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**INTERGOVERNMENTAL FISCAL REFORM IN SOUTH AFRICA:
PREFERENCE MATCHING, EFFICIENCY AND
ACCOUNTABILITY**

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ABSTRACT

In the past four decades many countries have moved towards a system that awards more fiscal responsibilities to sub national governments- a phenomenon known as fiscal decentralisation. This phenomenon also characterizes the reforms that have taken place in South Africa in the past twelve years. The theory of fiscal federalism claims that the advantages of fiscal decentralisation are mainly preference matching, efficiency and increased accountability. Preference matching refers to the correlation between the goods and services provided by sub national governments and the preference of their citizens, efficiency refers to economic and cost effective manner in which public services are provided, while accountability is based on the fact that closer proximity of sub national to their residents facilitates increased public participation which in turn aid accountability. The central purpose of this paper is to assess whether the South African intergovernmental fiscal relations system enables provinces to achieve preference matching, efficiency and accountability. In the final analysis the paper contests that the system does not enable preference matching because of centralized policy making, provincial over reliance on national transfers to finance their expenditures and the fact that the system was not necessarily crafted for purposes of preference matching but national unity and the need to address the imbalances of the past. In the second instance South Africa has put in place systems aimed at promoting efficient service delivery across all three spheres of government. However, efficiency in provincial governments has been affected by a number of factors including limited capacity particularly in human resources. Furthermore, it is evident that inter provincial migration in South Africa is based on economic opportunities and better career prospects rather than competition between provinces as purported by the theory of fiscal decentralisation. The last element relates to accountability. In this regard the paper contests that although some degree of accountability has been achieved, this is not necessarily because of public participation that is facilitated by close of proximity of sub national governments to their residents. Rather, accountability of provincial government has been enhanced by the existing legislative framework, institutions such as the Auditor-General, the role played by the media and other civil society organizations.

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This work has not been previously submitted in whole, or in part, for the award of any degree. It is my own work. Each significant contribution to, and quotation in this dissertation from the work, or works, of other people has been attributed, and has been cited and referenced.

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TABLE OF CONTENTS

| | |
|--|--------------|
| Chapter 1 | 1-12 |
| 1. Introduction and Background | 1-2 |
| 1.1. Research Question | 3-4 |
| 1.2. Rationale | 4-6 |
| 1.3. Methodology | 6-7 |
| 1.3.1. Scope of Research | 7 |
| 1.4. Conceptual Framework | 8 |
| 1.4.1. IGFR | 8-9 |
| 1.4.2. Measuring Fiscal Decentralisation | 9-10 |
| 1.4.3. Fiscal Decentralisation Foundation | 10-12 |
| Chapter 2 | 13-32 |
| 2. Literature Review | 13 |
| 2.1. Fiscal Federalism Theory | 13-15 |
| 2.1.1. Macro-economic Stabilisation | 15-16 |
| 2.1.2. Income Redistribution | 16-18 |
| 2.1.3. Resource Allocation | 18-19 |
| 2.2. Advantages of Fiscal Decentralisation | 19 |
| 2.2.1. Preference Matching | 19-20 |
| 2.2.2. Efficiency Argument | 20-21 |
| 2.2.3. Increased Accountability | 21-22 |
| 2.3. FD in Developing Countries | 22-23 |
| 2.4. Revenue Assignment | 24-27 |
| 2.5. Politics and Fiscal Federalism | 27-28 |
| 2.5.1. National Unity | 29 |
| 2.5.2. Political Systems | 29-30 |
| 2.5.3. Historical Factors | 31 |
| 2.6. Point of Departure | 32 |
| Chapter 3 | 33-41 |
| 3. RSA Intergovernmental Relations | 33 |
| 3.1. Background | 33-34 |
| 3.2. The Government System | 34-35 |
| 3.3. Intergovernmental Fiscal Relations | 36 |
| 3.4. Provincial Revenue Sources | 36-38 |
| 3.5. Institutional Arrangements | 38 |
| 3.5.1. Budget Council | 39 |
| 3.5.2. Local Government Budget Forum | 39-40 |
| 3.5.3. Financial and Fiscal Commission | 40 |
| 3.6. Point of Departure | 40-41 |
| Chapter 4 | 42-55 |
| 4. Preference Matching | 42 |

| | | |
|-------------------|---|--------------|
| 4.1. | Intergovernmental System | 43-44 |
| 4.1.1. | ANC- Political Centralisation | 44-45 |
| 4.1.2. | Electoral Support | 45-47 |
| 4.1.3. | Mbeki's Leadership Style | 47-49 |
| 4.2. | Limited Decentralisation | 49-51 |
| 4.3. | Impetus for RSA Fiscal Decentralisation | 51-52 |
| 4.3.1. | Racial and Ethnic Fragmentation | 52-53 |
| 4.3.2. | Regional Disparities | 53-54 |
| 4.4. | Point of Departure | 55 |
| Chapter 5 | | 56-64 |
| 5. | Efficiency and Fiscal Decentralisation | 56 |
| 5.1. | Summary of Argument | 56-57 |
| 5.2. | Capacity of Provincial Bureaucracy | 57-59 |
| 5.3. | Financial Systems | 59-61 |
| 5.4. | Competition for Mobile Residents | 62-64 |
| 5.4.1. | Inter-provincial Migration | 64 |
| 5.5. | Point of Departure | 64 |
| Chapter 6 | | 65-75 |
| 6. | Increased Accountability | 65-66 |
| 6.1. | Electoral Accountability | 66-67 |
| 6.2. | Public Participation and Accountability | 67-69 |
| 6.3. | The Role of the Media | 69-71 |
| 6.4. | The Role of Civil Society | 71-72 |
| 6.5. | Corruption | 72-75 |
| 6.6. | Point of Departure | 75 |
| Chapter 7 | | 76-78 |
| 7. | Conclusion | 76-78 |
| References | | 79-85 |

ACRONYMS

| | |
|----------|--|
| ANC - | African National Congress |
| A-G- | Auditor General |
| CIU- | Coordination and Implementation Unit |
| DRC- | Democratic Republic of Congo |
| DFID- | Department for International Development |
| ETT- | Electoral Task Team |
| FFC- | Financial and Fiscal Commission |
| HSRC- | Human Sciences Research Council |
| IDASA- | Institute for Democracy in South Africa |
| IGR- | Intergovernmental Relations |
| IGFR- | Intergovernmental Fiscal Relations |
| MFMA- | Municipal Finance Management Act |
| MEC- | Member of the Executive Council |
| MINMECs- | Ministers and Members of the Executive Council |
| MTEF- | Medium Term Expenditure Framework |
| MPL- | Member of Provincial Legislature |
| NGO- | Non-Governmental Organisation |
| RDP- | Reconstruction and Development Programme |
| RSA- | Republic of South Africa |
| PCAS- | Policy Coordination and Advisory Services |
| PFMA- | Public Finance Management Act |
| PSAM- | Public Service Accountability Monitor |
| PSC- | Public Service Commission |
| SCOPA- | Standing Committee on Public Accounts |
| STATSSA- | Statistics South Africa |
| SAARF- | South African Advertising Research Foundation |

1. INTRODUCTION AND BACKGROUND

“Fiscal decentralisation-the devolution of taxing and spending powers to lower levels of government-has become an important theme of governance in many developing countries in recent years”. (Fjeldstad, 2001:01)

Although the nature and content of fiscal decentralisation differs from one country to another, most countries have since the 60's and 70s tended to move towards a system that awards sub-national governments more fiscal responsibility. In terms of the theory on fiscal decentralisation, the advantages of this phenomenon are threefold, namely; preference matching, increased accountability and efficiency through competition (Kolstad and Fjeldstad, 2006:03). “Preference matching” refers to the way in which fiscal decentralisation improves allocative efficiency, in the sense that the goods and services provided by governments in their own localities will be better matched to the preferences of the residents in those localities (Hindricks and Lockwood, 2005:02).

It is also argued that disappointing progress in meeting national goals through a centralised process has induced many developing countries to think beyond top-down development strategies, and to take decentralisation more seriously than they have done in the past (Smoke, 2001:01). In line with this argument, the World Development Report (2000:108) observes that a classic argument in favour of decentralisation is that it increases the efficiency and responsiveness of government. This argument is based on the premise that locally located leaders are in a better position to know the needs of their constituencies than national authorities.

It is in this regard that a close relationship exists between preference matching and the second claim pertaining to efficiency. In this regard, it is said that public services can also be made more efficient and more innovative when sub national governments compete with one another for the custom of mobile citizens

(Kolstad and Fjeldstad, 2006:03). This claim is known as efficiency through competition. The relationship between efficiency and preference matching is located in the claim that decentralisation facilitates allocative efficiency by matching the preferences of local community members (Hindricks and Lockwood, 2005:02).

The third rationale provided in the literature is that fiscal decentralisation increases the accountability of government (Hindricks and Lockwood, 2005:02). In essence, and as a result of the proximity of sub national governments to their citizens, fiscal decentralisation stimulates participation and improves accountability (Kolstad and Fjeldstad, 2006:03).¹

Although these three arguments together represent a conventional rationale for fiscal decentralisation, it is important to note that these purported benefits do not explain why decentralisation actually occurs. Indeed, there is also a school of thought that argues that in practice the impetus for the creation of a decentralised fiscal configuration tends to be primarily political and not economic (Ajam, 2001:127). Ajam (2001:126), for example, observes that the South African Constitution -- which is the bedrock upon which the new intergovernmental fiscal arrangements are based -- reflects the basic political choices and compromises arrived at during the constitution making process. These political choices and compromises -- rather than economic considerations such as preference matching and efficiency through competition -- have shaped and informed the nature of intergovernmental fiscal relations in South Africa. This dissertation is concerned with the consequences of fiscal decentralisation rather than with its causes.

¹ It is important to note that as Hindricks and Lockwood (2005:02) argue, accountability is used here to refer to the extent to which rent-seeking activities of office holders, such as bribes, favouring of particular interest groups, and in insufficient innovation and effort are held in check.

1.1. RESEARCH QUESTION

The primary interest of this paper is to assess to what degree the system of intergovernmental fiscal relations in South Africa enables provinces (sub national governments) to capitalise on the theoretical advantages of decentralisation – and to explore why it does or does not do so. There is clear consensus (Ajam, 2001, and Rao, 2003) that following the 1994 democratic breakthrough, the South African system of governance including intergovernmental fiscal relations afforded more powers and fiscal responsibility than hitherto to sub-national governments (provincial and local government). Nonetheless the question remains; to what extent does the South African system of intergovernmental relations enable provincial governments to achieve preference matching, efficiency and increased accountability? While this paper cannot offer a definitive answer to such complex and empirical questions, it hopes to set out the key considerations that must inform fuller and more complete answers.

The paper will show that the South African Intergovernmental Fiscal Relations system indeed does not enable provinces to achieve preference matching, that there remain a number of challenges to achieving efficiency and that only a degree of accountability has been achieved. This is hardly a surprise, in that the architects of the system did not have purposes of preference matching at the forefront of their minds. In fact South African IGFR system was designed deliberately to facilitate equity and address the imbalances created by the apartheid regime.

Furthermore, the paper argues that preference matching is not achievable in the context of South African provinces because policy making is centralised and determined at national level. The provinces in the main, implement policy determined at national level with very little discretion. It cannot be argued that

any province can match preferences of its residents without being able to exercise policy making discretion.

In relation to efficiency, it is argued that although financial systems have been put in place aimed at ensuring efficient utilisation of state resources, a number of capacity-related challenges hamper efficient service delivery amongst provinces. Secondly, the notion that competition between sub national governments for mobile custom might occur will be contested. Instead it will be argued that the main driver of inter-provincial migration is the search for economic activities such as job opportunities rather than competition between provinces.

In relation to the accountability, we will find that the South African Intergovernmental Fiscal Relations system does enable increased accountability by provinces. However, it will be argued that this is not, at least primarily, because of the proximity of provincial governments to their residents, but rather as a result of a legislative framework (e.g. Public Finance Management Act), the watchdog role of civil society and to some extent the role of the media. It will be argued that there is in fact limited public participation in the provincial governance processes apart from the periodic general elections.

1.2. RATIONALE FOR THE STUDY

This paper is rooted on my Honours Research Project titled "*Exploring Intergovernmental Relations in South Africa: A Literature Review*". Central to this project was a tour of the South African system of intergovernmental relations and the review of relevant literature with the view to identify issues that may be explored further through a Master's Thesis. The paper in question concluded amongst other things that lack of capacity in provinces has led to extensive involvement of the National Treasury in provincial fiscal affairs and that provinces are dependent on national transfers to finance their expenditure. The findings of

this project form the basis for a further examination of the South African Intergovernmental Fiscal Relations system.

Secondly, there is limited literature on intergovernmental relations or in particular intergovernmental fiscal relations in South Africa. There is a great need for scholars to provide insight into the system that guides the allocation and management of financial resources in South Africa. The nature and content of intergovernmental relations need to be explored with a view to contributing to improved management and a better allocation of financial resources. This paper aims to contribute by exploring some of the challenges facing the system.

This study is also located in the context of the current national discussion on the role of provinces and whether provinces should be scrapped. According to one report (Sunday Times, 2006:01) government has produced a confidential document titled "*Towards a Discussion on the Division of Powers and Functions between the Three Spheres of Government*". This document is said to be proposing the reduction of provinces from nine to four and an overhaul of powers and functions to better position the new structures for improved service delivery (Sunday Times, 2006). Amongst other things, the document is also said to be dealing with the notion of the form and nature of decentralisation appropriate for South Africa. Although some government officials have denied existence of any plan to scrap the provincial structure the discussion around the role of provinces continues. It is for this reason that this study is said to be located in the context of an on-going discussion or debate on the role of provinces.

Finally, there is always a need to test theory against reality. Fiscal Federalism theory claims that decentralised intergovernmental fiscal relations lead to preference matching, efficiency and increased accountability. This paper seeks to test this assertion and demonstrates that the theory does not in fact very much inform those seeking to understand the realities of contemporary South Africa. The paper will demonstrate that although intergovernmental fiscal

decentralisation has taken place in South Africa, in itself, it did not lead to preference matching, efficiency or increased accountability.

1.3. METHODOLOGY

The nature of this study requires a combination of both qualitative and quantitative methods. One part relies heavily on government policy documents, relevant literature and media reports (qualitative) while the other uses opinion surveys (quantitative). Since this document aims to test theory against practical situation, relevant academic literature such as books, journals, discussion documents, documents presented at conferences and relevant analysis will be of main use. This will be used to amongst other things outline what the theory asserts as the reasons for fiscal federalism.

The other part of this document will be dealing with how the theory applies to the South African system. In this regard government research reports, annual reports, legislations, discussion documents and submissions would be analysed and used as key sources of information. In essence, the main sources of information for this paper are government reports and policy documents including the documents mentioned above and academic literature relevant to this study. The latter (academic literature) source of information will be used to provide the theoretical basis as well as shed light on the comparative aspect of the study.

In order to demonstrate certain aspects of this paper quantitative data would be used. This would relate to issues such as public participation, corruption and the performance of government.

There are various types of applied research. However, this paper is concerned with evaluation research. Newman (2003:24) argues that the most widely used type of applied research is evaluation research. Evaluation research is used in large bureaucratic organisation such as government, NGOs, etc to find out

whether a program or a new way of doing something or policy is effective. In this case research will be used to assess whether the system operates as per the precepts of theory.

Limitations of this type of research is that research reports rarely go through a peer review process, raw data are rarely publicly available, and the focus is narrowed to select inputs and outputs more than the full process by which a program affects people's lives (Newman, 2003:25). Nonetheless, it is important to note that since this is a paper written for academic purposes it is expected to go through rigorous processes of peer review.

1.3.1. SCOPE OF RESEARCH

This paper focuses primarily on fiscal decentralisation in South Africa. It pays particular attention to fiscal decentralisation pertaining to provinces and does not pay much attention to local government. It is also important to note that although lessons will be drawn from other developing countries the document is meant specifically to assess the South African fiscal decentralisation system.

Furthermore, it is imperative to note that the paper focuses specifically on preference matching, efficiency and increased accountability as the three themes whose application is tested against the South African system. It must be acknowledged that there are other consequences of fiscal decentralisation -- for example, it can help to address various political imperatives -- but this document will not be dealing with these but will instead concentrate on the three identified themes.

1.4. CONCEPTUAL FRAMEWORK

It is essential that before dealing with the main sections of this document the conceptual issues relating to the notion of intergovernmental fiscal relations be

identified and explained. This includes looking at definition of the main concepts and the elements that makes up intergovernmental fiscal relations. The issue of why fiscal federalism has taken place will not be explored in this section due to the fact that the literature review deals extensively with this notion.

1.4.1. INTERGOVERNMENTAL FISCAL RELATIONS

Intergovernmental Fiscal Relations is defined amongst other things as the concept that is concerned with the structure of public finances in a state with more than one level of government: how taxing, spending and regulatory functions are allocated to the different tiers of government, as well as the nature of transfers between national, provincial and local governments (Ajam, 2001:126). This concept is also known as fiscal federalism or fiscal decentralisation. Fukasaku and de Mello (1997) define fiscal decentralisation as involving the reassignment of expenditure functions and revenue sources to lower tiers of government.

Another useful definition of fiscal decentralisation is provided by Boex (2004:03) who defines it as “the assignment of fiscal decision-making powers and management responsibilities to lower levels of government. Boex (2004:03) further notes that an important precondition for fiscal decentralisation is political decentralisation. This aims to decentralise power by establishing semi-autonomous sub national government bodies that have a corporate charter (they should be able to hold property, generate revenue and incur expenditures) as well as politically account to the local electorate (Boex:2004:02).

It is also important that we draw a clear distinction between the concept federalism/decentralisation in political science and how federalism and fiscal federalism are used in the intergovernmental fiscal relations literature. In order to outline this difference, Ajam (2001:126) states that contrary to the use of the concept of decentralisation in political science and constitutional law, the generic

meaning of the word federalism in economics is decentralisation, and the fiscal federalism literature deals with the fiscal implications of a decentralised system of multi-level government.

Irrespective of the particular emphases of different scholars, there is consensus that fiscal federalism or fiscal decentralisation – the two terms are used interchangeably here and in the literature -- addresses the nature and content of fiscal responsibilities of different levels of government in one state.

1.4.2. MEASURING FISCAL DECENTRALISATION

Another important point that needs to be addressed in attempt to understand fiscal decentralisation is how to measure it? What are the indicators that fiscal decentralisation has taken place and to what extent? Scholars of fiscal decentralisation do not necessarily agree on this issue. On the one hand, the simplest indicator of the degree of fiscal decentralisation is the measure of sub-national expenditure as a percentage of total government expenditure (IDASA, 2004:03).

On the other hand Prud'homme and Shah (2002:01) warn that this concept is multi-dimensional, many faceted and cannot be reduced to a simplistic ratio, such as the ratio of sub-national government expenditures to total expenditures (the so called expenditure decentralisation ratio), or the ratio of sub-national taxes to total taxes (the so-called tax decentralisation ratio). Prud'homme and Shah (2002:01) note that although these are important dimensions of decentralisation, the concept means more than this as it involves a large number of interrelated rules, institutions, constraints, mechanisms and practices that are constantly changing over time.

IDASA (2004) also highlights the limitations of its indicator by noting that it is merely indicative and does not capture the notion of policy discretion in terms of

what to spend the budget on. In essence this means that a country where large proportions of money is spend by sub national governments on behalf of national government will record the same measure of fiscal decentralisation as a country where sub national government has the political and fiscal discretion to spend large proportions of money in accordance with its own policies (IDASA, 2004:03). This demonstrates complications referred to by Prud'homme.

Against this background it can be argued that any measure of the extent of fiscal decentralisation must take into account both the proportion of sub-national spending as percentage of overall national spending, as well as the level of discretion provided to sub-national government to spend money on priorities or policies determined by them. It is for reason that an alternative measure entails that under the assumption that sub national government has the authority over its expenditure, the higher the ratio, the more the fiscal decentralisation (Hehui et al, 1999:16). This represents a more balanced measure of the level of fiscal decentralisation.

1.4.3. FOUNDATION FOR FISCAL DECENTRALISATION

The work of Smoke (2002) identifies at least five elements or foundations of fiscal decentralisation. The first element entails constitutional or legal mandates spelling out some minimum level of autonomy, rights and responsibilities for sub-national governments and is known as *adequate enabling environment* (Smoke, 2001:02). This is said to be the basic foundation for fiscal decentralisation. Another important related factor identified by Smoke (2001) is adequate political will and appropriately empowered mechanisms for co-ordinating the complex activities typically associated with decentralisation; without which competing and reluctant central agencies can work against each other, as well as the recognition that sub-national governments need adequate resources and capacity to meet their responsibilities.

The second element relates to the division of powers and functions amongst the different spheres of government and is known as *assignment of appropriate functions to sub-national governments* (Smoke, 2001:03). The debate on the assignment of functions will be further explored in the literature review section. The third element in creating an enabling environment is the *assignment of appropriate revenues to sub national governments* (Smoke, 2001:03). This issue is also further debated in the assignment of functions literature. Nonetheless, Smoke (2001:04) makes the observation that central government generally attempt to assign sub-national governments revenue bases that are relatively immobile, that do not compete seriously with central tax bases, that establish a link between taxed paid and benefits received .

In addition, he also notes the following problems in relation to this element: assignments of revenues are almost never adequate to meet the expenditure requirements thus mandating intergovernmental transfers; sub-national governments often use too many unproductive revenue sources that barely cover the collection costs; and lastly individual local revenue sources suffer from serious design problems, such as stagnant bases, overly complex structures, and ineffective administration (Smoke, 2001:05).

The fourth element relates to *developing an appropriate intergovernmental transfer system* which includes designing transfers to balance key objectives, consolidating unduly fragmented programmes, and adopting transparent allocation criteria that create incentives for good fiscal behaviour (Smoke, 2001:05). The purpose of intergovernmental transfers are to cover sub-national governments fiscal imbalances in order to allow them to meet national distribution objectives and to encourage local expenditures on services that exhibit positive externalities or are considered to be basic needs (Smoke, 2001:04)

The final element relates to *developing adequate local access to investment capital*. This requires the development of an appropriate spectrum of options to finance capital investment, from grants and subsidised loans for poorer sub-national governments and non-self-financing projects to various types of loans and bonds for fiscally sound sub-national governments and self-financing projects (Smoke, 2001:05). Smoke further notes that where decentralised governments are strong, it makes sense to create direct access to capital markets, but central government must regulate municipal borrowing and enforce a hard budget constraint. The final point in this regard is the observation that the most critical challenge in more advanced fiscal decentralisation is how to graduate sub-national governments from extreme dependence on grants and subsidised loans to greater use of credit markets (Smoke, 2001:06).

Boex (2004:04) also identifies what he refers to as the four building blocks or pillars of fiscal decentralisation as:

- The assignment of expenditure responsibilities: what are the functions and expenditure responsibilities of each level of government?
- Assignment of tax sources: which tax or non-tax revenue sources will be made available to sub national governments in order to provide them with resources?
- Intergovernmental fiscal transfers: what additional resources does central government provide to sub national governments?
- Sub national deficits, borrowing and debt.

These elements form the basis or foundation of fiscal decentralisation in any given country. It is also important to note that the application or implementation of these elements vary from one country to another because countries take different approaches to fiscal decentralisation.

CHAPTER 2

2. LITERATURE REVIEW

For purposes of this paper the literature on fiscal federalism is divided into three aspects, namely; the theory of fiscal federalism, assignment of functions amongst respective levels of government and issues of finances -- particularly revenue base of sub national governments.

2.1. THEORY OF FISCAL FEDERALISM

The theory of fiscal federalism can be traced as far back as Musgrave's classical 1959 work on fiscal decentralisation, *The Theory of Public Finance*. This work marked the beginning of rigorous scholarly debate in the study of fiscal decentralisation. Musgrave (1959:03) moved from the premise that the problem of public finance is primarily about resource allocation, the distribution of income, full employment, and price level stability and growth. Accordingly, his work was concerned with setting out the principles that must guide how these problems must be addressed in the functioning of the public sector.

In order to address these issues Musgrave (1959:05) identified three objectives for what he called 'Fiscal Department', namely the use of fiscal instruments to: (1) secure adjustments in the allocation of resources; (2) secure adjustments in the distribution of income and wealth; and (3) secure economic stabilisation. Each of the identified functions is performed by a particular branch namely Allocation, Distribution and Stabilisation branch.

The Allocation Branch must determine what adjustments in allocation are needed, who is to bear the cost, and what revenue and expenditure policies are required to achieve the desired objectives (Musgrave, 1959:05). The Distribution

Branch determines what steps are needed to establish the desired or proper state of distribution, and the Stabilisation Branch must decide what must be done to secure price-level stability and full employment (Musgrave, 1959:06). In summary macro-economic stabilisation, income distribution and resource allocation are identified as the three main public sector functions in terms of theory (Fjeldstad, 2001:145).

Another important contributor to the theory of fiscal federalism is Oates (1999:1120) who argues that the basic subject matter of fiscal federalism is the understanding of which functions and instruments are best centralised and which are best placed in the sphere of decentralised levels of government. Oates (1999:1121) asserts that central government should have the basic responsibility for the macroeconomic stabilisation and income redistribution functions. This assertion is premised on some of the fundamental constraints on lower levels of government.

For an example it is argued that in the absence of monetary and exchange-rate prerogatives and with highly open economics that cannot contain much of the expansionary impact of fiscal stimuli, provincial and local governments do not have the adequate means for traditional macroeconomic control on their economics (Oates, 1999:1121). In the same breadth it is said that mobility of economic units can seriously constrain attempts to redistribute income (Oates, 1999:1121). It is these constraints that are outlined as the basis for macroeconomic management and income redistribution functions being best located at central government.

The theory outlined by Oates (1999) further entails that decentralised levels of government have their primary function in the provision of goods and services whose consumption is limited to their jurisdiction. It is argued that by tailoring goods and services to the particular preferences and circumstances of their constituencies, decentralised provision increases economic welfare above that

which results from the more uniform levels of such services that are likely under national provision (Oates, 1999:1122). This is the essence of preference matching which forms the basis of this document.

Since the work of both Musgrave and Oates scholars have engaged the theory of fiscal federalism vigorously. Below is a summary of some of the most recent works.

2.1.1. MACRO-ECONOMIC STABILISATION

The prescription by the fiscal federalism theory that national government must take the responsibility for the stabilisation function is shared by many scholars. This argument is also reflected upon by Bahl and Linn (1994:03) when they note that according to the *theory of public finance* the stimulation of stable economic growth and the distribution of income are proper budget objectives of national government. In essence, macro-economic stabilisation function is in most cases considered to be inherently national in nature partly because other levels of government have few or no incentives to undertake it and also because they often lack the necessary tools to carry out such policies (Fjeldstad, 2001:145). In the same spirit Prud'homme (1995) identifies fiscal policy as one of the main instruments of macro-economic policy further arguing that it is an instrument that only central government can manipulate, because local authorities have no incentives to undertake economic stabilisation policies.

Few important points can be noted about this argument. Firstly, the impact a particular regional government could have on national or global demand and on prices is insignificant. Furthermore if regional governments had that much influence most of the impact will be out of its jurisdiction because sub national economies are much more open than national ones and sustain greater linkages to other regions as a result of overspending and under spending (Prud'homme,

1995:205). In addition, regional governments would have to pay the full political cost of an economic stabilisation policy that may bring only partial benefits.

It is also said that there are possibilities that the fiscal policies of sub-national governments will run counter to those of the central government (Prud'homme, 1995:206). For an example local government may end up increasing expenditures or taxes while the central government is trying to reduce spending or cut taxes. It is against this background that Prud'homme (1995:206) concludes that regional and local governments will never provide enough economic stabilisation, which must in turn be conducted by central governments. It is important to note that in line with theory, macro-economic stabilisation is a function of national government in South Africa.

2.1.2. INCOME REDISTRIBUTION

One of the roles of the 'finance department' identified in the theory of public finance is income redistribution. Earlier scholars seemed to agree that this role is best suited for the central government. However, as demonstrated below the recent literature reflects a shift in this regard. Before addressing this issue, it is important to look at the earlier and traditional argument on which level of government should be responsible for income redistribution.

The traditional argument in this regard is summarised by Prud'homme (1995:202) when he notes that because decentralisation measures can adversely affect the distribution of equity, a substantial body of public finance holds that the redistribution of income should remain the responsibility of the central government for two main reasons. Firstly, efforts by local governments to redress income disparities are likely to be unfair as the poor in well-off regions will fare better than the poor in more deprived regions. Secondly, decentralised redistribution is self-defeating (Prud'homme, 1995:202). In a way of elaboration Prud'homme (1995) argues that if a jurisdiction adopts income redistributive

policies by imposing high taxes on the rich and giving high benefits to the poor, the rich will tend to leave for more lightly taxed areas and the poor will tend to move in from areas that offer lower benefits. The generous jurisdiction will soon be unable to sustain its policy, he concludes.

In the same vein, the World Bank (2000) notes that income redistribution function is usually assigned to the central government because local attempts at taxing the rich and redistributing wealth to the poor would result in inefficient population movements- with high-income groups moving to areas with low taxes and low-income groups moving to areas offering high benefits. According to Boex, the key principle in determining which level of government should do what in a fiscally decentralised system of governance is known as the *subsidiary principle* (Boex, 2004:04). He states that this principle suggests that government services should be provided at the lowest level of government that is capable of efficiently providing this good and service.

The subsidiary principle suggests that three types of activities are best performed or funded by central government, namely; provision of public goods and services that benefit the entire nation, income distribution or social policies, and government activities that involve spillovers or externalities between districts (Boex, 2004;05). It is argued that because sub national governments by their nature would not be able to address income differentials between regions and because wealthy households and firms would have an incentive to move away from jurisdictions that engage in income distribution, sub national government would not be able to effectively engage in income distribution programs (Boex, 2004, 05).

Be that as it may, the World Bank (2000:115) identifies the recent shift in thinking when it observes that while central government should continue funding and designing redistribution efforts, local governments are often in a good position to implement and administer standardized national policies. It further notes that

local governments usually administer services that have important redistributive implications, such as primary health care, education, childcare, housing, and public transportation. This argument basically means that central government may be responsible for national norms and standards but allow the other levels of government to implement redistributive policies. Oates (1998:13) also argues that there is certainly some decentralised support of the poor. In this argument Oates (1998) raises issues of efficiency in poor relief by endorsing the argument that there is much greater concern in a community for local indigent than for the poor elsewhere.

In South Africa for an example, the national government maintains national norms and standards but the Provincial government implements the redistributive policies. Provincial governments are responsible for services such as health, education, housing, social development and so on. All these services have redistributive implications. The national sectoral departments are responsible to ensure that provinces maintain uniform norms and standards by developing policies in these respective sectors.

2.1.3. RESOURCE ALLOCATION

The third function identified by the theory of public finance is about allocation of resources. In this regard the literature on fiscal federalism awards significant role to sub national governments in allocating resources (World Development Report, 2000:115). In fact Musgrave (1959:13) argues that “the heart of fiscal federalism is to be found in the Allocation Branch”. The standard observation in the literature is that decentralisation has definite advantages in the allocation branch (Bird et al, 2003:59). This view is premised on the assertion that when the benefits of certain services are largely confined to local jurisdictions, the appropriate levels and mix of services can be set to suit local preference (World Development Report, 2000:115).

Furthermore, it is argued that the “mobility of capital and labour rules out local government success with policies in either area leaving allocation as the main role for local government (i.e. the decision about how much to spend for each service and how to finance expenditures)” (Bahl and Linn, 1994:03). The local government allocation role is premised on the argument that sub national governments are closest to voter consumers and is in the best position to read local preferences for public services and for various kinds of user taxes and user charges (Bahl and Linn, 1994:03). As noted elsewhere in this paper this argument is better known as preference matching.

The same point is also made by Ajam (2001:126) who notes that the prime economic justification for the role of sub national governments within fiscally decentralised systems is the potential to improve allocative efficiency. According to Ajam (2001:126) allocative efficiency in the public sector is concerned with whether subject to budget constraints, the public sectors produces the level and mix of public services (public expenditures) which citizens demand and which corresponds with their preferences.

2.2. ADVANTAGES OF FISCAL DECENTRALISATION

2.2.1. PREFERENCE MATCHING

The advantages of fiscal decentralisation as enshrined in the literature are located in the assignment of function debate as outlined above. Analysis of the literature reveals that preference matching, efficiency and increased accountability emerge as three common advantages associated with fiscal decentralisation. On the first advantage it is assumed that under a centralised system provision of services will entail a uniform level of output across all jurisdictions (Oates, 1999:1123). The problem with this scenario is that it does not take into account diverse preferences in respective regions. In addition, it is said that under this system citizens have to voice their demand for better

services through central authorities who in turn direct local authorities to respond (Fritzen and Lim, 2006:04).

On the other hand fiscal decentralisation is said to be advantageous because of the gains associated with moving government closer to the people (Bahl, 1999:04). This argument entails that when preferences among voters are diverse and local government is responsible for provision of services that do not have major external effects, the potential benefits entails better public services, better accountability amongst government officials, and more willingness to pay for services (Bahl:1999:04). In essence, this argument entails that the government most closer to people is better positioned to understand and provide services in line with what local citizens prefer.

2.2.2. EFFICIENCY ARGUMENT

Another important theme that emerges in the literature is that fiscal decentralisation leads to efficiency. This argument is summarised by Oates (1972:35) when he states: “for a public good- the consumption of which is defined over geographical subsets of the total population, and for which the costs of providing each level of output of the good in each jurisdiction are the same for central or for the respective local government- it will always be more efficient (or at least as efficient) for local government to provide the Pareto-efficient levels of output for their respective jurisdictions than for the central government to provide any specified and uniform level of output across all jurisdictions”. This normative assertion is based on the assumption that services and goods provided by central government are offered in a uniform manner irrespective of the dynamics or circumstances in regional or local governments. On the other hand services provided by sub national governments are tailor made for the residents of that particular locality.

It is also argued that fiscal decentralisation leads to efficiency through competition. This argument entails that public services can be made more

efficient and perhaps innovative when territories compete with each other for the custom of mobile citizens (Kolstad and Fjeldstad, 2006:03). According to theory, residents of localities are similar to consumers, because they are essentially “shopping” between different municipalities to find the one that has the right mix of taxes and public services (Tiebout, 1956). The ability of citizens to choose results in towns competing against one another, and that competition means that the towns are better able to discover and serve the needs of their citizens (Tiebout, 1956). Accordingly, it is said that competition between jurisdictions leads to efficiency and innovative service delivery.

2.2.3. INCREASED ACCOUNTABILITY

It is also argued that fiscal decentralisation increases accountability of government (Hindricks and Lockwood, 2005:02). The increased accountability argument is also premised on the proximity of elected representatives to their officials. It entails that because decision making activities are placed closer to the people, responsiveness and accountability to citizens are enhanced (Kee, 2003:03). Decentralisation is also thought to enhance political participation at local government level, which in turn entrenches democratic values and political stability at local government level (Kee, 2003:03).

The literature on fiscal decentralisation also asserts that local governments are more accountable compared to the central governments (Seabright, 1996; Persson and Tabellini, 2000). Furthermore, it is said that local governments compete on more concrete policy issues during elections compared to the central governments where many dimensions of policies are bundled together (Besley and Coate, 2003). In addition, another dimension of the accountability argument is that local governments are accountable only to local constituencies in decentralised states have incentives to pursue policies that have negative externalities on other jurisdictions of the country (Besley and Coate, 2003 and

Tanzi, 1996). It is for these reasons that fiscal decentralisation is said to increase accountability of sub national governments.

2.3. FISCAL DECENTRALISATION IN DEVELOPING COUNTRIES

The early version of the theory of fiscal federalism was informed in the main by circumstances found in industrialised or developed countries. In the later stages of scholarly debate around fiscal decentralisation developing countries were provided with some attention. In particular, scholars have written about whether the theory as applied in developed countries can be relevant to developing countries. This particular theme is very important in the context of this paper because it is primarily about fiscal decentralisation in a developing country. For this reason the section below focuses on the application of the fiscal decentralisation theory to developing countries.

Before dealing with the application of theory in developing countries it is important to note that there is general consensus amongst scholars that fiscal decentralisation is taking place in developing countries.² Some of the reasons for the emergence of this phenomenon in developing countries includes the fact that traditionally centralisation and direct central government control were emphasised and this control have in most cases failed (Shah, 1997:14). Furthermore, accountability remains weak because central governments escape scrutiny except where they need funding from international institutions such as the IMF (Shah, 1997:14). In addition, it is said that the political and economic autocratic failure in many transition economies, as well as highly centralised socialist regimes may have provided an impetus to the subsequent decentralisation initiative (Dubla-Norris, 2006;101). It is against this background and other related frustrations about centralisation in developing countries that decentralisation were championed.

² See Bird, 1995; Fukasaku and de Mello Jr. 1997 and Fjeldstad, 2001

Although there is consensus about the fact that fiscal decentralisation is taking place in developing countries, there are differences about whether or not fiscal decentralisation theory applies the same way in these countries. Amongst other things, it is argued that the theory of fiscal decentralisation does not apply in its entirety to developing countries because the circumstances and challenges of governance are very different. For an example, Prud'homme (2005:208) argues that preference matching is not necessarily applicable in developing countries. He asserts that the main difference between various local or regional jurisdictions is not in their tastes or preferences but rather in income, whether household income or potential tax income. It is further argued that although the theory holds it that locally elected mayors will satisfy the preferences of the locals but often the electoral mandate is vague or inconsistent-or both (Prud'homme, 1995:208). In addition even if elected officials wanted to fulfil the preferences of locals, they could not, usually because of a gross mismatch between available resources and promised expenditure.

The difference in tastes is only part of the story, contests McLure (1995; 224) in response to these arguments. He argues that the more important point is the discrepancy between the tastes of local communities and the tastes of their national governments is that these governments do not necessarily represent their citizens (McLure, 1995:224). This argument relates to instances where governments are not elected democratically and hence do not necessarily represent the views and wishes of the people they lead. For an example in a country like the Democratic Republic of Congo where democratic elections were only held this year after more than 40 years of dictatorship, it cannot be argued that the dictators that ruled over the DRC in the past 40 years represented the views of the Citizens in any way.

2.4. REVENUE ASSIGNMENT

Apart from the function assignment another important theme in the literature pertains to revenue assignment. This theme relates to the question of where different levels of government receive funds to carry out their responsibility as well as the type of taxes allocated to them. Revenue assignment has been a matter of robust debate amongst scholars for a long time. In this part of the section we start by looking at theoretical prescription of revenue assignment before examining the situation in practice.

The economic literature on revenue assignment holds that the nature and content of function assignment should determine the type of revenue sources. This point is also made by Boex (2004:06) when he states that an important determinant of the assignment of revenue sources to subnational governments is the assignment of expenditure responsibilities, giving rise to the adage: finance should follow function. In terms of the assignment of specific taxes, Boex (2004:06) asserts that subnational taxes should be easy to administer (examples include estate property taxes, motor vehicle fees, and user charges) and bad local taxes include the value added tax (VAT), corporate income taxes and trade taxes. Boex (2004) also makes an observation that one problem regarding the assignment of revenue sources in many countries is that while subnational governments need to have at least some revenue discretion in order to fully benefit from fiscal decentralisation reforms, central governments often seem unwilling to provide any degree of real revenue autonomy to subnational governments. This has resulted in many sub-national governments remaining dependent on national/central government to finance their expenditure.

Often than not this situation necessitates intergovernmental transfers to ensure that subnational government have some financial resources to fulfil their expenditure responsibilities (Boex, 2004:07). Transfers are grants from one level of government to another (often from higher level to lower governments) for

purpose of funding government activities. The final pillar of fiscal decentralisation is a logical corollary to the first three pillars. This relates to subnational deficits, borrowing and debt financing. To this end Boex (2004:07) observes that since these factors have important ramifications for macroeconomic conditions and the ability of central government to rely on fiscal policy as a tool to manage macroeconomic conditions, central governments often require subnational government to balance their budgets or tightly regulate their ability to hold debt.

Bird (2004:02) who asserts that traditional theory of fiscal federalism prescribes very limited tax base for subnational governments shares the observations and some of the arguments above. He argues that the only good local taxes are said to be those that are easy to administer locally, that are imposed solely or mainly on local residents, and that do not raise problems of harmonisation or competition between subnational governments or between subnational and national governments. The main taxes identified by Bird (2004:02) as being suggested for strengthening subnational tax regime are: user charges, property tax, excise taxes, personal income tax, payroll taxes, consumption taxes and business tax.

However, Bird (2004:03) argues that while many of them have merit, on the whole they seem unlikely to suffice, for two reasons namely; in total the revenues usually assigned to subnational governments are likely to prove inadequate to the task of financing social services (education, health, social assistance) increasingly being assigned to subnational governments in many countries, and that some of the conventional recommendations both underestimate the difficulty of increasing local revenues from some sources and overestimate the problems (and the undesirability) of using other sources. He further argues that good subnational taxes should in principle satisfy two main criteria: firstly they should provide sufficient revenue for the richest subnational units to be essentially fiscally autonomous; second, they should clearly impose fiscal responsibility at the margin on subnational governments (Bird, 2004:03).

In another work Bird (1999) argues that the conventional model of tax assignment in a multi-tier governmental structure basically assigns all productive revenue sources to the central government. In this work Bird (1999:02) makes a case for strengthening subnational tax regimes. To this end he proposes two approaches. The first entails establishing subnational value added taxes that are not subject to the problems that have long been thought to preclude such taxes. The second approach involves replacing all or some of the various unsatisfactory state and local taxes on business that exist in most countries by a 'business value tax'- in essence, a relatively low rate flat tax levied on an income-type value added base. In his discussion of the assignment of taxes, Bird (1999:05) observes that the apparent professional consensus until recently was that only really acceptable general tax for intermediate governments such as states or provinces was a single-stage and preferably retail sales taxes (RST) levied directly on the final (resident) consumers along with, perhaps, a few relatively uniform exercise taxes.

Some scholars also argue for greater subnational fiscal autonomy. For instance McLure (1999:03) argues that "If decentralisation is to be a reality, subnational governments must control their own sources of revenue". He further asserts that subnational governments that lack independent sources of revenue can never truly enjoy fiscal autonomy and that they are probably under the financial thumb of the central government (McLure, 1999:03). It is against this background that McLure notes that the question then, is which revenue sources can and should be assigned to subnational levels of government and how these assignments are to be effected ('the tax assignment problem').

According to McLure (1999) a rational tax system should exhibit the following characteristics: they must have enough own revenues to finance the services they provide. It is important to note that McLure argues that even if a subnational government relies on grants from a higher-level government, it may reasonably

be considered to have own revenues, provided the grants are determined in an objective way and are guaranteed by the constitution or legislation of long-standing. The second characteristic is that subnational governments must be assigned sources of marginal own revenues –own revenues whose level they can control—if they are truly autonomous (McLure, 1999:08). The last characteristic is called subsidiarity in taxation which refers to the fact that a given tax should be assigned to lowest level of government that can implement it (or for which it can be implemented) and for which it is not inappropriate (McLure, 1999:09).

Ebel and Taliencio (2004) also outline a framework for revenue decentralisation. The framework move from the premise that it is established that the decentralisation of expenditure responsibilities brings with it the need to decentralise revenue-raising responsibilities, and that without own revenue sources, subnational governments would be fully dependent on funding from the centre (or other external 'source' such as international donor aid) and thus the benefits of decentralised decision-making will not be achieved (Ebel and Taliencio, 2004:11). The framework further asserts that once this has been done the next task entails sorting-out revenues among governments while the third step is to add in broad normative principles for guiding subnational revenue policy (Ebel and Taliencio, 2004:11). The last step is to take the tax choices that result from the first two steps and test them against a set of the criteria judging what constitutes a good local revenue system. It is worth noting that this framework assumes that function and revenue assignment is done in a rationale way with no conflict of interests or political pressures. However, in practice a variety of factors including politics determine the way this exercise is conducted.

2.5. POLITICS AND FISCAL FEDERALISM

Although the literature above demonstrates the influence of economic factors on the degree and nature of fiscal decentralisation decisions, it is important to note

that these decisions are ultimately political ones taken in specific legal, historical and political contexts. The view that the fiscal federalism is primarily determined by politics rather than economic logic emerges very strongly in the recent literature on this subject. Amongst other things Ebel and Taliercio (2004:02) also make the same point when they note, "the decision to decentralise is political". It also emerges that different countries have designed different systems of intergovernmental relations depending on the political situation in those countries. For an example, it is said that political and ethnic conflicts in many transition countries created a complex setting for fiscal decentralisation leading to uneven progress in different countries and across various components of intergovernmental relations (Dubla-Norris, 2006:102). It is also argued that the differences between countries pertaining to fiscal decentralisation partly reflect the historical and geographical characteristics of every country, the degree of heterogeneity of the population and the extent of government intervention in the economy (Fjeldstad, 2001:01). These arguments highlight the centrality of politics in determining the nature and content of fiscal decentralisation in any given country.

Furthermore it is also emerges that in some countries the decision made regarding the nature and content of the intergovernmental system have not necessarily been consistent with the prescriptions of the economic literature. Ajam (2001:127) makes this observation about South Africa by noting that it is no exception to this factor since the impetus for the creation of a decentralised intergovernmental fiscal system in South Africa was primarily political not economic. For instance although economic theory would dictate that assignment of functions to the various spheres of government should take place first, and the assignment of revenue sources should follow, in South Africa the arrangements for revenue sharing were enshrined in the Constitution prior to the detailed assignment of expenditure functions (Ajam, 2001:127).

2.5.1. NATIONAL UNITY

The World Development report (2000) highlights the fact that in some instances the need to build national unity significantly affects the degree and nature of fiscal decentralisation. In explaining various reasons behind decentralisation this report asserts that when a country finds itself deeply divided, especially along geographic or ethnic lines, decentralisation provides an institutional mechanism for bringing opposition groups into a formal, rule-bound bargaining process. The report further notes that decentralisation has served as a path to national unity in South Africa and Uganda. This point serves to demonstrate the fact that the political situation of a country determines to a larger extent the form and content of fiscal decentralisation.

Furthermore Spain, which is characterised by diversity and political plurality, is one of the examples of how political circumstances shape the decisions taken regarding the system of intergovernmental relations. In assessing the case of Spain Castells (2001:93) observes that diversity certainly has a cost and problems of different nature that do not exist in uniform political systems. He (2001:93) further argues that where the option for political decentralisation is exercised it is because diversity brings with it more benefits than costs and that it also allows for preference expression as well the possibility of contrasting alternative solutions for the same problem. It is these factors that have determined and shaped the fiscal federalism in Spain.

2.5.2. POLITICAL SYSTEM

Another political element which shapes the nature and content of fiscal decentralisation is the type of political system in a particular country. This refers to whether or not a country is of federal or unitary system. Although some scholars argue that "federalism is not a necessary condition for decentralisation" and that there is "no completely unitary state", these systems shape the nature of

decentralisation including fiscal federalism in various countries (Work, 2002:07). The issue of whether or not a country is federal or unitary has an impact on the degree and nature of fiscal decentralisation.

Federal system is often than seen as prone to fiscal decentralisation. On the other hand the federal system entails constitutionally allocating powers to subnational governments to facilitate decentralised decision making, public participation. It is said that Federal states are more apt for deconcentration since the administrative and political structures are already in place (Work, 2002:07). In a federal system the centre does not control member state, whereas subnational governments in unitary states can operate within the legislative powers assigned to them by the centre (Work, 2002:07).

Under the Unitary systems the subnational governments function largely as the administrative unit of the centre with one government level dominating the fiscal decisions (Work, 2002:08). Sub-national governments in unitary states can operate only within the legislative powers that are assigned to them by the centre. Thus, the workability of decentralisation depends on the goodwill of the unitary central government than on existing constitutional division of powers (Work, 2002:08). It is these differences that shape the nature and content of fiscal decentralisation.

It is also argued that federalism is a 'special case of decentralisation'- a system in which public sector decisions can be taken at various levels of government- a compromise between the a unitary state and complete decentralisation. On the hand within unitary systems one government dominates the fiscal decisions, which may include giving some devolution or deconcentration with authority. Devolution of authority means that some level of autonomy to subnational governments can take place even under unitary systems.

2.5.3. HISTORICAL FACTORS

Another important and related factor that influences the nature of fiscal decentralisation is the history of a particular country. The history of every country has an impact on the nature of governance in that particular country. It is for this reason that countries have adopted different types of decentralisation. Often these types of decentralisation are tailor made to suit the conditions (political, social, economic and cultural) of that particular country.

This assertion is demonstrated by Shah (2005:716) when he observes that in Africa, both former French and English colonies inherited highly centralised systems of governance geared towards command and control with little concern for citizen's preference. In addition, Shah (2005:716) argues that developing and transition economies have by and large followed a path of centralisation, and as a result they are more centralised than industrialised countries were in their early stages of development. This difference speaks directly to diverse historical situations of developing and developed countries.

The situation of Russia is also an example of how historical factors shape the nature of decentralisation. Russia has a history of deep rooted political centralisation because of its socialist outlook. In the 1980's significant reforms took place awarding more powers to subnational governments. However, despite relatively large subnational budgets on paper, the formal fiscal federalist system remains highly centralised with large share of regional and local revenue expenditure being dictated by laws and regulations of higher levels of government (Aleksei *et al*, 2000:02). The main reason for continued centralisation in the face of federalist reforms is the deep rooted culture of political centralisation in the history of the Soviet Russia. The point being made here is that history has an influence on the nature of fiscal decentralisation.

2.6. POINT OF DEPARTURE

The theory of fiscal decentralisation asserts that preference matching, increased accountability and efficiency through competition are the main advantages for fiscal decentralisation. There is no consensus on the applicability of this assertion to developing countries. Some scholars argue that the theoretical prescripts do not necessarily apply to developing countries because it's unique challenges and political circumstances. The literature also highlights the importance of other factors such as politics, history, political system and national unity in shaping the nature and content of fiscal decentralisation. Revenue assignment is also one of the important themes in the literature on fiscal decentralisation. Many scholars argue that effective fiscal decentralisation requires appropriate assignment of revenue raising functions to subnational countries. Nonetheless, it is clear in the literature that subnational governments remain heavily dependent on central governments to finance their expenditures.

CHAPTER 3

3. OVERVIEW OF IGFR IN RSA

This chapter explores the key features of intergovernmental fiscal relations in South Africa. Its purpose is to set out the context for the analysis conducted later in the paper. It starts with a brief reflection on the past (apartheid) system of intergovernmental relations, moving to the description of the current system and concluding with the overview of institutional arrangement for intergovernmental fiscal relations.

3.1. BACKGROUND

The apartheid era system of intergovernmental fiscal relations was both extremely centralised and highly fragmented along racial lines and into a plethora of independent states and self-governing homelands (Ajam, 2001:127). Vosloo *et al* (1974:23) argue that provincial governments were in many ways subordinate to the central government although they had jurisdiction over hospitals, roads and bridges, fish and game matters, the licensing and control of trade, recreational and cultural amenities, the control of local authorities, as well as secondary education for whites. This means therefore that subnational governments had limited powers to make spending and borrowing decisions since the system was more centralised.

Furthermore Vosloo *et al* (1974:23) asserts that lack of provincial autonomy under apartheid was demonstrated by their financial dependence on the central government. This assertion is premised on the principle that the extent to which one level of government is financially depended or independent of another demonstrates the independence or dependence of that government. For an example the more provinces depend on central government to finance their

expenditures the lesser independent they become. In the pre-1993 South Africa, provinces had no financial autonomy as central government restricted their taxing powers leading them to depend on annual transfer payments and special grants in aid from the central government (Vosloo et al, 1974:24).

In essence, during the apartheid era the lower levels of government had very limited spending, taxation and borrowing powers. Although the four Provinces performed provincial functions in health, education etc., they were merely administrative extensions of government with policy formulation highly centralised in Pretoria. On the other hand the homelands were accorded considerable fiscal latitude as they received transfers from central government and were allowed to borrow and raise certain forms of revenue on their own account (Ajam, 2001:127). The transition to democratic system in 1994 brought about significant changes to this situation.

3.2. THE CURRENT GOVERNMENT SYSTEM

In order to understand the changes in intergovernmental relations including fiscal relations since 1994 it is important to comprehend the system of governance. This is mainly because the system of government (federal or unitary) has significant influence on the nature of intergovernmental relations. On the debate around whether or not South Africa is a Federal or Unitary system, Haysom (2001:43) argues that if the South African constitutional schema were to be analysed against a formal federal checklist, it could, with justification, be classified as federal. This argument is premised on the fact that South Africa has all the trademarks of a federal system: nine subnational political bodies called provinces, with each possessing constitutionally protected boundaries (Haysom, 2001:43).

In the same breath Haysom (2001:43) observes that closer examination would also reveal that the treatment of provincial or regional governments in the final

constitution promotes or sanctions an integrated system of government in which both national and subnational governments are deeply implicated in each other's functioning. This reflects a unitary system of government.

Although this paper does not address in detail the issue of whether South Africa is unitary or federal, this distinction is important in order to understand the nature and content of decentralisation. The importance of this distinction lies in the fact that often than not federalism requires greater measures of decentralisation while unitary systems can accommodate centralisation much easier.

South Africa can be best described, as a constitutional democracy with a three-tier system of government (national, provincial and local). In terms of section 40 of the Constitution these spheres of government are distinctive, interdependent and interrelated. The principle of co-operative governance underpins the intergovernmental system in South Africa.

In summary the South African system of government has the following features:

- A unitary system of government with three distinctive, interrelated and interdependent spheres, with significant decentralisation powers, functions and budgeting;
- National Parliament comprises two houses: a national assembly, and a national council of provinces representing provinces and organised local government;
- The nine provinces have their own legislatures and executive committees as well as administrative structures;
- There are 284 municipalities categorised as metropolitan, district wide or local structures, and comprise of political and administrative components.

3.3. INTERGOVERNMENTAL FISCAL RELATIONS

The 1996 final constitution did not only create a new form of intergovernmental relations but also significantly shifted fiscal relations amongst the three spheres of government. The South African system of intergovernmental fiscal relations is grounded and rooted in the 'Constitution of the Republic of South Africa, 1996 Act 108. The Constitution provides for the creation of a National Revenue Fund into which all money received by the national government must be paid (RSA Constitution, 1996: section 213 {1}). Section 214 (1) of the constitution states that an Act of Parliament must provide for the equitable division of revenue raised nationally among the national, provincial and local spheres of government.

Accordingly, in 1997 parliament passed the Intergovernmental Fiscal Relations Act. The purpose of this Act was "to promote co-operation between the national, provincial and local spheres of government on fiscal, budgetary and financial matters; to prescribe a process for the determination of an equitable sharing and allocation of revenue raised nationally" (Intergovernmental Fiscal Relations Act, 1997). In essence, this legislation was passed in order to ensure that the system of sharing national revenue is fair and equitable. In line with the spirit of the Constitution and related legislations, South Africa's fiscal system is based on a revenue sharing model, with most of the nine provinces receiving more funds than they raise through national taxes (National Treasury, 2004). The municipalities except for the major urban municipalities are also dependent on national transfers, although to a lesser extent than provinces.

3.4. PROVINCIAL REVENUE SOURCES

There are number of ways through which Provinces and local government can raise funds under the current system of intergovernmental fiscal relations. The constitution provides for at least three sources of revenue for provincial governments. The first source of revenue is the equitable share. Both Provinces

and local government are entitled to an equitable share of revenue raised nationally to enable them to provide basic services and perform the functions allocated to them. In addition, they may receive other allocations from national government revenue either conditionally or unconditionally (RSA Constitution, 1996). The equitable share and national transfers form the main sources of revenue for provinces in South Africa. The equitable share is allocated in terms of a set criteria aimed at ensuring that all spheres of government benefit equally and fairly from revenue raised nationally.

Provinces are also allowed to apply certain prescribed taxes. According to the Constitution, Provincial Legislatures may impose taxes, levies and duties other than income tax, value-added tax, general sales tax, rates on property or custom duties; and flat-rate surcharges on the tax bases of any tax, levy or duty that is imposed by national legislation, other than the tax bases of corporate income tax, value-added tax, rates on property or custom duties (RSA Constitution, 1996). The South African provincial government's main sources of revenue are motor vehicle fees, gambling revenue, and hospital user charges (Smoke, 2001:08). This is a very limited tax base hence dependence on national transfers.

Another source of revenue for provinces is in the form of loans. In 1996 the Borrowing Powers of Provincial Governments Act was passed to provide for norms and conditions in respect of the borrowing powers of provincial governments. The act sets out a number of conditions under which provinces could be allowed to borrow including amongst other things prohibition of provinces from obtaining loans denominated in a foreign currency without the approval of the Minister of Finance, the establishment of the loan co-ordinating committee to co-ordinate the borrowing requirements of provincial governments and limitation of provincial debt by the Minister of Finance. It is also important to note that section 230 (1) of the Constitution allows provinces and municipalities to borrow for capital and bridging finance. The subnational borrowing model of South Africa can be described as one characterised by administrative controls.

This description is premised on the fact that subnational borrowing is subject to national approval and satisfaction of certain norms set by national government.

The table below demonstrates that provinces are overwhelmingly dependent on transfers. For instance on average provinces are dependent on the national transfer system to finance about 97 percent of their expenditures. The table also demonstrates the fact that there has been very limited growth in provincial own revenue over the past three years. In fact between 2000/1 and 2001/2 financial years the provincial own revenue dropped.

| Provincial Revenue R million | 1999/00 Revised estimate | 2000/1 Medium-term estimates | 2001/2 Medium-term estimates | 2002/3 |
|---|-------------------------------------|---|---|---------------|
| Transfers from national:* | 100 030 | 106 650 | 112 433 | 117 690 |
| Own revenues: | 3 640 | 3 630 | 3 896 | 4 164 |
| Total provincial revenues: | 103 670 | 110 280 | 116 329 | 121 854 |
| Own revenue as* % of total revenue | 3.5% | 3.3% | 3.3% | 3.4% |
| % growth of own revenue | | -0.3% | 7.3% | 6.9% |

*transfers from national government include both equitable share grants and conditional grants
Source: Budget Review 2000, table 7,6, page 158

Rao (2003:08) also observes that during the 2001/2002 financial year provinces raised 1.3 percent of total revenues raised at all spheres of government and that this could only finance 3.2 percent of their expenditures. In summary, the table above demonstrates the great extent to which provinces are dependent on the national transfer system as a result of amongst other things inability to raise own revenue.

3.5. INSTITUTIONAL ARRANGEMENTS

There are various institutional arrangements for intergovernmental fiscal relations in South Africa. Below is the brief outline of the main institutions.

3.5.1. BUDGET COUNCIL

The Budget Council is one of the formal institutions created for amongst other things management of intergovernmental fiscal relations. The Budget Council was established in terms of the Intergovernmental Fiscal Relations Act of 1997. In terms of this act the Budget Council is essentially a body through which “National and Provincial governments consult on any fiscal, budgetary or financial matter affecting the provincial sphere of government, any proposed legislation or policy which has a financial implication for the provinces, any matter concerning the financial management or the monitoring of finances and any other matter which the minister refers to the council”.

Its membership includes all Members of Executive Council (MEC) responsible for Finance in respective Provinces as well as relevant central government officials. The Minister of Finance is a permanent Chairperson of the Budget Council. The Budget Council also serve to co-ordinate financial relations between national and provincial spheres of government and it makes recommendations on the horizontal division of revenue before finalisation by cabinet (Van Zyl, 2003:22).

3.5.2. LOCAL GOVERNEMENT BUDGET FORUM

Another institution created for the purposes of intergovernmental fiscal relations is the Local Government Budget Forum. This forum consists of the Minister of Finance, the MEC for Finance in each province; five representatives nominated by the national organisation recognised in terms of the Organised Local Government Act of 1997 and one representative nominated by each provincial organisation recognised in terms of that Act (Intergovernmental Fiscal Relations Act, 1997). Like the budget council, the local government budget forum is a body through which “national, provincial and organised local government consult on any fiscal, budgetary or financial matter affecting the local sphere of government, proposed legislation or policy which has financial implication for local

government, any matter concerning the financial management, or monitoring of the finances of local government or any other matter referred to the forum by the minister" (Intergovernmental Fiscal Relations Act, 1997).

3.5.3. FINANCIAL AND FISCAL COMMISSION

The Financial and Fiscal commission established in terms of the Financial and Fiscal commission Act of 1997 is the third main institution created for the purposes of intergovernmental fiscal relations. According to the founding Act the Financial and Fiscal commission acts as a consultative body, makes recommendations, and gives advice to organs of state in national, provincial and local spheres of government on financial and fiscal matters. The commission is expected to at least ten months before the start of each financial year submit to houses of parliament and the provincial legislatures as well to the minister recommendations for that financial year regarding the equitable division of revenue raised nationally, the determination of each province's equitable share in the provincial share of that revenue and other allocations to provinces, local government or municipalities form the national government's share of revenue (Financial and Fiscal Commission Act, 1997). These recommendations must be tabled in the mentioned legislative houses.

3.6. POINT OF DEPARTURE

The main purpose of this chapter was to provide an overview of the intergovernmental fiscal relations in South Africa. Outlining or describing the main features of intergovernmental fiscal relations is important in terms of providing a context for the ensuing sections of the document. It is clear in this section that provinces remain significantly depended on national transfers and that they have a limited tax base. An important point to note is that closer comparative analysis of the apartheid system and current intergovernmental fiscal relations reveals striking similarities in the sense that provinces remain depended on national transfers. However, it is important to note that the current

legislation sets out the exact system of sharing revenue amongst the three spheres government preventing opportunities for discrimination or prejudice of any province on the bases of race, geography, political or any other fact. By failing to address these factors, the apartheid system facilitated their manifestation in the social and political outlook of South Africa.

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CHAPTER 4

4. PREFERENCE MATCHING

The literature on intergovernmental relations claims that fiscal decentralisation leads to preference matching. This means that the set of goods and services provided to citizens or residents by subnational governments are consistent with what they prefer. Over the past decade South Africa has awarded more and more fiscal responsibility to both provinces and local government. This begs the question of whether this process has put provinces in a better position to achieve preference matching. In this section it is contested that the South African system of intergovernmental fiscal relations does not allow provinces to achieve preference matching because of limited policy making discretion at provincial level and because the system does not necessarily aim to achieve preference match but seeks to facilitate national unity by addressing the imbalances of the past.

In order for provinces to match the preferences of their residents a number of requirements would have to be met. Amongst other things provinces must have discretion over policy making; secondly the system must be deliberately designed to facilitate that process. Through policy making discretion, a particular province would have an opportunity to provide goods and services that are desired by its residents. In the current system national consistency is pursued and provinces cannot deviate from national norm. The impetus for the creation of a system has a direct bearing on whether or not subnational governments can achieve preference matching. For an example if the impetus is to ensure preference matching then system would be created deliberately to ensure this. However, if the impetus is political as in the case of South Africa the system would seek to pursue the goals determined politically.

4.1. INTERGOVERNMENTAL SYSTEM

An analysis of whether South African provinces can achieve preference matching must first assess the allocation of functions amongst different spheres of government. Function allocation demonstrates whether or not subnational governments have the room and space to determine their own priorities and achieve preference matching. The South African system of intergovernmental relations is designed so that certain functions are exclusive (performed by one sphere only), while others are concurrent (shared between different spheres). The concurrent functions include school education, health services, social welfare services, housing and agriculture (Schedule 4 of the Constitution).

In relation to these functions national government is largely responsible for providing leadership, formulating policy, determining the regulatory framework including setting minimum norms and standards, and monitoring overall implementation by provincial governments (National Treasury, 2005:02). This means that although provinces receive transfers from central government to distribute amongst its departments, they are highly limited by national norms and standards and that there is little room for them to decide upon priorities (Friedman, 2000). As Friedman (2000) correctly notes, in health, education and welfare, national government sets the direction; at best, provinces decides how to follow them. Section 146 of the Constitution states that national legislation that prevails uniformly with regard to the country as a whole prevails over provincial under listed conditions. This demonstrates the limitation of provinces in formulating their own policies or legislation. The exclusive functions of provinces include provincial roads, ambulance services and provincial planning.

The driving force behind policy making in South Africa is said to include the urgent need for delivery, the need for consistency in policies, the political culture that confers legitimacy on high political and government leadership, and the need

to protect the liberation gains (Booyesen, 2000:09). The need for consistency dictates that policies must be applied similarly throughout the Republic. For an example despite regional income inequalities the budgets for all South African provinces remain biased towards the poor through higher allocations towards the social services. This point is demonstrated by the fact that together, social services make up approximately 82 per cent of total provincial expenditure (National Treasury, 2005:129). In addition, the Minister of Finance noted (Budget Speech, 2005) that over the past decade government has made steady progress in increasing the proportion of spending on social services that goes to the poorest 40 per cent of South Africans.

In essence the manner in which functions have been allocated to different spheres demonstrates that provinces do not have any significant policy making discretion. In order for provinces to achieve preference matching they need to have discretion on the setting of priorities and formulation of policy. However, in the case of South Africa, policies are formulated nationally and apply consistently to all provinces. Certain room for innovation is applicable to provincial roads, ambulance services and provincial planning. Overall provinces in South Africa are not in a position to achieve the notion of preference matching because policy making is centralized. The reasons for centralized policy making in South Africa is a result of three factors, namely; culture of political centralisation in the ANC, electoral support enjoyed by the ANC, and the leadership style of President Thabo Mbeki.

4.1.1. ANC CULTURE OF CENTRALISATION

Firstly, the ANC can be described as a highly centralized party whose leadership is focused on the centrally elected Party President, Party Executive, and National Executive Committee of sixty five members, from which the National Working Committee is drawn consisting of fifteen members exercising central power over the party in a day to day way (Hawker, 2000:633). The centralisation tendencies

can be explained in more ways than one. Firstly, it is said that the ANC has traditions derived from the hierarchy and cadre deployment of exile and from domestic mass movement politics that mirrors some organizational and structural features of the classic Democratic Party (Butler, 2005:729). It is also argued that the ascendancy of hierarchy, democratic centralisation and deference to leadership blocs results partly from political normalization and partly from the particular local challenges of ethnicity and careerism (Butler, 2005:730).

Furthermore, politics of exile appears to have profound impact on the notions of democratic centralisation and hierarchy in the ANC. According to Cronin (2002) the bureaucratization, intimidation, and centralisation that have bedevilled the movement reflect the somewhat Stalinist party school education from the exiles. Southall (2003) also notes that the logic of liberation is a creation of protracted armed struggle in settler-dominated states of the South in which organizational secrecy and hierarchical liberation movement defined opposition to leaders as illegitimate and fused Leninist vanguardist ideas and democratic centralist discipline. These practices have had profound bearing on centralisation of decision making in South Africa.

4.1.2. ELECTORAL SUPPORT

Centralisation of decision making in the ANC as described above manifested itself in government structures mainly as a result of the electoral support that the ANC enjoys. During the 1994 general elections the ANC won elections in seven of the nine provinces. In 1999 the same scenario prevailed with a coalition government being formed in KwaZulu Natal. The 2004 general elections outcome marked consolidation of support throughout all provinces as the ANC registered electoral victory and for the first time took political control of all provinces in South Africa.

The significance of this scenario is that it has allowed further consolidation of central control of provincial governments through adherence to party discipline. This is facilitated by the appointment of the provincial leadership by the President. Murray and Pillay (2005:203) argue correctly that the most demonstrable control of party elites of provincial representation is the identification of Premiers. In 2004 the Premiers were appointed by the President and duly elected by their respective legislatures (Murray and Pillay, 2005:203). Critics of the President have often argued that it is this appointment of Premiers that award him central control of the provinces. The ramification of this practice is that central or other interests dominate policy making and that sub national government responsiveness to the interest of local residents may be adversely affected (Dabla-Norris, 2006:126). In the context of South Africa appointment of officials by the centre has ensured uniformity in policy formulation and promotion of national interest. This is facilitated by the authority that the President has over elected ANC officials in provinces especially Premiers. Given this authority the President has the ability to reward those loyal to the central government, and punish those who take contrary stands (Dickovick, 2006:26).

The type of intergovernmental relations forums in place also ensures that policy is coordinated through out provinces and that national interests are put before regional interest. Amongst other things, through the Presidential Coordinating Council attended by all Ministers, Premiers and Director-Generals it is ensured that provinces implement national policy in accordance with norms and standards determined nationally. It can also be argued that other structures such as MINMECs and the Budget Council facilitate national control of provinces. Although these forums were meant to accommodate the principle of interdependence between national and provincial spheres, they are largely dominated by representatives of the centre, with provinces asserting that it is where the centre brings errant provinces into line (Dickovick, 2006:19).

In the same breath Van Zyl (2001:22) argues that by 2001 the national government controlled provinces more than provided for in the constitution. In his analysis Van Zyl concludes that the manner in which business is conducted in the Budget Council has resulted in a tendency to resituate provincial interests in the context of national priorities. This is demonstrated by assertion of the Northern Cape MEC for Finance and Economy in his budget speech of 1999 where he reportedly stated that “at a national level we as a province participate in the Budget Council ... At this level we have to consider the broader national impact and not just narrow provincial interests” (Van Zyl, 2001:27). This reflects the arguable notion that this structure seeks to first and foremost sell the national agenda to provinces and that in most cases provinces conform in the spirit of ‘team’ work.

In many instances there is a relationship between politics and public policy. The manner in which the Budget Council operates is likely to be facilitated by politics than anything else. It must be noted that the Minister of Finance chairing the Budget Council is also a very senior member of the ruling party. To date in all nine provinces of South Africa the Ministry of Finance is led politically by a relatively junior member of the ANC. This situation dictates the type and nature of relationship between these MECs and the Minister of Finance. Thus, it is easy for the national sphere to dominate and control the provinces through structures such as the Budget Council.

4.1.3. MBEKI'S LEADERSHIP STYLE

The leadership style of President Thabo Mbeki has also further promoted centralized decision-making in government. As a result of this leadership style policy making in South Africa is centralized with the process centering around a group of actors in top ANC, Cabinet, Presidency and government policy bureaucrats and top ordinary civil servants (Booyesen: 2000:10). The Presidency remains the most powerful and dominant actor in part as a result of the

restructuring that occurred in the office of the President and Deputy through the recommendations of the Presidential Review Commission. Immediately after the release of the commission's report significant and radical changes were made particularly in offices of the President and Deputy.

The restructuring included the merger of the former office of the President and the Executive Deputy President to form the 'The Presidency' in 17 June 1999 (The Presidency, 2000:07). The Presidency is made up of the President, Deputy President and the Minister in The Presidency with an integrated administrative establishment managed by one Director-General (The Presidency, 2000:07). The Staff component was increased from 296 to 341 with the aim of enhancing the capacity of the Cabinet Office, the Policy Co-ordination and Advisory Services (PCAS) unit and the Private Offices of the Political Principals (The Presidency, 2000:07). Amongst Administrative structures created, the Cabinet office with the help of the PCAS unit and the Cabinet Operations Chief Directorate assess the content of matters tabled with Cabinet to ensure the necessary policy synergies and alignment and the PCAS advises the President on all aspects of policy coordination, implementation and monitoring and assists on special cross-cutting projects and programmes (The Presidency, 2000:12).

The restructuring described above has turned the Presidency into the most powerful actor in policy making. Although this situation appears to be the direct outcome of the Presidential Review Commission, other commentators attribute this to the personality and leadership of the former Executive Deputy President and current President- Thabo Mbeki. For instance accumulation of control powers by President Mbeki is said to have been orchestrated while he was still a Deputy President. A number of developments took place whilst Mbeki was a deputy president resulting in concentration of power in his Presidential Office.

According to Chothia and Jacobs (2002:148) a key factor in the evolution of the office of the Deputy President was the closure of the RDP office and its merger

into Mbeki's office. A number of other offices and institutions were also established in the deputy President's office. The Government Communication and Information Service were set up to co-ordinate and modernize government communication which also became the propaganda arm of central government and the Presidency in particular (Chothia and Jacobs, 2002:149). In 1997 Cabinet approved the establishment of the Co-ordination and Implementation Unit (CIU) also in the office of the Deputy President. The CIU evolved into the Policy Coordination and Advisory Service.

One of the fundamental questions raised about the new structure of the Presidency was whether provincial governments and line ministries were being sidelined (Chothia and Jacobs, 2002:149). According to Chothia and Jacobs (2002:150) the reason given by officials in the office of Mbeki for restructuring the centre was that it will improve policy co-ordination, and thus help ensure economic growth, job creation and social development. Their work raises what they call 'a central question'; "how much of the restructuring is about improved coordination, and how much is about power?" (Chothia and Jacobs, 2002:150). They further charge that such centralisation could presage an imperial presidency: powerful, imposing, and impenetrable and that critics suggest that the centralisation of policy and decision making power in the President's office is the last piece in a jigsaw of consolidated control over every aspect of government.

4.2. LIMITED FISCAL DECENTRALISATION

In order for provinces to be able to provide a mix of goods and services that their residents prefer they require adequate financial autonomy in both income and expenditure. However, although significant movement towards fiscal decentralisation has occurred in South Africa, these developments did not give provinces true financial autonomy (Dickovick, 2006:02). According to Dickovick (2006:10) elected officials with fiscal resources still have little power as central

government determines spending priorities, sets subnational government budgets, and mandates as well as closely monitor expenditures, and if they are dependent on the centre for transfers or have a severely constrained tax base.

In the case of South Africa, spending priorities are centrally determined as expenditure mandates and budgets passed down from the centre are quite tight, leaving little room for shifting money from one budget item to another (Dickovick, 2006:10). Furthermore provinces are highly dependent on national transfers as they have very limited revenue base. For instance on average provinces are dependent on the national transfer system to finance about 97 percent of their expenditures. Rao (2003:08) observes that during the 2001/2002 financial year provinces raised 1.3 percent of total revenues raised at all spheres of government and that this could only finance 3.2 percent of their expenditures.

The implications of provincial over-reliance on funding from central government is that it erodes and undermine provincial fiscal autonomy and creates a weak link between revenue raising responsibility, which is mainly at national level, and the responsibility for spending decisions, which is at provincial level (Ajam, 2001:140). Another important point to note is that the centre has constrained provincial access to capital markets (Dickovick, 2006:10). This constrain is facilitated by the fact that provinces have to seek permission from the centre (National Treasury) when they wish to access capital markets.

The weak fiscal autonomy at provincial level means that provinces are not in a position to finance goods and services preferred by their residents if they do not fall within the nationally financed priorities. As Dickovick (2006:18) correctly notes, if the provinces had any meaningful degree of spending autonomy, they would no doubt divert funds to other public or political goods, be it to other services sectors or to patronage. The control over spending priorities begins with formulation of the Medium Term Expenditure Framework (MTEF). Although the MTEF is said to be improving the capacity of South Africa's various spheres of

government to plan expenditures over a three to five year time frame, it is also gives the centre greater oversight and influence into the long-term provincial planning (Dickovick, 2006:18).

4.3. IMPETUS FOR FISCAL DECENTRALISTION IN RSA

Apart from the centralisation of policy making that does not allow provinces to formulate policy and/or achieve preference matching, it is important to note that the South African intergovernmental fiscal relations system was not necessarily designed for purposes of preference matching. The impetus for fiscal decentralisation in South African was primarily political and not based on economic factors as outlined in the theory for fiscal federalism. In essence, the features of the new intergovernmental system emanate from political, historical and constitutional factors rather than fiscal considerations (Momoniat, 2005). Amongst other things, the ANC noted in the pre-election period that regional government should not be able to contradict national policy, though it could influence policy and develop mechanisms for implementation (Hawker, 2000:632). This implies that from the conceptualization of provinces it was decided that they would not have any considerable policy making discretion but would rather implement policy determined at national level. This clearly means that the system does not position provinces in a position to achieve preference matching.

There are number of reasons why provinces were eventually not granted any significant policy formulation discretion. Firstly, the nature and content of fiscal decentralisation in South Africa must be understood within the political and socio-economic challenges that the country faced at the point of formulating the new constitution. It is the contention of the author that these challenges had a significant influence on the nature and content of fiscal decentralisation in South Africa. It is also important to note that decentralisation strategies that emanate from political considerations would not necessarily be conceptualized soundly

and comprehensively from the public finance theory point of view, and may be deliberately designed to retain power over the purse-strings at the centre (Budget Brief, 2004:07). It is partly for this reason that South African system does not necessarily give effect to fiscal federalism theory in particular on the role of provinces regarding preference matching.

4.3.1. RACIAL AND ETHNIC FRAGMENTATION

One of the pressing challenges that system had to address is the fact that the apartheid regime had managed to fragment the country along racial lines by amongst other things creating the so called homelands for blacks. By 1994 South Africa had ten separate homeland governments each with its own arrangement for elected representation (Nupen, 2004:121). These so called homelands were a direct result of the National Party's policy of separate development. Through various racially discriminatory legislations the apartheid regime managed to suppress black property rights and land ownership, pushing many of them to the so called homelands. From 1913, Blacks were not allowed to own property in the 93 per cent of the country designated exclusively for white people (Cameron, 1999:76). Blacks could only own property in the remaining 7 per cent which was increased to about 13 percent in 1936 (Cameron, 1999:76). It is important to note that the homelands are mostly rural with limited economic activities taking place; a factor that contributed tremendously to regional inequality in South Africa.

The Bantustans are a direct example of how blacks were not only separated from whites but also got divided along ethnic lines. For instance Batswana were taken to Bophuthatswana and Xhosa to Transkei and Ciskei. These divisions still find expression in the current provincial system as many provinces incorporated the former areas of the Bantustans. The fact that KwaZulu Natal is a predominantly Zulu province or the Eastern Cape is predominantly Xhosa demonstrates the impact of ethnic fragmentation facilitated by apartheid. This fragmentation along racial and ethnic lines meant that the new system including intergovernmental

fiscal relations must be able to serve purpose of unifying the nation and reconciling its different segments.

4.3.2. REGIONAL DISPARITIES

The significance and relevance of the issue of homelands and property ownership lies in the fact that it has led to the problem of regional inequalities in both income and service delivery. Today, there are noticeable disparities amongst nine provinces created through the 1993 Interim Constitution. It is only the Western Cape, Gauteng and the Northern Cape Province that did not have former Bantustans incorporated in their territory although the Northern Cape has a significant share of rural coloured people whose living conditions were almost similar to those of the Bantustans (Gelb, 2004:11). Furthermore, it has been demonstrated that the poorest provinces in terms of both prevalence of poverty and access to services are the Eastern Cape and Limpopo province both of which are dominated by former Bantustans in terms of land area and population composition (Gelb, 2004:11).

On the other hand the Western Cape and Gauteng provinces driven by the strong economies of Cape Town and Johannesburg respectively are significantly better off than the provinces mentioned above or provinces that include former Bantustans. These provinces are almost fully urbanised, have much lower unemployment and poverty rates than the other provinces (Gelb, 2004:11). This scenario has also contributed to Horizontal fiscal imbalances which results from differences in the financial capacity of subnational governments to address the demands for public services in their jurisdiction (Budget Brief, 2004: 06). Against this background one of the pressing challenges for the new system of intergovernmental fiscal relations was to ensure that horizontal imbalances are addressed.

In addition, at the time of formulating the constitution and even the present day South Africa is characterized by large socio-economic backlogs and under-servicing across social groups and regions (Yemek, 2005:02). The regional inequalities articulated above translated into service delivery backlogs. Gelb notes that there is a significant 'apartheid backlogs' which still remains unredressed and this impacts fundamentally on the quality of service delivery (Gelb, 2004:11). It is for this reason that the new system was compelled to be able to address this challenge in a manner that does not promote existing disparities amongst regions.

Given this background one of the critical challenges facing the South African government is how best to distribute the limited resources with a view to achieve equity and poverty alleviation (Yemek, 2005:03). In order to achieve this situation an appropriate system of intergovernmental relations system had to be created. Bayl (1999:05) argues correctly that equalization potential is greater at a centralized public sector or that the more money national government has to redistribute, the greater is the potential to equalize. Accordingly, the new system of fiscal decentralisation in South Africa had to facilitate adequate national government control over redistribution of resources.

Failure to ensure redress would result in the entrenchment of disparities created by the apartheid regime. The need to address both regional and income inequality were also made important by the fact that promotion of national unity and reconciliation remains depended on the extent of redress. The more poverty and underdevelopment continue to be manifested along racial lines the dangerous it becomes for reconciliation and uniting the nation. It is only through stronger national control and intervention that redress could be properly coordinated in such a way that regional inequalities are dealt with.

4.4. POINT OF DEPARTURE

The South African system of intergovernmental fiscal relations does not allow provinces to achieve preference matching because policy making is centralised and provinces do not have any significant discretion over policy development. Centralisation of policy making is mainly as a result of culture of political centralisation within the ANC, electoral support enjoyed by the ANC and the leadership style of President Mbeki. Another factor that limits provinces from achieving preference matching is their over reliance on national transfers to finance their expenditure. Lastly, it appears that South African system was created with specific intention to address the imbalances of the past and build national unity. In order to achieve this central control over policy development and resource allocation remains central.

University of Cape Town

CHAPTER 5

5. EFFICIENCY AND FISCAL DECENTRALISATION

The main concern of this section is whether the South African system of intergovernmental fiscal relations enables provinces to achieve efficiency as outlined in the literature. Before dwelling into main arguments of this paper it is important to mention few important points. Firstly, the preceding chapter has already argued that South African provinces cannot achieve preference matching and the relevant facts were presented. So this section will not revisit this notion but would rather deal with the aspects that relates specifically to notion of efficiency. However, it is important to note that because of the close relationship between preference matching and efficiency notions, some of the issues already raised in the previous chapter may be briefly resuscitated.

5.1. SUMMARY OF ARGUMENT

The literature on public finance claims that fiscal decentralisation leads to efficiency. This argument is based on three premises or assumptions. The first factor draws a close link between preference matching and efficient provision of public services. In terms of this notion it is said that "... to the extent that decentralisation can help identify different population group's preferences for public goods, these groups can be made to pay a price (tax) based on the benefit they receive from the public goods, and individual vote on their feet, by moving to the jurisdiction that best reflect their preferences (Tanzi, 1995:299). This refers to the contestation that public services can be made more efficient when territories compete with each other. It is premised on the assumption that citizens are like consumers essentially searching between localities to find the right mix of taxes and public services.

The other factor relates to the fact that under fiscal decentralisation sub national governments have an incentive to be innovative. In this regard it is said that when the provision of a public service (e.g. Education) is the responsibility of sub national government, jurisdictions are free to provide the service in any way they deem appropriate, some jurisdictions will discover better ways of providing the service, and other jurisdictions will emulate the successful ones (Tanzi, 1995:299). It is expected that by being innovative sub national governments would improve the quality of service delivery, hence efficiency.

The third factor that leads to efficient provision of public services under fiscal decentralisation pertains to motivation derived from responsibility in service delivery. To this end, Tanzi (1995:300) argues that individuals who are responsible for the results of their actions, and who thus have ownership rights over the outcome, are likely to have stronger incentives to perform better. This means that when local officials are directly responsible for providing a public service, they will have a greater interest in succeeding. In addition, it is also argued that when the costs of providing a service are borne by the local jurisdiction, the service is likely to be provided cost-effective to the point where marginal benefits equal marginal costs (Tanzi, 1995:300).

5.2. CAPACITY OF THE PROVINCIAL BUREACRACY

One of the challenges to efficient service delivery by provinces in South Africa is the lack of capacity. Efficient service delivery depends amongst other things on the availability and utilization of appropriately skilled and capacitated human resources. Often than not sub national unlike central governments struggle to recruit appropriately skilled personnel and this adversely affects the quality of services provided. In this regard, Prud'homme (1994:09) notes correctly that central governments are more likely to attract more qualified people because they offer better career, more possibilities of promotion and better salaries.

This scenario reflects the challenges faced by the provincial bureaucracies in South Africa. Several government and media reports highlight the fact that lack of adequately skilled personnel amongst provinces has adversely affected service delivery which limits the efficiency of service delivery. Amongst other things, earlier this year, The Office of the Public Service Commission released a report on the State of the Public Service. This report reflects on the progress made in terms of pursuing the nine principles of the public service as enshrined in the Constitution (1996) of the Republic of South Africa. The report (1996) observes correctly in relation to (principle two) efficient, economic and effective use of resources, that weaknesses in the capacity of the public service to use resources efficiently, economically and effectively ties the hands of government in meeting the challenge to create a better life for all and fulfil commitments made in the *People's Contract*.

One of the key elements in this regard is satisfying the principle of *allocative efficiency*. The principle relates to existence of adequate capacity to ensure that resources are deployed in line with the priorities of government. It is correctly noted in the PSC report (1996) that in order to achieve this, the capacity to understand clearly what these priorities are and what they are intended to achieve is vital. In addition, the Northern Cape Budget Speech of 2006 notes that concerns raised by a National Treasury study aimed at assessing the quality and impact of 2005 strategic and performance plans prepared by Provincial departments on planning, budgeting, implementation and reporting on service delivery and to establish whether the linkages between these processes have strengthened or improved. According to the Budget Speech (2006:10) National Treasury study found amongst other things that although departments follow proper format in formulating strategic plans there is limited evidence that the process has improved the quality of service delivery and efficiency of resource allocation.

Media reports on the role of provinces highlights the fact that there are serious concerns in government regarding efficient service delivery at this level. According to the Sunday Times (2006) there is a view in government and the ruling party circle that provinces hamper development, the current boundaries are unnecessary and inefficient and that provinces have failed to support local governments in areas where capacity is lacking. Amongst other things, it is argued that South African problems arise not from a failure in the management of political or social diversity, but mostly from perceived shortcomings in the capacity of the state to implement its programmes- a factor attributed largely on the ineffectiveness of provinces and municipalities (Xundu, 2006:04).

5.3. FINANCIAL SYSTEM

Another element that affects sub national government's ability to provide efficient public service is financial management. Tanzi (1995:301) correctly questions whether sub national governments especially in developing countries have capacity to manage the flow of revenue necessary to finance their functions and the flow of expenditures. He points out that often than not public expenditure management systems are deficient in developing and transitional countries especially in Africa. Against this background financial management system forms an important point of analysis on whether South African provinces achieve efficiency.

Financial management systems include strong budget offices capable of forecasting expected revenue and anticipated expenditure as well as budgetary classifications that allow the controlling agencies/authorities to determine whether money is actually going to the relevant budget items and functions (Tanzi, 1995:303). They also refer to accounting systems that allow monitoring and control of cash flows and that provide information on the status of expenditure and revenues in a timely, accurate and reliable manner (Tanzi,

1995:303). It is these aspects that form the basis of sound financial management systems that can lead to efficiency in decentralized government structure.

South Africa has made significant progress in terms of improving financial management system across all three spheres of government. The legislation put in place and the independent watchdog role of the Auditor-General demonstrates the sound framework and systems put in place for financial management amongst all three spheres of government. In 1999 the Public Finance Management Act was passed in order to improve financial management systems and accountability in both national and provincial governments. This was followed by the enactment of the Municipal Finance Management Act in 2003 which focuses in putting financial management systems at local government level. These pieces of legislation oblige provinces to account on how they manage financial resources. Amongst other things the act requires provinces to report to National Treasury on the financial situation of the province.

Another development in this regard is the office of the Auditor-General. The Office of the Auditor General which operates in terms of the Audit Arrangement Act of 1992 oversees the overall management of finances in government. This office has been very central in highlighting areas where state resources are not efficiently utilised. The A-Gs office is hailed for having improved the timeliness of audit reports and meeting PFMA and MFMA deadlines, as well as improving the quality of audits (Mail and Guardian, 2006:18). The work of the A-G has received affirmation from various quarters of society and in particular from Parliament. According to 2005 Markinor survey 100 per cent of Members of Parliament's Portfolio Committee on Public Accounts (SCOPA) were satisfied with quality of work of the A-G, 90 per cent felt that the office leads to better financial management and accountability. This demonstrates the positive light which the A-G enjoys in parliament.

Although admittedly, good systems have been put in place and the A-G continues to play a pivotal role, the efficiency of provincial government remains a course of concern. Amongst other things one of the indicators that can be used to demonstrate the inefficiency in the provincial administration is under-expenditure that is rife at this level of government. According to the Sunday Times (2006) it is believed that provincial governments of Mpumalanga, North West, Northern Cape and Free State have consistently failed to invest the funds on building or upgrading schools, clinics and hospitals. There is a general concern regarding failure by provinces to spend money on infrastructure and social services. This is demonstrated by the fact that in the 2005/06 financial year, all nine provinces spent only 84 per cent of their nearly R12 billion which effectively left about R1, 9 billion unspent (Xundu, 2006).

The MEC for Finance in the Northern Cape recently point out to the Provincial Legislature that for reasons including but not limited to slow spending, inconsistency in reporting and late submission of departmental infrastructure plans, National Treasury withheld R41, 974 million in respect of Provincial Infrastructure Grant in the 2005/06 financial year. Although these funds were eventually released they highlight the serious capacity problems in the provincial administration and the extent to which this affects efficient service delivery. It is also important to note that the Northern Cape is not the only province where funds were withheld. This situation demonstrates the lack of capacity within the provincial administration which arguably adversely affects efficient service delivery.

5.4. COMPETITION FOR MOBILE RESIDENTS

Another important point of analysis pertaining to the notion of efficiency under fiscal decentralisation is the movement of citizens to areas that provide better mix of public services and goods. Although there is evidence that residents in

different provinces move to areas that seems to provide better opportunities it is not clear that this has come as a result of or led to competition amongst provinces. Is Gauteng competing with North West or any province to attract people? The argument of the author is that there is no competition for people amongst provinces and that were people move to other provinces is mainly for economic opportunities such as jobs rather than government services such as good school education, health or welfare services.

5.4.1. INTER-PROVINCIAL MIGRATION

The first point that needs to be acknowledged is that there is movement of people amongst the South African provinces. This is demonstrated by the fact that of the people who have changed residence at least once between 1996 and 2001, 31 per cent had been between provinces (Umrabulo, 2006). Inter-provincial migration in South Africa is characterised, in the main, by migration of people from poor provinces with very limited economic opportunities to provinces perceived to possess more economic opportunities such as jobs. This is evident in Statistics South Africa's (2006:05) assertion that internal migration streams shows that Gauteng, Western Cape and KwaZulu Natal experience positive net migration. The same report reveals that there seems to be a high migration from Limpopo and the North West provinces into Gauteng and the provinces that experience the highest outflow of people were the Western Cape and Limpopo (Statistics South Africa, 2005:05).

Further analysis of the population information provided by STATSSA shows that the Northern cape was the only province in South Africa that experienced a decrease (-2,1) in population between 1996 and 2001 (Statistics South Africa, 2001:04). According to the Northern Cape Provincial Growth and Development Strategy (2005) the population trends indicates a shift of 0.9 per cent in the 20-24 year old cohort, which can possibly be attributed to amongst other things people

in this cohort moving to other provinces for tertiary education and better career or job opportunities.

The statistical information provided above demonstrates the fact that South Africans do move primarily to provinces with better economic opportunities than for purposes of public services such as education or health. At the same time during the des-establishment of the cross boundary municipality some residents expressed preference to be incorporated into provinces perceived to be providing better public services. For an example the people of Khutsong in the Merafong Municipality violently protested against being incorporated to the North West province citing poor quality service delivery compared to their original Gauteng province (Mail and Guardian, 2005). The people of Kuruman also successfully lobbied the ANC leadership to incorporate them into the Northern Cape from North West. These residents also cited poor service delivery as the main reason for desire to move to the Northern Cape (Mass Meeting, 2005).

It is clear from above that residence insisted on being incorporate into particular provinces for better service delivery. However, this does not provide us with any evidence that these residents would migrate to the preferred province if not incorporated. In fact in instances where areas were not incorporated to preferred provinces there has been no evidence that people have relocated. So this leads one to conclude that there are no grounds to believe that South Africans move between provinces in search of better mix of public goods and services other than for economic opportunities.

Furthermore, South African provinces do not seem to view inward migration as a positive factor. They appear to view this mainly as undesirable because it puts the resources of the provinces under serious strain and creates back log in service delivery. A report commissioned by the Premier of Gauteng reveals the

fact that the increasing burden of health care system resulting from migration into Gauteng would require the province to establish at least 16 clinics annually (Development Policy Research Unit, 2005:10). In addition, the province is likely to face challenges in addressing existing housing backlogs exacerbated by migration of people into Gauteng (Development Policy Research Unit, 2005:11). These issues demonstrate the immense burden placed on service delivery by inter-provincial migration and the fact that this does not serve as an incentive for richer provinces.

On the other hand provinces with a small population such as the Northern Cape have some incentives that come with growing population. An increase in the Northern Cape would mean a bigger budget because the current equitable share formula is highly reliant on population numbers. The incorporation of Kgalagadi District Municipality and Pampierstad in Phokwane Municipality has increased the Northern Cape proportion of the national budget from 1, 2 percent to 2, 7 percent. This represents significant budget increase that can be channelled to improved service delivery.

5.5. POINT OF DEPARTURE

The main argument in this chapter is that South Africa has put systems in place aimed at achieving efficiency in service delivery across all three spheres of government. However, contrary to the prescripts of the theory of fiscal federalism efficiency has been affected by lack of capacity at provincial level. In addition, although there is evidence of inter-provincial migration there is no evidence that this comes as result of active search for better mix of public goods and services but rather for economic opportunities such as jobs and better careers. At the same time it is not evident that provinces compete with each other for mobile residents but rather that provision of services in provinces attracting inward migration has been under tremendous pressure by increased demand.

CHAPTER 6

6. INCREASED ACCOUNTABILITY

The theory of fiscal decentralisation entails that fiscal decentralisation leads to increased accountability for sub national governments. The basic tenets of this argument are, firstly, that proximity of sub national governments facilitates public participation which leads to increased accountability. Secondly, it is said that sub national governments are more accountable than national government because they compete in elections on more concrete policy issues. Against this background, this section seeks to assess whether fiscal decentralisation as applied in South Africa has led to increased accountability by provinces. Are South African provinces more accountable as a result of fiscal responsibilities bestowed on them?

Since the accountability argument rests more on the notion of public participation, it is important to outline what is meant by this concept. At least four different types of citizen participation or interaction between government and citizens can be identified. The first one relates to citizen's action which is initiated and controlled by them for a purpose that they determine e.g. by means of lobbying of parliamentary committees, public demonstration and protests (Kabemba, 2003:02). The second type relates to citizen involvement, which is initiated by government to improve and/or gain support for decisions, programs and services (Kabemba, 2003:02). Public hearings, consultation with advisory committees, and attitudinal surveys are some of the examples of the second type of interaction. The third type refers to electoral participation, which is initiated by government according to the law in order to elect representatives, while the fourth one relates to obligatory participation, which involves mandatory responsibilities of citizens such as taxation and military services (Kabemba, 2003:02).

Kabemba (2003:02) argues correctly that while all these forms of participation are important, electoral participation remains the most crucial. Accordingly, our analysis begins by looking at the role of elections in holding sub national governments accountable. This will be followed by focus on participation that is initiated by citizens and the one initiated by government.

6.1. ELECTORAL ACCOUNTABILITY

An important component of the accountability argument is that local elections strengthen the accountability of officials to citizens (DFID, 2002). In the same breath an important of analysis for this paper revolves around whether the elections of public representatives at provincial government encourages or facilitates accountability. Elections in South Africa are held every five years providing citizens with an opportunity to elect their provincial government. The South African electoral system has a number of limitations in terms of facilitating accountability of elected officials. It is a proportional representation system characterized by a closed party lists. In 2003 Cabinet appointed an Electoral Task Team to draft legislation for the 2004 National and Provincial Elections. One of the findings of ETT was that although the electoral system may encourage but not ensure accountability, with very few exceptions a lack of or perceived lack of accountability was identified as a problem in the current system (Electoral Task Team, 2003:17). This perception was demonstrated by the fact that only 68 per cent of South Africans felt that electoral system helped voters hold parties accountable while 60 per cent felt that the system helped voters hold individual representatives accountable (Electoral Task Team, 2003:18). In general lack of accountability and availability/responsiveness was identified as the weak point of the South African electoral system which people are otherwise generally happy with (Electoral Task Team, 2003:18).

Furthermore, the fact that the public does not elect individuals in their own right but rather as a result of their association with a particular political party presents

serious challenges to accountability of individual representatives. This situation leads to stifling dissent and ensuring accountability to parties rather than citizens (Mail Guardian, 2006). In fact, it is also argued that individual Members of Parliament or Members of Provincial Legislatures are unaccountable and ineffective because they are guaranteed of party support even when they do not perform (Kabemba, 2003:08).

The powers that political parties have over public representatives have led to a situation where they become accountable primarily to the party than their constituencies. In the previous chapter the notion of political centralisation as it relates to the ANC was debunked. Its implications with regard to the accountability argument are that it makes ANC MPs accountable first and foremost to senior leadership of the party. It has been argued elsewhere that power is concentrated in the Presidency and because of his control of the ruling party and ability to appoint Premiers, Directors-General, Mayors and Party Lists, he can end the career of anyone seen to have embarrassed or disgraced with party policy (Mail Guardian, 2006). This situation further entrenches political centralisation and shifts accountability of public representatives towards their political party.

6.2. PUBLIC PARTICIPATION AND ACCOUNTABILITY

The second element of the accountability argument is that increased fiscal decentralisation is seen as an important means of increasing democratic participation in the decision making process, thereby enhancing accountability and transparency of government actions (Dabla-Norris, 2006:101). The spirit of the RSA 1996 Constitution encourages a participatory democracy by awarding citizens rights to elections, participation in political parties of their choice and to stand for public office. In particular, section 59 and 118 dealing with access to national and provincial legislatures requires them to facilitate public involvement in the legislative and other processes of the assembly and its committees, and

conduct its business in an open manner as well as hold its sittings and those of its committees in public (RSA Constitution, 1996).

Although the Constitution upholds the notion of participatory democracy, serious challenges exist in this regard, especially at the provincial government level. It must be acknowledged upfront that the most notable participation in provincial governance processes is through the provincial elections. The voter turn out for the national and provincial elections was 76 per cent (2004), 88 per cent (1999) and 86 per cent (1994) (HSRC, 2006:03). Although reflects a steadily decreasing voter turn over it is still significant. However, this is the only time when citizens participate in governance process in significant numbers.

A survey conducted by the Centre for policy studies has found that opposition parties, Members of the Provincial Legislature (MPL) and ordinary citizens (public participation) are the least influential policy actors in provinces (Rapoo, 2003:02). For purpose of this paper our focus is on public participation. In this regard, one of the major challenges is the lack of awareness by citizens on the opportunities of participation available in provincial legislatures. According to the survey conducted by the HSRC in 2000, almost nine out of ten South Africans said that they had insufficient or no knowledge about the functions of provincial government, 89 per cent never attended a public hearing of a provincial legislature and more than 90 per cent never made written submissions to public hearings at provincial legislatures (De Villiers, 2002:56). This scenario demonstrates lack of awareness about opportunities for participation which arguable leads to limited public participation in provincial governance processes.

However, it is also important to note that in the face of challenges around formal participation by the public in terms of submissions alternative means have been identified. In particular the government Imbizo programme has awarded citizens with an opportunity to interact with government officials at their places of residence. Imbizo is a forum for dialogue and interaction between government

and the people, it provides an opportunity for government to communicate its programme of action and as well as seek to promote participation of the public in the programmes (RSA Government Online, 2006). In addition Imbizo highlights people's concerns, grievances and advice about government work.

Since the introduction of the Imbizo programme in 2001 it has become the most useful means for the citizens in rural and remotes areas who cannot afford to attend legislature proceedings, to interact and share their opinions about service delivery. Although the Imbizo's have potential to allow citizens to hold government accountable they are limited in this regard. It is important to note that whether residents can hold provincial governments accountable depends on the quality of participation- the ability of citizens to articulate their demands clearly and forcefully to (Smoke, 2001:18). Although some important issues such as housing, unemployment and poverty issues are raised during Imbizo's citizens seem to be under the impression that can be assisted with issues such as maintenance, labour issues and so on.

Secondly, there is no clear feedback mechanisms to ensure that it is communicated to citizens on whether corrective measures have been implemented on the concern their raised. In this regard an important point to note is that accountability requires that local government both develop and make residents feel that their opinion is being solicited, and provide outcomes that make residents feel that their public service needs are being met (Smoke, 2001:19). This means that simply consult with citizens without ensuring that their concerns are addressed effectively is inadequate for accountability purposes. The Imbizo programme has shortcomings in this regard.

6.3. THE ROLE OF MEDIA

Another initiative aimed at promoting public participation in all spheres of government is the usage of online facilities, print and electronic media. Through

these channels government has attempted to communicate the message that other than elections citizens can participate in their private capacity by commenting on government policies, make submission, lobby, petition and how to get involved in legislative processes (Government Online, 2006). Although online facilities are accessed by very small size of the population, many citizens have access to radio. According to Gadget Magazine in 1994 only 24 000 people had access to internet while 3 million people gained access by 2004. In terms of the latest SAARF Radio Measurement Survey of October 2006 on average Monday to Friday radio reaches 77.4 per cent of the adult population. This demonstrates the fact that radio is the one medium that reaches the bigger chunk of the population. To the credit of government public representatives have participated in radio talk shows interacting with communities on whole range of policy and service delivery issues.

Accordingly, instead of the proximity of provincial government promoting accountability the media has been one of the tools used to promote accountability across all spheres of government. The media has a very significant role to play in ensuring that governments are held accountable. An example of how the media can play an important role in ensuring subnational government accountability is the study by Reinikka and Svensson (2004). This study demonstrates the dramatic effect of a media campaign via radio and newspapers informing local communities of their entitlement to school funds from central government in Uganda. According to the study this campaign, along with increase in central government monitoring, reduced diversion of these funds by intermediate provincial governments from 80 to 20 per cent (Reinikka and Svensson, 2004).

In the South African context the media has played an important role especially with regard to corruption and overspending issues. The issue of corruption will be addressed separately in the ensuing sections. An example of how the media has assisted is when they reported on serious overspending in certain provinces. In

2004 the media exposed the fact that the Northern Cape was in the red with more than R800 million. Following this exposure national government intervened and forced the province to develop debt redemption strategy and cost contained measures. As result of these measures the province announced during the 2005 Budget Speech that overspending patterns in some quarters had been arrested and that projections derived from the in-year-monitoring and reporting system indicates that the province will break even for the 2004/2005 financial year (Dikgetsi, 2005:06).

6.4. THE ROLE OF CIVIL SOCIETY

In the face of serious challenges relating to ensuring accountability through public participation, the role of civil society organizations has been pivotal in promoting good governance principles in provincial governments. There is no doubt that civil society has an important role to play in this regard. The role of civil society pertains to increased opportunities for public monitoring and evaluation, which in turn contributes to improved fiscal administration (IDASA, 2004:09). In addition, more responsive governments are said to be providing opportunities for more consultation and participation with civil society in the formulation of sub national policies (IDASA, 2004:09). Furthermore it is expected that fiscal decentralisation may encourage more partnerships between governments, business and non-profit organizations (IDASA, 2004:09). All these factors put together demonstrates the important role that civil society can play in promoting accountability by sub national governments.

In the context of South Africa, a number of non-profit organizations continue to play a leading role in monitoring fiscal administration at both national and provincial level. Amongst other things the Budget Information Service of IDASA has done extensive work on budget transparency and participation as well as monitoring of sub national spending and policies (IDASA, 2006). The Public Service Accountability Monitor (PSAM) also plays a very important role by

conducting independent research, monitoring and analysis as well as gather information on management of public resources and the handling of misconduct and corruption cases by government departments (PSAM, 2006). Another organization that is worth noting in this regard is the Centre for Policy Studies which amongst other things also conduct research and analysis on governance and policy related issues amongst provincial governments.

These organizations continue to play an important role in promoting good governance and accountability amongst provinces. An example of the effectiveness of their role is when PSAM exposed maladministration in the Eastern Cape government resulting a national task team developed to normalize the administration of the province. Amongst other things, PSAM exposed the case of Dr. Goqwana who admitted to owning a private specialist medical practice and an ambulance service whilst in public office at the end of October 2000 (Cwathi, 2004:47). The Budget Information Service continues to make submissions to relevant portfolio committees and engage National Treasury on fiscal administration in general. Amongst other things in 2001 BIS made a submission to the Select Committee on Finance regarding the Financial and Fiscal Commission recommendation for the 2001-2004 MTEF Cycle (IDASA Budget Brief b, 2000).

6.5. CORRUPTION

One of the significant challenges to sub national governments under fiscal decentralisation is corruption. It is important to note that in the context of this paper, corruption refers broadly to activities that include but not limited to bribes, costly efforts made by citizens to influence the design and/or application of laws in their own self-interests, when interest groups apply unusual forms of influence over policy makers to receive preferential treatments (Bardhan and Mookherjee, 2005). Another common activity of corruption especially amongst sub national governments is South Africa, is where procurement policies are flouted to award

tenders to companies that government officials have vested interests. In particular, this entails kick backs paid to officials by opportunistic business people keen to access government funds to build houses, schools, roads and deliver services to local and provincial governments (Van Vuuren, 2004).

There are a number of ways in which fiscal decentralisation has an effect on corruption. Firstly, it is said that "if sub national governments are more capacity constrained, or have less adequate system of accounting and reporting, or contribute to a more opaque government structure or face less critical or powerful opponents, fiscal decentralisation may lead to increased corruption" (Kolstad and Fjeldstad, 2006:05). Secondly, it is argued that abstract principal agent models of contracting elucidate some of the trade-offs involved in delegation of decision making i.e. decisions are made on the basis of better (local) information, but they are made by an agent whose incentives differ from those of the principal thus leading to a loss of control or abuse of power (Bardhan and Mookherjee, 2005).

This assertion is closely related to the argument that decentralisation may serve the interests of local elites who may be able to extract more concessions and preferential arrangements from sub national governments than they would with national government (IDASA, 2006:08). The basic argument is that there are possibilities that fiscal decentralisation simply shifts power from national to local elites and that augmented access of local elites to public resources increases opportunities for corruption (Dabla-Norris, 2006:102). In essence this argument highlights the centrality of the notion of conflict of interests between sub national and national actors. According to Dabla-Norris (2006:102) the impact of fiscal decentralisation on corruption depends to a large extent on the quality of the supporting institutional framework and in particular, the degrees that sub national government or officials can be held accountable.

It is important to note that there are no consensus amongst scholars about the correlation between corruption and fiscal decentralisation. Some authors in

certain contexts provide an optimistic assessment of the effect decentralisation on corruption, others claim that the effects are insignificant, ambiguous and context dependent, while others at the extreme are arguing that decentralisation seriously worsens problems of corruption (Bardhan and Mookherjee, 2005). Furthermore according to two studies from 2001 and 2002 the share of sub national expenditure to total government expenditure is negatively and significantly correlated with corruption (Kolstad and Fjeldstad, 2006:05). These studies are said to conclude that countries with more fiscal decentralisation have lower levels of corruption (Kolstad and Fjeldstad, 2006:06). Although these studies provide a more optimistic picture it is important to note that effect of fiscal decentralisation on corruption is context dependent.

South African provinces are used as a specific context in this paper. In the face of adequate data and information it is difficult to ascertain whether corruption has increased amongst provinces as a result of fiscal decentralisation. However, it can be argued sustainably that the legislative framework and institutional arrangements put in place for fiscal administration goes a long way in curbing the corruption in the system. Amongst other in 1999 the government introduced the Public Finance Management Act in order to modernize the system of financial management, allow public sector managers to manage but at the same time hold them accountable and eliminate waste and corruption in the use of public assets (PFMA, 1999). The manner in which the PFMA has been implemented has left limited room for corruption.

Amongst other things, section 18.1.2 of the Treasury Regulations issued in terms of the PFMA requires Provincial Treasuries to submit a report to the National Treasury on actual revenue and expenditure with regard to its revenue fund before the 22nd day of each month in the format determined by National Treasury (Treasury Regulations, 2001). These type reporting requirements are meant to ensure that sound management of finances by provincial governments. It is

argument of the writer that it is this legislative framework that has minimized corruption rather than proximity to local residents.

Nonetheless it is important to note that the PFAM minimized but not stopped corruption within provincial governments. A number of corruption cases continue to be reported. The Goqwana case mentioned earlier in this chapter is a perfect example of corruption in provinces. In 2003 John Block resigned as Northern Cape MEC for Transport after the Sunday Times exposed him for spending more than R50 000 of tax payers money on jazz festivals and luxury hotels (Sunday Times, 2003). A number of cases can be cited where corruption was exposed in provincial administration. However, one cannot argue that the exposed corruption is a direct result of fiscal decentralisation. Accordingly, it is concluded that corruption is a challenge to fiscal decentralisation and that in South Africa it has been minimized by strong legislative framework.

6.6. POINT OF DEPARTURE

Accountability of provincial governments has not been facilitated necessarily by the close proximity to residents. In the contrary, accountability has been facilitated by the legislative framework, Institutions such as Auditor-General, role of the media and Civil Society. Public participation in governance remains limited as very few people make use of provincial legislatures to hold government accountable.

7. CONCLUSION

The literature on fiscal decentralisation asserts that this phenomenon leads to preference matching, efficiency and accountable sub-national governments. It asserts that because of the proximity of local representatives to their residence they better understand the mix of goods and services they prefer. This allows them to match their preferences. Furthermore, the literature asserts that this leads to allocative efficiency and that competition amongst sub national government for mobile custom also leads to more efficient and innovative means of delivering services. The third advantage identified by the literature is that decentralisation brings sub national government closer to people which create opportunities for public participation that leads to more accountable government.

Over the past twelve years South Africa has indeed awarded more fiscal responsibilities to local and provincial government, a phenomenon known as fiscal decentralisation. The central question being addressed in this paper was whether the fiscal responsibilities awarded to provinces have enabled them to achieve preference matching, efficiency and accountability in line with claims of the theory of fiscal decentralisation. This exercise was conducted for purposes of testing theory against the realities of a developing country.

The paper argues that South African provinces cannot achieve preference matching because they do not have any significant discretion over policy making. This means that provinces are not in a position to decide on particular set of goods and services unique to the preference of their residence other than implement the programmes of national government. In addition, the primary impetus for fiscal decentralisation in South Africa was not for purposes of facilitating preference matching but rather for national unity through addressing the imbalances of the past. This reason requires centralisation of resource allocation function.

Over and above the need to build national unity policy making is centralisation in South Africa comes as result of culture of political centralisation with the ruling ANC, significant electoral support enjoyed by the ANC across all provinces and the leadership style of President Mbeki. Furthermore provincial reliance on national transfers to finance their expenditures has also limited their ability to provide a particular mix of goods and services preferred by their residents.

In the context of South Africa legislative and institutional systems have been put in plays to ensure efficient utilisation of state resources across all three spheres of government. The PFMA seeks to ensure prevent wasteful, unauthorised and irregular expenditure by putting in plays reporting mechanisms. Institutional the office of the Auditor-General continues to play an important role in terms of monitoring financial management in the public sector.

However, a number of challenges to efficient service delivery exist. Amongst other things the lack of capacity amongst provinces has had adverse implications for efficient service delivery. Under-spending on social services and infrastructure development is one the examples of inefficiency that stems, inter-alia, from lack of capacity. In addition, contrary to theory there is no evidence that provinces compete with each other for mobile custom. In fact some provinces lament the pressure that inter-provincial migration puts on service delivery. The Northern Cape is the only province that would benefit from inward migration as this would increase its share of the total provincial budget.

It has also been argued in this paper that provinces are accountable in the main because of the systems put in place by national government and the role of media and civil society. This accountability cannot be accredited to public participation as this remains very limited except as it relates to general elections.

In addition, the current electoral system limits the power that provincial residents have in holding their governments accountable as they do not elect them directly.

The other forms of participation such as submission to the Provincial Legislature have not been successful as very few people utilise them. However, alternative means such as Imbizo have provided a platform for the public to interact with government. Nonetheless, Imbizo programme has not necessarily translated into accountability because of lack of feedback mechanisms on issues raised by the public. The media and other civil society organisations continue to play an important role in terms of promoting good governance and accountability of provincial governments. Radio which is accessed to most people in the country has assisted in terms of inviting government officials to interact and report to the public about service delivery. Civil society organisations such as IDASA and PSAM also play an important role in terms of holding provincial governments accountable.

Corruption remains a significant challenge for fiscal decentralisation. Although it remains difficult to ascertain that corruption increased as a result of fiscal decentralisation, there is clear evidence that it remains a problem for provincial governments. However, legislative frameworks such as the PFMA have played an important role in limiting corruption within provincial governments.

In summary, South African provinces cannot achieve preference matching because they do not have policy making discretion; although systems have been put in place to ensure efficient utilisation of financial resources lack of capacity creates inefficiency problems for provinces; and provinces are accountable not as result of more public participation but rather because of the legislative framework and role of media and civil society.

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