CHAPTER 13

A Collaborative Effort to Enhance Revenue Generation in Rural Municipalities

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A Collaborative Effort to Enhance Revenue Generation in Rural Municipalities

13.1 Introduction

Understanding the dynamics of rural municipality revenue sources and revenue capacity is crucial for policy-makers. An important lever, which can contribute effectively to rural development in South Africa, is a sound tax base and the ability of rural municipalities to carry out effectively their expenditure and developmental mandates. Many rural municipalities cannot achieve this without support from national and provincial government. Therefore, all three spheres of government need to collaborate to ensure investment in the local economy and efficient use of existing tax bases in rural municipalities.

The main purpose of this chapter is to study the dynamics and influencing factors of the rural municipal tax base. It looks at whether the revenue limitations in rural municipalities, as evident in Table 42, are a result of structural (i.e. limited or non-existent tax bases) or administrative (i.e. poor performance in collecting revenues owed to the municipality) problems. Using the property tax instrument as a general indicator/proxy for the rural tax base, statistical methods[7] were used to estimate the tax potential from property rates and the ability of rural municipalities to maximise this tax base. The factors (including historical factors that affect local politics and society) that influence rural municipalities' ability to generate revenues were also determined.

In general, the chapter confirms that the rural tax base is highly constrained, although rural municipalities also do not perform well in collecting the revenue owed to them. Rural areas are characterised by high levels of poverty and low levels of economic activity, which limits their capacity to perform duties effectively and stimulate the local economy.

13.2 The Context of South African Municipalities

13.2.1 Historical Development of Rural Municipalities

Prior to South Africa's first democratic elections in 1994, apartheid policies effectively distorted market forces and skewed the efficient distribution of resources along racial lines. Rural municipalities were historically found mostly in the former Bantustan areas, which were characterised by a lack of investment and predominantly subsistence farming activities. In these areas, no formal local government structures existed, and traditional leaders, with the power to allocate and administer land, dominated local politics.

Following the demise of apartheid, South Africa's new Constitution simultaneously created a developmental local Government[8] system and recognised the role of traditional authorities within these regions.[9] Establishing a democratic Local Government structure alongside the authority of traditional leaders created issues of political accountability in these areas. These historical factors continue to have an impact on contemporary rural Local Government's expenditure mandates and generated revenues.

[7] The study used the Stochastic Frontier Analysis (SFA) method for a sample of 70 rural municipalities (as per the Department of Cooperative Governance's classification system) over an eight-year period. The method estimates the potential (property rates) revenue that a rural municipality can generate from its local community given the characteristics of the local tax base (economic activity, poverty etc.). The SFA method was also used to quantify the efficiency (or performance) of the municipality in reaching this potential revenue.

[8] Section 153

[9] Section 211

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13.2.2 Funding Mix Across Different Municipalities

Local government is assigned various expenditure responsibilities along with complementary taxation powers, supported by grants, to fund such responsibilities. Municipalities are mandated to provide basic services to communities (such as water and sanitation), while playing a direct and indirect role in the development of the local economy. Therefore, the fiscal powers afforded to municipalities can have a significant impact on local development, and ultimately national development, as well as enhance democracy by creating a direct link between local taxes and service provision that meets the needs of communities.

Expenditure and revenue powers may be devolved uniformly to the local government sphere, but the ability to use those powers differs quite markedly. Each municipality operates in unique economic and demographic circumstances that are fundamental in determining revenue and expenditure performance. The differences reflect the social and economic inequalities across the South African landscape. Therefore, the ability to generate taxes varies considerably across the various municipal jurisdictions.

Tables 42 and 43 highlight the markedly varying ability of different types of municipalities to generate revenues. As Table 42 shows, rural municipalities are highly reliant on intergovernmental transfers, with grants comprising 70 per cent of their total revenue in 2009/10. This trend is expected because of high levels of poverty and low levels of economic activity (Table 43) that have a negative impact on the ability to generate own revenues from local communities.

Table 42: The Funding Mix Across Different Municipalities 2009/10

Type of Municipality	Government Grants	Investment Revenue	Other	Property Rates	Public Contri-butions and Donations	Service Charges
Metropolitan Municipalities	24%	2%	9%	18%	0%	48%
Secondary Cities	25%	1%	14%	14%	0%	46%
Larger Towns	28%	1%	9%	19%	0%	42%
Smaller Towns	40%	1%	10%	11%	0%	37%
Rural Municipalities	70%	1%	12%	6%	0%	11%
Districts without P&F	75%	5%	16%	1%	1%	2%
Districts with P&F	85%	2%	5%	0%	0%	8%
Total	**33%**	**2%**	**10%**	**15%**	**0%**	**41%**

Source: Commission's calculations

Table 43: Differences in Economic and Demographic Profiles Across Types of Municipalities

Type of Municipality	Total Population	Total households	Total gross Total value added per capita	% of people employed	% of households below R3200pm	Average population density	Operating expenditure per capita	Revenues from local taxes per capita
Metropolitan Municipalities	16,974,424	4714,021	75.67	34%	46%	1388	3,789.48	3,279.51
Secondary Cities	8,233,208	2,207,004	50.80	29%	59%	221	2,242.55	1,940.00
Larger Towns	3,985,216	1,074,513	40.83	27%	62%	87	1,843.08	1,513.82
Smaller Towns	6,906,926	1,808,666	29.16	22%	69%	19	1,466.46	988.70
Rural Municipalities	12,331,695	2,673,914	9.44	13%	80%	81	370.49	120.77
Total	**48,431,469**	**12,478,118**	**41.18**	**25%**	**63%**	**359**	**1,942.41**	**1568.56**

LG Turnaround Strategy

13.2.3 Defining Rural Revenue Capacity and Revenue Effort

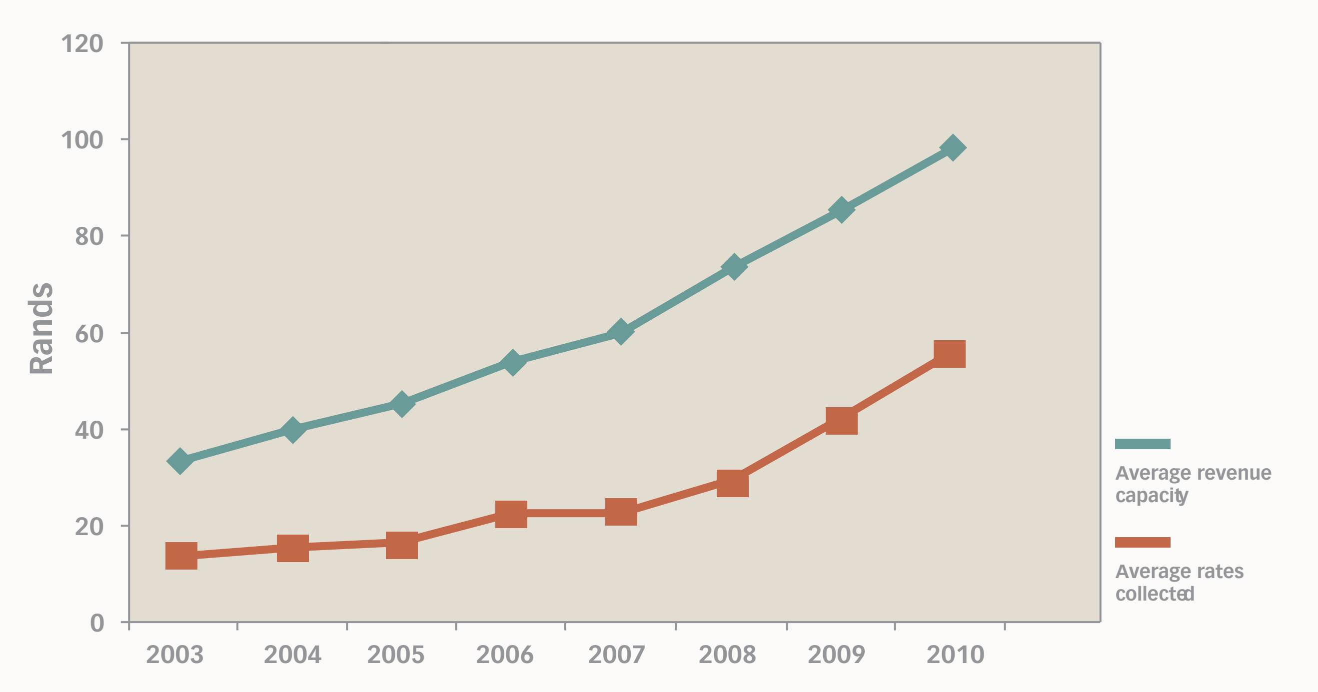
Revenue capacity is the ability to generate revenues, whereas revenue effort is the effectiveness in collecting revenues. Factors outside the municipality's control affect revenue capacity. These factors include economic activities and demographic factors, such as population size, income levels and high levels of poverty that can diminish the ability of local community members to pay taxes and for services. In contrast, revenue effort highlights internal aspects, such as the municipality's inefficiency or lack of capacity to collect revenues from local residents. These internal aspects usually manifest in the form of high vacancy rates, inadequate skill levels and low levels of competence to undertake operational tasks. Issues such as financial mismanagement and corruption can also exacerbate such inefficiencies and will ultimately affect the revenue effort of rural municipalities.

13.3 The Findings

13.3.1 Econometric Results

Statistical methods are used to estimate the revenue capacity of the rural property rates base and assess the ability of rural municipalities to maximise this base.

Figure 23: Property Rates Revenue Capacity Versus Actual Property Rates Collected



Source: Commission's calculations

As Figure 23 shows, rural municipalities collected much less revenue from property rates than they could have collected. In 2010/11, rural municipalities collected only R56 out of potential revenue of R99 per person, or just over half of the potential revenue. Although performance has been improving, rural municipalities still collect far less than the predicted property rates revenue.

A comparison of property rates per capita collected shows that the property rates tax base is much weaker in rural areas than in urban areas. For example, in 2003/04, metros collected on average R647 per person compared to R34 per person for rural municipalities. This is the metros' revenue *effort* (not revenue capacity) for property rates. To emphasise, in 2009 the average revenue effort of metros was R1,075 per capita, whereas the average revenue potential of rural municipalities was R85 per capita. The rural tax base for property rates is clearly constrained relative to other areas.

The findings also reveal that revenue capacity (the blue line in Figure 23) is determined by the local economic activity and demographic factors, such as the proportion of people over the age of 65. A higher proportion of people above the pension age suggest that such individuals benefit from property

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tax rebates, as they cannot afford to pay for property rates. High levels of unemployment also have a negative effect on the ability to generate property rates in rural areas. Ultimately, the low levels of economic activity explain the limited tax base in rural areas.

The performance of rural municipalities in collecting revenues (revenue effort or the ability to maximise their tax base – the red line in Figure 23) shows that social issues play an important role. Revenue collection is better in areas where local residents have higher levels of disposable income, indicating that people who can pay are willing to pay property rates. Municipalities with high levels of income inequalities within their communities have a lower ability to collect the revenues due. This is likely because of social tensions that result in local communities not being willing to pay taxes and services.

Interestingly, municipalities with higher levels of traditional households have a lower ability to collect revenues due. However, this is not a statistically robust finding, which is surprising given the complexities of traditional leadership in respect to revenue collection in these areas, particularly property rates. The other factors highlighted above appear to be more significant in explaining revenue effort. The local government equitable share (LES) allocated to rural municipalities is another interesting variable, as a positive and significant relationship was found between the LES allocations and revenue effort in collecting property rates. One explanation could be that municipalities are using this funding to improve their billing and collection efforts.

13.3.2 A Spatial Perspective of Findings

A spatial analysis of the rural tax base and tax effort is used to explore the dynamics of the rural tax base, by assessing whether revenue capacity and effort improve as a result of jurisdictional spill-over effects, based on the location of the rural municipality in question. Spill-over effects from adjacent urban areas may in certain cases affect the local tax base and tax effort of rural municipalities. Figure 24 offers a spatial illustration of the relative revenue capacity (the blue line in Figure 23) of each rural municipality and the location of metropolitan municipalities, secondary cities and larger towns. It includes the impact of economic and social spill-over on property rates, revenue capacity and revenue effort. Some rural municipalities adjacent to urban municipalities have a higher tax base, which is likely the result of spill-over effects.

It is important to reiterate here that, although the property rates tax base is largely immobile, this analysis is on the general tax base, with the property rates tax base being used as an illustration. Furthermore, economic and social spill-over (for example people working in the urban municipality but residing in the adjacent rural municipality) can have an impact on the property rates tax base. Specifically, rural municipalities around eThekwini (for example, Vulamehlo), Buffalo City and Gauteng appear to benefit relatively from the economic spill-over effects. In contrast, municipalities in deep-lying rural areas have no or a very limited tax base.

The property rates revenue effort map illustrates the proximity of rural municipalities to their urban counterparts and the subsequent revenue effort in maximising their tax bases (the red line in Figure 23). Interestingly, the municipalities that have stronger property tax revenue bases (due to possible spill-over effects from adjacent urban areas) do not maximise their tax base. Other factors appear to affect this revenue performance, such as potential social dynamics or funding constraints.

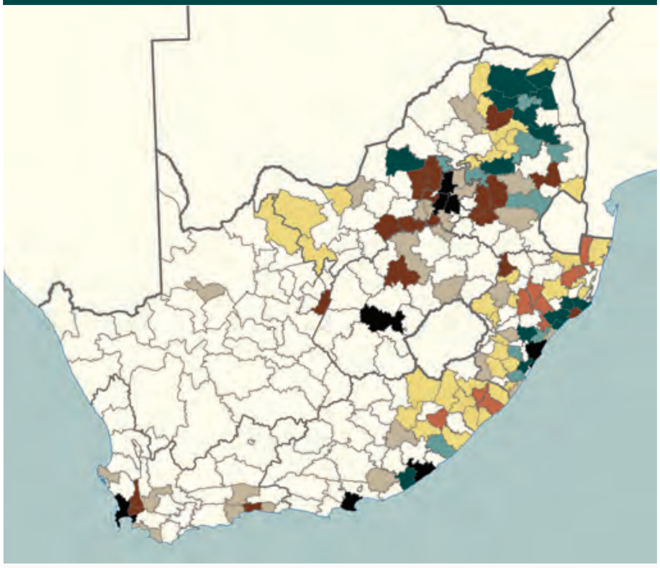
Figure 25 extends the analysis by looking at adjacent municipalities with high economic activity, as measured by gross value add (GVA) per capita. As expected, the trend is similar to the one described above. The economic activity in deep-lying rural areas is highly limited, and the country has pockets of areas with very low levels of economic activity and no adjacent economic base.

(See Figures 24 & 25 on page 148)

[10] As mentioned above, traditional leadership coexisting with a democratic local government structure creates ambiguities over political leadership in such areas. The primary issue is the apparent conflict between traditional authorities (chiefs) and local government, which emanates from the question of who has rights over land administration in these rural areas. Consequently, municipalities experience difficulties in collecting revenues from households that are under the administration of these traditional authorities i.e. communal land.

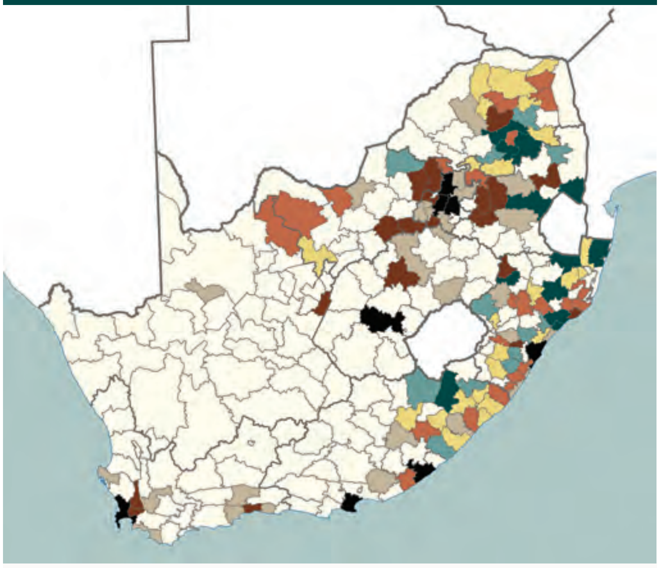
Figure 24: Property Rates Revenue Capacity/Effort 2010 and Proximity to Urban Areas

Property Rates Revenue Capacity



- Revenue capacity of 0 to R50;
- R50 to R100;
- R100 to R150;
- over R150
- Metropolitan Area;
- Secondary City;
- Large Town

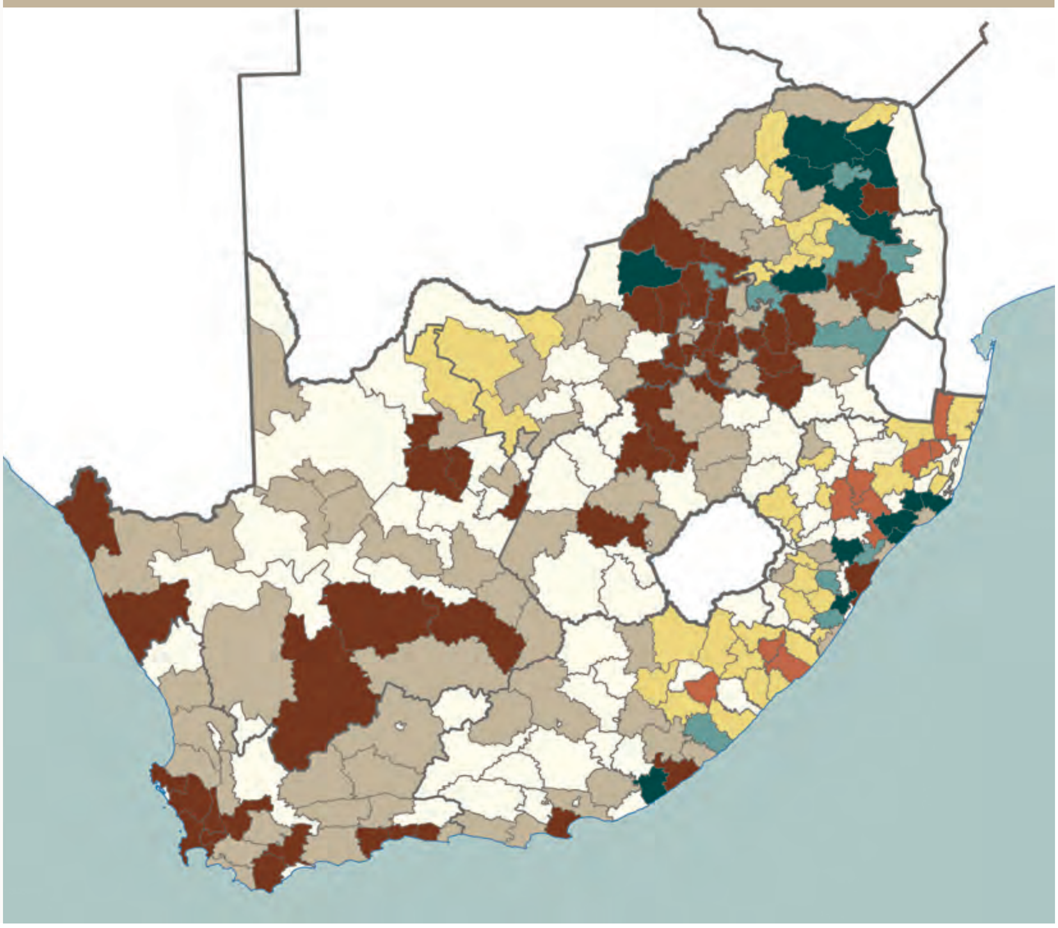
Property Rates Revenue Effort



- Revenue effort score 0 to 0.25;
- 0.25 to 0.5;
- 0.5 to 0.75;
- 0.75 to 1
- Metropolitan Area;
- Secondary City;
- Large Town

Source: Global Insight

Figure 25: Gross Value Added 2010 and Property Rates Revenue Capacity 2010



- Revenue capacity of 0 to R50;
- R50 to R100; light blue – R100 to R150;
- Over R150.(Dark Blue)
- Over R50000 per capita GVA;
- R25000 to R50000 per capita GVA

Source: Global Insight

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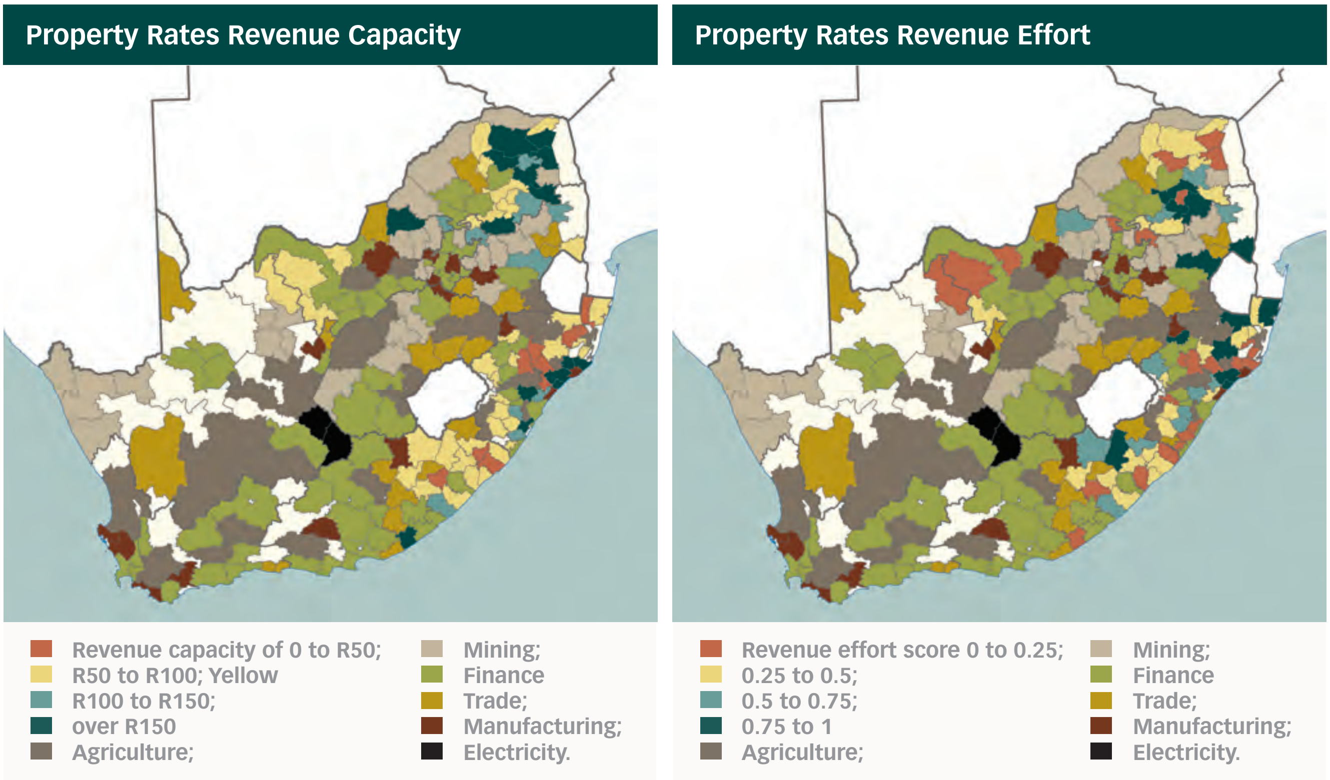
Figure 26 assesses the impact of adjacent major economic activity on the revenue capacity and effort of rural municipalities. Rural municipalities in areas dominated by agriculture appear to have a very limited property tax base. This is understandable given the low value-adding subsistent farming or low property values in these areas. Rural municipalities with a relatively strong revenue base are found along in the mining belt of the country as well as along the coast (which is logical given the greater value of property along the coastline). Figure 26 also compares the revenue effort of these rural municipalities with the dominant economic activity in adjacent municipalities. It shows that the rural municipalities along the coast, which have the greater revenue-raising capabilities, are not maximising their revenue base. This suggests that these municipalities are not taking advantage of their location, and other, non-structural factors clearly affect revenue efforts.

Figure 26: Dominant Adjacent Economic Activities and Property Rates Revenue Capacity/Effort



Note: Graph excludes community/government services: Source Global Insight

13.4 Analysis of Rural Development Policies

Understanding the dynamics of the rural tax base is clearly a complex issue. Based on the estimated revenue capacity of property rates, rural municipalities could collect much more revenue from property rates. However, relative to other areas in the country, the revenue base of rural municipalities is still quite low. Various dynamics are also at play within a rural tax base, including the availability of a coastline, an adjacent urban municipality or proximity to an important economic activity.

Given these dynamics, it is worth discussing South Africa's rural development strategies and efforts to stimulate economic development in rural areas. Rural development in South Africa cuts across all three spheres of government. General economic development through macroeconomic planning and investment is a national government policy priority, while provincial and local governments are constitutionally mandated to invest in their regional and local economies respectively. Both urban and rural municipalities are empowered to stimulate the local economy through their expenditure, revenue, and planning powers and functions. Generating higher levels of local economic activities will extend municipal tax bases, by increasing the number of potential taxpayers and reducing poverty and unemployment, resulting in higher revenues. In general, municipalities can stimulate the local economy by fostering local economic development (LED) strategies, investing in local infrastructure, improving service delivery to communities and investing in human and natural resource development.

South Africa's national rural development policies are pivotal in developing rural areas, enhancing the livelihoods of rural communities and making rural local governments financially viable. These policies materialise at the local government level through LED strategies, at the provincial level through Provincial Growth and Development Strategies (PGDS) and at the national level through the country's national rural development strategy, currently in the form of the Comprehensive Rural Development Programme (CRDP) of 2009 (DRDLR, 2009) which takes forward the Integrated Sustainable Rural Development Strategy of 2000 (The Presidency, 2000). It is important that these strategies are coherent across these spheres of government.

Municipalities are sometimes best placed to identify a comparative advantage or growth opportunity within their local economy. Well-constructed LED strategies should nurture these opportunities by supporting the appropriate allocation of scarce resources in a focused and sustainable way. The result would be social and economic development and greater own revenue-generation capacity for rural municipalities. However, the ability to implementing the framework in general, and municipal ability to implement LED strategies in particular, also continues to be a challenge. This is exacerbated by the large-scale migration of labour from rural areas to urban areas and the concomitant inability to attract such skills back to rural municipalities. Skilled labour is less attracted to areas with lower levels of services such as those evident in rural areas. Therefore, rural municipalities are likely to pay a wage "premium" to attract skilled labour to rural areas, which is difficult given the resource limitations. The key challenge for implementing LED projects is the lack of common understanding of the role of LED and LED processing in most areas (SALGA, 2010). This can be linked to a lack of appropriate skills needed to implement LED strategies.

Rural municipalities have limited resources and are funded by intergovernmental transfers. Therefore, in order to boost rural economics, a concerted effort is required from all levels of government. Human and financial resources need to be pooled in order to ensure that the formulated development strategies do in fact materialise. The intergovernmental relations system is vital for providing district and/or provincial support to rural municipalities that are struggling to implement sound LED strategies and projects because of capacity constraints. However, interaction and support from higher spheres of government to most rural municipalities have been poor.

Introduced in 2009, the latest rural development strategy (the CRDP) focuses on agrarian transformation, rural development and land reform, and promotes greater community participation. Although most national development policies appear well formulated and comprehensive, the failure appears to be in ensuring such strategies are implemented. Yet ultimately, national rural development strategies can only offer strategic direction for growth in key economic areas, such as agriculture and mining. The fundamental driver of rural development should be municipal intervention through its LED strategy and policies, supported intensely by the district municipal and provincial government.

13.5 Conclusion

This chapter discusses the dynamics of the general tax base of rural municipalities. The results reveal that depressed economic activity is the fundamental factor constraining rural tax bases. Furthermore, rural municipalities use their limited existing revenue base inefficiently, as they currently only collect half of the potential property rates tax base. The chapter concludes by critically reviewing some of the current avenues through which rural municipalities can stimulate their local tax bases. Rural municipalities are best placed to identify a comparative advantage in the local economy and develop the local economy through their LED strategies. However, skills shortages, policy misalignment and a lack of coordination and cooperation can limit the successful implementation of LED and other rural development strategies. Therefore a concerted effort is required from all spheres of government to ensure the successful development of rural economies.

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13.6 Recommendations

With respect to **developing rural revenue capacity** the Commission recommends that:

In the short term:

- National and provincial governments support weaker rural municipalities to ensure improved revenue and expenditure outcomes. This should be done through:
  - o Improved assistance in formulating and implementing budgets, IDPs, LED, debtor management and credit control policies.
  - o More effective capacity-building initiatives, which deal holistically with governance, systems and business processes, as well as recruitment, retention and the development of requisite skills.
- National and provincial governments ensure that grant funding to rural municipalities is linked to capacity-building initiatives and structured assistance, so that systems are built to improve the municipality's ability to collect revenues due and increase the quality of spending.
- Municipalities ensure that revenue-enhancement strategies are sensitive to broader constraints, such as inequality, unemployment, local politics and land tenure issues so that revenue effort is maximised.

In the long term

- Given the skills and resource shortages in rural areas, municipalities explore greater collaboration with the district municipality, neighbouring local municipalities and provinces to pool resources in order to ensure greater regional planning and investments. Where rural municipalities are adjacent to better performing municipalities, best practice methods should be shared through peer learning arrangements among municipalities.