

# ERSA Research Brief

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## The Contribution of Fiscal Decentralization to Regional Inequality: Empirical Results for South African Municipalities

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In recent years, questions have been raised on whether the current functions and powers of South Africa's municipalities are sufficient for to achieve the developmental mandates set out in the Constitution. As the representative government closest to citizens, there has been increased demand for the transfer certain functions, such as housing, public transport and land use planning to municipalities. To address these questions, this study sets out to examine the effects of fiscal decentralization on inter-municipal inequalities across the 234 municipalities that constitute South Africa's local government sphere. To facilitate the analysis, we rely on a theoretical model of fiscal decentralization, where the devolution of fiscal powers away from to sub-national units acts as a commitment device that motivates sub-national authorities to implement policies to reduce inter-regional inequality. The theoretical predictions are tested using a panel data covering the period 2003–2012.

The result of the empirical analysis provides evidence of a statistically significant relationship between fiscal decentralization and inequality in the context of South Africa's municipality. Specifically, the nature of the relationship depends on how fiscal decentralization is measured.


Where measures of fiscal decentralization are revenue based, the regression estimates support the hypothesis that the commitment device of fiscal decentralization provides incentives that decrease inters-municipal inequality. On the other hand, expenditure based fiscal decentralization contribute to increased inter-municipal disparities. This conclusion is robust to alternative estimation strategies and methods.

So, can greater levels of decentralization help reduce inter-regional disparities in South Africa? As the regression results indicate, increased expenditure decentralization may actually worsen inter-municipal inequality, particularly given limited planning resources and inadequate capacity issues faced by a number of municipalities. Policies aimed at having municipalities take up increased responsibilities for implementing inequality reducing expenditure programs must acknowledge the existence of large variations in capacity levels across the 234 metropolitan and local municipalities. A more pragmatic approach could be a policy that places emphasis on ensuring that municipalities are able to focus on those responsibilities that they are able to deliver on. This would imply that certain municipalities ought to focus on a

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smaller set of functions while other municipalities could expand their expenditure focus. In this regard, ongoing discussions on the practicalities of implementing a differentiated approach, which takes into account the different capacities at the local sphere when devolving additional expenditure and revenue functions to municipalities will be of positive benefit to reforms targeting the improved efficiency of South Africa's intergovernmental fiscal relations.