



FINANCIAL
AND FISCAL
COMMISSION

**SELECT COMMITTEE ON APPROPRIATIONS
PRESENTATION ON THE LOCAL
GOVERNMENT EQUITABLE SHARE FORMULA**

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PRESENTATION OUTLINE

- About the Financial and Fiscal Commission (FFC)
- Legislative and economic principles underpinning Local Government Equitable Share (LGES)
- LGES formula: results of recent review
- Concluding Remarks

CONSTITUTIONAL AND LEGISLATIVE MANDATE

- Financial and Fiscal Commission (FFC)
 - ❖ Permanent statutory body established in terms of Section 220 of Constitution
 - ❖ Independent and subject only to Constitution and the law
 - ❖ Must function in terms of an act of Parliament
- Mandate of FFC
 - ❖ Makes recommendations, envisaged in Chapter 13 of the Constitution or in national legislation to Parliament, Provincial Legislatures, and any other organs of state determined by national legislation

HOW FFC INFLUENCES POLICY

- Identify weakness within the IGFR system
- Propose evidence based policy proposals
- Interact and participate with/in forums and institutions responsible for IGFR policy
- Information dissemination – invitations from nine provincial legislatures
- Interact with various committees within parliament



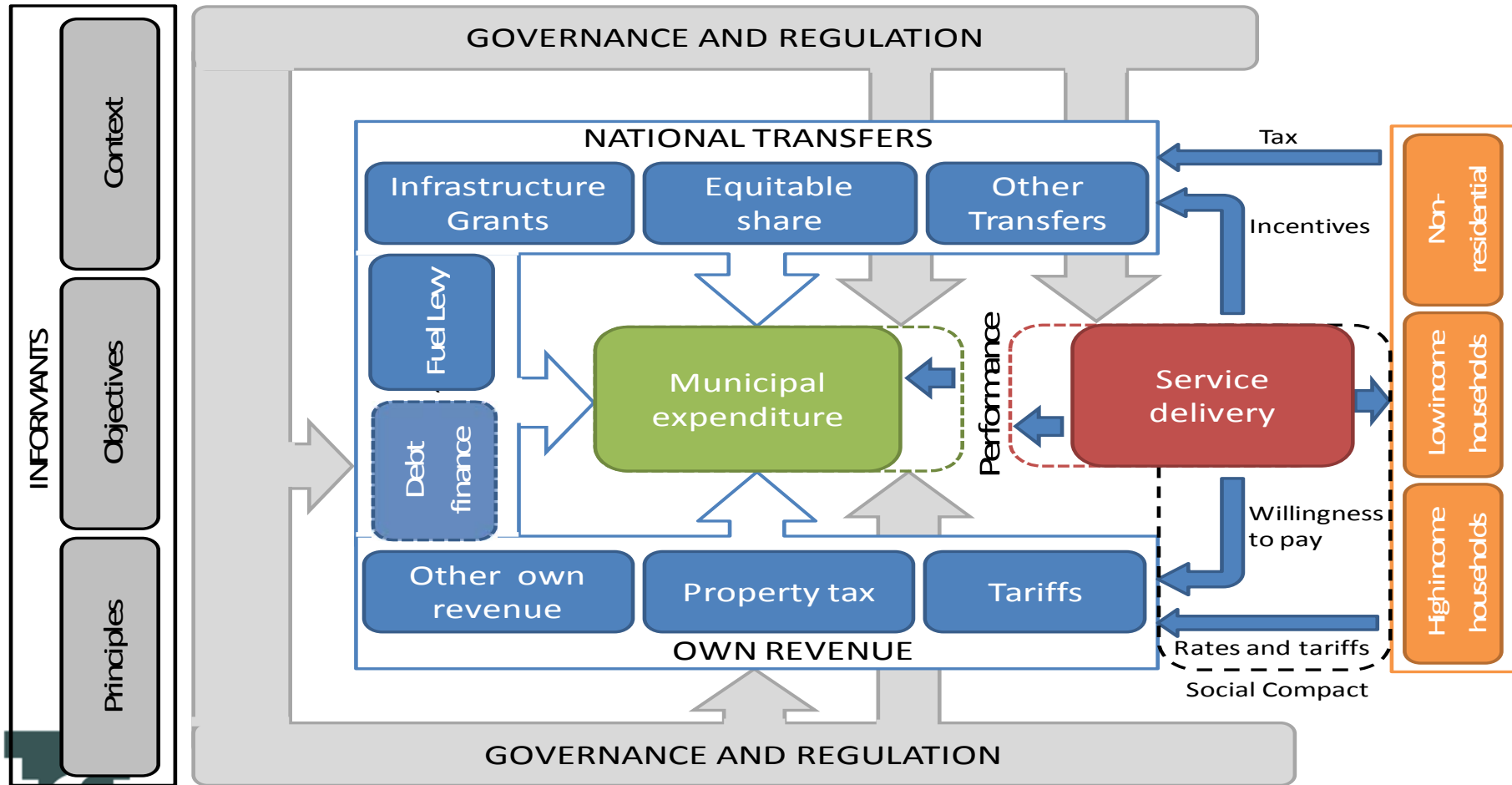
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LOCAL GOVERNMENT EQUITABLE SHARE FORMULA (LGES)

INTRODUCTION: LOCAL GOVERNMENT SPHERE

- There are 278 municipalities in South Africa's local government sphere:
 - ❖ 8 metropolitan municipalities
 - ❖ 44 district municipalities
 - ❖ 226 local municipalities
- In 2016 there will be 257 municipalities, due to further amalgamations
 - ❖ 8 metropolitan municipalities
 - ❖ 44 district municipalities
 - ❖ 205 local municipalities

THE LGES IN CONTEXT



CONTEXTUALISING THE LGES WITHIN THE BROADER LGFF

- Local Government Fiscal Framework (LGFF) structure is complex and multi-dimensional
- Aim of the LGFF is to ensure adequate service delivery to communities through appropriate funding of municipalities
- Recipients of municipal services are **non-residential** (private sector, non-governmental organisations etc.) and **low-income** and **high-income households**
- Service delivery to communities is achieved with **municipal expenditure supported by various revenue streams**
- Interplay between service delivery, consumers and municipal own revenues takes the form of the principle of a **social contract**,
- A comprehensive system of **governance and regulation** informs the operation of the LGFF

LES AND SERVICE DELIVERY

① LGES formula divides total LGES allocation among 257 municipalities (like slicing a R47bn cake (2016/17))



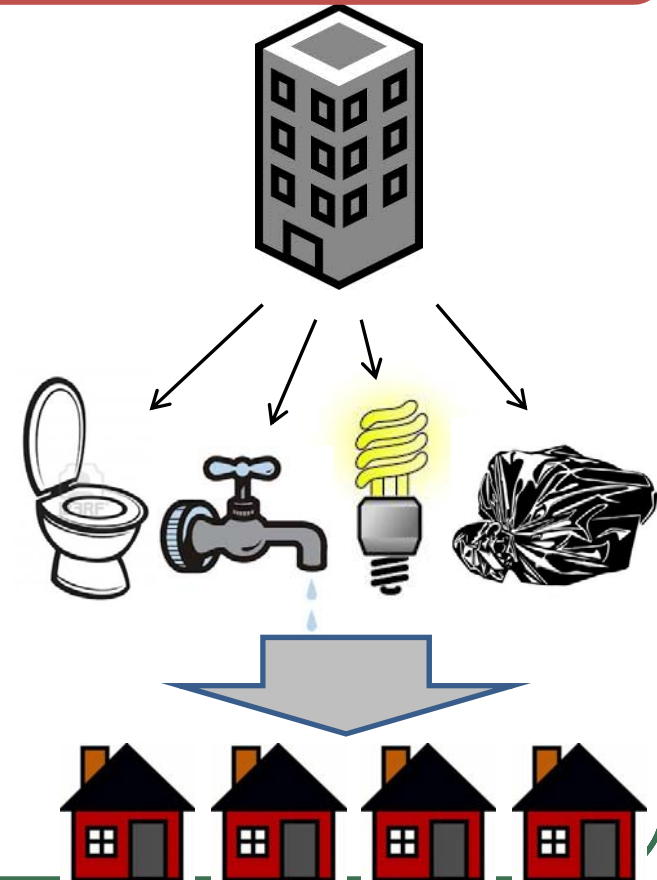
② Results in allocation per municipality

Includes funding for basic services, community services & administration



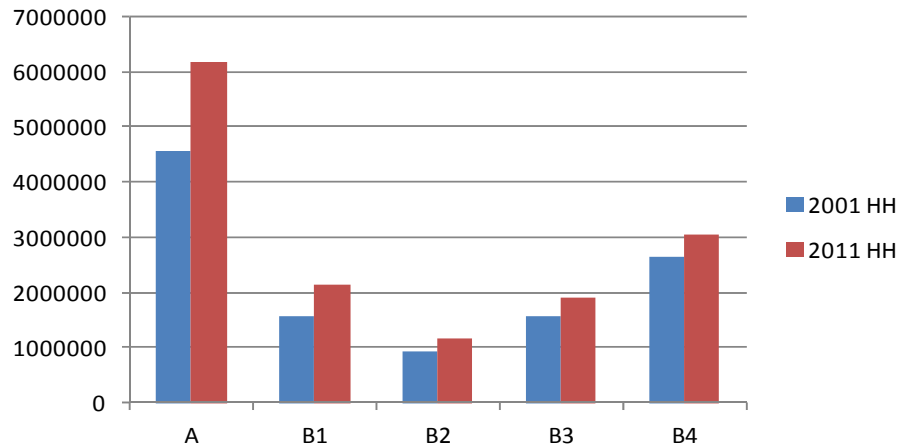
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③ Allocation is unconditional so each municipality decides how best to use it to fulfill its mandate to deliver services

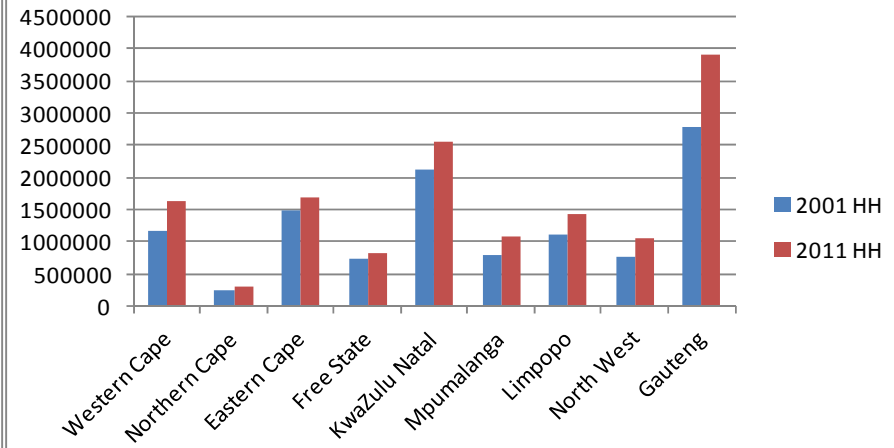


CONTEXT OF THE NEW FORMULA: EXTREME POPULATION CHANGES BETWEEN 2001 AND 2011

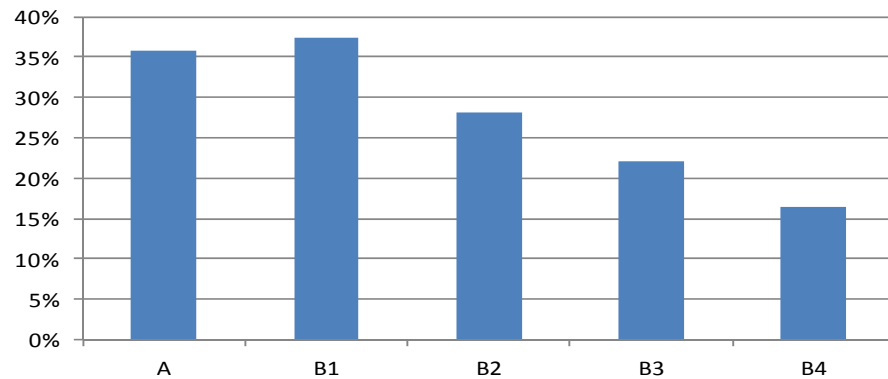
HH numbers by Municipal Type



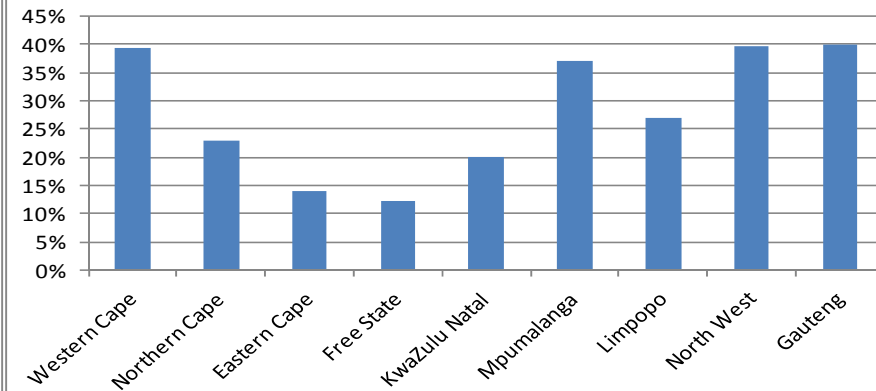
HH numbers per Province



Percentage Growth 2001-2011



Percentage Growth 2001-2011



CONTEXT OF THE NEW FORMULA: EXTREME POPULATION CHANGES

❖ Aggregate changes in number of households hides the significant changes experienced at individual municipal level

❖ Such increases, or even decreases, are considerable drivers of the changes in LGES allocations

10 Fastest Growing Municipalities			
Name	Province	Municipal Type	2001-2011 Percentage Growth
Gamagara	Northern Cape	Small town	104%
Bitou	Western Cape	Small town	90%
Steve Tshwete	Mpumalanga	Secondary city	79%
Rustenburg	North West	Secondary city	76%
Musina	Limpopo	Small town	73%
Swartland	Western Cape	Small town	68%
Madibeng	North West	Secondary city	68%
Tlokwe	North West	Secondary city	64%
Lesedi	Gauteng	Small town	61%
Emalahleni	Mpumalanga	Secondary city	60%
10 Slowest Growing Municipalities			
Name	Province	Municipal Type	2001-2011 Percentage Growth
Nala	Free State	Small town	-16%
Kopanong	Free State	Small town	-11%
Maphumulo	KwaZulu-Natal	Rural municipality	-10%
Great Kei	Eastern Cape	Small town	-9%
Umzumbe	KwaZulu-Natal	Rural municipality	-8%
Nkandla	KwaZulu-Natal	Rural municipality	-7%
Indaka	KwaZulu-Natal	Rural municipality	-6%
Letsemeng	Free State	Small town	-6%
Ntabankulu	Eastern Cape	Rural municipality	-5%
Siyancuma	Northern Cape	Small town	-5%

REVIEW OF LGES PROCESS – EMPHASIS ON CONSULTATION

Stage 1:
Principles and objectives agreed



Stage 2:
New formula structure agreed



Stage 3:
New allocations determined

- ❖ Agreed by LGES Steering Committee
- ❖ Discussion papers on principles and objectives circulated for comments
- ❖ Workshops held with municipalities
- ❖ Agreed by LGES Steering Committee
- ❖ Discussion paper on proposed formula circulated for comments
- ❖ Workshop held with municipalities
- ❖ Draft Endorsed By Budget Forum
- ❖ Release of Census data
- ❖ Revisions approved by LGES Steering Committee
- ❖ Final formula endorsed by Budget Forum (7 February 2013)
- ❖ Approved by Cabinet (13 February 2013)

PRINCIPLES OF LGES FORMULA

•The following are the agreed principles guiding the formula:

- ❖ Objective and fair
- ❖ Dynamic and able to respond to changes
- ❖ Recognise diversity among municipalities
- ❖ Only use high quality, verifiable and credible data
- ❖ Transparent and simple
- ❖ Provide for predictability and stability

OBJECTIVES OF LGES FORMULA

- The agreed objectives of the LGES formula are to:
 - ❖ Enable municipalities to provide basic services to poor households
 - ❖ Enable municipalities with limited own resources to afford basic administrative and governance capacity and perform core municipal functions

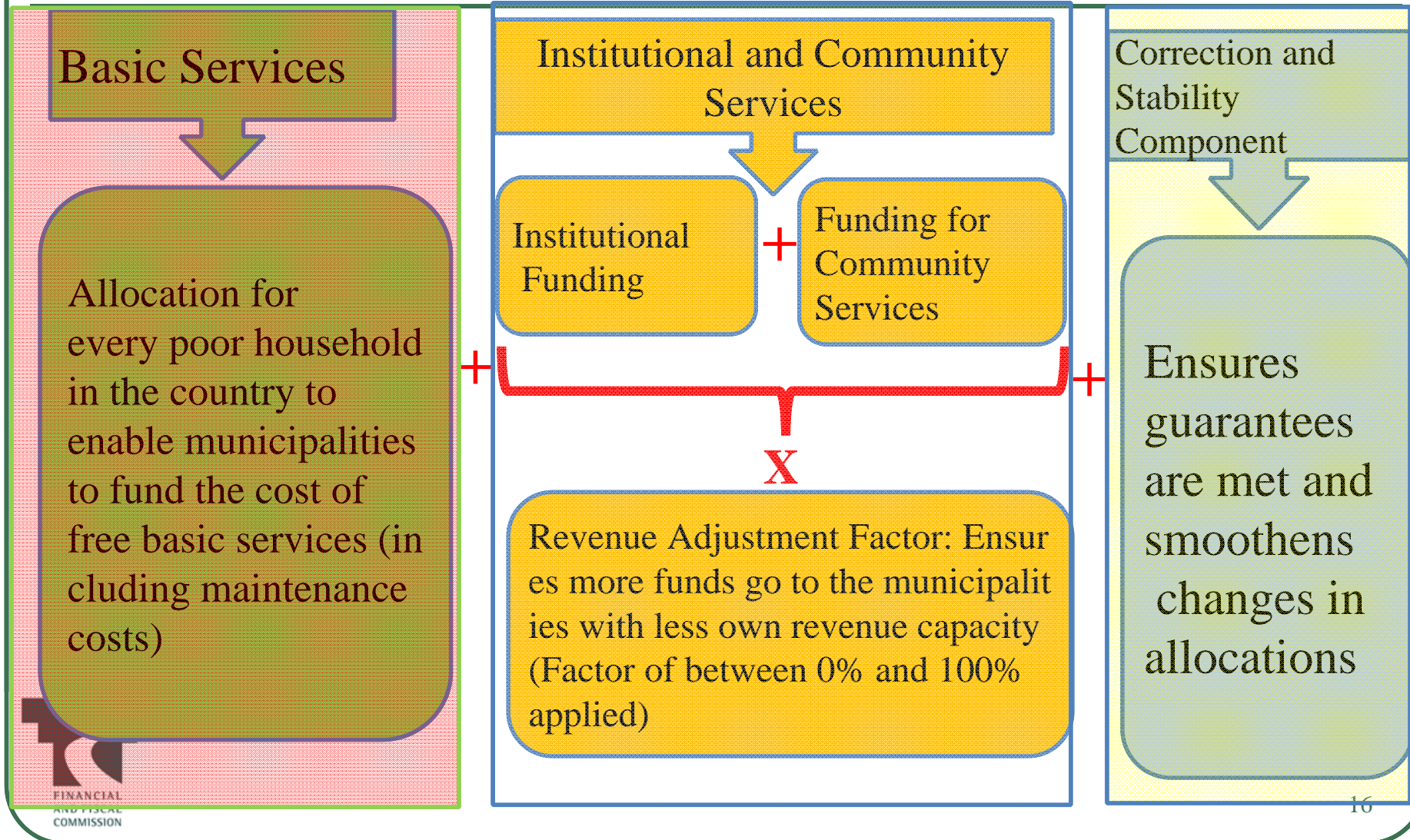
THE NEW LGES FORMULA

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

Where:

- ❖ **LGES** is the local government equitable share
- ❖ **BS** is the basic services component
- ❖ **I** is the institutional component
- ❖ **CS** is the community services component
- ❖ **RA** is the revenue adjustment factor
- ❖ **C** is the correction and stabilisation factor

SUMMARY OF THE LGES FORMULA STRUCTURE



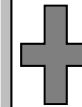
HOW THE LOCAL GOVERNMENT EQUITABLE SHARE FORMULA WORKS

Formula has two main parts:

- Part 1:
 - ❖ Basic services component funds the delivery of free basic services and accounts for 78% of funds allocated in 2016/17
 - ❖ Addresses the first objective of the formula
 - Part 2:
 - ❖ This part directs greater funds towards municipalities that cannot raise substantial own revenues
 - ❖ Institutional component funds admin costs
 - ❖ Community services component funds general municipal services
- Addresses second objective of the formula



Free basic services
R37 billion
R335 per month for a package of free basic services for 59% of SA households with an income of less than 2 old age pensions per month

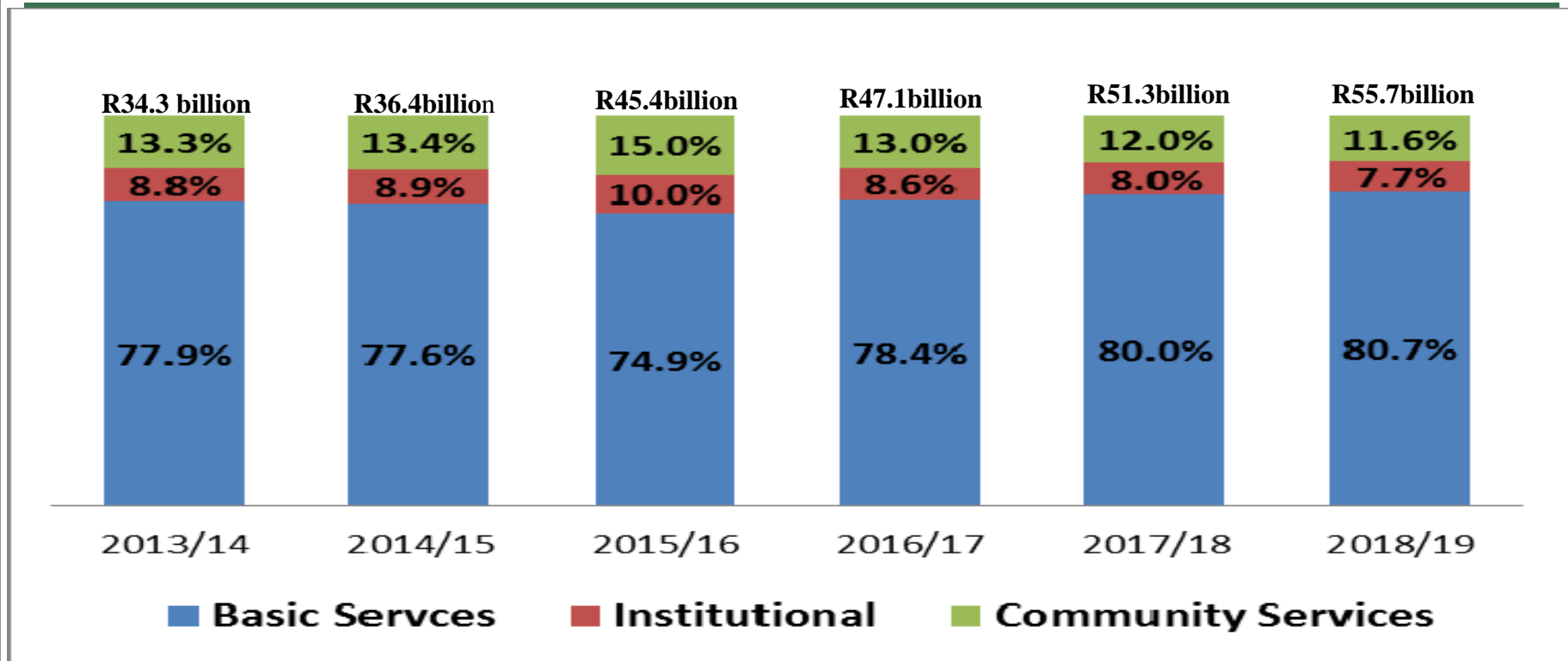


Institutional
R4.1 billion to assist with administration costs

Community Services
R6.1 billion to fund community services

These funds are only allocated to poorer municipalities
(some cities can fund these from own revenues)

SIZES OF THE DIFFERENT LGES COMPONENTS



- Shares of the institutional and community services components grew as more funds were added to the formula from 2013 - 2015, but as basic services costs increase the share of basic services increases over the 2016 MTEF

FORMULA COMPONENTS EXPLAINED

(1 OF 2)

Basic Services Component

- The affordability threshold used in the formula is R2300 household income per month
- Based on value of 2 state Old Age Pensions in the 2011 Census as favoured by municipalities during the consultation process
 - ❖ 59% of all households in SA fall below this threshold
- Subsidy of R335 per month allocated for providing free basic services to each household below the affordability threshold
 - ❖ Subsidy is based on an estimate of the average cost of providing services. Due to a lack of credible data on the different costs in each municipality the same cost is assumed for all municipalities.

Local government equitable share

	Allocation per household below affordability threshold (R per month)			Total allocation per service (R million)
	Operations	Maintenance	Total	
Energy	63.87	7.10	70.97	7 830
Water	96.58	10.73	107.31	11 839
Sanitation	76.72	8.52	85.24	9 403
Refuse	64.30	7.15	71.45	7 882
Total basic services	301.47	33.50	334.97	36 953



INSTITUTIONAL COMPONENT

- Provides funds for administration costs necessary to run a municipality: Allocated as follows:

Base allocation of R5.9 million for every municipality

Additional funds based on council size
(recognises that bigger municipalities face more admin costs)

Revenue adjustment factor is applied

Average Institutional component allocation for selected types of municipalities (2016/17)

Large towns	R11.1 million
Small towns	R9.9 million
Rural municipalities	R32.4 million

COMMUNITY SERVICES COMPONENT

- Funds services outside the basic services
- Allocations for Municipal Health and Fire Services go to District Municipalities
- Allocations for all other services go to Local Municipalities
 - ❖ allocated based on number of households in the municipality

Average Community Services component allocation for selected types of municipalities (2016/17)

Large towns	R21.1 million
Small towns	R13 million
Rural municipalities	R54.7 million

REVENUE ADJUSTMENT FACTOR

- Some municipalities are able to fund the costs of their administration and the provision of community services from own revenues (e.g. property rates and surcharges)
- The LGES applies a revenue adjustment factor to ensure funds from the Institutional and Community Services components only go to municipalities with limited own revenue

CORRECTION AND STABILISATION FACTOR

- Need to provide stability in allocations
- During the phase-in period, all municipalities are guaranteed to receive at least 90% of their allocation gazetted in terms of the Division of Revenue Act
- Five year phase-in used to cushion impact of data updates and new formula: 2013/14 - 2017/18 (5 Years)

SUMMARY OF DIFFERENCES BETWEEN OLD AND NEW LGES FORMULAS

Old formula

- Complex structure, not transparent
- Differentiated between households with or without access to basic services (allocated 1/3 as much for poor households without access to services)
- Poverty threshold of R800 per HH used (2001 prices)
- Subtracts a revenue-raising capacity correction from all of the formula's components
- Covers only major basic services
- Data only updated every 10 years
- Strongly population biased

New formula

- Simpler structure, more transparent
- Does not differentiate between households with or without access to basic services (rights-based approach subsidises all poor households)
- Higher poverty threshold of R2300 (2011 prices)
- Applies a revenue adjustment factor to the I and CS components only
- New CS component funds other core municipal services
- Data updated annually
- More redistributive

ANNUAL UPDATES TO THE DATA USED

The formula is updated annually with:

- **Cost data to account for price increases**
 - ❖ Electricity cost is updated using NERSA approved tariff increases for bulk portion of the costs and CPI inflation for other costs
 - ❖ Water cost is updated using average of approved water board tariff increases for bulk costs and CPI inflation for other costs
 - ❖ Sanitation and Refuse Removal costs are updated using CPI inflation
- **Household numbers are updated annually based on:**
 - ❖ Rate of growth in households per municipality between 2001 and 2011
 - ❖ These estimates are then adjusted so that the total number of households per province matches the estimates in StatsSA's General Household Survey
 - ❖ Although these estimates are not produced by StatsSA they have checked the methodology used (StatsSA may in future produce municipal level HH estimates)

CONCLUSION

- FFC notes the shift in the LGES allocation to smaller poorer municipalities due to the new formula
- Challenge has been the costing of Basic services. There is no consensus on the costing framework within the IGFR fraternity.
- FFC and SALGA have commissioned development of an appropriate and flexible model to estimate costs of all basic services to inform LGES.



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THANK YOU.

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