

An evaluation of revenue and expenditure assignments to sub-national governments in South Africa

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Abstract

The motivation for fiscal decentralisation in a vast number of countries is to tackle the challenges facing modern government in its desire to provide public services in an effective and efficient manner. The study deals with the general theoretical framework of fiscal decentralisation and continues to focus on the significance of fiscal decentralisation in governance in a majority of countries, including South Africa. With particular reference to South Africa, the right of citizens to have access to publicly provided goods and services is entrenched in the Constitution. The Constitution further provides for cooperative governance and recognizes the three spheres of government as distinctive, interdependent and interrelated. Provincial and local governments are also mandated to perform an important function of delivering services to the people in a manner that ensures equity. Since the attainment of democracy in 1994 there has been some progress and remarkable changes, as well as challenges.

The Constitution is instrumental in the assignment of functions to each sphere of government including revenue raising powers to provincial and local governments. However, a situation exists that significant revenue raising powers lie with the central government compared to the provinces and municipalities which are assigned less taxing powers. The intergovernmental fiscal system in South Africa provides for the distribution of nationally raised revenue to sub-national governments to deal with a variety of issues including addressing vertical and horizontal fiscal imbalances and the delivery of services. The existence of vertical fiscal imbalances is a result of, amongst other factors, the concentration of broad taxing powers at the national sphere of government, while provinces and municipalities have limited access to own sources of revenue. Despite the inadequacy of revenue sources at the disposal of provincial and local governments, many expenditure responsibilities are decentralised. As a result, challenges such as the delivery of services at sub-national government level, capacity issues and unfunded mandates are experienced.

In spite of the challenges experienced by provincial and local governments in South Africa regarding the current exercise of revenue assignment and expenditure responsibilities, there is room for enhancing delivery of services. There is a need to improve on the efforts and ability of provincial and local governments to collect existing revenues assigned to them as well as the provision of public goods as mandated by the Constitution. This is crucial because of concerns that intergovernmental fiscal grants are a contributing factor to some municipalities and provinces which do not make an effort to maximise their own revenue collection. There are various challenges that contribute to insufficient revenue collection at sub national government. The Financial and Fiscal Commission (2006:163) notes that even though provinces and municipalities have revenue collection as a key strategic priority in their strategic plans, there is a general lack of commitment to increasing own revenue collection, particularly by line departments tasked with service delivery. There is also another challenge related to poor policies and procedures regarding revenue management and controls in the collection of revenue by both municipalities and provinces.

The study continues to make a comparative analysis between South Africa and selected countries which are already implementing fiscal decentralisation in order to deal with the inefficiencies and ineffectiveness of providing publicly provided goods and services. This is done with the view to assist in identifying both similarities and differences with South Africa, and where possible, provide meaningful lessons. The countries which have been selected for the comparative analysis are India, Hungary and Spain. These countries have been chosen on the basis of the existence of certain characteristics and basic building blocks of fiscal decentralisation which are comparable to South Africa. The similarities between South Africa and the selected countries include, amongst other things, the concentration of significant taxing powers at central government level as opposed to sub-national governments. Consequently, sub-national governments

are forced to rely on intergovernmental fiscal transfers, thus compromising autonomy and leading to ineffective delivery of services. Another similarity between South Africa and these selected countries pertains to the existence of borrowing powers of sub-national governments in order to finance capital infrastructure expenditure. There are however, differences between the intergovernmental fiscal framework systems of South Africa and each of the selected countries. These differences include, amongst other things, property tax is one of the taxes levied by local government in South Africa. However, in Hungary, property tax at local government is said to raise constitutional issues due to problems of multiple taxation. The other differences relate to the devolution of taxing powers to sub-national governments in India and South Africa. In South Africa, sections 227 and 228 of the Constitution provide for the devolution of taxing powers to the provincial and local governments respectively. Regarding the intergovernmental fiscal system in India, its Constitution empowers the president to establish the institution called the Finance Commission on a five yearly basis. The Finance Commission is required to recommend, amongst other things, the devolution of taxing powers from the central government to sub-national government as well as provide grants to the states in need of additional financial assistance.

The study concludes by focusing on the importance of a clear assignment of revenue sources and expenditure responsibilities which should incorporate central as well as sub-national components to fully realize the possible benefits of fiscal decentralisation. In addition, it is important that the priorities of national government and the sub-national governments' budgets be aligned to avoid problems arising from service delivery and unfunded mandates.

Abbreviations and Acronyms

EDI	Electricity Distribution Industry
ERIC	Electricity Restructuring Inter-departmental Committee
FFC	Financial and Fiscal Commission
FFPC	Fiscal and Financial Policy Council
GDP	Gross Domestic Product
IDASA	Institute for Democracy in Africa
IGFR	Intergovernmental Fiscal relations
INCA	Infrastructure Finance Corporation Limited
LDOs	Land Development Objectives
MDGs	Millennium Development Goals
MECs	Members of Executive Committee
MPRA	Municipal Property Rates Act
PES	Provincial Equitable Share
PIT	Personal Income Tax
PFMA	Public Finance Management Act
REDs	Regional Electricity Distributors
RSC/JSB	Regional Services Council/Joint Services Board
VAT	Value Added Tax

Table of Contents

Acknowledgements	2
Abstract	3
Abbreviations and Acronyms	6
Table of Contents.....	7
Chapter 1: Introduction	11
1.1. Objective	11
1.2. Problem statement	11
1.3. Aims of the study and research questions.....	12
1.4. Methods and procedures regarding the study	13
1.5. The structure of the study.....	14
Chapter 2: An overview of the concept of fiscal decentralisation and its problematic issues	15
2.1. Introduction.....	15
2.2. An overview of the assignment of government functions	16
2.3. The nature of fiscal decentralisation.....	18
2.3.1. More types of decentralisation	20
2.3.2. Factors that drive decentralisation	21
2.3.3. The systems in which fiscal decentralisation occurs.....	23
2.4. Arguments in favour of fiscal decentralisation	24
2.5. Arguments against fiscal decentralisation	29
2.6. Guidelines for an efficient fiscal decentralisation system	32
2.7. Summary and conclusions	39
Chapter 3: An evaluation of revenue and expenditure responsibilities in South Africa	43
3.1. Introduction.....	43
3.2. An overview of fiscal decentralisation in South Africa	44
3.2.1. Expenditure Responsibilities.....	46
3.2.2. Revenue raising powers	49
3.2.3 Intergovernmental fiscal transfers.....	49

3.2.4 Sub-national Borrowing.....	53
3.3. Challenges faced by sub-national governments regarding fiscal decentralisation	55
3.3.1. Provinces	55
3.3.1.1. Provincial Surcharge on the national income tax	57
3.3.2. Local governments	59
3.3.2.1. The Abolition of the RSC/JSB Levies.....	61
3.3.2.2. Property Rates	65
3.3.2.3. The Reform of the Electricity Distribution Industry	66
3.3.2.4. User chargers	67
3.5. Opportunities for further improvement at the local government sphere	70
3.5.1. Local government autonomy and the challenges of service delivery .	71
3.5.2. Local government regulatory and fiscal environment.....	74
3.5.3. Unfunded mandates	77
3.5.3.1 Evidence of unfunded mandates.....	78
3.5.4. Capacity issues.....	81
3.6. Summary and conclusions	82
Chapter 4: A comparative analysis of fiscal decentralisation within selected developing and developed countries	84
4.1. Introduction.....	84
4.2. Fiscal decentralisation and the improvement of sub- national government autonomy and accountability	85
4.3. Case Study Analysis:	88
4.3.1. India and South Africa.....	92
4.3.1.1. Assignment of taxing powers	93
4.3.1.2. Expenditure assignments	94
4.3.1.3. Intergovernmental fiscal transfers	95
4.3.1.4. Sub-national borrowing	98
4.3.2. South Africa and Hungary.....	99
4.3.2.1. Assignment of taxing powers	100
4.3.2.2. Expenditure assignments	102

4.3.2.3. Intergovernmental fiscal transfers	102
4.3.2.4. Sub-national borrowing	103
4.3.3. South Africa and Spain	104
4.3.3.1. Assignment of taxing powers	105
4.3.3.2. Expenditure assignments	106
4.3.3.3. Intergovernmental fiscal transfers	107
4.3.3.4. Sub-national borrowing	109
4.4. Fiscal decentralisation and service delivery and accountability.....	111
4.6. Lessons for South Africa	112
4.7. Conclusion and Recommendations.....	115
Chapter 5: Summary, conclusions and recommendations.....	118
5.1. Summary.....	119
5.2. Conclusions.....	125
5.3. Recommendations	126
References	128

List of Tables

Table 1: Structure of powers and functions in the constitution	46
Table 2: Assessment of the RSC/JSB levies	62
Table 3: Principles and requirements of municipal tariff policy	67
Table 4: Comparative analysis of fiscal decentralisation between south africa and selected countries	88
Table 5: Central transfers to the states in India	96
Table 6: The variables chosen for the Spanish formula and their weights	108

Chapter 1: Introduction

1.1. Objective

The objective of the study is to examine the effectiveness of revenue and expenditure assignments to sub-national governments in South Africa and assess whether the current revenue and expenditure assignments are assisting with the effective provision of basic services as envisaged in the Constitution and public finance literature.

1.2. Problem statement

The Constitution of South Africa provides for a system of decentralisation to bring government and services closer to the citizens. Since 1994 provinces together with local governments have become the conduits for delivery of services for a better life for all. There have been many changes, many achievements and challenges. Currently, sub-national governments struggle with service delivery and face protests from the voting public. Consequently, it is imperative that an assessment of fiscal decentralisation in South Africa be carried out. Of particular concern for this study is a combination of centralising tendencies by central governments and structural weaknesses of sub-national government which have the potential of depriving the latter with operational autonomy. One of the potential causes of tax centralisation occurs due to sub-national government's ineffectiveness in assessing and collecting taxes. On the other hand, the structural weaknesses at sub-national government level are caused by a majority of factors which contribute to provinces and municipalities being deprived of fiscal autonomy due to, amongst other things, too much reliance on intergovernmental fiscal transfers in the discharge of their responsibilities. In the process, sub-national governments could possibly lose voice and therefore initiative in the governance process, and consequently, they may not be regarded

as contributing positively to either democratic governance or democratic development. This is likely to occur as long as sub-national governments continue to rely on the central government for resources required for their own operation and even existence.

1.3. Aims of the study and research questions

In South Africa, the Constitution provides for the assignment of revenue and expenditure responsibilities to provincial and local governments to effectively deliver services to the citizens. According to Ajam (2006:304) tax assignment should complement expenditure assignment, that is, the more the spending responsibilities allocated to a particular level of government, the more the tax revenue sources should be assigned to it. In instances where there are significant differences between expenditure assignments and tax assignments, sub-national governments will become more dependent on grants from national government to meet their expenditure responsibilities. Too much dependence of sub-national governments on intergovernmental transfers always leads to a number of unintended consequences, including the lack of fiscal autonomy of sub-national governments and subsequently the inability to adequately enforce fiscal accountability to the voting public.

The questions that the study seeks to address are the following:

- The effectiveness of the current assignment of revenue sources and expenditure responsibilities to sub-national government in South Africa in entrenching the guiding principle of revenue assignment: finance should follow function. The point of departure is the economic rationale for the devolution of taxing and spending powers to sub-national governments, followed by the explanation of the considerations on which the assignment of tax and spending powers to sub-national governments are based. Furthermore, the issue concerning whether the current assignment of revenue sources and expenditure responsibilities to sub-national

government is such that it allows for effective delivery of basic services will be tackled.

- The assessment of experiences of selected developing and developed countries on issues related to revenue and expenditure assignments. This is done with a view to make comparisons with the South African situation, and where possible, draw meaningful lessons for South Africa.

1.4. Methods and procedures regarding the study

A major constraint with regard to the subject of fiscal decentralisation, particularly the question involving revenue and expenditure assignments to sub-national government, is that even though there is an existence of enormous public finance literature to explain what fiscal decentralisation should or should not do, it is difficult to find any particular piece of literature that offers concrete proposals and rules on what can be adopted for successful fiscal decentralisation purposes. Accordingly, the methodological approach chosen in this study is qualitative in nature. The report will focus on the assessment of literature on fiscal decentralisation and intergovernmental fiscal relations as they relate to South Africa, and also continue to offer an analytical critique of the economic aspects of issues pertaining to the field of fiscal decentralisation and intergovernmental fiscal relations as raised by a number of well-known authors and peer reviewers, in South Africa and other developing and developed countries. The qualitative dimensions of the study concentrate on those aspects of the intergovernmental fiscal framework which deal with the extent of autonomy which sub-national governments possess in managing their budgets, and the extent of sub-national governments' accountability to their electorate. It includes such issues as

- The level of discretion sub-national governments have to spend their income according to sub-national preference and priority;

- The degree of autonomy that sub-national governments have to determine the rates of the sub-national taxes, fees and charges accruing to their budgets;
- Whether intergovernmental transfers are distributed by objective criteria free of political bias and manipulation.

1.5. The structure of the study

The study is divided into five chapters. Chapter 1 provides an introduction to the subject of study. Chapter 2 provides an overview of the concept of fiscal decentralisation and its problematic issues. Chapter 3 tackles revenue and expenditure responsibilities in South Africa with emphasis on the provincial and local government fiscal framework, including the challenges faced by sub-national governments. Chapter 4 provides an evaluation of the international experiences as they relate to the assignment of revenue and expenditure responsibilities. Chapter 5 provides an overall conclusion on intergovernmental fiscal relations issue, particularly the assignment of revenue and expenditure responsibilities.

Chapter 2: An overview of the concept of fiscal decentralisation and its problematic issues

2.1. Introduction

The essence of fiscal decentralisation in a majority of countries is to deal with the challenges facing modern government in its desire to efficiently provide public services in a manner that achieves equity. Boex (2001:17) contends that some of the reasons for pursuing a decentralised system of intergovernmental fiscal relations in many countries include promoting the efficient delivery of public services based on the notion that sub-national governments are more participatory, accountable and responsive public sector institutions. Accordingly, the chapter seeks to provide the meaning of fiscal decentralisation and to also probe the rationale for the extent of the confidence which is placed in fiscal decentralisation.

Regarding the assignment of revenue sources, Smoke (2000:4) maintains that central governments generally attempt to assign to sub-national governments revenue bases that are relatively immobile and should therefore not lead to serious spatial efficiency effects, and do not compete seriously with central tax bases. Smoke (2000:4) notes that the assigned revenues are almost never adequate to meet the local expenditure requirements, thereby necessitating central government transfer programs. Sub-national governments often use too many unproductive revenue sources that barely cover the costs of collecting them. Smoke (2000:4) further contends that there is a problem related to individual local revenue sources suffering from some serious design problems, such as stagnant bases, overly complex structures and ineffective collection mechanisms.

The chapter begins with the conceptual explanation of the term fiscal decentralisation and the discussion proceeds by making a distinction between

fiscal decentralisation and other forms of decentralisation. This chapter envisages providing an overview of fiscal decentralisation by examining the advantages as well as the disadvantages of fiscal decentralisation. The chapter also looks at guidelines for attaining an efficient system of fiscal decentralisation by highlighting the principles, constraints and concerns with regard to fiscal decentralisation. Hence the purpose of this chapter is to describe a framework that allows one to assess the effectiveness of fiscal decentralisation by making a distinction between revenue and expenditure assignments in federal and unitary states.

2.2. An overview of the assignment of government functions

The appropriate allocation of government functions in multi-tiered systems is important as it provides guidelines on the allocation of revenue bases among the different spheres of government. Fjelstad (2001:2) as well as Rao and Sen (1996) concur that the functions of national government in general are macroeconomic stabilisation; income redistribution and resource allocation. Musgrave and Musgrave (1984:625) mention that in order for a fiscal system to be deemed efficient, a situation should exist where the stabilisation and distribution functions are a competency of the national government and sub-national governments should perform the allocation function. Allen and Flynn (2006:14) concur with the observation by Musgrave and Musgrave regarding the central government performance of the macroeconomic stabilisation function, involving the use of fiscal and monetary policies to stabilize growth of the Gross Domestic Product (GDP), level of inflation and unemployment.

Rao and Sen (1996:14) emphasize the difficulty of local governments with small, open economies to pursue independent stabilisation policies. Local governments cannot be given the power to vary money supply and the effectiveness of fiscal policy since stabilisation at the sub-national level is limited by the spill-over of effective demand to areas outside their jurisdiction. Similarly, the potential

mobility of economic agents places limits on the ability of sub-national government to pursue serious redistributive policies. In addition, there is a need for consistency between fiscal policies of sub-national governments and macroeconomic policy objectives.

Along with the stabilisation function, national government is well-placed to decide on a variety of matters including the promotion of equity and redistribution, by virtue of its position as the highest level of government. Redistribution deals with the distribution of individual and or households' incomes through tax and spending decisions. The question then arises whether redistribution is a national or sub-national government function, or can redistribution be allocated to both national and sub-national governments? Different schools of thought continue to engage on the discussion regarding the appropriateness of performance of equity and redistribution functions at the central government level as opposed to sub-national government level. Some economists argue that this function is well-placed at central government level because of social welfare reasons involving treating everyone equally. However, economists from the school of public choice advocate for redistribution to be placed at sub-national government level in line with local preferences (Shah & Boadway 1994:25). Nevertheless, the general view is that redistribution should be largely a central government function.

The last function involves the allocation of resources for publicly provided goods and services. For this function, there is a strong case to be made in favour of sub-national governments. According to Allen and Flynn (2006:7) central government is likely to be insensitive to varying preferences among residents of different communities. Allen and Flynn (2006) continue to argue that central government provision of public services is likely to mean a uniform approach across all communities, thereby resulting in either under or over-provision at sub-national level. Therefore, sub-national provision is better able to match the allocation of resources for public goods with local preferences and the ability to pay. There is also a further view that at sub-national government level, residents

can see more clearly the link between benefits and costs and this improves accountability.

2.3. The nature of fiscal decentralisation

Fiscal decentralisation entails, amongst other things, the allocation of revenue and expenditure responsibilities to lower levels of government. According to Davey (2003:1) the amount of power and responsibility that sub-national governments actually exercise depends substantially on:

- what range of public services they finance;
- whether their revenues are commensurate with these responsibilities;
- how much real choice they have in allocating their budget to individual services; and
- whether they can determine the rates of their taxes and charges, both allowing them to vary their level of spending and making them answerable to the taxpayers.

Tanzi (2004:430) further mentions that the relationship between decentralisation and the allocation of revenue and expenditure responsibilities to sub-national government is a crucial element of fiscal decentralisation. Tanzi maintains that expenditure assignment involves the decision of spending by sub-national governments while on the other hand revenue assignment has to do with giving sub-national governments the option of ensuring that sub-national governments finance their expenditure responsibilities with their own resources. Over and above the issues identified by Tanzi and Davey above, (Yemek 2003: 4) identifies additional questions that fiscal decentralisation ordinarily addresses. These questions relate to the objectives and impacts of the way in which responsibilities are assigned across levels of government and these include:

- Who spends the money (the question of expenditure assignment)?
- Revenue assignment (entails the manner in which expenditure is funded).

- The extent to which vertical fiscal imbalances are remedied with intergovernmental transfers.
- Balancing the varying needs and capacities of governments at the same level (the horizontal imbalance) through inter-regional compensation.

Shah (2005:7) corroborates Davey and Yemek's assertions by adding that fiscal decentralisation entails the transfer of funds to deliver decentralised functions and revenue-generating power, as well as authority to decide on expenditures to sub-national government and private organisations. Fiscal decentralisation can take different forms including the following:

- Self-financing or cost-recovery through user charges
- Co-financing or co-production arrangements through which the users participate in providing services and infrastructure through monetary or labour contributions
- Expansion of sub-national revenues through property taxes
- Intergovernmental transfers that shift general revenues from taxes collected by the central government to sub-national governments for general or specific uses
- Authorisation of sub-national borrowing and the mobilization of either national or sub-national government resources through loan guarantees.

In addition to the different forms which fiscal decentralisation can take, as identified by Shah (2005), Timofeev (2002) maintains that true fiscal decentralisation should be measured by the extent to which sub-national governments have responsibility over the funds at their disposal, including the utilisation of these funds.

According to Litvack (2006:1) the extent to which different countries decide to allocate expenditure and revenue raising responsibilities and give fiscal autonomy to their sub-national governments differ. Hence it is important that when dealing with assignment of revenue and expenditure responsibilities,

certain fundamental principles regarding fiscal decentralisation should always be borne in mind. According to Bahl (2008:4) the principles for effective assignment of taxing powers include key considerations such as:

- Sub-national governments should be allocated taxes whose burdens are sub-national, that is, taxes should not easily be exported to residents who do not benefit from the sub-national services that are being financed by the revenues raised¹. Conversely, sub-national governments that depend on central transfers are not likely to be accountable to their populations. Sub-national governments should not levy taxes that cause business to adopt inefficient methods of doing business that might harm growth in the sub-national and national economy;
- Sub-national governments should not levy taxes that impose heavy administrative and compliance burdens.
- In order to achieve the benefits of fiscal decentralisation, there must be considerable sub-national government autonomy given on both the revenue and expenditure side

2.3.1. More types of decentralisation

In addition to fiscal decentralisation, there are various other types of decentralisation which will be discussed so as to clarify the concept:

The first form of decentralisation involves complete decentralisation which takes place when all the powers and responsibilities are assigned simultaneously to sub-national governments. However, complete decentralisation is not usually practiced and hardly ever occurs. It is very rare at any given point in time that

¹ This view is further corroborated by Ribot (2001:84) that the manner in which revenue is raised seriously affects the relations of accountability between people and their governments. In other words, governments that depend on taxes derived from the earned income of their populations are more likely to have populations that make demands on government and hold their governments accountable.

sub-national governments are given responsibility for political, administrative and fiscal functions. The second form of decentralisation is administrative decentralisation. According to Von Braun and Grote (2000:6) this form of limited decentralisation refers to the transfer of power and planning, funding and administration of certain public functions from the national government and its agencies to field units of government agencies. Administrative decentralisation manifests itself in two ways, which is deconcentration and delegation.

Deconcentration involves the allocation of decision-making powers and financial and management responsibilities among different levels of the central government. Von Braun and Grote (2000:6) purports that deconcentration is used most frequently in unitary states, and it is viewed as the weakest form of decentralisation as it merely creates local administrative capacity under the supervision of central government ministries. Delegation on the other hand, is a more extensive form of decentralisation because it involves the transfer of responsibility for decision-making and administration of public functions from the central government to sub-national government, with central government maintaining overall control (Allen & Flynn 2006:3).

There are a variety of factors that contribute to political, administrative or fiscal decentralisation. The factors that lead to the pursuit to decentralise include regional autonomy and the reduction of political conflict, globalisation with its forces of competition and efficient resource allocation and improved service delivery (Von Braun and Grote 2000: 4-5). The following section provides a discussion of some of the factors that contribute to decentralisation.

2.3.2. Factors that drive decentralisation

Three key drivers of decentralisation have been identified. The first is diffusing political and ethnic tensions. Some African countries, in a desire to accommodate diversity and diffuse ethnic tension have resorted to decentralisation. In another

piece of literature, Shah (2004) asserts that for many countries decentralisation occurred against the backdrop of political expediency rather than for reasons of trying to achieve the right balance in the division of powers among levels of government.

The second driver is the failure of centralised approaches. The ineffectiveness of centralised approaches to some of the economic challenges facing developing countries is another factor behind decentralisation in developing and least developed countries (Smoke 2000). In some instances central governments decentralise and shift responsibilities to sub-national governments under the pretext of giving them autonomy and a greater role in service delivery while this is just a veneer to hide its own inefficiencies. This is particularly the case with those services which are of problematic nature to national government and may have resulted in its unpopularity. As a result central government passes down its own inadequacy to lower levels of government in an attempt to balance its fiscal situation. This occurred in Russia during the transition from communist rule where central government 'off-loaded' some of its expenditure responsibilities to sub-national governments (Timofeev 2002).

Finally, globalisation has meant increased contact with the outside world and has resulted in "heightened cultural awareness at local and regional levels" (Joumard and Kongsrud 2003:21). Shah (2004: 10) agrees that, with globalisation identities are being localised and people "are increasingly inclined to link their identities and allegiances to cities and regions". In addition, technological improvement, ease of movement from one jurisdiction to another due to transport efficiencies and increasing literacy have led to competition for improved service delivery and awareness by local citizens (Joumard & Kongsrud 2003). Globalisation has also changed and redefined the role of the nation-state. It has brought about a shift from having one centre of power to having many. As a result of its size, the nation-state is now unwieldy for some functions, while for some, such as international trade, it is small (Shah 2004:4).

2.3.3. The systems in which fiscal decentralisation occurs

The extents to which countries implement policies relating to the allocation of revenue and expenditure responsibilities differ. Thus, the analysis of fiscal decentralisation in this section will capture a distinction between unitary versus federal states when examining the revenue assignment and expenditure responsibilities. A unitary state is “a country whose three organs of state are governed as one single unit. The political power of government in such states may well be transferred to lower levels, to national, regional or local elected assemblies, governors and mayors (devolved government), but the central government retains the principal right to recall such delegated power” (Allen & Flynn 2006:2). Conversely, “a federal system consists of different levels of government that provide public goods and services and have some scope for making decisions, and thus the subject of fiscal federalism explores the role of the different levels of government and the ways in which they relate to one another” (Rosen & Gayer 2008: 508).

According to Jensen (2002:7) there exists an extensive debate over the relationship of federalism and decentralisation among development practitioners. However, Jensen (2002:7) contends that in practice, the line between decentralisation, federalism, unitary states and centralised systems becomes blurred. Jensen (2002:7) further argues that “there is no completely unitary state” since every state is at least composed of municipalities as decentralised units, which then raises a question of how to differentiate among a unitary state practicing deconcentration, a decentralised unitary state and a federal state. Jensen (2002:7) ultimately argues that within a federal state the autonomy of member states has been established and guaranteed on a constitutional level, which is not the case with the autonomy of decentralised units within a unitary state.

To further explain the decentralisation of public finances in federal systems, Hyman (2008: 695) purports that the Tiebout Model is useful in gaining insight into government expenditures within such a decentralised system of sub-national jurisdictions. According to Hyman (2008: 695) Tiebout points out that the level and mix of sub-national expenditures and taxes are likely to demonstrate extensive disparities among sub-national political jurisdictions. As a result, many citizens will prefer to live in communities where the government budget best satisfies their own preferences for public services, provided they are not constrained in their mobility among communities. To a certain extent, however, the Tiebout Model is restrictive in the sense that it is not always the case that the citizens are well versed with the government budgets within their own jurisdictions

2.4. Arguments in favour of fiscal decentralisation

There are numerous reasons on the basis of which fiscal decentralisation can be justified. According to Smoke (2000:42) one of those grounds exists when different services are demanded by various jurisdictions and where such provision does not go against the requirement for economies of scale or is comprised by the existence of externalities. A similar view is held by Dafflon (2006:87) who maintains that some of the decisive factors taken into consideration when decentralising fiscal functions include “economies of scale, homogeneity of preferences, spill-overs and congestion cost”.

In addition to the views expressed by Smoke and Dafflon above, Shah (2004:9) concurs that fiscal decentralisation is justifiable on the basis factors such as economies of scale, economies of scope and cost/benefit spillovers, proximity to beneficiaries and consumer preferences. Bahl (1995:74) confirms Shah’s view by arguing that fiscal decentralisation contributes in the attainment of the efficiency criteria through having smaller local government. Bahl (1995:74) also argues that if preferences for public goods differ across subgroups of the population, and if

spillovers are not present, then national welfare is maximised if local communities vote their preferences and provide the level and mix of public services that they want. Bjornestad (2009:7) also argues that fiscal decentralisation is a desirable phenomenon because of the proximity of policy makers to the citizens, information and transaction costs in identifying the poor are reduced. Therefore, the non-existence of scale economies and externalities or spill overs is an important determining factor because where economies of scale and externalities are present, provision by sub-national governments might not be appropriate.

Bahl (1995:74) continues to point out that another argument for fiscal decentralisation that is not normally made is that of revenue mobilisation. Bahl (1995) reiterates that some taxes are suited to sub-national governments in that their assessment and collection requires familiarity with the provincial and local economy and population and because they are perceived as quasi-benefit charges that finance sub-national services.

Another reason that necessitates fiscal decentralisation is that the benefits associated with the provision of some public goods by different levels of government sometimes extends up to a certain point and are geographically bound (Musgrave and Musgrave 1984:615). Musgrave and Musgrave assert that when people reside in one area and are involved in sharing the cost of providing a particular service, if the benefits they are used to receiving diminish in size or quality relative to the cost, individuals will move to other areas and demand services that match what they pay. This argument was actually pioneered by Tiebout (1955) when he illustrated a model where people were able to vote with their feet as a result of competition among jurisdictions and where communities with homogenous preferences were created. Thus, varied service provision and financing ensues in line with the varied demands found in different jurisdictions. Under these circumstances, decentralisation is normally preferred as an option for the provision and financing of public services.

Some of the underpinnings of fiscal decentralisation are principles such as 'subsidiarity', fiscal equivalence and the 'decentralisation theorem' (Olson 1969, and Shah 2004). The principle of subsidiarity means that assignment of responsibility should be at the lowest level of efficiency. Hence Joumard and Kongsrud (2003:15) mention that by being closer to local citizens, sub-national governments are in principle better placed to respond to their demands for services and to target these at the right people. Thus, by virtue of sub-national governments being closer to communities and know more about them, sub-national governments must, as a matter of course, be given responsibility for providing those functions that are of immediate benefit to their communities. The similar view on subsidiarity is expressed by Litvack (2006:1) when he mentions that many would argue that decision-making should occur according to the principal of "subsidiarity", that is, at the lowest level of government consistent with allocative efficiency.

Yemek (2005:8) also continues to assert that on the basis of the "subsidiarity" principle, sub-national governments are often given the responsibility for managing many "pro-poor" priority sectors, including primary and secondary education, primary health care, agricultural extension, water and sanitation services, and local roads and public infrastructure. In many countries, responsibilities for reducing income poverty and improving food security are also assigned to the local government level, since it is assumed that the proximity of local government officials to the target groups reduces the information and transaction costs associated with identifying the poor and thus puts them in a better position to deliver pro-poor services.

On the question of the relevance of decentralisation as it applies to the subsidiarity principle and poverty reduction, the views expressed by Litvack (2006) are also similar to Yemek's assertions. Yemek (2005:8) asserts that there is a broader relationship between decentralisation in general and poverty

reduction in the sense that by bringing decision-making about the provision of public goods and services closer to citizens, decentralisation allows poor people to voice themselves more clearly, facilitates communication and information flows between local policy-makers and their constituents, and fosters improved accountability. Yemek (2005:9) stresses that the concern then becomes one of understanding how sub-national governments can best finance such service provision functions in ways that positively promote pro-poor outcomes and avoid regressive ones.

Yemek (2005:8) further argues that if the assumptions mentioned above do hold, an appropriately crafted set of intergovernmental fiscal relations constitutes an important requirement for translating the promise of decentralisation into the reality of poverty reduction. In other words, what sub-national governments offer, that is, better opportunities for public participation, improved transparency, and greater accountability will only lead to pro-poor services and outcomes if: (i) sub-national governments do what they are best suited to doing; (ii) they have access to the fiscal resources with which to finance sub-national public service delivery; and (iii) the financial resources needed by sub-national governments are made available in equitable and non-regressive ways. Therefore, Yemek (2005:8) mentions that fiscal decentralisation is an important cross-cutting thematic area with major implications for poverty reduction and the achievement of the Millennium Development Goals (MDGs).

Ahmad and Tanzi (2002:2) also agree with the views expressed above with respect to the contribution of fiscal decentralisation to poverty reduction. According to them, decentralisation leads to greater participation by the poor in the political process. Von Braun and Grote (2002: 76) are also of the view that decentralisation and poverty reduction may be correlated even though in theory there is no clear-cut functional relationship between the two. Von Braun and Grote (2002:76) argue that the relationship between poverty and decentralisation is two-fold in the sense that on the one hand, direct effects of decentralisation on

poverty reduction relates to the regional targeting of transfers which may have a direct effect to the poor. On the other hand, decentralisation is perceived to be an instrument of efficient participatory governance and not a goal in itself.

Shah (2005:14) further argues that the decentralising of basic services are becoming more apparent in the sense that sub-national governments have an informational advantage in identifying citizens' preferences as well as the flexibility to respond to sub-national conditions. Thus, sub-national governments are important providers of basic services, particularly to the low-income population, in order to improve equity in the distribution of infrastructures and to enhance accountability. Fiscal equivalence, as developed by Olson (1969), calls for an overlap between the benefit spread of a public service and the area where political authority is to be exercised. Similar to this view, Rao and Sen (1996) maintain that, the focal point of fiscal decentralisation is to attempt to match as closely as possible the benefit span of public goods to government units.

Oates' (1972) decentralisation theorem supports this further by proposing that, where the benefit and cost of providing a service are internalized within an area, the service must be provided at that level. The precise argument for providing services and public goods at the level where benefit and cost are related is because of proximity or "contiguity provides more information while distance reduces the amount of information necessary to make good decisions" (Tanzi 2002:2). This view is also supported by Allen and Flynn (2006:36) who argue that the basic principles with regard to fiscal decentralisation are that "own" source revenues should ideally be sufficient to enable the least richest sub-national governments to finance all locally provided services that primarily benefit local residents from their own resources. Allen and Flynn (2006:36) also mention that sub-national government revenues should, as far as possible, be collected only from local residents and preferably be related to the benefits that the local residents receive from local services. Fiscal decentralisation, through the provision of services at the suitable level, is assumed to shorten the process of

providing services by lowering 'transaction cost' through increased knowledge of local circumstances (de Mello 1999:9). Some of the transaction costs minimised by fiscal decentralisation include mobility; signaling; administration and coordination costs (Rao & Sen 1996:16).

It is thus evident that fiscal decentralisation is appropriate in instances where the delivery of a service and its benefit is geographically limited and does not extend to other jurisdictions. It also functions well if the preferences of a community are met in providing the service. Therefore, by taking into consideration economies of scale and spill-overs and by placing the provision of a public service at the most suitable level of government, gains in welfare will be achieved through reduced transaction costs. Furthermore, Bjornestad (2009:1) mentions that the classic argument for maximising sub-national discretion was made by Oates, who envisaged that the greatest efficiency is achieved when choices regarding the budget are made by sub-national government officials elected by citizens who have to finance the full cost of their preferences through sub-national taxes.

As can be seen from the above paragraphs there are numerous advantages associated with decentralisation. However, in order to facilitate the design of a proper fiscal balance between levels of government, issues regarding expenditure responsibilities need to be properly dealt with. "Until the assignment of expenditure responsibilities is decided, it is not possible to decide on the proper division of sub-national taxing and borrowing powers, and the right level of transfers" Bahl (2008:13).

2.5. Arguments against fiscal decentralisation

Various studies have emphasised the advantages of a fiscally decentralised system as discussed in the section above. In the same vein, there are studies that present arguments which can be made against fiscal decentralisation. In

addition, based on the discussion of government functions made in section 2.2 above, there are further arguments against a fiscally decentralised system.

According to Jensen (2002:11) the disadvantage of fiscal decentralisation is the possibility that some services may be subject to economies of scale which would be lost through sub-national provision. This argument has lost some of its force in recent years because there has been more interest in sub-national authorities purchasing services from private producers who might themselves be large enough to be able to enjoy the relevant economies of scale. The other disadvantage, according to Jensen (2002:11), is that sub-national governments might provide a service with external 'spillover' effects to residents elsewhere. A providing authority might ignore these externalities when deciding on its provision, and so it might ignore any benefits or costs which its services impose on non-residents. In contrast, if there is central provision, then the central government can allow for the effects of government services on everyone.

Other factors that support the case for the centralisation of taxing powers include lack of necessary capacity by sub-national governments to collect taxes, particularly in developing countries, and the administrative cost associated with performing this function. These have acted as constraints to the decentralisation of broad taxing powers to sub-national governments. Shah (2004:4) makes an observation that "in developing and transition economies centralisation of taxing responsibilities is much more pronounced than would be based on economic considerations". In addition, the argument for allocating central government more tax room is strengthened by the fact that where sub-national governments have access to a variety of tax handles and can set rates, they may engage in 'beggar-thy neighbour' tendencies and the 'race-to-bottom' through tax competition and activities that do not consider what other jurisdictions are doing (Bahl 1999:4). This view is emphasised by Prud' homme (2001:16) when he mentions that, holding everything equal, with more decentralisation, disparities are likely to increase. Thus, equalisation and redistribution by central government

necessitates that it be entitled to a wide range of taxes. It is understandable, therefore, that in many countries, central government has responsibility for collecting revenue on broad based taxes.

Concern over macroeconomic destabilization has made many countries reluctant of decentralising broad revenue powers to sub-national governments. As Fjelstad (2001:11) briefly points out, “the destabilising potential of sub-national governments is greatest when they face no hard budget constraint”. Sub-national governments cannot be given the liberty to do as they wish without any limitations as they may engage in behavior that is contrary to macro-economic stabilisation. Tanzi (2000:14) concurs when he argues that “sub-national governments may pursue expansionary fiscal policy at the time when central government is pursuing a contractionary policy”.

In view of the fact that fiscal decentralisation requires that expenditures match revenues (Bahl 1999: 23, Shah 2004: 22, Prud' homme 2001:13), where it is strictly adhered to and sub-national governments end up with broad taxing powers, they may end up increasing their expenditure commitments with the view that more reviewing will be forthcoming. In cases where the latter is not achievable, sub-national government expenditure patterns may be on a collision course with the stabilisation objectives of national government, such as the need to maintain a low budget deficit. Alternatively, sub-national governments may borrow to finance their increased expenditure commitments. In the case of developing countries with weak financial markets, this may not be feasible and may further compound the problem as their financial markets are prone to external shocks and may not be able to sustain long-term borrowing.

From the arguments for and against decentralisation it is possible to identify some guidelines for efficient decentralisation. These are presented in the final sub-section.

2.6. Guidelines for an efficient fiscal decentralisation system

Based on the discussion of the advantages and disadvantages of fiscal decentralisation as encountered in the preceding sections, it is clear that the design of an efficient intergovernmental fiscal relations system can be a very daunting task. According to Dafflon (1996) the best way of assigning revenue and expenditure functions is still an open question. This is because countries face varying challenges. They have different backgrounds and histories and differ in geography and size. As a result, there is no one best way of designing a system of intergovernmental relations. Country-specific factors have to be taken into account. Another challenge that Nath and Schroeder (2007: 3) identify is that the extensive literature on fiscal decentralization does not provide any set of empirically determinable rules as an aid to guide decentralisation strategies by allocating functions to appropriate governmental spheres. The conventional literature on fiscal federalism, for instance, only suggests that a government's redistribution and stabilization functions should be more important relative to its allocative functions, the higher it is in the federal hierarchy. Moreover, the literature on the principle of subsidiarity places much more emphasis on sub-national governance; the power to make decisions should be passed on to the next (subsidiary) level until the appropriate level is reached (Nath and Schroeder, (2007: 3).

Despite the difficulty of this process, principles and guidelines are in place on how to approach the design of intergovernmental fiscal relations. According to Smoke (2001:19) there are five principles that determine a good fiscal decentralisation system: These are:

- An adequate enabling environment where sub-national governments are provided some constitutional or legal autonomy. However even though an enabling legal and constitutional environment provides a foundation on which to build decentralisation, it does not necessarily guarantee successful decentralisation as there are many countries with constitutional

clauses and laws on sub-national government that have not managed to decentralise successfully.

- An appropriate assignment of functions to sub-national governments;
- An appropriate set of own-sources revenues for sub-national governments;
- Establishment of a sufficient intergovernmental fiscal transfer system and
- Adequate access by sub-national governments to developmental capital.

Sub-national revenue-generating powers, such as powers to tax land, income, and natural resource exploitation may also create greater sub-national independence and legitimacy. According to Shah (2005:15) sub-national governments are often not as efficient as they are supposed to be because they lack resources. An example that Shah (2005:15) provides is that in many countries, sub-national governments collect taxes according to a tax base decided by the central government. These tax bases are often insufficient and taxes are difficult to collect, prompting sub-national governments to depend on central government transfers. Thus, due to the shortage of resources, even when sub-national governments are granted significant powers from the central government, they have difficulties in delivering basic services and respond in an adequate way to people's needs. The Financial and Fiscal Commission (2006:163) notes that in South Africa, the situation is such that there are certain provinces like Western Cape, Gauteng, Mpumalanga and Kwazulu-Natal which have made an effort to maximise revenue collection by designing own revenue collection strategies. However, the remaining provinces still lack the requisite commitment to optimise the collection of own revenue. This general failure to optimally collect revenue sources at sub-national government is exacerbated by a number of factors including the failure by provincial line departments to generate additional revenue from existing revenue sources.

Martinez- Vazquez (2001:5) further identifies common challenges particularly with respect to the assignment of expenditure responsibilities. Firstly, he

identifies a lack of formal expenditure assignment and mentions that while a great deal of attention has been given to issues of revenue sharing and inter-governmental transfers, expenditure assignments have been continuously reworked by the central authorities simply for fiscal convenience and as a tool of fiscal deficit containment. Martinez- Vazquez (2001:5) argues that from a fiscal management point of view, formal expenditure assignments introduce an important element of certainty for budget planning at all levels of government. The other challenge that Martinez- Vazquez (2001:5) identifies is the issue of inefficient assignments, particularly of all capital expenditure responsibilities at the central level, independently of the level of government responsible for the provision of the services associated with the capital infrastructure.

Regarding the question of whether or not fiscal decentralisation is a relevant phenomenon, Boex (2009:11) maintains that even though fiscal decentralisation reforms have been pursued in literally dozens of countries over the past half century, there is no conclusive empirical evidence to suggest that fiscal decentralisation actually has a consistent, positive impact on public service delivery and governance. Boex (2009:11) continues to argue however, that in the absence of strong empirical evidence to the contrary, it would be equally inappropriate to dismiss the relevance of fiscal decentralisation and intergovernmental finance as an effective public policy reform.

In an attempt to evaluate whether or not it is necessary to decentralise, Ribot (2001:66) purports that it is imperative that the following factors are investigated:

- Whether more efficient outcomes can be established through decentralisation. In practice, can greater efficiency be measured in decentralisation and under what conditions?
- Of the many causal links hypothesized between decentralisation and greater efficiency, which can be shown to be in operation? Which of the causal links is most effective in fostering greater efficiency?

- Are the sub-national authorities that are being mobilised in the name of decentralisation representative and downwardly accountable?
- Do sub-national governments serve the poor better than central governments do and what are the necessary roles of central government in serving poor and marginalised populations? In answering this question, the World Bank (1999: 109) asserts that decentralisation and deconcentration are believed to increase service delivery. First, central government monopoly power over service provision is argued to be the source of much inefficiency even though evidence that decentralization or deconcentration leads to better service provision is thin. This is partly because the assumed causal relations are difficult to demonstrate. “Given that claims of service improvements are so central to the arguments of decentralization advocates, it is somewhat surprising that so little research has been conducted to see if decentralization indeed increases the level of services delivered and their quality” (Smoke 2000:16). On the other hand, Ribot (2001:14) argues that the existing evidence is mixed since a study of decentralization in ten developing countries showed increased infrastructure expenditures at the national and sub-national levels. Where service provision was low, decentralisation appears to increase sub-nationally produced services.
- Are sub-national taxes progressive or regressive overall?
- Whether decentralisation can be associated with improved service delivery and how can these improvements be explained?

According to Bird (2000:1) the traditional theory of fiscal federalism prescribes a very limited tax base for sub-national governments. The only good sub-national taxes are said to be those that are easy to administer sub-nationally, are imposed mainly on sub-national residents, and do not raise issues with regard to harmonisation or competition between sub-national and provincial governments or do not raise problems regarding harmonisation or competition between the sub-national governments and the national government. Hyman (2008:697)

maintains that the ability of tax bases to migrate partially from one jurisdiction to another creates problems that constrain the revenue raising capabilities of sub-national government.

Bird (2000:1) asserts that the only major revenue source that usually passes these stringent tests is the property tax, with perhaps a secondary role for taxes on vehicles and user charges and fees and since national governments are in general reluctant to provide sub-national governments access to more lucrative sales or income taxes, it has become conventional wisdom that sub national governments should be allocated property tax; taxes on vehicles and user charges and fees.

The allocation of fiscal powers to provincial and local spheres of government can improve efficiency and encourage more responsible governance. However, there are various issues which should be considered before advocating for increased decentralisation in all instances. Verwey (2006:7) identifies challenges which should be taken into account when dealing with the subject of fiscal decentralisation. According to Verwey (2006) political and administrative decentralisation has a tendency to take precedence over fiscal decentralisation in many countries. However, decentralisation strategies which stem from political considerations will not necessarily be conceptualised thoroughly and comprehensively from a fiscal point of view. Verwey also maintains that unfunded or under-funded decentralisation can also be used by national government to shift accountability downwards, in other words, provincial and local governments may take responsibility for functions which national government was not able to perform efficiently and effectively, whilst being provided with less funds for this.

In addition, Braun and Tommasi (2002:3) assert that intergovernmental fiscal systems which include large transfers from the central governments can create many incentive problems. Among the incentive problems identified by Braun and

Tommasi (2002:3) are the moral hazard issues that might arise where provincial and sub-national governments tend to overspend, undertax, overborrow, underprovide services, and accumulate arrears, in the hope that sub-national public expenditures will ultimately be subsidised by taxpayers in other jurisdictions. Rodden (2001:670) is also of the view that there are formidable challenges facing multi-tiered levels of government where fiscal indiscipline by the provincial and sub-national governments exists.

According to Rodden (2001:670) the intergovernmental commitment problem is encountered where multi-tiered governments face the possibility that provincial and sub-national governments will attempt to over-spend the common revenue pool by shifting their costs onto the central government. For instance, provincial and sub-national governments should determine whether or not to undertake a costly new project that will lead to dangerous debt levels, or when faced with a negative revenue threat, provincial and sub-national governments should be in a position to decide whether to undertake adjustment measures or fund current expenditures without borrowing.

Rodden (2001:670) further maintains that a rapid growth in the autonomy and responsibilities of provincial and sub-national governments is one of the most noteworthy trends in governments around the world, but there are times when fiscal decentralisation can be dangerous particularly in developing countries. On the other hand, Joumard and Kongsrud (2003:15) maintain that funding principles play a key role in shaping sub-national government spending behaviour. In addition, Joumard and Kongsrud (2003:16) further maintain that matching revenue-raising powers to spending responsibilities is desirable to allow sub-national governments to tailor the supply of public goods to local citizens' preferences and willingness to pay, and hence to be held accountable.

National Treasury (2008) mentions that there have been recently encountered in South Africa where a number of fiscally undisciplined municipalities have been

put under administration by the provincial and central government. This situation presents an undesirable consequence of expenditure assignments to sub-national government. According to Rodden (2001:684) the combination of wide-ranging sub-national autonomy and growing transfer dependence is increasingly common, especially as countries decentralise expenditures by ramping up intergovernmental transfers rather than building up the sub-national tax bases.

On the other hand, a sound system of intergovernmental fiscal relations should ensure that the provincial and sub-national spheres of government are able to execute the functions assigned to them. According to Verwey (2006:8) this comprises of the politically independent determination of how national revenue is to be divided up between the spheres of government and taking into consideration the administrative capacity before fiscal responsibilities are allocated to provincial and sub-national governments. In addition, Cottarelli (2009:4) contends that control over a portion of own resources is key to promoting accountability of sub-national governments to their constituents as well as fiscal responsibility. The assignment of own revenue sources to sub-national governments must take into account economic considerations such as the degree of mobility of the tax base as well as institutional considerations, particularly the capacity of sub-national tax administrations.

With regard to literature on fiscal decentralisation, Nath and Schroeder (2007: 3) assert that much of the fiscal decentralization literature focuses on the division of public service functions between the central government and sub-national governments, and thus it is necessary to create an environment in which centralization can provide different levels of sub-national public goods in different districts, through a central legislature consisting of elected representative from each district. Thus, with representation of districts in the central legislature, the problem of spillovers can also be addressed, thereby ensuring that sharing the cost of sub-national public spending in a centralized system does not create a conflict of interest between citizens in different jurisdictions.

Dabla-Norris (2006:16) maintains that effective implementation of fiscal decentralisation requires the presence of a comprehensive institutional framework. In addition, Dabla-Norris (2006:4) mentions that international experiences have shown that a basic requirement for efficient multi-tier government is the presence of intensive co-operation between the main stakeholders at different levels of government.

Fiscal decentralisation can be achieved with a genuine political will to share power and to devolve resources to sub-national governments, thereby ensuring that provincial and sub-national governments are autonomous. In order for effective fiscal decentralisation to be attained in any country, Shah (2005:18) maintains that the following factors are necessary:

- Financial resources of sub-national authorities must be adequate to meet their responsibilities.
- Sub-national governments must be aware of service delivery costs in order to take the right decisions.
- Sub-national governments must be better informed to take relevant decisions regarding basic services delivery and basic needs.
- Communities must have means to express their voice directly to politicians. People must be given the opportunity to participate in sub-national initiatives without experiencing central government pressures.
- Accountability must be achieved as well as transparency in information.

2.7. Summary and conclusions

This chapter provided a definition and discussion of decentralisation. Decentralisation is an all-encompassing term which includes political, administrative and fiscal decentralisation. The latter refers to the division of fiscal powers, including taxation; spending and borrowing between the central government and sub-national governments. The decentralisation of government

finances and expenditure responsibilities is a prerequisite of sound intergovernmental fiscal relations. The assignment of revenue and expenditure functions is premised on the view that sub-national government provision is better able to match the delivery of public goods with local preferences and the ability to pay. In addition, sub-national governments are perceived to be more sensitive to the preferences of their citizens and are more accountable to their electorate.

The chapter briefly looked at the assignment of government functions based on appropriateness and effectiveness of these functions at different levels of government. These functions include macro-economic stabilisation; redistribution as well as allocation of resources for publicly provided goods and services. Stabilisation involves the use of fiscal and monetary policies to stabilise growth of the GDP, level of inflation and unemployment. This function is clearly suited for central government's assignment. Redistribution on the other hand deals with the distribution of individual and/or households' income through tax and spending decisions.

The allocative function deals with the allocation of resources for publicly provided goods and services. The chapter discussed the suitability of this function for central government as opposed to sub-national governments, based on different schools of thought. With regard to the shifting of the allocation function to sub-national government, Oates' correspondence principle maintains that the provision of public goods should be performed at the lowest level such as to allow an approximate correspondence between those who benefit from their provision, those who pay and those who decide on the amount provided. Oates also argues that decentralisation will result in greater experimentation and innovation in the provision of public services. In addition, Tiebout (1955) maintains that competition between local jurisdictions ensures they will better meet local preferences. On the basis of these justifications, the chapter

concluded that there is a strong case for sub-national government administration of this function.

The chapter continued to discuss arguments in favour of fiscal decentralisation and also looked at disadvantages of fiscal decentralisation. Among the arguments cited in favour of decentralisation are the autonomy of sub-national governments that rely on their own sources of funding is greatly enhanced. Furthermore, fiscal decentralisation contributes in ensuring that sub-national governments are accountable to their electorate. On the other hand, opponents of fiscal decentralisation argue that the shifting of revenue and expenditure assignments to sub-national governments might result in under-provision of regional and local public goods as sub-national governments will only consider impacts within their jurisdiction and ignore external impacts in other jurisdictions. Opponents of fiscal decentralisation also argue that if not properly managed, the assignment of expenditure responsibilities without the commensurate funding sometimes contribute to the problem of unfunded mandates.

The chapter concluded by looking at the guidelines for an efficient decentralisation system. The chapter continued to discuss the five guiding principles for an efficient fiscally decentralised system. The first principle refers to the existence of an enabling environment which is accompanied by political will to decentralise, the presence of a constitutional and legal framework. Additional principles include an appropriate assignment of functions to sub-national governments; an appropriate set of own-source revenues for sub-national governments; the establishment of a sufficient intergovernmental fiscal transfer system and lastly, adequate access by sub-national governments to developmental capital. The chapter conceded that sub-national governments that have access and control of their own revenue sources are desirable in any country for purposes of fiscal autonomy and independence. Even though many pieces of legislation in different countries including public finance theory literature

advocates for provision of public goods at sub-national government level, the notion of fiscal decentralisation continues to be quite a complex one.

Based on the theoretical framework and the trends of fiscal decentralisation in general, chapter three focuses on fiscal decentralisation as it relates to the South African context in particular. Chapter three will also examine in detail the evolution as well as the status quo of the allocation of revenue and expenditure assignments to sub-national government after the attainment of democracy in 1994.

Chapter 3: An evaluation of revenue and expenditure responsibilities in South Africa

3.1. Introduction

Chapter two provided a theoretical background, a definition and a discussion of fiscal decentralisation. Fiscal decentralisation was defined as the deliberate and planned transfer of fiscal powers between national government and sub-national governments. It was also mentioned that decentralisation takes many forms, including administrative decentralisation, political decentralisation as well as fiscal decentralisation. The chapter discussed the efficient allocation of government functions among the levels of government, including the arguments for and against a fiscally decentralised system. It was argued that fiscal decentralisation is desirable at sub-national government level by virtue of the sub-national government being closer to the citizens, and hence being in a position to efficiently provide publicly produced goods. Fiscal decentralisation is also important because the access to own sources of revenue is necessary in entrenching autonomy as well as accountability of provincial and local government to their electorate.

The purpose of this chapter is to provide a critical analysis of fiscal decentralisation in South Africa, based on the theoretical framework of fiscal decentralisation as set out in chapter two. The chapter begins by analysing the status quo with regard to the fiscal framework of sub-national governments in South Africa. This is done with the intent of determining whether the fiscal framework is one that meets the requirements of sound intergovernmental fiscal relations and to also establish how the intergovernmental fiscal system can be further enhanced in the delivery of services as required by the Constitution.

The structure of the chapter is as follows: Section 3.2 outlines fiscal decentralisation in South Africa according to its pillars, which are, expenditure responsibilities, revenue raising powers, intergovernmental fiscal transfers and sub-national borrowing. In 3.3 the challenges faced by sub-national governments with respect to fiscal decentralisation are discussed. Section 3.4 presents a discussion of other outstanding current issues and continues to investigate opportunities for further improvement. The chapter concludes with a summary in section 3.5.

3.2. An overview of fiscal decentralisation in South Africa

South Africa is a unitary country that achieved democracy in 1994. The country is governed at three spheres, namely, national, provincial and local governments. Sections 228 and 229 of the Constitution provide guidelines on which taxes can be devolved to the provincial and local governments respectively. The South African Constitution also provides for a co-operative form of governance consisting of three spheres, national; provincial and local sphere. These three spheres of government are independent, yet interrelated. Constitutionally, each sphere of government is assigned certain powers and functions. These powers and functions are either concurrent or a sole responsibility. The Constitution entrenches 'co-operative' governance; obliging the three spheres of government to co-operate and negotiate political and budgeting issues among themselves (National Treasury 2006: 3).

According to Derichs and Einfeldt (2006:4) the status quo of fiscal decentralisation in South Africa can best be reviewed along the four pillars of fiscal decentralisation which are expenditure responsibilities, assignment of tax sources, intergovernmental fiscal transfers and sub-national borrowing. Bird (2000:1) concurs that four basic questions must always be answered with respect to intergovernmental finance in any country and these are:

- The question of expenditure assignment, dealing with the division of expenditure functions to spheres of government.
- The question of revenue assignment, which deals with the devolution of taxes among spheres of government.
- The question of vertical fiscal imbalance wherein the disparities between the revenues and expenditures of sub-national governments that almost invariably results from the answers to the first two questions are examined and consequently resolved.
- The question of horizontal imbalance, or equalization dealing with the extent to which any adjustment should be made for differences in needs and abilities between different sub-national government units at the same level of government.

Bird (2000:1) continues to argue that the design of the three key instrumental components of intergovernmental fiscal relations in any country, namely, revenues, expenditures, and transfers not only answers these questions but to a large extent determines whether and to what extent sub-national governments are likely to act in a fiscally responsible way.

There have been a series of fiscal framework and legislative changes that have taken place at both the provincial and local government spheres since 2000 with a view of dealing with intergovernmental fiscal and legislative challenges in South Africa. The changes that have recently taken place include, amongst other things, the abolition of Regional Services Council/Joint Services Board (RSC/JSB) levies and ongoing attempts to find a suitable revenue source for their replacement, the enactment of the Municipal Fiscal Powers and Functions Act in 2007, the restructuring of the electricity distribution industry, as well as the review of the Provincial Equitable Share formula (Maseko in FFC 2008:451). In addition to these changes, expenditure pressures on sub-national spheres of government have intensified over the past years in South Africa.

3.2.1. Expenditure Responsibilities

Bahl (2001:28) maintains that a clear understanding of the actual division of expenditures, by function, provides the baseline numbers necessary for the government's assessment of the vertical balance in the intergovernmental system. In addition, Derichs and Einfeldt (2006:7) concur and assert that the South African Constitution provides a very detailed framework for the assignment of expenditure responsibilities. Table 1 below details expenditure responsibilities of government as contained in the Constitution.

Table 1: Structure of powers and functions in the Constitution

Schedule	Description	Sharing of roles: direct responsibility for function and regulatory responsibility
Not listed in the schedules	Plenary powers of national government	National government has sole responsibility
Schedule 4A	Concurrent powers of provincial and national government	Provincial functions over which national government has regulatory oversight.
Schedule 5A	Exclusive powers of provinces	Provincial government has sole responsibility; national government has norms and standards responsibility.
Schedule 4B	Local government matters over which national and provincial government have concurrent legislative functions.	Local government functions with province and national government having regulatory oversight.
Schedule 5B	Local government matters over which provincial government has exclusive	Local government functions with province having regulatory oversight; national

	legislative competence	government has norms and standards responsibility.
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Source: IDASA – Budget Information Service. 2004. Local Government Powers and Functions.

Table 1 above depicts the Constitutional assignment of competencies to three spheres of government, and also provides for concurrent jurisdiction of some functions among the three spheres. For instance, a municipality can also perform national or provincial functions or visa versa. According to Derichs and Einfeldt (2006:9) the system of expenditure responsibilities, as set out in the South African legislative framework, endeavors to comply with the core principles of public finance decentralisation theory. The Constitution provides for a detailed division of powers and functions. Whilst national government is mainly responsible for expenditures having macroeconomic or redistributive implications (pensions, unemployment compensation), sub-national governments, on the other hand, account especially for the delivery of goods and services.

With regard to the structure of powers and functions in the Constitution, it is envisaged that local government must strive, within its financial and administrative capacity, to ensure the provision of services to communities in a sustainable manner. It is expected that municipalities must promote social and economic development; and encourage the involvement of communities in the matters of local government. By the same token, the Constitution envisages that the national or a provincial government may not compromise or impede a municipality's ability or right to exercise its powers or perform its functions. Furthermore, in some instances, certain functions, which are shared by different spheres of government, lack a clear delineation of responsibility. There are, for example, municipal roads that are not yet classified as district or local routes, and therefore run the risk of not being maintained (National Treasury 2008).

Another concern relates to uncertainties about the nature of the transfer of a function. This occurs in cases, when functions lie within one sphere of government and are carried out by another sphere. The transfer of the function can be an assignment, a delegation or an agency agreement, which makes municipal planning and budgeting more difficult. According to Derichs and Einfeldt (2006:9) these problems may lead to an increase of financial accounting and reporting responsibilities for municipalities dealing with a variety of delegation and agency agreements in different sectors. In many cases, there is no adequate funding or capacity building for these additional responsibilities.

Derichs and Einfeldt (2006:9) maintain that a first step towards addressing the above mentioned problems has to be the draft Policy Framework for the Assignment of Powers and Functions to the Local Government Sphere, elaborated by the Department of Provincial and Local Government (DPLG) in 2004, as it sets out clear definitions of the different forms of responsibility transfers and provides advice concerning their carrying out. However, the Framework is not comprehensive. First, not all the legislation by different national departments is covered and, more important; it concentrates on the sphere of local government and omits transfers from national government to the provincial sphere (Derichs and Einfeldt, 2006:9).

Derichs and Einfeldt (2006:4) contend that the aims of expenditure assignment in South Africa are efficient allocation of resources, equitable provision of services and macroeconomic stability and economic growth. Accordingly, expenditure functions are divided between the three spheres of government. National government is, inter alia, responsible for expenditures concerning defence, justice, foreign affairs, tertiary education as well as for expenditures having macroeconomic and redistributive implications, e.g. unemployment compensation. Functional areas of concurrent competence of national and provincial governments are e.g. education (excluding tertiary education), health

services, housing and public transport. The functional areas of exclusive provincial competence are e.g. abattoirs, ambulance services, libraries and museums (other than national libraries and museums) and provincial roads and traffic. The area of responsibility of local government comprises, inter alia, child care facilities, firefighting services, street lighting, municipal health care services as well as municipal public transport.

3.2.2. Revenue raising powers

With regard to the question of revenue raising powers, Bahl (2001:11) is of the view that almost all countries face a similar stumbling block in deciding on revenue sources that can be assigned to sub-national government. Sub-national governments in South Africa, particularly provinces, have been assigned with limited revenue raising capabilities and more expenditure responsibilities (Donnelly, 2009:1). According to Donnelly, this was deliberately designed in the intergovernmental fiscal relations system and the Constitution to ensure that there is redistribution of resources across provinces. Mashele (2009:2) echoes Donnelly's views by mentioning that the intergovernmental fiscal system is designed such that significant revenue raising powers are vested with the national government in relation to provinces.

3.2.3 Intergovernmental fiscal transfers

Bahl (1999:1) maintains that intergovernmental transfers are a basis of financing sub-national governments in both developed and developing countries. In the same vein, Smoke (2000:5) concurs by stipulating that intergovernmental transfer programs assist to cover sub-national government fiscal imbalances; supplementing inadequate local own-revenue sources in order to improve the ability of sub-national governments to meet their expenditure responsibilities. Intergovernmental transfers can be further utilised to meet national redistribution

objectives, thereby helping to offset fiscal capacity differences among sub-national governments. Bahl (1999:2) concurs and adds that one justification for the use of intergovernmental transfers is to offset externalities. Another reason advanced by Bahl (1999:2) for intergovernmental transfers relates to disparities between the expenditure responsibilities of sub-national governments and their revenue raising power. Therefore, one option is to fill the gap through assigning local governments more revenue raising powers or by intergovernmental fiscal transfers from the national government to sub-national governments (Bahl 1999:2).

In addition to (Bahl 1999 and Smoke 2005), Anwar in Johnson (2005:41) identifies six comprehensive purposes of intergovernmental fiscal transfers to sub-national governments. These are:

- To bridge fiscal gap: Fiscal gaps should be dealt with through reassignment of responsibilities, assignment of taxes and sharing of tax bases. Bridging the fiscal gap without paying adequate attention to these issues can lead to a steep rise in fiscal deficit.
- To correct fiscal inequities and fiscal inefficiencies arising from differentials in regional fiscal capacities.
- To compensate for benefit spillovers: Since local governments do not have sufficient incentives to provide for spillover benefits to citizens from other jurisdictions higher level governments need to provide for transfer grants to enable local governments to provide for spill over benefits.
- Setting national minimum standards to preserve internal common markets and to attain national equity objectives: National governments are quite often committed to providing minimum standards of public services, which they accomplish through transfers.
- Influencing local priorities in areas of high national but low local priority.
- To create macroeconomic stability in depressed regions”.

In the same vein, Heredia-Ortiz and Rider (2005:4) also reiterate the conventional argument that intergovernmental fiscal transfers are commonly

aimed at correcting vertical and horizontal fiscal imbalances, inter-jurisdictional spillovers and the promotion of national government objectives.

In South Africa, the Constitution provides for the equitable sharing of revenue raised nationally among the national, provincial and local spheres of government. Section 214 (a) to j of the Constitution clearly points out the factors that have to be taken into account in the division of nationally raised revenue. These factors are:

- a) the national interest;
- b) any provision that must be made in respect of the national debt and other national obligations;
- c) the needs and interests of the national government, determined by objective criteria;
- d) the need to ensure that the provinces and municipalities are able to provide basic services and perform the functions allocated to them;
- e) the fiscal capacity and efficiency of the provinces and municipalities;
- f) developmental and other needs of provinces, local government and municipalities;
- g) economic disparities within and among the provinces;
- h) obligations of the provinces and municipalities in terms of national legislation;
- i) the desirability of stable and predictable allocations of revenue shares, and
- j) the need for flexibility in responding to emergencies or other temporary needs, and other factors based on similar objective criteria.

The factors which are relevant in this study are the allocation of nationally raised revenue to provinces and municipalities. These include factors such as ensuring that provinces and municipalities are in a position to execute responsibilities assigned to them, their fiscal capacity and efficiency and their developmental needs. Inequalities in fiscal capacity among provincial and local governments are

one of the reasons that necessitate intergovernmental assistance. Hyman (2008: 704) concurs that intergovernmental support is necessary as a mechanism to help achieve a more efficient allocation of resources in the government sector by internalizing inter-jurisdictional externalities. Thus, intergovernmental transfers are vital within the South African fiscal system, as provincial and local governments require adequate financial resources to enable them to perform expenditure responsibilities devolved to them.

National Treasury (2008:51) also emphasises three important roles that intergovernmental transfers play. Firstly, the intergovernmental transfers are meant to address the structural imbalance between income available to sub-national governments and the expenditure responsibilities assigned to them. Secondly, the transfers are aimed at supporting national priorities as outlined through different sectoral policies, in particular those priorities which are focused on providing universal and sustainable access to services. Thirdly, intergovernmental transfers are envisaged to establish incentives for good governance and building local government capacity within a sound fiscal framework. Transfers from national and provincial government are primarily obtained from income raised nationally and fall into two main categories, namely, equitable share allocations and conditional grants.

Ajam in Black et al. (2006:313) describes intergovernmental fiscal grants as all-purpose or unconditional grants whose intention is to reduce fiscal imbalances emanating from inconsistencies between revenue and expenditure functions. Ajam (2006) also continues to mention that equitable allocations are meant to enable sub-national governments to provide basic services and perform any functions assigned to them. Regarding conditional grants, these are “specific purpose grants intended to correct inter-jurisdictional spillovers, meet national redistribution objectives, and achieve specific national priorities and policies concerning services provided by sub-national spheres of government” (Ajam in Black et al. (2006:316)

National Treasury (2008:8) maintains that some municipalities are becoming too reliant on grants from national government, such that the rapid increase in intergovernmental transfers has reduced the amount of revenues that municipalities raise from their own local sources. According to National Treasury (2008:8) "In some instances municipalities have stopped making serious attempts to collect their own revenues, for example by not collecting money owed to them by customers who can afford to pay. As a result municipalities are becoming more reliant on grants. In the long term this will result in municipalities becoming more accountable to national government than to their own residents".

Additional factors cited by (Derichs and Einfeldt, 2006:4) for municipalities' dependence on intergovernmental fiscal transfers include the notion that most communities are characterised by high unemployment rates and low local economic development (no tax base), free basic service delivery requires high municipal expenditures that can only be met by national transfers, and a lack of 'payment culture' for services within the population is prevailing. Derichs and Einfeldt (2006:6) continue to argue that there is strong inequality between responsibilities of revenue generation and service provision within the South African intergovernmental fiscal system. Whilst provincial and local governments already take over a large share of expenditure responsibilities, their revenue-raising abilities are minimal. Provincial government in particular is highly dependent on national transfers, thus exacerbating the risk that national preferences can override those of sub-national governments.

3.2.4 Sub-national Borrowing

The Constitution assigns limited borrowing powers to sub-national government (Derichs and Einfeldt, 2006:6). Sub-national governments may raise loans only for capital and bridging purposes. However, Dahlby (2004:4) argues that the

notion that all types of sub-national borrowing should be closely regulated by the central authorities distorts spending by limiting provincial and local governments' discretion with respect to capital expenditures. Dahlby (2004:4) also argues that central government control may create an indirect guarantee of sub-national debt, thereby reducing accountability. Hence it is better to allow the private financial markets to control sub-national borrowing.

In as far as macroeconomic stability is concerned; national government supervises the debt operations on provincial and local level. Derichs and Einfeldt (2006:20) mention that in 2004, the Budget Council revisited the moratorium imposed on borrowing and introduced tight guidelines for provincial borrowing. All borrowing by provincial government would be restricted to specific infrastructure programmes or projects and the total amount of funds each province is allowed to borrow would be determined by its ability to raise own revenue, as well as the amount of funding it receives in the form of national infrastructure grants to provinces.

With regard to local government, a municipal borrowing framework was developed as part of the Municipal Finance Management Act (MFMA). The aim of the municipal borrowing framework is to re-establish local access to credit markets by clarifying the legal processes for borrowing and the rights and obligations of borrowers and lenders. The MFMA permits borrowing by municipalities to finance capital expenditure provided the loans are denominated in rand and not tied to the value of foreign currencies. (Derichs & Einfeldt, 2006:20).

3.3. Challenges faced by sub-national governments regarding fiscal decentralisation

Provincial governments as well as municipalities are currently facing a variety of challenges, particularly relating to their revenue raising abilities. According to Ndlangisa (2009: 22) provinces are still costly to maintain and generate very little revenue for their own upkeep, for instance, a province such as the Free State has a budget of R18.4 billion, yet it only manages to raise a tiny fraction of its revenue (R616million).

Fjeldstad and Moore (2008:1) also maintains that recent studies done on the causes of the poor collection of revenues by provincial and local governments conclude that this is due to poor administrative capacity to assess the revenue base; poor administrative capacity to enforce the taxes; evasion and resistance from taxpayers, predominantly with regards to the RSC/ JSB levies, license fees and hospital fees. In this setting, fundamental issues to be addressed in the context of provincial and local government fiscal reforms are to redesign the current revenue structure and to strengthen financial management. It is also important to enhance measures to encourage taxpayers' compliance and to improve the accountability of sub-national governments. There is undoubtedly room for further improved financial management in most local authorities as well as improved co-ordination between the different spheres of government.

3.3.1. Provinces

Section 228 of the South African Constitution allows provinces to impose taxes, levies, and duties other than income tax, value added tax, general sales tax and rates on property or customs duties. According to Ajam in Black et al. (2006:313) (2006:313) provinces may impose these taxes provided they do not prejudice

national economic policies, economic activities across provincial boundaries and national goods and service or factor mobility.

Revenue raised by provinces from own sources constitute less than 2.5 percent of total provincial revenue Ajam in Black, et al (2006:313). Provincial Own revenue is made up of tax receipts, casino taxes, horse racing taxes, liquor licences and motor vehicle licences. According to National Treasury (2006: 132), given their Constitutional mandate, the current situation in South Africa's Intergovernmental framework (IGFR) system is one in which provinces raise an insignificant amount of revenue compared to their expenditure needs, an outcome that generates an overwhelming dependence on intergovernmental fiscal transfers and this outcome has a negative outcome on provincial expenditure.

The dependence on equitable allocations imposes a constraint on the provinces' ability to alter the manner in which they exercise their expenditure patterns. Thus, the volume of expenditure incurred by each province depends on the volume of transfers. The dependence on intergovernmental fiscal grants also means that national government has considerable influence on equity considerations in spending through the structure of the Provincial Equitable Share (PES) formula. The asymmetry between provincial own revenues and expenditure needs, coupled with the heavy reliance on intergovernmental fiscal transfers creates the potential for widening vertical fiscal imbalances that could negatively affect the capacity of provinces to perform obligated responsibilities in a fiscally responsible way (Ajam in Black et al. 2006: 317).

According to the Financial and Fiscal Commission (2001:24) it is imperative for provinces to raise their own revenue. When provinces are responsible for raising a larger share of their revenue, it puts them in a position where they are able to execute policies that will ensure that they promote provincial fiscal accountability and the fiscal autonomy provided for in the Constitution. In addition, by virtue of

provinces being fully fledged political entities, they should be able to manage their affairs. To further instill accountability and ensure that the specific needs of their electorate are being met, provinces should have at their discretion the power to vary the amount of revenue collected from their citizens.

3.3.1.1. Provincial Surcharge on the national income tax

The Financial and Fiscal Commission (the FFC) is a constitutional body whose mandate is to provide independent and impartial advice and recommendations on intergovernmental fiscal relations including the technical consideration and design of provincial and sub-national fiscal and economic policy. The FFC was established by the Constitution of South Africa in 1994 and assist in providing information to all organs of state so that they can make informed decisions about complex fiscal issues. One of the main objectives of the FFC in this respect is to help inform the following year's budget by making recommendations on the division of revenue among the three spheres of government.

With respect to the provincial surcharge on personal income tax, the FFC argued for the implementation of national legislation to allow provincial government to introduce a surcharge on the national personal income tax base, in accordance with the Constitution, related legislation, and also in support of enhanced provincial accountability, autonomy and democracy (The Financial & Fiscal Commission: 2001, 23). The rationale for the FFC's proposal is based on the fact that sub-national governments that are totally reliant on intergovernmental fiscal transfers are not as accountable as those sub-national governments which are able to raise substantial revenues from their electorate (The Financial and Fiscal Commission: 2001, 25). It should be stressed that the Constitution also ensures that, even if provinces raise a substantial amount of their own revenue, they will not be made worse off in the revenue sharing process from the national pool. Section 227(2) of the Constitution maintains that "additional revenue raised by

provinces or municipalities may not be deducted from their share of revenue raised nationally, or from other allocations made to them out of national government revenue. Equally, there is no obligation on the national government to compensate provinces or municipalities that do not raise revenue commensurate with their fiscal capacity and tax base” (Financial and Fiscal Commission: 2001, 25).

The Financial and Fiscal Commission (2009:4) maintains that with respect to revenue assignments, the current position dictates that South Africa displays a weak assignment of revenue responsibilities to provincial governments. This inadequacy of revenue sources then raises concerns regarding the discretion that provinces have over national government fiscal transfers and provincial allocative efficiency. In order to circumvent the weakness associated with inadequate revenue sources, the solution might be to provide greater revenue autonomy to provincial governments. However, the Financial and Fiscal Commission (2009:4) notes that in South Africa’s case the notion of revenue autonomy is not important because the assigned functions to provinces are mainly basic social services. By their nature, the basic social services are conveniently funded when financed through equitable allocations from the central government.

The Financial and Fiscal Commission further identifies certain significant structural and institutional impediments that contribute to the weaknesses manifested in the manner in which the provincial exercise of revenue is unfolding. The Financial and Fiscal Commission (2009:5) maintains that weaknesses of the intergovernmental fiscal system are rooted in the organisations created primarily to enhance collaboration between national and provincial government, as well as to facilitate alignment of policy and budgets on concurrent functions during the budget process. The institutions referred to are statutory bodies such as the FFC, and intergovernmental forums such as the Budget Council, which is a statutory body composed of the Minister of Finance and the members of the executive

councils (MECs) in charge of finance in each province (National Treasury, 2005:3). Other statutory bodies that are responsible for encouraging collaboration between national and provincial government are MinMECs which are sectoral policy forums consisting of the national ministers responsible for concurrent functions and their provincial counterparts (National Treasury, 2005:3).

The Financial and Fiscal Commission (2009:5) is of the view that while the national and provincial governments are represented within these structures and in the budget process, there is a tendency for national government to control the proceedings and sometimes impose on the provinces. Equally the provinces' representation and contribution in the system is at times perceived as inadequate, given their capacity and inability to influence decisions at this level.

3.3.2. Local governments

According to Derichs and Einfeldt (2006:6) even though there is a strong commitment of the South African government to establish a sound system of fiscal decentralisation, the fundamental change from the apartheid system to a democratic government is such that the South African society is still characterised by large socioeconomic inequalities and under-servicing across social groups and regions. The government of South Africa set as a central priority the efficient delivery of public services with a focus on equity and poverty alleviation. One of the central challenges is therefore the implementation of an intergovernmental fiscal system which matches the social needs of poor communities and, at the same time, strengthens the economy. Furthermore, (Derichs and Einfeldt 2006:6) maintain that, an important challenge of fiscal decentralisation in South Africa remains capacity building at the provincial and local level. For example, under-spending in both, provincial and local government, is widespread. Many provinces and municipalities are still lacking

the required financial management and strategic planning skills to handle the complexity of the intergovernmental fiscal system.

Furthermore, the local government sphere is an important part of the South African economy and has undergone significant changes since 2000. Fiscal reorganisation of local government began from 1998 when the equitable share for local government was initially introduced. In 2000 the Municipal Structures Act was amended to assist in bringing about a variety of tax instruments for categories of municipalities. In addition, the Municipal Property Rates Act was introduced on 2 July 2005 to create a new and uniform property rating system for the local government sphere. It is expected that the implementation of the Property Rates Act will have an impact on local government revenue.

On the other hand, one of the significant sources of tax revenue for district and metropolitan municipalities, the Regional Services Council/Joint Services Board (RSC/JSB) levies were abolished with effect from 1 July 2006. The abolition of the RSC/JSB levies has had a negative impact on the revenue stream of local government because these levies constituted a significant amount of municipal own revenue. The Municipal Fiscal Powers and Functions Act (Act No. 12 of 2007) was approved in 2007. The objectives of the Act is to, amongst other things, regulate the exercise by municipalities of their power to impose surcharges on fees for services provided under section 229(1)(a) of the Constitution; to provide for the authorisation of taxes, levies and duties that municipalities may levy under section 229(1)(b) of the Constitution. It is thus expected that this Act will result in considerable changes to the local government fiscal framework through the regulation of the introduction of taxes and the management of certain municipal surcharges. The Municipal Fiscal Powers and Functions Act encourage municipalities to be proactive in requesting specific revenue sources and motivating for them in terms of stipulated criteria.

The income and expenditures of local governments determine to a large extent, the municipalities' ability to deliver services in their respective areas of jurisdiction. Municipalities are given the responsibility for making their own decisions concerning the provision of public services and are assigned substantial taxing powers to give effect to these decisions. Unlike the provinces, the local government sphere has a more substantial revenue base and generate more than 90 per cent of their aggregate budget from own revenue sources (Ajam 2006:18).

However, the South African local government situation is such that there are considerable differences between municipalities across the country, mainly because of the massively diverse environments that they work in. Small, largely rural municipalities have large poor populations but little economic activity, whereas large urban municipalities have rapidly growing populations and experience rapid economic growth. These differences have a big impact on what each municipality needs to do in order to support the development of its area of jurisdiction (National Treasury: 2008, 23). The following sections provide a discussion of the pertinent issues in the local government fiscal framework system.

3.3.2.1. The Abolition of the RSC/JSB Levies

The RSC/JSB levies were local business taxes based on turnover and remuneration of businesses based in the jurisdiction of district and metropolitan municipalities and the levies were collected by the municipalities themselves. According to Whelan (2002:21) one of the principal functions of the RSC/JSB levies was the funding of infrastructure, especially in areas of the highest relative need. RSC/JSB levies were the main funding source for intergovernmental fiscal equalisation between local municipalities in non-metropolitan areas (Whelan, 2002:21). Regarding the administration of the RSC/JSC levies, metropolitan and

district municipalities could not conduct their own assessment of liabilities of taxpayers, but had to rely on the assessment by the taxpayers themselves. As a result, false self-assessment by taxpayers was frequently experienced and the scope for tax evasion was highly prevalent (Whelan, 2002:34).

National Treasury announced its decision to abolish the RSC/JSB with effect from 1 July 2006. The abolition was as a result of the review of the local government fiscal framework that revealed that the RSC/JSB levies do not meet good tax criteria. An assessment of the RSC/JSB levies, which culminated in their abolition, is provided in Table 2 below:

Table 2: Assessment of the RSC/ JSB levies

Criterion	Assessment
Equity	• Incidence: Turnover tax is transmitted to users and payroll to employees in formal sector. • Ability-to-pay: Turnover is viewed as being more regressive than VAT because of fewer exemptions. Payroll has a tendency of excluding high-earning self-employed (as they often do not declare their tax liability) and excludes capital income. • Benefit: Some of the benefit is exported away from the area in which the income is spent. a) The administrative systems do not pick up sales transactions in the municipality in which the transaction actually occurs but in the municipality in which they are recorded by the company, frequently in larger towns. b) Company payrolls are normally kept at company headquarters, which are often in large urban areas.
Efficiency	• The taxed: Turnover tax is a form of general sales tax. The tax is carried forward at each phase of the production process when goods from one company in the production

	chain are sold on to the next company. Consequently, tax amounts are themselves taxed at each consecutive stage of the production process. As companies can make tax savings by vertically integrating, this tax arrangement has a tendency of misrepresenting companies' decisions about whether to vertically integrate. • The taxer: Tax exporting from metro and larger urban areas lessens fiscal accountability over revenue raising and spending, which may lead to efficiency losses
Administrative Costs	• Collection: Because only a tiny portion of tax liability is collected, collection costs are high. If evasion costs are excluded, total collection costs are low. Total costs may increase considerably if evasion costs are included. • Compliance costs: These are low due to weak enforcement. If it was obligatory for businesses to report payroll by place of employment and sales by place of transaction, compliance could be a lot higher.
Political feasibility	• Given the low rates and poor administration, these taxes are politically accepted. • Higher rates and tighter control will highlight the taxes' negative aspects.
Legal Implications	• Turnover tax is broadly seen as a general sales tax, a type of tax from which local government is specifically excluded. This may make turnover tax subject to legal challenges, which can undermine district and metropolitan government. It is thus conceivably viewed as a risk factor by potential investors

Source: Bahl and Solomon (2000)

As a temporary measure, the levies have been substituted by a national grant while new revenue instruments are being explored. Although the RSC/JSB levies were deemed to be inefficient, at the time of their abolition they were making a significant contribution to the revenue of metropolitan and district municipalities.

According to Dawood and Pahwa (2006:19) the RSC/JSB levies have historically formed an important source of revenue for metropolitan and district municipalities making up to 9% or R5.5 billion of total local government revenue in the 2003/04 fiscal year. The RSC/JSB levies accounted for 34% of overall district municipality income and were used to fund utility infrastructure thus they were considered essential for local governments to meet the developmental mandate (Dawood & Pahwa 2006:19).

In its Submission to the Division of Revenue Act for the fiscal year of 2007/08, The Financial and Fiscal Commission (2008:34) recommended that, in light of the abolition of the RSC/JSB levy, which formed a significant source of municipal revenue, the replacement revenue source for municipalities should be a tax that enhances the fiscal autonomy and discretion of local governments; strengthens the accountability of local government regarding the administration and use of the proposed tax base; yields an adequate and buoyant revenue stream for municipalities in the face of cyclical instability; and maintains macroeconomic balance. In its response to the FFC's recommendation regarding the replacement of RSC/JSB levies National Treasury (2009:8) mentioned that it is important that any changes to the structure of local government finances must ensure that the fiscal autonomy of municipalities is not compromised but enhanced. The National Treasury (2009) also supports the principles proposed to underpin the choice(s) for replacement sources of revenue for the RSC/JSB levy. These principles include that whatever revenue option is adopted should be one that ensures revenue adequacy for municipalities, is buoyant and does not undermine the macroeconomic principles of stabilisation.

However, National Treasury (2009:8) maintains that the revenue raising abilities of individual municipalities need to be taken into account, because a replacement revenue instrument that is purely in the form of a tax is unlikely to achieve the desired goal of enhancing local government fiscal autonomy for poorly resourced

and rural municipalities, and will at best reproduce the existing inequalities in local government own-revenue generation.

3.3.2.2. Property Rates

Taxes on immovable property are one of the most important sources of local government revenue. Municipal Property Rates Act of 2004 (the MPRA) took effect from 2 July 2005. The MPRA envisages that the new property rating and valuation system should only be implemented when council has adopted its rates policy and has prepared the first valuation roll (National Treasury: 2008, 24). Prior to the establishment of the new Property Rates Act, the powers of the municipalities to raise property rates were mainly generated by provincial ordinances of the four former provinces of the old RSA (Whelan, 2002: 29).

Initially, the MPRA required municipalities to have brought their valuation records up to date within four years of the effective date of the legislation, that is, between 1 July 2006 and 1 July 2009. The MPRA called for municipalities to prepare both the new rates policy and the valuation roll before the implementation of the Act. However, preparation of rates policy and valuation roll requires a substantial amount of money. Small and poor municipalities may not be able to afford very high fees of property valuers. These municipalities might also be expected to give rebates and exemptions to majority of its poor residents who are classified as poor. According to (Franzsen 2009:28), the situation prevailing as at 1 July 2009, was such that only 104 municipalities have implemented the MPRA while a further 162 municipalities were still yet to implement new valuation rolls and municipal rates policies.

In light of the above factors, including some practical difficulties in implementing parts of the MPRA and other public objections to certain aspects of the MPRA, in 2009 the Department of Cooperative Governance and Traditional Affairs decided

to have public hearings on the MPRA with the view of amending the Act. In essence, the MPRA would not yet be implemented as anticipated.

Franzsen (2009:25) notes that unlike other property tax legislations in other countries such as Canada and the United States, the MPRA provides for a single standard for the determination of value payable for all properties, irrespective of use, namely market value. Therefore, the uniform standard applied by all municipalities across all property use categories means that all property owners are treated equitably and fairly.

3.3.2.3. The Reform of the Electricity Distribution Industry

The restructuring of the electricity distribution industry is a process which has been conceptualised since the 1990s. The need to restructure the electricity distribution industry was brought about by a variety of factors including the disparities resulting from the different tariffs charged by municipalities and poor service delivery due to inadequate capacity in poor municipalities (Maseko in FFC 2008:431). The restructuring of the industry calls for the electricity distribution industry to be restructured into six Regional Electricity Distributors (REDs). It is also expected that the REDs will be public entities which are governed by the Public Finance Management Act (PFMA). Despite the inevitable need to reform the electricity distribution industry, it must be mentioned that municipal electricity levy is also the biggest contributor to municipal own-revenue. Dawood and Pahwa (2006:19) estimate that in the fiscal year 2003/04, the surpluses generated by municipalities from their electricity distribution contributed between R1.6 billion and R1.8 billion in municipal revenue.

The restructuring of the electricity distribution industry is not void of challenges. For instances, Part B of Schedule 4 of the Constitution empowers local government to perform the electricity reticulation function. As a result, it is not permissible for any other organisation or institution to reticulate electricity unless

certain Constitutional amendments are effected. Therefore, the Constitution is perceived as a possible impediment to the successful implementation of the restructuring process. It is also expected that the REDs will be registered as public entities in which both national and local government will participate. Such an entity or governance arrangement might violate the provisions of the Constitution since municipalities are exclusively mandated to perform the electricity reticulation function.

3.3.2.4. User chargers

User charges are direct charges to individuals and communities for the use of public facility or consumption of goods and services provided by the central government or provincial and local governments and include electricity charges, water charges, health service charges, and license taxes (Moeti, et al, :2007,38). Municipalities levy the following user charges: sewerage services; refuse removal services; water provision and electricity provision. In Table 3 below, Paul et al (2009:306) identify a set of conditions that municipalities should take into account in designing their respective user charges or tariff policy:

Table 3: Principles and requirements of municipal tariff policy

Principles	Requirements
Payment in relation to quantity consumed	The quantity of services individual users are charged for should ideally be a fraction of their use of that service.
Ability-to-pay	Poor households must have access to at least basic services through user charges that are adequate for only operating and maintenance costs.
Fairness	Consumers of municipal services should be dealt with equitably in the application of user charges.

Transparency	The tariff policy should be transparent to all users and any subsidies and allowances which exist must be able to be seen and understood by all users.
User charges must reflect cost of service	Tariffs must reflect the realistic costs of providing the service; however, provision may be made in appropriate circumstances for a surcharge on the tariff for a service.
Financial sustainability	User charges must be set such that they promote the financial sustainability of the service, considering subsidization from sources other than the service concerned.
Full payment of service costs	All users, except the indigent, should be charged the full cost of the service provided.
Affordability	The cost of municipal services should be largely reasonably priced to all consumers and users, other than registered or identified indigent.
Local determination of tariff levels	Municipalities should be flexible in the determination of their own user charges or tariff levels.
Reliable tariff enforcement	A reliable policy addressing non-payment of accounts needs to be made available. This must be targeted and implemented with thoughtfulness to sub-national conditions.
Ensuring competitive of local economies	Sub-national tariffs must not unreasonably burden sub-national businesses as these costs have an effect on the sustainability and competitiveness of such businesses.
Optimal use of resources	The economical, efficient and effective utilisation of resources must be supported.

Source: Pauw et al. 2009

Notwithstanding the systems in place for effective collection of revenue by municipalities, challenges regarding municipalities enforcing those guidelines including in circumstances where the users of the municipal services are in a position to contribute financially for the use of such services. National Treasury (2008: 172) attributes this failure to inadequate capacity at the senior management level and a lack of appropriate financial management skills in municipalities, thereby resulting in poor municipal service delivery.

According to National Treasury (2008: 23) user charges' share in total operating revenue for local government has declined by from 49 per cent in 2003/04 to 42.9 per cent in 2009/10 mainly due to the sharp increase in national transfers. Municipalities also generate other income in the form of traffic fines, business licences, rental fees, entrance fees for use of municipal facilities and fresh produce markets and the revenue from these sources has increased from R8 billion in 2003/04 to R17.2 billion in 2007/08 (National Treasury, 2008: 23).

The fiscal framework of the South African local government sphere has undergone many challenges and a number of legislative changes since its inception. These include, amongst other things, the introduction of the local government equitable share formula, the abolition of RSC/JSB levies, the enactment of local government legislation such as the Municipal Fiscal Powers and Functions Act, the introduction of the new Property Rates Act as well as the proposed restructuring of the electricity distribution industry. The abolition of the RSC/JSB levies presented a challenge to the financial situation of municipalities because these levies contributed a significant amount to municipal own-revenue. In addition to the abolition RSC/JSB levies, the proposed restructuring of the electricity distribution industry into Regional Electricity Distributors has a potential of adversely affecting the revenue stream of municipalities. On the other hand, the introduction of the new Property Rates Act which introduces a uniform rating system to municipalities is a positive development at the local government level.

The enactment of the Municipal Fiscal Powers and Functions Act is also positive change to the local government fiscal framework system because this Act provides for the introduction of new taxes by local government. Despite all these challenges and changes experienced by local government, section 3.5 below provides a discussion of opportunities for further improvement at the local government sphere.

3.5. Opportunities for further improvement at the local government sphere

Local governments face a variety of challenges including service delivery, unfunded mandates, a number of legislative development and amendments and administrative capacity. In order for fiscal decentralisation to be fully realisable, it is imperative that these challenges and issues related to the capacities of municipalities to raise revenue are dealt with.

According to the National Treasury (2008:2) major issues that municipalities should address as a matter of urgency involve the following:

- Acting in response to the increasing demand for services, through increasing their capital and maintenance budgets, whilst limiting the amount they spend on operating costs, such as administration.
- Devoting their efforts to collecting all the money owed to them, while at the same time understanding the problems encountered by the poor. It is imperative for local government to endeavor that the incomes that they generate grow at the same rate as the revenues they receive from equitable allocations.
- The price of municipal services should be regularly assessed in order to ensure that they cover the full costs of producing the service, particularly with respect to water, sanitation, electricity and refuse removal.

- Eliminating organisational incompetence that is caused by poor human resource management.

3.5.1. Local government autonomy and the challenges of service delivery

Progressive realisation of universal access to the basic services outlined in the Bill of Rights is required by the Constitution. Universal access to basic services is also an essential step towards poverty alleviation. Since the provision of basic services is a core economic mandate of sub-national government in South Africa, public finances emphasise budget spending towards the provision of these services. However, National Treasury (2008:13) mentions that there are considerable variations in levels of poverty and access to services between the different categories of municipalities and individual municipalities within the same category. National Treasury (2008:13) continues to mention that high levels of poverty limit the ability of residents in more rural municipalities to pay for even basic services.

Derichs and Einfeldt (2006:24) maintains that with regard to fiscal decentralisation and poverty alleviation, the following elements still require attention: political commitment and effective leadership with regard to pro-poor decentralised service delivery, mobilisation and institutionalised participation of all groups of society, the provision of adequate financial resources and the strengthening of technical and managerial capacity. Derichs and Einfeldt (2006:24) further maintains that all over the world, local government is pushing for autonomy and decentralised decision-making. This is sometimes done in a way that leaves municipalities with many needs for new skills to meet new performance demands.

In its desire to make the vision of developmental local government a reality, further pieces of legislation were enacted by the new democratic government. There was the Demarcation Act of 1998 (the Demarcation Act), which developed criteria for the arrangement of new local government boundaries. Under this Act, criteria for the formation of new boundaries for local government included mobility, infrastructure, settlement patterns, administrative and financial viability together with a consideration of those areas under the control of traditional leaders. The aim was largely intended to turn local governments that were inherited from apartheid into functional and viable entities. Through the Demarcation Act, the number of local governments was cut down from 1 200 to 843. Some of the newly formed localities were cross-boundary municipalities that straddled two areas. The latter resulted in service delivery problems and also gave communities the perverse incentive of moving to localities that provided better services. Thus, a further process of demarcation in the year 2000 did away with cross-boundary municipalities and brought the number of local governments from 843 to 284.

While the positive results of demarcation are yet to be realised the one challenge arising from it has been that some of the newly demarcated municipalities must now provide services to larger areas with increased populations, something they were not familiar with. Could this be the reason behind the predicament that some municipalities find themselves in? Cases such as the one involving the community of *Khutsong* presents demarcation not as a solution but as the reason behind further problems. The community of *Khutsong* perceived effective service delivery as a function of their provincial location rather than their municipal one. In other words, the response of this community to redemarcation reiterated citizen's provincial identity rather than their municipal identity. Is this not an indictment against the said municipality and municipalities in general? The struggle by the community of *Khutsong* to be incorporated into Gauteng province also represents a disjuncture between community perceptions and those perceptions held by government officials on the socially beneficial course of

action. Thus, while demarcation was intended to turn localities into viable entities, it ended up having the opposite effect. On the other hand, the case of *Khutsong* municipality can also be viewed as a clear case of effective community participation.

Cashdan (2002:11) have also viewed the demarcation process itself as having contributed to some of the problems that local government is facing. The particular challenge to local governments that emanates from the demarcation process is that it happened alongside other reforms such as the attempt to set their finances and budgeting in order. However these processes were out of step and not coordinated and this put local governments in a difficult position (Cashdan 2002:11). The result was a disjuncture and lack of cohesion in efforts to transform local government.

What is sufficient to mention at this point is the observation that the spate of community protests that took place across the country had something to do with community frustrations at the lack of space to voice their concerns. An established media publication, writing about community protests observed that, "... service delivery protest are a seismograph charting the anger of desperate people whose government is failing them" (Mail and Guardian Editorial 2007). The choice of these desperate measures implies that ordinary mechanism through which concerns could be raised were not effective. In another separate article McKinley and Veriava (2007: 11) echoed the same sentiment that,

"Thirteen years into South Africa's transition, it seems that the only way in which the poor can be seen is by creating an out-of-the-ordinary localized 'crisis' that has the potential to draw the gaze of the national state – and other players within the system – on to the developmental failures of the local state and its individual actors"

By failing to create sufficient space within which communities can participate, localities seem to be failing to carry out one aspect of their post-apartheid

function of being developmental. It is also apparent that even with some of the changes they have already undergone; the ability of local governments to provide services has not improved. Hoffman (undated) found that municipalities performed badly in terms of their core functions, viz. water, electricity, sanitation and waste removal - which are critical to people's everyday living. Further findings by Hoffman also indicated that the ability by communities to access services depended on the willingness to pay rather than the policy discretion of politicians. Hoffman (undated: 29) puts it poignantly that,

“...while democratic elections exist at the local level, strong fiscal accountability severely minimises the substantive content of those elections by predetermining how local governments will allocate services”

Thus politicians at the local government level, as a result of the predominant economic ideology which favoured fiscal austerity, often found themselves unable to steer the direction of spending in line with the developmental needs of their constituencies.

In addition, a majority of municipalities in South Africa are faced with the challenge of delivering services in such a way as to promote the development of sustainable communities and local economies. At present there is a need for accelerated delivery and local economic development, and it is clear that municipalities cannot do it alone. For instance, Mpumalanga has also been plagued by violent service delivery protests, specifically in the towns of Mashishing (formerly Lydenburg) and Volksrust, where residents have blamed poor service delivery on corrupt officials.

3.5.2. Local government regulatory and fiscal environment

Ever since its establishment in 1998, local government has gone through various legislative changes that had an impact on the governance of municipalities, both from a financial and administrative perspective. One such piece of legislation is

the Municipal Structures Act of 2000 (the Structures Act). The Structures Act was aimed at elucidating the position of municipalities and the division of powers among them, especially categories B and C or ordinary local municipalities and districts. The latter were given the function of district-wide coordination and the former of providing basic services. Category C municipalities or districts were also given the power to intervene in category B municipalities where the latter failed to carry out their assigned functions. Subsequent amendments to the Structures Act gave category C municipalities the power to provide some of the basic services assigned to category B municipalities due to capacity constraints of the latter.

Among the difficulties emanating from this two-tiered system of local governments was the fact that districts were assumed to have capacity whereas this may have actually not been the case. Their accountability to local populations was also limited and participation by communities might have been reduced due to their size and lack of proximity (Perret 2007). This held implications for the promotion of local democracy, which is an important component of developmental local government. There are currently 6 category A municipalities, 231 category Bs and 47 category Cs. While new legislation was aimed at reconstructing apartheid-created localities, it is clear that it also brought with it new challenges. Are these challenges putting a brake on the ability of local government to become developmental? If transformation was to be repeated, what would have to be done differently?

Other additional pieces of legislation are the Municipal Finance Management Act, which calls for efficient spending and proper budgeting and the Property Rates Act, which introduced one method of property assessment for local governments. These two pieces of legislation were intended to put local governments on a sound financial footing. However, recent assessment indicates that, even with “state-of-the-art municipal finance legislation, local governments [were] set to underspend on their capital budgets by as much as a third” (Mail and Guardian

Editorial 2007). Among some of the capacity constraints affecting local governments is the lack of appropriately experienced financial managers. A study of local government indicated that “lack of state capacity is worse at local government level” since “79 out of 231 local municipalities, and 4 out of 47 district municipalities, had no technical or engineering expertise” (Ramphela in Dinokeng Scenarios 2009: 19). The Municipal System Act of 2000 is another law that was introduced and it set out how municipalities should operate. In particular, the Municipal Systems Act introduced Integrated Development Planning (IDP) in which municipalities should interact with communities to plan for the areas under their jurisdiction. The IDP process has since replaced the need to come up with land development objectives (LDOs).

Even with the legislated nature of community participation in the planning of municipalities, its translation into action has not materialised to a satisfactory level. According to Mathekga and Buccus (undated) it is this lack of participation and inclusion in decision-making process that communities are currently protesting against. Since 2004, public protests have become a common occurrence in municipalities across South Africa (Rossouw 2007: 6). In a study conducted on the underlying causes behind these community protests, which include, *inter alia*, unhealthy intergovernmental relations, poor housing delivery management, improper financial management, non-existent youth development programmes and ineffective ward committees, “institutional lack of transparency was arguably the single most important reason for the protests” (Botes 2007: 9). Local municipalities operate at arms length and are failing to sufficiently involve communities into their processes. A similar observation is made by Cashdan (2002: 18). He maintains that participation in local government matters has not been as significant as anticipated in the Local Government White Paper. A particular contributing factor that Cashdan identifies for this state of affairs is globalisation and the limitations it has imposed on democratic participation by creating distance between decision-making and political representation. Mlinar

(1995) argued along the same line by maintaining that globalisation has reduced the probability of public participation at local government level.

3.5.3. Unfunded mandates

National government and provincial governments must support, and strengthen the capacity of municipalities to manage their own affairs, to exercise their powers and to perform their functions (Sutcliffe, 2002:1). But still, Derichs and Einfeldt (2006:9) maintain that a considerable number of problems remain unresolved. A case in point is the so called 'unfunded mandates'. Unfunded mandates are created because sub-national governments at times find themselves having to perform functions which are not assigned to them, yet no commensurate funding is made available for the execution of such functions. The Constitution of South Africa emphasises co-operative governance and inter-dependence among the three spheres of government and at the same time recognizing that each sphere of government is mandated to perform certain functions as assigned to them. In addition, the national and provincial governments have a constitutional mandate, in section 154 of the Constitution to support and strengthen the capacity of municipalities in the exercise of their functions and powers as well as managing their own affairs. Provinces are further constitutionally mandated in section 155 to provide monitoring and support to local government.

National as well as provincial legislation, including schedules 4B and 5B assign powers to municipalities to execute their functions. According to DPLG (2002:9) these assigned powers cannot be removed by ordinary statutes or by provincial acts, save for a Constitutional amendment. Provincial governments also have powers over Schedule 4B and 5B matters, but only to the degree set out in section 155 of the Constitution.

In the same vein, the Guideline document on provincial-local intergovernmental relations (2002:3) outlines key elements which are to be adhered to in the quest to realise effective cooperative governance among the spheres of government. These elements provide clear instructions to each sphere of government to:

- respect the constitutional status, institutions, and powers and functions of government in the other spheres;
- exercise their powers and perform their functions in a manner that does not encroach on the geographical, functional or institutional integrity of government in another sphere;
- co-operate with one another in mutual trust and good faith by:
 - assisting and supporting one another;
 - consulting one another on matters of common interest;
 - co-coordinating their actions and legislation with one another; and
- adhere to agreed procedures (DPLG 2002:7).

It should be noted that even though the Constitution and legislation clearly provide for the functional responsibilities of sub-national governments, National Treasury (2006:44) maintains that unfunded mandates still pose a challenge in the intergovernmental system. In this regard, the South African Local Government Association (SALGA) proposed that there should be an intense focus on the impact of unfunded mandates at sub-national government level (Parliamentary Monitoring Group 2009: 2). The section below details evidence of unfunded mandates as they prevail in the intergovernmental framework of South Africa.

3.5.3.1 Evidence of unfunded mandates

Biyela (2008:3) reiterates the fact that unfunded mandates are a result of legislative processes and delegation by national and provincial spheres of government to local government without the accompanying funds being made

available. According to DBSA (2009:1) the primary economic function of local government is to provide household infrastructure and municipal services. However, DBSA (2009:1) contends that poor municipalities are faced with a variety of challenges including backlogs on household infrastructure, low revenue bases and insufficient skilled management. Unfunded mandates (such as minimum service standards in health, education and infrastructure), unspecified responsibilities, and new obligations within existing functions have created a number of financial consequences. One of these is that there may be significant disparities between the powers and functions assigned to spheres on the one hand, and the revenue on the other. Another consequence is that provincial governments, and in particular municipal authorities, face overwhelming accounting and reporting responsibilities for functions conducted on an agency or delegation basis without funds or capacity being made available (National Treasury (2008:51).

In addition, Biyela contends that with respect to health care, food, water and social security as recognized by section 27 of the Constitution, most rural municipalities find themselves having to allot a larger portion of their equitable allocation for the provision of these services. Municipalities also find themselves having to assist with the building of crèches and introducing community gardens for food provision, without any revenue made available by either the national or provincial governments for these functions.

Additional issues relating to unfunded mandates at sub-national government level include the following:

- Public Libraries. Anderson (2006:2) maintains that in terms of Schedule 5 of the Constitution public libraries are the competency of the national Department of Arts and Culture. However, Anderson continues to mention that decisions and spending on libraries occur at either municipal or provincial sphere of government, resulting in provinces and municipalities having to devote their resources in the implementation of the library

function. Anderson continues to mention that in the majority of municipalities library personnel are paid by municipalities and this leads to approximately 80% of the municipal budgets being consumed for salaries and allowances. A suggestion was therefore made that a constitutional amendment handing over the control of libraries to municipalities should be considered. Alternatively, provincial legislation assigning the library function to municipalities is another option (Anderson 2006:3).

- Unfunded mandates in education. Litvack (2006:8) notes that there is currently a global trend of decentralizing education systems. Most countries are continuously investigating possibilities of some form of education decentralization. The process involves transferring decision-making powers from central Ministries of Education to provincial governments, local governments, communities, and schools. In South Africa, the education function is clearly stipulated in Schedule 4A of the Constitution, where education at all levels excluding tertiary education is a concurrent function of both the national and provincial governments. However, Lemon (2003:5) maintains that while policy development and coordination are national government responsibilities, the management and financing of school education is devolved to provincial governments. Lemon continues to mention that this has contributed to a situation where national government policy goals and objectives are inconsistent with the administrative and resource limitations of provinces, thus resulting in unfunded mandates. These unfunded mandates are brought about by, amongst other things, when policy commitments found in central government legislation require provincial financial and human resources capacity to implement. An example of this national government policy aspiration is the reduction of learner: teacher ratios without any commensurate increase in resources to pay teachers' salaries (Lemon 2003:11).

- Unfunded mandates in the provision of housing. The mandate on housing is entrenched in the Constitution and other national and provincial legislation. In particular, Schedule 4A of the Constitution provides that housing is a concurrent function between the national and provincial governments. Biyela (2008:4) also mentions that unfunded mandates arise because of a number of challenges involving lack of consultation when legislation is formulated. For instance, the Constitution recognizes the right of everyone to have access to shelter. Biyela (2008:4) mentions that even though the provision of houses is a concurrent competency between national and provincial governments, municipalities, due to their close proximity to communities are flooded with requests for houses. Derichs and Einfeldt (2006:9) concur with Biyela when they mention that national government raises the standards for the supply of adequate housing, but the available funding does not reflect the additional costs. This might force municipalities to cover the remaining gap out of their own budget. With regard to this, a sound system for the assessment of costs should be introduced and the financial implications being discussed simultaneously.

3.5.4. Capacity issues

National Treasury (2008:181) maintains that municipalities need sufficient workers and the combination of the correct skills to deliver services effectively. However, National Treasury (2008: 2 and 195) mentions that even though national government has provided extensive support to municipalities over the past few years as a way of helping this sphere of government to function better, many municipalities still do not address issues effectively. The support referred to is in the form of more money, targeted support programmes, improved policy and laws. The other challenge regarding capacity that the National Treasury has highlighted relates to the fact that there has been relatively modest contribution that municipalities make to overall employment.

3.6. Summary and conclusions

The chapter presented an analysis of revenue and expenditure assignments in South Africa, based on the theoretical framework of fiscal decentralisation. South Africa achieved democracy in 1994. It is a unitary state governed at three levels by the 1996 Constitution. The Constitution requires cooperative governance and recognizes the three spheres of government as “distinctive, interdependent and interrelated”. Thus while the Constitution recognizes each sphere of government as independent, it promotes a consultative approach to solving any differences that may arise. On the expenditure side, the Constitution is instrumental in assigning functions for each sphere of government. The Constitution also assigns revenue raising powers to the sub-national governments. However, a situation exists that significant revenue raising powers lie with the central government compared to the provinces and municipalities which are assigned less taxing powers.

Provision is also made for equitable allocations in the South African fiscal system. Intergovernmental fiscal transfers are desirable for a variety of reasons. They address issues relating to, amongst other things, vertical and horizontal fiscal imbalances as well as the existence of jurisdictional spill-overs among sub-national governments. According to Krugell (1999:207) in South Africa the existence of a vertical fiscal imbalance intergovernmental fiscal system is a result of the concentration of taxation powers at the national sphere of government, while provinces have limited access to own sources of revenue. Krugell (1999) continues to argue that despite the limited revenue at the disposal of provincial governments, many expenditure responsibilities are decentralised.

The chapter has identified additional weaknesses regarding the assignment of revenue and expenditure responsibilities to sub-national governments. The challenges identified relate to service delivery issues at local government level; capacity issues and the question related to unfunded mandates. Notwithstanding

the challenges faced by sub-national and provincial governments in South Africa regarding the current exercise of revenue assignment and expenditure responsibilities, there is always scope for improvement. Sub-national governments can improve on their efforts to collect revenues assigned to them as well as to deliver public goods as mandated by the Constitution. This is necessary because there are concerns that intergovernmental fiscal grants contribute to some municipalities and provinces to not seriously endeavor to maximise their own revenue collection. There are also opportunities to increase coordination among the three spheres of government in South Africa.

Chapter four focuses on fiscal decentralisation in developing as well as developed countries which are already implementing fiscal decentralisation in order to deal with the inefficiencies and ineffectiveness of providing publicly provided goods and services. It is envisaged that the study of these countries will assist in identifying similarities with South Africa, and where possible, provide meaningful lessons.

Chapter 4: A comparative analysis of fiscal decentralisation within selected developing and developed countries

4.1. Introduction

Chapter three provided an analysis of fiscal decentralisation in South Africa. This chapter envisages making a comparative analysis of fiscal decentralisation between South Africa and selected developing and developed countries that are already implementing fiscal decentralisation. The comparative analysis is based on the comprehensive discussion in chapter two. The countries selected for the comparative analysis are India, Hungary and Spain. The appropriateness of selecting these three countries is informed by the following justifications: India is a middle-income country which is almost at a similar level of development with South Africa and has been implementing fiscal decentralisation for a very long time. Similarly, India has a unitary constitution, and planning occurs mainly at the central government level. It is on this basis that it is hoped that South Africa could draw meaningful lessons from India. Hungary is also similar to South Africa in the sense that it is a unitary country governed at three levels of government. Spain, like South Africa, is characterised by important cultural, linguistic and historical differences across regions. It is therefore anticipated that the experience of sub-national governments' fiscal framework in Spain has certain similarities to South Africa, which are relevant for this study. The comparative analysis between South Africa and the three selected countries is largely based on pillars of fiscal decentralisation which include the assignment of expenditure responsibilities, the allocation of taxing powers, the design of intergovernmental fiscal transfers as well as sub-national borrowing.

The Chapter is structured as follows: Section 4.2 deals with fiscal decentralisation and the improvement of sub- national government autonomy and accountability. Section 4.3 focuses on the case study analysis of selected countries. The pillars of decentralisation, including the assignment of taxing powers, expenditure responsibilities, intergovernmental fiscal transfers as well as sub-national borrowing will be made in section 4.3.1, Hungary (section 4.3.2) and Spain in section 4.3.3. Section 4.4 tackles the issue of fiscal decentralisation, service delivery and accountability. Section 4.5 focus on lessons which can be drawn by South Africa based on the case study analysis of the selected countries. Lastly, section 4.6 provides conclusions and possible recommendations.

4.2. Fiscal decentralisation and the improvement of sub- national government autonomy and accountability

Dabla-Norris and Wade (2002:15) argue that some degree of autonomy for sub-national governments to decide on expenditure and revenue is required for realizing the efficiency gains of decentralised government and supporting macroeconomic stability. In as far as autonomy on the expenditure side is concerned; Dabla-Norris and Wade maintain that sub-national governments require the flexibility of the budget in determining, within reasonable limits, expenditure priorities and a combination of output and methods of production. In the same vein, Fjelstad (2006:5) argue that in instances where decentralisation of expenditure is not accompanied by decentralisation of revenue generation, sub-national government officials usually overlook the financial implications of their spending. In addition, Dabla-Norris and Wade (2002:15) maintain that sub-national governments should have the ability to set some tax rates and be allocated at least one significant tax source. It is also important for vertical fiscal imbalances to be reduced to allow sub-national governments to perform the functions which are assigned to them. Lastly, Dabla-Norris and Wade also stress the importance of sub-national borrowing for purposes of supporting hard budget

constraints and reducing the moral hazard of implicit or explicit bail-outs by central governments.

Most of the public finance literature's precondition for sub-national government autonomy is for the latter to be in a position to raise own sources of revenue. However, in this regard, Ebel and Talierco (2004:8) mention that many country comparative studies are unclear about the key question of what constitutes a sub-national tax. According to Bahl (1999:6) countries that pursue fiscal decentralisation differ in that, amongst them, there would be those countries who give more autonomy to local governments than their counterparts.

The study intends making an in-depth comparison between the fiscal decentralisation experiences of the selected countries, despite factors such as, in some instances, dearth of information pertaining to the similarity of these countries. According to Joumard and Kongsrud (2003:17) assessing the degree of fiscal decentralisation and drawing cross-country comparisons is difficult at times because fiscal autonomy has several dimensions, including the authority to decide on the level and composition of spending, revenues and borrowing which often interact and which are not always easy to rank. This view is also supported by Dabla-Norris and Wade (2002:10) when they argue that one complexity in comparing the extent of decentralisation to date across the various countries is that fiscal decentralisation is a multifaceted experience, involving not only the allocation of expenditure and taxing powers among different levels of government, but also the extent of sub-national policymaking autonomy. They continue by mentioning that the requirement of improved and effective decentralisation is a close correspondence between responsibility and decision-making authority. However, there are some countries where efficient expenditure autonomy at the sub-national level has been curtailed, and in other countries where sub-national government autonomy is prevalent. An example that Dabla-Norris and Wade (2002:24) give is Hungary, where they maintain that sub-national governments in this country are unrestricted to decide on the approach

of service delivery in accordance with the requirements of the local population and their fiscal means.

In addition to having control over sub-national revenue sources, Johnson (2005:46) has developed four general propositions about the conditions under which decentralisation can enhance accountability for poor and disadvantaged groups in society. These are:

- “active participation among broad elements of society, involving activities such as voting, campaigning, attending meetings, running office, etc.;
- fiscal and political support from higher level authorities within government;
- the existence of competitive political parties whose legitimacy depends at least in part in support of the poor; and
- deeper economic transformations, which encourage traditionally subordinate groups to challenge local authority structures”.

Section 4.3 below provides a comparison of the pillars of fiscal decentralisation between South Africa, India, Hungary and Spain. The comparison is aimed at benchmarking South Africa’s fiscal decentralisation to the selected countries and, and where possible propose meaningful lessons that should be drawn from each country-specific experience.

4.3. Case Study Analysis:

Table 4: Comparative analysis of fiscal decentralisation between South Africa and selected countries

Pillars of fiscal decentralisation	South Africa	India	Hungary	Spain
Assignment of revenue raising powers	Sections 228 and 229 of the Constitution assign taxes to both provincial and local governments respectively. The Constitution and legislations such as the Intergovernmental Framework Act mandates the Financial and Fiscal Commission to make recommendations to parliament as well as government and to also advise on issues related to intergovernmental fiscal relations. However, the FFC identifies inherent structural and institutional limitations in the South African intergovernmental fiscal framework, particularly as it	The Constitution assigns revenue sources to sub-national (state) governments. The Constitution also established the Finance Commission whose role is to advise the central government on how the latter should share revenues with the state.	Like South Africa, Hungary is a unitary country consisting of three levels of governments. Fiscal decentralisation, as it relates to municipal own-revenue sources in Hungary is provided for in the country's Constitution as well as the Act on Local Governments.	The process of decentralisation in Spain was one that was voluntary and general, albeit constitutionally provided and open to all the provincial governments which fulfilled certain requirements. Fiscal decentralisation is asymmetric and the regional governments in have different taxation powers. The Spanish situation is almost similar to South Africa in that the central government has more taxing powers as compared to sub-national governments.

	relates to the provincial exercise of revenue raising. These weaknesses, according to the FFC are found in the organisations, such as the Budget Council and MinMECs which are created mainly to improve cooperation and coordination between national and provincial governments, and to assist in the alignment of policy and budgets on concurrent functions during the budget process.			
Clear Assignment of Expenditure Responsibilities	The Constitution of South Africa clearly articulates the functions of each sphere of government. The Constitution also clearly spells out concurrent functions among the spheres of government.	Like South Africa, the Constitution of India assigns the powers and functions to the central government as well the states. There are those powers and functions which solely belong to	Legislation on the assignment of expenditure responsibilities to sub-national governments, particularly local government is ambiguous. Charbit (2009:7) notes that local governments in	The Spanish Constitution and the statutes of autonomy provide for the assignment of expenditure responsibilities. Similar to the taxation powers of regional governments in

		either the central government or other functions which are the responsibility of the state. The Indian government also has some functions which are concurrent functions of the central government and the states.	Hungary decide whether to make arrangements for the supply of public goods, and in certain instances the provision of goods by local governments is imposed by the Act on local governments.	Spain, there exist differences in the extent of the allocation of expenditure responsibilities in Spain.
Transparency of Intergovernmental fiscal transfers	The Constitution of South Africa provides for nationally raised revenue to be divided equitably among the spheres of government. Transfers from the national government to provincial and local governments consist of conditional as well as unconditional grants. Sub-national governments depend to a large extent on intergovernmental fiscal grants to	The Constitution of India provides for intergovernmental fiscal transfers to sub-national governments. Unlike South Africa, the Constitution further provides for the establishment of the Finance Commission on a five-yearly period to recommend the	The Hungarian local governments are at liberty to levy local taxes. Unlike in South Africa, where the property taxes is assigned to the local government level, in Hungary the property rates tax raises constitutional implications due to the possibility of multiple taxation.	The regional governments in Spain did not have any tax autonomy until 1996. As a result, the situation involving the dependence of Spanish regional governments on intergovernmental fiscal transfers is prevalent.

	provide publicly produced goods and services. The Financial and Fiscal Commission is an independent advisory body established by the Constitution to make recommendations on issues regarding the intergovernmental fiscal framework.	devolution of taxes from the central government to the states and to also provide grants to those states in need of financial aid.		
The exercise of borrowing powers by sub-national governments	The Constitution of South Africa, including legislations such as the Provincial Borrowing Powers Act and the Municipal Finance Management Act empowers sub-national governments to borrow. However, borrowing is controlled and limited to capital expenditures by sub-national governments.	The Constitution of India provides for stringent measures to control borrowing by sub-national governments. States in India borrow predominantly for infrastructure projects.	Hungarian local governments are allowed to borrow subject to a cap. In addition, the Hungarian Parliament has enacted local bankruptcy legislation preventing bailouts by the central government. This is done with the intention to discourage the use of local government assets as collateral.	Similar to South Africa, the Spanish sub-national governments are allowed to borrow for capital investment. The FFPC is tasked with coordinating the borrowing policy of the Spanish national government and the regional governments. Borrowing by sub-national governments is controlled to deal with issues such as fiscal discipline among regional governments.

4.3.1. India and South Africa

The independence of India was obtained from the British colonial rule in 1950. India is a federal country with considerable decentralisation of fiscal and regulatory powers. However, de Silva (2008:10) mentions that India's constitution has unitary features with the central government retaining significant planning powers. The Indian government consists of three levels made up of the central government, state and local level. On the other hand, South Africa is a unitary country consisting of the central government; nine provinces and 284 municipalities.

According to Johnson (2003:16), from the initial phase in the course of independence in India, the country has shown dedication to reducing poverty and the empowering of marginal groups. This commitment to reduce poverty, Johnson argues, has been keenly linked to at least some form of decentralisation. Similar observations can be made with regard to South Africa, as the Constitution provides for, amongst other things, a system of decentralisation to bring government and services closer to the citizens. In addition, since 1994 sub-national governments have become the instruments of delivery of services for a better life for all, even though there are still some service delivery challenges in some parts of the country. Further aspects relating to the similarity of the intergovernmental fiscal system between South Africa and India include the fact that in these two countries, sub-national governments are assigned more spending responsibilities in proportion to tax raising instruments. In other words, the taxing powers are significantly situated in central governments in both countries.

4.3.1.1. Assignment of taxing powers

This section will focus on the current assignments for raising revenues at various levels of the Indian and South African governments. The section will continue to compare the current issues in the assignment of taxes and tax administration in the two countries.

In India, Johnson (2003:21) identifies certain weaknesses relating to the generation of revenue by the states. According to Johnson, the legislatures of the States have the power to decide on which taxes, duties, tolls and fees should be allocated to local authorities and which taxes should be shared by the states. The consequence of this situation is that, while expenditure responsibilities of local authorities are significantly enhanced, there is no suitable legislation that ensures a corresponding assignment of taxes to match expenditure responsibilities. Contrary to Johnson's assertions regarding fiscal decentralisation in India, Malik (2008:18) mentions that decentralisation of fiscal powers between the Indian central government and the states is fairly significant. However, Malik notes that even though the states had the responsibility to devolve powers relating to the collection of taxes and expenditure responsibilities to local governments, there are disparities concerning the implementation of decentralisation across the states. Malik further makes an observation of the slow pace of fiscal decentralisation at the local government level of India, as evidenced by the insignificant revenues being collected at local government level. Rao (2000:9) supports Malik's earlier assertion regarding fiscal decentralisation in India when he stresses the constitutional differentiation of revenue and expenditure responsibilities among the three levels of the Indian government.

On the other hand, South Africa's Constitution entrenches the powers of provincial and local governments to impose taxes in sections 228 and 229 respectively. Section 228 restricts provincial governments and they cannot impose corporate income taxes, VAT excise levies or property taxes, yet they

may impose a surcharge on personal income tax and on the fuel levy (Momoniat 2001: 7). With regard to the imposition of taxes by local government in section 229, the Constitution entitles a municipality to impose, amongst other taxes, rates on property and surcharges on fees for services provided by or on behalf of the municipality. In addition, section 229 provides that in instances where two municipalities have the same fiscal powers and functions with regard to the same area, proper separation of those powers and functions must be made in terms of national legislation, after taking into consideration the following principles:

- (a) “The need to comply with sound principles of taxation.
- (b) The powers and functions performed by each municipality.
- (c) The fiscal capacity of each municipality.
- (d) The effectiveness and efficiency of raising taxes, levies and duties.
- (e) Equity”.

4.3.1.2. Expenditure assignments

This section on expenditure assignments will attempt to compare the current assignment of spending and regulatory responsibilities between India and South Africa. The yardstick that is going to be used in the comparison pertains to the financing of powers and functions allocated to sub-national governments of the two countries.

Similar to South Africa, the powers and functions assigned to various levels of government are spelt out in the constitution of India. According to Rao and Sen (1996:21) the major expenditure responsibilities entrusted to the central government of India include issuing currency, foreign exchange and loans, central banking, interstate trade, transport, major minerals, national highways, railway operations and inland waterways. For reasons pertaining to economies of scale and the efficient delivery of public services, Rao and Singh (1998:9) identify additional functions of the Indian central government, including macroeconomic

stability and those functions that have spillover effects. On the other hand the functional assignments to the states are public order policing, public health, agriculture, land rights, irrigation and industries. Some functions such as education, transport, social security and social insurance are shared between the central government and the states. Further similarities relating to the assignment of powers and functions between India and South Africa include the fact that the constitutions of these two countries spell out exclusive powers and functions of national government, provinces as well as those powers and functions which are concurrent competencies between central and sub-national governments. According to Rao and Singh (1998:10) the concurrent functions between the central government in India and the states include among other things, functions such as economic and social planning, commercial and industrial monopolies and social security. On the other hand, the concurrent functions between the national and provincial governments as stipulated in Schedule 4A of the South African constitution include amongst other things, regional planning and development, population development, health services as well as education at all levels , excluding tertiary education.

4.3.1.3. Intergovernmental fiscal transfers

The Constitution of India assigns certain expenditure responsibilities to the states. Bahl and Martinez-Vazquez (2005:38) identify three types of intergovernmental fiscal grants in India. The first type of transfers is recommended by the Finance Commission and it is the unconditional grants-in-aid for equalisation purposes. The second source of intergovernmental fiscal transfers includes conditional grants which are formula-based transfers by the Planning Commission to fund states' current expenditures such as salaries.

Lastly, there are conditional matching and non-matching grants allocated by line ministries of the central government for a variety of purposes such as family

planning and poverty alleviation. However, Heredia-Ortiz and Rider (2005:3) contend that the tax revenues of the states are not adequate to finance these expenditure assignments, thus necessitating intergovernmental fiscal transfers from the central government. Even then, Heredia-Ortiz and Rider mentions that states in India depend largely on intergovernmental fiscal transfers and are not fiscally disciplined due to a flawed intergovernmental transfer system that promotes fiscal extravagance at the state level. The table below depicts intergovernmental fiscal transfers to the states over a period of time starting from the fiscal years 1993/94 through to 2002/03: Table 5 below shows own revenue from states in India is less than transfers from the central government. According to Srivastava (2003:97) intergovernmental fiscal grants and non-corporate taxes are transferred to those states in need. These include “net proceeds of all union taxes and duties, except the central sales and consignment taxes, surcharges on central taxes and duties”. According to Rao and Sen (1996: 136) the allocation and size of intergovernmental fiscal transfers in India are determined by the Finance Commission which is appointed on a five yearly basis by the President. Heredia-Ortiz and Rider (2005) support Rao and Sen’s observation that the high dependence on intergovernmental fiscal transfers by the states in India has undermined accountability and fiscal discipline.

Table 5: Central Transfers to the States in India

Year	Transfers as a % of Central Tax Revenues	Transfers as a % of State Total Revenues
1993-94	50.10	42.39
1994-95	42.77	39.13
1995-96	42.13	38.50
1996-97	47.96	39.50

1997-98	46.43	39.17
1998-99	38.57	38.78
1999-00	40.28	36.94
2000-01	46.17	38.22
2001-02	49.88	38.76
2002-03	45.32	37.33

Source: Heredia-Ortiz and Rider's calculations from Report of the Twelfth Finance Commission (2004)

The situation similar to India where sub-national governments are largely dependent on transfers from national government is also experienced in South Africa. As has been discussed in Chapter 2, even in the case of South Africa, National Treasury (2008:8) raised a concern that some municipalities are too reliant on intergovernmental fiscal grants from national government, such that the rapid increase in intergovernmental transfers has reduced the amount of revenues that municipalities raise from their own local sources.

According to National Treasury (2008:8) "In some instances municipalities have stopped making serious attempts to collect their own revenues, for example by not collecting money owed to them by customers who can afford to pay. As a result municipalities are becoming more reliant on grants. Again with regard to provincial governments in South Africa, the situation is such that revenue raised by provinces from own sources constitute less than 2.5 percent of total provincial revenue (National Treasury: 2006, 132). Provincial own-revenue is made up of tax receipts such as casino taxes, horse racing taxes, liquor licences and motor vehicle licences. National Treasury (2006: 132) contends that, given their Constitutional mandate, the current situation in South Africa's Intergovernmental

framework (IGFR) system is one in which provinces raise an insignificant amount of revenue compared to their expenditure needs, an outcome that generates an overwhelming dependence on intergovernmental fiscal transfers and this outcome has a negative outcome on provincial expenditure.

4.3.1.4. Sub-national borrowing

Feruglio and Anderson (2003:13) define sub-national borrowing as the capacity for provincial and local governments to borrow money for purposes of executing their expenditure responsibilities. Litvack (2003:14) identifies three key objectives that necessitate sub-national governments to access financial markets. These are:

- “Financing capital investments. Due to the long-term benefits of capital expenditures, and taking into account equity consideration, it is sensible for sub-national governments to borrow in financing them, thus ensuring that future generations also participate their financing.
- Matching spending and the flow of tax revenues. Sub-national borrowing assist in instances where there are disparities between expenditures incurred and revenue generation.
- Promoting political accountability in the sense that “financial markets may signal the poor performance of sub-national governments through increases in interest rates or by simply blocking access”.

De Silva (2008:9) agrees with the above motivations by alluding to the fact that when considerable decentralisation of public finances to sub-national governments occurs in the absence of proper institutional mechanisms, there is a tendency for sub-national governments to spend more and tax less, thus contributing to macroeconomic instability. In such instances, de Silva maintains that it then becomes necessary to impose hard budget constraints on sub-national borrowing. The intergovernmental fiscal relations in South Africa support

borrowing by sub-national governments to finance capital expenditure. The rationale for borrowing for capital expenditure is that costs and benefits of long term assets are being related to each other (FFC 2006:3). In the case of India, Rao (2000:12) mentions that the country's constitution allocates borrowing powers to both the central and state governments. The Indian states are allowed to borrow from the financial markets as well as the central government. In the event that the states are indebted to the central government, the states are required to obtain permission from the central government before issuing new debt.

Bahl (1999) stresses the importance of controlled borrowing by sub-national governments. Notwithstanding this, Liu (2006:12) cites a number of benefits emanating from sub-national borrowing. These include exposing sub-national governments to market discipline, reporting requirements, fiscal transparency and good governance. In addition, assessing the creditworthiness of sub-national governments is one of the prerequisites for sub-national governments' access to capital markets. Liu continues to mention that countries such as India and South Africa are making progressing with regard to public reporting of sub-national government finance.

4.3.2. South Africa and Hungary

This section compares the experiences of fiscal decentralisation between Hungary, as one of most the decentralised countries in Europe and South Africa which has a constitution and legislative framework that provides for the decentralisation of fiscal system of government. There are a bit of similarities between the Hungarian decentralisation process and South Africa. The reform of the intergovernmental system in Hungary was politically motivated and it also was implemented on a gradual scale. According to the Canadian Urban Institute (2006:2), the Hungarian decentralisation was initiated in the early 1990s due to

factors including, amongst other things, the fact that the country was experiencing a difficult transition to democracy and a market-based economy. The Hungarian decentralisation contributed to immense autonomy and discretion of local governments, with the legislative framework ensuring that sub-national governments are assigned a wide variety of functions and taxing powers (Dethier 2000:3). The Canadian Urban Institute (2006:2) further notes that sub-national governments in Hungary were facing a situation where they would no longer be able to rely on financial transfers from the state to fund their service delivery responsibilities, hence it was imperative for sub-national governments to explore attaining fiscal autonomy by increasing their collection of own revenue and encouraging the participation of the private sector in the delivery of services. In addition, sub-national governments' autonomy was also emphasised to allow them to become credit-worthy in order to gain access to capital markets. The Canadian Institute's view is further supported by Vigvari (2006:3) when he mentions that the local government in Hungary was formed as a result of the political forces which shaped that country. Vigvari further alludes to the adoption of the Hungarian Constitution and the Act on Local Governments containing which strengthens the establishment of local governments. The situation in South Africa is also such that the Constitution the primary legislative framework that provides for the three spheres of government, including local government.

4.3.2.1. Assignment of taxing powers

According to Vigvari (2006:8) the Constitution in Hungary has enacted specific policies relating to tax legislation. This legislation as laid out in the Constitution specifies the detailed rules regarding the types of local governments, their obligatory powers and the economic foundations of the local government processes (Charbit 2009:5). A system of local government taxation was introduced in Hungary in 1990 for purposes of enabling local governments to deliver public services. Charbit (2009:6) stipulates that "under authorisation by

and in accordance with the act on local taxes, the council of elected representatives of a municipal government may issue decrees imposing local taxes". The taxes which are collected by the local governments in Hungary include, amongst others the following taxes:

- Building tax imposed on taxpayers for buildings and parts of buildings for residential or other purposes, in the jurisdiction of a particular municipality;
- Land tax imposed on vacant sites in the jurisdiction area of a given municipal government;
- Communal tax for private individuals which is imposed on taxpayers who are property owners or alternatively private individuals holding rental rights of residential property;
- Communal tax for business is imposed on employers and business owners in a given municipal area;
- Tourism tax imposed owners of a building suitable for use as holiday accommodation and including private individuals staying at least one night as guests, and
- Local business tax collected from commercial activities within the jurisdictional area or head office in a particular municipality (OECD 2005:43).

Similarly, sections 228 and 229 of the South African Constitution empower both local and provincial governments to impose taxes respectively. The taxes which can be imposed by municipalities include property taxes and surcharges on fees for services provided by or on behalf of the municipality. Provinces on the other hand collect taxes and various fees, mainly from motor vehicle licences and gambling levies from horse racing. Provinces are also empowered to impose a surcharge on personal income tax. In contrast to the situation in South Africa, where property taxes are assigned to the local sphere of government, the Hungarian situation is such that introduction of property taxes at local government raises constitutional problems due to the possibility of multiple taxation (Vigvari: 2006:11). The similarity between the Hungarian and the South

African local governments involves the imposition of the local business tax. While in South Africa the local business tax was proposed for local government as one of the possible taxes to replace the RSC/JSB levies at local government, in Hungary, the local business tax is already levied by municipalities.

4.3.2.2. Expenditure assignments

Kumar (2003:35) maintains that fiscal decentralisation contributes to enhanced allocative and productive efficiency. In Hungary, the decentralisation of the fiscal systems contributed to a number of desirable outcomes such as municipalities assuming new functions including urban planning and development, economic development and environmental management (Canadian Urban Institute 2006:3). According to Dethier (2000: 3) the common principle of subsidiarity became the order of the day due to decentralisation in Hungary, where administratively and economically competent sub-national governments were responsible for the provision of public services. “Local governments were obliged to provide primary education, basic health and social welfare provisions, waste disposal, safe drinking water, public lighting and to maintain local public roads and cemeteries” Dethier (2000: 4). However, Charbit (2009:7) mentions that local governments are entitled to make a decision and determination of the manner and approach of performance of their responsibilities in accordance with the requirements of the local population and the availability of fiscal resources. On the contrary, legislation as well as the Constitution of South Africa in Schedules 4 and 5 assign functional areas to both provincial and local governments.

4.3.2.3. Intergovernmental fiscal transfers

Dethier (2000:4) maintains that the reliance of local government on intergovernmental fiscal transfers is quite significant. According to Dethier(2000:4), “local government expenditures in Hungary have accounted for

roughly 20 percent of public sector expenditures and 35 percent of public sector investment. Locally raised revenues over which localities have control amount to only 20 percent of total revenues, or roughly 3 percent of the Gross Domestic Product (GDP). As a result, local governments depend heavily on transfers from other parts of the public sector to finance their expenditures". In the same way, the reliance of provincial and local governments in South Africa on intergovernmental fiscal transfers can never be overemphasized. The provincial and local governments in South Africa are assigned revenue sources of their own, but intergovernmental fiscal transfers are also predominantly part of the funds for these sub-national governments in the delivery of services mandated to them.

4.3.2.4. Sub-national borrowing

National Treasury (2005: 12) mentions that oversight by national government provides a basis for loans to be raised for purposes of capital expenditure and for bridging temporary revenue shortfalls. National Treasury also reiterates the provisions of the Constitution for national legislation to govern the power of provinces and local government to borrow. According to Bahl (2008:10) over and above raising revenues from taxation and charges, governments normally resort to borrowing money, particularly for capital investments. In view of the fact that these borrowed funds have to be paid back in the future; sub-national borrowing can also be considered as deferred taxes. However, Plekhanov and Singh (2007: 24) maintain that giving unlimited borrowing capacity to sub-national governments is not likely to be the best possible solution. It is in this regard, that in South Africa borrowing by sub-national governments is monitored by legislation as well as in the Constitution. The issue of no bail-outs as espoused in legislation is necessary to guard against irresponsible borrowing by sub-national governments. Plekhanov and Singh (2007: 7) continue to mention that in countries such as Hungary, central governments endeavor to manage sub-

national borrowing by applying rule-based controls to monitor the level of accumulated sub-national debt.

4.3.3. South Africa and Spain

Spain is a fiscally decentralised country consisting of three levels of government, namely the central, regional as well as local. The rationale for fiscal decentralisation in South Africa is almost similar to the decentralisation in Spain, albeit a few differences which can be drawn from these countries. The decentralisation processes of both countries are specified in their respective Constitutions. Garcia-Mila and McGuire (2002) commend the peaceful and fast transition from a dictatorship to democracy in Spain. Similarly, South Africa moved from apartheid to a democratic dispensation in 1994 in a peaceful manner. In addition, Yemek mentions that political liberalization and economic globalisation are the key features that unlocked the potential for fiscal decentralisation in the case of South Africa.

The Bill of Rights in South Africa promotes the progressive realisation of basic needs and services to citizens of the country within the available limited resources. However, Yemek (2005:2) maintains that large socioeconomic backlogs and under-servicing across social groups and regions is still a challenge confronting the national government. In this regard, Yemek asserts that the plan for the intergovernmental fiscal system in South Africa is to deal with these challenges through the allocation of responsibilities to each sphere of government. Yemek (2005:3) continues to mention that the rationale for fiscal decentralisation in South Africa is “to provide a framework for the efficient provision of public services by aligning expenditure with regionally based priorities”. On the other hand, the Spanish government implemented its decentralisation system for political reasons as opposed to economic considerations.

Garcia-Mila and McGuire (2002:11) notes that as much as the Spanish decentralisation process presents a learning experience for developing countries, there are certain aspects of the Spanish decentralisation which are not commendable for replication. For instance, Garcia-Mila and McGuire argue that the asymmetric decentralisation in Spain is a cause for concern as it is sometimes linked to lack of transparency and may hide perverse economic incentives, thereby resulting in inefficient regional decision making.

4.3.3.1. Assignment of taxing powers

Vinuela (2004:12) notes that the division of taxes among the levels of government in Spain is readily discernible, with the national government retaining the main broad-based taxes and local governments being financed through property taxes, motor vehicle taxes and fees as well as user charges. The Spanish assignment of taxes is almost similar to the situation in South Africa. The situation where sub-national governments have limited own revenue sources is prevalent in both Spain and South Africa. According to Donnelly in Mail and Guardian (2009:1) the assignment of revenue raising powers, particularly provincial governments in South Africa is limited, yet expenditure responsibilities are significant. Donnelly asserts that this was intentionally put into operation in the intergovernmental fiscal relations system and the Constitution to ensure that there is redistribution of resources across provinces. Mashele (2009:2) confirms Donnelly's observation when he points out that the intergovernmental fiscal system is designed in such a way that significant revenue raising powers are allocated to the national government. Vinuela (2004:12) also mentions that in the Spanish intergovernmental system the situation is such that the decentralisation of expenditure responsibilities to sub-national governments proceeded at a fast pace, with the taxing powers of the latter lagging behind.

4.3.3.2. Expenditure assignments

According to Davies et al. (2006:48) the Constitution and the statutes of autonomy make provision for the assignment of expenditure powers to sub-national governments in Spain. The Spanish assignment has some similarities with South Africa in the sense that the assignment of expenditure powers and responsibilities to local and provincial governments is clearly stipulated in both the Constitution and the legislative framework of the country. However, with regard to Spain, Davies et al. (2006) also notice that the Constitution and the statutes were intentionally written in an ambiguous way. According to Davies et al. (2006) there was confusion regarding the accurate allocation of powers among levels of the Spanish government. This was due to the fact that the phrase "exclusive competence" in both the Constitution and statutes essentially referred to what were in many instances shared or concurrent powers. On the contrary, section 3 of the South African Constitution makes provision for cooperative governance among the spheres of government, where it is clearly stipulated which powers and functions are concurrent (a shared responsibility) or a sole responsibility. The Constitution mandates central government to take exclusive responsibility for matters relating to foreign affairs, defence, intelligence, tertiary education, national transport and national taxation. Provinces, on the other hand, can either be solely responsible for an issue, or can share responsibility with the national government. The areas which the Constitution gives provincial government exclusive competence include ambulances, libraries, liquor licences, provincial roads, recreational amenities and provincial sport. The "concurrent areas of competence" between national and provincial governments include agriculture, schools, police, public transport and health and welfare services. Lastly, the local sphere of government is assigned responsibilities such as cleansing, sewerage and traffic as well as the development of their communities

4.3.3.3. Intergovernmental fiscal transfers

Garcia-Mila and McGuire (2002:7) note that the largest sources of revenue for sub-national governments in Spain are intergovernmental fiscal transfers from the national government. Similar to South Africa, Garcia-Mila and McGuire (2002) mention that the unconditional grant in Spain was distributed according to formulas that differed for the high and low responsibility regions, with the population being the most important factor. Once more, there is a similarity regarding the way the intergovernmental transfers have been determined overtime. As can be noted in the case of South Africa, the formula for the allocation of the equitable share has been reviewed over the years. In the same vein, the Spanish formula for distributing transfers has also undergone some revisions over the years.

In South Africa, the size of the equitable share going to each province is determined by a formula whose objective is to divide the funds collected nationally among the provinces based on the relative need and the different demographic and economic profiles of each province. The provincial equitable share formula has undergone a number of revisions since its inception. However, the latest formula according to National Treasury (2008:18) is made up of seven components, each of which allocated a percentage weighting. The weightings are as follows:

- “An education share based on the average school-age population (ages 6–17) and the number of learners in schools (41 per cent).
- A health share based on the proportion of the population without access to medical aid funding (19 per cent).
- A social security component based on the estimated number of people entitled to social security grants – the elderly, disabled and children – weighted by using a poverty index derived from the 1995 Income and Expenditure Survey (18 per cent).

- An economic output share based on the distribution of total remuneration in the country (7 per cent).
- A basic share derived from each province's share of the total population of the country (7 per cent).
- An institutional component divided equally among the provinces to contribute to the costs of running a provincial government that are not associated with the size of population (5 per cent).
- A backlog component based on the distribution of capital needs as captured in the schools register of needs, the audit of hospital facilities and share of the rural population (3 per cent)".

In contrast to the provincial equitable share formula described above, Table 2 below depicts the variables as well as the weights which have been taken into account in the Spanish formula.

Table 6: The variables chosen for the Spanish formula and their weights

Common functions	1987-91	1992-96
Population	59	64
Surface	16	16.6
Administrative units	24.3	2
Relative poverty	4.2	17
Fiscal effort	5	2.7
Population dispersion		2
Education		
Population	84.4	94
Population dispersion		0.6
Surface	15	3.5
Relative poverty	0.4	2.7
Fiscal effort	1.7	1.82
Constant	-2.5	
Administrative units		0.4

Source: Vinuela (2000:16)

Table 6 above indicates that intergovernmental fiscal transfers in Spain are distributed in line with weighted population, and the weights increasing as the

population size rises in order to explain the higher expenditure responsibilities and needs of municipalities (Solé-Ollé 2006:17). In addition, Blochliger (2007:72) concurs with this observation when he mentions that more than 70 percent of income of sub-national government revenue in Spain is derived from intergovernmental fiscal transfers. In South Africa, education excluding tertiary education is a concurrent function between national and provincial governments. The same observation can also be made with regard to Spain. According to Font et al. (1999:23) the national government and regional authorities are responsible for the supervision of policies that deal with education.

4.3.3.4. Sub-national borrowing

Dabla-Norris and Wade (2002:31) maintain that allowing sub-national borrowing from financial markets is necessary to enhance resource allocation and accountability of public service delivery. However, Dabla-Norris and Wade caution that in situations where there is an absence of hard budget constraints and tough regulatory and supervisory measures, sub-national government borrowing has the potential of compromising the macroeconomic stability of a country. Litvack (2003:16) shares these views by advocating for a well-designed framework to ensure that sub-national borrowing does not provide perverse incentives for excessive lending by markets and excessive borrowing by sub-national governments.

In terms of provincial and municipal borrowing in South Africa, the Constitution permits borrowing for capital and bridging purposes only (Momoniat 2001:8). In addition, legislation such as the Borrowing Powers of Provincial Governments Act of 1996 (the Act) seeks to provide norms and conditions which provincial governments are expected to adhere to when negotiating loans. However, there have been subsequent amendments to the Public Financial Management Act (PFMA), which sought to, amongst other things repeal the provisions of the Act.

In this regard, the FFC has raised serious concerns to the intended repealing of the Act. According to the FFC (2008:7) “the power of a province to borrow as provided for in section 230 of the Constitution in principle involves more than matters of public finance management”. The FFC is concerned that the integration of the Act into the PFMA diminishes the provincial governments’ power to borrow to a mere financial management issue rather than a conscious policy decision that provinces may possibly desire to pursue. With regard to municipalities, Allan et al. (2005:6) assert that the Municipal Finance Management Act (MFMA) of 2003 has led to renewed interest in municipal borrowing. Allan et al. note that in relation to lenders to the local government sphere, the Development Bank of Southern Africa (DBSA) dominates the municipal borrowing market, followed by other commercial banks as well as Infrastructure Finance Corporation Limited (INCA).

In the case of Spain, the Fiscal and Financial Policy Council (FFPC) is the advisory body qualified to make decisions on issues relating to regional financing. The FFPC has the responsibility of coordinating the borrowing policy of both the national as well as sub-national governments (Vinuela 2004:22). Davies et al (2006: 153) mentions that there are three conditions on which sub-national government borrowing is permissible in Spain. Firstly, sub-national governments can borrow in the short term for cash management purposes. Secondly, long-term borrowing by sub-national governments is utilised for capital investments. Lastly, borrowing is allowed provided sub-national government debt service does not exceed 25 percent of current revenues. In terms of long term sub-national borrowing, the Spanish fiscal framework system is similar to South Africa in the sense that long term borrowing is allowed for purposes of financing capital investments.

4.4. Fiscal decentralisation and service delivery and accountability

The section seeks to briefly look at whether fiscal decentralisation lead to unsustainable fiscal deficits or does it contribute to the efficient and better provision of publicly provided goods. Rakate (2006:11) define the delivery of public services as the local, municipal, or larger-scale's supply of services which contribute to the improvement of the lives of all the citizens, in line with the latter's preferences. Rakate maintains that one of the justifications for taxation is the anticipation that these services reach the people and localities they are meant for. An example of sub-national government services that he gives are sewage, refuse removal and street lighting. Does the allocation of revenue and expenditure responsibilities to lower levels of government contribute to desirable outcomes such as efficient delivery of public services, sub-national government autonomy as well as accountability to the citizens?

There are differing views regarding whether fiscal decentralisation enhances service delivery at sub-national government level. The traditional public finance literature purports that transferring service provision to sub-national government is consistent with the notion of subsidiarity, and that "it results in improved efficiency in the delivery of public services and, hence, a more efficient allocation of resources in the economy" (Dabla-Norris & Wade, 2002:3). The appropriateness of having public services provided by sub-national government is the latter's proximity to the citizens. Ekpo (2007:1) also supports this assumption because of the impression that sub-national governments are more familiar with the preferences of their voters for public services than central government. Boex (2001:17) also argues that one of the reasons for implementing a decentralised system of intergovernmental fiscal relations in many countries is to encourage the efficient delivery of public services on the basis of the assumption that sub-national governments are more involved, accountable and quick to respond to the needs of their communities.

However, Ekpo continues to argue that decentralisation has the potential to lead to ineffective delivery of public services in instances where corruption by officials is prevalent. Other factors which might contribute to sub-national not delivering public services efficiently, is when decentralisation is implemented on the basis of diffusing political tensions (Ekpo 2007:16). In addition, issues relating to capacity at sub-national government should also be addressed to ensure that sufficient financial and human resources are provided. Ekpo (2007:10) also stresses the importance of the existence of a proper understanding of the legislative framework to manage the functional relationship between the national and sub-national governments. However, Ter-Minassian and Fedelino (2005:3) maintain that the evidence regarding the contribution of fiscal decentralisation to enhanced service delivery is not that conclusive.

4.6. Lessons for South Africa

The fiscal decentralisation system of South Africa has come a long way since the country's first democratic elections in 1994, when sub-national governments became conduits of delivery of services for a better life for all. There have been many changes, many achievements and challenges. The Constitution of South Africa provides for a system of decentralisation to bring government and services closer to the citizens. In this regard, the autonomy of sub-national governments to determine the degree of expenditure and revenue is important in the realisation of efficiency gains of decentralised government. It is also important for sub-national governments to have some flexibility with regard to their budget determination within reasonable limits, of course. It is also imperative for revenue generation at sub-national government level to enable the latter to be in a position to execute the powers and responsibilities assigned to them. Intergovernmental fiscal transfers are also an important source of sub-national government revenue streams, in ensuring that equitable provision of public services is realised. Another issue concerns the importance of sub-national

government borrowing which should be motivated by the reduction of moral hazards of bail-outs by the central government.

The comparative analysis between India and South Africa demonstrate a number of similarities regarding the two countries. For starters, the initial phase of the Indian independence dispensation and decentralisation was dedicated to the reduction of poverty and the empowering of marginal groups. In the same way, the Constitution of South Africa promotes the roles of provincial and local governments to be instruments of delivery of services for a better life for all. Even though sub-national governments in South Africa have made tremendous progress to deal with the challenges pertaining to the delivery of basic services, it could be argued that there is still room for improvement based on the number of public protests that the country experiences as a result of perceived lack of service delivery. After thorough consideration of all the progress and challenges achieved thus far, the question remains whether the design of the fiscal decentralisation system in South Africa assists in the facilitation of delivery of services in South Africa. There are further similarities between India and South Africa pertaining to the concurrent allocation of functional responsibilities between the central governments of the two countries and their provincial governments. In addition, issues relating to vertical fiscal imbalances at sub-national government level are experienced between India and South Africa.

With regard to Hungary, Spain and South Africa, the inability of sub-national governments in both countries to adequately collect their own taxes of which they have absolute control is a cause of concern. However, in the case of Hungary the situation is a bit different from the experiences of the other selected countries in the sense that Hungarian sub-national governments are unrestricted to determine the strategy of service delivery in line with the requirements of the local population and their fiscal resources. In addition, decentralisation in Hungary contributed to enhanced autonomy and discretion at local government level, with sub-national governments being assigned a variety of expenditure

responsibilities and significant revenue sources. The ideal situation for countries is to have sub-national governments which have access to own sources of revenue, thus enhancing their autonomy and accountability to their electorate. In South Africa, the misalignment between national priorities and the budgets of sub-national governments has been often identified, and this has contributed to unintended consequences such as compromising service delivery and the issue of unfunded mandates.

The framework of intergovernmental fiscal arrangements is one of the more complicated areas of public finance. Elhiraika (2007:21) mentions that sub-national governments in South Africa do not have enough liberty to plan in terms of the relationship between sources of revenue and expenditure allocations. As a result, sub-national government find themselves being less responsive to the priorities of the local people. This shortcoming to ardently deal with the plans of communities inevitably results in sub-national governments being less accountable to the voting public. According to Cottarelli (2009:46) the reason for this complexity stems from the fact that intergovernmental fiscal arrangements spans a number of policy and institution-building issues requiring careful coordination. Even fifteen years after the advent of democracy in South Africa, the country still finds itself facing large socioeconomic backlogs and under-servicing across social groups and regions. According to Yemek (2005:1) one of the critical challenges that the national government faces is how best to redistribute national revenues with a view to equity and poverty alleviation. The South African intergovernmental fiscal system is designed to address this concern through the assignment functions allocated to each sphere of government.

Financial and Fiscal Commission (2009: 30) further notes that to a certain extent, South Africa has a reputation for good fiscal administration, financial markets that are opening increasingly over time, and prudent regulatory system. However, there is a growing awareness of the big challenges that lie ahead. These include, at the macroeconomic level; maintaining a reasonable deficit to gross domestic

product ratio, an inflation rate that is within acceptable targeted limits, an economic growth rate sufficient to make inroads into high unemployment and poverty levels as well as an acceptable balance of payments deficit. At a sub-national level, the challenges include sub national borrowing and poverty alleviation, and improved access to basic services.

In addition, service delivery protests that have been encountered in the majority of municipalities around the country are a cause for concern. The question that we are grappling with is that is fiscal decentralisation contributing effectively to the sub-national governments' ability to deliver basic services, particularly to the poor? If that is the situation, does this state of affairs calls for a rethink of the allocation of revenue and expenditure responsibilities to sub-national governments?

4.7. Conclusion and Recommendations

Based on the discussion of the pillars of fiscal decentralisation in chapter two, chapter four focused on a comparative analysis of fiscal decentralisation between South Africa and selected countries. In this chapter, it became clear the basis for a successful fiscal decentralisation system lies in the strategy design and implementation. The comparative analysis between South Africa, India Hungary and Spain reveals certain similarities with respect to the basic building blocks of fiscal decentralisation. For instance, regarding the issue of taxing powers, all these countries are almost similar in the sense that broad based taxing powers lie with the central governments as opposed to sub-national governments. The unintended consequences resulting from sub-national governments' inability to access adequate revenue sources compromise their autonomy and also lead to issues concerned with effective delivery of services. Additionally, the dependence of sub-national governments on intergovernmental fiscal transfers tend to undermine fiscal discipline and accountability while encouraging transfer

dependencies that stifle economic growth of fiscally disadvantaged regions. However, it is shown that intergovernmental fiscal transfers have to be properly designed in order to enhance competition for the supply of publicly produced goods, fiscal harmonisation as well as sub-national accountability and equity among provincial governments.

Borrowing by sub-national governments is another financing mechanism of sub-national governments' capital infrastructure expenditure. The chapter indicates that sub-national borrowing has a number of benefits including exposing sub-national governments to market discipline, reporting requirements, fiscal transparency as well as good governance.

In addition to sub-national governments' access to own revenue sources, the chapter has shown that active participation among broad elements of society plays a significant role in enhancing accountability and autonomy of sub-national governments. An additional impact of sub-national governments' inability to raise adequate revenue sources to finance expenditures result in vertical fiscal imbalances. Accordingly, where there are imbalances between revenue assignment and expenditure needs, intergovernmental fiscal transfers are often necessary to assure revenue adequacy. In addition, the comparative analysis focused on sub-national borrowing for purposes of financing capital infrastructure expenditure and tax flows and to foster political accountability.

In this chapter, it is clear that the strategy regarding the assignment of revenue sources and expenditure responsibilities must incorporate central as well as sub-national components to fully comprehend the possible benefits of fiscal decentralisation. It was shown that the priorities of national government and the budgets of provinces and local governments should be properly aligned to circumvent problems arising from service delivery and unfunded mandates. On the other hand, the Constitution of South Africa is clear on which taxes are devolved to sub-national governments. It is incumbent upon provinces and

municipalities to fully exercise the powers given to them with respect to taxing powers and expenditure responsibilities.

Chapter 5: Summary, conclusions and recommendations

The decentralisation of revenue and expenditure responsibilities is one of the significant prerequisites of sound intergovernmental fiscal relations. For this reason, a majority of countries around the world, including South Africa implement fiscal decentralisation for a multiplicity of reasons including improved governance as well as to enhance the delivery of services at sub-national government. In order for fiscal decentralisation to be properly executed, it is important for a variety of factors to be prevalent such as an enabling legislative environment the political will to decentralise. Experiences of other countries that are already implementing fiscal decentralisation normally assist in providing lessons to those countries that decide to go the fiscal decentralisation route. However, it should be mentioned that when implementing fiscal decentralisation policies, a blanket approach to fiscal decentralisation is not entirely possible because governance structures of countries are unique. In addition, country specific circumstances should always serve as the best determinant of effective fiscal decentralisation.

In concluding the study, section 5.1 provides a summary of what prompted the study to be carried out, including the approach on how the study was performed. Section 5.2 presents conclusions regarding the efficiency of the assignment of revenue and expenditure responsibilities to sub-national governments in South Africa concerning the provision of government services. In section 5.3 the recommendations regarding the system of the assignment of revenue and expenditure responsibilities to provincial and local governments including the scope for further research is presented.

5.1. Summary

The study on the evaluation of revenue and expenditure assignments in South Africa sought to firstly explore the rationale for fiscal decentralisation generally and in South Africa. The study attempted to discuss the effectiveness of fiscal decentralisation in the delivery of services in line with the provisions of the Constitution.

Chapter two focused on the theoretical framework of the advantages and disadvantages of fiscal decentralisation. The standard argument presented by the chapter is that the assignment of revenue and expenditure responsibilities to sub-national governments is necessary as the delivery of services by the latter is an ideal option. This is premised on the view that provincial and local governments are better able to match the delivery of public goods with local preferences and the ability to pay. The chapter further presented decentralisation as a comprehensive term which includes fiscal, political, and administrative decentralisation. The pillars comprising fiscal decentralisation are the assignment of revenue raising powers, expenditure assignment, borrowing at sub-national government as well as intergovernmental fiscal transfers. The latter is necessary to deal with a variety of issues at sub-national government level, including horizontal and vertical fiscal imbalances. The chapter briefly looked at the assignment of government functions based on appropriateness and effectiveness of these functions at different levels of government. These functions include macro-economic stabilisation; redistribution as well as allocation of resources for publicly provided goods and services. The chapter supports Oates's (1972) correspondence principle which maintains that the shifting of the allocation function to sub-national government, because the provision of public goods should be performed at the lowest level to allow an approximate correspondence between those who benefit from their provision, those who pay and those who decide on the amount provided. In the same vein, chapter two concludes that there is a strong case for sub-national government administration of the

allocation function to sub-national governments based on Tiebout's (1955) assertion that competition between local jurisdictions ensures they will better meet local preferences. The chapter continued to provide a discussion of arguments in favour of fiscal decentralisation and also looked at disadvantages of fiscal decentralisation. One of the advantages of decentralisation is enhanced autonomy of sub-national governments that rely on their own sources of revenue.

Chapter two further alluded to disadvantages of fiscal decentralisation emanating from the shifting of revenue and expenditure assignments to sub-national governments which could result in under-provision of regional and local public goods as sub-national governments will only consider impacts within their jurisdiction and ignore external impacts in other jurisdictions. An additional disadvantage of fiscal decentralisation as argued by opponents of fiscal decentralisation is that if the process is not properly managed, the assignment of expenditure responsibilities without the commensurate funding sometimes contributes to the problem of unfunded mandates. Chapter two concluded by looking at the guidelines for an efficient decentralisation system. The chapter continued to discuss the five guiding principles for an efficient fiscally decentralised system. The first principle refers to the existence of an enabling environment which is accompanied by political will to decentralise, the presence of a constitutional and legal framework. Other principles of fiscal decentralisation discussed in chapter two include an appropriate assignment of functions to sub-national governments; an appropriate set of own-sources revenues for sub-national governments; the establishment of a sufficient intergovernmental fiscal transfer system and lastly, adequate access by sub-national governments to developmental capital. The chapter conceded that sub-national governments that have access and control of their own revenue sources are desirable in any country for purposes of fiscal autonomy and independence.

Chapter three provided an analysis of revenue and expenditure assignments in South Africa in line with the theoretical framework of fiscal decentralisation. The

Constitution requires cooperative governance and recognizes the three spheres of government as “distinctive, interdependent and interrelated”. Thus while the Constitution recognizes each sphere of government as independent, it promotes a consultative approach to solving any differences that may arise. On the expenditure side, the Constitution is instrumental in assigning functions for each sphere of government. The Constitution also assigns revenue raising powers to the sub-national governments. However, a situation exists that significant revenue raising powers are concentrated at the central government compared to the provinces and municipalities which are assigned less taxing powers. Chapter three conceded that the situation of having more taxing powers being situated at the national sphere while significant expenditure responsibilities are decentralised exacerbates the existence of vertical fiscal imbalance in the intergovernmental fiscal system. Chapter three also alluded to provision for intergovernmental fiscal transfers being made in the South African fiscal system. Equitable allocations are desirable for a variety of reasons. They address issues relating to, amongst other things, vertical and horizontal fiscal imbalances as well as the existence of spillovers between jurisdictions.

However, the chapter has identified additional weaknesses regarding the assignment of revenue and expenditure responsibilities to sub-national governments. The challenges identified relate to service delivery issues at local government level; capacity issues and the question related to unfunded mandates. Notwithstanding the challenges faced by sub-national and provincial governments in South Africa regarding the current exercise of revenue assignment and expenditure responsibilities, it was concluded that there is scope for improvement. Sub-national governments can improve on their efforts to collect revenues assigned to them as well as to deliver public goods as mandated by the Constitution. This is necessary because there are concerns that intergovernmental fiscal grants contribute to some municipalities and provinces to not seriously endeavor to maximise their own revenue collection. There are

also opportunities to increase coordination among the three spheres of government in South Africa.

In terms of the comparative analysis presented between South Africa and selected countries, chapter four notes that the fiscal decentralisation system of South Africa has come a long way since the country's first democratic elections in 1994. South African provincial and local governments have since become conduits of delivery of services for a better life for all. There have been many changes, many achievements and challenges. Chapter stresses the provisions of the Constitution of South Africa for a system of decentralisation to bring government and services closer to the citizens. In this regard, the autonomy of sub-national governments to determine the degree of expenditure and revenue is important in the realisation of efficiency gains of decentralised government. It is also important for sub-national governments to have some flexibility with regard to their budget determination within reasonable limits. It is also imperative for revenue generation at sub-national government level to enable the latter to be in a position to execute the powers and responsibilities assigned to them. Intergovernmental fiscal transfers are also an important source of sub-national government revenue streams, in ensuring that provision of public services is realised. Another issue concerns the importance of sub-national government borrowing which should be motivated by the reduction of moral hazards of bail-outs by the central government.

In chapter four the comparative analysis between India and South Africa demonstrated a number of similarities regarding the two countries. For starters, the initial phase of the Indian independence dispensation and decentralisation was dedicated to the reduction of poverty and the empowering of marginal groups. In the same way, the Constitution of South Africa promotes the roles of provincial and local governments to be instruments of delivery of services for a better life for all. There are also similarities between India and South Africa with regard to the existence of vertical fiscal imbalances at sub-national government

levels. Rakate (2006:11) observes that the period preceding the democratic dispensation in 1994 was characterised by a number of weaknesses, including poor public services provision and capacity issues associated with low skills base. However, it could be argued that Rakate's observation still persist to this present day, based on the number of public protests that the country experiences as a result of perceived lack of service delivery. After thorough consideration of all the progress made and challenges met thus far, the question remains whether the design of the fiscal decentralisation system in South Africa assists in the facilitation of delivery of services in South Africa.

With regard to Hungary, Spain and South Africa, the inability of sub-national governments in these countries to adequately collect their own taxes of which they have absolute control is a cause for concern. However, in the case of Hungary the situation is somehow different from the experiences of the other selected countries in the sense that Hungarian sub-national governments are unrestricted to determine the strategy of service delivery in line with the requirements of the local population and their fiscal resources. In addition, decentralisation in Hungary contributed to enhanced autonomy and discretion at local government level, with sub-national governments being assigned a variety of expenditure responsibilities and significant revenue sources. The ideal situation for countries is to have sub-national governments which have access to own sources of revenue, thus enhancing their autonomy and accountability to their electorate. In South Africa, the misalignment between national priorities and the budgets of sub-national governments has been often identified, and this has contributed to unintended consequences such as compromising service delivery and the issue of unfunded mandates.

The framework of intergovernmental fiscal arrangements is one of the more complicated areas of public finance. Elhiraika (2007:21) mentions that sub-national governments in South Africa do not have enough liberty to plan in terms of the relationship between sources of revenue and expenditure allocations. As a

result, sub-national government find themselves being less responsive to the priorities of the local people. This lack to ardently deal with the plans of communities inevitably results in sub-national governments being less accountable to the voting public. According to Cottarelli (2009:46) the reason for this complexity stems from the fact that intergovernmental fiscal arrangements spans a number of policy and institution-building issues requiring careful coordination. Even fifteen years after the advent of democracy in South Africa, the country finds itself still facing large socioeconomic backlogs and under-servicing across social groups and regions. According to Yemek (2005:1) one of the critical challenges that the national government faces is how best to redistribute national revenues with a view to equity and poverty alleviation. The South African intergovernmental fiscal system is designed to address this concern through the assignment functions allocated to each sphere of government.

Financial and Fiscal Commission (2009: 30) further notes that to a certain extent, South Africa has a reputation for good fiscal administration, financial markets that are opening increasingly over time, and prudent regulatory system. However, there is a growing awareness of the big challenges that lie ahead. These include, at the macroeconomic level; maintaining a reasonable deficit to gross domestic product ratio, an inflation rate that is within acceptable targeted limits, an economic growth rate sufficient to make inroads into high unemployment and poverty levels as well as an acceptable balance of payments deficit. At a sub-national level, the challenges include sub national borrowing and poverty alleviation, and improved access to basic services.

In addition, service delivery protests that have been encountered in the majority of municipalities around the country are a cause for concern. The question that we are grappling with is that is fiscal decentralisation contributing effectively to the sub-national governments' ability to deliver basic services, particularly to the poor? If that is the situation, does this state of affairs calls for a rethink of the

allocation of revenue and expenditure responsibilities to sub-national governments?

5.2. Conclusions

The basis of the study was on the provisions of the Constitution of South Africa which provides for a system of decentralisation to bring government and services closer to the citizens. The study noted that since 1994 provincial and local governments have become instruments for delivery of services for a better life for all. Notwithstanding this, many changes, achievements and challenges have been encountered in the broader intergovernmental framework system. Some of the challenges which the study identified include the current struggle by sub-national governments to deliver services, and thus culminating in a number of protests from the voting public. In light of this, the study deemed it appropriate to examine the fiscal decentralisation system in South Africa to determine how best to deal with issues relating to the assignment of revenue and expenditure responsibilities to sub-national governments. The Constitution further provides for the assignment of revenue and expenditure responsibilities to provincial and local governments, to amongst other things, effectively deliver services to the citizens. The study emphasises the importance of the correlation between the assignment of expenditure responsibilities and revenue assignment to provincial and local governments. However, the study noted the lack of adequate revenue raising abilities at sub-national government level as opposed to central government having significant taxing powers. As a result, sub-national governments have to depend to a large extent on transfers from the national government. Consequently, provincial and local governments are not in a position to autonomously exercise their expenditure responsibilities because the central government priorities take precedence over sub-national government preferences.

The questions that the study sought to address included the effectiveness of the current assignment of revenue sources and expenditure responsibilities to sub-national government in South Africa in entrenching the guiding principle of revenue assignment: finance should follow function. The point of departure was the economic rationale for the devolution of taxing and spending powers to sub-national governments, followed by the explanation of the considerations on which the assignment of tax and spending powers to sub-national governments are based. In addition, the issue regarding the effectiveness of the current assignment of revenue sources and expenditure responsibilities to sub-national government in the delivery of basic services was looked at. The study also sought to look at whether intergovernmental fiscal transfers in South Africa are distributed without any political bias and manipulation. However, it was clear from the study that the objectivity of institutions such as your Budget Council which are paramount in the budget process is compromised. Lastly, the evaluation of expenditure and revenue assignment involved a comparative analysis between South Africa and a list of selected countries to assist in evaluating similarities between these countries and to also draw meaningful lessons for South Africa.

In conclusion, the comparative analysis between South Africa and the list of the selected countries reveal that there is an existence of enabling Constitutional and legislative frameworks which are required for efficient assignment of revenue and expenditure responsibilities. However, the weakness identified by the study relate to the inefficient utilisation of the constitutional and legislative provisions to achieving sound intergovernmental fiscal relations.

5.3. Recommendations

The study recognizes the progress made by the South African intergovernmental fiscal framework system the delivery of services by provincial and local governments since 1994. The study also draws meaningful lessons from countries that are already implementing fiscal decentralisation. However, it is

recognized that the experiences of other countries cannot be fully replicated for reasons pertaining to the uniqueness of circumstances of each and every country, including South Africa. Notwithstanding the achievements of the South African intergovernmental fiscal framework system, the study notes that there are intergovernmental framework gaps that government still grapples with in the efficient delivery of services. The issue of capacity constraints, lack of skills and general inefficiency is what plaques South Africa's sub-national government, particularly local government. In this regard, it is appropriate to evaluate the assignment of revenue and expenditure responsibilities to provincial and local governments in South Africa so as to determine the best possible option in maximising the delivery of services. The study notes that there is minimal effort made by sub-national government in South Africa to optimally collect existing revenue source. It is for this reason that the study proposes that existing revenue raising powers at both provincial and local government levels should be fully exploited in order to increase sub-national government revenue collection, thus minimising the reliance of provinces and municipalities on intergovernmental fiscal transfers.

In particular, it is necessary that future research should explore the following issues:

- In line with the objectives of optimising service delivery at provincial and local governments and promoting intergovernmental relations, explore mechanisms to strengthen the alignment and coordination among the three spheres of government and between institutions involved in the budgeting process ,
- Evaluation and analysis of basic services backlogs with a view of improving the provision in areas where they are still lacking.
- Effective mechanisms for dealing with service delivery protests emanating from perceived inadequate revenue sources of sub-national governments.

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