REVIEW OF THE LOCAL GOVERNMENT EQUITABLE SHARE FORMULA

In partnership with:

Quick Guide to the Proposal

PROPOSED FORMULA STRUCTURE

Purpose of this presentation

- This presentation is designed to give a quick overview of the proposed new structure for the LGES formula

- For a detailed discussion of the proposed structure of the new formula please read the discussion document available at:

    - http://mfma.treasury.gov.za/Media_Releases/ LGESDiscussions/Pages/default.aspx

Background to the LGES formula review

- The local government equitable share (LGES) is an unconditional transfer of nationally raised revenue to municipalities
- The LGES is allocated among the country's 278 municipalities using a formula
- This formula is being reviewed during 2012 by a working group that includes National Treasury, the Department of Cooperative Governance, and the South African Local Government Association and in partnership with the Financial and Fiscal Commission and StatsSA
- This review only looks at the LGES formula, it does <u>not</u> examine the size of the total amount allocated to the local government equitable share
- It is also not a review of the RSC levies replacement grant or any conditional grant
- The review will propose a new formula for use in the 2013 Budget

Timeline for LGES Formula Review

May 2012
- ☐ Discussion papers circulated on principles and objectives for the formula
- ☐ Phase 1 of consultation process

15 June 2012
- ☐ Deadline for written comments on principles and objectives for the LGES formula

Mid-September
- ☐ Proposed new formula structure circulated and phase 2 of consultation process

Now

26 September
- ☐ Deadline for written comments on proposed new formula structure

8 October
- ☐ Budget Forum (revised options presented)
- ☐ Testing and refinement of formula

February 2013
- ☐ New formula used in 2013 Budget

Principles of the LGES formula

The following principles of the formula were consulted on during phase 1, and broadly agreed to by stakeholders:

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

Objectives of the LGES formula

The following are the objectives of the LGES formula (amended after phase 1 of the consultation process):

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

☐ Third proposed objective to "Create incentives that promote efficient service delivery" has been dropped as stakeholders suggested it was unclear what this objective was aiming to achieve

Proposed LGES formula structure

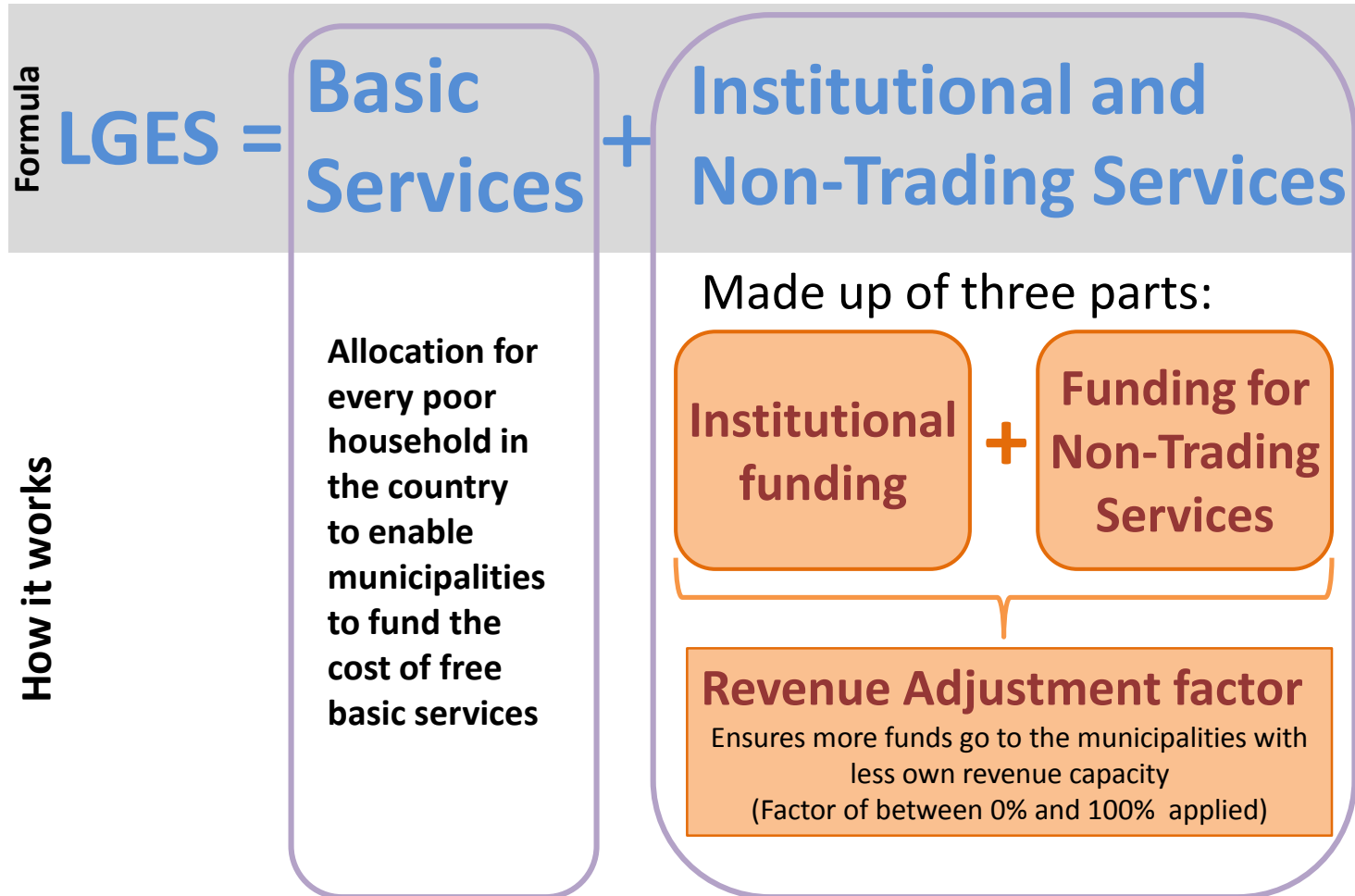*The proposed structure of the new LGES formula is as follows:*

$$LGES = BS + (I + NTS)xRA \pm C$$

Where:

- **LGES** is the local government equitable share
- **BS** is the basic services component
- **I** is the institutional component
- **NTS** is the non-trading services component
- **RA** is the revenue adjustment factor
- **C** is the correction and stabilisation factor

Simplified summary of the proposed LGES formula structure

Formula

LGES = **Basic Services** **+** **Institutional and Non-Trading Services**

How it works

Allocation for every poor household in the country to enable municipalities to fund the cost of free basic services

Made up of three parts:

Institutional funding **+** **Funding for Non-Trading Services**

Revenue Adjustment factor
Ensures more funds go to the municipalities with less own revenue capacity
(Factor of between 0% and 100% applied)

*Correction factor is also applied to ensure guarantees are met

Objective 1 - Enable municipalities to provide basic services to poor households:

- ☐ The **basic services component** funds the provision of free basic services for poor households

- ☐ This component provides an allocation for every poor household in a municipality to cover the cost of providing a package of free basic water, sanitation, electricity and refuse removal

- ☐ The same allocation per poor household is provided to all municipalities

- ☐ Only poor households are included in the calculation of this component as non-poor consumers should be able to pay for their own basic services

How the formula meets its objectives (2 of 2)

Objective 2 - Enable municipalities with limited own resources to afford basic administrative and governance capacity and perform core municipal functions:

☐ The **institutional component** provides funding for municipalities to assist them with their administration and governance costs (though it is not intended to fully fund these costs).

☐ The **non-trading services** component provides funding for municipalities to provide core municipal services like municipal health services, fire fighting, roads and storm water, municipal planning and cemeteries and other services. As with the institutional services component, this component does not intend to fully fund the costs of these services.

☐ To ensure that funds for these two components only go to municipalities with limited ability to raise own revenues to fund these costs a **revenue adjustment factor** is applied. This factor is based on an index that estimates the different revenue raising potential of municipalities. The revenue adjustment factor then reduces the allocations to municipalities with large own revenue potential so that more can go to less-resourced municipalities

Comparison with the structure of the current LGES formula

$$Grant = BS + D + I - R \pm C$$

where

- **BS** is the basic services component
- **D** is the development component
- **I** is the institutional support component
- **R** is the revenue-raising capacity correction and
- **C** is a correction and stabilisation factor.

- Both have basic services, institutional and correction components
- Old formula subtracts a revenue-raising capacity correction from the whole formula. Proposed new formula applies a revenue adjustment factor to the I and NTS components only
- The development component in the current formula has never been activated (and the FFC have recommended its not necessary)
- The non-trading services (NTS) component is a new addition to the formula

Distributional impacts of the new formula (1 of 2)

☐ The current formula allocates less (on a per poor household basis) to those municipalities with the least ability to raise own revenues

**Allocations per poor household in the current formula (2012/13)**
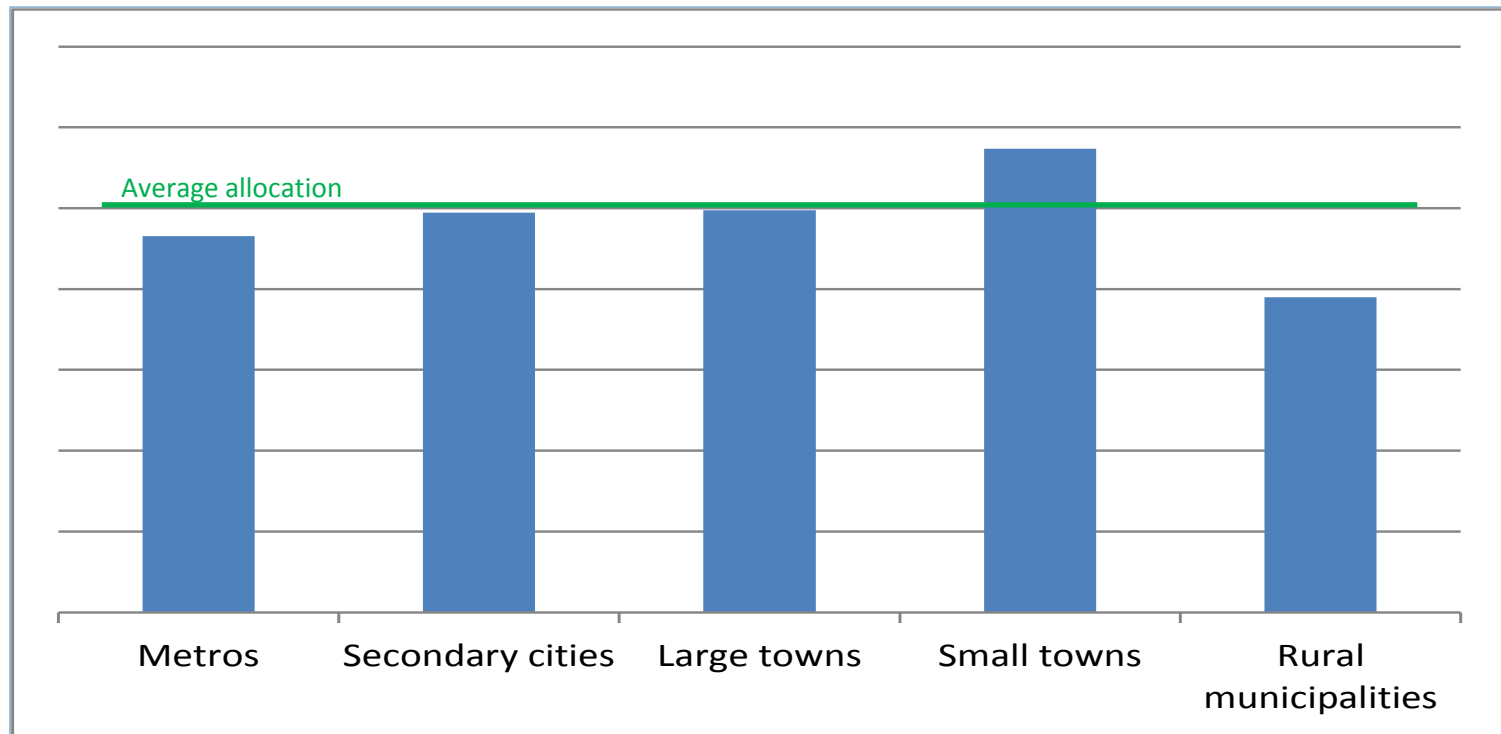
Note: allocations for district and local municipalities have been added together in this data

Distributional impacts of the new formula (2 of 2)

☐ Proposed formula structure ensures those with least own resources get the larges LGES allocations

Approximate allocations per poor household in the new formula
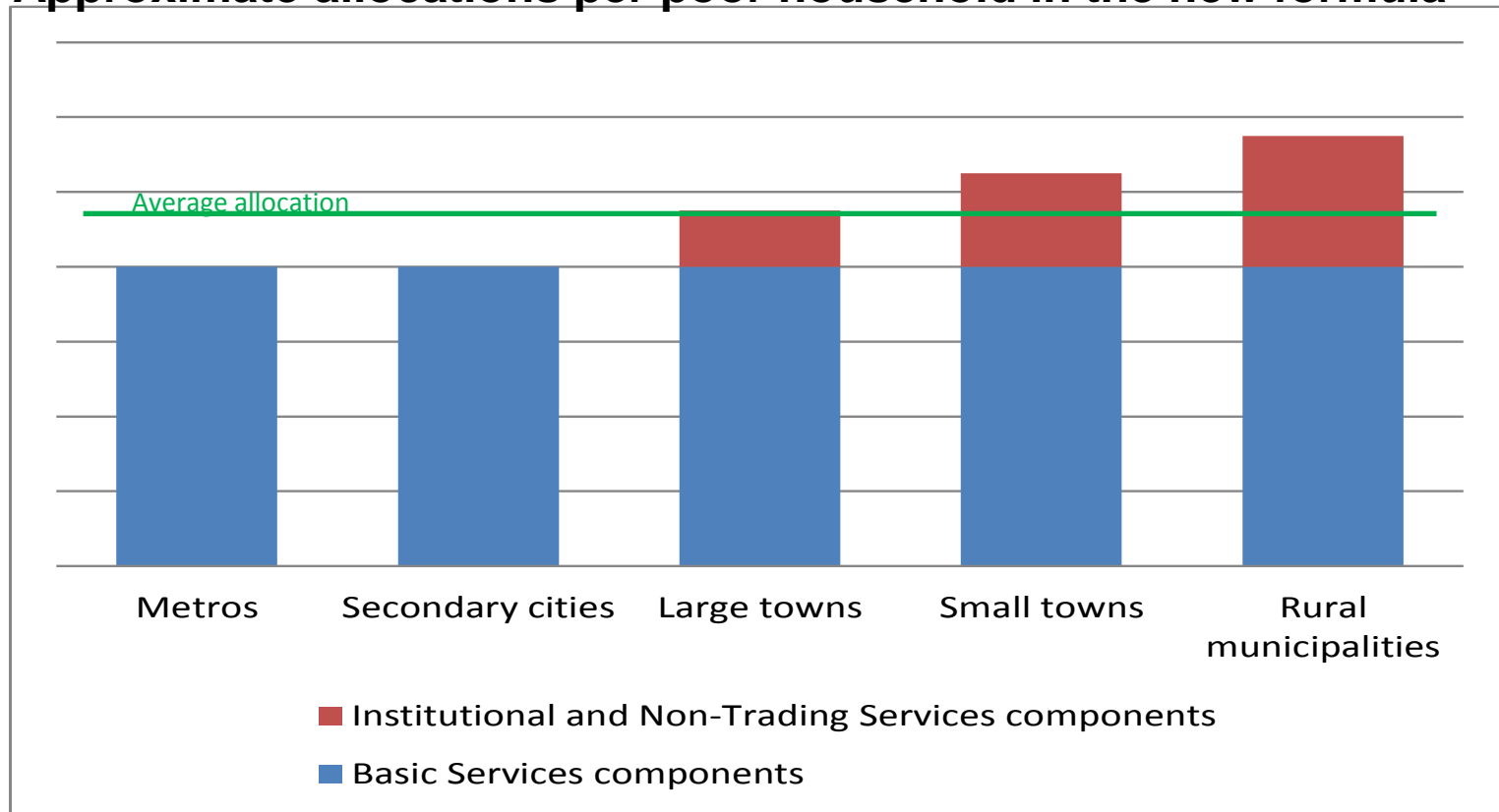
Note: values are estimates only, as proposed new formula is not operational yet

Main advantages of the new LGES formula

- ☐ Simpler formula structure is easier to understand
- ☐ Updated poverty measure
- ☐ More realistic cost estimates for basic services
- ☐ Capability to update data
  - ☐ Can reflect different cost pressures for each service (e.g. electricity)
  - ☐ Incorporates estimates of population growth
- ☐ More realistic level of institutional funding for those municipalities that need transfers to sustain their administration
- ☐ Includes funding for key non-trading services

For more detail on the LGES formula proposal and how each component will work please read the full discussion document