

Changing Municipal Boundaries Comes at a Cost

EXECUTIVE SUMMARY

FINANCIAL AND FISCAL COMMISSION 8/2014 **POLICY BRIEF**



The number of municipalities declined from 843 in 1996 to 278 in 2011 and will decline further by 2016. Concerns have been raised about the impact of demarcation, or reconfiguring of municipal boundaries, on municipal finances. An assessment by the Financial and Fiscal Commission (the Commission) found that demarcation processes result in unintended economic consequences, significant transaction costs and negative impacts on human resources and other municipal processes. The costs associated with demarcation are both direct and indirect, ranging from perverse incentives to administrative and infrastructure costs. The Commission recommends that, before any decision is taken regarding demarcation, the costs involved should be established and funding identified. A transitional demarcation grant is suggested as the most appropriate funding instrument.

Johannesburg Civic Centre: The headquarters of Johannesburg municipal government

BACKGROUND

Over the past two decades, the reconfiguration of the local government sector has seen the number of municipalities decline from 843 in 1996 to 284 in 2000 and to 278 ahead of the 2011 elections. The number of municipalities is expected to decline further by 2016, as new demarcations come into effect. The current 278 municipalities consist of eight metropolitan municipalities, 44 district municipalities and 226 local municipalities. Concerns have been raised about the impact of demarcation (i.e. redrawing municipal boundaries and reconfiguring the size, number and type of municipalities) on municipal financial and fiscal performance. While many factors affect municipal fiscal performance (e.g. the lack of a tax base, poor revenue collection, corruption and poor skills, or unfunded mandates), the impact of demarcations also needs to be evaluated. Therefore, using case studies (local and international) and econometric modelling techniques, the Financial and Fiscal Commission (the Commission) assessed the impact of boundary changes on municipal finances.¹

FINDINGS

The research found that the demarcation process results in unintended economic consequences and significant transaction costs, especially during the transitional phase. Demarcation processes also have implications for human resources and other municipal processes, when personnel are shifted from one municipality to another. Other negative consequences may result from issues relating to the supply chain, long-term contracts, municipal plans and policies, financial and other systems, information and databases, asset registers, and asset maintenance and repairs. Disruptions in the billing systems are common and negatively affect municipal revenues. Redefining boundaries also makes projections and budgeting more complicated, as such processes rely on historical trends and data. For instance, Integrated Development Plans, which are the cornerstone of a municipality's existence, are often altered during a demarcation process.

In light of the above, before any decision is taken to change municipal boundaries, the financial and fiscal implications of such changes should be established and made publicly available. The costs should ideally include both direct and indirect transitional costs that are associated with a merger process.



Table 1: Financial and fiscal costs associated with demarcation

Table 1 provides a list of the costs associated with demarcation.

Cost		Itemised Costs
Direct Costs	Financial Costs	<ul style="list-style-type: none"> Infrastructure Costs <ul style="list-style-type: none"> Integrating and consolidating programmes Upgrading of data services Repair and maintenance Eliminating backlogs
		<ul style="list-style-type: none"> Administrative Costs <ul style="list-style-type: none"> Rationalisation of services Change management costs Acquisition of new technology for human resources, financial and payroll systems Harmonisation of systems Rationalisation of administrative policies Rationalisation of fees and tax rates Harmonisation of asset registers Rationalisation of voters roll Merger management, coordination and communication costs
		<ul style="list-style-type: none"> Human Resources Costs <ul style="list-style-type: none"> Harmonisation of wages, salaries and allowance (wages are often set at the highest level paid by separate municipalities) Harmonisation of human resources policies Harmonisation of councillor allowances Costs associated with retraining and retooling of workers Costs associated with staff redeployment Retrenchment or staff layoff costs
		<ul style="list-style-type: none"> Debt <ul style="list-style-type: none"> Debt servicing costs Liabilities
	Fiscal Costs	<ul style="list-style-type: none"> Revenues and Expenditures <ul style="list-style-type: none"> Irrecoverable consumer debt Increase in expenditures due to wage and services rationalisation Tariffs <ul style="list-style-type: none"> Tariffs may increase for some consumers in previously low tariff municipalities
Indirect Costs		<ul style="list-style-type: none"> Perverse Incentives <ul style="list-style-type: none"> Amalgamation offers municipalities an incentive to accumulate debt so as to download this to a new municipality Last minute spending that results in budget overruns Competition <ul style="list-style-type: none"> Diminished competition results in poor services



Municipal demarcation is an ongoing process that takes place throughout the country on an ongoing basis.

CONCLUSION

Over the past twenty years, successive demarcation processes have seen the number, size and type of municipalities change. Concerns about the impact of demarcations on municipal finances led to the Commission undertaking an assessment of boundary changes on municipal fiscal performance. It found that demarcation processes result in significant direct and indirect costs for the affected municipalities, and have negative consequences on human resources and other municipal processes. Before taking any decision to change municipal boundaries, the financial implications of such changes should be established, and adequate funding (in the form of a transitional grant) made available through the transfer system. The Commission recommends that:

- The financial and fiscal implications of boundary changes are established and funding identified before any decision about demarcations is taken.
- A transitional demarcation grant is awarded to the amalgamated municipality to facilitate the restructuring process and to minimise the effect of demarcation on municipal budgets.

Financial and Fiscal Commission

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