2011, 13.7% of households in the Local Municipality earned less than R400 per month. The area also has the lowest GDP rate in the region of R25 182 compared to Cape Agulhas which is R40 191.

The economic growth forecast slowed down to 3.8%, despite it recording the highest economic growth in the region, it remained the slowest growing economy in that area.

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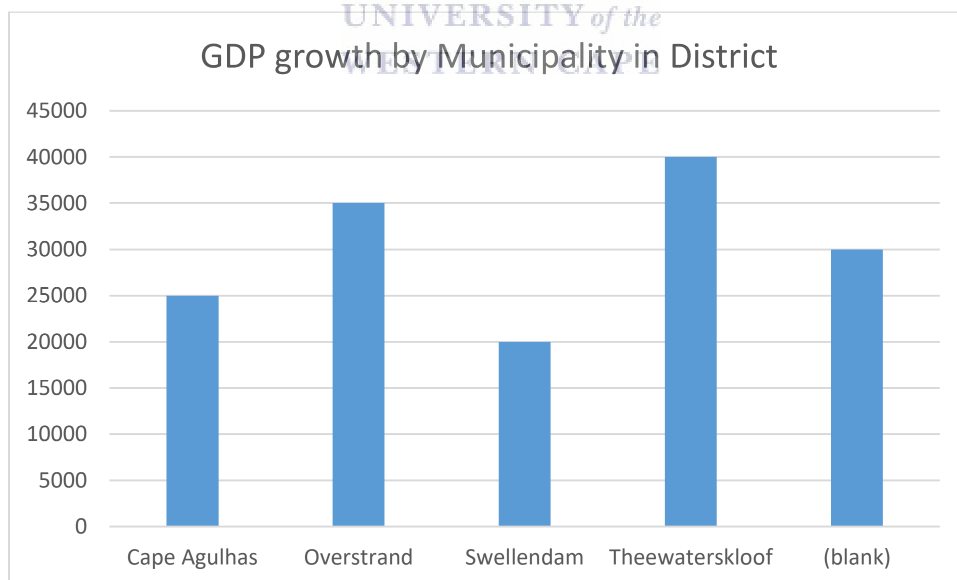

Figure 9: Theewaterskloof GDP Growth 2005 - 2016

Source: Theewaterskloof, IDP 2016-2017

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In summary, Theewaterskloof present an overall picture of a municipality with high levels of inequality and historical infrastructure backlogs in bulk services. The Integrated Development Plan does not highlight Telecommunications as a planning priority as this is not a municipal function, in terms of the Municipal Structures Act of 1998. The municipality has a narrow tax base and so income from revenue cannot assist in the self-funding of infrastructure projects. Currently the large infrastructure areas of water, sanitation and electricity remain unfunded.

3.8 DATA FINDINGS AND ANALYSES

The section which follows will present findings of the analyses of development finance loan agreements for infrastructure development between Theewaterskloof Municipality and the DBSA, and the commercial Amalgamated Banks of South Africa, (ABSA) between the years 2006 - 2012.

For the purposes of data analyses 9 ABSA loan agreements were reviewed, 10 DBSA agreements, and 3 Standard Bank agreements. As indicated in the section dealing with Limitations of the Study, these agreements were available on the Theewaterskloof public electronic repository.

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Each agreement was reviewed, with specific focus on loan borrowings, period of repayment, interest rate instruments and derivatives, specific loan conditions as it relates to grace periods, special conditions, and financial covenants. Findings as each as it relates to these focus areas are presented in the section which follows.

The second section of this chapter will discuss these specific elements noted above in the context of the socio-economic conditions of the municipality as it relates to the economy of Theewaterskloof and its current economic sector development overview, household income and poverty, rates of employment and un-employment, revenue collection and existing municipal debt levels.

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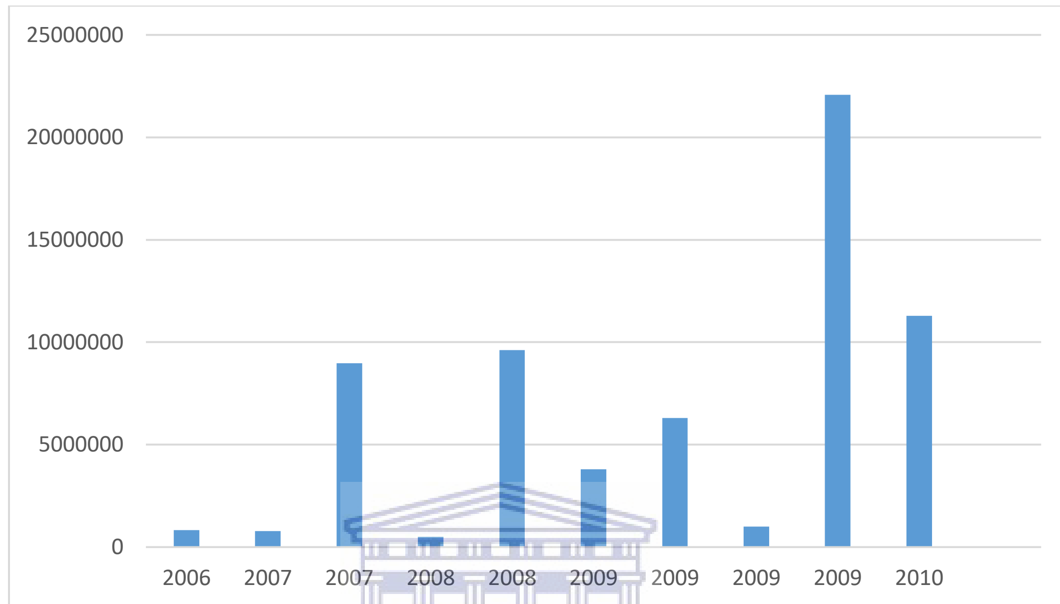
3.8. LOAN BORROWINGS

Figure 10: Development Bank of Southern Africa



Source: Authors' graph

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During the 2013-2014 financial year, the Bank disbursed R9.2 billion in support of strategic infrastructure projects. Approvals to the metropolitan municipal market totalled R12.3 billion. Development finance support, during the same period, totalled R12.3 billion, while support to poor and under-resourced municipalities totalled R937 million. During the 2015-2016 financial year DBSA disbursements totalled R8.1 billion, R7.3 billion to secondary municipalities and R1.3 billion to poor and under-resourced municipalities.

The DBSA is recognised as a critical component of the national infrastructure system. The State has mandated the Bank to 1) invest in water, energy, transport and telecoms infrastructure; 2) provide planning and implementation support to municipalities with an emphasis on secondary cities and under-resourced municipalities.

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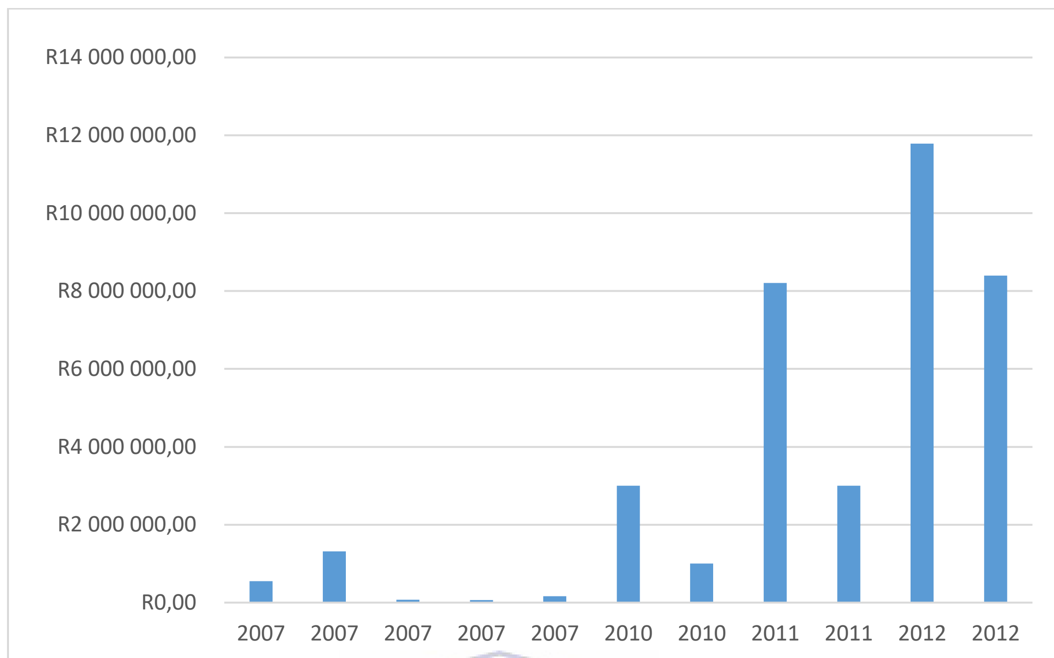

Figure 11: ABSA and Standard Bank borrowings

Source: Authors' graph

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Theewaterskloof borrowings from the DBSA between the period 2006 and 2010 were taken for the purposes of infrastructure projects in the sector of water, electricity and road, assets and buildings. The largest loan amount during the period was taken during 2009, when R33 177 960 was borrowed over a 20-year period. For the period 2006 – 2010 the municipality borrowed R 65 141 452,00 for infrastructure development from the DBSA.

The borrowings chart reflected in Figure 2 above reflects the period 2007 – 2012 as available on the Theewaterskloof website. The loans were borrowed from commercial banks, ABSA and Standard Bank between the periods 2007 and 2012. The loans were borrowed for the purposes of capital infrastructure projects. The largest loan amount is R11, 785, 121 loaned by ABSA Bank in 2012 and the smallest amount is R 554 384,59 during the period 2007, also from ABSA. For period 2007-2012 the capital amount of R 16 894 597,66 was borrowed from ABSA Bank. For the period 2010-2011 R12 209 060 was borrowed from STD Bank. For

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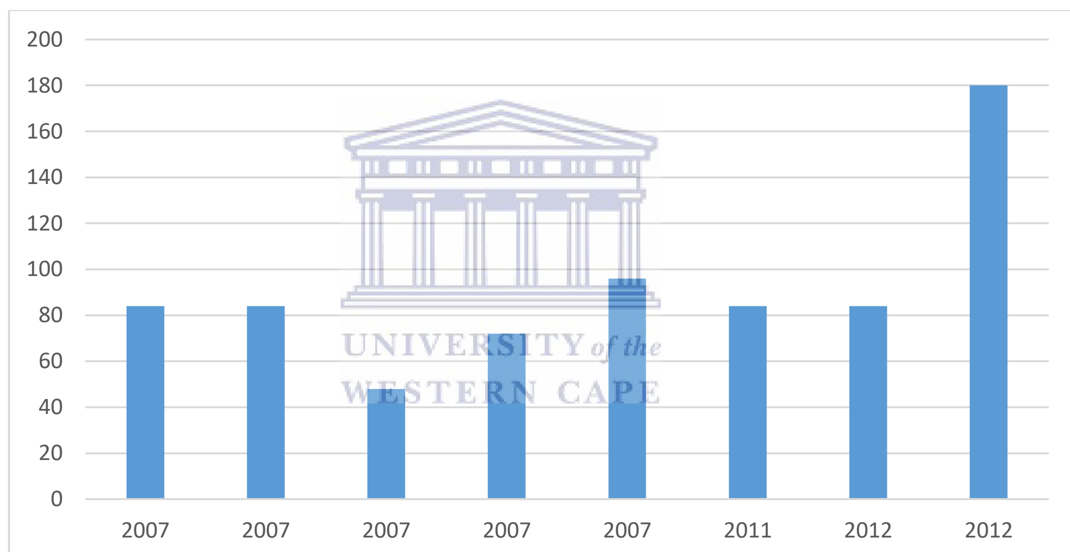
the period 2007-2012 the municipality borrowed R29 103 657 from commercial entities.

3.10. LOAN TERMS

A term loan is a loan from a bank for a specific amount that has specified repayment schedule and a fixed or floating interest rate (http://www.investopedia.com/terms/t/termloan.asp).

Figure 12: ABSA loan terms (in months)



Source: Authors' graph

Figure 13 above shows the term of loan borrowings from ABSA bank. The period 2007 shows individual loan agreements signed during the 2007 period. There are 5 loans taken during 2007 for the purposes of infrastructure development. For this period therefor the accumulated number of years for each loan taken during 2007 is 32 years, or 384 months.

Figure 14 below shows the term of loan borrowings from the DBSA. The period 2009 shows the largest loans taken in any one year within the period. There were 5 loans signed for the purposes of infrastructure development. For this period therefor

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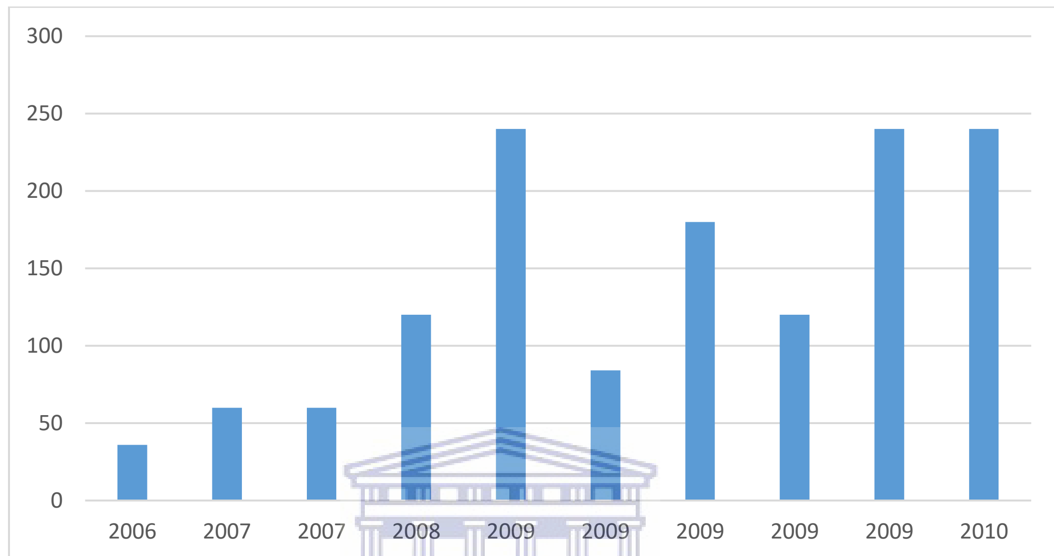
the accumulated number of years for each loan taken during 2009 is 52 years, or 624 months.

Figure 13: DBSA loan term (in months)



Source: Authors' graph

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The following points can be made in relation to loan terms: 1) the number of years overall for a loan period is a maximum of 20 years; 2) As in 2009, the sum of R33 177 960 was borrowed from the DBSA by Theewaterskloof. This amount represents development finance for infrastructure sectors. These include waste water, electricity, roads, water, movable assets and buildings. Bulk infrastructure project loans for water, electricity and roads are taken over a 20-year period, while loans for moveable assets are taken over a 7 to 10-year period.

3.11 INTEREST RATES AND DERIVATIVES

In DBSA loan agreements (10 agreements) for the years 2006 (clause 3.1.1) and 2007 (clause 3.1.1) a fixed interest rate was calculated against 3-year, 5-year and 20-year government bonds, inclusive of 123, 140 and 186 basis point respectively. Basis point refers to changes in interest rates.

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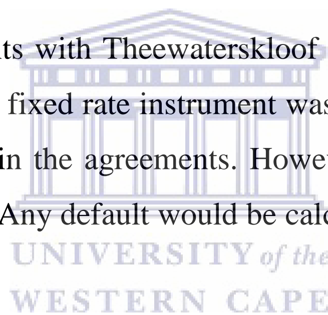
In the DBSA loan agreements for the years 2008 and 2009 another derivative was employed namely, the Amortized Swap Rates (ASR). In clause 3.1.1 of the loan agreement, it was agreed that the capital amount of R6 295 000 would bear interest at a nominal fixed rate over a 15-year Amortized Swap Rate plus 1.77%. The swap rate is an instrument used exclusively for the exchange of interest cash payment exchanges.

Within the DBSA agreements a default interest instrument was calculated in the 2010 agreement (Clause 5.3.1). The default interest instrument is usually applied to mitigate the risk exposure of the bank. In the 2010 agreement, default interest is paid on demand by the borrower, and used to offset risk exposure. In this agreement the DBSA will determine the default interest rate.

In ABSA loan agreements with Theewaterskloof for the periods 2007, 2011 and 2012 (9 agreements), the fixed rate instrument was employed for all the loans. No percentages were noted in the agreements. However, the interest rates would be determined by the bank. Any default would be calculated at the prime interest rate plus 3%.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In the Standard Bank agreements (3 agreements) for the period 2010-2011, the fixed rate instrument was used at the average interest rate of 11.87%.

3.12 LOAN CONDITIONS

In the loan agreements reviewed for the research project, the following conditions were put in place as can be seen from Figure 15 below

Loan Conditions and requirements are elements which specify the loan amount, term, interest rate, and other enforceable conditions agreed to by the borrower and the lender. In development finance banking, conditions are often attached to policy advancement strategies (Koeberle, 2012).

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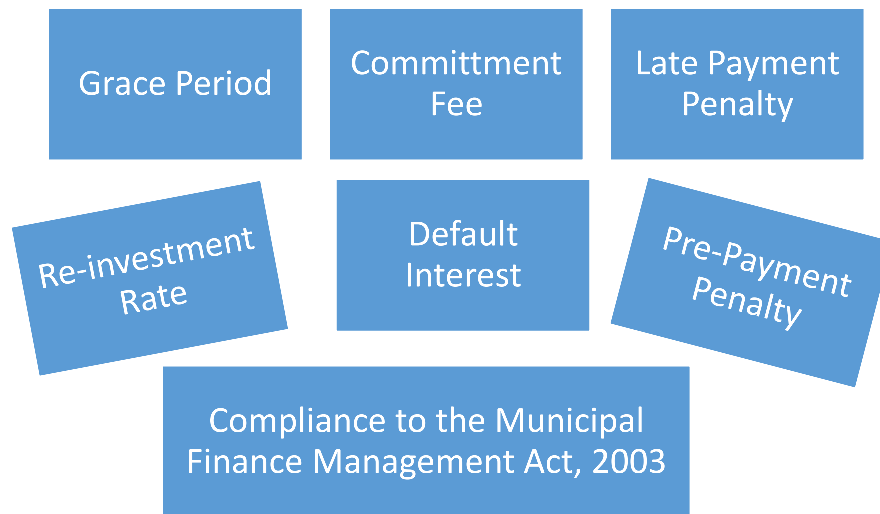
Figure 14:



Source: Authors' graphic

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Conditions in commercial loan agreements are often put in place to mitigate against the risk for the lender. Default interest and penalty interest clauses ensure that late or non-payments on the part of the borrower, protect the risks associated with lending and the income yielded during the repayment period. The section below will present the findings on the conditions of grace period, financial covenants, penalty interests, and MFMA compliance.

3.13. GRACE PERIODS AND FINANCIAL COVENANTS

A grace period is the provision that allows payment to be received for a certain period of time after the actual due date. The DBSA loan agreements (graph5) for the period 2006-2012 cover a total of 130 years. The grace periods for a loan of R818 337 over 3 years, is 5.5 years. A loan over 20 years with a capital value of R11 286 900 has a grace period of 1 year. Over the period of loans 2006-2012, the collective grace period is 12 years. There are 2 loan periods, 20 years and 5 years respectively, where no grace periods are allowed. It must be noted the 20-year loan agreement, is valued at R33 177 960, spread over different loan agreements for

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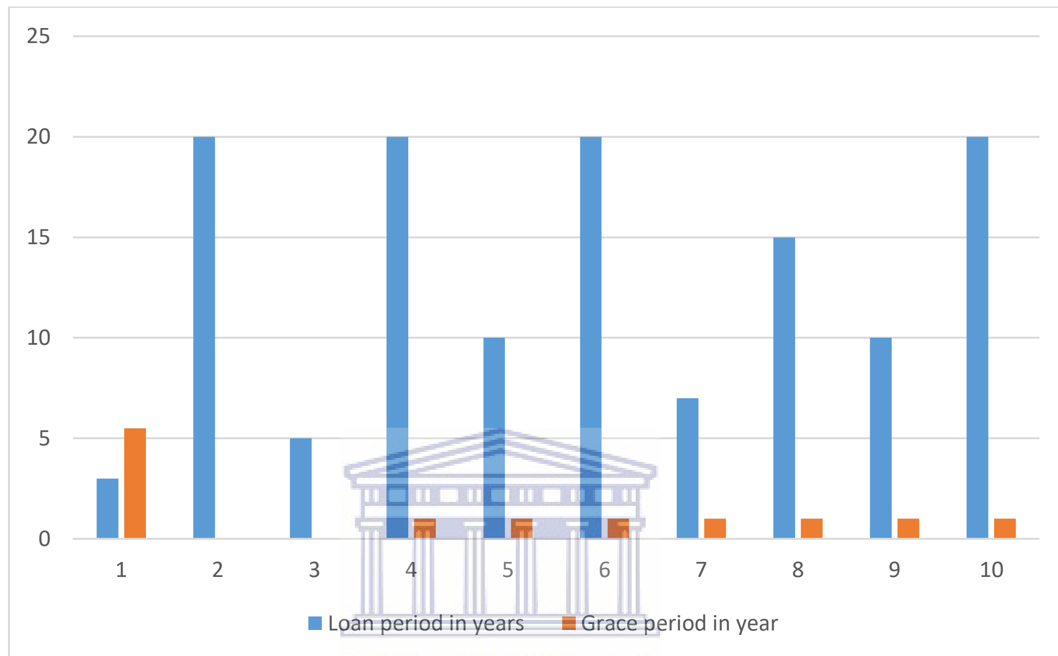
electricity, water, road, movable assets and buildings. The total repayment period is spread over 45 years.

Figure 15: DBSA loan grace period



Source: Authors' graphic

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Of the ten loans reviewed during the period 2006-2012, 8 have a commitment fee of 5% per annum. Eight of the loans have a late penalty clause of 2% per annum. One loan has a default interest formula, which is payable on demand.

As can be seen from Figure 16 there are no grace periods noted in the ABSA loan agreements. Each of the loans reviewed have a default interest clause, formulated as 'default interest at the Prime Interest Rate Plus an added percentage'. The added percentage varies from 2% to 3%. The loan of R11 785 121 (Loan Agreement 2012) has a commitment fee option (Clause 4.4) for the lender, a default interest clause (Clause 5.3), and a swap interest option (Clause 7.4). All the contracts reviewed have Municipal Finance Management Act compliance clauses contained in each of them.

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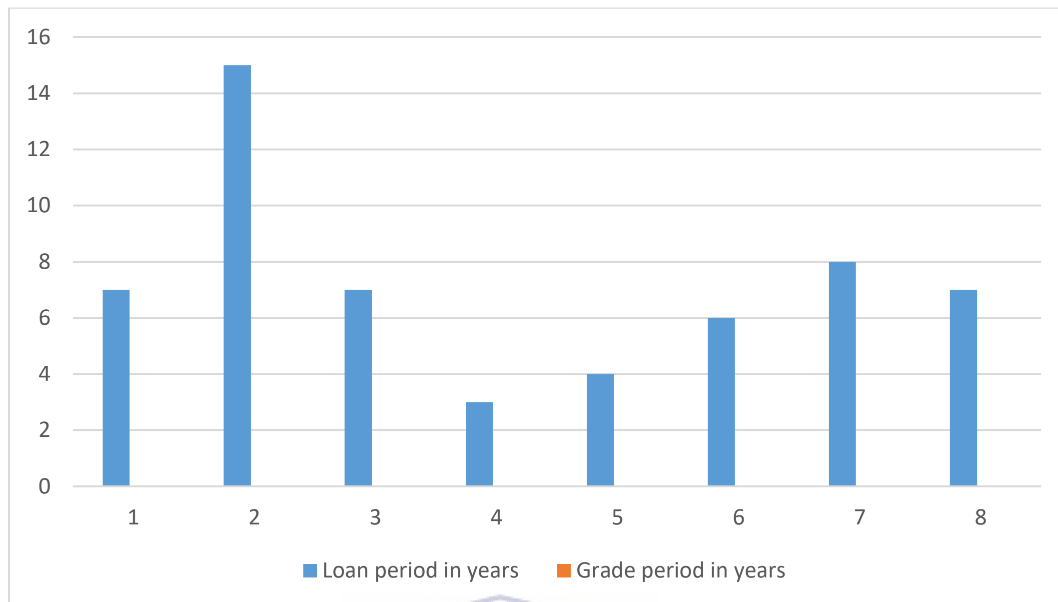
Figure 16: ABSA grace period



Source: Authors' graphic

3.14. COMPLIANCE AND FINANCIAL COVERNANTS

All the loans reviewed for this research, both DBSA and the commercial banks, contained clauses guiding on compliance to the MFMA 2003. Municipal borrowing is framed by the requirements of the MFMA, 2003 and the Municipal Regulations on Debt Disclosure ("the Disclosure Regulations") published under in Government Gazette 29966 of 15 June 2007. While all municipalities must borrow with these frameworks, the limitation of the study could not uncover a borrowing policy for Theewaterskloof.

An example of this is contained in the DBSA agreement 2009, Clause 11.3. The Clause guides that 'the borrower shall furnish the DBSA with proof of compliance with Section 46(3) of the MFMA'.

A 2009 ABSA agreement, Clause 11, requires that the municipality furnish the Bank with signed Municipal Council Resolutions empowering senior municipal

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officials to authorise the loan. In addition, the municipality must submit proof of compliance with the MFMA 2003.

The 2011 ABSA bank agreement require as in Clause 8.1.2 that the municipality submit copies of its audited statements to the bank within 30 days of signing of the agreement. Clause 15 of this agreement also entitles the Bank to review the Annual Financial Statements, the Annual Budget, the Integrated Development Plan and its repayment schedule on an annual basis. The chapter which follows will discuss the findings presented here.

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CHAPTER 4: ANALYSIS OF RESEARCH FINDINGS

4.1. INTRODUCTION

This chapter will discuss the findings of the research. This will include the following: 1) discussion on theoretical reflections of the findings; 2) a conceptual reflection on the findings; 3) a discussion on the findings in relation to patterns emerging from the loan agreements; and 4) a general discussion reflecting on the overall research question and make recommendation.

'Infrastructure is not just essential for faster economic growth and higher employment. It also promotes inclusive growth, providing citizens with the means to improve their own lives and boost their incomes. Infrastructure is essential to development'. (National Development Plan, 2030)

The State, through the NDP 2030 as its vision, and a raft of legislation, empowers all spheres of government, to support the infrastructure pathways to development. The NDP provides guiding principles on infrastructure in rural areas, in particular, infrastructure which supports the 'provision of basic universal services'. This principle is a clear acknowledgement of the spatial and economic inequalities which exist in the rural countryside.

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The States' growth agenda, and legislative and policy prescripts, through the Municipal Finance Management Act 2003, the Infrastructure Growth Plan, the Municipal Structures Act 1998, the DBSA Act 1997 and the myriad of interlinked policy and socio-economic planning tools are poised to ready the country, and its diverse needs and communities, for the vision of NDP 2030: a society in which the dreams and aspirations of all can be realised.

However, this vision, is intricately connected to the global environment, in which the ruling system of capital, and inequality, form the dominant structures of human society. A permutation of which can be found in the theoretical underpinnings of

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the relationship between DBSA, commercial Banks, and Theewaterskloof. The section which follows will discuss this.

4.2. THEORETICAL REFLECTIONS

4.2.1. The World System Theory

A crucial element of World Systems Theory is the unit of analyses. Nation states in the theoretical articulation are characterized into core, semi-periphery, periphery, core and periphery, metropole and satellite. The relationship between the core and periphery are interdependent (Martinez Vela, 2001) and while culturally different, the relationship is structural with one focused on labour-intensive activities and the other on capital intensive activities. The DBSA is an illustrative functionary of the global capitalist system in the manner its relationships with municipalities are structured. The success of capitalism is reliant on the structure of the area in which it operates.

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An example of the 'structure of the area' is financial instruments in place in the DBSA loan agreements. The commercial bank instruments, as one would expect as they are private sector proxies of the capitalist structure, offers a single instrument (fixed interest) and an additional risk mitigating instrument in the form of a default penalty interest.

4.2.2. Loan agreements

The DBSA loan agreement is much more punitive to the municipality in the way its risk mitigating instruments are structured. An example is the 2007, 20-year loan agreement. In this agreement a nominal fixed interest clause plus an amortised swap rate with an additional levy of 1.84% is cited. In addition to this, interest is compounded on a six monthly basis, and while there is no commitment fee, a punitive clause of deviation from the scheduled payments will incur a 0.5%

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commitment fee. An additional punitive clause includes a penalty interest clause calculated at the Prime Lending rate plus 2%.

The punitive structure of the loan DBSA loan agreements is in contrast to the development mandates and vision of the 2012 restructuring process of the Bank. The DBSA programmes and work specific to municipalities is about supporting infrastructure growth, and helping local government to achieve its mandates in relation to infrastructure development. However, the punitive clauses contained in its contracts with municipalities is based exclusively on accumalatory practices. As Wallerstein notes: 'capitalism is 'endless accumulation' and means the accumulation of capital to acquire ever more capital'.

4.3. CONCEPTUAL REFLECTIONS

4.3.1. Borrowing

Long term borrowing is one major instrument for financing infrastructure development. Responsible borrowing by municipalities is strongly supported in government policy and legislation as an efficient and equitable mechanism to finance municipal capital investment needs (Municipal Borrowing Bulletin, 2016).

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Between the period 2006 and 2012, a 6-year period, Theewaterskloof borrowed an amount of R5 385 4552 from the DBSA. Between 2007 – 2011, ABSA loaned an amount of R25 932 080. STD Bank loaned the municipality an amount of R12 209 060 over a 2-year period (2010 -2011). Given the highly unequal socio-economic conditions of Theewaterskloof and the narrow tax base I would offer that the concentration borrowings could mire the municipality in a cycle of debt repayment, or worse, debt default, placing further economic strain on the narrow tax base.

4.3.2. Generational debt

The loan servicing requirements, particularly from the DBSA, as noted in the previous section, will place a burden on the municipality and its residents in the

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context of the narrow tax base of the municipality. The period of loan repayments for DBSA translates to 1 380 months or 115 years. I would offer that the loan period for DBSA loan repayments places an unyielding burden on the residents given the narrow tax base which lowers the income revenue for the municipality. Without adequate revenue collection through taxes and services, the municipality may never substantially repay these loans. The high rate of unemployment will also affect the ability of the municipality to recoup its infrastructure investment.

The burden of debt should not create a burden of debt for future generations (Black, Calitz and Steenekamp 2011). Theewaterskloof has a population of 121 739 (IDP, 2016). Yet with an unemployment rate of 14.9%, a youth population of 25%, a school drop-out rate of 31% a social welfare dependency ratio of 44%, a child dependency rate of 25%, and 11.8% of households who have no income, the chances of this municipality meeting its debt obligations within the next generation, are very small.

Theewaterskloof has the lowest GDP per capita in the Overberg District, 25 692 in comparison to 40 191 of Cape Augulus. Despite potential in sectors such as agri-processing, tourism and construction, it is estimated (Theewaterskloof IDP, 20160) that only a third of the 3000 jobs lost in the agricultural will be re-absorbed in the economy. Unemployment is likely to reach 44% by 2030. Theewaterskloof has high levels of inequality and a large infrastructure backlog. The chances of internal revenue collection to help fund these sectors remain threatened as the municipality has a narrow revenue and tax collection base.

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4.3.3. Loan terms

The largest loan amount during the period was taken during 2009, when R33 177 960 was borrowed over a 20-year period. For the period 2006 – 2010 the municipality borrowed R 65 141 452,00 for infrastructure development from the DBSA. For the period 2007-2012 the municipality borrowed R29 103 657 from commercial entities. For the period 2007 the collective loan repayment period for ABSA Bank is 32 years, or 384 months. For the period 2009 the accumulated

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number of years for each DBSA loan is 52 years, or 624 months. I would offer that the generational debt burden for future and current members of the Theewaterskloof municipality may well see the municipality mired in a continuous cycle of debt, unless the socio-economic patterns of redistribution is addressed.

4.3.4. Interest Rates

The commercial borrowings of Theewaterskloof are fixed interest rates calculated by the ABSA and Standard banks with an additional 3% added to the prime lending rate. It would be incumbent of the Banks to ascertain risk in this calculation, as is the practice in most commercial entities.

The DBSA loan agreements to Theewaterskloof is a combination of fixed, nominal fixed, swap rates, default interest rates and basis point calculations. I would offer that the combination of interest rate instruments is punitive given the socio-economic profile of Theewaterskloof. The infrastructure and resource landscape as outlined, profiles a municipality which has aging infrastructure, high levels of inequality, an influx of indigent people and a narrow rates collection base.

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The net amounts payable through interest rate instruments used in combination in single loan agreements may affect the ability of the municipality to pay off the capital amount in the allotted time frame. Furthermore, the use of default interest rates instruments in DBSA loan agreements to municipalities is an anathema to the development agenda of the State. While the narrative protecting the Bank against risk is the underlying rationale for the use of default interest clauses, it speaks to the State not displaying confidence in its own socio-economic grow pathways.

4.3.5. Loan conditions

A grace period is the provision that allows payment to be received for a certain period of time after the actual due date. The DBSA loan period across all loans

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reviewed is for 45 years. The total grace period across all loans are for 12 years. The commercial loan with ABSA Bank has no grace period. Despite the 12-year grace period across all DBSA loans the multi-interest rate instruments at play in DNSA loan agreements may well nullify the grace period clause, particularly if late payment penalty clauses (present in DBSA loan agreements) are actioned. In addition, none of the grace period clauses present in the DBA loan agreements spell out the notice period for grace periods on the part of lender.

4.4. RECOMMENDATIONS

4.4.1. DBSA loan agreements and transparency

It was challenging sourcing loan agreements from the DBSA website. While the research was limited in funds and time, and a broader study encompassing face to face interviews with DBSA and municipal officials could not be conducted, the DBSA website was unhelpful. The Bank does not have an electronic loan repository unlike its African Development Bank, World Bank, International Monetary Fund and Asian Development Bank counterparts.

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The DBSA also does not have a clear communication tool which spells out its loan conditions for municipalities. The recommendation of this study is that the DBSA, as a State institution, becomes more transparent in its loans to municipalities by making its loan agreements more accessible to the public. This would help in building alternative narratives for South African development finance at the academic and social policy level. It would also dispel the perception of the Bank as a conduit for elite wealth creation by those occupying high level political office.

4.4.2. Multi-interest rate instruments in a single loan agreement

Given the lack of technical capacity in particularly rural municipalities such as Theewaterskloof gave the perception that these loan agreements were needlessly

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complicated in its use of multiple interest rates instruments. The legal language present in the loan agreements were almost punitive in its articulation, and detracted from the overall development and co-operative governance agenda of the State.

It is the recommendation of this study that development finance agreements by a State institution such as the DBSA are seen as public documents. As such they should be written in a manner which communicates the development agenda of the State, spelling out the rights and responsibilities of the municipality as the lender, while being accessible to residents and communities who wish to engage with them.

4.4.3. Inter-government transfers versus DBSA loans

Theewaterskloof is a rural municipality and has high levels of socio-economic inequality. As a rural municipality the entity is eligible for a raft inter-government grants and financial support in its infrastructure development programme. In addition, the Department of Co-operative Governance and The National Treasurery have legislative municipal capacity building programmes to support rural municipalities in their fiscal and planning management. This research hold the view that the DBSA loans mire rural municipalities in generational debt burdens. It is the recommendation of this study that a municipal moratorium on external loans is actioned for a 10-year period to ensure that municipalities are first capacitated within a decade to manage large fiscal infrastructure programmes.

4.4.4. Transformation of the rural country-side

The most note-worthy challenge in the Theewaterskloof IDP 2016 was the lament by the municipality of the drain on resources and services by migrant agricultural workers in search of seasonal work. It is the view of this stud that this stance may perpetuate a weakness of transformation in small under-resourced municipalities. Rural areas, much like urban centres, have population movements as a result of economic ebbs and flow. Services and resources are not the exclusive domain of

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generations of the same families owning the same rural farms. The IDP as a document of vision should articulate the transformation to a sharing and caring society.

It is the recommendation of this study that the Theewaterskloof municipality share a vision of expanded services to include migrant populations who can potentially revive the agri-processing business through small scale farming activities, contribute to the tourism industry through labour and related tourism activities. A bigger population would mitigate the need for common goods such as schools and hospitals.

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CHAPTER 5: CONCLUSION AND RECOMMENDATIONS

5. 1 Summary Chapter 1:

This chapter introduced the study by providing a background to the study and a context of the DBSA, the States' infrastructure development agenda and the legislative framework within which municipal lending and infrastructure development takes place.

The interconnectedness between DBSA and municipal infrastructure financing presents itself as part of the States' development agenda. From the historical perspective of deracialising the development mandate of local government and cementing a co-operative government system, the support of the DBSA is a crucial cog in the wheel of development in municipalities. This chapter sought to present the agenda of the DBSA in relation to the infrastructure delivery at the municipal level.

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The first chapter presented the significance of the research and its potential scholarly contribution to a broader societal discussion on DBSA lending and its impact on poor municipalities. This chapter also identified the aims of the study, the problem statement and introduced the research methodology. The chapter which follows presents the conceptual framework and literature review of the study.

5.2 Summary Chapter 2

Chapter 2 was presented through two sections. The first section presented a theoretical and conceptual framework for the research study. It discussed the WST and its units of analyses, i.e. core, periphery and semi-periphery. From the theoretical perspective, the intricate workings of the relationship between the DBSA and its municipal client points to world system in which concentric circles

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of power are interrelated to perpetuate itself. At the core is a system (capitalism) based on producing a profit for an elite.

The first section of Chapter 2 also presented a discussion on the concepts of development finance. This included borrowing policy, credit-risk, credit-rating, credit- worthiness, financial derivatives, interest rates and municipal bonds, and loan conditions and policy. Through the conceptual framework presented, the chapter sought to illustrate the complexities of development finance loan agreements.

The review of literature contained in the second section of this chapter focused on the development banking landscape and its historical foundation, from a national and global perspective. It looked at the historical underpinnings of development banking from pre-20th century to the contemporary. It also looked at debates and discussions on the refocusing of the development banking premise and alternatives to development banking within the neo-liberal context. The final section of this chapter focused on two issues: 1) the DBSA and its loans to municipalities and 2) municipalities, its structure and financing for its infrastructure.

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5.3 Chapter 3 Summary

Chapter 3 presented data and findings of DBSA loans to the Theewaterskloof municipality. This section firstly gave an overview of the infrastructure profile of the municipality. It also focused on the socio-economic profile. In this it was revealed that Theewaterskloof has high levels of inequality with a large social and economic divide. White farmers have historical ownership of the land and black migrants provide the unskilled farm labour. The patterns of migrancy, and low income tax collection have also impacted on the demand for infrastructure and bulk services.

In terms of loans, the chapter presented findings of 10 loan agreements between the DBSA and Theewaterskloof municipality, 9 loan agreements between

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Theewaterskloof and ABSA bank, and 3 loan agreements with Standard Bank. Each agreement was reviewed with specific focus on borrowings, repayments periods, interest rate instruments, and loan conditions. The loans represent the period 2006 – 2010. DBSA was the largest borrower at R65 141 452 in contrast to the R29 103 657 borrowed from commercial entities.

5.4 Chapter 4 Summary

This chapter reflected on an analysis of the research findings and reflections on theory and concepts.

Within the theoretical context of the WST, the DBSA loans are an illustrative functionary of the global capitalist system in the manner in which its relationships with municipalities are structured. An example of the 'structure of the area' are the financial instruments present in DBSA loan agreements. The commercial banks with whom the municipalities have loan agreements can be viewed as private sector proxies of the capitalist structure.

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In the context of loan agreements, it can be concluded that the DBSA loan agreement is more punitive to Theewaterskloof in the way that its risk instruments are structured. The 2007, 20-year loan agreements is a case in point in which a nominal fixed interest clause plus an amortised swap interest rate and an additional 1.84% levy is incorporated into the loan.

In addition the DBSA loan period for 2006-2010 translates to 1 380 months of loan repayments. In my view the punitive structure of the loan is in contrast to the development mandates and vision of the 2012 DBSA restructuring process to support infrastructure development.

The concept of generational debt burden should be noted, in relation to the point made of punitive loan clauses and loan repayment period as noted above. The

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DBSA loans will place an unyielding burden of debt on current and future generations of Theewaterskloof residents given the narrow tax base. Without greater revenue and tax collection the municipality may never repay these loans or recoup its infrastructure investment.

In concluding this section, the context of the DBSA's status as government owned, its lending practices to municipalities are questionable in light of its comparably higher interest rates and punitive repayment clauses. The research evidence and findings does offer some critical evidence to the research question: Does the DBSA lending modalities perpetuate or diminish inequality?

Given the socio-economic profiles of Theewaterskloof and the low tax base, and revenue collection rates of the municipality, ***it would seem that DBSA loans are punitive with onerous terms and conditions thus perpetuating a cycle of inequality.*** Given the burden of debt on the tax base the DBSA loans will perpetuate a cycle of poverty and inequality.

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The lending and borrowing structure of the DBSA must be critically questioned in the context of its developmental agenda. This can only be done if the Bank is more transparent in its relationships with municipalities and thereby contribute to a more equitable vision for South Africa: one in which this country belongs to all who live and work here. The section which follows will offer recommendations linked to the specific problems raised in this research.

5.5 Recommendations

Small municipalities, such as Theewaterskloof, identified in this study, find accessing funding, from external development finance institutions challenging. Due to their narrow tax bases they are unable to generate enough revenue to increase their credit-worthy and credit-risk profile. Where they are successful, loan conditions are punitive and places debt burdens on current municipal economies, and on future generations. This which follows suggests recommendations to

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mitigate the challenges of accessing external finance from finance institutions such as the DBSA, and commercial lenders.

5.5 (a) DBSA loan agreements and transparency

The DBSA is not a transparent institution as it relates to making public its lending practices to municipalities, as was discovered in the gathering of data. The Bank should become more transparent by making its processes more accessible to the public beyond generic media statements.

It would help to place a complete repository of its loan agreements to municipalities on its website, much like its development bank counterparts in Asia, Africa, the World Bank and the IMF. This will help to contribute to policy thinking on alternatives to development finance to municipalities at the academic and social policy level. It may also dispel the perception of the Bank as a conduit for wealth creation for the politically connected elite.

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5.5 (b) Multi-interest rates instruments

Rural municipalities often lack technical capacities to manage its development planning processes. They also lack the technical staff capable of negotiating large development finance contracts. The DBSA loan agreements were needlessly complicated in its use of multiple interest rates instruments to avert risk to the Bank. In, addition the use of complex legal language in the contracts were punitive in its articulation.

I would recommend that such agreements by a State owned bank are put into the public domain as public documents. They should be written in a manner which communicates the development agenda of the State, spelling out the rights and responsibilities of municipal lenders, while being accessible to society at large to engage with.

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5.5 (c) Inter-government transfers versus DBSA loans

Theewaterskloof is one of many municipalities nationally, eligible for inter-government transfers to support infrastructure development. These transfers are delivered through provincial government conduits for programmes supporting infrastructure and IDP targets. They are also directly transferred from national government departments. Given the problem identified with managing large external loan agreements, and the generational debt burden, it is recommended that a 10-year moratorium is placed on external municipal loans from DBSA and commercial entities.

During this 10-year period, the existing municipal support programmes to strengthen the skills base of municipal managers and finance managers can be increased; a succession plan for new layers of municipal leadership can be strengthened; and an increase in the tax and revenue base can be broadened. This will help municipalities to increase their credit-worthiness should they broaden their revenue base and ensure that municipal mandates in relation to planning and implementation for large infrastructure projects can be achieved. The burden of external debt servicing will therefore not place an added challenge to municipalities already challenged by socio-economic backlogs.

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5.5 (d) Transformation of the rural country-side

There is a lack of transformation in the rural country-side. This notion is illustrated in the Theewaterskloof IDP (2016) where migrant populations in search of seasonal agricultural work are blamed for the drain on services and resources. Services and resources are not the exclusive domain of generations of the same families owning the same rural land. The IDP document as a vision of the future must articulate the transformation to a sharing, and caring society.

It is recommended that the Theewaterskloof municipality structure its IDP process to reflect on a transforming and diverse population in the future by acknowledging

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the potential contribution of seasonal and migrant populations, as well as the local non-land-owning populations. The IDP vision of a Theewaterskloof future can include plans on how to hold migrant populations in the area through expanded industrial plans which require their labour. Industries which can be revived are the agri-processing industry, tourism and small-scale farming.

A bigger population would mitigate the need for more schools, hospitals, and small local economic hubs. This in turn would expand the revenue and tax base; provide an economic stream to support the services and resources needed by a greater, diverse population that imbibes the founding spirit of The Bill of Rights: South Africa belongs to all who live in it.

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