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Decentralisation and the Free Basic Water Policy in South Africa: what role for the private sector?

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Introduction

“While privatisation is an emotional and very much political issue in South Africa, the private sector has played and will continue to play an important role in water services. The challenges facing us are simply too big to be addressed by government alone. We will, however, not sell our public water services infrastructure to the private sector but this is no obstacle to the private sector getting involved in a whole range of activities.”

Minister Kasrils, *African Investment Forum*, April 2003

Within Sub-Saharan Africa, South Africa is a country apart. Its economic development is quite distinct from its neighbours, and South African GDP accounts for 40% of this region's GDP. Its singular history, marked by major conflicts between the English and Dutch in the 19th century and then between the white minorities and black majority in the 20th century, together with its move towards decentralisation are two other features that set South Africa apart.

South Africa is, moreover, a land of contrast, be it geographic, demographic, hydrological, political or ideological. It is also a country marked by inequalities. A recent study¹ comparing the levels of infrastructure development in various upper middle-income countries concluded that the basic service level in South Africa globally fell below that of the reference group. This backlog is very pronounced in rural areas and particularly with regard to sanitation services. Only 44% of the country's rural population have access to safe sanitation, compared to the 86% average for countries with the same income level. Aware of these inequalities in services, South Africa has engaged water sector reforms that give priority to social policies aimed at providing the most disadvantaged communities with access to safe water.

As for private sector participation in municipal services, South Africa's position is somewhat paradoxical. Since 1994, the official stance towards private sector participation has been a favourable one, as this could provide a new source of technical expertise and investment capital. Yet

moves to put this ideology into practice have come up against strong opposition not only from local communities, who are wary of private-sector involvement, but also from academics, who contend that the State is thereby withdrawing from its public service role. As a result, ten years on from the first water reforms, the private sector has not yet found its place within the existing institutional framework. Within the debate on the private sector's role in Sub-Saharan Africa, we were thus prompted to undertake a more detailed examination of South Africa as a country that is prioritising service access for the very poor. More specifically, we concentrate on three lines of inquiry:

- How can adequate water services be delivered to the very poor? Can several levels of service be envisaged? How can the move from one level of service to a higher level be ensured?
- What role can the local and international private sector play? What are the main obstacles to developing this role? What benefits does the private sector have to offer?
- How are social policies funded? With respect to funding, what balance is there between national subsidies and user revenues? What cross-subsidisation mechanisms and solidarity measures are implemented?

To answer these questions, we first outline the key players involved in the debate on private sector participation. Next, we examine the standpoints of each of the parties and show the relative weight of the private sector in 2006. We then go on to highlight the implications of the Free Basic Water policy in effect since 2001, and conclude by reviewing the possible lessons to be learnt from a scheme that combines decentralisation with innovative social policies.

¹ World Bank, *International Benchmarking of South Africa's Infrastructure Performance*, Bogetic and Fedderke, WPS3830, 2006.

1. The debate on private sector participation in water services

1.1 The key players

The water services in South Africa involve a good many key players including local authorities, government departments, public and private utilities, community-based organisations and civil society, all of whom are actively engaged

in the debate on private-sector participation (PSP) in the water sector. This section will briefly outline the role of each stakeholder and their stance on the issue of public-private partnerships (PPPs) in this sector.

BOX 1. Key texts regulating the water sector in South Africa

Since 1994, South Africa has passed a series of bills and acts providing a regulatory framework for the water services sector and the transfer of powers to local authorities. Below is a selection of the main texts and documents:

- **The Constitution** (Act No. 108, 1996) defines the founding principles of the nation and specifically regarding fundamental rights of access to services: "The State must take reasonable legislative and other measures, within its available resources, to achieve the progressive realisation of these each of these rights." The municipalities are associated with the provision of services, but the regulatory authority remains vested in national government.
- **The White Paper on Water Supply and Sanitation Policy (1994).**
- The Water Services Act (Act No. 108, 1997) delegates the authority for water services management to local government. A municipality can either operate its own water services via an internal trading unit or delegate them to a Water Services Provider, who may be a public or private operator. It recognises the right of community-based organisations to manage the water services network and stipulates that it is forbidden to deny access to water to any person who has furnished proof of indigence.
- The National Water Act (Act No. 36, 1998) replaces the 1956 Water Act and abolishes private ownership of water. It protects community rights to access to water resources for domestic use.
- The Municipal Systems Act (Act No. 32, 2000) protects the poorest populations by controlling the tariffs of essential services. Tariffs must cover only operating and maintenance costs and be reasonable enough to allow everyone access to a minimum quantity of water.
- The White Paper on revisions to the Water Services Act (2001) introduces access to a minimum monthly volume of free water for each person (6 kilolitres), to be implemented within two years. Funding for this measure comes via the Equitable Share, updated in 2003.
- The Strategic Framework for Water Services (2003) updates the water services policy in South Africa by redefining the role of the Department of Water Affairs and Forestry (DWAF). It redefines the scope of each stakeholder's responsibilities and stresses the need to improve the sector's financial viability and the level of service provided to users.

1.1.1 Water Services Authority and Water Services Provider

Since the 1997 and 2000 water sector reforms, responsibility for provision of water services has been devolved to the local authorities. More specifically, two key players are now involved in ensuring these services: the Water Services Authority and the Water Services Provider.

The **Water Services Authority (WSA)** is responsible for providing water services within its area of jurisdiction. Since the Water Services Act (Act No. 108, 1997), this role has been entrusted to municipalities, who ensure access to basic water services for all, prepare water-services development plans and regulate contracts signed with Water Services Provider(s).

The **Water Services Provider (WSP)** denotes the entity responsible for technical management of the water assets and water distribution. The WSP acts as either:

- a bulk Water Services Provider, in which case it contracts with the WSA or another WSP to sell water to and/or accept wastewater for treatment from the WSA; or
- a retail Water Services Provider, in which case it contracts with the WSA to assume operational responsibility for delivering water services to one or more consumers (end users) within a defined geographical area; or
- an operator providing both of the above services.

The role of the WSP can be taken on by different types of entity. The municipality can retain direct responsibility for the delivery function through an internal trading unit and, in

this event, the WSA and the WSP are one and the same. It can also delegate supply and treatment services to a Water Board, which is a public corporation operating as a bulk Water Services Provider. For retail distribution, it can contract with a public or private utility, or community-based organisations.

1.1.2 National level support

At the national level, three government departments are specifically involved in the water services sector.

The DWAF (Department of Water Affairs and Forestry) is the government department responsible for water resources management and water services provision. The DWAF plays a key role in four areas:

- **Water Policy.** The DWAF is in charge of developing national water management policy guidelines, which take into account imperatives at national and international level.
- **Regulation.** The DWAF oversees the WSPs and can intervene in the event that the service level provided does not comply with the set standards.
- **Technical support to the local authorities.** As defined in the Constitution, the DWAF's function is also to support local authorities, in co-operation with other state departments.
- **Information management.** The DWAF collects and publishes information on the water services sector in order to promote benchmarking and yardstick competition between municipalities.

BOX 2. The three types of municipalities in South Africa

South Africa is organised into 284 municipalities, each belonging to one of 3 categories depending on its size and level of authority:

- **Category A or Metropolitan Municipalities** are 6 in number and involve the largest cities (Johannesburg, Pretoria, Cape Town, Durban, East Rand and Port Elizabeth). This category has exclusive municipal executive and legislative authority in its jurisdictional area, unlike Categories B or C. It notably has the power of a Water Services Authority.
- **Category B or Local Municipalities** number 231. This category shares its authority with the district municipality within whose area it falls.
- **Category C or District Municipalities** number 47. A district municipality is made up of a group of Category B municipalities. Its main areas of competence include town planning and capacity-building. In the water services sector, a C Category municipality has the authority of a WSA, except in the event of derogation.

The **National Treasury** monitors and regulates the finances of all public bodies, including municipalities. The Department's **PPP Unit** plays an active role in promoting public/private partnerships contracts at national, provincial and local levels. One of the missions of the Unit is to provide procedural guidelines to municipalities interested in entering into PPP agreements.

The **DPLG** (Department of Provincial and Local Government) has overall responsibility for regulating and overseeing local government affairs. In the water services sector, it is this Department that approves water-services development plans and allocates funds, such as the Municipal Infrastructure Grant (MIG) and the Equitable Share (ES).

1.1.3 Civil society and trade unions

This cursory overview of the key players would be incomplete without mention of civil society and the trade unions, both of which are highly engaged in the water sector.

The **SAMWU** (South African Municipal Workers Union),

representing 122,000 local government workers, is particularly active in this sector. The union is affiliated to the national confederation, COSATU², which strongly opposes private sector participation in the water services. It considers that public sector participation represents a potential threat to employment and working conditions for municipal workers, and would likely entail price increases that would disadvantage the poor.

In South Africa, **NGOs** are important partners for some municipalities, since they act as WSPs or technical advisors to rural communities for implementing projects. This is the case of Mvula Trust, which has water and sanitation expertise.

Finally, grassroots organisations such as the Anti-Privatisation Forum and the Municipal Services Project bring together academics and intellectuals who are fiercely opposed to private sector involvement in the water sector. These provide ideological support in the form of articles and books, and are also active on the ground, organising and attending anti-private sector demonstrations. As such, they constitute a powerful lobby group.

BOX 3. How is the water sector financed?

The WSAs have two distinct sources of revenue.

Firstly, they collect revenue through billing. Users may be charged at either a flat rate (i.e. a fixed price whatever the volume of water consumed), or a metered rate (based on volume consumed). The WSAs set tariffs and collect payments.

Secondly, budgets are topped up by national subsidies. Two main subsidies exist for water services. The Municipal Infrastructure Grant helps to finance capital costs. It is a conditional grant and scaled to a given investment plan. The Equitable Share subsidizes operating costs and is non-conditional. The amount allocated is calculated on the number of households within the municipality that have an income of less than R1100 per month. Neither of these two grants is earmarked exclusively for water services, which means that other basic services (energy, transport, etc.) are competing for these resources.

² COSATU (Congress of South African Trade Unions), created in 1985, is a member of the tripartite alliance along with the ANC and the South African Communist Party.

1.2 The different standpoints

A great many players are thus involved to a greater or lesser extent in water management, each one more or less favourable to the question of private sector participation. The following sociogram uses two axes to visualise each player's standpoint.

The first conclusion to be drawn from Figure 1 is that the anti-PSP lobby seems far more powerful than the pro-PSP lobby. Those players most averse to PSP are the trade unions and the Anti-Privatisation Forum on ideological grounds, and the Water Boards for reasons of competition. When the water sector was re-structured, the Water Boards (controlled by the DWAF) found their role restricted to providing bulk water to municipalities. Although there are no legal grounds preventing Water Boards from broadening

their function to include retail distribution, moving into this kind of service would place them in direct competition with the private sector.

Given that previous Public-Private Partnership agreements in South Africa have shown certain shortcomings, municipalities are now more reluctant to sign new contracts. From a legal point of view, the contracting procedure is certainly lengthy and complex, and service level improvements are not necessarily visible within the four-year term of office of local elected officials. Civil society is less implicated in water services issues. It tends, however, to oppose private sector participation, the reason being that the private sector's arrival on the scene often goes hand in hand with a strong drive to improve bill collection.

Figure 1. Each player's standpoint on the question of private sector participation

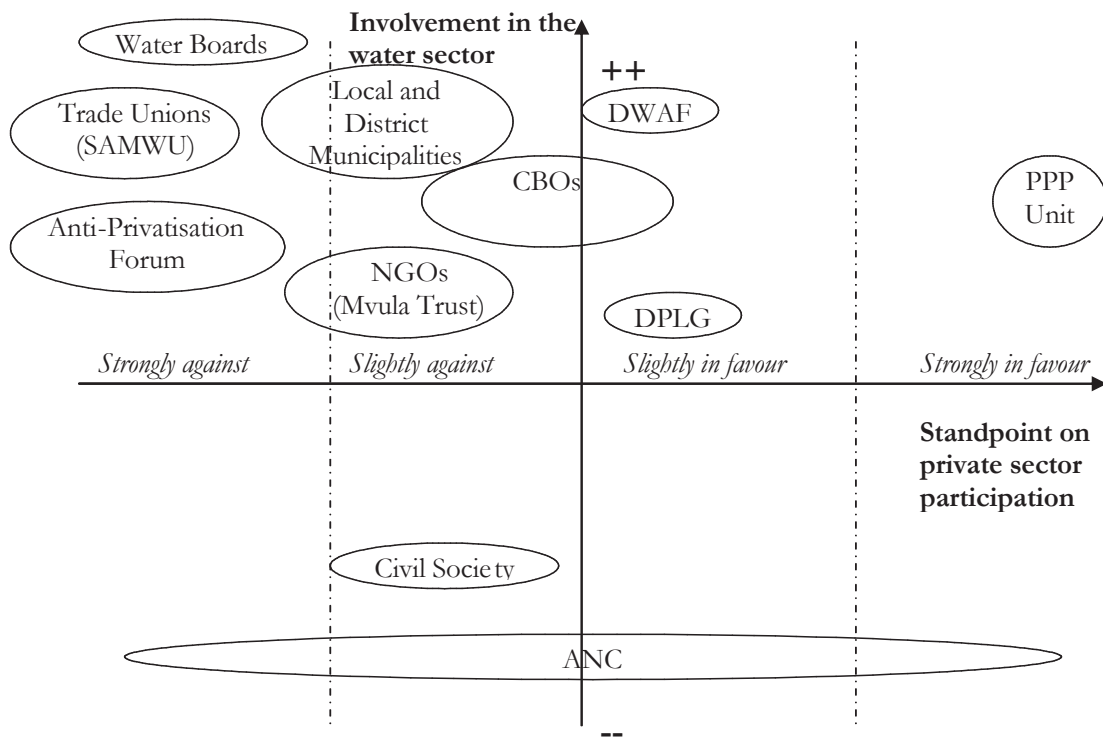


Table 1. Summary of arguments for and against PPP in water service delivery

| | Pro-PPP arguments | Anti-PSP arguments |
|---------------|--|---|
| Ideological | | <ul style="list-style-type: none"> Water is an essential service which should not be operated for profit Water delivery has a strong impact on health: it must therefore remain the responsibility of the local authority In the main, the disadvantaged are the ones to suffer from cut-offs There is a danger that the private sector will 'cherry pick' affluent areas where revenues are higher |
| Institutional | <ul style="list-style-type: none"> Municipalities have insufficient technical skills to efficiently manage service delivery | <ul style="list-style-type: none"> Municipalities lack the skills to ensure contract regulation |
| Financial | <ul style="list-style-type: none"> Private-sector capital enables better development of services, with particular focus on pro-poor objectives With appropriate incentives, the private sector can increase bill collection | <ul style="list-style-type: none"> National-level subsidies allocated by the National Treasury are sufficient to finance water service delivery Private-sector profits would be made at the users' and/or municipalities' expense |
| Social | <ul style="list-style-type: none"> The private sector helps to develop skills training for water employees Local communities can also benefit from capacity-building | <ul style="list-style-type: none"> Fear of job losses |
| Technical | <ul style="list-style-type: none"> The private sector brings technical expertise on technical matters such as unaccounted-for water The private sector has more incentive to efficiently operate and maintain water network assets | |

Support for PPPs comes primarily from national institutions. The National Treasury, via its PPP Unit, helps municipalities along the pro-PPP route. In view of the challenges to be met, it is the most active advocate of this model. The DWAF adopts a more neutral, even slightly favourable, stance towards the private sector, particularly when local authorities do not have the adequate capacities for managing the network.

An overall analysis of the two groups' relative positions

shows that their respective arguments are not grounded in the same rationale. Pro-PPP standpoints rely more on rational, technical or financial arguments, the aim being to show that the private sector is better equipped to manage resources efficiently. The standpoints of the anti-PPP proponents are based more on ideological and social considerations, their main concern being that the involvement of the private sector may be detrimental rather than beneficial to underprivileged communities and workers.

1.3 The state of PPP in the water sector

Contrary to common belief, private sector participation in the water services sector is not very high. As on 1 January 2006, four PPP contracts were in progress, one of which terminated in April 2006. A summary description of each of these contracts is given below, the purpose being not to provide an exhaustive view, but rather to examine the relationships between the different players and the way in which the Free Basic Water (FBW) policy is implemented under each contract. The FBW policy will be presented in greater detail in a later section.

1.3.1 Lukhanji Municipality (Queenstown)³

Public partner: Lukhanji Local Municipality

Private partner: WSSA (Water and Sanitation Services SA)

Contract:

- Type: Operation and Maintenance
- Date of signature: 1992
- Duration of contract: 25 years
- Value of contract: R16 million

Population covered: 200,000

³The two reference documents that sourced this summary are Evaluation Report of the Water and Sanitation Contract between Lukhanji Local Municipality and WSSA, WZC (Pty) Ltd, 2003 and PPP and the Poor in Water and Sanitation – Case study: Queenstown, South Africa, PDG, 2000.

1.3.1.1 *Background to the contract*

In 1992, the original contract signed between WSSA and Queenstown Municipality covered only the old ‘white’ Queenstown municipality (22,000 residents). Water consumption was billed on a volumetric basis and all households benefited from a full level of service, including in-house water supply and flushing toilets. In 1995, following the local authority restructuring and amalgamation process, the municipality’s boundaries were extended to include the two townships of Ezibeleni (previously administered by the homeland of Transkei) and Mlungisi (previously administered by the Cape Provincial Government). This increased the population by some 170,000. Service levels for these two predominantly black townships were relatively high (taps or in-house water and outside or inside flushing toilets), but maintenance had been neglected for some thirty years, leading to a poor standard of service with high levels of unaccounted-for water and an urgent need for infrastructure rehabilitation.

Given this new situation, the Queenstown Municipality brought into play a clause in the PPP contract authorising extension of the service area. With this major amendment to the contract, the number of residents serviced leapt from 22,000 to almost 200,000. A sharp increase in financial charges ensued but this was not matched by a corresponding rise in revenue given the extremely low payment rates in Ezibeleni and Mlungisi.

In 2000, the surrounding rural communities were incorporated into the new Queensland Municipality, which was renamed Lukhanji Local Municipality. From 1 July 2003, this Local Municipality is one of the nine municipalities included in the Chris Hani District Municipality.⁴ Lukhanji Municipality is still in charge of monitoring and regulating the PPP contract.

1.3.1.2 *Relationships between the key players*

For Lukhanji Municipality, this partnership contract is seen in a positive light. The Councillors regarded the PPP contract as a chance to improve technical and commercial efficiency and were supportive from the outset. Indeed, cost savings since 1992 have been estimated at about 17%. One particularity of the contract is that the municipality, over and above monitoring and regulating the contract, has retained various other functions such as billing and collection.

In the Ezibeleni and Mlungisi townships, the local communities have two major concerns. One serious source of discontent is the tariff structure, but neither the private operator (WSSA) nor the public operator (Lukhanji Local Municipality) has any decision-making power on this issue, as tariff setting is now the responsibility of the Chris Hani District Municipality. The second concern is the fact that household leaks are resulting in high unaccounted-for-water levels and, since meters have been installed, in high bills. As these leaks generally originate on private property, WSSA is not responsible for repairs.

Trade unions and WSSA employees are chiefly concerned by the issues of internal organisation and wages. They are of the opinion that their efforts to improve contract performance have not been sufficiently recognised. In 2002, two strikes broke out following the dismissal of employees for disciplinary reasons.

1.3.1.3 *Free Basic Water policy*

In the Lukhanji Local Municipality, the free basic water block has been set at 10kl rather than the nationally recommended 6kl. To benefit from this measure, residents need to register with the municipality—some 16,000 out of 200,000 have done so.

The cost of this measure is not borne by WSSA, as the private operator is paid by Lukhanji Local Municipality and not directly from billing revenue. However, as the municipality is bearing the brunt of this measure, it is currently negotiating with Chris Hani District Municipality for a larger portion of the Equitable Share subsidy.

Table 2. Delivering water to the poor: has the private sector helped?

| Income category | Percentage (1997) |
|------------------------------------|-------------------|
| < R800 per month | 50 |
| Between R800 and R1500 per month | 24 |
| Between R1 500 and R3500 per month | 14 |
| Above R3500 | 12 |

⁴ See Box 2 on local authority organisation for more details on how roles are shared between municipalities.

1.3.1.4 *Delivering water to the poor: has the private sector helped?*

Almost all of the 200,000 residents serviced by the contract were already connected to the network before the contract came into force in 1992. The private company's mission was not, therefore, to expand the water services. Since the contract was signed, however, the level of service has been enhanced. For example, the unaccounted-for-water rate has dropped from 45% to 21%. These improvements, though, are not necessarily visible to the poor communities. Before implementation of the Free Basic Water policy, those 50% of households with monthly incomes of under R800 faced serious problems of accumulated debt and frequent cut-offs for non-payment of bills. The Free Basic Water policy has thus provided support for the poor households, although no meaningful figures have yet been advanced on the progress made with collection rates.

To conclude, WSSA, as a private partner, has enabled considerable improvements to be made, particularly in the area of unaccounted-for water. Yet, given that WSSA has no direct contact with the population and that Lukhanji Municipality still assumes billing and collection functions, it is difficult to assess the impact of private sector participation on service provision for the very poor.

1.3.2 Dolphin Coast⁵

Public partner: KwaDukuza Municipality

Private partner: Siza (56% owned by SAUR Services Ltd)

Contract:

- Type: Concession
- Date of signature: 1999
- Duration of contract: 30 years
- Value of contract: R33 million

Population covered: 34,000

1.3.2.1 *Background to the contract*

Faced with severe budget constraints, Dolphin Coast Municipality found that it was lacking the necessary financial capacity to engage capital investments of an estimated R230m over a thirty-year period. The municipality therefore decided to tender a concession agreement. In April 1999, the

contract was signed with Siza Water Company, a local company in which SAUR has a 56% holding alongside other South African empowerment partners (black empowerment policy is a large-scale programme in South Africa aimed at transferring White economic power to the Black population). Two years later, Siza encountered serious financial setbacks for a number of reasons: the predicted increase in water consumption had been largely overestimated, the bulk water supplier (Umgeni Water) had substantially raised its tariffs, and the maintenance required was greater than expected. As a result, the contract was re-negotiated and a supplementary agreement was signed. This provided for a 50% reduction in the concession fee that Siza paid to the municipality, two extra-ordinary price increases in 2001 and 2002 and a readjustment of Siza's investment commitments. A new financial balance, which was more favourable to Siza Water Company, was thus reached.

1.3.2.2 *Relationships between the key players*

Those employees transferred to Siza Water benefited from sizeable wage increases (an estimated 60% over four years). A training programme was set up to improve the staff's technical and bookkeeping skills. As a result, employees seem to view the new contract in a basically positive light.

Siza regrets that the municipality has not been forthcoming with respect to its regulatory function and political commitment. Since the commencement of the contract in 1999, not only have many of the municipal councillors changed, but they have also spent insufficient time on contract monitoring. One sign of this is that the Water Committee, which is supposed to examine and approve the activities reports submitted by Siza Water, has not convened since 2002.

The information on user-concessionaire relations is somewhat out of date, as it was collected in 2000, before the implementation of Free Basic Water policy. At the time, the substantial tariff increase aroused massive opposition from the local communities, who also complained that they had not been sufficiently consulted on the choice of the concession contract.

⁵ For further information see Evaluation Report of the Water and Sanitation Contract between KwaDukuza Local Municipality and Siza Water, WZC (Pty) Ltd, 2003, and PPP and the Poor in Water and Sanitation: Dolphin Coast Water Concession, South Africa, Hemson & Batisdzirai, 2002.

1.3.2.3 Free Basic Water policy

Although the Free Basic Water policy had not been foreseen in the original concession contract between Siza and the municipality, it was nonetheless implemented for the Dolphin Coast target populations (limited to residents supplied by standpipes or yard taps) in 2003. Prior to this, poor households had paid for water with tokens entitling them to a set quantity of water. Since the introduction of the Free Basic Water policy, there has been no charge for standpipe water given that average household consumption is under 6kl per month.

The costs incurred by this policy are shared between the private operator and the municipality. Siza meters consumption of the free standpipe water and is then reimbursed by the municipality for the corresponding cost of the bulk water supplied to Siza by Umgeni Water. The costs of distributing this free water (e.g. pumping and network maintenance) are borne by Siza.

1.3.2.4 Delivering water to the poor: has the private sector helped?

Dolphin Coast has quite a singular profile in the South African landscape. Half of its population lives in the wealthy coastal strip area and paying for water services seems to pose no problem. This population generates about 80% of revenues, which enables service delivery to be extended to the other half of the population living inland from the coastal freeway on much lower incomes. This balance enables Siza to finance service delivery without any form of municipal subsidy apart from the above-mentioned recovered costs for supplies delivered within the Free Basic Water policy.

At investment level, Siza is responsible for level-4-service infrastructure (in-house connections) and has planned a five-year R10-million programme for its development and maintenance. The programme, however, prioritises bulk infrastructure rather than the extension of private connections. Level-2 investments (standpipes and yard taps), on the other hand, are financed by subsidies from the provincial housing board and other grants.

In terms of performance, private sector participation has brought in additional investments that have helped to upgrade service levels. The tariff increases required to fund these investments have had a limited impact on poor households thanks to the provision of free water at standpipes.

1.3.3 Johannesburg⁶

Public partner: Johannesburg Water (JW)

Private partner: JOWAM (Suez subsidiary)

Contract:

- Type: Management contract
- Date of signature: April 2001
- Duration of contract: 5 years
- Value of contract: R10m/year

Population covered: 2.8 million

1.3.3.1 Background to the contract

Johannesburg is one of the six Metropolitan areas in South Africa, covering around 1,380 km² with an estimated population of 2,800,000 and providing 11% of the country's GDP. Soon after the end of apartheid, between 1995 and 1997, the municipality embarked on a series of ambitious projects aimed at reducing inequalities amongst the different communities, but it soon came up against problems of cost. These years are known as the period of "growth without sustainability". Between 1997 and 1999, there ensued a period of austerity, dubbed the years of "sustainability without growth", when investments were frozen. In addition to being cash-strapped, the city of Johannesburg also faced a particularly high unaccounted-for-water rate. In 2001, this was estimated at 43%,⁷ representing a annual loss of R1.15 billion of potential sales.

In 2001, the City of Johannesburg restructured its core services and created Johannesburg Water (JW), a public water utility fully owned by the City. To ensure the operational efficiency of this new utility, the authorities tendered a five-year Management Contract that was awarded to JOWAM, a consortium 63% owned by Suez. In order to win the contract, Suez had made a strategic bid⁸ in the hope that, after five years, the contract would be renewed on the a higher-risk and more lucrative basis. In this scenario, the company that won the initial Management contract would have had a substantial competitive edge insofar as it would already have had a working knowledge of the network and the key players.

⁶ Information from Smith, Neither Public nor Private: Unpacking the Johannesburg Water Corporatisation Model, UNRISD and Hansen, The struggle for Water in Johannesburg, Lunds University, 2005

⁷ Source: the JW web site (13/06/2006)

⁸ Interview with Jean-Pierre Mas, CEO of JOWAM

At the commencement of the contract, about thirteen members of staff were deployed full time into managerial and technical assistance positions. Under the terms of the contract, these experts were to be gradually replaced by local staff and, in April 2004, only two of these original staff members remained full-time. This phasing-out clause guaranteed Johannesburg Water an effective transfer of knowledge between JOWAM and the public corporation.

The compensation scheme for the private operator was three-pronged. First, a fixed management fee of R5m was paid annually. Secondly, a performance-based incentive, which was not to exceed an annual R4m, was paid on the basis of five criteria (capacitation and human development, decreased wastewater spillage and overflow, improved customer service, implementation of an annual capital investment programme and improved operations and facilities). Finally, JOWAM was awarded a very modest level of incentive based on 0.18% of EBIDTA (earnings before deduction of Interest, Taxes, Depreciation and Amortisation). By way of comparison, Vivendi had asked for 1.25% and Thames Water 5%.

In fact, the hoped-for 2006 extension of the contract did not materialise. The City of Johannesburg was highly satisfied with

the performance of the Management Contract, but thought that JW could henceforth manage water and sanitation services alone. For JOWAM, although the contract was a technical success, in commercial terms it has been a failure insofar as the consortium had planned to offset its low rate of compensation by obtaining a new longer-term contract in 2006.

1.3.3.2 Relationships between the key players

Relations between the public JW utility and the private JOWAM operator seem to have been satisfactory throughout the contract. At a political level, the City's municipal council deliberately restricted the autonomy of both JW and JOWAM, notably in investment matters, since it was aware of what enormous political impact core services such as water have, particularly on the very poor.

The role of anti-privatisation organisations has been very influential. During Operation Gcin'Amanzi (which means "conserve water" in Zulu)—aimed at developing the water network and water demand management in Soweto and other townships—, these organisations ran grassroots protests against the installation of pre-paid meters in these townships. The movements were widely covered in the press, which denounced the strict cost-recovery measures as being unfavourable to the very poor.

Box 4: The Gcin'Amanzi Project⁹

In Soweto (1.1m inhabitants), unaccounted-for-water losses total 7 million kilolitres per month. Operation Gcin'Amanzi aims at cutting this water loss in two ways. First, by upgrading the water assets (some of which date back more than a century) and private dwelling installations. Second, by launching an anti-wastage policy including an education and awareness campaign targeting water conservation and the installation of pre-paid household meters.

The project began in 2003 with a 5-year horizon. AFD is involved in the project through a R320m loan. In the pilot community of Phiri, average household consumption has dropped from 55kl to 11kl, which represents a saving of 220 000kl over four months. The project has met with strong opposition from certain communities who are supported by movements such as the Anti-Privatisation Forum.

⁹ Source: the City of Johannesburg Web site www.joburg.org.za (13/06/2006)

1.3.3.3 Free Basic Water policy

The Free Basic Water policy was launched in Johannesburg in 2001 and benefits all households. The cost of this measure has been estimated at about R95m per year. This has been funded partly by strengthening cross-subsidisation: in 2001-2002, a 5% tariff increase was introduced, affecting primarily high-volume domestic users and industrial users. At present, about one third of the population is cross-subsidising the remaining two thirds. This fragile balance, however, could be upset by the massive migration of the rural poor to Johannesburg.

Complementing the tariff increase, another source of funding for the Free Basic Water policy is the Equitable Share subsidy, the amount allocated to the municipality being partly determined by the number of residents from households with a monthly income of less than R1100 a month. The National Treasury, however, would appear to underestimate these residents: it estimates the number of poor at 360,000, whereas the 2001 census enumerated 1,000,000. Consequently, the portion of Equitable Share allocated is less than the amount required to finance the Free Basic Water policy.

1.3.3.4 Delivering water to the poor: has the private sector helped?

Under the Management contract, the private sector (JOWAM) and the public sector (JW) worked on a joint basis, particularly for sensitive projects like Operation Gcin'Amanzi. The private sector has thus contributed to setting up a water management and conservation policy, as it has been able to establish a satisfactory balance between basic free water provision, a reduction in unaccounted-for water and the roll-out of pre-paid meters in the poorest districts. A culture of payment is gradually taking root, forming a sound basis for sustainable and balanced funding.

It is nonetheless interesting to note that of the five performance criteria applied to JOWAM (capacitation and human development, decreased wastewater spillage and overflow, improved customer service, implementation of an annual capital-investment programme and improved operations and facilities), none is specifically focused on the very poor.

1.3.4 Nelspruit

Public partner: Mbombela Local Municipality

Private partner: GNUC (Great Nelspruit Utility Company, 90% owned by BiWater and Nuon)

Contract:

- Type: Concession
- Date of signature: 1992
- Duration of contract: 30 years

Population covered: 230,000

1.3.4.1 Background to the contract

Nelspruit is the provincial capital of Mpumalanga. Before 1994, the town had a typical apartheid structure with a white urban town centre and two black townships, KaNyamazane and Matsulu, which came under the jurisdiction of the KaNgwane Bantustan.

Following the restructuring of local government, Nelspruit and the two townships were amalgamated to form the Mbombela Local Municipality with a population of 230,000. The new municipality found itself facing huge infrastructure backlogs, which were particularly acute in the water sector. It also had to deal with:

- poor service standards. Apart from in the town centre, service delivery and billing were often unreliable, and in many districts there was no provision of water or sanitation services.
- non-payment for services. Collection rates in KaNyamazane and Matsulu were respectively 21% and 12%, which threatened the financial viability of these municipal services. Doubtless, the fact that the unemployment rate in Matsulu stood at 36%, and 25% over the entire concession area, partly explains the problems of collecting payment.
- an urgent need to expand the network. In 1999, over 200,000 people had no access to basic water and sanitation services. According to financial projections, connecting all the residents would have taken 20 to 30 years, which was not a politically viable option for those who were unconnected.

Before tendering a PPP contract, Nelspruit explored possible solutions for internal reform, but all of them came up against the issue of funding. The tendering process was launched in 1997, but strong opposition from the trade unions led to an 18-month delay. The contract was

eventually signed with BiWater in April 1999.

1.3.4.2 *Relationships between the key players*

The relationship between the GNUC (the private operator) and Mbombela Local Municipality is somewhat paradoxical. On the one hand, during the lengthy negotiation phase (close on two years), the municipal councillors gave firm backing to the PPP contract—for instance, the Mayor, Isaiah Khoza, rapidly emerged as a fervent advocate of the PPP initiative. On the other hand, the Compliance Monitoring Unit (CMU), set up in 1997 at the time of tendering, has never played an active regulatory role. Consequently, the GNUC has had to deal alone with the problems of non-payment and the controversy surrounding the Free Basic Water initiative.

Two trade unions represented the municipal workers of water services. IMATU, an independent union, was not averse to private sector participation on condition that the number of jobs and the employment conditions remained favourable for employees. SAMWU, affiliated to the national COSATU confederation, was strongly opposed to PPP largely for ideological reasons, and thus refused to engage in negotiations for over a year and a half.

Amongst KaNyamazane and Matsulu residents, the private operator's reputation is relatively poor. In fact, the operator's arrival coincided with a move towards a more strictly enforced collection policy. Their subjects of complaint include:

- over-complicated water bills. Residents feel that the amounts billed are too high and do not take the free 6kl allocation into account;
- disconnection by the operator for non-payment is perceived very negatively in cases where indebtedness is due to specific circumstances such as unemployment;
- installation of meters with no explanation or prior warning given to households;
- decision to award a water concession without any prior consultation between the municipality and the communities involved.

1.3.4.3 *Free Basic Water policy*

The Free Basic Water policy was not put into immediate effect July in 2001. In fact, this initiative had not been provided for in the concession agreement and the GNUC could not afford to finance this measure on its own. After seven

months of negotiating, it was decided that all residents would benefit from the 6kl of free water. The cost (R2.2m) was to be borne by Mbombela Local Municipality, which allocates 30% of the Equitable Share to financing this policy.

Implementation of the Free Basic Water policy had also unforeseen and undesirable consequences on the bill collection rate. Logically, the amounts billed to low-volume users should have decreased following the introduction of the 6kl free water allocation. Payment rates should therefore have increased, since the poorer users should have found the amounts more affordable. In reality, the announcement of this initiative created a somewhat confused situation. Many poor households had understood, in varying degrees of good faith, that free water was unlimited, and the collection rate fell dramatically. Thus, in KaNyamazane and Matsulu, payment dropped from 38% in June 2001 to 27% in December 2001.

1.3.4.4 *Delivering water to the poor: has the private sector helped?*

The municipality entered into this concession contract with the GNUC once it had become evident that it did not, itself, have the financial capacity to expand the network. Under the contract, the GNUC had undertaken to invest R190m during the first five years but, due to financial constraints, investment reached only R110m. Should this be regarded as failure by the concession to inject the contractually agreed amount of capital, as many opponents of PPP in South Africa claim? Or should one consider that the municipality would not have otherwise been able to invest R110m, and that the concession is therefore a success? There is no easy answer. Viewed objectively, 5,200 new water connections were made, corresponding to a coverage of about 40,000 people,* and in KaNyamazane township the number of residents benefiting from a 24-hour water supply increased by 80,000. The other side to this expansion was a tariff increase of 3.4% excluding inflation.

The major challenge for the GNUC now is to work on awareness-building, particularly in the two townships where collection rates are much too low to ensure financial viability. This change in thinking will take time, as well as a strong political will, to educate and empower communities to control their water consumption. Failing this, it is to be feared that the concession contract be jeopardised and terminated prematurely.

2. The Free Basic Water policy

Access to water and sanitation services comes in different forms. These vary with respect to the health risks involved, the level of affordability and the degree of accessibility for populations living far from the water networks. In 1994, South Africa drew up the Reconstruction and Development Plan that set the standards for a minimum required level of water and sanitation services.

2.1 Background history¹⁰

The decade 1994-2004 was marked by massive capital investment in water supply and sanitation. According to the DWAF, 13.6 million people gained access to basic water services and 6.9 million to sanitation services, at a total cost of R14.8 billion.

The year 2000 stands out as a key milestone for water policy in South Africa. A firm cost recovery drive in previous years had resulted in a spectacular number of service cut-offs for non-payment of bills and between 1996 and 2001, almost 100,000 households experienced water cut-offs. Yet at the same time, the unemployment rate was constantly rising and income disparities were growing.

What is more, in some cases, the lack of geographical cross-subsidisation has engendered situations contrary to all social logic. Due to the low density of users and the sometimes severe geographical constraints, rural areas face operating costs that are often higher than those in urban areas—bearing in mind that rural populations are, on the whole, poorer than urban populations. A strict cost recovery policy thus meant that consumers with a lower capacity to pay were being made to pay more.

Durban pioneered free water supply as early as 1997, exempting households that consumed less than 6kl of

As far as potable water is concerned, every South African household must have a water supply providing 25 litres per day per person and located no further than 200 metres from the dwelling.

As for sanitation, every South African household must be equipped with a sanitation facility that is safe, protected from the weather, ventilated, keeps smells to the minimum, is easy to keep clean, minimises the risk of the spread of sanitation-related diseases, in order to safeguard the natural environment and individual health.

water per month from paying their bills. The purpose of this measure was to encourage households to conserve water. However, the idea quickly took root throughout the country, as it also seemed to offer a means of socially appeasing poor communities.

What gelled criticism of the cost recovery approach was the cholera outbreak in KwaZulu-Natal between August 2000 and April 2001, which caused the death of 168 people. Significantly, the epidemic had originated in the uThungulu district, where pre-paid meters had been installed in 1997 causing some of the population to switch to using unsafe water from alternative sources.

In 1999, the then DWAF Minister, Ronnie Kasrils, was visiting a rural village and noticed that some of the villagers were continuing to use traditional water sources, even though there was a newly-installed network of standpipes available. The explanation for this was that they could not afford the monthly R10 user fee. As a result, during the

¹⁰ For further information, see *A history of the first decade of Water Services delivery in South Africa—1999 to 2004*, DWAF and Vircoulon, *L'exemple de la nouvelle politique de l'eau en Afrique du Sud*, Afrique contemporaine, 2003

December 2000 election campaign, the ANC promised to extend the free basic water supply to all the municipalities under its control. This agenda proved so popular that the measure was gradually implemented in all municipalities. Interestingly enough, supplying free basic water is not a statutory obligation for municipalities, but a recommendation from the 2001 White Paper on water policy. This

means that the Water Services Authorities are responsible for deciding whether or not to implement the policy and under what conditions. In practice, however, and given ANC's power base, it is a measure that is difficult to avoid. Under electoral pressure, the initiative has been extended to all municipalities but with varying modalities.¹¹

2.2 Questions raised by this policy

When the Free Basic Water policy was announced by Minister Kasrils in 2000, the details of how it was to be implemented were not clearly defined. Concrete application of the policy raises four fundamental questions, which are discussed below.

2.2.1 How can this policy be funded?

This question is certainly the most crucial one. As mentioned above, the Water Service Authorities rely on two sources of funding, namely billing to the consumer and national subsidies. The adoption of a policy for the free supply of the first 6kl of water, however, implies a loss of earnings for the WSAs. This loss is estimated at around R1.3 billion, calculated on the basis of 3 Rand per kilolitre and a population of 48 million, and represents 20% of a total estimated budget of R8 billion.¹²

The funding mechanisms vary according to the size of the municipality and to the ratio between affluent residents and poor residents within the municipality's jurisdiction.

For Metropolitan Municipalities, with a total population of about 12.6m inhabitants, this ratio is sufficiently high for cross-subsidisation to effectively finance the Free Basic Water policy. For example, it was this system that enabled Durban to implement the Free Basic Water policy in 1997. For the 105 District or Local Municipalities in which average household income is around R2400, the potential for cross-subsidisation exists but only to a limited extent, and this form of self-financing can only benefit a small percentage of the population.

For the 102 District or Local Municipalities in which average household income are below R1200, the potential for cross-subsidisation is virtually non-existent, which means that funding the Free Water Policy depends primarily on national subsidies.

The DWAF estimates that free basic water supply to the poor is financially viable for most WSAs provided both that operating and maintenance costs do not run over R4.30 per kilolitre and that the WSAs earmark approximately 30% of the Equitable Share (equal to R9.6 billion for the year 2005/2006) for subsidising the very poor. In rural areas, however, operational and maintenance expenditure is very high and municipalities are facing huge financial difficulties.

2.2.2 Is 6 kilolitres the right choice?

The figure of 6kl was obtained on the basis that the quantity of 25 litres was the required minimum per person per day. Assuming that an average household comprises 8 people, this yields 6kl. Both of these assumptions, however, are subject to debate.

Firstly, the figure of 25 litres per person per day as a minimal quantity is questionable and other estimates from different organisations range, in fact, from 20 to 50 litres. In 1994, South Africa opted for the 25-litre reference figure in

¹¹ Cf. the varying conditions for implementing the Free Basic Water Policy as mentioned above for the four towns of Queenstown, Nelspruit, Johannesburg and Dolphin Coast.

¹² Source: Economic Mission, South Africa

its Reconstruction and Development Plan. Yet this quantity is insufficient if activities like washing clothes are taken into account.

Secondly, this fixed ceiling applies to all households whatever their size. Yet, it has been proved that it is the most needy populations that have households with the most members, as several generations live together under the same roof. This measure, therefore, would seem unfair as it penalises the large, generally poor households and favours those that are smaller and generally more affluent. There is, of course, there is no ideal solution, not least because it is very difficult for a municipality to know each household's size or level of income. Some municipalities such as Queenstown have decided to raise the basic free water allocation to 10kl. Certainly, many users with in-house connections also use water for vegetable gardens and their needs are thus greater.

2.2.3 Can the Free Basic Water policy target the very poor?

The DWAF's statistics on the implementation of the Free Basic Water policy offer an interesting insight into policy results after 5 years. Out of a population of 48.1 million inhabitants, 22 million people are considered as poor. In May 2006, 15.4 million poor people (68.7%) were benefiting from the Free Basic Water policy and, if the total population is taken into account, this percentage reaches 74.3%.¹³

A more detailed examination of results at provincial level reveals pronounced disparities. In three of the country's nine provinces (Western Cape, Eastern Cape and Northern Cape), a higher proportion of poor people benefit from the Free Basic Water policy than in the other provinces. In the remaining six, it is the opposite case.

At first sight, these figures may seem surprising if not appalling. How can a pro-poor social policy not benefit the very populations it is targeting? To begin with, around 5.3 million poor people still have no access to potable water and conti-

nue to use unsafe traditional sources of supply. This population gains no benefit from the policy. Secondly, in some rural areas, the Free Basic Water policy is not implemented because the municipalities do not have sufficient financial capacity to cover the costs of such a measure. Given that the rural population is largely poor, the two forgoing factors can help to explain why 31.1% of the country's poor do not benefit from the Free Basic Water policy.

In urban areas, the most desirable approach would be to focus the Free Basic Water measures exclusively on very poor households. Yet, the problem for WSAs is how to define one or more criteria in order to identify which residents should benefit from the measure. A geographic criterion could be envisaged to differentiate between eligible and non-eligible areas, but this could create perverse effects of urban segregation. One could also use criteria related to housing (as is the case in Chile and Argentina), means-test criteria or voluntary registration with the city hall. None of these methods is currently applied on a large scale in South Africa. Affluent populations who pay their water bills are claiming equal treatment for all citizens and have opposed any kind of discriminatory measures regarding the Free Basic Water policy. They argue that their high levels of consumption mean that they are already contributing substantially to financing the system.

2.2.4 What impact on mentalities?

The fundamental problem of the Free Basic Water policy is making sure that users understand that only essential needs are covered, and not all the water they consume. Many households are unable to assess how much water they use each month and have little idea of what using 6kl represents. Consequently, not only are they convinced that their consumption is reasonable, but they also do not

¹³Source: <http://www.dwaf.gov.za/FreeBasicWater/Default.asp?ServiceType=1> (13/06/2006)

understand why they have to pay. This is particularly true for households that had previously been billed at a flat rate (which does not reflect the volume of water used) and who now have metered billing. In the township of

Nelspruit, for example, following the announcement of the free water initiative, the payment rate dropped from 38% to 27% in 2001, which completely wiped out five years of efforts to improve the bill recovery rate.

2.3 The consequences for those without in-house connections

Most households that do not have in-house connections are located in rural or periurban areas. They are not large consumers for the simple reason that their water has to be carried daily from a standpipe to their dwelling. Although this standpipe consumption is not metered, the Water Services Providers in Queenstown and Dolphin Coast estimate average monthly consumption at around 3kl per household. This means that, according to the Free Basic Water policy, households with no in-house connection should not be charged for the water they consume.

The fact that the basic water allocation is free of charge raises a series of problems.¹⁴

Financial:

- dependency on national subsidies. All, or almost all the cost of implementing the Free Basic Water policy in rural areas is met by national subsidies. Rural communities are thus totally reliant on the amounts allocated to them. These amounts, however, are subject to unilateral revision by the DPLG or the District Municipality without any requirement for community consultation.
- increased operating costs. Should management of the operating budget change hands, this may lead to a sharp rise in costs, as some rural water schemes have been functioning on very meagre budgets thanks to the virtually unremunerated involvement of communities. Even if there were few financial resources, communities felt involved and therefore bound to resolve problems. Were the municipality to take over this side of management, the volunteering spirit could very rapidly disappear: the new managers would almost certainly not agree to being paid R200 a month for bookkeeping or maintenance tasks and would demand that their salaries be brought into line with municipi-

pal employees' salaries (about R2000 per month).

Organisational:

- loss of influence for local community structures. Effective empowerment of local communities is, to some degree, acquired through their having the capacity to generate their own revenues. This capacity, however, is compromised by the Free Basic Water policy, since the local committees that managed water network operations and maintenance prior to the reform no longer have income from the user fees. They could take on the role of WSP, but they would then have no control over the monies paid by the WSA for ensuring service delivery.

Behavioural:

- water is less valued. As water is free, there is no longer any strong incentive to declare and repair leaks speedily. Reinforcing communication and training could offset this to some extent, but would probably prove to be of limited effect.
- risk of vandalism and destruction of installations. If the community as a whole is directly involved in financing the infrastructure, a self-regulating form of control comes into play that prevents equipment from being damaged by acts of vandalism or negligence. When funds are sourced from outside the community, this social control mechanism is less effective as the inhabitants feel less concerned by the consequences of equipment damage.

¹⁴ See STILL, David. *Free Basic Water in Rural areas: is it feasible?*, 2001

2.4 The consequences for those with in-house connections

Unlike households with no in-house connections, those that have in-house connections can easily run over the 6kl-per-month ceiling, as the practical constraint of having to carry water from a standpipe does not come into play. The pivotal question, therefore, is whether or not these households are willing to pay for the quantities consumed over and above the first 6kl.

In affluent areas, where metered billing has long been in operation, residents are used to paying for their water and the Free Basic Water policy does not entail any great change. The saving they gain from their free first 6kl is cancelled out by a tariff increase in the higher-volume tariff blocks. The impact on the amounts billed is therefore negligible.

In poorer areas, where the bill collection rate is lower for historical reasons rooted in apartheid and where households were billed at a flat rate, the Free Basic Water policy can be implemented in two different ways.

First, if users are unwilling to pay for water, their monthly consumption can be limited to 6kl (200 litres per day) using technical solutions such as flow restrictors and 200-litre low-pressure roof or ground tanks¹⁵. When consumption is thus restricted, the household no longer receives water bills. This option, however, raises a number of criticisms. Should these users wish to increase their consumption and be willing to pay accordingly, technical problems make this impossible, as the installations are not sized for greater volumes. Consequently, there is no easy solution for “climbing the service ladder”, apart from rebuilding the network. The second method is to provide standard access to water supply via the network. Experience shows that, in this case, users and communities need training and capacitation to make them aware of how much water they consume. This

option is time-consuming and heavy on human resources. An intermediate solution would be to install pre-paid meters that are programmed to deliver 6kl of free water per month. Beyond this ceiling, access would be available through pre-paid cards, much like those used for cellular phones. Yet this option is also subject to debate. Its critics consider that it depoliticises the issue of disconnection and establishes discriminatory service levels, whilst its proponents see it as a way of developing the users’ responsibility, as the latter soon learn how to manage their consumption. In the writers’ opinion, pre-paid meters—despite the high cost incurred of about \$150 per meter—provide an efficient way of controlling consumption for both the affluent and the most needy households. One of the issues raised is that the free water allocation only lasts for two or three weeks and that, consequently, households have to go without water for several days. A possible remedy to this might be to apply a weekly 1.5kl or daily 200l ceiling, rather than the monthly 6kl. This would avoid households having no access to water for too long a period (at most one or two days).

¹⁵ For further information on possible technical solutions, see the case studies on the City of Durban, notably WSP, Durban Metro Water, Private Sector Partnerships to Serve the Poor, 2001

3. What lessons are to be learnt for South Africa... and beyond?

3.1 PPSs cannot develop in an ideologically adverse environment

No new PPP water contract has been signed since 2001. Three contracts are still under way and a fourth terminated in April 2006 without renewal. This may seem somewhat surprising in a country where everything has been arranged to enhance private sector participation in municipal services delivery: an act was passed defining the public service delegation procedure; a real need exists to develop service levels in the former townships, and a number of municipalities now have a regulatory capacity. What reasons, then, can explain why municipalities are so reluctant to team up with the private sector?

First of all, essential services and especially water services are “soft targets”. As the quality of these services has an immediate impact on health and welfare, they are given high coverage. Certainly, essential services managed by private companies are subject to closer scrutiny than telecommunications or airports for example, and any incident is widely covered by the media and activist organisations.

As mentioned in paragraph 1.1.1.3 on the debate over private sector participation, PSP opponents constitute a powerful and well-organised lobby. University academics working in a wide range of disciplines, including economics, sociology and political sciences, are actively helping to develop well-structured arguments against the privatisation of water services, as well as denouncing the burden of reforms that primarily disadvantage the very poor. Patrick Bond, for example, is a political economist from KwaZulu-Natal University in Durban, where he heads the Centre for Civil Society. He takes a very active role in conferences and has written a number of books, including *Talk Left, Walk Right* (University of KwaZulu-Natal Press, 2004) and *Against Global Apartheid* (Zed Books, 2003). The Anti-Privatisation Forum is also very active at grassroots level, encouraging township communities to resist reforms and any moves to bring in the private sector. This lobby has a substantial

influence on municipal councillors, who are under strong pressure not to contract out to the private sector.

At national level, the trade unions and notably COSATU are opposed to private sector participation. They speak out against job losses, tougher working conditions and the serious social impact on workers, all of which are sensitive issues in country where unemployment is a high-priority concern. At local level, the unions' stance seems more nuanced. For example, the skills training and wage increase given by the private operator in Queenstown have proved to be popular measures that reinforce the arguments for greater involvement from the private sector.

PPP contracts are long-term agreements. Operation and Maintenance contracts typically last for about 10 years and a Concession contract can reach up to 30 years to allow the private operator sufficient time to make committed capital investments financially viable. Councillors, on the other hand, hold office for only four years. This is obviously not conducive to developing a long-term vision for water services, as councillors well know that their municipal office is a short-term affair.

Consumers are poorly represented within the institutional framework for water management. The only representatives expected to defend user interests and to exert pressure on the WSA to ensure that water assets yield value for money are the municipal councillors. The users themselves have practically no contact with the WSA other than through billing. Furthermore, as the water sector is heavily subsidised, especially in rural and periurban areas, the revenue from water bills does not cover the all of the network's operating costs. Unless the service has seriously deteriorated, consumers put little pressure on the operators to improve the service level provided,.

For small municipalities, the procurement procedure for service contracts—known as the Section 78 process

because it comes under paragraph 78 of the Municipal Systems Act (2000) —is cumbersome and costly. Many of the small, newly formed municipalities do not know how to go about contracting with the private sector. Since the complete legislative framework was instituted in 2003, no municipal PPP contract has been signed in the water sector.

In line with the Section 78 process and the Water Services Act (1997) for the restructuring of the water sector, preference has been given to public institutions

for provision of the water services. As a result, a municipality can only contract out to the private sector if it has already proved that the public sector does not have adequate capacity to ensure satisfactory service delivery itself.

The above considerations all help to explain why the private sector is encountering obstacles to partnerships in the water services sector in South Africa.

3.2 Decentralisation: the challenge of capacity-building

Decentralization in South Africa was undertaken a quite rapid pace around the turn of the millennium. In the water sector, responsibility for service delivery was devolved from the DWAF to municipalities between the years 2000 and 2005, depending on the area. Key roles were redefined with the DWAF being confirmed as regulator for the water sector and the WSAs being made responsible for service provision within their own areas of jurisdiction.

The choice of a decentralised structure offers the following advantages:

- management more appropriately tailored to local constraints, and local officials are more deeply involved in project ownership;
- greater flexibility for organising the service. To best meet demand, the WSA has total leeway to choose one or more WSPs (NGOs, community-based organisations, private or public companies, Water Boards) in order to meet local constraints;
- local dimension to financial management. Subsidies are allocated to the municipalities, who then decide how these will be apportioned between the different service sectors. In 2005/2006, the Equitable Share totalled some R9.8 billion and the MIG about R5.4 billion.

However, local municipalities come up against two major challenges. In the first place, capacity-building needs greatly reinforcing so as to ensure that water utilities are properly managed and water-services development plans suitably prepared. Situations vary, of course, depending

on the size the municipality.

For the six Metropolitan Municipalities, capacity poses no apparent problem. Their staff is well trained and, even though the level of expertise could do with upgrading (as in the Johannesburg Management contract), their technical departments are able to manage the water and sanitation utilities.

In the larger District Municipalities, there is a pressing need for capacity-building. Managing extensive water assets is a relatively complex affair and demands expert skills. After the ANC came to power in 1994, many white civil servants went into retirement, but as no training had been foreseen for their successors, this caused a heavy loss of skills.

In the smaller District Municipalities, water assets are less complex to manage, but skilled people are still difficult to find, as they prefer to take jobs in larger urban centres.

The second major challenge involves more efficient usage of the national subsidies (MIG and ES). Most often, municipalities lack the technical capability to design projects and implement capital investment projects. As a result, either a portion of the monies available at national level is not transferred to local level for want of viable projects, or those subsidies that are transferred are not put to optimal use.

On both these counts, the private sector has some useful assets to offer. If provided for under the contract, the private sector can help to build up local capacity and transfer

skills. In some cases, private companies could also make better use of national subsidies and, in partnership with the

WSA, help to implement projects for network rehabilitation and expansion.

3.3 What role for the private sector?

Of the three current PPP contracts in South Africa, two are Concessions and one a Management contract—not forgetting the fourth, recently terminated Operation and Maintenance contract. In the light of our earlier observations, there seems little likelihood of further concession contracts being signed in the near future. So does the private sector still have a role to play? And if so, which one? At this point, a distinction must be made between urban areas and rural areas, since the challenges involved are different—as is the private sector's potential role.

3.3.1 In urban areas

The foremost cause for concern for the Water Services Authorities is free riding. As often happens with public services, everyone enjoys the benefits of the service provided, but no-one is willing to pay for using it—hoping rather that other users or the State will foot the bill. In South Africa, the apartheid legacy shaped a system whereby the former white areas enjoyed a “first class” service that was paid for, whereas the townships made do with a poorer level of service delivery. Rallying to the ANC's call to “make the townships ungovernable”, the poor communities took to boycotting their water bills. Since 1994, however, attitudes have been slowly changing, even though collection rates remain extremely low (about 60% in Queenstown compared to 97% in Senegal). This is partly due to the users' unwillingness to pay, but also to the fact that the WSAs lack the capacity both to address bills correctly and apply a strict, consistent policy towards free riders.

For the moment, billing is the sole function that has not yet been entrusted to private companies within PPP contract arrangements (apart from concessions). Although this could be envisaged with a view to increasing revenue, municipalities are very reluctant to do so for various reasons. To begin with, some municipalities have a joint

billing system for electricity and water. This provides a convenient disincentive for non-payers, as it is easier to cut off electricity supply, which is not deemed a vital service, than to cut off water, which people cannot do without. Another reason is that bill collection is a highly sensitive issue. In some cases, municipal councillors see non-enforcement of strict recovery measures as a means of supporting a pro-poor “social policy”. We are inclined to think, however, that this kind of behaviour is rather unfair because it penalises good payers and encourages free riders. Our view is that the Free Basic Water policy and the use of rising block tariffs both seem to constitute better approaches, since they are applicable to all connected households.

An econometric study¹⁶ from the Water Research Commission, based on fifty South African municipalities, compares the level of collection rates using different parameters. The study concludes that adopting volume-related tariffs and a strict cut-off policy enhanced the collection rate by an average 23%, which represents a substantial amount of funds.

In the specific context of South Africa, we are of the opinion that the public and private sectors could work together efficiently to improve payment recovery performance. In this case, the private sector would take on a more educational role regarding the importance of paying bills, whereas the private sector would assume a managerial role aimed at organising an efficient and consistent service.

3.3.2 In rural areas

The challenges in rural areas differ somewhat from those in urban areas. As the density of rural housing is lower, the cost of providing water services is generally higher, given

¹⁶ Marah, L. et al., Effective cost recovery in a changing institutional and policy environment: municipal demarcation, the “Free Basic Water Policy” and financially sustainable service delivery, WRC report No. 1384/1/04, 2004

that economy of scale does not apply. Most of the rural population is supplied through standpipes and there are proportionally fewer private connections. As a result, household consumption is relatively low (estimated between 3kl and 6kl for Dolphin Coast and Queenstown). Implementing the Free Basic Water policy thus generates no revenue in low-consumption areas. Furthermore, South Africa, like all other Sub-Saharan countries, is experiencing a massive rural exodus, which the authorities are attempting to stem by developing the role of local communities. These specifically rural factors tend to mean priority is given to rural schemes in which partnerships between local actors and NGOs with expertise in water can enhance local capacities and develop employment.

The private sector can fulfil the role of “technical intermediary” between a WSA and local communities. One stumbling block to this, however, is that rural projects do not always have the necessary critical size to cover the costs borne by the private sector. In view of this, an interesting initiative was launched in four provinces (the Eastern Cape, KwaZulu-Natal, Mpumalanga et Limpopo) where water infrastructure needs were the most pressing. The public sector—in this event the DWAF—singled a BoTT¹⁷ contract with the private sector and NGOs for the delivery of a new rural infrastructure¹⁸. The innovative side of this programme was that it associated NGOs and the private sector within a single company called the PIA (Program Implementation Agent), capable of managing the project from start to finish. During the first four years of the programme, over 2.5 million people gained access to a safe water supply. The programme’s success can be explained by the DWAF’s involvement as contract regulator, the financial support received from donors (including the European Union), efficient partnering between the private sector and NGOs, and the fact that local authorities actively provided social capacitation at community level. This solution seemed more efficient than one in which each

municipality contracts individually with a private operator for a specific project.

The overall organisational scheme that could be recommended would be a two-tiered structure. At a first level, one or more WSAs (depending on the project size) would contract with a private operator for capital investment and service delivery. At the second level, the private operator then contracts the operation and maintenance of the networks and relations with the users to local community-based organisations. The private operator would then focus on the roles of coordination, design and monitoring of the works. This two-tiered contracting system already exists in other Sub-Saharan African countries.¹⁹ Funding would be largely through national subsidies, local revenues being generally low given the Free Basic Water policy.

3.3.3 Is managing rural and urban areas jointly a realistic option?

The above classification of rural areas and urban areas is certainly useful for clearly highlighting the different challenges facing the two types of habitat. In practice, however, most rural areas comprise a central town, with typically urban characteristics, surrounded by large rural-type settlements. Chris Hani District Municipality (Queenstown), for example, has a total population of 810,000, of which 232,000 are urban dwellers and 579,000 are rural. For this kind of municipality, two water service delivery scenarios could be envisaged.

Water services could be operated by two public or private

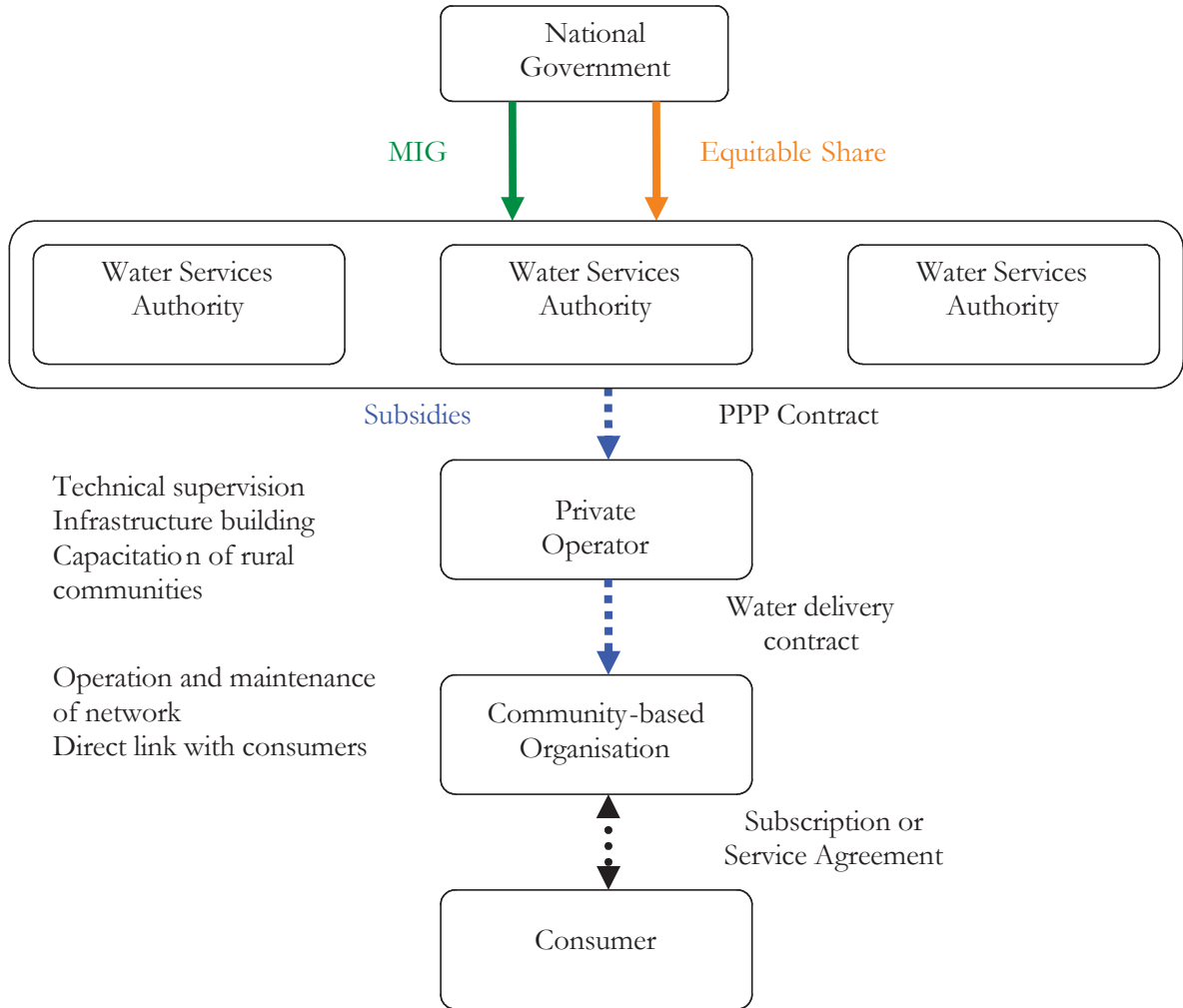
¹⁷ In a BoTT (Build, Operate, Train and Transfer) programme, the private sector builds an infrastructure, operates it, trains local operators and then transfers the assets to the Water Services Authority.

¹⁸ See Ayoub, P. et al., South Africa’s BoTT Model: an innovative solution for delivering sustainable water services to the rural poor, 2002

¹⁹ Standpipe management in Dakar is a good example of a contract associating the public sector, private sector and local communities.

The diagram below illustrates this type of scheme:

Figure 2. Possible organisational scheme for rural areas



WSPs, one for the rural areas and the other for urban areas, the advantage being that each could specialize in one type of service delivery. In this scenario, there would be the danger of setting up a lasting two-speed system: urban dwellers would be equipped with in-house connections and collective sewerage, whereas rural dwellers would have to make do with a basic level of service comprising standpipes and local sanitation systems. Funding for the urban areas need not rely on subsidies, providing that there is a sufficiently high ratio of large volume household and industrial users to the total number of users. The rural areas could

then be entirely funded by subsidies.

The second scenario would involve only one public or private WSP managing the entire sector. As service delivery is less costly and revenues higher in urban areas, this would allow for cross-subsidisation between urban and rural residents and would help rural areas to “step up the service ladder”. In this type of scheme, funding would combine the revenues levied on individual users with national subsidies. In order to create stronger incentives for the WSP (either public or private), these subsidies could be channelled onto specific targets such as service delivery for the poorest areas.

3.4 Is the Free Basic Water policy an adequate answer to the challenges facing South Africa and developing countries?

Within the specific South African context, it would seem to us that the 6kl free water policy is more a social compromise based on a political decision, rather than a solution grounded on technical rationale. The underlying idea is that this policy must be counter-balanced by an improved bill collection rate for the water consumed in excess of the free allocation. In some townships, as is the case for Johannesburg where collection rates do not exceed 30%, this compromise would seem promising as the costs of the initiative can mostly be covered by an improved collection rate.

In addition, for very small-volume users, the cost of issuing a bill (about R20) is higher than the amount billed, which means that billing such small quantities of water is not a financially sound policy.

On the other hand, we doubt that it would be advisable to extend a free basic water policy to other Sub-Saharan African countries. In the first place, the leading argument that a free water allocation would help to increase collection rates would not seem applicable to countries where the average collection rate is already 80% and even reaches 97% in countries such as Uganda and Senegal.²⁰

What is more, basic-level consumption is very high in these countries. In Senegal, household users consume 34% of water, and the revenue from this source accounts for 14% of total revenue.²¹ Should a free water allocation be implemented, this would automatically result in a 14% decrease in revenue. Moreover, given these countries' often-narrow fiscal base, the loss of revenue would not be compensated by national subsidies, as is the case in South Africa. This, of course, does not prevent other social policies, such as social connections and rising block tariffs, from working.

It would also seem to us that the practicalities of implementing a free water policy run counter to the logic of providing free water, even for low volume consumption. Certainly in South Africa, it has been observed that households find it

very difficult to comprehend that only the first 6kl of water are free and that any further consumption is to be paid for. After the Free Basic Water policy was introduced, some households with good payment records refused to continue paying their bills, as they thought—in good or bad faith—that the service was now free.²² Finally, questions can be raised as to the risk of negligence when water is free. A willingness to pay for water services does exist, even amongst the most disadvantaged populations.²³ The fact of paying for water incites users to a greater vigilance as to how the service is provided, as well as encouraging them to reduce wastage and leakage.

The free basic water initiative is thus an innovative policy that has so far been adopted only by South Africa. We do not, at present, have sufficient hindsight to assess the long-term impacts of this policy. The heavy costs incurred by this measure—which are borne by local government thanks to national subsidies—would seem to reinforce the case against extending this kind of measure to other Sub-Saharan African countries. It has, nonetheless, succeeded in injecting a flailing water services policy with new impetus and in strengthening social peace and stability.

²⁰ See KFW, Ballance, T. and Trémolet, S., *Private Sector Participation in Urban Water Supply in Sub-Saharan Africa*, November 2005, 248 p.

²¹ According to an AFD case study by Blanc, A. and Ghesquieres, C., *Secteur de l'eau au Sénégal : un partenariat équilibré entre acteurs publics et privés pour servir les plus démunis ?*, 2006

²² Source: Vircoulon, T., *L'exemple de la nouvelle politique de l'eau en Afrique du Sud*, in *Afrique contemporaine*, 2003

²³ See Collington, B. and Veniza, M., *Independent Water and Sanitation Providers in African Cities: Full Report of a Ten-Country Study*, Water and Sanitation Programme, 2000