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Asymmetric Decentralisation in South Africa: Implications for Municipal Governance

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Abstract.

This paper examines how asymmetric decentralisation shapes municipal governance in South Africa. Building on fiscal federalism perspectives, it analyses how differentiated powers, functions, and revenue capacities among municipalities at the same constitutional tier affect service delivery. The study uses a qualitative case study that synthesises secondary evidence from national audit findings, intergovernmental financial reports, and policy and oversight documents. Findings indicate a multi-speed local state. Metropolitan municipalities benefit from broader own-revenue bases and stronger administrative systems, enabling more reliable infrastructure investment and service provision. Many local municipalities remain transfer-dependent with uneven delivery, while district municipalities operate under rigid mandates that are not matched by commensurate revenue instruments. These asymmetries reinforce vertical and horizontal inequalities in the country. The study argues for capacity-linked functional assignments, targeted equalisation, clearer and enforceable mandate definitions, and the disciplined use of conditional grants and performance contracts. Such measures would align responsibilities with capability, mitigate regressive effects of asymmetry, and support more equitable and accountable local governance.

Keywords: *Asymmetric decentralisation; fiscal federalism; local government; municipal finance; equalisation; service delivery; South Africa*

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1. Introduction

Municipalities in South Africa occupy a single constitutional sphere of government, yet they exhibit systematically divergent fiscal conditions that shape the reliability with which basic services can be financed. The central research question is: How do de jure differences in municipal expenditure responsibilities and financing arrangements affect service delivery? The object of analysis is the assignment of functions and financing attached to municipalities within the local government sphere, with attention to constitutionally defined municipal categories as the institutional mechanism through which asymmetry is created and sustained (Republic of South Africa, 1996).

Using a case study of South Africa's local government system, the paper examines how asymmetric decentralisation generates governance divergence across municipalities. It shows that functional asymmetries, while often introduced to reflect spatial heterogeneity and differentiated local capacities, become fiscally and institutionally destabilising when they are not accompanied by commensurate fiscal powers, intergovernmental transfers, or adaptive planning instruments. The paper makes both theoretical and applied contributions. Theoretically, it advances debates on asymmetric decentralisation by clarifying how differentiated expenditure mandates, when insufficiently matched with revenue-raising authority and fiscal equalisation mechanisms, translate into persistent vertical and horizontal fiscal imbalances. Applied, the paper provides an empirically grounded basis for rethinking the system of local government reform in South Africa, with direct relevance for the design of more coherent and equitable intergovernmental fiscal arrangements. Specifically, the analysis examines how differences in expenditure responsibilities, own revenue performance, and transfer design are associated with persistent fiscal inequality across municipal categories. In doing so, it offers a structured way to interpret fiscal patterns and draw design implications which can inform reforms aimed at strengthening local revenue autonomy, recalibrating fiscal equalisation, and improving the long-run sustainability of decentralised service delivery within an asymmetric decentralisation regime.

The case study first sets out the conceptual framework and situates the analysis within the literature on asymmetric decentralisation. It then details the research design and methods, followed by an overview of South Africa's local government system. Subsequent sections analyse revenue and expenditure outcomes. The paper concludes with key findings and policy recommendations.

2. Conceptual Framework

Fiscal federalism provides the core analytical lens for assessing how formally assigned functions and fiscal instruments shape subnational fiscal outcomes. Within the fiscal federalism theory, the assignment principle is often summarised as "finance follows function" implying that where a lower tier is mandated to deliver basic services, the fiscal framework must supply either strong own-source revenue instruments that co-move with expenditure needs or predictable and sufficiently sized transfers that close the gap without undermining accountability (Bird & Smart, 2002; Boadway & Shah, 2007).

This study focuses on de jure asymmetric decentralisation, defined as formally differentiated powers, functional assignments, and financing rules applied to subnational governments within the same local sphere, where such differentiation is anchored in constitutional provisions, statutes, regulations, or legally binding intergovernmental rules (Allain-Dupré, Chatry, & Moisio, 2020). This definition excludes divergence arising solely from implementation variance, administrative capability, local political dynamics, or other practice-based variations.

A common critique of asymmetry analyses is that units classified as being at "the same level of government" may not be functionally comparable. This study addresses that concern by treating South Africa's constitutionally mandated three-tier municipal system as the exogenous institutional design condition of interest. The relevant question is therefore not whether municipalities are identical, but whether the Constitution systematically assigns differentiated functions and financing rules across municipal categories while retaining them within a single local government sphere (Allain-Dupré, Chatry, & Moisio, 2020).

2.1.Hypotheses

Building on the de jure asymmetry framework and the institutional design of South Africa's municipal system, this study advances four hypotheses that trace the fiscal and service-delivery consequences of differentiated functional and financing assignments.

- **H1 (Vertical imbalance channel)**: the asymmetric assignment of functional mandates and revenue authority across municipal categories structurally embeds vertical fiscal imbalance risk, observable in transfer dependence and constrained fiscal space.
- **H2 (Horizontal inequality channel)**: the constitutionally differentiated assignment bundles across municipal categories systematically generate horizontal fiscal inequality, observable as persistent dispersion in revenue and expenditure capacity between categories.
- **H3 (Expenditure quality channel)**: revenue constraints embedded within differentiated assignment bundles are associated with structurally weaker expenditure performance in affected municipal categories, reflected in lower capital execution rates, reduced maintenance effort, and grant absorption.
- **H4 (Equalisation limitation, design-consistent)**: while intergovernmental transfers mitigate the fiscal gaps implied by asymmetric assignment bundles, the current equalisation framework does not fully neutralise them, resulting in persistent category-level divergence over time.

Taken together, the four hypotheses frame the legal design of local government as a key determinant of fiscal outcomes. Structural conditions such as poverty, geography, unemployment, and unequal tax bases matter, but they do not fully explain the persistent differences observed across municipal categories. The paper therefore interprets the patterns in transfer dependence, revenue and expenditure dispersion, spending execution, and the limits of equalisation through the lens of formally assigned functions, revenue authority, and transfer rules.

3. Literature Review

Decentralisation is the transfer of decision-making, administrative, and fiscal authority from the centre to regional or local governments to improve local responsiveness, democratic accountability, and policy effectiveness. In fiscal decentralisation, the classic view laid out by Musgrave (1959) and Oates (1972) holds that assigning the provision of certain public goods to the lowest competent tier can improve allocative efficiency by better matching services to local preferences, provided spillovers are limited, and costs are comparable. This is a principle formalised in Oates' decentralisation theorem.

In symmetric systems, these powers are allocated equally across subnational units. By contrast, asymmetric decentralisation arises when powers differ across units due to history, capacity, or identity, granting some regions greater autonomy than others (Bird & Ebel, 2007; Blöchliger & Montes-Nebreda, 2024). Asymmetry may be de jure, anchored in constitutional or statutory provisions, or de facto, emerging through practice, path dependence, elite bargains, or implementation gaps (Allain-Dupré, Chatry, & Moisio, 2020; Hobdari, Nguyen, Dell'Erba, & Ruggiero, 2018; Blöchliger & Montes-Nebreda, 2024).

The literature points to political and administrative motivations as the two broad drivers of asymmetrical decentralisation. Political motivations include managing ethnic or regional diversity, accommodating separatist pressures, or responding to electoral incentives. Administrative motivations, on the other hand, reflect efforts to account for heterogeneity in local capacity, levels of economic development, and geographic conditions (Allain-Dupré, Chatry, & Moisio, 2020).

While asymmetry can tailor governance to local conditions, it also raises risks for equity, cohesion, and accountability. Asymmetry can entrench vertical and horizontal fiscal gaps. Poor municipalities with weak tax bases become reliant on central transfers, while wealthier metros achieve greater self-financing (Allain-Dupré, Chatry, & Moisio, 2020). If transfers are reduced or costs shifted downward, less-endowed areas face budget shortfalls, service cuts, or debt. Without robust equalisation, disparities can destabilise service delivery.

Asymmetric systems risk institutionalising two-speed governance where well-resourced areas provide comprehensive services while poorer regions manage only minimum standards. Strong local governments may inadvertently exacerbate geographic inequality if wealthy districts capture a disproportionate share of resources (Hobdari, Nguyen, Dell'Erba, & Ruggiero, 2018). Differences in service quality and access can harden into wider questions of citizenship and equity, fuelling territorial cleavages, and potentially threatening national cohesion and stability.

The legal foundation of asymmetric arrangements presents another source of vulnerability. In many cases, asymmetry lacks robust constitutional anchoring, relying instead on statutory provisions subject to executive discretion. On the other hand, India's Article 370 demonstrates how even long-standing provisions in the Constitution can be revoked amid political change (Bhattacharyya, 2024). The durability of asymmetry, therefore, depends as much on politics as on law. The legal design must be coupled with cross-party support, clear safeguards, and credible oversight to resist opportunistic reversal.

In the South African context, persistent municipal governance failures, evidenced by service-delivery breakdowns, fiscal distress, and declining public trust, suggest structural rather than merely managerial problems. Much of the scholarship on municipal crisis in South Africa focuses on administrative incapacity (Magagula, Mukonza, Manyaka, & Moeti, 2022), coalition volatility (Zweni, Koma, & Ndevu, 2024), and Section 139 interventions (Greffrath & Waldt, 2016). However, these outcomes are typically treated in isolation and rarely analysed through the lens of the asymmetric design. Even foundational analyses of asymmetry (do Vale & Cameron, 2016; Wehner, 2000) pay limited attention to the dynamic interplay between decentralised design and subnational dysfunction, and how these can co-produce persistent performance gaps. Building on these insights, this study adopts a multidimensional approach that connects institutional design and fiscal instruments to observed revenue and expenditure outcomes and then examines how these fiscal outcomes relate to service delivery.

4. Research design and methods

The study adopts a qualitative single-country case study of South Africa. The empirical comparisons are organised around the constitutionally defined municipal categories A, B, and C, which sit in the same local government sphere but face different legally defined revenue powers and expenditure assignments. The paper tests four hypotheses by linking de jure asymmetric decentralisation to observed fiscal outcomes. The case study does not establish causality but tests whether the pattern of outcomes across categories and over time is consistent with the mechanisms implied by the hypotheses.

First, the paper documents the legal provisions that distinguish municipal categories A, B and C in South Africa. This clarifies which municipalities are meant to do what, and what revenue instruments and intergovernmental transfer arrangements are available to them under the governing framework. Second, it measures realised fiscal performance using standard municipal fiscal datasets. Third, it compares these indicators across municipal categories and then interprets the patterns using audit-cycle synthesis.

4.1.Data

Two data streams are used. First, the de jure assignment of responsibilities and revenue architecture is derived from legal and policy sources, including the constitutional provisions establishing municipal functions and fiscal powers, and the principal statutes governing municipal institutional form and fiscal governance (including the Municipal Structures Act, the Municipal Finance Management Act (MFMA), the Municipal Fiscal Powers and Functions Act, and the Municipal Property Rates Act (MPRA). Transfer rules are captured through the annual division-of-revenue framework and its explanatory documentation insofar as these instruments define the structure of the local government's equitable share and conditional grants relevant to basic municipal services (Republic of South Africa, 1996; National Treasury, 2025).

Secondly, outcomes are measured using publicly available, routinely produced municipal fiscal datasets. The outcomes are derived from:

- National Treasury's Local Government Revenue and Expenditure "Section 71" reports, which provide in-year budget implementation and conditional grant spending information for the municipal financial year; and
- Statistics South Africa's Financial Census of Municipalities, which provides annual consolidated revenue and expenditure reporting for municipalities (National Treasury, 2025; StatsSA, 2025).

Audit-cycle synthesis reporting from the Auditor-General is used to support measurement interpretation (AGSA, 2025).

4.2.Variables of interest

The variables of interest are restricted to fiscal outcomes, that is, revenue and expenditure indicators that operationalise the study's hypotheses.

Revenue outcomes capture the realised fiscal space available to finance basic services. They are operationalised as: (i) own-revenue, (ii) transfer share/transfer dependence, (iii) collection ratio, and (iv) debtor pressure.

Expenditure outcomes capture service-relevant spending performance. They are operationalised as: (i) capital budget execution, (ii) repairs and maintenance share, (iii) conditional grant spending rate and (iv) service-related operating expenditure.

4.3.Method of analysis

The analysis is descriptive and comparative. It evaluates whether the observed fiscal patterns align with the hypotheses' expectations, given the institutional differences documented in the first stage. Specifically grounded in a de jure asymmetric decentralisation framework, the study assesses four design-consistent hypotheses. H1 (vertical imbalance channel) posits that constitutionally differentiated assignment bundles embed structural vertical fiscal imbalance, such that municipalities with narrower own-revenue authority relative to mandated functions exhibit systematically higher transfer dependence and constrained fiscal space. H2 (horizontal inequality Channel) asserts that this legal differentiation generates persistent horizontal fiscal disparities in revenue and expenditure capacity across categories. H3 (expenditure quality channel) hypothesises that revenue constraints inherent in differentiated assignment bundles translate into weaker expenditure performance, reflected in lower capital execution, maintenance effort, and grant absorption. H4 (equalisation limitation channel) contends that while intergovernmental transfers mitigate these gaps, the existing equalisation framework does not fully offset structurally embedded imbalances, resulting in sustained category-level divergence.

4.4.Validity and limitations

The core inference risk is that municipal differences in category are correlated with structural economic geography, including settlement density, local tax bases, and inherited infrastructure backlogs. As a result, the paper does not claim that de jure asymmetry produces a clean causal "effect" on fiscal outcomes. Rather, the paper advances that legally differentiated assignment and financing arrangements within the local government sphere are associated with persistent

vertical and horizontal fiscal inequalities observable in municipal revenue and expenditure outcomes, even as deeper structural conditions also shape those outcomes. A second limitation concerns measurement and comparability. Municipal fiscal data are subject to variations in reporting quality and audit adjustments. These constraints are managed through reliance on standardised national reporting.

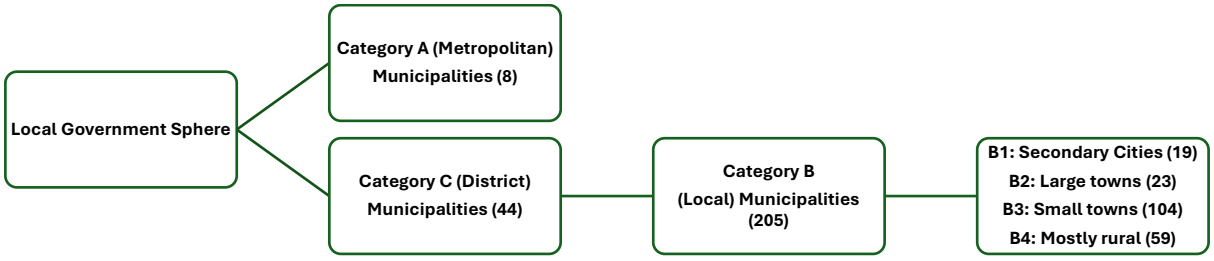
5. Asymmetric Decentralisation in the South African Context

This section sets out the minimum institutional facts required to interpret the conceptual framework and hypotheses. The focus is strictly de jure, that is, constitutional provisions and national legislation that define the following:

- municipal categories and the associated division of functions,
- basic service expenditure responsibilities, and
- revenue instruments and intergovernmental financing rules available to municipalities.

South Africa's post-1994 governance settlement created a unitary, decentralised state with three spheres, national, provincial, and local (Republic of South Africa, 1996). The legislative architecture that followed fundamentally restructured municipal governance. The White Paper on Local Government (1998) articulated the vision of a "developmental local government", positioning municipalities as agents of social and economic transformation. The Municipal Structures Act 117 of 1998 established a three-category municipal system: metropolitan (Category A), local (Category B), and district (Category C), to allocate powers and responsibilities in ways that support effective service delivery and local development (Republic of South Africa, 1998). The Municipal Systems Act 32 of 2000 operationalised developmental mandates through Integrated Development Plans (IDPs)[3] and performance-management systems (Christmas & Visser, 2009; Republic of South Africa, 2000). The Constitution also establishes a non-partisan Financial and Fiscal Commission (FFC) to advise on revenue sharing, grants, and borrowing (see Appendix Tables 1 and 2 for a summary of municipal functions and revenue powers).

Figure 1: Organisation of South Africa's local sphere



Source: South African Government, 2023

[3] An IDP is a five-year plan that outlines a municipality's economic and social development goals in the short, medium, and long term, coordinated with local government, various stakeholders, and the public (DPME, 2022).

Section 229 of the Constitution provides that a municipality may impose rates on property and surcharges on fees for services provided by or on behalf of the municipality and may impose other taxes, levies and duties only if authorised by national legislation (Republic of South Africa, 1996). It further subjects the exercise of municipal fiscal powers to macroeconomic safeguards and national regulation.

In statutory terms, property rates are regulated by the Local Government Municipal Property Rates Act (MPRA), which sets the framework for valuation, rating policies, exemptions, rebates, and procedural safeguards (Republic of South Africa, 2004). Municipal service charges and tariffs operate within national legislative frameworks governing municipal financial management and municipal services, with the MFMA providing the overarching regime for budgeting, financial governance, and fiscal discipline in the local sphere (Republic of South Africa, 2003). Municipal surcharges and any potential municipal taxes authorised under section 229(1)(b) of the Constitution are further governed by the Municipal Fiscal Powers and Functions Act (MFPFA), which regulates the exercise of surcharge powers and establishes a framework for the authorisation of municipal taxes, levies and duties (Republic of South Africa, 2007). Municipal borrowing is also legally structured. The constitutional framework permits municipal borrowing subject to national legislation, and the MFMA establishes detailed rules and procedures for short-term and long-term debt, linking borrowing to governance, disclosure, affordability, and fiscal sustainability requirements (Republic of South Africa, 2003).

Intergovernmental financing is constitutionally entrenched. Section 214 of the Constitution requires an annual Act of Parliament to determine the equitable division of nationally raised revenue among the three spheres of government and to provide for any other allocations to provinces and municipalities, including conditions attached to such allocations (Republic of South Africa, 1996). This is operationalised through the annual Division of Revenue Act (DORA) and associated explanatory instruments, which present the logic of the local government's equitable share as a revenue stream intended to support municipal service obligations. At the same time, conditional grants are designed to fund specific policy objectives and service functions subject to conditions (National Treasury, 2025). In this case study, the key institutional point is that the transfer system is legally structured as a mix of unconditional or formula-based support and conditional allocations tied to defined purposes, an architecture directly relevant to hypotheses concerning transfer dependence, equalisation limits, and expenditure execution channels.

5.1.De jure Asymmetry in the South African Context

Decentralisation in South Africa exhibits de jure asymmetry through differentiated functional assignments set out in the Constitution and supporting legislation. The eight metropolitan municipalities (Category A) are responsible for all local services within their jurisdictions (Republic of South Africa, 1996). By contrast, the 205 local municipalities (Category B) share certain functions, such as water, sanitation, and firefighting, with the 44 district municipalities (Category C). In many rural areas, districts provide bulk services and coordinate infrastructure planning, development plans, resource allocation, and disaster risk management, whereas capable local municipalities may be authorised to perform these functions themselves (Republic of South Africa, 1998; Republic of South Africa, 2000). This differentiation seeks to

align responsibilities with capacity and thus constitutes de jure asymmetric decentralisation (Wehner, 2000).

Asymmetry also extends to revenue assignments. Section 229 of the Constitution outlines that where two municipalities have the same fiscal powers and functions in the same area, an appropriate division must be made in terms of national legislation, and revenue raised can be shared (Republic of South Africa, 1996). Regarding property rates, the MPRA provides that a metropolitan (A) or local municipality (B) may levy a rate on property in its area. In contrast, a district municipality (C) may not levy a rate on property, except on property in a district management area (Republic of South Africa, 2004). Metropolitan and local municipalities also raise substantial operating revenue from trading services, especially electricity, whereas districts often have fewer retail service charges. This leaves district municipalities with a narrower tax base. Metropolitan municipalities have a broader tax base, not only because of denser, high-value property markets and commercial activity, but also because of de jure asymmetry. General fuel levy revenue is shared only with metropolitan municipalities and not with district or local municipalities (National Treasury, 2025). In addition, although borrowing powers are legally general as outlined in the MFMA, market access is highly asymmetric, as evidenced by the concentration of municipal debt capital and bond finance in metropolitan municipalities and a small set of secondary cities (Republic of South Africa, 2003; City Creditworthiness Initiative, 2025).

5.2.MIIF Sub-Classifications

Administrative frameworks further refine asymmetric decentralisation in the South African local government sphere. The Municipal Infrastructure Investment Framework (MIIF), Round 4 (2003-2006) subdivides Category B municipalities into B1–B4 and Category C into C1–C2, based on capacity, resources, and service responsibilities (DBSA, 2011). This further subdivision recognises differing circumstances and financial viability across municipalities. B1 comprises secondary cities (21) with the largest budgets; B2 are municipalities centred on a large town; B3 have smaller populations with a significant urban share but no dominant town; and B4 are predominantly rural with few small towns (DBSA, 2011). These classifications are used to tailor planning, grant design, and support.

Among districts, C1 are not water service authorities (WSAs) and have more limited service-delivery roles, whereas C2 districts are designated water service authorities with broader responsibilities. The WSA status matters for own revenue because the Water Services Act links the duty to ensure access to water services to the right to levy and collect user charges (Republic of South Africa, 1997). This status, therefore, determines what districts must do and the own-revenue instruments they can plausibly mobilise, reinforcing de jure asymmetry.

6. Analysis of the Implications of Asymmetric Decentralisation in South Africa

This section presents the study's main empirical analysis. It answers the research question and tests the four hypotheses using the variables of interest set out in Section 4.2. The paper analyses revenue outcomes using own revenue, transfer dependence, collection performance, and debtor pressure. This is followed by an analysis of expenditure outcomes using capital execution, repairs and maintenance effort, conditional grant spending or grant absorption, and

service-related operating expenditure. The analysis is descriptive and comparative across municipal categories. It draws on National Treasury reporting, Statistics South Africa municipal finance data, and Auditor-General audit-cycle evidence to quantify the variables of interest and interpret the implications of the observed patterns for fiscal sustainability and basic service delivery. The service delivery outcomes subsection examines how the revenue and expenditure patterns result in differences in service access and quality across municipal categories.

6.1.Revenue Outcomes

Differences in powers, functions, and revenue instruments create uneven abilities to raise and collect revenue, which, in turn, largely determine who can deliver services reliably. Metropolitan municipalities, which, together with their municipal entities, are responsible for service delivery for 46% of all households in South Africa, retain a far larger own-revenue share (about 87.9%) and manage 57% of the estimated local government expenditure (AGSA, 2025; National Treasury, 2025). Many rural and smaller municipalities rely on national transfers for as much as 68.4% of their budgets (National Treasury, 2025).

A second, closely related structural feature concerns the unevenness of tariff-based revenues, especially electricity. Electricity distribution is split between Eskom[4] and municipalities, with municipalities supplying around 40% of electricity, mainly to households and small businesses, while Eskom supplies the remaining 60%, mainly to large consumers and municipalities that have no distribution network of their own (OECD, 2025). Across the municipal system, electricity revenues are estimated to account for roughly 25–30% of total municipal income on average, but the share varies widely from about 3% in municipalities where Eskom distributes electricity to nearly 50% in municipalities operating their own distribution networks (OECD, 2025). This range matters for the revenue-side analysis because it reflects substantial dispersion in the practical yield of a legally available financing channel; electricity reticulation and tariffing, reinforcing category-linked differences in the composition and resilience of municipal revenue portfolios.

In its latest Financial Census of Municipalities for the year ended 30 June 2024, Statistics South Africa reported that Metropolitan municipalities purchased R86,208 billion of electricity and made sales worth R100,553 billion, while local municipalities recorded R45,614 billion in purchases and R47,634 billion in sales (StatsSA, 2025). In addition, Metropolitan municipalities recorded R66,432 billion in property rates revenue while local municipalities recorded R27,860 billion (StatsSA, 2025). This stark contrast in revenue is consistent with the de jure financing expectations embedded in the local government fiscal model. Where legally authorised own-revenue instruments sit atop a robust economic base, own-source funding dominates; where the effective yield of those instruments is structurally constrained, transfers become the primary financing pillar.

[4] Eskom is South Africa's state-owned corporation (SOC) which operates across the electricity value chain, providing generation, transmission, and distribution services within South Africa, and participates in electricity trading within the Southern African Development Community (SADC) (Eskom, 2025).

Revenue structure alone does not determine service-delivery fiscal space; the binding constraint is often the extent to which billed or budgeted amounts translate into revenue available to finance operations, maintenance, and service continuity. Collection efficiency is weaker outside the metros, where debtors days [5] often exceed 30, and municipalities themselves estimate that a substantial portion of billed revenue (67.8%) is unrecoverable (AGSA, 2025; National Treasury, 2023). Treated strictly as fiscal-capacity constraints, these indicators imply that the effective yield of own-revenue instruments is materially below nominal billing rates, thereby tightening operating revenue for basic services.

These structural gaps are compounded by rising household non-payment. By 31 December 2024, municipal consumer debt reached R405.1 billion, with households responsible for 72.7% (National Treasury, 2025). This concentration of arrears in the household account segment is analytically important because it determines the revenue available to maintain service delivery. The result is a cash-flow squeeze that pushes fragile councils into a vicious cycle of falling affordability and further non-payment.

Liquidity pressure then surfaces as arrears to Eskom and water boards, and as technical losses in neglected networks. By January 2025, municipalities owed Eskom approximately R94 billion in overdue debt (Parliament of the Republic of South Africa, 2025). Despite a debt-relief programme introduced in 2023, 47 municipalities were still in default to Eskom as of May 2025, unable to adhere to payment plans (National Treasury, 2025). Electricity and water losses, due to illegal connections and inadequate infrastructure maintenance, also generated R37.28 billion in foregone revenue (AGSA, 2025). This situation has direct service-delivery implications.

6.1.1. Intergovernmental Fiscal Transfers

Vertical fiscal imbalance (VFI) is defined as the structural mismatch between the expenditure responsibilities assigned to subnational governments and the revenue instruments available to them at reasonable rates and administrative effort. VFI is not a short-term revenue shortfall; it is a design feature of multi-level systems in which national governments retain broader, more elastic tax bases while lower-tier governments carry substantial service mandates. Transfers are then required to reconcile the mismatch, often generating transfer dependence, which is a sustained reliance on intergovernmental grants that conditions budget discretion, compliance burdens, and accountability (Ahmad & Craig, 1997; Boadway & Shah, 2007). VFI is not inherently undesirable, but its magnitude and the type of transfers used to manage it (unconditional vs conditional; formula-based vs discretionary; equalising vs specific-purpose) shape observed revenue performance and spending patterns (Bird & Smart, 2002; Boadway & Shah, 2007).

On the other hand, horizontal fiscal imbalance arises when subnational governments at the same tier differ materially in fiscal capacity and/or expenditure needs (Ahmad & Craig, 1997). Transfer systems should narrow disparities so that jurisdictions can provide broadly comparable levels of public services without imposing higher tax burdens on residents in

[5] Debtors days refers to the average number of days required for a municipality to receive payment from its consumers for bills/ invoices issued for services.

fiscally weaker areas (Blöchliger, Merk, Charbit, & Mizell, 2007; Dougherty & Forman, 2021). Equalisation may operate through explicit equalisation grants, implicit formula components, or a mix of vertical and horizontal transfers, and it typically mitigates but does not fully erase cross-jurisdictional dispersion (Blöchliger, Merk, Charbit, & Mizell, 2007; Dougherty & Forman, 2021).

Local government in South Africa bears a large share of spending obligations; however, the ability to raise revenue is highly centralised at the national level, leading to a vertical fiscal imbalance (Siddle, 2011; Financial and Fiscal Commission, 2023). The Constitution guarantees subnational governments an equitable share of nationally raised revenue to enable them to provide basic services and perform their functions (Sections 214 and 227). At the same time, significant horizontal fiscal imbalances persist across municipalities, driven by stark differences in their economic bases, revenue-raising capacity, and service delivery needs (Financial and Fiscal Commission, 2023).

The system of intergovernmental fiscal transfers and revenue-sharing mechanisms, implemented through the annual DORA, divides nationally collected taxes among the national, provincial, and local governments (the vertical division) and allocates funds to individual provinces and municipalities using formulae designed to account for differing needs and capacities (the horizontal division). The overarching goal of these transfers is to equalise fiscal resources by supplementing subnational budgets and redistributing funds to other regions equitably and transparently (National Treasury, 2025).

Table 1: Division of Nationally Raised Revenue

	2021/22	2022/23	2023/24	2024/25
R million	Outcome			Preliminary outcome
Division of available funds				
National Departments	822 785	855 868	826 901	859 961
Provinces	660 799	69 4131	706 258	730 632
Equitable Share	544 835	57 0868	585 086	600 476
Conditional grants	115 964	123 263	121 172	130 156
Local Government	135 625	150 699	157 650	167 685
Equitable Share	76 169	83 938	92 262	99 504
Conditional grants	44 839	51 426	49 955	52 055
General fuel levy sharing with metros	14 617	15 335	15 433	16 127
Non-interest allocations	1 619 208	1 700 698	1 690 809	1 758 279
Debt service costs	268 072	308 459	356 110	385 8222
Main budget expenditure	1 887 280	2 009 157	2 046 919	2 144 101
Percentage increase	5.5%	6.5%	1.9%	4.7%

Percentage shares				
National departments	50.8%	50.3%	48.9%	48.9%
Provinces	40.8%	40.8%	41.8%	41.6%
Local government	8.4%	8.9%	9.3%	9.5%

Source: National Treasury, 2025

As seen in Table 1, as of 2024/25, national departments received 48.9% of nationally raised revenue, while provinces received 41.6% and local government received 9.5% (National Treasury, 2025). This vertical split recognises that provinces and municipalities have expenditure mandates that far exceed their own revenue capacities.

6.1.2. Unconditional Grants

The local government equitable share (LGES) is an unconditional grant given to each municipality to enable them to provide free basic services to poor households and to account for municipalities' differing revenue-raising abilities. The formula is the primary tool for addressing horizontal imbalances, as it allocates funds based on each municipality's population size, poverty levels, and other indicators of need or fiscal capacity, so that poorer or smaller jurisdictions receive comparatively more support per capita (see Table 2). The formula is expressed as follows:

$$LGES = BS + (I + CS) \times RA \pm C$$

As shown in Table 2, the LGES formula includes components for basic services (BS), an institutional component (I), and a community services component (CS), all weighted by the number of indigent (low-income) households in a municipality. It also features a revenue adjustment (RA) factor and a stabilisation component (C) (National Treasury, 2025). In essence, the formula aims to equalise funding across areas by allocating more funding per poor resident to rural and economically disadvantaged areas. It is updated annually with recent data on costs, household numbers, etc., with the last major revision completed in 2012 and introduced in the 2013/14 Medium-Term Expenditure Framework (MTEF) (Republic of South Africa, 2016).

Table 2: Local Government Equitable Share

Component	Basis of Allocation	Purpose
Basic Services (BS)	Number of poor households (earning below the threshold)	Fund free basic services (water, electricity, sanitation, refuse)
Institutional Support (IS)	Fixed base + scaling based on population size	Support governance and administrative functions
Community Services (CS)	Population/households with cost weights for services outside the basic services basket	Fund other core municipal services not included in basic services.
Revenue Adjustment (RA)	The municipality's ability to raise its own revenue	Assist municipalities with low revenue-generating capacity
Stabilisation (C)	Transitional and correction mechanisms	Avoid large year-to-year fluctuations in funding

Source: Authors' compilation

The distribution of transfers is strongly pro-poor. For instance, metropolitan municipalities, which account for 70.1% of personal income tax, only receive 32.6% of local government

transfers. Yet, a group of 61 predominantly rural local municipalities, which account for only 5.7% of the personal income tax base, receives 27.3% ofocal government transfers (National Treasury, 2024). Local own revenues are also not deducted from their equitable shares, which protects tax effort and avoids perverse incentives (Department of Finance, 1997)

6.1.3. Conditional Grants

In addition to the equitable shares, South Africa employs a range of conditional grants to address specific objectives and further mitigate imbalances. Conditional grants are funds transferred from national departments to provinces or municipalities, subject to conditions on their use, often for infrastructure investment or specific services. At the local level, the largest conditional grant is the Municipal Infrastructure Grant (MIG), which finances capital projects for basic infrastructure, including water, sanitation, roads, etc., in poor communities (National Treasury, 2020; GTAC, 2025). The Urban Settlements Development Grant (USDG) is a Schedule 4B supplementary capital grant transferred only to metropolitan municipalities, intended to supplement their capital budgets (National Treasury, 2020).

Other conditional grants support services such as housing, public transport, and capacity-building in municipalities. These grants are an important part of the revenue-sharing mechanism because they enable targeted funding for national priorities and development needs that the equitable share formula might not fully address. As seen in Table 1 above, in 2024/25, conditional grants accounted for approximately 31% of total transfers to local government (National Treasury, 2025). Many conditional grants are geared toward historically disadvantaged or poorer areas, such as rural towns with infrastructure backlogs, thereby functioning as horizontal equalisation tools with a specific purpose.

6.1.4. General Fuel Levy Sharing with Metros

Another form of transfer is the sharing of a portion of the general fuel levy (GFL) with metropolitan municipalities, which provides additional revenue to cities (National Treasury, 2025). This recognises the transport infrastructure responsibilities of metros and partially compensates them for the fuel taxes collected nationally within their areas. The Taxation Laws Amendment framework provides that "an amount equal to a fixed percentage of revenue raised from the collection of the GFL is a direct charge against the National Revenue Fund for the credit of the metropolitan municipalities" (Republic of South Africa, 2009). That percentage is set by law at 23% of GFL revenue, with the Minister of Finance empowered to revise it annually by notice in the Government Gazette (Republic of South Africa, 2009). For 2024/25, Treasury's gazetted allocations of about R16.849 billion are divided as follows:

Table 3: General Fuel Levy Allocations

Metro	GFL allocation 2024/25 (approx.)	Share of metro pool*
City of Johannesburg	R4.572 billion	27%
eThekwini	R3.875 billion	23%
City of Cape Town	R2.851 billion	17%
Ekurhuleni	R1.795 billion	11%
City of Tshwane	R1.666 billion	10%
Nelson Mandela Bay	R0.862 billion	5%
Buffalo City	R0.798 billion	5%
Mangaung	R0.427 billion	3%

Source: National Treasury, 2025

**Percentages are rounded to show order of magnitude.*

The sharing of the general fuel levy is based on fuel sales, and this figure comes from the (now) Department of Mineral Resources and Energy; they are adjusted using Census population data to line up sales with municipal boundaries, because magisterial district boundaries do not perfectly match municipal borders (National Treasury, 2014). GFL sharing is a revenue-sharing arrangement; hence, the metros treat the fuel levy sharing as their own revenue within their operating budgets (SALGA, 2012). This instrument further entrenches the horizontal fiscal imbalance resulting from asymmetric decentralisation in favour of metros.

The revenue results discussed in this section are consistent with the hypothesis H1 (vertical imbalance channel). Municipalities with weak realised own-revenue capacity exhibit substantially higher transfer dependence, with transfer shares reaching up to 68.4%, compared to an implied 12.1% in metros. They also display weaker revenue performance, as evidenced by higher debtors days and a large share of billed revenue assessed as unrecoverable (National Treasury, 2023; National Treasury, 2025; AGSA, 2025). The magnitude of consumer debt (R405.1 billion, 72.7% household) further indicates that own-revenue instruments alone do not guarantee revenue availability for basic services, because the realised yield is heavily mediated by arrears accumulation in the household account base that underpins service charges (National Treasury, 2025).

The same evidence supports hypothesis H2 (the horizontal inequality channel) by making dispersion explicit. The transfer dependence ratio between local and metropolitan municipalities (68.4% versus 12.1%; ratio ≈5.65) and the 56.3 percentage-point gap in own-source revenue shares (87.9% in metros versus 31.6% in and local municipalities) indicate pronounced horizontal inequality in the composition of municipal revenue. In addition, the electricity revenue exposure range (approximately 3% to 50%) underscores marked heterogeneity in dependence on, and yield from, tariff-based financing channels (National Treasury, 2025; OECD, 2025). These patterns yield revenue-side inequality outcomes consistent with the hypothesised channels.

6.2.Expenditure outcomes

The most policy-relevant expenditure signal for basic services is the persistent inability to translate available capital allocations into realised infrastructure spending. This is visible in conditional infrastructure grants, which are designed precisely to finance or co-finance service-delivery capital programmes. Of the R36.58 billion in infrastructure grants reportedly received

in 2024/25, municipalities spent R18.53 billion, equivalent to 50.7% of the total (Parliamentary Budget Office, 2025). These execution constraints matter for service delivery finance because capital underspending delays network rehabilitation and expansion, increasing future operating costs and raising the probability of service interruptions as assets degrade. To the extent that ageing infrastructure is not renewed on schedule, operating budgets are increasingly absorbed by reactive responses, higher technical losses, and emergency interventions, which typically crowd out planned operations and routine maintenance. In this sense, capital underspending should be treated as an early indicator of downstream operating stress in basic service functions.

A second expenditure channel relevant to service reliability is the adequacy of repairs and maintenance effort relative to the replacement value of municipal assets. Repairs and maintenance routinely fall short of the 8% of asset value norm (National Treasury, 2021).

Disaggregation by grant type reinforces the picture that transfer financing does not automatically lead to investment into infrastructure for service delivery, which is central to evaluating equalisation limits in practice. For 2023/24, MIG, a core instrument for municipal basic services infrastructure, recorded an expenditure rate of 54.9%, while the Municipal Disaster Recovery Grant recorded an expenditure rate of 16.9% (National Treasury, 2025). These deviations indicate that, in aggregate, nearly half of MIG resources and the large majority of disaster recovery resources were not spent within the intended timeframes, weakening the extent to which transfers can offset structural fiscal gaps through realised capital formation.

Furthermore, spending performance diverges systematically across municipality types. Metropolitan municipalities reportedly achieved an overall infrastructure grant absorption rate of 70.1%, compared with an all-municipality average of approximately 51% (Parliamentary Budget Office, 2025). This shows expenditure-side "multi-speed" municipal investment capability. Metros convert a materially larger share of conditional capital financing into executed spending than the system-wide average. Execution quality also imposes an additional constraint on the service-delivery yield of expenditure. Across audited infrastructure projects in all municipalities, 77% reportedly exhibited deficiencies, suggesting that even executed capital projects can underperform in terms of functionality and durability, thereby diminishing the service reliability gains expected from capital outlays (AGSA, 2025). Taken together, these indicators show that conditional grants partially address financing constraints but, on their own, do not secure effective expenditure on service-delivery infrastructure.

Beyond execution rates and project quality, audit outcomes for 2023/24 point to weak budget credibility and weak financial control. Councils adopted unfunded budgets despite advice from the National Treasury and provincial treasuries (AGSA, 2025). A budget is unfunded when budgeted expenditure exceeds projected revenue. After the mid-year adjustments process, 113 municipalities (44%) still operated with unfunded budgets, up from 108 (42%) in the prior year, and 86 of the 113 (76%) have adopted unfunded budgets repeatedly for three consecutive years (AGSA, 2025). The most common reasons are that municipalities struggle to match expenditure to expected revenue, and they overestimate the property rates and service charges they will collect (AGSA, 2025). Unauthorised expenditure totalled R31.79 billion and was incurred by 174 municipalities (68%). The aggregate local government deficit was R11.29

billion, with 90 municipalities (39%) spending more than they had available (AGSA, 2025). The pattern is concentrated in the Free State, Gauteng, and North West provinces, with high prevalence also reported in Mpumalanga and the Northern Cape. Metropolitan municipalities are not exempt, as the City of Tshwane and the City of Ekurhuleni adopted unfunded adjustment budgets in 2023/24, and Tshwane has done so for three consecutive years (AGSA, 2025). This evidence supports the expenditure-quality channel by showing that constrained fiscal space is reinforced by repeated non-credible budgeting and weak corrective action.

These expenditure findings are consistent with the hypothesis H3. Where municipalities face tighter revenue conditions and thus greater reliance on conditional transfers for service infrastructure. The observed pattern is not simply higher grant receipt but weaker expenditure performance, including low capital execution, low grant spending rates, and under-maintenance relative to sustainability norms. The 54.9% MIG expenditure rate and 16.9% disaster recovery grant expenditure rate, alongside the broader evidence of only 50.7% spending of received infrastructure grants in 2024/25, is consistent with fiscal and administrative constraints intensified under asymmetric decentralisation, translating into lower implementation capacity, especially for services reliant on capital investment (National Treasury, 2025; Parliamentary Budget Office, 2025).

This pattern of low grant spending and under-maintenance is also consistent with an unfunded mandate when the full cost of services is taken into account. Infrastructure grants mainly fund capital projects, while municipalities must cover operations and bulk purchases from their own revenue and general transfers. When those recurrent sources are insufficient or not reliably realised, operating pressure rises. Maintenance is deferred, and projects stall, so capital grants are not converted into working assets. Under asymmetric decentralisation, this constraint is more likely to bind in municipalities with weak revenue realisation and limited administrative capacity.

The findings also support the hypothesis H4. South Africa's intergovernmental transfer system, through unconditional and conditional grants, can reduce fiscal disparities in allocations, but it does not equalise capital expenditure and maintenance. The sustained gap between metropolitan grant absorption (70.1%) and the all-municipality average (~51%) indicates that equalisation through transfers does not automatically lead to equalisation in implementation (Parliamentary Budget Office, 2025).

6.3.Service Delivery Outcomes

This section compares service access outcomes across municipal categories to illustrate how the fiscal differences identified in the revenue and expenditure analyses are mirrored in unequal service delivery patterns. The Auditor General noted that basic services are inadequately and inconsistently delivered, despite significant national funding (R68.4 billion for infrastructure projects in 2023/24). Over 2011–2022, access to clean water rose from 85.1% to 88.5% and improved sanitation from 68.9% to 80.7%; electricity access exceeded 94.3% (StatsSA, 2024). Weekly refuse removal services, an indicator of municipal waste management, reached 67.1% of households in 2022, about 5 percentage points higher than a decade earlier (StatsSA, 2024). However, outcomes differ per municipal category. While Metropolitan municipalities recorded

75% of households with access to piped water inside the dwelling, only 26% of households in B4 municipalities had such access (StatsSA, 2024). Households also had higher access to solid waste disposal in Metropolitan municipalities (90.1%) than in B4 municipalities (47.7%) (StatsSA, 2024). Table 4 below further disaggregates access to basic services per municipal category.

Table 4: Access to Basic Services per Municipal Category

	Metro (A)	Secondary City (B1)	Large Town (B2)	Small Town (B3)	Rural (B4)
Access to piped water inside the dwelling	75	60,5	62,3	51,9	26,6
Access to improved water backlog	3,4	8,5	10,1	12,1	33,7
Water service infrastructure quality index[6]	**4,6**	**4,3**	**4,3**	**4,1**	**3,2**
Household access to improved sanitation	90,3	81,1	83,2	79,8	56,6
Household access to a flush toilet	88	74,6	72,7	68,7	27,3
Sanitation service index[7]	**4,76**	**4,53**	**4,53**	**4,41**	**3,78**
Households with an appropriate level of access to solid waste disposal services	90,1	73,1	77,3	73,8	47,7
Solid waste service infrastructure quality index[8]	**4,62**	**3,96**	**4,01**	**3,83**	**2,72**
Percentage of households that used electricity for lighting	94,3	93,7	95,2	93,1	95
Percentage distribution of households by energy used for cooking	65,8	70,4	64,4	67,2	57,1
Electricity supply infrastructure quality index[9]	**4,8**	**4,8**	**4,8**	**4,7**	**4,8**

[6] The water infrastructure quality index (WIQI) classifies the engineering infrastructure based on the level of service that households have access to.
[7] The sanitation infrastructure quality index (SIQI) classifies the infrastructure based on the level of service that households have access to.
[8] The solid waste infrastructure quality index (SWIQI) classifies the infrastructure based on the level of service that households have access to.
[9] The Electricity infrastructure quality index (EIQI) classifies the infrastructure based on the level of service that households have access to.

Composite service delivery index[10]	4,7	4,4	4,411	4,28	3,63

Source: Statistics South Africa, 2024

In conclusion, section 6 shows that the outcomes of South Africa's decentralised municipal system are a study in contrasts. Some municipalities remain financially healthy, engage in long-term planning, invest in infrastructure, and contribute to local economic development, demonstrating that, when decentralisation is paired with capacity, it can deliver growth and improved services. Others, however, experience a "decentralisation of hardship", i.e., autonomy without the capability to deliver, leading to poor services and economic decline. Although the asymmetric model was intended to mitigate these divergences by tailoring functions and funding to local conditions, in practice, such adjustments have not fully offset underlying disparities.

7. Discussion: Implications of de jure asymmetric decentralisation in South Africa

South Africa's local government illustrates a particularly demanding form of asymmetric decentralisation because differentiation is built into a single constitutional system rather than negotiated as special autonomy for a particular region. Municipal categorisation creates legally distinct sets of functions and fiscal powers within the same sphere of local government. For fiscal federalism, this shifts the central question away from whether decentralisation improves allocative efficiency, and towards a more basic design test: whether revenue and transfers are sufficient for assigned responsibilities ("finance follows function") and whether equalisation is strong enough to keep all municipality types capable of meeting minimum service standards (Musgrave, 1959; Oates, 1972; Allain-Dupré, Chatry, & Moisio, 2020). Once differentiation is embedded in law, the system's legitimacy turns on whether these assignment and financing arrangements are coherent across municipal categories, as reflected in realised revenue and expenditure outcomes.

A first implication is that de jure asymmetry in South Africa creates a structural risk of vertical fiscal imbalance. Municipalities are required to deliver basic services, but their own-revenue instruments are limited. When the cost of assigned functions grows faster than the revenue from rates and service charges, the result is higher transfer dependence and a tighter fiscal space. Under such conditions, the sustainability of basic service provision depends on how well the intergovernmental transfer system closes the gap and on whether billed service charges are actually collected and converted into cash.

A second implication is that legally embedded asymmetry tends to widen horizontal fiscal inequality unless equalisation is both technically sound and credible. In fiscal federalism, equalisation is intended to offset differences in fiscal capacity and expenditure needs so that access to basic services is not determined by location (Financial and Fiscal Commission, 2023; Allain-Dupré, Chatry, & Moisio, 2020). In South Africa, municipalities face different revenue

[10] The Infrastructure Quality Index combines the individual index scores that were calculated for sanitation, water, refuse disposal and electricity in order to create an overall measure of service delivery across municipalities.

yields and cost structures across municipal categories, so equalisation must do more than distribute funds; it must narrow the gap between mandated functions and sustainable financing. The implication of the case, as inferred from hypotheses H2 and H4, is that when category-linked divergence persists, the asymmetry is functionally "unmanaged". While transfers may soften the fiscal gap, they do not close it sufficiently to prevent divergence in service-financing conditions across municipal categories (National Treasury, 2025; Financial and Fiscal Commission, 2023).

This leads to a third implication. South Africa's experience clarifies the distinction between managed and unmanaged de jure asymmetry as an evaluative framework. Managed asymmetry is identifiable by three design characteristics:

- assignment clarity (limited ambiguity about which municipal category is responsible for which service functions and investment obligations),
- financing coherence (a plausible mapping from the assignment to revenue authority, borrowing space, and transfer design), and
- credible equalisation (a transfer architecture capable of preventing the different municipal types from drifting into permanently unequal service-financing positions).

Unmanaged asymmetry, by contrast, is indicated by persistent fiscal divergence that is predictable from the legal structure and the transfer system does not materially correct that. The point is not that budgets should be identical; fiscal federalism does not require uniformity, but that divergence should not become an entrenched proxy for unequal basic service delivery (Allain-Dupré, Chatry, & Moisio, 2020; Oates, 1972).

A fourth implication concerns inequality more directly. In asymmetric systems, fiscal inequality is not only a distributional outcome; it becomes an institutional condition that shapes the types of local government that are feasible. Where the municipal revenue model is structurally constrained by weak realisation of own-revenue instruments and high arrears exposure, expenditure quality problems, especially delayed renewal, deferred maintenance, and weak capital execution, become rational responses to a tight budget constraint rather than isolated failures. This means that de jure asymmetry can reinforce inequality through an interlocking mechanism in which revenue stress reduces operating discretion; reduced discretion weakens maintenance and the ability to co-finance or implement investments; and weakened asset sustainability increases the future cost of service delivery. The case, therefore, adds a specific fiscal federalism insight that in legally differentiated local systems, inequality is reproduced not merely through unequal fiscal capacity, but also through unequal fiscal trajectories. Some municipal categories can sustain the asset base and service networks. In contrast, others face predictable degradation dynamics unless financing coherence and equalisation are strong enough to interrupt the cycle (National Treasury, 2025).

Finally, a coherent asymmetric design should account for predictable differences in costs and capacity through clear assignments and effective equalisation, rather than allowing these differences to harden into persistent fiscal inequality across municipal categories. In the South African case, the principal risk of asymmetric decentralisation is not differentiation per se, but differentiation without a financing and equalisation approach robust enough to prevent

predictable divergence in the fiscal conditions that support basic service delivery (Musgrave, 1959; Oates, 1972; Allain-Dupré, Chatry, & Moisio, 2020). This calls for deliberate institutional design responses.

8. Policy implications

This section translates the discussion into three design packages that can be implemented within the existing constitutional and statutory framework. The packages target coherence between functions and funding (H1), equalisation through delivery rather than allocations on paper (H4), and the capital expenditure implementation and maintenance efforts that enable service delivery.

8.1.Re-align service functions and financing

Introduce a regular rules-based review that tests whether each municipal category's legally assigned basic service responsibilities can be financed in a realistic way from own-revenue and transfers. Where the review shows a persistent mismatch, it should trigger one of two responses:

- financing adjustment (through formula recalibration or targeted financing support for the residual gap) or
- functional reconfiguration (shared-service arrangements or reallocation within the district–local system) for specific service components that municipalities demonstrably cannot finance and execute sustainably under current rules.

This makes the "finance follows function" principle an ongoing management process rather than a once-off design assumption (Oates, 1972; Musgrave, 1959). The review process can be added within the ongoing White Paper on Local Government (WPLG26).

The expected fiscal effect is a reduction in chronic vertical fiscal imbalance pressure in structurally weaker municipalities by making the residual gap explicit and financeable, and by limiting de facto rationing of core service functions through under-maintenance or stalled investment. It should also improve accountability by clarifying where municipalities are carrying service mandates that are not supported by their feasible revenue and transfer envelope.

The principal risk is that "coherence reviews" become discretionary or politicised. This can be reduced by using objective triggers that already exist in the fiscal system, such as sustained transfer dependence, persistent collection shortfalls and arrears, and repeated failure to execute service-related capital programmes, and by running the process through existing intergovernmental fiscal institutions rather than ad hoc bargaining (National Treasury, 2025).

Where implementation constraints are binding, financing adjustments should be paired with minimum technical capability requirements in asset management, project preparation, procurement, and contract management as a condition for sustained infrastructure financing support, because sustained grant underspending and poor project quality undermine the service-delivery yield of transfers (AGSA, 2025; National Treasury, 2025).

8.2.Equalisation and conditional grant design for service delivery

Equalisation and conditional infrastructure grants should help municipalities deliver and sustain basic services at an acceptable minimum level across all municipal categories (Dougherty, Nebreda, & Mota, 2024). In South Africa, this implies that infrastructure funding should include financed project preparation for weaker municipalities, rather than assuming they can fund design and pipeline work from their own budgets because the fiscal framework already recognises project preparation as a distinct support function through instruments such as the programme and project preparation support grant and through grant rules that explicitly allow pipeline development (National Treasury, 2025).

Grant conditions should also focus on a small set of lifecycle requirements for the assets being financed, because infrastructure performance depends on management across planning, construction, operations, maintenance, and renewal, and weak lifecycle management is a documented contributor to municipal infrastructure failure (Rakabe & Mabugu, 2024). Since the fiscal framework explicitly allows funds to be withheld to offset conditional-grant underspending, additional requirements should be limited to those essential for execution and sustainability and paired with practical support; otherwise, the system risks reinforcing low spending outcomes rather than improving delivery. Stronger conditions can slow disbursements and increase the compliance burden, potentially lowering short-run spending rates. The mitigation is to keep reporting requirements minimal and standardised, and provide deeper technical support and staged milestones for weaker municipalities so that conditions improve execution rather than function as a de facto funding withdrawal mechanism (National Treasury, 2025).

This addresses the empirical pattern that transfer design can partially offset financing gaps while still leaving persistent divergence in realised expenditure execution (H4), and it directly targets the expenditure quality channel (H3).

8.3.Temporality and "graduation" rules

Where the law differentiates municipal financing by municipal type, the framework should state who qualifies, when the status ends and how often it is reviewed. South Africa's intergovernmental system already uses legislated grant frameworks with conditions and reporting requirements, which are periodically reviewed (National Treasury, 2020; National Treasury, 2025; SALGA, 2012). A practical approach is to set entry criteria, exit ("graduation") criteria, and a fixed review cycle, using indicators relevant to the assignment of functions and revenue powers and that are measurable from the existing reporting series. Examples include sustained improvements in own-revenue performance and budget execution reported in statutory in-year statements, a credible repairs and maintenance effort based on standard municipal ratios/norms, and consistent delivery of capital programmes funded through conditional grants (Republic of South Africa, 2003; National Treasury, 2023; National Treasury, 2020).

The expected effect is to turn de jure asymmetry into a managed path rather than an indefinite status. Clear graduation rules reduce the risk that differentiated support becomes a permanent substitute for improvements in service-finance performance. The main risks include the

contestation of threshold choices, performance indicators and classification decisions. Mitigation is to keep the criteria few, transparent, and anchored in objective, routinely published fiscal series, because formula-based and oversight mechanisms are less vulnerable to arbitrary manipulation when they rely on standardised data.

The expected effect is to convert de jure asymmetry from an open-ended condition into a managed trajectory. Over time, this reduces the probability that municipalities become permanently locked into high transfer dependence with weak investment outcomes, and it improves the credibility of equalisation by linking differentiated support to demonstrable improvements in service-finance performance (H4).

9. Conclusion

This paper asked how de jure differences in municipal expenditure responsibilities and financing arrangements affect service delivery in South Africa. The evidence indicates that differentiated expenditure assignments and revenue powers across metropolitan, local and district municipalities are associated with persistent vertical and horizontal fiscal inequalities. These gaps translate to uneven basic service delivery outcomes so that one constitutional local sphere operates with materially different delivery trajectories across municipality types.

The results are consistent with the hypotheses. On the revenue side, the differentiation results in a systematic divergence in the balance between own-source revenue and reliance on transfers. On the expenditure side, limited fiscal space is associated with weaker execution of service-related capital and conditional grants, and sustained underinvestment in repairs, maintenance, and renewal. This pattern fits an expenditure-quality mechanism in which tight revenues reduce the feasible level of infrastructure maintenance, with predictable consequences for service reliability.

The policy implication is that differentiation must be managed so that finance follows function in realised terms. Where mandates exceed feasible revenue and implementation capacity, the system produces fiscal stress, low capital formation and weaker maintenance, which then shows up as unreliable basic services. The main contribution of the paper is therefore to link the legally differentiated assignment of functions and financing rules to observable revenue and expenditure outcomes directly relevant to service delivery, and to show why equalisation that does not translate into executed investment cannot close the gap.

Future research should prioritise the core fiscal federalism proposition that finance follows function and test it with longitudinal municipal panel data, asking whether service delivery and budget execution outcomes improved or deteriorated over time in municipalities facing tighter de jure constraints. Useful outcome measures include grant absorption and project completion, repairs and maintenance effort, audited control and compliance findings, and service reliability indicators such as water losses, electricity outages, and road conditions. A second strand should evaluate the temporal logic of asymmetry by examining whether capacity building and, where relevant, temporary functional reassignment reduce fiscal gaps, while also distinguishing de jure from de facto asymmetries and using carefully chosen African comparators to refine what constitutes functional versus dysfunctional asymmetry.

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Appendix

Table A 1: Functions and responsibilities of South African municipalities

Municipality type	Core functions	Key legislative framework	Implications
Metropolitan Municipality (Category A)	Integrated planning, service delivery (housing, electricity, water, sanitation, roads, public transport, health), and economic development.	•Constitution: Schedules 4B & 5B •Municipal Structures Act (1998) •Municipal Systems Act (2000) • White Paper on Local Government (1998)	Metros combine district and local functions, enabling holistic governance. They have greater autonomy and revenue-raising capacity, but also face complex governance and infrastructure challenges due to scale and urbanisation.
District Municipality (Category C)	District-wide coordination and planning, provision of bulk services (water, sanitation, transport), capacity building for local municipalities, and disaster management.	• Constitution: Schedule 4B & 5B • Municipal Structures Act • Systems Act	Districts are meant to support and coordinate local municipalities. Weak coordination, capacity gaps, and role duplication often undermine effectiveness, especially in rural areas.
Local Municipality (Category B)	Service delivery (basic infrastructure, waste management, local roads, spatial planning), housing delivery, economic development, and licensing.	• Constitution: Schedules 4B & 5B • Municipal Structures Act • Systems Act • IDP Guidelines	Functionality and capacity vary. Urban locals often act like metros; rural ones are under-resourced and dependent on districts or provinces for technical and financial support.

Source: Authors' compilation

Table A2: Revenue powers of South African municipalities

Revenue powers	Municipality type	Key legislative framework	Implications
Full revenue-raising powers, including property rates, service charges (water, electricity, sanitation, waste), and municipal levies. Can impose surcharges on fees and access capital markets for borrowing.	Metropolitan Municipality (Category A)	• Constitution: Section 229 • Municipal Systems Act • Municipal Finance Management Act (MFMA) • Municipal Property Rates Act (MPRA)	Metros have the broadest and most diversified revenue base due to their urban density, property values and integration of local and district functions. Financial autonomy supports investment in large-scale infrastructure and sustainable service delivery.
Limited revenue powers. May impose property rates in certain rural areas not covered by local municipalities, and may collect levies (e.g., for fire or disaster services) as authorised by national legislation.	District Municipality (Category C)	• Constitution: Section 229 • Municipal Structures Act • MFMA • National Treasury Guidelines	Districts rely heavily on intergovernmental transfers. Their limited own-revenue powers and weak collection infrastructure constrain financial independence, requiring coordination with locals to avoid role duplication.
May levy property rates, service charges, and surcharges. Can borrow, subject to MFMA conditions. Many are heavily dependent on equitable share and grants, especially in rural and under-capacitated areas.	Local Municipality (Category B)	• Constitution: Section 229 • Municipal Property Rates Act • MFMA • Municipal Systems Act	Revenue powers vary with capacity. Many rural and small towns struggle with collection and coverage, leading to underfunded mandates and service delivery shortfalls.

Source: Authors' compilation

Table A3: Components of the provincial government equitable share formula

Component	Weight (%)	Basis of Allocation	Purpose
Education	48%	School-age population (5–17) and public-school enrolment	Fund basic education services
Health	27%	Population adjusted for age, gender, and health facility use	Fund primary health care and hospitals
Basic Component	16%	Share of total national population	Provide a minimum level of services for all residents
Institutional	5%	An equal amount per province	Cover fixed governance and administrative costs
Poverty	3%	Number of people below the poverty line	Target funding to address poverty-related service needs
Economic Activity	1%	Share of national GDP	Reflect the cost of services tied to economic activity

Source: Authors' compilation