FINANCIAL AND FUNCTIONAL VIABILITY, AND SUSTAINABILITY OF MUNICIPALITIES – BEYOND THE DEMARCATION INSTRUMENT

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MDB Conference on Demarcation and Spatial Transformation

23 June 2016

For an Equitable Sharing of National Revenue

STRUCTURE OF PRESENTATION

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INTRODUCTION

- The relationship between financial viability, functionality and demarcation once again came to the fore in 2015.
- The Minister of CoGTA proposed that some municipalities be amalgamated in order to deal with challenges of financially non-viable and dysfunctional municipalities- i.e. make municipalities self-reliant, self sufficient and self sustaining.
- According to CoGTA, only a third of the SA municipalities were viable in 2015, with the remaining two thirds financially non-viable (whatever the definition) and non-functional.
- To correct for dysfunctionality and financial viability, the Minister of CoGTA proposed the redrawing of some municipal boundaries.

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Policy Questions

Is amalgamation a sustainable approach to securing viable local municipalities? Many related policy questions emerge from this:

- What constitutes a viable/dysfunctional municipality?
- Whatever the definition, will the proposed mergers create financially viable municipalities?
- Is viability a requirement for demarcations and can it be elevated to dominate other factors?
- Can re-demarcating boundaries eliminate dysfunctionality, and should dysfunctionality be a factor when determining demarcations?

FFC has examined these questions and examined whether current amalgamations will create "viable" or self -sufficient/self-reliant or functional rural municipalities?

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Approach

We report results from:

- Desktop work by Commission on the impact of demarcations before
- International case studies
- Desktop work by the Commission on the likely impact of the 2016 demarcations
- Colloquium held exactly a year ago -included over 80 participants from national departments (CoGTA, National Treasury, Department of Performance, Monitoring and Evaluation in the Presidency); provincial treasuries (Gauteng, Free-State and Western Cape); provincial CoGTAs (KwaZulu-Natal and Gauteng); municipalities SALGA); SACN; academic institutions; Institutions Supporting Democracy and MDB

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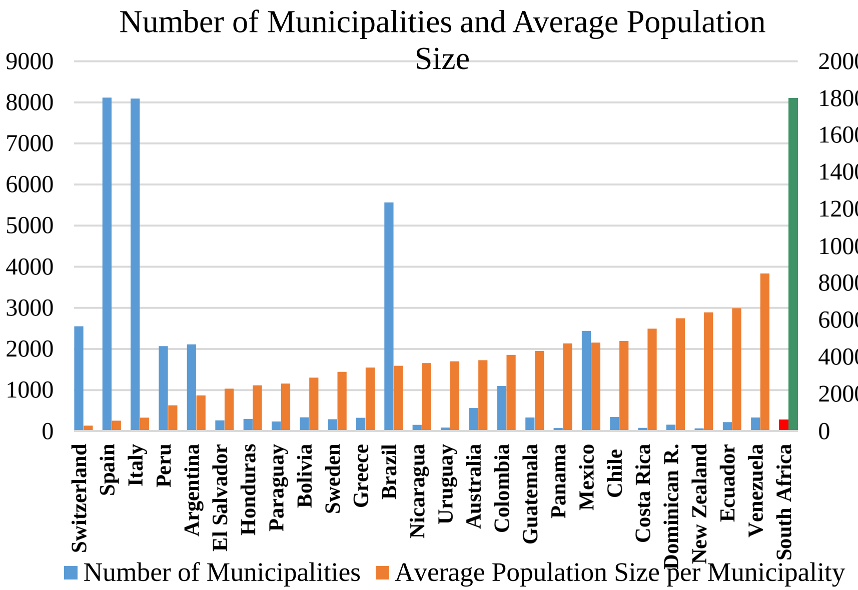
BACKGROUND



	Number of councillors	Number of citizens per councillor
Republic of Ireland (2014)	949	4861
New Zealand (2000)	1892	2039
Philippines (2000)	2102	37075
Malaysia (2000)	2921	7654
Nepal (2000)	3344	7099
Australia (2000)	6637	2886
South Africa (2011)	9090	5671
Canada (2014)	19534	1819
Japan (2000)	62452	2031
China (2000)	653244	1933

- Literature is clear that there is no optimal municipality size but…
- South Africa is among countries with the lowest number of municipalities but one of the highest average population sizes per municipalities: Potentially compromises representativity and accountability
- When local government structures are large then citizen participation becomes weaker, save for technologically connected municipalities.

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FINANCIAL VIABILITY: THE CONCEPT

- Proposals to amalgamate municipalities in 2016 was partly underpinned by a desire to make municipalities financially viable. To elevate financial viability to a criterion/factor for demarcation, it is important that stakeholders have a common understanding of its meaning. This will assist in the implementation, monitoring and evaluation of the merger project. If there is no common understanding among stakeholders, it becomes difficult as the yardstick for assessing the outcomes will vary as the definition varies
- National Treasury, refers to financial viability as the sustainability of the municipal budget, and whether the municipality is able to sustainably meet its expenditure commitments from its own revenues and transfers. NT definition allows for dependency.
- According to CoGTA a municipality that is not self-sufficient/self-reliant or if it is dependent on grants is considered financially non-viable.
  - The Constitution (214 a-j) allows for dependency, i.e. some municipalities will have poor revenue bases and therefore be dependent on transfers
- Are district municipalities financially non-viable due to limited revenue bases?

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Financial Viability: The Concept

- **Two points from this:**
  - There is a need for a common understanding of what constitutes a financially viable municipality.
    - In the absence of a common understanding of the concept, financial viability should not dominate other factors in the demarcation process.
  - The main point is that financial viability should not be equated to self-sustainability or lack of dependence. The Constitution and Division of Revenue Act allow municipalities that are transfer dependent to exist as they serve other purposes, e.g. political representativity or coordination, as is the case with district municipalities.
- **Is financial viability a factor or a criteria?**
  - Section 24 of the Municipal Demarcation Act is clear that financial viability is but one of the 12 factors that has to be taken into account when demarcating municipalities:
  - The elevation of financial viability to *the* demarcation criterion can thus be effected by reviewing the MDB Act.

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IMPACT OF AMALGAMATIONS ON THE FINANCIAL VIABILITY OF MUNICIPALITIES: LESSONS FROM OTHER COUNTRIES

- One view is that consolidation of municipalities improves their effectiveness and efficiency, or simply "bigger is better" or "bigger is cheaper" and bigger translates to improved services, bigger is more efficient, and more recently bigger is more financially viable and implies increased financial sustainability.
  - Larger municipalities are cost saving, enhance productivity, improve the quantity, quality and mix of local services, facilitate more effective lobbying
- A different view is that smaller and many municipalities are also more efficient, more responsive to the changes in community needs, and accountability channels are clear cut.
  - Smaller municipalities stimulate competition resulting in efficiency
- Studies mainly from Australia, Canada, Japan, America and Western Europe show mixed results….
  - Hence conclusion that there is no optimal size of municipality

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Impact of Demarcations: Empirical evidence from previous FFC work

- The FFC has been working on demarcation impacts since 2013 when Tshwane municipality requested the Commission to evaluate the impact of its merger with other municipalities. The Commission broadened this exercise to include case studies of other municipalities that have gone through mergers
- The Commission concluded that demarcation processes:
  - Are costly, and in the short run and affect the financial sustainability of municipalities have potentially negative effects on the viability of affected municipalities.
  - The main cost drivers include the integration and consolidation of programmes, upgrading of data services; rationalisation of services, fees and tax rates, payroll systems, voters roll and administrative policies; change management costs; harmonisation of systems, harmonisation of asset registers, human resources policies, wages, salaries and allowances; and costs associated with coordination, communication, retraining and retooling of workers.

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PREVIOUS FFC RECOMMENDATIONS

- The Commission recommended
  - that before the actual decision to change boundaries is pronounced, the financial and fiscal implications of boundary changes should be established
  - that a transitional demarcation grant be awarded to the amalgamated municipality to facilitate the restructuring process and to minimise the effect of demarcation on municipal budgets.
    - In 2014 Government subsequently introduced a transitional grant to support municipalities undergoing major boundary changes.

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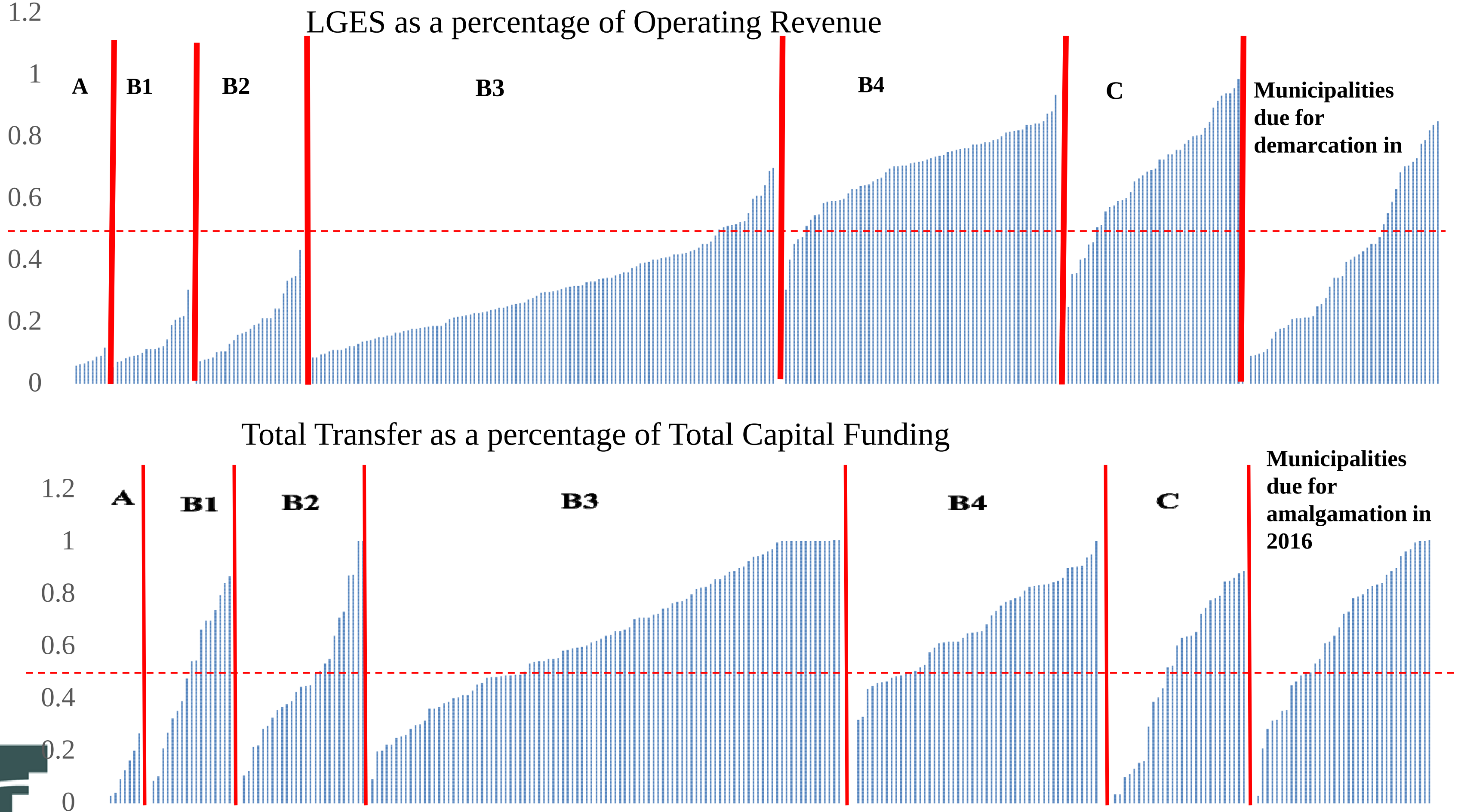
2016 Demarcations and Financial Viability: Empirical evidence

MDB Conference: 23 May 2016

DEPENDENCY



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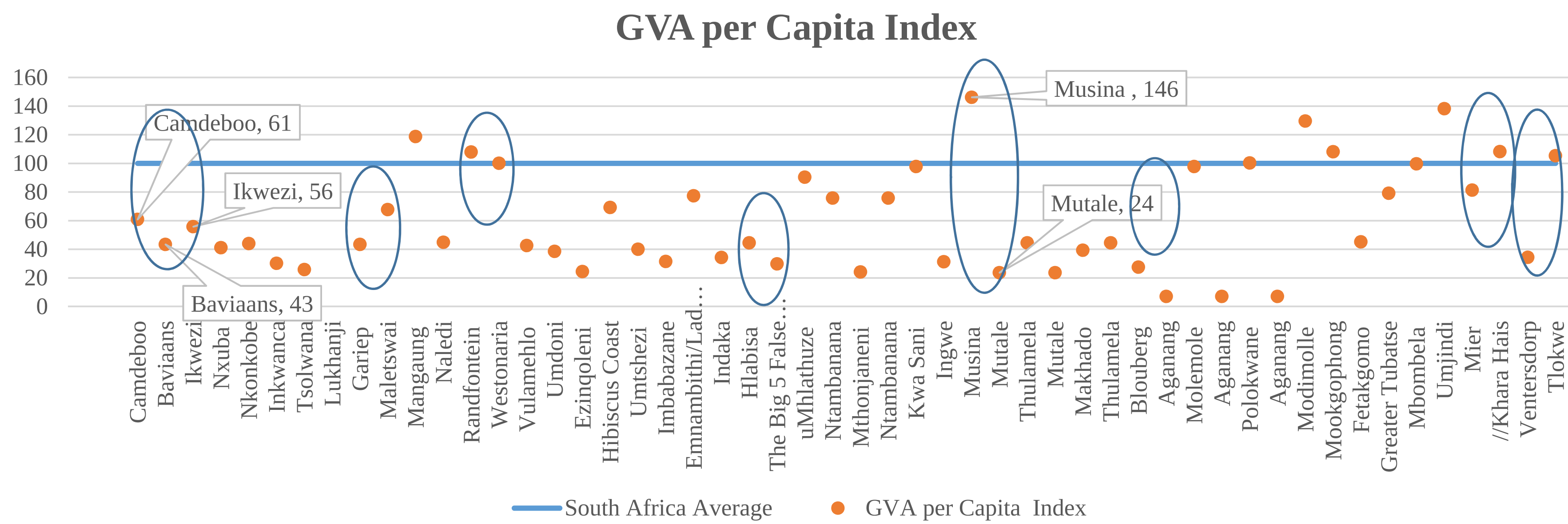
RESULTS: GVA PER CAPITA INDEX



- The majority of municipalities due for demarcation in 2016 are below the South African GVA average.
- Over 80% of the municipalities due for demarcation thus have a weak potential revenue base.

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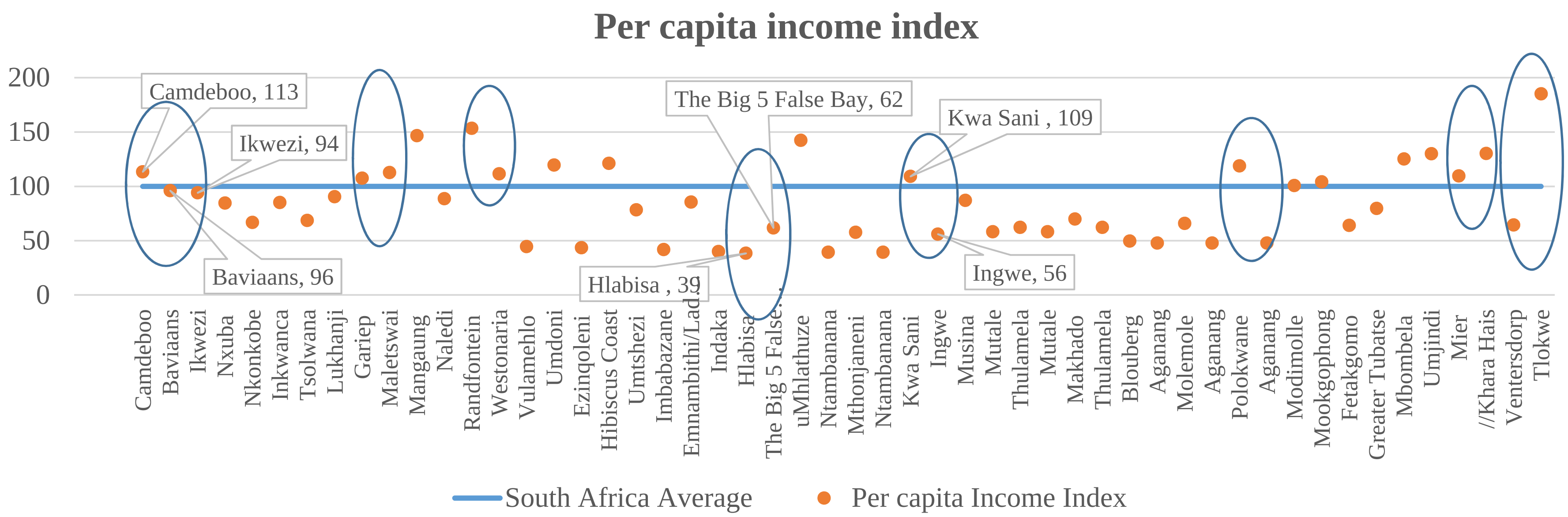
RESULTS: PER CAPITA INCOME INDEX



- Almost 70% of the affected municipalities fall below the South African average.
- An indication that, other things held constant, the communities of such municipalities would be hard pressed to meet their financial needs (e.g. the Hlabisa and Big 5 False Bay amalgamation).

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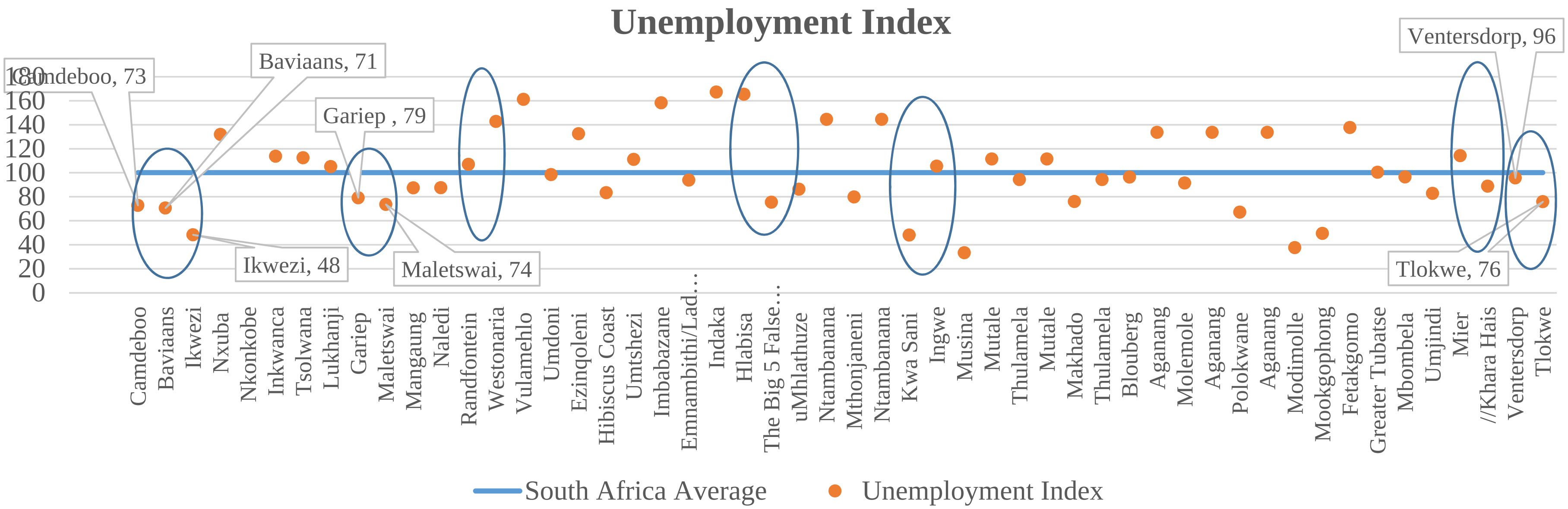
RESULTS: UNEMPLOYMENT INDEX



- Almost half of the municipalities due for amalgamation in 2016 have below average unemployment rates.
- An indication that a significant proportion of municipalities due for amalgamation have weak revenue bases.

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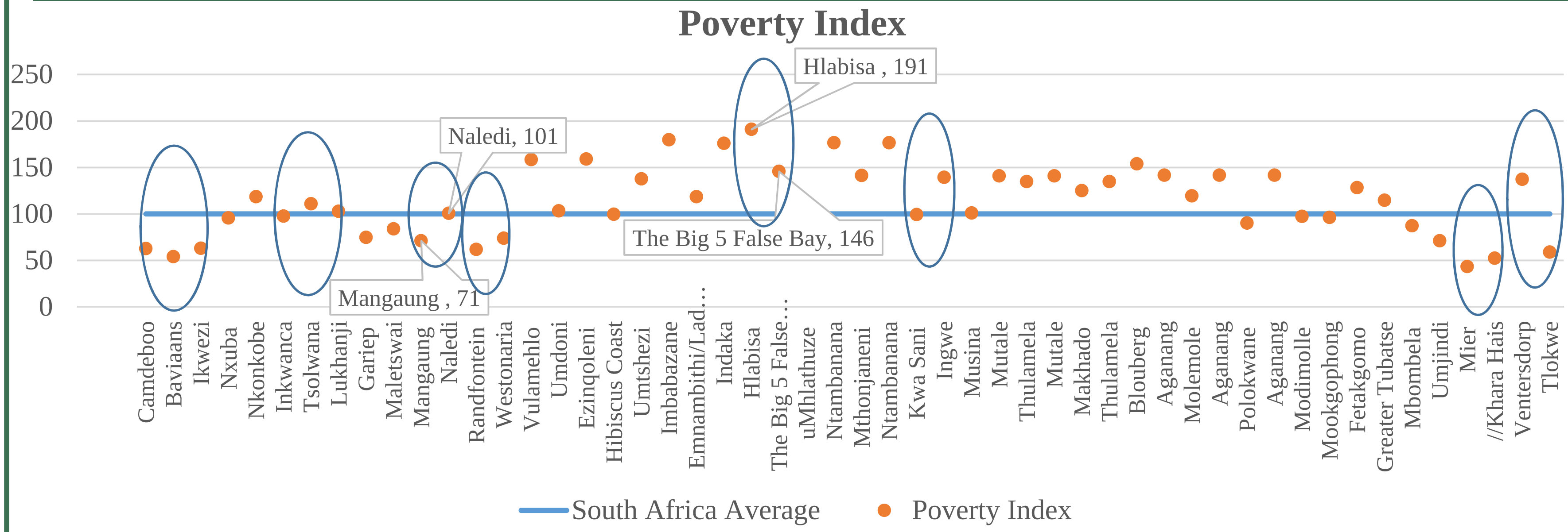
RESULTS: POVERTY INDEX



- Over 60% of municipalities fall below the average poverty level for all South African municipalities.
- This suggests that for many municipalities the mergers will not improve their poverty levels, or their revenue base (e.g. Hlabisa and The Big 5 False Bay).

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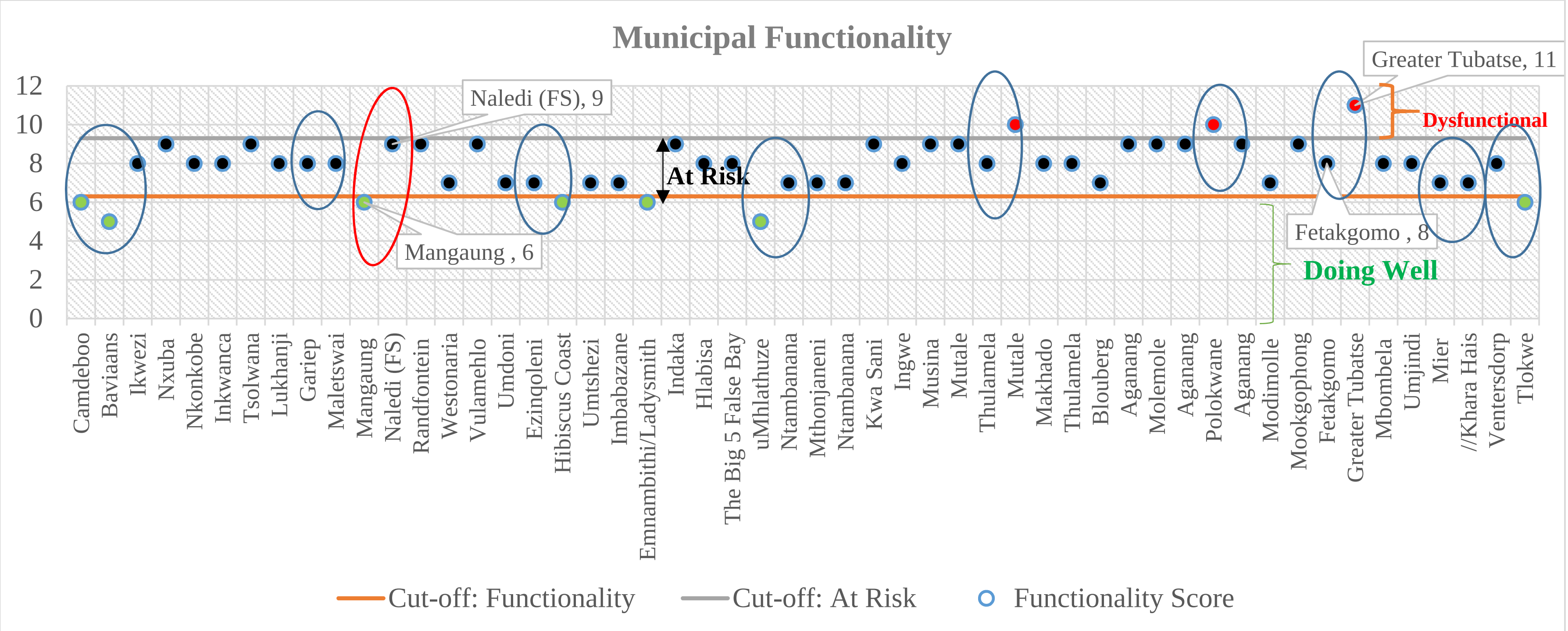
RESULTS: FUNCTIONALITY



- Most municipalities (80%) are at risk of being dysfunctional and 6% are dysfunctional.
- Amalgamating municipalities that are at risk of being dysfunctional may actually worsen the problem.

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CONCLUSION

- Amalgamations may not necessarily result in financially viable municipalities, and in many cases the situation of demarcated municipalities can worsen.
- The dependency ratio of many demarcated rural municipalities is too high to be reversed by amalgamations.
- The results indicate that many rural municipalities will continue to be transfer dependent as their revenues bases are fragile and weak. T
  - ransfers will remain the main revenue source of many rural municipalities.
  - It is also important to note that the constitution is sensitive to transfer dependent municipalities and the transfer system has to cater for this.
  - Thus government should fund political and democratic representativity in municipalities considered unviable.
- Some municipalities should exist to serve other equally important roles such as ensuring that communities are politically and democratically represented

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CONCLUSION CONT'

- Elevating functionality to a demarcation criterion is problematic as there is neither a direct nor an indirect link with municipal boundaries.
  - Such a move may simply raise expectations about the demarcation instrument that the tool will never be able to realistically fulfil.
- Amalgamations are a long term measure that cannot correct for short term operational problems associated with municipal dysfunctionality.
- The huge costs associated with boundary changes demand a relook at the frequency of demarcations.
  - Very frequent demarcations can be disruptive and counterproductive to many policies and initiatives to improve the wellbeing of municipalities.

RECOMMENDATIONS: BEYOND THE DEMARCATION INSTRUMENT

- The MDB should not make "financial viability", the core criterion of demarcation in the absence of a shared definition or common understanding of this concept.
  - The MDB should continue to treat financial viability as **one** of the 12 criteria when making boundary changes until definitional and common understanding of the concept is established.
- The MDB needs to consider conducting studies on the viability of previously demarcated municipalities before making its final decisions on demarcations.
  - The financial and fiscal implications of boundary re-determinations should be prioritised and established before any demarcation decision is pronounced

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RECOMMENDATIONS: BEYOND THE DEMARCATION INSTRUMENT

- The National Treasury and the Department Cooperative Governance and Traditional Affairs should:
  - Allow municipalities that are not self-sufficient to be funded through the transfer system as per constitutional provisions and not amalgamate such municipalities as they could be serving other crucial constitutional imperatives such as democratic representation and community participation. The transfer system should be allowed to fund political and democratic representation, and community participation in municipalities considered "financial unviable".
  - Seek to achieve "financial viability" in municipalities by increasing or developing tax bases through economic development rather than amalgamating municipalities.
- The Department of Cooperative Governance should:
  - Amend the Municipal Structures Act to ensure that the financial impact and financial model of new municipality have been assessed before any amalgamations are done.

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RECOMMENDATIONS: BEYOND THE DEMARCATION INSTRUMENT

- Should seek to correct for dysfunctionality through relevant legislative, policy and capacity building measures than through amalgamations.
- Monitor whether mergers have been successful, and what the actual cost of mergers were.

- The Municipal Demarcation Board
  - Should assess the financial impact of mergers and actual costs determined before any merger is undertaken
  - Should not at this stage allow functionality to be elevated to a demarcation criteria as it has no direct nor indirect link with boundary changes.

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THANK YOU.

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