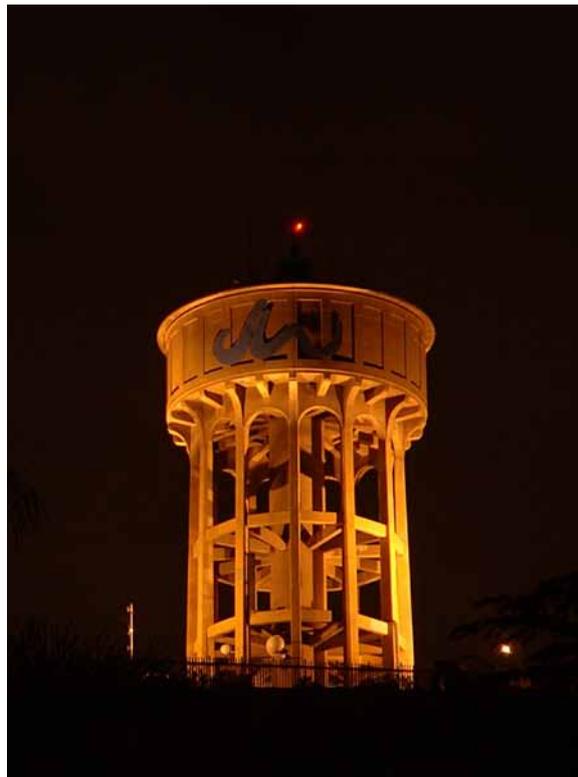


FINANCIAL AND FISCAL COMMISSION
POLICY BRIEF
**GETTING CREATIVE
ABOUT DELIVERY OF
MUNICIPAL SERVICES**
EXECUTIVE SUMMARY

The Commission's recommendations on ASD arrangements are geared specifically towards achieving this balance.

Currently, South African municipalities use alternative service delivery (ASD) arrangements, such as agencies, for a range of activities, from development and planning activities to solid waste removal. In principle, if used appropriately, ASD arrangements have numerous advantages, as they have a specialised focus and significant operational autonomy. The key is for government to achieve a balance between the potential benefits and risks of using this alternative to the traditional delivery of public services.



BACKGROUND

South African municipalities are beset by many challenges, in particular limited financial and human resources. A number of municipalities are not financially viable and/or face crippling human capital constraints. In this context, the use of ASD arrangements can be beneficial, particularly for delivering the basic services that municipalities are constitutionally responsible for. However, using ASD mechanisms is not without risks. Certain types of services lend themselves more easily to this type of arrangement.

Transaction cost¹ theory provides a useful framework for assessing which services are better suited to being delivered by an agency. According to the literature, key aspects to consider are the *measurability* and *asset specificity* of the service in question.² *Measurability* refers to the ease with which service delivery can be monitored, or anticipated outcomes measured,³ whereas *asset specificity* concerns how much specialised investment is required to perform a function or deliver a service.⁴ The general rule is that services with high measurability and low asset specificity can benefit from being outsourced to an agency. However, a strong business case needs to be made for using an ASD arrangement, and the parent municipality must have strong oversight and management ability to ensure that the social objectives of the service being delivered are not lost.

Within South African municipalities, the use of agencies for service delivery has declined for two reasons:

1. Standardisation of the forms that an agency can take, following amendments to the Municipal Systems Act dated 1st August 2004. Municipal agencies can take one of three forms: service utilities, multijurisdictional service utilities and private companies. This has led to a number of existing agencies being disestablished or reorganised. However, an assessment of the National Treasury's list of agencies in 2010 and the Auditor-General's audit report of 2009/10 found that a number of agencies in existence do not as yet meet these criteria.
2. Under current regulations, the requirements for using an ASD arrangement are burdensome, especially for smaller, lesser resourced municipalities. This prevents smaller municipalities from tapping into the potential benefits of using an agency.

FINDINGS

Three key findings come out of the research.

Based on the analysis of South African municipal agencies, the following five key findings are highlighted:

- Legislation and policy is vocal on the use of ASD arrangements, including agencies, but certain clauses pose prohibitive costs. Prime examples are Sections 77 and 78 of the *Municipal Systems Act* and Section 33 of the *Municipal Finance Management Act* (MFMA). In addition to the groundwork necessary to motivate for using ASD mechanisms, Section 33 requires municipalities to follow costly and time-consuming processes if they want to use an ASD arrangement for longer than three years.

- There is a lack of visible reporting on municipal agencies, despite Section 127(5)(a)(i) of the MFMA that requires a municipal agency to make public its annual report after tabling in the municipal council. Yet very few agencies have websites and those that do have websites do not provide the annual reports.
- Currently, no central portal of information on municipal agencies exists, and determining the number of municipal agencies is also difficult. The National Treasury's report and the Auditor-General's report do not contain all the same municipal agencies. Establishing a central information portal would facilitate better oversight, transparency and overall clarity.
- The municipal agency mandates assessed were found to run contrary to what is envisaged for an agency. They have broad, all-encompassing requirements instead of a specialised focus. Broad mandates make the job of overseeing an agency's performance more complex, particularly as municipalities lack key management/strategic-level personnel. Many municipalities also do not demonstrate high standards and ability to oversee governance within their own administration, but they are overseeing agencies.



1. Transaction costs refer to the management costs involved in delivering a service. These costs arise because of "limited information, uncertainty about the future, and the prospect that people or organisations behave opportunistically in their interactions with others" (Brown and Potoski, 2005)

2. See for example Brown and Potoski, 2001.

3. For example, measurability is high in the case of street lighting, as the outcome of service delivery is easily visible. Services where measurability is harder include health care – because an individual's health is the outcome of a range of factors not solely the delivery of a health care service.

4. For example, asset specificity is high in a sector such as electricity distribution. This is due to the specialised nature of the skills and equipment required in this sector – skills and equipment that are not easily transferable to another sector such as, for example, street signage.

POLICY OPTIONS

Two key recommendations emanate from this research:

- Government should review existing legislation governing the establishment of agencies (or the use of any other ASD arrangement), so as to ensure that costly and time-consuming regulations are avoided. To this end, the stringent requirements of Sections 77 and 78 of the Municipal Systems Act and Section 33 of the MFMA should be reconsidered.
- The establishment of municipal agencies (or use of any ASD arrangement) should be intricately tied to the parent municipality's level of performance. Determining whether performance is adequate or not should be linked to the parent municipality's audit outcomes. Parent municipalities play a crucial role in ensuring that the social and developmental objectives of public service delivery are upheld. Therefore, government should discourage the creation of agencies in cases where the parent municipality is manifestly weak, as shown for example by receiving a severely qualified, adverse or disclaimed audit result.

Additional recommendations based on the research undertaken include (1) to enforce more strictly the positive aspects of the existing legislative framework (for example the requirement to publicise details of agencies' performances and plans⁵), (2) to create a platform for greater sharing of information about the performance of municipal agencies, and (3) for government⁶ to play a more supportive role in advising municipalities whether they have a sound business case for the establishment and use of an ASD arrangement.

Government should review existing legislation governing the establishment of agencies (or the use of any other ASD arrangement), so as to ensure that costly and time-consuming regulations are avoided.



5. This is required in terms of Section 127(5)(a)(i) of the MFMA.

6. This role could be taken up by the National Treasury's Public Private Partnership (PPP) unit.

RECOMMENDED READING SOURCES

Brown, TL and Potoski, M. 2001. The Influence of Costs on Municipal and County Government Choices about Alternative Modes of Service Provision. *Paper for Presentation at the 6th National Public Management Research Conference, Indiana University.*

National Treasury. 2010. *Updated Municipal Entities Report.* Available online: www.treasury.gov.za.

South Africa. 2000. *Local Government: Municipal Systems Act, 2000.* Pretoria: Government Printer.

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Enquiries: Sasha Peters (sasha@ffc.co.za) - Phone: 0861315710

Financial and Fiscal Commission
2nd Floor, Montrose Place, Bekker Street,
Waterfall Park, Vorna Valley, Midrand,
Private Bag X69, Halfway House, 1685
www.ffc.co.za
Tel: +27 11 207 2300
Fax: +27 86 589 1038

