



**POLITICAL COMPETITION AND LOCAL GOVERNMENT DEBT:  
IMPLICATIONS FOR HUMAN DEVELOPMENT. A CASE STUDY OF  
EASTERN CAPE MUNICIPALITIES.**

By

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A thesis submitted in fulfilment of the requirements for the degree of

**MASTER OF COMMERCE**

In the subject

**ECONOMICS**

In the Department of

**ECONOMICS AND ECONOMIC HISTORY**

At

**RHODES UNIVERSITY**

**SUPERVISOR: PROFESSOR JUNIOURS T. MARIRE**

NOVEMBER 2023

## **DECLARATION OF ORIGINAL WORK.**

This page declares that the work produced in this thesis is my own and was concluded whilst completing the degree of Master of Commerce in Economics at Rhodes University. Any work that is not my own has been credited accordingly. I, Fadzai Valerie Matapuri, certify that this thesis has not been submitted for a degree in any other university, Technikon or college.

## **ACKNOWLEDGEMENTS**

Firstly, all honour and glory goes to the Lord Almighty, who started a good thing and helped me complete it. I thank God for guiding me, instilling in me a persevering spirit, and giving me the mental capacity, strength, and knowledge to complete this task.

I want to acknowledge and thank the following for their help in completing this work.

I want to thank my amazing and supportive parents, Molyn and Walter. Thank you for your constant love, encouragement, support and guidance. My dearest mum, thank you for the unwavering confidence you had in me; thank you for going over and beyond. And a special mention to my brothers, George, for all the assistance and random waffle dates. Wallie, thank you for being such a ray of sunshine in my life.

My excellent supervisor, Professor Marire, thank you for all the guidance and support and, above all, the patience you displayed throughout this research journey.

Nonceba, my dear friend, I would not have made it without you. A special mention to my private cheerleading squad, Nonhlanhla, Tariro, Priscilla and Andrew. Thank you for listening to all my ideas and believing in me. Gogo Gatsi, thank you for all the prayers.

This thesis is dedicated to the memory of my late grandmother (Gogo Matongorere)-the most hardworking, loving, and inspirational woman I knew.

## **ABSTRACT**

South African Municipalities are currently in a precarious financial situation. The financial distress has intensified so much that local governments are on the brink of collapse. Municipalities in South Africa currently owe over 35.5 billion rands. Reports from the Auditor-General of South Africa portrayed a grim picture of the state of financial affairs in municipalities; only 33 municipalities out of 278 had received a clean audit, with over 30 billion rands in expenditure declared irregular. The report further revealed that there were numerous cases of non-compliance with key legislation in municipalities. The poor financial audits across the country have stressed the severe lack of accountability, government issues and political turmoil. Due to this state of affairs, municipalities cannot deliver services such as sanitation, electricity, and water. As a result, many service delivery protests have occurred over the years. Political factors have been highlighted as the leading cause of these local government woes. This study aims to investigate the relationship between political competition and local government debt and its effect on human development in Eastern Cape municipalities.

The study used a panel data set for 32 municipalities and electoral data from 2009 to 2016. The panel vector autoregression model, generalized least squares, fixed and random effects methods were used to investigate the relationship between political competition and local government debt. The study found a positive unidirectional relationship between political competition and local debt. This was found using the normalized Herfindahl index, debt to asset, tress index, human development index, population and poverty variables. Moreover, estimated results showed that local governments in the eastern cape were characterised by a political monopoly that, in turn, increased local government debt through growth-hindering policies adopted by political leaders. Resulting in economic concentration, which hinders local economic growth and human development.

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## LIST OF ABBREVIATIONS

AG	Auditor General
ANC	African National Congress
DA	Democratic Alliance
ECM	Random Effects
ECSECC	Eastern Cape socio-economic consultative council.
EFF	Economic Freedom Fighters
FEM	Fixed Effects
GDP	Gross Domestic Product
GLS	Generalized Least Squares
HHI	Hirschman-Herfindahl Index
IEC	Independent Electoral Commission of South Africa
MMT	Modern Monetary Theory
NHHI	Normalized Herfindahl Index
PDMs	Panel Data Models
PVAR	Panel Vector Autoregression
SALGA	South African Local Government Association
SDG	Sustainable Development Goals
VAR	Vector Autoregression

# CHAPTER 1

## INTRODUCTION

### 1.1 RESEARCH CONTEXT.

Municipalities in South Africa are currently faced with an imminent debt crisis. There is a bulk of consumer debt owed to municipalities. A financial crisis affects the ability of the local government to fulfil its functions and address governance challenges. Municipalities cannot pay their creditors, for instance, Eskom and water boards, to provide water and electricity (Magubane, 2019). However, the critical financial position of municipalities cannot be attributed solely to municipal debt. The latest Auditor-General's report shows that only 33 municipalities out of 283 received a clean audit, with over 28 billion rand in expenditure declared irregular (Auditor General South Africa,2020). There was also a high percentage of noncompliance with key legislation since 2013, for instance, failure to provide required documentation and evidence of expenditures (Auditor General of South Africa.,2020). The poor financial audits against municipalities across the country have highlighted the severe lack of accountability, systematic governance issues, and political turmoil within local government (Merten, 2019).

In effect, there are consequences to this state of affairs, the most important of which is that municipalities cannot deliver services such as sanitation, electricity and clean water. Moreover, there is a lack of infrastructure maintenance (including schools) in towns and cities nationwide (Morudu, 2017). As a result, the number of service delivery protests has risen in South Africa. In 2017, service delivery reached a record high of 173 protests; however, this record was preceded by 237 protests in 2018. In the year 2019, a total of 218 protests were recorded; in 2020, the number fell to 102. The rise in protests by disgruntled citizens indicates people's frustrations at the failure of local government to provide essential services that it is mandated to provide. (Runciman, 2015) ;(Morudu, 2017). Municipalities are the focal points in providing services to the citizenry. This includes water supply, sanitation, refuse collection, and electricity, which are fundamental to the economy's social well-being and growth. Provision or failure to provide such services, in turn, affects local development and quality of life for households.

The municipal debt crisis in South Africa seems to be politically driven (Merten, 2019). Furthermore, the system-wide evidence of governance failure has been found by the Auditor-

General throughout the state and by numerous commissions of inquiry, state capture commission of inquiry, Moreane Commission on political killings, VBS Mutual Bank heist, Parliamentary enquiry on Eskom, and these are all severe signs of economic misgovernance emanating from extractive political incentives. Furthermore, there have been reports of excessive rent extraction at all levels of governance, which is eating away at economic and social development; this can be seen through the Auditor-General's reports on wasteful expenditures in municipalities. According to the Auditor General of South Africa (2020), 27 billion of local government expenditure was fruitless and wasteful. This amount could even be higher as just over a third of municipalities had qualified on the completeness of their disclosures. The rest were still being investigated to see the extent of the irregular expenditure. Could these political economy developments be fuelling the municipal debt crisis? North et al. (2012) suggest that these are all signs of a monopolistic political market that fosters a monopolistic economy, hindering human development.

This thesis seeks to contribute to the growing literature on local government debt. The literature on municipal debt is most prevalent in Europe, the United States, China, Colombia, Brazil, and New Zealand. However, to the best of my knowledge, very few studies have been carried out in Africa, not to mention South Africa. Various studies sought to explain the determinants of debt in municipalities. Predominately, researchers like Boex and Martinez-Vazquez (2006) and Bisogno et al. (2017) have focused on public debt and its impact on economic growth, management, and determinants of debt.

The local level of governance bears a large part of the burden of developmental spending and is a significant locus of debt; there is a great sense of lack of governance and accountability at all levels of government in South Africa. There has been little emphasis on local/municipal debt in the peer-reviewed literature; it seems there is less known about the crucial issue of public debt at the municipal level. Current debates concentrate on the national debt, for instance, studies by Panizza and Presbitero (2014) and Coulibaly, Gandhi and Senbet, (2019:2). Municipal debt developments have almost been neglected. To my knowledge, no studies in South Africa have paid attention to the debt dynamics of municipalities and their human development implications. In addition, numerous studies focus on political competition and economic growth but not the effect of political competition on municipal debt. Therefore, research must be carried out at the municipal level.

The motivation to study South African municipal government was derived from Turok (2010), who finds that local governments in South Africa have failed "to release latent economic potential, encourage enterprise and make better use of neglected resources." Furthermore, according to Turok (2010), South African local governments must provide quality services that promote human capability expansion and achieve sustainable economic transformation. However, the key to service delivery lies in a municipality's ability to manage its fiscal policy, which includes prudently managing municipal public debt (Auditor General of South Africa 2020).

## **1.2 GOALS OF THE RESEARCH**

This research seeks to analyse the relationship between political competition and local government debt in the Eastern Cape Province and to observe the effects on local economic government growth and human development.

The objectives of the study are as follows:

- Firstly, to investigate the relationship between political competition and local government debt.
- Secondly, to analyse the relationship between local government debt and economic growth in the Eastern Cape.
- Lastly, to determine the impact of political competition and local government debt on local economic growth and human development.

From the above goals, one can hypothesise that political competition influences local government debt, which affects economic growth and human development.

## **1.3 METHODS AND DATA**

The study uses panel data and panel data models to achieve the main goal of the research. Panel data models have been proven to produce more efficient and reliable estimates (Abrigo and Love, 2016).

The study uses Fixed effects Models (FEM), Random effects (REM), General least squares and Panel Vector autoregression (PVAR) to find the causal relationship between political competition and local government debt and its cumulative effect on economic growth and human development.

An ethics application form using the Ethical Review Application System (ERSA) was not submitted for publicly available data, as the study involved low-risk desktop research.

#### **1.4 DATA AND DATA COLLECTION**

For the first objective, data will be obtained from the Eastern Cape Socio-Economic Consultative Council. The panel dataset for 45 municipalities exists for 1996-2015/16, which makes the total number of observations approximately 900.

Data was compiled from the South African Local Government Association, the Auditor-General, and the Independent Electoral Commission of South Africa to address the second objective. Electoral data was used to measure political competition within the municipality. The study used electoral data from 1996 to 2019 to measure political competition in the Eastern Cape using the Hirschman-Herfindahl Index (HHI). The HHI was normalized to control the growing number of political parties in municipal electoral dynamics. The HHI measures the concentration of political power. There have been four local government electoral cycles between 2009 and 2016.

#### **1.5 RESEARCH DESIGN**

The study follows a quantitative research method within a positivist research paradigm. The goal is to obtain objective evidence on the relationship between political competition, local government debt, economic growth, and human development.

#### **1.6 ORGANIZATION OF THESIS**

This thesis is made up of six chapters. The first chapter is the introduction, which sets out the study's rationale, aims, and objectives.

Chapter two is the literature review, outlining the framework and overarching theory used. This theory was derived from the World Bank Report. North et al. (2011) suggested that political competition has a bi-directional relationship with economic competition and yields results that increase efficiency and reduce rents up to a certain threshold. The chapter then presents the political competition and local government debates and reviews the relationship and its application in South Africa.

Chapter three is the context section; it describes the economic and social position of South Africa. Debt in local governments in South African provinces, financial performances, and overall political competition are discussed. It gives a fundamental South African local

government social trend; the focus is then narrowed down to the Eastern Cape Province. The section also provides the socioeconomic standing.

The research methods are presented in the fourth chapter. This chapter discusses the research methodology and describes how data was collected to create the measure for political competition, the normalized Herfindahl–Hirschman Index. This is followed by an explanation of how the debt proxy was created using standard financial ratios. Finally, the chapter explains the estimation of causality between political competition, local government debt, local government economic growth and human development using the Panel auto-regressive Granger model.

The fifth chapter presents the Results and Discussion; this section presents the PVAR, GLS, Fixed Effects and Random Effects. The chapter answers the research questions.

The sixth chapter is the conclusion that considers this research's contributions. This chapter summarises the study's main findings and discusses the successes of the methods used to collect and analyse the data.

## **CHAPTER 2**

### **LITERATURE REVIEW**

#### **2.1 INTRODUCTION**

This thesis aims to bring together the political competition and the municipal debt narrative to explore its effects on local economic growth and further implications on service delivery and human development within the Eastern Cape. To the best of my knowledge, the current literature has not fully explored the institutionalist's theory on political competition and its perceived effects on local government economic growth and human development. Secondly, the thesis aims to examine the impact of municipal debt on local growth, and here, the priori expectation is to find a causal relationship between local economic development and municipal debt. Thirdly, the thesis will strive to find the impact of political competition on municipal debt and its effect on local economic growth and service delivery. Local governments bear the duty to provide social services essential to human development, which warrants research focus on their fiscal and electoral affairs.

#### **2.2 CONVENTIONAL THEORY**

It has been more than ten years since the global financial crisis. However, several middle-income countries are currently faced with the threat of another financial and debt crisis, and many low-income countries are reaching critical debt levels (Griffiths, 2018). There is a global concern over the rapid debt increases. Such concerns are warranted because debt problems were one of the major underlying issues behind the global financial crisis. Fears are looming regarding whether the present global debt rise will lead to another financial crisis (Griffiths, 2018).

In Africa, concerns about an impending debt crisis are rising (Onyekawena and Ekeruche, 2019). In 2017, 19 African countries surpassed the 60 percent debt-to-GDP ratio threshold set by the African Monetary Co-operation Programme for developing economies, while 24 countries surpassed the 55 per cent debt-to-GDP ratio suggested by the International Monetary Fund. Exceeding this threshold makes those African countries vulnerable to economic changes. Furthermore, it reduces the government's ability to support the economy in the event of recessions (Onyekawena and Ekeruche, 2019). Additionally, an unsustainable debt would set back the progress made towards achieving the sustainable development goals and reverse developmental progress (ODI, 2018).

The leading causes for increments in public debt in Africa have been narrowed down to poor economic performance, growing populations, exchange rate depreciations, and in a few countries, poor governance and corruption (Coulibably et al., 2019:2). According to Easterly (2012:157), weak governments are known to over-borrow and then over-invest, detracting from economic performance. These concerns are consistent with the belief that poor governance and fiscal indiscipline contribute to excessive debt accumulation and that debt will continue rising in Africa unless there are serious reforms. Onyekawena and Ekeruche (2019) suggest that there are inherent structural problems within the political and economic institutions in the countries that have constrained sustainable development financing in Africa, which have led to increases in public debt (Coulibably et al., 2019:2). Similarly, Collier & O'Connell (2007), Collier (2008) and Ndulu (2008) established the existence of four policy syndromes namely state failure, regulatory, intertemporal and redistributive, in African economies. These syndromes have persistently hindered growth and have wasted important economic growth opportunities (Marire, 2019).

Redistributive syndrome policies are most likely to be instituted to favour the dominant party's electoral base. Government officials redistribute resources to their cronies and in favour of their regional constituencies, usually with ethnic undertones, in a manner that exacerbates polarisation (Collier & O'Connell, 2007; Collier, 2008 and Ndulu, 2008). Where the intertemporal syndrome is prevalent, corruption is most likely to be the channel through which growth is undermined (Marire, 2019). 'Inter-temporal resource allocation' is a syndrome of revenue misallocation over time. It entails overspending in commodity booms and under-spending during the subsequent busts (Collier & O'Connell, 2008; Fosu, 2008a; Fosu & O'Connell, 2006). The intertemporal syndrome suggests a lack of accountability, another indicator of a lack of political competition.

Where the regulatory syndrome is prevalent, we have a sense of lack of economic competition and stifling of growth and innovation. Where the state failure syndrome is prevalent, it could be an interplay of the other three syndromes driving it. The four syndromes speak to the problem of adverse rent-seeking activities among political entrepreneurs. Rent-seeking activities are manifestations of extractive institutions (Marire, 2019).

In the recent decade, the excessive rises in public debt have promoted literature on political competition-debt dynamics. There are many theoretical lines of inquiry and empirical debates

about the impact of public debt. These can be found in Classical economic theory, Keynesian fiscal theory, Modern Monetary Theory and Public choice theory.

The classical school of Economics is primarily pessimistic about debt, with contributions from David Hume (1752), Adam Smith (1909), and Jean Baptiste Say (1803), among many, who argued that a government should be as prudent as a household in its finances, and refrain from burdensome debt accumulation. They argued that governments must maintain a balanced budget and that government spending should be limited to basic needs such as military, law and order, security of life, public education and infrastructure (Salsman, 2017: 31). For classists, public debt represents a loss of fiscal discipline and breeds poverty and national impotence. Furthermore, public debt increases inflation, crowds out private spending and weakens investment confidence (Salsman, 2017:36).

In contrast, Keynesian views on public debt are optimistic (Salsman, 2017: 94). They advocate for more government spending and deficit spending. According to Keynes (1936), government spending can provide productive functions like infrastructure and social insurance. Moreover, government spending provides the means to mitigate and correct market failures; therefore, public debt and budget deficits are needed to stimulate or sustain economic activity and ensure full employment (Salsman, 2017:95). However, there were a few realists within the Keynesian school, like David McCord Wright (1909-1968) and Seymour Harris (1897-1974), who endorsed cyclical but not chronic deficit spending (Salsman, 2017:110). Hansen's secular stagnation theory extended Keynes's original argument that debt finance was to be used as a short-term cyclical instrument by arguing that the state could perpetually accumulate debt for as long as the debt-to-GDP ratio grew at a slower rate than GDP growth (Salsman, 2017). The idea was that chronic unemployment and weak growth rates often came across as perennial problems. On the other hand, Abba Lerner rejected any fixed principles of public finance and claimed that the government could continue borrowing internally to finance every expenditure decision for as long as it delivered the macroeconomic goal of full employment (Salsman, 2017). There is no limit to domestic debt accumulation.

Unlike the other schools of thought on debt, the public choice theory focuses on the causation of public debt, "particularly the interaction of politics and markets and the institutions that distinguish fiscal regimes of frugality and integrity from those of profligacy and deficits" (Salsman, 2017:153). The public choice theory states that high public debt ratios are associated with government failure. The presumption within the public choice school is that everyone is

self-interested, economic actors constantly seek to create and accumulate wealth, and they seek to amass and exercise coercive power (Salsman, 2017: 158). They use public debt to fund their political propaganda. Democracies tend to accumulate significant levels of unproductive debt because political entrepreneurs ride on the fiscal illusion of the electorate.

Similarly, Alesina and Passalacqua (2015:1) found that public debts are indirectly connected to the electoral decision. This can be explained as follows: Parliament comprises elected politicians who choose policies and fiscal control over the country's pocket on behalf of the citizenry. Politicians enact the decision to finance spending through deficit spending or printing more money. However, public finances can be contaminated by rent-seeking political interests in such a setup. Moreover, elites, in their bid to stay in office, are incentivized to maximize spending and minimize taxation as elections draw near. Less spending in such a setting is a losing electoral approach (Persson and Swenson, 1989:341). The unavoidable result is deficit spending and public debt escalation.

James Buchanan proposed that public debt was like a shell game within the democratic political economy (Eusepi and Wagner, 2018:51-54). The authors meant that public debt can often be considered deceptive and can be used for political ploys. The language of public debt focuses on the amount of public debt available, thereby shifting attention away from the budgetary politics through which significant liabilities are created. According to Eusepi and Wagner (2018:53), democracies tend to overspend. This is caused by the short-sightedness of voters and the opportunism of politicians. In contrast, Streeck (2013:14) states that rising public debt is associated with eroding democratic accountability, not excessive democracy.

Baber, Pradyort and Sen (1986) presented empirical evidence which suggests that the decisions by the state government officials to effect debt-financed spending depend in part on the state's gubernatorial election cycles. The general premise is that bargaining among political parties and interest groups influences the timing of state debt issues. Further findings showed that increases and decreases are more significant for states where interparty political competition is high than for states where competition is low. Politicians attract votes via increased spending, which is characteristic of public choice theory thinking and the idea that state officials seek ways to increase spending without raising taxes. This shifts the expenditure burden to future generations, who have no representation.

Studies by Roubini and Sachs (1989), Volkerink and De Haan (2001) and Alesina and Passalacqua (2016) found that fragmented governments generate higher public debt and budget

deficits. Fragmentation of political power and lack of unified control leads to myopic fiscal policies such as borrowing or delaying tax reform. They found that the ideological polarization among the partisans reduces the chance of making a collective decision. Similarly, North (1990), Weingast (1981), and Alesina and Passalacqua (2016) theorized that public debt rises with the number of political actors involved in the decision-making process. On this note, Plumper and Martin (2003:27) found a need for an optimal level of political participation. Too little participation breeds excessive public spending and less rapid political competition.

According to Skilling and Zeckhauser (2005), there is a negative relationship between political competition and debt accumulation; this study was based on the Japanese context, stating that lower political competition led to reduced financial prudence and higher debt levels. They observed that Japan's lack of political competition led to an increase in debt and unsustainable fiscal policies. The authors contended that in a competitive political system, the level of debt would reduce once the debt reaches a high level, conclusively stating that political competition explains the variations of debt accumulation in a country, and political competition in a country encourages fiscal prudence. The main findings lean towards the idea that countries with non-competitive political systems are likely to build upon public debt as they lack the political safeguards that promote fiscal prudence.

Skilling and Zeckhauser (2005) found that Japan's debt build-up was attributed to political reasons rather than economic ones. The authors provide more understanding of political fiscal policy by outlining and testing the theory of fiscal decisions. The theory incorporates voters' preferences as a building block. The independent variable is how the political system affects the incumbent government's response to these preferences, giving a solid case for political competition leading to prudence. The authors used the Political Competition Index in analysing political competition in Japan. Alesina et al. (1998) and Franzese (2002) state that economic factors alone cannot explain fiscal policy and that politics and institutions play a vital role in explaining a state's debt levels and patterns.

The theories of public debt stated, also apply to national public debt. However, further literature analysis shows that the core principles of public debt also apply to local government debt. This is only fitting since local government debt feeds into national government debt. For instance, local governments do not have the same power of taxation as national governments; local governments depend on national governments for certain transfers and grants. Concerning MMT theory, local governments cannot issue currency like a national government; however,

local governments accumulate debt by not paying suppliers, and they can also raise their rates, which ultimately has the same effect as taxation.

Fiscal federalism or intergovernmental fiscal relations is concerned with the existence of different levels or tiers of government and which functions are best centralized, performed at the national level or decentralized (performed by provincial and local governments) (Black et al., 2016). Countries like South Africa, Indonesia, and China have engaged in decentralization reforms, meaning provinces and regions have autonomy over fiscal functions. According to the Oates theorem (1972) and Tiebout model (1956), decentralizing the fiscal system can accommodate the diversity of public goods preferences in individual states and enhance welfare. Under Tiebout (1956), as well as Oates (1972), the local government might be the best agent to provide public services more efficiently and is maybe better suited to respond to the needs of local communities, in contrast to a single central government. Boex et al. (2006) state that local governments are critical central government partners in implementing national strategies due to their proximity to the people.

Ponce-Rodriguez et al. (2020) state that political processes and institutions shape the fiscal choices of a local government. Different political processes and institutions might shape the fiscal decisions made by policymakers and, with them, the outcomes of fiscal federalism. When local governments are elected and autonomous, their leaders possess the accountability necessary to incentivise public goods provision. However, when national party leaders also control access to the ballot, local leaders have strong reasons to provide an efficient level of goods even when their benefits spill over across jurisdictions. Put differently, democratic (de)centralization affects public spending because local and nationwide elections create different incentives for the officials who design public policy. Upward accountability through integrated party mechanisms can influence these incentives. “Given the absence of well-functioning political mechanisms at the local level to ensure participation and accountability, concerns arise that political elites might inevitably "capture" the local decision-making processes, including the control of government finance” (Boex and Martinez-Vasquez, 2006 :). With that in mind, there is a danger of moral hazard, the political risk of borrowing, and pushing debts to the future.

There are varying opinions on local government debt. The classist theories show the importance of government in controlling a municipality's budget. The government is at the helm of the budget. It may lead to poverty and national impotence if it fails to maintain balance. From

Keynesian theory, we see the impact of public policy and debt again. It states that debt can be accumulated, but it must be to sustain and stimulate economic activity. MMT theory is not applicable in this case since municipalities are not sovereign nations. However, a strong bureaucracy is needed to ensure fiscal discipline. Robini and Sachs (1989) and Alesina Passalacqua (2016) found that fragmentation of political power leads to a lack of unified fiscal control. This results in myopic fiscal policies that limit growth. In addition to this is polarization among the political leaders in government, which reduces the chances of making collective decisions in a local government.

The first goal of the research is to find the relationship between political competition and local government debt. The conventional theories from the literature above indicate that political policies influence fiscal policies and, in turn, influence local government debt. Political power and institutions shape the fiscal policies of a government. These influences can either lead to positive use of debt as envisioned by Keynes and Keynesians, and it can breed poverty. The second goal of the research is to find the impact of local government debt on economic growth. According to Ponce-Rodriguez et al. (2020) debt can be used to sustain and stimulate economic growth, but that is only if accountable leadership use their powers and authority to drive economic growth. Eusepi and Wagner (2018:53) mentioned the dangers associated with democracy. According to Eusepi and Wagner (2018:53), democracies tend to overspend. This is caused by the short-sightedness of voters and the opportunism of politicians. The above literature shows the importance of local government debt in research. The following section explains the meaning of political competition and the relationship between political competition and local government debt. The section explores literature from various countries.

## **2.3 POLITICAL COMPETITION AND LOCAL GOVERNMENT DEBT**

### **2.3.1 DEFINING POLITICAL COMPETITION**

Political competition can be defined as the vying for political influence among parties in a state (Becker, 1983; Alfano and Baraldi, 2015). The seminal contributions of Downs (1957) and Becker (1983) were the first to investigate the idea of political competition. Stigler (1972) used a hypothesis that likened a political market to an economic market. In the analogy, he showed that political competition could potentially lead to more significant developmental benefits through the influence of political power on public policy. "However, a political party could also use its political power to influence public policy in ways that could lead to adverse

economic outcomes, especially if the policy design created grave inefficiencies in the economy and became a conduit for local state capture" (Marire, 2019).

Further advancements in the political and economic relationship can be found in Mbeki (2009) and North et al. (2012). They proposed a bi-directional relationship between political competition and economic competition. In a functional democracy, political competition fosters economic competition, which feeds into political competition, thus creating a virtuous circle - resulting in a faster rate of economic growth and human development in an inclusive manner.

On the other hand, political monopoly fosters economic monopoly and vice versa; this creates a vicious circle that hinders economic growth and human development in its entirety (Duch and Stevenson, 2008). Sustainable economic and human development depends on the strength of the bi-directional relationship between political competition and economic growth (North et al., 2011). The concentration of political power could pose a deadweight loss. Besley (2010) and Alfano and Baraldi (2012) found that the absence of political competition is associated with poor growth performances mainly because of anti-growth policies, extractive rent-seeking, lack of accountability and political pork-barrelling policies, which pose a threat to public finances. Furthermore, Acemoglu and Robinson (2008), North et al. (2011), and Alfano and Baraldi (2015) suggest that an optimal level of political competition is welfare-enhancing and could lead to the enactment of pro-business policies that would lead to economic growth and human development. One can hypothesize that an optimal level of political competition could maintain an optimum level of public debt.

### **2.3.2 POLITICAL COMPETITION AND LOCAL GOVERNMENT DEBT**

Various studies have been conducted on municipal debt. Financial, socio-economic, and political factors were seen as crucial determinants of rising debt levels (Batsida et al., 2015). Literature on municipal debt is non-conclusive about the impact of political competition on municipal debt. For instance, Blais and Nadeau (1992) found empirical evidence that there is no significant link between political competition and municipal debt. Dickson and Yu (1999) investigated spending in local governments and concluded that left-wing governments spend more than right-wing governments; however, increases in spending are also due to per capita income and not only political factors. Galli and Rossi (2002) discovered that the party variable does not affect spending decisions. Abizadeh and Gray (1993) and Galli and Rossi (2002) found no significant relationship between political competition and municipal debt. They claim that

the expenditure policies of provincial governments are independent of the political stance of the ruling political power.

On the other hand, Petterson and Lidbom (2002) found a positive link between political competition and municipal debt. Similarly, Benito and Batsida (2004) and Balaguer and Coll (2018) found that political competition affected the efficiency of municipalities, leading to poor financial management of the fiscus. Baber (1983) and Ingram (1984) found that local governments with higher press visibility engaged in less debt. Geominne and Smoulders (2008) found that higher political competition leads to higher debt levels. Tabellini and Persson (2020), Svensson (1989), Battaglioni and Coates (2008) discussed additional political determinants such as political stability, political turnover, quality of institutions and pork-barrelling as factors that increase municipal debt (Baber and Sens, 1986; Nordhaus, 1975).

Many factors influence municipal debt; however, this thesis will analyse the relationship between political competition and local government debt.

### **2.3.3 WEAK GOVERNMENTS**

Firstly, weaker governments face more significant deficits. A weak government is defined as an ineffective government that cannot raise adequate taxes to provide for the social needs of its citizenry. These governments are characterised by excessive rent creation and corruption, and the leaders have little to no control of the state (Alesina and Perotti, 1995). Roubini and Sachs (1986) analysed the fiscal behaviour of 13 OECD countries, using the type of government index to measure political fragmentation. The findings confirmed that multiparty governments face higher budget deficits. On the contrary, Hagen and Vabo (2005) used the Herfindahl index to measure fragmentation. They found little evidence for the claim that deficits are lower in local governments with stronger political competition.

Other literature sources found that weak governments showed a significant deficit rise only when there was low GDP growth. According to Manin, Goda and Pozas (2021), “political competition can adversely affect fiscal performance”. Weak performance can be attributed to the nature of the multiparty system. A multiparty system requires many political parties to join hands and work together as a coalition. In such governments, there are high risks of vetoing and failure to agree in discussions, leading to policy inertia. Most importantly, it delays the implementation of crucial fiscal reforms (Manin et al., 2021).

### **2.3.4 LOCAL GOVERNMENT FRAGMENTATION**

The Oxford Dictionary defines fragmentation as “the process or state of breaking or being broken”. Fragmented governments are usually weak and have united leaders who cannot agree in decision-making. Alesina and Perotti (1998) claimed that fragmentation increases deficits, which raises debt. Ashworth et al. (2005) state that government fragmentation leads to higher public deficits and debts. Research from Roubini and Sachs (1989) shows that weaker governments face more significant deficits at the local government level. Alesina and Perotti (2005) studied Flemish municipalities and used the error correction model. Ashworth et al. (2005) found that fragmentation caused government inactivity. Obikili (2018) found this to be a trait in South African local government. Governments faced with large coalitions could not come together to make policy decisions because of their opposing views and failure to get the required veto numbers. When parties are at loggerheads, policy implementation and decision-making are delayed.

Further findings suggest that fragmented governments tend to postpone changes in their policy because of the constant fiscal consolidation delay, and deficits and debts are allowed to increase further than in the case of a one-party majority government. Fragmented governments do not create deficits; instead, they procrastinate in implementing the adjustment shocks (Alesina and Perotti, 1995). Lack of action is the leading cause of financial mismanagement, leading to increased debt levels (Obikili, 2018). Political competition causes a war of attrition among the politicians; the more players within the coalition government, the longer it takes for coalitions to make decisions.

### **2.3.5 ELECTORAL CYCLES**

Although government revenue is obtained from tax, benefits are targeted to specific groups. This was referred to as a common pool problem by Ashworth and Geys (2005). The rational strategy for each politician is to oversupply public projects directed to their electorate. The situation worsens when the number of politicians increases. The evidence, as shown by Ashworth and Geys (2005) and Roubini and Sachs (1989), indicates a structural problem and implies that government fragmentation has a long-run effect on local government debt and deficits.

The agency theory essentially concedes that electoral cycles influence public finances. This is also called agency theory, whereby politicians manipulate the system to suit their needs (opportunistic behaviour). Budget spending or debt influences the parties to be re-elected (Blais

and Nadeau, 1992). Therefore, the self-interested incumbents tend to manipulate economic policies to their advantage to maximize votes.

Svensson (1989), writing on the strategic cycles of debt, found that mainstream models postulate that politicians are self-interested. This was exemplified in studies from the UK that showed (a) that the government targeted municipal budget benefits for party political advantage and (b) the belief that the government manipulates voters' preferences to remain in power after the next elections. There is strong evidence of political manipulation of government finances; politicians withdraw more funds in response to deficit shocks in election years (Manin et al., 2021). This supports the idea of governments having strong incentives to use the public budget tactically to either obtain the electoral support of new voters or strengthen the loyalty of their traditional supporters.

Strategic cycles of debt have also emerged in research applied to local governments (Geominne and Smoulders, 2008; Ashworth et al., 2014). In several studies, the strategic cycle of debt analysis is related to political parties and the government's political strength. Left-wing and right-wing leadership comparisons show that left-wing governments have a greater tendency toward public intervention; they are more likely to present more significant expenditures, leading to higher debt levels. Lessons from studies in Portugal showed that the management of municipality debt seems to be driven by factors other than political ones, namely, endogenous economic issues.

Boulding and Brown (2014), inspired by electoral theories of democracy, imply that electoral competition ensures accountability and responsiveness. They found that municipalities with more competitive elections allocate less to social spending than municipalities with little or no competition. For instance, close elections can compel politicians to perform better to keep their jobs, as underperforming politicians lose elections. The competition then serves as motivation for better financial management.

Liu et al. (2017) found that corruption manifested through rent-seeking increases public debt. Yared (2010) argues that a non-benevolent government will likely over-accumulate debt in the long run. As Balaunger and Coll suggested, there are no conclusive answers about what debt arises in certain municipalities or regions. Thus, the research aims to empirically find the relationship between political competition and local government debt and the culminating factors, such as the effect of debt on local economic growth and service delivery.

From the above literature, the rise of public debt is not just a market failure but a political failure, a failure of democracy in its purest form (proportional representation concession). There is a need to address the implications of political competition on public debt.

Chatterjee et al. (2019) state that political competition is a valuable predictor of local government debt. The artificial neural network (ANN) was used to test whether the ANN can learn from the observed data and make reliable sample predictions of the local government's debt. Debt to asset ratio was log-transformed to DEBT LN, and the independent (i.e., primary predictor) variable of interest used was the level of political competition, denoted by "POL" in the tabulated results. Chatterjee et al. (2019) found a positive relationship between political competition and debt levels. The findings predicted that typical increases in political competition typically led to increases in local government debt levels. A significant takeaway is that there is a risk of political motivation in approving local government debt.

Haecock (2006) found a positive link between political competition and local government through their study on political competition and subnational education spending in Mexico during 1999-1994. They found that greater electoral competition led to increased spending. Spending on popular programs like healthcare, education and housing increases the chances of re-election, hence the reason for political cycles. Public choice theory dictates that spending is a sign of government competency; the myopic voter votes for the government that is likely to spend more than tax. Some voters do not monitor the government's behaviour enough to predict the consequences of higher spending and lower taxes. The results are that the future generation is burdened by debts (Zeckhauser and Skilling, 2002; Galli and Rossi, 2002). However, voters are also known to be punitive, sacking incapable incumbents when they fail to deliver or for poor fiscal management (Zeckhauser and Skilling). Rosenberg (1992) states that in some instances, incumbents are not seeking to be re-elected but show their self-interested behaviour.

In contrast, Boulding and Brown (2014) found that governments with higher competition allocated lower social spending than those with lower political competition. This was more evident in municipalities with lower resource levels facing higher competition levels. The authors conducted a study on Brazilian municipalities using spending on healthcare, education, and housing per capita as indicators of social spending and the vote margin of the winning party as an indicator of political competition. Obiliki (2018), in support, showed that increased political competition led to political fragmentation and that inefficiency in decision-making,

inertia and poor financial management can be associated with higher debt levels in South African municipalities.

Geomine and Smoulders (2008) show that government spending and tariffs are used as political tools by governments to win elections. This strongly suggests that local government debts and deficits may be associated with incumbents' political agendas and ambitions rather than the actual needs of local governments.

Coalition governments have higher fiscal deficits. While investigating Chile, Leonardo and Letlier (2011) found a correlation between politically diverse municipal councils and years close to elections. The main argument was that politicians were self-motivated in their policy-making decisions; municipal budgets were not tightly controlled. This was contradictory to the works of Skilling and Zeckhauser (2002), who found a negative relationship between political competition and debt accumulation in the Japanese context.

In the local government context, studies have shown that political electoral cycles have been associated with debt levels, with local government debt rising towards election years (Ribeiro and Jorge, 2015). An increase in debt influenced by political motivations is consistent with public choice theory. Incumbent's self-maximization nature, as explained by Musgrave and Musgrave (1989), incumbents increase spending whilst taxes are unchanged or decrease. Further evidence can be seen in Batsida et al. (2013). The authors investigated 238 municipalities during 1992-2005. They found that per capita debt is related to municipal debt. Furthermore, Riberio and Jorge (2015) stated that the municipal debt accumulated before the elections contributed to 90 per cent of overall debt in municipalities. This is consistent with public choice theory, evidence of the strategic use of debt to influence voters.

### **2.3.6 CONCLUSION**

Section 2.3 starts by defining political competition as the vying for political influence by political parties in a country. According to Stigler (1972), the political market influences the economic market, which in turn influences the development of an economy. North et al. (2012) and Mbeki found a bi-directional relationship between political and economic competition. In a functional democracy, political competition fosters economic competition, creating a virtuous circle that results in faster economic growth and human development. In contrast, political monopoly fosters economic monopoly that hinders economic growth and human development. Sustainable economic growth and human development depend on the bidirectional relationship between political competition and economic growth (North et al., 2012). This is imperative for

the study as it addresses goal one- investigating the relationship between political competition and local government economic growth.’

The results from the literature were not conclusive about the impact of political competition on municipal debt. This prompted the study to investigate further the reason for high debts in municipalities in South Africa. Some of the contradictory debates come from Benito and Batsida (2004) and Balaguer and Coll (2018). These authors found that political competition affected the efficiency of municipalities, leading to poor financial management of the fiscus. In addition, Geominne and Smoulders (2008) found that higher political competition leads to higher debt levels. On the other hand, Galli and Rossi (2002) contended that the party variable does not affect spending decisions. Abizadeh and Gray (1993) and Galli and Rossi (2002) found no significant relationship between political competition and municipal debt.

Section 2.3 explored Weak governments, local government fragmentation and electoral cycles. These topics provided more insight into how political competition in varying forms has informed public policy and fiscal policy. A weak government is defined as an ineffective government that cannot raise adequate taxes to provide for the social needs of its citizenry. These governments are characterised by excessive rent creation and corruption, and the leaders have little to no control of the state (Alesina and Perotti, 1995). Weak performance can be attributed to the nature of the multiparty system. A multiparty system requires many political parties to join hands and work together as a coalition. In such governments, there are high risks of vetoing and failure to agree in discussions, leading to policy inertia. Most importantly, it delays the implementation of crucial fiscal reforms (Manin et al., 2021). Weak governments are inefficient. A characteristic symptom that can be seen in the four policy syndromes namely state failure, regulatory, intertemporal and redistributive, in African economies. introduced by Collier and Ndulu in 2008. These syndromes have persistently hindered growth and have wasted important economic growth opportunities (Marire, 2019).

## **2.4 LOCAL GOVERNMENT AND LOCAL ECONOMIC GROWTH.**

The debt-economic growth relationship is complicated. There are varied results in the macroeconomic literature. Various works (Barro, 1979; Eberhardt and Presbitero, 2015) found no simple relationship between debt and economic growth, and many factors are significant. The debt and growth debate begins with the classical and Keynesian schools. Classists believe

that public debt taken for uses other than funding investment would crowd out private investments.

On the contrary, the Keynesian school of thought suggests that debt would crowd in investments, especially if spent on infrastructure development. The Endogenous growth theory model assumptions of constant tax and interest reflect that increasing public debt reduces the growth rate of an economy, and future generations will be disadvantaged. Economists such as Krugman (2011) stated that countries should not shy away from expansionary fiscal policy using debt. Other economists argue that high debt levels are detrimental to economic growth and that financial considerations are necessary to anchor expectations and restore confidence. However, the IMF is highly concerned about the unprecedented increases in public debt and possible economic growth implications.

According to Panizza and Presbitero (2014), local government debt can accelerate economic growth by boosting local financial resources that crowd investments and increase public expenditure. The main argument is that local government debt can promote local economic growth; however, once debt exceeds the acceptable threshold, the debt performance will continue to decline due to an excessive government investment rate (Panizza and Presbitero, 2014). Additionally, increased debt accumulation weakens the ability to counter market failures (Reinhart and Rogoff, 2010), which is when the positive effect that government debt has on economic growth will turn negative (Zhao et al., 2019).

Arvate (2013) also show that electoral competition increases the supply of some local public goods, such as student enrolments and free immunisations. Dash and Mukherjee (2015) find that persistent rule by a political party lowers political competition in some sense and has positive effects on HDI.

Local governments are mandated to promote local economic growth proponents of economic growth (Panizza and Presbitero, 2014; Zhao et al., 2019; Ziolo and Fidanoski, 2017). Mo (2018) identifies that the proper application of debt could stimulate economic growth; however, with warnings of impending consequences for economic development if debt accumulates over debt ceiling thresholds. Further findings have indicated that a certain level of debt can inhibit economic development and crowd out private investment. Likewise, debt spikes increase the debt burden and slow economic growth (Reinhart and Rogoff, 2010). For instance, the local China debt has been multiplying. Subsequently, China's growth projectors have been negatively affected.

In China, for many provinces, finance is the lifeblood of economic development and sustainability (Ziolo and Fidanoski, 2017). Local government debt can be used strategically to promote sustainable economic growth. In essence, this asserts that local government debt can kick-start economic growth with infrastructure spending. This type of financing has aided China to become a global powerhouse (Zhao et al., 2019). This supports MMT; realist debt can promote infrastructure and construction and stimulate local economic growth, ultimately sparking regional and national development. In other words, whether the debt is good or bad depends on the uses to which it is committed. If committed to recurrent consumption, it is anti-growth, but committed to long-term real investment in infrastructure will ensure growth is promoted.

Citizens who live in municipalities with sound financial health have a higher quality of life than others. Financial health means a municipality can provide for itself without damaging its ability to face future obligations. The successful provision of public services characterises good financial health. Financing is the lifeblood of economic development and sustainability (Ziolo et al., 2017). Financing debt can either be beneficial or can hinder growth. Many governments and local governments have resorted to debt financing in one way or another to fund development (Zhao et al., 2019).

Zhao et al. (2019:4-6) state that debt financing is valuable in kick-starting economic growth with infrastructure development. For instance, 88.8 percent of local government debt in China was invested in basic infrastructure projects in municipalities. According to Zhao et al. (2019), applying debt within the debt ceiling can promote urban and rural infrastructure construction and stimulate regional economic growth. Additionally, most cities depend on debt for tourism and infrastructure development; thus, their debt levels tend to be high.

Studies by Dermuger (2016) verify that prudent use of local government debt positively affects overall economic growth, primarily when debt is used to build and maintain infrastructure. The infrastructure improvements lead to growth. Besides, it stimulates regional research and development efficiency, accelerating sustainable regional economic development (Zhao et al., 2019). Conversely, local government debt surpassing the debt ceiling can inhibit economic growth, according to Zhao et al. 2019.; Panizza and Presbitero 2014, and Reinhart and Rogoff (2010), debt above the threshold crowds out investment, increases the debt burden and slows down the economic growth.

The relationship between local government debt and regional economic growth presents nonlinear characteristics rather than having an inverted U-shaped relationship (Zhao et al.,2019). Zhao et al. (2019) used the semiparametric spatial model to analyse the nonlinear relationship between local government debt and regional economic growth. The results from the study showed that when the scale of local government debt exceeds a certain level, economic growth will be suppressed by the crowding out of private investment and the reduction of public expenditure (Zhao et al.,2019). For example, records have shown that China's local government debt has multiplied and is now threatening the country's economic and financial security (He and Jia, 2020).

Unsustainable debt levels reduce a country's competitiveness and increase a country's financial market susceptibility to global shocks. Existing theoretical and empirical literature supports this view. High municipal debt could indicate bad management (Cropf & Wendell, 1998). Previous works by Metcalf (1991), Kiewiet and Szalaky (1996), Dickson and Yu (1997), Dahlberg and Johansson (1991), and Brown (2001) have focused on the effectiveness of limits imposed on indebtedness, rating of municipal debt and factors influencing municipal debt. Brothaler's (2016) findings show that local governments face fiscal challenges due to mismanagement (insufficient knowledge of managing debt), declining economies, and institutional weaknesses of communal budgetary management.

Section 2.4 addresses goal 3. This goal intends to investigate the relationship between local government debt and economic growth. The literature showed varying results; according to Panizza and Prebitero (2014), local government debt can accelerate economic growth by boosting local financial resources. However, once that debt exceeds an acceptable threshold, it leads to more debt accumulation that inhibits local economic growth. The literature shows that local government can be used for productive purposes, just like in China. However, the effectiveness, as suggested by Dermuger (2016) and Zhao et al. (2019), is dependent on the local government leaders who manage the business finances. Section 2.5 addresses the third goal; it analyses the relationship between political competition, local government debt, economic growth and human development,

## **2.5 POLITICAL COMPETITION, LOCAL GOVERNMENT DEBT, ECONOMIC GROWTH AND SERVICE DELIVERY**

Cuadrado, Ballesteros and Noemi (2014) set out to find the significance of the financial health of local governments to social welfare. When the financial health of local governments is in

decline, the government fails to provide the public services that require financial obligation, for example, electricity supply. This generally reduces the quantity and quality of the public services offered by local governments, thus affecting citizens' quality of life since the most critical welfare needs are usually related to public debts. A local government's sound financial health is seen through its ability to provide public services without damaging its ability to face future obligations. Cuadrado, Ballestros and Noemi (2014) found that citizens who lived in municipalities with sound financial health have a higher quality of life than others. In general, citizens from municipalities governed by right-wing parties with low political competition had a higher quality of life. There was also further evidence of political unity being associated with good financial health because politicians may neglect or ignore their electoral promises when political competition is low.

## **2.6 CONCLUSION**

Chapter 2 presented the conventional theories on public debt at a national level. The chapter explored Classical economic theories, Keynesian fiscal theories, and public choice theories. Classical theories maintain that public debt represents a loss of fiscal discipline and breeds poverty and national importance. In contrast, Keynesians contend that public debt and budget deficits could stimulate and sustain economic activity. Public choice theories showed the interaction of politics, institutions and markets and their impact on fiscal regimes. The main lesson from public choice theory is that high public debt ratios are associated with government failure. Alessina and Passsalacqua (2015) found that public debts were indirectly connected to electoral decisions. The chapter also defined political competition as the vying for political influence among political parties in a state. The conventional theories show evidence of political policies influencing fiscal policies and, in turn, influencing local government debt. Political powers and institutions shape the fiscal policies of a government. These influences can either lead to positive use of debt as envisioned by Keynes and Keynesians, and it can breed poverty.

Section 2.3 addressed goal one, which sought to find the relationship between political competition and local government debt. The results from the literature were not conclusive about the impact of political competition on municipal debt. This prompted the study to investigate further the reason for high debts in municipalities in South Africa. Section 2.3 explored Weak governments, local government fragmentation and electoral cycles. These

topics provided more insight into how political competition in varying forms has informed public policy and fiscal policy.

Section 2.4 addresses goal two, which analyses the relationship between local government and economic growth. Local government debt can be used for productive purposes. The literature shows that local government can be used for productive purposes, just like in China. However, the effectiveness, as suggested by Dermuger (2016) and Zhao et al. (2019), is dependent on the local government leaders who manage the local government finances.

Lastly, section 2.5 addresses goal 3, which investigates the relationship between political competition, local government and its impact on economic growth and human development.

Some research has been done on political competition in different countries. The effect of political competition seems to depend on the specific context in the studied countries. The main findings from the literature review were that political competition influences local government debt, which, in turn, impacts economic growth and human development.

The next chapter will provide the background of the Eastern Cape province in South Africa. The study will explore the political market of South Africa, voting patterns, Local government operation and the effects of debt in municipalities in the Eastern Cape, Sources of finance, and causes of local government debt in the Eastern Cape.

# CHAPTER 3

## THE SOUTH AFRICAN CASE

### 3.1 INTRODUCTION

The chapter starts with a brief introduction to South Africa and its local governments. The study then proceeds to explain the political climate in South Africa, party participation, the nature of politics in South Africa and the current state of local government debt and its impact on service delivery and human development. In the analysis of local government debt, the research explores the causes of local government's financial woes. South Africa is a stable democracy with reasonably free and fair elections held every five years since the end of apartheid.

The political system and mode of public administration also allow South Africa to serve as a test case on political competition and local government debt. Public administration in South Africa is broken up into different levels of government, with provincial governments divided up into district municipalities. District municipalities are then divided into metropolitan and local municipalities (SALGA, 2020). A variant of the mixed-member proportional representation system elects the governments of metropolitan and local municipalities. In this system, half the members of each municipal government are elected at the ward level on a first-past-the-post basis. In contrast, half are elected based on the proportional representation of overall votes cast. This system guarantees that political parties that win a significant share of the vote but not a majority still participate in government (SALGA, 2020). In the context of political competition, the higher the fraction of the total seats won by the majority party, the more independent control that party has. Even though the majority party directly controls the government in terms of appointments to local ministries and agencies, opposition parties can still influence policy with their influence depending on the fraction of votes they win during elections.

### 3.2 SOUTH AFRICA

South Africa is a large country with a population of 59 million people and a land area of 1,221,000 km<sup>2</sup>, divided into nine provinces, which are Eastern Cape, Free State, Gauteng, KwaZulu-Natal, Limpopo, Mpumalanga, Northern Cape, Northwest, and Western Cape. South Africa, often called the "rainbow nation", is one of Africa's most ethnically endowed countries

(nationsonline,2021). South Africa is known for its cultural diversity, boasting eleven official languages, and its history of aggressive colonial expansion for centuries, mainly by the Dutch, French and British. The known history of Apartheid ended in 1994 with South Africa's transition to democracy and with the inauguration of Nelson Mandela as South Africa's first democratically elected president.

### 3.2.1 THE EASTERN CAPE PROVINCE

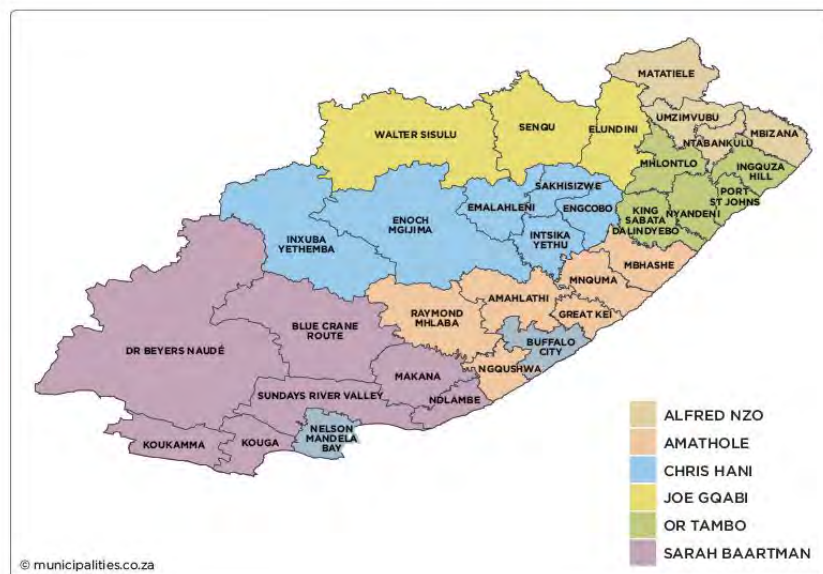


Figure 1 Map of the Eastern Cape Province. Source: Municipalities.co.za

The Eastern Cape is the second largest province in terms of surface area, boasting an area of 1689 666 km<sup>2</sup>. The Eastern Cape is the third-largest province based on population, with a population of 6 996 976. The province is divided into two metropolitan municipalities (Buffalo City and Nelson Mandela Bay Metropolitan Municipality) and six district municipalities, which are further divided into 31 local municipalities (Municipalities of South Africa, 2020).

The Eastern Cape region is endowed with natural diversity, ranging from the Great Karoo to the forests of the Wild Coast and Keiskamma Valley, fertile land, and mountain ranges, all touristic spots that bring in income. The Eastern Cape has great agricultural and forestry potential; for instance, the Langkloof valley in the southwest has enormous deciduous fruit orchards, and the Karoo is a crucial sheep farming area. The Alexandria-Makhanda area produces pineapples, chicory and dairy products. Magwa makes coffee and tea. However, people are still highly dependent on farming and animal rearing. The Eastern Cape is South Africa's automotive industry hub, with Port Elizabeth and East London being the core

metropolitan economies (Municipalities of South Africa, 2020). The Eastern Cape is also the second poorest province with the largest areas of South Africa's previously disadvantaged homelands, hence the poverty, political scandals, and inadequacies.

### **3.3 LOCAL GOVERNMENT IN SOUTH AFRICA**

South Africa is a stable democracy with reasonably free and fair elections held every five years since the end of Apartheid. North et al. (2011) state that South Africa is a mature limited access order. There is steady control over violence and growing competition in the political market, as can be seen by the number of parties that partake in elections; however, this competition has not yet spurred enough economic competition to achieve adequate development. South Africa faces the imminent issues of unemployment, poverty, and inequality. As a result, South Africans are generally dissatisfied with their quality of life. Currently, the human development index is at 0.709, and 55.5 per cent of South Africa live in poverty (UNDP, 2020). This dissatisfaction can also be seen in the rise of service delivery protests (237 in 2018 and 218 in 2019) (Glasser and Wright, 2020).

The South African government follows a three-tier system, with a national government, a provincial government, and local municipalities as the lowest tier. The local government has the right to govern the affairs of local municipalities. Section 151 of the Constitution of the Republic of South Africa, 1996 (the Constitution) provides municipalities with legislative and executive authority to run their businesses and to ensure that provincial or national government does not interfere with local government affairs (Reddy, 2016). They face the same checks and balances stated in the Constitution. The Constitution guarantees municipalities individual freedom and press freedom. The same accountability rules apply to all municipalities in the Eastern Cape (Obikili, 2016). Municipal leaders have discretionary power to implement either good or bad policies. However, this discretionary power is limited in a democracy where leaders are held accountable to the electorate and face a constant threat of removal (Obikili, 2016).

The government of the metropolitan and local municipalities are elected by a variant of the mixed-member proportional representation system. Half of the members of each municipal government are elected at the ward level, and the other half are selected based on the proportional representation system of overall cast votes. The system guarantees that parties that win a significant share of the votes but not the majority votes can still participate in government. The majority party directly controls the government in terms of the appointments

of positions in the local ministries and agencies. However, due to the nature of the system, opposition parties can still influence policy. This depends on the fraction of votes that the opposition party wins during elections.

### **3.4 LOCAL GOVERNMENT DEBT**

Municipalities are currently faced with an imminent financial crisis. Only one-third of 278 municipalities are fully functional, with only seven municipalities performing well and the rest in financial distress (Glasser and Wright, 2020). Annual reports from the Auditor-General, regular newspaper reports and political debates in different legislatures confirm the dreadful state of affairs in many municipalities, local governments and in many provinces. According to Mertens (2019), escalating municipal debt poses a significant threat to municipalities' financial stability and directly impacts service delivery. Furthermore, the Auditor-General report (2020) indicated that over 28 billion rand in expenditure was irregular. The poor financial audits against municipalities have highlighted the severe lack of accountability in systematic governance issues within local government and political turmoil (Mertens, 2019).

Debt accumulation has worsened over time. Numerous municipalities like Eskom and the Water Boards cannot pay their creditors. As of 2019, debt owed to Eskom reached 72.4 billion Rands in nominal terms (Magubane, 2019). As a result, Eskom's financial position is under threat; this has led to increased power cuts and the entire cutting off of electricity supply to some municipalities. In the last two years, Eskom debt and water debts have swelled 26% to over 35 billion South African Rands (ZAR), resulting in many municipalities being cut off from receiving services. This had adverse implications for citizens, as power cuts have been dire for the citizenry's daily livelihoods, affecting day-to-day business operations, which has affected economic growth and job creation in some municipalities and provinces (Merten,2021),

Not only do municipalities owe money, but they are owed money from consumers and institutions. Consumer debt comes from non-payment of rates or charges for services provided by municipalities. Municipalities are owed by their debtors, the state and people who receive services, and in turn, they owe institutions such as Eskom. Approximately 50.6 billion rands is owed by municipalities in South Africa. Hendriks (2017), Creamer (2019) and Merten (2019) have identified that there is a culture of non-payment of services by community members. The culture of non-payment may result from the high poverty levels in South Africa and the failure

of municipalities to collect debts from consumers. Besides, citizens are purposefully withholding payment as a form of protest against poor or non-existent services.

Municipalities obtain revenue from the collection of rates and levies from their citizens. The revenue pays off debtors such as Eskom and the water boards. However, some citizens of South Africa are not paying levies to the municipalities. Under-collection of revenue and a culture of non-payment of consumers has led to severe cash flow problems, which prevent municipalities from rendering quality and quantity services to the citizenry. Ironically, citizens continuously protest against paying levies because of poor service delivery. Municipalities are in a precarious cash position, and the high number of protests against poor service delivery and the issue of sustainability only serve to escalate the severity of the situation (Brandt, 2016).

Due to this dire situation, municipalities cannot provide water, sanitation, and electricity services. Moreover, infrastructure maintenance (schools and hospitals) has been neglected (Morudu, 2017). As a result, service delivery protests have been rising in the past years. Over the years, protest action has increased in South Africa; Figure 3.1 shows the countrywide and per-province rise in protest actions from 2004 to 2020. A visible trend is apparent: a surge in demonstrations in most years and a decline during the electoral years. However, service delivery protests dipped to a low in 2020; protests fell from 78 percent to 75 percent. This can be attributed to the heavily policed lockdown restrictions that prevented people from gathering in public. Base of protests in the country).

### **3.5 SERVICE DELIVERY**

The rise in the number of service delivery protests indicates that municipalities in South Africa are failing to carry out their legislative duties of providing adequate public services. Municipalities are the focal point in providing services to the citizenry; these services include water supply, which is imperative for the growth of the economy and a fundamental input to social well-being. Provision or failure to provide such services, in turn, affects local development and quality of life for households.

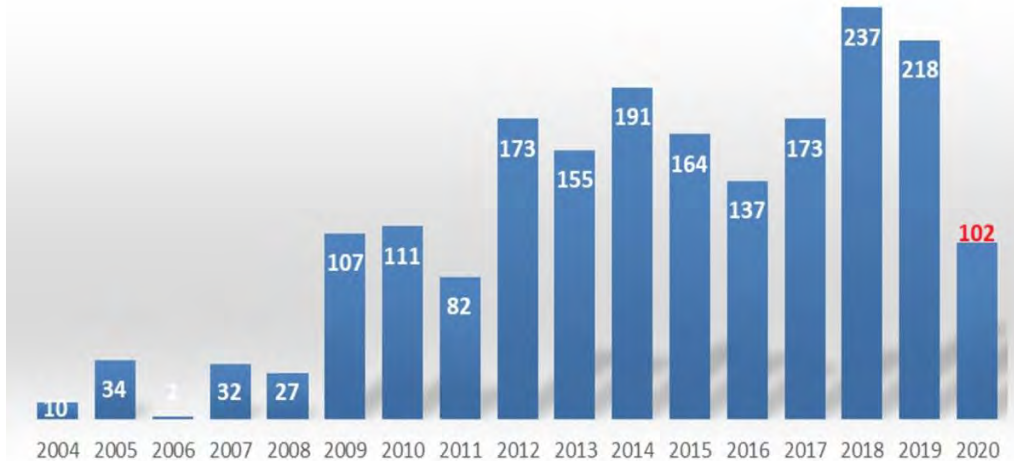


Figure 2 Service delivery graph 2004-2020

Source STATSSA

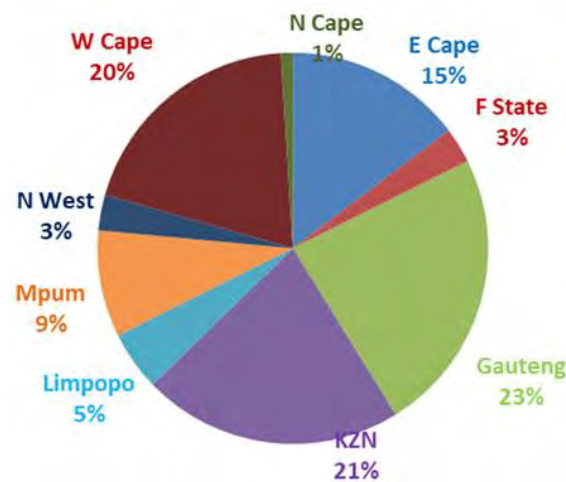


Figure 3 service delivery protests by province.

Source STATSSA.

In the Back-to-Basics report, Brandt and Hendriks (2014) identified that in South Africa, financial viability and sustainability in most municipalities is under pressure. The 2008 financial crisis exacerbated this municipal debt crisis. The financial crisis led to slow economic growth and widespread poverty, leading to municipalities having to provide for a higher number of citizens while being themselves under-resourced. Subsequently, this meant that municipalities could not collect taxes from the poverty-stricken citizens who were already stretched thin by the financial crisis.

The 2018-2019 Auditor-General report shows that local governments had the potential, in money and assets, to fulfil most of the basic needs and aspirations of the citizens. However, drastic actions have to be taken to realize that potential. There are increasing calls in the media for proper administration and superintendence over the financial affairs of local governments. The Auditor-General report for 2018-2019 shows abundant evidence of improper administration, which was found to be seriously lacking, with some devastating consequences already evident in most provinces.

Conclusively, the financial statements of municipalities should depict a story of efficient management, disciplined spending that achieves value for the citizens, accurate billing and collecting practices, good safeguarding of assets, careful investments, and savings for emergencies and future projects. In reality, South African local government municipalities are crippled by debt and have not prepared credible financial statements, even after paying millions to consultants.

### **3.6 SOURCES OF FINANCE FOR LOCAL GOVERNMENTS**

Municipalities in South Africa use the following sources of finance: equitable share and government grants, own revenue and lending. However, not all municipalities have a stable financial system that allows them to borrow funds or attract investors. Therefore, they are mostly confined and can only depend on central government grants and revenue efforts. Municipalities receive funds in the form of government grants, with the municipal financial grant being the most essential. The financial grant is used to extend infrastructure to provide basic services such as water, electricity, and sanitation (Brand, 2016).

However, the national government aims to make municipalities self-sufficient, which can be achieved by enhancing revenue and directly gaining access to capital markets. This raises the need for accountability measures for operational performance, shouldered by municipal management. For the following reasons, the central government needs to be protected from inheriting the debts of the local government. When a local government borrows internationally, the debt becomes the government's debt through the central government. Accordingly, municipalities must be incentivised to improve their management and creditworthiness because the government will not bail them out for their faulty management or policies.

There is a need for discipline, especially in municipalities that borrow from abroad. Credit allocation decisions can be less commercial; with rent creation, capital stops flowing in for productive uses but instead is given to the politically astute. Accountability measures become

diluted, and incentives for inefficient and wasteful decision-making can replace those that encourage the effective use of capital and tight financial management. Expanding investment resources such as local government borrowing via central government can result in squeezing out of the private capital from the municipal sector.

In most instances, municipalities raise their funds by charging tariffs for services such as water, electricity and refuse collection and through hiring out of municipality facilities and transfers from the National government. Municipalities receive funds in the form of municipal conditional grants; these are used to extend or maintain the infrastructure for the provision of basic services such as water, electricity, and sanitation. Conditional grants have been used in South Africa to transfer funding to provinces and municipalities for the purpose of achieving particular national government policy objectives. This mechanism is especially important in South Africa, where the Constitution provides for equal access to basic public services, including health, education, water and welfare. Issues of municipalities not making full use of the money allocated to them and concerns over the mismanagement of funds or a mismatch of funds and functions result in municipalities resorting to borrowing.

Against this backdrop of themes, this study will investigate whether political competition influences local government debt in South Africa.

Factors such as the 2008 financial crisis, now exacerbated by the COVID-19 pandemic, show the need for support for the municipalities, pinpointing the cracks in the system and the need for sound financial health. The national treasury blames the weak political leadership and weak accountability of financial managers in municipalities. Furthermore, there has been brazen theft of public resources. Keppler and Van Rooyen (2017) say that political instability and weaknesses in government are the two leading causes of poor service delivery at the municipal level, along with a lack of citizen engagement and the inability of the municipalities to claim money owed to them. Furthermore, Mertens (2019) attests that the escalating municipal debt poses a significant threat to the financial stability of cities and directly affects service delivery.

There is much speculation that political forces are behind the continuous rise in debt in municipalities. Runciman (2015) states that political instability and weak governance are the two primary causes of poor service delivery at the municipal level, plus the lack of citizen engagement and the inability of municipalities to collect debts owed to them by the citizens. Treasury blames weak political leadership and a lack of accountability for the municipal debt woes. Merten (2019) also expressed that the municipal debt crisis is politically driven. Findings

from the Auditor-General through numerous commissions of inquiry such as the 2018 Moeroane Commission), have indicated severe signs of economic misgovernance, eroding economic development and social development. Further reports indicate wasteful and unauthorised fiscal expenditure at municipal levels of government, which may increase municipal debt.

Political factors have been highlighted as contributing to the financial woes currently faced by municipalities in South Africa. The prominent financial decision-makers in all spheres of government are electorally selected. Several cases of corruption, mismanagement, and financial reports show unfruitful expenditure. Moreover, political competition creates an institution that can open the economy, leading to efficient growth and human development. On the other hand, a lack of political competition can produce a vicious circle that corrodes growth and paves the way for rent creation and corruption. Public choice theory states that incumbents in office are self-interested and may not make financially beneficial decisions for economic growth.

Poor management and corruption have caused an increase in unauthorised expenditures and wasted funds. Municipalities in South Africa are lacking on the labour front. There is a shortage of skilled, qualified people to manage municipalities efficiently. An excellent municipal management team is needed to deliver operationally by optimising income and spending cash economically, efficiently and effectively (Brandt, 2017).

Globally, there has been a rise in interest in municipal debts and local government financial sustainability. Studies by, Chatterjee et al (2019) and Marin and Goda (2021) have investigated the relationship between political competition and fiscal performance. Currently, to the best of my knowledge, no studies have been made on the debt dynamics of municipalities and municipal economic growth and Human Development. Hendriks (2018) states that the hurdles that South Africa faces indicate the mismatch between local government's increasing responsibilities and state revenues, resulting in local governments failing to fund rising demands for investment infrastructure and public services.

Frieden (2020:4) stated that we should pay closer attention to the interactions between politics, economics, and other realms. North et al. (2011) and Acemoglu (2011) wrote about the role of institutions in economic growth. In some instances, the causes of the local government debt have been narrowed down to unaccountability, slow economic growth, and the rent-seeking behaviour of politicians in an economy.

Why do debt studies matter? The financial stability of a municipality indicates its ability to manage its money in such a way as to deliver services and develop and maintain the infrastructure required by residents in that area. It also indicates that a municipality can absorb financial shocks caused by external factors without needing financial assistance from third parties (Auditor General,2020).

Ratings Afrika assessed the financial statements of municipalities in South Africa as reported by the National Treasury; the 2018 municipal financial stability index found that most municipalities were in financial distress. Municipalities lacked appropriate budget planning and failed to exercise adequate fiscal discipline. As a result, these municipalities had expenses exceeding income (debt). Out of the 100 assessed municipalities, 77% reported operating deficits (Ratings Afrika, 2018). The combined surpluses in Municipalities amounted to 1.4 billion rand, which was outweighed by the combined losses of a whopping 13.3 billion rand. According to the findings of Ratings Afrika (2018), the combined working capital shortfall for the 100 municipalities was 23 billion Rands. This magnitude of this amount will cause an inability to provide quality services, which may result in catastrophic consequences for residents and businesses and could cause political unrest.

Good Governance Africa (2019) found that of the top twenty municipalities, twelve are in the Western Cape, the Democratic Alliance runs eleven, and four are a coalition between DA and others. Of the bottom twenty municipalities, nine are found in KwaZulu-Natal, and seven are in the Eastern Cape. Most are ANC-led, with IFP running four of them.

From observations made during the data collection for this study, the ANC has had the most significant share in the political market. However, over the years, market share has been dwindling; this may be due to the introduction of new parties, for instance, the EFF. Loyalty to the party that brought freedom to South Africa has reduced, and this can be attributed to the current state of the country, unemployment, poverty, crime and inequality.

The South African municipal sector is currently facing collapse (AGSA,2020). The necessary solution is decisive political leadership that looks after the interests of the residents, including that of the business community. Fears have spread that the main reason for the deterioration of the financial stability of the municipal sector is the lack of political leadership to provide sound governance. Suggestions are that leaders stop looking after their own interests and root out corruption, appoint managers with the right skills and experience to offer sound budgetary practices, and exercise strict financial discipline.

### 3.7 POLITICAL COMPETITION IN THE EASTERN CAPE

There are varying definitions of politics, for example, the aspirations for and, more importantly, the retention of power over residents of a particular jurisdiction by specific individuals or a group of individuals. Through locally defined processes, these individuals will inherently introduce policies and programmes that will enhance the quality of life in their constituents. The process includes the selection of local leaders and how power will be exercised in a municipality (Reddy, 2016).

Local governments in South Africa demonstrate a concentration of political power. Numerous parties are participating in electoral competitions. Numbers increase each year due to the freedoms afforded to individuals and groups to form political parties in South Africa. The political parties contest in elections, and the votes taken by the majority party give them a monopoly on political power. Figures 3.2, 3.3, 3.4 and 3.5 show the distribution of political power in the political market in the local government elections of 2000, 2006, 2011 and 2016.

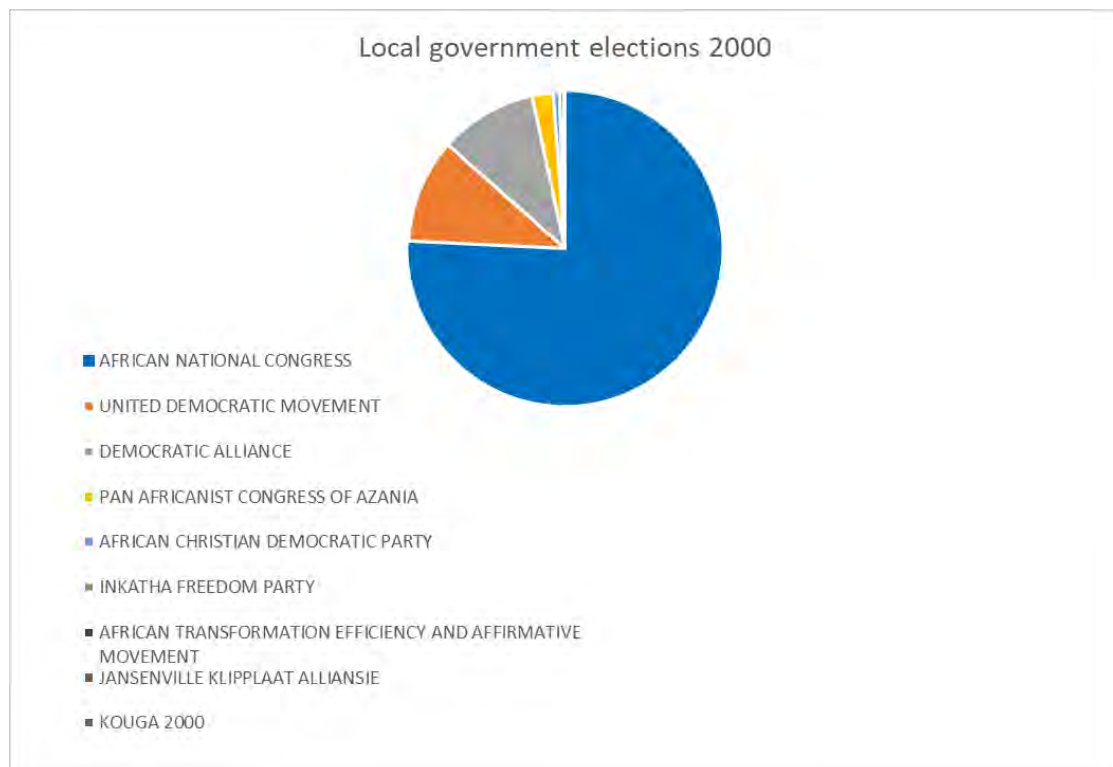


Figure 3.2 Pie chart showing political party market share. Source: Electoral Commission of South Africa.

Figure 3.2 shows the top 10 political parties in the 2000 local government election, when the ANC had a 75% share of the political market, followed by the United Democratic Movement

party, which had 10.79% of the votes and the Democratic Alliance, with 10.07%. Support for ANC was very high during the first few years after Apartheid, with strong party loyalty and hope for transformation and economic growth.

Figure 4 Government elections 2006

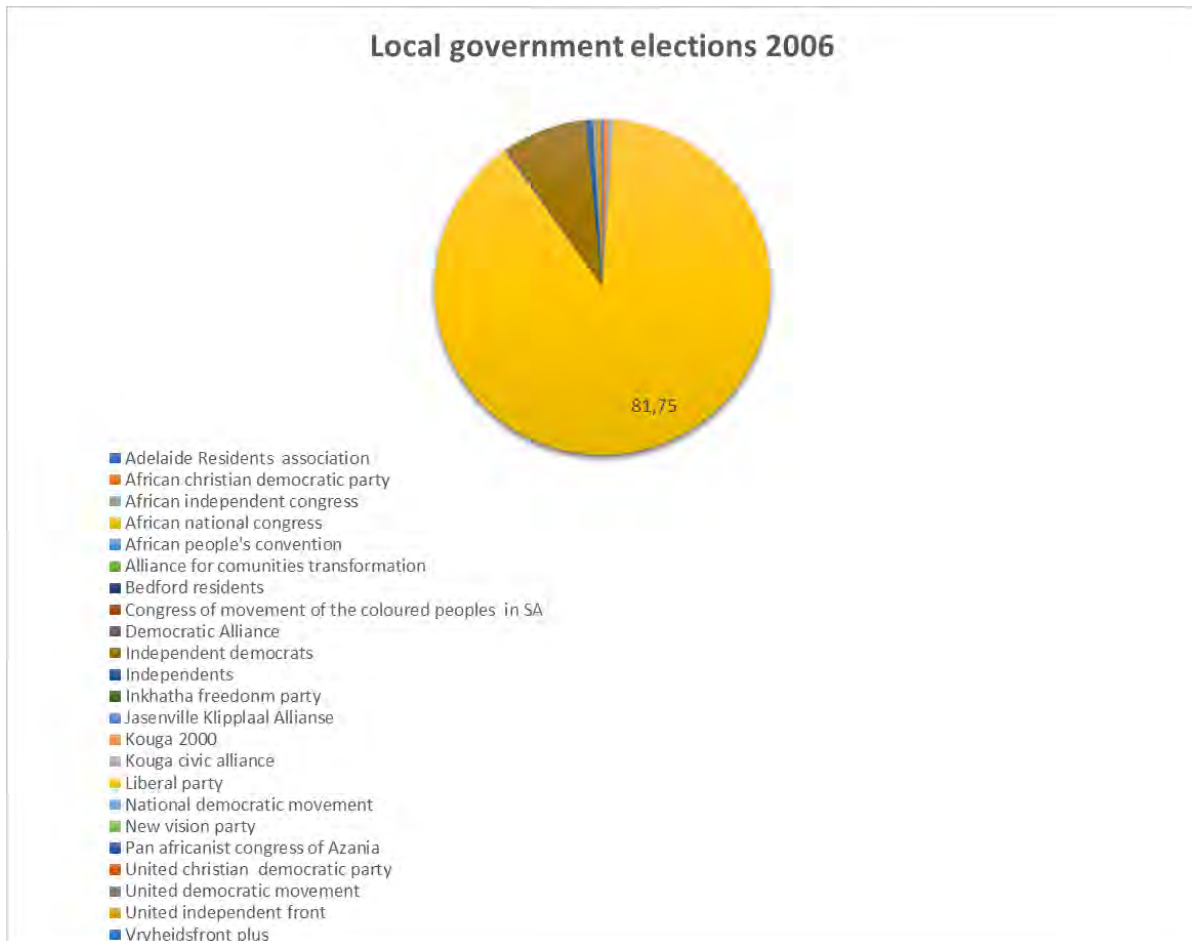
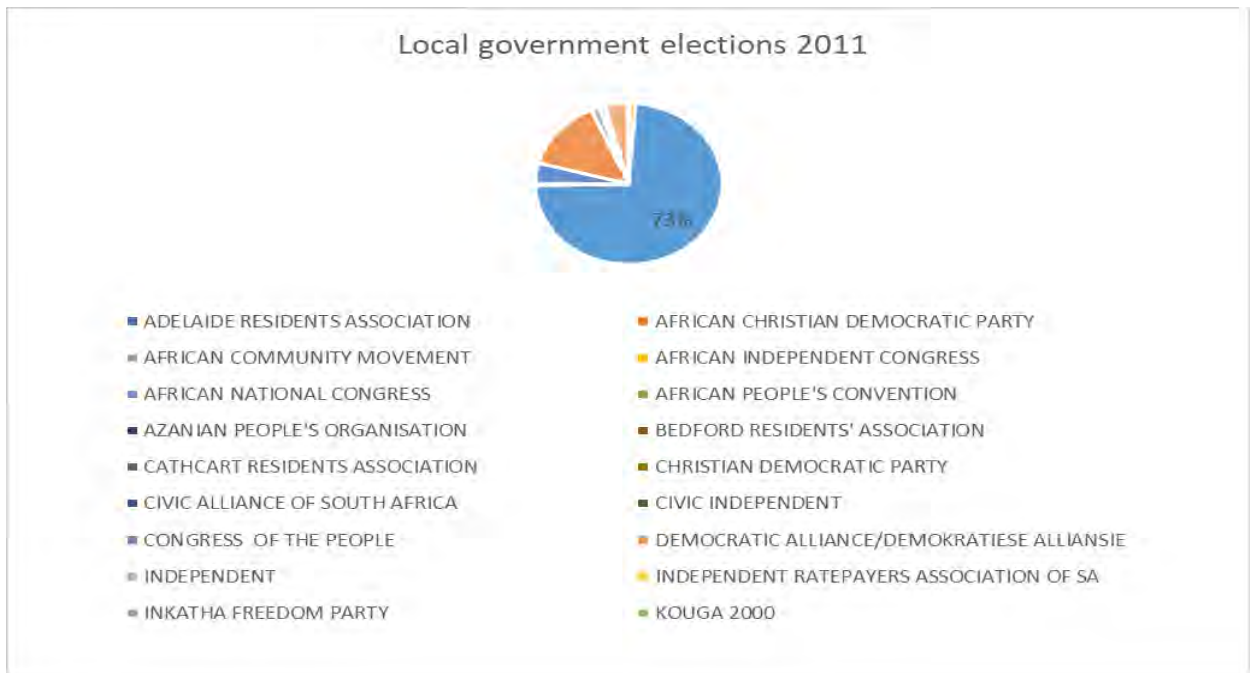
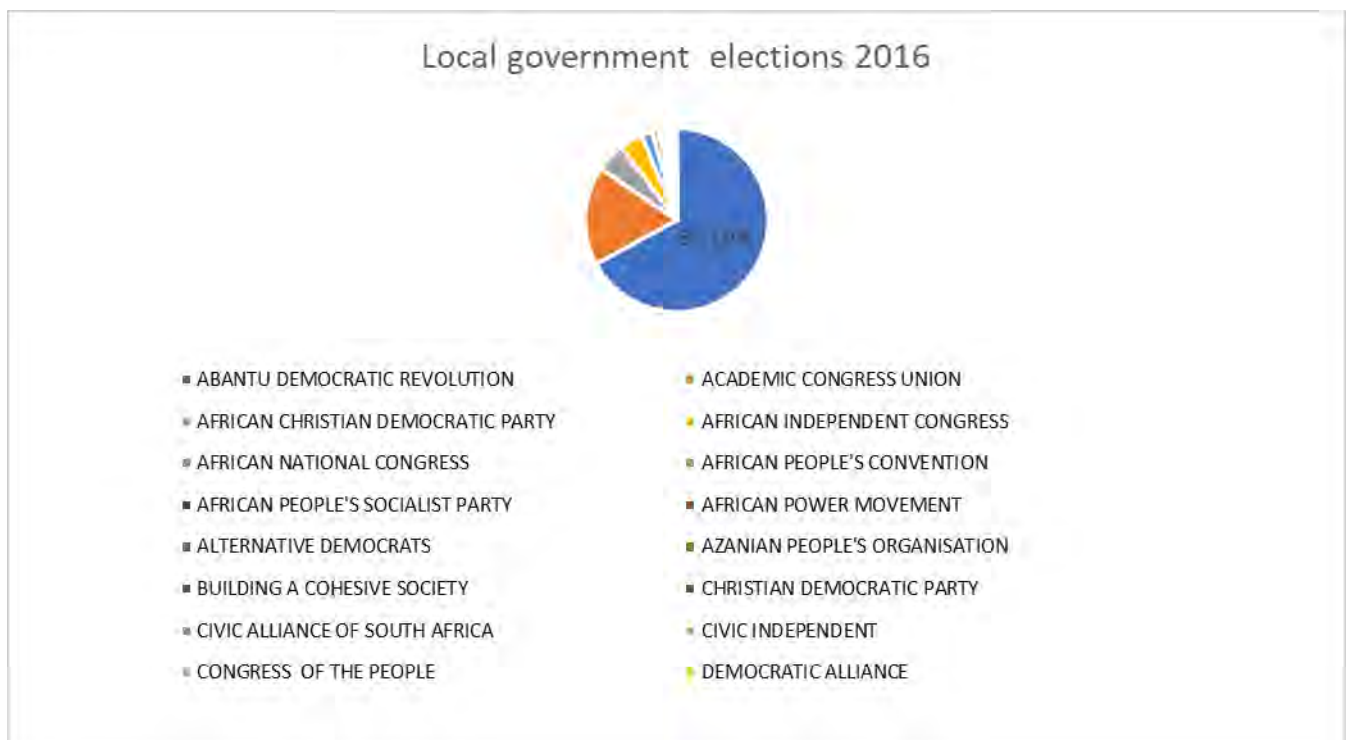


Figure:5 Local government elections 2011 (author's work)



Source (author's work)

Figure:6 Local government elections 2016



Source (Author's work).

As in the previous local government elections, the ANC has dominated the political market. However, support has declined over the last decade (Runciman, 2015). In 2000 the ANC had

81.5% of the total votes. In 2006, ANC received 73%, and in 2016, 63 % of the political market share. The decline in support could be emanating from the increase in the choice of parties; for instance, the EFF has grown since its start in 2013, from rising support for rival parties or from political protest in several municipalities in different provinces throughout South Africa. The decline was also noticed in the liberal party, the Democratic Alliance. The three biggest parties to date are the African National Congress (ANC), Economic Freedom Fighters (EFF) and the Democratic Alliance (DA). The ANC continues to experience declining support.

Voting patterns are also drawn through ethnic differences. For instance, isiXhosa speakers are more likely to vote for ANC, and Sepedi speakers are most likely to vote for the EFF. isiZulu speakers strongly leaned more towards the ANC when Zuma was president. However, support for ANC is still strong among the Zulus; however, research shows that Zulus are more likely to vote for other oppositions beyond the EFF and DA. Those who have participated in protest action are most likely to vote for the opposition (Obikili, 2016)

Many municipalities are governed by coalition governments. This creates some friction within parties, especially when it comes to making policy decisions. Besides the political fragmentation, there is political infighting and related clashes between political and management components in local government adversely affect service delivery.

South Africa has seen many cases of cadre deployment of the ruling party. Cadre deployment, in the South African context, is the idea that the ruling party seeks to place its people in positions of authority in the state and other fields of influence. This plays more on the accountability issue. Positions are limited to certain parties, yet democracy affords all members of a country to participate in elections. Cadre deployment: The appointment by a government's governing party of a loyalist to an institution as a means of enhancing public reporting lines and ensuring that the institution stays true to the mandate of the party as elected by voters.

### **3.8 IRREGULAR, WASTEFUL, AND UNAUTHORIZED EXPENDITURE**

The Auditor General of South Africa (2020) defines fruitless expenditure as spending done in vain that could have been avoided, if necessary, measures had been taken. For instance, irregular spending is incurred in contravention of legislative procedure and the requirements of the Municipal Finance Movement Act (MFMA). Irregular spending is defined as expenditure that was not incurred in the manner prescribed by the legislation; in other words, somewhere in the process that led to the expenditure, the auditee did not comply with the applicable legislation (Auditor General of South Africa, 2020). Wasted finances speak volumes on the

poor management of funds and the weak economic governance controls. This could be because of rent extraction of the elite; there is a lack of transparency in management and accountability, and this harms service delivery. Those wasted funds could be redirected to serve a greater purpose.

### **3.9 LOCAL GOVERNMENT AND THE NATIONAL DEVELOPMENT PLAN.**

The National Development Plan expresses the desire for South Africa to strengthen the capacity of local government to fulfil its developmental role. It is a municipality mandate to help develop the people. The Municipal Integrated Development Plans (IDPs) need to be used more strategically to focus attention on critical priorities in the national development plans (NDP) that relate to the mandate of local government, such as spatial planning, infrastructure, and basic services. Like provincial planning processes, municipal IDPs should focus on aspects of the NDP that fit within a municipality's core responsibility. This would allow the IDP process to become more manageable and the participation process more meaningful, thus helping to narrow the gap between the aspirations contained in the plans and what can be achieved.

To achieve this, the IDP process needs to be led by municipal staff, not outsourced to consultants. Political leadership is critical for effective performance. Premiers and Mayors need to be visible and active champions of the Plan, with their offices being the catalytic agencies to drive implementation at provincial and municipal levels. This expresses the importance of accountable and capable leadership in local governments (Reddy, 2016).

*“It is often said that, like all politics, all development is ultimately local. As the world strives for a more sustainable path in the years ahead, particularly beyond 2015, local voices and local action will be crucial elements in our midst .... It is crucial to preserve and nurture political spaces where local authorities can have an impact on decision-making at the global level .... Local authorities have significantly increased their engagement in global processes. The inputs of local leaders and municipal planners have never been more critical to guiding member states towards embracing policies that achieve green, sustainable and inclusive cities (UNDP 2014b:1)”.*

### **3.10 CONCLUSION**

This chapter has outlined the economic and policy backgrounds at national and local government levels and contextualizes the nexus between political competition and debt in South Africa.

This section also introduced the Eastern Cape as a province, and background information on the formation of local government. There is overwhelming evidence that local governments in South Africa are under financial distress, and the Eastern Cape is no exception. The chapter also showed that there seems to be a political monopoly in the Eastern Cape. However, various reasons for local government debt were highlighted, with politics being seen as a possible force driving local government debt. However, the effect is still to be studied in the next chapter.

Chapter 4 will explain the methods used to collect electoral data to construct the normalized Herfindahl index. The chapter will describe the socioeconomic and financial data collection used to analyze the relationship between political competition, local government debt, and human development in the Eastern Cape province in South Africa.

# CHAPTER 4

## RESEARCH METHODOLOGY AND DATA

### 4.1 INTRODUCTION

The chapter presents data, data sources, and methods employed to analyse the relationship between political competition and local government debt. This chapter describes the research methodology before describing how the local government debt variable was created. The chapter describes how the NHHI, Tress index and, finally, how the panel granger vector autoregressive model was constructed to model the interaction between local government debt, local government economic growth, service delivery and Human development in the Eastern Cape province.

### 4.2 RESEARCH PARADIGM

This study falls under the quantitative research approach. The research isolated specific variables in the study framework to find a correlation, relationship, and causality between them (Bell,2010:5). Quantitative data is used to avoid personal bias, and statistics is used to find correlations between data. Financial data about the local governments were collected from the Auditor General from 2009 to 2016.

Under the quantitative research approach umbrella, the thesis is a positivist research philosophy adopted from the natural sciences. The central premise of the positivist approach is that "one can best understand human behaviour through observation and reason". Positivism entails the collection of verifiable empirical evidence to support theories and hypotheses. The researcher is independent and takes the role of an objective analyst (Blumberge,2018). The study is based on a real and objective interpretation of data at the researcher's disposal. The expectation is that the same research results will be obtained using similar methods under the same conditions. This study can be replicated in different local governments in South Africa and worldwide variable definitions and Data sources.

All the variables of interest except for political competition were sourced from the Eastern Cape socioeconomic. Consultative Council The research uses electoral data from the Independent Electoral Commission of South Africa to measure political competition in South Africa using the Normalized Herfindahl Index (NHHI) to measure political power concentration within the local governments in the Eastern Cape. The Tress index was used to

measure the economic structure of a municipality. A panel granger vector autoregressive model was constructed to model the interaction between municipal debt, local government growth, service delivery and human development. While it is theoretically plausible that political competition impacts debt dynamics, there is a possibility of reverse casualty due to political rent-seeking processes surrounding municipal debt contraction.

No ethics application form was submitted for this research. The data sets used were readily available on the Eastern Cape Socio-economic Consultative Council, the South African Local Government Association, The Auditor General and the Independent Electoral Commission of South Africa.

The research is focused on the Eastern Cape province, the second-largest province in South Africa based on size and the third based on population (Statssa,2021). The Financial statements were readily available from the Auditor General website, and socio-economic data was readily available on SALGA. However, there were gaps in some of the financial statements, which can affect the data quality. These gaps were due to poor financial reporting, which is the trend in most South African provinces.

### **4.3 DESCRIPTION OF DATA VARIABLES**

This section explores the data variables that were used in the study.

#### **4.3.1 POLITICAL COMPETITION PROXY**

The political competition index was constructed from election results published by the Independent Electoral Commission on its website. Election cycles from 2000: 2000-2005, 2006-2010,2011-2015 and 2016-2020. The next local government elections that occurred in 2021; thus, the 2021 electoral cycle was excluded from this analysis. There have been Four local government electoral cycles. With 32 Municipalities and four electoral cycles, there are 128 observations available for estimating the interactions among variables. The winning margin will be used as a robust check for variables. Normalized Herfindahl Index

According to Alfano and Baraldi (2016), the number of political parties competing in elections is an essential feature of democracy. Political competition shows the extent to which political power is fragmented, dispersed, or concentrated. The number of party competition alone is not sufficient evidence to prove that there is actual political competition. The number of parties competing does not show relevance or influence in completion for the local government office. Numerous parties may be actively campaigning for office, but only a handful are effectively or

recognized by the public. South Africa has numerous parties vying for political influence at all spheres of government; however, three main parties' names can be heard in main media reports or seen in offices at Local government offices and national offices. This shall be explained further in the analysis of the empirical data.

South Africa uses a mixed system. Seats in the council are allocated according to the percentage of votes a party gain. Alfano and Baraldi (2016) argue that characterizing a party system based on the number of seats gained does not effectively measure political competition. According to such a system, all competing political parties are treated as equal, when in fact, some dominant parties in existence show more rigour in the competition for office. The crux of the matter is that all parties cannot be treated equally. One needs to consider the differences in size to analyse the influence in the competition for office. Thus, this study uses the Herfindahl- Hirschman Index (HHI) to measure political power and relevancy in the local government political market.

The seminal work of Stigler (1972) states that the political market and the economic market are both defined by the process of competition. In the goods market, the supply-side consists of firms. Similarly, the supply side of the political market consists of political parties that form government at all spheres and execute the desires of the electorate or politics. In this scenario, the people's votes can be considered as demand for certain public goods. These are provided by the supplier (Political party), advertised through a campaign manifesto. (Downs,1957).

Following this line of thinking, it is only logical to believe that it is in each political party's best interest to increase its share of seats in local government to exert its influence on the economic policy and other institutions that define "who gets what in the economy". The HHI is suited to measuring the concentration of political power, and the index indicates the size of the political party relative to the size of the political market. (Marire,2019).

The Herfindahl- Hirschman Index or HHI measures the size of a firm in relation to the industry, and it is an indicator of the amount of competition among them (Varian,2010). HHI is the sum of the squares of the firm's market shares within the industry, which are expressed as fractions. The result is proportional to the average market share weighted by the market share. It ranges from  $1/n$  ( $n$  is the number of firms) to 1, moving from a huge number of very small firms to a monopoly. Increases in HHI generally indicate a decrease in competition and an increase in market power, whereas decreases indicate a competitive industry with no dominant players (Alfano and Baraldi,2016: 9).

It is based on the number of parties and the distribution of their share of votes. The same market industry logic is used; a small index indicates a competitive market of votes without dominant political parties, whereas a large index shows that votes are concentrated in the hands of a few political parties. However, as noted by various authors (Rhoades, 1993); Alfano and Baraldi (2016), the HHI has an inherent problem; it does not give weight to the relative size of each party with respect to each other, which is crucial for the political analysis. It is imperative to explain the level of competition within the parties and analyse which parties have influence in the office.

To remedy the problem, the study used the normalized Herfindahl Index to measure political competitiveness in a political market (Alfano and Baraldi, 2016: 9). It ranges from 0 (Perfect competition with an equally sized party) to 1 (monopoly). The formula for a normalized Herfindahl Index is:

$$NH_{erf} = \frac{\left( Herf - \frac{1}{n} \right)}{1 - \frac{1}{n}}$$

With  $n$  being the number of parties in an election and  $Herf$  the standard Herfindahl Index.

The Normalized Herfindahl index positively depends on the standard Herfindahl Index and the number of parties (Alfano and Baraldi, 2016: 10). The NHHI helps assess the performance of incumbent politicians (Alfano and Baraldi, 2016: 10). The normalized Herfindahl index considers the concentration of votes in the hands of the parties and of their relative market power, which makes it the best measure for political competition; therefore, this paper shall use the NHHI in the empirical analysis in the South African Context.

However, the conventional HHI only considers the size of the political parties as measured by their electoral shares; there is a need to find a measure that captures both the number of parties and their relative sizes.

$$HHI_{it} = \sum_{all\ t} \sum_{all\ i} s_{it}^2, \forall i = 1, 2, \dots, n; t = 1, \dots, T \quad (1)$$

share of electoral votes that a political party gets from an election event in election year  $t$  and  $n$  is the number of political parties.

$$\frac{1}{n} \leq HHI_{it} \leq 1 \therefore HHI_{it} \in [0,1] \quad (2)$$

As the number of political parties increases,  $1/n \rightarrow 0$ . To correct for the weakness of the HHI, the HHI was normalized in the following manner:

$$NHHI_{it} = \frac{(\sum_{i=1}^n s_{it}^2 - \frac{1}{n})}{1 - \frac{1}{n}} = \frac{(HHI_{it} - \frac{1}{n})}{1 - \frac{1}{n}} \quad (3)$$

A critical property of this measure is that it is a positive function of the number of political parties. The first derivative of (3) yields:

$$NHHI'_{it} = \frac{\frac{1}{n^2}(1-HHI_{it})}{(1-\frac{1}{n})^2} > 0, \forall n > 1 \quad (4)$$

Equation (4) holds true always because  $HHI_{it}$  in the context of  $n > 1$  is always less than unity. Literature e.g., Alfano & Baraldi (2015), suggests that  $NHHI_{it} < 0.1$  means very low levels of political power concentration. For the  $[NHH]_{it} \in (0.1; 0.18)$ , there is a moderate concentration of political power, but an  $[NHHI]_{it} > 0.18$  means high concentration of political power.

## 4.3.2 LOCAL GOVERNMENT DEBT PROXY

### 4.3.2.1 Debt to asset ratio

The local government debt proxy was obtained using the debt-to-asset ratio using data from the Auditor general financial statements. The debt-to-asset ratio measures the financial leverage of a business or government institution. The debt ratio is calculated by dividing the total amount of municipal debt (or liabilities) by the total value of assets and is expressed as a decimal or percentage 1 (Stassa, 2020). Entities with higher debt levels than assets are considered highly leveraged and riskier for lenders. This ratio helps stakeholders such as lenders and creditors analyse the overall financial health of a local government.

In terms of local governments, it is an indication of the financial management of assets and the amount of debt. explicitly, the debt ratio indicates how much municipalities rely on borrowed money to finance their assets (StasSA, 2016).

Further analysis of the debt-to-asset ratio allows individuals to assess whether there has been a change in debtors' behaviours and sources of revenue. For instance, government grants municipal rents payments. Additionally, it shows the creditors, water boards, medium to long term loans and borrowings from different State holders.

Financial ratios are designed to provide users of annual financial reports with a more precise interpretation of a local government's performance and financial results and a comparison of trends over several years (Brand, 2016). Financial ratios provide a short-term measure of the

financial sustainability of local governments and complement the national criteria endorsed by the Local Government and Planning Ministers' Council. They provide for a comprehensive tool for monitoring the financial sustainability of local governments.

$$\text{Debt to asset ratio} = (\text{Total Liabilities}) / (\text{Total Assets})$$

The ratio is shown in decimal format as a percentage. A lower ratio is more favourable, showing stability or potential for longevity. Each industry has a benchmark for debt; the ratio ranges between 0-1. With 0 indicating that there are no debts, the Local government is funded by assets, and one shows that debts completely fund total assets. The National Treasury has stated that municipalities should not have a debt ratio higher than 45% (Statssa,2020). Therefore, the study uses the standard decimal number of 0.45 as a reasonable ratio. Where 0.45 is equal to low risk or 45 per cent of assets funded by debt, and one shows that total assets equal total liabilities (Stassa,2020).

#### **4.3.2.2 Working Capital Ratio**

A working capital ratio was used to gauge Local government institutions' ability to pay back short-term debt. The working capital ratio was used to verify the level of debt in municipalities. The working capital ratio is a financial indicator; it uses data from the entity's balance sheet. It is calculated by dividing current assets by current liabilities. Current liabilities include any debt that needs to be settled in a year, such as short-term loans (Brand, 2016)

$$\text{Working capital ratio} = (\text{Current assets}) / (\text{Current liabilities})$$

A working capital ratio of 1 or higher indicates that an entity is in a favourable financial position and has enough assets to settle its current liabilities. A ratio less than 1 indicates that Current liabilities exceed current assets. An institution may be in a precarious financial position and may have difficulties paying back creditors like water boards and Eskom. (Brand,2020).

Low working capital can signify that the institution or government is not operating efficiently and may struggle to meet its debt obligations. In 2019 half of the municipalities reported a less than one working ratio. These included the Free state, Northwest, and northern cape. Low ratios are associated with several challenges: high debt levels, decreasing sales revenue, mismanagement of inventory, and receiving payments from debtors such as households and businesses using municipal services (BusinessTech,2020).

Although higher working capital is perceived as favourable, it can indicate that a business or government institution allows excess cash to sit idle rather than investing it (Brand,2016). According to StatSA (2020), a comfortable range for a working capital ratio is 1.2 to 2.0.

#### **4.3.2.3 Tress Index**

A tress index measures the diversification or concentration of a region's economy. A tress index of zero represents a diversified economy. On the other hand, the higher the index (closer to 100), the more concentrated or vulnerable the region's economy to exogenous variables, such as adverse climatic conditions and commodity price fluctuations. The tress index was obtained from the Eastern Cape Socioeconomic Consultative Council's database.

#### **4.3.2.4 Human Development Index**

The Human Development Index (HDI) is a summary measure of the average achievement in the dimensions of human development. It is based on measurements of life expectancy, literacy, and income. It is a measure of people's ability to live a long and healthy life, communicate, participate in the community's life, and have sufficient resources to make a decent living. The HDI can assume a maximum value of 1, indicating a high level of human development and a minimum of 0 (UNDP,2020).

#### **4.3.2.5 Inpoverty and Inpop**

Inpoverty and Inpop (population) is the logged poverty and population estimates in local governments in the Eastern Cape. The Eastern Cape is currently the second poorest province in South Africa (StatSA, 2022). Inpop shows the possible voter base. (Inpop covers all person who are eligible to vote).; the poverty rate gives a glimpse of the ability of the tax base to add to the revenue of the municipality and the number of people dependent on the local government for service delivery.

### **4.4 MODEL SPECIFICATIONS.**

#### **4.4.1 STUDY SAMPLE**

The Eastern Cape has 45 municipalities. However, 32 municipalities were selected for the study due to data availability constraints. The sample was decided on based on data availability. The municipalities are as follows:

Buffalo City	Blue Crane	Makana	Nelson Mandela bay
Ndlambe	Sundays River Valley	Kouga	Kou-komma
Mbashe	Mnquma	Great Kai	Amahlathi
Ngqushwa	Nkonkobe	Nxuba	Inxuba Yethemba
Tsolwana	Lukanji	Intsika Yethu	Emalahleni
Engcobo	Sakhisizwe	Elundini	Senqu
Maletswai	Gariep	Ngquza Hill	Port st Johans
Nyandeni	Mhlontlo	King Sabata Dalindyebo	Umzimvubu

Figure 7 Case study sample

Sample of 32 municipalities selected for the study. Student's work

#### 4.4.2 GENERAL LEAST SQUARES (GLS)

The research hypothesizes that there is a causal relationship between political competition and local government debt. Studies by Besley et al. (2010), Acemoglu et al. (2009), North et al. (2012) found that there is a link between political competition and economic growth, and this has further implications on development. Local government debt is a product of financial management policies, spending habits and tax collection habits by the political leaders in office. (Baber, Pradyort and Sen,1986). North et al. (2012) and Mbeki postulated that sustainable economic and human development is dependent on the bidirectional relation between political competition and economic competition. A deadweight loss can be anticipated when there is a concentration of power. In this case, this might lead to antigrowth policies, extractive rents, poor accountability that negatively affects the fiscal management in local governments.

The study also used the generalized least squares model to estimate the relationship between political competition and local government debt. This technique estimates the unknown parameters in a linear regression when a certain degree of correlation exists between residuals in a regression model. The GLS considers prior information in estimations (Lawson and Hanson,1974); (Wiggins,1992); (Tarontola and Valette, 1982). Flach and Mattos (2020): Paola and Scopa (2010) used the GLS model to analyse political competition and municipal

performance in Brazil and Italy, respectively. Following their example, the study estimated the GLS as follows:

$$y_{i,t}^* = \beta_1^* + \beta_2^* x_{i,t}^* + \varepsilon_t$$

$$debt2asset_{i,t} = \beta_1^* + \beta_2^* Nhh_{i,t}^* + \beta_3^* tress_t^* + \beta_4^* Inpov_t^* + \beta_6^* Inpoverty_t^* + \beta_7^* HDI_t^* + \varepsilon_t$$

The study used a GLS with heteroscedastic panels and panel specific AR (1) to assess the relationship between the data variables.

#### 4.4.3 FIXED EFFECTS

In FEM, the Intercept in the regression model differs among individuals because each individual or cross-sectional unit may have its own characteristic. Municipalities have different leaders with differing management styles, although in South Africa, laws and rules are the same. The study pooled all 256 observations but allowed each cross-section unit to have its own Intercept. The study uses a two-way fixed effects model with a time effect. Political competition varies over time. A time dummy variable that accounts for years 2009-2016 is used to account for these.

Model mathematical form.

$$Y_{it} = \beta_1 \chi_{it} + \beta_2 Z_{it} + \varphi_i + \varepsilon_{it}$$

Where  $\gamma$  represents the variable for local government debt of municipality  $i$  in the period of local government  $t$ . On the other hand,  $\chi$  represents the variable of political competition and  $Z$  is a set of control variables, while  $\varphi$  the fixed effects by the municipality.  $\beta_1$  represents the parameter that captures the impact of political competition level on the municipal local government debt during the period and  $\varepsilon$  is the term for disturbance (Marin et al. ,2021).

#### 4.4.4 RANDOM EFFECTS (REM)

An alternative to FEM is the Random-effects model. It assumes that the intercept values are random. The Intercept represents the mean value of all the cross-sectional intercepts, and the error term component represents the random deviation of individual Intercepts from the mean value (Gujarati and Porter, 2009: 603). The model is best applied in instances where variables like ethnicity, gender and religion, which do not vary, are used.

$$TCit = \beta_1 + \beta_2 Qit + \beta_3 PFit + \beta_4 LFit + \omega_{it}$$

An assumption is made that  $\beta_{1i}$  is random with a mean value of  $\beta_1$ . The Intercept of each individual municipality is expressed as follows:

$$\beta_{1i} = \beta_1 + \varepsilon_i$$

Where  $\varepsilon_i$  is a random error term with a mean value of zero and a variance of  $\varepsilon_i$ , the individual differences of each municipality are reflected in the error term  $\varepsilon_i$  (Woolridge, 2002). The composite error term  $\omega_{it}$  consists of two components:  $\varepsilon_i$ , which is the cross-section component or individual-specific error component, and  $u_{it}$ , representing the time series and cross-section.

#### **4.4.5 HAUSMAN TESTS**

The test is applied to decide whether the random-effects model is appropriate. The Null hypothesis underlying the Hausman test is that the FEM AND ECM estimators do not differ substantially. The test statistic developed by Hausman has an asymptotic  $\chi^2$  distribution. If the null hypothesis is rejected, the ECM is not an appropriate model because the random effects are probably correlated with one or more regressors. Thus, the FEM is preferred to ECM.

#### **4.4.6 BREUSCH AND PAGAN LAGRANGE MULTIPLIER TEST (BP)**

The BP test is used to reinforce the Hausman test. The BP is used to test the hypothesis that there are no random effects,  $\sigma_{\varepsilon}^2 = 0$ . Under the null hypothesis, the BP follows a chi-square distribution with one df as only one single test is being conducted (Gujarati and Porter, 2009),

#### **4.4.7 PANEL DATA MODEL**

Panel data is used to analyse individuals, firms, states and countries over time. Therefore, it is applicable to studying the local governments in the Eastern Cape. Panel data combines cross-section observations and time series, thus allowing for more informative data, variability of data, more degrees of freedom, and collinearity amongst variables, rendering the models efficient. It detects and measures effects that are difficult to observe and enriches empirical analysis in ways that may not be possible when we only have time series and cross-section data. Panels constitute of Balanced and unbalanced panels, short and long panels. The research study panel has a balanced panel in which all variables contain 256 variables. The study can be described as short as the number of cross-sections  $N$  is greater than the number of  $T$ . ( $n$ - number and the  $T$  being time)

#### 4.4.8 PANEL GRANGER AUTOREGRESSIVE MODEL (PVAR)

To address the objectives, a panel granger vector autoregressive model was constructed to model the interaction between political competition, municipal debt, local government growth, and human development. While it is theoretically plausible that political competition impacts debt dynamics, there is a possibility of reverse casualty due to political rent-seeking processes surrounding municipal debt contraction. Panel VARs seem particularly suited to address issues that are currently at the centre stage of discussions in academic and the policy arena, as they can (i) capture both static and dynamic interdependencies, (ii) treat the links across units in an unrestricted fashion, (iii) easily incorporate time variations in the coefficients, and the variance of the shocks, and (iv) account for cross-sectional dynamic heterogeneities (Abrigo and Love, 2016).

The panel VAR require the lag structure to be identical for all municipalities and the panel to be strongly balanced (Love and Zuchini, 2006).

The model was specified as follows:

$$debt2asset_{i,t} = \alpha_i + \sum_{k=i}^k \beta_{ik} debt2asset_{i,t-k} + \sum_{k=i}^k \gamma_{ik} NHHI_{i,t-k} + \sum_{k=i}^k \theta_{ik} TRESS_{i,t-k} + \varepsilon_{i,t} \quad (1)$$

$$NHHI_{i,t} = \alpha_i + \sum_{k=i}^k \beta_{ik} NHHI_{i,t-k} + \sum_{k=i}^k \gamma_{ik} debt2asset_{i,t-k} + \sum_{k=i}^k \theta_{ik} Tress_{i,t-k} + \omega_{i,t} \quad (2)$$

$$Tress_{i,t} = \alpha_i + \sum_{k=i}^k \beta_{ik} Tress_{i,t-k} + \sum_{k=i}^k \gamma_{ik} debt2asset_{i,t-k} + \sum_{k=i}^k \theta_{ik} NHHI_{i,t-k} + \epsilon_{i,t} \quad (3)$$

$$hdi_{i,t} = \alpha_i + \sum_{k=i}^k \beta_{ik} hdi_{i,t-k} + \sum_{k=i}^k \gamma_{ik} debt2asset_{i,t-k} + \sum_{k=i}^k \theta_{ik} NHHI_{i,t-k} + \epsilon_{i,t} \quad (4)$$

$i = 1, \dots, N$   $t = 1, \dots, T$  and  $\mu_i$  time invariant effects of a municipality

The variables in Eqs. 1-4: *localgovdebt* is the local government proxy, ranging from 0 to 1. However, the government of South Africa subscribes that all municipalities use 0.45 as the benchmark for a healthy leverage (StatSA). Where 0.45 is equal to low risk or 45 per cent of assets funded by debt, and one shows that total assets equal total liabilities (Stassa,2020). The NHHI is the normalized Herfindahl index, which ranges between that  $NHHI_{it} < 0.1$  means very low levels of political power concentration. For the  $[NHH]_{i,t} \in (0.1;0.18)$ , there is a moderate concentration of political power, but an  $[[NHHI]]_{i,t} > 0.18$  means a high concentration of political power.; and Tress Index, this ranges from 0-100. The closer the index is to 100, the more concentrated and vulnerable the region is.

In Eqs 1-3, all the variables must be stationary for each local government I at time t. In Eqs. 1-3, k is the number of lags.  $\varepsilon_{i,t}$ ,  $\omega_{i,t}$  and  $\epsilon_{i,t}$  are white noise error terms.  $\alpha_i$  are panel specific fixed effects, which are eliminated in the estimation process through the Helmert transformation.  $\beta_{ik}, \gamma_{ik}, \theta_{ik}, \delta_{ik}, \pi_{ik}, \rho_{ik}, \varphi_{ik}, \lambda_{ik}$  and  $\psi_{ik}$  are parameters to be estimated. Despite coefficients being allowed to vary from country to country, they remain time-invariant.

We test the following hypothesis:

$$H_0: \gamma_{i1} = \dots = \gamma_{iK} = \theta_{i1} = \dots = \theta_{iK} = 0 \dots = \pi_{i1} = \dots = \pi_{iK} = \dots = \rho_{i1} = \dots = \rho_{iK} = \lambda_{i1} \dots = \lambda_{iK} \dots = \psi_{i1} = \dots = \psi_{iK} \quad \forall i = 1, \dots, N$$

$$H_1: \gamma_{i1} = \dots = \gamma_{iK} = \theta_{i1} = \dots = \theta_{iK} = 0 \quad \forall i = 1, \dots, N_1$$

$$\gamma_{i1} \neq 0 \text{ or } \dots \text{ or } \gamma_{iK} \neq 0 \text{ or } \theta_{i1} \neq 0 \dots \text{ or } \theta_{iK} \neq 0 \dots \text{ or } \pi_{i1} \neq 0 \dots \text{ or } \pi_{iK} \neq 0 \dots \text{ or } \rho_{i1} \neq 0 \dots \text{ or } \rho_{iK} \neq 0 \dots \text{ or } \lambda_{i1} \neq 0 \dots \text{ or } \lambda_{iK} \neq 0 \dots \text{ or } \psi_{i1} \neq 0 \dots \text{ or } \psi_{iK} \neq 0 \quad \forall i = N_1 + 1, \dots, N$$

The test above assumes that causality amongst *debt2asset*, *NHHI*, *tress*, *HDI* and *Inpoverty* might exist for some municipalities but not necessarily for all municipalities. In this representation,  $N_1$  is an element of 0 and  $N-1$ .  $N_1$  is assumed to be unknown such that if  $N_1 = 0$ , there is causality for all municipalities in the panel, meaning that the alternative hypothesis becomes identical to the null hypothesis. The Wald statistic is used to test the h. The research used the granger tests as a post estimation to see if political competition contains valuable information for predicting local government debt over and above the past histories of the other variables in the system.

#### 4.5 CONCLUSION

This chapter has shown the various estimation techniques used to investigate the relationship between political competition and local government and its effect on human development in Eastern Cape municipalities. Data collection techniques included using previous studies, internet searches, analysis of financial records from the Auditor General and data collection from South African Local Government Association and Eastern Cape Socio-economic Consultative Council. Data validation was carried out at each stage to ensure that data was as accurate as possible. The Normalised Herfindahl Index and winning margins were produced using electoral data. The debt proxy was created using financial records from the Auditor General. It was formulated into ratios using the South African government's international accounting standards and prescriptions.

Chapter 5; is the results and discussion chapter; it will discuss the levels of political competition, the nature of the relationship between political competition debt in local government in South Africa and how these two factors impact economic growth and human development.

# CHAPTER 5

## ESTIMATION AND RESULTS

### 5.1 INTRODUCTION

This chapter applies the methodologies described in chapter four. It is divided into five sections, including the introduction. This is followed by the summary statistics of the variables in the model. Section three provides the results and a discussion of the unit root test. Section 4 analyses the results from the General Least Squares, Fixed Effects Model, Random Effects model and Panel Vector Autoregressive models. This is followed by the conclusion of the chapter.

### 5.2 DESCRIPTIVE STATISTICS

This section of results and discussion specifies the findings of the descriptive statistics. Descriptive statistics are utilized to demonstrate the overall analysis of the user data.

Table 5.2:1 Descriptive statistics

	Mean	Median	STD.DEV	Min	Max	Observations
<b>NHHI</b>	0.577	0.582	0.148	0.217	0.887	256
<b>Debt2assets</b>	24.904	14.767	34.156	0.994	397.171	256
<b>Wcapital</b>	296.567	136.624	1448.882	0	22965.63	256
<b>Tress</b>	58.84	60.838	7.29	40.8	70.733	256
<b>HDI</b>	0.275	0.274	0.087	0.101	0.504	256
<b>Inpop</b>	11.678	11.744	0.918	10.099	14.049	256
<b>Inpoverty</b>	10.257	10.514	1.173	7.548	12.312	256

Source: Authors work from STATA

Table 1 demonstrates that the mean of the NHHI IS 0.577. The median is 0.582, while the max and the min are 0.887 and 0.217, respectively. This indicates that municipalities in the Eastern Cape have high levels of political power concentration. The mean, median min, and max values are all bigger than 0.18. Most of the municipalities are approaching political monopoly. The African National Congress (here after “ANC”) party governs majority of the municipalities. The ANC the most dominant party in the Eastern Cape as it receives the most votes in all of the electoral elections over the years.

The debt2asset was transformed and multiplied by 100 to help with the analysis. The mean is 24.90 and median is 136.624. The min and max 0.994 and 397.171. A ratio equal to 1 (100) in

this case means that the municipality owns the same amount of debt as it owns assets. Any ratio above 1 (100) greater than one indicates the municipality is highly leveraged and cannot meet its debt obligations, which is highly risky to lend to. Any ratio below 1, the municipality can meet its obligations. The Wcapital ratio has a mean of 296.6, a min of 0 and a max of 22965.63. A comfortable range for a municipality is within the 1-2 threshold (StatSA, 2022).

The Tress Index shows a mean of 58.84. The median is 60.838, a min and max of 40.8 and a max of 70.73, respectively. This shows high levels of economic concentration by all statistical measures. The tress index is bigger than zero. The HDI has a mean of 0.27, a min of 0.101 and a max of 0.504. the Eastern cape has a low human development index. It could be because of the poverty levels, low standard of living, limited access to schools and health care services. Over the years, there have been slight improvements. However, poverty and the municipality's financial health has a significant impact on the overall welfare of the citizens.

Inpoverty was log-transformed to stabilize the variance of the series. The Eastern Cape is the second poorest province in the Eastern Cape. Poverty levels show the population's ability to pay for their debts to the municipality. Consumers are debtors to the municipality; they are assets in terms of accounting. Therefore, if consumers can pay what they owe to the municipality, they will have the revenue to pay their own debts, which affects the revenue and cash flow. The data shows a mean of 10.26, a median of 10.514, a min of 7.548 and a max of 12.31. poverty levels are quite high, with many people living under the food poverty line. Inpop shows the size effects of government support in each municipality; it also determines the amount of municipal grant each municipality receives.

### **5.3 UNIT ROOT TEST**

Investigating the time-series properties of a data set is necessary before implementing any time series methodology (Murphy and O'Reilly, 2018). The study used the Harris Tzavalis panel unit root test ("HT" hereafter). The HT test is designed for a finite T and a large N (T stands for time and N number of variables) (Murphy and O'Reilly,2018) and has the best performance amongst the first-generation unit root test for small T samples (Choi,2015). The HT allows for a sample correction to improve the size of the tests in small T (Harris Tzavalis, 1999). The data collected for this research has a small T of 5 year. Each time series is tested for the presence of the unit root. Tests are on a demeaned data series; this is done to ease concerns about the cross-sectional dependence. The Null hypothesis of the HT test is that the series contains a unit root;

therefore, failing to reject the null is evidence of a unit root; rejecting the null hypothesis signifies that there are no unit roots present for a significant proportion of the cross-sections. The HT test was conducted on a balanced panel of 32 municipalities. The results of the HT test are presented in Table 5.2. Thirty-two municipalities were chosen because of data availability.

Table 5.3:1 Panel unit root tests: Harris Tzavalis test.

Variable	Levels	First Difference	Second difference	Order of Integration
debt2asset	0,041***			Zero
NHHI	0,481***			Zero
Wcapital	0,001***			Zero
Tress	0,457***			Zero
HDI	0,608	-0,261***		One
Inpoverty	0,730	0.255***		One
Inpop	0,907	0.780	0.300***	Two

Note

<sup>1</sup>Tests were conducted on a sample of 32 municipalities for 3 periods. Statistical significance at 1%

<sup>2</sup> Source: Author's work from STATA

Using the significance level of 1 %, the results show that the series is non-stationary. We fail to reject the presence of a unit root in HDI, Inpoverty, and Inpop at the first level. The HT rejects the null hypothesis for the NHHI, Debt2asset, Tress, indicating that the series is nonstationary and requires differencing. The Harris Tzavalis test rejects the null hypothesis for HDI and Inpoverty at the first difference level, indicating that a statistically significant proportion of the series is stationary. The Inpop becomes stationary at the second difference, therefore it will not be used in the data analysis.

#### 5.4 ECONOMETRIC RESULTS

Table 5.3 shows that there is serial correlation among the variables, as the coefficient Inpop and Inpoverty is 0.93 which is greater than 0.8. The presence of multicollinearity can have an adverse impact on the model quality, therefore the study opted to eliminate the variables with a high multi-correlation.

Table 5.4:1 Pairwise correlation matrix.

	DEBT2ASSET	NHHI	WCAPITAL	TRESS	HDI	INPOVERTY	LNPOP
DEBT2ASSET	1.000						
NHHI	-0.148 0.0179	1.000					
WCAPITAL	-0.036 0.5679	0.081 0.1976	1.000				
TRESS	-0.247 0.0001	0.560 0.0000	0.026 0.6841	1.000			
HDI	-0.229 0.0002	0.654 0.0000	0.195 0.0017	0.651 0.0000	1.000		
INPOVERTY	-0.217 0.0005	0.4 0.0000	0.099 0.1125	0.556 0.0000	0.657 0.0000	1.000	
LNPOP	-0.187 0.0027	0.169 0.0068	0.059 0.3496	0.337 0.0000	0.377 0.0000	0.931 0.0000	1.0000

Table 5.4:2: Estimated Regression (Fixed, random and GLS)

Debt2asset	Fixed Effects	Random effects	FGLS Assuming heteroscedasticity across panels, and panel specific AR (1) process
NHHI	-22.52109 (31.071)	4.978 (22.841)	-12.056 (10.266)
Wcapital	-0.001 (0.001)	0.000 0.001	-0.001 (0.001)
Tress	-0.875 (2.16)	-1.171** 0.588	-0.963*** (0.277)
HDI	9.489 (358.647)	-136.623 84.850	-127.616*** (35.549)
Inpoverty	-1.011 (90.615)	28.470* 18.126	28.188*** (8.598)
Inpop	-135.513 (152.85)	-33.259*** (18.614)	-29.853*** 9.316
Year	-3.298** (2.018)		-3.763*** (0.492)
Y2			5.122*** (2.034)
Y3			-9.309*** (2.223)
Y4			-12.279*** (2.223)
Y5			-10.068*** (2.260)

Y6			5.189** (2.24)
Y7			-1.572 (2.125)
Constant	8316.693*** (3230.969)	224.8*** (76.192)	7758.274*** (997.324)
Observations	256		256
Number of Groups	32	32	32
Number of time periods			8
Wald Chi2		45.34 (p=0.000)	173.40 (p=0.000)

Note 1 \*\*\* mean  $p < 0.01$ ; \*\* means  $p < 0.05$  and \* means  $p < 0.10$ .

numbers in brackets are standard errors.

Table 5.4:3 Hausman Test

Hausman Test	
ch <sup>2</sup>	3.6
Prob > ch <sup>2</sup>	0.614

H0: FEM and REM estimators do not differ substantially.

H1: The FEM and REM differ substantially (REM is not appropriate).

The study carried out a Hausman test to determine whether to use the fixed or random effects model. The Hausman tests showed that the random effects would be an appropriate model to estimate the results. According to the Hausman test in table 5.4:3, we fail to reject the null hypothesis since the  $P > 0.05$  and conclude that effects are not constant over time; they are random.

The NHHI shows a negative sign in both the random effects and the general least squares; however, it does not exhibit any significance in both models. The estimates indicate that there is a negative sign on the Wcapital. Debt2asset ratio and Wcapital are two ratios that observe the country's local government debt levels.

The tress index shows an ambiguous sign; A one-unit increase in the tress index on average leads to a 0.913 decrease in local government debt *ceteris paribus*. A diversified economy is associated with economic growth, whereas a highly concentrated economy is not associated

with high levels of growth. The theoretical expectation is that as the local government economy becomes more diversified there will be a decrease in debt.

In addition, the results show that, a 1 unit increase in the HDI on average leads to a 213.54 % decrease in debt *ceteris paribus*. This is not surprising as a municipality's wellbeing is linked to the fiscal stability of the economy. The human development index is a composite of indicator of education, health, and income, an improvement in people's well-being means there is a larger tax base with the ability to pay revenues to the municipality. This could likely improve debt levels of the municipality.

The GLS model shows that a one percent increase in the population, on average, leads to a (29.86/100) percentage points decrease in debt, *ceteris paribus*. Whereas the random effects model did not show any significance. Approximately, 30.4 million South African live below the upper bound of the poverty line of 1268 rands this suggests that most municipalities have a small tax base (StatsSA,2022 and Worldbank,2022) Therefore, there is not enough tax to build revenue for municipalities, which reduces the municipality's assets. Inpop shows the size effect of the government support; simply put, it determines the size of the municipal grant that a municipality will receive from the government.

Dummy variables for 2009 -2016 were created to capture the time effects, and  $u_i$  measures measure municipal fixed effects model. The Year dummy showed a decrease of 3. 763. Year 2 debt was debt decreased by 5.122 in the base year. In the preceding year, debt decreased by 9.01 than in the base year. Year 3 saw another decrease of debt by 12.279 than debt in the base year. Year 4 debt had decreased by 12.279 than in the base year. Year 5 debt decreased by 10.06 than in the base year, year 6 debt was 5.189 less than in the base year. Year 7 was not significant. Electoral cycles have been cited to be linked with high local government debts. In the preceding years, from 2011 to 2015. There is a negative sign showing that debt2 asset is decreasing. However, the debt continues to fall at a smaller rate over time.

## **5.5 PANEL VECTOR AUTOREGRESSION RESULTS**

The study was met with sample size limitations; adding more variables in the PVAR resulted in losing degrees of freedom, which would have rendered the results biased. Therefore, a simple model was used to investigate the relationship between local government debt and political competition.

Table 5.5: 1 Panel VAR DEBT2ASSET, NHHI, TRESS AND HDI

	@ 1 lag for instruments			
	debt2asset <sub>i, t</sub>	Nhhi <sub>i, t</sub>	Tress <sub>i, t</sub>	HDI <sub>i, t</sub>
debt2asset <sub>i, t-1</sub>	-0,0056	208,24***	-1,4483	-53,279
NHHI <sub>i, t-1</sub>	-0,0016	-0.9131***	0.011**	3.8190***
Tress <sub>i, t-1</sub>	0.0021	26.777***	0.2320***	10.8654
HDI <sub>i, t-1</sub>	-0.0002	-0.19789	0.0023***	0.3588***
<b>Hansen's J</b>				
<b>Final GMM criterion (Qb)</b>	0,254			
<b>Observations</b>	192			
<b>Panels</b>	32			
<b>The average number of time periods</b>	6			
<b>Panel VAR stability</b>	All eigen values lie inside the unit circle. PVAR is Stable			

Note:

<sup>1</sup> \*\*\* means significant at 1%, \*\* means significant at 5%, \* means significant at 10%.

<sup>2</sup> Instruments used were debt2asset and NHHI

Table 5.5:1 shows that the lagged effect of a 1 unit increase in NHHI (Normalized Herfindahl-Hirschman index) on average is about 208.24 points worsening debt2asset in both regressions when instruments have one lag. An increase in NHHI means that the municipality is reaching monopoly, it is moving towards concentration of power, and that is associated with extractive rent behaviour, poor business policy decisions that hinder economic growth and human development at large. This is characterized in South Africa by frivolous spending, wasteful expenditures, heavy borrowing of municipalities and lack of accountability of council members and municipality employees.

At the first lag, tress and HDI do not have a significant effect on debt2asset. At the first lag, debt2asset does not have a significant effect on NHHI. However, the tress index has a significant positive effect on NHHI, at the first lag, Tress index increases NHHI by 0.011 units on average, all else held constant. The HDI also showed to increase NHHI. At the first lag. At the first lag, a unit increase in the HDI increased the NHHI by 3.81 units on average all else

held constant. At the first lag, the tress index has a positive effect on the HDI; a one-unit increase in the tress increased HDI by 0.002 on average, ceteris paribus.

The Granger causality results are presented in the table. The Granger causality test is a statistical hypothesis for determining whether one time series is useful for forecasting another. If the probability value is less than any alpha level, then the hypothesis will be rejected.

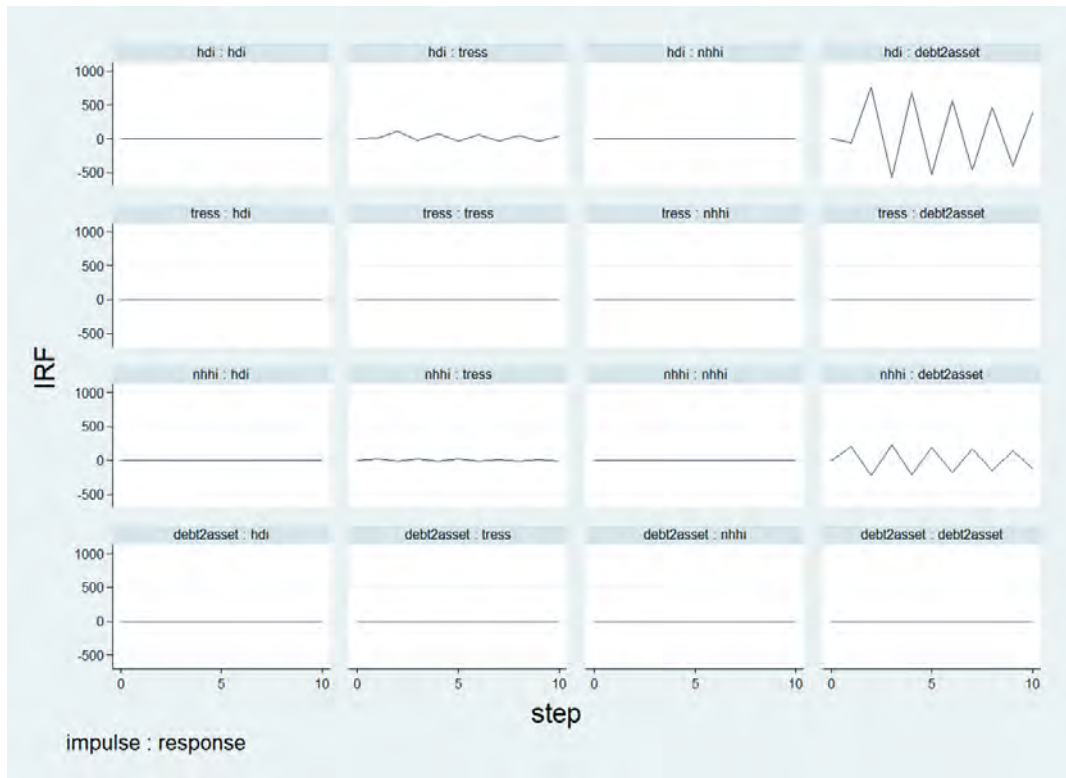


Figure 8 Impulse response

Figure 14 shows that a one standard deviation increase in NHHI leads to an increase in debt2asset. However, the shocks are not stable, it shifts up and down in different time periods. The shocks could be resulting from electoral cycles, the government in power could change their spending patterns towards elections to appease the citizens. HDI and debt2assets show the same patterns. A one standard deviation improvement in HDI increases the debt2asset ratio above 500. However, the shock is not stable. It increases for a short period of time and then subsequently decreases throughout periods 0-10.

Table 5.5:1 Panel Granger Causality

		@1 lag for instruments
Equation Variable	Excluded Variable	Chi <sup>2</sup>
<b>Debt2asset</b>	NHHI	14.631***
	Tress	1.055
	HDI	0.253
	ALL	17.757***
<b>NHHI</b>	Debt2asset	0.914
	Tress	3.483*
	HDI	51.707***
	ALL	106.462***
<b>Tress</b>	Debt2asset	1.660
	NHHI	31.656***
	HDI	2.598
	ALL	58.153***
<b>HDI</b>	Debt2asset	1.610
	NHHI	0.671
	Tress	18.387***
	ALL	18.953***

Note:

<sup>1</sup> The null hypothesis is that the excluded variable (s) does (do) not Granger cause equation variable. The alternative hypothesis is that the excluded variable (s) does (do) Granger- cause equation variable.

<sup>2</sup> \*\*\* means significant at 1%, \*\* means significant at 5%, \* means significant at 10%.

H0: Excluded variable does not granger cause equation variable.

Ha: Excluded variable Granger-causes equation variable.

The results in Table 5.5:2 illustrate that the null hypothesis that NHHI does not granger cause debt2asset is rejected at the 95% confidence level. The alpha value  $0.000 < 0.05$  means we reject the null hypothesis and conclude that NHHI granger causes debt.

However, the study fails to reject the null hypothesis that debt2asset granger does not granger cause NHHI. This shows that there is a unidirectional relationship between political competition and local government debt. NHHI has a strong casual influence on debt2asset when instruments are at one lag. However, debt2asset does not have an influence on the NHHI at one lag. The table also shows that there is a significant causality between HDI AND NHHI. HDI granger causes NHHI at a 95% confidence level when the instruments are at one lag.

However, NHHI does not granger cause HDI. NHHI granger- causes tress when instrument is at one lag, Tress significantly grangers NHHI when instruments are at one lag.

Results for goals one and two showed that the NHHI and debt2 assets have a unidirectional relationship, in which political competition influences local government debt. From the results, it was determined that debt2asset did not have a significant effect on the HDI. The HDI also has a significant positive relation to the NHHI, which can be explained by the fact that in a democracy, people usually become attached and loyal to one party. In the context of South Africa, people vote for the ANC due to loyalty to the party and numerous citizens are enticed by the governmental social grants.

The results in Table 5.5:2 indicate that the Tress index had no significance on local government debt. Theoretically, if there is economic growth, as seen in China, there is bound to be more debt as a lot of infrastructure spending will be taking place. Granted, China is a different institution from South Africa; it has checks and balances that ensure accountability is instilled at all levels of government. These checks and balances ensure that debt or borrowing is limited to infrastructure development. However, South Africa has deeply entrenched accountability issues.

In specifying the model, the study evaluated additional variables like Inpop and Inpoverty. However, the results were not used as they did not meet the stability condition. From an analytical point of view, Inpoverty is an indicator that shows the ability of citizens to pay for their municipal rates. In poor province, consumers are unlikely to keep up with the rates besides that an issue of affordability has been raised. According to Ledger and Ramapedi (2016), state that since municipalities cannot raise their own finances, they have become akin to raising rates as a well to increase revenue. Increased rates pose as a heavy burden in a poor municipality, this exacerbates the non-payment culture in municipalities.

## **5.6 CONCLUSION**

The chapter reported empirical results of the relationship between Political competition and local government debt (objective 1). And the effect it has on economic growth (objective 2) and its cumulative effect on human development (objective 3) in 32 local governments in South Africa. This chapter consisted of 6 sections. The chapter commenced with a descriptive summary statistic and an analysis of the Harris Tzavalis unit root test. The results of the unit root test found all variables of interest to be stationary.

The panel vector autoregressive model, generalized least squares, and random effects were used to address the goals of the research. The priori expectation was that political competition influences local government debt, and this in turn has an impact on local government growth and human development. A unidirectional relationship was found between political competition and local government debt. HDI and Tress did not have significant impact on local government debt; however, they increased political competition in the Eastern Cape. The results also showed improvements in local government Eastern Cape debt over time. This is attributed to the small improvements in financial outcomes, although these are not sustainable.

The final chapter concludes by summing up the results and main findings of the analysis as well as making recommendations to improve local government debt in the Eastern Cape

# CHAPTER 6

## SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

### 6.1 INTRODUCTION.

This chapter concludes the study by reviewing the previous chapters and presenting some conclusions, policy recommendations and areas of further research. The next section offers a summary of the study. Section three presents some insightful findings of the study; section four identifies possible policy implications and provides some recommendations. Lastly, section 5 outlines the limitations of the research and offers recommendations for areas for future research on the same or a similar topic.

### 6.2 SUMMARY OF THE STUDY

The purpose of this study was to investigate the relationship between political competition and local government debt and its implications on human development in the Eastern Cape. The study made use of electoral data from 2011 to 2016. The local government is the focal point of development and growth; it is the closest level of government to the people. The financial health of a local government is crucial for the health, safety, and development of the people in the Eastern Cape. Over the years, we have seen a rise in service delivery protests all over South Africa. People are dissatisfied with the quality of service or lack thereof in their various municipalities. Over the last two years, the COVID-19 pandemic has blatantly revealed how far the cracks are in the services delivery system, which can be linked back to the financial malaise in Local governments in South Africa.

The study reviewed the theoretical and empirical literature on political competition and debt studies. However, there was limited literature on the link between political competition and local government debt in developmental countries. The study explored theories of public choice theory, Keynesian, classical debt theories, modern monetary theory, Institutional theories, and fiscal federalism. The core lesson that was discovered was that political competition influences local government debt. The incentives of political actors shape the sort of policies that are adopted by a local government. These policies can either enhance economic growth or they can inhibit economic growth.

The study also confirmed the theories brought forward by Mbeki (2009) and North et al. (2011); these authors suggested that lack of political competition, or in other words, political monopoly breeds excessive rent extraction behaviour by some politicians. This could be seen

in the continuous rise of wasteful and unauthorized expenditure in the Eastern Cape and other provinces. There are perilous issues of accountability in local government, and these have not been resolved as there is little political competition. As a result, debt is still on the rise, yet local government growth potential is still latent, and people are tired of their municipalities 'inadequacies.

In this case, the monopolistic nature of the political market in the Eastern Cape can be blamed for the poor fiscal performance of local governments in the Eastern Cape.

### **6.3 CONCLUSION OF THE STUDY**

The first objective of the study was to investigate the relationship between political competition and local government debt. The study showed that political competition and local government debt have a unidirectional relationship. Political competition influences the growth of local government debt. There is a positive relationship between local government debt and political competition. When there is political monopoly, local government debt rises. This could be possibly explained by the fact that political monopoly fosters rent-seeking behaviour and pork barrelling, and with less competition, there is more opportunistic behaviour by incumbents and unaccountability (North et al., 2011). Therefore, there is less control over the financial matters of a local government. This is evident in the increase of wasteful and fruitless expenditures in local governments (Obikili, 2018). To support the research findings, Chatterjee et al. found that political competition is a useful predictor of a local government's debt level. Their studies showed a positive relationship between political competition and debt level. In essence, increases in political competition typically lead to increases in a local government's level of debt.

Objective two was to find the relationship between local government debt and local government growth in Eastern Cape municipalities. The results from the generalized least squares showed that economic concentration led to a decrease in local government debt. This was surprising. One would expect an increase in local government debt. The priori expectation was that economic diversity would lead to local government growth. Economic diversity would bring additional revenue and wealth for a local government. The PVAR showed that the tress index did not have a significant impact on local government debt.

The third objective of the study was to find the impact of political competition and local government debt on economic growth and human development. Political competition is meant to foster economic growth, bring about pro-business policies and efficiency. However, local

governments in the Eastern Cape were characterised as having political monopoly that increased local government debt through the growth-hindering policies adopted by political leaders. This, in turn, was met with economic concentration, which hindered growth and human development. Other countries like China have used local government debt finance as a tool for regional economic growth. However, this just shows how prudent the municipalities are when it comes to debt. local governments in the Eastern Cape have shown a widespread lack of financial control and project monitoring. This blatant lack of accountability and failure to manage the municipality. People in South Africa are disgruntled by the failures in local government. The large sum of debt and wasteful expenditure of municipalities diminished the capacity of municipalities to render quality services. Which reduces the human development index of local governments.

The findings in the study extend the literature on political competition and local government studies. The study investigated the political competition and debt nexus in the South African context and extended the study to human development. This study attempts to add on to why South African local governments are struggling to release the latent economic growth as envisioned by Turok (2008).

#### **6.4 POLICY IMPLICATIONS AND RECOMMENDATIONS**

For South Africa, it is a question of iron-clad accountability. Political leaders need to be held accountable for their failure to manage municipalities and their failure to produce complete documents for auditing. To ensure accountability, more investigations on spending patterns should be initiated. The study proved that local government policymakers are at risk of potential political motivation in the process of approving political debt (Brandt, 2016: 149). The Auditor General would need to amass more powers to aid it in holding politicians accountable for inefficient use of local government finances.

The cash flow and growth issues can be mediated by efficient collection of Debts from consumers. Many municipalities are failing to collect consumer debt. Failure to collect consumer debts has crippled local government financial health in many ways. Improve financial and credit ratios (debt collection being the most significant issue). One of them is that municipalities do not have enough funds to keep rendering services to the people. Municipalities cannot pay their debtors like Eskom, which snowballs on locals and local businesses.

To address goal three, local governments need to adopt a citizen-centred approach to the delivery of services. There needs to be effective service delivery, using the little resources available to ensure that people live a decent life. Therefore, there must be a reasonable cost of services, updating customer databases showing tax rates clearly, and collecting revenue.

There needs to be an improvement in the management of municipalities. In most studies and research, managing finances was one of the most significant issues leading to local government debts in South Africa and Spanish municipalities. South Africa needs to strengthen its administration and management. Consolidating management can be done by filling vacancies in municipalities instead of hiring a third party who is an expert to perform tasks for which they must be paid at an extra cost. Municipalities need to employ qualified personnel to expertly manage municipal finances.

#### **6.5 LIMITATIONS OF THE STUDY AND AREAS FOR FURTHER RESEARCH.**

The limitations of the study included data unavailability. There is limited research that has been conducted on debt at the local level of government. More theories that have been formulated focus on the debt at a government level. Other limitations were the missing financial data on municipalities and the possibility of accounting errors. Electoral data was missing for some years as well. Based on the conclusions, future researchers need to research local government debt and its impact on service delivery.

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