

Understanding the Dynamics of Rural Tax Bases and Their Influencing Factors

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7.1 Introduction

7.1.1 Background

In theory, a fiscally decentralised system of government usually results in the devolution of expenditure responsibilities to lower spheres of governments along with complementary taxation powers to fund these service delivery mandates. The assignment of these concomitant revenue powers to sub-national governments also enhances the local autonomy of the sub-national entity, decreases the administration costs of these taxes, and enhances democracy by creating a direct link between local taxes and local service provision. The latter assists local communities in holding their councils accountable for the use of their taxes.

Although such fiscal powers are usually devolved uniformly to all sub-national entities within a sphere,⁶² the expenditure potential and ability of sub-national entities to generate funds from these taxation powers vary quite markedly. This is usually due to differences in the revenue capacity and revenue effort across sub-national governments. Revenue effort refers to the effectiveness in collecting revenues, which can vary because of capacity constraints, weak incentives, or simple mismanagement within sub-national governments. Revenue capacity is a relatively more complex concept and assumes that if all sub-national governments apply the same effort in collecting revenues, any difference in revenue collection is due to differences in tax bases. The tax base can be defined generally as the item or measure on which the liability to pay tax is based.⁶³ The characteristics and size of the tax base give an indication of how “taxable” the base is, i.e. the amount of revenues that can be generated subject to the extent of economic activity or the ability of households to pay taxes within a municipality’s jurisdiction. In other words, in the short run, other factors exogenous to a municipality’s influence determine the size and nature of a municipality’s tax base.

In most countries, sub-national governments that implement a fiscal decentralised system are likely to have different revenue-raising capacities (because of differences in their respective tax bases) and different revenue efforts (because of differences in capacity, ability and willingness to collect revenues). Within a national landscape, social, demographic and economic circumstances are likely to differ across various regions. Therefore, different revenue-raising capacity(ies) is a

⁶² This is a simplified statement, as several countries assign expenditure and revenue powers across sub-national tiers within spheres of government

⁶³ In the case of municipalities, property tax is based on the value of the property, while a surcharge on a user charge is based on the amount of services consumed by a household. In terms of the latter, one can see why business activity, household poverty and income levels are important in describing the tax base of municipalities, as richer households have a greater ability to pay for services and can thus consume more services, while businesses are likely to consume a higher quantity of services to support their productive activities.

structural characteristic of fiscal decentralisation, as not all sub-national governments are likely to have the ability to support their expenditure mandates from their devolved taxation instruments. In such instances, intergovernmental transfers aim to fund a fiscal gap⁶⁴ in sub-national governments with limited revenue-raising capacity but with greater or relatively similar expenditure responsibilities compared to other provincial or local governments.

7.1.2 Problem Statement

Within South Africa's intergovernmental fiscal system, municipalities are also subject to the realities of fiscal decentralisation described above. South African society is very diverse, and characterised by large inequalities in the distribution of resources across its economic landscape. As mentioned, such diversity and inequality also manifest themselves at the local government level. The country's 278 municipalities each operate in unique economic and demographic circumstances, which are fundamental in determining their revenue and expenditure performance. The inherent inequalities in South African society mean that the ability to generate taxes differs considerably across the various municipal jurisdictions. Varying economic, social and demographic circumstances are likely to result in differences in the respective tax bases of municipalities. Thus revenue capacities will differ across local government.

Inefficiencies and ineffectiveness are inherent in the system, as highlighted by recent service delivery protests and poor financial performance at the local government level. Factors such as sub-standard services, financial mismanagement, and severe capacity constraints can explain some of this poor municipal performance and are likely to affect the ability of municipalities to maximise their revenue bases; indeed, low revenue efforts across the sphere are possible.

Compared to their urban counterparts, rural municipalities generate/collect low levels of actual revenue, but the primary driver is difficult to explain. It could be because of structural problems (i.e. limited tax bases in areas characterised by high levels of poverty, low levels of employment, and limited business activities) or administrative problems (i.e. weak revenue effort).

The aim of this chapter is to understand the dynamics of the rural municipal tax base and to identify the structural and/or administrative factors that explain revenue constraints in these areas. The study uses the Stochastic Frontier Analysis (SFA) method to explicitly compute the current revenue capacity of the rural property tax base and the extent to which this tax base is maximised. Ultimately, the chapter assesses the adequacy or appropriateness of the revenue instruments devolved to rural municipalities to support their expenditure mandates.

⁶⁴ A fiscal gap can also arise due to differences in expenditure assignments across municipalities and not solely due to differences in revenue capacity and revenue effort. For example, municipalities can deliver a relative higher quality of service or be devolved more service functions, which can increase a municipality's fiscal gap relative to others. Thus, it is important that norms and standards to guide minimum service levels.

7.2 The Context of South African Rural Municipalities

7.2.1 Defining Rural Municipalities

In South Africa, there is currently no accepted methodology for distinguishing rural areas from urban areas, let alone rural from urban municipalities. The Constitution (South Africa, 1996) recognises three categories of municipalities: category A (metropolitan), category B (local), and category C (district) municipalities. Although metropolitan municipalities are widely accepted as being large urban hubs, the contexts of various local municipalities differ considerably. For instance, Msunduzi contains Pietermaritzburg, which forms a large urban core within the municipality, whereas Msinga has no central town at all.

Without a common understanding of what constitutes a rural municipality, the categorisation methodology developed by the Department of Cooperative Government and Traditional Affairs (CoGTA, 2009) is used. The methodology identifies 70 local municipalities that are mainly rural with, at most, one or two small towns in their areas. Table 56 locates these municipalities in the nine provinces, based on the pre-2011 demarcations. Most of these rural municipalities (84 per cent) are in the provinces that are predominantly former homeland areas, i.e. the Eastern Cape, Limpopo and KwaZulu-Natal.

Table 56: Categories of Municipalities per Province

Province	Metros	Top 21 Locals	Small Towns	Rural Locals	Districts	Grand Total
Eastern Cape	1	1	22	15	6	45
Free State		2	18		5	25
Gauteng	3	2	6		3	14
KwaZulu-Natal	1	3	19	28	10	61
Limpopo		1	8	16	5	30
Mpumalanga		4	9	5	3	21
Northen Cape		4	12	5	4	25
North West		1	25	1	5	32
Western Cape	1	3	21		5	30
Grand Total	6	21	140	70	46	283

Source: Author's own tabulation using CoGTA classifications (CoGTA, 2009)

7.2.2 Historical Development of Rural Municipalities

Prior to South Africa's first democratic elections in 1994, apartheid policies effectively distorted market forces and skewed the efficient distribution of resources along racial lines. The system of decentralisation was also based largely on racial grounds: a first tier of central government; a second tier of four provinces in South Africa proper; six semi-independent Black homelands (or Bantustans) and four "independent" Black homelands;⁶⁵

⁶⁵ The pre-1994 apartheid government instituted a policy of separate development characterised by the reservation of certain areas for various African groups, usually on ethno-linguistic grounds. These areas were called homelands or Bantustans. They were given varying degrees of autonomy of governance, with four being given nominal independence that was not internationally recognised.

and a third tier of government in the four provinces, comprising White Local Authorities and Black Local Authorities ⁶⁶ (Amusa, 2012).

The Black homelands had no representative municipalities or proper local government system (Franzsen, 2000). In those areas, local governance took the form of apartheid-supported local traditional authorities and chiefs. Those traditional authorities enjoyed substantial authoritative powers and were “undemocratic, unaccountable, autocratic and, in many instances, feared” (Ntsebeza, 2004: 72). One of the most important roles of these local chiefs was the allocation of land, which has important implications for the contemporary local government system and fiscal decentralisation in rural areas.

In addition, the Bantustans were poor, corrupt, and located in economically stagnant rural areas (King, 2004). Without substantial resources to maintain an able local economy and government structures, those states were highly dependent on apartheid South Africa for grants and subsidies. No investment took place, resulting in decades of economic stagnation. Against this backdrop, the consequences of apartheid policies and planning were most apparent at the local government level. Adding to skewed resource distribution and development were political dynamics that complicated the South African social landscape.

After the 1994 elections, the new democratic government needed to develop a system of (decentralised) governance that incorporated all the apartheid structures highlighted above. Transitional arrangements were required in order to develop a culture and institution of local government. These included establishing metropolitan councils in the six metropolitan areas (each containing local councils), and local councils and rural councils in non-metropolitan areas that fell under a higher tier of district and regional councils. At that time, the country had 843 municipalities.

Following the 2000 local government elections, the 843 municipalities were consolidated into 284 municipalities. Following further demarcation processes in 2005 and 2011, South Africa currently has 278 municipalities. The Constitution (South Africa, 1996) and legislative developments since 2000 ⁶⁷ provide the legal fundamentals for a fully functioning local government sphere. In devolving powers and functions to all local governments, the legislation assumed that the local government system had matured substantially during the transitional period.⁶⁸ However, recognising capacity constraints in rural areas, powers and functions are divided asymmetrically between the rural local municipality and its district municipality.

In rural areas, the Constitution created an implicit ambiguity by creating a developmental local government⁶⁹ system but simultaneously recognising the role of traditional authorities.⁷⁰ The ambiguity is around how local governments and traditional leaders in rural areas should co-exist

⁶⁶ These subsequently evolved to Regional Services Council and Joint Services Boards (in KZN).

⁶⁷ These include the Municipal Systems Act (South Africa, 2000), the Municipal Finance Management Act (South Africa, 2003), the Municipal Property Rates Act (South Africa, 2004) and the Municipal Structures Amendments Act (South Africa, 2011).

⁶⁸ Although the Constitution provides for support where capacity to implement municipal mandates does not exist, the point is that the transitional arrangements to develop a culture of local government in rural areas were assumed to be effective. Operationally, active capacity support and capacity-building in rural municipalities continue.

⁶⁹ Section 153.

⁷⁰ Section 211.

in terms of local authority, land tenure, and local governance. The primary issue is the apparent conflict between traditional authorities (chiefs) and local government regarding who has the right to administer land in these rural areas (Ntsebeza, 2004), which has made the collection of taxes such as property taxes difficult for rural municipalities. Drimie (2001) argues that the current arrangement is an underlying cause of poverty and rural conflicts, which in turn can have a negative impact on revenue generation and collection in such areas.

As the roles and responsibilities of traditional leadership remain unclear, a degree of political conflict exists, with traditional leaders accusing councillors of taking over their roles and powers. This issue has been exacerbated by the Municipal Structures Act (South Africa, 2000), which gives all the powers conferred on traditional leaders to municipal structures, as part of giving powers to all South Africans (Drimie, 2001). Ultimately, communities are confused over the true political authorities in these areas.

Furthermore, extending property rates collection to rural areas remains a complex and unresolved matter, due to the lack of formal land ownership. Municipalities may be unable to collect rates in rural areas because some land is not serviced by the municipality or because some local communities receiving municipal services recognise the local chief, not the municipality, as the political authority (Whelan, 2002).

Clearly the historical context and subsequent development complicates the current rural local government structure. The devolution of expenditure mandates and revenue instruments assumes that these municipalities can implement the mandates with adequate and effective revenue instruments. However, the revenue and administrative capacity, on top of the political dynamics of traditional leadership, calls into question the adequacy and sustainability of the revenue instruments relative to expenditure needs. This is particularly true for property rates in those areas. Therefore, it is important to better understand the concepts of revenue capacity, revenue effort, and the potential factors that measure and describe them. Section 7.3 is a literature review that explores previous research into these concepts, and assists in identifying its explanatory factors.

7.3 Literature Review

7.3.1 Defining Revenue Capacity and Revenue Effort

Revenue capacity can be defined as “the amount of revenue it [a municipality] can raise using the revenue instruments it has at its disposal and applying a standard set of rates” (Reschovsky, 2003: 207). This definition suggests that the revenue capacity depends on the characteristics of a municipality’s tax base. The characteristics and size of the tax base give an indication of how “taxable” the base is, i.e. the amount of revenues that can be generated subject to the extent of economic activity or the ability of households to pay taxes within a municipality’s jurisdiction. In other words, factors outside a municipality’s influence determine the size and nature of a municipality’s tax base.⁷¹ As Chernick and Reschovsky (2006:8) point out, “The foundation for all local government fiscal capacity measures is the economic base of each local government”.

⁷¹ Although municipalities can increase their tax bases indirectly by attracting greater economic activities to their jurisdictions to invest in the local economy.

It is important here to provide a clear distinction between revenue capacity and revenue effort. Revenue capacity is the potential revenue that can be raised within the jurisdiction of a municipality subject to the characteristics of the corresponding tax base, whereas revenue effort is the actual revenues collected by municipalities. Martinez-Vazquez and Jameson Boex (1997: 4) define municipal revenue effort as “the degree to which a government or a sub national region utilises the revenue bases available to it”. To reiterate, revenue capacity is largely exogenous to the municipality, whereas revenue effort is to some extent influenced by the municipality’s own actions – it depends on the performance and (in)efficiencies of the municipality.

7.3.2 Factors that Affect Rural Revenue Capacity and Revenue Effort

As revenue capacity and/or revenue effort (or a combination of both) can have an impact on the total revenue generation in rural local governments, the factors that affect revenue capacity and revenue effort need first to be ascertained.

Gallagher (2001) modelled revenue capacity and revenue effort as functions of poverty, urbanisation, population density, income level and individual asserts, arguing that the tax base in places with high levels of poverty and small populations is small, as residents cannot afford the taxes levied on them. Most rural municipalities are characterised by high levels of poverty and outward migration, which could explain why they are revenue-constrained. Ultimately, the economic, social and demographic profiles of the local populace affects a municipality’s capacity to generate revenues, and determines the extent to which it can impose local taxes (Lewis, 2003).

In Tanzania, Allers and Ishemoi (2010) used personal income as an indicator of revenue capacity across local governments. In effect, this was an application of the macroeconomic-based indicator⁷² approach to measuring revenue capacity by equalising the tax burdens across municipalities. Local individual income is one of the most fundamental indicators of a community’s ability to pay for local services.

Using the representative tax system⁷³ approach for municipalities in Massachusetts to explain the impact of demographics on the rural tax base, Zhao (2005) looked at how potential option taxes, such as taxes on meals, payroll taxes, income and general sales, affect revenue-raising capacity. He found that larger cities benefit more from these revenue sources than smaller towns and rural municipalities because of differences in geographical locations and demographics. Once again, revenue capacity depends largely on the economic and socio-demographic profiles of communities that are influenced by spatial forms, i.e. urban and rural characteristics. An important finding was the impact of geographic locations on revenue capacity; being close to areas of economic activity or urban spaces can result in spill-over effects for certain jurisdictions.

⁷² The macroeconomic-based indicator approach measures revenue capacity by assuming a standard tax burden across municipalities. An appropriate indicator is then used to assess the ability of municipalities to generate revenues.

⁷³ The representative tax system approach measures revenue-raising capacity by assuming an average tax rate across municipalities.

A municipality's ability to generate revenues from imposing local taxes clearly depends on the characteristics of the local tax base. Local poverty levels, economic activity, and other social characteristics affect the ability to pay for services provided by local governments. In general, rural municipalities are also characterised by lower revenue capacities relative to urban areas due to rural communities being less able to pay for services.

As noted earlier, local tax bases are affected by various exogenous factors, which ultimately affect the revenue-raising capacity of municipalities. However, in some instances the municipality is not maximising its local tax base, i.e. is not collecting the revenues reflective of the economic and social profile of its local community.

In assessing the impact of fiscal transfers on municipal revenue collection efforts in Mexico and Germany respectively, Canavire-Bacarreza and Espinoza (2010) and Buettner (2006) found a negative relationship between revenue collection and fiscal transfers. This implies that increased grants from the central government leads to local municipalities becoming lazy, over-reliant on fiscal grants, and making less effort to collect their own revenue. As a result, municipalities find it difficult to close the fiscal gap.

Transfers were meant to correct vertical and horizontal imbalances, and so a municipality that relies solely on fiscal transfers is bound to experience a lot of inefficiencies, as the transfers are unlikely to be enough to cover all its operating expenses (Prud'Homme, 2007, quoted in Espinoza and Gustavo, 2010). This problem is common in both urban and rural municipalities, but the effect on local government is severe in rural municipalities.

Rural municipalities may also have severe capacity constraints (which manifest as high vacancy rates, inadequate skill levels and low levels of competence) for undertaking operational tasks. Exacerbating these inefficiencies are issues such as financial mismanagement and corruption, that will ultimately affect municipal own revenues. A combination of these factors is likely to affect a municipality's revenue effort. Therefore, the factors affecting revenue capacity and effort are analysed to test their impact on rural municipalities' ability to raise revenues.

7.4 Descriptive Analysis

First, the context of rural municipalities in South Africa needs to be understood, and why they differ from their urban counterparts through the apparent limited tax base and revenue potential in rural areas.

7.4.1 Funding Mix of Rural Municipalities and Determining Factors

Table 57 shows that rural municipalities are highly reliant on transfers from national government, compared to other, more urbanised municipalities, which fund approximately 75 per cent of their expenditure from own revenues. In South Africa, the local government sphere as a whole receives 33 per cent of its revenue from government grants, but rural municipalities receive 70 per cent of their revenue from this source, more than double the national average.

Table 57: The Funding Mix Across Different Municipalities, 2009/10

Type of Municipality	Government Grants	Investment Revenue	Other	Property Rates	Public Contributions and Donations	Service Charges
Metropolitan Municipalities	24%	2%	9%	18%	0%	48%
Secondary Cities	25%	1%	14%	14%	0%	46%
Larger Towns	28%	1%	9%	19%	0%	42%
Smaller Towns	40%	1%	10%	11%	0%	37%
Rural Municipalities	70%	1%	12%	6%	0%	11%
Districts without P&F	75%	5%	16%	1%	1%	2%
Districts with P&F	85%	2%	5%	0%	0%	8%
Total	33%	2%	10%	15%	0%	41%

Source: National Treasury Local Government Database

The funding mix illustrated in Table 57 can be explained by a variation in revenue capacity or revenue effort, particularly for rural municipalities. A strong municipal tax base is usually characterised by high levels of business activity, an affluent demographic profile, and a strong local economy. Using proxies for these factors, Table 58 shows the differences across these municipalities.

Table 58: Differences in Economic and Demographic Profiles Across Types of Municipalities

Type of Municipality	Total Population	Total households	Total gross Total value added per capita	% of people employed	% of households below R3200pm	Average population density	Operating expenditure per capita	Revenues from local taxes per capita
Metropolitan Municipalities	16,974,424	4,714,021	75.67	34%	46%	1388	3,789.48	3,279.51
Secondary Cities	8,233,208	2,207,004	50.80	29%	59%	221	2,242.55	1,940.00
Larger Towns	3,985,216	1,074,513	40.83	27%	62%	87	1,843.08	1,513.82
Smaller Towns	6,906,926	1,808,666	29.16	22%	69%	19	1,466.46	988.70
Rural Municipalities	12,331,695	2,673,914	9.44	13%	80%	81	370.49	120.77
Total	48,431,469	12,478,118	41.18	25%	63%	359	1,942.41	1 568.56

Source: 2007 Community Survey, 2009 Local Government Turnaround Strategy

Table 58 shows clearly that urbanised municipalities are characterised by high levels of economic activity, greater employment levels, and relatively lower levels of poverty. Rural municipalities have the highest levels of poverty and unemployment, with the lowest expenditure and revenue share per capita. In these areas, over 80 per cent of households earn less than R3,200 per month, and only 13 per cent of the population is employed. These proxies can explain the reasons behind a limited tax base in rural municipalities – poor people with no income are unlikely to be able to afford (or pay for) municipal services and other municipal taxes. This affects the revenue capacity of municipalities.

Another factor that affects revenue capacity is the extent and nature of economic activity within a municipality. As evident in Table 58, rural areas have a relatively lower level of economic activity.

Table 59 delves deeper into this issue by showing the sectors that contribute to economic activity in South Africa across the various types of municipalities.

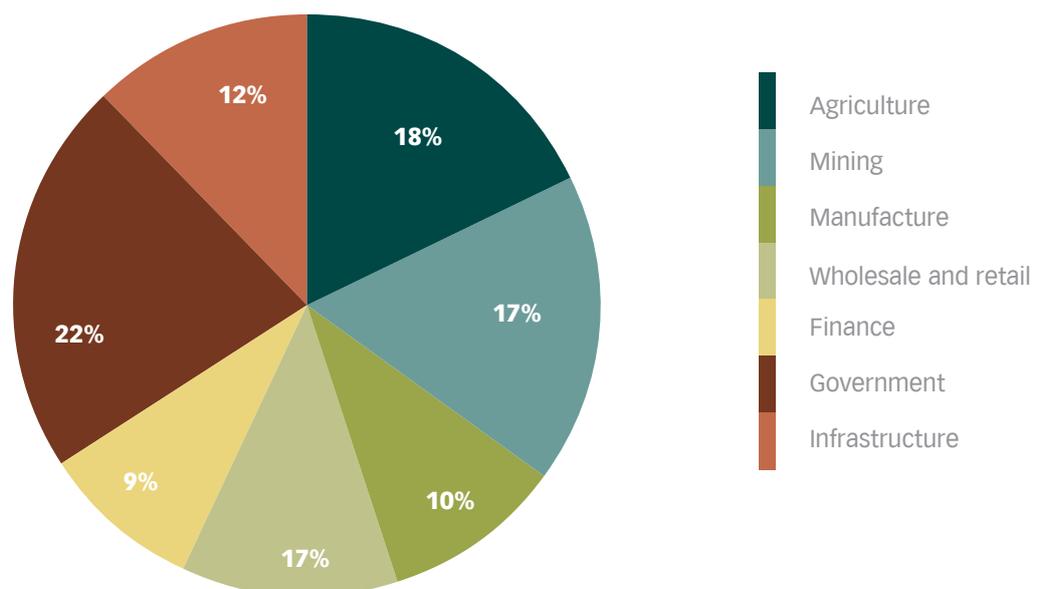
Table 59: Economic Profiles of by Municipal Type – Gross Value Added, 2010

Type of Municipality	Agriculture	Mining	Manufacture	Retail	Finance	Government	Infrastructure	Total
Metropolitan Municipalities	7%	7%	61%	65%	76%	56%	65%	58%
Secondary Cities	11%	55%	23%	16%	13%	18%	18%	20%
Larger Towns	14%	12%	8%	6%	5%	7%	6%	7%
Smaller Towns	51%	23%	5%	8%	5%	10%	8%	10%
Rural Municipalities	17%	4%	3%	5%	2%	9%	3%	5%
Total	100%	100%						

Source: IHS Global Insight Database.

As Table 59 shows, rural municipalities contribute about five per cent of total value to the South African economy. Furthermore, agriculture is the dominant economic activity in those areas. However, this is not commercial agriculture (which is a characteristic of smaller towns) but subsistence agriculture, which does generate substantial value-add or income. In contrast, metropolitan municipalities, for example, have high levels of manufacturing, retail and financial activities which are usually driven by the private sector, indicating high levels of business activity. Higher levels of economic activity result in greater consumption of municipal services, and hence increasing municipal revenues via higher user charges and other taxes. In rural municipalities, the lack of business activities and consequent lower consumption of municipal services mean that the municipal revenues are limited to user fees and taxes. Figure 14 illustrates the contribution of each sector to the general economy of rural areas.

Figure 14: Breakdown of Economic Activity in Rural Areas, 2010



Source: IHS Global Insight Database

Agriculture is a predominant activity in rural areas relative to other areas, with government services contributing the most (22 per cent) to the rural economy, followed by agriculture and mining.

Revenue capacity in rural municipalities is clearly constrained by various economic, social and demographic factors, which are exogenous to those municipalities, and largely the result of disparities across the country. The other aspect that could explain revenue-raising variations is the revenue effort: the ability of rural municipalities to maximise their tax base relative to other municipalities. Figure 15 computes a ratio between the budgeted⁷⁴ and actual property rates revenues collected across the various types of municipalities.⁷⁵

Figure 15: Property Rates Collected Relative to Budget, 2009/10



Source: National Treasury Local Government Database

Assuming that there is the ability to do so, budgeting for revenue collection reflects proper municipal planning based on sound assumptions that inform the expected revenues which are likely to be generated from tax. In the case of Figure 15, any deviations from collecting budgeted revenues can be assumed to be due to poor revenue effort or poor planning. As Figure 15 shows, apart from 2004/05, rural municipalities always collected less than their budgeted amounts, while other types of municipalities performed much better (with the exception perhaps of smaller towns).

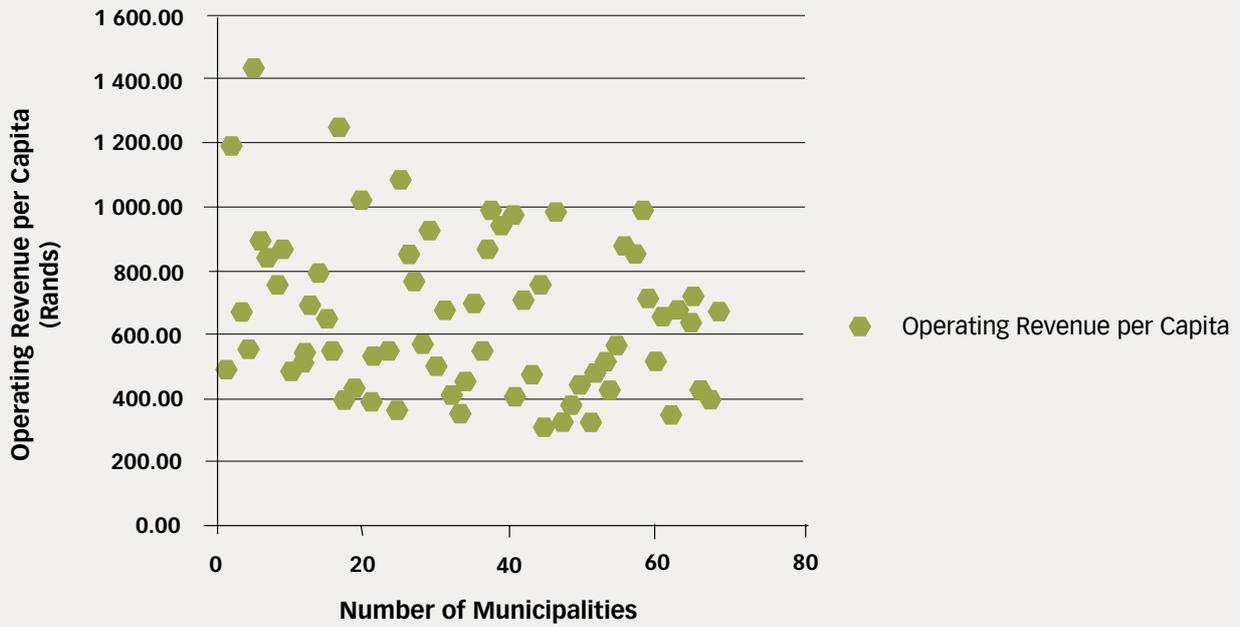
7.4.2 Differences in Revenue Raising Across Rural Municipalities

Figure 16 illustrates the different operating revenues per capita across the 70 rural municipalities. They vary considerably, from R314 to R1,429. Although rural municipalities generally have relatively lower revenues than other municipalities, significant contrasts can be seen in revenues collected across rural municipalities. Figure 17 replicates the analysis for property rates, the primary revenue sources of those municipalities. Once again, the variations in property rates revenues are evident.

⁷⁴ Budgeted property rates are the property rates that a municipality expects to collect based on various assumptions and included in the budget for the financial year

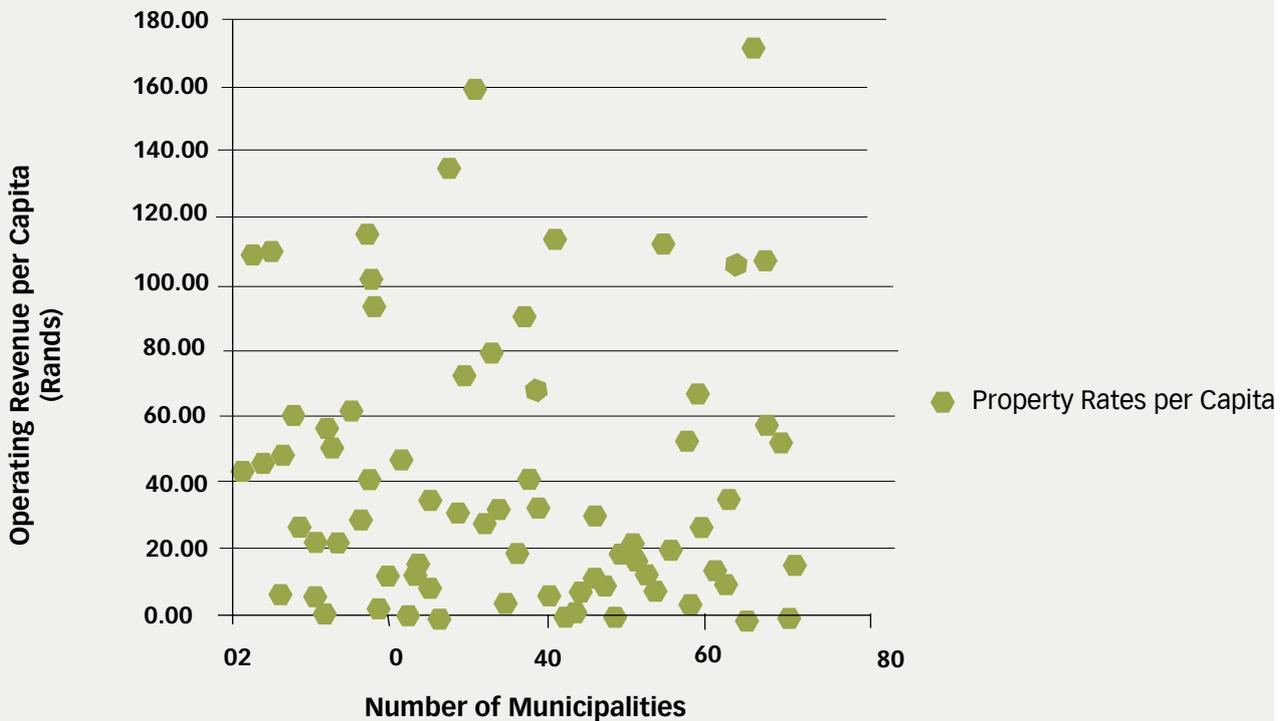
⁷⁵ Here property rates are used rather than other revenue sources because all rural municipalities have access to revenues from property rates, while other revenue instruments (such as user charges and surcharges) are asymmetrically applied by the district and/or local municipality.

Figure 16: Operating Revenue per Capita – Rural Municipalities, 2009/10



Source: National Treasury Local Government Database.

Figure 17: Property Rates per Capita – Rural Municipalities, 2009/10



Source: National Treasury Local Government Database.

7.5 Research Methodology

7.5.1 The Focus on Property Rates

Rural municipalities in South Africa clearly depend on intergovernmental transfers to support their expenditure mandates. The lower revenue-raising capabilities of these municipalities are driven by differences in revenue capacity and revenue effort. There appears to be a correlation between the relatively lower revenue-raising capacity of rural municipalities and various exogenous and endogenous factors.

The next step of the analysis is to test the impact of these various exogenous factors on the revenues raised by rural municipalities, in an effort to calculate their actual revenue capacity. In other words, the impacts of these factors on revenues raised and the revenue capacity of rural municipalities will be quantified. The SFA estimation method is used for a panel dataset of the 70 rural municipalities over an eight-year period (2003/04 to 2010/11). In estimating the revenue capacity, this method also estimates the deviation from the rural municipality's revenue capacity, or how efficiently a municipality maximises this revenue base. Effectively, the revenue capacity and revenue effort will be estimated for rural municipalities in aggregate and per individual rural municipality.

As indicated above, about 25 per cent of rural municipal revenues derives from own revenue sources, predominantly service charges and property rates, which represent 35 per cent and 21 per cent of total own revenues respectively, with the remaining 44 per cent from smaller taxes, fees, licences and fines. All rural municipalities have the power to levy property rates, but only certain rural municipalities can levy tariffs and surcharges on services rendered because of the asymmetrical provision of services by these municipalities and their respective district municipalities. Furthermore, in most of these areas Eskom provides the electricity. As the powers and functions to deliver various basic services are not uniform, total operating revenues will vary significantly across rural municipalities.

Although it is possible to control for the varying service provision functions, it was deemed more feasible (and simpler) to focus the analysis on property rates, as all rural municipalities have the power to levy property rates. In addition, estimating the revenue capacity of property rates will also give an indication of the general rural tax base, as most exogenous factors (such as unemployment, economic activity, poverty) that affect property rates would affect other revenue sources. Therefore, although the potential and inefficiencies related to the collection of property rates will be quantified, this analysis can be used to qualify and depict the extent of the rural tax base in general.

7.5.2 Description of the SFA Method

The property rates collected by a rural municipality are viewed as the following function:

$$PR_{it} = f(RC_{it}) + \varepsilon_{it} \quad [1]$$

where PR_{it} is the property rates collected by rural municipality i in time t , RC_{it} is the revenue capacity of municipality i in time t , and ε_{it} is a random error term capturing various other, usually

unobservable and immeasurable, factors that have an impact on municipal property rates. As indicated, revenue capacity constitutes the exogenous factors that affect the local population's ability to pay for property rates. Also inherent within ε_{it} is a degree of inefficiency in collecting property rates, i.e., the revenue effort of a municipality. A fully specified property rates function, accounting for all observable factors that can determine the ability of the local populace to pay for property rates (revenue capacity), would result in ε_{it} , capturing varying levels of revenue effort across municipalities.

The inherent problem with this function is that ε_{it} measures revenue effort, as well as other unobservable and immeasurable effects specific to municipalities. Therefore, one can argue that the ε_{it} computed in equation [1] can be a biased and inaccurate estimation of true inefficiencies in maximising revenues in municipalities. Thus distinguishing between the random (other unobservable) factors from the inefficiency in ε_{it} is required.

In order to distinguish inefficiency in collecting revenues from other random factors, equation [1] is estimated using SFA. Therefore, equation [1] can be modified with SFA estimation to:

$$PR_{it} = f(RC_{it}) - u_{it} + v_{it} \quad [2]$$

Once again, PR_{it} is the property rates collected by rural municipality i in time t , and RC_{it} is the revenue capacity. However, u_{it} now explicitly measures the efficiency of collecting property rates revenues. The term v_{it} measures the random, immeasurable and unobservable factors that can have an impact on property rates revenues collected, random shocks in revenue collections, and measurement errors in the data used. It is worth reiterating that u_{it} and v_{it} are independent of each other.

The use of the SFA estimation is predominant in analysing the efficiency of decision-making units, such as firms. In undertaking efficiency analysis using SFA, a functional form of a relationship between outputs and inputs of a decision-making unit is specified. As opposed to the ordinary least squares estimation, the functional form estimated using SFA takes the form of a frontier. Therefore, the production function in the efficiency analysis and the property rates function in this analysis are assumed to be in the form of a (production) possibility frontier. In other words, the frontier estimates the most a municipality can raise from property rates given its fiscal capacity. The SFA method effectively generates a frontier for each unique rural municipality by shifting the general revenue function. In other words, SFA creates hypothetical municipalities relative to an actual observation against which the latter can be benchmarked. Rearranging equation [2], this can be depicted as:

$$PR_{ht} / PR_{it} = f(RC) / f(RC_{it}) + v \quad [3]$$

Here, given the actual property rates collected, PR_{it} , the actual property rates collected by the hypothetical municipality, PR_{ht} , is determined by the revenue capacity and random effects unique to municipality i . In other words, PR_{ht} is what rural municipality i could collect given its revenue capacity (RC_{it}) and other random factors that distinguish it from the deterministic revenue-capacity frontier generated by the general sample of municipalities (RC). Thus, PR_{ht} can now be over or beneath the general frontier of the sampled municipalities.

Effectively, inefficiency in collecting property rates is thus measured as:

$$-u_{it} = PR_{it} - PR_{it} \quad [4]$$

Assuming a logarithmic functional form for the SFA estimation (the variables are logged to the base e), the inability of a rural municipality to maximise its revenue base is computed as

$$\exp(-u_{it}) \quad [5]$$

The transformation in equation [5] is necessary, since a logarithm functional form is assumed. The measurement $\exp(-u_{it})$ is the inefficiency value or score that computes the level by which a rural municipality maximises its revenue base. The inefficiency measurements range from 0 to 1, with a measurement of 1 indicating that the rural municipality is optimising revenues from its local tax base. Therefore, the higher the inefficiency measure, the greater the performance of a rural municipality in collecting property rates due, subject to the conditions of the local economy i.e. revenue effort. It is also assumed that inefficiency or efficiency varies with time; i.e., the efficiency of maximising the property rates base can improve or regress over the financial years.

7.5.3 Empirical Model

From the discussion thus far, it is clear that the revenue capacity and revenue effort of rural municipalities are largely dependent on exogenous and endogenous factors respectively. In other words, a rural municipality's revenue capacity is driven by its socioeconomic context, while its revenue effort depends largely on its performance and ability.

In order to measure the revenue capacity and revenue effort using the SFA method, a two-stage estimation technique is required. First, the revenue capacity of property rates needs to be estimated using all of the exogenous factors that can affect property rates collected. Effectively, this would quantify the impact of factors such as economic activity and poverty on property rates collected by municipalities, and also allow for the estimation of the maximum that a rural municipality can collect from its property rates base given these factors.

The general functional form of property rates revenues collected is given as:

$$pr_{it} = f(rc_{it}, ex_{it}, oh_{it}) \quad [6]$$

In equation [6], pr_{it} is property rates revenues in per capita terms for municipality i in time t , rc_{it} constitutes a vector of revenue capacity (exogenous) measures, ex_{it} are a vector of expenditure needs measures, while oh_{it} are a vector of other control variables. A standard logarithmic model for property rates revenue capacity was specified as follows:

$$\ln prc_{it} = \alpha + \ln incomepc + \log gvapc_{it} + \text{formalh}_{it} + \text{unemployed}_{it} + \log pop_{it} + \log holds_{it} + \text{percent15}_{it} + \text{percent65}_{it} - u_{it} + v_{it} \quad [7]$$

In equation [7], $\ln prc_{it}$ is the log of property rates per capita for municipality i in time t . Revenue capacity or exogenous factors were measured by total disposable income per capita in log form

(*lnincomepc*), total gross value added (GVA) in log form (*lngvapc*), percentage of total households that are formal (*formalh*), and the percentage of people officially unemployed within the municipal boundaries (*unemployed*). Local demand for non-basic (general) municipal services was depicted using total population in log form (*logpop*), total households in log form (*logholds*), and the percentage of total population below 15 (*percent15*) and above 65 (*percent65*) per municipality *i* in time *t*.

As property rates are based on the value of properties within a municipal jurisdiction, property valuations are the key determinant of the ability to generate revenues from property rates. However, comprehensive data on property values per municipality is not readily available, and not within the time dimension of the panel dataset used in this model. Although legislation⁷⁶ requires municipalities to compile comprehensive valuation rolls prior to levying property rates, the accuracy of these valuation rolls are cause for concern. Furthermore, such data could not be obtained over the period of the estimation. To proxy this effect, the percentage of formal households within a municipality was used. It is assumed that formal households are of a higher value, and municipalities are likely to generate higher property rates revenues if most of their households are formal (as opposed to informal dwellings, shacks or traditional dwellings that are of very low value).

Given the difficulty of not having the primary determinant or the base of municipal property rates available, other ways of effectively measuring the ability of local communities to pay for property tax are necessary. As noted above, several studies identify disposable incomes of both households and businesses as a proxy for the ability to pay. Annual total disposable income per capita and GVA per capita are used to proxy these effects. Annual disposable income per capita also captures general poverty levels. The use of GVA per capita gives an indication of the business activity in these areas.

Property rates could be generated from business premises, mines and other commercial properties. It is also important to measure the capacity of a municipality to raise revenues relative to the range of services that it provides. The primary services provided are water and sanitation, electricity and refuse removal, and typically account for most of municipal expenditure. Furthermore, as noted above, revenue from property rates usually constitutes municipal general revenues, which fund a range of other municipal services (and not the four primary services mentioned above). Therefore, using access to the four primary services in a model of fiscal capacity of property rates might not be accurate, as the demand for these services are almost exclusively funded by other revenue streams. As other local services are not readily measureable, total population and households are used to proxy community demand for services.

The above estimation of property rates capacity, using the SFA method, allows the efficiency of rural municipalities in maximising their local revenue property rates base to be computed. This revenue maximisation inefficiency, or revenue effort, is given by $\exp(\text{uit})$.

⁷⁶ Section 30 of the MPRA.

As mentioned, revenue effort is determined by endogenous performance-related factors. The impact of these factors on revenue effort was also assessed using the following specification.

$$\text{Exp}(-u_{it}) = \alpha + \ln\text{incomepc} + \text{percent15}_{it} + \text{percent65}_{it} + \text{noschool}_{it} + \text{traditional}_{it} + \ln\text{lespc}_{it} + \text{badopinion}_{it} + \epsilon_{it} \quad [8]$$

Equation [8] tests the impacts of various factors that could affect the revenue effort measurement generated from the SFA estimation. Revenue effort can be affected by willingness to pay, which is measured by disposable income per capita in log form ($\ln\text{incomepc}$) and percentage of individuals below 15 and above 65 (percent15 and percent65 respectively). Revenue effort can also be influenced by the general ability of a community to understand the concept of liability of paying tax. This effect is measured by the percentage of local populace without formal schooling (noschool). The variables traditional_{it} (percentage of traditional households) $\ln\text{lespc}_{it}$ (log of the local government equitable share (LES)⁷⁷ allocations per capita) and bad opinion (a dummy equalling 1 if a municipality that received a disclaimer, adverse, or qualified audit opinion or did not submit financial statements) are specific variables of interest in terms of impact on effort in collecting property rates. As highlighted above, land tenure issues continue to be a problem in rural municipalities in the former Bantustan areas. The impact of traditional land tenure issues was not explicitly included in the general estimation in equation [7], as it was deemed not to affect revenue capacity (ability to pay) but rather as a political constraint in collecting property rates in certain areas (revenue effort). The percentage of traditional households within a municipality is used to proxy traditional land. The $\ln\text{lespc}_{it}$ aims to assess the impacts of grants on municipal effort in collecting property rates owed, while the disclaimer dummy variable assesses internal financial capacity constraints and its effect on fiscal effort.

7.5.4 Data Sources

Important data sources used include the Regional Explorer database developed by IHS Global Insight for most of the economic, social and demographic information. Most of the financial data of municipalities were sourced from the Local Government Budget and Expenditure Review (National Treasury, 2008; 2011). Other data sources used include the Municipal Demarcation Board's annual capacity assessments, and financial audit outcomes sourced from the Auditor-General of South Africa (MDB, 2010).

As explained in section 7.2.1, the study uses a panel dataset constituting 70 municipalities deemed to be rural, and spanning a period of eight municipal financial years (2003/04 to 2010/11). Municipal property rates data collected for the sampled rural municipalities were sourced from National Treasury's local government financial database: section 71 of the Municipal Finance Management Act requires all municipalities to submit financial reports to the National Treasury on a monthly basis (South Africa, 2003). Property rates data was available for a period of eight

⁷⁷ The local government equitable share (LES) is a lump-sum, non-matching unconditional grant that accrues to all municipalities. It is the primary transfer that accrues to municipalities and is aimed at supporting general revenues and operating expenditures.

years (from 2003/04 to 2010/11), of which the first seven years are audited actual property rates collected per municipality.

Government data at the local government level is poor, particularly in terms of demographic, social and economic data. Such data disaggregated to local municipal level is only available from the National Census, which has occurred three times since 1994, in 1996, 2001 and 2011. Data at such disjointed intervals did not suffice for panel estimation. Thus, most of the social, economic and demographic data were sourced from the Regional Explorer database hosted by IHS Global Insight, including data on population, households, household structure, employment, and GVA information disaggregated to a local municipal level.

7.6 Analysis and Results

7.6.1 Results of the SFA Analysis

The results of estimating Equation [7] using the various techniques is presented in Table 60. Remember that the aim of this estimation is to quantify the factors that affect the property rates base of municipalities. The SFA estimation allows the estimation of this base and the efficiency of each municipality in maximising its respective tax base. For illustrative purposes, a fixed-effects and random-effects panel model were also estimated.

Table 60: Property Rates Capacity Estimations

Dependent Variable: Log of property rates per capita			
Independent Variables	Fixed Effects	Random Effects	SFA
$\ln\text{incomepc}_{it}$	0.419	0.867**	0.302
$\log\text{gvapc}_{it}$	0.237	0.153	0.591**
formalh_{it}	0.956	-0.841	-0.629
unemployed_{it}	-11.121***	-5.387**	-0.457
$\log\text{pop}_{it}$	-3.658*	0.721**	0.156
$\log\text{holds}_{it}$	-0.0028	0.007	0.0130
percent15_{it}	-15.731**	-13.911***	-5.238
percent65_{it}	6.884	-11.089	-15.858**
constant	47.060*	-8.411	-2.687

*** Significant at 1% Level

** Significant at 5% Level

*Significant at 10% Level

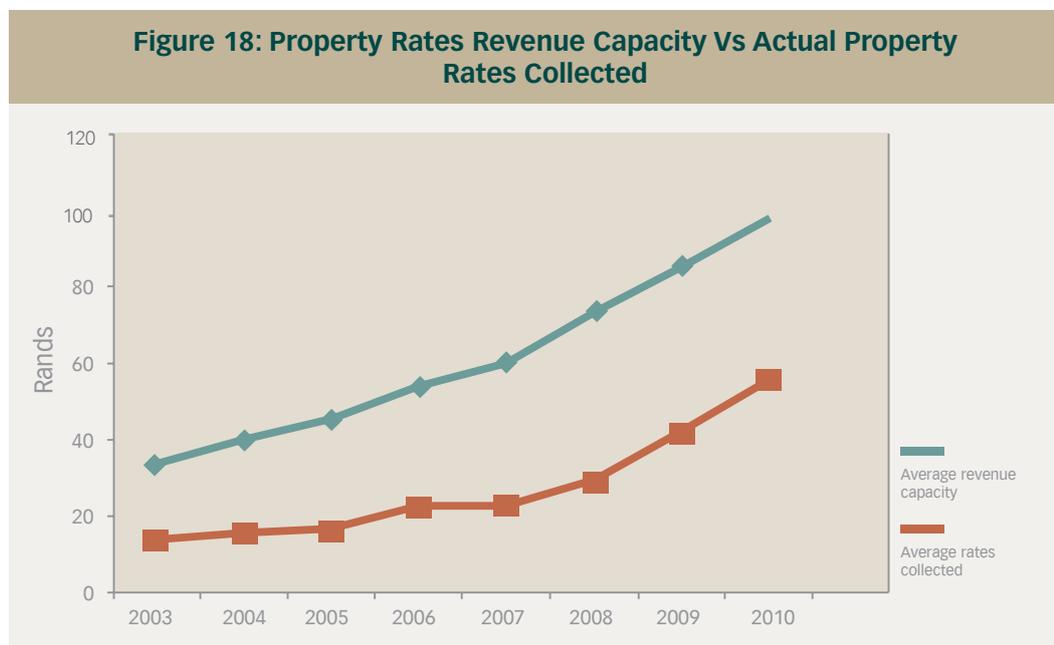
Source: Author's Calculations.

In terms of the SFA estimation, only local economic activity (GVA per capita) and the proportion of people over the age of 65 has a statistically significant impact on property rate revenues. A higher proportion of people above pensionable age suggests that such individuals benefit from property tax rebates, as they cannot afford to pay for property rates. The positive sign on GVA suggests that rates generated from local commercial properties can be important.

In terms of the other estimations, various tests suggest that the fixed-effects model is the most

appropriate, given the existence of unique effects in cross-sections within the model.⁷⁸ The results from the fixed-effects estimation find that unemployment has a negative effect on municipal property rates generated. A one per cent increase in the local unemployment rate can decrease property rates capacity by 11 per cent. The effect is similar on the proportion of individuals below 15, indicating that local demographics can have a major impact on the ability to generate revenues. Interestingly, population has a negative impact on the ability to generate property rates as per the fixed-effects model. This may suggest that rural municipalities are losing their existing tax base because of migration away from those regions.⁷⁹

This analysis shows that local economic and demographic factors have an impact on a municipality's own revenue efforts. Given these factors, the SFA method predicted the property rates that a rural municipality can collect. Figure 18 traces the estimated revenue capacity from property rates computed from the SFA analysis for all rural municipalities on average relative to the actual property rates collected on average in 2003/04–2010/11.



Source: Author's Calculations.

In 2003/04, rural municipalities, on aggregate, collected R13 per capita from property rates. Given the factors used in the modelling, the SFA predicts that these municipalities could have collected R34 per person, almost three times the actual revenue collected. In 2010/11, rural municipalities collected only R56 per capita out of potential revenue of R99 per capita, or just over half of potential revenue. Although performance has been improving, rural municipalities still collect far below the predicted property rates capacity. A comparison of property rates per capita collected shows that the property rates tax base is much weaker in rural areas than in urban areas. For example, in 2003/04, metros collected R647 per capita on average compared to the rural municipalities' predicted R34 per capita. This is the metros' revenue effort (not revenue capacity) in respect of property rates. To emphasise, in 2009, the average revenue effort of metros was R1,075

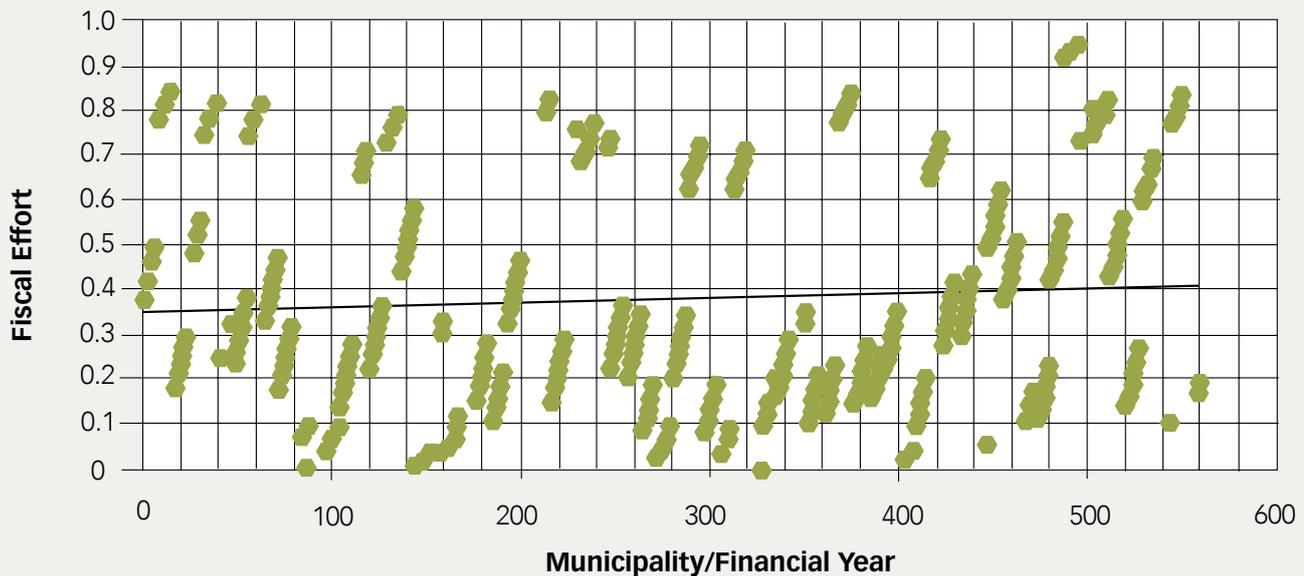
⁷⁸ A Hausman test was undertaken to confirm the robustness of the fixed-effects model.

⁷⁹ Although the impact of population has the opposite effect in the random-effects model, statistical tests confirm that the fixed-effects is more robust than the random-effects model.

per capita, whereas the average revenue potential of rural municipalities was R85 per capita. The rural tax base for property rates is clearly constrained relative to other areas.

The revenue inefficiency scores generated to measure the revenue effort in collecting

Figure 19: Distribution of Revenue Effort Scores



Source: Author's Calculations.

Each cluster represents a single municipality and the changes of its efficiency score over the eight financial years in question. The x axis represents the sample of the estimation given by $n*t$ or the number of municipalities multiplied by the eight financial years ($70*8$).

The results from Figure 19 are of utmost important to this study, showing the ability of each rural municipality to maximise its local tax base. It is clear that no rural municipality is currently maximising its local tax base, as determined by the factors in Table 60. The best performing municipality is Ulundi local municipality in KwaZulu-Natal, which collects around 95 per cent (score of 0.945) of its tax base. In other words, this municipality can only collect five per cent more from its local tax base. Certain municipalities do not collect revenues from property rates in any given year, which is reflected by a 0 efficiency estimate (or 100 per cent inefficiency in revenue collection). In 2003/04 the average efficiency score was 0.34, gradually increasing to 0.42 in 2010/11. Although rural municipalities in general are improving the efficiency in maximising their property rates revenue base, on aggregate, property rates collection could improve by 58 per cent. In other words, in 2010/11, rural municipalities under-utilised their property rates tax base by 58 per cent.

From the first stage of this analysis, it is apparent that economic activity and the demographic profiles of municipalities affect the capacity to generate revenues. However, although certain municipalities may have similar economic and demographic characteristics, and hence similar property rates capacities, performance in optimising such tax bases may differ. The next stage of the analysis is to determine the factors that have an impact on the revenue effort of property rates. As indicated above, varying revenue effort can be explained by different levels of performance of rural municipalities, as well as social and political complexities. Table 61 illustrates the results of the second-stage analysis, which looked at the factors that affect the revenue effort scores. A fixed and random effects estimation was used.

Table 61: Revenue Effort Estimation

Dependent Variable: SFA efficiency scores ($\exp(-u_{it})$)		
Independent Variables	Fixed Effects	Random Effects
$\ln\text{incomepc}_{it}$	0.085***	0.085***
percent15_{it}	-0.235**	-0.240**
percent65_{it}	-0.313	-0.331
noschool_{it}	0.128	0.112
traditional_{it}	-0.014	-0.014
$\ln\text{lespc}_{it}$	0.006*	0.006*
badopinion_{it}	0.001	0.001
Gini_{it}	-0.605***	-0.592***
constant	0.011	0.003

Standard errors in parentheses

*** Significant at 1% Level

** Significant at 5% Level

*Significant at 10% Level

Source: Author's calculations.

The results in Table 61 indicate that social issues appear to be the determining factors. Revenue collection is better in areas where local residents have higher levels of disposable income, indicating that people who can pay are willing to pay property rates. Although this impact is small, it is statically significant in both estimations. Another significant indicator of property rates revenue effort is the Gini variable, which has a negative impact. It appears that areas with high levels of income inequalities also tend to have high levels of social tensions, social tensions, resulting in communities being unwilling to pay property rates.

Interestingly, higher levels of traditional households have a negative impact on revenue optimisation, but this relationship is statistically insignificant. This is surprising given the complexities of traditional leadership in respect to revenue collection in those areas, particularly property rates. Other factors appear to be more significant in explaining revenue effort. Another interesting variable is the LES allocations to rural municipalities, as a positive and significant relationship was found between the LES allocations and revenue effort in collecting property rates. It could be that these municipalities use such funding to improve their billing and collection efforts. Another surprising result is that the financial capacity of a municipality, measured by the audit outcome, does not have a significant bearing on revenue effort. Although financial mismanagement and inefficiencies remain a problem in rural municipalities, it appears that this factor does not have an impact on rural municipalities' ability in maximising their property rates revenue base.

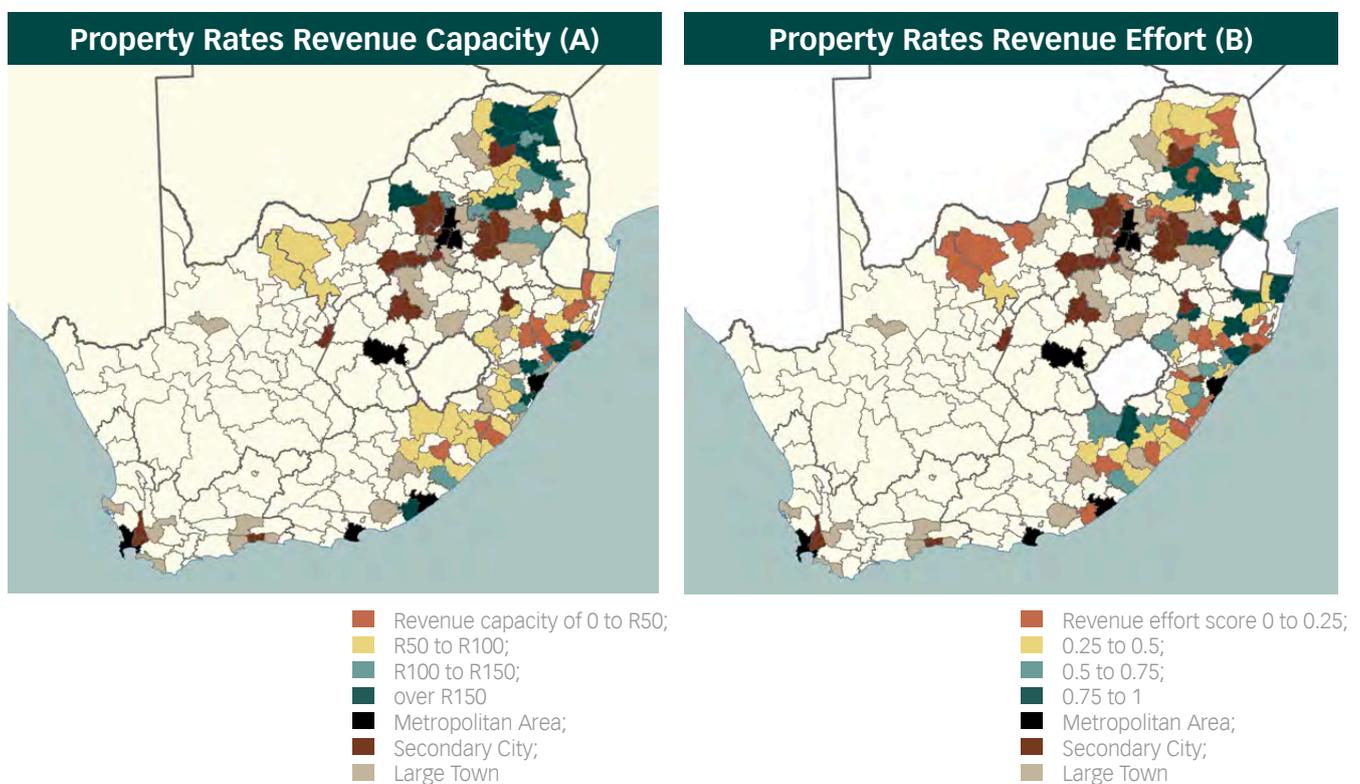
7.6.2 Understanding the Dynamics of Rural Tax Optimisation – A Spatial Perspective

The study has thus far predicted the revenue capacity of property rates (as a rough indication of the general tax base of rural municipalities), its determining factors, the extent to which this revenue capacity is maximised, and the factors impacting on this revenue effort (social and possibly funding issues). The econometric analysis above provides an aggregate understanding of

the rural tax base. It is now important to delve more deeply into these issues. A spatial analysis of the rural tax base and tax effort is used to explore the true dynamics of the rural tax base, by assessing whether revenue capacity and effort improve as a result of jurisdictional spill-over effects, based on the location of the rural municipality in question. To assess this, a spatial analysis of the rural property tax base and tax effort is undertaken.

In certain cases, spill-over effects from adjacent urban areas may affect the local tax base and tax effort of rural municipalities. Figure 20 offers a spatial illustration of the relative revenue capacity and revenue effort (measured by the SFA efficiency scores) computed by the SFA analysis of each rural municipality and the location of metropolitan municipalities, secondary cities and larger towns.

Figure 20: Property Rates Revenue Capacity/Effort in 2010 and Proximity to Urban Areas



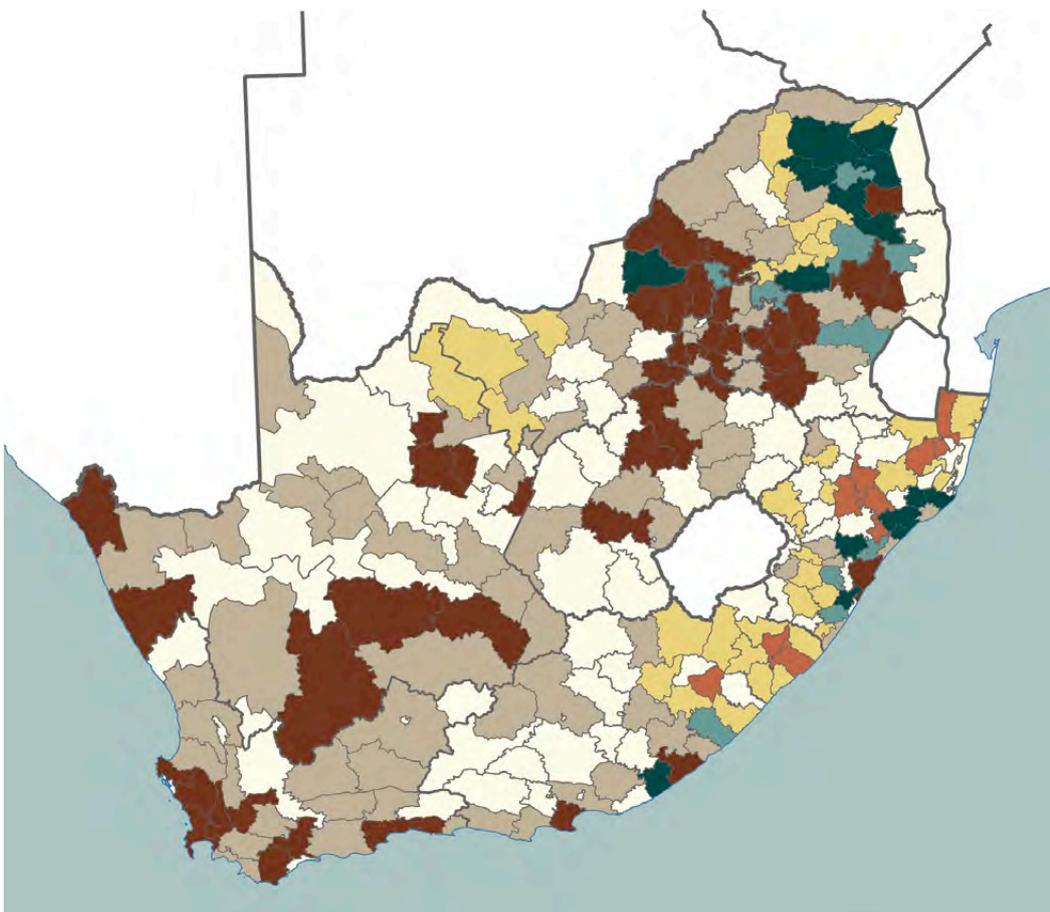
Source: Adapted using data from IHS Global Insight

Part A of Figure 20 shows that some rural municipalities adjacent to urban municipalities have a higher tax base or revenue capacity, which is probably the result of spill-over effects from these adjacent areas. It is important to reiterate here that, although the property rates tax base is largely immobile, this analysis focuses on the general tax base, with the property rates tax base being used as an illustration. Furthermore, economic and social spill-overs (for example, people working in an urban municipality but residing in the adjacent rural municipality) can have an impact on the property rates tax base. Specifically, rural municipalities around eThekweni (Vulamehlo, for example), Buffalo City and Gauteng appear to benefit from the economic spill-over effects. In contrast, municipalities in deep-lying rural areas have no or a very limited tax base.

For revenue effort, Part B of Figure 20 shows that municipalities with stronger property tax revenue bases (due to possible spill-over effects from adjacent urban areas) do not maximise their tax base. Other factors appear to affect this poor revenue performance, such as potential social dynamics or funding constraints.

Figure 21 extends the analysis by looking at adjacent municipalities with high levels of economic activity, as measured by GVA per capita. As expected, the trend is similar to the one described above. The economic activity in deep-lying rural areas is highly constrained, and the country has pockets of areas with very low levels of economic activity and no adjacent economic base.

Figure 21: Gross Value Added, 2010 and Property Rates Revenue Capacity, 2010

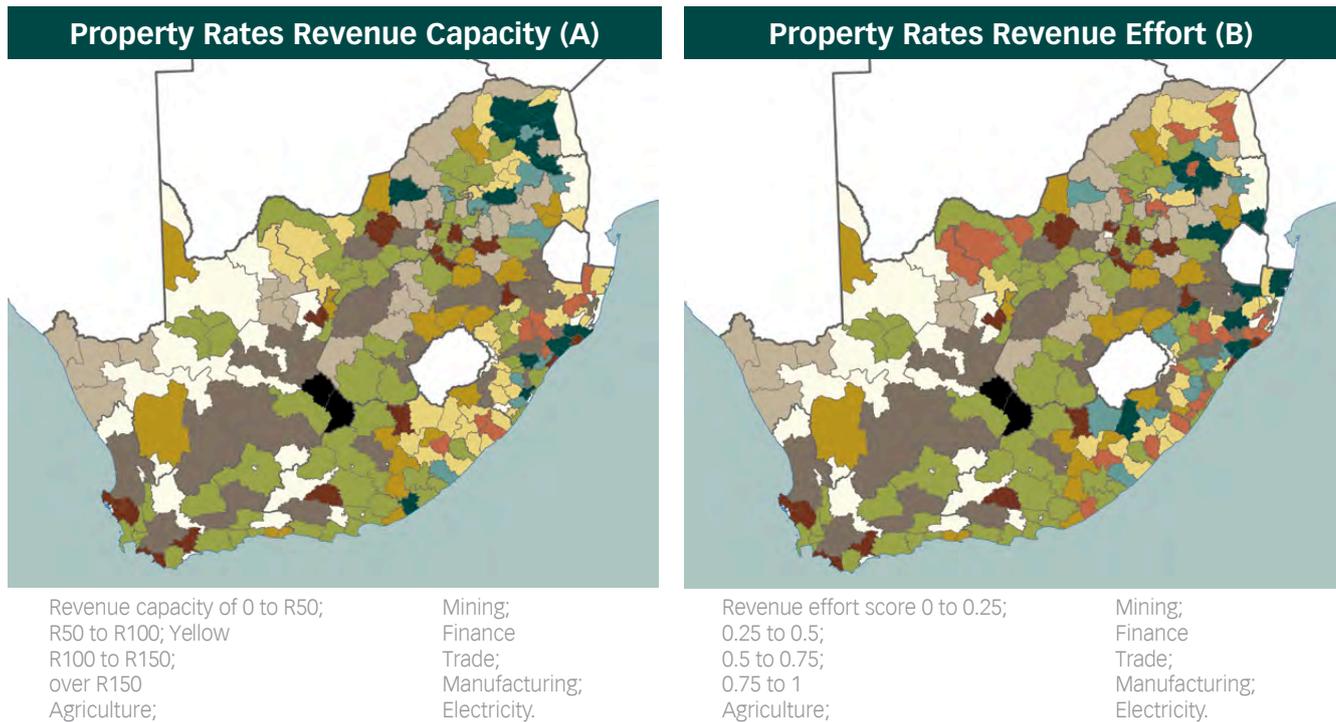


Revenue capacity of 0 to R50;
 R50 to R100; light blue – R100 to R150;
 Over R150.(Dark Blue)
 Over R50000 per capita GVA;
 R25000 to R50000 per capita GVA

Source: Adapted using data from IHS Global Insight

Figure 22 (page 190) extends the analysis to assess the impact of adjacent major economic activity on the revenue capacity and effort of rural municipalities.

Figure 22: Dominant Adjacent Economic Activities and Property Rates Revenue Capacity/Effort



Source: Adapted using data from IHS Global Insight

From Part A of Figure 22, rural municipalities in areas dominated by agriculture appear to have a very limited property tax base. This is understandable given the low value-adding subsistence farming or low property values in these areas. Interestingly, rural municipalities with a relatively stronger revenue base are found along the mining belt of the country as well as along the coast (which is understandable given the higher property values along the coastline).

Part B of Figure 22 compares the revenue effort of those rural municipalities with the dominant economic activity in adjacent municipalities. It shows that rural municipalities along the coast, which have a greater revenue-raising capacity, are not maximising their revenue base. This suggests that those municipalities are not taking advantage of their location, and that other non-structural factors are affecting their revenue collection efforts.

7.7 Conclusion

The purpose of this study was to unpack the dynamics of the general tax base of rural municipalities. Some of the consequences assessed included the legacy of apartheid and former Bantustan governments, which contributed to low levels of investment in rural areas, as well as the former Bantustan political system that created a local political structure of traditional leadership. The traditional leadership structure in these tribal lands spilled over into the democratic era, and continues to create ambiguities in these rural areas. Some of these consequences were assessed in the study.

The analysis was limited to the property rates tax base, which can be regarded as a fair reflection of the general tax base of a given municipality. The study used the SFA technique to estimate the revenue capacity of property rates in rural areas and its determining factors. In the absence of property valuations, the key factors for explaining revenue capacity were local economic activity, and social circumstances. The SFA technique also allowed the efficiency of municipalities in maximising their revenue capacity to be computed.

The analysis found that rural municipalities use only half of their existing property rates revenue base. Nevertheless, in general the revenue capacity in those areas is very limited –less than a tenth of those in urban municipalities. Therefore, although revenue efforts in these areas are poor, the revenue bases are very limited. Thus one can conclude that, while revenues from property rates are not adequate to support expenditure needs (due to structural issues), the collection of such revenues can be improved.

Contrary to anecdotal evidence, capacity constraints and confusion over land tenure in traditional areas are not the driving factors of the poor revenue effort in those rural municipalities. In fact, social dynamics and possible financial constraints appear to be hindering revenue efforts in those areas.

Rural tax bases are clearly a complex issue, and several dynamics are at play. Proximity to urban areas, specific economic activities, and a coastline are some of the factors that have a positive impact on revenue capacity. However, in most cases, rural municipalities do not take advantage of such opportunities from neighbouring municipalities. Furthermore, the deep rural areas appear to be financially unviable, given their low levels of economic activity and high levels of poverty.

7.8 Recommendations

With respect to **developing rural fiscal capacity**, the Commission recommends that:

In the short term:

- National and provincial governments support weaker rural municipalities to ensure improved revenue and expenditure outcomes. This should be done through:
 - Improved assistance in formulating and implementing budgets, IDPs, LED, debtor management and credit control policies.
 - More effective capacity-building initiatives, which deal holistically with governance, systems and business processes, as well as recruitment, retention and the development of requisite skills.
- National and provincial governments ensure that grant funding to rural municipalities is linked to capacity-building initiatives and structured assistance, so that systems are built to improve the municipality's ability to collect revenues due and increase the quality of spending.
- Municipalities ensure that revenue-enhancement strategies are sensitive to broader constraints, such as inequality, unemployment, local politics and land tenure issues so that revenue effort is maximised.

In the long term

- Given the skills and resource shortages in rural areas, municipalities explore greater collaboration with the district municipality, neighbouring local municipalities and provinces to pool resources in order to ensure greater regional planning and investments. Where rural municipalities are adjacent to better performing municipalities, best practice methods should be shared through peer learning arrangements among municipalities.

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