

# Post-constitutional Rules and the Redistributive State: Insights from a South African Case

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## **Abstract**

This paper regards the two stages in which rules emerge, namely, the constitutional (the protective state) and the post-constitutional (the productive state). By considering the South African case of the Municipal Systems Act in conjunction with the South African Constitution of 1996, we see how a limiting post-constitutional rule leads individuals to increasingly look to the state rather than to the market to fulfill some needs that should be private rather than public, and, by so doing, degenerates the productive state into the redistributive one.

## **1. Introduction**

One of the fundamental lessons of Public Choice is that the economic development path of an economy is not indifferent to its institutional matrix. In short, social institutions, or a society's rules of the game, matter.

In this regard, the Public Choice view is a voluntaristic one, namely, it rests on a conjectural agreement on a social contract that leads individuals out of the anarchic status quo. Moreover, rules emerge in two different stages. The first stage sees the emergence of the most fundamental rule: the constitution. The second stage sees the emergence of other rules in accordance with the constitution (e.g., Buchanan and Tullock 1962; Mueller 2003).

The two stages define two types of states. The first stage – the constitutional one – defines the protective state. The protective state is what saves individuals from anarchy on the one side and extreme state coercion on the other. The second stage – the post-constitutional one – defines the productive state. The productive state rationalizes the existence of the state through time because its role is to supply public goods. But there is a catch: in actual fact, the productive state often deviates from its ideal public good-supplying role and often assumes the role of a redistributive state. A redistributive state is a degeneration for it basically assumes some of the roles of the market. As such, individuals will increasingly look to the state rather than to the market to fulfill some needs that should be private rather than public. Thus, we have well-known coalitions and results that direct a society's resources and talents towards rent-seeking and rent-destruction rather than rent-creation (Buchanan 1975).

This paper employs these insights to study one possible degeneration of the South African productive state. The Constitution establishes a decentralized system of government in three tiers, namely, national, provincial and local government with

municipalities. Through the South African *Municipal Systems Act of 2000*, there are incentives to substitute market mechanisms for service delivery with state ones - what we identify as insourcing - at the municipal level. A substitution, we point out, that is not in full alignment with the South African Constitution.

South Africa is an interesting case study because not long ago it has undergone a constitutional transition from an autocratic regime to a democratic one. The transition out of Apartheid represents a concrete rather than conjectural historical case that is consistent with the nature of a quasi-experiment whereby exogenous variation in a number of key explanatory variables can be observed both before and after a policy change. The discussion thus will have implications beyond the South African case.

## **2. The Rules of the Game**

During Apartheid, there was no single system of local government across South Africa. Instead, there were separate local governments according to two race groups: White Local Authorities and Black Local Authorities (e.g., Steytler 2005; de Visser 2009). The Apartheid-driven premise was in fact “own management for own areas” (de Visser 2009).<sup>1</sup>

Since the transition to democracy in the 1990s, there have been many reforms to the organization of South African government.<sup>2</sup> The reforms mostly intended to address inequalities fostered during Apartheid. The foundation of the reforms is the

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<sup>1</sup> Some White Local Authorities persisted with segregation policies even after they were abandoned by the National Government. For example, in 1988, the White Local Authority of the City of Boksburg chose to segregate city-owned parks, libraries, restrooms and sports facilities. Even after the Separate Amenities Act was repealed by the National Government in 1990, White Local Authorities still passed ordinances either to restrict local facilities to town residents or to raise the user charges for non-residents to exclude non-whites (Lowenberg and Kaempfer 2001: 55).

<sup>2</sup> For details of transition arrangements for local governments from Apartheid to Democracy (1993-1998), see Pycroft (2000), Bahl and Smoke (2003), Schroeder (2003), Heymans (2006), and de Visser (2009).

Constitution. Moreover, the reforms also have the objective to improve resource allocation. By improving resource allocation, the reforms are supposed to address socio-economic backlogs, regional disparities and racial inequalities (Amusa and Mathane 2007: 266).

The Constitution establishes and assigns roles and functions to the three spheres of the post-Apartheid government.<sup>3</sup> The first sphere is national government. The second, which changed considerably, is provincial government: nine provinces replaced four provinces, four homelands and six self-governing territories of Apartheid.<sup>4</sup> The third tier – the one that will take up most of our interest – is local government. Section 151 of the Constitution, together with the Local Government Municipal Structures Act of 1998, consolidates local governments into two hundred and eighty-four local municipalities of three different categories: six metropolitan municipalities for urban areas, two hundred and thirty-two municipalities for rural and urban areas, and forty-six district municipalities for rural areas (Amusa and Mathane 2007: 270-271; Bahl and Smoke 2003: 7).

In changing local government, a concerted effort was made to remove racial constructs from municipalities. Thus, white towns were amalgamated with their outlying black townships and informal settlements to form a single tax base under one municipality (Pycroft 2000: 145). Section 152 of the Constitution gives local governments authority and functions not unlike those given previously to the White Local Authorities under Apartheid. Thus, the authority and functions are similar across all three categories of municipalities. All municipalities are created equal.

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<sup>3</sup> Note that the Constitution refers to three spheres of government rather than the three tiers of government under Apartheid. The use of spheres instead of tiers is to indicate the greater autonomy assigned to the sub-national governments (de Visser 2009).

<sup>4</sup> See Amusa and Mathane (2007: 271-272) for revenue and expenditure of provincial government after Apartheid.

Chapter 8 (Sections 76 to 82) of the Municipal Systems Act deals with the provision of services, from which “mechanisms” are available to provide a service (for example, by another municipality, by a private company or internally by the municipality itself) to how to go about deciding between the different mechanisms, and how to provide the service once a mechanism is chosen.

Section 76 of the Municipal Systems Act defines two mechanisms through which a municipality can provide a service. A municipality can provide a municipal service through either an “internal mechanism” or an “external mechanism.” An “internal mechanism” (or an internal service provider) is a department or administrative unit within the municipality, a business unit under the administration of the municipality, or another component within the administration of the municipality. That is, an internal service provider is some unit or division within the municipality itself that the municipality itself can use to provide a service. An “external mechanism” (or external service provider) is when the municipality enters a service agreement with either another municipality, another “organ of state,” an NGO or community organization, or a business entity. That is, an external service provider is when the municipality outsources its service, be it to another part of government or to a private company.

Section 78 of the Municipal Systems Act provides the legal framework as to how a municipality should choose between either an internal service provider or an external service provider (i.e., outsource service provision) to provide a service.

The first consideration for the municipality relates to provision by an internal service provider, i.e., the municipality providing the service itself. Part of first considering provision by internal service provider requires that the municipality consider the costs and benefits of providing the service through internal provision.

The municipality must then consider both its capacity and its future capacity to provide the service. The municipality must also determine if reorganizing its administrative functions and developing its human resources would help with providing the service. Then, the municipality must consider the impact on development, job creation, employment patterns, and the views of organized labor in the community. The municipality may take into account trends in sustainable provision but this is not a requirement. Only after first considering the feasibility of providing the service by the internal service provider, can the municipality decide that an internal service provider is the correct choice (in which case the municipality can move on to providing the service as per Sections 79 and 80 of the Municipal Systems Act) or to carry on the process by considering an external service provider.

If the municipality decides to consider external provision, i.e., outsourcing the service to an external service provider, the process continues. The municipality must first give notice to the local community of its intention to explore the possibility of using an external service provider. The municipality must then consider the costs and benefits of providing the service by an external service provider. It moreover must assess the different types of external service providers by taking into account the costs and benefits of the project, capacity and future capacity of prospective external service providers to provide the service, the views of the local community, the impact on development, job creation, employment patterns and the views of organized labor. Finally, the municipality must conduct a feasibility study.

The feasibility study must include identification of the service under consideration, the number of years that the external service provider would provide the service, the projected outputs and an assessment to the extent which the external service provider will provide value for money. The feasibility must also assess

whether providing the service by an external service provider will address the needs of the poor and be affordable to the local community, transfer the appropriate technical, operational and financial risk. The feasibility study must also determine what the projected impact is on the municipality's staff, the municipality's assets and liabilities, the municipality's integrated development plan and municipality's budget.

Only after both considering the option of providing the service by an external service provider and completing a feasibility study can the municipality decide whether to outsource to an external service provider or else to provide the service through an internal service provider. Then, if the municipality chooses an external provider, it must also ensure it complies with any legislation that might apply.

### 3. Post-constitutional Analysis

Before a municipality can even consider an external service provider, the municipality is required to determine whether it has the capacity to deliver the service or whether it can reorganize itself to deliver the service. Then it has to consult with organized labor. If the municipality decides on an internal service provider to provide the service, at this stage, it can move on to provide the service without further consideration.

However, considering an external service provider can only occur after the process to consider an internal service provider is completed. To consider an external service provider to outsource the service to means that the municipality first has to notify the local community that it is merely considering this option. Then, it has to consider the suitability of outsourcing the service to the external service provider. The municipality then has to consider the views of both the local community and

organized labor as regards the feasibility of outsourcing. Thereafter, the municipality has to conduct a feasibility study.

Section 78 of the Municipal Systems Act requires municipalities are to investigate internal reorganization before considering the option of using an external service provider. Thus, while Section 78 seemingly encourages improvement to the internal functioning of municipalities, it actually can hinder service provision because it discourages external provision.

Furthermore, municipalities are required to consult both the local community and organized labor as regards service provision. This requirement can lead to a conflict of interest. The local community is concerned with efficient service delivery. While, for the most part, in South Africa, organized labor tends to be against outsourcing, preferring instead to protect the jobs of existing employees. Thus, organized labor is generally not in favor of outsourcing any services, even if it means improved service delivery for the local community.<sup>5</sup>

Section 78 of the Municipal Systems Act favors the appointment of internal service providers to provide services. For a municipality to outsource a service to an external service provider requires a far more lengthy process than to provide the service internally. Additionally, the way that the legislation guides the municipality through examining the suitability of an internal provider well before moving on to considering the suitability of an external provider encourages a municipality to see outsourcing to an external service provider as a secondary or least favored option. Ultimately Section 78 discourages outsourcing. In light of the above, we can define the following four social states:

(x) Municipality 1 insources; Municipality 2 outsources.

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<sup>5</sup> See, for example, News24.com (2011).

(y) Municipality 1 outsources; Municipality 2 insources.

(z) Municipality 1 insources; Municipality 2 insources.

(w) Municipality 1 outsources; Municipality 2 outsources.

Assume that each municipality can only choose between two of the four social states. For example, municipality 1 chooses between x and y whereas municipality 2 chooses between z and w. It is worth emphasizing that neither municipality is decisive in its choice. This is required to avoid any discrepancies. For example, if the choice of y by municipality 1 is decisive this would preclude the concurrent choice of z by municipality 2.

The choices among the social states together with their pay-offs are illustrated in Table 1. The top entries illustrate social states whereas the bottom entries illustrate payoffs.

**Table 1: Social States and Pay-offs**

(x, z)	a, c	(x, w)	b, c
(y, z)	a, d	(y, w)	b, d

In the Post-Constitution and Pre-Act period (1996-2000), there is no preferential treatment. We have,

Municipality 1 ( $x \sim y \sim z \sim w$ ), and

Municipality 2 ( $x \sim y \sim z \sim w$ ),

with the following holding: “when an organ of state in the national, provincial or local sphere of government, or any other institution identified in the national legislation, contracts for goods or services, it must do so in accordance with a system which is

fair, equitable, transparent, competitive and cost-effective” (Constitution: Section 217(1)).

This implies that both municipalities are indifferent between any elements in the defined social states. If  $a, c > b, d$ , then Section (217(1)) would lead one to choose  $(x, z)$ ; while if  $b, d > a, c$ , then Section (217(1)) would lead one to choose  $(y, w)$ .

Stated differently, as per the Constitution, there is indifference between the defined social states while at the same time there is no indifference between the pay-offs attached to those same social states. Accordingly, the choice will fall rationally on the state with the larger payoff.

However, if we consider the Post-Constitution and Post-Act period (2000-present) things differ. In this period indifference does not hold. Section 78 of the Municipal Systems Act, as we saw, induces a preference towards insourcing, entailing that,

Municipality 1 ( $x \sim z \succ y \sim w$ )

Municipality 2 ( $y \sim z \succ x \sim w$ ).

In terms of Figure 2, municipality 1 prefers  $x$  to  $y$ , resulting in row dominance; while municipality 2 prefers  $z$  over  $w$ , resulting in column dominance. Given each municipality’s preference rankings, the core – the most preferred social state – is  $(x, z)$ . This is different from the Post-Constitution and Pre-Act state of affairs where both municipalities were indifferent between any elements within social states.

The Pre-Act and Post-Act states entail additional differences. For example, in the Post-Act, if, say,  $b, d > a, c$  we have the classical prisoners’ dilemma. That is, even though efficiency would require choosing the higher pay-off, preference ranking

by municipalities would bind the choice to  $(x, z)$  and the relevant comparable lower pay-off  $a, c$ .

Consider a more general example. The first column of Table 2 illustrates different configurations under the control of Municipality 1.<sup>6</sup> Each configuration has two choices arranged in a preference order. For example, configuration  $(A, B)$  implies that Municipality 1 prefers  $A$  to  $B$  and configuration  $(B, A)$  implies that Municipality 1 prefers  $B$  to  $A$ . The second and the third columns of Table 2 represent the ranking of the order of the choice sets. Column two illustrates the ranking of the configurations at the Post-Constitution and Pre-Act state of nature whereas column three illustrates the ranking of the configurations at the Post-Constitution and Post-Act state of nature.

**Table 2: The Constitution and the Municipal Systems Act**

Configurations	Rankings by Municipality 1	
	Post-Constitution/Pre-Act	Post-Constitution/Post-Act
A, B	First	First
B, A	First	Second

Table 2 shows that whereas in the Post-Constitution and Pre-Act stage Municipality 1 allocates equal weights between the two configuration in the Post-Constitution and Post-Act stage Municipality 1 prefers configuration  $(A, B)$  to  $(B, A)$ . That is, should insourcing be possible Municipality 1 is to insource even if efficiency commands otherwise. In other words, even though the Post-Constitution and Post-Act state of nature does not really decrease the set of available choices in the sense of e.g., eliminating choice  $B$  altogether it, nevertheless, distorts the choices. And it is this distortion that creates room for distributional outcomes.

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<sup>6</sup> The choice of Municipality 1 is for illustrative purposes. The same result holds if one considers Municipality 2.

Therefore, even though the constraints set up in the Municipal systems act appear not to excessively limit the set of available choices a priori this is what happens de facto (at least partially).

## SECTION TO BE CONCLUDED

### 4. A Graphical Illustration

Figure 1 illustrates the pay-offs of each contractual sequence. Point A denotes the Pre-1994 period associated with the Apartheid regime. Point B denotes the fall of Apartheid. From B to C we have the drafting of the Constitution. Point C denotes the promulgation of the Constitution in 1996. All points past C denote the Post-Constitutional stage. Between C and D we have the Pre-Act stage whereas all points past D denote the Post-Act stage. For the purposes of this paper we shall ignore points A and B. It suffices to know that the promulgation of the Constitution leaves society better off.

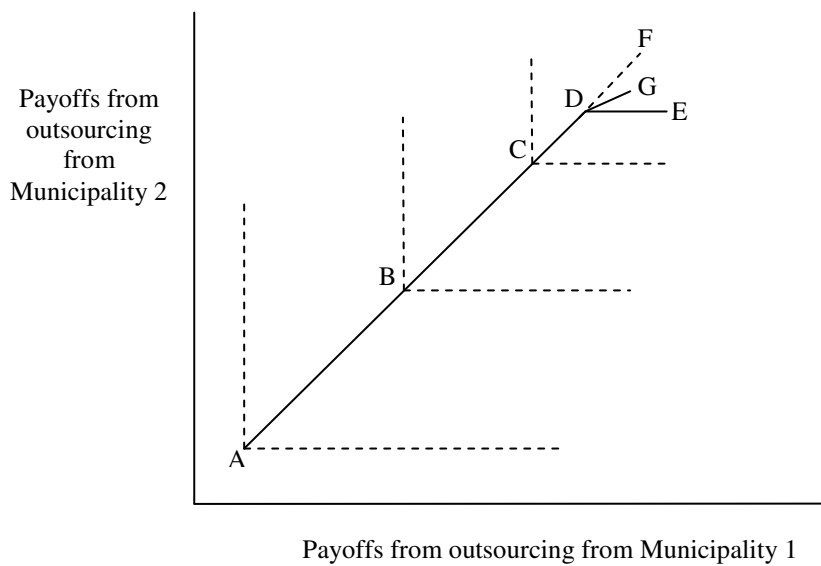
The Post-Constitution and Pre-Act stage denoted by line CD is associated with the role of the state as a protective agent. At this stage coercion is kept to a minimum and choices are not excessively constrained. All sequences past D are associated with the role of the state as a productive agent. Point F is a hypothetical sequence. It represents the outcome of state intervention qua productive agent in the absence of the Municipal Systems Act. Point E denotes the outcome that the Municipal Systems Act attempts to achieve. Point G denotes the de facto outcome.

The fact that point G does not coincide with point F implies that the outcome associated with point G is not (entirely) directed by the natural conditions of exchange relations but by institutional conditions. For example, even though a move from D to

F would require forfeiting some degree of freedom (in the sense of more state intervention) it nevertheless improves the choice set for at F the pay-offs for citizens of both municipalities are higher than at any other possible point. However, even though at G society is still better off some loss of freedom may have not been compensated for. Accordingly, the choice set as implied by G is inferior to the choice set implied by F. Therefore, the constraints as presented by the Municipal Systems Act worsen society's set of available choices.

SECTION TO BE CONCLUDED

**Figure 1: Payoffs from Each Stage of the Contractual Sequence**



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