Fiscal centralisation in a federal state: the South African case

E. Calitz & H. Essop

ABSTRACT

The paper seeks to determine whether the observation from a constitutional law and public administration perspective, namely that a distinct centralist tendency has become evident in South Africa in recent years, in terms of legislation, policy and practice of government, is borne out by an empirical analysis of fiscal data. An overview of key legislative, policy and operational changes is combined with an investigation of trends of indicators pertaining to intergovernmental fiscal relations. It is established that the South African fiscal scene has, over many decades, been characterised by a steady and gradual reduction of the fiscal autonomy of sub-national governments. Fiscally, South Africa has become more centralised, thus strengthening the *de facto* erosion of the federal state.

Key words: structure of government, intergovernmental fiscal relations, fiscal centralisation, fiscal decentralisation, public economics, sub-national government, local government, local fiscal autonomy, intergovernmental fiscal relations in South Africa

> We do not have democracy [in Russia] for the simple fact that no functioning self-government has [yet] been established. Local party bosses continue to call the tune at the lower administration level. Alexandr Solzhenitsyn, Russian Nobel laureate 1994 (Hoffschulte 2008: 114)

Introduction

Political (de)centralisation is not necessarily equivalent to or an accurate indicator of fiscal (de)centralisation. Scottish devolution shows, for example, that substantial political decentralisation might take place without fiscal decentralisation (Garrett &

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Rodden (2001: 3). China, conversely, is an example of significant fiscal decentralisation and strong political centralisation (see Zhang 2006).

The South African Constitution, Act 106 of 1996 (RSA 1996) determines as follows regarding the authorities of and relationship between the three tiers of government (Malherbe 2008b: 54):

- Government is constituted as national, provincial and local spheres of government that are distinctive, interdependent and interrelated (Section 40(1)).
- Functional areas of concurrent national and provincial legislative competence and exclusive provincial legislative competence are listed in Schedules 4 and 5, respectively.
- A municipality has executive authority in respect of matters listed in Part B of Schedule 4 and Part B of Schedule 5; and any other matter assigned to it by national or provincial legislation (Section 156(1)). Municipalities also have the authority to impose rates, taxes and surcharges (Thornhill 2008: 73).

There are clear differences of interpretation as to whether and to what extent the Constitution establishes a federal or a unitary state. Ajam and Aron (2007: 749) describe the result of the South African Constitution as a complete restructuring into a *unitary* state with three spheres of government: national, nine provincial governments and 283 local municipalities (down from 784 in the apartheid era), coupled with the creation of a *fiscally decentralised* system of intergovernmental fiscal relations. By contrast, De Villiers (2008b: 2) speaks of a "federal-type dispensation". Malherbe (2008a: 19), also recognising the federal properties, provides yet another description, namely that the Constitution provides that South Africa is a so-called *composite state* with at least three particular *federal features*: the constitutionally entrenched distribution of powers between the national and provincial spheres; the power of the judiciary (specifically the Constitutional Court) to adjudicate jurisdictional disputes between these spheres; and the right of provinces to enact their own constitutions, the Western Cape being the only province functioning under its own constitution (Malherbe 2008a: 20). In addition, the *White Paper on Local Government 1998* (RSA 1998) reflects the acceptance of local government (as distinct from provincial government) as a sphere of government in its own right, no longer viewed as subordinate to provincial and national government (Thornhill 2008: 64).

Malherbe (2008b: 46–50) argues that the *de facto* position with regard to provinces differs significantly from the *de jure* constitutional arrangement and that, fuelled mainly by political and ideological reasons, a "distinct centralist tendency has become evident in South Africa over the past decade". Evidence of this includes:

- the shifting of welfare payment administration from provincial to national government;
- the transfer of social security administration to a national agency;
- the indicated shift of Further Education and Training (FET) colleges from provinces to the national Department of Higher Education and Training;
- increased expenditure norms and standards enforced on the provincial expenditure side;
- the non-activation of income tax sharing and fuel levies as provincial revenue sources;
- the remark in the policy review of provincial and local government undertaken by the South African national Department of Provincial and Local Government[1] that provincial administrations were amalgamated to become "a single public service with national government departments" (De Villiers 2009b: 132);
- the abolishment of the local government regional service levy and the subsequent establishment of a nationally collected and allocated local-government share in the fuel levy;
- the prospective new composition of regional electricity distributors, which is likely to remove the electricity surcharge as a source of local government revenue; and
- the effective possible removal of the health function from provincial governments as implied by the recommendation in the *Green Paper on National Health Insurance*, namely that the public health system be centralised under the control of a "national fund" (under a chief executive appointed by the Minister of Health) with regional offices (Van den Heever 2011: 5).

Two examples of centralisation attempts that were blocked by the Constitutional Court are the objection by the Western Cape province to national legislation that sought to regulate liquor licensing, an exclusive provincial competency, and the Premier of KwaZulu-Natal's resistance to the intention to regulate gambling nationally (Fessha & Kirkby 2008: 263).

Although few and far between, there is evidence of increased decentralisation at the local government level: for metros there has been increased decentralisation in the form of expenditure assignment (devolution of human settlements and public transport functions) and decreased conditionality in grants (e.g. the Municipal Infrastructure Grant), whilst potentially new sources of revenue (e.g. a local business tax) have been under consideration.

Purpose and methodology

The purpose of this paper is to determine whether the centralisation observations from a constitutional law and public administration perspective, as reflected, respectively, in Malherbe (2008a 2008b) and Thornhill (2008), are borne out by empirical analysis of fiscal data. Our main finding is that, over a long time period, intergovernmental fiscal relations in South Africa have become more centralised and this fiscal centralisation appears to strengthen the *de facto* erosion of the federal state.

We combine an overview of key legislative, policy and operational changes with an investigation of fiscal trends. We use the databases of the South African Reserve Bank (SARB) (national accounting statistics and government finance statistics), data obtained from the SARB's Occasional Papers series, and National Treasury data on intergovernmental transfers and aspects of local government finance (see Annexure 1). Throughout we use the term "sub-national" to refer to all non-national (or non-central) government activities as classified in national accounting terms under the heading of general government. We deliberately avoid the debate on devolution versus decentralisation and use the latter term throughout, but we realise that we nonetheless remain vulnerable to all the confusion about the meaning of the concept of decentralisation, as pointed out by Schneider (2003: 34–35). Our focus is on *fiscal* (de)centralisation, although we will also refer to aspects that may be classified as administrative and political (de)centralisation, to use the distinction by Schneider (2003: 33).

The rest of the paper is organised as follows. The next section gives a brief overview of international experience and theoretical considerations regarding fiscal (de)centralisation, which is followed by an indication of the kind of empirical work on decentralisation found in the literature, and then empirical evidence of the South African trend since 1973 is given, before the conclusion.

International experience and theoretical considerations[2]

Globally, the history and experimentation of countries with fiscal (de)centralisation portrays a pendulum of continual search for the right balance between the centralisation and decentralisation of the delivery and financing of government services, that is, of seeking the optimal level of centralisation (or decentralisation).

In recent times, globalisation appears to have had contradictory effects on the choice of the centralisation–decentralisation mix. Trade benefits associated with globalisation and the uneven regional distribution within a country of benefits and costs of trade liberalisation tend to favour centralisation. By contrast, the strengthening of democracy in a globalised world, where decision-making is increasingly – through economic integration – elevated to higher spheres of government, is seen as being ever more dependent on the strengthening of and participation in local decision-making (see for example Hoffschulte 2008). The idea that local (sub-national) government constitutes a separate sphere of government gained formal international recognition in March 1999, when the representation of local authorities was institutionalised in the organs of the United Nations (UN) (Hoffschulte 2008: 112). In so doing, the UN broke with the earlier assumption that sub-national tiers of political responsibility are automatically accounted for when interacting with national governments.

Indicators provide strong evidence of increasing fiscal decentralisation in a majority of countries of the Organisation for Economic Cooperation and Development (OECD) during the past three decades. Multilateral institutions such as the World Bank, United Nations and OECD actively support fiscal decentralisation in developing countries and East European transformation countries to promote economic and social development, and efficiency and transparency in the public sector (Stegarescu 2005). Since 1990, the world has actually witnessed strong movements towards decentralisation and/or secession, such as in Argentina, Colombia, Ethiopia, the republics of the former Soviet Union, Yugoslavia, India, Czechoslovakia, Canada, Belgium, Italy and Spain (Panizza 1999: 97–98).

By contrast, Germany was reunified, and the European Union is the most prominent example of the establishment of economic and monetary union, embodying a dimension of fiscal centralisation. The latter, which came under the most intensive scrutiny and review in the aftermath of the international financial crisis of 2007–2009, had to do with the responsibility towards and accountability for macroeconomic stability and is not necessarily in contradiction of more decentralisation on allocative efficiency grounds.

Nonetheless, the on-going European financial crisis is a good example of the threat to regionalisation of delinquent decentralised fiscal sovereignty. Clearly, political considerations of how best to deal with divided societies or how best to build new societies tend to play a bigger role than pure economic considerations in determining the extent of (de)centralisation. The recent South African political experience is a case in point. In a survey of six African countries (including South Africa), Fessha & Kirkby (2008: 264) conclude that "the prevailing trend of sub-national autonomy in many African states is to reinforce central authority at the expense of democracy, development and accommodation of diversity".

The efficiency and equity arguments underpinning the debate about the appropriate centralisation–decentralistion mix are well documented in most public finance textbooks (see, for example, Ajam 2011) and need not be outlined here, save for mentioning a few key points pertinent to this analysis. An important point of reference, which explains the rationale for decentralisation and why this entails the strengthening of democracy, is the principle of subsidiarity. This is the idea that a central authority should have a subsidiary function, performing only those tasks that cannot be performed effectively at a more immediate or local level.[3]

The classic argument for maximising local discretion is most closely associated with Wallace Oates (1972, 1977), the argument being that the greatest *allocative* efficiency is achieved when budgetary choices are made by local officials elected by local people *who have to meet the full cost of their decisions through local taxes.* Decentralisation on the grounds of *technical* efficiency is based on the alleged reduction in organisational costs (i.e. mobility and signalling cost) and the benefits of vertical and horizontal competition between jurisdictions (see, for example, Panizza 1999: 98).

Arguments in support of centralisation are derived from considerations of technical efficiency (i.e. economies of scale and lower administrative and coordination cost), equity (in the sense of nation-wide redistribution of resources), externalities across borders of sub-national jurisdictions and, of course, macroeconomic stabilisation.

Revenue assignment on the basis of benefit taxation favours local taxes or revenues. The ability-to-pay approach and the associated redistribution function, as well as efficiency of tax collection, the mobility of tax bases across regional boundaries and macroeconomic stabilisation considerations, suggest taxation at a higher level (i.e. national level). Most countries' revenue assignment corresponds to Musgrave's (1983) guidelines.

Revenue shortfalls, given revenue assignments and the expenditure mandates (assignments) of sub-national governments, are addressed through conditional or unconditional transfers from higher to lower tiers of government. Borrowing powers are conditional upon debt-service ability and congruence with macroeconomic stabilisation policies.

Types of empirical work on fiscal decentralisation

Empirical work on fiscal federalism include: the development of appropriate indicators and the measurement of local discretion – for example, Stegarescu (2005); OECD (1999); and Libman (2009) on the Russian Federation; time-series and cross-sectional regression analyses with a view to determining the statistically significant and economically plausible explanatory variables (e.g. Panizza 1998); as well as studies of the impact of fiscal decentralisation on economic and productivity growth and inequality – for example, by Zhang (2006) for China, and Meloche, Vaillancourt & Yilmaz (2004) for European transition economies; on the size of government (as in Ehdaie 1994), or on macroeconomic stability (as in Shah 2005).

Panizza's (1999: 111) analysis of data on 55 countries confirms the finding of Oates that country size and income per capita are negatively correlated with fiscal centralisation. In addition, he finds that democracy and ethnic fractionalisation are negatively correlated with fiscal centralisation, but they have unstable coefficients, highly dependent on the sample used (Panizza 1999: 123).

Initial economic structures and conditions are an important factor in the measure of fiscal autonomy of sub-national governments, as pointed out by Zhang (2006: 713) with regard to China and implied by Schoeman (2006) about South Africa.

Our focus is on identifying indicators of fiscal decentralisation and measuring the extent. We follow Stegarescu (2005: 304) in viewing a system where sub-national levels of government have real autonomy to determine the allocation of their expenditure or to raise their own revenue as *more decentralised* than another system where local or regional government spending and revenue are determined by national legislation, even though the formal assignment of functions or revenues might be the same for both systems. Stegarescu (2005: 312) points out that in federal countries, local government taxes are regulated by regional or state legislation, without the involvement of the central government.

The correct specification of indicators and their correct measurement are obviously decisive for conclusions on trends. Stegarescu has, for example, constructed new data for a number of OECD countries by adjusting local tax revenue for tax-raising powers. One of his results was that, in the case of federal countries such as Austria and Germany, sub-national governments have only limited autonomy over taxation. Consequently, a drastically lower degree of decentralisation was measured than when unadjusted revenue statistics were used. In fact, he shows that some federal countries appear to be more centralised than unitary countries such as Denmark and France, while federal states such as Switzerland, Canada and the USA are among the most decentralised countries (Stegarescu 2005: 315).[4]

Public finance data do not properly reflect true decentralisation. Many years ago, Oates (1972), among others, had already pointed to the limitations of using budgetary shares. The share of sub-national government expenditure or revenue in consolidated general government expenditure or revenue is nonetheless still widely used as a proxy for the degree of decentralisation of the public sector. These measures have various shortcomings (Stegarescu 2005: 302). An increase in sub-national expenditure does not distinguish between an increase in volume (i.e. more of the same service), new services rendered on behalf of or dictated by a higher tier of government (which may not reflect an increase in decentralised discretion) and new services decided on by discretion of the particular sub-national government (which would be true decentralisation). Likewise, an increase in sub-national government revenue does not necessarily reflect more autonomy (i.e. an increase in decentralisation). Such revenue could represent conditional transfers, tax sharing or tax revenue governed and administered by national government laws – a problem of vertical decision-making structures. A clear distinction should therefore be drawn between the measurement of the size of a tier of government, *reflecting total expenditure or revenue at that level*, and the measurement of the extent of independent discretion or decentralised authority, *reflecting independence or autonomy of decision-making and accountability to a distinguishable and clearly defined sub-national constituency of tax-paying beneficiaries to whom the authority is eventually accountable.* The ratio between transfer income from a higher level of government and the total revenue of a sub-national authority could thus be referred to as the grant dependency ratio. The lower this ratio is, the higher the fiscal independence of autonomy.

Because of the above-mentioned complications, various other alternative measures of (de)centralisation have been used, such as the ratio of sub-national government employment to total government employment, the population-normalised number of sub-national jurisdictions and even the number of tiers of sub-national government (as listed by Stegarescu 2005: 306). None of these seem to overcome the above-mentioned problems and will not receive attention here.

Table 1: Classification of sub-national taxes, in decreasing order of control over revenue sources (or of tax autonomy)

Autonomy rank [(1)=highest)]		Nature of SNG tax authority	
(1)		SNG determines tax rate and tax base	
(2)		SNG determines tax rate only	
(3)		SNG determines tax base only	
(4)		Tax sharing:	
	(4.1)		SNG determines revenue split
	(4.2)		Revenue split only changed with consent of SNG
	(4.3)		Revenue split unilaterally changed by NG (legislation)
	(4.4)		Revenue split unilaterally changed by NG (annual budget)
(5)		NG determines tax rate and tax base	

Note: SNG is sub-national government; NG is national government.
Source: OECD (1999: 11)

Stegarescu (2005: 307) identifies three factors with a view to classifying sub-national taxes in decreasing order of fiscal autonomy: legislative competencies to determine the tax base and tax rate, the attribution of tax receipts, and tax administration. In his definition, only taxes that can be chosen independently, and over which sub-national levels of government have their own legislative and administrative powers, ensure complete financial autonomy. Based on an OECD (1999) investigation, Table 1 contains a classification of declining tax autonomy as used by Stegarescu.

The least subjective method of determining the extent of tax autonomy is given by the following formula:

$$\frac{\text{SNG own tax revenue}}{\text{GG total tax revenue}}$$

where SNG = sub-national government and GG = general government.

This corresponds to (1) in Table 1. As one moves down the list in Table 1, the indicators present increasingly weaker degrees of sub-national autonomy. Our analysis of South African trends will *inter alia* be with reference to this table.

Empirical evidence regarding fiscal (de)centralisation in South Africa since 1973

During the apartheid era, several regional governments were created with varied powers to govern, spend and tax. In order to capture a period of major sub-national governmental change, our analysis pertains to the period since 1973, just before the first region (Transkei) was given independent state status in 1976. With the advent of democracy in 1994, the Constitution required the reintegration of apartheid-defined independent and self-governing states into a single new state with nine provinces. Revenue-raising powers under the Constitution have remained highly centralised, however. Not only do the new provinces have limited taxing power, but the Constitution (section 228) (RSA 1996) also determines that these powers must be regulated by an act of the national Parliament. The same applies to the provinces' share in nationally collected revenue, which is transferred in terms of a special division of the annual revenue act of the national Parliament.

Additionally, the most productive taxes, such as value-added tax (VAT), personal and corporate income tax, are reserved for the national government. Provincial governments collect very little own revenue (Section 228 of the Constitution), and the income raised within the province typically amounts to less than 5% of the provincial budget, thus institutionalising huge unfunded mandates[5] and dependence on transfers from national government. The Constitution confirms the historical authority of local government to impose rates on property and surcharges on fees for services provided by or on behalf of the municipality (e.g. for electricity or sewerage). Both provinces and local governments have borrowing powers, but only to finance capital expenditure and not for current expenditure. Moreover, the national government does not guarantee sub-national loans (for more detail, see Aron & Ajam 2007: 750–751; Ajam 2011).

In a factor analysis of three types of decentralisation (fiscal, administrative and political), using 1996 data from 66 countries, Schneider (2003) puts South Africa in position number 19 for fiscal decentralisation (which measured sub-national revenue and expenditure as percentages of total government revenue and expenditure, respectively – in other words the very indicator that Oates advised against), number 63 for administrative decentralisation (a measurement corresponding with the criterion of sub-national tax autonomy) and number 10 for political decentralisation (which measures the occurrence of sub-national elections). In terms of the measures of fiscal and political decentralisation, South Africa has a more decentralised system than almost all the developing and transition economies in the sample, a position entirely lost in respect of administrative decentralisation, which comes closest to indicator (1) in Table 1.

Malherbe (2008b: 48–52) mentions several reasons why the South African Constitution "does not authorise the degree of centralisation we now experience", such as the various ways in which the national government's top-down style of management manifests, and the acute problem of sub-national capacity to manage the allocated functions and resources effectively (see also Smoke 2000: 29). The key point, however, is whether a lack of capacity is seen as something to be remedied by building capacity or solved by centralisation. The centralisation risk is no better illustrated than by former President Mbeki's response during the 2004 election campaign when, after hearing from residents about poor municipal service quality, he remarked that "it may have been a mistake to give local government all the responsibilities they have" (Steytler 2005: 208).

The above observations are borne out by a number of developments that over the years have added to the perception (if not reality) of fiscal centralisation. Data presented by Van Waasdijk (1964: 62) serve as a historical reference point. The average shares of the three tiers of government in total government revenue for the period 1959–1962 were as follows: national government (70.6%), provinces (9.6%) and local authorities (19.8%). Municipalities and other local authorities, with their property tax and access to user charges in respect of services, were financially largely self-sufficient, although much of their capital expenditure was subject to approval by the Treasury or Provincial Administration (see Van Waasdijk 1964: 60–62).

Van Waasdijk (1964: 100–119) and others, such as Browne (1983) and Calitz, Du Plessis & Siebrits (2009), have previously discussed the major changes in the state of responsibilities and revenue sources of sub-national government since the early 1960s. As a result, several conclusions can be drawn regarding fiscal (de)centralisation in the provincial government sphere. Firstly, the reduction in financial independence of provinces, which had already surrendered their share in national company tax as a revenue source in 1957, continued during the second half of the previous century with the abolition in 1971 of provincial income tax.

Secondly, during the period 1975–1994, the apartheid experiment of independent and self-governing states entailed the empowerment of these regional authorities with more tax powers. In fact, all the normal national taxes were at the disposal of the four "independent" states, even though their tax bases were so small that major transfers from the South African government were continuing. Within South Africa – as defined during the time of apartheid – the four provincial governments continued to experience dwindling decentralised autonomy, which manifested inter alia in the replacement in 1986 of elected provincial councils with executive councils.

Thirdly, the 1996 Constitution, by which the different apartheid regional governments were consolidated and restructured, in the form of the present nine provinces, provided for new provincial tax sources, notably income tax sharing and fuel levies, thus raising prospects of stronger provincial financial self-sufficiency. These tax sources are not out of line with, for example, Musgrave's assignment guidelines. However, such new provincial taxes have not been implemented, with the *de facto* situation showing a continuation of the pre-1994 pattern: for example, the envisaged implementation of a fuel levy in the Western Cape (Brown 2007) was not approved by the National Treasury, and a local government share in the national fuel levy was instituted instead (National Treasury 2008: 70). The irony is that, immediately after the Western Cape provincial government's attempt failed, National Treasury raised the national fuel levy by R0.50 country-wide to substitute for the Regional Services Council (RSC) levies at municipalities, notably the metros.

Even though the RSC levies were replaced by a fuel tax sharing dispensation, the local government sphere has experienced less erosion of autonomy than provinces over time. However, the poor revenue bases and capacity constraints that characterised many local authorities before 1994 did not disappear with the re-demarcation and concomitant rationalisation of municipalities after 1994. In the metropolitan municipalities (category A) and some of the local municipalities (category B) that were financially stronger, some of these deficiencies could be absorbed in the form of a redistributional obligation imposed on local government as developmental institutions (see Steytler 2005: 190). However, poor service, low revenue bases and capacity constraints still characterise many municipalities, threatening decentralisation unless an asymmetric approach is followed with sufficient accommodation and support for municipalities to graduate towards increased self-standing financial status.[6] Nonetheless, there appears to be a smaller difference between *de facto* and *de jure* decentralisation with regard to local government than provincial government.

Against this background of events and incidents, we now turn to an analysis of fiscal data to determine fiscal centralisation tendencies at both provincial and local government levels. We proceed with a description of the data before utilising several key (de)centralisation measures, as noted in Table 1, to determine whether South Africa has seen any clear trend towards becoming more or less fiscally centralised.

Data and methodology

The data employed in the analysis that follows were obtained from the South African Reserve Bank's (SARB) Quarterly Bulletin for several of the variables used in this paper. The underlying method and structure of public accounts data (and indeed national accounts) were changed over time (see De Clerck 2003), but neither Statistics South Africa (StatsSA) nor the SARB has officially reconstructed the public accounts data prior to 1992 on the basis of the latest method and structure. Consequently, we had to construct a unified series utilising other sources for data prior to 1992.

The SARB did, however, publish a paper that provides public-sector accounts data from 1973 to 1990 (SARB 1991), which represents an attempt to address the lack of historical data, albeit with unofficial data. It is believed that these two data sets are comparable, as the underlying methodologies are based on the International Monetary Fund's (IMF) *Manual on Government of Finance Statistics* (GFS). Consequently, the constructed series and results can be interpreted as if both data sets form a single complete set of data. However, if differences in the data sets cannot be reconciled, the resulting trends from each data set have to be interpreted separately. This is discussed in more detail following Figure 1. For purposes of clarity, we refer to the data described here as Data Set 1 (DS1).

As noted earlier, several indicators – listed as (a) to (f) in Table 2 – have been used in the literature to measure fiscal (de)centralisation.

The tax coverage ratio (e) is considered a strict measure of fiscal centralisation and comes closest to indicator (1) in Table 1. However, we regard indicators (b) and (c) in Table 2 as reflecting the *size* of operations rather than the extent of *autonomy*. Also note that, in the case of the total revenue ratio – (b) in Table 2) – high levels of transfers from national government would bias the SNG total revenue figures as indicators of fiscal decentralisation. Instead of the seemingly greater fiscal discretion, large transfers actually indicate exactly the opposite, namely greater dependency of SNG on national government. Consequently indicators (b) and (c) in Table 2 are not measured in this paper.

Table 2: Formulae for fiscal (de)centralisation indicators

	Indicator	Formula
(a)	SNG own tax revenue as % of total CGG tax revenue (tax revenue ratio)	$\frac{\text{SNG own tax revenue}}{\text{CGG total tax revenue}}$
(b)	SNG revenue as % of total CGG revenue (total revenue ratio)	$\frac{\text{SNG total revenue}}{\text{CGG total revenue}}$
(c)	SNG expenditure as % of total CGG expenditure (total expenditure ratio)	$\frac{\text{SNG own current expenditure}}{\text{CGG total current expenditure}}$
(d)	Grant to total revenue ratio (grant dependency ratio)	$\frac{\text{SNG grant revenue}}{\text{SNG total revenue}}$
(e)	Tax-expenditure coverage ratio	$\frac{\text{SNG own tax revenue}}{\text{SNG total current expenditure}}$
(f)	Tax-wage coverage ratio	$\frac{\text{SNG own tax revenue}}{\text{SNG wage bill}}$

Note: SNG is sub-national government; CGG is consolidated general government.

Instead, we suggest three additional indicators to measure the extent of sub-national autonomy. First, the grant dependency ratio (d) reflects the extent to which sub-national government is dependent on grants for revenue purposes. Next, the tax coverage ratio with respect to total expenditure reflects the ability of sub-national government to finance their expenditures with their own tax revenue. Under a balanced budget, the grant dependency ratio and the tax-expenditure coverage ratio are mirror images. The third indicator is the tax-wage coverage ratio (f), that is, the ability of SNG to fund salaries and wages with own tax revenue. This implicitly assumes that SNG pays wages before spending on any other item is considered.

In the next section, we utilise DS1 to construct the indicator (a) shown in Table 2 for the period 1973 to 1990, and 1992 to 2008, as well as indicators (d), (e) and (f). Note that DS1 does not contain data for 1991. The lack of data for 1991 is represented by a dashed line, assuming a linear trend between the 1990 and 1992 data points.

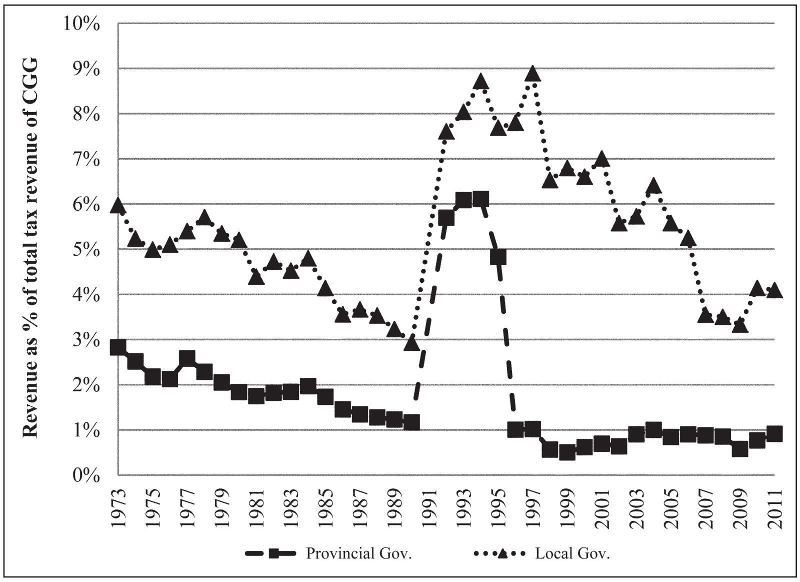
Results

As shown by Stegarescu (2005) and others, the tax ratio of sub-national to general government is considered the strictest (purest) measure of sub-national autonomy. An increasing (a decreasing) ratio indicates increased (decreased) fiscal autonomy. Figure 1 presents the sub-national (provincial and local government) tax ratio for South Africa.

We link the data series on provincial government up to 1990 (excluding Transkei, Bophuthatswana, Venda and Ciskei, generally referred to as the TBVC states), and after 1992 (in respect of the post-apartheid South Africa, which includes the revenues previously attributed to TBVC states) with a dashed line in Figure 1. The bulge in the period between 1990 and 1994 is attributed to the fact that the TBVC states were allowed to levy taxes[7] that provinces could not. Notwithstanding the inability to generate an integrated series, it is clear that the declining trend prior to 1990 continued after 1994, on balance indicating deteriorating fiscal autonomy for provincial government for the entire period under consideration. For the period 2003 to 2008, the provincial tax revenue ratio appears to stabilise at below 1%, far below the peak of almost 8% if the TBVC states were to be included during the apartheid years, as well as below the 3% provinces-only ratio of 1973. Note that the 1973 ratio was already far below the 9.6% average of 1959–1962, as reported earlier.

When the tax ratio for local government is considered, as shown in Figure 1, the results are somewhat ambiguous. For the period 1973 to 1990, there is a clear downward trend, implying reduced fiscal autonomy. However, this could also be a result of the campaign of non-payment for services launched against the then national government during the apartheid era. Then, with the inclusion of the TBVC states in the data post-1992, the number of local governments increased, which partly explains the increase from 1990 to 1992. After 1992, local government fiscal autonomy, as represented by the tax ratio, fluctuates around a mean of approximately 6%, and in recent years shows a substantial decline from 6.4% in 2004 to 4.1% in 2011. (Note that this ratio averaged 19.8% during 1959–1962, as reported by Van Waasdijk [1964: 62]). The latter dip can in part be attributed to the removal by National Treasury of RSC levies as a local government revenue source, but another factor is that arrears on municipal rates have recently become a major problem. Despite an apparent improvement in recent years, in December 2010 outstanding debtors stood at 30% of local government own revenue (National Treasury 2011: 61).

Unlike the provincial tax ratios, the local government tax ratios in Figure 1 did not quickly revert to the levels expected following the reincorporation of the TBVC states and the accompanying municipalities. The two trend lines in Figure 1 show that after the spike in the tax ratio for provinces and local government in 1991–1992, the trend line for local government fell much more slowly. A possible explanation is the reduction in revenue sources for local government noted above, which occurred with a lag. Another possible reason concerns the incorporation of data for local government in the former TBVC states after 1993. This raised the trend line above what it would have been if only non-TBVC local governments were included. In this sense, the important difference compared to the provincial trend line is that, after 1993, the revenue ratios pertaining to provinces were reduced because of the immediate reduction in revenue sources such as income and indirect taxes that accompanied the reincorporation of the TBVC states.

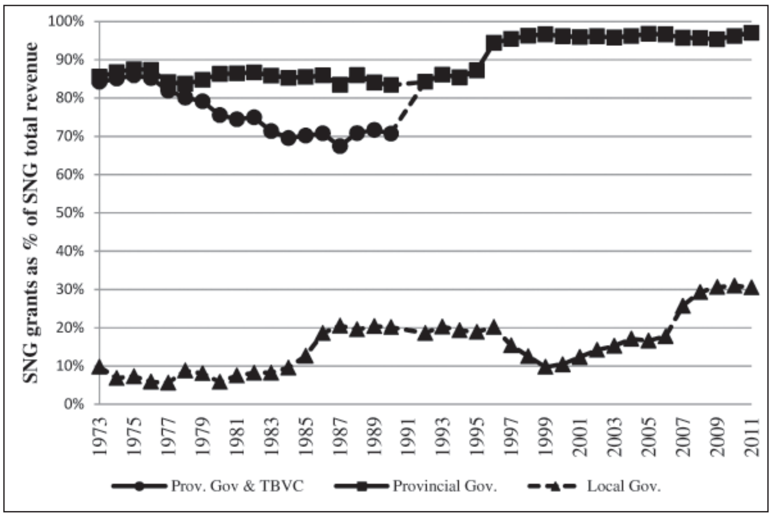


Note: CGG is consolidated general government.
Source: Own calculations based on SARB (1991) and SARB *Quarterly Bulletin* data

Figure 1: Tax ratio: tax revenue as a percentage of consolidated general government tax revenue, by type of SNG (1973–1990, 1992–2011)

In summary, the SNG tax ratio clearly indicates decreasing fiscal autonomy for provincial government for the period 1973 to 2011, even if the two data sets are considered non-comparable. Furthermore, the current tax ratio levels appear to have stabilised at less than 1% since the late 1990s. For local government, the result is less clear: we observe a decreasing trend from 1973 to 1990, fluctuations around a higher level from 1992 to 2006, and a subsequent sharp decline. This decline has been mitigated somewhat by an increase in the tax ratio to over 4% for 2010 and 2011.

Figure 2 presents the grant dependency ratio (indicator (d) in Table 2), which measures the extent to which SNG is dependent on grants (or transfers) from national government to finance their activities.



Note: SNG is sub-national government.
Source: Own calculations based on SARB (1991) and SARB *Quarterly Bulletin* data.

Figure 2: Grant dependency ratio: grant revenue as a percentage of total revenue, by type of SNG (1973–1990, 1992–2011)

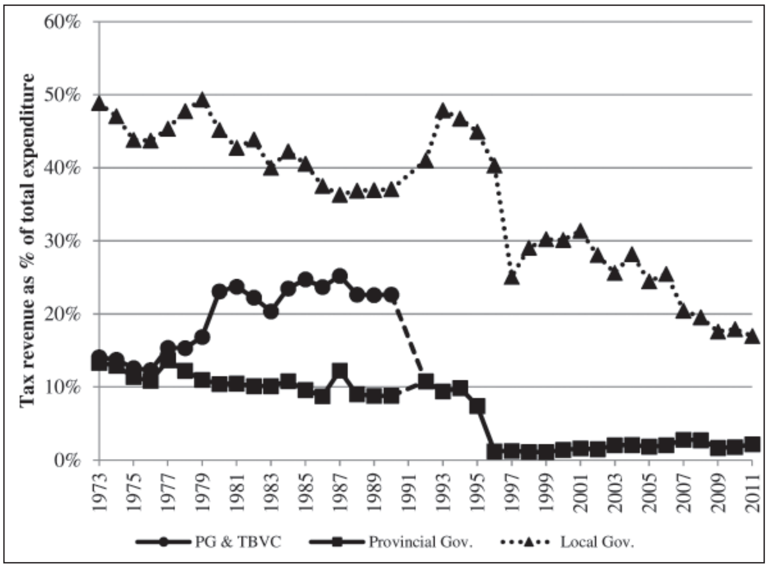
For the period 1973 to 1990, this ratio was just below 90%, but it increased to 97% by 2011, leaving no doubt as to the provinces' high and increasing dependence on grant revenue. The corresponding figures for the combination of provincial governments and TBVC states for the 1973 to 1990 period also showed a decline between 1973 and 1990, as would be expected given the TBVC states' tax ability, as noted earlier. However, even when these additional revenue sources are considered, the provincial governments and TBVC states combined at best still received 70% of their revenue from grants. Despite the share of tax revenue collected nationally, to which SNGs are *entitled* in the form of block grants, such a high level of dependency on national government for funds does nothing to change the view of a highly fiscally centralised system as far as the provinces are concerned.

Local government seems less dependent on grant revenue than provincial government, but has also become more dependent on national government since the

1970s, and again from 2000 onwards, with the grant dependency ratio increasing steeply and peaking at 31% in 2010.

A measure that is to a certain extent the inverse (or mirror image) of the grant dependency ratio is the tax coverage ratio. This ratio provides an indication of an SNG's ability to finance the activities imposed on it by the relevant acts and the Constitution of South Africa by means of own revenue resources. The ratio reflects tax effort, which may be equal to or less than the tax capacity, given the tax authority. Again, an increasing trend shows decreasing centralisation, or improved fiscal autonomy.

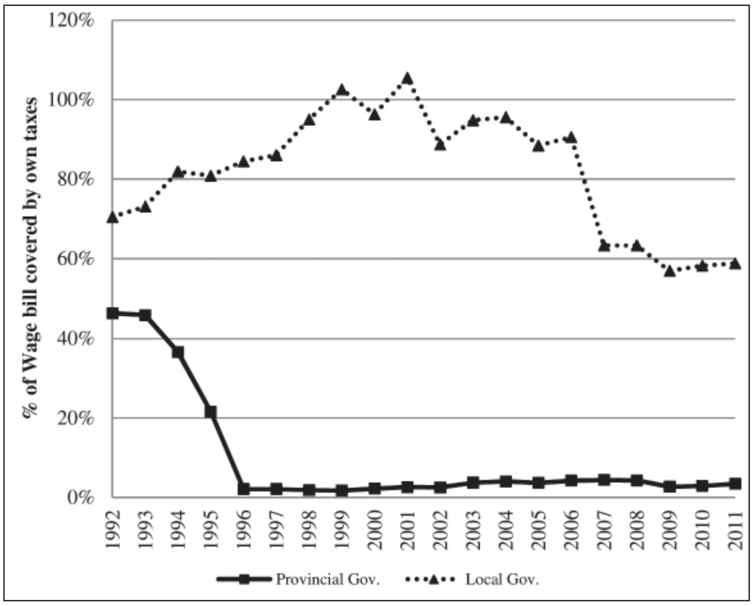
The same centralisation trend as in Figure 2 is now shown in Figure 3 in the form of a declining provincial and local government tax coverage ratio. Although the overall levels of the provincial tax coverage ratio are higher when the TBVC states are included in the 1973 to 1994 period, the overall trend remains the same, with the value reaching a rather low level of only 2.18% in 2011. This means that provinces in South Africa could only cover 2.18% of their current expenditure from own revenue.[8]



Source: Own calculations based on SARB (1991) and SARB *Quarterly Bulletin* data

Figure 3: Tax coverage ratio: tax revenue as a percentage of total expenditure, by type of sub-national government (1973–1990, 1992–2011)

Local government could cover about 50% of its current expenditure from own revenues at the beginning of the period under consideration. However, the tax coverage ratio declined to less than 17% by 2011.[9] Interestingly, the tax coverage ratio for local government also reveals that growth in local government expenditure has accelerated at a much faster pace than growth in own tax revenue. It is obvious that if this trend continues, local government's fiscal autonomy will be reduced even more in future.



Source: Own calculations based on SARB (1991) and SARB *Quarterly Bulletin* data

Figure 4: Tax-wage coverage ratio: wage expenditure as a percentage of own tax revenue, by type of sub-national government (1992–2011)

The trend of the tax-wage coverage ratio is shown in Figure 4. It shows that provinces in South Africa can foot less than 3.5% of their 2011 wage bill, which implies that 96.5% of all provincial employees' wages are *de facto* paid for by national government. Provincial government discretion is further eroded by the fact that the levels of and periodic adjustment in remuneration of provincial employees (which averaged 58% of provincial operating expenses from 1996) are determined as part and parcel of the wage negotiation process between national government and the labour unions. Local government fares better where tax-wage coverage is concerned, covering almost 60% of its wages with own taxes. However, the overall trend for local government is declining in this regard.

In summary, the indicators show that sub-national government faced increased fiscal centralisation for the period 1973 to 2011. There can be little doubt that provincial governments have been greatly centralised, rendering them *de facto* administrative offices of national government. Increased fiscal centralisation also holds for local government, but less than for provincial government. With regard to both provincial and local government, however, the unfunded mandate, defined as the difference between the cost of delivering on their constitutional mandate and the constitutional revenue sources, is growing. It might be argued that this is an excessively narrow definition of the unfunded mandate, because the Constitution provides for a share of provincial and local government in revenue collected nationally. The narrow definition is appropriate, however, as an indicator of independent ability.

Conclusions

The South African fiscal scene has over many decades been characterised by a steady and gradual reduction of the fiscal autonomy of sub-national governments, which continued after 1994 despite the federal constitution. This paper found evidence of this by investigating the trend in fiscal autonomy with regard to various legislative, policy and operational measures between 1973 and 2011, as well as a number of indicators of fiscal (de)centralisation.

Although the implications of this trend are not discussed here, the literature suggests that increasing fiscal centralisation poses a threat to the allocative and technical efficiency of public services and the development of democracy in South Africa. South Africa may therefore well be heading towards a state that may be described either as a highly centralised federal state – to use Libman's (2009) ironic characterisation of the Russian federation – or as a unitary state with "delegated" responsibility to provinces and a measure of decentralisation at local level. Whatever the description, the outcome seems to be *de facto* fiscal centralisation, which deviates from the *de jure* South African Constitution of 1994, and a continuation after 1994 of the historical trend towards increased fiscal centralisation.

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Endnotes

1. This review may well have been borne out of growing doubts within the African National Congress (ANC) government about the continued existence of provinces. Such doubts are not new. At the time of the Great Depression (1929–1933), the usefulness

and continued existence of the provincial system was also in doubt. Van Waasdijk (1964: 213–214) points out that the co-existence in the provincial system "of a fair degree of political autonomy with a great measure of financial dependence made many wonder whether provinces were really viable". How this type of doubt is dealt with results in the strengthening of either the unitary or the federalist route.

2. Much work has been done on the implications and efficiency impacts of fiscal centralisation and new research, particularly second and third generation fiscal centralisation theory – see, for instance, Oates (2005) and Vo (2010), who provides more support for a positive efficiency impact of centralisation. We note, however, that the focus of this paper is to determine the fiscal centralisation trend in South Africa, not its impact.
3. The principle of subsidiarity is linked to the Bishop of Mainz, Emmanuel von Ketteler (1811–1877), according to whom government should undertake only those initiatives which exceed the capacity of individuals or private groups acting independently. Functions of government, business and other secular activities should be as local as possible. In response to a request in 2003 by the UN Governing Council, the Advisory Group of Experts on Decentralisation drafted a Framework of Guidelines for Decentralisation and the Strengthening of Local Authorities. This report actually supported the subsidiarity principle, which was remarkable "given the fact that subsidiarity is recognised to go far beyond mere decentralisation" (Hoffschulte 2008: 118).
4. Other authors, such as Ebel and Yilmaz (2002), Zhang and Zou (2001) and Abachi and Salamatu (2012), make similar use of the definitions as Stegarescu (2005).
5. This is not a new phenomenon. Van Waasdijk (1964: 108), writing about local authorities in South Africa, comments as follows: "Superior government authorities have never been very generous in their aid to municipalities, councils and area boards, although they have not hesitated at times to allocate to them an increasing burden of civic responsibility."
6. In the 2010/11 financial year, only 13 of the 283 municipalities received clean audits, the most recent evidence of poor financial management at the third tier of government (Auditor-General 2012).
7. The TBVC states had six tax revenue categories according to the SARB (1991), namely (i) taxes on net income and profits, (ii) taxes on property, (iii) taxes on goods and services, (iv) taxes on international trade and transactions, (v) employer's payroll and manpower taxes and (vi) other taxes.
8. The non-tax part of own revenue is so small that one can safely interpret the tax coverage ratio in this wider sense.
9. In the case of local government, the difference between tax and total own revenue is bigger than for provinces; we therefore retain the distinction.

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Annexure I: Data series sources, codes and time periods

Series name	Code	Period
Government finance statistics of general government	T419,S070,24	1992–2011
Cash receipts from operating activities	4856F;A	1992–2011
Cash receipts from operating activities: Taxes	4857F;A	1992–2011
Cash receipts from operating activities: Social contributions	4858F;A	1992–2011
Cash receipts from operating activities: Grants	4859F;A	1992–2011
Cash receipts from operating activities: Other receipts	4860F;A	1992–2011
Cash payments for operating activities	4861F;A	1992–2011
Cash payments for operating activities: Compensation of employees	4862F;A	1992–2011
Government finance statistics of provincial governments	T417,S068,24	1992–2011
Cash receipts from operating activities	4801F;A	1992–2011
Cash receipts from operating activities: Taxes	4280F;A	1992–2011
Cash receipts from operating activities: Social contributions	4802F;A	1992–2011
Cash receipts from operating activities: Grants	4283F;A	1992–2011
Cash receipts from operating activities: Other receipts	4281F;A	1992–2011
Cash payments for operating activities	4803F;A	1992–2011
Cash payments for operating activities: Compensation of employees	4804F;A	1992–2011
Government finance statistics of local governments	T418,S069,24	1992–2011
Cash receipts from operating activities	4826F;A	1992–2011
Cash receipts from operating activities: Taxes	4827F;A	1992–2011
Cash receipts from operating activities: Social contributions	4828F;A	1992–2011
Cash receipts from operating activities: Grants	4829F;A	1992–2011
Cash receipts from operating activities: Other receipts	4830F;A	1992–2011
Cash payments for operating activities	4831F;A	1992–2011
Cash payments for operating activities: Compensation of employees	4832F;A	1992–2011
TBVC and self-governing states	GFS003	1973–1990
Tax revenue	SARB OP4	1973–1990
Non-tax revenue		1973–1990
Grants		1973–1990
Total current expenditure		1973–1990

Annexure I continued

Annexure I continued

Series name	Code	Period
Provincial government	GFS007	1973–1990
Tax revenue	SARB OP4	1973–1990
Non-tax revenue		1973–1990
Grants		1973–1990
Total current expenditure		1973–1990
Local government	GFS008	1973–1990
Tax revenue	SARB OP4	1973–1990
Non-tax revenue		1973–1990
Grants		1973–1990
Total current expenditure		1973–1990
Consolidated general government	GFS009	1973–1990
Tax revenue	SARB OP4	1973–1990
Non-tax revenue		1973–1990
Grants		1973–1990
Total current expenditure		1973–1990

Source: Unless noted otherwise, data were drawn from the SARB *Quarterly Bulletin*.

Note: 1. SARB OP4 refers to SARB Occasional Paper 4, cited as SARB (1991) herein.

2. Data as on 16 April 2012. Data for last two years (2010, 2011) are subject to revision.