

Guaranteeing loans to and by municipalities: The legal framework, problems and solutions

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1 INTRODUCTION

The congregation of people in cities, towns and villages is a fact of life in all modern societies. The advent of decentralisation has added a federal dimension in the form of states, provinces and districts. Both dimensions, however, constitute a phenomenon which requires financial and other resources to sustain it and to ensure that the basic necessities in education, health, housing, transportation, power, water, sanitation, etc are provided. In South Africa, the financial imponderables and impediments confronting municipal structures are known to be many and onerous. Indeed, it is a well known fact that many municipalities in South Africa today are practically bankrupt. The causes of these difficulties are many and varied. Some of them can be traced back to the small tax and service bases on which most of the country's cities are operating. They also include the culture of non-payment. In addition, it is well known that support for municipalities from the national fiscus has diminished over the years.

Given these difficulties, it is imperative that municipalities sharpen their tax collection methods and raise funds privately. One way of effecting that is by private borrowing. But as many municipalities do not possess the requisite collaterals for such borrowing, they require the assistance of the national and provincial governments to provide security. Another way is to mobilise private sector initiatives by guaranteeing loans made by this sector in the furtherance of local development projects. In both instances, guarantees increase the possible debt burden of the state as a whole.

Along with the regulation of a government's borrowing powers,¹ the Constitution has provided a framework for guaranteeing loans. Section 218(1) of the Constitution provides as follows:

"The national government, a provincial government or a municipality may guarantee a loan only if the guarantee complies with any conditions set out in national legislation."

The section adds further that the envisaged national legislation must take into account the recommendations of the Financial and Fiscal Commission.

¹ S 230 Constitution.

Moreover every level of government is required to publish annual reports of the guarantees it has given.

This paper will examine the present statutory and common law regulation of guarantees and assess its appropriateness under the Constitution. The study will be confined to local authorities as recipients of guarantees as well as providers of them.

2 CONSTITUTIONAL FRAMEWORK

The Constitution in section 218 does not state the aims and objects of the power to guarantee except that it is to guarantee loans. Ideally, the power to give guarantees ought only to be exercised for purposes of giving effect to the goals and objects which the guaranteeing level of government is constitutionally mandated to do. One way of determining it is by looking at the objectives of the borrowing powers of the local authorities themselves in general. In this regard, it has to be remembered that the giving of a guarantee is after all a form of assuming debt. In short the guarantor is as much a debtor as the principal debtor.

There can be no doubt that the guaranteeing power of municipal governments, like the rest of their revenue administration is aimed at facilitating their constitutional mandate and objectives. The Constitution gives in section 152(1) these objectives as follows:

- “(a) to provide democratic and accountable government for local communities;
- (b) to ensure the provision of services to communities in a sustainable manner;
- (c) to promote social and economic development;
- (d) to promote a safe and healthy environment; and
- (e) to encourage the involvement of communities and community organisations in matters of local government.”

A government's power to guarantee is limited to the guaranteeing of loans. The Constitution does not name local authorities as the bodies or entities on whose behalf such guarantees may be signed by the other levels of government. Nor, for that matter, does it name any other entities as possible primary debtors who should enjoy this benefit. This situation obviously is in stark contrast with section 188 of the interim Constitution which stated that the national government could guarantee loans on behalf of both the provincial and local governments. But by not naming those whose loans authorised levels of government may guarantee the Constitution has made it possible for loans other than those of the provincial or local government themselves to be guaranteed. In other words, these public bodies may guarantee loans made to private entities or persons by lenders. Indeed, it is precisely because of this development that there is a need for clear cut guidelines as to how the power to guarantee loans should be exercised. Without guidelines, it is not improbable that a purely commercial or private loan which is not necessary or incidental to the constitutional mandate and objectives of the guarantor can be guaranteed. This point will be returned to below. What is important is to establish some criteria for the application of this authority so as to forestall any possible abuse. What are the legal parameters and guidelines within which

any level of government giving a guarantee must operate? In this connection it is important to remember that special common law rules apply to guarantees as shall be shown below. While these may be altered by statute, it is nevertheless critical that such alteration should itself be known.

3 STATUTORY REQUIREMENTS OF A GUARANTEE

It is apparent that the Constitution does not itself outline any conditions or guidelines upon which any level of government may commit itself as guarantor for the loan or loans of another or for those of a private entity or body. It leaves the formulation of such requirements to national legislation once it has been enacted. That process has so far been lacking in speed and thoroughness. Thus, as far as the guaranteeing of municipal borrowing or by municipalities is concerned, it is notable that no steps were taken to spell out such conditions in earlier legislation. The Local Government Transition Act² plus virtually all the amendments made to it, for instance, are silent on the matter. Other possible sources such as the Local Authorities Loans Fund Act,³ and such provincial ordinances as the Cape Municipal Ordinance,⁴ the Natal Local Authorities Ordinance,⁵ the Orange Free State Local Government Ordinance⁶ and the Transvaal Local Government Ordinance⁷, may all have dealt with loans and the borrowing powers of local authorities but did not provide for the guaranteeing of their loans. The power to give guarantees, it would seem, was reserved for the national government. Moreover these sources are not pertinent to the post-apartheid or transitional era. Suffice to observe that the silence of those statutes which are concerned with the transitional phase of local government is, to say the least, baffling. After all, the acquisition and giving of loans and guarantees are key considerations to the attainment of the aims and objectives of decentralised governance, given the division of the country into several hundred municipal structures.

Even the Exchequer Act⁸ does not give an adequate guideline as to the norms and conditions with which the guarantees given by national government should comply. That Act rather reserves to the Minister virtual discretion in the awarding of government guarantees.⁹ Indeed, the Act is quite categorical in stating that the Minister giving the guarantee may also determine the terms and conditions therefor. The only aspects which thus may be regarded as constituting a criteria for the granting of

2 209 of 1993, as amended by Proclamation R129 of 1994, Act 34 of 1994, Proclamation R174 of 1994, Proclamation R35 of 1995, Proclamation R54 of 1995, Proclamation R58 of 1995, Proclamation R59 of 1995, Proclamation R65 of 1995 (as corrected by Government Notice R1038 of 1995), Act 61 of 1995, Act 89 of 1995, Act 12 of 1996 and Act 97 of 1996.

3 Act 67 of 1984, as amended by Act 41 of 1993 and Act 25 of 1995.

4 20 of 1974.

5 25 of 1974.

6 8 of 1962.

7 17 of 1939.

8 66 of 1975.

9 See s 35.

guarantees under this Act's provisions are the requirements that the Minister's decision should be in line with public interest and be approved by the Minister of Finance.

The Borrowing Power of Provincial Governments Act,¹⁰ by contrast, provides a few guidelines for provincial borrowing.¹¹ It, for instance, creates a Loans Coordinating Committee whose task shall be to coordinate the borrowing requirements of the various provincial governments.¹² This committee is required in its functions to estimate and aggregate the funds required from the capital market by each provincial government in any given year. The committee reports to the Financial and Fiscal Commission. For the purposes of enabling the Commission to discharge the functions assigned to it under the Constitution, the committee is obliged to report on the total debt of each provincial government and the bodies controlled by it. In addition, the committee is obliged to take into account, for the purposes of its reporting, the contingent liabilities of provincial governments as well as their ability to service their debt.

Other important conditions prescribed by this Act are that the loans raised under this power for bridging purposes may not be on a continuous basis or unlimited revolving credit.¹³ The provinces are, in addition, not allowed to raise loans denominated in foreign currency by way of issuing marketable financial instruments. Such loans may only be raised with the consent of the Minister of Finance if he or she is satisfied with the reasons and motivations for their conclusion. The approval of the Minister may, however, be given subject to the fulfilment of certain discretionary conditions which he or she may determine.

The actual borrowing functions are exercised by a responsible officer who must act on the instructions and resolutions of the Loans Coordinating Committee and the Financial and Fiscal Commission. The resolutions of the latter two bodies must be arrived at by consensus. If the members are unable to attain such consensus, the Minister may approve the aggregate amount of the required loan. Where this happens the Minister must make public the reasons for his or her determination.

Another important condition set in section 3 pertains to the amount of the loan which may be applied or approved. Such amount may not exceed one half of the total amount of loans still owing by the applicant provincial government. The loans themselves may be obtained from the national government, a bank or financial institution. Agreements, therefore, may be concluded with the lenders by the provincial government concerned, or they may be concluded on its behalf by national government, an institution established by an Act of Parliament or by an institution approved by the Minister. The amount of interest on any provincial loan may not exceed an amount equal to a percentage

10 48 of 1996.

11 S 5.

12 See s 2.

13 S 3.

“(i) of the total budgeted current revenue of that provincial government, recorded in terms of section 4(a)(i); and

(ii) annually determined for each provincial government by the Minister, who may request a recommendation in this connection from the Commission.”

Most importantly, the Act stipulates that any moneys borrowed by the responsible member, and the interest thereon, shall be the financial obligation of the provincial government concerned and shall be chargeable to and payable from the revenues and assets of that provincial government.

5 EFFICACY OF THE GUARANTEE PROVISIONS

Both the constitutional provision and that of the Exchequer Act¹⁴ creating the power to guarantee loans are short on specifics. The latter in particular leaves much to discretion. The exercise of unbridled discretion can some times lead to ill-advised decisions and corrupt deals. Even if the Minister may afterwards be required to account to Parliament it may be too late to arrest or repair the damage. It is for this reason necessary to retain the services of a committee even if it has to be chaired by the Minister. The resolutions of such a committee should be required to be taken by a majority before they can be binding.

Even more significantly, it is important to place some limits as to amounts or sizes of guarantees which the national or provincial governments may commit themselves to. It is submitted that without any clear stipulation as to such limits excesses cannot be ruled out. In this regard it is important to remember that the existence of a guarantee, whether it be a suretyship or some other form of intercession, ultimately enables the creditor to look to both the principal debtor and the guarantor for performance.¹⁵ In short, under a guarantee the guarantor is as much a debtor as the person whose indebtedness is guaranteed.¹⁶ Therefore, every time a sphere of government undertakes to be obliged as a guarantor for the loan of another, it increases its own indebtedness. Consequently, unless this practice is closely monitored and strictly controlled it can get out of hand and lead to an enormous debt burden. In the case of guarantees of municipal loans, it has to be remembered again that virtually all municipalities in South Africa are facing financial difficulties. The practical and legal implications of guaranteeing the obligations of these levels of government can therefore be quite real and enormous indeed. As far as the national government is concerned, these will after all be additional obligations to its own current debt of R280 billion or 56,0 per cent of GDP¹⁷ which is causing concern as it is.

In terms of the borrowing powers and regulations covered by the transitional local government statutes, it should be noted that they offer only a limited benefit as a guide for determining the scope and extent of

14 66 of 1975.

15 McGuinness 1986: 6.

16 Forsyth and Pretorius 1992: 86.

17 See Minister Trevor Manuel, Budget Speech March 1996.

the guaranteeing mandate of this sphere of government. Such guides pertain to restrictions on the raising of loans in foreign currency, the size or amount of the loan itself and its interest.

Another criticism is that, although the local government Acts are not specific on the period of each guarantee, it is clear from provisions governing provincial borrowing that Parliament intended to restrict it to no more than one budget year. As Craythorne¹⁸ argues in his comment on similar provisions under the old order, this may not give the borrowers and guarantors sufficient scope to plan their capital expenditures or commitments. Under circumstances where the amount and the rate of interest in future years may be influenced by the capital expenditure of the previous year, it may be critical to be able to plan several years in advance.

6 GUARANTEES UNDER SOUTH AFRICAN COMMON LAW

In South Africa the word “guarantee” is capable of several meanings. In its first meaning the word denotes the existence of an undertaking by one person to another expressing either that the quality, quantity, price, et cetera, of a thing is what the promisor says it to be or that it shall be so in future. The second is that it is a principal obligation to indemnify the promisee against loss upon the happening of a stipulated event. This latter designation of the term does not envisage the existence of another contract to which the guarantee undertaking could be an accessory.¹⁹ The third meaning of the term “guarantee” denotes an accessory form of liability. This puts it on par with a suretyship. Indeed the term itself is commonly applied to define and designate a “continuing suretyship”.²⁰ The difference between the latter and the second meaning is that in a guarantee under the second meaning the guarantor’s obligation is independent to that of the debtor. In addition, this obligation is to indemnify the creditor for the losses he or she has suffered through the debtor’s *non-performance*. This is quite different from the surety’s liability which is for losses resulting from the debtor’s *breach* of his contract. In the words of Forsyth and Pretorius:

“Thus if the creditor suffers grave losses when it turns out that the debtor’s contract is invalid, the guarantor’s obligation remains in force and he will have to pay those losses but the surety’s obligation falls away and he will not have to pay a penny. A second point of distinction is this: as we have seen, a suretyship is an undertaking, in the first instance, that the debtor himself will perform, and only secondarily that if he fails to perform that the surety will do so. With a guarantee, on the other hand, the guarantor undertakes to pay on the happening of a certain event but does not promise that event will not happen.”²¹

The question then is what kind of liability is the national, provincial or local government assuming when it undertakes to guarantee a loan. Is

18 Craythorne 1993: 336.

19 See *Accut v Bennet* (1906) 27 NLR 716.

20 See Forsyth and Pretorius 1992: 94. See also Pretorius 1988: 85.

21 1992: 30.

that liability primary or accessory? Can the creditor ignore the excussory processes and demand payment from the guarantor as soon as default occurs? If this is the case then the position of the guarantors can be quite tenuous as planning and budgeting can become extremely difficult thereby.

A close reading of section 218 and section 230 of the Constitution do not yield any answers to these questions regarding the nature of the national, provincial or local government's liability. Quite clearly such an answer would make a very big difference in so far as the time of attachment of liability is concerned. If the intended liability is that of a surety then these levels of government are entitled to certain benefits. These are the benefits of excussion, division among co-sureties, cession of actions as well as the rights of recourse, set-off and contribution by co-sureties.²² In addition, each can insist upon the taking and realisation of securities and cannot be held liable if transactions between principal debtors and creditors are either illegal, unenforceable or fall away. These principles do not apply where a sphere of government is a primary debtor. Another important consideration is that these advantages of an accessory form of security allow for a desirable degree of flexibility on the part of the guarantor. They can as such be enjoyed without prejudicing the creditor or borrower.

In the absence of any constitutional provisions spelling out all the applicable norms or conditions relating to guarantees or even defining them and the extent of liability under them, recourse may once more be had to other Acts of Parliament.

Generally, a review of the prescriptions of the Local Government Transition Second Amendment Act²³ indicates that both the national and provincial governments are unwilling to assume primary liability for municipal borrowing. Thus, under section 10G(8)(ii)(c) it is stipulated that all moneys borrowed by a municipality, together with interest thereon, shall be the financial responsibility of the municipality concerned and shall be chargeable to and payable from the revenues of that municipality.

The Local Government Transition Second Amendment Act, however, does not make any provision in respect of guarantees. This is also the case with the Exchequer Act. Both statutes do not state whether the guarantor's liability ceases once the liability of the principal debtor falls away. Such liability may fall away either as a result of lack of capacity to contract on the part of the principal debtor or due to illegality or invalidity of the contract pertaining to a particular borrowing.

Another important consideration is that these statutes do not take away the freedom of contract between guarantors or their representatives and the borrowers. While this freedom is desirable it is important to note that it may, in the absence of appropriate limitations, determine the nature of the guarantor's liability. Such freedom allows any level of government to guarantee a debt on its own initiative. In law, the results between requested guarantees and voluntary ones are different. Where the request

²² Forsyth and Pretorius 1992: 107-153. See also O'Donovan and Philips 1985.
²³ 97 of 1996.

for a guarantee emanates from the debtor, he or she is implied to have assumed responsibility to reimburse the guarantor once the creditor has been paid. On the other hand, when a contract of suretyship is negotiated between the creditor and the surety, the latter is merely entitled to be subrogated to the claims of the creditor.²⁴ Without requiring borrowers to reimburse guarantors, the statutes which make provision for borrowing shall generate the risk of an even bigger debt for governments.

Even if the foregoing considerations were unimportant, guarantees as a mechanism for achieving important national objectives would still be problematic. Certain requirements would still have to be satisfied. These are clear from the definition and functions of a guarantee at common law.

Guarantees are in general contractual obligations.²⁵ By definition a guarantee, in the form of an accessory contract, is simply a promise by one person to answer for the due performance of the obligation of another person (whether imposed by law or contract) in the event that the other person fails to perform that obligation as required.²⁶ In most, but by no means all, cases, the guaranteed obligation will be a debt.²⁷ In this way, a guarantee therefore is a form of contract security which reinforces the obligation of the original or principal obligor with the secondary undertaking or obligation of the guarantor or surety. Guarantees are some of the most common forms of security in use in commercial transactions. Closely akin to them are indemnities and stand-by letters of credit.²⁸ However, there are certain requirements and formalities which have to be complied with.

An obligee who hopes to benefit from a guarantee tendered to him as security must ensure that it is valid by ensuring that it conforms to certain legal requirements. Such requirements are contractual in nature. Indeed, as a guarantee is a form of contract, it is essential for it to satisfy the requirements that are peculiar to all contracts. Thus, in a guarantee, as in all the other contracts a degree of specificity must exist. There must be an offer to guarantee and an acceptance of that offer by the creditor. The parties must have legal capacity. They must also sign the guarantee either by their own hand or through a duly authorised agent. All the fundamental terms of the guarantee must be clearly spelt out. The guarantee may be made general or conditional. Where it is conditional, the condition must be fulfilled before the guarantor may become liable. Be this as it may, the guarantor's liability should never be in excess of that of the principal debtor. In addition, under the General Law Amendment Act:²⁹

"No contract of suretyship entered into after the commencement of this Act [22 June 1956] shall be valid, unless the terms thereof are embodied in a written document signed by or on behalf of the surety: Provided that nothing in this section shall affect the liability of the signer of an aval under the laws relating to negotiable instruments."

24 See e.g. Forsyth and Pretorius 1992: 55.

25 See e.g. Christie 1981: 1.

26 See e.g. *Re Conley* [1938] 2 All ER 127 (CA). See also McGuinness 1986: 1; O'Donovan and Philips 1985: 8.

27 McGuinness 1986: 1.

28 Bertrams 1990: 3.

29 50 of 1956, as amended (retrospectively to 22 June 1956) by s 34 of Act 80 of 1964.

Furthermore the provisions of the Stamp Duties Act³⁰ must be observed. It is the duty of the person executing the instrument to ensure its stamping.

While all spheres of government issuing guarantees may have no difficulty in complying with these requirements, it is clear that a formal reference to them in the enabling legislation would be appropriate. Such a reference would, in addition, have removed the danger of any sphere of government assuming that what is not specified in the Act need not be observed. It may, for instance, oblige itself as guarantor in respect of an *ad factum praestandum* obligation. Such an obligation consists of an undertaking to deliver some *res* or to perform some function which requires the exercise of personal skill.³¹ An undertaking of this nature may take the guarantor out of its mandate and expose it to losses through additional costs.

7 PROBLEMS OF A GUARANTEE

In identifying guarantees together with loans as some of the key sources of finance for local government structures, Parliament may have considered them to be the best suited mechanisms for that task. Undoubtedly, a guarantee has many attractions. These range from the benefit of giving substance to men of straw, acting as a means of transferring goodwill and reducing the transaction costs of enforcement³² or the elimination of doubts about title and risk spreading.³³ Other advantages are that guarantees themselves are a form of business for the guarantor and can constitute a part of a wider transaction involving related parties.

Guarantees also do have certain disadvantages. Significant about a guarantee is that unlike a mortgage or pledge, the security it affords is usually (although not necessarily) in the form of a personal undertaking of the surety that the debt will be paid or the obligation performed. It is not a security of a tangible or proprietary nature.³⁴ In other words, it is a security *in personam* as opposed to a security *in rem*. This means that in the event of a default by the principal debtor, the creditor has extended personal rights against not only the debtor but a third party as well. Those rights are merely personal and if the surety is unable to pay, the creditor may have to sequestrate the estate or join in as a concurrent claimant in the insolvent estate of the debtor. In these circumstances, the creditor may find him or herself at a disadvantage should the assets be insufficient or non-existent.

In the case of a surety who is a sovereign or organ of the state, the creditor is at a further disadvantage as the option of sequestration is usually not available. While most loans made to states are premised on the notion that these entities are above sequestration, it is known from experiences elsewhere that they do in fact suffer from bankruptcy in

30 77 of 1968.

31 Forsyth and Pretorius 1992: 90.

32 McGuinness 1986: 10-16.

33 McGuinness 1986: 17.

34 Goode 1982: 706. See also Millin and Wille 1995: 311 and Scott and Scott 1987: 5.

practice from time to time. The rescheduling of debts by African and other developing countries, which characterises the G7 meetings, is the case in point. Such rescheduling must, from the point of view of a commercial lender, entail some kind of loss or at the very least some discomfort. Another notable concern about a guarantee undertaken by the state is that although it is irrevocable,³⁵ there are other factors such as the state's monopoly over the determination of economic policy and rates of interest and exchange which may dilute its appeal to lenders. Given such considerations, and the well known liabilities of the South African state, it is doubtful whether lenders will be overly excited about the guarantee mechanism, at least in the years to come.

Perhaps no other example is more apposite in demonstrating the tendency of lenders to look askance at state sponsored guarantees than the experience of the Zambian small scale borrowers. When it was realised that that group of borrowers lacked the requisite securities to attract advances from financial intermediaries, the government stepped in with a credit guarantee scheme under the auspices of the Bank of Zambia Act. The Bank of Zambia itself, a state institution, was to give guarantees, provided certain simple requirements were satisfied. To date, the performance of that scheme has been unsatisfactory. Among other reasons, it has been acknowledged that the precarious financial situation of the country in general, and of the Bank in particular, does not instil confidence in the lenders that their advances will be recovered or recovered within the stipulated time frames.³⁶

Furthermore, it has been pointed out that being an instrument that only imposes an accessory liability on the guarantor, a guarantee is not exactly cheap.³⁷ Not only does it expose the guarantor to a risk of loss to which it would not otherwise be exposed, but by giving a guarantee a surety assumes the liability of another person in connection with the guaranteed obligation, although he or she may draw no direct benefit from the transaction to which that obligation relates.³⁸ Indeed it has been argued that merely giving a guarantee may do much to undermine the entire basis upon which the surety has structured his or her own commercial dealings.³⁹ For instance, where a shareholder gives a guarantee in favour of a limited corporation, he or she loses his or her limited liability in respect of the affairs of that corporation to the extent of the guarantee which he or she has given.⁴⁰

In addition, there are certain other direct and indirect costs to the creditor. These include the reduction in the creditor's freedom of movement in respect of the guaranteed debt.⁴¹ Moreover, a guarantee

35 Exchequer Act 66 of 1975, s 35 (3).

36 See Ailola 1985.

37 McGuinness 1986: 7.

38 McGuinness 1986: 7.

39 McGuinness 1986: 7.

40 McGuinness 1986: 7.

41 McGuinness 1986: 7.

must be bought for a consideration. While this is particularly true of guarantees given by commercial guarantors, it is also relevant to other situations. Thus, even where the consideration for the guarantee is no more than an agreement to enter into a transaction with the principal debtor, a creditor may find his insistence upon the provision of a guarantee to be costly to him. This is because the availability of other commercial lenders may force him to give his advance at a considerable discount.

Another important factor concerning the cost of guarantees is, of course, the expense of enforcement. A creditor may have to spend money to realise securities where they are provided or to excuss against the debtor, before he or she can demand settlement from the guarantor. Although the creditor can pass on these costs to the debtor by means of scrupulous drafting, the ultimate high cost of the guarantee serves to make it less attractive. The end result is that local authorities may be compelled to use it only as a last resort.

8 CONCLUSION

The need for effective local governments in post-apartheid South Africa has been recognised and firmly entrenched in its constitutional instruments. Those instruments provide for the allocation of public funds to this level of government for purposes of fulfilling its mandate. In addition, municipalities are allowed to use their own earnings or to borrow from other sources for bridging and capital projects. Such borrowing may, where necessary, be guaranteed by the national or provincial government. The loans of other entities may also be guaranteed in this way. All guarantees are, however, required by law to be based upon the satisfaction of certain legal basics. These relate to the nature, size and purpose of the borrowing. Also critical is the nature of the guarantor's liability. In particular, it is critical to limit that liability in light of the numerous competing obligations, at least on the part of the national government.

While these requirements may have been met in respect of the borrowing activity itself, virtually all the statutes dealing with the subject make no similar provisions in respect of guarantees. The Constitution is also silent on the matter. Quite clearly, a case exists for parliamentary intervention.

Other requirements, even if they are covered by the common law, should to some degree also be mentioned in the statutes to clarify the powers of the guarantor and the nature of its liability. These should include a stipulation to the effect that the guarantor may not incur a higher debt than the principal debtor. In addition, a guarantor's freedom to waive its rights to the benefits of suretyship or to reimbursement should be limited, as should the practice of giving unsolicited guarantees. All the common law requirements as to capacity to contract must be required and all liability must cease once the principal debtor is found not to be bound by the contract of loan either on account of incapacity, breach of contract, invalidity or illegality. Guarantees must also comply with the requirements of the Stamp Duties and the General Law Amendment Acts by being stamped and in writing, respectively.

The use of a guarantee as an instrument for achieving important local government goals is also susceptible to potential problems. The potential high cost of the guarantee mechanism to all the parties concerned may diminish its usefulness as a tool for achieving the stated goal and aspirations. In short, what is required is to strike a balance between aspirations of local governments to provide services efficiently and the need to ensure financial prudence on the part of the national and provincial governments. There is no better place to do so than in the envisaged enabling legislation.

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