national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

SALGA
South African Local Government Association

cooperative governance
Department:
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REVIEW OF THE LOCAL GOVERNMENT EQUITABLE SHARE FORMULA

Parliament
19 February 2013

INTRODUCING THE NEW FORMULA

Structure of the presentation

- Background to the formula and review
- Context: changes in population between 2001 and 2011
- The principles, objectives and structure of the new formula
- Detail on the components of the formula
- Allocations from the new formula (macro-level)
- A closer look at municipalities experiencing large changes

Background

- Local government is entitled to an equitable share of nationally raised revenue in terms of Section 227 of the Constitution
- The formula used to allocate the local government equitable share among the country's 278 municipalities was reviewed during 2012 by:
  - National Treasury, the Department of Cooperative Governance and SALGA
  - with assistance from the Financial and Fiscal Commission and Statistics South Africa
- This review looked at the LGES formula, it did not examine the size of the total amount allocated to the local government equitable share
- New formula is being implemented together with an update of decade-old data. There have been big changes in household numbers between 2001 and 2011

Outline of the formula review process

Stage 1:
Principles and objectives agreed

- Agreed by LGES Steering Committee
- Discussion papers circulated for comments
- Workshops held with municipalities

Stage 2:
New formula structure agreed

- Agreed by LGES Steering Committee
- Discussion paper circulated for comments
- Workshop held with municipalities
- Endorsed By Budget Forum

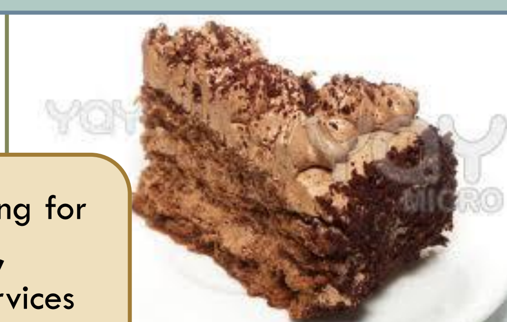
Stage 3:
New allocations determined

- Approved by LGES Steering Committee
- Minister of Finance
- Budget Forum (7 February 2013)
- Cabinet (13 February 2013)

How the LGES formula relates to service delivery

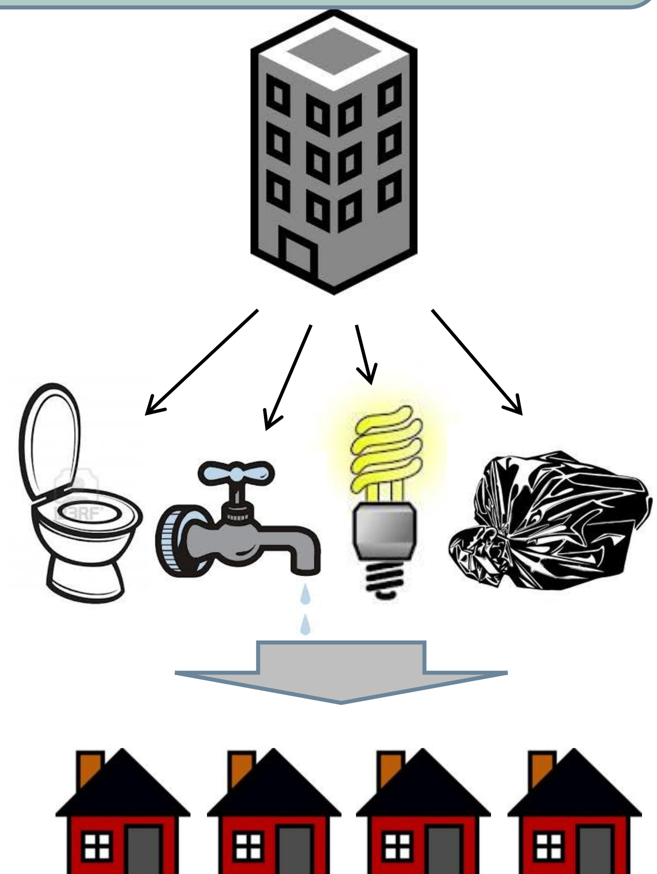
① LGES formula divides total LGES allocation among 278 municipalities (like slicing a R34bn cake)

② Results in allocation per municipality



Includes funding for basic services, community services & administration

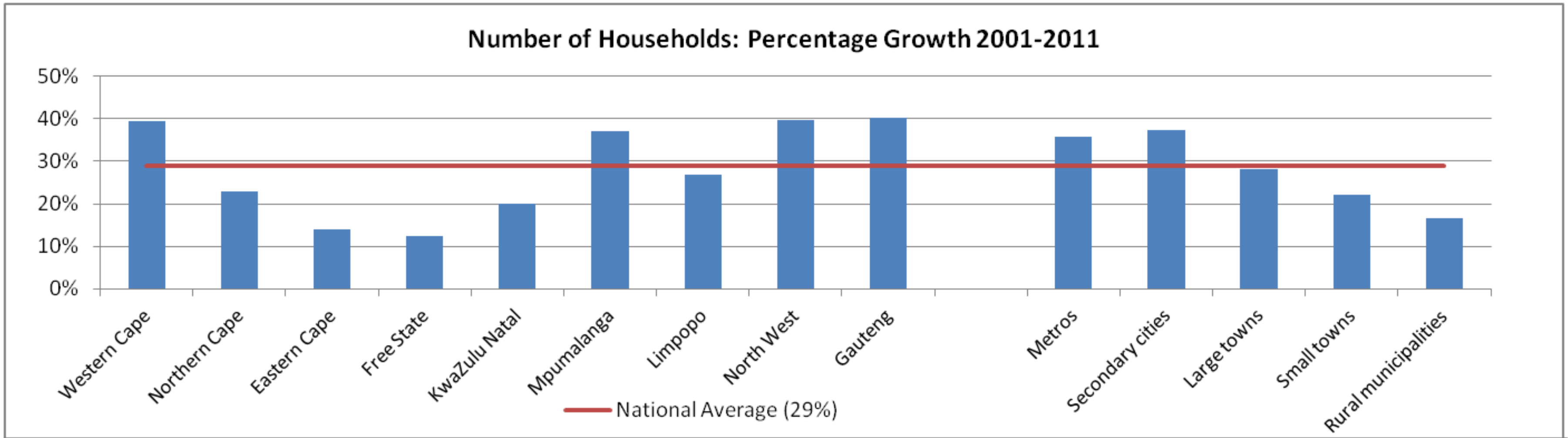
③ Allocation is unconditional so each municipality decides how best to use it to fulfill its mandate to deliver services

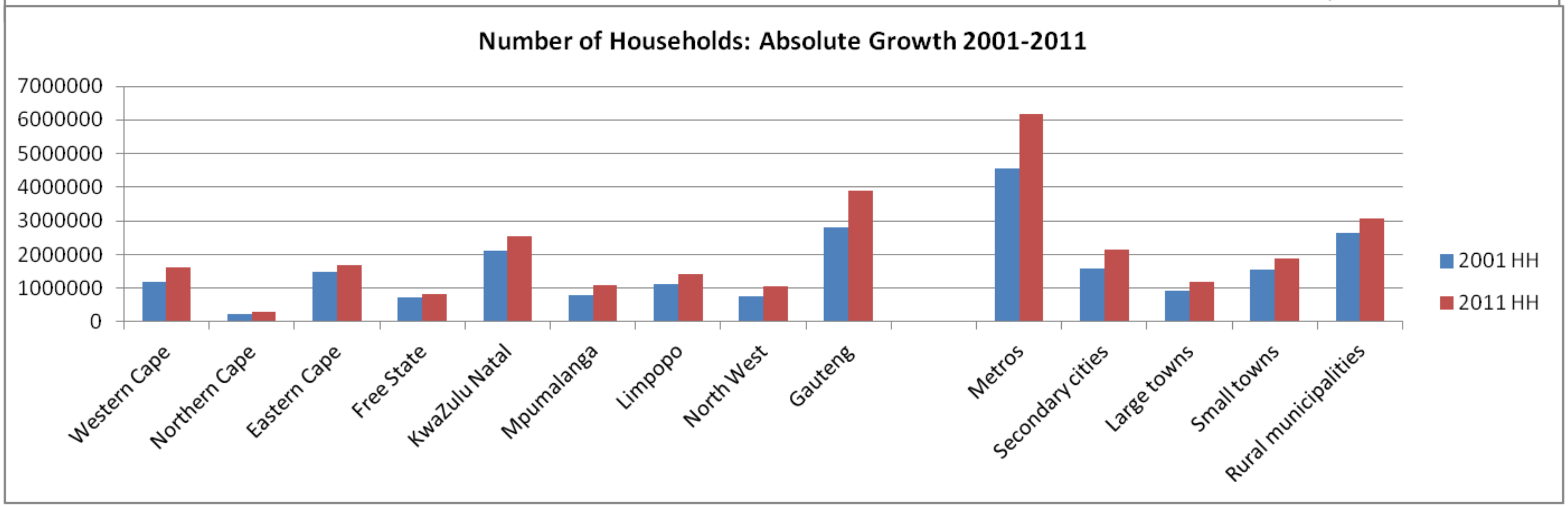


Some of the problems with the old LGES formula

- Stakeholders raised many problems with the old LGES formula, including:
  - It was based on data from 2001 that wasn't updated
  - Costs for services used in the formula didn't reflect actual cost pressures
  - Didn't include funding for all services
  - Allocated less funds to poorer municipalities (on a per poor household basis)

Context of the new formula: large growth in households between 2001 and 2011





Context of the new formula: extreme population changes at individual municipal level

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

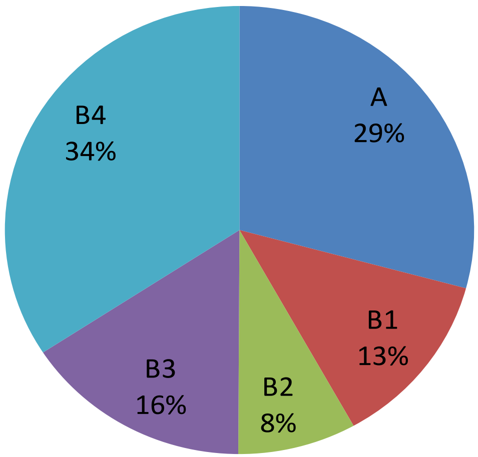
- Such increases, or even decreases, are considerable drivers of the changes in LGES allocations

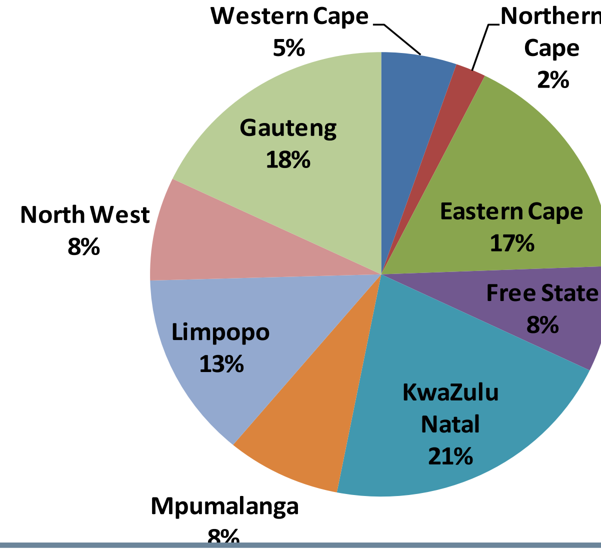
10 Fastest Growing Municipalities			
Name	**Province**	**Municipal Type**	**2001-2011 Percentage Growth**
Gamagara	Northern Cape	Small town	104%
Bitou	Western Cape	Small town	90%
Steve Tshwete	Mpumalanga	Secondary city	79%
Rustenburg	North West	Secondary city	76%
Musina	Limpopo	Small town	73%
Swartland	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%

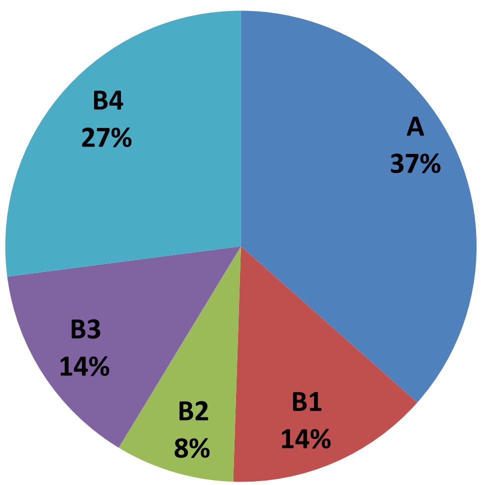
Context of the new formula : a changed distribution of poverty

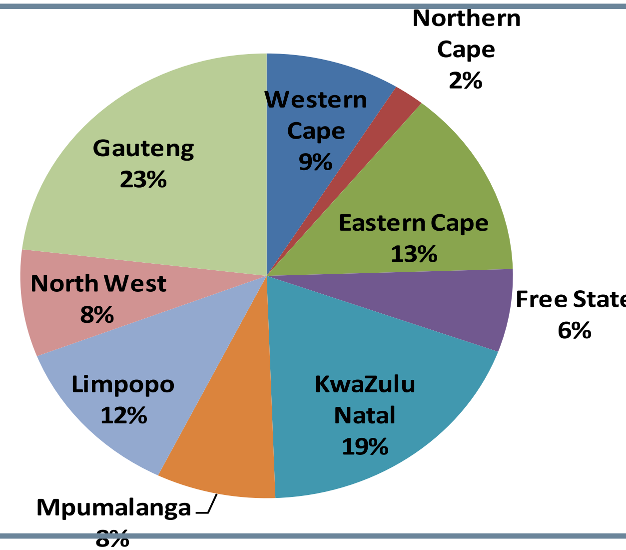
2001 Data: R800 affordability threshold used in OLD formula





2011 Data: R2300 affordability threshold used in NEW formula





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

New LGES formula structure

The structure of the new LGES formula is as follows:

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

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

Simplified summary of the proposed LGES formula structure

Formula

1 **Basic Services** + 2 **Institutional and Community Services** ± 3 **Correct-ion & Stability**

How it works

1. Basic Services

Allocation for every poor household in the country to enable municipalities to fund the cost of free basic services (including maintenance costs)

2. Institutional and Community Services

Made up of three parts:

Institutional funding + **Funding for Community Services**

Revenue Adjustment factor

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

3. Correction & Stability

Ensures guarantees are met and smoothes changes in allocations

LGES Allocation

Comparison with the structure of the old LGES formula

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

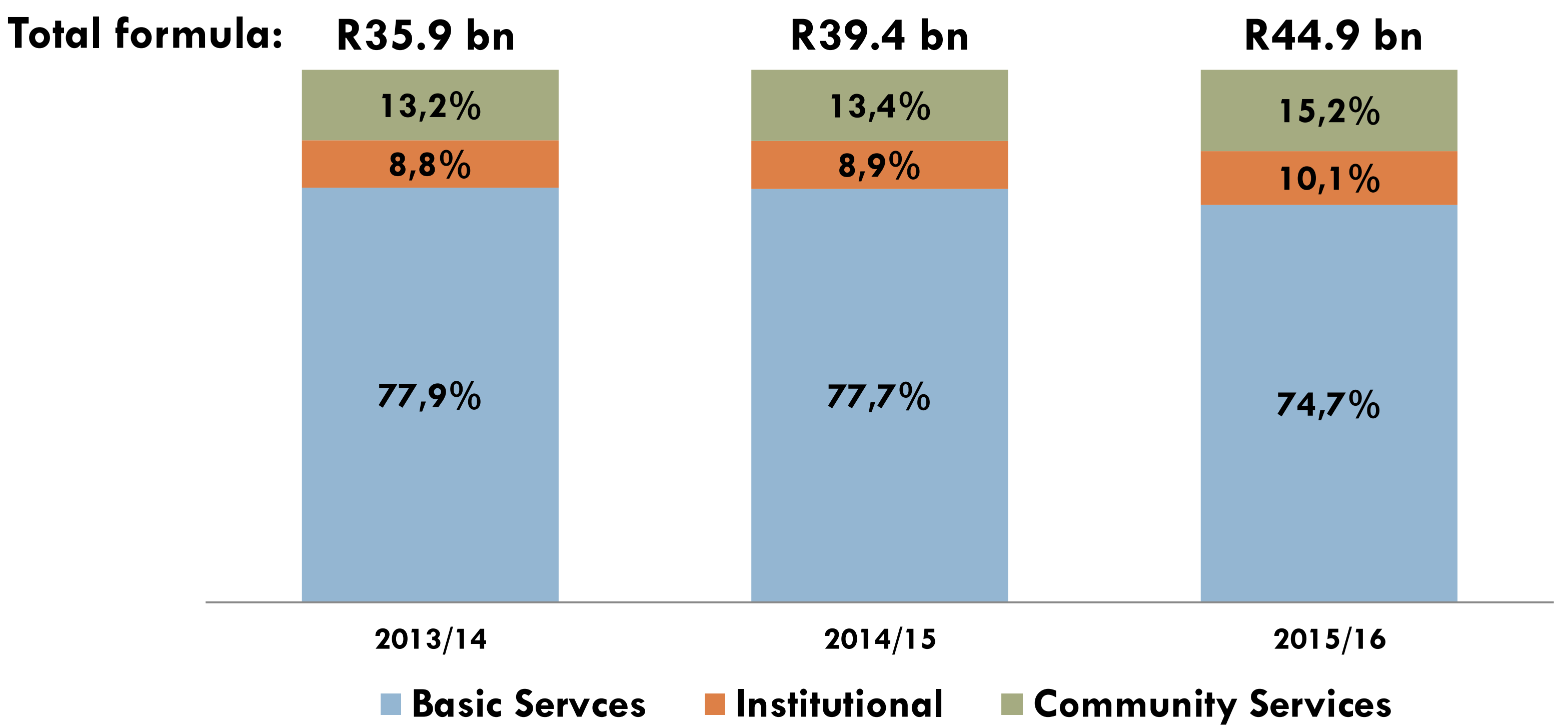
where

- ***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 CS components only
- The development component in the current formula has never been activated (and the FFC have recommended its not necessary)
- The community services (CS) component is a new addition to the formula

A CLOSER LOOK AT EACH COMPONENT

Sizes of the different components



- Shares of the institutional and community services components grow as more funds are added to the formula over the MTEF
- R5.4 billion is added to the LGES formula over the 2013 MTEF

Basic Services component (1 of 2)

Subsidy of R275.17 per month for a package of free basic services


Water: R86.45


Sanitation: R72.04


Energy: R56.29


Refuse removal: R60.39

Includes 10% for main-tenance

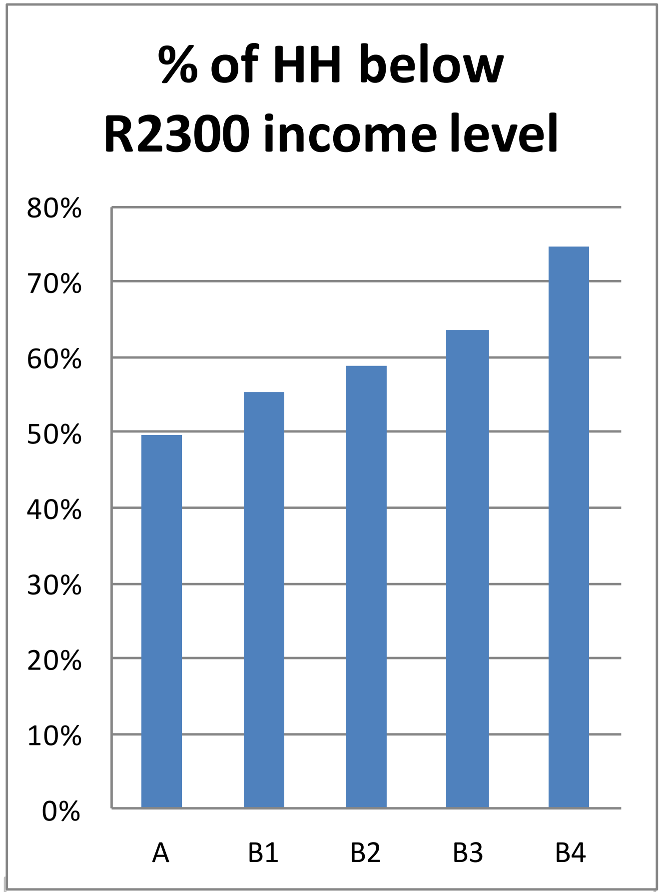
Provided for every household below the affordability threshold

Amounts are updated annually to reflect rising costs

Basic Services component (2 of 2)

- The **affordability threshold** used in the formula is R2300 household income per month in 2011
  - Based on value of 2 state Old Age Pensions as favoured by municipalities during the consultation process
- **59%** of all households in SA fall below this threshold
- Must not be seen to be an "official poverty line"

Number of households will be updated annually using average growth between 2001 and 2011 per municipality (adjusted to balance with estimated national population growth)



Lowest proportion =44%
Highest proportion = 81%

Institutional component

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

Base allocation of R5 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 (2013/14)	
Large towns	R6.8 million
Small towns	R6.3 million
Rural municipalities	R23.1 million

Community Services component

- New component that funds services outside the basic services
- Allocations for Municipal Health and related 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 (2013/14)	
Large towns	R13.4 million
Small towns	R7.8 million
Rural municipalities	R38.5 million

Revenue Adjustment Factor (1 of 3)

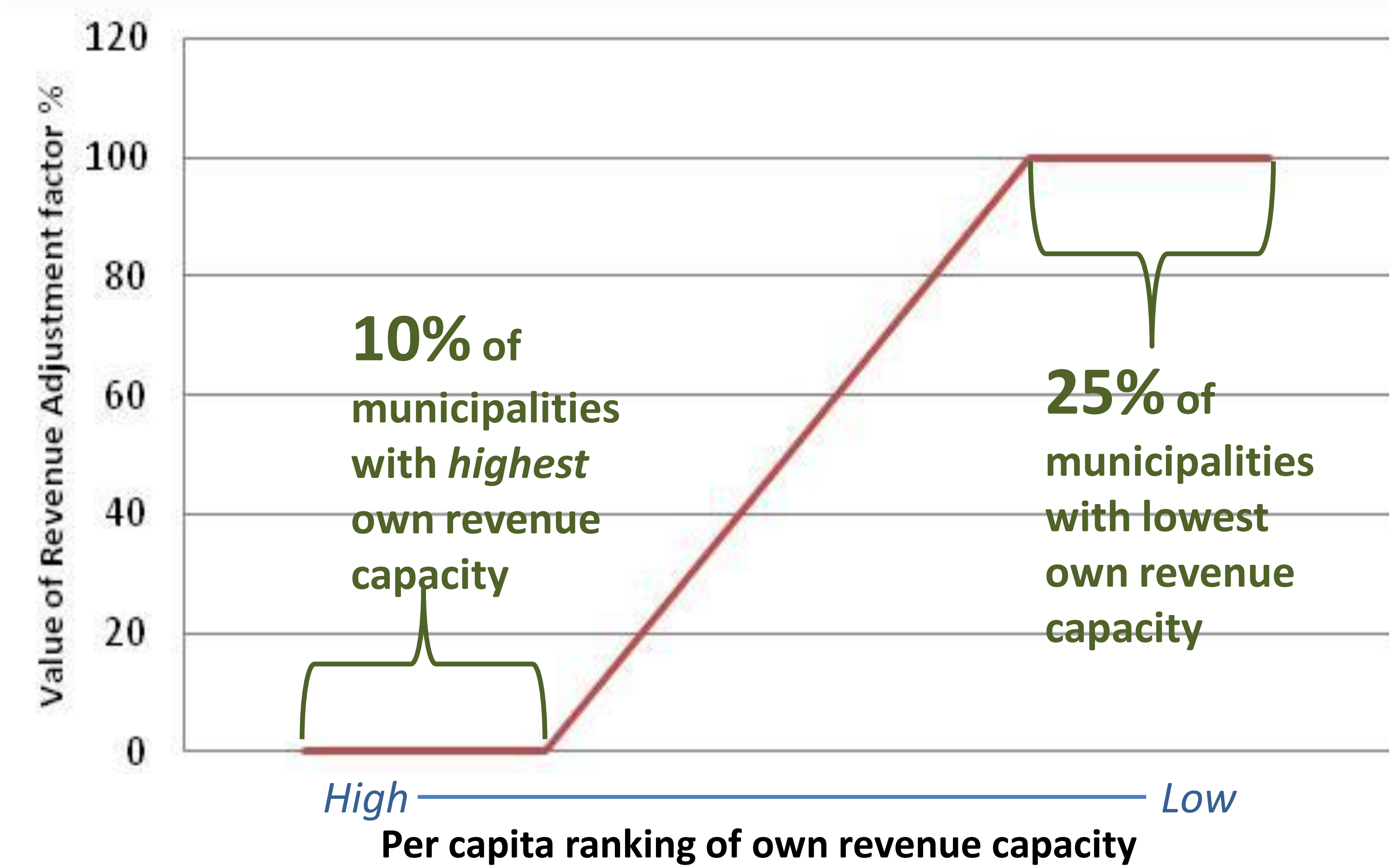
- Some municipalities are able to fund the costs of their administration and the provision of community services from own revenues (e.g. property rates and surcharges)
- The LGES therefore applies a revenue adjustment factor to ensure funds from the Institutional and Community Services components only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

Revenue Adjustment Factor (2 of 3)

- A statistical analysis was undertaken to assess the ability of municipalities to collect property rates given the following factors:
  - Total income of all individuals/households residing in a municipality
  - Reported property values
  - Number of households on traditional land
  - Unemployment rate
  - Proportion of poor households as percentage of total number of households in the municipality
- These factors were then used to construct an index to rank municipalities from greatest to lowest per capita revenue raising potential – only this measure of *relative* own-revenue raising ability is used in the formula

Revenue Adjustment Factor (3 of 3)

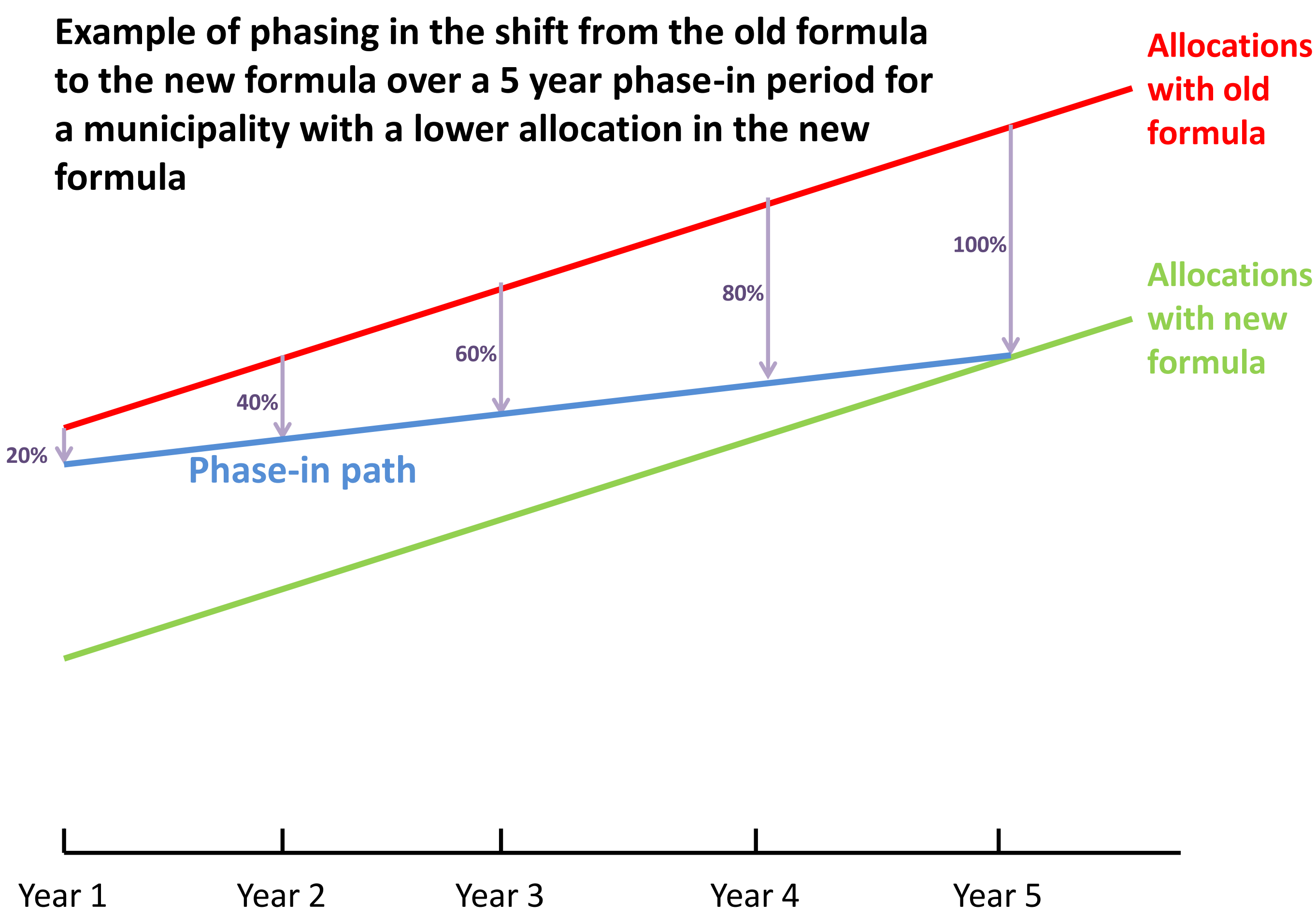
Diagrammatic representation of how the revenue adjustment factor will be applied to different municipalities



Correction and Stabilisation factor

- Need to provide stability in allocations (principle 6)
- All municipalities guaranteed to receive at least 90% of 2013/14 allocation gazetted in terms of the 2012 Division of Revenue Act
- In addition it is the new formula will be phased-in over 5 years
- Phase in will measure the gap between allocations through the old and new formula
- For municipalities with smaller allocations in the new formula the phase-in mechanism will close the gap between the old formula and the new formula by 20% each year
- Funds for this will be subtracted proportionately from "gaining" municipalities – giving them more time to adjust to their larger allocations

Example of phasing-in

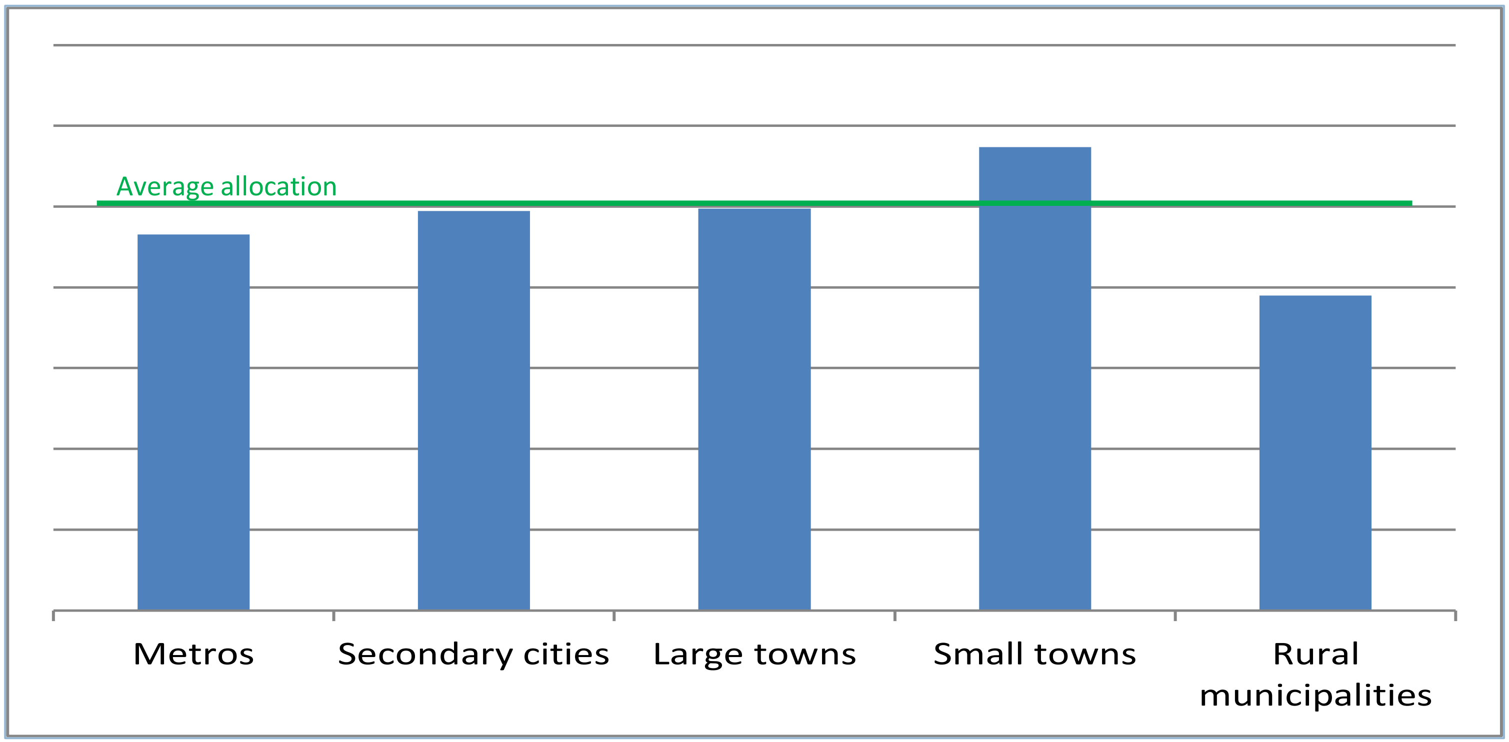


IMPACT OF THE NEW FORMULA

Distributional impacts of the new formula

- The old formula allocated less (on a per poor household basis) to those municipalities with the least ability to raise own revenues

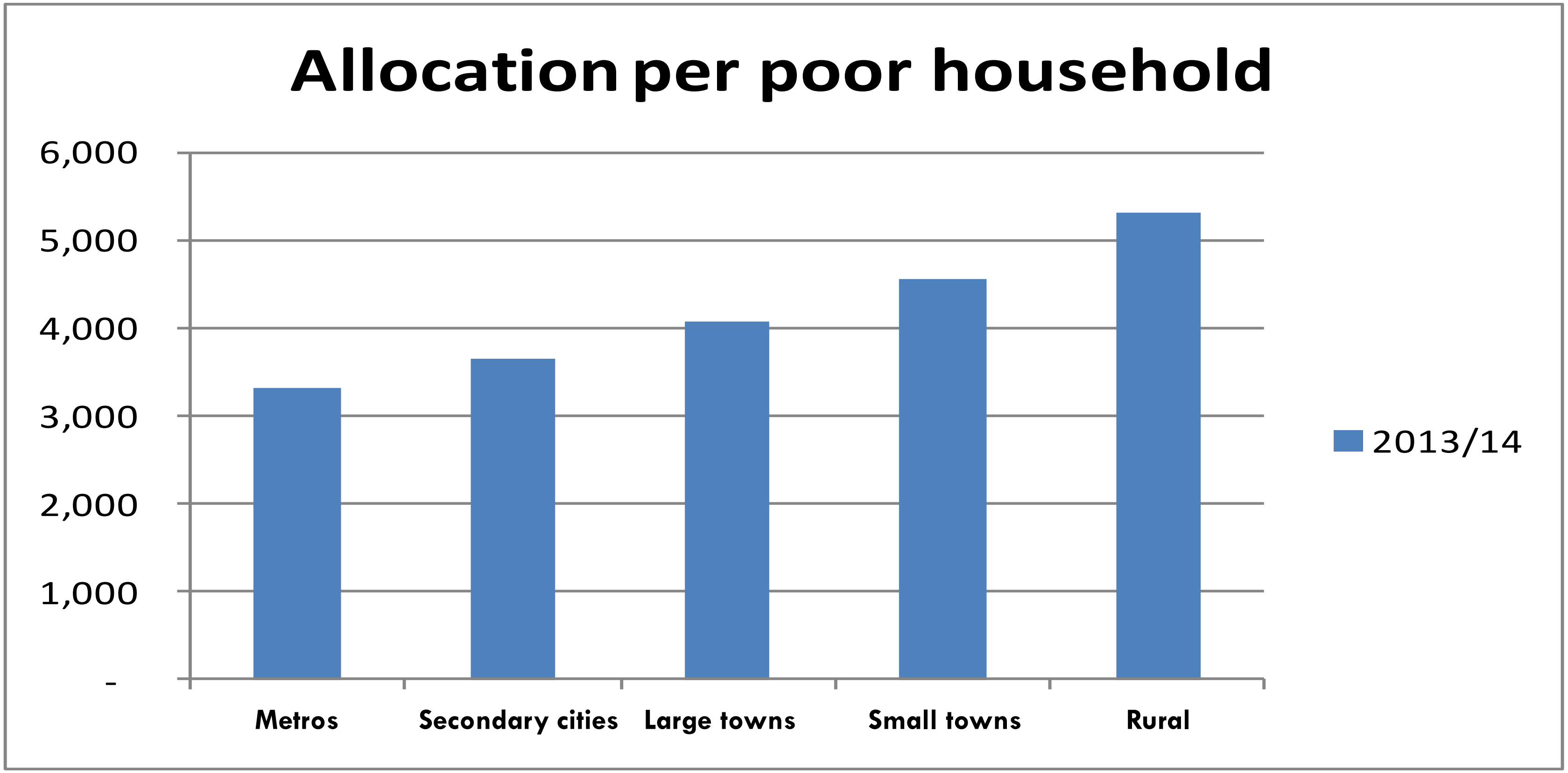
Allocations per poor household in old current formula (2012/13)



Note: allocations for district and local municipalities have been added together in this data

Distributional impact of the new formula

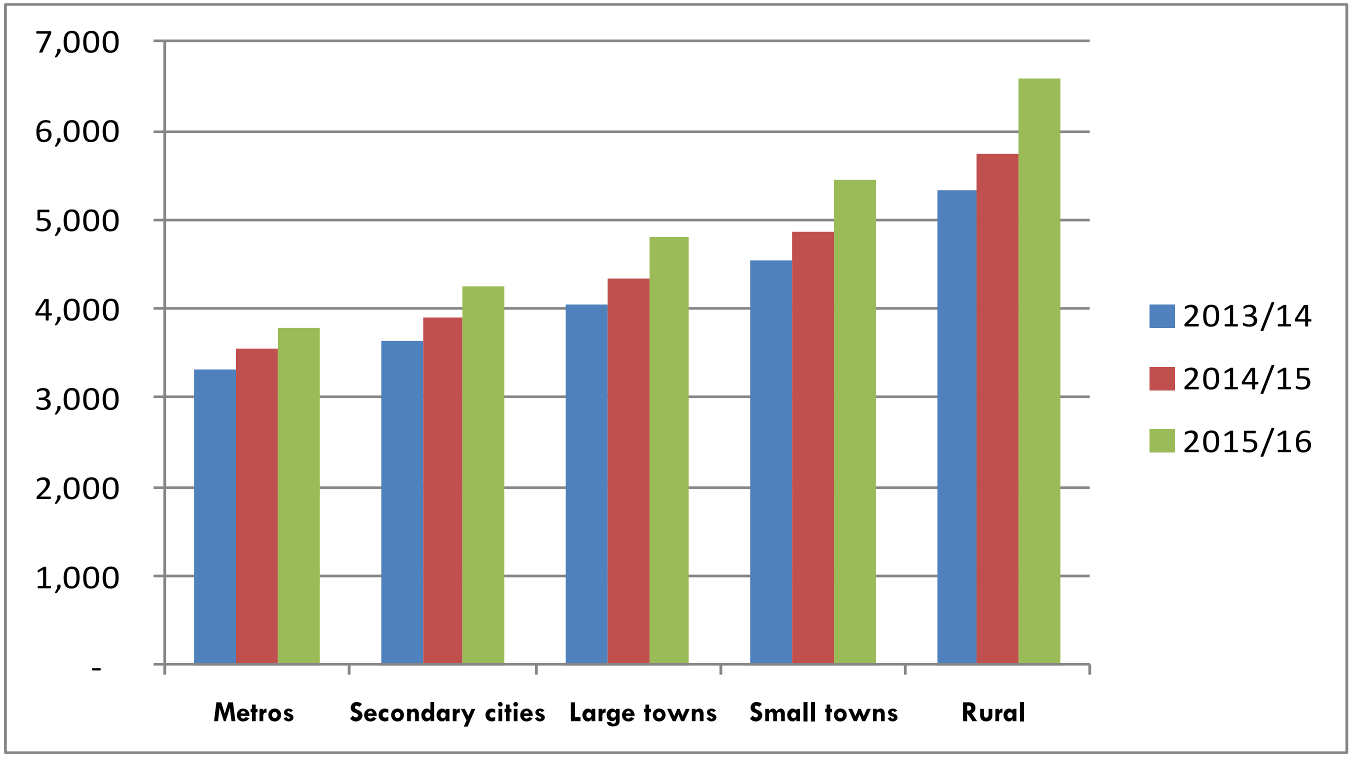
- The new formula ensures that municipalities with the least ability to raise own revenues get larger allocations (per poor household)



Note: allocations for district and local municipalities have been added together in this data

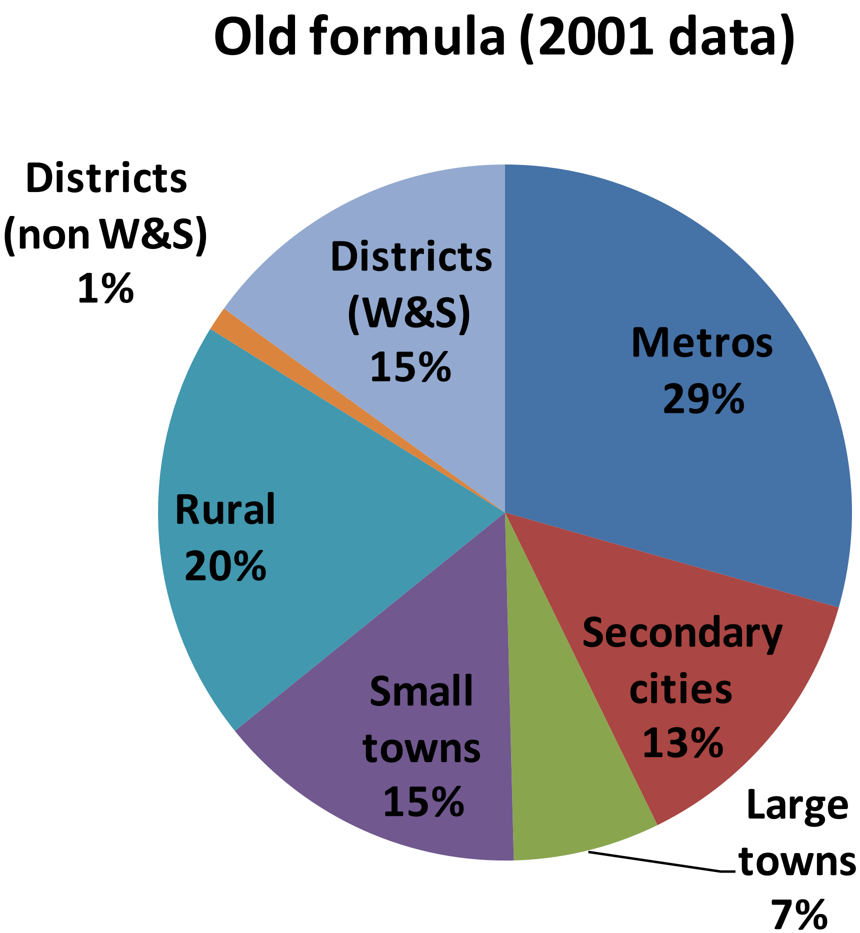
Distributional impact of the new formula

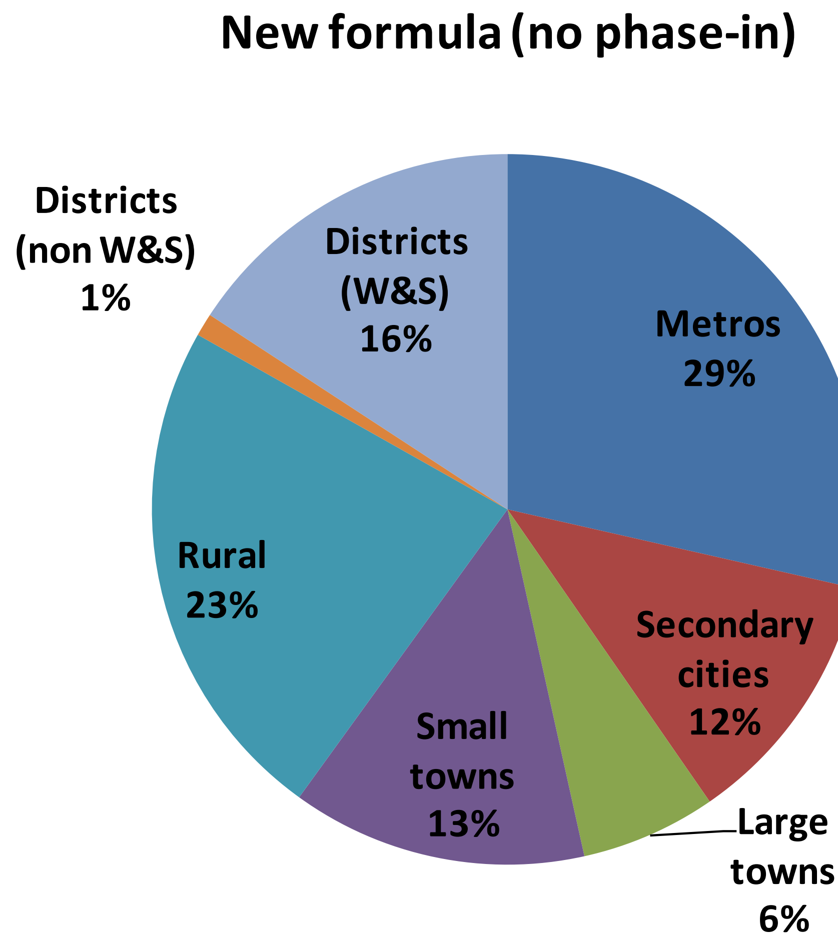
- This pattern becomes even more pronounced as more funds are added over the MTEF



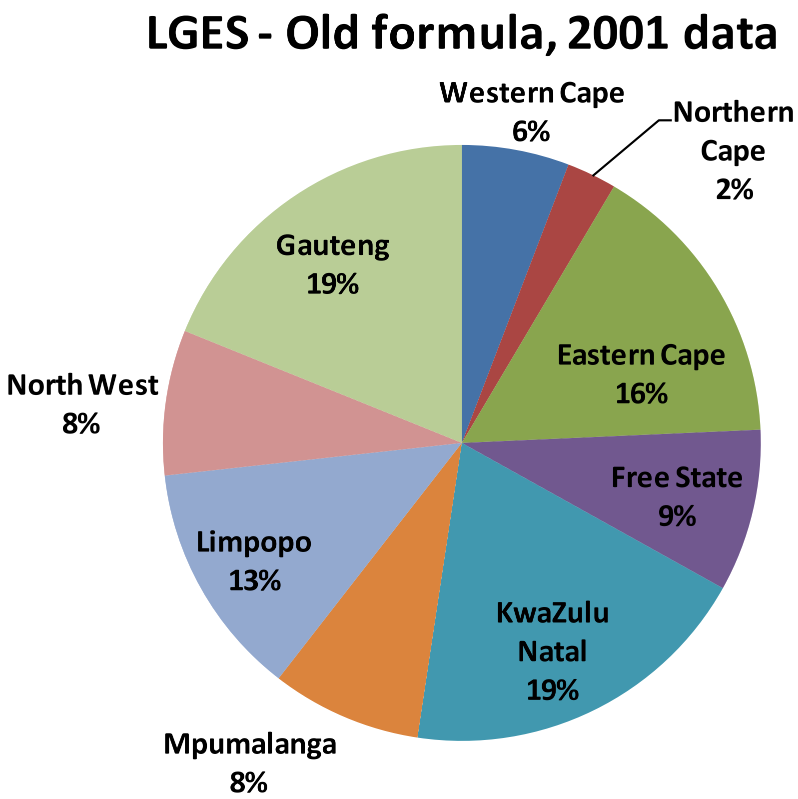
Note: allocations for district and local municipalities have been added together in this data

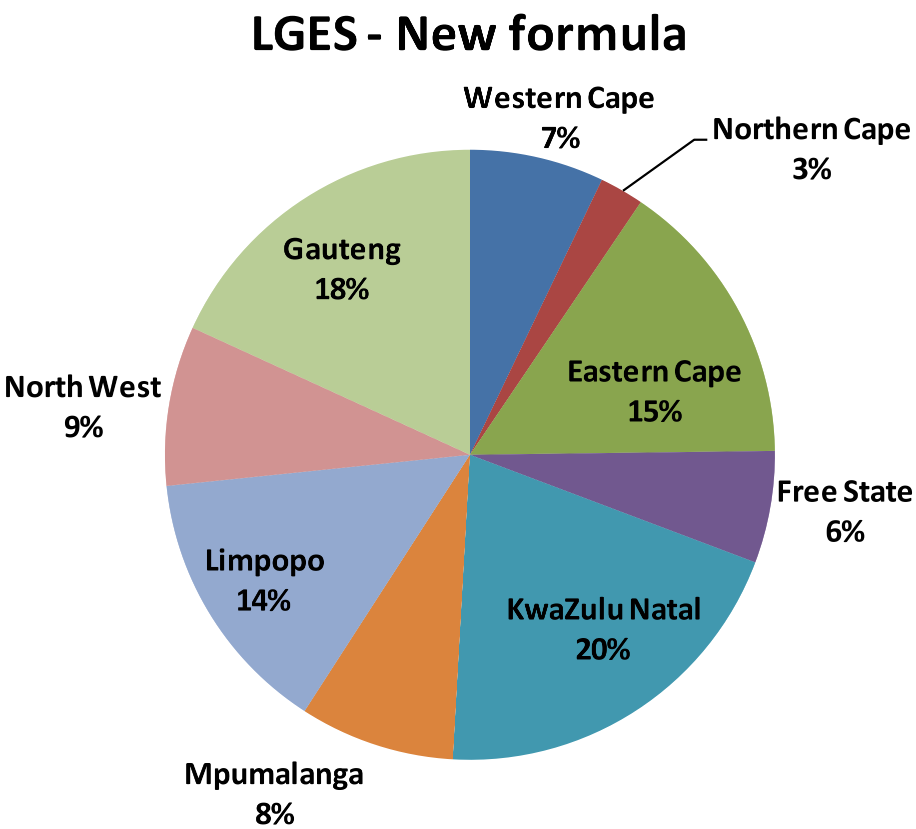
Allocations by type of municipality





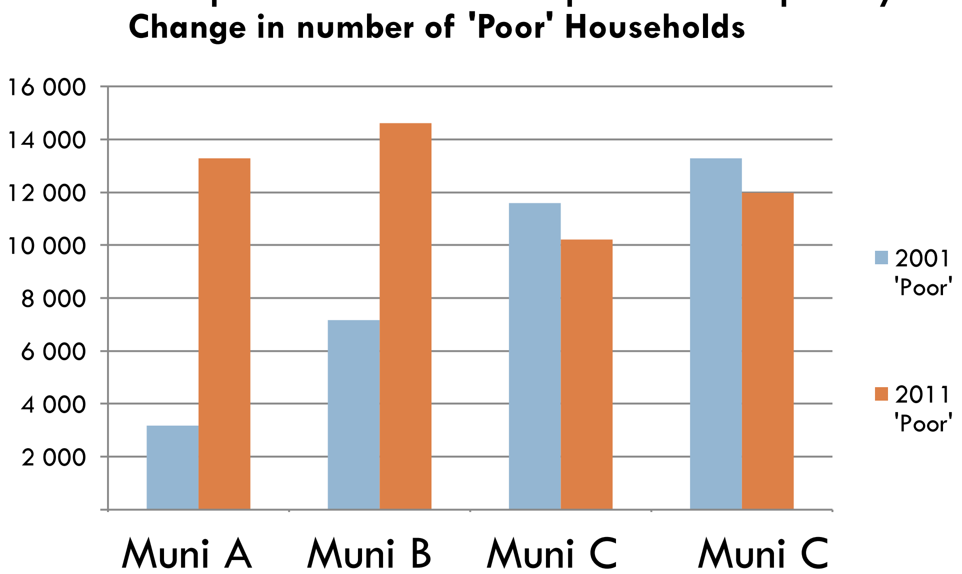
Provincial comparison





Changes to individual allocations are much more dramatic – some examples:

- If no phase-in was applied to cushion the impact of the new formula:
  - Some municipalities experience dramatic increases
    e.g. "Muni A" (83%) and "Muni B" (73%)
  - Others experience significant decreases
    e.g. "Muni C" (-49%) and "Muni D" (-41%)
  - These large changes are primarily the result of changes in population, and the number of poor households per municipality:



*The 2001 Census data uses the R800 affordability threshold, the 2011 Census data uses the R2300 threshold

Changes to individual allocations are much more dramatic – changes greater than 10%:

Municipal Type	Number of municipalities gaining by more than 10%	Number of municipalities losing by more than 10%	Total number of municipalities
Metros	2	4	8
Secondary cities	5	7	19
Large towns	5	12	27
Small towns	25	49	110
Rural	55	0	70
Districts (not water authorities)	6	10	23
Districts (water authorities)	6	0	21
National Total	104	82	278

Main advantages of the new LGES formula

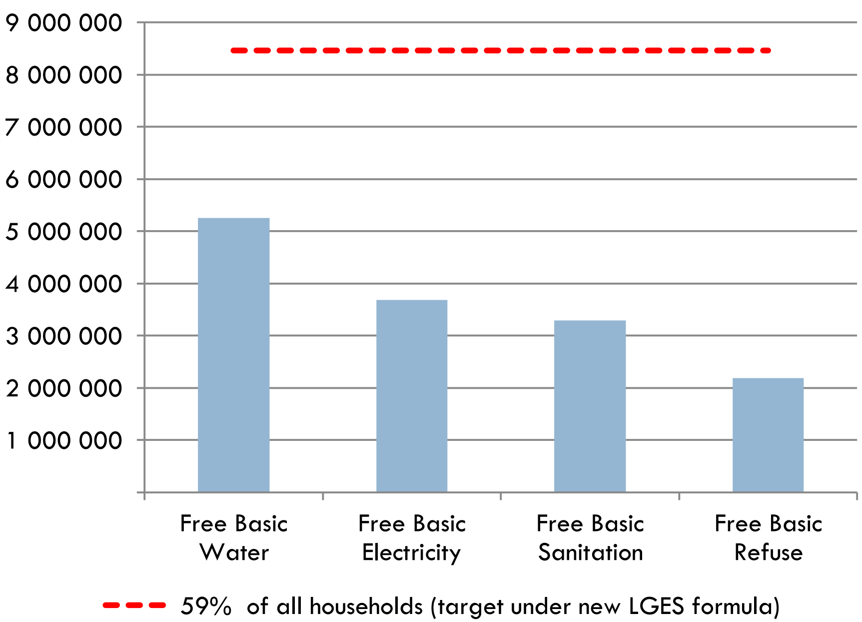
- Simpler formula structure is easier to understand
- Higher affordability threshold
- More realistic cost estimates for basic services
- Capability to update data
  - Can reflect different cost pressures for each service (e.g. electricity)
  - Incorporates estimates of population growth
- More realistic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

Main advantages of the new formula

- The new formula has many advantages:
  - Its structure responds directly to the formula's objectives;
  - Cost estimates for basic services are more realistic;
  - Poverty measure covers nearly 60 per cent of households in South Africa;
  - Institutional funding for poor municipalities is better targeted;
  - Funding for community services is included explicitly for the first time;
  - Key data used will be updated annually; and
  - Allocations to poorer municipalities are increased.

Implementing the formula (1 of 2)

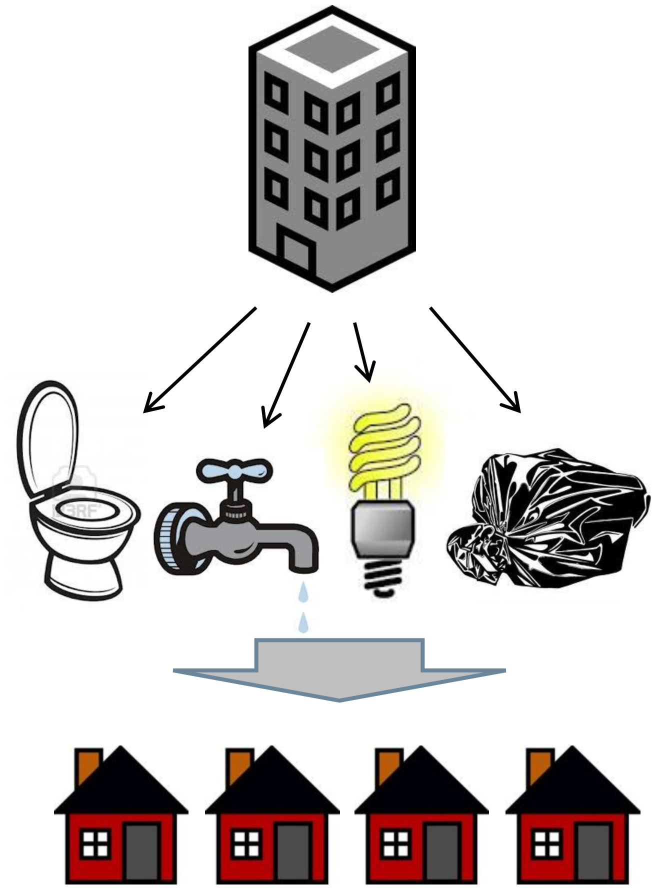
Number of HHs reported as receiving FBS



- Without adding any additional funds, this new formula shows that the LGES contains sufficient funding to provide free basic services to 59% of households
- However, looking at how many households are reported as receiving FBS in the 2011 Non-Financial Census of municipalities (plus Eskom FBE figures), we are far from achieving the impact we should
- As the formula is phased in and infrastructure is built that reaches all households, **our challenge is to ensure that all households bellow the affordability threshold feel the impact of FBS**

Implementing the formula (2 of 2)

- The challenge for all stakeholders is to ensure that the local government system works to use LGES funds appropriately and efficiently to deliver services



THANK YOU