



**Western Cape
Government**

Provincial Treasury

Local Government Functional Fiscal Framework Review

4 June 2012

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National Treasury Inputs

LG Equitable Share Review

- LG is entitled to an equitable share of revenue raised nationally to enable it to provide basic services and perform the functions allocated to it In terms of section 227 of the constitution.
- The size of local government's equitable share is decided through the national budget process.
- Local government's share then has to be divided among the country's 278 municipalities in a horizontal division."
- This is done through a formula that uses objective data so that the split cannot be arbitrarily manipulated to benefit an individual municipality.
- The local government equitable share (LGES) formula is being reviewed during 2012.

Scope LG Equitable Share Review

- Scope of the LG ES Review:
 - LG equitable share *formula* used to allocate funds horizontally among municipalities.
 - Will not examine the vertical division of revenue between the local, provincial and national spheres of government.
 - This process aims to solicit recommendations to strengthen existing systems and processes.
 - This review will not include a review of the RSC/JSB levies replacement grant.

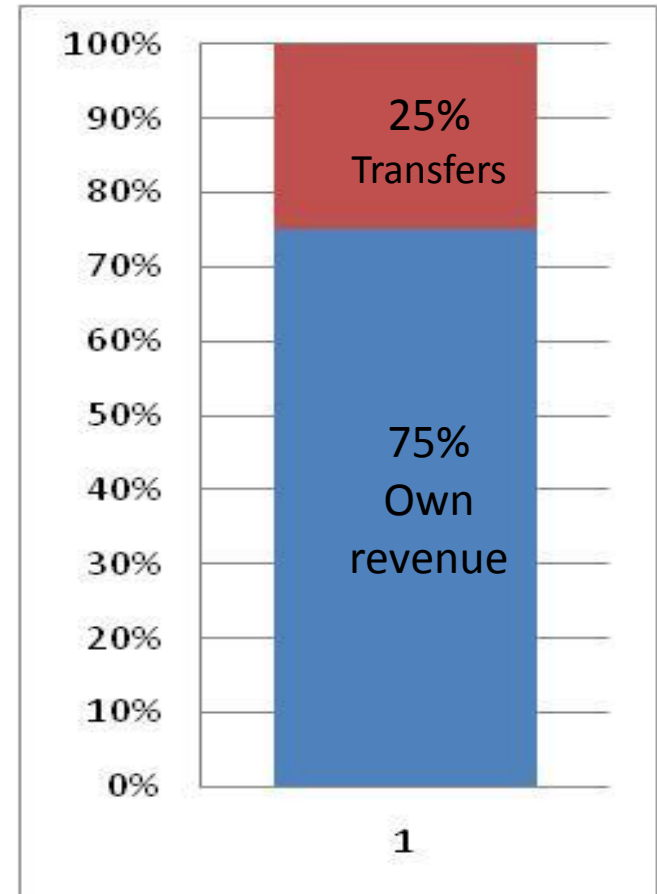
LG Functional Fiscal Framework Review

- The LGES formula review will work within the existing system of functional assignments of municipalities (e.g. the division of powers and functions between local and district municipalities and between municipalities and provinces).
- A range of functional and fiscal questions will be considered as part of the LG FFF Review Process including:
 - Conditional Grants
 - Functional assignments of municipalities
 - Governance framework for intergovernmental relations
 - Functional assignments of municipalities,
 - Implementation of differentiated approaches to dealing with municipalities.

Local Government Fiscal Framework

- In National Treasury's view the LGFF refers to all the revenues municipalities have at their disposal to meet their expenditure obligations
 - These include own revenue, borrowing and transfers
- Own revenue makes up 75% of the *total* LG Fiscal framework
 - But as the next slide shows the proportion own revenue and transfers contribute to the revenue of different municipalities varies greatly
- The LG FF is considered in the context of own municipal revenues and transfers.

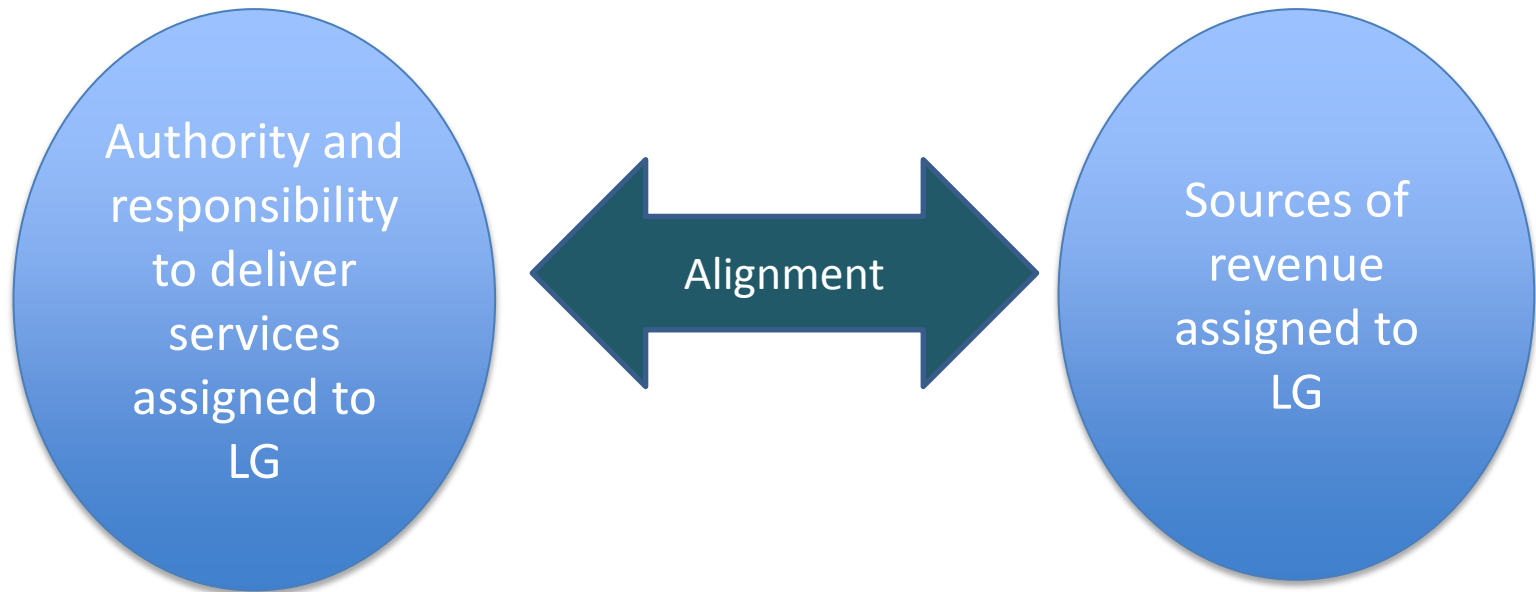
LG Fiscal Framework



Government's review of the Local Government Functional and Fiscal Framework

- National Treasury and DCoG are embarking on a joint review of the Local Government Functional and Fiscal Framework (LGFFF) running concurrently with the LG ES Review. Issues not addressed in the LG ES Review will be addressed in the broader LG FFF Review process.

LG Functional and Fiscal Framework



Reviewing the LG Equitable Share formula

- As part of the LGFFF process National Treasury and DCOG, together with SALGA and with assistance from the FFC and Statistics SA are reviewing the Local Government Equitable Share formula.
- 2 Discussion documents have been circulated and engagements with stakeholders have commenced.
- The new formula will be phased in from 2013/14.
- The intention is that the new formula will be:
 - Clearer and simpler
 - Improve transparency
 - Give greater recognition of the differences amongst municipalities (differentiation).
- LGES review will result in more rational formula allocations and greater clarity on what the formula is funding.

Current Formula

$$\text{LGES} = \text{BS} + \text{I} + \text{D} - \text{RRC} \pm \text{C}$$

<u>Where:</u>	BS	=	Basic Services Component (99.4%)
	I	=	Institutional Component (7.9%)
	D	=	Development Component (dormant)
	RRC	=	Revenue Raising Capacity Correction (less 7.4 %) Component
	C	=	Correction and Stabilisation Factor (negligible)

Most significant changes to the formula since 2005

- Introduction of funding for municipal health services as part of the basic services component (2007/08). This component includes electricity, water, sanitation, refuse and municipal health.
- Change in the measurement of the RRC correction and the introduction of the differentiated tax system in the RRC (2009/10).
- Adjustments to the subsidy levels in the BS component in light of the large increases in the electricity bulk price (2010/11).
- Removal of the population escalation factor from the I-component and its replacement with a poverty factor and reweighting of the basic services subsidies for serviced and un-serviced households (2011/12).

Proposed Objectives

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.

Overview of proposed principles

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



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Western Cape Discussions - George

28 May 2012

Finance Constraints – Basic Services

- Aging infrastructure and inability to extend existing infrastructure to roll services out to new HHs (*sensitivity of the FFF to backlogs*).
- Electricity provision to HH by ESKOM - compromises the debt collection leveraging municipalities have, especially where a large portion of towns are serviced by ESKOM. (e.g. Theewaterskloof, Swartland)
- Nationally ESKOM provides services to 40% of HH – interaction between ESKOM and municipalities concerning.
- Housing provision continues to add to the poverty constraint.
- Municipalities differs in various ways (coastal towns, in-land towns, high-revenue base, low-revenue base, geographic size), yet the legislative demands are the same.
- Rates rebates are increasingly contributing to revenue foregone.

Finance Constraints – Basic Services

- High tariff increases and affordability of municipal services.
- Impact of affordability on fiscal effort.
- Impact of demarcation on demand for basic services – mismatch between number of households and ES allocation because populations statistics not updated since 2001. *Funding should follow people.*
- Absence in poverty line results in huge variances in indigent HHs. (cut-off line can vary between R800 and R4000.
- What about the non-indigent/poor category that can also not afford services?
- Alternative means needed for determining levels of poverty at municipal level more regularly.
- Municipal Sustainability and data to inform it.

Financial Constraints - Other

Burden of Compliance

- Reporting
- Auditing
- Transformation i.t.o. the MFMA, MSA and other legislation and policies, e.g. Municipal Budget Reporting Regulations and Schedules, minimum standards, minimum competencies, GRAP, non-financial reporting (PdO).
- Property Rates – unbundling, re-valuation of assets.
- Ad hoc data requests from various institutions.

Political Stability

- Long standing acting arrangements , particularly in top management structures (section 57 and 56's)
- Ability and competence of Council to deliver on their mandate (oversight)
- Trust
- Impact of political instability and political interference on the stability of the administration, e.g. Stellenbosch, Saldanha Bay, George. (political oversight and intervention)
- Financial Viability – own revenue dwindling (Kannaland, Prince Albert, districts)

Financial Constraints - Other

Functional role of districts

- Value add from district municipalities to the broader regional space to bring about allocative efficiency.
- Areas identified where districts can play a more constructive role:
 - Disaster Management
 - Spatial Development Planning
 - Air Quality Management
 - Waste Management
 - Economic Growth Activities
 - Integration of SLA/assignment of responsibilities from other spheres of government.
 - Roads
- Important to create incentives for greater cooperation within districts and for districts to play a more strategic role in creating synergy in key regional planning areas.
- DCOG to look at the future role of districts to bring about value for money if districts are to stay.

Data Constraints

- Reliance on Stats SA Census which is conducted every 10 years with potential 2 year before release, e.g. demarcation and adjustment in ES.
- Reliability of the Community Survey data at municipal level makes is a constraint in use to fill the data gaps. Next Community Survey should address this.
- Data constraints hampers the responsiveness of the ES allocation and the LG FFF to local change.
- Start looking at alternative forms of data to fill the data gaps.
- Better and more scientific understanding of relative poverty.
- Fragmentation of data – input data vs. performance data.

Recommendation

- Fill data gaps – a lot hinges on getting the data right.
- Look at standardising property valuations and use the information drawn from this process as official data.
- Relook the institutional burden placed on municipalities by compliance
- Define poverty and ensure that the data is availability to respond to changes in the poverty.
- Intergovernmental fiscal transfers should look at the application when reviewing the formula so that past trends can inform the future formula.
- Transfer system should take into account actual own revenue, burdening factors emanating from national and provincial policies which places additional claims on municipal revenue, e.g. NERSA, DWA, Disaster Management, Compliance, Unfunded Mandates, etc.

Comments by 13 June

- Provincial Treasury sent out an e-mail to all municipalities to comment on the LG ES Formula Review and the NT Discussion documents has been distributed.
- Comments are due by 13 June for the latest, preferably earlier.
- No extension is possible.



Thank you