HOW ADEQUATE IS THE LOCAL GOVERNMENT EQUITABLE SHARE GRANT IN THE FACE OF ESCALATING COSTS OF MUNICIPAL SERVICE DELIVERY?

This fact sheet is based on a research study on the impact of the Covid-19 pandemic on municipal fiscal sustainability in the Western Cape (WC). The study was commissioned by the WC Department of Local Government in the Western Cape, and was conducted by the School for Public Leadership at the Stellenbosch University, with with the support of the Hanns Seidel Foundation.

What is the Local Government Equitable Share Grant (LGES)?

Unlike provincial governments, local municipalities generally have access to significant own revenue sources such as property rates and tariffs for the provision of services such as water, sanitation and electricity.

Fiscal capacity can vary markedly within the local government sphere – from the metropolitan municipalities in large cities with high concentrations of economic activity and employment opportunities, to small rural towns with low levels of economic activity and high concentrations of poverty and unemployment.

In order to provide basic services to indigent households and as a substitute for own revenues, local municipalities are accorded an “equitable share” of tax revenues raised at national level by the South African Revenue Service by Section 214 of the Constitution.

Each year there is a revenue sharing process whereby debt service costs are top-sliced from the pool of nationally collected revenue, and the remainder is split among national, provincial and local government (the “vertical division of revenue”).

The pool of funds accruing to the local government sphere is then allocated to each local municipality through a transparent formula, and the Local Government Equitable Share Grant (LGES) which will be transferred to each municipality.

Challenges reported by municipalities in the Western Cape relating to the LGES:

The challenges with the Local Government Equitable Share Grant (LGES) relate to its adequacy and stability:

- In recent years, the LGES grant has not kept pace with escalating costs of employment or increasing bulk services costs.
- Recent decisions by the National Energy Regulator of South Africa preventing municipalities from full passing increases in Eskom bulk electricity prices on to their customers have eroded electricity surpluses in many municipalities, undermining their ability to fund new infrastructure, upgrades and rehabilitation, or to cross-subsidise other services.
- A court case between ESKOM and the energy regulator, NERSA, had introduced an element of uncertainty for municipalities regarding bulk electricity prices in 2020/21.

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- The local government share of nationally collected revenue fell to 8.3% in 2018/19, but is anticipated to rise to 9.7% in 2023/24. While this aggregate allocation to local government takes into consideration the own revenue raising capacity of municipalities, the Financial and Fiscal Commission noted that the fairness of this vertical division of revenue has remained a bone of contention, especially given that the demand for local government services has expanded significant in the past two decades.

- Due to fiscal consolidation imperatives and pandemic induced fiscal constraints, Budget 2021 reduced the amounts flowing to municipalities via the LGES by R14.7 billion and from general fuel levy sharing with metropolitan municipalities by R2.7 billion.

- Rural municipalities in the WC are concerned that their higher costs of service delivery are not adequately factored into the LGES and that the LGES focuses mainly on Free Basic Services rather than other municipal services.

- Most of the sampled municipalities in the WC had instituted stringent cost containment measures for the last three years and contended that further cuts could severely compromise their service delivery.

What formula is used to distribute the revenue pool allocated to the municipal sphere among the individual municipalities?

The LGES formula has three components:

- **A Basic Services (BS) component** which covers the cost of providing free basic services based on the number of eligible households and the estimated cost of providing these services)

- **An Institutional and Community Services (I&CS) component** (modified by a revenue adjustment factor) which contributes towards administrative costs of a municipality (proxied by the number of councillors) as well as collective services such as municipal health, fire, roads, cemeteries, planning, stormwater management streetlighting and parks (proxied by the total number of households in the municipality).

  In order to prioritise municipalities which are least able to raise own revenues, municipalities are ranked in terms of an index which aims to capture their own revenue raising capability. The top 10% of municipalities receive zero I&CS component while the bottom 25% receive the full I&CS component and those in between receive a pro-rated amount based on a sliding scale.

  Because some WC municipalities have significant own revenue resources, their I&CS allocations tend to be vastly reduced by the revenue adjustment factor.

- **A Correction and Stabilisation (C) factor** to ensure a degree of stability in each municipality's allocation over the MTREF period.

Arguments that the LGES is inadequate:

The administrative component does not directly factor in the cost of increases in the administrative compliance burden such onerous reporting requirements, the municipal Standard Chart of Accounts and the proliferation of other administrative requirements from other spheres of government.

A gap between the "reasonable" efficient cost of delivering collective services to low income and indigent households and the grant revenue actually received could contribute a transfer funding gap, or a partially funded mandate.

Arguments that the LGES is adequate:

Municipalities often do not exploit their own revenue sources, preferring to remain dependent on intergovernmental grants instead.

While municipalities do not have control over the salaries and conditions of employment of their staff, they do have control over staff headcount, and that "fat" still exists in personnel budgets.

A high degree of inefficiency in municipal spending (including unacceptably high levels of water and electricity technical losses and theft), as well as fraud and corruption are the true reasons for the transfer funding gap.

Conclusion:

- Due to the protracted duration of the pandemic and its associated losses of jobs and livelihoods, the fiscal bases of municipalities are being further impaired.
- It is clear therefore that the contentious issue of the LGES adequacy is likely to become even more so.
- With politically high profiled state-owned entities like Eskom and SAA standing in line for bail-outs, calls for expansion of the social security system and a basic income grant, and the need to fund the National Health Insurance, the probability of local government receiving significant additional resources in the medium term is slim, unless growth rebounds substantially.

It is therefore critical that…

- the wage bill in municipalities needs to be contained during central bargaining,
- regulators understand the impact of their decisions on municipal financial viability,
- municipalities enhance their collection of existing revenue sources and that new sources are identified at national level, and
- greater value for money is obtained from existing spending through reduction of inefficiency (e.g. water and electricity losses), wasteful spending and financial mismanagement.

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