In partnership with:

LOCAL GOVERNMENT EQUITABLE SHARE FORMULA REVIEW

DISCUSSION PAPER 1:

Proposed Principles and Objectives of the Local Government Equitable Share Formula

May 2012

1. INTRODUCTION

1.1 Context

This paper is circulated to Local Government Equitable Share (LGES) stakeholders as part of the LGES formula review process. It should be read together with the outline of the review process and the discussion paper analysing the current formula, both of which have also been circulated. Stakeholders are invited to submit comments on the proposed principles and objectives in section 4 of this document. The principles and objectives will be revised in light of the inputs received and these revised principles and objectives will in turn be used in the design of a new LGES formula.

The LGES formula review looks at only one part of the funding of local government. However, the review forms part of the broader review of the local government functional and fiscal framework (LGFFF) review being undertaken jointly by the Department of Cooperative Governance and the National Treasury. The LGFFF review has a much broader scope to review the different aspects of the functional and fiscal arrangements of the local government system. Many of the issues not dealt with in this review due to its limited scope of only examining the LGES formula will be addressed as part of the broader LGFFF review.

1.2 The need for the LGES Formula Review to be based on clearly defined principles and objectives

There are many different ways of constructing a formula to allocate local government's equitable share of nationally raised revenue among municipalities. It is important that the choices made in designing the new formula be based on a clear set of principles and an agreed set of objectives. This will ensure that there is a sound basis for the design of the new formula and that stakeholders agree on what it should be trying to achieve.

The principles and objectives for the formula will only apply to the LGES formula, while other local government objectives may be funded through other instruments (such as own revenues and conditional grants) that are based on other principles.

1.3 Proposing a new set of principles and objectives

The current formula (introduced in 2005/06) was designed using the same set of principles and objectives that were used in the design of the original LGES formula introduced in 1998/99. The LGES Formula Review working group examined these principles and objectives and concluded that many of them were no longer as relevant to the current context of local government as they had been when the original LGES formula was introduced. As a result it was agreed that as part of the LGES formula review process the principles and objectives of the formula should be revised and updated.

This discussion paper reviews the previous set of principles and objectives of the formula in section 2, highlighting the need to consider, revise and update some of the principles and objectives. In section 3 the paper then describes the key constitutional and policy requirements the LGES formula must take into account. Finally, in section 4, the paper offers a draft set of principles and objectives for the formula that have been proposed by the working group driving this review process.

2. PRINCIPLES AND OBJECTIVES OF THE CURRENT LGES FORMULA

There have been two versions of the LGES formula, the first when the formula was introduced in 1998/99 and the second after a major review and revision to the formula was introduced in 2005/06. Both iterations of the LGES formula have used the same set of principles and objectives.

The LGES formula introduced in 1998/99 was accompanied by a document titled *Introducing an Equitable Share of Nationally Raised Revenue for Local Government* (published in 1998) which had the following to say about the principles underpinning the LGES:

> *"For any new system of intergovernmental transfers to achieve the above policy goals, it needs to incorporate certain basic principles:*
>
> - *Rationality. The level and distribution of transfers must be grounded in well articulated arguments showing how they promote goals such as equity, economic growth and efficiency, and so on;*
> - *Unintended consequences should be limited. In particular, the new system of transfers should create no perverse incentives;*
> - *Transfers should be predictable. Without predictability, budgeting and borrowing becomes difficult and expensive;*
> - *Transfers should promote accountability. Without accountability on the part of recipient governments, valuable national resources will be wasted, through inefficiency or corruption;*
> - *Transfers need to be politically acceptable and support institution-building at the local level*
> - *Transfers should be as simple and transparent as possible".*

The document also described the objectives of the LGES as follows:

> ***"Policy objectives***
>
> *The constitution does not specify the aims of a system of transfers to local government in detail. Policy goals have to be considered as well. Four central objectives have been established as a basis for restructuring the system of central-local transfers:*
>
> ***Equity -*** *Intergovernmental transfers should promote the constitutional and governmental goal of ensuring that all South Africans have access to basic services. In effect, this means the provision of subsidised basic services to the poor. Transfers should also treat jurisdictions fairly and according to a uniform set of criteria.*
>
> ***Efficiency -*** *A new transfer system should promote allocative efficiency by ensuring that inter-jurisdictional fiscal competition is an effective check on fiscal performance. This, in turn, requires that, where possible and appropriate, uniform equalisation measures should be introduced to ensure that local tax rates vary because of variations in local service costs rather because of disparities in tax bases.*
>
> *The character and scope of such equalisation measures needs to take into account the potential impact of equalisation on the economies and the competitive position of jurisdictions with richer tax bases. Full equalisation, or equalisation between areas with very unequal tax bases might entail potentially crippling fiscal outflows from richer areas. In addition, because factors of production are mobile not just across municipal borders, but across national ones, total cross-country equalisation might have a deleterious effect on the country's ability to attract international investment.*
>
> ***Spillover effects -*** *The provision of some public goods generates negative or positive externalities which may spill over into neighbouring jurisdictions. Such spillovers generate costs for one jurisdiction, but benefits for more than one, so that any given local authorities by itself could be expected to undersupply them. RSC levies were originally devised for*

allocation to metropolitan and district councils to finance projects whose benefits spilled over across municipal boundaries. However, they have been diverted to other purposes over most of the period during which they have been levied. A new transfer system needs to introduce a way of funding projects which have strong spillover effects.

Facilitating democracy - *Local authorities have certain fundamental administrative, functional and political responsibilities to their residents. In order to perform their basic roles, they require a minimum level of institutional and physical infrastructure.*

A new transfer system needs to enable local authorities to build or acquire this capacity. However, there is a certain minimum efficient scale for local authorities, and transfers should not be made available to entities falling below this level. In such cases, rationalisation and administrative restructuring are necessary."

Two additional policy positions are also described as implicit to the LGES model:

i. *"The current system of RSC levies (payroll and turnover taxes) is not economically efficient nor conducive to labour intensive economic growth. In the long term consideration should be given to replacing the levies with a more appropriate form of taxation. In the short term, however, the system needs to remain intact;*

ii. *The bulk of the redistributive effort intrinsic to the equity objective stated above should be funded by the central fiscus. Three factors underlie this position. First, for reasons of economic fairness, economic efficiency and sound fiscal management, national equity standards should be financed by national taxation on all citizens and enforced uniformly across the country. This is particularly true in a country such as South Africa where the overall fiscal structure is highly centralised. Second, it is not constitutionally possible for central government to reallocate locally raised revenues from one Metropolitan or District Council jurisdiction to another - any such lateral transfers would need to be entered into voluntarily. Third, the potential impact of any alternative needs also to be considered. Initial modelling conducted by the Department of Finance indicates that a general programme of urban-rural equalisation would impose crippling fiscal burdens on cities. It should be stressed that none of the above precludes any intra-local authority redistribution within specific jurisdictions. Municipalities may pursue such policies via their normal budgeting processes."*

While these objectives and principles were appropriate at the time of the introduction of the original formula in 1998/99, the LGES working group believes that a significant number of them are no longer as relevant as they had been. None of these original objectives and principles are irrelevant and are all still valid, but their priority has been significantly reduced due to other changes in the structure of local government in South Africa. The objectives of the original formula were crafted prior to the demarcation of municipalities that came into effect with the first fully democratic local government elections in 2000. These demarcations created unified metropolitan municipalities and wall-to-wall local municipalities that covered large geographic areas. The size of the new municipalities meant that in many cases the scope for inter-jurisdictional fiscal competition and spillover effects was much reduced, though they still exist. In other words these are no longer the major policy concerns around which the LGES formula should be structured. Similarly, while the objective of facilitating democracy is clearly still an important policy goal, the basic task of establishing municipal administrations in areas where none had existed prior to the advent of democracy (which the objective speaks to) has largely been accomplished. These objectives are also hard to measure, making them difficult to use as a basis for structuring funding flows and hard to measure performance against. The local government system has evolved significantly since the LGES objectives were originally defined and it is therefore appropriate that they should now be reviewed and updated.

The objectives listed for the original LGES also do not speak to what most people understand to be the purpose of the local government equitable share today, namely to enable municipalities to provide basic municipal services to poor households[1].

The principles listed for the original equitable share are all broadly still applicable. However, as part of the process to update the objectives of the formula it was decided to review both the principles and objectives of the formula to make sure they are relevant and appropriate to the new local government equitable share formula that is intended to be introduced in 2013.

3. PRINCIPLES AND OBJECTIVES IN LEGISLATION AND POLICY DOCUMENTS

In considering what objectives and principles the design of the new LGES formula should be based on we need to first consider the requirements for the LGES in existing legislation and policy. The Constitution and the White Paper on Local Government both refer to the LGES and make certain requirements that must be taken into account in the design of principles and objectives for the new formula.

However, it must be noted that many of the sections of the Constitution and White Paper quoted below are not intended to apply to the equitable share only. In the case of the Constitution, some of these clauses apply to the whole division of revenue which also includes conditional grants (such as the Municipal Infrastructure Grant). In the case of the White Paper the principles quoted below apply to the local government fiscal framework which includes all transfers (LGES and conditional grants) as well as own revenues (rates and service charges) and borrowing. It is therefore important to distinguish which of the points below apply to the LGES and which need to be met through other instruments.

3.1 Principles in the Constitution

Section 214 of the Constitution says that, "An Act of Parliament must provide for the equitable division of revenue raised nationally among the national, provincial and local spheres of government" and, "any other allocations to provinces, local government or municipalities from the national government's share of that revenue, and any conditions on which those allocations may be made."

Section 214(2) of the Constitution further stipulates that this division of revenue must take into account:

a) *"the national interest;*
b) *any provision that must be made in respect of the national debt and other national obligations;*
c) *the needs and interests of the national government, determined by objective criteria;*
d) *the need to ensure that the provinces and municipalities are able to provide basic services and perform the functions allocated to them;*
e) *the fiscal capacity and efficiency of the provinces and municipalities;*
f) *developmental and other needs of provinces, local government and municipalities;*
g) *economic disparities within and among the provinces;*
h) *obligations of the provinces and municipalities in terms of national legislation;*
i) *the desirability of stable and predictable allocations of revenue shares; and*
j) *the need for flexibility in responding to emergencies or other temporary needs, and other factors based on similar objective criteria."*

[1] See discussion paper 2 on the "Analysis of the LGES Formula" for a history of how basic services and free basic services became the primary items funded through the LGES.

The points listed in bullets a-c above are taken account of during the process of deciding on the vertical division of revenue (the split between national, provincial and local government) and so the LGES formula does not need to respond to them. The need for flexibility in responding to emergencies is largely provided for through special conditional grants and so bullet j is not strictly applicable to the LGES formula. Bullets d-i could therefore apply to the LGES formula, although the full weight of meeting them does not necessarily rest on the LGES alone. For example, many of the developmental needs of municipalities (bullet f) are funded through conditional grants that fund the construction of infrastructure for development.

Section 227 of the Constitution stipulates that:

> *"Local government and each province -*
> a) *is entitled to an equitable share of revenue raised nationally to enable it to provide basic services and perform the functions allocated to it.*
> b) *May receive other allocations from national government revenue either conditionallly or unconditionally"*

Section 227 also adds the following provision:

> *"Additional revenue raised by provinces or municipalities may not be deducted from their share of revenue raised nationally, or from other allocations made to them out of national government revenue. Equally, there is no obligation on the national government to compensate provinces or municipalities that do not raise revenue commensurate with their fiscal capacity and tax base."*

It is essential that the LGES formula complies with this stipulation not to deduct revenue raised by municipalities, while still taking account of the different levels of fiscal capacity of municipalities in terms of section 214(2)(e).

3.2 Principles and objectives in the White Paper on Local Government

The White Paper on Local Government was published in 1998 and sets out government's policy for transforming local government. In his foreword the then Minister of Provincial and Local Government says the White Paper "can almost be regarded as a 'mini-constitution' for local government."

The Chapter on Municipal Finance lists the following policy objectives for the new system of local government financing that the LGES forms part of:

- ***"Revenue adequacy and certainty*:** Municipalities need to have access to adequate sources of revenue – either own resources or intergovernmental transfers – to enable them to carry out the functions that have been assigned to them. Municipalities should be encouraged to fully exploit these sources of revenue to meet their developmental objectives. Municipalities should have reasonable certainty of revenue to allow for realistic planning.
- ***Sustainability*:** Financial sustainability requires that municipalities ensure that their budgets are balanced (income should cover expenditure). Given revenue constraints, this involves ensuring that services are provided at levels which are affordable, and that municipalities are able to recover the costs of service delivery. No bailout will be provided to a municipality that overspends its budget and/or fails to put in place proper financial management controls. It is the responsibility of the political leaders to ensure that they set realistic budgets. However, there is a need for subsidization to ensure that poor households, who are unable to pay even a proportion of service costs, have access to basic services.

- ***Effective and efficient resource use*:** Economic resources are scarce and should be used in the best possible way to reap the maximum benefit for local communities. However, there are no mechanisms available to ensure that municipal decisions will indeed lead to an effective allocation of resources. It is therefore important that local residents provide the necessary checks and balances. They can do this by participating in the budgeting process to ensure that resources are being put to their best use. Efficiencies in public spending and resource allocation will ultimately increase the access of the poor to basic services.
- ***Accountability, transparency and good governance*:** Municipalities should be held responsible and accountable to local taxpayers for the use of public funds. Elected representatives should be required to justify their expenditure decisions and explain why and how the revenue necessary to sustain that expenditure is raised. The fiscal system should be designed to encourage accountability. Municipal budgeting and financial affairs should be open to public scrutiny, and communities should have a greater voice in ratifying decisions about how revenue is raised and spent. Community participation in budgeting should aim to incorporate those groups in the community, such as women, who face particular constraints in participating. It should also include a capacity-building component to ensure that people understand the process of prioritisation – why resources are allocated to certain priorities rather than others. Accounting and financial reporting procedures should minimise opportunities for corruption and malpractice.
- ***Equity and redistribution*:** Municipalities must treat citizens equitably with regard to the provision of services. In turn, national and provincial government must treat municipalities equitably with regard to intergovernmental transfers. Local government cannot be solely responsible for redistribution, and national government has a critical role to play in this regard, particularly with respect to subsidising the provision of basic services. The equitable share of national revenue to which local government is entitled will be directed primarily at this purpose. In addition to targeted subsidies to poor households, funded from the equitable share, municipalities can cross-subsidise between high and low-income consumers, both within particular services and between services. The extent of this cross-subsidy is a local choice that needs to be exercised carefully, within the framework of the municipal integrated development plan.
- ***Development and investment*:** Meeting basic needs in the context of existing service backlogs will require increased investment in municipal infrastructure. Public Private Partnerships such as leases and concessions, provide a mechanism for attracting investment in municipal infrastructure.
- ***Macroeconomic management*:** Municipalities form an integral part of the public sector and their actions can substantially affect national policy. Municipalities need to operate within the national macroeconomic framework and their financial activities should not be such as to destabilise macroeconomic fiscal policy.”

The White Paper makes it clear that transfers from national government are only one part of the framework for the municipal financial system that also includes local revenue instruments and private investments (including borrowing). The White Paper estimates that at that time “on average, municipalities have sufficient revenue raising powers to fund the bulk of their expenditure, and finance 90 per cent of their recurrent expenditure out of own revenues.” This situation has changes substantially since 1998. Currently, transfers account for 25 per cent of municipal budgets on average, and in poor municipalities transfers can make up more than 75 per cent of municipal revenue.

The White Paper is very critical of the system of intergovernmental transfers that existed prior to 1998, describing the transfers (mostly paid from provinces to municipalities) as unpredictable, inconsistent and inequitable, with grants not being based on objective rational policy criteria while the incentives in the system sometimes encouraged poor financial management.

The White Paper stipulates that the equitable share will only fund the operating costs of municipalities and that capital transfers will be made through conditional grants. This means that the equitable share will constitute only a part of the total amount transferred to municipalities.

The White Paper sets out "five key objectives" that the horizontal division of the equitable share between municipalities must be driven by:

- Equity
- Efficiency
- Ensuring a basic level of administrative capacity in the most resource-poor municipalities
- Predictability
- Incentives for proper financial management at the local level

The White Paper says that in order to achieve these objectives a "transparent, formula-based system" needs to be phased in. It argues that a formula-based system is needed as this removes discretion over the allocation of funds, thereby eliminating the inconsistencies and inequities in the previous system of transfers from provinces to municipalities.

The White Paper lists two principles that the equitable share formula should be based on:

- **"The dominant principle underlying the system is equity** – the LGES should enable all municipalities to provide a basic level of service to low-income households at affordable cost.

- **A secondary principle is effective administrative infrastructure** – the LGES should ensure that even resource-poor municipalities are able to build a basic level of administrative infrastructure to allow it to govern its area effectively. Because many municipalities can afford this without transfers, this aspect of the formula must have an equalising dimension to it."

The White Paper also argues that transfers should be "allocated to those municipalities which have actual expenditure responsibilities in respect of service delivery and governance" in order to ensure certainty. This also establishes the principle that funding should follow functions (though this has become complicated in instances where functions are not actually performed by the municipality formally assigned the function).

While the White Paper makes it clear that the objective of the system of intergovernmental transfers is to ensure a package of basic services are provided to low-income and indigent households, transfers from national government are "a blunt instrument." Transfers cannot be targeted by national government so that they only benefit poor households, the White Paper concludes that, "the actual targeting of these intergovernmental transfers and ensuring that only eligible households have access to subsidised services will be the responsibility of individual municipalities."

3.3 Suggestion emerging from the Financial and Fiscal Commission's public hearings

The Financial and Fiscal Commission (FFC) held a public hearing on the local government fiscal framework in October 2011. A number of issues were raised, including several criticisms of the LGES formula. In their report on the public hearings the FFC introduces a somewhat different focus in arguing for:

> "The need to focus on the developmental impact and grant outcomes (second generation concerns) over and above equity and efficiency of grant allocations (first generation concerns). Similarly, first generation concerns (such as predictability, stability, avoiding perverse incentives) need to be supplemented by a focus on second generation concerns, related to creating incentives for behaviour change and performance, promoting accountability and ensuring long-term sustainability."

These first generation concerns refer to technical concerns of the type considered in the principles of the previous iterations of the LGES formula. Second generation concerns refer to the impact the allocations have in the way they are used. The FFC appears to be making a case that reviewing the fiscal framework (including the LGES) should give more consideration to how the structure of transfers affects the way services are delivered in municipalities as well as the ultimate developmental impacts of those services.

4. PROPOSED PRINCIPLES AND OBJECTIVES FOR THE REVISED FORMULA

This section sets out the set of principles and objectives for the revised formula that are being proposed by the LGES working group after considering the principles and objectives in the previous iterations of the formula as well as the requirements in legislation and policy documents outlined above.

The proposed principles and objectives set out below are only a draft. All comments and proposals from stakeholders will be welcomed as part of the consultation process. The LGES working group will revise the proposed principles and objectives based on inputs received and then issue a revised set of principles and objectives as part of the draft review of the formula.

Before outlining the proposed principles and objectives it is worth noting the difference between principles and objectives. The principles of the formula are the guiding requirements that the structure of the formula must comply with in as far as it is possible to do so. They refer to technical factors that the formula must take account of, but not to the policy goals the LGES formula is intended to achieve. The objectives of the formula describe the policy goals that the formula should assist in achieving.

4.1 Proposed principles of the LGES Formula

The LGES Formula must:

1. Be **objective** and fair
2. Be **dynamic** and able to respond to changes
3. Recognise **diversity** among municipalities
4. Only use high quality, verifiable and **credible data**
5. Be **transparent and simple**
6. Provide for **predictability** and stability

Principle	**Detail**
1. Be **objective** and fair	• Municipalities with similar characteristics must be treated in the same way by the formula • Formula design must be immune to subjective adjustments to favour a particular municipality
2. Be **dynamic** and able to respond to changes	• Formula must be capable of taking account of significant changes in the objective circumstances of municipalities • Formula structure should enable smooth updating of data • Formula should be able to respond to policy adjustments

3. Recognise **diversity** among municipalities	• Formula should be capable of taking account of the different characteristics and functions of municipalities • Funds allocated for a particular function must go to the municipality officially authorised to perform that function
4. Only use high quality, verifiable and **credible data**	• Official data should be used wherever possible • The most recent and up-to-date data available should be used • Data must not be manipulated (this does not preclude the use of credible estimates and projections) • Fair average cost estimates for basic services should be used (including maintenance costs)
5. Be **transparent and simple**	• The formula and information about how allocations are derived must be transparent and available to municipalities and the general public • The simpler and easier to understand the formula is, the more people will be able to engage with it
6. Provide for **predictability** and stability	• Municipalities should be provided with a degree of certainty about their allocations over a three year period in order to enable them to plan and budget effectively

Many of these principles are very similar to those used in the original LGES formula. The most significant changes are the inclusion of a principle to recognise the diversity among municipalities, this reflects increasing moves towards a differentiated approach to municipalities in local government policy. The explicit inclusion of the need for the formula to be dynamic in responding to changes in municipalities is also new, though it could to some extent be read into the previous principle of limiting unintended consequences (e.g. municipalities should not be penalised for growth).

Unlike the previous principles of the formula, this set of principles does not explicitly include promoting accountability, though this is enabled through the transparency principle. It has not proved practical to use equitable share allocations (which are unconditional) as an accountability mechanism. Enabling citizens to hold municipalities accountable is however one of the positive incentives that the formula should promote in terms of the objectives listed below. Because the LGES allocations form part of a well-institutionalised budget process at the national level that has clear political oversight, it is also no longer necessary to include a principle that refers to ensuring that allocations are politically acceptable. Rather, allocations should be evaluated based on whether they respond to policy objectives, which is done through defining clearly the objectives of the formula.

4.2 Proposed objectives of the LGES Formula

The following are the proposed objectives of the LGES formula, with more detail on each objective provided in the table below:

1. Enable municipalities to provide basic services to poor households
2. Enable municipalities with limited own resources to afford basic administrative and governance capacity and perform core municipal functions
3. Create incentives that promote efficient service delivery

Objective	Detail
1. Enable municipalities to provide basic services to poor households	• Supplement municipal budgets so that an efficient municipality will be able to progressively achieve the provision of free basic services to its poor households in line with national policy norms and standards • The LGES is intended to assist with the operational costs (including maintenance costs) of basic services for poor households, capital costs should be funded through conditional grants, own revenues and borrowing
2. Enable municipalities with limited own resources to afford basic administrative and governance capacity and perform essential municipal functions	• Provide funding to enable the most resource-poor municipalities to afford a basic level of administrative and governance capacity • Provide funding towards the cost of performing essential municipal functions in municipalities with limited own revenue bases • The LGES should recognise the ability of certain municipalities to cross-subsidise the delivery of administrative and other essential municipal services from their sources of own revenue • The formula should take account of the different levels of fiscal capacity in municipalities, but should not reward inefficiency
3. Create incentives that promote efficient service delivery	• Unintended consequences should be limited, in particular, the equitable share transfers should not create perverse incentives by rewarding underdevelopment or poor performance • The LGES should create positive incentives for municipalities that roll out services to reach more households • The LGES will not fund municipalities for services that are the competency of other spheres • The LGES should promote the efficient delivery of services and should not penalise alternative modes of service delivery if these are efficient • The structure of LGES allocations should reflect that maintenance should be budgeted for as part of the operational costs of service delivery • Local municipalities must remain accountable to their residents for resources they use, including transfers received – transparency can enable this • LGES allocations should not crowd out municipal own revenue raising efforts and the revenue-accountability link the collection of these revenues creates • The LGES should not undermine the long-term financial sustainability of municipalities and their ability to deliver services • LGES should support municipalities to create the foundation necessary for economic growth through the sustainable provision of municipal functions

These objectives meet the main requirements of section 224 of the constitution that can be applied to the LGES formula by clearly providing for basic services (in line with the requirements of section 227(a)), taking account of the different fiscal capacity and economic disparities between municipalities (through accounting for the potential to raise own revenues to cross-subsidise administrative and other essential municipal functions). The primary developmental function of municipalities is the provision of access to basic services which are foundational to almost all other aspects of development. The proposed LGES objectives include enabling municipalities to provide these services to poor, while conditional grants fund the infrastructure needed to provide these services. Some obligations in terms of national legislation will be provided for through the objective for basic services, while others will be provided for through the funding for administrative and other core services (still others will be funded through conditional grants and own revenues). The desirability of stable and predictable allocations is also provided for in the principles of the formula.

While the different economic circumstances and fiscal capacities of municipalities are taken account of in the objectives, they do not require the deduction of additional revenue raised by municipalities in order to achieve this (which could violate section 227 of the constitution).

In keeping with the vision for the formula in the White Paper, the LGES objectives only refer to contributing to the operational costs of municipalities, while capital budgets will be funded through conditional grants, own revenues and borrowing. The objectives also never refer to fully funding municipalities as all municipalities are expected to be able to raise some own revenues, though it is acknowledged that the amount of own revenues that different municipalities are able to raise will vary greatly.

The third objective of creating incentives that promote efficient service delivery goes some way to responding to the FFC's concern that the outcomes achieved through the equitable share should be given more consideration. Although no conditions can or should be placed on the LGES, the structure of the LGES formula should create incentives that promote accountability and effective service delivery. The detail of the type of positive incentives included in this objective also includes a lot of objectives listed in both the White Paper and the previous formula.

5. WAY FORWARD

The LGES formula review is a consultative process and this discussion document, together with the discussion document on the analysis of the current LGES formula is intended to stimulate discussion, debate and proposals from stakeholders. Stakeholders are therefore invited to make written comments on these documents as part of the LGES formula review. All written inputs must be sent to LGESreview@treasury.gov.za by **15 June 2012**. Due to the tight deadlines of the review process no late submissions will be considered.

In addition to the opportunity to provide written comments, groups of municipalities representing all types of municipalities will be invited to participate in focus groups on the LGES formula review. This process will take place in parallel with the opportunity to make written inputs to the review.

After considering all of the inputs received, draft proposals on the structure of the revised formula will be circulated for further consultation by the end of August 2012.